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Panel on Information Technology and Broadcasting

Meeting on 13 February 2012

**Background brief on
the Design Incubation Programme**

Purpose

This paper summarizes previous discussions by Members on the Design Incubation Programme (DIP, also called "Incu-Design Programme").

Background

2. On 10 March 2004, the Financial Secretary announced in his Budget Speech that the Government would launch a "DesignSmart Initiative" (DSI) with the creation of a \$250 million fund. The purpose was to encourage more product design activities in Hong Kong and further promote Hong Kong brand names and DSI sought to strengthen the Government's support for design and innovation. Following consultation with the Panel on Commerce and Industry (CI Panel), the funding proposal was approved by the Finance Committee on 11 June 2004.

3. The DSI comprised two programmes, namely the Design Support Programme (DSP) and the InnoCentre Programme. Under the DSP, \$180 million was set aside for financing projects under four funding schemes¹. Under the InnoCentre Programme, \$45 million was allocated to the Hong Kong Design Centre (HKDC) for supporting its operation and \$25 million²

¹ The four funding schemes are: (a) Design Research Scheme; (b) Design-Business Collaboration Scheme; (c) Professional Continuing Education Scheme; and (d) General Support Scheme.

² According to the Administration, the funding has subsequently been adjusted to \$33.5 million having regard to the requirements of the industry.

was allocated to the Hong Kong Science and Technology Parks Corporation (HKSTPC) for running the DIP for design ventures. The DIP is one of three business incubation programmes³ operated by HKSTPC providing incubation services⁴ to assist technology and design start-ups in their vulnerable inception stages. The DIP is a two-year non-profit making programme. Design start-up companies admitted under the DIP (incubatees) are eligible for a financial assistance package, up to \$500,000, to help cover business development costs during their start-up period. The financial package consists of five categories of assistance, namely rental, promotion and development, operation, technical and management matters, and training.

4. The Innovation and Technology Commission (ITC) was responsible for managing the DSI until the establishment of Create Hong Kong (CreateHK) under the Communications and Technology Branch of the Commerce and Economic Development Bureau in June 2009 as the dedicated one-stop shop to drive the development of creative industries. The administration of DSI was subsequently transferred to CreateHK.

Previous discussions

Panel on Commerce and Industry

5. At the CI Panel meeting on 10 May 2004, members were briefed on the proposal for the implementation of DSI. The Panel supported in principle the proposed \$250-million DSI to promote innovation and design. On the proposal to fund the development of new design training courses by local organizations or in collaboration with overseas training organizations, Panel members were keen to ensure that the programmes funded by DSI should meet the needs of the industry. In the light of the operational experience of other funding schemes, members also urged the Administration to ensure that the application procedures should be kept simple so as to encourage prospective applicants.

³ The three incubation programmes provide incubation service specifically for start-ups in technology, biotechnology and design respectively.

⁴ Incubation services refer to the provision of support services, such as management training, customized marketing services, business matching, business advisory services, networking services, professional services such as legal and financial advice as well as provision of office accommodation at affordable rent rendered to start-up companies in their critical, initial stages of development for operation and growth.

Public Accounts Committee

6. The Audit Commission conducted a review from March 2007 to June 2008 to examine the economy, efficiency and effectiveness of the administration of the DSI managed by ITC. The review focused, among others, on the administration of the DIP. In Chapter 2 of the Report No. 51 of the Director of Audit (D of A) on the administration of DSI published in 23 October 2008, D of A commented that there were certain areas where the administration of DIP should be improved. These areas included, inter alia, utilization of rental assistance, milestone targets and documentation of milestone assessment, and participation rate of the mentorship programme. The observations and recommendations made by the Audit Commission are in **Appendix I**. The Public Accounts Committee (PAC) held two public hearings on 15 and 18 December 2008 on the Administration of the DSI. The summary of the conclusions and recommendations made by PAC on the issue is in **Appendix II**. According to the Government Minute (**Appendix III**) in response to the Report No. 51 of PAC dated February 2009 issued on 20 May 2009, HKSTPC had taken follow-up actions to address D of A's various recommendations and concerns.

Panel on Information Technology and Broadcasting

7. Following the establishment of the CreateHK in June 2009, and with the transfer of the administration of DSI from ITC to CreateHK, the report of the work of CreateHK was submitted to the Panel on Information Technology and Broadcasting (ITB Panel) for discussion.

8. At the ITB Panel meeting on 13 May 2010, members noted that as at end-March 2010, 62 design start-ups had been admitted to the InnoCentre as incubatees. These incubatees had won 28 awards including the prestigious iF Product Design Awards based in Germany, and had applied for 35 intellectual property rights.

9. Some Panel members noted that Hong Kong had 32 000 creative industry-related establishments with more than 176 000 practitioners working in the industries which made up around 5% share of Hong Kong's Gross Domestic Product. These members urged the Administration to draw up, in the long run, benchmarking target on the economic and social benefits to be brought about by creative industries, design and innovation against which to assess and evaluate the effectiveness of the various initiatives. These members also called for additional measures to assist start-ups in creative industries.

10. The Administration noted members' suggestion and advised that under DIP and the Cyberport's IncuTrain Programme, incubatees were provided with financial assistance to help cover part of the costs in office rental, operation, business promotion and development. Office space, access to specialized hardware and software facilities, business development advice, legal services and marketing support were also provided to incubatees at discounted rates.

Special Finance Committee meeting

11. At the special meeting of the Finance Committee to examine the Estimates of Expenditure 2011-12 on 21 March 2011, Hon Tanya CHAN raised a question on reviewing the effectiveness of existing support for local creative industry. The Administration advised that over 80 design start-ups had been admitted to the DIP since 2006. The incubatees had won around 40 awards and filed nearly 40 applications for patents.

