CHAPTER 1

Government Property Agency
Water Supplies Department

Management of surplus quarters

Audit Commission
Hong Kong
4 April 2014

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. 62 of the Director of Audit contains 8 Chapters which are available on our website at http://www.aud.gov.hk

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MANAGEMENT OF SURPLUS QUARTERS

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MANAGEMENT OF SURPLUS QUARTERS

Executive Summary

1. It is the Government's policy to provide quarters to eligible civil servants as a type of housing benefits or for operational need. As at October 2013, there were 708 non-departmental quarters (NDQs) managed by the Civil Service Bureau (CSB), 22,543 departmental quarters (DQs) and 179 post-tied quarters managed by various bureaux/departments (B/Ds). The Government Property Agency (GPA) is responsible for formulating and reviewing policy on the provision, standards and management of quarters, ensuring their proper utilisation and management, and arranging purchase, leasing and disposal of them. As at 31 December 2013, 39 GPA staff were directly involved in management of quarters. The related expenditure was $354.4 million for 2013-14.

2. With the introduction of the Home Financing Scheme in October 1990, new appointees to the Civil Service are not eligible for NDQs. As a result, the demand for NDQs has gradually decreased. With the implementation of various re-engineering of the process of service delivery and other changing circumstances, some government departments were able to reduce their accommodation requirements. As at October 2013, there were 198 surplus NDQs leased and/or pending disposal by the GPA. In 2001, the GPA took over from the Housing Department (HD) seven blocks of surplus quarters. As at October 2013, two blocks had been used as quarters by disciplined services departments and the remaining five were pending redevelopment. Five other departments also had a total of 498 surplus quarters not yet put into use, of which 330 units (66%) were held by the Water Supplies Department (WSD). As surplus quarters are valuable assets, the Audit Commission (Audit) has recently conducted a review of the management of these surplus quarters.

Disposal of surplus NDQs by the GPA

3. In 1996, Audit conducted a review on "Management of surplus NDQs". The Public Accounts Committee (PAC) held the view that the selling of surplus NDQs and NDQs sites to generate revenue should be the ultimate objective of the Administration as the Government was not supposed to function as a landlord or

agent for leasing properties. The PAC recommended that the CSB Working Group should consider practical ways to dispose of all surplus NDQs within a reasonable specified time frame. This was accepted by the Administration (paras. 2.2 and 2.3).

4. ***Stock of surplus NDQs.*** Surplus NDQs held by the Financial Secretary Incorporated (FSI) may be sold by the GPA en bloc or individually. Of the 198 surplus NDQs as at October 2013, 114 were FSI-owned, with 90 in the leasing pool and 24 on the sale list. 69 of the 90 FSI-owned NDQs in the leasing pool had been transferred to the GPA for 15 to 17 years. While the GPA had made attempts to sell these 69 NDQs before 1998, 19 of them had not been put up for sale since then. There was a need to sell the FSI-owned surplus NDQs within a reasonable time frame (paras. 2.4 and 2.7 to 2.9).

5. ***Sale of NDQs units by public auction.*** From 2008 to 2013, the sale of NDQs was suspended on three occasions (lasting 25 months) due to the financial crisis and downturn of property market. During the 47 months when sale resumed, the GPA sold 71 NDQs by 1 public tender and 8 public auctions. As at October 2013, there were 24 FSI-owned NDQs on the sale list and 12 of them had been on the list for two to six years. NDQs on the sale list were no longer available for leasing and did not generate revenue during the holding period. They should be put on the market for sale. Audit noted that there was scope for expediting the sale of surplus NDQs stock through better public auction arrangements (such as increasing the frequency of public auction) when the sale programme resumed (paras. 2.12 to 2.15).

HD’s surplus quarters transferred to the GPA

6. ***Management of surplus quarters***. In 2001, the HD transferred seven blocks of its surplus quarters (167 of the total 228 Grades F and H units were then vacant) to the GPA on the basis that better utilisation of the premises would be achieved. As agreed between the GPA and HD, three blocks were vacated by 2002 and four blocks were designated for decanting. Of the three vacant blocks, only one was put into use in 2002. From 2002 to 2005, the GPA explored interim uses of the other two vacant blocks but in vain. Meanwhile the four blocks for decanting had decreasing number of occupants. It was only in 2007 and 2008 that the GPA invited the disciplined services departments to bid for the use of the six blocks (two vacant and four with decreased number of occupants) although these departments had great demands for these grades of quarters. As at October 2013, two of the seven blocks

had been put into use as disciplined services quarters (one in 2002 and the other in 2009). The remaining five blocks (three had been demolished and two entirely vacated) were pending redevelopment as disciplined services quarters under four capital works projects (paras. 3.4 to 3.13, 3.22 and 3.25 to 3.29).

7. ***Project planning process.*** In four redevelopment projects, the planning process for the Tsz Wan Shan and Kwun Tong sites had taken over six years and five years respectively before they were included in the Capital Works Programme. The long time taken was caused by factors including significant changes in cost estimates/project scope and long lead time in resolving technical issues. There is a need for the Architectural Services Department to work with relevant departments to define clearly key project requirements and planning parameters at an early stage (para. 3.37).

Surplus quarters of the WSD

8. ***Management of surplus quarters.*** In 2001, the WSD had 491 DQs which were used to accommodate operational staff serving at the waterworks installations nearby. The WSD considered that there were no longer strong operational needs for retention of most DQs. From 2001 to 2013, 378 surplus quarters of the WSD in various locations were declassified as surplus accommodation. However, up to December 2013, only 48 surplus accommodation units had been put into other departmental uses. There were delays in implementing the WSD's action plan of 2010 for co-locating quarters occupants which could have released more vacant premises for alternative uses at an early date and minimised recurrent cost in maintaining under-utilised premises. There were also delays in taking action in accordance with an Accommodation Circular issued in April 2008 to relinquish vacant premises for consideration of alternative uses by other departments (paras. 4.4 to 4.7, 4.13 to 4.15 and 4.18 to 4.20).

9. ***Monitoring the utilisation of surplus accommodation.*** Since 2005, the GPA has required B/Ds to report in annual returns vacant specialist and departmental buildings/premises under their control. Based on the returns, the GPA provides progress reports to the Property Strategy Group for monitoring the utilisation of these vacant buildings/premises. Audit examination revealed that the WSD had not reported in its 2012-13 return 147 surplus accommodation units in partially occupied premises and there were delays of one to eight years in reporting ten vacant premises (paras. 4.24 and 4.25).

Way forward

10. Besides the WSD, four other departments had a total of 168 surplus accommodation units not yet put into use as at October 2013. In the light of the management problems of surplus accommodation identified in the case of the WSD, there is a need for these four departments to take measures to prevent similar problems (para. 5.5).

Audit recommendations

11. **Audit recommendations are made in the respective sections of this Audit Report. Only the key ones are highlighted in this Executive Summary. Audit has *recommended* that the Government Property Administrator should:**

(a) **dispose of the surplus FSI-owned NDQs units by sale within a reasonable time frame (para. 2.20(a));**

(b) **improve the arrangements for the sale of surplus NDQs units by public auction (para. 2.20(b));**

(c) **take effective measures to ensure that surplus quarters under the GPA's purview are put into gainful use and strengthen its coordinating role in assisting departments to resolve their problems of surplus quarters or shortage in quarters (para. 3.38(a) and (b));**

(d) **assist the WSD in putting its surplus accommodation into gainful use as soon as possible (para. 4.29(c));**

(e) **step up control to ensure that the information on surplus accommodation (both converted to departmental use or not yet put into use) reported by B/Ds in their annual returns is accurate and complete (para. 4.29(e));**

(f) **make effective use of the annual returns provided by B/Ds for monitoring the utilisation of the surplus accommodation (para. 5.5(a)); and**

(g) **render necessary assistance to the four departments which also had surplus accommodation not yet put into use as at October 2013 with a view to optimising the use of government resources (para. 5.5(b)(ii)).**

12. **Audit has also *recommended* that:**

(a) **the Director of Architectural Services should work with project proponent departments to define clearly key project requirements at the beginning of the planning process with a view to providing advice on the cost and programme more accurately (para. 3.39(a)); and**

(b) **the Director of Water Supplies should:**

(i) **expedite action to co-locate quarters occupants with a view to releasing vacant quarters premises for alternative use and minimising the cost in maintaining under-utilised quarters premises (para. 4.28(d)); and**

(ii) **take measures to ensure that prompt action on surplus accommodation is taken in accordance with the Accommodation Circular requirements (para. 4.28(e)).**

Response from the Administration

13. The Administration agrees with the audit recommendations.

PART 1: INTRODUCTION

1.1 This PART describes the background to the audit and outlines the audit objectives and scope.

Background

1.2 It is the Government's policy to provide quarters to eligible civil servants as a type of housing benefits or for operational need. The rules and regulations governing the provision and management of quarters are set out in the Civil Service Regulations, the Accommodation Regulations and various departmental circulars.

1.3 Quarters are broadly classified as follows:

(a) ***Non-departmental quarters (NDQs).*** NDQs are provided to house officers who are eligible for quarters by their terms of service (Note 1) and for whom departmental quarters (DQs) are not provided. The Civil Service Bureau (CSB) is responsible for allocating NDQs in accordance with the Civil Service Regulations;

(b) ***DQs.*** DQs are allocated to eligible officers by the Heads of Department in accordance with the Accommodation Regulations. They are further classified into the following categories:

(i) ***Disciplined services quarters (DSQs).*** DSQs are provided, subject to the availability of resources, for married officers of the rank and file, local married officers in the rank of inspectors and superintendents of the Hong Kong Police Force and comparable ranks in six other disciplined services departments (Note 2). The

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Note 1: *NDQs may be allocated to officers appointed before 1 October 1990 and who have been receiving salaries on or above point 45 of the Master Pay Scale (or equivalent).*

Note 2: *The six other disciplined services departments comprise the Correctional Services Department (CSD), Customs and Excise Department (C&ED), Fire Services Department, Government Flying Service, Immigration Department (ImmD) and Independent Commission Against Corruption.*

policy objective on the provision of DSQs is to maintain morale in the disciplined services departments;

(ii) ***Judiciary quarters.*** Judiciary quarters are provided for Judges of the Court of First Instance of the High Court and above of the Judiciary;

(iii) ***Operational quarters.*** Operational quarters (Note 3) are provided for housing a restricted group of eligible officers who, by virtue of their ranks or postings, are required to perform specific operational duties (e.g. staff of the Water Supplies Department (WSD) serving at waterworks installations nearby); and

(iv) ***General quarters.*** General quarters are quarters without immediate operational requirement but, with the agreement of the Government Property Agency (GPA) are retained by the department holding the quarters. These quarters are made available for allocation to all interested eligible officers within the department; and

(c) ***Post-tied quarters.*** Post-tied quarters are provided for holders of specific posts who are required to live at or very close to their places of work (e.g. staff in specific posts of the CSD serving at correctional institutions).

Role of the GPA

1.4 The work of the GPA covers three programme areas, namely acquisition and allocation of government accommodation (offices and quarters), property management, and estate utilisation. According to the Accommodation Regulations, one of the objectives of the GPA is to ensure that all government accommodation is fully utilised with maximum efficiency and value for money. The major responsibilities of the GPA in respect of DQs and NDQs are to:

Note 3: *Under former Accommodation Regulations valid before 1 June 2003, operational quarters referred to quarters provided for specific policy or operational purposes. In other words, DSQs and judiciary quarters were also classified as operational quarters before 1 June 2003.*

(a) formulate and review policy on the provision, standards and management of government quarters;

(b) ensure proper utilisation and management of government quarters in line with established policy; and

(c) arrange purchase, leasing and disposal of government quarters.

1.5 The GPA's work in managing quarters is distributed over a number of functional divisions. According to the GPA, as at 31 December 2013, 39 staff were directly involved in management of quarters. The related expenditure in 2013-14 was $354.4 million, comprising staff cost of $29.4 million and operating cost of $325 million (Note 4).

Responsibilities of bureaux and departments

1.6 According to the Accommodation Regulations, Heads of Department are responsible for:

(a) reviewing the designation of operational quarters;

(b) allocating quarters in accordance with the Code of Practice for Allocation of DQs;

(c) ensuring that quarters are put to their intended uses;

(d) assessing the supply and demand situation of DQs in consultation with the policy bureau; when a need for quarters arises, submitting an acquisition proposal to the policy bureau for support and then seeking funding from the Financial Services and the Treasury Bureau (FSTB) for the proposed acquisition;

Note 4: *The operating cost included expenses for engaging property management services contractors to manage the wholly-owned government quarters, and management charges and expenses for renovation and maintenance works for quarters in private developments.*

(e) making an annual return to the GPA of the DQs under their control as at 31 March each year and a monthly return listing DQs vacant for over two months; and

(f) ensuring that the supply and demand of government quarters are kept under review. When quarters are no longer required for their originally approved purpose, the GPA should be advised at once so that proposals for alternative use or disposal through deleasing, letting or sale can be considered. According to Accommodation Circular No. 3/2008 which sets out the procedures for handling surplus specialist and departmental accommodation (including quarters), user departments have the primary responsibility and are accountable for the proper use and optimal utilisation of their specialist and departmental accommodation (see details in para. 4.18).

1.7 According to the GPA's records, as at October 2013, there were:

(a) 23,430 quarters units for allocation to eligible staff by relevant bureaux/departments (B/Ds), comprising 708 NDQs (Note 5), 22,436 DSQs, 23 judiciary quarters, 7 operational quarters, 77 general quarters and 179 post-tied quarters; and

(b) 198 surplus NDQs leased and/or pending disposal by the GPA. For surplus quarters which were declassified as surplus accommodation (Note 6) but retained and managed by the relevant B/Ds, they would not be included in the returns on DQs (see para. 1.6(e)). The GPA monitors their utilisation through other annual returns for non-quarters departmental accommodation (see para. 4.24) from B/Ds. No separate statistics are compiled for declassified quarters.

Note 5: *Of the 708 NDQs, 24 units were transferred to the GPA for temporary leasing as they had not been allocated after quarters allocation exercises. These units had specific dates for taking back from the GPA for reallocation as NDQs.*

Note 6: *According to the GPA, surplus accommodation may be turned into other departmental use. For example, surplus units in school have been approved for uses such as student changing room, library and multi-purpose rooms.*

Decreasing demand for NDQs

1.8 With the introduction of the Home Financing Scheme in October 1990, new appointees to the Civil Service are not eligible for NDQs. Instead, they are eligible for the Home Financing Scheme. For those residing in NDQs, they have to vacate their quarters if they opt for the Home Financing Scheme or when they reach their retirement age. As a result, the demand for NDQs is gradually decreasing.

1.9 In 1990, in recognition of the decreasing demand for NDQs, the CSB endorsed the following strategies to deal with the surplus NDQs:

(a) when there were surplus NDQs in leased accommodation, the vacant leased NDQs should be deleased;

(b) for government–owned quarters located in under-utilised prime sites, the preferred option was to sell the sites;

(c) where land sale was not practicable, consideration might be given to selling some individual flats surplus to the requirements in the open market; and

(d) surplus NDQs should be converted to DQs.

In 1995, the CSB set up a Working Group (Note 7) to tackle the issue of surplus NDQs. The Working Group reviews the demand for NDQs and decides on disposal of surplus NDQs.

1.10 In 1996, the Audit Commission (Audit) found in a review that with all vacant NDQs in leased accommodation having been deleased in the year, deleasing would cease to be an option to tackle the issue of surplus NDQs. In 1995, the monthly average number of vacant NDQs was 175 with a significant number of

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Note 7: *The Working Group is chaired by the Deputy Secretary for the Civil Service and comprises representatives from the Development Bureau (DEVB), the FSTB, the Security Bureau (SB), the Transport and Housing Bureau, the GPA, the Lands Department (Lands D) and the Planning Department (Plan D).*

them remaining vacant for considerable periods of time. The Administration accepted the audit recommendation to consider leasing surplus NDQs as an interim measure to put these valuable assets into economic use.

1.11 As at October 2013, the number of NDQs (Note 8) used for allocation was 708; additionally the number of surplus NDQs pending disposal was 198. Of the 198 surplus NDQs, 174 were in the leasing pool and 24 were on the sale list.

Decreasing demand for other quarters

1.12 With the implementation of various re-engineering of the process of service delivery and other changing circumstances, some departments were able to reduce their accommodation requirements. In 2001, the GPA took over from the Housing Department (HD) seven blocks of partially occupied quarters (i.e. 167 of the total 228 units were then vacant). As at October 2013, only two of the seven blocks (42 units) had been put into use as DSQs. The remaining five blocks (three had been demolished and two entirely vacated) were pending redevelopment as DSQs. Upon Audit's request, in February 2014, the GPA conducted a service-wide survey on the number of surplus quarters that had been declassified and managed by B/Ds as at October 2013. Based on B/Ds' returns, five other departments (Note 9) also had a total of 498 surplus quarters which had been declassified as surplus accommodation but not yet put into use. As shown in Table 1, a total of 330 (240 + 90) surplus quarters were held by the WSD, representing 66% of the total 498 surplus quarters. For easy reference, the numbers of government quarters for allocation and surplus units as at October 2013 are summarised at Appendix A.

Note 8: *Quarters are graded from the highest Grade AA to the lowest Grade L (totalling 16 grades) by the GPA according to a number of factors including size, quality and location. NDQs are of Grade AA to Grade C and their sizes range from 364 to 134 square metres.*

Note 9: *The five departments were the WSD, CSD, Food and Environmental Hygiene Department (FEHD), Electrical and Mechanical Services Department (EMSD) and Leisure and Cultural Services Department (LCSD).*

Table 1

Surplus quarters declassified
(October 2013)

Declassified surplus quarters				User departments
Type		Number of units	Grades (Note 1)	
(A) DQs				
	(i) DSQs	125	CD to IJ	All these units were held by the CSD (Note 2) in 3 correctional institutions on 2 outlying islands (Hei Ling Chau and Lantau Island).
	(ii) Operational quarters	260	G to K	240 of these units were held by the WSD, 12 by the FEHD and 8 by the EMSD (Note 3).
	(iii) General quarters	110	I to K	90 of these units were held by the WSD (Note 4), 19 by the FEHD and 1 by the LCSD (Note 5).
(B) Post-tied quarters		3	G to J	All 3 units were held by the FEHD (Note 6).
Total (A) + (B)		498		

Source: GPA records

Note 1: The sizes of the surplus quarters range from 17 to 144 square metres.

Note 2: According to the CSD, it had made attempts to use the 125 surplus DQs (see para. 5.7).

Note 3: Based on the GPA's information, the eight surplus DQs of the EMSD are in two sites, one of which will be disposed of by land sale and the other released for housing development.

Note 4: The 330 (240 + 90) surplus DQs of the WSD are scattered over 35 different locations. According to the WSD, actions had been taken in respect of these units (see para. 4.8).

Note 5: According to the LCSD, it had made attempts to use the surplus DQs (see para. 5.9).

Note 6: The 34 (12 + 19 + 3) surplus quarters of the FEHD are scattered over seven sites. Based on the GPA's information, units in five sites are reserved for office use or other departmental use (e.g. conversion into columbarium or temporary storage facilities for cremains), while the remaining two market sites will be released for disposal by land sale.

Audit reviews

1.13 In 1996, 2007 and 2008, Audit conducted three reviews on government quarters. The results were included in the Director of Audit's Report No. 26 of March 1996 ("Management of surplus NDQs"), No. 49 of October 2007 ("Allocation and management of DSQs") and No. 51 of October 2008 ("Provision and management of quarters") respectively.

1.14 As surplus quarters are valuable assets, Audit has recently conducted a review of the Government's management of these surplus quarters, focusing on the following areas:

(a) disposal of surplus NDQs by the GPA (PART 2);

(b) HD's surplus quarters transferred to the GPA (PART 3);

(c) surplus quarters of the WSD (PART 4); and

(d) way forward (PART 5).

Audit has found room for improvement in the above areas and has made a number of recommendations to address the issues.

Acknowledgement

1.15 Audit would like to acknowledge with gratitude the full cooperation of the staff of the CSB, SB, GPA, HD and WSD during the course of the audit review.

PART 2: DISPOSAL OF SURPLUS NDQs BY THE GPA

2.1 This PART examines the following issues relating to the disposal of surplus NDQs by the GPA:

(a) measures for disposing surplus NDQs (paras. 2.2 to 2.5);

(b) stock of surplus NDQs (paras. 2.6 to 2.10); and

(c) sale of NDQs units by public auction (paras. 2.11 to 2.19).

Measures for disposing surplus NDQs

2.2 In 1996, Audit conducted a review on "Management of surplus NDQs". The results were reported in the Director of Audit's Report No. 26 of March 1996 (see para. 1.13). The Public Accounts Committee (PAC) held a public hearing on this audit subject. In its report of June 1996, the PAC:

(a) stated that the selling of surplus NDQs and NDQs sites to generate revenue should be the ultimate objective of the Administration as the Government was not supposed to function as a landlord or agent for leasing properties; and

(b) recommended that the CSB Working Group (see para. 1.9) should consider:

   (i) leasing out as a viable interim measure to put surplus NDQs into economic use; and

   (ii) practical ways to dispose of all surplus NDQs within a reasonable specified time frame.

2.3 In response to the PAC report, the Administration stated in the Government Minute of October 1996 that:

(a) the CSB Working Group accepted that the leasing of surplus quarters was an appropriate interim measure to make full economic use of the surplus NDQs. It had decided to lease out units currently surplus to requirement prior to their disposal by sale or redevelopment; and

(b) on the time frame for disposal of all NDQs, in 1996, the Working Group had drawn up a rolling five-year NDQs disposal programme (Note 10). The full disposal of NDQs sites would take up to 30 years to complete because officers with an entitlement to NDQs would be in service for that period.

2.4 As set out in the GPA Manual, measures taken to dispose of the surplus NDQs stock include the following:

(a) ***Sale of NDQs sites.*** This method is used for NDQs built on government-owned sites. When the whole site becomes vacant, the site is disposed of through the Land Sale Programme (Note 11);

(b) ***Sale of NDQs under strata title.*** This method is used for NDQs under strata title, i.e. properties held in the name of the Financial Secretary Incorporated (FSI — Note 12). The GPA will consider the appropriate disposal method of these NDQs, i.e. to sell NDQs en bloc or individually, on a case by case basis taking account of various factors, including the nature and type of the properties, marketability, cost-effectiveness, the then market conditions and occupancy status;

Note 10: *The programme sets out the NDQs to be disposed of in the coming five years. It is reviewed by the Working Group annually having regard to the forecast surplus and reprovisioning requirements for affected NDQs occupants.*

Note 11: *The Land Sale Programme administered by the Lands D is outside the scope of this audit review.*

Note 12: *FSI is a corporation incorporated under the Financial Secretary Incorporation Ordinance (Cap. 1015) and has the capacity to acquire and to dispose of government lands/properties and to execute deeds and agreements.*

(c) ***Converted use of NDQs as DQs.*** NDQs are of higher grades than most types of DQs. Converted NDQs are mainly used as DSQs for meeting the accommodation need of their senior officers and should be ultimately returned to the surplus NDQs pool for disposal; and

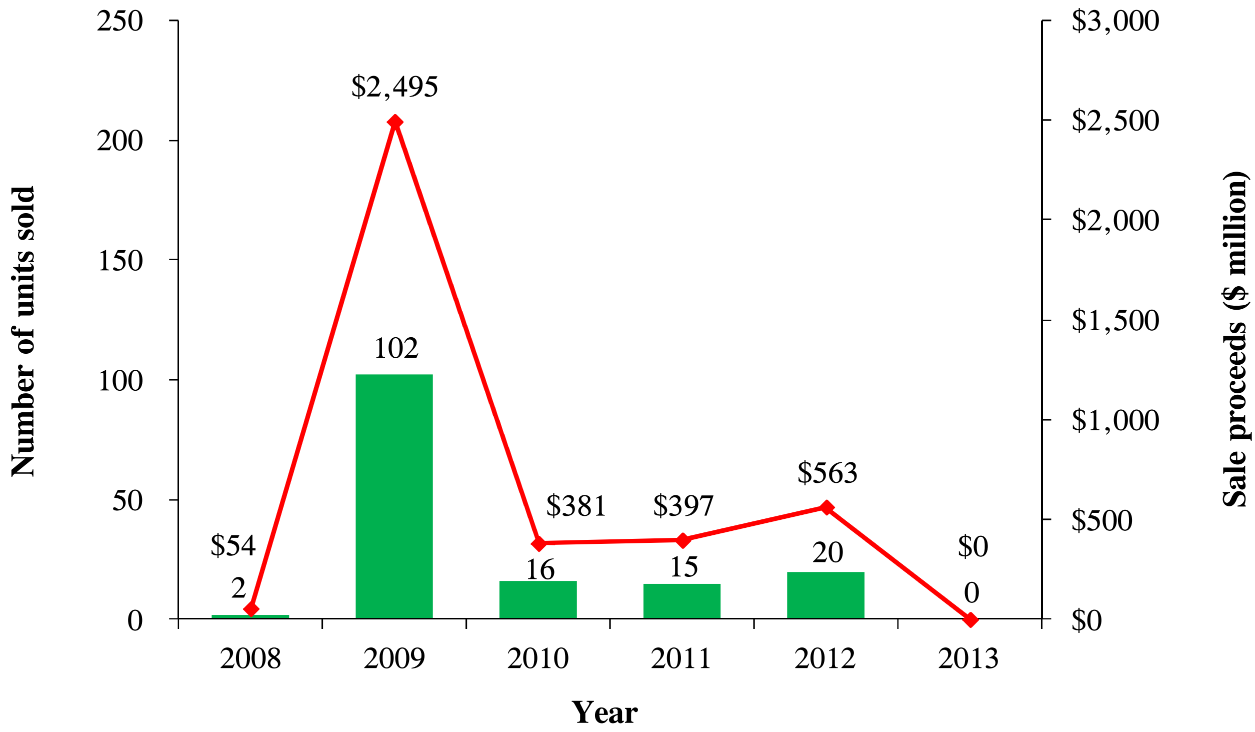
(d) ***Leasing.*** Surplus NDQs units pending disposal are normally let out on two-year leases with a provision which enables the Government to terminate the tenancy after the initial 12 months with a 3-month advance notice to facilitate the sale. Surplus NDQs units are always let on "as-is" conditions, i.e. with essential repairs carried out to bring them to habitable condition. Depending on the merit of individual case, the GPA will also consider carrying out some renovation before leasing to enhance the marketability.

Sale and leasing of surplus quarters

2.5 In 1998, following the downturn of the property market, the sale of surplus FSI-owned NDQs was suspended. In March 2004, the GPA considered it opportune to resume the sale of surplus NDQs. In the 2008 review, Audit found that the GPA planned in 2005 to sell the surplus NDQs in four buildings (involving a total of 237 units) en bloc by tender in two years' time. In November 2005, the sale of one building with 46 units by tender was cancelled because the tender prices were unacceptable. Up to September 2008, only 40 units in one of the four buildings were sold. In response to the audit recommendation on sale of surplus NDQs, the GPA said that the plans for the sale of surplus NDQs were under constant review and it had been exploring other options to dispose of surplus NDQs. In the six years from 2008 to 2013, the GPA sold 155 surplus NDQs for a total of $3,890 million and generated rental income of $1,021 million by leasing out surplus quarters pending disposal (see Figures 1 and 2).

Figure 1

Number of NDQs units sold and sale proceeds (2008 to 2013)

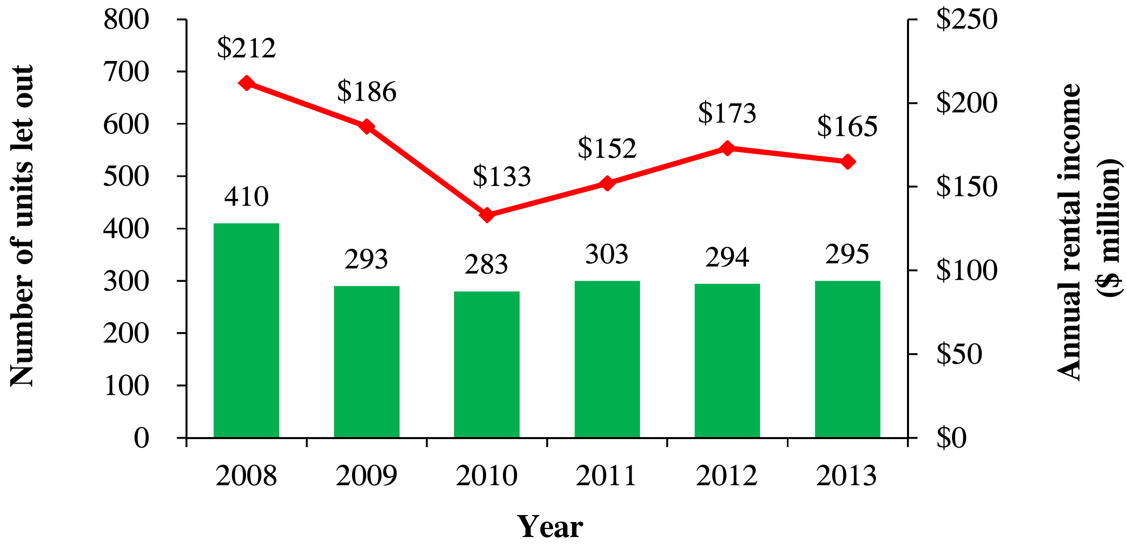


Legend: Number of units sold (155 units in total)
Sale proceeds ($3,890 million in total)

Source: GPA records

Figure 2

Number of surplus government quarters let out and annual rental income (2008 to 2013)



Legend: Number of units let out (Note 1)

Annual rental income ($1,021 million in total — Note 2)

Source:	*GPA records*
Note 1:	*The numbers shown are based on the GPA's Controlling Officer's Reports and annual reports. They reflect the snapshot position as at 31 December of the relevant years and exclude tenancies with tenure of less than two years.*
Note 2:	*The amounts shown are based on the GPA's Controlling Officer's Reports and annual reports. They include rental from all tenancies irrespective of their tenure.*
Remarks:	*The figures shown reflect the number of and rental income generated from all types of government quarters. The GPA did not compile separate statistics on the number of NDQs let out and the related rental income.*

Stock of surplus NDQs

Surplus NDQs records and statistics

2.6 According to the GPA's database, as at October 2013, there were 334 surplus NDQs. However, in February 2014, the GPA informed Audit that the number of surplus NDQs should be 198 because its database had included 136 quarters transferred by other parties to the GPA for interim leasing pending disposal (Note 13), which were also coded as "NDQs". Regarding the reasons why the surplus NDQs and quarters returned by other parties were not separately coded, and separate rental statistics were not compiled for surplus NDQs (see Remarks of Figure 2 in para. 2.5), in March and April 2014, the GPA informed Audit that:

(a) the database was designed to meet the GPA's daily/routine operation. It was suffice for the GPA's own operation to categorise all quarters other than DQs passed to the GPA for disposal as "NDQs"; and

(b) the GPA had proper record of each property transferred to it for disposal and could compile relevant statistics when operationally required. For example, of the $165 million rental income for 2013, about $117 million was generated from NDQs.

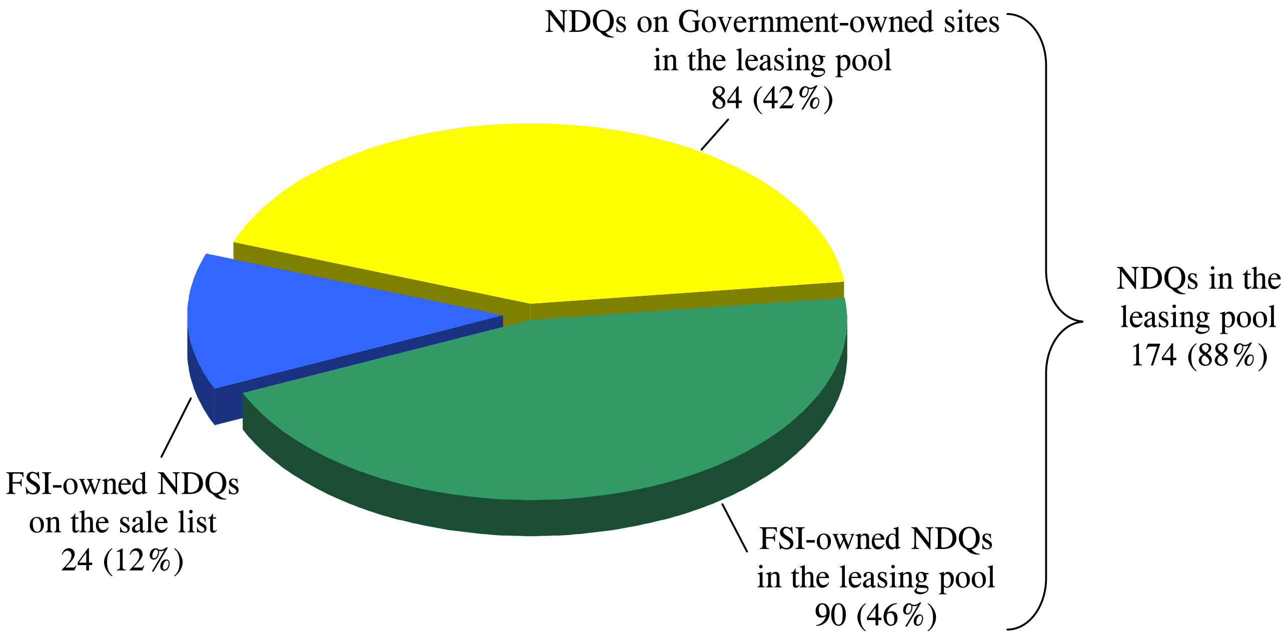
Long-term leasing of surplus NDQs

2.7 The PAC was of the view in 1996 that the selling of surplus NDQs and NDQs sites to generate revenue should be the ultimate objective of the Administration as the Government was not supposed to function as a landlord or agent for leasing properties (see para. 2.2(a)). This was accepted by the Administration and the GPA indicated in 2008 that the plans for the sale of surplus NDQs were under constant review (see paras. 2.3 and 2.5). Audit analysed the 198 surplus NDQs as at October 2013 and found that 174 (88%) of them were in the leasing pool (see Figure 3).

Note 13: *According to the GPA, of the 136 quarters, 80 were ex-military properties which would be cleared under the Kwu Tung North New Development Area in mid-2018, 55 were the Hospital Authority's properties and would be returned to the Hospital Authority for redevelopment, and the remaining one was an ex-Government guard house located in a green belt area and with no sale/redevelopment plan.*

Figure 3

Analysis of stock of surplus NDQs (October 2013)



Total stock of surplus NDQs = 198

Source: Audit analysis of GPA records

2.8 Of the 174 surplus NDQs in the leasing pool, 84 were on government-owned sites (Note 14) which could eventually be disposed of by the sale of the sites as a whole (see para. 2.4(a)). There was a need to lease them in the interim before the whole site became available for sale. However, for 90 FSI-owned NDQs units (Note 15), practical ways to dispose of them within a reasonable time frame should be considered in line with the PAC's recommendation, as accepted by the Administration (see paras. 2.2(b)(ii) and 2.3).

Note 14: Of the 84 units, 21 could be converted as DQs.

Note 15: *As at October 2013, of the 90 FSI-owned NDQs, 81 were let out, 5 were put up for letting and 4 were under renovation or rental valuation.*

Ageing analysis shows that 69 (77%) of the 90 FSI-owned NDQs in the leasing pool had been transferred to the GPA for 15 to 17 years (see Table 2).

Table 2

Ageing analysis of FSI-owned NDQs in the leasing pool (October 2013)

	Period (Note)	Number of NDQs units	Percentage
(a)	Less than 1 year	1	1%
(b)	1 year to less than 5 years	8	8%
(c)	5 years to less than 10 years	6	7%
(d)	10 years to less than 15 years	6	7%
(e)	15 years to 17 years	69	77%
	Total	90	100%

Source: Audit analysis of GPA records

Note: The period was counted from the date of transfer of NDQs units to the GPA.

2.9 Of the 90 surplus NDQs units in the leasing pool, the GPA had made various attempts to sell 75 units but without success:

(a) 69 units (item (e) of Table 2) had been put up for sale before 1998. The GPA subsequently made two attempts to sell 46 units (in 2005 and 2010) and one attempt to sell 4 units (in 2010-11) but no attempt was made to sell the remaining 19 units again;

(b) 3 units (of the 6 units in item (d) of Table 2) were put up for sale once in 2004; and

(c) 3 units (of the 6 units in item (c) of Table 2) were put up for sale once in 2010-11.

2.10 Audit noted that of the 708 NDQs used for allocation as at October 2013 (see para. 1.11), 164 were FSI-owned and would be transferred to the GPA for sale gradually over the next 20 years. The GPA needs to step up efforts to sell the FSI-owned NDQs units within a reasonable time frame instead of putting them on long-term leasing.

Sale of NDQs units by public auction

2.11 As shown in Figure 1 in paragraph 2.5, the GPA sold 155 NDQs units from 2008 to 2013. Among the units sold, 84 were in two blocks of a FSI-owned building sold en bloc by public tender in 2009. The remaining 71 FSI-owned NDQs were scattered in different premises and were sold in nine batches. The first batch was sold by public tender in 2008. After the sale, the GPA conducted a review of the disposal method and found that sale by public auction would have the following advantages:

(a) public auction took a shorter lead time than public tender and would be more effective to respond to sudden market changes;

(b) auction would enable higher transparency as prospective buyers offered their bids in the presence of other competitors; and

(c) auction would achieve the best result in a competitive atmosphere.

2.12 From 2009 to 2013, the GPA arranged eight public auctions for the sale of FSI-owned NDQs units through property consultants. Table 3 summarises the results of the sale of FSI-owned NDQs units by tender in 2008 and by public auctions from 2009 onwards.

Table 3

Sale of FSI–owned NDQs
(2008 to 2013)

Auction/tender date	Number of NDQs units		
	Put up for sale	Sold	Withdrawn/ cancelled (for tender) (Note)
13 June 2008	7	2	5
13 August 2009	10	10	0
12 November 2009	10	8	2
29 July 2010	11	9	2
17 November 2010	10	7	3
22 March 2011	10	8	2
6 July 2011	10	7	3
8 May 2012	10	10	0
18 September 2012	10	10	0
Total	88	71	17

Source: *GPA records*

Note: *The units were withdrawn/cancelled (for tender) from sale because the bidding prices offered were below the reserve prices set by the GPA.*

Remarks: *According to the GPA, for six of the eight auctions, one of the successful buyers each time was the only bidder and he had to make several bids before reaching the reserve prices set by the GPA.*

2.13 The average lead time for arranging the eight public auctions was about six weeks (Note 16) which was shorter than the two months taken for the public tender in 2008 (Note 17). Notwithstanding the adoption of the more expeditious sale method by public auction, as at October 2013, 24 (12% of the 198 surplus NDQs) FSI-owned NDQs units were still on the sale list (see Figure 3 in para. 2.7). Ageing analysis shows that 12 (50%) of them had been on the list for two to six years (see Table 4). The situation is not satisfactory bearing in mind the holding cost in terms of rental forgone.

Table 4

Ageing analysis of FSI-owned NDQs units on the sale list (October 2013)

	Period of vacancy	Number of NDQs units	Percentage	
(a)	Less than 1 year	8	33%	
(b)	1 year to less than 2 years	4	17%	
(c)	2 years to less than 5 years	7	29%	50%
(d)	5 years to 6 years	5	21%	
	Total	24 (Note)	100%	

Source: Audit analysis of GPA records

Note: From 2008 to 2013, of the 24 units, 19 had not been put up for sale. The remaining 5 units (two under item (a), one under item (b), one under item (c) and one under item (d)) had been put up for sale once but without success.

Note 16: *The lead time was counted from the date of giving instruction to the property consultant to the date of auction.*

Note 17: *The time taken was counted from the date of inviting tenders to the date of award of contract.*

Disposal of surplus NDQs by the GPA

2.14 In February and March 2014, the GPA informed Audit that:

(a) there was a need to keep a reserved stock of NDQs which usually attracted a higher sale price in the sale list because:

(i) to attract a wide range of potential buyers, it was desirable to have a good mix of properties of different qualities from different locations;

(ii) keeping a stock of 24 units in the sale list was not excessive having regard to the sale records in recent years. From 2010 to 2012, on average, 20 units were put up for sale and 17 units were sold each year. The reserved stock allowed the GPA to respond efficiently to market condition and launch sale readily when the appropriate opportunity arose;

(iii) units in the leasing pool could not be readily transferred to the sale list as it would take time to obtain vacant possession once leased out; and

(iv) selling units with tenants would deter potential buyers who were not looking for an investment, thereby affecting their marketability/attractiveness and prices achievable; and

(b) the main reasons for not putting up the 19 NDQs units (see Note to Table 4) for sale during the six years of 2008 to 2013 were as follows:

(i) the sale of NDQs units was suspended on three occasions (lasting a total of 25 months). The first suspension from October 2008 to May 2009 was due to the outbreak of the financial crisis (Note 18). The second one from October 2011 to March 2012 was due to the downturn of the property market (Note 19). The third one from November 2012 and still ongoing was due to the

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Note 18: *The decision to suspend the sale programme in 2008 was endorsed by the FSTB after the GPA had consulted the views of the Transport and Housing Bureau, the Economic Analysis Division and the DEVB.*

Note 19: *The GPA decided to suspend the sale programme in 2011 after taking into account the views of the property consultants.*

sluggish market condition arising from the Government's further measures to cool the property market in October 2012 (Note 20); and

(ii) during the periods (47 months) when the sale programme resumed, other units instead of the subject NDQs were selected to provide a good mix of properties for sale.

Need for better public auction arrangements

2.15 Surplus NDQs units on the sale list were no longer available for leasing and hence should be put on the market for sale. Audit noted that there was scope for expediting the disposal of the surplus NDQs stock through better public auction arrangements when the sale programme resumed:

(a) one of the advantages of public auction was its shorter lead time and hence NDQs units earmarked for sale could be put on the market within a short time (see paras. 2.11(a) and 2.13). However, during the 27 months from June 2009 (the end of the first suspension of the sale programme) to September 2011 (the start of the second suspension), the GPA only launched six public auctions, i.e. on average once every 4.5 months. There was scope for increasing the frequency of public auctions; and

(b) all the eight public auctions were half-day sessions and only 10 to 11 units could be put up for sale each time. Consideration could be given to holding full-day public auction so that more units could be put up for sale.

2.16 In response, the GPA has informed Audit the following reasons for not holding more frequent auctions or putting up more units in each sale:

(a) the NDQs are large in size with substantial sale prices and they are situated in a few locations. The pool of potential buyers is quite restrictive. There is a need to accumulate enough potential buyers before an auction can be carried out with success;

Note 20: *The decision to suspend the sale in 2012 was endorsed by the FSTB.*

(b) the GPA has formulated its sales plan in consultation with relevant government departments. All the disposal arrangements are handled with prudence with a view to achieving the best result but without affecting the market condition. The sale of NDQs attracts a lot of media interest and it is important to ensure that the result will not send any wrong or misleading signal to the market; and

(c) holding auction too frequently or putting up too many units for sale on each auction may adversely affect the marketability of the units and the Government's revenue from the sale.

Need for more flexible sale strategy

2.17 In suspending the sale of surplus NDQs since November 2012, the GPA has provided the FSTB with the following justifications:

(a) following the Government's measures to stabilise the property market (i.e. the introduction of the buyer's stamp duty in October 2012 and increasing the ad valorem stamp duty rates in February 2013), there was a substantial drop in the property sales volume;

(b) although the market condition gradually improved in early 2013, the sales volume dropped again in mid-2013 due to the imminent end of quantitative easing in the United States and the possible increase in Hong Kong's interest rates; and

(c) the GPA's property consultants were of the view that it might not be opportune to conduct public auction.

2.18 In an internal instruction on disposal of surplus quarters/properties by public auction issued by the GPA in January 2014, it was also stated that public auction might not be appropriate in bad economic time where buyers were more cautious in bidding and it would be difficult to create a competitive atmosphere to motivate buyers to compete for the properties.

2.19 While public auction might not be the appropriate method to sell surplus NDQs in 2013, there was no record to show that consideration had been given to alternative sale strategy to test the market response. Bearing in mind the holding cost (in terms of rental forgone) of surplus NDQs units pending sale, the GPA needs to flexibly adjust the sale strategy of NDQs units under different property market conditions.

Audit recommendations

2.20 **Audit has *recommended* that the Government Property Administrator should:**

(a) **dispose of the surplus FSI-owned NDQs units by sale within a reasonable time frame instead of putting them on long-term leasing;**

(b) **improve the arrangements for the sale of surplus FSI-owned NDQs units by public auction, such as increasing the frequency of public auctions and holding full-day auction; and**

(c) **flexibly adjust the sale strategy of surplus NDQs units under different property market conditions.**

Response from the Administration

2.21 The Government Property Administrator accepts the audit recommendations. He has said that the GPA will:

(a) aim to dispose of surplus NDQs having regard to market condition and with prudence and efficiency, with a view to achieving best revenue return for the Government and safeguarding the Government's interest in capital assets;

(b) increase the frequency of sale or put up more units for each sale where appropriate having regard to the nature of the properties, marketability, cost-effectiveness as well as market condition and considerations as set out in paragraph 2.16;

(c) continue to adopt a practical and flexible strategy in line with the Government procurement policy to dispose of the surplus NDQs and maintain an appropriate but not excessive sale stock; and

(d) conduct regular review of the sale programme and will arrange for leasing out the surplus NDQs pending disposal on a temporary basis in order to generate a reasonable return for the Government.

2.22 The Secretary for Financial Services and the Treasury generally accepts the audit recommendations. He has said that:

(a) surplus NDQs are valuable capital assets of the Government. The FSTB agrees in principle that the ultimate objective is to dispose of them by sale to generate revenue. Leasing them out should only be an interim arrangement; and

(b) to safeguard the Government's interest, the FSTB must ensure that in planning the disposal of surplus NDQs, the optimal return for the Government is achieved, having regard to the prevailing market condition, the nature and marketability of the properties in question and the cost-effectiveness of the GPA's sale strategy. While being mindful of the importance of disposing of these units within a reasonable time frame as recommended by Audit, the GPA will continue to adopt a practical and flexible approach in working out the details (such as the frequency of sale and number of units covered in each sale exercise) of the sale programme and reviewing/updating it regularly with due regard to all relevant considerations. For those surplus NDQs units which cannot be disposed of immediately, the GPA will arrange for them to be leased out on a temporary basis so that they will continue to generate a reasonable return for the Government in the interim.

PART 3: HD'S SURPLUS QUARTERS TRANSFERRED TO THE GPA

3.1 This PART examines the following issues relating to the surplus quarters of the HD transferred to the GPA:

(a) transfer of seven blocks of surplus quarters from the HD to GPA (paras. 3.2 to 3.5);

(b) use of three blocks of surplus quarters vacated by 2002 (paras. 3.6 to 3.24);

(c) use of the remaining four blocks of surplus quarters (paras. 3.25 to 3.33); and

(d) areas for improvement (paras. 3.34 to 3.37).

Transfer of seven blocks of surplus quarters from the HD to GPA

3.2 ***1998 review.*** Operational quarters were built in the 1960s for HD staff who were involved in estate management and maintenance work, and required to carry out emergency duties in case of typhoon, flooding and fire. In 1998, the HD noted that:

(a) due to the changed modes of estate management, the great improvement in transport and communication facilities and the setting up of the Departmental Communication Centre to handle emergency cases, the operational need of quarters had faded over the years; and

(b) of the 305 operational quarters units in 11 blocks of quarters, 159 were occupied and 146 were vacant.

Accordingly, the HD withheld the allocation of vacant quarters and conducted a review. In August 1999, based on the results of the review, the HD decided to phase out its operational quarters.

HD's surplus quarters transferred to the GPA

3.3 ***Transfer of land ownership of quarters to the GPA.*** To maximise the use of resources before the disposal of the quarters, in 2000, the HD explored the feasibility of letting out the vacant units on a short-term basis but found it inappropriate to do so because:

(a) the Housing Authority's power to let is subject to the provisions of the Housing Ordinance (Cap. 283); and

(b) the leasing of vacant quarters units was not consistent with providing subsidised housing for those in need.

3.4 After liaising with the GPA, the HD noted that transfer of ownership of the quarters was essential to empower the GPA to let out the vacant units and to provide it with greater flexibility to determine the long-term use of such quarters. In December 2000, the HD informed the GPA that:

(a) to enable better utilisation of the surplus quarters, it was prepared to transfer the ownership of all DQs (other than the one in Shek Lei which was designated for Home Ownership Scheme development) to the GPA; and

(b) to smooth out the phasing out of DQs, agreement had been reached with HD staff on the following relocation arrangements:

   (i) existing occupants would be allowed to reside in four blocks of quarters at Kwun Tong (No. 1 & No. 2), Lok Fu and Tin Wan (Note 21) until there were concrete development plans for these quarters sites; and

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Note 21: *In December 1999, the HD originally planned to retain the Lok Fu and Kwun Tong quarters only. The affected occupants appealed to the CSB, Legislative Council and Chief Secretary's Office against the phasing out arrangements. After taking into account the relevant parties' views and in order to minimise the disturbance to existing occupants, the HD decided in April 2000 to also retain the Tin Wan quarters due to their high occupancy rate.*

(ii) existing occupants in other quarters sites would be allowed 18 months to relocate their homes to the four blocks of quarters designated for decanting. They would have to vacate their existing quarters by end of January 2002.

3.5 ***2001 agreement.*** In March and May 2001, the GPA agreed to the transfer of seven blocks (Note 22) of the HD's DQs on the basis that better site utilisation or better use of existing premises would be achieved. It was agreed between the HD and GPA that:

(a) the premises were partly vacant and partly occupied by HD staff. These staff, upon the taking over of the quarters by the GPA, would be deemed to be authorised occupants of the concerned quarters;

(b) as the premises were partly occupied by HD staff, the HD would continue to fund and provide property management and maintenance services; and

(c) should the GPA allocate any of these premises to other civil servants as quarters or introduce private-sector tenants to these premises, the GPA would fund and provide management service.

Table 5 is a summary of the seven quarters transferred to the GPA.

Note 22: *Of the 11 blocks of quarters occupied by HD staff (see para. 3.2(b)), transfer of ownership to the GPA was required for seven only because one was designated for Home Ownership Scheme development (see para. 3.4(a)), two were to be returned to the Lands D direct and one was already under the GPA's purview. The land allocation for the seven sites was completed by July 2001.*

Table 5

Seven HD quarters transferred to the GPA (January 2001)

Name of quarters (Address)	Site zoning	Site area (square metres)	Total no. of units	No. of units occupied
Quarters designated for decanting				
1 Kwun Tong No. 1 (4 Tseung Kwan O Road)	Residential (A)	4,170	90	12
2 Kwun Tong No. 2 (4 Tseung Kwan O Road)				
3 Tin Wan (Tin Wan Street, Aberdeen)	Government, Institution or Community (GIC)	890	15	9
4 Lok Fu (20 Heng Lam Street)	GIC	2,650	43	24
Quarters to be vacated by 2002				
5 Lei Cheng Uk (40 Cheung Fat Street)	GIC	1,215	14	2
6 Shek Kip Mei (9 Nam Shan Chuen Road)	GIC	1,620	28	8
7 Tsz Wan Shan (57 Sheung Fung Street)	GIC	3,039	38	6
	Total	13,584	228 (Note)	61

Source: *GPA records*

Note: *The 228 units comprised 15 Grade F quarters (of 115 square metres each) and 213 Grade H quarters (ranging from 52 to 66 square metres). In 2000, the GPA estimated that the market rental values of these quarters ranged from $5,000 to $12,000 per month based on the assumption of reasonable state of repair.*

Remarks: *The then plot ratios of the seven quarters sites ranged from 1.07 to 1.82. In 1999, the GPA considered that the quarters sites were under-utilised when compared with the plot ratios of residential developments in the vicinity which ranged from 7.5 to 9.*

Use of three blocks of surplus quarters vacated by 2002

3.6 As agreed between the GPA and the HD, three operational quarters namely Lei Cheng Uk, Shek Kip Mei and Tsz Wan Shan were vacated from late 2001 to May 2002. The Shek Kip Mei quarters had been used as DSQs by the CSD and C&ED since 2002. The Lei Cheng Uk quarters were used by the ImmD as DSQs in February 2009 (some seven years later). As for the Tsz Wan Shan quarters, the site was incorporated into a capital works project for redevelopment as the C&ED's DSQs and included in the Capital Works Programme in July 2013 (after the lapse of about 11 years). The circumstances leading to the long time taken in putting the two surplus quarters into use are detailed in paragraphs 3.7 to 3.10 for the Lei Cheng Uk quarters and paragraphs 3.12 to 3.23 for the Tsz Wan Shan quarters.

Lei Cheng Uk quarters

3.7 The Lei Cheng Uk quarters site was reserved for school use in the Cheung Sha Wan Outline Zoning Plan. In May 2001, the GPA ascertained from the then Education Department that an adjoining school would be recommended to take up the site for educational use after demolition of the quarters by the HD. In February 2002, the GPA also ascertained from the HD that the latter had no plan to demolish the quarters as the ownership had already been transferred to the GPA in June 2001.

3.8 ***Interim uses explored.*** In January 2001, the HD informed the GPA that the ground floor of the quarters was being used by one of its operation units and asked for a 12-month advance notice in case the office would need to be vacated for other development. In October 2001, the HD informed the GPA that all tenants had moved out of the Lei Cheng Uk quarters. From 2002 to January 2004, the GPA explored various interim uses of the Lei Cheng Uk quarters but without success (see Appendix B for details).

3.9 In June and July 2006 (two and a half years later), the GPA received the following requests:

(a) noting that the quarters had been vacant for a number of years, the adjoining school (see para. 3.7) requested the then Education and Manpower Bureau to explore with the GPA the possibility of using the site; and

(b) the ImmD submitted a request for acquiring Grades F and G quarters for its staff.

The GPA then consulted the Lands D and Plan D about the feasibility of using the Lei Cheng Uk site as permanent quarters of the disciplined services departments.

3.10 ***For use as DSQs.*** In February 2007, the GPA invited the disciplined services departments to bid for the use of the Lei Cheng Uk quarters. On the advice of the SB, the Lei Cheng Uk quarters were allocated to the ImmD. In May 2007, the HD handed over the vacated quarters to the ImmD upon the GPA’s advice (see para. 3.8). In January 2008, the Lands D approved the land allocation of the Lei Cheng Uk quarters site to the ImmD. Refurbishment works for the Lei Cheng Uk quarters commenced in March 2008 and were completed in January 2009. The Lei Cheng Uk quarters had been used by the ImmD since February 2009.

3.11 The above sequence of events shows that while the GPA had explored various options for using the Lei Cheng Uk quarters from 2002 to 2004, there was a lapse of over two years before it invited the disciplined services departments in 2007 to bid for the use of the quarters. Similar delays were also seen in four other quarters (see para. 3.25). Areas for improvement are discussed in paragraphs 3.34 to 3.36.

Tsz Wan Shan quarters

3.12 ***Proposed interim uses from 2002 to 2005.*** Before the vacation of the Tsz Wan Shan quarters by the HD in May 2002, there were discussions among the Plan D, Lands D and the then Education Department on the use of the Tsz Wan Shan quarters site for school development. In July 2002, the GPA ascertained from the Plan D and Lands D that they had no objection to the temporary letting of the Tsz Wan Shan quarters for three years pending permanent development of the site. From 2002 to 2005, the GPA explored various interim uses of the quarters, given that the site was tentatively planned for disposal in 2006-07 (see Appendix C for details).

3.13 ***Planning for use as DSQs from 2007 to January 2014.*** In March 2007, noting that the Tsz Wan Shan site had been taken off from the Land Sale Programme and upon the request for additional quarters by the disciplined services departments, the GPA invited the SB to consider using the Tsz Wan Shan quarters to meet the shortfall in DSQs. After having been invited by the SB to take up the site, the C&ED explored with the Architectural Services Department (ArchSD) and Plan D the options of refurbishment or redevelopment but this turned out to be a lengthy process. In July 2013 (six years later), the site was incorporated into a capital works project for redevelopment as the C&ED's quarters and included in the Capital Works Programme. The key events are summarised in paragraphs 3.14 to 3.23.

3.14 ***Redevelopment option.*** In April 2007, in response to the C&ED's enquiry about redeveloping the Tsz Wan Shan site for DSQs, the Plan D advised that:

(a) as there was a shortage of GIC facilities in the locality, the site would be reserved for GIC development to cater for present and unforeseen future needs of the community; and

(b) the existing Tsz Wan Shan quarters were regarded as an "existing use" under the Tsz Wan Shan, Diamond Hill and San Po Kong Outline Zoning Plan, the premises could continue to be used for such purpose.

3.15 ***Refurbishment option.*** In May 2007, the C&ED sought the ArchSD's advice on the feasibility and cost for refurbishing the Tsz Wan Shan quarters. After consultations with relevant parties, in May 2008, the ArchSD informed the C&ED that:

(a) these quarters were built based on the 1969's statutory and design standard and it was critical that extensive improvement/alteration works should be further studied; and

(b) a rough indication of cost for the proposed improvement/alteration works was in the range of $18 million to $20 million. Such cost would be subject to final scope of works (Note 23) and results of further detailed feasibility study.

3.16 In July 2008, the ArchSD provided the C&ED with an updated project cost estimate of $28 million. Upon the request of the C&ED, the ArchSD subsequently scaled down the scope of works to reduce the project cost to $20 million (i.e. within the minor building works ceiling — Note 24). Works omitted included lift installation and structural alteration for staircase although the C&ED had been informed that such omission would not fully comply with the prevailing fire safety standards and barrier free access requirements.

3.17 ***Refurbishment as a minor works project.*** Based on the information provided by the ArchSD, the C&ED applied for funds to refurbish the Tsz Wan Shan quarters as a minor works project. However, in October 2008, the application was not selected by the Accommodation Strategy Group (Note 25) as the proposed works could not meet the prevailing fire safety standards. On the request of the C&ED, the ArchSD revised the scope of works to address the Accommodation Strategy Group's concern and to comply with the relevant requirements. In March 2009, the ArchSD estimated that the project cost would be $26 million, exceeding the minor building works ceiling.

Note 23: *According to the ArchSD, the works scope for refurbishment could differ significantly from patch repair, partial replacement to complete renovation.*

Note 24: *According to Financial Circular No. 2/2007 and the Legislative Council Finance Committee's approval of November 2007, building works not exceeding $21 million could be carried out as a minor works project under the Capital Works Reserve Fund Block Vote.*

Note 25: *The Accommodation Strategy Group chaired by a Deputy Secretary for Financial Services and the Treasury, and comprising the Government Property Administrator and the Director of Architectural Services as members, was responsible for examining and recommending for funding approval of projects costing more than $14 million but not exceeding $21 million.*

3.18 Given the high refurbishment cost, the C&ED consulted the Plan D again on the redevelopment option before submitting a bid for including the refurbishment project in the Capital Works Programme (Note 26). In March and April 2009, the Plan D informed the C&ED that:

(a) there was a change in planning circumstances and a maximum building height of six storeys (the existing building height of the Tsz Wan Shan quarters) had been imposed on the Tsz Wan Shan site. The GIC sites in the planning area would function as breathing space and visual relief to the urban built-up area (Note 27). Redevelopment of the Tsz Wan Shan quarters would be subject to the said height restriction. The existing plot ratio of the site could be adopted as the reference plot ratio; and

(b) an application for minor relaxation of the maximum building height for the Tsz Wan Shan site might be submitted to the Town Planning Board (Note 28) under section 16 of the Town Planning Ordinance (Cap. 131). The Plan D would unlikely give support to an application under section 12A of the Town Planning Ordinance for rezoning of the site for high-rise development as the current GIC zone should be retained as low-rise development.

Note 26: *A proposed capital works project costing more than the minor works ceiling has to be included in the Capital Works Programme for resources planning. Before inclusion as a Category C project in the Capital Works Programme, the relevant policy bureau needs to justify and define the scope of the proposed project with a Project Definition Statement (PDS) and the relevant works agent needs to confirm the technical feasibility of the proposed project on a prima facie basis with a Technical Feasibility Statement (TFS).*

Note 27: *The 2007-08 Policy Address announced that, in the light of the public concerns about the wall effect caused by the increasing number of high-rise buildings, the Administration should review the Outline Zoning Plans of various districts and, where justified, revise the relevant planning parameters to lower the development density. Under such context, amendments were made to the Tsz Wan Shan, Diamond Hill and San Po Kong Outline Zoning Plan to impose building height restrictions.*

Note 28: *The Town Planning Board is a statutory body responsible for preparing statutory plans such as the Outline Zoning Plans and considering representations for proposed amendments to the plans. The Board is chaired by the Permanent Secretary for Development (Planning and Lands) and comprises 5 official members (including the Director of Planning) and 29 unofficial members.*

3.19 ***Refurbishment as a capital works project.*** In March 2009, the C&ED prepared a PDS for refurbishing the Tsz Wan Shan quarters as a capital works project which was endorsed by the SB and the GPA in May 2009. However, in September 2009, the ArchSD informed the SB that its TFS indicated that, based on a more comprehensive works scope (Note 29), the project would cost $89.5 million. The improvement works were required to refurbish the aged quarters to a habitable condition and up to the latest statutory requirements. The ArchSD considered that the refurbishment project was not cost-effective and technically not advisable.

3.20 ***Project shelved.*** Given the advice of the Plan D and ArchSD (see paras. 3.18 and 3.19), in September 2009, the SB informed the GPA of its decision not to use the Tsz Wan Shan quarters. In August 2010, the GPA sought the FSTB's support to demolish the Tsz Wan Shan quarters and return the cleared site to the Lands D (Note 30).

3.21 ***Redevelopment option revisited.*** In June 2011, at an interdepartmental meeting held by the SB to formulate long-term measures to address the shortfall of DSQs, the Plan D advised that it would explore the feasibility of relaxing the building height restriction of the Tsz Wan Shan site for redevelopment. The C&ED then renewed its interest in constructing DSQs at the Tsz Wan Shan site. In August 2011, the Lands D indicated no objection to the redevelopment proposal. In March 2012, the Plan D advised the C&ED that a TFS for redeveloping the site could be conducted based on a minor relaxation of the building height to eight storeys (based on which, the ArchSD subsequently calculated that the plot ratio was 2.9). However, the redevelopment proposal would be subject to the planning permission of the Town Planning Board.

Note 29: *The works included slope upgrading, reconstruction of structural slabs, replacement of electrical, fire services, plumbing and drainage systems, inclusion of lift and environmental design features.*

Note 30: *The demolition works were completed in April 2012 and the cleared site was handed over to the Lands D.*

3.22 ***Redevelopment as a capital works project.*** In December 2012, the SB submitted a PDS for the construction of 56 quarters units on the Tsz Wan Shan site (based on a reference plot ratio of 2.9) to the ArchSD. In May 2013, the ArchSD completed the TFS which was endorsed by the DEVB in July 2013. According to the TFS, the project was expected to be completed by May 2018. In July 2013, the redevelopment project (based on a plot ratio of 2.9) was included in the Capital Works Programme.

3.23 ***Latest development.*** In order to optimise the utilisation of the Tsz Wan Shan site, in January 2014, the SB decided to pursue a rezoning application although the completion date of the quarters redevelopment project might be deferred (Note 31). The circumstances leading to the decision are summarised as follows:

(a) in April 2013, in the light of the difficulty in searching land for development of new DSQs, the SB sought the Plan D's assistance to review the parameters of the building heights and plot ratios of sites identified for developing DSQs including the Tsz Wan Shan site. In response to the Government's policy of optimising the use of land and increasing the development intensity of Government land as set out in the 2013 Policy Address and the SB's request, the Plan D started in April 2013 to comprehensively re-examine the possibility of a higher development intensity for a number of quarters sites; and

(b) in June 2013, the Plan D advised the SB that after a review, it might be possible to relax the development intensity of the Tsz Wan Shan site to a plot ratio of 7.5 through rezoning of the site to Residential Group (A) subject to technical assessments to demonstrate that the development would not result in adverse impacts on traffic, air ventilation and urban design aspects. Based on the Plan D's advice and after discussion with the C&ED, the ArchSD proposed that the number of quarters units could be increased from 56 to 104. The decision to pursue a rezoning application was made after discussions among departments concerned.

Note 31: *According to the Lands D, the site is currently used by another government department as a works site.*

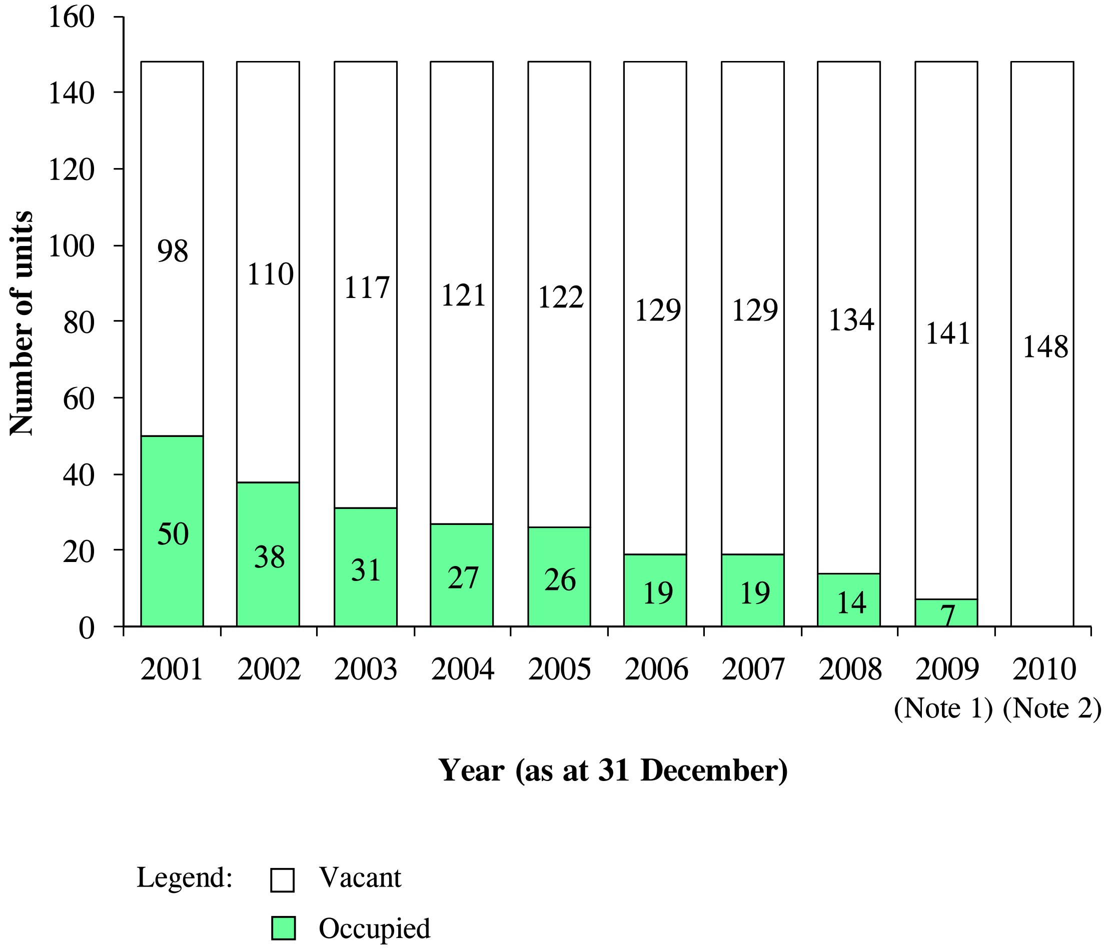
3.24 The above sequence of events shows that the long time taken in the project planning process for the redevelopment of the Tsz Wan Shan quarters was caused by factors including significant changes in cost estimates/project scope as well as the Government's planning policy. Similar issues were also seen in the redevelopment of the Kwun Tong quarters (see paras. 3.30 to 3.31). Areas for improvement are discussed in paragraph 3.37.

Use of the remaining four blocks of surplus quarters

3.25 According to the HD's plan of 2000, the four blocks of quarters at Kwun Tong (No. 1 & No. 2), Lok Fu and Tin Wan were designated for rehousing the occupants of the other blocks to be vacated by 2002 (see para. 3.4). They were allowed to reside in the four quarters until there were concrete development plans. From 2001 to 2006, due to retirement and promotion, some 31 occupants vacated their quarters units which were returned to the GPA for disposal. As a result, the surplus quarters units in the four blocks increased from 98 (66% of a total 148 units) in 2001 to 129 (87%) in 2006 (see Figure 4). On the other hand, there was shortage of Grades F and H DSQs (same grades as the surplus quarters of the HD) according to the analyses compiled by the SB which were copied to the GPA (see Figure 5). In 2007, the SB enquired the GPA about the availability of surplus quarters for reallocation to the disciplined services departments. The GPA then initiated actions to explore the use of the vacant units in the four blocks as DSQs (see paras. 3.26 to 3.33).

Figure 4

Utilisation of the four blocks of quarters (2001 to 2010)



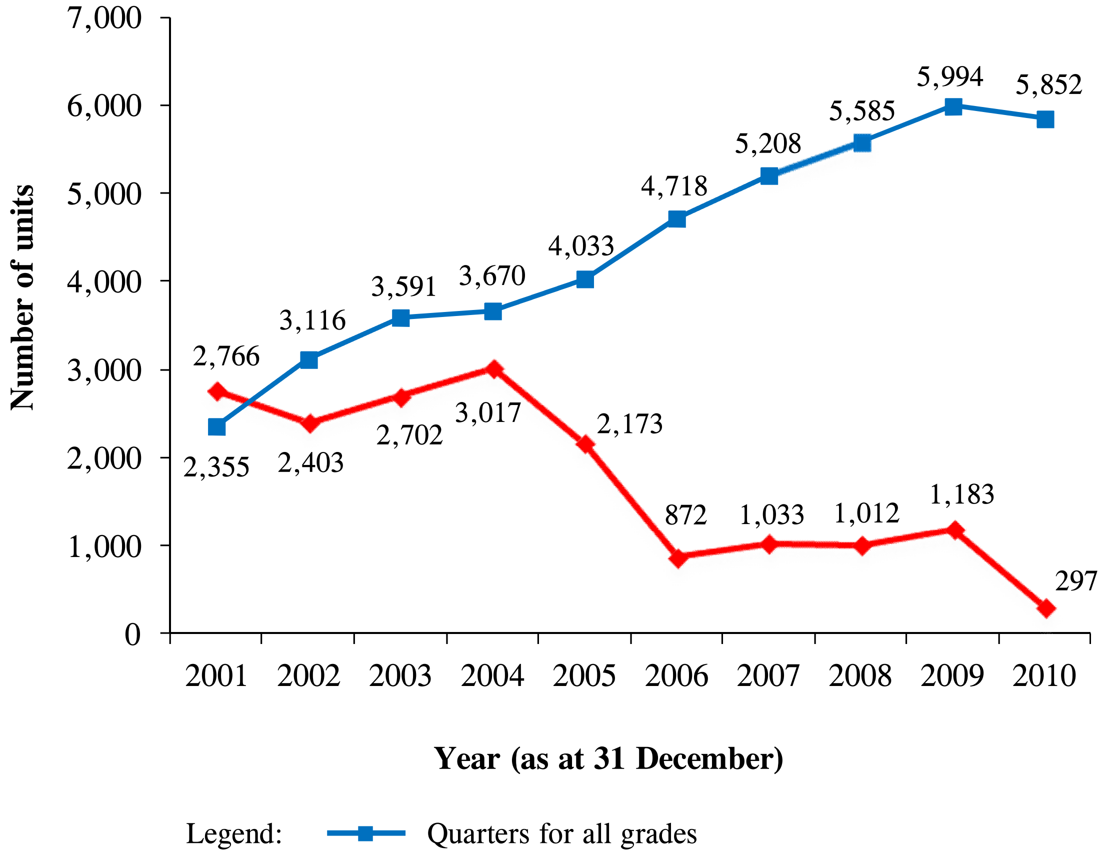
Source: *Audit analysis of HD records*

Note 1: *The last tenant of the Kwun Tong (No.1 & No.2) quarters moved out on 6 November 2009.*

Note 2: *The last tenants of the Lok Fu and Tin Wan quarters moved out on 13 August 2010 and 17 August 2010 respectively.*

Figure 5

Shortfall of DSQs
(2001 to 2010)



Source: *Audit analysis of GPA records*

Remarks: *The decrease in shortfall for Grades F and H quarters from the years 2004 to 2006 was due to the purchase of some 4,300 Home Ownership Scheme flats as DSQs (with some 2,000 graded as H).*

3.26 ***Proposed relocating occupants to vacate quarters sites.*** In April 2007, the GPA asked the HD about the earliest possible date of vacating the quarters sites. In June 2007, the HD informed the GPA that it had examined the feasibility of relocating the only occupant (Note 32) in the Tin Wan quarters to other quarters with a view to vacating the entire site for the GPA's disposal. The proposal had been turned down by the officer concerned in December 2006. According to the retirement schedule of the occupants, the quarters in Tin Wan, Kwun Tong and Lok Fu would become completely vacant in 2010, 2019 and 2020 respectively (Note 33). In the light of the low utilisation of the four quarters, the GPA urged the HD to re-examine the feasibility of relocating the occupants in Kwun Tong and Tin Wan to Lok Fu. In early October 2007, the HD informed the GPA that the occupants of Kwun Tong and Tin Wan quarters did not prefer to be relocated to Lok Fu.

3.27 ***Proposed shared-use of quarters.*** On the basis of the HD's reply, the SB considered that the more viable option was to share the Tin Wan and Kwun Tong quarters with the remaining occupants of the HD. In October 2007 and June 2008, the GPA invited the disciplined services departments to bid for shared-using the four quarters with the HD. However, no agreement was reached among the HD, the ArchSD and the GPA on the maintenance responsibility of the shared-use quarters. In March and May 2009, the HD directed the remaining occupants of the four quarters to vacate their units. In the event, the Kwun Tong quarters were completely vacant in November 2009 while the Tin Wan and Lok Fu quarters were completely vacant in August 2010.

Note 32: *According to the Civil Service Regulations, no officer is entitled as of right to reside in quarters. The Accommodation Regulations state that if the need to house an officer no longer exists, steps should be taken to direct the officer to vacate the quarters allocated to him. An officer may be required to vacate his quarters on at least one month's notice being given.*

Note 33: *According to the HD, noting the strong sentiment from staff who were authorised occupants of these four quarters, it had made projection of the latest possible return dates of the quarters for the scenario that there were no concrete development plans for the quarters sites and the occupants were to stay until their retirement.*

Planning for use as DSQs

3.28 In 2008 and 2009, the vacant units of the four ex-HD quarters were allocated for use as DSQs. Since these quarters were built in the 1960s, they were required to be refurbished or redeveloped before putting into use. After assessing the refurbishment and redevelopment options, the SB decided to redevelop all four quarters. The key milestone dates in planning the use of the four quarters are summarised in Table 6.

Table 6

Key milestone dates in planning the use of four ex-HD quarters (2008 to January 2014)

Site	Kwun Tong (No. 1 & No. 2)	Lok Fu	Tin Wan
User department	ImmD (Note 1)	ImmD	CSD
Date of site allocation (a)	January 2008	December 2009	February 2008
PDS signed date (for refurbishment)	February 2009	April 2010 (Note 2)	N/A (Note 3)
TFS completion date (for refurbishment)	June 2009	November 2010	N/A (Note 3)
PDS signed date (for redevelopment)	May 2010 (Note 4) February 2011	February 2011 (Note 5)	May 2009 (Note 6)
TFS completion date (for redevelopment) (b)	May 2013	June 2011	August 2009
Time lapse (b)-(a)	64 months	18 months	18 months
Project status (Note 7)	Category B	Category B	Category B

Source: GPA and SB records

Note 1: The ImmD is the leading department for the Kwun Tong quarters redevelopment project. The quarters units to be built under this project would be share-used by the C&ED, CSD and the Fire Services Department.

Note 2: In 2010, the ImmD pursued the refurbishment option after obtaining the Plan D's advice that it would unlikely support any rezoning proposal for redevelopment of high rise residential use at the site. According to the Plan D, the site was intended to provide GIC facilities to meet the needs of the local residents and there was a shortage of GIC facilities in the planning area. However, in May 2010, the ArchSD also advised that the refurbishment option would not be cost-effective. After this was confirmed in the TFS, the Plan D advised that it might be feasible to redevelop the site subject to meeting certain requirements (e.g. building height).

Note 3: According to the ArchSD's estimates, the cost of refurbishment was $11 million for 11 units (4 units had to be demolished to provide space for installation of lift which was required under the Disability Discrimination Ordinance — Cap. 487). In March 2009, the ArchSD further advised the CSD that 55 units could be built if the site was redeveloped. As such, the CSD went for the redevelopment option.

Note 4: The TFS for this PDS was discontinued in August 2010 (see para. 3.31).

Note 5: The PDS was for the construction of 80 quarters units.

Note 6: The PDS was for the construction of 55 quarters units.

Note 7: Category B projects under the Capital Works Programme are projects for which the necessary pre-construction work could be undertaken so as to render the project ready in all aspects for upgrading to Category A by the Finance Committee upon the recommendation of the Public Works Subcommittee.

3.29 As shown in Table 6, it had taken 64 months for planning the use of the Kwun Tong quarters (from the date of site allocation to the ImmD to the date of completion of the TFS for redeveloping the quarters) which was much longer than the other two projects. The redevelopment project was included in the Capital Works Programme in July 2013. Audit examined the planning of the redevelopment of the Kwun Tong quarters (see Photograph 1) and the findings are summarised in paragraphs 3.30 to 3.33.

Photograph 1

Ex-HD quarters at Kwun Tong

Source: Photograph taken by Audit on 21 January 2014

Kwun Tong quarters

3.30 ***Refurbishment option.*** In 2008, the ImmD planned to use the Kwun Tong quarters as DSQs after refurbishment (as two units were still occupied by HD staff at that time). In September 2008, the ArchSD advised the ImmD that to meet all statutory requirements, the rough indication of cost for the refurbishment works was $42 million (Note 34). In February 2009, the SB submitted a PDS for the refurbishment works to the ArchSD. In June 2009, the ArchSD advised the SB that after investigation, the estimated refurbishment cost of 90 units, with a more comprehensive works scope (Note 35) was $156 million, i.e. $1.73 million per unit. As the zoning of the Kwun Tong site allowed for a maximum plot ratio of 7.5, the ArchSD estimated that a maximum of 550 Grade H quarters units on two 35-storey towers could be built at a cost of $853 million, i.e. $1.55 million per unit. The ArchSD recommended the SB to consider the redevelopment option which was more cost-effective.

3.31 ***Height restriction on redevelopment option.*** According to the conditions of the land allocation to the HD, the Kwun Tong quarters were subject to a height limit of 11 storeys. To achieve a maximum plot ratio of 7.5, a relaxation of the height limit was necessary. After discussions among relevant departments, in December 2009, the Plan D informed the ImmD of its agreement to relaxing the building height restriction to 120 mPD (Note 36) taking into account the proposed construction of two 35-storey towers. Accordingly, in May 2010, the SB submitted a PDS for the construction of 476 quarters units (comprising 200 Grade H, 228 Grade G and 48 Grade F) on the Kwun Tong site to the ArchSD. However, in July 2010, the Plan D informed the ArchSD that having regard to the updated development parameters and the strong public sentiment against high rise and panel-like buildings, a building height of 78 mPD was considered more appropriate

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Note 34: *According to the ArchSD, the cost was worked out for examining whether the refurbishment works could be carried out as a minor works project. The scope covered basic essential repairs and improvement works for meeting health and safety requirements for living accommodation.*

Note 35: *The works included replacement of fire services, plumbing and drainage systems, inclusion of lift and energy and environmental design features.*

Note 36: *mPD stands for metres above the Hong Kong Principal Datum. It is a surveying term used in Outline Zoning Plans to denote building height restrictions besides number of storeys. The Hong Kong Principal Datum refers to 1.23 metres below sea level.*

for the Kwun Tong site if ancillary facilities such as carpark were provided at basement (Note 37). The ArchSD estimated that the number of quarters achievable would be reduced from 476 to 336 as a result and the TFS was discontinued in August 2010. After further discussions among relevant departments, in October and December 2010, the Plan D advised the ImmD to adopt a building height of 100 mPD for building 448 units as a basis for the TFS application. In February 2011, the SB submitted a new PDS for the construction of 448 quarters units.

3.32 ***Old tree issue.*** In September 2010, the ArchSD informed the ImmD that two large old trees located in the site might hinder its development potential. Upon the ArchSD's request, the ImmD then consulted the Lands D and LCSD which advised that any tree felling application should be made in accordance with the Government's guidelines. In April 2011, the ArchSD informed the SB that the TFS had to be withheld pending the resolution of the tree issue. Thereafter the ArchSD obtained funding for engaging a tree specialist to carry out a survey and submitted a tree felling application to the Lands D in November 2011. After several rounds of consultation with the ArchSD, Agriculture, Fisheries and Conservation Department and LCSD, the Lands D approved the tree felling application in July 2012. As about 1.5 years had been lapsed since the submission of the PDS in February 2011, the ArchSD had to consult relevant departments again on the planning parameters.

3.33 ***Traffic noise issue.*** After resolution of the tree issue in July 2012, the ArchSD examined the noise impact on the redeveloped quarters due to the heavily trafficked Tseung Kwan O Road and its flyover, and worked out a noise mitigation scheme. While the TFS was ready for submission to the DEVB in November 2012, the ArchSD noted that the noise mitigation scheme which required a number of acoustic installations could be improved. In January 2013, the ArchSD explored with the Plan D for relaxing the building height limit so that the units at lower floors facing the Tseung Kwan O Road could be moved to higher floors with fewer acoustic installation requirements. After obtaining the Plan D's approval of building height relaxation in March 2013, the ArchSD submitted the TFS to the DEVB in May 2013 and obtained the DEVB's approval in July 2013.

Note 37: *This was one of the sustainable building design measures recommended by the Council for Sustainable Development to the Government in June 2010. According to the Plan D, implementation of these measures is an important government policy which the Plan D has a duty to follow.*

Areas for improvement

Need to improve the management of surplus quarters

3.34 According to the agreement between the HD and GPA in 2001, the transfer of seven blocks of surplus quarters (Grades F and H) to the GPA was made on the basis that better site utilisation or better use of existing premises would be achieved (see para. 3.5). While there was great demand for such grades of staff quarters by the disciplined services departments (see Figure 5 in para. 3.25), only one of the seven quarters (the Shek Kip Mei quarters) was allocated to the C&ED and the CSD in 2002. For the remaining six ex-HD quarters (with 147 vacant units as at January 2001), it was only in 2007 and 2008 (after receiving requests from the ImmD and the SB — see paras. 3.9(b) and 3.25) that the GPA invited the disciplined services departments to bid for their use. The GPA also had not explored other interim uses (such as commercial letting) except for two of the six quarters (i.e. the Lei Cheng Uk quarters from 2002 to 2004 and the Tsz Wan Shan quarters from 2002 to 2005).

3.35 Upon enquiry, in February and March 2014, the GPA informed Audit that:

(a) the GPA had explored interim uses for the Lei Cheng Uk quarters (see para. 3.8 and Appendix B) and the Tsz Wan Shan quarters (see para. 3.12 and Appendix C). Due to various reasons, the interim uses did not materialise; and

(b) for the remaining four ex-HD quarters, the GPA had the following considerations:

   (i) in view of the low existing plot ratios of the sites compared with the plot ratios of residential developments in the vicinity (see Remarks of Table 5 in para. 3.5), the original intention of the GPA was to demolish the quarters to allow for redevelopment pending complete decantation of the concerned sites by the HD in order to fully release the development potential of the sites;

(ii) there was new development in respect of the provision of DSQs that the Administration launched a consultation in the early 2000's on the introduction of a Housing Assistance Scheme which could serve as an alternative to the option of DSQs;

(iii) as a result of the purchase of Home Ownership Scheme flats (with some 2,000 graded as H) in 2004 for reprovisioning of some old and substandard DSQs (see Remarks of Figure 5 in para. 3.25), the total shortfall of Grades F and H quarters was greatly reduced; and

(iv) in 2000, in connection with the relocation of the HD's quarters occupants to four blocks (see Note 21 to para. 3.4), the Legislative Council urged the departments concerned to make every effort to minimise disturbance to the occupants. Further pooling shortly after the first pooling exercise would cause substantial disturbance to the residents. As the HD's quarters were built in the 1960s and were in dilapidated conditions, converting only the vacant units into DSQs would require extensive refurbishment works which would also cause disturbance to the occupants of the Kwun Tong, Lok Fu and Tin Wan quarters.

3.36 However, it should be noted that Grades F and H quarters for the disciplined services departments were still in shortfall (i.e. 872 in 2006) after the purchase of Home Ownership Scheme flats (see Figure 5 in para. 3.25). Regarding the possible disturbance to occupants of the four partially occupied quarters, the total number of occupied units had been reduced from 50 in 2001 to 27 in 2004 (see Figure 4 in para. 3.25). The Tin Wan quarters only had 2 occupied units out of a total of 15 units in 2004 while the Kwun Tong quarters only had 3 occupied units out of a total of 90 units in 2006. In fact, the Lei Cheng Uk quarters were completely vacant in 2004. There was no record to show that the GPA had explored with the SB in making use of these surplus quarters before 2007. According to the 2001 agreement between the GPA and the HD, the transfer of the HD's surplus quarters was made on the basis that better site utilisation or better use of the quarters would be achieved (see para. 3.5). In Audit's view, the delay in identifying suitable users/uses of the surplus quarters was not conducive to the effective use of resources. The GPA needs to draw lesson from this case.

Need to improve the project planning process

3.37 According to the 2014 Policy Address, the Government would expedite eight DSQs projects (including the Tsz Wan Shan, Kwun Tong, Lok Fu and Tin Wan redevelopment projects) for providing more than 2,200 units by 2020. As mentioned in paragraphs 3.13 and 3.29, the planning process for the Tsz Wan Shan and Kwun Tong redevelopment projects had taken over six years and five years respectively which were longer than the other two projects. The long time taken was caused by factors including significant changes in cost estimates/project scope and technical issues, as follows:

(a) ***Provision of cost estimates.*** For the Tsz Wan Shan case, in March 2009, the ArchSD advised the C&ED that the estimated cost would be \$26 million, but after undertaking a TFS, the ArchSD advised the SB in September 2009 that the cost of works based on a more comprehensive works scope would be \$89.5 million, thus rendering the refurbishment option not cost-effective (see paras. 3.17 and 3.19). Similarly for the Kwun Tong case, the ArchSD advised the ImmD in September 2008 that to meet all possible statutory requirements, the rough indication of cost for the refurbishment works (covering essential repairs and improvement works) was \$42 million. However, in June 2009, the ArchSD advised the SB that after investigation, the estimated refurbishment cost based on a more comprehensive works scope was \$156 million, thus rendering the refurbishment option not cost-effective (see para. 3.30). In Audit's view, ArchSD should work with relevant project proponent departments to define clearly key project requirements (e.g. scope of works and refurbishment standards) at the beginning of the project planning process. In this way, the ArchSD could advise on the viability of options, cost and programme more accurately, thus minimising the need for subsequent revisions which would affect timely completion of TFSs and the delivery programme; and

(b) ***Timely resolution of technical issues.*** According to Financial Circular No. 11/2001 of November 2001, a TFS was expected to be completed within four months upon receipt of the PDS (Note 38). While more time was required for completing the TFS in the Kwun Tong case due to the old tree issue and noise issue, Audit noted that the two issues were dealt

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Note 38: *The target completion time of a TFS is still in force in accordance with Financial Circular No. 4/2012 which has superseded Financial Circular No. 11/2001.*

with in sequence. It turned out the resolution of the noise issue required the Plan D's input in relaxing height limit which had prolonged the time in completing the TFS. Audit considers that the ArchSD should liaise with relevant B/Ds at an early stage to determine all key planning parameters required for resolving technical issues with a view to shortening the lead time in completing a TFS.

Audit recommendations

3.38 **Audit has *recommended* that the Government Property Administrator should:**

(a) **take effective measures to ensure that surplus quarters under the GPA's purview are put into gainful use without delay; and**

(b) **strengthen the coordinating role of the GPA in assisting departments to resolve their problems of surplus quarters or shortage in quarters in a timely and cost-effective manner.**

3.39 **Audit has also *recommended* that the Director of Architectural Services should:**

(a) **work with project proponent departments to define clearly key project requirements at the beginning of the planning process so that the ArchSD could advise on the viability of options, cost and programme more accurately; and**

(b) **liaise with relevant B/Ds at an early stage to determine all key planning parameters required for resolving technical issues with a view to shortening the lead time in completing a TFS.**

Response from the Administration

3.40 The Government Property Administrator accepts the audit recommendations in paragraph 3.38. He has said that:

(a) the original intention of the GPA was to demolish the partially occupied Lok Fu, Kwun Tong and Tin Wan quarters to allow for redevelopment pending complete decantation of the concerned sites by the HD in order to fully release the development potential. It was difficult to put these partially occupied quarters to alternative short-term use because:

   (i) the affected occupants had raised strong objection to the HD's original decantation arrangement and appealed to, inter alia, the Legislative Council which subsequently urged the departments concerned to make every effort to minimise disturbance to the occupants; and

   (ii) since the quarters were built in the 1960s with outdated design, converting them into DSQs or other short-term use required extensive refurbishment works not only in individual units but also in the communal area (including installation of lifts, substantial structural works to bring the means of fire escape up to current statutory requirements, and structural reinforcement works) which would cause disturbance to the occupants shortly after their relocation.

   The concerned sites are now planned for redevelopment as new DSQs. There will be a threefold increase in the number of DSQs units from 148 units to around 600 units;

(b) in 2007, when the SB enquired about the availability of surplus quarters for reallocation to the disciplined services departments, the occupants of the HD's pooling exercise had already moved into the four concerned blocks for around five years. Having regard to the shortage of DSQs as raised by the SB/disciplined services departments and the increasing vacancy in respect of the four blocks, the GPA thus explored the use of the blocks as DSQs, including the options of site refurbishment and in-situ redevelopment;

(c) while there is room for improvement in handling the HD's surplus quarters, there are no surplus DQs currently under the purview of the GPA; and

(d) there are now established procedures and practice for both acquisition of additional quarters and handling of surplus quarters. As regards acquisition, the Heads of Department concerned should assess the supply and demand situation with the policy bureaux. When a need for quarters arises, they should submit an acquisition proposal to the policy bureaux for support and seek funding for the proposed acquisition. As regards surplus DQs, user departments should follow the procedures stipulated in Accommodation Circular No. 3/2008. The GPA stands ready to provide assistance to the departments concerned and to help coordinate the arrangements.

3.41 The Director of Architectural Services agrees with the audit recommendations in paragraph 3.39. He has said that:

(a) as the works scope for refurbishment projects could differ very significantly from patch repair, partial replacement to complete renovation, the ArchSD will in future work closely with project proponents to define the key project requirements such as refurbishment standards and scope of works at the beginning of the planning process; and

(b) the ArchSD will liaise closely with relevant B/Ds for early confirmation of all the key planning parameters required for resolving all technical issues with a view to shortening the lead time for completing all TFSs.

PART 4: SURPLUS QUARTERS OF THE WSD

4.1 This PART examines the following issues relating to the surplus quarters of the WSD:

(a) declassifying surplus quarters as surplus accommodation (paras. 4.2 to 4.10);

(b) co-locating quarters occupants (paras. 4.11 to 4.15);

(c) relinquishing vacant quarters premises (paras. 4.16 to 4.22); and

(d) monitoring the utilisation of surplus accommodation (paras. 4.23 to 4.27).

Declassifying surplus quarters as surplus accommodation

4.2 According to the Accommodation Regulations, the responsibilities of Heads of Department on the management of quarters include:

(a) allocating quarters in accordance with the Code of Practice for Allocation of DQs;

(b) ensuring that quarters are put to their intended use;

(c) ensuring that the supply and demand of government quarters are kept under review. When quarters are no longer required for their originally approved purpose, the GPA should be advised at once so that proposals for alternative use or disposal through deleasing, letting or sale can be considered; and

(d) making an annual return to the GPA of the DQs under their control as at 31 March each year and a monthly return listing DQs vacant for over two months.

Surplus quarters of the WSD

4.3 Each year, the GPA issues a circular to call for annual returns on DQs under the control of relevant B/Ds. Through these call circulars, the GPA has advised B/Ds the following options of putting vacant DQs into gainful uses:

(a) ***Institutional quarters.*** Institutional quarters are those attached to, and are part of an institution, which is an area under the full control of a department. These quarters are not normally capable of disposal either by redistribution to other departments, or commercial letting. They can be, as appropriate:

(i) turned to other departmental uses, e.g. storeroom, office and function room;

(ii) reclassified to "general quarters" (for non-disciplined services departments only);

(iii) declassified and retained as temporary surplus accommodation of the department; or

(iv) co-located and locked up on building basis to minimise recurrent expenditure; and

(b) ***Non-institutional quarters.*** For non-institutional quarters, the department quarters management may consider the following options:

(i) for DSQs above Grade I, the GPA would invite the SB to consider re-distributing the unallocated quarters to meet shortfall of other services. If not so redistributed, the SB's endorsement would be sought for putting the vacant quarters to assist deleasing of leased-in quarters in the hand of disciplined services. For quarters below Grade H, the disciplined services departments may, subject to approval from the SB, consider merging the vacant units to improve take-up; and

(ii) for non-disciplined services quarters above Grade I, the department should return the surplus to the GPA so that disposal through deleasing, for instance, can be considered. For both disciplined and non-disciplined services quarters below Grade H, and if neither redistribution nor deleasing is suitable, the GPA would consider if commercial letting is viable. If this is not possible, the quarters should be treated the same way as the institutional quarters.

4.4 According to the annual return on DQs submitted by the WSD, as at 31 March 2001, the WSD had 491 DQs units (Note 39) in 55 premises, which were used to accommodate operational staff at junior levels serving at the waterworks installations nearby. The WSD considered that there were no longer strong operational needs for the retention of most DQs and had since 2000 ceased to allocate DQs to staff except for a few locations still with operational needs. As a result, most of the WSD's DQs became surplus to requirements as and when they were vacated by their occupants (e.g. upon retirement).

4.5 In accordance with the Accommodation Regulations, the WSD conducted regular reviews of DQs and submitted disposal proposals for surplus DQs units to the GPA for consideration. This resulted in a reduction of the DQs stocks of the WSD from 491 units in 55 premises in March 2001 to 28 units in 15 premises in December 2013 (see Table 7). The changes in DQs stock and disposition of the surplus quarters over the same period are shown in Figure 6.

Note 39: *All the 491 DQs were operational quarters in 2001. Of the 491 DQs, 9 were above Grade I and the remaining 482 were Grade I or below. The sizes of the 482 quarters units ranged from 19 to 59 square metres. According to the SB's analyses from 2001 to August 2013, there was no shortfall in DSQs of Grade I or below.*

Table 7

A comparison of the DQs stock as at 31 March 2001 and 31 December 2013

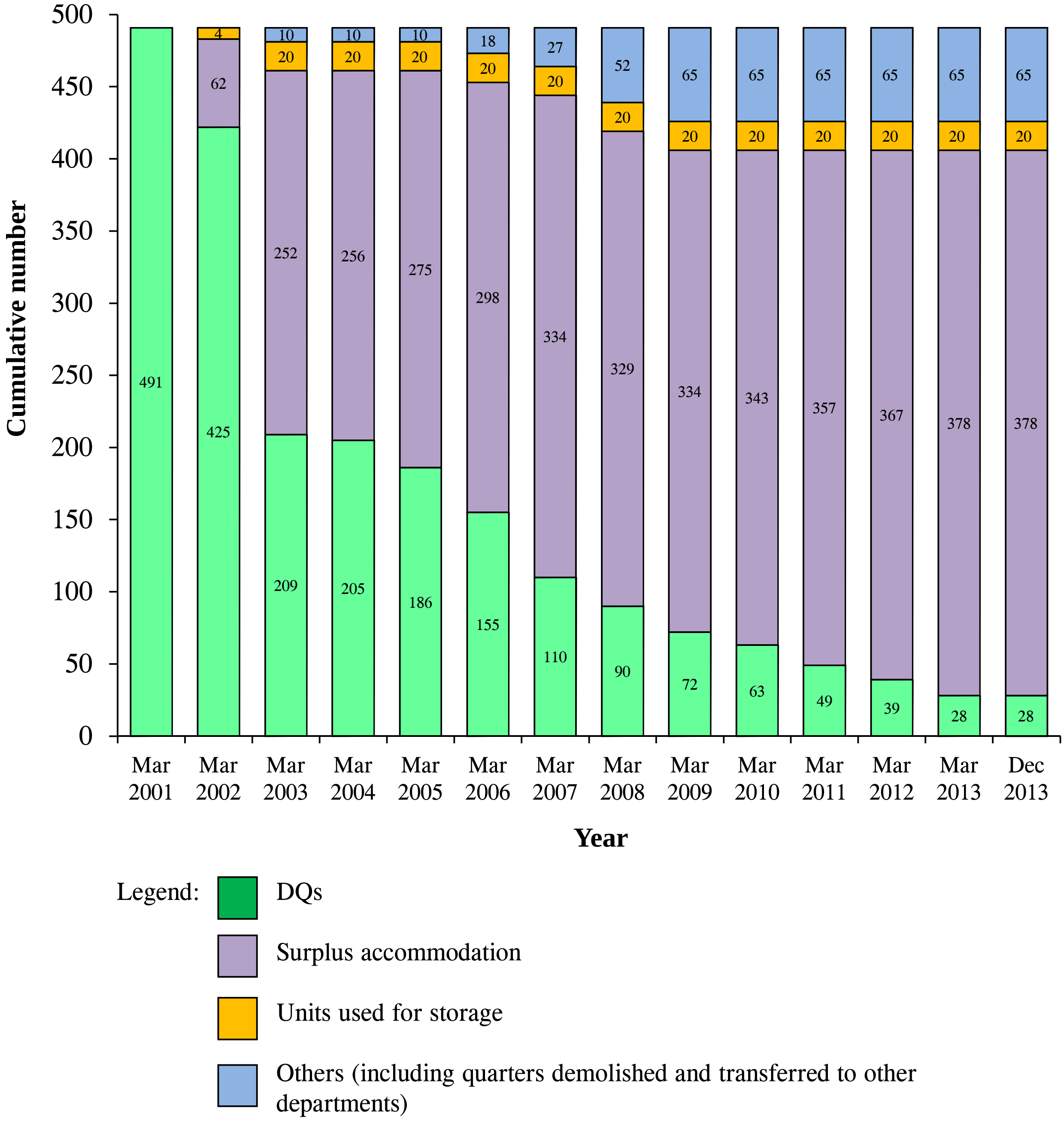
<table>
<tr><th></th><th>Units</th><th>Premises</th></tr>
<tr><td>DQs stock as at 31 March 2001</td><td>491</td><td>55</td></tr>
<tr><td>Less: Demolished</td><td>(37)</td><td>(6)</td></tr>
<tr><td>Transferred to other departments</td><td>(28)</td><td>(9)</td></tr>
<tr><td>Converted for storage use</td><td>(20)</td><td rowspan="3">40
(see details in Appendix D)</td></tr>
<tr><td>Declassified as surplus accommodation</td><td>(378)</td></tr>
<tr><td>DQs stock as at 31 December 2013</td><td>28
(Note)</td></tr>
</table>

Source: GPA and WSD records

Note: The 28 DQs units comprised 24 general quarters and 4 operational quarters. Of the 24 general quarters, one was vacated in October 2013 and the WSD would apply to the GPA for its declassification.

Figure 6

Changes in WSD's DQs stock and disposition of surplus quarters (March 2001 to December 2013)



Source: *WSD records*

Usage of surplus accommodation

4.6 In 2002 and 2003, when approving the WSD's applications for declassifying vacant DQs as surplus accommodation (see para. 4.3(a)(iii)), the GPA reminded the WSD that:

(a) surplus accommodation should be put to gainful use whenever possible; and

(b) for standalone DQs premises that could be occupied by other departments, the WSD should liaise with the GPA when they became completely vacated to see if any of them could be put to other uses or be returned to the Lands D for disposal.

4.7 In June 2005, the then Environment, Transport and Works Bureau (Note 40) expressed concern about the declassification of a large number of DQs as surplus accommodation. The Bureau considered that the declassification should be an interim arrangement and the declassified units should not be left unused for a long time. Audit found that up to December 2013, the WSD had put 48 of the 378 surplus accommodation units into use as follows:

(a) 24 units in 3 premises had been used as site offices by the WSD's contractors (10 units since 2004, 2 units since 2011, 8 units since 2012 and 4 units since 2013);

(b) 18 units in 6 premises had been used for storage purpose. There was no record of the commencement dates of such uses; and

(c) 6 units in 1 premises had been used for the WSD's regional Supervisory Control and Data Acquisition Centre since 2012.

Note 40: *After the re-organisation of policy bureaux of the Government Secretariat in July 2007, the WSD has been put under the policy responsibilities of the DEVB.*

4.8 In February 2014, the WSD informed Audit that:

(a) there were difficulties in putting the surplus units into gainful use because:

(i) they were mainly institutional quarters which were attached to waterworks installations like water treatment works, pumping stations and service reservoirs and were not readily accessible by non-WSD staff for security reasons;

(ii) a large number of its DQs premises were located in areas quite remote from access of public transport whilst occupants usually needed to take a long walk via staircases or otherwise from the nearest public transport unloading points; and

(iii) many of its DQs premises were aged buildings (83% being 30 or more years old), occupying small footprints (averaged site area was 0.017 hectare) and the units were mostly small in sizes, ranging from 19 to 59 square metres; and

(b) actions had been taken in respect of the 330 surplus accommodation units not yet in use (i.e. 378 units less 48 units — see para. 4.7), as follows:

(i) 76 units had been reserved for use of planned projects/site offices;

(ii) 126 units (in 11 premises) had been endorsed by the DEVB for relinquishing and that the Plan D had been requested to explore alternative use of the premises (see paras. 4.14(a) and 4.18). The GPA was also assisting the WSD to identify potential users of the surplus accommodation for the time being;

(iii) 7 units in a joint-user building had been referred to the GPA for identifying the temporary use of the units (see para. 4.26(a)(ii));

(iv) 24 units would be released for alternative uses pending co-locating the occupants/uses of 6 partially occupied/utilised premises (see para. 4.14(b)); and

(v) the remaining 97 units were not accessible to non-WSD staff for security reasons (see para. 4.8(a)(i)).

Inconsistencies in reporting accessibility of surplus DQs units

4.9 When submitting disposal proposals for surplus DQs units to the GPA (see para. 4.5), the WSD provided information about the locations and accessibility of these units by other departments. Audit examination revealed that for DQs premises with surplus units arising in different times, the WSD had reported some surplus units as accessible by other departments but some others in the same premises as not accessible. Of the 40 DQs premises as at December 2013 (see Table 7 in para. 4.5), 24 were found to have such problem of inconsistent information about their accessibility.

4.10 Upon Audit's enquiry, the WSD conducted a review of the accessibility of all the 40 DQs premises. In February 2014, the WSD informed Audit that:

(a) its staff had, over the past years, applied different interpretations when reporting accessibility of the surplus units in different times. For example, for the Diamond Hill Fresh Water and Salt Water Pumping Station Staff Quarters, its staff had once reported the units as accessible due to availability of public transport to reach the premises. On the other hand, other staff had reported the units as inaccessible at a different time for security of the pumping station nearby; and

(b) the inconsistencies mentioned in paragraph 4.9 had been rectified in early January 2014.

As inaccurate information on surplus accommodation may affect the GPA's assessment of its potential for use by other departments, the WSD needs to take measures to prevent recurrence of similar problem.

Co-locating quarters occupants

4.11 In 2009, the WSD reviewed the DQs position and noted that the number of occupied quarters units had decreased from 147 in March 2005 to 60 in September 2009. They were scattered in 25 partially occupied premises. To rationalise the use of quarters premises, the WSD considered different options of vacating and co-locating quarters occupants.

4.12 In January 2010, the WSD sought the GPA's views and agreement on its proposed action plan to co-locate all occupants to three quarters premises. At that time, there were only 47 occupied quarters units in 21 premises (in particular 11 premises had one occupied unit each, with occupancy rates ranging from 10% to 50%). In May 2010, the GPA informed the WSD that its relevant team was fully occupied by other urgent commitment and would revert to the WSD after reviewing the proposed action plan. In September 2010, the GPA informed the WSD that it was concerned that a vast majority of DQs in 21 premises were significantly under-utilised and it would revert to the WSD for supplementary information (such as profiles of existing occupants). Thereafter, there was no record to show that the GPA and WSD had further discussed about implementing the co-locating plan.

4.13 Audit found that as at December 2013, the number of occupied quarters units further decreased to 27. They were scattered in 15 premises which had a total of 254 quarters units. Of the 15 premises, only 2 were used as operational quarters for serving waterworks installations nearby. The other 13 premises (with 232 units) were used as general quarters for which co-locating the occupants was feasible according to the 2010 action plan. Audit was particularly concerned with the general quarters in Hing Fong Road, Kwai Fong (see Photograph 2). It was an 11-storey building built in 1977 to accommodate the operational staff of the then seawater desalting plant which was shut down in 1982. The building had 75 quarters units served by two lifts but only 5 units were occupied (see Photograph 3). While the WSD had taken measures to reduce the building management and maintenance costs to an optimum level (Note 41), the average annual cost (for cleaning and repairs) still amounted to $203,000 from 2010-11 to 2012-13.

Note 41: *The measures taken included locking up unused units, reducing general lighting to floors without occupants as far as possible, adopting less frequent refurbishment cycles and keeping repairing to the minimum in meeting safety requirements.*

Photograph 2

Hing Fong Road general quarters

Source: Photograph taken by Audit on 29 January 2014

Photograph 3

A vacant unit in Hing Fong Road general quarters

Source: Photograph taken by Audit on 17 December 2013

4.14 In February and March 2014, the WSD informed Audit that:

(a) in December 2013 (during the course of audit), the GPA recommended the WSD to consider co-locating the 5 occupants in the Hing Fong Road general quarters to other quarters with a view to releasing the site for alternative development. The WSD took the GPA's advice forward and sought the DEVB's endorsement to relinquish the whole Hing Fong Road general quarters. Subsequently, the WSD had notified the Plan D of its intention to release the site and sought the Plan D's assistance in identifying its long-term alternative use (Note 42);

Note 42: *The GPA informed Audit in March 2014 that the Property Strategy Group (see Note 48 to para. 4.24) had endorsed that the Hing Fong Road general quarters should be decanted by end of 2014 and the site would be disposed of by land sale.*

(b) in line with the GPA's recommendation of co-locating the occupants of the Hing Fong Road general quarters, the WSD revisited the 2010 action plan for co-locating occupants of the remaining 12 general quarters. Following receipt of the GPA's support, the WSD was taking action to actively pursue co-locating of the occupants; and

(c) in February 2014, the Plan D conducted a preliminary assessment to explore the long-term alternative use of the sites of the WSD's 15 partially occupied quarters (13 general quarters and 2 operational quarters). From the land use planning perspective and without consultation on technical feasibility, 3 sites (including the site of the Hing Fong Road general quarters) were assessed to have potential for alternative uses other than GIC use. The other 12 sites were recommended to be retained for GIC uses as some of them were located within the consultation zone of potentially hazardous installations and could not be considered for non-GIC uses which would involve a significant increase in population, not accessed by any roads, being a declared monument, or small in site area. Of these 12 sites, the WSD considered that 6 should either be retained for operational use or should not be used by non-WSD staff due to security reasons.

4.15 In Audit's view, had the 2010 action plan to co-locate quarters occupants been followed through, the under-utilised premises could have been released for alternative uses at an earlier date and the recurrent cost in maintaining them minimised.

Relinquishing vacant quarters premises

4.16 In 2002 and 2003, the GPA advised the WSD that for standalone DQs premises that could be occupied by other departments, the WSD should liaise with the GPA when they were completely vacated to see if any of them could be put to other uses or be returned to the Lands D for disposal (see para. 4.6).

4.17 Pursuant to the GPA's advice, the WSD informed the GPA on two occasions that a total of 13 quarters premises had been entirely vacated. However, only three premises were disposed of, as follows:

(a) in March 2004, the WSD provided the GPA with a list of five completely vacant premises. One of the five premises was demolished in 2007 and two others were transferred to the Lands D for other department's use in 2007 and 2008. The remaining two premises were on outlying islands. They were either not readily accessible by non-WSD staff for security reasons or planned for other use; and

(b) in December 2007, the WSD provided the GPA with a list of eight completely vacant premises. However, the GPA advised the WSD that as the listed premises had been declassified as surplus accommodation of the WSD, the WSD was responsible for ensuring their gainful use (Note 43). The GPA would not take back such accommodation.

4.18 In April 2008, the GPA issued Accommodation Circular No. 3/2008 setting out the procedures and arrangements for handling surplus specialist and departmental accommodation. According to the Circular, user departments have the primary responsibility and are accountable for the proper use and optimal utilisation of their specialist and departmental accommodation. A department with surplus accommodation should:

(a) explore and exhaust possible alternative use within the department before considering giving up the surplus accommodation;

(b) seek endorsement from the relevant policy bureau(x) for relinquishing the surplus accommodation;

(c) seek assistance from the GPA in identifying other government departments to make long-term use of its surplus accommodation. Where the surplus accommodation is in a free standing specialist/departmental building, the department concerned should first inform the Plan D and Lands D of its intended release of the site and building so that consideration could focus on exploring the long-term alternative use of the surplus premises; and

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Note 43: *According to the GPA, this arrangement was in line with its established policy, which was subsequently set out in Accommodation Circular No. 3/2008 (see para. 4.18).*

(d) consider putting the surplus accommodation to commercial use in case no government user is found. The GPA will act as a facilitator and assist the department in exploring suitable commercialisation opportunities.

4.19 From April 2008 (when Accommodation Circular No. 3/2008 was issued) to March 2013, the number of completely vacant quarters premises increased from 13 to 25. In March 2013, after conducting a review in accordance with Accommodation Circular No. 3/2008, the WSD sought the DEVB's endorsement for relinquishing 10 of the 25 (Note 44) premises without quarters occupants. In August 2013, the WSD informed the Plan D of its intention to release the 10 vacant premises (Note 45). In November 2013, the WSD also sought the GPA's assistance to circulate the 10 premises to other departments. Up to March 2014, two departments expressed interest in using 2 of the 10 premises for storage or training purposes.

4.20 In February 2014, the WSD informed Audit that it had taken four years (after the issue of Accommodation Circular No. 3/2008) to complete a review of its surplus accommodation in 2012 because:

(a) during the review, the WSD had explored the possible alternative use of the vacant DQs premises within the department before they were considered for relinquishing; and

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Note 44: *The DEVB's endorsement for relinquishing the 10 premises was obtained in September 2013. For the remaining 15 premises, the WSD's reasons for their retention included: (a) 8 premises were being used as site office/storage/data centre; (b) 3 premises were reserved for other planned projects; (c) 3 premises were not readily accessible by other non-WSD staff for security reasons; and (d) one was a joint-user quarters.*

Note 45: *The WSD informed Audit in March 2014 that according to the Plan D's assessment, 2 of the 10 quarters sites were considered having potential for alternative long-term use for non-GIC purposes, if the sites could be enlarged. For the remaining eight quarters sites, the Plan D considered that they should be retained for GIC use, due to inaccessibility by public transport, declared monument and small size in site areas.*

(b) this also involved the gathering of the necessary detailed information including but not limited to, site plans and drawings, site visits to individual DQs, consultation with relevant parties within the department on temporary and long-term alternative use of the vacant DQs.

Audit, however, noted that as early as December 2007, the WSD had assessed that 8 vacant premises could be returned to the GPA (see para. 4.17(b)). With the benefit of the 2007 assessment, the review for these 8 premises should have been completed earlier than others. It turned out that the WSD only sought endorsement for relinquishing 4 of the 8 premises in March 2013. For the other 4 premises, only 2 were put into use before 2013 (Note 46).

Areas for improvement

4.21 ***For WSD.*** Audit noted that the review by the WSD on its surplus accommodation was completed in 2012, more than four years after the issue of Accommodation Circular No. 3/2008. As a result, there was a delay in circulating information on its vacant premises to other departments. In Audit's view, the WSD should take prompt action on surplus accommodation in accordance with the Accommodation Circular requirements. Audit also noted that some of the premises were temporarily used (or planned to be used) as site offices by the WSD's contractors. The WSD should keep in view the long-term usage of these premises after the completion of contracts.

4.22 ***For GPA.*** In 2007, when informed by the WSD that it had eight vacant premises, the GPA only advised that the WSD was responsible for ensuring their gainful use (see para. 4.17(b)). In 2013, upon the WSD's request, the GPA circulated information on the WSD's ten vacant quarters premises to other departments. There was a lapse of almost six years. For one of the two departments expressing interest in using these premises, the planned use was storage. Audit noted from the GPA records that a number of departments had leased accommodation for storage. For example, 19 departments leased a total of about 30,000 square metres storage space in 2013, at a cost of $3 million a month. The GPA needs to explore with these departments the feasibility of using the surplus

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Note 46: *For the remaining 2 premises, one was reserved for a planned project and one was retained by the WSD because of security reasons.*

accommodation of the WSD to meet their storage space need with a view to saving rental cost.

Monitoring the utilisation of surplus accommodation

4.23 According to the Accommodation Regulations, B/Ds are required to provide the GPA with monthly returns on quarters which have remained vacant for over two months. However, for vacant quarters declassified as surplus accommodation, the GPA has advised the WSD (and other departments with declassified quarters) that they needed not be included in the monthly reports on vacant quarters (see paras. 1.6(e) and 1.7(b)).

4.24 Since 2005, the Treasury in consultation with the GPA has requested B/Ds to provide annual returns on government-owned buildings/premises occupied by them for the delivery of public services (Note 47). To enable the Administration to have an overview of the utilisation level of government-owned buildings/premises, the GPA has also required B/Ds to report in the same annual returns vacant specialist and departmental buildings/premises under their control (hereinafter referred to as the "annual returns on stewardship statement"). Based on information in the returns on stewardship statement, the GPA provides progress reports to the Property Strategy Group (Note 48) for monitoring the utilisation of vacant government-owned specialist and departmental buildings/premises (Note 49).

Note 47: *The information is used to compile a stewardship statement to support the accrual–based financial statements. The accrual–based financial statements are prepared in addition to the annual cash-based accounts and aim to present more comprehensive information on the financial position and performance of the Government. Only the cash-based accounts specified in the Public Finance Ordinance (Cap. 2) are subject to audit by the Audit Commission.*

Note 48: *The terms of reference of the Group include deciding on strategy and approach for management, alternative use and release of surplus government properties and the sites involved. The Group is chaired by the Permanent Secretary for the Financial Services and the Treasury (Treasury) and comprises representatives of the DEVB, ArchSD, Plan D, GPA and Home Affairs Department as members.*

Note 49: *According to Accommodation Circular No. 3/2000 and the GPA's annual call circulars, all B/Ds are also required to provide annual returns on office accommodation review. The returns should include information on surplus office accommodation in excess of 50 square metres which may be returned in the coming five years to facilitate overall accommodation planning.*

4.25 Audit examination revealed the following areas for improvement in the present arrangements for reporting and monitoring the utilisation of surplus accommodation:

(a) in its annual return on stewardship statement for 2012-13, the WSD had not reported 147 surplus accommodation units in partially occupied premises; and

(b) the Property Strategy Group was only informed in July 2013 that the WSD had ten premises which had been vacant for one to eight years (see para. 4.19). In fact, the delays in reporting four of the ten vacant premises could have been detected earlier had the GPA cross-checked the WSD's previous years' annual returns against the list of vacant premises submitted by the WSD to the GPA in 2007 (see para. 4.17(b)).

4.26 In February 2014, the WSD and GPA informed Audit the following:

(a) the WSD said that the reporting instructions of the annual return only required departments to provide information on vacant building/premises under departments' control (in a specified form known as Table B). The unreported units were outside the reporting scope of the annual return because they were either located in:

(i) partially occupied premises instead of vacant premises. A case in point was the Hing Fong Road general quarters where five units were still occupied; or

(ii) a joint-user building that was not under the WSD's control. The building concerned was the To Kwa Wan Road Government Staff Quarters (see Photograph 4) which was under the control of the EMSD (Note 50); and

Note 50: *According to the GPA's records, the building had been share-used by the WSD (7 units) and the EMSD (5 units) but became entirely vacant in 2010.*

(b) the GPA said that departments should report all the surplus accommodation units under their control in the annual returns as there was a column in Table B requiring departments to specify whether the reported units formed part or whole of a building.

4.27 In Audit's view, the GPA needs to have comprehensive records of all government quarters, including surplus ones that have been declassified as surplus accommodation. There is therefore a need to enhance the reporting requirement to avoid misunderstanding. Moreover, to improve the quality of information provided to the Property Strategy Group, the GPA also needs to step up control to ensure that the information of surplus accommodation reported by B/Ds is accurate and complete. Consideration may be given to requiring directorate grade staff of B/Ds to certify the correctness of their returns.

Photograph 4

To Kwa Wan Road Government Staff Quarters

Source: Photograph taken by Audit on 29 January 2014

Audit recommendations

4.28 **Audit has *recommended* that the Director of Water Supplies should:**

Declassifying surplus quarters as surplus accommodation

(a) **maintain detailed and centralised records of the usage of surplus accommodation for management review;**

(b) **take measures to ensure that information provided to the GPA about surplus accommodation (such as accessibility and the annual return on vacant premises) is accurate and complete;**

Co-locating quarters occupants

(c) **step up management control to ensure that outstanding issues on surplus accommodation are thoroughly followed up without delay;**

(d) **expedite action to co-locate quarters occupants with a view to releasing vacant quarters premises for alternative use at an early date and minimising the recurrent cost in maintaining under-utilised quarters premises;**

Relinquishing vacant quarters premises

(e) **take prompt action on surplus accommodation in accordance with the Accommodation Circular requirements; and**

(f) **keep in view the long-term usage of those premises which are temporarily used by the WSD's contractors as site offices**.

Surplus quarters of the WSD

4.29 **Audit has also *recommended* that the Government Property Administrator should:**

Co-locating quarter premises

(a) **step up management control to ensure that outstanding issues on surplus accommodation are thoroughly followed up without delay;**

Relinquishing vacant quarters premises

(b) **take measures to ensure that assistance to B/Ds in dealing with surplus accommodation is provided in a timely manner;**

(c) **assist the WSD in putting its surplus accommodation into gainful use as soon as possible, including exploring with departments, which have leased accommodation for storage, the feasibility of using the surplus accommodation of the WSD to meet their storage space need;**

Monitoring the utilisation of surplus accommodation

(d) **clarify the requirements for reporting surplus accommodation in the annual return on stewardship statement;**

(e) **step up control to ensure that the information on surplus accommodation (both converted to departmental use or not yet put into use) reported by B/Ds in their annual returns is accurate and complete. Consideration may be given to requiring directorate grade staff of B/Ds to certify the correctness of their returns; and**

(f) **remind B/Ds with surplus accommodation to take prompt action in accordance with the Accommodation Circular requirements.**

Response from the Administration

4.30 The Director of Water Supplies agrees with the audit recommendations in paragraph 4.28. He has said that the WSD:

Declassifying surplus quarters as surplus accommodation

(a) has set up a team headed by an Assistant Director and comprising Chief Engineers of each region to maintain detailed and centralised records of all surplus accommodation to facilitate management review;

(b) has rectified the inconsistencies in the reported accessibility of surplus accommodation following the senior management's assessment. Staff have been required to explain and seek endorsement from an officer at Assistant Director level for any subsequent changes. The WSD has also commenced a comprehensive review on quarters information to be provided to the GPA in the annual return;

Co-locating quarters occupants

(c) is currently working on the arrangements for co-locating the existing quarters occupants, taking due consideration the Plan D's assessment on development potential of the partially occupied quarters premises;

Relinquishing vacant quarters premises

(d) has taken proactive action on surplus accommodation according to Accommodation Circular No. 3/2008 since its promulgation. The WSD will continue to ensure that surplus accommodation is dealt with promptly in accordance with the requirements. The WSD will also follow up with the two departments which have expressed interest in using the vacant premises (see para. 4.19); and

(e) will keep in view of the temporary uses of the 24 surplus accommodation units in 3 premises as site offices (see para. 4.7(a)) and plan their long-term usage in accordance with the Accommodation Circular requirements in a timely manner.

4.31 The Government Property Administrator accepts the audit recommendations in paragraph 4.29. He has said that:

Co-locating quarters occupants

(a) the GPA has maintained a register since 2012 to record enquiries/cases relating to quarters management received from B/Ds to ensure that timely advice and assistance are given as and when appropriate. The register is regularly updated and reported to the management;

(b) in February 2014, the WSD revisited and sought the GPA's view on its proposal of co-locating occupants of the remaining partially occupied quarters premises. The GPA replied immediately to the WSD expressing support to its proposal and advised the WSD to consult the Plan D and Lands D to see if there was any long-term alternative use of those sites when designating sites for decanting purpose. The GPA stands ready to assist the WSD to handle the surplus accommodation in accordance with the established procedure set out in Accommodation Circular No. 3/2008. In particular, after the WSD had obtained the DEVB's endorsement to relinquish the Hing Fong Road general quarters, the GPA discussed and agreed with the WSD that the remaining occupants in the staff quarters could be relocated to other WSD's quarters premises as necessary. The quarters building will then be decanted and the site would be disposed of by land sale;

Relinquishing vacant quarters premises

(c) when assisting B/Ds in circulating their surplus accommodation to other B/Ds under Accommodation Circular No. 3/2008, the GPA will request the B/Ds concerned to explore if the surplus accommodation could meet their space requirements in existing leased accommodation with a view to achieving savings in accommodation costs;

Monitoring the utilisation of surplus accommodation

(d) the GPA has comprehensive records of all government quarters based on returns provided by B/Ds (see para. 1.6(e)). For surplus quarters declassified, they are no longer considered as quarters but as other non-quarters departmental accommodation. The GPA has required B/Ds to report vacant premises, whether in whole or in part, under their control in annual returns on stewardship statement. The GPA will monitor the utilisation of these declassified quarters through this arrangement. In addition, B/Ds are also required to include information on any surplus office accommodation in excess of 50 square metres in their annual returns on office accommodation reviews (see Note 49 to para. 4.24). Such returns are required to be cleared by Permanent Secretaries/Heads of Departments before submission to the GPA;

(e) in view of the audit recommendations, the GPA has agreed with the Treasury to introduce the following new measures in mid April 2014 when the Treasury calls for annual returns on stewardship statement:

(i) enhancing the description of requirements for reporting surplus accommodation in the annual returns; and

(ii) requiring the Heads of B/Ds or the heads of finance (with delegated authority) to confirm the correctness of information provided in the annual returns; and

(f) the procedures in handling surplus specialist/departmental accommodation are set out in Accommodation Circular No. 3/2008 which has been placed on the Government's Internet for easy reference by B/Ds. When declassifying a quarters unit, it has been the GPA's practice to remind the B/Ds concerned to follow the Circular's requirements. The GPA will remind B/Ds again to take prompt action under the Circular if they have any surplus accommodation when calling for annual returns. Furthermore, the GPA will also request B/Ds to arrange internal circulation of the Circular regularly so that their surplus accommodation can be handled promptly and properly.

