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The President of the Legislative Council,
Legislative Council Complex,
Hong Kong.

Sir,

In accordance with the paper tabled in the Provisional Legislative Council on 11 February 1998 on the Scope of Government Audit in the Hong Kong Special Administrative Region — ‘Value for Money Audits’, I have the honour to submit my Report No. 68 on the results of value for money audits completed in accordance with the value for money audit guidelines laid down in the paper. These guidelines are also attached.

Yours faithfully,

David Sun

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The Director of Audit's Report No. 68 contains the following chapters:

Chapter	Subject
1	Government's support and monitoring of charities
2	Monitoring of charitable fund-raising activities
3	Management of squatter and licensed structures
4	Provision of district council funds for community involvement projects
5	Kai Tak Cruise Terminal
6	Management of projects financed by the Lotteries Fund
7	Provision of dental services
8	The Language Fund

VALUE FOR MONEY AUDIT GUIDELINES

Value for money audit

Value for money audit is an examination into the economy, efficiency and effectiveness with which any bureau of the Government Secretariat, department, agency, other public body, public office, or audited organisation has discharged its functions. Value for money audit is 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 have been accepted by the Administration.

2. The guidelines are:

- firstly, the Director of Audit should have great freedom in presenting his reports to the Legislative Council. He may draw attention to any circumstance which comes to his knowledge in the course of audit, and point out its financial implications. Subject to the guidelines, he will not comment on policy decisions of the Executive and Legislative Councils, save from the point of view of their effect on the public purse;
- secondly, in the event that the Director of Audit, during the course of carrying out an examination into the implementation of policy objectives, reasonably believes that at the time policy objectives were set and decisions made there may have been a lack of sufficient, relevant and reliable financial and other data available upon which to set such policy objectives or to make such decisions, and that critical underlying assumptions may not have been made explicit, he may carry out an investigation as to whether that belief is well founded. If it appears to be so, he should bring the matter to the attention of the Legislative Council with a view to further inquiry by the Public Accounts Committee. As such an investigation may involve consideration of the methods by which policy objectives have been sought, the Director should, in his report to the Legislative Council on the matter in question, not make any judgement on the issue, but rather present facts upon which the Public Accounts Committee may make inquiry;
- thirdly, the Director of Audit may also consider as to whether policy objectives have been determined, and policy decisions taken, with appropriate authority;

- fourthly, he may also consider whether there are satisfactory arrangements for considering alternative options in the implementation of policy, including the identification, selection and evaluation of such options;
- fifthly, he may also consider as to whether established policy aims and objectives have been clearly set out; whether subsequent decisions on the implementation of policy are consistent with the approved aims and objectives, and have been taken with proper authority at the appropriate level; and whether the resultant instructions to staff accord with the approved policy aims and decisions and are clearly understood by those concerned;
- sixthly, he may also consider as to whether there is conflict or potential conflict between different policy aims or objectives, or between the means chosen to implement them;
- seventhly, he may also consider how far, and how effectively, policy aims and objectives have been translated into operational targets and measures of performance and whether the costs of alternative levels of service and other relevant factors have been considered, and are reviewed as costs change; and
- finally, he may also be entitled to exercise the powers given to him under section 9 of the Audit Ordinance (Cap. 122).

3. The Director of Audit is not entitled to question the merits of the policy objectives of any bureau of the Government Secretariat, department, agency, other public body, public office, or audited organisation in respect of which an examination is being carried out or, subject to the guidelines, the methods by which such policy objectives have been sought, but he may question the economy, efficiency and effectiveness of the means used to achieve them.

4. Value for money audit is conducted in accordance with a programme of work which is determined annually by the Director of Audit. The procedure of the Public Accounts Committee provides that the Committee shall hold informal consultations with the Director of Audit from time to time, so that the Committee can suggest fruitful areas for value for money audit by the Director of Audit.

CHAPTER 1

**Inland Revenue Department
Lands Department
Home Affairs Bureau
Social Welfare Department
Companies Registry
Hong Kong Police Force
Education Bureau
Development Bureau**

**Government's support
and monitoring of charities**

**Audit Commission
Hong Kong
3 April 2017**

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

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GOVERNMENT'S SUPPORT AND MONITORING OF CHARITIES

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GOVERNMENT'S SUPPORT AND MONITORING OF CHARITIES

Executive Summary

1. Charities make an important contribution to the community. The Government has provided various support to them, including: (a) tax exemption under the Inland Revenue Ordinance (IRO — Cap. 112) (for 8,923 recognised charitable organisations as at September 2016) and tax deduction for donations made to tax-exempt charities (totalling \$11.84 billion for the year of assessment 2014-15); (b) granting land at a nominal premium to non-profit-making charitable institutions mainly for operating schools, hospitals and social welfare facilities; and (c) provision of recurrent subventions to some of these institutions for providing services primarily in the education, social welfare and health sectors.

2. There is no overall statutory scheme for the registration and regulation of charities in Hong Kong. Depending on their legal forms and whether they have sought recognition of tax exemption status and government support, charities are subject to the monitoring and/or registration framework of different government bureaux/departments (B/Ds), as follows:

- (a) ***Inland Revenue Department (IRD).*** The IRD is responsible, as a tax administrator, for raising revenue through taxes, duties and fees in accordance with the relevant legislation. In addition to making tax assessments, collecting taxes, and other statutory functions, it processes applications for the recognition of tax exemption status of charities under section 88 of the IRO. Charities are chargeable to profits tax if they carry on trade or business with profits in Hong Kong and fail to satisfy the provisions of section 88;
- (b) ***Lands Department (Lands D).*** Land is made available by the Government by way of a private treaty grant (PTG) at nominal or concessionary premium or a short term tenancy at nominal or concessionary rent to non-profit-making organisations for operating schools, hospitals, and social welfare and community facilities. Many of the entities receiving such land grants are tax-exempt charities. In such

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cases, the charitable organisations are regulated by the Lands D and the supporting B/Ds to ensure their compliance with the conditions of land grant and the policy intention of granting the land;

- (c) ***Companies Registry (CR).*** The CR is responsible for administering and enforcing the Companies Ordinance (Cap. 622) for some 1.34 million limited companies on the Companies Register. As at September 2016, 6,619 charities which obtained tax exemption status under section 88 of the IRO were incorporated as companies under the Companies Ordinance;
- (d) ***Hong Kong Police Force (HKPF).*** The Societies Office of the HKPF is responsible for administering the Societies Ordinance (Cap. 151) and granted registration or exemption from registration to 37,861 local societies as at September 2016. 1,000 societies so registered or exempted from registration were charities and 811 of which had obtained tax exemption status under section 88 of the IRO;
- (e) ***Education Bureau (EDB).*** Under the Education Ordinance (Cap. 279), all aided schools are required to set up incorporated management committees (IMCs). Direct Subsidy Scheme schools may opt to establish IMCs under the Ordinance. As at September 2016, 772 of the 846 IMCs on the EDB's Register of IMCs obtained tax exemption status under section 88 of the IRO; and
- (f) ***Home Affairs Bureau (HAB).*** As at September 2016, there were 2,480 tax-exempt charities established for purposes of advancement of religion. It is the Government's policy to respect the autonomy of religious organisations. However, the Chinese Temples Ordinance (CTO — Cap. 153) was enacted in 1928 to suppress and prevent mismanagement of Chinese temples and abuses of donated funds. The Chinese Temples Committee (CTC) is established, with the Secretary for Home Affairs as the Chairman, to regulate Chinese temples. As at September 2016, 347 of around 600 Chinese temples were registered with the CTC under the CTO. Of these 347 registered Chinese temples, 45 were administered directly or indirectly by the CTC, with the remaining 302 managed by individuals or organisations. Of the 347 registered temples, 129 were managed by tax-exempt charities.

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The Audit Commission (Audit) has recently conducted a review on the Government's support and monitoring of charities with a view to identifying areas for improvement.

Administration of tax exemption of charities and tax-deductible donations

3. According to the legal advice obtained by the IRD, section 88 of the IRO does not confer on it the power to grant tax exemption status. What section 88 provides is that charitable institutions or trusts of a public character are exempt from tax and they can seek recognition of such exemption by the IRD. They will be put on a list of charitable institutions or trusts of a public character maintained by the IRD subject to their consent. The IRD is not responsible for the governance of a charity, nor does it have regulatory power over the operation of a charity. As administrative procedures, it will conduct periodic reviews to see whether the organisations' objects are still meeting the eligibility criteria of charitable purposes and their activities are compatible with their objects. According to the tax guide issued by the IRD, the governing instrument of a charity should generally include clauses stating its objects and limiting the application of its funds towards the attainment of its stated objects. The Charitable Donations Section (CDS), led by a Chief Assessor and comprises eight staff, is responsible for processing applications for recognition of tax exemption status and conducting periodic reviews by issuing questionnaires to obtain information from charities concerned (paras. 1.7(a), 2.3(b) and 2.4).

4. *Delays in taking follow-up actions in uncompleted review cases.* Audit analysis of the IRD's computer database revealed that as at September 2016, there were 635 uncompleted review cases, of which 71 (11%) had remained uncompleted over five years. Audit sample checked 17 of the 71 uncompleted review cases and found that in 15 (88%) cases, there were delays on the part of the IRD. For example, in one case, the charity concerned submitted a questionnaire in April 2009 which was left unattended to until September 2016 when the IRD resumed follow-up action. There is a need to closely monitor the uncompleted review cases because if the IRD subsequently finds it necessary to withdraw the recognition of the tax exemption status of a charity, there could be delays in raising assessments on its profits, given the six-year time limit in raising assessments and demanding tax under the IRO (paras. 2.10 to 2.12).

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5. Audit examined 160 review cases and 10 applications for reinstatement of tax exemption status and found limitations in the IRD's follow-up actions on matters of regulatory concern in 6 review/reinstatement cases (para. 2.13):

- (a) ***Directors' remuneration.*** In four cases, the IRD found that the charities concerned had paid remunerations to their directors, which were not allowed in their governing instruments. While remedial actions were taken by the charities concerned, ranging from cessation of payment (without any refund of \$13 million paid) to partial refund (5% of \$276,100 paid in one case and 50% of \$375,000 paid in another case) and full refund (of \$64,200 paid), their tax exemption status was not affected (para. 2.14); and
- (b) ***Expenses not in furtherance of charitable objects.*** In two cases, the IRD identified expenditures which were not in furtherance of the objects of the charities concerned. In both cases, the IRD continued their tax exemption status after remedial actions had been taken, i.e. a full refund (of \$704,500) in one case and an undertaking not to make similar payment (without refund of \$236,000 paid) in another case (para. 2.15).

6. ***Limitations of the IRO provisions on tax exemption status of charities.*** According to the IRD, while the breach of the directors' remuneration clauses may constitute a breach of fiduciary duty, such breach would not alter the charity's objects and hence its charitable status. Based on the legal advice obtained by the IRD in 2003, it was not legally proper to overturn a charity's tax exemption status solely because the charity had not complied with any obligations which were not provided in the IRO. The IRD also informed Audit that the IRD had no authority to demand the charity to refund (in full or in part) of the payment made. However, there is a gap between the public expectation of the IRD's role in administering the tax exemption status of charities and what the IRD can do under the existing provisions of the IRO. In its Report on Charities of 2013, the Law Reform Commission (LRC) considered that the IRD's function of reviewing the accounts of charities to ensure that their income was used solely for charitable purposes was highly important, underpinning the public's confidence in the charity sector. This view was shared by many respondents to the LRC's consultation paper on charities. The LRC has recommended that the IRD should conduct more frequent reviews of the accounts of tax-exempt charities. To address the expectation gap, there is a need to consider reviewing the provisions of the IRO with a view to enabling the

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IRD to effectively perform its role of administering the tax exemption status of charities (paras. 2.16 and 2.17).

7. ***Donations made by charities.*** In two review cases, the IRD's case officers had not requested the charities concerned to provide sufficient explanations on their donation expenditures to support that they were compatible with their objects, although such expenditures (\$1 million in one case and \$0.46 million in another) were the only activities of the charities concerned, using up all/most of their donation income for the years (para. 2.18).

8. ***Dormant charity.*** According to the CDS's Staff Handbook, the tax exemption status of a charity may be withdrawn if it has ceased operation or is dormant. Audit examined seven review cases and found that in three cases, the CDS had taken a long time (over two years) to deal with dormant cases. In one case, the charity had not commenced operation for 12 years since it was recognised as a tax-exempt charity (para. 2.19).

9. ***Need to take timely action upon dissolution of a tax-exempt charity.*** The IRD has made arrangements with the CR whereby companies to be struck off by the CR would be brought to the IRD's attention. Since January 2016, the CDS has used a computer program to conduct matching exercise twice a month to identify tax-exempt charities to be struck off by the CR. This is important for the IRD to: (a) protect revenue in case there are any outstanding tax liabilities of a company to be struck off; (b) make enquiry into whether the assets of such company after dissolution have been disposed of in accordance with the governing instrument requirement; and (c) update the list of tax-exempt charities posted on the IRD's website. Audit notes that the IRD has not made similar notification arrangements with relevant B/Ds for tax-exempt charities which are established under other ordinances (paras. 2.20 and 2.22).

10. ***Room for improvement in conducting desk audits on charitable donation claims.*** Since April 2001, in order to streamline the assessing procedures, the IRD has used a computerised Assess First Audit Later System for screening tax returns for automated assessment and selecting cases for post-assessment desk audit. Based on a sample check of 30 desk audit cases for profits tax and 50 desk audit cases for salaries tax/personal assessment in 2015-16, Audit found that in one profits tax case, the supporting schedule filed by the taxpayer did not show whether the donations

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were made to tax-exempt charities but the assessing officer had allowed tax deduction without seeking clarification from the taxpayer. In two salaries tax cases, the assessing officers had allowed tax deductions although the donation was not made to a recognised tax-exempt charity in one case and the taxpayer's name did not match with the donor's name in another case (paras. 2.26 and 2.28).

Administration of land granted to charities for operating welfare/social services

11. In 1959, the Executive Council (ExCo) noted the statement of government policy on land administration that for land granted by PTG at nil premium for welfare purposes, very stringent powers of control conditions would be included and no distribution of profits would be allowed. In 1981, ExCo endorsed the principle that lessees holding sites granted for social service purposes at nil/concessionary premium should be allowed to redevelop such sites to improve their facilities, provided that: (a) premium should be charged at full market value for the commercial element included in the development; (b) the income derived from the development would be applied to purposes acceptable to the Government; and (c) the project would benefit the public purse by decreasing the need for subventions (paras. 3.2 and 3.3).

12. ***Alleged hotel operations on sites granted to charities at nil or concessionary premium.*** From 2013 to 2015, there were media reports and public complaints to the Government alleging that 14 sites (under Leases A to N) granted at nil/concessionary premium were partly used to operate hotels. For the 14 sites, in each instance, the grantee (either the organisation or its parent organisation) was a tax-exempt charity. According to the Lands D, three of the sites were granted by virtually unrestricted leases (Leases A, B and E). For the other 11 leases, some specifically permitted the running of hostels and there was no definition under lease of the terms "hostel" and "hotel". Audit reviewed the provisions of the 11 leases (excluding the three unrestricted leases) and the Lands D's follow-up actions on 4 leases (Leases G, H, M and N) and found lessons to be learnt in the lease and planning control of these sites (paras. 3.7, 3.8 and 3.10).

13. ***Only one lease stipulated the no-profit-distribution requirement.*** According to the 1959 land administration policy (see para. 11 above), stringent powers of control would be included in the conditions and no distribution of profits

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would be allowed for a site granted at nil premium for welfare purposes. While 9 of 11 leases were granted for welfare/social services at nil or concessionary premium after 1959, Audit noted that only one lease (Lease M) stipulated the no-profit-distribution requirement. According to the Lands D: (a) the land administration policy had evolved since 1959 with due regard to 7 cases which were submitted to ExCo for approval; (b) the no-profit-distribution clause was not imposed in these seven cases which served as precedents for subsequent cases; and (c) accordingly, the no-profit-distribution requirement in PTGs for welfare purposes was no longer applicable. However, there were indications that the hostels in the 11 cases were being operated on a commercial basis. Audit noted that the grantees of 9 of the 11 leases had been operating their hostels with hotel licences issued by the Home Affairs Department (HAD). For the remaining two leases, the grantees had placed advertisements offering serviced residence to the public on a monthly rental basis. To ensure that all profits derived from facilities built on sites granted at nil/concessionary premium are applied to purposes acceptable to the Government, there is a need to incorporate the no-profit-distribution requirement in the leases. Moreover, while statements of accounts were important documents to show whether and how the profits derived had been distributed/applied, only 4 of the 11 leases required the submission of accounts. For these four leases, accounts were either not received or not always obtained (paras. 3.11 and 3.12).

14. ***Need to regularly monitor compliance with the lease requirements under Lease M and the related conditions.*** According to Lease M, Grantee M shall use the site for operating a hostel and other social welfare facilities. Since the facilities came into operation in 1991, the hostel was operated by Grantee M's appointed operator and the social welfare services were provided by Grantee M's parent organisation (Charity M). Although the lease condition specifies that there shall be no distribution of profit derived from the facilities, a letter issued by the then Director of Buildings and Lands in June 1989 allowed the profits derived from the facilities to be used towards the improvement and/or extension of all charitable services provided by Charity M. In this connection, the statements of accounts of Grantee M are important documents to show whether such requirements have been complied with. While Lease M provided that the grantee would submit a statement of accounts to the then Director of Buildings and Lands if so required, the Lands D only commenced to obtain such accounts in 2013 (22 years after the hostel came into operation). While some assurance was provided by Charity M's auditor in May 2014 and Grantee M in March 2016, there was insufficient information to show that income derived from the hostel/hotel had been applied towards the purposes specified by the Government for some 25 years during which the hostel was operated by Grantee M's appointed operator under a hotel licence. There is a

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need to regularly monitor compliance with the lease requirements under Lease M and the related conditions (paras. 3.13 and 3.14).

15. ***Monitoring income-generating facilities of a lease and subvention reduction arrangement.*** In 1989, ExCo approved granting of a site to Grantee N for the construction of: (a) a new headquarters including offices, hostel, dormitory and canteen at a nominal premium; and (b) other facilities including a multi-storey vehicle park at full land premium which was to be operated by Grantee N on a commercial basis in line with the 1981 land administration policy (see para. 11 above). The new headquarters and other facilities were completed in 1993 and came into operation in 1994 (paras. 3.15 and 3.16). Audit has found the following areas for improvement:

- (a) ***Management Committee and submission of accounts requirements.*** Lease N required Grantee N to: (i) establish a Management Committee with representatives of the Government to ensure the proper and efficient operation of the income-generating facilities of the headquarters and the vehicle park; and (ii) submit annually a statement of accounts on the operation of the headquarters and the vehicle park to the supporting B/D (the Social Welfare Department (SWD) up to 1999 and the HAB since 2000). While the Management Committee held five meetings from 1993 to 1998, no further meetings had been held thereafter. The SWD obtained the statements of accounts for three years (1995-96 to 1997-98) and there was no record showing that similar statements of accounts had been submitted thereafter (paras. 3.16 and 3.17);
- (b) ***Subvention reduction arrangement.*** The ExCo's approval of the land grant to Grantee N was made on the understanding that there would be reduction and eventual elimination of the annual subvention of Grantee N's activities. The SWD withheld part of the rent and rates subsidy in the sum of \$4.04 million for the five-year period from 1994-95 to 1998-99. In 2000, the HAB (as the supporting B/D) decided to review the subvention reduction issue but had not taken any action until 2010-11 when it froze Grantee N's subvention. After negotiation, the HAB and Grantee N agreed in February 2013 to reduce the subvention to the level in 1993-94 (when the new headquarters came into operation) in three years and to resume adjustment in subvention thereafter. However, the agreed subvention reduction arrangement has yet to give full effect to the ExCo's understanding of eventual elimination of the annual subvention

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to Grantee N. According to the HAB, it will continue its discussion with Grantee N to further reduce the subvention level having regard to Grantee N's financial situation and development needs, and will seek the ExCo's endorsement if it is eventually considered that the ExCo's understanding cannot be achieved (paras. 3.18 to 3.21); and

- (c) *Non-exclusive use of catering facilities.* According to the records of the Food and Environmental Hygiene Department (FEHD), from 1996 to 2015, Grantee N's canteen had been operated as a restaurant under a General Restaurant Licence. In connection with the application for a restaurant licence by Grantee N's new restaurant operator in 2015, the Lands D obtained legal advice and noted that the canteen should be used exclusively by Grantee N's members. The HAB commented that the restaurant was commercial in nature and could not be regarded as "ancillary accommodation and facilities" of Grantee N's headquarters under Lease N. The Planning Department also commented that planning permission for the restaurant was required under the relevant Outline Zoning Plan (OZP) before Grantee N could apply to the Lands D for a waiver to permit the use of the canteen space for restaurant purpose. In December 2016, Grantee N obtained the Town Planning Board's approval to use the canteen for a temporary restaurant for three years. Up to March 2017, the Lands D offered the waiver terms for Grantee N's acceptance. Based on the FEHD's licensing records of two other catering facilities of Grantee N's headquarters and relevant advertisement on a commercial website, there were indications that these facilities were also serving the public. There is a need to review whether the operations of these catering facilities are permitted under Lease N and the relevant OZP (para. 3.22).

16. *Consulting supporting B/Ds on compliance with lease conditions.* According to Lease N, the new headquarters shall include, among others, hostel, canteen and such other ancillary facilities as shall be approved by the SWD. In 1987, Grantee N confirmed to the SWD that all the areas in its headquarters were directly related to its purposes and the then Secretary for District Administration's support for the grant of the headquarters site at nominal premium was also based on the understanding that the facilities were to meet Grantee N's purposes. However, based on the HAD's hotel licence information (see para. 13), there were indications that the hostel had likely been converted to hotel use for the general public. Audit also found similar converted use of the hostels under Leases G and H. In Audit's

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view, for leases with clauses governing the use or operation of the hostels, the Lands D needs to seek confirmation from the relevant B/Ds on whether the current use or operation of the hostels is in line with their policy intent, and take necessary follow-up actions in case of any breach of the lease conditions (para. 3.23).

Filing and disclosure requirements of charities incorporated/established under three ordinances

17. *Filing requirements under the Companies Ordinance.* As at September 2016, there were 6,619 tax-exempt charities incorporated as limited companies, of which 6,523 were companies limited by guarantee. These charities need to comply with the same statutory requirements under the Companies Ordinance as other limited companies. For example, they are required to deliver annual returns to the CR within prescribed time periods. Members of the public can access company information posted on the CR's Cyber Search Centre (paras. 4.2, 4.3 and 4.5).

18. *Non-compliance with filing requirements under the Companies Ordinance.* The timely filing of annual returns by charities which are companies is important for donors to gain access to their financial information so as to make an informed choice when making donations. Audit's analysis of the CR's computer records of the 6,523 charities (which were companies limited by guarantee) revealed that up to November 2016, 1,237 annual returns for the years from 2011 to 2016 (i.e. 6 years) had not been filed. In particular, 21 companies had repeatedly breached the filing requirements, i.e. 12 companies for 5 years and 9 companies for 6 years. For the 2016 annual returns filed by 3,219 charities, 126 were late submissions. The delays were over 90 days in 35 cases (paras. 4.8 to 4.11).

19. *Filing requirements under the Societies Ordinance.* As at September 2016, there were 1,000 registered/exempted charitable societies, of which 811 were tax-exempt charities. These charitable societies are required to comply with the same statutory requirements under the Societies Ordinance as other registered/exempted societies. For example, they shall provide the HKPF with information such as their names, objects and particulars of office-bearers (paras. 4.14 and 4.15).

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20. *Need to keep the registered/exempted society information up-to-date.*

The HKPF keeps a list of registered/exempted societies which is posted on its website. According to the HKPF, it endeavours to update the list of registered/exempted societies as soon as possible. The HKPF also carries out regular reviews to identify inactive societies and requests them to furnish proof of their existence and updated particulars. Audit's examination revealed that the HKPF had not: (a) conducted any reviews of inactive societies in 2015 and 2016; (b) requested 53 charitable societies which had not contacted the HKPF for ten years or more at the time of the 2014 review to furnish proof of their existence; and (c) updated the list of registered/exempted societies in respect of 19 societies with society status marked cancelled (paras. 4.16 and 4.17).

21. *Filing requirements of IMCs.* As at September 2016, there were 846 IMCs of which 772 were tax-exempted. These 772 tax-exempt IMCs are required to comply with the same statutory requirements as other IMCs under the Education Ordinance, e.g. preparation of audited accounts. According to the EDB's guidelines, tax-exempt IMCs should submit the annual audited financial statements to the EDB within prescribed periods (paras. 4.22 and 4.23).

22. *Late submission of audited financial statements by some IMC schools.*

Audit's analysis of the EDB's computer records for the five school years from 2010/11 to 2014/15 revealed that the percentage of late submission of audited financial statements by IMC schools decreased from 40% for 2010/11 to 36% for 2014/15. However, of the 305 late submissions for 2014/15, 26 (9%) IMC schools had submitted their audited financial statements more than 120 days after the submission due date. Moreover, for school years 2010/11 to 2014/15, 68, 41 and 70 IMC schools had repeatedly submitted their audited financial statements late for 3, 4 and 5 years respectively (paras. 4.27 and 4.30).

Regulation of Chinese temples

23. The CTC was established to carry out duties under the CTO, including the registration of all Chinese temples. According to the HAB, the CTC has not taken any action against the unregistered temples because some provisions of the CTO might be outdated in the present day context. It was not the intention of the CTC to monitor the operation of Chinese temples other than the 25 temples under its

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direct administration and the 20 temples managed by delegated organisations (i.e. the delegated temples) (paras. 5.1 to 5.5).

24. *Need to renew two expired delegation agreements.* The delegation agreements for two temples expired in 2006 and 2007 respectively and have not been renewed because one delegated organisation did not accept some new agreement requirements (e.g. submission of audited accounts) and the other has not removed an unauthorised building structure at the temple. In the absence of any delegation agreements in force, donations and other revenues of these temples had been kept and used by the delegated organisations concerned without accountability to the CTC for some ten years (paras. 5.7 and 5.8).

25. *Need to enhance transparency.* Both the directly administered temples and the delegated temples receive voluntary donations from the public. However, at present, only the financial information of the 25 directly administered temples and 9 of the 20 delegated temples is accounted for in the financial statements of the Chinese Temples Fund, which are posted on the CTC's website for public inspection. The CTC has neither made available the audited accounts of the remaining 11 delegated temples for public inspection nor required the delegated organisations to do so (para. 5.9).

26. *Non-compliance with delegation agreement requirements.* Audit found cases of non-compliance with the audited accounts and administrative report submission requirements by four delegated organisations. Up to January 2017, an organisation had not submitted the audited accounts of its managed temple for the previous 3 years and its administrative reports for the previous 11 years. There were delays in submissions of three other organisations which together managed 15 temples. For example, for the organisation with 5 managed temples, the audited accounts due for submission in March 2014, 2015 and 2016 were not submitted until December 2016 (para. 5.10).

27. *Review of audited accounts.* According to the delegation agreement, the income of a delegated temple must be applied in the first instance to the due observance of the customary ceremonies and the maintenance of the temple. Any surplus shall be applied to pay staff salaries and expenses in compliance with the agreement and for the purposes of Chinese charity in Hong Kong. Audit noted in a submitted account a staff messing expenditure of about \$380,000 which was

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disproportionate to the salary expenditure of \$301,000 for the same year but the CTC had not sought clarification from the delegated organisation concerned (para. 5.11).

Way forward

28. According to the 2013 LRC Report, there are deficiencies in the existing regulatory framework of charities, including inconsistent standards or requirements on governance, accounting and reporting by charities, and limited control of charitable fund-raising activities. The LRC made 18 recommendations to improve the transparency and accountability of charities, which included, among others, establishing a clear statutory definition of what constitutes a charitable purpose, requiring all charitable organisations which solicit public donation and/or have sought for tax exemption to be registered, adopting a specifically formulated financial reporting standard for charities in Hong Kong, and ensuring that tax-exempt charities make information about their operations available to the public (paras. 6.2 and 6.3).

29. The HAB has been coordinating inputs from relevant B/Ds with a view to formulating a response to all the recommendations of the LRC Report for the Government's consideration. There is a need to take into account the areas of improvement identified in this Audit Report which are complementary to the LRC's recommendations in considering the way forward. For example, the need to review the provisions of the IRO to enable the IRD to perform effectively its role in administering the tax exemption status of charities should be addressed when taking forward the LRC's recommendation on more frequent review of tax-exempt charities by the IRD (paras. 6.3 and 6.4).

Audit recommendations

30. **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:**

- (a) **the Commissioner of Inland Revenue should:**

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- (i) **take measures to enhance the monitoring of the progress of periodic review cases of tax exemption status of charitable organisations (para. 2.29(b));**
 - (ii) **in consultation with the Secretary for Financial Services and the Treasury, consider the need for reviewing the provisions of the IRO with a view to enabling the IRD to effectively perform its role of administering the tax exemption status of charities (para. 2.29(d)(i)); and**
 - (iii) **remind CDS staff to obtain from the charities concerned a breakdown of their donation expenditures to support that they are compatible with their objects (para. 2.29(d)(ii));**
- (b) **the Director of Lands should:**
 - (i) **in collaboration with the supporting B/Ds, consider incorporating lease conditions restricting profit distribution and requiring submission of accounts in a PTG or lease modification (including land exchange) granted at nil/concessionary premium for welfare/social services in future; (para. 3.25(a));**
 - (ii) **require Grantee M to provide regularly sufficient information to demonstrate its compliance with the lease requirements and related conditions in the letter of approval of 1989 (see para. 3.13) and, where appropriate, seek the assistance of the SWD in scrutinising the statements of accounts obtained from Grantee M (para. 3.25(c)); and**
 - (iii) **for leases with clauses governing the use or operation of the hostels, seek confirmation from the relevant B/Ds on whether the current use or operation of the hostels is in line with their policy intent, and take necessary follow-up actions in case of any breach of the lease conditions (para. 3.25(d));**

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- (c) **the Secretary for Home Affairs should:**
 - (i) **seek the ExCo's endorsement for any material deviations from its understanding of the implementation of a PTG for operating welfare/social services on land granted at nil/concessionary premium (such as the subvention reduction arrangement in Lease N) (para. 3.27(b)); and**
 - (ii) **for Lease N, in consultation with the Director of Lands and the Director of Planning, review the operations of the western restaurant and lounge to determine whether they are permitted under the lease conditions and the relevant OZP, and take necessary follow-up actions accordingly (para. 3.27(c));**
- (d) **the Registrar of Companies should step up the CR's monitoring of the compliance with the statutory filing requirements by charities which are limited companies and take more timely follow-up actions against cases of repeated breaches of the filing requirements and the long delay cases (para. 4.12);**
- (e) **the Commissioner of Police should step up efforts to identify inactive societies and take timely follow-up actions to ensure that the list of registered/exempted societies posted on the HKPF's website is kept up-to-date (para. 4.19(b));**
- (f) **the Secretary for Education should continue to closely monitor the IMC schools' compliance with the filing requirements of audited financial statements and offer assistance to IMC schools for cases of long delays and/or repeated non-compliance where necessary (para. 4.31(a));**
- (g) **the Secretary for Home Affairs, as the Chairman of the CTC, should:**
 - (i) **for the two temples with expired delegation agreements, expedite action to resolve the long outstanding issues with the two delegated organisations concerned with a view to renewing the delegation agreements as soon as practicable (para. 5.15(a)); and**

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- (ii) **step up monitoring of the delegated organisations' compliance with the terms of the delegation agreements to ensure that audited accounts and administrative reports of the temples are submitted in a timely manner (para. 5.15(c)); and**
- (h) **the Secretary for Home Affairs should take into account the areas for improvement identified in this Audit Report in coordinating inputs from relevant B/Ds for formulating a response to the LRC's recommendations for the Government's consideration (para. 6.6).**

Response from the Government

31. The Government generally 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.

Charities in Hong Kong

1.2 Charities make an important contribution to Hong Kong, such as bringing communities together and providing transformational changes as well as caring services and support to meet the needs of some of the most vulnerable members of the community. Over the years, the Government has provided the following support to charities:

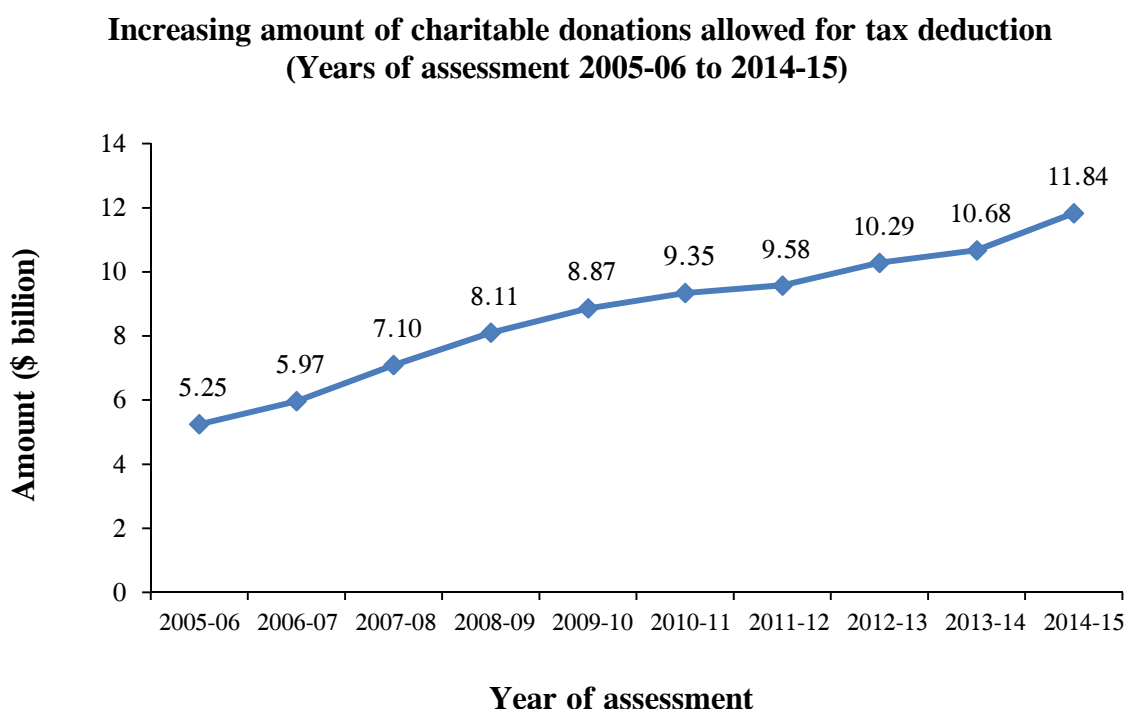
- (a) ***Tax relief.*** A charitable organisation recognised under the provisions of the Inland Revenue Ordinance (IRO — Cap. 112) is not generally liable to tax, and donations to such an organisation can be tax deductible (Note 1);
- (b) ***Land grant.*** Land is made available by the Government by way of a private treaty grant (PTG) at a nominal or concessionary land premium to non-profit-making educational, medical and charitable institutions for operating schools, hospitals, and social welfare and other community facilities; and
- (c) ***Subvention.*** The Government provides recurrent subventions to service providers primarily in the education, social welfare and health sectors, some of which are charitable organisations.

Note 1: *Tax deduction for charitable donations has been provided since 1970 under the IRO (first enacted in 1947). Sections 16D and 26C of the IRO allow a deduction for approved charitable donations made by a person during the year of assessment under profits tax and salaries tax/personal assessment respectively. Approved charitable donation is defined in the IRO as a donation of money to any charitable institution or trust of a public character exempt from tax under section 88 of the IRO or the Government for charitable purposes. The aggregate amount of donations deductible for the year should not be less than \$100 and should not exceed 35% of the total assessable profits/income (since the year of assessment 2008-09).*

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1.3 Figure 1 shows that the charitable donations allowed for tax deduction by the Inland Revenue Department (IRD) had increased from \$5.25 billion for the year of assessment 2005-06 to \$11.84 billion for 2014-15, or an increase of 126% in these ten years. The number of taxpayers with tax deduction allowed for approved charitable donations totalled 588,000 (comprising 558,000 for salaries tax, 21,000 for profits tax and 9,000 for personal assessments) in 2014-15. Tax revenue foregone is estimated to be over \$1.5 billion in the year of assessment of 2014-15 (Note 2). There are no readily available statistics on the revenue foregone by the Government by providing tax exemption to charities which carry on trade or business with profits chargeable to profits tax in Hong Kong (Note 3).

Figure 1



Source: IRD records

Note 2: *The estimation is based on a standard tax rate of 15%.*

Note 3: *According to the IRD, section 88 of the IRO (added in 1949) was introduced because it was considered not desirable to impose tax on institutions of a charitable, ecclesiastical or educational nature except in so far as such bodies may be engaged in trade or business. However, the profits derived by a charity can still be exempt from profits tax if, inter alia, the trade or business is exercised in carrying out the expressed objects of the institution and if the profits derived therefrom are not expended substantially outside Hong Kong.*

Existing monitoring framework for charities

1.4 At present, the statutory definition of what constitutes a charity or a charitable purpose in Hong Kong is limited. Under the provisions of the IRO, a charitable institution or trust of a public character is generally exempt from tax and donations made to such organisations are tax deductible. There is, however, no statutory definition in the IRO of what constitutes a charity. The IRD has to refer to the case law in determining whether an organisation is established for “charitable purposes” (Note 4). “Charitable purposes” are defined in the case law to mean:

- (a) relief of poverty;
- (b) advancement of education;
- (c) advancement of religion; and
- (d) other purposes of a charitable nature beneficial to the community not falling under any of the preceding categories.

Apart from case law definitions, “charitable purpose” as defined under section 2(1) of the Registered Trustees Incorporation Ordinance (Cap. 306) includes: (a) relief of poverty; (b) advancement of art, education, learning, literature, science or research; (c) provision for the cure, alleviation or prevention or the care of persons suffering from or subject to any disease, infirmity or disability affecting human beings (including the care of women before, during and after child birth); (d) advancement of religion; (e) any ecclesiastical purpose; (f) promotion of moral, social and physical well-being of the community; and (g) any other purpose beneficial to the community.

1.5 According to the IRD, the number of charitable organisations recognised for tax exemption purpose under section 88 of the IRO had doubled from 4,435 in March 2006 to 8,923 in September 2016 (see Figure 2). Charities have full autonomy in choosing their own legal forms, either as incorporated bodies (e.g. companies) or unincorporated bodies (e.g. societies and trusts) to suit their

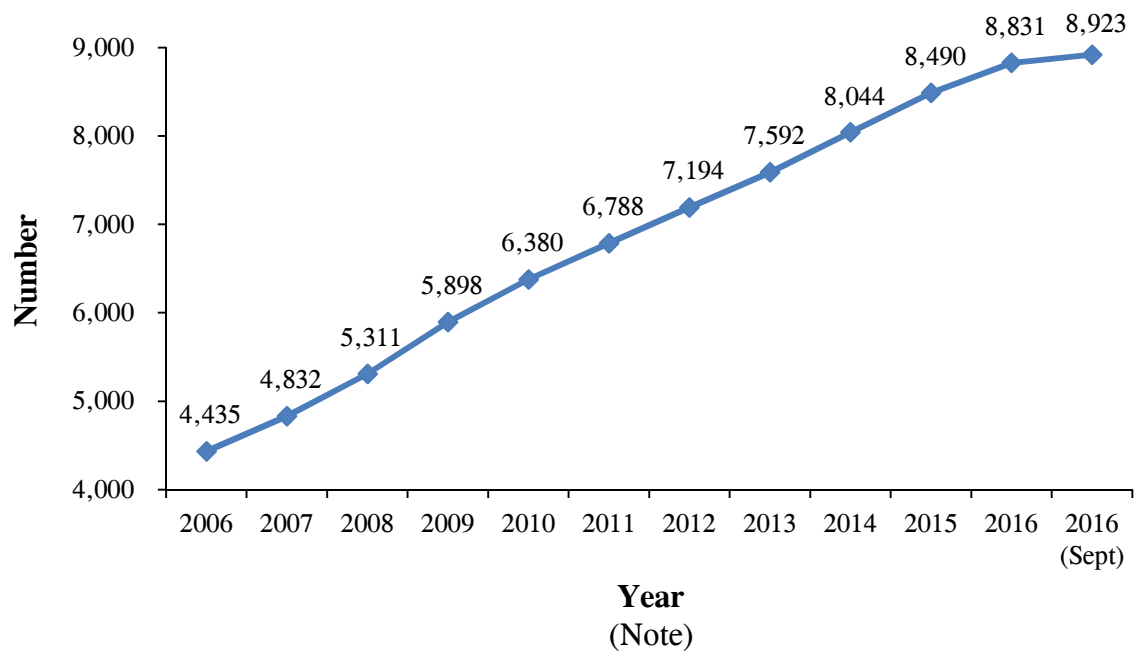
Note 4: *According to a case law ruling quoted by the IRD, whether an organisation is a charity is a matter for the court to decide, even though the organisation may have been recognised as a charitable institution for tax purposes.*

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operations in achieving their charitable causes. An analysis of the legal forms of the 8,923 tax-exempt charities is shown in Figure 3.

Figure 2

**Increasing number of tax-exempt charities
(March 2006 to September 2016)**

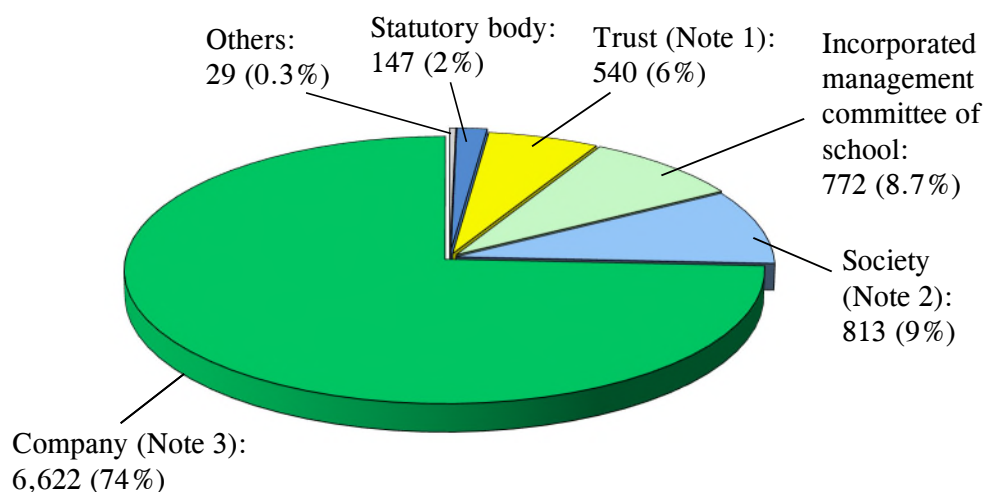


Source: Audit analysis of IRD records

Note: The figures show the numbers of tax-exempt charities as at end of March of each year from 2006 to 2016 and September 2016.

Figure 3

**Legal forms of 8,923 tax-exempt charities
(30 September 2016)**



Source: Audit analysis of IRD records

Note 1: Of the 540 tax-exempt charitable trusts, 58 were incorporated under the Registered Trustees Incorporation Ordinance (see para. 1.7(c)).

Note 2: Of the 813 tax-exempt societies, two had been deregistered as at 30 September 2016 but had not been reflected in the IRD's records (see para. 2.22).

Note 3: Of the 6,622 tax-exempt companies, three had been deregistered as at 30 September 2016 but had not been reflected in the IRD's records. One of the three deregistered companies remaining on the list of charitable institutions and trusts of a public character which are exempt from tax under section 88 of the IRO was due to the biweekly lead time in updating the list (see para. 2.20). The delays in updating the IRD's records for the other two cases are detailed in paragraph 2.21.

1.6 The rapid rise in philanthropy (see paras. 1.3 and 1.5) has highlighted the need to ensure that the charitable organisations exercise good governance, stewardship and ethical practices, and the monies collected are applied to their professed charitable purposes. From time to time, there have been public concerns over the adequacy of the Government's monitoring of charitable organisations and their activities. An effective monitoring framework has an important role to play in enhancing the standards of charities and ensuring that they uphold accountability and transparency for the donations they received.

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1.7 There is no overall statutory scheme for the registration and regulation of charities in Hong Kong. Depending on their legal forms and whether they have sought recognition of tax exemption status and government support, charities are subject to the monitoring and/or registration framework of different government bureaux/departments (B/Ds), as follows:

- (a) **IRD.** The IRD is responsible, as a tax administrator, for raising revenue through taxes, duties and fees in accordance with the relevant legislation. In addition to making tax assessments and collecting taxes, and other statutory functions, it processes applications for the recognition of tax exemption status of charities under section 88 of the IRO (Note 5). Charities are chargeable to profits tax if they carry on trade or business with profits in Hong Kong and fail to satisfy the provisions of section 88 (see para. 2.2). As administrative procedures, the IRD calls for accounts, annual reports or other documents from time to time from tax-exempt charities to review whether their objects are still meeting the eligibility criteria of “charitable purposes” (see para. 1.4) and their activities are compatible with their objects. Donations made to tax-exempt charities would be tax deductible under the IRO (see Note 1 to para. 1.2(a));
- (b) **Lands Department (Lands D).** The Lands D grants land by way of a PTG at nominal or concessionary premium or a short term tenancy at nominal or concessionary rent to some charitable organisations for operating schools, hospitals, and social welfare and community facilities. Many of the entities receiving such land grants are tax-exempt charities. In such cases, the charitable organisations are regulated by the Lands D and the supporting B/Ds to ensure their compliance with the conditions of land grant and the policy intention of granting the land;

Note 5: *According to the legal advice obtained by the IRD in 2003, section 88 of the IRO does not confer on it the power to grant tax exemption status. What section 88 provides is that charitable institutions or trusts of a public character are exempt from tax and they can seek recognition of such exemption by the IRD if they like. Such institutions are also exempt from certain duties and fees under the Stamp Duty Ordinance (Cap. 117) and registration under the Business Registration Ordinance (Cap. 310). Subject to the consent of the charitable institutions and trusts of a public character recognised for tax exemption under section 88, the IRD maintains a list of such institutions or trusts of a public character on its website. Donors can refer to the list to check whether a donee is a charitable institution not subject to tax and the donation is tax deductible. The IRD is not responsible for the governance of a charity, nor does it have regulatory power over the operation of a charity.*

- (c) ***Companies Registry (CR).*** The CR is responsible for administering and enforcing the Companies Ordinance (Cap. 622 — Note 6) for some 1.34 million limited companies on the Companies Register, e.g. filing of annual returns. Charities which choose to be incorporated as companies under the Ordinance need to comply with the same statutory requirements as other incorporated companies. The CR is also responsible for administering filings by trustees incorporated under the Registered Trustees Incorporation Ordinance (Note 7). The CR maintains records of registered companies and incorporated trustees which are open to public inspection. As of September 2016, there were 1,337,989 registered companies (including both local and registered non-Hong Kong companies) and 95 incorporated trustees, of which 6,619 (0.5%) registered companies and 58 (61%) incorporated trustees were on the IRD's list of approved tax-exempt charitable institutions or trusts of a public character (s88 list) (Note 8);
- (d) ***Hong Kong Police Force (HKPF).*** The Societies Office of the HKPF is responsible for administering the Societies Ordinance (Cap. 151) and has granted registration or exemption from registration to around 38,000 local societies. Charities wishing to be set up under the Societies Ordinance are required to comply with the same statutory requirements as other registered societies, e.g. they shall within one month of their establishment or deemed establishment apply to the Societies Officer (i.e. the Commissioner of Police) for registration or exemption from registration under the Ordinance. The Societies Officer may exempt a

Note 6: *The new Companies Ordinance took effect on 3 March 2014 and replaced the old Companies Ordinance (Cap. 32). All companies referred to in this Report include those incorporated under the new or old Companies Ordinances.*

Note 7: *According to the CR, its responsibilities do not encompass monitoring the "charity" status or conduct of the tax-exempt charities and there is no provision under the Companies Ordinance or the Registered Trustees Incorporation Ordinance that enables the CR to give any direction or seek information from a body by virtue of it being a charity.*

Note 8: *According to the CR, there are no provisions under the Companies Ordinance or the Registered Trustees Incorporation Ordinance for a charity to be incorporated as a company/trustee. The CR has no means under the Ordinances to identify whether an incorporated company is a tax-exempt charity. The numbers of incorporated trustees and registered companies on the s88 list as of September 2016 were derived by Audit after cross-checking the IRD's records against the records of registered companies and incorporated trustees of the CR.*

society from registration if he is satisfied that the society is established solely for religious, charitable, social or recreational purposes or as a rural committee or a federation or other association of rural committees. However, such societies exempt from registration are also subject to the same statutory requirements as registered societies. The HKPF maintains a list of societies which is available for public inspection on its website. As of September 2016, there were 37,861 societies. Of 1,000 charitable societies so registered or exempted from registration, 811 were on the IRD's s88 list;

- (e) ***Education Bureau (EDB).*** According to the Education Ordinance (Cap. 279), every aided school (Note 9) is required to set up an incorporated management committee (IMC), in the form of a statutory body, to manage the school. Direct Subsidy Scheme schools (Note 10) may, according to their own needs, opt to establish IMCs under the Ordinance. The purpose of establishing IMCs is to manage schools through participatory governance by key stakeholders. While schools with IMCs are given a high degree of autonomy, the IMCs themselves are required to account for their use of public funds. As such, the IMCs are required to maintain proper books of account and submit their audited statement of accounts to the EDB. As of September 2016, there were 846 IMCs, of which 772 (91%) were on the IRD's s88 list. These charities are required to comply with the same statutory requirements under the Education Ordinance as other IMCs;

- (f) ***Home Affairs Bureau (HAB).*** As of September 2016, there were 2,480 tax-exempt charities established for purposes of advancement of religion. It is the Government's policy to respect the autonomy of religious organisations. However, the Chinese Temples Ordinance (CTO — Cap. 153) was enacted in 1928 to suppress and prevent mismanagement of Chinese temples and abuses of donated funds. Under

Note 9: *Aided school means any school that receives subsidies from the Government in accordance with the codes of aid for primary schools, secondary schools or special schools.*

Note 10: *Direct Subsidy Scheme schools are schools receiving subsidies directly from the Government. The amount of subsidy is calculated by reference to the average unit cost of an aided school place and the number of student enrolment of the Direct Subsidy Scheme school.*

the CTO, all Chinese temples should be registered with the Chinese Temples Committee (CTC — Note 11). As of September 2016, 347 of around 600 Chinese temples were registered (Note 12), of which 129 (37%) were managed by organisations on the IRD's s88 list. The list of registered Chinese temples is available for public inspection on the HAB's website; and

- (g) **Other B/Ds.** Some other B/Ds also exercise monitoring functions in relation to charities falling within their purview as follows:
- (i) **Subvention.** Charitable organisations receiving government subventions (such as some non-governmental organisations providing services in education, social welfare and health sectors) are regulated by the Government to the extent that the relevant B/Ds (e.g. the EDB, Social Welfare Department (SWD) and Department of Health) monitor the use of their government subvention. The recurrent subventions in 2015-16 totalled \$128.8 billion, some of which were provided to charitable organisations; and
 - (ii) **Charitable trusts.** There is no specified regulator of charities under the Trustee Ordinance (Cap. 29). However, section 57A of the Ordinance empowers the Secretary for Justice to act if there is a case of a breach of a charitable trust or the need for better administration of a charitable trust.