Recent developments

12. In May 2011, the Administration issued an information paper on the consolidation of DSI and the CreateSmart Initiative (CSI)⁵ (CB(1)2134/10-11(01) issued on 9 May 2011). The purpose of the consolidation was to rationalize funding arrangements for the creative sector and streamline processing. The Administration advised that with the exhaustion of funding under DSI, it would seek funding for the initiatives related to design to be considered under CSI. DIP had been earmarked DSI funding to support its operation until the end of 2011-2012. The programme might be migrated to CSI in the financial year 2012-2013.

13. At the ITB Panel meeting on 14 November 2011, members noted that that the Administration was considering the possible transfer of the administration of DIP from the HKSTP to HKDC. At Ms Emily LAU's request, the Administration undertook to report progress of the matter to the Panel.

⁵ In 2009, the Government affirmed the commitment to promote the development of creative industries in Hong Kong. Other than setting up the dedicated office i.e. CreateHK, the Government proposed to set up the CSI with a commitment of \$300 million. Following consultation with the ITB Panel, the relevant funding proposal was approved by FC on 22 May 2009.

Latest position

14. The Administration will brief the ITB Panel on 13 February 2012 on the proposed provision of funding for extension of DIP.

Relevant papers

Information paper provided by the Administration for the Commerce and Industry Panel meeting on 10 May 2004

<http://www.legco.gov.hk/yr03-04/english/panels/ci/papers/ci0510cb1-1710-3e.pdf>

Minutes of Administration for the Commerce and Industry Panel meeting on 10 May 2004

<http://www.legco.gov.hk/yr03-04/english/panels/ci/minutes/ci040510.pdf>

Report No. 51 of the Director of Audit — Chapter 2. Administration of the DesignSmart Initiative

http://www.aud.gov.hk/eng/pubpr_arpt/rpt_51.htm

Public Accounts Committee Report No. 51

http://www.legco.gov.hk/yr08-09/english/pac/reports/pac_rpt_51.htm

Government Minute in response to the Report No. 51 of Public Accounts Committee

http://www.legco.gov.hk/yr08-09/english/pac/minutes/pac_gm_51-e.pdf

Audit Commission Annual Report 2008-2009

http://www.aud.gov.hk/pdf_e/Annual%20Report%202008e.pdf

Information paper provided by the Administration for the Information Technology and Broadcasting Panel meeting on 9 November 2009

<http://www.legco.gov.hk/yr09-10/english/panels/itb/papers/itb1109cb1-240-3-e.pdf>

Information paper provided by the Administration for the Information Technology and Broadcasting Panel meeting on 13 May 2010

<http://www.legco.gov.hk/yr09-10/english/panels/itb/papers/itb0513cb1-1843-5-e.pdf>

Background brief prepared by the Legislative Council Secretariat for the Information Technology and Broadcasting Panel meeting on 13 May 2010

<http://www.legco.gov.hk/yr09-10/english/panels/itb/papers/itb0513cb1-1843-6-e.pdf>

Minutes of Information Technology and Broadcasting Panel meeting on 13 May 2010

<http://www.legco.gov.hk/yr09-10/english/panels/itb/minutes/itb20100513.pdf>

Special meeting of the Finance Committee to examine the Estimates of Expenditure 2011-12 on 21 March 2011 — Administration's replies to Members initial written question (serial no. 3476)

http://www.legco.gov.hk/yr10-11/english/fc/fc/w_q/cedb-ct-e.pdf

Information paper provided by the Administration on Consolidation of the DesignSmart Initiative and the CreateSmart Initiative in May 2011

<http://www.legco.gov.hk/yr10-11/english/panels/itb/papers/itbcb1-2134-1-e.pdf>

Information paper provided by the Administration for the Information Technology and Broadcasting Panel meeting on 14 November 2011

<http://www.legco.gov.hk/yr11-12/english/panels/itb/papers/itb1114cb1-274-5-e.pdf>

Background brief prepared by the Legislative Council Secretariat for the Information Technology and Broadcasting Panel meeting on 14 November 2011

<http://www.legco.gov.hk/yr11-12/english/panels/itb/papers/itb1114cb1-274-6-e.pdf>

Minutes of Information Technology and Broadcasting Panel meeting on 14 November 2011

<http://www.legco.gov.hk/yr11-12/english/panels/itb/minutes/itb20111114.pdf>

Council Business Division 1
Legislative Council Secretariat
7 February 2012

CHAPTER 2

**Innovation and Technology Commission
Hong Kong Design Centre**

Administration of the DesignSmart Initiative

**Audit Commission
Hong Kong
23 October 2008**

This audit review was carried out under a set of guidelines tabled in the Provisional Legislative Council by the Chairman of the Public Accounts Committee on 11 February 1998. The guidelines were agreed between the Public Accounts Committee and the Director of Audit and accepted by the Government of the Hong Kong Special Administrative Region.

Report No. 51 of the Director of Audit contains 12 Chapters which are available on our website at <http://www.aud.gov.hk>.

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PART 5: ADMINISTRATION OF THE DESIGN INCUBATION PROGRAMME

5.1 This PART examines the administration of the DIP operated by the HKSTPC, and notes that there are certain areas where the administration of the programme can be improved.

Background

5.2 Under the DSI, a sum of \$25 million was earmarked for the HKSTPC to operate the DIP at the InnoCentre. The objective of the DIP is to support design start-up companies for a period up to two years. During the incubation period, design start-up companies admitted under the DIP (known as incubatees) are eligible for a financial assistance package, up to \$500,000, to help cover their business development costs during their start-up period.

