

## I. Introduction

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**The Establishment of the Committee** The Public Accounts Committee is established under Rule 72 of the Rules of Procedure of the Legislative Council of the Hong Kong Special Administrative Region, a copy of which is attached in *Appendix 1* to this Report.

2. **Membership of the Committee** The following Members are appointed by the President under Rule 72(3) of the Rules of Procedure to serve on the Committee:

**Chairman** : Dr Hon Eric LI Ka-cheung, GBS, JP

**Deputy Chairman** : Hon Emily LAU Wai-hing, JP

**Members** : Dr Hon David CHU Yu-lin, JP  
Hon SIN Chung-kai  
Hon Howard YOUNG, SBS, JP  
Hon LAU Kong-wah, JP  
Hon Abraham SHEK Lai-him, JP

**Clerk** : Ms Miranda HON Lut-fo

**Legal Adviser** : Mr Jimmy MA Yiu-tim, JP

## II. Procedure

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

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

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

2. **The Committee's Report** This Report by the Public Accounts Committee corresponds with Report No. 42 of the Director of Audit on the results of value for money audits which was tabled in the Legislative Council on 21 April 2004. Value for money audits are conducted in accordance with the guidelines and procedures set out in the Paper on Scope of Government Audit in the Hong Kong Special Administrative Region - 'Value for Money Audits' which was tabled in the Provisional Legislative Council on 11 February 1998. A copy of the Paper is attached in *Appendix 2*.

3. This Report also contains the Public Accounts Committee's supplemental report on Chapter 8 of Report No. 41 of the Director of Audit on the results of value for money audits which was tabled in the Legislative Council on 26 November 2003. The Committee's Report No. 41 was tabled in the Legislative Council on 25 February 2004.

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

### III. Committee Proceedings

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**Consideration of the Director of Audit's Report tabled in the Legislative Council on 21 April 2004** As in previous years, the Committee did not consider it necessary to investigate in detail every observation contained in the Director of Audit's Report. The Committee had therefore only selected those chapters in the Director of Audit's Report No. 42 which, in its view, referred to more serious irregularities or shortcomings. It is the investigation of those chapters which constitutes the bulk of this Report.

2. **Meetings** The Committee held a total of 25 meetings and 9 public hearings in respect of the subjects covered in this Report. During the public hearings, the Committee heard evidence from a total of 28 witnesses, including 3 Directors of Bureau and 8 Heads of Department. The names of the witnesses are listed in *Appendix 3* to this Report. A copy of the Chairman's introductory remarks at the first public hearing on 3 May 2004 is in *Appendix 4*.

3. **Arrangement of the Report** The evidence of the witnesses who appeared before the Committee, and the Committee's specific conclusions and recommendations based on the evidence and on its deliberations on the relevant chapters of the Director of Audit's Reports, are set out in Chapters 1 to 6 below.

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

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



## Chapter 1

### The acquisition and clearance of shipyard sites

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As stated in the Audit Report, the Government may acquire land for public purposes either by resumption, or by negotiation with the landowners for the surrender of land. For land let out under a short term tenancy (STT), the Government may terminate the STT so as to acquire the land for public purposes. In 1997, the Government resumed six leased shipyard sites and terminated 15 STTs at North Tsing Yi, Kwai Tsing (the NTY shipyard site) for the construction of district open space and government/institution/community facilities. In 2001, the Government negotiated with the lessee for the voluntary surrender of a leased shipyard site at Penny's Bay, Lantau (the PB shipyard site) for the development of a theme park project. Audit conducted a review on the acquisition and clearance of the above shipyard sites.

#### Resumption and clearance of the North Tsing Yi shipyard site

##### *Responsibility for clearance of the shipyard sites*

2. The Committee noted that there were conditions in the STTs, as set out in paragraph 2.6 of the Audit Report, stipulating that the tenants were responsible for clearing the structures at their own expense on termination of the STTs. However, as revealed in paragraph 2.12 of the Audit Report, Audit could not find evidence showing that the Lands Department (LandsD) had attempted to take action to enforce the STT conditions. In the event, the Government had spent some \$5.5 million to clear the site for the 15 STTs.

3. The Committee also noted that despite the explanation given by the Housing, Planning and Lands Bureau (HPLB) in paragraph 2.8, the Financial Services and the Treasury Bureau (FSTB) still considered that there needed to be a good reason for the Government not to exercise the discretion conferred on it by the STTs to require the tenants to restore the sites to the original condition. The FSTB's view was that the LandsD should consider amending the relevant policy if any of the STT conditions proved to be unenforceable in light of operational experience. In this connection, the Committee asked about the basis for the LandsD exempting the 15 STT tenants from clearing the site.

4. **Mr Patrick LAU Lai-chiu, Director of Lands**, stated at the public hearing and the **Secretary for Housing, Planning and Lands** stated, in his letter of 8 December 2003 in *Appendix 5*, that:

- between September 1996 and July 1998, a number of Legislative Council (LegCo) Members expressed concerns about and showed sympathy for the plight of the affected shipyard operators. The general view of these Members was that the Administration should provide appropriate assistance

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to the shipyard operators whose business and investment would be adversely affected by the clearance. At a case conference held on 24 October 1997 on this matter, some LegCo Members requested the Administration to provide more concrete assistance to the affected shipyard operators; and

- since some LegCo Members supported the shipyard operators and the public had also shown sympathy for them, the requirement for the shipyard operators to demolish the structures might be considered unreasonable and might arouse criticism. In the circumstances, the LandsD considered that it might be difficult for the Government to enforce the STT conditions effectively because:
  - (a) the tenants might be reluctant to clear the site;
  - (b) although there were conditions requiring the STT tenants to demolish and remove the affected structures on termination of the tenancies, it was both politically and practically difficult, if not impossible, to enforce the conditions effectively. It was very likely that the tenants would resist the clearance; and
  - (c) if the LandsD insisted on asking the tenants to clear the affected structures and the latter refused, the LandsD might have to institute legal action. Eventually, the Government might have to face a lot of criticism and the North Tsing Yi project might be delayed.

5. According to paragraph 2.13 of the Audit Report, the LandsD had not stated in the Lands Administration Office Instructions the specific justifications under which an STT tenant might be exempted from clearing the site. In this regard, the Committee enquired what the exemption criteria would be for dealing with similar cases in future. The **Director of Lands** responded at the hearing and in his letter of 5 January 2004, in *Appendix 6*, that:

- whether exemption would be granted in future cases would depend on the circumstances of each case. The HPLB would be consulted before a decision to grant exemption was made; and
- the LandsD, in principle, agreed to Audit's recommendation to seek the prior approval of the Secretary for Financial Services and the Treasury for any proposed waivers of, or variations to, the STT conditions, if such waivers or variations would have financial implications to the Government. The LandsD had consulted the HPLB on this matter and, on the advice of the

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Bureau, the LandsD would further discuss the matter with the FSTB. Land instructions would be clarified following the outcome of the discussion.

6. Having regard to the Director of Lands' response in paragraph 2.15(c) of the Audit Report that it was not uncommon not to strictly enforce all the terms of tenancies when STTs were terminated to make way for government projects, the Committee enquired:

- about the reasons for not strictly enforcing all STT terms; and
- whether there were any cases in the past five years (from 1998 to 2003) in which the LandsD had successfully asked the lessees or tenants to clear the structures on the sites upon termination of the leases or STTs in order to make way for government projects; if so, details of the cases; if not, why not.

7. The **Director of Lands** said at the hearing and in his letter of 5 January 2004 that:

- the LandsD had not strictly enforced all the terms of tenancies when STTs were terminated to make way for government projects because the Government needed to ensure that the site was recovered in a timely manner. If the LandsD left the site clearance to the tenant, there would be uncertainty as to whether the tenant could vacate the site at the time specified. If the tenant failed to vacate the site, the Government could only take legal action to recover the site. This would be a prolonged process and was likely to jeopardise the timetable of the public project. Moreover, the cost incurred in taking legal action might be higher than that required for clearing the site. Hence, the LandsD considered that in some cases, it was more desirable for the Government to undertake site clearance; and
- there was a total of 35 STT cases from 1998 to 2003 where the LandsD had successfully asked the tenants to clear the structures from the sites upon termination of STTs in order to make way for government projects.

8. The Committee appreciated the Government's need to ensure timely recovery of the site and to carry out the necessary clearance in order to meet the project timetable. However, it considered that the LandsD had the responsibility to ensure that the STT condition, which empowered the Government to recover the demolition cost from the tenant, was strictly enforced. The **Director of Lands** responded that the LandsD would consider the views of the Committee.

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### *Decontamination cost of the NTY shipyard site*

9. The Committee noted that after the leased sites had reverted to the Government in April 1997 and the STTs had been terminated between April and July 1997, about 75,000 cubic metres of soil were found contaminated. The Government had to incur about \$64.5 million to decontaminate the sites. Audit found that there were conditions, as set out in paragraphs 2.23 and 2.24 of the Audit Report, in all the six leases and five of the 15 STTs prohibiting contamination of the site. With these conditions, the lessees and the STT tenants concerned might have responsibility for decontaminating the sites. In view of the above findings, the LandsD had asked the Department of Justice (DoJ) as to whether these lessees and STT tenants had breached the conditions relating to contamination.

10. The Committee also noted from paragraphs 2.20 and 2.21 of the Audit Report that in May 2001, the Territory Development Department (TDD) had informed the LandsD that \$60 million would be required for decontaminating the site. The TDD considered that the decontamination cost was significantly out of proportion when compared with the project estimate of \$117 million for the whole North Tsing Yi project. It had, therefore, asked the LandsD to advise whether the STTs contained conditions requiring the tenants to undertake decontamination at their own expense on termination of the STTs. At that time, the LandsD replied that there was no such condition in those STTs. In this connection, the Committee questioned about the basis for the LandsD making such a statement.

11. **Mr John Corrigan, Deputy Director of Lands (General)**, explained that:

- in the view of the LandsD, the conditions referred to in paragraphs 2.23 and 2.24 of the Audit Report were not obvious clauses relating to contamination; and
- the LandsD had subsequently asked the DoJ for advice on the liability of the six lessees and the 15 STT tenants in view of the terms and conditions of their occupation and use of the shipyard sites, and whether any of them was liable for the contamination found at the site. The DoJ had considered the problems and was seeking the opinion of an outside counsel.

12. It appeared to the Committee that the conditions mentioned in paragraphs 2.23 and 2.24 of the Audit Report, such as General Condition No. 9 of the lease conditions of the six NTY shipyard sites, which read “The purchaser shall not permit sewage or refuse water to flow from the lot on to any adjoining land or allow any decaying, noisome, noxious, excrementitious, or other refuse matter to be deposited on any portion of the lot and shall

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see that all such matter is removed daily from the premises in a proper manner.”, already gave the Government a clear mandate to require the shipyard operators to undertake decontamination at their own expense on termination of the STTs. The Committee queried why the LandsD had not taken prompt action to recover the decontamination cost from the lessees and tenants concerned, but had to seek legal advice.

13. To ascertain whether the LandsD had discharged its duty to enforce the terms and conditions in leases or STTs, the Committee also asked:

- whether the LandsD had, in the past, attempted to apply, or sought legal advice on the applicability of, the terms and conditions in leases or STTs prohibiting contamination to require lessees or STT tenants to remove contamination from the site; if not, why not;
- whether there were any cases in the past five years (from 1998 to 2003) in which the lessees or tenants were required to undertake decontamination at their own expense on termination of the leases or STTs; if so, details of the cases and the amounts of money saved; if not, why not; and
- whether, in the LandsD’s view, there were loopholes in the six leases or the 15 STTs which had rendered it impossible for the Government to recover decontamination cost from the lessees or the STT tenants; if so, whether it would consider amending the terms and conditions of STTs with a view to plugging the loopholes.

14. The Committee also requested the LandsD to provide a summary of the legal advice from the outside counsel when it was available.

15. The **Director of Lands** responded in his letter of 5 January 2004 that:

- the LandsD had not been aware of any cases involving the problem of contamination which necessitated the seeking of legal advice on the applicability of clauses similar to those set out in paragraphs 2.23 and 2.24 of the Audit Report. The LandsD had only been aware of two STT cases which had land contamination problem, when making land available for public projects; and

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- pending receipt of legal advice, the LandsD was not in a position to comment if there were any loopholes in the six leases and the 15 STTs. However, as a precautionary measure and to focus directly on the issue of contamination, the LandsD had already introduced an amended clause to impose decontamination costs on lessees. Such a clause had been included in the leases of a number of petrol filling station sites disposed of earlier this year. This new clause would be imposed in all new industrial-related land sales and grants, including shipyards. Moreover, the LandsD was also amending the indemnity clause in STTs to ensure that tenants were made responsible for decontamination costs.

16. In his letter of 27 May 2004, in *Appendix 7*, the **Director of Lands** further informed the Committee that:

- the LandsD had received a summary of the legal advice from the outside counsel prepared by the DoJ (a copy was attached to the Director of Lands' letter); and
- the DoJ had issued 21 protective writs against the various parties just before the expiration of the statutory limitation period. The Government had until 22 April 2005 to serve the writs. In the meantime, the LandsD was gathering further evidence in order to prepare statements of claim against the 21 defendants.

### Assessment of contamination at the PB shipyard site

17. The Committee noted that the PB shipyard site was surrendered to the Government on 3 April 2001. According to the lease conditions of the site granted in 1970, the Government was not empowered to inspect the site to ascertain whether there was any breach of the lease conditions. After carrying out a limited scale preliminary site investigation with the consent of the lessee, it was reported in early 2001 that there was only localised surface contamination at the site. However, after the acquisition of the site in April 2001 and the carrying out of a detailed site investigation, it was found in October 2001 that the level of contamination was more serious than originally expected. Dioxins were also found in the contaminated soil. In the event, the Government had to incur an estimated cost of \$440 million to decontaminate the site.

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18. The Committee also noted that in November 1999, the Civil Engineering Department (CED) commissioned an engineering consultant, Consultant A, to carry out an environmental impact assessment (EIA) study for the theme park project. In April 2000, the CED appointed another engineering consultant, Consultant B, to undertake the “Infrastructure for Penny’s Bay Development - Engineering Design and Construction” consultancy study. Consultant B was also tasked to assess the contamination at the PB shipyard site. According to the brief of the consultancy study and in connection with the decommissioning of the site, an independent environmental consultant, Consultant C, was appointed in April 2000. Consultant C was tasked to monitor the preparation and implementation of a remedial investigation work plan, as well as the implementation of the remedial activities in order to ensure that all related works were conducted effectively and safely in accordance with the relevant legal requirements.

19. The Committee also took note of the following incidents from paragraphs 3.10, 3.11, 3.12, 3.14 and 3.15 of the Audit Report:

- in January 2001, Consultant B estimated that \$100 million, which was substantially greater than the original estimate of \$22 million approved by the Finance Committee (FC) in November 1999, would be required for the decontamination of the site. At that time, Consultant B advised that the exact decontamination cost could only be accurately assessed after the completion of the EIA study;
- in February 2001, the CED reported to the Steering Committee, which was set up to oversee the development of the theme park project and chaired by the Financial Secretary, that the preliminary site investigation had revealed that there was only localised surface contamination. There was no widespread contamination in the open area;
- at its meeting on 17 March 2001, the Steering Committee was informed that Consultant C had found more contamination than expected. Consultant B was requested to conduct a detailed site survey to identify all the chemical wastes found at the site;
- in July and August 2001, the CED informed the Steering Committee that the extent of contamination was not considered very serious. However, in September 2001, Consultant C considered that the extent of contamination would be greater than expected. Consultant B was recommended to carry out additional trench work; and

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- in late September 2001, after the completion of the additional trench work, the Environmental Protection Department (EPD) considered that the level of contamination was more serious than expected. In October 2001, Consultant B found that the soil was contaminated by dioxins.

20. Against the above background, the Committee was concerned whether any government officials had made misleading comments or reports to the Steering Committee over the matter. In response, **Mr TSAO Tak-kiang, Director of Civil Engineering**, said that:

- he would not make any presumption over the possibility of government officials making misleading comments or reports about the matter; and
- the PB shipyard site occupied 19 hectares of land. According to Consultant B's estimate in January 2001, the cost required for decontaminating such a large piece of land would be about \$100 million. Given the huge size of the shipyard site, it was not unreasonable to believe that the level of contamination at the site was not serious, although some contaminants normally found at shipyard sites, such as petroleum hydrocarbons and metals, had been identified during the preliminary site investigation. This was the reason why the Steering Committee was informed at the meeting in February 2001 that there was only localised surface contamination and there was no widespread contamination in the open area.

21. The Committee pointed out that there had been quite a number of signs of contamination at the PB shipyard site before it was surrendered to the Government. The various signs included the following:

- in early 2001, the lessee allowed Consultant C to carry out a preliminary site survey at the site. During the site survey, Consultant C found more contamination than expected and recommended the collection of some disturbed samples of apparent waste or burn-pit materials for chemical analysis. However, the CED did not carry out further site surveys to re-assess the level of contamination of the site;
- there had been a general comment by green groups that shipyard operation generated contaminants such as toxic metals, persistent organic pollutants and other hazardous substances. According to the summary of environmental concerns of green groups provided by the Director of Civil Engineering in his



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letters of 9 and 31 December 2003, in *Appendices 8 and 9*, Greenpeace had reported that waste combustion would release toxic substances, including dioxins. According to paragraphs 3.17 and 3.23 of the Audit Report, during the 1990s, complaints had been made to the EPD about the open burning of wastes at the PB shipyard site; and

- some LegCo Members had, on a number of occasions, alerted the Administration to the possibility of a greater extent of contamination at the PB shipyard site. For example,
  - (a) Ir Dr Hon Raymond HO Chung-tai asked a LegCo question at the Council meeting on 12 January 2000 enquiring, among others, whether the Government had assessed the extent to which the PB shipyard site had been polluted. He pointed out that the soil on the site had been seriously polluted over the years by oils, heavy metals, dyes and organic solvents brought about by ship-breaking activities; and
  - (b) at the meeting of the Panel on Economic Services on 27 March 2000, Hon LEE Wing-tat expressed concern that the actual level of contamination at the PB shipyard site might be higher than the anticipated level and sought explanations from the Administration on how the situation would be handled. He also questioned the basis of estimating the decontamination cost at \$22 million.

22. The Committee considered that, in view of the various signs of contamination, the Administration should have had reasonable suspicion that the level of contamination at the site might be more serious than expected. Detailed site investigations should have been conducted to ascertain the level of contamination prior to the surrender of the site. However, it appeared that the CED had not taken any further actions despite the various signs. The Committee questioned whether it was the CED's intention to play the problem down.

23. The **Director of Civil Engineering** said that there was no question of playing the problem down. He explained that:

- as dioxins were not commonly associated with shipyard activities, they were therefore not targeted for testing. Based on past experience, shipyard operations normally generated contaminants such as petroleum hydrocarbons and metals, but not dioxins;

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- the crux of the matter was that the Government did not have access to the site for carrying out detailed site investigation before it was surrendered. In February 2000, Consultant A could only conduct limited site investigation at the periphery of the site. The results indicated that there was a low concentration of total petroleum hydrocarbons and metals;
- in fact, Consultant B had initially proposed a full scale site investigation but the proposal was rejected by the shipyard operator in July 2000. After discussion with the LandsD and the CED, the shipyard operator agreed to allow the drilling of 13 boreholes on condition that these boreholes were not drilled within the workshops, working areas or in any areas that would have an adverse effect on the shipyard operations;
- in December 2000, the field work for the preliminary site investigation was substantially completed. The preliminary results indicated that, of the 13 boreholes drilled, only one showed traces of fuel contamination. It was, therefore, considered that the contamination at the site “appeared localised and superficial”. To complete the remedial investigation work plan in accordance with the EPD’s guidance notes, a comprehensive site survey was still necessary. However, this could not take place until after the surrender of the site; and
- in estimating the decontamination cost of the site, reference had been made to the level of contamination of the former Kai Tak International Airport. Although the level of contamination of a shipyard site was not normally as high as an airport, the CED had adopted a prudent approach and used the same basis as that for Kai Tak International Airport, which was \$600 per square metre, in calculating the decontamination cost for the PB shipyard site, thus arriving at \$22 million.

24. To ascertain whether the Steering Committee had been fully informed of all related facts, the Committee requested the CED to provide the relevant papers and minutes of the Steering Committee. The **Director of Civil Engineering** provided in his letter of 10 February 2004, in *Appendix 10*, extracts from relevant papers and minutes of 17 meetings of the Steering Committee in relation to the acquisition of the PB shipyard site.

25. As regards previous complaints about open burning of wastes at the PB shipyard site and the environmental concerns expressed by green groups in their web sites, the **Director of Civil Engineering** clarified at the hearing and in his letters of 9 and 31 December 2003 that:

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- dioxins were mainly generated in trace quantities as the by-product of combustion and chemical processes, including the incineration of chlorinated organic substances and chlorinated wastes. The likely cause of dioxins was the open burning of plastic materials, but not general wastes. However, there was no evidence showing that the apparent waste and burn-pit materials found at the site during the preliminary site survey conducted in early 2001 were burnt residue of plastic materials. Therefore, Consultant C had not associated the burning activities with dioxins; and
- the taking of soil samples for dioxin testing was triggered by the findings of the detailed site investigation carried out after the surrender of the site, rather than by green groups. The details were as follows:
  - (a) in mid-2001 during the initial phase of detailed site investigation carried out after the surrender of the site to the Government, Consultant B revealed that there were burnt chlorinated wastes buried in the southern portion of the site. The Consultant considered that soils in these burnt pits might have been contaminated by chlorinated substances and pollutants such as dioxins, thus testing of dioxins was warranted. At that time, the CED had not received any comments from local green groups and environmentalists about the detailed site investigation and testing at the PB shipyard site. Consultant B, however, conducted a general review of relevant reports published at the time in the web sites of various green groups as well as relevant discussions in some international environmental forums;
  - (b) the general concerns of the green groups and environmentalists were that there was a strong association of dioxin emissions with uncontrolled open burning of plastic waste, such as Polyvinyl Chloride (commonly known as PVC). There was also a worldwide concern of the harmful effect of persistent organic pollutants, including dioxins, to the environment. International initiatives to implement measures to reduce or eliminate releases of persistent organic pollutants including dioxins into the environment was urged. The CED was advised of these concerns during its discussions with the Consultants on the implementation of the detailed site investigation in mid-2001; and
  - (c) after the revelation of the burnt chlorinated wastes and the review of the environmental concerns, Consultant B decided to take soil samples from the burnt pits at the site for dioxin testing. The CED agreed to the Consultant's prudent decision to complete a full appraisal of the contamination of the site and devise the most appropriate remedial measures to address the contamination problem.

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26. As complaints had been made to the EPD in 1995 and 1999 about open burning of wastes at the PB shipyard site, the Committee enquired whether the EPD:

- had detected any signs of contamination, e.g. dioxin contamination, during the investigation of the complaints; and
- during the site acquisition process, had alerted the relevant works departments to any contamination, e.g. dioxin contamination, on the site already known to the EPD.

27. **Mr Robert Law, Director of Environmental Protection**, responded at the hearing and in his letter of 9 December 2003, in *Appendix II*, that:

- the EPD had inspected the site following the two complaints in 1995 and 1999 against open burning in the shipyard site occupied by the then Cheoy Lee Shipyard (CLS). No actual burning activity had been observed during the inspections. Other than ashes and burnt remains on the ground surface, there had been no signs of land contamination detected during the inspections. While dioxins could be formed by any combustion process (e.g. even cigarette smoking), there was no reason to believe any significant quantities of dioxins that would have been formed on the site as there was no evidence that large quantities of plastics had been burnt which could have given rise to dioxin contamination on a large scale;
- between December 1990 and April 2001, the EPD had also conducted regular inspections to CLS to monitor the operation and the pollution situation of the shipyard. The site inspections did not reveal any leakages, spillage nor land contamination from the shipyard operation. Hence, the EPD had no reason to believe that the CLS site would be more contaminated than any other shipyard site;
- exchange of information on the key issues was part of the established procedures in an EIA process. In the EIA studies for the PB shipyard site, the CED was the project proponent and the EPD was the statutory Authority. There were different levels of inter-departmental co-ordination and monitoring of the progress and findings of the EIA studies. The EPD had convened Environmental Study Management Group meetings to provide a forum for detailed discussion on the requirements for the EIA study brief, the methodology and the initial findings of the EIA study, including the nature and extent of the contamination at the site, and liaison with the proponent department. Relevant authorities and works departments, including the

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District Lands Office, had attended meetings of the Group for detailed discussion. This was to ensure that a forum did exist to exchange information and to alert the relevant works departments of key issues related to the EIA process;

- three EIA studies had been conducted, namely, the Northshore Lantau Development Feasibility Study (NLDFS) EIA, the Theme Park EIA and the Decommissioning EIA for the PB shipyard site, all by the CED;
- the CED had conducted the EIA for the NLDFS in 1998. In this EIA, CLS had been identified as the only industrial operation that had the potential to cause soil and groundwater contamination within the project area of the North Lantau development. The types of contamination of concern were identified to be total petroleum hydrocarbons and metals. It highlighted the need for a separate subsequent EIA study to examine the land contamination upon the decommissioning of the PB shipyard site. The Theme Park EIA conducted in 1999-2000 had made due reference to this finding and had required that a detailed EIA study be carried out to investigate specifically the issue of contamination on the PB shipyard site. Subsequently, the Advisory Council on the Environment endorsed the Theme Park EIA in April 2000 with a condition that no work should commence at the PB shipyard site until a separate EIA study for the decommissioning of the site had been completed and an environmental permit issued;
- during the site acquisition stage, which took place between mid-2000 and April 2001, land contamination at the PB shipyard site was well known to all the parties concerned. The CED commissioned the Theme Park EIA (November 1999 to April 2000) and subsequently the Decommissioning EIA (April 2000 to April 2002) to determine the precise extent of the land contamination problem and to recommend an appropriate remedial proposal to clean up the site; and
- in the case of dioxin contamination, the presence had been revealed at a later stage after completing a comprehensive site investigation. Consultant B subsequently found that the soil was contaminated by dioxins, in addition to those contaminants such as petroleum hydrocarbons and metals which were normally found at shipyard sites. The preliminary study report was made known to the CED, EPD and other works departments in October 2001.

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28. The Committee was aware that the lessee of the PB shipyard site had been engaged in manufacturing fibreglass boats. Since it was widely known that the processing, such as opening burning, of fibreglass could generate a significant amount of harmful substances, the Committee asked about the reasons why, prior to acquisition of the site, the CED had not suspected that the use of fibreglass by the lessee in manufacturing boats might cause dioxin contamination at the site.

29. The **Director of Civil Engineering** explained in his letter of 31 December 2003 that:

- chemically, fibreglass was formed by continuous filament, and its composition consisted principally of oxides of silicon, aluminium, calcium boron and magnesium, fused in an amorphous vitreous state. Fibreglass was used for the ship mould works. The ship mould was originally made by laying fibreglass cloth over a wooden replica of the intended boat hull and applying small amount of epoxy resin. The wooden moulds were used once and the wood recycled where possible. The resulting fibreglass mould was fixed within a sturdy wooden frame and could be re-used many times. Small amounts of excess resins were cleaned off using acetone solvent. Due to the woven nature of the fibreglass, there was very little waste fibre. Any cloth off-cuts were re-used and applied on some other part of the mould. The small amount of waste fibreglass produced were swept up and collected in bins for disposal. Since fibreglass was not defined as a chemical waste, its proper disposal method was landfilling; and
- the above normal work processes of fibreglass materials would not release significant amount of harmful substances such as total petroleum hydrocarbons, volatile and semi-volatile organic compounds and polyaromatic hydrocarbons, and would also not release any dioxins. Open burning was not a normal manufacturing operation of fibreglass vessels. Prior to acquisition of the shipyard site, the CED had paid visits to the site and had not observed any open burning of fibreglass materials.

30. The Committee understood that the lease conditions of the PB shipyard site did not empower the Government to enter the site to conduct site investigation. However, given the Consultants' findings and recommendations that more contamination had been found at the site and further site investigations were necessary to ascertain the level of contamination, the Committee asked whether the CED had considered any other options to enable it to enter the site for inspection. For example, by virtue of the Waste Disposal Ordinance, the CED might enter the site to inspect whether there were any illegal practices by the shipyard operator or his workers.

## The acquisition and clearance of shipyard sites

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31. The **Director of Civil Engineering** answered in the negative. He explained that the reason for not invoking ordinances to gain access to the site was that the CED had not been aware of any suspected breach of relevant ordinances by the shipyard operator.

32. According to Note 17 in paragraph 3.12 of the Audit Report, in early 2001, Consultant C observed that there was suspected chemical waste disposal practice by the shipyard workers and alerted the EPD to such an incident. Upon receipt of the complaint, the EPD had taken action to stop the illegal waste disposal and prosecuted the shipyard operator for the illegal act in July 2001. The Committee questioned whether the shipyard workers' waste disposal practice observed by Consultant C during the preliminary site survey could have constituted a reasonable suspicion of their breach of the Waste Disposal Ordinance such that the CED might, based on the power conferred by that Ordinance, enter the site to conduct a detailed site investigation.

33. The **Director of Environmental Protection** explained that:

- Consultant C had observed the shipyard workers disposing of a container of paint in a pit on the site. After having been informed of this incident, the EPD, by virtue of the power conferred on it by the Waste Disposal Ordinance, entered the site for an investigation on grounds of a suspected breach of the Ordinance. After gathering sufficient evidence, the EPD prosecuted the shipyard operator for the offence of failure to deliver the chemical waste to a reception point, which was in contravention of section 8(1)(a) of the Waste Disposal (Chemical Waste) (General) Regulation;
- the EPD could only make use of very explicit offence provisions in the Waste Disposal Ordinance to enter a site to investigate a suspected breach of the Ordinance. In other words, the EPD could only enter a site for such investigation where it had reasonable suspicion that an offence against the Ordinance was being or had been committed at the site. The EPD could not make use of those provisions to allow another department to enter the site for routine inspections or site investigations of any kind, such as contamination assessment;
- the contamination found at the site, apart from dioxins, was within the reasonable level expected of a shipyard with long operating history. In fact, the contamination found was neither necessarily related to the shipyard workers' illegal waste disposal practice nor any breach of the Waste Disposal Ordinance. It should be noted that the land of a shipyard site would inevitably gradually become contaminated over many years of shipyard operations;

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- as regards dioxin contamination, he recalled that a representative of Greenpeace had agreed that no one could have reasonably foreseen the presence of dioxins at the site; and
- the overwhelming majority of the dioxins found at the site were one to four metres below ground level. Some of them were not in the vicinity of any sites of previous open burning activities, and some obvious sites of previous opening burning activities did not have any dioxins near them. Based on these findings, it might mean that not all the dioxins found on the site had been formed there.

34. In response to the Committee's enquiry, the **Director of Environmental Protection** supplemented, in his letter of 31 December 2003 in *Appendix 12*, that:

- during a meeting of the Panel on Environmental Affairs held on 19 March 2002, in response to a request from LegCo Members to express a view on the Administration's statement that the presence of large quantities of dioxins at shipyard sites was unusual and could not reasonably have been foreseen, Dr Luscombe (the Greenpeace representative) said: "Shipyards had not been widely recognised as a source of dioxins. He was intrigued by the level of contamination."; and
- it was clear from the context of the discussion at the Panel meeting that Dr Luscombe basically agreed with the contention that significant quantities of dioxins could not reasonably have been foreseen at a shipyard site.

### **Surrender of the PB shipyard site to the Government**

35. The Committee noted that on 3 April 2001, the lessee of the PB shipyard site executed the Deed of Surrender and received a compensation of \$1,506 million from the Government. On the same date, the lessee surrendered the site to the Government on an "as is" basis, meaning that the Government agreed to accept the surrender of the site in the state and condition as at the date of surrender. Before the surrender, the Government had not been well-positioned to estimate the final cost of cleaning up the contamination due to the limitations in the existing lease conditions. After the surrender, the Government found that the site was heavily contaminated and the estimated decontamination cost had further increased to \$440 million.



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36. The Committee enquired whether it was common to include an “as is” clause in Deeds of Surrender, and whether the level of compensation to be paid under voluntary surrender was different from that of resumption.

37. The **Deputy Director of Lands (General)** replied that:

- the “as is” clause was not a common clause in Deeds of Surrender. It had been included in the Deed of Surrender of the PB shipyard site at the lessee’s request; and
- the Government paid compensation to the landowners who voluntarily surrendered the land on the same basis as that under resumption of land.

38. Having regard to the Consultants’ assessments and other signs of contamination that had emerged before the surrender of the site, as elaborated in the earlier part of this Report, the Committee considered that the Government should have negotiated more strenuously with the lessee to agree on a voluntary surrender arrangement that was more favourable to the Government. To better protect its interest, the Government should have at least gained access to the site for conducting EIA investigations prior to agreeing on the terms of the Deed of Surrender. The Committee questioned why the LandsD had accepted the “as is” clause before it had:

- critically evaluated and submitted to the relevant policy bureaux for consideration the potential risks and financial implications of accepting such clause; and
- obtained explicit approvals from the relevant policy bureaux.

39. In response, the **Director of Lands** said that:

- in view of the anticipated significant financial benefits that would be brought about by the Hong Kong Disneyland Project, it was the Government’s objective to complete the project as early as possible. The LandsD appreciated that early availability of the PB shipyard site was crucial to the overall programme since some of the works under the project could not commence until after the site was available. Against this background, a major consideration of the LandsD at that time was the early resumption of the site, either by voluntary surrender or by resumption; and

## The acquisition and clearance of shipyard sites

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- as far as the LandsD was aware, there had never been any question of the Government taking action against an ex-lessee of a resumed property in respect of breaches of the lease. Once a site had reverted to the Government, the factual situation was that breaches of the lease ceased to be an issue. The acceptance of the surrender of the site on an “as is” basis accorded with the position that the LandsD had previously taken on resumption. What would have happened, had the Government not agreed to the “as is” clause being included, could only be a speculation.

40. The Committee noted from paragraph 4.12 of the Audit Report that in another case of land surrender involving a special purpose site at Tsing Yi, a clause had been included in the Deed of Surrender to indemnify the Government from liabilities in connection with contamination found after the surrender of the site. In 2000, when the LandsD was processing the surrender of this site, the lessee proposed to surrender a portion of the site, with some underground structures left intact, to the Government. To protect the Government’s interest, the LandsD had included an indemnity clause in the Deed of Surrender whereby the lessee undertook to indemnify the Government from liabilities in connection with contaminants found within seven years after the date of the Deed of Surrender. The Committee questioned why the LandsD had not followed such practice in the case of the PB shipyard site.

41. The **Director of Lands** said that:

- if such an indemnity clause was to be included in the Deed of Surrender of the PB shipyard site, it was most probable that the lessee would not have surrendered the site to the Government on a voluntary basis. In the event, the overall project programme might be affected; and
- the LandsD was seeking legal advice on whether the Government could recover the decontamination cost from the ex-lessee of the PB shipyard site or the shipyard operator.

42. It appeared to the Committee that the Government had to resume the site “on time” at all costs in order to launch the Disneyland Project. The Committee asked whether, before accepting the “as is” clause, the LandsD had discussed with the Steering Committee the potential risks and financial implications that might arise from the acceptance of such a clause. The **Director of Lands** informed the Committee that the decision of accepting the “as is” clause was made by the then Director of Lands.

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43. In view of the above reply, the Committee requested the Director of Lands to ascertain, by checking of past records, whether the decision to include the “as is” clause in the Deed of Surrender of the PB shipyard site had been made by the then Director of Lands on his own, despite knowing the significant increase in the decontamination cost by more than four times from \$22 million to \$100 million; if so, what the rationale behind his decision was.

44. The **Director of Lands** replied, via his letter of 5 January 2004, that:

- the checking of past records showed that the LandsD received copies of Consultant B’s reports in June 2000 and February 2001 wherein the text stated that the exact cost of the decontamination work on the CLS site could only be accurately assessed after the completion of the EIA study. The LandsD’s negotiating team led by the then Deputy Director/Specialist also understood through the Steering Committee meeting in February 2001 that the preliminary site investigation had revealed that there was only localised surface contamination and there was no widespread contamination in the open area. The \$100 million estimated provision for decontamination work was set out in a schedule of capital cost estimate appended to Consultant B’s report in February 2001 and was not noticed at the time by the LandsD’s negotiating team; and
- the LandsD’s records also showed that the original proposal for surrender on an “as is” basis was made by the surveyor for the owners of CLS to allow the owners to surrender the lot with such structures and plant as remained on site. Considering that the outcome would have been the same if agreement could not be reached on the surrender and the site had been acquired by resumption, and since surrender was a speedier and more certain arrangement than resumption, the proposal was acceptable to the LandsD.

45. In the light of the Director of Lands’ above response, the Committee enquired whether the CED had formally alerted all relevant departments as soon as it knew of the assessments made by Consultants B and C concerning the higher level of contamination and significant increase in the estimated decontamination cost.

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46. The **Director of Civil Engineering** and **Mr YIP Sai-chor, Deputy Director of Civil Engineering (Special Duties)**, responded that:

- the findings of the site investigations had been included in the relevant draft EIA study reports and had been commented on by all relevant departments before finalisation. The EIA studies came under close scrutiny by the relevant Environmental Study Management Groups. These Groups comprised members from all relevant departments including representatives of the relevant District Lands Office and the EPD. They provided useful forums for detailed discussions about the requirements for the site investigations and the EIA studies, the methodologies and findings of the studies, including the nature and extent of the possible contamination at the shipyard site; and
- the CED had also convened and chaired regular inter-departmental co-ordination meetings to oversee the progress of, and discuss and resolve any issues relating to, the relevant EIA studies. The nature and possible extent of the contamination at the site had been a subject of concerns in these inter-departmental meetings.

47. At the request of the Committee, the **Director of Civil Engineering** provided, in his letter of 30 December 2003 in *Appendix 13*, the reports compiled by Consultants B and C in relation to the contamination of the PB shipyard site.

48. The Committee further enquired whether the FSTB and FC had been informed of the increase in the estimated cost of decommissioning the site from \$22 million to \$100 million after such increase was known to the relevant departments; if so, when the FSTB and FC had been informed; if not, whether that was in breach of the proper financial procedure.

49. The **Secretary for Financial Services and the Treasury** replied in his letter of 30 December 2003, in *Appendix 14*, that:

- the FSTB had checked its records and confirmed that the then Treasury Branch had not been previously informed of the increase in the estimated cost of decommissioning the PB shipyard site from \$22 million in November 1999 to \$100 million in January 2001. This piece of information came to its knowledge in the context of the first draft report circulated by the Director of Audit on 28 August 2003 for comments by the FSTB;

## The acquisition and clearance of shipyard sites

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- in the submission of 17 November 1999 to the Public Works Subcommittee (PWSC)/FC for acceptance in principle the financial implications at a rough order of \$13.6 billion for funding the infrastructure to support the development of an international theme park at Penny's Bay, the Administration included an estimated cost of \$22 million for miscellaneous works including decommissioning of the PB shipyard site. The submission also stated that the detailed design work for various components of the project had still to be undertaken and the capital cost estimates would be further refined as the Administration proceeded with the detailed design process. At the PWSC meeting, the Administration made clear that it would submit further funding proposals to PWSC/FC for upgrading the project works in phases to Category A of the Public Works Programme and that Members would have further opportunities to scrutinise the details of the project when considering the respective funding proposals. The Administration also undertook to carry out a detailed EIA study for the Disneyland Project to address potential environmental issues that might arise during the construction and the operation stages;
- as a normal practice in the planning of public works projects, works departments would refine the project estimates in the light of information available from site investigation, feasibility study, EIA studies and preliminary/detailed design. In that connection, works departments should ensure that the financial implications of a project, including the capital and recurrent cost, as set out in the PWSC/FC submissions were the most realistic estimates at the time of seeking funding approval and represented the best value for money. The Controlling Officer must seek funding approval from the PWSC/FC for any subsequent changes in the approved project estimates exceeding \$15 million with full justifications. For changes costing less than \$15 million, approval from the FSTB was required; and
- in the present case, the then Treasury Branch was not informed in early 2001 of the increase in the estimated decommissioning cost, which was still subject to the completion of the EIA study. However, all relevant departments/bureaux including the then Treasury Branch had been alerted to the more serious contamination and the likely increase in the decontamination cost due to the presence of dioxins after the completion of EIA studies on the decommissioning of CLS in late 2001. The project estimates were subsequently revised to include a higher and more accurate estimation of the decommissioning cost with justifications in the submission to the PWSC for funding approval for the Package 3 infrastructure works in May 2002. In that context, the FSTB considered that the preparation of the project estimates was in line with the normal practice.

## **The acquisition and clearance of shipyard sites**

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### 50. **Conclusions and recommendations** The Committee:

#### **Resumption and clearance of the North Tsing Yi shipyard site**

- expresses dismay that the Government:
  - (a) had not enforced the terms of 15 Short Term Tenancies (STTs) of the North Tsing Yi shipyard site, which stipulated that, on termination of the tenancy agreements, the tenants were responsible for clearing the structures at their own expense; and
  - (b) had to incur about \$64.5 million for decontaminating the North Tsing Yi shipyard site, notwithstanding that there were conditions in the six leases and in five of the 15 STTs prohibiting contamination of the site;
- notes that:
  - (a) the Government has sought legal advice from an outside counsel on the liability of the six lessees and the 15 STT tenants for the contamination found at the site, and has issued 21 protective writs against the various parties; and
  - (b) the Director of Lands will implement Audit's recommendations in paragraphs 2.14 and 2.28 of the Audit Report;

#### **Assessment of contamination at the Penny's Bay (PB) shipyard site**

- expresses dismay that the Government:
  - (a) had no legal authority to enter private sites for conducting environmental impact assessment site investigations; and
  - (b) had to incur an estimated cost of \$440 million for the decontamination work on the PB shipyard site after a detailed site investigation had revealed that the level of contamination was more serious than originally expected;
- notes that:
  - (a) the Director of Civil Engineering will implement Audit's recommendations in paragraph 3.25 of the Audit Report;

## **The acquisition and clearance of shipyard sites**

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- (b) the Director of Lands will implement Audit's recommendations in paragraph 3.26 of the Audit Report; and
- (c) the Secretary for the Environment, Transport and Works will notify all works departments of Audit's recommendations in paragraph 3.25 of the Audit Report;

### **Surrender of the PB shipyard site to the Government**

- expresses grave dismay that:
  - (a) the potential risks and financial implications of accepting the "as is" clause had not been critically evaluated by the Lands Department and submitted to the relevant policy bureaux for consideration, having regard to the fact that before the surrender of the site:
    - (i) Consultant C had found contamination at the site;
    - (ii) green groups had commented that shipyard operation generated contaminants such as toxic metals, persistent organic pollutants and other hazardous substances; and
    - (iii) some Legislative Council Members had, on a number of occasions, alerted the Administration to the possibility of a greater extent of contamination at the site; and
  - (b) the Lands Department had not included an indemnity clause in the Deed of Surrender of the PB shipyard site;
- notes that the Director of Lands:
  - (a) is seeking legal advice on whether the Government could recover the decontamination cost from the ex-lessee of the PB shipyard site or the shipyard operator; and
  - (b) will implement Audit's recommendations in paragraph 4.29 of the Audit Report; and

### **Follow-up action**

- wishes to be kept informed of the progress on the implementation of Audit's various recommendations.

## Chapter 2

### Funding of projects under the Applied Research Fund

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Audit conducted a review to examine the provision of funding support to applied research and development (R&D) projects under the Applied Research Fund (ARF), and to ascertain whether there were areas for improvement.

2. At the public hearing, **Hon John TSANG Chun-wah, Secretary for Commerce, Industry and Technology**, made an opening statement. In short, he said that:

- as noted in the Audit Report, there were non-financial objectives of the ARF. The ARF was a fund financed by the public. Reaping returns was important, but it was not the most important objective of the ARF. The achievements of the ARF should not be judged solely on the basis of financial returns. The ARF had to carry out its important public mission and fulfill the non-financial objectives;
- the main objective of the ARF was to encourage technology ventures and R&D activities that had the potential to yield commercially exploitable results in Hong Kong, by providing government funding as a catalyst. The longer-term aim of the ARF as a policy tool was to increase the technological capability and hence the competitiveness of local industries, thereby promoting high value added economic development in Hong Kong, not a tool to reap short-term financial returns;
- the investments of the ARF, which was a venture capital fund, were risky in nature. This was an inherent element of the ARF. The Audit Report stated that the ARF investments overall suffered a capital loss which represented 54% of the sum invested. The Report also pointed out that such capital loss included realised and unrealised losses. Unrealised loss, which referred to the difference between the original investment value and the latest valuation of projects, was a matter of valuation. A valuation which was below the original investment value was not equivalent to an investment loss. The valuation, which was done in accordance with the established practice of the venture capital industry, might go up or down as per the economy situation worldwide, the degree of technology development and the business prospects of the investee companies;
- the performance of the ARF was closely related to the global economy and the technology investment environment. Following the burst of the dot-com bubble in early 2000, the overall investment environment worldwide for technology business had been very difficult. The ARF investment projects were also affected. The valuation of the ARF investments was generally comparable to that of other venture capital funds. For instance,



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notwithstanding the very mature market in the United States of America (US) which had developed venture capital funds for over 30 years, the three-year result of the US venture capital funds, which were formed in 1999, showed a capital loss of about 38%. From September 2001 to June 2002, venture investment companies in Australia and New Zealand withdrew capital funds from 82 investee companies, of which 46% suffered losses. The index of the National Association of Securities Dealers Automated Quotations system (NASDAQ), which mainly consisted of technology-related stocks, had declined from its all-time high of over 5,000 points in the year 2000 to about 2,000 points at present, representing a decrease of about 60%. In Hong Kong, the Growth Enterprise Market index had declined to a very large extent from its all-time high of about 1020 points in March 2000 to its all-time low of about 105 points in October 2002. All these examples showed that the financial performance of the ARF was not out of line with other venture capital markets;

- the Administration reported to the Legislative Council (LegCo) Panel on Commerce and Industry twice this year that the Commerce, Industry and Technology Bureau (CITB) had conducted a review on the overall strategy of and direction on innovation and technology development, and hoped to adopt a demand-led, market-driven approach in concentrating resources to develop areas in which Hong Kong had competitive advantages, and leverage on the advantages of the Pearl River Delta region and its substantial market and demands, in order to promote the long-term development of Hong Kong's innovation and technology; and
- the Administration would strive to coordinate various policy tools, including the ARF, to produce the greatest synergy. He would lead the Steering Committee on Innovation and Technology which comprised members from relevant government departments, academia, industry and technology support institutes. The Steering Committee had held its first meeting. It would coordinate the formulation and implementation of innovation and technology policy, and ensure greater synergy among Hong Kong's technology programmes which had advantages and development potential. This also responded to Audit's view in paragraph 2.23 of the Audit Report that the CITB needed to take the lead in the ongoing review of the ARF and ensure that the review had a comprehensive coverage in the context of the Government's overall strategy for innovation and technology development.

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### Costs and achievements of the Applied Research Fund

3. According to paragraph 2.6 of the Audit Report, the former Industry Department's review in 1998 of the Applied Research and Development Scheme and the Cooperative Applied Research and Development Scheme, which were the predecessors of the ARF, found that it was difficult to come to any definitive conclusion on whether the schemes had met their objectives, and that there were difficulties in obtaining from the investee companies commercially sensitive information such as sales revenue and profits tax. As a result, the review could not reliably assess the commercial viability of the new technology venture. The Committee asked whether the access to commercially sensitive information of the investee companies was still a problem.

4. **Mr Francis HO, Permanent Secretary for Commerce, Industry and Technology (Communications and Technology (C&T))**, replied that before and at the time of the review in 1998, as civil servants who managed the schemes did not have the expertise in investments, funding support for investment projects was in the form of loan. Commercially sensitive information of the companies which borrowed was not released to the lender. As a result of the review, the form of funding support had been changed to investment by professional fund managers, which became members of the boards of directors of the investee companies concerned. As such, they could have access to the commercially sensitive information of these companies.

5. Noting that paragraphs 2.7(a) to (e) of the Audit Report contained statistics on the performance of the ARF as at 31 December 2002 since the engagement of fund managers, the Committee asked about the updated position.

6. In his letter of 19 May 2004, in *Appendix 15*, **Mr Anthony WONG Sik-kei, Commissioner for Innovation and Technology** provided the updated statistics as at 31 December 2003, as follows:

- the valuation of the 23 investments managed by fund managers was \$157.6 million, representing 44% of the investment at cost. Six of these investee companies had been liquidated or sold at nominal value;
- among the remaining 17 active investments, one was listed on the Growth Enterprise Market in May 2002. Another was acquired in February 2000 by a company listed on the Hong Kong Stock Exchange and four had won prestigious technology awards either locally or overseas. One other company was acquired in April 2004 by a company listed on NASDAQ;

## Funding of projects under the Applied Research Fund

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- as at 31 December 2002, the then 16 active investee companies attracted investments amounting to \$870 million, other than those from the ARF. As at end March 2004, the ARF further attracted \$7.5 million co-investments. Together with the \$870 million reported, the existing total amount of co-investments was about \$877.5 million, which was 1% higher than \$870 million as at end December 2002. This represented a multiplier factor of 2.9 against the corresponding ARF's investment;
- 14 investee companies were small-and-medium-sized enterprises with less than 50 employees at the time of ARF's initial investment. As at end December 2003, three were beyond this employment level; and
- after the engagement of fund managers, the Applied Research Council (ARC) approved investments into 23 cases with approved funding of \$378 million. This approved amount was about 3.9 times of the \$97 million funding approved for the 27 cases managed by the former Industry Department. More importantly, the institutional arrangements of engaging fund managers since November 1998 had much improved the then limitations in managing the funding scheme by the former Industry Department staffed by civil servants: more proactive ability to identify projects; better commercial sense and expertise in assessment; predominance of funding through equity participation instead of straight loans, more active project management and participation; more adequate expertise in arranging investment exit. Furthermore, the professional fund managers had enabled the ARC to better support the investee companies in that they could provide better networking advantages, as well as technical, management and marketing expertise, thereby enhancing the technical and commercial viability of the approved projects. These contributions were essential and had an impact, albeit difficult to quantify.

7. According to paragraph 2.8 of the Audit Report, in January 2003, one month before reporting to the LegCo Panel on Commerce and Industry, the ARC discussed the role and future of the ARF, and considered that the ARF would unlikely bring about local technology development opportunities with visibility or impact. It risked losing its purpose as a public policy tool to spearhead technology development. The Committee considered that such pessimistic view appeared to be different from the Administration's current view that the ARF should continue to operate. The Committee asked why there was such a difference.

## **Funding of projects under the Applied Research Fund**

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8. The **Permanent Secretary for Commerce, Industry and Technology (C&T)** responded that the ARF's view in 2003 was made having regard to the substantial drop in the number and amount of investments in 2001 and 2002 vis-à-vis those in 1999 and 2000, but not the achievements of the investments. The ARC was concerned that the drop might decrease the momentum of investment. To deal with such decrease, the ARC considered the options mentioned in paragraph 2.8 of the Audit Report, which sought to speed up and increase investments, such as making investments in the Mainland or overseas, matching ARF investments in external technology companies on the condition that they should set up R&D or technology-related business operations in Hong Kong and establishing a fund, with matching contributions from a consortium of industrialists and/or financiers, for investment in technology ventures.

9. The Committee wondered whether making investments in the Mainland or overseas would be even more risky.

10. The **Secretary for Commerce, Industry and Technology** responded that extending the ARF's ambit to the Mainland or overseas might incur higher risk. It might, however, not be so in view of the increase in the number and areas of investments. Nevertheless, the Administration's current position on the matter was to continue the ARF in the present modus operandi.

11. According to paragraph 2.13 of the Audit Report, fund managers had been engaged since November 1998 to improve the performance of the ARF. However, in terms of capital loss, the performance of investments made after the engagement of fund managers had not improved. Moreover, such engagement had its disadvantage because, unlike civil servants who had worked as part-time fund managers for the ARF before, management fees had to be paid to these full-time fund managers. The Committee asked whether it would be more appropriate for the Innovation and Technology Commission itself to manage the ARF investments.

12. The **Secretary for Commerce, Industry and Technology** responded that:

- the Administration still considered that professional fund managers were better than civil servants in the management of the ARF because the fund managers were more professional. Civil servants were less competent in terms of experience and expertise in technology-related investments. The competence of fund managers in managing the ARF investments could not be assessed solely on quantitative criteria. They were perhaps unfortunate

## Funding of projects under the Applied Research Fund

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in that they were engaged when there was a drastic change in the global economy. The percentages of capital loss of the ARF investments before and after the engagement of fund managers were comparable; and

- in addition, these fund managers had contributed a lot to the investee companies. Apart from making suggestions, they also assisted the companies in attracting investments from the private sector. In certain specific cases, the companies concerned even achieved unprecedented results, such as successful public listing or acquisition by publicly listed companies. The indirect benefits to industries accrued from the ARF investments by fund managers were more than those by civil servants.

13. The Committee wondered whether the Administration had knowledge or experience in the selection of competent fund managers. Moreover, while civil servants were replaced by professional fund managers in the management of the ARF, the Secretary for Commerce, Industry and Technology, being a public officer and the head of the CITB, was appointed to chair the Steering Committee on Innovation and Technology. The Committee queried whether this was a reversion to the old mode of management by civil servants.

14. The **Secretary for Commerce, Industry and Technology** and the **Permanent Secretary for Commerce, Industry and Technology (C&T)** responded that:

- before 1998, when civil servants were used as fund managers, the mechanism for vetting investment proposals was primitive and decisions on investment proposals were made by external assessors from the local academic community and civil servants. Investment was made in the form of loans to the investee companies;
- the selection of fund managers from 1998 onwards was through a tendering procedure. In the selection exercises in 1998 and 1999, the responses to the call for tender were overwhelming. Both local companies and overseas companies, such as those from Silicon Valley, responded to the call. The tender was vetted by the ARC, which comprised civil servants and reputable persons from various industries. Objective vetting criteria were adopted, which included the merits of the tender proposals, investment strategies and the track record of the fund managers' performance. Unfortunately, the investment environment in 1998 to 2000 was not normal and there was a drastic change from extreme optimism to extreme pessimism. The general market conditions were very unfavourable. As such, the performance of the ARF investments was adversely affected; and

## Funding of projects under the Applied Research Fund

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- the Steering Committee decided the policy direction to cater for the innovation and technology needs in Hong Kong. In alignment with this policy direction, the ARC, not the Steering Committee, selected the companies for making investment. For instance, if the Steering Committee decided that the optics industry should be the focus and priority industry, the ARC would decide on the specific areas of the optics industry in which it should invest.

15. According to paragraph 2.17 of the Audit Report, the ARC informed Audit that the structure of the management fees paid to fund managers had been revised from lump-sum fixed fees to performance-based fees. The effect was that the fees paid to fund managers had gradually decreased from \$44 million in the first two years to \$39 million in the last three years. It was estimated that the total management fees would further decrease to about \$18 million in the coming four years if investments stayed at the current level. The Committee asked:

- about the reasons for introducing the performance-based fee charging scheme; and
- why the cut in fees had not taken place earlier.

16. **The Secretary for Commerce, Industry and Technology, the Permanent Secretary for Commerce, Industry and Technology (C&T), and the Assistant Commissioner for Innovation and Technology (Infrastructure)** explained that:

- in engaging the fund managers for the first time in 1998, the Administration had negotiated with them the level of management fees. In the negotiations, the Administration hoped to lower the fees as much as possible. However, a fee level at 2.5% of the amount of fund entrusted to the fund managers concerned was the market norm, and was non-negotiable at that time before the burst of the dot-com bubble. It was also comparable to that of venture capital in other jurisdictions. As such, the Administration adopted the rate and hoped that the financial return of the investments could cover the management fees; and
- as the performance of the ARF investments was not satisfactory in 2002 and 2003, the Administration had, in accordance with commercial principles, conducted a new round of negotiations with the funds managers concerned, with a view to substantially reducing the management fees by, for instance, setting the fee level at 2.5% of the amount of investment rather than the

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amount entrusted to the funds managers. As the rate of management fees was prescribed in the management agreements, negotiations had to be conducted with the fund managers and could not be completed within a short time. In the end, the performance-based fee charging scheme was introduced in 2002 and the management fees was substantially reduced.

17. According to paragraph 2.18 of the Audit Report, at a meeting with the ARC in December 2001, a fund manager indicated that there was difficulty in identifying quality prospective investee companies in Hong Kong, the venture capital industry was well developed in Hong Kong and there were abundant sources of venture capital. The Committee asked about the Administration's comments on these views. It also asked whether the difficulty in identifying quality prospective investee companies in Hong Kong should better be addressed by providing innovative technology projects that met the venture capital companies' criteria for investments, rather than by the ARC's providing more venture funding.

18. In response, the **Secretary for Commerce, Industry and Technology** and the **Commissioner for Innovation and Technology** said that:

- it was true that the venture capital industry was well developed in Hong Kong. However, Hong Kong's venture capital was based in Hong Kong and made investments worldwide. Industry statistics had shown that only about 10% of the venture capital was disbursed to local companies, which might be a result of the technology-related companies' not being well developed in Hong Kong. This explained why there was difficulty in identifying quality prospective investee companies locally; and
- following the burst of the dot-com bubble, fund managers became very conservative and there had been very few ARF investments since last year. The Administration required that the ARF investment projects should be financed by funds from both the ARF and the private sector. There were two stages of investments, i.e. the pre-venture capital stage and the venture capital stage. The ARF investments were mainly made at the pre-venture capital stage where the products of the companies concerned were being developed. After completion of product development at that stage, fund managers of other venture capital might be interested in making investments at the venture capital stage.

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19. To facilitate a comparison of investments by venture capital with those by the ARF, the Committee asked about the amount of funds available from venture capital and, among which, the amount that had been invested in venture companies; as well as the percentage of the ARF investments in the overall investment in venture companies.

20. In his letter of 19 May 2004, the **Commissioner for Innovation and Technology** replied that:

- while some market statistics were available (e.g. the size of Hong Kong's venture capital investment portfolio; Hong Kong's disbursements by financing stage; disbursements to Hong Kong's companies, etc.), they needed to be treated with caution in that the degree of precision of these figures was very much affected by the lack of precision on what constituted "Hong Kong's venture capital" or "Hong Kong companies";
- unlike the ARF which might only be invested in technology venture / R&D projects that had commercial potentials and that must have substantial connections to Hong Kong, Hong Kong's venture capital might invest in "Hong Kong companies" outside Hong Kong;
- taking the above into account, the Administration considered that the figures needed to be interpreted with due care. As far as the Administration was aware, industry statistics had shown that the venture capital investment portfolio in Hong Kong was US\$10,817 million as at the end of 2002. However, industry sources had also shown that only about 11% was disbursed to "Hong Kong companies" and about 46% was disbursed to industries more closely related to technology, such as computer-related industries, electronics, information technology, medical/ biotechnology and telecommunications industries. On this basis, the investment portfolio into "Hong Kong companies" in technology-related industries was about US\$547 million as at the end of 2002. That of the ARF was about US\$29.6 million. The percentage of the ARF investments relative to the overall total was thus about 5.4%; and
- while the figure of 5.4% might seem to imply that the ARF investments occupied only a limited share of the venture capital invested in technology-related companies, according to industry statistics, only about 23% of the venture capital disbursements of Hong Kong was for companies at seed-stage or start-up stage in which ARF investments mostly focussed on and during which venture capital support by public sector fund like the ARF would be most critical and useful to augment any funding support from other



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sources. It therefore followed that if the above figures were further qualified by the relevant stage of financing in which ARF investments mostly focussed on, the investment portfolio into Hong Kong companies in technology-related industries in seed-stage or start-up stage might be about US\$126 million as at end 2002. This translated into ARF investments being about 23% of the relevant venture capital investment portfolio in technology-related industries in Hong Kong companies at the seed or start-up stage.

21. According to paragraphs 2.18 and 2.19 of the Audit Report, as at November 2003, the ARF had a large cash balance of \$434 million available for new investments. However, no new investment had been approved since May 2003. As it was difficult to identify new investee companies for investments, the Committee asked whether the surplus funds would be returned to the Government.

22. The **Secretary for Commerce, Industry and Technology** and the **Commissioner for Innovation and Technology** responded that:

- there was no plan to return the surplus funds to the Government because there was a need for technological development. The ARC would continue to search for worthwhile projects for investments to provide funding support for industries to conduct R&D activities. In fact, the fund managers had been searching for investment projects for the past few months and were deliberating the feasibility of a number of them; and
- as a result of the review of the operation of the ARF, there would be technology focus areas to align with the Government's overall strategy in innovation and technology investments. The fund managers would be asked to make more investments in these focus areas, which were relatively large in scope. These areas would be the major industries in Hong Kong for which the ARF would provide funding support for the conduct of more R&D activities. Apart from the ARF, the Innovation and Technology Fund (ITF) also provided funding for such purpose. Funding support from the two Funds should, in theory, bring in more new investment projects in the area of innovation and technology in future.

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23. According to paragraph 2.21 of the Audit Report, the main objective of the ARF was to encourage technology ventures and R&D activities that had the potential to yield commercially exploitable results in Hong Kong. However, Audit's findings indicated that many of the projects receiving ARF funds were commercially unsuccessful, and some had suffered heavy capital losses. The Committee asked:

- whether the Administration agreed that the ARF investments were commercially unsuccessful; and
- how the Administration could ensure that the future ARF investments could achieve the main objective.

24. The **Secretary for Commerce, Industry and Technology** and the **Commissioner for Innovation and Technology** responded that:

- the ARF investments were commercially unsuccessful because they had suffered heavy capital losses. The losses were incurred because the investment projects, which were related to the dot-com business, had suffered from the burst of the dot-com bubble; and
- it was unlikely that every investment using venture capital was successful. The venture capital portfolio included a basket of investment projects, some of which were successful and some not. The overall results of investments using venture capital would be regarded as successful if, among five or six investments made, one or two were successful and made an overall profit. The duration of such investments should be long term rather than short term. Moreover, being risky in nature, these projects were not commercially worthwhile for investment. As such, the ARF had to provide the funding support for such projects in the pre-venture capital stage so that they could attract private-sector investment which could benefit the development of industries.

25. Although the Secretary for Commerce, Industry and Technology and the Commissioner for Innovation and Technology had emphasised the long-term nature and overall success of the ARF investments, Audit's findings of the performance of the investments, which were made in a period of over 10 years, indicated that the overall investment results were unsuccessful. The Committee noted that the Government had revised the target rate of investment return from "at least 5% per annum of the sum advanced" to "the best return rate achievable" because of the need for flexibility. There was, however, no benchmark for assessing whether the revised target rate had been achieved. It asked:

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- about the normal duration of investment in venture companies by fund managers in the venture capital industry before they could reap investment returns; and
- when the overall investment results could be achieved and whether “the best return rate achievable” was still the target return rate.

26. The **Secretary for Commerce, Industry and Technology** stated at the hearing and the **Commissioner for Innovation and Technology** stated in his letter of 19 May 2004 that:

- venture capital had been developed in the US for more than three decades and the US was a very well-developed market. If the US was used as a benchmark and in accordance with studies of US venture capital market, it showed that “... nearly half of all venture capital-backed companies don't fulfill their potential, and nearly one-third go out of business”. According to the information of the National Venture Capital Association of the US, an early stage investment might take “seven to ten years to mature” while later stage investment may take “a few years”. It had also pointed out that, generally, venture funds had a life span, on average, of “10 to 12 years”;
- academics of the US had also pointed out that the median age of technology-based companies making use of initial public offering as a means for divestment and recouping return had recently been gradually increased from being about four years in 1999-2000 (during which many were just 18 months) to some nine years in 2001-02. This had reflected that the investment return duration of venture capital had been significantly lengthened in recent years;
- the ARF investments were indeed commercially unsuccessful. The Administration, however, had other non-financial objectives to achieve. The achievement of the three non-financial objectives of the ITF could serve as an example. The first objective, i.e. training more R&D manpower through investments in technology-related projects, was achieved as shown by a substantial increase of R&D manpower from about 10,000 in 1999 when the ITF was established to 13,000 in 2002. As a result of the ITF investments, an additional manpower of 1,000 was increased in these few years;

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- regarding the second objective, i.e. generation of private-sector R&D investments, there was a substantial increase of the amount of private-sector investments from about \$4.8 million before the establishment of the ITF to \$160 million in 2002. The corresponding percentage of R&D expenses to these investments rose substantially from 24% to 33% which, however, was on the low side when compared to the corresponding percentages for Finland and Japan, which were 71% and 69% respectively. As such, Hong Kong had to make more efforts in this respect; and
- regarding the third objective, i.e. increasing advanced technology and value-added production activities, there was no uniform benchmark for measuring the amount of advanced technology activities. Some statistics on the amount of such activities were as follows: universities in the US made about 13,000 inventions and carried out 23,000 technology transfers in 2001. In Hong Kong, there were 535 new technology items and products as well as 62 registered patents. Comparing the statistics of these two places, Hong Kong appeared to lag far behind the US. However, if the amount of funding support was also taken into account, the US invested a total of US\$20 billion in 2001 while the total amount of the ITF investments in four years was about US\$200 million, representing about 1% of the total investments by the US in 2001. In the US, about 65 items of patents were produced and 115 items of technology transfers made for every US\$100 million spent, whereas the corresponding numbers of patents and technology transfers for Hong Kong were 31 and 267 respectively. The comparison indicated that the performance of Hong Kong was not very bad. Nevertheless, the Administration would make more efforts in this respect.

27. The Committee was concerned that no benchmarks had been established for measuring the fulfilment of the ARF's non-financial objectives. The Committee asked whether the Administration would do so.

28. The **Secretary for Commerce, Industry and Technology** responded that the Administration would put forward benchmarks for measuring the fulfilment of the ARF's non-financial objectives or a basket of benchmarks to facilitate Audit's review of the performance of the ARF investments.

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29. According to paragraph 2.25 of the Audit Report, the ARF, in certain specific cases, had been able to achieve important milestones like successful public listing or acquisition by publicly listed companies which had not been achieved before. The Committee asked about the statistics in this regard. On the other hand, the Committee noted that Audit had reported six cases of unsuccessful investments managed by the fund managers (Table 5 in paragraph 3.2 of the Audit Report). To understand the performance of the fund managers, the Committee asked the Innovation and Technology Commission to provide details of the six most successful ARF investments managed by the fund managers, and the expected times of return.

30. The **Commissioner for Innovation and Technology** responded at the hearing and in his letter of 19 May 2004 that:

- as described in paragraph 2.7(b) of the Audit Report, one investee company had been listed on the Growth Enterprise Market in May 2002, and another had been acquired in February 2000 by a company listed in the Hong Kong Stock Exchange. They were among the 16 investee companies which were relatively young and required more time for development with the aim of being listed on the Growth Enterprise Market. The timing of listing depended on the mode of operation of individual companies and the preference of the shareholders;
- regarding the six most successful investment projects managed by the fund managers (details of which were given in his letter), it was difficult to project when ARF investments might be exited or whether such investments might bring return to the ARF. Many factors would affect the timing and outcome of exit from these investments, such as business cycle, financial market situation, performance of the technology market and the global economic trend; and
- the median age of technology-based companies matured for initial public offering, which was an important way for exiting venture capital investments, had recently been lengthened to some nine years. The ARC had, however, already stipulated in its relevant management agreements that the fund managers must use their reasonable endeavours to ensure that all of their investments were realised not later than the date of expiration of the management agreements, which would stay in force until 2007-08.

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### Disposal of completed investments by the fund managers

31. According to paragraph 3.1 of the Audit Report, under the management agreements with fund managers, the fund managers might in their absolute discretion realise or sell any of the investments of the ARF at such times and prices and in such manner as they might decide. The Committee asked:

- whether advice from the Department of Justice had been sought in drafting the management agreements with the fund managers; and
- whether the management agreements allowed fund managers to receive commission from the buyers for their sale of investee companies' shares.

32. In his letter of 7 May 2004, in *Appendix 16*, the **Commissioner for Innovation and Technology** said that:

- the ARC engaged private-sector legal firms to provide legal services for it. It had sought advice from them when drafting the management agreements; and
- the management agreements did not contain provisions allowing fund managers to receive commission for their sale of investee companies' shares.

33. In the light of the fund managers' disposal of completed investments, particularly Case A in the Audit Report in which the investments were sold at a nominal value, the Committee asked about the rationale for giving the fund managers absolute discretion.

34. The **Permanent Secretary for Commerce, Industry and Technology (C&T)** replied that it was a conscious and collective decision of the ARC to give absolute discretion to the fund managers. Such power was provided for in the management agreements.

35. According to paragraphs 3.3(k) and (l) of the Audit Report, in a meeting of the ARC held on 15 September 2000, the Directors of the ARC raised questions about the failure of Company A and how Fund Manager A had come to the conclusion that the ARC should sell its shares at US\$1. In an ARC emergency meeting held on 30 October 2000, Fund Manager A reported the details of the events leading to the sale of the ARC's shares in Company A. The Chairman of the ARC said that it was unsatisfactory that the ARC had not been informed in a timely manner. The Committee enquired:

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- about the grounds for the ARC Chairman making the above remarks, having regard to the fact that the management agreement had provided for the fund manager's absolute discretion in the disposal of investments;
- for Case A, whether the Administration had diligently discharged its duty to closely monitor the use of public funds, taking into account the level of risk of the investments; and
- whether the LegCo had been informed of the matter.

36. In his letter of 19 May 2004, the **Permanent Secretary for Commerce, Industry and Technology (C&T)** said that:

- although the management agreement did not require the relevant fund manager to seek the ARC's prior approval before selling the ARC's shares, the Chairman's remarks very much represented the sentiment of the ARC Board on the sale;
- in the past few years, the ARC had continuously sought ways to improve the achievement of the ARF. To this end, persons responsible for management of the ARF had been changed from civil servants to professional fund managers. It was hoped that, through these fund managers, the identification and vetting of investment projects could be carried out more effectively and in a professional manner. The fund managers might also be able to support the investee companies for technology and business development, provide the necessary networks and coaching. The engagement of fund managers was a very reasonable way to manage the ARF investments; and
- there was no procedural requirement for the ARC to inform the LegCo of the management of the ARF. However, since 2001, the ARC had reported to the LegCo on the overall performance of the ARF investments, but not on individual investments.

37. The Committee considered that the Administration should study how the ARC could tighten up the control over the disposal of the ARF investments so that the public money could be safeguarded. It asked whether the Administration would request the fund managers to put forward ways to avoid disposal of ARF investments by the fund managers without informing the ARC beforehand. The effectiveness of their suggestions could be taken into account in deciding whether to engage the relevant fund managers or renew the management agreements with them.

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38. The **Secretary for Commerce, Industry and Technology** responded that the Administration would take action to strengthen control over the disposal of ARF investments by requiring more frequent progress reporting by fund managers. It would also seek suitable changes to the existing management agreements.

39. The Committee noted that there was a co-investment provision in Clause 7.1(c) of the ARC's management agreement with Fund Manager A, which provided that the fund manager might "co-invest in any of the investments whether on its own account or on account of its other clients provided that such co-investment shall be made upon commercial terms which are comparable to those applicable to the Investments." It appeared to the Committee that the provision only set out the co-investment principle but was silent on implementation, as it did not require the initial and follow-on investments as well as divestments of the ARF to be followed on the same terms by the fund managers as co-investors. The Committee asked how the ARC ensured the fund managers' compliance with the co-investment provision in the management agreements.

40. In his letter of 19 May 2004, the **Commissioner for Innovation and Technology** informed the Committee of the system to deal with co-investment proposal and conflict of interest, as follows:

- in terms of system and process, the management agreements provided that the fund managers might co-invest in any of the investments on their own account or on account of their other clients, provided that such co-investment must be made upon commercial terms which were comparable to those applicable to the investments;
- the management agreements also required that the fund managers must not, among other things, invest the ARF in any investments already invested by any other funds managed by the fund managers concerned without the prior written consent and approval of the ARC which must not be unreasonably withheld;
- as regards making co-investment as a requirement, the three earlier management agreements concluded in November 1998 did not require co-investment as such. However, in the case of the fourth fund manager engaged by the ARC in March 2000, the relevant management agreement made co-investment as a requirement. There was no co-investment requirement in the management agreement for Fund Manager A;



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- through the management agreement, the ARC appointed the fund manager and the fund manager agreed to act as manager of the ARF in accordance with the terms of the management agreement. Under the relevant management agreement, the fund manager must use its reasonable endeavours to act in the best interests of the ARC in relation to the ARF and/or the investments. The fund manager was granted the authority, power and right on behalf of, for the account of and in the name of the ARC to, among other things, purchase or otherwise acquire or sell, dispose of, exchange, vary or invest in the investments; and
- the ARC-fund manager relationship was thus based on mutual good faith. The role of the ARC was to maintain a supervisory role and oversee the performance of the fund managers. The ARC vested trust in its fund manager and did not micro-manage the details of fund management.

41. The Committee further asked about the details of the follow-up actions that had been and would be taken by the ARC against the fund managers in Cases A and B (i.e. Fund Managers A and B). It also asked for the record of any follow-up actions that had been taken and the timetable for any future follow-up actions.

42. In his letter of 19 May 2004, the **Commissioner for Innovation and Technology** advised that:

### Case A

- the ARC had convened Board meetings to discuss the matter. Following a series of discussion with Fund Manager A, the ARC decided that the ARC Secretariat should issue a letter to the fund manager expressing the ARC's concerns. The ARC Board also agreed to test the water on possible disengagement of Fund Manager A while sending it another letter expressing grave concern on its performance;
- the ARC Board did not discern any criminal or fraudulent act but was concerned about the effectiveness of the fund manager. Action had been taken to terminate the management agreement and the fund manager ceased to manage the ARF on behalf of ARC with effect from 3 May 2002;

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### Case B

- the ARC considered that Fund Manager B had acted on the basis of its professional judgment of the market situation. The fund manager had reported to the ARC Board the disposal on 30 April 2003. The ARC Board did not discern any criminal or fraudulent act arising from Case B;
- the ARC Secretariat had also sought clarification from Fund Manager B about Company B reportedly attracted US\$16 million from the US. Fund Manager B explained to the ARC Secretariat on 29 October 2003 the situation and met the Secretariat on 17 November 2003. The main explanation was that the US\$16 million investment reported in a press article was not new fund injection into Company B. Rather, the fund was prepared for the perceived loss-making operation for the next 24 to 36 months of a new company, staffed by the founders of Company B, to work on new technologies that would pursue a totally different product and business strategy, targeting cable operators in the US as customers. In short, the US\$16 million investment should not be interpreted as the valuation of Company B;
- the ARC had taken action in the past two years to vary the terms of the management agreement to provide better protection for the ARC to the effect, among other things, that the management fee was reduced; the ARC might withdraw all undrawn/uncommitted funds with prior notice; and the ARC might object to any proposed investment in its absolute discretion;

### Other follow-up actions

- the ARC had initiated discussion with existing fund managers to examine how control over the disposal of ARF investments by fund managers might be improved. The ARC would take into account market practice in this regard as necessary and appropriate; and
- one of the fund managers had agreed in principle that controls on disposal of ARF investments might be strengthened. The necessary legal document was being drafted. The ARC would aim at concluding this issue with the fund managers as soon as practicable.

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### Interest earned on surplus funds

43. According to paragraph 4.6 of the Audit Report, for funds which exceeded the necessary liquidity level, the Commissioner for Innovation and Technology was willing to consider Audit's recommendation on implementing measures to improve the rate of return for the ARF surplus funds. The Committee asked about the options of measures being considered and when a decision would be made in this regard.

44. In his letter of 19 May 2004, the **Commissioner for Innovation and Technology** informed the Committee that:

- the ARC was considering the possibility of hiring professional investment firms to manage the surplus funds for ARC. However, the ARC was concerned that this might not only incur costs for the engagement of such firms but might at the same time incur risks to the ARF. The ARC had to analyse this option carefully before deciding if it should be pursued; and
- in considering what might be done to improve the rate of return for ARF surplus funds, the ARC would consider factors such as expected return, the risk tolerance level, the associated costs and the necessary liquidity. It would need to strike the best balance that might best fit the operations, nature and objective of the ARF. The ARC might consider diversifying the placing of its surplus funds in forms other than bank deposits such as bonds, certificate of deposits or Exchange Fund papers. This would require further analysis and consultation with the ARC. The ARC hoped to be able to come to a decision as soon as practicable.

45. The Committee further asked whether there were guidelines on the earning of income (e.g. interest) from surplus funds of government funds, such as the Quality Education Fund.

46. In his letter of 17 May 2004, in *Appendix 17*, the **Secretary for Financial Services and the Treasury** responded that the Treasury had issued an investment guide in March 1999 and updated it in January 2004. The purpose of the guide was to provide a handy reference for government departments which were required to set up and manage funds. This guide outlined the key steps in investment planning and the necessary controls for investment dealing activities in departments, including the investment of surplus funds.

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

### **Costs and achievements of the Applied Research Fund**

- expresses serious concern that:
  - (a) the money of the Applied Research Fund (ARF) has not been safeguarded and the ARF investments have not been subject to close monitoring commensurate with the risky nature of the investments;
  - (b) many of the projects receiving funds from the ARF were commercially unsuccessful, and some had suffered heavy capital losses;
  - (c) apart from the capital losses of \$247 million in investments, operating costs of \$127 million were incurred over the years against a total investment of \$461 million; and
  - (d) there has been difficulty in identifying worthwhile projects for ARF investments and that as at November 2003, the ARF had a large cash balance of \$434 million;
- notes that:
  - (a) the Secretary for Commerce, Industry and Technology has set up a Steering Committee on Innovation and Technology under his chairmanship to ensure alignment of the ARF with the overall strategy and programme in innovation and technology;
  - (b) the Government is formulating a new strategic framework for further innovation and technology development; and
  - (c) there is no shortage of private-sector venture capital in the area of innovation and technology;
- urges the Secretary for Commerce, Industry and Technology to expedite his review on the future positioning of the ARF, paying particular attention to the following:
  - (a) the expertise of the Innovation and Technology Commission in investments in high-risk venture companies, and the need to ensure the prudent use of money of the public-funded ARF and to closely monitor the ARF investments;

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- (b) the availability of venture capital from the private sector;
- (c) the need to establish benchmarks for measuring the fulfilment of the ARF's non-financial objectives and for assessing ARF's financial performance vis-à-vis that of private-sector venture capital in the same area, in order to facilitate assessment of whether the ARF investments achieve value for money;
- (d) the lack of worthwhile and commercially viable projects that meet the public mission test for ARF support; and
- (e) the heavy capital losses and the significant operating costs of the ARF;

### **Disposal of completed investments by the fund managers**

- expresses dismay that:
  - (a) the existing management agreements give the fund managers absolute discretion on matters concerning the disposal of ARF investments, and that the Applied Research Council (ARC) could lose control of the disposal of the investments; and
  - (b) the three management agreements concluded in November 1998 did not make co-investment as a requirement. The absence of such a requirement renders the agreements open to abuse by fund managers;
- notes that the Commissioner for Innovation and Technology, on behalf of the ARC, has agreed to strengthen control over the disposal of ARF investments and consider requiring more frequent progress reporting by fund managers;
- recommends that the Commissioner for Innovation and Technology should:
  - (a) review provisions of the management agreements to plug any loopholes, particularly the provision concerning the fund managers' absolute discretion on matters concerning the disposal of ARF investments;
  - (b) in case of ARF's co-investments with the fund managers in the same investee companies, ensure that the initial and follow-on investments as well as divestments of the ARF are followed on the same terms by the fund managers as co-investors; and

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- (c) ensure that proper declarations of interest are made by fund managers and that there are procedures to review the investments made by the fund managers concerned;
- notes that :
  - (a) for Case A, action had been taken to terminate the management agreement and the fund manager ceased to manage the ARF on behalf of ARC with effect from 3 May 2002;
  - (b) for Case B, action had been taken in the past two years to vary the terms of the management agreement to provide better protection for the ARC with the effect, among other things, that the management fee is reduced; the ARC may withdraw all undrawn/uncommitted funds with prior notice; and the ARC may object to any proposed investment in its absolute discretion;
  - (c) the ARC Board did not discern any criminal or fraudulent act arising from Case A and Case B; and
  - (d) the ARC has initiated discussion with the existing fund managers to examine how control over the disposal of ARF investments by the fund managers may be improved;
- urges the Administration to consider whether Case A and Case B should be referred to any law enforcement agencies for further investigation;

### **Interest earned on surplus funds**

- expresses dismay that the ARF has a large balance of surplus funds earning a relatively low rate of return;
- considers that the ARF surplus funds, being public funds and having been left idle for a significantly long time, should earn a rate of return which should at least be comparable to that earned by the Government on the fiscal reserves placed with the Exchange Fund;
- urges the Commissioner for Innovation and Technology to consider measures, in consultation with the Director of Accounting Services, to improve the rate of return for the surplus funds; and

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### **Follow-up actions**

- wishes to be kept informed of:
  - (a) the progress of the formulation and implementation of a new strategic framework for further innovation and technology development;
  - (b) the results of the review on the future positioning of the ARF;
  - (c) the progress made in strengthening the control over the disposal of the ARF investments;
  - (d) the Administration's decision regarding whether Case A and Case B should be referred to any law enforcement agencies for further investigation; and
  - (e) the progress made in improving the rate of return for the surplus funds of the ARF.

## Chapter 3

### Harbour Area Treatment Scheme Stage I

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The Harbour Area Treatment Scheme (HATS), previously known as the Strategic Sewage Disposal Scheme (SSDS), is an overall sewage collection, treatment and disposal strategy to deal with water pollution of Victoria Harbour. Implementation of HATS was divided into four stages. HATS Stage I was designed to collect and transfer 75% of the harbour sewage from the urban areas in Kowloon and Northeast Hong Kong Island via a sewage tunnel system to the Stonecutters Island Sewage Treatment Works (STW) for treatment. The remaining 25% of the sewage flow is to be dealt with by the further stages of HATS which are currently under planning.

2. Planning for HATS Stage I commenced in the early 1990s. It is a mega capital works programme comprising 19 individual works projects for designing and constructing four core components. These four components are a sewage tunnel system, the Stonecutters Island STW, a submarine outfall and the upgrading of existing preliminary treatment works. The Drainage Services Department (DSD) was responsible for the design and construction of the works under HATS Stage I.

3. The original target completion date for HATS Stage I was June 1997. However, due to problems encountered in the works projects, the final completion date was delayed by four and a half years to December 2001. While the total approved funding was \$6,211.3 million, additional funding of \$2,287.4 million was later sought to meet the substantial cost increase of the projects. The main cause of delay and cost increase was the problems encountered in constructing the sewage tunnel system.

4. The sewage tunnel system comprises six tunnels, namely Tunnels AB, C, D, E, F and G, built at an aggregate length of 23.6 kilometres and a depth of 80 metres to 150 metres below ground or sea level. In December 1994, two contracts (Contracts A and B) for constructing the six tunnels were awarded to the same contractor (Contractor A). In December 1996, the Government re-entered the two contracts as Contractor A unilaterally suspended works. The Government and Contractor A subsequently entered into arbitration to deal with the contractual disputes. In September 2001, a Settlement Agreement was signed to terminate all arbitration proceedings. Contractor A agreed to pay \$750 million to the Government. Despite such payment, the Government incurred an additional works expenditure of \$1,293 million and legal costs of \$129 million as a result of the forfeiture of the two tunnel contracts.



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5. In his Report No. 30 of June 1998, the Director of Audit reported on the acceleration of works in the SSDS Stage I and made recommendations for improvement in a number of areas. After considering the Audit Report, the Public Accounts Committee, in its Report No. 32 of July 1999, suggested that the Director of Audit should conduct, upon the conclusion of the SSDS Stage I, similar investigations to ascertain the full cost of the project and the factors leading to the budget overrun. Against this background, Audit recently conducted a review on the implementation of HATS Stage I.

### **Problems encountered in tunnel completion contracts**

6. The Committee noted that after the forfeiture of the two original tunnel contracts (i.e. Contracts A and B) in December 1996, the outstanding tunnel works were re-tendered under three separate contracts (Contracts C, D and E). In July 1997, the DSD awarded Contract E to Contractor E for the completion of Tunnels F and G. In January 1998, the DSD awarded Contract C to Contractor C for completing Tunnels AB and C, and Contract D to Contractor D for completing Tunnels D and E.

### *Claims arising from use of forfeited plant*

7. The Committee noted that in order to make better use of the forfeited plant and mitigate the losses arising from the forfeiture of Contracts A and B, the DSD had allowed Contractors C, D and E to choose whether or not to use the forfeited plant left over by Contractor A. The DSD did not intend to accept any liability arising from the use of such plant. Hence, an exclusion clause had been provided in the three tunnel completion contracts in order to protect the Government's interest. Moreover, the contractors had been required to sign a No Claim Statement to the effect that they had assessed the conditions and suitability of the forfeited plant and that they would not instigate any claim against the Government resulting from the use of such plant.

8. The Committee also noted that Contractor E commenced works in July 1997, which was about six months before Contractors C and D commenced their works. Between October and November 1997, Contractor E found that the mucking system could not operate effectively at full load. In January 1998, it submitted to the DSD its expert's findings on the defective mucking system and a claim for monetary compensation for the cost of replacement and extension of time. Upon receipt of the claim, the DSD's Consultant (the Consultant) commissioned a specialist to carry out an independent review of the defects of the mucking system and then made recommendations to the DSD. The DSD subsequently requested the Department of Justice (DoJ) to peruse the Consultant's assessment and give advice on the claim. After considering the views of the specialist, the

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Consultant and the DoJ, the DSD accepted Contractor E's claim in March 1998. As the mucking systems of Contracts C and D were similar to the one used in Contract E and were likely to have the same problems, the DSD also instructed Contractors C and D to replace their systems. In the event, the Government incurred an additional cost of \$135.7 million in settling the claims for replacement of the defective mucking systems.