Note 11: *The CTC is a statutory body established under the CTO, which comprises the Secretary for Home Affairs as the Chairman, 7 appointed members and 16 co-opted members. One of its major responsibilities is to operate and manage 25 directly administered temples.*

Note 12: *Of these 347 registered Chinese temples, 25 (7%) were directly administered by the CTC, 20 (6%) managed by organisations under the delegated authority of the CTC and the remaining 302 (87%) managed by individuals or organisations such as religious organisations.*

Previous audit review on monitoring of charities

1.8 In 1997, the Audit Commission (Audit) conducted a review of “Monitoring of charities: fund-raising and tax allowances” covering the Government’s procedures on monitoring of charitable fund-raising activities and those on administering tax exemptions. The results were reported in Chapter 4 of the Director of Audit’s Report No. 29 of October 1997. The Government accepted the audit recommendations for implementation.

Law Reform Commission Report on Charities

1.9 In view of the wide discussion by the community on the need for greater monitoring of charitable organisations, in June 2007, the Chief Justice and the Secretary for Justice asked the Law Reform Commission (LRC — Note 13) to review the subject. In December 2013, after completing a public consultation in 2011, the LRC published a Report on Charities (LRC Report) with a number of recommendations, including the definition and registration of charities, facilitation of good practice, financial reporting by charities and filing requirements (and requirement of display of registration number) for charitable fund-raising activities. In particular, the LRC Report recommended that all charitable organisations should be subject to the requirement of registration and a platform of coordination in dealing with applications for licences of charitable fund-raising activities among the relevant departments should be set up. Given that the recommendations touched on areas which fell within the policy responsibilities of several bureaux, the HAB has been tasked to coordinate inputs from relevant B/Ds for formulating a response to the LRC’s recommendations for the Government’s consideration.

Audit review

1.10 Against the above background, in October 2016, Audit commenced a review on the Government’s support and monitoring of the rapidly expanding charity sector (see paras. 1.3 and 1.5) and their charitable fund-raising activities.

Note 13: *The LRC, established in January 1980, considers for reform those aspects of the laws of Hong Kong which are referred to it by the Secretary for Justice or the Chief Justice. Members of the LRC are appointed by the Chief Executive of the Hong Kong Special Administrative Region and include academic and practising lawyers, and prominent members of the community.*

This audit did not cover the Government's management and control of the subventions provided to charitable organisations for their services (see para. 1.7(g)(i)). The audit findings are contained in two Audit Reports, namely the Government's support and monitoring of charities (the subject matter of this Audit Report) and the monitoring of charitable fund-raising activities (in Chapter 2 of the Director of Audit's Report No. 68).

1.11 This Audit Report focuses on the following areas:

- (a) administration of tax exemption of charities and tax-deductible donations (PART 2);
- (b) administration of land granted to charities for operating welfare/social services (PART 3);
- (c) filing and disclosure requirements of charities incorporated/established under three ordinances (PART 4);
- (d) regulation of Chinese temples (PART 5); and
- (e) way forward (PART 6).

General response from the Government

1.12 The Government generally agrees with the audit recommendations.

Acknowledgement

1.13 Audit would like to acknowledge with gratitude the assistance and full cooperation of the staff of the IRD, Lands D, HAB, Planning Department (Plan D), SWD, Home Affairs Department (HAD), Food and Environmental Hygiene Department (FEHD), CR, HKPF, EDB and Development Bureau during the course of the audit review.

PART 2: ADMINISTRATION OF TAX EXEMPTION OF CHARITIES AND TAX-DEDUCTIBLE DONATIONS

2.1 This PART examines the IRD's administration of tax exemption of charities and claims for tax deduction of approved charitable donations.

Administration of tax exemption of charities

The legal basis

2.2 Section 88 of the IRO states that:

“Notwithstanding anything to the contrary in this Ordinance contained there shall be exempt and there shall be deemed always to have been exempt from tax any charitable institution or trust of a public character:

Provided that where a trade or business is carried on by any such institution or trust the profits derived from such trade or business shall be exempt and shall be deemed to have been exempt from tax only if such profits are applied solely for charitable purposes; and are not expended substantially outside Hong Kong and either -

- (a) the trade or business is exercised in the course of the actual carrying out of the expressed objects of such institution or trust; or*
- (b) the work in connection with the trade or business is mainly carried on by persons for whose benefit such institution or trust is established.”*

According to the IRD, section 88 of the IRO provides general tax exemption to charitable institutions or trusts of a public character. However, it does not empower the Commissioner of Inland Revenue to determine whether an organisation is a charity or not. To provide certainty to charitable institutions and trusts of a public

character on their tax exemption status, the IRD has the practice of issuing confirmation to them if they apply to do so.

The tax guide

2.3 To facilitate an organisation to apply for recognition of tax exemption under section 88 of the IRO, the IRD has issued an information pamphlet entitled “A tax guide for charitable institutions and trusts of a public character” (the tax guide is also available on the IRD’s website) setting out the following:

- (a) ***Eligibility for tax exemption.*** To be eligible for tax exemption, a charity must be:
 - (i) established exclusively for charitable purposes (see examples of purposes which may be accepted as charitable in para. 1.4);
 - (ii) established by a written governing instrument (e.g. the Memorandum and Articles of Association in the case of a corporation); and
 - (iii) subject to the jurisdiction of Hong Kong courts, i.e. established in Hong Kong or Hong Kong establishments of overseas charities deemed to be established in Hong Kong under section 4 of the Societies Ordinance or registered under Part XI of the Companies Ordinance;
- (b) ***Documents required for processing applications.*** The documents required for filing an application include a certified true copy of the governing instrument, a list of activities for the past and coming years, and a copy of the accounts for the last financial year (for applicants established for more than 18 months). If the organisation has not yet been established, only a draft governing instrument and a list of the activities planned for the next 12 months from the date of establishment/application are required. To ensure that all the objects of the applicants are charitable and there are adequate safeguards to prevent the channelling of funds for non-charitable purposes, the tax guide draws particular attention to the following crucial clauses that the governing instrument of a charity should generally include:

Administration of tax exemption of charities and tax-deductible donations

- (i) clause stating precisely and clearly its objects;
 - (ii) clause limiting the application of its funds towards the attainment of its stated objects;
 - (iii) clause prohibiting distribution of its incomes and properties amongst its members;
 - (iv) clause prohibiting members of its governing body (e.g. directors, trustees, etc.) from receiving remuneration;
 - (v) clause requiring the keeping of sufficient records of income and expenditure (including donation receipts), proper accounting books and compilation of annual financial statements; and
 - (vi) clause specifying how the assets should be dealt with upon its dissolution (the remaining assets should normally be donated to other charities); and
- (c) ***Review requirement.*** The IRD will, from time to time, call for accounts, annual reports or other documents to review tax exemption status of a charity to ensure that its objects are still charitable and its activities are compatible with its objects.

IRD's organisation and instructions

2.4 The Charitable Donations Section (CDS) of the Commissioner's Unit (see Appendix A for an extract of the organisation chart of the IRD) is responsible for the work in connection with the tax exemption under section 88 of the IRO. The CDS is led by a Chief Assessor and comprises eight staff (Note 14). The IRD has issued a Staff Handbook setting out the practices and procedures in processing new applications for tax exemption and carrying out reviews of tax-exempt charities. The salient points are summarised below:

Note 14: *The IRD has also employed summer interns to assist in reviewing cases, e.g. in 2016, four summer interns were employed each for two months.*

- (a) ***Processing new applications.*** In considering a new application for tax exemption, the case officer is required to check the documents and information provided by the applicant until he is satisfied that the following requirements are fulfilled:
- (i) the applicant is a charity established according to the eligibility requirements set out in the tax guide (see para. 2.3(a));
 - (ii) the applicant's governing instrument contains all the crucial clauses set out in the tax guide (see para. 2.3(b)) and additional clauses viz. avoidance of conflict of interests of members of the governing body; and
 - (iii) the applicant's activities for the past 12 months and/or activities planned for the coming 12 months are compatible with its stated charitable objects.

The case officer's recommendation for recognising tax exemption status must be approved by the Section's Chief Assessor;

- (b) ***Review of tax-exempt charities.*** Such reviews are conducted from time to time having regard to their circumstances (such as receipt of complaints). In general, such reviews are conducted at least once every four years (Note 15). The charities selected for review are required to complete a questionnaire within one month providing information (such as whether the governing instrument has been changed since the last review) and documents (such as financial statements and reports on activities for the last financial year). The case officer is to examine the information provided by the charity to ensure that its objects are still charitable and that its activities are compatible with its charitable objects. Follow-up actions to be taken during the review include the following:

Note 15: *Prior to 2014, some 250 charities were not subject to periodic reviews (e.g. charities administered by government departments, and long and well-established charities). In 2014, the IRD started to review these charities by phases. As at December 2016, there were 94 such charities pending review.*

Administration of tax exemption of charities and tax-deductible donations

- (i) ***Qualified accounts.*** Where an auditor has expressed an adverse opinion on a charity's accounts on issues which may affect the charity's tax exemption status, the case officer may raise enquiries on the pertinent issues and seek remedial actions; and
- (ii) ***Directors' remuneration.*** Where a charity has paid remuneration to members of the governing body (e.g. directors) which is not allowed in the governing instrument, the case officer has to draw the charity's attention to the breach and seek the charity's remedial actions.

The review action is not regarded as completed unless a decision to continue or withdraw the recognition of tax exemption status is made;

- (c) ***Withdrawal of tax exemption.*** Recognition of tax exemption status is normally withdrawn for the following reasons:
 - (i) the charity was dissolved or wound up;
 - (ii) the charity has ceased operation or is dormant;
 - (iii) the charity no longer qualifies for the status of a charitable institution or trust of a public character; and
 - (iv) the charity did not respond to the IRD's enquiries or considered untraceable despite various efforts; and
- (d) ***Reinstatement.*** A charity whose recognition of tax exemption status is removed because it was untraceable or failed to give reply to the IRD's enquiries may apply for reinstatement of the recognition. In processing a tax exemption reinstatement application, the case officer will adopt an approach similar to processing new applications.

2.5 Table 1 shows the number of charities with their tax exemption status recognised, withdrawn and reinstated by the CDS from April 2012 to September 2016.

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Table 1

**Number of charities with tax exemption status
recognised, withdrawn and reinstated
(April 2012 to September 2016)**

Year	Number of charities with tax exemption status			Number of tax-exempt charities at year end
	recognised	withdrawn	reinstated	
2012-13	517	128	9	7,592
2013-14	594	156	14	8,044
2014-15	611	175	10	8,490
2015-16	540	213	14	8,831
2016-17 (Up to September 2016)	199	113	6	8,923

Source: IRD records

Processing of applications for recognition of tax exemption status

2.6 *Need to set a performance pledge for attending to new applications.* The tax exemption status of charitable organisations enhances their recognition in the community and provides tax deduction for donors who make donations to support their work. It is important that the tax exemption applications by bona-fide charitable organisations are processed in an efficient and effective manner. In this regard, the CDS of the IRD aims to attend to new applications (i.e. issuing an initial response to the applicant) within four months. Audit test checked 30 applications and found that in 27 cases (90%), the applications were attended to within four months. The remaining three cases (10%) were attended to with minor delays (averaging 12 days). To enhance transparency and public accountability, the IRD should consider setting a performance pledge for attending to new applications.

Administration of tax exemption of charities and tax-deductible donations

Periodic review of tax exemption status

2.7 According to the CDS's Staff Handbook, reviews of the tax exemption status of charities are conducted from time to time having regard to their circumstances (such as receipt of complaints). In general, such reviews are conducted at least once every four years (see para. 2.4(b)). With effect from 1 September 2016, it has been the aim of the CDS to attend to charities' submitted questionnaires and replies to the CDS's enquiries (such replies are hereinafter referred to as "correspondence") within four months. Table 2 shows the processing time of reviews which commenced or were scheduled for commencement from 2012 to 2016 and were completed by September 2016.

Table 2

Processing time of completed reviews

Review commencement year	Reviews completed by September 2016 (Number)	Processing time	
		Average (Day)	Range (Day)
2012	1,328	468	11 to 1,440
2013	1,308	385	13 to 985
2014	1,433	313	14 to 698
2015	1,053	200	11 to 366
2016	739	105	24 to 179

Source: Audit analysis of IRD records

Remarks: In April 2013, the number of staff in the CDS increased from 5 to 8.

2.8 *Monitoring the progress of review cases.* At the end of each month, the CDS prepares a work report for management information purposes (Note 16). The monthly report contains, among other things, the following information:

- (a) the number of charities with their tax exemption status recognised, withdrawn and reinstated by the CDS during the month;
- (b) the number of charities' submitted questionnaires and correspondence pending the CDS's attention. Based on the monthly reports from January 2012 to September 2016, the numbers of such review cases (with submitted questionnaires and correspondence pending the CDS's attention) are shown in Figure 4; and
- (c) the dates of receipt of the earliest questionnaire and correspondence among those pending the CDS's attention at the end of each month. Based on such dates, Audit calculated the number of days for which the earliest questionnaire and correspondence had been pending the CDS's attention as at the end of each month (Note 17). The results for the period from January 2012 to September 2016 are shown in Figure 5.

Based on the monthly reports from October 2015 to September 2016, the number of submitted questionnaires and correspondence pending the CDS's attention at month end during the year averaged 742 which was lower than 807, 1,028 and 1,139 for the years ended September 2013, 2014 and 2015 respectively. The longest waiting time of the earliest questionnaire at month end during the year from October 2015 to September 2016 was 324 days, which was lower than 487, 516 and 506 days for the years ended September 2013, 2014 and 2015 respectively. Similarly, the longest waiting time of the earliest correspondence during the year from October 2015 to

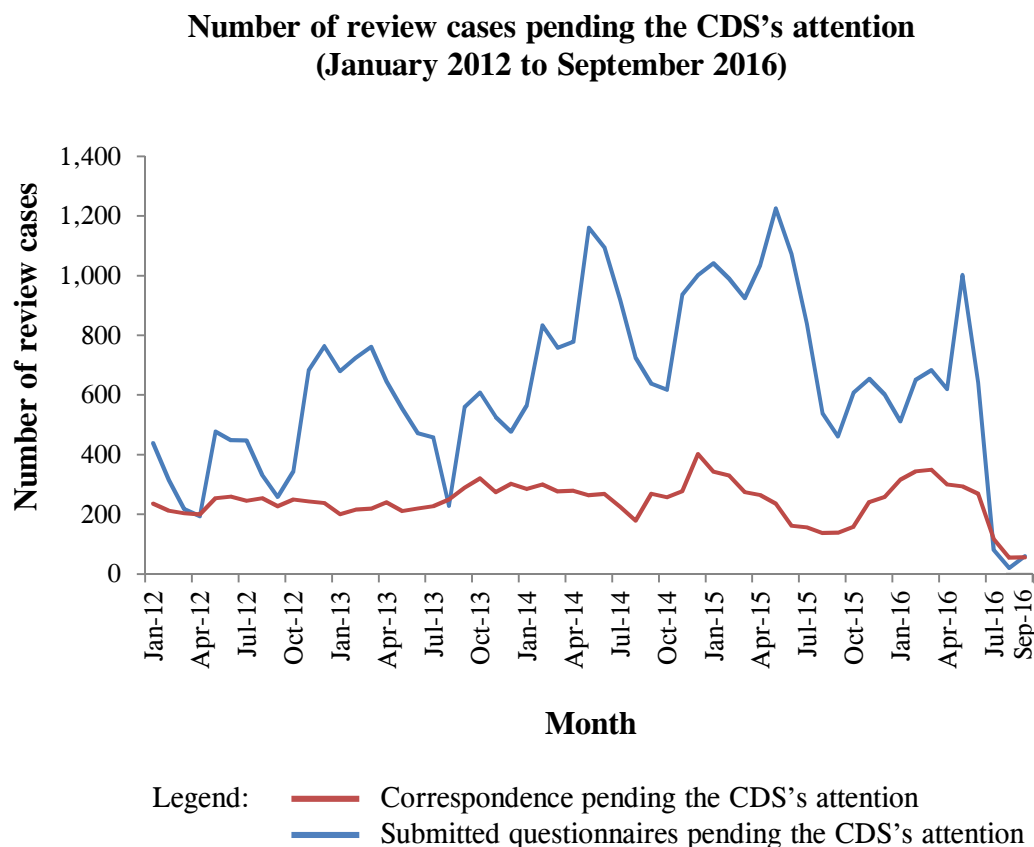
Note 16: *According to the IRD, the monthly report by the CDS serves to inform the IRD management of the volume of the outstanding work pending the CDS's attention but not the number of uncompleted review cases. The number and details of the uncompleted review cases can be extracted from the IRD's database as and when necessary.*

Note 17: *For example, as at 30 September 2016, the CDS had not attended to 60 submitted questionnaires. The waiting time for the earliest questionnaire which was received on 19 August 2016 was therefore 42 days up to 30 September 2016.*

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September 2016 was 283 days, which was lower than 661, 598 and 476 days for the years ended September 2013, 2014 and 2015 respectively.

Figure 4

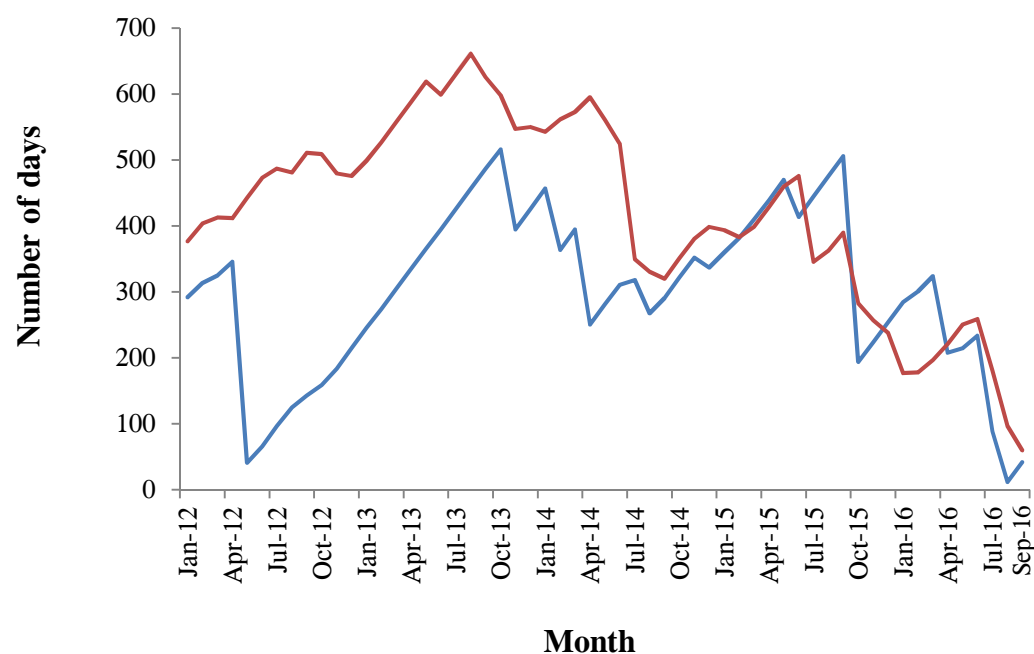


Source: IRD records

Remarks: The fluctuations from month to month in the number of submitted questionnaires/correspondence pending the CDS's attention were attributable to the CDS's practice of issuing questionnaires by three to four batches each year and the employment of summer interns to assist in reviewing cases (see Note 14 to para. 2.4).

Figure 5

**Number of days for which the earliest submitted questionnaire/correspondence
had been pending the CDS's attention
(January 2012 to September 2016)**



Legend: — Earliest correspondence
— Earliest submitted questionnaire

Source: Audit analysis of IRD records

Remarks: The fluctuations from month to month in the number of days for which the earliest submitted questionnaire/correspondence had been pending the CDS's attention were related to the fluctuations in the number of uncompleted review cases (see Remarks in Figure 4).

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2.9 *Inadequacies of the monthly work reports.* While both the number of review cases pending the CDS's attention and the number of days for which the earliest submitted questionnaire/correspondence had been pending the CDS's attention had decreased over the years (see para. 2.8), Audit's enquiries of the reporting mechanism revealed the following issues:

- (a) for each review case with correspondence pending the CDS's attention, there was no information showing the date on which the review first commenced. For review cases with several rounds of exchange of correspondence with the charities concerned, the dates of the most recent correspondence pending attention did not reflect how long the cases had been in process. Moreover, the reported figures did not cover those review cases where the charities concerned had not responded to the CDS's queries (see para. 2.12(b) for an example); and
- (b) the reported information was collated from returns provided by individual case officers. Audit examination of the uncompleted review cases revealed incidents of long delays by the CDS in attending to the charities' correspondence/submitted information suggesting that there could have been omissions of uncompleted cases under this manual reporting system (see para. 2.12(a) for an example).

As such, the monthly reports could not provide a complete picture of all the uncompleted cases and their age profile.

2.10 *Audit analysis.* The IRD has maintained a computer database of all the tax-exempt charities and kept a record of the review year for each charity. The review year provides an indication of the review status of a case (Note 18). Audit analysis of the review year records of 8,923 tax-exempt charities kept in the computer database revealed that the IRD's reviews of the tax exemption status of 635 charities commenced or scheduled for commencement from 2006 to 2015 had remained uncompleted as at 30 September 2016. However, the IRD's

Note 18: *For example, a charity with a review year record (say 2013) which is earlier than the current time (say March 2017) means that the review commenced/scheduled for commencement in 2013 has not been completed. When the review is completed (say in June 2017), the review year record will be updated to 2021 in accordance with the 4-year review interval.*

September 2016 report only showed 116 uncompleted review cases pending the CDS's attention due to the inadequacies mentioned in paragraph 2.9(a) and (b).

2.11 **635 uncompleted review cases.** An ageing analysis of the 635 uncompleted review cases showed that 71 (11%) had remained uncompleted over five years as at 30 September 2016 (see Table 3). There is a need for the IRD to closely monitor these uncompleted review cases because:

- (a) if the IRD subsequently finds it necessary to withdraw the recognition of the tax exemption status of a charity, there could be delays in raising assessments on its profits. Under the IRO, the IRD is empowered to raise assessments and demand tax within six years after the expiration of the relevant year of assessment; and
- (b) as the effective date of withdrawal would be dated back to the event leading to the withdrawal, members of the public could have made donations and claimed tax deductions on their tax returns based on the information about the tax exemption status of the charities concerned as posted on the IRD's website, which turns out to be inaccurate.

In this connection, Audit examined 30 cases of withdrawal and found that the IRD withdrew the recognition of the tax exemption status of the charities concerned a long time after commencing the periodic reviews, i.e. five to seven years in four cases.

Table 3

**Ageing analysis of the 635 uncompleted review cases
(30 September 2016)**

Number of years a review case remained uncompleted	Number of review cases
< 2	461 (73%)
2 to 5	103 (16%)
> 5	71 (11%)
Total	635 (100%)

Source: Audit analysis of IRD records

2.12 ***Delays in taking follow-up actions.*** According to the IRD, there is no operative provision under the IRO that requires a charity to respond to the IRD's requests for information and documents for the periodic reviews of its tax exemption status within a specific time. The long time taken in processing the cases could have been caused by delays of the charities concerned in responding to the IRD's enquiries. Audit selected 17 review cases for examination (i.e. about one-fourth of the 71 review cases which had remained uncompleted over five years). Audit found that in 15 (88%) cases, there were instances of delays by the IRD and the following are three examples:

- (a) ***Case A.*** In March 2009, the IRD commenced a review of the tax exemption status of a charity (Charity A) by issuing a questionnaire to obtain relevant information and documents. The questionnaire was submitted in April 2009. However, it was left unattended to until September 2016 (some 7.5 years later) when the IRD resumed its follow-up action. This case was not included in the monthly work report on the review cases pending the CDS's attention (see para. 2.9(b));
- (b) ***Case B.*** In March 2011, the IRD commenced a review of the tax exemption status of a charity (Charity B) by issuing a questionnaire to obtain relevant information and documents. The questionnaire was submitted in April 2011. In January 2012, the IRD raised an enquiry

about the financial accounts. While the enquiry was not answered by the charity concerned, the IRD had not taken any follow-up action until August 2016 (some 4.5 years later). This case was not included in the monthly report because it did not cover review cases where the charities concerned had not responded to the IRD's enquiries, i.e. an inadequacy mentioned in paragraph 2.9(a); and

- (c) **Case C.** In March 2011, the IRD commenced a review of the tax exemption status of a charity (Charity C) and the questionnaire was submitted in May 2011. During the course of review, the IRD found that Charity C had paid rent 67% higher than the rateable value in 2007-08 and 2008-09 for use of premises owned by a related company (which had common directors with Charity C) when its governing instrument only allowed the payment of proper and reasonable rent to members of the governing body. Up to December 2016 (after the lapse of five years), the IRD had not finalised the case. Audit noted that on three occasions during the five years, the IRD only requested further explanations and documents after long periods of inaction ranging from 9 to 16 months.

Follow-up actions on matters of regulatory concern

2.13 In both the periodic reviews and processing of new applications (including reinstatement applications) for tax exemption, the IRD would examine the submitted documents and make enquiries to ascertain whether the activities or expenditures of the charities concerned are compatible with their objects. Audit examined 160 review cases and 10 reinstatement application cases and found limitations/inadequacies in the IRD's follow-up actions on matters of regulatory concern in 10 review/reinstatement cases. The detailed findings are reported in paragraphs 2.14 to 2.19.

2.14 ***Directors' remuneration.*** According to the CDS's Staff Handbook, where a charity is found in a periodic review to have paid remunerations to directors which is not allowed in its governing instrument, the case officer has to draw the charity's attention to the breach and seek the charity's remedial actions (see para. 2.4(b)(ii)). Audit found four cases of breach of the directors' remuneration clauses (Cases D to G). While remedial actions were taken by the charities concerned, ranging from cessation of payment (Case D) to partial refund

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(Cases F and G) and full refund (Case E), their tax exemption status was not affected:

- (a) **Case D.** In March 2016, the IRD received a complaint that some members of a tax-exempt charity (Charity D) had received remunerations for the years ended 2012 to 2015. In May 2016, the IRD obtained the financial statements of Charity D for these years and identified that remunerations had been paid to nine directors totalling about \$13 million for the three years ended 2012 to 2014, which was not allowed under the Charity D's governing instrument. In August 2016, the IRD requested Charity D to confirm whether the practice had ceased and what remedial action would be taken. In October 2016, Charity D confirmed that it had ceased paying remuneration and provided information showing that the practice ceased in 2015. Audit noted from the IRD's records of an Employer's Return for salaries tax and financial statements filed by Charity D which showed that remunerations totalling \$5 million had also been paid by Charity D to ten directors for the year ended 2011;
- (b) **Case E.** In a 1999 review, the IRD found that a tax-exempt charity (Charity E) had breached the directors' remuneration clause and paid three directors a total sum of \$20,700 for the year ended 1999. Charity E arranged full refund of the remunerations by the three directors and undertook to comply with the governing instrument requirements in future. The IRD accepted the remedial action and continued Charity E's tax exemption status. However, in another review in 2007, the IRD found that Charity E had breached the directors' remuneration clause again and paid a director a total sum of \$43,500 for the years ended 2006 and 2007. Notwithstanding the repeated breaches, the IRD accepted Charity E's remedial action (i.e. full refund and undertaking of future compliance) and continued Charity E's tax exemption status. A warning that it would withdraw the tax exemption status for any recurrence of the similar problem was issued to Charity E after the detection of the breach in the 2007 review; and
- (c) **Cases F and G.** In processing a reinstatement application of Charity F in 2015 (the tax exemption status of Charity F was withdrawn in December 2003), the IRD found that Charity F had breached the directors' remuneration clause and paid a member of its governing body a total sum of \$276,100 for the years ended 2003 to 2013. After Charity F refunded \$13,100 (5% of the remuneration paid), the IRD reinstated the

recognition of its tax exemption status. Similarly, in processing a reinstatement application of Charity G in 2012 (the tax exemption status of Charity G was withdrawn in May 2006), the IRD found that Charity G had breached the directors' remuneration clause and paid a director a total sum of \$375,000 for the years ended 2008 to 2012. In the event, the IRD reinstated the recognition of its tax exemption status after Charity G proposed that \$187,500 (50% of the remuneration paid) would be refunded by the director.

2.15 ***Expenses not in furtherance of charitable objects.*** According to the CDS's Staff Handbook, the governing instrument of a tax-exempt charity should generally contain a clause limiting the application of its funds towards the attainment of its stated objects. Audit noted two cases (Cases H and I) in which the IRD had identified the expenditures which were not in furtherance of the objects of the charities concerned. In both cases, the IRD continued their tax exemption status after remedial actions had been taken, with one case satisfied by a full refund and the other case no refund, as follows:

- (a) ***Case H.*** In December 2010, the IRD received a complaint about a charity (Charity H) alleging that some of its income should be subject to tax. After obtaining clarifications from Charity H, the IRD found that the complaint was unsubstantiated. However, in the course of examining its financial statements for the years ended 2010 to 2013, the IRD found that some of its travelling expenditure items totalling \$704,500 could not have been used for furthering its charitable objects. In response to the IRD's observations, Charity H confirmed that it had claimed back \$500,000 of the money paid and the rest would be recovered in due course. No follow-up actions were taken and the IRD continued Charity H's tax exemption status; and
- (b) ***Case I.*** In a 2008 review, the IRD found that a charity (Charity I)'s activities included repairing of an ancestral tomb of a director. The IRD raised questions on how the activities were compatible with its objects of relief of poverty and requested Charity I to provide a breakdown of its donation expenses. As Charity I failed to respond to the IRD's enquiries despite repeated reminders, the IRD withdrew its tax exemption status in December 2011. In July 2014, Charity I applied for reinstatement of its tax exemption status. The IRD found from Charity I's submitted breakdown of donation expenses for the year ended 2008 that

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two expenditure items totalling \$236,000 were for the re-construction of an ancestral temple and repair of an ancestral tomb (related to the Charity's founder). While the IRD considered the former expenditure was not charitable in nature and the latter expenditure was for discharging the personal liability of the founder, it accepted Charity I's undertaking not to make similar payments as a remedy and reinstated its tax exemption status.

2.16 *Limitations of the IRO provisions on tax exemption status of charities.*

In response to the audit observations in paragraphs 2.14 and 2.15, the IRD informed Audit in March 2017 of the following limitations in its powers to take enforcement actions on the six cases of breach of the governing instrument/objects of charities:

- (a) ***Directors' remuneration.*** According to a case law ruling, while payment of remunerations to directors of a charity not provided for in the governing instrument might constitute a breach of fiduciary duty, such breach would not alter the charity's objects and hence its charitable status. The IRD had no legal basis or authority to withdraw the tax exemption status of a charity merely because of the non-compliance. Based on the legal advice obtained in 2003, the IRD noted that an offence committed by an official of the institution might not necessarily be attributable to the institution. The IRD also had no authority to demand the charities to refund (in full or in part) the directors' remunerations paid. The IRD had ceased to issue warning letters in respect of any breach of the directors' remuneration clause after the one issued in Case E (see para. 2.14(b)). Instead, a closing letter reminding the charities to comply with the relevant provisions in their governing instruments would be issued; and
- (b) ***Expenses not in furtherance of charitable objects.*** The IRD was not responsible for the governance of a charity, nor did it have regulatory power over the operation of a charity. Based on the legal advice obtained in 2003, the IRD noted that it was not legally proper to overturn a charity's tax exemption status solely because the charity had not complied with any obligations, whether statutory or not, which were not provided in the IRO. Even though the case officer was of the view that certain items of expenditure were not paid for the furtherance of the charitable objects of a charity, this did not affect its charitable status. The IRD had no authority to demand the charity to refund (in full or in part) the expenditure concerned. Based on the legal advice obtained in 2003, the

IRD noted that an isolated incident might not necessarily be conclusive as to the true nature of the business of an institution. The best the IRD could do was to remind the charity of the compliance with the income clause in its governing instrument and advise it to take remedial actions.

2.17 *Need to consider reviewing the provisions of the IRO on tax exemption status of charities.* In its Report on Charities of 2013, the LRC noted that the IRD would from time to time call for accounts, annual reports or other documents for the purpose of conducting a review of the tax exemption status of a particular organisation so as to ensure that the organisation remained charitable and its activities were compatible with its objects. The LRC considered that the IRD's function of reviewing the accounts of charities to ensure that their income was used solely for charitable purposes in compliance with the law was highly important, underpinning to a large extent, the public's confidence in the charity sector. Many responses obtained by the LRC during its consultation stage acknowledged the need for the IRD to carry out the function of reviewing annual accounts. There was also a suggestion that the IRD should carry out reviews on the charitable status of charities more frequently for the better monitoring of the accounts of charities and their operations related to charitable activities. The LRC has recommended that the IRD should conduct more frequent reviews of the accounts of tax-exempt charities as and when necessary, to ascertain whether the activities of these charities are compatible with their charitable objects. However, according to the IRD, there is a lack of enforcement powers under the existing provisions of the IRO for the IRD to take effective follow-up actions on charities found with expenses/activities contravening their governing instruments or incompatible with their charitable objects (see para. 2.16). Apparently, there is a gap between the public expectation of the IRD's role in administering the tax exemption status of charities and what the IRD can do under the existing provisions of the IRO. To address the expectation gap, there is a need to consider reviewing the provisions of the IRO with a view to enabling the IRD to effectively perform its role of administering the tax exemption status of charities.

2.18 *Donations made by charities.* According to the tax guide, a tax-exempt charity shall have a clause in its governing instrument requiring the keeping of sufficient records of income and expenditure, including donation receipts (where donations were made to another charity — see para. 2.3(b)(v)). Audit noted that in two review cases, the case officers had not requested the charities concerned to provide sufficient explanations on their donation expenditures to support that they were compatible with their objects:

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- (a) in one case (Case J), while the charity's financial statements for the year ended 2015 showed donation income of \$0.9 million and donation/scholarship expenditure of \$1 million, the case officer noted down on file that no expenditure breakdown was requested as similar information had been provided in the previous review of 2011. Given the lapse of four years and the possibility that the nature and extent of the donation expenditure items might have changed between the two reviews, a breakdown of the donation expenditures for 2015 should have been obtained; and
- (b) in another case (Case K), while the charity's financial statements for the year ended 2014 showed donation income of \$0.39 million and donation expenditure of \$0.46 million, no expenditure breakdown was requested. The case officer noted down on file her observation from the charity's submitted questionnaire that its activities in 2015 included supporting other charities in the relief of victims of an earthquake in Nepal and advancement of religion which were compatible with its objects as a reason for not requesting a breakdown of the donation expense. However, there was no explanation on why the donations in 2015 were considered relevant to those made in 2014. A breakdown of the donation expenditures for 2014 should have been obtained.

In March 2017, in response to Audit's enquiry, the IRD said that the case officers had exercised their professional judgement and adopted a risk-based approach in conducting reviews. In both cases, no expenditure breakdown was considered necessary by the IRD. However, Audit noted that there were instances that the case officers had requested the charities concerned to provide a breakdown of their donation expenditures even though similar information had been provided in previous reviews. For example, in one case, the CDS obtained a breakdown of donations of \$0.6 million made by a charity in its 2014 review although similar breakdown for donations of \$0.73 million had been provided in the 2009 review. Moreover, given that the donation expenditures in Cases J and K were the only activities of the charities using up all/most of their donations received for the years, there is a need to remind the case officers to also give due consideration to the materiality of the donation expenditures in relation to the charity's income in determining the extent of verification work.

2.19 ***Dormant charity.*** According to the CDS's Staff Handbook, the recognition of tax exemption status of a charity may be withdrawn if it has ceased operation or is dormant (see para. 2.4(c)(ii)). Audit examined seven review cases and found that in three cases, the CDS had taken a long time (over two years) to deal with dormant cases. The following are two examples:

- (a) in one case (Case L), the charity concerned was recognised as a tax-exempt charity in 1997. In three subsequent reviews of its tax exemption status (i.e. in 2002, 2004 and 2009), the submitted financial statements showed that the charity had not commenced operation (for some 12 years up to 2009). In the 2002 review, the charity stated in its submitted questionnaire that it had a plan to operate as a church later that year. In response to the case officer's enquiries in the 2004 review exercise, the charity stated that it would start operation in January 2005 and provided information in relation to the activities intended to carry out. In the 2009 review, the charity stated that it would start operation from November 2009. The IRD continued its tax exemption status each time after obtaining a future activity plan (to operate as a church). For the 2014 review, the charity provided information (including donation receipts dated 13 September 2015 and 31 July 2016, and an activity pamphlet of Sunday services) to show that it had charitable activities in 2015 and 2016. In the event, the IRD continued the charity's tax exemption status in September 2016. However, Audit noted from the financial statements of the charity for the year ended 31 March 2016 (which were available from the CR as the charity was a registered company) that there was no income for the year and a note to the financial statements also stated that the charity had not commenced any activities and remained dormant. The IRD needs to seek explanations from the charity in this regard; and

- (b) in another case (Case M), the charity concerned was recognised as a tax-exempt charity in 2006. In response to the IRD's 2011 review of its tax exemption status, the charity reported in April 2011 that it was dormant. In May 2012 (one year later), the IRD enquired the charity if it had a future activity plan. In July 2012, the charity requested an extension to furnish a reply about its future activities for one year. However, for three years the charity had not responded to the IRD's reminders (of December 2012, February 2014 and May 2015) on its outstanding reply. In June 2015, the charity (a registered company) applied to the IRD for a notice of no objection to its application to the CR

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for deregistration in accordance with the Companies Ordinance requirement. The case officer issued enquiries to the charity after noticing that it had applied for deregistration. In July 2015, the charity informed the IRD that it had never commenced business since its incorporation. The IRD then withdrew the recognition of its tax exemption status.

In March 2017, the IRD informed Audit that it had to strike a balance in maintaining the recognition of the tax exemption status of a charity and the damage that would be done to the charity if the recognition was withdrawn without a legally defensible reason. However, in four of the seven cases examined by Audit, the case officers had taken action to withdraw the recognition of tax exemption status of dormant charities in a more timely manner. For example, in one case, the charity replied in February 2015 that it had not held any activities. After issuing an enquiry letter for a future activity plan in April 2015 and three reminders in August and December 2015, and May 2016 which were met with no response, the CDS withdrew the recognition of tax exemption status of the charity in September 2016 (i.e. after 19 months). In Audit's view, the IRD needs to remind CDS staff to take action on dormant cases in accordance with the Staff Handbook requirements if the charities concerned have failed to respond to the CDS's enquiries or failed to realise their activity plans within a reasonable time.

Need to take timely action upon dissolution of a tax-exempt charity

2.20 According to the tax guide, the governing instrument of a tax-exempt charity should contain a clause specifying how its assets should be dealt with upon its dissolution (the remaining assets should normally be donated to other charities) (see para. 2.3(b)(vi)). The IRD has made arrangements with the CR whereby companies to be struck off by the CR would be brought to the IRD's attention. Since January 2016, the CDS has used a computer program to conduct matching exercise twice a month to identify tax-exempt charities to be struck off by the CR. This is important to protect revenue in case there are any outstanding tax liabilities of a company to be struck off. Where the company is a tax-exempt charity, the arrangements also enable the IRD to take timely actions on:

- (a) updating its s88 list by removing the name of the struck-off charitable company; and

- (b) making enquiry into whether the assets of such company after dissolution have been disposed of in accordance with the governing instrument requirement.

2.21 Audit examined the notification arrangements by cross-checking the tax-exempt charities on the IRD's s88 list as at 30 September 2016 against the Companies Register maintained by the CR. Audit found that two tax-exempt charitable companies which had been struck off by the CR were still on the s88 list:

- (a) in the first case, the charity had been struck off by the CR in October 2015 but was removed from the s88 list by the CDS on 7 December 2016 (when the case officer was informed by the IRD's Headquarters Unit about the striking off of the charity); and
- (b) in the second case, the matching exercise in June 2016 revealed that the charity was pending striking off. The case officer issued a letter on 16 June 2016 asking the charity to provide the final accounts. In response to the charity's enquiry of 7 September 2016, the case officer issued a letter on 29 September 2016 to explain the "striking off" arrangement and request the provision of the required information. Subsequently, the matching exercise (see para. 2.20) revealed that the charity was struck off on 30 September 2016 but the matching report for this file was mislaid. As a result, the recognition of tax exemption status of the struck-off company was only withdrawn on 27 January 2017.

In March 2017, the IRD informed Audit that: (i) before rolling out the computer program for the matching exercise in January 2016 (see para. 2.20), the CDS had to first manually check the status of the then existing corporate charities from the CR's cyber search centre; (ii) for the first case in (a) above, the manual checking of 6,532 corporate charities was accomplished within a month's time and the CDS had only failed to identify one struck-off case; and (iii) the mislaid matching report for the second case mentioned in (b) was also an isolated incident. However, given that members of the public have been advised by the IRD's departmental interpretation and practice notes to refer to the s88 list for checking whether their charitable donations will qualify for tax deduction, there is a need to ensure timely removal of the struck-off charitable companies from the s88 list.

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2.22 Audit also notes that the IRD has not made similar notification arrangements with relevant B/Ds for tax-exempt charities which are established under other ordinances (e.g. the Societies Ordinance administered by the HKPF — see para. 1.7(d)). In this connection, Audit cross-checked the tax-exempt charities on the IRD's s88 list as at 30 September 2016 against the register of societies maintained by the HKPF. Audit found that two tax-exempt charitable societies which had been deregistered by the HKPF (one in 1997 and the other in September 2016) were still on the s88 list. In March 2017, in response to Audit's observation, the IRD said that:

- (a) for the first case, notwithstanding that the charity was not registered with the Societies Office of the HKPF, in the four consecutive reviews of its tax exemption status (i.e. 2000, 2004, 2010 and 2015), the submitted financial statements and lists of activities showed that the charity operated a church and carried out charitable activities compatible with its charitable objects. Based on the manual checking exercise mentioned in paragraph 2.21 which also covered charities established by other legal structures (such as societies), the CDS identified that the charity had been deregistered during the exercise and then sought clarification with it. The charity advised the IRD in late August 2016 that it was trying to resolve the issue with the Societies Office and would provide relevant documents to the IRD. The IRD was of the view that the charity's failure of registration with the Societies Ordinance would not affect the charity's charitable status based on a case law ruling. As at March 2017, the CDS's clarification with the charity was still in progress; and
- (b) for the second case, the tax exemption status was removed on 19 December 2016 upon the Societies Office's confirmation that the charity was dissolved.

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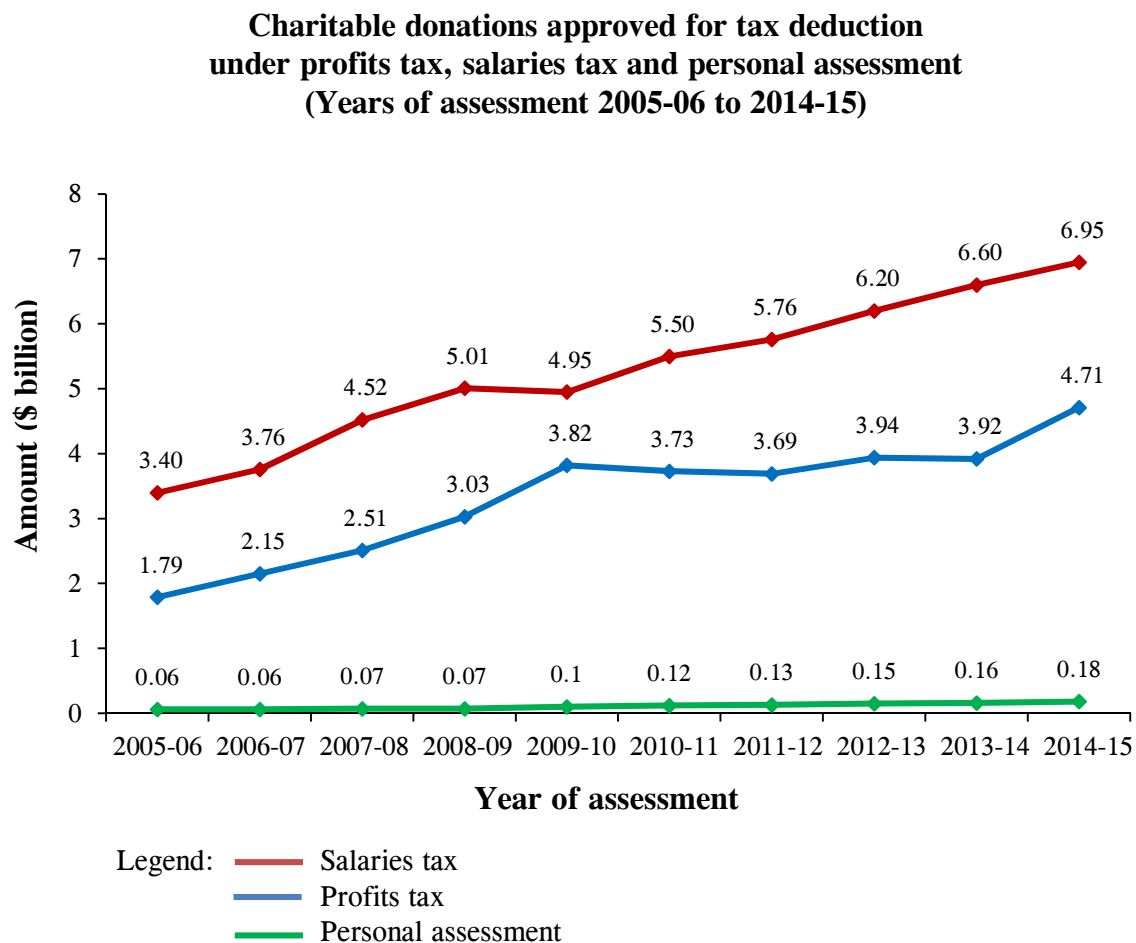
2.23 Under sections 16D and 26C of the IRO, a taxpayer making an approved charitable donation is allowed tax deduction under profits tax and salaries tax/personal assessment respectively. Besides the tax guide, the IRD has issued departmental interpretation and practice notes advising the public of the criteria governing the allowance of tax deduction for charitable donations under section 26C of the IRO, including the following:

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- (a) the payment must be a donation. The donor must not receive any benefit or advantage of a material nature by way of return. Examples of payments not recognised for tax deduction include purchase of raffle tickets, and cost of tickets for charity balls, concerts and film shows;
- (b) the donation must be a donation of money to a tax-exempt charitable institution or trust of a public character under section 88 of the IRO;
- (c) a deduction in respect of the same donation cannot be allowed to more than one taxpayer;
- (d) the aggregate of a taxpayer's donations (including the donations of his or her spouse, not being a spouse living apart from the person for salaries tax and personal assessment) must not be less than \$100; and
- (e) the allowable deduction in any year cannot exceed a specified percentage of the person's assessable income (i.e. 35% since year of assessment 2008-09).