5.3 When the DIP was approved in June 2004, it was expected that the \$25 million funding would provide a financial support of up to \$500,000 to at least 50 incubatees over a five-year period (from January 2006 to December 2010). The HKSTPC's records showed that, up to 31 March 2008, there were 33 incubatees admitted. The total financial assistance granted was about \$5 million (about 20% of the total DIP funding of \$25 million), as shown in Table 9.

Table 9

Number of incubatees and amount of financial assistance granted

	Number of incubatees			
	Admitted	Graduated	Dropped out	Total amount of financial assistance granted (\$'000)
2005-06	5	—	—	36
2006-07	13	—	—	1,522
2007-08	15	4	1 (Note)	3,449
Total	33	4	1	5,007

Source: HKSTPC records

Note: The incubatee dropped out of the DIP in October 2007 because its shareholders decided to dissolve the company.

5.4 According to the Memorandum of Administrative Arrangements signed between the HKSTPC and the ITC for the DIP (hereinafter refers to as the DIP-MAA), the HKSTPC is responsible for administering the DIP, as well as the pertinent costs incurred for promotion, admission and housekeeping. The DIP-MAA provides, among other things, that:

- (a) the funding of \$25 million is the maximum sum set aside for the DIP;
- (b) the HKSTPC should submit annually for the ITC's approval an annual programme and estimates which shall contain maximum number of incubatees and estimated amount of the financial support to incubatees for the forthcoming financial year;
- (c) on or before 30 September of each year, the HKSTPC should submit to the ITC audited accounts of the funds granted under the DIP in the preceding financial year, and also a report on the operation of the DIP;
- (d) a Design Advisory Panel comprising designers, industrialists and academics of various design disciplines will be set up. The Design Advisory Panel will give expert advice on proposal and vet the business plan submitted by DIP applicants. They will be required to give written reports for consideration by the Design Admission Panel (Note 7). They will also comment on the competency of the core members of the applicants; and
- (e) the Design Admission Panel will review the criteria for admission to the DIP, make recommendations to the HKSTPC to ensure the effectiveness of the DIP, and approve applications for admission to the DIP, taking into account advice from the Design Advisory Panel.

Financial assistance for incubatees

5.5 Under the DIP, the following five categories of financial assistance are available to the incubatees:

- (a) **Rental.** A ready-to-use office is provided to each incubatee at a special rental package up to 1,200 square feet (sq. ft. — Note 8);

Note 7: *The Design Admission Panel comprised staff from the HKSTPC and the HKDC, representatives from related design institutions, and the business and industrial sectors.*

Note 8: *During the first year of the incubation period, the monthly rent for the first 800 of the 1,200 sq. ft. occupied by the incubatee is free. The rent for the remaining 400 sq. ft. is \$8.65 per sq. ft.. Rental for the second year is \$8.65 per sq. ft..*

- (b) **Promotion and development.** Incubatees may claim reimbursement for up to 75% of the expenses incurred on promotion and related matters;
- (c) **Operation.** Up to 50% of the general operating costs incurred by incubatees may be reimbursed;
- (d) **Technical and management matters.** Incubatees may claim reimbursement of up to 75% of the expenses incurred for consultancy services on technical and management matters. A mentorship programme (see para. 5.10) for incubatees is also provided under this category; and
- (e) **Training.** Up to 50% of the actual expenses incurred by incubatees on training can be reimbursed.

Within the first six months after admission to the DIP or before the first milestone assessment (see para. 5.27) is completed, incubatees are only entitled to rental assistance. Assistance under other categories will become available after the incubatees concerned have been assessed as progressing satisfactorily in their first milestone assessment by the HKSTPC (Note 9).

5.6 Each of the five assistance categories is also capped by a quantitative limit. For categories (b) to (e) in paragraph 5.5, certain flexibility is available to shift the financial assistance between the categories. Details of the financial assistance of the five categories are shown at Appendix B.

Audit observations and recommendations

Utilisation of rental assistance

5.7 Audit noted that the estimate that incubatees would receive financial support of up to \$500,000 was based on the assumption that they would occupy up to 1,200 sq. ft. office space once they were admitted. Audit's examination of the HKSTPC's records revealed that incubatees did not require such a large office. As at 31 March 2008, only one of the 33 incubatees occupied an office of 1,200 sq. ft.. The average office size of the other 32 incubatees was about 556 sq. ft. (or about 46% of 1,200 sq. ft.).

Note 9: *In April 2008, it was agreed that milestone assessments for incubatees admitted after July 2008 should be carried out every four months.*

5.8 In this connection, Audit noted that at a meeting held in September 2006, members of the DSI Assessment Panel commented that incubatees might not be able to make full use of the rental assistance and recommended that the HKSTPC should look into the matter to see if any adjustment was needed. In response to Audit's enquiry, the HKSTPC advised that it was aware that incubatees' need for office space was less than that originally anticipated. The HKSTPC had therefore revised downwards the office space to 950 sq. ft. for 2006-07 and to 800 sq. ft. and 600 sq. ft. for 2007-08 and 2008-09 respectively.

5.9 In Audit's view, as incubatees' need for office space is far less than that originally anticipated, the HKSTPC should consider making necessary adjustments to the five categories of financial assistance, so as to ensure that the financial support would better meet the needs of incubatees. For example, the ceilings for categories of financial assistance other than rental assistance may be raised.

Mentorship programme

5.10 According to the DIP-MAA, the HKSTPC should offer a one-year mentorship programme, as part of the technical and management assistance to be provided to incubatees. Participation in the programme is on a voluntary basis. An incubatee who joins the programme will enter into a tripartite mentorship agreement with its mentor and the HKSTPC. He is expected to meet his mentor at least three times during the mentorship period and to inform the HKSTPC about the progress of the mentorship regularly.