9. In response to the Committee's enquiry concerning the experience of Contractors C, D and E in performing tunnelling works and in operating mucking systems, **Mr Raymond CHEUNG Tat-kwing, Director of Drainage Services**, said that:

- all the three contractors had tunnelling works experience, but it was not certain whether they had previously participated in tunnelling projects of a similar nature and scale as that of Contracts C, D and E. The tunnelling works under these three contracts were complex and difficult engineering works. They had been carried out deep underground as some of the tunnels were built as deep as 150 metres below ground or sea level; and
- all of them possessed knowledge in operating mucking systems. But they might not have practical experience in using the models left behind by Contractor A. These models were more sophisticated than ordinary mucking systems due to the complexity of the tunnelling works in question.

10. According to paragraphs 4.9 to 4.13 of the Audit Report, the specialist commissioned by the Consultant considered that the serious latent defects of the mucking system could not have reasonably been foreseen by a civil engineering contractor. On the other hand, given the importance of the system and the clear intention of the contract that the contractor had to accept the risk on the use of the system, it was not unreasonable to have expected that Contractor E would hire an expert to examine the suitability of the mucking system.

11. The Consultant considered that, on a balance of probability, Contractor E was unlikely to succeed in arguing that the exclusion clause was ineffective. On the other hand, if it attacked the applicability of the exclusion clause, this would be an arguable case because an arbitrator or a judge might be sympathetic to a contractor when the risk allocation was unfavourable to the contractor. Since Contractor E's claim was not a clear case and there was doubt about the applicability of the exclusion clause, the Consultant considered it desirable, from a dispute resolution point of view, to take into account the Government's overall cost. If the dispute was escalated, the Government would have to incur significant legal costs and the project would be delayed. With these considerations,

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the Consultant recommended that Contractor E should be given the benefit of doubt and the claim should be resolved under the terms of the contract in favour of the contractor. After examining the merits and demerits of the case, both the DSD and DoJ endorsed the Consultant's recommendations.

12. The Committee also noted from paragraphs 4.6 and 4.7 of the Audit Report that Contractors C, D and E had been given the opportunity to inspect the forfeited plant, including the mucking systems, before tendering. The decision to use the plant had been taken by them voluntarily and effected by the provision of an exclusion clause in the contract and the signing of a No Claim Statement, which clearly stipulated the contractor's liability in connection with the use of the forfeited plant. It therefore appeared to the Committee that claims should not be allowed on the grounds that the contractor did not or could not foresee any problem in connection with the use of the plant, and that the risks arising from such use should be fully borne by the contractors. In this connection, the Committee asked whether the DoJ had been consulted on the terms of the exclusion clause and No Claim Statement, if so:

- why the Government still cast doubt on the applicability of the exclusion clause over Contractor E's claim, and how the relevant provisions could protect the Government's interest; and
- whether there was a need to improve the terms of the exclusion clause and No Claim Statement so as to better protect the Government's interest.

13. The **Director of Drainage Services** responded that:

- the DoJ had been consulted on the terms of the exclusion clause and No Claim Statement. Outside legal advice had also been sought. Hence, he did not consider that there was any problem with the terms of the clause and the Statement. In his view, every legal provision, including exclusion clauses, had its own limitations;
- as the serious latent defects of the mucking system could not have reasonably been foreseen by either the contractor or the Government, and the problem could only be identified after the system was put to repeated use under full-load conditions, it would be unreasonable for the Government to shift all the risks to the contractor who had already suffered from very significant financial consequences due to the defects of the system. In this case, the Government considered that there should be a suitable balance in risk-sharing between the two parties; and

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- in future, the Government would conduct a risk-benefit analysis on the use of forfeited plant that were critical to the completion of the works, so as to better protect its interest. Any forfeited plant for which the Government had doubts about their reliability would be discarded.

14. The Committee asked whether it was the Government's policy not to take legal proceedings against contractors of public works projects as far as possible in order to avoid causing delay in works, incurring significant legal cost and festering the working relationship between the Government and the contractors and, if so, how the interests of the Government and the public could be safeguarded.

15. In reply, **Dr Hon Sarah LIAO Sau-tung, Secretary for the Environment, Transport and Works**, said that:

- the Government would critically consider the circumstances of each case before deciding whether or not legal action should be pursued. The factors considered included the presence of precedent cases, the chance of winning and the likely impact on the project; and
- the appointment of arbitrators to deal with contractual disputes in works projects was increasingly common because arbitrators were able to offer professional advice which were, on many occasions, very technical in nature. Such advice were not normally obtainable from courts.

16. The Committee further enquired:

- whether legal advice had been sought on the possibility of lodging claims against the supplier of the mucking systems for their defects; if so, what the legal advice was; if not, whether the Administration would consider doing so; and
- as the problems of the mucking system used by Contractor E had surfaced in December 1997 and a claim for replacement of the system was submitted by the contractor in January 1998, why the DSD had not taken the decision to proceed with the replacement until late March 1998.

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17. The **Director of Drainage Services** stated at the hearing and in his letter of 13 May 2004, in *Appendix 18*, that:

- the DSD had not sought legal advice specifically on the possibility of lodging claims against the supplier of the mucking systems. When the problem with the mucking system in Contract E was first revealed in late 1997, the DSD had been working closely with the DoJ and external legal advisors as a team on the arbitration with Contractor A and related problems arising from the forfeited contracts. The possibility of claiming against the supplier of the mucking systems had not been considered by the team because the Government did not have a contract with the supplier and the cost incurred in replacing the mucking system could be claimed against Contractor A as part of the additional cost arising from the forfeiture of the contracts. The claims had eventually been settled with a significant sum successfully recovered from Contractor A;
- following the Committee's enquiry, legal opinion had been sought on the possibility of lodging claims against the supplier of the mucking systems at this stage. The legal advice received suggested that such possibility was almost "zero". As the Government had no contract with the supplier, any action would have to be based on tort. Even assuming that it was not time barred by the six-year limitation period which had already expired, any claim in tort would also be very difficult; and
- there had been no delay in replacing the mucking systems. After receiving expert advice that the mucking system was not safe, Contractor E decided to replace the system in January 1998 and at the same time submitted his claim to the Government. Purchase order for the essential components of the replacement system was placed in the same month. The DSD's decision made in March 1998 on the claim submitted by Contractor E in January 1998 was only to accept the financial consequence of the replacement and the consequential time extension, which had not caused any delay to the replacement activities. To avoid unnecessary delay for Contracts C and D, the Government had notified the contractors of the mucking system problem at the time of contract commencement in January 1998. The decision to accept the financial and time extension consequences could only be made two months after receipt of the claim because the assessment process was technically and contractually complicated which required the input of expert advice.

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### *Difficult ground conditions*

18. The Committee noted that prior to tendering the tunnelling works, the DSD had made use of the geological information of the Geotechnical Engineering Office and had conducted extensive geological investigations to assess the ground conditions. A total of 150 boreholes had been drilled and the expenditure for the site investigations was \$220 million. However, the actual ground conditions were subsequently found to be worse than those indicated by the site investigations. Hence, the contractors had carried out additional ground strengthening and stabilisation measures. In the event, the DSD had to bear an additional cost of \$346 million. The additional works for tackling the difficult ground conditions had also seriously disrupted the progress of the works. In this connection, the Committee asked:

- when the site investigations were conducted; and
- whether the Government had misjudged the scope of and methodology for the site investigations.

19. In response, the **Director of Drainage Services** said that:

- the site investigation cost of \$220 million was incurred for all stages of HATS, not only for Stage I. The site investigation cost for Stage I was around \$124 million;
- these site investigations were carried out between 1992 and 1993. The delay of the whole HATS Stage I project was four and a half years, including the three years' delay caused by the forfeiture of the two original contracts and the remaining one and a half years by the unexpected difficult ground conditions and other problems;
- at the time of planning and implementing the projects, the DSD did not have any experience in this kind of tunnelling works. Therefore, it had to rely on the geological information compiled by the Geotechnical Engineering Office and the expert advice given by its consultant;
- similar to other tunnel projects, the boreholes could only provide an indication of the ground conditions. This reflected the inherent uncertainties of ground conditions for deep tunnel projects. Precise information on the actual ground conditions at each location could only be ascertained during tunnel excavation. Nevertheless, the DSD agreed that it had under-estimated the complexity of the works and the site investigations conducted were not sufficient to reveal the actual ground conditions; and

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- even if the difficult ground conditions had been detected prior to commencement of the works, the contract sums of the tunnel completion contracts would also go up because the contract periods would have been extended to cater for the necessary ground strengthening and stabilisation works. However, in such case, the Government would have been able to work out a more accurate assessment of project costs and works progress.

20. The Committee noted that the Government had compensated the contractors for the direct and prolongation costs arising from unexpected difficult ground conditions. It appeared to the Committee that such an arrangement was unable to protect the Government's interest. The Committee asked whether the Government would consider introducing a mechanism or other measures to enable it to recoup funds from contractors in cases where the contractors were able to complete the works ahead of schedule not due to efforts of their own. For example, in the case of HATS Stage I, the Government should preferably be able to recoup part of the contract sum from the contractors if the ground conditions were subsequently found to be better than those indicated by the site investigations.

21. The **Director of Drainage Services** said that:

- it was a matter of risk-sharing between the Government and the contractors. If the Government allocated all the risks to the contractors, the tender prices would go up. However, if the anticipated complications that had been factored in the tender prices did not occur eventually and hence the actual outturn prices were lower than the accepted tender prices, the contractors would be overpaid;
- if the Government shared the risks with the contractors, there would be room for the tender prices to go down. However, in the circumstances, the approval of the Finance Committee (FC) for increases in the approved project estimates (APEs) might have to be sought from time to time in the light of actual development and progress of the works; and
- in some overseas countries, a "partnering" arrangement was adopted in the tendering of works projects. Under this arrangement, there were no tender prices. Instead, the parties concerned would agree on a target contract price and aim at sharing the risks on an equal basis. The Administration would continue to examine how to strike a good balance in risk-sharing between the Government and its works contractors.

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22. Given the unsatisfactory outcome of the site investigations, the Committee queried whether the consultant appointed by the DSD for ground conditions assessment was the appropriate personnel for this task. The **Director of Drainage Services** replied that, with the benefit of hindsight, the consultant was not the most appropriate personnel for this task. In response to the Committee's further enquiry, **Mr CHUI Wing-wah, Chief Engineer/ Harbour Area Treatment Scheme, DSD**, said that the consultancy fee for conducting the ground conditions assessment, including feasibility study and site investigations, was approximately \$80 to \$90 million.

23. The Committee questioned whether any government officials should be held responsible for having appointed an inappropriate consultant for the ground conditions assessment which cost about \$90 million of public money. The **Director of Drainage Services** responded that:

- although, in his view, the consultant was not the most appropriate personnel for the task, it did not mean that this consultant was totally not suitable for the task; and
- the consultant indeed came from a consortium of four world-recognised construction companies which had abundant experience in tunnelling works at that time.

24. The **Secretary for the Environment, Transport and Works** supplemented that:

- undoubtedly, the Environment, Transport and Works Bureau (ETWB) should be accountable for works departments' failure in performing their duties relating to the management and supervision of public works projects. However, in her view, before identifying where the responsibilities should lie and deciding whether or not officials in the ETWB should be held responsible for the unsatisfactory outcome of the works, the Administration should ascertain whether:
  - (a) the works had been carried out with the application of suitable professional knowledge and expertise, and in accordance with relevant guidelines, established procedures and international best practices;
  - (b) the unsatisfactory outcome could have reasonably been foreseen; and
  - (c) the officials, or the consultants/experts appointed by the Government, had proceeded with the works with due diligence; and



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- each works project had its own uncertainties and it was not possible to wholly eliminate all uncertainties before commencement of the works. In the case of HATS Stage I, a deep tunnel conveyance system was adopted to achieve the shortest route and to minimise disturbance and nuisance to the public, the environment, traffic, existing utilities, transport systems and buildings during construction. To achieve the purpose, the tunnels were built 80 metres to 150 metres below ground or sea level (which were some 40 to 60 storeys in height). There was not much experience in the world in excavating tunnels at such depths and under such high water pressure.

### *Substantial cost increase in tunnel completion contracts*

25. The Committee noted that as a result of the replacement of the defective mucking systems and the additional works relating to difficult ground conditions, the three tunnel completion contracts had experienced significant delay and substantial cost increases. However, as the accepted tender prices of these three contracts were much lower than the estimated contract sums in the APEs, the surplus funds arising from the over-estimation of the contract sums were eventually used to meet the cost increases.

26. For Contracts C and D, the DSD did not have to seek additional funding from the FC because the cost increase of these two contracts totalling \$188.6 million was covered by the over-provision in the APEs of \$373.2 million (\$116 million for Contract C and \$257.2 million for Contract D). The DSD had also not informed the FC of such over-provision. For Contract E, the DSD sought additional funding of \$115 million from the FC because the over-provision in the APE of \$143.2 million was insufficient to meet the cost increase of \$248.4 million. However, the DSD had not informed the FC of the actual cost increase of \$248.4 million. Instead, it only provided the justifications for the additional funding of \$115 million. Details about the over-provision in the APEs, increase in the contract sums and the additional funding sought from the FC, where necessary, of the three tunnel completion contracts are summarised in the table below:

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### Over-provision in the APEs, increase in contract sums and additional funding sought from the FC in the three tunnel completion contracts

	Contract C	Contract D	Contract E
Surplus funds in the APE from over-estimation of contract sum (i.e. over-provision)	\$116 million	\$257.2 million	\$143.2 million
Percentage of over-estimation	13%	30.9%	28.6%
Cost increase (i.e. increase in contract sum)	\$48.7 million	\$139.9 million	\$248.4 million
Cost increase as a percentage of original contract sum	6.3%	24.3%	69.6%
Additional funding sought from the FC	Nil	Nil	\$115 million

27. As revealed in paragraph 4.46 of the Audit Report, despite the various guidelines, the DSD had not reduced the APEs of the tunnel completion contracts even though the accepted tender prices were much lower than the estimated contract sums in the APEs. Audit could not find any documentation of the reasons for the DSD not to do so. The Committee was very concerned that the heads of works departments were given too much discretionary power to decide whether or not to adjust the APE even when the accepted tender price was much lower than the estimated contract sum in the APE. In particular, the APE might be used to cover huge sums of highly uncertain dispute settlements and contract variations. It appeared to the Committee that the existing practices of works departments rendered it difficult for the Legislative Council (LegCo) to effectively monitor the use of funding for works projects.

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28. The **Director of Drainage Services** stated that:

- it was not the DSD's intention to over-estimate the contract sums of the three tunnel completion contracts. The awarded contract sums, which were heavily affected by the prevailing market conditions, the pricing strategies and the perception of risks of individual contractors, did not necessarily give an accurate indication of the final costs of the works. The final costs were influenced by the nature of the works and necessary variations for completion. Moreover, tenderers were in a better position to capture more up-to-date market information because of their commercial backgrounds. It was therefore not always easy for the Government to accurately estimate the cost of each project;
- the prices of the tenders received for the three tunnel completion contracts varied widely. For each contract, the average price of the tenders received was very close to or even higher than the estimated contract sum in the APE. There was no clear indication that the contract sums were grossly over-estimated;
- the problems with the mucking system surfaced in early November 1997, which was shortly after the commencement of Contract E in July 1997. In early February 1998, difficult ground conditions were encountered and tunnel excavation had to be suspended. As Contracts C and D were awarded in January 1998, it was not considered prudent to adjust the APEs downwards in view of these problems and the likely financial implications although the contracts were awarded at relatively lower tender prices. The subsequent development and the final contract sums showed that the consideration at the time was appropriate; and
- the above decision was in line with the spirit of the DSD Technical Circular No. 5/93 referred to in paragraph 4.45 of the Audit Report. As the DSD was not satisfied that the APEs of the three tunnel completion contracts could be reduced, it did not seek the approval of the Secretary for Financial Services and the Treasury to reduce the APEs.

29. According to paragraph 4.37 of the Audit Report, upon the approval by the FC, the APE of a works project became the expenditure ceiling under the project. Project proponents should estimate the cost accurately to avoid over-estimation of the APE. The Secretary for Financial Services and the Treasury had the delegated authority for approving an increase in the APE of up to \$15 million. Application for supplementary provision for increasing the APE by more than \$15 million had to be approved by the FC. The

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Committee was concerned about the magnitude of the over-estimation of contract sums in Contracts C, D and E, which had all far exceeded the \$15 million threshold. Against this background, the Committee asked:

- when the administrative cap arrangement to ensure proper control and use of funding under the APE mentioned in paragraph 4.54(a) of the Audit Report was promulgated, how effective it was in ensuring that works departments would reduce the APE when the accepted tender price was significantly lower than the estimated contract sum in the APE, and whether it had been strictly followed by works departments;
- about the details of the guidelines and/or measures that were in force during the relevant period of Contracts C, D and E, which required works departments to reduce the APE when the awarded contract sum was lower than the estimated contract sum in the APE; and
- whether the DSD's not reducing the APEs to reflect the lower tender prices had breached any of the guidelines and/or measures.

30. **Miss Amy TSE, Deputy Secretary for Financial Services and the Treasury (Treasury) 3**, responded at the hearing and in the letter of 15 May 2004, in *Appendix 19*, that:

- each year, the Administration had to make due allowance for the outstanding commitments of all Category A projects, i.e. the total APE minus the actual expenditure to date, before earmarking resources for Category B and other new projects. These outstanding commitments would be inflated if the project estimates were not suitably adjusted over time, taking into account actual works progress and any savings from reduction in scope or change in design or lower tender price, etc. In the light of this, the Administration had introduced the administrative cap arrangement since May 2002 to prevent internal resources allocated to Category A projects from being locked up unnecessarily;
- under the administrative cap arrangement, the FSTB would administratively adjust downwards the capital funding allocated to the projects as approved by the FC, i.e. the APE, taking into account the lower-than-estimated outturn tender price, the actual works progress and planning development in the course of the annual resource allocation exercise. This lower spending limit would then become the administrative cap on the project expenditure. While this arrangement would help release internal resources for allocation to other

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worthwhile projects, it would not obviate the need to seek necessary approval from the FC for an increase in the APE. Since its introduction, the administrative cap arrangement had been duly observed by works departments;

- with the administrative cap arrangement in place, works departments had to apply to the Treasury Branch for the lifting of the administrative cap to cover any subsequent increase in forecast expenditure even when the overall APE had not been exceeded. In doing so, works departments would need to account for the changes in the latest forecast expenditure as against the administrative cap. Through this process, any surplus fund in the APE used to cover an increase in forecast expenditure could be more clearly identified. The FSTB considered that this measure would enhance the transparency in the implementation of the works projects and help track down the changes and the reasons for such changes in the project estimates. As recommended by the Audit Report in paragraph 4.52(b), the Administration had already required all works departments to set out in their submissions to the FC for an increase in the APE information on the deployment of surplus funds under the APE to cover any cost increase; and
  
- the then Finance Branch had announced in 1993 a simplified procedure whereby relevant departments could make a request for reduction in the APE by memorandum to the then Secretary for the Treasury. The DSD subsequently included the above guideline in the DSD Technical Circular No. 5/93 issued in April 1993 concerning Public Works Subcommittee submissions. This guideline was in force during the period of Contracts C, D, and E, i.e. from 1997 to 2000. While the procedure promulgated then did not specifically require works departments to reduce the APE when the awarded contract sum under a works project was lower than the estimated contract sum in the APE, as a general financial management and control principle, works departments should put forward realistic estimates and review the project estimates in the light of actual progress so as not to lock up valuable resources. Under this principle, works departments would judge when the APE of a project should be reduced taking into account all relevant considerations including the outturn tender price. The FSTB, therefore, expected that the DSD had followed the simplified procedure as announced in 1993 when it came to the conclusion that there was no need to reduce the APE to reflect the lower tender prices. Seen in this light, the FSTB did not consider that the DSD had breached the above-mentioned simplified procedure.

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31. At the invitation of the Committee, the **Director of Audit** commented, in his letter of 22 May 2004 in *Appendix 20*, that:

- the administrative cap arrangement was not introduced to replace the mechanism for reducing the APE, which was a means to enhance financial accountability to the FC over the approved funding of works projects. Under the mechanism for reducing the APE, when the APE of a works project was reduced, a subsequent request for additional funding in excess of \$15 million over the reduced APE was required to be submitted to the FC for approval. Currently, both the administrative cap arrangement and the mechanism for reducing the APE were in force. These two measures, if properly implemented, would enhance the control and use of funding under the APE;
- in the letter of 15 May 2004, the Secretary for Financial Services and the Treasury mentioned the simplified procedure announced by the then Finance Branch in 1993 and the DSD Technical Circular No. 5/93. In Audit's view, the March 1996 information paper mentioned in paragraph 4.43 of the Audit Report also provided useful information on the guidelines. In that information paper, the Administration informed the FC that:

“Where the tender sum is below the estimate approved by the Finance Committee, we will consider reducing the approved project estimate to reflect the lower forecast outturn price.”; and

- Audit was aware that these guidelines allowed the relevant project controller to exercise judgement as to whether the APE could be reduced. In paragraph 4.46 of the Audit Report, Audit did not conclude that the DSD had breached the guidelines. Audit only noted that, despite the guidelines, the DSD had not reduced the APEs of the tunnel completion contracts even though the accepted tender prices were much lower than the estimated contract sums in the APEs. However, Audit could not find any documentation of the reasons for the DSD not to do so. Therefore, Audit had recommended in paragraph 4.51(b) of the Audit Report that the Director of Drainage Services should take action to reduce the APE of a project when the tender price was significantly lower than the estimated contract sum in the APE, and document the reasons where a reduction in the APE was considered not warranted.

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32. On the same questions, **Mr KWOK Ka-keung, Deputy Secretary (Works) 1**, informed the Committee that:

- since January 2000, each works department had set up a committee to examine the project estimate of each works project before tendering. A database had also been established in November 2000 to help monitor the project estimates and prices of the tenders received. These measures had proved to be very effective in deterring works departments from attempting to over-estimate the project costs. After the implementation of these measures, the accuracy of project estimates prepared by works departments had generally improved; and
- in 2003, the differences between the estimated contract sums and the accepted tender prices were in the range of 10% to 15% on average. He believed that, with this mechanism, the possibility of works departments reserving a substantial part of the contract sum for contingency was very remote. As it was not always possible to have very accurate project estimates and in view of the inherent uncertainties in works projects, the 10% to 15% difference was considered to be reasonable in serving as a buffer for works departments to cope with unforeseen circumstances.

33. Since there were guidelines stipulating that works departments should adjust the APE in cases where the awarded tender price was significantly lower than the estimated contract sum in the APE, the Committee asked whether, in the view of the Secretary for the Environment, Transport and Works, the DSD was at fault in not following the guidelines to reduce the APE.

34. The **Secretary for the Environment, Transport and Works** responded that:

- as project estimates might fluctuate from time to time, it was not desirable to reduce the APE whenever the latest estimate was lower than the APE, due to lower tender prices or other reasons, except where the Controlling Officer was certain that there would ultimately be significant surplus funds under the project. To have done otherwise would involve the FC and the FSTB in the micro-management of contracts and would detract them from the deliberation of other more important financial issues; and

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- in her view, the DSD's decision not to reduce the APE of the three tunnel completion contracts was understandable and justifiable in view of the complex nature of the projects and the various problems encountered during the course of the works. Moreover, under the existing tendering arrangement, works departments did not normally have the liberty to refuse the lowest tender even if the tender prices varied widely. From the practical point of view, it was not desirable to reduce the APE whenever the latest estimate was lower than the APE as some flexibility should be allowed to cope with uncertainties. Despite these considerations, the ETWB was willing to consider how the procedure in this regard could be improved.

35. The Committee did not agree that the requirement for reduction of the APE would lead to the micro-management of works contracts by the FC and the FSTB. While it appreciated the need for works departments to retain some flexibility to cope with uncertainties in works projects, it should not be taken to mean that they were not required to follow the guidelines to reduce the APEs. It also did not mean that they might choose not to seek approval from the FC for an increase in the APE that exceeded \$15 million and/or inform the FC of any over-provisions in the APEs. In this connection, the Committee asked about the views of the Secretary for the Environment, Transport and Works on the feasibility of implementing the following requirements in respect of all works projects:

- the APE should be reduced when the tender price was significantly lower than the estimated contract sum in the APE; and
- after the reduction of the APE, a new application should be submitted for approval by the FC for supplementary provision to increase the APE in cases where the increase in the estimated contract sum was more than \$15 million; for cases where the supplementary provision was \$15 million or below, the applications should only require the approval of the FSTB.

36. Noting that the Secretary for the Environment, Transport and Works had agreed to remind all works departments to follow the guidelines to adjust the APE when the tender price was significantly lower than the estimated contract sum in the APE (paragraph 4.52(a) of the Audit Report), the Committee asked:

- about the details of the guidelines; and
- whether and how these guidelines had been promulgated to works departments.



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37. The **Secretary for the Environment, Transport and Works** responded, in her letter of 18 May 2004 in *Appendix 21*, that:

- in theory, it would be feasible to reduce the APE for a project when the tender price was significantly lower than the estimated sum in the APE for the relevant contract. However, it was necessary to note that a lower tender price might not necessarily lead to a corresponding surplus of the same amount in the APE. For example, in the case of a multi-contract project, the lower tender price for one contract might be off-set by the higher-than-estimated tender price for another contract. Market conditions might also change considerably within a short period of time thus requiring larger estimated sums for the remaining contracts under the project. A larger contingency sum for the project might also be necessary to cater for unfavourable ground conditions. For these reasons, reducing the APE by the same amount of the whole of the saving from the lower tender price would not be feasible. Instead, it would only be reasonable to require works departments to first review the APE after awarding a contract at a price significantly lower than the original estimated sum. Works departments should then suitably adjust the APE where there would likely be surplus funds for the whole project after such a review;
- provided that an APE was to be reduced only after a review by the works departments as proposed above, the ETWB had no difficulty with the proposed requirement that after reducing the APE, a new application should be submitted for approval by the FC for supplementary provision to increase the APE, if so required, of more than \$15 million. For cases where the required supplementary provision to increase the APE was \$15 million or below, the approval of the FSTB under delegated authority would be sought;
- as stated in paragraph 4.41 of the Audit Report, in January 2000, the then Secretary for Works expressed concern about the over-estimation of APEs in some works projects. In that connection, he issued guidelines to works departments to require them to improve the accuracy of the project estimates and review the system of collecting, updating and sharing of the centralised database of unit costs of construction. He also directed works departments that the APE of projects should be suitably adjusted, if necessary, when the tender price was much lower than the approved estimates; and
- the above instruction was promulgated to all works departments in an internal memorandum on 12 January 2000. On 27 April 2004, in response to the recommendation in paragraph 4.52(a) of the Audit Report, the Works Branch further issued a memorandum to remind all works departments to suitably

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adjust the APE of projects when a tender price was significantly lower than the estimated contract sum in the APE and when there would likely be surplus funds under the project.

### Impact on water quality of Victoria Harbour

38. The Committee noted that since the full commissioning of HATS Stage I, there had been a significant improvement in the water quality in Victoria Harbour, especially in the eastern and central harbour areas, and at beaches on the eastern side of Hong Kong Island. However, there had been a substantial increase in the level of E. coli in the western harbour area, where the treated effluent from the Stonecutters Island STW was discharged, and in the Tsuen Wan beaches. Because of the increased bacteria level, four more Tsuen Wan beaches, in addition to the three already closed in the mid-1990s, had been closed since the 2003 bathing season.

39. The Committee also noted that the high bacteria level in the western harbour area would only be improved when the further stages of HATS were completed, with the treatment level at the Stonecutters Island STW upgraded and a permanent disinfection facility installed.

40. In view of the above findings, the Committee questioned whether the Administration had assessed the risks and benefits of HATS Stage I on the water quality of Victoria Harbour, in particular the bacteria level in the western harbour area and the Tsuen Wan beaches, and how it could ensure that the water quality of the harbour would not be adversely affected after the commissioning of HATS Stage I.

41. **Mr Robert Law, Director of Environmental Protection**, replied at the public hearing and in his letter of 18 May 2004, in *Appendix 22*, that:

- the Administration had actually assessed the effects that HATS Stage I might have on the water quality of Victoria Harbour. The assessment was conducted by means of a computer-based water quality modelling tool and the results were broadly in line with the actual observed outcome, taking the harbour as a whole. The water quality at the eastern end of the harbour and the beaches to the east of the harbour had improved dramatically as predicted. At the western end of the harbour, in the general vicinity of the outfall, it was expected that there would be some deterioration in water quality due to the concentration of the treated effluent in this area. This expected deterioration

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was judged to be acceptable, particularly having regard to the planned temporary nature of the outfall and the fact that the Tsuen Wan beaches were marginal beaches with relatively few swimmers;

- however, the small area of the harbour in question, i.e. in the vicinity of the Tsuen Wan beaches, was hydrodynamically very complex, with several narrow channels through which the water might flow. The model used at the time simply could not deal with such complexity of water movement on such a very fine geographical grid. The Environmental Protection Department (EPD) was, therefore, not aware that the expected deterioration in water quality at the western end of the harbour would affect the Tsuen Wan beaches to the extent that had been observed; and
- there was considerable uncertainty as to the degree of reduction in bacteria that the chemical treatment process might achieve on its own. This, together with the distance between the outfall and the Tsuen Wan beaches and the fact that the outfall was intended to be only temporary, led the EPD to believe that the prudent course of action would be to await the actual operation of the plant before drawing any conclusions about the need for disinfection because the cost for this would have been very high.

42. The **Secretary for the Environment, Transport and Works** supplemented at the public hearing and in her letter of 18 May 2004 that:

- HATS was divided into four stages. Stage I was only designed to treat 75% of the harbour sewage from the urban areas in Kowloon and Northeast Hong Kong Island at the Stonecutters Island STW. Hence, the Administration did not expect that HATS Stage I would be able to solve all the problems;
- at present, the Stonecutters Island STW was a chemically enhanced primary treatment works with no disinfection facility. It could only remove 50% of the bacteria in the sewage. The ETWB was considering, in the context of the development of the further stages of HATS, upgrading the treatment level at the Stonecutters Island STW and installing a disinfection facility. In the design of the Stonecutters Island STW, target rates were set on its pollutant removal efficiency. According to the DSD, the Stonecutters Island STW had exceeded the target pollutant removal rates and its performance had been excellent; and

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- the Administration was planning to consult the public shortly on HATS Stage II. If the public supported the project, the Administration planned to commence the detailed design and environmental assessment, etc, on the part of the permanent disinfection facilities for treating the Stage I flow by the end of 2004, after completing the necessary administrative procedures in bidding for resources. If the above preparatory work was completed smoothly, the Administration would be able to start the tendering process and seek the funding approval from the FC in parallel as early as 2006. Subject to the FC's approval, the construction of the disinfection facilities could start in the second half of 2006 for completion by the end of 2008 at the earliest.

43. In response to the Committee's enquiry as to whether interim measures would be implemented to reduce the bacterial level in the western harbour area having regard to the fact that the further stages of HATS might take many years to complete, the **Director of Environmental Protection** said that:

- the Administration was considering advancing the provision of part of the permanent disinfection facility under HATS Stage II with a view to improving the water quality in the western harbour area, which had deteriorated after the full commissioning of HATS Stage I; and
- such facility could be provided in around 30 months' time after the required funding was approved by the FC, but the recurrent cost for providing such facility would be high.

44. In the light of the above response, the Committee enquired about:

- the capital and recurrent costs of and the timetable for providing the said disinfection facility, and whether the recurrent costs would be met by existing resources; and
- apart from the provision of the said disinfection facility, whether there were other interim measures that might be put in place to improve the water quality in the western harbour area.

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45. In her letter of 18 May 2004, the **Secretary for the Environment, Transport and Works** informed the Committee that:

- the Administration had examined the possibility of advancing the provision of part of the permanent disinfection facilities that were proposed to be built under HATS Stage II with a view to improving the water quality (in terms of E. coli) in the western harbour waters. This would involve the installation of an electro-chlorination plant to produce the disinfectant agent (sodium hypochlorite or bleach solution) and ancillary facilities for dosing the disinfectant on the effluent before the effluent was discharged via the submarine outfall at the Stonecutters Island STW. Based on the Administration's preliminary estimation, the capital cost and annual recurrent cost of the disinfection facilities required for treating the Stage I flow would be around \$240 million and \$60 million respectively. The recurrent expenditure could not be met by existing resources; and
- regarding possible interim measures, the Administration had explored the possibility of installing temporary facilities to enable the disinfectant solution to be delivered in bulk by barge directly to the Stonecutters Island STW. Such temporary facilities included a barge unloading facility and a number of large storage tanks for storing the bleaching agent on-site. The capital cost for the temporary facilities would be about \$67 million and the recurrent cost about \$90 million per annum. Most of the temporary facilities would become redundant upon completion of the permanent disinfection facilities mentioned above. Hence, it would be more cost-effective to expedite the permanent installation instead of constructing the temporary facilities.

46. The Committee observed that there were still quite a large number of swimmers in the Tsuen Wan beaches although they were not suitable for swimming due to their high bacteria levels. The Committee enquired about the measures that the Administration had implemented and/or would implement to prevent the public from swimming in these polluted beaches in order to safeguard their health.

47. The **Director of Leisure and Cultural Services** responded in the letter of 27 May 2004, in *Appendix 23*, that:

- the Leisure and Cultural Services Department (LCSD) had posted notices and banners at prominent locations near the entrances of the beaches advising the public not to swim in these closed beaches;

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- public announcements were made in Cantonese and English at regular intervals at the more popular beaches (i.e. the Lido and Casam Beaches) advising the public not to swim in these polluted beaches;
- press releases on the re-opening of the gazetted beaches and the continued closure of certain beaches with very poor water quality, including those in the Tsuen Wan District, were issued at the beginning of each bathing season;
- the EPD had been issuing weekly press releases on the water quality of gazetted beaches. These press releases included the message that the seven gazetted beaches in the Tsuen Wan District were closed to swimmers throughout the year because of very poor water quality. The public were also advised not to swim at these closed beaches; and
- the staff of the LCSD also gave verbal warning to people who were found swimming in these closed beaches.

48. The Committee noted from Table 4 in Chapter 7 of the Director of Audit's Report No. 42 concerning "Provision of aquatic recreational and sports facilities" that the daily average numbers of beach goers at the seven closed Tsuen Wan beaches were low in recent years. It doubted the accuracy of the figures as, according to its observation, there were still quite a large number of swimmers in the Tsuen Wan beaches, e.g. the Lido Beach, especially in the early morning from 5:00 am to 7:00 am. In this connection, the Committee invited Audit to help verify the numbers of swimmers at these beaches.

49. In his letter of 5 June 2004, in *Appendix 24*, the **Director of Audit** advised that:

- the said Table 4 only provided the daily average numbers of beach goers at the Tsuen Wan beaches for the whole year from 2000 to 2002. Audit had further examined the statistics compiled by the LCSD, and provided a more comprehensive set of attendance figures of the Tsuen Wan beaches during the bathing season, from March to October, in 2001, 2002 and 2003;
- these figures provided the average daily attendance, indicating separately the attendance on weekdays and during weekends (including public holidays). In addition, the peak day and peak month attendance figures were also provided. The peak attendance figures showed that, despite the poor water quality, some of the Tsuen Wan beaches were quite popular. For example, for the Lido Beach in 2003, while the average daily attendance was 149 on weekdays and 283 on weekends and public holidays, the peak day attendance

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was as high as 3,950 and the peak month attendance was 8,430. Indeed, the total attendance during the period from March to October 2003 was 41,071; and

- according to paragraph 5.21 of the Audit Report, the Secretary for the Environment, Transport and Works had accepted Audit's recommendation to reduce the bacteria level in the western harbour area and the Tsuen Wan beaches. She had also indicated the Administration's intention to advance the provision of part of the permanent disinfection facilities at the Stonecutters Island STW so as to reduce the bacteria level of the treated effluent.

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

### **Delay in works and increase in cost**

- expresses dismay that there were substantial increase in cost and delay in works in completing Harbour Area Treatment Scheme (HATS) Stage I;
- notes that the Director of Drainage Services has agreed to:
  - (a) implement effective measures to ensure that large-scale works projects are delivered on time and within budget; and
  - (b) take action to ensure that Drainage Services Department (DSD) officers follow the guidelines promulgated in DSD Technical Circular No. 9/2000 for improving project management and budgetary control of time-critical projects, and that the guidelines are updated regularly;
- notes that the Secretary for the Environment, Transport and Works has conducted a post-implementation review of HATS Stage I. The findings will be reported to the Legislative Council (LegCo) Panel on Planning, Lands and Works in late June 2004;

### **Forfeiture of original tunnel contracts**

- expresses serious concern that:
  - (a) the DSD failed to ensure that the duly executed contract instruments for the completion contracts were submitted within the stipulated time limits; and

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- (b) in the forfeited contracts, while the Government had paid more than 40% of the contract sum, only about 15% of the works had been completed up to the date of forfeiture;
- notes that the Director of Drainage Services has agreed to:
  - (a) strictly implement the contract conditions for the provision of parent company guarantee and performance bond to ensure that the required instruments are submitted by contractors within the stipulated time limits; and
  - (b) for large-scale works projects, critically devise the contract payment schedules to ensure that progress payments are made, as far as possible, in line with the actual progress of works;
- notes that the Secretary for the Environment, Transport and Works has notified all works departments to take on board Audit's recommendations relating to contract forfeiture, for general application in future projects;

### **Problems encountered in tunnel completion contracts**

- disagrees with the view of the Secretary for the Environment, Transport and Works that it is not desirable to reduce the approved project estimate (APE) whenever the latest estimate is lower than the APE (due to lower tender prices or other reasons) except where the Controlling Officer is certain that there will ultimately be significant surplus funds under the project;
- considers that the heads of works departments are given too much discretionary power to decide whether or not to adjust the APE even when the accepted tender price was much lower than the estimated contract sum in the APE, especially when the APE might be used to cover huge sums of highly uncertain dispute settlements and contract variations;
- expresses serious dismay that the DSD:
  - (a) did not reduce the APEs of the tunnel completion contracts even though the accepted tender prices were much lower than the estimated contract sums in the APEs;
  - (b) only informed the Finance Committee (FC) that the shortfall for Contract E was \$115 million, whereas the true total cost increase was \$248.4 million;



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- (c) failed to inform the FC of the over-provision in the APEs for Contracts C and D of \$373.2 million (\$116 million for Contract C and \$257.2 million for Contract D) at all, and that it had used such over-provision to cover the cost increase of these two contracts totalling \$188.6 million, which was largely used for settling claims submitted by the two contractors concerned; and
  - (d) incurred an additional cost of \$135.7 million to replace the defective mucking systems in order to avoid further delays;
- notes that the Director of Drainage Services has agreed to:
- (a) review the arrangement for the use of forfeited plant in completion contracts, in particular, the applicability of the exclusion clause and No Claim Statement, with a view to formulating guidelines to protect the Government's interests;
  - (b) conduct a risk-benefit analysis, if there is intention to allow a contractor to use forfeited plant in a completion contract, on the use of those items of forfeited plant that are critical to the completion of the works;
  - (c) improve the methodology for conducting site investigations by adopting new technology;
  - (d) conduct comprehensive site investigations for major works projects involving substantial underground works (e.g. the further stages of HATS), with the assistance of geotechnical and tunnelling experts to provide more accurate information about the ground conditions;
  - (e) take action to improve the accuracy of project estimates and ensure that the promulgated guidelines for preparing project estimates are complied with; and
  - (f) take action to reduce the APE of a project when the tender price is significantly lower than the estimated contract sum in the APE, and document the reasons for cases where a reduction in the APE is considered not warranted;

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- notes that the Secretary for the Environment, Transport and Works:
  - (a) has reminded all works departments and relevant policy bureaux to state clearly in their submissions to the Public Works Subcommittee and FC, when seeking an increase in the APE for works projects:
    - (i) the total cost increase and the reasons for the increase; and
    - (ii) whether any surplus funds in the APE have been used to meet the cost increase; and
  - (b) has agreed to:
    - (i) take into account Audit's recommendations relating to the use of forfeited plant in completion contracts in considering the revision of the contract re-entry procedures; and
    - (ii) promulgate guidelines for improving site investigations, particularly for tunnel projects;
- recommends that, in order to ensure the LegCo's effective monitoring of the use of funding for works projects and to minimise the possibility of works departments' covering up their administrative bungles and settlement of claims of substantial amount, the works departments concerned should inform the LegCo, with full justifications provided, under the following circumstances:
  - (a) when the difference between the accepted tender price and the estimated contract sum in the APE is \$15 million or more, irrespective of whether or not there will be any substantial variations in the contract cost that may warrant an adjustment of the APE and/or require the FC's approval of an increase in the APE to cover the ultimate outturn price; and
  - (b) when the expenditure relating to dispute settlement under a works contract amounts to \$15 million or more;

### **Impact on water quality of Victoria Harbour**

- expresses serious concern that:
  - (a) there has been a rise in the bacteria level (E. coli) in the western harbour area and the Tsuen Wan beaches;

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- (b) the Stonecutters Island Sewage Treatment Works is not provided with disinfection facility; and
- (c) the Environmental Protection Department failed to accurately predict the impacts of HATS Stage I on the water quality in the western harbour area;
- expresses grave concern that some of the seven closed gazetted beaches in Tsuen Wan still had a large number of beach goers during the bathing season (e.g. the Lido Beach had a patronage of 41,071 from March to October 2003), despite the fact that their poor water quality poses a health hazard to swimmers;
- considers that the Administration has the responsibility to improve the water quality in the affected area in order that the gazetted beaches can be re-opened for public use;
- urges the Administration to:
  - (a) step up publicity effort and conduct more patrols to warn the public not to swim in the closed gazetted beaches; and
  - (b) advance the provision of part of the permanent disinfection facilities under HATS Stage II in order to improve the water quality in the western harbour area;
- notes that the Director of Environmental Protection has agreed to:
  - (a) continue to closely monitor the impact of HATS Stage I on the water quality of Victoria Harbour, particularly the bacteria level in the western harbour area and the Tsuen Wan beaches; and
  - (b) take into account the high bacteria level of the effluent discharged from the Stonecutters Island Sewage Treatment Works in planning the further stages of HATS, and in evaluating the options for providing a permanent disinfection facility in the long term; and

### Follow-up action

- wishes to be kept informed of the actions taken by the Administration to address the various issues cited above.

## Chapter 4

### Hong Kong Harbour Fest

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#### Background

Hong Kong's economy and international image suffered a major blow as a result of the outbreak of the Severe Acute Respiratory Syndrome (SARS). The Chief Executive (CE) announced on 23 April 2003 a package of relief measures amounting to \$11.8 billion to help the community tide over the difficulties and revive the economy, including \$1 billion for large-scale publicity and promotions to relaunch Hong Kong's economy. Two ad hoc bodies were established by the Government:

- the Economic Relaunch Strategy Group (ERSG), which comprised government officials and members of the business community, academics and other relevant parties, to give advice on the strategic approach for relaunching Hong Kong; and
- the Economic Relaunch Working Group (ERWG), which comprised the same government officials in the ERSG, to oversee and coordinate the implementation of the various relaunch programmes.

2. Both the ERSG and the ERWG were chaired by the Financial Secretary (FS) with the Director-General of Investment Promotion (DGIP) as the secretary. On 30 May 2003, the Finance Committee (FC) of the Legislative Council (LegCo) approved the creation of a new commitment of \$1 billion to provide funds for the campaign to relaunch Hong Kong's economy (the Relaunch Campaign). As head of Invest Hong Kong (InvestHK), the DGIP was the Controlling Officer responsible for administering the \$1 billion commitment for the Relaunch Campaign.

3. In response to the Relaunch Campaign, on 5 June 2003, the American Chamber of Commerce in Hong Kong (AmCham) proposed to organise an entertainment showcase festival, which was later named the Hong Kong Harbour Fest (HF). It was scheduled to be held at the Tamar site on Harcourt Road from 17 October to 9 November 2003. On 2 July 2003, AmCham presented its proposal to the ERWG which supported the proposal in principle. On 12 July 2003, the ERWG approved a maximum of \$100 million to InvestHK for underwriting the HF to be organised by AmCham.

4. Various problems were encountered during the organisation of the HF concerts, leading to a great deal of negative publicity and public concern over the financial arrangements and the cost-effectiveness of the event. Against this background, Audit conducted a review to examine the Administration's role in the planning, monitoring and implementation of the HF. The review focused on the following areas:

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- project conceptualisation and approval;
- project monitoring;
- organisation of the HF;
- evaluation of the HF; and
- lessons to be learned and Audit's recommendations.

5. In view of public concern over the HF, on 12 December 2003, the CE appointed a panel of inquiry to investigate the handling of the HF. The Independent Panel of Inquiry on the Harbour Fest (Inquiry Panel) submitted its Report to the CE on 15 May 2004. The Report was made available to the LegCo and the public on 17 May 2004. On the same day, the CE announced that he accepted the Inquiry Panel's findings and recommendations.

6. The Committee held four public hearings on 3, 7, 18 and 20 May 2004 to receive evidence from the Administration on the findings and observations of the Audit Report. As Chapters 2 and 4 of the Inquiry Panel Report concern the ERWG's assessment and approval of the HF proposal and the Government's role in the HF respectively and are directly relevant to Audit's review, the Committee drew on the materials contained therein, where appropriate, in its third and fourth hearings held on 18 and 20 May 2004.

7. The following paragraphs set out the evidence taken by the Committee at the four public hearings and the written evidence submitted to the Committee after the hearings, as well as the Committee's conclusions and recommendations.

8. **Mr Mike Rowse, DGIP**, made an opening statement at the second public hearing on 7 May 2004, the full text of which is in *Appendix 25*.

### **Project conceptualisation and approval**

#### *Assessment of project feasibility*

9. Audit stated in paragraph 2.8 of the Audit Report that four factors should have been thoroughly considered in assessing the feasibility of the HF, namely, concept viability, timeframe for organising the concerts, timeframe for promotion/publicity and ticketing, and

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organising ability of AmCham. However, Audit stated in paragraph 2.11 that it could not find documentary evidence that these important factors had been thoroughly analysed and discussed at the meeting of the ERWG on 2 July 2003 to consider AmCham's proposal.

10. According to paragraph 2.14(a), the FS accepted Audit's observation that the ERWG had not fully examined the above factors before accepting AmCham's proposal for the Government to be a sponsor, up to a maximum of \$100 million, of the HF. In particular, as pointed out in paragraph 2.11, the ERWG had not required AmCham to provide its track record in successfully organising similar events (i.e. large-scale open-air concerts). Neither had the ERWG requested AmCham to provide evidence, such as market research, that the series of concerts would be well received.

11. The Committee questioned:

- whether the FS agreed that the ERWG should have fully examined the above factors at its meeting on 2 July 2003 before deciding to support the proposal in principle, and why it had not done so;
- how AmCham had proved its ability to organise the HF when it sought the ERWG's support for the proposal. For example, whether it had informed the ERWG of the companies or experts that it would engage to organise and manage the project; and
- why the ERWG believed that AmCham had the ability and professional expertise to organise the HF despite the fact that it had no experience in organising large-scale concerts.

12. **Hon Henry TANG Ying-yen, FS**, responded that:

- the ERWG understood that AmCham per se did not have experience in organising entertainment events. In fact, Hong Kong companies did not have experience in organising such a large-scale festival which comprised a series of major open-air concerts. However, the members of the Sports and Entertainment Committee of AmCham included such companies as the Walt Disney Company and the National Basketball Association (NBA) which had the experience of organising entertainment and sports activities. The AmCham representatives who presented the proposal to the ERWG on 2 July 2003 included the chairman and vice-chairman of the Sports and Entertainment Committee. The ERWG therefore considered that AmCham had the ability to organise the HF;

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- it was against exceptional circumstances that the ERWG gave its in-principle support to the HF proposal. In July 2003, in the wake of the outbreak of SARS, the spirit of Hong Kong people was very low and the economy was in the doldrums. The Government was keen to take urgent action to relaunch Hong Kong, restore Hong Kong's reputation and boost the morale of the community. The ERWG considered that the HF proposal was worthy of Government support as it was an initiative volunteered by AmCham, which was a non-profit-making organisation, an entity in the business sector and a foreign chamber of commerce. In particular, the concept of creating an international entertainment showcase matched Hong Kong's image as a world city; and
- in the circumstances, the ERWG had not thoroughly assessed the factors highlighted by Audit before agreeing to support the proposal. As Chairman of the ERWG, he accepted responsibility for that.

13. Regarding Invest Hong Kong (InvestHK)'s evaluation of the HF proposal prior to the ERWG meeting on 2 July 2003, the **DGIP** said that:

- as the officer responsible for coordinating the entire Relaunch Campaign, he was part of the evaluation process even before InvestHK was designated the subject department for the HF. In early June 2003, the then AmCham Chairman approached InvestHK with the idea of an international entertainment festival. InvestHK then arranged a meeting on 26 June with relevant departments, i.e. the Leisure and Cultural Services Department (LCSD), the Environmental Protection Department and the Tourism Commission, to evaluate the proposal; and
- in view of the scale of the project and amount of funding sought, the meeting concluded that AmCham should put its proposal to the ERWG direct.

14. The Committee referred to Note 3 in paragraph 1.16(f) of the Audit Report in which Audit stated that the basic management principles should always be followed despite the unique circumstances in which the Administration found itself at the time. The Committee queried whether the ERWG had complied with such principles in handling the matter.

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15. The Committee also noted from paragraph 2.5 of the Audit Report that at the meeting on 26 June 2003, the government departments had commented that the concept of the HF was great but rather ambitious. In addition, as revealed in paragraph 4.18, during the ERWG's discussion on 2 July 2003, the Commissioner for Tourism had expressed the view that sufficient lead time must be available for marketing the HF. It appeared to the Committee that such initial reaction of the departments should have alerted the ERWG to the need to properly assess the risks involved in AmCham's proposal. However, as it turned out, the ERWG had not critically examined the feasibility of the HF proposal before agreeing to sponsor it.

16. The Committee further referred to paragraphs 3.9 and 3.16 of the Inquiry Panel Report which revealed that there was no formal structure within AmCham to support the "de facto Organising Committee" which only comprised the three AmCham representatives who presented the HF proposal to the ERWG. The AmCham Board of Governors had not been consulted on the terms of the sponsorship agreement signed between AmCham and the Government.

17. Against the above background, the Committee asked:

- why, despite the relevant departments' comment on the HF proposal at the inception stage, the ERWG still failed to critically assess the complexity and project risks involved; and
- whether, with the benefit of hindsight, the FS considered that the AmCham representatives had misled the ERWG into believing that they had the professional expertise to organise the event and that the Government had been fooled by them.

18. The FS responded that:

- the AmCham representatives had not misled or fooled the ERWG. Rather, they had put up the proposal with sincerity and a sense of commitment. The team that presented the proposal comprised people from world-class entertainment and marketing companies, such as the NBA. Therefore, at that time, the ERWG believed that AmCham had the necessary professional expertise for organising the event. It was disappointing that, in the end, the good initiative did not attain the results it set out to achieve;



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- the Administration had learnt a lesson from this incident. With hindsight, the ERWG had over-estimated the benefits of staging 16 large-scale concerts in 100 days as well as the number of people who would be willing to pay market price for the concert tickets. If the Government were to make the decision again, it might have adopted a different approach. For example, it might have considered more carefully AmCham's ability to organise the event, the resources that AmCham would commit to the programme, the feasibility of the proposal, etc.; and
- the Administration accepted that there was room for improvements with regard to the HF project. It also accepted the lessons to be learned and the recommendations set out in the Audit Report.

19. To ascertain the details of the ERWG's discussion on matters relating to the HF, the Committee requested to have sight of the minutes of the relevant meetings of the ERWG. In response, the Financial Secretary's Office provided extracts from the minutes of the ERWG meetings held on 2 July, 12 July, 2 August, 20 August and 31 October 2003 (in *Appendices 26 to 30* respectively).

20. Regarding the assessment by the ERWG at its meeting on 2 July 2003, the Committee noted from paragraph 2.4 of the Inquiry Panel Report that the presentation and subsequent discussion lasted for about 45 minutes only. Referring to the minutes of that meeting, the Committee noted that they were brief and had no record of the matters raised with the AmCham representatives, or details of the ERWG's deliberation. On the other hand, the FS had informed the Inquiry Panel that, in deciding that the Government would act as a sponsor only of the event, the intention was for the Government to maintain an overview of AmCham's preparation of the HF to ensure that the items as promised would be delivered and the objectives met (paragraphs 2.13 and 2.14 of the Inquiry Panel Report).

21. The Committee asked:

- about the basis of the ERWG's agreeing to give in-principle support to the proposal during its short meeting on 2 July 2003;
- whether the ERWG members were so impressed by the presentation that they neglected to look into the details of the proposal or raise pertinent questions with the AmCham representatives at the meeting; and
- whether the ERWG had given any instruction to InvestHK as to how it should maintain an overview of AmCham's preparation of the HF.

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22. In response, the **FS** said that:

- the ERWG had held two meetings on 2 and 12 July 2003 to consider the HF proposal. He was then Secretary for Commerce, Industry and Technology and attended both meetings. He remembered that at the meeting on 2 July, he had commented that as \$100 million was a huge sum, InvestHK should critically examine whether the budget could be reduced so as to reduce the amount for underwriting the project. However, as the minutes were brief, he could not recall the specific questions asked at the meeting or other details of the meeting; and
- given the unique circumstances at that time, the ERWG was very attracted by the innovative concept of the project. It had not discussed how the Government should maintain an overview of AmCham's preparation for the festival. It only decided that the Government would be the sponsor. With hindsight, he agreed that the ERWG should have considered more thoroughly such important issues as the scale of the concerts, time constraint, ticket price, etc.

23. In the light of the **FS**'s reply, the Committee referred to paragraph 2.10 of the Inquiry Panel Report which stated that, the ERWG, in assessing the HF proposal, primarily relied on the visual presentation by the AmCham representatives and their verbal undertakings as to the involvement of AmCham member companies, being US entertainment industry leaders, backed up by external professional expertise as appropriate. The Committee further noted the Inquiry Panel's observation in paragraph 2.17 that the ERWG's assessment lacked depth and was cursory in nature. It appeared to the Committee that the **FS**'s reply proved that the Inquiry Panel's criticism was justified.

24. The Committee queried whether the **FS** agreed that the ERWG had failed to discharge its duties.

25. The **FS** responded that:

- it was true that the ERWG did not have experience in organising concerts and was unable to appreciate the difficulties involved in staging a large number of concerts in a short time. The ERWG had under-estimated the complexity of organising the HF and over-estimated its benefits. There were indeed inadequacies in the preparation of the HF. In many respects, the Administration and all parties concerned could have done better. The Administration would certainly learn from these experiences; and

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- as regards the outcome, the 16 concerts had been held and the general feedback of the audience was not bad.

26. According to paragraph 2.17 of the Audit Report, instead of sponsoring the HF organised by AmCham, the Government had not considered taking over the project or exploring other options, such as organising the concerts in-house or outsourcing to the private sector through a competitive selection process. The Committee enquired:

- why the ERWG, at its meeting on 2 July 2003, had not considered the possibility of inviting other organisations or business associations to submit proposals for organising the HF;
- why the ERWG had not considered holding the HF at a later time, such as December, so as to allow a longer lead time for organising and marketing; and
- whether the ERWG had considered downsizing the scale of the HF.

27. The FS explained that:

- the ERWG had not considered conducting a tender exercise because there was not enough time. Moreover, the HF was AmCham's concept and AmCham would provide free and voluntary service and expertise for organising it. The ERWG also believed that AmCham had the ability to carry the project through as the presenters on 2 July had strong entertainment business background;
- there was only a short period of time in Hong Kong which was suitable for holding open-air concerts. The HF could not be held during the typhoon and rainy seasons, or chilly days. Thus, it was decided that the HF should be held in October and November; and
- when the ERWG viewed the presentation by AmCham, it had the impression that the programme had already been well thought out. It therefore had not considered downsizing the scale of the HF.

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28. The Committee referred to paragraph 2.15(a) of the Audit Report in which the DGIP said that AmCham's original proposal was to pitch ticket prices in the range of \$100 to \$150 and this might be the reason why AmCham did not see a need to conduct any market research to ascertain the receptivity of such a "big names-cheap tickets" formula. The Committee considered that the ERWG should be aware that changing the pricing strategy by pitching ticket prices at market level would affect the attendance rate of the HF concerts. It questioned why the ERWG had not considered conducting a market research when it decided to make the change.

29. Paragraph 2.44 of the Inquiry Panel Report also revealed that there was no discussion by the ERWG about the impact of the change in ticket pricing on ticket sales. The Committee doubted whether, in changing the pricing strategy of the HF concerts, the ERWG had made a prudent decision.

30. The **DGIP** explained that when the decision was made on 12 July to pitch ticket prices at market level, only 96 days were left before the date of the first concert. A proper market research would have taken a substantial part out of that already very short time. Therefore, AmCham proceeded to do the best it could within the parameters.

31. The **FS** said that while ticket price would have an impact on attendance rate, he did not agree that it was the only factor. In fact, the concerts of Santana and Rolling Stones almost had a full house despite their high ticket prices.

### *Appraisal of project proposal*

32. According to paragraphs 2.23 to 2.26 of the Audit Report, at the meeting on 2 July 2003, the ERWG agreed to support AmCham's proposal in principle, "subject to InvestHK's scrutiny and satisfaction of the detailed budget". However, Audit noted that InvestHK had neither sought the assistance of government departments with experience/expertise in the entertainment field (e.g. the LCSD and the Radio Television Hong Kong), nor engaged experts in the show business, to vet AmCham's detailed budget for the HF project. It only adopted a "common-sense approach" in checking the completeness and reasonableness of the budget submitted by AmCham.

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33. The Committee questioned whether:
- the FS considered that InvestHK's adoption of a common-sense approach in scrutinising the budget was reasonable and appropriate; and
  - InvestHK had diligently scrutinised and satisfied itself with the detailed budget of the HF proposal before its submission to the ERWG on 12 July 2003, as instructed by the ERWG.
34. The **FS** responded that the Administration would have asked more questions if it had been very objective and prudent. With hindsight, as \$100 million was a huge amount, it was doubtful whether sponsorship was an appropriate way of financing the event. The Administration should have done more work to monitor the use of the funds.
35. The **DGIP** said that AmCham submitted the budget to InvestHK on 6 July 2003. There was a reasonable amount of details to support the various items in the budget. InvestHK had looked at all the items for income and expenditure and asked itself whether they seemed reasonable. It had sent emails to AmCham asking a number of questions and seeking clarifications, and satisfied itself that the budget was reasonable. However, it had not specifically asked the LCSD to evaluate the budget professionally.
36. In reply to the Committee's enquiry about whether Audit had checked the emails sent by InvestHK in the course of the review, **Mr Benjamin TANG, Director of Audit**, advised, in his letter of 10 May 2004 in *Appendix 31*, that:
- Audit was aware that InvestHK had considered the budget submitted by AmCham and had sought clarifications from AmCham by emails about some of the items in the budget. In conducting the review on the HF, Audit had examined the emails exchanged between InvestHK and AmCham regarding the consideration of the budget. However, in Audit's view, InvestHK's "common-sense approach" of vetting did not provide a sound basis for it to satisfy itself that AmCham's budget for the project was reasonable and acceptable to the Government. Without the benefit of expert advice and information on the market prices of performances by international artists, InvestHK was unable to properly assess the reasonableness of the venue construction and operations costs and the talent costs in AmCham's budget; and

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- notwithstanding that InvestHK had considered the budget submitted by AmCham and had sought clarifications from AmCham by emails, Audit maintained that the observations in paragraph 2.25 of the Audit Report, that “Audit could not ascertain the basis on which InvestHK was able to satisfy itself that AmCham’s detailed budget for the project was reasonable and acceptable to the Government. It is unclear whether InvestHK had conducted a proper appraisal of AmCham’s budget proposal, as required by the ERWG....”, were valid.

37. Regarding the budget scrutiny process, the Committee pointed out that, according to paragraph 2.37 of the Inquiry Panel Report, there were only two emails in relation to the budget during the material time and these only raised minor questions. Moreover, the DGIP had said in paragraph 2.27 of the Audit Report that the outline budget submitted by AmCham on 6 July 2003 was still indicative only and it was not open to in-depth analysis. Having regard to the fact the ERWG gave its in-principle approval on 2 July on condition that InvestHK scrutinise and satisfy itself that the AmCham’s detailed budget was reasonable and acceptable to the Government, the Committee questioned:

- why the ERWG had not followed up the matter with InvestHK at the following meeting on 12 July 2003 before approving a maximum of \$100 million to InvestHK for underwriting the HF; and
- whether the InvestHK staff present at the meeting had informed the ERWG that AmCham’s budget was indicative only and not open to in-depth analysis by the department.

38. The **FS** replied that he had asked at the meeting on 2 July whether the project required \$100 million. He had also asked at the meeting on 12 July whether, after assessment, the budget of \$100 million was considered reasonable and whether it could be reduced. The answer given was that InvestHK had studied the budget and considered the amount reasonable. However, the ERWG had not raised questions about the details of the budget. As a matter of fact, the ERWG did not have the ability to examine each and every item in the budget.

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### Project monitoring

#### *Financing the project in the form of sponsorship*

39. As revealed in paragraph 2.29 of the Audit Report, at the ERWG meeting of 12 July 2003 when the HF project was approved, the Chairman of the ERWG emphasised that “the Government would act as the sponsor only” and “AmCham had to plan, organise and implement the whole event”. Audit considered that, by confining the Government’s role in the project to a sponsor and by capping the sponsorship grant at \$100 million, the Government intended to limit its role and liability.

40. The Committee also noted from paragraph 2.33 of the Audit Report that, according to the government guidelines “Miscellaneous Subventions — Guidelines on the Management and Control of Government Subventions” (the subvention guidelines) issued in 1988 (in *Appendix 32*), sponsorship referred to a contribution, usually of a token amount, to help meet part of an organisation’s operational expenses and to demonstrate support for the organisation’s objectives. The controls over an organisation in receipt of government sponsorship were generally much less stringent than in other forms of government grants.

41. The Committee asked:

- why the ERWG chose to adopt the less stringent form of control and distance itself from the project, when it should have known that the project was ambitious and involved high risks;
- whether the ERWG was aware of the subvention guidelines when it decided on 12 July 2003 to sponsor the HF project; and
- whether any person attending the meeting had raised query about the appropriateness of the Government’s financing the project in the form of sponsorship.

42. As the DGIP was absent at the ERWG’s meeting on 12 July 2003, the Committee also asked whether Ms Ophelia TSANG, Associate Director-General of Investment Promotion (ADG) who was present at the meeting, had brought the subvention guidelines to the attention of the DGIP subsequently.

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43. Ms **Ophelia TSANG, ADG**, replied that there was no mention of the subvention guidelines during the meeting. As a decision had been made by the ERWG, InvestHK only discharged its duties according to the decision.

44. The **DGIP** supplemented that as the FS who chaired the ERWG had already decided that the Government was to act as the sponsor and the \$100 million would be paid to AmCham as a sponsorship fee, there was no question of the InvestHK staff re-assessing the appropriateness of the decision after the meeting.

45. The **FS** said that:

- as there was only a short time between July and October, in order to allow AmCham the maximum flexibility and for the sake of efficiency, the ERWG decided that the Government should act as the sponsor while AmCham would take up the planning, organisation and implementation of the whole event;
- nobody had mentioned the subvention guidelines at the meeting on 12 July. The type of sponsorship referred to in the guidelines was that made by the Government on a recurrent basis. It was inappropriate to apply them in the present case as the HF was a one-off event; and
- in the absence of specific guidelines applicable to events like the HF, and drawing on the experience from the present case, the Administration had issued Financial Circular (FCir) No. 1/2004 in February 2004 to remind Controlling Officers of their responsibilities under the Public Finance Ordinance.

46. Regarding the responsibilities and accountability of Controlling Officers, the Committee referred to paragraph 9 of FCir No. 1/2004 (in **Appendix 33**). It was stated that “Controlling Officers are ultimately responsible and accountable for the proper use of funds under their control. Irrespective of whether public funds are disbursed through a procurement contract, subvention, sponsorship, or any other form or vehicle, Controlling Officers should satisfy themselves that an appropriate system of cost control or monitoring is in place, having regard to economy, efficiency and effectiveness in the delivery of public service and use of the public funds.” The Committee enquired whether there was any difference in the Controlling Officers’ responsibilities before the issuance of the circular.



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47. The FS responded that:

- FCir No. 1/2004 replaced FCir No. 14/84 (in *Appendix 34*). There was no difference between the requirements in these two circulars. It was stated in FCir No. 14/84 that “From time to time, controlling officers may find themselves the client for projects over which their exercise of control differs in some way from normal procedures ..... Controlling officers are reminded that, in these circumstances, they remain fully responsible and accountable for the proper disbursement of the funds under their control.” This requirement was basically the same as that in FCir No. 1/2004. As FCir No. 14/84 was brief, the Secretary for Financial Services and the Treasury issued another one in February 2004 to “remind” Controlling Officers of their responsibilities; and
- irrespective of whether an event was financed by the Government through sponsorship or other modes of subvention, the responsibilities of the Controlling Officers remained the same i.e. they should satisfy themselves that an appropriate system of cost control or monitoring was in place. In discharging their responsibilities, Controlling Officers would decide on the appropriate level of involvement in and the appropriate way for monitoring an event, having regard to the means of financing and their capacities.

48. In view of the FS’s comment that the subvention guidelines were not applicable in the case of the HF, the Committee enquired why Audit considered them relevant. In his letter of 20 May 2004, in *Appendix 35*, the **Director of Audit** advised that:

- it was stated in paragraph 2.34 of the Audit Report that “given that the Government paid for the bulk of the cost of the Harbour Fest, and in view of the need to account for such a large sum of public expenditure, Audit considers that sponsorship did not seem to be an appropriate form of financing this project”. Audit held this view because sponsorship in the present case had resulted in entrusting a large sum of public money to AmCham without stringent controls. Audit considered the amount of sponsorship should normally be a small portion of the sponsored project cost. This principle should always be followed; and
- in making the above remarks, it was noted that the subventions guidelines issued in 1988 had already referred to sponsorship as “a contribution, usually a token amount, to help meet part of an organisation’s operational expenses and to demonstrate support for the organisation’s objectives”. Audit therefore considered it relevant to refer to the principle and good practice set out in these guidelines.

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### *The DGIP's monitoring approach and interpretation of "sponsorship"*

49. According to paragraph 2.30 of the Audit Report, the DGIP had informed Audit that, in discharging his duties in relation to the HF, he adopted a "hands-off" approach, as it was not the Government's intention to "micro-manage" the project. The Committee queried why the DGIP had not realised that the HF project called for a more hands-on approach and more stringent control, because the amount of public money involved was by no means a token amount but an enormous sum.

50. The **DGIP** said that:

- on 12 July 2003, the ERWG decided to sponsor the HF project. InvestHK was designated as the subject department for the sponsorship arrangement. At that point, AmCham needed to carry out a number of important tasks very quickly. In the normal course of events, many of these tasks would have been carried out sequentially or with only minor overlaps requiring up to a year to implement. But with the very short timeframe of less than 100 days to implement the project, all these tasks had to be undertaken in parallel;
- this unprecedented set of circumstances inevitably affected the arrangements for monitoring. On the one hand, the Government was committing up to \$100 million of public funds, which argued for a high degree of scrutiny and even shared control. On the other hand, in recognition of the extraordinary time pressures, the ERWG had specifically decided that AmCham should have sole responsibility for planning, organising and implementing the event; and
- it was against the above background that InvestHK undertook its monitoring role. It had no direct executive responsibility or powers, because of the ERWG decision that it should be a sponsor only. But it needed to monitor the situation closely, identify problem areas, promptly draw them to AmCham's attention, and assist in remedying them - in cooperation with the organiser. InvestHK accepted that the outcome fell short of its hopes. But it did all of these things to the utmost of its ability and gave them its best effort.

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51. On the question of whether he had adopted a “hands-off” approach, the **DGIP** said that:

- he had never used the term “hands-off” approach with respect to monitoring. As stated in paragraph 3.20(d) of the Audit Report, he had adopted a “hands-off” approach only with respect to the implementation of the HF and the executive responsibility for it. It meant that because AmCham was made responsible for planning, organising and implementing the project, InvestHK was a step back from the direct implementation. However, InvestHK did realise that because of the amount of money involved, the novelty of the proposal and the high profile that the project inevitably would have, it needed to monitor the event closely; and
- InvestHK had maintained regular and frequent contacts with AmCham, either in the form of small group meetings or through telephone calls, email etc. to keep track of what was happening in different aspects of HF as it evolved. It identified problems and offered advice and assistance to AmCham as the circumstances warranted. For example, he had assisted in soliciting sponsorships. This was by no means hands off. Rather, InvestHK had monitored extremely closely and much more proactively than in its other sponsorship arrangements. But it was different from having executive responsibility for the actual implementation which had been specifically given to AmCham.

52. The Committee noted that the **DGIP** was absent at the ERWG’s meetings on 2 July, 12 July and 2 August 2003 during which important decisions about the HF project were made and the progress was discussed. Having regard to the fact that the HF proposal was introduced to the ERWG by InvestHK and **DGIP** was the Controlling Officer for the \$100 million sponsorship fee, the Committee considered that the **DGIP** had an important role over the event, and asked why he had not attended the meetings.

53. The **DGIP** explained that:

- on 2 July 2003, he was in Chicago conducting investment promotion work. At that time, InvestHK had not yet been designated as the subject department for the HF although he was the Controlling Officer of the \$1 billion funding for the Relaunch Campaign;

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- the meeting on 12 July 2003 involved a clash of priorities. That was the final day when the Government negotiated with various consortia for the construction of the \$2.3 billion International Exhibition Centre at the Chek Lap Kok Airport. He was the leader of the government team making the assessment and finalising the negotiations. He judged that it was appropriate for him to finalise those negotiations. Therefore he did not attend the ERWG meeting; and
- as regards the meeting on 2 August 2003, he was on leave.

54. As requested by the Committee, the DGIP provided, in his letter of 17 May 2003 in *Appendix 36*, a summary of the periods between July and mid-November 2003 during which he was not in office, either on duty trip or on vacation leave. The Committee noted that during the three months from July to September 2003, the DGIP was absent from Hong Kong for 60 days, including 34 days' vacation leave from 14 July to 16 August 2003. The Committee questioned how the DGIP could have effectively discharged his responsibilities regarding the HF, given that he was out of town for two-thirds of the lead-up to the HF.

55. In this connection, the Committee noted that the Inquiry Panel also made a similar observation. It was stated in paragraph 4.95 of the Inquiry Panel Report that, in considering InvestHK as the subject department, the ERWG should have examined the capabilities and suitability of InvestHK for the job. The Inquiry Panel also highlighted InvestHK's lack of experience in financial management and concert promotion, which was required for overseeing the HF project. The Committee doubted whether it was a prudent decision to appoint InvestHK as the subject department for the HF.

56. The FS responded that:

- he was then Secretary for Commerce, Industry and Technology and the supervisor of the DGIP. He knew that the DGIP was on leave at that time. As a head of department, when the DGIP applied for vacation leave, he should have already made the judgment that his leave would not affect his work; and
- apart from the HF, the DGIP had other duties as the head of InvestHK. He should have prioritised his different duties and decided if it was appropriate to undertake the duty visits.

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57. The **DGIP** responded that he had applied for vacation leave in the normal way and the leave was approved. He felt that it was not unreasonable to take leave as InvestHK had been undertaking the extra responsibilities in connection with the Relaunch Campaign for many months. In fact, the HF was only one project under the entire Relaunch Campaign. It was an additional responsibility given to InvestHK on top of its regular duties which InvestHK had attempted to continue to perform as best as it could.

58. The Committee pointed out that it was incumbent upon a senior official like the DGIP to have asked for assistance if he had concern over InvestHK's lack of resources to take up the extra responsibility as the subject department for the HF. The Committee queried why the DGIP had not done so.

59. The **DGIP** explained that:

- it was a question of juggling different priorities and responsibilities. As the DGIP, he was responsible for running InvestHK. The department performed strongly as an investment promotion agency, as shown by past results. Regarding the Relaunch Campaign, the department provided a secretariat for both the ERWG and ERSG. It had put in place a machinery for assessing economic relaunch proposals and coordinated with other bureaux and departments. Altogether, the ERWG considered 95 proposals and approved 84 of them; and
- InvestHK had a particular understanding of what sponsorship meant. That understanding did not include putting a member on the HF Organising Committee and sharing the executive responsibility, as suggested by the Inquiry Panel. For the HF, InvestHK had actually gone beyond its normal understanding of sponsorship arrangement and exercised close monitoring.

60. In view of the DGIP's claim that InvestHK had already exercised a high degree of monitoring over the HF, the Committee asked whether the various problems surrounding the HF was the result of wrong decisions or poor implementation.

61. The **FS** said that:

- as the Controlling Officer for the \$1 billion relaunch fund, the DGIP had the responsibility to properly monitor the use of the fund, irrespective of whether the fund was disbursed through sponsorship or other modes of subvention.

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It was possible that there was a disparity in the interpretation of “sponsorship” between the ERWG and InvestHK, which was responsible for implementation. Given that \$100 million was 10% of the relaunch fund and was a huge amount, the level of monitoring required for the HF should be different from that for other normal sponsored events; and

- it was difficult for him to judge whether the decision made by the ERWG at that time to finance the HF by way of sponsorship was right or wrong. At its meeting on 12 July 2003, the ERWG had not discussed whether sponsorship was an appropriate way to finance the HF. It decided to act as the sponsor because it did not want the Government to micro-manage the project. Admittedly, there was much room for improvement.

62. Regarding the DGIP’s interpretation of “sponsorship”, the Committee noted that the Inquiry Panel “considers it disappointing for DGIP and InvestHK to have over-leveraged on the concept of sponsorship” (paragraph 4.22 of the Inquiry Panel Report). The Inquiry Panel also concluded in paragraph 5.46 that the “DGIP and InvestHK traded due diligence for expediency in unjustifiably hiding behind a narrow interpretation of sponsorship”. To ascertain the basis of the DGIP’s and InvestHK’s interpretation of sponsorship, the Committee asked the DGIP whether he had, at any stage, communicated with the then Chairman of the ERWG as regards how he was expected to monitor the HF under the sponsorship arrangement.

63. The **DGIP** confirmed that he had not communicated with the Chairman of the ERWG in this respect. He further said that:

- he had not devised a new interpretation of sponsorship for the purpose of the HF. InvestHK had sponsored a number of events, such as the Fortune Global Forum in 2001 and the Forbes Global CEO Conference in 2002. For all these events, it sponsored them on the same basis, i.e. InvestHK compared the fee involved and the benefits. If the sponsorship was considered worthy of the fee, it would enter into a contract arrangement. In none of those cases did InvestHK send a representative to sit on the organising committee or track the cashflow;
- InvestHK initially applied the same interpretation to the HF and managed it on the same basis. However, it soon realised that it needed to exercise a higher degree of monitoring for the HF because of the magnitude of the sponsorship fee. It had therefore considerably enhanced its level of monitoring compared to its normal practice for other sponsorship

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arrangements. Indeed, InvestHK was very “hands-on” with regard to monitoring. That was why it could identify problems and rendered direct assistance to AmCham;

- with the benefit of hindsight, the decision that the Government was to be a sponsor, rather than a co-organiser, was not correct. He also accepted that whether it was called sponsorship or not, the Government should have co-organised the HF. Nevertheless, the word “sponsorship” was specifically used on 12 July 2003 and the Chairman of the ERWG also emphasised that the Government would act as the sponsor only. AmCham had to plan, organise and implement the whole event. To InvestHK, the decision was not ambiguous and it matched exactly InvestHK’s experience in sponsoring events. InvestHK understood it clearly in that meaning;
- the Inquiry Panel had commented that even if the ERWG had the narrow sponsorship concept in mind, he was duty bound to counter-propose a more responsible approach to the ERWG. As a member of the ERWG, similar to the ERWG Chairman, he felt at that time that sponsorship was an appropriate course of action; and
- if the ERWG had on 12 July 2003 considered that InvestHK should not only be a sponsor but also a co-organiser, and was to be involved in the execution of the HF, then InvestHK would have had to ask for reinforcement from other departments. Alternatively, in the extreme case, it should have asked for a change of subject department, since it was totally beyond InvestHK’s experience to be involved in the organisation of an event at the executive level to that degree.

### *The three Memoranda of Understanding (MOUs) and the agreement between the Government and AmCham*

64. According to paragraph 1.8 of the Audit Report, the Government and AmCham entered into three legally binding MOUs in relation to the HF on 31 July, 29 August and 3 October 2003 (in *Appendices 37, 38 and 39* respectively). On 10 October 2003, the Government and AmCham entered into a full agreement (in *Appendix 40*).

65. To ascertain the involvement of the Department of Justice (DoJ) in the MOUs and the agreement, the Committee asked the Secretary for Justice whether the DoJ:

- had been consulted on any of those agreements at any stage; and

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- had given any advice or comments upon such consultation and, if so, when they were given, and whether they were accepted and/or reflected in the agreements.

66. The **Deputy Principal Government Counsel (Commercial)** I informed the Committee, in his letter of 6 May 2004 in *Appendix 41*, that:

- the DoJ had not been consulted on any of the three MOUs, but it had been consulted on the draft agreement between the Government and AmCham. On 1 August 2003, the department received the request for advice on the draft agreement prepared by InvestHK vide its memo dated 30 July 2003;
- the DoJ was first consulted on 1 August 2003 after the ERWG had agreed in principle that the Government would sponsor the HF and after the Government and AmCham had entered into a legally binding MOU which provided, amongst other things, for the first installment (\$25 million) of the sponsorship fee payable to AmCham. The DoJ was given two draft agreements, one prepared by AmCham and the other by InvestHK. The department was invited to comment on some specific clauses in the draft agreement prepared by InvestHK to ensure that the wording accurately reflected the intention of InvestHK. In response to the specific requests, advice was given on 8 August 2003 and subsequently prior to the execution of the agreement. Most of the advice was adopted; and
- the DoJ had raised the need for provisions for access to documents in AmCham's possession and was instructed that the requirement for AmCham to prepare proper books of account and to submit independently audited accounts of the festival should instead be incorporated in the agreement. This was because the Government had decided to limit its role to that of sponsor only, and AmCham would be responsible for planning, organising and implementing the event.

67. The Committee was concerned that InvestHK had not consulted the DoJ before signing three legally binding MOUs with AmCham, each of which effected payment of \$25 million (or 25%) of the total sponsorship fee to AmCham. In addition, it had rejected the DoJ's advice to include in the agreement provisions for access to documents in AmCham's possession. In the event, the Government (including Audit) did not have the power to access the accounts, contracts and records in relation to the HF.



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68. In this regard, the Committee shared the feeling of the Inquiry Panel in paragraph 4.30 of its Report, that “The Panel is astonished to note that InvestHK could and did, on behalf of the Government, enter into binding obligations with AmCham to the extent of HK\$100 million under three MOUs without consulting DoJ.” The Committee queried the reason for such an omission.

69. The **DGIP** and the **ADG** explained, in their letters of 21 and 27 May 2004 in *Appendices 42 and 43* respectively, the background leading to the signing of the MOUs, before both parties entered into the final sponsorship agreement. They stated that:

- after InvestHK had conveyed to AmCham the ERWG’s decision of 12 July 2003 that the Government would sponsor the HF and that AmCham had to plan, organise and implement the whole event, AmCham came up with a draft sponsorship agreement on 24 July 2003 prepared by its lawyer. InvestHK made some initial comments and suggested amendments with a view to setting out more precisely the respective rights and obligations of the two signing parties, and sent out the revised draft document to the DoJ for legal advice on 30 July. It also included some specific questions for the DoJ’s comments;
- in parallel, AmCham was proceeding with the preparation for the HF itself. Mr James Thompson (then the Chairman of AmCham) approached ADG exploring the possibility of the Government making an advance payment, equivalent to 25% of the approved sponsorship fee, in order that AmCham would be able to settle some essential upfront payments. InvestHK was always mindful of the need to protect the interest of Government in view of the substantial amount of public money involved, notwithstanding the fact that the sponsorship fee had already been approved by ERWG. On the other hand, as the subject department responsible for coordinating Government’s support and facilitation to enable this economic relaunch project to proceed as smoothly as possible, it needed to strike the right balance with flexibility within its scope of authority; and
- against the above background, InvestHK entered into a simple legal document in the form of an MOU with AmCham, setting out the understanding between the two parties on their respective roles on the HF in anticipation of the full sponsorship agreement. This also provided the formal basis for making an advance payment of sponsorship fee to AmCham.

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70. As regards the reasons for not seeking legal advice on the MOUs, the **DGIP** and the **ADG** said at the public hearings and in the same letters that:

- InvestHK had not consulted the DoJ specifically on the (first) MOU because it was a simple legal document pointing to the final sponsorship agreement that the Government and AmCham would enter into. Most important of all, there was perceived urgency for executing the document before any advance payment of sponsorship fee could be made to AmCham;
- it was not unprecedented for government bureaux/departments to not seek legal advice from the DoJ on grounds of perceived urgency. In his letter to the Inquiry Panel dated 11 February 2004, the relevant DoJ officer stated, inter alia, that “there is no general requirement for a government bureau or department to consult the Department of Justice on every contract it enters into. From experience government bureaux or departments might not consult the Department of Justice for legal advice for various reasons, such as the absence of legal implications, the perceived urgency of the matter or in respect of the renewal of contracts in similar terms to those previously cleared by this Department”; and
- time was of the essence. In an ideal situation InvestHK should have proceeded to draw up and sign the full contract first before AmCham began preparation of the HF, including submission of a comprehensive business plan to the Government for approval, and before any advance payment was made to AmCham. In such a scenario, there would have been no need for any MOU at all. However, the HF was targeting a very narrow window of opportunity in the autumn of 2003. Therefore, a number of things which should have been done sequentially were done in parallel. In practice, both the Government and the AmCham were fully committed to the HF project in good faith. When signing the MOUs, neither side had contemplated that the final agreement would not come through.

71. The Committee further questioned the basis for InvestHK’s rejecting the DoJ’s advice on access to documents on the ground that the Government had decided to limit its role to that of sponsor. It asked whether InvestHK had made reference to the subvention guidelines of 1988 in making the decision.

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72. The **DGIP** stated at the public hearings and in his letter of 21 May 2004 that:

- he had not made specific reference to the subvention guidelines in connection with the organisation of the HF, although he was generally aware of them. InvestHK had relied in part on its past experience of event sponsorship, e.g. the Fortune Global Forum 2001, the Forbes Global CEO Conference 2002, the Business Week CEO Forum in 2003, the World Economic Forum's East Asia Economic Summit, annual meetings of the Cable & Satellite Broadcasting Association of Asia, etc. In none of these events did it seek access to the accounts. Against this background, InvestHK did not see that it needed to have access to all the detailed accounts in respect of the HF because it was a sponsorship arrangement;
- having regard to the special circumstances of the HF and the amount of government sponsorship, InvestHK felt that it should go further than its usual practice. Hence, in seeking the DoJ's advice on the draft sponsorship agreement, it sought specific input on the following aspects:
  - (a) whether the provisions were sufficient to make AmCham revise the budget when there were changes to the programme of events for the festival, including the performing talents;
  - (b) whether the provisions were adequate to make AmCham expend the government sponsorship fee in accordance with the budget (which would have to be agreed by the Government);
  - (c) whether the provisions adequately reflected the Government's intention that if the actual shortfall were smaller than the amount already advanced to AmCham, the latter should refund the difference to the Government; and
  - (d) whether (and, if so, how) any express reference should be made to the MOU signed with AmCham and the advance of sponsorship fee paid;
- having regard to the DoJ's advice on the above points, InvestHK felt that requiring AmCham to have the HF accounts independently audited and submitted to InvestHK represented a reasonable balance between the relatively limited requirements of sponsorship and the need for public accountability; and

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- the arrangement was also in line with normal sponsorship arrangements. As stated in paragraph 2.33(b) of the Audit Report, in the case of sponsorships, the Government normally did not have access to the subvented organisations' records and accounts. The Government would only review the audited accounts of the organisations.

73. The Committee pointed out that the objectives of the HF were to boost local morale and consumption, boost tourism and promote Hong Kong to international and Mainland communities. However, the agreement only required the delivery of a series of concerts and the production of a TV special. In none of the three MOUs or the agreement had InvestHK stipulated any measurable criteria, such as the minimum requirement for attendance or revenue, relating to the stated objectives. Moreover, as mentioned in paragraph 4.34 of the Inquiry Panel Report, there was no reference in the MOUs even to the repayment of funds advanced in the event that the parties failed to enter into a full agreement. In contrast, the Government had a clear obligation under these agreements to pay a sum of up to \$100 million to finance the HF. It appeared to the Committee that InvestHK had entered into unequal contracts on behalf of the Government. The Committee questioned how the MOUs and agreement could protect the Government's interest and safeguard the taxpayers' money.