2.24 The amounts of charitable donations approved for tax deduction under profits tax, salaries tax and personal assessment for the years of assessment from 2005-06 to 2014-15 are shown in Figure 6.

Figure 6



Source: IRD records

2.25 Unit 1 of the IRD is responsible for administering tax deduction claims for charitable donations of corporations and partnerships as part of its tax assessment work on their profits tax. Unit 2 is responsible for administering tax deduction claims for charitable donations of individuals as part of its tax assessment work on their salaries tax, profits tax and personal assessment. As at June 2016, there were 360 staff working in Unit 1 and 766 in Unit 2. In 2015-16, 461,000 assessments were made under profits tax, 2,797,000 under salaries tax and 362,000 under personal assessments.

2.26 *Desk audits.* Since April 2001, in order to streamline the assessing procedures, the IRD has used a computerised Assess First Audit Later System for screening tax returns for automated assessment and selecting cases for

post-assessment desk audit. Both Units 1 and 2 have used a risk-based approach in selecting returns for conducting desk audits:

- (a) for profits tax cases selected, assessing officers will examine the profits tax returns and supporting documents (e.g. tax computation and financial statements) already submitted by the taxpayers. According to the IRD, all aspects of a selected profits tax case (i.e. all account items including charitable donation claims) will be examined although special attention will be paid to the risk areas for which each case is selected. The objective is to ascertain whether assessable profits/loss issued by the automated assessment is correct. In the process, assessing officers would exercise professional judgement and may seek clarifications from the taxpayers concerned where necessary and worthwhile. There is no requirement that enquiries must be issued in each desk audit case. Original receipts and supporting evidence will only be asked in exceptional cases; and
- (b) for salaries tax and personal assessment cases selected based on charitable donation claims, the IRD will require taxpayers concerned to submit the donation receipts (usually the original receipts) or other acceptable supporting evidence (such as bank pay-in slips showing details of the donations made) for verification. In examining the documents submitted, assessing officers would exercise professional judgement on whether the donations made have fulfilled the deduction requirements.

2.27 The IRD will make adjustments where charitable donations are found to be overclaimed or underclaimed as a result of the desk audits. Table 4 shows the number of tax files with adjustments made and the corresponding adjustments made relating to charitable donations for the years of assessment 2010-11 to 2014-15.

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Table 4

Desk audit adjustments made in relation to disallowed charitable donation claims for the years of assessment 2010-11 to 2014-15 (September 2016)

Year of assessment	Unit 1		Unit 2	
	Number of tax files for corporations/partnerships	Adjustment (\$)	Number of tax files for individuals	Adjustment (\$)
2010-11	6	1,800,323	428	14,724,978
2011-12	10	978,978	305	14,516,564
2012-13	11	317,372	238	13,585,036
2013-14	5	216,882	140	7,711,211
2014-15	7	697,186	102	11,373,940
Total	39	4,010,741	1,213	61,911,729

Source: IRD records

Room for improvement in desk audits on charitable donation claims

2.28 Based on a sample check of 30 desk audit cases for profits tax conducted by Unit 1 in 2015-16 and 50 desk audit cases for salaries tax/personal assessment conducted by Unit 2 in 2015-16, Audit noted the following:

- (a) ***Profits tax.*** In one case, the supporting schedule filed by the taxpayer did not show whether the donations for \$50,000 were made to recognised charities on the s88 list. However, the assessing officers had allowed tax deduction for the said amount without seeking clarification from the taxpayer. While the claimed amount of \$50,000 representing only 0.72% of the assessable profits might not warrant a detailed verification, there is a need to maintain a minimum level of verification, such as requesting a breakdown of the donation expenditures to show that they are made to recognised charities on the s88 list. In this connection, Audit noted that for salaries tax, the IRD would require the taxpayers concerned to submit donation receipts for claims of \$100 or more; and

- (b) ***Salaries tax.*** In one case, the charity shown on the donation receipt for US\$100 was not a recognised charity on the s88 list. In another case, the donor's name on the donation receipt for \$100 did not match with the name of taxpayer or his spouse claiming tax deductions. However, the assessing officers had allowed tax deductions for the said amounts in both cases. In Audit's view, the IRD needs to remind assessing officers to be more vigilant in checking the validity of donation receipts in the desk audits.

Audit recommendations

2.29 **Audit has *recommended* that the Commissioner of Inland Revenue should:**

- (a) **consider setting a performance pledge for attending to new applications for recognition of tax exemption status;**
- (b) **take measures to enhance the monitoring of the progress of periodic review cases of tax exemption status of charitable organisations such as ensuring that all uncompleted review cases are included in the monthly work report submitted for management review;**
- (c) **closely monitor the uncompleted review cases and remind CDS staff to take timely follow-up actions on outstanding issues;**
- (d) **take measures to improve the follow-up actions on matters of regulatory concerns identified during reviews of the tax exemption status of charitable organisations, including:**
 - (i) **in consultation with the Secretary for Financial Services and the Treasury, considering the need for reviewing the provisions of the IRO with a view to enabling the IRD to effectively perform its role of administering the tax exemption status of charities;**
 - (ii) **reminding CDS staff to obtain from the charities concerned a breakdown of their donation expenditures to support that they are compatible with their objects and, in exercising their**

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judgement to determine the extent of verification work, give due consideration to the materiality of the donation expenditures; and

- (iii) reminding CDS staff to take action on dormant cases in accordance with the Staff Handbook requirements if the charities concerned have failed to respond to the CDS's enquiries or failed to realise their activity plans within a reasonable time, and seek further explanations from the charity mentioned in paragraph 2.19(a);**
- (e) remind CDS staff to take timely action on updating the s88 list by removing charities which had been deregistered by the CR/HKPF;**
- (f) expedite action to liaise with relevant B/Ds (such as the HKPF) to set up notification arrangements of charitable organisations which have been deregistered under their respective ordinances; and**
- (g) remind assessing staff in conducting desk audits:**
 - (i) to seek clarification from the taxpayer concerned if the supporting schedule for a profits tax case cannot show whether the claimed charitable donations are made to recognised charities on the s88 list; and**
 - (ii) to be more vigilant in checking the validity of donation receipts for allowing tax deduction under salaries tax.**

Response from the Government

2.30 The Commissioner of Inland Revenue generally agrees with the audit recommendations. He has said that:

- (a) regarding paragraph 2.9(b), the IRD management has noticed the large volume of outstanding work pending the CDS's attention and has taken steps (including increasing the CDS's manpower in 2013 and recruiting interns since 2014) to clear the outstanding work;**

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- (b) regarding paragraph 2.11(a), the IRD officers remain vigilant in reviewing the tax exemption status of charities under section 88 of the IRO. Assessments will be raised whenever necessary to assess the profits derived from trade or business carried on by charities where the profits so derived are not exempt by virtue of the proviso to section 88 of the IRO;
- (c) regarding paragraph 2.12, the review of the three cases, namely Cases A, B and C, has been completed;
- (d) regarding paragraph 2.13, the IRD performs no regulatory role as it is not responsible for the governance of a charity, nor does it have regulatory power over the operation of a charity. It also does not have any enforcement power when a charity's act contravenes its governing instrument. Periodic reviews, being administrative procedures, are conducted to ascertain whether charities recognised as tax-exempt should continue to be eligible for tax exemption;
- (e) regarding the audit recommendation in paragraph 2.29(a), the IRD publicised on its website on 1 April 2017 that the CDS would endeavor to give a reply to applications for recognition of tax exemption status (provided that all the required information and documents were received by the CDS) within four months of the date of receipt of the application, and will consider the feasibility of setting a performance pledge for attending to new applications;
- (f) regarding the audit recommendation in paragraph 2.29(b), since February 2017, the CDS has enhanced its monthly work report for management review by incorporating the number of all uncompleted review cases with their age profile and their position at the end of each month, so as to facilitate the monitoring of the progress of handling these cases;
- (g) regarding the audit recommendation in paragraph 2.29(c), the CDS will take further measures to closely monitor the uncompleted review cases, which include strengthening the control system of outstanding replies to enquiries raised by the IRD. CDS staff have been reminded to take timely follow-up actions on outstanding issues;

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- (h) regarding the audit recommendation in paragraph 2.29(d)(i), while appreciating Audit's efforts in putting forward constructive recommendations to improve the monitoring of charities, the IRD wishes to emphasise that its key responsibilities, as a tax administrator, are to make tax assessments and collect taxes. At the same time, the IRD needs to update the tax law from time to time to ensure that Hong Kong has a robust tax regime and is in compliance with the fast evolving world standards on tax cooperation (e.g. on exchange of information) as well as enhancing Hong Kong's competitiveness. The IRD is not in a position to oversee the governance of a charity (e.g. whether remunerations are paid to directors of a charity, or whether the expenses are paid for the furtherance of the charitable objects of a charity);
- (i) regarding the audit recommendation in paragraph 2.29(d)(ii), CDS staff would continue to exercise their professional judgement in administering the tax exemption status of charities. CDS staff have been reminded to give due consideration to the materiality of the donation expenditures when deciding the extent of verification work;
- (j) regarding the audit recommendation in paragraph 2.29(d)(iii), CDS staff have been reminded to continue taking timely follow-up actions on dormant cases in accordance with the requirements in the Staff Handbook if the charities concerned have failed to respond to the CDS's enquiries or the charities have apparently failed to carry out their objects as laid down in the governing instruments. For the case mentioned in paragraph 2.19(a), the CDS will seek clarification with the charity concerned as to its operational status;
- (k) regarding the audit recommendation in paragraph 2.29(e):
 - (i) with the launch of the computer matching exercise since January 2016, the IRD shall be able to prevent similar incident in updating the s88 list seen in the case mentioned in paragraph 2.21(a); and
 - (ii) the CDS has enhanced the control on the matching reports by requiring case officers to initial on the reports after withdrawing the recognition of tax exemption status of the relevant charities and an Assessor would review the matching reports by the end of each

month to ensure that the recognition of tax exemption status of all the charities which have been struck off by the CR has been timely withdrawn;

- (l) regarding the audit recommendation in paragraph 2.29(f), the CDS matched the s88 list with the records of Societies Office in January 2016 and liaised with the HKPF in March 2017 to set up a notification arrangement in respect of societies which have been deregistered under the Societies Ordinance to ensure the timely withdrawal of the recognition of their tax exemption status; and
- (m) regarding the audit recommendation in paragraph 2.29(g), the IRD attaches great importance to the assessment work and desk audit. To minimise revenue leakage due to incorrect claims, the IRD will from time to time remind its staff to stay vigilant in conducting desk audit, including checking the validity of donation receipts and seeking clarifications from taxpayers concerned whenever necessary.

2.31 The Commissioner of Police has said that he raises no objection to the proposed notification arrangement between the CDS and the Societies Office mentioned in paragraph 2.29(f).

PART 3: ADMINISTRATION OF LAND GRANTED TO CHARITIES FOR OPERATING WELFARE/SOCIAL SERVICES

3.1 In general, the Government sells government sites for commercial industrial or residential development, by public auction or tender to the highest bidder. However, government sites are sometimes granted by private treaty to charitable and non-profit-making organisations at nominal or concessionary premium for special purposes, such as for operating welfare/social services, private hospital developments, religious or educational purposes. All such direct land grants are subject to stringent policy scrutiny and are thoroughly considered to be justified in the public interest, with specific approval granted by the Executive Council (ExCo) or by delegated authority exercised in accordance with the approved criteria set by ExCo, on a case-by-case basis. This PART examines the administration of land granted directly to charities for operating welfare/social services.

Land administration policy

3.2 *Granting of sites by PTG.* In 1959, ExCo noted the statement of government policy on land administration that, among other things, for disposal of land by PTG, the following principles were laid down in that ExCo submission:

- (a) nil premium would be charged for non-profit-making schools, hospitals, clinics, nurseries, recreation clubs, and other welfare purposes. Very stringent powers of control would be included in the conditions under which land was granted for welfare purposes, and in each case the institution must be run to the satisfaction of the appropriate head of department. No distribution of profits would be allowed; they must be applied to improving the welfare services provided by the grantee;
- (b) concessionary premium would be charged at one-third of market value for workers housing schemes and at two-thirds of market value for churches; and
- (c) full market value would be charged for public utilities such as electric sub-stations.

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3.3 *Redevelopment of sites granted at nil or concessionary premium for social service purposes.* In the early 1980's, there were requests from some lessees holding under-developed sites that they should be allowed to redevelop the sites so as to provide new and improved social service facilities and then to use up the remaining plot ratio for profit-making "commercial" development. The aim of maximising the commercial element would be to pay for the redevelopment and provide future income for the maintenance and running of the social service facilities and for future expansion. In 1981, ExCo endorsed the principle that lessees holding sites granted for social service purposes at nil/concessionary premium should, as an alternative to surrendering the sites to the Government for redevelopment, be allowed to redevelop those sites or exchange sites to include a "commercial" element, provided that the following principles and criteria were met:

- (a) premium should be charged at full market value for the "commercial" element in the development;
- (b) the lessee should be made accountable for income derived from its share in the development and this income would be applied to purposes acceptable to the Government; and
- (c) the project would benefit the public purse by decreasing the need or potential need for direct subventions.

Each individual proposal would be submitted to ExCo for consideration, with an indication in each case as to how the proposal complied with the ExCo's requirements, and that the Director of Social Welfare (DSW) would explain, when the first proposal was put forward, how the DSW intended to implement monitoring arrangements for it.

3.4 According to the Government's information paper for the Legislative Council (LegCo) Panel on Development of January 2011, the land administration policy in respect of PTG was as follows:

"we also grant land by PTG for specified use in justified circumstances, to comply with approved Government policies and to meet Hong Kong's economic, social and community needs. All such direct land grants have to be subject to stringent policy scrutiny and are thoroughly considered to be

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justified in the public interest, with specific approval granted by ExCo or by delegated authority exercised in accordance with the approval criteria set by ExCo, on a case by case basis.

PTGs are normally for a specific purpose with the land use specified in the grant. Premium payable varies from nominal, concessionary to full market value depending on the nature of the use. Currently, the amount of nominal premium is \$1,000 which is applicable to all cases charging a nominal premium.”

3.5 ***Previous audit reviews.*** In 2012 and 2013, Audit completed two reviews to examine the monitoring of land grants for operating private hospitals and private sports clubs respectively. The review results were included in the following reports:

- (a) Chapter 4 of the Director of Audit’s Report No. 59 of October 2012 entitled “Land grants for private hospital development”; and
- (b) Chapter 1 of the Director of Audit’s Report No. 61 of October 2013 entitled “Direct land grants to private sports clubs at nil or nominal premium”.

The reviews found areas for improvement in administering the land grant and utilisation of the PTG sites. The Public Accounts Committee of LegCo held public hearings in 2012 and 2013 to examine the findings included in the two reports.

3.6 ***Protocol on delineation of responsibilities on PTGs.*** In July 2014, as part of the Administration’s responses to the recommendations of the Public Accounts Committee of LegCo and the Director of Audit on matters concerning PTGs (see para. 3.5(a)), the Lands D, after consulting the relevant B/Ds, issued a protocol delineating the sharing of responsibilities between the Lands D as the Government’s land agent and the B/Ds which supported various types of PTGs (hereinafter referred to as the 2014 Protocol). Among other things, the 2014 Protocol has stated that:

- (a) ***Application stage for a site.*** The policy bureau overseeing the proposed operations/services to be provided by the applicant at the proposed PTG

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site and its executive departments (supporting B/Ds) should advise on the lease conditions specific to the operations/services to be provided, e.g. types and scope of essential services/facilities to be provided, permissible ancillary facilities, etc.;

- (b) ***Monitoring and enforcement of lease conditions throughout lease term.*** The supporting B/Ds should be responsible for monitoring or exercising control over operations/services to the satisfaction of the Government. Examples included the PTG clauses concerning:
 - (i) user;
 - (ii) type of building;
 - (iii) continuous operation to a scale to the satisfaction of Government after commencement of operation;
 - (iv) submission of accounts and scrutiny; and
 - (v) non-distribution of profits; and
- (c) ***Supporting B/Ds.*** The corresponding supporting B/D for PTG relating to social welfare facilities (including those commercial facilities run on a non-profit-making basis) are the Labour and Welfare Bureau and the SWD respectively.

The Lands D also informed B/Ds that any departure from the Protocol should be discussed and agreed with the Lands D on a case-by-case basis.

Alleged hotel operations on sites granted to charities at nil or concessionary premium

3.7 From 2013 to 2015, there were media reports and public complaints to the Government alleging hotel operations on 14 sites (under Leases A to N — see particulars at Appendix B) granted to non-governmental organisations at nil or concessionary premium. However, only 8 of the 14 land leases specified hostel or

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dormitory use. All the grantees (except for Grantee M — Note 19) were tax-exempt charities on the s88 list (see para. 1.7(a)).

3.8 *Government's responses.* The replies of the Development Bureau and the Lands D to media enquiries and complaints on the 14 sites (including one complaint relating to Lease M addressed to LegCo) from 2013 to 2016 are summarised as follows:

- (a) there was no definition under lease of the terms “hostel” and “hotel” but generally both allowed lodging;
- (b) the contractual obligations of lessees/grantees of private lots were set out in the individual government leases which were executed at different points in time, having regard to different circumstances as well as considerations prevailing then;
- (c) 3 of the 14 sites were held on virtually unrestricted leases (see Leases A, B and E at Appendix B which were not PTGs and not restricted to operating welfare/social services), for which the Lands D was not in a position to exercise any control under the land leases concerned. For the remaining 11 sites:
 - (i) some were held on leases which referred to a broader use, for example, the leases permitted the lots to be used for any purposes carried out under the purview of the grantee organisations which might be governed by their respective Memoranda of Incorporation or incorporating ordinances (see Leases C, D and K at Appendix B); and
 - (ii) for cases where the leases specifically permitted the running of hostels by the non-profit-making organisations (see Leases F, G, H, I, J, L, M and N at Appendix B), in the absence of specific provisions governing aspects such as the clientele, services standards and charges of the hostels in question, the Lands D could not unilaterally assume that the hostels should be run in a

Note 19: *Grantee M was a company limited by guarantee which was owned by a tax-exempt charitable organisation (hereinafter referred to as Charity M).*

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manner different from commercial hotels in the market and thereby asserted that failure to do so would be a breach of the lease;

- (d) the non-profit-making operation referred to in Lease M did not mean that the grantee concerned was prohibited from making any profit from operating the facilities (including hostels). The prime and foremost requirement was that any profit derived from the facilities should not be distributed;
- (e) the Lands D had taken legal advice, solicited inputs from relevant departments as well as approached the hostel/hotel owners for clarifications as necessary. So far (i.e. up to the date of the Lands D's reply of September 2014), it had not established any case involving a breach of the user clause and the "non-profit-making" clause under those land leases carrying such clauses; and
- (f) should the Government contemplate the granting of new site or modification of existing leases at nominal or concessionary premium to non-profit-making organisations for the running of hostels or hotels in future, it would propose the inclusion of suitable clauses in the land grant document to avoid ambiguity (e.g. whether the hostel or hotel was expected to serve a particular group of clientele and/or offer services at certain charges) and impress upon the supporting policy bureau the need for designing an appropriate monitoring mechanism to ensure delivery of the stated policy objectives.

3.9 ***Lands D's follow-up actions.*** Since 2014, the Lands D in consultation with relevant departments had continued to monitor the alleged hotel operations on the 14 sites and conducted investigations on individual cases of doubt. The Lands D had summarised the progress of its actions up to January 2016 as follows:

- (a) ***10 cases with actions completed on the part of Lands D.*** For the three leases (Leases A, B and E) with virtually unrestricted user clause (see para. 3.8(c)) and two leases (Leases C and D) referred to a broader use (see para. 3.8(c)(i)), the Lands D was not in a position to exercise any control. For two leases with non-profit-making operation of the facilities requirement (Leases F and L), the Lands D had reminded the grantees concerned to comply with such requirement. For two leases with

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other specific requirements (such as submission of accounts requirement in Leases H and N), the Lands D had reminded the relevant supporting B/D (i.e. the SWD — see para. 3.6) to follow up on such requirements. For Lease J with both non-profit-making operation and submission of accounts requirements, the Lands D had reminded the grantee and relevant supporting B/D to take similar follow-up actions; and

- (b) **4 cases with ongoing actions.** The remaining four leases with ongoing actions included: (i) following up suspected breach of the user clause of Lease G; (ii) monitoring the submitted accounts of Lease M; (iii) responding to the SWD's request for records of its approval of the hostel operation of Lease I; and (iv) reminding the grantee of Lease K to comply with the user clause requirement.

3.10 **Audit examination.** Audit examined the provisions of the 11 leases related to charities for operating welfare/social services (i.e. excluding the three unrestricted leases — see para. 3.8(c)) to see whether there were lessons that could be applied generally. Audit also selected 4 of the 11 leases for reviewing the Lands D's follow-up actions on specific issues (including two leases, i.e. Leases H and N for which the Lands D had considered action completed on its part and two leases, i.e. Leases G and M for which actions were still ongoing). Audit found the following issues and lessons to be learnt:

- (a) implementing and monitoring the no-profit-distribution requirement (paras. 3.11 to 3.14);
- (b) monitoring income-generating facilities of a lease and subvention reduction arrangement (paras. 3.15 to 3.22);
- (c) consulting supporting B/Ds on compliance with lease conditions (para. 3.23); and
- (d) assessment of the taxability of profits derived from commercial operations on 13 sites (para. 3.24).

***Implementing and monitoring
the no-profit-distribution requirement***

3.11 ***Only one lease stipulated the no-profit-distribution requirement.*** According to the land administration policy of 1959, stringent powers of control would be included in the conditions and no distribution of profits would be allowed for a site granted at nil premium for welfare purposes (see para. 3.2(a)). However, as can be seen in Appendix B and Table 5, of the nine leases granted for welfare/social services at nil or concessionary premium after 1959, only one lease (Lease M) contained a clause restricting the distribution of profit derived from the facilities including the hostel. While the user clauses in four (Leases F, J, L and M) of the nine leases specified the non-profit-making operation of facilities (including hostels), the Lands D had taken the view that such clauses did not mean that the grantees were prohibited from making any profit from operating the facilities, and the prime and foremost requirement was that any profit derived from the facilities should not be distributed (see para. 3.8(d)). In response to Audit's enquiry in March 2017, the Lands D said that:

- (a) since 1959, PTG for welfare uses had been submitted to ExCo for consideration and approval on a case-by-case basis for 7 of the 11 cases examined by Audit. The no-profit-distribution clause was not imposed in these seven ExCo approved cases which served as precedents for subsequent cases; and
- (b) the land administration policy had evolved since 1959 with due regard to those individual cases submitted to ExCo for approval and also their terms and conditions approved by ExCo. The requirement on imposition of the no-profit-distribution clause in PTGs for welfare purposes was no longer applicable.

Administration of land granted to charities for operating welfare/social services

For all the 11 leases examined by Audit (comprising Lease M and 10 other leases without a no-profit-distribution clause), there were indications that the former hostels/dormitories had been converted to hotel/serviced residence use and operated on a commercial basis (see Table 5). Audit noted that the grantees of 9 of the 11 leases had been operating their hostels with hotel licences issued by the HAD (the licensing authority of the Hotel and Guesthouse Accommodation Ordinance (Cap. 349 — Note 20). Audit also found that the grantees of the remaining two leases (i.e. Leases G and L) had placed advertisements on their premises/websites and hotel websites offering serviced residence to the public on a monthly rental basis. To ensure that all profits derived from facilities built on the sites granted at nil/concessionary premium are applied to purposes acceptable to the Government, there is a need to incorporate the no-profit-distribution requirement in the leases. For the existing ten leases without a no-profit-distribution clause but with income-generating hotel/serviced residence operations, the Lands D in collaboration with the supporting B/Ds concerned should, upon their renewal or on receipt of applications for their modification, review whether there is a need to include such clause.

Note 20: *According to the Ordinance, a “hotel” and “guesthouse” mean any premises whose occupier, proprietor or tenant holds out that, to the extent of his available accommodation, sleeping accommodation is provided for any person presenting himself who appears able and willing to pay a reasonable sum for the services and facilities provided and is in a fit state to be received for a period of less than 28 continuous days.*

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for operating welfare/social services**

Table 5

**Lease conditions of 11 sites with hostels/dormitories operating
as hotels/serviced residence**

Lease	Lease condition			Hostel operating under hotel licence
	User clause (see Appendix B for details)	No-profit-distribution requirement	Submission of audited accounts requirement	
C	For grantee's object	No	No	Yes
D	For promoting grantee's religious character and spirit	No	No	Yes
K	For grantee's object	No	No	Yes
F	Non-profit-making institution providing accommodation for hostel and other facilities	No	No	Yes
G (Case 2 in para. 3.23)	Dormitory use permitted under the lease	No	No	No (operating as serviced residence)
H (Case 3 in para. 3.23)	Hostel use permitted under the leases	No	Yes	Yes
I		No	No	Yes
J	Non-profit-making hostel and other facilities	No	Yes	Yes
L		No	No (Note)	No (operating as serviced residence)
M (Case 1 in para. 3.14)		Yes	Yes	Yes
N (paras. 3.15 to 3.22)	Hostel use permitted under the lease	No	Yes	Yes

Source: Audit analysis of Lands D and HAD records

Note: The grantee is required to submit audited accounts for the nursery and educational facilities under the lease.

Remarks: Leases C and D were granted before 1959 while the remaining nine leases were granted after 1959.

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3.12 *Statements of accounts not always obtained.* Among the 11 leases examined by Audit, there were conditions in four leases (Leases H, J, M and N — see Table 5 in para. 3.11) requiring the submission of accounts for the operation of hostels. These accounts are important documents to show whether and how the profits derived have been distributed/applied. As mentioned in paragraph 3.11, for all the 11 leases, there were indications that the former hostels had been converted to hotel/serviced residence use. However, according to Lands D and SWD records, no hostel accounts had been received for Leases H and J. As for Leases M and N, the accounts had not always been obtained (see paras. 3.14 and 3.17). In Audit's view, there is a need to obtain accounts from the four grantees for monitoring the use of profits derived from operating the facilities on the land lots. For the 7 leases without no-profit-distribution and submission of accounts clauses, there is no assurance that all the profits so derived have been applied to purposes acceptable to the Government. The Lands D in collaboration with the supporting B/Ds concerned should, upon renewal of the 7 leases or on receipt of applications for their modification, review whether there is a need to include these clauses.

3.13 *Need to regularly monitor compliance with the lease requirements under Lease M and the related conditions.* Among the 11 leases granted at nil or concessionary premium and with hotel/hostel operation, Lease M is the only one which has incorporated both no-profit-distribution and submission of accounts clauses. The site under Lease M was originally held by Charity M, the parent organisation of Grantee M (see Note 19 to para. 3.7). In November 1986, the District Lands Conference (DLC — Note 21) agreed to grant the site to Grantee M by way of contemporaneous surrender of the site by Charity M. Lease M was granted in December 1988 at a nominal premium of \$1,000 with the following salient conditions:

Note 21: *The DLC is chaired by an Assistant Director of Lands. Its members include the responsible District Lands Officer, the case officers of the Lands D, and representatives from other relevant government departments (such as the Plan D and the Transport Department). The terms of reference of the DLC include the consideration, in the light of overall land policy and land instructions, of the terms and conditions for the disposal of land.*

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- (a) Grantee M shall at its own expense redevelop upon the lot a building or buildings comprising: (i) a non-profit-making hostel and ancillary offices as may be approved by the then Director of Buildings and Lands (Note 22); and (ii) accommodation for institution and community purposes which shall comprise (1) a children and youth centre; (2) a nursery; and (3) ancillary offices as may be approved by the then Director of Buildings and Lands;
- (b) Grantee M shall, if so required, submit to the then Director of Buildings and Lands annually a complete statement of accounts of the facilities mentioned in (a) above; and
- (c) there shall be no distribution of profit derived from the facilities. All profits, if any, derived from the facilities shall be applied towards the improvement or extension of the grantee's services provided in the facilities or such other services as may be approved by the then Director of Buildings and Lands.

Pursuant to a letter of June 1989 issued by the then Director of Buildings and Lands, approval was given to allow profits derived from the facilities to be used towards the improvement and/or extension of all charitable services provided by Charity M. In 1991, Grantee M obtained an occupation permit for its redeveloped building which comprised a hostel and other institution and community facilities as mentioned in Lease M.

3.14 Audit examined the Lands D's records to ascertain how the requirements on the use of profits in Lease M had been monitored (see para. 3.13) and found the following inadequacies as summarised in Case 1.

Note 22: *In 1982, the Lands D was established. In April 1986, the Lands D merged with the Buildings Ordinance Office of the former Public Works Department to become the then Buildings and Lands Department. Since August 1993, the Lands D has operated as an independent department.*

Case 1

**Need to regularly monitor compliance with the lease
requirements under Lease M and the related conditions**

1. ***Submission of accounts.*** In 1991, Grantee M obtained an occupation permit for its redeveloped building (see para. 3.13). Notwithstanding the submission of accounts provision in Lease M (see para. 3.13(b)), the Lands D had not requested Grantee M to do so until August 2013 (22 years later) in response to a complaint received in April 2011. In December 2013, Grantee M submitted the statements of accounts for the years ended March 2011 and March 2012 for the social welfare services provided by Charity M (see Note 19 to para. 3.7) in the lot (Note 1). However, these accounts did not include the financial affairs of the hostel/hotel which was operated by Grantee M's appointed operator. In November 2015, the Lands D requested Grantee M to submit complete statement of accounts of all facilities on the lot, including the hostel/hotel. Grantee M submitted the audited hostel/hotel operation accounts of its appointed operator to the Lands D for the years ended December 2013 and December 2014 in February 2016, and for the year ended December 2015 in May 2016 (Note 2).

2. ***Vetting of submitted accounts.*** In May 2014, in connection with a complaint referred by the LegCo Secretariat on alleged non-compliance with the lease conditions of Lease M, the SWD informed the Lands D that it had conducted preliminary vetting of the accounts on the welfare/welfare-related facilities provided on the lot as submitted by Charity M (see Note 1) for the years ended 31 March 2011 and 2012, and no serious irregularity or non-compliance regarding the deployment of profits derived from the self-financed welfare/welfare-related facilities had been observed. The SWD's comments were included in the Development Bureau's reply to the LegCo Secretariat in 2014 (see para. 3.8).

3. In May 2016, the Lands D forwarded the statements of accounts for both the hostel/hotel and welfare facilities submitted by Grantee M for the years ended 2013, 2014 and 2015 (see para. 1 above) to the SWD for comments on whether Grantee M had used profits derived from the facilities for the purposes as stated in the lease conditions and the letter of approval of June 1989. In its reply to the Lands D of January 2017, the SWD reiterated that its input would be confined to the welfare-related facilities/services (in vetting the accounts for the years ended March 2011 and 2012 — see para. 2 above). In the SWD's view, the hostel should not be treated as a welfare facility, and accordingly, the SWD would not comment on the compliance with the lease condition and the 1989 letter of approval in respect of the use of income derived from the hostel.

Case 1 (Cont'd)

4. *Use of income from hostel/hotel operation.* As Grantee M is a registered company, Audit examined its statements of accounts filed with the CR. Audit noted that \$16 million of hostel/hotel operation income was earned and the same amount was paid to Charity M in Grantee M's audited accounts for the year ended March 2013. The amounts of similar related party transactions were not shown in the accounts for the years 2014 and 2015. Instead, the notes to the accounts for the years 2014 and 2015 stated that the income derived from its hostel/hotel operation had been assigned to and belonged to Charity M and was not treated or accounted for as revenue of Grantee M (Note 3). Based on the audited accounts of the hostel/hotel operator in respect of the subject hostel/hotel provided by Grantee M to the Lands D, Audit noted that payments totalling some \$70 million had been made for the three years from 2013 to 2015 (Note 4) in accordance with the agreed operating arrangement. In two letters to the Lands D of May 2014 (Note 5) and March 2016, Grantee M confirmed that all surplus (if any) from the facilities provided on the lot had been used towards the improvement and/or extension of all charitable services provided by Charity M.

Audit comments

5. According to Lease M and the letter of approval of 1989, there shall be no distribution of profit derived from the facilities including the hostel as all profits shall be applied to purposes specified by the Government (see para. 3.13). The statements of accounts submitted by Grantee M are important documents to show the income derived from the hotel/hostel operation and whether the lease condition has been complied with. While Lease M provided that the grantee would submit a statement of accounts to the then Director of Buildings and Lands (see Note 22 to para. 3.13(a)) if so required (see para. 3.13(b)), the Lands D only commenced to obtain such accounts in 2013 (22 years after the hostel came into operation).

6. Apart from the assurance provided by Charity M's auditor in May 2014 and Grantee M in March 2016, there was insufficient detailed information to show that income derived from the hostel/hotel had been applied towards the social/charitable purposes as stated in the lease condition and the letter of approval of June 1989 for some 25 years since the hostel operated under a hotel licence in 1991. There is a need to require Grantee M to regularly submit sufficient information (including related party transactions with Charity M and the third party operator of the hostel/hotel) to demonstrate its compliance with the requirement that the profits derived from the facilities provided under Lease M had been used towards the improvement and/or extension of all charitable services provided by Charity M (as mentioned in para. 3.13).

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Case 1 (Cont'd)

7. In March 2017, the Lands D informed Audit that the lease did not mandate the submission of annual accounts but only specified that the grantee should submit the annual accounts if so required. The Lands D's understanding all along was that the submission of accounts was on a need basis upon instruction from the supporting B/Ds or upon receipt of complaints. Moreover, the Lands D did not have the expertise or knowledge to scrutinise the accounts submitted or determine whether the profit had been used in a manner and for purposes acceptable to the Government. However, Audit noted that no supporting B/D was specified in the lease except that the then Director of Buildings and Lands was designated as the authority for obtaining the statements of accounts from Grantee M and approving Grantee M's other services to which the profits derived shall be applied (see para. 3.13). In Audit's view, there is a need for the Lands D to take a more proactive role in enforcing the relevant requirements in respect of the hostel/hotel operation, and where appropriate, seek the assistance of the SWD in scrutinising the accounts obtained from Grantee M.

Source: Audit analysis of Lands D records

Note 1: In March 2017, the SWD informed Audit that Charity M separately submitted audited accounts for the self-financed welfare/welfare-related facilities operating on the site (excluding the hostel/hotel) to the SWD.

Note 2: Grantee M also separately submitted Charity M's audited accounts as related to the welfare-related facilities on the site for the years ended March 2013 and March 2014 in September 2015 and for the year ended March 2015 in March 2016 to the Lands D.

Note 3: The notes to the accounts for the years 2014 and 2015 also stated that in 2012, Grantee M had entered into an agreement with Charity M whereby Grantee M assigned all income from the hostel to Charity M.

Note 4: The year end of audited accounts of the hostel/hotel operator was December.

Note 5: Grantee M provided in its letter of May 2014 a certification by Charity M's independent auditor that the hostel income for the periods up to and including 31 December 2013 (see Note 3 above) had been applied by Charity M towards the improvement and/or extension of its charitable services.

***Monitoring income-generating facilities of a lease
and subvention reduction arrangement***

3.15 ***Redevelopment of a site under Lease N granted at concessionary premium.*** In February 1989, ExCo approved Grantee N's application for granting a site zoned as "Government, Institution or Community (G/IC)" under the Outline Zoning Plan (OZP — Note 23) site by private treaty for the construction of a new headquarters based on the following understanding and justifications:

- (a) the then existing headquarters building of Grantee N was inadequate for its need and the site thereof was also required to be returned to the Government for residential development;
- (b) to maximise the use of the G/IC site to be granted, Grantee N would be responsible for the construction of its new headquarters and other facilities to be provided thereon, including a multi-storey vehicle park, a coach terminus and a telephone exchange (Note 24). The new headquarters shall include an assembly hall, gymnasium, offices, grantee's shop, hostel, dormitory, canteen, staff quarters and such other non-industrial accommodation as shall be approved by the then Director of Buildings and Lands;
- (c) the grant of the proposed new headquarters, covering the income-generating facilities such as a hostel and a canteen, at a nominal premium was supported by the then Secretary for District Administration (now the Secretary for Home Affairs) and the DSW. Grantee N shall finance the full land premium of the vehicle park to be operated by it on a commercial basis and the construction cost of both the headquarters and the vehicle park. It was estimated that the income-generating facilities

Note 23: *OZP shows the land use zones, development parameters and major road systems of an individual planning area. Areas covered by OZPs are in general zoned for uses such as residential, commercial, industrial, green belt, open space, G/IC uses or other specified purposes.*

Note 24: *Grantee N would be reimbursed the construction cost of the coach terminus and the telephone exchange by the then Secretary for Transport and the relevant utility company respectively. The full market premium of the telephone exchange would also be paid by the relevant utility company.*

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used to their full capacity could fully repay the capital cost plus interest between 10 and 12 years after completion of the project; and

- (d) after repayment of the development costs, continued subvention of Grantee N's activities by the SWD would have regard to the level of income from the project. As Grantee N's income was expected to exceed the amount of government subvention, it would gradually cease to be reliant on the subvention and would be able to devote more resources to its activities. These arrangements were in line with the 1981 land administration policy on redevelopment of sites granted at nil or concessionary premium for social service purposes (see para. 3.3). The advantage of the arrangements to the Government would be reduction and eventual elimination of the annual subvention of Grantee N's activities.

3.16 In 1990, the Government entered into a lease (Lease N) with Grantee N and laid down the following conditions:

- (a) Grantee N shall not erect on the lot any building other than that comprising a headquarters, a vehicle park, a bus terminus and a telephone exchange;
- (b) Grantee N shall submit to the DSW annually beginning one year from the opening of the headquarters and vehicle park a complete statement of accounts on the operation of the headquarters and the vehicle park audited by an auditor approved by the then Governor; and
- (c) Grantee N shall establish a Management Committee comprising its own representatives, the DSW and the then Secretary for District Administration or their representatives to ensure the proper and efficient operation of the income-generating facilities of the headquarters and the vehicle park.

In June 1993, Grantee N was issued with an occupation permit for its new headquarters and other facilities thereof which came into operation in 1994.

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3.17 ***Management Committee and submission of accounts requirements.*** In accordance with the lease conditions, Grantee N formed a Management Committee in September 1993 with representatives of the SWD and the then City and New Territories Administration (the HAB since 1996) sitting in the Committee (see para. 3.16(c)). The Committee held five meetings from 1993 to 1998. Since then, the Committee had not held further meetings. From 1996 to 1998, the SWD obtained the statements of accounts of Grantee N's income-generating facilities for the years 1995-96, 1996-97 and 1997-98. However, there was no record showing that similar statements of accounts of Grantee N had been submitted annually thereafter. In April 2000, the HAB took over from the SWD the management and subvention of uniformed groups (including Grantee N) and assumed the supporting B/D's role for Lease N. In November 2014, the Lands D reminded the HAB about the lease conditions on the Management Committee and submission of accounts (see para. 3.9(a)). According to the HAB, its representative had attended Grantee N's Executive Committee meetings, which also discussed Grantee N's financial matters, as an observer. However, Audit noted that the Committee was not a designated forum for discussing the proper and efficient operation of the income-generating facilities. In Audit's view, the HAB (as the supporting B/D for Lease N) needs to enforce the lease conditions on Management Committee and submission of accounts.

3.18 ***Subvention reduction by SWD.*** Having regard to the 1989 ExCo's decision on reducing the annual subvention of Grantee N's activities (see para. 3.15(d)), the SWD (as the supporting B/D for Lease N at that time) started negotiation with Grantee N in 1997 and withheld part of the rent and rates subsidy totalling \$1.1 million for 1994-95, 1995-96 and 1996-97 from its reimbursement of government rent and rates to Grantee N. In 1999, the SWD informed the HAB that based on its analysis of Grantee N's financial situation from 1995-96 to 1997-98, operating surpluses were identified. On that basis, the SWD expected that there was room for reduction in its subvention to Grantee N. Meanwhile, the SWD withheld part of the reimbursement of rent and rates amounting to \$1.47 million each year for 1997-98, 1998-99 and 1999-2000 after discussion with Grantee N.

3.19 In January 2000, upon Grantee N's request for the release of the amount withheld in previous years in light of the unfavourable economic atmosphere, the HAB (as the new supporting B/D for Lease N — see para. 3.17) agreed with the SWD to release the withheld sum of \$1.47 million for the year 1999-2000 to Grantee N. The HAB then decided to review the subvention reduction issue. In the

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event, the HAB had not taken any action until 2010-11 (10 years later) when it froze Grantee N's subvention while other uniformed groups were granted an increase of subvention.

3.20 *Subvention reduction arrangement has yet to give full effect to the ExCo's understanding.* In 2012, the HAB conducted a review of the financial information obtained from Grantee N for its new headquarters and other facilities for the past 18 years since they came into operation in 1994. The HAB noted that the subvention level for Grantee N's activities had increased from \$10.61 million in 1993-94 (apart from the reductions in 2004-05 and 2005-06 by \$0.54 million and \$0.67 million respectively) to \$17.28 million in 2008-09 and thereafter remained at the same level up to 2010-11, totalling \$280 million. Over the 18 years of operation, the net profit from the income-generating facilities of Grantee N had reached a level of \$829 million (Note 25), enabling it to launch and develop new programmes and redevelop the dilapidated facilities for its members. On the other hand, in March 2011, Grantee N presented its views to the HAB that the proportion of government subvention to its expenditure had dropped from 64% in 1989-90 to 29% in 2009-10, giving effect to the ExCo's understanding that it had become less reliant on government subvention. After negotiation, the HAB and Grantee N agreed in February 2013 to reduce the subvention from \$17.28 million in 2012-13 to \$10.61 million in 2015-16 (the subvention level in 1993-94 when the headquarters facilities came into operation — Note 26) by \$2.23 million each year and thereafter to resume adjustment in subvention on par with other uniformed groups. In the event, the HAB's subvention for Grantee N's activities was reduced to \$15.06 million in 2013-14 but increased to \$25.66 million in 2014-15 (due to the increase in subvention for all uniformed groups — Note 27) and subsequently reduced to \$23.44 million in 2015-16.

Note 25: *According to the minutes of the fifth meeting of the Management Committee held in December 1998, the loan for financing the redevelopment of the headquarters was fully repaid in March 1998 (see para. 3.15(c)).*

Note 26: *According to the HAB, taking into account the inflation for 1993-94 to 2015-16, the real value of \$10.61 million in 2015-16 would approximately be \$5.9 million only, significantly less than the 1993-94 level.*

Note 27: *In line with the 2014 Chief Executive's Policy Address of doubling the subvention for all uniformed groups in 2014-15, the subvention for Grantee N was \$25.66 million [(\$15.06 million – \$2.23 million) × 2].*

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3.21 The ExCo's approval of the PTG to Grantee N was made on the understanding that there would be reduction and eventual elimination of the annual subvention of Grantee N's activities (see para. 3.15(d)). However, the agreed subvention reduction scheme reached between the HAB and Grantee N in February 2013 has yet to give full effect to the ExCo's understanding and there was no record showing that follow-up action had been taken in this regard. In response to Audit's enquiry in March 2017, the HAB said that:

- (a) the subvention reduction arrangement in 2013 was not a final step in implementing the 1989 ExCo's understanding. It remained the HAB's intention to continue its discussion with Grantee N to further reduce the subvention level having regard to its financial situation and development needs; and
- (b) the HAB would seek the ExCo's endorsement if it was eventually considered that the ExCo's understanding could not be achieved.

3.22 ***Non-exclusive use of catering facilities.*** According to Lease N, the new headquarters shall include assembly hall, gymnasium, offices, grantee's shop, hostel, dormitory, canteen, staff quarters and such other ancillary accommodation and facilities as shall be approved by the DSW. Audit has found the following issues on the non-exclusive use of catering facilities:

- (a) ***Canteen operating as a restaurant.*** According to the FEHD's records, from February 1996 to April 2015, Grantee N's canteen had been operated as a restaurant under a General Restaurant Licence. In December 2014, Grantee N appointed a new restaurant operator with effect from March 2015. In April 2015, the operator applied to the FEHD for a new General Restaurant Licence and commenced operating the restaurant at the same time. In processing the application, the FEHD consulted the Lands D and the HAB. In September 2015, the Lands D obtained legal advice and noted that pursuant to Lease N, the canteen should form part of the headquarters and was for the exclusive use of members of Grantee N (i.e. it should not be open to the public). In July and December 2015, the HAB informed the FEHD and Lands D respectively that the restaurant was commercial in nature and could not be regarded as "ancillary accommodation and facilities" of Grantee N's headquarters under Lease N. In December 2015, Grantee N applied to the Lands D for a temporary waiver to permit the use of the canteen space

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for restaurant purpose as it was difficult to prevent residents nearby to use the restaurant given its convenient location. In January 2016, the HAB informed the Lands D that it supported Grantee N's waiver application subject to the imposition of full administrative fee and waiver fee. At a DLC meeting held in June 2016, the Plan D advised that if the restaurant was directly related and ancillary to the permitted uses of Grantee N's headquarters, no planning application was required. However, as the HAB had indicated that the restaurant could not be regarded as ancillary accommodation and facilities, planning permission by the Town Planning Board (TPB) was required under the relevant OZP before the granting of waiver. In December 2016, Grantee N obtained the TPB's approval to use the canteen for a temporary restaurant for three years. Up to March 2017, the Lands D offered the waiver terms for Grantee N's acceptance; and

- (b) ***Other catering facilities.*** According to the FEHD's licensing records posted on its website, Audit noted that Grantee N had been operating two catering facilities (other than the restaurant mentioned in (a)) on different floors of its headquarters, i.e. a western restaurant under a General Restaurant Licence and a lounge under a Light Refreshment Restaurant Licence. The operation of the western restaurant and lounge under FEHD's licences suggested that these facilities were also open to the general public (not just Grantee N's members — Note 28). Moreover, Audit noted from an advertisement leaflet of a local travel agency of January 2017 that the western restaurant had offered buffet service as part of a package tour and buffet coupons were also available for sale on a commercial website, further suggesting that it had also served the general public. According to the Lands D records, while the lounge (for members only) was included in the approved building plan for the headquarters, the location of the western restaurant was designated as a foyer, thus raising question on whether the western restaurant and the lounge (both open to the public) were permitted uses. In Audit's view, the HAB, in consultation with the Lands D and the Plan D, needs to review whether the operations of the western restaurant and lounge are permitted under Lease N and the relevant OZP.

Note 28: *According to the Food Business Regulation (Cap. 132X), clubs offering food and drinks for members are not required to apply for a General Restaurant Licence or a Light Refreshment Restaurant Licence.*

Consulting supporting B/Ds on compliance with lease conditions

3.23 According to Lease N, the new headquarters shall include, among others, hostel, canteen and such other ancillary accommodation and facilities as shall be approved by the DSW (the HAB since April 2000 — see para. 3.17). In support of its application for the grant of the headquarters site at a nominal premium, Grantee N confirmed to the DSW in December 1987 that all the areas in its headquarters were directly related to its purposes. Moreover, in his memo of November 1987 to the then Secretary for Health and Welfare, the then Secretary for District Administration indicated that he had no objection to the grant of the headquarters site at nominal premium on the understanding that the facilities were to meet Grantee N's purposes. However, based on the HAD's hotel licence information (see para. 3.11), there were indications that the hostel had likely been converted to hotel use for the general public. Moreover, according to Grantee N's website, members' booking was entitled to preferential room booking rates, suggesting that the hostel/hotel could also serve non-members with different room rates. Similarly for two other leases also selected for case study (see para. 3.10), Audit found that the dormitory under Lease G (Case 2) had likely been operated as a hotel for the general public for 20 years before converting to the current use as a serviced residence for students, local people and non-local guests. Under Lease H (Case 3), the hostel had likely been used as a hotel. In Audit's view, for leases with clauses governing the use or operation of the hostels/dormitories, the Lands D needs to seek confirmation from the relevant B/Ds on whether the current use or operation of the hostels/dormitories is in line with their policy intent and to their satisfaction, and take necessary follow-up actions in case of any breach of the lease conditions.