PART 5: WAY FORWARD

5.1 This PART summarises the major audit observations identified in earlier PARTs and examines the way forward.

Major audit observations

5.2 The Government's strategies for the disposal of surplus NDQs are by sale of sites for those built on government-owned sites, sale of units en bloc or individually for those owned by the FSI and leasing for those pending disposal. In its 1996 report, the PAC expressed the view that the selling of surplus NDQs to generate revenue should be the ultimate objective of the Administration as the Government was not supposed to function as a landlord or agent for leasing properties and recommended the disposal of all surplus NDQs within a reasonable specified time frame. The PAC's recommendation was accepted by the Administration. In PART 2, Audit has found that as at October 2013, of the 90 FSI-owned NDQs in the leasing pool, 69 (77%) had been transferred to the GPA for 15 to 17 years. Among the 708 NDQs for allocation to eligible staff, 164 were also FSI-owned which would gradually be transferred to the GPA for sale. The GPA needs to dispose of these surplus NDQs by sale within a reasonable time frame. Audit examination has also revealed room for improvement in the GPA's arrangements for the sale of surplus NDQs by public auction.

5.3 In PART 3, Audit has found that in 2001, the HD transferred seven blocks of surplus quarters (Grades F and H) to the GPA on the basis that better utilisation of the premises would be achieved. However, only one block was used as DSQs in 2002. For the remaining six blocks, it was not until 2007 and 2008 that the disciplined services departments were invited to bid for their use even though these departments had great demands for such grades of quarters. In the event, only one block was used as DSQs in 2009 while the other five were pending redevelopment as at October 2013. In two of the redevelopment projects, the project planning process had taken a long time due to factors including significant changes to cost estimates/project scope and long lead time in resolving technical issues.

5.4 In 2001, the WSD had 491 DQs units which were used to accommodate operational staff serving at the waterworks installations nearby. The WSD considered that there were no longer strong operational needs for retention of most DQs. In PART 4, Audit has found that from 2001 to 2013, 378 surplus quarters units of the WSD in various locations were declassified as surplus accommodation. Up to December 2013, only 48 surplus accommodation units had been put into other departmental uses. While actions had been taken by the WSD in respect of the remaining 330 units for various uses (including reservation for planned projects — see para. 4.8(b)), there was a delay in completing a review of the surplus accommodation in accordance with Accommodation Circular No. 3/2008 of April 2008. As a result, the DEVB's endorsement was only obtained in September 2013 for relinquishing 56 units in 10 vacant premises for consideration of alternative uses by other departments. There were also delays in implementing the 2010 action plan for co-locating quarter occupants which could have released more vacant premises for alternative uses at an early date and minimised recurrent cost in maintaining under-utilised premises. Audit examination has also revealed room for improvement in the present arrangements for reporting and monitoring the utilisation of surplus accommodation by B/Ds.

Audit recommendations

5.5 As shown in Table 1 of paragraph 1.12, besides the WSD, four other departments (the CSD, EMSD, FEHD and LCSD) had a total of 168 surplus quarters which had been declassified as surplus accommodation but not yet put into use as at October 2013. **In the light of the various management problems of surplus accommodation identified in the case of the WSD in PART 4, Audit has *recommended* that the Government Property Administrator should:**

(a) **make effective use of the annual returns on stewardship statement provided by B/Ds to compile management statistics for monitoring the utilisation of the surplus accommodation;**

(b) **liaise with the CSD, EMSD, FEHD and LCSD to:**

(i) **find out the reasons for not yet putting their surplus accommodation into use; and**

(ii) **render necessary assistance to them with a view to optimising the use of government resources as soon as possible; and**

(c) **draw their attention to the management problems encountered in the case of the WSD and urge them to take measures to prevent similar problems.**

Response from the Administration

5.6 The Government Property Administrator accepts the audit recommendations. He has said that:

(a) the GPA will make effective use of the annual return on stewardship statement which enables the Administration to have an overview of the utilisation of government-owned buildings/premises (including former quarters which were declassified), submitted by B/Ds to compile management statistics for monitoring the utilisation of surplus accommodation;

(b) regarding the 168 surplus quarters of the CSD, EMSD, FEHD and LCSD which had been declassified but not put into use as at 31 October 2013, they are scattered in 13 sites. The CSD's 125 surplus accommodation units are located within three correctional institutions on two outlying islands (Hei Ling Chau and Lantau Island), which are difficult to be used by other departments. The surplus accommodation units of the FEHD and EMSD in eight of the sites are either earmarked for disposal/redevelopment or reserved for alternative uses. On the FEHD's request, the GPA has invited other government departments to make use of some of the vacant units. The surplus accommodation unit of the LCSD is now being handled under Accommodation Circular No. 3/2008; and

(c) the departments concerned have been reminded to follow Accommodation Circular No. 3/2008 to deal with surplus accommodation promptly. Furthermore, they have also been reminded to duly report the surplus accommodation in the annual return on stewardship statement. The GPA will follow Audit's recommendation and render prompt and necessary assistance to the B/Ds concerned in accordance with the Circular.

5.7 The Commissioner of Correctional Services has said that:

(a) in accordance with the prevailing practice, DQs not allocated for three consecutive times during the quarters allocation exercises would be locked up with the approval of the GPA, and would subsequently be declassified. Notwithstanding the keen demand for DQs, there are from time to time DQs which could not be successfully allocated particularly those situated at remote areas. The willingness of staff members applying for these remote DQs is hindered by inadequate public transportation and insufficient infrastructure available which can cause inconvenience to their family members. The 125 declassified surplus accommodation units are located at Hei Ling Chau (73 units), Sha Tsui (23 units) and Shek Pik (29 units) respectively. Apart from their remoteness, these quarters are also situated within the boundary of the prisons, which are restricted areas. For security reason, it is undesirable to release these quarters to other departments. Notwithstanding the above, the CSD has been exploring various options to achieve better use of the surplus accommodation units;

(b) the 23 units in Sha Tsui are reserved for a project of the SB's Narcotics Division, which will be brought up to the Resource Allocation Exercise in 2014;

(c) based on past experience of reverting some surplus accommodation as DQs, the CSD plans to revert the 29 units in Shek Pik to DQs;

(d) regarding the surplus accommodation units in Hei Ling Chau, the CSD had explored following uses:

(i) in 2009, the CSD proposed to the Property Vetting Committee for the conversion of all the surplus accommodation units into various facilities (e.g. Anti-drug Exhibition and Education Complex). The proposals were suspended by the Committee due to technical feasibility;

(ii) in 2012, the CSD proposed to the GPA for converting six surplus accommodation units in a DQs block to a Central Visit Room Complex to enhance the visiting services for the public. The project is now pending funding approval;

(iii) the CSD had studied the feasibility of converting 11 surplus accommodation units in a DQs block for centralised administration use. Recently, the ArchSD advised that the installation of a lift in the building was required for the proposal. In view of its complexity and high cost, other possible alternatives are being explored; and

(iv) the CSD had identified three of the surplus accommodation units for reverting as junior staff married quarters for allocation to staff in the coming quarters allocation exercise in mid-2014; and

(e) the CSD has all along tried to make good use of the government resources in order to enhance its services and facilities for staff and the public. On-going exploration and measures have been and will be taken to put surplus accommodation units into gainful use. The CSD also welcomes the assistance of the GPA with a view to optimising the use of government resources.

5.8 The Director of Food and Environmental Hygiene agrees with the audit recommendations generally. She has said that the FEHD has provided returns to the GPA regarding the reasons/justifications on why surplus accommodation is vacant and liaised with the GPA regarding the gainful use of the resources. The latest return was submitted in February 2014.

5.9 The Director of Leisure and Cultural Services has said that:

(a) the LCSD's surplus accommodation unit, namely the Albany Garden Staff Quarters at Garden Road has been vacant since 2002. Over the years, the LCSD has been liaising with the GPA and Lands D to explore alternative uses of the premises. The premises have also been repeatedly circulated within the LCSD and other government departments, but no parties have indicated interest in using the premises mainly because the site cannot be reached by any transportation and users can only access the premises via an uphill footpath; and

(b) the LCSD has taken active actions in accordance with Accommodation Circular No. 3/2008, including seeking advice from the ArchSD and Lands D on the safety, maintenance cost and available tenure of the premises. A rough indication is that, due to the conditions of the premises, the cost of improvement works of maintenance may far exceed the benefits that can be derived. That said, the LCSD will seek the GPA's assistance again in identifying other government departments to make long-term use of the surplus accommodation and/or in exploring suitable commercialisation opportunities with a view to optimising the use of the premises as soon as possible.

Appendix A
(para. 1.12 refers)

Government quarters for allocation and surplus units (October 2013)

Type		Number of units for allocation	Number of surplus units
(A)	NDQs	708	198 (174 in leasing pool and 24 on sale list)
(B)	DQs		
	(i) DSQs	22,436	125
	(ii) Operational quarters	7	260
	(iii) General quarters	77	110
	(iv) Judiciary quarters	23	0
		22,543	495
(C)	Post-tied quarters	179	3
Total (B) + (C)		22,722	498 (declassified as surplus accommodation)

Source: GPA records

Appendix B
(paras. 3.8
and 3.35(a) refer)

Interim uses of the Lei Cheng Uk quarters explored by the GPA (2002 to January 2004)

(A) **Use as dormitory or elderly home**

Such use was found not appropriate as there was no lift service in the premises.

(B) **Commercialisation**

Taking into account the location, layout and facilities of the premises, commercialisation opportunity of the site was considered low.

(C) **Reprovisioning of displaced occupants from Ha Hang DQs**

In February 2003, the GPA obtained confirmation from the then Education and Manpower Bureau that it had no objection to the GPA's proposed use of the Lei Cheng Uk site as quarters on a permanent basis to accommodate occupants that would be displaced from another DQs in Ha Hang, Tai Po which were earmarked for disposal. However, the disposal plan of the Ha Hang DQs was subsequently deferred. In January 2004, the Ha Hang DQs user departments also informed the GPA that there was no need to make available the Lei Cheng Uk quarters for reprovisioning purpose as they would not provide DQs for their staff due to improvement in transport infrastructure.

Appendix C
(paras. 3.12
and 3.35(a) refer)

Interim uses of the Tsz Wan Shan quarters explored by the GPA (2002 to 2005)

(A) **Leasing for non-industrial uses**

In January 2003, the GPA invited tenders for leasing the Tsz Wan Shan quarters for non-industrial uses on a three-year term. During the tender evaluation stage, the GPA noted that the quarters had water leakage problem. Having regard to the cost of repair required before letting, the GPA considered the received tenders not financially attractive. In April 2003, the then Government Supplies Department approved the GPA's proposed cancellation of the tender exercise.

(B) **Use as elderly centre**

In June 2003, the GPA sought the Social Welfare Department's views on whether the quarters were suitable for private elderly centre. In July 2003, the Social Welfare Department informed the GPA that as the quarters (a six-storey building) were located on a steep road and without lift service, they were undesirable for use by the elderly and people with disability.

(C) **Short-term leasing based on market feedback**

In February 2004, the GPA sought views from relevant departments on conducting an expression of interest exercise to test the market response to short-term leasing of the quarters. In March 2004, the Lands D informed the GPA that the Tsz Wan Shan site was tentatively planned for disposal in 2006-07 but it was subject to review on its permanent use. The Lands D had no objection to the short-term use of the quarters up to the end of 2006. In June 2004, the GPA received two submissions expressing interest to lease the quarters. In January and May 2005, the ArchSD informed the GPA that substantial repair/renovation works were required to put the quarters fit for occupation. Due to the short tenure (about 18 months up to end of 2006) and high renovation cost, the GPA considered it not cost-effective to lease the quarters.

Appendix D
(Table 7 in para. 4.5 refers)

WSD's DQs and surplus accommodation (31 December 2013)

Region	Premises	Total number of units	Used as quarters		Declassified as surplus accommodation		Converted as store rooms
			Occupied	Vacant	Used	Vacant	
Hong Kong	**Premises with quarters occupants**						
	Aberdeen Water Treatment Works Staff Quarters (Note 1)	22	2	1	–	19	–
	Cheung Chau Depot Staff Quarters (Note 1)	2	1	–	–	1	–
	Eastern Water Treatment Works Staff Quarters	15	3	–	12 (for temporary storage)	–	–
	Lamma Island Depot Staff Quarters	2	1	–	–	1	–
	Sandy Bay Fresh Water Pumping Station Staff Quarters	10	1	–	2 (for temporary storage)	7	–
	Silver Mine Bay Staff Quarters (Note 1)	20	4	–	4 (site offices) 1 (for temporary storage)	11	–
	Tai Tam Tuk Raw Water Pumping Station Staff Quarters	4	1	–	–	3	–
	Sub-total	**75 (7 premises)**	**13**	**1**	**19**	**42**	–
	Premises without quarters occupants						
	Albany Fresh Water Pumping Station Staff Quarters (Note 2)	8	–	–	–	8	–

Appendix D
(Cont'd)
(Table 7 in para. 4.5 refers)

Region	Premises	Total number of units	Used as quarters		Declassified as surplus accommodation		Converted as store rooms
			Occupied	**Vacant**	**Used**	**Vacant**	
Hong Kong	Cheung Chau Fresh Water Pumping Station Staff Quarters (Note 2)	3	–	–	–	3	–
	Cheung Sha Water Treatment Works Staff Quarters (Note 2)	4	–	–	–	4	–
	Peng Chau Depot Staff Quarters (Note 1)	2	–	–	–	2	–
	Peng Chau Fresh Water Pumping Station Staff Quarters	3	–	–	–	3	–
	Pok Fu Lam Reservoir Staff Quarters (Note 2)	12	–	–	–	12	–
	Tai O Depot Staff Quarters	2	–	–	–	2	–
	Tai Tam Tuk Raw Water Pumping Station No. 2 Staff Quarters (Note 2)	4	–	–	–	4	–
	Wong Nai Chung Staff Quarters (Note 2)	2	–	–	–	2	–
	Sub-total	**40 (9 premises)**	–	–	–	**40**	–
Kowloon	**Premises with quarters occupants**						
	Beacon Hill Fresh Water Pumping Station Staff Quarters (Note 1)	8	1	–	–	7	–
	Diamond Hill Fresh Water & Salt Water Pumping Station Staff Quarters (Note 1)	9	1	–	–	8	–
	Sub-total	**17 (2 premises)**	**2**	–	–	**15**	–
	Premises without quarters occupants						
	Lai Chi Kok Water Selling Kiosk Staff Quarters	4	–	–	–	–	4

Appendix D
(Cont'd)
(Table 7 in para. 4.5 refers)

Region	Premises	Total number of units	Used as quarters		Declassified as surplus accommodation		Converted as store rooms
			Occupied	Vacant	Used	Vacant	
Kowloon	Tai Po Road Water Treatment Works Staff Quarters (Note 1)	15	–	–	–	10	5
	Tai Po Road Water Treatment Works No. 2 Staff Quarters (Note 1)	1	–	–	–	1	–
	To Kwa Wan Road Government Staff Quarters	7	–	–	–	7	–
	Sub-total	**27 (4 premises)**	–	–	–	**18**	**9**
New Territories East	**Premises with quarters occupants**						
	Sheung Shui Water Treatment Works Staff Quarters (Note 1)	24	2	–	–	22	–
	Tai Po Tau Raw Water Pumping Station Staff Quarters (Note 1)	17	1	–	–	16	–
	Sub-total	**41 (2 premises)**	**3**	–	–	**38**	–
	Premises without quarters occupants						
	Lower Shing Mun Raw Water Pumping Station Staff Quarters (Note 2)	6	–	–	–	6	–
	Sai Kung Depot Staff Quarters	1	–	–	1 (for temporary storage)	–	–
	Sha Tin Water Treatment Works Staff Quarters	40	–	–	10 (site offices)	30	–
	Sub-total	**47 (3 premises)**	–	–	**11**	**36**	–

Appendix D
(Cont'd)
(Table 7 in para. 4.5 refers)

Region	Premises	Total number of units	Used as quarters		Declassified as surplus accommodation		Converted as store rooms
			Occupied	Vacant	Used	Vacant	
New Territories West	**Premises with quarters occupants**						
	Hing Fong Road Staff Quarters (Note 2)	75	5	–	–	70	–
	Tsing Yi Salt Water Pumping Station Staff Quarters	4	1	–	–	3	–
	Tsuen Wan Water Treatment Works Staff Quarters	31	1	–	–	20	10
	Yau Kom Tau Water Treatment Works Staff Quarters	11	2	–	–	9	–
	Sub-total	**121 (4 premises)**	**9**	–	–	**102**	**10**
	Premises without quarters occupants						
	Kau Wa Keng Fresh Water Pumping Station Staff Quarters (Note 2)	9	–	–	–	9	–
	Lam Tei Raw Water Pumping Station Staff Quarters	9	–	–	–	9	–
	Shing Mun Reservoir Staff Quarters	1	–	–	1 (for temporary storage)	–	–
	Tai Lam Chung Reservoir Staff Quarters	3	–	–	1 (for temporary storage)	1	1
	Tsuen Wan Raw Water Pumping Station Staff Quarters (Note 2)	7	–	–	–	7	–
	Tsuen Wan Water Treatment Works No. 2 Staff Quarters	2	–	–	–	2	–

Appendix D
(Cont'd)
(Table 7 in para. 4.5 refers)

Region	Premises	Total number of units	Used as quarters		Declassified as surplus accommodation		Converted as store rooms
			Occupied	Vacant	Used	Vacant	
New Territories West	Tsuen Wan Water Treatment Works No. 3 Staff Quarters (Note 2)	1	–	–	–	1	–
	Tuen Mun Salt Water Pumping Station Staff Quarters	6	–	–	6 (data centre)	–	–
	Tuen Mun Water Treatment Works Staff Quarters	20	–	–	10 (site offices)	10	–
	Sub-total	**58 (9 premises)**	–	–	**18**	**39**	**1**
	Total	**426 (40 premises)**	**27**	**1**	**48**	**330**	**20**
			28		378		

Source: WSD records

Note 1: Premises not accessible to non-WSD staff for security reasons (see para. 4.8(b)(v)).

Note 2: Premises endorsed for relinquishing (see para. 4.8(b)(ii)).

Acronyms and abbreviations

ArchSD	Architectural Services Department
Audit	Audit Commission
B/Ds	Bureaux/departments
CSB	Civil Service Bureau
CSD	Correctional Services Department
C&ED	Customs and Excise Department
DEVB	Development Bureau
DQs	Departmental quarters
DSQs	Disciplined services quarters
EMSD	Electrical and Mechanical Services Department
FEHD	Food and Environmental Hygiene Department
FSI	Financial Secretary Incorporated
FSTB	Financial Services and the Treasury Bureau
GIC	Government, Institution or Community
GPA	Government Property Agency
HD	Housing Department
ImmD	Immigration Department
Lands D	Lands Department
LCSD	Leisure and Cultural Services Department
NDQs	Non-departmental quarters
PAC	Public Accounts Committee
PDS	Project Definition Statement
Plan D	Planning Department
SB	Security Bureau
TFS	Technical Feasibility Statement
WSD	Water Supplies Department

CHAPTER 2

Transport and Housing Bureau
Hong Kong Housing Authority
Housing Department

Planning, construction and redevelopment of public rental housing flats

Audit Commission
Hong Kong
4 April 2014

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. 62 of the Director of Audit contains 8 Chapters which are available on our website at http://www.aud.gov.hk

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PLANNING, CONSTRUCTION AND REDEVELOPMENT OF PUBLIC RENTAL HOUSING FLATS

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PLANNING, CONSTRUCTION AND REDEVELOPMENT OF PUBLIC RENTAL HOUSING FLATS

Executive Summary

1. The Hong Kong Housing Authority (HA) is a statutory body established under the Housing Ordinance (Cap. 283) to implement the majority of Hong Kong's public housing programme, including public rental housing (PRH) to assist low-income families who cannot afford private rental accommodation. The Housing Department (HD) is the executive arm of the HA. The HA maintains a Waiting List (WL) of PRH applicants. The HA's current target is to maintain the average waiting time (AWT) for PRH at around three years for general applicants. As at end of December 2013, there were 121,100 general applicants on the WL. The current-term Government has made housing a top priority. As stated in the Policy Address of January 2014, the Government has decided to accept the recommendation of the Long Term Housing Strategy (LTHS) Steering Committee (set up in September 2012) to provide 200,000 PRH units as the new public supply target for the coming 10 years, which is a much higher production target compared to that of 150,000 PRH units set prior to 2013. The Audit Commission (Audit) has recently conducted a review to examine the planning, construction and redevelopment of PRH flats.

Planning for the provision of public rental housing flats

2. ***Assessment of public housing supply and demand.*** The Government had until recently used a mechanism for assessing, on an annual basis, the long-term housing demand for both private and public housing over a 10-year period. In order to determine the quantum of PRH production required to meet the AWT target of about three years, the HD had used a statistical model for assessing the demand for new PRH. The results of the housing demand assessment were reported annually to the Committee on Housing Development (CHD) for endorsement. Audit noted that, in the four years from 2008-09 to 2011-12, despite the increasing 10-year PRH demand as projected by the HD and endorsed by the CHD (from 151,900 to 186,100), the 10-year PRH production targets had remained unchanged at 150,000,

resulting in projected shortfalls in PRH production. Such projected shortfalls had remained relatively low (1% to 8%) initially, but increased to 19% for the forecast period 2011-12 to 2020-21. However, Audit noted that the HD no longer followed the established mechanism for assessing the long-term PRH demand since 2012-13 because the LTHS Steering Committee had adopted a new methodology for assessing the long-term housing demand and had made a timely recommendation to increase production target to 200,000. However, given that the target of maintaining the AWT at about three years is widely known and has been accepted as the measurement for timeliness in satisfying the PRH demand, Audit considers that the HD needs to continue to conduct assessments of long-term PRH demand periodically, duly taking into account the target (paras. 2.6, 2.9, 2.10 and 2.16 to 2.19).

3. S***hortfall in the supply of PRH in the 10-year projection.*** Audit examination of the HD's projections has revealed that the production forecast for the first five-year period from 2012-13 to 2016-17 is about 79,000 PRH flats. For the second five-year period from 2017-18 to 2021-22, the Government had identified sufficient sites to produce more than 100,000 PRH flats. Although this means that more than 179,000 flats would be produced for the 10-year period, Audit notes that there is still a projected shortfall of supply when compared to the new production target of 200,000 PRH flats (para. 2.27).

4. ***Increasing AWT expected.*** The increase in PRH demand and the shortage in PRH supply would have a negative impact on the Government's target of maintaining the AWT for general PRH applicants at around three years. Based on the HD's projections, the AWT for general applicants would reach 3 years by 2014-15 and further increase, in a few years' time, to a level well above 3 years. As the AWT is an important benchmark for assessing the timeliness in satisfying PRH demand, it is important for the HD to ascertain and monitor the quantum of PRH units required to maintain the AWT at or around three years and to closely monitor significant projected production shortfall and projected deterioration of AWT (paras. 2.29 and 2.30).

5. ***Shortage of land supply.*** Land supply is the major factor affecting the PRH production. The major source of land supply for PRH comes from the Government. It is imperative for the HD to secure an adequate supply of land from the Government for PRH production. Audit examination however revealed that subject to resolving many technical issues, local objections and necessary rezoning,

there is still a shortfall of 38 hectares of land based on the LTHS production target of 200,000 PRH flats for the next 10 years (see para. 1 above). To increase land supply for PRH, the Government is exploring possible sources, such as reclamation, opening up new areas, and site redevelopment. However, the complicated process and lengthy time involved in planning and land development present many challenges (paras. 2.33, 2.46 and 2.47).

6. ***Public housing sites returned to the Government.*** During the period 2001 to 2013, the HA had returned 24 PRH redevelopment sites to the Government for other uses. In exchange for these sites, the Government provided replacement sites to the HA for PRH development. Audit however found that in some cases, it took the HA a long time to develop the sites. For example, for the 13-hectare site at Shatin Area 52 (Case 1), the housing estate was originally expected to be completed in 2005 when it was first included in the HD's production programme in 1999. Due to changes in the housing policy and various considerations through the years, the site was returned to the Government. It was not until 2009 that the site was again included in HD's production programme. Construction would only be completed in 2015. For a number of returned sites, the development costs incurred by the HA aggregating $209 million had to be written off from its financial statements in 2011-12 and 2012-13 (paras. 2.60 to 2.62).

Management of public rental housing construction projects

7. ***Monitoring progress of construction projects.*** After a land site was ready for construction, it normally took the HD around 3.5 years to carry out the construction work. According to the 2012-13 public housing construction programme, six PRH projects would be completed in 2012-13 involving the production of 13,114 flats. Audit found that there had been some project delays, ranging from 2 to 7 months, in these six projects. According to the HD, the delays were mainly due to extra inclement weather and some legitimate or genuine grounds for extension of time that the contractors were entitled to. However, such project delays not only affect the timely delivery of PRH flats which were in great demand, but may also cause great inconvenience to the incoming tenants and lengthen their actual waiting time for PRH (paras. 3.9, 3.12 and 3.13).

8. ***Monitoring costs of construction projects.*** The HD has a system in place to monitor and control the costs of construction projects. Audit analysed the six projects completed in 2012-13. All of them involved budget revisions due to changes in construction cost yardsticks, award of contracts, or contract price fluctuations. Audit found that the actual/estimated costs of these six completed projects were within the approved budgets. However, in three of the six projects, there were large variances (27% to 37%) of the actual/estimated costs from the original budgets. There is room for improving the budgeting, monitoring and management of PRH project costs. According to the 2014-15 Budget Speech of 26 February 2014, the HA will have an estimated balance of $68 billion at the end of 2013-14, which can meet the funding requirement of the development programme for the next four years; however, to achieve the new housing production target, the HA must keep enhancing cost-effectiveness and sustainability of modus operandi in the long run (paras. 3.16, 3.20 and 3.21).

Redevelopment of public rental housing estates

9. ***Comprehensive Structural Investigation (CSI) Programme.*** The CSI Programme, rolled out in 2005, includes a detailed investigation which aims to determine the material strength and rate of deterioration of the structural elements of a building. The findings would facilitate the consideration and planning of the necessary follow-up actions such as monitoring, repair or clearance. Demolition will be considered for structurally unsafe blocks and blocks beyond economic repair. For other blocks, appropriate works would be arranged to sustain the buildings for at least 15 years before another detailed CSI. Up to January 2014, 26 old estates built in 1980 or earlier had been assessed under the CSI Programme and found to be structurally safe. Only So Uk Estate and Tung Tau Estate Block 22 were recommended for redevelopment because the estimated structural repair costs were not economically viable. Audit found that, based on the experience of the redevelopment of Tung Tau Estate Block 22, the process of redevelopment could take many years and the build-back potential of the site required careful analysis and planning. In consideration of the resource demand and the anticipated amount of works involved, the HD currently conducts the CSI for only 3 to 4 estates per year. Audit notes that there are 42 estates included in the CSI Programme covering the period from 2005 to 2018. More estates would likely be included in the next CSI Programme beyond 2018. The existing resources for investigating 3 to 4 estates per year might not be sufficient to cope with the work load in future (paras. 4.5 to 4.11).

10. ***Refined Policy on Redevelopment.*** To meet the high demand for public housing, the HA explores the scope for building more flats through redevelopment of existing PRH estates with a plot ratio lower than the maximum permissible. In November 2011, the HA implemented the Refined Policy on Redevelopment of aged PRH estates by considering the build-back potential and the availability of nearby rehousing resources. Under the Refined Policy on Redevelopment, the build-back potential is a key factor to be considered for the redevelopment of PRH estates. At the time of introduction of the Refined Policy, CSI had been completed for 26 old estates, but 22 had not been assessed for their build-back potential. Up to December 2013, Pak Tin Estate was the only estate identified for redevelopment after passing CSI. For Pak Tin Estate, in January 2012, the HA endorsed the plan for its redevelopment. However, Audit found that new lifts had been installed at a cost of about $32 million shortly before the decision to launch the redevelopment of Pak Tin Estate and less than one year after the installation of the new lifts, 94% of the tenants had moved out (Case 7). The HD should have better coordination within the department so that resources would not be wasted due to the launching of redevelopment plan shortly after the completion of improvement works in an estate in future (paras. 4.17, 4.18, and 4.20 to 4.24).

11. ***Better utilisation of vacant sites and Interim Housing (IH) blocks.*** Audit found that some PRH redevelopment sites which had been cleared a number of years ago were still left undeveloped. An example is the Phases 3, 6 and 7 of Shek Kip Mei Estate (Case 8). The HD needs to explore the better use of its existing land resources and explore the feasibility and expedite the process of putting the vacant sites into beneficial uses. Furthermore, as at January 2014, the HA had three IH estates, namely Shek Lei (II) IH, Long Bin IH (targeted to be cleared in January 2016) and Po Tin IH, which provided a total of 4,914 units, but had a vacancy rate of 60%, 40% and 8% respectively. In view of the age, increasing maintenance cost and high vacancy rates, the HD needs to explore measures to make better use of these resources (paras. 4.27 and 4.29).

Way forward

12. There has been an increasing demand for PRH flats in recent years. As at end of December 2013, the AWT for PRH was 2.9 years. The Government has accepted the LTHS Steering Committee's recommendation to adopt a higher 10-year target of 470,000 units for new public and private housing supply (with public

housing accounting for 60% of this target). There are challenges facing the HA and the Administration in planning, construction and redevelopment of PRH estates for meeting the production target for public housing and the three-year AWT target (paras. 5.2 and 5.3).

Audit recommendations

13. **Audit recommendations are made in the respective sections of this Audit Report. Only the key ones are highlighted in this Executive Summary. Audit has *recommended* that the Director of Housing should:**

Planning for the provision of PRH flats

(a) **continue to perform the assessment of long-term PRH demand annually and report the results for endorsement by the CHD and updating of the total housing demands of the LTHS (para. 2.22);**

(b) **step up efforts to increase PRH production with a view to meeting the 10-year production targets, taking into account the need to maintain the AWT at about three years for general applicants (para. 2.31(b));**

(c) **liaise closely with the Development Bureau and the Planning Department to secure sufficient number of suitable sites and discuss how best to make use of the identified sites to meet the new PRH production target (para. 2.56(a));**

(d) **take into consideration the projected long-term PRH demand and the production targets under the LTHS in his discussions with the relevant bureaux and departments about the return of public housing sites to the Government for other uses (para. 2.69(a));**

Management of PRH construction projects

(e) **closely monitor the PRH construction projects and take early remedial actions on project delays, in order to ensure their timely completion (para. 3.14(b));**

(f) **continue enhancing its system of budgeting and monitoring of project costs with a view to further improving the accuracy of budgeting for PRH construction projects (para. 3.22);**

Redevelopment of PRH estates

(g) **critically assess the resource requirements for the CSI and plan ahead for the implementation of the next CSI Programme (para. 4.12);**

(h) **expedite the detailed assessment of the build-back potential for all aged PRH estates with CSI completed (para. 4.25(b));**

(i) **closely monitor the demand and supply of IH flats and their vacancy rates and explore the feasibility for their redevelopment (para. 4.32(a));**

(j) **explore the feasibility of putting the vacant HA sites into beneficial uses (para. 4.32(b)); and**

(k) **duly take into account experiences from the previous PRH redevelopment projects in planning for future redevelopment, with a view to optimising land, manpower and financial resources (para. 4.32(c)).**

14. **Audit has also *recommended* that the Secretary for Transport and Housing should take on board the audit observations and recommendations in this Audit Report when formulating and implementing the LTHS (para. 5.7).**

Response from the Administration

15. The Director of Housing agrees with the audit recommendations. The Secretary for Transport and Housing has said that Audit's observations and recommendations would be taken into account in formulating the LTHS.

PART 1: INTRODUCTION

Background

1.1 This PART describes the background to the audit and outlines the audit objectives and scope.

1.2 Housing in Hong Kong is provided through three channels, namely private housing, public rental housing (PRH), and subsidised home ownership housing (primarily Home Ownership Scheme (HOS) flats). PRH and subsidised home ownership housing are primarily provided by the Hong Kong Housing Authority (HA).

1.3 The HA (Note 1) was established in 1973 as a statutory body under the Housing Ordinance (Cap. 283). It is responsible for implementing the majority of Hong Kong's public housing programme, including PRH to assist low-income families who cannot afford private rental accommodation.

1.4 The Housing Department (HD), as the executive arm of the HA, provides secretarial and executive support to the HA and its committees. The HD also supports the Transport and Housing Bureau (THB) in dealing with all housing-related policies and matters. The HD is headed by the Permanent Secretary for Transport and Housing (Housing) who also assumes the office of the Director of Housing. To help forge closer collaboration between the HA and the Government in the provision of public housing services, the Secretary for Transport and Housing and the Director of Housing have respectively assumed the positions of the Chairman and Vice-chairman of the HA. Appendix A shows an extract of the organisation chart of the HD.

Note 1: *As at end of December 2013, the membership of the HA comprised 25 non-official members and four official members. Appointments are made by the Chief Executive of the Hong Kong Special Administrative Region. Six standing committees together with a number of sub-committees are formed under the HA to formulate and oversee policies in specified areas.*

1.5 As at end of December 2013, the HA had a stock of about 742,000 PRH flats in 210 estates, accommodating some 2 million people (721,000 households) or about 30% of Hong Kong's total population. The operating income and expenditure for PRH in 2013-14 are estimated at $11.9 billion and $12.7 billion respectively (i.e. an operating deficit of about $0.8 billion). The construction expenditure for 2013-14 is budgeted at $9.9 billion (Note 2).

PRH production

1.6 One of the HA's strategic objectives is to facilitate the cost-effective provision of quality PRH. The HD is responsible for the provision of PRH including, among others, the planning, construction and redevelopment of PRH flats. The Development and Construction Division (DCD) is responsible for the new production of PRH (see Appendix A). As at 31 December 2013, out of a strength of 8,848 staff in the HD, about 2,135 staff worked in the DCD.

1.7 Public housing resources are valuable and heavily subsidised. According to the HD, the average construction cost for a PRH flat is about $700,000 (not including the land cost), and it takes about five years to complete a project containing PRH flats, from site inception to works completion. Table 1 shows the number of PRH flats built by the HD between 2003-04 and 2012-13. It can be seen that the annual production of new PRH flats fluctuated between a high of 24,682 in 2004-05 and a low of 7,192 in 2006-07, with an average of 15,031 for the 10-year period 2003-04 to 2012-13.

Note 2: *The sum is accounted for as construction in progress assets during the construction of the flats and transferred to fixed assets on completion of construction.*

Table 1

**Annual PRH production
(2003-04 and 2012-13)**

Financial year	Number of units
2003-04	15,148
2004-05	24,682
2005-06	17,153
2006-07	7,192
2007-08	13,726
2008-09	19,050
2009-10	15,389
2010-11	13,672
2011-12	11,186
2012-13	13,114
Average	15,031

Source: HD records

Increasing demand for PRH

1.8 The HA maintains a Waiting List (WL) of PRH applicants. The HA's current target is to maintain the average waiting time (AWT — Note 3) at around three years for general applicants (including both family applicants and single elderly applicants) and around two years for single elderly applicants. Non-elderly one-person applicants are placed under the Quota and Points System (QPS). No target is set on the AWT for applicants under the QPS.

Note 3: *The HA defines waiting time for PRH as the period between registration on the WL and the first housing offer, excluding any frozen period in between. The AWT for general applicants is the average of the waiting times up to the first housing offers for all general applicants who were housed in the past 12 months.*

1.9 In recent years, there has been an increasing demand for PRH. Table 2 shows the number of applicants on the WL for PRH in the 10-year period 2003-04 to 2012-13. As at end of December 2013, there were about 121,100 general applicants and about 122,200 non-elderly one-person applicants under the QPS on the WL. The large number of WL applicants indicates a great demand for PRH. This also puts immense pressure on the HA in meeting the AWT target of around three years for general applicants.

Table 2

Number of applicants on the WL for PRH (2003-04 to 2012-13)

Date	Number of applicants on the WL for PRH (Note 1)	
	General applicant	Non-elderly one-person applicant
31.3.2004	91,000	— (Note 2)
31.3.2005	91,400	— (Note 2)
31.3.2006	97,400	— (Note 2)
31.3.2007	70,500	36,700
31.3.2008	73,100	38,500
31.3.2009	71,700	42,700
31.3.2010	77,800	51,300
31.3.2011	89,100	63,400
31.3.2012	101,700	87,800
31.3.2013	116,900	111,500

Source: HD records

Note 1: Figures are rounded to the nearest hundred.

Note 2: Prior to the introduction of the QPS in September 2005, all PRH applicants were considered applicants on the WL for PRH and there was no formal classification into "non-elderly one-person applicants" and "general applicants". Statistics on the QPS (including the number of non-elderly one-person applicants) are only available starting from 2006-07.

Higher production target set for PRH

1.10 ***2013 Policy Address.*** The current-term Government has made housing a top priority. PRH remains the basic strata of the housing ladder. It is the Government's target to provide PRH to low-income families who cannot afford private rental accommodation. According to the Policy Address of January 2013, the Government would increase the supply of PRH, and adopt a target of producing 75,000 new PRH flats over the five years from 2012-13 and at least 100,000 units in total for the five years starting from 2018.

1.11 ***Long Term Housing Strategy (LTHS) Review.*** The Government embarked on the LTHS Review in October 2012. A public consultation on the LTHS was conducted by the LTHS Steering Committee, which ended on 2 December 2013. The report on the public consultation was submitted to the Government in February 2014. According to the report, the public generally concurs that the Government should adopt a supply-led strategy to resolve the housing problem. There is considerable public support for the long-term housing supply target of 470,000 units for the coming 10 years as recommended by the Steering Committee, with public housing accounting for at least 60% or about 280,000 units of the new housing production. The Government will take account of the consultation report and other views collected during the consultation in formulating the LTHS which is expected to be announced later in 2014.

1.12 ***2014 Policy Address.*** As stated in the Policy Address of January 2014, the Government has decided to accept, in advance, the LTHS Steering Committee's recommendation to adopt 470,000 units as the new public and private total supply target for the coming 10 years. Within public housing, the Government aims to provide an average of about 20,000 PRH units and about 8,000 HOS units per annum over the 10-year period, i.e. a total of 280,000 public housing units (about 60% of the housing supply target). This is a much higher production target compared to the previous one and is likely to exert significant pressure on the HA and the Government in the next few years.

Audit review

1.13 ***Audit review of October 2013.*** In October 2013, the Audit Commission (Audit) completed a review to examine the allocation and utilisation of PRH flats. The review found that there was room for improvement in a number of areas including allocating flats to people in need of PRH, maximising the rational utilisation of PRH flats, and tackling abuse of PRH. The review results were included in the Director of Audit's Report No. 61 of October 2013.

1.14 Against the above background, and in view of the higher production target set for PRH (see paras. 1.10 to 1.12), Audit conducted a review to examine the planning, construction and redevelopment of PRH flats. The audit review focused on the following areas:

(a) planning for the provision of PRH flats (PART 2);

(b) management of PRH construction projects (PART 3);

(c) redevelopment of PRH estates (PART 4); and

(d) way forward (PART 5).

Audit has found room for improvement in the above areas, and has made a number of recommendations to address the issues.

Acknowledgement

1.15 Audit would like to acknowledge with gratitude the assistance and full cooperation of the staff of the THB, the Development Bureau (DevB), the HA, the HD, the Lands Department (LandsD) and the Planning Department (PlanD) during the course of the audit review.

PART 2: PLANNING FOR THE PROVISION OF PUBLIC RENTAL HOUSING FLATS

2.1 This PART examines the HD's planning for the provision of PRH flats to people in need. The following issues are discussed:

(a) ***Assessment of public housing supply and demand.*** Audit noted that the Government had until recently adopted a mechanism for assessing the long-term housing demand, which was similar to the approach adopted by the LTHS Steering Committee. Despite increasing projected demands for PRH in the past few years, the previous PRH production targets had not been increased accordingly until 2013 (see paras. 2.2 to 2.23);

(b) ***Meeting the pledged production targets.*** Audit noted that, despite ups and downs in the annual PRH production, between 2003-04 and 2012-13, the previous 10-year production target of 150,000 had generally been met. However, with reference to the much higher production target recently announced for the next 10 years, the HD's latest PRH production forecast has revealed that there would be a projected shortfall in supply. The analysis also shows that the AWT for general applicants would, in a few years' time, increase to a level well above the benchmark of 3 years (see paras. 2.24 to 2.32);

(c) ***Supply of land for public housing.*** Audit noted that the shortage of land supply for public housing and the long time taken for planning and land development process had posed challenges to the Government in meeting the PRH production target in the past and would pose greater challenges going forward (see paras. 2.33 to 2.57); and

(d) ***Long process and time taken to develop sites.*** Audit noted that, in previous years, some PRH sites were returned for a variety of reasons to the Government for other uses. In exchange for these sites, the Government provided replacement sites to the HA for PRH development. However, in some cases, it took the HA a long time to develop the sites.

For a number of such returned sites, the development costs incurred by the HA had to be written off from its financial statements. In view of the higher production target for PRH, the HA and the Government need to closely monitor the possible delays that the returning of sites may cause to PRH production in future (see paras. 2.58 to 2.70).

Assessment of public housing supply and demand

Demand for PRH flats

2.2 According to the HD, the overall demand for PRH broadly comprises demand from WL applicants and other demands.

2.3 ***Demand from WL applicants.*** The HA maintains a WL of PRH applicants. The HA's current target is to maintain the AWT at around three years for general applicants. The demand for PRH from WL applicants has been increasing in recent years (see paras. 1.8 and 1.9).

2.4 ***Other demands.*** These are housing requirements arising from redevelopment of old PRH estates, urban renewal, clearance of squatters and roof-top structures, compassionate rehousing, quota for civil servants and transfer from sitting tenants. These demands are, to a large extent, dependent on the housing policies and programmes of the HA and the Government. Table 3 shows the actual allocation of PRH flats to meet different categories of demands from 2008-09 to 2012-13.

Table 3

Actual allocation of PRH flats to meet different categories of demands (2008-09 to 2012-13)

Demand	Number of flats allocated				
	2008-09	**2009-10**	**2010-11**	**2011-12**	**2012-13**
WL applicants	24,598	20,875	15,900	19,789	15,551
Other demands:					
Redevelopment/Estate clearance (Note 1)	3,084	3,360	78	80	2,527
Urban renewal (Note 2)	91	123	231	131	105
Other clearance (Note 2)	86	99	53	31	35
Compassionate rehousing (Note 3)	2,039	2,449	2,439	2,673	2,213
Civil service public housing quota (Note 4)	738	827	662	846	828
Transfer of sitting tenants (Note 5)	8,981	7,909	6,092	7,779	5,751
Emergency (Note 6)	0	8	8	4	0
Total	39,617	35,650	25,463	31,333	27,010

Source: HD records

Note 1: Tenants in old PRH estates scheduled for redevelopment or who have to move out due to comprehensive repair or improvement works of their PRH flats may apply for other PRH flats (see para. 4.31).

Note 2: For people affected by clearance projects of the Urban Renewal Authority or the Government (such as squatter clearance), PRH flats may be allocated to them.

Note 3: Applicants suffering from hardships of various nature (such as serious illness, disability or social problem) may apply direct to the Social Welfare Department (SWD), non-governmental organisations approved by the SWD, or Probation Offices for compassionate rehousing. After confirming the eligibility of applicants, they are recommended by the Director of Social Welfare to the HD for the allocation of PRH flats.

Note 4: This comprises a special quota and a general quota. The former is mainly for junior officers in the disciplined services who are within 10 years of retirement, residing in departmental quarters. The latter is for junior officers in the disciplined services who are not eligible for the special quota, Model Scale 1 staff and junior civilian staff. The quota is subject to review every year.

Note 5: Tenants may want to move to a bigger or another flat due to an increase in household size or special reasons. The HD has various transfer arrangements to cater for different needs of tenants.

Note 6: Flats are normally allocated to victims of natural disasters or fire and those who are in imminent need of housing.

2.5 ***Long-term housing demand assessment.*** While planning and land issues are overseen by the Secretary for Development, housing issues are overseen by the Secretary for Transport and Housing. The long-term housing demand assessment was monitored by the Committee on Housing Development (CHD — see Appendix B) under the chairmanship of the Permanent Secretary for Transport and Housing (Housing) cum Director of Housing. The objective of the assessment was to provide a broad-brush, indicative reference for long-term land-use planning and reservation for PRH. The production requirement for PRH should be guided and adjusted by the Government's objective to maintain the AWT at around three years for general WL applicants.

2.6 Following a recommendation of the Review of the Report of the Task Force on Land Supply and Property Prices in 1994, the Working Group on Housing Demand, which was then under the chairmanship of the PlanD, was tasked to conduct regular assessments of the long-term housing demand for both the private and public housing over a 10-year period. With the merger of the former Housing Bureau and the HD on 1 January 2003 and in view of the new housing policy framework, a housing demand assessment model was developed and endorsed by the then Committee on Housing Policy (CHP) in 2004. Thereafter, such housing demand assessments had been conducted by the HD basically on an annual basis. The results of the housing demand assessment were reported to the CHD annually for endorsement.

2.7 Under the assessment model, "housing demand" is defined as the number of new housing units required to provide adequate housing for each and every household during the 10-year projection period. This "household-based" approach is different from the market demand in the strict economic sense which is essentially market-driven and affected by a host of other prevailing economic factors.

2.8 Under this assessment framework, the total housing demand for both public and private sectors was assessed by summing up demands arising from the following three sources:

(a) formation of new households from population growth and household splitting based on projections from the Census and Statistics Department;

(b) rehousing of households affected by demolition of old buildings in both public and private sectors; and

(c) rehousing need from “inadequately housed” households (i.e. those residing in living quarters that are not self-contained or built of permanent materials, or those households who involuntarily share their living quarters with other households).

2.9 In addition, in order to determine the quantum of PRH production required to maintain the AWT at three years as pledged by the Government, the HD had since 2000 used a statistical model for assessing the demand for new PRH flats. A diagrammatic illustration of the methodology for assessing long-term housing demand for new PRH flats is shown at Appendix C.

2.10 The LTHS Steering Committee formed in September 2012 adopted a new methodology for projecting the long-term housing demand as disclosed in its consultation report (see para. 1.11). Under the methodology adopted by the Steering Committee, housing demand, which includes demand for both private and public housing, is defined as the total number of new housing units required to be built if each and every household is to be accommodated in adequate housing over the long term. The following major components are considered by the Steering Committee when projecting the number of new housing units required:

(a) net increase in the number of households;

(b) those who will be displaced by redevelopment; and

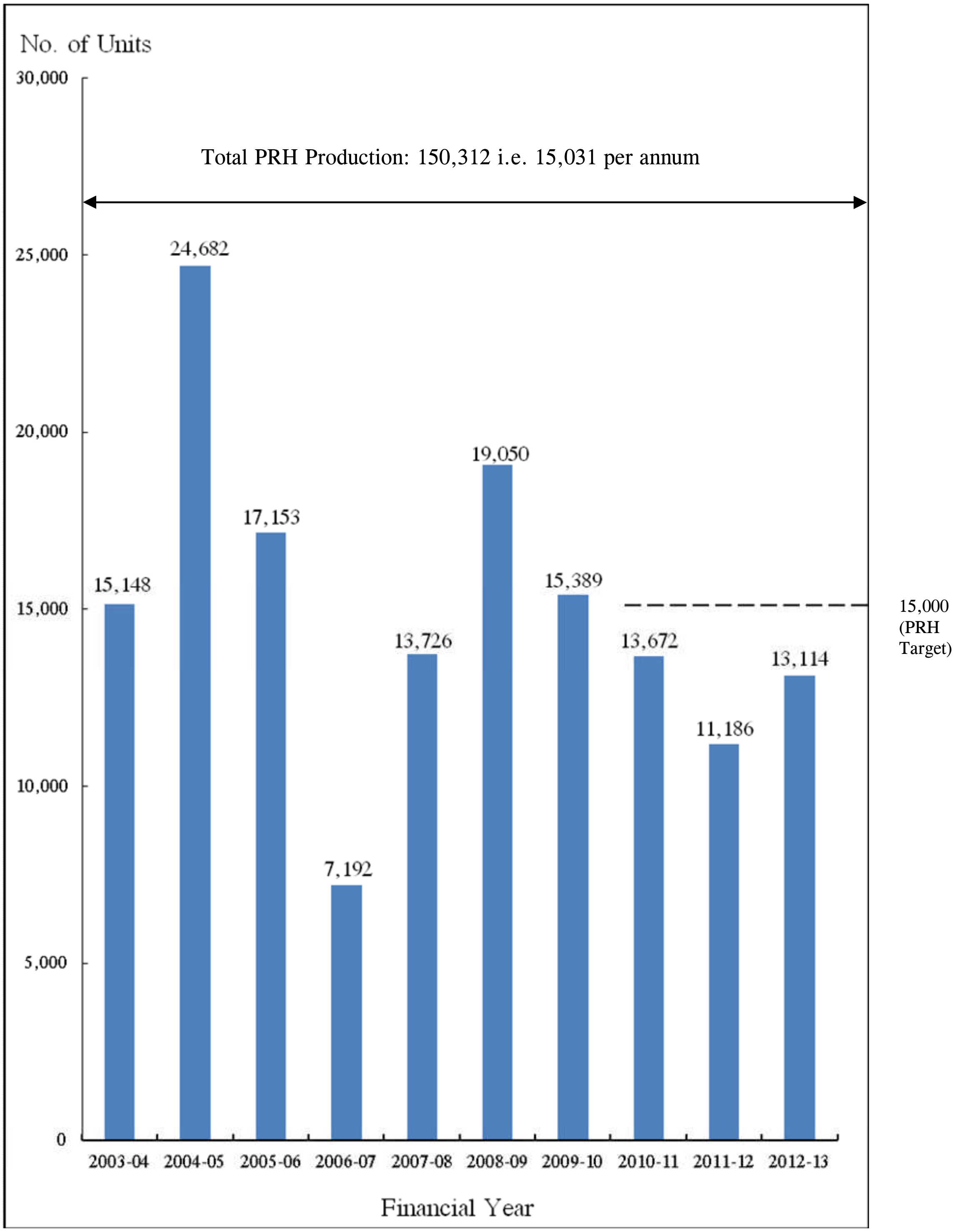
(c) those who are inadequately housed.

Supply of new PRH flats

2.11 ***PRH production.*** The overall supply of new PRH flats includes production of new flats and flats recovered from the surrender by and transfer of existing tenants. The total PRH production for the past 10 years was 150,312 flats, i.e. 15,031 per annum (see also para. 1.7). Figure 1 shows the PRH production for the past 10 years.

Figure 1

PRH production
(2003-04 to 2012-13)



Source: HD records

2.12 ***2010-11 pledged target.*** The 2010-11 Policy Address recognised the need to increase land supply and set a target of providing land to make available annually, on average, for some 20,000 private residential flats and about 15,000 PRH flats.

2.13 ***2013 pledged target.*** The Policy Address of January 2013 re-affirmed the provision of an annual average of about 15,000 new PRH flats during the five-year period 2012-13 to 2016-17 under the Public Housing Construction Programme (PHCP). It also pledged to increase the supply of PRH, and adopt a production target of at least 100,000 units in total (or an average of 20,000 units per year) for the five years starting 2018.

2.14 ***2014 pledged target.*** As stated in the Policy Address of January 2014, the Government accepted the recommendation of the LTHS Steering Committee to increase housing supply. In essence, it further increases the production target from the 2013 pledge. The new target is to provide a total of 470,000 units in the coming 10 years, with public housing accounting for 60% of this target (i.e. about 280,000 units in total, or an average of 28,000 units per year). The Steering Committee has recommended that the 60% target should be adjusted flexibly to cater for changes in circumstances, in order to give due consideration to and strike a balance between the two major objectives of increasing the production of public housing to satisfy public demand and stabilising the private market.

PRH supply and demand forecast

2.15 The objective of the Government and the HA is to provide PRH to low-income families who cannot afford private rental accommodation, with a target of maintaining the AWT for general PRH applicants at around three years. To this end, the HA has put in place the PHCP, which is a rolling programme forecasting PRH production of the coming five years, with the March PHCP as a baseline for each financial year. The production plans for the PHCP are generally firm and not subject to significant changes. The PHCP is reviewed periodically and the level of PRH production is adjusted as and when necessary. It is reported monthly to the Building Committee (BC) of the HA and annually to the Panel on Housing of the Legislative Council (LegCo).

2.16 The HA has also performed the Public Housing Development Forecast (PHDF) since 2003, which is a rolling programme forecasting PRH production of the second coming five years. Production and possible production sites are recorded and they may be subject to changes arising from issues like rezoning, clearance, land resumption, site formation, etc. The PHDF is reviewed periodically and the level of PRH production is adjusted as and when necessary. It is reported regularly to the CHD. Table 4 shows the projected shortfalls in PRH production against demand forecasts since 2008-09.

Table 4

Projected shortfalls in PRH production against demand forecasts (2008-09 to 2012-13)

Timeframe	Number of flats		
	PRH demand forecast endorsed by the CHD (Date endorsed)	**Baseline planned production (PHCP & PHDF)**	**Shortfall in PRH production against demand forecast (% over (a))**
	(a)	**(b)**	**(c) = (a) − (b)**
2008-09 to 2017-18	151,900 (9.7.2008)	150,000	1,900 (1%)
2009-10 to 2018-19	160,800 (11.11.2009)	150,000	10,800 (7%)
2010-11 to 2019-20	163,000 (22.12.2010)	150,000	13,000 (8%)
2011-12 to 2020-21	186,100 (22.2.2012)	150,000	36,100 (19%)
2012-13 to 2021-22	No assessment was made	150,000 originally, revised to 175,000 based on 2013 Policy Address	—

Source: Audit analysis of HD records

2.17 Audit noted that:

(a) the PHDF was used for internal reference and was not disclosed to the public. With the exception of the first assessment conducted in 1997, the results of the housing demand assessment had not been disclosed to the public. The last assessment was made in 2011-12 covering the 10-year period 2011-12 to 2020-21. The HD had not made any assessment of long-term PRH demand since 2012-13;

(b) in the four years from 2008-09 to 2011-12, despite increasing projected 10-year demand for PRH (from 151,900 to 186,100) based on the Long-term Housing Demand Assessment endorsed by the CHD, the 10-year production targets of the PHCP/PHDF had remained unchanged at 150,000, resulting in projected shortfalls in PRH production against demand forecasts (see Table 4 in para. 2.16 for details); and

(c) as can be seen from Table 4, the projected shortfalls in PRH production had remained relatively low (1% to 8%) initially, increasing to 19% for the forecast period 2011-12 to 2020-21.

2.18 Upon enquiry as to why the previous established mechanism for long-term PRH demand assessment (see paras. 2.15 to 2.17) had not been followed since 2012-13, the HD informed Audit in February and March 2014 that:

(a) the regular exercise to assess the long-term housing demand for PRH using the previous methodology was to provide a broad-brush, indicative reference for long-term land-use planning and reservation for PRH for internal reference only. The assessment results were presented to the CHD (see para. 2.5). The assessment was meant to serve as a tool to facilitate the CHD's deliberations only, since the projected housing demand is only one of the many factors considered by the CHD. The CHD noted and endorsed the results of the assessment. However, the CHD must also take into account a wide range of factors in order to assess the whole picture and formulate a holistic view and appropriate measures;

(b) apart from the CHD, the results of long-term housing demand assessment were also presented to the then Steering Committee on Housing Land Supply (SCHLS — see para. 2.34), which has the decision-making role in terms of housing land supply. Relevant bureaux and departments (B/Ds) of the Government were aware of both the assessment results of the long-term projection of PRH demand and the then latest PRH supply programme. The production target is not only guided by the long-term PRH demand assessment. A host of factors would be taken into account before the Government adopts new production targets;

(c) on the point about the assessment results not being disclosed, it should be noted that the then assessments focused on demand projection for PRH. Private housing demand was touched upon, but essentially as a residual under the then methodology (see Appendix C). There was however no detailed analysis into the private sector demand. Furthermore, such data and assessment were market sensitive; and

(d) the LTHS Steering Committee has reviewed and endorsed a new methodology for assessing the long-term housing demand, and the Chief Executive has adopted the results so assessed as the new housing supply targets in his 2014 Policy Address (see para. 1.12).

2.19 Audit also noted that the LTHS Steering Committee, set up in September 2012, had conducted its assessment of long-term housing demand in the coming 10 years and made a timely recommendation to increase production target (see para. 2.14). As can be seen from paragraphs 2.8 and 2.10, the methodology adopted by the LTHS Steering Committee was built upon that used by the CHD until recently, and has taken into consideration similar factors in assessing the total housing demand, except for not using the statistical model to determine the quantum of PRH production required to maintain the AWT at about three years (see para. 2.9). Since the AWT is widely known and accepted as the measurement for timeliness in satisfying PRH demand, Audit considers that the HD needs to continue to conduct assessments of long-term PRH demand periodically, duly taking into account the target of maintaining the AWT at about three years.

2.20 According to the LTHS Steering Committee's report on public consultation, the long-term housing demand projection would be updated annually to reflect any changes in circumstances in a timely manner. There is merit for the HD to provide the results of its assessment of PRH demand for the annual review/updating of the total housing demands of the LTHS.

2.21 In March 2014, the HD explained to Audit that:

(a) the old assessment was conducted to project PRH demand in order to provide a reference on land use planning and reservation for PRH only, while the LTHS's methodology aims to assess how many new units of all types are required in the coming 10 years so as to provide adequate accommodation to meet private and public housing needs. The LTHS's objective is to assess the long-term, overall housing demand for the whole of Hong Kong, while the old model was for the purpose of PRH only. They have different focuses and objectives;

(b) under the LTHS's methodology, housing demand (including both public and private housing) is assessed as a whole. The result of the assessment is that the total housing demand for public and private housing is 470,000 units over the next 10 years. After coming up with the overall demand assessment, the LTHS Steering Committee recommended a 60 : 40 public-private split in response to clear community aspirations that the Government must take the lead in increasing public housing supply in order to avert the deep-rooted problem of housing supply-demand imbalance. The overall housing supply target and the public-private split are guided by strategic policy considerations and are not just limited to maintaining the AWT for PRH; and

(c) PRH demand has been fully accounted for in the assessment methodology adopted by the LTHS Steering Committee. The HD will use this methodology to assess long-term housing demand in future. The housing demand projection will be reviewed on an annual basis. The results will be presented to the CHD for reference and will be published.

Audit recommendations

2.22 **Audit has *recommended* that the Director of Housing should continue to perform the assessment of long-term PRH demand annually and report the results for:**

(a) **endorsement by the CHD; and**

(b) **updating of the total housing demands of the LTHS.**

Response from the Administration

2.23 The Director of Housing generally agrees with the audit recommendations. He has said that the HD has considered the PRH demand within the context of the long-term housing demand assessment as adopted by the LTHS Steering Committee and will continue to do so in the annual updating of the demand assessment. The HD will continue to closely monitor the number of applications on the WL and maintain its objective to provide PRH for low-income families who cannot afford private rental accommodation, with a view to maintaining the AWT for general applicants on the WL at around three years. The development plans for PRH can be adjusted wherever feasible to maintain the target. The long-term housing demand projection formulated by the LTHS Steering Committee would also be updated annually to take into account latest Government policy changes and the prevailing economic circumstances.

Meeting the pledged production targets

PRH production in the past 10 years

2.24 Figure 1 in paragraph 2.11 shows the number of PRH flats produced by the HD between 2003-04 and 2012-13. The 10-year production target of 150,000 had generally been met. The average annual production was 15,031. However, in the last three years, the average annual production was 12,657 (ranging from 11,186 to 13,672), about 16% below the average of 15,000. The annual PRH production in the past 10 years fluctuated between a high 24,682 in 2004-05 and a low of 7,192 in 2006-07.

Higher pledged production targets

2.25 The 2013 Policy Address announced that the targets for PRH production were to produce "about 75,000 new PRH flats over the five years from 2012-13" and "at least 100,000 units over the five years starting from 2018". In other words, the Government aimed to produce a total of about 180,000 flats over a 10-year period 2013-14 to 2022-23.

2.26 In the 2014 Policy Address, the Government accepted the recommendation of the LTHS Steering Committee to increase housing supply, and set the new target to provide a total of 470,000 units in the coming 10 years, with public housing accounting for 60%. Therefore, the total production target for public housing over a 10-year period from 2013-14 to 2022-23 has been further revised to about 280,000 (i.e. 470,000 × 60%). The Government aims to provide 80,000 HOS/subsidised sales flats and 200,000 PRH flats in the 10-year period (see para. 1.12).

Shortfall in supply in the coming 10-year projection

2.27 Audit examination of the HD's 2012-13 projections has revealed that the production forecast for the first five-year period from 2012-13 to 2016-17 is about 79,000 PRH flats. For the second five-year period from 2017-18 to 2021-22, the Government has identified sufficient sites to produce more than 100,000 PRH flats. Although this means more than 179,000 flats would be produced for the 10-year period, Audit notes that there is currently still a projected shortfall of supply when compared to the new production target of 200,000 PRH flats.

2.28 According to the HD, the PHDF is subject to a lot of uncertainties and frequent changes. Feasibility of the sites in the PHDF are still subject to investigation. Meanwhile additional sites would be added in the PHDF once they have been agreed by the relevant departments for use as public housing. To meet the new production target, it is imperative to secure, among other things, timely suitable sites and adequate production capacity in the construction industry to ensure that the delivery of ramped-up production in the second five-year period makes up for the shortfall in the first five-year period in the next 10 years.

Increasing AWT expected

2.29 The increase in PRH demand and the shortage in PRH supply would have a negative impact on the Government's target of maintaining the AWT for general PRH applicants at around three years. As at December 2013, the AWT reported by the HD was already 2.9 years. Based on the assessment of long-term housing demand for PRH endorsed by the CHD on 22 December 2010, with a projected shortfall of 13,000 flats, when the net demand for PRH was 163,000 flats (see Table 4 in para. 2.16), the AWT would reach 3 years by 2014-15, 3.1 years by 2017-18, 3.3 years by 2018-19 and 4.6 years by 2020-21 (see Table 5). Audit is concerned that the situation may worsen with a projected PRH production shortfall in the coming 10 years. Based on the demand assessment in February 2012, with a projected production shortfall of 36,100 flats when the net demand for PRH was 186,100 flats (see Table 4 in para. 2.16), the AWT for general PRH applicants was projected to reach 3 years by 2014-15, 3.4 years by 2015-16, increasing to 3.5 years by 2018-19 and 5 years by 2020-21 (see Table 5).

Table 5

Forecast of AWT for general PRH applicants based on long-term housing demand forecast

Date endorsed by CHD	Long-term housing demand forecast (Net demand for PRH flats)	Financial year		
		2014-15	**2018-19**	**2020-21**
22.12.2010	2010-11 to 2019-20 (163,000 flats)	3.0	3.3	4.6
22.2.2012	2011-12 to 2020-21 (186,100 flats)	3.0	3.5	5.0

Source: HD records

2.30 In March 2014, the HD explained to Audit that the purpose of AWT projection was to provide a broad-brush picture of the situation and was indicative only. The projection was not intended to provide a precise estimate, since changes to the AWT are dependent on a number of factors such as the number of applicants on the WL, the applicants' choice of district, etc. Most of these factors are outside the control of the HD and could not be captured under the projection model.

Hence, the projected AWTs may or may not bear resemblance with what the AWT actually turns out to be. Audit appreciated the inherent limitations of all projections and the decreasing reliability as projections are made for the longer term. However, the projections made in 2010 and 2012 on the AWT in 2014-15 (within the first five-year period) to reach 3 years appeared to be quite accurate (the AWT as at end of December 2013 was 2.9 years — see para. 2.29). As the AWT is an important benchmark for assessing the timeliness in satisfying PRH demand, it is important for the HD to ascertain and monitor the quantum of PRH units required to maintain the AWT at or around three years and to closely monitor significant projected production shortfall and projected deterioration of AWT.

Audit recommendations

2.31 **Audit has *recommended* that the Director of Housing should:**

(a) **continue to closely monitor the projected shortfalls in the PRH production against the pledged 10-year production targets; and**

(b) **step up efforts to increase PRH production with a view to meeting the pledged 10-year production targets, taking into account the need to maintain the AWT at about three years for general applicants.**

Response from the Administration

2.32 The Director of Housing agrees with the audit recommendations. He has said that the HD will continue to closely monitor the changes in the AWT and will continue to publish the actual AWTs based on the waiting times of the general applicants rehoused to PRH in the previous 12 months.

Supply of land for public housing

2.33 Land supply is the major factor affecting the PRH production. The major source of land supply for PRH comes from the Government. According to the Supplemental Agreement between the Government and the HA, the Government would provide formed land and supporting infrastructure for the implementation of the approved public housing development. Hence, it is imperative for the HD to secure an adequate supply of land from the Government for PRH production.

Parties involved in development and supply of land

2.34 The SCHLS, chaired by the Financial Secretary, was set up in October 2010 to coordinate the efforts of the various policy bureaux and government departments concerned in making available land for the housing supply targets set by the Government. As announced in the 2013 Policy Address, the Steering Committee has been re-organised into the Steering Committee on Land Supply (SCLS) since February 2013 with its scope of work expanded to coordinate the overall plans for development and supply of land for different types of land uses including housing as well as commercial uses. Appendix D shows the terms of reference and membership of the SCLS.

2.35 While the SCLS provides the overall steer for land supply-related matters, the Committee on Planning and Land Development (CPLD), chaired by the Secretary for Development, oversees the formulation and review of development strategies and land-use planning. Appendix E shows the terms of reference and membership of the CPLD.

2.36 Under the strategic steer on land supply and planning matters provided by the SCLS and the CPLD, the task of driving and delivering individual potential sites currently involves different parties and mechanisms:

(a) sites for subsidised housing development (PRH/HOS) are tracked and driven by the HD which liaises with the relevant B/Ds on the delivery of sites for construction of subsidised housing;

(b) the PlanD-HD Liaison Meeting provides a forum for the two departments to discuss planning parameters and land provision for subsidised housing development, including the identification and earmarking of sites for PRH/HOS development; and

(c) the CHD assesses the public housing demand, monitors the supply of suitable land for public housing development, and addresses major inter-departmental or cross-bureau issues that affect the timely supply of public housing sites. The terms of reference and membership of the CHD are shown at Appendix B.

2.37 The B/Ds involved and their roles and responsibilities in land supply are listed at Appendix F. In particular, the DevB is responsible for providing adequate land supply. The THB has a role to monitor housing supply and ensure adequate production of public housing units to meet the housing need. The PlanD is responsible for site identification and land use zoning, and the LandsD is responsible for land disposal.

Land supply and site production for development

2.38 Broadly speaking, land supply and site production for development involves a number of major processes including, among others, the following:

(a) identifying potential areas/sites for development;

(b) undertaking planning and engineering studies and other studies to confirm the feasibility of development or adequacy of support infrastructures (e.g. technical feasibility study, hazard impact assessment, sewage impact assessment, air ventilation assessment, etc.), if required;

(c) completing statutory planning procedures (if required), and preparing Planning Briefs (PBs);

(d) invoking land resumption and clearance actions, if required;

(e) undertaking land decontamination, site formation and/or infrastructure works (including diversion or removal of major existing utility installations);

(f) processing and authorising road works scheme under the Road (Works, Use and Compensation) Ordinance, if required;

(g) obtaining funding approval for reimbursement of costs; and

(h) land grant (e.g. private treaty grant or vesting order under the Housing Ordinance).

2.39 ***Time taken for planning process.*** Increasing land supply requires not only identifying areas and land which are suitable for development, but also undertaking comprehensive planning, with a view to providing adequate infrastructure and facilities and addressing the impacts arising from developments, thereby making the development of land better suit the needs of people and community. Therefore, increasing land supply, either by way of optimal use of developed land or identification of new land for development, has to go through certain procedures.

2.40 According to the DevB, prior to considering the opening up of a large area for development, in particular, where there is no existing provision of infrastructure, a planning and engineering study (see para. 2.38(b)) would usually be required to provide the basis. In the process of the study, the public and stakeholders would be allowed to participate and express views, and detailed technical assessments covering the environment, transport, drainage, sewerage, water supply and air ventilation aspects, etc. would also be included. Therefore, a normal study process must include planning study, technical assessments, public engagement, environmental impact assessment (EIA) and initial design, etc. Amongst these, EIA would take about two years to complete. In addition, public engagement activities would also require at least one year. As such, just the study itself would usually require at least three years or even longer to complete. Taking North East New Territories New Development Areas as an example, it has taken five years to rezone the new development areas since resuming the planning in 2008 up till now.

2.41 For other situations where individual sites or groups of sites are identified as having potential for housing development, the planning process would take about 2 to 3 years to complete if an engineering feasibility study or technical assessments are required. For those sites with no major technical problems, the statutory planning process would normally take about 11 months to complete.

2.42 In view of the growing expectation of the public and stakeholders for transparency and involvement in the planning process, public consultation and engagement become an increasingly important and extensive part of the planning framework. In addition to the statutory requirements for plan exhibition, public representation and hearing under the Town Planning Ordinance (Cap. 131) in the statutory plan making process, consultation with the respective stakeholders, District Councils (DCs) and/or LegCo at different planning stages would usually be conducted as part and parcel of the planning studies or reviews conducted by the PlanD.

2.43 ***Long time taken for land development process.*** After formulating the development proposals for new development areas and completion of statutory planning procedures, the HD would commence the detailed design works. This part of work would take at least three to four years. It is also necessary to go through the statutory and other procedures on road works, land resumption and clearance, including surveys on the affected people and providing compensation and rehousing according to the eligibility criteria.

2.44 After the detailed design, the DevB needs to seek funding approval from the LegCo Finance Committee in phases again for carrying out the site formation and the related infrastructure works which would only commence after completion of the land resumption procedures, and compensation and rehousing arrangements. For projects which do not involve land resumption and affect a limited number of occupiers/households, the time required for completion of resumption/clearance would be about 18 to 24 months. In sum, it can take quite a long time from the commencement of planning to the provision of land for development purpose. Assuming that the site is immediately released for PRH development, it would then take another 42 months for completing the building and piling works.

2.45 ***Measures to ensure adequate land supply.*** The HA has taken the following measures to ensure adequate land supply for PRH development:

(a) liaising closely with relevant B/Ds, DCs, and local communities to identify suitable sites for PRH development in different parts of the territory;

(b) examining the build-back potential of aged PRH estates;

(c) optimising the development potentials of public housing sites to make more effective use of the precious land resources, irrespective of the sizes of individual sites; and

(d) striving to achieve relaxation in plot ratio (PR) and height restriction where appropriate without compromising the living environment.

2.46 ***Shortage of land supply for meeting the PRH production targets.*** Audit examination revealed that subject to resolving many technical issues, local objections and necessary rezoning, there is still a shortfall in the 10-year period 2013-14 to 2022-23 of:

(a) 16 hectares of land based on the production target of 180,000 PRH flats as pledged in the 2013 Policy Address; and

(b) 38 hectares of land based on the LTHS production target (or the latest 2014 Policy Address target) of about 200,000 PRH flats for the next 10 years.

2.47 Both the Government and the HA are striving to secure adequate land (of about 38 hectares of land) to meet the new PRH production target for the next decade (of about 200,000 units). To increase land supply for PRH, the Government is exploring possible sources, such as reclamation, opening up new areas, and site redevelopment. However, the complicated process and lengthy time involved in planning and land resumption/clearance present many difficulties and challenges. In March 2014, the DevB/PlanD explained to Audit that DevB and PlanD have already stepped up efforts to boost housing land and flat supply (both public and private) in the past few years, including undertaking various land use reviews, converting some private housing sites to PRH use, increasing the maximum domestic PR allowed for sites located in the respective Density Zone as appropriate, etc. However, a number of sites which had been earmarked for public housing had not been included in the HD's PHCP/PHDF. The HD responded that these sites cannot be made available for housing flat production in the PHCP/PHDF period because their availability is subject to technical assessments, engineering studies, rezoning, land resumption, graves/land clearance, reprovision/relocation of existing/planning facilities, extensive site formation, availability of basic infrastructures such as sewerage, land decontamination, road works gazettal, etc. The DevB/PlanD noted that the HD had faced some difficulties in technical assessments, site formation works and other procedures, and the DevB/PlanD and the HD would continue to discuss how best to fast-track the programme of sites to meet the PRH/HOS development within the LTHS 10-year period.

2.48 As the Financial Secretary recently stated in the 2014-15 Budget Speech of 26 February 2014, the Government is fully committed to supplying additional sites to the HA (see also para. 2.55). In this connection, the HD needs to continue:

(a) liaising proactively with the DevB/ PlanD to secure sufficient number of suitable sites and continue to discuss how best to make use of the identified sites to meet the new production target; and

(b) working closely with relevant B/Ds, in particular, to expedite the delivery of flat production from identified sites to meet production shortfall, including:

 (i) the delivery of the sites that require land resumption/clearance for PRH;

 (ii) the planning and administrative procedures for processing of PB, planning application, and availability of sites on Short Term Tenancy (STT) for preliminary works; and

 (iii) the implementation of proposals of PR increase for PRH in the PHDF period and submitting planning application to the Town Planning Board (TPB) if necessary.

Enhancements and arrangements to expedite PRH production

2.49 The current institutional set-up for land supply has provided a structure for high-level steer on planning and land supply matters — Executive Council/Policy Committee for major policies, the SCLS for overall land supply strategy, and the CPLD for land-use planning and land development projects. However, relevant departments may not always have the most up-to-date information and status on individual sites which are handled by other departments. Various data, checklists and reports are compiled and updated on an ad-hoc basis by departments as and when required, resulting in laborious and duplicative efforts, as well as potential inconsistencies in data or information so presented.

2.50 To address the projected shortfall in supply, the CHD has recently identified some arrangements and enhancements to expedite PRH production.

2.51 ***Parallel processing arrangements.*** The HD is required to obtain District Planning Conference (DipCon — Note 4) approval for PBs and District Lands Conference (DLC — Note 5) approval for letting of the site concerned on STT before the HD could commence the piling and building works on site. The HD would normally apply to LandsD for STT after obtaining the PB approvals. The PB approval would take about 4 to 6 months, whereas the processing of STT applications would need a lead time of about 12 months. For sites that require rezoning, minor relaxation on PR or building height, the whole process should, as far as practicable, be completed before the HD's piling tender invitation. The HD has carried out a stock-taking exercise on the projects for completion in 2017-18, 2018-19 and 2019-20 which face a tight development programme and has sought the assistance of the PlanD and the LandsD on the following fast-tracked parallel processing arrangements so as to avoid programme slippage:

(a) the PlanD will fast-track the approval of the PBs to tie in with the development programme. For projects that require rezoning or subject to planning approvals, the PBs can be approved subject to the results of the rezoning and the TPB's decision on the planning applications;

(b) for projects seeking minor relaxation of PR or building height through the planning applications, the PBs can be approved based on the increased PR and building height but stating that the PBs are subject to the TPB's decisions on the planning applications; and

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Note 4: *The DipCon provides an inter-departmental forum for discussing issues and proposals related to district planning and development before commencement of consultation with the relevant DCs or other bodies as appropriate. It also provides a forum to facilitate resolution of outstanding issues arising from the processing of applications for planning permission and amendments to statutory plans, the checking of compliance with conditions of approval imposed by the TPB, and the handling of development proposals submitted to the PlanD.*

Note 5: *The LandsD has set up the DLC in the District Lands Offices to approve applications for lease modification, exchanges and private treaty grants. The DLC is chaired by the Assistant Director/Regional. Its members include the respective District Lands Officer, the case officers and representatives from other government departments concerned.*

(c) the LandsD will process and approve the HD's STT applications based on the draft PBs.

2.52 ***Land resumption and clearance for public housing.*** Based on past experience, 24 months are required for land resumption and clearance under normal circumstances. According to HD records, there are 14 PRH projects (around 50,000 flats) in the period up to 2023-24 requiring land resumption and clearance. Among these PRH projects, four projects (around 13,000 flats, representing about 26% of the total 50,000 flats) need 48 months from the submission of the final Clearance Application Form to proceeding with the gazettal of the land resumption and completion of the subsequent resumption and clearance procedures. In March 2014, the LandsD explained to Audit that the time taken from the submission of a Clearance Application Form to the LandsD's resumption and clearance procedures depends heavily on the scale and complexity of the project and the timing of obtaining the necessary approvals for proceeding with the project. If the project is firmed-up, LandsD would actively follow up with the resumption and clearance exercise with an aim to meet the implementation of the programme. If there is any objection or resistance received during land resumption and/or clearance, substantial efforts have to be made in dealing with them which could require much longer time to complete. The HD considers that this will delay the completion of these projects if the lead time for resumption and clearance cannot be shortened.

2.53 ***Enhanced mechanism.*** Audit notes that the DevB is planning to:

(a) establish a new sub-committee under the CPLD, i.e. the Land Supply Tracking Subcommittee (LSTS), to be co-chaired by Deputy Secretary (Planning and Lands) and Deputy Secretary (Works), and comprising senior representatives of the relevant departments, and to be tasked to track and drive the production of individual sites with a view to expediting their delivery for development. The DevB plans to formally establish LSTS in the second quarter of 2014. Appendix G shows the terms of reference and membership of the LSTS; and

(b) set up a computerised Land Supply Information System (LSIS) as a supporting tool to facilitate the tracking of land production and identification of potential land supply so as to support the Government's policy objective of increasing land supply in the short, medium and long terms. It is the DevB's initial thinking to start preparatory work in 2014-15.

2.54 To enhance the efforts in increasing land supply for the production of PRH flats, Audit considers that:

(a) the Administration needs to expedite the enhancements of the current mechanism for tracking land supply and driving site production; and

(b) in order to ensure the timely delivery of PRH flats, the HD needs to work closely with:

  (i) the PlanD and the LandsD to streamline the planning and land administrative procedures;

  (ii) the LandsD to consider ways to shorten the clearance process; and

  (iii) the DevB to ensure the timely establishment of the LSTS under the CPLD and development of the LSIS to track the overall land supply and to ensure the timely availability of sites for public housing developments.

2.55 ***Government committed to supplying additional sites to the HA.*** As stated in the Budget Speech of February 2014, to achieve the new target on the provision of PRH and HOS flats, the Government is fully committed to supplying additional sites to the HA. There is a need for the HA to capitalise on the opportunity to liaise closely with the relevant B/Ds to secure sufficient land for the long-term sustainable development of public housing.

Audit recommendations

2.56 **Audit has *recommended* that the Director of Housing should step up efforts to:**

(a) **liaise closely with the DevB and the PlanD to secure sufficient number of suitable sites and discuss how best to make use of the identified sites to meet the new PRH production target; and**

(b) **work closely with relevant B/Ds, in particular, to:**

  (i) **streamline the planning and land administrative procedures so as to secure the flat production in a timely manner;**

  (ii) **consider ways to shorten the clearance process so as to ensure the timely delivery of PRH flats;**

  (iii) **implement proposals of PR increase for PRH in the PHDF period and submit planning application to the TPB if necessary; and**

  (iv) **ensure the timely establishment of the LSTS under the CPLD and development of the LSIS, so that it could track the overall land supply and to ensure the timely availability of sites for public housing developments.**

Response from the Administration

2.57 The Director of Housing agrees with the audit recommendations. He has said that the HD will continue to liaise closely with the DevB/PlanD to secure sufficient number of suitable sites.

Long process and time taken to develop sites

Background

2.58 The production of PRH involves a number of factors such as planning and construction. The HD prepares the PHCP for the first five-year period of production, and rolls forward the PHCP on a yearly basis. The construction plans for the PHCP are generally firmed up and will not be subject to major variations. The PHCP is submitted to the LegCo Panel on Housing. The HD also prepares the PHDF for the second five-year period. The construction plans of the PHDF record the situation of the sites and the number of flats to be provided by the HD. These sites include firm sites, "problematic" sites (Note 6), prime sites and potential sites under consideration. Sites not yet confirmed may need to be returned to the Government for uses other than public housing development.

2.59 Most of the sites identified for PRH involve site constraints and issues to overcome before development can proceed. To examine the development potential of a site and work out the optimal development intensity, development parameters and schematic layouts would be prepared taking into account the planning, traffic and environmental requirements and infrastructural assessments, geotechnical appraisals and investigations. Generally there are 15 general studies for potential PRH sites and 10 specific studies depending on the specific characteristics and constraints of individual sites (see Appendix H).

Public housing sites returned to the Government

2.60 During the period 2001 to 2013, the HA had returned 24 PRH redevelopment sites to the Government for other uses to tie in with local development needs, or to fully utilise the economic benefits of individual prime sites. These sites were already formed and were thus available for immediate PRH construction. In some cases, replacement sites were provided by the Government in exchange for the return of existing PRH sites. However, such replacement sites were usually at the early planning stage. They might not be immediately available for PRH development since it would normally involve rezoning of sites, land resumption clearance, large-scale site formation works, technical feasibility study and other site development constraints (also see para. 2.47).

2.61 As the replacement sites were not readily available for constructing PRH estates, it may take more than 10 years to develop a site into a PRH estate from identification of site to completion of construction. Shui Chuen O Estate (Shatin Area 52 — Case 1) and Ex-Yuen Long Estate (Case 2) are examples which illustrate the long time and difficulties in identifying and developing sites for PRH development (see Appendices I and J).

Note 6: *Problematic sites include sites which may require rezoning or subject to anticipated objections from DCs.*

Development costs written off

2.62 In general, the HA is not responsible for the costs of land formation. However, for redevelopment sites, agreement between Government and the HA is reached on a case by case basis. There are often cases in which the HA has agreed with the Government to take up the works and/or the costs of some site formation/reclamation to facilitate the development process. The Government is, in general, responsible for funding the land formation of the new sites. Before the return of the site of Shatin Area 52 to the Government in 2003, expenditure of about $70 million was incurred by the HA. Since the site was finally used as a PRH estate, the formation and development works could still be used and such costs would be capitalised as part of the costs of the new estate (see Case 1 in Appendix I). However, in some cases, the sites returned to the Government were finally sold to developers or converted to other uses, the development costs incurred by the HA had to be written off in its financial statements. The development costs for such returned sites written off in 2011-12 and 2012-13 were $84 million and $125 million respectively.

2.63 The costs written off in 2012 and 2013 were related to five returned sites (see paras. 2.64 to 2.66) and the ex-Homantin Estate Redevelopment site (see para. 2.67) respectively.

2.64 In December 2011, the BC of the HA approved the write-off of the development cost in its Consolidated Operating Account, arising from aborting the development of the five sites which were already sold in public land sales or converted to other uses. Table 6 shows the breakdown of the costs.

Table 6

Breakdown of the HA's development costs written off for the year ended 31 March 2012

Project	Development cost written off ($' M)					
	(a)	(b)	(c)	(d)	(e)	Total
(1) Inverness Road	—	—	5.20	47.41	0.02	52.63
(2) Welfare Road Aberdeen	8.05	0.24	1.61	5.65	0.45	16.00
(3) Wong Tai Sin Police Quarters	—	—	—	0.60	—	0.60
(4) Tseung Kwan O Area 74 South Phases 1 & 2	—	0.12	3.99	6.22	—	10.33
(5) Sha Tau Kok Road, Fanling	—	—	—	4.06	0.22	4.28
Total	8.05	0.36	10.80	63.94	0.69	83.84

Source: *HD records*

Remarks: *(a) Architectural-led consultancy fees and claims arising from termination of the contract*

(b) Consultancy fees for the quantity surveyors

(c) Site investigation cost

(d) Allocation of staff cost and other recurrent costs

(e) Sundry and miscellaneous items

2.65 The first four sites (items (1) to (4) in Table 6) were originally included in the list for HOS development in the early 2000s. Due to the repositioning of housing policy in 2002 to shelve the HOS, the Government decided to delete these sites from HOS development. Subsequently, they were all returned to the

Government and were then sold in public land sales or put into other uses. For the Sha Tau Kok Road site (item (5) in Table 6), the site had been agreed for PRH development by the Government in 2004, but was subsequently deleted in 2005 due to the high development cost to be incurred by the HA arising from its unfavourable geographical location. The site was then sold in public land sales in May 2010. In the event, the development costs of the above sites incurred by the HA had to be written off.

2.66 The Inverness Road project in Kowloon City (item (1) in Table 6) incurred the largest amount ($52.63 million) of development cost to be written off. Details of the write-off are given in Case 3 (see Appendix K). The case also illustrates that it took HA much longer time to develop PRH flats when it swapped sites during the planning process. Staff time as well as other costs have to be written off, even in successful swap cases.

2.67 Another significant case of write off was related to the ex-Homantin Estate (see Case 4 at Appendix L). The HA's development cost of $125 million had to be written off in 2012-13. Another $99 million would be required to be written off in coming years. Therefore, the total development costs to be written off for this site would be more significant and amount to some $224 million. Not only was the development of PRH in the area aborted, staff time and costs were also wasted as the result of changing the intended land use from public housing to private residential development.

Minimising delays caused by returning PRH sites

2.68 Past experiences in the return of PRH sites to the Government for other uses show that returning ready PRH sites to the Government in exchange of sites which take long time to develop will inevitably cause long delays in the PRH supply. Both the HA and the Administration need to consolidate experiences from the previous cases of return of PRH sites in order to fully recognise the adverse impacts on the PRH production in future. In particular, effective measures need to be taken to minimise changes to scheduled PRH construction programme in the PHCP or PHDF period.

Audit recommendations

2.69 **Audit has *recommended* that the Director of Housing should, in collaboration with the relevant B/Ds, consolidate experiences from the previous cases of return of PRH sites to the Government for other uses, with a view to assessing and fully recognising the possible adverse impacts (e.g. long delays) on PRH production in future. In particular, there is a need to:**

(a) **take into due consideration the projected long-term PRH demand and the production targets under the LTHS in his discussions with the relevant B/Ds about the return of public housing sites to the Government for other uses; and**

(b) **take measures to expedite the planning and consultation procedures to ensure early completion of PRH development on the replacement sites provided by the Government.**

Response from the Administration

2.70 The Director of Housing agrees with the audit recommendations.

PART 3: MANAGEMENT OF PUBLIC RENTAL HOUSING CONSTRUCTION PROJECTS

3.1 This PART examines the HA's management of PRH construction projects. Audit has found room for improvement in the following areas:

(a) ***Monitoring progress of construction projects.*** Audit notes that the HA has recently streamlined the PRH construction process. However, given the significant increase in production target within a more compacted timeline, the HD needs to step up efforts to closely monitor the PRH projects, report progress, and take early remedial actions on project delays, in order to ensure their timely completion in accordance with the PRH construction programme (see paras. 3.2 to 3.15); and

(b) ***Monitoring costs of construction projects.*** Audit notes that the HA has a system in place to monitor and control the costs of construction projects. In view of the need to further enhance cost-effectiveness of the PRH development programme in the midst of rising construction costs, the HA needs to continue its efforts in enhancing its system of budgeting, monitoring and management of project costs (see paras. 3.16 to 3.23).

Monitoring progress of construction projects

Construction works management

3.2 The HA currently has six standing committees, including the Strategic Planning Committee (SPC) and the BC. According to the terms of reference, the SPC considers the viability of projects relating to public housing development, approves the inclusion of sites in the production process, and reviews all housing programmes relating to policy targets. The BC approves project budget, master layout plans and scheme designs for public housing projects (see Appendix M).

3.3 The DCD of the HD is responsible for the production of new PRH. It is responsible for PRH project management and production from the initial site search and feasibility studies, public engagement, planning, design, contract management, commissioning for occupation, up to the expiry of the initial maintenance period and the settlement of final accounts.

3.4 As stated in the 2013 Policy Address, the THB agreed to expedite the construction of public housing flats without compromising quality, and find ways to simplify technical assessments under different regulatory requirements. Subsequently, the HA has refined the construction process to compress the lead time from three years to one year for preparing various feasibility studies, consulting the DCs and local communities, and conducting preliminary planning and design. Under the fast-track programme, a 40-storey housing project can be completed within five years provided that the site is properly zoned, resumed, cleared and formed with adequate provisions of infrastructure, and early support from DCs and the local communities secured. Table 7 shows a comparison of construction project life cycle of PRH under the normal timeframe and the fast–track programme.

Table 7

Comparison of construction project life cycle of PRH

	Project stage	**Duration (Note)**	
		Normal (year)	**Fast-track (year)**
(1)	Site inception and acceptance by the CHD for including the earmarked sites in the PHCP/PHDF	3	1
(2)	Conduct feasibility study and prepare a planning outline for SPC approval		
(3)	Prepare scheme design and project budget for BC approval		
(4)	Prepare detailed design and specification proposals		
(5)	Invite tenders and the BC examines the tenders and award the contracts to the successful tenderers	0.5	0.5
(6)	Construction (Foundation)	1	1
(7)	Construction (Building)	2.5	2.5
	Total	7	5

Source: LegCo Secretariat Information Note

Note: This is the timeframe required for constructing a 40-storey housing project.

3.5 Audit notes that the period of the construction project can be significantly shortened by two years because the first four stages relating to planning and approval will be compressed.

Planned timeframe for PRH production

3.6 Table 8 shows the planned timeframe for all PRH production in 2012-13. Audit noted that the planned timeframe for all 2012-13 PHCP projects was within five years, except the Tuen Mun Area 18 project.

Table 8

Planned duration for PRH production in 2012-13

	Project	Discussed at SPC	Discussed at BC	Planned completion as stated in the BC paper	Planned duration for PRH production (month)
(1)	Kai Tak Development Site 1A (Phases 1 and 2)	Nov 2008	Nov 2008	Jan 2013	51
(2)	Lower Ngau Tau Kok Estate Phase 1	Dec 2007	Dec 2007	Mar 2012	52
(3)	Ex-Cheung Sha Wan Police Quarters	Oct 2008	Oct 2008	Jan 2013	52
(4)	Ex-Sha Tin Married Quarters	Feb 2008	Feb 2008	Oct 2012	57
(5)	Heung Fan Liu Street, Shatin Area 4C	Sep 2008	Sep 2008	Dec 2012	52
(6)	Tuen Mun Area 18	Aug 2007	Feb 2009	Mar 2013	68

Source: Audit analysis of HD records

3.7 Audit noted that for the Tuen Mun Area 18 project, the HA's BC meeting was held 1.5 years after the SPC meeting (see item (6) in Table 8). The project was delayed because there had been a lengthy consultation between the HA and the Tuen Mun DC on the additional provision of community facilities, causing major changes to the original Project Brief. Details are given in Case 5 at Appendix N.

3.8 Audit noted that it was quite common that there were objections to the PRH projects from the local communities, on the grounds of a high concentration of public developments and inadequate community facilities in the district. Therefore, it took the HD a long time to discuss and resolve the demand of the Tuen Mun DC for more community facilities, and obtain the necessary agreement/approval from the relevant B/Ds. In March 2014, the HD explained to Audit that the provision of the community facilities was not planned by the HA and was beyond HA's control.

PRH construction project delays

3.9 As items (6) and (7) of Table 7 in paragraph 3.4 indicate, after the land site was ready for construction, it normally took the HD around 3.5 years to carry out the construction work. According to the 2012-13 PHCP, six PRH projects would be completed in 2012-13 involving the production of 13,114 flats. Audit found that there had been some project delays in these six projects. The period of delay ranged from 2 to 7 months as compared with the planned completion dates stated in the relevant BC papers. Table 9 shows the details.

Table 9

Projects completed in 2012-13

PRH project < BC meeting date >	Planned completion date stated in the BC paper	Completion date		Project delay		Number of flats
		(Building contract) (Note 1)	(Domestic blocks)	(Building contract)	(Domestic blocks)	
	(a)	(b)	(c)	(d) = (b) − (a) (month)	(e) = (c) − (a) (month)	
Kai Tak Development Site 1A (Phases 1 & 2) <21.11.2008>	Jan 2013	2.7.2013	9.4.2013	5 (Note 2)	3 (Note 2)	5,204
Lower Ngau Tau Kok Estate Phase 1 <14.12.2007>	Mar 2012	24.10.2012	1.4.2012	7 (Note 2)	—	2,707
Ex-Cheung Sha Wan Police Quarters <17.10.2008>	Jan 2013	30.3.2013 (extended completion date: 19.3.2013)	28.3.2013 (extended completion date: 19.3.2013)	2 (Note 2)	2 (Note 2)	1,390
Ex-Sha Tin Married Quarters <22.2.2008>	Oct 2012	8.3.2013	22.2.2013	4 (Note 2)	4 (Note 2)	1,607
Heung Fan Liu Street, Shatin Area 4C <19.9.2008>	Dec 2012	16.3.2013	1.2.2013	3 (Note 2)	2 (Note 2)	1,216
Tuen Mun Area 18 <20.2.2009>	Mar 2013 (Note 3)	30.9.2013	13.3.2013	NA (Note 3)	—	990
					Total	13,114

Source: *HD records*

Note 1: *Other than domestic blocks, a PRH project may include construction of carparks, ancillary facilities, footbridges and walkways, etc.*

Note 2: *According to the HD, there were genuine reasons for the slippages which were not anticipated at the BC stage (such as inclement weather, delays by other parties beyond the control of the HA, late possession of site, etc.). Usually there were 2 months of extension allowed for delays due to inclement weather for building contracts. For other reasons, the contractors can submit claims to the Contract Manager who would assess the claim and grant the extension if justified.*

Note 3: *Owing to the fact that the provision of the community facilities was not planned by the HA and was beyond HA's control, the planned completion date of the community hall was not specified in the BC paper.*

3.10 The BC is responsible for endorsing programmes of activities and monitoring their performance (see Appendix M). In seeking the BC's approval for the scheme design and project budget, a development programme is submitted, providing the completion dates of piling and building. According to Table 9, the completion date of the domestic blocks was usually earlier than the completion of the whole contract. This is because the HD often has to construct ancillary facilities for the PRH residents and the local communities after constructing the domestic blocks.

3.11 As can be seen from Table 9, the actual completion dates of the building contracts of all the six PRH projects were later than those stated in the relevant BC papers. For four of the six projects, there were also some delays in the completion of the domestic blocks.

3.12 According to the HD, the delays were mainly due to extra inclement weather and some legitimate or genuine grounds for extension of time that the contractors were entitled to. There were also reasons for delay which were not anticipated at the BC stage, such as late possession of site or delay by other parties beyond the control of the HA. As a result, most of these projects had legitimate postponement of project completion date which resulted in no or only very minor slippage.

3.13 Project delays not only affect the timely delivery of PRH flats which were in great demand, but may also cause great inconvenience to the incoming tenants and lengthen their actual waiting time for PRH. Given the significant planned increase in production of PRH units and the compressed timeframe, Audit considers that the HD needs to step up efforts to closely monitor the PRH projects to ensure that they are completed in accordance with the time schedule of the PHCP and report any project delays to the BC.

Audit recommendations

3.14 **Audit has *recommended* that the Director of Housing should step up efforts to:**

(a) **conduct early consultation work to deal with any possible objections from the local communities or other stakeholders, in order to ensure that the PRH production is delivered in a timely manner; and**

(b) **closely monitor the PRH construction projects and take early remedial actions on project delays, in order to ensure their timely completion in accordance with the PHCP.**

Response from the Administration

3.15 The Director of Housing generally agrees with the audit recommendations. He has said that:

(a) during the process of the development of housing projects, it is not unusual to encounter problems such as objections by the public or local concerned groups, or construction delays caused by genuine reasons which are beyond the control of the HA or the contractors (such as inclement weather and delays caused by other parties). Nevertheless, the HD project officers will closely monitor the situation, to avoid programme slippage, and minimise any such incidents. The HD regularly reports the progress on project programmes to the HA's BC; and

(b) the HD project officers have been very proactive and actively liaise with all stakeholders, such as local pressure groups and district councillors to deal with resistance or objections promptly; and to enhance communications with the relevant government B/Ds for necessary approval. Sometimes local objections are too strong with a consequence that some works progress is affected. Under such circumstances, the project officer concerned would endeavour to separate the domestic portion and try to complete it earlier so as not to affect PRH in-take. This is the reason that the completion of non-domestic portion is sometimes later than the domestic portion.

Monitoring costs of construction projects

3.16 Under the current HA's budget system, the Project Construction Cost Ceilings are approved by the SPC at the feasibility study stage. A Project Budget is approved by the BC at the budget stage provided that it is within the Project Construction Cost Ceiling previously approved by the SPC and the project budget is revised at the building tender stage (also see item (3) of Table 7 of para. 3.4).

3.17 The Construction Cost Ceilings/Budgets at the feasibility study and budget stage are prepared based on the cost yardsticks with adjustments made for known requirements and detailed design information of individual projects. To enable comparison between individual projects and standard cost yardsticks, all Construction Cost Ceilings/Budgets are worked out at the same base price levels of the standard yardsticks. The construction cost yardsticks are compiled in June every year to reflect the tender price movement and changes in design requirements since last compilation. Blanket approval covering those developments parameters requiring updating is sought from the SPC, or the BC where the updating only involves changes resulting from the use of the latest approved standard cost yardsticks, tender price inflation and contract price fluctuation adjustment factors.

3.18 The proposed project budget generally includes the site development costs (demolition and site preparation costs), construction costs (foundation and building costs), consultants' fees and other project costs (civil engineering and geo-technical studies, site investigation and material testing costs). Revisions to the project budget would also be submitted to the BC for approval after the Tender Committee's approval of the award of the contracts.

3.19 When preparing the tender documents, the contract team of the HD is responsible for monitoring costs against the approved budget parameters and amending the project design if required to bring costs within the approved budget parameters. Once the construction work starts, the project manager would carry out annual budget review for the latest estimate of annual construction expenditure to avoid over/under spending.

3.20 Audit analysed the six projects completed in 2012-13 (see Table 10 for details). All of them involved budget revisions, due to changes in construction cost yardsticks, award of contracts, or contract price fluctuations, etc. (see paras. 3.16 and 3.17). Audit noted that the actual/estimated costs of all the six completed projects were within the approved budgets. Comparing with the original budgets, variances of 1% to 37% were noted for the actual/estimated costs of these projects.

Table 10

Cost for projects completed in 2012-13

PRH project	Original budget ($M)	Revised budget 1 ($M)	Revised budget 2 ($M)	Revised budget 3 ($M)	Revised budget 4 ($M)	Revised budget 5 ($M)	Actual/estimated cost as at November 2013 (Variance as % of original budget) ($M)
Kai Tak Development Site 1A (Phases 1 and 2)	3,188.05	3,199.22	2,373.62	2,230.89 (Note)	2,343.07	—	2,336.18 (27%)
Redevelopment of Lower Ngau Tau Kok Estate Phase 1	1,596.84	2,207.28	2,217.03	1,600.85 (Note)	—	—	1,466.77 (8%)
Ex-Cheung Sha Wan Police Quarters	861.38	864.37	578.75	564.46 (Note)	584.37	—	578.47 (33%)
Ex-Shatin Married Quarters	625.24	628.69	711.07	627.54 (Note)	659.50	—	619.81 (1%)
Heung Fan Liu Street, Shatin Area 4C	809.32	811.90	581.79	482.26 (Note)	491.31	523.87	513.26 (37%)
Tuen Mun Area 18	560.78	562.91	489.96	511.44	506.30 (Note)	—	503.94 (10%)

Source: *HD records*

Note: *Figures represent revised project budgets after the approval of the award of the building contracts (para. 3.18 refers).*

3.21 Audit notes that the HA has a system in place to monitor and control the costs of construction projects. The actual/estimated costs of all the six completed projects were within the approved budgets as revised. However, in three of the six projects, there were large variances (27% to 37% — see Table 10) from the original budgets. It appears that there is room for improving the accuracy of budgeting for PRH construction projects. According to the 2014-15 Budget Speech of 26 February 2014, the HA will have an estimated balance of $68 billion at the end of 2013-14, which can meet the funding requirement of the development programme for the next four years; however, to achieve the new housing production target, the HA must keep enhancing cost-effectiveness and sustainability of modus operandi in the long run. In this connection, the Financial Secretary has indicated that the HA is expected to assess the additional financial resources needed for the next 10 years. Before starting its discussion with Government on a feasible long-term financial arrangement, the HA needs to continue enhancing its system of budgeting and monitoring of project costs with a view to further improving the accuracy of budgeting for PRH construction projects.

Audit recommendation

3.22 **Audit has *recommended* that the Director of Housing should continue enhancing its system of budgeting and monitoring of project costs with a view to further improving the accuracy of budgeting for PRH construction projects.**

Response from the Administration

3.23 The Director of Housing agrees with the audit recommendation. He has said that:

(a) the HA already has a proper budget preparation and approval process, and an effective budgetary control and monitoring system in place (see paras. 3.16 to 3.19). Project teams are required to follow the established mechanism in preparing the original project budgets in accordance with the latest designs and prevailing construction cost yardsticks which have taken into account the prevailing market conditions. The original project budgets are then scrutinised by the senior management and approved by relevant business committees of the HA. Project teams have also kept close monitoring of the project budget and sought relevant approval to update project budget promptly as appropriate. In addition, the HA compiles 5-year budgets and forecasts annually based on the latest approved project budgets and construction programmes. The assessment of the updated cashflow required is reflected in the budgets and forecasts promptly for the examination and endorsement by relevant committees of the HA;

(b) the major variances from the original budgets for the three projects identified (i.e. Kai Tak Development Site 1A, Ex-Cheung Sha Wan Police Quarters and Heung Fan Liu Street, Shatin Area 4C) were mainly due to the change in market conditions in 2009. The original budgets of these three completed projects with major variances had been prepared in 2008, i.e. using June 2008 Construction Cost Yardsticks which at that time turned out to be the record high since 2004. Due to the financial tsunami in late 2008, the HA made downward adjustments to the project budgets of these three projects in 2009 (i.e. Revised budget 2 in Table 10) to reflect the dramatic market downturn to strengthen the control. As a result, the variances between the estimated final costs and Revised budget 2 of these three completed projects were substantially reduced; and

(c) the estimated final costs of the six completed projects were within the respective original budgets, and the variance of each of these six projects from the respective revised project budgets after the approval of the award of the building contracts was less than 10%.

PART 4: REDEVELOPMENT OF PUBLIC RENTAL HOUSING ESTATES

4.1 This PART examines the following issues relating to the redevelopment of PRH estates:

(a) ***Comprehensive Structural Investigation (CSI) Programme.*** Audit notes that the CSI Programme will continue to draw on considerable resources of the HD. There is a need to critically assess the resource requirements for the CSI and plan early for the next CSI Programme (see paras. 4.4 to 4.13);

(b) ***Refined Policy on Redevelopment.*** Audit notes that there are areas for improvement in the implementation of the Refined Policy on Redevelopment (see paras. 4.14 to 4.26); and

(c) ***Exploring future redevelopment potential.*** While redevelopment of old PRH estates might increase the supply of PRH flats in the long term, it would in the near term reduce the public housing stock and generate additional rehousing needs from the affected tenants. This may have an immediate adverse impact on the AWT for PRH before the longer-term benefits of supply of new PRH flats from redevelopment can be realised. The HD needs to duly take this into account in planning and implementing major PRH redevelopment projects in future (see paras. 4.27 to 4.33).

Background

4.2 ***Comprehensive Redevelopment Programme (CRP).*** In the 1960s and 1970s, the production of PRH estates (i.e. Mark I to Mark VI and Former Government Low Cost Housing estates) was aimed at satisfying the need for low cost rental housing. As compared to the newer estates built since the 1980s, the older estates had small living areas and minimal supporting facilities. The Government's 1987 LTHS stated that marked differences between older and newer estates were socially unacceptable and most of the older estates were expensive to maintain. In 1988, the HD launched a CRP to redevelop most of the older estates

(Note 7). Upon completion of the CRP in January 2010, the HA had redeveloped all the old blocks of Former Government Low Cost Housing and Mark I to Mark VI estates.

4.3 A large-scale public housing redevelopment programme inevitably exerts a heavy drain on resources. The 1998 White Paper on the LTHS for Hong Kong, which was promulgated after extensive consultation, set out the strategy for redeveloping aged public housing estates after completion of the CRP. It stated that redevelopment would be carried out as required having regard to the actual conditions of individual estates. Clearance would be undertaken only when an estate was unsafe structurally or became uneconomic to maintain. The need for clearance should be considered on an estate or block basis only.

Comprehensive Structural Investigation Programme

4.4 Under the 1998 LTHS, the sustainability of the public housing resources was driven primarily by safety and cost-effectiveness considerations, alongside the maintenance regime. In essence, the basic principle was that public housing blocks and estates should not be demolished unless they were structurally unsafe or beyond economic repair. To ascertain the building conditions of individual estates, the HD conducted a CSI on ageing estates which was about 40 years old or above and often associated with soaring maintenance and repair costs.

The CSI Programme

4.5 The CSI Programme has been rolled out since September 2005. It includes a detailed investigation which aims to determine the material strength and rate of deterioration of the structural elements of a building, focusing on major aspects such as concrete strength, extent of spalling and cracks, and corrosion of steel reinforcement bars, etc. The whole investigation process covers desktop

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Note 7: *Redevelopment of PRH estates first began with 12 Mark I to Mark II resettlement estates in the early 1970s. The programme was expanded to cover 26 public housing blocks under the Extended Redevelopment Programme in 1985. The CRP was an extension of the redevelopment programme and covered a total of 566 public housing blocks comprising 244,000 flats in all Marks III to VI estates and Former Government Low Cost Housing estates, representing 42% of all PRH flats as at December 1988.*

study, visual inspection, site and laboratory testing, and technical assessment. The findings would facilitate the consideration and planning of the necessary follow-up actions such as monitoring, repair or clearance.

4.6 If certain blocks or estates are found to be structurally unsafe, demolition would be recommended. For other blocks or estates which remain structurally safe but require improvement works to enhance the structural capacity, appropriate works such as structural strengthening, recasting or tailor-designed concrete repair would be arranged so that no major structural repairs would be necessary for at least 15 years. Another detailed CSI would be carried out near the end of the 15-year period.

4.7 The expenses on maintenance and improvement works for old buildings generally increase with age. While it may be technically feasible to extend the serviceable lifespan of the rental blocks through various upgrading works, the associated costs will at a certain point outweigh the benefits, thus making it uneconomic to retain the buildings. Hence, a financial appraisal will be carried out for the costs of repair works to determine its financial viability. Demolition may be considered if the cost-benefit analysis suggests that the aged buildings or estates are beyond economic repair.

CSI findings

4.8 Primarily in consideration of the estates' age, a total of 42 estates built in 1980 or earlier were included under the CSI Programme in two batches (Note 8). Up to January 2014, assessment on the 26 oldest estates had been completed. So far, all estates had been found to be structurally safe. The CSI found varying extent of structural deterioration in the older public housing blocks. The HD had tailor-made solutions to sustain these buildings.

Note 8: *The first batch of CSI Programme included 10 estates with their CSIs conducted and completed between September 2005 and September 2008. The second batch included 32 estates with the CSI programmed from 2008 to 2018.*

4.9 The estimated repair cost per flat varied among various estates. It ranged from $1,200 to $47,900 per flat. Only So Uk Estate and Tung Tau Estate Block 22 had been recommended for redevelopment under the CSI Programme because their estimated structural repair costs per flat (in the range of $46,200 to $47,900) were not economically viable. Other PRH blocks, which were economically viable to retain and were not to be redeveloped/cleared, would be sustained for at least another 15 years through appropriate structural repairs and estate improvement works under the Estate Improvement Programme (EIP — Note 9). As can be seen from the redevelopment of Tung Tau Estate Block 22 in Case 6 (see Appendix O), the process of redevelopment could take many years, the timeliness in identifying all the significant issues related to the clearance of households and the demolition of the old blocks and careful analysis and planning of the build-back potential of the site are crucial to minimise delays.

Further planning needed for the CSI Programme

4.10 In consideration of the resource demand and the anticipated amount of works involved, the HD currently adopts a manageable programme approach by conducting CSI for only 3 to 4 estates per year. Audit notes that there are 42 estates included in the CSI Programme from 2005 to 2018 (26 estates completed during the 8 years from 2005 to 2013). More estates would probably be included in the next CSI Programme beyond 2018 (expected year of completion of the current CSI Programme). Moreover, by that time, some of the retained estates of the current CSI programme would approach the end of the 15-year cycle and thus would require another CSI (see para. 4.6 and Table 11).

Note 9: *After the aged buildings were identified as structurally safe in the CSI Programme and were determined not to be redeveloped/cleared, an EIP would be formulated and implemented to address the needs of the estate/tenants with respect to building improvements, lift addition and modernisation, as well as provision of disabled access, landscaping, elderly facilities, recreational and sports facilities, etc.*

Table 11

Age profile of old PRH estates

	Number of estates	Number of blocks	Completion year of the earliest block	Building age (as at 2013)	Building age (as at 2018)	Building age (as at 2032)
CSI Programme from 2005 to 2018	42	366 (Note 1)	1954 – 1980	34 – 60 years	39 – 65 years	53 – 79 years
Estates falling into the next CSI Programme (2019 to 2032)	80 (Note 2)	610	1981 – 1993	21 – 33 years	26 – 38 years	40 – 52 years

Source: HD records

Note 1: Out of the 366 blocks, there are 271 blocks built before 1981.

Note 2: These excluded the estates which had been subject to the CSI Programme from 2005 to 2018.

4.11 Audit notes that the existing resources for investigating 3 to 4 estates per year may not be sufficient to cope with the increasing number of blocks requiring inspection in future. The HD needs to critically assess the resource requirements for the CSI and plan ahead for the implementation of the next CSI Programme.

Audit recommendation

4.12 **Audit has *recommended* that the Director of Housing should critically assess the resource requirements for the CSI and plan ahead for the implementation of the next CSI Programme which is expected to start from 2018.**

Response from the Administration

4.13 The Director of Housing agrees with the audit recommendation. He has said that:

(a) the HD would prudently plan its redevelopment programme. Though it would be difficult to foresee all obstacles at the outset, the HD would allow adequate time for negotiations with the locals, DC members and LegCo members; and

(b) the HD would conduct an early review to assess the resource requirements for the CSI and prepare an implementation plan ahead of the next CSI Programme expected to start in 2018.

Refined Policy on Redevelopment

Assessment of redevelopment potential

4.14 In view of the shortage of land for PRH development, the HD held a meeting in June 2009 to discuss the redevelopment potential of some existing old PRH estates (Pak Tin Estate was one of the potential estates identified for discussion — see para. 4.22). The primary objective was to maximise the development potential of those underutilised estates in hand, but at the same time having due regard to the policy of three-year AWT for PRH applicants. In September 2009, a Working Group on PRH Redevelopment Potential Study was formally established. Its terms of reference are to:

(a) review the identified old estates with potential for redevelopment;

(b) assess the strategic/political/financial/legal implications of the redevelopment potential;

(c) formulate policy on redevelopment of old PRH estates if appropriate; and

(d) report findings to the senior management and the SPC for consideration.

4.15 The Working Group identified a few potential old PRH estates. However, given the general adverse impact on the AWT, political sensitivity, and stringent control on development intensity and building height, the Working Group suggested that a mechanism should be established to monitor the availability of local rehousing resources and conduct the redevelopment potential review for the estates under the CSI Programme.

4.16 The Senior Officials Meeting of March 2010 supported the recommendation of not proceeding with the redevelopment. It opined that since most of the estates with the CSI completed would be over 50 years of age and a few approaching 60 years of age after the 15-year cycle, a holistic review of the redevelopment potential of these estates would be required. In the long term, the aged buildings would require redevelopment irrespective of whether or not there was a lack of land supply for PRH development. It agreed to continue to identify opportunities and problems for redevelopment of CSI-completed estates and establish a programme for redevelopment of these estates in the long term. Consideration should also be given to identifying other potential redevelopment estates with reference to factors such as build-back flat gain and availability of rehousing resources.

Refined Policy on Redevelopment of aged PRH estates

4.17 To achieve the PRH production targets to meet the continuing high demand for public housing, apart from identification of new public housing sites, the HA would need to make better use of the valuable land resources in existing PRH estates with a PR lower than the maximum permissible, and explore scope for adding PRH units through redevelopment of the aged estates.

4.18 In November 2011, in response to an initiative announced in the Policy Address of 2011-12 "to explore ways to appropriately increase the densities and PR of PRH projects without compromising the living environment", the HA implemented the Refined Policy on Redevelopment of aged PRH estates by considering the build-back potential and the availability of rehousing resources of the estates in addition to the structural conditions and economic viability of the housing blocks under the current CSI Programme.

4.19 With regard to better utilisation of land resources, the objective to minimise waste and the need to sustain the public housing development programme, the framework of the redevelopment policy was refined in November 2011, as follows:

(a) if the housing blocks are no longer safe or economic to maintain as confirmed by the findings of the CSI, redevelopment should be adopted;

(b) where suitable rehousing resources are available nearby (Note 10), for estates with promising flat gain upon optimisation of development potential, the whole or part of estate will be redeveloped. The remaining blocks will be upgraded to meet current statutory standards and codes of practice where no further flat gain would accrue; and

(c) if rehousing resources are not adequately and suitably available, the blocks will be retained and be improved in the normal manner under the CSI Programme/EIP to prolong their life for at least another 15 years.

Build-back potential for the old estates

4.20 Under the Refined Policy on Redevelopment, the build-back potential is one of the factors to be considered for the redevelopment of PRH estates. Out of the 26 estates with the CSI completed, the HD had recommended the way forward for 16 estates. Since the recommendations were made before the introduction of the Refined Policy, the build-back potential of these 16 estates was not considered. However, for the remaining 10 estates, recommendations were put on hold pending the review of their redevelopment potential.

4.21 Up to December 2013, 22 estates with the CSI completed had not been assessed for their build-back potential. Pak Tin Estate was the only estate identified for redevelopment and had its CSI completed. Audit considers that the HD needs to expedite the detailed review on the build-back potential of aged estates with CSI completed.

Note 10: *According to the current practice, affected tenants will, wherever practicable, be rehoused in the same districts where they are living.*

4.22 Among estates in the pipeline for the CSI Programme and the 2009 redevelopment potential review (see paras. 4.14 and 4.15), Pak Tin Estate had been identified with high redevelopment potential and promising flat gain as well as with suitable rehousing resources. In January 2012, the HA endorsed the plan for the redevelopment of Pak Tin Estate. Net gain in flat production upon redevelopment of Pak Tin Estate will be about 2,400 flats (70%). However, Audit found that new lifts were installed shortly before the launching of the redevelopment of Pak Tin Estate (see Case 7 at Appendix P). Audit considers that when major improvement works will be undertaken, it is important to coordinate within the HD to ensure that the estate is not designated for redevelopment in the near future. The case study of Pak Tin Estate has illustrated that the HD should have better coordination within the department so that resources would not be wasted due to the launching of redevelopment plan shortly after the completion of the improvement works in an estate in future.

4.23 On 28 February 2014, the HD announced that it had completed a review of the redevelopment potential of 22 aged PRH estates. The two major findings of the review were:

(a) as at 2013, the 22 aged estates range in age from 34 to 60 years, and the structural conditions of these estates were basically sound; and

(b) given that the majority of the aged estates were located in urban areas where land for public housing was in short supply, finding suitable sites for the development of reception resources outside the individual aged estates was very difficult in many cases.

4.24 The review was a starting point for the HD to conduct detailed studies of selected aged estates in the future (Note 11). For the next stage of work, the HD will:

Note 11: *Wah Fu Estate was assessed under this review and was considered suitable for redevelopment following the Government's decision to partially lift the development moratorium at Pok Fu Lam South and adjacent government sites which will be used as reception resources.*

(a) conduct detailed review on each of the individual 22 aged PRH estates and conduct technical studies to identify suitable reception resources;

(b) liaise with relevant B/Ds on the provision of other social ancillary facilities to confirm the build-back potential and prepare for local consultation;

(c) prepare detailed redevelopment plan with a view to optimising valuable land resources; and

(d) seek the HA's approval on the redevelopment scheme.

Audit considers that detailed review is necessary for assessing the redevelopment potential of the aged PRH estates for long-term planning. In this connection, Audit notes that there will be new supply of PRH flats in the urban areas in the coming PRH production programme which can be considered as the reception resources for the redevelopment of old estates. The HD needs to seek opportunities for gainful redevelopment by assessing the build-back potential and availability of rehousing resources.

Audit recommendations

4.25 **Audit has *recommended* that the Director of Housing should:**

(a) **take measures to enhance coordination within the HD in order to avoid the possible wastage of resources due to the launching of redevelopment plan shortly after the completion of major improvement works (e.g. lift addition) in aged PRH estates;**

(b) **expedite the detailed assessment of the build-back potential for all the aged PRH estates with CSI completed in order to facilitate the future planning for redevelopment of PRH estates; and**

(c) **critically review the redevelopment projects, having due regard to the requirement of the Refined Policy on Redevelopment on the maximisation of build-back flat gain as far as possible.**

Response from the Administration

4.26 The Director of Housing generally agrees with the audit recommendations. He has said that:

(a) the HD has enhanced coordination within the department so that the Redevelopment Programme of the aged estates will be from time to time made known to the parties handling various programmes of maintenance and improvement works to the concerned estates to enable better planning; and

(b) under the Refined Policy, redevelopment of aged PRH estates will only be launched on a project-by-project basis. It is prudent to contain the scale and pace of redevelopment taking into account the availability of reception resources, demand from the general applicants on the WL, and other relevant factors.

Exploring future redevelopment potential

Better utilisation of vacant sites and PRH Interim Housing blocks

4.27 Audit found that some PRH redevelopment sites which had been cleared a number of years ago were still left undeveloped. An example is the Phases 3, 6 and 7 of Shek Kip Mei Estate (see Case 8 at Appendix Q). Audit considers that the HD needs to explore the better use of its existing land resources and explore the feasibility and expedite the process of putting the vacant sites into beneficial uses.

4.28 In October 2006, Audit completed a review of the allocation of PRH flats. The results were included in Chapter 3 of the Director of Audit's Report No. 47 of October 2006, which recommended, among others, that the HA should expedite action to explore the feasibility of converting the two old Kwai Shing East and Shek Lei (II) Interim Housing (IH) Estates (Note 12) into other beneficial uses in

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Note 12: *It is the Government's policy to ensure that no one will be rendered homeless as a result of natural disasters, fire, emergencies, as well as government's clearance and enforcement actions. The HD provides temporary accommodation through IH and Transit Centres to affected households not immediately eligible for allocation of PRH flats.*

view of their high vacancy rates and high operational costs. To take forward this audit recommendation, the HD conducted CSI for the two IH estates. Based on the CSI findings, in 2008 the HA approved the clearance of Kwai Shing East IH in consideration of its structural conditions and the financial implications of the extensive repair works required. Besides, the HA endorsed the refurbishment of Shek Lei (II) IH, monitored its vacancy rate and carried out a review in 2011.

4.29 As at January 2014, the HA had three IH estates, namely Shek Lei (II) IH, Long Bin IH (Note 13) and Po Tin IH, which provided a total of 4,914 units. The vacancy rates as at January 2014 of the three IHs were 60%, 40% and 8% respectively. Two Transit Centres (TCs), namely Po Tin TC and Lung Tin TC also provided temporary accommodation. In view of the age, increasing maintenance cost and high vacancy rates, Audit considers that the HD should explore measures to make better use of these resources (see Case 9 at Appendix R).

Consolidating experiences from the previous PRH redevelopment projects

4.30 The HA is committed to a production target to cope with the high demand of PRH flats. Redevelopment of aged building blocks with PR not yet fully utilised is one of the ways to increase the supply of PRH flats. Audit considers that the HA should consolidate experiences from the previous PRH redevelopment projects and take them into account when devising its long-term redevelopment plan. The 1998 LTHS stated that a large-scale public housing redevelopment programme inevitably exerted a heavy drain on resources. Redevelopment should therefore be undertaken when necessary to replace housing blocks which were no longer safe or economic to maintain.

4.31 Audit noted that from past experience, while redevelopment of old PRH estates might increase the supply of PRH flats in the long term, it would in the near term reduce the public housing stock and generate additional rehousing needs from those displaced tenants who would take priority over those on the WL in the allocation of PRH flats. In general, it would take a long time before the supply of

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Note 13: *In January 2014, the HA decided to clear Long Bin IH in Yuen Long for public housing development. Long Bin IH consists of eight low-rise blocks with 840 units. The target clearance date is January 2016.*

new PRH flats from the redevelopment can be realised. According to the HD's current practice, affected tenants will, wherever practicable, be rehoused in the same district. The practice of local rehousing would also severely hinder the HD in terms of housing allocation and created many problems. Audit considers that the HD needs to duly take into account the past experience in planning for future redevelopment projects with a view to optimising the use of land and resources.

Audit recommendations

4.32 **Audit has *recommended* that the Director of Housing should:**

(a) **continue to closely monitor the demand and supply of IH flats and their vacancy rates and explore the feasibility for their redevelopment;**

(b) **explore the feasibility of putting the vacant HA sites into beneficial uses; and**

(c) **duly take into account experiences from the previous PRH redevelopment projects in planning for future redevelopment, with a view to optimising the use of land and resources.**

Response from the Administration

4.33 The Director of Housing agrees with the audit recommendations. He has said that the HD will:

(a) continue to closely monitor the demand and supply of IH units and explore the feasibility of putting them into other beneficial uses;

(b) launch the future redevelopment projects on an estate basis under the prevailing Refined Policy on Redevelopment (see para. 4.26(b)); and

(c) apart from making reference to the experience of the CRP, also refer to recent experience gained in the latest redevelopment projects such as Pak Tin as and when appropriate in terms of optimisation of the use of land and resources.

PART 5: WAY FORWARD

5.1 This PART explores the way forward for the future planning and development of PRH flats.

Higher production target to meet increasing demand for public rental housing

5.2 The current-term Government has made housing a top priority. It is the Government policy to provide PRH to low-income families who cannot afford private rental accommodation, with a target of maintaining the AWT for general applicants at around three years. There has been an increasing demand for PRH flats in recent years. As at end of December 2013, the AWT for PRH was already 2.9 years. According to the Policy Address of January 2014, the Government has accepted the LTHS Steering Committee's recommendation to adopt a higher target of 470,000 units for new public and private housing supply (with public housing accounting for 60% of this target) in the coming 10 years (see para. 1.12). It is necessary to ensure that sufficient new PRH flats are constructed to meet this higher production target for public housing as well as the three-year AWT target for general applicants.

Challenges ahead

5.3 In this review, Audit has examined the HA's efforts in planning, construction and redevelopment of PRH flats. Audit has identified a number of areas that call for improvement (see PARTs 2 to 4). The major challenges facing the HA and the Administration in meeting the new PRH production target are summarised below.