5.11 Prior to August 2007, incubatees were responsible for the honorarium of \$3,000 payable to mentors. The payment could be treated as technical and management expenses. As such, up to 75% of the amount paid could be reimbursed. In August 2007, the HKSTPC decided that the full amount of the honorarium would be borne by the HKSTPC. The mentorship programme has since become a free service to incubatees.

5.12 Despite the fact that the mentorship programme was heavily subsidised (or free since August 2007), it was not very popular among incubatees. Audit's examination of the HKSTPC's records revealed that up to August 2008, only 9 (27%) of the 33 incubatees joined the mentorship programme.

5.13 Given that the mentorship programme is beneficial to incubatees, the HKSTPC should ascertain the reasons for the low utilisation of the mentorship programme, and take necessary action to encourage incubatees to participate in the programme.

Audit recommendations

5.14 **Audit has recommended that the HKSTPC should:**

- (a) **monitor the office space requirements of incubatees, and consider adjusting the ceilings of the financial support of the five categories under the DIP to better meet the needs of incubatees; and**
- (b) **investigate the reasons for the low participation rate of the mentorship programme, and take necessary action to encourage incubatees to participate in the programme.**

Response from the Hong Kong Science and Technology Parks Corporation

5.15 The CEO, HKSTPC accepts the audit recommendations. He has said that the HKSTPC:

- (a) will revise the maximum office space allocation from 1,200 sq. ft. down to 800 sq. ft.. The reduction of maximum rental subsidy will be shifted to other subsidies effective from October 2008. While the total maximum subsidy remains the same (i.e. \$500,000), incubatees will have more flexibility in claiming subsidies under the DIP. Details will be sent to the ITC for approval; and
- (b) recently conducted a survey in August 2008 to investigate the reasons for low participation of the mentorship programme. It will, with agreement from participating incubatees and mentors, publicise success cases of mentorship to non-participating incubatees to encourage their participation.

Applications for admission

5.16 According to the DIP-MAA and the HKSTPC's guidelines, DIP applications should be assessed based on the following qualitative admission criteria:

- (a) quality, competence and motivation of the designers;
- (b) quality and competence of the management team;
- (c) business viability of the start-up venture;
- (d) innovative design potential;
- (e) contribution to the development of design industry in Hong Kong; and

- (f) drive and commitment of the start-up venture.

5.17 DIP application will be vetted by a member of Design Advisory Panel. The member's assessments and recommendations will be forwarded to the Design Admission Panel for consideration and approval. Once admitted, a licence agreement, which lists out the obligations of the incubatee, will be signed between the HKSTPC and the incubatee.

Audit observations and recommendations

Due diligence visits

5.18 It is stated in the HKSTPC's DIP guidelines that, as part of the application vetting process, the responsible HKSTPC staff should conduct a due diligence visit to the office of the DIP applicant to verify the information provided in the application (e.g. company size, scale of operations, product/service nature, and the company's development plan). After the visit, an evaluation report should be prepared and filed.

5.19 Audit's examination of the application records of the 33 incubatees revealed that no records/evaluation reports were kept to show that due diligence visits had been carried out. In response to Audit's enquiry, the HKSTPC explained that since November 2007, the HKSTPC staff responsible would interview DIP applicants at the InnoCentre. Due diligence visits would only be carried out in case of doubt.

Documentation of the evaluation of applications

5.20 At a meeting held in January 2007, the Design Admission Panel agreed that a marking sheet (with passing score set at 60 out of 100) should be used for facilitating panel members to assess the qualitative aspects of DIP applicants. For the period January 2007 to June 2008, 24 cases were approved. However, Audit found that the marking sheet had not been used in any of these 24 cases.

Conditional approval cases

5.21 According to HKSTPC's DIP guidelines, for conditional approval cases, the HKSTPC should notify the applicants, seeking further information to satisfy the concerns raised by the Design Admission Panel. Information obtained would be submitted to the Design Admission Panel at the next meeting. Once the Design Admission Panel is satisfied that all stated conditions are met, the HKSTPC would issue a confirmation letter of full approval to the applicant.

5.22 Up to June 2008, there were six conditional approval cases. Audit could not find any documentation showing that supplementary information was submitted to the Design Admission Panel to clarify the concerns raised by the Panel. However, confirmation letters of full approval were issued by the HKSTPC in two of these cases.

Application processing time

5.23 In May 2006, the HKSTPC committed that the DIP application process would be completed within 11 weeks. Guidelines issued by the HKSTPC also require that if an application cannot be completed within 11 weeks, documentation of the reasons must be kept.

5.24 From May 2006 to June 2008, the HKSTPC processed 50 DIP applications. Audit examined the records of all these 50 applications and noted that, in 11 (22%) cases, the processing time took more than 11 weeks. However, the reasons for taking longer time to process the applications were not documented. In response to Audit's enquiry, the HKSTPC informed Audit in September 2008 that fixing a date when all members of the Design Admission Panel, whose discipline was the same as the applicants, were available was difficult. The long time taken in all these cases was due to the non-availability of panel members.