Case 2

Lease compliance issue under Lease G

1. A piece of land covering the lot under Lease G was sold by public auction at a premium in 1928 with conditions restricting the development to a church, detached or semi-detached European type houses, all limited to a height of 35 feet. In 1965 after obtaining a portion of the land (Lot G) through a Deed of Gift, Grantee G applied for modification of the lease terms to allow the construction on Lot G a 12-storey building containing a non-profit-making nursery, vocational training centre, dormitories for young male workers and such staff quarters as the DSW may permit.

2. In an ExCo submission of 1965 setting out the above background, the then Public Works Department and the SWD recommended modification of the lease condition at a nil premium as the proposed use was for welfare purposes. In September 1965, ExCo approved the modification of the original lease (which became Lease G) to allow the construction of the proposed new building at nil premium. The modification was to be effected by contemporaneous exchange (i.e. by surrendering and re-granting Lot G) on the same basic conditions but with modified terms including:

- (i) a building not exceeding 12 storeys which shall only be used for the purposes of a nursery, training centre, dormitories, and such staff quarters and other welfare purposes as the DSW may approve; and
- (ii) the whole to be conducted on a non-profit-making basis and to the satisfaction of the DSW.

In 1966, Lease G was granted with lease conditions as stated in paragraph 2 above.

3. In March and June 2014, the Lands D noted that the dormitory had been operating as a licensed hotel (in the name of a lodge) but the SWD had not given approval for such operation. In June 2014, the Lands D issued a warning letter to Grantee G requiring it to cease the hotel operation.

4. From June 2014 to April 2016, Grantee G sought the SWD and EDB's support for operating the dormitory to provide training opportunities to students studying hotel and catering management courses but without success. Meanwhile, the Lands D issued five more warning letters to Grantee G.

Case 2 (Cont'd)

5. In June 2016, Grantee G informed the Lands D that the lodge operation had ceased in May 2016 and the premises would be converted to a non-profit-making dormitory pursuant to the lease condition. In an inspection conducted in August 2016, Lands D staff found that the name of the lodge had been changed to a dormitory. However, Audit noted from an advertising leaflet obtained during a visit to the dormitory in December 2016 that Grantee G had been promoting the dormitory as serviced residence suitable for students, local people and non-local guests who needed a long-term accommodation arrangement.

Audit comments

6. According to the HAD's records, the dormitory under Lease G had been operating as a licensed hotel since the enactment of Hotel and Guesthouse Accommodation Ordinance in 1991, suggesting that it had been open to the public for over 20 years. Notwithstanding the cessation of the hotel operation in May 2016, its current use as a dormitory for the general public and non-local guests (see para. 5) might not fully meet the welfare purposes based on which the then Public Works Department and the SWD recommended the modification of the lease condition for Lease G at nil premium (see para. 2).

7. In March 2017, the Lands D informed Audit that Lease G required inter alia that the dormitory should be conducted to the satisfaction of the SWD. If the SWD considered and confirmed to the Lands D that the dormitory was not conducted in line with the policy intent and to the satisfaction of the SWD, there was an apparent breach, and appropriate lease enforcement action would be taken by the Lands D in accordance with the SWD's policy directive at such time.

Source: Audit analysis of Lands D records

Case 3

Lease compliance issue under Lease H

1. In October 1966, Grantee H applied for a direct grant of land to erect a welfare centre with hostel accommodation for young low-income factory workers. In the ExCo submission of 1969 setting out the above background, the then Director of Public Works recommended the granting of a site with a premium charged at one-third of the market value for the portion of land used for the hostel accommodation. The DSW also supported the application on the grounds that the hostel formed part of an overall welfare project. In July 1969, ExCo approved granting a site to Grantee H based on the following terms:

- (i) a welfare centre (including a hostel and staff quarters) to be operated at all times to the satisfaction of the DSW; and
- (ii) premium of \$115,641 (being one-third of the full market value for the portion of site used for hostel accommodation and the remainder at nil premium) should be charged.

2. In March 1971, Lease H was granted with lease conditions stating that Grantee H shall erect and maintain upon the subject lot a building providing accommodation for a welfare centre, including a hostel and staff quarters as may be approved by the DSW.

3. According to the HAD's records, the hostel has been operating under a hotel licence since the enactment of the Hotel and Guesthouse Accommodation Ordinance in 1991, suggesting that it has been open to the public for over 20 years. Audit also noted that online booking of the hostel rooms was available on commercial hotel-booking websites by the public and non-local visitors.

Audit comments

4. It appears that the current use of the hostel for the public (see para. 3) might not fully meet the welfare purposes based on which the then Public Works Department recommended the approval of the land grant at a concessionary premium (see para. 1).

5. In March 2017, the Lands D informed Audit that if the SWD considered and confirmed that the hostel was not operating in line with the policy intent and to the satisfaction of the SWD, the Lands D might consider taking lease enforcement action as appropriate in accordance with the SWD's policy directive at such time.

Source: Audit analysis of Lands D records

***Assessment of the taxability of profits
derived from commercial operations on 13 sites***

3.24 For 14 sites with suspected hostel/hotel operations, the grantees of 13 sites are recognised tax-exempt charitable organisations (Note 29). The profits derived from their income-generating operations are exempt from tax only if they meet the following requirements as laid down in a proviso to section 88 of the IRO (see para. 2.2):

- (a) such profits are applied solely for charitable purposes; and
- (b) the profits are not expended substantially outside Hong Kong and either:
 - (i) the trade or business is exercised in the course of the actual carrying out of the expressed objects of such institution or trust; or
 - (ii) the work in connection with the trade or business is mainly carried on by persons for whose benefit such institution or trust is established.

In this connection, Audit noted that the restaurant operation in Lease N was considered to be commercial in nature by the HAB (see para. 3.22(a)). Similarly, there was no indication that the SWD had given approval to the hotel operation under Lease G (see Case 2 in para. 3.23). In Audit's view, the IRD needs to review the taxability of the income derived from the commercial operations of the 13 sites for revenue protection.

Audit recommendations

3.25 **Audit has recommended that the Director of Lands should:**

- (a) **in collaboration with the supporting B/Ds, consider incorporating lease conditions restricting profit distribution and requiring submission of accounts in a PTG or lease modification (including land**

Note 29: *Grantee M of the remaining site is not a tax-exempt charitable organisation (see Note 19 to para. 3.7).*

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exchange) granted at nil/concessionary premium for welfare/social services in future;

- (b) upon renewal of leases or on receipt of applications for lease modification, in collaboration with the supporting B/Ds, review whether there is a need to include:
 - (i) a no-profit-distribution clause for the 10 leases granted at nil/concessionary premium for welfare/social services but without such clause (see para. 3.11); and
 - (ii) a submission of accounts clause for the 7 leases granted at nil/concessionary premium for welfare/social services but without such clause (see para. 3.12);
- (c) require Grantee M to provide regularly sufficient information to demonstrate its compliance with the lease requirements and related conditions in the letter of approval of 1989 (see para. 3.13) and, where appropriate, seek the assistance of the SWD in scrutinising the statements of accounts obtained from Grantee M; and
- (d) for leases with clauses governing the use or operation of the hostels/dormitories, seek confirmation from the relevant B/Ds on whether the current use or operation of the hostels/dormitories is in line with their policy intent and to their satisfaction, and take necessary follow-up actions in case of any breach of the lease conditions.

3.26 Audit has *recommended* that the Director of Social Welfare should remind grantees concerned to submit accounts in accordance with the lease conditions (such as for Leases H and J) and in case of non-compliance, take enforcement action in conjunction with the Director of Lands.

3.27 Audit has *recommended* that the Secretary for Home Affairs should:

- (a) in conjunction with the Director of Lands, step up monitoring and enforcement of the lease conditions on Management Committee and submission of accounts for Lease N;

- (b) seek the ExCo's endorsement for any material deviations from its understanding of the implementation of a PTG for operating welfare/social services on land granted at nil/concessionary premium (such as the subvention reduction arrangement in Lease N); and
- (c) for Lease N, in consultation with the Director of Lands and the Director of Planning, review the operations of the western restaurant and lounge to determine whether they are permitted under the lease conditions and the relevant OZP, and take necessary follow-up actions accordingly.

3.28 Audit has *recommended* that the Commissioner of Inland Revenue should review the taxability of the income derived from the commercial operations of the 13 sites for revenue protection.

Response from the Government

3.29 The Director of Lands generally agrees with the audit recommendations in paragraph 3.25. She has said that:

- (a) in processing proposed PTG cases for welfare/social service uses in future, the Lands D will consult the supporting B/Ds and impose the no-profit-distribution clause and submission of accounts clause if it is the policy intent;
- (b) as regards the audit recommendation in paragraph 3.25(b), according to the Lands D's practice, the Lands D will consult the supporting B/Ds upon renewal of the concerned leases (which do not expire on the same day) and when any application for modification of the concerned lease is received; and
- (c) the Lands D will follow up the recommendation in paragraph 3.25(c) as far as possible, by exercising the rights of the landlord conferred under Lease M.

3.30 The Director of Social Welfare agrees with the audit recommendation in paragraph 3.26.

Administration of land granted to charities for operating welfare/social services

3.31 The Secretary for Home Affairs agrees with the audit recommendations in paragraph 3.27. He has said that:

- (a) as regards the audit recommendation in paragraph 3.27(a), the HAB has taken action to step up its monitoring role under Lease N, and has requested Grantee N to reactivate the Management Committee for the income-generating facilities of its headquarters and the vehicle park, and submit the statements of accounts. The preparation work for the meeting is underway. The HAB will closely monitor the follow-up actions taken by Grantee N;
- (b) as regards the audit recommendation in paragraph 3.27(b), it is important to note that the ExCo's decision did not specify a timeline for achieving the objective of eventual elimination of Grantee N's subvention. Over the past 23 years, the annual subvention of Grantee N has been reduced or withheld several times (see paras. 3.18 to 3.20). He agrees that if the ExCo's understanding of eventual elimination of subvention could not be achieved ultimately, the ExCo's endorsement for the variation should be sought; and
- (c) as regards the audit recommendation in paragraph 3.27(c), since late 2015, the HAB has been reminding Grantee N to obtain necessary planning and lease permission as appropriate. The HAB will consult the Plan D and the Lands D on the issue and take necessary action accordingly.

3.32 The Commissioner of Inland Revenue generally agrees with the audit recommendation in paragraph 3.28. He has said that:

- (a) when conducting reviews for tax-exempt charities, the IRD would review whether the profits derived from any trade or business carried on by tax-exempt charities could be exempt from profits tax under the proviso to section 88 of the IRO; and
- (b) under the official secrecy provision in the IRO, the IRD cannot disclose any information of individual cases (including those of tax-exempt charities) or details of the review.

PART 4: FILING AND DISCLOSURE REQUIREMENTS OF CHARITIES INCORPORATED/ESTABLISHED UNDER THREE ORDINANCES

4.1 Charities of different legal forms may be granted tax exemption status provided that they satisfy the requirements of section 88 of the IRO. Some 92% of the tax-exempt charities on the s88 list are incorporated or established under three ordinances, i.e. as a limited company under the Companies Ordinance, as a society under the Societies Ordinance, or as an IMC of a school under the Education Ordinance. This PART examines the administration of these three ordinances, focusing on the filing and disclosure requirements through which members of the public may access information of these charities which have appealed to them for donations or received their donations.

Filing and disclosure requirements under the Companies Ordinance

4.2 The CR is responsible for administering and enforcing the Companies Ordinance. Its work includes registering local and non-Hong Kong companies and their statutory returns, de-registering defunct solvent companies and providing the public with services and facilities for inspecting and obtaining company information kept by the CR. As of September 2016, there were some 1.34 million limited companies on the Companies Register, of which 6,619 were tax-exempt charities on the IRD's s88 list. Among the 6,619 tax-exempt charitable companies, 6,523 (98.5%) were companies limited by guarantee (see para. 4.3(b)(i)). The remaining 96 (1.5%) were mainly private and non-Hong Kong companies. Tax-exempt charities which choose to be incorporated as companies under the Companies Ordinance need to comply with the same statutory requirements under the Companies Ordinance as other limited companies. They are also subject to review by the IRD regarding their tax exemption status once every four years (see para. 2.4(b)).

Statutory filing requirements

4.3 Under the present Companies Ordinance which came into effect in March 2014 (see Note 6 in para. 1.7(c)), when applying for registration, a company

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shall deliver to the CR its articles of association which include details of its name, liabilities of its members, the amount its members undertake to contribute if the company is wound up (for companies limited by guarantee — Note 30), share capital and initial shareholding (for companies limited by shares). After registration, a company shall deliver statutory returns to the CR within prescribed time periods including, but not limited to the following:

- (a) a notice of change of address of the registered office, company's director, company secretary, and/or in their particulars, within 15 days after the change;
- (b) an annual return together with an annual registration fee (Note 31):
 - (i) for a company limited by guarantee, in respect of every financial year, within 42 days after the company's return date (i.e. 9 months after the end of the company's accounting reference period (Note 32));
 - (ii) for a public company (Note 33), in respect of every financial year, within 42 days after the company's return date (i.e. 6 months after the end of the company's accounting reference period (see Note 32)); and

Note 30: *A company limited by guarantee does not have share capital. The liability of its members is limited by the company's articles to the amount that the members undertake.*

Note 31: *The annual registration fee varies for different types of companies (e.g. \$105 for a company limited by guarantee). Late submissions of annual returns are subject to higher annual registration fees under an escalating scale (i.e. at a multiple of \$870 for every three-month delay in submission until it reaches the ceiling of \$3,480 for a company limited by guarantee).*

Note 32: *Before the present Companies Ordinance came into effect in March 2014, a company limited by guarantee or a public company had to file the annual return within 42 days after its annual general meeting for the year.*

Note 33: *A company is a public company if it is not a private company nor a company limited by guarantee.*

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- (iii) for a private company (Note 34), in respect of every year, within 42 days after the anniversary of the date of incorporation of the company in that year; and
- (c) the annual return for a company limited by guarantee or a public company shall be accompanied by certified true copies of the company's financial statements, directors' report and auditor's report. This requirement is not applicable to a private company.

According to the CR, there are no provisions under the Companies Ordinance to identify or determine whether a company is a tax-exempt charity and the CR's enforcement policies are premised on all of the companies on the Companies Register.

Measures to ensure compliance with filing requirements

4.4 Over the years, the CR has implemented administrative measures to explain and promote compliance with the statutory filing requirements. These include: (a) setting up a thematic section on "Compliance" on the CR's website which provides information on the obligation of a company and its officers; (b) publication of information pamphlets, e.g. "Annual Return of a Local Public Company or a Company Limited by Guarantee" and "Filing Requirements of a Local Limited Company after Incorporation"; and (c) issuance of circular letters, etc. If a company fails to comply with the statutory requirements, the company and every responsible person of the company, including director, company secretary and manager of the company, commit an offence and are liable on conviction to fines (Note 35). To ensure compliance with the requirements and to optimise the use of judicial resources, since June 2014, the CR has compounded specified offences (e.g. failure to file annual return) under Schedule 7 of the present Companies

Note 34: *A company is a private company if its articles limit the number of its members to 50, restrict a member's right to transfer shares, prohibit any invitation to the public to subscribe for any shares or debentures of the company and it is not a company limited by guarantee.*

Note 35: *The maximum fine for failing to comply with the filing requirement of annual return is \$50,000 upon conviction and a daily fine of \$1,000 for a continuing offence.*

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Ordinance committed by companies, instead of direct prosecution (Note 36). If there is still non-compliance with the notice requirements specified in the compound offer, the CR may proceed to institute prosecution action. After introduction of this measure, the number of summonses issued by the CR had decreased by 58% from 6,624 in 2012 to 2,780 in 2016.

Public access to company information

4.5 Members of the public can use the search function in the CR's Cyber Search Centre (or through the Company Search Mobile Service by mobile devices) to conduct company searches on the current data of registered companies and image records of documents registered and kept by the CR. The CR provides free search services including search for company name and document index. Members of the public may also extend their search on payment of a fee. The payable search services include image record search (covering annual returns, financial statements and articles of association of companies), directors' index search and company particulars search (Note 37).

Compliance checks of filing requirements

4.6 The CR conducts compliance checks, including annual checks and weekly checks, to identify companies limited by guarantee which do not comply with the filing requirements of annual returns. The CR issues a notice-to-file to each of these default companies requiring them to file the outstanding documents within 28 days from the date of the notice. If a company still fails to comply with the notice requirements, the CR may prosecute the company or strike it off from the

Note 36: *In compounding an offence, the CR gives notice to a person who has been in breach of the specified offences, offering the person an opportunity to rectify the default by remedying the breach within a specified period and paying a specified amount (\$600) to the CR as a compounding fee. If the person accepts the offer and complies with the notice requirements, no prosecution action will be initiated. From June 2014 to December 2016, a total of 15,848 compound offers had been issued to private companies. According to the CR, compound offers would be extended to companies limited by guarantee in early 2018.*

Note 37: *According to the CR, the search function cannot identify a company which is also a charity as this is not a piece of information required to be recorded on the Companies Register under the Companies Ordinance.*

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Companies Register (Note 38). Companies to be struck off from the Companies Register would be brought to the attention of the IRD (see para. 2.20). In 2016, the CR issued 839 notices-to-file and took prosecution actions against some 200 default companies limited by guarantee as a result of the compliance checks.

Non-compliance with filing requirements for 2011 to 2016 annual returns by some charities which were companies limited by guarantee

4.7 Audit conducted a review to ascertain the compliance with the filing requirements by the 6,523 charities which were companies limited by guarantee (see para. 4.2). Audit findings are shown in paragraphs 4.8 to 4.10.

4.8 ***Failure to file annual returns.*** Audit's analysis of the CR's computer records of 2011 to 2016 annual returns filed by the 6,523 charities up to November 2016 revealed the following:

- (a) ***2011 to 2014 annual returns.*** Of the 6,523 charities, 263 (4%) had not filed 374 annual returns for the period 2011 to 2014; and
- (b) ***2015 and 2016 annual returns*** (Note 39). According to the CR's computer database, 342 and 830 charities had not filed their 2015 and 2016 annual returns respectively. After taking into account some companies not requiring to file annual returns in these years

Note 38: *In 2016, 42,162 companies were struck off from the Companies Register. The CR has not maintained separate statistics for the different types of struck-off companies.*

Note 39: *For 2015 annual returns, companies with their financial years straddling the effective date of the present Companies Ordinance on 3 March 2014 had to follow the filing requirements under the old Companies Ordinance (see Note 32 to para. 4.3(b)(i)). For companies with financial years commencing on or after 3 March 2014, they had to follow the filing requirements under the present Companies Ordinance.*

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(Note 40), it was estimated that 274 (4%) and 589 (9%) charities which were companies limited by guarantee had failed to submit the required annual returns for 2015 and 2016 respectively (Note 41).

Taking together, as at November 2016, some 1,237 (374 + 274 + 589) annual returns for the years from 2011 to 2016 had not been filed by the charities which were companies limited by guarantee.

4.9 ***Repeated breaches of filing requirements.*** Audit's analysis of the 263 non-compliant charities which were companies limited by guarantee (see para. 4.8(a)) found that 21 companies had repeatedly failed to do so up to 2016 (i.e. 12 companies for 5 years and 9 companies for 6 years). Audit's further analysis of the 9 companies with repeated breaches for 6 years revealed that:

- (a) 2 companies were not identified by the CR in its check (see para. 4.6) for the non-compliance. Upon Audit's enquiries, the CR said in March 2017 that the incidents were isolated cases as there had been confusion in identifying the two companies with annual returns submitted but returned for clarification subsequently. The CR was taking follow-up actions on these cases. As a result of the revised requirements for filing annual returns by companies limited by guarantee (see para. 4.3(b)(i)) under the Companies Ordinance, the CR was enhancing its bring-up system to conduct compliance checks, under which similar incidents would not occur again. The new system would be implemented in early 2018. Meanwhile, the CR had already reviewed its internal process for the proper identification of non-compliance cases;

Note 40: *Due to the implementation of the present Companies Ordinance, some companies were not required to file their 2015 and/or 2016 annual returns. For example: (a) for companies incorporated in November 2014 and the first set of financial statements covering 18 months after the date of incorporation (i.e. November 2014 to April 2016), they were not required to file their annual returns for 2015 and 2016; and (b) for companies with financial year ended on 30 June 2014 which had filed their annual returns on or before December 2014, they would not be required to file their 2015 annual returns.*

Note 41: *As seen in Note 40 above, the need to file annual returns in 2015 and 2016 depends on the specific circumstances of individual companies. Based on a sample check of 35 and 83 companies for their 2015 and 2016 annual returns respectively, Audit found that 20% and 29% of the sampled companies not having filed annual returns for 2015 and 2016 respectively were not required to do so or their returns were not yet due.*

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- (b) 4 companies had been prosecuted by the CR and were convicted between July 2013 and September 2015 respectively. For 2 companies which were convicted in 2015, the CR informed Audit in March 2017 that they were pending brought-up for review under the CR's established procedures after conviction. For the other 2 companies which were convicted in 2013 and 2015 respectively, the CR started the strike-off process for the companies in December 2016; and
- (c) for the remaining 3 companies, the CR published in the Gazette to strike off one company in December 2016 and withheld further actions against the other 2 companies either because there were legal proceedings or actions being taken by the IRD (see para. 2.20).

4.10 ***Late submission of annual returns.*** Audit's analysis of the 2016 annual returns submitted by 3,219 charities which were companies limited by guarantee revealed that, as of November 2016, 126 (3.9%) companies had filed their documents late. An ageing analysis of the late submission of annual returns is shown in Table 6.

Table 6

**Ageing analysis of late submission of 2016 annual returns
by charities which were companies limited by guarantee
(November 2016)**

Number of days elapsed after submission due date	Companies	
	(Number)	(%)
Less than 31	39	31 %
31 – 60	44	35 %
61 – 90	8	6 %
Over 90 (Note)	35	28 %
Total	126	100 %

Source: Audit analysis of CR records

Note: The longest delay in submission was 229 days after the due date.

4.11 The timely filing of annual returns by charities which are companies limited by guarantee is important for donors to gain access to their financial information so as to make an informed choice when making donations. In light of the findings mentioned in paragraphs 4.8 to 4.10, the CR needs to step up monitoring the compliance with the statutory filing requirements by charities which are limited companies and take more timely follow-up actions against cases of repeated breaches of the requirements and long delay cases.

Audit recommendations

4.12 **Audit has recommended that the Registrar of Companies should:**

- (a) **step up the CR's monitoring of the compliance with the statutory filing requirements by charities which are limited companies; and**
- (b) **take more timely follow-up actions against cases of repeated breaches of the filing requirements and the long delay cases.**

Response from the Government

4.13 The Registrar of Companies agrees with the audit recommendations in general. She has said that there are over 1.34 million companies on the Companies Register and the CR's current enforcement policy is premised on all of the companies on the Companies Register, bearing in mind that charities do not constitute a separate category of companies under the Companies Ordinance. Even if the CR may make reference to the s88 list kept in the website of the IRD (which is the most relevant information available in the public domain, though it may not be a complete list of tax-exempt charities) when considering enforcement actions against the defaulting companies which are charities, it is important to strike a reasonable balance between enforcement actions taken against charities and other companies on the Companies Register.

Filing and disclosure requirements under the Societies Ordinance

4.14 The Societies Office of the HKPF is responsible for administering the Societies Ordinance which provides that a local society shall apply to the Societies Officer for registration or exemption from registration (see para. 1.7(d)) within one month of its establishment. As of September 2016, there were 37,861 societies in the HKPF's list of societies, of which 1,000 (2.6%) were charitable societies, i.e. 811 had been granted tax exemption status under section 88 of the IRO and 189 were established for charitable purposes (as indicated in their applications for registration/exemption) but without tax exemption status. These charities are required to comply with the same statutory requirements under the Societies Ordinance as other registered/exempted societies. The 811 tax-exempt societies are also subject to review by the IRD regarding their tax exemption status once every four years (see para. 2.4(b)).

Statutory filing requirements

4.15 Under the Societies Ordinance, when applying for registration or exemption, a society shall provide the Societies Officer with the details of its name, objects, particulars of its office-bearers and the address of its principal place of business and of every place and premises owned or occupied by it (Note 42). The Ordinance also requires a registered/exempted society to inform the Societies Officer in writing of any change in its name, objects, office-bearers or principal place of business or closure of a branch which is registered or exempted from registration within one month from such change. While there is no provision requiring the submission of financial statements by a registered/exempted society, the Ordinance provides that the Societies Officer may, at any time, by notice in writing served on any society, require the society to furnish him in writing with information (including the income, the source of income and expenditure of the society or its branch) for the performance of his functions under the Ordinance (Note 43). The HKPF has not maintained statistics on non-compliance with the filing requirements by registered/exempted societies and its enforcement action in this regard.

Public access to registered/exempted society information

4.16 Under the Societies Ordinance, the Societies Officer shall keep a list of all registered/exempted societies setting out their names and the address of their principal places of business and the list shall be open to inspection by any person free of charge. The HKPF has posted the list onto its website for easy reference by the public. For other information of a society provided to the Societies Officer upon

Note 42: *If a society fails to comply with the application for registration/exemption requirements, every office-bearer commits an offence and is liable on summary conviction to a fine at level 3 (\$10,000) for a first conviction. For a second or subsequent conviction for the offence in relation to the same society, every office-bearer is liable to a fine at level 4 (\$25,000) and to imprisonment for three months and in addition to a fine of \$300 for each day during which the offence continues, commencing on the date of the first conviction.*

Note 43: *If a society fails to comply with the notification requirement, every office-bearer of the society shall be guilty of an offence and shall be liable on summary conviction to a fine of \$10,000. If a society fails to furnish the required information, every office-bearer and every person managing or assisting in the management of the society shall be liable on summary conviction to a fine of \$20,000.*

application for registration and exemption (such as its objects and particulars of its office-bearers — see para. 4.15), the Societies Officer may, on a request in writing by any person and on payment of a prescribed fee, provide such information. If the Societies Officer has reason to believe that any society on the list has ceased to exist, he may publish in the Gazette a notification calling upon the society to furnish him with proof of its existence within three months from the date of such notification. If the society fails to comply with the requirement, the Societies Officer may remove the society from the list.

Need to keep the registered/exempted society information up-to-date

4.17 According to the HKPF's website, the HKPF endeavours to update the list of registered/exempted societies as soon as possible, i.e. after a new application for registration is approved or a notification of dissolution of society is received, and publishes the updated list on the HKPF's website on a monthly basis. The HKPF also carries out regular reviews based on the computer records of "last contact date" to identify societies which have not contacted the HKPF in the preceding ten years. The HKPF will send letters to such "inactive" societies and request them to furnish proof of their existence and updated particulars. Audit's examination of the HKPF's review records revealed the following:

- (a) based on the reviews from 2012 to 2014, the HKPF had identified 1,308 inactive charitable as well as non-charitable societies which were subsequently published in the Gazettes in 2012, 2013 and 2015 for taking strike-off actions;
- (b) the HKPF had not conducted any reviews in 2015 and 2016 (Note 44). Upon Audit's enquiry in January 2017, the HKPF said that the Societies Office was occupied by other pressing operational commitments in the two years;
- (c) based on the computer records of the 1,000 charitable societies (see para. 4.14), Audit noted that the HKPF had not requested 53 (5.3%) registered/exempted societies which had not contacted the HKPF for

Note 44: *As a result, the number of societies which had not contacted the HKPF for ten years or more had increased from 53 in 2014 (see para. 4.17(c)) to 85 (of which 45 were on the s88 list) as at September 2016.*

ten years or more at the time of the 2014 review to furnish proof of their existence for taking follow-up actions. Of these 53 societies, 23 were on the s88 list; and

- (d) while the HKPF's computer records showed that the society status of 19 societies had been marked cancelled, they were still included in the list of registered/exempted societies posted on the HKPF's website as of December 2016 (Note 45).

4.18 Audit notes that the HKPF has not issued staff instructions to formalise the present practice of conducting regular reviews to identify inactive societies, including those which are charities, for compliance by staff of the Societies Office. In light of the findings in paragraph 4.17, Audit considers that the HKPF needs to step up efforts to identify inactive societies and take timely follow-up actions to ensure that the list of registered/exempted societies posted on the HKPF's website is kept up-to-date.

Audit recommendations

4.19 **Audit has *recommended* that the Commissioner of Police should:**

- (a) **issue staff instructions to formalise the present practice of conducting regular reviews to identify inactive societies for compliance by staff of the Societies Office; and**
- (b) **step up efforts to identify inactive societies including those which are charities and take timely follow-up actions to ensure that the list of registered/exempted societies posted on the HKPF's website is kept up-to-date.**

Note 45: *According to the HKPF, the error was due to problems in data migration during system upgrade and manual mistake during data input. The error was immediately rectified in January 2017 and the 19 societies were deleted from the list of registered/exempted societies accordingly.*

Response from the Government

4.20 The Commissioner of Police agrees with the audit recommendations.

Filing and disclosure requirements of IMCs of schools under the Education Ordinance

4.21 Under the Education Ordinance, all aided schools (see Note 9 to para. 1.7(e)) are required to set up an IMC, in the form of a statutory body, to manage the school. Direct Subsidy Scheme schools (see Note 10 to para. 1.7(e)) may, according to their own needs, opt to establish an IMC under the Ordinance. The IMC shall consist of key stakeholders (including representatives of the school sponsoring body, parents, teachers and alumni) to facilitate participatory decision-making, enhance the transparency and accountability of school governance and contribute to more effective school operation. As of September 2016, 826 (98%) of 840 aided schools in Hong Kong had set up IMCs. In addition, 23 (28%) of 82 Direct Subsidy Scheme schools opted to set up IMCs. The EDB is responsible for overseeing IMCs under the Education Ordinance.

4.22 Under the Education Ordinance, an IMC is responsible for handling funds and assets received from the Government as a trustee. It should also act as a trustee for subscriptions collected from students and for donations from the general public. According to the EDB's guidelines (Note 46), an IMC is required to establish proper and adequate financial management mechanism to ensure that the entrusted resources are properly spent and accounted for, and relevant policies and guidelines as promulgated by the EDB are complied with. According to the EDB, IMCs have also been advised to seek approval from the IRD to obtain tax exemption status under section 88 of the IRO. As of September 2016, there were 772 IMCs on the IRD's s88 list, representing 91% of the 846 IMCs (Note 47) on the EDB's Register of IMCs. These charities are required to comply with the same statutory requirements under the Education Ordinance as other IMCs. The 772 IMCs are

Note 46: *The EDB's guidelines highlight the principles and major points that warrant attention of the IMCs for establishing a sound and effective financial management mechanism.*

Note 47: *An IMC can oversee more than one school (e.g. an IMC may oversee a primary school cum secondary school). As of September 2016, there were 846 IMCs overseeing 849 schools.*

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also subject to review by the IRD regarding their tax exemption status once every four years (see para. 2.4(b)).

Filing requirements

4.23 Under the Education Ordinance, an IMC shall maintain proper books of account and prepare statements of the accounts of the IMC to be audited by a Certified Public Accountant (Practising). The EDB's guidelines also specify that an IMC should:

- (a) submit the annual audited accounts, auditor's report and management letter (hereinafter referred to as audited financial statements) to the EDB within six months for aided schools/seven months for Direct Subsidy Scheme schools after the end date of a school year or the end date of a financial year; and
- (b) give a financial summary in the school report for release to the stakeholders annually.

The EDB will review the audited financial statements submitted by IMCs and take follow-up action where necessary. In addition, the EDB's guidelines also specify that a financial statement for each fund-raising activity for school purposes should be properly compiled and displayed for a reasonable period of time on the school's notice board, after which it shall be retained for audit purposes.

Public access to IMC information

4.24 According to the EDB's guidelines, IMCs are advised to give a financial summary in their annual school reports (which are released to the stakeholders) uploaded onto their school websites. While there is no requirement for schools with IMCs (IMC schools) to publicise the audited financial statements, the EDB's guidelines state that IMC schools may consider uploading the annual audited accounts onto the school website to enhance transparency.

Measures to ensure compliance with filing requirements

4.25 According to the EDB, most of the IMC schools submitted their audited financial statements within three months from the submission deadline. In case of default, the EDB will issue reminders to the IMC schools concerned within two months after the submission deadline and the responsible EDB regional officer will take follow-up actions. If the outstanding audited financial statements have been overdue for more than ten months, the EDB will approach the sponsoring body of the school to request immediate submission. According to the EDB's guidelines, if an IMC school fails to submit its audited financial statements, the EDB may temporarily withhold payment of grants to the school.

Outstanding audited financial statements by some IMC schools

4.26 To ascertain the extent of IMC schools' compliance with the filing requirements of audited financial statements (see para. 4.23(a)), Audit analysed the EDB's computer records of the schools' filing of their audited financial statements for the 2010/11 to 2014/15 school years and found two IMC schools had not filed the audited financial statements for the 2014/15 school year up to January 2017 because of problems of filing and record keeping or change of accounting staff. According to the EDB, the two schools submitted their outstanding audited financial statements in mid-March 2017.

Late submission of audited financial statements by some IMC schools

4.27 Audit's further analysis of the EDB's computer records for the school years from 2010/11 to 2014/15 revealed that the percentage of late submission of audited financial statements by IMC schools decreased from 40% for 2010/11 to 36% for 2014/15 (see Table 7). An ageing analysis of the late submission of audited financial statements for 2014/15 shows that 26 (9%) of the 305 IMC schools had submitted their audited financial statements more than 120 days after the submission due date (see Table 8).

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Table 7

**Number of IMC schools with late submission of audited financial statements
(2010/11 to 2014/15)**

School year (Note)	Number of IMC schools (a)	Number of IMC schools with late submission (b)	Percentage (c) = (b)/(a) x 100%
2010/11	481	190	40 %
2011/12	531	167	31 %
2012/13	659	213	32 %
2013/14	764	221	29 %
2014/15	845	305	36 %

Source: Audit analysis of EDB records

Note: A school year runs from September to August of the following year.

Table 8

**Ageing analysis of the extent of late submission of
audited financial statements for 2014/15 by IMC schools
(January 2017)**

Time elapsed since submission due date (Day)	Number of IMC schools with late submission	
	(Number)	(%)
Less than 31	163	53 %
31 – 60	54	18 %
61 – 90	44	14 %
91 – 120	18	6 %
Over 120 (Note)	26	9 %
Total	305	100 %

Source: Audit analysis of EDB records

Note: The longest delay in submission was 332 days after the due date.

4.28 Audit considers that the EDB should continue to closely monitor the IMC schools' compliance with the filing requirements of audited financial statements. For cases of long delay in submission, the EDB needs to contact the school sponsoring bodies to ascertain the reasons for the delay and offer assistance where necessary.

4.29 As a test check of the IMC schools' adopting the good practice specified in the EDB's guidelines of uploading their financial summaries/annual audited accounts onto their school websites (see para. 4.24), Audit sample checked the websites of 30 IMC schools and found that 27 (90%) had uploaded their financial summaries onto their websites but none of them had uploaded their annual audited accounts. To enhance transparency and financial accountability of IMC schools, the EDB needs to encourage more IMC schools to adopt the good practice of uploading their financial summaries/annual audited accounts onto their websites.

Repeated delays in submission of audited financial statements

4.30 Audit's analysis also revealed that some IMC schools had repeatedly submitted their audited financial statements late for the 2010/11 to 2014/15 school years, i.e. 68, 41 and 70 IMC schools for 3, 4 and 5 years respectively. For 8 of the 70 IMC schools which had submitted their audited financial statements late for five consecutive school years, the delays in their submission averaged over 190 days each (ranging from 132 to 372 days). Since long delays in submitting the audited financial statements could undermine the effectiveness of monitoring by the EDB, Audit considers that the EDB should closely monitor IMC schools which had repeated non-compliance with the filing requirements of the EDB's guidelines and offer assistance to them, where necessary.

Audit recommendations

4.31 Audit has *recommended* that the Secretary for Education should:

- (a) **continue to closely monitor the IMC schools' compliance with the filing requirements of audited financial statements and offer assistance to IMC schools for cases of long delays and/or repeated non-compliance with the filing requirements where necessary; and**

- (b) encourage more IMC schools to adopt the good practice of uploading their financial summaries/annual audited accounts onto their websites.

Response from the Government

4.32 The Secretary for Education accepts the audit recommendations. He has said that:

- (a) the EDB will continue to monitor the IMC schools' compliance with the filing requirements of audited financial statements and offer assistance to those schools in need to avoid long delays and/or repeated non-compliance with the filing requirements; and
- (b) to enhance transparency, the EDB will encourage more schools to adopt the good practice of uploading their financial summaries/annual audited accounts onto their websites. The EDB will also update relevant guidelines and promulgate these messages in related seminars and briefings for IMC schools.

PART 5: REGULATION OF CHINESE TEMPLES

5.1 Advancement of religion is one of the charitable purposes defined in the case law (see para. 1.4(c)). According to the IRD's records, of the 8,923 tax-exempt charities as of September 2016, 2,480 (28%) tax-exempt charities are established for purposes of advancement of religion. It is the Government's policy to respect the autonomy of religious organisations. However, the CTO was specifically enacted in 1928 to suppress and prevent mismanagement of Chinese temples (Note 48) and abuses of donated funds. This PART examines issues relating to the regulation of Chinese temples under the CTO.

5.2 ***The legal basis.*** Under the CTO, a statutory body, namely the CTC was established to carry out the duties provided for in the CTO. Key provisions of the CTO include the following:

- (a) all Chinese temples must be registered;
- (b) the CTC has absolute control over the revenues, funds, investments and properties of all Chinese temples;
- (c) the CTC may require any person possessing or controlling the property of any Chinese temple to transfer or assign any such property to the Secretary for Home Affairs Incorporated (SHAI) which is established under the Secretary for Home Affairs Incorporation Ordinance (Cap. 1044); and
- (d) any person authorised by the Secretary for Home Affairs may enter and search any Chinese temples which may have breached the CTO.

5.3 ***Registered Chinese temples.*** Up to September 2016, 347 Chinese temples had registered with the CTC under the CTO, of which 129 (37%) were

Note 48: *The CTO defines Chinese temples as including, but not limited to, all temples, Buddhist monasteries, Taoist monasteries and nunneries.*

Regulation of Chinese temples

managed by tax-exempt charities. The 347 registered Chinese temples can be broadly classified into the following three categories:

- (a) ***Temples directly administered by the CTC.*** There are 25 (Note 49) temples currently under the direct administration of the CTC and most of these properties are vested in the SHAI and revenues are transferred to the Chinese Temples Fund (Note 50). The CTC, through open tendering, outsources the daily operation of the temples under its direct administration. A successful bidder (i.e. the temple keeper) is required to enter into a temple management agreement with the CTC (which normally lasts for a term of two years followed by renewal for another two years subject to satisfactory services and other conditions) and comply with the terms and conditions therein (Note 51). The CTC has also established a mechanism to receive and handle public complaints against the temples. From January to October 2016, 19 complaints against the directly administered temples had been received, mainly related to the temple environment and facilities (e.g. poor air quality and water seepage);

- (b) ***Temples managed by organisations under delegated authority from the CTC (hereinafter referred to as delegated temples).*** In exercise of its

Note 49: *Of the 25 Chinese temples directly administered by the CTC, only 24 are open to the public because the remaining temple has been closed since April 2004 due to its remote location.*

Note 50: *The Chinese Temples Fund is set up under the Chinese Temples Fund Regulations (Cap. 153A). The CTC transfers part of the accumulated surplus of the Chinese Temples Fund (i.e. after paying for customary ceremonies and maintenance of temple buildings) to the General Chinese Charities Fund, which is also set up under the CTC. The General Chinese Charities Fund can be applied to pay the staff and other expenses incurred by the CTC and for the purposes of any Chinese charity in Hong Kong. Both the Chinese Temples Fund and the General Chinese Charities Fund are exempt from tax under section 88 of the IRO.*

Note 51: *The conditions of the temple management agreements stipulate that: (a) worshippers' donations in the donation box set up in the temple belong to the CTC; (b) the temple keeper is required to pay a contract fee to the CTC; (c) the temple keeper is allowed to sell products (e.g. joss sticks) and provide customary services approved by the CTC in the temple, and retain the income; and (d) the temple keeper is required to submit income and expenditure accounts of the temple to the CTC on a quarterly basis.*

power under the CTO (Note 52), the CTC has delegated the administration of 20 Chinese temples (all standing on lands held by the SHAI) to eight organisations mainly because of their history and close linkage or connections with the temples. The delegates are allowed to keep and use the donations and any other revenues of delegated temples in the manner stipulated in the relevant delegation agreements; and

- (c) ***Other registered temples.*** The remaining 302 registered temples are managed by individuals or organisations such as religious organisations. The donations and any other revenues of these temples are managed by the respective temples themselves. The CTC maintains a register of the registered temples on its website. Basic information of the registered temples such as name of the temple, district in which the temple is situated and gods worshipped is available on the register.

5.4 ***Unregistered Chinese temples.*** According to a paper submitted by the HAB and the CTC to the LegCo Panel on Home Affairs in March 2015, there were around 600 Chinese temples and among them, about 350 had registered with the CTC. For the 250 unregistered temples, the CTC has not taken any action against these unregistered temples because:

- (a) the Government considers that some provisions of the CTO (including those mentioned in para. 5.2) may be outdated in the present day context. Comparing with the societal developments in the 1920s, members of the public are now more aware of the risks associated with “pseudo-religious establishments” and there is now various legislation (Note 53) providing protection and remedies against frauds, malpractices and misuses of funds;
- (b) if the CTC exercises its powers under the CTO to enforce some provisions (e.g. requesting a Chinese temple to transfer its property to the

Note 52: *Under section 11 of the CTO, the CTC may delegate to any person the administration of any temple and of the revenues of such temple and to revoke any such delegation.*

Note 53: *For example, the Theft Ordinance (Cap. 210) covers fraudulent or deceitful solicitation of money.*

Regulation of Chinese temples

SHAI), it may raise public concern over the protection of property rights and religious freedom; and

- (c) the HAB and the CTC initiated a review of the CTO in 2012 with a view to updating the regulatory regime for Chinese temples, and conducted a public consultation in mid-2015 (see paras. 5.12 to 5.14).

5.5 In its reply to questions raised by a Member of LegCo in January 2012, the HAB said that it was not the intention of the CTC to monitor the operation of Chinese temples other than those directly administered by the CTC or managed by delegated organisations (i.e. the delegated temples).

Management of delegated temples

5.6 Currently, the CTC has delegated the administration of 20 Chinese temples to eight organisations (Note 54) through delegation agreements which usually last for a term of three years. These agreements set out the terms and conditions that the delegated organisations have to comply with. It is important that these agreements contain proper control and accountability provisions to ensure that the temples managed under the delegated authority of the CTC are run properly and the temple funds are spent appropriately. Audit examination of the delegation agreements of the 20 temples has revealed that:

- (a) ***Agreements with reporting requirements.*** The delegation agreements for 17 temples contain the following requirements on reporting the financial affairs and operations of the temples:
 - (i) a statement of accounts of the temple for each financial year shall be prepared, duly audited by an authorised auditor (i.e. audited accounts) and forwarded to the CTC not later than three months after the end of the relevant financial year; and

Note 54: *Of the eight delegated organisations, two manage more than one temple each (i.e. one manages five temples and the other manages nine temples). Each of the remaining six organisations manages one temple.*

- (ii) an annual administrative report of the temple duly certified by the delegated organisation shall be submitted within one month or three months after the end of each financial year. The report shall cover matters relating to the management of the temple during the relevant financial year, including the major problems encountered in daily management of the temple, the activities organised by the delegated organisation at the temple and the number and details of complaints received in relation to the temple and the management thereof;
- (b) ***Agreement without reporting requirements.*** The delegation agreement for one temple has been in force since 1956 and does not contain an expiry clause and requirements on the submission of audited accounts and administrative reports. However, it is noted that the delegated organisation has published its annual reports (including financial information of the delegated temple) on its website and the Secretary for Home Affairs has appointed three independent directors of the organisation to monitor and advise on its business and operations; and
- (c) ***Expired agreements.*** The delegation agreements for the remaining two temples expired in 2006 and 2007 respectively and have not been renewed (see para. 5.7).

Inadequacies in monitoring of delegated temples

5.7 ***Need to renew two expired delegation agreements.*** Audit found that the delegation agreements for two temples expired in 2006 and 2007 respectively and have not been renewed (see para. 5.6(c)). Details of the two cases are as follows:

- (a) for the temple managed by Organisation A without a delegation agreement in force since 2006, the CTC had tried to introduce some new requirements in the new agreement (e.g. requiring the delegated organisation to repair and maintain the temple at its own expenses and to submit audited accounts and administrative reports) but met with opposition by Organisation A. In the meantime, donations and other revenues were kept and used by Organisation A without accountability to the CTC. Additionally, Organisation A disputed the ownership of the land on which the temple stands and refused to enter into a delegation

agreement with the CTC. There was no record to show that the CTC had followed up with Organisation A since 2007; and

- (b) for the temple managed by Organisation B without a delegation agreement in force since 2007 (Note 55), the CTC found that Organisation B had breached the conditions of the agreement by erecting an unauthorised building structure at the temple premises before the expiry of the agreement in 2007. The CTC requested Organisation B to remove the unauthorised building structure before renewing the agreement but met with opposition. The issue dragged on for some ten years and remained unresolved. In the meantime, donations and other revenues were kept and used by Organisation B without accountability to the CTC. According to the CTC, it has been liaising with Organisation B to resolve the issue.

5.8 It is unsatisfactory that the two temples have been managed by the delegated organisations (Organisations A and B) without any delegation agreements in force for some ten years. The CTC needs to expedite action to resolve the long-outstanding issues with the delegated organisations concerned with a view to renewing the delegation agreements as soon as practicable.

5.9 *Need to enhance transparency.* Both the directly administered temples and the delegated temples receive voluntary donations from the public. It is important that their financial information is made available for public inspection. However, at present, only the financial information of the 25 directly administered temples and 9 of the 20 delegated temples is accounted for in the financial statements of the Chinese Temples Fund, which are posted on the CTC's website for public inspection. The CTC has neither made available the audited accounts of the remaining 11 delegated temples for public inspection (e.g. publishing on the CTC's website) nor required the delegated organisations to do so. In Audit's view, the CTC needs to work out with the delegated organisations of the 11 temples agreements and means to disclose the financial information and operations of the temples.

Note 55: *Audit noted that the expired agreement (effective from 2005 to 2007) contained the requirements on submission of audited accounts and administrative reports but Organisation B had not submitted the required accounts and reports throughout the term of the agreement.*

5.10 *Non-compliance with delegation agreement requirements.* For the 17 delegated temples (Note 56) with the audited accounts and administrative report submission requirements (see para. 5.6(a)), Audit conducted a compliance check based on the CTC's records up to January 2017. Audit found cases of non-compliance by four delegated organisations as follows:

- (a) the first organisation (Organisation C) had not submitted the audited accounts of the temple under its management for the previous 3 years and its administrative reports for the previous 11 years;
- (b) the second organisation (Organisation D) had submitted all the audited accounts of the five temples under its management but there were delays in submission. In particular, the audited accounts for the years ended December 2013, 2014 and 2015 (due for submission in March 2014, 2015 and 2016 respectively) were not submitted until December 2016. Moreover, Organisation D had not submitted the administrative reports of the five temples under its management for the previous five years;
- (c) the third organisation (Organisation E) had submitted all the audited accounts and administrative reports of nine temples under its management but there were delays in submission of the administrative reports. In particular, the administrative report for the year ended March 2016 (due for submission in April 2016) was only submitted in January 2017; and
- (d) the fourth organisation (Organisation F) had submitted all the accounts and administrative reports of the temple under its management but there were delays in submission. In particular, the accounts and administrative report of the temple for the year ended December 2015 (due for submission in March and January 2016 respectively) were only submitted in December 2016. Moreover, the submitted accounts had not been audited by an authorised auditor, contrary to the delegation agreement's requirements.