Planning for the provision of PRH flats

(a) ***Monitoring demand for PRH and meeting the AWT target.*** As stated in the LTHS Consultation Document of September 2013, the Steering Committee is aware of the mounting challenges faced by the HA in maintaining the AWT target since the number of PRH applicants on the WL continues to increase under the current tight supply of PRH units, and it takes time to make available new supply of PRH units. The Steering Committee indicates concern about the possibility of the AWT departing from the target and considers that the AWT target underlines the Government's determination to provide affordable rental housing to the grassroots. Hence the Steering Committee has recommended that the Government should address the issue and strive to maintain the AWT target, despite the possibility of occasional departure from the target. To rise to the challenge, the HD needs to continue to closely monitor the demand for PRH and strive to meet the AWT target as far as possible (see paras. 2.2 to 2.22);

(b) ***Shortage of land supply for public housing.*** Land supply is the major factor affecting the PRH production. There are keen competing demands for the use of land which is scarce and valuable in Hong Kong. The shortage of land supply for public housing is a great challenge to the HA in meeting the PRH production target. As stated in the Budget Speech of February 2014, the Government is fully committed to supplying additional sites to the HA. The HA should capitalise on the opportunity to secure sufficient land for the long-term sustainable development of public housing (see paras. 2.46 to 2.48 and 2.55);

(c) ***Long time taken for planning and land development process.*** From past experiences, it often took a long time for the planning and land development process before a site could be used for PRH construction purpose. Delays are also caused by the need to amend Outline Zoning Plans (OZPs), consult DCs and local communities, liaise with different B/Ds, etc. Recently, measures have been taken to enhance the arrangements to expedite PRH production, but more needs to be done to reduce the long time taken for such process as far as possible (see paras. 2.38 to 2.55);

(to be continued)

(Cont'd)

Management of PRH construction projects

(d) ***Fast-tracking PRH construction.*** Since 2013, the HA has streamlined the construction process to reduce the timeframe for PRH construction from seven years to five years. The HD needs to closely monitor the PRH construction projects to ensure that the fast-track programme is implemented as intended (see paras. 3.2 to 3.14);

(e) ***Meeting the financial requirement of the 10-year PRH development programme.*** The higher production target set for the coming 10-year PRH development programme has put great pressure on the financial position of the HA. According to the Budget Speech of February 2014, the HA must keep enhancing cost-effectiveness and sustainability of modus operandi in the long run. The HA needs to continue its efforts in enhancing its system of budgeting and monitoring of PRH project costs (see paras. 3.16 to 3.22); and

Redevelopment of PRH estates

(f) ***Capitalising on the redevelopment of old PRH estates.*** Redevelopment of old PRH estates offers an opportunity for better utilising the PR of the sites and providing additional supply of PRH flats. However, based on experiences of the previous PRH redevelopment projects, redevelopment would in the near term reduce the public housing stock and generate additional rehousing needs from the affected tenants, resulting in an immediate adverse impact on the AWT for PRH. The HD needs to duly take this into account in planning and implementing major PRH redevelopment projects in future (see paras. 4.30 to 4.32).

Review of the Long Term Housing Strategy

5.4 The LTHS Steering Committee (see para. 1.11) issued its report on public consultation in February 2014. The consultation sought views of the public on:

(a) the proposal to adopt a supply-led strategy for LTHS and with public housing accounting for a higher proportion of the new housing production;

(b) the principles and methodology adopted for projecting the long-term housing demand;

(c) any other factors that should also be taken into account in projecting housing demand; and

(d) the projected total housing supply target for the next 10 years and the proposed public/private split for the future new housing supply.

5.5 The Steering Committee reported that for views of the respondents on overall housing strategy and long-term housing demand projection:

(a) there was general support for the recommendation to adopt a supply-led LTHS with public housing accounting for a higher proportion of the new housing production;

(b) respondents generally accepted the demand components (see para. 2.10(a) to (c)) adopted by the Steering Committee for long-term demand projection purposes;

(c) there was considerable support for the supply target of 470,000 units for the coming 10 years; and

(d) respondents generally agreed that public housing should play a more prominent role and should account for at least 60% of the new production for the coming 10 years.

The Government will take account of the consultation report and other views collected during the consultation in formulating the LTHS which is expected to be announced later in 2014.

5.6 The HA is tasked to provide affordable housing to meet the needs of households that cannot afford private rental accommodation. It is the primary provider of PRH. As stated in the report on public consultation, the Steering Committee noted the overall public support for maintaining the AWT at around three years for general applicants on the PRH WL. This audit review has highlighted various issues of concern relating to the planning, construction and redevelopment of PRH flats, and suggests measures for improvement. In this connection, the THB needs to give due consideration to the Steering Committee's recommendations, the public's views as well as the audit observations and recommendations in this Audit Report when formulating and implementing the LTHS.

Audit recommendation

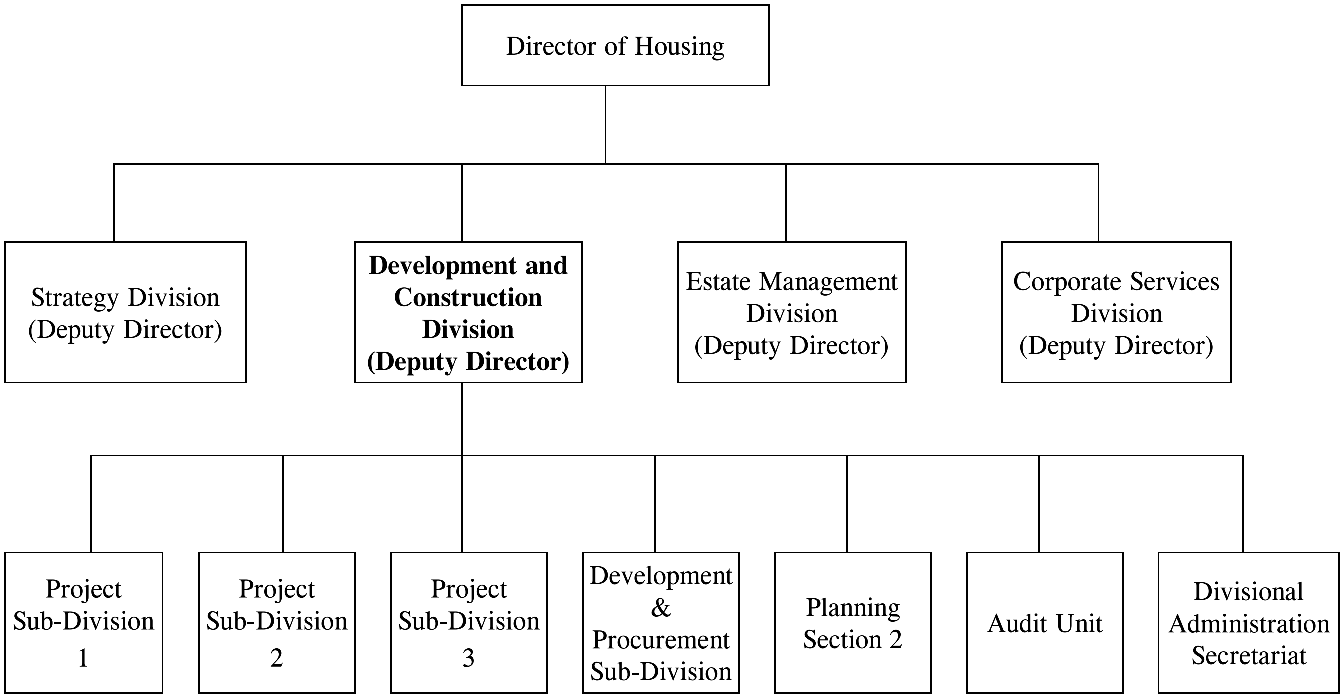
5.7 **Audit has *recommended* that the Secretary for Transport and Housing should take on board the audit observations and recommendations in this Audit Report when formulating and implementing the LTHS.**

Response from the Administration

5.8 The Secretary for Transport and Housing agrees that Audit's observations and recommendations would be taken into account in formulating the LTHS.

Appendix A
(paras. 1.4 and 1.6 refer)

Housing Department
Organisation chart (extract)
(31 December 2013)



Source: HD records

Appendix B
(paras. 2.5 and
2.36(c) refer)

The Committee on Housing Development

Terms of Reference

1. To endorse the results of the Assessment of Long-term Housing Demand;
2. To consider the housing type (public or private) of identified residential sites;
3. To monitor the timely supply of suitable land for public housing development to meet the anticipated demand; and
4. To consider and address major inter-departmental or cross-bureau issues that will affect timely supply of suitable public housing land.

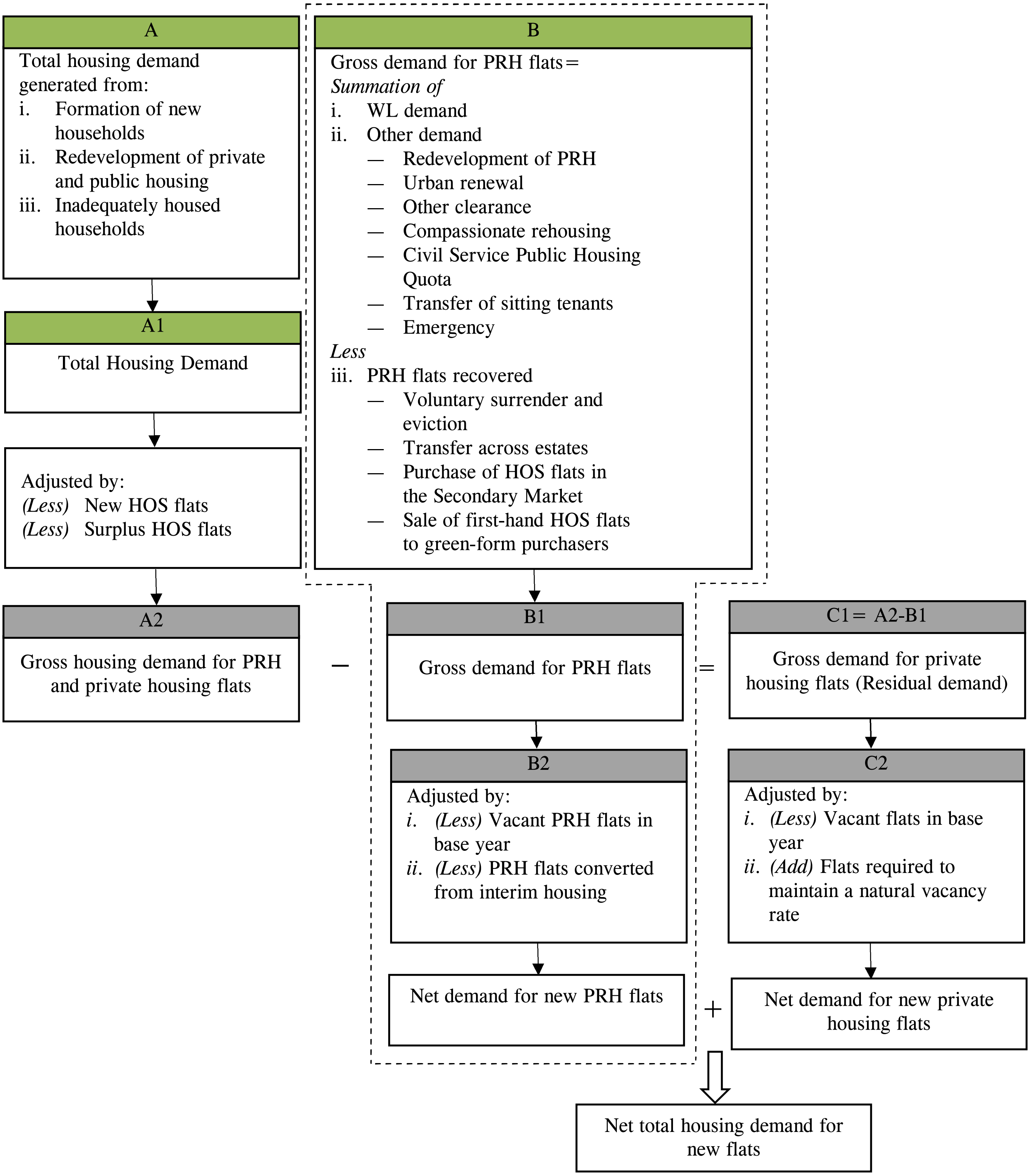
Membership

Chairman:	Permanent Secretary for Transport and Housing (Housing)	
Members:	Permanent Secretary for Development (Planning and Lands) Deputy Secretary, Development Bureau (Planning and Lands) Director of Planning Director of Lands Director of Civil Engineering and Development	or representatives (Deputy Director/ Principal Assistant Secretary level)
	Deputy Director (Strategy), Housing Department Deputy Director (Development & Construction), Housing Department	
Co-opted Members:	Government Economist Director of Environmental Protection	or representatives
	Other B/Ds if required	
Secretary:	Chief Planning Officer, Housing Department	

Source: THB records

Appendix C
(paras. 2.9 and 2.18(c) refer)

Diagrammatic illustration of the methodology for assessing long-term housing demand for new PRH flats



Source: THB records

Appendix D
(para. 2.34 refers)

Steering Committee on Land Supply

Terms of Reference

1. To coordinate the overall plans for development and supply of land in Hong Kong for different types of land uses;

2. monitor, prioritise, coordinate and steer the development of needed infrastructure in support of the timely supply of public and private housing land;

3. select the optimal options in identifying the supply of public and private housing land;

4. building up a land reserve of sufficient size for future disposal; and

5. provide a forum to resolve inter-bureau and inter-departmental issues affecting the availability of individual housing sites.

Membership

Chairman
Financial Secretary

Members
Secretary for Development
Secretary for Transport and Housing
Secretary for the Environment
Secretary for Financial Services and the Treasury
Permanent Secretary for Transport and Housing (Housing) / Director of Housing
Permanent Secretary for the Environment / Director of Environmental Protection
Director of Planning
Director of Lands
Commissioner for Transport
Director of Civil Engineering and Development

Other Principal Officials and Heads of Department may be invited to attend on a need basis

Secretary
Principal Assistant Secretary (Planning and Lands)1, Development Bureau

Source: DevB records

Appendix E
(para. 2.35 refers)

Committee on Planning and Land Development

Terms of Reference

1. To oversee the formulation and review of development strategies, and sub-regional and sectoral planning studies of strategic significance;

2. To consider development proposals from both the private and non-Government sectors and, where appropriate, ensure coordination and cooperation within the Government in order to facilitate the processing and implementation of such projects;

3. To consider and review policies on production, acquisition, use and disposal of land;

4. To perform a clearing house function for determining the development density of individual Government land sale sites and developments for which lease modification or planning approval is required;

5. To consider and approve land-use planning standards and guidelines;

6. To consider the need for the preparation or replacement of statutory plans;

7. To consider and approve outline development and layout plans;

8. To consider recommendations on land-use planning and control relating to potentially hazardous installations;

9. To consider population distribution projections for assessing development needs and planning of provision of facilities; and

10. To escalate matters to the Policy Committee for attention or resolution.

Membership

Chairman

Secretary for Development

Members

Permanent Secretary for Development (Planning and Lands)

(Alternate Chairman)

Permanent Secretary for Development (Works) or representative

Permanent Secretary for Financial Services and the Treasury (Treasury) or representative

Permanent Secretary for Transport and Housing (Transport) or representative

Permanent Secretary for the Environment/Director of Environmental Protection or representative

Director of Housing or representative

Director of Civil Engineering and Development or representative

Director of Home Affairs or representative

Director of Lands or representative

Director of Planning or representative

Director of Architectural Services or representative

Government Economist or representative

Deputy Secretary (Planning and Lands) 1

Secretary

Principal Assistant Secretary (Planning and Lands) 2, Development Bureau

Source: DevB records

Appendix F
(para. 2.37 refers)

Bureaux and departments involved and their roles/responsibilities in land supply

Bureau/department	Major roles/responsibilities
Development Bureau	• Provide land supply
Transport and Housing Bureau	• Monitor housing supply • Ensure adequate production of public housing units
Planning Department	• Coordinate planning matters • Prepare Outline Development Plans and OZPs • Carry out necessary land rezoning
Civil Engineering and Development Department	• Prepare and handle site formation and infrastructural works contracts including gazettal actions • Coordinate fill management • Comment on slope stability and geotechnical matters • Advise on blasting matters
Lands Department	• Process land resumption • Coordinate clearance matters • Issue possession licence
Transport Department	• Coordinate major traffic planning matters • Comment on Traffic Impact Assessment • Advise on road layout and capacity

Appendix F
(Cont'd)
(para. 2.37 refers)

Bureau/department	Major roles/responsibilities
Environmental Protection Department	• Comment on EIA • Advise on environmental nuisance control requirements • Control marine dumping
Highways Department	• Advise on road construction materials and maintenance responsibilities • Comment on road drainage design • Prepare gazettal actions under the Roads (Works, Use and Compensation) Ordinance (Cap. 370) as works agency
Water Supplies Department	• Advise and make provision for water supply
Drainage Services Department	• Advise and make provision of drainage connections • Advise on maintenance responsibility and drainage design • Comment on Drainage Impact Assessment

Source: THB records

Appendix G
(para. 2.53(a) refers)

Land Supply Tracking Subcommittee of Committee on Planning and Land Development

Terms of Reference

1. To support monitoring of land supply by tracking the status and progress of potential sites for development, including sites earmarked for private development through land sale, for subsidised housing development, or for other development as directed by CPLD;

2. To expedite land supply by coordinating and guiding the actions of relevant departments in site production, i.e. to address and resolve issues relating to the availability and delivery of sites for development, including assigning responsibilities and setting targets;

3. To oversee the development and operation of the LSIS, including interfacing with relevant information systems of relevant B/Ds, in order to support the monitoring of land supply, tracking of site progress, and taking of actions by departments;

4. To report to the Committee on Planning and Land Development on site production progress, identifying and bringing to CPLD's attention issues affecting site production that require steer, including proposing solutions for resolving inter-departmental issues for steer as appropriate; and

5. Based on the Land Supply Information System, to provide an overview on land supply situations for regular reporting to CPLD and SCLS.

Appendix G
(Cont'd)
(para. 2.53(a) refers)

Membership

Co-Chairman

Planning and Lands Branch — Deputy Secretary (Planning and Lands)
(Principal Assistant Secretary (Planning and Lands) as alternate)

Works Branch — Deputy Secretary (Works)
(Principal Assistant Secretary (Works) as alternate)

Members (Assistant Director level or above)

Planning Department representative

Lands Department representative

Civil Engineering and Development Department representative

Housing Department representative

Transport Department representative

Highways Department representative

Environmental Protection Department representative

Drainage Services Department representative

Representatives of other relevant departments to be invited as necessary

Secretary

Assistant Secretary (Lands) / Development Bureau

Source: DevB records

Appendix H
(para. 2.59 refers)

Technical studies for potential public housing sites in the planning process

General Studies	
1.	Site Potential Study
2.	Architectural Feasibility Study
3.	Traffic and Transport Impact Assessment
4.	Drainage Impact Assessment
5.	Sewerage Impact Assessment
6.	Noise Impact Assessment
7.	Air Quality Assessment
8.	Water Supply and Utilities Impact Assessment
9.	Geological and Geotechnical Appraisal
10.	Ground Investigation
11.	Microclimate Studies
12.	Air Ventilation Assessment
13.	Tree Survey and Impact Assessment
14.	Visual Appraisal
15.	Land Surveying
Specific Studies	
1.	Planning and Engineering Studies
2.	Land Use Assessment
3.	Land Contamination Assessment
4.	Quantitative Risk and Potentially Hazardous Installations Assessment
5.	Site Formation Assessment
6.	Natural Terrain Hazard Study
7.	Existing Slope Features Assessment
8.	Ecological Assessment
9.	Heritage Impact Assessment
10.	Retail Viability Study

Source: HD records

Appendix I
(paras. 2.61 and
2.62 refer)

Case 1

Shui Chuen O Estate (Shatin Area 52)

Background

1. One of the largest PRH estates to be completed in 2015 is Shui Chuen O Estate. The site is located at Shatin Area 52 with the size of 13 hectares, in the New Territories with the estate planned for completion in four phases from mid-2014 to end of 2015. The estate will comprise 18 blocks providing 11,123 PRH units.

2. The then Territory Development Department (TDD — Note) conducted a feasibility study of potential sites in Shui Chuen O, which was endorsed by the CPLD in October 1998. It was planned to provide 2,500 HOS flats and scheduled for completion in late 2005.

3. In 1999 and 2000, the SPC and the DipCon endorsed the development parameters and development cost ceiling. The Master Layout Plan and Project Development Budget was approved by the Project Design Review Committee. An Architectural Design Competition was held in October 2000. The winning team was entrusted with the execution of the project.

4. From 2001 to 2004, site formation work was undertaken by the then TDD.

5. Due to the repositioning of housing policy in 2002, the HA decided to withdraw from the direct provision of subsidised sale flats and the production and sale of HOS flats would cease from 2003 onwards. The HA assessed the viability of converting the site for PRH in 2003. However, due to the lack of infrastructural support and the foreseeable overloading of traffic, it was considered not viable to convert the site into PRH.

6. The site was taken off the PHCP and returned to the Government and was included in the Master List of Potential Land Sale Sites for private housing development. The expenditure incurred up to January 2003 was $70 million, which included consultant fees, site investigation work and mock up construction.

Case 1 (Cont'd)

7. At the then CHP meeting in November 2005, it was noted that many sites in the production programme were at risk, and hence additional sites and prime sites should also be considered. The PlanD identified a few proposed replacement sites for PRH development. During a meeting among the PlanD, LandsD and HD in May 2006, it was noted that the majority of the proposed replacement sites were long-term sites due to the need for rezoning, resumption, and relocation of the existing uses. Only the sites in Shatin Area 52 were more suitable as they were all formed and zoned residential.

8. In 2009, the site (2.5 hectares) together with adjacent sites (10.5 hectares) were included back in the PHCP for PRH development. The Development and Housing Committee of Shatin DC was consulted in July and December 2009. The DC supported the proposed PRH development in principle. The construction plan was then put in the 2009-10 PHCP. Phase 1 was expected to be completed in mid-2014.

Audit comments

9. Audit noted that the estate was originally expected to be completed in 2005 when it was first included in the HD's production programme in 1999. Due to the changes in the housing policy and various considerations through the years, the site would only be developed into a PRH estate after some 10 years and the construction would only be completed in 2015.

10. The case showed that sites identified in the HD's production programme could be changed due to policy change and other considerations. For PRH development, it often requires long-term planning to identify potential sites, to develop, rezone, clear and form the land to provide PRH sites. The HA should, based on a long-term housing strategy, implement measures to ensure a steady supply of PRH and PRH flats.

Source: Audit analysis of HD records

Note: It merged with the then Civil Engineering Department in 2004 to become the Civil Engineering and Development Department.

Appendix J
(para. 2.61 refers)

Case 2

Ex-Yuen Long Estate

Background

1. The ex-Yuen Long Estate site with the size of 1.63 hectares, was formerly used for five blocks of PRH with a total of 3,511 flats and two primary schools. The original redevelopment proposal in October 2000 was a Private Sector Participation Scheme. The proposal was dropped due to a change in housing policy.

2. The Estate was demolished in June 2003 and the site was handed over to the Government.

Local consultation

3. Around 2005, the HA got back the site from the Government and earmarked it for PRH to provide 1,988 flats in 2011-12. The consultation process started in September 2006. The Yuen Long DC and the local community objected to the use of the site for PRH development and indicated that the land should be used for Government facilities or commercial purposes instead.

4. In March 2008, the HA put forward the refined redevelopment project (reducing the PRH site to 1.4 hectares for building four blocks with about 1,600 flats) and liaised again with the DC. The proposal was not supported.

5. In May 2009, the HA liaised again with the DC of the revised schemes (reducing the PRH site to 1.2 hectares for building four blocks with about 1,300 flats). The revised proposal was still not supported in light of very strong views for private commercial development.

6. In June 2010, the HA further revised its plan to reduce the site area for PRH to 0.41 hectare (25% of the Ex-Yuen Long Estate site) for building two blocks with 390 flats and release the large portion of site area for commercial development by private sector. This finally gained the DC's support.

7. In February 2011, the DipCon approved the PB. Two domestic blocks with 437 flats would be built. The development works started in 2011 and were planned to be completed by October 2015.

Case 2 (Cont'd)

8. In March 2014, the HD explained to Audit that the HD had taken proactive measures to submit schemes for PRH development since site handover to the Government in 2003. It took years for district consultation, including agreement with the plot size designated for the PRH before the site was allowed to change back its use for PRH development.

Audit comments

9. Audit noted that the site was earmarked to be used for PRH development around 2005. However, it took a long time to change back its use for PRH development, which led to delay in the completion of the development of an estate of reduced size. It also took more than 3.5 years for the HA to reach an agreement with the DC.

Source: Audit analysis of HD records

Appendix K
(para. 2.66 refers)

Case 3

Inverness Road Kowloon City site

Background

1. The total cost written off under this project amounted to $52.63 million. The amount written off was mainly staff cost incurred since 2000 amounting to $47.41 million.

2. The Inverness Road site was originally identified as a potential site for HOS development, providing 800 HOS flats. Due to the repositioning of housing policy, in 2002, the site was transferred to PRH development for 896 PRH flats and expected to be completed in mid-2006. The then Civil Engineering Department stated that it had neither the expertise nor available resources to undertake the Land Contamination Assessment and the decontamination works of the site and therefore proposed to entrust the works to the HD. The site formation was completed by the HD in December 2004.

3. In 2005, in view of the site's prime location, the CHD and the then CHP agreed that it should be returned to the Government subject to identification of suitable replacement sites.

4. Tung Chung Area 56 was identified and allocated to the HA as the replacement. As the replacement site was larger in size and had higher flat production than Inverness Road, the HA would be required to return some other prime sites to the Government. In this connection, the HA returned ex-Valley Road Estate Phase 1 and Phase 3 in Homantin to the Government.

5. It was agreed by the B/Ds concerned (including the DevB, THB, PlanD and LandsD) that the site was more suitable for private housing development. Hence, it was included in the 2008-09 Application List announced in February 2008 and was sold at $2.17 billion in November 2010. Since the site was auctioned, the development costs spent on the site were written off in 2011-12.

Case 3 (Cont'd)

Audit comments

6. Audit noted that the HD needed to take up the site formation of Inverness Road site in this case but with no repayment from the Government and the HA finally had to write off the development costs.

7. The replacement site Tung Chung Area 56 was originally an HOS development site in 2000 providing 3,440 HOS flats by March 2007. Due to changes in housing policy in 2002, the site was used for PRH development. The PRH estate on Tung Chung Area 56 is expected to be completed in September 2016.

8. Audit also noted that apart from the costs written off, it generally took much longer time for the HA to develop PRH flats on the replacement sites. Returning ready sites to the Government in exchange for less ready sites which had inevitably caused delays in the PRH supply as it took a long time to conduct preliminary works.

Source: Audit analysis of HD records

Appendix L
(para. 2.67 refers)

Case 4

Ex-Homantin Estate redevelopment site

Background

1. The breakdown of total cost of abortive works related to the site is shown below. Part of the costs was written off in the financial year 2012-13 and the remaining costs would be written off in the coming financial years.

Cost breakdown of abortive works of ex-Homantin Estate

	Particulars	Development costs ($ million)	Clearance project adjustments ($ million)	Total ($ million)
(a)	Site formation	28.272	—	
(b)	Site investigation cost	9.486	—	
(c)	Soft landscape	0.941	—	
(d)	Consultancy fees for Quantity Surveyors and others	0.970	—	
(e)	Allocation of staff cost and other recurrent costs (over 88% of the expenditure was spent before year 2005 prior to the CHP's agreement to return the Homantin Redevelopment Sites to the Government)	103.241	14.057	
(f)	Sundry and miscellaneous items	2.422	—	
(g)	Demolition	—	34.688	
(h)	Ex-gratia payments	—	29.885	
	Total	145.332	78.630	223.962

Case 4 (Cont'd)

2. The redevelopment sites comprised seven phases. A PRH block in Phase 1 was completed in 2000 and a school was built on Phase 4 which was completed in 2006. Phases 2, 3, 5, 6 and 7 were grouped in 3 sites, combining Phases 2 and 7 as Site I, part of Phases 3 and 6 as Site II and part of Phases 3 and 5 as Site III.

3. In April 2005, the CHP agreed to return the three sites to the Government for private residential development. Sites I and II were put in the Land Sale by Tender in January and April 2013 respectively, and the sites were sold separately and respectively for $12 billion in March 2013 and for $4 billion in June 2013. Site III was reserved for Government, Institution and Community use.

4. As the Government has no implementation programme for Site III, there is no tentative date for its return to the Government. The HA has been tasked to continue to look after it. The site is now partly a public transport interchange and partly a storage site for a contractor responsible for the alteration and addition works of Homantin Estate.

5. Since Sites I and II were already sold, the development costs for these sites including site formation, design, site care and the associated staff costs needed to be written off. These costs would be charged to the HA accounts starting from 2012-13.

6. According to the DevB and PlanD, regarding Site III, development of the primary school is in progress. However, as there is an existing public transport terminus within Site III, its development for Government, Institution and Community uses would hinge on the relocation of the public transport terminus upon completion of the new facilities.

Audit comments

7. Audit noted that the decision for return of Site III to the Government had already been made for more than 8 years. From 2005 to 2013, the HD had been liaising with the Government on the return of Site III. The Government should expedite actions to put the site into gainful use.

Source: Audit analysis of HD records

Appendix M
(paras. 3.2 and 3.10 refer)

Strategic Planning Committee and Building Committee

Terms of reference

(A) Strategic Planning Committee

1. To review and endorse the corporate plan of the HA and to set strategic guidelines and planning parameters within the policies and objectives set by the HA for submission to the HA for approval;

2. To consider the viability of projects relating to public housing development and subsidised home ownership schemes and to approve the inclusion of sites in the production process;

3. To consider regular reviews of the housing demand and supply for various types of public housing and to recommend to the HA any changes necessary to meet with the policy targets;

4. To review all housing programmes related to policy targets;

5. To resolve any difference which may arise among the various standing committees of the HA in connection with or arising out of the carrying out of their various businesses; and

6. To oversee the HA's internal audit functions performed by the HD including the consideration of the implementation of agreed recommendations and the Report from the HA's external auditors (the Director of Audit) on the HA's accounts.

(B) Building Committee

1. To advise the HA on policies related to the implementation of the construction and major improvement, renovation and rehabilitation programmes and to monitor progress on these programmes; and

Appendix M
(Cont'd)
(paras. 3.2 and 3.10 refer)

2. To exercise the powers and functions of the HA in accordance with the relevant prevailing policies:

   (a) to endorse programmes of activities and monitor their performance, and to approve the financial targets, service standards and performance measures within the policies and objectives set by the HA for submission to the HA for approval; and

   (b) to approve project budget, master layout plans and scheme designs for public housing projects and projects under subsidised home ownership schemes.

Source: HA website

Appendix N
(para. 3.7 refers)

Case 5

Tuen Mun Area 18 project

Background

1. The 1.2-hectare site, Tuen Mun Area 18, was allocated for the PRH development by the CHD/CHP in mid-2004.

2. During December 2006 and November 2008, the HD had a series of consultation with Tuen Mun DC members. The DC members objected to the project because of the lack of community facilities and the unresolved public transport problem. Also, they objected the site being developed into a high density housing estate.

3. In August 2007, the SPC approved the development parameters and project construction cost ceilings for the PRH development of the site. The scheme design reserved 1,000 square metres (m^2) of gross floor area for development of community hall. Yet the DC members declined to support the PRH development.

4. During the lengthy consultation, the HD revised the scheme design proposal continuously. In November 2008, the HD presented a revised scheme design proposal to the DC. The proposal comprised two 33-storey domestic blocks providing a total of 990 flats, one 2-storey stand-alone community hall and other ancillary facilities. The proposal received both support and objections from DC members.

5. In February 2009, the BC approved the project scheme design and the project budget.

Audit comments

6. Audit noted that the project was delayed because there had been a lengthy consultation between the HA and the Tuen Mun DC on the additional provision of community facilities, causing major changes to the original Project Brief. According to the PlanD, public engagement is an essential and iterative process to gauge and incorporate stakeholders' views. The time taken for public engagement varies significantly depending on the complexity and contention of individual cases. There is a limit to compress the timeframe in public engagement, which is becoming more sophisticated in order to meet the rising expectation and aspiration of the public. Where the planning and land development process has to be adjusted, revised or even started over to take into account public views, the time taken could be substantially lengthened.

Source: Audit analysis of HD records

Appendix O
(para. 4.9 refers)

Case 6

Redevelopment of Tung Tau Estate Block 22

Background

1. Tung Tau Estate Block 22 is a 16-storey building, completed in 1965, with 906 domestic flats. The CSI work was started in April 2007 and completed in July 2007. The structural investigation results revealed that many strengthening works had to be done to uphold structural safety. The estimated cost for carrying out the necessary repair works was about $45.55 million. A financial viability assessment indicated that the repair option was less cost-effective than the redevelopment option.

2. In January 2008, the SPC of the HA endorsed the clearance of the Block 22 in consideration of its structural conditions, financial implications of the extensive repair works required, and poor living environment. To allow sufficient time for the rehousing arrangement and give affected households reasonable notification, the HA endorsed that the clearance date would be June 2012. It was later revised to September 2012 to tie in with the availability of reception resources.

3. A total of 840 households and 30 shop tenants (Note 1) were affected by the clearance exercise. Audit noted that, up to September 2012, all households had moved out. However, the repossession of the Block including nine shops only took place in March 2013 (i.e. 9 months after the original target clearance date) to cover the additional time for negotiation with the concerned parties involving LegCo and DC members.

4. As stated in its website of January 2014, the HD planned to redevelop the site into a new PRH block of about 700 flats by 2018-19.

Audit comments

5. ***Slow redevelopment process.*** While the whole Block was recovered by the HD in March 2013, as of February 2014, the Block still stood on the site (see Photograph 1). Upon Audit enquiry in March 2014, the HD explained that there was a staircase inside Block 22 serving as the exit staircase of the adjacent school. The HD needs to construct a standalone staircase serving as a new exit staircase for this school before Block 22 could be demolished. The demolition works is scheduled to be completed in February 2015. Audit considers that the delay in recovering the flats and redeveloping the site is undesirable as the progress of new public housing production may be affected. The HD needs to take into account all factors for better redevelopment planning in future.

Case 6 (Cont'd)

Photograph 1

Tung Tau Estate Block 22

Source: Photograph taken by Audit in February 2014

6. ***Build-back potential of the site.*** The Block had 906 domestic flats. After the redevelopment, the site was planned to be redeveloped into a new PRH block of about 700 flats by 2018-19. There will be a flat loss of 206 units (from 906 to 700 units) upon its redevelopment. Audit notes that the existing PR for the Block is 3.42 which is well below the permitted domestic PR (6 in urban area). The HD needs to optimise the use of the redevelopment sites as land resources are valuable. The HD should take measures to better utilise the redevelopment sites, such as liaising with the PlanD to raise the PR, building more flats under the permitted PR, and making use of the sitting-out area next to the site of the Block whenever possible (Note 2).

Source: Audit analysis of HD records

Note 1: These included 29 monthly-term tenancies and one three-year fixed-term commercial tenancy. The HA may terminate the tenancies by giving one month's notice to the graded shop tenants or three months' notice to the tenant on fixed-term tenancy. Provision of ex-gratia allowance and relocation arrangements would apply to shop tenancies affected by the clearance.

Note 2: According to the HD, the project officer is currently in liaison with the PlanD about raising the PR from 6 to 7, so that about 900 flats can be built with a PR of about 7. As compared with the original Block 22, the average flat size will be increased by about 30% in terms of internal floor area to house more people upon redevelopment.

Appendix P
(para. 4.22 refers)

Case 7

Redevelopment of Pak Tin Estate

Background

1. Pak Tin Estate was identified as one of the potential estates for redevelopment in June 2009 (see para. 4.14) and had its CSI completed in December 2010. The estate has been partially redeveloped under the CRP. It has a total of some 8,800 flats, comprising:

(a) the older non-CRP portion: eight domestic buildings (Blocks 1 to 3 and Blocks 9 to 13) completed between 1975 and 1979; and

(b) the newer CRP portion: five domestic buildings completed between 1993 and 1997 and seven domestic buildings completed between 1999 and 2004.

2. In November 2011, when the HA introduced the Refined Redevelopment Policy (see para. 4.18), Pak Tin Estate was identified as an estate with high redevelopment potential and promising flat gain as well as with suitable rehousing resources for a redevelopment programme. In January 2012, the HA endorsed the master plan and phased clearance for redevelopment of Pak Tin Estate. The phased redevelopment plan included the eight older non-CRP blocks which have a total of 3,500 flats. In April 2012, the HA set the final evacuation date as of April 2014 for Blocks 1, 2, 3 and 12. In September 2012, the HA further set the evacuation date for Blocks 9, 10, 11 and 13 as of September 2018.

Lift service enhancements

3. To enhance the barrier-free access for the disabled and the elderly, in 2009, the HA planned to add lifts to blocks without lifts in the PRH estates under a five-year lift addition programme. Meanwhile, a structured lift modernisation rolling programme was put in place where the conditions of all lifts over 25 years of age were evaluated. Lifts were replaced in accordance with priority based on their age, breakdown rates, and the benefits after replacement in terms of improved safety and energy efficiency. Opportunity was also taken to provide lift openings for every floor.

Appendix P
(Cont'd)
(para. 4.22 refers)

Case 7 (Cont'd)

4. In March 2014, the HD explained to Audit that addition of lifts is to enhance mobility of the tenants especially the senior citizens and disabled persons. The lift addition works at Blocks 2 and 12 commenced in January 2011, well before the implementation of the Refined Policy on Redevelopment of aged PRH estates, and were completed respectively in July and August 2012 (two years before the clearance date in April 2014). Upon demolition, the lifts will be re-used in other estates. This issue of lift additions was reported to the HA's SPC and LegCo's Housing Panel when the redevelopment was announced. The tender for lift addition work at Block 1 was cancelled once the redevelopment programme was confirmed.

Audit comments

5. Audit noted that Pak Tin Estate had been considered for both redevelopment and lift enhancements since 2009 and priority could have been given to move the disabled and the elderly to suitable rehousing resources. In December 2010, the HA awarded a tender of $31.9 million for adding 4 lifts in Blocks 2 and 12 for which the clearance date was approved to be April 2014. Works for lift addition commenced in January 2011. The added lifts for Block 2 and Block 12 were opened for use on 30 July 2012 and 30 August 2012 respectively. Less than one year after the installation, by end of June 2013, 94% of the tenants for these two blocks had moved out. Audit is concerned about the short service duration for these added lifts. It is not in line with the HD's intention to coordinate the lift addition exercise and the redevelopment programme to avoid wastage of resources.

6. Audit considers that the HD should have better coordination within the department so that resources would not be wasted due to the launching of redevelopment plan shortly after the completion of the improvement works in an estate in future.

Source: Audit analysis of HD records

Appendix Q
(para. 4.27 refers)

Case 8

Phases 3, 6 and 7 of Shek Kip Mei Estate

1. The ex-Shek Kip Mei Estate comprised some six to seven-storey buildings built in the 1950s and 1960s. In 2000, there were a total of 44 blocks. To address the community's increasing aspirations for better living conditions, the HA started in 2000 to redevelop part of Shek Kip Mei Estate by demolishing the dilapidated resettlement blocks (Note 1).

2. The older residential blocks of Shek Kip Mei Estate were redeveloped in seven phases (Phase 1 to Phase 7). Details of the redevelopment programme in Shek Kip Mei Estate by phases are given below.

The redevelopment programme of Shek Kip Mei Estate (January 2014)

Phase	Gross site area (m^2)	Demolition works completion date	Building works completion date	Existing land use
1	11,240	July 2001	March 2006	Two PRH blocks with 2,033 flats
2	11,430	July 2001	February 2012	Two PRH blocks with 1,558 flats
3	4,400 (Note 2)	May 2008	—	—
4	4,700	July 2001	August 2010	Construction of a primary school by the Education Bureau
5	13,700	April 2008	February 2012	Four PRH blocks with 2,496 flats
6	7,770	May 2008	—	—
7	2,500	May 2000	—	—

Case 8 (Cont'd)

3. Upon enquiry, the HD informed Audit in March 2014 that:

(a) the sites of Phases 3 and 7 were subject to a stringent height limit of 30m under the OZP and in 2006 it was earmarked for "cultural and heritage development". The very low development potential of the site would not be conducive for the HA to proceed with development in those days. In 2011, the HA in liaison with the PlanD reviewed the possibility of increasing the height limit of Phases 3 and 7. With the relaxed height limit, the project as a whole will have a total flat production of around 510; and

(b) in 2009, the HD made proposal to the Sham Shui Po DC to redevelop Phase 6 site. However, the DC members objected and bundled the PRH development with the adjacent old existing Shek Kip Mei clinic building. The HD continued active liaisons with the Government B/Ds and district consultations and finally obtained general agreement in 2013 to enable the housing development.

(c) Agreement from Sham Shui Po DC for the redevelopment proposal of Phases 3, 6 and 7 was finally obtained in November 2013. The detailed design was in progress targeting at project completion in 2017-18 for Phases 3 and 7, and in 2018-19 for Phase 6.

Audit comments

4. Audit noted that the demolition works of all phases of the Estate were completed during the period from 2000 to 2008. The building works of eight blocks under Phases 1, 2 and 5 were also completed during the period from 2006 to 2012. However, as in February 2014, the sites of Phases 3, 6 and 7 under the HD's possession were left undeveloped.

Source: Audit analysis of HD records

Note 1: The redevelopment programme does not cover nine blocks not under the CRP, and the Government has decided to preserve Block 41 and rejuvenate it into a youth hostel (known as Mei Ho House Youth Hostel which has commenced business since December 2013) with an attached museum on public housing history.

Note 2: The site area is about 4,400 m^2 (excluding Mei Ho House which was within the development boundary of Phase 3 of area 2,765 m^2).

Appendix R
(para. 4.29 refers)

Case 9

Shek Lei (II) IH

1. Shek Lei (II) IH comprises Blocks 10 and 11 (16 storeys each) which were built in 1968 and 1967 respectively. While originally constructed as PRH flats, they were converted into IH in the 1990s with 1,928 units. Audit noted that the overall vacancy rate of Shek Lei IH had increased from 46% in 2006 to 60% in 2014. The number of vacant units increased by 273 (30%) from 892 in 2006 to 1,165 in 2014.

2. As at 31 January 2014, the vacancy rates were 48% and 76% in Blocks 10 and 11 respectively (see details below). Among them, many units have been vacant for over 10 years.

Details of the two IH blocks in Shek Lei (II) Estate
(31 January 2014)

Particulars	Block 10	Block 11
No. of storeys	16	16
Age of building	45 years	46 years
No. of IH units	1,076	852
No. of occupied IH units	558	205
No. of vacant IH units	518	647
Vacancy rate	48%	76%

3. In 2007, a CSI was carried out by the HD to ascertain whether or not Shek Lei IH blocks were structurally safe and economically sustainable (see para. 4.28). The CSI revealed that the two blocks were structurally sustainable, with repair works to be carried out to uphold the structural safety and serviceability of the buildings for another 15 years. The estimated cost of repair works was about $26 million.

4. The HD reviewed the IH provision in 2011 and 2013. It resolved to retain Shek Lei IH and to clear Long Bin IH in January 2016. According to the HD, from an operational perspective, it is necessary to maintain Shek Lei IH because it is the only IH in Extended-urban areas to accommodate affected households of various emergencies occurred in Urban/Extended-urban areas.

Case 9 (Cont'd)

Audit comments

5. Audit noted that the maintenance and improvement costs for Shek Lei IH blocks increased from \$5.4 million in 2010-11 to \$7.4 million in 2012-13. In view of the age, increasing maintenance cost and the vacancy of the blocks, Audit considers that there is a need for the HA to explore measures to make better use of the blocks.

Source: Audit analysis of HD records

Acronyms and abbreviations

Audit	Audit Commission
AWT	Average waiting time
BC	Building Committee
B/Ds	Bureaux and departments
CHD	Committee on Housing Development
CHP	Committee on Housing Policy
CPLD	Committee on Planning and Land Development
CRP	Comprehensive Redevelopment Programme
CSI	Comprehensive Structural Investigation
DC	District Council
DCD	Development and Construction Division
DevB	Development Bureau
DipCon	District Planning Conference
DLC	District Lands Conference
EIA	Environmental Impact Assessment
EIP	Estate Improvement Programme
HA	Hong Kong Housing Authority
HD	Housing Department
HOS	Home Ownership Scheme
IH	Interim Housing
LandsD	Lands Department
LegCo	Legislative Council
LSIS	Land Supply Information System

LSTS	Land Supply Tracking Subcommittee
LTHS	Long Term Housing Strategy
m^2	Square metres
OZPs	Outline Zoning Plans
PBs	Planning Briefs
PHCP	Public Housing Construction Programme
PHDF	Public Housing Development Forecast
PlanD	Planning Department
PR	Plot ratio
PRH	Public rental housing
QPS	Quota and Points System
SCHLS	Steering Committee on Housing Land Supply
SCLS	Steering Committee on Land Supply
SPC	Strategic Planning Committee
STT	Short Term Tenancy
SWD	Social Welfare Department
TC	Transit Centre
TDD	Territory Development Department
THB	Transport and Housing Bureau
TPB	Town Planning Board
WL	Waiting List

CHAPTER 3

Commerce and Economic Development Bureau

Mega Events Fund

Audit Commission
Hong Kong
4 April 2014

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. 62 of the Director of Audit contains 8 Chapters which are available on our website at http://www.aud.gov.hk

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MEGA EVENTS FUND

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MEGA EVENTS FUND

Executive Summary

1. In May 2009, the Finance Committee (FC) of the Legislative Council (LegCo) approved a commitment of $100 million for setting up the Mega Events Fund (MEF) to provide financial support for local non-profit-making organisations to host mega arts, cultural and sports events in Hong Kong. The MEF was set up for a period of three years up to March 2012 (original MEF). In April 2012, the LegCo FC approved another commitment of $150 million to support the MEF which would continue to operate for another five years up to March 2017. The MEF was at the same time modified into a two-tier MEF (modified MEF) to enhance flexibility and facilitate its effective operation. The modified MEF has become effective since May 2012 and covers: (a) Tier 1 which is a new mechanism to attract internationally-acclaimed mega events to Hong Kong; and (b) Tier 2 which is essentially a revised version of the original MEF with scope expanded to cover events with more entertainment elements.

2. Since its inception and up to February 2014, the MEF had supported the hosting of 24 events, involving approved MEF funding of $97 million. The MEF is administered by the Tourism Commission (TC) of the Commerce and Economic Development Bureau (CEDB). An Assessment Committee was formed in June 2009 to advise the Government on the administration of the MEF. Six TC staff, with other duties, formed the MEF Secretariat which was set up to support the Assessment Committee and the operation of the MEF. Given that the MEF has operated for more than four years, the Audit Commission (Audit) has recently conducted a review of the operational effectiveness of the MEF.

Achievement of the MEF objectives

3. ***High percentage of rejected applications and frequent cases of MEF events subject to financial sanctions.*** The TC invited two rounds of applications each year. For both the original MEF and the modified MEF, the rejection rate for applications was 69%. Although the rejection rate was high, the number of MEF

events which had been subject to financial sanctions by the TC was still high. Audit noted that nine (41%) of the 22 completed MEF events as of February 2014 had been subject to financial sanctions (including one Tier 2 event in 2013). The Administration needs to take more effective measures to address the issue (paras. 2.8 to 2.11).

4. ***Deliverables and targets of MEF events.*** Funding agreements signed by the TC with the organisers set out in detail the event deliverables and targets, against which the latter have to report the actual outcome in their post-event evaluation reports submitted after the hosting of the events. In April 2012, the CEDB informed the LegCo FC that since the inception of the MEF, the 16 MEF events approved as of March 2012 had created a total of about 10 000 jobs during the event periods, and attracted a total of over 900 000 participants (paras. 2.13 and 2.15). Audit however found the following:

(a) most of the jobs created were extremely short term and temporary in nature, with many lasting for one to a few days only, and would have little or no impact on the labour market (para. 2.16);

(b) although the Secretariat staff conducted headcounts on the number of the organisers' staff present during on-site inspections, they did not randomly verify the number of paid staff employed for the events, nor did they carry out subsequent checks of the organisers' recruitment and payroll records. As a result, there could be a risk of over-reporting in the number of paid jobs created, as illustrated in one repeated MEF event held during the course of audit examination (see para. 5 below). Because similar events had been held by the organiser in earlier years, for which some 5 000 paid jobs were reported to have been created and included in the total of "10 000 paid jobs" reported to LegCo in April 2012, it is highly probable that the figure had been overstated (paras. 2.17 to 2.19);

(c) a large number of the reported figure of 900 000 participants were related to a few events which were held in open area with free-flow pedestrians. However, the organisers were not required to inform or agree with the MEF Secretariat beforehand the counting methods adopted and the Secretariat seldom verified or raised queries on the counting methods or the results the organisers reported in their post-event evaluation reports (para. 2.22); and

(d) the funding agreements have generally laid down the requirement for the organisers to develop special tourist packages to attract visitors to the events. Audit however noted that many of the MEF events had not been too successful in attracting overseas visitors to come to Hong Kong specifically for the events. For nine of 18 events with the requirement of developing special tourist packages included in the funding agreements, the organisers reported that no such packages could be developed (paras. 2.26 and 2.27).

5. Audit conducted an on-site visit on a one-day MEF event held in early 2014. The organiser undertook to create a minimum of 3 100 paid jobs for the local people of Hong Kong, including 3 000 performers of specified types for the event. Audit observed that many performers involved in specified shows on the event day were not professional ones, with many young children accompanied by parents/teachers and with some elderly people. After completion of the event, Audit made a request for the name list of the 3 000 "paid" performers and the pay they each received/would receive. The organiser reported that there were only some 1 850 performers, which was far less than the pledge of 3 000 "paid" performers set in the funding agreement. However, Audit noted that at least 410 of the 1 850 performers were directly recruited from three primary schools and eight kindergartens. Such young school children could hardly be regarded as "paid" performers and should not be counted as "paid jobs created" by the event. In late March 2014, the organiser informed the TC that the event had only created 1 317 paid jobs for performers (para. 2.17).

6. ***The need to identify new MEF events.*** Among the 24 MEF events approved as of February 2014, 18 events were ongoing and/or repeated events. Six brand new events had been held, but financial sanctions had been imposed by the TC on three of them. Only one brand new event had been approved since mid-2011. Audit considers that the MEF needs to address the imbalance between new and repeated events by identifying more new events (paras. 2.33 to 2.35).

Assessment of applications

7. ***Inadequacies in the governance of the Assessment Committee.*** In general, the Assessment Committee has a sound governance structure. However, there are a few areas in which the governance of the Committee can be improved. These include, among others, the low attendance of two Committee members and the need for the CEDB to work on identifying and appointing additional suitable members to serve the Committee as the appointment of the Chairman and all six non-official members would expire in June 2014 (para. 3.5).

8. ***Inadequacies in some event organisers' competence in organising MEF events.*** The success of an MEF event very often hinges on the organiser's capability and experience in organising the event. Organisers for two events had been disallowed to apply for MEF funds in future and were imposed financial sanctions by the TC on their MEF funding because of the lack of experience and the failure in complying with some of the terms and conditions in the funding agreements. Audit also found inadequacies in the TC's assessment of the organisers' associates who had assumed key roles in organising the events (paras. 3.6, 3.9 and 3.10).

9. ***Comments/reservations made by relevant Bureaux/Departments (B/Ds) not always followed up.*** The MEF Secretariat would seek comments from relevant B/Ds when processing the applications. Audit however noted that comments received from B/Ds did not appear to have been adequately followed up by the Secretariat. In one MEF event, despite the relevant B/Ds' comments that the "new" event was only merging and bundling together four local re-run productions which had been staged many times in the past, MEF funding was approved without any provisions set in the funding agreement to govern the re-performance of the four MEF performances on dates in close proximity to the MEF event period. The MEF event comprised a total of 45 shows, with 10 relating to Performance A. It transpired that the organisers had staged six shows of Performance A in Hong Kong and four shows in Guangdong Province of the Mainland before the funding agreement was signed, but the TC and the Assessment Committee had not been informed. Performance A was also found to have been re-performed in Macau on the second day after the funding agreement was signed, and three more times in Canada two days after the MEF shows for Performance A in Hong Kong were staged. The organisers eventually failed to attract the pledged numbers of participants and non-local visitors to the MEF event (para. 3.13).

Monitoring and evaluation of events

10. ***Conflicts of interest.*** In some of the MEF events, related agents were employed or major services were procured from associated service providers, but the organisers in most of the events had not declared their relationship with the related parties and had not notified the TC in writing for any related party procurements or staff recruitments they had made. The MEF Secretariat had also not requested clarifications and/or conducted additional checks on the organisers' procurements and recruitments (paras. 4.8 and 4.9).

11. ***Suspected irregularities identified by Audit.*** Audit examination of the MEF records for selected events has revealed various suspected irregularities in relation to event procurements, staff recruitments and other income and expenditure items (para. 4.14). Examples include the following:

(a) MEF funding in respect of the event mentioned in paragraph 9 above was granted solely for publicity of the four local re-run performances. As the organisers had staged Performance A in Macau two months before the MEF shows in Hong Kong and three more times in Canada two days after the MEF shows were over, the risk of improperly charging some of the organisers' advertising and promotion expenses for the same performance in other shows against the MEF funding is high. Audit identified various suspicious payments, but could not ascertain whether they were also incurred for the same performance in the other shows;

(b) service procurements and recruitment of performers from related parties amounted to 36% to 48% of the total expenditures incurred for three events, but the procurements and recruitments were not supported by quotations, invoices, staff recruitment and payroll records with performers' acknowledgement of receipt;

(c) an overpayment was made to an organiser, but had remained undetected even after the MEF Secretariat's checking; and

(d) improper refund of an unspent event balance to sponsor, instead of the Government.

12. ***Monitoring of ticket distribution for MEF events.*** Audit found that the TC had generally not set any conditions in the funding agreements to govern the distribution of tickets. For example, in one event involving MEF approved funding of $15 million (some 31% of the total event cost), it was found that 93% of the tickets were issued as free tickets to various parties, with only 7% sold to the general public and no special tourist packages developed for the event (para. 4.16).

Way forward

13. The modified MEF was launched in May 2012. As of March 2014, no Tier 1 events had been held and the number of approved Tier 2 events had also been decreasing. The overall situation calls for a review (paras. 2.12 and 5.10).

14. ***Challenges ahead.*** Audit notes that there are various challenges ahead in the implementation of the modified MEF. Such challenges include the difficulties in securing Tier 1 events, the need to identify new Tier 2 events, the risk of abuse, and the need to expedite the development of a more versatile mechanism for monitoring both Tier 1 and Tier 2 events (paras. 5.11 and 5.12).

Audit recommendations

15. **Audit recommendations are made in PART 5 of this Audit Report. Only the key ones are highlighted in this Executive Summary. Audit has *recommended* that the Permanent Secretary for Commerce and Economic Development (Commerce, Industry and Tourism), as the Controlling Officer of the MEF, should:**

Achievement of the MEF objectives

(a) **urge the TC to:**

- **conduct an overall review of the MEF, taking on board the audit findings and the challenges identified in this Audit Report; and**

— **exert more vigorous efforts to identify worthwhile Tier 1 events, and explore opportunities for more new Tier 2 events for implementation;**

(b) **ascertain the underlying reasons, and explore improvement measures, for the high percentage of rejected applications and the frequent cases of MEF events which had been subject to financial sanctions;**

(c) **develop a robust mechanism to validate the deliverables and targets as reported by the organisers to have been achieved by the MEF events;**

Assessment of applications

(d) **address the inadequacies relating to the governance of the Assessment Committee;**

(e) **ensure that the TC would require applicants to disclose their management teams and any associates who will be actively involved in organising the proposed events;**

(f) **ensure that the TC would take more proactive action in following up B/Ds' comments;**

Monitoring and evaluation of events

(g) **strictly enforce the funding requirement for the organiser and its agents/staff to declare any conflicts of interest in relation to procurement and staff recruitment, and ensure that the organiser has set up a mechanism to mitigate any such declared conflicts;**

(h) **follow up the various suspected irregularities identified by Audit relating to event procurements, recruitment and other income and expenditure items, and draw lessons to be learned;**

(i) **ensure that the TC would set funding conditions to govern the distribution of tickets in all future fee-charging MEF events; and**

Way forward

(j) **urge the TC to expedite its development of a more versatile mechanism for monitoring both Tier 1 and Tier 2 events.**

Response from the Administration

16. The Permanent Secretary for Commerce and Economic Development (Commerce, Industry and Tourism), as the Controlling Officer of the MEF, welcomes the audit review and generally agrees with the observations and recommendations in the Audit Report. He considers that the review can help improve the overall operation, management and effectiveness of the MEF. The TC will take follow-up actions as appropriate in response to Audit's recommendations.

PART 1: INTRODUCTION

1.1 This PART describes the background to the audit and outlines the audit objectives and scope.

Background

1.2 In May 2009, the Finance Committee (FC) of the Legislative Council (LegCo) approved a commitment of $100 million for setting up the Mega Events Fund (MEF) to provide financial support for local non-profit-making organisations to host mega arts, cultural and sports events in Hong Kong. The MEF was set up for a period of three years up to March 2012.

1.3 In April 2012, the LegCo FC approved another commitment of $150 million to support the MEF which would continue to operate for another five years up to March 2017. The MEF was at the same time modified into a two-tier MEF to enhance flexibility and facilitate its effective operation. The two-tier MEF has become effective since May 2012 and covers the following:

(a) ***Tier 1.*** It is a new mechanism to attract internationally-acclaimed mega events to Hong Kong; and

(b) ***Tier 2.*** It is essentially a revised version of the original MEF with scope expanded to cover events with more entertainment elements, such as street parade, beer festival, pop concert, fashion show, etc.

Operation of the Mega Events Fund

1.4 Since its inception and up to February 2014, the MEF had supported the hosting of 24 events. They were related mainly to sports and cultural events, with 23 events already held and one to be held in June 2014. They together had involved approved MEF funding of $97 million ($51 million under the original MEF and $46 million under the modified MEF). Of the 23 events already held, 22 had been completed by mid-February 2014, i.e. organisers had already submitted their post-event reports and audited accounts for the events as required by the MEF. More details of the 24 approved MEF-supported events are shown at Appendix A.

1.5 To be qualified for financial support from the MEF, an event must meet the following basic broad principles:

(a) the event should raise the profile of Hong Kong internationally, create a branding impact, attract visitors to come to Hong Kong specifically for the event and/or lengthen their stay in Hong Kong and generate media coverage (both local and overseas);

(b) the mega arts, cultural, sports or entertainment event should be of a considerable scale, with at least 10 000 people involved (including participants, spectators and reporters);

(c) the event should contain an international element and include participants from the Mainland and overseas; and

(d) the event should allow participation by the local public.

1.6 The MEF is administered by the Tourism Commission (TC — Note 1) of the Commerce and Economic Development Bureau (CEDB), with the Permanent Secretary for Commerce and Economic Development (Commerce, Industry and Tourism) serving as the Controlling Officer of the Fund. An Assessment Committee was formed in June 2009 to advise the Government on the administration of the MEF. The Committee, chaired by one non-official member, comprises six other non-official members from the tourism, cultural, arts, sports, event management and entertainment sectors as well as representatives from the Home Affairs Bureau (HAB), the Information Services Department (ISD) and the TC. Six TC staff, with other duties, formed the MEF Secretariat which was set up to support the Assessment Committee and the operation of the MEF.

Note 1: *The TC, headed by the Commissioner for Tourism, is responsible for formulating and coordinating the implementation of policies, strategies and plans for tourism development. It works closely with the Hong Kong Tourism Board and other organisations to promote the development of tourism in Hong Kong.*

1.7 When approving the MEF in May 2009, the LegCo FC set a funding condition (which has continued to apply under the modified MEF) that the Government's funding support for each event should not exceed 50% of the event's total cost. This condition was set in order to give a clear signal to event organisers that it would be their own responsibility to secure sufficient funding for the events and that they could not rely solely on public funding. In other words, the Government would only provide partial funding to the MEF events (Note 2). Contributions may be made to the events by the organisers, business sponsors or from event revenue (such as income from tickets sold).

1.8 For the operation of the MEF, the TC generally invites applications twice a year through the mass media and its website. For each round of applications, the MEF Secretariat conducts an initial screening of the applications and will consult relevant Government bureaux/departments (B/Ds) and the Hong Kong Tourism Board (HKTB) to assess the merits of the applications before making submissions to the Assessment Committee. In considering the applications, the Assessment Committee takes into account the following assessment criteria:

(a) the economic benefits of the proposal, such as the number of visitors and participants to be brought to the event, their likely length of stay, jobs to be created, etc;

(b) public relations and other benefits of the proposal, such as the event's ability to raise Hong Kong's international profile and the publicity value that will be generated in local and non-local media;

(c) the scale of the event, particularly the number of participants;

(d) the applicant's technical and project management capability, background and governance structure, track record, and whether the proposed implementation plan of the proposed event is practicable and reasonable, etc.; and

Note 2: *The MEF would generally provide funding that made up some 25% to 50% of the events' total costs.*

(e) financial viability of the project, whether the proposed budget is prudent and realistic, with sufficient alternative sources of funding, and whether the proposed performance indicators are reasonable.

In order to have a better understanding of selected applications, the Assessment Committee invites eligible applicants for a presentation before finalising its view. The Committee will make recommendations on individual applications to the Controlling Officer of the Fund (see para. 1.6) who will decide on approval or otherwise of the applications. Subject to a cap of the Government's funding at 50% of total cost for each event (see para. 1.7), MEF funding is usually granted to finance specific expenditure items (e.g. publicity expenses or players' fees) in the event cost budget submitted by the applicants.

1.9 Funding agreements are signed by the TC with the organisers (i.e. the successful applicants). The MEF Secretariat and the Assessment Committee monitor the progress of approved events and conduct evaluation upon completion of the events. Funds from the MEF are disbursed in phases. After completion of the approved events, organisers are required to submit post-event evaluation reports, publicity reports, survey reports (collectively termed "post-event reports") and audited accounts in a timely manner.

ICAC review

1.10 Since the inception of the MEF, the Independent Commission Against Corruption (ICAC) had been providing advice to the TC on the funding procedures of the Fund. In view of the risk of abuse, the ICAC conducted a follow-up study in 2010 to review the adequacy of the safeguards in the TC's procedures. In its Assignment Report of September 2010, the ICAC made recommendations to further enhance the application procedures to prevent corruption arising from the MEF scheme. The ICAC recommendations were accepted by the TC and have been implemented since December 2010.

1.11 After presenting the Assignment Report to its Corruption Prevention Advisory Committee, the ICAC further recommended that the TC should issue more stringent guidelines for its staff in evaluating events that involved substantial grants and carried a commercial name. Furthermore, the ICAC raised its concern with the need for continuing the MEF which was set up at a time of financial difficulties and, in view of the changed economic situation, suggested that the TC should consider returning the unused funds (i.e. the balance of the time-limited MEF of $100 million — see para. 1.2) to the Government. As it transpired, the MEF had continued to operate and in April 2012, the TC/CEDB introduced a modified two-tier MEF which comprised a new category called Tier 1 with Tier 2 which is essentially a revised version of the original scheme operated by the MEF (see paras. 1.3 and 2.4).

Audit review

1.12 According to the Administration, the MEF aims to finance the hosting of mega events in Hong Kong and to reinforce Hong Kong's position as the events capital of Asia. Most of the MEF events funded were initiated and organised by the private sector, with the Government's involvement at arms' length (see paras. 1.8 and 1.9). Since the inception of the MEF in 2009, events involving total MEF funding of $97 million had been approved and the MEF will continue to operate until March 2017. Given that the MEF has operated for more than four years, the Audit Commission (Audit) conducted a review of the operational effectiveness of the MEF.

1.13 This Audit Report covers the following areas:

(a) achievement of the MEF objectives (PART 2);

(b) assessment of applications (PART 3);

(c) monitoring and evaluation of events (PART 4); and

(d) way forward (PART 5).

Audit has identified in this review various areas which call for stepping up the controls, and the various challenges ahead in the implementation of the modified MEF.

General response from the Administration

1.14 The Permanent Secretary for Commerce and Economic Development (Commerce, Industry and Tourism), as the Controlling Officer of the MEF, welcomes the audit review of the MEF and generally agrees with the observations and recommendations as stated in this Audit Report. He considers that the review can help improve the overall operation, management and effectiveness of the MEF. He has said that the TC will take follow-up actions as appropriate in response to Audit's recommendations.

Acknowledgement

1.15 Audit would like to acknowledge with gratitude the full cooperation of the TC staff working in the MEF Secretariat and also some of the organisers whose records for their MEF events held had been examined during the course of this audit review.

PART 2: ACHIEVEMENT OF THE MEF OBJECTIVES

2.1 This PART examines the achievement of the MEF objectives.

Background and justification

2.2 A number of home-grown events are held regularly in Hong Kong. Examples include the Hong Kong Marathon, the Hong Kong Sevens, the Chinese New Year Night Parade and the Cheung Chau Bun Festival. Many of these events are organised by the private sector and receive assistance from B/Ds. They attract international publicity and record public participation. In 2009, the MEF was set up with an aim to further promote Hong Kong as the events capital of Asia. It was expected that the establishment of the MEF would help attract more tourists, stimulate consumption and promote economic development. At that time when the economy was sinking into recession and the employment situation was expected to deteriorate further, the Financial Secretary pledged not to reduce government expenditure in spite of the economic downturn and reduction in revenue. The Administration adopted measures to increase expenditure in 2009-10 in the hope of easing the pressure of economic contraction, boosting domestic demand and increasing employment opportunities. Among the various measures introduced by the Administration to provide jobs and internship opportunities, the MEF was proposed and approved in May 2009 to be set up to provide financial support for local non-profit-making organisations to host attractive mega events in the areas of arts, culture and sports in Hong Kong over the three years from 2009-10 to 2011-12 (see para. 1.2).

2.3 In order to justify the setting up of the MEF to support event organisers who were interested in bringing mega events to Hong Kong, the Administration informed LegCo in May 2009 the following:

- Hong Kong was a dynamic and vibrant city with many home-grown mega events held each year. Every year, each of these events attracted thousands of visitors in addition to a large number of local participants. Examples included the Chinese New Year Parade, Hong Kong Marathon, Hong Kong Sevens, Hong Kong Arts Festival, etc.

- Mega events not only added colour and vibrancy to the city, but also enriched the travel experience of visitors and reinforced Hong Kong's position as the events capital of Asia.

- Successful events generated extensive coverage of Hong Kong by the international media, created a branding effect for the city and raised Hong Kong's international profile. An example was the Chinese New Year Parade which was listed by the Lonely Planet and UK Times as a "not-to-be missed" event.

- Mega events also generated considerable economic benefits by boosting consumption and providing direct and indirect job opportunities in sectors including event planning and management, hotel, airline, food and beverage, retail, venue management, marketing and publicity, etc. Past experience had shown that different types of mega events created different types of jobs. A large-scale event such as the Hong Kong Sevens could lead to creation of roughly 800 to 900 jobs, while an event of smaller scale such as the Hong Kong International Dragon Boat Races would create about 130 jobs.

- Mega events would increase the opportunities to promote Hong Kong. For example, the Bledisloe Cup Rugby Tournament held for the first time in Hong Kong in November 2008 had attracted over 39 000 spectators (including 10 000 Australasian arrivals specifically for the event) and directly created some 800 jobs in the areas of event management, hospitality and security. The match was broadcast live on 12 international TV networks and a major TV channel in Hong Kong, reinforcing the branding of Hong Kong as Asia's events capital. It also allowed the Hong Kong Economic and Trade Offices and the HKTB's overseas offices (especially that in Australia) to leverage on the event for stepped-up promotion and publicity work on Hong Kong.

2.4 In the event, the LegCo FC approved in May 2009 a commitment of $100 million for setting up the MEF and another commitment in April 2012 of $150 million to support the continued operation of the MEF until March 2017 (see paras. 1.2 and 1.3). A brief description of how the MEF operated before and after May 2012 is shown below.

I. ***MEF which expired in March 2012:***

- One-tier scheme
- ***Coverage:*** arts, cultural or sports events
- The MEF was open for application from eligible organisations twice a year and only non-profit-making organisations were eligible to apply.
- There was no upper limit on the financial support for individual events, but the Government's financial support should not exceed 50% of the event's total cost.

II. ***Modified MEF since May 2012:***

- Two-tier scheme (Tier 1 and Tier 2)
- ***Coverage:*** arts, cultural, sports or entertainment events
- ***Tier 1:***
  - — aims to attract new or established high profile mega events (such as sports events involving top international sports teams, world class classical or pop concerts) to Hong Kong. These events may be owned and/or operated by private event management companies or professional organisations established outside Hong Kong; and

(to be continued)

(Cont'd)

- instead of inviting open applications, the CEDB will approach relevant event owners to explore whether they are interested in bringing these events to Hong Kong and, if so, will negotiate with the event owners on the terms and conditions.

- ***Tier 2:*** essentially similar to the original MEF in (I) above (Note). Tier 2 is open for application from eligible organisations twice a year and only non-profit-making organisations are eligible to apply.

- The 50% cap in (I) above continues to apply to both Tier 1 and Tier 2.

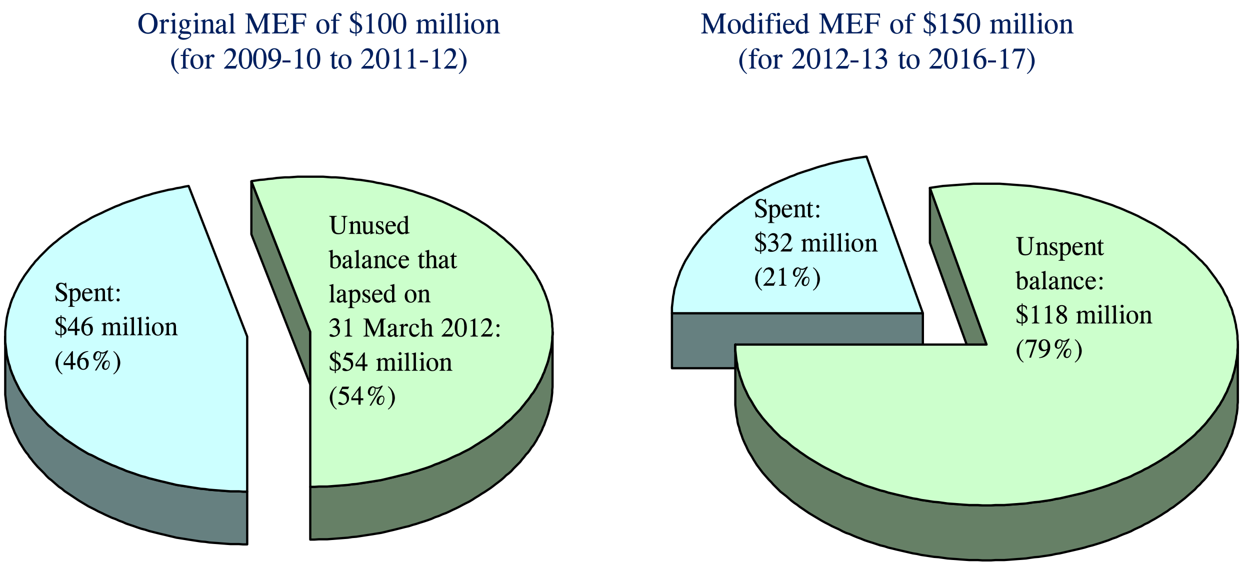
Note: Tier 2 improvements include expanding the MEF scope to cover entertainment events, removing the practice of reducing the funding amount for repeated applications and allowing organisers to retain operating surplus for organising the same event in the following year.

2.5 As mentioned earlier, the objective of the MEF is to provide financial support for local non-profit-making organisations to host attractive mega events in the areas of arts, culture, sports and entertainment to further promote Hong Kong as the events capital of Asia. With the modified MEF implemented since May 2012, the Administration has expected that the number of applications and MEF events would increase in the five years to March 2017 and more attractive mega events would be brought to Hong Kong.

2.6 As of February 2014, a total of 23 events had been held (see para. 1.4). The majority of the events funded were sports and cultural events. Figure 1 shows the actual expenditures up to 31 January 2014 for the MEF.

Figure 1

Expenditure spent under the MEF
(31 January 2014)



Source: *TC records*

Figure 1 shows that as at 31 January 2014:

(a) more than half of the funds under the original MEF had not been used, but lapsed on 31 March 2012; and

(b) almost 80% of the funds under the modified MEF had not been used although the modified MEF has been effective since May 2012.

Audit findings

2.7 The following audit issues are examined in this PART:

(a) high percentage of rejected applications and frequent cases of MEF events which had been subject to financial sanctions (paras. 2.8 to 2.12);

(b) deliverables and targets of MEF events (paras. 2.13 to 2.30);

(c) the need to identify new MEF events (paras. 2.31 to 2.35); and

(d) some MEF events also funded by other Government funding sources/schemes (paras. 2.36 to 2.39).

High percentage of rejected applications and frequent cases of MEF events subject to financial sanctions

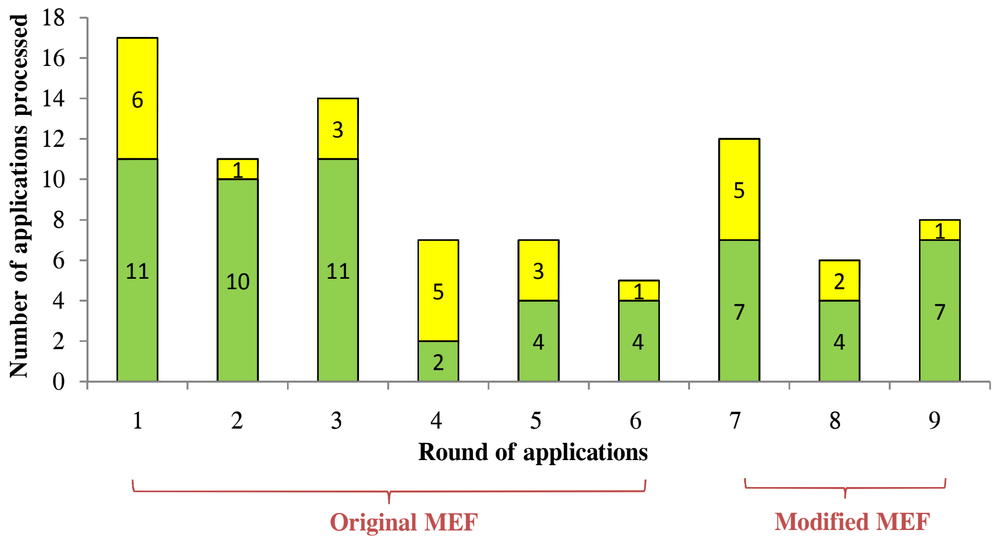
2.8. ***High percentage of rejected applications.*** The TC invited two rounds of applications each year. Figure 2 shows the number of approved and rejected applications in each round. In the first six rounds of applications received during the period (Rounds 1 to 6), of a total of 61 applications processed (Note 3), only 19 applications were approved (Note 4). The rejection rate was 69%. With the modified MEF implemented since May 2012, of a total of 26 Tier 2 applications processed (Rounds 7 to 9), only eight events had been approved. The rejection rate still remained high at 69%.

Note 3: *Applications withdrawn at different stages of processing were excluded for simplicity.*

Note 4: *Of 19 applications approved, three applicants subsequently withdrew their applications due to various reasons beyond the Government's control (e.g. event cancelled due to calendar conflict or difficulties encountered in finalising sponsors and venues). The approved MEF funding for these three events amounted to over $21 million.*

Figure 2

Approved and rejected applications under the MEF (31 January 2014)



Legend: Approved applications
Rejected applications

Source: TC records

2.9 Rejected applications may include two types, namely:

(a) applications rejected due to non-compliance with the MEF basic broad principles (see para. 1.5); and

(b) applications not recommended by the Assessment Committee after assessment.

Figure 2 shows that the number of rejected applications remained high, even after the implementation of the modified MEF. This indicates that many of the applicants still did not understand the MEF basic broad principles (e.g. the scale and type of events to be eligible for MEF) and/or many of the proposed events could not reach the standard required by the Assessment Committee and the TC. In fact, in April 2012, the CEDB informed LegCo that because only local non-profit-making organisations were eligible for applying MEF funds, events hosted were generally relatively small in scale, and some of the organisers lacked the experience and ability to host very large scale iconic events, and many proposals put forward by the applicants were unimpressive and of rather limited scale.

2.10 ***Frequent cases of MEF events which had been subject to financial sanctions.*** Even with the small number of applications which had been approved, Audit noted that among the 22 completed MEF events as of February 2014 (see para. 1.4), nine (41%) events had been subject to financial sanctions imposed by the TC, with funding reductions ranging from \$0.1 million to \$1.1 million. Two event organisers were disallowed to apply for MEF funds in future. Financial sanctions had been imposed due to the organisers' non-compliance with the terms and conditions of the funding agreements and/or their less than satisfactory performance. Two examples of events subject to financial sanctions are shown below.

Event	Financial sanction (as a % of actual MEF funding)	Reasons
A	40%	The organiser had failed to perform and deliver the event in compliance with the relevant terms and conditions of the funding agreement. Adverse publicity was generated and reported in the media headlines during the event period.
B (Tier 2)	15%	The organiser had failed to deliver one of the additional activities required by the MEF. There were a number of public complaints. The procurement procedures and documentations for procurement of some goods and services were not to the satisfaction of the MEF Secretariat.

2.11 Although a high percentage of applications had been rejected during processing, the number of MEF events which had been subject to financial sanctions was still high (including one Tier 2 event in 2013). The Administration needs to take more effective measures to address the issue. Possible measures to improve the situation may include the following:

(a) enhancing the publicity of the MEF, including taking steps to publicise more widely successful MEF events held to showcase the purpose and availability of the MEF, and upload the implementation of such successful events onto the TC website. In this connection, it was noted that the HKTB had helped promote the MEF events through its tourism website. The TC may wish to explore hyperlinking its MEF-dedicated website to the HKTB's website to step up promotion;

(b) enhancing the MEF transparency by informing unsuccessful applicants of the main reason(s) for their failure in applying for MEF grants (e.g. which criterion/criteria they had failed to meet — Note 5);

(c) giving due consideration to the organisers' competence, background, governance structure and track records when examining applications in future, as recommended by the ICAC in its review in September 2010; and

(d) holding briefing sessions with the organisers (especially first-time organisers), once their MEF applications have been approved to inform them the TC's expectations.

2.12 Audit further found that since the inception of the MEF, only six brand new events had been held, but three of them had been imposed with financial sanctions and only one brand new event had been approved in the recent five rounds of applications (i.e. since mid-2011). The lack of new events appears to be a challenge to the MEF. The CEDB's proposal of introducing a two-tier MEF, as approved by LegCo in April 2012 (see para. 2.4), may be a way forward to achieve the objectives of the MEF. According to the Administration, Tier 1 aimed to provide financial incentive to attract new or established high profile mega events to Hong Kong to reinforce the image of Hong Kong as the events capital of Asia. However, Audit notes that no Tier 1 events have been held even though the two-tier MEF has been implemented since May 2012, and the number of approved Tier 2 events was also reducing (see Figure 2 in para. 2.8). The overall situation calls for a review. This will be further discussed in PART 5.

Note 5: *According to the "Strengthening Integrity and Accountability — Administration of Government Funds" issued by the ICAC, unsuccessful applicants should be notified in writing of the results together with reasons for the decision, and whether they are allowed to re-submit applications and, if so, the conditions for re-submission.*

Deliverables and targets of MEF events

2.13 In order to qualify for financial support from the MEF, events should raise Hong Kong's profile, attract considerable visitors to come to Hong Kong, and allow local participation (see para. 1.5). Funding agreements signed by the TC with the organisers set out in detail the event deliverables and targets, against which the latter have to report the actual outcome in their post-event evaluation reports submitted after the hosting of MEF events. Such deliverables and targets may include:

(a) event deliverables (e.g. the holding of a musical concert or a sports match at a specified venue);

(b) number of paid jobs created by the event for the local people of Hong Kong;

(c) number of participants (including non-local visitors) in the event;

(d) media coverage of the event both locally and outside Hong Kong;

(e) special tourist packages developed; and

(f) feedback obtained from participants and spectators as well as from key stakeholders including the participating teams and organisations, tourism and travel trade operators.

For most events, some of the deliverables and targets (see (a), (b) and (c) above) were set in measurable terms, but some (see (d), (e) and (f) above) were not.

2.14 Given that MEF events involve the use of public funds, they have to be justified on the basis of the above deliverables and targets. The Administration should establish a more robust mechanism to measure the effective implementation of the deliverables and the achievement of the targets. In its 2010 review, the ICAC commented that there was the risk of abuse by the organisers' staff when they recruited temporary staff for the approved events. To reduce the risk of abuse and as measures to prevent corruption, the ICAC recommended, among others, that the Secretariat should randomly verify the number of staff employed by the organisers when making site visits. In this connection, the MEF Secretariat has required the organisers to keep proper books and records for inspections and to report the actual outcome in their post-event evaluation reports to the TC. Apart from conducting on-site inspections, the Secretariat staff also carried out document inspection checks for selected events. However, Audit found scope for improvement in that:

(a) during the on-site inspections for events held in open area with free-flow pedestrians, although the Secretariat staff conducted headcounts on the number of staff engaged by the organisers, they did not randomly verify the staff employed for the events against any attendance records on the spot and did not conduct subsequent checks against the organisers' recruitment and payroll records;

(b) while recognising that there may be practical constraints and operational difficulties in accurately counting the number of participants/attendees for an event held in open area with free-flow pedestrians, it is noted that the numbers of participants and non-local visitors are two important deliverables/targets to justify the granting of MEF funds. Audit noted that the organisers did not always state in their application forms their counting methods to be adopted and report the methods used in their post-event evaluation reports. During on-site inspections, the Secretariat staff did not always verify or make enquiries on the counting methods adopted by the organisers and how the latter allocated their counting staff; and

(c) the document inspection checks conducted for selected events after receipt of the organisers' post-event reports mainly focused on income and expenditure of the events. In future, the Secretariat staff needs to give more emphasis, apart from checking the income and expenditure, on checking the validity of the deliverables and targets reported to have been achieved by the organisers after the events.

Inadequacies in the existing mechanism are further elaborated in paragraphs 2.15 to 2.30.

Reported achievements not always verified

2.15 In April 2012, when seeking approval for funding commitment for the modified MEF, the CEDB informed the LegCo FC that since the inception of the MEF, the 16 MEF events approved as of March 2012 had achieved, among others, the following results:

- They had created a total of about 10 000 jobs during the events periods.
- They had attracted a total of over 900 000 participants, of which more than 170 000 were non-local visitors.

Prima facie, the 16 MEF events appeared to have produced encouraging results. Audit however found that the reported achievements had to be interpreted with the qualifications below.

Creation of 10 000 paid jobs by the MEF events

2.16 Although the 16 events were reported to have created a total of about 10 000 jobs during the events periods, it should be noted that most of the jobs created were extremely short term and temporary in nature, with many lasting for one to a few days only. The creation of such short term jobs would have little or no impact on the labour market, as pointed out by relevant B/Ds when they were consulted by the MEF Secretariat in assessing the applications.

2.17 As mentioned in paragraph 2.14(a), although the Secretariat staff conducted headcounts on the number of the organisers' staff present during on-site inspections, they did not randomly verify the number of paid staff employed for the events, nor did they carry out subsequent checks of the organisers' recruitment and payroll records. As a result, there could be a risk of over-reporting in the number of paid jobs created. An example of one event with inadequacies in the Secretariat's on-site inspection in monitoring the number of paid jobs created is shown below.

Example 1

1. Event C4 was the only MEF event held during the course of audit examination. It was a one-day event (involving MEF approved funding of $1.5 million) held in a popular tourist shopping area in early 2014. In the funding agreement, the organiser undertook to create a minimum of 3 100 paid jobs for the local people of Hong Kong, including 3 000 performers of specified types.

2. On the event day, three MEF Secretariat staff conducted an on-site inspection, accompanied by two Audit staff (attending the event as observers). Audit noted the following:

(a) the event was, prima facie, smoothly run and had been able to create a festive atmosphere;

(b) during the event, Secretariat staff conducted a headcount of the number of the organiser's staff present at the time of their inspection along the parade route, and reported that about 2 650 performers and supporting staff participated in the event. The number however could cover both "paid" and "non-paid" performers/staff because the Secretariat staff had not made any attempt to verify the attendance records of the paid performers/staff;

(c) nonetheless, Audit noted that many performers involved in specified shows on the event day were not professional ones, with many young children accompanied by parents/teachers and with some elderly people (see Photographs 1 and 2 taken by Audit in the kick-off ceremony waiting area — it can be seen that all the children, in uniforms provided by the organiser, had been dressed up for the show);

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(Cont'd)

Photograph 1

Photograph 2

(d) after completion of the event, on Audit's request through the Secretariat for the name list of the 3 000 "paid" performers involved in the show (see para. 1 above) together with the pay they each received/would receive, the organiser reported in late January 2014 that there were only some 1 850 performers (far less than the pledge of 3 000 "paid" performers set in the funding agreement);

(e) based on the name list provided (which was not a complete one), Audit noted that at least 410 of the 1 850 performers were directly recruited from three primary schools and eight kindergartens. Such young school children could hardly be regarded as "paid" performers and should not be counted as "paid jobs created" by the event. In mid-March 2014, the TC informed the organiser that these young children should not be included in the number of "paid jobs created" by the event. In response, the organiser informed the TC that the event had only created 1 317 paid jobs for performers; and

(f) the TC also informed Audit in late March 2014 that it would explore with the Labour Department to define the meaning of "paid jobs" in the funding agreement so as to avoid counting children as employees of the event.

Source: TC records and Audit site visit

2.18 Audit noted that Event C4 in Example 1 was a repeated event and similar events (namely Events C1, C2 and C3) had been held by the organiser from 2011 to 2013. According to the funding agreements of these earlier events, the organiser had pledged to create some 1 000 to 3 100 paid jobs for each event, mainly relating to the employment of performers to participate in the show. Based on the post-event evaluation reports submitted by the organiser for these events, some 9 300 paid jobs were reported to have been created. The CEDB had included some 5 000 jobs created from Events C1 and C2 in the total of "10 000 paid jobs" reported to LegCo in April 2012 (see para. 2.15).

2.19 According to documentation and photographs taken for the three earlier events (Events C1, C2 and C3) as kept in the MEF's records (see Photograph 3 taken as an example), Audit again found that many young children had participated in the show in these events. In response to Audit's enquiries, in March 2014, the organiser informed the TC that the number of jobs created in the three events might have included young school children, but it could not provide the TC with the actual number involved. Given the circumstances, it is highly probable that the figure of some 5 000 jobs reported to LegCo had been overstated.

Photograph 3

Source: TC records

2.20 In relation to the above three events (Events C1, C2 and C3), Audit further found that the number of paid jobs reported to have been created was mainly based on self-declarations made by two service providers (which were associates of the organiser). Staff recruitment, attendance and payroll records with individual performers' acknowledgement of receipt of payments were not available. Payments to these performers (including transportation fees for performing equipment) however accounted for some 30% to 50% of the total expenditures incurred in the three events. In response to Audit's enquiries, the organiser confirmed to the TC in March 2014 that individual performers' acknowledgement of receipt were not available.

2.21 Furthermore, Audit noted that in one of the three events, the organiser had invited non-local performing teams to participate in the show. There was however no evidence that the Secretariat had clarified with the organiser on whether these non-local performers had been counted as paid jobs created for local people of Hong Kong and whether their participation in the show had complied with the law of Hong Kong (e.g. Employment Ordinance (Cap. 57) and Immigration Ordinance (Cap. 115)).

Attracting over 900 000 participants, including 170 000 non-local visitors

2.22 For events with ticket income, the numbers of participants can be easily counted based on collection of ticket stubs. With the figure of 900 000 participants (including 170 000 non-local visitors) reported to LegCo in April 2012 (see para. 2.15), Audit noted that a large number of the reported figures were related to a few events which were held in open area (such as Tsim Sha Tsui) with free-flow pedestrians. However, the organisers were not required to inform or agree with the MEF Secretariat beforehand the counting methods adopted and the Secretariat seldom verified or raised queries on the counting methods or the results the organisers reported in their post-event evaluation reports. The number of non-local visitors was usually projected by the organisers based on the percentage of non-local visitors interviewed in their feedback surveys conducted.

2.23 Similar to the comments that the number of paid jobs created by MEF events would have little or no impact on the labour market (as mentioned in para. 2.16), relevant B/Ds and the HKTB (when consulted by the MEF Secretariat in assessing the applications) had commented that some of the events might not be able to bring in overseas visitors (who came to Hong Kong specifically for the events) or increase visitors' length of stay. They believed that the non-local visitors were mostly in-town visitors or passers-by. For a few events, they commented that the projected number of participants estimated might be high.

2.24 Audit has examined the reported numbers of participants for four events which were held in public places. These events lasted for one to three days each and the organisers reported that they each had attracted some 55 000 to 216 000 participants (including 10 000 to 54 000 non-local visitors), accounting for some half of the "900 000 participants" (or some 70% of the "170 000 non-local visitors") reported to LegCo in April 2012 (see para. 2.15). According to the funding agreements, the organisers were not required to seek the TC's approval for their methods used for counting the numbers of participants (and the projected numbers of non-local visitors). Counting plans were also not required to be submitted. After completion of the events, the organisers reported in their post-event evaluation reports the numbers of participants and non-local visitors attending the events, without providing documentation (e.g. counting plans and counting results by different days/places, etc.) to support the figures.

2.25 With Event C4 held during the course of audit examination (see Example 1 in para. 2.17), Audit staff attended as observers to the on-site inspection conducted in early 2014 by the MEF Secretariat staff. Audit observed that the Secretariat staff did not perform any checking on the counting procedures used by the organiser (e.g. how the counting had been performed and how the counting staff had been allocated). After completion of Event C4, at Audit's request, the organiser informed the TC that there were some 65 000 participants in the event, but could not produce details of its calculations in arriving at the figure. In March 2014, the TC informed Audit that, in future, the organisers would be required to provide more scientific counting methods on the number of participants.

Developing special tourist packages

2.26 Because the MEF has the objective of raising the profile of Hong Kong internationally and attracting visitors to come to Hong Kong specifically for the events (see para. 1.5(a)), the funding agreements have generally laid down the requirement for the organisers to develop special tourist packages to attract visitors to the events. However, no measurable target was set in the agreements on the number of such tourist packages to be developed (see para. 2.13(e)).

2.27 With the exception of a few sports events, Audit noted that many of the other MEF events had not been too successful in attracting overseas visitors to come to Hong Kong specifically for the events. For nine of 18 events with the requirement of developing special tourist packages included in the funding agreements, the organisers reported in their post-event evaluation reports that no such packages could be developed. Either reasons for the failure were not given or reasons, such as "not enough time to sell tour packages" or "tours not materialised" were stated.

Audit comments

2.28 MEF events aim to raise the profile of Hong Kong internationally, attract visitors to come to Hong Kong, allow participation by the local public and increase employment opportunities (see paras. 1.5 and 2.2). Deliverables and targets, such as the numbers of paid jobs created, the numbers of participants and non-local visitors, and the numbers of special tourist packages developed (see para. 2.13(b), (c) and (e)), are set in the funding agreements. They should be systematically reviewed to ensure that they are achieved and revised, if necessary, to take on board the evolving economic situation.

2.29 The funding agreements have stipulated that failure in meeting the pledged targets may result in a sanction in the level of MEF funding (see para. 2.10). Among the 22 events completed, Audit noted that the TC had imposed financial sanctions on organisers of three events for their failure in meeting the pledged numbers of participants and non-local visitors for the events, but no sanction on organisers for failing to create the pledged number of paid jobs in a few events.

2.30 Given the various findings mentioned above, Audit considers that the TC should establish a robust mechanism to validate the deliverables and achievements reported by the organisers. For example, with the number of paid jobs created, the TC may consider conducting random checking of the figures against the employment contracts, payroll and attendance records kept by the organisers.

The need to identify new MEF events

2.31 In May 2009 when proposing the MEF to be set up, the Administration assured LegCo that the MEF would not be used to support "ongoing" events (i.e. events which had already been held for many years before the MEF was introduced). Besides, funding for repeated applications (i.e. applications which had received MEF funding in previous years and would wish to receive support from the MEF again) would only be approved with a reduced level of funding support.

2.32 However, in April 2012, the CEDB informed the LegCo FC that the practice of reducing the funding support for repeated events would be removed and the Assessment Committee would have the discretion on the appropriate MEF funding amount for each repeated event, as long as the same event was found suitable for MEF support and its past performance was satisfactory. The proposal was approved by the LegCo FC.

2.33 Audit analysis of the 24 approved MEF events revealed that 18 events were ongoing and/or repeated events. To build their sustainability, these events were granted MEF funds on each occasion to, inter alia, organise additional activities which could enlarge their scale or expand their international profile. An example with repeated events held is shown below.

Example 2

1. Event D1 held in 2010 was an ongoing event which had already been held before the MEF was set up. Similar events (namely Events D2, D3 and D4) were held each year after Event D1, with Event D5 to be held in June 2014.

2. Additional activities or features were introduced in these ongoing/repeated events. They included:

- Event D1 was staged in Victoria Harbour (and not Shing Mun River in previous years), and had introduced live TV broadcasting;

- Event D2 held in 2011 had introduced a 10-passenger small dragon boat category to encourage overseas participation;

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- Event D3 held in 2012 had scale expanded by organising additional races at the Olympic level in the sports of Dragon Boating. In particular, the duration of the event was extended from 3 to 7 days and the land venue was much larger than previous years; and

- Event D4 held in 2013 had introduced the 250-metre standard boat races to the international categories to attract overseas participation and had arranged additional performance during the event.

Source: TC records

2.34 However, Audit noted that since the inception of the MEF, only six brand new events had been held, but for three of them, financial sanctions had been imposed by the TC due to non-compliance with the funding conditions or unsatisfactory performance. Only one brand new event had been approved in the recent five rounds of applications (i.e. since mid-2011).

2.35 Audit notes that unless new events are approved in the future, the MEF will be supporting only a few repeated events. While repeating successful events would build up the local and possibly international recognition and the size of these events over time, it is also important for the MEF to add new and promising events to address the imbalance between new and repeated events. In order to effectively reinforce Hong Kong's image as the events capital of Asia and to maximise the effectiveness of the MEF, the TC should step up efforts to identify more new events.

Some MEF events also funded by other Government funding sources/schemes

2.36 In May 2009, the CEDB informed the LegCo FC that events already earmarked under other Government funding sources/schemes would not be considered for the MEF funding unless full justification was given to the satisfaction of the Assessment Committee and the Controlling Officer to confirm that the additional funds sought would be deployed strictly to organise additional activities to broaden the scale of the event or raise its international profile.

2.37 Audit analysis however revealed that a few MEF events were also financially supported by other Government funding sources/schemes, with each source/scheme financing different expenditure items of the events (see Examples 3 and 4 below). Nonetheless, for each event, the Government's overall funding did not exceed 50% of the total cost.

Example 3

1. Event E1, held in 2010, had an estimated total cost of $24.3 million. It was approved with the MEF funding of $9 million. The MEF funding agreement had not defined the specific use of the MEF funding. In addition, the organiser obtained a cash subsidy of $2 million from the Sports Subvention Scheme of the Leisure and Cultural Services Department (LCSD) to cover various expenditure items, including board and lodging, staff remuneration in respect of technical support services for matches (e.g. tournament referee, chief umpire and scoreboard operators).

2. Both the MEF Secretariat and the LCSD required the organiser to submit post-event evaluation reports and audited accounts for their examination. The event was eventually funded by the MEF for $7.9 million and the Sports Subvention Scheme for $1.4 million.

3. Subsequently, the LCSD ceased to provide any cash subsidy to a similar event held by the organiser in the following year, for which the MEF funding of $5 million was approved.

Source: TC records

Example 4

1. Event D3, held in 2012, had an estimated total cost of $25 million. It was approved with the MEF funding of $6.5 million. In addition, the organiser sought funding support of $3 million for the event under the "M" Mark System of the HAB (Note).

2. According to the event budget, the MEF and "M" Mark System financed different expenditure items of Event D3. For example, the MEF funding was to cover the setting up of land venue, the employment of event managers and TV broadcasting whereas the "M" Mark System was to cover 50% of the event expenses for setting up the sea venue, manpower, collateral items and transportation for overseas teams, volunteers and equipment etc.

3. Both the MEF Secretariat and the HAB required the organiser to submit post-event evaluation reports and audited accounts for their examination. It transpired that Event D3 was eventually funded by the MEF for $6.3 million and the "M" Mark System for $2.4 million.

Note: The HAB launched the "M" Mark System in 2004 to help nurture more sustainable major sports events. "M" Mark status is awarded to recognised major sports events held in Hong Kong (e.g. the Hong Kong Marathon and the Hong Kong Sevens). Under the "M" Mark System, funding support and logistic support from relevant B/Ds are provided to help sports events evolve into regular, market-oriented and profitable events.

Source: TC records

2.38 As explained by the TC in March 2014, apart from obliging with the MEF ruling that the total amount of Government funding (including the MEF funding) should not exceed 50% of the total cost of the event, the Assessment Committee would normally not consider applications which have been provided with other Government funding unless full justifications were given. However, because many other Government funding sources usually have their own rules or restrictions or even limitation on the funding level, the MEF has become an additional funding source to events that look for an expanded scale despite that the event also received funding from other Government sources. The TC further mentioned that:

(a) the Assessment Committee had carefully considered the tourism merit of individual applications on a case-by-case basis and would only consider providing funding support to events with good tourism value; and

(b) events with limited tourism merit but good cultural/sport or other values might not be granted the MEF funding.

2.39 While noting the views of the Assessment Committee and the TC, Audit considers that the financing of one major event by two or more B/Ds to meet different purposes will involve duplication of Government efforts in monitoring the same event, which may not be conducive to the efficient operation of the Government. The TC may wish to explore how it can work in closer collaboration with other B/Ds to avoid the duplication of Government efforts.

PART 3: ASSESSMENT OF APPLICATIONS

3.1 This PART examines the TC's assessment and examination of applications for MEF support.

Assessment Committee of the MEF

3.2 As mentioned in paragraph 1.6, an Assessment Committee of the MEF was set up in June 2009 to advise the Government on the administration of the Fund, including drawing up the guidelines and criteria for assessing the applications, considering applications, monitoring the progress of events supported by the MEF and evaluating their performance. Chaired by a non-official member, the Committee comprises six other non-official members and three official members.

3.3 The Assessment Committee holds meetings as and when necessary, as decided by the Chairman. When necessary, the Committee may transact its business by circulation of papers. Each matter put for voting at a Committee meeting is determined by a majority of the members present and the Chairman has a casting vote, in the case where votes are tied. Agenda and papers have to be issued to Committee members at least three days before meetings. Supplementary information and documents may be tabled at meetings. Where necessary, the Assessment Committee may:

(a) invite an applicant for the Fund to present its proposal to the Committee, and provide clarifications and supplementary information relating to the proposal;

(b) invite an applicant to arrange site visits or meetings for the Committee; and

(c) invite representatives from relevant B/Ds or independent experts to attend a meeting to provide advice on an application.

Audit findings

3.4 The following audit issues are examined in this PART:

(a) inadequacies in the governance of the Assessment Committee (para. 3.5);

(b) inadequacies in some event organisers' competence in organising MEF events (paras. 3.6 to 3.11); and

(c) comments/reservations made by relevant B/Ds not always followed up (paras. 3.12 to 3.14).

Inadequacies in the governance of the Assessment Committee

3.5 In general, the Assessment Committee has been set up with a sound governance structure. Audit has however found a few areas where the governance of the Committee can be improved:

(a) ***Members' attendance.*** Up to January 2014, the Committee had held 14 meetings. Among the six non-official members (not including the Chairman), the attendance of two was particularly low, with one absent continuously for six meetings and another absent for four of the seven meetings since November 2011. The two members' attendance in all 14 meetings was 50% and 57% respectively. Given that members in the Assessment Committee represent different sectors (see para. 1.6), their low attendance may have deprived them of taking an active part in assessing the applications and the Government cannot always obtain their expert advice in the assessment and selection of events;

(b) ***Re-appointment of members.*** The appointment of both the Chairman and all six non-official members of the Assessment Committee would all expire in June 2014, by which time the Chairman and five members would have served the Committee for five years. Whilst it is understood that the Committee is not subject to the "six-year rule" (which is applicable to many advisory and statutory bodies as defined by the HAB), the CEDB may wish to work on identifying and appointing additional suitable members to ensure a reasonable distribution of workload and turnover of membership, given that the continuity of the Committee after June 2014 is important for ensuring the consistency of the assessment of the applications; and

(c) ***Assessment of applications.*** The Assessment Committee has set five assessment criteria (see para. 1.8(a) to (e)) with different maximum marks for each criterion. The Committee has set the rule that an application will be eligible for MEF support if the average marks awarded by members present at the meeting for individual assessment criterion have reached the passing marks (which are set at 60% of the maximum marks for each criterion). Audit however noted that in the minutes of meetings, only the overall marks awarded to individual applications were recorded, but not the scores they obtained for individual criterion.

Regarding (a) above, the TC informed Audit in late March 2014 that it agreed with Audit's view that low attendance of some members of the Assessment Committee was not desirable. The Assessment Committee comprised members from various fields in the tourism and other related sectors (such as hotel, public relations, accounting, etc.). Some members therefore needed to travel extensively due to business needs and might not be available for meetings as often as desirable. That said, the TC assured Audit that those members who could not attend the meetings had often provided pertinent advice on the basis of their vast experience in relevant sectors, in writing prior to the meetings to facilitate the Assessment Committee's discussion.

Inadequacies in some event organisers' competence in organising MEF events

3.6 Organisers for two events had been disallowed to apply for MEF funds in future (see para. 2.10). Audit found the following inadequacies in the experience and expertise of these two organisers in organising MEF events.

Example 5

1. Event F was an MEF event held in 2010. The organiser for the event was an organisation newly set up. Basically, it was a small team of artists. As commented by the TC when assessing the technical feasibility of the organiser's application, the applicant could not demonstrate its ability to handle complicated projects involving many iconic artists and movie stars. The key personnel involved was only a Hong Kong-based painter and artist who had organised solo exhibitions, and he had not worked on a project of the scale proposed.

2. It transpired that the organiser was imposed 35% financial sanctions by the TC on its MEF funding because of the organiser's lack of experience in project management and arts administration, which had significantly affected the implementation of the event. The organiser had also failed to comply with some of the terms and conditions in the funding agreement.

Source: TC records

Example 6

1. Event A was an MEF event which was approved in December 2010, but held in late 2011. The organiser for this event indicated in its application for the MEF funding that it had only one senior management staff. It could not produce the audited accounts of similar events held in previous years. It further indicated that all members of the organisation worked on a voluntary basis in the past, and it would require recruiting temporary staff to work on production, administration, publicity, finance and accounting if Event A was to be organised.

2. It transpired that the organiser was imposed 40% financial sanctions by the TC on its MEF funding because the organiser failed to perform and deliver the event in compliance with the relevant terms and conditions stipulated in the agreement (see para. 2.10), such as failure in carrying out publicity work of the event to cover the Mainland and overseas markets.

Source: TC records

Assessment of applications

3.7 The ICAC commented in its 2010 review that:

(a) although the TC had required the MEF applicants to submit, together with their applications, information on their background and organisation structure, these elements were not specifically included in the marking scheme; and

(b) there was a concern that the organisers might not have the expertise and resources to properly manage mega arts, cultural and sports events, hence increasing the risk of misuse or abuse of funds by unscrupulous staff of the organisers.

3.8 To address the above concern and primarily to prevent corruption, the ICAC recommended that the TC should include in the marking scheme the background and governance structure of the applicants, their track records in organising similar events, and their human, financial and technical resources (see para. 2.11(c)). The recommendation was accepted by the TC which has included since December 2010 the applicants' "technical and project management capabilities" and "past performances" for assessing their technical feasibility when considering their applications (see para. 1.8).

3.9 The success of an MEF event very often hinges on the organiser's capability and experience in organising the event. The problem did not appear to have been entirely resolved even after the TC's implementation of the ICAC's anti-corruption recommendation of considering the organisers' background, governance structure and track records in its assessment of applications. This was because some organisers were of a small scale and lacked the experience and ability to host large-scale events. In April 2012, the Administration informed LegCo that because only local non-profit-making organisations were eligible for applying grants under the MEF, events so far hosted were generally quite small in scale and some of such organisations lacked the experience and ability to host very large-scale iconic events, and often had to struggle with the problem of inadequate financial and human resources and the challenge in managing the logistics of mega events.

3.10 Inadequacies also existed in the TC's assessment of the organisers' associates who had assumed key roles in organising the events. For example, because of the success of an earlier event held in 2011, the TC approved all applications from the same organiser for similar events to be held from 2012 to 2014. The organiser for all four events was a preparatory committee of some 20 people. For the events held from 2011 to 2013, two key members of the preparatory committee were also members of the management of two major service providers for the events. Although they were not so named in the funding agreements and were not joint applicants in the application forms, they were named "Event Co-organisers" in all publicity documents for the events (including invitation cards, leaflets, posters and displays on stage platform). There was however no evidence that the MEF Secretariat had raised any enquiries with the organiser concerning the latter's relationship with, and the capability of, the associates (Note 6). While there may not be anything uncommon about an organiser using its associates to assist in organising a cultural event, particularly when the number of such service providers is limited and the market is small, it is important that such relationships be declared and understood by the TC and the Assessment Committee when assessing the ability of the organiser and the extent of arm's length dealings between the organiser and its associates.

3.11 Audit considers that the TC needs to request applicants to disclose their management teams and any associates who will be actively involved in organising the proposed events. The TC should also develop more specific guidelines to facilitate its staff in the conduct of the assessments more effectively.

Comments/reservations made by relevant B/Ds not always followed up

3.12 To ensure accurate cost budgets having been submitted by organisers, the MEF Secretariat would scrutinise the budgets, with input from relevant B/Ds, before proposing to the Assessment Committee on the MEF funding to be provided and before funding agreements are signed. In May 2009, the CEDB informed the LegCo FC that in assessing the MEF applications, the Assessment Committee should benefit from expertise of members in the relevant fields and comments from relevant B/Ds. It was also stated in the Guide to Application that in processing the applications, the Committee might invite assistance from independent experts of relevant fields.

Note 6: *In March 2014, the organiser informed the TC that the role of the two co-organisers could have been spotted by the MEF Secretariat from the records it submitted for the events, but the latter had not raised any enquiries.*

Assessment of applications

3.13 Audit noted that in practice, when processing the applications, the MEF Secretariat would seek comments from relevant B/Ds (including the HAB, the ISD, the Government Economist of the Financial Secretary's Office) and the HKTB, but had not consulted other outside organisations which might be expert in particular fields. Audit also noted one case (see Example 7) where the TC and the Assessment Committee had not been informed of the organisers' activities which had affected the attractiveness and attendance of the MEF event. In particular, comments received from B/Ds had not been adequately followed up by the Secretariat.

Example 7

1. Event G, with MEF approved funding of $2.5 million for promoting the event both locally and outside Hong Kong, comprised a total of 45 shows of four local production performances over a period of three weeks.

2. In their application, the four joint organisers claimed that the four performances had been successfully performed locally and outside Hong Kong, but did not mention about any plans for re-performing these performances shortly. When processing the application, the TC and the HAB/LCSD commented that the "new" event was just merging and bundling together four local re-run productions which had been staged many times in the past, including 11 shows of one performance (Performance A) which had been staged in LCSD venue one month before the organisers submitted their application. In the application submitted, the 45 shows in Event G included 10 shows of Performance A. The HAB/LCSD also commented that the budgeted marketing expenses of $2.5 million for Event G appeared high. It however transpired that the MEF Secretariat did not set any provisions in the funding agreement to govern the re-performance of the four MEF performances on dates in close proximity to the MEF event period, which might affect the attractiveness and attendance of the MEF shows.

(to be continued)

(Cont'd)

3. From information published on the organisers' websites, Audit found that after the submission of their application in late July 2009, the organisers had staged three of the four performances in Hong Kong and other places on dates in close proximity to the MEF event period. In particular, Audit noted that six shows of Performance A had been staged in Hong Kong (in the same venue as the MEF event), and four shows in Guangdong Province of the Mainland, before February 2010 when the MEF funding agreement was signed (see the timetable for the repeated shows of Performance A at Appendix B). In April 2010, 10 shows for Performance A were staged under Event G. The TC and the Assessment Committee had not been informed of the repeated re-performance of the shows by the organisers in their application for the MEF funding, before signing of the funding agreement or before the staging of the MEF shows.

4. Performance A was once again re-performed in Macau on the second day after the funding agreement was signed, and three more times in Canada two days after the MEF shows for Performance A in Hong Kong were staged (Note). Although the organisers reported in their post-event evaluation report for Event G that $0.91 million had been spent on promotion of Performance A locally and outside Hong Kong, Audit noted that the ticket income for Performance A under Event G was only $0.87 million (which was even less than the promotion expenses) and the average number of audience for Performance A in the 10 MEF shows was not at all higher than that for the six shows staged by the organisers before the MEF event period in the same venue (see para. 3 above).

5. The organisers emphasised in their application that they would conduct extensive publicity to attract non-local visitors to the MEF event, particularly targeting visitors from Macau, the Mainland and Canada, etc. Although the funding agreement has also stipulated that the organisers should promote tourist packages in Macau and the Mainland, it transpired that they had spent little moneys in promoting the MEF event in Macau and the Mainland, but much was spent in Canada (see para. 4.14(a)). Apparently, the MEF Secretariat had not taken any follow-up action on this.

(to be continued)

(Cont'd)

6. Finally, the organisers failed to meet some important targets set in the funding agreement, such as attracting the pledged numbers of participants and non-local visitors to the MEF event, with a significant shortfall by 67% for visitors participating in the event (actual of 3 300 visitors versus the pledged number of 10 000 visitors). In the light of the organisers' less than satisfactory performance, the Controlling Officer of the MEF accepted the Assessment Committee's recommendation to impose a financial sanction against the organisers. However, in determining the financial sanction, the Assessment Committee and the TC had not been informed of the re-performance of the shows by the organisers on dates in close proximity to the MEF event period.

Note: The MEF shows for Performance A had been rescheduled by the organisers in such a way that it had become the last performance to be staged during the MEF event period. There was no evidence that the TC had been informed. Strictly speaking, approval from the TC for such rescheduling should have been required.

Source: TC records and Audit research

3.14 Audit considers that there is scope for improvement in communicating to applicants that activities organised by them in close proximity to the MEF event should be reported or disclosed in their applications. The TC also needs to take more proactive follow-up of B/Ds' comments.

PART 4: MONITORING AND EVALUATION OF EVENTS

4.1 This PART examines the TC's monitoring and evaluation of the MEF events.

Monitoring and evaluation mechanism

4.2 When setting up the MEF in 2009, the Administration had assured LegCo that there would be safeguards to ensure that the public moneys would be prudently disbursed and administered. When seeking for the new commitment of $150 million for the modified MEF in April 2012, the Administration again informed LegCo that various control measures had been put in place to ensure proper monitoring of the use of the MEF and the progress of the events, including the requirement for the organisers to state the events' deliverables, key milestones, targets and methods for measuring the events' performance in their applications, the submission of post-event reports and audited accounts, and the conduct of on-site inspections by the Government and Assessment Committee representatives. More details of the control measures are shown at Appendix C.

Audit findings

4.3 The following audit issues are examined in this PART:

(a) execution of funding agreements (paras. 4.4 to 4.6);

(b) monitoring of event implementation (paras. 4.7 to 4.23); and

(c) disbursement of funds (paras. 4.24 to 4.27).

Execution of funding agreements

4.4 Funding agreements had been signed for 23 MEF events. Audit analysis of the MEF records revealed that for 13 of the 23 events, the funding agreements were signed by the TC with the organisers in less than one month before the event dates. In four extreme cases, the agreements were executed just a few days before the event dates, as follows:

Event	Date of application	Date of signing funding agreement (a)	Start date of event (b)	No. of days between agreement signed and the event started (c) = (b) – (a)
I	22/7/2009	9/11/2009	13/11/2009	4
D1	8/4/2010	16/7/2010	23/7/2010	7
D3	22/9/2011	27/6/2012	2/7/2012	5
H	5/7/2012	8/11/2012	15/11/2012	7

4.5 In the above four extreme cases, the funding agreements were executed quite late because the organisers had also taken a long time to finalise their operation plans and event budgets which formed part of the funding agreements. Although the MEF Secretariat had taken steps in a proactive manner, without waiting for the funding agreements to be finalised, to monitor the implementation of the events and remind the organisers to observe the terms and conditions of the yet-to-be-executed funding agreements, the arrangement can be improved.

4.6 Because of the late execution of the funding agreements, some of the control measures set out in the funding agreements could not be effectively enforced. For example, the funding agreements required the grantees to submit a progress report for every 6-month period from the commencement date (i.e. from the agreement date) to the expiry or termination of the agreement. However, Audit found that for all 23 events held as of mid-February 2014, no such progress reports had been submitted, apparently because the agreement date was too close to the event date.

Monitoring of event implementation

Conflicts of interest

4.7 Related party transactions often require closer attention because it is more difficult to ascertain whether they are conducted on normal commercial terms. Adequate safeguards are needed to prevent abuses. Since the outset of the MEF, the TC has stipulated in the Guide to Application and funding agreements that the organisers (including their staff and agents) should:

(a) declare any conflicts of interest in relation to procurement/tendering and staff recruitment;

(b) ensure that all purchases of goods, services and equipment of any value in relation to the event are made only from suppliers who are not associates or associated persons of the organisers, unless the Government agrees otherwise; and

(c) set up a mechanism to mitigate any such declared conflicts.

4.8 Audit examination of the MEF records however revealed that:

(a) in some of the MEF events, related agents were employed or major services were procured from associated service providers; and

(b) the organisers in most of the events in (a) above had not declared their relationship with the related parties and had not notified the TC in writing of any related party procurements or staff recruitments they had made.

4.9 Nonetheless, the relationship between the organisers and the agents they employed/service providers for the events could have been spotted from scrutiny of the information provided in the organisers' applications, or from examination of the organisers' books and records kept for the events. There was however no evidence that the MEF Secretariat had requested clarifications and/or conducted additional checks on the organisers' procurements and recruitments. An example of two MEF events with a related agent having been employed by the organiser is shown below.

Example 8

1. In relation to Events E1 and E2, based on company search, Audit found that the agent (a company) employed by the organiser was related to the latter in that the shareholders of the agent were also ex-officio members of the organiser's executive committee. Services of $2.9 million and $2.7 million had been provided by the agent in the two events, representing 12% of the total expenditures incurred.

2. However, the organiser had neither made any declarations of the relationship nor sought the Government's permissions for procurements from the related agent. In Event E1, Audit noted that the organiser had made an unbudgeted bonus payment of $0.2 million to the agent. With the bonus payment, the expenditure budget for the event had been exceeded, yet the MEF Secretariat did not raise any queries.

Source: TC records and Audit research

4.10 Audit further noted that with the exception of one MEF event, no related party disclosure was reported in the audited accounts submitted by the organisers to the MEF Secretariat, even though Audit could identify such transactions from the MEF records. However, as mentioned earlier, an organiser may need to use associates to assist in organising an event, which may be vital for the success of the event. It is therefore important that such relationships between the organisers and their associates should be declared and understood by the TC and the Assessment Committee.

Procurement and staff recruitment

4.11 In its 2010 review, the ICAC pointed out that there was the risk of abuse by the organisers' staff when they made procurement or recruited temporary staff for the approved events, and there were then inadequate measures to prevent the organisers from using falsified purchasing and payroll records. The ICAC recommended the MEF Secretariat, as measures to prevent corruption, to:

(a) randomly verify the number of staff employed by the organisers when making site inspections (see para. 2.14); and

(b) require the organisers to establish a two-tier vetting and approval system so that recruitment of key personnel or award of major goods or service contracts would be subjected to enhanced checks and balance.

With the endorsement of the Assessment Committee, the TC has suitably amended relevant MEF documents, including the Guide to Application, which have become effective since December 2010.

4.12 Since the ICAC's review, the MEF Secretariat has provided all MEF event organisers with copies of the ICAC Best Practice Checklists on procurement and staff recruitment, and laid down in the funding agreements that the organisers shall establish a two-tier approval system for the recruitment of key personnel/staff and the award of major goods, services and equipment contracts in procurement/tendering exercises conducted for the events. In addition, the funding agreements have contained the following provisions in relation to procurement and staff recruitment for the organisers to follow:

(a) they should exercise the utmost prudence in procurement of goods, services and equipment, and ensure that all purchases of all goods, services and equipment of any value are made on an open, unbiased, fair and competitive basis, and only from suppliers who are not associates or associated persons of the organisers, unless the Government agrees otherwise;

(b) they should exercise the utmost prudence in procurement of staff and should ensure that the recruitments of staff for the purpose of the project are carried out in an open, unbiased, fair and competitive manner;

(c) they should set up and operate a proper procurement/tendering and stores management system for the project with sufficient checks and control and in accordance with the principles of public accountability and value for money, transparency, openness and fair competition; and

(d) they should seek the ICAC's assistance in adopting the best practices stated in the ICAC's "Strengthening Integrity and Accountability —

Grantee's Guidebook" and draw up a Code of Conduct for compliance by the organisers' directors and employees, and to ensure proper corruption prevention safeguards were incorporated into their procurement and staff recruitment procedures.

4.13 However, in Audit's view, the inclusion of the above provisions in the funding agreements alone may not have provided adequate assurance that major procurements and recruitments made by the organisers have complied with the open, fair and competitive principles. The MEF Secretariat needs to take measures to ensure that the organisers have set up proper procurement/tendering and stores management systems, and step up its sample checks on major procurements or payroll records after the events were held. In particular, there is a need for the Secretariat to step up its checking and controls over the operation of the MEF events in view of the suspected irregularities found in paragraph 4.14.

Suspected irregularities identified by Audit

4.14 Audit examination of the MEF records for selected events has revealed the following suspected irregularities in relation to event procurements, staff recruitments and other income and expenditure items:

Suspected improper charging of expenditures in Event G (see (a) and (b))

(a) MEF funding of $2.5 million was granted solely for publicity of Event G which involved a series of shows of four local re-run performances in Cantonese and was held in 2010 (see Example 7 in para. 3.13). When processing the application, the HAB/LCSD commented that the budgeted marketing expenses of $2.5 million for Event G (representing 70% of the budgeted production cost) appeared high. Audit found that one of the four performances in Event G, Performance A, was then re-performed in Macau two months before the MEF shows in Hong Kong and three more times in Canada two days after the MEF shows were over (see para. 4 in Example 7). As such, the risk of improperly charging some of the organisers' advertising and promotion expenses for the same performance in other shows against the MEF funding is high. With the promotion budget of $2.5 million, funded by the MEF, for, inter alia, developing special tourist packages and promoting such packages in the Mainland, Macau and the Asia Pacific region (which was commented by the HAB/LCSD as high), Audit found that the organisers had subsequently spent $2.7 million on event promotion and noted the following:

Overseas TV advertisements (actual: $240,000)

(i) almost all expenditures were spent on TV promotion in Canada and solely for Performance A, instead of all four MEF performances. As mentioned in (a) above, three shows of Performance A were staged in Canada two days after the MEF shows in Hong Kong;

(ii) according to the funding agreement, the organisers should, after an MEF event has been held, submit a Publicity Report which keeps all the publicity materials and media coverage summary, both local and non-local, in relation to and arising from the event. However, the organisers for Event G made no reference to any of the TV advertisements in Canada in their Publicity Report submitted. Based on the MEF records, there was no evidence that such TV advertisements had been sent to the ISD for prior approval in accordance with the funding agreement;

(iii) for such reported expenditures, a payment of some $92,000 was not properly supported by any official invoice. The receipt in support of the payment was not an official one because it did not bear the customer name and there was no description of the service provided (such as the nature, duration and period of the advertisements). There was no authorised signature and no official company chop. Another payment of $32,970 for promotion in North America for all four performances was not supported by invoice or official receipt, but only by a bank exchange memo for purchase of Canadian dollars;

Production of TV trailers (actual: $470,000)

(iv) $460,000 had been spent on the production of trailers (by a Hong Kong company) in Cantonese, Putonghua and English versions. The MEF Secretariat had not clarified whether the trailers so produced were used solely for the MEF shows or in both the MEF shows and other shows staged by the organisers on dates in close proximity to the MEF event. Furthermore, Audit had made a request for a copy of the trailers but, as of late March 2014, the Secretariat was still following up with the organisers;

(v) similar to (ii) above, there was no evidence that the organisers had sent copies of the trailers to the ISD for approval, in accordance with the funding agreement;

(vi) service procurement by the organisers for the production of the trailers was not supported by quotations; and

Printing of promotion materials (actual: $387,000)

(vii) against a budget of $200,000 for the printing of promotion materials (e.g. leaflet and programme booklet) in the funding agreement, the organisers spent $387,000 on such printing. As explained by the organisers in their post-event evaluation report, the increase in printing cost was due to printing additional promotion materials and using higher quality of printing materials. There was no evidence that the Secretariat had raised any queries on whether the additional promotion materials were solely used for the MEF shows. Although commercial advertisements (e.g. advertisements from airline/jewellery companies) were published on the printed promotion materials, no income from this source was recorded in the audited accounts;

(b) relevant B/Ds commented, when assessing the application, that it was unnecessary to purchase new equipment and incur various expenditures on design, such as stage design, costume design, lighting, lyric writing (as the four performances were re-run productions). Their comments were made without the knowledge that the organisers would stage the performances many times shortly before and after the MEF shows. It transpired that such costs had been incurred. Event G had subsequently incurred a deficit of $2.3 million (net of MEF funding), including some $0.9 million for Performance A;

Regarding (a) and (b) above, the TC informed Audit in late March 2014 that a financial sanction had been imposed against the organisers due to their failure in meeting some important targets set in the funding agreement (see para. 6 in Example 7 in PART 3). Although the MEF Secretariat is taking follow-up action on the above findings with the organisers of Event G, the latter have recently explained to the TC that meanwhile they have no time to check their records due to their very limited manpower and can only provide feedback in late June 2014 the earliest;

Procurement and staff recruitment (see (c) to (e))

(c) ***Procurements and recruitments with related parties, but without Government permission.*** Taking the three one-day events held from 2011 to 2013 (Events C1, C2 and C3 mentioned in paras. 2.18 to 2.21) as examples, the majority of the services, including the recruitment of performers, were procured from two associates of the organiser which together had been paid \$1.5 million, \$1 million and \$1.4 million, representing 48%, 36% and 44% of the total expenditures incurred for the three events respectively. Audit found that quotations, invoices, staff recruitment and payroll records with performers' acknowledgement of receipt were not available to support the procurements and recruitments. The organiser had neither made any declarations on conflict of interests nor sought permissions from the TC for procurements from associated service providers in accordance with the funding agreements;

(d) ***Overpayment made to an organiser.*** Audit examination of MEF records revealed that in one event, the organiser had been overpaid \$227,000. The MEF Secretariat was not aware of the overpayment in its checking of the organiser's books and records. In January 2014, Audit informed the Secretariat about the overpayment and the Secretariat recovered the overpayment from the organiser in February 2014;

(e) ***MEF funding used for financing the publicity costs of commercial sponsors.*** In one event, the MEF had funded broadcasting fee of \$1.6 million to the organiser, including a payment of \$0.1 million for a commercial sponsor's product placement in the TV programme, which should not have been borne by the MEF. Similarly, in another event, the MEF had funded broadcasting fee of \$1.8 million, again including a payment of \$0.2 million for using the name of a commercial sponsor as the event title, instead of the event name as stipulated in the funding agreement. It is again not appropriate to use the MEF funding to finance the publicity costs for the commercial sponsors;

Achievement of key deliverables in the funding agreement (see (f))

(f) as one key deliverable for one event held in early 2013, the organiser was required to perform one activity to be awarded a record of the Guinness World Record. After completion of the event, the MEF Secretariat reported to the Assessment Committee that the organiser had successfully completed its Guinness record-breaking attempt. The final payment of the MEF approved funding of \$1.4 million for the event (representing 43% of the total event costs) was released in mid-2013. On Audit's enquiries in February 2014, the organiser informed the Secretariat that its application for the Guinness record-breaking was still in progress (more than one year after the record-breaking attempt). The Secretariat may wish to follow up;

Reporting of event income and disposal of unspent event balance (see (g) and (h))

(g) ***Suspected omission of reporting income from certain event activities.*** For one event, the actual income from event activities of \$161,000 as reported in the audited accounts was far below the budget of \$700,000. There were indications that income generated from some event activities had not been taken into account, and the reported income in the audited accounts might have been understated. For example, according to media reports, about 2 000 tickets (priced at \$300 each) for one event activity had been sold out. There was however no evidence showing that the MEF Secretariat had followed up with the organiser. In March 2014, the organiser explained to the TC that no income for the event activity was reported in the post-event evaluation report because the activity had been outsourced to be administered by a third party and only the net amount (deficit) was recorded. The TC concurred that the above practice might not be desirable from the accounting angle; and

(h) ***Improper refund of unspent event balance to sponsor.*** For one event, the organiser received a sponsorship of $0.8 million from one sponsor. Because the event had an unspent balance of $0.28 million, the organiser refunded $0.28 million to the sponsor. In accordance with the funding agreement, the organiser should have refunded the unspent event balance of $0.28 million to the Government. In March 2014, the organiser explained to the TC that the sponsor had committed to use its sponsorship to make up for any deficit of the event and, with an unspent event balance of $0.28 million, it refunded the amount to the sponsor. The TC informed Audit in late March 2014 that in future, it will state explicitly in the funding agreement that the organiser must notify the TC in writing and seek its prior consent, should there be any special arrangement for returning sponsorships to commercial sponsors.