Audit recommendations

5.25 **Audit has recommended that the HKSTPC should:**

- (a) **keep a proper record of the interviews and due diligence visits carried out;**
- (b) **ascertain the reason for not implementing the decision of using a marking sheet in assessing DIP applications, and take necessary follow-up action;**
- (c) **for DIP applications approved on a conditional basis, ensure that the Design Admission Panel is provided with the necessary supplementary information; and**
- (d) **ensure that the DIP application process is completed within 11 weeks in accordance with the HKSTPC's guidelines, and the reasons for taking longer time to process an application are properly documented.**

Response from the Hong Kong Science and Technology Parks Corporation

5.26 The CEO, HKSTPC accepts the audit recommendations. He has said that the HKSTPC:

- (a) will keep a proper record by revising the due diligence evaluation report format to capture the name of interviewers/interviewees and the date/time/venue of interview;
- (b) will seek the Design Admission Panel's formal decision as to the applicability of the original proposed quantitative marking sheet for assessing DIP applications;
- (c) has submitted all the collected supplementary information on previous conditional approval cases to the Design Admission Panel meeting held in September 2008. The HKSTPC will also provide the necessary supplementary information to the Panel for every conditional approval case in future; and
- (d) will in future record the reasons for taking longer time to process an application and will report to the Design Admission Panel for appropriate actions. He has also said that the long time taken to process the applications mentioned in paragraph 5.24 was mainly due to non-availability of panel members.

Monitoring the performance of incubatees

Milestone assessment

5.27 According to the DIP guidelines, incubatees admitted before July 2008 were assessed at six-month intervals. The assessment was to determine if incubatees were making satisfactory progress in meeting the milestones set out in their business plan. In case the HKSTPC considers that an incubatee is not making satisfactory progress at the first and second milestone assessments, the incubatee would be re-assessed within the next three months or be asked to withdraw from the DIP.

5.28 Milestone assessment is carried out mainly through interviews. Incubatees are required to submit a milestone assessment report before the interview, listing out the progress they made within the period (e.g. product development progress, usage of the DIP support services, headcount and sales revenue). Since October 2007, a standard milestone assessment form is used to record the assessment results.

5.29 Apart from carrying out half-yearly milestone assessment, the HKSTPC also requests incubatees to submit the following financial and management reports to facilitate its monitoring of incubatees' progress:

- (a) annual audited accounts/financial statements within three months after the end of each financial year; and
- (b) a monthly report within one week after the end of each calendar month.

Audit observations and recommendations

Milestone targets

5.30 Audit randomly selected five DIP applications submitted, and examined the milestones set out in the business plans submitted therein. Audit noted that the milestone targets set out by incubatees were often non-quantitative, which did not facilitate progress assessment or benchmarking (see Examples 1 and 2).

Example 1

1. Companies A, B and C were fashion design companies which were admitted as incubatees under the DIP.

2. **Company A.** In its business plan, the target set for product development (for its first, second and third six-month milestones) was as follows:

“evening and bridal wear, hi-end casual wear, styling jobs, design product/service for companies – menswear/ladieswear”.

3. **Company B.** The targets set for product development in its business plan were as follows:

- (a) for the first six-month milestone: development;
- (b) for the second six-month milestone: developing and market testing; and
- (c) for the third six-month milestone: launch in market.

4. **Company C.** The targets set for product development were as follows:

- (a) for the first six-month milestone: develop three collections (around ten items), and develop sales distribution in London and Hong Kong;
- (b) for the second six-month milestone: develop three to four more collections (around 12 more items), and explore more distribution in Paris and Japan; and
- (c) for the third six-month milestone: develop three to four more collections (around 12 more items), and start brand building projects.

Audit comments:

5. The targets set for product development by Companies A and B were non-quantitative and did not show the progress to be made during the incubation period. In contrast, the targets set by Company C were quantitative and showed clearly the progress to be made. **Audit considers that the HKSTPC should urge DIP applicants to set quantitative milestone targets in their business plans.**

Source: HKSTPC records

Example 2

1. **Company D.** It was an overseas product design company. No target for product development was stated in the business plan submitted in its DIP application. Its business plan was considered by the Design Advisory Panel as “too broad and too general” and was difficult to assess.

2. Notwithstanding the Design Advisory Panel’s comments, the Design Admission Panel approved the application of Company D without requesting the company to set out more specific and clear milestone targets in its business plan.

Audit comments:

3. **Audit considers that the HKSTPC should ensure that milestone targets set out in the business plans submitted by DIP applicants are specific and clear.**

Source: HKSTPC records

Documentation of milestone assessment

5.31 According to the DIP guidelines issued by the HKSTPC, staff responsible for carrying out milestone assessment should record the assessment results in a standardised assessment form.

5.32 Audit examined 30 milestone assessment forms completed between October 2007 and June 2008. Audit noted that in 16 (53%) cases, although relevant figures shown in the assessment forms clearly showed that some of the milestone targets were not met, the HKSTPC staff still assessed that satisfactory progress was being made by the incubatees concerned (see Example 3).

Example 3

1. Company B set out in its business plan that cumulative sales revenue by the end of the 18th month of its incubation period should amount to \$1 million. The HKSTPC's records showed that the actual cumulative sales revenue was only about \$300,000 (i.e. 30% of the target). Despite the shortfall, the HKSTPC still considered the progress of the incubatee in sales revenue was satisfactory. There was no record documenting the justifications for the judgment.

2. Company D stated in its business plan that it would hire about three staff at the beginning of its incubation period. The number of staff hired would be five to seven by the end of the 18th month. The HKSTPC's records showed that the number of staff hired by Company D remained at four throughout its incubation period. Notwithstanding this, the HKSTPC still considered that Company D's progress in hiring staff was satisfactory.

3. Company E stated in its business plan that it expected its sales revenue would have a 10% growth in the second six-month period, and a further 15% rise in the third six-month period. Actual figures from the HKSTPC's records showed that sales of Company E for the first three six-month periods were about \$340,000, \$210,000 and \$233,000 respectively. In fact the sales revenue showed a decline over the period. However, the HKSTPC still considered that Company E was making satisfactory progress.