Note 56: *As at January 2017, the audited accounts and administrative report of one temple were not yet due for submission as the temple was converted into a delegated temple in February 2016.*

Regulation of Chinese temples

In light of the non-compliance cases noted above, the CTC needs to step up monitoring of the delegated organisations' compliance with the audited accounts and administrative report submission requirements.

5.11 ***Review of audited accounts.*** According to the delegation agreement, the income of a delegated temple must be applied in the first instance to the due observance of the customary ceremonies of the temple, and the maintenance of the temple, the lots and the assets, fittings and properties therein. Any surplus shall be applied to pay the salaries of those staff responsible for managing the temple and the expenses of the delegated organisation in compliance with the agreement and for the purposes of Chinese charity in Hong Kong. In scrutinising the submitted accounts for the five temples under Organisation D's management for the year ended December 2015, Audit noted that there was a staff messing expenditure of about \$380,000 which:

- (a) was disproportionate to the operational expenses of the temples (the staff salary expenditure for the same year only amounted to \$301,000); and
- (b) was higher than the \$137,000 incurred in the previous year.

However, the CTC had not sought clarifications from Organisation D. The CTC needs to tighten up the provisions in delegation agreements so as to ensure that temple funds are properly spent.

Review of the Chinese Temples Ordinance

5.12 In light of the outdated provisions of the CTO (see para. 5.4(a)), the HAB and the CTC conducted a review of the provisions during 2012 to 2015 with a view to making legislative amendments to better reflect current practices and serve current needs. The review recommended, among other things (Note 57):

Note 57: *The other recommendations included establishing the CTC as a body corporate, stipulating in the law its powers and functions, and optimising its operational procedures, as well as merging the Chinese Temples Fund and the General Chinese Charities Fund into a single fund with a broader scope to provide grants to meet the needs of the relevant services of the community.*

- (a) removing the outdated restrictions imposed on all Chinese temples, including the provisions requiring all Chinese temples to be registered, the revenues and properties of all Chinese temples to be under the absolute control of the CTC, and any person who possesses or controls the property of any Chinese temple to transfer such property to the SHAI; and
- (b) establishing a more reasonable regulatory regime for Chinese temples by replacing the mandatory registration requirement with a voluntary registration scheme and providing the Secretary for Home Affairs with power to participate in any legal proceedings against mismanagement of Chinese temples or abuses of temples' funds so as to safeguard public interest.

5.13 The HAB and the CTC briefed the LegCo Panel on Home Affairs on the outcome of the review of the CTO in March 2015 and conducted a public consultation from March to May 2015. However, diverse views were received during the public consultation exercise. For example, there was no consensus on the implementation of the proposed voluntary registration scheme. In late 2015, there was a widely reported case of abuse of temple funds by an unregistered Chinese temple (Temple A) and the CTC received a request for taking possession of Temple A in January 2016. In view of these developments, the CTC formed a sub-committee in August 2016 to follow up the alleged malpractices of Temple A and the review of the CTO.

5.14 Given the recent development (especially the lack of general consensus on the registration scheme), it is not expected that the review of the CTO could be finalised in the short term. In Audit's view, the HAB and the CTC need to implement interim measures to promote the transparency and accountability of the operation of Chinese temples with a view to safeguarding the temple funds from abuse. For example, the CTC may encourage organisations managing the registered temples to adopt the best practices promulgated by the Government (e.g. the Reference Guide on Best Practices for Charitable Fund-raising Activities promulgated by the SWD). As an incentive, higher priority could be given to temples which have adopted the best practices when they apply for funding from the Chinese Temples Fund (see Note 50 to para. 5.3(a)).

Audit recommendations

5.15 Audit has *recommended* that the Secretary for Home Affairs, as the Chairman of the CTC, should:

- (a) for the two temples with expired delegation agreements (see para. 5.7), expedite action to resolve the long-outstanding issues with the two delegated organisations concerned with a view to renewing the delegation agreements as soon as practicable;
- (b) work out with the delegated organisations of the 11 temples (see para. 5.9) agreements and means to disclose the financial information and operations of the temples;
- (c) step up monitoring of the delegated organisations' compliance with the terms of the delegation agreements to ensure that audited accounts and administrative reports of the temples are submitted in a timely manner;
- (d) tighten up the provisions in delegation agreements to ensure that temple funds are properly spent; and
- (e) consider providing incentives to organisations managing registered temples to adopt the best practices promulgated by the Government to enhance the transparency and accountability of the temples' operation.

Response from the Government

5.16 The Secretary for Home Affairs generally accepts the audit recommendations. He has said that the HAB will take into consideration the areas for improvement of the CTC as identified by Audit.

PART 6: WAY FORWARD

6.1 This PART examines the way forward on the monitoring of charities with reference to the recommendations of the LRC Report on Charities.

Law Reform Commission Report on Charities

6.2 According to the 2013 LRC Report, the existing regulatory framework of charities has the following deficiencies:

- (a) ***Out-dated definition of charity.*** The definition of “charitable purpose” in Hong Kong is not based upon a clear statutory definition, but upon the common law interpretation of English legislation dating back hundreds of years. The leading case authority of 1891 on the definition of charity which enunciated the four principal divisions of charitable purpose (namely the relief of poverty, the advancement of education, the advancement of religion and any other purposes beneficial to the community not falling under any of these three heads) is still applied today. Many of the more recently developed charitable purposes necessarily fall within the vague “*any other purpose*” classification. This has resulted in evolving case law on charitable purposes which is confusing and unclear;
- (b) ***Lack of a coherent system for the registration of charities.*** While the IRD’s s88 list does not constitute a formal “register” of charitable organisations, there may be a danger that the public (and hence potential charity donors) may perceive that the recognition of tax exemption status and inclusion on the s88 list confers on those charities “*a cloak of respectability and the semblance of official sanction not intended by the Inland Revenue Ordinance*”;
- (c) ***Inconsistent standards or requirements on governance, accounting and reporting by charities.*** Charities of different legal forms established under different ordinances can be subject to different statutory controls. For example, charitable organisations established under the Companies Ordinance are required to prepare audited accounts in order to fulfil requirements under that Ordinance. However, this is not the case for

charitable organisations established as societies registered under the Societies Ordinance. As for charities which are neither statutory nor subvented, they may operate autonomously under their own governing bodies and according to their own rules and regulations; and

- (d) ***Limited control of charitable fund-raising activities.*** Government oversight of the fund-raising activities of charities is confined specifically to those activities requiring the permission of the SWD, the HAD and the FEHD, such as flag days, lotteries and on-street selling. For other forms of fund-raising activity such as charity auctions, balls, concerts, dinners, or requests for donations by mail or through advertisements, no government oversight applies.

Recommendations of the LRC Report

6.3 After conducting a detailed study, including analysing the charities' regimes in a number of overseas jurisdictions and seeking views and comments from the public in 2011, the LRC issued a Report on Charities in December 2013. The LRC Report concluded that:

- (a) it should be a long-term goal that a charity commission or a centralised regulatory authority for charities should be established for Hong Kong. Given the lack of general consensus among the public on this issue (Note 58), the LRC believed that the community needed more time to discuss the concept of a charity commission; and
- (b) in the interim period, expedient administrative measures should be implemented to improve the transparency and accountability of charities and thus provide better safeguards to the public. In this connection, the LRC made a total of 18 recommendations, which included, among others, establishing a clear statutory definition of what constitutes a charitable purpose, requiring all charitable organisations which solicit public

Note 58: *According to the LRC Report, the number of respondents not in support of the recommendation to set up a charity commission greatly out-numbered those in support of the recommendation. However, the majority of the respondents agreed that it was important for charities to be more transparent and accountable to the community and there was also consensus on the need to safeguard the rights of donors.*

donation and/or have sought for tax exemption to be registered, adopting a specifically formulated financial reporting standard for charities in Hong Kong, and ensuring that tax-exempt charities make information about their operations available to the public (see Appendix C for details).

The HAB has been coordinating inputs from relevant B/Ds with a view to formulating a response to all the recommendations of the LRC Report for the Government's consideration.

6.4 In considering the way forward in formulating a response to the LRC's recommendations, there is a need to take into account the areas of improvement identified in earlier PARTs of this Audit Report which are complementary to the LRC's recommendations, as follows:

- (a) ***LRC recommendation: more frequent reviews by the IRD.*** In PART 2, Audit has found that there is a need to review the provisions of the IRO to enable the IRD to perform effectively its role in administering the tax exemption status of charities; and
- (b) ***LRC recommendation: enforcement action for non-compliance with filing and disclosure requirements.*** In PART 4, Audit has found that there is room for improvement in the CR, the HKPF and the EDB's administration of the filing and disclosure requirements under their responsible legislation, which could help members of the public to access information of charities. Similarly, in PART 5, Audit has found that the HAB and the CTC can improve the management of delegated temples to enhance the transparency and accountability of the use of temple funds.

6.5 While the LRC has not made specific recommendations on the administration of land granted to charities, it commented that the current monitoring arrangements for charities with split responsibilities across different authorities appeared to be fragmented and cumbersome. In PART 3 of this Audit Report, Audit has found that notwithstanding the issue of the 2014 Protocol on the delineation of responsibilities on monitoring PTGs among the Lands D and relevant supporting B/Ds, there could be difficulties in implementing the Protocol where there is no designated supporting B/D in a lease. Lease M in paragraph 3.14 is a case in point.

Audit recommendations

6.6 Audit has *recommended* that the Secretary for Home Affairs should take into account the areas for improvement identified in this Audit Report (see para. 6.4) in coordinating inputs from relevant B/Ds for formulating a response to the LRC's recommendations for the Government's consideration.

6.7 Audit has also *recommended* that the Secretary for Development and the Director of Lands should, in collaboration with the supporting B/Ds, review the implementation of the 2014 Protocol to see whether there is room for improvement.

Response from the Government

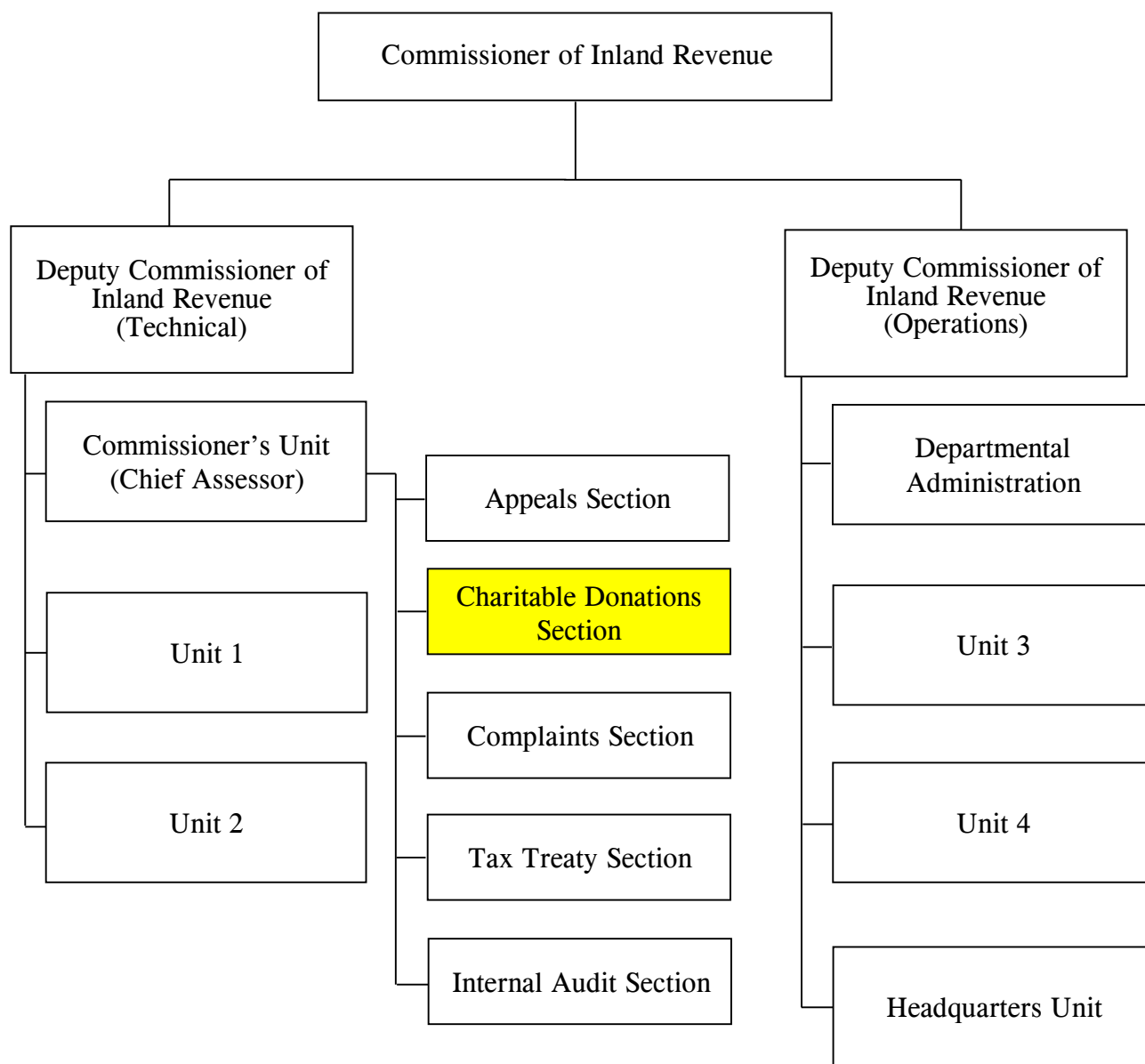
6.8 The Secretary for Home Affairs generally accepts the audit recommendation in paragraph 6.6. He has said that the HAB will continue to work with relevant B/Ds in coordinating their inputs for formulating a response to the recommendations of the LRC Report for the Government's consideration.

6.9 The Secretary for Development accepts the audit recommendation in paragraph 6.7. He has said that:

- (a) the 2014 Protocol was drawn up by the Lands D in response to the recommendations of the Public Accounts Committee of LegCo and the Director of Audit in 2012 on matters concerning PTGs, with a view to delineating the sharing of responsibilities between the Lands D (as the Government land agent) and the B/Ds which support various types of PTGs; and
- (b) with the benefit of additional actual experience in the past three years, the Development Bureau will work with the Lands D to follow up with relevant B/Ds to review and consider whether, and if so, how the Protocol may be refined.

6.10 The Director of Lands accepts the audit recommendation in paragraph 6.7. She has said that the Lands D would follow up with concerned B/Ds to see if there is any room for improvement and, as the Government land agent, will issue and monitor the land grant at the directive of concerned B/Ds.

**Inland Revenue Department:
Organisation chart (extract)
(31 December 2016)**



Source: IRD records

Appendix B
(paras. 3.7, 3.8(c)
and 3.11 refer)

Particulars of 14 land leases alleged to have hotel operations

(I) 5 leases granted before 1959

Lease	Year of land grant	Land use condition
A	1845	Virtually unrestricted
B	1859	Virtually unrestricted
C	1927	Not be used for any other purpose than for the grantee's object or such other purpose as approved by the then Governor.
D	1932	For purpose of promoting the formation of the grantee's religious character and cultivating the grantee's religious spirit of service amongst young men.
E	1969	Virtually unrestricted (Note)

(II) 9 leases granted in or after 1959

Lease	Year of land grant	Land use condition
F	1974	For the purposes of a non-profit-making institution providing accommodation for a gymnasium, library, domestic science rooms, hostel accommodation for business girls and ancillary administrative offices or for such other purposes as may be approved by the DSW. The grantee shall operate the said institution on a scale satisfactory to the DSW and conduct the said institution in accordance with all relevant Ordinances and Regulations that are or may at any time be in force in Hong Kong and in all respects to the satisfaction of the DSW.

Appendix B
(Cont'd)
(paras. 3.7, 3.8(c)
and 3.11 refer)

Lease	Year of land grant	Land use condition
G (Grantee G)	1966	Be used only for the purposes of a nursery, training centre, dormitories, such staff quarters as the DSW may approve in writing and such other welfare purposes as the DSW may approve in writing, the whole to be conducted on a non-profit-making basis and to the satisfaction of the DSW.
H (Grantee H)	1971	Erect and maintain a building providing accommodation for a welfare centre including a hostel, together with staff quarters as may be approved by the DSW. The grantee shall conduct the centre in accordance with all relevant Ordinances and Regulations that are or may at any time be in force in Hong Kong and in all respects to the satisfaction of the DSW.
I	1980	Not be used for any purpose other than for the purposes of a hostel and other allied services as may be approved by the DSW together with such domestic quarters as the DSW may consider reasonable for housing staff and workmen employed on the premises. The grantee shall conduct the said hostel in accordance with all Ordinances and Regulations relating to such hostel which are or may at any time be in force in Hong Kong and in all respects to the satisfaction of the DSW.
J	1981	Not be used for any purpose other than non-profit-making headquarters, staff quarters, training college, youth hostel, multi-purpose hall and rooms and a chapel which shall be of such size as may be first approved in writing by the then Director of Public Works, a non-profit-making child care centre, a non-profit-making multi-service centre for the elderly, a non-profit-making kindergarten of 4 classrooms, and such other non-profit-making purposes as may be approved by the DSW. The grantee shall conduct and operate the services in accordance with all relevant Ordinances and Regulations that are or may at any time be

Appendix B
(Cont'd)
(paras. 3.7, 3.8(c)
and 3.11 refer)

Lease	Year of land grant	Land use condition
		in force in Hong Kong and in all respects to the satisfaction of the Government.
K	1987	Not be used for any purpose other than for the purposes, of the grantee's object and a children's and youth centre. The grantee shall operate the premises in accordance with all relevant Ordinances and Regulations which are or may at any time in force in Hong Kong.
L	1987	Not be used for any purpose other than for the purposes of a non-profit-making nursery approved by the DSW, a non-profit-making hostel, such non-profit-making educational facilities as may be approved by the Director of Education, such domestic quarters as the Director of Lands may consider reasonable for the use and occupation of supervisors and caretakers employed on the lot, a non-profit-making day care centre for the elderly as may be approved by the DSW and such facilities ancillary to the uses permitted as may be approved by the Director of Lands. The grantee shall conduct and operate the nursery and the day care centre for the elderly, the hostel and the educational facilities in all respects to the satisfaction of the DSW, the Director of Lands and the then Director of Education respectively, and in accordance with all Ordinances and Regulations which are or may at any time be in force in Hong Kong.

Appendix B
(Cont'd)
(paras. 3.7, 3.8(c)
and 3.11 refer)

Lease	Year of land grant	Land use condition
M (Grantee M)	1988	Not be used for any purpose other than for a non-profit-making hostel (of not more than 400 rooms together with domestic quarters for housing staff and workmen employed in the hostel and ancillary offices as may be approved in writing by the then Director of Buildings and Lands), church, social and welfare purposes. The grantee shall conduct the facilities in accordance with all Ordinances and Regulations relating to these services which are or may at any time be in force in Hong Kong in all respects to the satisfaction of the then Director of Buildings and Lands.
N (Grantee N)	1990	Not be used for any purpose other than accommodation for the grantee's headquarters, the bus terminus, the telephone exchange and the vehicle park. The headquarters shall include assembly hall, gymnasium, offices, grantee's shop, hostel, dormitory, canteen, staff quarters and such other ancillary accommodation and facilities as shall be approved by the DSW. The grantee shall operate, conduct, manage and maintain the headquarters on a scale satisfactory to the then Governor and in accordance with all Ordinances, Regulations and By-laws relating to the headquarters which are or may at any time in force in Hong Kong.

Source: Lands D records

Note: The lease term commenced from 1888.

Recommendations of the Law Reform Commission Report

The LRC Report contained 18 recommendations on charities, covering aspects on definition and registration of charities, facilitation of good practice, financial reporting by charities, and filing requirements (and requirement of display of registration number) for charitable fund-raising activities. The 18 recommendations are summarised below:

Statutory definition

- (a) there should be a clear statutory definition of what constitutes a charitable purpose;

Categories of charitable purpose

- (b) the statutory definition of what constitutes a charitable purpose that is exclusively charitable should include 14 heads and all of these heads of charitable purpose must be also for the public benefit;

Legal forms of charitable organisations

- (c) the current system of allowing a variety of legal forms of charitable organisations to exist should continue;

Registration of charitable organisations

- (d) all charitable organisations which solicit from the public for the donation of cash or its equivalent; and/or have sought tax exemption should be subject to the requirement of registration. The list of registered charitable organisations should be established and maintained by a B/D and be available for public inspection;

Financial reporting standard

- (e) a specifically formulated financial reporting standard should be adopted for charities in Hong Kong;

Filing requirements

- (f) certain filing requirements should be imposed on charitable organisations in their applications for charitable fund-raising licences or permits;

Information available to the public

- (g) the Government should ensure that tax-exempt charities make information about their operations available to the public by publishing certain documents, such as their financial statements and activities' reports, on their websites;

Enforcement action for non-compliance with filing and disclosure requirements

- (h) the Government should designate a B/D to be responsible for enforcement action in cases of non-compliance with the filing and disclosure requirements;

Standardised application form and conditions

- (i) a standardised application form setting out some common basic requirements (including the requirement for disclosure of certain information about the charity) should be adopted in respect of different types of charitable fund-raising licence or permit applications and the existing function of the information portal under the "GovHK" website should be enhanced by making the information available for public inspection;

Centralised hotline

- (j) the function of the Government's existing 1823 Call Centre should be enhanced or a new telephone hotline should be set up for answering public enquiries and receiving complaints in relation to charitable fund-raising activities;

Display of registration number

- (k) the registration number of charitable organisations involved in all forms of charitable fund-raising activities (including those via the Internet or other electronic means and involving face-to-face solicitation of pledges from donors for regular donations) should be prominently displayed on, among others, any related documents, webpage, message transmitted by electronic means or any means through which appeals for charitable donations are made (as the case may be);

Facilitation of good practice

- (l) charitable organisations should be encouraged to work with institutions/organisations to facilitate good practice and to improve co-operation between charitable organisations and the Government. Good practice guidelines should be issued by a coordinating B/D;

Public education

- (m) the Government, through the coordinated efforts of B/Ds, should engage in more public education on how to become a smart donor and on matters relating to charitable fund-raising activities;

Setting up a platform of coordination

- (n) the Government should set up a platform of coordination in dealing with applications for charitable fund-raising licences among the different departments responsible for the licensing of charitable fund-raising activities;

Allocation of more resources

- (o) more resources should be allocated to Government departments involved in the licensing of charitable fund-raising activities in order to enhance their role in relation to the monitoring of charitable fund-raising activities;

More frequent reviews by the IRD

- (p) the IRD should conduct more frequent reviews of tax-exempt charities to ascertain whether the activities of these charities are compatible with their charitable objects and more resources should be allocated to the IRD for such purpose;

Cy-près doctrine

- (q) the Government should introduce legislation along the lines of the English statutory model of the cy-près doctrine (i.e. to solve the problems which arise when a charitable gift fails because the original purposes of such gift, in whole or in part, cannot be carried out) so as to provide a statutory basis for the doctrine in Hong Kong and to broaden the scope of its application; and

Setting up of a charity commission

- (r) a charity commission should not be set up at this stage. It should be a long-term goal to set up a charity commission or a centralised regulatory authority upon review of the impact and effect of the implementation of the other recommendations made in the LRC Report.

Source: LRC Report

Acronyms and abbreviations

Audit	Audit Commission
B/Ds	Bureaux/departments
CDS	Charitable Donations Section
CR	Companies Registry
CTC	Chinese Temples Committee
CTO	Chinese Temples Ordinance
DLC	District Lands Conference
DoJ	Department of Justice
DSW	Director of Social Welfare
EDB	Education Bureau
ExCo	Executive Council
FEHD	Food and Environmental Hygiene Department
G/IC	Government, Institution or Community
HAB	Home Affairs Bureau
HAD	Home Affairs Department
HKPF	Hong Kong Police Force
IMC	Incorporated management committee
IRD	Inland Revenue Department
IRO	Inland Revenue Ordinance
Lands D	Lands Department
LegCo	Legislative Council
LRC	Law Reform Commission
OZP	Outline Zoning Plan
Plan D	Planning Department
PTG	Private treaty grant
SHAI	Secretary for Home Affairs Incorporated
SWD	Social Welfare Department
TPB	Town Planning Board

CHAPTER 2

**Home Affairs Bureau
Social Welfare Department
Home Affairs Department
Food and Environmental Hygiene Department
Lands Department**

**Monitoring of charitable
fund-raising activities**

**Audit Commission
Hong Kong
3 April 2017**

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

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MONITORING OF CHARITABLE FUND-RAISING ACTIVITIES

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MONITORING OF CHARITABLE FUND-RAISING ACTIVITIES

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1. Fund-raising is an activity carried out by many charities and it often takes the charities into direct contact and dealings with members of the public. Currently, there is no legislation enacted specifically to control charitable fund-raising activities. The Government's regulation of certain charitable fund-raising activities is incidental to the legislation that controls nuisances committed in public places, gambling and hawking. Under the legislation, permits or licences are required for conducting charitable fund-raising activities in public places such as flag days and on-street charity sales, or involving sale of raffle tickets (hereinafter collectively referred to as "regulated charitable fund-raising activities"), which are granted by the relevant licensing departments, namely the Social Welfare Department (SWD), the Home Affairs Department (HAD) or the Food and Environmental Hygiene Department (FEHD). Additionally, the Lands Department (Lands D) grants approval for temporary occupation of unleased land for conducting fund-raising activities. However, other forms of fund-raising activities (such as charity auctions, balls, concerts, dinners, or requests for donations by mail or through advertisements) do not require a permit or a licence. Nevertheless, the funds raised by charities are significant and increasing in recent years. Proceeds raised from regulated charitable fund-raising activities approved by the SWD and the HAD totalled \$282 million in 2014-15, whereas charitable donations allowed for tax deduction under the Inland Revenue Ordinance (IRO — Cap. 112) reached \$11.84 billion for the year of assessment 2014-15. While charities are granted access to public areas to raise funds for their charity work, an effective monitoring framework has an important role to play in enhancing the governance standards of charities and ensuring that they uphold accountability and transparency for the donations they received. The Audit Commission (Audit) has recently conducted a review on the Government's monitoring of charitable fund-raising activities with a view to identifying areas for improvement.

Government's efforts to promote transparency and accountability of charitable fund-raising activities

2. *Voluntary system to enhance transparency and accountability.* In response to the recommendation on implementing a scheme of control over fund-raising activities raised in the Director of Audit's Report of October 1997 and the Report of the Public Accounts Committee of 1998, the Government decided in September 2002 that administrative controls should be strengthened with a view to enhancing transparency and accountability of fund-raising activities to enable donors to make an informed choice when making donations. In 2004, the SWD promulgated a guide on the best practices for charitable fund-raising activities (Reference Guide) and updated the 1998 guidance note on internal financial controls for charitable fund-raising activities for voluntary adoption by charities (paras. 2.4 to 2.6).

3. *Need to further promote the recognition and voluntary adoption of best practices.* Since the promulgation of the Reference Guide in 2004, 400 (94%) of the 426 respondents to surveys of 961 charitable organisations conducted by the SWD indicated that they would adopt the Guide. Audit's sample check of 40 tax-exempt charities suggested that there was a high correlation between those charities which had indicated adoption of the Reference Guide and the publication of their financial information on their websites (paras. 2.7, 2.9 and 2.10). Accordingly, there is a need to further promote the recognition and voluntary adoption of best practices for organising charitable fund-raising activities, particularly in light of the following developments:

- (a) *Rapidly expanding charity sector.* The number of tax-exempt charities under the IRO had doubled from 4,435 in March 2006 to 8,923 in September 2016. The charitable donations allowed for tax deduction had more than doubled during the period for the years of assessment from 2005-06 to 2014-15 (para. 2.11); and
- (b) *Other forms of fund-raising activities not subject to Government's monitoring.* Appeals for donations through the Internet and face-to-face solicitation of regular donations in public places are examples of other fund-raising activities not subject to the Government's monitoring. In 2016, 194 (77%) of 252 multi-district applications to the Lands D for temporary occupation of unleased land were for conducting face-to-face solicitation of regular donations in public places by means of signing

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direct debit authorisation forms. Among the 18 applicants involved in these 194 applications, only 6 (33%) had adopted the Reference Guide. In April 2016, a Legislative Council Member expressed the view that such mode of fund-raising involving a large sum of money had become a trend and the Government should study ways to regulate these activities (paras. 2.12 and 2.13).

4. ***Room for improvement in promoting best practices for organising charitable fund-raising activities.*** From 2004 to September 2016, the SWD reached out to 961 charitable organisations (which were PSP applicants or SWD subvented organisations) in promoting adoption of the Reference Guide. Given that there were 8,923 tax-exempt charities as at September 2016, the SWD may seek the assistance of relevant bureaux/departments (B/Ds) for the purpose of achieving wider promotion and recognition of the best practices for fund-raising. Audit also found that: (a) the SWD had not conducted any review on the effectiveness of the Reference Guide after the last review in September 2006; (b) the Government had not launched any large-scale promotional programmes of the Reference Guide after it was updated in December 2014; and (c) more guidance on other forms of fund-raising activities should be incorporated in the publications of best practices in light of the increased use of on-street face-to-face solicitation of regular donations and social media on the Internet for fund-raising (paras. 2.14 and 2.15).

5. ***Low usage of the one-stop finder.*** In July 2012, a one-stop finder on charitable fund-raising activities approved by the three licensing departments was launched on the government portal “GovHK” to provide easy and convenient access to such information. Audit found that the usage of the one-stop finder (i.e. the average daily hit rates) had decreased by 77% from 275 in 2012-13 (from July 2012) to 62 in 2016-17 (up to October 2016). The three licensing departments need to consider stepping up or renewing their publicity efforts to raise the public awareness of the service (paras. 2.16 to 2.18).

Administration of public subscription permits for charitable fund-raising activities

6. The Summary Offences Ordinance (Cap. 228) consolidates the law relating to summary offences including nuisances committed in public places. To regulate against nuisances committed in public places, the SWD issues public subscription permits (PSPs) for flag days and general charitable fund-raising

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activities in public places under section 4(17)(i) of the Ordinance. In 2015-16, the SWD issued 120 PSPs for flag days and 365 PSPs for general charitable fund-raising activities, and the gross proceeds raised amounted to \$119 million and \$69 million respectively (para. 3.2).

7. ***Need to issue guidelines on the scope of PSP.*** Given the wide varieties of fund-raising activities and the changes in their modes of collection of donations, the SWD has from time to time sought the Department of Justice's advice on whether a particular PSP application based on its individual circumstances is under the scope of the Summary Offences Ordinance. Drawing on this experience, the SWD should explore the feasibility of issuing more guidelines to facilitate charitable organisations in determining the relevance of PSP to their activities before filing their applications (paras. 3.8 and 3.10).

8. ***Compliance with permit conditions.*** Permittees' compliance with the permit conditions is important to ensure the proper conduct and accountability of charitable fund-raising activities (para. 3.11). Audit has found the following areas for improvement:

- (a) ***Delays in submission of audited reports.*** To enhance transparency and accountability of the funds raised, permittees are required to submit audited reports of fund-raising activities within 90 days of the last event day. This enables the public to make an informed choice when making donations. Of the 1,497 audited reports due for submission by 325 permittees from April 2012 to September 2016, 15 (1%) were outstanding as of September 2016, of which 6 were long overdue (ranging from 216 to 429 days, averaging 342 days). For the 1,482 submitted audited reports, 658 (44% of 1,482) were late reports, including 76 (12% of 658) which were late for more than 3 months. Moreover, 13 of the 325 permittees failed to submit the audited reports on time repeatedly, i.e. for two to four times (para. 3.12);
- (b) ***Fund-raising by organisations on the withholding list.*** As part of the SWD's monitoring mechanism, permittees which fail to submit audited reports after the issue of written reminders/warnings will be put on a withholding list so that the processing of their new PSP applications will be withheld. As of September 2016, there were 8 organisations on the withholding list. Audit found that 7 of them had continued to raise funds

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on their websites and through other activities outside the SWD's purview. To enable the public to make an informed choice when making donations, the SWD needs to consider publicising information on serious or repeated non-compliance with PSP conditions after warnings (paras. 3.5 and 3.13); and

- (c) ***Need to take concerted actions on repeated “no-show” cases.*** Use of public places (especially those with high pedestrian flow) for charitable fund-raising activities was in high demand. Audit sample check revealed that in 2016, the Lands D had rejected applications for 1,059 (50%) of 2,109 locations for fund-raising purposes. The SWD's random on-site inspections on general charitable fund-raising activities from June 2015 to September 2016 revealed no fund-raising activities in 30 (50%) of 60 inspections, i.e. the “no-show” cases. Inspections conducted by the FEHD on on-street selling activities for fund-raising purposes also found “no-show” cases in 59% of 2,128 inspections. The high percentage of “no-show” cases indicates an ineffective use of public resources as other charities are deprived of the opportunity to use the places. Among the SWD's inspected cases, 7 organisations had been repeatedly found not carrying out any fund-raising activities during the time of inspections. The SWD needs to liaise with the FEHD and the Lands D on the feasibility of sharing enforcement information and taking concerted actions on repeated “no-show” cases without valid reasons (paras. 3.14 and 5.11).
9. ***Monitoring of charitable fund-raising activities under PSPs.*** Audit has found the following areas for improvement in monitoring fund-raising activities:
- (a) ***High administration costs in some fund-raising activities.*** At present, the SWD imposes a permit condition that the fund-raising expenses of flag days should not exceed 10% of the gross proceeds, but not for general charitable fund-raising activities. Audit found that from 2012-13 to 2015-16, the overall percentages of expenses to gross proceeds of such fund-raising activities ranged from 22% to 30%. According to the SWD, it might not be practical to set an across-the-board ceiling for all general charitable fund-raising activities given the diversity of their nature and mode of operation, and the absence of a commonly agreed definition of “administration costs” of a fund-raising activity. However, the feasibility of defining the term “administration costs” with a view to setting an

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expenses ceiling as a PSP condition for on-street general charitable fund-raising activities which are similar in nature to flag days should be explored (paras. 3.17, 3.19 and 3.21); and

- (b) ***Limitations of audited reports of PSP fund-raising activities.*** Currently, the SWD does not specify whether accounts for PSP fund-raising activities should be prepared on a cash basis or an accrual basis. As accrued expenses could not be reflected in the accounts prepared on a cash basis, there could be an understatement of expenses, as evidenced by a case noted by Audit. Moreover, as permittees' auditors are not required to verify compliance with the permit condition of depositing the net proceeds into a bank account within 90 days from the last day of the event concerned, there is no assurance on compliance with this permit condition (para. 3.23).

Administration of lottery licences for charitable fund-raising activities

10. The Gambling Ordinance (Cap. 148) is the law relating to gambling, betting, gaming, gambling establishments and lotteries. Under the Ordinance, anyone who wishes to conduct a lottery event has to apply for a lottery licence from the Office of the Licensing Authority of the HAD. Lottery licences for charitable fund-raising are issued to bona-fide organisations to conduct lottery ticket sales for raising funds to meet the organisations' operating expenses and/or for making donations to tax-exempt charities. In 2015-16, the HAD granted 60 lottery licences which raised gross proceeds of \$88 million (para. 4.2).

11. ***Inadequate follow-up on late submission of required documents.*** Upon completion of a lottery event, the licensee is required under the licence conditions to submit to the HAD documents such as lottery accounts and lottery results within the stipulated time. Audit examined 263 lottery licences granted from 2012-13 to 2015-16 and found that there were delays in submitting the lottery accounts for 120 (46%) licences. The delays were over three months in 17 (14%) cases, up to 746 days in one case. For 10 lottery accounts which had been overdue for over 180 days, reminders/warning letters had not been issued to the licensees concerned within the HAD's stipulated time. While the HAD's computer system had records of the submission due dates, it could not generate exception reports to facilitate

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HAD staff in following up the outstanding cases in a timely manner (paras. 4.4, 4.6, 4.8 and 4.10).

12. *Need to ensure the use of proceeds is accounted for in submitted financial statements.* As a licence condition, if the net proceeds of the lottery are used for meeting the expenditure of the licensee, a copy of the audited annual financial statements of the licensee, which should show the income and expenditure of the lottery and the whereabouts of the net proceeds should be submitted to the HAD within one year. Audit sample checked 30 licences and found that in 6 (20%) cases, the submitted statements did not show separately the income and expenditure of their lottery events nor the use of net proceeds, but HAD staff accepted the licensees' explanation that they had been subsumed under other income and expenditure items in the submitted statements. The HAD needs to provide more guidance to licensees and ensure their compliance with the relevant licence condition on showing separately the income and expenditure of the lottery and the whereabouts of the net proceeds (para. 4.11).

13. *Need to facilitate public access to the lottery accounts.* The HAD publishes on its website a list of lottery accounts submitted by licensees. However, the HAD's requirements for the public to inspect the lottery accounts in the HAD's office physically and not allowing making copies of the accounts do not facilitate access and are not conducive to achieving the Government's objective of enhancing transparency and accountability of fund-raising activities. Moreover, while the HAD encourages lottery organisers to publish lottery accounts on their websites, Audit survey of the websites of 10 lottery organisers revealed that none of them had done so. The HAD needs to take measures to facilitate public access to the lottery accounts (paras. 4.12 and 4.13).

Administration of temporary hawker licences for fund-raising activities involving on-street selling

14. Since the early 1970's, the Government has stopped issuing new hawker licences under normal circumstances. Under the Hawker Regulation (Cap. 132AI), the FEHD issues temporary hawker licences to facilitate charities or other non-profit-making organisations for conducting on-street selling of commodities in raising funds and to regulate such hawking activities in public streets to ensure that they are conducted in a hygienic manner and will not cause nuisances. A

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tax-exempt charity which has obtained a PSP from the SWD for a fund-raising activity may apply for a waiver from obtaining a temporary hawker licence. In 2015-16, the FEHD issued 88 temporary hawker licences and granted 44 waivers. Aiming to enhance transparency and accountability of fund-raising activities, safeguard the proper use of donations, prevent abuse of temporary hawker licences and achieve a fair distribution of public resources among the fund-raising organisations, the FEHD introduced in 2012 a number of new administrative measures (such as limiting the number of licences granted to each fund-raising organisation and requiring organisations issued with more than 12 licences within 12 months to submit an audited account of the fund-raising activities for each and every licence subsequently issued) (paras. 5.2 to 5.5).

15. ***Different administrative/licensing requirements between the FEHD and other licensing departments.*** Comparing the administrative/licensing requirements of the FEHD with those of the other two licensing departments, Audit has found the following differences:

- (a) ***Custody of monies received.*** The FEHD has not required licensees to put in place safeguards to ensure the safe custody of the monies received during fund-raising activities for charitable purposes (para. 5.7(a));
- (b) ***Accounts for fund-raising activities.*** The FEHD has only required organisations granted with more than 12 licences within 12 months to submit audited accounts for the 13th licence onwards. In this connection, Audit noted that in one case, although 16 temporary hawker licences had been issued to an organisation within 12 months, the concerned organisation had not submitted the audited accounts for the last 4 licences issued and the FEHD had not taken any follow-up action (paras. 5.7(b) and 5.8(a)); and
- (c) ***Purpose of fund-raising and use of donations.*** The FEHD has not required licensees to inform donors or prospective donors about the purpose of fund-raising and to properly account for the use of donations (para. 5.7(c)).

16. ***Deficiencies in inspections.*** The FEHD conducts inspections at least twice a day to check licensees' compliance with licence conditions and on a daily basis to detect any irregularities for on-street selling activities covered by waivers.

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Audit examination of inspection records from April 2014 to December 2016 revealed that of the 2,508 required inspections, 139 (6%) inspections had not been conducted and the records of 241 (10%) inspections were either missing or inadequate to show whether inspections had been conducted (paras. 5.9 and 5.10).

17. ***Lack of one-stop service.*** Owing to the lack of one-stop service, an organisation may need to seek approvals from different departments (the FEHD, the SWD and the Lands D) for the same charitable fund-raising activity involving on-street selling, resulting in duplication of regulatory efforts and extra workload and inconvenience to charitable organisations. Some organisations might have breached the relevant legislation for not having sought all the required approvals. For example, of 42 PSPs issued by the SWD from January to September 2016 involving selling activities in public streets, 15 (36%) permittees had not applied to the FEHD for waivers. There is a need for the three departments to consider providing a one-stop service to streamline the processing and approvals of such activities (paras. 5.12 and 5.13).

Law Reform Commission Report on Charities

18. According to the Law Reform Commission (LRC) Report, there are deficiencies in the existing regulatory framework of charities, including inconsistent standards or requirements on governance, accounting and reporting by charities and limited control of charitable fund-raising activities. The LRC made 18 recommendations to improve the transparency and accountability of charities, which included, among others, imposing certain filing requirements in applications for charitable fund-raising licences or permits, setting up centralised telephone hotline for public enquiries and complaints in relation to charitable fund-raising activities, requiring charitable organisations to display their registration numbers during charitable fund-raising activities, and engaging in more public education on matters relating to charitable fund-raising activities (paras. 6.2 and 6.3).

19. ***Slow progress in responding to the LRC's recommendations.*** According to the Government's guidelines, a detailed public response to the LRC's recommendations should be provided within 12 months of its publication. However, for three years since the issue of the LRC Report in December 2013, the Home Affairs Bureau (HAB) had reported that it was still coordinating comments from relevant B/Ds for consideration of the way forward. Audit found that there were inadequacies in the internal consultation, e.g. while B/Ds' feedback had been

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received in April 2014, the HAB only consolidated the views into a preliminary assessment paper in June 2015 and convened two inter-departmental meetings in mid-August 2015 and October 2016. The HAB needs to: (a) expedite the consultation with relevant B/Ds with a view to formulating a response to all the recommendations of the LRC Report; and (b) take into account areas for improvement identified in this Audit Report which are complementary to the LRC's recommendations in considering the way forward in formulating a response (paras. 6.4 and 6.6 to 6.10).

Audit recommendations

20. **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:**

- (a) **the Director of Social Welfare, the Director of Home Affairs and the Director of Food and Environmental Hygiene should:**
 - (i) **step up promotion efforts to encourage more charitable organisations in adopting the best practices for organising charitable fund-raising activities (para. 2.19(a)(ii)); and**
 - (ii) **incorporate more guidance on other forms of fund-raising activities in the publications of best practices for organising charitable fund-raising activities (para. 2.19(a)(iii));**
- (b) **the Director of Social Welfare should:**
 - (i) **explore the feasibility of issuing more guidelines on the scope of the PSP for reference by applicants (para. 3.25(a));**
 - (ii) **step up enforcement actions on cases of repeated non-compliance with the permit conditions on submission of audited reports (para. 3.25(b));**
 - (iii) **in collaboration with the Director of Food and Environmental Hygiene and the Director of Lands, explore the feasibility of**

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sharing enforcement information on charitable fund-raising activities held in public places and taking concerted actions on repeated “no-show” cases without valid reasons (para. 3.25(c)); and

- (iv) explore the feasibility of defining the term “administration costs” with a view to setting an expenses ceiling for on-street general charitable fund-raising activities which are similar in nature to flag days (para. 3.25(e));

(c) **the Director of Home Affairs should:**

- (i) step up monitoring of licensees’ compliance with the lottery licence conditions, and consider taking suitable measures to deter cases of repeated late submission of documents (para. 4.14(a));
- (ii) provide more guidance to licensees and ensure their compliance with the condition that the use of net proceeds is accounted for in the financial statements (para. 4.14(c)); and
- (iii) take measures to facilitate public access to the lottery accounts (para. 4.14(d));

(d) **the Director of Food and Environmental Hygiene should:**

- (i) consider improving the administrative measures for monitoring on-street selling activities for charitable fund-raising purposes (para. 5.14(a));
- (ii) take measures to ensure that inspections on compliance with the licence conditions are carried out in accordance with laid-down guidelines (para. 5.14(d)(i)); and
- (iii) work in collaboration with the Director of Social Welfare and the Director of Lands to consider providing a one-stop service to streamline the processing and approvals of fund-raising activities involving on-street selling (para. 5.14(e)(ii)); and

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- (e) **the Secretary for Home Affairs should expedite the consultation with relevant B/Ds with a view to formulating a response to all the recommendations of the LRC Report for the Government's consideration (para. 6.11(a)).**

Response from the Government

- 21. The Government generally 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.

Charities in Hong Kong

1.2 Charities make an important contribution to Hong Kong, such as bringing communities together and providing transformational changes as well as caring services and support to meet the needs of some of the most vulnerable members of the community. Over the years, the Government has supported charities by providing them with tax-exemption status, land grants at nominal rent/premium, subventions, and allowing tax deduction for donors making donations to recognised tax-exempt charities (Note 1).

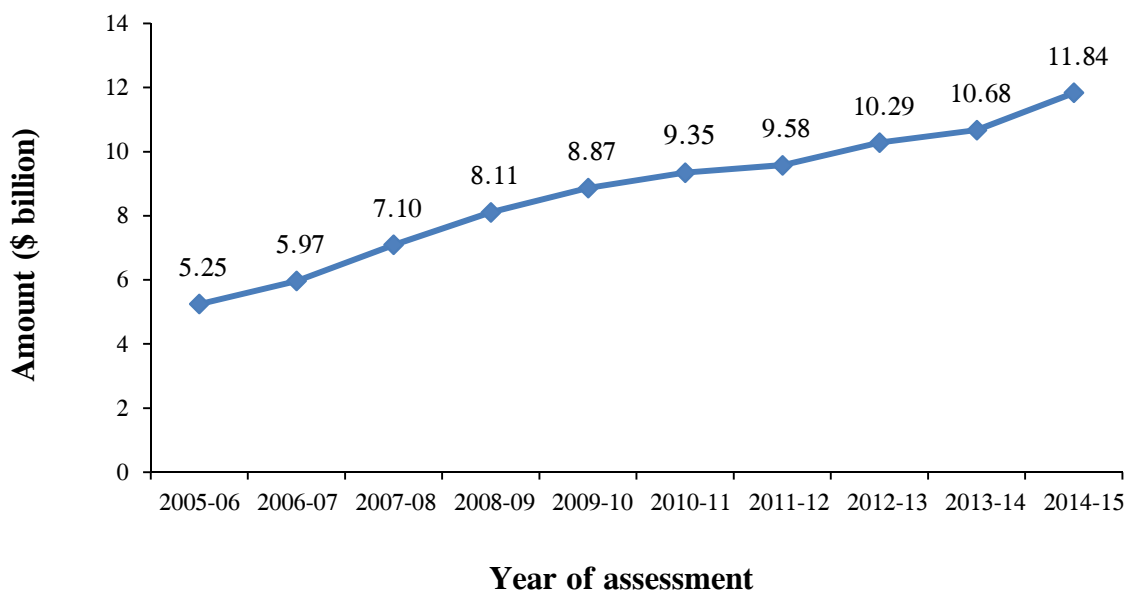
1.3 Funds raised by charities are significant and increasing in recent years. Figure 1 shows that the charitable donations allowed for tax deduction by the Inland Revenue Department (IRD) had increased from \$5.25 billion for the year of assessment 2005-06 to \$11.84 billion for 2014-15, or an increase of 126% in these ten years. Tax revenue foregone is estimated to be over \$1.5 billion in the year of assessment of 2014-15 (Note 2). There are no readily available statistics on the revenue foregone by the Government by providing tax exemption to charities.