74. The **DGIP** said at the public hearings and in his letter of 21 May 2004, that:

- the MOUs were simple documents setting out the understanding between the two parties on their respective roles on the HF in anticipation of the full sponsorship agreement. Clauses 1.1 to 1.4 set out the commitment of AmCham, the decision of the Government (as made by the ERWG) and pointed towards a full agreement setting out in detail each party's rights and obligations regarding the sponsorship arrangement;
- the MOUs were signed to register the commitment of both parties and provided a basis for the Government to make an advance payment of the approved sponsorship fee to AmCham. At the time when the first MOU was signed, a draft of the sponsorship agreement had been prepared and was pending legal advice. The formal signing of the contract was expected to be forthcoming imminently. However, the negotiation of some terms and conditions in the agreement took a longer lead-time than originally envisaged because priority had to be given to other aspects of HF preparation. Two more MOUs on identical terms were subsequently signed before the agreement itself was formally signed;

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- in a normal commercial relationship with a degree of adversarial nature, an advance payment should only be of a nominal amount or no advance payment should be made at all. However, the HF was a collaborative venture between the Government and AmCham to help relaunch Hong Kong's economy. That was why a number of things which would not normally have been done were done; and
- InvestHK had specified reasonable measures in the agreement, i.e. AmCham had to produce a specified number of concerts with world-class artists and a TV special. AmCham should arrange for the TV special to be as widely shown as possible and the clips from it could be used by the Government and its organs in other promotions. Having decided that the tickets should be priced at the market level, it would be impractical to set a target attendance because the popularity of different artists at the commercial level varied. Similarly, for viewership, while InvestHK could specify access to a number of TV homes, it would not have been possible to specify the number of TV viewers who would actually watch the film.

75. The Committee noted that the first two MOUs of 31 July and 29 August 2003 were signed by Ms Ophelia TSANG in the capacity of ADG, during the absence of DGIP. As revealed in paragraph 4.28 of the Inquiry Panel Report, when DGIP returned from leave and signed the third MoU, he considered it beside the point to consult the DoJ then because two installments were already advanced to AmCham with the execution of the first two MOUs. The Committee asked the DGIP:

- whether he had been consulted by his subordinates before the MOUs were signed;
- whether he had asked about the first MOU after he had returned from leave; and
- if he had not been on leave, whether he would have instructed that the DoJ be consulted first.

76. The **DGIP** replied that:

- his views had not been sought as he was on leave. Although he was in office for about a week after the signing of the first MOU, he did not know about it at that time. When he returned from duty visit and was presented with the third MOU, that was when he learnt that it was the third one;

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- he agreed that handing over \$50 million in exchange for very simple MOUs was out of ordinary. It was an exceptional way of coping with exceptional circumstances. The key point was that all the three MOUs pointed clearly towards the final agreement which was, in fact, negotiated and signed; and
- it would have been better if legal advice had been sought on the first MOU and then that would have carried through to the subsequent ones. Ideally, he would have preferred that top priority had been given to signing the full contract and avoided the MOUs altogether.

77. The Committee considered it unbelievable that two MOUs making payment of some \$50 million were signed by the DGIP's subordinate in the absence of a detailed budget, legal advice and instruction from the supervisor. It wondered whether this was the right procedure recognised by the civil service.

78. On the question of whether he had been consulted on the first MOU, the **DGIP** subsequently clarified, in another letter of 21 May 2004 in *Appendix 44*, that:

- at the hearing of the Committee held on 20 May 2004, he indicated that he did not recall having seen the first MOU dated 31 July 2003 before it was signed and arrangement made for payment of \$25 million to AmCham. That statement remained correct, but was incomplete;
- after an exhaustive search of InvestHK's records, he found an email dated 30 July sent by his deputy Ms Ophelia TSANG to his personal email address at home. He had not seen that email until 3 August as he was on leave and out of town. He apologised for this lapse of memory; and
- in his opinion, Ms TSANG's decision to sign the MOU and effected payment was understandable in the exceptional circumstances prevailing. He took full responsibility for it.

79. To ascertain whether Ms Ophelia TSANG had proper authorisation and followed proper internal procedure before she signed the two MOUs of 31 July and 29 August 2003, the Committee enquired:

- about the acting arrangements when the DGIP's was on leave from 14 July to 16 August 2003, and on duty visits to Shanghai from 21 to 22 August 2003 and Australasia from 25 to 30 August 2003;

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- whether Ms TSANG considered it necessary to obtain the approval of the DGIP or the Acting DGIP before signing the MOUs; if so, whether she had obtained the approval; if not, what the reasons were;
- whether she had informed, consulted or discussed with the DGIP or the Acting DGIP on the two MOUs before signing them and, if so, when and how, and what the details were;
- whether she had reported the signing of the two MOUs to the DGIP upon his return to office and if so, when and what the details were; if not, what the reasons were; and
- whether, in her view, there was any negligence on her part in signing the two MOUs, in view of the fact that no legal advice had been obtained on them beforehand and particularly if the DGIP or the Acting DGIP had not been properly consulted in the first instance.

80. In her letter of 27 May 2004, **Ms Ophelia TSANG, ADG**, informed the Committee of the acting arrangements to cover the DGIP's absence on leave/duty visits, as follows:

14 to 27 July 2003	ADG(1) Mr John Rutherford doubling up
28 July to 10 August 2003	ADG(2) Mr Simon Galpin doubling up
11 to 16 August 2003	ADG(3) (herself) doubling up
21 to 22 August 2003	ADG(1) Mr John Rutherford doubling up
25 to 30 August 2003	ADG(3) (herself) doubling up

81. The **ADG** further said that:

- she was deputising for the DGIP on all matters relating to the Relaunch Campaign, including the HF. In the light of the need for the organisation of the HF to proceed as smoothly as possible, she saw the need to effect the MOU urgently. This was fully in line with the ERWG's decision to sponsor and support the HF. For the first MOU, she had sent an email on 30 July 2003 to the DGIP's home email address informing him of it and the advance payment. She had also briefed the Acting DGIP on the MOU, but accepting

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that he was not at all familiar with the background to the Relaunch Campaign, she was prepared to sign it on her own authority. For the second MOU, she was the Acting DGIP herself though she signed it in the capacity of her substantive post;

- she had updated the DGIP on the progress of the HF, including the advance payments, on each occasion after he returned from leave/duty trip, though she did not recall the details of their discussions due to the lapse of time; and
- she did not consider that there was any negligence regarding her signing the two MOUs, which were part of implementing the ERWG's sponsorship decision on the HF under very exceptional circumstances. With the benefit of hindsight, she could have adopted a holding line and invited the DoJ's input before responding to AmCham's request for urgent advance payment of sponsorship fee in the absence of a full sponsorship agreement.

82. The Committee noted the reply of the DGIP and the ADG that there was perceived urgency for executing the MOUs so as to transfer money to AmCham for settling some essential upfront payments. However, the Committee noted from paragraph 4.29 of the Inquiry Panel Report that the first advance payment of \$25 million from InvestHK was effected on 4 August 2003. The first transfer of fund from AmCham to Red Canvas Limited (Red Canvas), the Special Purpose Vehicle appointed by AmCham to carry out the HF event, did not take place until 13 August 2003 at \$7 million. The second advance payment of \$25 million was effected on 1 September 2003. The transfer of fund to Red Canvas did not take place until 9 September 2003 at \$18 million. Paragraph 4.32 of the Inquiry Panel Report further revealed that InvestHK had not requested AmCham to substantiate the need for advance payment on each occasion of transfer.

83. The Committee questioned the basis for the perceived urgency and whether InvestHK had been over cooperative with AmCham.

84. The **DGIP** replied that there was a very short time span and Red Canvas, on behalf of AmCham, was entering into contracts that bound it to spend very large sums of money on a daily basis. AmCham had told InvestHK that it needed the money in the bank account as foreign artists' companies wanted proof of Red Canvas's ability to pay when it entered into contracts with them. InvestHK took on faith the then AmCham Chairman's requests for money.



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### *Due diligence checks on AmCham and Red Canvas*

85. The Committee was concerned that, as revealed in paragraph 4.50 of the Inquiry Panel Report, InvestHK had failed to conduct due diligence checks on AmCham's ability to pay in the event that the cost of the HF exceeded the government sponsorship of \$100 million. The Committee shared the Inquiry Panel's view that it would be highly embarrassing to the Government should there be non-payment to any contractor because of cost overrun in the HF beyond the sponsorship fee.

86. In addition, paragraph 4.47 of the Inquiry Panel Report further revealed that InvestHK had not conducted any due diligence checks on Red Canvas. In the circumstances, InvestHK failed to discover that Red Canvas was owned by Mr James Thompson and his wife, which was inconsistent with the reference in the sponsorship agreement that Red Canvas being "wholly owned by members of AmCham". The Committee questioned:

- why InvestHK had not followed the standard practice in the private sector of conducting due diligence checks on the contracting parties before the execution of an agreement; and
- whether InvestHK had placed all its trust on the then Chairman of AmCham such that it ignored the prudent practice.

87. The **DGIP** responded that:

- it was specified in the agreement with AmCham that on no account would the Government be responsible for more than \$100 million. Moreover, InvestHK had monitored the HF closely and kept in touch with its forecast finances as they rolled forward. All along, it had pressed for the final sponsorship fee to be less than \$100 million. In the end, the event had only a small amount of cost overrun and the former AmCham Chairman had agreed to pay for it;
- AmCham was a responsible organisation and its former Chairman was a prominent member of the community who had the global headquarters of his company in Hong Kong for a quarter of a century. InvestHK took his word for it that he was authorised to sign the agreement on behalf of AmCham and its Board of Governors. In fact, all the people involved in assessing the HF proposal and in assessing AmCham's ability to deliver were persuaded by the AmCham representatives who attended the various meetings; and

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- as regards Red Canvas, InvestHK signed the sponsorship agreement with AmCham and dealt only with AmCham. Hence, no company search on Red Canvas was conducted.

88. The Committee noted the Inquiry Panel's conclusion in paragraph 5.47 of its Report that the DGIP had failed to adequately discharge the role of Controlling Officer in respect of the \$100 million public funds for the HF. The Committee asked whether the DGIP agreed with this conclusion.

89. The **DGIP** said that:

- he did not agree with the conclusion that he had failed in his duty as Controlling Officer. He was actually Controlling Officer at two levels:
  - (a) first, he was the Controlling Officer for the whole Relaunch Campaign which involved \$1 billion. In discharging those duties, he and InvestHK staff had assisted the ERWG to receive, consider, reject or approve spending proposals to relaunch the economy of Hong Kong. InvestHK had devised the procedures and the criteria against which the different proposals would be measured. It also made arrangements to pay the sums. At this level, he believed that he had fulfilled his responsibilities as Controlling Officer; and
  - (b) second, he was the Controlling Officer of the subject department for the HF. At this level, he executed the decisions of the ERWG, of which he was also a member. He implemented the sponsorship arrangement, which was that InvestHK must make sure that AmCham deliver a series of world-class entertainment events and the Government would pay up to, but not exceeding, \$100 million. All these had materialised. Unfortunately, the final result was disappointing and did not meet the community's expectations;
- he was not the Controlling Officer for the HF project. In this regard, the Controlling Officer was the person who could authorise contracts and expenditure, etc. The only person in that position was the then Chairman of AmCham; and

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- the problem was in the execution, compounded with the short time within which AmCham had to plan, organise and implement the event. As noted in the Inquiry Panel Report, the HF was an extremely ambitious project and time was extremely short. InvestHK knew what the problems were and had drawn them to AmCham's attention. InvestHK had given AmCham its maximum support in putting them right.

### *Risk management and contingency planning*

90. The Committee noted Audit's observation in paragraph 3.28 of the Audit Report that no risk management and contingency plan had been prepared by the Government to formally identify, analyse and address the project risks of the HF. The Committee wondered how InvestHK could ignore such basic management practice in implementing such a high-risk and high-visibility project like the HF.

91. The **DGIP** responded that due to the shortage of time, there was not a formal contingency plan. In the present case, the contingency arrangements were that every time an emergency arose, everyone took immediate action to fix the problem.

### **Keeping the LegCo informed**

92. According to paragraphs 3.23 and 3.24 of the Audit Report, the DGIP had undertaken to keep the Financial Affairs (FA) Panel of the LegCo posted, on a regular basis, of the activities carried out under the Relaunch Campaign. However, he failed to act on his undertaking until he was required to respond to concerns raised by the public over the organisation of the HF at the FA Panel's meeting held on 11 October 2003, which was arranged at the Panel's request. The Committee queried why the DGIP had not diligently discharged his responsibility to keep the LegCo informed on a timely basis, and whether it was because he was on leave then.

93. The **DGIP** replied that his leave coincided with the summer recess of the LegCo. With hindsight, he accepted that he could have requested the FA Panel to call special meetings or could have submitted written reports to the Panel during the summer recess to brief it on the progress of the organisation of the HF.

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94. According to paragraph 3.8 of the Audit Report, it was stated in the FA Panel Paper of 11 October 2003 that, on the approval of a project by the ERWG, the Controlling Officer of the bureau/department concerned would oversee the implementation of the project, and monitor the performance of the outside party, who had been commissioned to carry out the project, where appropriate. On the other hand, the DGIP stated in paragraph 3.20(b) that AmCham had not been “commissioned” by the Government to implement the HF. It appeared to the Committee that, by emphasising that AmCham had not been “commissioned” to implement the HF, the DGIP was suggesting that the Government merely acted as a sponsor for the HF and hence InvestHK only had a limited monitoring role over the event.

95. The Committee asked why it was not mentioned in the FA Panel Paper that there were substantive differences in the Government’s monitoring role between commissioning other Relaunch Campaign projects and just acting as a sponsor for the HF.

96. The **FS** responded that given that \$100 million was a huge sum amounting to 10% of the \$1 billion relaunch fund, the Government had the duty to monitor how it was used, irrespective of whether the HF was a commissioned or sponsored event.

97. The **DGIP** explained that the reference to “commissioned” in paragraph 3.20(b) was only an effort to clarify that the HF was not a government project, but an AmCham project sponsored by the Government. But the requirement to report back to the LegCo was still valid even with a sponsorship arrangement. InvestHK had tried its best to oversee and monitor the implementation of the HF.

98. According to paragraph 5.12(b) of the Audit Report, the DGIP told the FA Panel on 15 November 2003 that “AmCham had already secured broadcast for the whole one-hour TV special by the ABC Channel in US, which had access to 80 million TV homes with a potential audience of 100 to 150 million viewers.....”. However, as revealed in paragraphs 5.15 and 5.18, the TV film was aired on MTV2 and MTV networks, not ABC. In making the airing arrangements, the AmCham representative had even said that “regarding the network, we almost have to live by ‘beggars can’t be choosers’”. In the event, the three airings in the USA had only achieved a total viewership of less than 1 million TV homes, which was less than 1% of the target viewership of 100 million TV homes in the USA.

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99. In the light of the above development, the Committee asked whether the DGIP had confirmed with AmCham the broadcast by the ABC network before advising the LegCo on such arrangement, and whether he had given misleading information to the LegCo.

100. The **DGIP** replied that:

- he did not mean to mislead the LegCo. He had only relayed the information from AmCham's submission. InvestHK had asked and were told that there was a written commitment from the ABC Family cable network, not the free-to-air ABC network. However, he had not seen the letter of commitment;
- he understood that the ABC Family network offered to air the TV film once but MTV networks offered to air it three times. The viewership of the MTV networks was also higher than that of the ABC Family network. Hence, AmCham decided to go for the MTV networks; and
- he said at the FA Panel meeting that the ABC Channel "had access" to 80 million TV homes with a "potential" audience of 100 to 150 million viewers. It was unfortunate that he had used the term "ABC Channel". However, as at that date, the TV special could have been shown on the ABC Family network and, if so, it could have reached 84 million TV homes. Hence, he had not been misleading or factually wrong. As regards the results, he agreed that the ultimate viewership in the USA was extremely disappointing.

101. As regards the reason for the scornful remark that "beggars can't be choosers", the **DGIP** said that the AmCham representative might be referring to the attitude of the free-to-air channels to this kind of programme.

102. In reply to the Committee's enquiry on the same question, **Ms Lucille Barale, Chairman of AmCham**, said in her letter of 20 May 2004, in *Appendix 45*, that the AmCham representative might be referring to the lack of a specified budget for promoting the airing of the film.

103. The Committee also noted that the DGIP had told the FA Panel on 15 November 2003 that the target was to bring the TV film to over 0.5 billion viewers worldwide. To ascertain whether this target could be achieved, the Committee asked about the viewership figures of the film so far.

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104. The **DGIP** informed the Committee, at the public hearings and in his letter of 15 June 2004, in *Appendix 46*, that:

- the figure of 0.5 billion viewers referred to the size of potential TV audience that the TV special could reach;
- following the broadcast of the TV special on the HF in the USA on the MTV2 and MTV channels in January and February 2004 respectively, the same video had been aired locally in Hong Kong on TVB Pearl on 1 May and in 34 countries in Asia and the Middle East in May on the STAR World International and STAR World India channels; and
- according to AC Nielson, the third airing of the video on the MTV channel achieved a viewership of 0.2 million households in the USA, representing about 314,000 viewers. AmCham had advised that the ratings for MTV2 were not released to the public. TVB had advised that there were 136,000 viewers of the local showing. STAR had also advised that the five broadcasts on their channels (two broadcasts on 5 and 6 May on STAR World International and three broadcasts on 19 and 20 May on STAR World India) were seen by 625,000 people in Hong Kong, Singapore, India and metro Manila. STAR World reached 15 million homes in the 34 countries, but it was not possible to quantify the total number of people who watched the TV special as the company did not monitor the viewership in places other than the four mentioned.

### Organisation of the HF

105. Audit pointed out in paragraph 4.11 of the Audit Report that the number of free tickets issued represented 30% of the audience turnout. The Committee was concerned that the distribution of a large number of free tickets gave the impression that the HF concerts were not well received by the market and the distribution of too many free tickets in the earlier concerts could have affected the ticket sales for some of the subsequent concerts. The Committee asked for a breakdown of the 12,000 complimentary tickets distributed by AmCham.

106. In his letter of 6 May 2004 in *Appendix 47*, the **DGIP** said that, according to AmCham, the 12,000 complimentary tickets had mainly been distributed to commercial entities (e.g. shops and restaurants, etc), which were either sponsoring the HF in kind or providing assistance in support of it (e.g. helped distribute flyers and/or put up posters in their premises, etc). Most of these tickets were for the less expensive seats. However, AmCham was not able to provide further details of the breakdown of the distribution.

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### Rolling Stones concerts

107. The Committee was concerned that the chequered events leading to the Rolling Stones concerts had caused much uncertainty and confusion and attracted a lot of negative media attention. As revealed in paragraph 4.25 of the Audit Report and paragraph 4.68 of the Inquiry Panel Report, when AmCham and the DGIP announced at the press conference on 3 September 2003 that the Rolling Stones would be performing in Hong Kong, AmCham had only reached a broad agreement with the Rolling Stones management. No firm commitment had been obtained from the band. The Inquiry Panel also commented that InvestHK should have ascertained from the AmCham representatives the actual state of play before rushing to a premature announcement on the Rolling Stones performance.

108. The Committee asked whether the DGIP was aware that no formal agreement had been signed with the Rolling Stones management when he attended the press conference on 3 September 2003. The **DGIP** responded that:

- he knew at that time that many of the contracts had not been signed and were oral contracts. The announcement was made by AmCham in consultation with InvestHK. It was a direct consequence of the shortness of time. As the time available for putting tickets on sale before the first concert was diminishing, AmCham felt that it could not delay any longer the announcement of the artist line-up for the HF; and
- it was one of Audit's criticisms that there was insufficient time for ticket sales. If the announcement had been delayed beyond 3 September, the situation would have been even worse.

109. In response to the Committee's enquiries, the **Chairman of AmCham** stated in her letter of 20 May 2004 that:

- AmCham understood that the announcement on 3 September 2003 was an indicative list of the talent line-up based on oral commitments; and
- the plans for the Rolling Stones concerts were made in consultation between Mr James Thompson and representatives of the Government. The Rolling Stones concerts were to be a major highlight of the HF. Both concerts had been sold out and thoroughly enjoyed by those who attended. This had been acknowledged in the press coverage.

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110. The Committee noted that there had been press reports that the Rolling Stones might have been overpaid for their appearance at the HF. To ascertain whether AmCham had incurred a substantial loss in staging the Rolling Stones concerts, the Committee asked InvestHK for a breakdown of the expenditure of \$89.1 million for artist fees in the audited accounts of Red Canvas, as well as a specific profit and loss account of the two Rolling Stones concerts.

111. In his letter of 6 May 2004, the **DGIP** stated that:

- regarding the breakdown of the expenditure of \$89.1 million for artist fees, InvestHK understood from AmCham that a confidentiality agreement existed covering all contracts of talents performing in the HF. Therefore, it did not have access to and hence were unable to provide the Committee with the breakdown; and
- AmCham had advised that there were no profit and loss accounts for individual shows of the HF, because a number of overhead costs were spread over the various shows in the festival.

112. Regarding the “confidentiality agreement”, the Inquiry Panel had discovered that, save the Rolling Stones’ contracts, there were no confidentiality clauses in the other artist contracts (paragraph 4.59 of the Inquiry Panel Report).

113. In the circumstances, the Committee asked whether the DGIP agreed with the Inquiry Panel’s comment that he had over relied on what he heard from the HF organisers without seeking documentary details. The **DGIP** responded that:

- the statement made in his letter of 6 May 2003 was factually correct. As noted by the Inquiry Panel, there was indeed a confidentiality provision covering the artists’ fees, but it was not in the artists’ contracts themselves. It existed in the talent acquisition agreement between Red Canvas and East Art International Limited (the western talent coordinator for the HF); and
- the then AmCham Chairman had informed InvestHK in writing that the artists’ fees were covered by a confidentiality clause, although he had not specified where the clause existed. InvestHK had only conveyed to the Committee the information provided by the then AmCham Chairman.



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114. The Committee also understood from paragraph 4.79 of the Inquiry Panel Report that the FS, upon reading the press report about the high fees for the Rolling Stones, had asked for an explanation from the DGIP. The Committee asked about the details of the meeting.

115. The FS responded that:

- there was a report in the English press in August 2003 that the Rolling Stones might have been overpaid. Therefore, he asked the DGIP for an explanation. He was not given a satisfactory answer and was told that there was a confidentiality clause in the artists' contracts. The Inquiry Panel had now confirmed that there was indeed a confidentiality clause in the contracts of the Rolling Stones; and
- his understanding at that time was that the original promoter of the Rolling Stones concerts had requested government sponsorship to stage the event but was unsuccessful. Subsequently, she complained about the high fees for the Rolling Stones. He had not ascertained whether this was true or not because at that time he did not realise that there would be upcoming problems over the staging of the concerts. In fact, the AmCham representatives made a presentation of the HF to the ERSG on 1 September 2003 and informed the meeting that the programme line-up had been confirmed. He thus had the impression that the overall situation was under their control.

116. Based on the information available, the Committee calculated that the artist fees for the Rolling Stones would amount to some \$40 million. The Committee asked how this figure compared to the amount of sponsorship requested by the original promoter.

117. The DGIP said at the public hearings and in his letter of 27 May 2004, in *Appendix 48*, that:

- the original promoter's first proposal, dated 8 July 2003, quoted a total fee of HK\$50.57 million (US\$6.48 million) for the Rolling Stones to perform two shows at the Hong Kong Stadium, including artist fee, staging and production and freight and airfares. The anticipated deficit for the two shows was in excess of HK\$18 million, and she was seeking government sponsorship to offset it; and

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- she submitted later in the same month (July 2003) a revised proposal for a single show by the Rolling Stones, again at the Hong Kong Stadium. This time, the quoted total fee was substantially reduced to HK\$24.12 million. She was seeking government subsidy in the order of HK\$6 million.

### Follow-up actions

118. Noting that the Inquiry Panel Report had raised a number of questions concerning the accounts of the HF, the Committee asked whether the Administration would:

- consider referring the Inquiry Panel Report to any law enforcement agencies for investigation; and
- request AmCham to fully cooperate with Audit to facilitate the conduct of a value-for-money audit on Red Canvas and any records relating to the HF held by AmCham and the project subcontractors.

119. In his letter of 15 June 2004, the **DGIP** advised that:

- the Administration had referred the Inquiry Panel Report to the Police for further follow-up action as deemed necessary. The Independent Commission Against Corruption was also carrying out an investigation; and
- InvestHK had written to AmCham on 27 May 2004 requesting permission for the Director of Audit to have access to the records of AmCham and Red Canvas on matters relating to the HF. It was still awaiting a formal reply from AmCham, but had been advised that both AmCham and Red Canvas were prepared to allow access to the same files as examined by the Inquiry Panel.

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

### Project conceptualisation and approval

- expresses grave dismay that the Economic Relaunch Working Group (ERWG) had put a substantial amount of public fund at risk as early as the inception stage of the event by approving too hastily the American Chamber of Commerce in Hong Kong (AmCham)'s proposal for the Government to sponsor the Harbour Fest (HF), in that it:

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- (a) failed to thoroughly assess the complexity and risks involved, as well as the benefits, before agreeing to support the proposal in principle;
  - (b) failed to ask for a proper business plan from AmCham, thus depriving itself of the detailed information required (such as market analysis, risk assessment and human resource plan) for conducting a proper project appraisal;
  - (c) failed to call for the views of experts within the relevant departments on the feasibility of the HF despite the initial reaction of the departments that the project was rather ambitious;
  - (d) appointed the Invest Hong Kong (InvestHK), which had little hands-on experience in organising such mega event, as the subject department without considering other available options; and
  - (e) failed to explore the options of organising the concerts in-house, outsourcing to the private sector through a competitive selection process or co-organising the HF with AmCham;
- notes that the Financial Secretary (FS) has accepted Audit's observation that the ERWG had not fully examined the concept viability, the timeframe for organising the concerts, the timeframe for promotion and ticketing, and the organising ability of AmCham, before it accepted AmCham's proposal for the Government to sponsor the HF;

### **Project monitoring**

- condemns the Director-General of Investment Promotion (DGIP) for the reasons that he:
  - (a) failed to take positive steps to consult the government bureau and departments with expertise in the entertainment field, engage outside experts in the show business, or make reference to their relevant practices during the critical initial stages of budget-vetting and monitoring processes;
  - (b) failed to seek the Department of Justice (DoJ)'s advice on the three Memoranda of Understanding (MOUs) with AmCham, which are legally binding;

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- (c) rejected the DoJ's advice to include in the agreement with AmCham provisions for access to documents in AmCham's possession; and
- (d) failed to adhere to the basic management principles and to put in place an appropriate system of cost control or monitoring to oversee the project. In particular, he:
  - (i) failed to adequately supervise InvestHK in the discharge of his responsibilities over the HF, which was evidenced by:
    - the fact that he was absent from Hong Kong for 60 days during the three-month period leading up to the HF; and
    - his ignorance of the fact that two legally binding MOUs were signed during his absence and \$50 million were paid to AmCham;
  - (ii) failed to conduct any due diligence checks on AmCham and Red Canvas Limited and to inquire into AmCham's ability to pay the difference between the cost of the HF and the government sponsorship;
  - (iii) failed to ensure that there were proper risk management and contingency planning on the HF; and
  - (iv) chose to rely on a liberal interpretation of "sponsorship" in order to justify his monitoring the HF from a distance;
- concurs with the FS that irrespective of whether the HF is financed by the Government through sponsorship or other modes of subvention, the responsibilities of the Controlling Officers remain the same as those provided in FCir No. 1/2004, i.e. they should satisfy themselves that an appropriate system of cost control or monitoring is in place;
- expresses serious dismay that the ERWG:
  - (a) failed to carry out appropriate supervision over such crucial matters as InvestHK's scrutiny of the budget for the HF and the InvestHK's monitoring of the actual progress of the organisation of HF;

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- (b) failed to ensure that the DGIP exercise the appropriate level of supervision over the sponsorship of the HF which is effectively close to its full cost; and
- (c) had not considered downsizing the scale of the HF;

### **Keeping the Legislative Council (LegCo) informed**

- expresses serious dismay that the DGIP failed to discharge his responsibility to keep the LegCo informed by providing reliable and complete information in a timely manner, in that he:
  - (a) failed to act on his undertaking to keep the LegCo informed on a regular basis until 11 October 2003 when he was required to respond to concerns raised by the public over the organisation of the HF;
  - (b) misled the LegCo into believing that AmCham had already secured the broadcast of the whole one-hour TV special by the ABC Channel in the USA and that the film would be brought to 0.5 billion viewers worldwide, which ultimately did not materialise; and
  - (c) failed to inform the LegCo that there were substantive differences in the Government's monitoring role between commissioning other Relaunch Campaign projects and just acting as a sponsor for the HF;
- notes that the DGIP has accepted that he could have requested the Financial Affairs Panel to call special meetings or submitted written reports to the Panel during the summer recess of the LegCo, to brief the Panel about the HF;

### **Organisation of the HF**

- expresses serious concern that:
  - (a) although the HF was expected to generate positive publicity, the vast majority of the media reports on the HF were negative;
  - (b) the overall audience turnout rate for the HF concerts was only 61%, including 18% being holders of free tickets;
  - (c) the ticket sales position was not satisfactory as tickets sold represented only 43% of the total capacity of all concerts, with the number of tickets sold for individual concerts varying from 15% to 89% of concert capacity;

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- (d) the distribution of a large number of free tickets, amounting to 30% of the audience turnout, gave the impression that the concerts were not well received by the market and the distribution of too many free tickets in the earlier concerts could have affected the ticket sales for some of the subsequent concerts;
  - (e) the three months allowed for the organisation of the HF, involving a total of 16 high profile performances by international, regional and local artists, were grossly inadequate;
  - (f) because of the insufficient time for organising the HF, the programme line-up was only completed at a very late stage, which in turn affected the time allowed for the promotion of individual artists and the time available for ticket sales; and
  - (g) the significant changes in the line-up of artists had resulted in the late completion of the final programme line-up which affected the time allowed for the promotion of individual performances and the time available for ticket sales;
- acknowledges the assurance by the FS that the Administration will follow up the outstanding tasks that require monitoring by the Government;

### **Rolling Stones concerts**

- expresses serious concern that:
  - (a) the Rolling Stones concerts were included late in the programme line-up for the HF in late August 2003, leaving little lead time for the smooth organisation of concerts of such high international profile;
  - (b) the concerts had caused uncertainty and confusion and attracted a lot of negative media attention, which gave the impression that the organising of the concerts was not well coordinated; and
  - (c) in organising these concerts, AmCham incurred a substantial loss at taxpayers' expense, although the number of tickets sold was 25% of the overall tickets sold for the HF concerts, and their audience turnout was 19% of the total audience turnout;

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### **Evaluation of the HF**

- expresses dismay that the agreement between AmCham and the Government only required the delivery of a programme of events and the TV production without providing safeguards and measurable criteria to ensure that the stated objectives of the HF (i.e. boosting local morale and consumption, boosting tourism and promoting Hong Kong to international and Mainland communities) would be achieved. In the event, the Government's interests were left unprotected in that:
  - (a) the HF concerts had fallen short of expectations and some of the concerts were not well attended;
  - (b) the TV film was not aired on the ABC network and the three airings in the USA only achieved less than 1% of the target viewership; and
  - (c) to date, the viewership of the TV film worldwide has been far lower than the target viewership;

### **Follow-up actions**

- urges InvestHK to liaise with AmCham to make arrangements for the Government to have access to all HF records of AmCham, Red Canvas Limited and the project subcontractors, in order to facilitate any necessary follow-up actions by the Government and the Audit Commission;
- invites the Director of Audit to consider conducting a value for money audit on other events and activities sponsored by InvestHK to ensure that they did not similarly suffer from the lack of proper cost control;
- urges the Administration to consider taking disciplinary action against the DGIP, having regard to the gravity of his failure in discharging his duties; and
- wishes to be kept informed of the developments in following up the outstanding tasks of the HF and the progress on the implementation of Audit's recommendations.

## Chapter 5

### Provision of aquatic recreational and sports facilities

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Audit conducted a review to examine the provision and management of aquatic recreational and sports facilities by the Leisure and Cultural Services Department (LCSD) and to ascertain whether there were areas for improvement.

#### Gazetted beaches

2. According to paragraph 2.4(a) of the Audit Report, a consultant, who carried out a coastal safety audit on the beaches of Hong Kong in 2000, had advised that the Rocky Bay Beach should be deleted from the list of gazetted beaches because of safety reason and low usage. However, the LCSD considered that de-gazetting beaches was a sensitive issue and decided not to take further action. The Committee asked about the sensitivity of the de-gazetting and whether the LCSD would de-gazette the beach.

3. In response, **Ms Anissa WONG Sean-ye, Director of Leisure and Cultural Services**, said that:

- in deciding to close the Rocky Bay Beach because of its poor water quality, the Administration had considered whether the beach should be de-gazetted. At that time, the Administration was of the view that it should consider the development of the beach water quality. It was also concerned that the relevant District Council and beach goers might consider that they might need to observe the development of the issue for a period of time; and
- taking into account the current situation of the water quality, the usage of the beach, as well as other factors, such as the usage rate of the Shek O Beach, the LCSD agreed in principle to Audit's recommendation that the Rocky Bay Beach be de-gazetted. The LCSD would seek the views of the relevant District Council on the proposed de-gazetting of the beach.

4. Noting that some of the gazetted beaches in Tsuen Wan District were closed because the water quality of these beaches had deteriorated following the full commissioning of the Stage 1 of the Harbour Area Treatment Scheme (HATS), the Committee asked whether the LCSD had forewarned or warned the public about the matter.

5. **Mr Paul CHEUNG Kwok-kee, Assistant Director of Leisure and Cultural Services (Leisure Services) 1**, said that the LCSD was not aware in advance of the adverse impact of the Stage 1 of the HATS. As the water in these beaches was shallow, rainfall might bring pollutants from the land to the beaches. As a result, the beach water quality



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was affected. As the beach water quality was affected by many environmental factors, the LCSD, in consultation with the Environmental Protection Department (EPD), monitored the water quality regularly and, through posting prominent notices on the beaches, advised beach goers whether the current beach water quality was good, fair or poor.

6. The Committee noted that the seven gazetted beaches in Tsuen Wan District had been closed. Although Table 4 in paragraph 2.4(b) of the Audit Report showed that the daily average number of beach goers at these beaches in 2002 was low, beach goers still went to these beaches. The Committee asked:

- about the actions taken by the LCSD to make these beaches suitable for public use; and
- how the health of the beach goers could be safeguarded, and what actions the LCSD had taken to ensure that the public did not swim at these beaches.

7. The **Assistant Director of Leisure and Cultural Services (Leisure Services) 1** responded that:

- the LCSD, the EPD and the Drainage Services Department would join together to improve the water quality of these beaches. The LCSD did not de-gazette these beaches as it saw the public need for them. It hoped that the beaches would be reopened as soon as possible; and
- as a result of the closure of these beaches, the LCSD had advised the public not to swim there. Because the public took heed of the LCSD's advice, the number of beach goers was low. This showed the LCSD's efforts in safeguarding the health of the beach goers.

8. The Committee further asked about the facilities provided as an alternative to the closed gazetted beaches in Tsuen Wan District.

9. The **Assistant Director of Leisure and Cultural Services (Leisure Services) 1** responded that apart from beaches, the LCSD also provided swimming pools which could meet part of the public's swimming needs. The LCSD hoped that the water quality of the closed beaches could be improved as soon as possible so that the beaches could be reopened for public use.

## Provision of aquatic recreational and sports facilities

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10. The **Director of Leisure and Cultural Services** added that:

- subject to the conditions of the surrounding environment, the LCSD would provide these beaches with recreational facilities such as barbecue pits. The beaches were, however, unsuitable for swimming due to a number of factors such as poor water quality. The LCSD had liaised with the relevant government departments on whether there were other improvement measures. It had reminded the public of the water quality of these beaches and of the alternative facilities such as swimming pools; and
- in fact, the overall patronage of the beaches was decreasing while that of the swimming pools was on the rise. This might reflect the different choices of swimmers or the effects of other factors. The LCSD would not reopen the beaches while their water quality was below standard. Apart from urging the relevant departments to improve the water quality, the LCSD met the public's swimming needs by providing other facilities and extending the opening hours of swimming pools, etc.

11. The Committee further asked for documents showing that the LCSD:

- had conveyed to the relevant government departments its concern that four gazetted beaches in Tsuen Wan District were closed because the water quality of these beaches had deteriorated upon the full commissioning of the Stage 1 of the HATS, and had urged for expedient completion of the improvement works concerned; and
- had sought additional resources for the provision of aquatic recreational and sports facilities in view of the closure of the above beaches, and had taken measures to promote the availability of such facilities.

12. In her letter of 18 May 2004, in *Appendix 49*, the **Director of Leisure and Cultural Services** advised that:

- the LCSD was not aware in advance of the adverse impact of the Stage 1 of the HATS on the water quality of the gazetted beaches in Tsuen Wan District. On 15 January 2003, the LCSD asked the EPD to provide it with a report on the water quality of the gazetted beaches to enable it to determine the opening arrangement of beaches in the swimming season of 2003. This was a normal step to take annually. The EPD informed the LCSD on 22 January 2003 that the water quality of the seven beaches in Tsuen Wan District had

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deteriorated as a result of the commissioning of the Stage 1 of the HATS and recommended closing all the seven gazetted beaches along the coastal line of Tsuen Wan;

- in anticipation that the Tsuen Wan District Council (TWDC) would have strong reaction to the closure of the beaches, the LCSD expressed its concern to the EPD and requested it to attend the relevant committees of the TWDC in February and March 2003 to explain to the TWDC members the reasons for the deterioration of the water quality and the subsequent closure of these beaches. At a meeting of one of the committees of the TWDC, the EPD admitted that it had not anticipated the deterioration of water quality in Tsuen Wan beaches upon the full commissioning of the Stage 1 of the HATS;
- in view of the closure of the four gazetted beaches, the LCSD had, at the TWDC meetings held in February and March 2003, promoted the use of a number of nearby swimming facilities such as the Ma Wan Tung Wan Beach in Tsuen Wan District and the five beaches in Tuen Mun District, namely the Butterfly, the Kadoorie, the Cafeteria Old, the Cafeteria New and the Golden Beaches. In addition, the LCSD had, also at the same meetings, promoted the use of two public swimming pools in Tsuen Wan, namely the Shing Mun Valley Swimming Pool and the Tsuen King Circuit Wu Chung Swimming Pool; and
- improvement works at the Ma Wan Tung Wan Beach, including re-sanding, renewal of shark prevention net and refurbishment of the beach building, were completed in April and May 2004. The LCSD had set up two new beach volleyball courts at the Lido Beach in July 2003 to promote the use of land based facilities. In addition, the LCSD had produced pamphlets and booklets to introduce the public swimming pools and gazetted beaches managed by it. At the same time, information on these facilities was uploaded to the web page of the LCSD for publicity.

13. The Committee noted from paragraphs 2.5 to 2.7 of the Audit Report that in 2002-03, the LCSD provided 35 established posts (six Amenities Assistant (AA) IIIs and 29 Lifeguards) for eight closed gazetted beaches and redeployed the 29 lifeguards to fill other vacant posts. Audit recommended that the LCSD should consider deleting the lifeguard posts and critically review the need and cost-effectiveness of deploying AA IIIs. In response, the Director of Leisure and Cultural Services said that the 29 lifeguard posts had already been frozen. The lifeguards originally filling the posts had been redeployed to fill other vacant posts. If these posts were deleted and the beaches were eventually reopened, new posts would have to be separately created. The LCSD did not see the advantage of

## Provision of aquatic recreational and sports facilities

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deleting the posts at this stage. The department would review the cost-effectiveness of deploying AA IIIs stationed at beaches with low attendance and primitive facilities and the need to retain the AA III post at the Rocky Bay Beach.

14. In view of the fiscal deficit and the absence of a firm timing on the reopening of these beaches, which depended on, inter alia, the progress of the Stage 2 works of the HATS, the Committee queried whether there was a need to retain the lifeguard posts. It therefore asked:

- whether the lifeguard posts would be deleted; if so, when the deletion would be done; if not, the reasons for that; and
- when the review of the cost-effectiveness of deploying six AA IIIs at the eight beaches would be conducted.

15. In her letter of 18 May 2004, the **Director of Leisure and Cultural Services** said that:

- in consideration of the recent advice from the EPD that the Stage 2 works of the HATS for improvement of the beach water quality of Tsuen Wan District would take at least 30 months to complete, the LCSD agreed that the lifeguard posts were unlikely to be filled in the near future and the LCSD would delete them; and
- the LCSD had reviewed the cost-effectiveness of deploying six AA IIIs at the eight beaches. The AA III originally stationed at the Rocky Bay Beach had already been redeployed to the Shek O Beach. One AA III would be retained to carry out daily management of the seven beaches in Tsuen Wan District and the other four would be deployed to other leisure venues as soon as possible.

16. According to paragraph 2.12 of the Audit Report, the LCSD would seek the Southern District Council's support before implementing Audit's recommendation to the effect that the less frequently used urban beaches should be closed from November to March each year. However, in response to Audit's recommendation that it should examine whether the Kiu Tsui Beach on Sharp Island in Sai Kung should continue to be designated as a gazetted beach, the LCSD did not mention whether it would consult the relevant District Council in its consideration of whether to de-gazette the beach. It therefore appeared to the Committee that the LCSD adopted two different approaches to this matter.

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The Committee considered it important that the relevant District Council's views should be sought. It asked when the LCSD would consult the relevant District Council on the respective proposals regarding the urban beaches and the Kiu Tsui Beach.

17. The **Assistant Director of Leisure and Cultural Services (Leisure Services) 1** explained that the LCSD would consult the Southern District Council on the proposal regarding the urban beaches within two to three months' time. On the proposal regarding the Kiu Tsui Beach, there was a private-sector initiative of developing Sharp Island into a resort. Although there was no problem in the beach water quality, the beach condition was not satisfactory. In fact, the patronage of the Kiu Tsui Beach was decreasing. De-gazetting of the Kiu Tsui Beach would be considered in the future development of Sharp Island in one go. The LCSD would inform the relevant District Council shortly of the development plan and consult it on the matter.

18. The Committee asked whether there was flexibility in deploying staff to man those beaches the patronage of which was low on weekdays but high on Saturdays, Sundays and public holidays, so that the staffing level at these beaches was commensurate with the patronage.

19. The **Assistant Director of Leisure and Cultural Services (Leisure Services) 1** responded that the patronage of some beaches, e.g. the Hairpin Beach, was low on weekdays. In fact, there were hardly any swimmers at the Hairpin Beach on weekdays. As such, the LCSD did not provide these beaches with lifeguards except on Saturdays, Sundays and public holidays.

20. In response to the Committee's enquiry, the **Assistant Director of Leisure and Cultural Services (Leisure Services) 1** confirmed that the LCSD had a policy to close these beaches on weekdays and open them on Saturdays, Sundays and public holidays.

### Swimming pool complexes

21. According to paragraph 3.13 of the Audit Report, in the planning of new swimming pool complexes, the LCSD would provide indoor heated pools instead of outdoor heated pools. The Committee noted that a number of heated pools, the financial proposals for which had been approved by the Legislative Council, would be built in future. It asked whether such pools would be indoor heated pools or indoor heated pools converted from outdoor ones by the provision of a light-weight cover.

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22. The **Assistant Director of Leisure and Cultural Services (Leisure Services) 1** replied that two indoor heated swimming pools, one in Tai Kwok Tsui and the other in Hin Tin, would be built. As the public had an increasing interest in swimming during winter months, the LCSD considered that more indoor heated pools should be built to meet their needs. In contrast, the demand for outdoor heated pools was low. As such, the LCSD had plans to convert outdoor heated pools into indoor ones by providing a light-weight cover.

### Provision of lifeguards

23. According to paragraphs 5.20 and 5.21 of the Audit Report, the difference in the daily cost of using one volunteer lifeguard and employing one temporary lifeguard was small. In view of the low turnout rates of volunteer lifeguards, Audit considered that the LCSD needed to examine the cost-effectiveness of using the volunteer lifeguards. The Committee asked about the progress of the LCSD's examination.

24. The **Assistant Director of Leisure and Cultural Services (Leisure Services) 1** responded that the LCSD had informed the Hong Kong Life Saving Society (HKLSS) that it had stopped using HKLSS's volunteer lifeguards. In the light of the small difference in the cost of using volunteer lifeguards and employing temporary lifeguards, and the fact that the service provided by volunteer lifeguards was training for them to gain experience and acquire higher qualification for life saving, the LCSD considered that the service of HKLSS's volunteer lifeguards should be voluntary in nature and they should not earn daily honorarium at the current high rate. As such, the LCSD had asked the HKLSS to reduce the rate.

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

#### Gazetted beaches

- expresses concern that in 2002-03, the Leisure and Cultural Services Department (LCSD) provided 35 established posts [6 Amenities Assistant (AA) IIIs and 29 Lifeguards] for eight closed gazetted beaches and redeployed the 29 lifeguards to fill other vacant posts. The eight closed beaches were still manned by six AA IIIs at a staff cost of \$1.6 million in 2002-03;

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- notes that:
  - (a) the LCSD will delete the 29 lifeguard posts;
  - (b) the LCSD has reviewed the cost-effectiveness of deploying six AA IIIs at the eight beaches. The AA III originally stationed at the Rocky Bay Beach has already been redeployed to the Shek O Beach. One AA III will be retained to carry out daily management of the seven beaches in Tsuen Wan District and the other four would be deployed to other leisure venues as soon as possible;
  - (c) the Director of Leisure and Cultural Services intends to implement Audit's recommendations in paragraphs 2.6(a) and (d), 2.11 and 2.17 of the Audit Report; and
  - (d) the Administration will take interim and long-term measures to improve the water quality of the gazetted beaches in Tsuen Wan District, which has deteriorated after the full commissioning of the Harbour Area Treatment Scheme Stage I;
- considers that the Administration has the responsibility to improve the water quality of the gazetted beaches in Tsuen Wan District in order that they can be re-opened for public use;
- recommends that the Director of Leisure and Cultural Services should consult the relevant District Councils (DCs) and the Legislative Council (LegCo) before deciding whether measures should be taken to de-gazette the Rocky Bay Beach;

### **Swimming pool complexes**

- expresses concern that:
  - (a) for swimming pool complexes, the admission fee in the New Territories for non-peak days is lower than that for peak-days, but the admission fees in the urban areas are the same for both peak and non-peak days; and
  - (b) the review on subsidy levels and cost recovery rates for the different types of leisure and cultural services has not been carried out;

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- notes that the Director of Leisure and Cultural Services intends to implement Audit's recommendations in paragraphs 3.7, 3.16, 3.21 and 3.25 of the Audit Report;
- recommends that the Director of Leisure and Cultural Services should consult the relevant DCs and the LegCo before deciding whether measures should be taken to adjust the admission fees for all swimming pool complexes, shorten the opening hours of outdoor heated pools where the usage is low, and close in November the five swimming pool complexes which are not provided with heated pools;

### **Water sports centres**

- expresses concern about:
  - (a) the absence of a fairer basis for assessing the enrolment rate of water sports centres to provide better management information;
  - (b) the low usage of the Chong Hing Water Sports Centre and the Jockey Club Wong Shek Water Sports Centre, as well as the problem of congestion at the St. Stephen's Beach Water Sports Centre and the Tai Mei Tuk Water Sports Centre; and
  - (c) the availability of spare craft hours at the four water sports centres;
- notes that the Director of Leisure and Cultural Services will implement Audit's recommendations in paragraphs 4.15 and 4.21 of the Audit Report;

### **Provision of lifeguards**

- expresses concern that:
  - (a) in 2003, the number of core lifeguards exceeded the optimal size of the core life-saving workforce. During the peak swimming months from June to August 2003, the highest number of lifeguards employed was 1,887, which comprised 980 core lifeguards and 907 non-core lifeguards. The optimal size of the core life-saving workforce should be 944;
  - (b) the core to non-core lifeguard ratios of the 18 Type 1 swimming pool complexes during the peak swimming months in 2002-03 varied considerably, ranging from 0.5:1 to 1.9:1;



## **Provision of aquatic recreational and sports facilities**

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- (c) the highest average numbers of swimmers per lifeguard during the peak swimming months in 2002-03 for the 18 Type 1 swimming pool complexes varied significantly;
  - (d) during the non-peak swimming months in 2002-03, the daily average patronage of the Mui Wo Swimming Pool and the Sai Kung Swimming Pool were 51 and 218 respectively. Notwithstanding such low patronage, monthly-rated temporary lifeguards were also employed at these complexes;
  - (e) the operating deficit of the Mui Wo Swimming Pool was \$6.5 million in 2002-03; and
  - (f) the operating deficit of the Sai Kung Swimming Pool was \$19 million in 2002-03;
- notes that the Director of Leisure and Cultural Services will implement Audit's recommendations in paragraphs 5.17 and 5.22 of the Audit Report;

### **Deployment of surplus staff during the winter months**

- expresses concern that:
  - (a) there was inadequate assurance that the 521 surplus lifeguards and 66 surplus filtration plant artisans were gainfully employed during the winter months in 2002-03. Work records of the mandays spent on individual tasks were not properly maintained in some districts and there were no laid down monitoring procedures on the winter works programme;
  - (b) during the winter months in 2002-03, the participation rate of the surplus lifeguards and filtration plant artisans in the cross-branch/district programme was unsatisfactory; and
  - (c) when most of the gazetted beaches and swimming pool complexes were closed during the winter months in 2002-03, 140 surplus AA grade staff might also be underemployed because of the much reduced workload at their venues;
- notes that the Director of Leisure and Cultural Services will implement Audit's recommendations in paragraph 6.8 of the Audit Report; and

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### **Follow-up actions**

- wishes to be kept informed of:
  - (a) the progress on and results of the implementation of the interim and long-term measures to improve the water quality of the gazetted beaches in Tsuen Wan District; and
  - (b) the progress on the implementation of Audit's recommendations mentioned in paragraphs 2.6(a) and (d), 2.11, 2.17, 3.7, 3.16, 3.21, 3.25, 4.15, 4.21, 5.17, 5.22 and 6.8 of the Audit Report.

## Chapter 6

### **Training, employment and residential services for people with disabilities**

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Audit conducted a review to examine the economy, efficiency and effectiveness of the provision of training, employment and residential services for people with disabilities by the Social Welfare Department (SWD) and by non-governmental organisations (NGOs) receiving government subventions.

#### **Provision of training, employment and residential services**

2. According to Table 3 in paragraph 2.11 of the Audit Report, the average unit costs of training, employment and residential services provided by the SWD exceeded those of NGOs by 7% to 57%. As stated in paragraph 2.14(b), the SWD had prepared an action plan to transfer the operation of one day activity centre, two sheltered workshops, one hostel for moderately mentally handicapped persons and one hostel for severely mentally handicapped persons to NGOs by April 2004. The Committee asked about the progress so far and the reasons for the high costs of the services provided by the SWD.

3. **Miss Ophelia CHAN, Assistant Director of Social Welfare (Rehabilitation and Medical Social Services (R&MSS))**, replied that:

- since mid-2003, the SWD had outsourced to NGOs the operation of three sheltered workshops, one day activity centre, one day activity centre cum hostel, and one hostel for moderately mentally handicapped persons;
- as at May 2004, the SWD still ran two sheltered workshops, each of which was paired up with a hostel for moderately mentally handicapped persons. At present, the SWD had no plan to outsource these hostels as some of the places were required for providing emergency places and performing a statutory function of place of refuge for disabled children. Moreover, if the SWD was to outsource these service units, the SWD staff working there would be affected; and
- the unit costs of SWD-run services were high as the costs of SWD staff who worked there, such as Social Work Assistant and Senior Social Work Assistant, were higher than those of NGOs. Some sheltered workshops which were paired up with hostels were supervised by staff at officer grade. Moreover, the SWD's hostels were of a large scale and provided services for people with a higher degree of disabilities. More facilities and more healthcare personnel were required, resulting in higher costs.

## **Training, employment and residential services for people with disabilities**

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4. **Mr Paul TANG Kwok-wai, Director of Social Welfare**, supplemented that the SWD would keep in view the possibility of outsourcing its remaining service units, having regard to the capability of the department in redeploying affected staff and the availability of alternative service providers in the rehabilitation sector.

5. The Committee was concerned that, as stated by the SWD in paragraph 2.14(c), not all the savings resulting from the closure of the SWD's service units could be realised because it had to absorb the surplus staff until they retired. The Committee asked whether:

- the SWD had considered transferring its surplus staff to other government departments or NGOs so as to realise the savings;
- SWD staff were eligible for the voluntary retirement scheme; and
- any SWD staff were idle due to the outsourcing of the service units.

6. The **Director of Social Welfare** responded that:

- it had been the SWD's practice to give priority to absorbing its staff affected by outsourcing through internal redeployment. While the SWD would also consider the possibility of transferring surplus staff to other departments, there was not much room for doing so. Other departments were also under pressure to reduce their manpower and they might not have suitable job types for SWD staff;
- transferring SWD staff to NGOs would involve a lot of complicated issues, such as the willingness of the NGOs and the affected staff to accept such arrangement. As it was a policy issue, he would have to consult the Civil Service Bureau (CSB); and
- some SWD staff had joined the voluntary retirement scheme. No SWD staff was left idle. All the staff members affected by outsourcing had been redeployed to other posts within the department. However, such a problem might arise eventually if the SWD continued to outsource its remaining service units.

7. The Committee enquired whether the CSB could assist the SWD in transferring its surplus staff to NGOs or other government departments, so as to help it realise the savings resulting from the closure of its service units.

## **Training, employment and residential services for people with disabilities**

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8. In his letter of 21 May 2004 in *Appendix 50*, the **Secretary for the Civil Service** stated that:

- the CSB had confirmed with the SWD that there was at present no need to transfer any of its surplus staff to NGOs or other government departments as all of them had been gainfully redeployed within the department to meet new service needs. Notwithstanding this, if such a need arose in future, the CSB would assist in identifying redeployment opportunities elsewhere in the civil service to accommodate the surplus staff as far as practicable; and
- as regards the suggestion to transfer surplus staff to NGOs, it involved quite a number of issues such as whether the NGOs were prepared to take on the surplus staff, funding arrangement, and staff sentiments.

9. The Committee noted from Table 4 in paragraph 2.15 of the Audit Report that as at 31 March 2003, the average waiting time for admission to a long-stay care home was 102 months. The Committee considered it unsatisfactory that people had to wait for more than eight years and queried whether the SWD had any plan to shorten the long waiting time.

10. The **Assistant Director of Social Welfare (R&MSS)** responded that:

- long-stay care homes were provided for ex-mentally ill persons who were discharged from hospitals after receiving treatment but were not yet able to lead an independent life. As the discharge rate for such homes was low, very few vacant places were available;
- to meet the demand, the SWD had allocated resources to increase the supply of long-stay-care-home places. 400 new places would be provided by the end of 2004. In order to reduce the number of applicants on the waiting list for long-stay care homes, the SWD had, in collaboration with the Hospital Authority (HA), conducted a review on the condition of the applicants on the waiting list to examine their genuine need for the service. The department had also stepped up the outreach service for ex-mentally ill persons who were staying at home; and
- in order to raise the discharge rate for long-stay care homes, thereby increasing supply, the SWD encouraged the residents of such homes to settle in the community through compassionate rehousing or to move to halfway houses. It had also identified other service options for these people, such as

## **Training, employment and residential services for people with disabilities**

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self-financing hostels at the ex-staff quarters of the Castle Peak Hospital for those who could afford them. The social workers of voluntary agencies and other healthcare personnel near the Castle Peak Hospital could provide support and follow-up service.

11. The Committee asked what the waiting time would be after all the above measures had been implemented. The **Assistant Director of Social Welfare (R&MSS)** replied that:

- according to the latest information, there were 919 applicants on the waiting list. About 20 persons had been admitted so far in 2004 and they had waited for about 86 months, i.e. about seven years; and
- unless the SWD was given new resources for providing more places for such service, there was bound to be a gap between supply and demand.

12. The Committee pointed out that the waiting time was still too long. It enquired whether there were many applicants who died while waiting for the service and whether the SWD would strive for more resources to increase long-stay-care-home places.

13. The Committee was also concerned that there might be some applicants for long-term residential care service who were forced to stay in hospitals before they were admitted to long-stay care homes. In particular, the cost of taking care of such persons in the hospital setting would be higher than that in the rehabilitation setting. The Committee asked whether this was the case.

14. The **Director of Social Welfare** and the **Assistant Director of Social Welfare (R&MSS)** responded that:

- some applicants had to stay in hospitals as assessed by doctors or social workers. They might require long-term care service and thus had to apply for admission to long-stay care homes. Among the 900 odd applicants on the waiting list, about 170 persons were above the age of 60 while more than 700 were below 60. Many of the ex-mentally ill persons belonged to the middle-age group;

## **Training, employment and residential services for people with disabilities**

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- in order to shorten the waiting time for long-stay care homes, the SWD had all along tried to provide more new places. In this regard, 400 new places had been provided recently to meet the demand. All these places would be allocated by June 2005. However, while the waiting list would be shortened by these 400 places, it would continue to grow at the same time with the addition of several dozens of new applicants every month;
- the SWD accepted Audit's recommendation to allocate more resources to such service when new resources were available. It would reflect to the bureau the need for new resources. As far as the SWD was concerned, it would have to allocate its resources having regard to all the services provided by the department; and
- to achieve cost-effectiveness in the use of resources, the SWD had been reviewing with the HA the condition of the waitlistees to determine whether they were genuinely in need of the service. The SWD would only put an applicant on the waiting list if his/her family could not provide the necessary support and care at home. Of the 900 odd people currently on the waiting list, 600 had been identified as having genuine need for the service and were already in hospitals. The other 300 were in the community and had been waiting for a long time. These 300 people might be able to continue to settle in the community with strengthened community support. The SWD would review the situation when it began to allocate the 400 new places at the end of 2004.

15. To ascertain whether the SWD could speed up the admission of in-patients to long-stay care homes so as to reduce the overall resources spent on taking care of such people, the Committee enquired:

- whether an arrangement could be made between the HA and the SWD whereby the transfer of an applicant for long-term residential care service from a hospital to a long-stay care home would be accompanied by a corresponding budget transfer from the HA to the SWD;
- about the cost differential between taking care of a person in need of long-term residential care service in a hospital and in a long-stay care home; and
- about the amount of saving that could be achieved if all the applicants on the waiting list for the long-term residential care service and who were in hospitals were admitted to long-stay care homes.

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16. The **Secretary for Health, Welfare and Food** advised, in the letter of 15 June 2004 in *Appendix 51*, that:

- at present, the average cost of treating an extended care patient in a HA hospital was about \$1,260 per day. The unit cost of a residential place in a long-stay care home receiving subvention from the SWD was about \$304 per day. Based on these cost estimates, the difference was \$956 per day. It should be noted that the service needs of patients and residents of long-stay care homes were very different and this was reflected in the different costs of providing extended care in the hospital and residential service in the long-stay care home settings;
- as at 31 March 2004, there were 919 applicants on the SWD's waiting list for a place in long-stay care homes and 466 of them were receiving in-patient treatment in HA hospitals. It should be noted that the circumstances of these 466 applicants might have changed since they first came on the waiting list. At present, when a long-stay care home place became available, the first applicant on the list, if he/she happened to be receiving in-patient treatment in a hospital, would be reviewed to assess his/her suitability to be transferred to a long-stay care home and his/her personal and family preference for such transfer. Some applicants might decline the transfer. Hence, it would be difficult to state whether all the 466 applicants were suitable and ready to be transferred. It should also be noted that as mental illness was a chronic illness, the beds vacated by chronic patients might eventually be filled by other mentally ill patients who required hospitalisation and the "savings" resulting from the transfer might not necessarily materialise; and
- hospitals and long-stay care homes provided different and essential treatment and services for the rehabilitation of chronic mental patients characterised by relapses and remissions. There was a strong demand for their treatment and services. It was necessary to adopt a prudent and holistic approach in examining any proposal on transfer of resources. The Administration would need to establish that the arrangement suggested by the Committee (i.e. an arrangement whereby the admission of an applicant for long-term residential care service who was in a hospital to a long-stay care home would be accompanied by a corresponding budget transfer from the HA to the SWD) would not affect medical care for patients with chronic mental illness.



## **Training, employment and residential services for people with disabilities**

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17. The Committee noted that it would be most cost-effective for disabled persons to be provided with a continuum of care and services so that they would not forget the skills that they had acquired earlier. As the waiting time for different types of service was long, the Committee asked how the SWD could ensure that a continuum of care and services was provided.

18. The **Assistant Director of Social Welfare (R&MSS)** stated that:

- the SWD ran a central waitlist system for six types of residential services and was moving towards the direction of providing integrated services. The aim was to provide different levels of care and facilities in one integrated centre to meet the changing needs of clients. For example, there were hostels for severely mentally handicapped persons, moderately mentally handicapped persons and physically handicapped persons in the newly renovated Fanling Hospital. This could remove the need for the clients who were already residing in a particular type of residential home to wait for another type of residential home due to the deterioration of their health;
- the SWD had also approved the construction of a hostel for severely disabled persons adjacent to a large-scale hostel providing 200 places for mentally handicapped persons in Sha Tin. The aim was to turn the original hostel into an integrated centre so that it could provide a higher level of care to meet the needs of its clients as they grew old and their functioning level deteriorated;
- the SWD had developed a standardised assessment tool to identify the needs of persons with mental/physical handicap applying for residential service, with a view to matching their needs with appropriate levels and categories of service; and
- the SWD had in place the emergency placement arrangement for those on the waiting lists for residential services whose health conditions had become very poor or whose families had undergone changes, provided that they were supported by social workers for priority admission into the hostels.

19. Referring to the large number of applicants on the waiting lists for different types of services, as listed out in Table 4 of the Audit Report, the Committee asked how many of them were receiving other modes of support services in the community, as well as the effectiveness of the services in meeting their needs.

## **Training, employment and residential services for people with disabilities**

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20. The **Assistant Director of Social Welfare (R&MSS)** said that:

- of the 1,798 waiting for hostels for severely mentally handicapped persons, about 1,000 were already receiving day service. Of the 1,200 odd waiting for hostels for moderately mentally handicapped persons, more than 50% were already working in the sheltered workshops or supported-employment units; and
- parents of those waiting for hostels for mentally handicapped persons still wanted to secure residential places for their children as they worried that they would grow old and could not take care of their children.

21. In response to the Committee's request, the **Director of Social Welfare** provided, in his letter of 17 May 2004 in *Appendix 52*, details of other more targeted services received by the applicants waitlisted for the various types of residential rehabilitation services, and the number of applicants who were not receiving any regular service. He also stated that:

- the services received by the applicants included regular day centre training programmes, home-based training service, supported employment and sheltered workshop and day care service. These programmes were under regular review of the SWD and were generally well received by the disabled persons and their families;
- there were other general support services in the community available to the disabled persons to strengthen the capability of their families in taking care of them and to enhance their quality of living. Such services included casework services, home help service, home care service, respite service, share care projects, mental health link, holiday care, gateway club, social and recreation centres, etc. However, the participation of the disabled persons in these support services was not captured by the Central Referral System for Rehabilitation Services. Hence, it was likely that some of the applicants who were not recorded to be receiving any regular service were in fact receiving some form of general support services in the community; and
- not all applicants who were waiting for the residential services required immediate placement. For example, some of them were special school students, in-patients in the hospital or residents in other institutions. Hence, the waiting list and the waiting time had to be interpreted in such context.

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### **Staff training and staff safety at service units**

22. According to paragraph 3.10 of the Audit Report, from January 2000 to September 2003, Service Unit 29 (a day activity centre) and Service Unit 13 (a day activity centre cum hostel) respectively granted, on average, 24.3 days and 8.3 days of sick leave to each staff member in a year, as a result of injuries during work. In particular, as revealed in Appendix C of the Audit Report, Service Unit 29 granted 702 and 634 days of sick leave in April 2000 and July 2001 respectively to its staff members who sustained back injury due to slipping down on the floor. The Committee asked whether:

- the SWD had replaced the PVC floor tiles of Service Unit 29 with anti-slippery floor tiles, as suggested by its staff; and
- other improvements had been made by these two service units in providing a safe working environment for their staff.

23. The **Director of Social Welfare** and the **Assistant Director of Social Welfare (R&MSS)** replied that:

- as a matter of principle, the SWD would remind the service units with high staff injury rates of the need to improve staff training and staff safety. Actually, it was one of the SWD's stated service quality standards that service units should ensure that they provided a safe physical environment for their staff and service users;
- funds were available from the Lotteries Fund for fitting out the service units and for purchasing appropriate facilities and equipment, including floor tiles, to ensure the safety of the working environment; and
- regarding staff training, in 2003, NGOs had arranged more than 600 certificate programmes for front-line workers who had no previous experience or training in working with people with disabilities. The SWD had also assisted in organising several such training courses.

### **Services provided at sheltered workshops and supported-employment units**

24. The Committee noted from paragraph 5.10 of the Audit Report that the expenditure of the SWD's Marketing Consultancy Office (MCO) in 2002-03 was \$4.6 million. According to paragraph 5.12, Audit's survey revealed that, in the same year, on average, the respondent service units obtained only 7% of their job opportunities through

## **Training, employment and residential services for people with disabilities**

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the MCO. The Committee asked whether the SWD agreed with Audit's view that it should review the cost-effectiveness of the MCO.

25. The **Director of Social Welfare** and the **Assistant Director of Social Welfare (R&MSS)** explained that:

- the effectiveness of the MCO should not be assessed only by the job orders secured. Actually, it was the duty and responsibility of the service operators of sheltered workshop and supported-employment units to secure job orders and job placements as the SWD had already provided them with funding and staff to do so;
- the MCO was staffed by a dozen personnel outside the civil service with marketing experience. The expenditure of \$4.6 million for salary was only an estimate and the actual amount would fluctuate depending on the staff employed;
- the MCO's services included promoting the working abilities of people with disabilities and providing business consultation services to NGOs. More importantly, it explored and coordinated large-scale projects from government departments and public organisations to secure long-term and stable work opportunities for service users of sheltered workshops and supported-employment units. For example, it had obtained car cleaning service orders from government departments and the HA. Although only 22% of the job orders obtained from government departments were secured through the MCO, the SWD was satisfied with the result. Very often, the clients would contact the sheltered workshops directly after having used their service once;
- the MCO also promoted the work ability of people with disabilities among the business sector and had secured many free promotion channels. Recently, it had obtained car cleaning service orders from private estate management companies; and
- the MCO was also involved in vetting the applications under the "Enhancing Employment of People with Disabilities through Small Enterprise" Project. In addition, the MCO provided support to the kiosks set up under SEPD, i.e. "Support the Employment of People with Disabilities", which sold the arts and crafts made by people with disabilities. The trademark of SEPD was registered.

## **Training, employment and residential services for people with disabilities**

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26. The Committee noted the Director of Social Welfare's comment in paragraph 5.19(d) of the Audit Report that, after two years of operation, it was an opportune time to review the cost-effectiveness of the MCO. The Committee enquired about:

- the timetable and methodology of the review; and
- the yardsticks that would be adopted for measuring the MCO's effectiveness and whether the total number of job orders obtained from government departments through the MCO would be taken into account.

27. In his letter of 17 May 2004, the **Director of Social Welfare** advised that:

- the SWD aimed to start the internal review on the MCO by the end of June 2004 and this would take four to five months. The review would cover the following functions of the MCO:
  - (a) to enhance the marketing orientation of sheltered workshops, supported-employment units and integrated vocational rehabilitation services centres, etc.;
  - (b) to devise strategies for promoting and marketing the products and services of the sheltered workshops, supported-employment units and integrated vocational rehabilitation services centres;
  - (c) to secure sales orders and to coordinate sheltered workshops, supported-employment units and integrated vocational rehabilitation services centres in the procurement of large job orders;
  - (d) to provide advice to NGOs on the setting up and running of small businesses; and
  - (e) to provide consultation to NGOs on productivity, marketing strategies, etc.;
- in conducting the review, the views of the NGOs, government departments and private enterprises who had made use of the MCO's services would be solicited via questionnaires and focus group meetings. The performance statistics of the MCO in the past two years would also be analysed;

## **Training, employment and residential services for people with disabilities**

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- the yardsticks for measuring the MCO's effectiveness would include both qualitative and quantitative benchmarks. The number of job orders obtained from government departments might well be one of the quantitative benchmarks; and
- the SWD was still working on the details of the review and would seek the views of the Advisory Committee on Enhancing Employment of People with Disabilities comprising businessmen, financial/accounting/legal personnel, government officials and representatives of people with disabilities.

### **Monitoring the provision of services**

28. According to paragraph 6.23 of the Audit Report, in one of the SWD's on-site assessments conducted in 2003-04, SWD staff found that a sheltered workshop had previously submitted incorrect performance information to the SWD. However, apart from requesting this sheltered workshop to submit an action plan for improvement, the SWD did not verify other performance information previously submitted by it. The Committee asked:

- about the details of the case; and
- whether the SWD had now verified other performance information previously submitted by the workshop and, if so, what the results were.

29. The **Director of Social Welfare** informed the Committee in his letter of 17 May 2004 that:

- during the on-site assessment in August 2003, the SWD had thoroughly checked and verified the sheltered workshop's daily attendance records, case review records, payment vouchers, bank autopay slips and salary pay lists. They were found to be in order; and
- the incorrect performance information stemmed from the agency's misinterpretation of the calculation method of the output standard of "Rate of progress review completed in a year". The agency had subsequently rectified the calculation methodology and attained the agreed level of this output standard in 2003-04. The SWD would continue to closely scrutinise the performance information submitted periodically by the sheltered workshop.

## **Training, employment and residential services for people with disabilities**

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30. The Committee noted from paragraph 6.26 of the Audit Report that the SWD did not disclose to the public the statistical and self-assessment reports of service units collected in the periodic returns, its review visit reports and on-site assessment reports. Audit had recommended in paragraph 6.30(f) that such reports and returns should be made available on the SWD's website. In paragraph 6.30(g), Audit had also recommended that the SWD should ask service units to upload their annual plans and assessments of achievement of the plans onto their websites, with links to the SWD's website. The Committee asked about the progress made in implementing the recommendations.

31. The **Director of Social Welfare** stated at the public hearing and in his letter of 17 May 2004 that the SWD was considering the technical feasibility of Audit's recommendation. It would also consult the NGOs concerned regarding Audit's recommendation that they should upload their annual plans and assessments of achievement of the plans onto their websites.

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

### **Provision of training, employment and residential services**

- expresses concern that the unit costs of training, employment and residential services provided by the Social Welfare Department (SWD) exceeded those of non-governmental organisations (NGOs) by 7% to 57%;
- notes that:
  - (a) the SWD has taken action to transfer the operation of some of its service units to NGOs;
  - (b) as at May 2004, the SWD still ran two sheltered workshops, each of which was paired up with a hostel for moderately mentally handicapped persons; and
  - (c) the SWD will review the costs and benefits of outsourcing these remaining service units;
- expresses concern that:
  - (a) at the time of the Audit Report, people applying for the long-stay-care-home service and the day-activity-centre service had to wait for 102 months and 24 months respectively;

## **Training, employment and residential services for people with disabilities**

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- (b) not all the savings resulting from the closure of the SWD's service units can be realised because the SWD needs to absorb the surplus staff until they retire; and
  - (c) the SWD will require new resources before it can allocate more resources to those services, such as the long-stay-care-home service, for which people had to wait for a long time;
- recommends that:
- (a) the Director of Social Welfare should consider seeking the assistance of the Civil Service Bureau in transferring the surplus staff to other government departments or NGOs, so as to realise the savings resulting from the closure of its service units; and
  - (b) the Secretary for Health, Welfare and Food should discuss with the Hospital Authority (HA) and the SWD, with a view to making an arrangement whereby the transfer of an applicant for long-term residential care service from a hospital to a long-stay care home will be accompanied by a corresponding budget transfer from the HA to the SWD;
- notes that:
- (a) as at May 2004, the waiting time for the long-stay-care-home service had been reduced to 86 months;
  - (b) the SWD will step up the supply of those services with great demand through planning of new service units and in-situ expansion; and
  - (c) the Director of Social Welfare will implement Audit's recommendations in paragraph 2.18 of the Audit Report;

### **Staff training and staff safety at service units**

- expresses concern that, of the staff of the service units covered in the Audit survey, 5% did not receive any job-related training and another 35% received only ten hours or less job-related training;
- expresses serious concern that a day activity centre and a day activity centre cum hostel respectively granted an average of 24.3 days and 8.3 days of sick leave to each staff member in a year, as a result of injuries during work;



## **Training, employment and residential services for people with disabilities**

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- notes that:
  - (a) the SWD will discuss with the rehabilitation sector the details of reporting and disclosing training received by staff of service units;
  - (b) the SWD will conduct investigations into those service units having a high rate of injuries caused to staff and service users; and
  - (c) the Director of Social Welfare will implement Audit's recommendations in paragraph 3.19 of the Audit Report;

### **Medical services and assistance from parents and volunteers**

- expresses concern that 45% of the respondent service units had not established a parents association;
- notes that the Director of Social Welfare will implement Audit's recommendations in paragraph 4.21 of the Audit Report;

### **Services provided at sheltered workshops and supported-employment units**

- expresses serious concern that:
  - (a) the SWD did not specify the duration of employment for calculating the successful discharge rates for service users of the supported-employment service;
  - (b) the respondent service units obtained only 7% of their job opportunities through the SWD's Marketing Consultancy Office (MCO); and
  - (c) government offices provided only 6% of the total job opportunities for the respondent service units;
- notes that the Director of Social Welfare will implement Audit's recommendations in paragraph 5.18 of the Audit Report and has established criteria for measuring the effectiveness of the additional aspects of work taken up by the MCO;

## **Training, employment and residential services for people with disabilities**

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### **Monitoring the provision of services**

- expresses concern that:
  - (a) the SWD did not take appropriate action against the sheltered workshop which submitted incorrect performance information to it; and
  - (b) the SWD does not disclose to the public the statistical and self-assessment reports of service units collected in the periodic returns, its review visit reports and on-site assessment reports;
- notes that the Director of Social Welfare will implement Audit's recommendations in paragraph 6.30 of the Audit Report; and

### **Follow-up actions**

- wishes to be kept informed of:
  - (a) the results of the SWD's review on outsourcing its remaining service units for people with disabilities;
  - (b) the progress of the SWD's efforts to reduce the waiting time for people with disabilities seeking services;
  - (c) any action taken by the Secretary for Health, Welfare and Food to address the problem in allocating resources between the HA and the SWD regarding the provision of long-term residential care service;
  - (d) the action taken by the SWD to improve staff training and staff safety at service units for people with disabilities;
  - (e) the progress of implementing the private general-practitioner scheme in service units;
  - (f) the progress of establishing parents associations in service units;
  - (g) the progress of introducing additional output standards for evaluating the effectiveness of the services provided at sheltered workshops and supported-employment units;
  - (h) the results of the SWD's review of the MCO;

## **Training, employment and residential services for people with disabilities**

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- (i) the progress of adopting more outcome indicators for reporting the performance of rehabilitation services;
- (j) the progress of modifying the annual self-assessment reports for rehabilitation services;
- (k) the progress of preparing overall plans and setting targets for conducting on-site assessments and users' satisfaction surveys;
- (l) the progress of making available on the SWD's website the statistical reports, self-assessment reports, review-visit reports and on-site assessment reports;
- (m) the progress of asking service units to upload their annual plans and assessments of achievement of the plans onto their websites; and
- (n) the progress of involving external personnel to provide advice to rehabilitation service units.

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

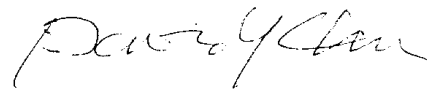
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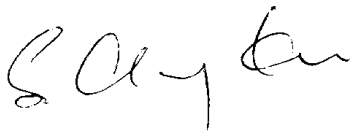
Eric LI Ka-cheung  
(Chairman)



Emily LAU Wai-hing  
(Deputy Chairman)



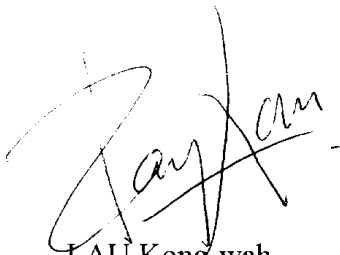
David CHU Yu-lin



SIN Chung-kai



Howard YOUNG



LAU Kong-wah



Abraham SHEK Lai-him

9 June 2004

**CHAPTERS IN THE DIRECTOR OF AUDIT'S REPORT NOS. 41 AND 42  
DEALT WITH IN THE PUBLIC ACCOUNTS COMMITTEE'S REPORT**

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**Director of  
Audit's Report  
No. 41**

**P.A.C. Report  
No. 42**

<u>Chapter</u>	<u>Subject</u>	<u>Chapter</u>
8	The acquisition and clearance of shipyard sites	1

**Director of  
Audit's Report  
No. 42**

Chapter

2	Funding of projects under the Applied Research Fund	2
3	Harbour Area Treatment Scheme Stage I	3
4	Hong Kong Harbour Fest	4
7	Provision of aquatic recreational and sports facilities	5
9	Training, employment and residential services for people with disabilities	6

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

**72. Public Accounts Committee**

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

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

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

(3) The committee shall consist of a chairman, deputy chairman and 5 members who shall be Members appointed by the President in accordance with an election procedure determined by the House Committee. In the event of the temporary absence of the chairman and deputy chairman, the committee may elect a chairman to act during such absence. The chairman and 2 other members shall constitute a quorum.

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

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

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

(7) All matters before the committee shall be decided by a majority of the members voting. Neither the chairman nor any other member presiding shall vote, unless the votes of the other members are equally divided, in which case he shall have a casting vote.

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

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

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

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

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

**SCOPE OF WORK**

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



## GUIDELINES

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

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

6. The Director of Audit may also -

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

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

## **PROCEDURES**

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

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

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

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

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

Dr Hon Sarah LIAO Sau-tung, JP	Secretary for the Environment, Transport and Works
Mr TSUI Wai	Principal Assistant Secretary for the Environment, Transport and Works (Works)
Mr TSAO Tak-kiang, JP	Director of Civil Engineering
Mr YIP Sai-chor, JP	Deputy Director of Civil Engineering (Special Duties)
Mr Patrick LAU Lai-chiu, JP	Director of Lands
Mr John Corrigan, JP	Deputy Director of Lands (General)
Mr Robert Law, JP	Director of Environmental Protection
Hon Henry TANG Ying-yen, GBS, JP	Financial Secretary
Miss Shirley YUEN	Administrative Assistant to Financial Secretary
Mr Mike Rowse, JP	Director-General of Investment Promotion
Ms Ophelia TSANG	Associate Director-General of Investment Promotion
Mr Paul TANG Kwok-wai, JP	Director of Social Welfare
Miss Ophelia CHAN	Assistant Director of Social Welfare (Rehabilitation and Medical Social Services)
Mr Raymond CHEUNG Tat-kiung, JP	Director of Drainage Services
Mr CHUI Wing-wah	Chief Engineer/Harbour Area Treatment Scheme, Drainage Services Department
Mr KWOK Ka-keung, JP	Deputy Secretary (Works) 1, Environment, Transport and Works Bureau
Mr Raistlin LAU	Principal Assistant Secretary (Environment) 1, Environment, Transport and Works Bureau

Mr Benny WONG	Assistant Director (Waste and Water), Environmental Protection Department
Mrs Pamela TAN KAM Mi-wah, JP	Acting Permanent Secretary for Home Affairs
Ms Anissa WONG Sean-yea, JP	Director of Leisure and Cultural Services
Mr Alan SIU	Deputy Director of Leisure and Cultural Services (Leisure Services)
Mr Paul CHEUNG Kwok-kee	Assistant Director of Leisure and Cultural Services (Leisure Services) <sup>1</sup>
Mr Lawrence CHEUNG Yiu-kong	Chief Leisure Manager (Facilities Management), Leisure and Cultural Services Department
Hon John TSANG Chun-wah, JP	Secretary for Commerce, Industry and Technology
Mr Francis HO, JP	Permanent Secretary for Commerce, Industry and Technology (Communications and Technology)
Mr Anthony WONG Sik-kei, JP	Commissioner for Innovation and Technology
Mr Tony LAM	Assistant Commissioner for Innovation and Technology (Infrastructure)
Mr David CHIU	Acting Associate Director-General of Investment Promotion

**Introductory Remarks by the  
Chairman of the Public Accounts Committee,  
Dr Hon Eric LI Ka-cheung, GBS, JP,  
at the First Public Hearing of the Committee  
on Monday, 3 May 2004**

Good morning, ladies and gentlemen. Welcome to the Public Accounts Committee's first public hearing relating to Report No. 42 of the Director of Audit on the results of value for money audits, which was tabled in the Legislative Council on 21 April 2004.

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

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

Following a preliminary study of the Director of Audit's Report No. 42, the Committee has decided, in respect of five chapters in the Report, to invite the relevant public officers and parties concerned to appear before the Committee and answer our questions. We have, apart from this morning's hearing, also set aside the mornings of 6 and 7 May for the public hearings.

I now declare the Committee to be in formal session.

香港特別行政區政府  
The Government of the Hong Kong Special Administrative Region

房屋及規劃地政局

香港花園道美利大廈  
電話：2848 2266  
傳真：2845 3489



Housing, Planning and Lands  
Bureau  
Murray Building,  
Garden Road, Hong Kong

本局檔號 Our Ref. (41) in HPLB(CR)(PL) 172/66 Pt. 3

來函檔號 Your Ref. CB(3)PAC/R41

**Urgent By Fax (No. 2537 1204)**

8 December 2003

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

(Attn: Ms Dora WAI)

Dear Ms Wai,

**The Director of Audit's Report on the  
results of value for money audits (Report No. 41)**

**Chapter 8: The acquisition and clearance of shipyard sites**

Thank you for your letter of 3 December 2003. The requested information is as follows:

- (a) **The forum where the Legislative Council Members expressed their support for the shipyard operators**

Between September 1996 and July 1998, a number of Legislative Council (LegCo) Members expressed their concerns about the plight of the affected shipyard operators. Their general view was that the Administration should provide appropriate assistance to the shipyard

operators whose business and investment would be adversely affected by the clearance. In this respect and during the aforementioned period, LegCo Members who had written to or exchanged views with the Administration included the following Honourable Members : Chan Yuen-han, Allen Lee, Selina Chow, Albert Chan, Lee Wing-tat, Sin Chung-kai, Leung Yiu-chung, Kan Fook-ye, Miriam Lau and Tam Yiu-chung.

Prior to July 1998, a Provisional LegCo Case Conference on this matter was held on 24 October 1997. A copy of the minutes of the Case Conference is at Annex for your reference please. In paragraph 14 of the minutes of the aforementioned Case Conference, Members requested that the Administration should provide more concrete assistance to the affected shipyard operators.

(b) Party who made the comment in paragraph 2.8(a) of the Audit Report

The statement in paragraph 2.8(a) of the Audit Report quoted in your letter was the Administration's assessment of the then prevailing circumstances. It was not a specific comment made by any particular LegCo Member. As explained in section (a) above, a number of LegCo Members had shown sympathy to the plight of the affected shipyard operators. Hence, in response to the then Secretary for the Treasury's question as to why the shipyard operators were not required to demolish the structures, the then Planning, Environment and Lands Bureau made the statement as quoted in paragraph 2.8(a) of the Audit Report.

Yours sincerely,



( Gary Y S Yeung )  
for Secretary for Housing, Planning and Lands

c.c. Director of Audit

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





地政總署  
LANDS DEPARTMENT

5 January 2004

電話 *Tel:* 2231 3000  
圖文傳真 *Fax:* 2525 4960  
本署檔號 *Our Ref:* (55) in LD 1/2010/03 IV (TC)  
來函檔號 *Your Ref:* CB(3)PAC/R41

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

(Attn : Ms Dora Wai)

Dear Ms Wai,

**The Director of Audit's Report on the  
Results of Value for Money Audits (Report No. 41)**

**Chapter 8 : The Acquisition and Clearance of Shipyard Sites**

Thank you for your letter of 17.12.2003.

Regarding paragraphs 2 and 3 of your letter, I have followed up the matter with the Housing, Planning and Lands Bureau (HPLB). As advised by HPLB, Lands Department (LandsD) will further discuss with the Financial Services and the Treasury Bureau (FSTB) on any proposed waivers or variations of the short term tenancy (STT) terms if such waivers or variations would have financial implications to Government. Land instructions will be clarified following the outcome of discussion with FSTB.

Regarding paragraph 4 of your letter, I would provide the additional information requested using the same numbering system :-

- (a) A schedule, at Annex A, is attached listing STT cases from 1998 to 2003 where LandsD has successfully asked tenants to clear the structures from sites upon termination of STTs, in order to make way for Government projects.
- (b) Apart from the two STT cases listed in a schedule at Annex B, we are not aware of any other land contamination problem cases in STT or leases when making land available for public projects.

(c) We are not aware of any such cases, involving the problem of contamination, which necessitated seeking advice on the applicability of clauses similar to those quoted in paragraphs 2.23 and 2.24 of the Audit Report..

(d) Pending receipt of legal advice (see (e) below), it is not possible to say if there are any loopholes in these leases and tenancies.

As a precautionary measure and to focus directly on the issue of contamination, we have already introduced an amended clause to impose decontamination costs on lessees. Such a clause was included in the leases of a number of petrol filling station sites disposed of earlier this year. This new clause is to be imposed in all new industrial related land sales and grants, including shipyards. A copy of the clause is attached at Annex C.

We are also amending the indemnity clause in STTs to ensure that tenants are made responsible for decontamination costs.

(e) The outside leading counsel has provided certain advice to the Department of Justice (D of J) on the liabilities of the former lessees and short term tenants of the North Tsing Yi shipyards towards the decontamination costs. However, in order to allow the counsel to assess and advise definitely on the chance of success of any legal actions by the Government to recover the decontamination costs from any of the parties concerned, D of J has advised that further information relating to shipyard operations and Government practice and policies therefor should be given to the counsel for his consideration. The further information provided by the relevant departments has been sent to the outside leading counsel with further instructions to advise. Upon receipt of the further instructions, the counsel may take up to 4 weeks to advise, subject to his availability. A summary of the advice of the counsel will be provided as soon as possible thereafter.