4.15 Given that public funds are involved, the audit findings reported in paragraph 4.14 suggest that there is an urgent need for the TC to step up its communication with event applicants and organisers, and step up its checking and controls over the operation of the MEF events. Audit considers that the TC needs to make more vigorous efforts in this regard, given that the implementation of Tier 1 events will involve MEF funding of significant amounts and may involve event operation by commercial organisations abroad.

Monitoring of ticket distribution for MEF events

4.16 Audit found that the TC had generally <u>not</u> set any conditions in the funding agreements to govern the distribution of tickets. For example, with Event H which was a four-day event held in 2012 and involving MEF approved funding of $15 million (representing 31% of the total event cost), the TC did not stipulate in the funding agreement the number or extent of paid or complimentary tickets available to general public and the number of tickets to be bundled for sales of special tourist packages. As it transpired:

(a) 93% of Event H tickets (23 000 tickets) were issued as free tickets by the organiser to various parties, including the venue provider, sponsors and the organiser itself, and only 7% (1 500 tickets) were sold to the general public; and

(b) no special tourist packages were developed for Event H.

The MEF Secretariat did not make any enquiries on the distribution of tickets for the event until Audit made such an enquiry in early 2014. The organiser was also not required to provide any information on the distribution of tickets in its post-event evaluation report.

4.17 On the other hand, Audit found that in another event (Event J) held in 2013, the MEF had funded $8 million for the event (some 25% of the total event cost). The funding agreement has provided for the organiser to reserve 4 000 tickets for sale to overseas visitors direct, another 4 000 tickets for overseas promotion by the HKTB and at least 18 000 tickets for sale to the public. Audit considers that it is a good practice to set funding conditions to govern the distribution of tickets and it should be adopted in all future fee-charging MEF events.

Organisation of Event J

4.18 The MEF financed the organiser of Event J with $8 million (see para. 4.17) for holding a football match in Hong Kong Stadium in late July 2013. It was regarded as a signature event as the organiser had invited a famous football team to come and play in an exhibition match in Hong Kong. However, owing to the poor condition of the Stadium turf pitch, Event J received some negative publicity.

4.19 Event J revealed the following areas that require follow-up:

(a) ***Enforcement of funding condition.*** According to the funding agreement which was executed in January 2013, the organiser undertook that <u>no</u> similar matches would be held by the organiser/team in the Southern China and "nearby South East Asian countries" during the 2013 tour. However, the team had held a match in Thailand (which is in South East Asia) during its 2013 tour. Even though the MEF Secretariat had been informed of the match in Thailand, yet because the funding agreement had not defined clearly the term "<u>nearby</u> South East Asian countries", the funding condition of requiring the organiser/team <u>not</u> to hold similar matches in "nearby" places was difficult to enforce;

(b) ***Venue management.*** After the event, the LCSD which managed the Stadium immediately reviewed the pitch problem of the venue. It was considered that various factors had led to the undesirable pitch condition for the football match, including the state of the turf pitch, the prolonged adverse weather conditions (continual heavy rainfall in July 2013) and the packed event schedule before the match (with four other matches held in the week before Event J was held). On the day after the match, the LCSD announced that it would undertake a comprehensive review of the turf maintenance and management issues of the Stadium, and formulate measures to be taken in the short, medium and long terms to address the issues concerned; and

(c) ***Concrete contingency plan.*** The organiser had recognised the risk of bad weather in its application submitted in July 2012, and the HAB when consulted by the TC in assessing the application had also raised its concerns on the bad weather during summer in Hong Kong and on the absence of a concrete contingency plan having been submitted by the applicant. However, there is no evidence that the MEF Secretariat had adequately followed up to ensure that the organiser had properly prepared a contingency plan to address the risk. Fortuitously, the weather during the football match day was fine.

In late March 2014, the Administration informed Audit that the Assessment Committee and the TC had considered that Event J would be attractive to both Hong Kong residents and tourists, but had recognised that it would be unrealistic to request the famous football Team to make a trip specifically to Hong Kong. The MEF Secretariat had therefore been instructed to ensure that the Team concerned would not be playing a match in a city in the close neighbourhood which might affect the attractiveness of the match in Hong Kong. As regards (c) above, the Assessment Committee and the TC noted the risk of a football match in the summer season which could be affected by weather, but recognised that it would not be easy to draw up a viable contingency plan without considerably compromising the scale of the event or increasing the cost until an all-weather stadium is available in Hong Kong.

MEF funding not used for specified purposes

4.20 As mentioned earlier, it is often stipulated in the funding agreement that the Government funding should be used for specific purposes, such as using the MEF fund to secure publicity or to enrich the content of the event to boost the tourist attendance. Audit has however found that for a few events, the MEF funds were not used for the specified purposes. Example 9 is shown for illustration.

Example 9

1. According to the funding agreement of Event D4, the joint organisers should only use the MEF funding ($5.5 million — Note) for the following three purposes:

(a) strengthening the overseas participation of the event;

(b) further enhancing the publicity of the event outside Hong Kong; and

(c) attracting more visitors to Hong Kong for the event.

2. However, according to the organisers' budget, which formed part of the funding agreement, the MEF funding would be used to cover the following expenditure items:

Type of expenditures	Amount ($ million)
Venue setup	3.2
Equipment rentals	2.0
Cleaning service	0.1
Others	0.2
Total	5.5

It would appear that the MEF funding had been used for expenditure incurred in staging the event, rather than overseas publicity, which cannot be easily associated with the specified purposes in the funding agreement (see para. 1 above).

3. In the event, the organisers were funded by the MEF for the specified expenditure items in accordance with the budget.

Note: Event D4 was approved with MEF funding of $5.3 million plus a reserved balance of $0.2 million, being operating surplus generated from a similar event held in the previous year and allowed by the TC to be retained by the organisers for organising the same event in 2013.

Source: TC records

Enforcing the acknowledgement requirements

4.21 According to the funding agreements, organisers are required to feature prominently the acknowledgement of the Government's support on all publicity materials for the event. The acknowledgement must have dominant presence at the event venues and other related locations. Effective from May 2012, written approval from both the ISD and the MEF Secretariat must be obtained for information on all advertising, publicity and sponsor displays at event venues. Audit has however found that, although approvals from the ISD were usually obtained, approvals from the MEF Secretariat had not been sought and, in at least three events, there is scope for improvement in displaying the acknowledgement of the Government's support.

Desirability of conducting a debriefing session shortly after an event has been held

4.22 In accordance with the funding agreement, the organiser is required to submit post-event reports and audited accounts within four months after the completion of the event. With Event J (see paras. 4.18 and 4.19) as an example, although the football match had been held in as early as July 2013, the organiser was allowed to submit its post-event evaluation report and audited accounts by the end of January 2014 which was six months after the event (with two months' extension for submission allowed by the TC).

4.23 Given that post-event reports and audited accounts are only available months after an event has been held, the TC should consider holding a debriefing meeting, say, within a month after an event, with the organiser to assess the results of the event and to draw lessons to be learned from the event.

Disbursement of funds

4.24 According to the Guide to Application, the Government will only disburse the MEF funding after the funding agreements have been duly executed. The MEF funding may be paid by instalments on the satisfactory performance of appropriate milestones by the grantee. The final payment may be effected upon:

(a) satisfactory completion of the event;

(b) the submission of the event's evaluation report, publicity report, the survey report and audited accounts to the satisfaction of the Assessment Committee and the Controlling Officer; and

(c) the grantee's full compliance with all its obligations and duties under the funding agreement.

Disbursement of funds not in accordance with pre-set milestones

4.25 In June 2009, shortly after the inception of the MEF, the Assessment Committee endorsed that disbursement of funds would be made by phases "in accordance with business plan, budget and cash flow requirement of the successful event, ... subject to fulfilment of pre-set and clearly defined milestones/targets acceptable to the Assessment Committee."

4.26 Audit however found that, instead of disbursing funds in accordance with the pre-set milestones of the events, payments were made to the organisers in all 22 completed MEF events based on the same payment schedule, i.e. 50% upon the execution of the funding agreements and the remaining 50% after the successful completion of the events and the submission of post-event reports and audited accounts to the satisfaction of the Assessment Committee and the Controlling Officer.

4.27 Given the variations in the scope and nature of the MEF events, Audit considers that the TC needs to determine the payment schedule on the basis of individual events. Whilst the standard payment schedule of paying 50% after the execution of the funding agreement and the remaining 50% after completion of the event and submission of post-event reports and audited accounts may generally be acceptable in the case of Tier 2 events, the TC needs to work out a proper payment schedule for individual Tier 1 events in future.

PART 5: WAY FORWARD

5.1 This PART examines the more recent development of the MEF and challenges ahead, and makes audit recommendations on the way forward.

Need to capitalise on benefits brought from mega events

5.2 Mega events not only add colour and vibrancy to Hong Kong, but also enrich visitors' experiences. Spectacular mega events will attract visitors to make a special trip to Hong Kong, which will in turn fuel the growth of such tourism-related sectors such as hotel, air transport, catering and retail in Hong Kong, and create more jobs. The successful staging of mega events can attract overseas media coverage that helps burnish Hong Kong's image as an international metropolis and reinforce its status as the events capital of Asia. The introduction of the MEF has provided opportunities to bring such mega events to Hong Kong and to capitalise on such opportunities.

Modified MEF

5.3 Based on the experience gained from the first three years of the MEF operation and the result of a review conducted in 2011, the Administration came up with a proposed modified MEF which was approved by the LegCo FC in April 2012 and launched in May 2012. As pointed out in paragraph 2.4, the modified MEF involves two tiers, namely:

(a) ***Tier 1.*** It aims to provide financial incentive to attract new or established high profile mega events to Hong Kong to reinforce Hong Kong's image as the events capital of Asia. These events may be owned and/or operated by private event management companies or professional organisations established outside Hong Kong. Through the introduction of Tier 1, the CEDB hopes to attract events to Hong Kong with the objectives of attracting more tourists and enhancing the city's international recognition; and

(b) ***Tier 2.*** It is essentially an enhanced version of the previous MEF system. Tier 2 aims to provide funding support to local non-profit-making organisations to host events which have the potential to become mega events in Hong Kong, especially those activities which can showcase traditional Chinese culture and local heritage. All locally registered non-profit-making bodies are eligible to apply for MEF funding support under Tier 2. Tier 2 applications are assessed based on the broad principles and assessment criteria as described in paragraphs 1.5 and 1.8.

Audit findings

5.4 The following audit issues are examined in this PART:

(a) challenges ahead in the implementation of the modified MEF (paras. 5.5 to 5.12); and

(b) the need to define key performance targets to measure the effectiveness of the modified MEF (paras. 5.13 to 5.15).

Challenges ahead in the implementation of the modified MEF

5.5 In April 2012, the CEDB informed the LegCo FC that, to take forward the implementation of Tier 1, the Administration would:

(a) engage an independent consultant to conduct a comprehensive survey to identify a list of potential Tier 1 events to be introduced to Hong Kong; and

(b) after consideration by the Assessment Committee and obtaining in-principle approval from the Controlling Officer, approach the relevant owners of the identified events according to the agreed priority to explore whether they are interested in bringing these events to Hong Kong. There would then be a negotiation process between the Government and the event owners on the terms and conditions. Based on the negotiation results, the organisers would be invited to submit formal MEF applications.

On the recommendation of the Assessment Committee, the Controlling Officer would be the authority to grant approval. If approved, the Government would enter into funding agreements with the organisers and other relevant parties as appropriate.

5.6 The CEDB also informed the LegCo FC in April 2012 that:

(a) the existing monitoring mechanism should apply to both Tier 1 and Tier 2 events in future. For Tier 1 events, the TC would consult the ICAC to develop more stringent monitoring and control measures from the corruption prevention angle; and

(b) the allocation of $150 million would be able to support the modified MEF to operate for about five years up to March 2017. The Administration expected that under the modified MEF, the numbers of applications and MEF events would increase. To ensure proper control and monitoring, the Administration would enhance the manpower in the MEF Secretariat to cope with the increased workload.

Employment of a consultant to conduct a survey on potential Tier 1 events

5.7 A consultant was appointed in September 2012 at a cost of $0.6 million to conduct a comprehensive survey to identify a list of potential Tier 1 events to be introduced to Hong Kong. Following the Government's acceptance of the consultant's report, the consultant was required to provide service for a continuing period of 12 months (which would lapse by May 2014) to assist the Government in liaising with the organisers/owners of the recommended events. The Government would however take the lead in inviting the organisers to host the events in Hong Kong (see para. 2.4).

5.8 The consultant's report was accepted by the Assessment Committee in May 2013. The Committee held a brainstorming session in June 2013 in which one event, "Event X", was identified for immediate follow-up action, including approaching the organiser with a view to bringing the event to Hong Kong under MEF Tier 1.

More recent development

5.9 However, it transpired that Event X would not be hosted in Hong Kong in 2014. In response to an enquiry from one LegCo Member, the CEDB informed LegCo in January 2014 that:

(a) the event organiser was once interested in staging Event X in Hong Kong in November 2014. The Government also supported the proposal in principle;

(b) the TC could however not reach an agreement with the organiser on the design of the racetrack and related issues within the extremely limited timeframe; and

(c) the TC would keep in close contact with the organiser to explore actively the optimal solutions to the engineering works and other issues relating to the race.

5.10 As of March 2014, the following position stands:

(a) the TC had identified two potential Tier 1 events for action;

(b) since April 2012, usage of the MEF and the number of MEF events approved had been decreasing (see para. 2.8); and

(c) actual grants made by the modified MEF in 2012-13 and 2013-14 (up to January 2014) were only $17 million and $15 million respectively, falling far short of the estimated $25 million and $35 million as indicated in the LegCo FC paper.

In March 2014, the TC informed Audit that, given that MEF funding was limited and was designated for use of both Tier 1 and Tier 2 events, the TC and the Assessment Committee aimed to identify and focus on one or two mega events with real potential to be introduced to Hong Kong, and considered it not practical to approach a list of potential event organisers at once. They are adopting a step-by-step approach to take forward the Tier 1 scheme, and meanwhile, follow-up actions are taken on two events which may be introduced to Hong Kong under Tier 1 scheme.

5.11 Audit welcomes the TC's recent efforts taken, but notes that there are various challenges ahead in the implementation of the modified MEF. They are outlined as follows:

Tier 1

(a) ***Difficulties in securing Tier 1 events.*** Tier 1 events are expected to bear a strong international appeal, generate wide international media coverage and attract considerable number of visitors coming to Hong Kong particularly for that purpose. If possible, the events may be held in Hong Kong for a few years to generate sustainable recognition and impact. Almost one year has lapsed since the consultancy survey which was completed in May 2013 (see paras. 5.7 and 5.8). The TC needs to exert greater efforts to identify and secure Tier 1 events for hosting in Hong Kong;

(b) ***Local factors and constraints.*** Various local factors and constraints, such as event culture and physical/venue considerations, have to be overcome in bringing Tier 1 events to Hong Kong;

(c) ***Government's readiness to monitor Tier 1 events.*** While Hong Kong has significant experience in staging many mega events, the TC would need to develop a more versatile monitoring and control mechanism as Tier 1 events would entail substantial amounts of public funds and would involve commercial event organisers or professional sports associations established outside Hong Kong. The CEDB informed LegCo in April 2012 that whilst the existing monitoring mechanism would similarly apply to Tier 1 events, it would consult the ICAC to develop more stringent monitoring and control measures from the corruption prevention angle. However, as of February 2014, the ICAC had not been consulted and a more versatile monitoring mechanism had not yet been worked out for Tier 1 events;

Tier 2

(d) the high percentage of rejected applications and the frequent cases of events subject to financial sanctions would affect the effective achievement of the MEF objectives (see paras. 2.8 to 2.10);

(e) the need to identify more new events in order to address the imbalance between new and repeated events (see para. 2.35); and

(f) the risk of abuse and various inadequacies in event monitoring and evaluation as pointed out in PART 4.

5.12 Apart from making more vigorous efforts to identify genuine Tier 1 events which could showcase Hong Kong as the events capital of Asia, the TC also needs to expedite its development of a more versatile mechanism for monitoring both Tier 1 and Tier 2 events. Meanwhile, a number of mega events, such as the Hong Kong Marathon and the Hong Kong Sevens, which received no MEF funding are attracting international publicity and record public participation (see para. 2.2).

The need to define key performance targets to measure the effectiveness of the modified MEF

5.13 In April 2012, when seeking the LegCo FC's approval for extending the MEF by creating a new commitment of $150 million (see para. 1.3), the Administration stated that the initial MEF had served its purpose in facilitating the hosting of more signature events in Hong Kong to enrich the experience of visitors and should be extended. No measurable and quantifiable key performance targets had however been set to justify the new commitment. The Administration needs to define revised performance targets for the modified MEF.

5.14 As mentioned in paragraph 2.2, the MEF was set up at a difficult time when the economy was sinking into recession and employment situation was deteriorating, and the MEF was set up to host mega events to attract more visitors and to make them extend their duration of stay and increase their spending. To justify the setting up of the MEF in May 2009, the Administration estimated that the

MEF would create some 2 800 jobs in the three years of operation. Today, the economic situation in Hong Kong is quite different. In recent years, tourism has continued to record significant growth. Unemployment in Hong Kong had also fallen to a low level of 3.3% in 2013, signifying full employment.

5.15 Given the quite different economic situation which now prevails, the Administration needs to consider whether it is still necessary and appropriate to continue using the number of additional paid jobs created as an important assessment criterion to measure the effectiveness of the MEF. At the same time as revised performance targets are set for the modified MEF, the TC needs to devise a robust mechanism to monitor and evaluate its effectiveness.

Audit recommendations and response from the Administration

PART 2: Achievement of the MEF objectives

5.16 **Audit has *recommended* that the Permanent Secretary for Commerce and Economic Development (Commerce, Industry and Tourism), as the Controlling Officer of the MEF, should:**

(a) **urge the TC to:**

- **conduct an overall review of the MEF, taking on board the audit findings identified in this Audit Report and the challenges Audit identified in paragraph 5.11; and**

- **exert more vigorous efforts to identify worthwhile Tier 1 events, and explore opportunities for more new Tier 2 events for implementation (see paras. 2.12 and 2.35);**

(b) **ascertain the underlying reasons, and explore improvement measures, for the high percentage of rejected applications and the frequent cases of MEF events which had been subject to financial sanctions, taking into account the various improvement measures Audit suggested in paragraph 2.11;**

(c) **take follow-up action on the reported findings in paragraphs 2.16 to 2.29, and develop a robust mechanism to validate the deliverables and targets as reported by the organisers to have been achieved by the MEF events (see para. 2.30); and**

(d) **explore how the TC can work in closer collaboration with other B/Ds to avoid the duplication of Government efforts in monitoring the same event (see para. 2.39).**

5.17 The Permanent Secretary for Commerce and Economic Development (Commerce, Industry and Tourism) generally agrees with the audit recommendations on ensuring the operation of the MEF achieves its objectives. He has said that:

(a) the MEF was introduced in May 2009 to provide financial support for local non-profit-making organisations to host mega events in Hong Kong and to reinforce Hong Kong's position as the events capital of Asia. The Administration acknowledges that during the early stage of the establishment of the MEF, it had endeavoured to provide opportunities to some non-profit-making organisations which might have relatively less experience than professional and commercial event organisers in organising large scale events. However, experience showed that the performance of some of these MEF-supported events was less than desirable. The Administration therefore imposed substantial financial sanctions and, in two cases, even disallowed the organisers concerned from applying for the MEF. Regarding the need to strike a reasonable balance between encouraging the staging of more new and attractive events on one hand, and safeguarding the proper use of public money on the other, the Assessment Committee has been putting more emphasis on the organisation ability and track record of applicants when assessing Tier 2 applications in subsequent years;

(b) he also concurs that there is a need to look into the operation of the MEF (both the Tier 1 and Tier 2 schemes), as well as for the TC to endeavour to identify worthwhile Tier 1 events and appealing new Tier 2 events for possible support by the MEF. In this connection, the TC has been in discussion with the organisers of two potential Tier 1 events. There are certain local factors and constraints which may make it not possible for these events to take place in Hong Kong. The TC will continue to follow up the discussion in a proactive manner. Given that the discussion involves commercially sensitive information, the Administration considers it premature to make public the details at this juncture. The ICAC will be duly consulted on the monitoring and assessment mechanism pertaining to future Tier 1 events in due course;

(c) on the Tier 2 scheme, the TC and the Assessment Committee concur that there is room for further enhancement to the operation of the scheme which has been operating for more than four years. A brainstorming session of the Assessment Committee took place on 20 March 2014 to look into possible ways to improve the prevailing Tier 2 scheme with an aim to support more new events. The TC will follow up with the Assessment Committee's comments, such as enhancing the transparency of the MEF application schedule, proactively providing information of reasons for failure for unsuccessful applications and introducing a mechanism for eligible unsuccessful applicants to submit revised applications for the Assessment Committee's further consideration;

(d) the Administration will promulgate the following improvement measures as suggested by Audit in paragraph 2.11:

(i) the TC will explore with the HKTB to see how best to support the promotion of MEF-supported events on a case-by-case basis, taking into account the merits of individual events. The TC will also provide a hyperlink about the MEF-supported events at the TC's dedicated MEF website to the HKTB's website to help step up promotion;

(ii) the TC will, starting from the next round of Tier 2 applications, state in the regret letter for every unsuccessful application the main reasons for the failure;

(iii) the TC has accepted the ICAC's recommendations and revised one of the assessment criteria (i.e. technical feasibility) accordingly to cover the technical and project management capabilities as well as past performance of the applicant. The TC will also, by making reference to the internal guidelines of other relevant Government Funds, draw up internal guidelines to facilitate staff members serving the MEF Secretariat in vetting the Tier 2 applications; and

(iv) the TC will, in addition to adopting the prevailing practice of arranging meetings with the organisers upon execution of the funding agreements and ad hoc meetings as necessary, hold kick-off meetings with the organisers, including those first-time ones, if necessary, upon approval of their MEF applications and receipt of their acceptance of the conditional offers. These meetings will serve to inform the organisers of the expectations of the Government and Assessment Committee and the organisers' obligation to facilitate the TC's monitoring work;

(e) the TC has looked into the reported findings in paragraphs 2.16 to 2.27 and will develop a robust mechanism to validate whether the deliverables and targets of the MEF events have been achieved as reported by the organisers. Details of the proposed enhancement measures include the following:

(i) conducting random checks on the deliverables and targets (e.g. number of paid jobs created) as reported by the organisers in their evaluation reports. Resources permitting, random checks against the employment contract, payroll records, bank statement or other evidence as appropriate will also be conducted;

(ii) conducting random verification on the staff employed for the events against the attendance records on the spot during the MEF Secretariat's on-site inspection;

(iii) requesting the organisers to specify clearly the number of local/non-local participants, visitors, employees and reporters respectively without overlapping and identify ways for random checking;

(iv) improving the documentation of the checking and/or clarifications made with the organisers as appropriate, and continuing to endeavour to check the validity of the events' recruitment as far as practicable;

(v) requesting the organisers to develop more scientific methods in counting participants such as by commissioning tertiary institutions or professional entities to conduct the survey, etc; indicating their counting method in the application form; and assisting the TC in counting the staff employed for the event during the MEF Secretariat's on-site inspection as far as practicable;

(vi) exploring with the Labour Department to define the meaning of "paid jobs" in the funding agreement so as to avoid counting those non-local/local children as employees of the event; and

(vii) liaising with the organisers and other relevant parties (e.g. HKTB) on how best to promote the events to overseas markets, such as developing tourist packages and/or conducting overseas promotion. Where practicable, the TC will consider, taking into account the circumstances of individual events, whether additional requirements on the development of tourist packages such as setting a reasonable target to be imposed under the funding agreement; and

(f) resources permitting, the TC will better coordinate with the concerned B/Ds on the monitoring of the events in future to avoid unnecessary duplication of the Government's efforts in monitoring the same event.

PART 3: Assessment of applications

5.18 **Audit has *recommended* that the Permanent Secretary for Commerce and Economic Development (Commerce, Industry and Tourism), as the Controlling Officer of the MEF, should:**

(a) **address the inadequacies identified in paragraph 3.5 to enhance the governance of the Assessment Committee;**

(b) **follow up on the reported findings in paragraph 3.10 relating to the titling of the two associates of the organiser in the various events as "Event Co-organisers" in the publicity documents;**

(c) **ensure that the TC would require applicants to disclose their management teams and any associates who will be actively involved in organising the proposed events, and that the TC would also develop more specific guidelines to facilitate its staff in the conduct of assessments more effectively (see para. 3.11); and**

(d) **ensure that the TC would take improvement measures in communicating to applicants that activities organised by the organisers in close proximity to the MEF event should be reported or disclosed, and that the TC would take more proactive action in following up B/Ds' comments (see para. 3.14).**

5.19 The Permanent Secretary for Commerce and Economic Development (Commerce, Industry and Tourism) agrees with the audit recommendations. He has said that:

(a) he agrees that there is a need to improve the governance of the Assessment Committee. The following improvement measures will be introduced:

   (i) when considering appointment/re-appointment of members of the Assessment Committee in future, the TC will, bearing in mind that the continuity of the Assessment Committee is important in ensuring the consistency of assessment, consider introducing new blood to the Committee; and

   (ii) the TC will record properly the scores awarded to each application under individual assessment criteria in the minutes of the corresponding Assessment Committee meetings;

(b) the TC has looked into the reported findings in paragraph 3.10 relating to the titling of the two associates of the organiser in the various events as "Event Co-organisers" in the publicity documents and will further step up the monitoring mechanism by requesting the organiser to duly declare any potential conflict of interest particularly involving monetary transactions in the application form and evaluation report, and to record properly such declarations for TC's checking;

(c) the TC will request the organisers to duly disclose their management teams and any associates who will be actively involved in organising the proposed events in the application form and post-event evaluation report, and to record properly such declarations for TC's checking. The TC will also, by making reference to the internal guidelines of other relevant Government Funds, draw up internal guidelines to assist the MEF Secretariat in vetting Tier 2 applications; and

(d) the TC will request the organisers to disclose in the application form and post-event evaluation report in detail should they intend to organise in Hong Kong or overseas any kind of activities/events of similar content or nature in close proximity to the MEF-supported event. A standard clause in the funding agreement will be added to require the organiser to make such a disclosure and secure the Government's prior consent as appropriate. The TC will take proactive action in following up with relevant B/Ds' comments with the organisers pertaining to the MEF-supported events as appropriate.

PART 4: Monitoring and evaluation of events

5.20 **Audit has *recommended* that the Permanent Secretary for Commerce and Economic Development (Commerce, Industry and Tourism), as the Controlling Officer of the MEF, should:**

(a) **endeavour to have the funding agreements executed in a timely manner so that the TC can more effectively enforce the control measures set out in the agreements (see para. 4.6);**

(b) **strictly enforce the funding requirement for the organiser and its agents/staff to declare any conflicts of interest in relation to procurement and staff recruitment, and ensure that the organiser has set up a mechanism to mitigate any such declared conflicts (see paras. 4.7 to 4.9);**

(c) **follow up the suspected irregularities highlighted in paragraph 4.14 and draw lessons to be learned from the findings reported in PART 4;**

(d) **step up the TC's checking and controls over the operation of the MEF events (see paras. 4.13 and 4.15);**

(e) **ensure that the TC would set funding conditions to govern the distribution of tickets in all future fee-charging MEF events (see para. 4.17);**

(f) **draw lessons to be learned from the inadequacies in relation to the organisation of Event J (see para. 4.19);**

(g) **ensure that the TC would require the organisers to use the MEF funding only for the specified purposes as stipulated in the funding agreements (see para. 4.20);**

(h) **ensure that the TC would step up its enforcement of the acknowledgement requirement, including requiring the organisers to seek its approvals for information on advertising, publicity and sponsor displays at event venues (see para. 4.21);**

(i) **explore the desirability of conducting a debriefing meeting with the organiser, within a shorter period after an MEF event has been held, to assess the success or otherwise of the event and to draw lessons for the future (see para. 4.23); and**

(j) **work out guidelines on how MEF funding should be released for Tier 1 events in future (see para. 4.27).**

5.21 The Permanent Secretary for Commerce and Economic Development (Commerce, Industry and Tourism) generally agrees with the audit recommendations. He has said that:

(a) the TC will endeavour to execute funding agreements as early as practicable after giving a conditional MEF offer to the applicant. To ensure proper use of public money and the disbursement of Government funding at an appropriate time, the TC will only sign agreement with an organiser upon the finalisation of its operation plan and event budget, as well as fulfilment of other conditions laid down by the Assessment Committee. Should the organiser be unable to fulfill all requirements within a reasonable period, the Assessment Committee could terminate the conditional offer at its sole discretion;

(b) the TC will step up monitoring of the declaration of conflicts of interest in relation to procurement and staff recruitment by the organisers. Applicants to the MEF will also be requested to disclose their procurement and staff recruitment mechanism in the application form and to report the operation of the mechanism with supporting documents in the evaluation report to the TC;

(c) the TC will take a series of follow-up actions having due regard to the audit findings as highlighted in paragraph 4.14 and in other paragraphs in PART 4. Details are as follows:

(i) depending on the nature/type of individual cases, the TC will continue its prevailing practice to disallow the organiser to stage similar events in Hong Kong or in overseas within a reasonable period or require the organiser to set out clearly the incremental costs on the advertising, promotion or costumes solely arising from the staging of the MEF-supported event. The Assessment Committee will be invited to take note of this and its potential impact on the attractiveness of an event during assessment;

(ii) the TC will request organisers to ensure that all event expenditure items should be supported by official invoices/receipts as described in the Guide to Application and the TC will check whether the organisers have fulfilled the requirement when conducting the random document inspection checks. Should organisers be unable to submit official invoices/receipts, they will be required to provide written explanation to the satisfaction of the Assessment Committee. The Assessment Committee and the Controlling Officer of MEF could, at their absolute discretion, decide not to disburse the concerned MEF funding in respect of those expenditure items;

(iii) the TC will continue to pay extra attention to those expenditure items which exceed the original budget by 10% as well as those that the relevant B/Ds are of concern, and require the organisers to provide detailed explanation with supporting documents as appropriate;

(iv) the TC will state explicitly in the funding agreement that charges relating to commercial sponsors should not be covered by the MEF funding and the organisers will be further requested to state clearly the incremental charges under respective expenditure items arising from commercial sponsors;

(v) the TC will state explicitly in the funding agreement that the organisers must notify the Government in writing and seek its prior consent should there be any special arrangement for returning sponsorships to commercial sponsors; and

(vi) in addition to the normal random document inspection checks conducted by the MEF Secretariat staff, the TC will arrange an additional staff with accounting background to conduct random cross checks. In the long run, the TC will consider recruiting a part-time auditor and recruiting/deploying staff members with accounting/audit background/knowledge to serve the Secretariat with a view to enhancing the effectiveness of its monitoring work;

(d) the TC will step up its communication with organisers and will require them to provide documentation for the procurement exercises (e.g. tendering documents, quotations) when they submit application forms and evaluation reports to facilitate random document inspection checks. The TC will also consult the ICAC on the monitoring and assessment mechanism for Tier 1 events in due course;

(e) he concurs that there may be merits to regulate the distribution of tickets in fee-charging MEF events. The TC, having regard to the circumstances of individual events, will consider specifying the minimum number of tickets required to be made available for public sale for fee-charging events in the funding agreement;

(f) the TC notes the experience from Event J. In future, the TC will give due consideration to defining key terms under the funding agreement to avoid enforcement difficulty. Depending on the nature of the events, the TC will continue to request the organisers to explore and develop a contingency plan (such as postponement of the event, purchase of insurance to cover adverse weather conditions in particular for those outdoor events, etc.) as far as practicable and specify such requirements in the funding agreement;

(g) the TC will endeavour to ensure that the organisers use the MEF funding only for the specified purposes as stipulated in the funding agreement, and will design more relevant and specified purposes in the funding agreement as appropriate in future. The TC will also require the organisers to fully justify the relevance of the expenditure items in relation to the specified purposes in the funding agreement;

(h) under the prevailing practice, the organisers are required to submit all publicity materials with the acknowledgement of Government support to the ISD for approval. The TC will also comment on the materials and related arrangements. To step up the monitoring efforts, the TC will require that when organisers seek the ISD's approval of all publicity materials on the acknowledgement of Government support, they should copy their applications to the TC so that more coordinated comments could be provided in a timely manner;

(i) the TC will conduct a wash-up meeting with the organiser of the MEF-supported event within a month after the event has been held; and

(j) the TC will, for future Tier 1 events, draw up appropriate payment schedules taking into account the nature and merit of individual events.

PART 5: Way forward

5.22 **Audit has *recommended* that the Permanent Secretary for Commerce and Economic Development (Commerce, Industry and Tourism), as the Controlling Officer of the MEF, should urge the TC to expedite its development of a more versatile mechanism for monitoring both Tier 1 and Tier 2 events, consult the ICAC on the monitoring of Tier 1 events, set suitably revised performance targets for the modified MEF and monitor and evaluate its effectiveness (see paras. 5.11(c), 5.12 and 5.15).**

Way forward

5.23 The Permanent Secretary for Commerce and Economic Development (Commerce, Industry and Tourism) agrees with the audit recommendations. He has said that for MEF Tier 1 scheme, the TC will consult the ICAC on the monitoring and assessment mechanism for future Tier 1 events in due course; and for MEF Tier 2 scheme, the TC will look into whether it is appropriate to use the number of additional paid jobs created as one of the key criteria to measure the performance of the MEF Tier 2 events in future.

5.24 The Director of Corruption Prevention, ICAC has said that the ICAC welcomes all government, public and private organisations to seek its corruption prevention services, and stands ready to assist the TC in building necessary safeguards in the monitoring and control of Tier 1 events as well as in other areas.

Appendix A
(para. 1.4 refers)

24 approved MEF-supported events

Item	Date of event	Event title
1	13 Nov 2009	Swire "Symphony Under the Stars"
2	6 – 9 Jan 2010	Hong Kong Tennis Classic 2010
3	26 – 29 Mar 2010	Mui Wo Water Lantern and Sky Lantern Festival
4	27 Mar – 22 Apr 2010	Hong Kong 2010 International a cappella Festival
5	29 Mar – 21 Apr 2010	Hong Kong Musical Festival
6	8 Apr – 30 May 2010	Hope and Glory
7	23 – 25 Jul 2010	Hong Kong Dragon Boat Carnival (Note)
8	1 Jan 2011	Record Breaking Dragon and Lion Dance Extravaganza
9	5 – 8 Jan 2011	Hong Kong Tennis Classic 2011
10	11 – 17 Feb 2011	Hong Kong Well-wishing Festival
11	17 – 19 Jun 2011	2011 Hong Kong Dragon Boat Carnival (Note)
12	25 Sep – 2 Oct 2011	Hong Kong International Jazz Festival 2011
13	28 – 30 Oct 2011	Hong Kong Cricket Sixes 2011
14	1 – 4 Dec 2011	UBS Hong Kong Open Championship 2011
15	1 Jan 2012	Dragon and Lion Dance Extravaganza

Appendix A
(Cont'd)
(para. 1.4 refers)

Item	Date of event	Event title
16	23 Jan – 6 Feb 2012	Hong Kong Well-wishing Festival 2012
17	2 – 8 Jul 2012	2012 Hong Kong Dragon Boat Carnival (Note)
18	15 – 18 Nov 2012	UBS Hong Kong Open Championship 2012
19	1 Jan 2013	Dragon and Lion Dance Extravaganza 2013
20	10 – 17 and 23 Feb 2013	Hong Kong Well-wishing Festival 2013
21	21 – 23 Jun 2013	2013 Hong Kong Dragon Boat Carnival (Note)
22	29 Jul 2013	Manchester United Asia Tour 2013 (Hong Kong Leg)
23	1 Jan 2014	Dragon and Lion Dance Extravaganza 2014
24	6 – 8 Jun 2014	2014 Hong Kong Dragon Boat Carnival (Note)

Source: *TC records*

Note: *The Hong Kong Dragon Boat Carnival was a mega event, funded by the MEF, which was usually held each year a few days/weeks after the Tuen Ng Festival.*

Appendix B
(Example 7 in para. 3.13 refers)

Timetable for the repeated shows of Performance A

Date	Particulars
17 – 27 Jun 2009	11 shows held in Hong Kong
30 Jul 2009	**Organisers' submission of MEF application**
13 – 16 Aug 2009	6 shows held in Hong Kong (held in the same venue as Event G)
28 – 29 Aug 2009	2 shows held in Guangdong Province, Mainland
4 – 5 Sept 2009	2 shows held in Guangdong Province, Mainland
8 Oct 2009	**Issue of MEF letter of offer to the organisers**
5 Feb 2010	**MEF funding agreement signed**
6 Feb 2010	One show held in Macau
15 to 21 Apr 2010 (Note)	**10 shows held in Hong Kong under Event G**
23 Apr and 1 May 2010	3 shows held in Canada

Source: *TC records and Audit research*

Note: *Performance A was scheduled in the funding agreement to be staged on 8 to 14 April 2010, but the organisers had rescheduled the time schedule without informing the TC or seeking its approval.*

Appendix C
(para. 4.2 refers)

Control and monitoring mechanism of the MEF

To ensure proper monitoring of the use of the MEF and the progress of the events, the CEDB has put in place the following control measures:

(a) applicants are required to state in their applications submitted for consideration by the Assessment Committee the events' deliverables, key milestones, targets, and their methods for measuring the events' performance;

(b) the Controlling Officer may stipulate specific terms to control the use of the allocated funds and request compliance by the applicants who receive support from the MEF;

(c) the Controlling Officer has the right to decide that the approved funds be paid by installments after the organisers have achieved the pre-determined milestones;

(d) organisers are required to maintain all relevant records of the events (including procurement/tendering and staff payroll records), separate and complete books of accounts and register of equipment procured, for inspection and checking by Assessment Committee members or Government representatives as and when required. Such records are required to be kept for a period of seven years following completion of the event;

(e) Assessment Committee members or Government representatives may participate in progress review or organising committee meetings of the events, conduct visits to the relevant venues of the events and record on-site observations of visits and meetings;

(f) organisers are required to submit final audited accounts, evaluation reports, publicity reports and survey reports upon completion of the events to the satisfaction of the Assessment Committee and the Controlling Officer; and

(g) the Controlling Officer reserves the right not to disburse the outstanding funds to the organisers or reduce the amount of outstanding funds to be paid, if their performance in organising the events are not satisfactory or if the events fail to achieve the pre-determined deliverables/targets; or if they breach any funding terms and conditions as stated in the agreements.

Source: TC records

Appendix D

Acronyms and abbreviations

Audit	Audit Commission
B/Ds	Bureaux/departments
CEDB	Commerce and Economic Development Bureau
FC	Finance Committee
HAB	Home Affairs Bureau
HKTB	Hong Kong Tourism Board
ICAC	Independent Commission Against Corruption
ISD	Information Services Department
LCSD	Leisure and Cultural Services Department
LegCo	Legislative Council
MEF	Mega Events Fund
TC	Tourism Commission

CHAPTER 4

Highways Department

Tsing Yi Section of Route 8

Audit Commission
Hong Kong
4 April 2014

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. 62 of the Director of Audit contains 8 Chapters which are available on our website at http://www.aud.gov.hk

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TSING YI SECTION OF ROUTE 8

Contents

TSING YI SECTION OF ROUTE 8

Executive Summary

1. Route 8 connects Sha Tin with North Lantau. In order to alleviate the anticipated traffic congestion at Route 3 between West Kowloon and Tsing Yi, the Government decided in 1998 to construct Tsing Yi Section (connecting Cheung Sha Wan with Tsing Yi) of Route 8. The Tsing Yi Section project was implemented by the Highways Department (HyD) through awarding four works contracts, namely Contracts A, B, C and D. In addition, the HyD awarded Contract E for the installation of a traffic control and surveillance system (TCS System), and Consultant X was appointed for the design and construction supervision of the five contracts.

2. Between December 1998 and November 2008, the Finance Committee of the Legislative Council approved funding of $12,191.7 million for the design, investigation and construction of Tsing Yi Section. The 7.6-kilometre dual three-lane expressway of Tsing Yi Section was completed and open to traffic in December 2009. As of December 2013, the Government had incurred $9,926 million for the Tsing Yi Section project.

3. The construction of Tsing Yi Section was to provide an alternative route between Cheung Sha Wan and Tsing Yi, and its timely completion was important for the full commissioning of Route 8. In the event, Tsing Yi Section was completed 16 months later than the original target completion date. The Audit Commission (Audit) has recently conducted a review of the HyD's planning and implementation of Tsing Yi Section, covering Contracts A, C, D and E.

Additional time and cost under Contract A

4. Contract A mainly involved the construction of Ngong Shuen Chau (NSC) Viaduct. In April 2002, the HyD awarded Contract A to Contractor A at a contract sum of $1,538.7 million. In the event, the contract works were substantially completed in August 2007, nine months later than the original target completion

date of November 2006, at a final contract sum of $1,647.7 million, with contract sum increase mainly due to price fluctuation adjustments (paras. 1.10, 2.2 and 2.3).

5. ***Works item omitted from Bills of Quantity (BQ).*** Under Contract A, two tests were required to be carried out on completed piles, namely full-depth coring test on 5% of completed piles and proof drilling test on all completed piles. However, the BQ of Contract A only included the full-depth coring test but not the proof drilling test. Hence, Contractor A was unable to include a tender rate for the latter and eventually made a financial claim for performing the test. In the event, Contractor A was paid a sum of $32.8 million for settling his claim on the missing BQ item on proof drilling test (paras. 2.4 to 2.6).

6. ***HyD not informed before Contractor A was requested to review the piling design.*** In December 2003, the HyD and Contractor A entered into a Supplementary Agreement for implementing Contractor A's alternative-design works for NSC Viaduct to substitute part of the original works. In April 2004, during the construction stage, Consultant X requested Contractor A to review the founding levels of some piles. In order to avoid delaying the works, while conducting the piling-design review, Contractor A carried out the piling works to deeper founding levels than those certified by an Independent Checking Engineer. Subsequently, Contractor A made a financial claim for carrying out additional works to lower the pile founding levels, and was eventually paid a sum of $12 million and granted an extension of time (EOT) of 46 days for settling his claim. According to the HyD, Consultant X had not sought its comments before requesting Contractor A to review the pile founding levels (paras. 2.12 to 2.15, 2.17 and 2.19).

7. ***Inadequate consultation before including private land in contract as a temporary works area.*** Under Contract A, a piece of private land on Stonecutters Island (Lot A) was earmarked to be used as a works area by Contractor A. In April 2000, the road scheme for Tsing Yi Section was gazetted which included the proposed declaration of Rights of Temporary Occupation of Lot A as a works area. In August 2003, the owner of Lot A raised objection to the proposed temporary occupation of Lot A as a works area on the grounds that he had not been consulted on the issue since the notice gazetted in April 2000, and that the creation of a works area on his land would seriously interrupt his business operation leading to a substantial financial loss. Subsequently, the HyD made use of three nearby alternative land lots, instead of Lot A, as temporary works areas for Contract A.

In the event, Contractor A was paid a sum of $23.8 million and granted EOTs of 66 days for settling his claims for additional costs and time arising from changes in the works area (paras. 2.22 to 2.24).

8. ***Financial implications not provided for informed decision.*** In May 2002, a Traffic Management Liaison Group (TML Group) including representatives from the Transport Department (TD) and the Hong Kong Police Force (HKPF) was set up to review temporary traffic arrangements proposed by Contractor A. In August 2003, Contractor A informed the TML Group that a three-time launching scheme would be introduced for the erection works of three bridges. In December 2003, the representatives of the TD and the HKPF of the TML Group raised objection to the three-time launching scheme on the grounds of the prolonged traffic impact on West Kowloon Highway. Subsequently, after obtaining agreement of the TML Group, a two-time launching scheme was adopted. After completing the erection works for Bridge I, on the grounds that the works had no adverse traffic impact and only a few minor complaints had been received, the TML Group agreed in November 2004 that the works could be reverted back to the three-time launching scheme. In the event, Contractor A was paid a sum of $17 million and granted an EOT of 26 days for settling his claim for additional costs and time arising from the change of the three-time launching scheme to the two-time launching scheme. Audit notes that the TML Group had not been informed of the financial implications of possible contract claims arising from the change (see paras. 2.30 to 2.42).

Additional cost under Contract D

9. Contract D involved the construction of Nam Wan Tunnel and West Tsing Yi Viaduct. In April 2003, the HyD awarded Contract D to Contractor D at a contract sum of $1,479.3 million. In the event, the contract works were substantially completed in November 2007, five and a half months later than the original target completion date of May 2007, at a final contract sum of $1,699.4 million, with contract sum increase partly due to price fluctuation adjustments (paras. 1.10, 3.2 and 3.3).

10. ***Additional cost arising from different tunnel lengths for different lining thickness between BQ and Ground Investigation (GI) Drawings.*** Under Contract D, Contractor D was responsible for constructing concrete linings covering the inside surface of the twin tunnels and the cross passages of Nam Wan Tunnel. The thickness of the linings was to be determined by referring to Q-values (under

the Norwegian Geotechnical Institute System) measured in-situ on the excavated rock face. In the tender BQ, the estimated tunnel lengths for lining thickness of 400 millimetres (mm), 500 mm and 600 mm were stated at 787 metres (m) each. On the other hand, GI Drawings with estimated Q-values for different tunnel sections (provided to tenderers for reference upon request) reflected that the estimated tunnel lengths for lining thickness of 400 mm, 500 mm and 600 mm were "1,855 m", "130 m" and "320 m" respectively, differing significantly from the "787 m" stated in the tender BQ. In his tender submitted, Contractor D specified a BQ rate of $95,151/m for 400 mm tunnel linings but nil rates for both 500 mm and 600 mm tunnel linings, resulting in an estimated cost of $75 million for the tunnel lining works (paras. 3.5 to 3.8).

11. According to in-situ Q-values obtained after tunnel excavation, linings with thickness of 400 mm, 500 mm and 600 mm should have been constructed for tunnel lengths of "2,069 m", "145 m" and "147 m" respectively. However, during works implementation, Consultant X instructed Contractor D to construct linings with thickness of 400 mm, 500 mm and 600 mm for tunnel lengths of "1,157 m", "1,036 m" and "168 m" respectively, resulting in a cost of $110 million. In the event, Contractor D was paid an additional sum of $43 million for settling his claim that site instructions given to him to construct linings with thickness of 400 mm for less tunnel lengths and 500 mm and 600 mm for more tunnel lengths were at variance with contract requirements. As a result, the final cost of the concrete lining works amounted to $153 million, which was 104% higher than the original contract estimate of $75 million. Audit notes that the HyD had not identified the significant differences in tunnel lengths for different lining thickness between those stated in the BQ and those derived from the GI Drawings (see para. 10 above) during its checking of the BQ included in the tender document (paras. 3.10, 3.11, 3.14, 3.15 and 3.18).

12. ***Risk of unreasonably high BQ rate.*** Contractor D's BQ rate of $95,151/m for tunnel lining of 400 mm was three times higher than the pre-tender cost estimate of $22,000/m. However, the HyD and Consultant X had not requested Contractor D to provide reasons for submitting this unreasonably high BQ rate. Furthermore, the HyD had not assessed the financial implications of possible related contract claims and included them in the Tender Assessment Report for submission to the Central Tender Board (para. 3.20).

Provision of traffic control and surveillance system under Contract E

13. The TCS System is installed at Tsing Yi Section and Sha Tin Section of Route 8 for traffic management by the TD. The TCS System includes closed-circuit television cameras, automatic vehicle detection devices, lane control signals and variable message signs. In October 2004, the HyD awarded Contract E to Contractor E at a lump-sum-fixed price of $255 million. In the event, Contract E was substantially completed in January 2010, 17 months later than the original target completion date of August 2008, at a final contract sum of $309.2 million (paras. 4.2 and 4.7).

14. ***Long time taken to provide site access to Contractor E.*** Tsing Yi Section and Sha Tin Section of Route 8 were implemented under seven civil works contracts, which included constructing facilities related to the installation of the TCS System. The related civil works were to be completed (according to milestone dates specified in the seven works contracts) before providing the completed facilities and site access to Contractor E for carrying out the TCS System installation work. On the other hand, site access dates corresponding to the completion of the seven work contracts were specified in Contract E for Contractor E to gain access to the sites for commencing the system installation work. Owing to longer time taken in completing the related civil works vis-à-vis the original scheduled time under some works contracts, site access to most of the sites were only provided to Contractor E by phases a long time after the site access dates specified in Contract E. In the event, Contractor E was paid a sum of $52.2 million for settling his claim for additional costs arising from contract modifications and delays in providing site access to him for carrying out the TCS System installation work. Audit notes that the longer time taken in completing civil works under some works contracts had knock-on effects on the subsequent system installation work and had resulted in substantial financial claims (paras. 4.8, 4.9, 4.12 to 4.14, and 4.22).

Audit recommendations

15. **Audit recommendations are provided in the respective sections of this Audit Report. This Executive Summary only highlights the key recommendations. Audit has *recommended* that the Director of Highways should:**

(a) **take measures to ensure that HyD staff and consultants provide separate BQ items for works of different nature in the tender documents of a contract (para. 2.10(a));**

(b) **in implementing a lump-sum fixed-price contract involving a contractor's design, establish proper control procedures to require the HyD consultant to seek the HyD's comments before instructing the contractor to carry out works which may subsequently constitute works variations involving additional cost which exceeds $300,000 (para. 2.20);**

(c) **in implementing a works project in future involving the use of private land as a temporary works area, take measures to ensure that pertinent land-lot owners have been consulted and their concerns have been properly dealt with before including such land in a works contract (para. 2.28);**

(d) **in implementing a works project in future involving a change in the works procedures on the grounds of traffic considerations, provide the TML Group with the related financial implications of possible contract claims for making informed decisions (para. 2.44);**

(e) **take measures to ensure that HyD staff and consultants strengthen checking of BQ items to safeguard their completeness and accuracy, and pay particular attention to any unreasonable BQ rates (para. 3.22(a) and (b)); and**

(f) **in implementing a works project with independent system installations in future, take measures to strengthen the HyD's monitoring of the civil works completion, taking into account the knock-on effects and potential financial claims resulting from any significant delay in providing site access to a system contractor (para. 4.23(b)).**

Response from the Administration

16. The Administration agrees with the audit recommendations.

PART 1: INTRODUCTION

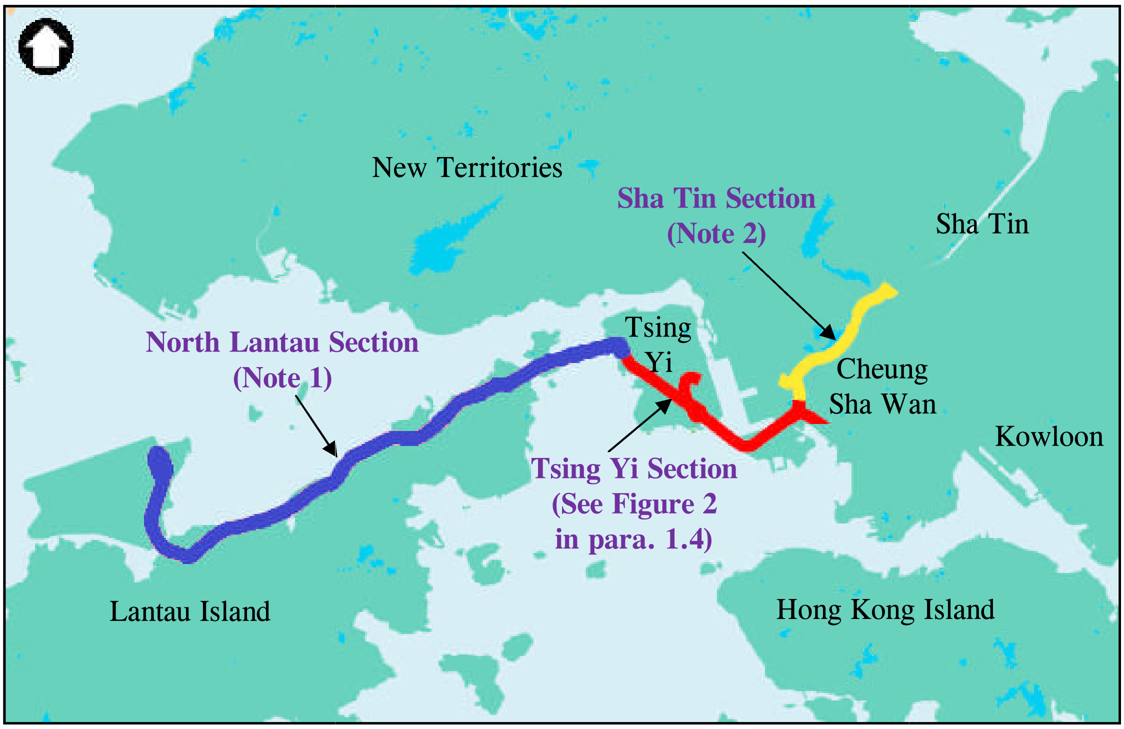
1.1 This PART describes the background to the audit and outlines the audit objectives and scope.

Route 8

1.2 Route 8 is a 27.7 kilometre (km) dual three-lane expressway connecting Sha Tin with North Lantau via Cheung Sha Wan and Tsing Yi, which was implemented by the Highways Department (HyD). It comprises three road sections, namely North Lantau Section, Tsing Yi Section and Sha Tin Section (see Figure 1).

Figure 1

Route 8



Source: HyD records

Note 1: North Lantau Section of Route 8 includes Lantau Link (comprising Tsing Ma Bridge, Ma Wan Viaduct and Kap Shui Mun Bridge) and North Lantau Highway.

Note 2: Sha Tin Section of Route 8 comprises Sha Tin Heights Tunnel and Approaches, Eagle's Nest Tunnel and Lai Chi Kok Viaduct.

1.3 North Lantau Section of Route 8 (which is 14.5 km long and comprises Tsing Ma Bridge, Ma Wan Viaduct, Kap Shui Mun Bridge and North Lantau Highway) was constructed from May 1992 to April 1997 to provide a direct road link between Tsing Yi and the Hong Kong International Airport on North Lantau. To cope with the increasing traffic demand, Tsing Yi Section and Sha Tin Section were constructed between April 2002 and November 2009 (see Table 1).

Table 1

Tsing Yi Section and Sha Tin Section of Route 8

Road section	**Road length (km)**	**Major part**	**Works commenced in**	**Works completed in**
Tsing Yi Section (from Cheung Sha Wan to Tsing Yi — see Figure 2)	7.6	Ngong Shuen Chau (NSC) Viaduct Stonecutters Bridge East Tsing Yi Viaduct Nam Wan Tunnel West Tsing Yi Viaduct	April 2002	November 2009
Sha Tin Section (from Sha Tin to Cheung Sha Wan)	5.6	Sha Tin Heights Tunnel and Approaches Eagle's Nest Tunnel Lai Chi Kok Viaduct	November 2002	December 2007

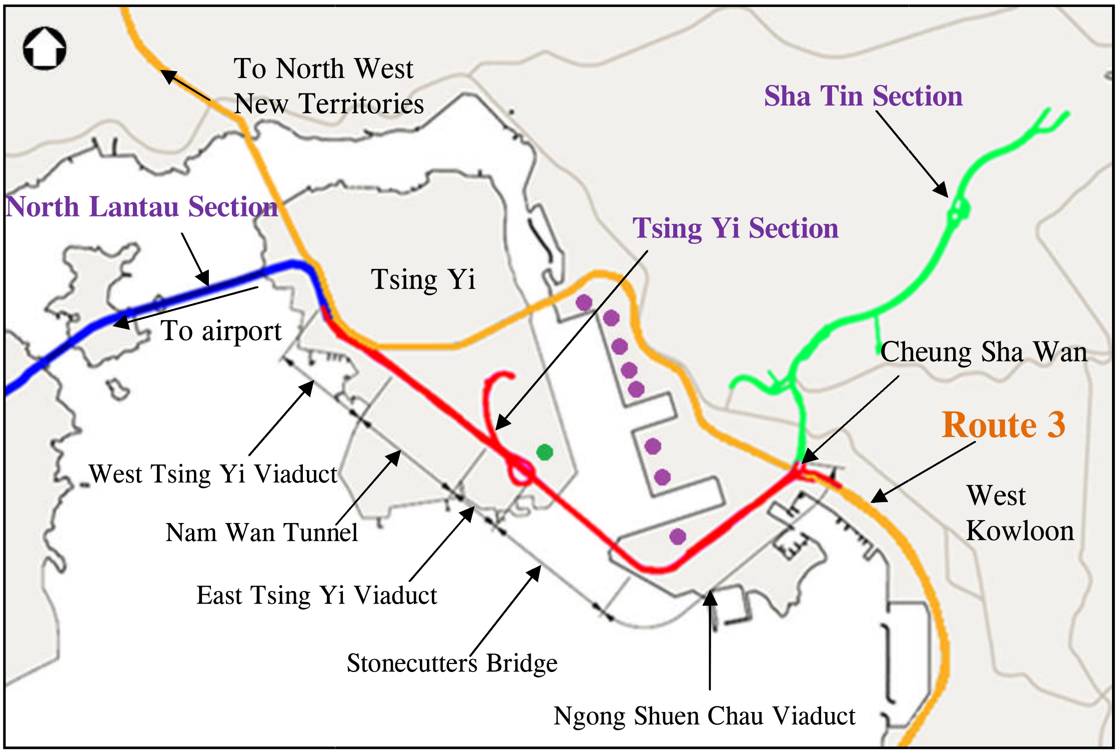
Source: HyD records

Justifications for constructing Tsing Yi Section

1.4 At the time of the opening of the Hong Kong International Airport at Chek Lap Kok in July 1998, North Lantau Section of Route 8 between Tsing Yi and North Lantau had been completed. At that time, Route 3 connecting West Kowloon with North West New Territories via Tsing Yi (see Figure 2) had also been completed and was providing a highway link to the airport on North Lantau via North Lantau Section of Route 8.

Figure 2

Tsing Yi Section of Route 8



Legend: ● Container terminals in Kwai Tsing District

● Container Terminal 9

Source: HyD records

1.5 In October 1998, the HyD completed a feasibility study for constructing Tsing Yi Section of Route 8. Based on forecast population growth in Tung Chung, Yuen Long, Tuen Mun and Tin Shui Wai, the study estimated that there would be traffic-demand growth among North West New Territories, Lantau and the urban areas, and the capacity of Route 3 between West Kowloon and Tsing Yi (comprising Tsing Kwai Highway, Cheung Tsing Tunnel and Cheung Tsing Highway) would be saturated by 2006. Therefore, with a view to alleviating the anticipated traffic congestion at Route 3 between West Kowloon and Tsing Yi, the Administration decided to construct Tsing Yi Section of Route 8 to provide an alternative route connecting Lantau Link with West Kowloon Highway at Cheung Sha Wan and provide direct access to Container Terminal 9 and container terminals in Kwai Tsing District without going through the Tsing Yi road network (see Figure 2).

1.6 Between December 1998 and November 2008, the Finance Committee (FC) of the Legislative Council approved funding of $12,191.7 million for the design and investigation, and the construction of Tsing Yi Section under two projects, namely Projects A and B (see Table 2).

Table 2

Funding approvals for Tsing Yi Section (December 1998 to November 2008)

Date	Particulars	Amount ($ million)
Design and investigation		
December 1998	Detail design and investigation	473.5
Construction works		
Project A		
July 2001	Implementing NSC Viaduct	3,650.0 (Note)
Project B		
June 2002	Implementing West Tsing Yi Viaduct, Nam Wan Tunnel, East Tsing Yi Viaduct, Stonecutters Bridge, and associated traffic control and surveillance system (TCS System)	7,468.2
November 2008	Increase in approved project estimate (APE) to meet anticipated contract-price fluctuation payments	600.0
	Total	12,191.7

Source: HyD records

Note: The works contract was awarded in April 2002 at $1,538.7 million. In view of the lower-than-estimated contract price, in 2003, the Financial Services and the Treasury Bureau imposed a ceiling of $1,946.8 million on the project estimate.

1.7 In February 1999 and March 2001, the HyD awarded two consultancies respectively for the design and construction supervision of Tsing Yi Section (see Table 3).

Table 3

Consultancies and contracts for Tsing Yi Section

Consultancy	Consultant	Cost ($ million)	Responsible for design and construction supervision (see Figure 2)
X (Awarded in February 1999)	X	105	NSC Viaduct (Contract A) East Tsing Yi Viaduct (Contract C) Nam Wan Tunnel and West Tsing Yi Viaduct (Contract D) TCS System (Contract E)
Y (Awarded in March 2001)	X (Note)	52	Stonecutters Bridge (Contract B)

Source: HyD records

Note: After conducting two separate open consultant selection exercises and obtaining approval of the Engineering and Associated Consultants Selection Board, the HyD awarded both Consultancies X and Y to Consultant X.

1.8 Between April 2002 and November 2004, the HyD awarded four works contracts and a TCS System contract to five contractors (see Table 4).

Table 4

Contracts A to E for Tsing Yi Section
(April 2002 to August 2008)

Contract	Works	Commencement date	Original contract completion date	Original contract sum ($ million)
Works contracts				
A	NSC Viaduct (2.2 km)	10.4.2002	13.11.2006	1,538.7
B	Stonecutters Bridge (1.6 km)	27.4.2004	26.6.2008	2,760.0
C	East Tsing Yi Viaduct (1.1 km)	7.12.2004	6.4.2008	1,011.9
D	Nam Wan Tunnel (1.2 km) and West Tsing Yi Viaduct (1.5 km)	23.4.2003	23.5.2007	1,479.3
TCS System contract				
E	TCS System (Note)	12.10.2004	8.8.2008	255.0
			Total	7,044.9

Source: *HyD records*

Note: *Under Contract E, the TCS System was implemented for both Tsing Yi and Sha Tin Sections and the system cost was to be shared between the two road projects.*

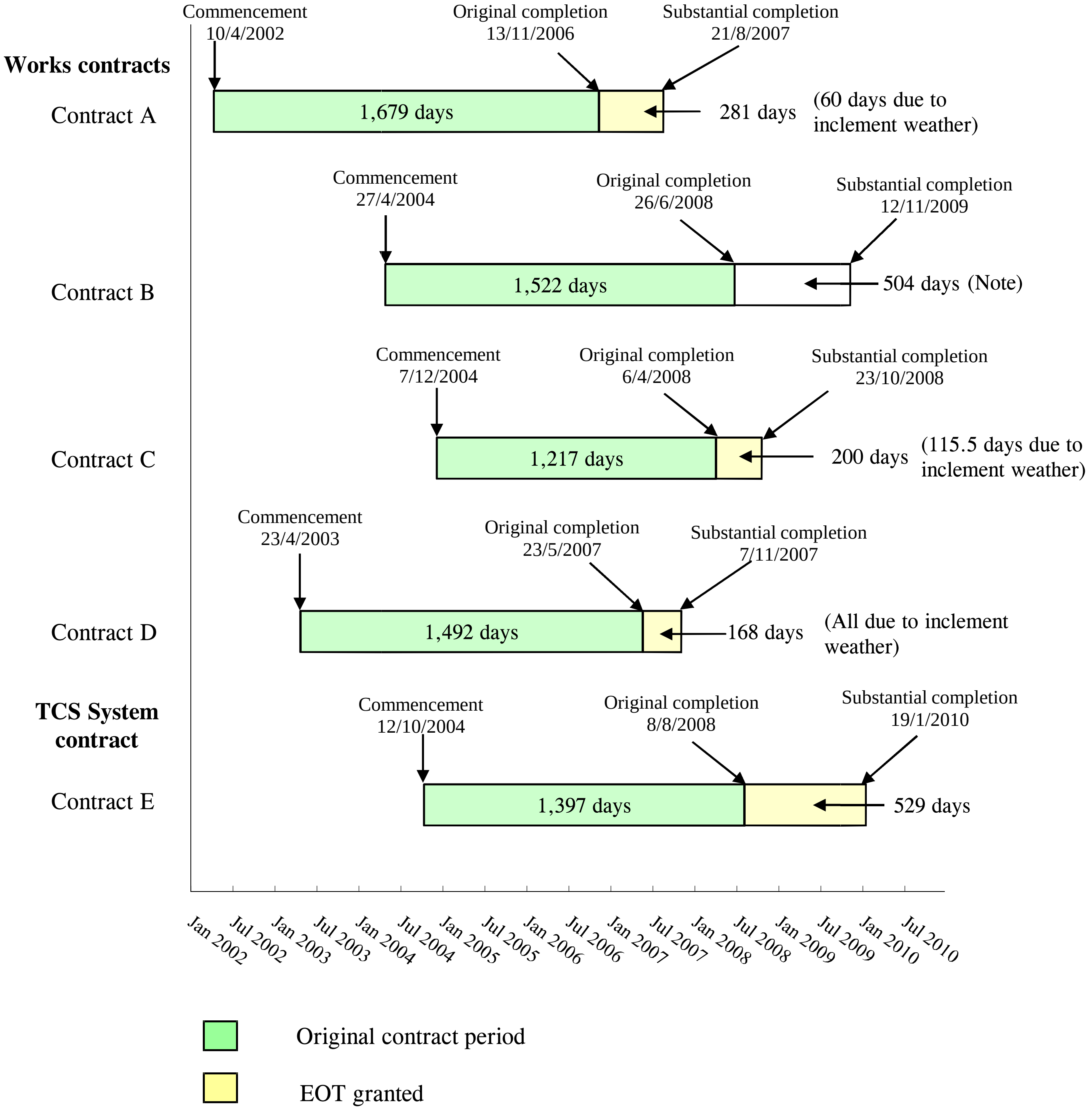
Completion of Tsing Yi Section

1.9 Contracts A to D were substantially completed between August 2007 and November 2009 and the TCS System under Contract E was completed in December 2009 (Note 1), where Tsing Yi Section of Route 8 was opened to traffic on 20 December 2009. The time of completion of the five contracts had been extended (see Figure 3), resulting in prolongation costs and delays in relieving the traffic load on Route 3 between Tsing Yi and Cheung Sha Wan. In the event, the Tsing Yi Section was commissioned in December 2009, 16 months later than the original completion date in August 2008. The contractors were granted extensions of time (EOTs) for completion of works due to various reasons, including inclement weather.

Note 1: *The TCS System under Contract E was completed on 19 December 2009. The system underwent an operability test for a month before the substantial contract completion on 19 January 2010.*

Figure 3

Time of completing Contracts A to E (April 2002 to January 2010)



Source: *HyD records*

Note: *Contract B was substantially completed in November 2009. As of February 2014, the EOTs and the account of Contract B had not been finalised.*

Cost of Tsing Yi Section

1.10 As of December 2013:

(a) $9,926 million (81.4%) of the APE totalling $12,191.7 million for Tsing Yi Section had been incurred;

(b) the accounts of Contracts A, C, D and E had been finalised (see Table 5); and

(c) the account of Contract B had not been finalised, where the HyD and Contractor B were negotiating over outstanding contract issues.

Of the $9,926 million in (a) above, $8,336.1 million (84%) related to expenditures for Tsing Yi Section under Contracts A to E (see Note 4 to Table 5). The remaining $1,589.9 million (16%) covered the following items:

Item	**Amount ($ million)**
Resident site staff costs	1,006.0
Consultancy fees to Consultant X	215.0 (Note)
Project insurance premium	84.0
Other works carried out by government departments	96.0
Miscellaneous costs	188.9
Total	1,589.9

Note: In addition to $157 million under Consultancies X and Y (see Table 3 in para. 1.7), Consultant X was paid $58 million for other consultancy services, such as supervising the conduct of site investigations.

Table 5

Contract sums of Contracts A to E (December 2013)

Contract	Original contract sum (a) ($ million)	Final/ Up-to-date contract sum (b) ($ million)	Increase in contract sum (c) = (b) − (a) ($ million)	Contract sum increase due to price fluctuation adjustment (Note 1) (d) ($ million)	Increase/ (Decrease) after price fluctuation adjustment (e) = (c) − (d) ($ million)
A	1,538.7	1,647.7	109.0 (7%)	115.0 (7%)	(6.0)
B	2,760.0	3,669.2 (Note 2)	909.2 (33%)	754.5 (27%)	154.7
C	1,011.9	1,183.6	171.7 (17%)	69.9 (7%)	101.8
D	1,479.3	1,699.4	220.1 (15%)	95.3 (6%)	124.8
E (Note 3)	255.0	309.2	54.2 (21%)	—	54.2
Total	7,044.9	8,509.1 (Note 4)	1,464.2 (21%)	1,034.7 (15%)	429.5

Source: HyD records

Note 1: The original contract sums of Contracts A to D already included provisions for price fluctuation adjustments. These are additional sums to cover excessive price fluctuation adjustments.

Note 2: As of February 2014, the account of Contract B had not been finalised. Hence, this was the up-to-date contract sum.

Note 3: Contract E did not include a provision for price fluctuation adjustments. Furthermore, $173 million of the final contract sum of $309.2 million was funded under the works project of Sha Tin Section.

Note 4: Of the $8,509.1 million, $8,336.1 million related to Tsing Yi Section and $173 million related to Sha Tin Section (see Note 3).

Audit review

1.11 Tsing Yi Section of Route 8 is one of the major road projects implemented by the HyD. Its objective is to provide an alternative route between Cheung Sha Wan and Tsing Yi, and its timely completion was important for the full commissioning of Route 8. In the event, Tsing Yi Section was completed 16 months later than the original completion date (see para. 1.9).

1.12 The Audit Commission (Audit) has recently conducted a review of the HyD's planning and implementation of Tsing Yi Section. This review mainly covered Contracts A, C, D and E, but not Contract B, because at the time of conducting this review, the account of Contract B had not been finalised. No major audit observations under Contract C were noted (see Appendix A for major cost components).

1.13 The following audit issues relating to Contracts A, D and E were examined:

(a) additional time and cost under Contract A (PART 2);

(b) additional cost under Contract D (PART 3); and

(c) provision of a traffic control and surveillance system under Contract E (PART 4).

Audit has found that there are areas where improvements can be made by the HyD in implementing similar road projects in future, and has made a number of recommendations to address the issues.

Acknowledgement

1.14 Audit would like to acknowledge with gratitude the full cooperation of the staff of the HyD, the Transport Department (TD), the Hong Kong Police Force (HKPF), and the Lands Department (Lands D) during the course of the audit review.

PART 2: ADDITIONAL TIME AND COST UNDER CONTRACT A

2.1 This PART examines the causes of granting EOTs and additional costs to Contractor A under Contract A. The following audit issues were examined:

(a) omission of a Bills of Quantity (BQ — Note 2) item (paras. 2.4 to 2.11);

(b) additional piling works (paras. 2.12 to 2.21);

(c) changes of works areas (paras. 2.22 to 2.29); and

(d) changes of bridge-deck erection arrangements (paras. 2.30 to 2.46).

Contract A

2.2 Contract A was a remeasurement contract (Note 3) covering the construction of NSC Viaduct (see Photograph 1) and its slip roads, the realignment of Container Port Road South (CPS Road — Note 4) underneath NSC Viaduct on Stonecutters Island, and civil works associated with the TCS System.

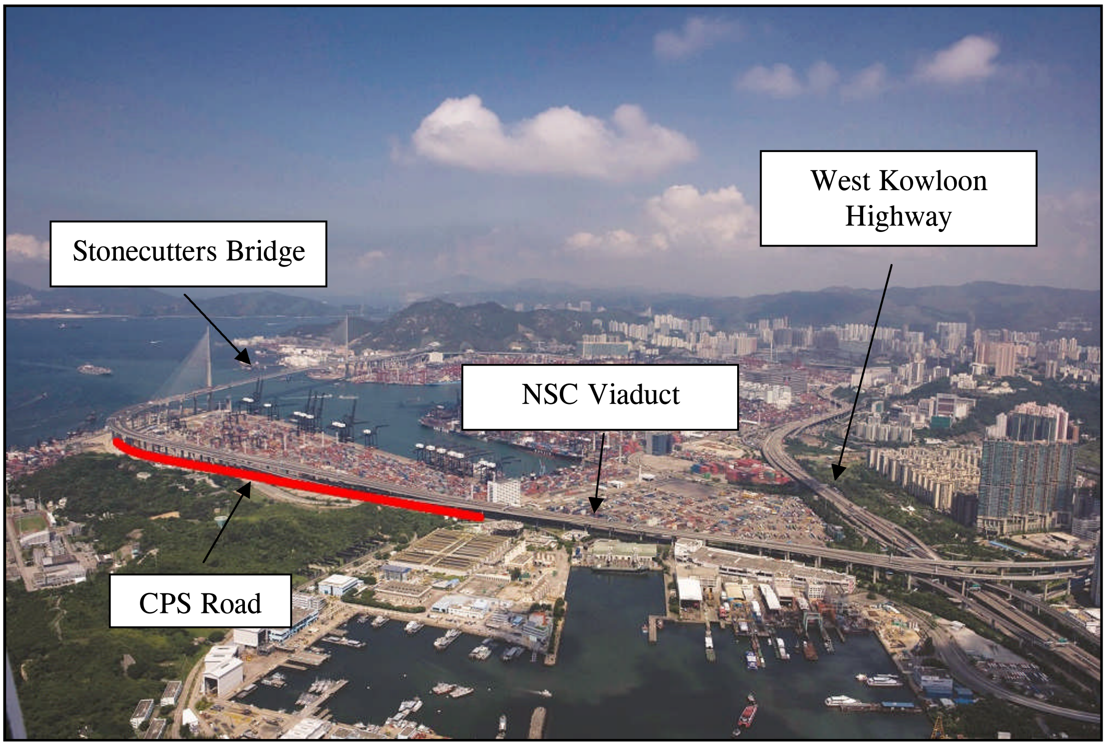
Note 2: *Under a remeasurement contract, a BQ, which forms part of the tender documents and subsequently the contract documents after the award of a contract, contains estimated quantities of various works items. A tenderer needs to provide a tender price for the relevant BQ items. For the successful tenderer, the BQ prices would be used for valuing the actual work performed.*

Note 3: *Under a remeasurement contract, the costs of works are based on the actual quantities of works done and the prices of different works items as stated in the BQ of the contract.*

Note 4: *CPS Road originally was a road with some bends (see Figure 4 in para. 2.22). For the purpose of improving land utilisation, CPS Road was re-aligned underneath NSC Viaduct under Contract A.*

Photograph 1

NSC Viaduct



Source: HyD records

2.3 After conducting a prequalification exercise (Note 5) and a tender exercise, the HyD awarded Contract A to Contractor A in April 2002 at a contract sum of $1,538.7 million. The works commenced in April 2002 and were scheduled for completion in November 2006. Consultant X was the Engineer responsible for supervising the contract works. In the event, the contract works were substantially completed in August 2007, nine months later than the scheduled completion date (Note 6). Contract A account was finalised in December 2009 and the final contract sum was $1,647.7 million (see Table 6).

Note 5: *According to Works Branch Technical Circular No. 15/1994, the responsible Government department needed to invite eligible contractors to apply for prequalification assessments for undertaking a works contract of an unusually high value and special technicality. The prequalified contractors would then be invited to submit tenders for the contract.*

Note 6: *Owing to inclement weather, EOTs of 60 days were granted to Contractor A.*

Table 6

Final contract sum of Contract A (December 2009)

Particulars	Amount ($ million)	Amount ($ million)
1. Contract works completed	443.3	
2. Payment for contract price fluctuation	235.0	
3. Alternative-design works completed under Supplementary Agreement (SA) 1 (Note 1)	851.0	
4. Alternative-design works completed under SA2 (Note 2)	17.6	
Total works completed		1,546.9
Payments for settling contract claims		
5. Claims related to an omitted BQ item ($32.8 million — see paras. 2.4 to 2.11) and additional piling works ($12 million — see paras. 2.12 to 2.21) settled under SA3	44.8	
6. Claims related to changes of works areas (see paras. 2.22 to 2.29)	23.8	
7. Claims related to changes of bridge-deck erection arrangements (see paras. 2.30 to 2.46)	17.0	
8. Other claims (Note 3)	15.2	
Total claims		100.8
Final contract sum		1,647.7

Source: HyD records

Note 1: In December 2003, the HyD and Contractor A entered into SA1, under which Contractor A's alternative design and construction of some piles and superstructures of NSC Viaduct at a fixed cost of $851 million would replace the corresponding contract works of $876 million, with a saving of $25 million.

Note 2: In April 2007, the HyD and Contractor A entered into SA2, under which Contractor A's alternative design for waterproofing works for the viaduct bridge-decks at a fixed cost of $17.6 million would replace the corresponding contract works of $23.2 million, with a saving of $5.6 million.

Note 3: Other claims mainly included costs relating to additional traffic management requirements for parapet construction ($6.8 million) and changes of parapet types ($3.7 million).

Omission of a BQ item

2.4 According to Contract A, the following two tests were required to be carried out on completed piles:

(a) a full-depth coring test (Note 7) on 5% of the completed piles to verify their structural integrity; and

(b) a proof drilling test (Note 7) on all completed piles to ascertain whether they were founded on bedrock.

2.5 In the BQ of Contract A, a BQ item for the "core test" was included. According to Contractor A:

(a) the nature of the full-depth coring test and the proof drilling test was different; and

(b) owing to the omission of a BQ item for the proof drilling test in the BQ, he was unable to include a tender rate for that test although the test was required to be carried out under Contract A.

Hence, Contractor A made a claim for the costs of performing the proof drilling test which had not been specified as a BQ item. On the other hand, Consultant X considered that the full-depth coring test and the proof drilling test were variations of the same type of test and should be paid for under the BQ item for the "core test".

Contractor A's claim

2.6 In September 2006, after obtaining legal advice and the Financial Services and the Treasury Bureau (FSTB)'s approval, the HyD and Contractor A entered into SA3 (see item 5 in Table 6), under which Contractor A was paid a settlement sum

Note 7: *Under the full-depth coring test, samples of completed piles are tested at an approved laboratory for ascertaining their strength. Under the proof drilling test, samples of completed piles are inspected on site to ascertain whether they are founded on the bedrock.*

of $44.8 million ($32.8 million related to the missing BQ item on proof drilling test and $12 million related to additional piling works — see paras. 2.12 to 2.21), and was awarded an EOT of 46 days related to additional piling works.

2.7 In March 2014, the HyD informed Audit that:

(a) Consultant X did not include a BQ item for the proof drilling test because he considered that the related works should be paid for under the BQ item for the "core test"; and

(b) subsequent to Contractor A's claim, separate BQ items for the proof drilling test had been included in Contracts B and C.

Areas for improvement

Works item omitted from BQ

2.8 Audit notes that full-depth coring and proof drilling tests (see para. 2.4 (a) and (b)) are works of different nature in terms of their scope and methodology, and serve different purposes. Therefore, two separate BQ items should have been provided for them. Audit considers that the HyD needs to take measures to ensure that separate BQ items for works of different natures are provided in the tender documents of a contract.

2.9 The proof drilling test should not have been omitted from the BQ of Contract A. After the award of Contract A in April 2002, in the light of a similar Audit finding on omitted BQ items as reported in Chapter 3 of the Director of Audit's Report No. 53 of October 2009, the Civil Engineering and Development Department amended the Project Administration Handbook for Civil Engineering Works in July 2010 to require works departments to keep omitted items to an absolute minimum through proper preparation of BQs and contract documents, and require the Engineer of a contract to provide the Government with reasons justifying the acceptance of omitted items and the basis of his valuation. Audit considers that the HyD needs to take measures to ensure compliance with this requirement. This would help minimise contract claims and disputes, and enhance competitive tendering.

Audit recommendations

2.10 **Audit has *recommended* that, in implementing a works project in future, the Director of Highways should take measures to ensure that HyD staff and consultants:**

(a) **provide separate BQ items for works of different nature in the tender documents of a contract; and**

(b) **include all works items in the BQ of the contract as far as practicable.**

Response from the Administration

2.11 The Director of Highways agrees with the audit recommendations. He has said that:

(a) the HyD will remind its staff and consultants to provide separate BQ items for works of different nature where appropriate; and

(b) the HyD has followed the guidelines in the Project Administration Handbook for Civil Engineering Works promulgated in July 2010 requiring works departments to keep omitted items to an absolute minimum through proper preparation of BQs and contract documents, and require the Engineer of a contract to provide the HyD with reasons justifying the acceptance of omitted items and the basis of his valuation. The HyD has included the requirements in its quality management manual. The HyD will remind its staff and consultants to keep omitted items to an absolute minimum through proper preparation of BQs.

Additional piling works

2.12 In early 2003, Contractor A proposed an alternative viaduct design for NSC Viaduct, which would substitute part of the original works, including some bored piles and support works, superstructures and associated drainage ducts and railing works. Under the alternative design, the number of bored piles to be constructed would be reduced from 585 to 413, and the related BQ cost of works of

$876 million under the original design would be replaced by a lump-sum-fixed price of $851 million (with a saving of $25 million). In December 2003, the HyD and Contractor A entered into SA1 for implementing the alternative-design works (see item 3 in Table 6).

2.13 According to SA1, Contractor A needed to employ an Independent Checking Engineer (ICE) to check the alternative design and issue check certificates to Consultant X certifying that the works designs were in compliance with the terms and conditions of Contract A. According to Contractor A, the alternative design for the piling works was based on the relevant Government standards and the geological information available. In March 2004, Consultant X approved the check certificate issued by the ICE on the design principles for the pile foundation.

2.14 In April 2004, during the construction stage, in view of some available geological information, Consultant X wrote to Contractor A expressing concerns over the piling works and requested Contractor A to review the piling designs of 96 piles and to resubmit a design certified by the ICE for Consultant X's consent. According to Contractor A:

(a) to avoid delaying the works, he had continued with the piling works of the 96 piles to founding levels deeper than those certified by the ICE while reviewing the design of the piles to address Consultant X's concern;

(b) after noting that the rock samples extracted were inferior, Consultant X also issued verbal site instructions requesting him to lower the founding levels of the remaining 317 piles (413 minus 96 piles); and

(c) the lowering of the founding levels of the piles (see (a) and (b) above) was additional works and he had requested Consultant X to issue a Variation Order (VO) for the works, but Consultant X did not do so.

Contractor A's claim

2.15 Contractor A subsequently made a claim that he had incurred extra time and additional costs for lowering the founding levels of the piles than actually required. In response to the HyD's enquiries, Consultant X said that:

(a) he, as the Engineer of Contract A, was required under the contract to satisfy himself that the proposed founding levels of the piling works were adequate;

(b) it was Contractor A's own decision to revise the founding levels; and

(c) the cost of the additional piling works was deemed to have been included in the lump-sum-fixed price of SA1, and therefore he did not issue a VO for the works.

2.16 In March 2014, the HyD informed Audit that, according to site records, of the total 413 piles involved under SA1 (see para. 2.12):

(a) the founding levels of 86 piles were 0.5 m to 11 m deeper than the original certified founding levels; and

(b) the founding levels of the remaining 327 piles were less than 0.5 m deeper than the original certified founding levels, which were within the usual range of variations for such works.

2.17 After obtaining legal advice, the HyD agreed that the lowering of the founding levels of 86 piles might constitute "deemed" variations. In this connection, Contractor A submitted calculations demonstrating that the original piling design was in line with Contract A requirements. After obtaining the FSTB's approval in July 2006, the HyD negotiated with Contractor A to settle the claim on the issue. In September 2006, the HyD and Contractor A entered into SA3 to settle this claim and another claim (see paras. 2.4 to 2.11), under which Contractor A was awarded a payment of $12 million and an EOT of 46 days for his claim on additional piling works (see item 5 in Table 6 and para. 2.6).

Areas for improvement

HyD not informed before Contractor A was requested to review the piling design

2.18 Under SA1, Contractor A was responsible for implementing works under the alternative design which was subject to independent checking and certification by an ICE. The alternative design also formed the basis for determining the lump-sum-fixed price of SA1. However, according to Contractor A, Consultant X had requested Contractor A to review the founding levels of 96 piles and verbally commented on the founding levels of 317 piles. According to the HyD, the lowering of the founding levels of 86 piles (see para. 2.17) might constitute "deemed" variations, resulting in a payment of $12 million and the grant of an EOT of 46 days to Contractor A.

2.19 According to Project Administration Handbook for Civil Engineering Works, for works variations estimated to exceed $300,000 in value, the Engineer of a consultant-managed contract should seek prior approval from the responsible Government department. In March 2014, the HyD informed Audit that:

(a) in response to Consultant X's requests for Contractor A to review the founding levels of the 96 piles, in order to avoid disruption to the works, Contractor A took action to found the piles at deeper levels while conducting the review;

(b) it was not clear, at the time of executing the piling works, whether Contractor A's choice to lower the founding levels while conducting the piling review was actually a variation to the requirements under SA1; and

(c) the HyD only realised that the request for Contractor A to review the piling design and the various verbal comments made by Consultant X on the founding levels should be considered as "deemed" variations after seeking legal advice in the process of negotiation with Contractor A on settling the related claim.

According to the HyD, Consultant X had not sought the HyD's comments before requesting Contractor A to review the pile founding levels, which subsequently led to an additional contract cost. In Audit's view, for a lump-sum fixed-price contract involving a contractor's design, some of the Engineer's comments relating to such works may have cost implications. The HyD needs to establish proper control procedures to require its consultants to seek its comments before requesting a contractor to take any action which may subsequently constitute works variations involving additional cost which exceeds $300,000.

Audit recommendation

2.20 **Audit has *recommended* that the Director of Highways should, in implementing a lump-sum fixed-price contract involving a contractor's design, establish proper control procedures to require the HyD consultant to seek the HyD's comments before instructing the contractor to carry out works which may subsequently constitute works variations involving additional cost which exceeds $300,000.**

Response from the Administration

2.21 The Director of Highways agrees with the audit recommendation.

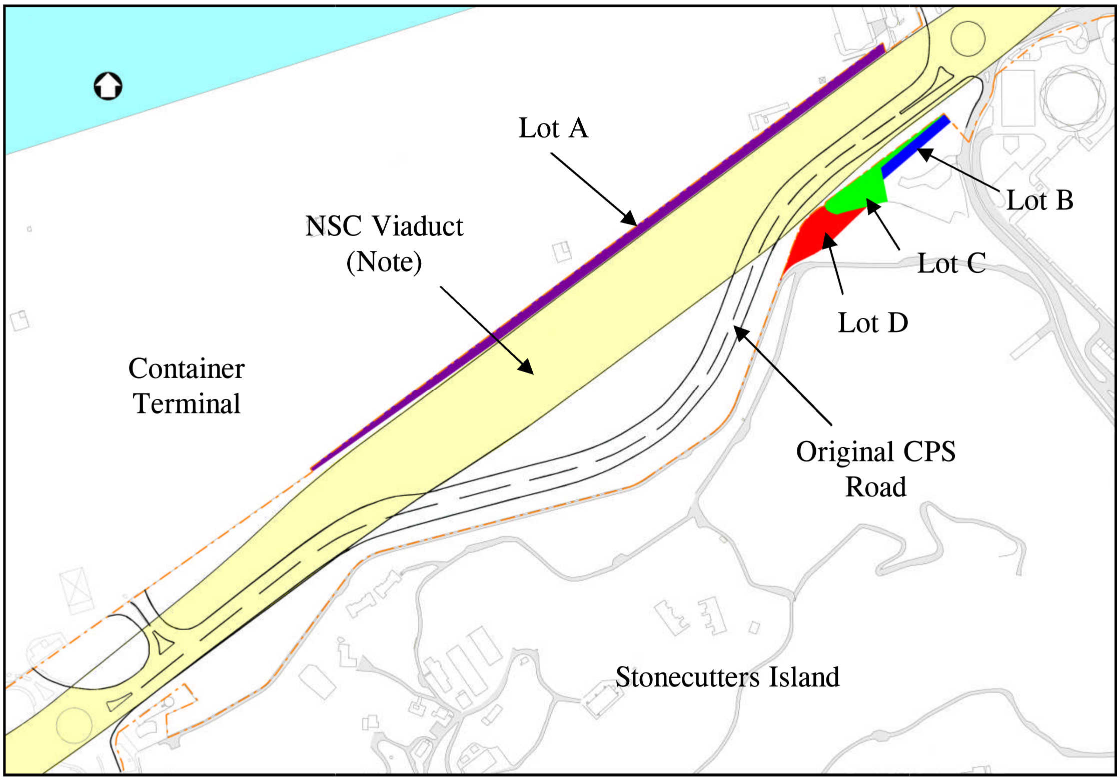
Changes of works areas

Designating private land as a works area

2.22 Under the works design of Contract A, a piece of private land of 4,660 square metres (m^2) on Stonecutters Island (Lot A — see Figure 4) owned by a private company (Company A) was earmarked to be used as a works area by Contractor A.

Figure 4

Works areas along CPS Road



Legend: — · — Works site of Contract A

Lot A of 4,660 m^2

Lot B of 450 m^2

Lot C of 1,600 m^2

Lot D of 1,800 m^2

Source: *HyD records*

Note: *Re-aligned CPS Road was constructed underneath NSC Viaduct to replace original CPS Road.*

Additional time and cost under Contract A

2.23 In April 2000, the HyD took actions to inform the public and stakeholders of the road scheme for Tsing Yi Section under the Roads (Works, Use and Compensation) Ordinance (Roads Ordinance — Cap. 370), including the proposed designation of Lot A as a works area. A chronology of key events is shown in Table 7.

Table 7

Chronology of key events of designating private land as a works area (April 2000 to February 2004)

Date	Event
April 2000	A notice was published in the gazette regarding the proposed road scheme for Tsing Yi Section under the Roads Ordinance, which included the proposed declaration of Rights of Temporary Occupation (Note 1) of Lot A as a works area. Under the Ordinance, the HyD deposited a copy of the road scheme in the Land Registry, published the gazette notice in one local Chinese and one English newspaper, affixed copies of the plan in prominent places, including a place near the entrance to Lot A, and provided the Kwai Tsing District Council with a copy of the plan.
June 2000	Within 60 days after the notice was first gazetted in April 2000, the HyD did not receive any objections on the designation of Lot A as a works area (Note 2).
September 2000	The road scheme was approved by the Secretary for Transport under the Roads Ordinance.
April 2002	Contract A was awarded in which Lot A was indicated as a works area.
July 2003	Contractor A informed Consultant X that he had planned to use Lot A as a temporary road to divert traffic from CPS Road during the construction of NSC Viaduct.

Table 7 (Cont'd)

Date	Event
July 2003	The Lands D gazetted a notice for the creation of Rights of Temporary Occupation of Lot A from 1 November 2003 to 31 December 2006, and served the notice on Company A.
August 2003	Company A (which had not raised objections during the gazettal of the road scheme) raised objection to the proposed temporary occupation of Lot A as a works area on the following grounds: (a) it had not been consulted on the proposal since the first notice gazetted in April 2000; and (b) using Lot A as a temporary road with heavy vehicular traffic would adversely affect the facilities located underneath the area, and would seriously interrupt the company's operation thus inducing a substantial financial loss, which would not be adequately covered by compensation provided in the Roads Ordinance (Note 3).
February 2004	After obtaining the consent of the occupiers of Lots B, C and D (see Figure 4), the HyD was allowed to make use of the three land lots to form a temporary road to divert traffic on part of CPS Road during the construction of NSC Viaduct. Consultant X issued a VO to Contractor A on implementing revised Temporary Traffic Arrangements using Lots B, C and D.

Source: HyD records

Note 1: Under the Roads Ordinance, the Secretary for Transport and Housing may declare Rights of Temporary Occupation of a piece of private land for the purpose of carrying out road works.

Note 2: Under the Roads Ordinance, a person may raise objection to proposed works or proposed use of land within 60 days from the publication of a gazette notice.

Note 3: Under the Roads Ordinance, any person having an interest in a piece of land being declared for Rights of Temporary Occupation may claim for compensation, which is the amount of an open market value of the right during the period of easement. In the event of a dispute, the case can be referred to the Lands Tribunal for settlement.

Contractor A's claim

2.24 The traffic-diversion arrangements on CPS Road took place from April 2004 to November 2006. Between October 2003 and March 2005, Contractor A made claims for EOTs and additional payments on the grounds of the changes in the provision of the works area from Lot A to Lots B, C and D. In the event, Contractor A was granted EOTs of 66 days and additional payments totalling $23.8 million (see item 6 in Table 6 in para. 2.3) for settling the related claims, including:

(a) an EOT of 47 days, a prolongation cost of $10.3 million and an additional payment of $6.5 million for additional site formation and pavement works owing to the changes in the works area;

(b) an additional payment of $2.9 million for the return of one of the alternative works areas to the occupier before completion of the related works, as additional resources were required to be deployed to re-prioritise the works; and

(c) an EOT of 19 days and a prolongation cost of $4.1 million for the permanent diversion of two water mains under the temporary road.

Areas for improvement

Inadequate consultation before including private land in contract as a temporary works area

2.25 Audit notes that the HyD complied with the requirements of the Roads Ordinance to gazette the road scheme for Tsing Yi Section in April 2000, including the proposed declaration of Rights of Temporary Occupation of Lot A as a works area. The HyD also affixed copies of the road scheme in prominent places within the areas delineated in the plan (see Table 7 in para. 2.23). However, in August 2003, after the Lands D had gazetted a notice for the creation of Rights of Temporary Occupation of Lot A and served the notice on Company A (the owner of Lot A), the latter raised objection to the proposed temporary occupation of Lot A as a works area. According to Company A, it had not been consulted on the proposed temporary occupation of Lot A, the proposed use of Lot A as a temporary road would adversely affect the underground facilities in the area, and it would suffer a substantial financial loss owing to disruption to the company's business during the land occupation period. In the event, the HyD took actions to make use of Lots B, C and D as temporary works areas for the purpose. However, because of the changes in the works area, Contractor A was granted an EOT of 66 days and an additional payment of $23.8 million.

2.26 According to Company A, it had not been consulted about the proposed designation of Lot A as a temporary works area for Contract A between April 2000 (when the Tsing Yi Section road plan was first gazetted) and July 2003 (when the Lands D served the notice on it about the creation of Rights of Temporary Occupation of Lot A). In Audit's view, had the HyD consulted the owner of Lot A before the award of Contract A in April 2002, it might have chosen other areas (such as Lots B, C and D) instead of Lot A for inclusion in Contract A as the works area, because the owner of Lot A would have informed the HyD about the presence of underground facilities in the area and its financial loss arising from the HyD's temporary use of Lot A as a temporary road. The lack of direct consultation with the private-land owner before including a piece of private land in Contract A as a temporary works area led to subsequent changes in the works area and resulted in additional contract time and payment.

2.27 In this connection, the "Guideline on public consultation and engagement for works projects" issued by the HyD in August 2010 (eight years after the award of Contract A in April 2002) requires HyD staff and consultants to conduct consultation with the pertinent individuals (including private-land owners) through arrangements of the District Offices of the Home Affairs Department during the planning and design stages of a road project. In Audit's view, in implementing a works project in future involving using private land as a temporary works area, the HyD needs to take measures to ensure that pertinent land-lot owners have been consulted and their concerns have been dealt with before including such land in a works contract.

Audit recommendation

2.28 **Audit has *recommended* that, in implementing a works project in future involving the use of private land as a temporary works area, the Director of Highways should take measures to ensure that pertinent land-lot owners have been consulted and their concerns have been properly dealt with before including such land in a works contract.**

Response from the Administration

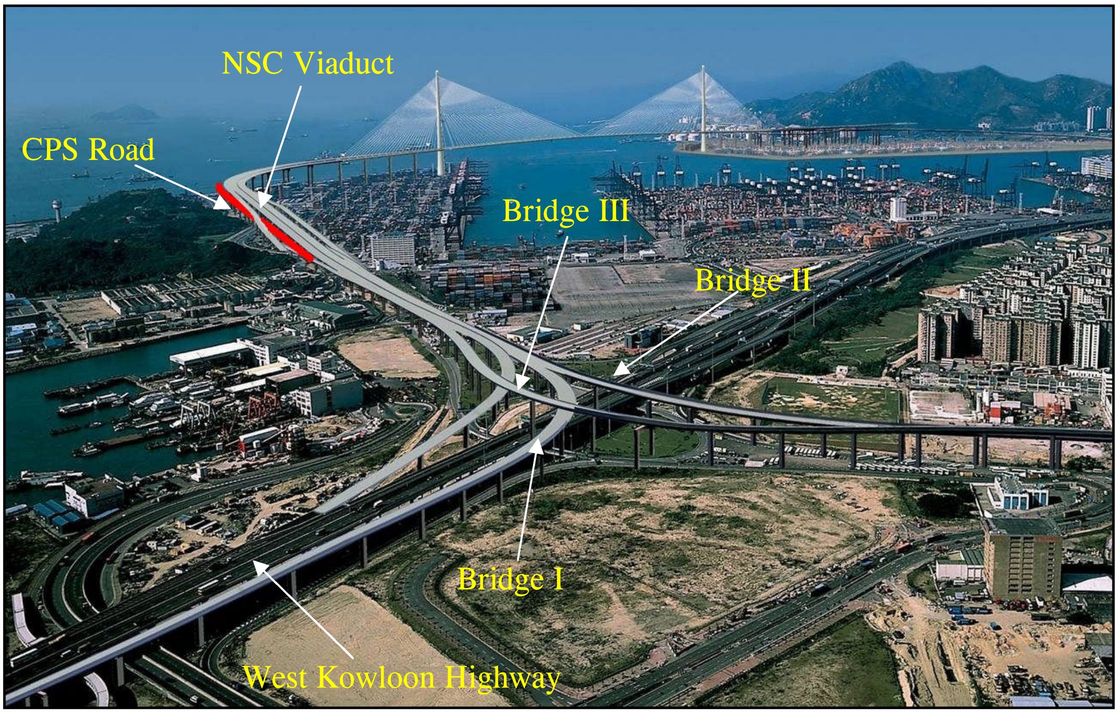
2.29 The Director of Highways agrees with the audit recommendation.

Changes of bridge-deck erection arrangements

2.30 Contract A included the construction of three bridges (namely Bridges I, II and III) which span over West Kowloon Highway linking to the NSC Viaduct (see Figure 5).

Figure 5

Bridges I, II and III



Source: HyD records

Guidelines on Traffic Impact Assessment

2.31 Under the "Guidelines on Traffic Impact Assessment (TIA) and Day-time Ban Requirements for Road Works on Traffic Sensitive Routes" issued by the HyD in July 1995, HyD staff and consultants should, during the planning stage of a road project:

(a) assess the anticipated traffic implications of carrying out the works; and

(b) devise appropriate temporary traffic management measures to ameliorate the traffic impact of the road works.

2.32 For a project affecting traffic, during the design stage, the HyD needs to conduct a TIA and submit a TIA report with a proposed temporary traffic management scheme to the relevant parties, including the TD and the HKPF, for comment. During the construction stage, a Traffic Management Liaison Group (TML Group — Note 8) would be set up for the project to review and provide comments on the temporary traffic arrangements proposed by a contractor based on the prevailing/projected traffic conditions and with due consideration of road safety.

Temporary Traffic Management scheme

2.33 In November and December 2000, in the TIA report and Temporary Traffic Management scheme report submitted to the HyD and circulated to the TD and the HKPF, Consultant X proposed that:

(a) temporary traffic arrangements should be made for the bridge-deck erections for Bridges I, II and III;

(b) as an option, segments of the decks of Bridges I, II and III might be launched separately;

Note 8: *A TML Group for a road project usually comprises representatives from the TD, the HKPF, the HyD, the Engineer, the Contractor, the relevant District Offices and various public transport operators.*

(c) the launching operations of bridge-decks, which would be carried out after mid-night and before 6:30 am, would affect West Kowloon Highway for 39 nights; and

(d) the actual implementation programme would be developed by the contractor to tie in with his preferred construction method and works programme.

2.34 In May 2002, the TML Group for Contract A was set up. In August 2003, Contractor A informed the TML Group that the erection of the decks of the three bridges would be carried out one after the other in three times (three-time launching scheme) using one launching girder from 10:30 pm to 5:30 am for about 7.5 months with West Kowloon Highway partially closed for traffic for 41 nights and fully closed for 9 nights (totally 50 nights). During the partial and full closure of West Kowloon Highway, vehicular traffic would be diverted to other roads.

2.35 At the TML Group meeting held in December 2003, the TD and the HKPF representatives raised objection to the three-time launching scheme proposed by Contractor A because of the prolonged traffic impact on West Kowloon Highway. They requested Contractor A to explore the viability of reducing the number of bridge-deck erection works from three times to two times (two-time launching scheme). At the same meeting, Contractor A informed the TML Group that the three-time launching scheme would be the best arrangement and beneficial to the overall progress of the project. In response, the TML Group said that, as the Group would dominantly focus on the impacts, disruptions and public safety related to the temporary traffic arrangement scheme, all other contractual issues without jeopardizing public interest were outside the TML Group's jurisdiction.

2.36 At the TML Group meeting held in January 2004, Contractor A submitted and the TML Group agreed in principle to a revised temporary traffic management scheme involving a two-time launching scheme. Under the two-time launching scheme, the bridge-deck erection works for Bridges II and III would be carried out at the same time.

2.37 In February 2004, Consultant X informed the TD and the HKPF that:

(a) the proposed two-time launching scheme would cause less inconvenience to the public and road users, because West Kowloon Highway would be partially closed for traffic for 33 nights and fully closed for 8 nights only (totally 41 nights); and

(b) however, this scheme would cause a one-month delay to the completion of the project, and a similar delay to the completion of the re-aligned CPS Road, which aimed to provide relief to the traffic congestion in container port area.

2.38 At a meeting held in March 2004:

(a) Consultant X advised the TD and the HKPF that the two-time launching scheme would cause some delays to the completion of Bridges II and III and would defer the commissioning date of the road link between West Kowloon Highway and CPS Road;

(b) Consultant X also pointed out that according to a study, closure of West Kowloon Highway would result in extra journey time of about three to four minutes for affected vehicles;

(c) the TD raised reservations on the study results and requested Consultant X to substantiate the study findings; and

(d) Consultant X advised that two-time launching would require additional resources which might not be readily available in the market, including another rescue team for handling emergencies.

2.39 Between August and October 2004, the bridge-deck erection works for Bridge I were carried out, during which West Kowloon Highway was partially closed for traffic for 22 nights and fully closed for 4 nights (totally 26 nights). At a TML Group meeting held in November 2004, Contractor A proposed and the TML Group agreed that the bridge-deck erection works for Bridges II and III should be carried out separately on the following grounds:

(a) the carrying out of bridge-deck erection works for Bridge I had no adverse traffic impact and only a few minor complaints were received; and

(b) the proposed works arrangement would minimise the interfacing issues with other projects in the vicinity and obviate the complex procedures for carrying out bridge-deck erection works for Bridges II and III at the same time.

2.40 From January to July 2005, bridge-deck erection works for Bridges II and III were carried out separately, during which West Kowloon Highway was partially closed for traffic for 31 nights and fully closed for 24 nights (totally 55 nights).

Contractor A's claim

2.41 In June 2004, Contractor A submitted a claim for additional costs and an EOT arising from the change of the three-time launching scheme to the two-time launching scheme (see para. 2.36) on the grounds that he had incurred additional costs and the progress of works had been affected. After assessing the claims, Contractor A was awarded an EOT of 26 days and an additional payment of $17 million (see item 7 in Table 6 in para. 2.3), comprising additional expenses of $11.3 million and prolongation costs of $5.7 million.

Areas for improvement

Financial implications not provided for informed decision

2.42 In January 2004, in the light of objection of the TD and the HKPF representatives in the TML Group on the three-time launching scheme on the grounds of the forecast prolonged traffic impact on West Kowloon Highway, Contractor A adopted the two-time launching scheme for Bridges I, II and III (see paras. 2.35 to 2.37). At that time, Consultant X informed the TD and the HKPF that the adoption of the two-time launching scheme, instead of the original three-time launching scheme, would cause a one-month delay to the completion of the project, and a similar delay to the completion of the re-aligned CPS Road, but there was no mention of the additional cost to be incurred. As it transpired, the decision to change the three-time launching scheme to the two-time launching scheme in January 2004 resulted in an EOT of 26 days and an additional payment of $17 million granted for Contract A (see para. 2.41). In the event, after completion of bridge-deck erection works for Bridge I, the TD and the HKPF representatives agreed with Contractor A in November 2004 that the latter could revert to the original three-time launching scheme (see para. 2.39).

2.43 In Audit's view, the TML Group should have been provided with the financial implications of possible contract claims arising from changing the three-time launching scheme to the two-time launching scheme for making informed decisions. The HyD needs to learn lessons from this incident.

Audit recommendation

2.44 **Audit has *recommended* that, in implementing a works project in future involving a change in the works procedures on the grounds of traffic considerations, the Director of Highways should provide the TML Group with the related financial implications of possible contract claims for making informed decisions.**

Response from the Administration

2.45 The Director of Highways agrees with the audit recommendation. He has said that the HyD will require its staff and consultants to advise members of TML Groups of possible time and cost implications when matters to be considered by these groups may involve risks of contract claims.

2.46 The Commissioner of Police also agrees with the audit recommendation. He has said that the confirmed cost implications of proposed changes to a project should be made known to a TML Group.

PART 3: ADDITIONAL COST UNDER CONTRACT D

3.1 This PART examines the causes of incurring additional cost under Contract D relating to tunnel-lining works (Note 9).

Contract D

3.2 Contract D was a remeasurement contract for the construction of:

(a) Nam Wan Tunnel (see Figure 2 in para. 1.4 and Photograph 2) which is a twin three-lane tunnel, each of 1.25 km long (Note 10);

(b) West Tsing Yi Viaduct (see Figure 2) of 1.5 km long; and

(c) civil works associated with the TCS System.

Note 9: *A tunnel lining is a layer of structure covering the inside surface of a tunnel to uphold the excavated rock face of the tunnel.*

Note 10: *The completed Nam Wan Tunnel was 1.2 km long.*

Photograph 2

Eastern entrance of Nam Wan Tunnel

Source: HyD records

3.3 After conducting a prequalification exercise and a tender exercise, in April 2003, on the recommendation of the Central Tender Board (Note 11) and the approval of the FSTB, the HyD awarded Contract D to Contractor D at a contract sum of $1,479.3 million. The works commenced in the same month and were scheduled for completion in May 2007. Consultant X was the Engineer supervising the contract works. Owing to inclement weather, EOTs of 168 days were granted to Contractor D. In the event, the contract works were substantially completed in November 2007, 168 days (five and a half months) later than the original scheduled completion date. Contract D account was finalised in August 2010 and the final contract sum was $1,699.4 million (see Table 8).

Note 11: *In April 2003, the Central Tender Board was chaired by the Permanent Secretary for Financial Services and the Treasury (Treasury) and comprised four members.*

Table 8

Final contract sum of Contract D
(August 2010)

Particulars	**Amount ($ million)**	**Amount ($ million)**
1. Contract works completed	1,427.5	
2. Payment for contract price fluctuation	205.3	
3. Alternative-design works completed under SA4 (Note 1)	21.9	
4. Alternative-design works completed under SA5 (Note 2)	1.7	
Total works completed		1,656.4
Payment for settling contract claim		
5. Claim related to tunnel-lining works settled under SA6 (see paras. 3.5 to 3.24)		43.0
Final contract sum		1,699.4

Source: HyD records

Note 1: In September 2005, the HyD and Contractor D entered into SA4, under which Contractor D's alternative design for the construction of some dams for mitigating natural terrain hazards was accepted to replace the original design for implementation, with a saving of $4.8 million.

Note 2: In May 2007, the HyD and Contractor D entered into SA5, under which Contractor D's alternative design for a viaduct waterproofing system was accepted to replace the original design for implementation, with a saving of $0.5 million.

3.4 One of the major works items under Contract D was the construction of Nam Wan Tunnel (see para. 3.2(a)) which consisted of twin tunnels each of 1.25 km long with a height of 9.5 metres (m). Cross passages connecting the twin tunnels were provided at 100-m intervals for use during emergencies.

Construction of tunnel linings

3.5 The twin tunnels were excavated through hills by the drill and blast method. Under Contract D, for the purpose of upholding the excavated rock face of the tunnels:

(a) Contractor D was responsible for constructing concrete linings for the twin tunnels and the cross passages (see Photograph 3); and

(b) the thickness of the linings was to be determined by referring to the Norwegian Geotechnical Institute "Q-value" System with Q-values measured in-situ on the excavated rock face (In-situ Q-values — Note 12).

Note 12: *Q-value is a rock-condition classification system for use in the design of tunnel lining works, which takes into account the effects of blasting, the influence of underground water pressure and the quality of materials covering the inside surfaces of tunnels. The higher the Q-value, the higher is the rock quality and stability, and the thinner is the tunnel lining required.*

Photograph 3

Tunnel lining works at Nam Wan Tunnel

Source: HyD records

Specifications in tender documents

3.6 The estimated tunnel lengths requiring different tunnel-lining thickness were provided in the tender BQ of Contract D. On the other hand, drawings showing the ground investigation (GI) information (GI Drawings) obtained at the design stage were also provided to tenderers for reference upon request. The GI Drawings showed the estimated Q-values of the rock along various sections of the tunnels which were estimated based on the GI information (estimated Q-values). According to the HyD, the GI Drawings were not tender drawings and were not intended to show the thickness of tunnel linings to be adopted for various sections of the tunnels.

3.7 The estimated tunnel lengths requiring different lining thickness stated in the tender BQ and reflected in the GI Drawings are shown in Table 9:

Table 9

Estimated tunnel lengths requiring different tunnel-lining thickness

Estimated Q-value	**Lining thickness required**	**Estimated tunnel length**	
		stated in BQ	**calculated by Audit based on estimated Q-values in GI Drawings**
	millimetre (mm)	**(m)**	**(m)**
Larger than 1	400	787	1,855
0.4 to 1	500	787	130
Less than 0.4	600	787	320
	Total	2,361	2,305 (Note)

Source: *Audit analysis of Contract D's BQ and GI Drawings*

Note: *The total length of the twin tunnels was 2.5 km (1.25 km × 2). As other protection treatments were required for the tunnel portals, the length of tunnels requiring concrete linings was shorter than 2.5 km. Furthermore, the total tunnel length under the GI drawings was shorter than that under the BQ because the former did not include the length of the cross passages.*

As shown in Table 9, the estimated tunnel lengths requiring different lining thickness stated in the BQ differed significantly from those calculated based on the estimated Q-values stated in the GI Drawings.

Additional cost under Contract D

3.8 In the tender submitted by Contractor D, he specified a BQ rate of $95,151/m for 400 mm tunnel linings but nil rates for both 500 mm and 600 mm tunnel linings (see Table 10).

Table 10

Contractor D's BQ rates for tunnel linings (November 2002)

	Lining thickness required (mm)	**BQ quantity**	**Contractor D's tender**	
		Length (m)	**BQ rate ($/m)**	**BQ amount ($)**
(a)	400	787	95,151	74,883,837
(b)	500	787	0	0
(c)	600	787	0	0
	Total	2,361	—	74,883,837

Source: HyD records

3.9 In response to Consultant X's enquiry in January 2003, Contractor D indicated that the 500 mm and 600 mm lining works would be implemented free of charge, and the costs of which would be covered in the rates of other works items. Audit notes that Consultant X and the HyD had not assessed the cost implications if the outturn tunnel lengths requiring different lining thickness were similar to those based on the GI Drawings, namely "1,855 m", "130 m" and "320 m" for lining thickness of 400 mm, 500 mm and 600 mm respectively (see Table 9). Contractor D was subsequently awarded Contract D and the tender documents and the BQ rates became part of Contract D.

Consultant X's Site Instructions during works implementation

3.10 During works implementation from May 2004 to May 2005, Consultant X issued 41 Site Instructions to Contractor D specifying the thickness of the tunnel linings in some tunnel sections. Based on Consultant X's Site Instructions, the following tunnel linings were constructed:

Tunnel lining thickness (mm)	**Tunnel length (m)**
400	1,157
500	1,036
600	168
Total	2,361

Disputes over tunnel-lining requirements

Contractor D's claim

3.11 Subsequently, Consultant X certified the completion of the tunnel lining works at a cost of $110 million (1,157 m × $95,151/m — see item (a) in Table 10 in para. 3.8). As the BQ rates of 500 mm and 600 mm lining works were nil, no cost was certified by Consultant X for the related works. In May 2005, Contractor D served a notification on the HyD claiming an additional cost for the tunnel lining works on the following grounds:

(a) during the tender stage, based on the estimated Q-values at various locations of the tunnels, Contractor D expected that there should be more 400 mm-thick lining works than those stated in the BQ (see Table 9 in para. 3.7). Accordingly, he submitted in his tender an "enhanced" rate for the 400 mm item in the BQ, while the 500 mm and 600 mm items would be constructed free of charge. He considered that this pricing strategy would enable him to submit a lower and more competitive tender price;

(b) also, under Contract D, the only criterion provided for determining the lining thickness levels was the In-situ Q-values. The Site Instructions issued by Consultant X during works implementation (see para. 3.10) had involved a change in the tunnel length requiring different lining thickness, which was at variance with the lining requirements based on the In-situ Q-values; and

(c) according to Contractor D, the tunnel lengths requiring each of the three types of tunnel lining based on the In-situ Q-values obtained after completing the tunnel excavation works should have been as follows:

Q-value	**Tunnel lining thickness (mm)**	**Tunnel length (m)**
Larger than 1	400	2,069
0.4 to 1	500	145
Less than 0.4	600	147
	Total	2,361

Audit notes that Contractor D had been instructed to construct less lengths of 400 mm lining works (of 1,157 m) than those reflected in the in-situ measurement (of 2,069 m).

Independent engineering expert's assessment

3.12 From October 2005 to February 2006, the HyD and Contractor D entered into mediation over the latter's financial claim. In January 2006, the Development Bureau (DEVB — Note 13) appointed an independent engineering expert to assess

Note 13: *Before July 2002, the then Works Bureau was responsible for the policy portfolio of works matters. In July 2003, the then Environment, Transport and Works Bureau was formed to take over the policy portfolio. In July 2007, the Development Bureau was formed to take over the works policy portfolio. For simplicity, the then Works Bureau and the then Environment, Transport and Works Bureau responsible for works matters are referred to as the DEVB in this Audit Report.*

Contractor D's claim. In his report submitted in February 2006, the expert said that:

(a) the contract drawings did not indicate that the selection of lining thicknesses was dependent on anything other than the In-situ Q-values; and

(b) work calculations demonstrated that 400 mm linings were structurally adequate in some locations where thicker linings had been instructed through the issue of site instructions, and therefore some instructions were unnecessary.

Consultant X's explanations

3.13 In response to the HyD's enquiry in November 2005, Consultant X said that:

(a) when estimating the tunnel lengths requiring different lining thickness levels for incorporation into the BQ, other known geological information and features (such as localised areas of poor soil materials and water drainage) had also been considered; and

(b) therefore, the estimated tunnel lengths provided in the BQ, particularly for the 400 mm item, did not correlate with the estimated tunnel lengths calculated based on the estimated Q-values shown in the GI Drawings.

Claim settlement

3.14 In August 2006, with the approval of the FSTB, the HyD and Contractor D entered into SA6, under which Contractor D was paid a sum of $43 million to settle the related claim.

Areas for improvement

Cost increase in tunnel lining works

3.15 According to the BQ in Contract D, the cost of the concrete lining works was estimated to be $75 million (see Table 10 in para. 3.8). As it transpired, the final cost amounted to $153 million ($110 million plus $43 million — see paras. 3.11 and 3.14), which was 104% higher than the original estimate of $75 million.

Additional cost arising from different tunnel lengths requiring different lining thickness between BQ and GI Drawings

3.16 Audit notes that the estimated tunnel lengths requiring different lining thickness stated in the BQ differed significantly from those calculated based on the estimated Q-values stated in the GI Drawings (see para. 3.7). Subsequent to contract award, Consultant X issued Site Instructions requiring Contractor D to construct thicker linings in some tunnel sections. Table 11 shows the BQ quantities, the quantities derived from the GI Drawings, the actual quantities instructed by Consultant X, and the quantities based on the In-situ Q-values obtained after completing the tunnel excavation works.

Table 11

Estimated and actual quantities of lining works

	Tunnel length			
Tunnel lining thickness **(a)** **(mm)**	**BQ quantity estimated by Consultant X (see Table 9)** **(b)** **(m)**	**Quantity based on estimated Q-values shown in GI Drawings (see Table 9)** **(c)** **(m)**	**Actual quantity instructed by Consultant X (see para. 3.10)** **(d)** **(m)**	**Estimated quantity based on In-situ Q-values (see para. 3.11(c))** **(e)** **(m)**
400	787	1,855	1,157	2,069
500	787	130	1,036	145
600	787	320	168	147
Total	2,361	2,305 (Note)	2,361	2,361

Source: HyD records

Note: The GI Drawings did not include the length of the cross passages.

3.17 As shown in Table 11, the tunnel lengths requiring different lining thickness based on the estimated Q-values (see column (c)) approximated the tunnel lengths based on the In-situ Q-values (see column (e)). If the tunnel linings had been constructed based on the In-situ Q-values, the tunnel lengths constructed with 400 mm lining would have been about 2,069 m.

3.18 According to Project Administration Handbook for Civil Engineering Works issued by the Civil Engineering and Development Department providing guidance to all works departments, during the pre-tender stage of a works project:

(a) the BQ should be prepared in a way that the quantities should be computed from the tender drawings, unless otherwise stated in the tender documents; and

(b) the BQ should undergo a checking process to enable its completeness and accuracy and elimination of major errors. This would facilitate competitive tendering.

In this case, Audit notes that the HyD had not identified the significant differences in tunnel lengths requiring lining thickness between those stated in the BQ and those derived from the GI Drawings during its checking of the BQ included in the tender documents.

3.19 In Audit's view, in implementing a works project in the future, the HyD needs to take measures to ensure that HyD staff and consultants strengthen checking of BQ items to safeguard their completeness and accuracy.

Risk of unreasonably high BQ rate

3.20 Audit notes that Contractor D's BQ rate of $95,151/m for the 400 mm item for tunnel lining works (see para. 3.8) was 333% higher than the pre-tender cost estimate of $22,000/m. However, the HyD and Consultant X had only requested Contractor D to provide reasons for submitting the unreasonably low BQ rates (nil rates) for the 500 mm and 600 mm items (see para. 3.9), but not for the unreasonably high BQ rate for the 400 mm item. Furthermore, the HyD had not assessed the cost implications of related possible contract claims and included them in the Tender Assessment Report for submission to the Central Tender Board.

3.21 According to Technical Circular (Works) No. 7/2004 issued by the DEVB in April 2004 (promulgated subsequent to the letting of Contract D in April 2003), if a Government department considers that certain rates in a tender are unreasonably high and that there is a risk that the tenderer will take advantage of such rates in future claims, the department should assess the risk that the Government will be exposed to in accepting such a tender. In Audit's view, the HyD needs to take measures to ensure that its staff pay particular attention to any unreasonable BQ rates.

Audit recommendations

3.22 **Audit has *recommended* that, in conducting a tender exercise for implementing a works project in future, the Director of Highways should take measures to ensure that HyD staff and consultants:**

(a) **strengthen checking of BQ items to safeguard their completeness and accuracy;**

(b) **pay particular attention to any unreasonable BQ rates; and**

(c) **when encountering unreasonable BQ rates, assess the cost implications and the associated risks of financial claims, and include the results of assessment in the tender assessment report for submission to the relevant tender board for consideration.**

Response from the Administration

3.23 The Director of Highways agrees with the audit recommendations. He has said that:

(a) HyD consultants are responsible for ensuring the completeness and accuracy of BQ items. The HyD will remind them to strengthen such checking; and

(b) the HyD will remind its staff and consultants to be more vigilant in assessing the risks resulting from unreasonably high BQ rates in accordance with DEVB Technical Circular (Works) No. 7/2004 (see para. 3.21).