Note 1: *Tax deduction for charitable donations has been provided since 1970 under the Inland Revenue Ordinance (Cap. 112 — first enacted in 1947). Sections 16D and 26C of the Ordinance allow a deduction for approved charitable donations made by a person during the year of assessment under profits tax and salaries tax/personal assessment respectively. The aggregate amount of donations deductible for the year should not be less than \$100 and should not exceed 35% of the total assessable profits/income (since the year of assessment 2008-09).*

Note 2: *The estimation is based on a standard tax rate of 15%.*

Figure 1

**Increasing amount of charitable donations allowed for tax deduction
(Years of assessment 2005-06 to 2014-15)**



Source: IRD records

Existing monitoring framework for charitable fund-raising activities

1.4 Fund-raising is an activity carried out by many charities and it often takes the charities into direct contact and dealings with members of the public. Charities are granted access to public areas to raise funds for their charity work. Currently, there is no legislation enacted specifically to control charitable fund-raising activities. The Government's regulation of certain charitable fund-raising activities is incidental to the legislation that controls nuisances committed in public places, gambling and hawking. Under the legislation, permits or licences are required for conducting charitable fund-raising activities in public places such as flag days and on-street charity sales, or involving sale of raffle tickets (hereinafter collectively referred to as "regulated charitable fund-raising activities"). However, other forms of fund-raising activities (such as charity auctions, balls, concerts, dinners, or requests for donations by mail or through advertisements) do not require a permit or a licence. The following departments are responsible for the monitoring of charitable fund-raising activities, depending on their nature:

- (a) ***Social Welfare Department (SWD).*** Under section 4(17)(i) of the Summary Offences Ordinance (Cap. 228), public subscription permits (PSPs) are required for any collection of money or sale or exchange for donations of badges, tokens or similar articles in public places (Note 3). The SWD issues PSPs for charitable fund-raising activities (Note 4). The PSPs issued by the SWD cover two types of charitable fund-raising activities in public places, namely flag days (Note 5) and general charitable fund-raising activities (Note 6);
- (b) ***Home Affairs Department (HAD).*** Under section 22 of the Gambling Ordinance (Cap. 148), the Office of the Licensing Authority of the HAD issues lottery licences (Note 7) to bona-fide organisations for the conduct and sale of fund-raising lottery tickets;

Note 3: *The term “public place” is defined in the Summary Offences Ordinance as “all piers, thoroughfares, streets, roads, lanes, alleys, courts, squares, archways, waterways, passages, paths, ways and places to which the public have access either continuously or periodically, whether the same are the property of the Government or of private persons”.*

Note 4: *The responsibility for issuing PSPs for non-charitable fund-raising activities in public places (e.g. raising funds for election expenses by political organisations) under section 4(17)(ii) of the Summary Offences Ordinance rests with the Home Affairs Bureau.*

Note 5: *Through an annual exercise, the SWD allocates some Wednesdays which fall on school or public holidays and Saturdays (except special festive days such as Hong Kong Special Administrative Region Establishment Day, in view of the difficulty in recruiting volunteers and/or possible inconvenience to the Hong Kong Police Force in keeping order in public places) to eligible charitable organisations for holding flag days, either on a territory-wide or regional basis. For a regional-based flag day, three permittees will each conduct flag sale activities in one of the three regions, viz. the Hong Kong Island region, the Kowloon region and the New Territories region. For a territory-wide flag day, one permittee will conduct flag sale activities in all three regions. The flag selling hours are from 7:00 am to 12:30 pm.*

Note 6: *General charitable fund-raising activities include charity sale of badges, tokens or similar articles, setting up of donation boxes at stationed counters, moving around solicitation with money-collection boxes/bags and door-to-door donation in public housing estates.*

Note 7: *In April 2012, the HAD took over the responsibility for issuing lottery licences from the former Television and Entertainment Licensing Authority which was merged with the former Office of the Telecommunications Authority to form the Office of the Communications Authority.*

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- (c) ***Food and Environmental Hygiene Department (FEHD).*** Under the Hawker Regulation (Cap. 132AI) of the Public Health and Municipal Services Ordinance (Cap. 132), the FEHD issues temporary hawker licences to persons authorised by:
- (i) charitable institutions or trusts of a public character exempt from tax under section 88 of the Inland Revenue Ordinance (IRO — Cap. 112) (hereinafter referred to as tax-exempt charities) for charitable fund-raising activities involving on-street selling of commodities; or
 - (ii) other non-profit-making organisations incorporated or registered under the laws of Hong Kong for fund-raising activities involving on-street selling of commodities for non-charitable or non-commercial purposes; and
- (d) ***Lands Department (Lands D).*** The Lands D grants approval for temporary occupation of unleased land to non-profit-making organisations wishing to set up booths or counters for conducting fund-raising activities.

1.5 Table 1 shows the numbers of permits and licences issued for charitable fund-raising activities for the period from April 2012 to September 2016.

Table 1

**Permits and licences issued for charitable fund-raising activities
(April 2012 to September 2016)**

Year	Type			
	PSP for		Lottery licence	Temporary hawker licence (Note 1)
	flag days	general charitable fund-raising activities		
	(Number)			
2012-13	117	400	66	222
2013-14	117	447	69	60
2014-15	117	376	68	41
2015-16	120	365	60	41
2016-17 (Up to September 2016)	116 (Note 2)	154 (Note 3)	23	10

Source: SWD, HAD and FEHD records

Note 1: The figures only included the temporary hawker licences issued to persons authorised by tax-exempt charities for charitable fund-raising activities. According to the FEHD, the number of all temporary hawker licences issued in 2011 was about 1,200 (of which over 90% were issued to tax-exempt charities). After the introduction of a limit on the number of licences issued for each fund-raising organisation within 12 months in July 2012 (see para. 5.5), there was a decrease in the number of licences issued.

Note 2: PSPs for flag days are issued to all successful organisations around December each year (see para. 3.2(a)). Up to September 2016, 65 flag-day fund-raising activities had been conducted.

Note 3: Up to March 2017, about 370 PSPs for general charitable fund-raising activities had been issued.

Previous audit review on monitoring of charities

1.6 In 1997, the Audit Commission (Audit) conducted a review of “Monitoring of charities: fund-raising and tax allowances” covering the Government’s procedures on monitoring of charitable fund-raising activities and those on administering tax exemptions. The results were reported in Chapter 4 of the Director of Audit’s Report No. 29 of October 1997. The Government accepted the audit recommendations for implementation.

Government’s efforts to enhance the transparency and accountability of charitable fund-raising activities

1.7 In the past years, the Government implemented various measures to enhance the transparency and accountability of charitable fund-raising activities, as follows:

- (a) ***Publication of best practices.*** In November 2004, the SWD promulgated the “Reference Guide on Best Practices for Charitable Fund-raising Activities” (Reference Guide) suggesting best practices in the areas of donors’ rights, fund-raising practices and financial accountability. It also updated the “Guidance Note on Internal Financial Controls for Charitable Fund-raising Activities” (Guidance Note — first issued in 1998) for voluntary adoption by charities. The Guidance Note sets out advice in respect of the safe custody of cash, and proper documentation of income and expenditure generated from charitable fund-raising activities (Note 8). In December 2014, the Reference Guide was updated to incorporate new guidance on donors’ rights and fund-raising practices (see para. 2.6 and Appendix A); and
- (b) ***One-stop finder for fund-raising activities.*** In July 2012, the Office of the Government Chief Information Officer (OGCIO) launched a one-stop finder on charitable fund-raising activities approved by the three licensing departments listed in paragraph 1.4(a) to (c) on the Government Portal

Note 8: *In October 2009, the Independent Commission Against Corruption also published the “Best Practice Checklist for the Management of Charities and Fundraising Activities” to help charities enhance internal governance, and transparency and accountability in fund-raising activities.*

“GovHK” to provide easy and convenient public access to such information on one single website.

1.8 The rapid rise in philanthropy (see para. 1.3) has highlighted the need to ensure that charitable organisations exercise good governance, stewardship, and ethical practices, and the monies collected are applied to their professed charitable purposes. From time to time, there have been public concerns over the adequacy of the Government’s monitoring of charitable organisations and their activities. The following are some examples:

- (a) at a meeting of the Legislative Council (LegCo) Panel on Welfare Services in April 2016, Members expressed concerns on various aspects of on-street fund-raising activities:
 - (i) it had become a trend to request donors to set up standing donation instructions (i.e. signing direct debit authorisation forms) and such mode of fund-raising could involve a large sum of money. The Government should study ways to regulate these activities;
 - (ii) some organisations would engage intermediaries to solicit donations and might be charged an unreasonable administrative fee. The Government should make public the names of the organisations which incurred an unreasonable administrative fee for their fund-raising activities and remind members of the public to stay vigilant when making donations; and
 - (iii) there was a need for the Government to implement the recommendations put forward by the Law Reform Commission (LRC — Note 9 and see para. 1.9), including the setting up of a platform of coordination in dealing with applications for charitable fund-raising licences among the relevant departments, and making

Note 9: *The LRC, established in January 1980, considers for reform those aspects of the laws of Hong Kong which are referred to it by the Secretary for Justice or the Chief Justice. Members of the LRC are appointed by the Chief Executive of the Hong Kong Special Administrative Region and include academics, practising lawyers, and prominent members of the community.*

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improvements to the existing mechanism for overseeing fund-raising activities;

- (b) there was a media report in January 2017 alleging that some organisations incurred high administration and fund-raising costs. In this connection, a LegCo Member expressed concern on the lack of government control on charities; and
- (c) over the years, the SWD has been receiving enquiries/complaints from the public on fund-raising activities. According to the SWD, from April 2012 to September 2016, 46 (5%) of 891 such enquiries/complaints received were suspected cases of illegal fund-raising activities and were referred to the Hong Kong Police Force (HKPF) for further investigation.

An effective monitoring framework has an important role to play in enhancing the governance standards of charities and ensuring that they uphold accountability and transparency for the donations they received.

Law Reform Commission Report on Charities

1.9 In view of the wide discussion by the community on the need for greater monitoring of charitable organisations, in June 2007, the Chief Justice and the Secretary for Justice asked the LRC to review the subject. In December 2013, after completing a public consultation in 2011, the LRC published a Report on Charities (LRC Report) with a number of recommendations, including the definition and registration of charities, facilitation of good practice, financial reporting by charities and filing requirements (and requirement of display of registration number) for charitable fund-raising activities. In particular, the LRC Report recommended that all charitable organisations should be subject to the requirement of registration and a platform of coordination in dealing with applications for licences of charitable fund-raising activities among the relevant departments should be set up. Given that the recommendations touched on areas which fell within the policy responsibilities of several bureaux, the Home Affairs Bureau (HAB) has been tasked to coordinate inputs from relevant bureaux/departments (B/Ds) for formulating a response to the LRC's recommendations for the Government's consideration.

Audit review

1.10 Against the above background, in October 2016, Audit commenced a review on the Government's support and monitoring of the rapidly expanding charity sector and their charitable fund-raising activities. The audit findings are contained in two Audit Reports, namely the monitoring of charitable fund-raising activities (the subject matter of this Audit Report) and the Government's support and monitoring of charities (in Chapter 1 of the Director of Audit's Report No. 68).

1.11 This Audit Report focuses on the following areas:

- (a) Government's efforts to promote transparency and accountability of charitable fund-raising activities (PART 2);
- (b) administration of public subscription permits for charitable fund-raising activities (PART 3);
- (c) administration of lottery licences for charitable fund-raising activities (PART 4);
- (d) administration of temporary hawkker licences for fund-raising activities involving on-street selling (PART 5); and
- (e) way forward (PART 6).

General response from the Government

1.12 The Secretary for Home Affairs, the Director of Home Affairs and the Director of Food and Environmental Hygiene generally agree with the audit recommendations.

1.13 The Director of Social Welfare welcomes Audit's review on the SWD's monitoring of charitable fund-raising activities in public places and generally agrees with the recommendations on enhancing the transparency and accountability of charitable fund-raising activities and strengthening the administrative measures in regulating these activities.

Acknowledgement

1.14 Audit would like to acknowledge with gratitude the assistance and full cooperation of the staff of the HAB, the SWD, the HAD, the FEHD, the Lands D and the OGCIO during the course of the audit review.

PART 2: GOVERNMENT'S EFFORTS TO PROMOTE TRANSPARENCY AND ACCOUNTABILITY OF CHARITABLE FUND-RAISING ACTIVITIES

2.1 This PART examines the Government's efforts in promoting transparency and accountability of charitable fund-raising activities, focusing on:

- (a) voluntary adoption of best practices for organising fund-raising activities by charities (paras. 2.7 to 2.15); and
- (b) usage of the one-stop finder (paras. 2.16 to 2.18).

Voluntary system to enhance transparency and accountability

2.2 To promote Hong Kong as a caring society and a community supportive of charitable causes, the Government keeps regulatory procedures to a minimum to facilitate charitable organisations to attract community resources to fund their charitable causes. However, from time to time, there were some concerns over fund-raising practices and the proper use of funds raised.

2.3 Under existing legislation, the Government's monitoring of charitable fund-raising activities is only confined to those carried out in public places or involving lotteries where permits or licences are required and administered by the SWD, the HAD or the FEHD (i.e. regulated charitable fund-raising activities). Other forms of fund-raising activities (such as on-street face-to-face solicitation of regular donations (by means of signing direct debit authorisation forms), charity auctions, balls, concerts, dinners, sales, walks, film premieres, and appeals for donations by mail, phone advertisements, mass media and the Internet) do not require a permit or a licence (see para. 1.4).

2.4 In Chapter 4 of the Director of Audit's Report No. 29 of October 1997 on the audit review of "Monitoring of charities: fund-raising and tax allowances" (see para. 1.6), Audit expressed concern over the inadequacy of government control over charitable fund-raising activities and recommended that the Government should expedite action on implementing a scheme of control over fund-raising activities.

Government's efforts to promote transparency and accountability of charitable fund-raising activities

The Public Accounts Committee of LegCo in its 1998 Report also expressed concern on the issue. To take the recommendation forward, the Government decided in September 2002 that:

- (a) administrative controls should be strengthened with a view to enhancing transparency and accountability of fund-raising activities, instead of formulating legislative proposals as legislation would entail onerous bureaucracy and resource implications given the small number of problematic cases;
- (b) the administrative measures should enable donors to make an informed choice when making donations; and
- (c) the SWD would revisit the Guidance Note issued in 1998 (see para. 1.7(a)) and encourage voluntary compliance by charities and consider setting up a Public Register of charitable fund-raising organisations which had pledged and demonstrated compliance with a guide on the best fund-raising practices. This would include disclosing the intended purposes and beneficiaries of the donations and the percentage of donations used for administration costs (i.e. the Reference Guide subsequently promulgated by the SWD in 2004 — see para. 2.6).

2.5 In February 2003, the Ombudsman published a report of a direct investigation into the monitoring of charitable fund-raising activities, which also recommended the Government drawing up a Reference Guide for charities and setting up the proposed Public Register, as a voluntary system to enhance transparency and accountability of charitable fund-raising activities. The Report also recommended that the Government should in the longer term, review the adequacy and appropriateness of government control in monitoring charities in general and their fund-raising activities in particular. After a public consultation exercise from August to September 2003, the Government informed the LegCo Panel on Welfare Services in July 2004 that:

- (a) the SWD would draw up a Reference Guide covering best practices on areas of donors' rights, fund-raising practices and accounting/auditing requirements for voluntary adoption by charities. The Reference Guide would encourage charities to disclose more of their financial information and to minimise the fund-raising costs. Charities which voluntarily adopted the Reference Guide might choose to adhere to all or part of the

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Guide. The Guide could also serve as a reference for the public in gauging the performance of a charity in fund-raising;

- (b) the proposed Public Register would not be considered at that stage as a voluntary registration system would not be able to help the public identify the so-called “dubious” charities. If a compulsory registration system was introduced, stringent vetting and review procedures had to be put in place which would have considerable resource implications. Furthermore, the procedures and the need to ensure cost recovery for such a system might inadvertently stifle the fund-raising activities, in particular small-scale charities; and
- (c) the SWD would proceed to issue the updated Guidance Note (which included advice on safe custody of cash, and proper documentation of income and expenditure generated from charitable fund-raising activities) in conjunction with the launch of the Reference Guide.

2.6 ***Reference Guide and Guidance Note.*** The Reference Guide which contained 21 best practices on donors’ rights, fund-raising practices and accounting/auditing requirements was promulgated by the SWD in November 2004, together with the updated Guidance Note. In September 2006, the SWD conducted a review on the effectiveness of the Reference Guide by means of a survey of the charities. Based on the survey results, the SWD concluded that the voluntary adoption of the Reference Guide was effective in enhancing transparency and accountability of the fund-raising activities. In December 2014, the Reference Guide was updated with new guidance on donors’ rights and fund-raising practices, such as providing donors with charitable service records and providing due care to fund-raisers with specific needs (e.g. elderly and children). Some of the major best practices and internal financial controls specified in the Reference Guide and the Guidance Note are shown at Appendices A and B respectively.

Voluntary adoption of best practices for organising fund-raising activities by charities

2.7 Since the promulgation of the Reference Guide in November 2004, the SWD has taken actions to promote the voluntary adoption of the Guide by charities. In early years, the SWD issued the Guide to all charities which had obtained subvention from the SWD or those which had applied for PSPs. The SWD also

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prepared printed copies of the Guide for distribution by other B/Ds, such as the Education Bureau for schools and the Leisure and Cultural Services Department for the general public visiting public libraries, museums and cultural centres (Note 10). Furthermore, the SWD has uploaded the Guide onto its website and solicited charitable organisations' support for the voluntary adoption of the Reference Guide.

2.8 To understand the extent of voluntary adoption of the Reference Guide, the SWD has collected information from charitable organisations through various channels:

- (a) in November 2004, the SWD issued letters to charities under its purview appealing for their adoption of the Guide and requesting them to indicate their choices. Similar letters to charitable organisations appealing for adopting the Guide were also uploaded onto the SWD's website shortly after the promulgation of the Guide in 2004;
- (b) the SWD has also made use of the acknowledgement letters of PSP applications to request applicant organisations to indicate whether they would adopt the Reference Guide; and
- (c) the SWD has since 2010 issued letters annually to invite charities (which have not responded to its requests in (a) and/or (b)) to provide information on whether they would adopt the Reference Guide. Up to September 2016, 116 organisations had replied to these annual invitations.

2.9 Up to September 2016, the SWD had invited 961 charitable organisations to provide information on adopting the Reference Guide and received responses from 426 organisations. Among these 426 responding organisations, 400 had indicated that they would adopt the Guide. As shown in Table 2, the number of

Note 10: *In connection with the public consultation on the Reference Guide (see para. 2.5), in August 2003, the SWD sought the IRD's assistance in issuing a circular letter to the tax-exempt charities for soliciting their views. However, owing to the official secrecy provision of the IRO, the IRD, based on the advice of the Department of Justice, considered it inappropriate to distribute the circular letter on the SWD's behalf. Thereafter, the SWD had not approached the IRD for assistance in distributing the Reference Guide to the tax-exempt charities.*

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organisations fully or partially adopting the Reference Guide had increased by 56% from 256 in April 2006 to 400 in September 2016.

Table 2

Number of charitable organisations adopting the Reference Guide (April 2006 and September 2016)

Charitable organisations	April 2006 (Note)	September 2016
	(No.)	
Informing the SWD of their extent of adoption	279	426
Fully adopting the Reference Guide	225 (81 %)	360 (85 %)
Partially adopting the Reference Guide	31 (11 %)	40 (9 %)
Total	256 (92 %)	400 (94 %)
Not adopting the Reference Guide	23 (8 %)	26 (6 %)

Source: SWD records

Note: The SWD has maintained statistics on the adoption of the Reference Guide since January 2005.

2.10 Audit selected 40 tax-exempt charities which solicited public donations to examine whether they had published their financial information (e.g. annual reports or annual audited financial statements) on their websites for reference by members of the public. Audit found that as at February 2017:

- (a) 23 (58% of 40) tax-exempt charities had indicated to the SWD that they would adopt the Reference Guide. Of the 23 tax-exempt charities, 21 (91%) had published their financial information on their websites; and

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- (b) the other 17 (42% of 40) tax-exempt charities either had indicated to the SWD that they would not adopt the Reference Guide, had not replied to or had not been contacted by the SWD. Of these 17 tax-exempt charities, only 4 (24%) had published their financial information on their websites.

There was a high correlation between those charities which had indicated adoption of the Reference Guide and the publication of their financial information on their websites.

Need to further promote the recognition and voluntary adoption of best practices

2.11 ***Rapidly expanding charity sector.*** Over the past 10.5 years, the number of tax-exempt charities had doubled from 4,435 in March 2006 to 8,923 in September 2016. The charitable donations allowed for tax deduction had also increased by 126% from \$5.25 billion for the year of assessment 2005-06 to \$11.84 billion for 2014-15 (see para. 1.3). Most of the tax-deductible charitable donations were raised by fund-raising activities that did not require a permit or a licence (see para. 1.4). By comparison, in 2014-15, proceeds raised from regulated charitable fund-raising activities approved by the SWD and the HAD totalled \$282 million only (Note 11). Most of the charitable donations collected through these regulated fund-raising activities do not meet the criteria for claiming tax deduction under the IRO. For example, purchases of lottery tickets and commodities on sale at public places for charitable purposes under the lottery licences and the temporary hawker licences respectively are not tax deductible because they are not pure donations without benefits in return. For flag days, receipts are not given for donations raised through street collections generally because of their small amounts and therefore, such donation claims will not be recognised for tax deduction purpose.

Note 11: *The FEHD has not maintained records of funds raised by charities issued with temporary hawker licences for selling activities in public places.*

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2.12 *Other forms of fund-raising activities not subject to Government's monitoring.* In recent years, the mode of fund-raising has been evolving rapidly and it is no longer limited to traditional means such as setting up of cash donation boxes. Appeals for donations through the Internet and face-to-face solicitation of regular donations in public places by means of signing direct debit authorisation forms (see Photograph 1) are examples of other fund-raising activities not subject to the Government's monitoring (Note 12).

Photograph 1

Face-to-face solicitation of regular donations in public places
by means of signing direct debit authorisation forms



Source: Photograph taken by Audit on 9 December 2016

Note 12: According to the SWD, based on the legal interpretation of the wording of “collection of money” used in the Summary Offences Ordinance, face-to-face solicitation of regular donations in public places by means of signing direct debit authorisation forms does not require a PSP as it does not involve collection of money on the spot (see Note 19 to para. 3.9(c)).

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2.13 The Lands D grants approval for temporary occupation of unleased land to non-profit-making organisations for conducting fund-raising activities (see para. 1.4(d)). Audit analysed the number of multi-district applications for temporary occupation of unleased land made to the Lands D for setting up booths or counters for charitable fund-raising activities from January to December 2016. Audit noted that 194 (77%) of 252 multi-district applications were for conducting face-to-face solicitation of regular donations in public places by means of signing direct debit authorisation forms. Among the 18 applicants involved in these 194 applications, only 6 (33%) had adopted the Reference Guide. At a meeting of the LegCo Panel on Welfare Services in April 2016, a Member expressed the view that solicitation of regular donations in public places by means of signing direct debit authorisation forms had become a trend and could involve a large sum of money, and hence the Government should study ways to regulate these activities (see para. 1.8(a)(i)).

2.14 *Room for improvement in promoting best practices for organising charitable fund-raising activities.* Audit examination of the Government's efforts on promotion of the Reference Guide has revealed the following areas for improvement:

- (a) although the Reference Guide was updated in December 2014, the Government has not launched any large-scale promotional programmes to enhance the awareness and recognition of the Reference Guide among the charitable organisations and the general public;
- (b) from 2004 to September 2016, the SWD reached out to 961 charitable organisations (which were PSP applicants or SWD subvented organisations) in promoting the adoption of the Reference Guide. Given that there were 8,923 tax-exempt charities (see para. 2.11), the SWD may consider seeking the assistance of relevant B/Ds for the purpose of achieving wider promotion and recognition of the best practices for fund-raising. For example, as 83% of the tax-exempt charities were registered as companies or societies, the SWD may make use of contact information available from the Companies Registry and the HKPF in this regard; and
- (c) after the SWD's review of the effectiveness of the Reference Guide through a survey of the charities conducted in September 2006 (see para. 2.6), similar review has not been conducted for over ten years.

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With the lapse of time, the SWD needs to consider conducting another review to evaluate the effectiveness of the Reference Guide in achieving the Government's objective of enhancing the transparency and accountability of charitable fund-raising activities in public places (see para. 2.4(a)).

In Audit's view, there should be concerted efforts among the three licensing departments to promote the public awareness and the charitable organisations' adoption and recognition of the best practices for organising charitable fund-raising activities.

2.15 *Need to incorporate more guidance on other forms of charitable fund-raising activities.* While the Reference Guide was last updated in December 2014, there had not been any revision of the Guidance Note after its promulgation in November 2004. The SWD needs to review and update the Guidance Note and the Reference Guide in light of the changed circumstances. Given the increased use of on-street face-to-face solicitation of regular donations and social media on the Internet for fund-raising, there is a need to incorporate more guidance on other forms of fund-raising activities in the publications of best practices for organising charitable fund-raising activities as far as practicable. In this connection, Audit has noted that:

- (a) the Face-to-Face Monthly Giving Alliance, set up under the Hong Kong Council of Social Service, has issued the "Code of Practice on Face-to-Face Monthly Donors' Recruitment", with some requirements tailor-made for new forms of donations. For example, when soliciting regular donations, the charitable organisations must inform potential donors of the procedures to amend their donation instructions (such as cancelling or changing the frequency of donations). Currently, the Reference Guide only advises charitable organisations to respond promptly to a donor's request to amend the donor's standing donation instruction and take all reasonable steps to facilitate such amendment upon request by the donor; and
- (b) in respect of financial controls on donations made online which involve electronic payment service providers, the guidelines issued by the Fundraising Institute Australia state that charitable organisations need to ensure that the service provider maintains a separate bank account into which all donations are to be deposited and puts in place policies for data

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protection (including financial information security). Currently, the Guidance Note does not have any similar provision in this regard.

According to the SWD, there have been ongoing inter-departmental discussions on possible enhancement of the Reference Guide for general application to fund-raising activities in the context of the HAB's coordination of B/D's inputs for formulating the Government's response to the LRC's recommendations (see para. 1.9). In this connection, Audit considers that there is a need to incorporate more guidance on other forms of fund-raising activities in the publications of best practices for organising charitable fund-raising activities as far as practicable.

Usage of the one-stop finder

2.16 In July 2012, a one-stop finder (www.gov.hk/fundraising) on charitable fund-raising activities approved by the SWD, the HAD and the FEHD was launched on the government portal "GovHK" to provide easy and convenient access to such information. The finder puts together information on the regulated charitable fund-raising activities managed by the three licensing departments to enhance public awareness and facilitate monitoring of these activities. The public can browse the list of approved activities of the day or search the activity details by date, location and organisation. The finder is also optimised for display on mobile devices. The general public can check whether the on-street charitable fund-raising activities they chance upon have been approved by the relevant departments.

Low usage of the one-stop finder

2.17 Audit analysed the hit rates of the web pages of the one-stop finder. As shown in Table 3, the usage of the one-stop finder had been on the low side and on a decreasing trend, i.e. the average daily hit rates had decreased by 77% from 275 in 2012-13 (from July 2012) to 62 in 2016-17 (up to October 2016).

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accountability of charitable fund-raising activities**

Table 3

**Hit rates of the web pages of the one-stop finder
(July 2012 to October 2016)**

Web page	Average number of daily hit rates					
	2012-13 (from July 2012)	2013-14	2014-15	2015-16	2016-17 (up to October 2016)	Percentage decrease from July 2012 to October 2016
Flag days	34	14	14	11	9	74%
General charitable fund-raising activities	38	15	12	9	8	79%
Lottery events	34	12	10	9	7	79%
On-street selling activities	148	38	32	25	24	84%
Searching fund-raising activities	21	15	15	10	14	33%
Overall	275	94	83	64	62	77%

Source: Audit analysis of one-stop finder log records

2.18 Since the launch of the one-stop finder in July 2012, various departments have made publicity efforts to promote the service, as follows:

- (a) the Information Services Department published a press release and the HKPF published one article in Police Magazine (which was also broadcast via television programme “Police Report”) on the launch of the one-stop finder in July 2012;

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- (b) since 2013-14, the SWD has produced publicity materials (e.g. posters) to promote the website link of the one-stop finder;
- (c) since 2014-15, the SWD has required printing the Quick Response Code (commonly known as the QR code) to the one-stop finder on all PSPs and publicity items;
- (d) in 2013, the OGCIO launched a mobile application, namely "EventHK", to provide information including the fund-raising activities approved by the licensing departments; and
- (e) the SWD has taken opportunities to promote the one-stop finder in its verbal/written replies to enquiries and/or complaints from members of the public, mass media as well as LegCo Members and District Councillors.

In view of the decreasing usage of the one-stop finder (see para. 2.17), the relevant departments responsible for uploading charitable fund-raising information (i.e. the SWD, the HAD and the FEHD) onto the one-stop finder need to consider stepping up or renewing their publicity efforts to raise the public awareness of the service.

Audit recommendations

2.19 **Audit has *recommended* that:**

- (a) **the Director of Social Welfare, the Director of Home Affairs and the Director of Food and Environmental Hygiene should:**
 - (i) **launch large-scale promotional programmes to enhance the awareness and recognition among the charitable organisations and the general public on the best practices for organising charitable fund-raising activities;**
 - (ii) **step up promotion efforts to encourage more charitable organisations in adopting the best practices for organising charitable fund-raising activities and endeavour to reach out to more organisations by seeking assistance from relevant B/Ds to provide their contact information;**

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- (iii) **incorporate more guidance on other forms of fund-raising activities in the publications of best practices for organising charitable fund-raising activities as far as practicable; and**
 - (iv) **consider stepping up or renewing the publicity efforts to raise public awareness of the one-stop finder service on charitable fund-raising activities on the government portal “GovHK”;**
- (b) **the Director of Social Welfare should:**
 - (i) **conduct a review of the effectiveness of the Reference Guide to evaluate the extent of achieving the Government's objective of enhancing transparency and accountability of charitable fund-raising activities in public places; and**
 - (ii) **review and update the Reference Guide and the Guidance Note in light of the changed circumstances; and**
- (c) **the Secretary for Home Affairs should take into consideration the recommendations in (a) and (b) in coordinating inputs from relevant B/Ds for the Government's consideration of the response to the LRC's recommendations.**

Response from the Government

2.20 The Director of Social Welfare agrees with the audit recommendations in paragraph 2.19(a) and (b). She has said that the SWD will conduct a survey to collate views for reviewing and updating the Reference Guide and the Guidance Note.

2.21 The Director of Home Affairs agrees with the audit recommendations in paragraph 2.19(a). She has said that the HAD is prepared to work with the SWD and the FEHD on the feasibility of the proposed measures.

Government's efforts to promote transparency and accountability of charitable fund-raising activities

2.22 The Director of Food and Environmental Hygiene generally agrees with the audit recommendations in paragraph 2.19(a). She has said that the FEHD will continue to work in collaboration with the SWD and the HAD in this regard and continue to take part in the inter-departmental discussions mentioned in paragraph 2.15 concerning on-street hawking activities.

2.23 The Secretary for Home Affairs accepts the audit recommendation in paragraph 2.19(c).

PART 3: ADMINISTRATION OF PUBLIC SUBSCRIPTION PERMITS FOR CHARITABLE FUND-RAISING ACTIVITIES

3.1 This PART examines the work of the SWD in administering PSPs issued for charitable fund-raising activities, focusing on:

- (a) processing of applications (paras. 3.8 to 3.10);
- (b) compliance with permit conditions (paras. 3.11 to 3.14); and
- (c) monitoring of charitable fund-raising activities under PSPs (paras. 3.15 to 3.24).

Public subscription permits

3.2 The Summary Offences Ordinance consolidates the law relating to summary offences including nuisances committed in public places. According to section 4(17)(i) of the Ordinance, any person who organises, provides equipment for, or participates in any collection of money or sale or exchange for donations of badges, tokens or similar articles in public places for charitable purposes is required to apply for a permit (i.e. PSP) issued by the Director of Social Welfare. Headed by a Chief Executive Officer, the Lotteries Fund Projects Section (Note 13) under the Subventions Branch of the SWD (see Appendix C for an extract of the SWD's organisation chart) is responsible for issuing PSPs in respect of two types of charitable fund-raising activities:

- (a) ***Flag days.*** The SWD conducts an annual exercise to invite and approve charities to hold flag days to raise funds for their charitable projects (see Note 5 to para. 1.4(a)). Invitation for applications is advertised on newspapers and via the SWD's website in April or May each year. An applicant organisation must be a bona-fide non-profit-making organisation

Note 13: *The Lotteries Fund Projects Section is mainly responsible for administering the Lotteries Fund grants to meet the capital costs of welfare projects. About 10 staff are allocated to the processing and monitoring of PSPs.*

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exempted from tax under the IRO. Applications with details of the projects/services to be funded by the flag sale and breakdown of the usage of target net proceeds from flag-day fund-raising are considered and endorsed by the Lotteries Fund Advisory Committee (LFAC — Note 14) around September. When the number of applications received exceeds the number of flag days available for allocation, there will be a drawing of lots to decide on the successful organisations. Eligible applicant organisations will be invited to witness the lots drawing which determines the order of priority for their selection of flag days. The SWD issues PSPs to successful organisations around December each year. Table 4 shows the number of PSPs issued and proceeds raised for flag days from April 2012 to September 2016; and

- (b) ***General charitable fund-raising activities.*** These activities cover charity sale of badges, tokens or similar articles, door to door donation in public housing estates, setting up of donation boxes in stationed counters, charity ride, and passing of offering bags. Applications for PSPs for holding general charitable fund-raising activities in public places can be submitted throughout the year. An applicant organisation must possess a valid registration under the Companies Ordinance (Cap. 622), or the Societies Ordinance (Cap. 151), or be a tax-exempt charity. In submitting an application to the SWD, the applicant organisation should provide relevant supporting documents together with information on the time, duration, locations, products for sale and purposes of the fund-raising activities at least three weeks before the commencement of the activities. The validity period of the PSP issued by the SWD depends on the nature of the activities (Note 15). Table 5 shows the number of PSPs issued and proceeds raised for general charitable fund-raising activities from April 2012 to September 2016.

Note 14: *The LFAC is chaired by the Director of Social Welfare, and comprises representatives from the Labour and Welfare Bureau and members from the social welfare, academic, professional and business sectors as appointed by the Secretary for Labour and Welfare. It is the advisory body to the SWD in advising the Director of Social Welfare on applications for allocations from the Lotteries Fund and on charitable fund-raising activities. The LFAC holds meetings once every two months.*

Note 15: *For example, the validity period of PSPs for setting up fixed donation boxes at locations (such as hospitals) can be up to one year, while that of PSPs for moving around solicitation with donation boxes/bags varies depending on various factors including the consent of the management authority of the venue for the fund-raising activities.*

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Table 4

**Number of PSPs issued and proceeds raised for flag days
(April 2012 to September 2016)**

Flag days		Year				
		2012-13	2013-14	2014-15	2015-16	2016-17 (Up to September 2016) (Note)
Territory- wide	Eligible applications (No.)	60	60	65	61	63
	PSPs issued (No.)	30	30	30	30	29
	Gross proceeds (\$ million)	63	59	60	64	13
	Net proceeds (\$ million)	59	55	56	60	12
Regional	Eligible applications (No.)	142	143	135	133	135
	PSPs issued (No.)	87	87	87	90	87
	Gross proceeds (\$ million)	54	54	54	55	19
	Net proceeds (\$ million)	51	51	50	52	17
Total	Eligible applications (No.)	202	203	200	194	198
	PSPs issued (No.)	117	117	117	120	116
	Gross proceeds (\$ million)	117	113	114	119	32
	Net proceeds (\$ million)	110	106	106	112	29

Source: Audit analysis of SWD records

Note: Among the 116 PSPs issued, 65 flag-day fund-raising activities had been conducted up to 30 September 2016, and information on gross and net proceeds of 43 activities had been submitted to the SWD (see para. 3.4(a)).

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Table 5

**Number of PSPs issued and proceeds raised for
general charitable fund-raising activities
(April 2012 to September 2016)**

Year	General charitable fund-raising activities		
	PSPs	Gross proceeds	Net proceeds (Note 1)
	(No.)	(\$ million)	(\$ million)
2012-13	400	115	82
2013-14	447	90	74
2014-15	376	78	62
2015-16	365	69	53
2016-17 (Up to September 2016)	154 (Note 2)	8	4

Source: Audit analysis of SWD records

Note 1: For the deficit cases where expenses exceeded gross proceeds (see Note 1 to Table 6 in para. 3.18), the deficits were not counted towards the total net proceeds for each year.

Note 2: Up to 30 September 2016, among the 154 PSPs issued, fund-raising activities approved under 108 PSPs had been completed and information on gross and net proceeds of 54 activities had been submitted to the SWD (see para. 3.4(a)).

3.3 Based on the figures for 2012-13 to 2015-16 in Tables 4 and 5, for flag days, the number of PSPs issued averaged 118 each year, and the gross proceeds raised averaged \$2 million for each territory-wide flag day and \$0.6 million for each regional flag day. For general charitable fund-raising activities, the number of PSPs issued and the gross proceeds raised averaged 397 each year and \$0.22 million for each PSP respectively.

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3.4 ***Permit conditions.*** To ensure the proper conduct and financial accountability of charitable fund-raising activities, various conditions governing the operation and accountability are stipulated in the PSPs for both flag days and general charitable fund-raising activities. For example, regarding the operation of general charitable fund-raising activities, permittees should display the permits prominently at approved locations to inform the public of the SWD's approval. Regarding accountability, the salient permit conditions stipulate that:

- (a) the permittee shall be accountable for the funds raised and disbursement made in relation to the PSP. It is required to prepare an income and expenditure account, including all the income from public donation and a detailed breakdown of each disbursement item for audit by a Certified Public Accountant (CPA). The report prepared in accordance with Practice Note 850 issued by the Hong Kong Institute of Certified Public Accountants (HKICPA) is deemed acceptable for compliance with the relevant permit conditions by the SWD. The income and expenditure account together with the auditor's report (collectively referred to as the audited report by the SWD) should be submitted to the SWD within 90 days of the last event day;
- (b) within 90 days of the last event day, the permittee shall cause the balance of the donations (after deducting any expenses incurred) to be (i) used for the purposes specified in the permit; or (ii) credited to a bank account; and
- (c) within 90 days of the last event day, the permittee shall publish the audited report either on its website, in its annual report, newsletter or special circular to its members.

3.5 PSP permittees are required to comply with the permit conditions. Whenever non-compliance is substantiated, the SWD will issue written reminders/warnings to the permittees concerned. For permittees which fail to submit the audited report according to permit conditions, the SWD will suspend their new PSP applications until all the required documents are received and checked in order. If the audited report is still outstanding after the issue of written reminders/warnings by the SWD, the non-compliant permittee will be put on a withholding list, i.e. the processing of its new PSP applications, if any, will be

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withheld. For serious violation, the SWD will revoke its ongoing PSPs. For cases that are suspected to have contravened the law (Note 16), the SWD will refer them to the HKPF for investigation (see para. 1.8(c)). For flag-day applications, the eligibility of applicant organisations with outstanding audited reports or record of delay in submission of audited reports will be considered by a vetting panel set up by the LFAC during the annual allocation exercise.

3.6 SWD's monitoring mechanism. The SWD has developed a monitoring mechanism to ensure that flag days and general charitable fund-raising activities in public places are conducted in a proper manner. The monitoring measures include:

- (a) setting conditions in the PSPs for compliance by permittees (see para. 3.4). The purposes of these permit conditions are mainly to maintain order and discipline in public places during the fund-raising events and to improve the transparency and accountability of their activities;
- (b) putting in place a complaint mechanism to address non-compliance with permit conditions and unauthorised fund-raising activities. As mentioned in paragraph 3.5, the SWD will either issue written reminders/warnings to permittees, revoke the PSPs issued or suspend issuing new PSPs to non-compliant permittees (Note 17). Since 2015, to step up monitoring of general charitable fund-raising activities, the SWD has also been conducting random on-site inspections (see para. 3.14) and sample checking of annual audited financial statements of selected permittees to ensure their proper use of proceeds upon completion of fund-raising activities; and
- (c) encouraging charitable organisations to adopt the Reference Guide and the Guidance Note in organising flag days and general charitable fund-raising activities (see para. 2.6).

Note 16: *According to section 4 of the Summary Offences Ordinance, any person who without lawful authority or excuse carries out fund-raising activities in public places except under and in accordance with the PSPs shall be liable to a fine of \$2,000 or to imprisonment for 3 months.*

Note 17: *Of the 103 complaints received from April 2015 to September 2016, written reminders/alert letters/warning letters were issued for 33 (32%) cases.*

3.7 *Measures to enhance transparency and accountability of fund-raising activities.* With the increasing public concern and expectation of the transparency and accountability of charitable fund-raising activities, the SWD, on the advice of the LFAC, has regularly reviewed the monitoring mechanism. Improvement measures to step up controls and monitoring of fund-raising activities arising from these reviews included the following:

- (a) in August 2011, “six administrative measures” were implemented requiring, among other things, permittees to publish audited reports of the approved fund-raising activities on their websites or through other means (see para. 3.4(c)), and to make available these documents for public inspection upon request;
- (b) in April 2014, another “five new initiatives” came into effect. For establishing a structured vetting mechanism with reference to the track record of PSP applicants, applicant organisations should submit in their applications a three-year track record of their charitable activities together with their annual audited financial statements for vetting by the SWD; and
- (c) in January 2017, the LFAC endorsed further measures to promote easy identification of approved activities and enhance financial transparency. In particular, fund-raisers need to wear identity badges during the fund-raising activities, and charitable organisations need to report donation income received in respect of the approved PSP activities in their annual audited financial statements. Charitable organisations are encouraged to upload their annual audited financial statements onto their websites for public inspection. These measures are expected to be implemented within the second quarter of 2017.

Processing of applications

Need to issue guidelines on the scope of PSP

3.8 Under the Summary Offences Ordinance, a PSP is required only if the activities involve collection of money or sale or exchange for donations of badges, tokens or similar articles in public places (see para. 3.2). In processing PSP applications, the SWD needs to ensure that the charitable fund-raising activities to be organised fall within the scope of such statutory requirement. According to the SWD, given the wide varieties of fund-raising activities and the changes in their

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modes of collection of donations, the SWD has from time to time sought the Department of Justice (DoJ)'s advice on whether a particular PSP application based on its individual circumstances is under the scope of the Ordinance. In this connection, the Lotteries Fund Projects Section of the SWD has since 1988 maintained a database of legal advice obtained on fund-raising activities to provide useful reference for its staff in processing PSP applications.

3.9 According to the database, up to September 2016, the SWD had obtained the DoJ's advice for about 300 times mainly on the interpretation of the following legal terms of the Summary Offences Ordinance as applicable to individual PSP applications:

- (a) whether the venue under application fell within the definition of a "public place" under the Ordinance (Note 18);
- (b) whether the charity sale items under application constituted "badges, tokens, or similar articles"; and
- (c) whether the transaction under application involved "collection of money" (Note 19).

3.10 Audit noted that the number of requests for the DoJ's clarification had decreased in recent years, totalling 21 from 2012-13 to 2015-16, indicating that the SWD had built up the experience in processing PSP applications based on the database of past legal advice obtained. Drawing on this experience, the SWD should explore the feasibility of issuing more guidelines for reference by applicants, and in this connection seek further legal advice from the DoJ where appropriate. This would facilitate charitable organisations in determining the relevance of PSP to

Note 18: *According to the SWD, based on the DoJ's advice, whether a place is a "public place" may be subject to interpretations. For example, it may depend on accessibility to the public to determine if it can be classified as a "passage" in the Ordinance.*

Note 19: *The meaning of "collection of money" is not defined in the Summary Offences Ordinance. The DoJ had advised the SWD that only effecting of payment (including cash and electronic payment) on the spot was under the scope of PSPs.*

their activities before filing their applications which in turn would help the SWD reduce its workload on processing unwarranted applications.

Compliance with permit conditions

3.11 Permittees' compliance with the permit conditions is important to ensure the proper conduct and accountability of charitable fund-raising activities. Audit's examination of the general charitable fund-raising activities with PSPs issued from April 2012 to September 2016 has revealed cases of non-compliance, as elaborated in paragraphs 3.12 to 3.14.

3.12 *Delays in submission of audited reports.* The requirement on filing audited reports on time is intended to enhance the transparency and accountability of the charitable organisations in relation to the funds they raised from the public. Permittees are required to submit audited reports within 90 days of the last event day (see para. 3.4(a)). From April 2012 to September 2016, audited reports for 1,497 cases were due for submission by 325 permittees. Audit's analysis has revealed that:

- (a) audited reports of 15 (1%) cases were outstanding as at 30 September 2016, of which 6 were long overdue, ranging from 216 to 429 days (averaging 342 days);
- (b) for the remaining 1,482 cases (99%) with audited reports submitted on or before 30 September 2016:
 - (i) there were delays in submission of 658 (44%) reports, averaging 43 days; and
 - (ii) of the 658 late reports, 76 (12%) were late for more than 3 months. In one case, the permittee submitted the audited report 4 years after the last event day; and
- (c) the 82 (6+76) longer delay cases mentioned in (a) and (b)(ii) above involved 64 (20%) of the 325 permittees, and 13 (4%) of them failed to submit the audited reports within 90 days of the last event day repeatedly, i.e. for two to four times.

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Notwithstanding the SWD's follow-up mechanism (see para. 3.5), the cases of delay in submission of audited reports noted above indicate the need to step up enforcement actions, especially for those permittees with repeated cases of non-compliance.

3.13 *Fund-raising by organisations on the withholding list.* As of September 2016, there were 8 organisations on the withholding list because of their non-compliance with the permit conditions of 14 PSPs after repeated reminders and warnings (see para. 3.5). Audit's examination revealed that all 8 organisations had not been issued any PSPs since being placed on the withholding list, but 7 of them had continued to raise funds on their websites and through other activities which were outside the purview of the SWD (Note 20). Case 1 is an example.

Case 1

Fund-raising by organisations on the withholding list

1. Organisation A was granted 27 PSPs for conducting general charitable fund-raising activities from April 2012 to August 2015, including three PSPs granted in February, April and June 2015 respectively. After the approval of the June 2015 PSP, the SWD noted an expense without full justifications in the audited report of a previous PSP (granted in 2014), and that the audited report for the February 2015 PSP was overdue. As the June 2015 PSP had already been approved, the fund-raising activities were conducted as scheduled.

(to be continued)

Note 20: *The remaining organisation did not have a website and no information was available on whether it had continued to raise donations through other means after being put on the SWD's withholding list.*

Case 1 (Cont'd)

2. In the event, Organisation A also did not submit the audited reports for the April and June 2015 PSPs, i.e. a total of three audited reports (including the one for February 2015 PSP) were outstanding. As a result, the SWD put Organisation A onto its withholding list in February 2016 after the issue of four reminders. In May 2016, Organisation A replied to the SWD that because of poor donation income, it could not afford the audit fee and therefore no audited reports for the three PSPs would be prepared.

3. *Audit findings.* Audit found that:

- (a) the Chairman of Organisation A had also set up another charity (Organisation B). It was also granted 22 PSPs from April 2012 to July 2015 for conducting fund-raising activities similar to those of Organisation A. In January 2016, Organisation B was put on the SWD's withholding list as it also had not submitted audited reports which were due for submission in August 2015; and
- (b) both Organisations A and B were on the IRD's list of tax-exempt charities as at September 2016 and had continued to appeal for donations through their websites and other fund-raising activities (e.g. organising a fund-raising music concert).

4. *Audit comments.* While Organisations A and B had been suspended from conducting general charitable fund-raising activities in public places by the SWD, they continued to raise donations through other means not regulated by the Government. In this connection, Audit noted that the SWD had obtained the DoJ's advice that publication of information on breach of permit conditions rested with the SWD's consideration of the seriousness of the case, the harm or prejudice that could result to the organisation and the public interest involved. To enable the public to make an informed choice when making donations (see para. 2.4(b)), the SWD needs to consider publicising information on serious or repeated non-compliance with PSP conditions after warnings.

Source: Audit analysis of SWD and IRD records

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3.14 *Inspection of fund-raising activities.* Since June 2015, the SWD has been conducting random on-site inspections on general charitable fund-raising activities. Up to September 2016, 60 activities had been inspected. Based on the SWD's inspection records, Audit noted the following issues:

- (a) *Need to take concerted actions on repeated "no-show" cases.* Use of public places (especially those with high pedestrian flow) for charitable fund-raising activities was in high demand. Based on a sample check of 65 applications for temporary occupation of unleased land for setting up counters or booths in 2,109 locations for fund-raising purposes received by the Lands D in 2016, Audit found that the applications for 1,059 (50%) locations had been rejected and one of the common reasons was that the locations applied for had already been allocated to another organisation. During the SWD's inspections of 30 (50%) of the 60 activities, no fund-raising activities were found at the approved locations. The high percentage of "no-show" cases indicates an ineffective use of public resources as other charities are deprived of the opportunity to use the places for organising their activities. Audit noted that while the SWD had taken follow-up actions on "no-show" cases, such as making enquiry with the permittees concerned (Note 21) and giving verbal warnings or issuing alert letters in some of the cases, there was still recurrence of such situation. Among the inspected cases, 7 organisations had been repeatedly found not carrying out any fund-raising activities during the time of inspections. In this connection, Audit noted that the FEHD also conducted inspections of the licensed fund-raising activities (see paras. 5.9 to 5.11). The SWD needs to liaise with the FEHD and the Lands D on the feasibility of sharing enforcement information and taking concerted actions on repeated "no-show" cases without valid reasons; and
- (b) *No display of PSPs.* Permittees are required to display the permits prominently at the approved locations of the fund-raising activities so as to inform the public of the SWD's approval in accordance with the permit

Note 21: *According to the SWD, most of the permittees in question attributed their absence at the inspected locations to unanticipated bad weather forecast and unforeseeable manpower shortage (e.g. unanticipated absence of fund-raisers which rendered only one fund-raiser available that eventually led to the call-off of event due to security concern), whilst a few permittees explained that the fund-raising activities had ended before the SWD's officers' arrival at the locations or started after the officers' departure.*

condition (see para. 3.4). Of the remaining 30 activities inspected by the SWD, the permittees of 11 activities (37%) failed to display the permits prominently at the approved locations. According to the SWD, most if not all of the permittees concerned had in fact brought along the permits (e.g. kept inside a file jacket) during the inspections. The SWD should continue its efforts in reminding the permittees of the requirement.