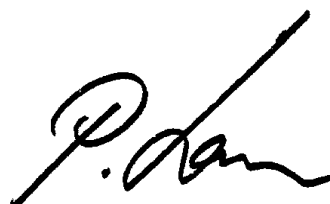
(f) Checking of past records shows that LandsD received copies of Consultant B's reports in June 2000 and February 2001 wherein the text stated that the exact cost of the decontamination work on the Cheoy Lee Shipyard site could only be accurately assessed after the completion of the EIA study. The LandsD's negotiating team led by the then Deputy Director/Specialist also understood through the Steering Committee meeting in February 2001 that the preliminary site investigation revealed

that there was only localized surface contamination and no widespread contamination in the open area. The \$100 million estimated provision for decontamination work was set out in a schedule of capital cost estimate appended to Consultant B's report in February 2001 and was not noticed at the time by the LandsD's negotiating team.

LandsD's records also show that the original proposal for surrender on an "as is" basis was made by the surveyor for the owners of Cheoy Lee Shipyard to allow the owners to surrender the lot with such structures and plant as remained on site. A copy of the surveyor's letter of 5 December 2000 is at Annex D. As this would have been the outcome if agreement could not be reached on the surrender and the shipyard had been resumed, and since surrender is a speedier and more certain arrangement than resumption, the proposal was acceptable to LandsD.

The decision by LandsD in March 2001 to accept a surrender on an "as is" basis was made in the circumstances explained in the foregoing paragraphs.

Yours sincerely,



(Patrick Lau)  
Director of Lands

Encls

c.c. Secretary for Housing, Planning and Lands  
Secretary for the Environment, Transport and Works  
Secretary for Financial Services and the Treasury  
(Attn : Miss Amy Tse)  
Director of Audit  
Director of Civil Engineering  
Director of Environmental Protection  
Commissioner for Tourism

Annex A

<u>STT No.</u>	<u>User</u>	<u>Project</u>	<u>Remarks</u>
3303	Open storage and/or loading, unloading and storage of containers from sea or land including container consolidation (stuffing and destuffing)	Reprovisioning of Tsuen Wan Public Cargo Working Area to Stonecutters Island	Only minor structures involved
3210	A fee-paying public car-park for the parking of motor vehicles (excluding container tractors and trailers)	GLA-KT No. 1132 to ED for Primary School	Only minor structures involved
3389	A fee-paying public car-park for the parking of motor vehicles (excluding container tractors and trailers)	Implementation of Village Layout	Only minor structures involved
3204	A fee-paying public car-park for the parking of private cars and light goods vehicles (excluding heavy vehicles, container tractors and trailers)	GLA-KT No. 1105 to LCSD for Public Promenade in Area 3 & 8 Tsing Yi	Only minor structures involved
3483	a) Open Storage of containers and fumigation treatment of container cargoes; b) a weigh-bridge & a fee-paying public car-park for the parking of motor vehicles; c) both a & b above	Route 9 between Tsing Yi and Cheung Sha Wan Project	Only minor structures involved
3437	A fee-paying public car-park for the parking of licensed motor vehicles (including container tractors and trailers)	Route 9 between Tsing Yi and Cheung Sha Wan Project	Only minor structures involved
3461	A weigh-bridge and a fee-paying public car-park for the parking of licensed motor vehicles (including container tractors and trailers)	Route 9 between Tsing Yi and Cheung Sha Wan Project	Only minor structures involved

<u>STT No.</u>	<u>User</u>	<u>Project</u>	<u>Remarks</u>
3465	A fee-paying public car-park for the parking of motor vehicles (including container tractors and trailers)	Route 9 between Tsing Yi and Cheung Sha Wan Project	Only minor structures involved
3489	Consolidation and handling of container cargoes or storage of containers and other non-offensive goods or a fee-paying public car-park for the parking of motor vehicles (including container tractors and trailers) or all or any combination thereof	Route 9 between Tsing Yi and Cheung Sha Wan Project	Only minor structures involved
3493	Consolidation and handling of container cargoes or storage of containers and other non-offensive goods or a fee-paying public car-park for the parking of motor vehicles (including container tractors and trailers) or all or any combination thereof	Route 9 between Tsing Yi and Cheung Sha Wan Project	Only minor structures involved
3500	Consolidation and handling of container cargoes or open storage of goods or a fee-paying public car-park for the parking of motor vehicles (including container tractors and trailers) or all or any combination thereof	Route 9 between Tsing Yi and Cheung Sha Wan Project	Only minor structures involved
3501	Consolidation and handling of container cargoes or open storage of goods or a fee-paying public car-park for the parking of motor vehicles (including container tractors and trailers) or all or any combination thereof	Route 9 between Tsing Yi and Cheung Sha Wan Project	Only minor structures involved

<u>STT No.</u>	<u>User</u>	<u>Project</u>	<u>Remarks</u>
517	Electricity Substation	Reclamation and Servicing of Tuen Mun Area 38 for Special Industries Lung Mun Road Improvement	
573	Open Storage	Foothill Bypass and Improvement Works along Wong Chu Road in Tuen Mun	Only minor structures involved
763	Container Storage and Warehouse	Foothill Bypass and Improvement Works along Wong Chu Road in Tuen Mun	Only minor structures involved
576	Public Fee Paying Car-park	Closure of Yuk Hong Street Exit to Tuen Mun Road Sliproad connecting Tuen Mun Road and San Wo Lane, Tuen Mun	Only minor structures involved
839	Open Storage	West Rail (Phase 1)	Only minor structures involved
991	Concrete Batching Plant	Improvement to Castle Peak Road between Ka Loon Tsuen and Siu Lam	
1023	Recreational Use	Works Area for Deep Bay Link Project	
T/A 564	Open storage and plant maintenance depot	Site Formation and Infrastructure Works for Housing Sites in Area 56	
T/A 565	Open storage and plant maintenance depot	Site Formation and Infrastructure Works for Housing Sites in Area 56	
T/A 576	Vehicles and plant and maintenance depot	Site Formation and Infrastructure Works for Housing Sites in Area 56	Only minor structures involved
T/A 619	1) A driver training center 2) A Transport Department Test Centre 3) Road Safety Centre for promotion of road safety	Site Formation and Infrastructure Works for Housing Sites in Area 56	
T/A 712	Cycle Recreation Park	East Rail Extension – Tai Wai to Ma On Shan (MOS Rail)	Only minor structures involved

<u>STT No.</u>	<u>User</u>	<u>Project</u>	<u>Remarks</u>
T/A 855	Shooting Range	Site Formation and Infrastructure Works for Housing Sites in Area 56	
T/A 1034	Storage of sand and cement	Sha Tin Treatment Works Stage III Extension	Only minor structures involved
T/A 1035	Storage of goods, plant and machinery containers, vehicles and building materials	Sha Tin Treatment Works Stage III Extension	Only minor structures involved
EHX0004	Open bus parking (excluding repairing and maintenance of buses)	HyD Road Widening Project	Only minor structures involved
EHX0183	Works Area	Development of a Primary School	Only minor structures involved
EHX0185	Storage of cable drums & asso. equip.	Promenade & Open Space	Only minor structures involved
EHX0003	Storage or fee-paying car-park	Development of Quarry Bay Park	Only minor structures involved
EHX0137	Storage/fee-paying car-park/waste paper collection	Quarry Bay Park Development	Only minor structures involved
EHX0154	Fee-paying car-park/waste paper collection	Quarry Bay Park Development	
EHX0206	Fee-paying car-park	PSPS Development	Only minor structures involved
EHX0213	Bus depot for parking, fuelling, cleaning & maintenance	Promenade development	Only minor structures involved

Annex B

<u>Lease/STT No.</u>	<u>User</u>	<u>Project</u>	<u>Remarks</u>
STT619 (ST)	Driver Training Centre	East Rail Extension – Tai Wai to Ma On Shan (MOS Rail)	Petrol tank and pump were built by the Tenant to facilitate fuelling of their vehicles. Tenant was requested to deliver the site to Government free from contamination. Some contamination was found. EPD agreed to accept the contaminated soil for disposal in the SENT landfill. This was carried out by the Tenant at no cost to Government.
STT677 (TM)	Open Storage	Foothill Bypass and Associated Slope Stabilization Works	Upon default of the tenant, an underground oil tank was cleared by Government with costs (\$112,500) deducted from the deposit held under the STT.



Standard Decontamination Clause

(a) The Purchaser shall take or cause to be taken such action as shall be necessary to avoid soil and groundwater contamination to the lot and any adjacent or adjoining Government land or any part thereof or any building or structure thereon (whether on, above or below ground level) arising out of the development, redevelopment or use of the lot or otherwise and shall at his own expense carry out all necessary works (hereinafter referred to as "the Preventive Works") to prevent such soil and groundwater contamination occurring.

(b) The Purchaser shall, within 18 calendar months or such shorter period as specified by the Director, before the expiration or sooner determination of the term hereby agreed to be granted carry out at his own expense a soil and groundwater contamination assessment (hereinafter referred to as "the Contamination Assessment") to the satisfaction of the Director of Environmental Protection in respect of the lot and any adjacent or adjoining Government land and thereafter submit a report on the Contamination Assessment to the Director not later than 12 calendar months before the expiration or sooner determination of the term hereby agreed to be granted or such other date as may be specified and notified in writing to the Purchaser by the Director. Upon demand in writing by the Director, the Purchaser shall at his own expense and in all respects to the satisfaction of the Director of Environmental Protection carry out in such manner and within such time limit as the Director shall specify such decontamination or other works as shall be required by the Director (hereinafter referred to as "the Decontamination Works") in respect of the lot and any adjacent or adjoining Government land.

(c) If the Purchaser shall in any respect neglect or fail to carry out the Preventive Works or the Contamination Assessment or the Decontamination Works in accordance with sub-clauses (a) and (b) of this Special Condition,

- (i) the Director may at his sole discretion execute and carry out the Preventive Works, the Contamination Assessment or the Decontamination Works (collectively referred to as "the Works") and the Purchaser shall on demand pay to the Director the cost thereof as shall be certified by the Director on a full indemnity basis; or
- (ii) the Purchaser shall on demand pay to the Director in one lump sum an amount equal to the estimated cost of carrying out the Works which estimated cost shall be determined by the Director of Environmental Protection at his sole discretion. In the event of the said lump sum payment being insufficient to cover the cost of carrying out the Works whether by the Director or by any person entrusted with the Works, the Purchaser shall on demand pay the shortfall to the Director on a full recovery basis.



F A C S I M I L E

DATE : 5 December 2000 NO. OF PAGES : 1 (INCLUDING THIS SHEET)  
 COMPANY : Lands Department FAX NO. : 2116-0859  
 TO : Mr John Corrigan FROM : David C Lee  
 SUBJECT : Penny's Bay PROJECT NO : 72900

(Please notify sender by phone 2802 8336 if message received incomplete or illegible.)

Dear John

Further to my fax to you of 4 December 2000, I would respectfully suggest that you consider the following wordings, in lieu of those contained in our fax under reference.

"PBI, will not be required to:-

1. Demolish any of the existing buildings or structures erected on the Property and/or any fittings therein;
2. Decommission or remove any plants and/or machinery which may have been installed at the Property and/or any other chattels or objects which may have been left as abandoned thereat;

and the Government shall accept the Property and the surrender thereof on an "As-Is" basis with all plants, equipment, chattels, articles and/or objects of whatsoever nature left as abandoned thereat."

I do apologies for the inconvenience caused but would mention that the Government's agreement to this proposal will significantly facilitate the surrender process.

If you should have any queries, please call me on my mobile no 9196-8898, as I will be out of town for a few days on business trip.

Regards

  
David C Lee, BBS, JP

DCL/mw/P:72900/corr:0072

MANAGING DIRECTOR  
董事總經理

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李頌熹, BBS, JP  
FRICS, FHKIS, ASVA,  
ACIARB, AP, Chartered Surveyor

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 來函檔號 *Your Ref:* CB(3)/PAC/R41

***Urgent By Fax & By Hand***

27 May 2004

Ms Dora Wai  
 Clerk  
 Public Accounts Committee  
 Legislative Council Building  
 8 Jackson Road  
 Central  
 Hong Kong  
 [Fax: 2537 1204]

Dear Ms Wai,

**The Director of Audit's Report on the  
 results of value for money audits (Reports No. 41)**

**Chapter 8: The acquisition and clearance of shipyard sites**

Further to my letters of 9 December 2003 and 5 January 2004, I have now received a summary of the legal advice from the outside counsel, prepared by the Department of Justice. A copy is enclosed herewith for the consideration of the Public Accounts Committee.

I wish to advise that the Department of Justice issued 21 protective writs against various parties just before the expiration of the statutory limitation period. The Government has until 22 April 2005 to serve the writs. In the meantime, we are gathering further evidence in order to prepare statements of claim against the 21 defendants.

Yours sincerely,

(Patrick Lau)  
 Director of Lands

c.c. Director of Audit [Fax: 2583 9063]

Summary of legal advice on the contamination of the  
North Tsing Yi Shipyards

Background

The 21 North Tsing Yi shipyard sites were required for district open space and Government, Institutions and Community facilities (“GICs”). Six of the shipyard sites were held under long leases and 15 of the shipyard sites were held under short term tenancies. The 6 shipyard sites which were held under long leases were resumed under the Lands Resumption Ordinance (Cap. 124) on 26 April 1997. 14 of the short term tenancies were terminated on 24 April 1997 and one of the short term tenancies was terminated on 24 July 1997.

2. Due to strong resistance of the lessees and tenants of the 21 shipyard sites, they were allowed to “holdover” after the leases and short term tenancies had terminated. In this connection, the Government had indicated to the lessees and tenants that the Government would be prepared to allow them to continue to occupy the sites for a further one year after their leases or short term tenancies had terminated. Copies of two of the Government’s letters sent to the lessees and tenants are attached at Annex A. The lessees and tenants remained in occupation of the sites until November 1999 or June 2000 when they left the premises. The Government took possession of Lot No. 611 in D.D. 436 and STT 3029 on 2 November 1999 and took possession of the other 19 shipyards sites on 1 June 2000.

3. After taking possession of the 21 shipyard sites, the Government carried out a contamination assessment of the shipyard sites and discovered that the shipyard sites were contaminated with heavy metals and organic compounds. Contamination Assessment Reports were prepared by the Civil Engineering Department’s consultant in May 2001 and November 2001. According to the contamination assessment reports, heavy metals and organic compounds were present in the soil in a concentration or quantity which was over the acceptable level. Thus remediation work

was required to be carried out to decontaminate the land to reduce the concentration or quantity of the heavy metals and organic compounds to an acceptable level in order to render the land safe and suitable for district open space and GICs. The decontamination costs incurred by Government was substantial.

4. A chronology of events is attached at Annex B.

#### Summary of legal advice

5. As regards the six lots held under long leases, the deposit of heavy metals and organic compounds in the soil was a breach of General Condition 9 of the long leases in that the deposit was noisome and noxious matters. The failure to remove the materials deposited which contaminated the land was a breach of the same condition on each day that the failure continued up to the end of the long leases in April 1997. The relevant conditions of the long leases are set out at Annex C. The deposit of heavy metals and organic compounds by the lessees of the six lots was also a breach by the long lessees of the law of waste in that it was voluntary waste.

6. As regard the 15 short term tenancies, certain provisions in the tenancies were broken by the tenants by their deposit of heavy metals and organic compounds. The tenants' failure to remove the materials deposited which contaminated the land at or before the end of a tenancy also constituted a further and separate breach of the relevant conditions. The relevant conditions of the short term tenancies are set out at Annex D. The deposit of heavy metals and organic compounds by the tenants of the 15 short term tenancies also constituted a breach of their duty not to commit voluntary waste.

7. By reason of the events that occurred, the lessees and tenants became Government's tenants for one further year after the determination of the initial long leases and short term tenancies and then became tenants at will until they left the sites in November 1999 or June 2000. Their obligations as regards the terms of the

tenancies and as regards voluntary waste continued in the same way under the tenancies for one year and the tenancies at will as they did during the initially granted period of long leases or short term tenancies.

8. The obligation not to deposit noxious substances is an obligation not to deposit substances which will adversely affect the use of the premises for any reasonable use to which the premises may be put at the end of the leases or tenancies. There is no justification for assuming that after the end of the leases and tenancies the premises will continue to be used for the same purpose for which they were used during the leases or tenancies. A landlord may wish to put the premises to a very different use after the end of a lease or tenancy. The measure of damages is the cost of the remediation works incurred by the landlord.

9. While it is noted that there are not any specific cases in which the deposit of materials commonly associated with shipyard operations or activities such as heavy metals and organic compounds was held to be a breach of a noncontamination or decontamination clause in the lease, each case would turn on its facts and the relevant clauses in the leases or tenancies. Even if the lessees and tenants could, to all intents and purposes, only use the sites as shipyards, such limitation as to use does not in principle provide an overall defence as to the breaches of their obligations noted.

10. It is considered that Government can seek to recover the costs of decontamination from the lessees and tenants of the 21 shipyard sites.

Annex A

- 1) The Government's letter dated 12 May 1997 to the tenant of Short Term Tenancy No. 373
- 2) The Government's letter dated 11 June 1997 to the lessee of Lot Nos. 600 and 601 in D.D. 436



地政處  
葵青地政處  
District Lands Office, Kwai Ts.  
LANDS DEPARTMENT

電話 Tel: 2402 1111  
圖文傳真 Fax: 2415 0703 & 2412 0505  
本署檔號 Our Ref: (200) in DLO/KT STT 373  
來函檔號 Your Ref:

By Recorded Delivery

12 MAY 1997

Hip Shing Timber Company Limited,  
STT 373, Tam Kon Shan Road,  
Tsing Yi North, Tsing Yi Island,  
N.T.

Dear Sirs,

**Short Term Tenancy No. 373**  
**Tam Kon Shan Road, North Tsing Yi**

I am prepared to recommend to the Government to allow you to occupy the premises ("the said premises") previously held under the above tenancy ("the previous tenancy") which has been terminated, after the termination of the previous tenancy, on the following terms and conditions :-

- (A) The occupation shall be for a fixed term of 1 year commencing from the date of termination of the previous tenancy (i.e. up to 23 April 1998). Upon the expiry of the fixed term of 1 year, you must vacate from the said premises and you shall not be entitled to any compensation whatsoever.
- (B) You agree that you shall not lodge any objection or claim in respect of any reclamation of any foreshores and sea-beds taking place at any time in relation to the said premises whether such reclamation takes place before or after the termination of the previous tenancy, and that you shall not be entitled to any compensation whatsoever whether under the Foreshore and Sea-bed (Reclamations) Ordinance (Chapter 127 of the Laws of Hong Kong) or otherwise in respect of such reclamation.
- (C) No rent or administrative fee will be payable to the Government.
- (D) The occupation shall be (where applicable or appropriate) on the terms and conditions under which the previous tenancy was held except as varied hereinabove and except as being inconsistent with the occupation for a fixed term of 1 year.

/p. 2. ....



- (E) You shall at all times during the said occupation period permit the Government, the Director of Lands and his officers, contractors and any persons authorized by him with or without tools, equipment, plant, machinery or motor vehicles, the right of free and uninterrupted ingress, egress and regress to from and through the premises for the purpose of carrying out any site investigation or geotechnical exploration or such other related works necessary for the implementation of the Reclamation Works for District Open Space and Government Institution and Community Facilities in North Tsing Yi.

The above offer is open for acceptance within 28 days from the date hereof. If written confirmation of the acceptance is not received within the aforesaid period, the offer shall be deemed to have been withdrawn.

Notwithstanding anything contained herein including your confirmation of the acceptance, or any previous correspondence, this offer is not intended to create any legal relation or legal obligations. The Government will not accept any legal obligations until a formal holding over letter has been duly signed by you and by the Government and issued out of this office.

To confirm your acceptance of the above terms and conditions, please sign the docket below and return the duplicate of this letter to me as soon as possible.

Yours faithfully,



(Ms. Eugina FOK)  
District Lands Officer, Kwai Tsing

WTC/EF/sll (12K16) p.11-12

---

I/We hereby accept the above terms and conditions as herein set out.

Signature :

Full Name :

2402 1111

**By Recorded Delivery**

2415 0703/2412 0505

( ) in DLO/KT 49/KTPA/59

11 June 1997

LAU CHEONG  
c/o Messrs. Alfred Lau & Co.  
Solicitors & Notaries  
705, Hong Kong & Shanghai Bank Building  
673, Nathan Road  
Kowloon

Dear Sir,

**New Grant Nos. 4172 and 4173  
for Lot Nos. 600 & 601 in DD 436  
Tam Kon Shan Road, North Tsing Yi**

I am prepared to recommend to the Government to allow you to occupy the premises ("the said premises") previously held under the above New Grant Nos. 4172 and 4173 ("the previous leases") which have been terminated, after the termination of the previous leases, on the following terms and conditions :-

- (A) The occupation shall be for a fixed term of 1 year commencing from the date of termination of the previous leases. Upon the expiry of the fixed term of 1 year, you must vacate from the said premises and you shall not be entitled to any compensation whatsoever.
- (B) You agree that you shall not lodge any objection or claim in respect of any reclamation of any foreshores and sea-beds taking place at any time in relation to the said premises whether such reclamation takes place before or after the termination of the previous leases, and that you shall not be entitled to any compensation whatsoever whether under the Foreshore and Sea-bed (Reclamations) Ordinance (Chapter 127 of the Laws of Hong Kong) or otherwise in respect of such reclamation.
- (C) No rent or administrative fee will be payable to the Government.
- (D) The occupation shall be (where applicable or appropriate) on the terms and conditions under which the previous leases were held except as varied hereinabove and except as being inconsistent with the occupation for a fixed term of 1 year.

/You shall at .....

- (E) You shall at all times during the said occupation period permit the Government, the Director of Lands and his officers, contractors and any persons authorized by him with or without tools, equipment, plant, machinery or motor vehicles, the right of free and uninterrupted ingress, egress and regress to from and through the premises for the purpose of carrying out any site investigation or geotechnical exploration or such other related works necessary for the implementation of the Reclamation Works for District Open Space and Government Institution and Community Facilities in North Tsing Yi.

The above offer is open for acceptance within 28 days from the date hereof. If written confirmation of the acceptance is not received within the aforesaid period, the offer shall be deemed to have been withdrawn.

Notwithstanding anything contained herein including your confirmation of the acceptance, or any previous correspondence, this offer is not intended to create any legal relation or legal obligations. The Government will not accept any legal obligations until a formal holding over letter has been duly signed by you and by the Government and issued out of this office.

To confirm your acceptance of the above terms and conditions, please sign the docket below and return the duplicate of this letter to me as soon as possible.

Yours faithfully,



(Ms. Eugina FOK)  
District Lands Officer,  
Kwai Tsing

JP/AC/EF/kc (JUN-0-3-0)

---

I/We hereby accept the above terms and conditions as herein set out.

Signature :

Full Name :

Chronology of events

- 24-4-1997 14 of the 15 short term tenancies were terminated  
(STT 330 was terminated on 24 July 1997)
- 26-4-1997 The 6 lots under long leases were resumed under the Lands Resumption Ordinance (Cap. 124)
- Feb to June 1997 The Government indicated to the lessees and tenants of the shipyard sites that the Government would be prepared to allow them to continue to occupy the sites for a further one year after their leases or short term tenancies had terminated
- April 1997 to April 1998  
(or July 1997 to July 1998 for STT 330) The lessees and tenants of the shipyard sites became tenants for a further one year after the determination of the initial long leases and short term tenancies
- April 1998 to Nov 1999 or June 2000 The lessees and tenants of the shipyard sites became tenants at will until the Government took possession of the sites

- 2 Nov 1999 The Government took possession of Lot No. 611 in D.D. 436 and STT 3029
- 1 June 2000 The Government took possession of the other 19 shipyard sites
- May 2001 A contamination assessment report was prepared by the Civil Engineering Department's consultant
- Nov 2001 A Further site investigation – contamination assessment report was prepared by the Civil Engineering Department's consultant

Relevant terms of the long leases of the 6 lots which were resumed

1) General Condition 9 of the long leases of the 6 lots which were resumed provides that :

“The purchaser shall not permit sewage or refuse water to flow from the lot on to any adjoining land or allow any decaying, noisome, noxious, excrementitious, or other refuse matter to be deposited on any portion of the lot and shall see that all such matter is removed daily from the premises in a proper manner.”

2) The user clause of the long leases provides that the lot and all buildings to be erected thereon shall not be used for any purposes other than ship/boat building and repairing.

Relevant terms of the 15 short term tenancies

1) STT 737, STT 600, STT 3006, STT 330 and STT 3029 contain a condition which is similar to General Condition 9 of the long lease of the 6 lots which were resumed which provides that :

“The Tenant shall not permit sewage or refuse water to flow from the Premises onto any adjoining land or allow any decaying, noisome, noxious, excrementitious, or other refuse matter to be deposited on any portion of the Premises and shall have all such matter removed from the Premises or any building erected thereon in a proper manner.”

2) STT 3181 contains a condition which provides that

“The Tenant shall not.....allow any waste matter which is not the final product from waste processing plant to be deposited anywhere within the Premises and shall have all such matter removed from the Premises or any building erected or to be erected thereon in a proper manner to the satisfaction of the Director of Environmental Protection”

3) However, there is no provision in STT 367, STT 374, STT 373, STT 376, STT 365, STT 379, STT 364, STT 381 and STT 380 which is similar to General Condition 9 of the long leases of the 6 lots.

4) STT 737 contains a condition which provides that :

“The Tenant shall not install or use on the Premises...any fuel or method or process of manufacture or treatment which might in any circumstances result in the discharge or emission, whether aerial or otherwise, on or from the Premises ....of any noxious, harmful or corrosive matter.....and which shall in the opinion of the District Lands Officer and the Commissioner for Labour be excessive in or unnecessary for the proper use and enjoyment of the Premises by the Tenant for the purpose for which the Premises is granted.”

5) The following conditions of the short term tenancies are also relevant :

- a) “To maintain and keep to the satisfaction of the District Lands Officer the Premises.....in good and tenantable repair and condition ...and so to hand over the same on termination of this Agreement.”
- b) “Not to do, cause, permit or suffer anything to be done..... in or upon the Premises or any part thereof which may be or become a nuisance or annoyance or which may cause damage or inconvenience to the Landlord.....”
- c) “To indemnify and keep indemnified the Landlord.....against all actions, suits, costs, claims, demands and expenses whatsoever arising directly or indirectly out of or in connection with the occupation and use of the Premises by the Tenant”.

6) The user clause of the short term tenancies are similar and provides to the effect that the premises shall not be used for any purpose other than boat and/or shipbuilding and repairing.





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**Civil Engineering  
Department**

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Your reference 來函檔號 : CB(3)/PAC/R41

Clerk  
Public Accounts Committee  
Legislative Council,  
Building S,  
Jackson Road, Central,  
Hong Kong.  
Fax No. 2537 1204  
(Attn: Ms. Dora WAI)

9 December 2003

Dear Sir/Madam,

**The Director of Audit's Report on the  
Results of value for money audits (Report No. 41)**

**Chapter 8 : The acquisition and clearance of shipyard sites**

I refer to your letter of 3 December 2003 and advise below.

In mid 2001 during the initial phase of detailed site investigation carried out after the surrender of the Penny's Bay shipyard site to Government, our project consultants (Consultant B as referred in the Audit Report) revealed that there were burnt chlorinated wastes buried in the southern portion of the site. The Consultant B considered that soils in these burnt pits might have been contaminated by chlorinated substances and pollutants such as dioxins and testing of dioxins was needed. At that time, we did not receive any comments from the local green groups and environmentalists on detailed site investigation and testing at the Penny's Bay shipyard site. The Consultant B, however, conducted a general review of relevant reports published at the time in the web sites of various green groups as well as relevant discussions in some international environmental forums. A summary is attached at **Annex A**.

The general concerns of the green groups and environmentalists were that there was a strong association of dioxin emissions with uncontrolled open burning of plastic waste, such as Polyvinyl Chloride (PVC). There was also a worldwide concern of the harmful effect of persistent organic pollutants including

dioxins to the environment. International initiatives to implement measures to reduce or eliminate releases of persistent organic pollutants including dioxins into the environment was urged.

After the reveal of the burnt chlorinated wastes and the review of the environmental concerns as described in paragraph 2, the Consultants B decided to take soil samples from these burnt pits at the Penny's Bay shipyard site for dioxin testing. We agreed to Consultant B's prudent decision to complete a full appraisal of the contamination of the Penny's Bay shipyard site and devise the most appropriate remedial measures to address the contamination problem.

Yours faithfully,



( T K Tsao )

Director of Civil Engineering

c.c. Director of Audit

**Summary of environmental concerns at the time when Consultant B was carrying out the detailed site investigation at the Penny's Bay Shipyard site**

<b>Green Groups/ Environmentalists</b>	<b>Concerns</b>
Greenpeace	<p>Greenpeace reported that waste combustion would release toxic substances, including cancer-causing dioxins. Greenpeace stated that dioxins would be created when Polyvinyl Chloride (PVC) plastic was burnt.</p> <p>Greenpeace also gave examples of soil and sediments contaminated with dioxins at the sites, which received the discharges of PVC industries. In Venice, Greenpeace had analysed sediment from the Porto Marghera. It clearly showed contamination of the lagoon with dioxin near the Enichem Plant, where Vinyl Chlorinated Monomer (VCM) was among the chlorinated chemicals manufactured.</p>
Friends of the Earth	<p>Friends of the Earth reported that incinerator ash from Edmonton incinerator in North London containing dioxins had been used to make aggregates for road building in the London borough of Haringey. They were concerned dioxins and heavy metal contents in the mixture of ashes were never analysed.</p>
United Nations Environment Programme (UNEP)	<p>The Stockholm Convention on Persistent Organic Pollutants (POPs) which include dioxins was adopted in Stockholm on 22 May 2001. Stockholm is an international scientific community under the auspices of the United Nations Environment Programme (UNEP). The Convention requires each Convention Party to implement measures to reduce or eliminate releases from intentional and unintentional production and use of POPs.</p>
United States Environmental Protection Agency (USEPA)	<p>USEPA's Science Advisory Board posted its Draft Reassessment Report on Dioxin on the Agency's website. The report presented the emerging scientific knowledge of dioxins toxicity, potential for carcinogenic health effects of dioxin on people, human exposure pathway, and the adverse effects on the environment. The report highlighted the risk of dioxins was higher than previously thought.</p>

Edward Alperin and Kevin Sullivan (IT Corporation)	In the 4 <sup>th</sup> International Workshop on Geo-Environmental Restoration, in Jan 2001, Tokyo Japan, a paper was presented on "Remediation of Dioxin Contaminated Soils in the United States". The authors pointed out combustion of organic and/or chlorinated wastes could result in the formation of dioxins in the process off-gas. They suggested detailed site information such as contaminant type should be available to develop a specific treatment process for dioxins.
US Army Corps of Engineers	The first stage of treatment of Dioxin Contaminated Soil at the Coleman-Evans Wood Preserving Site in Florida USA was being implemented. It was shown that the US government took a conservative approach towards to the dioxin clean up criteria. It also demonstrated complex technology was required for clean up.
Waterways Authority, New South Wales, Australia and the Federal Government of Australia	Due to public concern of the extensive dioxins contamination found in Homebush Bay, the Australia Government signed up to the Stockholm Convention and announced major funding of the National Dioxins Programme. The State government also conducted various studies and pilot programme for the removal and treatment of dioxins soil.
Richard Spiers, Carlisle DC	In the Chartered Institute of Environmental Health Conference 2001, the author presented a talk on the poor disposal practices of agricultural wastes. He stated some farmers in the UK were burning farm waste as an alternative to disinfection, resulting in potentially high dioxin levels.
Arnold Schechter, University of Texas	Dr Schechter reported on the dioxins seepage into soil and river beds and becoming concentrated in fish and water in Bien Hoa, south Vietnam. Schechter found dioxins levels to be 135 times higher than those in samples taken from people in Hanoi.



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Your reference 來函檔號: CB(3)/PAC/R41

Clerk  
Public Accounts Committee  
Legislative Council Building,  
8 Jackson Road, Central,  
Hong Kong.  
Fax No. 2537 1204

31 December 2003

(Attn: Ms. Dora WAI)

Dear Sir,

**The Director of Audit's Report on the  
Results of value for money audits (Report No. 41)**

**Chapter 8 : The acquisition and clearance of shipyard sites**

I refer to your letter dated 16 December 2003.

On your enquiry of the dates when the green groups/environmentalists posted their concerns (as described in Annex A of our letter of 9 December 2003) onto their websites, I would advise that this information was not normally available on websites. Nevertheless, some of the relevant reports, articles, and news releases posted in these websites contained information on the timing of publication, and these dates are now added to the attached revised Annex A. We were advised of these concerns during our discussions with our consultants about the implementation of the detailed site investigation in mid 2001.

Regarding the enquiry on the reasons why, prior to acquisition of the Penny's Bay shipyard site, we had not suspected that the use of fibre glass by the lessee in manufacturing boats at the site might cause dioxin contamination, I would advise that chemically, fibreglass is formed by continuous filament, and its composition consists principally of oxides of silicon, aluminium, calcium boron and magnesium, fused in an amorphous vitreous state. Fibreglass is used for the ship mould works. The ship mould is originally made by laying fibreglass cloth over a wooden replica of the intended boat hull and applying small amount of epoxy resin. The wooden moulds are used once and the wood recycled where possible. The resulting fibreglass mould is fixed within a sturdy wooden frame and can be re-used many times. Small amounts of excess resins are cleaned off using acetone solvent. Due to the woven nature of the fibreglass, there is very little

waste fibre. Any cloth off-cuts were re-used and applied on some other part of the mould. The small amount of waste fibreglass produced were swept up and collected in bins for disposal. Since fibreglass is not defined as a chemical waste, its proper disposal method is landfilling. The above normal work processes of fibreglass materials would not release significant amount of harmful substances such as total petroleum hydrocarbons, volatile and semi-volatile organic compounds and polyaromatic hydrocarbons and also would not release any dioxins. Open burning is not a normal manufacturing operation of fibreglass vessels. Prior to acquisition of the shipyard site, we have paid visits to the site and have not observed any open burning of fibreglass materials.

Yours faithfully,



( R K S Chan )

Director of Civil Engineering (Acting)

c.c. Secretary for the Environment, Transport and Works  
Director of Lands  
Director of Environmental Protection  
Commissioner for Tourism  
Secretary for Financial Services and the Treasury (Attn: Miss Amy TSE)  
Director of Audit

**Summary of environmental concerns at the time when Consultant B was carrying out the detailed site investigation at the Penny's Bay Shipyard site**

<b>Green Groups/ Environmentalists</b>	<b>Concerns</b>
Greenpeace	<p>Greenpeace reported that waste combustion would release toxic substances, including cancer-causing dioxins. Greenpeace stated that dioxins would be created when Polyvinyl Chloride (PVC) plastic was burnt.</p> <p>Greenpeace also gave examples of soil and sediments contaminated with dioxins at the sites, which received the discharges of PVC industries. In Venice, Greenpeace had analysed sediment from the Porto Marghera. It clearly showed contamination of the lagoon with dioxin near the Enichem Plant, where Vinyl Chlorinated Monomer (VCM) was among the chlorinated chemicals manufactured. <b>(Article in March 2001)</b></p>
Friends of the Earth	<p>Friends of the Earth reported that incinerator ash from Edmonton incinerator in North London containing dioxins had been used to make aggregates for road building in the London borough of Haringey. They were concerned dioxins and heavy metal contents in the mixture of ashes were never analysed. <b>(Press release on 5 January 2001)</b></p>
United Nations Environment Programme (UNEP)	<p>The Stockholm Convention on Persistent Organic Pollutants (POPs) which include dioxins was adopted in Stockholm on 22 May 2001. Stockholm is an international scientific community under the auspices of the United Nations Environment Programme (UNEP). The Convention requires each Convention Party to implement measures to reduce or eliminate releases from intentional and unintentional production and use of POPs. <b>(UNEP Chemicals Newsletter in May 2001)</b></p>
United States Environmental Protection Agency (USEPA)	<p>USEPA's Science Advisory Board posted its Draft Reassessment Report on Dioxin on the Agency's website. The report presented the emerging scientific knowledge of dioxins toxicity, potential for carcinogenic health effects of dioxin on people, human exposure pathway, and the adverse effects on the environment. The report highlighted the risk of dioxins was higher than previously thought. <b>(USEPA Information Sheet 3 on 25 May 2001)</b></p>

<p>Edward Alperin and Kevin Sullivan (IT Corporation)</p>	<p>In the 4<sup>th</sup> International Workshop on Geo-Environmental Restoration, in Jan 2001, Tokyo Japan, a paper was presented on "Remediation of Dioxin Contaminated Soils in the United States". The authors pointed out combustion of organic and/or chlorinated wastes could result in the formation of dioxins in the process off-gas. They suggested detailed site information such as contaminant type should be available to develop a specific treatment process for dioxins. <b>(Conference held on 19 January 2001)</b></p>
<p>US Army Corps of Engineers</p>	<p>The first stage of treatment of Dioxin Contaminated Soil at the Coleman-Evans Wood Preserving Site in Florida USA was being implemented. It was shown that the US government took a conservative approach towards to the dioxin clean up criteria. It also demonstrated complex technology was required for clean up. <b>(Project commenced in June 1999 and targeted for completion in April 2001.)</b></p>
<p>Waterways Authority, New South Wales, Australia and the Federal Government of Australia</p>	<p>Due to public concern of the extensive dioxins contamination found in Homebush Bay, the Australia Government signed up to the Stockholm Convention and announced major funding of the National Dioxins Programme. The State government also conducted various studies and pilot programme for the removal and treatment of dioxins soil. <b>(Some 20 site investigations and /or reports prepared between 1987 and 2001. Full remediation not yet commence)</b></p>
<p>Richard Spiers, Carlisle DC</p>	<p>In the Chartered Institute of Environmental Health Conference 2001, the author presented a talk on the poor disposal practices of agricultural wastes. He stated some farmers in the UK were burning farm waste as an alternative to disinfection, resulting in potentially high dioxin levels. <b>(Conference held on 10 - 12 September 2001)</b></p>
<p>Arnold Schecter, University of Texas</p>	<p>Dr Schecter reported on the dioxins seepage into soil and river beds and becoming concentrated in fish and water in Bien Hoa, south Vietnam. Schecter found dioxins levels to be 135 times higher than those in samples taken from people in Hanoi. <b>(Article on 18 May 2001 from Pesticide Action Network Asia and the Pacific (PANAP))</b></p>





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Clerk  
Public Accounts Committee  
Legislative Council Building,  
8 Jackson Road, Central,  
Hong Kong.  
Fax No. 2537 1204  
(Attn: Ms. Dora WAI)

10 February 2004

**Urgent By Hand**

Dear Sir,

**The Director of Audit's Report on the  
Results of value for money audits (Report No. 41)  
Chapter 8 : The acquisition and clearance of shipyard sites**

I refer to your letter dated 12 December 2003. I attach copies of the extracts of papers and minutes of the meetings of the Steering Committee relevant to the acquisition of the PB shipyard site. These records cover 17 meetings.

As Government is considering legal actions to seek to recover the decontamination costs incurred, following legal advice, all communications between Government and its legal advisers for the purpose of seeking or giving legal advice (i.e. information subject to legal professional privilege) and information that may prejudice Government's position in litigation are not included in the attached extracts.

Furthermore, the decommissioning and decontamination of the Penny's Bay Shipyard is part of the Government's works required to be done under the agreement between Government and the theme park operators on the Hong Kong Disneyland Project, and Government has to comply with the confidentiality provisions in the said agreement. On legal advice, the information subject to confidentiality restrictions, therefore, has not been included in the attached extracts.

Chinese translation of this letter and the attached documents will follow.

Yours faithfully,



( T K Tsao )

Director of Civil Engineering

Encl.

c.c.	Secretary for the Environment, Transport, and Works	}
	Director of Lands	}
	Director of Environmental Protection	} w/encl.
	Commissioner for Tourism	}
	Secretary for Financial Services and the Treasury (Attn: Ms Amy TSE)	}
	Director of Audit	}

**Relevant papers and minutes of the meetings of the Steering Committee in relation to the acquisition of the PB shipyard sites in chronological order**

<u>Meeting on 22 December 1999</u>	<ul style="list-style-type: none"> <li>• Paras.11 and 18 of the minutes of the meeting</li> </ul>
<u>Meeting on 16 February 2000</u>	<ul style="list-style-type: none"> <li>• Para.12 of the minutes of the meeting</li> </ul>
<u>Meeting on 25 March 2000</u>	<ul style="list-style-type: none"> <li>• Paras. 4 and 6 and paras. 9 - 10 of the minutes of the meeting</li> </ul>
<u>Meeting on 15 April 2000</u>	<ul style="list-style-type: none"> <li>• Paras. 8 and 9 (b) &amp; (c) of the minutes of the meeting</li> </ul>
<u>Meeting on 20 May 2000</u>	<ul style="list-style-type: none"> <li>• Paras. 7 – 8 and 12 of the minutes of the meeting</li> </ul>
<u>Meeting on 17 June 2000</u>	<ul style="list-style-type: none"> <li>• Paras. 17 – 19 of the minutes of the meeting</li> </ul>
<u>Meeting on 19 August 2000</u>	<ul style="list-style-type: none"> <li>• Paras. 8 - 9 and paras 11 – 12 of the minutes of the meeting</li> </ul>
<u>Meeting on 14 September 2000</u>	<ul style="list-style-type: none"> <li>• Paras. 11 – 13 of the minutes of the meeting</li> <li>• Lands D’s paper (No. 19/00) on Resumption of Cheoy Lee Shipyard</li> </ul>
<u>Meeting on 21 October 2000</u>	<ul style="list-style-type: none"> <li>• Paras. 4 - 6 of the minutes of the meeting</li> <li>• Proposed resumption schedules</li> </ul>
<u>Meeting on 18 November 2000</u>	<ul style="list-style-type: none"> <li>• Paras. 3 and 4 of the minutes of the meeting</li> <li>• Lands D’s Information Note on Caltex Procedures</li> </ul>
<u>Meeting on 16 December 2000</u>	<ul style="list-style-type: none"> <li>• Para. 8 of CED’s paper (No. 25/00)</li> </ul>
<u>Meeting on 17 February 2001</u>	<ul style="list-style-type: none"> <li>• Para. 9 of minutes of the meeting</li> <li>• Para. 11 of CED’s paper (No. 3/01)</li> </ul>
<u>Meeting on 17 March 2001</u>	<ul style="list-style-type: none"> <li>• Paras. 6 - 8 of minutes of the meeting</li> <li>• Para. 12 of CED’s paper (No. 6/01)</li> </ul>

**Relevant papers and minutes of the meetings of the Steering Committee in relation to the acquisition of the PB shipyard sites in chronological order**

<u>Meeting on 11 April 2001</u>	<ul style="list-style-type: none"><li>• Paras. 6 and 7 of minutes of the meeting</li><li>• Para. 11 of CED's paper (No. 9/01)</li></ul>
<u>Meeting on 14 July 2001</u>	<ul style="list-style-type: none"><li>• Para. 8 of the minutes of the meeting</li><li>• Para. 11 of CED's paper (No. 15/01)</li></ul>
<u>Meeting on 18 August 2001</u>	<ul style="list-style-type: none"><li>• Para. 6 of the minutes of the meeting</li><li>• Para. 9 of CED's paper (No. 17/01)</li></ul>
<u>Meeting on 15 September 2001</u>	<ul style="list-style-type: none"><li>• Para. 3 of the minutes of the meeting</li><li>• Para. 10 of CED's paper (No. 20/01)</li></ul>

**Notes of Preparatory Meeting**  
**Steering Committee on Implementation of Hong Kong Disneyland**  
**22 December 1999 at 2:30pm at Room 1220, CGO West Wing**

**PRESENT**

Mr Donald Tsang (Chairman)	Financial Secretary
Mr Stephen Ip	Secretary for Economic Services
Mr Nicholas Ng	Secretary for Transport
Miss Denise Yue	Secretary for the Treasury
Mr S S Lee	Secretary for Works
Mr M J T Rowse	Commissioner for Tourism
Mr Gary Yeung	Ag. Deputy Secretary for Planning, Environment & Lands (Lands & Planning)
Mr Wilson Fung	Principal Assistant Secretary for Planning, Environment & Lands (Planning)
Mr Jonathan McKinley	Principal Assistant Secretary for Home Affairs (Recreation & Sports)
Mr Y C Lo	Director of Civil Engineering
Mr R D Pope	Director of Lands
Mr Bosco Fung	Director of Planning
Mr W K Tam	Deputy Director of Civil Engineering (Special Duties)
Mr D J Howells	Assistant Director (Geo)/Mainland, Civil Engineering Department
Mr Elvis Au	Assistant Director of Environmental Protection (Environmental Assessment & Noise)
Mr Joe Wong (Secretary)	Assistant Commissioner for Tourism 3
Ms Winnie Ng	Assistant Secretary for Economic Services (Tourism)3

**Steering Committee on Implementation of Hong Kong Disneyland**  
**Extracts of Notes of Meeting on 22 December 1999**

11.

Mr Lo reported that the gazettal period ended on 15 December 1999 and we had received five objections from the Cheoy Lee Shipyard, a green group and two fishermen's associations. These objections were being processed and a submission would be put to ExCo later.

18. On early access to the Cheoy Lee Shipyard to carry out site investigations, Mr Pope reported that he had spoken with the two agents concerned and understood that they would try to persuade their clients to be co-operative. However what form this would take had yet to be identified.

**Notes of First Meeting**  
**Steering Committee on Implementation of Hong Kong Disneyland**  
**16 February at 10:00am at Room 1220, CGO West Wing**

**PRESENT**

Mr Donald Tsang (Chairman)	Financial Secretary
Mr Stephen Ip	Secretary for Economic Services
Miss Denise Yue	Secretary for the Treasury
Mr M J T Rowse	Commissioner for Tourism
Mr Kevin Ho	Deputy Secretary for Transport
Mr M M Glass	Deputy Secretary for the Treasury
Mr Patrick Lau	Deputy Secretary for Planning and Lands
Mrs Stella Hung	Deputy Secretary for Works
Mr Kim Salkeld	Deputy Secretary for Environment and Food
Mr Jonathan McKinley	Principal Assistant Secretary for Home Affairs (Recreation & Sports)
Mr Frankie Fan	Senior Executive Officer (Recreation & Sports), Home Affairs Bureau
Mr Thomas Chan	Director of Information Services
Mr Y C Lo	Director of Civil Engineering
Mr Bosco Fung	Director of Planning
Mr W K Tam	Deputy Director of Civil Engineering (Special Duties)
Mr J S Corrigan	Deputy Director of Lands (Specialist)
Mr Elvis Au	Assistant Director of Environmental Protection (Environmental Assessment & Noise)
Mr Joe Wong (Secretary)	Assistant Commissioner for Tourism 3
Ms Winnie Ng	Assistant Secretary for Economic Services (Tourism)3

Steering Committee on Implementation of Hong Kong Disneyland  
Extracts of Notes of Meeting on 16 February 2000

12. Mr Lo pointed out that the resumption of Cheoy Lee Shipyard was critical to the timely completion of Government's works. In response –

- (a) Mr Rowse explained that two issues were involved – early access to the shipyard site to carry out investigation for the subsequent decommissioning work, and resumption or surrender of the site. In respect of the latter, the preferred approach was voluntary surrender by negotiations. / Otherwise three ordinances would need to be invoked for resumption, i.e. Roads (Works, Use and Compensation) Ordinance, Railways Ordinance and Lands Resumption Ordinance. We could only determine the area to be resumed under the third ordinance after completion of procedures under the first two which might necessitate a revision in the alignment of the rail and roads in question.
  
- (b) Mr Corrigan said on funding he had a brief discussion with Mr Rowse and agreed that D of L should bid for provisions in the 2001-02 financial year for payment of compensation to be negotiated in the coming year.



**Notes of Second Meeting**  
**Steering Committee on Implementation of Hong Kong Disneyland**  
**25 March 2000 at 10:00am at Room 1220, CGO West Wing**

**PRESENT**

Mr Donald Tsang (Chairman)	Financial Secretary
Mr Stephen Ip	Secretary for Economic Services
Miss Denise Yue	Secretary for the Treasury
Mr S S Lee	Secretary for Works
Mr Patrick Lau	Ag. Secretary for Planning and Lands
Mr M J T Rowse	Commissioner for Tourism
Mr Kevin Ho	Deputy Secretary for Transport
Mr Kim Salkeld	Deputy Secretary for Environment and Food
Mr R D Pope	Director of Lands
Mr Y C Lo	Director of Civil Engineering
Mr W K Tam	Deputy Director of Civil Engineering (Special Duties)
Mr Elvis Au	Assistant Director of Environmental Protection (Environmental Assessment & Noise)
Mr P Y Tam	Assistant Director of Planning (New Territories)
Ms Winnie Ng (Secretary)	Ag. Assistant Commissioner for Tourism 3

**Steering Committee on Implementation of Hong Kong Disneyland**  
**Extracts of Notes of Meeting on 25 March 2000**

4. the latest position –

Mr Pope reported

- (a) On the advice of a London QC, the Government was planning to seek ExCo's approval on 28 March to de-gazette the 1995 notice, in addition to gazetting a new scheme under the Foreshore and Seabed (Reclamations) Ordinance.
- (b) Prior to serving a notice on the appellant in respect of the de-gazettal as required by law, the Government had explained to the appellant's agent that the de-gazettal was necessary for tidying up purposes.
- (c) Nevertheless, the appellant submitted a letter of objection threatening a judicial review in respect of the de-gazettal.
- (d) On review, Lands D, subject to legal advice, considered that it would be better for the Government to proceed without the de-gazettal.
- (e) Lands D was checking to confirm that in the event of a judicial review, the 2000 reclamation scheme would not be affected.

*(Post-meeting note : Subsequent to receiving legal advice, D of Lands did not change the recommendation in the ExCo paper to de-gazette the 1995 reclamation.)*

6. On compensation, Mr Pope said that he was recommending that this project fall under the "Zone A" category given its territory-wide significance, in which case the amount of compensation would exceed \$1 billion. Lands D would put the proposal to CSC to confirm the "Zone A" status, and would bid for resources under its block vote for 2001-02 for the compensation.

**Steering Committee on Implementation of Hong Kong Disneyland**  
**Extracts of Notes of Meeting on 25 March 2000**

9. Mr Lee pointed out that early access to and early resumption of the site were critical to the overall programme. In addition, EPD had expressed concern that there might not be sufficient time for preparation of the EIA for decommissioning of the shipyard.

10. Mr Pope responded that Lands D had been in discussion with the shipyard on voluntary surrender. Nevertheless, there must first be in place a gazetted scheme after which the site could be surrendered any time. Lands D had also been trying to secure early access to the site. The latest development in respect of the de-gazettal (see paragraph 4 above) had however complicated the situation.

**Notes of Third Meeting**  
**Steering Committee on Implementation of Hong Kong Disneyland**  
**15 April 2000 at 9:30am at Room 1220, CGO West Wing**

**PRESENT**

Mr Donald Tsang (Chairman)	Financial Secretary
Mr Stephen Ip	Secretary for Economic Services
Miss Denise Yue	Secretary for the Treasury
Mr Gordon Siu	Secretary for Planning and Lands
Mr H K Wong	Ag. Secretary for Works
Mr M J T Rowse	Commissioner for Tourism
Mr Kevin Ho	Deputy Secretary for Transport
Mr C C Chan	Ag. Director of Civil Engineering
Mr W K Tam	Deputy Director of Civil Engineering (Special Duties)
Mr P C Chan	Deputy Director of Planning
Mr Elvis Au	Assistant Director of Environmental Protection (Environmental Assessment & Noise)
Miss Winnie Ho (Secretary)	Assistant Commissioner for Tourism 3
Ms Winnie Ng	Assistant Secretary for Economic Services (Tourism)3

**Steering Committee on Implementation of Hong Kong Disneyland**  
**Extracts of Notes of Meeting on 15 April 2000**

8. Mr Rowse reported that with the knowledge of D of L, he had met the agents representing the two shareholders of Penny's Bay Investment Limited, the owner company of the shipyard site. The outcome of the discussion, which had been conveyed to D of L, was as follows –

- (a) The Company wished to proceed by voluntary surrender. They hoped to reach a conclusion in the next few months so that compensation would be awarded around April next year. This matched the Government's timetable.
- (b) There was a difference of views regarding the methodology for calculating the compensation.
- (c) The Company felt aggrieved by the de-gazettal of the 1995 reclamation notice as they wanted to rely on this previous gazette to seek compensation, which it believed would be to its advantage.

9. In response to Members' comments and questions, Mr Rowse made the following points –

- (b) The alternative to voluntary surrender would be resumption. DCE had requested D of L to expedite physical resumption of the site upon completion of the statutory procedures.
- (c) We were proceeding in parallel with both alternatives, and had made clear to the shipyard owners that the project timetable could cope with the resumption route.

**Notes of Fourth Meeting**  
**Steering Committee on Implementation of Hong Kong Disneyland**  
**20 May 2000 at 9:30am at Room 1220, CGO West Wing**

**PRESENT**

Mr Rafael S Y Hui (Chairman)	Ag. Financial Secretary
Mr S S Lee	Secretary for Works
Mr Patrick Lau	Ag. Secretary for Planning and Lands
Mr M J T Rowse	Commissioner for Tourism
Mr M M Glass	Deputy Secretary for the Treasury (2)
Ms Kitty Choi	Principal Assistant Secretary for Transport (8)
Mr R D Pope	Director of Lands
Mr Y C Lo	Director of Civil Engineering
Mr W K Tam	Deputy Director of Civil Engineering (Special Duties)
Mr Elvis Au	Assistant Director of Environmental Protection (Environmental Assessment & Noise)
Mr P Y Tam	Assistant Director for Planning (NT)
Mr Charles Barr	Deputy Law Officer (Civil Law)
Ms Elsa Po	Senior Government Counsel
Miss Winnie Ho (Secretary)	Assistant Commissioner for Tourism (3)
Ms Winnie Ng	Assistant Secretary for Economic Services (Tourism)3

**ABSENT WITH APOLOGY**

Mr Stephen Ip	Secretary for Economic Services
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**Steering Committee on Implementation of Hong Kong Disneyland**  
**Extracts of Notes of Meeting on 20 May 2000**

7. Mr Lo reported that as advised by DEP, six out of the eight environmental permits had been issued. The remaining two would only be available in about 18 to 24 months' time, after completion of the decommissioning study for Cheoy Lee Shipyard.

8. On the number of permits, Mr Rowse said that another permit would be needed for Penny's Bay Rail Link. On the two outstanding permits, Mr Pope advised that the owners of Cheoy Lee Shipyard had indicated that they were prepared to allow early access to the site and would confirm in writing. On resumption of the site, Lands D had been working towards an early surrender and would seek clearance from CSC in June to upgrade the land from "Zone C" to "Zone A" for the purpose of calculating ex-gratia compensation rates.

12. The Chairman noted that overall the timetable had remained intact. Mr Rowse explained that in the "real world", the critical issues were commencement of the reclamation which we had achieved, early access to and resumption of Cheoy Lee Shipyard, and completion of our negotiations with MTRC on the rail link.

**Notes of Fifth Meeting**  
**Steering Committee on Implementation of Hong Kong Disneyland**  
**17 June 2000 at 9:30am at Room 1220, CGO West Wing**

**PRESENT**

Miss Denise Yue (Chairman)	Ag. Financial Secretary
Mr Gordon Siu	Secretary for Planning and Lands
Mr S S Lee	Secretary for Works
Mr M J T Rowse	Commissioner for Tourism
Mr M M Glass	Deputy Secretary for the Treasury (2)
Mr Kevin Ho	Deputy Secretary for Transport (1)
Mr Y C Lo	Director of Civil Engineering
Mr W K Tam	Deputy Director of Civil Engineering (Special Duties)
Mr Elvis Au	Assistant Director of Environmental Protection (Environmental Assessment & Noise)
Mr P Y Tam	Assistant Director for Planning (NT)
Mr Charles Barr	Deputy Law Officer (Civil Law)
Ms Monna Lai	Government Counsel
Miss Winnie Ho (Secretary)	Assistant Commissioner for Tourism (3)
Ms Winnie Ng	Assistant Secretary for Economic Services (Tourism)3

**ABSENT WITH APOLOGY**

Ms Maria Kwan	Ag. Secretary for Economic Services
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**Steering Committee on Implementation of Hong Kong Disneyland**  
**Extracts of Notes of Meeting on 17 June 2000**

17. Mr Au informed Members that the owners of Cheoy Lee Shipyard had agreed to allow the Government early access to the site to carry out investigation works. He urged CED to commence work on the decommissioning study as soon as possible.

18. Mr W K Tam responded that there were restrictions on the types of work that could be done on site at this stage. A full-scale investigation could only be completed after resumption (or voluntary surrender) of the site. CED could nevertheless take this opportunity to define the scope of the decommissioning study.

19. The Chairman said that we should carry out as much advance work as possible, within the parameters laid down by the owners.

**Notes of Seventh Meeting**  
**Steering Committee on Implementation of Hong Kong Disneyland**  
**19 August 2000 at 9:30am at Room 1220, CGO West Wing**

**PRESENT**

Mr Stephen Ip (Chairman)	Ag. Financial Secretary
Miss Denise Yue	Secretary for the Treasury
Mr S S Lee	Secretary for Works
Ms Sandra Lee	Secretary for Economic Services
Mr Kevin Ho	Deputy Secretary for Transport
Mr Patrick Lau	Deputy Secretary for Planning and Lands
Mr C C Chan	Ag. Director of Civil Engineering
Mr W K Tam	Deputy Director of Civil Engineering (Special Duties)
Mr Elvis Au	Assistant Director of Environmental Protection (Environmental Assessment & Noise)
Mr P Y Tam	Assistant Director for Planning (NT)
Mr Charles Barr	Deputy Law Officer (Civil Law) (Commercial)
Ms Monna Lai	Government Counsel
Miss Winnie Ho (Secretary)	Assistant Commissioner for Tourism (3)

Steering Committee on Implementation of Hong Kong Disneyland  
Extracts of Notes of Meeting on 19 August 2000

8. In response to the Chairman's query on whether CLS could be resumed earlier than November 2001, Mr Lee said that Lands Department were negotiating with the owners of CLS on voluntary surrender which, if successful, would expedite the entire resumption programme. It was possible that the CLS site could be secured earlier than November 2001, though not necessarily as early as April 2001. Lands Department were proceeding in parallel with the necessary work for resumption.

9. Ms Lee remarked that an early internal deadline should be set for the voluntary surrender negotiations to allow the Government enough time to proceed with resumption procedures should the negotiations fail. Mr Lau and Mr Lee advised that an internal target date had been set for April 2001. The resumption procedures would start on 18 April 2001.

11. In response to Miss Yue's query, Mr Lau confirmed that the compensation rates for CLS had been upgraded to Zone A.

12. Mr Au noted that the decommissioning EIA study for CLS would only commence in December 2001. He asked if the study could commence earlier. The acquisition of soil samples and other investigation work, for example, could be done now. In response, Mr Tam said that CED were trying to do as much advance work as possible, for example, preparing the study brief for EPD's consideration and approval. However, as the CLS site was currently privately owned and some areas had been built over, full-scale investigation work could not be conducted at this stage.

**Notes of Eighth Meeting**  
**Steering Committee on Implementation of Hong Kong Disneyland**  
**14 September 2000 at 9:30am at Room 1220, CGO West Wing**

**PRESENT**

Mr Donald Tsang (Chairman)	Financial Secretary
Ms Sandra Lee	Secretary for Economic Services
Miss Denise Yue	Secretary for the Treasury
Mr S S Lee	Secretary for Works
Mr Patrick Lau	Ag. Secretary for Planning and Lands
Mr M J T Rowse	Commissioner for Tourism
Mr Kevin Ho	Deputy Secretary for Transport
Mr Kim Salkeld	Deputy Secretary for Environment and Food
Mr R D Pope	Director of Lands
Mr C C Chan	Ag. Director of Civil Engineering
Mr W K Tam	Deputy Director of Civil Engineering (Special Duties)
Mr Elvis Au	Assistant Director of Environmental Protection (Environmental Assessment & Noise)
Mr P Y Tam	Assistant Director of Planning (NT)
Mr Charles Barr	Deputy Law Officer (Civil Law) (Commercial)
Ms Elsa Po	Senior Government Counsel
Miss Winnie Ho (Secretary)	Assistant Commissioner for Tourism (3)
Ms Winnie Ng	Assistant Secretary for Economic Services (Tourism)3

Steering Committee on Implementation of Hong Kong Disneyland  
Extracts of Notes of Meeting on 14 September 2000

**(Paper No. 19/00 for Information)**

11. Mr Pope introduced the paper, pointing out that –

- (a) Lands D had opened negotiations with the agents of the lot owner. Relationship between the two sides remained good, as evident by the agreement to allow CED to enter the site for preliminary investigation.
- (b) Resumption or voluntary surrender could only take place after authorisation of the road schemes. The authorisation was anticipated in April 2001 but there had been indication that it might be advanced to January 2001.
- (c) As agreed earlier, instead of seeking FC's approval for payment within the current financial year, payment would be effected in 2001-02.

12. Mr Lee advised that the road schemes had been gazetted and the objection period would end later this month. At the last Works Progress Committee meeting, it was agreed that CED should try to expedite and secure the authorisation by January 2001. He was however concerned that the overall project timetable would be at risk if the negotiations on voluntary surrender failed. He urged Lands D to speed up the procedures as far as possible.

13. In response, Mr Pope said that the owners had indicated willingness to surrender the site early given the substantial amount of compensation, but at this stage he could not foresee the outcome. Should the negotiations fail, an additional six months or so would be needed given possible complications during site clearance. Lands D would consider ways to speed up the resumption programme should this become necessary.

**Steering Committee on  
Implementation of Hong Kong Disneyland**

**Resumption of Cheoy Lee Shipyard**

**Purpose**

To brief the Committee on the resumption programme for Lot No. 22 in DD 356 which is occupied by Cheoy Lee Shipyard (the Lot) and to discuss whether the Lot could be made available earlier through voluntary surrender.

**Current Compensation Negotiation with Lot Owner**

2. Lands D has opened negotiations with the Agents of the lot owner, PBI Ltd, on the basis of compensation for the loss of marine right due to the two authorizations gazetted under the Foreshore and Sea-Bed (Reclamations) Ordinance (Cap. 127) on 5.5.1995 and 14.4.2000 respectively and for the eventual acquisition of the Lot, by resumption under the Lands Resumption Ordinance (Cap. 124) or by agreement. During the course of negotiation, the Agents have indicated that the lot owner is interested in surrendering the Lot voluntarily, particularly given the lot's Zone A status for NT building land ex-gratia compensation (about \$1,483M).

**Current Permitted Works within the Lot**

3. CED intends to carry out preliminary site investigation works (drilling 13 boreholes) within the Lot in September, 2000. The lot owner has agreed to allow CED to do so subject to an agreement being reached on the terms and conditions imposed by the lot owner for such works. CED is still in discussion with the lot owner on the said terms and conditions.

4. CED also hopes to obtain consent from the lot owner to allow them to carry out the full site investigation works for the shipyard decommissioning and EIA study prior to the reversion of the Lot to the Government. This will enable earlier commencement of construction works.

**Site Handover Date**

5. According to Lands D's previous discussion with CED, the target date for handing vacant possession of the whole Lot (with structures) to CED was 30.11.2001.

6. However, CED has now drawn up 3 Milestone Programmes for essential Government works within the Lot with the site possession dates at 1/2001, 4/2001 and 9/2001.

### Tentative Resumption Programme

7. The Roads (Works, Use and Compensation) Ordinance (Cap. 370) and the Lands Resumption Ordinance (Cap. 124) will be invoked to resume different parts of the Lot (see attached plan).

Gazetting under

Cap. 370 took place on 21.7.2000 with the objection period expiring on 19.9.2000. Lands D's original target was for CED to obtain authorization of the road schemes by mid-January 2001, after which Lands D would seek approval from the Deputy Director of Lands under delegated authority to resume parts of the Lot under Cap. 370 and ExCo's Order to resume the remaining parts of the Lot under Cap. 124. Whilst resumption can only take place upon authorization of the road schemes, preparatory works including the preparation of the draft ExCo paper can be carried out before that. Resumption under the two Ordinances will be implemented simultaneously with a common reversion date. The resumption submissions under Cap. 370 and Cap. 124 will be circulated and finalised before the authorization of the road schemes.

8. The time required for the major activities after the authorization of the road schemes is summarised as follows:-

- |       |  |                                 |
|-------|--|---------------------------------|
| (i)   | Approval of resumption submission under Cap. 370 and gazetting of resumption notice  | ½ month                         |
| (ii)  | Approval for resumption submission under Cap. 124 and gazetting of resumption notice | 1¾ months                       |
| (iii) | Reversion after gazetting of resumption notice                                       | 3 months<br>(Statutory 1 month) |
| (iv)  | Clearance of occupier after reversion  | 1 month                         |

9. As CED has advised that their infrastructure works consultants are currently programming the proposed road works to be authorised under Cap. 370 in mid-April 2001, a Jan 2001 possession date is out of the question and the only way an April 2001 possession date can be achieved is by our negotiating a voluntary surrender.

### Voluntary Surrender

10. Under the current land policy, a voluntary surrender for cash compensation can only take place if the following conditions have been met:-

- (i) The client department has confirmed that the land to be acquired is within the project boundary or an approved layout and is urgently required for the implementation of the project.
- (ii) The client department has requested Lands D to proceed with the acquisition of the affected land.
- (iii) Acquisition funds are available.
- (iv) All the required statutory authorizations are in place.

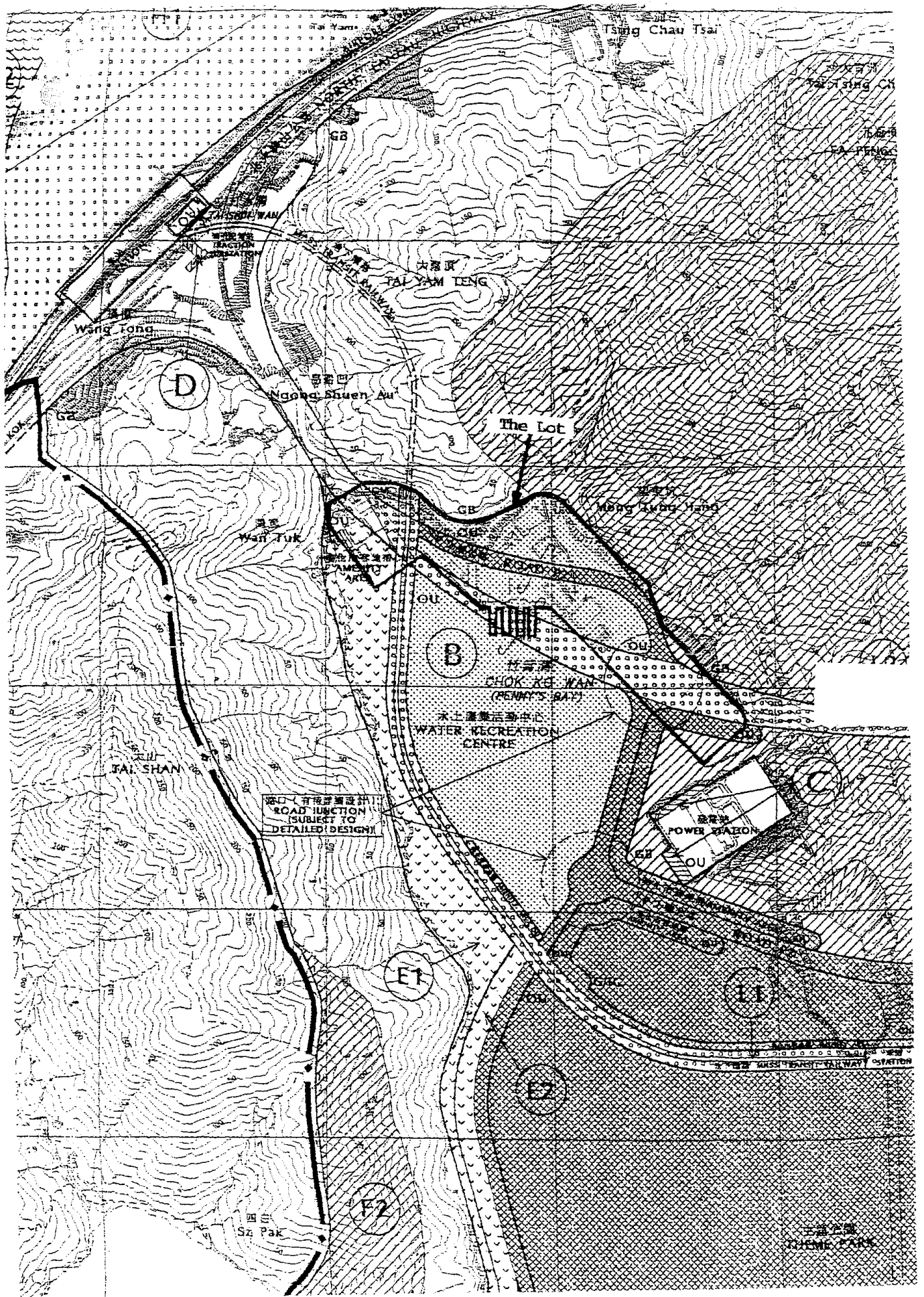
11. In this case, Conditions (i) & (ii) have been met but no funds have been reserved for the acquisition of the Lot in this financial year. Whilst it would be possible to seek special allocation of funds (estimated in the sum of about \$2B) from FC in this financial year, it is understood that this is not favoured. In any event, it would be inappropriate to approve a voluntary surrender of the Lot before the authorization of the road schemes as this would have the implication of pre-empting ExCo's approval for the road schemes.

### The Way Forward

12. Lands D will prepare an ExCo memorandum recommending resumption with a view to getting this approved as soon as possible after authorization of the road works. Negotiations for a voluntary surrender will be opened around Jan 2001 with a view to reaching agreement on a voluntary surrender to take place in April 2001 (or after such later date as the road schemes may be authorized). If those negotiations fail, the resumption will run its course and possession should be obtained sometime at the earliest by 7.10.2001. This assumes everything proceeds in straightforward manner, with, for example, no objections to the resumption being received and there being no application for judicial review.

Lands Department  
September 2000





**Notes of Ninth Meeting**  
**Steering Committee on Implementation of Hong Kong Disneyland**  
**21 October 2000 at 9:30am at Room 1220, CGO West Wing**

**PRESENT**

Miss Denise Yue (Chairperson)	Ag. Financial Secretary
Ms Sandra Lee	Secretary for Economic Services
Mr S S Lee	Secretary for Works
Mr Gordon Siu	Secretary for Planning and Lands
Mr M M Glass	Deputy Secretary for the Treasury
Mr Kevin Ho	Deputy Secretary for Transport
Mr Arthur Ng	Deputy Secretary for Home Affairs
Mrs Erika Hui	Ag. Commissioner for Tourism
Dr C K Lau	Director of Civil Engineering
Mr W K Tam	Deputy Director of Civil Engineering (Special Duties)
Mr Elvis Au	Assistant Director of Environmental Protection (Environmental Assessment & Noise)
Mr P Y Tam	Assistant Director of Planning (NT)
Mr Charles Barr	Deputy Law Officer (Civil Law) (Commercial)
Ms Monna Lai	Government Counsel
Miss Winnie Ho (Secretary)	Assistant Commissioner for Tourism (3)
Ms Winnie Ng	Assistant Secretary for Economic Services (Tourism)3

**Steering Committee on Implementation of Hong Kong Disneyland**  
**Extracts of Notes of Meeting on 21 October 2000**

4. Mr Lee referred to the two resumption schedules tabled which had been agreed with Lands D. According to the schedules, resumption of CLS would take place in April 2001 under both the Roads Ordinance and Lands Resumption Ordinance, which fit in well with CED's overall project timetable.

5. Ms Lee commented that it was important to ensure that procedures under both ordinances proceed at the same pace to ensure a timely reversion. In response, Mr Siu said that PLB could instruct Lands D to assign the same team of staff to handle both sets of procedures. He also proposed that D of Lands be present at coming Committee meetings until completion of the exercise.

6. On "Caltex Procedures", Mr Lee explained that this arose from a court case which required the Government to duly take into account the objectors' views. The Chairperson stressed the importance of ensuring a due process so that the Government would not be caught by this technicality. She asked the Secretary to request additional information on this issue from Lands D and circulate to Members for their information.

**9<sup>th</sup> Meeting of Steering Committee on Implementation of HKD  
Information Note on Resumption Programme of Cheoy Lee Shipyard**

- (1) Proposed schedule for resuming lands within Cheoy Lee Shipyard affected by roadworks under Roads Ordinance, Cap. 370

Step	Activity	Responsible Party	Target Date (Actual)
1	Gazette Scheme & Plan under sec 8 of the Ordinance	CED/TB	(21 July 2000)
2	Resolve objections if any & prepare ExCo Paper	CED	
3	Authorise Scheme & Plan	(L&WSC)  ExCo	5 January 2001  16 January 2001
4	ExCo decision received (already accounted for Chinese New Year recess)		2 February 2001
5	Gazette authorisation under sec 11 of the Ordinance	CED/TB	9 February 2001
6	Submission for Resumption Order under sec 13 and Notice under sec 14 of the Ordinance	DLO/Is	16 February 2001
7	Clearance of resumption submission & order of resumption	ACQ/HQ Lands D DD/S	2 March 2001
8	Gazette of Resumption Notice under sec 14 of the Ordinance	Lands D	9 March 2001
9	Affixing of Resumption Notice	DLO/Is	8 March 2001
10	Reversion (1 month)		9 April 2001

(II) Proposed schedule for resuming all remaining lands of Cheoy Lee Shipyard under Lands Resumption Ordinance, Cap. 124

Step	Activity	Responsible Party	Target Date (Actual)
1	Draft Resumption submission	DLO/Is	(10 October 2000)
2	Internal clearance of draft ExCo submission	ACQ/HQ Lands D	To be advised by Lands D
3	External circulation of ExCo submission  1 <sup>st</sup> draft  revised drafts  clearance of final draft	Lands D   D of J	mid December 2000 *
4	Submission to Clerk to Council	Lands D	
5	L&WSC of ExCo meeting	(L&WSC)  ExCo	16 January 2001
6	ExCo decision received		
7	Gazette Resumption Notice under sec 4 of the Ordinance	Lands D	2 March 2001
8	Affixing of Resumption Notice (action to be synchronized with that under Roads Ordinance)	DLO/Is	8 March 2001
9	Reversion (1 month)		9 April 2001

\* Assume no Caltex Procedures

**Notes of Tenth Meeting**  
**Steering Committee on Implementation of Hong Kong Disneyland**  
**18 November 2000 at 9:30am at Room 1220, CGO West Wing**

**PRESENT**

Mr Stephen Ip (Chairman)	Ag. Financial Secretary
Ms Sandra Lee	Secretary for Economic Services
Mr S S Lee	Secretary for Works
Mr M M Glass	Deputy Secretary for the Treasury
Mr Kevin Ho	Deputy Secretary for Transport
Mr Kim Salkeld	Deputy Secretary for Environment & Food
Mr Stephen Fisher	Deputy Secretary for Planning & Lands
Mr R D Pope	Director of Lands
Dr C K Lau	Director of Civil Engineering
Mr W K Tam	Deputy Director of Civil Engineering (Special Duties)
Mr Elvis Au	Assistant Director of Environmental Protection (Environmental Assessment & Noise)
Mr P Y Tam	Assistant Director of Planning (NT)
Mr Charles Barr	Deputy Law Officer (Civil Law) (Commercial)
Ms Elsa Po	Senior Government Counsel
Ms Winnie Ng (Secretary)	Ag. Assistant Commissioner for Tourism (3)

**IN ATTENDANCE (for agenda item no. 5 only)**

Miss Dora Fu	Principal Assistant Secretary for Environment and Food
Mr M K Cheung	Assistant Director (Fisheries), AFCD

**ABSENT WITH APOLOGIES**

Mrs Erika Hui	Ag. Commissioner for Tourism
---------------	------------------------------

**Steering Committee on Implementation of Hong Kong Disneyland**  
**Extracts of Notes of Meeting on 18 November 2000**

3. Mr Pope confirmed that he would attend future meetings of this Committee until the completion of this resumption exercise, and that the same team of staff in Lands D would process different parts of the resumption concurrently being dealt with under the Roads Ordinance and Lands Resumption Ordinance.

4. Mr Pope introduced the information note on Caltex Procedures. He advised that Lands D had been maintaining a useful dialogue with CLS. So far there was no indication that CLS would raise any objections under the Lands Resumption Ordinance which would then invoke the Caltex Procedures.

**Steering Committee on  
Implementation of Hong Kong Disneyland**

**Information Note - Caltex Procedures**

The Lands Resumption Ordinance (Cap. 124) has no provision for parties to be affected by a proposed resumption to be consulted, unlike most other ordinances where resumption powers may be invoked e.g. the Roads (Works, Use and Compensation) Ordinance Cap. 370.

2. In 1996, a Madam FOK Lai Ying's land in Shatin was resumed under the (then) Crown Lands Resumption Ordinance for a village extension scheme. Before the actual 1996 resumption, Madam FOK became aware of the proposed resumption during the various stages of the planning and engineering design of the scheme. During these various stages, Madam FOK did not make her objection very clear, but did request the planning of the scheme be amended to avoid her land. Then, in March 1995, Madam FOK's solicitors wrote the Clerk to ExCo and requested that Madam FOK's objection be brought to the notice of the members of the ExCo when considering the resumption. In November 1995, ExCo approved the resumption, having noted Madam FOK's objections. Her land reverted to Government in early 1996.

3. Madam FOK sued all the way to the Privy Council. In fact, this was the last Hong Kong case to go to the Privy Council. She complained that before ExCo decided on the resumption, she was given no opportunity to respond to the arguments by officials in support of their proposal that her land be resumed, and against her objection stated in her solicitor's letter to the Clerk to ExCo. Her case was based on the principles of natural justice and the Hong Kong Bill of Rights.

4. The Privy Council dismissed her case on the case's particular facts. It was ruled that she had in fact been given a chance to be heard but did not use it.

5. At the same time, the Privy Council suggested (by way of obiter dicta) that s3 of Cap. 124 should "now be construed, at least when the compulsory acquisition of a home or part of a home is at stake, to require a fair procedure including a reasonable opportunity of objection". Section 3 says 'Whenever the Governor in Council decides that the resumption of any land is required for a public purpose, the Governor may order the resumption thereof under this Ordinance'.



7. The Caltex case was another resumption case when a Governor-in-Council decision was challenged in Court. Although the Caltex case resumption was done under the Roads Ordinance, it was considered the lessons learned from it were applicable to Cap. 124 resumptions. The Caltex procedures are :-

- (i) upon the receipt of an objection (to a Cap. 124 resumption), where an accommodation cannot be found, LandsD should ensure that each objector is fully informed of the case it intends to submit to ExCo seeking to have the objection over-ruled,
- (ii) if an objector requests any relevant information that was available to be Administration in the formulation of its own proposals, the relevant departments should, as far as possible, make this same information available to the objector to assist him to formulate his objection,
- (iii) if an objector submits any revised proposal, even if it is only a minor variation to the original proposal, it must be annexed to the ExCo paper so that Members have a complete dossier of all objections and the Administration's comments on the revised proposal. The objector must always be given the opportunity to have the last word.
- (iv) where a project is urgent, and it appears that an objector is attempting to enter into protracted negotiations on a particular issue, departments should advise the objector of a reasonable cut-off date for him to finalise his submission. The submission will then be present to Members in the normal way in order that account may be taken of it in the final decision process.

8. The whole of Lot 22 in DD 356, Lantau (i.e. Cheoy Lee Shipyard) will have to be resumed in the near future for three different purposes, all associated with Hong Kong Disneyland :-

- (a) resumption under Roads (Works, Use and Compensation) Ordinance (Cap. 370) for road works;
- (b) resumption under Lands Resumption Ordinance (Cap. 124) for a water recreation centre; and
- (c) resumption under Lands Resumption Ordinance (Cap. 124) for drainage works.

9. A road scheme has been gazetted under Cap. 370 and Cheoy Lee has submitted an objection. Taking the opportunity of resolving Cheoy Lee's Cap. 370 objection, DLO/Is has recently informed Cheoy Lee of the two imminent Cap. 124 resumptions. Cheoy Lee has been told our plans to complete the above three resumptions on the same day. To date, Cheoy Lee has not voiced objection to the two planned Cap. 124 resumptions.

10. If, however, later Cheoy Lee do submit objections to the two Cap. 124 resumptions we shall have no choice but to go through the Caltex procedure. The two Cap. 124 resumptions will then be delayed for at least three months i.e. earliest reversion 9 July 2001.

Lands Department  
November 2000

**Notes of Eleventh Meeting**  
**Steering Committee on Implementation of Hong Kong Disneyland**  
**16 December 2000 at 9:30 am at Room 1220, CGO West Wing**

**PRESENT**

Mr Donald Tsang (Chairman)	Financial Secretary
Miss Denise Yue	Secretary for the Treasury
Mr Gordon Siu	Secretary for Planning & Lands
Ms Maria Kwan	Ag. Secretary for Economic Services
Mr Y C Lo	Ag. Secretary for Works
Mrs Rebecca Lai	Commissioner for Tourism
Mr Kevin Ho	Deputy Secretary for Transport
Mr R D Pope	Director of Lands
Mr C C Chan	Ag. Director of Civil Engineering
Mr W K Tam	Deputy Director of Civil Engineering (Special Duties)
Mr Elvis Au	Assistant Director of Environmental Protection (Environmental Assessment & Noise)
Mr P Y Tam	Assistant Director of Planning (NT)
Mr Charles Barr	Deputy Law Officer (Civil Law) (Commercial)
Miss Monna Lai	Government Counsel
Miss Winnie Ho (Secretary)	Assistant Commissioner for Tourism (3)
Ms Winnie Ng	Assistant Secretary for Tourism (3)
Miss Alice Cheung	Assistant Secretary for Tourism (3) (Designate)

**CED's Paper (No. 25/00) for  
Steering Committee on Implementation of Hong Kong Disneyland  
on 16 December 2000**

8. CED has submitted the draft ExCo memorandum to seek authorization of the proposed road works in Penny's Bay to TB for further action. Regarding the proposed sewerage works at Penny's Bay and Yam O gazetted under the Water Pollution Control (Sewerage) Regulation, the objection period expired on 28 November 2000. CED has only received one objection lodged by the Cheoy Lee Shipyard owner.

**Notes of Thirteenth Meeting**  
**Steering Committee on Implementation of Hong Kong Disneyland**  
**17 February 2001 at 8:30 am at Room 1220, CGO West Wing**

**PRESENT**

Mr Donald Tsang (Chairman)	Financial Secretary
Ms Sandra Lee	Secretary for Economic Services
Miss Denise Yue	Secretary for the Treasury
Mr Gordon Siu	Secretary for Planning & Lands
Mr S S Lee	Secretary for Works
Mrs Rebecca Lai	Commissioner for Tourism
Mr Kevin Ho	Deputy Secretary for Transport
Mr R D Pope	Director of Lands
Dr C K Lau	Director of Civil Engineering
Mr W K Tam	Deputy Director of Civil Engineering (Special Duties)
Mr Elvis Au	Assistant Director of Environmental Protection (Environmental Assessment & Noise)
Mr P Y Tam	Assistant Director of Planning (NT)
Mr Charles Barr	Deputy Law Officer (Civil Law) (Commercial)
Miss Monna Lai	Government Counsel
Miss Winnie Ho (Secretary)	Assistant Commissioner for Tourism (3)
Miss Alice Cheung	Assistant Secretary for Tourism (3)

**Steering Committee on Implementation of Hong Kong Disneyland**  
**Extracts of Notes of Meeting on 17 February 2001**

9. On the reversion of Cheoy Lee Shipyard, D of Lands advised that the negotiation with the owner of the shipyard on voluntary surrender was progressing smoothly. He was confident that reversion of the site would be completed in April.

**CED's Paper (No. 3/01) for**  
**Steering Committee on Implementation of Hong Kong Disneyland**

11. The laboratory testing of soil samples obtained from the advance site investigation works at Cheoy Lee Shipyard has been substantially completed. The testing results indicated only localized surface contamination of total petroleum hydrocarbon and heavy metals at some of the workshop buildings. There is no widespread contamination in the open area.

## Notes of Fourteenth Meeting

### Steering Committee on Implementation of Hong Kong Disneyland

17 March 2001 at 9:30 am at Room 1220, CGO West Wing

#### PRESENT

Mr Donald Tsang (Chairman)	Financial Secretary
Ms Sandra Lee	Secretary for Economic Services
Miss Denise Yue	Secretary for the Treasury
Mr S S Lee	Secretary for Works
Mrs Rebecca Lai	Commissioner for Tourism
Mr Kevin Ho	Deputy Secretary for Transport
Mr Gary Yeung	Deputy Secretary for Planning & Lands (Acting)
Mr R D Pope	Director of Lands
Dr C K Lau	Director of Civil Engineering
Mr W K Tam	Deputy Director of Civil Engineering (Special Duties)
Mr Elvis Au	Assistant Director of Environmental Protection (Environmental Assessment & Noise)
Mr P Y Tam	Assistant Director of Planning (NT)
Miss Elsa Po	Senior Government Counsel
Miss Winnie Ho (Secretary)	Assistant Commissioner for Tourism (3)
Miss Alice Cheung	Assistant Secretary for Tourism (3)

**Steering Committee on Implementation of Hong Kong Disneyland**  
**Extracts of Notes of Meeting on 17 March 2001**

6. DDCE said that the IEC had successfully completed a 5-day site investigation at Cheoy Lee Shipyard (CLS) last week. During the site investigation, the IEC observed suspected chemical waste disposal practices by CLS workers and alerted EPD. ADEP said that EPD had acted immediately to stop the illegal act upon receipt of the complaint and would closely monitor the situation. D of Lands added that he had spoken to the agent of CLS after the incident and told them to stop illegal dumping.