Audit comments:

4. **Audit considers that the HKSTPC should remind its staff to document the justifications for the judgements made in their milestone assessments, particularly in cases where incubatees fail to meet quantitative targets.**

Source: HKSTPC records

Supporting documents for milestone achievements reported by incubatees

5.33 To facilitate milestone assessment, incubatees are required to submit to the HKSTPC, before the assessment interview, a completed milestone assessment report including information about its activities in the past six months. The HKSTPC would discuss the milestone assessment report with incubatees to assess their progress.

5.34 Audit's examination of the 30 milestone assessment forms completed up to June 2008 revealed that, in 25 (83%) cases, there was no record showing that the HKSTPC staff had reviewed supporting evidence for the information provided in the milestone assessment forms. In response to Audit's enquiry, the HKSTPC explained that incubatees were requested to provide supporting documents for review during assessment interview.

However, the HKSTPC would not keep the documents to avoid leaking incubatees' confidential information. The HKSTPC would modify the milestone assessment form to include a checklist on supporting documents reviewed.

Submission of audited financial statements

5.35 An audit examination revealed that 18 (55%) of the 33 incubatees were admitted before April 2007 (i.e. they had been admitted for 15 months or more as at 30 June 2008). However, the HKSTPC's records showed that only six (33%) of these 18 incubatees had submitted their audited financial statements by 30 June 2008. Of these six incubatees, five took more than three months to submit their statements. The delays in submitting the statements ranged from five to nine months. Regarding the remaining 12 (67%) incubatees, the submission of their financial statements had already been overdue.

Submission of monthly progress reports

5.36 Apart from annual audited financial statements, an incubatee is also required to complete a monthly progress report within the first week of each month, which provides information about its success (e.g. awards received, patents filed, funding obtained, manpower growth and sales). Audit found that, up to June 2008, five (15%) of the 33 incubatees had not filed any monthly report to the HKSTPC. Details of the audit findings are shown in Table 10.

Table 10

Analysis of the percentage of omission in submission of monthly reports

Percentage of omission (%)	Number of incubatees
0	5 (15%)
1 — 19	3 (9%)
20 — 59	10 (31%)
60 — 79	8 (24%)
80 — 99	2 (6%)
100	5 (15%)
Total	33 (100%)

Source: Audit analysis of HKSTPC records

5.37 Table 10 shows that only five (15%) of the 33 incubatees managed to submit their monthly progress reports on time. The HKSTPC needs to remind incubatees to submit monthly progress reports in a timely manner.

Audit recommendations

5.38 **Audit has recommended that the HKSTPC should:**

- (a) **consider issuing guidelines to DIP applicants to help them set quantitative milestone targets in their business plans;**
- (b) **document the justifications for the judgements made in milestone assessments, particularly in cases where incubatees fail to meet quantitative targets;**
- (c) **ensure that adequate records are kept to document the review of supporting documents submitted by incubatees for the information provided in milestone assessment reports; and**
- (d) **remind incubatees to submit annual audited financial statements and monthly progress reports in a timely manner.**

Response from the Hong Kong Science and Technology Parks Corporation

5.39 The **CEO, HKSTPC** accepts the audit recommendations. He said that the HKSTPC will:

- (a) request the Design Advisory Panel to give guidelines to DIP applicants to help them set realistic quantitative milestone targets;
- (b) modify the milestone assessment form so that the assessor can fill in justifications for the judgments made;
- (c) modify the milestone assessment form to include a checklist on supporting documents to be reviewed; and
- (d) change the requirement for incubatees to submit the audited reports/financial statements 18 months after admission to the incubation programme. The HKSTPC will ensure that all incubatees submit monthly reports on time.

Disbursement of financial assistance

5.40 Audit selected a sample of 100 claims for reimbursement submitted by incubatees up to June 2008 for examination. The sample comprised 25 claims for each of the following four types of expenses:

- (a) training;
- (b) operation;
- (c) technical and management matters; and
- (d) promotion and development.

Audit observations and recommendations

5.41 Audit's examination of the 100 samples of claims for reimbursement revealed that there was room for improvement in the following areas:

- (a) ***Percentage of training expenses claimed.*** According to the DIP-MAA, each incubatee is allowed to seek reimbursement up to 50% of the actual training expenses under the DIP. The audit sample check revealed that 15 incubatees had mistakenly claimed 75% (instead of 50% in accordance with the DIP-MAA) of the training expenses they incurred during the incubation period. The total amount over-claimed was about \$41,000. In April 2008, these cases came to the notice of the ITC. In response to the ITC's enquiry, the HKSTPC agreed that the amount over-claimed would be borne by the HKSTPC;
- (b) ***Attendance records for training.*** Audit examined 25 reimbursement claims for training expenses and noted that no attendance records were submitted in 22 (88%) claims. In response to Audit's enquiry, the HKSTPC agreed that, as a good practice, incubatees should have been asked to produce attendance records to support their claims for reimbursement of training expenses; and
- (c) ***Supporting documents for operational expenses.*** According to the terms set out in the reimbursement form, original invoices, receipts or payment proofs should be submitted as supporting documents for reimbursement of operational expenses. Moreover, all supporting documents must bear the name and address of the incubatee concerned. If the incubatee cannot submit adequate supporting documents, the incubatee should be asked to make a declaration. Audit's examination of the 25 reimbursement claims for operational expenses revealed that in one case (4%), no receipt was submitted for a reimbursement of

\$140 expenditure. In seven (28%) other cases, some of the supporting documents (i.e. invoices) did not bear the names and addresses of the incubatees concerned. In two of these seven cases, no declaration was made by the incubatees stating that the expenses were incurred for their operational expenses.