3.24 The Secretary for Financial Services and the Treasury agrees with the audit recommendation in paragraph 3.22(c). He has said that the recommendation is in line with the guideline stated in DEVB Technical Circular (Works) No. 7/2004.

PART 4: PROVISION OF TRAFFIC CONTROL AND SURVEILLANCE SYSTEM UNDER CONTRACT E

4.1 This PART examines the provision of the TCS System under Contract E for Tsing Yi and Sha Tin Sections of Route 8, focusing on:

(a) site access for implementing the TCS System (paras. 4.8 to 4.24); and

(b) implementation of Speed Enforcement Camera (SEC) System (paras. 4.25 to 4.41).

Traffic Control and Surveillance System

4.2 The TCS System is installed at Tsing Yi and Sha Tin Sections of Route 8 for traffic management by the TD. The TCS System includes closed-circuit television cameras, automatic vehicle detection devices (Note 14), lane control signals and variable message signs (see Photograph 4).

Note 14: *The devices are used to detect vehicles exceeding the height limits of the road sections, monitor traffic incidents and collect traffic data.*

Photograph 4

Variable message sign at Sha Tin Section

Source: TD records

4.3 In February and November 1998, when seeking funding for the detailed design of Sha Tin and Tsing Yi Sections respectively from the FC, the HyD said that each of the two road sections would be installed with a TCS System.

4.4 In February and July 1999, the HyD awarded Consultancy X at a cost of \$105 million to Consultant X and another consultancy (Consultancy Z) at a cost of \$50 million to Consultant Z for the design and construction supervision of Tsing Yi and Sha Tin Sections respectively, including the preliminary designs for the TCS Systems for the two road sections.

4.5 In early 2000, the TD and the HyD exchanged views on adopting a single TCS System for both Sha Tin and Tsing Yi Sections instead of two TCS Systems. In March 2000, the TD informed the HyD that a single TCS System would save $12.2 million in capital cost and $63 million in recurrent cost over the 10-year life cycle of the System.

4.6 In June 2000, the TD and the HyD decided to adopt a single TCS System for the two road sections, and the HyD assigned Consultant X for the preliminary design of the single TCS System, with the main TCS System control centre to be provided at Tsing Yi Section.

Contract E

4.7 After conducting a tender exercise, in October 2004, the HyD awarded Contract E to Contractor E at a lump-sum-fixed price of $255 million. Contractor E was responsible for the detailed design, installation, and commissioning of the TCS System for Tsing Yi and Sha Tin Sections of Route 8. The works commenced in October 2004 and were scheduled for completion in August 2008. Consultant X was responsible for the preliminary design, civil-works design and supervision of the contract works. In the event, the contract works were substantially completed in January 2010, 17 months later than the original scheduled completion date. Contract E account was finalised in December 2012 and the final contract sum was $309.2 million (see Table 12).

Table 12

Final contract sum of Contract E
(December 2012)

Particulars	Amount ($ million)	Amount ($ million)
1. Lump-sum-fixed price (A)		255.0
Payments for settling contract claims		
2. Claim related to delays in gaining access to works sites along Tsing Yi Section settled under SA7 (see para. 4.13)	45.5	
3. Claims related to delays in gaining access to works sites along Sha Tin Section (see para. 4.14)	6.7	
4. Claim related to rescheduling of testing work (see para. 4.15)	3.8	
Total claims (B)		56.0
(A) + (B)		311.0
5. Less: cost saving identified in provisional items provided in Contract E		(1.8)
Final contract sum		309.2

Source: HyD records

Site access for implementing the TCS System

4.8 The TCS System for both Tsing Yi and Sha Tin Sections was installed under Contract E. While road works for Tsing Yi Section were undertaken under Contracts A, B, C and D, road works for the Sha Tin Section were under three other works contracts, namely Contracts F, G and H (Note 15).

4.9 The seven works contracts (Contracts A, B, C, D, F, G and H) included constructing facilities related to the installation of the TCS System, such as provisions of ducting, sign gantries, power-supply equipment, and electrical and mechanical (E&M) installations. The related civil works were required to be completed according to milestone completion dates specified in the seven works contracts before providing the completed facilities and site access to Contractor E for carrying out the TCS System installation work. On the other hand, corresponding site access dates were also specified in Contract E for Contractor E to gain access to the sites for commencing the system installation work.

4.10 The works programme of Contract E comprised six sections of works, which were further broken down into 15 sites. To provide contingencies for any delay in completing the related civil works and providing site access and related facilities to Contractor E, the corresponding site access dates specified in Contract E had already provided time gaps of one (Site 14) to six (Site 13) months counting from the scheduled milestone completion dates specified in the seven works contracts (see Appendix B — Note 16).

Note 15: *Contracts F, G and H at a total project cost of about $6 billion were for the construction and construction supervision of Eagle's Nest Tunnel, Lai Chi Kok Viaduct and Sha Tin Height Tunnel respectively. Contracts F and G were administered by the HyD while Contract H by the Civil Engineering and Development Department.*

Note 16: *According to the HyD, as Contract E was the last contract awarded for the whole Route 8 project, the setting of site access dates had taken into account the programme and progress of the related works contracts (except for Contract C) at the time of inviting tenders for Contract E.*

4.11 In the tender documents of Contract E, tenderers were required to indicate in the BQ the amount of compensation per day payable to the contractor for the first 180 days of delay after the specified site possession dates. In the event, Contractor E stated in his tender a compensation of $1 per day for the first 180 days of delay in site possession, which became a BQ item in Contract E.

Provision of site access to Contractor E

4.12 During the construction of Tsing Yi and Sha Tin Sections, the time of completing the civil works at 15 sites under the civil works contracts was later than the scheduled milestone completion dates, ranging from 16 days (Site 11) to 483 days (Site 15). During works implementation, site access was nonetheless provided to Contractor E for carrying out the TCS System installation work by phases. With the exception of Sites 11 and 12, full site access to most of the sites was provided to Contractor E a long time after the site access dates specified in Contract E. For example, for Site 1, the scheduled site access date was 11 June 2006, but the site access was only provided to Contractor E by phases from 10 April 2006 to 30 November 2007, 537 days after the original scheduled date for providing full site access to Contractor E (see Appendix B).

Claims for delays in gaining full access to works sites

4.13 Contract E was completed in January 2010, 17 months later than the scheduled completion date. In the event, Contractor E submitted claims for an additional cost arising from delays in providing site access to him for carrying out the TCS System installation work. According to Contractor E, he had provided additional resources to address the work-site interfacing problems and rescheduling his work to mitigate work delays to enable timely opening of the road sections. After assessment of Contractor E's claims, in July 2009, the HyD and Contractor E entered into SA7 under which some works items were subdivided into more items with different site access dates in Site 15, and Contractor E was paid an additional sum of $45.5 million for the contract modifications and delays in providing site access to him along Tsing Yi Section (see item 2 in Table 12 in para. 4.7).

4.14 Furthermore, the HyD also paid $6.7 million to Contractor E to settle his claims relating to delays in providing site access to him at Sites 1 to 6 along Sha Tin Section (see item 3 in Table 12).

4.15 Moreover, owing to a delay in completing the road works, a commissioning test for the TCS System originally scheduled for October 2009 was deferred to December 2009. After assessing Contractor E's claim for the delay, the HyD paid a prolongation cost of $3.8 million to him (see item 4 in Table 12).

4.16 In March 2014, the HyD informed Audit that:

(a) under the provisions of Contract E, Contractor E should take due recognition of the restrictive accessibility of the sites in formulating his programme and construction method, and to work with other contractors during the execution of his works. Contractor E should also liaise and coordinate with all parties whose works involved interfacing with the work of Contract E, and agree with them the interfacing arrangements, including timing of interfacing site activities, site access arrangements and working space; and

(b) the certified substantial completion dates (see column (b) of Appendix B) were the stage achievement dates, by which works under the civil works contracts were completed to a degree such that Contractor E could carry out the TCS System installation work, whilst the contractors for civil works contracts could work in parallel within the same site to complete the remaining civil and E&M works. In the event, programmes for phased handing over of sites were agreed between Contractor E and the various civil works contractors before commencing the TCS System installation work.

4.17 In March 2014, the Civil Engineering and Development Department (which was responsible for administering Contract H) informed Audit that:

(a) taking into account the extended contract completion dates after the award of EOTs, there were no delays in completing the civil works under Contract H; and

(b) the site handover dates for Sites 6 and 9, although slightly beyond Contract E's site access dates, were within the timeframe agreed with the HyD.

4.18 In March 2014, in response to Audit's observations in paragraph 4.12, Consultant Z (who was the consultant of Contracts F and G) furnished the following views:

(a) regarding Contract F, the dates shown in column (b) of Appendix B, namely certified substantial completion dates, were the stage achievement dates by which works under the civil works contracts had been completed to a degree such that Contractor E could access the sites to carry out the TCS System installation works, whilst the civil works contractors worked in parallel within the same sites to complete the remaining civil and E&M works; and

(b) given that the entire site of Contract F covered a length of around 3.6 km of Route 8, both Contractor E and Contractor F were not required, and should not have had sufficient resources, to work along the whole length of such a large site at the same time. Therefore, according to agreements made in the regular interfacing meetings, access to these sites was granted in stages to suit the work programmes of both contractors.

Areas for improvement

Long time taken to provide full site access to Contractor E

4.19 Audit notes that, with the exception of Sites 11 and 12, Contract E was provided with full site access to the other 13 sites by phases, many spanning over a long period of time after the site access dates specified in Contract E. Audit also notes that full site access to most of the sites was provided to Contractor E by phases a long time after the substantial completion of the related civil works (see Appendix B).

4.20 Audit is concerned about the long time taken by the HyD to provide full site access to Contractor E after the scheduled site access dates stated in Contract E, particularly for Sites 1 to 6 and 15, resulting in additional costs totalling \$52.2 million (\$45.5 million plus \$6.7 million — see paras. 4.13 and 4.14). In Audit's view, the HyD needs to take measures to prevent the recurrence of similar incidents in future.

Knock-on effects of delays in completing road works

4.21 With a view to mitigating claims relating to any delay in providing site access to Contractor E, the HyD incorporated the following two measures into Contract E:

(a) provision of time gaps of one to six months between scheduled milestone completion dates specified in the seven works contracts and the site access dates specified in Contract E (see para. 4.10); and

(b) specified financial compensations for the first 180 days of delay in providing the site access (see para. 4.11).

4.22 However, it transpired that the mitigating measures were not fully effective in preventing claims from Contractor E on the grounds of significant delays in providing site access to him. In Audit's view, in implementing a works project with independent system installations in future, the HyD needs to take measure to strengthen its monitoring of the civil works completion, taking into account the knock-on effects and potential financial claims resulting from any significant delay in providing site access to a system contractor.

Audit recommendations

4.23 **Audit has *recommended* that the Director of Highways should:**

(a) **take measures to prevent the recurrence of incidents of providing site access to a contractor a long time after the site access date specified in a contract; and**

(b) **in implementing a works project with independent system installations in future, take measures to strengthen the HyD's monitoring of the civil works completion, taking into account the knock-on effects and potential financial claims resulting from any significant delay in providing site access to a system contractor.**

Response from the Administration

4.24 The Director of Highways agrees with the audit recommendations. He has said that:

(a) the HyD will take measures to prevent the recurrence of similar incidents of providing site access to a contractor a long time after the site access date specified in a contract in future; and

(b) the HyD will remind its staff and consultants to strengthen the monitoring of the completion of civil works for timely handing over sites to contractors for system installation.

Implementation of Speed Enforcement Camera System

4.25 An SEC System comprises digital cameras and radar units installed at different locations of a highway. The data captured by an SEC System normally include the registration number of a speeding vehicle, date and time, speed limit in force and location. Control-area operators (authorised by the Commissioner for Transport) and the HKPF make use of vehicle-speed-detection devices for speed enforcement action in government-owned tunnels and control areas (Note 17).

SEC System for Tsing Yi and Sha Tin Sections

4.26 In 2002, Consultant X proposed and the TD agreed to install an SEC System for Tsing Yi and Sha Tin Sections with the following features:

Note 17: *Under the Road Traffic Ordinance (Cap. 374), the Commissioner for Transport and the Commissioner of Police can take prosecution action against speeding offenders. Under the Tsing Sha Control Area Ordinance (Cap. 594), the Tsing Sha Control Area operator is authorised to take speed enforcement action under delegated authority of the Commissioner for Transport.*

(a) the system would comprise 6 sets of digital cameras and radar detectors which would have automated coordination with variable speed limit signs (VSL Signs — Note 18) installed at the gantries along Tsing Yi and Sha Tin Sections; and

(b) the system would be interfaced with the TCS System where the data captured would be relayed to a work station for processing, storage and retrieval for prosecution purposes.

4.27 At that time, SEC Systems on other roads were not automatically coordinated with VSL Signs and speed limits were generally indicated by fixed traffic signs. The proposed SEC System for Tsing Yi and Sha Tin Sections was the first system in Hong Kong having such new features. The installation of the SEC System was incorporated into Contract E at an estimated cost of $4.8 million.

4.28 Before inviting tenders for Contract E in March 2004, there were exchanges of views about the incorporation of the new SEC System into Contract E, as follows:

(a) in September 2002, the Department of Justice (DoJ) informed the TD that the proposed SEC System was acceptable provided that the truth of the produced images would be testified by an expert so that the images could be accepted by the Court as evidence for prosecution actions;

(b) in August and September 2003, as the SEC System needed to go through a trial and an assessment by an expert, the HyD informed the TD that the application of the proposed SEC System for prosecution actions had not been cleared by the DoJ and it would take a long time to clear the legal issues if new features such as interfacing with the TCS System were required. Therefore, it was inappropriate to incorporate the SEC System into Contract E and there was a risk that the SEC System would become redundant if its use for prosecution purposes could not be fully justified; and

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Note 18: *According to the TD, VSL Signs are installed on new strategic roads with variable speed limits (as determined by the road operator or according to pre-set rules) to enhance road safety and efficiency based on the actual road traffic conditions.*

(c) in response to the TD's consultation, the DoJ said that it did not see any special problem with the proposed link between the SEC System and the VSL Signs from a criminal or prosecution perspective on the condition that an expert should testify the truth of images produced through the system.

4.29 In February 2004, after detailed deliberations, the HyD and the TD agreed to adopt a two-stage approach for implementing the SEC System, as follows:

(a) Stage 1 works would cover civil works (such as ducting, power supply and communication connections), system design and a trial run of the SEC System at one of the 16 planned SEC sites; and

(b) Stage 2 works would be implemented upon satisfactory completion of Stage 1 works, and would cover the full installation of the SEC System and be included in Contract E as provisional works.

Stages 1 and 2 works were subsequently incorporated into Contract E. According to the TD, the two-stage approach was to safeguard the Government's interest in pursuit of the latest technology at that time, taking into consideration the possible write-off of the SEC equipment.

Abandonment of SEC System under Contract E

4.30 In 2007, an independent SEC Engineer was engaged to carry out a desktop review of the design to resolve certain design problems and identify areas for improvement before conducting the actual trial and producing expert reports for the DoJ's consideration (see para. 4.28(a)). Subsequently, Contractor E was instructed to make some enhancements proposed by the SEC Engineer to the system design.

4.31 In March 2008, Sha Tin Section was opened to traffic. In December 2008, following the DoJ's earlier advice, an expert was engaged to conduct a real-traffic trial run to ascertain the accuracy and proper functioning of the equipment, and to prepare expert reports for submission to the DoJ. Upon completion of the trial run, the expert reports concluded that the proposed SEC System was accurate and reliable in performing its designed functions, and suggested some enhancements to the System. In July 2010, the DoJ approved the expert reports that the System was acceptable for taking prosecution actions, and advised the TD to implement the expert's recommendations on enhancing the SEC System, including the use of the double photo mode, enhancement in encryption with the latest industry standard and provision of real time transfer of law-violation data.

4.32 However, in August 2010, the TD informed the HyD that Stage 2 of the SEC System under Contract E should not be pursued for the following reasons:

(a) after the TD's assessment, implementing the SEC System enhancements would increase the system cost estimate from $4.8 million to over $20 million; and

(b) even with the considerable amount to be spent on the SEC System enhancements, the System might not resolve some technical difficulties.

In March 2014, the TD informed Audit that the SEC System could not detect the speed of three vehicles on three lanes at the same section of a carriageway at the same time.

Interim measure to detect vehicle speeding

4.33 With the abandonment of the SEC System (see para. 4.32), as an interim measure, the TD instructed the Route 8 operator to make use of a portable speed enforcement camera to carry out the speeding detection work at different locations along Tsing Yi and Sha Tin Sections since the opening of the two roads. According to the TD, the interim measure was not as desirable as an SEC System in terms of operational efficiency and deterrent effects.

4.34 In November 2010, the FSTB approved funding of $8 million for the TD to develop a new digital SEC System for the two road sections. System equipment would be installed at 14 sites along the tunnel areas. Unlike the SEC System under Contract E, the new SEC System would not have any direct interfaces with the TCS central system. The TD commenced the works in December 2011 by phases, and the works were completed in January 2014.

4.35 As of December 2013, \$9.2 million (Note 19) had been spent on the SEC System, but the digital cameras and radar detectors of the SEC System installed on site were not put into use, and some other SEC System equipment was stored in Nam Wan Administration Building near Nam Wan Tunnel without use.

Areas for improvement

4.36 The SEC System for Tsing Yi and Sha Tin Sections was intended for detecting speeding offences and providing information as evidence for prosecution actions. Notwithstanding that \$9.2 million had been spent, the SEC System was eventually abandoned because of the technical difficulties encountered and the anticipated increase in cost from \$4.8 million to over \$20 million for system enhancements. In the event, the TD did not proceed with the Stage 2 works under Contract E and spent another \$8 million to provide an alternative system (which does not have automatic coordination with VSL Signs) in January 2014.

New system arrangements not tested before incorporating into contract

4.37 According to the TD, it had planned to adopt the latest technology in setting out the SEC System requirements, including integrating the system with the TCS System. These arrangements had not been tested and adopted on other roads in Hong Kong at that time. In the event, installation of the system was incorporated into Contract E under a two-stage approach. As it transpired, the TD did not adopt the SEC System for Tsing Yi and Sha Tin Sections after conducting a trial run.

4.38 In March 2014, the TD informed Audit that:

(a) the total cost of \$9.2 million spent on the trial run for the SEC System was not a waste as the results of the trial had laid a firm foundation for providing clear and useful directions for subsequent projects involving an SEC and VSL Signs, including Central Wanchai Bypass, Tolo Highway,

Note 19: *\$9.2 million comprised \$4.4 million spending on providing the system equipment, supporting networks and installation works, and \$4.8 million on engaging an SEC Engineer and an expert for conducting a desktop review and a trial run.*

Hong Kong-Zhuhai-Macao Bridge and related projects. All new transport technologies had to be tested before application in Hong Kong, even if the technology had been in use in other countries and cities. In testing any technology, costs would be involved, while success could never be guaranteed. In the majority of cases, it was not pragmatic to conduct independent testing before incorporating a new technology into a works contract. For example, if independent testing were conducted at a purpose-built site, the costs involved in forming and setting up the site would be high. If independent testing were conducted at an existing site with live traffic, this would be more costly than testing at a new road to be constructed under a works contract. This was because, in the former case, it was not only more difficult and costly to erect the installation work on a road with live traffic, it was also necessary to divert the traffic during construction. If the trial was not successful or if a decision was made to cease the trial, the testing installations would have to be dismantled and removed and the affected road section reinstated to the pre-testing condition. The traffic disruption would result in substantial social and economic loss. If off-site independent tests were adopted and the results turned out to be favourable, testing on the highway where the system was to be installed was still necessary as the trial and the report that was subject to legal clearance was site specific;

(b) in the case of Route 8, any off-site testing ground should be a strategic highway with VSL Signs installed. During the planning stage of Contract E in 2004, the only open highway equipped with VSL Signs that might be suitable for off-site independent testing was Tsing Ma Bridge and its approach roads. As Tsing Ma Bridge and its approach roads were the only road link to the international airport of Hong Kong, it was not acceptable to have them partially closed, and traffic on them disrupted, for a certain period for erecting testing installations and equipment and conducting trial runs. In short, if the technology trial for the Route 8 project were to be revisited, the TD would still need to conduct an on-site trial instead of off-site independent trial. For on-site testing such as the one in Route 8, there were no complications to the works contract as there were no time or monetary claims under Contract E; and

(c) both the costs of independent testing and on-site testing under a works contract should not be considered as a waste. The introduction of a new technology to the Route 8 project was a first step to an automated speed enforcement system for progressive use and enhancement of road safety in all strategic highways with VSL Signs in Hong Kong. A two-stage prudent approach was adopted to try out the SEC System by conducting tests first and exercising a contractual right to continue with or forgo full implementation.

4.39 In Audit's view, in adopting a new technology for law enforcement purposes in future, the TD should conduct independent testing and obtain legal clearance before proposing to a works department to incorporate such a technology into a works contract. This would help minimise abortive work and expenditure, and reduce the risks of lowering the operational efficiency and deterrent effects in carrying out the related law enforcement actions (see para. 4.33). In this connection, Audit notes that, in May 2013, the TD planned to conduct a trial scheme for assessing the feasibility of introducing an Average Speed Camera System (Note 20) at Hong Kong Shenzhen Western Corridor. On this occasion, the TD adopted a good practice to conduct a trial scheme before full system implementation.

Audit recommendation

4.40 **Audit has *recommended* that, in adopting a new technology for law enforcement purposes in future, the Commissioner for Transport should, as far as practicable, consider conducting independent testing as an alternative to on-site testing and obtain legal clearance before proposing to a works department to incorporate such a technology into a works contract.**

Response from the Administration

4.41 The Commissioner for Transport agrees with the audit recommendation.

Note 20: *The proposed system will calculate the average speed of a vehicle passing through cameras placed at two locations of a road section. If the average speed exceeds the related speed limit, the captured data can be used as evidence for prosecution purposes.*

Appendix A
(para. 1.12 refers)

Final contract sum of Contract C (August 2013)

Particulars	Amount ($ million)	Amount ($ million)
1. Contract works completed	1,030.6	
2. Payment for contract price fluctuation	119.9	
3. Alternative-design works completed under SA8 (Note 1)	11.2	
Total works completed		1,161.7
Payment for settling contract claim		
4. Claim related to additional time taken for excavation works (Note 2)		21.9
Final contract sum		1,183.6

Source: HyD records

Note 1: In April 2008, the HyD and Contractor C entered into a Supplementary Agreement (SA8), under which Contractor C's alternative design for a viaduct waterproofing system was accepted to replace the original design for implementation. The alternative design resulted in a cost saving of $2.8 million.

Note 2: The claim was related to the construction of East Tsing Yi Viaduct.

Appendix B
(paras. 4.10, 4.12, 4.16(b), 4.18(a) and 4.19 refer)

Provision of site access to Contractor E

Works Section	Site	Works contract	Completion date of works contract			Site access date of Contract E		
			Scheduled milestone (a)	Certified substantial completion (b)	Delay (c) = (b) − (a) (No. of days)	Scheduled (Note) (d)	Actual (e)	Delay in providing full site access (f) = (e) − (d) (No. of days)
1	1	F	30.11.2005	9.4.2006	130	11.6.2006	10.4.2006 – 30.11.2007	0 to 537
	2	F	1.10.2005	9.1.2006	100	12.4.2006	10.1.2006 – 21.11.2006	0 to 223
	3	F	25.3.2006	24.8.2006	152	7.7.2006	11.5.2006 – 5.7.2007	0 to 363
	4	G	1.3.2006	30.11.2006	274	11.6.2006	30.11.2006 – 15.5.2007	172 to 338
	5	G	1.12.2005	20.12.2006	384	11.6.2006	20.12.2006 – 30.7.2007	192 to 414
2	6	H	24.6.2005	15.12.2005	174	26.11.2005	16.2.2006 – 12.3.2007	82 to 471
	7	H	2.10.2005	17.1.2006	107	29.3.2006	6.6.2006 – 27.7.2006	69 to 120
	8	H	2.10.2005	19.1.2006	109	30.3.2006	6.6.2006 – 21.11.2006	68 to 236
3	9	H	2.10.2005	7.1.2006	97	28.12.2005	15.2.2006 – 21.11.2006	49 to 328
4	10	H	2.10.2005	2.12.2005	61	11.12.2005	28.7.2006 – 17.8.2006	229 to 249
5	11	D	15.6.2006	1.7.2006	16	13.9.2006	11.7.2006	0
6	12	D	16.10.2006	15.2.2007	122	7.2.2007	7.2.2007	0
	13	A	14.9.2006	27.6.2007	286	12.4.2007	27.3.2007 – 27.6.2007	0 to 76
	14	C	29.10.2007	15.7.2008	260	12.12.2007	1.2.2008 – 7.8.2008	51 to 239
	15	B	28.12.2007	24.4.2009	483	9.2.2008	21.4.2009 – 14.7.2009	437 to 521

Source: HyD records

Note: Time gaps of one to six months had been provided by the HyD between the scheduled works completion dates (column (a)) and scheduled site possession dates of Contract E (column (d))(see para. 4.10).

Acronyms and abbreviations

APE	Approved project estimate
Audit	Audit Commission
BQ	Bill of Quantity
CPS Road	Container Port Road South
DEVB	Development Bureau
DoJ	Department of Justice
EOT	Extension of time
E&M	Electrical and Mechanical
FC	Finance Committee
FSTB	Financial Services and the Treasury Bureau
GI	Ground Investigation
HKPF	Hong Kong Police Force
HyD	Highways Department
ICE	Independent Checking Engineer
km	Kilometre
Lands D	Lands Department
m	Metre
mm	Millimetre
m^2	Square metre
NSC Viaduct	Ngong Shuen Chau Viaduct
SA	Supplementary Agreement
SEC System	Speed Enforcement Camera System
TCS System	Traffic Control and Surveillance System
TD	Transport Department
TIA	Traffic Impact Assessment
TML Group	Traffic Management Liaison Group
VO	Variation Order
VSL Sign	Variable speed limit Sign

CHAPTER 5

Electrical and Mechanical Services Department

Electrical and Mechanical Services Trading Fund

Audit Commission
Hong Kong
4 April 2014

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. 62 of the Director of Audit contains 8 Chapters which are available on our website at http://www.aud.gov.hk

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ELECTRICAL AND MECHANICAL SERVICES TRADING FUND

Contents

ELECTRICAL AND MECHANICAL SERVICES TRADING FUND

Executive Summary

1. The Electrical and Mechanical Services Trading Fund (EMSTF) was set up in August 1996 to manage and account for the operations of the Electrical and Mechanical Services Department (EMSD) with the exception of its regulatory services. The services of the EMSTF include operation and maintenance of electrical, mechanical, electronic and building services systems and equipment at major installations, and maintenance of vehicle fleets. The objectives of the EMSTF are to provide quality services to customers, continuously review the markets in which the EMSTF operates, identify new business opportunities and provide a suitable environment for EMSD staff to continuously improve processes and hence customer satisfaction.

2. The Director of Electrical and Mechanical Services is the General Manager of the EMSTF and the Development Bureau (DEVB) is responsible for formulating and reviewing government policies and aims in respect of provision of services under the EMSTF. The EMSTF is overseen by an Executive Board chaired by the Permanent Secretary for Development (Works). The Executive Board meets quarterly to review the policy, business strategies and financial performance of EMSTF services. Furthermore, the Financial Services and the Treasury Bureau holds half-yearly meetings with the EMSTF to monitor the latter's financial performance. Moreover, EMSTF annual reports and audited financial statements are submitted to the DEVB and the Legislative Council (LegCo) every year. According to Financial Circular No. 9/99, from August 2002, user departments are free to retain the services of the EMSTF or to choose alternative service providers to meet part or all of their electrical and mechanical (E&M) service needs. The Audit Commission (Audit) has recently conducted a review of the operation of the EMSTF with a view to identifying areas for improvement.

Financial and operation performance

3. In 2012-13, EMSTF operating revenue was $4,643 million while its operating cost was $4,262 million, with an operating profit of $381 million. In the same year, the actual rate of return on its Average Net Fixed Assets was 38.1%, and its actual rate of return on revenue was 6.9% (para. 1.16).

4. ***Lack of systematic comparison and alignment of EMSTF prices with market prices.*** In April 1996, the Government informed LegCo that exposing the EMSD's services to direct price and performance comparisons would further improve its service standards and cost effectiveness. In December 1996, the Financial Secretary advised the EMSTF that it should find out what the private sector was charging for similar services provided by the EMSTF, and it should be able to match the commercial rates by 1999. However, Audit notes that the EMSTF only conducted a comprehensive market-price comparison exercise 16 years ago in 1998. From 1996-97 to 2012-13, having participated in 329 competitive tendering exercises, the EMSTF was successful in bidding the provision of E&M work on 155 (47%) occasions with a total contract value representing only 3.4% of its total turnover during the 17-year period. Although the EMSTF informed Audit that it had reviewed the market prices through participating in competitive tendering exercises and outsourcing its work to outside contractors, the EMSTF had not made use of the information obtained from the tendering exercises and outsourcing to systematically compare and align EMSTF prices with the market prices (paras. 2.7, 2.11, 2.13 and 2.14).

5. ***Lack of plan to gainfully use the retained earnings.*** As of March 2013, the EMSTF had accumulated retained earnings of $2,308 million. However, the EMSTF has not conducted a review to ascertain the amount of reserve and working capital required for its operation, so that it could return any surplus fund to the Government (paras. 2.16 and 2.20).

6. ***EMSTF clients confined to government bureaux and departments and quasi-government bodies.*** According to the Framework Agreement entered into between the Government and the EMSTF in 1996, the services of the EMSTF would be provided to government bureaux and departments (B/Ds) and other government subvented or financially assisted agencies, and the opportunity would be taken to bid for and win business in other markets as they arise. However, Audit

examination revealed that the EMSTF mainly derived its revenue from B/Ds and quasi-government bodies. In 2012-13, the EMSTF only derived $4 million (0.1% of its revenue) from private organisations (paras. 2.24, 2.28 and 2.29).

7. ***B/Ds not conducting competitive tendering before obtaining EMSTF services.*** According to the Stores and Procurement Regulations, competitive bidding is a reliable safeguard for securing value for money procurement. Financial Circular No. 6/2001 states that a Controlling Officer may however choose to enter into a service level agreement with a trading fund direct without recourse to competitive bidding if he is clearly satisfied that, having regard to the circumstances of the case, inviting competitive bidding for the delivery of such services is not appropriate. However, Audit survey on major EMSTF clients revealed that, as of December 2013, the Food and Environmental Hygiene Department, the Architectural Services Department, the Hong Kong Police Force, the Government Property Agency and the Leisure and Cultural Services Department had awarded service agreements for all or most of their E&M services to the EMSTF through direct negotiation without going through competitive tendering (paras. 2.34, 2.39 and 2.40).

Management of overtime work

8. As of December 2013, the EMSTF had 4,768 staff, comprising 3,341 civil servants and 1,427 non-civil-service contract (NCSC) staff. In 2012-13, the EMSTF paid overtime allowance of $117 million to its civil servants and $22 million to its NCSC staff (para. 3.8).

9. ***Granting of overtime allowance to NCSC staff inconsistent with Civil Service Bureau policy and guidelines.*** According to Civil Service Bureau (CSB) Circular No. 2/2001 issued in January 2001, NCSC staff are not entitled to overtime allowance. However, the EMSTF has given approval for its NCSC staff to receive overtime allowance since May 2001. In 2012-13, overtime allowance paid to NCSC staff of the EMSTF amounted to $22 million (paras. 3.3 and 3.6).

10. ***Overtime work largely recompensed by overtime allowance instead of time off.*** According to Civil Service Regulations (CSRs), overtime work performed by staff should normally be compensated by time off in lieu. However, Audit

examination revealed that, in 2012-13, 96% of overtime work performed by EMSTF civil servants and 90% by its NCSC staff was recompensed by overtime allowance instead of time off in lieu. Furthermore, according to CSB Circular No. 18/2000, time off is granted preferably before a staff takes his earned vacation leave, unless the staff concerned has accumulated the maximum amount of earned vacation leave permissible under the relevant CSR. However, Audit sample test revealed that 25 EMSTF civil servants had been approved to take vacation leave during the period from November 2012 to October 2013 while they had accumulated uncompensated overtime work balance, and at the same time their vacation leave balance had not reached the maximum levels (paras. 3.19, 3.25 and 3.26).

Release of EMSD sites

11. ***Long time taken in releasing a site in Causeway Bay for development.*** In June 2001, LegCo was informed that a site (with an area of 16,000 square metres) in Causeway Bay (CWB Site) on Hong Kong Island would be released for development in 2004-05. In 2005, the EMSD Headquarters at CWB Site was relocated to a building at Kai Tak in Kowloon. However, it transpired that CWB Site would only be handed over to the Lands Department for disposal in May 2014, ten years later than the original target date (paras. 4.2, 4.5 and 4.9).

Performance reporting

12. ***Performance pledges for majority of services not formulated and published.*** Audit notes that the EMSTF has not published performance pledges, targets and achievements of majority of its services in annual reports or website for information of the public (para. 5.10).

Way forward

13. Audit notes that, 17 years after its establishment, EMSTF clients are primarily B/Ds and quasi-government bodies. On the other hand, B/Ds predominantly rely on the EMSTF to provide E&M services. This situation may not have helped the EMSTF to fully achieve the objective of exposing its services to market competition (para. 6.12).

Audit recommendations

14. **Audit recommendations are provided in the respective sections of this Audit Report. This Executive Summary only highlights the key recommendations. Audit has *recommended* that, regarding EMSTF operations, the Administration should:**

Financial and operation performance

(a) **take action to systematically compare and align EMSTF prices with market prices (para. 2.21(a));**

(b) **conduct a review to ascertain the amount of reserve required for the operation of the EMSTF, and return any surplus fund to the Government (para. 2.21(b));**

(c) **take action to explore business opportunities in markets other than B/Ds, government subvented or financially assisted agencies (para. 2.32);**

(d) **conduct competitive tendering in procuring E&M services in future as far as possible (para. 2.43(a));**

Management of overtime work

(e) **take action to rectify the granting of overtime allowance to NCSC staff which is inconsistent with CSB policy and guidelines (para. 3.27(a));**

(f) **conduct a review of the high percentages of overtime work being recompensed by overtime allowance instead of time off in lieu and take necessary remedial action (para. 3.27(c));**

(g) **closely monitor and take measures to prevent habitual and long hours of overtime work of some EMSTF staff (para. 3.27(d));**

(h) **take measures to ensure that time off for any uncompensated overtime hours accumulated is granted preferably before a staff takes his earned leave, unless the staff concerned has accumulated the maximum amount of earned vacation leave permissible under the relevant CSR (para. 3.27(e));**

Release of EMSD sites

(i) **inform the LegCo Panel on Development of the ten-year slippage in releasing CWB Site for development vis-à-vis the time stated in the funding application submitted to LegCo in June 2001 (para. 4.14);**

Performance reporting

(j) **formulate and publish appropriate performance pledges for EMSTF services (para. 5.16(b)); and**

Way forward

(k) **conduct a review to evaluate the effectiveness of the EMSTF in achieving its objective of exposing its services to market competition and determine the way forward for the Fund (para. 6.13).**

Response from the Administration

15. The Administration agrees with the audit recommendations.

PART 1: INTRODUCTION

1.1 This PART describes the background to the audit and outlines the audit objectives and scope.

Background

Setting up of trading funds

1.2 According to a paper on Public Sector Reform (Note 1) issued by the Government in 1989:

(a) trading funds are accounting frameworks established by law for departments providing services on a quasi-commercial basis with the objective of recovering costs;

(b) trading-fund departments do not have the same autonomy as a corporation, but have greater financial flexibility than traditional government departments. Their staff, however, remain part of the civil service and subject to its terms and conditions;

(c) for support services, the decision to establish a trading fund would be to promote one or more of the following:

   (i) a more economical use of the service, particularly where no charge has been raised in the past;

   (ii) greater efficiency, by exposing the service to competition or to proxy competitive pressures through price comparisons and cost consciousness on the part of the user; and

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Note 1: *In 1989, the Government issued a paper on Public Sector Reform, suggesting ways to improve the financial and performance management of the public sector. The aim of the reform programme was to improve the quality of management within the civil service by promoting an increased awareness of what results were actually being achieved by the Government and at what cost.*

(iii) the reorientation of the service to a customer-led rather than producer-driven organisation and culture; and

(d) since trading funds are intended to operate on a commercial basis, they would charge for their services and user departments would have the choice of using more or less of those services. A real customer/supplier relationship would develop.

1.3 In November 1992, in submitting the Trading Funds Bill to the Legislative Council (LegCo), the Administration informed LegCo that the major benefits which were expected from establishing trading funds were improvements in the quality of service provided to customers through the following initiatives:

(a) the promotion of a customer-led rather than producer-driven regime;

(b) greater efficiency and cost-consciousness by exposing the service to competition or to quasi-commercial pressures; and

(c) the removal of those constraints of the vote accounting system which inhibited responsive and efficient management.

1.4 The Trading Funds Ordinance (Cap. 430) was enacted in 1993, under which the Financial Secretary shall designate a general manager to manage a trading fund with the objectives of:

(a) providing an efficient and effective operation that meets an appropriate standard of service;

(b) within a reasonable time, meeting expenses incurred in the provision of the government service and financing liabilities of the trading fund out of the income of the trading fund, taking one year with another; and

(c) achieving a reasonable return, as determined by the Financial Secretary, on the fixed assets employed.

1.5 Between 1993 and 1996, the following six trading funds had been set up:

(a) Companies Registry Trading Fund (in 1993);

(b) Land Registry Trading Fund (in 1993);

(c) Sewage Services Trading Fund (in 1994);

(d) Office of the Communications Authority Trading Fund (in 1995);

(e) Post Office Trading Fund (in 1995); and

(f) Electrical and Mechanical Services Trading Fund (EMSTF — in 1996).

1.6 Owing to large projected operating deficits, the Sewage Services Trading Fund was dissolved in 1998. Since then, no new trading fund has been set up.

Establishment of EMSTF

1.7 In June 1996, in proposing to set up the EMSTF, the Government informed LegCo that the EMSTF aimed to:

(a) provide quality services to its customers in a cost-effective, safe and reliable manner;

(b) continuously review the markets in which the EMSTF operated;

(c) identify new business opportunities; and

(d) provide a suitable environment for the Electrical and Mechanical Services Department (EMSD) staff to continuously improve processes and hence customer satisfaction.

1.8 In August 1996, subsequent to LegCo's approval, the EMSTF was established to manage and account for the operations of the EMSD with the exception of its regulatory services. The Director of Electrical and Mechanical Services has been designated as the General Manager of the EMSTF to control and manage the trading fund. The Development Bureau (DEVB — Note 2) is responsible for formulating and reviewing government policies and aims in respect of provision of services under the EMSTF.

1.9 According to the Trading Funds Ordinance, the EMSTF shall be established to manage and account for the operation of certain government services of the EMSD. The services provided by the EMSTF include:

(a) operation and maintenance of electrical, mechanical, electronic and building services systems and equipment at major installations, such as office buildings, hospitals, airports and civic venues;

(b) maintenance of other electrical, mechanical, electronic and building services systems and equipment;

(c) maintenance of vehicle fleets;

(d) design, procurement, project management and other technical consultancy services in relation to electrical, mechanical and electronic systems and vehicle fleets; and

(e) operation and maintenance of a refuse incineration plant.

Note 2: *Before July 2002, the then Works Bureau (July 1997 to June 2002) and the then Works Branch (before July 1997) were responsible for the policy portfolio on works matters. In July 2002, the then Environment, Transport and Works Bureau was set up and took over the policy portfolio on works matters from the Works Bureau. In July 2007, the DEVB was formed to take over the works policy portfolio. For simplicity, all previous policy bureaux responsible for the policy portfolio on works matters are referred to as the DEVB in this Audit Report.*

Framework Agreement of EMSTF

1.10 In September 1996, the then Secretary for Works (now the Secretary for Development) and the Director of Electrical and Mechanical Services entered into a Framework Agreement on the operation of the EMSTF. The Agreement delineated the broad organisational basis and responsibilities of the EMSTF within the overall structure of the Government. It also stated that the Secretary for Development will prescribe the aims and objectives of the EMSTF, while the Director of Electrical and Mechanical Services is responsible for the actual delivery of services to meet such aims and objectives. According to the Framework Agreement:

(a) the mission of the EMSTF is to be the most comprehensive and reliable provider of quality and cost-effective electrical and mechanical (E&M) services in Hong Kong;

(b) the services of the EMSTF will be provided to government departments, municipal councils (Note 3), and other government subvented or financially assisted agencies. The opportunity will be taken to bid for and win business in other markets as they arise;

(c) every year, the Director of Electrical and Mechanical Services will prepare a Corporate and Business Plan covering the current year and four subsequent years for approval by the Secretary for Development. The Plan outlines the EMSTF's objectives, services targets and medium term financial projections; and

(d) the Secretary for Development may at any time, in consultation with the Director of Electrical and Mechanical Services and as appropriate others in Government, vary the contents of the Agreement, or issue supplementary directions or guidance to clarify any matter in the Agreement.

Note 3: *Municipal councils, known as the Urban Council and the Regional Council, were the statutory authorities responsible for providing municipal services in urban areas and the New Territories respectively. The services included environmental hygiene, public health, liquor licensing, and the provision of recreation, sports and cultural facilities. The two councils were dissolved at end of 1999, and their functions were taken over by government departments, such as the Food and Environmental Hygiene Department and the Leisure and Cultural Services Department.*

Monitoring of EMSTF

1.11 The EMSTF is overseen by an Executive Board which is chaired by the Permanent Secretary for Development (Works), with members comprising representatives from the DEVB and the EMSTF, including the Director of Electrical and Mechanical Services. The terms of reference of the Board include:

(a) providing liaison between the Permanent Secretary and the Director on implementation of initiatives under the EMSTF in accordance with the Framework Agreement;

(b) considering the annual Corporate and Business Plans and recommending them to the Permanent Secretary; and

(c) monitoring the overall pricing levels and measures taken to make services provided by the EMSTF more competitive.

The Executive Board meets quarterly to review the policy, business strategies and financial performance of EMSTF services.

1.12 Furthermore, the EMSTF annual Corporate and Business Plans are submitted to the Financial Services and the Treasury Bureau (FSTB — Note 4) and it holds half-yearly meetings with the EMSTF for the purpose of monitoring the latter's financial performance. Moreover, the EMSTF submits an annual report with audited financial statements to the DEVB, and the latter tables the report and statements at LegCo every year.

Note 4: *Before July 2002, the then Finance Bureau (July 1997 to June 2002) and the then Finance Branch (before July 1997) were responsible for the policy portfolio on treasury matters. In July 2002, the FSTB was set up and took over the policy portfolio on treasury matters. For simplicity, all previous policy bureaux responsible for the policy portfolio on treasury matters are referred to as the FSTB in this Audit Report.*

Vision and missions of EMSTF

1.13 According to EMSTF 2012-13 Annual Report, the vision of the EMSTF is to improve the quality of life for the community through continuous enhancement of its E&M engineering services. Its missions are:

(a) providing quality engineering solutions to satisfy the customers' needs;

(b) developing a competent workforce and maintaining a harmonious environment; and

(c) keeping pace with technology development and process improvement for service enhancement.

1.14 As stated in EMSTF 2012-13 Annual Report, the EMSTF focuses on public value based on a new business model which operates with a minimal profit. As stated in EMSTF Corporate and Business Plan for 2013-14 to 2017-18, the EMSTF will achieve a minimal profit exceeding the financial target set by the FSTB while leaving its clients with more resources for achieving their core missions.

Untying arrangement for EMSTF

1.15 According to Financial Circular No. 9/99 "Untying Departments from the Services of the EMSTF" issued in June 1999:

(a) government departments and autonomous bodies were tied to using services provided by the EMSTF for three years up to July 1999;

(b) with effect from August 1999, user departments would be untied from the services of the EMSTF by phases over a three-year period; and

(c) upon untying from August 2002, user departments would be free to retain the services of the EMSTF or to choose alternative service providers to meet part or all of their E&M service needs.

Financial performance of EMSTF

1.16 In order to achieve a reasonable return on fixed assets (see para. 1.4(c)), the Financial Secretary has directed that the EMSTF's target rate of return should be measured based on its Average Net Fixed Assets (ANFA — Note 5). According to the FSTB, the target rate of return on ANFA is set to reflect the cost of capital employed in setting up, maintaining and enhancing the services, and to provide a tool for evaluating and monitoring the financial performance of a trading fund as a whole, and is set through benchmarking against similar commercial operations in the private sectors. The target rates of return on ANFA of the EMSTF as determined by the Financial Secretary from 1996-97 to 2013-14 were as follows:

Period	Target rate of return on ANFA
1996-97 to 2005-06	13.5%
2006-07 to 2011-12	8.5%
2012-13 to 2013-14	7.8%

In addition to the return on ANFA, the EMSTF also adopts the rate of return on revenue (RoR) to measure its financial performance. Table 1 shows the financial performance of the EMSTF from 1997-98 to 2012-13 at five-year intervals.

Note 5: *ANFA is the average of the opening and closing balances of fixed assets in a financial year.*

Table 1

Financial performance of EMSTF (1997-98 to 2012-13 at five-year intervals)

Particulars	1997-98 ($ million)	2002-03 ($ million)	2007-08 ($ million)	2012-13 ($ million)
Turnover				
(i) Electrical, mechanical and electronic services	2,106	2,780	3,101	4,025
(ii) Project and consultancy services	176	305	169	331
(iii) Vehicle services	347	208	236	268
(iv) Others	25	29	28	19
Total turnover (a)	2,654	3,322	3,534	4,643
Operating costs				
(i) Staff cost	1,489	1,693	1,665	2,095
(ii) Contractor cost	413	689	1,003	1,551
(iii) Materials	251	237	343	396
(iv) Others	198	227	202	220
Total operating costs (b)	2,351	2,846	3,213	4,262
Profit from operations (c)=(a)−(b)	303	476	321	381
Interest income (d)	36	62	102	152
Interest expense (e)	26	6	—	—
Profit before notional profits tax (f)=(c)+(d)−(e)	313	532	423	533
Notional profits tax (g) (Note 1)	51	77	56	84
Total comprehensive income (h)=(f)−(g)	262	455	367	449
Rate of return on ANFA (Note 2)	25.7%	44.4%	30.0%	38.1%
Rate of RoR (Note 3)	9.5%	12.0%	7.5%	6.9%

Source: EMSTF records

Note 1: The EMSTF does not need to pay profits tax under the Inland Revenue Ordinance (Cap. 112). However, for trading-fund purposes, it is required to pay the Government an amount equivalent to profits tax payable according to the relevant provisions of the Inland Revenue Ordinance.

Note 2: From 2006-07, the rate is the percentage of the profit from operations (interest income not included) after notional tax on such profit over the value of the ANFA. For simplicity and comparison purposes, the rates shown in this Table are net of interest income.

Note 3: The rate is the percentage of the profit from operations after notional tax on such profit over the value of turnover. For example, in 2012-13, the RoR rate is: [$381 million × (100%−16.5%) ÷ 4,643 million] × 100% = 6.9%.

1.17 As of December 2013, the EMSTF had 4,768 staff, comprising 3,341 (70%) civil-service staff and 1,427 (30%) non-civil-service contract (NCSC) staff. An organisation chart of the EMSTF is shown in Appendix A.

Audit review

1.18 As of December 2013, 11 years after government bureaux and departments (B/Ds) were allowed to choose E&M service providers other than the EMSTF (see para. 1.15(c)), most B/Ds still heavily relied on the EMSTF to provide such services. In 2012-13, 74.6% of the EMSTF's operating revenue of $4,643 million was derived from B/Ds, 25.3% from quasi-government bodies and 0.1% from private organisations. Of the 25.3% of the EMSTF's operating revenue, 19.5% came from the Hospital Authority (HA), 2.9% from the Airport Authority Hong Kong and the remaining 2.9% from other pertinent bodies (Note 6).

1.19 The Audit Commission (Audit) has recently conducted a review of the operation of the EMSTF with a view to identifying areas for improvements. The review focuses on the following areas:

(a) financial and operation performance (PART 2);

(b) management of overtime work (PART 3);

(c) release of EMSD sites (PART 4);

(d) performance reporting (PART 5); and

(e) way forward (PART 6).

Audit has identified areas where improvements can be made by the Government in the above areas, and has made recommendations to address the issues.

Note 6: *Other pertinent bodies included LegCo, the Prince Philip Dental Hospital and the Environment and Conservation Fund.*

Acknowledgement

1.20 Audit would like to acknowledge with gratitude the full cooperation of the staff of the EMSTF, the DEVB, the FSTB, the Civil Service Bureau (CSB), the Architectural Services Department (ArchSD), the Food and Environmental Hygiene Department (FEHD), the Government Property Agency (GPA), the HA, the Hong Kong Police Force (HKPF), the Lands Department (Lands D), the Leisure and Cultural Services Department (LCSD) and the Planning Department (PlanD) during the course of the audit review.

PART 2: FINANCIAL AND OPERATION PERFORMANCE

2.1 This PART examines the financial and operation performance of the EMSTF, focusing on:

(a) financial performance (paras. 2.2 to 2.23);

(b) EMSTF efforts to seek business opportunities outside the government sector (paras. 2.24 to 2.33); and

(c) B/D efforts to acquire E&M services through competitive tendering (paras. 2.34 to 2.50).

Financial performance

Return on ANFA and RoR rate

2.2 Under the Trading Funds Ordinance, the EMSTF is required to achieve a reasonable return on the fixed assets employed as determined by the Financial Secretary (see para. 1.4(c)). In addition to the rate of return on ANFA, the EMSTF also adopts the RoR rate to measure its financial performance (see para. 1.16). Table 2 shows the target and actual rates of return on ANFA and the actual RoR rates of the EMSTF from 1996-97 to 2012-13.

Table 2

Rates of return on ANFA and RoR rates of the EMSTF (1996-97 to 2012-13)

Year	Rate of return on ANFA (Note 1)		Actual RoR rate (Note 2)
	Target (a)	Actual (b)	(c)
1996-97	13.5%	16.0%	9.6%
1997-98	13.5%	25.7%	9.5%
1998-99	13.5%	29.5%	9.8%
1999-00	13.5%	30.8%	9.5%
2000-01	13.5%	41.4%	12.2%
2001-02	13.5%	45.9%	12.6%
2002-03	13.5%	44.4%	12.0%
2003-04	13.5%	28.9%	8.0%
2004-05	13.5%	33.2%	9.4%
2005-06	13.5%	31.4%	8.6%
2006-07	8.5%	34.9%	9.4%
2007-08	8.5%	30.0%	7.5%
2008-09	8.5%	30.9%	7.2%
2009-10	8.5%	49.1%	10.4%
2010-11	8.5%	58.1%	11.9%
2011-12	8.5%	45.5%	9.0%
2012-13	7.8%	38.1%	6.9%

Source: *Audit analysis of EMSTF records*

Note 1: *The rate of return on ANFA is the percentage of the profit from operations after notional tax on such profit over the value of the ANFA (see para. 1.16). From 2006-07, the EMSTF has excluded interest income from the calculation of the rate of return on ANFA. For simplicity and comparison purposes, the rates shown in this Table are net of interest income.*

Note 2: *The RoR rate is the percentage of the profit from operations after notional tax on such profit over the value of turnover.*

2.3 As shown in Table 2, the actual rates of return on ANFA (column (b)) over the past 17 years were significantly higher than the target rates. Moreover, the financial performance of the EMSTF can also be measured by the actual RoR rates (column (c)).

2.4 In June 2001, the DEVB asked the EMSTF to explain why it was able to achieve a high rate of return on ANFA for 2000-01 (actual rate of 41.4%, net of interest income) which far exceeded the target rate of 13.5%. In response, the EMSTF informed the DEVB that the target return rate was regarded as the minimum requirement, and the high return rate was mainly due to:

(a) additional revenue from services not included in service agreements; and

(b) tight control of operating expenditure with more outsourcing of work.

Pricing strategy

2.5 According to the EMSTF, since November 2010, it has adopted a pricing strategy with a view to ensuring reasonable prices with lower profit margins while achieving the target rate of return on ANFA, and its target profit margins range from 5% to 10% for different services, and due consideration is given to market prices when bidding for tenders. Furthermore, as stated in EMSTF 2012-13 Annual Report, the EMSTF is in the process of trimming down its profit margins.

Achievement of EMSTF objectives

2.6 In February and March 2014, the EMSTF informed Audit that:

(a) the development of the EMSTF had been on the right track since its establishment in 1996, and it had taken actions to achieve the four objectives (see para. 1.7) of setting up the Fund;

(b) it was the first government department in Hong Kong which obtained the Corporate Certification for International Organization for Standardization (ISO — Note 7) 9001 Quality Management System for delivery of quality, safe and reliable services;

(c) it won the Gold Award of 2006 Hong Kong Management Association Quality Award; and

(d) the annual turnover of the EMSTF had increased from $2,654 million in 1997-98 to $4,643 million in 2012-13.

The EMSTF also informed Audit of its other achievements in the past 17 years (see Appendix B).

Actions taken to compare EMSTF prices with market prices

2.7 In April 1996, the Government informed the LegCo Panel on Financial Affairs that exposing the EMSD's services to direct price and performance comparisons would further improve its service standards and cost effectiveness. Furthermore, in June 1996, when proposing to establish the EMSTF, the Government informed LegCo that the purpose of setting up the EMSTF was to provide services and maintain competitiveness in a more flexible manner, and the EMSTF would continuously review the markets in which it would operate. In December 1996, the FSTB informed the EMSTF that B/Ds had expressed concerns over the EMSTF's high level of charges and the need for the EMSTF to become more competitive. In the same month, the Financial Secretary (Note 8) advised the EMSTF that it should find out what the private sector was charging for similar services provided by the EMSTF, and it should be able to match the commercial rates by 1999.

Note 7: *The ISO is an independent non-government organisation comprising national standards bodies for facilitating international coordination and unification of industrial standards.*

Note 8: *Under section 6(5) of the Trading Funds Ordinance, the Financial Secretary may issue directions to the General Manager of the EMSTF for the control and management of the trading fund and the General Manager shall comply with the directions.*

2.8 In September 1998, the EMSTF completed a benchmarking study (1998 Benchmarking Study) on the market prices for similar services provided by the EMSTF. The Study covered six divisions under the Engineering Services Branches 1 and 2 of the EMSTF (see Appendix A) and compared the EMSTF prices with those charged by selected private service providers for 37 types of E&M services, the revenue of which accounted for 73% of the EMSTF's operating revenue in 1998-99. The findings are shown in Table 3.

Table 3

Findings of 1998 Benchmarking Study
(September 1998)

Particulars	**EMSTF prices comparing with market prices**			
	More expensive (a)	**Less expensive (b)**	**Comparable (c)**	**Total (d) = (a) + (b) + (c)**
Types of E&M services	14 (38%)	16 (43%)	7 (19%)	37 (100%)
Percentage of operating revenue in 1998-99	46%	14%	13%	73% (Note)

Source: Audit analysis of EMSTF records

Note: E&M services accounting for 27% of the operating revenue in 1998-99 were not covered in this Study.

2.9 In February 2000, the Government informed the LegCo Panel on Financial Affairs that the EMSTF's prices and practice were generally comparable to major competitors in the market, and the EMSTF was particularly strong in areas of reliability, the range and depth of technical expertise, independent professional judgement and accountability.

2.10 From 2005-06 to 2009-10, the EMSTF had conducted small-scale benchmarking studies covering the prices of 13 types of E&M services. According to the EMSTF, these small-scale benchmarking studies mainly aimed at understanding the market practices for the purposes of improving the EMSTF's productivity, service quality and market competitiveness. Table 4 summarises the results of the price comparison of 13 types of E&M services with the market prices.

Table 4

Findings of small-scale benchmarking studies (2005-06 to 2009-10)

Particulars	EMSTF prices comparing with market prices			
	More expensive (a)	**Less expensive (b)**	**Comparable (c)**	**Total (d) = (a) + (b) + (c)**
Types of E&M services	4 (31%)	6 (46%)	3 (23%)	13 (100%)

Source: Audit analysis of EMSTF records

Areas for improvement

Lack of systematic comparison and alignment of EMSTF prices with market prices

2.11 Audit notes that the last EMSTF comprehensive market-price comparison exercise was conducted 16 years ago in 1998.

2.12 In February and March 2014, the EMSTF and the DEVB informed Audit that:

EMSTF

(a) the data obtained in the 1998 Benchmarking Study were limited and like-with-like comparison could not be made for some types of E&M services, and some data from the Study were outdated. Moreover, the findings of the Study were used for developing qualitative business strategies in the EMSTF's Corporate and Business Plans;

(b) in addition to the small-scale benchmarking studies conducted in subsequent years (see para. 2.10), the EMSTF had adopted the following approaches to review the market prices:

(i) ***Participating in competitive tendering exercises.*** The EMSTF obtained understanding of the latest market position and gathered market information through participation in competitive tendering exercises for E&M services, which covered the bulk of the EMSTF's services. Post-tender analyses were conducted for some unsuccessful EMSTF tenders to compare EMSTF tender prices and service quality with those of the winning tenders, and to review its tender pricing strategy and the impact on its overall business; and

(ii) ***Outsourcing work to contractors in the private sector.*** The EMSTF engaged contractors in the private sector to carry out some of its services, and collected updated market information through management of over 500 outsourced contracts of various E&M services;

(c) the market price information captured through competitive tendering exercises and outsourcing was analysed and used as reference for setting EMSTF prices. The outsourcing expenditure increased from $413 million in 1997-98 to $1,551 million in 2012-13;

(d) the annual review of the EMSTF's "Statement of Services and Charging Rates" took into account the results of price comparisons of tendering exercises conducted in the year, inflation as well as different service requirements;

(e) the EMSTF would continue to set reasonable prices with a view to maintaining the quality of services for the benefit of its clients and the public. In setting the prices, the delivery of safe, reliable, efficient and quality services was more important than alignment with the market prices; and

DEVB

(f) in the light of similar nature of work among contracts, results of post-tender analyses of competitive tendering exercises (see (b)(i) above) were applicable to similar work under other contracts. The EMSTF clients also made reference to market prices in negotiating service level agreements (SLAs — Note 9) with the EMSTF. Moreover, the EMSTF's outsourcing of services could also drive its prices towards the market prices.

2.13 Regarding the EMSTF's participation in competitive tendering exercises (see para. 2.12(b)(i)), Audit notes that, over the 17-year period from 1996-97 to 2012-13, the EMSTF had participated in 329 competitive tendering exercises for E&M services, of which 155 (47%) were successful. The total value of these 155 successful tenders was $1,972 million, which only accounted for 3.4% of the EMSTF's total turnover of $57,437 million during the 17-year period.

Note 9: *An SLA between the EMSTF and a user department incorporates the technical requirements, specifications and terms and conditions for the provision of EMSTF services.*

2.14 Although the EMSTF informed Audit that it had reviewed the market prices through participating in competitive tendering exercises and outsourcing its work to outside contractors (see para. 2.12(b)), Audit could not find evidence showing that the EMSTF had made use of the information obtained from the tendering exercises and outsourcing to systematically compare and align EMSTF prices with the market prices.

2.15 In Audit's view, the EMSTF needs to take action to systematically compare and align EMSTF prices with the market prices because the Financial Secretary had directed as early as in December 1996 that the EMSTF should be able to match the commercial rates by 1999 (see para. 2.7). Besides, this arrangement will help achieve one of the trading funds' objectives that the EMSTF should promote greater efficiency by exposing its services to competition through price comparisons (see para. 1.2(c)(ii)), and will help it more effectively reflect its financial performance.

Lack of plan to gainfully use the retained earnings

2.16 The EMSTF has accumulated substantial retained earnings since its establishment, from $104 million in 1996-97 to $2,308 million in 2012-13. During the 17-year period, the EMSTF had paid dividends totalling $3,945 million to the Government (see Table 5).

Table 5

Retained earnings and cumulative dividends paid to the Government (1996-97 to 2012-13)

Year	Retained earnings ($ million)	Cumulative dividends paid to Government (Note) ($ million)
1996-97	104	45
1997-98	288	124
1998-99	517	222
1999-00	752	323
2000-01	1,086	466
2001-02	1,441	618
2002-03	1,372	754
2003-04	1,627	863
2004-05	1,749	1,085
2005-06	1,843	1,319
2006-07	1,960	1,576
2007-08	1,973	1,930
2008-09	1,946	2,323
2009-10	1,980	2,777
2010-11	2,108	3,185
2011-12	2,223	3,580
2012-13	2,308	3,945

Source: EMSTF records

Note: According to the 1996 Framework Agreement, the amount of dividends paid to the Government shall be determined by the Secretary for Financial Services and the Treasury. The EMSTF's dividend payout ratio increased from 30% (from 1996-97 to 2003-04) to 50% (from 2004-05 to 2012-13), and special dividends totalling $1,200 million had been paid to the Government from 2004-05 to 2012-13. For 2013-14, the FSTB has set a dividend payout ratio of 100%.

2.17 In June 2001, the FSTB informed the EMSTF that it could finance its capital investment from its retained earnings. In 2003, in response to the DEVB's request, the EMSTF conducted a review of the use of its retained earnings of $1,441 million as of March 2002. According to the EMSTF, the review was conducted having regard to the business uncertainties underpinned by some external factors, such as tightening of government expenditure and pressure for price reductions. The review concluded that the retained earnings would be used to meet various requirements such as investments in the EMSTF's corporate computer system and human resources development. At a meeting in July 2007 on the financial monitoring of the EMSTF (see para. 1.12), the FSTB said that, in general, surplus funds in the EMSTF should be returned to the Government.

2.18 In June 2011, based on the FSTB's advice, the EMSTF made a placement of $2,200 million with the Exchange Fund (managed by the Hong Kong Monetary Authority) for a six-year term. In March 2013, the FSTB informed the EMSTF that the dividend payout ratio should be increased to 100% of the profit for 2013-14.

2.19 In February and March 2014, the EMSTF informed Audit that:

(a) since 2001, the EMSTF had been regularly reviewing the way to make the best use of the retained earnings for business development and would continue to do so. The DEVB and the FSTB also regularly reviewed the financial performance of the EMSTF, including its retained earnings;

(b) in 2002, in view of the external factors underlining some major business uncertainties, EMSTF decided to utilise its retained earnings to strengthen its competitiveness and to develop businesses. From 2004-05 to 2009-10, the EMSTF contributed a total sum of $400 million from its retained earnings as a special dividend for implementation of energy saving projects in government premises. From 2004-05 to 2012-13, special dividends totalling $1,200 million had been paid out to the Government from the EMSTF's retained earnings; and

(c) other than the need to meet the funding requirement for the EMSTF's capital expenditure for information technology projects, improvement works and replacement of vehicles and equipment, the retained earnings of $2,308 million as of March 2013 could cover five months' operating expenditure of the EMSTF.

2.20 In Audit's view, the EMSTF needs to conduct a review to ascertain the amount of reserve and working capital required for its operation, including the amount of fund required for the acquisition and replacement of fixed assets in the near future. It should also return any surplus fund to the Government upon the maturity of the placement of $2,200 million with the Exchange Fund in May 2017.

Audit recommendations

2.21 **Audit has *recommended* that the Director of Electrical and Mechanical Services should:**

(a) **take action to systematically compare and align EMSTF prices with market prices; and**

(b) **conduct a review to ascertain the amount of reserve required for the operation of the EMSTF and return any surplus fund to the Government.**

Response from the Administration

2.22 The Director of Electrical and Mechanical Services agrees with the audit recommendations. He has said that the EMSTF will continue to take action on the audit recommendations, and set reasonable prices in maintaining the quality of services for the benefit of its clients and the public.

2.23 The Secretary for Financial Services and the Treasury agrees with the audit recommendation in paragraph 2.21(b).

EMSTF efforts to seek business opportunities outside the government sector

2.24 According to the 1996 Framework Agreement, the EMSTF will bid for and win business in other markets as the opportunity arises (see para. 1.10(b)). In October 1998, in seeking legal advice on the legal status of the EMSTF, the EMSTF informed the Department of Justice that the EMSTF had to compete for survival upon untying, and might have to seek business opportunities outside the government-sector clientele.

2.25 Furthermore, according to EMSTF Corporate and Business Plan for 1999-2000 to 2003-04:

(a) the overall policy of setting up the EMSTF was to improve the efficiency of the EMSD in the delivery of E&M services through market competition; and

(b) the EMSTF was required to compete against private-sector operators in the provision of services to government departments and public bodies. In order to survive, the EMSTF must remain competitive and explore new opportunities.

2.26 In March 2001, the DEVB informed the EMSTF that, in order to acquire a separate legal status for engaging in business and widening its scope of services, legislative amendments to the Trading Funds Ordinance might be needed. In the same month, after seeking legal advice, the EMSTF informed its Executive Board (see para. 1.11) that:

(a) for the short term, the EMSTF would continue the present strategy to retain existing businesses and develop new ones in the public sector;

(b) for the medium term, amendments should be made to the Trading Funds Ordinance to the effect that the EMSTF could expand the scope of services to include facilities management; and

(c) for the long term, the EMSTF would keep in view the need for seeking a separate legal status having regard to the roll out of the untying programme relating to the EMSTF.

2.27 In June 2001, the EMSTF informed the DEVB that there was no urgency in pursuing the amendment to the Trading Funds Ordinance because it considered, among other things, that the perceived threats of business loss of the EMSTF could largely be avoided by means of administrative measures. In March 2014, the EMSTF informed Audit that:

(a) the perceived threat of business loss in June 2001 was the difficulty to form a joint venture to bid for contracts involving non-E&M works; and

(b) to address this difficulty, the EMSTF had sub-let the relevant work to sub-contractors or consultants with relevant expertise.

Areas for improvement

EMSTF clients confined to B/Ds and quasi-government bodies

2.28 Audit examination revealed that the EMSTF mainly derived its revenue from B/Ds and the HA. Table 6 shows the major clients (in terms of revenue) of the EMSTF in 2002-03 and 2012-13.

Table 6

Major EMSTF clients
(2002-03 and 2012-13)

Client	Revenue			
	2002-03 ($ million)		**2012-13 ($ million)**	
(a) HA	676	62%	907	56%
(b) LCSD	485		646	
(c) FEHD	226		281	
(d) ArchSD	266		266	
(e) HKPF	202		256	
(f) GPA	220		222	
(g) Others (Note)	1,247		2,065	
Total	3,322		4,643	

Source: EMSTF records

Note: These mainly included other B/Ds, the Airport Authority Hong Kong and LegCo.

Financial and operation performance

2.29 In 2012-13, the EMSTF derived $4 million of revenue from private organisations, accounting for only 0.1% of its revenue. Examples of private-sector clients included:

(a) ***Company A.*** The EMSTF acted as the sub-consultant for Company A (who was the main consultant to the ArchSD) in providing building services for public swimming pool complexes in Tung Chung and Tuen Mun, and construction of an annex building for a theatre (EMSTF revenue of $2.2 million); and

(b) ***Company B.*** The EMSTF charged the operating cost of a generator for a radio base station installed by Company B at a room located in government premises (which was managed by the GPA) on Green Island (EMSTF revenue of $0.3 million).

2.30 In February 2014, the EMSTF informed Audit that:

(a) since its establishment in 1996, it had been exploring new business opportunities in new areas, which included providing services to private-sector clients and expanding its E&M services to cover other E&M related services (such as information and communication technology) for the existing clients;

(b) it had sought legal advice between 1999 and 2001 and considered that the EMSTF should not go beyond the scope of government service. In the event, the EMSTF focused on business development opportunities within the government sector. From 1997-98 to 2012-13, its annual business turnover increased from $2.65 billion to $4.64 billion; and

(c) the objectives of private-sector participation in paragraph 2.29 were to facilitate the provision of EMSTF services to the public. They were exceptional because the EMSTF focused its business in the government sector.

2.31 Audit notes that the EMSTF may, having regard to the roll out of the untying arrangement, widen its scope of services after obtaining a separate legal status (see para. 2.26(c)). In Audit's view, in accordance with the 1996 Framework Agreement, the EMSTF needs to bid for and win business in markets other than B/Ds, government subvented or financially assisted agencies as opportunities arise (see para. 1.10(b)). In this connection, greater efficiency and cost-consciousness would be achieved by exposing EMSTF services to competition or to quasi-commercial pressures (see para. 1.3(b)). Furthermore, as the EMSTF may lose business if B/Ds diversify their acquisition of E&M services to other service providers, the EMSTF needs to explore business opportunities in other markets.

Audit recommendation

2.32 **Audit has *recommended* that the Director of Electrical and Mechanical Services should take action to explore business opportunities in markets other than B/Ds, government subvented or financially assisted agencies.**

Response from the Administration

2.33 The Director of Electrical and Mechanical Services agrees with the audit recommendation.

B/D efforts to acquire E&M services through competitive tendering

Untying arrangement of EMSTF services

2.34 According to Financial Circular No. 9/99 "Untying Departments from the Services of the EMSTF" issued in June 1999, upon untying from August 2002, user departments would be free to retain the services of the EMSTF or to choose alternative service providers to meet part or all of their E&M service needs (see para. 1.15(c)). Furthermore, Financial Circular No. 6/2001 "Use of Trading Fund Services" issued in August 2001 states that a Controlling Officer may choose to enter into an SLA with a trading fund direct, without recourse to competitive bidding, if he or she is clearly satisfied that:

(a) the trading fund is fully capable of delivering in a cost-effective manner specific services that his or her department needs; and

(b) having regard to the circumstances of the case (such as the urgency or the special circumstances of the services required), inviting competitive bidding for the delivery of such services is not appropriate.

The Controlling Officer will be accountable for the decision on why competitive bidding is not appropriate.

Previous Audit Reports on B/Ds acquiring EMSTF services without competitive tendering

2.35 From 2001 to 2012, Audit had issued five Audit Reports which covered some B/Ds which had entered into SLAs with the EMSTF without conducting competitive tendering (see Appendix C).

Areas for improvement

B/Ds not conducting competitive tendering before obtaining EMSTF services

2.36 ***Audit survey.*** According to EMSTF Corporate and Business Plan for 2012-13 to 2016-17, about 75% of its business revenue was secured through SLAs for operation and maintenance services, with the remaining from ad hoc jobs and projects, and annual maintenance contracts. In December 2013 and January 2014, Audit conducted a user survey on the procurement of E&M services by major EMSTF clients through service agreements which were in force as of December 2008 and December 2013. The survey included six major EMSTF clients covering the HA and five B/Ds (namely the LCSD, the FEHD, the ArchSD, the HKPF and the GPA). In view of the fact that the HA is an autonomous body which has the discretion to choose its service providers, Audit analysis focused on the five B/Ds. The survey results are shown in Table 7.

Table 7

Award of E&M service agreements exceeding the quotation limits by the five B/Ds (Note 1) (December 2008 and December 2013)

B/D	As of December 2008				As of December 2013			
	Service agreement awarded				Service agreement awarded			
	through competitive tendering (Note 2)		to EMSTF through direct negotiation		through competitive tendering (Note 2)		to EMSTF through direct negotiation	
	No.	Estimated annual value ($ million)	No.	Estimated annual value ($ million)	No.	Estimated annual value ($ million)	No.	Estimated annual value ($ million)
LCSD	6 (Note 3)	55 (10%)	1	507 (90%)	6 (Note 4)	87 (13%)	1	571 (87%)
FEHD	2 (Note 5)	9 (5%)	2	161 (95%)	0	0 (0%)	3	222 (100%)
ArchSD	0	0 (0%)	2	169 (100%)	0	0 (0%)	4	187 (100%)
HKPF	0	0 (0%)	2	198 (100%)	0	0 (0%)	1	202 (100%)
GPA	0	0 (0%)	1	166 (100%)	0	0 (0%)	1	210 (100%)
Overall	8	64 (5%)	8	1,201 (95%)	6	87 (6%)	10	1,392 (94%)

Source: Audit survey

Note 1: According to Stores and Procurement Regulation 220 (updated in June 2013), the quotation limit for procuring stores, services and revenue contracts is $1.43 million, and the quotation limit for procuring services for construction and engineering works is $4 million. The number of service agreements refers to those in force as of December 2008 and December 2013.

Note 2: Some of the service agreements were awarded to the EMSTF and some to private service providers.

Note 3: The EMSTF had participated in 4 of the 6 tender exercises and won 1 service agreement.

Note 4: The EMSTF had participated in 2 of the 6 tender exercises and won 2 service agreements.

Note 5: The EMSTF had participated in the 2 tender exercises and won the 2 service agreements.

2.37 For the LCSD, as of December 2013, seven E&M service agreements were in force (see Table 8 for details).

Table 8

Seven E&M service agreements of the LCSD
(December 2013)

Agreement particulars	Service agreement awarded through	Service provider	Estimated annual value ($ million)
(a) Comprehensive E&M services for 1,700 LCSD venues	Direct negotiation	EMSTF	571
(b) Technical sound services for performing arts venues	Competitive tendering	A private company	53
(c) Technical services for Ko Shan Theatre	Competitive tendering	EMSTF	11
(d) Technical services for Hong Kong Science Museum and Hong Kong Space Museum	Competitive tendering	A private company	7
(e) Technical sound services for Hong Kong Coliseum and Queen Elizabeth Stadium	Competitive tendering	A private company	6
(f) Technical services for Hong Kong Museum of History and Hong Kong Heritage Museum	Competitive tendering	A private company	6
(g) Maintenance services for LCSD vehicles	Competitive tendering	EMSTF	4
		Total	658

Source: LCSD records

2.38 The LCSD's SLA for comprehensive E&M services for 1,700 LCSD venues (item (a) in Table 8) at an estimated annual value of $571 million expired on 31 March 2014. From October 2013 to March 2014, the EMSTF conducted direct negotiation with the LCSD and entered into a new SLA for three years commencing 1 April 2014, with an option of a further three-year term from 1 April 2017. In Audit's view, the LCSD needs to conduct competitive tendering in procuring E&M services for its venues as far as possible. In order to attract private service providers to participate in the tendering, the LCSD may consider splitting the service agreement covering all the 1,700 LCSD venues into service agreements covering different clusters of venues.

2.39 Audit survey revealed that major EMSTF clients mostly awarded their SLAs to the EMSTF through direct negotiation, instead of through competitive tendering. As of December 2013, in terms of contract value, except the LCSD of which 87% of its E&M service agreements had been awarded to the EMSTF through direct negotiation, the other four B/Ds, namely the FEHD, the ArchSD, the HKPF and the GPA, had awarded all their service agreements to the EMSTF through direct negotiation (see Tables 7 and 8). According to Audit survey, the LCSD, the FEHD, the ArchSD, the HKPF and the GPA provided the following reasons for concluding all or most of their E&M service agreements with the EMSTF without conducting competitive tendering:

(a) ***Direct approach allowed under Financial Circular No. 6/2001.*** According to the Circular, a Controlling Officer might choose to enter into an SLA with a trading fund direct, without recourse to competitive bidding (the LCSD, the FEHD, the HKPF and the GPA);

(b) ***Lack of expertise in tendering.*** B/Ds lacked the expertise in preparing tender specifications. Additional costs and efforts would also be involved in conducting tender exercises and contract arrangements (the LCSD and the FEHD);

(c) ***Lack of capability in supervising private contractors.*** B/Ds lacked the capability to supervise and monitor the work of private contractors (the LCSD and the GPA);

(d) ***Difficulty in finding a private contractor for comprehensive services.*** It was difficult to find a private contractor to provide services for a comprehensive range of facilities and equipment, respond timely under emergency situations and deliver the required services in a cost-effective manner (the LCSD, the FEHD and the ArchSD);

(e) ***Previous tendering experience.*** Competitive tendering for some services had been conducted in the past, but no tender was received from the private sector or the prices quoted by the EMSTF were the lowest (the FEHD and the GPA); and

(f) ***Expertise of the EMSTF.*** The EMSTF had expertise in providing E&M services for a wide range of areas and systems of its clients, and could attend to emergency situations. Inviting competitive bidding for delivery of some services was not appropriate (the LCSD, the FEHD, the ArchSD and the GPA). The EMSTF was familiar with government policies and regulations, as well as facilities requiring maintenance (the ArchSD).

2.40 According to Stores and Procurement Regulation 126, in conducting procurement exercises, competition is a reliable safeguard against bidders overcharging and Controlling Officers should adopt open bidding as far as practicable to secure value for money procurement. Regarding the reasons quoted by the pertinent B/Ds for not conducting competitive tendering for E&M services on the lack of experience in drawing up tenders and supervising a contractor's work, it is relevant to note that the Efficiency Unit organised in 2002 various seminars and experience sharing sessions to assist B/Ds to prepare their specific tender specifications and resolve their difficulties in outsourcing services. Therefore, they should take action to enhance their expertise in these areas. Furthermore, according to Financial Circular No. 5/2001 "Guidelines for Trading Funds Bidding for Government Contracts" issued in August 2001, procuring departments may engage independent consultants to assist in the preparation of tender invitation documents and the design of tender evaluation processes. Moreover, B/Ds need to conduct competitive tendering upon the expiry of SLAs with the EMSTF because the EMSTF may not be the best service provider given that the business environment and market competitors may change over time.

2.41 In debating the motion of establishing the EMSTF in June 1996, some LegCo Members expressed the following views:

(a) the rationale of establishing trading funds was to enable government departments to cater to the market and seek cost effectiveness by means of market operation, including the introduction of competition to increase the efficiency of their operations. Only those government departments which organised activities and provided services of a commercial nature should be operated under trading funds; and

(b) unlike other trading funds, the EMSD acted as a service provider to government departments and quasi-government bodies, and the majority of its services were easily available in the private sector. If the EMSD did not have to compete in the market, it would never attain its maximum efficiency.

2.42 Audit is concerned that, 17 years after its establishment, the EMSTF still relies primarily on B/Ds and some quasi-government bodies for its business, and B/Ds continue to rely predominantly on the EMSTF to supply E&M services. In Audit's view, in order to secure value for money, B/Ds need to conduct competitive tendering in procuring their E&M services in future as far as possible. The FSTB also needs to remind B/Ds of the need to conduct competitive tendering in procuring E&M services in future as far as possible.

Audit recommendations

2.43 **Audit has *recommended* that the Director of Leisure and Cultural Services, the Director of Food and Environmental Hygiene, the Director of Architectural Services, the Commissioner of Police and the Government Property Administrator should:**

(a) **conduct competitive tendering in procuring E&M services in future as far as possible;**

(b) **provide training to their staff to enhance their expertise in preparing tender specifications, and supervising and monitoring the work of private contractors; and**

(c) **engage consultants, if necessary, to assist in the tender preparation and evaluation.**

2.44 **Audit has also *recommended* that the Secretary for Financial Services and the Treasury should remind B/Ds of the need to conduct competitive tendering in procuring E&M services in future as far as possible.**

Response from the Administration

2.45 The Director of Leisure and Cultural Services agrees with the audit recommendations in paragraph 2.43. She has said that the LCSD has carried out tender exercises where appropriate, and would continue to do so as far as practicable.

2.46 The Director of Food and Environmental Hygiene agrees with the audit recommendations in paragraph 2.43. She has said that the FEHD would review the procurement of E&M services before the expiry of the SLAs with the EMSTF.

2.47 The Director of Architectural Services agrees with the audit recommendations in paragraph 2.43. He has said that the ArchSD will conduct competitive tendering in procuring E&M services in future as far as possible.

2.48 The Commissioner of Police agrees with the audit recommendations in paragraph 2.43.

2.49 The Government Property Administrator agrees with the audit recommendations in paragraph 2.43. He has said that the GPA:

(a) has a mechanism to conduct competitive tendering in procuring E&M services and will continue its implementation as far as practicable; and

(b) will consider providing staff training on the preparation of tender specifications and engaging consultants for tender preparation and evaluation.

2.50 The Secretary for Financial Services and the Treasury agrees with the audit recommendation in paragraph 2.44.

PART 3: MANAGEMENT OF OVERTIME WORK

3.1 This PART examines the EMSTF's management of staff overtime work.

Overtime work

3.2 According to the Civil Service Regulations (CSRs):

(a) overtime is work undertaken over and beyond an officer's conditioned hours, which may be undertaken only when it is unavoidable;

(b) overtime must be authorised in advance and should be strictly controlled, properly supervised, and kept to the absolute minimum compatible with operational requirements. Regular or excessive overtime is not in the interest of staff or the service and should be avoided as far as possible and strictly limited;

(c) government departments should set a ceiling for the overtime hours, as follows:

  (i) normally at 60 hours in a month which an officer may undertake or at a lower level if the departments see fit; and

  (ii) normally at 180 uncompensated overtime hours accumulated at any one time by an officer or at a lower level if the departments see fit;

(d) overtime work performed should normally be compensated by time off in lieu. Granting of time off is subject to exigencies of service; and

(e) where time off in lieu is, or is likely to be, impracticable within one month of the date on which the overtime is worked, an overtime allowance (Note 10) may be paid.

NCSC staff not entitled to overtime allowance

3.3 According to CSB Circular No. 2/2001 "Employment of NCSC Staff" issued in January 2001, apart from the basic pay, NCSC staff are not entitled to any of the civil service job-related cash allowances, overtime allowance and acting allowances. The Circular also states that overtime work done in excess of the normal hours of work should be compensated by time off in lieu.

Pay for overtime work of NCSC staff of EMSTF

3.4 Regulations, rules and guidelines promulgated by the CSB relating to civil servants and NCSC staff are applicable to the EMSTF.

Exchange of views of the EMSTF and the CSB in March 2001

3.5 In March 2001, the EMSD sought the CSB's confirmation of its understanding that, in order to enable it to have more flexibility in staff deployment in providing quality and efficient service to its clients, the EMSD had the discretion to remunerate NCSC staff at an hourly rate, where necessary, in addition to the monthly salary paid. In response, the CSB advised the EMSD that:

(a) under the NCSC scheme, Heads of Departments were given the discretion to decide on the way their NCSC staff were remunerated, i.e. on an hourly, weekly, or monthly basis; and

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Note 10: *Except for officers in certain ranks or grades such as those in administrative and professional grades, officers in ranks whose maximum pay point is on or below Point 25 and whose minimum pay point is on or below Point 19 of the Master Pay Scale, and officers in ranks under Model Scale 1 are eligible for overtime allowance. The normal hourly rate of overtime allowance is 1/140 of an officer's monthly salary. For daily-rated staff, the normal rate is one and a half times of the hourly pay.*

(b) Heads of Departments were held fully accountable for the funding and employment of NCSC staff, and were responsible for justifying or defending the employment of NCSC staff when questioned.

EMSTF's creation in 2001 of "hourly-rated pay for additional work in addition to monthly salary" for NCSC staff

3.6 In May 2001, the EMSTF issued internal guidelines stating that, in addition to the monthly salary, exceptional approval might be given for five categories of technical NCSC staff (namely Contract Assistant Inspector, Contract Works Supervisor, Technician, Craftsman and Contract Workman) to be remunerated at an hourly rate (Note 11) for additional work when the granting of time off in lieu was not practicable. The EMSTF also laid down control guidelines and procedures for applications and approvals of such hourly-rated pay. From 2002 to 2013, the EMSTF granted approvals for additional 17 categories of NCSC staff (including Clerical Support Assistant, Management Support Officer and Senior Information Technology Officer) to be remunerated at an hourly rate for additional work. As of December 2013, 895 NCSC staff of the EMSTF had been approved to receive such hourly-rated pay. In 2012-13, the hourly-rated pay to NCSC staff for additional work amounted to $22 million.

Audit views on "hourly-rated pay for additional work in addition to monthly salary"

3.7 In Audit's view, the EMSTF's "hourly-rated pay for additional work in addition to monthly salary" for NCSC staff is essentially the same as overtime allowance. Therefore, in this Audit Report, overtime allowance is used to cover both the overtime allowance of civil servants and "hourly-rated pay for additional work in addition to monthly salary" for NCSC staff.

Note 11: *The hourly rate for additional work (essentially the same as overtime allowance — see para. 3.7) of an officer is equivalent to his average hourly rate (monthly salary divided by the monthly normal working hours).*

Overtime allowance in recent years

3.8 As of December 2013, the EMSTF had 4,768 staff, comprising 3,341 civil servants and 1,427 NCSC staff. Table 9 shows overtime allowance paid to EMSTF staff in the past three years.

Table 9

Overtime allowance paid
(2010-11 to 2012-13)

Particulars	Civil servants	NCSC staff
(a) Overtime allowance paid in 2010-11	\$106 million	\$22 million
(b) Overtime allowance paid in 2011-12	\$112 million	\$21 million
(c) Overtime allowance paid in 2012-13	\$117 million	\$22 million
(d) Number of staff as of December 2013	3,341 staff	1,427 staff
(e) Number of staff claimed to be eligible for overtime allowance as of December 2013 (see Note 10 to para. 3.2(e))	2,708 staff (81%)	895 staff (63%) (Note)
(f) Average overtime allowance per eligible staff in 2012-13 [(f) = (c) ÷ (e)]	\$43,205	\$24,581

Source: Audit analysis of EMSTF records

Note: According to CSB Circular No. 2/2001, NCSC staff are not entitled to overtime allowance (see para. 3.3).

3.9 In February 2014, the EMSTF informed Audit that:

(a) in 2012-13, each eligible civil servant on average earned overtime allowance of $831 for working 5.9 overtime hours a week;

(b) in the same year, each eligible NCSC staff on average earned overtime allowance of $473 for working 5.6 overtime hours a week; and

(c) in 2012-13, the total overtime allowance of $139 million ($117 million plus $22 million) represented 6.6% of the total EMSTF staff cost of $2,095 million. The percentages in 2010-11 and 2011-12 were 7.1% and 6.8% respectively.

3.10 The EMSTF has promulgated circulars and guidelines for the administration and control of overtime for civil servants and NCSC staff. According to EMSTF guidelines on application and approval of overtime work issued in May 2009:

(a) officers should well be aware that overtime work shall be undertaken when it is strictly unavoidable; and

(b) for overtime work in excess of 40 hours but not exceeding 60 hours a month, and for overtime work in excess of 60 hours a month, approval should be sought from an Assistant Director and the Deputy Director of the EMSTF respectively.

Areas for improvement

Granting of overtime allowance to NCSC staff inconsistent with CSB policy and guidelines

3.11 CSB Circular No. 2/2001 (see para. 3.3) has stipulated that NCSC staff should not be entitled to overtime allowance. This guideline applies to the NCSC staff of the EMSTF.

3.12 In March 2014, the CSB informed Audit and the EMSTF that:

(a) CSB Circular No. 2/2001 issued in January 2001 provided guidelines on the employment of NCSC staff. The Circular and the guidelines in respect of compensation for overtime work therein remained valid today; and

(b) the CSB's advice that "Heads of Departments are given the discretion to decide on the way their NCSC staff are remunerated" (see para. 3.5(a)) did not pinpoint overtime work. It merely reiterated the general principle that Heads of Departments had the authority to determine how NCSC staff should be remunerated for the hours of work stipulated in the appointment letter. In any event, the advice should be read in conjunction with and interpreted in the context of CSB Circular No. 2/2001. Granting overtime pay to NCSC staff was inconsistent with CSB policy and guidelines. Such being the case, the EMSD should, and had been advised to, rectify the situation and consider the need to change, and if so, the basis on which its NCSC staff would be remunerated within a reasonable timeframe.

3.13 In the same month, after noting the CSB's views in paragraph 3.12, the EMSTF informed Audit and the CSB that:

(a) EMSTF management was aware of the restriction laid down in CSB Circular No. 2/2001. However, the EMSTF's NCSC technical staff (over 180 in 2001) were very often required to perform shift duties and work long hours to meet operational requirements because of the need to maintain or restore public services during and outside office hours. It was generally impractical to recompense the overtime work of the NCSC staff with time off in lieu given the EMSTF's tight manpower and the unavoidable nature of the work. EMSTF staff had expressed concerns over the condition of services of NCSC staff, including lack of fair payments for their work rendered beyond the normal working hours. The EMSTF management also noted that section managers had difficulties to manage their workforce in carrying out duties. Moreover, since the EMSTF had all along been conscientious in keeping tight control over the growth of manpower, it was unable to solve the problem simply by an increase in staff size;

(b) the EMSD therefore approached the CSB in 2001 to look for an appropriate way to tackle the issue (see para. 3.5). Based on the CSB's view then given (see para. 3.5(a)), the EMSTF management considered that it had the discretion to remunerate NCSC staff at hourly-rated pay in addition to the monthly salary. On the understanding that overtime allowance could not be granted to NCSC staff, the EMSTF worked out a remuneration package with hourly-rated pay for additional work for NCSC staff in addition to their monthly salary. The pay was fair compensation for work done. The EMSTF management then believed that the hourly-rated pay was not overtime allowance under CSRs 670 to 672 (Note 12), as they were different in the calculation method. The hourly-rated pay scheme had been in place since 2001 and had been a cost-effective way to solve the EMSTF's manpower problem and to address its special operation needs; and

(c) as revealed from the CSB's advice in March 2014 (see para. 3.12), it was unfortunate that the EMSTF management's understanding and interpretation of the exchange of views with the CSB back in 2001 (see para. 3.5) were different from those of the CSB.

Note 12: *CSRs 670 to 672 specify the types of officers eligible for overtime allowance and the method of remunerating staff for working long overtime hours.*

3.14 The CSB has clearly stated that granting overtime pay to NCSC staff of the EMSTF is inconsistent with the CSB policy and guidelines (see para. 3.12(b)). In this connection, the EMSTF agrees that it was unfortunate that its understanding and interpretation of the exchange of views with the CSB back in 2001 were different from those of the CSB (see para. 3.13(c)). In Audit's view, in order to comply with the Government's policy on granting allowance to NCSC staff as promulgated in CSB Circular No. 2/2001, the EMSTF needs to take action to rectify the situation. The EMSTF also needs to comply with the CSB guidelines for compensating staff overtime work in future.

EMSTF approval with retrospective effect given for some NCSC staff to receive overtime allowance

3.15 In August 2007, the EMSTF created a new NCSC rank of Worker (Cremation Service). Audit examination revealed that, from August 2007 to January 2014 (6 years and 6 months), a total of 30 Workers (Cremation Service) had been granted overtime allowance amounting to $565,000. However, Audit noted that, as of January 2014, the EMSTF had not given approval for this rank of officers to receive overtime allowance. On 21 February 2014, after noting Audit's observation, the Director of Electrical and Mechanical Services approved the granting of overtime allowance to Workers (Cremation Service) with retrospective effect from August 2007.

3.16 In March 2014, the EMSTF informed Audit that:

(a) the job nature of the Workers (Cremation Service) justified hourly-rated pay and it was only due to an oversight that approval had not been sought before; and

(b) the Director of Electrical and Mechanical Services was therefore duty bound to exercise his discretion to give the covering approval for the work already done by the workers concerned since August 2007.

3.17 In the same month, the CSB informed Audit and the EMSTF that:

(a) given that NCSC staff's overtime work should not be compensated by pay as a matter of policy, the EMSD should not have granted overtime allowance to NCSC staff in the first place; and

(b) therefore, there should be no question of giving approval, retrospective or not, to the grant of overtime allowance.

Similar to the granting of overtime allowance to NCSC staff (see para. 3.14), Audit considers that the EMSTF needs to take action to comply with CSB Circular No. 2/2001 in compensating staff overtime work.

Overtime work largely recompensed by overtime allowance

3.18 In 2012-13, the total overtime allowance paid to civil servants of all B/Ds accounted for under the General Revenue Account amounted to $253 million. In the same year, overtime allowance paid to civil servants under the EMSTF (not accounted for in the General Revenue Account) was $117 million, representing 46% of $253 million.

3.19 Audit examination revealed that, in 2012-13, a high percentage of EMSTF overtime work was recompensed by overtime allowance, as follows:

EMSTF Staff	**Total overtime work in 2012-13 (hour)**	**Overtime work recompensed by allowance (hour)**	**Overtime work recompensed by time off in lieu (hour)**
Civil servants	837,318 (100%)	803,647 (96%)	33,671 (4%)
NCSC staff	260,305 (100%)	234,163 (90%)	26,142 (10%)

However, according to CSR, overtime work performed should normally be compensated by time off in lieu (see para. 3.2(d)). In addition, according to CSB Circular No. 18/2000 "Guidelines on Control and Administration of Overtime" issued in November 2000, time off is granted preferably before a staff takes his earned leave, unless the staff concerned has accumulated the maximum amount of earned vacation leave permissible under the relevant CSR. The CSB Circular further states that, where the problem is serious, Heads of Departments must review the overtime situation at least annually with a view to identifying any problem areas and taking rectification measures. In Audit's view, apart from the fact that NCSC staff should not be entitled to overtime allowance (see para. 3.3), the EMSTF needs to conduct a review of the high percentages of overtime work being recompensed by overtime allowance instead of time off in lieu.

Some staff continuously performed long hours of overtime work

3.20 Audit examination revealed that, for the 12 months from November 2012 to October 2013, 116 civil servants and 9 NCSC staff each performed overtime work in excess of 40 hours every month during the period. These 125 officers each on average performed 47 to 62 hours of overtime work a month during the period (equivalent to 11 to 14 hours of overtime work a week, or 24% to 31% of the normal working hours in a 45 working-hour week). EMSTF approvals had been given for the overtime work. In February 2014, the EMSTF informed Audit that these 125 officers having long hours of overtime work a month represented only 3.5% of all 3,603 EMSTF staff eligible for receiving overtime allowance (2,708 civil servants and 895 NCSC staff — see Table 9 in para. 3.8).

3.21 Furthermore, Audit notes that, of the 125 officers, 9 civil servants performed over 60 hours of overtime work in one or more months (see Table 10).

Table 10

**Overtime work of 9 officers
(November 2012 to October 2013)**

Officer	Overtime work exceeding 60 hours in a month	Average monthly overtime work (hour)
Officer A	64 hours in March 2013	55
Officer B	61.5 hours in September 2013	57
Officer C	62 hours in February 2013	58
Officer D	63.5 hours in August 2013	59
Officer E	66 hours in September 2013	59
Officer F	66.5 hours in September 2013	59
Officer G	63.5 hours in February 2013 and 67.5 hours in April 2013	59
Officer H	67.5 hours in February 2013 and 66.5 hours in March 2013	60
Officer I	68 hours in December 2012, 69 hours in February 2013 and 75.5 hours in March 2013	62

Source: Audit analysis of EMSTF records

3.22 According to CSR, regular or excessive overtime work is not in the interest of staff or the service and should be avoided as far as possible and strictly limited (see para. 3.2(b)). Furthermore, as stated in CSB Circular No. 18/2000:

(a) habitual overtime work is undesirable, and excessive or regular overtime should be discouraged as far as possible; and

(b) when overtime work becomes a regular pattern of work, management should review the work patterns and consider alternative methods of deploying staff.

3.23 In February and March 2014, the EMSTF informed Audit that:

(a) overtime work covered both unpredicted and planned activities to meet clients' needs, and they were strictly unavoidable. The duties were essential, must be performed, and could not be performed by another officer at that time. Such duties included emergency work, attendance to breakdown of essential machinery, equipment, systems and plants, and special work requested by clients. It was impractical to recompense the overtime work by time off in lieu in view of the manpower constraints;

(b) the granting of overtime approval was subject to stringent control of the EMSTF. EMSTF division heads had been paying personal attention to ensure that overtime work was kept to the absolute minimum compatible with operational requirements; and

(c) the EMSTF conducted annual reviews in accordance with CSB Circular No. 18/2000. According to the review conducted in 2012, the amount of overtime allowance paid to civil servants for 2010-11 was contained at a level of $106 million, despite the limited manpower resources and increase in service demand.

3.24 In Audit's view, the EMSTF needs to closely monitor the situation and step up measures to prevent habitual and long hours of overtime work of its staff.

Officers allowed to take vacation leave instead of time off for compensating overtime work

3.25 According to CSB Circular No. 18/2000, time off for overtime work is granted preferably before a staff takes his earned leave, unless the staff concerned has accumulated the maximum amount of earned vacation leave permissible under the relevant CSR (Note 13).

Note 13: *Under the CSR, there is a ceiling on the amount of earned vacation leave an officer can accumulate which differs among officers with different terms of employment. Upon reaching the accumulated leave ceiling, any leave earned by an officer is forfeited.*

3.26 From November 2012 to October 2013, a total of 34 civil servants of the EMSTF performed overtime work of at least 55 hours every month during the period. Audit examination revealed that, of these 34 civil servants, 25 (74%) had been approved to take vacation leave during the period while they had uncompensated overtime work balance, and at the same time their vacation leave balance had not reached the maximum levels (see Case 1 for an example). In February 2014, the EMSTF informed Audit that these 25 civil servants represented 0.9% of all 2,708 civil servants eligible for receiving overtime allowance as of December 2013.

Case 1

1. The EMSTF records the overtime-work hours of officers in a computer system. At the month end, overtime-work hours of an officer which have not been compensated by time off in lieu may be recompensed by overtime allowance, or carried forward to the next month.

2. Officer J performed 58 hours of overtime work from 1 to 26 August 2013. On 26 August 2013, in addition to the 58 hours of overtime work earned in the month, he also had 23 hours of time-off balance carried forward from the previous months. Instead of taking time off from the 81 (58 plus 23) hours of time-off balance, he was approved to take vacation leave on 27 and 28 August 2013 (totalled 18 working hours). Before he took his vacation leave on 27 August 2013, his leave balance had not reached the maximum level.

Audit comments

3. According to CSB Circular No. 18/2000 (see para. 3.25), Officer J should preferably have been granted time off on 27 and 28 August 2013 instead of vacation leave.

Source: Audit analysis of EMSTF records

In Audit's view, the EMSTF needs to take measures to ensure that a staff takes time off for any uncompensated overtime hours accumulated preferably before taking vacation leave, unless his accumulated leave balance has reached the maximum level.

Audit recommendations

3.27 **Audit has *recommended* that the Director of Electrical and Mechanical Services should:**

(a) **take action to rectify the granting of overtime allowance to NCSC staff which is inconsistent with CSB policy and guidelines;**

(b) **comply with the CSB guidelines on compensating staff overtime work in future;**

(c) **conduct a review of the high percentages of overtime work being recompensed by overtime allowance instead of time off in lieu and take necessary remedial action;**

(d) **closely monitor and take measures to prevent habitual and long hours of overtime work of some EMSTF staff; and**

(e) **take measures to ensure that time off for any uncompensated overtime hours accumulated is granted preferably before a staff takes his earned leave, unless the staff concerned has accumulated the maximum amount of earned vacation leave permissible under the relevant CSR.**

Response from the Administration

3.28 The Director of Electrical and Mechanical Services agrees with the audit recommendations. He has said that the EMSTF will:

(a) take action to rectify the granting of overtime allowance to NCSC staff and consider the need to change the arrangement within a reasonable timeframe, and if so, the basis on which EMSTF's NCSC staff should be remunerated on a fair basis, having regard to the operational need of the services; and

(b) review NCSC staff remuneration arrangement with the CSB including extending their normal work hours and drawing up a fair payment arrangement for them.

3.29 The Secretary for Development has said that the EMSTF should work with the CSB to review how NCSC staff should be paid for overtime work performed, having regard to the particular operational need of the EMSTF in providing critical public services.

3.30 The Secretary for the Civil Service has said that:

(a) the CSB considers it appropriate and reasonable for the EMSTF to stop making overtime payments after it has reviewed the existing arrangements and drawn up a new remuneration package for its serving and future NCSC staff within a reasonable timeframe. The CSB is mindful of the likely strong sentiments of the staff concerned; and

(b) should the EMSTF envisage long working hours for its staff on a regular basis, consideration may be given to engaging more full-time or part-time NCSC staff, seeking resources for the creation of civil service posts provided that their permanent service need could be established, revising the contractual work hours and pay of its existing NCSC staff through contract variations, or any combination of the above options.

3.31 The Secretary for Financial Services and the Treasury has said that:

(a) the grant of overtime allowance to NCSC staff of the EMSTF since 2001 could be considered an unfortunate exception to the policy of the CSB as set out in CSB Circular No. 2/2001; and

(b) if the EMSTF envisages the need for extensive overtime work, it may wish to discuss with the CSB on longer-term options available, such as increasing the number of NCSC staff and revising the remuneration basis for NCSC staff in future.

PART 4: RELEASE OF EMSD SITES

4.1 This PART examines actions taken by the EMSD and other B/Ds on releasing a site at Caroline Hill Road in Causeway Bay (CWB Site) and a site at Sung Wong Toi (SWT Site) to the Lands D for disposal.

Relocation of EMSD Headquarters

4.2 In 1966, the Government allocated CWB Site with an area of 16,000 square metres (m^2) to the EMSD for use as its Headquarters and other uses. An office block (for accommodating the EMSD Headquarters), a vehicle maintenance workshop (vehicle workshop), E&M maintenance workshops (collectively referred to as a non-vehicle workshop) and ancillary supplies stores were provided at CWB Site. In addition, the EMSD had also been allocated SWT Site and another site at Kowloon Bay (Kowloon Bay Site) for different purposes (see Table 11).

Table 11

Three EMSD sites (1966 to 2005)

Site	Use	Site area (m^2)	Floor area (m^2)
(a) CWB Site	EMSD Headquarters	16,000	29,329
(b) SWT Site	Regional depot	24,000	47,100
(c) Kowloon Bay Site	Vehicle servicing station	4,152	4,525
	Total	44,152	80,954

Source: EMSD records

4.3 In 1994, the Government conducted a review of the use of government sites. The review found that CWB Site was under-utilised and, in order to achieve more economical land use, the Site should be released for redevelopment. In July 1999, the GPA (Note 14) proposed to relocate the EMSD Headquarters to the former Hong Kong Air Cargo Terminal 2 Building at Kai Tak (Kai Tak Site). Kai Tak Site covers an area of 16,708 m^2 providing a floor area of 81,800 m^2. In August 1999, the EMSD accepted the proposal, subject to an arrangement to retain a small workshop on Hong Kong Island to provide essential and emergency services to its clients.

4.4 In June 2001, the LegCo Finance Committee approved funding of $878.9 million for reprovisioning EMSD facilities at CWB Site, SWT Site and Kowloon Bay Site to Kai Tak Site.

4.5 In 2005, after the completion of the reprovisioning works, the EMSD Headquarters at CWB Site, the regional depot at SWT Site and the vehicle servicing station at Kowloon Bay Site were relocated to Kai Tak Site. From May 2005 to March 2014, part of CWB Site had been used as EMSD Hong Kong Depot, and some floor areas had been used by some B/Ds.

Note 14: *In searching for sites for use by B/Ds, the GPA will enlist the assistance of the PlanD and the Lands D.*

Release of Kowloon Bay Site

4.6 A chronology of key events relating to the release of Kowloon Bay Site for development is as follows:

Month	Key event
(a) October 2006	The EMSD commenced the contamination assessment.
(b) June to December 2011	The EMSD carried out the decontamination works.
(c) February 2012	The Environmental Protection Department (EPD) approved the remediation report (Note).
(d) April 2013	The Minor Building Works Committee (chaired by the Director of Architectural Services) approved funding of \$13.5 million for carrying out the demolition works.
(e) July 2013	The EMSD commenced the demolition works which were targeted for completion in December 2014. The Site would be handed over to the Lands D for development thereafter.

Note: Under established procedures, the EMSD was required to assess the level of contamination of Kowloon Bay Site (which had been used as a vehicle workshop) before handing over the Site to the Lands D. In this connection, the EMSD was required to submit a remediation report (documenting the remediation actions) for the EPD's approval.

Areas for improvement

Long time taken in releasing SWT Site for development

4.7 A chronology of key events relating to the release of SWT Site for development is as follows:

Month	Key event
(a) October 2006	The EMSD commenced the contamination assessment.
(b) August 2011 to September 2012	The EMSD carried out the decontamination works.
(c) December 2012	After approval of the remediation report by the EPD, the EMSD commenced the demolition works.
(d) November 2013	The DEVB issued a Project Definition Statement to the ArchSD, which specified the requirements and justifications for a proposed project for a public housing development and other designated uses on the site. The DEVB also stated that 11,500 m^2 (48%) of the total site area of 24,000 m^2 would be handed over to the Lands D for development in 2019.
(e) February 2014	The EMSD handed over 12,500 m^2 (52%) of the total site area to the Civil Engineering and Development Department for constructing a sewerage pumping station.

4.8 In February and March 2014, the EMSD and the ArchSD informed Audit that:

EMSD

(a) the EMSD had been working with the concerned B/Ds for releasing SWT Site to suit the required land sale programme. It would rely on the ArchSD for carrying out the demolition works on the remaining part of SWT Site, and the ArchSD was conducting a Technical Feasibility Study for carrying out the demolition works. It had to bid funding for the demolition works through the resource allocation process;

(b) in September 2005, the Lands D requested the EMSD, in collaboration with the GPA, to invite interested departments to take up SWT Site on a temporary basis pending the confirmation on the permanent land use. Since the relocation of the EMSD regional depot to Kai Tak Site in 2005, SWT Site had been temporarily used by different B/Ds. The EMSD would continue to consider further temporary usage requests until the remaining part of SWT Site had to be vacated for demolition works; and

ArchSD

(c) since receiving the Project Definition Statement (see item (d) in para. 4.7) in November 2013 for the demolition of the remaining structures in SWT Site, the ArchSD had commenced the preparation of the Technical Feasibility Study and planned to complete the study by mid-March 2014 for the DEVB's approval. Based on the present findings, it was feasible to complete the demolition works and hand over the remaining part of SWT Site to the Lands D by early 2019.

Audit is concerned that half of SWT Site would only be released and handed over to the Lands D for development in 2019, 14 years after the moving out of the EMSD regional depot from the Site in 2005. In Audit's view, the EMSD, in collaboration with the ArchSD, needs to expedite action to complete the demolition works and return the remaining part of SWT Site to the Lands D for development as soon as possible.

Long time taken in releasing CWB Site for development

4.9 In seeking funding for reprovisioning EMSD facilities in June 2001 (see para. 4.4), the Government informed LegCo that it would release CWB Site in 2004-05. In December 2012, the PlanD informed the Committee on Planning and Land Development (Note 15) that CWB Site would be targeted for disposal in 2013-14 to meet the land demand for office and commercial use. According to the EMSD, CWB Site would be handed over to the Lands D for disposal after relocation of the EMSD Hong Kong Depot in May 2014. In the 2014-15 Budget published in February 2014, the Administration stated that it would complete the land use and traffic impact study of CWB Site as soon as possible for the provision of more commercial floor area in Causeway Bay. Appendix D shows the chronology of the key events relating to the release of CWB Site for development.

4.10 Audit notes that CWB Site would only be released for development ten years later than the original target date of 2004-05. In Audit's view, the delay in releasing CWB Site for development is unsatisfactory because:

(a) as revealed in the 1994 review (see para. 4.3), CWB Site had been under-utilised and should be redeveloped. There is a significant opportunity cost in deferring for ten years to release CWB Site for better beneficial use. In this connection, in April 2001, the DEVB informed the then LegCo Panel on Planning, Lands and Works (now Panel on Development) that the disposal of CWB Site, SWT Site and Kowloon Bay Site would generate a revenue of $4 billion; and

(b) if CWB Site of 16,000 m^2 in a prime area of Hong Kong had been released to the Lands D for disposal earlier, it might have been put into beneficial temporary use before implementation of a development plan for the Site, including use by other B/Ds or other suitable parties outside the Government under short-term tenancies.

Note 15: *The Committee is chaired by the Secretary for Development and is responsible for considering and reviewing policies on production, acquisition, use and land disposal.*

4.11 In February and March 2014, the EMSD and the DEVB informed Audit that:

EMSD

(a) the projection of releasing CWB Site in 2004-05 was not made by the EMSD. The target site releasing date had apparently not taken into account the time required for carrying out the decontamination and demolition works, and for obtaining related funding approval. The delay in releasing CWB Site was due to numerous reasons such as late availability of a reprovisioned EMSD Hong Kong Depot, which were beyond the EMSD's control;

(b) the EMSD had taken a proactive role and made the best effort to realise the then land development programme and had been making every endeavour to release CWB Site as early as possible. In order to advance the land disposal date, in January 2011, the EMSD proposed to the Lands D to include the decontamination and demolition works in the land sale conditions and require the future developer to carry out the works. The proposal was supported by the DEVB and agreed by the Lands D;

DEVB

(c) the proposed target date for the release of CWB Site in 2004-05 was in response to a proposed land sale for the Site scheduled under the Programme of the Steering Committee on Land Supply for Housing (HOUSCOM — Note 16). However, due to evolving considerations and priorities, the proposed inclusion of CWB Site for land sale had been deferred; and

(d) the release date of 2004-05 for CWB Site stated in the funding paper submitted to LegCo in June 2001 (see para. 4.9) was not committed by the EMSD, but was only a reference to a target date of the HOUSCOM Programme. The inclusion of any site in a land sale programme was not under the control or influence of the EMSD. Furthermore, the statutory and procedural requirements for the release of land were not under the ambit or management of the EMSD.

Note 16: *HOUSCOM is chaired by the Financial Secretary.*

4.12 In view of the ten-year slippage in releasing CWB Site for development vis-à-vis the date of site release stated in the funding paper submitted to LegCo in June 2001, Audit considers that the DEVB needs to inform, in collaboration with the EMSD, the LegCo Panel on Development of the slippage and the underlying reasons.

Audit recommendations

4.13 **Audit has *recommended* that the Director of Electrical and Mechanical Services should, in collaboration with the Director of Architectural Services, expedite action to complete the demolition works of SWT Site and return the remaining half of the Site to the Lands D for development as soon as possible.**

4.14 **Audit has also *recommended* that the Secretary for Development should, in collaboration with the Director of Electrical and Mechanical Services, inform the LegCo Panel on Development of the ten-year slippage in releasing CWB Site for development vis-à-vis the time stated in the funding application submitted to LegCo in June 2001.**

Response from the Administration

SWT Site

4.15 The Director of Electrical and Mechanical Services and the Director of Architectural Services agree with the audit recommendation in paragraph 4.13. The Director of Architectural Services has said that the ArchSD will continue to provide the necessary assistance to the EMSD to expedite completion of the demolition works at SWT Site.

4.16 The Secretary for Financial Services and the Treasury has said that the EMSD has to bid for resource for the demolition works at SWT Site, and as no funding application for the demolition works for the remaining part of SWT Site has been submitted, funding availability was not an issue relating to the delay in the release of the whole SWT Site.

CWB Site

4.17 The Secretary for Development agrees with the audit recommendation in paragraph 4.14. He has said that:

(a) CWB Site has been reserved internally for other uses over the past years. As mentioned in the 2014-15 Budget, the DEVB is reviewing the way to release the Site as soon as possible; and

(b) the DEVB will report to the LegCo Panel on Development of the progress in due course.

4.18 The Government Property Administrator has said that the GPA stands ready to assist the EMSD to release the latter's sites for development.

PART 5: PERFORMANCE REPORTING

5.1 This PART examines the performance reporting of the EMSTF.

Background

Key performance indicators

5.2 In its annual Corporate and Business Plan submitted to the DEVB (see para. 1.10(c)), the EMSTF set targets and reported the achievement of the targets on 13 key performance indicators (KPIs). Table 12 shows the achievement of the KPIs in 2011-12 and 2012-13. The EMSTF did not meet two targets (namely new business and growth of business, and awards for staff suggestion scheme proposal) in 2011-12, and it met all targets in 2012-13.

Table 12

Key performance indicators (2011-12 and 2012-13)

KPI (Unit)	2011-12		2012-13	
	Target	**Actual**	**Target**	**Actual**
1. RoR rate (%) (Note 1)	11.5	11.8	9.2	9.7
2. New business and growth of business ($ million)	270.7	243.9	268.4	330.8
3. Customer satisfaction index (on an 8-point scale)	6.03	6.12	— (Note 2)	— (Note 2)
4. Percentage of SLA renewed during the year (%)	95	96.9	95	99.8
5. **Percentage of SLA service performance target compliance (%)** (Note 3)	99	**99.9**	99	**99.8**
6. Awards for staff suggestion scheme proposal (no.) (Note 4)	24	19	20	32
7. Benchmarking exercises completed (no.)	6	9	6	6
8. Reportable accident per 1,000 EMSD staff (no.)	5.4	3.7	5.3	4.2
9. Statutory non-compliance (no.)	0	0	0	0
10. Electricity consumption at EMSD Headquarters (kilowatt-hour)	11,264,900	10,611,794	11,193,200	10,763,588
11. Staff satisfaction rating (on a 10-point scale)	6.4	6.5	— (Note 2)	— (Note 2)
12. Training day/staff (day)	4.5	4.57	4.5	5.4
13. Stock turnover rate (Note 5)	0.86	1.06	0.87	1.16

Source: EMSTF records

Note 1: In this Table, RoR is the percentage of net profit (interest income included) over revenue in 2011-12 and 2012-13. If interest income is excluded, the RoR for 2012-13 will be reduced from 9.7% to 6.9% (see Table 1 in para. 1.16). According to the EMSTF, to align with the calculation for the rate of return on ANFA, from 2013-14, the calculation for the RoR rate would be revised to the percentage of profit from operations (interest income not included) after notional tax on such profit over the value of turnover.

Note 2: Customer opinion survey and staff satisfaction survey are conducted biennially.

Note 3: This represents the rate of compliance of actual performance against targets specified in SLAs. The targets include system availability, average response time to fault calls and time to repair.

Note 4: Staff suggestion scheme is an incentive award scheme to encourage staff to make improvement suggestions on civil service efficiency.

Note 5: Stock turnover rate is calculated by dividing the annual cost of materials by the average stock level.

EMSD performance pledge

5.3 As of February 2014, the EMSD published the following performance pledges related to the EMSTF on its website:

Type of Service	Target Response Time	Actual compliance level in 2011
Time taken to attend to reported major malfunctions of:		
(a) Traffic signals	2.5 hours	100%
(b) Footbridge lighting	2 hours	100%
(c) Subway lighting	2 hours	100%
Time taken to attend to other reported defects of:		
(d) Traffic signals	1 working day	99.9%
(e) Footbridge lighting	1 working day	100%
(f) Subway lighting	1 working day	100%

Customer surveys

5.4 Since 1997, the EMSTF has taken the following measures to gauge customers' views on the quality of services provided:

(a) ***Customer opinion surveys*** were conducted biennially (Note 17) by consultants. Two indices, namely the customer satisfaction index and the service competitiveness index, were derived from the results of the customer opinion surveys to gauge the customer satisfaction level and competitiveness of service provided by the EMSTF. The customer satisfaction index increased from 4.84 in 1996-97 to 6.12 in 2011-12, and the service competitiveness index increased from 5.07 in 2001-02 (Note 18) to 5.87 in 2011-12 (both indices were measured on an 8-point scale). Furthermore, in the customer opinion surveys, the EMSTF also evaluated customers' preference for EMSTF services as compared with other service providers and the related index dropped from 77% in 2005-06 to 57% in 2011-12;

(b) ***Telephone surveys*** were conducted by the EMSTF. About 210 telephone contacts were made a month. During a telephone contact, the EMSTF would ask a customer whether he was satisfied with the services provided by the EMSTF. If the customer was satisfied with the services, no further questions would be asked. If the customer was dissatisfied with the services, the EMSTF would take necessary follow-up action. In 2013, the EMSTF made 2,569 telephone contacts and recorded 11 cases where the customers were dissatisfied with EMSTF services; and

(c) ***Customer feedback cards*** were provided to customers of vehicle services upon completion of job orders to collect their views on the service provided. Customers' return of the feedback cards was voluntary. The Business Development Division would summarise customers' views provided in the feedback cards in monthly reports for submission to the senior management.

Note 17: *Customer opinion surveys were conducted annually before 2000 and biennially afterwards.*

Note 18: *No service competitiveness index was compiled before 2001-02.*

Areas for improvement

Irregularities in compiling SLA compliance rates

5.5 SLAs for E&M services provided by the EMSTF include a number of performance indicators, including system availability, average response time to fault calls and time to repair. The target and actual performance of the SLAs are input into the EMSTF computer system for compiling the KPI.

5.6 As shown in Item 5 of Table 12 in paragraph 5.2, the EMSTF achieved 99.9% and 99.8% in 2011-12 and 2012-13 respectively on compliance with performance targets set for SLAs. However, Audit examination revealed the following irregularities in compiling the compliance rates:

(a) of the 24 SLAs (which had performance pledges with 915 performance indicators) relating to the six major EMSTF clients (namely the HA, the LCSD, the FEHD, the ArchSD, the HKPF and the GPA) which were in force as of March 2013, all 58 performance indicators of 4 SLAs had not been input into the EMSTF computer system for compiling the KPI compliance rate; and

(b) of the six bulk SLAs (each costing over $100 million in 2012-13) selected for examination which contained 672 performance indicators, Audit found that the computer system had recorded data for 958 indicators in March 2013. The difference of 286 (958 less 672) indicators was attributable to 378 duplicated/extra records and 92 omitted entries.

5.7 In March 2014, the EMSTF informed Audit that:

(a) there were currently 217 SLAs in force with more than 3,000 performance indicators; and

(b) the duplication of records in paragraph 5.6(b) was mainly attributed to the input of data for performance indicators on a regional basis instead of a territory-wide basis. The irregularities reported in paragraph 5.6 had been rectified.

5.8 According to the EMSTF, the KPI for SLA performance target compliance is a measure of its quality of services delivered to customers. In Audit's view, the EMSTF needs to take measures to improve the data accuracy for compiling the compliance rates of SLA performance targets.

Performance pledges for majority of services not formulated and published

5.9 According to CSB Circular No. 7/2009 "Performance Pledges in the Civil Service":

(a) performance pledges inform the public of the standards of service that they can expect from the Government, and the course of action open to them on substandard service;

(b) all B/Ds that provide direct services to the public have promulgated performance pledges. Many B/Ds which provide services to internal customers have also formulated performance pledges; and

(c) performance pledges, their updates and achievement should be publicised and disseminated to customers and the public at large.

5.10 Audit notes that the 13 EMSTF KPIs (see Table 12 in para. 5.2) have not been published for information of the public or submitted to LegCo. Furthermore, before the establishment of the EMSTF in August 1996, the EMSD had published in its Controlling Officer's Report its performance pledges, targets and achievements in respect of the provision of E&M services (Note 19). Audit also notes that the other four trading funds (namely the Companies Registry, the Land Registry, the Post Office and the Office of the Communications Authority Trading Funds) have published their performance pledges, targets and achievements in their annual reports and websites. However, apart from the time taken to attend to reported malfunction of traffic signals and lighting of footbridges and subways (see

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Note 19: *Examples include time of response to job requisition, time of conducting tender assessments, time to rectify plant and equipment faults and time of completing electrical works orders.*

para. 5.3), the EMSTF has not published performance pledges, targets and achievements on majority of its services in annual reports or website for information of the public.

5.11 In March 2014, the EMSTF informed Audit that:

(a) unlike the other four trading funds, the EMSTF provided its services to client B/Ds and not directly to the public. The performance pledges agreed in SLAs were reported regularly to client B/Ds. For those public-related performance pledges, they had been published on the EMSD's website. The EMSTF had also published the actual performance of two KPIs (RoR rate and customer satisfaction index) in EMSTF annual reports (Note 20); and

(b) the EMSD had published the electricity consumption, the number of reportable accident per 1,000 staff, the staff satisfaction rating and training days per staff of the whole Department in EMSD Social and Environmental Reports on EMSD website.

5.12 In Audit's view, in order to enhance transparency and public accountability of EMSTF activities, in addition to the performance pledges stated in paragraph 5.10, the EMSTF needs to formulate and publish appropriate performance pledges for the majority of its services. In this connection, Audit considers that the RoR rate, new business and growth of business, customer satisfaction index (see Items 1 to 3 of Table 12 in para. 5.2), service competitiveness index and the index of customers' preference for the EMSTF services (see para. 5.4(a)) may be considered for inclusion as EMSTF performance pledges. In setting performance pledges, the EMSTF also needs to make reference to EMSD performance pledges stated in the EMSD Controlling Officer's Report before 1996 (see para. 5.10).

Note 20: *EMSTF annual reports only published the actual performance but not the targets of the two KPIs.*

Areas for improvement in conducting staff and customer surveys

5.13 ***Staff satisfaction survey.*** Apart from customer opinion surveys, the EMSD also conducts a staff satisfaction survey biennially. The main purpose of the survey is to gauge the opinion of EMSD staff on various aspects including their working environment, perceptions on elements that have impact on service culture and any other major concerns of their staff. Audit notes that, in the 2011 satisfaction survey, the overall response rate of EMSD staff was 30%, and the response rate of EMSTF staff was 27%. In Audit's view, the EMSTF needs to take measures to encourage its staff to actively participate in staff satisfaction surveys.

5.14 ***Customer feedback card.*** Upon completion of a job order for vehicle services, EMSTF staff would request the customer to complete a customer feedback card on a voluntary basis to gather the customer's views on the service provided. However, Audit examination of the monthly reports (see para. 5.4(c)) of 2013 revealed that no customer feedback cards had been received in the year. In Audit's view, the EMSTF needs to conduct a review to ascertain the reasons for the nil return on all the customer feedback cards sent out and take measures to improve the return rate.

5.15 In March 2014, the EMSTF informed Audit that:

(a) it had conducted a preliminary review on the use of customer feedback cards and decided not to use this passive means to collect customer feedback for all services in future; and

(b) it would conduct a review of other better options to collect customer feedback. There were better ways to collect customer feedback, taking into account technology advancement, environmental consideration and customer convenience. Customers could also provide their views and comments to the EMSTF through a 24-hour hotline and facsimile.

Audit recommendations

5.16 **Audit has *recommended* that the Director of Electrical and Mechanical Services should:**

(a) **take measures to improve the data accuracy for compiling the compliance rates of SLA performance targets;**

(b) **formulate and publish appropriate performance pledges for EMSTF services; and**

(c) **take measures to encourage EMSTF staff to actively participate in staff satisfaction surveys.**

Response from the Administration

5.17 The Director of Electrical and Mechanical Services agrees with the audit recommendations. He has also said that the EMSTF is in the process of reviewing the KPIs and performance pledges, and will take the opportunity to formulate and publish appropriate performance pledges for majority of its services.

PART 6: WAY FORWARD

6.1 This PART outlines the major audit observations and examines the way forward.

Electrical and Mechanical Services Trading Fund

6.2 With the objectives of providing quality services to customers, continuously reviewing the markets in which the EMSTF operates, identifying new business opportunities and providing a suitable environment for EMSD staff to continuously improve processes and hence customer satisfaction, the EMSTF was established in August 1996. According to the Framework Agreement entered into in September 1996, the services of the EMSTF will be provided to B/Ds and other government subvented or financially assisted agencies, and the opportunity will be taken to bid for and win business in other markets as they arise.