7. C for Tourism said that                    had also alerted her and S for W of the incident and they commended EPD for the prompt response to the complaint. On the site investigation itself, she said that the IEC had found more contamination than expected. The IEC would now conduct analysis of the samples obtained.

8. D of Lands reported that the CLS site would be surrendered to Government on 3 April. A cheque of \$1.5 billion would be made available to the owner on the same date.

**CED's Paper (No. 6/01) for**  
**Steering Committee on Implementation of Hong Kong Disneyland**

12. The laboratory testing for the advance site investigation works at Cheoy Lee Shipyard has been completed. The testing report confirmed that land contamination was only localized and at surface. There is no widespread contamination in the open area. For the shipyard decommissioning EIA Study, the consultants have started the impact assessments based on the available information. We have obtained the agreement from the owner of the Cheoy Lee Shipyard for the 5-day visit by the Independent Environmental Consultant (IEC). The 5-day visit is being conducted from 6 March 2001 to 10 March 2001. The IEC's requirements will be fully incorporated into the proposed site investigation works which are targeted to commence in May 2001.



## Notes of Fifteen Meeting

### Steering Committee on Implementation of Hong Kong Disneyland

11 April 2001 at 9:30 am at Room 1220, CGO West Wing

#### PRESENT

Mr Donald Tsang (Chairman)	Financial Secretary
Mr Antony Leung	Financial Secretary (Designate)
Ms Sandra Lee	Secretary for Economic Services
Mr Gordon Siu	Secretary for Planning & Lands
Mr S S Lee	Secretary for Works
Mrs Rebecca Lai	Commissioner for Tourism
Mr Kevin Ho	Deputy Secretary for Transport
Mr Martin Glass	Deputy Secretary for the Treasury
Mr R D Pope	Director of Lands
Dr C K Lau	Director of Civil Engineering
Mr W K Tam	Deputy Director of Civil Engineering (Special Duties)
Mr Elvis Au	Assistant Director of Environmental Protection (Environmental Assessment & Noise)
Mr P Y Tam	Assistant Director of Planning (NT)
Mr Charles Barr	Deputy Law Officer (Civil Law) (Comm)
Miss Monna Lai	Government Counsel
Miss Winnie Ho (Secretary)	Assistant Commissioner for Tourism (3)
Miss Alice Cheung	Assistant Secretary for Tourism (3)

**Steering Committee on Implementation of Hong Kong Disneyland  
Extracts of Notes of Meeting on 11 April 2001**

6. D of Lands reported that the CLS site was surrendered to Government on 3 April after execution of the Deed of Surrender and payment of compensation for the land. The site was handed over to CED on 9 April. DDCE remarked that investigation work for the decommissioning of the shipyard commenced on site on the same day.

7. D of Lands advised that there was still an outstanding \$1 billion claim from the ex-owner of CLS regarding the loss of marine rights due to a previous gazettal.

**CED's Paper (No. 9/01) for  
Steering Committee on Implementation of Hong Kong Disneyland**

11. The Independent Environmental Consultant (IEC) conducted a 5-day site inspection on Cheoy Lee Shipyard in early March 2001. The IEC considered that the extent and degree of land contamination might be more severe than that revealed by the advance site investigation conducted in last December.

**Notes of Eighteenth Meeting**  
**Steering Committee on Implementation of Hong Kong Disneyland**  
**14 July 2001 at 8:45 am at Room 1220, CGO West Wing**

**PRESENT**

Mr Antony Leung (Chairman)	Financial Secretary
Ms Sandra Lee	Secretary for Economic Services
Miss Denise Yue	Secretary for the Treasury
Mr S S Lee	Secretary for Works
Mr Thomas Tso	Acting Secretary for Planning and Lands
Mr Duncan Pescod	Acting Commissioner for Tourism
Mr Paul Tang	Deputy Secretary for Transport
Dr C K Lau	Director of Civil Engineering
Mr S C Yip	Acting Deputy Director of Civil Engineering (Special Duties)
Mr Elvis Au	Assistant Director of Environmental Protection (Environmental Assessment & Noise)
Mr P Y Tam	Assistant Director of Planning (NT)
Mr Charles Barr	Deputy Law Officer (Civil Law) (Commercial)
Miss Winnie Ho (Secretary)	Assistant Commissioner for Tourism (3)
Miss Alice Cheung	Assistant Secretary for Economic Services

**Steering Committee on Implementation of Hong Kong Disneyland  
Extracts of Notes of Meeting on 14 July 2001**

8            DCE reported that detailed site investigation and geophysical surveys at the former Cheoy Lee Shipyard (CLS) site were in progress. So far, the degree of land contamination found was not very serious and consideration was being given to treating the contaminated mud off-site in North Lantau.

**CED's Paper (No. 15/01) for  
Steering Committee on Implementation of Hong Kong Disneyland**

11.          The progress of the detailed site investigation works and geophysical surveys on the former Cheoy Lee Shipyard site was satisfactory.

**Notes of Nineteenth Meeting**  
**Steering Committee on Implementation of Hong Kong Disneyland**  
**18 August 2001 at 8:45 am at Room 1220, CGO West Wing**

**PRESENT**

Mr Antony Leung (Chairman)	Financial Secretary
Mrs Rebecca Lai	Acting Secretary for Economic Services / Commissioner for Tourism
Miss Denise Yue	Secretary for the Treasury
Mr S S Lee	Secretary for Works
Mr John C Tsang	Secretary for Planning and Lands
Mr Paul Tang	Deputy Secretary for Transport
Mr R D Pope	Director of Lands
Dr C K Lau	Director of Civil Engineering
Mr W K Tam	Deputy Director of Civil Engineering (Special Duties)
Mr P Y Tam	Assistant Director of Planning (NT)
Mr Simon Hui	Principal Environmental Protection Officer
Mr Charles Barr	Deputy Law Officer (Civil Law) (Commercial)
Ms Elsa Po	Senior Government Counsel
Miss Winnie Ho (Secretary)	Assistant Commissioner for Tourism
Miss Alice Cheung	Assistant Secretary for Economic Services

**Steering Committee on Implementation of Hong Kong Disneyland**  
**Extracts of Notes of Meeting on 18 August 2001**

6. DCE reported that detailed site investigation and geophysical surveys at the former Cheoy Lee Shipyard (CLS) site were progressing on schedule. So far, the degree of land contamination found was not considered very serious. He expected the investigation to complete in October / November 2001.

**CED's Paper (No. 17/01) for**  
**Steering Committee on Implementation of Hong Kong Disneyland**

9. The progress of the detailed site investigation works and geophysical surveys on the former Cheoy Lee Shipyard site was satisfactory.

**Notes of 20<sup>th</sup> Meeting**

**Steering Committee on Implementation of Hong Kong Disneyland**

**15 September 2001 at 8:45 am at Room 1220, CGO West Wing**

**PRESENT**

Mr Antony Leung (Chairman)	Financial Secretary
Ms Sandra Lee	Secretary for Economic Services
Mr S S Lee	Secretary for Works
Mr John C Tsang	Secretary for Planning and Lands
Mr Stanley Ying	Acting Secretary for the Treasury
Mr Duncan Pescod	Acting Commissioner for Tourism
Mr Paul Tang	Deputy Secretary for Transport
Dr C K Lau	Director of Civil Engineering
Mr W K Tam	Deputy Director of Civil Engineering (Special Duties)
Mr Elvis Au	Assistant Director of Environmental Protection
Mr P Y Tam	Assistant Director of Planning
Ms Elsa Po	Senior Government Counsel
Miss Winnie Ho (Secretary)	Assistant Commissioner for Tourism
Miss Alice Cheung	Assistant Secretary for Economic Services

**Steering Committee on Implementation of Hong Kong Disneyland**  
**Extracts of Notes of Meeting on 15 September 2001**

3. DCE reported that the Independent Environmental Consultant (IEC) considered the extent of contamination at the former CLS site to be greater than previously anticipated and had requested additional trench work to be carried out.

**CED's Paper (No. 20/01) for**  
**Steering Committee on Implementation of Hong Kong Disneyland**

10. The Independent Environmental Consultant considered the extent of contamination within the former Cheoy Lee Shipyard site to be greater than anticipated previously, and instructed additional trench works on 5 September 2001.



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環境保護署署長  
香港灣仔  
軒尼詩道  
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9 December 2003

(BY FAX 25371204)

Clerk to Public Accounts Committee  
Legislative Council  
Legislative Council Building  
8 Jackson Road  
Central  
Hong Kong  
(Attn: Ms Dora WAI)

Dear Ms Wai,

***The Director of Audit's Report on the  
results of value for money audits (Report No. 41)***

***Chapter 8: The acquisition and clearance of shipyard sites***

I refer to your letter of 3 December 2003, seeking further information in connection of the above chapter. I would like to provide the response as follows:

***(a) whether the EPD had detected any signs of contamination, e.g. Dioxin contamination, during the investigation of the above-mentioned complaints;***

EPD inspected the site following the two complaints in 1995 & 1999 against open burning in the Penny's Bay (PB) shipyard site occupied by the then Cheoy Lee Shipyard (CLS). No actual burning activity was observed during the inspections. Other than some remains of ashes on the ground surface, there were no signs of land contamination detected during the inspections. It should be noted that while dioxins can be formed by any combustion process (e.g. even cigarette smoking) there was no reason to believe any significant quantities of dioxins would have been formed on the site as there was no evidence that large quantities of plastics had been burned which could have given rise to dioxin contamination on a large scale.

Between December 1990 and April 2001 when the site was surrendered to Government, EPD also conducted regular inspections to the CLS to monitor the operation and the pollution situation of the shipyard. The site inspections of our staff did not reveal any leakages, spillage nor land contamination from the shipyard operation. We had no reason to believe that the CLS site would be any more contaminated than any other shipyard site.

***(b) during the site acquisition process, whether the EPD had alerted the relevant works department to any contamination, e.g. Dioxin contamination, on the site known to EPD.***

For the background information of the Committee, it should be noted that exchange of information of the key issues is part of the established procedures in an EIA process. In the conduct of the EIA studies for the PB shipyard site, CED was the project proponent and EPD the statutory Authority. There were different levels of inter-departmental coordination and monitoring of the progress and the findings of the EIA studies. EPD convened Environmental Study Management Group meetings to provide a forum for detailed discussion on the requirements for the EIA study brief, the methodology and the initial findings of the EIA study including the nature and extent of the contamination at the shipyard site, and liaison with the proponent department. Relevant authorities and works departments, including the District Lands Office attended the Group for detailed discussion. This was to ensure that a forum did exist to exchange information and to alert the relevant works departments of key issues related to the EIA process.

Three EIA studies had been conducted, namely, the Northshore Lantau Development Feasibility Study (NLDFS) EIA, the Theme Park EIA and the Decommissioning EIA for the PB shipyard site, all by the CED.

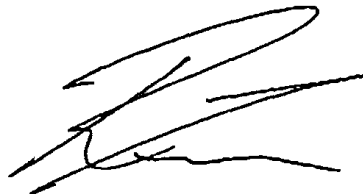
CED conducted the EIA for the NLDFS in 1998. In this EIA, CLS has been identified as the only industrial operation that has the potential to cause soil and groundwater contamination within the project area of the north Lantau development. The contaminations of concern were identified to be total petroleum hydrocarbon and metals. It highlighted the need for a separate subsequent EIA Study to examine the land contamination upon the decommissioning of the PB shipyard site. The Theme Park EIA conducted in 1999 / 2000 made due reference to this finding and required that a detailed EIA study should be carried out to investigate specifically the issue of contamination on the PB shipyard site. Subsequently, the Advisory Council on the Environment (ACE) endorsed the Theme Park EIA in April 2000 with a condition that no work should commence at the PB shipyard site until a separate EIA study for the

decommissioning of the site had been completed and an environmental permit issued.

During the site acquisition stage, which took place between mid-2000 and April 2001, land contamination at the shipyard site was well known to all parties concerned. CED commissioned the Theme Park EIA (Nov. 1999 to April 2000), and subsequently the Decommissioning EIA (April 2000 to April 2002) to determine the precise extent of the land contamination problem and recommend an appropriate remediation proposal to clean up the PB shipyard site.

In the case of dioxin contamination, the presence was revealed at a later stage after completing a comprehensive site investigation at the PB shipyard site. The consultant undertaking the Decommissioning EIA found that the soil was contaminated by dioxins, in addition to those contaminations of metals and petroleum hydrocarbon normally found at shipyard sites. The preliminary study report was made known to CED, EPD and other works departments in October 2001.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'R. J. Law', with a large, sweeping flourish above the name.

( Robert J S Law )  
Director of Environmental Protection

檔號 (122) in CR L/M 20/2003 II Director of Environmental Protection  
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環境保護署署長  
香港灣仔  
軒尼詩道  
一百三十號  
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31 December 2003

(BY FAX 2537 1204)

Clerk  
Public Accounts Committee  
Legislative Council  
Legislative Council Building  
8 Jackson Road, Central  
Hong Kong  
(Attn: Ms Dora WAI)

Dear Ms Wai,

***The Director of Audit's Report on the  
Results of value for money audits (Report No. 41)  
Chapter 8: The acquisition and clearance of shipyard sites***

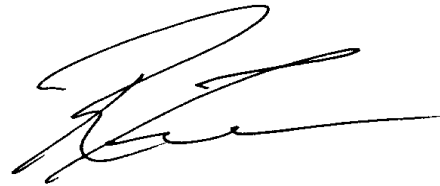
Re your request concerning my reference to views previously expressed by a Greenpeace representative, I would refer you to para 18 of the minutes of the LegCo Environmental Affairs Panel meeting of 19 March 2002.

In response to a request from members to express a view on the Administration's statement that the presence of large quantities of dioxins at shipyard sites was unusual and could not reasonably have been foreseen, Dr Luscombe (the Greenpeace representative) said: "Shipyards had not been widely recognized as a source of dioxins. He was intrigued by the level of contamination".

I think it is clear from the context of the discussion at the Panel meeting that Dr Luscombe basically agreed with the contention that significant quantities of dioxins could not reasonably have been foreseen at a shipyard site.

I believe you have access to the minutes of all the Panel meetings, so I have not attached a copy.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'R. J. Law', written in a cursive style.

( Robert J S Law )  
Director of Environmental Protection

cc            Secretary for the Environment, Transport and Works  
              Director of Civil Engineering  
              Director of Lands  
              Commissioner for Tourism  
              Secretary for Financial Services and the Treasury  
              (Attn: Miss Amy TSE)  
              Director of Audit

*\*Note by Clerk, PAC: Minutes not attached.*



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**Civil Engineering  
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Our reference 本署檔號 : CED CR 10/6/37 Pt 14  
Your reference 來函檔號 : CB(3)PAC/R41

30 December, 2003

The Clerk,  
Public Accounts Committee,  
Legislative Council,  
Legislative Council Building,  
6 Jackson Road,  
Hong Kong

(Attn : Ms Dora Wai)

Dear Ms Wai,

**The Director of Audit's Report on the  
results of value for money audits (Report No. 41)**

**Chapter 8 : The acquisition and clearance of shipyard sites**

Further to my letter dated 24 December 2003, I enclose one copy each of the following reports in relation to contamination at the PB shipyard site :-

- (i) Decommissioning of Cheoy Lee Shipyard at Penny's Bay, EIA – Final Report, Executive Summary.
- (ii) 竹篙灣財利船廠清拆工程, 環境影響評估 – 行政摘要
- (iii) Decommissioning of Cheoy Lee Shipyard at Penny's Bay, EIA Report (Final), Volumes 1 – 2.

Yours faithfully,

( YIP Sai-chor )  
for Director of Civil Engineering

*\*Note by Clerk, PAC: Volumes 1 and 2 of the EIA Report not attached.*

Civil Engineering Department  
The Government of the Hong Kong Special Administrative Region

Agreement No. CE 68/99

# **Infrastructure for Penny's Bay Development Engineering Design and Construction**

**Decommissioning of Cheoy Lee Shipyard  
At Penny's Bay**

**EIA – Final Report**

**Executive Summary**

February 2002

**Maunsell Consultants Asia Ltd.**  
in association with  
Maunsell Geotechnical Services Ltd  
Maunsell Environmental Management Consultants Ltd

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Figure 2.2 Excavation Plan for Soil Contaminated Areas at Area 1

Figure 2.3 Excavation Plan for Soil Contaminated Areas at Area 2

Figure 2.4 Excavation Plan for Soil Contaminated Areas at Area 3

Figure 2.5 Site Layout at To Kau Wan for Off-site Decontamination



## 1. INTRODUCTION

- 1.1 The decommissioning of the existing Cheoy Lee Shipyard (CLS) at Penny's Bay (the Project) involves the demolition of all buildings and structures, and where necessary, decontamination of site areas. The area cleared up will be used for the construction of infrastructures associated with Hong Kong Disneyland Phase 1, including the Penny's Bay Section of the Chok Ko Wan Link Road (CKWLR), Road P2, etc. The Project shall be on the critical path of the Hong Kong Disneyland Theme Park Project.
- 1.2 The Project proposes to decommission the existing CLS at Penny's Bay in order to make space available for the infrastructure construction in association with the Hong Kong Disneyland Phase 1 development. Key works of the Project comprise:
- (a) Demolition of the existing structures within CLS;
  - (b) Removal of abandoned equipment/ installation/ facilities and waste materials in CLS;
  - (c) Excavation of the contaminated soil in CLS and on-site treatment or transportation to the off-site treatment plants;
  - (d) Installation and operation of the on-site and off-site treatment plants;
  - (e) Decommissioning of the on-site and off-site treatment plants, site re-instatement and associated clean up work;
  - (f) Slope improving works behind the CLS;
  - (g) Filling of the CLS to a new formation level after decommissioning; and
  - (h) Implementation of appropriate mitigation measures as recommended in this EIA report to avoid/ minimise any adverse environmental impacts arising from the Project, so that the Project site would be made safe and free of hazards for the planned future use.
- 1.3 The Project consists of two Designated Projects (DPs), viz. item G.4 of Part I (a waste disposal facility, or waste disposal activity for refuse or chemical, industrial or special wastes) and item 17 of Part II (a facility for ship building or repairing more than 1 ha in size or with lifting capacity in excess of 20,000 tonnes) under Schedule 2 of the Environmental Impact Assessment (EIA) Ordinance. In compliance with the EIA Ordinance, environmental impacts due to the Project shall be comprehensively assessed and an Environmental Permit (EP) shall be obtained from the Director of Environmental Protection (DEP) prior to the Project commencement. In September 2000, the Project Proponent, Special Duties (Works) Division of Civil Engineering Department applied to the Environmental Protection Department for an EIA Study Brief with a Project Profile. An EIA Study Brief (No. ESB-062/2000) that purposes to guide the carrying out of the EIA study, was issued on 9 November 2000.
- 1.4 The EIA Report has been prepared in accordance with the requirements stipulated in the *Technical Memorandum on Environmental Impact Assessment Process*. This covers relevant project information, relevant legislation, existing environmental conditions, assessment criteria and methods, assessment findings and proposed mitigation measures.

- 1.5 A comparison of the options for decontamination works areas has been prepared taking into account of the key factors and constraints. The characteristics of particular importance are the size and availability of the site over the duration of the decontamination treatment period, the implications of any delays in the completion of the treatment affecting the infrastructure development, the distance from the shipyard and means of access, the suitability of existing facilities for access, the site constraints such as the presence of any sensitive receivers and the potential environmental effects from storage and treatment.
- 1.6 The review has determined that a suitable site at To Kau Wan is available for the expected duration of the proposed decontamination works. The site at To Kau Wan is 5.8ha and is adequate to accommodate all the treatment works on one site. The site is reasonably close to Penny's Bay and impacts arising from the land transportation of contaminated soils are expected to be minimal. Potential environmental impacts associated with the decontamination works are acceptable and can be mitigated as no sensitive land uses are located nearby. Accordingly, it is recommended that the site at To Kau Wan be used as the decontamination works site.

## 2. LAND CONTAMINATION

### Soil Contamination

- 2.1 Based on the laboratory results of the site investigation, soil contamination is found in Area 1, Area 2 and Area 3 of CLS. The soil in Area 1 is predominantly contaminated with 'metals' and 'metals/TPH/SVOCs' whereas the soil in Area 3 is predominantly contaminated with 'metals' and 'dioxins/metals/TPH/SVOCs'. The soil in Area 2 is contaminated with 'metals', 'metals/TPH/SVOCs' and 'dioxins/metals/TPH/SVOCs'. (Please refer Figures 2.2 to 2.4 for Areas 1 to 3, respectively.)
- 2.2 The volumes of soils contaminated by different types of contaminants have been estimated based on the extensive laboratory results and are tabulated in Table 2.1 respectively.

**Table 2.1 Estimated Volumes of Soils Contaminated by Different Types of Contaminants**

Contaminant Type(s)	Estimated Volume (m <sup>3</sup> )
Metals only	48,000
TPH / SVOCs	700
Metals and TPH / SVOCs	8,300
Dioxins and Metals / TPH / SVOCs	30,000
Total Estimated Volume	87,000

### Groundwater Contamination

- 2.3 Although the laboratory results of groundwater samples reveal some exceedances in the screening criteria for risk assessment. A risk assessment has been undertaken to assess the risk posed by the contaminants in groundwater. The results of the risk assessment reveal that the concentrations of all chemicals of concern do not exceed the calculated 'allowable' concentrations and the risk posed by the contaminants in groundwater is acceptable.
- 2.4 As only a thin layer of TPH free product was discovered on the groundwater table in one well

during site investigation, the impact is considered insignificant.

### Remedial Methods

2.5 The objectives of the remediation are:

- To clean up the site to the remediation targets and within the overall development programme with cost effective and well established method;
- To minimise the environmental impacts during the excavation, construction and operation of the remedial systems; and
- To protect construction workers adequately from site hazards.

#### *Selection of Remedial Methods for Non-dioxin Contaminated Soil*

2.6 Various treatment technologies have been screened and evaluated. Cement solidification has been proposed for soil contaminated with metals and biopiling for soil contaminated with TPH and/or SVOC, taking into account of the applicability and limitations of the treatment technologies.

#### *Selection of Remedial Method for Dioxin-contaminated Soil*

2.7 Various thermal and non-thermal technologies have been evaluated. Based on the comparative analysis in terms of effectiveness, implementability and cost implications, thermal desorption is proposed for the treatment of dioxin-contaminated soil and the residue generated will be destroyed by incineration at Chemical Waste Treatment Centre (CWTC).

#### *Selection of Implementation Option*

2.8 Five different implementation options in relation to remedial method as well as remedial location have been evaluated. The option of excavating all contaminated soil, and treating them either on-site at CLS or off-site at TKW (depending on the nature of contaminants) is recommended.

### Outline of Proposed Implementation Option

2.9 The proposed implementation option is recapitulated in Table 2.2. These methods are proposed based on the evaluation of their effectiveness and implementability described above. During remediation, the contaminated soils will be excavated. Metal-contaminated soil will be treated on site whereas soil contaminated with other contaminants will be transported to TKW (please refer to Figure 2.1 for location of TKW site) for off-site treatment. The excavation plans for soil contaminated areas at Area 1, Area 2 and Area 3 are depicted in Figures 2.2, 2.3 and 2.4, respectively. The proposed decontamination works area at To Kau Wan is depicted in Figure 2.5.

**Table 2.2 Proposed Remediation Methods for Soil Contamination**

Soil Contaminant	Proposed Remediation Method	Location
Metals only	Cement Solidification	CLS
TPH / SVOCs	Biopiling	TKW
Metals and TPH / SVOCs	Biopiling followed by Cement Solidification	TKW

Dioxins and Metals / TPH / SVOCs	Thermal Desorption followed by Cement Solidification	TKW
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### Confirmation Sampling and Testing

2.10 Confirmation sampling and testing have been proposed for the followings:

- i) Soil excavation to ensure complete removal of all contaminated soil;
- ii) Biopile treatment to ensure attainment of cleanup targets for soil contaminated with TPH/SVOC;
- iii) Cement solidification to ensure attainment of cleanup targets for soil contaminated with metals;
- iv) Thermal desorption to ensure attainment for cleanup targets for soil contaminated with dioxins; and
- v) Skimming of any TPH free product encountered at excavation areas to ensure complete removal of the TPH free product.

### Mitigation Measures

2.11 Various environmental mitigation measures and health & safety measures have been proposed for soil excavation, stockpiling of soil, biopile treatment, cement solidification and thermal desorption. With the incorporation of these measures during excavation and operation of the remediation system, as well as the provisions of safety measures to site workers, there is no residual impact arising from land contamination. Mitigation measures have been proposed for excavation and operation of the remediation system regarding air, water, waste and ecology, and are provided in the respective chapters of the EIA Report.

## 3. AIR QUALITY IMPACT

3.1 Dust emission from the site is a concern for the building demolition, slope improvement works of CLS. Total Suspended Particulates (TSP) would be generated from materials handling and truck movement over haul roads. With the incorporation of dust control measures stipulated in the *Air Pollution Control (Construction Dust) Regulation*, the TSP level at the ASR will be low. Mitigation measures have been proposed for the building demolition and slope improvement works CLS and are included in the chapter of air quality.

3.2 Excavation of contaminated area would disturb the soil, and dioxins bind onto the soil would be dispersed in form of dust. Modelling results indicated that the impacts at the ASRs are low and satisfied the hourly criteria. The following mitigation measures are proposed at work sites of contaminated pits.

- The top layer soils shall be sprayed with fine misting of water immediately before the excavation to avoid dust emission.
- Inactive excavated area shall be covered by impermeable sheeting to minimise dust emissions.

- 3.3 Solidification will be conducted at the CLS to stabilise heavy metals in soil. Biopiling, thermal desorption and solidification as parts of the decontamination process will be conducted at TKW. The biopiles could reduce organic constituents by 99% whereas the solidification process could immobilise the toxic material. The design of thermal desorption plant and associated air treatment unit shall allow only 0.0001% of dioxins, organic gases and Polycyclic Aromatic Hydrocarbons (PAHs) from the soils, escaped as gaseous pollutants. Air emissions from these facilities have been modelled and assessed to be within the respective criteria. The following mitigation measures are proposed for the treatment facilities:
- The thermal desorption shall be of enclosed process;
  - For the thermal desorption process, the dioxin emissions shall be limited to 0.1 ng/m<sup>3</sup> and Total Organic Compounds (TOC) emission limited to 20 mg/m<sup>3</sup>;
  - The design of thermal desorption plant is of enclosed type and together with the associated air treatment unit shall allow only 0.0001% of dioxins, organic gas and PAHs from the soils, escaped as gaseous pollutants;
  - TOC emission from the biopile shall be limited to 20 mg/m<sup>3</sup>, with maximum flow rate of 56 m<sup>3</sup>/min;
  - Back-up carbon absorber shall be installed for the biopile to ensure that the TOC criteria is satisfied;
  - The biopiles shall be covered by impermeable sheeting to avoid emission of VOCs; and
  - Mixing process at TKW will be enclosed and cement for solidification shall follow the *Air Pollution Control (Construction Dust) Regulation*.
- 3.4 Air quality impact associated with the decommissioning of TKW site will be low and complied with the criteria.
- 3.5 The health risk of inhalation associated with the operation of the treatment facilities has been assessed to be insignificant, and comply with international criteria.
- 3.6 With implementation of the proposed mitigation measures, there will be no residual impact.

#### **4. WASTE MANAGEMENT AND TRANSPORTATION OF CONTAMINATED MATERIALS**

- 4.1 Construction & Demolition (C&D) material will be generated during the demolition of the shipyard facilities. It is estimated that about 10,000m<sup>3</sup> C&D material will be generated of which about 1,000m<sup>3</sup> are contaminated. In addition, about 1,000 tonnes of steel and 5,000 m<sup>3</sup> of general refuse will also be generated. It is considered that adverse waste impacts will not be generated provided that good site practices and sound waste handling practices recommended are strictly followed.
- 4.2 During slope improvement behind CLS, around 40,000m<sup>3</sup> soil and 2,100m<sup>3</sup> rock will be generated. It is considered that no adverse impact will arise provided that the excavated materials will be reused/ recycled within CLS as much as practical.
- 4.3 During remediation, about 87,000m<sup>3</sup> contaminated soil will be excavated from Cheoy Lee

Shipyard and either treated on-site or transported to TKW for off-site treatment depending on the types of contaminants. The soils after treatment will turn to clean inert materials suitable for public filling. The condensate as the end product of the treatment and other chemical wastes will be collected and disposed of at the Chemical Waste Treatment Centre. Thus, no residual waste impact is expected.

- 4.4 The overall total of C&D material to be generated by this Project is estimated around 0.4Mm<sup>3</sup>. The C&D material will be reused and recycled as far as practicable in the land formation works within CLS site so as to minimise the amount of C&D material to be disposed of at public filling areas (PFAs).
- 4.5 Mitigation measures have been proposed in relation to waste collection, handling, transportation, storage and disposal to minimise environmental impacts.
- 4.6 To ensure proper waste handling and management procedures are strictly followed, the Contractor shall prepare the following documents for the Engineer's approval prior to work.
- Waste Management Plan;
  - Operational Plan;
  - Spill Handling Contingency Plan; and
  - Building Decommissioning Plan.
- 4.7 In addition, the following registration/ licence/ approval/ permit/ notification are required:
- Waste Producer Registration: The Contractor is required to be registered under the *Waste Disposal (Chemical Waste) (General) Regulation*;
  - Waste Collection Licence: A Waste Collection Licence under the *Waste Disposal Ordinance* is required for the transport/ delivery of chemical wastes to off-site waste disposal facilities;
  - Waste Disposal Licence: A Waste Disposal Licence is required for the operation of the off-site treatment facility a TKW for the treatment for dioxin-contaminated soil.
  - Approval for Using Large Container: Approval is required under the *Waste Disposal (Chemical Waste) (General) Regulation* for using chemical waste container with a capacity exceeding 450L.
  - Part A Notification: Prior notification to the Environmental Protection Department is required before any collection of Part A chemical waste.
  - Noise Permit: A Noise Permit under *Noise Control Ordinance* is required for night-time operation of the decontamination system and transportation of contaminated soil by trucks to TKW at night.
- 4.8 With implementation of the proposed mitigation measures, there will be no residual impact.

## 5. WATER QUALITY IMPACT

### Building Demolition and Slope Improvement

- 5.1 During the building demolition and slope improvement, adverse water quality impacts arising from runoff and sewage effluent generated by the construction workforce are not likely with 'best practical' site procedures implemented. Regular site audits are therefore recommended to ensure that 'best site practices' and relevant mitigation measures be implemented throughout the Project.

### Soil Remediation

#### *At Cheoy Lee Site*

- 5.2 After demolished the building, contaminated soils at CLS would be excavated for on-site and off-site treatment. Local groundwater will be drawn out (i.e. dewatering) when excavation proceeds below the water table. The groundwater with elevated metal and TPH levels, though not contaminated in accordance with risk-based assessment, would impose water quality impact if being directly discharged into the drainage channel. As a mitigation measure, the groundwater pumped out shall be recharged within CLS site in such a manner that it would not cause local rising of water table leading to contaminant migration. Wheel wash water and decontamination wastewater generated will be considered contaminated. A mitigation measure to install a centralised water treatment unit is recommended to treat the effluent before discharged. With the implementation of the mitigation measures, no adverse water quality impact is envisaged.
- 5.3 Impact of groundwater seepage to nearby marine water via the future drainage channel to the north of CLS site was also assessed. The drainage channel would be built above the existing CLS ground level thus this effectively isolates the groundwater from seeping into the channel. In any case, the groundwater, if any seeped into the channel would be diluted a lot, therefore water quality impact arising from the groundwater seepage to the nearby marine water is not likely. No impact on the artificial lake of the future water recreation centre is predicted arising from groundwater seepage. This is because:
- the planned water level of the artificial lake will be higher than the CLS water table level;
  - there is an impermeable liner at the bottom of the lake to subsurface contaminants infiltration; and
  - the soil contamination would be cleaned up during the CLS decommissioning, thus removing the contaminant source.
- 5.4 Pending receipt by the solidification facility, there would be temporary stockpiles of metal-contaminated soil. It is recommended that temporary stockpiles be lined with impervious sheeting, bunded and covered by impermeable sheeting during rain events whereby the volume of contaminated runoff and leachate would be reduced. The generation of contaminated runoff and leachate would be further minimised respectively by sheltering the solidification facility and controlling water addition during the solidification process. In the end, a licensed centralised wastewater treatment unit is recommended for treating the contaminated runoff and leachate prior to their discharging into local drainage. Taking the above considerations, no adverse impact arising from the operation of the solidification

facility is predicted.

### ***At To Kau Wan Site***

- 5.5 Biopile, thermal desorption process and solidification are the major decontamination processes conducted at the To Kau Wan decontamination site. Potential water quality impact of contaminating the nearby water bodies would be arising from various site effluents, viz. plant leachate, contaminated run-off from the thermal desorption plant, wheel wash water and decontamination water. It is therefore recommended to install a licensed centralised wastewater treatment unit for treating the effluent before being discharged. With the wastewater treatment unit in place and in operation, no adverse water quality impact is envisaged.
- 5.6 Other mitigation measures as follows have been recommended in relation to biopiling, thermal desorption and solidification desorption processes to minimise generation of contaminated runoff and leachate:

#### Biopiling

- Impermeable floor liner to be placed and associated leachate collection sump to be installed for the biopile,
- Concrete bund to be constructed along the perimeter of biopiles,
- Impermeable sheeting to be provided over the formed biopile during rain events.

#### Thermal Desorption

- Shelter and leachate collection system to be provided for the storage bin of dioxin contaminated soils,
- Concrete bund to be constructed at the perimeter of the plant,
- Runoff collection system to be installed for the plant.

#### Solidification

- Shelter to be provided for soil loading and unloading area and the entire facility,
- Concrete bund to be constructed at the perimeter of the facility,
- Any pits used for solidification process to be shallower than the water table to avoid leaching of the contaminated soil and to be lined with impermeable membrane.

## **6. ECOLOGICAL IMPACT**

- 6.1 Based on the assessment, works associated with this project have the potential to cause high level impacts on ecological resources.
- 6.2 The greatest possible disturbance is to Rice-fish (*Oryzias curvinotus*) habitats at Mong Tung Hang Stream (MTHS), and restricted / protected plant species around CLS.
- 6.3 Detailed measures to mitigate high level ecological impacts arising from this project are recommended. Good construction practice is recommended to avoid / minimise disturbance to other habitats surrounding the shipyards.



6.4 The following mitigation measures are proposed:

***Impacts to Restricted/Protected Plant Species***

- Where possible, restricted/protected plant species are to be preserved *in situ*. Areas supporting the highest concentrations of restricted/protected species have been fenced off to prevent tipping, vehicle movement and encroachment of personnel into these areas.
- Design of slope works has been modified to minimise impact to the plants concerned.
- Plants directly affected by the proposed works are to be transplanted to suitable receptor site at Tai Tam Country Park. To maximise the transplantation success, seeds will be collected and stored in specialist facilities prior to transplantation. If transplanting proves unsuccessful, the introduction of germinated seed and stored plants to receptor sites shall be considered.

***Impacts to Rice Fish (*Oryzias curvinotus*) Habitats at MTHS***

- The lower course of MTHS will be affected by the proposed works at CLS. The specific nature of mitigation measures will be determined by the results of future studies of the stream as the Rice Fish previously recorded has not been found again in this study: It is recommended that more detailed surveys of fish populations are carried out prior to the commencement of fill works.
- If Rice Fish (*Oryzias curvinotus*) are found in future surveys, they shall be temporarily relocated to holding aquaria. A recreated habitat suitable for the fish shall then be constructed at MTHS, and the fish returned to the habitat.
- If no Rice Fish (*Oryzias curvinotus*) are found in future surveys, it will be possible to source a captive population, and re-introduce the fish to a re-created habitat at MTHS.
- Environmentally friendly design will be incorporated in the future drainage channel to encourage recolonisation of the lower stream fauna.

***Disturbance to To Kau Wan***

- The construction of biopiles (where high levels of activity may disturb the birds) shall take place from October-February, outside of the Ardeid breeding season;
- Bio-piles shall be placed at the west of the site, to minimise disturbance to area where egrets were seen;
- Blowers shall be placed at the back of biopiles to minimise disturbance to area where egrets were seen.

***Shipyard Decommissioning and Transport of Harmful Contaminants***

- All potentially harmful contaminants from CLS shall be handled, treated and disposed of in an appropriate manner; to minimise risks to human health and flora and fauna.

***Fill / Slope Works***

- Shotcrete should not be used for the slope works. The design of slope works shall make reference to the GEO Publication No. 1/2000 “Technical Guidelines on Landscape Treatment and Bioengineering for Man-made Slopes and Retaining Walls”.
  - Works on slopes supporting natural vegetation shall be minimised as far as slope safety standards allow.
  - Hydroseeding and planting of trees and shrubs including native species will be undertaken on newly created slopes.
- 6.5 With the proposed mitigation measures in place, residual impacts arising from the project will be ecologically acceptable.

**7. IMPACT ON CULTURAL HERITAGE**

- 7.1 An archaeological survey has been conducted for the CLS, and revealed artifacts of high archaeological values in CLS. Many artifacts of different periods, including the Late Neolithic period, Bronze Age, Tang Dynasty, Song Dynasty, Ming Dynasty and Ching Dynasty have been recovered in CLS, along the ancient coastal area.
- 7.2 Potential impact to archaeological resources may arise from landtake, ground compaction, topsoil or subsoil disturbance during construction, change in watertable and a limitation on accessibility for future investigation, which may result in damage to, or loss of the archaeological remains. Preservation measures include covering the archaeological potential sites, where are not subjected to rescue excavation, by impermeable sheeting before filling. Detailed design of filling work should include diversion of site runoff to prevent any waterlogged conditions at the archaeological sites. On-site monitoring has been proposed to minimise the impacts of archaeological deposits. For areas where preservation in site is not possible, the impact in the heritage resources should be mitigated by rescue excavation. All rescue works have to be completed prior to the decontaminated works of CLS.

**8. ENVIRONMENTAL MONITORING AND AUDIT**

- 8.1 Environmental monitoring and audit are recommended for land contamination, air quality, water quality, waste management and ecology. Details of the recommended mitigation measures, monitoring procedures and locations have been presented in a stand-alone Environmental Monitoring and Audit Manual (EM&A). This will enable the Contractor to have early warning and provide necessary action to reduce impacts at specific areas if the assessment criteria are approached. The effectiveness of on-site control measures could also be evaluated through the monitoring exercise. All the recommended mitigation measures shall be incorporated into the EM&A programme for implementation.
- 8.2 A summary for all parameters to be monitored and audited during construction phase and operational phases are summarised in Table 8.1.

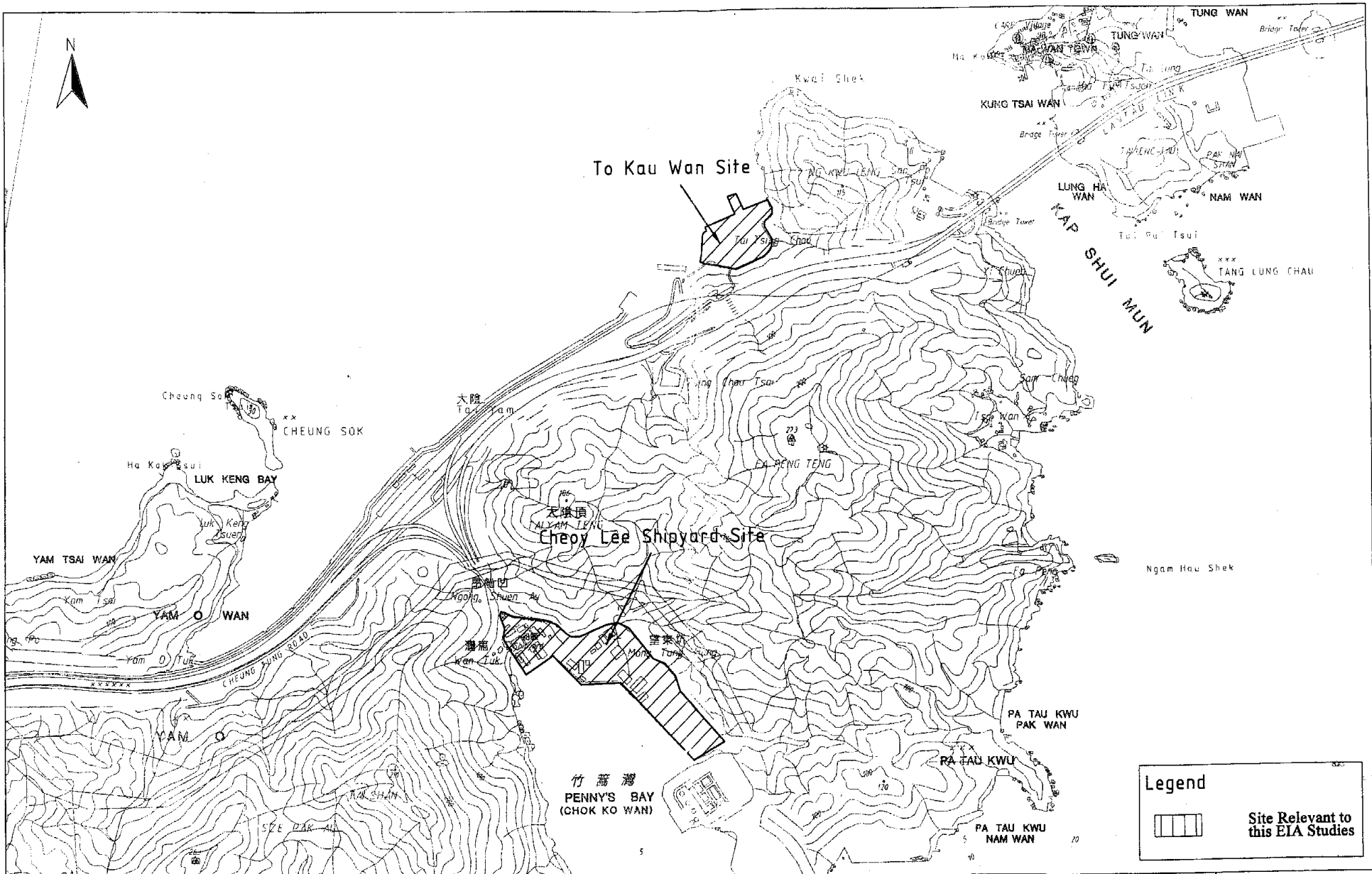
**Table 8.1 Summary for All Monitoring Parameters**

Parameter	Monitoring and Audit Requirements			
	Building Demolition and Slope Improvement Phases	Remediation Phase		TKW Decommissioning Phase
		At CLS	At TKW	
Land Contamination	Nil	<ul style="list-style-type: none"> <li>Monitoring of groundwater level at recharge point and the proximate location during dewatering.</li> <li>Monitoring and confirmation sampling/testing shall be carried out to ensure complete removal of any free product encountered during excavation.</li> <li>Confirmation sampling/testing shall be carried out for: (i) soil excavation; (ii) biopile treatment; (iii) solidification; and (iv) thermal desorption process.</li> </ul>	<ul style="list-style-type: none"> <li>Weekly site audits</li> </ul>	<ul style="list-style-type: none"> <li>Weekly site audits</li> </ul>
Air Quality	<ul style="list-style-type: none"> <li>Weekly site audits</li> </ul>	<ul style="list-style-type: none"> <li>Ambient TSP and dioxin monitoring at sensitive receivers.</li> </ul>	<ul style="list-style-type: none"> <li>Ambient TSP and dioxin monitoring at sensitive receivers.</li> <li>Monitoring of TOC in biopile gas effluent</li> <li>Stack monitoring of dioxin emission from the thermal desorption plant</li> <li>CEM of TOC, O<sub>2</sub>, CO<sub>2</sub> and CO from the stack of thermal desorption plant</li> <li>Weekly site audits</li> </ul>	<ul style="list-style-type: none"> <li>Weekly site audits</li> </ul>
Waste Management	<ul style="list-style-type: none"> <li>Weekly site audits</li> </ul>	<ul style="list-style-type: none"> <li>Weekly site audits</li> </ul>	<ul style="list-style-type: none"> <li>Weekly site audits</li> </ul>	<ul style="list-style-type: none"> <li>Weekly site audits</li> </ul>
Water Quality	<ul style="list-style-type: none"> <li>Weekly site audits</li> </ul>	<ul style="list-style-type: none"> <li>Monitoring of the effluent quality of the water treatment</li> </ul>	<ul style="list-style-type: none"> <li>Monitoring of the effluent quality of the water treatment</li> </ul>	<ul style="list-style-type: none"> <li>Weekly site audits</li> </ul>

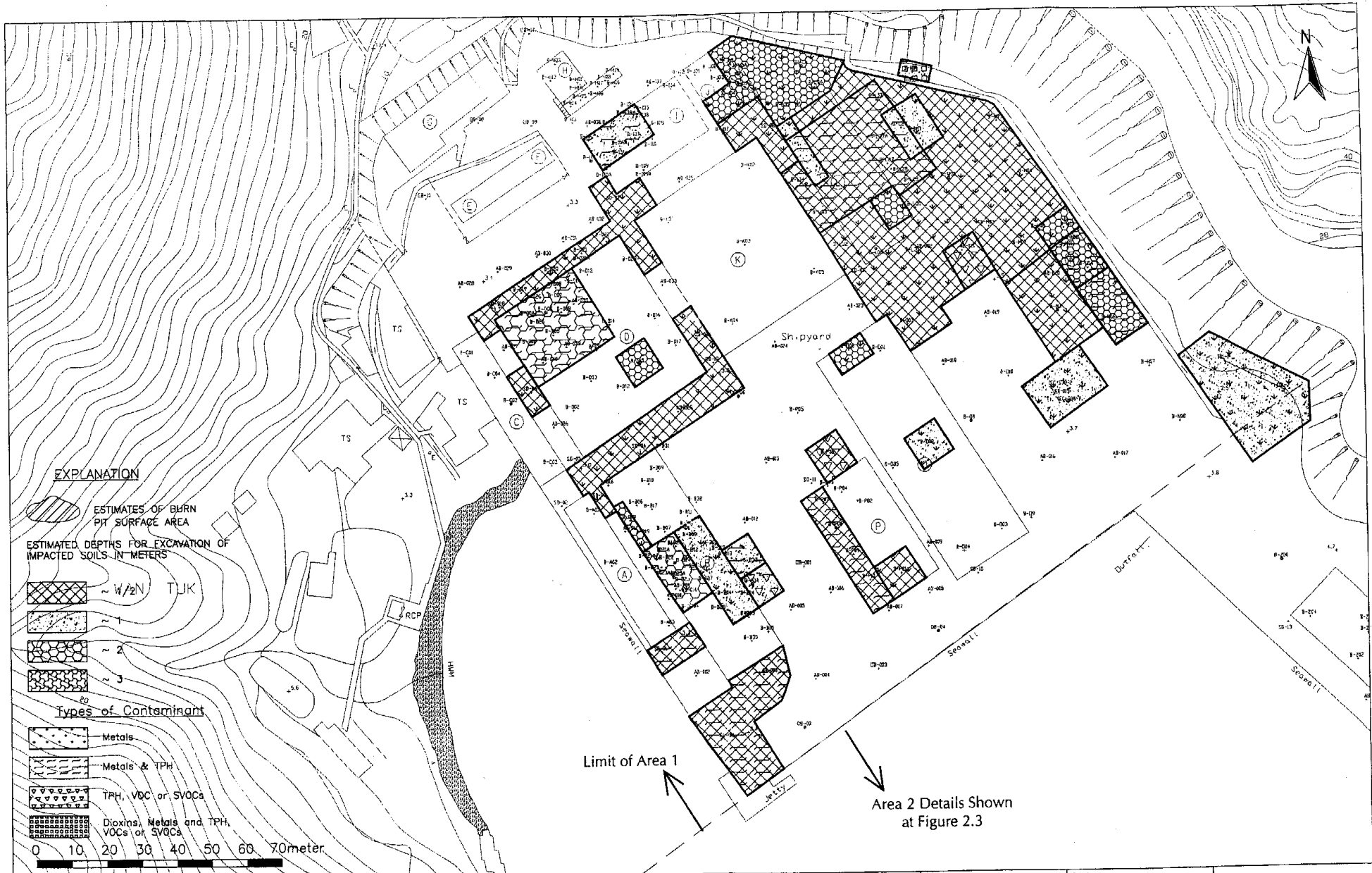
Parameter	Monitoring and Audit Requirements			TKW Decommissioning Phase
	Building Demolition and Slope Improvement Phases	Remediation Phase		
		At CLS	At TKW	
		unit (for wheel washing water and decontamination water) <ul style="list-style-type: none"> <li>Weekly site audits</li> </ul>	unit (for wheel washing water, decontamination water, leachate and runoff from thermal desorption plant) <ul style="list-style-type: none"> <li>Weekly site audits</li> </ul>	
Ecology	<ul style="list-style-type: none"> <li>Monitoring of transplanted plants at the receptor site.</li> <li>Monitoring of stream fauna (e.g. macroinvertebrates at the new habitat prior to the relocation of Rice fish).</li> <li>Monitoring of relocated fish species at the new habitat</li> </ul>			

## 9. CONCLUSIONS

- 9.1 The findings of this EIA have provided information on the nature and extent of environmental impacts arising from the decommissioning of the CLS. The EIA has, where appropriate, identified mitigation measures to ensure compliance with environmental legislation and standards.
- 9.2 Overall, the EIA Report for the decommissioning of the CLS has predicted that the Project will comply with all environmental standards and legislation after the proposed construction and operational stage mitigation measures are implemented. This EIA has also demonstrated the general acceptability of the residual impacts from the Project and the protection of the population and environmentally sensitive receivers. Environmental monitoring and audit mechanisms have been recommended during the decommissioning of CLS, where necessary, to verify the accuracy of the EIA predictions and the effectiveness of recommended mitigation measures.
- 9.3 The nature of the project is primarily of environmental improvement. Contaminated materials are permanently removed from the ground and cleaned up, removing a source of long term liability. After the shipyard is decommissioned, it provides room for the infrastructure in support of the Theme Park Development. The safety of the slopes is improved. The habitat of the Rich Fish which is of conservation interest will be recreated, and restricted/protected plants will be conserved on-site, or transplanted to a suitable receptor site. The archaeological artefacts are rescued or preserved from the site.

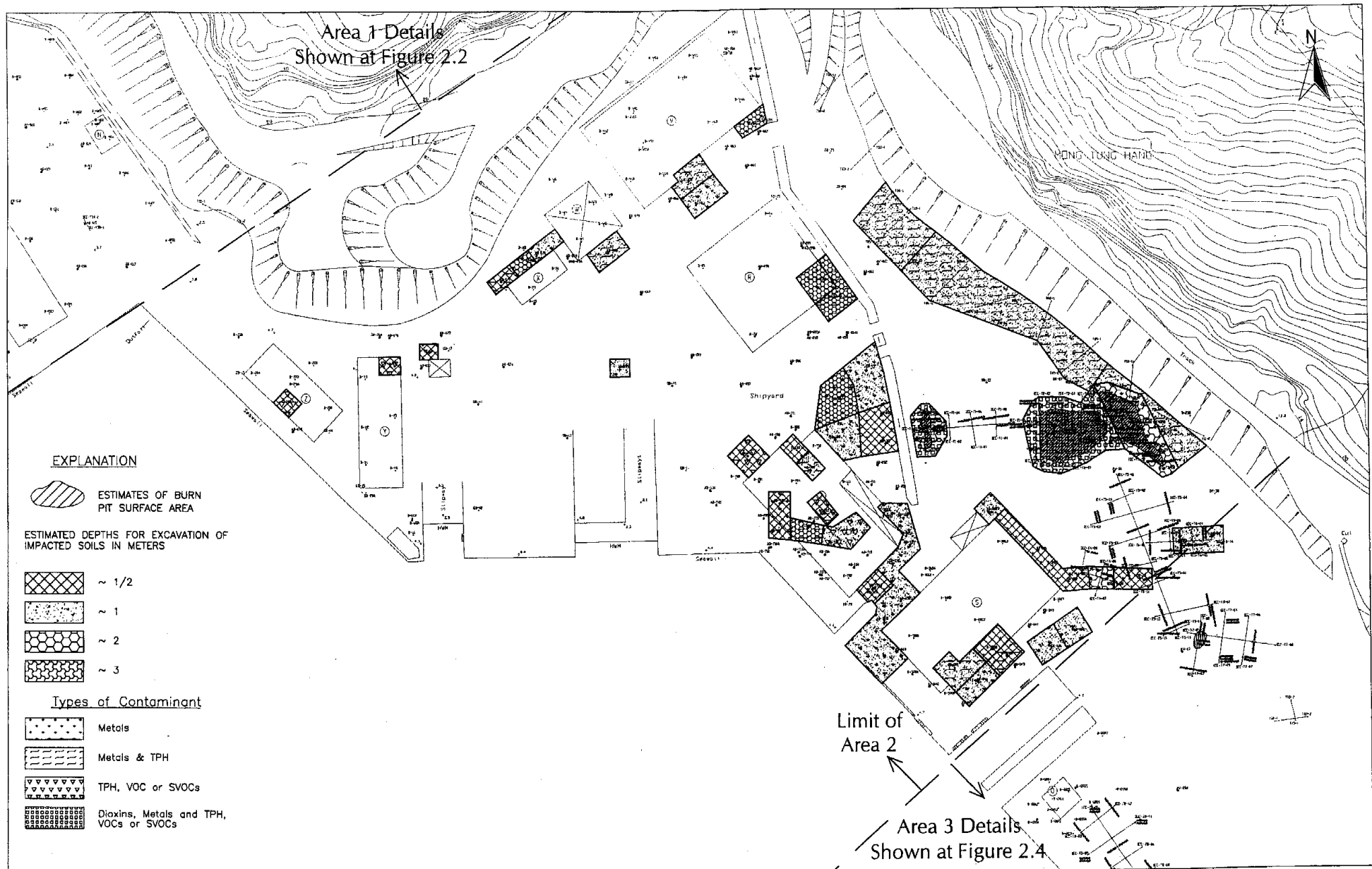


Title Agreement No. CE 68/99 Infrastructure for Penny's Bay Development - Engineering Design and Construction Decommissioning of Cheoy Lee Shipyard  <b>Site Location Map</b>	Scale 1 : 15000	Project No. R06100	<b>Maunsell</b> MAUNSELL ENVIRONMENTAL MANAGEMENT CONSULTANTS LTD
	Date Feb 2002	Figure No. 2.1	




Title	Agreement No. CE 68/99 Infrastructure for Penny's Bay Development - Engineering Design and Construction Decommissioning of Choey Lee Shipyard		Scale	1 : 1000	Project No.	R06100
	Excavation Plan for Soil Contaminated Areas at Area 1		Date	Feb 2002	Figure No.	2.2




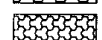





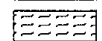
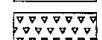
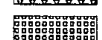
**EXPLANATION**


 ESTIMATES OF BURN PIT SURFACE AREA

**ESTIMATED DEPTHS FOR EXCAVATION OF IMPACTED SOILS IN METERS**

-  ~ 1/2
-  ~ 1
-  ~ 2
-  ~ 3

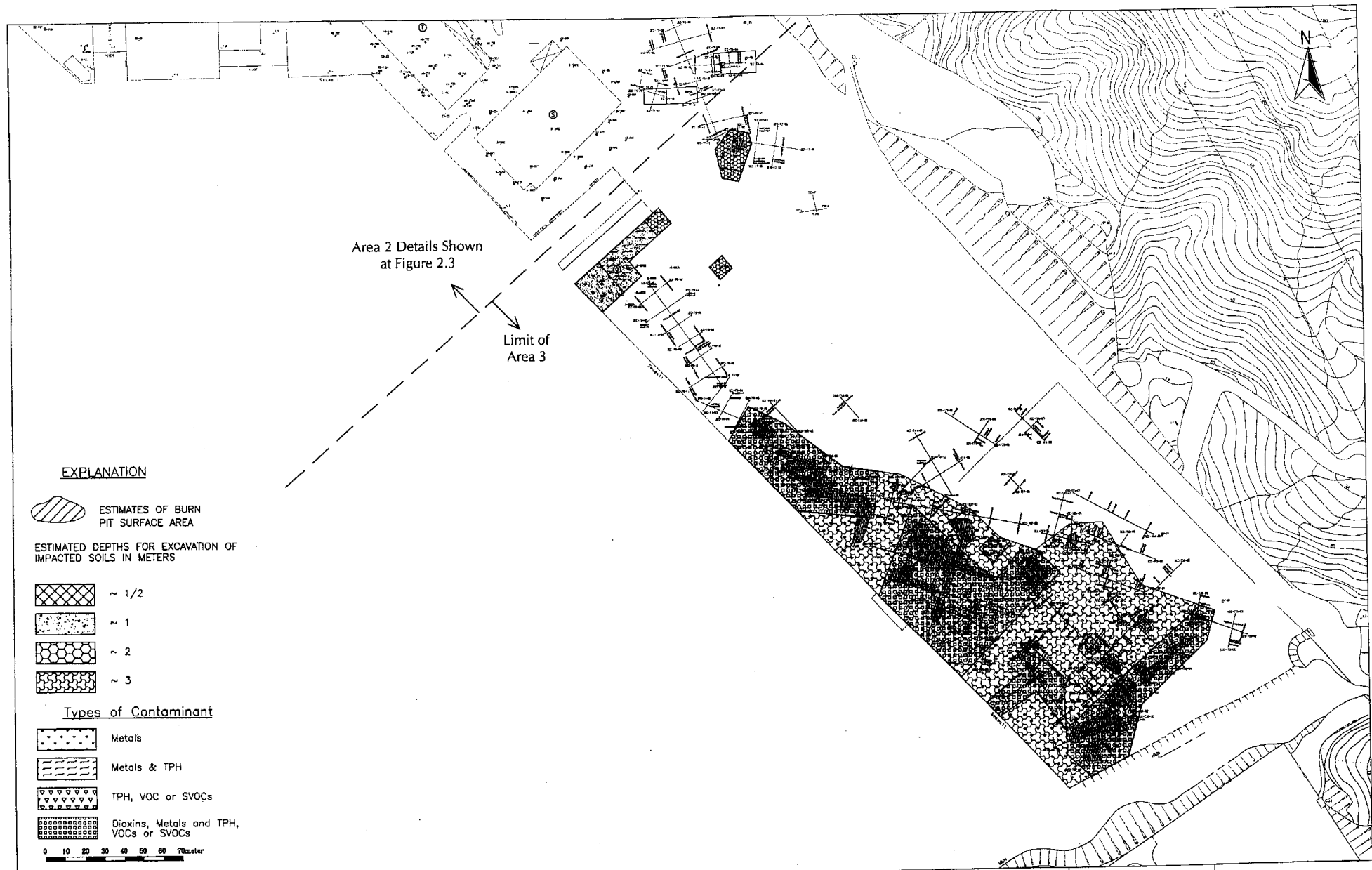
**Types of Contaminant**

-  Metals
-  Metals & TPH
-  TPH, VOC or SVOCs
-  Dioxins, Metals and TPH, VOCs or SVOCs

Title	Agreement No. CE 68/99 Infrastructure for Penny's Bay Development - Engineering Design and Construction Decommissioning of Choey Lee Shipyard		Scale	1 : 1500	Project No.	R06100	
	Excavation Plan for Soil Contaminated Areas at Area 2		Date	Feb 2002	Figure No.	2.3	
						 <small>MAUNSELL ENVIRONMENTAL MANAGEMENT CONSULTANTS LTD</small>	

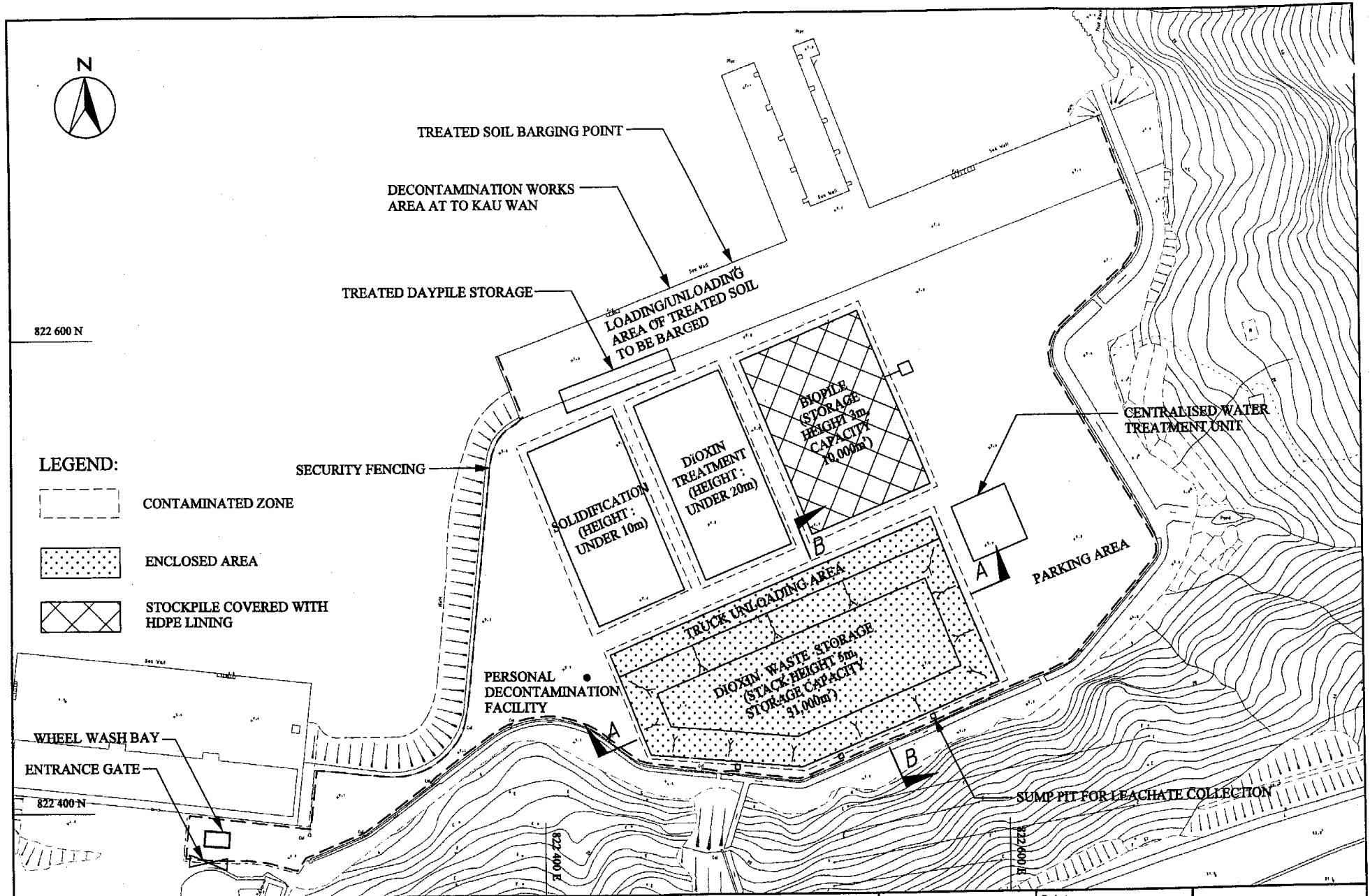
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Title	Agreement No. CE 68/99 Infrastructure for Penny's Bay Development - Engineering Design and Construction Decommissioning of Choey Lee Shipyard		Scale	1 : 1800	Project No.	R06100
	Excavation Plan for Soil Contaminated Areas at Area 3		Date	Feb 2002	Figure No.	2.4





Title Agreement No. CE 68/99 Infrastructure for Penny's Bay Development - Engineering Design and Construction Decommissioning of Cheoy Lee Shipyards  <b>DECONTAMINATION WORKS AREA AT TO KAU WAN</b>	Scale	1:1500	Projects No.	R06100	<b>Maunsell</b> <small>MAUNSELL ENVIRONMENTAL MANAGEMENT CONSULTANTS LTD</small>
	Date	Feb 2002	Figure No.	2.5	

財經事務及庫務局  
(庫務科)

香港下亞厘畢道  
中區政府合署



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

Central Government Offices,  
Lower Albert Road,  
Hong Kong

電話號碼 Tel. No. : 2810 3132  
傳真號碼 Fax No. : 2523 5722  
本函檔號 Our Ref. : LM to FIN CR 2/2191/03  
來函檔號 Your Ref. : CB(3)/PAC/R41

30 December 2003

Ms Dora Wai  
Clerk to Public Accounts Committee  
Legislative Council  
Legislative Council Building  
8 Jackson Road  
Central  
Hong Kong  
(Fax : 2537 1204)

Dear Ms Wai,

**The Director of Audit's Report on the  
results of value for money audits (Report No. 41)**

**Chapter 8 : The acquisition and clearance of shipyard sites**

Thank you for your letter of 16 December 2003.

We have checked our records and would like to confirm that this Branch had not been previously informed of the increase in the estimated cost of decommissioning the Penny's Bay shipyard site from \$22 million in November 1999 to \$100 million in January 2001. This piece of information came to our knowledge in the context of the first draft report circulated by the Director of Audit on 28 August 2003 for our comments.

In the submission of 17 November 1999 to the Public Works Subcommittee (PWSC)/Finance Committee (FC) for acceptance in principle the financial implications at a rough order of \$13.6 billion for funding the infrastructure to support the development of an international theme park at Penny's Bay, the Administration included an estimated cost of \$22 million for miscellaneous works including decommissioning of an existing shipyard, i.e. the Penny's Bay shipyard site. The submission also stated that the detailed design work for various components of the project had still to be undertaken and the capital cost estimates would be refined further as we proceeded with the detailed design process. At the PWSC meeting, the Administration made clear that we would submit further funding proposals to PWSC/FC for upgrading the project works in phases to Category A of the Public Works Programme and that Members would have further opportunities to scrutinise the details of the project when considering the respective funding proposals. The Administration also undertook to carry out a detailed Environmental Impact Assessment (EIA) study for the Hong Kong Disneyland Project to address potential environmental issues that might arise during the construction and the operation stages.

As a normal practice in the planning of public works projects, works departments would refine the project estimates in the light of information available from site investigation, feasibility study, EIA studies and preliminary/detailed design. In that connection, works departments should ensure that the financial implications of a project, including the capital and recurrent cost, as set out in the PWSC/FC submissions are the most realistic estimates at the time of seeking funding approval and represent the best value for money. The Controlling Officer must seek funding approval from the PWSC/FC for any subsequent changes in the approved project estimates exceeding \$15 million with full justifications. For changes costing less than \$15 million, approval from the Financial Services and the Treasury Bureau is required.

In the present case, Treasury Branch was not informed in early 2001 of the increase in the estimated cost of decommissioning the Penny's Bay shipyard site from \$22 million to \$100 million, which was still subject to the completion of the EIA study. However, all relevant departments/bureaux including Treasury Branch were alerted of the more serious contamination and the likely increase in the decontamination cost due to the presence of dioxin after the completion of EIA studies on the decommissioning of CLS in end 2001. The project estimates were subsequently revised to include a higher and more

accurate estimation of the decommissioning cost with justifications in the submission to PWSC for funding approval for the package 3 infrastructure works in May 2002. In that context, we see that the preparation of the project estimates is in line with the normal practice.

Yours sincerely,



(Miss Amy Tse)  
for Secretary for Financial Services  
and the Treasury

cc Secretary for the Environment, Transport and Works  
Director of Civil Engineering  
Director of Lands  
Director of Environmental Protection  
Commissioner for Tourism  
Director of Audit

Ref : ARC/300/16  
Tel : 2737 2220  
Fax : 2730 1771

19 May 2004

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. 42)**

**Chapter 2 : Funding of projects under the Applied Research Fund**

Thank you for your letter dated 11 May 2004.

We attach the requested information in seriatim herewith for your reference, please. Please note that some of the specifics, such as individual names of companies or persons, have been blotted in view of commercial sensitivity. We have also highlighted information, such as fee levels or specific terms of management agreement, which may be particularly commercially sensitive. We should be grateful if you would treat the information with due care.

Yours sincerely,



( Tony Lam )

for Commissioner for Innovation and Technology

cc Secretary for Commerce, Industry and Technology  
Secretary for Financial Services and the Treasury  
(Attn : Mr Manfred Wong)  
Director of Audit

**\*Note by Clerk, PAC: Item (c) not attached.**

**(a) General investment return duration  
of venture capital**

- Venture capital has been developed in the U.S. for more than three decades and the U.S. is a very well-developed market.
- If we use the U.S. as a benchmark and in accordance with studies of U.S. venture capital market, it shows that “... nearly half of all venture capital-backed companies don't fulfill their potential, and nearly one-third go out of business”<sup>1</sup>.
- According to the information of the National Venture Capital Association of the U.S., an early stage investment may take “seven to ten years to mature” while later stage investment may take “a few years”. It has also pointed out that, generally, venture funds have a life span on average of “10 to 12 years”.
- Separately, academics of the U.S. have also pointed out that the median age of technology-based companies making use of initial public offering as a means for divestment and recouping return has recently been gradually increased to some nine years in 2001-02 from being about four years in 1999-2000 (during which many were just 18 months)<sup>2</sup>. This has reflected that the investment return duration of venture capital has been significantly lengthened in recent years.

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<sup>1</sup> Source : “The Money of Invention: How Venture Capital Creates New Wealth”, by Paul A Goupers and Josh Lerner, Harvard Business School Press, pg. 28.

<sup>2</sup> Source : “USA Today” (a national U.S. newspaper) dated 12 April 2003, quoting Professor Jay Ritter, University of Florida.

**(b) Report No. 42 of the Director of Audit**  
**Chapter 2: Funding of Projects Under**  
**the Applied Research Fund (ARF)**

- The statistics provided in paragraph 2.7(a) to (e) of the Audit Report are currently updated as at 31 December 2003 as follows:
  - (a) as at 31 December 2003, the valuation of the 23 investments managed by fund managers was \$157.6 million, representing 44% of the investment at cost. Six of these investee companies were liquidated or sold at nominal value.
  - (b) among the remaining 17 active investments, one was listed on the Growth Enterprise Market in May 2002. Another was acquired in February 2000 by a company listed on the Hong Kong Stock Exchange and four had won prestigious technology awards either locally or overseas. One other company was acquired in April 2004 by a company listed on NASDAQ.
  - (c) as at 31 December 2002, the then 16 active investee companies attracted investments amounting to \$870 million other than those from the ARF. As at end March 2004, the ARF further attracted \$7.5 million co-investments. Together with the \$870 million reported, the existing total amount of co-investments was about \$877.5 million, which was 1% higher than the figure (\$870 million) as end December 2002. This represents a multiplier factor of 2.9 against the corresponding ARF's investment.
  - (d) 14 investee companies were small-and-medium-sized enterprises with less than 50 employees at the time of ARF's initial investment. As at end December 2003, 3 were beyond this employment level.
  - (e) After the engagement of fund managers, the ARC approved investments into 23 cases with approved funding of \$378 million. This approved amount is higher than the \$97 million funding approved for the 27 cases managed by the former Industry Department by about 3.9 times. More importantly, the institutional arrangements of engaging fund managers since November 1998 have much improved the then limitations in



managing the funding scheme by the former Industry Department staffed by civil servants : more proactive ability to identify projects; better commercial sense and expertise in assessment; predominance of funding through equity participation instead of straight loans, more active project management and participation; more adequate expertise in arranging investment exit. Furthermore, the professional fund managers have enabled the ARC to better support the investee companies in that they could provide better networking advantages, as well as technical, management and marketing expertise, thereby enhancing the technical and commercial viability of approved projects. These contributions are essential and have an impact, albeit difficult to quantify.

#### (d) Venture capital in the market versus Applied Research Fund

- We would like to point out that while some market statistics are available (e.g. the size of Hong Kong's venture capital investment portfolio; Hong Kong's disbursements by financing stage; disbursements to Hong Kong's companies, etc.), they need to be treated with caution in that the degree of precision of these figures is very much affected by the lack of precision on what constitutes "Hong Kong's venture capital" or "Hong Kong companies".
- Unlike the ARF which may only be invested in technology venture / R&D projects that have commercial potentials and that must have substantial connections to Hong Kong, Hong Kong's venture capital may invest in "Hong Kong companies" outside Hong Kong.
- Taking into account the above argument, we consider that the figures presented below need to be interpreted with due care.
- As far as we are aware, industry statistics have shown that the venture capital investment portfolio in Hong Kong was US\$10,817 million as at end 2002.<sup>1</sup>
- However, industry sources have also shown that only about 11% was disbursed to "Hong Kong companies".<sup>2</sup>
- Industry statistics have also shown that about 46% was disbursed to industries more closely related to technology, such as computer-related industries, electronics, information technology, medical / biotechnology and telecommunications industries.<sup>3</sup>
- On the above basis, the investment portfolio into "Hong Kong companies" in technology-related industries was about US\$547 million<sup>4</sup> as at end 2002. That of the ARF was about US\$29.6 million as at end 2002<sup>5</sup>.

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<sup>1</sup> Source : Asian Private Equity 300 (15<sup>th</sup> Edition) : The 2004 Guide to Venture Capital in Asia

<sup>2</sup> Source : The 2003 Guide to Venture Capital in Asia. The figure is with respect to year 2001.

<sup>3</sup> Source : The 2003 Guide to Venture Capital in Asia. The figure is with respect to year 2001.

<sup>4</sup> US\$547 million = US\$10,817 million x 11% x 46%. We have applied the figures of 11% and 46% for the year 2001 in this calculation as corresponding figures for 2002 are not yet available.

<sup>5</sup> Source : See paragraph 2.7(a) of the Audit report, which quotes that the valuation of 21 investments

- The percentage of ARF investments relative to the overall total is thus about 5.4%<sup>6</sup>.
- While the figure of 5.4% may seem to imply that ARF investments occupy only a limited share of the venture capital invested in technology-related companies, we would like to point out that, according to industry statistics, only about 23% of the venture capital disbursements of Hong Kong is for companies at seed-stage or start-up stage<sup>7</sup> in which ARF investments mostly focus on and during which venture capital support by public sector fund like ARF would be most critical and useful to augment any funding support from other sources.
- It therefore follows that if we further qualify the aforementioned figures by the relevant stage of financing in which ARF investments mostly focus on, the investment portfolio into Hong Kong companies in technology-related industries in seed-stage or start-up stage might be about US\$126 million<sup>8</sup> as at end 2002. This translates into ARF investments being about 23%<sup>9</sup> of the relevant venture capital investment portfolio in technology-related industries in Hong Kong companies at the seed or start-up stage.

END

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managed by fund managers was HK\$231 million as at 31 December 2002.

<sup>6</sup> 5.4% = US\$29.6 million / US\$547 million x 100%

<sup>7</sup> Source : The 2003 Guide to Venture Capital in Asia. This figure is with respect to year 2001.

<sup>8</sup> US\$126 million = US\$547 million x 23%. We have applied the figure of 23% for the year 2001 in this calculation as the corresponding figure for 2002 are not yet available.

<sup>9</sup> 23% = US\$29.6 million / US\$126 million x 100%

**(e) Six most successful investment projects managed  
by the fund managers**

- We have attached some details of six most successful investment projects managed by the fund managers.
- It is difficult to project when ARF investments may be exited or whether such investments may bring return to ARF. Many factors would affect the timing and outcome of exit from these investments, such as business cycle, financial market situation, performance of the technology market and the global economic trend.
- As stated in our reply to part (a), the median age of technology-based companies matured for initial public offering, which is an important way for exiting venture capital investments, has recently been lengthened to some nine years. The ARC has, however, already stipulated in its relevant management agreements that the fund managers shall use their reasonable endeavours to ensure that all of their investments are realized not later than the date of expiration of the management agreements, which will stay in force until 2007-08 as pointed out in paragraph 3.6 of the Audit report.

**Applied Research Fund**  
**Six Most Successful Cases**

**Case A**

- The fund manager proposed the Applied Research Council (ARC) to invest in Company A in November 1998. The investment was considered to be in line with the public mission of the Applied Research Fund (ARF).
- Company A was a network equipment distributor when ARC invested in the company.
- With the investment of ARC in 1998, Company A has successfully transformed into a network infrastructure integrated system provider and has developed formidable research and development (R&D) capability in network software.
- Company A was listed on the Growth Enterprise Market (GEM) on 17 May 2002. It is the first publicly listed ARC investee company. The accomplishment of initial public offering is generally considered as an important milestone in venture capital investment.
- Company A is currently seeking to develop a “New Generation Network” to integrate the transfer of voice, data and graphics in one network. This has the potential of creating a new model for the future communications industry.
- ARC invested a total of \$46.7 million in Company A. \$30.4 million has been recouped.

## **Case B**

- The fund manager proposed the ARC to invest in Company B in November 1998. The investment was considered to be in line with the public mission of the ARF.
- Company B engages in the provision of services in real-time financial quote system and securities exchange system so that investors can obtain financial information, such as information of listed companies, the Hang Seng Index and index futures, share price quotes, and Chinese and English financial news and commentaries, via the Internet and leased line connections.
- In February 2000, Company B was acquired by another company listed on the Hong Kong Stock Exchange which engaged in the sales of pagers, information devices and financial information services. The acquisition of an investee company by a listed company is generally considered as an important milestone in venture capital investment.
- The amount approved by the ARC for this investment is \$8 million.

### Case C

- The fund manager proposed the ARC to invest in Company C in March 1999. The investment was considered to be in line with the public mission of the ARF.
- Company C engaged in the development of software tools for enhancing database performance.
- Company C won the IT Excellence Awards - Gold Award for Product organized by the Hong Kong Computer Society in 1999 and the Hong Kong Award for Industry - Technological Achievement Award in 2000. It is also the first-ever non-US company winning the “National Business Incubation Association Award - Graduate of the Year” in 2000.
- In April 2004, Company C was acquired by a listed company on NASDAQ of the U.S.. That U.S. company engages primarily in the development and sales of a range of software tools to optimize the performance of application software and database. The turnover of that company was about US\$300 million and its market capitalization was about US\$1.2 billion. Upon acquisition, the U.S. company plans to focus part of its R&D work in database software in Hong Kong.
- Company C received a total of \$24.59 million investment from the ARC.

## Case D

- The fund manager proposed the ARC to invest in Company D in December 1998. The investment was considered to be in line with the public mission of the ARF.
- Company D engages in the development of speech recognition system.
- In 1999 when ARC invested in the company, the then annual business turnover of Company D was about US\$650,000. As at December 2003, Company D's business turnover for 2003 increased to about US\$1.3 million.
- Company D is a provider of conversational speech recognition technology. Its technology in speech recognition system has won the Singapore National Infocomm Awards 2001/02 and also the Asia Pacific Information and Communications Technology Awards 2001.
- These awards are recognition of Company D's innovation and contribution in international speech technology areas, and affirmation of its position in the market.
- Company D received a total of \$24.16 million investment from the ARC.



## Case E

- The fund manager proposed the ARC to invest in Company E in August 2002. The investment was considered to be in line with the public mission of the ARF.
- Company E engages in the research of tests concerning the genotype materials in human plasma. The plasma genotype information is valuable to tests and diagnoses for cancers, prenatal diseases and other diseases. For instance, the technology developed by Company E provides a non-invasive method for the detection of prenatal diseases of the fetus.
- Company E's technology is originated from R&D work carried out by a university. At present, Company E is engaging in the development of diagnoses and tests for congenital and other cancers. Company E is an investment example demonstrating how the ARF assists in the commercialization of research results of universities. When ARC invested in Company E, the company's turnover was about HK\$850,000. In 2003, its turnover was about HK\$1.80 million.
- The amount approved by the ARC for this investment is \$11.7 million.

## **Case F**

- The fund manager proposed the ARC to invest in Company F in July 1999. The investment was considered to be in line with the public mission of the ARF.
- Company F was a technology-based venture originating from a local university. It engages in electronic aggregation and distribution of Chinese language-based content. Since the injection of ARC's investment, Company F's business turnover has increased by some 40 times from \$690,000 to about \$28 million in 2003. Its Chinese digital press cutting service is also very popular.
- Company F is an investment example demonstrating how the ARF assists the commercialization of R&D results of universities.
- Company F received \$33.84 million funding from the ARC.

**(f) Minutes of meeting of  
the Applied Research Council (ARC)  
held on 15 September 2000  
related to Case A**

(b)

9. \_\_\_\_\_ pointed out that two investee companies managed by \_\_\_\_\_ were experiencing difficulties. They were \_\_\_\_\_ I and \_\_\_\_\_ and the details had been set out in the covering paper. She drew Directors' attention that that the Council had lost a total of \$23 million in \_\_\_\_\_. Besides, \_\_\_\_\_ had proposed to sell off the Council's shares in \_\_\_\_\_ as soon as practicable and this could mean another loss of \$12 million. \_\_\_\_\_ commented that those were serious cases and Directors might wish to gather more information from \_\_\_\_\_ representative and decide whether any actions would be needed.

\_\_\_\_\_ of \_\_\_\_\_ attended the meeting for this item]

10. \_\_\_\_\_ briefly reported to the Directors the latest position of the investee companies managed by \_\_\_\_\_

11. Directors asked for more information on the three problematic cases, i.e. \_\_\_\_\_, \_\_\_\_\_ and \_\_\_\_\_. On \_\_\_\_\_, Directors asked the details of the market change that had caused a failure of the company and how \_\_\_\_\_ had come to the conclusion that we should sell the company. Directors further asked why \_\_\_\_\_ was willing to buy \_\_\_\_\_ if the company had no future as commented by \_\_\_\_\_. Moreover, Directors considered that even if the Council did not sell our shares, it would not make any difference to the Council in terms of liability and financial outcome, i.e. the Council would lose all our investments in the company. Besides, Directors asked why \_\_\_\_\_ had not provided any details to the Council before or after that major decision to sell the Council's shares. \_\_\_\_\_ said that she had not been involved in the handling of this case personally and therefore did not know the answers to such detailed questions. But, she remarked that the situation for \_\_\_\_\_ had developed in a very short period of time and it had not been possible for them to inform the Council beforehand.

12. On [redacted], Directors asked why [redacted] had held back their decision in investing in the company. Directors also asked why [redacted] had valued the Council's shares in this company at zero and would like to know whether [redacted] was very pessimistic about the situation. [redacted] explained that a new business model was being tried out in this company and [redacted] would only sell the Council's shares if the new model was not working. In the meantime, [redacted] had to be cautious and had therefore valued the Council's shares at zero.

13. On [redacted], Directors asked why the company required as much money as \$90 million to support its activities from end June to end 2000. [redacted] undertook to check and revert.

14. [redacted] also asked for clearer information on the calculations of internal rates of return.

15. In response to [redacted] question on what [redacted] had learned from those problematic cases, [redacted] indicated that the lesson for them was that they would have to monitor the spending of their investee companies more closely. [redacted] remarked that it was a surprise to him that [redacted], which was such a well-established company, still needed to go through such experience to 'learn' this lesson.

16. In response to [redacted] question on whether [redacted] had any new investment plans in the near future, [redacted] indicated that there was nothing concrete at the moment. [redacted] asked whether [redacted] Executive Director of [redacted] would be available to give a more detailed account of the events to the Council. [redacted] indicated that [redacted] would be back to Hong Kong the following Wednesday. [redacted] suggested and Directors agreed that [redacted] should withhold all new investments until the Council had been provided with details of the problematic cases and were satisfied with the explanations.

[ [redacted] left the meeting.]

17. Directors were very concerned with the three problematic cases and that the Council had not been consulted or informed of the major decisions (such as selling our shares in [redacted]) in a timely manner. [redacted] clarified that the agreement provided the fund manager with the full discretion to make any changes to the investments so long as

the public mission was not affected. But, she also found it highly undesirable that / did not inform the Council or even the of the incident immediately after their major decision about had only come to know the incident when she was reading the normal quarterly report. She further disclosed that unlike other fund managers, / maintained little day to day contacts with the Secretariat. / also pointed out that he had gathered from the newspapers that had moved its operation to the USA and this appeared to be in breach of the public mission. Besides, / pointed out that while / mentioned in their report that the Council had only invested \$16 million in , the Council had indeed invested a total of \$24 million.

18. / also pointed out that the quality of work was not satisfactory. For example, the financial reports of some investee companies in / quarterly reports contained so little information that it was hardly useful to the Directors.

19. / considered that we now had a prima facie case for possible breach of the Council's trust on / and the Council should intervene despite the agreement provided for much discretion to fund managers. He suggested and some Directors agreed that the Council might have to consider requesting / to seek the Council's prior approval before making any major decisions such as buying or selling shares. / also considered that we might need to make it a condition for our fund managers that the Council should only put in our investments until all the other co-investors had done so.

20. Directors agreed that the situation was serious and that / should be asked to submit a detailed report on the three problematic cases in three weeks' time. An emergency meeting should be held with / presence to discuss the detailed reports in one month's time. Until and unless the Council was satisfied with / explanations, / should not be allowed to make any new investments. Directors also requested that the Secretariat provide background papers on how the three cases had been approved in the first instance.

(Action : / )

21. While Directors recalled that when our fund managers were appointed, / was supposed to assume the more risky businesses while / was more on traditional technology companies, / asked whether we should revise our guidelines for the fund managers so

as to prescribe the level of risks that our fund managers could take on.

22.                    suggested and Directors agreed that the Secretariat write to                    pointing out the problems and that the Council was not satisfied with its performance. The Secretariat should take a fairly firm position.