Monitoring of charitable fund-raising activities under public subscription permits

3.15 *Reference Guide.* In December 2014, the SWD updated the Reference Guide (first promulgated in November 2004) to enhance governance, transparency and accountability, covering donors' rights, fund-raising practices and financial reporting for the voluntary adoption by charitable organisations (see para. 2.6 and Appendix A). On financial accountability, the updated Reference Guide includes the following major clauses:

- (a) annual financial reports should be factual and accurate in all material respects and externally audited, disclosing information such as the total revenue and total expense of fund-raising events;
- (b) it is a good practice to make the financial statements of individual projects available to the public. The statements shall be factual and accurate in all material respects, disclosing information which includes the total revenue and total expenses of fund-raising events, and the uses of the net proceeds, and be prepared in accordance with the generally accepted accounting principles and standards established by the HKICPA; and
- (c) no more should be spent on administration and fund-raising than is required to ensure effective management and resource development. Permittees are recommended to ensure that fund-raising costs and administration costs should be reasonable, and that the greatest amount should be devoted to charitable programmes. A charitable organisation should as far as practicable disclose the ratio of costs to total revenue for donors' reference.

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3.16 ***Guidance Note.*** Updated in November 2004, the Guidance Note (see Appendix B) proposes some basic controls to charitable organisations with a view to ensuring that the income generated from charitable fund-raising activities is spent for the professed or stated purpose, and that such income and expenses are properly documented. For example, organisations should make regular checks and surprise inspections to ensure that records are being accurately maintained. For charity sale of commodities, the sale proceeds should be regularly counted and recorded in the presence of at least two authorised persons.

High administration costs in some fund-raising activities

3.17 ***No ceiling on fund-raising expenses for general charitable fund-raising activities.*** For PSPs for flag days, the SWD imposes a permit condition that the fund-raising expenses should not exceed 10% of the gross proceeds. However, the SWD does not set similar requirement for PSPs for general charitable fund-raising activities. In a review in 2010, some members of the LFAC proposed to limit fund-raising expenses to 20% of gross proceeds and to suspend new applications for PSP from organisations that had previously conducted loss-making events for a certain period of time. As there were comments that an across-the-board ceiling was not practical for the wide-ranging activities, the proposal had not been implemented. The current Reference Guide only recommends that fund-raising costs and administration costs should be reasonable, and that the greatest amount should be devoted to charitable programmes (see para. 3.15(c)).

3.18 ***High expenses in some fund-raising activities.*** According to the audited reports received by the SWD, the percentage of fund-raising expenses to gross proceeds of general charitable fund-raising activities varied significantly. Table 6 shows the percentages of expenses to gross proceeds of general charitable fund-raising activities under PSPs for the past four years from 2012-13 to 2015-16.

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for charitable fund-raising activities**

Table 6

**Percentages of expenses to gross proceeds
of general charitable fund-raising activities under PSPs
(2012-13 to 2015-16)**

Percentage of expenses to gross proceeds	Number of general charitable fund-raising activities under PSPs			
	2012-13	2013-14	2014-15	2015-16
0% – 20%	231 (64%)	286 (70%)	230 (66%)	209 (67%)
> 20% – 40%	50 (14%)	40 (10%)	41 (12%)	42 (14%)
> 40% – 60%	39 (11%)	38 (9%)	31 (9%)	24 (8%)
> 60% – 80%	16 (4%)	21 (5%)	15 (4%)	10 (3%)
> 80% – 100%	11 (3%)	6 (1%)	14 (4%)	13 (4%)
Deficit (Note 1)	14 (4%)	19 (5%)	17 (5%)	13 (4%)
Total (Note 2)	361 (100%)	410 (100%)	348 (100%)	311 (100%)
Total gross proceeds (\$ million)	115	90	78	69
Total expenses (\$ million)	34	20	21	20
Overall percentage of expenses to gross proceeds (Note 3)	30%	22%	27%	29%

Source: Audit analysis of SWD records

Note 1: According to the SWD, the majority of the 63 deficit cases (i.e. expenses exceeding gross proceeds) were large-scale events (such as ceremonies/concerts) which involved a higher level of production/marketing costs.

Note 2: The total number of PSPs is smaller than that in Table 5 in paragraph 3.2 because some permittees had not submitted audited reports, or they had extended their PSPs by applying for additional PSPs (e.g. longer duration of events or more venues). In the latter case, the SWD had allowed them to submit one audited report for the same event under two or more PSPs.

Note 3: According to the SWD, the increase in the overall percentage from 2013-14 to 2015-16 was partly attributable to the drop in the total gross proceeds while the total expenses remained comparatively stable.

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3.19 Over the years, some LegCo Members and the public have raised concerns about the high proportion of administrative fee charged as fund-raising expenses, the low transparency of the donation money and also the use of the donation income for other than the stated purposes. As shown in Table 6, the overall percentages of expenses to gross proceeds for general charitable fund-raising activities ranged from 22% to 30% during 2012-13 to 2015-16.

3.20 Audit selected 60 deficit cases (see Note 1 to Table 6 in para. 3.18) and 45 high expenses cases (i.e. percentages of expenses to gross proceeds exceeding 40%) relating to the fund-raising activities held from April 2012 to March 2016 for examining their audited reports. Audit found that:

- (a) of the 60 selected deficit cases, 50 were activities primarily for public education or religious purposes (e.g. ceremonies/concerts for religious purposes and carnivals for public education), and fund-raising only formed a small part of the events. Therefore, most of the expenses were related to the publicity/production of the events. However, for the remaining 10 deficit cases, the activities of which were primarily organised for raising funds for the organisations' operation and programme. The funds raised (ranging from \$400 to \$28,000) could not cover the administration costs (including salary/allowance to fund-raisers, transportation and audit fee), resulting in deficits ranging from \$15 to some \$20,000; and
- (b) the 45 high expenses cases were organised by 8 permittees. Audit's further analysis of the nature of expenses of these fund-raising activities (see Appendix D) revealed that:
 - (i) for activities involving charity sale (see Permittees G and H at Appendix D), about one-fourth of the proceeds were spent on the cost of items sold; and
 - (ii) 4 of the 8 permittees (Permittees B, C, E and F at Appendix D) had spent more than 30% of their donation proceeds on hiring fund-raisers or paying allowance to volunteers for the on-street fund-raising activities.

3.21 High administration costs of fund-raising activities reduce the amount of donations that can reach the final beneficiaries for the designated purposes. At present, the SWD imposes a permit condition that the fund-raising expenses of a flag day should not exceed 10% of the gross proceeds, but not for general charitable fund-raising activities. According to the SWD, it might not be practical to set an across-the-board ceiling for all general charitable fund-raising activities given the diversity of their nature and mode of operation (see para. 3.17), and the absence of a commonly agreed definition of “administration costs” of a fund-raising activity. However, to address the public concerns over high administration costs, the feasibility of defining the term “administration costs” with a view to setting an expenses ceiling as a PSP condition for on-street general charitable fund-raising activities which are similar in nature to flag days should be explored.

Limitations of audited reports of PSP fund-raising activities

3.22 ***Practice Note issued by the HKICPA.*** The HKICPA has issued Practice Note 850 for CPAs on the review of accounts for flag days and general charitable fund-raising activities (Note 22). The SWD has also uploaded onto its website a sample of the income and expenditure accounts for approved fund-raising activities (see Appendix E). The permittees should draw reference to this sample to report all monies and all sorts of expenses in relation to the activities covered by the PSPs. According to Practice Note 850, the CPA will give an assurance on whether anything has come to the CPA’s attention that the income and expenditure account does not reflect, in all material respects, the gross subscription raised and the expenses incurred by the permittee in respect of an event that has been recorded in its books and records made available to the CPA in accordance with the basis of preparation.

3.23 ***Limitations of audited reports.*** The SWD does not specify the use of cash-based or accrual-based accounts for PSP fund-raising activities. Of the accounts for 105 fund-raising activities (i.e. the 60 deficit cases and 45 high expenses cases mentioned in paragraph 3.20), 29 (28%) were prepared on a cash basis. Also, the SWD does not require the audited reports to provide an assurance on the compliance with the permit condition of depositing the net proceeds into a

Note 22: *The HKICPA first issued in 1999 Practice Note 850 for CPAs on the review of accounts for flag days. It also issued a circular in 2007 on reporting on general charitable fund-raising activities. These were consolidated to form the current Practice Note 850 in 2014.*

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bank account within 90 days from the last event day (see para. 3.4(b)). Audit noted a case (Case 2) which raised concern over the limitations of audited reports in these two aspects.

Case 2

Limitations of audited reports

1. Based on the audited reports received in December 2010 and March 2011, the SWD noted that cash receipts of some \$256,000 were retained by the founder of the charity (Organisation C), instead of being banked in within 90 days from the last event day in accordance with the permit condition (see para. 3.4(b)). Upon the SWD's enquiry, the founder claimed that some \$82,000 in cash was retained for paying consultancy fee for the related fund-raising activities, and the rest would be used for daily operation expenses. According to Organisation C, the consultancy fee was an accrued expense not recorded in the accounts prepared on a cash basis and was only paid in March 2011.

Audit comments

2. Organisation C did not comply with the permit condition of depositing the net proceeds into a bank account within 90 days from the last event day. Moreover, due to the use of cash-based accounting, the audited reports of the events could not reflect the accrued expense, thus resulting in an overstatement of the net proceeds.

3. ***Need to check compliance with bank-in requirement.*** The HKICPA's Practice Note 850 has not specifically required CPAs to verify compliance with the permit condition of depositing the net proceeds into a bank account within 90 days from the last event day. Therefore, there is no assurance on compliance with the permit condition. In Audit's view, the SWD needs to take measures to monitor permittees' compliance with the condition, such as strengthening its compliance checking on such requirement, or requiring the permittees to engage CPAs to provide assurance on the compliance with such condition in the audited reports.

4. ***Need to prepare accounts on an accrual basis.*** The SWD has not specified whether the accounts of fund-raising activities should be prepared on an accrual basis. In the event, the accrued expense of \$82,000 in this case was not included in the cash-based accounts as it was disbursed after the report had been prepared. As a result, the expenses were understated. The SWD needs to consider requiring permittees to prepare their accounts on an accrual basis.

Source: Audit analysis of SWD records

***Need to facilitate public access to
financial information of fund-raising activities***

3.24 Currently, under the PSP conditions, a charitable organisation is required to publish the audited report for a fund-raising activity within 90 days from the last event day for 6 months. This could be done either on its website or in its annual report/newsletter/special circular to its members (see para. 3.4(c)). Audit found that most permittees had chosen to publish the audited reports on their own websites. However, as the layout of their websites varies, the audited reports may not be easily located by the general public. In view of the concerns of LegCo Members and the public over the high administration costs of fund-raising activities (see para. 3.19) and the difficulties for members of the public to obtain such information, the SWD needs to consider publicising such information on its website or the one-stop finder on “GovHK”, such as providing key financial information (e.g. amount of funds raised, use of donation proceeds and percentages of expenses to gross proceeds) or providing website links to the audited reports, to enhance transparency of such activities.

Audit recommendations

3.25 **Audit has *recommended* that the Director of Social Welfare should:**

Processing of applications

- (a) **explore the feasibility of issuing more guidelines on the scope of the PSP under section 4(17)(i) of the Summary Offences Ordinance for reference by applicants, and in this connection seek further legal advice from the DoJ where appropriate;**

Compliance with permit conditions

- (b) **step up enforcement actions on cases of repeated non-compliance with the permit conditions on submission of audited reports, such as considering publicising information on serious or repeated cases of non-compliance with permit conditions after warnings;**

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- (c) in collaboration with the Director of Food and Environmental Hygiene and the Director of Lands, explore the feasibility of sharing enforcement information on charitable fund-raising activities held in public places and taking concerted actions on repeated “no-show” cases without valid reasons;
- (d) continue the SWD’s efforts to remind permittees of the permit condition on displaying the permits prominently at the approved locations of the fund-raising activities;

Monitoring of charitable fund-raising activities under PSPs

- (e) explore the feasibility of defining the term “administration costs” with a view to setting an expenses ceiling for on-street general charitable fund-raising activities which are similar in nature to flag days;
- (f) take measures to monitor permittees’ compliance with the permit condition that net proceeds should be deposited into a bank account within 90 days from the last event day;
- (g) consider requiring permittees to prepare their income and expenditure accounts of fund-raising activities on an accrual basis to ensure that all relevant income and expenditure are properly accounted for; and
- (h) consider publicising on the SWD’s website or the one-stop finder on “GovHK” key financial information (e.g. amount of funds raised, use of donation proceeds and percentages of expenses to gross proceeds) or providing website links to the audited reports of fund-raising activities to enhance transparency of such activities.

Response from the Government

3.26 The Director of Social Welfare generally agrees with the audit recommendations. She has said that the SWD will:

- (a) sustain the efforts to remind permittees of the permit condition on displaying the permits prominently at the approved locations of the fund-raising activities;
- (b) examine the feasibility of issuing general guidelines on the scope of the PSP;
- (c) consider publicising information on non-compliance with permit conditions on submission of audited reports; and
- (d) examine the existing accounting requirements for charitable fund-raising activities in public places.

3.27 The Director of Food and Environmental Hygiene generally agrees with the audit recommendation in paragraph 3.25(c).

PART 4: ADMINISTRATION OF LOTTERY LICENCES FOR CHARITABLE FUND-RAISING ACTIVITIES

4.1 This PART examines the work of the HAD in administering lottery licences for charitable fund-raising activities.

Lottery licences

4.2 The Gambling Ordinance is the law relating to gambling, betting, gaming, gambling establishments and lotteries. Five types of licences are issued under the Ordinance, namely the amusements with prizes licence, lottery licence, mahjong/tin kau licence, tombola licence and trade promotion competition licence. Under the Ordinance, anyone who wishes to conduct a lottery event (Note 23) has to apply for a lottery licence from the Entertainment Licensing Team (Note 24) under the Office of the Licensing Authority of the HAD (see Appendix F for an extract of the HAD's organisation chart). Applicants are advised to apply for a lottery licence at least three calendar weeks in advance. Lottery licences are issued to bona-fide organisations (Note 25) to conduct lottery ticket sales for raising funds to meet the organisations' operating expenses and/or for making donations to tax-exempt charities. A lottery organiser is required to seek prior approval from the HAD if it

Note 23: *The term "lottery" as defined in section 2 of the Gambling Ordinance includes: a raffle; a sweepstake; any competition for money or other property success in which: (a) involves guessing or estimating the results of future events, or of past events the results of which are not generally known; or (b) does not depend to a substantial degree upon the exercise of skill by the competitors; and any game, method, device or scheme for distributing or allotting prizes by lot or chance.*

Note 24: *The Entertainment Licensing Team, which is led by a Chief Executive Officer, is responsible for issuing various entertainment licences, including lottery licences under the Gambling Ordinance. One Licensing Officer, assisted by two clerical staff and supervised by one Senior Licensing Officer, is responsible for processing and monitoring lottery licences.*

Note 25: *If an applicant organisation is a tax-exempt charity, it may apply for a waiver of the licence fee of \$3,165. Alternatively, an applicant organisation may apply for a refund of the licence fee if at least 75% of the net proceeds have been appropriated to another tax-exempt charity.*

Administration of lottery licences for charitable fund-raising activities

plans to sell lottery tickets on public streets. The number of lottery licences granted for charitable fund-raising purposes and the proceeds received from April 2012 to September 2016 are shown in Table 7. Based on the figures for 2012-13 to 2015-16, the number of lottery licences issued averaged 66 each year and the gross proceeds averaged \$86 million each year.

Table 7

**Number of lottery licences granted and proceeds received
(April 2012 to September 2016)**

Year	Number of licences granted (with prior approval for sale on public streets)	Gross proceeds	Net proceeds
		(\$ million)	
2012-13 (Note 1)	66 (13)	82	79
2013-14	263 { 69 (17)	85	82
2014-15	68 (16)	90	87
2015-16	60 (16)	88	85
2016-17 (Up to September 2016)	23 (8) (Note 2)	7	7

Source: HAD records

Note 1: In April 2012, the HAD took over the responsibility for issuing lottery licences from the former Television and Entertainment Licensing Authority (see Note 7 to para. 1.4(b)).

Note 2: Up to September 2016, while 23 lottery licences had been granted, only 11 lottery accounts with information on gross and net proceeds had been submitted to the HAD (see Item (b) in Table 8 in para. 4.4).

4.3 Licensees are required to comply with a number of licence conditions, which are legal requirements under the Gambling Ordinance. A breach of the

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licence condition is an offence which may result in the licence being revoked and prosecution (Note 26). Such licence conditions can be classified into four types:

- (a) conditions to be complied with upon application for a lottery licence (e.g. no cash prize shall be offered or distributed and every lottery ticket should be numbered serially);
- (b) conditions to be complied with when conducting a lottery event (e.g. providing collection bags or boxes with security safeguards and printed name of the organisation for use by collectors);
- (c) conditions to which a lottery licence is subject upon the completion of the lottery event (e.g. submission of required documents — see Table 8 in para. 4.4); and
- (d) conditions to be complied with upon approval of the sale of lottery tickets on public streets (e.g. prominently displaying the name of the organiser at each sale location).

In addition to licence conditions, the licensee should ensure that other administrative requirements stipulated by the HAD are fully met. Among others, the licensee is required to keep the administration costs of the lottery event as low as possible, which should not be more than 20% of the total proceeds received from the sale of lottery tickets.

Monitoring of charitable lottery events

4.4 Upon completion of a lottery event, the licensee is required under the licence conditions to submit to the HAD certain documents (such as the lottery accounts — see Table 8) within the due dates stipulated in the licence.

Note 26: *According to the Gambling Ordinance, where a licence condition is contravened, unless the licensee proves that the contravention occurred without his consent or connivance and that he has exercised all due diligence to prevent it, the licensee commits an offence and is liable on conviction to a fine of \$50,000 and to imprisonment for 2 years.*

Table 8

Documents required to be submitted upon completion of a lottery event

Required documents	Due date (from the date of the draw of the lottery)
(a) A copy of the newspaper cuttings showing the details of the result of the lottery	Within 10 days
(b) A copy of the income and expenditure account of the lottery event and the review report (Note) made by a CPA on the income and expenditure account of the lottery event (hereinafter referred to as the lottery account)	Within 90 days
(c) A copy of the cash count record jointly signed by the counting staff/volunteers and the witness persons	
(d) Official receipt(s) in respect of the net proceeds of the lottery from the organisation(s) receiving the donation (hereinafter referred to as the donation receipt)	
(e) If the net proceeds of the lottery are used for meeting the expenditure of the licensee, a copy of the audited annual financial statement of the licensee, which should show the income and expenditure of the lottery and the whereabouts of the net proceeds (in the form of “note to account” if appropriate)	Within 1 year

Source: HAD records

Note: According to the licence condition, the CPA should state in the review report that in the opinion of the CPA, the income and expenditure account of the lottery event is properly prepared from the books and records of the licensee made available to the CPA, and no matter has come to the attention of the CPA which indicates that the income and expenditure account of the lottery event does not accurately reflect all the moneys collected or received from the sale of lottery tickets and all the disbursements made from the moneys so collected or received.

Administration of lottery licences for charitable fund-raising activities

4.5 The HAD shall make available each lottery account received for public inspection for a period of one year. The HAD publishes a list of lottery accounts received on its website and a member of the public can make a request for inspecting a lottery account in the HAD's office by submitting a standard request form via post or by fax. The purpose is to enhance the transparency and accountability of the lottery events.

Late submission of documents

4.6 The HAD uses a computer system, namely the Licensing Information System (LIS) for recording information relating to licence applications, including the due dates and actual dates of receipt of all required documents, with the exception of the cash count records (see Item (c) in Table 8 in para. 4.4). Audit analysed the information in the LIS as of October 2016 for the 263 lottery licences granted from 2012-13 to 2015-16 (see Table 7 in para. 4.2) and found that there were delays in submission of required documents by the licensees, as follows:

- (a) for 197 (75% of 263) licences, the newspaper cuttings of the lottery results were submitted late, for over three months in 51 (26% of 197) cases (the longest delay was 512 days);
- (b) for 120 (46% of 263) licences, the lottery accounts were submitted late, for over three months in 17 (14% of 120) cases (the longest delay was 746 days);
- (c) of the 263 lottery licences granted, 153 licences required the submission of audited annual financial statements (see item (e) in Table 8 in para. 4.4). There were delays in submitting audited annual financial statements for 106 (69%) licences including 71 (46%) for over three months (the longest delay was 645 days). In addition, the audited annual financial statements for 6 (4%) licences had been overdue for more than three months up to October 2016; and
- (d) of the 263 lottery licences granted, 100 licences required the submission of donation receipts (see item (d) in Table 8 in para. 4.4). There were delays in submitting the donation receipts for 65 (65%) licences, including 32 (32%) for over three months (the longest delay was 540 days).

For cash count records, as no information on the due dates and actual dates of receipt is recorded in the LIS, Audit selected 30 licences granted from 2012-13 to 2015-16 for examination and found that in 25 (83%) cases, the licensees submitted the cash count records late, including 21 (70%) for over three months (the longest delay was 547 days).

Inadequate follow-up actions on outstanding documents

4.7 According to the HAD's internal guidelines (set by the former Television and Entertainment Licensing Authority before the licensing work was taken over by the HAD in April 2012), if a licensee does not submit the required documents (see Table 8 in para. 4.4) on or before the due dates as stipulated in the licence, two reminders and a warning letter will be issued in the following manner:

- (a) for Items (a) to (d) in Table 8, the first reminder, second reminder and a warning letter will be issued 14 days, 21 days and 28 days respectively after the due dates; and
- (b) for Item (e) in Table 8, the first reminder, second reminder and a warning letter will be issued 14 days, 28 days and 35 days respectively after the due dates.

4.8 Audit analysed the information in the LIS relating to the issue of reminders and warning letters for the lottery licences from 2012-13 to 2015-16 and found that HAD staff had not followed the internal guidelines in issuing reminders and warning letters. For example, Audit's analysis of the issue of reminders and warning letters (see para. 4.7(a)) for 10 lottery accounts which had been overdue for over 180 days before submission to the HAD revealed that:

- (a) in one case, no reminders or warning letter had been issued to the licensee;
- (b) in two cases, there were delays in issuing reminders/warning letters. The first reminder, second reminder and the warning letter were issued 125 days, 287 days and 374 days respectively after the due date in the first case. In the second case, the first and second reminders were issued 110 days and 293 days respectively after the due date and no warning letter was issued; and

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- (c) for the remaining 7 cases, the first reminders were issued to the licensees 18 to 196 days (averaging 107 days) after the due dates. No second reminders or warning letters had been issued to the licensees.

4.9 In Audit's view, timely submission of the required documents, especially the lottery accounts, is important for making available the results and financial information of lottery events for inspection by members of the public, including donors. There is a need for the HAD to step up its monitoring of licensees' compliance with the licence conditions, and consider taking suitable measures to deter cases of repeated late submission of documents.

Need to enhance the computer system to facilitate monitoring work

4.10 The HAD has been using the LIS to record useful information relating to the lottery licence applications, including the due dates and actual dates of receipt of all required documents (with the exception of cash count records) under the licence conditions, as well as the dates of issue of the first and second reminders and the warning letters. However, the LIS could not generate exception reports to facilitate HAD staff in following up the outstanding cases in a timely manner. As a result, HAD staff currently use a separate spreadsheet to record and bring up the outstanding cases for follow-up actions. In view of the observed delays in submission of required documents and issuing of reminders and warning letters (see paras. 4.6 and 4.8), the HAD should enhance the LIS to facilitate its monitoring and follow-up work.

Need to ensure the use of proceeds is accounted for in submitted financial statements

4.11 Under the licence conditions, apart from the submission of the lottery accounts within 90 days after the lottery event, if the net proceeds of the lottery are used for meeting the expenditure of the licensee, a copy of the audited annual financial statements of the licensee, which should show the income and expenditure of the lottery and the whereabouts of the net proceeds should be submitted to the HAD within one year (see Item (e) in Table 8 in para. 4.4). Audit examined the audited annual financial statements submitted by licensees of 30 licences granted from 2012-13 to 2015-16 and found that in 6 (20%) cases, the submitted statements did not show separately the income and expenditure of their lottery events nor the use of net proceeds. Audit found that in such cases, HAD staff accepted the

licensees' explanation that the income and expenditure of the lottery events and the use of net proceeds had been subsumed under other income and expenditure items in the audited annual financial statements. The HAD needs to provide more guidance to licensees and ensure their compliance with the relevant licence condition.

Need to facilitate public access to the lottery accounts

4.12 It is a licence condition that a licensee should submit a copy of the lottery account. As mentioned in paragraph 4.5, the HAD publishes on its website a list of lottery accounts received and a member of the public can make a request for inspecting a lottery account in the HAD's office by submitting a standard request form via post or by fax. It is also stated on the request form that reproduction of the whole or any part of the lottery account is not allowed. According to the HAD, it has not received any request for inspecting the lottery accounts since taking over the licensing responsibility in April 2012 (see Note 7 to para. 1.4(b)). In Audit's view, the HAD's requirements for the public to inspect the lottery accounts in the HAD's office physically and not allowing making copies of the accounts do not facilitate access and are not conducive to achieving the Government's objective of enhancing transparency and accountability of fund-raising activities (see para. 2.4(a)).

4.13 According to the application guide issued by the HAD, lottery organisers are encouraged to publicise their lottery accounts in their own publications or on their own websites and/or make available copies of these documents at their offices for public inspection. However, the HAD has not collected information to gauge the extent of the lottery organisers' publication of their lottery accounts. Audit conducted a survey of the websites of 10 lottery organisers and found that none of them had published the lottery accounts on their websites. With a view to enhancing the transparency and accountability of lottery events, the HAD should take measures to facilitate public access to the lottery accounts (e.g. providing direct access to the lottery accounts on the HAD's website or the one-stop finder on "GovHK").

Audit recommendations

4.14 **Audit has *recommended* that the Director of Home Affairs should:**

- (a) **step up monitoring of licensees' compliance with the lottery licence conditions, including the timely submission of required documents upon completion of a lottery event, and consider taking suitable measures to deter cases of repeated late submission of documents;**
- (b) **enhance the LIS to facilitate the monitoring of licensees' compliance with the lottery licence conditions;**
- (c) **provide more guidance to licensees and ensure their compliance with the condition that the use of net proceeds is accounted for in the financial statements; and**
- (d) **take measures to facilitate public access to the lottery accounts.**

Response from the Government

4.15 The Director of Home Affairs agrees with the audit recommendations. She has said that:

- (a) the HAD will review the monitoring mechanism and consider suitable measures to deter cases of repeated late submission of documents;
- (b) the enhancement of the LIS will facilitate the monitoring of outstanding documents from the licensees, thus relieving the stringent manpower resources; and
- (c) the HAD will consider providing more guidance to licensees for preparing the annual financial statements.

PART 5: ADMINISTRATION OF TEMPORARY HAWKER LICENCES FOR FUND-RAISING ACTIVITIES INVOLVING ON-STREET SELLING

5.1 This PART examines the work of the FEHD in administering temporary hawker licences for fund-raising activities involving on-street selling.

Temporary hawker licences

5.2 The FEHD is tasked to regulate public health and municipal services under the Public Health and Municipal Services Ordinance. According to the FEHD, it does not have a role to play in regulating fund-raising activities, unless such activities involve hawking on the streets. The FEHD has stopped issuing hawker licences under normal circumstances (Note 27) in a bid to gradually reduce street trading and to minimise obstructions and nuisances created by hawking. If charities or other non-profit-making organisations need to raise funds by way of hawking of commodities (Note 28) in public streets, consideration would be given to issuing temporary hawker licences. The main purpose of issuing temporary hawker licences is to facilitate such organisations in raising funds and regulate such hawking activities in public streets to ensure that they are conducted in a hygienic manner and will not cause nuisances such as obstruction to public places. Under the Hawker Regulation, the Director of Food and Environmental Hygiene may issue a temporary hawker licence to a person who is authorised by the following

Note 27: *Since the early 1970's, the former Urban Council had stopped issuing new hawker licences under normal circumstances. Following the hawker licensing policy review concluded in early 2009, the Director of Food and Environmental Hygiene had, during the period from July 2009 to April 2012, completed the issuing of 218 new fixed-pitch (other classes) hawker licences and 61 new itinerant (frozen confectionery) hawker licences (see Note 29 to para. 5.2).*

Note 28: *According to the Hawker Regulation, commodities means any goods, wares, or merchandise; and includes any samples and patterns of goods, wares, and merchandise. Examples of commodities sold under temporary hawker licences are stationery, accessories and books.*

Administration of temporary hawker licences for fund-raising activities involving on-street selling

organisations to conduct fund-raising activities involving on-street selling of commodities (Note 29):

- (a) tax-exempt charities; or
- (b) other non-profit-making organisations which are incorporated or registered under the laws of Hong Kong (e.g. a company incorporated under the Companies Ordinance, a society registered under the Societies Ordinance, or a trade union registered under the Trade Unions Ordinance (Cap. 332)).

Applications for temporary hawker licence should be made to the FEHD at least 12 working days before the start of the fund-raising activities. Licensees are required to comply with the licence conditions (Note 30). Any non-compliance with the licence conditions is an offence under the Hawker Regulation (Note 31) and the FEHD may cancel the relevant licence. According to the FEHD, temporary hawker licence applications for fund-raising for commercial or profit-making purposes will not be considered.

Note 29: *Under the Hawker Regulation, a temporary hawker licence may be issued to an applicant as the Director of Food and Environmental Hygiene thinks fit and it permits the licensee to hawk for such period (not exceeding one month) and for such purpose as the Director specifies in the licence, subject to any conditions that the Director thinks fits to specify in the licence. In addition to temporary hawker licences, fixed-pitch hawker licences (covering cooked food or light refreshment) and itinerant hawker licences (covering frozen confectionery and mobile van) may also be issued by the Director of Food and Environmental Hygiene under the Hawker Regulation.*

Note 30: *Examples of licence conditions are: (a) the stall shall only be used for selling commodities specified on the relevant licence; and (b) the licence shall be displayed conspicuously at the stall at all times when any fund-raising sale activity is carried on.*

Note 31: *For non-compliance with any licence conditions, the licensee is liable on conviction to a fine at level 2 (i.e. \$5,000) and, in the case of a continuing offence, is liable to a further fine of \$100 for each day during which the offence has continued.*

Administration of temporary hawker licences for fund-raising activities involving on-street selling

5.3 An organisation may apply for a waiver from obtaining a temporary hawker licence for carrying on-street selling activities in public places if the following three conditions are satisfied:

- (a) the organisation is a tax-exempt charity;
- (b) the proposed activity should be of charity nature and written submission is required to set out what specific charitable purposes the monies generated from the activity will be spent; and
- (c) necessary approvals have been obtained from the SWD for the required PSP and from the Lands D for the land use (see para. 1.4(a) and (d)).

5.4 While applications for temporary hawker licences are processed by the respective Hawkers Section of the 19 District Environmental Hygiene Offices (Note 32), applications for waivers are processed by the Hawker and Market Section of the Headquarters Division under the Environmental Hygiene Branch of the FEHD (see Appendix G for an extract of the FEHD's organisation chart). Table 9 shows the number of temporary hawker licences issued and waivers granted in the period from April 2012 to September 2016.

Note 32: *According to the FEHD's internal guidelines, if an organisation submits an application of temporary hawker licence for the first time, policy support should be sought from the Hawker and Market Section of the Headquarters Division.*

Administration of temporary hawker licences for fund-raising activities involving on-street selling

Table 9

**Number of temporary hawker licences issued and waivers granted
(April 2012 to September 2016)**

Year	Number of temporary hawker licences issued			Number of waivers granted
	Tax-exempt charities	Other non-profit-making organisations	Total (Note)	
2012-13	222	45	267	47
2013-14	60	97	157	42
2014-15	41	79	120	37
2015-16	41	47	88	44
2016-17 (Up to September 2016)	10	38	48	20

Source: FEHD records

Note: According to the FEHD, the number of temporary hawker licences issued in 2011 was about 1,200 (of which over 90% were issued to tax-exempt charities). After the introduction of a limit on the number of licences issued for each fund-raising organisation within 12 months in July 2012 (see para. 5.5), there was a significant decrease in the number of licences issued.

Remarks: Unlike PSPs issued by the SWD and lottery licences issued by the HAD, the FEHD does not maintain records of financial information (e.g. the gross receipt, fund-raising expenditure and net proceeds) of the fund-raising activities involving on-street selling covered by temporary hawker licences.

5.5 New administrative measures introduced in 2012. According to the FEHD's application guidelines for temporary hawker licences for fund-raising purposes, in light of media reports on some suspicious on-street fund-raising activities in 2012 (Note 33), the FEHD conducted a review of the arrangements for

Note 33: In February 2012, a media report revealed that a tax-exempt charity had been issued with more than 120 temporary hawker licences in a year for conducting on-street selling activities and monies received were not put into any donation boxes. Also, the organisation was not required to submit any financial statements for the fund-raising activities involving on-street selling to the FEHD.

Administration of temporary hawker licences for fund-raising activities involving on-street selling

issuing temporary hawker licences for the sale of goods in public places for fund-raising purposes. Aiming to enhance transparency and accountability of fund-raising activities, safeguard the proper use of donations, prevent abuse of temporary hawker licences and achieve a fair distribution of public resources among the fund-raising organisations, the FEHD has laid down the following new administrative measures in its application guidelines for applications received on or after 31 July 2012:

- (a) except with the approval of the Director of Food and Environmental Hygiene (Note 34), the total number of temporary hawker licences granted to each fund-raising organisation in 12 months shall not exceed 20. Among them, no more than 2 licences shall be granted for selling goods in the same district and no more than 4 licences shall be granted for selling goods at hawker black spots (Note 35);
- (b) the maximum licence period is five days in any two consecutive weeks; and
- (c) an organisation issued with more than 12 licences within 12 months shall be subject to the following additional conditions for each and every licence subsequently issued:
 - (i) the organisation shall prepare an income and expenditure account relating to the fund-raising activities covered by the licence for audit by a CPA; and

Note 34: *In April 2013, the FEHD issued a set of internal guidelines on processing applications for temporary hawker licences for fund-raising purposes exceeding the stated limits. According to the guidelines, if an applicant can provide justifications to the satisfaction of the FEHD (e.g. the licence being applied for is for short duration on special occasions or events), the case will be considered on its merits to see if any of the application limits can be exceeded.*

Note 35: *Hawker black spots refer to locations at which no prior warning would be given by the FEHD inspectors before taking prosecution action against hawking and related offences. The FEHD maintains a list of hawker black spots on its website.*

Administration of temporary hawker licences for fund-raising activities involving on-street selling

- (ii) the original copy of the auditor's report shall be forwarded to the Director of Food and Environmental Hygiene within 90 days from the last day of the licence period, and the Director may publicise the auditor's report in any form or manner for public inspection.

Monitoring of fund-raising activities involving on-street selling

5.6 As stated in the FEHD's application guidelines for temporary hawker licences for fund-raising purposes:

- (a) the Government strives to provide a friendly environment with administrative procedures kept to a minimum to facilitate charitable organisations to mobilise community resources for their fund-raising activities; and
- (b) nevertheless, fund-raising activities involve public interest because the community is concerned whether these activities are properly conducted and the donations are properly used. Therefore, there is an expectation that the Government should exercise adequate control over fund-raising activities.

Different administrative/licensing requirements between the FEHD and other licensing departments

5.7 To ascertain the adequacies of controls over different charitable fund-raising activities regulated by the three departments (i.e. the SWD, the HAD and the FEHD), Audit has compared the relevant requirements in the permit or licence conditions and/or administrative measures imposed by the three licensing departments (see Appendix H for detailed comparison) and found the following differences:

- (a) ***Custody of monies received.*** Both the SWD and the HAD have imposed conditions relating to the custody of the monies received during the fund-raising activities. For example, the SWD requires a permittee to take sufficient security measures for safe keeping of the funds raised, and ensure that all the donation boxes are secure and properly sealed to

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prevent pilfering. However, no similar licence condition or administrative measure has been imposed by the FEHD. In fact, the media report in 2012 (see Note 33 to para. 5.5) had raised similar concern but it had not been addressed in the FEHD review conducted in 2012 (see para. 5.5);

- (b) ***Accounts for fund-raising activities.*** While both the SWD and the HAD have imposed conditions relating to the preparation, audit and submission of the income and expenditure accounts for the fund-raising activities covered by each and every permit or licence issued, the FEHD has only imposed similar requirement (see para. 5.5(c)) on organisations granted with more than 12 licences within 12 months as an administrative measure (Note 36). Since the introduction of the new administrative measure in 2012, only one organisation has been issued with more than 12 temporary hawker licences within 12 months (see para. 5.8(a)). Also, the FEHD has not maintained records of the actual amount of funds raised in on-street selling activities covered by temporary hawker licences. Audit understands that there may be concern over disproportionate administration costs if an organisation is required to submit an audited account for each and every temporary hawker licence given that the amount of funds so raised is likely to be less than that of a PSP activity or a lottery event (Note 37). Nevertheless, Audit considers that there is room for improvement in the following areas:

-
- Note 36:** *According to the FEHD, about 60% of the temporary hawker licences in 2013-14 to 2015-16 were issued to other non-profit-making organisations such as trade unions and political groups for conducting fund-raising activities which lasted for at most a few hours. If an organisation is required to submit an audited account for each and every temporary hawker licence, given that the amount of funds so raised is likely to be less than that of a PSP activity or a lottery event, there will be concern over disproportionate administration costs on the part of the organisation. The FEHD considers it not unreasonable to continue with the existing requirement on audited accounts (see para. 5.5(c)) for fund-raising activities conducted by non-profit-making organisations. If it is considered that the current regime needs to be tightened up, wide recognition from the community is required and consultation with relevant stakeholders is necessary.*
- Note 37:** *It is because a fund-raising activity involving on-street selling covered by a temporary hawker licence is restricted to five days and one sale location only, while there are no such restrictions imposed on PSPs or lottery licences (i.e. charitable fund-raising activities covered by a PSP or a lottery licence can take place in multiple locations and for a much longer period).*

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- (i) organisations should be required to keep proper records for the income and expenditure of on-street selling activity for each and every licence issued and submit such records to the FEHD upon request; and
 - (ii) for organisations granted with more than 12 licences within 12 months, they should be required to prepare and submit audited accounts for the on-street selling activities covered by all temporary hawker licences issued during the year (not only for the 13th licence onwards); and
- (c) ***Purpose of fund-raising and use of donations.*** Both the SWD and the HAD have imposed conditions requiring a permittee/licensee to inform donors or prospective donors about the purpose of fund-raising (e.g. displaying information about the purpose of fund-raising at the approved locations or stating the purpose of fund-raising on lottery tickets) and to properly account for the use of donations (e.g. submitting copies of donation receipt if the funds raised have been donated to another charity). However, no similar licence condition or administrative measure has been imposed by the FEHD.

Deficiencies in implementing the new administrative measures introduced in 2012

5.8 The FEHD uses a computer system, namely the Hawker Licensing and Hawker Conviction System (HLCS) for processing applications of temporary hawker licences. To implement the new application guidelines introduced in 2012, the FEHD has enhanced the HLCS to include a function to automatically alert its staff processing an application if: (a) the application limit has been exceeded (see para. 5.5(a) and (b)); or (b) there is a need to impose an additional administrative measure on the submission of audited accounts in the temporary hawker licence (see para. 5.5(c)). Audit analysed the HLCS records relating to applications submitted on or after 31 July 2012 and approved up to 30 September 2016 (involving 496 applications submitted by 104 organisations) and found that:

- (a) although 16 temporary hawker licences had been issued to an organisation in the 12-month period from mid-December 2012 to mid-December 2013, the concerned organisation had not submitted the audited accounts for the

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last 4 licences issued and the FEHD had not taken any follow-up action; and

- (b) the FEHD had granted more than 2 licences in the same district within 12 months to 14 organisations without documenting the justifications for approving the exceptional cases (see Note 34 to para. 5.5(a)).

In Audit's view, the FEHD needs to take measures to ensure compliance with the administrative measure on submission of audited accounts. The FEHD also needs to remind its staff to document the justifications for issuing temporary hawker licences in exceptional cases.

Deficiencies in inspections

5.9 According to the FEHD's internal guidelines, the inspectors of the District Environmental Hygiene Offices conduct inspections at the approved sale locations covered by temporary hawker licences at least twice a day to check licensees' compliance with licence conditions (e.g. only selling commodities specified in the licences). They are also responsible for carrying out daily inspections on on-street selling activities covered by waivers to detect any irregularities.

5.10 Audit examined the inspection records of three District Environmental Hygiene Offices (which had the highest number of approved on-street selling activities under temporary hawker licences in each of the three regions, i.e. Hong Kong Island, Kowloon and the New Territories) from April 2014 to December 2016. Of the 2,508 required inspections (including 242 inspections for 50 temporary hawker licences issued to 30 organisations and 2,266 inspections for 72 waivers granted to 16 organisations):

- (a) 139 (6%) inspections had not been conducted mainly due to delays in notifying the FEHD's inspectors. According to the FEHD, one of the reasons for the delays was that the organisations had submitted the applications for waivers at a very short notice. Sometimes, the FEHD was given less than one working day to process the application. Given the limited time to process the application, the FEHD had genuine difficulty in timely notifying frontline staff to conduct inspection; and

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- (b) for 241 (10%) inspections, the inspection records were either missing or inadequate to show whether inspections had been conducted.

The FEHD needs to take measures to ensure that inspections on compliance with the licence conditions are carried out in accordance with laid-down guidelines (such as setting a timeline for submission of applications for waiver) and inspection records are properly maintained.

5.11 For the remaining 2,128 (84%) inspections conducted, Audit found that:

- (a) in 1,251 (59%) inspections, the records revealed that no approved on-street selling activities had been carried out in the approved locations (i.e. “no-show” cases), which was similar to the results of the random on-site inspections on PSP fund-raising activities conducted by the SWD (see para. 3.14(a)); and
- (b) in 14 (1%) inspections, selling activities outside the approved time period were found, contrary to the licence condition. However, no record was available to show that any regulatory actions had been taken in respect of the non-compliance identified.

Regarding (a) above, the FEHD currently does not take any follow-up actions on the “no-show” cases (e.g. sharing of enforcement information with the SWD as a large number of “no-show” cases (Note 38) were related to on-street selling activities covered by waivers issued by the FEHD to PSP permittees). In Audit’s view, the high percentage of “no-show” cases indicates an ineffective use of public resources because use of public places (especially those with high pedestrian flow) for charitable fund-raising activities was in high demand. Based on the sample check of 65 applications received by the Lands D for temporary occupation of unleased land for setting up counters or booths in 2,109 locations for fund-raising purposes in 2016, Audit found that the applications for 1,059 (50%) locations had been rejected

Note 38: *Of the 1,251 inspections mentioned in paragraph 5.11(a), 1,190 (95%) were related to on-street selling activities covered by waivers issued to 15 PSP permittees. Among the inspected cases, 14 (93%) permittees had been repeatedly found not carrying out any fund-raising activities during the time of inspection, e.g. no approved selling activities were found in 19 (76%) of 25 inspections in one case.*

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and one of the common reasons was that the locations applied for had already been allocated to another organisation. The FEHD needs to liaise with relevant departments (i.e. the SWD and the Lands D) on the feasibility of sharing of enforcement information and taking concerted actions on repeated “no-show” cases (see relevant audit recommendation in para. 3.25(c)). Regarding (b), the FEHD needs to take regulatory actions on any cases of non-compliance.

Lack of one-stop service for fund-raising activities involving on-street selling

5.12 According to the LRC Report (see para. 1.9), the different licensing authorities (e.g. the SWD and the FEHD for processing permits/licences and the Lands D for approving temporary occupation of unleased land to set up counters or booths) currently appear to be lacking coordination in dealing with applications for charitable fund-raising licences and permits (see para. 1.4). As a result, sometimes an organisation needs to seek approvals from different departments for the same charitable fund-raising activity. For example, the organisation needs to seek approvals from:

- (a) the FEHD for the issue of a temporary hawker licence or a waiver from obtaining the licence for sale of commodities on streets;
- (b) the SWD for the issue of a PSP if the items sold are badges, tokens or similar articles as defined in the Summary Offences Ordinance; and
- (c) the Lands D for the approval of temporary occupation of unleased land for the setting up of a counter or booth.

Owing to the lack of one-stop service, the need to seek multiple approvals for a fund-raising activity involving the same on-street selling event duplicates regulatory efforts, and creates extra workload and inconvenience to charitable organisations.

5.13 Audit has also noted that in some cases, the organisations might have breached the relevant legislation for not having sought all the required approvals for fund-raising activities involving on-street selling, as follows:

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- (a) of 42 PSPs issued by the SWD from January to September 2016 involving selling activities in public streets, 15 (36%) permittees had not applied to the FEHD for waivers from obtaining the temporary hawker licences, which might have constituted a breach of the Hawker Regulation. In this connection, Audit has noted that the requirement to apply for a waiver of temporary hawker licence by a permittee is not mentioned in the FEHD's guidelines provided to the public (Note 39). Besides, there is also no established mechanism for the SWD to notify the FEHD on the approvals of PSPs involving on-street selling activities which may require the issue of a waiver of temporary hawker licence; and
- (b) of 50 temporary hawker licences issued from April 2014 to December 2016 selected for Audit's examination, 32 (64%) licensees had not sought the Lands D's approval for temporary occupation of unleased land for setting up counters or booths for the fund-raising activities. Similar to (a) above, the requirement to apply for the Lands D's approval of temporary occupation of unleased land is also not mentioned in the FEHD's guidelines provided to the public. Audit notes that, in processing an application for a temporary hawker licence, the FEHD will seek comments from various departments, including the Lands D, and issue a licence to the applicant if no objections are received from the departments. In response to Audit's enquiry, the Lands D in February 2017 said that upon the FEHD's requests for comments on temporary hawker licence applications, the Lands D would first check and confirm the land status of the concerned locations. If the sites situated on unleased and unallocated land and were available for the concerned selling activities, the Lands D would return a "no objection" reply to the FEHD for its further processing of the applications, i.e. separate approval for temporary occupation was not required from the Lands D.

Note 39: *The current guidelines only inform the applicants to seek advice from other B/Ds including the SWD and the HAB as to whether a permit under section 4(17) of the Summary Offences Ordinance is required for the concerned fund-raising activities.*

Administration of temporary hawker licences for fund-raising activities involving on-street selling

In Audit's view, the FEHD should work in collaboration with the SWD and the Lands D to facilitate applicants in meeting related licensing requirements for fund-raising activities involving on-street selling in public places (e.g. providing information about locations available for fund-raising activities, publicising the waiver arrangement and formalising the practice of exempting applicants of temporary hawker licences from obtaining separate approvals from the Lands D). In addition, there is a need for the three departments to consider providing a one-stop service to streamline the processing and approvals of such activities.