6.3 As promulgated by the FSTB, since August 2002, B/Ds and autonomous bodies have been free to retain the services of the EMSTF or to choose alternative service providers to meet part or all of their E&M service needs. In 2012-13, EMSTF operating revenue was $4,643 million while the operating cost was $4,262 million, resulting in an operating profit of $381 million. The rate of return on ANFA was 38.1% and the RoR rate was 6.9% in the year.

Major audit observations

6.4 In PART 2, Audit has found that the actual rates of return on ANFA over the past 17 years were significantly higher than the target rates. Furthermore, in response to the Financial Secretary's advice in December 1996 that the EMSTF should find out what the private sector was charging for similar services provided by it, and that it should be able to match the commercial rates by 1999, the EMSTF conducted a comprehensive benchmarking study in 1998 on the commercial rates for similar services provided by the EMSTF. According to the EMSTF, since 1998, it has reviewed the market prices through participation in competitive tendering exercises and outsourcing its work to contractors in the private sector. However, there is no evidence that the EMSTF has taken action to systematically compare and align EMSTF prices with the market prices. As of March 2013, the EMSTF had accumulated retained earnings of $2,308 million. However, the EMSTF has not determined the amount of reserve required for its operation so that it could return surplus fund to the Government.

6.5 While the Framework Agreement requires that the EMSTF would bid for and win business in other markets as opportunities arise, the EMSTF only derived $4 million (0.1% of its revenue) from private organisations. Furthermore, as promulgated by the FSTB, B/Ds and autonomous bodies would be free to retain the services of the EMSTF or to choose alternative providers to meet part or all of their E&M services from August 2002. However, Audit survey revealed that, as of December 2013, all E&M service agreements of the FEHD, the ArchSD, the HKPF and the GPA had been awarded to the EMSTF through direct negotiation without going through competitive tendering.

6.6 In PART 3, Audit has reported that, according to CSB Circular No. 2/2001, NCSC staff are not entitled to overtime allowance. However, Audit examination revealed that the EMSTF had given approval for its NCSC staff to receive overtime allowance since May 2001. Audit has also found that, although CSR requires that overtime work performed should normally be compensated by time off in lieu, 96% and 90% of overtime work respectively performed by civil servants and NCSC staff of the EMSTF was recompensed by overtime allowance.

6.7 While the CSB has promulgated that time off is granted preferably before a staff takes his earned leave, Audit has found that 25 EMSTF officers had been approved to take vacation leave during the period while they had accumulated uncompensated overtime hours.

6.8 In PART 4, Audit notes that LegCo was informed in June 2001 that, upon relocation of the EMSD Headquarters to Kai Tak Site, CWB Site previously occupied by the EMSD would be released for development in 2004-05. However, as it transpired, CWB Site would only be released to the Lands D for disposal in May 2014, ten years later than the original target date.

Way forward

6.9 In PART 5, Audit has found that the EMSTF has not formulated and published performance pledges for majority of its services.

Achievement of objective on seeking business outside the government sector

6.10 The main objectives of setting up the EMSTF include, among others, achieving greater efficiency by exposing the service to competition or to proxy competitive pressures through price comparisons and cost consciousness on the part of the users, and continuously reviewing the markets in which the EMSTF operates and identifying new business opportunities. However, Audit notes that the EMSTF only derived $4 million, or 0.1% of its revenue, from private organisations. According to the EMSTF, it did not seek business in the private markets because there was no legal support to go beyond the scope of government service. In this connection, Audit notes that the EMSTF may widen its scope of services after obtaining a separate legal status.

6.11 On the other hand, although B/Ds have been allowed to choose service providers other than the EMSTF to meet part or all of their E&M services from August 2002, Audit survey revealed that most B/Ds acquired E&M services from the EMSTF through direct negotiation without going through competitive tendering. The reasons of the pertinent B/Ds for not conducting competitive tendering for procuring E&M services include the lack of expertise in preparing tender specifications, supervising and monitoring the work of private contractors, and additional costs and efforts involved in conducting tender exercises.

6.12 Audit notes that, 17 years after the establishment of the EMSTF in 1996, the EMSTF's clients are primarily B/Ds and some quasi-government bodies. On the other hand, B/Ds predominantly rely on the EMSTF to provide E&M services (see para. 2.42). In Audit's view, this situation may not have helped the EMSTF to fully achieve the objective of exposing its services to market competition (see para. 6.10). Therefore, the DEVB, in collaboration with the FSTB, needs to conduct a review to evaluate the effectiveness of the EMSTF in achieving the pertinent objectives and determine the way forward for the Fund.

Audit recommendation

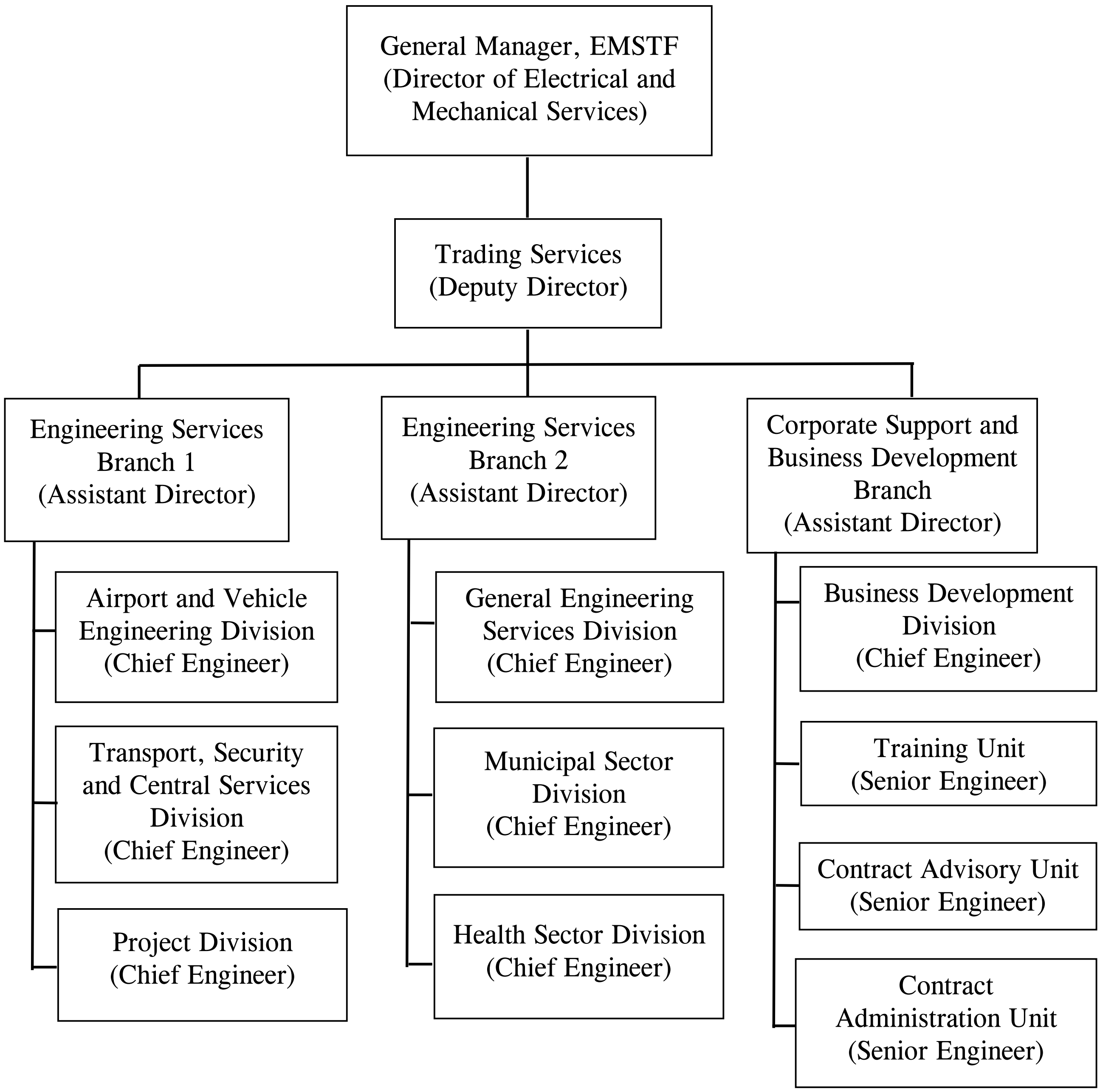
6.13 **Audit has *recommended* that the Secretary for Development should, in collaboration with the Secretary for Financial Services and the Treasury, conduct a review to evaluate the effectiveness of the EMSTF in achieving its objective of exposing its services to market competition and determine the way forward for the Fund.**

Response from the Administration

6.14 The Secretary for Development and the Secretary for Financial Services and the Treasury agree with the audit recommendation. The Secretary for Development has said that the DEVB, in collaboration with the FSTB, will continue to monitor and evaluate the effectiveness of the EMSTF through reviewing the latter's Corporate and Business Plans and annual reports, and attending quarterly EMSTF Executive Board meetings and biannual financial monitoring meetings.

Appendix A
(paras. 1.17 and
2.8 refer)

Organisation Chart of the EMSTF
(31 December 2013)



Source: EMSTF records

Appendix B
(para. 2.6 refers)

Achievements of the EMSTF (August 1996 to February 2014)

<table>
<tr><th>Area</th><th>Achievement</th></tr>
<tr><td colspan="2">(A) Provide quality services to customers in a cost-effective, safe and reliable manner</td></tr>
<tr><td>Quality improvement</td><td>It has obtained:
— the ISO 9001 Quality Management Corporate Certification (in 1999);
— 2006 Hong Kong Management Association Quality Award (Gold Award);
— ISO 14001 environmental management system;
— Occupational Health and Safety Assessment Series 18001 (Note 1) occupational health and safety management system;
— ISO 27001 information security management system; and
— Publicly Available Specification (Note 2) 55 asset management system.</td></tr>
<tr><td>Productivity improvement</td><td>• From 1996 to 2002, it had raised its productivity by 22.5%.
• Between 2008 and 2012, it had achieved productivity saving equivalent to 5% of its annual turnover.</td></tr>
<tr><td colspan="2">(B) Continuously review the markets in which the EMSTF operated</td></tr>
<tr><td>Competitive tendering</td><td>From August 1996 to February 2014, it had submitted 337 tenders to 30 different clients with a total tender sum of $4,000 million. These tenders covered project and consultancy service, vehicle service, and operation and maintenance of various systems in E&M and building services, and specialised airport, medical and electronic systems.</td></tr>
<tr><td>Outsourcing</td><td>As of February 2014, it managed some 500 contracts of various E&M services. In 2012-13, the amount of outsourcing work managed by the EMSTF was $1,551 million, representing 36% of its total operating cost.</td></tr>
</table>

Appendix B
(Cont'd)
(para. 2.6 refers)

Area	Achievement
(C) Identify new business opportunities	
Exploring new business opportunities	• The annual business volume had risen from \$2,654 million in 1997-98 to \$4,643 million in 2012-13. • A data centre has been set up since 2003-04. • It has engaged in information and communication technology (e.g. Wi-Fi for the community, information technology support for the World Trade Organisation Ministerial Conference in 2005) since 2005-06. • It has engaged in railway E&M engineering consultancy service and engineering service for food waste recycling since 2008-09. • It has engaged in water saving consultancy service since 2009-10.
(D) Provide a suitable environment for the EMSD staff to continuously improve processes and hence customer satisfaction	
Reorganisation and regionalisation	• Upon its establishment, a strategic reorganisation and regionalisation exercise was initiated, which reorganised the functional divisions into strategic business units focusing on specific customers. • After the exercise, more than 1,000 staff were deployed to regional depots at geographic locations at or closer to clients' premises, which enabled the staff to respond to service requests promptly and improved efficiency. About \$30 million was saved annually through reduced travelling time to work sites, reduced accommodation costs and improved productivity. • In 2010, the Business Development Division was established for responding to the rapid change in the business environment and facilitating development of new business.

Appendix B
(Cont'd)
(para. 2.6 refers)

Area	Achievement
Customer opinion survey	• It engaged external consultants to conduct customer opinion surveys biennially to measure customer satisfaction levels and identify potential areas for improvement. • According to the survey results, the customer satisfaction index increased from 4.84 in 1996-97 to 6.12 in 2011-12 on an 8-point scale.

Source: EMSTF records

Note 1: This is an international occupational health and safety management system specification, which specifies requirements for an organisation to control its occupational health and safety risks and improves its performance in the area.

Note 2: This is a document published by the British Standards Institution for introducing standardisation in different systems.

Appendix C
(para. 2.35 refers)

Audit Reports covering EMSTF services (2001 to 2012)

Audit Report No.	Subject	Response from B/D
58 (March 2012)	Procurement of goods and services for correctional institutions	The Correctional Services Department said that the existing SLA would expire on 31 March 2018. It would review the cost-effectiveness of the EMSTF's services before entering into a new SLA with the EMSTF.
55 (October 2010)	Management of performing arts venues	The LCSD said that: • if and when E&M services for suitable venues were identified, it would remove them from the bulk SLA with EMSTF for separate tendering; and • sufficient lead time would be allowed to review the existing arrangement and put in place new arrangements before entering into a new SLA starting from 1 April 2014.
42 (March 2004)	Management and maintenance of fire-fighting and rescue vehicles	The Fire Services Department said that: • for the phased approach of outsourcing provision of maintenance services for 448 ambulances and other support vehicles, it issued a tender for the maintenance service of a fleet of 18 ambulances in the Hong Kong region in January 2005; and • evaluation of tender was completed in March 2005 and the tendering exercise was subsequently cancelled as the cost of the lowest conforming bid offered by a private service provider was almost 100% higher than the current fees charged by the EMSTF for the provision of similar service.

Audit Report No.	Subject	Response from B/D
38 (March 2002)	Provision of services by the Government Laboratory	The Government Laboratory said that it would review the provision of E&M services in the fourth year of the SLA period.
37 (October 2001)	Management of government properties by the Government Property Agency	The GPA said that it would introduce a pilot scheme to subcontract the servicing of E&M installations in June 2002, and carry out a post-trial evaluation to assess the cost-effectiveness of such subcontract arrangements.

Source: Audit records

Appendix D
(para. 4.9 refers)

Chronology of key events relating to the release of CWB Site (February 1996 to February 2014)

Month	Key event
(a) February 1996	The GPA identified a site at Chai Wan East Industrial Area (Chai Wan East Site) for the relocation of the EMSD Headquarters and depot and was accepted by the EMSD.
(b) March 1996	The GPA requested the PlanD to earmark the site for use by the EMSD.
(c) December 1996	The GPA invited various departments (including the EMSD) to bid for using Chai Wan East Site as a joint government departmental depot.
(d) January 1999	The draft Chai Wan Outline Zoning Plan No. S/H20/7 was gazetted, which included the proposed joint government departmental depot in Chai Wan.
(e) July 1999	The GPA proposed that the EMSD Headquarters should be relocated to Kai Tak Site.
(f) August 1999	The EMSD accepted the GPA's proposal and advised the GPA that a regional workshop on Hong Kong Island should be maintained.
(g) November 1999	The Administration decided not to pursue the proposed joint government departmental depot at Chai Wan East Site.
(h) February 2000	The EMSD assessed that the Hong Kong Depot would require a floor area of 6,870 m^2.
(i) June 2000	The EMSD proposed to reprovision the Hong Kong Depot to a site at Whitfield Road, Causeway Bay, which was then used by the FEHD as a vehicle depot. The EMSD proposed to share the site with the FEHD.

Month	Key event
(j) March 2001	• The EMSD revised the required area of the Hong Kong Depot to 5,570 m^2. • The EMSD noted that an area of only 1,210 m^2 would be available at the Whitfield Road site and advised that the shortfall could be met by accommodation in industrial buildings. In this connection, the EMSD proposed seven possible sites for the reprovisioning. • The GPA considered that the seven possible sites proposed by the EMSD were not suitable for the reprovisioning.
(k) June 2001	• The LegCo Finance Committee approved funding of $878.9 million for reprovisioning the EMSD facilities at CWB Site, SWT Site and Kowloon Bay Site to the Kai Tak Site. • The FEHD agreed to release a floor area of 1,800 m^2 at Whitfield Road site to accommodate the EMSD Hong Kong Depot. In this connection, the GPA proposed to meet the shortfall of about 3,770 m^2 by making use of an ex-cooked food market at Ap Lei Chau (about 330 m^2) and the remainder of 3,440 m^2 by commercial leasing/government accommodation.
(l) September 2002	The EMSD informed the GPA that it preferred to have a single large workshop instead of various scattered workshops on Hong Kong Island.
(m) December 2002	The FEHD declined to share its depot at Whitfield Road with the EMSD on operational grounds.
(n) March 2003	• The EMSD requested the Lands D to identify temporary sites for the reprovisioning of the Hong Kong Depot. • The EMSD identified two sites but it subsequently considered them not suitable.
(o) November 2003 to January 2004	The EMSD requested the GPA to negotiate with the FEHD on reprovisioning the Hong Kong Depot at the Whitfield Road site (see Item (m)).

Month	Key event
(p) February 2004	• After further negotiation with the FEHD, the GPA informed the EMSD that the FEHD did not agree to release the space at its depot at Whitfield Road, and in view of the long-term planning intention to free up the site for more compatible development, the reprovisioning proposal of the Hong Kong Depot to Whitfield Road was no longer feasible. • The GPA searched through its property list but no suitable site could be identified. • The GPA requested the EMSD to consider if the EMSD Siu Ho Wan Maintenance Depot was suitable for accommodating the Hong Kong Depot. • The EMSD and the GPA noted that there was no urgency to vacate CWB Site for land sale before 2006.
(q) March 2004	• The EMSD replied that the Siu Ho Wan Depot was not suitable on operational grounds. • The EMSD suggested to the GPA to further pursue the reprovisioning proposal of the Hong Kong Depot to Whitfield Road. • As an alternative, the EMSD also requested the GPA to conduct another site search for reprovisioning the Hong Kong Depot with suggestions of possible sites. • The GPA requested the PlanD to undertake a site search for reprovisioning the EMSD's vehicle and non-vehicle workshops.
(r) April 2004	• The GPA advised that the EMSD's reprovisioning proposal of the Hong Kong Depot might not be cost-effective because vacation of CWB Site would not be required before 2006. • The EMSD considered that the GPA's proposal to postpone the reprovisioning schedule of the Hong Kong Depot until 2006 undesirable and requested the GPA to urgently pursue the reprovisioning.

Month	Key event
(s) July 2004	The PlanD proposed to accommodate the Hong Kong Depot at Chai Wan East Site. The EMSD had no objection to the proposal.
(t) August 2004	• The GPA requested the EMSD to provide more information about their operational requirement for recommending the most cost effective reprovisioning option. • The EMSD reminded the GPA that the EMSD should vacate CWB Site and hand over the Site to the GPA or the Lands D by mid-2005. The EMSD requested the GPA to explore its proposal of March 2004 (see Item (q)) as an alternative solution. • The EMSD revised the area required for the vehicle workshop to 1,904 m^2.
(u) September 2004	The EMSD requested the GPA to urgently follow up its proposed alternatives (see Items (q) and (t)) and suggested three other possible sites for the GPA's consideration.
(v) October 2004	The EMSD revised the area required for the non-vehicle workshop to 570 m^2.
(w) March 2005	The GPA informed the PlanD that the EMSD decided to continue staying at CWB Site to operate the vehicle and non-vehicle workshops until the Site had to be disposed of. In this connection, the GPA would not further proceed with site searches for reprovisioning the EMSD workshops pending confirmation of site disposal schedule. The GPA further clarified that the project proponent or major user department is the lead department to coordinate the project implementation.
(x) May 2005	The EMSD informed the GPA that CWB Site was ready for vacation. However, the EMSD would continue to use part of CWB Site (3,790 m^2) for the operation of the Hong Kong Depot until required by the Lands D for land sale.
(y) August 2005	• The DEVB indicated policy support to reprovision the non-vehicle workshop in private leased premises. • The GPA requested the Lands D and the PlanD to conduct a site search for accommodating the Hong Kong Depot.

Appendix D
(Cont'd)
(para. 4.9 refers)

Month	Key event
(z) October 2005	• The EMSD informed the GPA and the Lands D that CWB Site, SWT Site and Kowloon Bay Site were ready for taking over by them and requested them to consider ways to dispose of the sites. • The Lands D said that it would take over CWB Site after the site had been free from any occupation, structures or building and cleared from contamination. • The GPA requested the EMSD to consider other options such as contracting out the depot service.
(aa) November 2005	The PlanD said that Chai Wan East Site was found suitable for accommodating the Hong Kong Depot (see Item (s)).
(ab) March 2006	• The DEVB and the GPA expressed reservations on the PlanD's proposal in Item (aa). • The EMSD considered that the PlanD's proposal not suitable for the EMSD's vehicle and non-vehicle workshops and requested the GPA, the Lands D and the PlanD to conduct another round of site search to identify other suitable government or private premises.
(ac) June 2006	• The EMSD informed the GPA that there was no need to co-locate the vehicle and non-vehicle workshops together. It had no preference on whether the non-vehicle workshop was located on government-owned premises or private leased premises. The required floor area for the non-vehicle workshop was revised to 962 m^2 and that of the vehicle workshop was maintained at 1,904 m^2. It also requested the GPA to conduct another round of site search. • In view of the uncertainty of the availability of a permanent site for reprovisioning the Hong Kong Depot, the EMSD requested the Lands D to identify suitable temporary sites on Hong Kong Island for reprovisioning the Hong Kong Depot. The EMSD also proposed one possible site to the Lands D for consideration.
(ad) July 2006	The GPA informed the EMSD not to rule out other options, including requiring the contractors to build their own facilities or to provide their depot facilities.

Appendix D
(Cont'd)
(para. 4.9 refers)

Month	Key event
(ae) October 2006	The Lands D said that the site proposed by the EMSD in Item (ac) was a private lot and hence could not be allocated to the EMSD.
(af) November 2006	The EMSD requested the Lands D's assistance in conducting the site search.
(ag) May 2007	The Lands D identified a temporary site at Sheung On Street, Chai Wan (Temporary Chai Wan Site), with a site area of 2,100 m^2, for setting up a temporary workshop.
(ah) July 2009	The Lands D approved the allocation of the Temporary Chai Wan Site to the EMSD for a period of five years from the date of possession for setting up temporary vehicle and non-vehicle workshops.
(ai) July 2010	• The EMSD requested the PlanD to conduct a site search to permanently relocate the vehicle workshop. • The PlanD proposed and the EMSD agreed to relocate the Hong Kong Depot to a site (with a site area of about 7,006 m^2) bound by Sheung Tat Street, Sheung Mau Street and Sheung On Street in Chai Wan (Permanent Chai Wan Site) which would be shared with other joint users (namely the HKPF, the FEHD and the Government Laboratory). The permanent Hong Kong Depot is planned to be commissioned in 2018.
(aj) June 2011	The EMSD requested the GPA to identify suitable premises on Hong Kong Island for reprovisioning the non-vehicle workshop.
(ak) July 2011	The Accommodation Strategy Group (Note 1) approved funding of $18.34 million for constructing a temporary vehicle workshop at the Temporary Chai Wan Site.

Month	Key event
(al) March 2012	The GPA identified an accommodation with a floor area of 860 m^2 in an industrial building in Chai Wan for relocating the non-vehicle workshop.
(am) August 2012	The EMSD obtained an Environmental Permit (Note 2) from the Director of Environmental Protection for commencement of construction works at the Temporary Chai Wan Site.
(an) October 2012	The EMSD agreed in principle to the proposal of relocating the non-vehicle workshop to the industrial building.
(ao) April 2013	The GPA, on behalf of the EMSD, signed an agreement (commencing on 2 May 2013) for renting the private premises for use by the non-vehicle workshop.
(ap) October 2013	The non-vehicle workshop moved into the leased premises.
(aq) February 2014	In the 2014-15 Budget published in February 2014, the Administration stated that it would complete the land use and traffic impact study of the CWB Site as soon as possible for the provision of more commercial floor area in Causeway Bay.

Source: EMSD records

Note 1: The Group is chaired by the Deputy Secretary for Financial Services and the Treasury (Treasury)3 and is responsible for, among others, deciding the distribution of funds under Head 703 Subhead 3101GX for minor building works not exceeding $30 million.

Note 2: The works is a designated project under the Environmental Impact Assessment Ordinance (Cap. 499), which requires the project proponent to obtain an Environmental Permit granted by the Director of Environmental Protection before commencement of construction works.

Acronyms and abbreviations

ANFA	Average Net Fixed Assets
ArchSD	Architectural Services Department
Audit	Audit Commission
B/Ds	Government bureaux and departments
CSB	Civil Service Bureau
CSRs	Civil Service Regulations
CWB Site	Causeway Bay Site
DEVB	Development Bureau
EMSD	Electrical and Mechanical Services Department
EMSTF	Electrical and Mechanical Services Trading Fund
EPD	Environmental Protection Department
E&M	Electrical and mechanical
FEHD	Food and Environmental Hygiene Department
FSTB	Financial Services and the Treasury Bureau
GPA	Government Property Agency
HA	Hospital Authority
HKPF	Hong Kong Police Force
HOUSCOM	Steering Committee on Land Supply for Housing
ISO	International Organization for Standardization
KPI	Key performance indicator
Lands D	Lands Department
LCSD	Leisure and Cultural Services Department
LegCo	Legislative Council
m^2	Square metres
NCSC	Non-civil-service contract
PlanD	Planning Department
RoR	Return on revenue
SLA	Service level agreement
SWT Site	Sung Wong Toi Site

CHAPTER 6

Create Hong Kong

CreateSmart Initiative

Audit Commission
Hong Kong
4 April 2014

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. 62 of the Director of Audit contains 8 Chapters which are available on our website at http://www.aud.gov.hk

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CREATESMART INITIATIVE

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CREATESMART INITIATIVE

Executive Summary

1. In June 2009, the Government set up the CreateSmart Initiative (CSI) with a commitment of $300 million to provide financial support to non-profit-making creative projects initiated by local creative sectors (including advertising, architecture, design, digital entertainment, music, publishing and printing, and television). In May 2013, the Government injected another $300 million into the CSI to continue its operation. The Permanent Secretary for Commerce and Economic Development (Communications and Technology) is the Controlling Officer of the CSI. Create Hong Kong (CreateHK) under the Commerce and Economic Development Bureau is responsible for the administration of the CSI. From the inception of the CSI to 30 November 2013, 165 applications with a total funding of $323 million were approved. The Audit Commission (Audit) has recently conducted a review of the administration of the CSI.

Vetting and assessing project applications

2. ***Declaration of interests.*** CreateHK adopts a two-tier system of declaration of interests for the CSI Vetting Committee. Committee members have to make 1st tier declarations upon appointment and annually thereafter. CreateHK sent 1st tier declaration forms to members only a few days before the commencement of their terms. As a result, few members could submit their declarations before the commencement of their terms. Moreover, CreateHK had not taken adequate follow-up action on long outstanding declarations. Members are required to submit their 2nd tier declarations before they serve in Assessment Panels. A chairperson who served in an Assessment Panel in May 2013 had not submitted the 2nd tier declaration until February 2014 (paras. 2.5 to 2.7).

3. ***Assessing capability of applicants.*** In assessing project applications, one of the factors to be considered is the capability of the project team. However, Audit found that the applicants' provision of project team's information (e.g. the qualifications and experience of project team members) was optional. Such

information was provided in only 4 of the 10 project applications examined by Audit. Another factor that should be considered is whether the project coordinator and/or project team members would work on more than two projects within the same project period. Audit found that three project coordinators undertook more than two projects concurrently with some of the project periods overlapped. Such information was however not included in the Internal Assessment Reports for the Assessment Panels' consideration (paras. 2.11 to 2.13).

Control of use of funds

4. ***Keeping of books and records.*** Instead of following the normal seven-year requirement, grantees of CSI funds are required to retain the books and records for only two years after the project completion or termination date. Audit's examination of the books and records of 15 projects (involving total approved funding of $52.8 million) revealed that: (a) some expenditure items (amounting to some $547,000) did not have supporting documents; and (b) the books and records of some projects were incomplete (paras. 3.3 and 3.5).

5. ***Use of funds by grantees.*** Audit examination of 15 projects revealed that: (a) the grantees of 12 projects had not kept a designated bank account solely and exclusively for the project to ensure that there was no misuse of CSI funds; (b) the grantees of three projects had used the funds to cover unallowable costs ($63,000); (c) Unlike other CSI projects, the unspent fund balances of one of the 15 projects and its two previous projects (some $1.35 million in total) were not returned to the Government. These projects were funded under an alternative funding approach which allowed the grantee to retain the unspent fund balances and use funds to cover otherwise unallowable costs ($100,000 for the project examined); and (d) CreateHK had not followed up the subsequent settlement of accounts payable (some $8.75 million) of the 15 projects to ensure that the amounts payable were required and the unspent CSI funds were returned to the Government. Audit found that some expenditure items of a project were subsequently cancelled or a lesser amount was paid after the project completion (paras. 3.9 to 3.16).

6. ***Inspection of books and records.*** Although the Project Agreements confer on CreateHK the right to inspect the books and records of the projects, CreateHK has not done so for any projects (paras. 3.4 and 3.23).

Monitoring and evaluating projects

7. ***Mode of funding.*** According to CreateHK's Procedural Guidelines, for projects which span more than one year, interim instalments (in addition to the upfront and final instalments) will be made on satisfactory performance of appropriate milestones and submission of Progress Reports. Audit examination of 10 projects which spanned more than one year revealed that contrary to the Procedural Guidelines, 5 were funded by only two standardised instalments. No records were available showing the justifications for the non-compliances (paras. 4.3 and 4.4).

8. ***Monitoring progress of approved projects.*** For projects funded by two instalments, no documentary evidence was available showing that CreateHK had reviewed their progress. Moreover, the CSI Vetting Committee was not informed of the progress of these projects (paras. 4.7 and 4.9).

9. ***Site visits.*** CreateHK has not set out the selection criteria, the frequency, the checks to be performed and the reporting requirements for site visits. Audit examination of the Site Visit Reports for 30 projects revealed that: (a) all the visits were attendance to open ceremonies, press conferences, exhibitions or music shows; (b) for 18 projects, the inspecting officers had not met the staff of the grantees; (c) visits were completed in an average of 1.6 hours (ranging from 0.3 to 3.5 hours); and (d) for one of four projects where follow-up action was recommended, no documentation showed whether the recommended follow-up action had been taken (paras. 4.11 and 4.12).

10. ***Verification of information reported by grantees.*** CreateHK prepares Evaluation Reports based on the information provided by the grantees without verifying the accuracy of such information. The lack of a verification mechanism may undermine the reliability and usefulness of the Evaluation Reports (para. 4.18).

Meeting the objectives of CSI and the way forward

11. ***CSI funding strategy.*** From the establishment of the CSI in June 2009 to November 2013, the number of projects initiated by the design sector (43 projects) and the digital entertainment sector (55 projects) were far more than those by other sectors (for example, the publishing and printing sector had initiated five projects only). CreateHK needs to ascertain the reasons for the relatively small number of projects initiated by some creative sectors (paras. 5.4 and 5.5).

12. ***Measuring performance of CSI.*** Audit found that: (a) CreateHK informed periodically the Legislative Council about the performance of the CSI, but the information disclosed was brief and fragmented; (b) it published only two performance indicators; and (c) in disclosing the CSI's performance to the Legislative Council, it provided the economic contributions of all creative sectors, including the sectors not covered by the CSI (paras. 5.12 to 5.16).

13. ***Comprehensive review of CSI.*** In his 2014 Policy Address, the Chief Executive of the Hong Kong Special Administrative Region said that the Working Group under the Economic Development Commission was studying the future development of the creative industries. In view of this and coupled with the fact that the CSI has been in operation since 2009, CreateHK needs to set a timetable for conducting a comprehensive review of the administration and the way forward of the CSI (para. 5.21).

Audit recommendations

14. **Audit recommendations are made in the respective sections of this Audit Report. Only the key ones are highlighted in this Executive Summary. Audit has *recommended* that the Head of Create Hong Kong should:**

Vetting and assessing project applications

(a) **take measures to ensure that sufficient time is given to CSI Vetting Committee members to return their 1st tier declaration of interests on appointment (para. 2.8(a));**

(b) **revise the project application form to require the provision of the information on applicants' project teams wherever applicable (para. 2.14(a));**

Control of use of funds

(c) **lengthen the required retention period of the books and records of the projects (para. 3.6(a));**

(d) **follow up with the grantees concerned on the anomalies identified by Audit relating to the expenditure items and accounts payable (para. 3.6(b));**

(e) **follow up those projects where designated bank accounts had not been maintained to ensure that there is no improper use of project funds and take remedial action where necessary (para. 3.17(c));**

(f) **in future, test check the books and records of grantees to identify unallowable costs and demand repayments from them where warranted (para. 3.17(e));**

(g) **conduct a review of the alternative funding approach (para. 3.17(f));**

(h) **test check the subsequent settlement of accounts payable and take remedial measures where necessary (para. 3.17(h));**

(i) **on a risk basis, carry out sample inspections of the grantees' books and records (para. 3.24);**

Monitoring and evaluating projects

(j) **issue guidelines setting out the factors that should be taken into account in determining the mode of funding of a project (i.e. number of instalments and amount of each instalment) (para. 4.15(a));**

(k) **regularly provide the CSI Vetting Committee with information on the progress of the approved projects with a view to seeking its advice and facilitating its monitoring work (para. 4.15(d));**

(l) **adopt a structured approach for site visits and issue guidelines setting out the basis of selection, checks to be performed, frequency of visits and the reporting requirements, taking into account project risks involved (para. 4.15(e));**

Meeting the objectives of CSI and the way forward

(m) **ascertain the reasons for the few projects initiated from some creative sectors and where necessary, take measures to boost the project applications from these sectors (para. 5.10(a));**

(n) **in addition to disclosing statistics pertinent to all creative sectors, disclose also those statistics that are pertinent only to the creative sectors covered by the CSI (para. 5.18(b)); and**

(o) **establish a timetable for conducting a comprehensive review of the administration and the way forward of the CSI (para. 5.22).**

Response from the Administration

15. The Head of Create Hong Kong agrees with the audit recommendations.

PART 1: INTRODUCTION

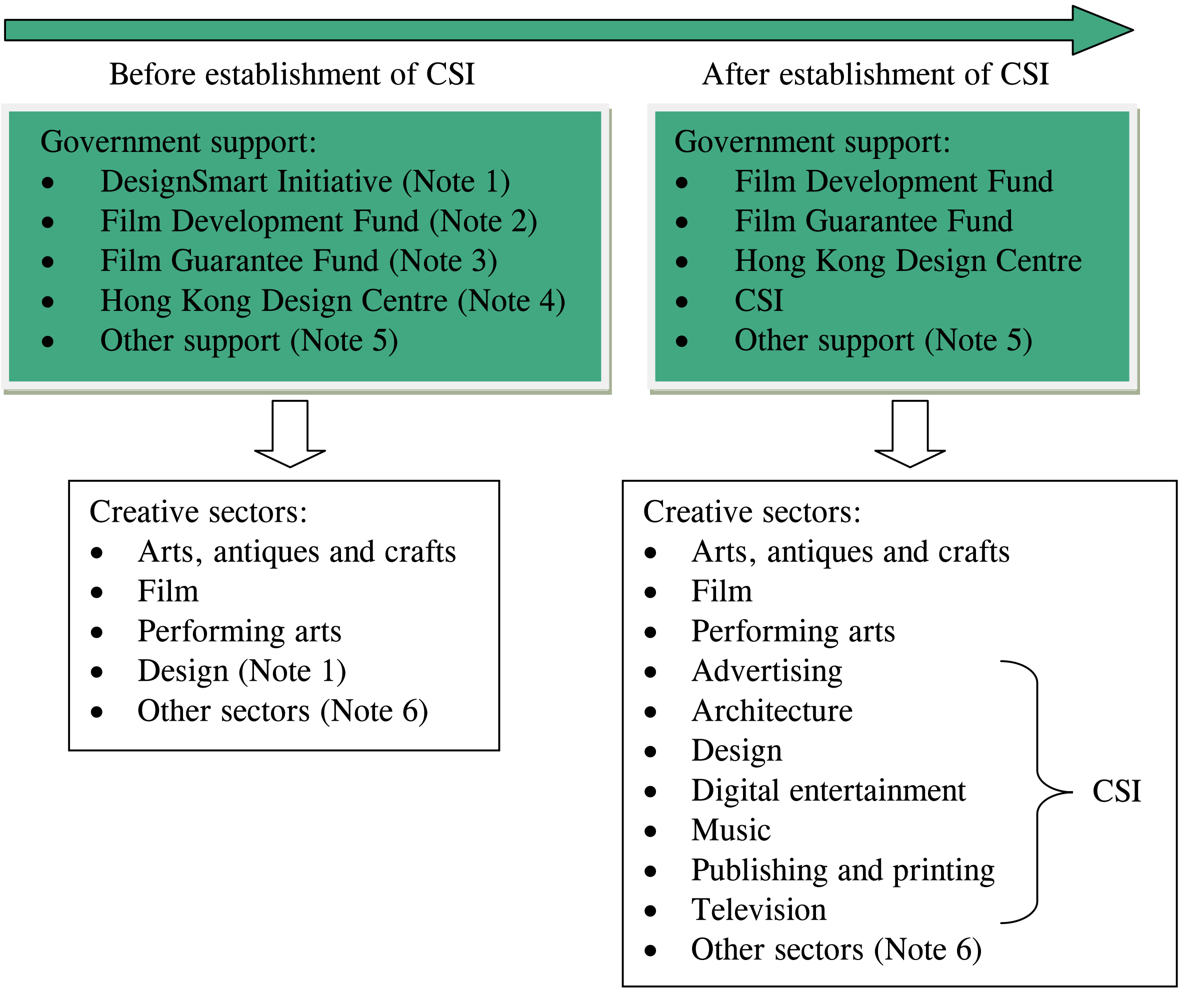
1.1 This PART describes the background to the audit and outlines the audit objectives and scope.

Background

1.2 Creative industries are important economic drivers of Hong Kong. They help increase the innovation capacity of the economy and can be a powerhouse for future economic growth. It is the Government's policy to promote the development of creative industries in Hong Kong. Creative industries are defined by the Government as those industries which have their origins in individual creativity, skill and talent, and which have a potential for wealth and job creation through the generation and exploitation of intellectual property.

1.3 In the 2007 Policy Address, the Chief Executive of the Hong Kong Special Administrative Region pledged that Hong Kong should accelerate the development of creative industries in order to maintain its competitive edge. In June 2009, the Government set up the CreateSmart Initiative (CSI) with a commitment of $300 million to provide financial support to projects initiated by local creative sectors which had not been covered by other forms of government support. The creative sectors supported by the CSI include advertising, architecture, design, digital entertainment, music, publishing and printing, and television. Figure 1 shows the government support to the creative sectors before and after the establishment of the CSI in June 2009.

Figure 1
Government support to creative sectors



Source: *Audit analysis of Create Hong Kong records*

Note 1: *The DesignSmart Initiative funded design-related projects and activities. It has been subsumed in the CSI since June 2011. The CSI is administered by Create Hong Kong, established in the Commerce and Economic Development Bureau in June 2009.*

Note 2: *The Film Development Fund provides financial support for the production of small-to-medium budget films and other film-related projects. The Fund is administered by Create Hong Kong.*

Note 3: *The Film Guarantee Fund provides guarantee to help local film production companies to obtain loans from lending institutions for producing films. The Fund is administered by Create Hong Kong.*

Note 4: *The Hong Kong Design Centre aims to raise design standards and foster design-related education, and to raise the profile of Hong Kong as an innovation and creative hub. Create Hong Kong is responsible for the housekeeping of the Centre.*

Note 5: *Other support includes that from the Home Affairs Bureau and that from the Education Bureau (see Note 6 below).*

Note 6: *Other sectors include promotion of the importance of creativity from the cultural, education and training perspectives. For example, the Home Affairs Bureau funds the operation of the Hong Kong Arts Development Council and the Hong Kong Academy for Performing Arts, and the Education Bureau promotes creativity from the education perspective.*

1.4 In May 2013, as the CSI fund of $300 million was near depletion, the Government injected another $300 million into the CSI. It was expected that the additional funding would sustain the CSI's operation up to 2016-17.

1.5 The CSI funds non-profit-making projects with objectives that are in line with the Government's seven strategic directions of driving and promoting the development of creative industries, as follows:

(a) nurturing a pool of creative human capital which will form the backbone of Hong Kong's creative economy;

(b) facilitating start-ups and the development of creative establishments;

(c) generating demand for innovation and creativity and expanding local market size for creative industries;

(d) promoting creative industries in the Mainland and overseas to help explore outside markets;

(e) fostering a creative atmosphere within the community;

(f) developing creative clusters (Note 1) in the territory to generate synergy and facilitate exchanges; and

(g) promoting Hong Kong as Asia's creative capital.

Organisational structure of CSI

1.6 The Permanent Secretary for Commerce and Economic Development (Communications and Technology) (hereinafter referred to as the Permanent Secretary) is the Controlling Officer of the CSI. Create Hong Kong (CreateHK),

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Note 1: *Creative clusters refer to the physical and geographical concentrations of creative activities that pool together resources to optimise the creation, production, dissemination and exploitation of creative work. An example of creative clusters is the former Police Married Quarters on Hollywood Road, which is undergoing revitalisation work.*

set up concurrently with the CSI under the Commerce and Economic Development Bureau (CEDB) in June 2009, is responsible for the administration of the CSI. CreateHK is overseen by the Head of Create Hong Kong. It incurred an annual expenditure of $63.5 million for personal emoluments and departmental expenses, and had a staff strength of 69 posts as at 31 December 2013 (Note 2). According to CreateHK, among the 69 posts, 14 officers are responsible for the operation and promotion of the CSI (see Appendix A).

1.7 CreateHK also acts as the Secretariat of the CSI Vetting Committee, which is responsible for assessing CSI project applications and recommending shortlisted projects for approval by the Permanent Secretary. The Committee consists of academics, professionals and representatives from the creative and other industries.

CSI projects

1.8 From the inception of the CSI in June 2009 to November 2013, there were 329 applications for CSI funding. Of these applications, 165 (50%) were approved. Details are as follows:

(a)	Number of projects approved	:	165 (126 completed and 39 in progress)
(b)	Total amount of approved funding	:	$323 million
(c)	Duration of approved projects	:	2 to 45 months (109 projects with duration less than one year)
(d)	Approved funding of individual projects	:	$216,000 to $8.4 million (no pre-set maximum amount, majority of the projects had funding less than $3 million)

Note 2: *In addition to the CSI, CreateHK is also responsible for, among others: (a) administering the Film Development Fund and the Film Guarantee Fund; (b) overseeing the operation of the Facilitation Service Unit and the Special Effects Licensing Unit to support the film and entertainment industries; and (c) housekeeping of the Hong Kong Design Centre.*

(e)	Mode of funding	:	Funding are paid to individual project grantees by instalments
(f)	Actual funding paid	:	$247 million

1.9 The nature of the 165 approved projects is as follows:

(a) competition, award scheme and festival;

(b) conference, workshop, seminar and forum;

(c) exhibition and trade show;

(d) employment programme;

(e) research and publication, and platform development;

(f) study mission and delegation; and

(g) others (such as start-up programme and television programme).

Table 1 and Photographs 1 and 2 show examples of projects initiated by different sectors of the creative industries.

Table 1

Examples of approved CSI projects

Sector	Project	Events organised	Approved funding ($ million)
Advertising	HK4As Graduate Trainee Programme	• Graduates trainee programme	1.93
Architecture	The 13th Venice Biennale International Architecture Exhibition (Hong Kong Exhibition)	• Exhibition at Venice Biennale • Exhibition in Hong Kong	2.24
Design	International Design Summer Camp Programme	• Summer camp with field trip to the Pearl River Delta • Visit to the Milan Design week	1.82
Digital entertainment	Promoting Hong Kong Comics by establishing Avenue of Comic Stars (see Photograph 1)	• Exhibition • Launching of mobile application software	5.37
Music	Hong Kong Asian-Pop Music Festival 2012 (see Photograph 2)	• Music performance, contest and forum • Networking events and receptions • Press conference • Television broadcast	5.73
Publishing and printing	Soaring Creativity — Hong Kong Publishers and Printers' Participation at London Book Fair	• Exhibition • Networking seminar	2.17
Television	TV World	• 3D TV workshop • Digital TV World Directory • Forum • Showcases	1.02
Others (Note)	"Tian Tian Xiang Shang" Creativity-For-Community and School Development Programme 2012	• Exhibitions • Workshops	4.56

Source: *Audit analysis of CreateHK records*

Note: *Others include cross-sector projects and miscellaneous projects aiming to foster a creative atmosphere within the community in general.*

Photograph 1

Project: Promoting Hong Kong Comics by establishing Avenue of Comic Stars

Source: CreateHK records

Photograph 2

Project: Hong Kong Asian-Pop Music Festival 2012

Source: CreateHK records

Audit review

1.10 The Audit Commission (Audit) has recently conducted a review of the administration of the CSI. The audit focused on the following areas:

(a) vetting and assessing project applications (PART 2);

(b) control of use of funds (PART 3);

(c) monitoring and evaluating projects (PART 4); and

(d) meeting the objectives of CSI and the way forward (PART 5).

Acknowledgement

1.11 Audit would like to acknowledge with gratitude the full cooperation of the staff of CreateHK and the CEDB during the course of the audit review. Audit would also like to thank the grantees visited by Audit for their assistance.

PART 2: VETTING AND ASSESSING PROJECT APPLICATIONS

2.1 This PART examines CreateHK's effectiveness in vetting and assessing project applications under the CSI.

CSI Guide

2.2 CreateHK has issued a CSI Guide to provide project applicants a reference. The CSI Guide sets out, among others, the eligibility criteria, vetting and assessment procedures as well as the obligations of project applicants.

2.3 Upon receipt of a project application, CreateHK will conduct a preliminary screening and initial checking of the application to validate the information and documents (e.g. Business Registration Certificate) submitted by the applicant. Thereafter, CreateHK will conduct an internal assessment in accordance with the criteria set out in the CSI Guide. Finally, an Internal Assessment Report will be submitted to the CSI Vetting Committee for consideration.

CSI Vetting Committee

2.4 The CSI Vetting Committee comprises academics, professionals, and representatives from creative and other industries. According to its terms of reference, the Committee is responsible for, among others:

(a) assessing project applications;

(b) making recommendations to the Permanent Secretary on the approval of projects; and

(c) monitoring progress of approved projects and reviewing their quality.

Members of the Vetting Committee are appointed to serve on two-year terms. There were 37 and 34 members for the first and second terms respectively (Note 3). There are 55 members for the third term. The first term started on 1 August 2009. About once a month, an Assessment Panel comprising six to eight Committee members is formed to assess project applications. The quorum of Assessment Panel meetings is four (including the chairperson).

Declaration of interests

2.5 CreateHK adopts a two-tier system of declaration of interests for the CSI Vetting Committee. Under the two-tier system, to maintain public confidence in the integrity of members and the impartiality of their advice tendered, Committee members have to disclose their general pecuniary interests on appointment and annually thereafter, in addition to the report of conflict of interest as and when they arise:

(a) ***1st tier declarations.*** CreateHK requires Committee members to register in writing their personal investment and employment status (including both remunerated and non-remunerated employments) upon appointment, and annually thereafter; and

(b) ***2nd tier declarations.*** Before each Assessment Panel meeting, CreateHK circulates information on project applications (e.g. project titles, name of applicants and parties involved) to the Panel members. The members have to submit their 2nd tier declarations on whether they perceive any potential conflict of interest in the applications concerned. Members who declare a conflict of interest will refrain from the meeting and CreateHK will not circulate the relevant papers to them. When a member has received a paper which he/she knows presents a direct conflict of interest, he/she would immediately inform CreateHK and return the paper. All Panel members are required to undertake to comply with the confidentiality requirements.

For transparency, the 1st tier declarations are made available for public inspection.

Note 3: *Upon consolidation of the DesignSmart Initiative and the CSI in June 2011, the DesignSmart Initiative Assessment Panel was disbanded and the 17 members were appointed to the CSI Vetting Committee on 16 January 2012. Since then, there were 51 members for the remaining period of the second term.*

Administration of 1st tier declarations

2.6 Audit examination of the records of the 1st tier declarations of the past three terms found that there was room for improvement:

(a) ***Too short period allowed for members to make declarations.*** Before the commencement of each term, CreateHK sent declaration forms to members allowing them to submit the declaration forms within two weeks from the date of the letter. However, CreateHK sent the declaration forms to members only a few days before the commencement of their terms. Audit noted that:

(i) ***First term and third term.*** CreateHK sent declaration forms to members only one day and two days before the commencement of the first and third terms respectively. As a result, although most members (30 out of 37 for the first term and 42 out of 55 for the third term) were able to return their declarations within two weeks, the register of declarations was not available for public inspection at the commencement of the two terms; and

(ii) ***Second term.*** CreateHK sent the forms six days before commencement of the term. As a result, although 23 of the 34 members submitted their declarations within two weeks, only 8 members' declarations were available for public inspection at the commencement of the term. As at 28 February 2014, one member had not yet submitted the declaration (see (b)(ii) below);

(b) ***Inadequate follow-up action on long outstanding declarations.*** Inadequate follow-up action was taken by CreateHK (e.g. sending reminders). As a result, declarations were not always returned in a timely manner:

(i) ***First term and third term.*** Three and four members submitted their declarations more than 30 days after commencement of their respective terms; and

(ii) ***Second term.*** Up to 28 February 2014, a member had not submitted the declaration form. Four members submitted their declarations more than 30 days after term commencement (the latest submission was 136 days after term commencement); and

(c) ***Members without 1st tier declarations served in an Assessment Panel.*** CreateHK would not select Committee members to serve in Assessment Panels before they had submitted 1st tier declarations because there was a greater risk of conflict of interest. However, Audit noted that in the second term, four Committee members were selected to serve in an Assessment Panel even though they had not submitted their 1st tier declarations. Although in the end they had all submitted their 2nd tier declarations and confirmed that no conflict of interest existed, this should be avoided to maintain public confidence in the Committee.

CreateHK needs to ensure that declaration forms are sent to members as early as practicable before the commencement of their terms, so that they have sufficient time to return their declarations. This would ensure that the register of declarations is complete and made available to the public for inspection as early as possible. It would also enhance public confidence in the integrity of the Committee. For long overdue 1st tier declarations, CreateHK needs to promptly follow up (e.g. remind members through telephone calls or e-mails). For those members who have not submitted their 1st tier declarations, CreateHK should refrain from inviting them to serve in Assessment Panels as conflict of interest may arise.

Administration of 2nd tier declarations

2.7 CSI Vetting Committee members are required to submit their 2nd tier declarations every time they are invited to serve in Assessment Panels. Upon clearance of conflict of interest in the 2nd tier declarations, CreateHK will send the projects' Internal Assessment Reports and relevant documents to the members at least two days before the meetings. Audit examined 6 of the 26 Assessment Panels formed in the second term and found the following areas where improvement could be made:

(a) ***Chairing an Assessment Panel without submitting 2nd tier declaration.*** One of the vice chairpersons of the CSI Vetting Committee served as the chairperson of an Assessment Panel in May 2013. However, the chairperson had not submitted the 2nd tier declaration until Audit raised the issue in February 2014. The declaration received did not indicate any conflict of interest; and

(b) ***Releasing project papers to members who had not submitted their 2nd tier declarations.*** For four Assessment Panels held in 2012 and 2013, CreateHK sent project papers to five members four to six days before the meetings, even though it had not received their 2nd tier declarations. Subsequently, they submitted their declarations (Note 4) indicating that they had conflict of interest with the projects concerned and had not participated in the assessment work (Note 5).

CreateHK needs to ensure that project documents are only circulated to members who have returned their 2nd tier declarations and have declared no conflict of interest with the projects concerned.

Audit recommendations

2.8 **Audit has *recommended* that the Head of Create Hong Kong should:**

(a) **take measures to ensure that sufficient time is given to CSI Vetting Committee members to return their 1st tier declaration of interests on appointment;**

(b) **implement procedures to ensure that only members who have duly submitted their 1st tier declaration of interests which indicate no conflict of interest are invited to serve in Assessment Panels;**

(c) **take measures to ensure that Assessment Panel members have submitted their 2nd tier declaration of interests before issuing documents relating to project applications to them and allowing them to participate in the Panels; and**

(d) **take steps to ensure that adequate follow-up action is taken on cases of overdue declarations of interests.**

Note 4: *Of the five members, two submitted their declarations a few days before the meetings whereas three submitted their declarations on the dates of the meetings.*

Note 5: *The quorum of these four Panels was not affected and CreateHK did not have to select new Panel members.*

Response from the Administration

2.9 The Head of Create Hong Kong agrees with the audit recommendations. He has said that:

(a) CreateHK will implement procedures to ensure that only members who have duly submitted their 1st tier declaration of interests are invited to serve in Assessment Panels;

(b) it is the usual practice of CreateHK to remind members to declare interests at the start of the Panel meetings before the projects are discussed. If a member declares conflict of interest, CreateHK will put on record the declarations and arrange the member concerned to withdraw from the meeting when the project in question is discussed. In future, CreateHK will record in the notes of Panel meeting both declaration of no conflict of interest and declaration of conflict of interest made at the Panel meeting;

(c) in future, CreateHK will take measures to ensure that the 2nd tier declaration forms are received before issuing documents relating to project applications to the members; and

(d) CreateHK had taken follow-up action on all outstanding declaration forms. Regarding the outstanding declaration forms mentioned in paragraph 2.6(a)(ii) and (b)(ii), CreateHK was unable to contact the member concerned through various means. The member was not invited to any Assessment Panel meetings during his term. Should there be similar case in future, CreateHK will consider annulling the appointment.

Assessing capability of applicants

2.10 Upon receipt of project applications, CreateHK conducts assessment according to the CSI Guide, including whether the project is non-profit making in nature and the potential of the project in promoting the development of creative industries in Hong Kong. CreateHK also reviews and where necessary, revises downward the applicant's proposed project budget. Afterwards, it submits an Internal Assessment Report together with the revised project budget to the Assessment Panel for consideration.

Capability of project teams

2.11 One of the assessment factors specified in the CSI Guide is the capability of the project team, i.e. technical capabilities, project management capability, expertise, experience, qualifications, track record, and the resources available for the project. However, Audit found that:

(a) ***Absence of information on project teams.*** The applicants' provision of project teams' information was stated as optional in the application form. Applicants could choose not to provide such information. Audit examination of 10 project applications revealed that information on the qualifications and experience of the project team members (such as curricula vitae) was provided in only 4 project applications; and

(b) ***Projects carried out by third parties.*** Audit noted that some projects were carried out substantially by third parties rather than the project applicants. In such projects, the obligations imposed by the Project Agreements to perform specific tasks were largely assigned to third parties and a large proportion of the CSI grants was received by such parties (i.e. the sub-grantees). For projects of such nature, the capability of the sub-grantees was more important than that of the project applicants. However, the CSI Guide did not require the assessment of the capability of the sub-grantees in the assessment of the project applications and did not require the applicants to provide such information of sub-grantees.

Projects sharing resources

2.12 CreateHK states on its website that there is no restriction on the number of applications submitted by an applicant at any one time. In assessing each application, it will consider the capability of the applicant to deploy adequate resources to complete the project, taking into account the number of projects the same applicant was undertaking. In the assessment checklist, the factors that should be considered by the CSI Vetting Committee in assessing project applications included the following:

> *"whether the project coordinator nominated by the applicant and/or project team members will work on more than two projects within the same project period"*

2.13 Audit's analysis of the 165 approved projects revealed that 3 applicants and 3 corresponding project coordinators undertook more than two projects concurrently. For the period from 2011 to 2013, they undertook a total of 21 projects. Each of the project coordinators was concurrently responsible for 4 to 5 projects with some of the project periods overlapped. For example, 4 projects (with approved funding ranging from $501,000 to $5.4 million) were overseen by the same coordinator for a continuous period of 6 months. Of the four projects, one project involved organising events in the Mainland. Audit however found that no information on the number of projects concurrently undertaken by the same coordinator and/or project team member had been included in the Internal Assessment Reports for the Assessment Panels' consideration.

Audit recommendations

2.14 **Audit has *recommended* that the Head of Create Hong Kong should:**

(a) **revise the project application form to require the provision of the information on applicants' project teams wherever applicable;**

(b) **for projects involving the engagement of major sub-grantees, require project applicants to provide information on the sub-grantees' project teams for the Assessment Panel's consideration wherever applicable; and**

(c) **take measures to ensure that information is provided wherever applicable by the applicant on whether the project coordinator and/or any project team members will work concurrently on three or more projects within the same project period.**

Response from the Administration

2.15 The Head of Create Hong Kong agrees with the audit recommendations. He has said that project team members are usually recruited after the project is approved. CreateHK will revise the project application form to require information on the project team if the team has been formed.

Repeated projects

2.16 CreateHK allows applicants to submit applications for repeated projects (i.e. projects which are re-run of previous projects) to provide flexibility for them to develop projects with a longer-term vision for the benefit of the creative industries. Of the 165 projects approved in the period from June 2009 to November 2013, CreateHK identified 54 (33%) as repeated projects (with approved funding totalled $89.6 million). They were re-runs of 28 projects. Each of the 28 projects was re-run for one to four times.

Two-control Rule

2.17 Applications for repeated projects are subject to the Two-control Rule. One objective of the Two-control Rule is to ensure that repeated projects have the capability of obtaining some financial support from the commercial and industrial sectors to prove the project's sustainability. Another objective is to strike a balance between helping the sustainable development of a repeated project and allowing more resources to be provided for new projects which can benefit the creative sectors at large. Under the Rule, one of the following two conditions must be fulfilled:

(a) the amount of approved funding should not exceed that of the previous project; or

(b) the amount of public funding as a percentage of the project cost should not exceed that of the previous project.

Applications which have failed to meet the Rule will only be considered with full justifications.

Identification of repeated projects

2.18 CreateHK has not established clear criteria for what constitutes a repeated project. Audit noted that in the period from 2011 to 2013, an applicant had undertaken a series of five similar projects (with approved funding totalled $17.4 million), but only one of the projects (Project C) was identified as a repeated project (see Table 2).

Table 2

Five similar projects undertaken by an applicant (2011 to 2013)

Project	Locations of international book fair	Date of submitting application	Project period	Date of approval	Approved funding ($ million)
A	Cities I, II and III	1/2011	3/2011 to 2/2012	2/2011	4.8
B	City IV	12/2011	1/2012 to 5/2012	1/2012	2.2
C	Cities I, II and III	5/2012	4/2012 to 5/2013	7/2012	3.5
D	Cities II and V	12/2012	12/2012 to 7/2014	2/2013	3.9
E	Cities I, III and VI	1/2013	1/2013 to 5/2014	4/2013	3.0
				Total	17.4

Source: CreateHK records

2.19 The activities undertaken in the five projects were similar, namely the setting up of pavilions at international book fairs to demonstrate the creativity and accomplishment of Hong Kong's publishing and printing industries as well as helping local companies explore markets. Some locations of the activities organised under the projects overlapped with each other. The major difference among the projects was the locations. Audit, however, noted that only Project C was identified as a repeated project of Project A. Upon enquiry, CreateHK informed Audit in December 2013 that Project C covered the same scope as that of Project A (i.e. participating the same book fairs held in the same cities). CreateHK also said that as Projects B, D and E involved in participating book fairs held in cities different from those of Project A, they were not identified as repeated projects.

2.20 Contrary to the criterion adopted by CreateHK for identifying repeated projects mentioned in paragraph 2.19, Audit noted that in April 2012 (i.e. about eight months before processing applications of Projects D and E), CreateHK identified Project G as a repeated project of Project F even though the two projects (see Table 3) involved significant differences in thematic focus on, and scale of profiling of Hong Kong's creative sectors, and the locations of the events organised.

Table 3

Projects F and G

Project	Date of submitting application	Project period	Date of approval	Approved funding ($ million)
F	1/2011	9/2010 to 6/2011	3/2011	1.9
G	2/2012	12/2011 to 10/2012	4/2012	2.1

Source: CreateHK records

2.21 Audit further found that had Project D been identified as a repeated project, it would have failed to meet the Two-control Rule and needed full justifications for approval.

Re-running project funded by other government schemes

2.22 CreateHK publishes on the CSI's website that re-running projects previously funded by other government schemes will be subject to the Two-control Rule. However, Audit found that in practice CreateHK only checked whether the project concerned was a re-run of previous projects funded by the CSI and the DesignSmart Initiative (Note 6). It did not check or ask the applicant to declare whether the project was a re-run of projects previously funded by government schemes other than the CSI.

2.23 In February 2014, CreateHK informed Audit that:

(a) the Two-control Rule was only applicable to projects which were re-runs of projects previously funded by the CSI and the DesignSmart Initiative; and

(b) the information on the CSI's website was not entirely correct.

Note 6: *The DesignSmart Initiative has been subsumed in the CSI since June 2011.*

2.24 Audit considers that information published by CreateHK on its website is an important reference for potential project applicants. They may be misinformed if incorrect information is published.

Audit recommendations

2.25 **Audit has *recommended* that the Head of Create Hong Kong should:**

(a) **issue clear guidelines on the criteria for the identification of repeated projects and promulgate the same on the CSI's website to enhance transparency and public accountability; and**

(b) **take measures to ensure that information published on the CSI's website is correct and accurate.**

Response from the Administration

2.26 The Head of Create Hong Kong agrees with the audit recommendations. He has said that the information on the CSI's website regarding the application of the Two-control Rule to re-run projects was amended on 28 February 2014 in the light of Audit's observation.

PART 3: CONTROL OF USE OF FUNDS

3.1 This PART examines the CreateHK's control of use of project funds.

Funding requirements

3.2 The grantee of an approved project is required to comply with the terms and conditions laid down in the Project Agreement and use the funds only for expenditures set out in the approved project budget. On completion of a project, the grantee is required to submit a Completion Report and audited accounts to the satisfaction of CreateHK (Note 7). Audit examination of the use of funds by grantees revealed room for improvement in the following areas:

(a) keeping of books and records (paras. 3.3 to 3.7);

(b) use of funds by grantees (paras. 3.8 to 3.18);

(c) use of funds by subsidised parties (paras. 3.19 to 3.22); and

(d) inspection of books and records (paras. 3.23 to 3.25).

Keeping of books and records

Retention period for books and records

3.3 It is stipulated in Project Agreements that grantees have to keep proper books and records for inspection by CreateHK. Audit noted that instead of following the normal seven-year requirement under various Ordinances (e.g. the Companies Ordinance (Cap. 622), the Insurance Companies Ordinance (Cap. 41) and the Inland Revenue Ordinance (Cap. 112)), grantees are required to retain the books and records for only two years after either the project completion date or early termination date.

Note 7: *The requirement to submit audited accounts is to assure the Government that the project funds have been fully and properly applied to the project for which they are paid, and received and expended in accordance with the approved project budget, and the grantee complied with the funding terms and conditions in the administration, management and usage of the project.*

3.4 The Project Agreements confer on CreateHK the right of access to the projects' books and records for inspections (see also para. 3.23). They also confer the same right on Audit for conducting audits. Audit considers that CreateHK needs to lengthen the retention periods of the projects' books and records to conform to the usual practice.

Grantees' books and records

3.5 Audit examined the grantees' books and records of 15 completed projects (Note 8) with a total approved funding of $52.8 million. Audit found that:

(a) ***Expenditure without supporting documents.*** Some expenditure items of Projects M and R amounting to some $547,000 did not have supporting documents (e.g. receipts); and

(b) ***Incomplete books and records.*** There were no balance sheets for Projects H, M, R and T. It was therefore uncertain whether the amounts of accounts payable were correct (see also para. 3.16).

Audit recommendations

3.6 **Audit has *recommended* that the Head of Create Hong Kong should:**

(a) **lengthen the required retention period of the books and records of the projects;**

(b) **follow up with the grantees concerned on the anomalies identified by Audit relating to the expenditure items and accounts payable; and**

(c) **take measures to ensure that grantees keep proper books and records for their projects.**

Note 8: *The 15 projects were completed in the period from April 2011 to May 2013. They covered various creative sectors with approved funding ranging from $261,000 to $8,379,000.*

Response from the Administration

3.7 The Head of Create Hong Kong agrees with the audit recommendations. He has said that CreateHK has initiated action to follow up with the grantees concerned on the anomalies identified by Audit. It is also preparing a Quick Reference Guide to remind grantees of the requirements in the implementation of CSI projects, which include the keeping of books and records. The following arrangements will be put in place shortly:

(a) CreateHK will explain to the grantees details of the Guide before the CSI funds are released to them;

(b) the grantees will be required to acknowledge the full understanding of the Guide;

(c) upon completion of projects, the grantees will be required to confirm that the required action as set out in the Guide has been taken; and

(d) the Guide will be passed to the auditors to facilitate their checking of the grantees' compliance with the Guide.

Use of funds by grantees

3.8 Grantees are required to observe the following requirements laid down in the Project Agreements:

(a) ***Designated bank account.*** The grantee is required to keep a designated bank account solely and exclusively for depositing all receipts and making payments in relation to the project;

(b) ***Approved project proposal.*** The grantee should use the project funds only for carrying out the project in accordance with the budget containing all expenditure items set out in the approved project proposal;

(c) ***Unallowable costs.*** The grantee should not use the project funds to cover building facilities (e.g. office and accommodation), rates, rental, project staff gratuities, fringe benefits, allowances, meals, etc.;

(d) ***Unspent balance.*** Upon completion of the project, unspent balance is required to be returned to the Government; and

(e) ***Procurement requirements.*** The grantee is required to obtain adequate number of written quotations for every procurements as follows:

Procurement amount	No. of quotations
＞$5,000 to ＜$10,000	2
≧$10,000 to ＜$500,000	3
≧$500,000	5

If the grantee procures goods or services from a single supplier/service provider, prior approval from CreateHK should be sought.

Projects without designated bank account

3.9 Audit examination of the 15 projects (see para. 3.5) revealed that the grantees of 12 projects had not kept a designated bank account. Case 1 demonstrates the anomaly.

Case 1

1. Project M was approved with a funding of some $3.6 million for organising a series of overseas and local events to promote Hong Kong as a nexus for creative talents in Asia.

2. In November 2013, in response to Audit's enquiry, the grantee informed CreateHK that the project's bank accounts had been used to handle funds not related to the project. It also said that due to oversight and cashflow reasons, it had deposited CSI funds into its own bank accounts and settled payments unrelated to the project from such accounts. Audit noted that the grantee was granted CSI funds of some $3.6 million to re-run the project (Project N) in 2014.

Case 1 (Cont'd)

Audit comments

3. Audit considers that CreateHK needs to follow up the case with the grantee to ensure that there was no misuse of CSI funds and to instigate remedial action where warranted (e.g. recoupment of CSI funds and consider penalising the grantee).

Source: Audit analysis of CreateHK records

Unallowable costs

3.10 As mentioned in paragraph 3.8(c), project funds should not be used to cover unallowable costs. Audit, however, noted that of the 15 projects examined, the grantees of three projects had used the funds for unallowable costs. Details are given below:

(a) ***Travelling expenditure.*** Under Project I, the grantee led a group of designers to participate in an overseas exhibition. Project funding of some $14,000 was used on expenditure items not set out in the approved project budget (i.e. additional travelling and accommodation costs for two designers who stayed behind after the exhibition);

(b) ***Costs disallowed by CSI Vetting Committee.*** For Project M, the CSI Vetting Committee rejected the grantee's request for the printing of the Year Book as it doubted the necessity and cost-effectiveness of doing so. Nevertheless, the grantee used some $19,000 of the CSI funds to print the Year Book; and

(c) ***Allowances.*** For Project U, some $30,000 was paid to the staff of the grantee as meal allowances. For Project M, which was funded under an alternative funding approach (see para. 3.13(a)), the grantee paid a total of some $100,000 to its Director as monthly allowances. CreateHK informed Audit in late March 2014 that the $100,000 allowances were paid out of sponsorship (i.e. non-CSI funds). Under the existing practice, CreateHK did not monitor the expenditure covered by non-CSI funds.

Unspent fund balance

3.11 According to the CSI Guide, in making an application for CSI funding, the applicant is required to submit a proposed budget showing all income (e.g. from sale of admission tickets and donations), sponsorship and expenditure of the project. CSI funding is given by way of a grant. It will cover only the net approved project costs after deducting the expected income and the amount of sponsorship (i.e. the income and the sponsorship are lumped together and offset against the project costs, any excess of project costs will be funded by the CSI). After the completion of the project, any unspent fund balance of the project is required to be returned to the Government.

3.12 Of the 15 projects examined, Audit noted that Project M had an unspent fund balance of some $580,000. Project M was a repeated project and the previous projects implemented in 2011 and 2012 (Projects K and L, which were not included in the 15 projects) also had unspent fund balances (see Table 4). Audit found that the unspent fund balances of the three projects had not been returned to the Government.

Table 4

Unspent fund balances of Projects K, L and M

	Project K	**Project L**	**Project M**
Total income	$6.33 million	$6.17 million	$6.14 million
Total expenditure	$5.89 million	$5.84 million	$5.56 million
Unspent fund balance	$0.44 million	$0.33 million	$0.58 million

Source: Audit analysis of CreateHK records

3.13 In late March 2014, CreateHK informed Audit that:

(a) the unspent fund balance of Project M was not required to be returned to the Government because in its application for CSI funding, the grantee had proposed an alternative funding approach, which was different from the traditional approach (see para. 3.11). Under the alternative funding approach, the CSI funding would be used to cover certain designated expenditure items of the project (which did not include the director’s allowances mentioned in para. 3.10(c)), while some other expenditure items would be covered by sponsorship (which was non-CSI funds). The grantee informed CreateHK that it had expended all the CSI funds on designated CSI-funded expenditure items. The unspent fund balance originated from sponsorship;

(b) the Assessment Panel and the Government were aware of the alternative funding approach at the project assessment and approval stages. By permitting the grantee not to apply the sponsorship to offset the designated expenditure items would allow the overall project to expand in scope, develop into a larger platform benefitting more people, and in turn reduce the share of public funding in the total cost of the overall project. As approved by the Government, sponsorship and budgeted income from the admission charge and sale of on-site merchandise would not be used to offset CSI funding support but to cover other expenditure items of the project;

(c) the grantee had advised that the unspent fund balance had been used as general working capital for the continuous development of the grantee's overall programme, of which Project M was a part, to fund the operational expenses as well as networking and researches conducted throughout the year; and

(d) as regards Projects K and L (for which the same alternative funding approach was adopted), the grantee had confirmed that the unspent fund balances of these two projects also originated from sponsorship.

3.14 Audit noted that the grantee was granted CSI funding of some \$3.6 million to re-run the project again in 2014. The project, which was also funded under the alternative funding approach, was expected to complete in May 2014. Audit considers that CreateHK needs to conduct a review of the alternative funding approach taking into account the following factors:

(a) of the 15 projects examined by Audit, only Project M used the alternative funding approach in seeking CSI funding. Of the remaining 14 projects, the grantees of six projects (with sponsorship totalling \$2.9 million) had returned unspent fund balances of some \$2.1 million to the Government; and

(b) it is a general practice of the Government that unspent fund balances of government funded projects need to be returned to the Government. The unspent fund balance is defined as the residue of all receipts of a project (including the government grant, sponsorship, donations and other incomes) after deducting all the project's expenditure. An example of other Government Funds that require return of unspent fund balance is the Film Development Fund administered by CreateHK.

In the light of the results of the review, CreateHK needs to revise the CSI Guide as appropriate to stipulate whether or not the alternative funding approach is allowed.

Procurement

3.15 Audit examination of the 15 projects indicated that the grantees of all the projects had not fully followed the procurement requirements. Examples included cases where the grantee:

(a) obtained less than three written quotations from supplier/service provider for procurement with value exceeding $10,000;

(b) selected the supplier/service provider who was not the one that submitted the lowest bid and no proper justification was given; and

(c) procured from a single supplier/service provider without seeking CreateHK's prior approval.

Subsequent settlement of accounts payable

3.16 The last instalment of the approved funding of a project is disbursed upon acceptance of the Completion Report and audited accounts. Some expenditure items are recorded in the audited accounts as accounts payable. According to the books and records of the 15 projects examined by Audit, such expenditure items (ranged from $9,000 to $2.1 million) amounted to a total of some $8.75 million (17% of the projects' total approved funding of $52.8 million). Audit noted that CreateHK had not taken steps to follow up the subsequent settlement of these expenditure items. Given the large amounts of accounts payable of some projects, Audit considers that CreateHK needs to follow up their subsequent settlement to ensure that project funds are disbursed properly. Case 2 illustrates the importance of such verification.

Case 2

1. Some $1.2 million of Project R's expenditure remained to be settled after project completion in March 2012. Upon Audit's request for inspection of books and records, the grantee of Project R informed CreateHK in January 2014 that some expenditure items were subsequently cancelled or paid with a lesser amount after the project completion:

(a) "conference operations expenditure" of $20,000 and "layout fee of research report" of $15,000 were waived by the creditors;

(b) an item of "research fee" of RMB 20,000 was overstated as RMB 50,000 due to typographical error; and

(c) another item of "research fee" was reduced from RMB 150,000 to RMB 112,500 as the researcher agreed to receive a lesser amount due to his failure to complete part of his work.

2. The grantee said that some $118,000 would be returned to CreateHK upon its final verification of the amounts.

Audit comments

3. CreateHK needs to test-check the subsequent settlement of accounts payable, and to demand repayments from grantees where warranted.

Source: Audit analysis of CreateHK records

Audit recommendations

3.17 **Audit has *recommended* that the Head of Create Hong Kong should:**

(a) **remind grantees the need to maintain designated bank accounts solely for handling project funds;**

(b) **consider penalising grantees who failed to maintain designated bank accounts;**

(c) **follow up those projects where designated bank accounts had not been maintained to ensure that there is no improper use of project funds and take remedial action where necessary (e.g. initiating recoupment of funds and/or penal action);**

(d) **follow up those projects where the grantees have used project funds to cover unallowable costs (see para. 3.10) and seek repayments from them;**

(e) **in future, test check the books and records of grantees to identify unallowable costs and demand repayments from them where warranted;**

(f) **conduct a review of the alternative funding approach;**

(g) **remind grantees of the procurement requirements and conduct test-checks to ensure compliance;**

(h) **test check the subsequent settlement of accounts payable and take remedial measures (e.g. demand repayments from grantees if any payables have been settled with smaller amounts) where necessary;**

(i) **revise the Project Agreement to spell out the requirement that if the amount of project funds used to settle accounts payable is less than the amount received by the grantee from the Government for such purpose, the grantee should refund the difference to the Government; and**

(j) **ensure that grantees' track records of handling project funds is taken into account in assessing their new applications for funding.**

Response from the Administration

3.18 The Head of Create Hong Kong agrees with the audit recommendations. He has said that:

(a) CreateHK is preparing a Quick Reference Guide to remind grantees of the requirements in implementing CSI projects, which include maintaining a designated bank account, a highlight on unallowable costs and the compliance with the procurement requirements. CreateHK will arrange an independent auditor to conduct test checks on the compliance with the Guide;

(b) CreateHK has initiated actions to follow up projects where designated bank accounts have not been maintained;

(c) CreateHK will seek repayment from the grantees for the unallowable costs incurred;

(d) for Case 1, follow-up action with the grantee and the auditor concerned has been initiated. CreateHK is seeking further information from both parties. It also intends to conduct a second audit by another independent auditor. Remedial action will be taken;

(e) in the light of the large number of completed projects, CreateHK will ask grantees to declare if there is any unspent balance in their projects, and conduct random verification and recoup unspent balances as appropriate; and

(f) CreateHK has initiated follow-up action to ascertain the subsequent settlement of accounts payable and take remedial action where necessary. For future CSI projects, it will ask grantees to provide a list of accounts payable upon submission of the audited accounts, so that it could follow up the actual amount paid at a later date and demand repayments where necessary.

Use of funds by subsidised parties

3.19 Project V was a programme aiming to train animation start-up companies to produce animation films. The grantee of Project V entered into an agreement with each of the 20 programme participants and provided from the project funds a subsidy of $80,000 to each of them for the production of a 3-minute animation film. To prevent possible abuse of project funds, the CSI Vetting Committee specified that the grantee should set out clear guidelines and criteria for the participants to follow. These guidelines and criteria were subsequently incorporated into the agreements. Audit, however, found the following anomalies:

(a) ***Acquisition of fixed assets without grantee's endorsement.*** The grantee specified that the participants had to obtain its endorsement before procuring equipment. Six participants incurred some $72,000 to procure equipment (such as a notebook computer with retina display costing $21,000) without following the requirement;

(b) ***Eligibility of participants.*** The participants were required to be incorporated in Hong Kong under the Companies Ordinance. Of the 20 participants, 12 did not meet such eligibility criterion; and

(c) ***Unallowable expenditure.*** Of the $80,000 subsidy, a maximum of $56,000 was allowed to cover manpower expenditure (animation specialist) while the remaining balance was for other expenditure relating to the production of the animation work (e.g. script writing, hardware or equipment, voice talent, audio recording studio, and music). Audit found that a participant had used some $1,000 of the subsidy to pay part of office rental.

3.20 To ensure that grantees properly oversee the use of subsidy by project funds parties, Audit considers that the Project Agreement needs to provide that grantees are liable for the inappropriate use of project funds (including making repayments to the Government) by subsidised parties.

Audit recommendations

3.21 **Audit has *recommended* that the Head of Create Hong Kong should:**

(a) **require grantees to ensure that parties subsidised by them properly used the subsidies;**

(b) **provide in the Project Agreement that grantees are liable for inappropriate use of project funds by subsidised parties; and**

(c) **recoup from grantees funds used for unallowable expenditure by subsidised parties.**

Response from the Administration

3.22 The Head of Create Hong Kong agrees with the audit recommendations.

Inspection of books and records

3.23 It is specified in the Project Agreements that CreateHK or its authorised representatives have the right to inspect the grantees' books and records during the period of the Agreements and the two-year retention period. However, CreateHK has not done so for any of the projects funded by the CSI since its inception in 2009. In view of the various anomalies described in this PART, and to ensure that the grantees' expenditures are properly accounted for, Audit considers that CreateHK needs to work out a plan for inspecting the books and records of projects on a sample basis, taking into account risk factors such as the approved funding amount and track records of grantees (e.g. in the case of repeated projects).

Audit recommendation

3.24 **Audit has *recommended* that the Head of Create Hong Kong should, on a risk basis, carry out sample inspections of the grantees' books and records.**

Response from the Administration

3.25 The Head of Create Hong Kong agrees with the audit recommendation. He has said that CreateHK will arrange an independent auditor to conduct sample inspections of the grantees' books and records.

PART 4: MONITORING AND EVALUATING PROJECTS

4.1 This PART examines the work of CreateHK in monitoring and evaluating approved projects.

Project monitoring

4.2 According to the CSI Guide, the approved funding will be disbursed by instalments on satisfactory performance of appropriate milestones, and strictly in accordance with the terms and conditions as set out in the Project Agreement. The last instalment will be made upon:

(a) the successful implementation of the project in accordance with the project proposal;

(b) the due compliance with the Project Agreement;

(c) the submission of Completion Report and the final audited accounts to the satisfaction of CreateHK; and

(d) evidence showing that all committed sponsorship have been in place.

Mode of funding

4.3 The mode of funding (i.e. the number of instalments and the percentages of funds released in each instalment) of projects varies. According to CreateHK's Procedural Guidelines, projects which span one year or less will be funded by two instalments, i.e. an upfront instalment and a final instalment. For projects which span more than one year, interim instalments (in addition to the upfront and final instalments) will be made on satisfactory performance of appropriate milestones and submission of Progress Reports. The Progress Reports will be considered by the CSI Vetting Committee and approved by the Permanent Secretary before releasing the instalments to the applicant. Of the 165 approved projects, 112 (68%) spanned one year or less and 53 (32%) spanned more than one year (ranged from 13 to 45 months). Audit examined the funding mode of 20 projects (10 spanned one year or less and 10 more than one year).

4.4 Of the 10 projects which spanned more than one year, 5 (spanned 17 to 24 months) were funded by only two instalments, contrary to the Procedural Guidelines. No records were available showing the justifications for the non-compliances. Furthermore, Audit noted that for all the 13 projects which were funded by two instalments, despite the significant variations among them (e.g. their amounts of approved funding and cash flow pattern), the percentages of funds released in the two instalments (70% upfront and 30% final) were the same. No records were available showing the justifications for the fixed percentages of funds released. CreateHK informed Audit in March 2014 that they did not record the justifications for adopting the standard mode of funding (i.e. 70% upfront and 30% final). For non-standard mode of funding, they had recorded the justifications.

4.5 Audit considers that CreateHK needs to provide clear guidance on the factors to be considered (e.g. cash flow pattern of a project) in the Procedural Guidelines with a view to facilitating the determination of the mode of funding.

Monitoring progress of approved projects

4.6 It was stated in the CSI Guide that CreateHK could suspend or terminate the funding support to a project for reasons including:

(a) non-compliance with all or any of the terms and conditions as set out in the Project Agreement;

(b) lack of progress of the project in a material way;

(c) slim chance of completion of the project in accordance with the project proposal;

(d) the original objectives of the project were no longer relevant to the needs of the creative industry as a result of material change in the circumstances;

(e) the objectives and relevance of the project had been overtaken by events; and

(f) CreateHK saw the need to suspend or terminate the project in public interest.

4.7 If a project's funding is released by interim instalments, CreateHK requires grantees to submit progress reports. CreateHK will review the project progress and seek the CSI Vetting Committee's support and the Permanent Secretary's approval for disbursing the interim instalments. For projects funded by two instalments only (i.e. no interim instalments are released), no documentary evidence was available showing that their progress (deliverables and milestones) had been reviewed. In February 2014, CreateHK informed Audit that during the course of the implementation of the projects, grantees were required to submit publicity materials wherever applicable for review to ensure that acknowledgement of CreateHK was properly made. At that time, CreateHK would review whether the event concerned was being carried out in accordance with the approved project proposal.

4.8 In order for CreateHK to exercise timely action in response to the situations listed in paragraph 4.6, there is a need for CreateHK to monitor closely the progress of all approved projects (e.g. requiring grantees to submit progress reports at suitable time intervals), taking into account the nature of individual projects.

4.9 According to its terms of reference, the CSI Vetting Committee is responsible for monitoring the progress and reviewing the quality of approved projects. However, Audit found that CreateHK only informed the Committee of the progress of a project when it sought the Committee's support and the Permanent Secretary's approval to release interim instalment of the project. For projects without interim instalments, the Committee was not informed of their progress.

4.10 Audit considers that CreateHK needs to take measures to facilitate the CSI Vetting Committee in monitoring the progress of approved projects. For instance, periodic progress reports on all approved projects should be submitted to the Committee for consideration.

Site visits

4.11 CreateHK did not promulgate guidelines or prepare work plans for site visits. For example, CreateHK did not set out the criteria for selecting projects for site visits, the frequency of visits, the checks to be performed during visits and the reporting requirements. As a result, projects were not selected on a consistent basis, and checks performed during the visits and the site visit reports varied from project to project.

4.12 Audit examined the records of 38 projects (comprising 31 completed projects and 7 projects in progress). Audit found that CreateHK did not conduct site visit for 8 completed projects (approved funding for each project ranged from $0.25 million to $2.91 million). Of the 8 projects, 5 involved overseas events. For the remaining 30 projects (with approved funding ranged from $0.28 million to $7.37 million), CreateHK conducted one site visit for each of them. Audit found that all the site visits were attendance to open ceremonies, press conferences, exhibitions or music shows. Audit reviewed the Site Visit Reports and found that:

(a) ***Meeting staff of grantees.*** For 12 of the 30 projects, the inspecting officer(s) had met the staff of the grantees. However, there was no information on the issues (e.g. the progress of the projects or challenges and difficulties encountered) that had been discussed. For the remaining 18 projects, the inspecting officers had not met the staff of the grantees;

(b) ***Duration of site visit.*** For the 30 projects, the inspecting officer(s) completed the site visit in an average of 1.6 hours (ranging from 0.3 to 3.5 hours). Audit could not identify a correlation between the time taken for the visits and the complexity of the projects, the amounts of the approved funding or the checks performed during the visits; and

(c) ***Follow-up action.*** For 26 of the 30 projects, no follow-up action was recommended in the Site Visit Reports. For the remaining 4 projects, the Report recommended follow-up action on matters relating to the size of the pavilion and number of exhibits, and the boosting up of the public attendance for coming events. For one of the four projects, there was no documentation showing whether the recommended follow-up action had been taken.

Completion Reports and audited accounts

4.13 Grantees are required to submit a Completion Report together with the audited accounts within two months from project completion. Audit analysis of all the 102 projects whose Completion Reports were due for submission as at 30 September 2013 revealed that the Completion Reports and audited accounts of 62 (61%) projects were submitted on average about two months (the longest overdue period was about 9 months) after the due dates (i.e. the expiry of the two-month period).

4.14 The number of grantees who failed to submit the Completion Reports and audited accounts on time was significant. This suggests a need for CreateHK to review why the grantees have difficulties in complying with the deadline. In the light of results of its review, CreateHK may need to take appropriate action either to tighten its follow-up action on late submissions or set a more realistic and achievable submission deadline taking into account the feedbacks from the creative industries. CreateHK may also consider setting a submission deadline for each project, taking into account its complexity and nature.

Audit recommendations

4.15 **Audit has *recommended* that the Head of Create Hong Kong should:**

(a) **issue guidelines setting out the factors (such as the cash-flow pattern of projects) that should be taken into account in determining the mode of funding of a project (i.e. number of instalments and amount of each instalment);**

(b) **take measures to ensure that the justifications for the mode of funding are documented;**

(c) **monitor the progress of all approved projects and document the action taken in monitoring the projects;**

(d) **regularly provide the CSI Vetting Committee with information on the progress of the approved projects with a view to seeking its advice and facilitating its monitoring work;**

(e) **adopt a structured approach for site visits and issue guidelines setting out the basis of selection, checks to be performed, frequency of visits and the reporting requirements, taking into account project risks involved (such as the funding amounts and nature of the projects);**

(f) **ensure that observations made during site visits are followed up and the results of the follow-up action taken are documented; and**

(g) **review the deadline for submitting Completion Reports and audited accounts and consider either tightening up follow-up action on late submissions or revising the submission requirement by setting a more realistic and achievable submission deadline.**

Response from the Administration

4.16 The Head of Create Hong Kong agrees with the audit recommendations. He has said that:

(a) CreateHK will formally issue guidelines setting out the factors that should be taken into account in determining the mode of funding of a project;

(b) CreateHK will ensure proper documentation of the action taken in monitoring the progress of approved projects;

(c) since November 2013, all new projects spanned more than one year are required to submit mid-term progress reports to the CSI Vetting Committee for consideration;

(d) CreateHK will follow up the observations made during site visits as appropriate and ensure the proper documentation of follow-up action taken; and

(e) site visit is not applicable to those projects which involve research, writing of guidelines, etc. For overseas events, CreateHK will balance the merits against cost effectiveness of site visits. For local events, the existing practice of CreateHK is to arrange site visit as far as practicable. CreateHK will develop criteria for conducting site visits and ensure proper documentation is kept for site visit.

Project evaluation

4.17 Upon the receipt of Completion Reports and the audited accounts for completed projects, CreateHK will prepare Evaluation Reports and submit them with the grantees' Completion Reports to the CSI Vetting Committee for consideration. The Committee will then make recommendations to the Permanent

Secretary on the acceptance of the Completion Reports and audited accounts, as well as the disbursement of the final instalments to the grantees.

Verification of information reported by grantees

4.18 CreateHK prepares Evaluation Reports based on the information in the Completion Reports and supplementary information provided by the grantees. The information of the projects that may be relevant to the preparation of Evaluation Reports include the number of visitors, participants and grantees' efforts in promoting the projects. There may be a risk that the information obtained includes intended or unintended misstatements. The lack of a verification mechanism on the information obtained from the grantees may undermine the reliability and usefulness of CreateHK's Evaluation Reports. CreateHK should devise a system to verify the accuracy of the information as far as practicable to enhance the reliability and usefulness of its evaluation results.

Time schedule for project evaluation

4.19 CreateHK did not have a time schedule or target completion date for conducting evaluation of projects. Audit examined 20 completed projects and noted that CreateHK completed the evaluations on average 2.5 months (ranging from 17 days to 8.5 months) after receiving the Completion Reports from the grantees. Late completion of the evaluations may lead to late recovery of unspent balances and late release of final instalments to the grantees, and may also affect the assessment of new project applications submitted by the same applicants (see para. 2 of Case 4 in para. 4.27). Audit considers that CreateHK needs to conduct project evaluation in a timely manner and set a target completion date in finalising the evaluation reports.

Post-project Evaluation Questionnaire

4.20 To evaluate the effectiveness of the projects in achieving their objectives, it is stated in the Project Agreements that:

(a) whenever so required by the Government, the grantees shall complete and return to the Government a Post-project Evaluation Questionnaire within six months from the date of completion of the project or earlier termination of this Agreement; and

(b) the grantee shall report in the Post-project Evaluation Questionnaire the efforts in publicising the Project, and provide quantitative measurement on the adoption of the Project achievements by the industry.

Audit noted that CreateHK had not required any grantees to complete and submit the Questionnaire stated in the Project Agreements.

4.21 In February 2014, CreateHK informed Audit that:

(a) there was no material difference between the contents of Post-project Evaluation Questionnaire and those of the Completion Report; and

(b) it would be desirable to remove from the Project Agreement the requirement to complete a Post-project Evaluation Questionnaire.

4.22 Audit considers that CreateHK needs to regularly review the Project Agreement to ensure that it is up-to-date and does not include unnecessary requirements.

Use of questionnaire in conducting review

4.23 It is common that questionnaire survey is used in conducting reviews, comprehensive or otherwise, of programs, initiatives and schemes. When seeking the additional funding of $300 million for sustaining the operation of the CSI in May 2013, CreateHK informed the Finance Committee of the Legislative Council that a review in the form of a questionnaire survey was conducted in late 2012 to evaluate the mode of operation of the CSI. The results of the review indicated that the parties concerned were satisfied with the mode of operation.

4.24 CreateHK used different questionnaires for three target groups (i.e. (a) grantees; (b) members of the CSI Vetting Committee; and (c) the relevant industry and trade associations). Two questionnaires contained ten questions and one questionnaire contained eight questions. Audit noted that in three of the eight or ten questions in the questionnaires, there was bias in the ratings for respondents to choose from. In these questions, the majority of the ratings tended to be favourable ratings. For example, for the question “How useful is the CSI in assisting your organisation to achieve the project objective(s)?”, respondents were asked to choose one of the following ratings: “definitely useful”, “very useful”, “useful”, “fair” and “not useful”.

4.25 To avoid bias, a good practice is to balance the ratings around a neutral mid-point. For example, the respondents are offered ratings “very useful”, “useful”, “neither useful nor unuseful”, “unuseful” and “very unuseful”.

Using previous evaluation results for assessing new applications

4.26 Audit scrutiny of the Internal Assessment Reports on project applications revealed that in assessing project applications, CreateHK took into account the track records of the applicants in running previous CSI projects. In particular, CreateHK relied on applicants’ past performance to assess their capabilities. However, Audit noted that for some projects, information on past performance of the applicants included in the Internal Assessment Reports had missed some important information (e.g. the failure of the applicant in soliciting the committed sponsorship).

4.27 In assessing the application for re-running a previously funded project, it is important that the evaluation results of the previously funded project are included in the Internal Assessment Report and are taken into consideration by the Assessment Panel. Audit examination revealed that this was not always the case (see Cases 3 and 4).

Case 3

Sponsorship obtained less than committed

1. Projects L, M and N were repeated projects of Project K. For Projects L and M, the grantee failed to solicit the committed amounts of sponsorship.

Project	Project period	Approved funding ($ million)	Sponsorship		
			Committed ($ million)	Actual ($ million)	Variance ($ million)
K	4/2010 to 3/2011	3.3	3.31	3.36	0.05
L	5/2011 to 5/2012	3.6	3.30	2.08	(1.22)
M	6/2012 to 5/2013	3.6	3.50	2.06	(1.44)
N	7/2013 to 5/2014	3.6	2.62	(Note)	—

Note: *As at December 2013, the information was not yet available as the project had not been completed.*

Remarks: *In addition to the CSI fund and the sponsorship from the private sector, the projects had other income (e.g. admission charges for participants of project events).*

2. For Projects L and M, the grantee substantially reduced the project costs by $1.58 million (21%) and $2.36 million (30%) respectively. CreateHK included such information in the Evaluation Reports of the two projects. The assessment of the Completion Report of Project L and the application of Project M were discussed in the same Panel meeting while that of the Completion Report of Project M and application of Project N were discussed at another Panel meeting. According to CreateHK, the respective Assessment Panels concerned were in full picture of the past performance of the applicant and the evaluation results of the previously funded project.

Case 3 (Cont'd)

Audit comments

3. The Assessment Panel was aware of the failure of the grantee to solicit the committed amount in the Project M. However, the fact that the grantee had repeatedly failed to solicit the committed amounts in two previous projects (i.e. Projects L and M), and the effects of the consequential cutting of the project costs were not included in the Internal Assessment Report of Project N. The substantial shortfalls in the amounts of sponsorship of Projects L and M might indicate that the applicant was unable to obtain adequate support from the commercial and industrial sectors. CreateHK should have included such information in the Internal Assessment Report of Project N for the Assessment Panel's attention.

Source: Audit analysis of CreateHK records

Case 4

CSI Vetting Committee's comments not included in Internal Assessment Reports

1. Projects P and Q were repeated projects of Project O.

Project	Approved funding ($ million)	Date of approval	Project period	Date of Internal Assessment Report	Date of Evaluation Report
O	3.5	11/2011	10/2011 to 2/2012	10/2011	9/2012
P	3.5	9/2012	9/2012 to 1/2013	7/2012	4/2013
Q	3.7	8/2013	8/2013 to 2/2014	7/2013	(Note)

Note: As at January 2014, the Evaluation Report was not available as the project had not yet been completed.

Case 4 (Cont'd)

2. On reviewing Project O after its completion, the CSI Vetting Committee commented that more efforts should be put in collecting feedback in future as the response rate to the questionnaire survey was low (88 of 50,000 participants responded). For Project P, the Internal Assessment Report was prepared in July 2012 before the Evaluation Report of Project O was completed in September 2012. As a result, the Internal Assessment Report of Project P did not include such information.

3. After reviewing the Evaluation Report of Project P, the CSI Vetting Committee noted that the grantee had not sought CreateHK's prior approval for some changes of project deliverables and that there was a significant financial deficit. The Committee commented that the grantee should exercise better control in budget monitoring in future and more efforts should be put in collecting feedback in future as the response rate was low (166 of 60,000 participants responded).

4. CreateHK considered that the low response rate of the questionnaire survey was not unique to Projects O and P, and the changes in project deliverables were considered as having the same effects as the original deliverables. Therefore, the information about the grantee's failure to obtain prior approval for changing deliverables and the low response rate of the questionnaire survey for Projects O and P were not included in the Internal Assessment Report of Project Q.

Audit comments

5. Audit considers that as CreateHK had included the information of the low response rate of the questionnaire survey conducted by the grantee and the grantee's failure to obtain prior approval for the changes in project deliverable in the Evaluation Reports, such information should also be included in the Internal Assessment Reports of the repeated Project Q to help the CSI Vetting Committee assess the applications for the repeated projects more effectively.

Source: Audit analysis of CreateHK records

Audit recommendations

4.28 **Audit has *recommended* that the Head of Create Hong Kong should:**

(a) **issue guidelines setting out a systematic approach in conducting project evaluation, e.g. the information to be collected, the mechanism of verifying the information as far as practicable, and the time frame for each stage of evaluation;**

(b) **take measures to ensure that evaluations of completed projects are finalised in a timely manner;**

(c) **regularly review the Project Agreement to ensure that it is up-to-date and does not include unnecessary requirements;**

(d) **if questionnaire is used in reviews of the CSI, balance the ratings around a neutral mid-point;**

(e) **take measures to ensure that the performance of grantees in previous projects (e.g. failure to solicit the committed amount of sponsorship) is recorded in the Internal Assessment Reports of the grantees' subsequent applications; and**

(f) **ensure that the CSI Vetting Committee's comments on individual projects are followed up and incorporated in the Internal Assessment Reports of subsequent applications of repeated projects.**

Response from the Administration

4.29 The Head of Create Hong Kong agrees with the audit recommendations. He has said that:

(a) to verify the correctness of the information provided by the grantee (such as the number of visitors and participants), CreateHK will seek further information or proof from the grantee in case of doubt;

(b) CreateHK will ensure that the deadlines in each stage of evaluation are met; and

(c) to give the Assessment Panel a full picture of the previous project, CreateHK will attach the Evaluation Report and relevant notes of Panel meeting of the previous project to the Internal Assessment Report of repeated projects.

PART 5: MEETING THE OBJECTIVES OF CSI AND THE WAY FORWARD

5.1 This PART examines CreateHK's strategic planning and performance management and evaluates how they have helped CreateHK meet the objectives of the CSI. This PART also examines the way forward for the operation of the CSI.

Importance of strategic planning and performance management

5.2 Strategic planning is very important to the CSI as it helps determine the direction and scope and matches resources to changing environment and new demands. Performance management, on the other hand, not only provides a means to measure how well the CSI has performed, but also helps enhance transparency and accountability.

5.3 Audit's examination of CreateHK's strategic planning and performance management revealed room for improvement in the following areas:

(a) CSI funding strategy (paras. 5.4 to 5.11);

(b) measuring the performance of CSI (paras. 5.12 to 5.19); and

(c) comprehensive review of CSI (paras. 5.20 to 5.23).

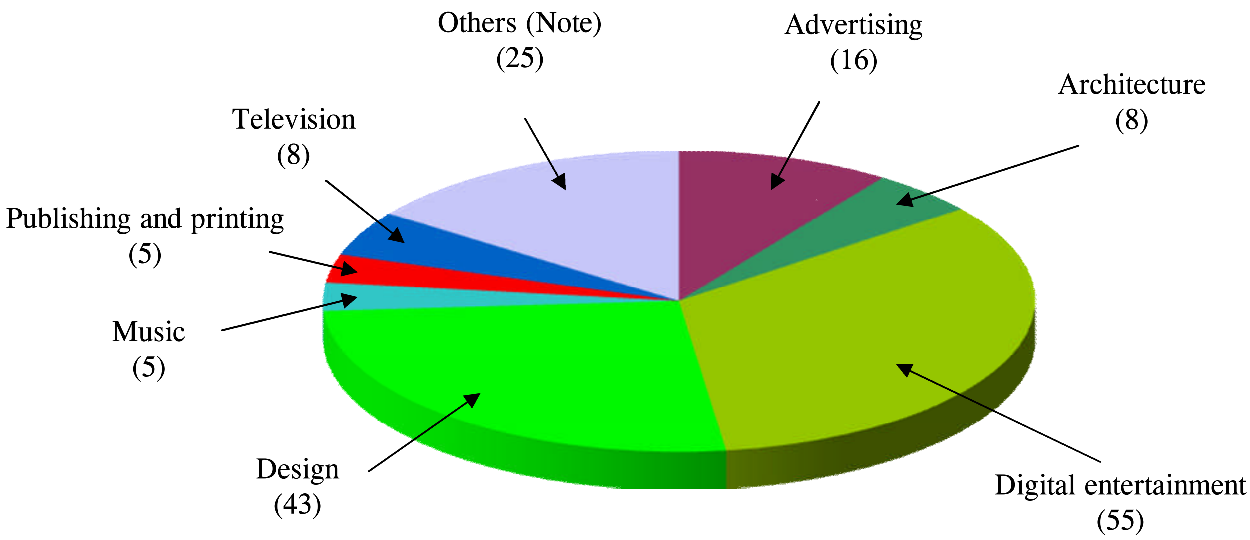
CSI funding strategy

Number of projects initiated by creative sectors

5.4 Figure 2 shows, since the establishment of the CSI in June 2009, the number of approved projects initiated by individual creative sectors.

Figure 2

Number of approved projects in various creative sectors (30 November 2013)



Source: *CreateHK records*

Note: *Others included cross-sector projects and miscellaneous projects aiming to foster a creative atmosphere within the community in general. An example of a cross-sector project is the SmartHK programme in which various creative sectors such as advertising, architecture and design were included.*

As shown in Figure 2, the CSI funded far more projects from the design sector and the digital entertainment sector (98 projects in total) than other sectors (67 projects in total).

5.5 Audit considers that CreateHK needs to ascertain the reasons for the relatively small number of projects in some of the creative sectors. It also needs to boost project applications from those creative sectors with few projects initiated, where necessary. For example, CreateHK may initiate theme-specific topics to solicit project applications from such sectors. Its Promotion Team (see Appendix A) may also encourage the relevant sectors to initiate more projects.

Publicising creative sectors funded by CSI

5.6 The CSI funds projects initiated by creative sectors including advertising, architecture, design, digital entertainment, music, publishing and printing, and television. It also funds cross-sector projects.

5.7 CreateHK publishes on its website the following information for its approved CSI projects:

(a) project reference;

(b) project title;

(c) applicant organisation;

(d) approved funding;

(e) brief description of the project;

(f) event date; and

(g) contact information.

5.8 Audit, however, noted that CreateHK has not clearly shown on its website or in any of its public documents (e.g. the guidelines for project applications which include such information as eligibility and assessment criteria) the aforesaid creative sectors (e.g. the creative industries of animation, comics and digital games covered by the digital entertainment sector) that the CSI funds. To enable potential project applicants to better understand the sectors funded by the CSI, Audit considers that CreateHK needs to publish such information on its website and in its public documents.

Strategic plan

5.9 According to CreateHK, it has conducted strategic planning exercise of the CSI to set out the strategic areas of focus. Audit recognises CreateHK's efforts on strategic planning. However, Audit noted that CreateHK has not formally documented its strategic plan. Audit considers that it needs to establish a strategic plan to formally lay down the strategic goals of the CSI and the way it addresses the challenges facing the CSI in the short term and the longer term. The process and the plan could be used as a platform to elicit ideas, expert advice, and feedback from its Assessment Panel members and other stakeholders. Such a document will bring the benefits of:

(a) more systematically driving and promoting the development of creative industries. In fact, strategic plans have been prepared by overseas entities carrying out the function similar to that of CreateHK (such as the Creative Industries Working Group in the Northern Ireland and the Creative Industries Taskforce in New South Wales);

(b) helping inform and remind the management and staff (and especially their successors) the strategic goals and challenges of the CSI so as to facilitate them to work collaboratively towards achieving the goals and meeting the challenges; and

(c) forming a basis for evaluating the extent that the strategic goals have been achieved and the challenges have been met.

Audit recommendations

5.10 **Audit has *recommended* that the Head of Create Hong Kong should:**

(a) ascertain the reasons for the few projects initiated from some creative sectors and where necessary, take measures to boost the project applications from these sectors;

(b) publish on the CSI's website and in relevant public documents the creative sectors and industries funded by the CSI; and

(c) develop a formal strategic plan for the CSI and update the plan periodically to take into account changes in the CSI's strategic goals and challenges.

Response from the Administration

5.11 The Head of Create Hong Kong agrees with the audit recommendations. He has said that:

(a) CreateHK adopts a "partnership approach" whereby the industry draws up and drives the support programmes while the Government provides funding support through the CSI. All creative sectors may approach CreateHK for CSI funding as long as the project meets the CSI's objectives and assessment criteria;

(b) one reason for more projects in the design sector and the digital entertainment sector is that both sectors have a wide coverage (e.g. the design sector covers product design, graphic design, fashion design and interior design, etc., whereas the digital entertainment sector covers animation, comics and digital games). Moreover, design is a value-added tool across trade and industry, which may also initiate design-related projects to help boost their competitiveness. Another reason is that the Government initiated large-scale promotional programme for the design and animation-comic sectors in 2012 and 2013 through the "2012 Hong Kong Design Year" and "Hong Kong Ani-com Summer" respectively. This programme has stimulated interest for organising programmes and hence seeking funding support from the CSI; and

(c) based on CreateHK's observation, some creative sectors with fewer industry associations may take on fewer projects. Moreover, some creative sectors manage to obtain funding support from other sources and hence need not seek funding from the CSI.

Measuring performance of CSI

Performance information

5.12 ***Information on achieving strategic directions.*** CreateHK has informed periodically the Panel on Information Technology and Broadcasting (the Panel) and the Finance Committee of the Legislative Council about how the CSI has helped drive and promote the development of creative industries. Before early 2013, CreateHK grouped the information on the performance of the CSI with that of other schemes it administered (see Note 2 in para. 1.6). In early 2013, CreateHK provided a separate account of the performance of the CSI. Audit, however, noted that the information disclosed was brief and fragmented. It did not illustrate comprehensively how and the extent to which the CSI-funded projects had achieved the individual strategic directions required of the projects by the CSI (see para. 1.5). For example, in disclosing the performance of the projects in "fostering a creative atmosphere within the community", "developing creative clusters in the territory" and "promoting Hong Kong as Asia's creative capital" to the Finance Committee in May 2013, CreateHK stated that:

> *"the CSI has so far committed $87.3 million …….. for 29 approved projects …….. which involve mega creative events, regional forums and conferences, music festivals, fashion show, etc. These programmes help raise the profile of Hong Kong's creative industries locally, in the region and overseas."*

5.13 ***Disclosing performance information to public.*** CreateHK also discloses to the public the CSI's performance by publishing performance indicators in the Controlling Officer's Report of the CEDB. Audit, however, noted that it only published two performance indicators, namely the number of CSI applications received and processed, and the number of CSI projects funded and being monitored.

5.14 For better transparency and public accountability, Audit considers that CreateHK needs to disclose more performance information (both quantitative and qualitative ones). It is also desirable to show the performance information on the CSI's website as very often this is the first place interested parties would visit to obtain information about the CSI. Examples of such performance information are:

(a) ***Quantitative performance information.*** CreateHK may disclose other performance information that it has maintained. For instance, it may disclose the number of job opportunities created by the programmes organised under the CSI projects, and the number of business development opportunities created for small and medium enterprises by the CSI projects; and

(b) ***Qualitative performance information.*** CreateHK may regularly tell the success stories of projects.

5.15 ***Disclosing performance information to Legislative Council.*** In disclosing the CSI's performance to the Panel and the Finance Committee of the Legislative Council, CreateHK sometimes (e.g. in the paper submitted to the Finance Committee in May 2012) provided the statistics compiled by the Census and Statistics Department on the economic contributions relating to not only the creative sectors covered by the CSI, but also other sectors not covered by the CSI. Such sectors included arts, antiques and crafts, cultural education and library, archive and museum services, and performing arts. CreateHK explained to Audit that the statistics were intended to be background information on the cultural and creative environments in Hong Kong as a whole.

5.16 Audit notes CreateHK's intention. Nevertheless, Audit considers that it would be more relevant and appropriate for CreateHK to separately show the statistics relating only to those creative sectors covered by the CSI. By doing so, a more precise picture about the economic contributions of the sectors covered by the CSI would be provided (see Table 5 for an example).

Table 5

Economic contributions of creative sectors in 2010

	Statistics stated in the paper submitted to the Finance Committee in May 2012 (Note 1)	**Statistics relevant to CSI (Note 2)**
Number of establishments	34,000	27,000
Number of persons engaged	189,000	161,000
Value added to Hong Kong's Gross Domestic Product	$78 billion	$69 billion

Source: CreateHK records and Audit analysis of Hong Kong Monthly Digest of Statistics of the Census and Statistics Department

Note 1: The figures included the economic contributions of creative sectors both covered and not covered by the CSI.

Note 2: The figures included the economic contributions of only the creative sectors covered by the CSI.

Performance pledges

5.17 CreateHK has stated in the CSI Guide (see para. 2.2) that applicants will be informed of the project assessment results within 50 working days. However, Audit noted that apart from this performance pledge, no other pledges had been established (e.g. the number of working days required for releasing funds to grantees upon project approval). For public accountability and continuous improvement of the CSI operation, CreateHK needs to establish more performance pledges and to report the achievements of the pledges.

Audit recommendations

5.18 **Audit has *recommended* that the Head of Create Hong Kong should:**

(a) **disclose more quantitative and qualitative performance information (including, where appropriate, the achievements of projects by each individual strategic directions) on the CSI's website;**

(b) **in addition to disclosing statistics pertinent to all creative sectors, disclose also those statistics that are pertinent only to the creative sectors covered by the CSI; and**

(c) **establish more performance pledges and report the extent of achieving the pledges.**

Response from the Administration

5.19 The Head of Create Hong Kong agrees with the audit recommendations. He has said that the extent of achieving the performance pledges will be included in the annual update on the work of CreateHK reported to the Panel of the Legislative Council.

Comprehensive review of CSI

5.20 In this audit review, Audit has identified scope for improvement in meeting the objectives of the CSI and in enhancing the administration of the CSI funds (PARTs 2 to 5). Audit considers that CreateHK should take on board the audit recommendations to address the issues discussed in this Audit Report. In addition, Audit considers that CreateHK needs to conduct on a periodic basis comprehensive reviews of the CSI to continuously improve its administration and evaluate its effectiveness in driving and promoting the development of the creative industries.

5.21 In his 2014 Policy Address, the Chief Executive of the Hong Kong Special Administrative Region said that the Working Group on Manufacturing Industries, Innovative Technology, and Cultural and Creative Industries under the Economic Development Commission (Note 9) was studying, among other things, the future development of the creative industries. In view of this and coupled with the fact that the CSI has been in operation since 2009, Audit considers that CreateHK needs to set a timetable for conducting a comprehensive review of the administration and the way forward of the CSI.

Audit recommendation

5.22 **Audit has *recommended* that the Head of Create Hong Kong should establish a timetable for conducting a comprehensive review of the administration and the way forward of the CSI.**

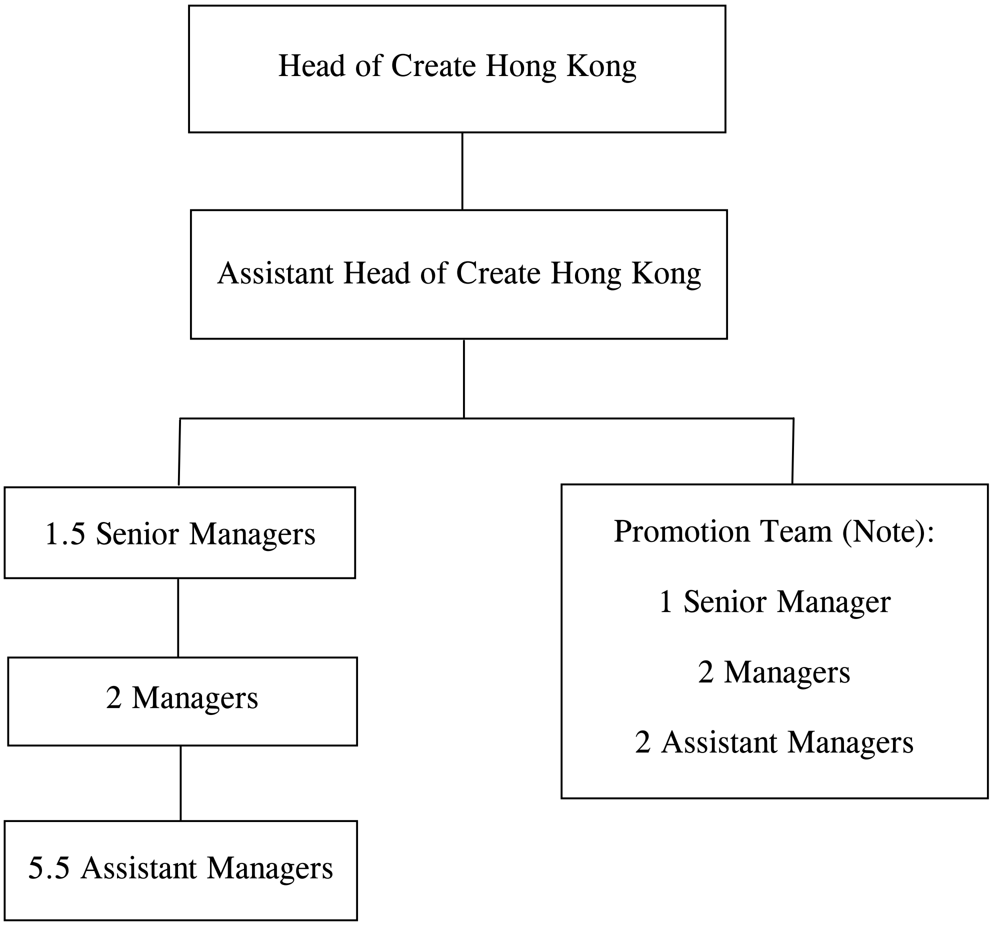
Response from the Administration

5.23 The Head of Create Hong Kong agrees with the audit recommendation.

Note 9: *The Economic Development Commission was established in January 2013 to provide visionary direction and advice to the Government on the overall strategy and policy to broaden Hong Kong's economic base and to enhance Hong Kong's economic growth and development. The Commission is chaired by the Chief Executive and comprises non-official members and ex-officio members appointed by him. One of the four working groups under the Commission is the Working Group on Manufacturing Industries, Innovative Technology, and Cultural and Creative Industries.*

Appendix A
(paras. 1.6 and 5.5 refer)

CreateSmart Initiative organisation chart (extract) (31 December 2013)



Source: CreateHK records

Note: The Promotion Team also conducts promotional and policy support work for CreateHK.

Appendix B

Acronyms and abbreviations

Audit	Audit Commission
CEDB	Commerce and Economic Development Bureau
CreateHK	Create Hong Kong
CSI	CreateSmart Initiative
Panel	Panel on Information Technology and Broadcasting
Permanent Secretary	Permanent Secretary for Commerce and Economic Development (Communications and Technology)

CHAPTER 7

Home Affairs Bureau
Home Affairs Department
Social Welfare Department

Promoting the development of social enterprises

Audit Commission
Hong Kong
4 April 2014

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. 62 of the Director of Audit contains 8 Chapters which are available on our website at http://www.aud.gov.hk

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PROMOTING THE DEVELOPMENT OF SOCIAL ENTERPRISES

Contents

PROMOTING THE DEVELOPMENT OF SOCIAL ENTERPRISES

Executive Summary

1. A social enterprise (SE) is a business to achieve specific social objectives. Its profits will be principally reinvested in the business for the social objectives that it pursues, rather than distributed to its shareholders. The Government's objectives in promoting the development of SEs are to enable the socially disadvantaged to be self-reliant through employment, and to meet the needs of different community groups with entrepreneurial thinking and innovative approaches. While a number of programmes have been launched by the Home Affairs Bureau (HAB), the Home Affairs Department (HAD), the Social Welfare Department (SWD), the Labour and Welfare Bureau and the Development Bureau to encourage and support the development of SEs, the HAB, with the support of the HAD, has taken up the SE portfolio following the reorganisation of the Government in July 2007. The Audit Commission (Audit) has recently conducted a review to examine the Government's efforts in promoting the development of SEs.

Enhancing Employment of People with Disabilities through Small Enterprise Project (the 3E Project)

2. The 3E Project, launched in 2001 by the SWD, provides grants to non-governmental organisations (NGOs) to set up and run SEs for employing persons with disabilities (PWDs). The maximum funding support for an approved project is $2 million, comprising a capital grant and an operating grant. Up to September 2013, the 3E Project had received 137 applications, and approved 81 (59%) of them with a total grant of $62 million (paras. 2.2, 2.6 and 2.16).

3. ***Processing of applications.*** The SWD took a long time to process applications, with an average time of 184 days from submitting an application to signing the funding agreement. This would delay project commencement and grant payments. Besides, there was room for improvement in the determination of capital and operating grants for approved projects (paras. 2.9 to 2.11 and 2.16 to 2.22).

4. *Effectiveness of the 3E Project.* The effectiveness of the 3E Project can be assessed by the sustainability of the SEs and the jobs created for PWDs. In the 12 years of operation of the 3E Project, a total of 81 projects were approved with a target number of 622 PWD jobs. On average, only 7 projects (with 52 PWD jobs) were approved each year. The average grant per PWD job for the 81 approved projects also varied widely from $12,500 to $368,800. As at September 2013, of the 81 approved projects, 24 had ceased operation and 57 were still in operation. According to the management information compiled by the SWD from data collected from 52 of the 57 operating projects as at September 2013, there were a total of 385 PWD jobs involving the employment of 1,882 PWDs since the commencement of these projects. For these projects, the actual number of PWD jobs created was lower than the target number by 10%. The SWD needs to step up its publicity efforts and invite more NGOs to participate in the 3E Project. It should also find out why many PWDs had joined and left the jobs, to ascertain whether additional measures are required to enhance the effectiveness of the 3E Project (paras. 2.25, 2.26, 2.28, 2.34 and 2.38 to 2.40).

5. *Monitoring of projects.* Audit examination of the 15 projects selected for review showed that, up to September 2013, many of the grantees had submitted their progress reports and annual audited accounts late. Although the SWD had issued reminders in some of the cases, Audit considers that late submission of progress reports is not desirable (para. 2.48).

Enhancing Self-Reliance Through District Partnership Programme (the ESR Programme)

6. The ESR Programme, established in 2006 by the HAD, provides grants for eligible organisations to set up SEs so as to promote sustainable poverty prevention and alleviation efforts at the district level that help enhance self-reliance, targeting socially disadvantaged groups. The maximum funding support for an approved project is $3 million, comprising a capital grant and an operating grant. Up to September 2013, the ESR Programme had processed 459 applications, and approved 145 (32%) of them with a total grant of $158 million (paras. 3.2 and 3.26).

7. *Processing of applications.* The HAD took a long time to process applications, with an average time of 239 days from submitting an application to signing the funding agreement. The long time taken would dampen applicants'

enthusiasm and undermines their capability to seize opportunities. Besides, there was room for improvement in the determination of capital and operating grants for approved projects (paras. 3.22, 3.23 and 3.26 to 3.32).

8. ***Effectiveness of the ESR Programme.*** The effectiveness of the ESR Programme can be assessed by the sustainability of the SEs and the jobs created for the socially disadvantaged. In the 7 years of operation of the ESR Programme, a total of 145 projects were approved with a target number of 2,287 jobs. On average, 21 projects (with 327 jobs) were approved each year. The average grant per job for the 145 approved projects also varied widely from $9,000 to $360,000. As at September 2013, of the 145 approved projects, 25 had ceased operation and 120 were still in operation. For the operating projects, the actual number of jobs created was below the target number by 39% for full-time jobs and 22% for part-time jobs (paras. 3.35, 3.41 and 3.44).

9. ***Monitoring of projects.*** Audit examined a sample of 90 progress reports and noted that 55 (61%) reports were submitted late. The HAD also took a long time (267 days on average) to finalise its processing of progress reports before payment of operating grants. Delays in the submission and finalisation of progress reports resulted in late payment of operating grants (paras. 3.54 and 3.55).

Publicity and promotional work

10. The HAB and the HAD implement various initiatives to promote the development of SEs. For example, the HAD operates the Partnership Programme to enhance cross-sector collaboration to promote the development of SEs. The Programme comprises the Mentorship Scheme and the Matching Forum. The Mentorship Scheme aims at forming mentorships between SEs and voluntary mentors. Since March 2012, as a temporary measure, the HAD has confined the recruitment of mentees to projects under the ESR Programme. This will deprive other SEs of the opportunities. Regarding the Matching Forum, it aims at forming partnerships so that business organisations will procure services and products from and provide assistance to SEs. Activities of the Matching Forum have been low since its set up in 2008. The HAD needs to review the effectiveness of the Matching Forum and to identify improvement measures (paras. 4.2, 4.26, 4.27, 4.32 to 4.34 and 4.39).

Way Forward

11. In January 2010, the HAB set up the Social Enterprise Advisory Committee to advise the Government on the formulation of policies and strategies for supporting the sustainable development of SEs and on programmes/activities that promote the development of SEs in Hong Kong (para. 5.2).

12. ***Funding schemes of different bureaux and departments (B/Ds).*** The social objectives of SEs are wide-ranging and may span across programme areas of different B/Ds, with a number of funding schemes providing start-up funds for establishing SEs. In formulating policies and strategies for promoting the development of SEs, the HAB and the HAD need to take stock of the progress and outcome of the efforts made by different B/Ds, with a view to promoting best practices, identifying service gaps, and creating synergies. In particular, there is a need to identify any synergistic effects between the 3E Project and the ESR Programme to improve their future operations (paras. 5.17, 5.18 and 5.26).

13. ***Developing a more refined definition for SEs.*** The Government's intention was not to unilaterally set a strict definition and a definitive list of SEs which would limit the development of the SE sector at its early stage. With the rapid development of SEs locally and overseas, there have been concerns about providing a clear definition of SEs from the SE sector and the Legislative Council. Audit considers that, for the long-term sustainable development of SEs, there is merit for the Government to adopt a more refined definition of SEs for formulating support strategies and programmes, and for providing a clear identity to SEs to enhance public understanding and acceptance (paras. 5.34 to 5.36).

Audit recommendations

14. **Audit recommendations are made in the respective sections of this Audit Report. Only the key ones are highlighted in this Executive Summary. Audit has *recommended* that the Director of Social Welfare should:**

3E Project

(a) **expedite the processing of applications for the 3E Project, state clearly the basis for determining capital and operating grants, and take measures to ensure consistency in applying the basis to all applications (paras. 2.14(a) and 2.23(c));**

(b) **encourage more NGOs to participate in the 3E Project, and step up the SWD's publicity efforts in promoting the 3E Project (para. 2.42(b) and (c));**

(c) **strengthen the monitoring of the creation of PWD jobs by funded SEs and provide necessary advice and assistance to help them achieve the job creation target (para. 2.42(f)); and**

(d) **take measures to ensure that progress reports are submitted timely by grantees (para. 2.53(a)).**

15. **Audit has *recommended* that the Director of Home Affairs should:**

ESR Programme

(a) **take measures to expedite the processing of applications, and state clearly the basis and the justifications for determining the operating grant for each approved project (paras. 3.24(b) and 3.33(c));**

(b) **strengthen the monitoring of the creation of jobs by funded SEs and provide necessary advice and assistance to help them achieve the job creation target (para. 3.51(b));**

(c) **take measures to ensure that progress reports are submitted timely by grantees and are finalised within a reasonable timeframe (para. 3.62(a));**

Publicity and promotional work

(d) **keep in view the need to have the Mentorship Scheme open to SEs other than projects under the ESR Programme (para. 4.40(c));**

(e) **review the effectiveness of the Matching Forum and identify measures to promote the formation of partnerships between SEs and the business sector (para. 4.40(f)); and**

Way forward

(f) **in collaboration with the Director of Social Welfare, jointly review the ESR Programme and the 3E Project, with a view to identifying any synergistic effects between the two funding schemes to improve their future operations (para. 5.28).**

16. **On the way forward, Audit has *recommended* that the Secretary for Home Affairs should:**

(a) **periodically take stock of the progress and outcome of the efforts made by different B/Ds that may contribute to the development of SEs, with a view to promoting best practices, identifying service gaps, and creating synergies (para. 5.27); and**

(b) **keep in view the need to formulate a more refined definition and an official list of SEs for promoting the long-term sustainable development of SEs (para. 5.38).**

Response from the Administration

17. The Administration agrees with the audit recommendations.

PART 1: INTRODUCTION

1.1 This PART describes the background to the audit and outlines the audit objectives and scope.

Background

Government policy on social enterprise

1.2 According to the Government's website on social enterprises (SEs), there is no universal definition of SE. In general, an SE is a business to achieve specific social objectives, such as providing services or products needed by the community, creating employment and training opportunities for the socially disadvantaged, and protecting the environment. Its profits will be principally reinvested in the business for the social objectives that it pursues, rather than distributed to its shareholders.