Audit recommendations

5.42 **Audit has recommended that the HKSTPC should:**

- (a) **ensure the disbursements of financial assistances are made in accordance with the DIP-MAA, licence agreements and the HKSTPC's guidelines; and**
- (b) **ensure that sufficient and relevant supporting documents are submitted by incubatees in making claims for reimbursement.**

Response from the Hong Kong Science and Technology Parks Corporation

5.43 The CEO, HKSTPC accepts the audit recommendations. He has said that the HKSTPC will modify its guidelines and ensure that they are complied with.

~~work closely with the trades to boost the development of creative industries. It would also consider providing more effective support for Hong Kong's creative industries through integration of resources; and~~

- ~~- to implement the above policy initiative, the CEDB should work together with and listen to the views of the relevant trades and industries. The CEDB had commenced work in this respect and was consulting the relevant representatives from the industries on how to take forward the policy initiative. The CEDB aimed to set up the Creative Industry Office on 1 April 2009 and would, at the same time, formulate strategic measures for implementing the government policy on promoting the development of creative industries.~~

65. The Committee further asked about the progress made in developing suitable targets and methods/indicators for measuring the performance and effectiveness of the DSI. The **Secretary for Commerce and Economic Development** said that the Administration would study the experience of overseas countries in evaluating and reporting the performance of their initiatives to promote design, with a view to developing more suitable ~~outcome targets and indicators on design promotion in Hong Kong.~~

G. Conclusions and recommendations

66. The Committee:

~~Corporate governance and administration of the Hong Kong Design Centre ("HKDC")~~

- ~~- regrets that the HKDC is yet another government-funded organisation found to have problems and inadequacies in corporate governance that has become the subject of a report by the Director of Audit and has required examination by the Committee in recent years, the others being the English Schools Foundation, Hong Kong Applied Science and Technology Research Institute Company Limited, Hong Kong Tourism Board and Society for the Aid and Rehabilitation of Drug Abusers;~~
- ~~- expresses serious concern and finds it unacceptable that the Board of Directors ("Board"), which is responsible for directing the development and operations of the HKDC and monitoring the performance of the HKDC's management, has not properly discharged its responsibilities, as reflected by the following:~~

Administration of the Design Incubation Programme ("DIP")

- expresses serious dismay and finds it unacceptable that:
 - (a) in some cases, disbursement of financial assistance was not made in accordance with the Memorandum of Administrative Arrangements for the DIP and the guidelines issued by the Hong Kong Science and Technology Parks Corporation ("HKSTPC"); and
 - (b) supporting documents submitted by incubatees in making claims for reimbursement of expenses under the DIP were often inadequate;
- expresses dissatisfaction that:
 - (a) no records were kept to show that due diligence visits had been carried out by the HKSTPC to verify information provided by DIP applicants;
 - (b) there was no documentation showing that the HKSTPC had submitted supplementary information to the Design Admission Panel to clarify its concerns in conditional approval cases;
 - (c) the milestone targets set by incubatees in their applications were often non-quantitative, which did not facilitate progress assessment or benchmarking; and
 - (d) documentation of milestone assessments was not always kept;
- acknowledges that:
 - (a) the HKSTPC will:
 - (i) revise the due diligence evaluation report format to capture the name of interviewers/interviewees and the date/time/venue of interview; and
 - (ii) modify the milestone assessment form to enable the assessor to fill in justifications for the judgments made, and to include a checklist on supporting documents to be reviewed; and
 - (b) the Chief Executive Officer, HKSTPC has accepted the audit recommendations in paragraphs 5.14, 5.25, 5.38 and 5.42 of the Audit Report;

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- urges the Chief Executive Officer, HKSTPC to ensure compliance with the Memorandum of Administrative Arrangements for the DIP and the HKSTPC's guidelines, and expeditiously implement the above audit recommendations;

~~Overseas practices in the promotion of design~~

- notes that the Government has devoted a large amount of money to promoting design in Hong Kong over the past five years, i.e. 250 million for launching the DSI in June 2004 and another \$100 million to the HKDC in May 2007 to enhance its roles in promoting design;
- expresses serious concern that there is a lack of outcome targets/indicators to evaluate the effectiveness of the Government's initiatives to promote design in Hong Kong;
- acknowledges that:
 - (a) the Commerce and Economic Development Bureau aims to set up a dedicated Creative Industry Office with integrated and realigned resources from related departments on 1 April 2009. The Office will co-ordinate the work of different departments and work closely with the trades to boost the development of creative industries; and
 - (b) the Commissioner for Innovation and Technology has accepted the audit recommendations in paragraph 6.11 of the Audit Report;
- strongly urges the Secretary for Commerce and Economic Development to expeditiously issue a policy paper to set out the Government's vision and policy for promoting the development of creative industries, including design, and engage various stakeholders and the public in its policy direction; and

Follow-up actions

- wishes to be kept informed of:
 - (a) the HKDC's decision regarding publishing the attendance records of Board/Committee meetings in its annual reports;
 - (b) the Administration's decision regarding the measures proposed by the Committee to strengthen corporate governance in government-funded organisations by system design;
 - ~~(c) the progress of the ITC's reviews of the PCES, the GSS and the DSP;~~

THE GOVERNMENT MINUTE

in response to the

**REPORT NO. 51 OF
THE PUBLIC ACCOUNTS COMMITTEE**

dated February 2009

20 May 2009

Management of potential conflicts of interest

70. HKDC Board has adopted a set of guidelines for managing conflicts of interest, which is modeled on the guidelines issued by HAB on declaration of interests for advisory and statutory bodies. Suggestions made by the Independent Commission Against Corruption have also been incorporated where appropriate. The two-tier reporting system has also been implemented with effect from 1 April 2009. Furthermore, a register of Board directors' declaration of interests is maintained and is made available for inspection by the public upon request. As HKDC has taken follow-up action to address Audit's recommendation, we recommend deleting this part from the next progress report.