**(f) Minutes of meeting of  
the Applied Research Council (ARC)  
held on 30 October 2000  
related to Case A**



\_\_\_\_\_ briefed the Directors on the purpose of this emergency meeting. At the last meeting in September, the Directors noticed that three investee companies managed by \_\_\_\_\_ had experienced difficulties. However, the representative of \_\_\_\_\_ was not able to provide satisfactory explanations to the Directors. Therefore, it was decided that \_\_\_\_\_, Executive Director of \_\_\_\_\_, should come for an emergency meeting to explain the details to the Directors.

2. \_\_\_\_\_ commented that it was obvious that \_\_\_\_\_ was not performing a proper monitoring work. He invited the Directors to exchange ideas on what questions to ask \_\_\_\_\_ before inviting him to join the meeting.

3. \_\_\_\_\_ said that the mission of ARF was to fund Hong Kong-based technology start-ups. Taking \_\_\_\_\_ as an example, the company had invested little in technology development and he was not sure why funding had been approved for this type of company. He also asked whether the marketing activities, which was strictly speaking not related to technology development, should be funded. \_\_\_\_\_ explained that the original ambit of the Council was to fund R&D activities in the manufacturing sectors. But, given the change in our economic structure, starting from 1998-99, internet-based companies had also been considered. After the appointment of fund managers, the focus of the ARF was on the whole portfolio of investments. So, human resources development and marketing were also supported. \_\_\_\_\_ added that it was true that \_\_\_\_\_ focused on investing dotcom companies and it seemed to him that the most important concern for ARC at the moment was the monitoring of the remaining investee companies managed by \_\_\_\_\_.

4. \_\_\_\_\_ pointed out that the most unsatisfactory point was this Council had not been kept informed in a timely manner. \_\_\_\_\_ reported that \_\_\_\_\_ had admitted that \_\_\_\_\_ had not been communicating well with the Council. \_\_\_\_\_ said that the Directors might also ask for account statements or audit reports of \_\_\_\_\_ to see if the company was still in a sound financial position as \_\_\_\_\_ might have also invested into the three problematic companies.

attended the meeting]

5. [redacted] admitted that there had been a lack of communication between his Company and the Council but he stressed that things had been moving very fast. On [redacted], [redacted] explained that it had also been a hard time for [redacted]. They evaluated the company as the superstar of their portfolio especially when [redacted] and [redacted] had also invested in [redacted]. They had planned to list the company in March – June 2000. He admitted that as they evaluated the company positively, they allowed it to spend ahead of time and it had proved to be a wrong bet.

6. [redacted] asked when [redacted] had first discovered the problem. [redacted] replied that it was March – April 2000 when the revenue had been flattening out. However, at that time their investment evaluation had mainly been on the technology but not the revenue. Moreover, it was quite beyond the expectation of [redacted] Board that the Company had to spend around US\$3 million to settle a legal and accounting bill relating to an acquisition. [redacted] asked whether the Council had been put in a similar position as the other investors of [redacted]. [redacted] replied that all investors had been treated equally.

7. On [redacted] [redacted] said that [redacted] had signed agreements with [redacted] and [redacted] and everything had been fine. But the two companies had not kept their promise to invest into [redacted]. [redacted] had been talking to the lawyers to sue the two companies concerned. [redacted] asked when [redacted] sensed that there might have been some troubles. [redacted] replied that it was in March 2000 when [redacted] dragged on their investments for three to four months and suggested putting in shares and services instead. In response to [redacted]s query, [redacted] had also explained briefly the reasons that he had gathered as to why [redacted] had changed so suddenly.

8. On [redacted] [redacted] said that the company was doing well in developing convenient internet plugs for the hotel industry. They had managed to obtain master contracts with major hotel groups. However, the time needed to raise funds had been longer than expected and the company was running out of cash. The company was at the risk of not being able to honour their commitments in the contracts. Therefore, [redacted] would propose to the Council to inject bridge loan at the third round financing for [redacted] shortly.

9. [redacted] noted from the latest figures of [redacted] that the revenue for the company was so low that the company would not be able to pay off their investments. He was worried that when 3G came, the entire investment would be totally wasted. He therefore did not consider that the company was in a financial healthy situation. [redacted] further asked if the Council could sell its shares to other investors with some discount.

[redacted] replied that it was possible but would probably hurt the company since other investors would lose confidence in the company.

[redacted] asked about the chance for other investors to invest if ARC invested in the third round financing. [redacted] replied that ARC was the largest investor at the moment and another existing shareholder [redacted]

[redacted] had indicated that they would also invest about HK\$8 million. Other new investors like [redacted] would put in money.

10. [redacted] asked about the minimum amount of money that would be needed to be invested in [redacted] before the company could become viable. [redacted] replied that it would need about \$234 million to complete the next round of financing. When asked by [redacted]

[redacted] indicated that he was reasonably confident that the \$234 million would be forthcoming. In particular, the financing was overseen by [redacted] which had never failed though he admitted that nothing had been signed at the moment.

11. [redacted] asked why the company needed so much money for bridge financing. [redacted] replied that the company had all along run on a minimal subsistence level and it was not installing new hotel rooms. The company was running the danger of violating their contracts with the hotels. The company had also stopped sales and marketing activities. The bridge financing would be able to help the company to fulfill the minimum obligations.

12. [redacted] commented that it was a sign of bad management as the company took on a very high burn rate before they were sure of the outcome of the next round of financing. [redacted] commented that it would not be useful to provide just \$2 million if it did not help the company to reach the critical point. [redacted] responded that it was likely that the breakeven point would happen in April 2001. In response to [redacted], [redacted] responded that [redacted]'s revenue in Q3 2000 was about \$8-9 million because of the large number of hotels installed in March/April 2000. [redacted] suggested [redacted] spending more time to work on this proposal before submitting it to the Council.

13. [redacted] asked if [redacted] was happy with the management of [redacted]

the ARC cases. \_\_\_\_\_, indicated that he was reasonably happy with the \_\_\_\_\_ case. For \_\_\_\_\_, he considered that the \_\_\_\_\_ Board was to be blamed. In response to \_\_\_\_\_'s question as to how much time \_\_\_\_\_ spent on monitoring the cases, \_\_\_\_\_ clarified that he did not travel much. He sat on the boards of five to seven investee companies and in particular on the boards for \_\_\_\_\_ and \_\_\_\_\_.

The boards normally met on a monthly or quarterly basis. \_\_\_\_\_ also got accounting staff to monitor the accounts and cashflow of the investee companies. They also got six investment staff in Hong Kong.

14. \_\_\_\_\_ asked for the current situation of other investments. On \_\_\_\_\_, \_\_\_\_\_ replied that they managed to bring in investors from Beijing and it seemed that the company would soon be ready to go public. He considered that the company was substantially a profitable company and there was no need for new money at the moment. The problem was how to enable it to grow fast enough as the company had more projects than they could probably handle and they might need more money in future. At the moment, the company needed to conserve cash and be more prudent in their expansion plan. \_\_\_\_\_ had been approached by a large system integrator for acquiring the entire company and the negotiations had started.

15. \_\_\_\_\_ pointed out that it might be difficult for \_\_\_\_\_ to penetrate the Mainland market. The majority of the banks there were happy with the proprietary products which were fine for day-to-day operations. He had also gathered that the CEO and most of the staff of \_\_\_\_\_ had left the company and he was not sure whether the skills could be retained.

[ \_\_\_\_\_ left the meeting]

16. \_\_\_\_\_ asked which investments \_\_\_\_\_ considered to be the most successful. \_\_\_\_\_ replied that they were \_\_\_\_\_ and \_\_\_\_\_ (formerly known as \_\_\_\_\_) which had the best valuations.

17. As regards \_\_\_\_\_ asked whether the Council could sell our shares. \_\_\_\_\_ said that we could but he was disappointed with \_\_\_\_\_ and a proper listing might be done for \_\_\_\_\_ later. On \_\_\_\_\_, \_\_\_\_\_ said that the company was growing slowly and \_\_\_\_\_ was helping it to strengthen its sales and marketing by bringing in a sales director from \_\_\_\_\_ and a marketing manager from \_\_\_\_\_.

18. \_\_\_\_\_ asked how A \_\_\_\_\_ would improve the situation in the future. \_\_\_\_\_ said that they would tighten up the monitoring work. They had started to monitor and police the financial side of the investee companies four months ago. In the past, they just monitored the operation side. Moreover, they would not allow investee companies to spend aggressively as the ability to raise money could be seriously hampered by the market situations.

19. \_\_\_\_\_ asked whether \_\_\_\_\_ itself was involved in the problematic investments. \_\_\_\_\_ said that for the fund called \_\_\_\_\_ managed by \_\_\_\_\_, out of the fund size of US\$ \_\_\_\_\_ million, US\$ \_\_\_\_\_ million came from the staff and management of \_\_\_\_\_. This Fund had been able to yield a return which was more than the losses. As regards another fund called \_\_\_\_\_ managed by \_\_\_\_\_, out of the fund size of US\$ \_\_\_\_\_ million, US\$ \_\_\_\_\_ million came from \_\_\_\_\_; staff and management. At present, again, the return was more than the fund size.

20. \_\_\_\_\_ further asked how the communications between \_\_\_\_\_ and the Council could be improved. He also requested for more frequent reports. \_\_\_\_\_ responded that they could prepare exceptional reports to the Council when there were major events such as writing off an investment, public offering or another round of financing. Also, as discussed with the \_\_\_\_\_, he could come to the ARC Board Meetings quarterly instead of half-yearly.

21. \_\_\_\_\_ requested that \_\_\_\_\_ alert the Directors whenever there were irregularities even when the situation was fluid. They should provide a 2-3 page summary to the Secretariat who would then circulate it to the Directors. \_\_\_\_\_ agreed and indicated that he would work out a proper format.

22. \_\_\_\_\_ requested \_\_\_\_\_ to have a tighter control on the financial situation of the investee companies and \_\_\_\_\_ should provide the information to the Council on a regular basis. \_\_\_\_\_ further requested that the financial information be presented in a way that was more easily understood by laymen and that the issues of interest to the management should be highlighted.

23. \_\_\_\_\_ suggested \_\_\_\_\_ to have a better support from his own company. When his colleague \_\_\_\_\_ came to the meeting last time, she was not able to give proper answers to the questions raised.

[1 left the meeting]

24. commented that / was a small firm with poor management. When the industry flourished, they were very busy in finding new investments but overlooked the monitoring work of the existing investments. further said that it was obvious that the reports on the problematic cases had just come too late.

25. said that for t, it had come to his knowledge that it had planned to go for IPO but had recently withdrawn and would turn to ARC for another round of financing. said that it indicated that the company had no underwriter at the moment and it was a bad sign. He further added that he was not convinced of the business model of.

26. asked if / knew that the mission of ARC was to assist Hong Kong-technology companies but not to earn large sums of money. said that had not done anything wrong purely from a profit-making point of view. In response to some Directors' suggestion to maintain a tighter control over indicated that it was stated in our agreements with the Fund Managers that the Council would only comments on the public mission but not the revenue model of a proposed investment. said that the interpretation of public mission should give the Council sufficient leeway to comment on the proposals. But, I opined that if the Council should only assess the public mission, Directors should not look at the investment details then. However, considered that it would be more prudent for Directors to raise objections to the proposed investments if we found anything wrong.

27. considered that the Council should now consider how to exercise control on / and whether its new investments should be frozen. I said that as bound by the Agreement with n, the Council could not freeze any proposed investments put forward by However, a closer monitoring of its work was necessary. also added that the Council should be careful in handling the matter to avoid projecting a negative image on the Council.

28. After some discussions, it was agreed that a consensus would be needed from the Directors before any approval for new or follow-on investment proposal from was granted. If such a consensus could not be reached, an urgent meeting should be held to resolve the matter. Also, should come to the Board meeting quarterly.

asked that a letter be sent to informing him of the decision of the Council and urged him to improve communications with the Council in future.

**(g)(i) Case A : whether and how co-investing proposal to resolve the conflict of interest declared in the Initial Investment Proposal was implemented and how should the co-investment provision of the relevant management agreements be enforced**

System to deal with co-investment proposal and conflict of interest

- In terms of system and process, the management agreements provide that the fund managers may co-invest in any of the investments on their own account or on account of their other clients provided that such co-investment shall be made upon commercial terms which are comparable to those applicable to the investments.
- The management agreements also require that the fund managers shall not, among other things, invest the ARF in any investments already invested by any other funds managed by the fund managers concerned without the prior written consent and approval of the Council which shall not be unreasonably withheld.
- As regards making co-investment as a requirement, the three earlier management agreements concluded in November 1998 did not require co-investment as such. However, in the case of the fourth fund manager engaged by the ARC in March 2000, the relevant management agreement did make co-investment as a requirement.
- Through the management agreement, the ARC appoints the fund manager and the fund manager agrees to act as manager of the ARF in accordance with the terms of the management agreement.
- Under the relevant management agreement, the fund manager shall use its reasonable endeavours to act in the best interests of the Council in relation to the ARF and / or the investments.
- Also under the management agreement, the fund manager is granted the



authority, power and right on behalf of, for the account of and in the name of the ARC to, among other things, purchase or otherwise acquire or sell, dispose of, exchange, vary or invest in the investments.

- The ARC-fund manager relationship is thus based on mutual good faith. The role of the ARC is to maintain a supervisory role and oversee the performance of the fund managers. The Council vests trust in its fund manager and does not micro-manage details of fund management.

#### Case A

- The relevant fund manager has declared, among other things, in its initial investment proposal in July 1999 that :
  - (a) it wishes to resolve the conflict of interest by co-investing into Company A under the terms and conditions set by the third-party lead investor groups consisting of X and Y; and
  - (b) it will not “participate in the negotiations of the terms and conditions by X and Y ...”.
- By putting in co-investment from third party sources consisting of X and Y, it is a mechanism intended to resolve potential conflict of interest.
- By having the two third-party lead investor groups, X and Y, to negotiate the terms and conditions of investment, it is another step intended to resolve potential conflict of interest.
- With the above safeguards, the ARC Board did not cast any doubt on the proposed investment.
- In the relevant quarterly report for July-September 1999, the fund manager reported that “[i]n September, we (i.e. Fund Manager A) closed the investments in ... Company A ...”.<sup>1</sup> In the quarterly report for October-December 1999, the fund manager reported that “[i]n September 1999, ARC completed its HK\$16 million funding into Company A. X and

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<sup>1</sup> Page 2 of the relevant quarterly report refers.

Y also invested HK\$16 million each in the same round”.<sup>2</sup> This showed that the co-investments from other sources were in place.

- The approved initial investment of HK\$16 million by ARC into Company A resulted in 8.93% of shareholding in that company<sup>3</sup>. X and Y also held 8.93% each of Company A. The follow-on investment proposal of Case A also shows that X and Y each has 8.93% shareholding in Company A<sup>4</sup>.
- The Audit report pointed out that another shareholder of Company A offered to take over the company and that the fund manager sold the ARC’s shares in Company A at US\$1.<sup>5</sup> In a quarterly report by the fund manager for April-June 2000 discussed by the ARC Board on 15 September 2000, the fund manager reported that the terms of purchase were the same for all shareholders<sup>6</sup>. According to the same quarterly report, the shareholder which took over Company A also offered to inject US\$5 million into Company A to assume all responsibilities and liabilities in exchange for all the shares. At that time, Company A was still US\$4 million in debt.<sup>7</sup>
- The public mission of the ARF is to spur local technology development through providing funding support to technology ventures and research and development projects that have commercial potential. Viewing from this perspective, if it is in the professional judgment of the fund manager of the then market situation for selling ARC’s shares at nominal price to a buyer, the company and the personnel concerned would still have some further opportunities of development as opposed to putting the company in liquidation.
- There is no co-investment requirement in the management agreement for fund manager A.
- In cases where the fund manager has committed any material breach of any of the provisions of the management agreement or fail to perform and

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<sup>2</sup> Page 9 of the relevant quarterly report refers.

<sup>3</sup> See the 8.93% figure against ARC on page 3 of the follow-on investment proposal of Case A submitted to the Public Accounts Committee (“PAC”) on 7 May 2004.

<sup>4</sup> The names of X and Y were blotted in the version of the follow-on investment proposal of Case A submitted to PAC on 7 May 2004.

<sup>5</sup> Item(j)(iii) on page 19 of the Audit report refers.

<sup>6</sup> Page 9 of the relevant quarterly report refers.

<sup>7</sup> ditto.

discharge any of its duties or obligations which are of a material nature, the ARC may terminate the management agreement.

- Concerning Case A, the ARC Board did not discern any criminal or fraudulent act but was concerned about the effectiveness of the fund manager. Action was taken to terminate the management agreement and the fund manager ceased to manage ARF on behalf of ARC in May 2002.

**(g)(ii) Follow-up actions that have been and will be taken by the  
Administration in respect of Cases A and B**

Case A

- As mentioned in the Audit report, the ARC has convened Board meetings to discuss the matter. A series of discussion with the fund manager ensued.
- The discussion led to, among other things, the ARC Secretariat issuing letter to Fund Manager A expressing concerns on the part of the ARC (Annex A); ARC Board agreeing to test the water on possible disengagement of Fund Manager A (Annex B) while sending Fund Manager A another letter expressing grave concern on its performance (Annex C).
- The ARC Board did not discern any criminal or fraudulent act but was concerned about the effectiveness of the fund manager.
- Action was taken to terminate the management agreement and the fund manager ceased to manage the ARF on behalf of ARC with effect from 3 May 2002. (Please see press statement at Annex D.)

Case B

- Regarding the disposal of Case B, we consider that the fund manager acted on the basis of its professional judgment of the market situation.
- Fund Manager B reported to the ARC Board the disposal on 30 April 2003. The ARC Board did not discern any criminal or fraudulent act arising from Case B.
- The ARC Secretariat also sought clarification from Fund Manager B about Company B reportedly attracted US\$16 million from the U.S.<sup>1</sup>. Fund Manager B did explain to the ARC Secretariat on 29 October 2003 the

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<sup>1</sup> Item (p) on page 27 of the Audit report refers.

situation (Annex E) and met with the Secretariat on 17 November 2003.

- The main explanation was that the US\$16 million investment reported in a press article was not new fund injection into Company B. Rather, the fund was prepared for the perceived loss-making operation for the next 24-36 months of a new company, staffed by the founders of Company B, to work on new technologies that would pursue a totally different product and business strategy, targeting cable operators in the U.S. as customers. In short, the US\$16 million investment should not be interpreted as the valuation of Company B.
- In any event, the ARC has been taking action in the past two years to vary the terms of the management agreement to provide better protection for the ARC with effect, among other things, that management fee is reduced; the ARC may withdraw all undrawn / uncommitted funds with prior notice; and the ARC may object to any proposed investment in its absolute discretion. (Please see the management agreement and supplemental agreements attached at Annex F.)

#### Other follow-up actions

- The ARC has initiated discussion with existing fund managers to examine how control over the disposal of ARF investments by fund manager may be improved. (Please see Annex G.) The ARC will take into account market practice in this regard as necessary and appropriate.
- One of the fund managers has agreed in principle that controls on disposal of ARF investments may be strengthened (Annex H). As of 19 May 2004, the necessary legal document is being drafted.
- The ARC would aim at concluding this issue with the fund managers as soon as practicable.

END

***\*Note by Clerk, PAC: Annexes A to H not attached.***

**(h) Compliance with co-investment provision of the relevant management agreement**

- In terms of system and process, the management agreements provide that the fund managers may co-invest in any of the investments on their own account or on account of their other clients provided that such co-investment shall be made upon commercial terms which are comparable to those applicable to the investments.
- The management agreements also require that the fund managers shall not, among other things, invest the ARF in any investments already invested by any other funds managed by the fund managers concerned without the prior written consent and approval of the Council which shall not be unreasonably withheld.
- In the three earlier management agreements concluded in November 1998, the management agreements did not make co-investment as a requirement as such.
- However, in the case of the fourth fund manager engaged by the ARC in March 2000 (Fund Manager B in Case B below and as mentioned in the Audit report), the relevant management agreement did make co-investment as a requirement.
- Take Case B as an example. The relevant management agreement requires co-investment. The initial investment proposal of Case B shows that a fund (other than ARF) managed by the fund manager will be co-investing<sup>1</sup>. In its quarterly report for October - December 2000, the fund manager reports that the ARC has invested US\$1 million into Company B and that another fund managed by the fund manager is investing an additional US\$2.5 million into Company B on the same term.<sup>2</sup>

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<sup>1</sup> Please refer to paragraph (c) of page 1 of the initial investment proposal dated 13 December 2000 submitted to the Public Accounts Committee ("PAC") on 7 May 2004. The shareholding of 166,667 shares with post-funding 1.57% shareholding is with respect to the ARC. The shareholding of 416,667 with post-funding 3.94% shareholding is co-investment by a fund (other than ARF) managed by the fund manager, the name of which has been blotted in the version sent to the PAC on 7 May 2004.

<sup>2</sup> Page 4 of the relevant quarterly report refers.

- Similarly for the follow-on investment proposal in Case B. The follow-on investment proposal shows that a fund (other than ARF) managed by the fund manager will be co-investing US\$1 million<sup>3</sup>. In its quarterly report for January-March 2002, the fund manager reported that “[a] total of US\$4 million has been raised in this round of funding with ..., X Fund<sup>4</sup> investing US\$1 million and Applied Research Fund investing US\$1 million”.<sup>5</sup> There is no prima facie doubt on the compliance of co-investment.
- However, if doubts arise, the ARC may act as it sees fit. For instance, it may decline the investment proposal. In cases where the fund manager has committed any material breach of any of the provisions of the management agreement or fail to perform and discharge any of its duties or obligations which are of a material nature, the ARC may terminate the management agreement.

END

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<sup>3</sup> Please refer to the third paragraph of page 1 of the follow-on investment proposal dated 1 February 2002 submitted to the PAC on 7 May 2004. It states that “... is committing US\$1 million. The investment committee of ... has already approved the investment.” This investor is a fund (other than ARF) managed by the fund manager concerned, the name of which has been blotted in the version sent to the PAC on 7 May 2004.

<sup>4</sup> “X Fund” is the fund (other than ARF) managed by the fund manager concerned.

<sup>5</sup> Page 2 of the relevant quarterly report refers.

(i) **Improving the rate of return for the ARF surplus fund**

- As stated in paragraph 4.6 of the Audit report, the Innovation and Technology Commission (ITC) has stated that, for funds which exceed the necessary liquidity level, it is willing to consider the audit recommendation on measures to improve the rate of return for ARF surplus funds.
- We are considering the possibility of hiring professional investment firms to manage the surplus funds for ARC. However, while this is a possibility, initially, we are concerned that this may not only incur costs for the engagement of such firms but it may at the same time incur risks to the ARF. We have to analyse this option carefully before deciding if this option should be pursued.
- In considering what may be done to improve the rate of return for ARF surplus funds, the ARC will consider factors such as expected return, the risk tolerance level, the associated costs and the necessary liquidity. It will need to strike the best balance that may best fit the operations, nature and objective of the ARF. The ARC may consider diversifying the placing of its surplus funds in forms other than bank deposits such as bonds, certificate of deposits or Exchange Fund papers. This will require further analysis and consultation with the ARC. We hope to be able to come to a decision as soon as practicable.

END



Ref: ARC/300/16

Tel : 2737 2220

Fax: 2730 1771

7 May 2004

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. 42)**

**Chapter 2 : Funding of projects under the Applied Research Fund**

Thank you for your letter dated 4 May. We confirm that the four officials mentioned in your letter will attend the public hearing on 10 May (9:00am to 10:30 am).

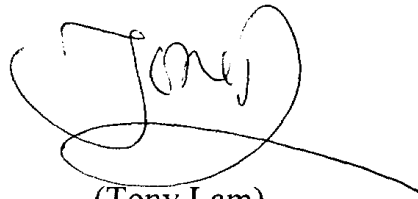
We also attach the requested information herewith for your reference, please :

- (a) A copy of the management agreements with fund managers is attached. Please note that names of individual companies or persons have been blotted. We have also highlighted information, such as fee levels, which may be particularly commercially sensitive. We should be grateful if you would treat the information with due care.

The Applied Research Council (ARC) engages private sector legal firms to provide legal services for it. The ARC has sought legal advice from them when drafting the management agreements.

- (b) The management agreements do not contain provisions allowing fund managers to receive commission for their sale of investee companies' shares from the buyers concerned.
- (c) The investments in question were considered and approved by the ARC through circulation of papers. There were no minutes as such.
- (d) The information which was furnished to the ARC by the fund managers in support of the initial and follow-on investments in Companies A and B are attached. Some of the specifics, such as individual names of companies and persons, in the investment proposals have been blotted in view of commercial sensitivity.

Yours sincerely,



(Tony Lam)

for Commissioner for Innovation and Technology

- cc Secretary for Commerce, Industry and Technology )
- Director of Audit ) – w/encl.
- Secretary for Financial Services and The Treasury )
- (Attn : Mr Manfred Wong)

***\*Note by Clerk, PAC: The management agreements and the information mentioned in (d) above are not attached, except for the co-investment provisions in the agreements and the Initial Investment Proposal for Case A.***

**Extract from the three Management Agreements\*  
dated 4<sup>th</sup> November 1998  
showing the provisions concerning co-investment**

**7. Conflict of Interest**

**7.1** The Council acknowledges and agrees that the Manager and any member of the Group may act as investment manager or adviser to other persons in relation to other investment business or transactions. In particular, the Manager and any member of the Group may :-

**X                                  X                                  X                                  X                                  X**

(c) co-invest in any of the Investments whether on its own account or on account of its other clients provided that such co-investment shall be made upon commercial terms which are comparable to those applicable to the Investments.

**X                                  X                                  X                                  X                                  X**

**7.3** The Manager shall not do any of the following without the prior written consent and approval of the Council which shall not be unreasonably withheld :-

**X                                  X                                  X                                  X                                  X**

(b) invest the Fund in any investments already invested by any other funds managed by the Manager; or

**X                                  X                                  X                                  X                                  X**

\* The provisions concerning co-investment in the three Management Agreements, which were concluded in November 1998, are the same.

**Extract from the Management Agreement  
dated 27<sup>th</sup> March 2000  
showing the provisions concerning co-investment**

7. Conflict of Interest

7.1 The Council acknowledges and agrees that the Manager and any member of the Group may act as investment manager or adviser to other persons in relation to other investment business or transactions. In particular, the Manager and any member of the Group may :-

**X**                      **X**                      **X**                      **X**                      **X**

(c) co-invest in any of the Investments whether on its own account or on account of its other clients provided that such co-investment shall be made upon commercial terms which are comparable to those applicable to the Investments.

**X**                      **X**                      **X**                      **X**                      **X**

7.3 The Manager shall not do any of the following without the prior written consent and approval of the Council which shall not be unreasonably withheld :-

**X**                      **X**                      **X**                      **X**                      **X**

(b) invest the Fund in any investments already invested by any other funds managed by the Manager; or

**X**                      **X**                      **X**                      **X**                      **X**

Schedule 1

Objective, Guidelines and Restrictions

**X**                      **X**                      **X**                      **X**                      **X**

2.    Investment Guidelines and Restrictions

**X**                      **X**                      **X**                      **X**                      **X**

- (g) The aggregate total amount of all the Investments (including follow-on investments) on the last day of the sixth (6th) Year of the term of this Agreement must be less than or equal to fifty per cent. (50%) of the aggregate total amount of all other investments in the same relevant Investee Companies made by the Manager on the same day, whether on its own account or on behalf of any other person.

**Extract from the Third Supplemental Agreement  
to Management Agreement  
dated 27<sup>th</sup> September 2003  
showing the provisions concerning co-investment**

3. AMENDMENTS TO MANAGEMENT AGREEMENT

3.1 As of and with effect from the Effective Date, the Management Agreement shall be amended as follows:-

**X                      X                      X                      X                      X**

(g) Paragraph 2(i) of Schedule 1 of the Management Agreement shall be deleted in its entirety and replaced with the following :

“(i) Subject to paragraph 2(j) of this Schedule, in respect of at least two thirds (2/3) of the amount of the Investments made from the First Tranche and the Second Tranche respectively, the aggregate total amount of such Investments (including follow-on investments) made on or after 28th September 2003 in respect of :

- (i) each separate Investee Company; and
- (ii) all Investee Companies in aggregate

at all times during the term of this Agreement must be less than or equal to one hundred per cent (100%) of the aggregate total amount of all other investments in the same Investee Company (in the case of sub-paragraph (i)) or Investee Companies (in the case of sub-paragraph (ii)) made by the Manager or any other person at the same time and on the same terms.” and

**X                      X                      X                      X                      X**

**Case A :**

**Initial Investment Proposal**



Vetting Report for Applied Research Fund

1. Company Information

Certificate No: BR21770989-000-06-99-1  
Date of Incorporation: JUNE 25, 1998  
Name of Business: [REDACTED] (" [REDACTED] ")  
Registered office address: [REDACTED]  
Business Address: [REDACTED]  
Nature of Business: Online toy and pop-culture retail community  
Status: Corporation  
Estimated investment from ARC: HK\$16 Million

2. Shareholders & Directors

The following are the shareholders of [REDACTED] Limited:

[REDACTED]	20%
[REDACTED]	16%
[REDACTED]	15%
[REDACTED]	24.5%
[REDACTED]	24.5%

The directors of [REDACTED] are: [REDACTED]

3. Business Activities

[REDACTED] is currently the largest site retailing brand-name American and Japanese toys, action figures, collectors items, movies, anime and delivering related content through its proprietary [REDACTED] and affiliate sites.

[REDACTED] has recently expanded its reach into the greater niche of toy related products with the introduction of more mass market items such as videos, computer/video games,



[REDACTED]

[REDACTED]

comics, manga, sci-fi/fantasy books, game cheats and anime, as well as unique Hong Kong and Japanese movies and print.

[REDACTED] takes advantage of the fact that Hong Kong is the toy capital and hub of the world, and builds a state of the art e-commerce site around it. In fact, [REDACTED] is now the largest site of its kind in the world. Exports from Hong Kong and Japan (toys, computer/video games, movies, comics, actors) are some of the hottest properties in the US and Europe. The three top cartoons on TNT's Cartoon Network are Japanese exports (Pokemon, Dragonball, Sailormoon).

The Company is also an Internet leader in toy sales and content about Star Wars and its related topics. [REDACTED] is poised to take full advantage of the impact of the new Star Wars films premiering in May 1999 and running through to 2005, and the massive merchandising wave that will follow.

[REDACTED] has secured a unique niche in bringing these products to the market. Carrying the largest selection of toys, hosting some of the most popular related sites and producing the most unique and original content have garnered [REDACTED] a reputation as the first stop on the Net for this group.

Taking advantage of new strategic relationships with suppliers, [REDACTED] will increase its inventory count to over 8,000 items by July 1999 and to over 12,000 items by October 1. These relationships allow [REDACTED] to maintain much of its stock in virtual inventory, purchasing from suppliers only after an order has been confirmed, thereby stretching its purchasing power to its furthest extent.

With the addition of new auction sites, trading areas, chat rooms, clubs and the expanding affiliate network, [REDACTED] will create a large advertising platform to market to a wide range of advertisers targeting our community demographic.

To exploit the depth of products and content on site, [REDACTED] will work with six of the largest portals and communities on the Internet. These relationships will form the backbone of [REDACTED]'s sales, community and affiliations.

Since [REDACTED] is a pure e-commerce company, it does not suffer from the limitation in setting up physical retail shops. [REDACTED] takes advantage of the wide penetration of the Internet and with [REDACTED] [REDACTED] has effectively setup a global retail store that can be accessed by anyone in the world with an Internet connection.

Without the physical limitation, [REDACTED] is able to expand aggressively through business alliances. Working with the major community sites, (ie Lycos, Geocities, Xoom.com, FortuneCity.com) [REDACTED] will strive to develop the fastest growing and largest affiliate network on the Internet. Over 2.25 million new members per month will have the opportunity to affiliate with [REDACTED] to provide links, share content and even build their own virtual store from [REDACTED] merchandise.

[REDACTED]

The Company is also signing on with a number of networks (ie AOL, Lycos, Xoom.com) to provide original content and exclusive merchandise to their respective members.

Not only will [REDACTED] receive widespread marketing coverage, but actual sales and product endorsement from some of the most reputable groups online today.

#### 4. Application of Technology

[REDACTED] is developing, integrating, and applying state of the art technologies in the fields of software integration, broadband-delivery entertainment, 3-D user interfaces, and customizable content interfaces to create a unique shopping, supply chain management and entertainment platform.

The Company is developing a showcase site inconjunction with Intershop, the leading e-commerce middle-ware provider. [REDACTED] will intergrate its shopping platform with all aspects of its operation.

[REDACTED] start by using Intershop Enterprise Edition 3.0, the leading electronic commerce middle-ware. Intershop's powerful eCommerce development platform has the core infrastructure and extensibility to meet the needs of our enterprise market. With its Template Language Extension (TLE) capability, extreme degrec of customization and development is easily achievable which enable us to provide our customers the best shopping experience.

A high performance website requires a potent database, Sybase Adaptive Server Enterprise Edition XI was chosen as the back-end database engine. Being the only ISO9001 DBMS certified database in the market, high performance and availability is guaranteed. Sybase Adaptive Server also provides high performance for transactions processing and the capability to adapt to the unpredictable requirements of the Internet. It integrates seamlessly with Intershop for a total robust eCommerce backbone.

Other advanced technologies are used to streamline and expedite the order fulfillment process. Real-time, SET encrypted credit card data transaction is used for customers' protection against unauthorized access. A multi-carrier, enterprise-wide shipping system from Neopost called PS600 is integrated to Intershop to provide fast and accurate shipping to the customers. The PS600 is integrated together with our warehouse management & logistics systems for better resource planning.

To offer our affiliates the easiest to use interface and the fastest time-to-market, BeFree Version 3.0 was selected as our affiliates management program. BFAST (BeFree Affiliate Serving Technology) offers our merchants a full array of decision-support tools to maximize their online revenues and BFIT (BeFree Intelligent Targeting) allows our merchants to centrally place their advertisements according to their targeted audiences. It is a complete advertising solution that incorporate the placement, tracking, automated campaign fulfillment, reporting, and invoicing tailored for their needs. BeFree also features Virtual Shelf Space for sales of advertising for extra revenue generation.

[REDACTED]

Opensite Auction 4.0 Merchant Edition was chosen as our auction engine. Auto Bidding and Bidding Watch are just some of the advanced features of Opensite. Other features include automatic encryption, digital certificate compatibility, etc. Its easy to use interface makes our auction site fun and effective for our customers. And with its taut integration with the Intershop storefront, customization is never a problem.

[REDACTED] also used EShare Expressions 4.0 to form our online users community. As being the pre-eminent expert in human interaction on the Internet, not only it is able to provide conventional text based online chatting, but full multimedia support is also included in Expressions 4.0. Streaming or prerecorded video, audio, and live conversations are all possibilities of Expressions 4.0. These allow us to create a full featured, unparalleled, and effective community web sites.

WebTrends Professional Suite is used to constantly monitor our website. Its features includes; Log Analysis which provide detailed web site analysis and traffic reporting; Proxy Server analysis which keeps track of the usage trends and better understand the servers' efficiency; Link Analysis and Quality Control which is to improve the quality, performance, and integrity of our web site; and the most important Site Monitoring, Alerting and Recovery feature to minimize out site's downtime as much as possible.

One of the most exciting aspects of the [REDACTED] site is its strategic alliance with [REDACTED]. Together with Muse, [REDACTED] will create the first totally integrated 3-D, multi-person, e-commerce shopping experiences.

In order to integrate so many different external technologies, [REDACTED] has hired a team of over fifteen highly skilled developers. [REDACTED] development team has been able to tightly integrate different technologies into one easy to use product. By Q4 1999, [REDACTED] will have one of the most sophisticated sites on the Internet. A fully integrated retail, entertainment and supply chain system.

##### 5. Hong Kong Operation

[REDACTED] now has more than twenty people in development, integration and buying of advertising content.

##### 6. Key Personnel

###### PRESIDENT/CEO

[REDACTED], 33, holds a BA and MA in clinical psychology from [REDACTED]. He has an extensive background in developing start-up ventures. Mr. [REDACTED] has founded/co-founded a number of companies including [REDACTED] (an early leader in micro-breweries, IPO on NASDAQ in 1996), [REDACTED] (an Internet based research and analytic product for the real estate market), [REDACTED] (a Hong Kong based marketing and advertising company) as well as developing and arranging funding for many others such as [REDACTED] (develops and markets

[REDACTED]  
[REDACTED]  
high-tech computer peripherals including rapid prototyping systems) and [REDACTED]  
[REDACTED] which produces international standard food products for the global market in  
China and Hong Kong. His background in start-up companies and venture capital are  
valuable assets to the Company.

#### DIRECTOR OF BUSINESS DEVELOPMENT

[REDACTED] 31, received his BA in International Relations from [REDACTED]  
University. He has gained valuable experience working in various industries such as  
freight forwarding, print/premium production, and media. Mr. [REDACTED]'s previous two  
positions were Accounts Director for [REDACTED] a digital design studio and Business  
Development Manager for [REDACTED]. Mr. [REDACTED] is one of the co-founders  
of [REDACTED] and is responsible for business development and also chairs the product  
committee.

#### WEB DIRECTOR

[REDACTED] 26, has been working in the multimedia and Internet industry for the past 5  
years. Originally from Vancouver, Canada, Mr. [REDACTED] moved to Hong Kong after finishing  
design school. Since then, he has been an integral part of production of interactive CD-  
ROM and corporate web-sites for highly visible clients such as [REDACTED], [REDACTED],  
[REDACTED] and [REDACTED]. Mr. [REDACTED], the other co-founder, is responsible for the  
creation, development, and marketing of the web-site.

#### Editor-in-Chief

[REDACTED] 28, has worked in the collecting field for nearly ten years, having  
written and edited for [REDACTED], [REDACTED], and the [REDACTED]  
[REDACTED] recognized as the foundation publication for all comic book related  
collecting. [REDACTED] holds an M.S. in Professional Journalism from [REDACTED] University and  
an M.F.A. in Creative Writing and Marketing from [REDACTED] University. He  
is an Associate Professor in the English department at [REDACTED] in New York. His work as  
an editor with [REDACTED] earned him a place in the collecting community as an  
authority on toys and comic pricing and collecting. He also served as founding editor of  
[REDACTED], the well-received national news-stand publication that first incorporated  
collecting and entertainment news into one package. Recognizing the potential of the  
internet in relation to collecting, [REDACTED] began working for the on-line branch of the  
[REDACTED] Company and their collecting division, notably in relation to their  
auctionuniverse.com holding, where he served as contributing editor.

#### IT Manager

[REDACTED] 35, received his BS in Electronic Engineering/Computer Science from  
[REDACTED] London. His first management position was as Senior  
Programmer/Hardware Specialist for [REDACTED] in London prior to his emigrating  
to Hong Kong where he took the position of Senior Specialist with [REDACTED] overseeing

[REDACTED]

financial services IT. [REDACTED]'s most recent position was Senior Manager IT for [REDACTED] in Hong Kong. [REDACTED] specialises in developing large scale networks and software integrtrion. He will be overseeing all development of the [REDACTED] site. [REDACTED] has been with [REDACTED] for 3 months.

7. Startup Status

Began Development in June '98, operational in September '98.

8. Conflict of Interest Declaration

[REDACTED] and [REDACTED] two funds managed by [REDACTED] have invested a total of US\$1,250,000 into [REDACTED] during different times in 1998. Mr. [REDACTED] Executive Director of [REDACTED] serves on the Board of Directors of [REDACTED] on behalf of the two funds. Mr. [REDACTED] has no direct personal interest in [REDACTED].

It is anticipated that a Conflict of Interest will occur as [REDACTED] seeks to invest the Applied Research Fund into [REDACTED] as agreed in Clause 7.3(b) of the Management Agreement between [REDACTED] and the Applied Research Council.

[REDACTED] hereby wishes to resolve this Conflict of Interest by co-investing into [REDACTED] under the terms and conditions set by the third party lead investors group consisting of [REDACTED] and [REDACTED] [REDACTED] will not participate in the negotiations of the terms and conditions by [REDACTED] and [REDACTED] but will co-invest together with these parties under the terms and conditions set by the two parties.

[REDACTED] is investing in [REDACTED] with the intent of hosting the company as a showcase in the future [REDACTED] project.

財經事務及庫務局  
(庫務科)

香港下亞厘畢道  
中區政府合署



FINANCIAL SERVICES AND THE  
TREASURY BUREAU  
(The Treasury Branch)

Central Government Offices,  
Lower Albert Road,  
Hong Kong

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本函檔號 Our Ref. : FIN 150/7/1 Pt.1  
來函檔號 Your Ref. : CB(3)/PAC/R42

17 May 2004

Clerk to Public Accounts Committee  
(Attn.: Mr Colin Chui)  
Legislative Council  
Legislative Council Building  
8 Jackson Road, Central  
Hong Kong

Dear Mr Chui,

**The Director of Audit's Report on the  
results of value for money audits (Report No. 42)**

**Chapter 2: Funding of projects under the Applied Research Fund**

Thank you for your letter dated 11 May 2004. The Treasury issued an investment guide in March 1999 and updated it in January 2004. The purpose of the guide is to provide a handy reference for government departments who are required to set up and manage funds. This guide outlines the key steps in investment planning and the necessary controls for investment dealing activities in departments, including the investment of surplus funds. A copy of the guide is attached.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Eliza Yau'.

(Miss Eliza Yau)  
for Secretary for Financial Services  
and the Treasury

c.c. Secretary for Commerce, Industry and Technology  
Commissioner for Innovation and Technology  
Director of Audit

Internal  
AA/SFST

# *Investment Guide*



The Treasury  
Hong Kong

March 1999  
*[updated January 2004]*

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**LIST OF APPENDICES**

- A. Circular memorandum from the then Secretary for Financial Services of 12 February 2001 on “The Choice of Bank Counterparties In the Investment of Public Assets”**
- B. Second Schedule of the Trustee Ordinance on “Authorized Investments”**
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***\*Note by Clerk, PAC: Appendices not attached.***

## CHAPTER 1 - INTRODUCTION AND OVERVIEW

### 1.1 Purpose of the Guide

1.1.1 There are an increasing number of funds being managed by government departments. They may be in the form of :-

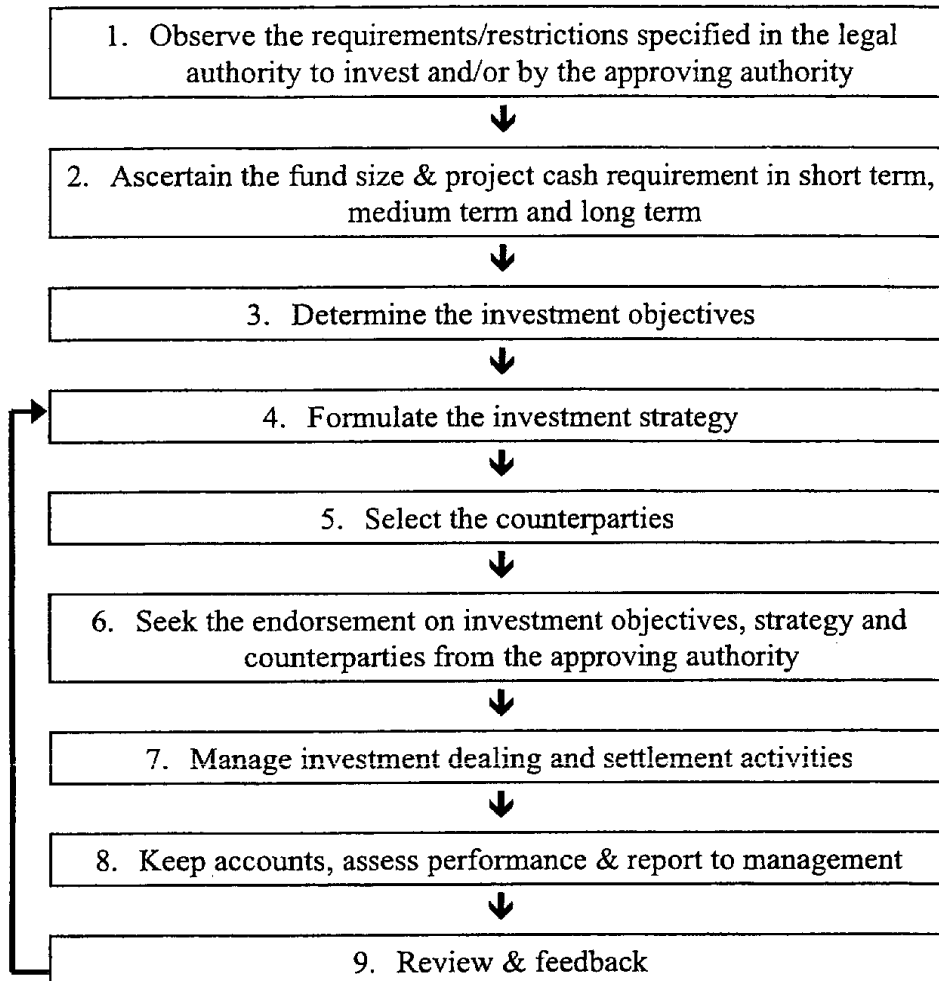
- donations,
- funds set up for schemes of special/designated purposes,
- money of general public held for administrative or legal proceeding purposes, or
- operating surplus of trading funds or financially autonomous bodies.

1.1.2 This Guide prepared by the Treasury aims at providing a handy reference for government departments who are required to set up and manage funds. It outlines the key steps in investment planning and the necessary controls for investment dealing activities in departments. In addition, specific features of funds managed by government departments, such as statutory requirements, and some other useful investment references are highlighted for attention. They are, however, by no means exhaustive.

1.1.3 Funds managed by government departments may differ in nature and in size, and are mostly subject to different authority to invest. This Guide is not intended to dictate the investment operations in departments. Taking into account the guidelines and references given in this Guide, departments are advised to formulate their own investment strategies and guidelines to meet their specific requirements and environments. The approval from the respective authorities to invest should always be sought and observed and the responsibility to comply with the requirements of the relevant authorities and to ensure accountability remains with the controlling officers.

**1.2 Basic Steps in Funds Management**

1.2.1 The basic steps in funds management by departments are summarized in the following chart, which will be elaborated in the subsequent chapters.



## CHAPTER 2 - KEY AREAS FOR INVESTMENT PLANNING

### 2.1 Authority to Invest

2.1.1 The authority for investment of funds by government departments is usually given by a statutory provision. The related Ordinance stipulates the approving authority for investment matters and may give specific investment directions. For example,

<i>Types of funds</i>	<i>Examples</i>	<i>Related statutory provisions on investment of funds</i>
Donation	Agricultural Products Scholarship Fund of the AFCD	S 9D of Agricultural Products (Marketing) Ordinance "The trustee may invest any of the moneys of the fund in investments of any kind whether such investments are permitted for the investment of trust funds or not, subject, in the case of investments which are not so permitted, to the prior approval of the Financial Secretary."
Fund for specific scheme	Traffic Accident Victims Assistance Fund of the SWD	S 8 of Traffic Accident Victims (Assistance Fund) Ordinance "The Director may invest any moneys of the fund in such investments as the Financial Secretary may direct, whether or not such investments are investments authorized under the Trustee Ordinance."
Money held on behalf of third parties	Bankruptcy Estates Account of the ORO	S 128A (1) of Bankruptcy Ordinance "Whenever the cash balance standing to the credit of .....(the Bankruptcy Estates Account) is in excess of the amount which, in the opinion of the Official Receiver, is required for the time being to answer demands in respect of debtor's estates, the Official Receiver may deposit the whole or any part of that excess with a bank."
Surplus Fund	Surplus fund of the Housing Authority	S 13 (1) of Housing Ordinance "Any moneys in the hands of the Authority which are not immediately required for the purposes of the Authority may be invested in such securities as may be approved by the Financial Secretary: Provided that, during such time as any moneys are due by the Authority to the Government, no such investment shall be made without the prior approval of the Financial Secretary."

2.1.2 The approving authority is usually the Financial Secretary, Secretary for Financial Services and the Treasury, Director of Bureau, Permanent Secretary or Head of Department. It normally :-

- sets direction for investment objectives,
- approves/selects investment vehicles & counterparties,
- monitors funds performance, and
- approves any change in investment strategy.

2.1.3 The approving authority may be assisted by an independent Investment Advisory Board/Committee to perform regular supervision on the investment activities.

## **2.2 Investment Objectives**

2.2.1 The following factors should be considered in setting investment objectives for a fund :

- a) ***Specific directions or requirements, if any, laid down in the relevant statutory provisions***
- b) ***Target Return required*** - it may be
  - to earn a better than cash rate of return,
  - to protect principal/capital against inflation,
  - to earn a return relative to the market indices e.g. return not lower than the Hang Seng Stock Index, or
  - to earn a specific strategic level of return e.g. 10% of the capital per annum.
- c) ***Risk level involved*** - Inevitably, investing involves a degree of risk. Risk is broadly defined here as the uncertainty of future net returns and includes :-
  - credit risk - risk of loss because of inability of counterparty to meet its obligations. In a mark to market context, credit risk refers to the uncertainty or volatility of value as a result of changes in the credit quality of an investment.

- market risk - risk that prices of securities fluctuate in value due to changes in market conditions e.g. interest rate environment (interest rate risk), currency fluctuations (currency risk).

- d) **Cashflow requirements** - It is a common requirement for funds to maintain a reasonable level of liquidity so as to have sufficient available fund in meeting expenditure on capital projects and for operational needs.
- e) **Time horizon** - This would provide investors with a clearer definition of the investment horizon in accordance with the investment objectives.

2.2.2 If more than one objective is identified after considering all relevant factors, departments may need to assign the relative priority and decide the prime objective. It should be recognized that **risk normally correlates positively with return**. Investments producing the highest returns are usually those which are the most risky. If there are tight & immediate fund requirements from time to time, the prime investment objective may be to generate sufficient return to meet operational needs and risk avoidance would be the main criterion while only a reasonably good yield could be expected. Therefore, in setting the financial objectives, **departments may need to strike a balance between return, liquidity & the tolerable risk level** that best fit the financial & legal requirements of the funds.

2.2.3 For example, after considering all relevant factors, the investment objective for the Schools Provident Funds managed by the Treasury is defined as to provide contributors with a target return equal to C.P.I. + x% subject to the following risk constraints :

- to minimize a chance of requiring a Government loan, and
- to minimize a chance of achieving a return less than 5 % over any 2 years or a negative return in any one year.

Another example is the Beat Drugs Fund. Its long-term investment objective is to achieve a target return equal to C.P.I. + x% in order to maintain the real value of the fund and generate recurrent income to finance anti-drug projects.

## 2.3 Investment Strategy

### 2.3.1 Formulation of Strategy

Having defined the investment objectives, departments may formulate the investment strategy by considering :-

- the appropriate types of investment vehicle/instrument and currency that meet the objectives,
- the appropriate asset allocation model if more than one type of investment instrument is selected, and
- whether to manage the funds by in-house or external fund managers.

### 2.3.2 Investment Vehicle/Instrument

The investment objectives generally dictate the choice of investment vehicles/instruments. Some common types of investment vehicles and the risk associated are described briefly in the following table :-

	<i>Particulars</i>	<i>Reward</i>	<i>Risk level</i>	<i>Risk associated</i>
<b>Bank deposit</b>	<ul style="list-style-type: none"> <li>• the most common type of investment</li> </ul>	<ul style="list-style-type: none"> <li>• low</li> </ul>	<ul style="list-style-type: none"> <li>• low</li> </ul>	<ul style="list-style-type: none"> <li>• default by bank</li> </ul>
<b>Negotiable certificate of deposit (CD)</b>	<ul style="list-style-type: none"> <li>• purchase from secondary market or direct issue from bank</li> </ul>	<ul style="list-style-type: none"> <li>• low</li> </ul>	<ul style="list-style-type: none"> <li>• low</li> </ul>	<ul style="list-style-type: none"> <li>• default by CD Issuer (Bank)</li> </ul>
<b>Exchange Fund bills or notes</b>	<ul style="list-style-type: none"> <li>• bills with a minimum denomination of HK\$500,000 and a life of up to a year,</li> <li>• notes can be bought in unit of HK\$50,000 with maturity ranging from 1 to 10 years</li> <li>• normal dealing size: HK\$1m to 2m</li> </ul>	<ul style="list-style-type: none"> <li>• low</li> </ul>	<ul style="list-style-type: none"> <li>• low</li> </ul>	<ul style="list-style-type: none"> <li>• fall in market value on sale before maturity</li> </ul>

	<i>Particulars</i>	<i>Reward</i>	<i>Risk level</i>	<i>Risk associated</i>
<b>Placement with the Exchange Fund</b>	<ul style="list-style-type: none"> <li>• normal dealing size : HK\$100m</li> <li>• maturity normally not shorter than 1 month</li> <li>• interest rates based upon the prevailing interbank rates</li> </ul>	• low	• low	• nil
<b>Other Debt instrument</b>	<ul style="list-style-type: none"> <li>• purchase from market or direct placement from the institution</li> <li>• coupon rate: the periodic interest payment</li> <li>• yield to maturity: the IRR</li> <li>• minimum dealing size: HK\$500,000 usually</li> </ul>	• low to medium	• low to medium	<ul style="list-style-type: none"> <li>• fall in market value on sale before maturity</li> <li>• default by bond issuer</li> </ul>
<b>Equities</b>	<ul style="list-style-type: none"> <li>• primary market: direct placement of the shares from the company to the public</li> <li>• secondary market: trading of shares in the Stock Exchange</li> </ul>	• high	• medium to high	<ul style="list-style-type: none"> <li>• fall in market value</li> <li>• reduction in dividend payment</li> <li>• collapse of company</li> </ul>
<b>Unit Trust / Mutual funds</b>	<ul style="list-style-type: none"> <li>• investment in Funds that holds securities</li> <li>• diversification</li> </ul>	• high	• medium to high	• fall in market value
<b>All the above investments in foreign currencies</b>	<ul style="list-style-type: none"> <li>• should be in currencies freely convertible to HK\$</li> <li>• hedging need to be considered to protect against currency loss</li> </ul>	• can be better or worse than HK\$ investment	• slightly higher than equiv. HK\$ investment	<ul style="list-style-type: none"> <li>• same as HK\$ investments above</li> <li>• fall in currency exchange</li> </ul>



### 2.3.3 Diversification & Hedging

In general, the risks in investments can be properly reduced by ways of diversification and hedging :-

- a) As markets do not all normally move in tandem, and there are periods when one investment will perform better than another, therefore, diversification by investment, by maturity, by counterparty, and/or by geographical location will help to spread the risk.
- b) Hedging is a strategy designed to reduce investment risk using certain financial instruments. A hedge can help lock in existing profits. Its purpose is to reduce the volatility of a portfolio, by reducing the risk of loss. For example, financial instruments that could be held to manage interest rate and foreign currencies exposures for hedging purposes include interest rate swap agreements, forward exchange contracts, foreign currency swap agreements and options.

### 2.3.4 Asset Allocation

A key area of risk management is asset allocation, which involves defining the proportions of the fund to be placed in different types of investment vehicles, such as equities, bonds, deposits, etc., and/or different currencies in order to balance risk & return and to meet the overall investment objective of the fund.

- a) In general,
  - the portfolio of a long term growth and risk-taking fund, which can tolerate volatility of returns, may include a large percentage of equities and mutual funds and a relatively small portion of bonds and cash deposits, and
  - for a short term fund with high cash flow requirement, equities will likely be excluded and the portfolio may consist of bonds, certificates of deposit and cash deposits only.

However, if the fund managed by a department is small, diversification by investment type to reduce risk may not be practicable and the choice of investment is likely limited to fixed income instruments only.

- b) **Four typical asset allocation models** and the types of fund for which these models could be assigned are illustrated below. The 4 models, which are not exhaustive, could be used for different types of fund and of course could be used with some modifications:-

- Model A (“Growth”) :-

<i>Investment Types</i>	<i>Target Weighting</i>	<i>Tactical Range</i>
Equities, Mutual Funds	60%	45% to 75%
<u>Long term : one year or over</u> Bonds, CDs, Deposits	30%	22% to 38%
<u>Short term : less than one year</u> Bonds, CDs, Deposits, Cash	10%	Any

It would be suitable for a fund which has long term objectives, and which uses investment income to supplement other forms of income, or for one reason or another does not need immediate return from the investments. Where investment is successful, the fund could perhaps improve its activities in quantity or quality at some time in the future. The investment approach here may be considered more ‘risk-taking’.

- Model B (“Growth and Income”) :-

<i>Investment Types</i>	<i>Target Weighting</i>	<i>Tactical Range</i>
Equities, Mutual Funds	40%	30% to 50%
<u>Long term : one year or over</u> Bonds, CDs, Deposits	40%	30% to 50%
<u>Short term : less than one year</u> Bonds, CDs, Deposits, Cash	20%	Any

It would be suitable for a fund which has similar long term objectives, but which is likely to be more dependent on investment income. The fund needs some income in the early years to fulfil its primary purpose. This demands an investment approach which generates some growth in the value of the fund to ensure it can perform in the long term whilst producing some current income as well. Obviously, this income yield cannot be very high.

- Model C (“Income”) :-

<i>Investment Types</i>	<i>Target Weighting</i>	<i>Tactical Range</i>
Equities, Mutual Funds	20%	15% to 25%
<u>Long term : one year or over</u> Bonds, CDs, Deposits	40%	30% to 50%
<u>Short term : less than one year</u> Bonds, CDs, Deposits, Cash	40%	25% to 55%

It would suit a fund whose activities are shorter term, say, seven to ten years. Here, inflation is of less concern, and maximizing current yield is the important investment criterion. A small amount of the fund is allocated for growth.

- Model D (“Cash”) :-

<i>Investment Types</i>	<i>Target Weighting</i>	<i>Tactical Range</i>
<u>Long term : one year or over</u> Bonds, CDs, Deposits	40%	30% to 50%
<u>Short term : less than one year</u> Bonds, CDs, Deposits, Cash	60%	50% to 70%

It would suit a short-term fund, say up to seven years. Risk avoidance is the main criterion and a reasonably good yield is required.

- c) Departments should note that asset allocation may change, either accidentally due to changing market values, or deliberately to reflect changing circumstances. Models need to be reviewed on a yearly basis.
  
- d) The **currency exposure** should also be considered carefully. As a guideline, no more than 30% of the fund assets should be exposed to currencies other than HK\$/US\$. Exposure to any individual currency other than HK\$/US\$ should not exceed 5% of the fund assets and exposure to currencies not freely convertible should be zero.

### 2.3.5 General Guidance on Management of Risk

To reduce risk relating to over-exposure and over-concentration, the then **Secretary for Financial Services (SFS)** has given a **general guidance on the choice of bank counterparties** (Appendix A), which will be discussed in more detail in para. 2.4.3. In addition, the **Second Schedule of the Trustee Ordinance on 'Authorized Investments'** (Appendix B) lays down restrictions for selecting certificates of deposit, bonds, equities, etc. for trust funds. For example, it is stipulated that equities should be listed on a recognized stock market or specified stock exchange as defined in section 1 of Part 1 of Schedule 1 to the Securities and Futures Ordinance, with a 5 year dividend history and a minimum market capitalization of HK\$10 billion or equivalent in foreign currency. The Second Schedule could also serve as a good reference for non-trust funds managed by departments. As a general guideline, fund managers should avoid investing in companies and mutual funds that invest in derivatives and/or deal in currency speculations.

### 2.3.6 In-house vs. External Fund Managers

If the funds to be managed are considerable, departments may consider appointing external fund managers for portfolio management if internal expertise or resources, i.e. professional staff with expertise in funds management, are not available. However, this does not affect the responsibilities of the department to the approving authority. The benefits and costs of appointing external fund managers include :-

- a) the benefits :-
- they are professionals in the investment industry with experience and technical back-up in selecting the most appropriate investment and risk diversification,
  - they have access to market information more readily and would likely be able to capitalize on the growth opportunities in overseas investment,
  - they can provide research support and training for in-house managers, and
  - the performance of external managed portfolio can be served as a meaningful comparison for investment being managed in-house.
- b) the costs :-
- annual management fee which is usually expressed as a percentage of the fund size, and
  - internal resources deployed and/or cost of appointing independent party for monitoring the compliance and performance of external fund managers.

Owing to the relatively high costs involved, usually only funds with large size (say, greater than HK\$100m) and frequent trading activities would be considered suitable for appointing external fund manager. In any event, the Investment Division of Financial Services and the Treasury Bureau should be consulted when a department is faced with the choice of using the “Growth” or “Growth and Income” models. Advice will be given as to whether it may be appropriate to manage the funds internally or appoint external fund manager.

## 2.4 Counterparties

2.4.1 Counterparties are defined in this Guide as persons, agents or organizations with which departments deal in the management of funds. They include :-

- **Banks/financial institutions** - the most common investment counterparties of departments as most funds managed by departments are invested in bank deposits.

- **Brokers/Investment bankers** - for securities trading or investment in bonds.
- **Fund managers** - invest and manage funds for departments if departments decide to use them.
- **Custodians** - safekeeping of investment assets such as documents of title and of certificates evidencing title to investments under the fund for departments/fund managers. The custodian may sometimes be assigned the responsibility for coordinating/consolidating the performance of fund managers. Custodians facilitate trade settlement and should be independent from the fund manager. Custodians could be custodian banks or trust companies capable of providing asset custody services. For funds managed either by an in-house or external fund manager, it is advisable for the custodian to be an organization separated from the fund manager in order to segregate the investment function from custodian function. A global custodian can be appointed for all assets or different custodians for different type of assets.
- **Settlement agents** - usually appointed to undertake the settlement process for department to ensure that investment transactions involving exchange of moneys and investment assets are properly and successfully conducted before payments are effected.

2.4.2 Departments are advised to consider the selection criteria for building up an authorized list of investment counterparties, and the appropriate exposure limits.

#### 2.4.3 Selection of Counterparties

In general, credit ratings from approved credit rating agencies (which, at present, include Standard & Poor's, Moody's Investors Service, Rating & Investment Information, Inc., Fitch Ratings, and the list may be expanded from time to time), total assets and shareholder's equity, and/or other information about the capability, stability and performance of a counterparty would form the basis of selection criteria. In particular, departments may note the following guidance :-

a) *Selection of bank counterparties*

- (i) The circular memo from the then SFS dated 12 February 2001 (Ref. : G6/33C II) gives a general guidance on the choice of bank counterparties. (Please see Appendix A for details). The key points include :-
- Departments should not conduct financial business of a banking nature with an institution which has not been granted Authorized Institution status by the Hong Kong Monetary Authority (HKMA).
  - Maximum exposure to any one institution should be kept within set limits, preferably in the region of
    - ◊ 1% of the overall deposit base of that institution, and
    - ◊ 10% of the capital base of that institution.
  - Funds with any one institution should be subject to a maximum exposure equivalent to 20% of the total funds under management. For fund under HK\$100m in size, the exposure to any one institution could be limited to 50% of the total fund.
  - Departments transacting HK\$ debt securities business are advised to consider institutions designated as Recognized Dealers and Market Makers in Exchange Fund Paper by the HKMA.
  - As an alternative, funds may be placed either in Exchange Fund Paper or directly with the Exchange Fund.
- (ii) Information on capital base or deposit base of individual banks is public information and departments, as the customers, can ask for copies from individual banks.
- (iii) In addition, departments should note the Accounting Circular No. 3/96 which stipulates that departments should obtain the approval of the Director of Accounting Services before any banking, security or safe custody accounts are opened for the purposes of S25 of the Public Finance Ordinance (PFO). (See also para. 3.4). Departments

dealing with non-PFO funds may also consult the Treasury on the placement of deposits with banks.

b) ***Selection of fund managers*** - If an external fund manager is appointed, the selection should be carried out through a competitive process. The following areas may need to be considered :-

- type of mandate (balanced or specialist),
- complementary of investment styles with investment objectives,
- past performance and experience in fund management,
- the investment process,
- regular reporting of the investment transactions, and
- support services provided (such as performance evaluation, market commentary, training).

If no in-house resources/expertise is available for the above assessment, departments may consider hiring consultants.

c) ***Selection of asset custodians*** - Similar to fund managers, custodians, if appointed, should be selected through a competitive process. The following aspects may need to be considered :

- credit rating and financial position,
- insurance coverage and indemnity available,
- sub-custodian network (global custodian only),
- reporting requirements,
- segregation of the fund's and the custodian's asset,
- internal controls, and
- availability of other support service such as performance analysis.



## CHAPTER 3 - NECESSARY CONTROLS IN INVESTMENT OPERATIONS

### 3.1 Investment Guidelines and Operational Manual

3.1.1 To maintain effective control over fund management, departments are advised to develop comprehensive investment guidelines and an operational manual for the benefit of all levels of staff who are responsible for investment operations. The manual/guidelines generally include :-

- the investment objectives, strategies and policies approved by the Authority,
- a list of approved investment vehicles/instruments,
- a framework of risk management e.g. policy of diversification, asset allocation model adopted,
- a list of approved counterparties and related exposure limits, including the criteria for selecting or evaluating counterparties,
- the organizational chart setting out clearly the responsibility of each party concerned and the reporting lines,
- operational procedures for cash forecast, investment dealing, settlement and reconciliation,
- benchmarking or standards for measuring investment performance,
- accounting procedures and policies, and
- scope and approach of internal audit.

3.1.2 In preparing guidelines/manuals to meet the specific needs of the funds, departments may also wish to refer to the Guidelines for Corruption Prevention on “Investment of Surplus Funds in Fixed Income Instruments” issued by the ICAC in 2001.

### **3.2 Segregation of Duties**

Adequate segregation of duties will provide a high level of protection against malpractice. Typical functions which are normally performed by different parties include :-

- setting of investment objectives, strategies and policies,
- maintenance and evaluation of the approved list of counterparties,
- investment dealing,
- settlement, confirmation and reconciliation,
- safe custody,
- evaluation of investment performance, and
- internal audit.

### **3.3 Conflict of Interest**

Conflict of interest may arise when officers who have the responsibility for approving/assessing the offers or choosing the counterparties in dealing have any personal or related financial interest which might affect the objectivity of their actions and decisions. Departments should remind all officers concerned to declare their own investments regularly or report any investments which may give rise to conflict of interest between their investments and official duties in accordance with the Civil Service Regulations (CSRs) 461-466 and Civil Service Bureau Circular No. 9/2001.

### **3.4 Operation of Bank Accounts**

- 3.4.1 Effective controls over the operation of bank accounts will reduce the risk of misappropriation.
- 3.4.2 As promulgated in Accounting Circular No. 3/96, the approval of the Director of Accounting Services must be obtained before any banking, security or safe custody accounts are opened for the purposes of S 25 of the Public Finance Ordinance.

3.4.3 Instructions on the operation of bank accounts are laid down in Standing Accounting Instructions 1610-1690. In particular, payment from a bank account should be effected only by cheques, which must be signed by 2 authorized signatories.

3.4.4 In addition, departments may consider the following in operating bank accounts :-

- open separate investment accounts which are independent of operational accounts,
- set appropriate financial limits for different levels of authorized signatories to effect transfer of funds,
- instruct banks to accept instructions to transfer funds only when they are made to other bank accounts in the same name as the account holder and the instructions are properly signed by 2 authorized signatories, and
- arrange to check the accounting and bank accounts independently by senior staff.

### **3.5 Quotations**

3.5.1 The seeking of quotations for investments such as deposits and fixed interest securities is normally done by telephone and the quotations are subject to change until the deals are confirmed. To enhance control over the quotation procedures, departments may consider obtaining quotations from all approved investment counterparties. However, if it is not practicable, departments should formulate a rotation system and decide the minimum number of quotations to be obtained each time in advance. The selection can be done on a random, sequential or other basis. For example, in placing a bank deposit a department may get quotations from the 2 banks which gave the best rates last time, and select another 2 from the approved list in sequence. The formulated basis should be clearly laid down and followed consistently by the staff concerned.

3.5.2 To ensure that the quotations are fairly obtained, departments may consider the following :-

- assign at least 2 staff to call different counterparties for quotations,
- use telephones with recording system to get quotations if the volume justifies, or use conference calls to enable 2 staff to listen to telephone calls simultaneously during the quotation process, and/or
- random check the quotations against other sources and confirm the best rate by a separate officer.

3.5.3 Details of quotations (including the rates and officer-in-charge) should be properly documented to facilitate subsequent verification and checking.

### **3.6 Settlement, Recording and Accounting**

3.6.1 Departments are advised to devise appropriate procedures for the settlement arrangements to ensure proper segregation of duties and authorization of transactions. For example, banking instructions for fund transfers and/or confirmation letters should be checked by appropriate level of officers to ensure that the details match with the data contained in the approved quotation sheets and comply with the laid down departmental guidelines. Instructions/confirmation letters should be delivered to the counterparties concerned promptly before deadline. Any discrepancy or late delivery should be followed up by senior officers.

3.6.2 There should be procedures for reconciling the confirmation notes and bank statements received from counterparties. Procedures for proper follow-up of any outstanding confirmation notes and monthly statements not received within a specified period must be laid down. The reconciliation should be reviewed by management on a timely basis to ensure that any differences are adequately resolved or appropriate action is being taken.

3.6.3 The investment transactions should be properly recorded onto the general ledger on a timely basis. The accounting policies for investment will be discussed in Chapter 4.

### **3.7 Controls on External Fund Managers**

To maintain effective control over fund managers and to prevent possible abuse, departments may consider the following precautions:

- setting financial limits on the aggregate level of funds placed with each fund manager,
- clear documentation of the investment objectives, policies and strategies on investments for the compliance of the fund managers and regular review of such guidelines,
- use of a separate custodian to safekeep assets managed by the manager,
- close monitoring of fund managers' performance and regular review of their performance against pre-defined benchmarks and criteria, and
- appointment or re-appointment of fund managers subject to regular review based on performance. There should be provision in the Fund Manager Agreement for termination in the event of poor performance and a mechanism to ensure the consideration of new fund managers.

### **3.8 Controls on Custodians**

To maintain effective control, departments may consider the following prudent steps :-

- setting financial limits on the aggregate level of assets placed with each custodian,
- stipulating clearly the duties and responsibilities in the custodian agreement,
- regular reporting by custodians in respect of the investment transactions,
- obtaining evidence/information of the operation of specific internal controls in relation to safeguarding of assets and recording of transactions by the custodians,

- reconciling custodians' records with fund managers' records and/or internal records at periodic intervals, and
- making provisions for regular review and termination in the event of poor performance in the custodian agreement. There should also be a mechanism to ensure the consideration of new custodians.

### **3.9 Internal Audit**

3.9.1 Internal audit is a vital part of the overall control system. It is an independent appraisal service provided to the management by measuring and evaluating the effectiveness, efficiency and economy of the internal control system.

3.9.2 The internal audit functions must be carried out by officers independent from the investment functions. If the fund exceeds \$100 million, the head of the internal audit should be a qualified accountant.

3.9.3 The scope of services generally include :-

- ongoing evaluation of management and operational controls to ensure that they are appropriate and effective to the level of operations,
- compliance testing to ensure that all controls are operating in accordance with the established procedures and guidelines,
- physical and substantive checks of individual transactions to ensure that all funds are safeguarded and the accounts are properly recorded, and
- investigations of non-compliance or other odd situations, and reporting to independent senior management on a timely basis.

3.9.4 The internal audit work may cover investment operations conducted by both in-house and external fund managers.

## CHAPTER 4 - ACCOUNTING, MONITORING & REVIEW

### 4.1 Accounting

#### 4.1.1 Departments are advised to :-

- maintain proper books of accounts and supporting documents for each fund under their management in order to provide audit trails for subsequent reviews and audits,
- select proper accounting policies for accounting and disclosure of investments, in particular, for reporting the carrying value of investments and for recognition of investment income and expenditures of their funds. For example :-
  - ◇ investments may be carried in the balance sheet at :-
    - ⇒ historical cost, or
    - ⇒ market value, or
    - ⇒ the lower of cost and market value
  - ◇ investment income and expenditure may be recognized on :-
    - ⇒ a cash basis, or
    - ⇒ an accrual basis
- prepare annual financial statements reporting the financial position and the performance of the funds to the relevant committee and/or approving authority.
- comply with the disclosure requirements promulgated in the Statement(s) of Standard Accounting Practice issued from time to time by the Hong Kong Society of Accountants.

4.1.2 In considering the accounting policies, departments may refer to the Hong Kong Society of Accountants' Statement of Standard Accounting Practice No. 24 on 'Accounting for Investments in Securities', International Accounting Standard No. 32 on 'Financial Instruments: Disclosure and Presentation' and International Accounting Standard No. 39 on 'Financial Instruments: Recognition and Measurement'.

## **4.2 Performance Measurement**

4.2.1 Departments are advised to evaluate the performance of the investment portfolio to determine whether the investment objectives are met on a regular basis. The performance can be measured against some benchmarks that can reflect the investment objectives of the fund. Common benchmarks include :-

- a fixed rate of return,
- a three-month Hong Kong Interbank Offer Rate,
- an inflation related index, and
- an equity/bond index related measure.

4.2.2. In particular, the investment performance in mutual funds should be reviewed against the performance of similar funds in the industry.

## **4.3 Reports to Management**

4.3.1 Regular management reports should be submitted to the department head, Investment Advisory Committee, and/or approving authority from time to time. The frequency and details may be specified by the approving authority or its delegates as appropriate. The reports generally include :-

- the consolidated funds position,
- the investment results for the period,
- comparison of the current performance with the targets or benchmarks already set, and explanations/comments on significant differences,
- projections and/or market outlook, and
- highlight of exceptions or confirmation of full compliance to the approved Investment Guidelines.



#### **4.4 Audit**

4.4.1 Departments should appoint an external auditor, who may be the Director of Audit or other auditors as appropriate, to carry out audit of the annual financial statements. The audit will enable the department to :-

- comply with the requirements laid down by the approving authority or the relevant statutory provisions, and
- enhance the credibility of the financial statements.

4.4.2 The auditor would, based on the audit conducted, express an independent opinion on whether the financial statements, in all material respects, are properly presented and whether they have been prepared in accordance with the provisions laid down in relevant ordinance or by the approving authority.

4.4.3 Subject to the requirements laid down in the relevant ordinances or by the approving authority, departments are usually required to submit the audited financial statements, together with a report by the Director on the administration of the fund during the period.

#### **4.5 Review & Feedback**

4.5.1 To better monitor the investment operations and provide feedback, departments are advised to carry out :-

- reviews on the investment objectives and strategies when there are changes in statutory provisions, fund flow requirements, and/or the investment environment,
- reviews on the current status of counterparties on the approved list on a regular basis to ensure that the established selection criteria are being met and the exposure limits, if applicable, are still appropriate, and
- continuous assessment of the internal controls built in the operational procedures to ensure that they are effective and relevant to the changing circumstances.

4.5.2 Departments are advised to take immediate action to update the investment strategies and/or improve the operational procedures whenever appropriate.



香港特別行政區政府 The Government of the Hong Kong Special Administrative Region

渠務署署長 Director of Drainage Services

香港灣仔告士打道5號稅務大樓43樓 43/F Revenue Tower, 5 Gloucester Road, Wan Chai, Hong Kong

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來函檔號 Your Ref: CB(3)/PAC/R42

本署檔號 Our Ref: DSD CRC 4/35/1/10 Pt 2

13 May 2004

Public Accounts Committee,  
Legislative Council Building,  
8 Jackson Road,  
Central,  
Hong Kong  
(Attn : Ms Dora WAI)

Dear Ms Wai,

**The Director of Audit's Report on the  
Results of value for money audits (Reports 42)**

**Chapter 3 : Harbour Area Treatment Scheme Stage I**

I refer to your letter of 10 May 2004.

DSD had not sought legal advice specifically on the possibility of lodging claims against the supplier of the mucking system. When the problem with the mucking system in Contract E was first revealed in late 1997, DSD was working closely with the Department of Justice and external legal advisors as a team on the arbitration with Contractor A and related problems arising from the completion contracts. The possibility of claiming against the supplier of the mucking system was not considered by the team because Government did not have a contract with the supplier and the cost incurred in replacing the mucking system could be claimed against Contractor A under the contract as part of the additional cost arising from the forfeiture of the contract. The claims were eventually settled with a significant sum successfully recovered from Contractor A as mentioned in paragraph 3.9 of the Audit Report.

Following the receipt of your letter, legal opinion has been sought on the possibility of lodging claims against the suppliers of the mucking systems now for their defects. The legal advice we just received suggests that such possibility is almost certainly no. Government has no contract with the suppliers. Any action would therefore have to be based on tort. Even assuming it were not time barred by the six year limitation period which has already expired, any claim in tort would be very difficult.

我們的**抱負**是要建立達至國際水準的渠務系統，以保障市民的健康及安全  
Our **VISION** is to develop and maintain world-class drainage systems to keep our community healthy and safe



ISO 9001:2000  
Corporate Certificate No. HC 012

I would like to clarify that there was no delay in replacing the mucking systems. After receiving expert advice that the mucking system was not safe, Contractor E decided to replace the system in January 1998 and at the same time submit his claim. Purchase order for the essential components of the replacement system was placed in the same month. Our decision made in March 1998 on the claim submitted by Contractor E in January 1998 was to accept the financial consequence of the replacement and the consequential time extension and therefore had not caused any delay to the replacement activities. As for Contracts C and D, the contractors were notified of the mucking gantry problem at the time of contract commencement in January 1998 to avoid unnecessary delay. The decision to accept the financial and time extension consequences could only be made 2 months after receipt of the claim submitted by Contractor E because the assessment processes were technically and contractually complicated requiring expertise input.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'R T K Cheung', with a horizontal line extending to the left from the start of the signature.

( R T K Cheung )  
Director of Drainage Services

c.c. : Secretary for the Environment, Transport and Works  
Director of Audit  
Secretary for Financial Services and the Treasury (Attn.: Miss Amy Tse)

財經事務及庫務局  
(庫務科)

香港下亞厘畢道  
中區政府合署



FINANCIAL SERVICES AND THE  
TREASURY BUREAU  
(The Treasury Branch)

Central Government Offices  
Lower Albert Road  
Hong Kong

電話號碼 Tel. No. : 2810 3132  
傳真號碼 Fax No. : 2523 5722  
本函檔號 Our Ref. : FIN A6/163 Pt.1  
來函檔號 Your Ref. : CB(3)/PAC/R42

15 May 2004

Clerk, Public Accounts Committee  
Legislative Council Secretariat  
Legislative Council Building  
8 Jackson Road  
Central  
Hong Kong  
(Attn: Ms Dora Wai)

Dear Ms Wai,

**The Director of Audit's Report on the  
results of value for money audits (Report No. 42)**

**Chapter 3: Harbour Area Treatment Scheme (HATS) Stage I**

Thank you for your letter of 10 May 2004.

In response to your query in paragraph 2(a) of your letter, I would like to first explain the purpose of introducing the administrative cap arrangement as set out in paragraph 4.54 of Chapter 3 of Audit Report No. 42 before assessing its effect on improving the financial control over and monitoring of works projects.

Each year, the Administration has to make due allowance for the outstanding commitments of all Category A projects (i.e. the total Approved Project Estimates (APE) minus the actual expenditure to date) before earmarking resources for Category B and other new projects. These outstanding commitments would be inflated if the project estimates were not suitably adjusted over time taking into account actual works progress, and any savings from reduction in scope/change in design/lower tender price etc. In the light of this, we have introduced the administrative cap arrangement since May 2002 to prevent internal resources allocated to Category A projects from being locked up unnecessarily.

Under the administrative cap arrangement, we would administratively adjust downwards the capital funding allocated to the projects as approved by the Finance Committee i.e. the APE, taking into account the lower-than-estimated outturn tender price, the actual works progress and planning development in the course of the annual resources allocation exercise. This lower spending limit would then become the administrative cap on the project expenditure. While this arrangement will help release internal resources for allocation to other worthwhile projects, it will not obviate the need to seek necessary Finance Committee approval for an increase in the APE. Since its introduction, the administrative cap arrangement has been duly observed by works departments.

With the administrative cap arrangement in place, the works departments have to apply to Treasury Branch for the lifting of the administrative cap to cover any subsequent increase in forecast expenditure even when the overall APE has not been exceeded. In doing so, works departments would need to account for the changes in the latest forecast expenditure as against the administrative cap. Through this process, any surplus fund in the APE used to cover an increase in forecast expenditure can be more clearly identified. We are thus of the view that this measure would enhance the transparency in the implementation of the works projects and help track down the changes and the reasons for such changes in the project estimates. As recommended by the Audit Report in paragraph 4.52(b), we have already required all works departments to set out in their submissions to Finance Committee for an increase in APE information on the deployment of surplus funds under the APE to cover any cost increase.

As regards the information required in paragraph 2(b) of your letter, in 1993 the then Finance Branch announced a simplified procedure whereby relevant departments could make a request for reduction in APE by memorandum to the then Secretary for the Treasury containing the details of the project and a concise explanation as to why the reduction is proposed if there was no change in the scope of a project. The relevant memo is attached for your reference. Drainage Services Department (DSD) subsequently included the guideline announced by the then Finance Branch in DSD Technical Circular No. 5/93. This guideline was in force during the period of Contracts C, D, and E under the HATS Stage I works, i.e. from 1997 to 2000. While the procedure promulgated then did not specifically require the works departments to reduce the APE when the awarded contract sum of a contract under a works project is lower than the contract estimate included in the APE, as a general financial management and control principle, works departments should put forward realistic estimates and review the project estimates in the light of actual progress so as not to lock up valuable resources. Under this principle, works departments would judge when the APE of a project should be reduced taking into account all relevant considerations including the outturn tender price. We therefore expected that DSD had followed the simplified procedure as announced in 1993 when it came to the conclusion that there was no need to reduce the APE to reflect the lower tender prices. Seen in this light, we do not consider that DSD had breached the simplified procedure announced by the then Finance Branch and promulgated in the DSD's Technical Circular.

I hope the above would help clarify your questions. Should you have further questions, please do not hesitate to contact me.

Yours sincerely,



(Miss Amy Tse)  
for Secretary for Financial Services  
and the Treasury

c.c. Secretary for the Environment, Transport and Works  
Director of Drainage Services  
Director of Audit  
Administrative Assistant to Secretary for Financial  
Services and the Treasury

## MEMO

From Secretary for the Treasury  
 Ref. (31) In FIN P6/9 VIII  
 Tel. No. 810 2232  
 Date 9 February 1993

To Distribution  
 Your Ref. in  
 dated \_\_\_\_\_

Approval for Reduction in Approved Project Estimates

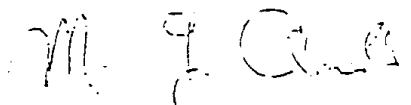
This memorandum introduces simplified procedures to reduce an approved project estimate (APE) where no change of scope is involved.

2. The authority to approve (unlimited) reductions in APEs where no change of scope is involved has been delegated by Finance Committee to the Secretary for the Treasury, Deputy Secretary for the Treasury and Principal Assistant Secretary for the Treasury. Paragraph 23 of Financial Circular 8/90 requires that, where an APE of a project in Category A requires amendment, a submission should be made to Finance Branch in the form of a PWSC paper addressed to the Secretary, PWSC copied to the Works Branch.

3. In future, where there is no change of scope, requests for reductions in APE may be made by memorandum addressed to the Secretary for the Treasury, attention PAS(Tsy)(Works) copied to the Works Branch. (Where the reduction in APE involves a substantial change in scope, the submission must still be made in the form of a PWSC paper as Finance Committee's approval may need to be sought.)

4. The memorandum should contain the subhead, project title, a brief description of the project scope, the original and proposed (reduced) APE, a concise explanation as to why the reduction is proposed and a final statement to confirm that the reduction does not involve any change of scope.

5. Queries on this memorandum should be addressed to PAS(Tsy)(Works) tel. no. 810 2232, fax no. 524 2386.



( M.J. Arnold )  
 for Secretary for the Treasury



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本署檔號 Our Ref. : UB/PAC/VFM/42-2

來函檔號 Your Ref. : CB(3)/PAC/R42

22 May 2004

Clerk, Public Accounts Committee  
Legislative Council Secretariat  
Legislative Council Building  
8 Jackson Road, Central  
Hong Kong  
(Attn: Ms Dora Wai)

Dear Ms Wai,

**The Director of Audit's Report on the  
results of value for money audits (Report No. 42)**

**Chapter 3: Harbour Area Treatment Scheme (HATS) Stage I**

Thank you for your letter of 17 May 2004 inviting my comments on the additional information provided by the Secretary for Financial Services and the Treasury in his letter of 15 May 2004.

As mentioned by the Secretary in the third paragraph of his letter, the administrative cap arrangement was introduced to prevent internal resources allocated to Category A projects from being locked up unnecessarily. With the administrative cap arrangement in place, the works departments have to apply to the Financial Services and the Treasury Bureau for the lifting of the administrative cap to cover any subsequent increase in forecast expenditure. According to the Secretary, the administrative cap arrangement has been duly observed by works departments since its introduction in May 2002.

The administrative cap arrangement is not introduced to replace the mechanism for reducing the Approved Project Estimate (APE), which is a means to enhance financial accountability to the Finance Committee over the approved funding of works projects. Under the mechanism for reducing the APE, when the APE of a works project is reduced, a subsequent request for additional funding in excess of \$15 million over the reduced APE is required to be submitted to the Finance Committee for approval. Currently, both the administrative cap arrangement and the mechanism for reducing the



APE are in force. These two measures, if properly implemented, would enhance the control and use of funding under the APE.

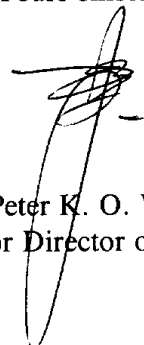
In the sixth paragraph of his letter, the Secretary has mentioned the simplified procedure announced by the then Finance Branch in 1993 and DSD Technical Circular No. 5/93. In Audit's view, the March 1996 information paper mentioned in paragraph 4.43 of the Audit Report also provided useful information on the guidelines. In this information paper, the Administration informed the Finance Committee that:

“Where the tender sum is below the estimate approved by the Finance Committee, we will consider reducing the approved project estimate to reflect the lower forecast outturn price.”