1.3 The Government's objectives in promoting the development of SEs are to enable the socially disadvantaged to be self-reliant through employment, and to meet the needs of different community groups with entrepreneurial thinking and innovative approaches, with a view to cultivating a caring culture as well as promoting social cohesion and mutual help.

Government's efforts in promoting the development of SEs

1.4 ***Enhancing Employment of People with Disabilities through Small Enterprise Project.*** In Hong Kong, there is a relatively longer history for the Government to promote the development of SEs in the provision of employment and training opportunities for the disabled. In September 2001, the Social Welfare Department (SWD) launched the Enhancing Employment of People with Disabilities through Small Enterprise Project (the 3E Project). The Project aims at providing grants for non-governmental organisations (NGOs) to set up small enterprises to provide employment opportunities for the disabled.

1.5 ***Commission on Poverty's recommendation.*** In February 2005, the Government set up the Commission on Poverty (CoP — Note 1) to study, from a macro perspective, how to help the poor and alleviate poverty. The CoP recognised the benefits of the development of SEs in assisting the socially disadvantaged in moving from welfare to self-reliance. In September 2005 and in its report of June 2007, the CoP recommended further encouraging the development of SEs as an innovative approach to promoting self-reliance and providing community employment opportunities for the unemployed to integrate into the job market.

1.6 ***Enhancing Self-Reliance Through District Partnership Programme.*** In 2006-07, the Financial Secretary earmarked a sum of $150 million over the following five years to provide grants for non-profit-making organisations to set up SEs for the socially disadvantaged. The Home Affairs Department (HAD) subsequently launched the Enhancing Self-Reliance Through District Partnership Programme (the ESR Programme). The Programme aims at providing grants for non-profit-making organisations to set up SEs to provide employment opportunities for the socially disadvantaged.

1.7 ***Four-pronged approach to promoting the development of SEs.*** Following the re-organisation of the Government in July 2007, the Home Affairs Bureau (HAB) has taken up the SE portfolio with the support of the HAD. In December 2007, the HAB organised a summit on SEs. Taking into account the views expressed at the summit, the Government has adopted a four-pronged approach to promoting the development of SEs:

(a) ***Enhancing public understanding of SEs.*** This will facilitate SEs to recruit staff, find commercial partners and sponsorship, and to market their services and products;

(b) ***Promoting cross-sector collaboration.*** This will encourage more private enterprises and professionals to participate in the development of SEs;

(c) ***Nurturing social entrepreneurs.*** There is a general consensus that social entrepreneurship is key to the development of SEs; and

Note 1: *The CoP was dissolved in June 2007, but was re-established in December 2012.*

(d) ***Strengthening support for SEs.*** The Government will continue to provide seed money to eligible SEs to help finance their initial operation.

1.8 ***Social Enterprises Support Unit.*** In 2008, the HAD set up the Social Enterprises Support Unit to implement initiatives to promote the development of SEs, including:

(a) ***Enhancing public understanding of SEs.*** An SE directory by service category and SE booklets (on stories of successful SEs and on SE business strategies) have been compiled. Announcements in the public interest to promote public understanding of SEs have been launched. The HAD has set up a dedicated website for SEs (the SE website) and has organised activities (e.g. district market fairs) to promote services and products of SEs; and

(b) ***Promoting cross-sector collaboration.*** The HAD has set up the Partnership Programme comprising the Mentorship Scheme and the Matching Forum. The Mentorship Scheme aims at forming mentorships through which mentors recruited from business and professional sectors will provide advice and guidance to SEs. The Matching Forum aims at forming partnerships through which business organisations will procure services and products of SEs and will provide assistance (e.g. concessionary rentals) to SEs.

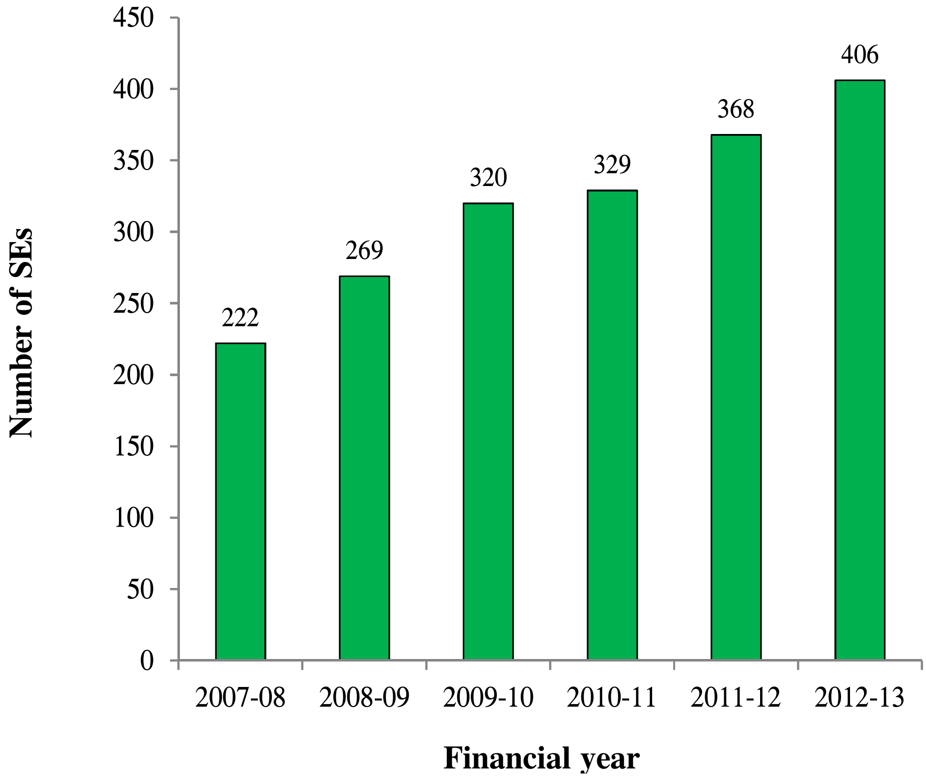
1.9 ***Social Enterprise Advisory Committee.*** In January 2010, the Government set up the Social Enterprise Advisory Committee (SEAC) to advise on the policies, strategies, programmes and activities for promoting the development of SEs. In conjunction with the SEAC, the Government has launched a number of promotional initiatives, including the SE Award Scheme and the SE Training Programme.

Landscape of SEs in Hong Kong

1.10 The Government does not publish official statistics of all the SEs in Hong Kong. Statistics on SEs in Hong Kong are however compiled by the Social Enterprise Business Centre (SEBC — Note 2) which conducts annual landscape surveys of SEs in Hong Kong. These statistics are widely used by the community. According to the results of the surveys, there has been a steady growth in the number of SEs, as shown in Figure 1. SEs in Hong Kong carry out different trades. Figure 2 shows the number of SEs engaged in different trades according to the 2012-13 landscape survey.

Figure 1

Number of SEs in Hong Kong

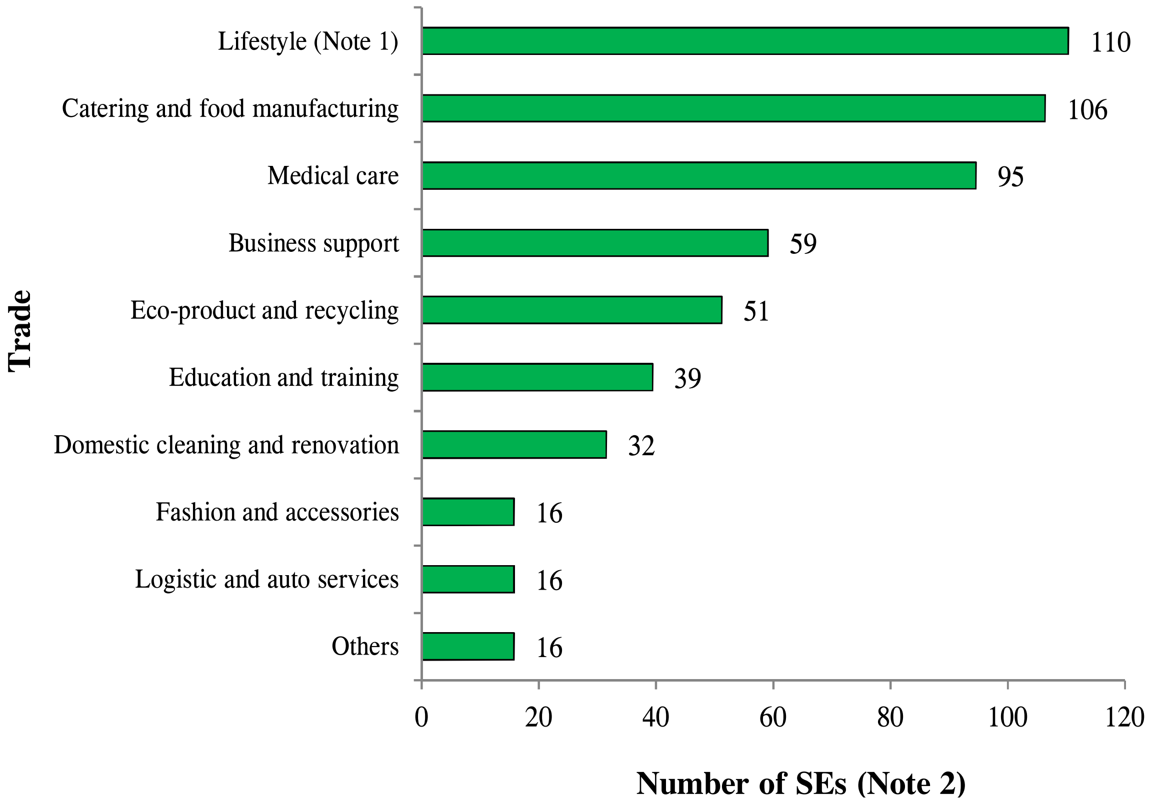


Source: The SEBC's 2012-13 landscape survey

Note 2: *The SEBC was set up by the Hong Kong Council of Social Service in 2008 with funding provided by the private sector and the Government. Its objective is to advance social entrepreneurship and mobilise social innovation.*

Figure 2

Number of SEs engaged in different trades (2012-13)



Source: *The SEBC's 2012-13 landscape survey*

Note 1: *This includes products and services such as handicrafts, massage and hair-styling.*

Note 2: *Since one SE could engage in more than one trade, the number of SEs added up (540) was more than the number of SEs responding to the survey (406).*

Legislative Council's concerns about the development of SEs

1.11 In recent years, the Legislative Council (LegCo) has expressed concerns about the development of SEs in Hong Kong. It debated and passed three motions in June 2006, December 2007 and July 2010 respectively to urge the Administration to promote the development of SEs.

1.12 In November 2004, a Subcommittee to Study the Subject of Combating Poverty was set up under the House Committee of LegCo. The Subcommittee discussed the launch of the ESR Programme in June 2006, and discussed the development of SEs in July and December 2007. In June 2008, the Subcommittee completed a report on the development of SEs. The report set out the problems faced by the SE sector and recommended strategies and measures to promote the development of SEs for the Administration to consider.

1.13 Since 2007, the Administration has regularly briefed the LegCo Panel on Welfare Services on the Administration's initiatives to promote the development of SEs. In particular, the Panel discussed the improvement measures for the ESR Programme in February 2011, and the development of SEs in April 2011 and January 2012.

Other funding schemes involving SEs

1.14 Besides the 3E Project and the ESR Programme mentioned in paragraphs 1.4 and 1.6, the Administration has operated the following two other funding schemes that may also provide funding support for setting up SEs:

(a) ***Capital Investment and Inclusion Fund (CIIF) operated by the Labour and Welfare Bureau.*** The key objective of this Fund is to promote community participation, mutual assistance, support and social inclusion through strengthening community networks. It provides seed money to eligible organisations for funding projects that promote the development of social capital (Note 3); and

Note 3: *The Audit Commission completed a review of the CIIF in October 2010 and the review result was reported in Chapter 11 of the Director of Audit's Report No. 55.*

(b) ***Revitalising Historic Buildings Through Partnership Scheme operated by the Development Bureau.*** The key objective of this Scheme is to preserve and put government-owned historic buildings into good and innovative use. Non-profit-making organisations are invited to submit applications for using these buildings to provide services or run business in the form of SEs (Note 4).

Audit review

1.15 Against the above background, the Audit Commission (Audit) has recently conducted a review of the Government's efforts in promoting the development of SEs. The audit review focused on the following areas:

(a) the 3E Project (PART 2);

(b) the ESR Programme (PART 3);

(c) publicity and promotional work (PART 4); and

(d) way forward (PART 5).

Audit has found that there is room for improvement in the above areas and has made recommendations to address the issues.

Acknowledgement

1.16 Audit would like to acknowledge with gratitude the full cooperation of the staff of the HAB, the HAD, and the SWD during the course of the audit review.

Note 4: *The Audit Commission completed a review of the Partnership Scheme in March 2013 and the review result was reported in Chapter 1 of the Director of Audit's Report No. 60.*

PART 2: ENHANCING EMPLOYMENT OF PEOPLE WITH DISABILITIES THROUGH SMALL ENTERPRISE PROJECT

2.1 This PART examines the SWD's administration of the 3E Project. Audit has found room for improvement in the following areas:

(a) processing of applications (paras. 2.7 to 2.15);

(b) determination of capital and operating grants (paras. 2.16 to 2.24);

(c) effectiveness of the 3E Project (paras. 2.25 to 2.45); and

(d) monitoring of projects (paras. 2.46 to 2.54).

Background

2.2 In the 2001-02 Budget, the Financial Secretary announced in March 2001 a package of initiatives to provide better care for the disabled, including a one-off provision of $50 million for NGOs to create employment opportunities for persons with disabilities (PWDs). In June 2001, the Administration briefed the LegCo Panel on Welfare Services about the implementation plan for the new initiatives to assist PWDs. With the approval of the Finance Committee (FC) of LegCo in June 2001, a new non-recurrent commitment of $50 million was created for the SWD to launch the 3E Project in September 2001.

2.3 In October 2011, the commitment of the 3E Project was increased by $4 million to $54 million under delegated authority to meet imminent cashflow requirements. In order to encourage more NGOs to participate in the 3E Project to sustain the momentum in creating more job opportunities for PWDs, the commitment of the Project was further increased by $100 million to $154 million. For this injection of funding, the Panel on Welfare Services was consulted in December 2011 and the FC's funding approval was given in January 2012.

2.4 The objective of the 3E Project is to help NGOs create and run SEs employing PWDs so that they can enjoy genuine employment in a carefully planned and sympathetic working environment. The SWD has set up the Advisory Committee on Enhancing Employment of People with Disabilities to assist it in administering the Project. The Committee comprises 16 non-official members (including the Chairman) and 2 official members. The Committee is responsible for advising the Director of Social Welfare in implementing the Project, including examining and recommending applications.

2.5 The SWD has also set up the 3E Project Secretariat, headed by an Assistant Director with an establishment of six staff (Note 5), to administer the Project. To enhance the sustainability of the businesses funded by the 3E Project, the Secretariat provides advisory services to the funded SEs and organises various activities for the development and promotion of their products and services. The Secretariat is also tasked to monitor the position of individual funded SEs against the milestones pledged by the NGOs concerned and provide advice where necessary.

2.6 For administering the 3E Project, the SWD has issued a Guide to the 3E Project (the 3E Guide), which is available at the SWD's website. It sets out the Project's funding objectives, application eligibilities, application procedures, assessment criteria, monitoring requirements, etc. A grant to support the operation of an SE from the date of commencement should be confined to the funding period (currently three years — Note 6). The funded SE is expected to become self-sustaining after the funding period. Progress reports are required to be submitted during the contract period (Note 7). Up to September 2013, the 3E Project had received a total of 137 applications, and approved 81 (59%) of them with a total grant of $62 million (Note 8).

Note 5: *The six staff also perform some other duties. According to the SWD, the duties relating to the 3E Project constitute about 15% to 50% of their work.*

Note 6: *The funding period was set at one year when the Project was launched in September 2001. It was revised to two years in November 2006, and further revised to three years in April 2012.*

Note 7: *The contract period was set at three years when the Project was launched in September 2001. It was revised to four years in April 2012.*

Note 8: *Of the 137 applications received, 55 were withdrawn or rejected (mainly on grounds of business viability) and 1 was being processed.*

Processing of applications

2.7 The 3E Guide lays down the conditions for application under the Project, including the following:

(a) the applicant should be a bona fide charitable NGO which possesses the tax exemption status under section 88 of the Inland Revenue Ordinance (Cap. 112);

(b) the applicant may submit application at any time throughout the year and will be notified of the assessment result within two months after the submission of all relevant information of an application;

(c) only an application for setting up a new business is eligible for a grant under the Project. The application should contain details of a viable business proposal. The proposed business is expected to commence not later than six months after approval of the grant; and

(d) the funded SE will be required to employ PWDs of at least 50% (Note 9) of the total workforce in the business. This is to ensure that the objective of the Project in improving the employment opportunities of PWDs is safeguarded while recognising that in some cases, the employment of able-bodied persons is necessary to ensure the smooth operation of the business.

2.8 An application is initially vetted by the Project Secretariat. It is then assessed in accordance with laid-down guidelines by an assessment panel comprising two members selected from the Advisory Committee (see para. 2.4) and the Assistant Director of the Project Secretariat. The criteria for assessing applications include:

(a) viability of the business plan;

Note 9: *When the 3E Project was launched in September 2001, the requirement on the proportion of PWDs employed was set at 60%. It was revised to 50% in November 2006.*

(b) management capability of the applicant; and

(c) extent of benefit to PWDs (e.g. number of PWDs to be employed, salaries payable, etc.).

The assessment panel makes recommendations to the Director of Social Welfare who is responsible for approving applications. After approval of an application, a service agreement will be signed between the SWD and the applicant.

Time taken in processing applications

2.9 Audit conducted an analysis of the processing time of applications for a sample of 15 projects selected for review (Note 10). Table 1 shows the details.

Table 1

Processing time of applications for 15 projects selected for audit review

	Processing stage	**Average time (No. of days)**
(a)	From submission of application to submission of all relevant information requested by the SWD	63
(b)	From submission of all relevant information to notification of assessment result	86
(c)	From notification of assessment result to signing of agreement	35
	Total	184

Source: Audit analysis of SWD records

Note 10: *Out of the 81 approved projects (see para. 2.6), an audit sample of 15 projects was selected from projects operated by the top 8 NGOs that had the highest number of projects under the 3E Project. Of the 15 selected projects, 8 had ceased business and 7 were still in operation as at September 2013.*

2.10 Audit's analysis showed that the processing of applications often took a long time to complete. The average time taken from submission of application to signing of agreement was 184 days, ranging from 69 to 438 days. Audit noted that:

(a) for processing stage (b) in Table 1, the SWD had set a target time of two months (see para. 2.7(b)). However, of the 15 projects selected for review, the target time was not met in 9 (60%) cases with an average time of 4 months; and

(b) for processing stage (c) in Table 1, it took 35 days on average from notification of assessment result to signing of agreement. According to the SWD's practice, the agreement would be signed when the business commencement date was confirmed by the applicant.

2.11 The long time taken in processing applications would delay the commencement of business and thus the creation of jobs for PWDs. It would also delay the payment of grants to applicants, which could be made only after the agreements were signed. In this connection, Audit scrutiny of cases other than the 15 cases selected for review (see para. 2.9) showed that, in one case (Case 1), it took 127 days from notification of assessment result to signing of agreement, due to delay on the part of the SWD. The delay in signing the agreement resulted in late payment of capital and operating grants. There is a need for the SWD to take measures to shorten the processing time as far as possible.

Case 1

Long delay in arranging for the signing of agreement

1. On 24 August 2012, the SWD received an application under the 3E project. At a meeting held on 12 September 2012, the applicant informed the assessment panel that the SE would commence business on 17 September 2012. The application was approved on 26 September 2012.

2. On 3 October 2012, the SWD notified the result to the applicant. On 29 November 2012, the SWD requested the applicant to provide the actual business commencement date of the SE. On 3 December 2012, the applicant replied that the SE had commenced business on 17 September 2012.

3. From records available, Audit noted that the SWD had not taken prompt action to arrange for signing of the agreement after being informed. In the event, the agreement was not signed until 7 February 2013.

Audit comments

4. In this case, it took 127 days from notification of assessment result to the applicant (3 October 2012) to signing of agreement (7 February 2013). Grant payments totalling $0.58 million were also delayed.

Source: Audit analysis of SWD records

Commencement of business before funding approval

2.12 The 3E Guide requires that the SEs under the 3E Project should commence business not later than six months after approval, and only new businesses will be supported (see para. 2.7(c)). However, the Guide does not state clearly the meaning of new business. Audit examination of the 15 projects selected for review (see para. 2.9) found that the business operations of 8 projects actually commenced before the approval of funding was given. On average, businesses commenced 3.9 months earlier than the funding approval dates. Six of them commenced business when the applications were being processed by the SWD. The remaining two had already commenced business one month before the applications were submitted. Upon enquiry, the SWD informed Audit in February 2014 that the two projects with business commenced before submission of application were processed a few years ago. According to the staff concerned, initial applications might have been submitted by the applicants before commencement of business. However, there was no documentary evidence available.

2.13 An applicant who commences business before funding approval is taking his own risks as the SWD may or may not approve his application for funding under the 3E Project. While the SWD approved all the 8 projects (see para. 2.12) which had already commenced business, Audit noted that in another application (not one of the projects selected for review — see para. 2.9) submitted in November 2012, the SWD rejected it on the grounds that the proposed business had already commenced operation in October 2012. It appears that the SWD has not adopted a consistent approach in handling applications with commencement of business before funding approval. The SWD needs to lay down clear guidelines in this regard, including whether or not an SE which has just commenced business is eligible for assistance under the 3E Project.

Audit recommendations

2.14 **Audit has *recommended* that the Director of Social Welfare should, in respect of the 3E Project:**

(a) **take measures to expedite the processing of applications as far as possible. In particular, the SWD should:**

  (i) **render necessary assistance to applicants to timely submit all relevant information (e.g. providing a checklist in the 3E Guide for the required information);**

  (ii) **ensure that the target time of two months (between applicants' submission of all relevant information and notification of assessment results) is met; and**

  (iii) **ensure that the service agreements are promptly signed; and**

(b) **lay down clear guidelines on handling applications with business already commenced before funding approval is given so as to ensure consistent treatment to all applications.**

Response from the Administration

2.15 The Director of Social Welfare agrees with the audit recommendations. She has said that the SWD:

(a) put in place in April 2012 an effective monitoring mechanism to ensure timely processing of applications. Since then, for all the approved projects, the two-month timeframe from receipt of applicants' relevant information to notification of assessment results and timely signing of service agreements has been strictly adhered to; and

(b) will provide detailed guidelines in the 3E Guide by mid-2014:

  (i) by including a checklist to remind applicants of the information required and the points to note in preparing their applications; and

  (ii) to elaborate on the handling of applications with business commencement before funding approval.

Determination of capital and operating grants

2.16 Funding support under the 3E Project is given in the form of a non-recurrent grant, consisting of two portions, namely the capital grant and the operating grant. The capital grant is disbursed on a reimbursement basis to pay for the necessary set-up cost in respect of equipment, fitting-out works, etc. The operating grant is used to meet the operating loss during the funding period (currently three years). The maximum funding support of an approved project is $2 million. The 3E Guide does not provide detailed information on how the capital grant and the operating grant are determined.

Refundable deposits funded by capital grants

2.17 The capital grant is approved on an item-by-item basis, but the 3E Guide does not specify what items are eligible. Deposits, such as rental and utility deposits, are a common type of cash outlay in starting a business, and are usually refundable. According to the 3E Guide, refundable deposit will not be eligible for claiming operating grant. Of the 81 approved projects, 29 were in retail business. Audit examined these 29 approved projects and noted that the capital grants for 8 projects included items of refundable deposits with a total amount of $0.53 million. For two projects, the service agreements had provisions for the Government to recover the deposit amounts on project termination. There were however no such provisions for the other six projects.

2.18 Deposit is not an expense and is usually refundable. The SWD needs to examine whether refundable deposits are to be funded by the capital grant. When capital funding is provided for a refundable deposit, the SWD may need to establish a mechanism to recover the amount when the deposit is refunded to the grantee.

Trading stock funded by capital grants

2.19 Out of the 81 approved projects, 29 were in retail business with trading stock. Audit noted that the capital grants provided to 11 approved projects in retail business included items for acquiring trading stock. The total amount involved was $0.75 million. Cost of trading stock is an operating expenditure for calculating the operating loss which is funded by the operating grant (see para. 2.16). If this item is also funded by the capital grant, it will result in double counting and thus double funding for the same expenditure. The SWD needs to lay down guidelines to ensure that the cost of trading stock is not counted twice and does not receive double funding from both the capital grant and the operating grant.

2.20 Upon enquiry, the SWD informed Audit in October 2013 that, since August 2010, it had not approved any cost of trading stock for funding under the capital grant. However, Audit noted that this practice has not yet been stated in the 3E Guide for reference by both applicants and SWD staff.

Inconsistencies in determining operating grants

2.21 According to the 3E Guide, the operating grant is provided to meet the operating loss during the funding period. In other words, operating grants should be provided on a deficit basis. However, the 3E Guide does not provide detailed information on the basis for determining operating grants. Audit reviewed the 81 approved projects and noted that there were inconsistencies in determining operating grants:

(a) the deficit basis only applied to 68 (84%) projects. For the remaining 13 (16%) projects, the operating grant was determined on the expenditure basis, with reference to the operating expenses (e.g. salary expenses for the first quarter). Audit estimated that if the deficit basis had been adopted for these 13 projects (3 of which had forecast surplus of $2,600, $0.28 million and $0.29 million respectively), the total operating grants involved would have been reduced by $2.6 million; and

(b) of the 68 projects mentioned in (a) above, 57 had budgeted operating loss in each year of the funding period. For the remaining 11 projects, they had budgeted operating surplus or loss in different years of the funding period. For these 11 cases, the gross deficit basis (without netting off of surplus from deficit) was applied in 8 (73%) cases, while the net deficit basis (with netting off of surplus from deficit) was applied in 3 (27%) cases. If the net deficit basis had been adopted in all these cases, Audit estimated that the total operating grants involved would have been reduced by $0.34 million.

2.22 While the SWD had generally adopted the deficit basis for determining the operating grant (see para. 2.21), in practice, it was not applied on a consistent basis. To reduce ambiguity and to ensure fair treatment to all applicants, the SWD needs to state clearly in the 3E Guide its basis adopted for determining operating grants.

Audit recommendations

2.23 **Audit has *recommended* that the Director of Social Welfare should, in respect of the 3E Project:**

(a) **examine whether refundable deposits are to be funded by the capital grant and, if so, whether a mechanism should be established to recover the amount when the deposit is refunded to the grantee;**

(b) **take measures (e.g. revising the 3E Guide) to ensure that the cost of trading stock would not be counted twice for computing funding from the capital grant and the operating grant; and**

(c) **state clearly in the 3E Guide the basis for determining capital and operating grants, and take measures to ensure consistency in applying the basis to all project applications.**

Response from the Administration

2.24 The Director of Social Welfare agrees with the audit recommendations. She has said that the SWD will provide detailed guidelines in the 3E Guide by mid-2014 regarding the issues raised.

Effectiveness of the 3E Project

2.25 The 3E Project was launched in September 2001. Its effectiveness can be assessed by the sustainability of the SEs created and the jobs created for PWDs. Up to September 2013, the 3E Project had been implemented for 12 years. Table 2 shows a summary of approved projects since the inception of the 3E Project. As at September 2013, of the 81 approved projects, 24 had ceased operation (terminated projects) and 57 were still in operation (operating projects). Appendix A shows the years in operation of the 57 operating projects and the 24 terminated projects. It can be seen that 26 (32%) projects had operated for seven years or more.

Table 2

Summary of approved projects since the inception of the 3E Project (September 2001 to September 2013)

Financial year	No. of approved projects (a)	Target no. of PWD jobs (b)	Total approved grant (c) ($ million)	Average grant per project (Note) (d) = (c)/(a) ($ million)	Average grant per PWD job (e) = (c)/(b) ($)
2002-03	10	114	6.20	0.62	54,386
2003-04	10	102	3.76	0.38	36,863
2004-05	7	49	4.12	0.59	84,082
2005-06	8	77	4.19	0.52	54,416
2006-07	7	29	3.45	0.49	118,966
2007-08	3	19	3.04	1.01	160,000
2008-09	7	49	5.59	0.80	114,082
2009-10	8	50	4.13	0.52	82,600
2010-11	6	38	6.62	1.10	174,211
2011-12	4	28	4.72	1.18	168,571
2012-13	6	35	8.42	1.40	240,571
2013-14 (up to September 2013)	5	32	7.53	1.51	235,313
Overall	81	622	61.77	0.76	99,309
Annual average	7	52	5.15	—	—

Source: *SWD records*

Note: *The approved grants for individual projects ranged from $0.1 million to $2 million. The overall split between capital grant and operating grant was 59 : 41.*

Progress of implementing the 3E Project

2.26 Table 2 shows that, in the 12 years (from September 2001 to September 2013) of operation of the 3E Project, a total of 81 projects had been approved with a target number of 622 PWD jobs. On average, 7 projects were approved a year with a target number of 52 PWD jobs. Compared with the first two years of implementation of the 3E Project (i.e. 2002-03 and 2003-04), in recent years both the number of projects and the target number of PWD jobs had decreased. In particular, there has been a clear decreasing trend for the target number of PWD jobs created. The Government has provided a total funding of $154 million for the 3E Project. As at September 2013, the total approved grant amounted to $62 million (40%), with a remaining fund balance of $92 million (60%). In this connection, Audit noted that LegCo Members had expressed concerns in June 2008 and December 2011 about the slow progress in implementing the 3E Project.

2.27 The 3E Project is open to application by all charitable NGOs possessing tax-exemption status under section 88 of the Inland Revenue Ordinance. Theoretically, there are a large number of potential applicants. In practice, however, so far only 40 NGOs have submitted applications (137 in total) under the 3E Project. The vast majority of these applicants were NGOs specialised in providing vocational rehabilitation services for PWDs (rehab-NGOs). Regarding the 81 approved projects, 80 (99%) projects were operated by 23 rehab-NGOs. PWDs employed under these approved projects were mainly recruited by referrals from these rehab-NGOs.

2.28 According to the SWD records, publicity efforts of promoting the 3E Project were targeted at rehab-NGOs (35 in total). It is evident that the 3E Project has been relying very much on rehab-NGOs for applications. However, there is a risk that some rehab-NGOs might have reached their capacities in operating SEs. For example, 9 rehab-NGOs were operating 61 SEs under the 3E Project. In order to encourage the setting up of more SEs which focus on employing PWDs, the SWD needs to step up its publicity efforts and invite more rehab-NGOs or other NGOs to participate in the Project.

2.29 It also appears that the progress of the 3E Project had been affected by the introduction of the ESR Programme by the HAD since 2006. Audit noted that some rehab-NGOs had switched to the ESR Programme for funding to operate their SEs. Details will be further discussed in paragraphs 5.22 to 5.31.

Sustainability of funded SEs

2.30 According to the 3E Guide, funded projects are expected to be self-sustainable after the funding period. Funding support available under the 3E Project has to be justified mainly on the basis of commercial viability of the business proposal as the business and jobs created have to be sustained on a self-financing basis after the funding period. As at September 2013, among the 81 approved projects, the funding period had expired for 69 of them. Out of the 69 SEs which had completed the funding period, 24 (35%) ceased business, involving 160 jobs for PWDs and $12.6 million of approved grant. These 24 projects had operated for an average of 4.4 years (including the funding period) before they ceased business, ranging from 2 to 11 years. According to the SWD, the main reasons for cessation of business were expiry of venue contracts and operational difficulties. Since April 2012, the SWD has strengthened its monitoring of funded SEs through:

(a) provision of advice and support to the SEs on business matters through scheduled/surprise visits or progress review meetings;

(b) early intervention for under-performing businesses and provision of prompt assistance/guidance without jeopardy to the employment of PWDs; and

(c) putting in place a review panel mechanism for monitoring and supporting the businesses regarding the jobs created for PWDs, financial condition and submission of progress reports.

2.31 ***Sustainability of SEs beyond the funding period.*** Normally, the approved projects operate at a deficit initially and attain breakeven towards the end of the funding period. They are expected to operate at a surplus in order to sustain a self-financing status thereafter. As at 30 September 2013, 45 SEs were operating beyond the funding period (excluding 24 terminated projects and 12 projects which were still within the funding period). For these 45 SEs, Audit noted from their last progress reports submitted to the SWD that 16 (36%) were still operating at a deficit. This indicated that many funded SEs operating beyond the funding period had not yet achieved a self-financing status and were receiving subsidies from their sponsoring bodies. There is a need for the SWD to continue monitoring the financial performance of SEs after the funding period to see whether they need further support and assistance. In this connection, Audit noted that, under the 3E Project, the period for monitoring the performance of SEs after the funding period (monitoring period) was currently only one year, whereas that under the ESR Programme was set at three years (see para. 3.5). Audit considers that a longer monitoring period may allow for the provision of continued support and assistance to the SEs concerned in order to help them become self-sustainable.

2.32 ***Repeated seed funding to different NGOs for setting up SEs in the same venue.*** According to the SWD, the expiry of venue contracts was a major reason for cessation of SE business under the 3E Project (see para. 2.30). Many SEs under the 3E Project operated retail/catering businesses at venues of government departments or public organisations, e.g. the Hospital Authority (HA). Such venues were usually let out by open tender with a fixed term subject to re-tendering on expiry. As there was competition among NGOs for these venues, the SEs under the 3E Project might not be able to win the venue contracts on re-tendering. Audit noted that there were cases in which government-funded SEs competed among themselves for venue contracts, resulting in replacements of SEs operating the same business at the same venues with repeated government seed funding (under the 3E Project and the ESR Programme). Case 2 shows the details.

Case 2

Repeated seed funding to different NGOs for setting up SEs in the same venue

1. The HA let out venues in hospitals for retail/catering businesses by open tender with assessment criteria giving weight to businesses employing PWDs. In 2005 and 2006, the SWD approved funding under the 3E Project for NGO-A to operate two SEs ($0.22 million and $0.4 million respectively) in two HA venues (designated as retail shops for selling rehabilitation products). In 2009, the contracts for the two HA venues expired and were re-tendered. NGO-A failed to win the new venue contracts and terminated the two SEs. The two venues were let to NGO-B at higher bidding prices. NGO-B submitted applications for operating the same type of business in the two venues under the 3E Project. The applications were approved by the SWD in 2009 with grants of $0.33 million and $0.42 million respectively.

2. The two SEs operated by NGO-A were making profits before cessation of business. Their terminations were due to the loss of the venue contracts to NGO-B. In each of these two venues, the 3E Project provided seed money to two different NGOs to set up SEs operating the same type of business. In the event, the SWD considered such cases not satisfactory and revised the conditions of the 3E Project. With effect from April 2012, an application would be considered ineligible if it would replace a funded SE under the 3E Project conducted by another grantee of the same business nature in the same venue.

3. However, the two SEs operated by NGO-B ceased business in December 2012 and January 2013 when NGO-B failed to win the new venue contracts on re-tendering. The venue contracts were won back by NGO-A by a higher bidding price. This time, NGO-A made an application under the ESR Programme to operate the two shops by one SE to provide jobs for the socially disadvantaged. In March 2013, the HAD approved funding of $1.2 million to NGO-A under the ESR Programme. As a result, repeated seed funding was provided to set up SEs three times in each of the two venues.

Audit comments

4. The measure implemented by the SWD in April 2012 (see para. 2 above) was not entirely effective to prevent the provision of repeated seed funding to different NGOs for setting up an SE in the same venue (see para. 3 above). There is a need for the SWD and the HAD to work out an effective arrangement to prevent such repeated seed funding by the 3E Project and the ESR Programme.

Source: Audit analysis of SWD and HAD records

Jobs created for PWDs

2.33 The main objective of the 3E Project is to create job opportunities for PWDs, thereby facilitating their self-reliance and integration into the community (Note 11). The 81 approved projects proposed to create 870 jobs comprising 622 for PWDs and 248 for able-bodied persons. So far, 24 SEs ceased business, involving 160 proposed PWD jobs. According to the SWD's survey on operating projects as at September 2013 (see para. 2.47), the target and actual numbers of PWD jobs were 427 and 385 respectively (see Table 3 for details).

Table 3

PWD jobs created for operating projects (Note 1)
(30 September 2013)

Job type (Note 2)	**Target (Note 3)**	**Actual**	**Variance**	
	(a)	**(b)**	**(c) = (b)-(a)**	**(d) = (c)/(a)**
	(No.)	**(No.)**	**(No.)**	**(%)**
Full-time	—	115 (30%)	—	—
Part-time	—	270 (70%)	—	—
Overall	427	385 (100%)	-42	-10%

Source: *Audit analysis of SWD records*

Note 1: *There were 57 operating projects as at 30 September 2013 (see para. 2.25). The SWD survey covered only 52 projects because five projects were recently approved and had not yet commenced business.*

Note 2: *The SWD conducts quarterly surveys on operating projects to collect information on PWD employment, with breakdown between full-time jobs and part-time jobs.*

Note 3: *The project applicants were not required to provide breakdown in their applications between full-time and part-time jobs to be created for PWDs.*

Note 11: *According to a report compiled by the Census and Statistics Department in 2008, there were about 361,300 PWDs (excluding persons with intellectual disability) in Hong Kong, including 41,000 employed ones.*

2.34 ***Number of PWD jobs created.*** Table 3 shows that as at September 2013, the actual number of PWD jobs for 52 operating projects was lower than the target by 42 (10%). The variance was the net result of an additional 97 jobs (above target) from 17 projects and a shortfall of 139 jobs (below target) from 30 projects. For the 30 projects with shortfall in PWD jobs, 12 of them (beyond the monitoring period) employed less than 50% of the target number of PWD employees, including 2 projects which did not employ any PWDs at all. It appears that some of the jobs created for PWDs could not be sustained for these SEs. There is a need for the SWD to strengthen its monitoring of PWD jobs created by SEs under the 3E Project and to provide necessary advice and assistance to them.

2.35 ***Full-time and part-time jobs.*** Table 3 shows that among the 385 PWD jobs created, only 115 (30%) were full-time jobs, while 270 (70%) were part-time jobs. The SWD's survey results indicated that the monthly salaries of part-time jobs varied widely from less than \$1,000 to more than \$8,000. In submitting an application, the applicant is only required to provide the target number of PWD jobs in total, without specifying whether they are full-time or part-time jobs. The assessment was conducted on the basis of the total number of PWD jobs to be created. In the progress reports, the grantees were also not required to provide employment information with breakdowns into full-time and part-time jobs. Audit considers that there is a need for the applicants to provide more detailed information about the PWD jobs proposed (e.g. breakdowns into full-time and part-time jobs, and breakdowns of part-time jobs into different bands according to the number of working hours of a job) in the applications to facilitate the SWD's assessment. The same information should also be provided in the progress reports to the SWD for monitoring purposes.

2.36 ***Cost-effectiveness of grant for PWD job creation.*** Most of the SEs funded under the 3E Project were small business undertakings. The average target number of PWD jobs to be created by the 81 approved projects was 7.7, ranging from 2 to 29. For 38 (47%) projects, the target number of PWD jobs to be created was not more than 5, including 13 (16%) for creating 2 or 3 PWD jobs. Table 4 shows the details.

Table 4

Target number of PWD jobs to be created
(September 2001 to September 2013)

Number of PWD jobs for the project	Number of projects		Total number of PWD jobs
2 — 3	13 (16%)	38 (47%)	36 (6%)
4 — 5	25 (31%)		113 (18%)
6 — 10	26 (32%)		203 (33%)
11 — 20	15 (19%)		214 (34%)
21 — 29	2 (2%)		56 (9%)
Overall	81 (100%)		622 (100%)

Source: Audit analysis of SWD records

2.37 As can be seen from Table 2 in paragraph 2.25, for all the 81 approved projects, the average grant per project was $0.76 million and the average grant per PWD job was $99,309. For individual years, the average grant per project increased by 144%, from $0.62 million in 2002-03 to $1.51 million in 2013-14. This was mainly due to the extension of funding period from 1 year to 2 years in 2006 and further to 3 years in 2012. Besides, the average grant per PWD job increased substantially from $54,386 in 2002-03 to $235,313 in 2013-14, by 333%. The increasing trend is a cause for concern regarding the cost effectiveness of the grant for PWD job creation, even after taking into consideration the inflation factor.

2.38 Audit analysis also shows that, for all the 81 projects, the grant per PWD job varied widely from $12,500 to $368,800. The SWD has not issued any guidelines for taking into account the average grant per PWD job in assessing applications under the 3E Project. The SWD may explore setting a selection criterion for assessing applications based on the average grant per PWD job to be created.

Enhancing self-reliance

2.39 The 3E Project aims to create employment opportunities to enhance the self-reliance of PWDs. The SWD conducts quarterly surveys to collect statistics from all operating projects about the employment of PWDs, including the number of PWDs employed, their salaries, source of recruitment, etc. According to management information compiled by the SWD from data collected from 52 of the 57 operating projects as at September 2013 (see Note 1 to Table 3 in para. 2.33), there were a total of 385 PWD jobs involving the employment of 1,882 PWDs since the commencement of these projects. Among the PWD employees, 49 of them ceased receiving the Comprehensive Social Security Allowance after they were employed by the funded SEs. This is a good indication that the PWDs had become self-reliant because of the jobs created by funded SEs.

2.40 On the other hand, 1,882 PWDs had worked in the PWD jobs created, indicating that many had joined and left the jobs. However, the SWD did not collect information or feedback about why PWDs had left the funded SEs. If such information was also collected from grantees, the SWD could have better information about whether the PWDs had moved on to open employment (i.e. achieving self-reliance) or reverted to supported employment or other rehabilitation services. Such information can provide valuable information about the effectiveness of the 3E Project.

Performance information provided to LegCo

2.41 From time to time, the SWD provides information to LegCo about the progress of implementing the 3E Project. In reporting the results on creation of jobs for PWDs, the SWD only provided the target number of jobs to be created, without providing the actual number of jobs created and a breakdown between full-time and part-time jobs. Audit considers that the SWD needs to consider providing LegCo with more comprehensive information on the number and details of jobs created for PWDs under the 3E Project in future.

Audit recommendations

2.42 **Audit has *recommended* that the Director of Social Welfare should:**

Progress of implementing the 3E Project

(a) **examine the reasons for the slow progress of the 3E Project in creating job opportunities for PWDs through development of SEs, with a view to identifying improvement measures;**

(b) **take measures to encourage more NGOs (including those not currently engaged in vocational rehabilitation services for PWDs) to participate in the 3E Project;**

(c) **step up the SWD's publicity efforts in promoting the 3E Project;**

Sustainability of funded SEs

(d) **continue to monitor closely the financial performance of SEs after the funding period of the 3E Project for evaluating their sustainability, and provide necessary advice and support to help them achieve a self-financing status;**

(e) **consider extending the length of the contract period so as to allow more time for monitoring the financial performance of SEs after the funding period of the 3E Project;**

Jobs created for PWDs

(f) **strengthen the monitoring of the creation of PWD jobs by funded SEs, and provide necessary advice and assistance to help them achieve the job creation target;**

(g) **require the applicants to provide more detailed information about the PWD jobs to be created (e.g. breakdowns into full-time and part-time jobs, and breakdowns of part-time jobs into different bands according to the number of working hours of a job) in the applications and progress reports for the SWD's assessment and monitoring;**

(h) **consider setting a selection criterion for assessing applications based on the average grant per PWD job to be created;**

Enhancing self-reliance

(i) **consider requiring grantees to provide information about why PWDs left their jobs in the funded SEs for evaluating the effectiveness of the 3E Project in enhancing self-reliance of PWDs; and**

Performance information provided to LegCo

(j) **provide more comprehensive information to LegCo on the number and details of PWD jobs created under the 3E Project in future.**

2.43 **Audit has also *recommended* that the Director of Social Welfare and the Director of Home Affairs should jointly work out an effective arrangement to prevent the provision of repeated seed funding under the 3E Project or the ESR Programme to different NGOs for setting up an SE in the same venue.**

Response from the Administration

2.44 The Director of Social Welfare agrees with the audit recommendations in paragraphs 2.42 and 2.43. She has said that the SWD:

(a) has taken the following measures in the past years to encourage more NGOs to make applications under the 3E Project:

   (i) for non-SWD-subvented organisations, lowering the length of time required to participate in welfare and charitable activities from five to two years; and

   (ii) extending the maximum funding period from two to three years to allow funded SEs more time to gain operating experience and become self-sustainable;

(b) will continue to extend the publicity in promoting the 3E Project to NGOs not providing vocational rehabilitation services for PWDs;

(c) will explore the possibility of further extending the length of the contract period so as to strengthen the monitoring of and support for the businesses;

(d) will continue to strengthen the assistance and support provided for the funded SEs to help them achieve the job creation target;

(e) will collect more information about the jobs created for PWDs in different stages of the businesses with effect from mid-2014 and take on board the average grant per job for PWDs in assessing individual applications under the 3E Project;

(f) will collect, with effect from mid-2014, information as to why PWDs left their jobs in the funded SEs;

(g) will provide more details on PWD jobs created under the 3E Project to LegCo as required; and

(h) will continue to collaborate with the HAD to work out an effective arrangement to prevent provision of repeated grants under different funding schemes for setting up similar businesses in the same venue.

2.45 The Director of Home Affairs agrees with the audit recommendation in paragraph 2.43. She has said that under the current arrangement, the SWD is a member of the ESR Advisory Committee (see para. 3.3) and the SWD's comments are sought on all applications under the ESR Programme to, among others, avoid overlapping of resource provision to the same SE. In the light of Case 2 (see para. 2.32), the HAD would work with the SWD to review the existing arrangement for cases of this nature and see if any change is necessary for the HAD to consider similar applications in future.

Monitoring of projects

2.46 The SWD requires grantees of the 3E Project to submit progress reports with details of the jobs created, the people employed and the financial performance of the project. Progress reports are required to be submitted quarterly during the funding period, and thereafter annually during the remainder of the contract period (i.e. the monitoring period). Annual audited accounts of the SE are also required to be submitted throughout the contract period. The Finance Branch of the SWD examines the submitted reports and forwards its findings to the Project Secretariat to take follow-up actions. The relevant reports are required to be submitted within two months (for progress reports) or six months (for audited accounts) from the end of the reporting period. The SWD introduced a system in April 2012 to issue a first reminder one week after the deadline and a final reminder another week later for chasing up overdue reports. For business with persistent non-compliance with submission of progress reports, review panel meetings will be convened for advice on the course of action.

2.47 The SWD conducts visits or progress review meetings to give advice and support on matters relating to business operations. For grantees with unsatisfactory business performance, a review panel comprising members of assessment panels will be formed to review improvement plans submitted by the grantees. On a quarterly basis, the SWD conducts surveys to collect statistics from all operating projects about the employment of PWDs, including the number of PWDs employed, their salaries, source of recruitment, etc.

Submission of reports

2.48 Audit examination of the 15 projects selected for review (see para. 2.9) showed that, up to September 2013, many of the grantees had submitted their progress reports and annual audited accounts late. Although the SWD had issued reminders in some of the cases, Audit considers that late submission of progress reports is not desirable. There is a need to remind grantees to submit their progress reports on a timely basis.

Review of progress reports

2.49 The progress reports provide useful information to monitor the performance of the project. In examining progress reports and audited accounts submitted by grantees, the SWD's Finance Branch often identified findings for the Project Secretariat to follow up, including:

(a) discrepancies between audited accounts and progress reports; and

(b) non-compliance with requirements of the 3E Guide (e.g. no separate bank account for the SE, internal control weaknesses on cash transactions, etc.).

2.50 From the 15 projects examined, Audit found that the SWD's Finance Branch had identified findings for the Project Secretariat to follow up. However, for 8 projects, the Project Secretariat had not adequately followed up all the Finance Branch's findings.

Recovery of unspent operating grants

2.51 According to the 3E Guide, the grantee was required to return the unspent amount of operating grant to the SWD. The SWD's Finance Branch would calculate the amount of unspent grant on the net deficit basis (i.e. the excess of operating grant over the actual deficit incurred) and informed the Project Secretariat to take follow-up action. The grantee could put up proposals with justifications for retaining the unspent grant for financing the business for the SWD's approval.

2.52 Audit examination of the 15 projects under review found that:

(a) 9 projects were determined by the Finance Branch to have unspent operating grants, totalling $2 million (ranging from $50,000 to $398,000). The Finance Branch informed the Project Secretariat of the results. However, the Project Secretariat had not taken adequate follow-up actions to recover the unspent grants from the grantees. Upon Audit enquiry in October 2013, the Project Secretariat undertook to take follow-up action; and

(b) in one case, there was an error in calculating the unspent operating grant in that a sum of withheld operating grant ($292,000) subsequently released had not been included in the calculation. As a result, the unspent operating grant to be recovered had been understated by the same amount.

Audit recommendations

2.53 **Audit has *recommended* that the Director of Social Welfare should:**

(a) **take improvement measures to ensure that:**

 (i) **progress reports are submitted timely by grantees; and**

 (ii) **reminders are issued promptly for chasing up overdue progress reports;**

(b) **ensure that the Project Secretariat takes necessary follow-up actions on the findings identified by the SWD's Finance Branch from the review of progress reports, and documents the actions taken;**

(c) **for those cases in which the grantees are allowed to retain their unspent operating grants, ensure that sufficient justifications are provided by them and are documented on file for review by the SWD management;**

(d) **for those cases in which sufficient justifications are not provided, take timely follow-up actions to recover the unspent grants from the grantees; and**

(e) **follow up on the case mentioned in paragraph 2.52(b) in which the unspent operating grant to be recovered had been understated.**

Response from the Administration

2.54 The Director of Social Welfare agrees with the audit recommendations. She has said that the SWD:

(a) has established a bring-up system to ensure timely and proper handling of the unspent grants, and will continue to implement the measures for ensuring timely submission of reports, follow-up actions and proper handling of unspent grants; and

(b) is taking rectification action to recover the actual unspent grants from the NGOs concerned.

PART 3: ENHANCING SELF-RELIANCE THROUGH DISTRICT PARTNERSHIP PROGRAMME

3.1 This PART examines the HAD's administration of the ESR Programme. Audit has found room for improvement in the following areas:

(a) funding arrangements (paras. 3.6 to 3.17);

(b) processing of applications (paras. 3.18 to 3.25);

(c) determination of capital and operating grants (paras. 3.26 to 3.34);

(d) effectiveness of the ESR Programme (paras. 3.35 to 3.52); and

(e) monitoring of projects (paras. 3.53 to 3.63).

Background

3.2 The ESR Programme was established in 2006 under the HAD in response to an initiative of the CoP (see paras. 1.5 and 1.6). The Programme provides seed grants for eligible organisations to set up SEs so as to promote sustainable poverty prevention and alleviation efforts at the district level that help enhance self-reliance, targeting socially disadvantaged groups. Instead of providing welfare or short-term relief, the Programme aims at job creation, increasing the skills and capacities of the employable, and providing opportunities for the disadvantaged to upgrade themselves and to be effectively integrated with the community. Up to September 2013, the ESR Programme had received and processed a total of 459 applications, and approved 145 (32%) of them with a total grant of $158 million (Note 12).

Note 12: *Of the 459 applications received, 314 (68%) applications were withdrawn or rejected, mainly on grounds of business viability.*

3.3 The HAD administers the Programme through its ESR Programme Secretariat (with 8 contract staff under the supervision of 2 Executive Officers). The HAD has also set up the ESR Advisory Committee, comprising a Chairman, 21 non-official members (from different sectors of the community), and 3 official members (from the HAD, the Labour Department and the SWD). The Committee is responsible for examining and recommending applications, monitoring and evaluating approved projects, and advising the Government on the administration of the Programme.

3.4 The HAD has prepared the Guide to ESR Programme (the ESR Guide) which provides essential information of the Programme and assists eligible organisations in applying for funding support. Applicants should be bona fide non-profit-making organisations which possess the tax exemption status under section 88 of the Inland Revenue Ordinance. Applications can be submitted all year round, but deadlines are set roughly on a half-yearly basis (in phases — Note 13) to enable the processing of applications in batches.

3.5 A grantee is required to sign a funding agreement with the Government. The project proposal (including the employment of socially disadvantaged people) and the particulars of the funding support (including the items covered by the capital grant and the release schedule of the operating grant) form part of the agreement. The project should commence active operation/service within six months from signing the agreement, and should aim at continuation after the funding period (Note 14), either on a self-financing basis or through other form of resources support to be generated. A grantee has to submit to the HAD progress reports during the funding period and the monitoring period (Note 15).

Note 13: *As at September 2013, the ESR Programme had operated for 14 phases, with Phase 14 still in the processing stage. Phase 13 was completed within 2012-13.*

Note 14: *For Phases 1 to 9, the funding period is two years counting from the date of funding agreement. From Phase 10 onwards, the funding period is three years.*

Note 15: *For Phases 10 to 12, the monitoring period is two years following the funding period. For other Phases (i.e. Phases 1 to 9, and Phase 13 onwards), the monitoring period is three years.*

Funding arrangements

3.6 Community building has long been one of the major programme areas of the HAD. To enhance the HAD's work in this area, the Financial Secretary announced in the 2006-07 Budget Speech of February 2006 that an additional amount of $150 million would be earmarked for strengthening district-based poverty alleviation work, including support for social enterprises, from 2006-07 to 2010-11. The initiative was subsequently implemented through the ESR Programme (see para. 1.6). In June 2006, the HAD submitted an information paper to brief the LegCo Subcommittee to Study the Subject of Combating Poverty (see para. 1.12) on the launching of the Programme. In November 2006, the HAD submitted another information paper to brief the CoP on the progress of implementation of the Programme.

3.7 In the 2009-10 Policy Address, the Government indicated its commitment to encouraging further development of SEs and reinforcing the district-based approach in alleviating poverty through implementing the ESR Programme. The HAD submitted a request in May 2010 to the Financial Services and the Treasury Bureau (FSTB) for additional funding of $150 million for continued implementation of the ESR Programme for another five years from 2011-12 to 2015-16. A time-limited funding of $150 million was approved by the Administration in September 2010 for extending the ESR Programme. In the 2011-12 Budget Speech, the Financial Secretary announced in February 2011 that $150 million had been earmarked for the continued implementation of the ESR Programme from 2011-12 to 2015-16. In April 2011, the LegCo Panel on Welfare Services was informed of the extension of the ESR Programme and the increase in funding.

3.8 The ESR Programme was planned to operate for five years (see para. 3.6) to provide one-off grants to eligible organisations as seed money for setting up SEs. Audit noted that the expenditure of the ESR Programme was charged as recurrent expenditure in the HAD's expenditure vote. No non-recurrent commitment was created to account for and control the funding position of the Programme. As such, the FC's approval for the creation of a new commitment or the increase in a commitment was not required.

3.9 In this connection, Audit noted that for similar funding schemes providing seed moneys for setting up SEs, other bureaux/departments (B/Ds) had, in each case, created a non-recurrent commitment item in the Estimates to account for the expenditure. As the amount involved was more than $10 million, approval of the FC was sought in each case (see Table 5 for details). Apparently, the practice adopted by the HAD is not consistent with the common practice adopted by other B/Ds (e.g. the SWD for the 3E Project — see paras. 2.2 and 2.3).

Table 5

Creation of commitments for funding schemes similar to the ESR Programme

Responsible B/D	Funding schemes involving non-recurrent funding for setting up SEs	New/Additional commitment ($ million)	FC approval obtained
SWD	3E Project	50 4 (Note) 100 154	June 2001 Not applicable January 2012
Labour and Welfare Bureau	CIIF	100 200 300	February 2002 January 2013
Development Bureau	Revitalising Historic Buildings Through Partnership Scheme	100	February 2008

Source: Government websites

Note: Additional commitment was approved in October 2011 by the FSTB under delegated authority.

3.10 In September and October 2013, the HAD informed Audit that:

(a) community building had long been one of the HAD's major programme areas. The $150 million funding provided for the five-year period from 2006-07 to 2010-11 to strengthen district-based poverty alleviation work was to enhance the HAD's work in this area. The time-limited funding for the ESR Programme, as part and parcel of the HAD's on-going district-based community building work, was put under recurrent expenditure;

(b) the existing funding arrangement for the ESR Programme was agreed by the FSTB in 2005-06. As clarified by the FSTB, it was not uncommon that recurrent resources were provided to B/Ds on a time-limited basis for implementing various initiatives within an on-going programme area;

(c) the HAD had no intention to avoid seeking the FC's approval for the creation of a new non-recurrent commitment; and

(d) it agreed to revisit the existing accounting arrangement of the ESR Programme in consultation with the FSTB.

3.11 Audit noted that the HAD had, in consultation with the FSTB, decided not to create a commitment for the non-recurrent expenditure of the ESR Programme. On this basis, the FC's approval for the creation of a new non-recurrent commitment was not required. The expenditure of the ESR Programme was subsumed in the recurrent expenditure of the HAD. While the relevant Subcommittee and Panel of LegCo were consulted about the launching and extension of the Programme and the funding provision, they were not informed of the details of the funding arrangement adopted and the fact that the FC's approval for the total non-recurrent commitment would not be sought.

3.12 Upon enquiry, the FSTB informed Audit in March 2014 that expenditure items under the General Revenue Account could be charged to three categories of subheads: Recurrent subheads, Non-recurrent subheads and Capital Account subheads, as briefly described below:

(a) Recurrent subheads — mainly cover expenditure items which are recurrent in nature, such as remuneration for public servants and recurrent subventions for organisations;

(b) Non-recurrent subheads — mainly cover expenditure items which are one-off in nature and cost more than $150,000 each but do not involve acquisition or construction of a physical asset, such as injection of funds and launching of major one-off projects/programmes; and

(c) Capital Account subheads — cover capital expenditure items such as minor capital works, acquisition of motor vehicles, dinghies and launches.

Expenditures charged to all three categories of subheads under the General Revenue Account are approved by LegCo on an annual basis in the context of the Appropriation Bill. In-year variations to all subhead ceilings exceeding $10 million and the creation of non-recurrent subhead items (with project “commitments”) exceeding $10 million require separate approval from the FC of LegCo unless otherwise authorised by the FC.

3.13 According to the FSTB, expenditure items which seek to cover time-limited programmes or projects within the core policy areas of B/Ds may either be charged to a recurrent subhead or a non-recurrent subhead. Controlling Officers are responsible and accountable for the charging of different expenditure items to the appropriate subheads having regard to the nature of the items. From the FSTB’s perspective, the overriding consideration is whether the charge to public funds for any time-limited programme is justified from value-for-money considerations and is properly authorised following internal due process and statutory requirements. Regardless of the accounting arrangement adopted, Controlling Officers should take measures to ensure accountability and transparency in the use of public funds.

3.14 Audit is of the view that there is merit for the HAD to create a commitment for the non-recurrent expenditure of the ESR Programme and seek the FC’s approval. In this case, the relevant LegCo Panel had been consulted about the launching and extension of the Programme and the funding provision (see para. 3.11), but not the FC.

3.15 Currently, because the funding of the ESR Programme is subsumed in a recurrent expenditure item, little information is provided about its financial position (e.g. total commitment, accumulated expenditure to date, and outstanding fund balance) in the HAD’s Controlling Officer’s Report (COR). In this connection, Audit notes that the HAD has provided more information in its COR for 2014-15 about the expenditure of the ESR Programme.

Audit recommendations

3.16 **Audit has *recommended* that the Director of Home Affairs should, for implementing projects similar to the ESR Programme in future:**

(a) **consider creating a non-recurrent commitment as far as possible and seek the FC's approval as appropriate; and**

(b) **in the event that a non-recurrent commitment is not to be created, inform the relevant LegCo Panel of the details of the funding/accounting arrangement adopted.**

Response from the Administration

3.17 The Director of Home Affairs agrees with the audit recommendations. She has said that the HAD:

(a) had consulted and sought the FSTB's agreement before deciding not to create a non-recurrent commitment for the expenditure of the ESR Programme; and

(b) for future non-recurrent commitment for similar projects, will revisit the arrangement in consultation with the FSTB.

Processing of applications

3.18 In processing applications, the Programme Secretariat conducts screening and preliminary assessment. It then distributes valid applications to a number of assessment panels (each comprising three or four non-official members of the ESR Advisory Committee) for detailed assessment. The criteria used for assessing applications include business viability, social objective, partnership, number of socially disadvantaged to be employed, and technical and management capability.

3.19 After vetting by assessment panels, applications are submitted to the ESR Advisory Committee for discussion. Subsequently, applications supported by the

ESR Advisory Committee are submitted to the Permanent Secretary for Home Affairs for approval. Finally, funding agreements are signed.

Conflict of interest of Advisory Committee members

3.20 To manage conflict of interest in assessing and endorsing applications, the HAD has put in place the following measures:

(a) ***A two-tier system of declaring interests.*** Members of the ESR Advisory Committee are required to declare interests at the start of their two years' term of service and annually thereafter. Members are also required to declare possible conflict of interest prior to discussing applications in an Advisory Committee meeting. In September 2008, the HAD reminded members of the requirements that members with possible conflict of interest regarding an application were required to withdraw from the meeting, or the Chairman would decide whether they needed to withdraw from the meeting when the application was discussed; and

(b) ***Assigning applications to members without conflict of interest.*** In assigning applications to assessment panels, the Programme Secretariat makes reference to the declared interests of members to avoid assigning an application to any member with possible conflict of interest regarding the application.

3.21 Audit noted that at four Advisory Committee meetings held after September 2008, some members declared possible conflict of interest regarding five applications but none of the members concerned withdrew from the meetings. There was, however, no explicit documentation in the meeting minutes of the Chairman's rulings as to whether the members concerned needed to withdraw from the meetings when the applications were discussed.

Time taken in processing applications and signing funding agreement

3.22 Audit analysed the time taken in processing applications for the 145 approved projects of Phases 1 to 13. Table 6 shows the analysis results.

Table 6

Time taken in processing applications and signing funding agreements (145 approved projects of Phases 1 to 13)

Processing stage (Note 1)	Average time (No. of days)
From application submission to endorsement by the Advisory Committee	102
From endorsement to approval by the Permanent Secretary for Home Affairs	24
First two stages	126
From approval to signing the funding agreement (Note 2)	113
Overall	239

Source: Audit analysis of HAD records

Note 1: Under the batch processing mode (see para. 3.4), all applications received in the same phase will be processed together for the first two stages. Signing of the funding agreement will take place separately for individual projects.

Note 2: According to the HAD, some time-consuming preparatory work needs to be done before starting a business (e.g. identifying a suitable business venue and applying for the requisite licences). The HAD will try to work with a successful applicant an appropriate time for signing the funding agreement so that the funding period (which starts from the date of signing the agreement) can closely tie in with the start of the business.

3.23 Long time taken for processing applications and signing funding agreements is not desirable as it dampens applicants' enthusiasm and undermines their capability to seize opportunities in a fast changing economic environment.

Audit recommendations

3.24 **Audit has *recommended* that the Director of Home Affairs should:**

(a) **take measure to ensure that when the ESR Advisory Committee members declare possible conflict of interest regarding an application, the Chairman's ruling as to whether they need to withdraw from the meeting is explicitly made and documented in the minutes; and**

(b) **take measures to expedite the processing of applications as far as possible.**

Response from the Administration

3.25 The Director of Home Affairs agrees with the audit recommendations. She has said that the HAD:

(a) would ensure that the declarations of the ESR Advisory Committee members and the rulings of the Chairman would be properly documented in the minutes of meetings; and

(b) will make further efforts to expedite the processing of applications.

Determination of capital and operating grants

3.26 In endorsing a project, the Advisory Committee also endorses the amount of funding support to the project, subject to a maximum of $3 million, which comprises a capital grant and an operating grant. The capital grant (paid by reimbursement) is used to pay for the initial capital expenditure (e.g. equipment cost and fitting-out works) of a project. The operating grant (paid in advance by half-yearly instalments) is used to pay for the operating expenses (e.g. cost of goods sold and staff salaries) during the funding period. Apart from such general descriptions, the ESR Guide does not provide detailed information on how the capital grant and the operating grant are determined.

Refundable deposits funded by capital grants

3.27 Similar to the case for the 3E Project (see para. 2.17), the ESR Guide does not specify what items are eligible for capital grant. In particular, the ESR Guide does not have clear guidelines on whether refundable deposits are eligible for claiming capital grant. Audit noted that for 20 (14%) of the 145 approved projects, the approved capital grants included 28 items of refundable deposits, ranging from $5,000 to $200,000, with a total amount of $1.7 million. The funding agreements contained no provision for the Government to recover the amounts when the deposits were refunded.

3.28 Refundable deposits (such as rental and utility deposits) are a common type of cash outlay in starting a business. Audit considers that the HAD needs to examine whether refundable deposits are to be funded by the capital grant. When capital funding is provided for a refundable deposit, the HAD needs to establish a mechanism for the Government to recover the amount when the deposit is refunded to the grantee.

Trading stock funded by capital grants

3.29 Out of the 145 approved projects, 39 were in retail business with trading stock. Audit noted that the capital grants provided to 5 approved projects in retail business included items for acquiring trading stock. The total amount involved was $0.63 million. Similar to the case for the 3E Project (see para. 2.19), Audit considers that the HAD needs to lay down guidelines to ensure that the cost of trading stock does not receive double funding from both the capital grant and the operating grant.

Inconsistencies in determining operating grants

3.30 The ESR Guide does not stipulate the basis for determining operating grant. Upon enquiry, the HAD informed Audit in July 2013 that, in general, the operating grant of an approved project was determined as follows:

(a) ***Deficit basis.*** When the budget of a project proposal showed deficits in one or more years during the funding period, the operating grant would be determined based on the sum of the deficits;

(b) ***Expenditure basis.*** When the budget showed surpluses for all years of the funding period, the operating grant would be determined based on the total of recognised expenses of the initial period (e.g. the first two quarters); and

(c) other factors would also be taken into account (e.g. the reasonableness of the budget and the amount applied for).

3.31 Audit examined a sample of 30 approved projects (Note 16) to ascertain how the operating grants were determined and found that:

(a) for 28 projects, some or all years of the funding period showed forecast deficits. In the circumstances, the deficit basis should be used. However, the deficit basis was used in 19 (68%) cases only. For 4 (14%) projects, the expenditure basis was used. For the remaining 5 (18%) projects, the bases used were not documented;

(b) in applying the deficit basis, when there were surpluses in one year or more, such surpluses might be deducted (the net deficit basis) or might not be deducted (the gross deficit basis) from the deficits; and

(c) for the other 2 projects, while all years of the funding period showed forecast surpluses, the expenditure basis was used. The grant was based on the expenditure of the first one or two quarters.

3.32 It appears that there were inconsistencies in determining operating grants of approved projects under the ESR Programme. Audit considers that there is a need for the HAD to state clearly, for each approved project, the basis and the justifications for determining the operating grant.

Audit recommendations

3.33 **Audit has *recommended* that the Director of Home Affairs should:**

Note 16: *The audit sample of 30 projects consisted of projects at different stages (i.e. within the funding period, within the monitoring period, and beyond the monitoring period). Of the 30 selected projects, 7 were terminated projects.*

(a) **examine whether refundable deposits are to be funded by the capital grant and, if so, whether a mechanism should be established to recover the amount when the deposit is refunded to the grantee;**

(b) **take measures to ensure that the cost of trading stock does not receive double funding from both the capital grant and the operating grant; and**

(c) **for each approved project, state clearly the basis and the justifications for determining the operating grant.**

Response from the Administration

3.34 The Director of Home Affairs agrees with the audit recommendations. She has said that:

(a) the HAD will draw up suitable arrangements for refundable deposits and costs of trading stock; and

(b) since November 2013, the ESR Programme Secretariat has stated clearly the basis of the operating grant recommended when submitting an application to the assessment panel for support.

Effectiveness of the ESR Programme

3.35 The ESR Programme has been in operation for over 7 years since its launch in 2006. The effectiveness of the ESR Programme can be assessed by the sustainability of the SEs created and the jobs created for the socially disadvantaged. Table 7 shows a summary of approved projects as at 30 September 2013. As at September 2013, of the 145 approved projects, 25 had ceased operation (terminated projects), and 120 were still in operation (operating projects). Appendix B shows the years of operation of the 120 operating projects and the 25 terminated projects. It can be seen that 49 (34%) projects had operated for five years or more.

Table 7

Summary of approved projects (30 September 2013)

Financial year (Note 1)	**No. of approved projects (a)**	**Target no. of jobs (b)**	**Total approved grant (c) ($ million)**	**Average grant per approved project (Note 2) (d) = (c)/(a) ($ million)**	**Average grant per job (e) = (c)/(b) ($)**
2006-07	39	665	41.31	1.06	62,120
2007-08	15	266	15.52	1.03	58,346
2008-09	25	445	25.01	1.00	56,202
2009-10	14	163	13.29	0.95	81,534
2010-11	13	183	14.29	1.10	78,087
2011-12	18	291	22.06	1.23	75,808
2012-13	21	274	26.86	1.28	98,029
Overall	145	**2,287**	**158.34**	**1.09**	**69,235**
Annual average	21	327	22.62	—	—

Source: Audit analysis of HAD records

Note 1: Applications are processed in batches (see para. 3.4). For 2013-14, the applications received were still being processed and no projects had been approved up to 30 September.

Note 2: The approved grants for individual projects ranged from \$0.3 million to \$3 million. The overall split between capital grant and operating grant was 45 : 55.

Sustainability of funded SEs

3.36 The ESR Programme's objective is to create jobs for socially disadvantaged people to enhance their self-reliance. It is necessary to sustain projects under the Programme in order to sustain jobs created by them. Table 7 shows that, as at 30 September 2013, 145 projects had been approved with a total approved grant of $158 million, and a target of creating 2,287 jobs. HAD records showed that, among the 145 approved projects, 25 (17%) had been terminated (all after the funding period — Note 17), involving $24 million of grant payment and 308 proposed jobs.

3.37 If a grantee has ceased or intended to cease the project, the HAD will conduct an exit interview. The grantee will also be required to complete an exit questionnaire for the HAD to gain insight into the reasons of cessation so as to draw up improvement measures for the ESR Programme. In February 2012, the HAD reported to the Advisory Committee a summary of the reasons of termination of 11 projects. These projects were terminated within one year after the funding period. According to the summary, the common reasons for not being able to sustain business included increase in shop rent, unfavourable shop location and employee problems.

3.38 Normally, the approved projects operate at a deficit initially and attain breakeven towards the end of the funding period. They are expected to operate at a surplus to sustain a self-financing status during the monitoring period and beyond. As at 30 September 2013, there were 120 operating projects (excluding 25 terminated projects — see para. 3.36). Of these operating projects, 41 were still within the funding period and 79 were beyond. Audit analysis of the 79 projects operating beyond the funding period showed that about half of them were operating at a surplus (see Table 8).

Note 17: *Of the 25 terminated projects, 6 (24%) were terminated at the end of the funding period, 17 (68%) during the monitoring period, and 2 (8%) after the monitoring period.*

Table 8

Operating results of projects operating beyond funding period (based on last progress reports submitted up to September 2013)

	No. of projects		
	Operating with a surplus	**Operating with a deficit**	**Total**
Within monitoring period	11 (34%)	21 (66%)	32
Beyond monitoring period	29 (62%)	18 (38%)	47
Overall	40 (51%)	39 (49%)	79

Source: Audit analysis of HAD records

3.39 Funding support from the ESR Programme is in the form of non-recurrent grant over the funding period. Beyond the funding period, the grantee has to rely on its own sources of financial support (e.g. funding from parent organisation to cover the deficit). Audit considers that in monitoring the financial performance of projects after the funding period for evaluating their sustainability, the HAD needs to provide necessary support and advice to improve their financial performance (e.g. arranging Task Force meetings with grantees — see para. 3.53).

Jobs created by funded SEs

3.40 For the 145 approved projects as at 30 September 2013, according to the funding agreements, the target was to create 2,287 jobs, including 862 full-time jobs and 1,425 part-time jobs. Out of the 120 operating projects (see para. 3.38), 99 had submitted progress reports as at 30 September 2013. Based on the latest available reports, Audit compared the target and actual number of jobs created. Table 9 shows the comparison results.

Table 9

Number of jobs created for 99 operating projects (Note 1)
(as at 30 September 2013)

Job type	Target	Actual	Variance	
	(a)	(b)	(c) = (b)-(a)	(d) = (c)/(a)
	(No.)	(No.)	(No.)	(%)
Full-time	548	335	-213	-39%
Part-time	1,115	874	-241	-22%
Overall	1,663	1,209 (Note 2)	-454	-27%

Source: Audit analysis of HAD records

Note 1: Of the 99 operating projects which had submitted progress reports, 47 were beyond the monitoring period without further funding support from the Government.

Note 2: According to the HAD, the number of people who benefited from the projects was greater than the number of jobs created as some people had joined and left the jobs.

3.41 ***Monitoring of the actual number of jobs created.*** Table 9 shows that the actual number of jobs created had fallen short of the target (by 39% for full-time jobs, and 22% for part-time jobs). The shortfall in the number of jobs created would call to question the effectiveness of the ESR Programme in creating employment opportunities for the socially disadvantaged. Audit noted that, in monitoring project progress, the HAD mainly focused on their financial performance (as evidenced by the basis of arranging Task Force meetings — see para. 3.53). Audit considers that the HAD needs to strengthen its monitoring on job creation and encourage grantees to meet the target number of job creation.

3.42 ***Full-time and part-time jobs.*** The HAD has not laid down guidelines on the minimum working hours for part-time jobs. In project proposals and progress reports, the total number of jobs to be or actually created was simply the sum of full-time and part-time jobs. Audit noted from project proposals and progress reports that there was little information about the number of working hours for part-time jobs. Audit considers that there is a need for the applicants/grantees to provide additional information on the part-time jobs to be or actually created (e.g. breakdowns of part-time jobs into different bands according to the number of working hours of a job). This can provide better information for detailed assessment and monitoring.

3.43 ***Cost-effectiveness of grant for job creation.*** Most of the funded SEs were small business undertakings. The average target number of jobs to be created for the 145 approved projects was about 16, ranging from 3 to 83 jobs. Some 60 (41%) funded SEs targeted to create only 10 jobs or less. In particular, there were 6 funded projects each targeting to create only 3 jobs.

3.44 Table 7 in paragraph 3.35 shows that the average grant per project was $1.09 million and the average grant per job to be created was some $69,000. Audit analysis shows that the average grant per job for individual projects varied widely from $9,000 to $360,000 per job. For 3 projects, each creating 3 jobs, the average grant per job was over $300,000. Audit noted that the number of jobs to be created was adopted by the HAD in 2009 as one of the assessment criteria for vetting applications. Nevertheless, there is merit for the HAD to consider setting a selection criterion for assessing applications based on the average grant per job to be created.

Jobs created for the socially disadvantaged

3.45 According to the ESR Guide, jobs created by projects under the ESR programme should target low-skilled and socially disadvantaged persons. In making an application under the ESR Programme, the applicant is required to provide the target number of jobs to be created and the target groups of socially disadvantaged persons. The applicant is also required to state its understanding of the target groups and its strategies of reaching them for recruitment. Usually, applicants state that the socially disadvantaged persons can be recruited by referrals from the parent organisations, other NGOs, the Employees Retraining Board or relevant departments (e.g. the SWD and the Labour Department). In the progress reports, the grantees have to report the number of jobs created and state whether the employees belong to the target socially disadvantaged groups. For the 99 projects (see para. 3.40), Audit analysis of the latest progress reports found that 83% of the employees belonged to the target socially disadvantaged groups intended for recruitment under the projects. About 17% of the employees did not belong to the target socially disadvantaged groups.

3.46 In the ESR Guide, there is no definition provided for socially disadvantaged persons and no detailed information on relevant target groups. In the progress report template, the HAD has provided a list of target groups of socially disadvantaged persons for reference by the grantees in reporting employment information (Note 18).

3.47 Audit notes that some target groups in the list may not clearly demonstrate that they are socially disadvantaged. There is a need to refine the list of target socially disadvantaged groups for support under the ESR Programme. Moreover, the HAD relied on the information provided by grantees as to whether employees belonged to the target socially disadvantaged groups. Although the HAD conducted surprise visits to the funded projects and checked employment records, the checking did not specifically verify whether employees belonged to the target socially disadvantaged groups. There is a need to further strengthen the monitoring of the funded projects in employing the socially disadvantaged.

Enhancing self-reliance

3.48 The ESR Programme aims to create employment opportunities to enhance the self-reliance of socially disadvantaged persons. To assess the extent to which this objective is achieved, the HAD has developed a questionnaire for the employees to conduct a self-assessment. The questionnaire comprises 15 questions asking employees about their ratings of their work and life situations (Note 19), with two questions directly relating to their self-reliance. The survey results are included in progress reports for submission by grantees to the HAD. However, Audit could not ascertain from the HAD records that follow-up action had been taken to evaluate the survey results. Based on the survey results available for examination, Audit found that 78% of employees strongly agreed or agreed that their jobs let them learn more working skills, and 82% of employees strongly agreed or agreed that they

Note 18: *The list comprises 14 target groups, e.g. PWDs, ethnic minority, unemployed, women and middle-aged.*

Note 19: *There are five ratings from "Strongly agree" to "Strongly disagree".*

were confident with their future employment. The results indicated that the projects were reasonably effective in enhancing employees' self-reliance. There is a need for the HAD to analyse periodically the survey results.

3.49 According to the ESR Guide, in order to help as many people as possible, the project should have a mechanism to help participants move into the open labour market, instead of staying in the project for a prolonged period. Currently, the HAD does not track the number of employees who have moved on to open market employment after joining the funded SE. Audit considers that such information is also an indicator of participants achieving self-reliance. The HAD may consider asking the grantees to provide this information in the progress reports.

Performance information provided to LegCo

3.50 From time to time, the HAD provides information to LegCo about the progress of implementing the ESR Programme. In reporting the results on creation of employment opportunities under the Programme, the HAD only provided the target number of jobs to be created, without providing the actual number of jobs created and a breakdown between full-time and part-time jobs, or specifying those created for the socially disadvantaged. Audit considers that the HAD needs to consider providing LegCo with more comprehensive information on the number and details of jobs created under the ESR Programme in future.

Audit recommendations

3.51 **Audit has *recommended* that the Director of Home Affairs should:**

Sustainability of funded SEs

(a) **continue to monitor the financial performance of SEs after the funding period for evaluating their sustainability, and provide necessary advice and support to help them achieve a self-financing status, where appropriate;**

Jobs created by funded SEs

(b) **strengthen the monitoring of the creation of jobs by funded SEs, and provide necessary advice and assistance to help them achieve the job creation target;**

(c) **require the applicants/grantees to provide more detailed information about the jobs to be or actually created (e.g. breakdowns into full-time and part-time jobs, and breakdowns of part-time jobs into different bands according to the number of working hours of a job) in the applications and progress reports for the HAD's assessment and monitoring;**

(d) **consider setting a selection criterion for assessing applications based on the average grant per job to be created;**

Jobs created for the socially disadvantaged

(e) **specify and define clearly the socially disadvantaged groups targeted for support under the ESR Programme;**

(f) **strengthen the monitoring of the funded SEs in employing the socially disadvantaged;**

Enhancing self-reliance

(g) **analyse periodically the survey results of questionnaires completed by employees to evaluate the effectiveness of funded projects in enhancing employees' self-reliance;**

(h) **consider requiring grantees to provide information about the number of employees who have moved on to open labour market after joining the funded SEs; and**

Performance information provided to LegCo

(i) **provide more comprehensive information to LegCo on the number and details of jobs created under the ESR Programme in future.**

Response from the Administration

3.52 The Director of Home Affairs agrees with the audit recommendations. She has said that the HAD will:

(a) provide advice to funded SEs after the funding period, if necessary, subject to availability of resources. However, given the resource constraint, priority will be given to newly formed SEs;

(b) step up its monitoring on the employment situation of funded SEs;

(c) request funded SEs to provide more comprehensive information on the working hours of their part-time employees;

(d) try to define more clearly the socially disadvantaged groups under the ESR Programme; and

(e) issue questionnaires to funded SEs to collect information on the number of employees in the socially disadvantaged groups moving into the open labour market.

Monitoring of projects

3.53 To monitor the progress of projects, the HAD requires grantees to submit progress reports with details of the jobs created, the people employed and the financial performance of the projects. The reporting interval is half-yearly during the funding period and yearly during the monitoring period. During the funding period, the yearly report is required to be accompanied by an audited statement of accounts. A progress report is required to be submitted within two months from the end of the reporting period. The operating grant instalment will be released only when the progress report of the previous period is submitted by the grantee, vetted by the Programme Secretariat and accepted by the ESR Advisory Committee. If the financial performance of the project is not satisfactory, the ESR Advisory Committee may form a Task Force (comprising several committee members) to meet with the grantee to offer improvement advice. The HAD also conducts visits to approved projects to ensure that the approved grants have been fully and properly applied to the project and the grantee has complied with the terms and conditions of the funding agreement.

Submission of progress reports

3.54 In October 2009, the HAD noted that there were significant delays in submission of progress reports. Progress reports of 16 projects had been overdue for more than 3 months. As a remedial measure, the HAD set up a computerised bring-up system to issue reminders to chase up late progress reports. Despite the bring-up system, Audit noted that most progress reports were still not submitted timely. Audit selected for review a sample of 30 approved projects (see para. 3.31) with 90 reports submitted after the setting up of the bring-up system. Audit analysis found that 55 (61%) of the 90 reports were submitted late, with an average delay of 104 days. As at September 2013, 4 progress reports were found to have been overdue for more than 3 months. Audit also noted that HAD reminders were generally issued late.

Finalisation of progress reports

3.55 Audit analysed the time taken by the HAD to finalise its processing of the 90 progress reports of the audit sample of 30 approved projects. Regarding the progress reports for the funding period, the average time taken was 267 days. The delay in submission of progress reports and long time taken to finalise them had resulted in late payment of operating grant instalments to grantees, with an average delay of 288 days. Prolonged delay of payment of operating grant was not conducive to providing funding support to approved projects and might adversely affect their cashflow position. The HAD needs to enhance the monitoring system to ensure timely submission of progress reports and prompt release of operating grants.

Monitoring of fund movement

3.56 According to the funding agreement, the grantee of a project shall use the grant exclusively for the project objective and in accordance with the approved budget only. The grantee shall also use all profit solely and exclusively for the purpose of the project during the funding period and the monitoring period.

3.57 Audit examined the audited accounts of the approved projects and noted that, in 14 cases, there were balances owed by the grantees to the projects. The total amount was $1.75 million, with individual amounts ranging from $100 to $395,000. As requested by Audit, in September and December 2013, the HAD enquired with the grantees and found that:

(a) for 13 of the 14 cases, the amounts involved were related to normal business operations (e.g. trading transactions between projects and grantees); and

(b) for the remaining case, the amount of some $304,000 involved was related to a payment by the project on behalf of the grantee (which was described in a note to the audited accounts for the period ended May 2012 as "unsecured, interest-free and has no fixed term of repayment"). This was not in compliance with the requirement that all profit should be used solely and exclusively for the project (but the non-compliance was not highlighted in the auditor report). The grantee informed the HAD that the sum had been settled in November 2012. The HAD would follow up the case by examining the project's audited accounts for 2012-13 upon submission.

3.58 In view of the case in paragraph 3.57(b), in October 2013, the HAD revised the "Notes to Auditors of Grantees" to require the auditor of a project to clearly confirm in the auditor report the grantee's compliance with the requirement that all profit should be used solely and exclusively for the project. In February 2014, the HAD informed Audit that it would continue to remind auditors to examine grantees' compliance with the terms of the funding agreements in carrying out the audits of projects. Nevertheless, Audit considers that the HAD needs to scrutinise the progress reports and audited accounts submitted by grantees on a timely basis to ensure grantees' compliance with the terms of the funding agreements.

Recovery of unspent operating grants

3.59 According to the ESR Guide, upon expiry of the funding period of a project, any unspent operating grant over the recognised total expense will be clawed back and returned to the Government. Starting from early 2013, the HAD has ascertained if there is any unspent grant (using the expenditure basis) before releasing the final instalment of the operating grant. If there is unspent grant, it will be deducted from the final instalment.

3.60 Audit considers that in principle, the unspent grant should be the amount over the deficit of the funding period (i.e. the deficit basis). The deficit basis can ensure that the funding support provided to a project for the funding period will not be more than the actual deficit incurred by the grantee. For the audit sample of 30 projects (see para. 3.31), 22 projects were operating beyond the funding period. Applying the deficit basis, Audit found that 12 (55%) of the 22 projects would have unspent operating grants, ranging from $1,000 to $750,000, totalling $3.57 million.

3.61 The HAD needs to ascertain and recover unspent operating grants using the net deficit basis. Similar to the approach adopted by the 3E Project (see para. 2.51), grantees of the ESR Programme are also allowed to put up proposals with justifications for utilising the unspent grant for sustaining or expanding the business. The HAD needs to remind grantees of this arrangement, and exercise discretion for them to retain the unspent grant having regard to the merits of individual cases.

Audit recommendations

3.62 **Audit has *recommended* that the Director of Home Affairs should, in respect of the ESR Programme:**

(a) **take measures to enhance the project monitoring system to ensure that:**

(i) **progress reports are submitted timely by grantees;**

(ii) **reminders are issued promptly under the bring-up system;**

(iii) **progress reports received are finalised within a reasonable timeframe; and**

(iv) **operating grant instalments can be released promptly to meet grantees' cashflow requirements;**

(b) **scrutinise the progress reports and audited accounts submitted by grantees to ensure compliance with the terms of the funding agreements;**

(c) **use the net deficit basis for determining the unspent grants to be recovered and lay down such basis in the ESR Guide; and**

(d) **remind grantees of the arrangement for them to put up proposals with justifications for utilising the unspent grants for sustaining or expanding the business.**

Response from the Administration

3.63 The Director of Home Affairs agrees with the audit recommendations. She has said that the HAD:

(a) has been striving hard to encourage grantees to submit progress reports in a timely manner and will further step up its efforts; and

(b) will use the net deficit basis for determining the unspent grants to be recovered. However, the HAD would consider exercising discretion for justified cases to retain the unspent grants to sustain or expand the operation of the SEs concerned.

PART 4: PUBLICITY AND PROMOTIONAL WORK

4.1 This PART examines the publicity and promotional work of the HAB and the HAD for the development of SEs, focusing on the following areas:

(a) publicity initiatives (paras. 4.2 to 4.25); and

(b) the Partnership Programme (paras. 4.26 to 4.41).

Publicity initiatives

4.2 Both the HAB and the HAD implement publicity initiatives to promote the development of SEs. These publicity initiatives target at enhancing public understanding of SEs, promoting caring consumption by purchasing products and services from SEs, and creating an enabling environment for SEs to flourish.

SE Summit

4.3 The first SE Submit was organised by the HAB in 2007. Since 2008, the Summit has been organised by the SE sector as an annual event with the HAB's funding support. The Summit has been well supported by the SE, academic and business sectors. During the Summit, world-renowned experts, leading local social entrepreneurs, frontline SE practitioners, academics, business leaders and government representatives have gathered to exchange ideas and experiences.

4.4 The latest SE Summit was held in November 2013. There were a total of 1,400 participants, including representatives from 14 countries. The Summit has attracted increasing local and overseas attention. It has also become a flagship event of the SE sector.

SE Award Scheme

4.5 In 2011, the SEAC and the HAB jointly organised the first SE Award Scheme to give recognition to successful SEs, and to promote the sharing of best practices among SEs. In the SE Award Scheme 2011, eight SEs were granted the Outstanding SEs Award. In March 2012, in assessing the results of the SE Award Scheme, the SEAC and the HAB decided that the Scheme would be held once every two years to allow time for "young" SEs to learn from successful cases, and gain confidence and capability to compete in the Scheme.

4.6 In 2013, the SEAC and the HAB organised the second SE Award Scheme. There were eight categories of awards. In the SE Award Scheme 2013, 14 SEs were granted 21 awards. Of the 14 awardees, 9 have operated SEs funded by either the ESR Programme or the 3E Project. Audit considers that showcasing successful SEs through the SE Award Scheme is an effective initiative to promote the development of SEs. The HAB needs to continue exploring ways to capitalise on the Scheme to publicise the success stories of SEs, especially those with government funding.

Friends of SE Award Scheme

4.7 In 2011, the SEAC and the HAB jointly organised the "Be a Friend to SE" Campaign to give recognition to those organisations or individuals providing support to SEs. In March 2012, in assessing the results of the Campaign, the SEAC and the HAB decided that the Campaign would be organised by the HAD to achieve synergy with its Mentorship Scheme, and would be held once every two years.

4.8 In 2013, the HAD organised the Friends of SE Award Scheme to replace the Campaign. Among the 38 nominating SEs, 16 were funded by the ESR Programme, and 5 were funded by the 3E Project. A total of 39 nominees were granted awards.

4.9 In assessing the results of the "Be a Friend to SE" Campaign of 2011, it was proposed that the HAD could recruit mentors for its Mentorship Scheme from the awardees of the 2011 Campaign. In 2012, the HAD approached 20 organisations which were awardees of the Campaign. Eventually, only one mentor was recruited. Audit also noted that, of the awardees of the Friends of SE Award Scheme of 2013, only two were mentors of the Mentorship Scheme. There is room for improving the synergy between the Friends of SE Award Scheme and the Mentorship Scheme. The HAD needs to make efforts to encourage awardees of the Award Scheme to become mentors of the Mentorship Scheme.

Social Enterprises Support Unit

4.10 In 2008, the HAD set up the Social Enterprises Support Unit to implement initiatives to promote the development of SEs, including the following:

(a) arranging SEs to showcase their services and products at market fairs;

(b) producing announcements in the public interest, television programmes and radio programmes about SEs;

(c) publishing advertorials on SEs in newspapers and magazines; and

(d) maintaining the SE website and the SE directory.

Market fairs

4.11 The HAD arranges SEs to participate in market fairs to showcase their services and products. Generally, there are three types of market fairs:

(a) ***District fairs organised by the HAD.*** These include the North District Market Fair for SEs and the Shatin Market Fair for SEs;

(b) ***District SE carnivals organised by the HAD.*** Following the SEAC/HAB's proposal in March 2012, the HAD organises annual district SE carnivals alternating between New Territories and urban districts. So far, two carnivals have been held (i.e. the Ma On Shan Festival — SE Winter Fete in November 2012, and the Sham Shui Po SE District Carnival in November 2013 — see Photograph 1); and

Photograph 1

Sham Shui Po SE District Carnival
(November 2013)

Source: HAD records

(c) ***Territory-wide fairs organised by other parties.*** These include the Hong Kong Brands and Products Expo (see Photograph 2) and the Food Carnival organised by the Chinese Manufacturers' Association, and the Food Expo organised by the Trade Development Council.

Photograph 2

Hong Kong Brands and Products Expo
(December 2013 to January 2014)

Source: *HAD records*

4.12 During the three financial years 2011-12 to 2013-14, through invitations, the HAD arranged 41 SEs to participate in 15 market fairs. Audit noted that the HAD only invited SEs under the ESR Programme to participate in these fairs. Arranging SEs to participate in market fairs give them valuable opportunities to publicise their services and products. The HAD should consider expanding the invitation lists to cover SEs not funded under the ESR Programme (e.g. SEs funded under the SWD's 3E Project and other SEs operated by NGOs without government funding).

Advertorials on SEs

4.13 The HAD periodically publishes advertorials on SEs (see Figure 3 for an example). These advertorials enhance public understanding of SEs, and promote caring consumption of services and products of SEs. Publishing advertorials is a common publicity means. However, the HAD's advertorials on SEs were only published in newspapers and magazines, but not on the HAD's SE website. To reach a wider audience, the HAD needs to consider uploading these advertorials onto its SE website.

Figure 3

An advertorial on SEs

Source: *HAD records*

Publications on SEs

4.14 The HAB has produced two booklets on SEs which are placed on the HAD's SE website:

(a) one booklet (produced in 2007) is on the success stories of a number of local and overseas SEs. It provides accounts of the experience in setting up and running SEs; and

(b) the other booklet (produced in 2010) is on the business strategies for SEs. It provides reference to the success factors for setting up and running SEs.

4.15 As the two booklets were produced some years ago, the materials contained therein may not be up-to-date. For example, two SEs quoted in the 2007 booklet as successful SEs had already ceased business. The HAB needs to periodically update the booklets to take into account new developments.

SE website

4.16 In June 2008, the HAD launched the SE website. The SE website provides a repository of materials relating to SEs, such as information of supporting measures and promotional activities, publications, and the HAD's SE directory. It is expected that these materials will enhance public understanding of SEs, and will assist the setting up and running of SEs.

4.17 The SE website is the place for the Government to disseminate updated information of promotional activities of SEs. Audit however noted that the public might not obtain updated information from the SE website because the pop-up of "Upcoming events" was not always used and no "What's new" webpage was provided. Besides, press releases of some promotional activities were only placed in the HAD's homepage, but not on the SE website. The HAD needs to make better use of the SE website to promote the activities of SEs. The HAD may also consider the use of social media for promoting the development of SEs.

SE directory

4.18 The HAD does not compile official statistics of all the SEs in Hong Kong. It only maintains a directory of selected SEs. SEs contained therein are categorised according to the services and products they provided. The directory facilitates the public to search for SEs and their services and products, and helps promote caring consumption. As at December 2013, the directory contained about 170 SEs from two sources, namely SEs set up under government funding schemes and SEs set up by major charitable organisations.

4.19 The SEBC (see para. 1.10) conducts annual surveys and maintains another SE directory with more detailed information. SEs contained in the directory are categorised according to the services and products they provided, their locations, and their social objectives. As at December 2013, the directory contained about 440 SEs. Apparently, the SEBC's directory has a wider coverage than the HAD's directory. Besides, the SEBC, with the HAD's funding support, also provides a mobile version of its directory.

4.20 On the SE website, the webpage containing the HAD's SE directory also provides a hyperlink to the SEBC's directory. In view of the wider coverage and the availability of a mobile version of the SEBC's directory, the HAD needs to review whether its own directory is still required. If the HAD sees the need to maintain its own SE directory, it needs to enhance and expands its contents.

Display of publicity materials by District Offices

4.21 The HAD provides SE publicity materials (on easy-mount frames) to District Offices. They are required to display these materials during district activities (such as job fairs, carnivals and seminars) and at district venues (such as community centres and community halls). Based on returns submitted by District Offices, for the period 2011-12 to 2013-14, there was no display of SE publicity materials during district activities for 8 of the 18 District Offices. The HAD needs to remind District Offices to display SE publicity materials during district activities, whenever appropriate.

Audit recommendations

4.22 **Audit has *recommended* that the Secretary for Home Affairs should:**

(a) **continue to showcase successful SEs by organising the SE Award Scheme, and to explore ways to further publicise the success stories of SEs, especially those with government funding;**

(b) **update the HAB's booklets about SEs to take into account new developments; and**

(c) **continue to make use of the SE website for more effective sharing of information useful to the SE sector.**

4.23 **Audit has *recommended* that the Director of Home Affairs should:**

(a) **improve the synergy between the Friends of SE Award Scheme and the Mentorship Scheme by encouraging awardees of the Award Scheme to become mentors of the Mentorship Scheme;**

(b) **in arranging SEs to participate in market fairs, consider expanding the invitation lists to cover other SEs not funded under the ESR Programme, where appropriate and practicable;**

(c) **in publishing advertorials on SEs in newspapers and magazines, consider also uploading them onto the SE website;**

(d) **make better use of the SE website to disseminate updated information of promotional activities of SEs;**

(e) **given the availability of a more comprehensive SE directory maintained by the SEBC, review whether the HAD's SE directory is still required and, if so, what enhancements can be made; and**

(f) **remind District Offices to display, whenever appropriate, SE publicity materials during district activities.**

Response from the Administration

4.24 The Secretary for Home Affairs agrees with the audit recommendations in paragraph 4.22. He has said that:

(a) the HAB will continue with its promotional efforts to showcase successful SEs by the SE Award Scheme. By working with partners to best utilise resources, it has already implemented various new initiatives to enhance promotion;

(b) since the last publication of the booklets (see para. 4.14), the HAB has been working with various SE support organisations (e.g. through sponsoring the SE Summit) to encourage and support their initiatives to provide useful and up-to-date information to the SE sector. Very often, such information from practitioners or support organisations better reflects the needs of the sector. Such an approach could facilitate the development of more support organisations and programmes in the community for SEs. The HAB will continue updating the SE website to give these efforts a highlight; and

(c) the HAB will continue to make good use of various means (online platforms and publications) to disseminate useful information on SEs for public consumption.

4.25 The Director of Home Affairs agrees with the audit recommendations in paragraph 4.23. She has said that the HAD will:

(a) adopt the recommended means for the existing publicity work; and

(b) consider expanding the invitation list to other suitable SEs not funded under the ESR Programme as appropriate. However, given the limited number of booths made available to the HAD by the organisers of market fairs, priority should be given to SEs under the ESR Programme.

Partnership Programme

4.26 In 2008, the HAD set up the Partnership Programme to enhance cross-sector collaboration to promote the development of SEs. The Partnership Programme comprises the Mentorship Scheme and the Matching Forum. The HAD's Social Enterprises Support Unit is responsible for implementing the Partnership Programme.

Mentorship Scheme

4.27 The Mentorship Scheme aims at forming mentorships between SEs and voluntary mentors recruited from business and professional sectors. Through such mentorships, mentors will provide advice and guidance to SEs to enhance their competitiveness and to assist them in dealing with problems and difficulties.

4.28 In processing the request of an SE for becoming a mentee of the Mentorship Scheme, the Social Enterprises Support Unit carries out a matching, taking into account a number of factors such as the trade and the requested expertise areas of the SE. The matching proposal will be submitted to the HAD senior management for approval. The Unit will then arrange the first meeting of the mentorship. The SE and the mentor will arrange subsequent meetings themselves. The mentorship lasts for nine months, and it is expected that at least three meetings will be held. Both the SE and the mentor are each required to complete a questionnaire at the end of the mentorship. As at 30 November 2013, 53 mentees (50 of which were projects under the ESR Programme) had been registered under the Scheme and mentorships had been arranged for 41 of them.

4.29 ***Long time taken in arranging mentorships.*** Audit analysed the time taken in arranging mentorships (from the date of receiving the application to the date of notifying the SE of the assignment of a mentor) for a sample of 10 SEs. For 7 SEs, the time taken ranged from 15 to 67 days. However, for 3 SEs with applications received in June 2012, the time taken ranged from 301 to 319 days. According to the HAD, the long time taken was partly due to the time spent waiting for necessary information from mentees, and partly due to posting of staff responsible for arranging mentorships. Audit considers that the long time taken in arranging mentorship might undermine the provision of timely assistance to SEs.

4.30 ***Feedback and comments of participants.*** At the end of a mentorship, the SE and the mentor are each required to complete a questionnaire to provide feedback and comments to the HAD. As at 30 November 2013, 34 mentorships had been completed, and 59 questionnaires had been received from 32 completed mentorships. Audit scrutinised relevant HAD records but could not find documentation on any review of the questionnaires received. Audit reviewed the 59 questionnaires received and noted that:

(a) for 13 mentorships, the SE or the mentor commented that the mentorship period of 9 months was not long enough;

(b) for 11 mentorships, less than three meetings (the expected number of meetings) were held;

(c) for 7 mentorships, the mentor commented that the mentorship was not effective for reasons including the mentorship period was not long enough, or the SE was not devoted; and

(d) for 2 mentorships, the SE commented that the mentorship was not effective for the reason the mentor did not possess the requested expertise.

4.31 Audit considers that feedback and comments of SEs and mentors can provide useful information to evaluate the effectiveness of the Mentorship Scheme and to identify improvement measures. The HAD needs to review questionnaires completed by SEs and mentors of the Mentorship Scheme to examine their feedback and comments for compiling management information, with a view to identifying areas for improvement.

4.32 ***Recruitment of mentors and mentees.*** When the Mentorship Scheme was launched in 2008, recruitment of mentors and mentees was open to all eligible parties. An application form for participating in the Scheme as a mentor or a mentee was placed on the HAD's SE website. Since March 2012, as a temporary measure, the HAD has confined the recruitment of mentees to projects under the ESR Programme. The HAD has also confined the recruitment of mentors to certain groups of professionals and supporters of SEs. The aforesaid application form has also been removed from the SE website.

4.33 Regarding the current recruitment arrangement, Audit noted the following issues that call for the HAD's attention:

(a) the Mentorship Scheme is supposed to serve all SEs of Hong Kong. The current arrangement of confining recruitment of mentees to projects under the ESR Programme would deprive other SEs of the opportunities;

(b) the HAD's intention is to make the participation in the Mentorship Scheme a requirement for projects under the ESR Programme starting from Phase 11. However, as at 30 November 2013, of the 27 projects of Phases 11 to 13, 9 (33%) had turned down invitations to participate in the Scheme; and

(c) the HAD maintained two lists of mentors, namely one list with about 80 mentors recruited before March 2012, and another with about 50 mentors recruited after March 2012. Audit noted that the HAD did not regularly update the particulars of mentors and ascertain whether they were still interested in serving as mentors. Audit also noted that some of the recruited mentors (particularly those on the old list) had been inactive and without assignments for some time.

Matching Forum

4.34 The Matching Forum aims at forming partnerships between SEs and business organisations. Through such partnerships, business organisations will pair up with non-profit-making organisations to form SEs, procure services (e.g. cleaning and catering services) and products of SEs, or provide assistance (e.g. concessionary rentals and access to clients) to SEs.

4.35 According to the HAD, senior government officials and the HAD's District Officers will appeal to business corporations and relevant district organisations to promote cross-sector collaboration to form SEs. The HAD has periodically reported to the LegCo Panel on Welfare Services on the number of SE projects involving cross-sector collaboration launched through the Matching Forum. For example, in January 2012, the HAD informed the Panel that about 30 SE projects had been launched through the Matching Forum.

4.36 To facilitate procurement of services and products of SEs and provision of assistance to SEs, before March 2012, a standard form of the Matching Forum was placed on the SE website for interested organisations to make proposals. In March 2012, considering that interested organisations could use telephone and e-mails to make proposals, the HAD removed the standard form from the SE website.

4.37 ***Proposals of procuring services and products of SEs.*** Audit reviewed HAD records of the Matching Forum and noted nine documented cases in which interested organisations made proposals (using the standard form) of procuring services and products of SEs. In each case, the HAD sent to the interested organisation lists of SEs (in the HAD's directory of SEs) providing the requested services and products, and advised the interested organisation to contact the SEs directly. The HAD did not follow up the outcome of these proposals. According to the HAD, since the removal of the standard form in March 2012, only one proposal of procuring services and products had been received.

4.38 ***Proposals of providing assistance to SEs.*** Audit also noted six cases in which interested organisations made proposals of providing assistance to SEs. Five proposals were made by using the standard form. The last proposal was made by using an e-mail in September 2012. In each case, the HAD circulated the proposal to relevant SEs (in the HAD's directory of SEs). There were two successful cases of forming partnerships in which service contracts were awarded to two NGOs. For the other four cases, the results were unknown or not successful. According to the HAD, since the receipt of the last proposal in September 2012, proposals of providing assistance to SEs have not been received.

4.39 ***Room for improvement.*** Activities of the Matching Forum have been low since its set up in 2008. Only a few proposals of forming partnerships with SEs have been received from the business sector. On receiving proposals, the HAD only made referrals but did not actively follow up the outcome. There is a need to review the effectiveness of the Matching Forum and to identify improvement measures. In addition, the publicity of the Matching Forum needs to be enhanced. Since the removal of the standard form, the SE website provides only a brief description of the Matching Forum but not a ready channel for putting up proposals.

Audit recommendations

4.40 **Audit has *recommended* that the Director of Home Affairs should:**

(a) **take measures to ensure that mentorships are arranged in a timely manner for registered mentees;**

(b) **put in place a system to review questionnaires completed by participants of the Mentorship Scheme to examine their feedback and comments for compiling management information;**

(c) **keep in view the need to have the Mentorship Scheme open to SEs other than projects under the ESR Programme;**

(d) **take measures to encourage more projects under the ESR Programme to participate in the Mentorship Scheme as intended;**

(e) **regularly update the particulars of recruited mentors;**

(f) **review the effectiveness of the Matching Forum and identify measures to further promote the formation of partnerships between SEs and the business sector; and**

(g) **enhance the publicity of the Matching Forum and provide a ready channel for putting up proposals on the SE website.**

Response from the Administration

4.41 The Director of Home Affairs agrees with the audit recommendations. She has said that the HAD will, among others, review the operation of the Mentorship Scheme and the Matching Forum.

PART 5: WAY FORWARD

5.1 This PART explores the way forward for the development of SEs in Hong Kong. The following issues are discussed:

(a) problems encountered in the development of SEs (paras. 5.2 to 5.4);

(b) role of the SEAC (paras. 5.5 to 5.10);

(c) priority bidding for government service contracts (paras. 5.11 to 5.16);

(d) funding schemes of different B/Ds (paras. 5.17 to 5.31);

(e) developing a definition and regulatory framework for SEs (paras. 5.32 to 5.39); and

(f) accountability and performance management (paras. 5.40 to 5.43).

Problems encountered in the development of SEs

5.2 SEs have been developed in many advanced countries, notably the United Kingdom and the United States, to achieve social objectives through commercial operations. In Hong Kong, the SWD launched the 3E Project in 2001 to provide start-up capital for NGOs to establish SEs to create employment opportunities for PWDs. In 2006, the HAD launched the ESR Programme to provide start-up capital for SEs to create jobs for the socially disadvantaged. Following the re-organisation of the Government in July 2007, the HAB has taken up the SE portfolio with the support from the HAD. In January 2010, the SEAC was set up to advise the Government on the formulation of policies and strategies for supporting the sustainable development of SEs and on programmes/activities that promote the development of SEs in Hong Kong.

5.3 In recent years, LegCo has expressed concerns about the development of SEs in Hong Kong (see para. 1.11). In 2008, the LegCo Subcommittee to Study the Subject of Combating Poverty (see para. 1.12) conducted a study and reported that the development of SEs faced the following major problems:

(a) lack of policy support;

(b) lack of public understanding and a clear definition of SEs;

(c) lack of the relevant business entrepreneurship and professional knowledge;

(d) lack of an appropriate legal and regulatory framework; and

(e) difficulties in gaining access to finance.

The study report was forwarded to the Administration for consideration.

5.4 Since 2008, the HAB and the HAD have made progress in various areas in addressing these problems in promoting the development of SEs. In this review, Audit has taken stock of the Government's initiatives in addressing the aforesaid LegCo's concerns and identified the following issues which call for attention:

(a) regarding paragraph 5.3(a), there is a need to further strengthen the policy advice and support, and to take stock of the work of SE support platforms and different B/Ds in promoting the development of SEs. Details are discussed in paragraphs 5.5 to 5.31;

(b) regarding paragraph 5.3(b) to (d), Audit's examination of the Government's publicity and promotional work relating to the development of SEs has highlighted areas for improvement as discussed in PART 4. As far as the development of a clear definition and an appropriate legal and regulatory framework for SEs is concerned, there is a need to study the degree of public awareness of SEs and the development needs of SEs to keep the matter under regular review (see paras. 5.32 to 5.39); and

(c) regarding paragraph 5.3(e), Audit has identified areas for improvement in the 3E Project administered by the SWD (PART 2) and the ESR Programme administered by the HAD (PART 3). Audit also notes that there are a number of other funding schemes that help eligible SEs to gain access to finance. The challenge is how to create more synergy and value for money from these funding schemes operated by different B/Ds for different social/policy objectives. In this regard, accountability and performance measurement and reporting are issues of concern (see paras. 5.40 to 5.43).

Role of the Social Enterprise Advisory Committee

5.5 In January 2010, the HAB set up the SEAC to advise the Government on the development of SEs, with the following terms of reference:

(a) advising the Government on the formulation of policies and strategies for supporting the sustainable development of SEs in Hong Kong;

(b) advising the Government on programmes/activities that promote the development of SEs and monitor their implementation;

(c) fostering better understanding and encourage closer cooperation among relevant stakeholders in the development of SEs; and

(d) undertaking research studies on matters pertaining to the development of SEs.

5.6. The SEAC is chaired by the Secretary for Home Affairs and its members comprise SE practitioners, persons from the business and the academic sectors, and government representatives (from the HAB, the HAD, the Labour and Welfare Bureau and the Commerce and Economic Development Bureau).

5.7 Audit reviewed the activities of the SEAC from its inception in January 2010 to September 2013 and found that:

(a) up to early 2012, the SEAC was mainly involved in implementing a number of initiatives (i.e. the SE Award Scheme, the Friends of SE Campaign, the SE Bazaar and the SE Training Programme). These initiatives are important policy initiatives announced in the 2010-11 Policy Address;

(b) in 2012, the SEAC deliberated on the establishment of the Social Enterprise Development Fund (see para. 5.19); and

(c) in 2013, the SEAC was mainly involved in implementing a number of initiatives, i.e. the SE Award Scheme 2013, the SE Training Programme, a research study (see para. 5.36) to capture the existing landscape of SEs in Hong Kong, and measuring social impact of SEs.

5.8 Audit considers that it is now timely for the SEAC to advise the Government on the necessary updates on the strategies, programmes and activities for promoting the development of SEs in Hong Kong. In doing this, the SEAC needs to take into account the efforts made so far by various B/Ds and SE support organisations, the results of the research study, and relevant overseas experience.

Audit recommendation

5.9 **Audit has *recommended* that the Secretary for Home Affairs should consider taking measures to facilitate the SEAC to advise the Government on the necessary updates on the strategies, programmes and activities for promoting the development of SEs, taking into account the efforts made so far by the Government and SE support organisations, the results of the research study, and relevant overseas experience.**

Response from the Administration

5.10 The Secretary for Home Affairs agrees with the audit recommendation. He has said that the HAB:

(a) will continue to engage and facilitate the SEAC in advising the Government on the strategies, programmes and activities for promoting the sustainable development of SEs; and

(b) has already commissioned a study on the latest developments of SEs (see para. 5.36). The study will help the HAB and the SEAC in formulating the strategy for further support to the fast-growing SE sector in a holistic manner.

Priority bidding for government service contracts

5.11 In 2008, as a policy support to promote the development of SEs, the Government launched a pilot scheme for priority bidding of selected government service contracts by SEs. Under the pilot scheme, eligible SEs were first invited to bid for the selected contracts. Only when no suitable SEs were identified for the contracts would non-SE service providers be invited to bid. In administering the pilot scheme, the HAB provided the policy steer, while the HAD coordinated the implementation and compiled the lists of eligible SEs.

5.12 Three phases of the pilot scheme were rolled out, respectively in 2008, 2009 and 2011. For the three phases taken together, a total of 132 service contracts (comprising 120 cleaning contracts and 12 gardening contracts) were made available for biding by SEs. In the event, 75 contracts valued at $30 million were awarded to SEs, involving about 570 jobs. The HAD conducted a review for each phase of the pilot scheme. According to the reviews, participating B/Ds had no problems in implementing the scheme and contracted SEs complied well with the service requirements. As contracted SEs were mainly small establishments, they might not be able to cope with labour-intensive and multiple contracts. In some cases, the prices quoted by SEs were on the high side.

Cessation of the pilot scheme

5.13 After the July 2012 review, the HAB decided to discontinue the pilot scheme, taking into account the following:

(a) as pointed out by the FSTB, the scheme accorded preferential treatment to SEs (which should compete in the market) and was not in line with the Government's procurement principles of fairness and open competition. The scheme should be a transitional measure only for helping SEs establish themselves; and

(b) the scheme had achieved its mission by providing business opportunities to a considerable number of SEs and raised their competitiveness in the open market. Participating B/Ds had become familiar with SEs and had confidence in SEs' general capability in fulfilling contract requirements.

Way forward

In December 2012, the HAB informed B/Ds of the cessation of the pilot scheme and encouraged them to continue their support to promote the development of SEs by including SEs in their quotation invitation lists for procurement of stores and services.

5.14 LegCo has expressed concerns about the development of SEs in Hong Kong (see paras. 1.11 and 1.12) and has advocated policy support to enable the growth of SEs. All along, the HAB had reported to the LegCo Panel on Welfare Services on the implementation of the pilot scheme (e.g. in April 2011 and January 2012 when reporting the development of SEs). Audit noted that after the HAB discontinued the pilot scheme in July 2012, the Panel had not yet been informed of the event. Audit also considers that the HAB may review the need and feasibility of other forms of support to SEs in bidding government service contracts.

Audit recommendations

5.15 **Audit has *recommended* that the Secretary for Home Affairs should:**

(a) **consider reviewing the need and feasibility of providing other forms of support to SEs in bidding government service contracts, having regard to the Government's procurement principles of fairness and open competition; and**

(b) **inform the LegCo Panel on Welfare Services the outcome of the review in (a) above and the cessation of the trial scheme for priority bidding of government service contracts by SEs.**

Response from the Administration

5.16 The Secretary for Home Affairs agrees with the audit recommendations. He has said that the HAB will keep in view the suitable support measures to SEs and keep the LegCo Panel on Welfare Services informed.

Funding schemes of different bureaux and departments

5.17 The social objectives of SEs are wide-ranging, e.g. providing the services or products needed by the community, creating employment and training opportunities for the socially disadvantaged, and protecting the environment, etc. These social objectives may span across different programme areas of various B/Ds. The HAD's SE website listed four government funding schemes providing start-up funds for establishing SEs. The SEs created under each scheme targeted at specific social objectives (Table 10).

Table 10

Government funding schemes for setting up SEs

Responsible B/D	Funding scheme	Social objective	Programme area
SWD	3E Project	To enhance the employment of PWDs through market-driven approach and direct creation of more work opportunities	Rehabilitation and medical social services
HAD	ESR Programme	To promote sustainable poverty prevention and alleviation efforts at the district level that help enhance self-reliance, targeting socially disadvantaged groups	Community Building
Labour and Welfare Bureau	CIIF (Note)	To implement diversified social capital development projects in the community, promote reciprocity between the public and different sectors, and build together a cross-sectoral collaborative platform and mutual help network	Social welfare
Development Bureau	Revitalising Historic Buildings Through Partnership Scheme	To preserve and put historic buildings into unique cultural landmarks for good and innovative use with active public participation, and create job opportunities in particular at the district level	Heritage conservation

Source: Government websites

Note: Funding support under the CIIF is provided for social capital development projects which are not confined to setting up of SEs or SE projects.

Need for stocktaking outcomes of funding schemes

5.18 The social objectives of the SEs under the above funding schemes fall under the programme areas of different B/Ds. In formulating an overall strategy and policy for promoting the development of SEs, there is a need for the HAB and the HAD to take stock of how far various funding schemes may have contributed to the development of SEs, with a view to promoting best practices, identifying service gaps as well as creating synergies.

Other funding schemes for the development of SEs

5.19 Apart from the four schemes mentioned in paragraph 5.17, Audit notes that there are other government funding schemes supporting the setting up of SEs. In July 2012, the Chief Executive of the Hong Kong Special Administrative Region announced a plan to establish a Social Enterprise Development Fund to support the further development of SEs by seeking a funding of $500 million from the Lotteries Fund. Preparatory work was undertaken by the HAB for establishing this Fund. In December 2012, the Administration reconvened the CoP chaired by the Chief Secretary. The Social Enterprise Development Fund was renamed the Social Innovation and Entrepreneurship Development Fund (SIE Fund) and was subsumed under the CoP, with poverty alleviation as its key priority. Beneficiaries of the SIE Fund might cover, but not limited to, SEs. A Task Force was set up under the CoP to oversee the SIE Fund.

5.20 In February 2013, an information paper was prepared to brief the Task Force about the current landscape of the social entrepreneurship and social innovation space, as well as the existing funding schemes for supporting SEs. Regarding government funding schemes, the information paper mentioned a total of six funding schemes. Besides the four schemes listed on the SE website (see para. 5.17), the paper also mentioned two other government funding schemes, namely:

(a) ***Partnership Fund for the Disadvantaged.*** The Fund is administered by the SWD with the objective to incentivise the welfare sector to expand their network in seeking and securing corporate participation, and to encourage the business sector to take up more social responsibility for creating a cohesive, inclusive and caring society; and

(b) ***Environmental and Conservation Fund.*** The fund is administered by the Environment Bureau with the objective to fund educational, research and other projects and activities in relation to environmental and conservation matters.

5.21 Audit considers that these two funding schemes as well as the SIE Fund may also contribute to promoting the development of SEs. Again, there is a need for the HAB and the HAD to keep abreast of the progress made by these three funding schemes in formulating strategies and measuring outcome in promoting the development of SEs.

Creating synergies between the 3E Project and the ESR Programme

5.22 The 3E Project and the ESR Programme are the two major government funding schemes providing support for setting up SEs. The 3E Project was launched in 2001 for providing employment opportunities for PWDs. The ESR Programme was launched in 2006 on the CoP's recommendation. In 2005, when deliberating the proposal to set up the ESR Programme, the CoP made reference to the 3E Project which had already been in operation. To strengthen district-based poverty alleviation work and help disadvantaged groups gain self-reliance, the CoP recommended the setting up of another funding scheme for providing employment opportunities for "disadvantaged groups other than the disabled". In 2006, the HAD launched the ESR Programme on the CoP's recommendation.

5.23 Audit noted that, in implementing the ESR Programme, the HAD had not clearly defined the target groups of the socially disadvantaged for support under the Programme (see para. 3.46). Moreover, the HAD had included PWDs as one of the target groups under the ESR Programme (see Note 18 to para. 3.46). As such, NGOs interested in setting up SEs for providing employment opportunities for PWDs might choose between the 3E Project and the ESR Programme.

5.24 When the ESR Programme was launched in 2006, the terms and conditions of the Programme were modelled on those of the 3E Project. The two schemes currently still share many common features. They, however, differ in the following two key parameters that appear to make the ESR Programme more appealing to applicants:

(a) the maximum grant under the ESR Programme is $3 million, which is 50% more than the maximum grant of $2 million under the 3E Project; and

(b) SEs funded under the 3E Project are required to employ PWDs of at least 50% of the total workforce. There is no such restriction under the ESR Programme for employing a minimum proportion of any specific target groups of socially disadvantaged people.

5.25 The SWD has all along relied on rehab-NGOs as the primary source of applications under the 3E Project (see para. 2.28). Audit noted that, since the launch of the ESR Programme, many rehab-NGOs have also submitted applications under the Programme to set up SEs for providing employment opportunities to the socially disadvantaged, including PWDs. As at September 2013, among the 35 rehab-NGOs, 15 had submitted 22 applications under the ESR Programme. A total of 13 applications (from 10 rehab-NGOs) were eventually approved. This trend of rehab-NGOs setting up SEs under the ESR Programme for creating PWD jobs has adversely affected the progress of implementing the 3E Project (see paras. 2.26 to 2.29).

5.26 Audit noted that the HAD and the SWD had not discussed, in the light of their operational experiences in recent years, the need for further delineating the ambit, target groups, and terms and conditions of the two funding schemes. There is a need for a review to address this issue. Moreover, as the two schemes share many common features, the opportunity should be taken to identify any synergistic effects between the schemes to improve their future operations.

Audit recommendations

5.27 **Audit has *recommended* that the Secretary for Home Affairs and the Director of Home Affairs should periodically take stock of the progress and outcome of the efforts made by relevant B/Ds that may contribute to the development of SEs, in particular their funding schemes for setting up SEs, with a view to promoting best practices, identifying service gaps as well as creating synergies.**

5.28 **Audit has also *recommended* that the Director of Home Affairs and the Director of Social Welfare should jointly review the ESR Programme and the 3E Project, covering their ambit, target groups, and terms and conditions, with a view to identifying any synergistic effects between the two funding schemes to improve their future operations.**

Response from the Administration

5.29 The Secretary for Home Affairs agrees with the audit recommendation in paragraph 5.27. He has said that the HAB has been stocktaking the various government initiatives that could benefit SEs and make available such information on the SE website and in the HAB's reports to LegCo. The HAB will continue to engage SEs, stakeholders and B/Ds with a view to creating partnership and synergies.

5.30 The Director of Home Affairs agrees with the audit recommendation in paragraph 5.28. She has said that:

(a) the two funding schemes with their own objectives are to help their target groups in different contexts. The 3E Project is to provide employment opportunities for PWDs, while the ESR Programme aims to alleviate poverty at the district level and create employment opportunities for the underprivileged to enhance their self-reliance through the setup of SEs;

(b) the 3E Project has a requirement of employing PWDs of at least 50% of the workforce. However, some SE proposals may only be viable with a mix of target groups and cannot meet the said 50% requirement. The inclusion of PWDs as one of the target groups of the ESR Programme would enable the Government to provide a funding source for deserving SE proposals with less than 50% of workforce for PWDs. Otherwise, such SE proposals would be deprived of the opportunity to start and provide employment opportunities for PWDs;

(c) at present, the HAD will advise an applicant to apply for the 3E Project in case its proposal is more for the rehabilitation of PWDs; and

(d) the HAD will work with the SWD to identify synergistic effects between the two funding schemes to improve their operations.

5.31 The Director of Social Welfare agrees with the audit recommendation in paragraph 5.28. She has said that the SWD will liaise with the HAD for a joint review on the issues raised by Audit with a view to identifying any synergistic effects between the two funding schemes to improve their future operations.

Developing a definition and regulatory framework for SEs

5.32 As the Government has been appealing for public support for SEs, members of the public might have the impression that there is a clear definition of SEs and a well-defined list of SEs for ready identification of genuine SEs.

5.33 However, the HAB and the HAD have stated that there is no universal definition of SEs and referred to an SE as a business aiming to achieve certain social objectives and its profits are principally reinvested into the business (see para. 1.2). On its SE website, the HAD provides an SE directory (see para. 4.18) in the form of a list of "Hot spots for consumption at SEs in Hong Kong". This directory contains only those SEs supported by government funding schemes and those SEs operated by a few major NGOs, with a total number of 170. The SE website also provides a link to the SE directory compiled by the SEBC (see para. 4.19). This directory contains information about some 440 SEs that have made applications for listing as SEs in the directory.