Procurement of goods and services

71. HKDC management has tightened up its internal control system to monitor compliance with the procurement procedures stipulated in the Corporate Governance Manual. Cases deviating from the Guidelines will be fully justified, properly approved and documented. As HKDC has taken follow-up action to address Audit's recommendations, we recommend deleting this part from the next progress report.

Administration of the Design Incubation Programme (DIP)

Utilisation of rental assistance

72. As reflected in the Director of Audit Report No. 51, HKSTPC has revised downwards the maximum office space allocation from 1,200 sq.ft. to 800 sq.ft. and launched a revised subsidy package to allow greater flexibility for incubatees in making claims. As HKSTPC has taken follow-up action to address Audit's concern, we recommend deleting this part from the next progress report.

Disbursements of financial assistances

73. HKSTPC has revised the claim forms and reimbursement arrangements to ensure that the disbursements of financial assistance comply with the Memorandum of Administrative Arrangements governing DIP, license agreements and the relevant HKSTPC guidelines. Measures have been put in place to ensure that incubatees submit sufficient and relevant supporting documents, such as receipt or payment proof, in making claims for reimbursement. As HKSTPC has taken follow-up action to address Audit's concern, we recommend deleting this part from the next progress report.

Mentorship programme

74. HKSTPC held a seminar in November 2008 to promote the mentorship programme to incubatees, and as a result four design incubatees joined the service. Success cases of the programme were published in the November/December 2008 issue

of HKSTPC's newsletter. More success cases will be promulgated in the coming issues. As HKSTPC has taken follow-up action to address Audit's concern, we recommend deleting this part from the next progress report.

Due diligence visits

75. HKSTPC has revised the format of its due diligence evaluation report to capture the date, time, venue, name of interviewers and interviewees of the due diligence visits. As HKSTPC has taken follow-up action to address Audit's concern, we recommend deleting this part from the next progress report.

Marking sheet for the evaluation of applications

76. The Design Admission Panel has re-considered the need to use a marking sheet which was originally devised as a trial and had never been put to use. The Panel was of the view that the vetting process would be complicated by using the marking sheet. Since the Panel members only need to evaluate applications against the qualitative admission criteria and do not need to grade each application, the Panel concluded that the marking sheet was not applicable. As HKSTPC has given due deliberation to the matter, we recommend deleting this part from the next progress report.

Conditional approval cases

77. HKSTPC will circulate supplementary information for conditionally approved applications to relevant members of the Admission Panel for review and final approval. As HKSTPC has taken follow-up action to address Audit's concern, we recommend deleting this part from the next progress report.

Application processing time

78. The reason for taking longer time to process the applications was the unavailability of Panel members who were in the same design disciplines of the applications. The Admission Panel has discussed the issue and concluded that members from the design field possessed the expertise in cross/multi design disciplines, and hence the need to match the disciplines of Admission Panel members with the disciplines of the applications could be obviated. HKSTPC will record the reasons for taking longer time to process an application and report to the Design Admission Panel for appropriate action. As HKSTPC has taken follow-up action to address Audit's concern, we recommend deleting this part from the next progress report.

Milestone targets and milestone assessments

79. New guidelines provided by the Design Advisory Panel were issued in February 2009 to assist DIP applicants in setting realistic quantitative milestone targets. The milestone assessment form has been revised to allow assessors to fill in

justifications for the judgments made, particularly for incubatees' failed milestones. The new form also includes a checklist on supporting documents reviewed. As HKSTPC has taken follow-up action to address Audit's concern, we recommend deleting this part from the next progress report.

Submission of audited financial statements and monthly progress reports

80. As reflected in the Director of Audit's Report No. 51, incubatees are now required to submit audited reports/financial statements 18 months instead of 12 months after admission to DIP. Reminders will be sent to ensure incubatees submit monthly progress reports in a timely manner. As HKSTPC has taken follow-up action to address Audit's concern, we recommend deleting this part from the next progress report.

~~*Overseas practice in the promotion of design*~~

81. The Administration has all along been making reference to overseas experience in promoting design in Hong Kong. As an illustration, SCED and ITC officials joined the delegation organised by HKDC and Hong Kong Trade Development Council to visit France, the partner country for BODW 2009, in early March 2009 to study its development in creative industries and technology. The Administration will continue to tap overseas experience, when appropriate.

82. HKDC intends to embark on a study comprising (i) construction of a Design Index to measure design performance in Hong Kong, (ii) a baseline study of the Hong Kong Design industries; and (iii) subject to further review upon completion of the above two deliverables, an in-depth comparative study of design councils and their work in selected countries. The study will fill the existing knowledge gaps in measuring design performance and providing basic facts and figures of the local design industries. It also represents the commitment of HKDC to conduct tracking surveys on design awareness and standard in Hong Kong, and benchmarking studies on the economic/social benefits brought about by design and innovation. The research is expected to provide useful information for future policy formulation. We recommend deleting this part from the next progress report.

~~*Other Audit recommendations*~~

83. As regards Audit recommendations mentioned in paragraphs 2.46, 2.62(b)-(d), 3.16, 3.17, 4.13(c)-(e), 4.21 and 4.34 of the Director of Audit Report No. 51, HKDC had indicated in the same report and at the PAC public hearings that it has accepted the recommendations. For specific irregularities identified, corrective actions have been completed to the satisfaction of ITC. Where follow-up action is required for HKDC to step up its internal administrative and financial control procedures and ensure that the irregularities will not recur in future, the response under "Further measures taken by HKDC to improve its internal control and accounting systems" above applies. ITC will continue to closely monitor the work of HKDC. We recommend deleting this part from the next progress report.