Audit was aware that these guidelines allow the relevant project controller to exercise judgement as to whether the APE could be reduced. In paragraph 4.46 of the Audit Report, Audit did not conclude that the DSD had breached the guidelines. Audit only noted that, despite the guidelines, the DSD did not reduce the APEs of the tunnel completion contracts even though the accepted tender prices were much lower than the estimated contract sums included in the APEs. However, Audit could not find any documentation of the reasons for the DSD not to do so. Therefore, Audit has recommended in paragraph 4.51(b) of the Audit Report that the Director of Drainage Services should take action to reduce the APE of a project when the tender price is significantly lower than the estimated contract sum in the APE, and document the reasons where a reduction in the APE is considered not warranted.

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

Yours sincerely,



(Peter K. O. Wong)  
for Director of Audit

c.c. Secretary for Financial Services and the Treasury (Attn: Miss Amy Tse)  
Secretary for the Environment, Transport and Works  
Director of Drainage Services

香港特別行政區政府  
The Government of the Hong Kong Special Administrative Region

政府總部  
環境運輸及工務局  
香港花園道美利大廈



Environment, Transport  
and Works Bureau  
Government Secretariat  
Murray Building, Garden Road,  
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本局檔號 Our Ref. ETWB(CR)(W) 1-150/4 Pt.2

來函檔號 Your Ref. CB(3)/PAC/R42

Tel No. : 3110 2788  
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18 May 2004

Clerk, Public Accounts Committee  
Legislative Council Secretariat  
Legislative Council Building  
8 Jackson Road  
Central  
Hong Kong  
(Attn: Ms Dora Wai)

Dear Ms Wai,

**The Director of Audit's Report on the  
results of value for money audits (Report No. 42)**

**Chapter 3: Harbour Area Treatment Scheme (HATS) Stage I**

Thank you for your letter of 11 May 2004.

Regarding the feasibility of implementing the two proposed measures as set out in paragraph (2) of your letter, my views are as follows –

- (a) In theory, it would be feasible to reduce the Approved Project Estimate (APE) for a project when the tender price is significantly lower than the estimated sum allowed in the APE for the relevant contract. However, it is necessary to note that a lower tender price may not necessarily lead to a corresponding surplus of the same amount in the APE. For example, in the case of a multi-contract project, the lower

tender price for one contract may be off-set by the higher-than-estimated tender price for another contract. Market conditions may also change considerably within a short period of time thus requiring larger estimated sums for the remaining contracts under the project. A larger contingency sum for the project may also be necessary to cater for unfavourable ground conditions. For these reasons, reducing the APE by the same amount of the whole of the saving from the lower tender price will not be feasible. Instead, it would only be reasonable to require works departments to first review the APE after awarding a contract at a price significantly lower than the original estimated sum. Works departments should then suitably adjust the APE where there will likely be surplus funds for the whole project after such a review.

- (b) Provided that an APE is to be reduced only after a review by the works departments as proposed in paragraph (a) above, we have no difficulty with the proposed requirement that after reducing the APE, a new application should be submitted for approval by the Finance Committee (FC) for supplementary provision to increase the APE, if so required, of more than \$15 million. For cases where the required supplementary provision to increase the APE is \$15 million or below, the approval of the Financial Services and the Treasury Bureau under delegated authority will be sought.

I would also like to provide the following information as requested in paragraph (3) of your letter.

#### **Capital and recurrent costs for providing the disinfection facility**

- (a)(i) We have examined the possibility of advancing the provision of part of the permanent disinfection facilities that we propose to build under HATS Stage 2 so as to improve the water quality (in terms of E.coli) in the western harbour waters. This would involve the installation of an electro-chlorination plant to produce the disinfectant agent (sodium hypochlorite or bleach solution) and ancillary facilities for dosing the disinfectant on the effluent before the effluent is discharged via the submarine outfall at Stonecutters Island Sewage Treatment Works.

Based on our preliminary estimation, the capital cost and annual recurrent cost of the disinfection facilities required for treating the Stage 1 flow would be around \$240 million and \$60 million respectively. The recurrent expenditure cannot be met by existing resources.

We are planning to consult the public shortly on HATS Stage 2. If the public support it, we plan to commence the detailed design, environmental assessment, etc. on the part of the permanent disinfection facilities for treating the Stage 1 flow by the end of 2004, after completing the necessary administrative procedures in bidding for resources. If the above preparatory works are completed smoothly, we shall be able to start the tendering process and seek the funding approval of FC in parallel as early as 2006. Subject to the approval of FC, the construction of the disinfection facilities can start in the second half of 2006 for completion by the end of 2008 the earliest.

#### **Possible interim measures**

- (a)(ii) Regarding possible interim measures, we have explored the possibility of installing temporary facilities to enable the disinfectant solution to be delivered in bulk by barge directly to the Stonecutters Island Sewage Treatment Works. Such temporary facilities include a barge unloading facility and a number of large storage tanks to store the bleaching agent on-site. The capital cost for the temporary facilities would be about \$67 million and the recurrent cost would be about \$90 million per annum. Most of the temporary facilities would become redundant upon completion of the permanent disinfection facilities described above. Hence, it would be more cost effective to expedite the permanent installation instead of constructing the temporary facilities.

#### **Guidelines to adjust the APE**

- (b)(i) As stated in paragraph 4.41 of the Audit Report, in January 2000, the then Secretary for Works expressed concern about the over-estimation of APEs in some works projects. In that connection, he issued

guidelines to the works departments to require them to improve the accuracy of the project estimates and review the system of collecting, updating and sharing of the centralised database of unit costs of construction. He also directed the works departments that APE of projects should be suitably adjusted, if necessary, when the tender price is much lower than the approved estimates.

### **Promulgation of the guidelines**

(b)(ii) The above instruction was promulgated to all works departments in an internal memorandum on 12 January 2000.

On 27 April 2004, in response to the recommendation in paragraph 4.52(a) of the Audit Report, the Works Branch further issued a memorandum to remind all works departments to suitably adjust the APE of projects when a tender price is significantly lower than the estimated contract sum in the APE and there will likely be surplus funds under the project.

I hope you will find the above useful in answering your questions.

Yours sincerely,



(Sarah LIAO)

Secretary for the Environment, Transport and Works

c.c. Director of Drainage Services  
Director of Environmental Protection  
Director of Audit  
Secretary for Financial Services and the Treasury (Attn: Miss Amy Tse)

## MEMO

<p><b>From</b> Secretary for the Environment, Transport and Works</p> <p><b>Ref.</b> in ETWB(CR)(W) 1-150/4 Pt.2</p> <p><b>Tel. No.</b> 2848 2708</p> <p><b>Fax. No.</b> 2971 0774</p> <p><b>Date</b> 27 April 2004</p>	<p><b>To</b> Distribution</p> <p><b>(Attn.:</b> _____ <b>)</b></p> <p><b>Your Ref.</b> _____ <b>in</b> _____</p> <p><b>dated</b> _____ <b>Fax. No.</b> _____</p> <p><b>Total Pages</b> 3</p>
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### Audit Review on Harbour Area Treatment Scheme Stage I Project and Contract Management

The Director of Audit tabled in LegCo on 21 April 2004 his Audit Report No. 42, which includes at Chapter 3 an audit review on the captioned project.

2. Pursuant to the D of A's recommendations in the audit review on **reducing the risk of contract forfeiture**, you are reminded in the course of PWP project delivery to –

- (a) continue to implement measures (such as the use of parent company guarantee and performance bond) to minimise the risk of contract forfeiture in future similar projects;
- (b) strictly implement the contract conditions for the provision of parent company guarantee and performance bond to ensure that the required contract instruments are submitted by contractors within the stipulated time limits; and
- (c) for large-scale works projects, critically devise the contract payment schedules to ensure that progress payments are made, as far as possible, in line with the actual progress of works.

3. Pursuant to the D of A's recommendations in the audit review on **budgetary control over public works projects**, you are reminded in the course of PWP project delivery to –

- (a) suitably adjust the APE and the RAE estimates of projects when a tender price is significantly lower than the estimated contract sum in the APE and there will likely be surplus funds under the project; and
- (b) state clearly in the submissions to the PWSC and FC of LegCo seeking an increase in the APE for works projects:
  - (i) the total cost increase and the reasons for the increase; and

(ii) whether any surplus funds in the APE have been used to meet the cost increase.

4. I should be grateful if you would remind your staff to follow the recommendations in paragraphs 2 and 3 above in improving project and contract management. Would DCE please also review the Project Administration Handbook (PAH) and amend the relevant sections of the PAH to reflect the audit recommendations as necessary.

5. In the Audit Report, the Director of Audit has also put forward other recommendations which are being studied by this Bureau. When adopted, these recommendations will be effected later through promulgation of technical circulars or issuance of memoranda.



(K K Kwok)

for Secretary for the Environment,  
Transport and Works

Distribution

Director of Architectural Services  
Director of Civil Engineering  
Director of Drainage Services  
Director of Electrical and Mechanical Services  
Director of Environmental Protection  
Director of Highways  
Director of Home Affairs (Attn: CE/Works)  
Director of Territory Development  
Director of Water Supplies

c.c. (Relevant Bureaux and Client Departments are requested to note paragraph 3(b) when approving PWSC/FC submissions seeking an increase in the APE for works projects)

Secretary for Commence, Industry and Technology  
Secretary for Economic Development and Labour  
Secretary for Education and Manpower  
Secretary for Home Affairs  
Secretary for Financial Services and the Treasury  
Secretary for Health, Welfare and Food  
Secretary for Housing, Planning and Lands  
Secretary for Security  
Commissioner, Independent Commission Against Corruption  
Director of Administration  
Judiciary Administrator  
The Ombudsman

Internal

PSET  
DS(W)2  
PEO(ET)  
CEO(RM)



來函檔號  
 OUR REF: EP CR 15/2004  
 來函檔號  
 YOUR REF: CB(3)/PAC/R42  
 電話  
 TEL. NO.: (852) 2835 1001  
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**Director of Environmental Protection**  
 28th Floor, Southern Centre,  
 130 Hennessy Road,  
 Wanchai, Hong Kong.  
 HOMEPAGE: <http://www.info.gov.hk/epd/>



環境保護署署長  
 香港灣仔  
 軒尼詩道  
 一百三十號  
 修頓中心廿八樓

18 May 2004

Legislative Council Secretariat  
 Legislative Council Building  
 8 Jackson Road  
 Central  
 Hong Kong  
 (Attn. : Ms Dora WAI  
 c/o Clerk Public Accounts Committee)

Dear Ms Wai,

**The Director of Audit's Report on the  
 results of value for money audits (Report No. 42)**

**Chapter 3 : Harbour Area Treatment Scheme (HATS) Stage I**

Thank you for your letter of 11 May 2004 relaying the follow up question of the Public Accounts Committee. My response is set out below.

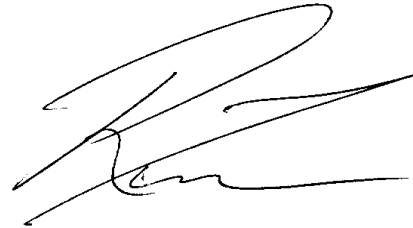
The Administration did indeed assess the effects that HATS Stage 1 might have on the water quality of Victoria Harbour. The assessment was conducted by means of a computer based water quality modelling tool and the results were, in fact, broadly in line with the actual observed outcome, taking the harbour as a whole. The water quality at the eastern end of the harbour and the beaches to the east of the harbour has improved dramatically, as predicted. At the western end of the harbour, in the general vicinity of the outfall, it was expected that there would be some deterioration in water quality due to concentrating the treated effluent in this area. This expected deterioration was judged to be acceptable, particularly having regard to the planned temporary nature of the outfall.

However, the small area of the harbour now in question, i.e. in the vicinity of the Tsuen Wan beaches, is hydrodynamically very complex, with several narrow channels through which the water may flow. The model used at the time simply could not deal with such complexity of water movement on such a very fine geographical grid. We were therefore not aware that the expected deterioration in water quality at the western end of the harbour would affect the Tsuen Wan beaches to the extent that has been observed.

Furthermore, as I pointed out at the PAC meeting, there was considerable uncertainty as to the degree of reduction in bacteria that the chemical treatment process might achieve on its own. This, together with the distance between the

outfall and the Tsuen Wan beaches and the fact that the outfall was intended to be only temporary, led us to believe that the prudent course of action would be to await the actual operation of the plant before drawing any conclusions about the need for disinfection, as the cost for this would have been very high.

Yours sincerely,

A handwritten signature in black ink, appearing to be 'R. J. S. Law', written in a cursive style.

( Robert J S Law )  
Director of Environmental Protection

c.c. Secretary for the Environment, Transport and Works  
Director of Drainage Services  
Director of Audit  
Secretary for Financial Services and the Treasury  
(Attn : Miss Amy TSE)



康樂及文化事務署  
Leisure and Cultural Services Department

電話 TEL: 2601 8966  
圖文傳真 FAX NO: 2602 0297  
本署檔號 OUR REF: (6) in LCS 1/HQ 1802/04 II  
來函檔號 YOUR REF:

27 May 2004

Ms Dora Wai  
Clerk  
Public Accounts Committee  
(By Fax : 2537 1204)

Dear Ms Wai,

**The Director of Audit's Report on the  
Results of value for money audits (Report No. 42)  
Chapter 3 : Harbour Area Treatment Scheme (HATS) Stage I**

I refer to your letter of 19 May 2004 addressed to the Director of Environmental Protection and was referred to me for reply.

As requested, I set out below the additional information on measures taken to prevent the public from swimming at the closed gazetted beaches in Tsuen Wan District to safeguard their health –

- (a) The Leisure and Cultural Services Department (LCSD) has posted up notices and banners at prominent locations near the entrances of the beaches advising the public not to swim in these closed beaches. Photographs of the notices and banners are at **Annex I**;
- (b) Public Announcements are made in Cantonese and English at regular intervals at the more popular beaches (i.e. Lido and Casam Beaches) advising the public not to swim in the water of these beaches. The script of the announcements is at **Annex II**;

- (c) Press releases on the re-opening of the gazetted beaches and the continued closure of certain beaches with very poor water quality including those in Tsuen Wan District are issued at the beginning of each swimming season. A copy of the press release made in February 2004 is at **Annex III**;
- (d) Environmental Protection Department has been issuing weekly press releases on the water quality of gazetted beaches. These press releases, include the message that the seven gazetted beaches in Tsuen Wan District are closed to swimmers throughout the year because of very poor water quality. The public are also advised not to swim at these closed beaches. The latest press release issued on 14 May 2004 is at **Annex IV**; and
- (e) The staff of LCSD also give verbal warning to people who are found swimming in the water of these closed beaches.

Yours sincerely,



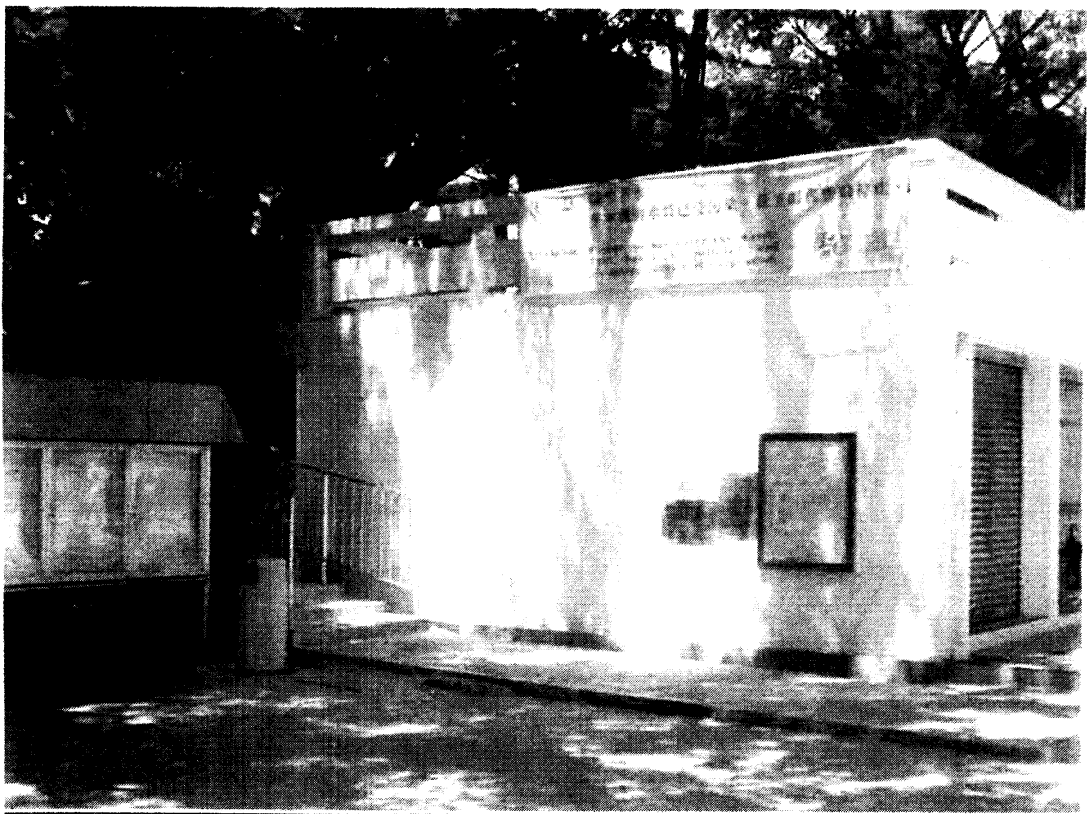
(Paul K K Cheung)

for Director of Leisure and Cultural Services

c.c. Secretary for the Environment, Transport and Works  
Secretary for Home Affairs  
Secretary for Financial Services and Treasury  
Director of Drainage Services  
Director of Audit  
Director of Environment Protection



Lido Beach Office



## **Annex II**

各位泳客請注意：(2次)

此泳灘之海水受污染，不宜游泳，亦無救生服務。若冒險在此處游泳，需對自己安全負責。

Attention please: (Twice)

The sea water at this district is polluted and not suitable for swimming. No lifeguard service is provided. Swimming will be at your own risk.

**32 beaches to reopen soon**

\*\*\*\*\*

The Leisure and Cultural Services Department will reopen 11 beaches in the urban areas from March 1 and 21 beaches in the New Territories from April 1.

The 11 beaches in the urban areas are:

Deep Water Bay Beach  
Repulse Bay Beach  
Middle Bay Beach  
South Bay Beach  
Chung Hom Kok Beach  
St Stephen's Beach  
Stanley Main Beach  
Hairpin Beach  
Turtle Cove Beach  
Shek O Beach  
Big Wave Bay Beach

Lifeguard services will be provided daily from 9am to 6pm from March to May and from September to November. During the peak season from June to August, lifeguards will be on duty from 9am to 6pm Monday to Friday and from 8am to 7pm on Saturdays, Sundays and public holidays.

The 21 beaches in the New Territories are:

Sai Kung District

-----

Trio Beach  
Kiu Tsui Beach  
Hap Mun Bay Beach  
Silverstrand Beach  
Clear Water Bay First Beach  
Clear Water Bay Second Beach

Tsuen Wan District

-----

Ma Wan Tung Wan Beach

Tuen Mun District

-----

Butterfly Beach  
Kadoorie Beach  
Cafeteria Old Beach  
Cafeteria New Beach  
Golden Beach

Lamma Island

-----



Hung Shing Yeh Beach  
Lo So Shing Beach

Cheung Chau  
-----

Kwun Yam Beach  
Cheung Chau Tung Wan Beach

Lantau Island  
-----

Silver Mine Bay Beach  
Pui O Beach  
Lower Cheung Sha Beach  
Upper Cheung Sha Beach  
Tong Fuk Beach

Daily lifeguard services at the above beaches in April, May, September and October will operate from 9am to 6pm. Again, during the peak season from June to August, lifeguards will be on duty from 9am to 6pm from Mondays to Fridays and from 8am to 7pm on Saturdays, Sundays and public holidays.

All these beaches have been installed with shark prevention nets except Lower Cheung Sha Beach on Lantau Island and Cafeteria Old Beach in Tuen Mun District.

Meanwhile, the following beaches will not be opened to the public for swimming. However, ancillary services on these beaches such as the sand areas, toilet, changing facilities and barbecue pits will still be provided. They are:

Hong Kong Island  
-----

Rocky Beach

Tsuen Wan District  
-----

Anglers' Beach  
Casam Beach  
Gemini Beaches  
Hoi Mei Wan Beach  
Lido Beach  
Ting Kau Beach  
Approach Beach

Tuen Mun District  
-----

Castle Peak Beach

Ends/Saturday, February 28, 2004  
NNNN

## Press Release

### Grading of beach water quality released

The Environmental Protection Department today (May 14) released the latest grading of water quality of 33 beaches open to the public, rating 19 as Good (Grade 1), 13 as Fair (Grade 2) and one as Poor (Grade 3).

The beach with an asterisk is a non-gazetted beach. (S) indicates a beach that is equipped with a shark net.

Grade 1 beaches are:

Cheung Chau Tung Wan Beach (S)	Deep Water Bay Beach (S)
Kwun Yam Beach (S)	Hairpin Beach (S)
Hung Shing Yeh Beach (S)	Middle Bay Beach (S)
Lo So Shing Beach (S)	Repulse Bay Beach (S)
Pui O Beach (S)	Stanley Main Beach (S)
Lower Cheung Sha Beach	St. Stephen's Beach (S)
Tong Fuk Beach (S)	Turtle Cove Beach (S)
Upper Cheung Sha Beach (S)	Kiu Tsui Beach (S)
Clear Water Bay Second Beach (S)	Trio Beach (S)
Hap Mun Bay Beach (S)	

Grade 2 beaches are:

Silver Mine Bay Beach (S)	Big Wave Bay Beach (S)
Butterfly Beach (S)	Chung Hom Kok Beach (S)
Cafeteria New Beach (S)	Shek O Beach (S)
Cafeteria Old Beach	South Bay Beach (S)
Golden Beach (S)	Silverstrand Beach (S)
Clear Water Bay First Beach (S)	Discovery Bay*
Ma Wan Tung Wan Beach (S)	

Grade 3 beach is Kadoorie Beach (S).

Comparing with the grading released last week, Clear Water Bay First Beach and South Bay Beach have changed from Grade 1 to Grade 2 and Kadoorie Beach from Grade 2 to Grade 3.

"The changes are generally within the normal range of fluctuation of the bacteriological water quality of the beach," a spokesman said.

Beach grades are published weekly before the weekend. The information may also be obtained from the department's homepage at [www.epd.gov.hk](http://www.epd.gov.hk) or the beach hotline, 2511 6666.

Under the grading system, beaches are classified into four grades according to the level of E. coli in the water.

Grades are calculated on the basis of the geometric mean of the E. coli counts on the five most recent sampling occasions.

Grade 4 is assigned to beaches whose last E. coli reading exceeded a threshold figure, irrespective of the geometric mean. Swimmers are advised to avoid these beaches until the water quality improves.

Seven gazetted beaches - Anglers' Beach, Approach Beach, Ting Kau Beach, Casam Beach, Gemini Beaches, Hoi Mei Wan Beach and Lido Beach - are closed to swimmers year round

EPD - Press Releases

because of poor water quality.

The public is advised not to swim at these closed beaches.

The spokesman cautioned that many beaches were likely to be more polluted than their grades suggested during and after periods of heavy rain. Bathers should avoid swimming at beaches for up to three days after a storm or heavy rainfall.

Ends/Friday, May 14, 2004



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本署檔號 Our Ref. : UB/PAC/VFM/42-2

來函檔號 Your Ref. : CB(3)/PAC/R42

5 June 2004

Clerk, Public Accounts Committee  
Legislative Council Secretariat  
Legislative Council Building  
8 Jackson Road, Central  
Hong Kong  
(Attn: Ms Dora Wai)

Dear Ms Wai,

**The Director of Audit's Report on the  
results of value for money audits (Report No. 42)**

**Chapter 3: Harbour Area Treatment Scheme (HATS) Stage I**

Thank you for your letter of 29 May 2004 inviting my additional comments on the following issues.

**Beach attendance**

Table 4 in Chapter 7 of my Report No. 42 only provided the **daily average** numbers of beach goers at the Tsuen Wan beaches **for the whole year from 2000 to 2002**. Audit has further examined the statistics compiled by the Leisure and Cultural Services Department. At the Appendix is a more comprehensive set of attendance figures of the Tsuen Wan beaches **during the bathing season**, from March to October, in 2001, 2002 and 2003.

Figures in the Appendix provide the average daily attendance, indicating separately the attendance on weekdays and during weekends (including public holidays). In addition, the peak day and peak month attendance figures are also provided. The peak attendance figures show that, despite the poor water quality, some of the Tsuen Wan beaches were quite popular. For example, for Lido Beach in 2003, while the average daily attendance was 149 on weekdays and 283 on weekends and public holidays, **the peak day attendance was as high as 3,950 and the peak month attendance was 8,430**. Indeed, the total attendance during the period from March to October 2003 was 41,071. In Audit's

view, the figures in the Appendix give a clear picture about the attendance of the Tsuen Wan beaches and obviate the need for Audit to conduct site visits to the beaches to verify the number of swimmers from 5 am to 7 am for two to three days, as suggested by the Public Accounts Committee.

According to paragraph 5.21 of the Audit Report, the Secretary for the Environment, Transport and Works has accepted the audit recommendation to reduce the bacteria level in the western harbour area and the Tsuen Wan beaches. In her letter of 18 May 2004 addressed to you, the Secretary said that she intended to advance the provision of part of the permanent disinfection facilities at the Stonecutters Island Sewage Treatment Works so as to reduce the bacteria level of the treated effluent.

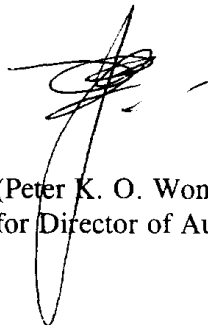
#### **Replacement cost for defective mucking system**

*The exclusion clause and the no claim statement* were only relevant in the Drainage Services Department's (DSD) decision as to whether the claim submitted by Contractor E for the replacement cost of the defective mucking system should be accepted. ***Once the claim was accepted, the clause and the statement did not affect the assessment of the quantum of payment to Contractor E.***

As mentioned in paragraph 4.13 of the Audit Report, the DSD had sought legal advice in determining whether to accept the claim submitted by Contractor E. On the strength of the advice given, the DSD accepted Contractor E's claim, and was obliged to pay for the replacement cost ***under the terms of the contract.*** As such, Contractor E was entitled to be compensated in full the additional expenditure incurred for replacing the mucking system. Audit reviewed the basis of assessing the quantum of payment to Contractor E and found that the assessment was made in accordance with the terms of the contract. The Consultant verified the actual additional expenditure incurred by Contractor E and the DSD approved the payment.

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

Yours sincerely,



(Peter K. O. Wong)  
for Director of Audit

## Number of visitors to Tsuen Wan beaches

Beach	Average daily attendance		Peak attendance		Total attendance	Beach closed
	Weekdays	Weekends & public holidays	Peak day	Peak month		
<b>2001 (March - October)</b>						
Lido	121	393	2,100	11,900	51,400	
Anglers'	56	172	1,859	9,568	22,956	*
Casam	27	72	350	2,030	10,238	
Approach	29	60	145	1,533	9,532	*
Ting Kau	19	37	111	994	6,186	*
Hoi Mei Wan	0	7	47	168	614	
Gemini	0	4	35	138	325	
<b>2002 (March - October)</b>						
Lido	99	222	1,305	6,665	33,816	
Anglers'	48	133	844	3,387	18,333	*
Casam	26	52	170	1,573	8,400	
Approach	21	43	69	917	6,914	*
Ting Kau	10	26	42	537	3,606	*
Gemini	7	17	40	447	2,529	
Hoi Mei Wan	2	11	49	220	1,152	
<b>2003 (March - October)</b>						
Lido	149	283	3,950	8,430	41,071	*
Anglers'	61	134	1,515	3,921	18,089	*
Casam	30	62	560	1,972	8,585	*
Approach	26	51	82	1,043	7,299	*
Hoi Mei Wan	7	32	103	711	3,183	*
Ting Kau	9	24	43	411	2,915	*
Gemini	1	2	20	301	301	*

Source: Records of the Leisure and Cultural Services Department

\* Denotes this beach was closed during that period.

**Opening statement by Mr Mike Rowse, JP  
Director-General of Investment Promotion  
at the public hearing  
on 7 May 2004**

I am grateful to the Chairman for his permission to make a short statement to the Committee.

As the officer responsible for co-ordinating the entire Economic Relaunch programme, I was part of the evaluation process, even before InvestHK was designated the subject department for Harbour Fest. In other words, InvestHK as the first port of call for all Relaunch ideas allowed this item through the gate.

I was unable to attend the 2 July meeting. But the InvestHK position would not have been different because I shared the general view of ERWG members that this was a creative and exciting project that would help Hong Kong rebound from SARS.

As the Financial Secretary has said, the decision to fund the proposal was made in exceptional circumstances. The Director of Audit's report describes the major blow suffered to Hong Kong people, our economy and international image as a result of SARS, which lasted over three months and affected some 1,755 individuals. Yet, with hindsight, it is clear that the ERWG members, myself included, underestimated the difficulties and overestimated the benefits of the festival proposal.

I would like to turn now to the implementation and monitoring phase. At the second key meeting, on 12 July, ERWG decided that the government would support the event in the capacity of sponsor and that AmCham would be responsible for planning, organising and implementing the festival. This was in accord with the original intention that the Economic Relaunch programme should actively involve the business sector and the wider community. InvestHK was designated as the subject department for the sponsorship arrangement.

At that point, AmCham needed to carry out a number of important tasks very quickly. Among other things, they needed to negotiate and agree a contract with the government; develop a business plan, ideally with proper milestones; secure the site; make arrangements for the venue to be erected and fitted out; develop and agree the artist line-up and programme; sign contracts with performers and contractors; prepare a comprehensive marketing plan, including targeting of short-haul tourists; make detailed ticketing arrangements; etc.

In the normal course of events, many of these tasks would have been carried out sequentially or with only minor overlaps requiring up to a year to implement. But with the very short timeframe of less than 100 days to implement the project, AmCham did not have that luxury. So, in the unique circumstances of the SARS crisis and the Economic Relaunch, all the tasks had to be undertaken in parallel.

This unprecedented set of circumstances inevitably affected the arrangements for monitoring. On the one hand, the government was committing up to \$100 million of public funds, which argued for a high degree of scrutiny and even shared control. On the other hand, in recognition of the extraordinary time pressures, ERWG had specifically decided that AmCham should have sole responsibility for planning, organising and implementing the event.

It was against this background that we in InvestHK undertook our monitoring role. We had no direct executive responsibility or powers, because of the ERWG decision that we should be a sponsor only. But we needed to monitor the situation closely, identify problem areas, promptly draw them to AmCham's attention, and assist in remedying them – in cooperation with the organiser.

I accept that the outcome fell short of our hopes. But we did all of these things to the utmost of our ability. We gave them our best effort.

Thank you Chairman.



**Extract of**  
**Economic Relaunch Working Group**  
**Minutes of the Eighth Meeting held on 2 July 2003 (Wednesday)**  
**at 11:00 a.m. in Room 1220, West Wing, CGO**

Present

Mr Antony Leung, FS (Chairman)  
Mr Henry Tang, SCIT  
Mr Stephen Ip, SEDL  
Miss Yvonne Choi, DIS

In attendance

Miss Denise Yue, PS(CI)  
Mr Alan Lai, PS(Tsy)  
Mrs Pamela Tan, DHA  
Ms Eva Cheng, CT  
Mrs Ella Tam, DDIS  
Mr Raymond Tam, AA/FS  
Mrs Mary Leung, PrS/FS  
Mr Ian McCabe, Burson-Marsteller  
Ms Ophelia Tsang, ADG(3), InvestHK (Note-taker)  
Mr David Chiu, CEO(SD), InvestHK  
Miss Hannafew Chan, AA/ADG3/InvestHK  
Mr Chris Sun, AD2/HAD (for ERWG Paper 27/03)  
Mr James Thompson, (for item 3)  
American Chamber of Commerce in Hong Kong  
Mr Jon Niermann, Walt Disney Co Ltd (for item 3)  
Mr Mike Denzel, NBA Asia, Ltd (for item 3)  
Mr John Berrick (for item 3)

Apologies

Dr Patrick Ho, SHA  
Mr Frederick Ma, SFST  
Mr W K Lam, D/CEO  
Mr M J T Rowse, DGIP (Secretary)

Action

**Agenda item 3 : Presentation by American Chamber of Commerce in Hong Kong on “International Autumn Festival”**

4. Messrs James Thompson, Jon Niermann, Mike Denzel and John Berrick made a presentation on “International Autumn Festival”. Under the proposal, a variety of entertainment events would run from Friday evening to Sunday for four consecutive weekends in October. Performance highlights would be broadcast in USA and other countries. The estimated subsidy from the Government was about HK\$100 million.

InvestHK 5. **The meeting** agreed to support the proposal in principle and to underwrite the event up to HK\$100 million, subject to InvestHK’s scrutiny and satisfaction of the detailed budget. Members also agreed that November would be preferable to October for holding the Festival. AmCham/Disney should endeavour to make the event as commercially viable as possible, with a view to reducing the Government’s subsidy and making it an annual event.

InvestHK 6. **CT** said that sufficient lead time should be allowed for promoting the Festival to attract inbound tourists. She also pointed out that incidental costs should be taken into account in studying the detailed budget as there could be cost to Government not included in AmCham’s budget. InvestHK would keep the Working Group informed of the development in organising the “International Autumn Festival”.

*InvestHK  
July 2003*

**Extract of**  
**Economic Relaunch Working Group**  
**Minutes of the Ninth Meeting held on 12 July 2003 (Saturday)**  
**at 10:30 a.m. in Room 1220, West Wing, CGO**

Present

Mr Antony Leung, FS (Chairman)  
Mr Henry Tang, SCIT  
Mr Stephen Ip, SEDL  
Mr Frederick Ma, SFST  
Miss Yvonne Choi, DIS

In attendance

Mr Raymond Young, PS(CI) (Ag)  
Ms Eva Cheng, CT  
Ms Anissa Wong, DLCS  
Mrs Ella Tam, DDIS  
Mr Raymond Tam, AA/FS  
Mrs Mary Leung, PrS/FS  
Mr Ian McCabe, Burson-Marsteller  
Ms Ophelia Tsang, ADG(3), InvestHK (Note-taker)  
Mr David Chiu, CEO(SD), InvestHK  
Miss Hannafew Chan, AA/ADG3/InvestHK  
Mr Tam Wing Pong, DDBO (for item 3)  
Mr Ngai Wing Chit, PAS(C)1/HAB (for item 5)  
Mr Joe Cheng, CLM/LCSD (for item 5)

Apologies

Dr Patrick Ho, SHA  
Mr W K Lam, D/CEO  
Mr M J T Rowse, DGIP (Secretary)

Action

**Agenda item 5 : Consideration of Specific Spending Proposals**  
**(ERWG Paper 32/03)**

12. The following bids were approved :

- (a) a maximum of HK\$100 million to InvestHK for underwriting the “International Autumn Festival” organised by the American Chamber of Commerce in Hong Kong (AmCham) (S/N 39). **DLCS** said that the ticket prices should be pitched at market level so as to raise the revenue and reduce the Government subsidy. **ADG3** said that the budget presented the worst case scenario. She would revert to AmCham on raising the ticket prices. **The Chairman** said that differential pricing could be adopted, with concessionary tickets for senior citizens and students. He also emphasised that the Government would act as the sponsor only. AmCham had to plan, organise, and implement the whole event.

InvestHK

*InvestHK*  
*July 2003*

**Extract of**  
**Economic Relaunch Working Group**  
**Minutes of the Tenth Meeting held on 2 August 2003 (Saturday)**  
**at 9:00 a.m. in Room 1220, West Wing, CGO**

Present

Mr Stephen Ip, FS (Ag)/SEDL (Chairman)  
Mr Henry Tang, SCIT  
Mr Frederick Ma, SFST  
Miss Yvonne Choi, DIS

In attendance

Miss Denise Yue, PS(CI)  
Mr Duncan Pescod, CT (Ag)  
Ms Janet Wong, DHA (Ag)  
Mr Alan Siu, DD(LS)  
Mrs Ella Tam, DDIS  
Mr Jacky Lum, AA/FS  
Mr Laurie Lo, PrS/FS  
Ms Ophelia Tsang, ADG(3), InvestHK (Note-taker)  
Mr David Chiu, CEO(SD), InvestHK  
Miss Hannafew Chan, AA/ADG3/InvestHK  
Mr Ian McCabe, Burson-Marsteller  
Mr K F Yeung, DD/Lands (for item (4) only)  
Ms Winnie Shiu, Land Surveyor/Lands (for item (4) only)  
Mr Gorden Andreassend,  
7<sup>th</sup> SEASC 2003 Organising Committee (for item (4) only)  
Mr Hak Chan, 7<sup>th</sup> SEASC 2003 Organising Committee (for item (4) only)

Apologies

Dr Patrick Ho, SHA  
Mr W K Lam, D/CEO  
Mr M J T Rowse, DGIP (Secretary)

Action

**Agenda item 3 : Master Programme of Relaunch Activities  
(ERWG Paper 35/03)**

6. **ADG3, InvestHK** reported that the American Chamber of Commerce was in the course of signing up performing talents. InvestHK had paid cash advance to AmCham for this purpose. **The Chairman** said that the ticket prices should be set at market level.

*InvestHK  
July 2003*

**Extract of**  
**Economic Relaunch Working Group**  
**Minutes of the Eleventh Meeting held on 20 August 2003 (Wednesday)**  
**at 2:30 p.m. in Room 1220, West Wing, CGO**

Present

Mr Henry Tang, FS (Chairman)  
Mr John Tsang, SCIT  
Mr Stephen Ip, SEDL  
Dr Patrick Ho, SHA  
Mr M J T Rowse, DGIP (Secretary)

In attendance

Miss Denise Yue, PS(CI)  
Mr Alan Lai, PS(Tsy)  
Ms Eva Cheng, CT  
Ms Janet Wong, DHA (Ag)  
Mr Alan Siu, DLCS (Ag)  
Mrs Ella Tam, DDIS  
Miss Shirley Yuen, AA/FS  
Mr Laurie Lo, PrS/FS  
Ms Ophelia Tsang, ADG(3), InvestHK (Note-taker)  
Miss M Y Chan, ISO(SD), InvestHK  
Mr Ian McCabe, Burson-Marsteller  
Miss Rosa Ho, PA to DGIP

Apologies

Mr Frederick Ma, SFST  
Mr W K Lam, D/CEO  
Miss Yvonne Choi, DIS

Action

**Agenda item 3 : Master Programme of Relaunch Activities  
(ERWG Paper 38/03)**

7. **DGIP** said that the line-up of the talent for the International Autumn Festival (now renamed as “Hong Kong Harbour Fest”) would be finalised in the next 10 days and announced in early September. **The Chairman** expressed concern that the performances should not appeal to a certain age group only but to a wider audience. **SEDL** said that the tickets should be sold at competitive market level. **PS(CI)** suggested that local performers should be allowed to use the venue in the weekdays. **ADG3** said that HAD and LCSD had been asked to help in putting up local performances. **SHA** said that the programme of the Festival should be forwarded to LCSD/HAD after it was finalised.

InvestHK

*InvestHK  
September 2003*



**Economic Relaunch Working Group**  
**Minutes of the thirteen Meeting held on 31 October 2003 (Friday)**  
**at 2.30 p.m. in Conference Room 822, CGO West Wing**

**Present**

Mr Henry Tang, FS (Chairman)  
Mr John Tsang, SCIT  
Mr Stephen Ip, SEDL  
Mr Frederick Ma, SFST  
Mr Patrick Ho, SHA  
Miss Yvonne Choi, DIS  
Mr Mike Rowse, DGIP (Secretary)

**In Attendance**

Mr Jim Thompson, AmCham  
Miss Denise Yue, PS(CI)  
Miss Clara Tang, PAS(CI)1  
Miss Amy Chan, AS(CI)1A  
Mr Alan Siu, DDLCS(LS)  
Mrs Ella Tam, DDIS  
Miss Shirley Yuen, AA/FS  
Mr Laurie Lo, PrS/FS  
Mr Te Chi Wang, AS/FSO  
Mr Daniel Cheng, AA/SCIT  
Ms Alice Cheung, AA/SEDL  
Mrs Avia Lai, AA/SFST  
Mr David Chiu, CEO(SD), InvestHK

**Apologies**

Mr W K Lam, D/CEO

Action

**The Chairman** welcomed all to the meeting, and explained the purpose of this special meeting, which was to take stock of the various issues pertaining to Harbour Fest. He recalled that LegCo Members had raised four oral questions on Harbour Fest for the coming sitting on 5 November, and a special FA Panel meeting would be convened on 15 November to follow up matters relating to the festival.

2. **PS(CI)** had prepared a set of draft Q&As on Harbour Fest which was tabled for Members' consideration. **DIS** also distributed a summary of media commentaries over the past few weeks on matters relating to Harbour Fest.

DIS

3. **The Chairman** reiterated his pledge, which had been made publicly, that he would accept responsibility for ERWG's decision on Harbour Fest. Members agreed that a consistent line-to-take should be adopted and they should be all speaking in the same voice on Government's position regarding the Harbour Fest. All media inquiries towards ERWG would be channelled through DIS, who would recommend which to be entertained by whom, and make reference to AmCham for input where appropriate. **SFST** took the opportunity to dispel a recent rumour and made it very clear that he had not urged any LegCo Member to move a motion of non-confidence against any government official.

FS  
DGIP

4. It was agreed that the Chairman and DGIP would be the key spokesmen on matters relating to Harbour Fest for the Government. They would jointly conduct a media briefing before the LegCo session on 5 November.

5. **SFST** pointed out that, according to the minutes of the ERWG meeting on 2 July, InvestHK had a role for overseeing the budget of the Harbour Fest. **PS(CI)** recalled the decision of ERWG at its 9<sup>th</sup> meeting on 12 July that the Government would act as the sponsor of Harbour Fest only. AmCham had to plan, organise and implement the whole event. It was clear from the outset that the Government was not to micro-manage the detailed organisation and implementation work, which was a matter for AmCham. This was also reflected in the

sponsorship agreement signed between the Government and AmCham. As the lead government agency putting up the application for the approval of ERWG, InvestHK was undertaking a facilitating role, responsible for maintaining close liaison with AmCham and coordinating the support and facilitation by various government departments. It had never been charged with any overseeing responsibility. **The Chairman** said that as the major sponsor committing \$100m financial undertaking for the event, the Government would be perceived as acting very irresponsibly if it tried to wash its hands completely. Since AmCham seemed to have problems managing the event, InvestHK should monitor more closely.

6. **The Chairman** welcomed Mr Jim Thompson (who joined the meeting at 3.00 p.m.) and on behalf of ERWG commended AmCham for its commitment and services to Hong Kong in putting forward the Harbour Fest initiative, one of the largest pop-musical events ever held in Asia. With hindsight, all parties concerned might have underestimated the complexity involved, and it was a very ambitious attempt in putting together the event within such a short time span. The audience feedback was largely positively, commenting that the shows were fantastic. With the benefit of learning from experience, there was continuous improvement in a number of logistical arrangements. He did not observe any trace of irregularity in the organisation and implementation process. He understood that AmCham conducting the business of organising the festival through a SPV was an established commercial practice entirely for operational convenience. It sought to shield AmCham from all financial liability to any third party arising from the commercial activities of organising the event.

7. **PS(CI)** recalled that the local media had widely reported the Harbour Fest over the past few weeks, and some Members of the LegCo had also expressed grave concern about the various related issues. Further to the four LegCo questions to be raised on 5 November, she anticipated some more follow-up questions, which would require input from AmCham, e.g. ticket sale, actual audience turn out, and the updated financial position, etc. Besides, an information paper was being prepared for the FA Panel meeting on 15 November,

providing an updated account of the various issues relating to the festival. She understood that AmCham representatives would also be invited to attend the Panel meeting.

AmCham 8. In response, **Mr Jim Thompson** reiterated that the whole process had been highly transparent, and he was personally in control of every aspect. The latest estimate of net deficit would be very close to \$100 million, as some commercial sponsorship did not come forward as envisaged. He expected that a provisional out turn of revenue and expenditure could be made available before the FA Panel meeting on 15 November. To avoid confusion, Members agreed that further disclosure of any revised budget during the interim would not be necessary.

9. **Mr Jim Thompson** briefed Members on AmCham's latest publicity efforts in boosting ticket sales. Additional TV and print advertisements had been launched. The Rolling Stones had undertaken to help out in the promotional efforts. The lead singer, Mick Jagger, would probably take part in a local radio phone-in programme. A 4-minute video news release on the festival was broadcast overseas every weekend. The former US President, Bill Clinton, who happened to be in town attending the Business Week CEO Forum in early November, would be invited to one of the closing shows. However, it might involve some security issues and a firm undertaking was still awaited. Other business chambers had also been approached but the overall response was not too enthusiastic. **PS(CI)** suggested approaching large corporations for bulk purchase of tickets for staff welfare purpose, e.g. Panasonic when celebrating its 50<sup>th</sup> anniversary. **DIS** also suggested exploring the possibility of promoting the event to the participants of the forthcoming Business Week CEO Forum in Hong Kong with the help of the forum organiser.

10. **Mr Jim Thompson** went on to say that AmCham had indeed accomplished all undertakings in the proposal of Harbour Fest. The only setback was the unexpected withdrawal of the British group Atomic Kitten. AmCham would pursue compensation from insurance coverage. Most of the international artists lined up for the shows, except Prince, had taken part in promotional efforts to boost ticket sales.

He was hopeful that arrangement would be made for the TV special to be broadcast on local TV. He felt somewhat disappointed with some of the local artists who declined to appear as supporting acts in the shows.

11. In response to FS's inquiry about the sub-contractors, **Mr Jim Thompson** explained that Garman Hill & Co Ltd was appointed as the key agent predominantly because of Mr Ray Garman's experience in the entertainment industry. His personal background as reported by some local media was not a matter of concern to AmCham. A number of the sub-contractors were charging very reasonable prices, some even at a nominal fee.

AmCham 12. On ticketing, **Mr Jim Thompson** said that there were very sophisticated records of ticket sale through Hong Kong Ticketing, sale proceeds, and the actual audience turn out at the venue. All these, together with those bonus tickets issued to commercial sponsors and other free tickets for Hospital Authority staff and other social services/charitable organisations would be properly accounted for in the final audited accounts. **The Chairman** reminded AmCham that it would need to properly account for the actual number of tickets that had been given away, and the distribution criteria.

13. On artist fees, **Mr Jim Thompson** said that he would be happy to provide all information and leave it to the Government for disposal, subject to any confidentiality clause in the individual contracts with the artists concerned. It was noted that this is market sensitive information, which many artists would be unwilling to release.

PS(CI) 14. On the Chairman's request, **PS(CI)** undertook to compile a chronology of events in relation to Harbour Fest before the media briefing session.

15. There being no other business, the meeting was adjourned at 4.45 p.m. A smaller group meeting would be held on 3 November to tackle the oral questions to be raised at the LegCo sitting on 5 November.

*Invest Hong Kong  
November 2003*



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來函檔號 Your Ref.: CB(3)/PAC/R42

10 May 2004

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

(Fax No. 2537 1204)

Dear Ms Hon,

**The Director of Audit's Report on the  
results of value for money audits (Report No. 42)**

**Chapter 4: Hong Kong Harbour Fest**

Thank you for your letter of 5 May 2004, asking me to advise whether Audit, having regard to the Director-General of Investment Promotion's evidence given at the public hearing on 3 May 2004, still considers that its observations in paragraph 2.25 of the Audit Report are valid.

Audit was aware that Invest Hong Kong (InvestHK) had considered the detailed budget submitted by the American Chamber of Commerce in Hong Kong (AmCham) and had sought clarifications from AmCham by emails about some of the items in the budget. In conducting the review on Harbour Fest, Audit had examined the email correspondence between InvestHK and AmCham regarding the consideration of the detailed budget.

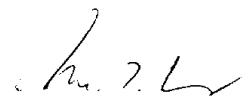
However, as stated in paragraph 2.24 of the Audit Report, Audit noted that InvestHK had neither sought the assistance of government departments with experience/expertise in the entertainment field (e.g. the Leisure and Cultural Services Department, and the Radio Television Hong Kong), nor engaged experts in the show business, to vet AmCham's detailed budget for the Harbour Fest project. Audit noted that InvestHK only adopted a "*common-sense approach*" in checking the completeness and reasonableness of the detailed budget submitted by AmCham.

**In Audit's view, this "*common-sense approach*" of vetting did not provide a sound basis for InvestHK to satisfy itself that AmCham's detailed budget for the project was reasonable and acceptable to the Government (see para. 2.25 of the Audit Report).** Without the benefit of expert advice and information on the market prices of performances by international artists, InvestHK was unable to properly assess the reasonableness of the venue construction and operations costs and the talent costs in AmCham's detailed budget (see para. 2.24 of the Audit Report).

Therefore, notwithstanding that InvestHK had considered the detailed budget submitted by AmCham and had sought clarifications from AmCham by emails, I maintain that the observations in paragraph 2.25 of the Audit Report that "Audit could not ascertain the basis on which InvestHK was able to satisfy itself that AmCham's detailed budget for the project was reasonable and acceptable to the Government. It is unclear whether InvestHK had conducted a proper appraisal of AmCham's budget proposal, as required by the ERWG...." are valid.

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

Yours sincerely,



(David Leung)  
for Director of Audit

c.c. Financial Secretary  
Director-General of Investment Promotion  
Secretary for Financial Services and the Treasury  
(Attn: Mr Manfred WONG)

MISCELLANEOUS SUBVENTIONS—  
GUIDELINES ON THE MANAGEMENT  
AND CONTROL OF  
GOVERNMENT SUBVENTIONS



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Annexes

- A - Classification of Subvented Organizations Funded  
From Head 176
- B - Guidelines Applicable to Subscriptions
- C - Guidelines Applicable to Sponsorships
- D - Notes for Guidance on Capital Subventions

## Miscellaneous Subventions

### Guidelines on the Management and Control of Government Subventions

#### 1. Introduction

1.1 These guidelines describe the main principles which should govern the relationships between the Government and outside organizations as listed in Annex A in receipt of subventions. In particular, they detail the responsibilities of Controlling Officers with respect to these subvented organizations.

1.2 In some respects current practice vis-a-vis subvented organizations may not conform with these guidelines. Where that is the case, Controlling Officers should set targets for completing the action required to bring current practice into line with the principles set out below, if necessary and appropriate by requiring the organization to conform with the guidelines as a condition of further subvention.

1.3 Notwithstanding paragraph 1.2, it is accepted that given the wide range of disparate organizations receiving subventions, the guidelines may not be universally applicable. If a Controlling Officer considers that a subvented organization should be exempted from certain parts of these guidelines, he should seek the advice of Finance Branch. If it is subsequently agreed that an exemption should be granted, the Controlling Officer may so inform the subvented organization in writing. In some cases, the Ordinance governing the operation and control of a subvented organization may depart from these guidelines. In such cases the guidelines are of course subservient to the relevant Ordinance.

1.4 Where appropriate, a Controlling Officer may with the agreement of Finance Branch set out additional guidelines for a subvented organization.

1.5 Observation of the principles described in these guidelines will underpin the Controlling Officer's accountability to the Legislative Council and the subvented organization's accountability to the Controlling Officer for the value for money obtained from the Government's subvention.

1.6 The operation of these guidelines will be monitored by Finance Branch of the Government Secretariat on a continuous basis and may be revised from time to time in accordance with current needs.

2. Definitions

2.1 Subventions comprise four main categories -

- (i) deficiency grants;
- (ii) discretionary grants;
- (iii) subscriptions; and
- (iv) sponsorships.

A list showing the organizations covered by these guidelines and the category into which they fall is at Annex A.

Deficiency grants

2.2 A deficiency grant is a subvention intended to meet the difference in full between a subvented organization's estimated income and its, approved expenditure on a programme of activities approved by the Government. It does not however mean that deficiencies are automatically made up from public funds. The subvention itself places a responsibility on the organization to be economical in expenditure and to look for other sources of income. In general, an organization in receipt of a deficiency grant must use it for the purpose for which it was voted and abide by certain basic conditions and rules.

### Discretionary grants

2.3 A discretionary grant is a subvention intended to meet the cost, in whole or in part, of specified programmes of activities, where the selection of the programmes of activities and the degree of financial assistance given are entirely at the discretion of the Government. This does not mean that discretionary grants are arbitrary subventions; quite the contrary, there is a considerable body of rules stipulating conditions for their award, the size of each subvention and how it should be used and accounted for.

2.4. In general, an organization in receipt of a discretionary grant must use it solely for the purpose for which it was voted and abide by certain basic conditions and rules. All discretionary grants are block grants, i.e. they are maximum grants and cannot normally be increased.

2.5 The amount of a discretionary grant is usually determined in advance having regard to the estimated income and expenditure of the organization; the extent to which its activities are considered to be worthy of financial support, and prevailing financial policy in the Public Sector.

### Subscriptions

2.6 A subscription is essentially a membership fee payable to a regional or international organization, enabling Hong Kong to become a member in pursuit of certain Government objectives. The fee is either set at a fixed rate or determined according to an approved formula. A subscription normally forms only a very small percentage of the organization's total income.

2.7 Since subscriptions are in many respects different from either deficiency or discretionary grants, the guidelines that should apply to them are discussed separately at Annex B.

### Sponsorships

2.8 A sponsorship is a contribution, usually of a token amount, made by the Government to help meet part of an organization's running expenses and to demonstrate support for the organization's objectives. By its nature, sponsorship forms only a small percentage of the organization's total income. Guidelines applicable to sponsorships are discussed at Annex C.

3. General guidelines

3.1 The following guidelines apply to all deficiency and discretionary subventions.

Objectives

3.2 The Controlling Officer, in consultation with the subvented organizations as appropriate, is responsible for -

- (i) formally defining the objectives (in terms of results) that the Government expects to achieve by payment of the subvention;
- (ii) reviewing achievements against those objectives and assessing the value for money obtained from the subvention no less frequently than annually ~~in the context of the draft Estimates submission to Finance Branch~~; and
- (iii) reviewing the objectives themselves no less frequently than once every three years.

3.3 In some cases the objectives of the organization are set out in the legislation establishing that organization. Such objectives are, however, in many cases too broad to allow for effective management of the subvention. The Controlling Officer should consider whether more detailed objectives are necessary and, where appropriate and consistent with the relevant legislation, agree specific objectives with the organization as a condition of the annual subvention.



### Budget Requirements

3.4 The organization is required to produce a detailed budget. The budget should be accompanied by accounts for the previous year audited by an auditor registered under section 22 of the Professional Accountants Ordinance (Cap. 50). The accounts shall be prepared in such form as may be approved by the Controlling Officer in consultation with the Director of Accounting Services. Once the budget, revised if necessary, has been accepted by the Controlling Officer and Finance Branch, a subvention is recommended for inclusion in the Estimates.

3.5 It is on the basis of the budget that the amount of the subvention is determined, and it is therefore important that it gives a full and accurate picture. The budget proposed by the organization should be fully justified by reference to the organization's objectives and the results that the organization is aiming to achieve in the period to which the budget relates. Achievements in the last (i.e. fully audited) year and in the current year should also be reported for comparison.

3.6 In order to aid comprehension, the budget should be prepared according to a standard layout, divided into three parts as follows -

## PART I - Organizations' Objectives

3.7 It is intended that Finance Branch's examination of subvented organizations' budgets will increasingly focus on analysis by objectives and related activities. It is therefore essential that a subvented organization should clearly state in its budget the objectives (in terms of results) which it seeks to achieve. The organization should also make full use of statistics, graphs, charts and performance measures to show what has actually been achieved and is expected to be achieved by its activities.

## PART II - Revenue Estimates

3.8 Income should be divided into categories; for example, dividend income, donations, fees and grants from the Community Chest. As well as estimated income for the forthcoming year, the actual revenue for the previous year and the revised estimate for the current year should be stated. Any material variations between years, or between actual and estimated revenue in the current year, should be explained. The basis for determining any scale of fees should be explained so that the Controlling Officer can determine whether any revisions should be sought.

## PART III - Expenditure Estimates

3.9 Expenditure should be shown under three components; in all cases the actual expenditure in the previous year and the approved estimate of expenditure for the current year (together with a note of any revisions necessary) should be given for comparison.

### Component I : Personal Emoluments

3.10 Under this component should be shown the number of staff of various grades; their duties and job responsibilities; salary scales, and the cost and scales of other benefits (including provident funds, cost of living allowances for minor staff, rent allowances, etc.). The list of staff and salary scales approved in previous years should be clearly distinguished from new staff and salary scales, and detailed justification for the latter given. Estimates of salaries should preferably be based on the actual expenditure to be incurred (i.e. in the case of existing staff, last year's payments plus increments, if any; or in the case of new staff, the starting salary).

### Component II : Other Charges

3.11 Under this component is shown a detailed list of expenditure of an annually recurrent nature other than personal emoluments. Items of capital expenditure costing less than \$70,000 per item are regarded as recurrent expenditure for this purpose. Examples of typical expenditure classifications are -

1. Administration -
  - (1) Cleaning of offices
  - (2) Fuel, light and power
  - (3) Publications
2. Rent
3. Stores and equipment
4. Transport
  - (1) Running expenses of vehicles
  - (2) Travelling expenses
5. Maintenance of buildings

Any significant changes from the current year should be explained.

*Capital Account*  
Component III : Special Expenditure

3.12 Under this component should be shown any item of non-recurrent expenditure which exceeds \$100,000 or any single project involving maintenance, repair, re-equipment or re-furnishing costing more than \$100,000 for the complete project. For example, furnishing and equipping a recreation hall would be regarded as one project. Each item should be shown as a separate subhead and be supported by full justification. Further information on <sup>*Capital Account*</sup> Special Expenditure is given in the Notes for Guidance of Organizations on Capital Subventions at Annex D.

Depreciation

3.13 An organization may show depreciation of capital assets in its income and expenditure accounts but depreciation must be shown separately. It will be ignored in calculating a level of subvention.

Timing

3.14 Each year Controlling Officers will advise subvented organizations of the time and manner in which applications for subvention are to be submitted. All organisations must strictly adhere to this time-table, notwithstanding that certain organizations may be required by law to submit separately to Government details of their activities and finances. An organization which delays its submission may find that no subvention is available in the next financial year. A typical time-table is as follows -

(a) April

: Controlling Officers will normally at around this time of year invite subvented organizations to identify any proposals for major or minor new services or improvements to current services to be introduced in the next financial year and the three subsequent years. Controlling Officers will set out the definition of "major" and "minor" items and prescribe a format for submissions in writing.

(b) June - August

: organizations to submit to Controlling Officers their audited accounts for the previous year and revised estimates for the current year.

(c) September

: budgets for the coming financial year to be presented to the Controlling Officers.

(d) September - November

: representatives of the organizations invited to discuss their budgets with the Controlling Officer or his staff and to answer any queries and requests for further justification of their requirements.

3.15 Finance Branch will process recommendations and seek provisional approval for inclusion of funds in the draft Estimates. It should be noted that budgets prepared by subvented organizations may be subject to modification by the Government. When the subvention has been provisionally entered, Finance Branch will inform the Controlling Officer who will in turn inform subvented organisations of the amount provisionally entered, in order to assist the latter with forward planning. It is emphasized that -

- (i) as the amount is subject to the approval of the Legislature, it should be regarded as provisional; and
- (ii) the amount will not be definitely known until the Appropriation Bill is enacted (when the Controlling Officer will formally notify organizations of the amount of funds voted). Once the Estimates have been approved by the Legislative Council, the Controlling Officer will give the organization a copy of the approved budget, detailing the revised revenue and expenditure estimates, together with a summary of agreed targets for the new financial year. Except as provided in paragraph 3.21, any deviation from this budget must first be approved by the Controlling Officer and Finance Branch.

## The handling of surpluses and deficits

3.16 In order to show the true financial position, an organization's accounts should show clearly any provisions for, or transfers to, reserves or outside bodies.

3.17 Subject to the agreement of Finance Branch and the provisions of relevant legislation, an organization may carry a contingency reserve. An organization which considers that it needs to carry a reserve must justify in its budget the amount of reserve it needs and the intended purposes of the reserve. If at the end of a financial year the level of reserve exceeds the approved level, the excess amount will be netted off in the following year's subvention. The level of reserves, if any, will be subject to the approval of the Legislature in the context of the draft Estimates.

## Donation

3.18 As a condition of grant, the following rules apply in respect of donations -

- (i) the acceptance of any donations which have recurrent financial implications for subvented activities in excess of \$2,000 a year must be approved in advance by the Controlling Officer; and
- (ii) the application of non-designated funds and donations is subject to the prior agreement of the Controlling Officer.

Donations include all forms of donation e.g. grant, endowment, bequest and funds raised e.g. the proceeds of flag-days. Donations may be in cash or in kind.

3.19 Donations in kind or cash donations towards the capital or recurrent cost of a service or project will often have recurrent expenditure implications for subvented activities. These donations must be approved in advance by the Controlling Officer to ensure that there are no unforeseen or unacceptable implied commitments for Government financing. If approval is not sought before acceptance, the Government will not accept any commitment to meet the remaining capital or recurrent cost of the project or service, or the eventual replacement cost if equipment is obtained.

3.20 Where donations and funds received are not designated for a particular purpose and where the subvented organization undertakes both subvented and non-subvented activities, or activities subvented on different bases, the application of these non-designated donations must be agreed with the Controlling Officer.

#### Virement

3.21 No deviation from the approved budget is normally permitted, with the following exception. Unforeseeable circumstances may from time to time give rise to a need to deviate from the approved budget without resulting in the amount of the subvention being increased, and it is recognised that organizations should be given a degree of discretion in meeting such circumstances by virement of funds. That is to say, funds approved for one purpose may be used for another within the following rules -

- (i) no virement between recurrent subventions (Components I and II) and capital subventions (Component III) is allowed;



(ii) virement from Component II to Component I must first be approved by the Controlling Officer. Virement from Component I to Component II is permissible provided that the virement does not commit the organization to any annually recurrent increase in expenditure under Component II.

(iii) virement between the various subheads of Component I is permissible provided that permanent staff numbers do not exceed the establishment approved in the context of finalising the draft Estimates.

There is no objection to virement between the various subheads of Component II.

#### Other financial responsibilities

3.22 Organizations in receipt of subventions are required to make every effort to improve the value for money they obtain from the subvention. In particular, they should -

(i) actively seek opportunities to reduce overheads (for example through effective management of accommodation and other input costs);

(ii) actively seek opportunities to reduce running costs (for example through computerization or by seeking to take advantage of the economies of scale that may result from using, on a full repayment basis, Government purchasing and supply services); and

(iii) actively seek opportunities to co-operate with other Government and subvented organizations to improve value for money (for example by sharing facilities or accommodation where practicable and cost-effective).

3.23 Where appropriate, Controlling Officers should seek the advice of the relevant Government departments to assist them in managing subventions in these respects. Any services provided directly to subvented organizations under these circumstances on their own request will be charged to the organization at full cost. Subvented organizations may also seek funds to obtain external consultancy services to help them secure better value for money.

3.24 The subvented organization will need an effective management structure and effective management systems if it is fully to maximize the value for money obtained from the Government's subvention. The Controlling Officer is responsible for ensuring that the organization has suitable systems in place to enable it to discharge its responsibilities for maximising the value for money obtained from public funds. Where necessary, the Controlling Officer may nominate representatives to become members or observers of the management board or the executive committee.

3.25 The organization must make a convincing effort to raise funds and is responsible for maximizing its own revenue from, for example, membership or affiliation fees and the sale of products and services, where such an approach is consistent with its approved objectives. The sale prices of such products and services should aim to recover full costs together, where appropriate, with a "profit" margin to contribute to other non-recoverable costs of the organization.

#### Access to records and accounts

3.26 The Controlling Officer and Director of Audit will have unhindered access to the records and accounts of an organization in receipt of a subvention. When so requested in this connection, the organization will be obliged to explain to the Controlling Officer and the Director any matters relating to the receipt, expenditure or custody of any money derived from public funds.

3.27 In accordance with the provisions of Deputy Chief Secretary's Circular No. 5/86, the Director of Audit may carry out value for money studies in any organization which receives more than 50% of its income from the Government. The Director of Audit may also, by prior agreement between the Controlling Officer and a subvented organization as a condition of subvention, carry out similar studies in organizations which receive less than 50% of their income from public funds.

### Anti-corruption procedures

3.28 The Commissioner of the Independent Commission Against Corruption may examine the management and control procedures in a subvented organization with a view to providing corruption prevention advice to the executive committee. The organization is expected to heed the advice given and to take such remedial actions as are appropriate.

3.29 It is the responsibility of each subvented organization to ensure that its management and staff conform with the requirements of the Prevention of Bribery Ordinance.

### Terms of service

3.30 As a general rule, the terms of service for subvented posts may not be superior to those offered by the Government to comparable grades in the Civil Service. This does not mean that an organization's terms of service must always be the same as the Government's; and Government is not obliged to increase its subvention to enable an organization to maintain its terms of service at any particular level. Where the terms of service for subvented posts exceed the equivalent Government conditions, a subvention should be payable only up to the estimated equivalent cost of meeting the level of the Government's conditions.

3.31 In examining an organization's terms of service, the Controlling Officer should -

- (i) study the organization's grading structure, salary scales and fringe benefits and ensure that the total benefits available to staff do not exceed those that would be made available to comparably graded civil service staff. In reaching judgements on this issue, Controlling Officers may find it helpful to examine salaries and benefits separately;
- (ii) in all instances ensure that the organization's total expenditure on staff does not exceed the cost that would be incurred if the organization were staffed by civil servants in comparable grades; and
- (iii) keep abreast of terms of service offered by the organization and any changes to these conditions.

3.32 Where there is any doubt on the comparability of ranking and terms of service, the Controlling Officer should seek advice from Finance Branch and Civil Service Branch. The Controlling Officer may engage the services of management consultancy firms to advise on such issues. The recommendations of the consultants are not binding on the Government.

3.33 Any adjustments to the terms of service for existing subvented posts and any proposals relating to the terms of service for new subvented posts must receive the prior agreement of the Controlling Officer who must seek the advice of Finance Branch on any proposals.

Payment of subvention

3.34 Recurrent subvention is normally payable -

- (a) if \$5 million or more, monthly in advance; or
- (b) if under \$5 million, quarterly in advance.

4. Guidelines applicable to deficiency subvention

4.1 In addition to the requirements set out in paragraphs 3.1 to 3.34, in order to assist the Controlling Officer in ensuring that the budget is not exceeded, organizations in receipt of deficiency subventions are required to forward to the Controlling Officer at the end of each month or quarter (depending on the method of payment of the subvention - see paragraph 3.34) a statement of the financial position at the close of the previous month or quarter. Should these statements show a surplus in excess of any agreed reserve, the subvention payable in the next month or quarter will be reduced accordingly. Any surplus in excess of any agreed reserve remaining at the close of the financial year (as shown in the audited accounts for the year) is required to be credited to General Revenue.

4.2 Normally there should be no deficit at the end of the year; if the organization sees that one is likely then expenditure should be cut or a request for supplementary provision made in good time. It must not be assumed that requests for supplementary provision will be granted. A subvention should generally be regarded as being cash limited. However, deficiency grant organizations that pay their staff on civil service pay scales will normally, subject to need, be granted supplementary provision for the cost of implementing pay adjustments equivalent to those agreed for the civil service. Discretionary grant organizations may also seek supplementary provision for salary adjustments in line with civil service adjustments. Such requests will be considered on their merits.

(WP2096A/106B(11))

Classification of Subvented Organizations  
 NOT funded from Head 37 - Dept. of Health, Head 40 - Education Dept.,  
 Head 61 - Hospital Services Dept., Head 170 - Social Welfare Dept.,  
 Head 178 - Technical Education and Industrial Training Dept. or  
 Head 190 - Universities and Polytechnics *fruits Committee*

<u>Head</u>	<u>Subhead</u>	<u>Organization</u>	<u>Category</u>	<u>Controlling Officer</u>
22	423	Commonwealth Agriculture Bureaux	Subscription	DAF
	<del>424</del>	<del>Oxford Forestry Institute</del>	<del>Subscription</del>	<del>DAF</del>
	452	Royal Society for the Prevention of Cruelty to Animals (Hong Kong)	Discretionary	DAF
	455	Network of Aquaculture Centres in Asia and the Pacific (NACA)	Discretionary	DAF
	456	World Wide Fund for Nature (Hong Kong)	Subscription	DAF
<del>25</del>	<del>414</del>	<del>Environmental Advisory Service</del>	<del>Discretionary</del>	<del>D Arch, S</del>
26	453	Statistical Institute for Asia and the Pacific	Subscription	C for C&S
53	469	Commonwealth Youth Programme	Subscription	SHA
63	470	Subventions to New Territories organisations	Sponsorship	SHA HA
<del>73</del>	<del>513</del>	<del>Hong Kong Quality Assurance Agency</del>	<del>Discretionary</del>	<del>D of Ind.</del>
80	447	Magistrates poor box	Discretionary	R, SC
92	507	Commonwealth Legal Advisory Service	Subscription	AG
<del>126</del> 113	430	Asia-Pacific Telecommunity	Subscription	DC & T PMG
158	463	World Meteorological Organisation	Subscription	D of RO



<u>Head</u>	<u>Subhead</u>	<u>Organization</u>	<u>Category</u>	<u>Controlling Officer</u>
176	<del>416</del>	<del>Commonwealth Parliamentary Association (Hong Kong Branch)</del>	Subscription	<del>SCA</del>
	417	Community involvement projects of the Action Committee Against Narcotics	Discretionary	S for S
	<del>419</del>	<del>Hong Kong Council for Academic Accreditation</del>	Discretionary	SEM
	420	Asian and Pacific Development Centre	Subscription	STI
	421	Asian Productivity Organization	Subscription	STI
	425	Commonwealth Foundation	Subscription	SEM
	<del>426</del>	<del>Commonwealth Fund for Technical Co-operation</del>	Subscription	<del>SES</del>
	427	Commonwealth Institute	Subscription	D of Adm.
	<del>428</del>	<del>Commonwealth War Graves Commission</del>	Sponsorship	<del>BES</del>
	<del>432</del>	<del>Far Eastern Relief Fund</del>	<del>Deficiency</del>	<del>SEW</del>
	437	Hong Kong-Japan Business Co-operation Committee	Discretionary	STI
	446	<del>Law Society Legal Advice and Duty Lawyer Schemes Service</del>	Discretionary	<del>D. H. H. SCA</del>
	<del>449</del>	<del>Road Safety Association</del>	<del>Discretionary</del>	<del>S for T</del>
	450	Royal Asiatic Society	Subscription	SRC
	451	Royal Life Saving Society, Hong Kong Branch	Discretionary	DUS
	457	Customs Co-operation Council	Subscription	STI
	460	United Nations Children's Fund	Subscription	SEW
	461	United Nations Development Programme	Subscription	STI
	462	<del>United Nations Fund for Drug Abuse Control Programme</del> <i>International Child</i>	Subscription	S for S
	475	Outward Bound Trust of Hong Kong	Sponsorship	SRC
	487	Subventions for <del>performing</del> arts activities	Discretionary	SRC

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<u>Head</u>	<u>Subhead</u>	<u>Organization</u>	<u>Category</u>	<u>Controlling Officer</u>
176 (Cont'd)	-488	<del>Hong Kong War Memorial Fund</del>	<del>Deficiency</del>	SHW
	502	Hong Kong Archaeological Society	Discretionary	SRC
	503	Subventions to voluntary agency camps	Discretionary	SRC
	504	Hong Kong Council on Smoking and Health	Discretionary	SHW
177	506	<del>Trade Policy Research Centre</del>	<del>Sponsorship</del>	<del>STI</del>
	<del>318</del>	<del>Hong Kong Institute of Education</del>	<del>Deficiency</del>	<del>SEM</del>
	415	Hong Kong Sports Development Board	Discretionary	SRC
	429	Consumer Council	Discretionary	STI
	441	Hong Kong Productivity Council	Discretionary	STI
	443	Hong Kong Tourist Association	Discretionary	SES
	444	Hong Kong Trade Development Council	Discretionary	STI
	<del>454</del>	<del>Securities and Futures Commission</del>	<del>Discretionary</del>	<del>EMA</del>
	459	Hong Kong Academy for Performing Arts	Discretionary	SRC
	<del>508</del>	<del>Open Learning Institute of Hong Kong</del>	<del>Deficiency</del>	<del>SEM</del>
	<del>509</del>	<del>Hong Kong University of Science and Technology Council</del>	<del>Deficiency</del>	<del>SEM</del>
186	520	Vocational Training Council	Deficiency	SEM
	443	Coast Safety Association	Discretionary	C for T
	505	Special transport facilities for the disabled	Deficiency	C for T

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Guidelines Applicable to Subscriptions

In respect of all subscriptions, Controlling Officers are responsible for -

- (i) formally defining the objectives (in term of results) which Government expects to achieve by payment of the subscription;
- (ii) reviewing achievements against those objectives and assessing the value for money obtained from the subscription no less frequently than annually (in the context of draft Estimates submissions to Finance Branch);
- (iii) reviewing the objectives themselves no less frequently than once every three years;
- (iv) securing the most up-to-date information on the organization's audited accounts and activities;
- (v) ensuring that applications to Finance Branch for funds are prepared in accordance with Government procedures;

(vi) ensuring that the approved subscription is paid on time in accordance with a schedule previously agreed with the organization; and

(vii) ensuring that Government and other appropriate sectors of the community are able to make full use of the services and facilities provided by the organization.

(WP2096A/106B(5))

Guidelines Applicable to Sponsorships

In respect of all sponsorships, Controlling Officers are responsible for -

- (i) formally defining the objectives (in term of results) which Government expects to achieve by payment of the sponsorships;
- (ii) reviewing achievements against those objectives and assessing the value for money obtained from the sponsorships no less frequently than annually (in the context of draft Estimates submissions to Finance Branch);
- (iii) reviewing the objectives themselves no less frequently than once every, three years;
- (iv) securing the most up-to-date information on the organization's audited accounts and activities;
- (v) having regard to (i) and (ii) above, proposing for Finance Branch's approval the annual level of sponsorship;

(vi) ensuring, where payment is made on a reimbursement basis, that receipts submitted by the organizations have been properly prepared and endorsed; and

(vii) ensuring that Government and other appropriate sectors of the community are able to make full use of the services and facilities provided by the organization.

(WP2096A/106B)

*\*Note by Clerk, PAC: Annex D not attached.*

FIN H/MISC/33 Pt 1

GOVERNMENT SECRETARIAT  
HONG KONG  
23 February 2004

## FINANCIAL CIRCULAR NO. 1/2004

### Responsibility of Controlling Officers

(Note : Distribution of this Circular is **Scale C**. It should be read by Directors of Bureaux, Controlling Officers, departmental secretaries and by all other officers dealing with funds established by the Government.)

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#### Introduction

This Circular seeks to –

- (a) remind Controlling Officers of their responsibilities under the Public Finance Ordinance (PFO), and
  - (b) highlight certain financial management considerations which Controlling Officers should observe in the process of managing changes.
2. This Circular replaces Financial Circulars No. 14/84 and 16/96.

**/Public Finance Ordinance.....**

To : Directors of Bureaux  
Controlling Officers  
Judiciary Administrator (f.i.)

## **Public Finance Ordinance**

3. The Public Finance Ordinance (Cap 2) and subsidiary regulations and circulars provide the framework for the control and management of public finances in Hong Kong. Controlling Officers are advised to familiarise themselves with the provisions in the Ordinance and to arrange for designated officers to brief them on a need basis.

4. The main points relating to Controlling Officers are highlighted in Annex A. The guide is not meant to be comprehensive and should be read in conjunction with the Ordinance itself.

## **Change management**

### **Due process**

5. As part of Government's continual economy drive, bureaux and departments would have been exploring ways to re-engineer, re-prioritise work, de-regulate, streamline procedures, etc. In all cases, Controlling Officers should go through a due process to ensure that the changes are introduced after conscious deliberations on all relevant factors including but not limited to the need to have due regard to economy and cost effectiveness.

### **Programme and expenditure reviews**

6. If it is necessary to undertake fundamental expenditure reviews, and economy drive initiatives as referred to in paragraph 5, Controlling Officers should consider seeking the assistance of the Efficiency Unit. If information on expenditure/cost control and monitoring is needed, Controlling Officers can approach the Director of Accounting Services for advice or assistance.

### **Changes with financial implications**

7. If bureaux or departments intend to change their policies or initiate funding initiatives, Controlling Officers should ensure that the rules for internal clearance of funding initiatives, as set out in Annex B, are observed. These rules, as have been issued separately to Directors of Bureaux, are attached herewith for clarity.

**/Impact on performance pledges.....**



### **Impact on performance pledges**

8. If the fundamental roles of bureaux or departments and their performance pledges set out in the Controlling Officers' Reports in the Estimates of Expenditure are to be varied, Controlling Officers should ensure that proper consultation be undertaken where necessary and proper authorisation (both within Government and beyond) be sought. This avoids bureaux and departments from being judged, unfairly, against outdated performance pledges.

### **Accountability**

9. Controlling Officers are ultimately responsible and accountable for the proper use of funds under their control. Irrespective of whether public funds are disbursed through a procurement contract, subvention, sponsorship, or any other form or vehicle, Controlling Officers should satisfy themselves that an appropriate system of cost control or monitoring is in place, having regard to economy, efficiency and effectiveness in the delivery of public service and use of the public funds.

### **Applicability**

10. This circular applies to trading funds to the extent that the general manager of a trading fund is a designated Controlling Officer in the Estimates.

### **Enquiries**

11. Please contact the resource divisions of Treasury Branch for enquiries on this circular.

FREDERICK S. MA  
Secretary for Financial Services  
and the Treasury

## Key provisions in the Public Finance Ordinance

### Approved provision

1. **Section 6(3) of the PFO** limits expenditure within the approved provision for each subhead. Controlling Officers must satisfy themselves that there are adequate procedures to monitor expenditure in order to ensure that it is only incurred within the **limits and scope** authorised.

### Changes to the approved estimates

2. **Section 8 of the PFO** provides that changes may be made to the approved estimates of expenditure but only in prescribed circumstances as set out in section 8(2), which may include –

- (a) the creation of new heads or subheads,
- (b) supplementary provision in approved or new subheads,
- (c) variations in the establishments of posts, and
- (d) increases in the limit to the commitments which may be entered into in respect of expenditure which is not annually recurrent.

3. Besides, material changes in the scope and ambit of expenditure subheads or capital account items are also likely to require Finance Committee approval. Where in doubt, Controlling Officers should consult Treasury Branch.

4. Basically the approved provision for each subhead is **cash-limited** except for subheads identified otherwise. Other than increase to the salaries and allowances portion of the Operational Expenses in line with civil service pay adjustment or in the most exceptional cases, supplementary provision should not be considered. In any case, it requires approval from either the Finance Committee, or Treasury Branch or Controlling Officers under delegated authority.

5. All requests for supplementary provision or other changes to the approved Estimates ought to be submitted in a **timely manner** to allow proper scrutiny. In particular, where the changes require approval by Finance Committee, Controlling Officers must give due regard to the schedule of Finance Committee meetings and the lead time involved in the preparation of Finance Committee Agenda Items, plus possible need to consult the relevant Panel(s) of the Legislative Council.

6. Controlling Officers **must not pre-empt** the outcome of LegCo's deliberations. Otherwise, incurring expenditure in such circumstances is **unlawful** under the PFO. Besides, changes to the Estimates cannot be approved retrospectively except in the case of urgent and unavoidable expenditure which has been properly dealt with in accordance with sections 15 and 21 of the PFO (see paragraphs 11-13 below).

### **Controlling Officers**

7. According to **section 12** of the PFO, "a controlling officer shall be responsible and accountable for all expenditure from any head or subhead for which he is the controlling officer, and for all public moneys and Government property in respect of the department or service for which he is responsible."

### **Regulations and Directions**

8. **Section 13** of the PFO requires every Controlling Officer to obey all administrative regulations and directions/instructions made in accordance with section 11 of the PFO. These include the Financial and Accounting Regulations (F&ARs), Stores and Procurement Regulations, and Financial Circulars. Controlling Officers should familiarise themselves with the key provisions or ensure that they can be properly briefed and advised through their supporting staff.

9. In particular, Controlling Officers should note that F&AR 320 stipulates that –

- (a) It is the responsibility of Controlling Officers to **exercise strict economy** in the expenditure of funds under their control.
- (b) Where Controlling Officers have reason to believe that funds surplus to requirements exist under a Capital Account<sup>1</sup> subhead, they shall immediately inform the Secretary for Financial Services and the Treasury so that the excess may be reserved.
- (c) In **no** circumstances may surplus funds be spent unnecessarily, for example by drawing unallocated stores in excess of reasonable requirements, simply because they are available and would otherwise lapse at the close of the financial year.

### **Allocation Warrant**

10. Under **section 14(4) of the PFO**, a Controlling Officer may, in respect of any subhead for which he is the controlling officer, by allocation warrant authorise any other controlling officer to incur expenditure against any provision shown in that subhead. Controlling Officers should not assume that they can freely re-deploy any potential savings from within these allocations unless a variation has been issued with the agreement of the recipient of the allocation warrant.

### **Urgent expenditure and payments**

11. **Sections 15 and 21 of the PFO** make provision for incurring urgent expenditure and processing payments pending the approval of supplementary provision or increases in commitment. Under section 15, where an urgent need has arisen for expenditure to be incurred –

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<sup>1</sup> F&AR 320(2) is hereby amended to include the words “Capital Account” before “subhead”. With the implementation of the Operating Expenditure Envelope system, and subject to the prevailing rules and regulations on changes to estimates, Directors of Bureaux and envelope holders now have the flexibility to deploy surplus resources within their operating expenditure envelope to other heads and subheads according to their policy priorities.

- (a) which requires supplementary provision in an approved or new subhead or increases in the limit to the non-recurrent commitments; and
- (b) which, in the opinion of the Controlling Officer, cannot be deferred without serious detriment to the public interest,

the Controlling Officer may incur the expenditure on his personal responsibility pending the approval of such supplementary provision or increase in commitments.

12. In accordance with section 21 of the PFO, where an urgent need has arisen for payment –

- (a) to meet expenditure for which no provision or insufficient provision is shown in the approved estimates; and
- (b) which cannot be deferred without detriment to the public interest,

the Financial Secretary (FS) may issue contingencies warrant authorising the Director of Accounting Services (DAS) to make payment. Controlling Officers should note that, while they may incur expenditure under section 15 of the PFO, **if** the urgent payment involves payment in advance of approval of a **supplementary provision**, contingencies warrant will still have to be issued by the FS before the DAS may make such payment.

13. A Controlling Officer who wishes to resort to sections 15 and 21 of the PFO must, before incurring any such expenditure -

- (a) write personally to Treasury Branch explaining fully the reason for the excess expenditure and why the expenditure cannot be deferred without serious detriment to the public interest;
- (b) request the issue of a contingencies warrant by the FS under section 21 of the PFO to permit the DAS to effect the related payment;

- (c) process the payment on his personal authority only when Treasury Branch advises that the FS has issued the contingencies warrant to DAS; and
- (d) subsequently seek covering approval for the necessary supplementary provision.

### **Guarantees**

14. Under **section 28 of the PFO**, no public officer shall give a guarantee involving any financial liability upon the Government unless such is given for the purpose of and in accordance with the provisions of an Ordinance or a resolution of the Legislative Council or with the prior approval of the Finance Committee.

### **Surcharge**

15. Under **section 32 of the PFO**, a public officer may be subject to surcharge if he/she –

- (a) has failed to collect any moneys owing to the Government;
- (b) is responsible for any improper payment of public moneys;
- (c) has improperly incurred expenditure;
- (d) is responsible for any deficiency in or loss or destruction of or damage to any public moneys or Government property; and
- (e) is responsible for any loss or destruction of or damage to any property as a result of which the Government is liable for the cost of replacement, repair or compensation.

## Applicability

16. Although some of the control requirements of the PFO relate only to the General Revenue Account, Controlling Officers should apply similar disciplines to control expenditure from Funds set up under **section 29 of the PFO**. These include the Capital Works Reserve Fund, the Capital Investment Fund, the Disaster Relief Fund, the Innovation and Technology Fund, the Loan Fund and the Lotteries Fund, etc.

17. The provisions on guarantees, surcharge, etc. are binding on all “public officers”<sup>2</sup>.

18. The foregoing is meant to be read in conjunction with the PFO. Controlling Officers are reminded to familiarise themselves with the Ordinance.

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<sup>2</sup> As defined under section 3 of Interpretation and General Clauses Ordinance (Cap 1), “public officer” means any person holding an office of emolument under the Government, whether such office be permanent or temporary.

## Rules for funding initiatives

1. It is the established practice within Government for all new policy or funding initiatives to be subject to an internal vetting or resource allocation process before any commitments can be offered or made in their respect in public. To reinforce this internal discipline and to better align the internal vetting process with the “operating expenditure envelope” approach to funding, it is necessary to restate our existing ground rules.

### Ground rules

2. Directors of Bureaux and Controlling Officers are requested to observe the following –

- (a) Where a bureau or department proposes a new policy that has financial implications on public expenditure and necessitates internal clearance through the Policy Committee or Executive Council, Treasury Branch should be consulted.
  - (i) For those policy initiatives that can be funded from resources **within** the proposing bureau’s “operating expenditure envelope”, Treasury Branch’s contribution would focus primarily on potential read-across for Government or the wider public sector and on “value for money” perspectives.
  - (ii) For those policy initiatives that are to be funded from resources **outside** the “operating expenditure envelope” of the proposing bureau or department (that is, from the Centre), Treasury Branch’s **prior approval** must be secured before any public commitment is offered or made. In any event, the section on “Financial Implications” in the relevant submissions should be cleared in advance by Treasury Branch.