5.34 For the provision of public funding to individual SEs, the Government has adopted a stricter definition of SEs, as reflected by the eligibility criteria of the 3E Project (see para. 2.7) and the ESR Programme (see para. 3.4). On the other hand, according to the HAB, the Government's intention was not to unilaterally set a strict definition and a definitive list of SEs which would limit the development of the SE sector at its early stage. This was particularly important given the diversity of SEs (in respect of their trades, business scales, development stages and operation modes). Instead, the Government has encouraged and supported sector-led initiatives to enhance public understanding of SEs.

5.35 With the rapid development of SEs locally and overseas, there have been concerns about providing a clear definition of SEs from the SE sector and LegCo (see para. 5.3(b)). Members of the SEAC have also raised such concerns, and have discussed the following:

(a) the need for a general definition (like the one mentioned in para. 5.33) for guiding the Government's sector-wide promotional support; and

(b) the need for a refined definition for guiding the provision of public resources to individual SEs. When deliberating on the establishment of the Social Enterprise Development Fund (see para. 5.19), the SEAC has discussed a refined definition of SEs, i.e. an SE is a business targeted to achieve specific social objectives through entrepreneurial strategies and self-sustaining operations, and not less than 70% of its distributable profits are reinvested in the business for the social objectives that it pursues.

5.36 Audit considers that, for the long-term sustainable development of SEs, there is merit for the Government to adopt a more refined definition of SEs for formulating support strategies and programmes, and for providing a clear identity to SEs to enhance public understanding and acceptance. In this connection, Audit noted that, in April 2013, the HAB commissioned a research study to capture the existing landscape of SEs in Hong Kong with the objectives to:

(a) outline the current situations of local SEs;

(b) ascertain the public perception of SEs; and

(c) identify the best practices and innovative approaches in running an SE.

5.37 The research study was scheduled for completion in April 2014. This study was intended to capture useful information about the current landscape of SEs in Hong Kong. The HAB may take the opportunity to capitalise on the findings of this research study to assess the need for a more refined definition of SEs. This will facilitate the community to discuss, in a more focused manner, whether an appropriate legal and regulatory framework (see para. 5.3(d)) should be developed for the long-term sustainable development of SEs in Hong Kong.

Audit recommendation

5.38 **Audit has *recommended* that the Secretary for Home Affairs should, in consultation with the SEAC, keep in view the need to formulate a more refined definition and an official list of SEs for promoting the long-term sustainable development of SEs, taking into account the findings of the research study to be completed in April 2014.**

Response from the Administration

5.39 The Secretary for Home Affairs agrees with the audit recommendation. He has said that:

(a) the HAB has been adopting various approaches in developing the SE sector. For example, the HAB organises the SE Award Scheme (to promote public awareness of SEs and give due recognition to outstanding SEs) and funds various industry-led initiatives such as the Ethical Consumption Month (to support caring consumption by encouraging the public to patronise SE products and services). For these SE initiatives, the HAB does not need a strict definition to make them successful;

(b) for the HAD's ESR Programme, SEs have to meet eligibility criteria to ensure the transparency and accountability in the use of public funds;

(c) in formulating new initiatives involving public resources to support individual SEs, the SEAC has endorsed a working definition for SEs (see para. 5.35(b)). This has guided the HAB in further deliberations of measures that will support individual SEs, recognising the need to support for-profit SEs; and

(d) nevertheless, the HAB agrees that there is a need to keep in view the case for adopting a more refined definition of SE. The HAB will continue to support the SEBC's efforts in publishing its directory, which is widely used as the SE directory in the industry.

Accountability and performance management

5.40 The HAB and the HAD are responsible for promoting the development of SEs under the programme areas of "Social Harmony and Civic Education" and "Community Building" respectively. According to its COR, the responsibilities of the HAB are to promote the understanding of SEs among members of the public, and foster partnership between the community, the business sector and the Government in promoting the development of SEs. In the HAD's COR, it was stated that the Department had been administering the ESR Programme since June 2006 to promote sustainable poverty prevention and alleviation efforts that helped enhance self-reliance at the district level, targeting socially disadvantaged groups.

5.41 Audit noted that, besides these descriptions, there was little information on the performance of the HAB and the HAD in promoting the development of SEs. There were no performance targets and indicators for measuring and reporting the progress made on the development of SEs. Audit considers that there is a need for the HAB and HAD to develop more useful performance targets and indicators for publishing in their CORs in this policy area. In this connection, there is a need to consolidate relevant information from other B/Ds the activities of which are also related to the development of SEs, e.g. the SWD (the 3E Project) and the Labour and Welfare Bureau (the CIIF).

Audit recommendation

5.42 **Audit has *recommended* that the Secretary for Home Affairs and the Director of Home Affairs should develop more useful performance targets and indicators for measuring and reporting the progress made on promoting the development of SEs, and publish them in the CORs.**

Response from the Administration

5.43 The Secretary for Home Affairs and the Director of Home Affairs agrees with the audit recommendation.

Appendix A
(para. 2.25 refers)

Years in operation of approved projects under the 3E Project (30 September 2013)

Years in operation	Terminated projects (a) (No.)	Operating projects (b) (No.)	Total (c) = (a) + (b) (No.)	
< 1	0 (0%)	9 (16%)	9 (11%)	
1 to < 2	0 (0%)	3 (5%)	3 (4%)	
2 to < 3	7 (29%)	7 (12%)	14 (17%)	
3 to < 4	5 (21%)	4 (7%)	9 (11%)	
4 to < 5	3 (13%)	4 (7%)	7 (9%)	
5 to < 6	5 (21%)	2 (4%)	7 (9%)	
6 to < 7	3 (13%)	3 (5%)	6 (7%)	
7 to < 8	0 (0%)	4 (7%)	4 (5%)	
8 to < 9	0 (0%)	5 (8%)	5 (6%)	
9 to < 10	0 (0%)	8 (14%)	8 (10%)	26 (32%)
10 to < 11	1 (3%)	2 (4%)	3 (4%)	
11 to < 12	0 (0%)	6 (11%)	6 (7%)	
Total	24 (100%)	57 (100%)	81 (100%)	

Source: Audit analysis of SWD records

Appendix B
(para. 3.35 refers)

Years in operation of approved projects under the ESR Programme (30 September 2013)

Years in operation	Terminated projects (a) (No.)	Operating projects (b) (No.)	Total (c) = (a) + (b) (No.)	
< 1	0 (0%)	21 (18%)	21 (14%)	
1 to < 2	0 (0%)	19 (16%)	19 (13%)	
2 to < 3	12 (48%)	9 (7%)	21 (14%)	
3 to < 4	7 (28%)	11 (9%)	18 (13%)	
4 to < 5	4 (16%)	13 (11%)	17 (12%)	
5 to < 6	1 (4%)	19 (16%)	20 (14%)	49 (34%)
6 to < 7	1 (4%)	28 (23%)	29 (20%)	
Total	25 (100%)	120 (100%)	145 (100%)	

Source: Audit analysis of HAD records

Acronyms and abbreviations

Audit	Audit Commission
B/Ds	Bureaux/departments
CIIF	Community Investment and Inclusion Fund
CoP	Commission on Poverty
COR	Controlling Officer's Report
FC	Finance Committee
FSTB	Financial Services and the Treasury Bureau
HA	Hospital Authority
HAB	Home Affairs Bureau
HAD	Home Affairs Department
LegCo	Legislative Council
NGOs	Non-governmental organisations
PWDs	Persons with disabilities
SE	Social Enterprise
SEAC	Social Enterprise Advisory Committee
SEBC	Social Enterprise Business Centre
SIE Fund	Social Innovation and Entrepreneurship Development Fund
SWD	Social Welfare Department

CHAPTER 8

Civil Service Bureau
Education Bureau
Correctional Services Department
Food and Environmental Hygiene Department
Leisure and Cultural Services Department

Recruitment of staff

Audit Commission
Hong Kong
4 April 2014

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. 62 of the Director of Audit contains 8 Chapters which are available on our website at http://www.aud.gov.hk

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RECRUITMENT OF STAFF

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RECRUITMENT OF STAFF

Executive Summary

1. As at 31 March 2013, the civil service had a strength of some 162,000 staff. Bureaux/departments (B/Ds) normally fill civil service vacancies at basic ranks by recruitment. The Civil Service Bureau (CSB), in addition to recruiting staff for 14 general civil service grades under its direct control, is responsible for setting service-wide recruitment policies and providing B/Ds with guidelines. In recruiting senior rank civil servants under the Public Service Commission (PSC)'s purview, B/Ds are required to seek its advice. During 2011-12 and 2012-13, 9,784 and 9,595 civil service appointments were made. The Audit Commission (Audit) has recently conducted a review of the staff recruitment work of the CSB and four B/Ds (namely the Correctional Services Department (CSD), Education Bureau (EDB), Food and Environmental Hygiene Department (FEHD), and Leisure and Cultural Services Department (LCSD)), and has found room for improvement in a number of areas.

Open recruitment of civil servants

2. According to the Government's civil service recruitment policy, B/Ds should normally conduct open recruitment to cast the widest net for candidates. For 2010-11 and 2011-12, a total of 343 open recruitment exercises were conducted (paras. 2.2 and 2.4).

3. ***Shortening the recruitment process.*** Prior to 2007, an open recruitment exercise could span for three to nine months. After the introduction of streamlining measures for the recruitment of civil servants between 2007 and 2009, the PSC reported that the recruitment process was shortened by about two months. In 96% of the open recruitment exercises under its purview in 2009, the PSC found that the recruitment board report was submitted for its advice within two to seven months. However, Audit analysis of the open recruitment exercises conducted by B/Ds in 2010-11 and 2011-12 revealed that there was still room for improvement. For example, 21% of the 77 exercises within the PSC's purview in 2010-11 and 20% of the 74 exercises in 2011-12 took over eight months before offers of appointment were made (paras. 2.3 to 2.5).

4. Audit examination of 50 open recruitment exercises conducted by the CSB, CSD, EDB, FEHD and LCSD between 2010-11 and 2012-13 revealed that the CSD took a very long time of 356 to 714 days to complete 10 small-scale exercises. For 17 exercises (including the 10 small-scale exercises), the recruiting B/Ds had not followed the CSB guidelines to draw up recruitment schedules for monitoring the progress of these exercises. Moreover, the CSB did not have an established mechanism to collect information on recruitment exercises conducted by B/Ds and monitor their completion time. A lengthy recruitment process can put the Government in a disadvantageous position in competing with the private sector for talents. It can also result in higher recruitment costs and delays in filling vacancies. The recruiting B/Ds and CSB need to enhance their monitoring work (paras. 2.6, 2.8 and 2.13 to 2.15).

5. ***Publicising recruitment exercises.*** The CSB has not provided B/Ds with guidelines on the period for submitting applications or the use of e-mail for communicating with candidates. For the 50 open recruitment exercises (see para. 4 above), the application period ranged from 11 to 28 days and e-mail was not used in 43 exercises. Providing B/Ds with guidelines would be useful for ensuring that they do not lengthen the application period beyond the norm without good reasons and make appropriate use of e-mail to enhance efficiency and cost-effectiveness (paras. 2.26 and 2.27).

6. ***Vetting applications.*** Of the total of 258,400 candidates in the 50 open recruitment exercises, 43% were found not meeting the entry requirements stated in the recruitment advertisements. The situation was unsatisfactory as significant time and resources were wasted in processing their applications. The CSB needs to review exercises having a high percentage of unqualified candidates together with the B/Ds concerned and implement effective measures to address the issue (para. 2.33).

7. ***Holding skill tests/examinations and conducting selection interiews.*** Skill tests/examinations were held in 34 of the 50 open recruitment exercises. Audit found cases where candidates were given notice shorter than the period of two weeks required by the CSB guidelines or not given the same notice period. The CSB needs to remind B/Ds to give sufficient and uniform advance notice. In 7 of the 50 open recruitment exercises, group interviews were conducted. Further CSB guidelines on how to make the best use of group interviews in the recruitment process would be useful to B/Ds (paras. 2.38 and 2.40).

In-service recruitment of civil servants

8. An in-service recruitment exercise is restricted to serving civil servants. According to the Government's civil service recruitment policy, B/Ds would conduct in-service recruitment only when there are special reasons (e.g. the required skills can be met by serving officers in other civil service grades with potential surplus staff) (para. 1.4).

9. ***In-service recruitment of controlled grade staff.*** The CSB maintains control on the open recruitment for controlled grades (e.g. those with surplus staff or under institutional review). According to a CSB Circular Memorandum of 2007, for these controlled grades, B/Ds may conduct in-service recruitment to fill vacancies as they consider necessary or apply for the CSB's approval to conduct open recruitment in justifiable circumstances. However, Audit found the following issues relating to the in-service recruitment of staff in controlled grades (notably Workman I and Workman II): (a) between 2010-11 and 2012-13, the EDB, FEHD and LCSD conducted a total of nine in-service recruitment exercises for Workman I/Workman II to fill vacancies. Due to the reduced pool of candidates and high decline rates, the three B/Ds failed to recruit sufficient staff. As at 31 March 2013, they had a total of 435 Workman I and 497 Workman II vacancies; (b) where an appointee did not come from a civil service grade with surplus staff, there was still a need to fill the vacancy left by the appointee on in-service transfer. Consequently, the civil service vacancies would not be reduced and the B/D concerned would need to conduct a recruitment exercise to fill the vacancy. The competition for candidates among B/Ds continued, resulting in ineffective use of government resources and higher staff turnover; and (c) the operations of a B/D would be adversely affected when a large number of its staff were transferred out to other B/Ds because it is restricted under the Civil Service Regulations from filling the posts vacated by such staff during their trial period (usually one year) in the recruiting B/Ds (paras. 3.6, 3.7, 3.9 and 3.14 to 3.20).

10. ***In-service recruitment of other civil servants.*** For grades other than the controlled grades, B/Ds should normally conduct open recruitment to fill vacancies. However, between 2010-11 and 2012-13, the CSD conducted a total of 12 in-service recruitment exercises for grades other than the controlled grades. For four of these exercises, the CSD received only a small number of applications and failed to recruit the target number of officers. The CSB needs to regularly remind B/Ds that open recruitment is the norm for filling civil service vacancies (paras. 3.26 to 3.28).

Recruitment of non-civil service staff

11. In addition to civil servants, B/Ds may employ non-civil service staff, including non-civil service contract (NCSC) staff, to meet service needs. As at 30 June 2013, there were 14,759 full-time non-civil service staff, representing roughly 9% of the civil service strength. The appointments of such staff are separate from the system for making civil service appointments. In general, the norm for recruiting such staff is open recruitment (paras. 1.7 and 4.2 to 4.4).

12. ***Using online job application system.*** The CSB has implemented a job application system to allow candidates to complete and submit application forms online. B/Ds may use the system in conducting open recruitment exercises for civil servants or non-civil service staff. However, Audit examination of 80 recruitment advertisements for NCSC staff revealed that online applications were accepted for only 18 (23%) exercises (para. 4.6).

13. ***LCSD's open recruitment of NCSC staff.*** NCSC staff may be used where the mode of service delivery is under review. The LCSD has employed Music Officers, Stage Management Officers and Stage Technicians on NCSC terms for some 14 years and has taken a long time to review these NCSC positions. Due to high turnover, the LCSD had conducted frequent exercises for recruiting these staff. The LCSD needs to closely monitor the staff turnover of the NCSC positions and agree/finalise with the CSB on the way forward for the positions at an early date (paras. 4.9 to 4.11).

Way forward

14. To fill vacancies arising from wastage and creation of posts in a timely manner, B/Ds need to continue to strive to conduct necessary recruitment exercises effectively and efficiently. The CSB also needs to work with B/Ds in refining and streamlining the recruitment process (paras. 1.6 and 5.5).

Audit recommendations

15. **Audit recommendations are made in the respective sections of this Audit Report. Only the key ones are highlighted in this Executive Summary.**

Audit has *recommended* that the Secretary for the Civil Service should:

(a) **remind B/Ds to draw up recruitment schedules and closely monitor the progress of their open recruitment exercises (para. 2.17(b));**

(b) **monitor and conduct regular analyses of the time taken by B/Ds to complete open recruitment exercises (para. 2.17(c));**

(c) **provide B/Ds with appropriate guidelines on the period allowed for submitting applications and the use of e-mail for communicating with candidates (para. 2.29(a) and (b));**

(d) **review open recruitment exercises having a high percentage of unqualified candidates together with the B/Ds concerned and implement effective measures to address the issue (para. 2.36(a));**

(e) **remind B/Ds to give sufficient and uniform advance notice of a skill test/examination to all candidates (para. 2.41(a));**

(f) **provide B/Ds with further guidelines on conducting group interviews in the recruitment process (para. 2.41(c));**

(g) **review the issues relating to the in-service recruitment of controlled grade staff identified by Audit and improve the recruitment arrangements for the controlled grades (para. 3.24(a) and (b));**

(h) **regularly remind B/Ds that in-service recruitment should only be conducted under special justifiable circumstances (para. 3.29(a));**

(i) **take appropriate measures to facilitate B/Ds' use of the CSB's job application system in conducting recruitment exercises for NCSC staff to enhance efficiency (para. 4.13(b)); and**

(j) **work with the PSC to keep a closer monitoring of the recruitment efforts among the B/Ds and review the controlled grade arrangements (para. 5.5(a) and (c)).**

16. **Audit has also *recommended* that:**

(a) **the Commissioner of Correctional Services should:**

(i) **continue to work on streamlining the recruitment procedures through a comprehensive review of the overall recruitment processes (para. 2.19); and**

(ii) **recruit staff through open recruitment as a norm and conduct in-service recruitment only under special justifiable circumstances (para. 3.30(a)); and**

(b) **the Director of Leisure and Cultural Services should closely monitor the staff turnover of the NCSC positions of Music Officers, Stage Management Officers and Stage Technicians, and agree/finalise with the CSB on the way forward for the positions at an early date (para. 4.15(a)).**

Response from the Administration

17. The Administration agrees with the audit recommendations.

PART 1: INTRODUCTION

1.1 This PART describes the background to the audit and outlines the audit objectives and scope.

Recruitment of civil servants

1.2 ***Civil service establishment and vacancies.*** The civil service divides its establishment into different grades. Each grade normally comprises basic and higher ranks according to job levels (Note 1). The establishment of a bureau/department (B/D) is the number of approved posts in specific ranks to which appointments may be made (Note 2). From time to time, civil service vacancies arise from wastage and creation of posts. Vacancies at the basic ranks are normally filled by recruitment. Table 1 shows an analysis of the vacancies of the civil service as at 31 March 2013.

Note 1: *For example, the Clerical Officer grade is sub-divided into the Assistant Clerical Officer, Clerical Officer and Senior Clerical Officer ranks. On the other hand, there are some grades that have one rank only, such as the Workman I grade. As at July 2013, there were 526 grades and 1,430 ranks in total.*

Note 2: *The Finance Committee of the Legislative Council has delegated certain powers relating to the creation of posts to the Financial Secretary, who has further delegated his powers to Controlling Officers subject to stipulated conditions.*

Table 1

Establishment, strength and vacancies of the civil service
(31 March 2013)

B/D	Establishment (a) (No.)	Strength (b) (No.)	Vacancies (c) = (a) − (b) (No.)	Vacancy rate (d) = $\frac{(c)}{(a)} \times 100\%$
Top three B/Ds in terms of number of vacancies				
Food and Environmental Hygiene Department	11,142	10,073	1,069	9.6%
Leisure and Cultural Services Department	8,731	8,202	529	6.1%
Education Bureau	5,447	4,923	524	9.6%
Other B/Ds				
71 other B/Ds	143,274	138,996	4,278	3.0%
Service-wide	168,594	162,194	6,400	3.8%

Source: Audit analysis of Civil Service Bureau records

Remarks: If judges and judicial officers, Independent Commission Against Corruption officers and locally engaged staff working in Hong Kong Economic and Trade Offices are excluded, the establishment, strength, vacancies and vacancy rate of the civil service were 166,903, 160,663, 6,240 and 3.7% respectively as at 31 March 2013.

1.3 ***Responsibilities for civil service recruitment.*** Civil service grades are classified under three categories, as follows:

(a) ***General grades.*** A general grade is a grade common to B/Ds and controlled by a central authority (e.g. the Executive Officer grade is controlled by the Civil Service Bureau (CSB) and the Accounting Officer grade is controlled by the Treasury). The central authority is responsible for recruiting staff and deploying them to B/Ds;

(b) ***Common grades.*** A common grade is a grade employed in different B/Ds but controlled by the individual B/Ds (e.g. Workman I and Workman II grades). Each B/D is responsible for recruiting its own staff in a common grade; and

(c) ***Departmental grades.*** A departmental grade is a unique grade employed in one B/D only and controlled by the B/D (e.g. Assessor grade of the Inland Revenue Department and Printing Officer grade of the Government Logistics Department). Each B/D is responsible for recruiting its departmental grade staff.

1.4 ***Types of civil service recruitment.*** There are two types of civil service recruitment:

(a) ***Open recruitment.*** It is open to candidates both outside and within the civil service; and

(b) ***In-service recruitment.*** It is restricted to all or selected groups of serving civil servants.

According to the Government's civil service recruitment policy, the guiding principle on civil service recruitment is to select qualified and suitable persons through an open, fair and competitive process. B/Ds should normally conduct open recruitment to cast the widest net for candidates. They would conduct in-service recruitment only when there are special reasons. For example, in cases where the skills, experience or expertise required can be met by serving officers in other civil service grades with potential surplus staff, in-service recruitment may be preferred for the benefit of the overall manpower planning of the civil service.

1.5 ***Civil service recruitment statistics.*** Table 2 shows the civil service appointments made during 2010-11 to 2012-13. Except for 14 grades which are directly controlled by the CSB (Note 3), the CSB is not involved in recruitment of staff. B/Ds are responsible for conducting their recruitment exercises in accordance with the CSB guidelines. While the CSB has monitored the civil service vacancy position to assess whether vacancies are filled in a timely manner, it has not specifically collected information on the time taken by B/Ds in completing recruitment exercises for analysis on a routine basis. In connection with its study on the attractiveness of civil service jobs, the CSB collected information on recruitment exercises conducted in 2010-11 and 2011-12. For the two years, a total of 472 recruitment exercises were conducted and 912,102 applications were processed (i.e. averaging 236 exercises and 456,051 applications a year).

Table 2

Civil service appointments
(2010-11 to 2012-13)

	2010-11	2011-12	2012-13
Appointment of persons who were not serving officers	5,465	7,877	7,316
Appointment of in-service transferees who have participated in open or in-service recruitment exercises	1,452	1,614	1,949
Re-employment after retirement	299	293	330
Total	7,216	9,784	9,595

Source: *CSB records*

Remarks: *The above figures as compiled by the CSB do not include judges and judicial officers, Independent Commission Against Corruption officers and locally engaged staff working in Hong Kong Economic and Trade Offices.*

Note 3: *The 14 grades comprise Administrative Officer, Executive Officer, Official Languages Officer, Simultaneous Interpreter, Calligraphist, Training Officer, Clerical Officer and seven other clerical and secretarial grades.*

1.6 According to the CSB, as the civil service grew significantly in the 1980s and many of the civil servants then recruited are approaching retirement age, the number of civil servants retiring will continue to increase in the coming years. From 2013-14 to 2017-18, it is estimated that on average around 6,000 civil servants will retire every year. From 2018-19 to 2022-23, the number will increase to around 7,000 a year. B/Ds need to continue to strive to conduct necessary recruitment exercises effectively and efficiently.

Recruitment of non-civil service staff

1.7 B/Ds may, subject to the specified conditions and availability of funding, employ non-civil service staff to meet various service needs (e.g. short-term service needs). Non-civil service staff do not occupy posts on the establishment of the B/Ds and are not counted towards the establishment or strength of the B/Ds. Their appointments are separate and distinct from the system for making civil service appointments. B/Ds are required to draw up appropriate procedures for the recruitment of non-civil service staff. As at 30 June 2013, there were 14,759 full-time non-civil service staff, representing roughly 9% of the civil service strength.

Role of CSB

1.8 The CSB is responsible for the management and development of the civil service. Regarding civil service recruitment, the CSB is responsible for setting service-wide recruitment policies, administering the relevant provisions of the Civil Service Regulations (CSRs — Note 4) and providing guidance to B/Ds. In this regard, the CSB has produced a Guidebook on Appointments as a handy reference by B/Ds. The Guidebook is essentially a digest of the rules and regulations promulgated in the CSRs, CSB Circulars, CSB Circular Memoranda and other guidelines issued by the CSB on individual areas. Besides, the CSB is the appointment authority for 14 general grades (see para. 1.5) and thus responsible for recruiting staff for these grades. As regards non-civil service staff, the CSB is responsible for providing recruitment guidelines to B/Ds.

Note 4: *The CSRs are administrative regulations made by or with the authority of the Chief Executive. They set out, among others, the provisions on recruitment of civil servants. The Secretary for the Civil Service is authorised to amend, supplement, apply, interpret and make exceptions to the CSRs. The Secretary may issue CSB Circulars and Circular Memoranda to supplement the CSRs.*

Public Service Commission

1.9 The Public Service Commission (PSC), established under the Public Service Commission Ordinance (Cap. 93), is an independent body responsible for advising the Chief Executive of the Hong Kong Special Administrative Region on civil service appointment, promotion and disciplinary matters to ensure impartiality, integrity and fairness. In recruiting civil servants in ranks under the purview of the PSC (Note 5), B/Ds are required to seek the PSC's advice mainly on:

(a) the proposed adoption of shortlisting criteria for selecting candidates to be interviewed, if any;

(b) the proposed offers of appointment to selected candidates; and

(c) any proposed deviations from the established appointment rules, procedures and practices.

In examining submissions from B/Ds, the PSC may make queries and observations where necessary. B/Ds are required to clarify or justify their proposals in response to such queries and observations. In the event that a recruiting B/D wishes not to act according to the PSC's advice, it is required to make a submission to the Chief Executive after seeking the CSB's advice.

Audit review

1.10 The Audit Commission (Audit) has recently conducted a review of the staff recruitment work of the CSB and four selected B/Ds with a view to identifying room for improvement. The four selected B/Ds are the Correctional Services Department (CSD), Education Bureau (EDB), Food and Environmental Hygiene

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Note 5: *The PSC's advice on recruitment matters basically relates only to the senior ranks of the civil service (i.e. ranks attracting a maximum monthly salary not less than the amount specified at Master Pay Scale Point 26 or equivalent, but excluding: (a) the basic ranks of non-degree entry and non-professional grades; and (b) the judicial service, the Independent Commission Against Corruption and the disciplined ranks of the Hong Kong Police Force). According to the PSC 2012 Annual Report, about 39,000 civil service posts (23% of the total) were under the PSC's purview.*

Department (FEHD), and Leisure and Cultural Services Department (LCSD) (Note 6). The review has focused on the following areas:

(a) open recruitment of civil servants (PART 2);

(b) in-service recruitment of civil servants (PART 3);

(c) recruitment of non-civil service staff (PART 4); and

(d) way forward (PART 5).

Audit has found room for improvement in the above areas and has made recommendations to address the issues.

Acknowledgement

1.11 Audit would like to acknowledge with gratitude the full cooperation of the staff of the CSB, CSD, EDB, FEHD and LCSD during the course of the audit review.

Note 6: *Based on CSB records, these four B/Ds were selected for audit examination because the CSD had taken a long time to complete some of its recruitment exercises and the other three B/Ds had the largest number of vacancies (see Table 1 in para. 1.2).*

PART 2: OPEN RECRUITMENT OF CIVIL SERVANTS

2.1 This PART examines the following issues relating to the open recruitment of civil servants:

(a) shortening the recruitment process (paras. 2.3 to 2.25);

(b) publicising recruitment exercises (paras. 2.26 to 2.32);

(c) vetting applications and shortlisting candidates (paras. 2.33 to 2.37);

(d) holding skill tests/examinations and conducting selection interviews (paras. 2.38 to 2.46); and

(e) making offers of appointment (paras. 2.47 to 2.49).

Key processes in open recruitment

2.2 As mentioned in paragraph 1.4, B/Ds should normally conduct open recruitment of civil servants. The key processes in an open recruitment exercise are summarised as follows:

(a) ***Publicising recruitment exercise.*** The recruiting B/D publicises a recruitment exercise by various means (e.g. posting recruitment information on the CSB's website, placing advertisements in newspapers and journals, issuing a vacancy circular to serving civil servants, and using the employment services of the Labour Department and local tertiary institutions). Acknowledgments are issued upon the receipt of applications;

(b) ***Vetting applications and shortlisting candidates.*** The recruiting B/D vets the applications received to identify qualified candidates meeting the entry requirements. If there is a large number of qualified candidates, the recruiting B/D may use shortlisting criteria to reduce the number of candidates to be interviewed. Where the rank involved falls under the purview of the PSC (see para. 1.9), the recruiting B/D is required to seek the PSC's advice on the adoption of shortlisting criteria;

(c) ***Holding skill tests/examinations.*** The recruiting B/D may hold a skill test/examination to screen out unqualified candidates (i.e. specifying that a "pass" is a prerequisite for appointment), or as a criterion for shortlisting candidates for selection interviews;

(d) ***Conducting selection interviews.*** The recruiting B/D forms a recruitment board to conduct interviews of the candidates. The assessment form for evaluating the performance and qualities of each candidate and selecting those suitable for appointment should be agreed by the recruitment board and approved by the appointment authority prior to the interviews;

(e) ***Compiling recruitment board report.*** Having regard to the timing of the availability of vacancies, number of vacancies and merits of individual candidates, the recruitment board selects candidates for immediate appointment or waitlisting for future appointment and decides on the candidates to be rejected. The board compiles and submits a report to the appointment authority (Note 7) for consideration. Where the rank involved falls under the PSC's purview, the appointment authority is required to submit the report to the PSC for advice (Note 8); and

(f) ***Arranging recruitment formalities and making offers of appointment.*** Before making an offer to a candidate, the recruiting B/D needs to arrange relevant recruitment formalities (e.g. employer reference and medical examination). A conditional offer may be made prior to completing certain formalities such as medical examination.

Note 7: *The Chief Executive has delegated his powers to appoint holders of public offices to various public officers, depending on the level of the posts. For example, Heads of Department have delegated powers to appoint posts below Directorate Pay Point 2 or equivalent level.*

Note 8: *According to its Annual Reports for 2011 and 2012, the PSC achieved its target of tendering advice within four weeks upon receipt of a submission for each recruitment case handled in 2011 and 2012.*

Shortening the recruitment process

Streamlining measures introduced between 2007 and 2009

2.3 The PSC recommended/introduced/required a number of streamlining measures for the recruitment of civil servants in 2007, 2008 and 2009 as described in the PSC's Annual Reports:

(a) prior to December 2007, an open recruitment exercise could span from three to nine months (Note 9). The PSC was concerned that a lengthy recruitment process could put the Government in a disadvantageous position in competing with the private sector for talents;

(b) in December 2007, after a joint review by the PSC and CSB, certain streamlining measures were introduced, including that B/Ds were no longer required to submit the following for the PSC's advice:

(i) vacancy circulars and recruitment advertisements;

(ii) results of sorting applications into qualified and unqualified ones; and

(iii) selection arrangements, including the assessment form to be used in selection interviews, the selection format and interview arrangements.

Of the 97 open recruitment exercises processed by the PSC in 2008, 95% (i.e. 92 cases) were completed within 2.5 to eight months, indicating a general shortening of the recruitment process by about four weeks. However, the PSC considered that a duration of eight months was still long for completing a recruitment exercise; and

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Note 9: *The time was counted from the date of placing an advertisement to the date of submitting the recruitment board report to the PSC for advice.*

(c) in December 2008, in response to the PSC's request, the CSB promulgated a list of streamlining initiatives for B/Ds to follow (Note 10). In 2009, as advised by the PSC, the CSB introduced further measures to improve the recruitment process, including that for those candidates who are serving civil servants or ex-civil servants, B/Ds should only call for and make reference to their staff reports after they are selected for offer of appointment (Note 11). Of the 107 open recruitment exercises processed by the PSC in 2009, 96% (i.e. 103 cases) were completed within two to seven months, indicating a further shortening of the recruitment process by about four weeks.

Audit analysis of completion time of recruitment exercises

2.4 Information on recruitment exercises is kept by the recruiting B/Ds. The CSB does not have an established mechanism to monitor the time taken by B/Ds in completing their recruitment exercises. Instead, the CSB monitors the civil service vacancy position to assess whether vacancies are filled in a timely manner. In 2012 and 2013, for the purpose of assessing the attractiveness of civil service jobs, the CSB completed two studies by calling returns from B/Ds and collecting from them certain recruitment data on their recruitment exercises in 2010-11 and 2011-12 (Note 12). Audit used such recruitment data to analyse the time taken by B/Ds to complete open recruitment exercises in these two years. Table 3 summarises the results. Details are at Appendix A.

Note 10: *The initiatives were related to processes under the recruiting B/Ds' sole control (e.g. planning and staggering recruitment exercises, holding examinations, conducting selection interviews and compiling recruitment board reports).*

Note 11: *According to the PSC, the unduly long time taken by some B/Ds to complete recruitment exercises was due in part to the time spent on checking such staff reports and the time wasted in competing for such reports with other recruiting B/Ds in respect of candidates who had applied for more than one job.*

Note 12: *The requested information included the details of each recruitment exercise conducted (e.g. date of placing an advertisement, number of applications received, number of offers of appointment made including the date of first offer, and number of offers declined by candidates). The CSB found that the competition for civil service job offers remained keen, and the decline and resignation rates were generally low. It considered that civil service jobs remained attractive to job seekers.*

Table 3

Time taken to complete open recruitment exercises
(2010-11 and 2011-12)

		2010-11	2011-12
Exercises within the purview of PSC			
No. of exercises conducted		77	74
No. of days taken to complete exercise	Range	84 to 421	74 to 424
	Average	200	194
Exercises outside the purview of PSC			
No. of exercises conducted		99	93
No. of days taken to complete exercise	Range	57 to 714	96 to 496
	Average	197	206
Overall			
No. of exercises conducted		176	167
No. of days taken to complete exercise	Range	57 to 714	74 to 496
	Average	198	201

Source: *Audit analysis of CSB records*

Remarks: 1. *The recruitment exercises for each year were those with recruitment advertisements placed in the year.*

2. *The time taken to complete each exercise was counted from the date of placing an advertisement to the date of making the first offer of appointment. Therefore, the above figures do not include all-year-round recruitment exercises (e.g. those for Inspector/Superintendent of Police and Police Constable conducted by the Hong Kong Police Force) which do not have definite dates of placing advertisements and making offers of appointment.*

3. *The above figures do not include exercises for the recruitment of judges and judicial officers, Independent Commission Against Corruption officers and locally engaged staff working in Hong Kong Economic and Trade Offices because they were not covered in the CSB's studies of attractiveness of civil service jobs.*

2.5 For the 2010-11 and 2011-12 open recruitment exercises, Audit has the following observations:

(a) ***Exercises within the purview of PSC.*** Table 3 shows that for the exercises within the purview of the PSC, the average completion time (counting from the date of placing an advertisement to the date of making the first offer of appointment) had slightly improved from 200 days in 2010-11 to 194 days in 2011-12. However, it can be seen from Appendix A that 16 (21%) exercises in 2010-11 and 15 (20%) exercises in 2011-12 took over 240 days (over 8 months) to complete (Note 13). The position suggests that there is room for improvement taking into account the timeframe suggested by the PSC (Note 14); and

(b) ***Exercises outside the purview of PSC.*** For the exercises outside the purview of the PSC, the recruitment board reports were not submitted to the PSC for advice and this generally should have reduced their completion time. However, Table 3 shows that their average completion time was 206 days in 2011-12, longer than that of 194 days for the exercises within the purview of the PSC. Moreover, as shown in Appendix A, for the exercises outside the purview of the PSC, 24 (24%) exercises in 2010-11 and 25 (27%) exercises in 2011-12 took over

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Note 13: *According to the CSB, it has been monitoring the civil service vacancy position to assess the situation and noted that the overall vacancy position of the civil service has generally remained low at 4% or below of the establishment since 2008, which is generally comparable to the position before the lifting of the recruitment freeze. Based on information available to the CSB, in 2012-13, the decline rate of appointment has remained low at 12%, indicating that the civil service is by no means disadvantaged in competing for talents.*

Note 14: *In its 2009 Annual Report, the PSC indicated that the recruitment process had been shortened to seven months. The PSC counted the completion time of a recruitment exercise from the date of placing an advertisement to the date of submitting the recruitment board report to the PSC for advice. Given that the PSC's target was to process each case within four weeks and the target was fully achieved in 2011 and 2012, 240 days (7 months plus 4 weeks) was used as a benchmark in Audit analysis.*

240 days (over 8 months) to complete, both more than that for the exercises within the purview of the PSC (see (a) above — Note 15).

Audit examination of 50 open recruitment exercises

2.6 Between 2010-11 and 2012-13, the CSB and the four selected B/Ds (i.e. the CSD, EDB, FEHD and LCSD — see para. 1.10) conducted a total of 70 open recruitment exercises (Note 16). Audit examined 50 of the 70 exercises (Note 17). Appendix B shows the details of the 50 exercises. The audit findings on various issues are in paragraphs 2.7 to 2.49.

2.7 Table 4 shows an analysis of the completion time of the 50 exercises.

Note 15: *According to the CSB, there are a host of factors affecting the processing time of a recruitment exercise, such as the number of applications received and whether skill tests/examinations have to be conducted. Based on the data in the CSB's records, for example, the average number of applications received for the open recruitment exercises outside the purview of the PSC in 2011-12 was 2,930 which was larger than the corresponding figure of 1,819 for exercises within the purview of the PSC. The larger number of applications could be a contributing factor for the longer processing time of the exercises outside the purview of the PSC.*

Note 16: *The recruitment advertisements of the exercises were placed between 2010-11 and 2012-13, and the exercises were completed within or after the period.*

Note 17: *The number of exercises selected from each of the five B/Ds for examination was largely in proportion to its total number of exercises conducted during the period.*

Table 4

Analysis of completion time of 50 open recruitment exercises examined by Audit

B/D	No. of exercises	No. of applications processed in each exercise		No. of days taken to complete each exercise (Note)	
		Range	Average	Range	Average
CSB	10	247 to 24,244	10,129	141 to 253	215
CSD	18	96 to 11,695	2,878	125 to 714	382
EDB	7	29 to 4,394	1,801	108 to 259	209
FEHD	8	1,176 to 6,600	3,655	158 to 235	184
LCSD	7	1,253 to 18,100	9,067	134 to 315	224
Overall	50	29 to 24,244	5,168	108 to 714	270

Source: Audit analysis of CSB, CSD, EDB, FEHD and LCSD records

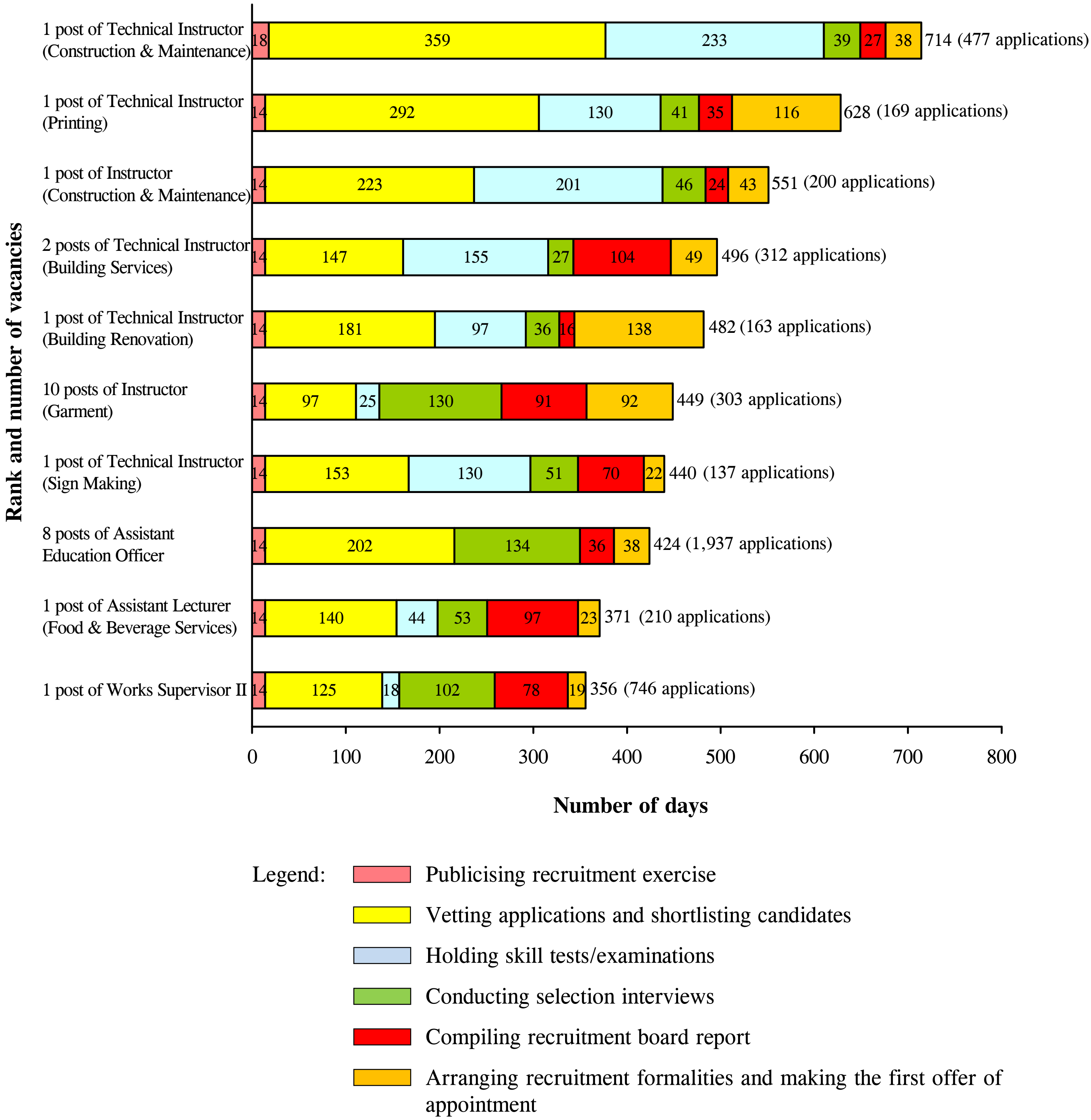
Note: The time was counted from the date of placing an advertisement to the date of making the first offer of appointment.

Long completion time of CSD recruitment exercises

2.8 It can be seen from Table 4 that the CSD on average took a much longer time to complete its 18 open recruitment exercises. Audit analysis revealed that the 10 CSD exercises taking the longest time (i.e. 356 to 714 days) to complete were all small-scale exercises, involving 1 to 10 vacancies. Figure 1 shows an analysis by key recruitment steps of the 10 exercises.

Figure 1

10 CSD open recruitment exercises which took a long time to complete



Source: *Audit analysis of CSD records*

2.9 Audit further analysed the key recruitment steps (i.e. vetting applications and shortlisting candidates, and holding skill tests/examinations) which accounted for a large portion of the total time taken for the CSD's 10 recruitment exercises (see Figure 1), taking into account the number of applications/candidates involved. The following issues were identified:

(a) ***Vetting applications and shortlisting candidates.*** With the exception of the Assistant Education Officer recruitment exercise which involved 1,937 applications, the number of applications for the other nine exercises ranged from 137 to 746. For four of the seven exercises for the Technical Instructor/Instructor posts, the CSD had taken on average more than one day to vet each application (ranging from 1.1 to 1.7 days). Audit noted that the CSD's Appointments Unit had taken a long time to vet the applications because the training and experience requirements were specialised. Direct involvement of the user section which is familiar with the requirements may help speed up the vetting process as seen in some other departments' recruitment exercises (see para. 2.16); and

(b) ***Holding skill tests/examinations.*** For six of the seven exercises for the Technical Instructor/Instructor posts, the skill tests consisted of a written test and a practical test (for the Instructor (Garment) post, the skill test consisted of only the written test). The CSD took 97 to 233 days to complete the skill tests for the six exercises, which involved 30 to 179 candidates. Audit noted that the CSD only invited external service providers to submit tenders for providing the test services after vetting the applications when the number of candidates to be invited for the tests was known. To save time, consideration may be given to inviting tenders for the test services on a unit cost basis (i.e. cost per candidate) in parallel with the vetting of applications.

2.10 In February and March 2014, the CSD informed Audit that:

Heavy workload from the large-scale recruitment exercises

(a) the CSD is encountering a period of high natural wastage of staff starting a few years ago. The CSD has been under great pressure and urgency in recruiting sufficient new blood at the Officer and Assistant Officer II ranks. The two grades constitute the core operational strength of the

CSD, accounting for around 15% and 70% of its establishment. For the recruitment exercises for Officer and Assistant Officer II conducted between 2010 and 2012, the CSD processed over 25,180 and 30,200 applications respectively and recruited 197 Officers and 742 Assistant Officer IIs. The workload arising from the large-scale recruitment exercises on the CSD's Appointments Unit has been enormous;

(b) with attention being focused on the all important recruitment exercises for large number of Officers and Assistant Officer IIs, the CSD has taken a long time to complete other smaller scale recruitment exercises for non-main stream ranks;

Long time taken to complete the 10 small-scale recruitment exercises

(c) ***Vetting applications and shortlisting candidates.*** The work nature of Technical Instructors/Instructors of the CSD was very unique and there were hardly any comparable jobs in the labour market. For some CSD trades, there was no directly relevant institutional training available in Hong Kong. Therefore, it was very difficult to verify applicants' relevant apprenticeship/institutional training and work experience. As applicants very often did not provide clear information on their work experience and training records, the CSD Appointments Unit had to contact many applicants for clarification and spend a lot of time to consider whether to endorse the vetting results of such applications;

(d) ***Holding skill tests/examinations.*** Technical Instructor/Instructor candidates were required to pass a skill test. The test was trade-specific and was outsourced to an outside contractor. It took additional time to attend to the outsourcing exercises, which included drawing up specifications, inviting quotations, evaluating proposals, seeking internal approval and entering into contract;

(e) ***Other factors.*** Other factors leading to the long time taken to complete the 10 small-scale recruitment exercises included the following:

(i) due to the uniqueness of the Technical Instructor/Instructor posts and the complexity of the vetting work and selection process, the CSD Appointments Unit and user section required extra time to compile recruitment board reports and consider whether to endorse the assessments;

(ii) the recruitment of instructing staff was suspended before the merger of two user sections (i.e. the Correctional Services Industries with the Vocational Training Unit to form the Industries and Vocational Training Section) in early 2009. When recruitment exercises resumed, manpower resources of the Appointments Unit and user section were stressed in handling various exercises at the same time, especially in 2010-11; and

(iii) for the posts of Assistant Education Officer, it was the first occasion to recruit Assistant Education Officers after the implementation of Specialised Teaching policy. The long time required was mainly due to inexperience in vetting applications, devising shortlisting criteria and making various logistics arrangements; and

(f) ***Improvement measures.*** The CSD has taken improvement actions as follows:

(i) comprehensive reviews were conducted on the large-scale Officer and Assistant Officer II recruitment exercises. Significant changes were introduced and the logistics arrangements were revamped to achieve more satisfactory results. For example, the completion time of the annual Assistant Officer II recruitment exercises had been significantly shortened from about eight months in the 2010 exercise to an average of four months in the 2011, 2012 and 2013 exercises; and

(ii) learning from experience, a series of improvement measures have been implemented since February 2014 to ensure that both large-scale and small-scale recruitment exercises are conducted efficiently. For example, the vetting process has been streamlined so that verification of relevant work experience is now conducted by user section. The CSD is also exploring the feasibility of modifying the quotation specification of skill test, say procuring the service by unit cost, in order to reduce the lead time of contracting-out procedures. The CSD will also consider starting the appointment of external training and examination bodies and the vetting of their examination papers and materials upon initiation of a recruitment exercise. In addition, the CSD is conducting a comprehensive review of the overall recruitment processes to identify further room for improvement.

2.11 Audit notes the CSD's recent efforts and suggests that the CSD continues to work on streamlining the procedures for arranging skill tests/examinations, and sets a deadline for completing its comprehensive review of the overall recruitment processes.

Long time taken in some EDB recruitment exercises for arranging formalities and making offers of appointment

2.12 Apart from the 18 CSD recruitment exercises, Audit analysis revealed that three EDB exercises (involving 3 to 59 candidates recommended for appointment) took a long time of 67 to 85 days to arrange recruitment formalities and make offers of appointment, compared with the average of 23 days for the remaining 29 exercises (Note 18). In Audit's view, the EDB needs to review the long time taken to arrange recruitment formalities and make offers of appointment in the three exercises and take appropriate improvement measures.

Implementation of streamlining measures

2.13 In general, as pointed out by the PSC, a lengthy recruitment process can put the Government in a disadvantageous position in competing with the private sector for talents (see para. 2.3(a)). It can also result in higher recruitment costs

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Note 18: *According to the EDB, for the recruitment exercise of Specialist (Education Services) II posts in 2010, all the three selected candidates had already been serving as non-civil service contract staff prior to the offer in the section to which they were posted. The time taken should not have caused any operational difficulties to the office concerned.*

and delays in filling vacancies. Audit noted that the CSB had incorporated the streamlining measures introduced between 2007 and 2009 in its Guidebook on Appointments (see para. 1.8). However, as at December 2013, it had made no amendments appropriately to the CSRs to reflect the relevant measures. For example, according to Annex 1.1 to the CSRs, recruitment boards are required to study the staff reports of candidates who are serving officers before they are interviewed, contrary to the streamlining measure of calling and making reference to such reports after the candidates are selected for offer of appointment (see para. 2.3(c)). In 17 (34%) of the 50 open recruitment exercises examined by Audit, the relevant staff reports were called before interviews (Note 19). In Audit's view, the CSB needs to amend the CSRs to reflect all the streamlining measures and ensure that B/Ds implement them properly.

Departmental monitoring of progress of recruitment exercises

2.14 According to the CSB guidelines, B/Ds should complete the recruitment process within a reasonable timeframe so that timely offers can be made to secure the most suitable candidates. They should draw up a recruitment schedule to specify the timeframe for each stage of a recruitment exercise to facilitate monitoring. The CSRs specifically provide that any undue delay in finalising a particular stage should be explained to the approving authority (see Note 7 to para. 2.2(e)). Audit examination of the 50 open recruitment exercises revealed cases of non-compliance with these requirements (see Table 5). In particular, no recruitment schedule was used in 13 CSD recruitment exercises, including the 10 small-scale exercises mentioned in paragraph 2.8. Audit noted that the 13 exercises took an average of 435 days to complete, compared with that of 243 days for the remaining 5 CSD exercises in which recruitment schedules were used. In Audit's view, the CSB needs to remind B/Ds of the need to closely monitor the progress of their recruitment exercises in accordance with the requirements.

Note 19: *According to the CSB's Guidebook on Appointments, the recruiting B/Ds should as far as possible only call for staff reports of recommended candidates who are serving officers after the conclusion of recruitment interviews, so as to help reduce abortive work and time of calling for and checking staff reports of candidates who are not selected for appointment. In exceptional cases where, for example, there are a large number of candidates who are serving officers, recruiting B/Ds may retrieve the staff report files of all candidates before interview in order not to hold up the recruitment board's deliberation in finalising its recommendation.*

Table 5

Using recruitment schedules to monitor recruitment progress

B/D	No. of open recruitment exercises		
	Recruitment schedule used	Recruitment schedule not used	Total
CSB	10 (Note)	—	10
CSD	5	13	18
EDB	4 (Note)	3	7
FEHD	7	1	8
LCSD	7 (Note)	—	7
Overall	33	17	50

Source: CSB, CSD, EDB, FEHD and LCSD records

Note: The CSB, EDB and LCSD had 3, 1 and 3 exercises respectively not meeting the recruitment schedules. There was no documentary evidence that explanations had been given to the approving authorities.

CSB monitoring of time taken to complete recruitment exercises

2.15 Since working with the PSC to monitor the effectiveness of the streamlining measures in speeding up civil service recruitment in 2009 (see para. 2.3(c)), the CSB had not conducted any analysis of the time taken by B/Ds to complete open recruitment exercises. Audit analyses (see paras. 2.4 to 2.12) revealed cases of delay in completing open recruitment exercises by B/Ds. In Audit's view, the CSB needs to monitor and conduct regular analyses of the time taken by B/Ds to complete open recruitment exercises. This will help the CSB assess the overall effectiveness and efficiency of civil service recruitment and ascertain the need for introducing further streamlining measures service-wide.

2.16 Where the CSB identifies recruitment exercises taking a very long time to complete, it needs to provide specific guidance to the B/Ds concerned to help them shorten their processes. For exercises completed in a very short timeframe, it may wish to identify good practices that can be shared with other B/Ds. For example, in analysing the time taken by B/Ds to complete open recruitment exercises in 2010-11 (see para. 2.4), Audit noted that the Housing Department took 69 and 75 days to complete two exercises (Note 20). According to the Housing Department, in both exercises, the user sections provided support on vetting technical qualifications and working experience of candidates in accordance with the agreed recruitment schedule, and preparations for appointment of the first batch of recommended candidates were started in parallel with the finalisation of the recruitment board report to save time.

Audit recommendations

2.17 **Audit has *recommended* that the Secretary for the Civil Service should:**

(a) **amend the CSRs to reflect all the streamlining measures that had been implemented between 2007 and 2009 for shortening the recruitment process, and ensure that B/Ds implement them properly in conducting recruitment exercises;**

(b) **remind B/Ds of the need to draw up a recruitment schedule to specify the timeframe for each stage of a recruitment exercise and follow the prevailing guidelines in monitoring the progress; and**

(c) **monitor and conduct regular analyses of the time taken by B/Ds to complete open recruitment exercises, with a view to:**

(i) **assessing the overall effectiveness of the streamlining measures in speeding up civil service recruitment and ascertaining the need for introducing further streamlining measures service-wide;**

Note 20: *For the two exercises respectively, the Housing Department received 454 and 398 applications, shortlisted 46 and 36 candidates for selection interviews, and appointed 12 and 3 candidates.*

(ii) **identifying open recruitment exercises that have taken a very long time to complete so as to provide specific guidance to the B/Ds concerned to help them shorten their recruitment processes; and**

(iii) **identifying open recruitment exercises that have been completed in a very short timeframe to see whether there are any good practices that can be shared with other B/Ds.**

2.18 **Audit has *recommended* that the Secretary for the Civil Service, Secretary for Education, Commissioner of Correctional Services, Director of Food and Environmental Hygiene and Director of Leisure and Cultural Services should ensure that their staff draw up a recruitment schedule to specify the timeframe for each stage of a recruitment exercise and/or follow the prevailing guidelines in monitoring the progress**.

2.19 **Audit has *recommended* that the Commissioner of Correctional Services should:**

(a) **continue to work on streamlining the procedures for arranging skill tests/examinations; and**

(b) **set a deadline for completing the comprehensive review of the overall recruitment processes.**

2.20 **Audit has *recommended* that the Secretary for Education should review the long time taken to arrange recruitment formalities and make offers of appointment in the three open recruitment exercises mentioned in paragraph 2.12 and take appropriate improvement measures.**

Response from the Administration

2.21 The Secretary for the Civil Service agrees with the audit recommendations in paragraphs 2.17 and 2.18. He has said that:

(a) the CSB has, since 2007, worked with the PSC and introduced measures to streamline the recruitment process. Taking into account the experience gained in the past few years, the CSB would, on top of the ongoing efforts in monitoring the filling of civil service vacancies, work with B/Ds in considering suitable refinements to the arrangements for monitoring and streamlining the recruitment process. While there is always room to further streamline and expedite the recruitment process, any additional resources to be invested in expediting the process should be proportional to the improvement in efficiency. It is also important to strike a balance between upholding fairness and due process in conducting recruitment exercises, and achieving an efficient processing time so as to fill vacancies in a timely manner; and

(b) for the recruitment exercises of Training Officer I in 2011 and 2013 (i.e. two of the three CSB exercises mentioned in the Note to Table 5 in para. 2.14), recruitment schedules were drawn up. Overall speaking, submission of the recruitment board report to the PSC for advice was delayed by four and three working days for the 2011 and 2013 exercises respectively. There was no substantial delay in each exercise. The CSB will continue to closely monitor the progress of the recruitment exercises under its purview and follow the relevant guidelines.

2.22 The Secretary for Education agrees with the audit recommendations in paragraphs 2.18 and 2.20. He has said that:

(a) the EDB's Administration Division and Appointment and Personnel Section have all along had regular meetings to monitor effectively the progress of recruitment exercises. The approving authority was fully aware of the development of the recruitment exercises through these meetings. The EDB will formalise the use of recruitment schedule to monitor the progress of recruitment exercises in future; and

(b) the time taken to arrange recruitment formalities and make offers of appointment in the three open recruitment exercises mentioned in paragraph 2.12 would have been shortened if some of the steps had been undertaken concurrently. The EDB would closely monitor the recruitment process of future exercises and arrange concurrent completion of steps whenever possible with a view to shortening the lead time.

2.23 The Commissioner of Correctional Services agrees with the audit recommendations in paragraphs 2.18 and 2.19. In addition to those comments in paragraph 2.10, he has said that:

(a) the CSD is actively following up the audit recommendations on implementing relevant improvement measures and ensuring timely completion of both large-scale and small-scale recruitment exercises;

(b) for all ongoing recruitment exercises, the CSD has drawn up recruitment schedules since February 2014. For the large-scale recruitment exercises for Officer and Assistant Officer II organised annually, the CSD will continue to draw up a recruitment schedule before the launch of each exercise. For other small-scale recruitment exercises not conducted regularly, recruitment schedules will be drawn up shortly after the closing dates for applications because the time required for each stage can be better estimated when the actual number of applications is known; and

(c) the CSD already commenced a comprehensive review of the overall recruitment processes in mid-February 2014. Initial views, including suggestions on streamlining the procedures of contracting-out skill tests/examinations, are being invited from user sections. The CSD will take appropriate measures, in consultation with the CSB where necessary, to ensure compliance with the relevant CSB guidelines. The CSD aims at completing the comprehensive review by the fourth quarter of 2014.

2.24 The Director of Food and Environmental Hygiene agrees with the audit recommendation in paragraph 2.18. She has said that in respect of the FEHD recruitment exercise for which a formal recruitment schedule had not been prepared, there had been close monitoring of each stage of the exercise, and it was completed in a timely manner within 187 days. The FEHD will ensure that there will be formal recruitment schedules for all recruitment exercises to specify the timeframe for each stage.

2.25 The Director of Leisure and Cultural Services agrees with the audit recommendation in paragraph 2.18. She has said that it has been the existing practice in the LCSD for all recruiting offices to report progress to the approving authority at various stages of the recruitment process. The LCSD has reminded the recruiting offices to closely monitor the progress of the recruitment exercises in accordance with the prevailing CSB guidelines.

Publicising recruitment exercises

2.26 ***Period for submitting applications.*** The CSB has not provided guidelines on the period for submitting applications. For the 50 open recruitment exercises examined by Audit, the application period ranged from 11 to 28 days. While a reasonable time should be allowed to notify potential applicants and for them to prepare applications, B/Ds normally should not lengthen the application period beyond the norm (in 35 (70%) of the 50 exercises, the application periods were 14 or 15 days) without good reasons. In Audit's view, the CSB needs to consider providing B/Ds with appropriate guidelines.

2.27 ***E-mail not commonly used for communicating with candidates.*** E-mail communication is generally efficient and cost-effective. In all the 50 open recruitment exercises, candidates could choose to submit applications online, by post or by hand. Online applications were acknowledged by e-mail automatically and others acknowledged by post. For 7 of the 50 exercises (4 for the CSB and 3 for the CSD), e-mail was used for sending invitation letters to candidates shortlisted for selection interviews and/or regret letters to unsuccessful candidates. As regards the remaining 43 exercises, e-mail was not used for communicating with candidates. In Audit's view, the CSB needs to provide B/Ds with guidelines on using e-mail for communicating with candidates, with a view to enhancing efficiency and cost-effectiveness.

2.28 ***Verification of candidates' local qualifications.*** According to the CSB guidelines, B/Ds should not require candidates to send copies of local qualification documents at the application stage unless it is operationally necessary to do so (e.g. the collection of such is essential for the recruiting B/D to determine whether to send invitations for candidates to take recruitment examinations or attend selection interviews). Instead, B/Ds may verify candidates' qualifications when they attend recruitment examinations/selection interviews. However, of the 50 open recruitment exercises, the recruitment advertisements in 2 LCSD exercises required, without any operational need, attaching copies of qualification documents with application forms. In Audit's view, the CSB needs to remind B/Ds to follow the requirements of the CSB guidelines.

Audit recommendations

2.29 **Audit has *recommended* that the Secretary for the Civil Service should:**

(a) **provide B/Ds with appropriate guidelines on the period allowed for submitting applications in open recruitment exercises and remind B/Ds that the period normally should not be lengthened without good reasons;**

(b) **provide B/Ds with guidelines on using e-mail for communicating with candidates; and**

(c) **remind B/Ds to verify candidates' local qualifications when they attend recruitment examinations/selection interviews, instead of requiring candidates to send copies of their local qualification documents at the application stage, unless it is operationally necessary to do so.**

2.30 **Audit has *recommended* that the Director of Leisure and Cultural Services should ensure that LCSD staff verify candidates' local qualifications when they attend recruitment examinations/selection interviews, instead of requiring candidates to send copies of their local qualification documents at the application stage, unless it is operationally necessary to do so.**

Response from the Administration

2.31 The Secretary for the Civil Service agrees with the audit recommendations in paragraph 2.29.

2.32 The Director of Leisure and Cultural Services agrees with the audit recommendation in paragraph 2.30. She has said that the LCSD has reminded the recruiting offices not to require candidates to send copies of local qualification documents at the application stage unless it is operationally necessary to do so.

Vetting applications and shortlisting candidates

2.33 ***Many unqualified candidates.*** Of the total of 258,400 candidates in the 50 open recruitment exercises, 43% (ranging from 6.5% to 99.7% for each exercise) were found not meeting the entry requirements stated in the recruitment advertisements. The situation was unsatisfactory as significant time and resources were wasted in processing their applications. In Audit's view, the CSB needs to review open recruitment exercises having a high percentage of unqualified candidates together with the B/Ds concerned and implement effective measures to address the issue. For example, B/Ds should spell out the entry requirements in the recruitment advertisements more specifically to avoid any misunderstanding by potential applicants. Consideration may also be given to making more use of computerised processes to assist in processing applications. In this regard, the CSB has implemented an improvement measure since 2013 by revising the standard application form of civil service jobs and enhancing the online job application system to add built-in reminders for applicants to confirm that they meet the entry requirements of the jobs selected. In Audit's view, the CSB needs to monitor the effectiveness and adequacy of the improvement measure.

2.34 ***Shortlisting candidates.*** B/Ds commonly used shortlisting criteria (usually academic qualifications and working experience) to reduce the number of candidates to be interviewed. Where appropriate, B/Ds may adopt assessment tools and methods such as recruitment examinations or preliminary interviews to assist in assessing the skills or attributes required of desired candidates. Of the 50 open recruitment exercises, 36 adopted these tools. In Audit's view, these tools are useful for B/Ds to assess suitable candidates in addition to shortlisting criteria. The CSB needs to remind B/Ds to consider using such tools and provide them with necessary assistance.

2.35 ***Seeking PSC advice.*** Of the 50 open recruitment exercises, 24 involved ranks under the purview of the PSC. The shortlisting criteria adopted in such exercises and the shortlisting result were submitted to the PSC for advice in accordance with the requirements stated in the CSB guidelines (see para. 2.2(b)). According to the PSC, B/Ds should maintain consistency in the shortlisting criteria adopted for the same rank in different exercises unless special circumstances have arisen. As such, the CSB may explore with the PSC as to whether the process can be streamlined by dispensing with the requirement to submit the shortlisting criteria and shortlisting result to the PSC for advice if the criteria are the same as those adopted in the preceding recruitment exercise for the same rank.

Audit recommendations

2.36 **Audit has *recommended* that the Secretary for the Civil Service should:**

(a) **review open recruitment exercises having a high percentage of unqualified candidates together with the B/Ds concerned and implement effective measures to address the issue;**

(b) **monitor the effectiveness and adequacy of the enhancement of the online job application system to address the issue of unqualified applications;**

(c) **remind B/Ds to consider assessment tools, such as recruitment examinations or preliminary interviews, apart from shortlisting criteria to assist in identifying suitable candidates, and provide them with necessary assistance; and**

(d) **explore with the PSC as to whether the requirement to submit the shortlisting criteria and shortlisting result to the PSC for advice can be dispensed with if the criteria are the same as those adopted in the preceding recruitment exercise for the same rank.**

Response from the Administration

2.37 The Secretary for the Civil Service agrees with the audit recommendations.

Holding skill tests/examinations and conducting selection interviews

2.38 ***Short notice of skill tests/examinations.*** Skill tests/examinations were held in 34 of the 50 open recruitment exercises examined by Audit. According to the CSB guidelines, B/Ds should give sufficient advance notice of a skill test/examination to candidates, usually two weeks before the test/examination. However, in 6 of the 34 exercises (1 for the CSB, 4 for the CSD and 1 for the EDB), the B/Ds concerned gave notice to the candidates only 9 to 13 days before the test/examination (Note 21). For two FEHD exercises, not all candidates were given the same notice period and some were given less than two weeks' notice (Note 22). In Audit's view, the CSB needs to remind B/Ds of the need to give sufficient and uniform advance notice of a skill test/examination to all candidates to facilitate their preparation.

2.39 ***Formation of recruitment board.*** Audit examination of the 50 open recruitment exercises revealed that the majority of the recruitment boards (32 exercises) had four officers, including the secretary if there was one. The remaining recruitment boards had three (12 exercises) or five officers (5 exercises) (Note 23). In this respect, Audit noted that there were inconsistencies in the CSRs and CSB guidelines, as follows:

(a) ***Annex 1.1 to the CSRs.*** A chairman, a member and a member/secretary should be nominated to form a recruitment board. Exceptionally, additional members may be nominated, but an unduly large or high-powered board must be avoided; and

(b) ***CSB's Guidebook on Appointments.*** A recruitment board should comprise at least three officers, excluding the secretary.

In Audit's view, the CSB needs to review the requirements on the formation of recruitment board and provide B/Ds with clear guidelines.

Note 21: *According to the CSB, for the recruitment exercise of Training Office I in 2011, invitation letters for attending the written test were sent to candidates 11 days before the test. The CSB contacted the candidates by phone on the same day separately with a view to giving advance notice to them. The arrangement has improved in the 2013 exercise whereby candidates were given 20 days' notice.*

Note 22: *For one exercise, 1,527 candidates were given 25 days' notice. The remaining 24 candidates were given 5 or 6 days' notice after the FEHD had confirmed their eligibility by further examining their documentary proof of academic qualifications. For the other exercise, 3,029 candidates were invited in batches to skill tests over a period of about two weeks. According to the FEHD, it had a tight schedule and the first batch of 149 candidates were given a 6-day notice. It improved gradually on the period of notification for subsequent batches.*

Note 23: *For one exercise, the recruitment board was not formed as no suitable candidate was identified for selection interviews.*

2.40 ***Interviews conducted on a group basis.*** In 7 of the 50 open recruitment exercises (2 for the CSB, 3 for the CSD and 2 for the LCSD), group interviews were conducted. In Audit's view, group interviews have provided an additional tool to help B/Ds identify suitable candidates and where appropriate, could be used as a step in the recruitment process to identify candidates for further interview on an individual basis. The CSB needs to provide further guidelines to B/Ds on how to make the best use of group interviews in the recruitment process.

Audit recommendations

2.41 **Audit has *recommended* that the Secretary for the Civil Service should:**

(a) **remind B/Ds of the need to give sufficient and uniform advance notice of a skill test/examination to all candidates to facilitate their preparation;**

(b) **review the requirements on the formation of recruitment board and provide B/Ds with clear guidelines; and**

(c) **provide B/Ds with further guidelines on conducting group interviews in the recruitment process.**

2.42 **Audit has *recommended* that the Secretary for the Civil Service, Secretary for Education, Commissioner of Correctional Services and Director of Food and Environmental Hygiene should ensure that their staff give sufficient and uniform advance notice of a skill test/examination to all candidates to facilitate their preparation.**

Response from the Administration

2.43 The Secretary for the Civil Service agrees with the audit recommendations in paragraphs 2.41 and 2.42.

2.44 The Secretary for Education agrees with the audit recommendation in paragraph 2.42. He has said that the EDB will in future ensure that the full two-week advance notice of a test/examination is given to all candidates.

2.45 The Commissioner of Correctional Services agrees with the audit recommendation in paragraph 2.42. He has said that the CSD will give at least 14 days of advance notice to individual candidates for attending various selection processes of all recruitment exercises as a standard practice.

2.46 The Director of Food and Environmental Hygiene agrees with the audit recommendation in paragraph 2.42. She has said that the FEHD will closely monitor the progress of each stage of a recruitment exercise to ensure that sufficient and uniform advance notice can be and is given to all candidates of a skill test/examination.

Making offers of appointment

2.47 ***Making offers of appointment by batch.*** In 4 of the 50 open recruitment exercises, the CSB made offers of appointment to candidates in batches in the course of conducting the selection interviews, in order to speed up the filling of a large number of vacancies by suitable persons selected from a large pool of candidates. For the remaining 46 recruitment exercises, the B/Ds made offers of appointment after conducting all selection interviews. There were cases where making offers by batch also appeared appropriate (e.g. the CSD's recruitment of 283 Assistant Officer IIs in August 2011). The CSB has not issued any guidelines on making offers by batch. In Audit's view, such guidelines are useful for ensuring that proper procedures are followed by B/Ds.

Audit recommendation

2.48 **Audit has *recommended* that the Secretary for the Civil Service should provide B/Ds with guidelines on making offers of appointment by batch.**

Response from the Administration

2.49 The Secretary for the Civil Service agrees with the audit recommendation.

PART 3: IN-SERVICE RECRUITMENT OF CIVIL SERVANTS

3.1 This PART examines issues relating to the in-service recruitment of civil servants. The following issues are discussed:

(a) in-service recruitment of controlled grade staff (paras. 3.5 to 3.25);

(b) in-service recruitment of other civil servants (paras. 3.26 to 3.32); and

(c) concessionary in-service appointment requirements (paras. 3.33 to 3.38).

Key processes in in-service recruitment

3.2 As mentioned in paragraph 1.4, the Government's civil service recruitment policy is that B/Ds should normally conduct open recruitment of civil servants to cast the widest net for candidates. They would conduct in-service recruitment only when there are special reasons. For example, in cases where the skills, experience or expertise required can be met by serving officers in other civil service grades with potential surplus staff, in-service recruitment of civil servants may be preferred for the benefit of the overall manpower planning of the civil service. In this respect, it is worth noting that in its 2011 Annual Report, the PSC has expressed the view that:

(a) as a norm, open recruitment should be conducted for basic ranks irrespective of the number of vacancies; and

(b) in-service recruitment should only be considered when there are potential surplus staff in the service, such as during the service-wide recruitment freeze, or when there are other special reasons that suit the needs or special circumstances of certain grades.

3.3 For the majority of the civil service grades, since January 2012, B/Ds have been required to seek the advice of the PSC, or the CSB if the rank of the officers to be recruited is outside the PSC's purview, before conducting in-service recruitment. For controlled grades (see para. 3.6), B/Ds may conduct in-service recruitment as they consider necessary.

3.4 In conducting an in-service recruitment exercise, the recruiting B/D issues a vacancy circular to serving civil servants to invite their applications. The other key processes in an in-service recruitment exercise are basically the same as those in an open recruitment exercise (see para. 2.2).

In-service recruitment of controlled grade staff

3.5 ***Open recruitment freeze.*** To achieve the target of reducing the size of the civil service to around 160,000 by 2006-07, the Government announced in January 2003 that a civil service general open recruitment freeze would be imposed with effect from April 2003. In March 2003, the Government launched the Second Voluntary Retirement Scheme for officers in 229 designated grades as a means to achieve the target. To ensure the cost-effectiveness of the Scheme, the 229 grades were subject to a five-year open recruitment freeze until March 2008. The target reduction of the civil service was achieved in March 2007, and the civil service general open recruitment freeze and the five-year open recruitment freeze for grades included in the Second Voluntary Retirement Scheme were lifted in April 2007 and March 2008 respectively.

3.6 ***Controlled grades.*** In July 2007, the CSB issued CSB Circular Memorandum No. 15/2007 to set out the arrangements associated with the lifting of open recruitment freeze imposed on grades included in the Second Voluntary Retirement Scheme in March 2008. According to the Circular Memorandum, to ensure that open recruitment will only be conducted where it is fully justified, the CSB will continue to maintain control on the open recruitment for grades belonging to any one of the following categories (Note 24):

Note 24: *Before July 2012, grades included in various targeted voluntary retirement schemes launched after the Second Voluntary Retirement Scheme were also selected as controlled grades. In July 2012, this criterion was removed as open recruitment freeze period for all such schemes had expired.*

(a) grades that have existing or anticipated surplus based on the latest manpower plans prepared by their B/Ds and submitted to the CSB in the annual manpower plan updating exercise;

(b) grades (or their duties) that are under review or may be affected by ongoing/impending institutional reviews, and/or reviews on mode of service delivery;

(c) grades considered by their grade management as being in a state of obsolescence; or

(d) grades where the new intakes normally come from in-service recruitment, or requiring skill sets that are commonly available within the civil service or can easily be acquired through training.

The Circular Memorandum promulgated a list of 76 grades selected as controlled grades.

3.7 ***Control mechanism.*** The recruitment arrangements for controlled grades set out in CSB Circular Memorandum No. 15/2007 are as follows:

(a) for the controlled grades, B/Ds may conduct in-service recruitment to fill vacancies as they consider necessary; and

(b) having regard to their specific operational needs, B/Ds may also apply for the CSB's approval to conduct open recruitment for controlled grades in accordance with the established mechanism. In seeking approval, they are required to provide relevant information for the CSB's consideration, such as the up-to-date manpower position of the grade concerned, whether in-service recruitment can provide the required intake (Note 25) and whether alternative modes of service delivery have been critically explored and considered infeasible.

Note 25: *B/Ds are required to indicate either the results of in-service recruitment that has been conducted or the reasons why in-service recruitment is considered unlikely to be able to identify sufficient number of candidates to fill the vacancies.*

According to the CSB, the control mechanism was introduced in support of the Government's established policy to maintain a lean and efficient civil service, and has helped ensure that open recruitment of selected grades, in particular the grades included in the voluntary retirement schemes, will only be conducted where it is fully justified. During July 2007 to January 2014, the CSB approved a total of 61 applications from B/Ds for conducting open recruitment to fill about 5,200 vacancies in 18 controlled grades. It has approved most of the applications for mounting open recruitment exercises to meet B/Ds' operational needs.

3.8 ***CSB revisions of the list of controlled grades.*** The list of controlled grades promulgated in July 2007 comprised 76 grades (see para. 3.6). The list had remained unchanged until August 2008 when the CSB conducted a review and revised the number of controlled grades to 88 (adding 13 grades and removing 1 grade). In July 2012, after another review, the CSB reduced the number of controlled grades to 74 (adding 1 grade and removing 15 grades). The 74 grades varied considerably in terms of their establishment and vacancy situation. Among them, 54 grades had an establishment of less than 100 posts and 12 grades had an establishment of between 100 and 500 posts as at 31 March 2013. The Artisan, Workman I and Workman II grades were the three largest grades among the controlled grades in terms of establishment, and were the only three controlled grades that had an establishment of over 2,000 posts.

3.9 ***Large number of vacancies in a few controlled grades.*** Unfilled vacancies may undermine the quality of public service unless: (a) the posts are no longer needed and should be deleted; or (b) endeavour has been made to meet genuine service needs through reshuffling of duties, streamlining or re-engineering of procedures, redeployment of existing manpower and/or alternative means of service delivery. The CSB guidelines specify that B/Ds may conduct recruitment exercises in advance before the emergence of vacancies to achieve smooth succession. According to CSB records, as at 31 March 2013, the Workman I and Workman II grades (Note 26) had 675 and 1,110 vacancies respectively, the most among the 74 controlled grades. The Artisan, Education Officer and Office Assistant grades ranked number three to five, having 375, 174 and 157 vacancies respectively. Among the remaining controlled grades, three grades had more than

Note 26: *The Workman I grade has only one rank, namely Workman I. Similarly, the Workman II grade has only the rank of Workman II. The two grades have been selected as controlled grades since July 2007.*

100 vacancies while 60 grades had fewer than 20 vacancies. Audit analysis revealed that the top three B/Ds in terms of number of vacancies (FEHD, LCSD and EDB — see Table 1 in para. 1.2) had high vacancy rates because they had a large number of vacancies in the controlled grades, notably the Workman I and Workman II grades (see Tables 6 and 7).

Table 6

Analysis of vacancies of FEHD, LCSD and EDB (31 March 2013)

Grade	Establishment (a) (No.)	Strength (b) (No.)	Vacancies (c) = (a) − (b) (No.)	Vacancy rate $(d) = \frac{(c)}{(a)} \times 100\%$
FEHD				
Controlled grades	4,536	3,675	861	19.0%
Other grades	6,606	6,398	208	3.1%
Overall	11,142	10,073	1,069	9.6%
LCSD				
Controlled grades	2,980	2,603	377	12.7%
Other grades	5,751	5,599	152	2.6%
Overall	8,731	8,202	529	6.1%
EDB				
Controlled grades	3,536	3,093	443	12.5%
Other grades	1,911	1,830	81	4.2%
Overall	5,447	4,923	524	9.6%

Source: Audit analysis of CSB records

Table 7

Top two controlled grades in terms of number of vacancies (2010-11 to 2012-13)

B/D	No. of vacancies (vacancy rate) as at 31 March		
	2011	**2012**	**2013**
Workman II			
EDB	50 (17%)	61 (23%)	52 (23%)
FEHD	557 (16%)	508 (15%)	393 (12%)
LCSD	-6 (-5%) (Note)	36 (28%)	52 (40%)
Other B/Ds	415 (14%)	539 (19%)	613 (22%)
Service-wide	1,016 (15%)	1,144 (17%)	1,110 (17%)
Workman I			
EDB	No Workman I posts		
FEHD	188 (33%)	190 (33%)	234 (41%)
LCSD	291 (27%)	263 (25%)	201 (19%)
Other B/Ds	166 (16%)	251 (25%)	240 (25%)
Service-wide	645 (24%)	704 (27%)	675 (26%)

Source: *Audit analysis of CSB records*

Note: *In 2010-11, the LCSD converted some Workman II posts to Workman I posts to meet urgent manpower need for inspection and maintenance of trees. During the conversion period, the strength of Workman II (including some Workman IIs acting as Workman Is on operational grounds) exceeded the establishment.*

Remarks: *As at 31 March 2013, the establishment of the civil service had a total of 2,630 Workman I posts and 6,404 Workman II posts.*

3.10 ***Audit examination of recruitment of Workman Is and Workman IIs.*** Audit examined the recruitment exercises conducted by the FEHD, LCSD and EDB for the Workman I and Workman II grades during 2010-11 to 2012-13. Audit also examined the CSB's justifications for selecting the two grades as controlled grades. The audit findings are in paragraphs 3.11 to 3.25.

Only one open recruitment exercise conducted

3.11 According to the CSB, in some circumstances, when vacancies of controlled grade arise, B/Ds may take the opportunity to review the current mode of operation and explore if more effective use of government resources can be achieved through alternative modes of service delivery (e.g. outsourcing) or restructuring of work procedures. As a result, B/Ds may be able to streamline its establishment, and regrade or delete some civil service posts of these grades through outsourcing and other restructuring efforts. However, for the vacancies in the Workman I and Workman II grades, the FEHD, LCSD and EDB spent considerable efforts to conduct recruitment exercises to select suitable candidates to fill the vacancies to meet their operational needs.

3.12 In January 2012, the FEHD obtained the CSB's approval to conduct an open recruitment exercise for Workman II, targeting to recruit 680 officers to fill existing/anticipated vacancies. It placed the recruitment advertisement in March 2012 and received 6,600 applications. The recruitment board recommended 1,481 candidates for appointment/waitlisting. Between September 2012 and January 2014, 852 candidates accepted the FEHD's offers of appointment and 85 declined. Other than this exercise, the FEHD did not apply or conduct any open recruitment exercise for Workman I and Workman II during 2010-11 to 2012-13.

3.13 As regards the EDB and LCSD, during 2010-11 to 2012-13, none of them conducted any open recruitment exercise for Workman I or Workman II (Note 27).

Note 27: *In January 2013, the LCSD obtained the CSB's approval for open recruitment of Workman IIs. The recruitment exercise was launched in September 2013 and was in progress as at January 2014. The EDB did not apply to the CSB for conducting any open recruitment exercise for Workman I or Workman II during 2010-11 to 2012-13.*

Failure to recruit sufficient officers through in-service recruitment

3.14 Between 2010-11 and 2012-13, the EDB, FEHD and LCSD conducted a total of nine in-service recruitment exercises, comprising four exercises for Workman I and five exercises for Workman II (see Appendix C). Audit found that these exercises failed to recruit sufficient officers to fill the vacancies, as follows:

(a) ***Reduced pool of candidates.*** In all the nine exercises, only serving officers were invited to apply, thus reducing the pool and mix of candidates when compared with open recruitment exercises in which candidates both outside and within the civil service may apply. The impact was particularly significant for the Workman I and Workman II grades because they were in the lower salary bands and few serving officers in other grades were interested in submitting applications. As a result, on average, only 155 applications were received in each exercise; and

(b) ***High decline rates.*** In its 2011 exercise for Workman I, the LCSD targeted to appoint 256 officers and made offers of appointment to 295 candidates. However, 103 (35%) candidates declined the offers and eventually the 192 appointees was 64 less than targeted. For the other eight exercises, the number of candidates offered appointment was less than the target number of appointees. Coupled with a decline rate of 14% to 80% (46% on average), the number of appointees was 3 to 93 (38 on average) less than targeted.

It is worth noting that Audit analysis of six open recruitment exercises for Workman I/Workman II conducted by six B/Ds during 2010-11 to 2012-13 revealed that, on average, 3,396 applications were received in each exercise. Of the total of 1,127 candidates offered appointment, only 96 (9%) declined the offers.

Civil service vacancies not reduced

3.15 The CSB guidelines specify that in cases where the skills, experience or expertise required can be met by serving officers in other civil service grades with potential surplus staff, in-service recruitment may be preferred for the benefit of the overall manpower planning of the civil service (see para. 3.2). There is assurance that such benefit will be achieved if:

(a) an in-service recruitment exercise is restricted to officers in selected civil service grades with potential surplus staff; and

(b) after any officers in the selected civil service grades are transferred to the recruiting B/Ds, action is taken to delete any surplus posts vacated by such officers.

However, this was not the case in the nine in-service recruitment exercises for Workman I and Workman II because all serving officers could submit applications.

3.16 Where an appointee does not come from a civil service grade with surplus staff, there is still a need to fill the vacancy left by the appointee on in-service transfer. Consequently, the civil service vacancies will not be reduced and the B/D concerned will need to conduct a recruitment exercise to fill the vacancy (see also para. 3.19).

3.17 The problem was exacerbated when an appointee was also of the Workman I or Workman II grade (e.g. a Workman II might apply for a higher paid Workman I post and some Workman Is and Workman IIs might also apply for posts of the same rank for change of working environment). There was no reduction in the total number of vacancies in the Workman I and Workman II grades service-wide. The B/D concerned conducted another in-service recruitment exercise to select a serving officer to fill the vacancy. The competition for candidates among B/Ds therefore continued, resulting in ineffective use of government resources and higher staff turnover. According to CSB records, in 2010-11 and 2011-12, 26 B/Ds conducted a total of 51 in-service Workman I or Workman II recruitment exercises to compete for candidates among themselves. Based on B/Ds' returns submitted to the CSB, there would be an average of 200 Workman I and 460 Workman II vacancies arising each year between 2013-14 and 2016-17.

Adverse impact on operations of B/Ds with officers transferred out

3.18 According to the CSRs, a B/D with officers who have been offered appointment by another B/D should release them within three months. Where a large number of officers are to be released by the B/D, there may be significant adverse impact on its operations. Audit found that the 192 appointees in the LCSD's 2011 in-service recruitment exercise for Workman I (see para. 3.14(b)) included 141 serving in the FEHD. In the end, the FEHD agreed with the LCSD to release the officers concerned to the LCSD in seven batches from April 2012 to January 2013.

3.19 In addition, according to the CSRs, an officer confirmed to the permanent establishment on in-service transfer to a new office is usually appointed on trial terms and may revert to his former office during the trial period (usually one year). Normally the B/D concerned may not fill the post vacated by the officer until the trial period ends. Therefore, the strength of the B/D may be reduced during the trial period. According to the CSB: (a) similar issues may arise in the case of open recruitment as some of the appointees may be serving officers; and (b) in some circumstances, B/Ds may prefer to fill vacancies through in-service recruitment to ensure that the time and staff costs commensurate with the number of recruits targeted in a recruitment exercise. However, Audit noted that the adverse impact of in-service recruitment where all appointees were serving officers would be much greater than in the case of open recruitment (Note 28). Furthermore, the PSC expressed the view that as a norm, open recruitment should be conducted for basic ranks irrespective of the number of vacancies (see para. 3.2(a)).

Improving the recruitment arrangements for controlled grades

3.20 As mentioned in paragraph 3.6, the CSB's objective of requiring B/Ds to obtain its approval before conducting open recruitment exercises for controlled grades is to ensure that open recruitment will only be conducted where it is fully justified. However, Audit examination revealed that a number of issues arose (see paras. 3.14 to 3.19) where B/Ds conducted in-service recruitment exercises, instead of open recruitment, for controlled grades. In Audit's view, the CSB needs to take on board the audit observations and review the recruitment arrangements for the controlled grades.

Note 28: *For the CSD's and FEHD's open recruitment of Workman IIs in 2011 and 2012 (see items 18 and 41 of Appendix B), none of the 878 appointees was a serving officer.*

Reviewing the controlled grade selection criteria

3.21 The existing controlled grade selection criteria include: (a) grades where the new intakes normally come from in-service recruitment; and (b) grades requiring skill sets that are commonly available within the civil service or can easily be acquired through training (see para. 3.6(d)). Given the Government's policy that B/Ds should normally conduct open recruitment (see para. 1.4), it is unclear:

(a) why there are still grades where the new intakes normally come from in-service recruitment; and

(b) what are the grounds to deviate from this policy for grades requiring skill sets that are commonly available within the civil service or can easily be acquired through training. B/Ds may conduct in-service recruitment to fill vacancies in any grade only under special justifiable circumstances (e.g. when surplus staff have already been identified in another grade and an in-service recruitment restricted to staff in that grade may help absorb the surplus staff).

In Audit's view, the CSB needs to review whether the two criteria need revisions.

Reviewing the controlled grade list

3.22 According to CSB records, the Workman I and Workman II grades have been selected as controlled grades since July 2007 because of meeting the following criteria:

Criterion met by Workman I grade

(a) grades that have existing or anticipated surplus based on the latest manpower plans prepared by their B/Ds and submitted to the CSB in the annual manpower plan updating exercise (see para. 3.6(a));

Criterion met by Workman II grade

(b) grades considered by their grade management as being in a state of obsolescence (see para. 3.6(c)); and

Criterion met by both Workman I and Workman II grades

(c) grades where the new intakes normally come from in-service recruitment, or requiring skill sets that are commonly available within the civil service or can easily be acquired through training (see paras. 3.6(d) and 3.21).

3.23 In preparing manpower plans, each B/D is required to indicate the number of existing or anticipated surplus staff in any grade. According to CSB records, in the 2012 manpower plans, only one department indicated a total of three surplus staff in the Workman I grade up to March 2016, which is insignificant when compared with an establishment of some 2,600 posts in the grade. It is questionable whether the Workman I grade should be selected as a controlled grade based on the surplus staff criterion (see para. 3.22(a)). In Audit's view, for grades selected as controlled grades based on the surplus staff criterion, the CSB needs to monitor their surplus staff situation to see whether the criterion remains applicable.

Audit recommendations

3.24 **Audit has *recommended* that the Secretary for the Civil Service should:**

(a) **review the issues relating to the in-service recruitment of controlled grade staff identified by Audit in paragraphs 3.14 to 3.19;**

(b) **based on the review results in (a) above, improve the recruitment arrangements for the controlled grades;**

(c) **review and revise as appropriate the following selection criteria for controlled grades:**

(i) **grades where the new intakes normally come from in-service recruitment; and**

(ii) **grades requiring skill sets that are commonly available within the civil service or can easily be acquired through training; and**

(d) **for all grades selected as controlled grades based on the surplus staff criterion, monitor their surplus staff situation to see whether the criterion remains applicable.**

Response from the Administration

3.25 The Secretary for the Civil Service agrees with the audit recommendations. He has said that the CSB will continue to closely monitor the implementation of the controlled grade mechanism and the situation of surplus staff in different grades, and from time to time update the list of controlled grades and examine the set of criteria for control in the light of the latest circumstances. The CSB will take into account the audit recommendations when it next reviews the aforesaid matters.

In-service recruitment of other civil servants

3.26 For grades other than the controlled grades, B/Ds should normally conduct open recruitment to cast the widest net for candidates. However, between 2010-11 and 2012-13, the CSD conducted a total of 12 in-service recruitment exercises for grades other than the controlled grades. Of these 12 exercises, four failed to recruit sufficient officers to fill the vacancies. Table 8 shows the details of the four exercises.

Table 8

Four in-service recruitment exercises conducted by CSD

Rank	Date of vacancy circular	No. of applications	No. of appointees		
			Target	Actual	Shortfall
Technical Instructor (Garment)	31 December 2010	35 (Note 1)	9	1	8
Technical Instructor (Leather Work)	31 December 2010	6 (Note 1)	1	—	1
Instructor (Construction and Maintenance)	17 June 2011	11 (Note 1)	1	—	1
Technical Instructor (Garment)	27 March 2012	5 (Note 2)	20	3	17

Source: CSD records

Note 1: The recruitment exercise was restricted to all serving officers in the Government.

Note 2: The recruitment exercise was restricted to serving Instructors in the CSD.

Remarks: The ranks in all the four exercises were outside the purview of the PSC.

3.27 Table 8 shows that for all the four in-service recruitment exercises, the CSD received only a small number of applications and failed to recruit the target number of officers. Audit is particularly concerned that although the 2010 in-service recruitment exercise for Technical Instructor (Garment) was unsatisfactory, the CSD still conducted another in-service recruitment exercise in 2012. Furthermore, since January 2012, B/Ds have been required to seek the advice of the CSB before conducting in-service recruitment (see para. 3.3). However, the CSD has not done so in respect of the March 2012 recruitment exercise for Technical Instructor (Garment).

3.28 Audit noted that for the post of Instructor (Construction and Maintenance), after the unsuccessful 2011 in-service recruitment exercise, the CSD conducted an open recruitment exercise in 2012 and eventually appointed one of the 200 applicants (see Figure 1 in para. 2.8). In Audit's view, the CSB needs to regularly remind B/Ds that open recruitment is the norm for filling civil service vacancies, and in-service recruitment should only be conducted under special justifiable circumstances in accordance with the CSB guidelines.

Audit recommendations

3.29 **Audit has *recommended* that the Secretary for the Civil Service should regularly remind B/Ds that:**

(a) **in-service recruitment should only be conducted under special justifiable circumstances in accordance with the CSB guidelines; and**

(b) **the advice of the PSC or CSB should be sought before conducting in-service recruitment for the specified grades.**

3.30 **Audit has *recommended* that the Commissioner of Correctional Services should:**

(a) **recruit staff through open recruitment as a norm and conduct in-service recruitment only under special justifiable circumstances; and**

(b) **seek the advice of the PSC or CSB, where required by the CSB guidelines, before conducting in-service recruitment.**

Response from the Administration

3.31 The Secretary for the Civil Service agrees with the audit recommendations in paragraph 3.29.

3.32 The Commissioner of Correctional Services agrees with the audit recommendations in paragraph 3.30. He has said that the CSD will adopt open recruitment as a norm. Should in-service recruitment be considered the most suitable mode of recruitment, the CSD will seek prior advice/approval from the PSC or CSB as appropriate.

Concessionary in-service appointment requirements

3.33 For some civil service ranks, the B/Ds concerned have set in-service appointment requirements which are lower than the entry requirements for open recruitment. The concessionary in-service appointment requirements aim to provide serving officers in specific grades with an avenue for advancement and lift staff morale. In examining the CSB's recruitment of Administrative Officers, Executive Officer IIs and Assistant Clerical Officers, Audit noted that concessionary in-service appointment requirements were set by the CSB. Table 9 shows the details.

Table 9

Concessionary in-service appointment requirements set by CSB

<table>
<tr><th rowspan="2">Rank</th><th rowspan="2">Entry requirements for open recruitment</th><th colspan="2">Concessionary in-service appointment requirements</th></tr>
<tr><th>Serving officers</th><th>Requirements</th></tr>
<tr><td rowspan="2">Administrative Officer</td><td rowspan="2">A first or second class honours bachelor's degree or postgraduate degree</td><td>Executive Officers, Labour Officers, Management Services Officers, and Trade Officers</td><td>An ordinary bachelor's degree</td></tr>
<tr><td>Other serving officers</td><td>An ordinary bachelor's degree and three years government service</td></tr>
<tr><td>Executive Officer II</td><td>A bachelor's degree or equivalent</td><td>Clerical Officers and Personal Secretaries</td><td>(a) A specific number of years of government service;

(b) for Senior Clerical Officers with less than three years' service in their present rank, Clerical Officers and Personal Secretaries, pass in five subjects in the Hong Kong Diploma of Secondary Education Examination, with Level 3 or above in either Chinese Language or English Language; and

(c) very effective or above performance</td></tr>
<tr><td>Assistant Clerical Officer</td><td>Pass in five subjects in the Hong Kong Diploma of Secondary Education Examination or equivalent</td><td>Clerical Assistants</td><td>(a) Pass in three subjects in the Hong Kong Diploma of Secondary Education Examination or equivalent and three years government service; or four years government service; and

(b) very effective or above performance</td></tr>
</table>

Source: *CSB records*

3.34 In April 2007, in a circular to B/Ds, the CSB stated that:

(a) in view of rising education standards and public expectations, the PSC was of the view that B/Ds should consider raising the in-service appointment requirements set by them for the ranks concerned to bring them on a par with the entry requirements for open recruitment. The CSB agreed with the PSC; and

(b) B/Ds should review the concessionary requirements for the ranks concerned. If, upon review, there were any special reasons to retain the requirements, B/Ds needed to advise the CSB.

3.35 As at December 2013, the CSB had not yet completed reviewing the concessionary in-service appointment requirements for all the three ranks shown in Table 9. The audit findings are as follows:

(a) ***Administrative Officer.*** In 2005, the PSC recommended that the CSB should review whether it was necessary to keep the concessionary requirements in the long run having regard to the experiences gained in future recruitment exercises. Since then, the CSB has kept in view the concessionary arrangements in rolling out each recruitment exercise and considered that they should be retained in the interest of attracting the talents of other grades. According to the CSB, the review will be finalised in 2014;

(b) ***Executive Officer II.*** In 2009, the CSB undertook to conduct an overall review of the concessionary requirements after completing the 2010-11 recruitment exercise. Up to December 2013, the CSB had not yet completed the review. According to the CSB, it has kept in view the concessionary arrangements and considered that they should be retained. The review will be finalised in 2014; and

(c) ***Assistant Clerical Officer.*** In 2010, the CSB decided to continue the concessionary requirements. However, it undertook to conduct a further review on the requirements. Up to December 2013, the CSB had not completed the review. According to the CSB, there should be no change to the concessionary arrangements and the review will be completed shortly.

3.36 In Audit's view, the CSB needs to complete reviewing the concessionary in-service appointment requirements for the three ranks as soon as possible. It also needs to find out whether all B/Ds concerned have completed their reviews of the concessionary in-service appointment requirements set by them and take appropriate follow-up action (see para. 3.34(b)).

Audit recommendations

3.37 **Audit has *recommended* that the Secretary for the Civil Service should:**

(a) **complete reviewing the concessionary in-service appointment requirements for the Administrative Officer, Executive Officer II and Assistant Clerical Officer ranks as soon as possible; and**

(b) **find out whether all B/Ds concerned have completed their reviews of the concessionary in-service appointment requirements set by them for the ranks concerned and take appropriate follow-up action.**

Response from the Administration

3.38 The Secretary for the Civil Service agrees with the audit recommendations. He has said that the CSB has kept in view the concessionary in-service appointment requirements. The CSB will complete the relevant reviews in 2014.

PART 4: RECRUITMENT OF NON-CIVIL SERVICE STAFF

4.1 This PART examines the following issues relating to the recruitment of non-civil service staff:

(a) open recruitment of non-civil service staff (paras. 4.5 to 4.18); and

(b) restricted recruitment exercises for non-civil service staff (paras. 4.19 to 4.23).

Non-civil service staff

4.2 In addition to civil servants, B/Ds may employ non-civil service staff to meet service needs, as follows:

(a) ***Non-civil service contract (NCSC) staff.*** The NCSC scheme was introduced in 1999 to replace the previous arrangement for employing temporary staff. Under the scheme, B/Ds may, subject to availability of funding, employ NCSC staff for the following purposes:

  (i) to meet service need that is short-term or does not require keeping staff on a long-term or permanent basis;

  (ii) to meet service need that requires staff on a part-time basis;

  (iii) to meet service need where the mode of delivery of the service is under review or likely to be changed (e.g. pending contracting out of the service); or

  (iv) to meet service need which is subject to market fluctuations or requires tapping expertise in a particular area; and

(b) ***Other non-civil service staff.*** B/Ds may recruit other non-civil service staff under justifiable circumstances, such as performing urgent time-limited assignments.

Recruitment of non-civil service staff

As at 30 June 2013, there were 14,759 full-time non-civil service staff, comprising 12,900 NCSC staff and 1,859 other non-civil service staff.

4.3 Non-civil service staff do not occupy posts on the establishment of the B/Ds and are not counted towards the establishment or strength of the B/Ds. Their appointments are separate and distinct from the system for making civil service appointments. Subject to the requirements specified in the CSB guidelines, B/Ds have the full authority to decide on the employment of non-civil service staff, and are held fully accountable for the funding and employment of these staff.

4.4 The CSB guidelines on the recruitment of non-civil service staff include the following:

(a) ***Using non-civil service staff.*** Where the service need is long-term and the duties can be aptly performed by civil service staff, civil servants rather than non-civil service staff should be used as a norm;

(b) ***Recruitment procedures.*** In general, the norm for recruiting non-civil service staff is open recruitment. B/Ds should draw up appropriate recruitment procedures, having regard to the principle of openness and fairness and the need to minimise the risk of corruption or allegations of such;

(c) ***Direct appointment.*** Direct appointment (i.e. without conducting a recruitment exercise) is permitted where there are special circumstances justifying the arrangement, such as appropriate expertise is urgently required or the expertise/experience/skill required is not readily available in the open market. B/Ds should ensure that a due process has been followed in arriving at the conclusion of direct appointment. Selection based on pre-determined criteria can help ward off any perceived conflict of interest or favouritism being given to a particular candidate or group of candidates; and

(d) ***Appointing retired civil servants.*** B/Ds may appoint retired civil servants to non-civil service positions. However, B/Ds should ensure that such appointments should not be, or should not be seen as, an extension of service for those reaching retirement, and that retired civil servants should not be appointed to take up duties which are essentially the same as those of their pre-retirement positions.

In practice, B/Ds' procedures for the open recruitment of non-civil service staff are generally the same as those in an open recruitment exercise for civil servants (see para. 2.2).

Open recruitment of non-civil service staff

4.5 Audit examination revealed room for improvement in the open recruitment of non-civil service staff. Details are in paragraphs 4.6 to 4.18.

Use of job application system

4.6 The CSB has implemented a job application system to allow candidates to complete and submit application forms online. B/Ds may use the system in conducting open recruitment exercises for civil servants or non-civil service staff. However, Audit examination of the recruitment advertisements placed by 30 B/Ds for 80 NCSC positions around mid-2013 revealed that online applications were accepted for only 18 (23%) of the 80 positions. In Audit's view, the CSB needs to find out why many B/Ds did not use the job application system and take appropriate measures to facilitate their use of the system to enhance efficiency.

CSD's open recruitment of NCSC staff

4.7 ***Recruitment procedures not drawn up.*** The CSB guidelines require B/Ds to draw up appropriate procedures for the recruitment of NCSC staff (see para. 4.4(b)). Audit noted that the CSD has not drawn up specific procedures for the recruitment of NCSC staff. According to the CSD, the procedures used were the same as those in an open recruitment exercise for civil servants where applicable. However, Audit examination of one CSD recruitment exercise for NCSC staff revealed exceptions (see para. 4.8).

4.8 ***Selection interviews not conducted.*** Audit found that in recruiting a part-time NCSC staff (Museum Assistant) in March 2011, after ranking the applicants according to their academic qualifications and experience, the CSD selected the top one for appointment without conducting any selection interview. Such selection process was not in line with the procedures for the recruitment of civil servants. According to the CSB guidelines, conducting selection interviews is a key process in civil service recruitment. The selection interviews aim to select persons best fitted for the job, not necessarily the best qualified or most experienced candidate. In Audit's view, the CSD needs to draw up appropriate procedures for the recruitment of NCSC staff and ensure that CSD staff conduct recruitment exercises properly in accordance with such procedures.

LCSD's open recruitment of NCSC staff

4.9 Due to high staff turnover, the LCSD had conducted frequent exercises for recruiting certain NCSC staff, as follows:

(a) ***Music Officers.*** The Music Office has been manned by 62 Music Officers on NCSC terms since the establishment of the LCSD in 2000 (Note 29). Between 2010-11 and 2012-13, 14 Music Officers left the Office and the LCSD conducted a total of 15 recruitment exercises to fill the vacancies in various work streams and levels; and

(b) ***Stage Management Officers and Stage Technicians.*** Since 2000, the LCSD has engaged Stage Management Officers and Stage Technicians on NCSC terms for providing stage-related services for its 16 performing arts venues (Note 30). Between April 2010 and December 2013, the LCSD conducted a total of eight recruitment exercises for filling 47 vacancies at various levels arising from staff turnover.

Note 29: *The Music Office was established by the Government in 1977 to promote knowledge and appreciation of music in the community. In 2000, in taking over the Office from the two ex-municipal councils, the LCSD offered contract positions to 57 staff of the Office on ex-council contract terms and the remaining 5 staff on NCSC terms. Upon the departure of any such staff, the LCSD's practice has been to recruit NCSC staff to meet the service needs. For simplicity, staff on ex-council contract terms, being non-civil service staff, are also referred to as NCSC staff in this Audit Report.*

Note 30: *As at 31 December 2013, there were 54 Stage Management Officers and 26 Stage Technicians (37 and 11 respectively on 1 July 2001).*

4.10 The high staff turnover may indicate that the LCSD had difficulties in retaining Music Officers, Stage Management Officers and Stage Technicians on NCSC terms. However, the LCSD had taken a long time to review the NCSC positions, as follows:

(a) ***Music Officers.*** In 2006, the Committee on Performing Arts (Note 31) studied the long-term mode of operation of the Music Office, and recommended the transfer of the Office to an outside organisation. Since then, the LCSD had conducted rounds of consultation with the staff and stakeholders on the recommendation, which was met with objection. In late November 2013, after reviewing the alternative modes of operation of the Office, the LCSD came up with a staffing proposal for the longer term development of the Office and consulted the CSB on the principles of the proposal. As an interim measure, the LCSD also restructured the NCSC positions of Music Officer with a view to retaining the serving officers and reducing the high staff turnover; and

(b) ***Stage Management Officers and Stage Technicians.*** In 2007, the LCSD set up a working group to review stage-related services and the way forward for the NCSC positions. As at January 2014, the LCSD was finalising its proposal for the long-term manpower plans and had consulted the CSB on various issues of the proposal.

4.11 While NCSC staff may be used to meet service need that is short-term or where the mode of delivery of the service is under review (see paras. 4.2(a)(i) and (iii) and 4.4(a)), the LCSD has employed Music Officers, Stage Management Officers and Stage Technicians on NCSC terms for some 14 years since 2000. In Audit's view, the LCSD needs to closely monitor the staff turnover of the NCSC positions and agree/finalise with the CSB on the way forward for the positions at an early date.

4.12 ***Non-local qualifications not authenticated.*** According to the LCSD's Manual on the Employment and Management of Contract Staff (non-civil service), the recruiting office should authenticate non-local qualifications obtained by

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Note 31: *The Committee on Performing Arts was established in 2004 to advise the Secretary for Home Affairs on the provision of performing arts services.*

candidates. Of the 15 recruitment exercises for Music Officers conducted between 2010-11 and 2012-13, in eight exercises there were candidates holding non-local qualifications. However, there was no documentary evidence that the LCSD had taken action to authenticate their qualifications. In Audit's view, the LCSD needs to remind its staff to authenticate candidates' non-local qualifications in accordance with its guidelines.

Audit recommendations

4.13 **Audit has *recommended* that the Secretary for the Civil Service should:**

(a) **find out why many B/Ds did not use the CSB's job application system in conducting recruitment exercises for NCSC staff; and**

(b) **take appropriate measures to facilitate B/Ds' use of the system to enhance efficiency.**

4.14 **Audit has *recommended* that the Commissioner of Correctional Services should:**

(a) **draw up appropriate procedures for the recruitment of NCSC staff; and**

(b) **ensure that CSD staff conduct recruitment exercises for NCSC staff properly in accordance with such procedures.**

4.15 **Audit has *recommended* that the Director of Leisure and Cultural Services should:**

(a) **closely monitor the staff turnover of the NCSC positions of Music Officers, Stage Management Officers and Stage Technicians, and agree/finalise with the CSB on the way forward for the positions at an early date; and**

(b) **remind LCSD staff of the need to authenticate candidates' non-local qualifications in conducting recruitment exercises for NCSC staff.**

Response from the Administration

4.16 The Secretary for the Civil Service agrees with the audit recommendations in paragraph 4.13. He has said that the CSB will remind B/Ds to make more use of the CSB's electronic job application system in conducting recruitment exercises of NCSC staff and, where appropriate, take measures to facilitate B/Ds to use the system.

4.17 The Commissioner of Correctional Services agrees with the audit recommendations in paragraph 4.14. He has said that the CSD already commenced a comprehensive review of the overall recruitment processes in mid-February 2014, which covers the recruitment procedures for NCSC staff. The CSD will take appropriate measures, in consultation with the CSB where necessary, to ensure compliance with the relevant CSB guidelines.

4.18 The Director of Leisure and Cultural Services agrees with the audit recommendations in paragraph 4.15. She has said that:

(a) the LCSD has engaged Music Officers, Stage Management Officers and Stage Technicians on NCSC terms in the past years to provide services in the Music Office and performing arts venues where the mode of service delivery is under review. The LCSD has completed these reviews and is consulting the CSB on the manpower proposals. Where the work involved is of a permanent nature, the LCSD will work with the CSB to replace the NCSC positions by civil service posts in accordance with the established procedures. In the interim, the LCSD has restructured the NCSC positions of Music Officer and improved their pay package with a view to retaining the serving officers; and

(b) for the recruitment of Music Officers, the LCSD authenticated non-local qualifications of candidates through written test, audition and interview by qualified professionals in the Music Office. The LCSD has reminded the recruiting office to authenticate non-local qualifications of candidates with the issuing institutions, in addition to the test, audition and interview to be conducted.

Restricted recruitment exercises for non-civil service staff

FEHD's restricted recruitment exercises for NCSC staff

4.19 According to the CSB guidelines, the norm for recruiting non-civil service staff is open recruitment. However, between 2010-11 and 2012-13, the FEHD conducted four restricted recruitment exercises for NCSC staff confining to selected groups of retired civil servants (Note 32). Table 10 shows the details.

Table 10

FEHD's restricted recruitment exercises for NCSC staff (2010-11 to 2012-13)

Year	Position	No. of applications	No. of appointees
2010-11	Food Traders Registration Officer	54	15
2011-12	Food Control Assistant	24	24
2012-13	Coordinator	2	1
	Food Control Assistant	29	12

Source: *FEHD records*

Remarks: *All the four exercises were confined to selected groups of retired civil servants.*

4.20 Audit examination of the recruitment of Food Control Assistants in 2011-12 revealed that, unlike the other three restricted recruitment exercises, there was insufficient documentation of the recruitment process and decisions. For example, Audit could not find from FEHD records details about the entry requirements, vetting of applications, selection interviews and assessment form. In February 2014, upon enquiry, the FEHD informed Audit that:

Note 32: *According to the FEHD guidelines on the recruitment of NCSC staff, if it is considered necessary, direct or restricted appointments should be put up with full justifications through the Appointments Section to the respective Directorate officer for consideration and approval.*

(a) after the Fukushima nuclear power plant incident in March 2011, the FEHD was committed to conducting radiation tests on foods imported from Japan. Hence, the FEHD needed to recruit 24 Food Control Assistants on NCSC terms urgently to cope with the additional workload;

(b) in view of the urgent need of recruiting sufficient experienced staff, arrangement had been made to contact by phone (being the most expeditious and effective means in the circumstances) ex-Health Inspector grade officers who retired within the last 10 years, possessed a diploma in Meat and Other Foods Inspections and had good track records/food control experience. With essential background information of the retired officers already in possession, the FEHD tried to call all the ex-Health Inspector grade officers who met the selection criteria. In the event, only 24 of them were successfully contacted and they agreed to take up offers of appointment; and

(c) since the number of candidates available was the same as the target number of appointees, no further selection process was considered necessary. All of them were then appointed.

4.21 While restricted recruitment/direct appointment is permitted where there are special circumstances justifying the arrangement, it is important that a due process is followed and there is no perceived conflict of interest or favouritism being given to a particular candidate or group of candidates (see para. 4.4(c)). In Audit's view, the FEHD needs to ensure that proper documentation on the recruitment process and decisions is maintained for review and accountability purposes.

Audit recommendation

4.22 **Audit has *recommended* that the Director of Food and Environmental Hygiene should ensure that, in conducting restricted recruitment exercises for non-civil service staff under special justifiable circumstances, proper documentation on the recruitment process and decisions is maintained.**

Response from the Administration

4.23 The Director of Food and Environmental Hygiene agrees with the audit recommendation. She has said that for subsequent similar exercises, documentation has been done properly.

PART 5: WAY FORWARD

5.1 This PART outlines the major audit observations and examines the way forward.

Summary of observations

5.2 In PART 2, Audit has found that the CSB does not have an established mechanism to collect information on recruitment exercises conducted by B/Ds and monitor their completion time. Audit analysis of the completion time of open recruitment exercises conducted by B/Ds in 2010-11 and 2011-12 has revealed that some 20% of the exercises took over eight months to complete. In the examination of 50 open recruitment exercises conducted between 2010-11 and 2012-13 by five B/Ds including three with the largest number of vacancies and one having taken a long time to complete some of its recruitment exercises, Audit has found that one department took on average 382 days to complete its 18 open recruitment exercises, with the longest exercise having taken 714 days. Audit has also found room for improvement in the recruitment processes, including vetting applications, shortlisting candidates and holding skill tests/examinations.

5.3 In PART 3, Audit has reported various issues relating to the in-service recruitment of staff in controlled grades, notably Workman I and Workman II. As at 31 March 2013, the EDB, FEHD and LCSD had a total of 435 Workman I and 497 Workman II vacancies. Audit examination has revealed that during 2010-11 to 2012-13 they conducted a total of nine in-service recruitment exercises for Workman I/Workman II. However, due to the reduced pool of candidates and high decline rates, these nine exercises failed to recruit sufficient officers to fill the vacancies. Such in-service recruitment exercises generally did not reduce civil service vacancies service-wide but resulted in ineffective use of government resources by B/Ds to compete for staff and high staff turnover in such B/Ds. Additionally, since there is a requirement on the part of the B/D which has lost staff due to such in-service transfers to keep the post of the departed staff open during his trial period in the recruiting B/D, those B/Ds with large number of officers transferred out would have a prolonged period of vacancies during which they are restricted from recruiting new staff to fill the posts. This would have an adverse impact on the operations of these B/Ds.

5.4 In PART 4, Audit has found room for improvement in the recruitment of non-civil service staff by B/Ds, including using the online job application system, drawing up recruitment procedures, conducting selection interviews and reviewing the NCSC positions.

Audit recommendations

5.5 According to the 2014-15 Budget, the civil service establishment is expected to expand by 2,556 posts in 2014-15 (50% up from that of 2013-14). Based on the CSB's estimate, around 6,000 civil servants will retire each year from 2013-14 to 2017-18 and the number will further increase to around 7,000 a year from 2018-19 to 2022-23. **To fill vacancies arising from wastage and creation of posts in a timely manner, Audit has *recommended* that the Secretary for the Civil Service should work with the PSC to:**

(a) **keep a closer monitoring of the recruitment efforts among the B/Ds;**

(b) **assist Controlling Officers to speed up recruitment exercises, analyse long period of vacancies and devise solutions, and enhance/improve the mechanism in gathering recruitment statistics; and**

(c) **review the controlled grade arrangements.**

Response from the Administration

5.6 The Secretary for the Civil Service agrees with the audit recommendations. He has said that:

(a) the CSB would, on top of the ongoing efforts in monitoring the filling of civil service vacancies, work with B/Ds in considering suitable refinements to the arrangements for monitoring and streamlining the recruitment process; and

(b) the CSB will continue to closely monitor the implementation of the controlled grade mechanism and examine the set of criteria for control in the light of the latest circumstances.

Appendix A
(paras. 2.4 and 2.5 refer)

Time taken to complete open recruitment exercises (2010-11 and 2011-12)

<table>
<tr><th rowspan="3">No. of days taken to complete exercise</th><th colspan="10">No. of exercises</th></tr>
<tr><th colspan="5">2010-11</th><th colspan="5">2011-12</th></tr>
<tr><th colspan="2">Within the PSC's purview</th><th colspan="2">Outside the PSC's purview</th><th>Total</th><th colspan="2">Within the PSC's purview</th><th colspan="2">Outside the PSC's purview</th><th>Total</th></tr>
<tr><td>60 or less</td><td colspan="2">0 (0%)</td><td colspan="2">1 (1%)</td><td>1 (1%)</td><td colspan="2">0 (0%)</td><td colspan="2">0 (0%)</td><td>0 (0%)</td></tr>
<tr><td>61 to 120</td><td colspan="2">7 (9%)</td><td colspan="2">14 (14%)</td><td>21 (12%)</td><td colspan="2">5 (7%)</td><td colspan="2">6 (6%)</td><td>11 (7%)</td></tr>
<tr><td>121 to 180</td><td colspan="2">21 (27%)</td><td colspan="2">36 (37%)</td><td>57 (32%)</td><td colspan="2">34 (46%)</td><td colspan="2">36 (39%)</td><td>70 (42%)</td></tr>
<tr><td>181 to 240</td><td colspan="2">33 (43%)</td><td colspan="2">24 (24%)</td><td>57 (32%)</td><td colspan="2">20 (27%)</td><td colspan="2">26 (28%)</td><td>46 (27%)</td></tr>
<tr><td>241 to 300</td><td>11 (14%)</td><td rowspan="3">16 (21%)</td><td>13 (13%)</td><td rowspan="3">24 (24%)</td><td>24 (14%)</td><td>9 (12%)</td><td rowspan="3">15 (20%)</td><td>18 (19%)</td><td rowspan="3">25 (27%)</td><td>27 (16%)</td></tr>
<tr><td>301 to 360</td><td>3 (4%)</td><td>8 (8%)</td><td>11 (6%)</td><td>5 (7%)</td><td>2 (2%)</td><td>7 (4%)</td></tr>
<tr><td>Over 360</td><td>2 (3%)</td><td>3 (3%)</td><td>5 (3%)</td><td>1 (1%)</td><td>5 (6%)</td><td>6 (4%)</td></tr>
<tr><td>Total</td><td colspan="2">77 (100%)</td><td colspan="2">99 (100%)</td><td>176 (100%)</td><td colspan="2">74 (100%)</td><td colspan="2">93 (100%)</td><td>167 (100%)</td></tr>
</table>

Source: Audit analysis of CSB records

Remarks:

1. *The recruitment exercises for each year were those with recruitment advertisements placed in the year.*
2. *The time taken to complete each exercise was counted from the date of placing an advertisement to the date of making the first offer of appointment. Therefore, the above figures do not include all-year-round recruitment exercises (e.g. those for Inspector/Superintendent of Police and Police Constable conducted by the Hong Kong Police Force) which do not have definite dates of placing advertisements and making offers of appointment.*
3. *The above figures do not include exercises for the recruitment of judges and judicial officers, Independent Commission Against Corruption officers and locally engaged staff working in Hong Kong Economic and Trade Offices because they were not covered in the CSB's studies of attractiveness of civil service jobs.*

Appendix B
(paras. 2.6 and 3.19 refer)

50 open recruitment exercises examined by Audit

	Rank	No. of vacancies	Date of placing advertisement	No. of applications received	No. of days taken after placing advertisement to submit board report to PSC	No. of days taken after placing advertisement to make first offer of appointment
CSB						
1	Assistant Clerical Officer	1,435	10/12/2010	24,244	Not required	141
2	Simultaneous Interpreter	2	18/2/2011	247	187	202
3	Training Officer I	5	25/2/2011	1,057	193	210
4	Administrative Officer	40	3/9/2011	15,141	206	216
5	Executive Officer II	200	3/9/2011	22,169	210	224
6	Official Languages Officer II	26	16/12/2011	2,206	217	253
7	Simultaneous Interpreter	1	29/6/2012	250	190	217 (Note 1)
8	Administrative Officer	30	8/9/2012	13,973	208	221
9	Executive Officer II	140	8/9/2012	21,053	202	214
10	Training Officer I	4	25/1/2013	950	209	249
CSD						
11	Officer	51	25/6/2010	11,695	322	342
12	Dispenser	3	30/7/2010	162	Not required	246
13	Technical Instructor (Printing)	1	6/8/2010	169	Not required	628 (Note 2)
14	Technical Instructor (Sign Making)	1	6/8/2010	137	Not required	440
15	Technical Instructor (Construction and Maintenance)	1	10/9/2010	477	Not required	714
16	Assistant Officer II	329	17/9/2010	10,367	Not required	243
17	Instructor (Carpentry)	3	17/12/2010	96	Not required	309
18	Workman II	26	28/1/2011	1,602	Not required	188
19	Assistant Lecturer (Food and Beverage Services)	1	24/6/2011	210	Not required	371
20	Assistant Education Officer	8	29/7/2011	1,937	390	424
21	Assistant Officer II	283	19/8/2011	9,731	Not required	125
22	Technical Instructor (Building Renovation)	1	9/9/2011	163	Not required	482
23	Technical Instructor (Building Services)	2	9/9/2011	312	Not required	496
24	Officer	25	28/10/2011	6,592	225	258
25	Instructor (Construction and Maintenance)	1	15/6/2012	200	Not required	551
26	Instructor (Garment)	10	15/6/2012	303	Not required	449
27	Works Supervisor II	1	3/8/2012	746	Not required	356
28	Officer	25	30/11/2012	6,900	196	245

Appendix B
(Cont'd)
(paras. 2.6 and 3.19 refer)

	Rank	No. of vacancies	Date of placing advertisement	No. of applications received	No. of days taken after placing advertisement to	
					submit board report to PSC	make first offer of appointment
EDB						
29	Specialist (Education Services) II	3	28/8/2010	129	166	249
30	Assistant Education Officer (Admin)	18	2/10/2010	2,134	196	238
31	Assistant Inspector (Graduate)	47	2/10/2010	4,394	180	215
32	Specialist (Education Services) I	12	12/2/2011	29	74	108
33	Assistant Education Officer	61	24/9/2011	3,620	166	238
34	Specialist (Education Services) I	12	17/3/2012	30	90	158
35	Assistant Education Officer (Admin)	42	31/3/2012	2,271	220	259
FEHD						
36	Laboratory Attendant	5	30/4/2010	1,951	Not required	169
37	Assistant Pest Control Officer	3	17/9/2010	1,277	Not required	180
38	Pest Control Assistant II	8	17/9/2010	1,850	Not required	172
39	Health Inspector II	157	24/9/2010	5,131	Not required	158
40	Student Pest Control Assistant	5	21/1/2011	1,176	Not required	175
41	Workman II	680	23/3/2012	6,600	Not required	187
42	Assistant Hawker Control Officer	170	13/4/2012	6,206	Not required	197
43	Health Inspector II	65	25/5/2012	5,051	Not required	235
LCSD						
44	Assistant Curator II (History)	19	23/4/2010	1,253	116	138
45	Assistant Manager, Cultural Services	24	24/9/2010	10,332	203	242
46	Amenities Assistant III	114	8/10/2010	11,460	Not required	134
47	Assistant Leisure Services Manager II	9	25/2/2011	2,873	Not required	200
48	Cultural Services Assistant II	92	13/5/2011	18,100	Not required	315
49	Assistant Librarian	21	11/11/2011	7,926	214	234
50	Assistant Librarian	17	17/8/2012	11,523	266	305

Source: Audit analysis of CSB, CSD, EDB, FEHD and LCSD records

Note 1: As no suitable candidate was identified, the time between the date of placing advertisement and the date of the PSC's endorsement of the notification of the results is shown.

Note 2: As the CSD decided not to appoint any candidate after completing all recruitment formalities, the time between the date of placing advertisement and the date of the decision is shown.

Appendix C
(para. 3.14 refers)

Nine in-service recruitment exercises examined by Audit

B/D	Date of issue of vacancy circular	No. of applications received (a)	Target no. of appointees (b)	No. of candidates offered appointment (c)	No. of candidates accepting appointment (d)	Decline rate (e) = $\frac{(c)-(d)}{(c)} \times 100\%$	Shortfall in no. of appointees (f) = (b) − (d)
Recruitment exercises for Workman I							
FEHD	14/1/2011	182	110	93	63	32%	47
	22/2/2013	142	56	51	26	49%	30
LCSD	13/8/2010	257	254	187	161	14%	93
	28/10/2011	358	256	295	192	35%	64
Recruitment exercises for Workman II							
EDB	19/8/2011	91	18	5	1	80%	17
	22/2/2013	56	46	18	10	44%	36
LCSD	1/12/2010	99	8	7	5	29%	3
	10/10/2011	128	22	21	7	67%	15
	22/3/2013	78	45	17	6	65%	39

Source: Audit analysis of EDB, FEHD and LCSD records

Acronyms and abbreviations

Audit	Audit Commission
B/D	Bureau/department
CSB	Civil Service Bureau
CSD	Correctional Services Department
CSRs	Civil Service Regulations
EDB	Education Bureau
FEHD	Food and Environmental Hygiene Department
LCSD	Leisure and Cultural Services Department
NCSC	Non-civil service contract
PSC	Public Service Commission