- (b) All other proposals that require additional funding from the Centre (whether or not involving policy changes and whether recurrent or one-off in nature) should be subject to vetting through the annual resource allocation exercise. In-year bids are to be considered only on an exceptional basis.

### **Urgent cases**

- (c) There may be occasions when urgent decisions have to be made involving additional funding from the Centre but necessitating exceptions to the established rules in (a) or (b) above.
  - (i) In these exceptional circumstances, the onus remains on the proposing bureau or department to secure confirmation from Treasury Branch that funding can and will be made available from the Centre for the said purpose **before** offering or making any public commitment on it. Such confirmation should be in traceable record form.
  - (ii) Given known budgetary constraints, it should **not** be presumed that funding would always be available from the Centre to meet commitments offered on a premature basis without having secured internal funding clearance. Unless with the aforesaid prior confirmation from Treasury Branch, the proposing bureau or department will be expected to account for and fund from **within** its own resources all commitments it has offered or made in public.

**Read-across**

- (d) There may be policy initiatives or proposals which are clearly within the prerogative of a Director of Bureau or Controlling Officer to decide on. Whilst clearance or funding approval from the Centre may not be required, the Director or Controlling Officer should be mindful of potential read-across implications on public expenditure or government revenue and should consult Treasury Branch where appropriate.

3. The above requirements are necessary to preserve the system of prudent financial management for Government as a whole and to ensure that commitments offered in public would have gone through a due process within Government.

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RESTRICTED  
CR 20/2041/77 VII

GOVERNMENT SECRETARIAT  
HONG KONG  
23 June 1984

## FINANCIAL CIRCULAR NO. 14/84

### Responsibility of Controlling Officers

(Note : Distribution of this Circular is **Scale C**. It should be read by Controlling Officers, departmental secretaries and accountants, and by all other officers concerned with the control of public finance.)

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Section 12 of the Public Finance Ordinance states that "a controlling officer shall be responsible and accountable for all expenditure from any head or subhead for which he is the controlling officer, and for all public moneys and Government property in respect of the department or service for which he is responsible".

2. From time to time, controlling officers may find themselves the client for projects over which their exercise of control differs in some way from normal procedures. Examples are the commissioning of a capital project, the provision of services and the procurement of specialised equipment in conjunction with, or through, a third party.

3. Controlling officers are reminded that, in these circumstances, they remain fully responsible and accountable for the proper disbursement of the funds under their control. In case of doubt, they should seek immediate clarification of their position from their policy branch and Finance Branch.

/4. ....

To : Heads of Departments  
c.c. Registrar, Supreme Court (f.i.)

4. As regards the procurement of stores and equipment in connection with these projects, government tender procedures should be followed. If there are exceptional circumstances which would appear to warrant a departure from these procedures, approval must be obtained from the appropriate authorities beforehand.

A.N. SAVAGE  
Deputy Financial Secretary



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

圖文傳真 Facsimile : 2583 9063

電話 Telephone : 2829 4251

本署檔號 Our Ref. : UB/PAC/VFM/42

來函檔號 Your Ref. : CB(3)/PAC/R42

20 May 2004

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

(Fax No. 2537 1204)

Dear Ms Hon,

**The Director of Audit's Report on the  
results of value for money audits (Report No.42)**

**Chapter 4: Hong Kong Harbour Fest**

Thank you for your letter of 13 May 2004.

With reference to the questions raised in paragraph 3 of your letter, I set out the information as follows:

- (a) *Why Audit made reference to the 1988 guidelines in commenting on the form of financing the Harbour Fest?*

In paragraph 2.34 of the Audit Report, it is stated that “given that the Government paid for the bulk of the cost of the Harbour Fest, and in view of the need to account for such a large sum of public expenditure, Audit considers that sponsorship did not seem to be an appropriate form of financing this project”. Audit held this view because sponsorship in this case had resulted in entrusting a large sum of public money to AmCham without stringent controls. Audit considered the amount of sponsorship should normally be a small portion of the sponsored project cost. This principle should always be followed. In making these remarks, it was noted that the

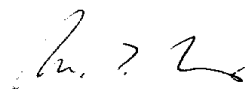
Government guidelines "Miscellaneous Subventions — Guidelines on the Management and Control of Government Subventions" issued in 1988 had already referred to sponsorship as "a contribution, usually a token amount, to help meet part of an organisation's operational expenses and to demonstrate support for the organisation's objectives". Audit therefore considered it relevant to refer to the principle and good practice set out in these guidelines.

- (b) *Whether Audit has any evidence that the Director-General of Investment Promotion had made reference to these guidelines in relation to the Harbour Fest?*

I confirm that Audit did not find any evidence in this respect.

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

Yours sincerely,



(David Leung)  
for Director of Audit

- c.c. Financial Secretary  
Director-General of Investment Promotion  
Secretary for Financial Services and the Treasury  
(Attn: Mr. Manfred WONG)

Our Ref : L/M to IHK/AMB/2/3 IV  
Your Ref: CB(3)/PAC/R42

17 May 2004

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

*{Urgent by fax}*

Dear Ms Hon,

**The Director of Audit's Report on the  
Results of Value for Money Audits (Report No. 42)  
Chapter 4 : Hong Kong Harbour Fest**

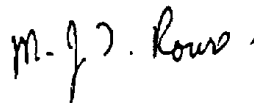
Thank you for your letter of 11 May 2004.

On (a), I attach a summary of those periods between July and mid-November 2003 when I was not in the office, either on duty trip or vacation leave.

On (b), the regional broadcast on Star World International took place on 5 and 6 May. According to AmCham, the viewership figures should be available shortly and we will pass them on as soon as we have them. Broadcast on Star World India is scheduled for 19 and 20 May. We will obtain and pass on these viewership figures also.

I trust this is helpful.

Yours sincerely,



(M J T Rowse)

Director-General of Investment Promotion

**Invest Hong Kong 投資推廣署**

**The Government of the Hong Kong Special Administrative Region 香港特別行政區政府**

15th Floor, One Pacific Place, Queensway, Hong Kong 香港金鐘太古廣場第一期十五樓

Telephone 電話: (852) 3107 1001 Facsimile 傳真: (852) 3107 9006 E-mail 電子郵件: dg@InvestHK.gov.hk Web Site 網址: <http://www.investhk.gov.hk>

cc Financial Secretary  
Director of Audit  
Secretary for Financial Services and the Treasury  
(Attn: Mr Manfred Wong)



**Director-General of Investment Promotion's  
overseas trips & vacation leave**

30 June – 5 July 2003	Duty visit to USA (East) & Canada
14 July – 16 August 2003	Vacation leave
21 – 22 August 2003	Duty visit to Shanghai
25 – 30 August 2003	Duty visit to Australasia
8 – 9 September 2003	Duty visit to Xiamen
11 – 12 September 2003	Duty visit to Beijing
20 – 27 September 2003	Duty visit to Europe
22 – 23 October 2003	Duty visit to Korea
29 – 30 October 2003	Duty visit to Japan

\* Periods quoted exclude departure/arrival on Sundays.

**THIS MEMORANDUM OF UNDERSTANDING ("MoU") is made on 31 July 2003 between THE AMERICAN CHAMBER OF COMMERCE IN HONG KONG, the principal office of which is at 1904 Bank of America Tower, 12 Harcourt Road, Central, Hong Kong ("AmCham") and THE GOVERNMENT OF THE HONG KONG SPECIAL ADMINISTRATIVE REGION (the "Government") as represented by THE DIRECTOR GENERAL OF INVESTMENT PROMOTION, INVEST HONG KONG, at Suites 1501-6, Level 15, One Pacific Place, 88 Queensway, Hong Kong.**

The parties intend this MoU to be legally binding.

**1. Scope and Purpose of this MoU**

- 1.1 AmCham has made a proposal to the Government for the convening (either by AmCham or through a special purpose company, and references in this MoU to AmCham include any such company) of an entertainment showcase festival in Hong Kong to be called the "Hong Kong International Autumn Festival" (the "Festival") within the period between 1 October 2003 and 30 November 2003.
- 1.2 The Government has agreed to support the Festival and to underwrite the shortfall between the organising expenses for, as agreed by both parties, and the revenue generated from the Festival, up to the maximum sum of HK\$100 million in the form of a Sponsorship Fee, which shall be the maximum liability of the Government in relation to the Festival.
- 1.3 AmCham and the Government expect to enter into a full agreement setting out in detail each party's obligations with regard to the convening and underwriting of the Festival. The purpose of this MoU is to record AmCham's and the Government's respective general understanding with regard to the convening and the underwriting of the Festival, and to provide for payment of the initial instalment referred to in Clause 2.
- 1.4 The parties expect the detailed agreement to provide, without limitation, in relation to the keeping of proper books of account, and the preparation of audited accounts by AmCham in relation to the Festival, and the full support and all necessary facilitation by HKI in the procurement of possession and use of the Festival site and of all necessary licences, consents and permissions by AmCham to enable the Festival to take place as envisaged.

**2. Payment of Initial Instalment**

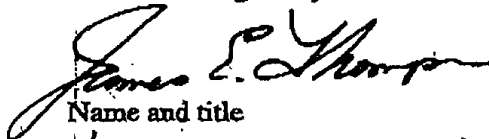
The Government will pay to AmCham on execution of this MoU an initial instalment of HK\$25 million, representing 25% of the maximum Sponsorship Fee of HK\$100 million.

**3. Miscellaneous**

- 3.1 No failure or delay in exercising any right under this MoU shall operate as a waiver thereof; and no variation shall be effective unless in writing and signed by each party. This MoU cancels and supersedes all prior oral or written agreements or understandings between the parties concerning the subject matter hereof.
- 3.2 This MoU is not assignable by either party without the prior written consent of the other party, which consent shall not be unreasonably withheld or delayed.
- 3.3 Neither party shall disclose the subject matter, purpose or existence of this MoU without the prior written consent of the other party, except as required by law and government regulations, and except for disclosure on a need to know basis to its own employees and its legal or other professional advisers.
- 3.4 Each party shall bear its own expenses and costs for all negotiations and activities relating to this MoU.
- 3.5 This MoU shall be governed by and construed according to Hong Kong Special Administrative Region law.

Accepted and agreed to by  
The American Chamber of Commerce  
in Hong Kong

Authorised Signatory



Name and title

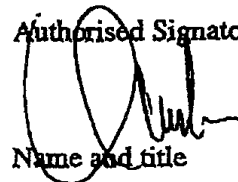
JAMES E. THOMPSON  
CHAIRMAN

Date:

31 July 2003

Accepted and agreed to  
for and on behalf  
of the Government of the  
Hong Kong Special  
Administration Region by

Authorised Signatory



Name and title

Ms Ophelia Tsang  
Associate Director-General  
Invest Hong Kong

Date:

31 July 2003

**THIS MEMORANDUM OF UNDERSTANDING ("MoU") is made on 29 August 2003 between THE AMERICAN CHAMBER OF COMMERCE IN HONG KONG, the principal office of which is at 1904 Bank of America Tower, 12 Harcourt Road, Central, Hong Kong ("AmCham") and THE GOVERNMENT OF THE HONG KONG SPECIAL ADMINISTRATIVE REGION (the "Government") as represented by THE DIRECTOR GENERAL OF INVESTMENT PROMOTION, INVEST HONG KONG, at Suites 1501-6, Level 15, One Pacific Place, 88 Queensway, Hong Kong ("IHK").**

The parties intend this MoU to be legally binding.

**1. Scope and Purpose of this MoU**

- 1.1 AmCham has made a proposal to the Government for the convening (either by AmCham or through a special purpose company, and references in this MoU to AmCham include any such company) of an entertainment showcase festival in Hong Kong to be called the "Hong Kong Harbour Fest 2003" (the "Festival", which was formerly referred to the "Hong Kong International Autumn Festival" in all previous correspondence between the two parties) within the period between 1 October 2003 and 30 November 2003.
- 1.2 The Government has agreed to support the Festival and to underwrite the shortfall between the organising expenses for, as agreed by both parties, and the revenue generated from the Festival, up to the maximum sum of HK\$100 million in the form of a Sponsorship Fee, which shall be the maximum liability of the Government in relation to the Festival.
- 1.3 AmCham and the Government expect to enter into a full agreement setting out in detail each party's obligations with regard to the convening and underwriting of the Festival. The purpose of this MoU is to record AmCham's and the Government's respective general understanding with regard to the convening and the underwriting of the Festival, and to provide for payment of the second instalment referred to in Clause 2.
- 1.4 The parties expect the detailed agreement to provide, without limitation, in relation to the keeping of proper books of account, and the preparation of audited accounts by AmCham in relation to the Festival, and the full support and all necessary facilitation by IHK in the procurement of possession and use of the Festival site and of all necessary licences, consents and permissions by AmCham to enable the Festival to take place as envisaged.

**2. Payment of Second Instalment**

- 2.1 On execution of the MoU signed between the two parties on 31 July 2003, the Government paid the initial instalment of HK\$25 million, representing 25% of the maximum Sponsorship Fee of HK\$100 million to AmCham on 4 August 2003.

2.2 The Government will pay to AmCham on execution of this MoU a second instalment of HK\$25 million, which together with the first instalment paid will make up to 50% of the maximum Sponsorship Fee of HK\$100 million.

3. **Miscellaneous**

3.1 No failure or delay in exercising any right under this MoU shall operate as a waiver thereof; and no variation shall be effective unless in writing and signed by each party. This MoU cancels and supersedes all prior oral or written agreements or understandings between the parties concerning the subject matter hereof.

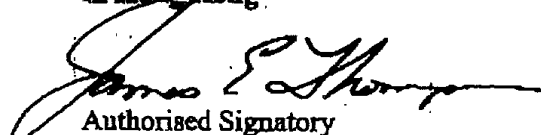
3.2 This MoU is not assignable by either party without the prior written consent of the other party, which consent shall not be unreasonably withheld or delayed.

3.3 Neither party shall disclose the subject matter, purpose or existence of this MoU without the prior written consent of the other party, except as required by law and government regulations, and except for disclosure on a need to know basis to its own employees and its legal or other professional advisers.

3.4 Each party shall bear its own expenses and costs for all negotiations and activities relating to this MoU.

3.5 This MoU shall be governed by and construed according to Hong Kong Special Administrative Region law.

Accepted and agreed to by  
The American Chamber of Commerce  
in Hong Kong



Authorised Signatory

Name and title Mr. James E. Thompson  
Chairman

Date: August 29, 2003

Accepted and agreed to  
for and on behalf  
of the Government of the  
Hong Kong Special  
Administration Region by



Authorised Signatory

Name and title: Ms Ophelia Tsang  
Associate-Director General  
of Investment Promotion

Date: 29 August 2003

**THIS MEMORANDUM OF UNDERSTANDING ("MoU") is made on 3 October 2003 between THE AMERICAN CHAMBER OF COMMERCE IN HONG KONG, the principal office of which is at 1904 Bank of America Tower, 12 Harcourt Road, Central, Hong Kong ("AmCham") and THE GOVERNMENT OF THE HONG KONG SPECIAL ADMINISTRATIVE REGION (the "Government") as represented by THE DIRECTOR GENERAL OF INVESTMENT PROMOTION, INVEST HONG KONG, at Suites 1501-6, Level 15, One Pacific Place, 88 Queensway, Hong Kong ("IHK").**

The parties intend this MoU to be legally binding.

**1. Scope and Purpose of this MoU**

- 1.1 AmCham has made a proposal to the Government for the convening (either by AmCham or through a special purpose company, and references in this MoU to AmCham include any such company) of an entertainment showcase festival in Hong Kong to be called the "Hong Kong Harbour Fest 2003" (the "Festival", which was formerly referred to the "Hong Kong International Autumn Festival" in all previous correspondence between the two parties) within the period between 1 October 2003 and 30 November 2003.
- 1.2 The Government has agreed to support the Festival and to underwrite the shortfall between the organising expenses for, as agreed by both parties, and the revenue generated from the Festival, up to the maximum sum of HK\$100 million in the form of a Sponsorship Fee, which shall be the maximum liability of the Government in relation to the Festival.
- 1.3 AmCham and the Government expect to enter into a full agreement setting out in detail each party's obligations with regard to the convening and underwriting of the Festival. The purpose of this MoU is to record AmCham's and the Government's respective general understanding with regard to the convening and the underwriting of the Festival, and to provide for payment of the third instalment referred to in Clause 2.
- 1.4 The parties expect the detailed agreement to provide, without limitation, in relation to the keeping of proper books of account, and the preparation of audited accounts by AmCham in relation to the Festival, and the full support and all necessary facilitation by IHK in the procurement of possession and use of the Festival site and of all necessary licences, consents and permissions by AmCham to enable the Festival to take place as envisaged.

**2. Payment of Third Instalment**

- 2.1 On execution of the two previous MoUs signed between the two parties on 31 July 2003 and 29 August 2003, the Government already paid two instalments each

of HK\$25 million to AmCham, with the aggregate sum of HK\$50 million paid representing 50% of the maximum Sponsorship Fee of HK\$100 million.

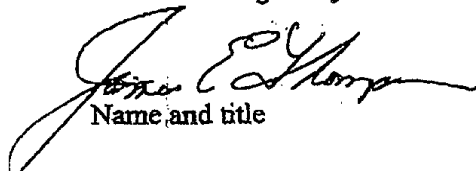
- 2.2 The Government will pay to AmCham on execution of this MoU the third instalment of HK\$25 million, which together with the first two instalments paid will make up to 75% of the maximum Sponsorship Fee of HK\$100 million.

3. **Miscellaneous**

- 3.1 No failure or delay in exercising any right under this MoU shall operate as a waiver thereof; and no variation shall be effective unless in writing and signed by each party. This MoU cancels and supersedes all prior oral or written agreements or understandings between the parties concerning the subject matter hereof.
- 3.2 This MoU is not assignable by either party without the prior written consent of the other party, which consent shall not be unreasonably withheld or delayed.
- 3.3 Neither party shall disclose the subject matter, purpose or existence of this MoU without the prior written consent of the other party, except as required by law and government regulations, and except for disclosure on a need to know basis to its own employees and its legal or other professional advisers.
- 3.4 Each party shall bear its own expenses and costs for all negotiations and activities relating to this MoU.
- 3.5 This MoU shall be governed by and construed according to Hong Kong Special Administrative Region law.

Accepted and agreed to by  
The American Chamber of Commerce  
in Hong Kong

Authorised Signatory

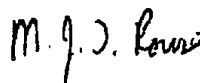


Name and title

Date:

Accepted and agreed to  
for and on behalf  
of the Government of the  
Hong Kong Special  
Administration Region by

Authorised Signatory



Name and title: Mr M J T Rowse  
Director General of Investment Promotion

Date: 3 October 2003

**AGREEMENT**

**Dated 10 October 2003**

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

**AND**

**THE AMERICAN CHAMBER OF COMMERCE IN HONG KONG**

---

**AGREEMENT  
IN RELATION TO  
HONG KONG HARBOUR FEST 2003**

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**THIS AGREEMENT** made on the 10th day of October 2003

**PARTIES:**

- (1) **THE GOVERNMENT OF THE HONG KONG SPECIAL ADMINISTRATIVE REGION** (the "Government") as represented by THE DIRECTOR-GENERAL OF INVESTMENT PROMOTION at Suites 1501-6, Level 15, One Pacific Place, 88 Queensway, Hong Kong; and
- (2) **THE AMERICAN CHAMBER OF COMMERCE IN HONG KONG** (the "AmCham"), a registered society whose principal office is at 1904 Bank of America Tower, 12 Harcourt Road, Central, Hong Kong.

**RECITALS:**

- (A) AmCham has made a proposal to the Government for the convening (through a special purpose vehicle of AmCham wholly-owned by members of AmCham (the "SPV") of an entertainment showcase festival in Hong Kong, to be called "Hong Kong Harbour Fest" the first such Hong Kong Harbour Fest to be held within the period between 1 October 2003 and 30 November 2003 (the "2003 Festival").
- (B) The Government has agreed to support the Hong Kong Harbour Fest and to underwrite the shortfall between the organising expenses for and the revenue generated from the 2003 Festival in the form of a fee (the "Sponsorship Fee"), the aggregate amount of the Sponsorship Fee not to exceed HK\$100 million which shall be the maximum amount payable under this Agreement by the Government in relation to the 2003 Festival.
- (C) On each of 31 July, 29 August and 3 October 2003, AmCham and the Government entered into legally binding memoranda of understanding in relation to the 2003 Festival (the "MoUs").
- (D) This Agreement has been entered into for the purposes of setting out in detail each party's obligations with regard to the convening and underwriting of the Festival as envisaged by the MoUs.

**NOW IT IS HEREBY AGREED as follows:**

**1. INTERPRETATION**

1.1 In this Agreement, unless the context requires otherwise, the following expressions have the following meanings:

- “2003 Festival”** means the Hong Kong Harbour Fest 2003 that is scheduled to take place during the period between 1 October 2003 and 30 November 2003 in Hong Kong;
- “2003 Festival Accounts”** means the audited accounts of the SPV (and AmCham, as the case may require) prepared in relation to the 2003 Festival which shall detail the Organising Expenses, relevant revenues and the Net Deficit;
- “Business Plan”** shall have the meaning given in Clause 2.2, or the revised plan as set out in Clause 2.6 and accepted by the Government;
- “Business Day”** means a day on which HSBC is open to the public for normal consumer banking business;
- “Festival”** means the Hong Kong Harbour Fest in Hong Kong;
- “Festival Venue”** means the location known as the Tamar Site on Harcourt Road, or other location which may be agreed in writing by AmCham and the Government;
- “Hong Kong”** means the Hong Kong Special Administrative Region of the People’s Republic of China;

<b>"Indicative Budget"</b>	means the latest budget agreed by both parties as set out in the Second Schedule;
<b>"Indicative Proposal"</b>	means the up-to-date programme of events agreed by both parties as set out in the First Schedule;
<b>"Intellectual Property Rights"</b>	means (i) patents, designs, trade marks and trade names (whether registered or unregistered), copyright and related rights, database rights, know-how and confidential information; (ii) all other intellectual property rights and similar or equivalent rights anywhere in the world which currently exist or are recognised in the future; and (iii) applications, extensions and renewals in relation to any such rights;
<b>"Net Deficit"</b>	means the shortfall (if any) between the Organising Expenses and all recognised revenues represented in the 2003 Festival Accounts as cash at bank or in hand which cash is available for payment or distribution by the SPV (not including the Sponsorship Fee as a revenue item for these purposes) associated with and generated by the 2003 Festival in the period to which the 2003 Festival Accounts are made up;
<b>"Organising Expenses"</b>	means all costs and expenses of an actual or contingent nature (including, without limitation, all taxes, deductions, withholdings and liabilities of AmCham and the SPV whatsoever) in each case in relation to the 2003 Festival as initially detailed for information purposes only in the Indicative Budget (as may be amended from time to time in accordance with the

provisions of this Agreement) as shall be detailed in the 2003 Festival Accounts;

**"Performing Talents"** means the named artists and performers in the Indicative Proposal or other artists and performers as may be agreed by AmCham and the Government from time to time;

**"Sponsorship Fee"** means the sum specified in Clause 3.2; and

**"Sponsorship Rights"** means the rights and powers set out in the Third Schedule.

- 1.2 The Clause and Schedule headings are for convenience only and shall not affect the interpretation of this Agreement.
- 1.3 References to Clauses are to Clauses in the main body of this Agreement, and references to Paragraphs are to Paragraphs of the Schedules.
- 1.4 References to the singular include the plural and vice versa, and references to one gender include the other gender.

## **2. BUSINESS AND BUDGET**

- 2.1 AmCham shall, with the financial support of the Government as detailed in this Agreement, use its best endeavours to manage the organisation, operation and implementation of the 2003 Festival in accordance with the intended objectives, event mission, rationale and tentative calendar of events for the 2003 Festival set out in the indicative proposal by the Sports and Entertainment Committee of AmCham (as detailed in the **First Schedule** of this Agreement (the "**Indicative Proposal**").
- 2.2 AmCham shall, in consultation with promoters, sponsors, advisers, agents, producers and other persons involved in the 2003 Festival (including the Government), develop the Indicative Proposal as may be necessary or convenient with a view to making a success of the underlying objectives of the 2003 Festival, such document to be adopted as the business plan in relation

to the 2003 Festival ("**Business Plan**").

- 2.3 AmCham may conduct the business of managing, organising, operating, implementing, promoting and marketing the 2003 Festival (the "**Business**") through Red Canvas Limited, a company incorporated in Hong Kong under registration number 718441 (the "**SPV**") wholly-owned by members of AmCham, whose registered office is at Suite 2001, Mass Mutual Tower, 38 Gloucester Road, Wan Chai, Hong Kong, provided that AmCham shall not be relieved from any of its obligations hereunder by the engagement of Red Canvas for the performance of any part of this Agreement.
- 2.4 The indicative budget for the Festival is set out in the **Second Schedule** of this Agreement (the "**Indicative Budget**").
- 2.5 AmCham shall, in consultation with and subject to the scrutiny of its (or the SPV's) accountants and the Government, develop the Indicative Budget and adopt it as the budget in relation to the 2003 Festival ("**Budget**").
- 2.6 If AmCham wishes to materially alter the Business Plan or the Budget then AmCham shall provide the Government with full written particulars of such alterations and with such further information as the Government may reasonably require including up-to-date particulars of the then estimated final amount of the Sponsorship Fee, subject to the maximum Sponsorship Fee of HK\$100 million.
- 2.7 Upon receipt of such revised Business Plan or the revised Budget the Government may elect either:
- (a) to accept such revised Business Plan or revised Budget in writing, in which case this Agreement shall be amended in accordance therewith;  
or
  - (b) to accept such revised Business Plan or revised Budget subject to such modifications as may be proposed by the Government. In the absence of written agreement as to modifications within 10 days after the date of receipt of the revised Business Plan or revised Budget, the Government shall be entitled to reject the revised Business Plan or revised Budget in accordance with paragraph (c) below; or

(c) to reject the revised Business Plan or revised Budget in which event AmCham shall withdraw the revised Business Plan or revised Budget and this Agreement shall continue in force unchanged.

2.8 The Government shall not be obliged to consider or make any modifications to the revised Business Plan or revised Budget save in accordance with the aforesaid procedure.

### **3. UNDERWRITING FEES**

3.1 In consideration of AmCham's agreement to manage the organisation, operation and implementation of the Festival to fulfil its obligations stated herein, the Government shall (subject to the matters set out below) pay to AmCham the Sponsorship Fee.

3.2 The Sponsorship Fee shall be HK\$100 million but shall be reduced (upon finalisation of the 2003 Festival Accounts) to the extent that the Net Deficit is less than that amount. The maximum amount repayable to the Government shall be \$100 million. It shall be assumed, for accounting and practical convenience only until the 2003 Festival Accounts are finalised, that the Sponsorship Fee shall be \$100 million.

3.3 The Sponsorship Fee shall be for use by the SPV in relation to the 2003 Festival.

3.4 HK\$25 million was paid to AmCham upon execution of the first MoU on 31 July 2003, and a further HK\$25 million on each of 29 August and 3 October 2003. The aggregate sum of HK\$75 million already paid to AmCham represents an advance of the Sponsorship Fee.

3.5 In the event that the amount advanced by the Government to AmCham exceeds the amount payable under Clause 3.2, AmCham shall take all steps necessary to the intent that the SPV shall refund the excess to the Government as the Government shall reasonably direct.

3.6 The balance of the Sponsorship Fee (or any part of it not then drawn-down)

shall be made available to AmCham by way of banker's cheque or draft payable in Hong Kong (in such amounts as it shall think fit to draw down) upon 3 Business Day's notice in writing (unless otherwise agreed between the parties in writing) to the Government in accordance with this Agreement.

#### **4. SPONSORSHIP RIGHTS**

- 4.1 AmCham hereby grants to the Government the Sponsorship Rights as set out in the **Third Schedule**.

#### **5. THE GOVERNMENT'S OBLIGATIONS**

- 5.1 The Government agrees to observe and perform the obligations set out in the **Fourth Schedule**.

#### **6. AMCHAM'S WARRANTY AND UNDERTAKING**

- 6.1 AmCham hereby represents, warrants and undertakes to the Government the matters set out in the **Fifth Schedule**.

#### **7. DISCLOSURE OF FINANCIAL ARRANGEMENT**

- 7.1 AmCham hereby acknowledges and agrees that the Government may, whenever it considers appropriate or upon request by any person (written or otherwise) and without any further reference to AmCham, disclose to any person in such form and manner as the Government deems fit the Sponsorship Fee and any other fees, costs and expenses payable to AmCham pursuant to this Agreement.

#### **8. CUSTODIAN OF RIGHTS**

- 8.1 Having regard to the objectives and mission of the Harbour Fest as set out in the **First Schedule**, the parties acknowledge and agree that the Government is

the owner of all of its Intellectual Property Rights, sponsorship and other rights and privileges in relation to the Hong Kong Harbour Fest. AmCham and the SPV shall be the custodian (for all the people of Hong Kong) of all rights granted, assigned or transferred to AmCham by the Government under this Agreement, which permit AmCham to promote, operate and manage the Hong Kong Harbour Fest in conjunction with the SPV.

- 8.2 On 31 December 2008, AmCham shall re-assign or re-transfer all and any such rights and privileges (or procure the same) back to the Government for the benefit of the people of Hong Kong and shall execute and do all such further deeds, documents and things as may be necessary to carry the provisions of this Clause 8 into full force and effect. Until such time, AmCham (or the SPV as the case may be) shall be entitled to any revenues in relation to such rights, which shall be recorded in proper books of account.
- 8.3 The Government shall review its financial support for the annual Hong Kong Harbour Fest in the years subsequent to 2003.

## **9. CONFIDENTIALITY**

- 9.1 Except as expressly provided in this Agreement, all materials and data furnished by or on behalf of the Government and by or on behalf of AmCham or the SPV pursuant to this Agreement shall be treated as confidential information. Neither party shall, during the continuance of the Agreement or at any time thereafter, disclose to any person the terms and conditions of the Agreement, or any confidential information of the other, PROVIDED that the restrictions on disclosure contained in this Clause shall not apply:
- (a) to the disclosure of any information to any person in circumstances where such disclosure is necessary for the performance of either party's duties and obligations under this Agreement;
  - (b) to the disclosure of any information which was rightfully in the possession of such party prior to the commencement of the negotiation leading to this Agreement;
  - (c) to the disclosure of any information which is or becomes public



knowledge otherwise than as a result of breach of this Clause;

- (d) to the disclosure of any information in circumstances where such disclosure is required pursuant to any law or order of a Court of competent jurisdiction; and
- (e) to the disclosure of any information with the prior written consent of the party.

9.2 Nothing in this Clause shall apply to disclosures made by the Government to the Executive Council and/or the Legislative Council of Hong Kong.

9.3 If AmCham shall appoint any agent or subcontractor then AmCham may disclose such information as may be necessary or convenient to enable the agent or the subcontractor to perform its obligations subject to such agent or subcontractor giving the Government an undertaking in similar terms to the provisions of this Clause. The foregoing obligations as to confidentiality shall survive termination of this Agreement.

## **10. ASSIGNMENT**

10.1 Neither party shall assign, or otherwise dispose of any interest, right, benefit or obligation under this Agreement without the other party's prior written consent except that AmCham shall be entitled to assign rights to the SPV and the SPV shall have the right to enforce the benefit of obligations expressed under this Agreement to operate in its favour.

## **11. NOTICES**

11.1 Each notice, demand or other communication given or made under this Agreement shall be in writing and delivered or sent to the relevant party at its address or facsimile number set out below (or such other address or facsimile number as the addressee has by 5 days' prior written notice specified to the other party):

To the Government : Director General of Investment Promotion  
Invest Hong Kong  
Address : Suites 1501-6, Level 15,  
One Pacific Place  
88 Queensway,  
Hong Kong  
Attn.: Mr Mike Rowse  
Facsimile Number : 3107 9006

To AmCham : 1904 Bank of America Tower  
12 Harcourt Road,  
Hong Kong  
Attn: Mr Jim Thompson  
Facsimile Number : 2810 1289

- 11.2 Such notices shall be deemed to have been properly given hereunder and shall be effective (a) on the date of delivery if hand-delivered; (b) on the date after transmission if sent by facsimile; and (c) if dispatched by mail (whether registered or not), on the day on which the same shall have been confirmed delivered by the postal authority in Hong Kong.

## **12. USE OF THE GOVERNMENT'S NAME**

- 12.1 Subject to Subclause (2) below, AmCham agrees not to use the Government's name in any document, publication, advertisements or publicity material without the prior written consent of the Government except pursuant to AmCham's performance of its obligations hereunder.
- 12.2 AmCham may, with the prior written consent of the Government, use the Government's logo, trademarks and service marks in advertising and promotional materials for the 2003 Festival.

## **13. INDEMNITY**

- 13.1 AmCham shall indemnify the Government and keep the Government fully and effectively indemnified against any and all losses, claims, damages, costs, charges, expenses, liabilities, demands, proceedings and actions or which may be brought or established against it by any person (in each case, arising

out of or in relation to or by reason of any infringement on the copyrights, intellectual property or innominate rights of any third party) which the Government may sustain or incur in relation to the 2003 Festival

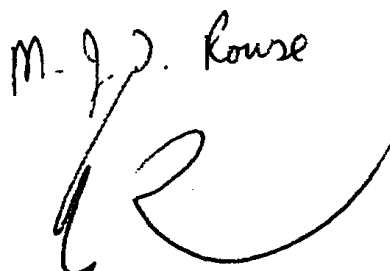
**14. GENERAL**

14.1 AmCham is [contracting in its own right] and nothing in this Agreement shall render it an agent or partner of the Government and AmCham shall not hold itself out as such. AmCham shall not have any right or power to bind the Government to any obligation. This Agreement constitutes the entire understanding between the parties concerning the subject matter hereof and shall be governed by and construed in accordance with the laws of Hong Kong. No waiver or amendment of any provision of this Agreement shall be effective unless made by a written instrument signed by both parties.

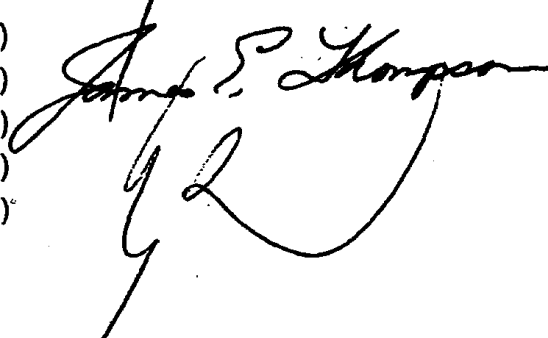
14.2 Time shall be of the essence of this Agreement (except as regards the timing of any particular acts or of the 2003 Festival), both as regards any dates and periods mentioned and as regards any dates and periods which may be substituted for them in accordance with this Agreement or by agreement in writing between the parties.

**IN WITNESS WHEREOF**, this Agreement has been executed on the day and the year first written above and evidenced by as many copies as there are parties hereto.

SIGNED by M J T Rowse )  
for and on behalf of )  
THE GOVERNMENT OF )  
THE HONG KONG SPECIAL )  
ADMINISTRATIVE REGION )  
In the presence of: ANTHONY LEE )



SIGNED by Jim Thompson )  
for and on behalf of )  
the American Chamber of )  
Commerce in Hong Kong )  
in the presence of: ANTHONY LEE )



**THE FIRST SCHEDULE  
INDICATIVE PROPOSAL**

(1) AmCham has presented to the Government and has agreed to manage the organisation, operation and implementation of the 2003 Festival with the intent of developing the following Indicative Proposal in accordance with the terms of this Agreement:

(a) Objectives –

- ※ Attract visitors from around the region, and around the world, to Hong Kong while providing residents the best in “feel good” international entertainment (***“The World’s Stage”***).
- ※ Create an annual entertainment festival to promote tourism, and brand Hong Kong as a destination for quality, world-class entertainment and entertainers (***“Where the World Comes to Perform”***).
- ※ Establish a Harbour-side entertainment landmark venue, with the culture and skyline of Hong Kong as a scenic backdrop, and its people the international hosts (***“World-Class Performing Arts and World-Class Hospitality, Surrounded by World-Famous Architecture”***).

(b) Event Mission –

- ※ The Festival celebrates the diversity of the “Asia’s World City” with world-class entertainment from around the globe, while highlighting the amazing cultural crossroads that is Hong Kong.
- ※ The Ultimate objective is to create an entertainment showcase in support of the Government’s effort to revitalise Hong Kong, providing the biggest bang for the investment via a high-profile attention-grabbing collection of world famous performing talents.

(c) Rationale –

- ※ Autumn is “wide open” and ideal for a regular entertainment event in Asia. Hong Kong can be its home.
- ※ Hong Kong can build upon the traditional Asian “Mid-Autumn Festival” by adding an international entertainment component, and become the World’s Stage.
- ※ For the world to understand Hong Kong is open for business and visitors, Hong Kong needs to show them the best that the city has to offer and truly create a visible scene of life.
- ※ To rebuild Hong Kong’s image, there are strategic needs to incorporate a signature international showcase.

(d) Tentative Programme of Events

<u>Serial No.</u>	<u>Date / Time</u>	<u>Artists</u>	<u>Ticket Prices (HK\$)</u>			
			<u>A</u>	<u>B</u>	<u>C</u>	<u>D</u>
<u>Week 1</u>						
1	Friday 17 Oct	Prince	988	758	488	258
2	Saturday 18 Oct am	Family Fest	All seats \$100			
3	Saturday 18 Oct pm	Craig David	588	388	288	158
4	Sunday 19 Oct am	Family Fest	All seats \$100			
5	Monday 20 Oct	Jose Carreras; Charlotte Church; and HK Philharmonic	988	758	488	258
<u>Week 2</u>						
6	Friday 24 Oct	Twins; t.A.T.u.; Atomic Kitten	588	388	288	158
7	Saturday 25 Oct	Westlife; Energy; evonne Hsu	588	388	288	158
8	Sunday 26 Oct	Air Supply; Ronald Cheng; Eason Chan	388	288	158	-
9	Tuesday 28 Oct	Umoja Charity Premiere	495	395	295	195

<b>Serial No.</b>	<b>Date / Time</b>	<b>Artists</b>	<b>Ticket Prices (HK\$)</b>			
			<b>A</b>	<b>B</b>	<b>C</b>	<b>D</b>
<b>Week 3</b>						
10	Thursday 30 Oct	Gypsy Kings; Danny Diaz	588	388	288	158
11	Friday 31 Oct	Asian All-Star Night Fly to the Sky; Shine; Boyz; Candy Lo; Gigi Leung; Yumiko; "S"	388	288	158	-
12	Saturday 1 Nov	Santana	988	758	488	258
13	Sunday 2 Nov am	Gary Valenciano (1)	All seats \$158			
14		Gary Valenciano (2)	All seats \$158			
<b>Week 4</b>						
15	Thursday 6 Nov	Neil Young, Michelle Branch	988	758	488	258

**THE SECOND SCHEDULE  
THE INDICATIVE BUDGET**

- (1) AmCham has presented to the Government the following Indicative Budget for the 2003 Festival and has agreed to finalise a Budget on the basis of the programme of events in the First Schedule with any subsequent changes to the Budget to be as determined from time to time in accordance with this Agreement but having regard to the objectives of this Agreement as well as commercial profit making principles, including but not limited to sales of admission tickets and the procurement of commercial sponsorship, with the intent of generating and increasing revenues for the 2003 Festival –

<u>Expenditure#</u>	<u>\$m</u>
Artist Fees	85.8
Operations	30.4
Marketing	6.2
TV Production	6.6
Insurance	4.7
Contingency	<u>2.5</u>
	136.2
<u>Revenue#</u>	<u>\$m</u>
Ticket Sales (assuming 50%)	52.5
Sponsorship	3.1
Merchandise	0.3
Concessions	1.6
TV Rights	<u>1.6</u>
	59.1
 <b>Estimated Shortfall (as at 22.9.03)</b>	 <b>\$77.1 million</b>

Note#: Neither expenditure nor revenue forecasts include provision of \$8 million for air tickets and hotel rooms, which it is assumed will be sponsored and therefore balanced out.

**THE THIRD SCHEDULE**  
**THE GOVERNMENT'S SPONSORSHIP RIGHTS**  
**(Clause 4)**

AmCham hereby grants to the Government the following rights –

- (1) (a) With effect from the date of this Agreement the Government's name and the logo nominated by the Government shall be featured and included in all promotional materials and signages relating to and/or displayed for the purpose of the 2003 Festival;
- (b) The right to nominate a logo for the purpose of paragraph (1)(a) above, and to change the logo on giving AmCham seven (7) days' prior notice;
- (c) The right to use the individual image of any of the Performing Talents for the promotion of Hong Kong to the extent permitted (and notified by AmCham to the Government as so permitted) including by virtue of the agreements and arrangements to which the Performing Talents are a party or otherwise;
- (d) The right to use TV footages and programmes of performance and related activities of the 2003 Festival for the promotion of Hong Kong, to the extent permitted (and notified by AmCham to the Government as so permitted) including by virtue of the agreements and arrangements to which the Performing Talents are a party or otherwise.



**THE FOURTH SCHEDULE**  
**THE GOVERNMENT'S OBLIGATIONS**  
**(Clause 5)**

The Government agrees –

- (1) to use all reasonable endeavours to assist AmCham and the SPV (including their employees, contractors, sponsors, licensees and other persons nominated by them) in procuring full and unencumbered vacant possession (including access to and egress from the public highway) as intended of the 2003 Festival Venue not later than the date of this Agreement, and the essential utility supplies to AmCham and the SPV's reasonable satisfaction.
- (2) to use all reasonable endeavours to assist AmCham and the SPV in procuring (subject to cooperation of AmCham and the SPV in reasonable time as may be required or convenient) all necessary licences, consents and permissions to enable the 2003 Festival to take place as envisaged and work with such persons on an on-going basis to ensure the same are procured in good time.
- (3) to ensure that AmCham shall be permitted to use the 2003 Festival Site until 30 November 2003; and
- (4) to supply at its own costs finished artwork relating to the Government's name, logo and other identification provided for herein by the deadlines mutually agreed by both parties.

**THE FIFTH SCHEDULE**  
**AMCHAM'S COMMITMENTS**  
**(Clause 6)**

- (1) AmCham hereby represents, warrants and undertakes to the Government that –
- (a) AmCham shall use its best endeavours to conduct the Business on sound and proper commercial profit making principles in accordance with this Agreement, including but not exclusive of the determination of appropriate pricing strategy for the admission tickets, the procurement of commercial sponsorship, with the intent of generating and increasing revenues for the 2003 Festival having regard to the overall objectives set out in this Agreement;
  - (b) AmCham shall use its best endeavours to ensure proper administration of the sale of admission tickets and to identify opportunities for securing appropriate commercial sponsorship for the 2003 Festival;
  - (c) AmCham agrees to procure the production of a Hong Kong marketing video, being one special TV programme, capturing the highlights of the 2003 Festival, for airing and distribution to networks for broadcast in overseas markets with a view to expanding the broadcast coverage of the programmes;
  - (d) AmCham shall take all reasonably prudent steps to secure its or the SPV's Intellectual Property Rights in relation to the Hong Kong Harbour Fest and related matters;
  - (e) AmCham shall use reasonable endeavours such that the secured performing talents shall take part in side programmes as arranged by AmCham, and/or other promotional activities as the Government may reasonably request from time to time during their stay in Hong Kong, for the purpose of promoting Hong Kong;
  - (f) AmCham shall cause proper books of account in relation to the 2003 Festival to be kept with respect to :

- (i) all sums of money received and expended and the matters in respect of which the receipt and expenditure takes place;
  - (ii) all sales and purchases of goods; and
  - (iii) all assets and liabilities;
- (g) AmCham shall procure that there shall be prepared and submitted to the Government the following information as soon as reasonably practicable after their preparation by the appointed accountants:
  - (i) the Business Plan;
  - (ii) the Budget;
  - (iii) a review of the Budget; and
  - (iv) audited accounts in relation to the 2003 Festival not later than 28 February 2004 (to include an analysis of revenue and a statement of the source and applications of funds);
- (h) AmCham shall use its best endeavours to procure compliance by the SPV with all legislation and regulations regarding health and safety and crowd security matters relating to the 2003 Festival Site;
- (i) AmCham shall procure that the SPV shall, as part of the Organising Expenses, at all relevant times in relation to the 2003 Festival take out and maintain appropriate insurance cover.
- (j) Save as otherwise provided in the Fourth Schedule, the SPV shall, at its own cost provide, manage and implement all security measures and services relating to the 2003 Festival as part of the Organising Expenses;
- (k) AmCham shall ensure that all press releases to the media by it mentioning the Government are approved in advance by the Government who shall likewise allow AmCham an approval right in

relation to any releases which mention AmCham, the SPV or the 2003 Festival, such approval not to be unreasonably withheld or delayed by either party;

- (l) AmCham shall consider all reasonable requests from the Government or its agents to run joint promotional activities;
  
- (m) AmCham shall use its best endeavours to uphold the good name, image and reputation of the Government in relation to the 2003 Festival and shall not make any statements or engage in conduct which is likely to damage or bring into disrepute the name and/or image and/or reputation of the Government. AmCham shall ensure that the obligation to uphold the Government's image as referred to in this paragraph is notified to all of its employees, contractors and agents.

律政司  
民事法律科

香港金鐘道 66 號  
金鐘道政府合署高座 3 樓  
圖文傳真: 852-2869 0670  
852-2868 1068



DEPARTMENT OF JUSTICE  
Civil Division

3/F., High Block  
Queensway Government Offices  
66 Queensway, Hong Kong  
Fax: 852-2869 0670  
852-2868 1068

本司檔號 Our Ref.: ADV/5002/105/2C  
來函檔號 Your Ref.: CB(3)/PAC/R42  
電話號碼 Tel. No.: 2867 2096

6 May 2004

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

**URGENT BY FAX: 2537 1204**

Attn: Ms. Miranda Hon, Clerk  
Public Accounts Committee

**The Director of Audit's Report on the  
results of value for money audits (Report No. 42)**

**Chapter 4: Hong Kong Harbour Fest**

Thank you for your letter of 4 May 2004 which was referred to me for reply.

With reference to the questions raised in paragraph 4 of your letter, I set out the information as follows:

- (a) Whether the Department of Justice was consulted on any of those agreements at any stage, and if so, when and by whom?

The Department of Justice was not consulted on any of the three Memoranda of Understanding. This Department was however consulted on the draft agreement between the Hong Kong Government and AmCham. On 1 August 2003, this Department received the request for advice on the draft agreement prepared by InvestHK vide its memo dated 30 July 2003.

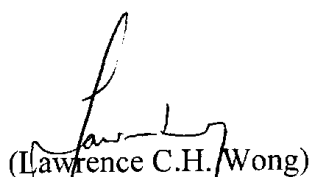
- (b) Whether any advice or comments were given upon such consultation and if so, when were they given and whether they were accepted and/or reflected in the agreements?

This Department was first consulted on 1 August 2003 after the Economic Relaunch Working Group, chaired by the former FS, agreed in principle that the Government would sponsor the Harbour Fest and after the Government and AmCham entered into a legally binding MOU which provided, amongst other things, for the first instalment (HKD\$25 million) of the sponsorship fee payable to Amcham. The Department of Justice was given two draft Agreements, one prepared by AmCham and the other by InvestHK. This Department was invited to comment on some specific clauses in the draft agreement prepared by InvestHK to ensure that the wording accurately reflected the intention of InvestHK.

In response to the specific requests, advice was given on 8 August 2003 and subsequently prior to the execution of the agreement.

Most of the advice was adopted. As the Committee will appreciate, I am subject to the rules of legal professional privilege as regards the extent of disclosure of full details or content of the advice given. However, I am able to say that this Department had raised the provision for access to documents in AmCham's possession and was instructed that that the requirement for AmCham to prepare proper books of account and to submit independently audited accounts of the festival should instead be incorporated in the Agreement. This was because the Government had decided to limit its role to that of sponsor only, and AmCham would be responsible for planning, organising and implementing the event.

Yours sincerely,



(Lawrence C.H. Wong)  
Deputy Principal Government Counsel  
(Commercial) I

c.c.	Financial Secretary	2840 0569
	Director-General of Investment Promotion	3107 9027
	Director of Audit	2583 9063
	Secretary for Financial Services and the Treasury	2147 5239
	(Attn: Mr Manfred Wong)	

Our Ref : L/M to IHK/AMB/2/3 IV

Your Ref: CB(3)/PAC/R42

21 May 2004

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

{Urgent by fax}

Dear Ms Hon,

**The Director of Audit's Report on the  
Results of Value for Money Audits (Report No. 42)  
Chapter 4 : Hong Kong Harbour Fest**

I refer to your letter of 14 May 2004.

On (a), I did not make specific reference to the Government guidelines "Miscellaneous Subventions – Guidelines on the Management and Control of Government Subventions" in connection with the organisation of Harbour Fest, although I was generally aware of them.

We relied in part on our past experience of event sponsorship, for example the Fortune Global Forum 2001, the Forbes Global CEO Conference 2002, the Business Week CEO Forum in 2003, the World Economic Forum's East Asia Economic Summit, annual meetings of the Cable & Satellite Broadcasting Association of Asia etc. In none of these did we seek access to the accounts.

Having regard to the special circumstances of Harbour Fest and the amount of Government sponsorship, we felt we should go further than our usual practice. Hence in seeking DoJ's advice on the draft Sponsorship Agreement we sought specific input on the following aspects:

- (i) whether the provisions were sufficient to make AmCham revise the budget when there were changes to the programme of events for the festival, including the performing talents;
- (ii) whether the provisions were adequate to make AmCham expend the Government sponsorship fee in accordance with the budget (which

Invest Hong Kong 投資推廣署

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would have to be agreed by the Government);

- (iii) whether the provisions adequately reflected the Government's intention that if the actual shortfall were smaller than the amount already advanced to AmCham, the latter should refund the difference to the Government; and
- (iv) whether (and, if so, how) any express reference should be made to the MoU signed with AmCham and the advance of sponsorship fee paid.

Having regard to DoJ's advice on these points, we felt that requiring AmCham to have the Harbour Fest accounts independently audited and submitted to us represented a reasonable balance between the relatively limited requirements of sponsorship and the need for public accountability.

On (b), the MoUs were simple documents setting out the understanding between the two parties on their respective roles on Harbour Fest in anticipation of the full Sponsorship Agreement. Clauses 1.1 to 1.4 set out the commitment of AmCham, the decision of Government (as made by ERWG) and pointed toward a full Agreement setting out in detail each party's rights and obligations regarding the sponsorship arrangement.

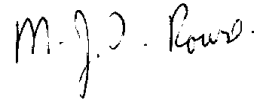
The MoUs were signed to register the commitment of both parties and provide a basis for the Government to make an advance payment of the approved sponsorship fee to AmCham. There was a perceived urgency for the advance payment as AmCham indicated that it needed to commit some upfront payments for the preparation of the festival. At the time when the first MoU was signed, a draft of the Sponsorship Agreement had been prepared and was pending legal advice. The formal signing of the contract was expected to be forthcoming imminently. However, the negotiation of some terms and conditions in the Agreement took a longer lead-time than originally envisaged because priority had to be given to other aspects of Harbour Fest preparation. Two more MoUs on identical terms were subsequently signed before the 10 October Agreement itself was formally signed.

It is worth recording that time was of the essence. In an ideal situation we should have proceeded to draw up and sign the full contract first before AmCham began preparation of the festival, including submission of a comprehensive business plan to Government for approval, and before any advance payment was made to AmCham. Under such a scenario, there would have been no need for any MoU at all. However, the Harbour Fest event was targeting a very narrow window of opportunity in the autumn of 2003. In practice, both the Government and the AmCham were fully committed to the Harbour Fest project in good faith. When signing the MoUs, neither side contemplated that the final Agreement would not come through.



I hope the above clarifications would be useful to the Committee.

Yours sincerely,

A handwritten signature in black ink, appearing to read "M. J. T. Rowse". The signature is written in a cursive style with some loops and flourishes.

(M J T Rowse)  
Director-General of Investment Promotion

cc Financial Secretary  
Director of Audit  
Secretary for Financial Services and the Treasury  
(Attn: Mr Manfred Wong)

Our Ref : L/M to IHK/AMB/2/3 IV

27 May 2004

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

Dear Ms Hon,

**The Director of Audit's Report on the  
Results of Value for Money Audits (Report No. 42)  
Chapter 4 : Hong Kong Harbour Fest**

I refer to your letter of 21 May 2004.

I wish to take this opportunity to set out the background leading to the signing of the Memorandum of Understanding (MoU) between the Government and the American Chamber of Commerce in Hong Kong (AmCham) on Harbour Fest, before both parties entered into the final Sponsorship Agreement.

After InvestHK had conveyed to AmCham the Economic Relaunch Working Group's (ERWG) decision of 12 July 2003 that the Government would sponsor Harbour Fest and that AmCham had to plan, organise and implement the whole event, AmCham came up with a draft Sponsorship Agreement on 24 July prepared by its lawyer. We made some initial comments and suggested amendments with a view to setting out more precisely the respective rights and obligations of the two signing parties, and sent out the revised draft document to the Department of Justice (DoJ) for legal advice on 30 July. We also included some specific questions on which we invited DoJ's comments, the details of which are set out in Mr Rowse's letter to you of 21 May.



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In parallel, AmCham was proceeding with the preparation for the Harbour Fest event itself. I recall Mr Jim Thompson had approached me exploring the possibility of the Government making an advance payment, equivalent to 25% of the approved sponsorship fee, in order that AmCham would be able to settle some essential upfront payments. We were always mindful of the need to protect the interest of Government in view of the substantial amount of public money involved, notwithstanding the fact that the sponsorship fee had already been approved by ERWG. On the other hand, as the subject department responsible for coordinating Government's support and facilitation to enable this economic relaunch project to proceed as smoothly as possible, we needed to strike the right balance with flexibility within our scope of authority. Against this background, we entered into a simple legal document in the form of an MoU with AmCham, setting out the understanding between the two parties on their respective roles on Harbour Fest in anticipation of the full Sponsorship Agreement. This also provided the formal basis for making an advance payment of sponsorship fee to AmCham.

We did not consult DoJ specifically on the MoU because it was a simple legal document pointing to the final Sponsorship Agreement that the Government and AmCham would enter into and most important of all, there was a perceived urgency for executing the document before any advance payment of sponsorship fee could be made to AmCham. I understand it is not unprecedented for Government bureaux/departments not to seek legal advice from DoJ on grounds of perceived urgency. In his letter to the Inquiry Panel dated 11 February 2004, the relevant DoJ officer states inter alia *"there is no general requirement for a government bureau or department to consult the Department of Justice on every contract it enters into. From experience government bureaux or departments might not consult the Department of Justice for legal advice for various reasons such as the absence of legal implications, the perceived urgency of the matter or in respect of the renewal of contracts in similar terms to those previously cleared by this Department"*.

On your paragraph 4(a), the acting arrangements to cover Mr Rowse's absence on leave/duty visits are as follows:

- (a) 14.7.03 to 27.7.03 ADG(1) Mr John Rutherford doubling up  
 28.7.03 to 10.8.03 ADG(2) Mr Simon Galpin doubling up  
 11.8.03 to 16.8.03 ADG(3) (myself) doubling up
- (b) 21.8.03 to 22.8.03 ADG(1) Mr John Rutherford doubling up
- (c) 25.8.03 to 30.8.03 ADG(3) (myself) doubling up.

On (b), I was deputising for Mr Rowse on all matters relating to the economic relaunch campaign, including the Harbour Fest. In the light of the need for the organisation of the Harbour Fest to proceed as smoothly as possible as explained earlier, I saw the need to effect the MoU urgently. I also considered this to be fully in line with ERWG's decision to sponsor and support the Harbour Fest. For the first MoU, I sent out an email on 30 July 2003 to Mr Rowse's home email address informing him about it and the advance payment. I also briefed the Acting DGIP on the MoU, but accepting that he was not at all familiar with the background to the economic relaunch campaign, I was prepared to sign it on my own authority. For the second MoU, I was the Acting DGIP myself though I signed it in the capacity of my substantive post.

On (c), as explained in the preceding paragraph, I had informed the Acting DGIP and had sent an email to Mr Rowse on the first MoU, but not on the second occasion when I was acting DGIP.

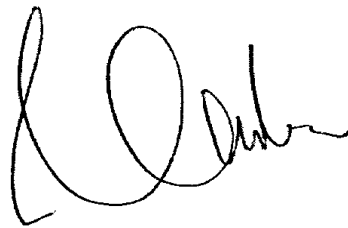
On (d), I updated Mr Rowse on the progress of Harbour Fest, including the advance payments, on each occasion after he returned from leave/duty trip, though I do not recall the details of our discussions given the lapse of time.

On (e), I do not consider there was any negligence at all regarding my signing the two MoUs, which as mentioned above were part of implementing the ERWG's sponsorship decision on Harbour Fest under very exceptional circumstances. With the benefit of hindsight, we could have adopted a holding line and invited DoJ's input before responding to AmCham's request for urgent

advance payment of sponsorship fee (which was already approved by ERWG) in the absence of a full Sponsorship Agreement. However, time was of the essence, and the full Agreement was being drawn up in consultation with DoJ. As Mr Rowse has pointed out in his letter, both the Government and AmCham were fully committed to the Harbour Fest project and acting in good faith. When signing the MoUs, neither party contemplated that the final Agreement would not come through.

I hope the above would be useful to the Committee.

Yours sincerely,

A handwritten signature in black ink, appearing to be 'Ophelia Tsang', written in a cursive style.

(Ms Ophelia Tsang)  
Associate Director-General of Investment Promotion

c.c. Financial Secretary  
Director of Audit  
Secretary for Financial Services and the Treasury  
(Attn: Mr Manfred Wong)

Our Ref : LM to IHK/AMB/2/3 IV

21 May 2004

Mr Eric Li  
Chairman  
Public Accounts Committee  
c/o Legislative Council Building  
8 Jackson Road  
Central  
Hong Kong

{Urgent by fax}

Dear Sir,

**Harbour Fest  
Memorandum of Understanding**

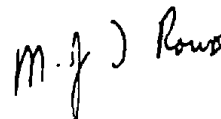
At the meeting of the Public Accounts Committee held on 20 May 2004, in response to a Member's question, I indicated that I did not recall having seen the first MoU dated 31 July 2003 before it was signed and arrangement made for payment of \$25 million to AmCham. That statement remains correct, but is incomplete.

After an exhaustive search of our records, we have found an e-mail dated 30 July sent by my deputy Ms Ophelia Tsang to my personal e-mail address at home. I did not see that e-mail until 3 August as I was on leave and out of town.

I would like to apologise for this lapse of memory, and hope this letter clarifies the position.

I would also like to repeat my statement to the Committee that Ms Tsang's decision to sign the MoU and effect payment was in my opinion understandable in the exceptional circumstances prevailing. I take full responsibility for it.

Yours faithfully,



(M J T Rowse)

Director-General of Investment Promotion

**Invest Hong Kong 投資推廣署**

**The Government of the Hong Kong Special Administrative Region 香港特別行政區政府**

15th Floor, One Pacific Place, Queensway, Hong Kong 香港金鐘太古廣場第一期十五樓

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cc Financial Secretary  
Secretary for Commerce, Industry and Technology  
Director of Audit  
Secretary for Financial Services and the Treasury  
(Attn: Mr Manfred Wong)

Lucille A. Barale  
Chairman



THE AMERICAN  
CHAMBER OF COMMERCE  
IN HONG KONG

國  
商  
會

May 20, 2004

By hand and by email (*URGENT*)

Ms. Miranda Hon  
Clerk  
Public Accounts Committee  
Legislative Council of the HKSAR  
Legislative Council Building  
8 Jackson Road  
Central  
Hong Kong

Dear Ms. Hon,

**The Director of Audit's Report No. 42 on the  
results of the value for money audits**

This letter will reply to the questions listed in your letter of 10 May 2004 to our American Chamber of Commerce in Hong Kong ("AmCham"). We wish to thank you for granting us an extension of time until 20 May to reply to those questions. We have sought answers from files and persons directly associated with organizing Harbour Fest.

- (a)(i) Mr. Jon Niermann was the AmCham member who was instrumental in making the arrangements for the video. We understand from Mr. Niermann that originally the plans were that "Disney/ABC will help produce a TV special," and that this was stated in presentations made to the Economic Relaunch Working Group. AmCham does not have records showing how the commitments to produce or air the video were obtained. Mr. Niermann, who is no longer with Disney, is familiar with the details of the arrangements.
- (a)(ii) AmCham does not have any records which would help us answer your question regarding the statement that "regarding the network, we almost have to live by 'beggars can't be choosers'." We understand that the comment was



**Lucille A. Barale**  
Chairman



**THE AMERICAN  
CHAMBER OF COMMERCE  
IN HONG KONG**

美  
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會

made by Mr. Niermann and may have been a reference to the lack of a specified budget for promoting the airing of the video.

(b) We understand from Mr. Jim Thompson, our former Chairman, and Mr. Niermann that the announcement on 3 September was an indicative list of the talent line-up based on oral commitments.

(c) Our understanding is that the plans for the Rolling Stones concerts were made in consultation between Mr. Thompson and representatives of the Government. The Rolling Stones concerts were to be a major highlight of Harbour Fest. Both concerts were sold out and thoroughly enjoyed by those who attended. This was acknowledged in the press coverage. We have no files with materials on the financial results of the Rolling Stones concerts. We believe that Mr. Thompson has already provided as much detail as possible on this question.

In response to your request, we are also providing a Chinese version of this letter. Please let us know if you have further questions. We wish to cooperate with the Public Accounts Committee to the fullest extent possible.

Yours sincerely,

Lucille A. Barale  
Chairman

cc: Mr. Frank Martin  
President, The American Chamber of Commerce in Hong Kong

Our Ref : LM to IHK/AMB/2/3 IV

15 June 2004

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

Dear Ms Hon,

**The Director of Audit's Report on the  
Results of Value for Money Audits (Report No. 42)  
Chapter 4 : Hong Kong Harbour Fest**

I refer to your letter of 7 June 2004.

On (a), following the broadcast of the TV special on Harbour Fest in the USA on the MTV2 and MTV channels in January and February 2004 respectively, the same video was aired locally in Hong Kong on TVB Pearl on 1 May and in 34 countries in Asia and the Middle East in May on the STAR World International and STAR World India channels. According to AC Nielson, the third airing of the video on the MTV channel achieved a viewership of 0.2 million households in the USA, representing about 314,000 viewers. The American Chamber of Commerce in Hong Kong (AmCham) advised that the ratings for MTV2 are not released to the public. TVB has advised that there were 136,000 viewers of the local showing. STAR has also advised that the five broadcasts on their channels (two broadcasts on 5 & 6 May on STAR World International and three broadcasts on 19 & 20 May on STAR World India) were seen by 625,000 people in Hong Kong, Singapore, India and metro Manila. STAR World reaches 15 million homes in the 34 countries, but it is not possible to quantify the total number of people who watched the TV special as the company

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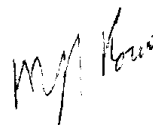
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does not monitor the viewership in places other than the four mentioned.

On (b), InvestHK wrote to AmCham on 27 May 2004 requesting permission for the Director of Audit to have access to the records of AmCham and Red Canvas Limited on matters relating to Harbour Fest. We are still awaiting a formal reply from AmCham, but have been advised that both AmCham and Red Canvas are prepared to allow access to the same files as examined by the Panel of Inquiry.

In passing, you may wish to note that the ICAC is carrying out an investigation, and the Administration has also referred the Inquiry Panel Report to the Police for further follow-up action as deemed necessary.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'M J T Rowse', written in a cursive style.

(M J T Rowse)

Director-General of Investment Promotion

c.c. Financial Secretary  
Director of Audit  
Secretary for Financial Services & the Treasury  
(Attn.: Mr Manfred Wong)



*From the desk of the  
Director-General  
投資推廣署署長用箋*

Our Ref : IHK/AMB/2/3 IX  
Your Ref : CB(3)/PAC/R42

6 May 2004

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

**Urgent by Fax**

Dear Ms Hon,

**The Director of Audit's Report on the  
Results of Value for Money Audits (Report No. 42)**

**Chapter 4 : Hong Kong Harbour Fest**

Thank you for your letter of 3 May 2004.

On (a), the breakdown of the talent budget of \$73.3 million as submitted by the American Chamber of Commerce in Hong Kong (AmCham) on 6 July 2003 is enclosed.

As regards the breakdown of the expenditure of \$89.1 million for artist fees in the audited accounts of Red Canvas, we understand from AmCham that a confidentiality agreement exists covering all contracts of talents performing in Harbour Fest. Against this background, we do not have access to and hence are unable to provide the Committee with the breakdown.

On (b), AmCham has advised that there are no profit and loss accounts for individual shows of Harbour Fest, because a number of overhead costs are spread over the various shows in the festival.

On (c), AmCham has advised us that the 12 000 complimentary tickets were mainly distributed to commercial entities (e.g. shops and

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restaurants, etc), which were either sponsoring the festival in kind or providing assistance in support of the festival (e.g. help distribute flyers and/or put up posters in their premises, etc). According to AmCham, most of these tickets were for the less expensive seats. However, they have not been able to provide further details of the breakdown of distribution.

I shall be pleased to discuss further if you or the Committee require any further clarification.

Yours sincerely,

A handwritten signature in black ink, appearing to read "M J T Rowse". The signature is written in a cursive style with a large initial "M".

(M J T Rowse)  
Director-General of Investment Promotion

cc AA/FS

# *Hong Kong International Autumn Festival*

<i>Talent Budget</i>	COMPONENT TOTAL IN USD
Talent costs all delivered: (fees plus all expenses)	
Bruce Springsteen and Band	1,800,000
Family Festival	450,000
Viva Las Vegas	850,000
Linkin Park or J Lo	750,000
NBA Experience	500,000
X Games	200,000
Asian Pop Stars/Coco Lee	1,000,000
Sting	1,000,000
Jazz and Comedy Fest	500,000
Blues Fest with James Brown	400,000
Kylie or Britney or Faith	1,000,000
Santana or Enrique	800,000
Taste of Hong Kong	150,000
<b>TOTALS</b>	<b>\$ 9,400,000</b>

Our Ref : L/M to IHK/AMB/2/3 IV  
Your Ref: CB(3)/PAC/R42

27 May 2004

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

*{Urgent by fax}*

Dear Ms Hon,

**The Director of Audit's Report on the  
Results of Value for Money Audits (Report No. 42)  
Chapter 4 : Hong Kong Harbour Fest**

I refer to your letter of 21 May 2004.

On (a), I do not recall any person saying at the public hearing on 20 May that I had knowledge of the artist fee for the Rolling Stones concerts at the Harbour Fest. My only comment on this subject was in respect of Miss Ironside's proposals to us. One, dated 8 July 2003, quoted a total fee of HK\$50.57 million (US\$6.48 million) for the Rolling Stones to perform two shows at the Hong Kong Stadium, including artist fee, staging and production and freight and airfares. The anticipated deficit for the two shows was in excess of HK\$18 million, and Miss Ironside was seeking Government sponsorship to offset it. I had no knowledge of the artist fee actually paid by AmCham.

On (b), Miss Ironside submitted later in the same month (July 2003) a revised proposal for a single show by the Rolling Stones, again at the Hong Kong Stadium. This time, the quoted total fee was substantially reduced to HK\$24.12 million. She was seeking Government subsidy in the order of HK\$6 million.

On (c), I have written to the current Chairman of the American Chamber of Commerce in Hong Kong (AmCham), and am still awaiting her response. I shall advise the Committee of the outcome as soon as a reply from AmCham is available.

On (d), we are seeking the advice of the Economic Relaunch Working Group and other Government departments concerned, and will determine

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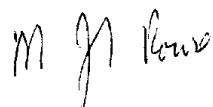
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the way forward as soon as possible.

You also sought information about other events sponsored by our department. In this connection, I wish to take the opportunity to reiterate that InvestHK is the Government's investment promotion agency. Established in July 2000, we exist to attract and retain in Hong Kong economically and strategically important investment. The department's structure and working procedures are all geared to the same end. In the course of its investment promotion work, InvestHK has acquired some experience in the field of event sponsorship and in giving limited assistance to event organisers. However, we do not ourselves organise or co-organise major events. The events we sponsor are organised by private organisations on commercial or semi-commercial lines. Our sponsorships are in the form of a pre-determined fixed amount for an event and not in the form of deficit financing subject to a ceiling amount. Accordingly, we do not seek access to the accounts of the sponsored event. Hence, we are unable to compare the amount of our sponsorship with the total expenditure incurred by the organisers in any particular past event. As a sponsor, our main focus is with the profile of the organiser and event itself, the composition of its target audience, the cost and benefits of the sponsorship deal, etc.

I hope the above clarifications would be useful to the Committee.

Yours sincerely,



(M J T Rowse)

Director-General of Investment Promotion

cc Financial Secretary  
Director of Audit  
Secretary for Financial Services and the Treasury  
(Attn: Mr Manfred Wong)





康樂及文化事務署  
Leisure and Cultural Services Department

電話 TEL: 2601 8966  
圖文傳真 FAX NO: 2602 0297  
本署檔號 OUR REF: (3) in LCS 1/HQ 1802/04 II  
來函檔號 YOUR REF:

18 May 2004

Mr. Colin CHUI  
Clerk  
Public Accounts Committee  
(By Fax : 2537 1204)

Dear Mr. CHUI,

**The Director of Audit's Report on the  
Results of value for money audits (Report No. 42)**

Thank you for your letters dated 7 and 11 May 2004.

As requested, I enclose the following additional information which was requested by the Public Accounts Committee at its public hearing held on 7 May 2004: -

- (a) The Leisure and Cultural Services Department (LCSD) was not aware in advance of the adverse impact of the Stage 1 of the Harbour Area Treatment Scheme (HATS) on the water quality of the gazetted beaches in Tsuen Wan District. On 15 January 2003, LCSD asked Environment Protection Department (EPD) to provide us with a report on the water quality of the gazetted beaches to enable us to determine the opening arrangement of beaches in the swimming season of 2003. This was a normal step to take annually. In response, Environmental Protection Department (EPD) informed us on 22 January 2003 that the water quality of the seven beaches in Tsuen Wan District had deteriorated as a result of the commissioning of the Stage 1 of the HATS and recommended us to close all the seven gazetted beaches along the coastal line of Tsuen Wan. In anticipation that the Tsuen Wan District Council would have strong reaction on the closure of the beaches, we expressed our concern to EPD and requested EPD to


attend the relevant committees of the Tsuen Wan District Council in February and March 2003 to explain to the members the reasons for deterioration of the water quality and the subsequent closure of these beaches. EPD admitted that the deterioration of water quality in Tsuen Wan beaches was not anticipated upon the full commissioning of Stage 1 of the HATS at one of these committees. The relevant document and a summary of sequence of events related to the above incidents are attached at the **Appendix**.

In view of the closure of the four gazetted beaches, we have at the Tsuen Wan District Council meetings held in February and March 2003 promoted the use of a number of nearby swimming facilities such as the Ma Wan Tung Wan Beach in Tsuen Wan District and the five beaches in Tuen Mun District, namely Butterfly, Kadoorie, Cafeteria Old, Cafeteria New and Golden Beaches. In addition, we have also at the same meetings promoted the use of two public swimming pools in Tsuen Wan District, namely Shing Mun Valley Swimming Pool and Tsuen King Circuit Wu Chung Swimming Pool. Moreover, improvement works at Ma Wan Tung Wan Beach including re-sanding, renewal of shark prevention net and refurbishment of the beach building have been completed in April and May 2004. We have set up two new beach volleyball courts at the Lido Beach in July 2003 to promote the use of land based facilities. In addition, we have produced pamphlets and booklets to introduce the public swimming pools and gazetted beaches managed by LCSD. At the same time, information on these facilities is uploaded to the web page of LCSD for publicity.

- (b) On the question as to whether the 29 established lifeguard posts for the Rocky Bay Beach and the seven beaches in Tsuen Wan District will be deleted, we would like to reiterate that, as a matter of fact, the 29 lifeguard posts have already been frozen and unfilled since the closure of these gazetted beaches. The lifeguards previously deployed to these beaches have been redeployed to fill other vacant posts elsewhere. In consideration of a recent advice from EPD that the Stage 2 works of HATS for improvement of the beach water quality of Tsuen Wan will take at least thirty months to complete, we agree that these 29 posts are unlikely to be filled in the near future and we will delete these posts.

- (c) We have conducted a review on the cost-effectiveness of deploying 6 Amenities Assistant IIIs (AAIIIs) stationed at the closed beaches including the Rocky Bay Beach and the seven beaches in Tsuen Wan District. The one AAIII originally stationed at Rocky Bay Beach has already been redeployed to Shek O Beach. For the remaining 5 AAIIIs, we shall retain one AAIII to carry out daily management of the seven closed beaches in Tsuen Wan District. The other 4 AAIIIs would be deployed to other leisure venues as soon as possible.

Yours sincerely,



(Paul K K CHEUNG)

for Director of Leisure and Cultural Services

c.c. Secretary for Home Affairs  
Director of Audit

**Sequence of Events on  
Closure of Gazetted Beaches in Tsuen Wan District**

- The Anglers' Beach was closed since 1994 because of consistent very poor water quality.
- The Approach Beach and Ting Kau Beach were closed since 1996 because of the very poor water quality due to local pollution.
- On 15 January 2003, the Leisure and Cultural Services Department (LCSD) asked Environment Protection Department (EPD) to provide a report on the water quality of the gazetted beaches for determining the opening arrangement of beaches in the swimming season of 2003. Please see **Annex I**.
- On 22 January 2003, EPD informed LCSD for the first time that upon the full commissioning of Stage 1 of the Harbour Area Treatment Scheme (HATS), sewage generated from around the Victoria Harbour has been transferred to Stonecutters Island Sewage Treatment Works for treatment, and then discharged into the sea near Stonecutters Island. As a result, the water quality of the Tsuen Wan Beaches has deteriorated significantly. Since the remaining stages of HATS would not be completed in the next few years, EPD advised that the water quality of these beaches would not improve before 2006. To safeguard the health of bathers, EPD advised LCSD to close the remaining four beaches along the Tsuen Wan coast, including Lido, Casam, Hoi Mei Wan and Gemini Beaches, in the 2003 swimming season. Please see **Annex II**.
- In reply to EPD's request, we expressed our concern on the deterioration of the water quality of beaches along the Tsuen Wan coast. In addition,

we also advised EPD that we anticipated strong reaction from the Tsuen Wan District Council as it had all along been anxious for improvement of the water quality and knew that mitigation measures were being taken along Castle Peak Road and Sham Tseng by diverting the sewage and providing treatment plants. We have also asked EPD to attend the relevant committees of the Tsuen Wan District Council in February and March 2003 to explain to members the reasons for the deterioration of the water quality. Please see **Annex III** on our reply to EPD and **Annex IV** on the relevant Tsuen Wan District Council paper.

- On 25 February 2003, the LCSD informed the Tsuen Wan District Council of the closure of the seven beaches along the Tsuen Wan coast with background information about Harbour Area Treatment Scheme (HATS) provided by EPD. Officers of EPD were invited to take questions from Tsuen Wan District Council. A copy of the relevant Paper and minutes of the meeting is at **Annex IV**.
- Although the seven beaches in Tsuen Wan District have been closed since 1 April 2003, the land-based facilities remain open to the public.
- On 7 May 2004, we wrote to EPD to seek its advice on the remedial measures to be taken and target date for improvement of water quality at the seven closed gazetted beaches in Tsuen Wan District. Please see **Annex V**.
- On 12 May 2004, EPD advised that it will take 30 months to complete the Stage 2 works of HATS for improvement of the beach water quality of Tsuen Wan subject to the availability of funding for the project. Please see **Annex VI**.

*\*Note by Clerk, PAC: Annexes I to VI not attached.*

政府總部  
公務員事務局  
香港下亞厘畢道



CIVIL SERVICE BUREAU  
GOVERNMENT SECRETARIAT  
LOWER ALBERT ROAD  
HONG KONG

本函檔號 Our Ref.: MP/P350/172 Pt.9 (TC)

來函檔號 Your Ref.:

電話號碼 Tél. No.: 28102746

傳真號碼 Fax No.: 25305827

電郵地址 E-mail: csbts@csb.gov.hk

21 May 2004

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. 42)**

**Chapter 9: Training, employment and  
residential services for people with disabilities**

Thank you for your letter on the above subject of 13 May 2004.

We have confirmed with the Social Welfare Department (SWD) that there is at present no need for transferring any of its surplus staff to non-governmental organizations (NGOs) or other government departments as all of them have been gainfully redeployed within the department to meet new service needs. Notwithstanding, if such a need arises in future, we will assist in identifying redeployment opportunities elsewhere in the civil service to accommodate the surplus staff as far as practicable. As regards the suggestion to transfer surplus staff to NGOs, it involves quite a number of issues such as whether the NGOs are prepared to take on the surplus staff, funding arrangement, staff sentiments, etc.

Yours sincerely,

A handwritten signature in black ink, appearing to be 'Sharon Yip', written in a cursive style.

( Mrs Sharon YIP )  
for Secretary for the Civil Service

c.c. Director of Social Welfare (Attn: Mr Paul TUNG)  
Director of Audit



中華人民共和國香港特別行政區政府總部衛生福利及食物局  
Health, Welfare and Food Bureau  
Government Secretariat, Government of the Hong Kong Special Administrative Region  
The People's Republic of China

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電話號碼 Tel No.: 2973 8116  
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15 June 2004

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. 42)**

**Chapter 9: Training, employment and  
residential services for people with disabilities**

Your letter dated 13 May 2004 on the above subject refers.

The information requested in your letter is set out below:

- (a) at present, the average cost of treating an extended care patient in a HA hospital is about \$1,260 per day. The unit cost of a residential place in Long Stay Care Home (LSCH) receiving subvention from SWD is about \$304 per day. Based on these cost estimates, the difference is \$956 per day. It should be noted that the service needs of patients and residents of LSCH are very different and this is reflected in the different costs of providing extended care in the hospital and residential service in the LSCH settings;



- (b) as at 31 March 2004, there were 919 applicants on SWD's waiting list for a place in LSCH and 466 of them were receiving in-patient treatment in HA hospitals. It should be noted that the circumstances of these 466 applicants might have changed since they first came on the waiting list. At present, when a LSCH place becomes available, the first applicant on the list, if he/she happens to be receiving in-patient treatment in a hospital, would be reviewed to assess his/her suitability to be transferred to a LSCH and his/her personal and family preference for such transfer. Some applicants might decline the transfer. Hence it would be difficult to state whether all the 466 applicants are suitable and ready to be transferred. It should also be noted that as mental illness is a chronic illness, the beds vacated by chronic patients may eventually be filled by other mentally ill patients who require hospitalization and the 'savings' resulting from the transfer may not necessarily materialise.
- (c) hospitals and LSCH provide different and essential treatment and services for the rehabilitation of chronic mental patients characterized by relapses and remissions. There is a strong demand for their treatment and services. It is necessary to adopt a prudent and holistic approach in examining any proposal on transfer of resources. We would need to establish that the arrangement suggested in paragraph 3(c) of your letter (i.e. an arrangement whereby the admission of an applicant for long term residential care service who is in a hospital to a Long Stay Care Home will be accompanied by a corresponding budget transfer from HA to SWD) will not affect medical care for patients with chronic mental illness.

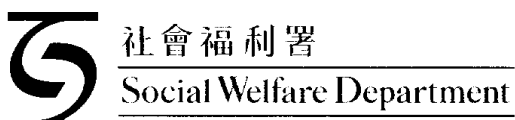
Yours sincerely,



( Susie Ho )

for Secretary for Health, Welfare and Food

c.c. Director of Social Welfare  
Chief Executive, Hospital Authority  
Director of Audit



Our Ref. : SWD 103/980/87 II  
Your Ref. : CB(3)/PAC/R42  
Tel. No. : 2892 5151  
Fax No. : 2838 0757

By Fax & Post

17 May 2004

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. 42)**

**Chapter 9: Training, employment and  
Residential services for people with disabilities**

Your letter of 6.5.04 refers. I would like to provide additional information on (a) to (e) as follows:

- (a) SHWF will give his comments in response to a separate letter being sent to him on 13.5.04 which covers the same subject.
- (b) Details of other more targetted services received by the applicants waitlisted for the various types of residential rehabilitation services and the number of applicants not receiving any regular service but likely receiving other general support services in the community are given at Annex. The services received by these applicants include regular day centre training programmes, home-based training service, supported employment and sheltered workshop and day care service. These programmes are under regular review of SWD and are generally well-received by the PWDs and their families.



In addition, there are other general support services in the community available to the PWDs including casework services, home help service, home care service, respite service, share care projects, mental health link, holiday care, gateway club, social and recreation centres, etc. to strengthen the capability of the families of the PWDs in taking care of the PWDs and to enhance their quality of living. However, the participation of the PWDs in these support services is not captured by the Central Rehabilitation System for Rehabilitation Services. Hence, it is likely that some of those grouped under column (f) are in fact receiving some form of general support services in the community.

It is also worth noting that not all applicants waitlisting for the residential services require immediate placement. For example, special school students, in-patients in the hospital or residents in other institutions. Hence, the waiting list and the waiting time have to be interpreted in such context.

- (c) SWD aims to start the internal review on the MCO by end June 2004 and this will take 4 to 5 months. The areas of review will cover the following functions of the MCO:
  - (i) to enhance the marketing orientation of Sheltered Workshops (SWs), Supported Employment Units (SEUs) and Integrated Vocational Rehabilitation Services Centres (IVRSCs), etc.;
  - (ii) to devise strategies for promoting and marketing the products and services of the SWs, SEUs and IVRSCs;
  - (iii) to secure sales orders and to co-ordinate SWs, SEUs and IVRSCs in procurement of large job orders;
  - (iv) to provide advice to Non-Governmental Organizations (NGOs) on setting up and running of small businesses; and
  - (v) to provide consultation to NGOs on productivity and marketing strategies, etc.

In conducting the review, the views of the NGOs, government departments and private enterprises who have had made use of MCO's services will be solicited via questionnaires and focus group meetings. The performance statistics of the MCO in the past two years will also be analysed. Yardsticks for measuring the MCO's effectiveness will include both qualitative and quantitative benchmarks. The number of



job orders obtained from government department may well be one of the quantitative benchmark.

We are still working on the details of the review and will seek the views of the Advisory Committee on Enhancing Employment of People with Disabilities comprising businessmen, financial/accounting/legal personnel, government officials and representatives of people with disabilities.

- (d) SWD had thoroughly checked and verified the sheltered workshop's daily attendance records, case review records, payment vouchers, bank autopay slips and salary pay lists and were found to be in order during the on-site assessment in August 2003.

The incorrect performance information stemmed from the agency's misinterpretation of the calculation method of the output standard of "Rate of progress review completed in a year". The agency had subsequently rectified the calculation methodology and attained the agreed level of this output standard in 2003-04. SWD will continue its close scrutiny to the performance information submitted periodically by the sheltered workshop.

- (e) SWD will consult the NGOs concerned regarding Audit's recommendation on asking service units to upload their annual plans and assessments of achievement of the plans onto their websites and inform the Public Accounts Committee in due course.

Yours sincerely,

(Paul TANG)

Director of Social Welfare

Encl.

c.c. Director of Audit  
Secretary for Health, Welfare and Food

**Services received by residential service applicants  
(31 March 2004)**

Service	No. on waiting list (a)	No. receiving day service (SE,SW,DAC, TAC,HBTS,DC/SD) (b)	No. living in other subvented residential rehabilitation service pending transfer (c)	Estimated no. of special school students <sup>1</sup> (d)	Estimated no. of cases still receiving in-patient treatment <sup>1</sup> (e)	No. who may be receiving general support services in the community <sup>2</sup> (f)
Long-stay care homes	919 100.0%	157 17.1%	136 14.8%		466 50.7%	160 17.4%
Hostels for severely mentally handicapped persons	1,870 100.0%	1,299 69.5%	118 6.3%	246 13.2%		207 11.1%
Hostels for moderately mentally handicapped persons	1,302 100.0%	854 65.6%	60 4.6%	149 11.4%		239 18.4%
Care-and-attention homes for severely disabled persons	361 100.0%	67 18.6%	39 10.8%	59 16.3%		196 54.3%
Hostels for severely physically handicapped persons	243 100.0%	105 43.2%	7 2.9%	42 17.3%		89 36.6%
Homes for the aged blind <sup>3</sup>	0 0.0%					0 0.0%
Supported hostels	262 100.0%	149 56.9%	27 10.3%	1 0.4%	8 3.1%	77 29.4%
Care-and-attention homes for the aged blind	121 100.0%	4 3.3%	15 12.4%			102 84.3%
Halfway houses	602 100.0%	109 18.1%	2 0.3%		306 50.8%	185 30.7%

Glossary

SE: supported employment      SW: sheltered workshop      DAC: day activity centre      TAC: training and activity centre      HBTS: home-based training and support service  
DC/SD: day care service for severely disabled persons

Note

1: Information mainly collected through referrers and therefore the figures provided are only by estimation.

2: The general support services included casework services, home help service, home care service, respite service, holiday care, share care projects,

mental health links, gateway club, social and recreation centre, etc. For supported hostel applicants, they may be engaged in open employment which is one of the admission criteria for the hostels.

3: The waiting list for the homes for the aged blind has been exhausted following the phasing out of the service in 2003-04 and all the waitlistees had been admitted to the service as appropriate.