Audit recommendations

5.14 Audit has *recommended* that the Director of Food and Environmental Hygiene should:

- (a) consider improving administrative measures for monitoring on-street selling activities for charitable fund-raising purposes covered by temporary hawker licences (see para. 5.7);**
- (b) take measures to ensure licensees' compliance with the administrative measure on submission of audited accounts upon issue of more than 12 temporary hawker licences within 12 months;**
- (c) remind FEHD staff to document the justifications for issuing temporary hawker licences in exceptional cases;**
- (d) take measures to ensure that:**
 - (i) inspections on compliance with the licence conditions are carried out in accordance with laid-down guidelines;**
 - (ii) inspection records are properly maintained; and**
 - (iii) regulatory actions are taken on cases of non-compliance; and**
- (e) work in collaboration with the Director of Social Welfare and the Director of Lands to:**
 - (i) facilitate applicants in meeting related licensing requirements for fund-raising activities involving on-street selling in public places; and**
 - (ii) consider providing a one-stop service to streamline the processing and approvals of fund-raising activities involving on-street selling.**

Response from the Government

5.15 The Director of Food and Environmental Hygiene generally agrees with the audit recommendations. She has said that:

- (a) consistent with the object of the Public Health and Municipal Services Ordinance, the main purpose of issuing temporary hawker licences is to regulate the sale of commodities in public places in a hygienic manner as well as to ensure that the hawking activities will not cause nuisances such as obstruction to public places. The licence conditions stipulate that the licence is issued to the licensee to raise funds through the sale of commodities where a customer is paying the seller money in exchange for an actual commodity, i.e. a business transaction actually takes place. The FEHD opines that the sale of commodities is normal business transaction which should be distinguished from charitable fund-raising activities which do not involve a commercial transaction;
- (b) the FEHD acknowledges the public's views for better transparency and accountability for fund-raising activities for charitable purpose, including those involving on-street selling of commodities. In this connection, with reference to the best practices specified in the Reference Guide, the FEHD will consider incorporating as far as practicable further administrative measures comparable to those conditions currently imposed by the SWD and the HAD into temporary hawker licences issued to charitable organisations, having due regard to factors such as the nature, scale and duration of the fund-raising activities, proportionality of the requirements, cost of compliance, etc.;
- (c) for the audit recommendation in paragraph 5.14(a), the FEHD is actively looking into incorporating additional measures (such as ensuring the safe custody of the monies received) into the licence conditions and/or administrative measures with a view to enhancing transparency and accountability of charitable fund-raising activities involving on-street selling of commodities by tax-exempt charities. The FEHD will also explore how best to enhance the financial accountability of charitable fund-raising activities covered by temporary hawker licences, with due regard to the factors mentioned in (b). In the process, the FEHD will seek to strike a reasonable balance between the need for controlling on-street hawking activities and the need for addressing public concerns on fund-raising activities;

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- (d) for the audit recommendation in paragraph 5.14(b), the FEHD will actively consider introducing a new administrative measure, i.e. not processing any subsequent application from any organisation until the audited accounts for the previous fund-raising activities are submitted as required. The FEHD believes that this new measure will provide incentive for licensees to comply with the requirement on submission of audited accounts;
- (e) for the audit recommendation in paragraph 5.14(c), the FEHD has reminded staff to properly document the justifications for approving the exceptional cases;
- (f) for the audit recommendation in paragraph 5.14(d), the FEHD has reminded staff to conduct inspections according to the operating time as specified on the licences and to keep proper inspection records. They have been reminded to take appropriate follow-up actions including enforcement actions against illegal hawking activities in accordance with the established departmental guidelines;
- (g) regarding the “no-show” cases mentioned in paragraph 5.11(a), she generally agrees with the related audit recommendation in paragraph 3.25(c) (see para. 3.27). As most of the “no-show” cases were related to fund-raising activities covered by waivers issued to organisations that had obtained PSPs from the SWD, the FEHD will explore with the SWD the feasibility of imposing sanction to forestall frivolous applications for PSP, tackling the problem at source; and
- (h) for the audit recommendation in paragraph 5.14(e), the FEHD stands ready to explore with the SWD and the Lands D means to enhance communication among the departments to streamline application processing, referrals and approvals. The FEHD will update its guidelines:
 - (i) to require PSP permittees involving on-street selling activities to apply for a waiver of temporary hawker licence; and
 - (ii) to specify the requirement to apply for the Lands D’s approval for occupation of unleased land in connection with the processing applications for temporary hawker licence.

PART 6: WAY FORWARD

6.1 This PART examines the way forward on the monitoring of charitable fund-raising activities, focusing on the Government's follow-up actions on the LRC Report on Charities.

Law Reform Commission Report on Charities

6.2 According to the 2013 LRC Report, the existing regulatory framework of charities has the following deficiencies:

- (a) ***Out-dated definition of charity.*** The definition of “charitable purpose” in Hong Kong is not based upon a clear statutory definition, but upon the common law interpretation of English legislation dating back hundreds of years. The leading case authority of 1891 on the definition of charity which enunciated the four principal divisions of charitable purpose (namely the relief of poverty, the advancement of education, the advancement of religion and any other purposes beneficial to the community not falling under any of these three heads) is still applied today. Many of the more recently developed charitable purposes necessarily fall within the vague “*any other purpose*” classification. This has resulted in evolving case law on charitable purposes which is confusing and unclear;
- (b) ***Lack of a coherent system for the registration of charities.*** While the IRD's list of tax-exempt charities does not constitute a formal “register” of charitable organisations, there may be a danger that the public (and hence potential charity donors) may perceive that the recognition of tax exemption status and inclusion on the list of tax-exempt charities confers on those charities “*a cloak of respectability and the semblance of official sanction not intended by the Inland Revenue Ordinance*”;
- (c) ***Inconsistent standards or requirements on governance, accounting and reporting by charities.*** Charities of different legal forms established under different ordinances can be subject to different statutory controls. For example, charitable organisations established under the Companies Ordinance are required to prepare audited accounts in order to fulfil

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requirements under that Ordinance. However, this is not the case for charitable organisations established as societies registered under the Societies Ordinance. As for charities which are neither statutory nor subvented, they may operate autonomously under their own governing bodies and according to their own rules and regulations; and

- (d) *Limited control of charitable fund-raising activities.* Government oversight of the fund-raising activities of charities is confined specifically to those activities requiring the permission of the SWD, the HAD and the FEHD, such as flag days, lotteries and on-street selling. For other forms of fund-raising activity such as charity auctions, balls, concerts, dinners, or requests for donations by mail or through advertisements, no government oversight applies.

Recommendations of the LRC Report

6.3 After conducting a detailed study, including analysing the charities' regimes in a number of overseas jurisdictions and seeking views and comments from the public in 2011, the LRC issued a Report on Charities in December 2013. The LRC Report concluded that:

- (a) it should be a long-term goal that a charity commission or a centralised regulatory authority for charities should be established for Hong Kong. Given the lack of general consensus among the public on this issue (Note 40), the LRC believed that the community needed more time to discuss the concept of a charity commission; and
- (b) in the interim period, expedient administrative measures should be implemented to improve the transparency and accountability of charities and thus provide better safeguards to the public. In this connection, the LRC made a total of 18 recommendations, which included, among others, imposing certain filing requirements in applications for charitable

Note 40: *According to the LRC Report, the number of respondents not in support of the recommendation to set up a charity commission greatly out-numbered those in support of the recommendation. However, the majority of the respondents agreed that it was important for charities to be more transparent and accountable to the community and there was also consensus on the need to safeguard the rights of donors.*

fund-raising licences or permits, setting up centralised telephone hotline for public enquiries and complaints in relation to charitable fund-raising activities, requiring charitable organisations to display their registration numbers during charitable fund-raising activities, and engaging in more public education on matters relating to charitable fund-raising activities (see Appendix I for details).

Government's follow-up actions on the Law Reform Commission's recommendations

Government's guidelines

6.4 In October 2011, the Director of Administration issued a General Circular setting out the guidelines for B/Ds when considering the LRC proposals. According to the guidelines (which are still in force in accordance with the reissued General Circular in 2016), it is in the interests of all concerned that a decision on whether or not to implement the LRC's proposals for reform should be taken within a reasonable timeframe. Delay may lead to problems such as flaws in the legal system identified by the objective and high-powered LRC study remain not corrected and the validity of the detailed research and consultation carried out by the LRC diminishes, as it becomes out of date. The Government has therefore agreed, among others, that:

- (a) when a consultation paper is issued by the LRC, the Government should at that stage decide (and resolve should there be any disagreement) which bureau (or bureaux) will take up the primary responsibility for consideration/implementation of the final report and should notify the LRC; and
- (b) B/Ds having policy responsibility in respect of any LRC Report should:
 - (i) give full consideration to its recommendations and provide a detailed public response (setting out which recommendations they accept, reject or intend to implement in modified form) to the Secretary for Justice (as Chairman of the LRC) as soon as practicable;
 - (ii) in any event, provide at least an interim response within six months of publication of the report which sets out a clear

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timetable for completion of the detailed responses and the steps taken so far; and

- (iii) provide a detailed public response to the Secretary for Justice within 12 months of its publication, unless otherwise agreed by him as Chairman of the LRC.

6.5 In December 2011, during the consultation stage of the LRC's proposals, the Secretary for Justice as Chairman of the LRC invited the Chief Secretary for Administration to designate a bureau to take primary responsibility for LRC's proposals given that the proposals touched on areas which fell within the policy responsibilities of several bureaux. In May 2012, the Chief Secretary designated the HAB as the responsible bureau for coordinating inputs from relevant B/Ds for formulating a response to the LRC's recommendations for the Government's consideration.

Slow progress in responding to the LRC's recommendations

6.6 For three years since the issue of the LRC Report on Charities in December 2013, the HAB had provided similar responses to the Secretary for Justice for incorporation in his annual report on implementation of LRC Reports to the LegCo Panel on the Administration of Justice and Legal Services. The 2016 response stated that:

"The recommendations of the LRC Report on Charities are relevant to the purviews of various Government bureaux and departments. Given that the recommendations will have significant implications on the operation of the charities in Hong Kong, the Government needs to study in detail and carefully consider the recommendations. The Bureau (HAB) is coordinating comments from relevant bureaux and departments for consideration of the way forward."

6.7 In May 2016, the Secretary for Justice wrote to the HAB conveying the strong concerns of some members of the former LRC Charities Sub-committee about the lack of progress in implementing the LRC's recommendations. At the meeting of the LegCo Panel on Welfare Services of April 2016, the Chairman also

expressed similar view that since the release of the LRC Report, the Government had not made any progress in taking forward the LRC's recommendations.

6.8 Audit reviewed the HAB's records to examine how it had performed its coordinating role and found the following issues:

- (a) ***Inadequacies in internal consultation.*** Following the publication of the LRC Report in December 2013, the HAB commenced the internal consultation process in January 2014 by writing to nine B/Ds and received their feedback from February to April 2014. However, it only consolidated the views into a preliminary assessment paper in June 2015. Since then, the HAB convened two inter-departmental meetings in mid-August 2015 and October 2016 respectively; and
- (b) ***Belated consideration of a recommendation.*** One of the recommendations of the LRC Report is the introduction of legislation along the lines of the English model to solve the problems which arise when a charitable gift fails because the original purposes of such gift, in whole or in part, cannot be carried out. The HAB had not made reference to this recommendation in its correspondence with the B/Ds when it first solicited their views in January 2014. The HAB only invited views of the DoJ on the recommendation in September 2016.

6.9 In line with the 2016 General Circular requirements, the HAB needs to expedite the consultation with relevant B/Ds with a view to formulating a response to all the recommendations of the LRC Report.

6.10 In considering the way forward in formulating a response to the LRC's recommendations, there is a need to take into account the areas for improvement identified by Audit in earlier PARTs of this Audit Report which are complementary to the LRC's recommendations, as follows:

- (a) ***LRC recommendation: facilitation of good practice.*** In PART 2, Audit has found that there is a need to step up promotion efforts to encourage and recognise more charitable organisations to adopt the best practices for organising charitable fund-raising activities to enhance their transparency and accountability;

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- (b) ***LRC recommendation: information available to the public.*** In PARTs 3 and 4, Audit has found that there is room for the SWD and the HAD to facilitate public access to the financial information of the fund-raising activities under their purview. In PART 5, Audit has found that the FEHD needs to step up the administrative requirements on licensees to more fully account for their charitable fund-raising activities; and
- (c) ***LRC recommendation: setting up a platform of coordination.*** In PARTs 3 and 5, Audit has found that the SWD, the FEHD and the Lands D need to improve their coordination (e.g. exploring the feasibility of sharing of enforcement information and taking concerted actions on repeated “no-show” cases, and facilitating applicants in meeting related licensing requirements for fund-raising activities involving on-street selling).

Audit recommendations

6.11 **Audit has *recommended* that the Secretary for Home Affairs should:**

- (a) **expedite the consultation with relevant B/Ds with a view to formulating a response to all the recommendations of the LRC Report; and**
- (b) **take into account the areas for improvement identified in this Audit Report (such as enhancing the transparency and accountability of charitable fund-raising activities, and improving the coordination of the licensing departments in their licensing and monitoring of these activities), in coordinating inputs from relevant B/Ds for formulating a response to the LRC’s recommendations for the Government’s consideration.**

Response from the Government

6.12 The Secretary for Home Affairs accepts the audit recommendations. He has said that the HAB will take into consideration the areas for improvement as identified by Audit and continue to work with relevant B/Ds in coordinating their inputs for formulating a response to the recommendations of the LRC on charities for the Government’s consideration.

**Reference Guide on Best Practices
for Charitable Fund-raising Activities (extract)**

The major clauses of the Reference Guide relating to transparency and accountability of fund-raising activities are shown below:

Donors' rights

- (a) all donors are entitled to receive official receipts for the money donated;
- (b) all fund-raising activities shall disclose the organisation's name and the purpose for which funds are requested. Printed materials seeking donations shall also include its address, website or other contact information;
- (c) donors/prospective donors are entitled to examine the following documents promptly upon request: organisation's constitutional documents, recent annual report and audited financial statements, document confirming its status as a tax-exempt charity and a list of names of the members of the governing board;

Fund-raising practices

- (d) when conducting fund-raising activities, the organisation should accurately describe its background, activities, service details and the intended use of the donated funds;
- (e) the organisation should ensure that the volunteers, employees and hired solicitors will act with fairness, integrity, and in accordance with all applicable laws and regulations;
- (f) paid fund-raisers should be compensated by a salary, and not be paid commissions or other payments based on the number of donors secured or amount received;

Financial accountability

- (g) the organisation's financial affairs shall be conducted in a responsible manner;
- (h) annual financial reports shall disclose information which includes the total revenue and total expenses of fund-raising events, and total expenditure of the charitable activities, and separately identify the revenue generated from individual project/event involving an appeal to the public;
- (i) it is a good practice to make financial statements of individual projects available to the public, disclosing information which includes the total revenue and total expenses of fund-raising events, and the uses of net proceeds; and
- (j) no more should be spent on administration and fund-raising than is required to ensure effective management and resource development. A charitable organisation should disclose the ratio of costs to total revenue for donors' reference, and disclose the return and expenses figures for high value and well-defined projects.

Source: SWD records

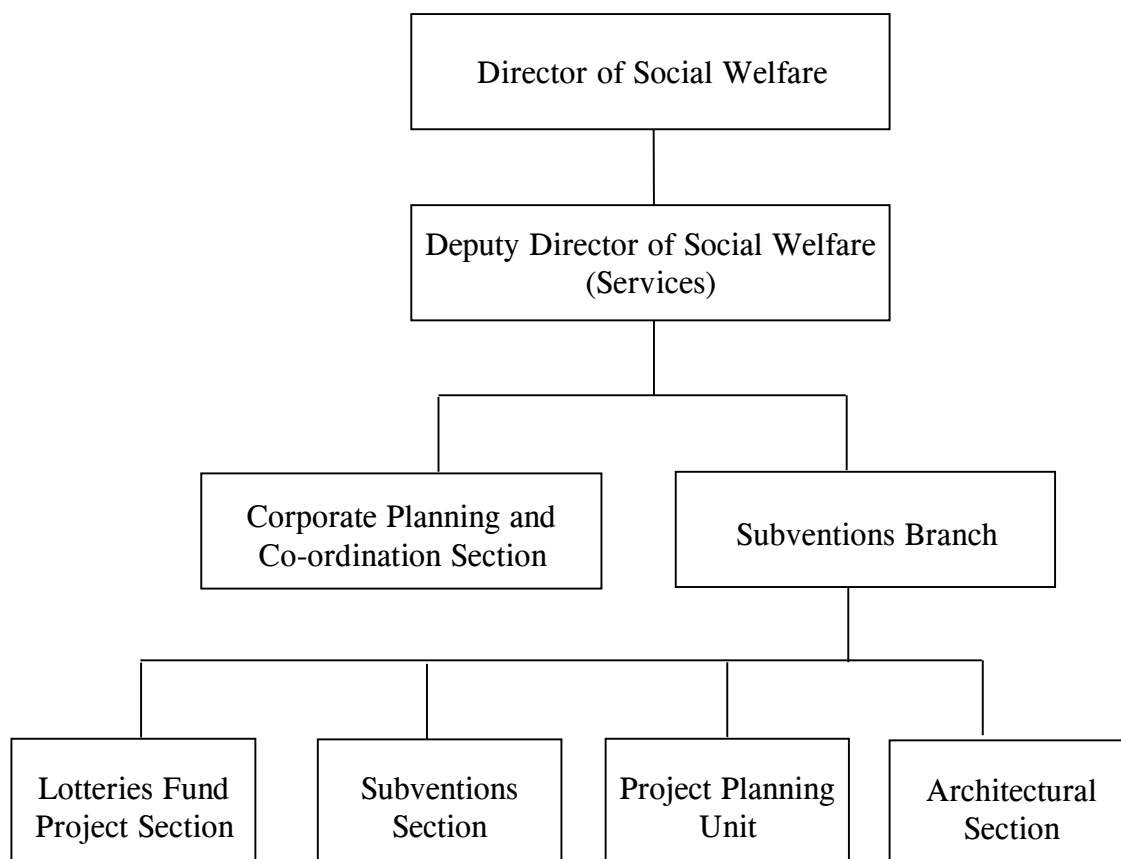
**Guidance Note on Internal Financial Controls
for Charitable Fund-raising Activities (extract)**

The Guidance Note proposes some basic controls to be considered by charitable fund-raising organisations with a view to ensuring that income generated from charitable fund-raising activities is spent for the designated purpose and that such income and expenditure are properly documented. The more important ones are shown below:

- (a) charitable fund-raising organisations should make regular checks and surprise inspections to ensure that records are being accurately maintained, and that there are no discrepancies in the accounting records;
- (b) for flag days, collection bags/boxes should be properly numbered and sealed, and collectors should make signature upon receipt and return of collection bag/boxes;
- (c) for collection boxes placed in stationed counters, boxes should be regularly opened and contents should be counted and recorded in the presence of at least two people authorised by the agency management;
- (d) for charity sale of commodities, the sale proceeds should be regularly counted and recorded in the presence of at least two people authorised by the charitable fund-raising organisation;
- (e) for charity walk receiving donations after the event, appeal for donations through advertisements, telephone calls, letters and leaflets, all incoming cheques and cash should be recorded immediately and entries verified by someone other than the person who has made the entry;
- (f) for charity ball, concert and film premiere, issue of official receipt signed by collectors should be made for each transaction of ticket sale; and
- (g) for charity show through the mass media, the pledged donation made by donors should be properly recorded. Should cancellation of the pledged donation be required afterwards, it has to be verified by someone other than the person who has made the entry.

Source: SWD records

**Social Welfare Department:
Organisation chart (extract)
(31 December 2016)**



Source: SWD records

**Major expenses of 45 public subscription permit activities
organised by 8 permittees with percentages of
expenses to gross proceeds exceeding 40%**

Permittee	Gross proceeds involved (\$)	Expenses to gross proceeds percentage					
		Fund-raiser cost	Transport cost	Venue cost	Cost of items sold	Others	Total
A	2,367,000	1 %	1 %	65 %	—	9 %	76 %
B	97,000	38 %	28 %	—	—	4 %	70 %
C	1,130,000	44 %	15 %	—	—	8 %	67 %
D	845,000	8 %	2 %	51 %	—	4 %	65 %
E	106,000	34 %	23 %	—	—	3 %	60 %
F	310,000	57 %	—	1 %	—	1 %	59 %
G	2,981,000	16 %	8 %	—	26 %	1 %	51 %
H	52,000	0 %	7 %	—	27 %	7 %	41 %

Source: Audit analysis of SWD records

**Sample of the income and expenditure account for a
general charitable fund-raising activity
covered by a public subscription permit**

[Registered Name of the Permittee]

Income and Expenditure Account

[Name of Activity] - [Approved Date / Period of Activity]

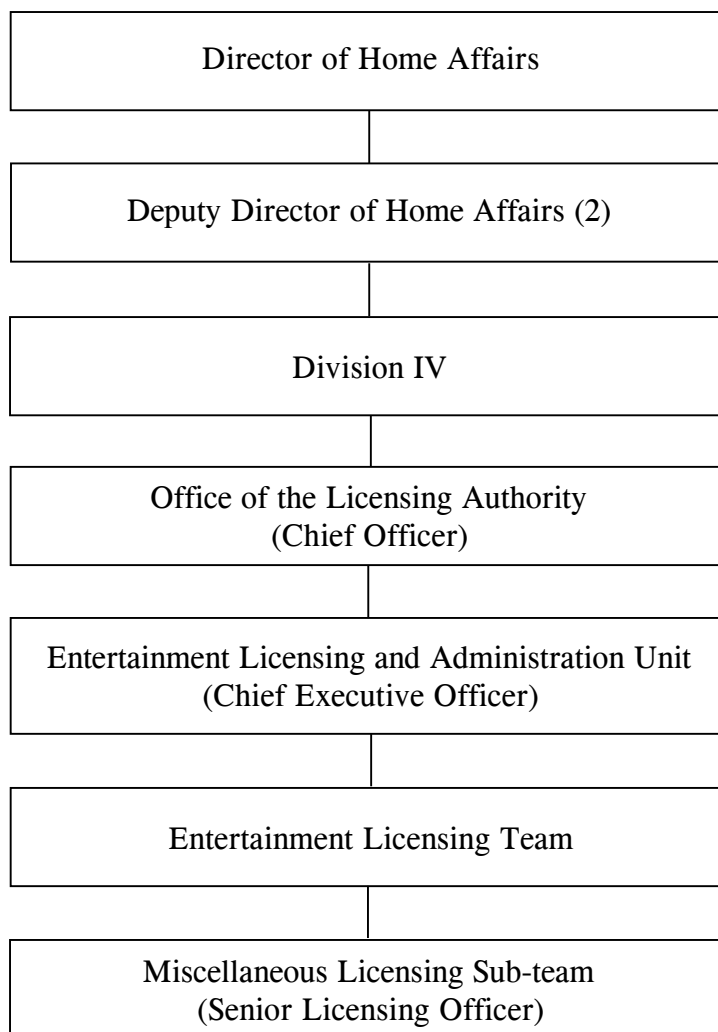
Public Subscription Permit No. 2013/XXX/1

<u>Income</u>	<u>HK\$</u>
Charity sales	XXX
Donations received	XXX
	XXX
<u>Expenditure</u>	
Advertising	XXX
Allowances/souvenirs for volunteers	XXX
Auditors' remuneration/professional fee	XXX
Salaries for fundraisers	XXX
Printing and stationery	XXX
Transportation	XXX
Miscellaneous	XXX
	XXX
Excess of income over expenditure	XXX

Approved and authorised for issue by the Board of Directors on [DATE].

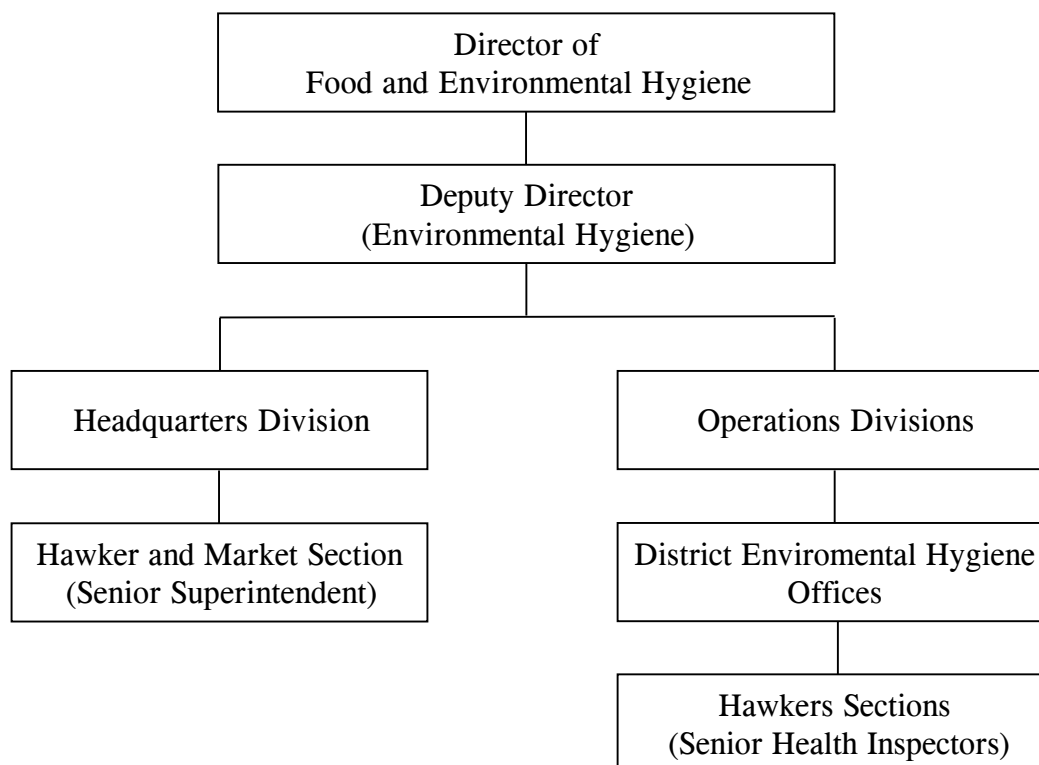
Source: SWD records

**Home Affairs Department:
Organisation chart (extract)
(31 December 2016)**



Source: HAD records

**Food and Environmental Hygiene Department:
Organisation chart (extract)
(31 December 2016)**



Source: FEHD records

Comparison of key permit/licence conditions and administrative measures imposed by the three licensing departments

Aspect covered	Extracts of the relevant condition and administrative measure		
	SWD	HAD	FEHD
	PSP for general charitable fund-raising activities	Lottery licence	Temporary hawker licence
(a) Track record requirement	The applicant must have at least three years' track record of charitable activities	If this is the first application, the applicant is required to submit audited annual financial statements for the past three years and three years' worth of track records of activities/charitable works	Not available
(b) Disclosure of fund-raising purpose	The permittee shall display its service information prominently at the approved locations to facilitate public understanding of the organiser and the purposes of fund-raising	Lottery tickets should contain a statement stating clearly the intended use of the net lottery proceeds	Not available
(c) Custody of funds raised	The permittee shall take sufficient security measures for the safe keeping of the funds raised, and ensure that all the donation boxes are secure and properly sealed	Lottery organisers must ensure the proper collection and counting of all donations received	Not available
(d) Preparation of audited accounts	The permittee is required to prepare an account for audit by a CPA	The licensee shall prepare an account and obtain a written report made by a CPA	Organisations issued with more than 12 licences within 12 months shall prepare an account for each and every of the licences subsequently issued for audit by a CPA
(e) Submission of audited accounts	Within 90 days of the last event day	Within 90 days of the date of the draw of the lottery	Within 90 days of the last day of the licence period

Appendix H
(Cont'd)
(para. 5.7 refers)

Aspect covered	Extracts of the relevant condition and administrative measure		
	SWD	HAD	FEHD
	PSP for general charitable fund-raising activities	Lottery licence	Temporary hawker licence
(f) Standard of audited accounts	The audited report prepared by a CPA in accordance with Practice Note 850 issued by the HKICPA is deemed acceptable	The CPA is required to give an assurance that the account is properly prepared from the licensee's books and records and no matter has come to the CPA's attention which indicates that the account does not accurately reflect all the moneys collected or received from the sale of lottery tickets and all the disbursements made	Not available
(g) Publication of audited accounts by the organisation	The audited report may be published in newspaper, organisation's newsletter or websites (for at least 6 months in the case of website)	Not available	Not available
(h) Funds raised donated to other organisation	The permittee is required to submit a copy of the receipt from the organisation or institution	The licensee shall submit copies of receipt of donations from the beneficiaries	Not available
(i) Funds raised used for meeting the operation expenses of the organisation	Not available	The licensee shall submit an audited annual financial statement of the organisation, which should show the income and expenditure of the lottery, and the whereabouts of the net proceeds in meeting the approved purpose(s) of the lottery event	Not available
(j) Restriction on fund-raising expenses	Not available	Administrative expenses should not exceed 20% of the gross proceeds received from lottery tickets sold	Not available

Source: SWD, HAD and FEHD records

Recommendations of the Law Reform Commission Report

The LRC Report contained 18 recommendations on charities, covering aspects on definition and registration of charities, facilitation of good practice, financial reporting by charities, and filing requirements (and requirement of display of registration number) for charitable fund-raising activities. The 18 recommendations are summarised below:

Statutory definition

- (a) there should be a clear statutory definition of what constitutes a charitable purpose;

Categories of charitable purpose

- (b) the statutory definition of what constitutes a charitable purpose that is exclusively charitable should include 14 heads and all of these heads of charitable purpose must be also for the public benefit;

Legal forms of charitable organisations

- (c) the current system of allowing a variety of legal forms of charitable organisations to exist should continue;

Registration of charitable organisations

- (d) all charitable organisations which solicit from the public for the donation of cash or its equivalent; and/or have sought tax exemption should be subject to the requirement of registration. The list of registered charitable organisations should be established and maintained by a B/D and be available for public inspection;

Financial reporting standard

- (e) a specifically formulated financial reporting standard should be adopted for charities in Hong Kong;

Filing requirements

- (f) certain filing requirements should be imposed on charitable organisations in their applications for charitable fund-raising licences or permits;

Information available to the public

- (g) the Government should ensure that tax-exempt charities make information about their operations available to the public by publishing certain documents, such as their financial statements and activities' reports, on their websites;

Enforcement action for non-compliance with filing and disclosure requirements

- (h) the Government should designate a B/D to be responsible for enforcement action in cases of non-compliance with the filing and disclosure requirements;

Standardised application form and conditions

- (i) a standardised application form setting out some common basic requirements (including the requirement for disclosure of certain information about the charity) should be adopted in respect of different types of charitable fund-raising licence or permit applications and the existing function of the information portal under the "GovHK" website should be enhanced by making the information available for public inspection;

Centralised hotline

- (j) the function of the Government's existing 1823 Call Centre should be enhanced or a new telephone hotline should be set up for answering public enquiries and receiving complaints in relation to charitable fund-raising activities;

Display of registration number

- (k) the registration number of charitable organisations involved in all forms of charitable fund-raising activities (including those via the Internet or other electronic means and involving face-to-face solicitation of pledges from donors for regular donations) should be prominently displayed on, among others, any related documents, webpage, message transmitted by electronic means or any means through which appeals for charitable donations are made (as the case may be);

Facilitation of good practice

- (l) charitable organisations should be encouraged to work with institutions/organisations to facilitate good practice and to improve co-operation between charitable organisations and the Government. Good practice guidelines should be issued by a coordinating B/D;

Public education

- (m) the Government, through the coordinated efforts of B/Ds, should engage in more public education on how to become a smart donor and on matters relating to charitable fund-raising activities;

Setting up a platform of coordination

- (n) the Government should set up a platform of coordination in dealing with applications for charitable fund-raising licences among the different departments responsible for the licensing of charitable fund-raising activities;

Allocation of more resources

- (o) more resources should be allocated to Government departments involved in the licensing of charitable fund-raising activities in order to enhance their role in relation to the monitoring of charitable fund-raising activities;

More frequent reviews by the IRD

- (p) the IRD should conduct more frequent reviews of tax-exempt charities to ascertain whether the activities of these charities are compatible with their charitable objects and more resources should be allocated to the IRD for such purpose;

Cy-près doctrine

- (q) the Government should introduce legislation along the lines of the English statutory model of the cy-près doctrine (i.e. to solve the problems which arise when a charitable gift fails because the original purposes of such gift, in whole or in part, cannot be carried out) so as to provide a statutory basis for the doctrine in Hong Kong and to broaden the scope of its application; and

Setting up of a charity commission

- (r) a charity commission should not be set up at this stage. It should be a long-term goal to set up a charity commission or a centralised regulatory authority upon review of the impact and effect of the implementation of the other recommendations made in the LRC Report.

Source: LRC Report

Acronyms and abbreviations

Audit	Audit Commission
B/Ds	Bureaux/departments
CPA	Certified Public Accountant
DoJ	Department of Justice
FEHD	Food and Environmental Hygiene Department
HAB	Home Affairs Bureau
HAD	Home Affairs Department
HKICPA	Hong Kong Institute of Certified Public Accountants
HKPF	Hong Kong Police Force
HLCS	Hawker Licensing and Hawker Conviction System
IRD	Inland Revenue Department
IRO	Inland Revenue Ordinance
Lands D	Lands Department
LegCo	Legislative Council
LFAC	Lotteries Fund Advisory Committee
LIS	Licensing Information System
LRC	Law Reform Commission
OGCIO	Office of the Government Chief Information Officer
PSP	Public subscription permit
SWD	Social Welfare Department

CHAPTER 3

**Lands Department
Rating and Valuation Department
Civil Engineering and Development Department**

**Management of squatter and
licensed structures**

**Audit Commission
Hong Kong
3 April 2017**

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. 68 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 SQUATTER AND LICENSED STRUCTURES

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MANAGEMENT OF SQUATTER AND LICENSED STRUCTURES

Executive Summary

1. From mid-1940s to late 1970s, mainly due to the influx of Mainland immigrants, thousands of people erected squatter structures on undeveloped and unleased government land or private agricultural land. In 1982, the Housing Department (HD)'s territory-wide survey (the 1982 Squatter Survey) revealed that there were 1,049 squatter areas comprising 578,000 squatter structures in Hong Kong. During the Survey, each surveyed squatter structure (SS structure) was assigned a squatter survey number. In 1984 and 1985, the HD's territory-wide squatter occupancy survey registered the personal particulars of 477,184 persons residing in SS structures. Since April 2006, the Lands Department (Lands D) has taken over the squatter control (SC) responsibilities from the HD. According to the Lands D, mainly due to the Government's clearance operations, the number of squatter areas had decreased to 772 and SS structures to 388,497 as of March 2016.

2. Under the Lands D's SC Policy, new squatter structures and unauthorised extensions of squatter structures are not allowed to be erected on government land or private agricultural land after the 1982 Squatter Survey, and SS structures are allowed to remain in existence on a "temporary" basis, provided that the location, dimensions, building materials and use of each structure are the same as those recorded in the 1982 Squatter Survey, and until they are cleared for development, safety or environmental reasons, or until they are phased out through natural wastage. Repairs of SS structures and rebuilding of domestic SS structures using temporary building materials in the New Territories areas are allowed so long as government approval is first obtained. Unauthorised squatter structures erected or rebuilt after the 1982 Squatter Survey and SS structures not complying with the SC Policy are subject to the Lands D's enforcement actions, such as requiring the occupants to carry out rectification works, cancelling the squatter survey numbers and demolishing the pertinent structures.

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3. Under the Land (Miscellaneous Provisions) Ordinance (Cap. 28 — the Cap. 28 Ordinance), on payment of a prescribed fee, the Lands D may issue a Government Land Licence (GLL) permitting a licensee to erect structures of specified dimensions, for specified purposes and for a specified period of time on a piece of unleased government land. A GLL is not transferable, and the Lands D may cancel a GLL if there is a breach of any licence conditions. Prior to mid-1970s, the Government had issued GLLs for erection of some domestic and non-domestic structures on government land. Since then, the Lands D has not issued new GLLs. As of March 2016, 15,214 GLLs (comprising 10,481 domestic and 4,733 non-domestic GLLs) were in force. The structures covered under GLLs are referred to as licensed structures in this Audit Report. The Audit Commission (Audit) has recently conducted a review to examine the Government's management of squatter and licensed structures (S&L structures).

Monitoring of squatter and licensed structures

4. The seven Squatter Control Offices (SCOs) of the Lands D had a total of 347 staff as of March 2016. They were responsible for monitoring and patrolling squatter structures to ensure their compliance with the SC Policy. The seven SCOs kept information in individual case files on SS structures that did not comply with the SC Policy and the follow-up actions taken, and no centralised database to record the information was readily available for effective monitoring by the Lands D's management. Under a tri-colour system adopted for SCO routine-patrol purposes, squatter areas in the territory were classified into red, yellow and green areas in descending order of vulnerability to new squatting activities. Of the 388,497 SS structures as of March 2016, 4,170 SS structures (1%) were located in red areas under the tri-colour system. As all red patrol areas were located on Hong Kong Island and in Lei Yue Mun, Audit selected the SCO/Hong Kong and Lei Yue Mun (HK&LYM) of the Lands D for carrying out a review of the SCO's SC work (paras. 2.4, 2.6 to 2.8, 2.10 and 2.38).

5. ***Non-compliant SS structures not detected.*** In December 2016, Audit visited a village located on Hong Kong Island which was classified as a red patrol area, and found that 50 structures might not have complied with the SC Policy. Subsequent to the site visit, the suspected cases were referred to the Lands D for investigations. As of January 2017, the Lands D's investigations revealed that the structures of 5 cases located on private land were not SS structures. For the remaining 45 cases: (a) the SS structures of 19 cases were confirmed to be not complying with the SC Policy. Of the 19 cases, 12 non-compliant cases had been

Executive Summary

noted by the Lands D before Audit's site visit and enforcement actions on these structures were in progress, the other 7 cases were new non-compliant cases; (b) the SS structures of 5 cases did not involve non-compliance with the SC Policy; and (c) investigations of the remaining 21 cases were still ongoing and the Lands D had not confirmed as to whether or not they complied with the SC Policy (para. 2.11).

6. Audit's review of 2 of the 7 new non-compliant cases mentioned in paragraph 5(a) revealed that, in one case, the total area of two SS structures had expanded from 690 square feet (ft²) to 800 ft² (a 16% increase), and the height of the two structures had increased from 11 feet (ft) and 9 ft respectively to 27 ft (on average a 170% increase). In another case, the total area of two SS structures had increased from 230 ft² to 460 ft² (a 100% increase), and the height of the two structures had increased from 5 ft and 6 ft respectively to 12 ft (on average a 118% increase). Additionally, the use of the structures had been changed from storage to domestic, and the building materials had been changed from wood to concrete/wood. Furthermore, Audit's review of 1 of the 12 non-compliant cases of which the Lands D's follow-up actions were in progress as mentioned in paragraph 5(a) revealed that the Lands D's investigation was made in response to a public complaint. In this case, the height of an SS structure had increased from 11 ft to 19 ft (a 73% increase). In all the three cases reviewed by Audit, the SCO's routine patrols had not detected the significant irregularities of the SS structures (para. 2.12).

7. *Non-compliant SS structures mainly identified through complaints or referrals.* From January 2015 to September 2016, SC staff of the seven SCOs had identified 939 confirmed cases of non-compliance with the SC Policy. However, of the seven SCOs, only one (namely SCO/New Territories East (1)) maintained information on the source of identifying non-compliant SS structures, of which 181 (88%) of the 206 cases originated from public complaints or referrals from other government bureaux or departments (B/Ds), and only 25 cases (12%) were detected during SC patrols. Moreover, according to the SCO/HK&LYM's Case Monitoring Report of October 2016, of the 35 cases of non-compliant SS structures with enforcement actions in progress: (a) 28 cases (80%) originated from public complaints (including media enquiries) or B/D referrals; and (b) the remaining 7 cases (20%) were detected during SC patrols (paras. 2.15, 2.16 and 2.18).

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8. Audit examination of 4 of the 28 cases mentioned in paragraph 7(a) revealed that some of the SS structure occupants had claimed hardship in rectifying the non-compliances with the SC Policy, and: (a) as of February 2017, a de-registered SS structure was being re-occupied but, mainly due to unclear responsibilities among different Lands D units, enforcement actions had not been taken on the structure since July 2015; (b) repeated control actions taken on a non-compliant SS structure in 2013 and 2014 had failed to deter the recurrence of unauthorised works and extension of the structure; (c) the height of two SS structures had increased from 11 ft and 7 ft respectively to 18 ft (on average a 100% increase), and despite repeated actions taken from November 2015 to October 2016, the irregularities had not been rectified; and (d) despite the cancellation of squatter survey numbers and issuance of demolition notices in August/September 2016 on three SS structures due to their non-compliance with the SC Policy, demolition works had not commenced as of January 2017 (para. 2.19).

9. ***Ineffective squatter structure monitoring system.*** The Lands D's seven SCOs with 312 operation staff conducted patrols of the squatter areas on a routine basis. Audit selected two patrol teams responsible for patrolling two patrol areas in the SCO/HK&LYM for review. From January 2015 to September 2016 (comprising 432 working days), the two patrol teams had respectively conducted patrols to the two patrol areas on 257 and 208 working days respectively. Audit examination revealed that only 2 of the 465 (257 + 208) daily patrol reports recorded irregularities found during the patrols, and the patrol teams often spent a short time at each of the 49 designated check-points in the two patrol areas. Moreover, the SCOs did not maintain a centralised database to record the time of inspecting each SS structure, the irregularities observed and the follow-up actions taken, and the information was kept in individual case files. Therefore, there is no assurance that SS structures have satisfactorily complied with the SC Policy (paras. 2.20 to 2.28, 2.38 and 2.40).

10. ***Licensed structures not complying with licence conditions.*** The Lands D's 12 District Lands Offices (DLOs) are responsible for monitoring licensed structures to ensure their compliance with the licence conditions. The DLOs kept information in individual case files on licensed structures that did not comply with the licence conditions and the follow-up actions taken. In January 2017, Audit visited 30 licensed structures located on an outlying island and noted that the structures of two cases might not have complied with the licence conditions. Audit examination of their case files revealed that, in one case, despite a warning letter issued in February 2005 to a licensee requiring him to demolish an unauthorised

Executive Summary

rooftop structure constructed on a licensed structure, after 12 years in January 2017, the unauthorised structure had not been demolished. In another case, up to January 2017, despite the death of the licensee of a licensed structure made known to the DLO/Islands in November 2011, and in the absence of an application and approval of a transfer of the GLL concerned, the Lands D had not taken the necessary enforcement actions (paras. 2.46 and 2.47).

11. *Lack of inspection programmes and inspection information on licensed structures.* Pursuant to the Lands D's instructions, each licensed structure should be inspected at least once a year, and the inspection interval may be changed subject to not less than once every three years after considering work priorities. However, the 12 DLOs did not compile inspection programmes for inspecting licensed structures, and they did not maintain a centralised database to record the time of inspecting each licensed structure, the irregularities observed and the follow-up actions taken. Therefore, there is no assurance that licensed structures have satisfactorily complied with the licence conditions (paras. 2.48 and 2.49).

Rates, government rent and licence fees on squatter and licensed structures

12. *Omissions in charging rates and government rent on S&L structures.* Under the Rating Ordinance (Cap. 116), subject to certain exemptions, rates are chargeable on squatter structures erected on private agricultural land and on licensed structures. In addition, under the Government Rent (Assessment and Collection) Ordinance (Cap. 515), subject to certain exemptions, government rent is chargeable on squatter structures erected on private agricultural land. However, Audit noted that the Lands D had not provided the Rating and Valuation Department (RVD) with information on all the 262,128 SS structures erected on private agricultural land and all the licensed structures covered under 15,214 GLLs as of March 2016 for the latter to assess and charge rates and government rent as appropriate (paras. 1.6, 1.14, 3.2 to 3.4 and 3.7).

13. Regarding SS structures erected on private agricultural land, owing to the fact that the RVD's database did not maintain information on the squatter survey numbers of SS structures (which did not normally bear proper addresses for rates and government rent assessment purposes), and that data matching between records of the RVD and the Lands D had not been carried out, there is no assurance that

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rates and government rent have been properly charged on all pertinent SS structures. Regarding licensed structures, Audit noted that, of the total 15,214 GLLs, as of March 2017, the RVD's database only maintained the rates assessment records of structures covered under 6,659 GLLs (44%). Audit's sample-check of licensed structures covered under 30 GLLs (1%) of the 3,326 GLLs under the monitoring of the DLO/Islands revealed that the RVD had not assessed and charged rates on the licensed structures covered under 18 (60%) GLLs. According to the RVD, these 18 cases related to premises located in remote areas involving relatively low rateable values (paras. 3.6, 3.8 and 3.10).

14. ***Lack of review and revision of GLL fees since 1972.*** Audit noted that licence fees for licensed structures had not been revised since the enactment of the Cap. 28 Ordinance in 1972. Audit also noted that the licence fees for licensed structures were very low. For example, the licence fee for a domestic licensed structure located in the New Territories was only \$0.3 per square metre a year (para. 3.19).

Clearance of squatter and licensed structures

15. Occupants of S&L structures affected by the Government's development clearance operations may be re-housed to public rental housing (PRH), subject to meeting certain eligibility criteria. From 2012 to 2016, 5,606 structures had been cleared under the Government's development clearance operations. Among these operations, a works project (Project A) involved clearance of the largest number of 1,669 (30% of 5,606) structures, and \$211 million had been approved for Project A clearance. Audit selected Project A for examination. Under Project A, 147 households were provided with various re-housing arrangements and/or ex-gratia allowances (paras. 4.4, 4.5, 4.7 and 4.8).

16. ***Household not meeting PRH re-housing criteria referred to HD for allocation of PRH flat.*** In one case, Audit noted that, while the household did not meet one of the requirements for re-housing to PRH (namely, residing in an affected structure for two years immediately before the announcement of the clearance under Project A), the Lands D forwarded the case to the HD which eventually allocated a PRH flat to the household (para. 4.10).

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17. *Need to monitor and report progress of upgrading works for public slopes affecting S&L structures.* As of February 2017, of the 1,582 government man-made slopes posing landslide risks to S&L structures, the Civil Engineering and Development Department (CEDD) had not commenced upgrading works for 940 (59%) slopes. Moreover, as of January 2016, while 199 squatter structures were prone to landslide risks posed by natural terrains, the CEDD had not conducted related natural terrain hazard studies to identify required mitigation measures (paras. 4.25 and 4.27).

18. *Need to strengthen actions to upgrade private slopes posing landslide risks to S&L structures.* Under the Buildings Ordinance (Cap. 123), the Buildings Department may issue a Dangerous Hillside Order (DHO) to a private-slope owner requiring him to carry out slope upgrading works within a specified period. However, as of January 2017, 210 DHOs on private slopes posing landslide risks to S&L structures had not been satisfactorily complied with. Of these 210 DHOs, 34 (16%) had been outstanding for 10 to 21 years (paras. 4.28 and 4.30).

Audit recommendations

19. **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 should:**

Monitoring of S&L structures

- (a) **take appropriate enforcement actions on non-compliant SS structures in a timely manner (para. 2.42(a));**
- (b) **take measures to prevent recurrence of delays in taking enforcement actions due to unclear responsibilities among different Lands D units (para. 2.42(c));**
- (c) **based on available staff resources, formulate an inspection programme for every inspection team covering all SS structures within an inspection area over a certain period of time (para. 2.42(g));**

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- (d) **conduct a review of the effectiveness of the systems for monitoring S&L structures and consider implementing improved systems for monitoring these structures (paras. 2.42(j) and 2.54(e));**
- (e) **take effective measures to ensure that licensed structures comply with licence conditions (para. 2.54(a));**

Rates, government rent and licence fees on S&L structures

- (f) **take actions to charge rates and government rent on pertinent S&L structures, and recover rates and government rent on such structures for which charging has been omitted in the past (para. 3.12(b));**
- (g) **expedite actions on conducting a review of the GLL fee levels (para. 3.25(a));**

Clearance of S&L structures

- (h) **take measures to ensure that only eligible households affected by a clearance operation are referred to the HD for PRH re-housing (para. 4.14(a));**
- (i) **monitor and periodically inform the Legislative Council of the progress of implementing upgrading works for government man-made slopes and natural terrains posing landslide risks to S&L structures (para. 4.33); and**
- (j) **strengthen actions on private slopes for which the required upgrading works specified in DHOs have not been satisfactorily carried out over a long period of time (para. 4.34).**

Response from the Government

20. The Government 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

Squatter structures

1.2 From mid-1940s to late 1970s, due to the influx of Mainland immigrants and the rising birth rate, housing supply was unable to cope with the surge in demand. As a result, thousands of people erected squatter structures (see Photograph 1) on undeveloped and unleased government land or private agricultural land.

Photograph 1

Squatter structures in Sham Tseng (February 2017)



Source: Photograph taken by Audit Commission in February 2017

Introduction

1.3 In 1982, with a view to controlling the number of squatter structures, the Housing Department (HD) conducted a territory-wide survey on squatter structures being erected on unleased government land and private agricultural land (hereinafter referred to as the 1982 Squatter Survey), during which each surveyed squatter structure (SS structure) was assigned a squatter survey number. Squatter structures erected on government land or private agricultural land without squatter survey numbers are subject to the Lands Department (Lands D — Note 1) enforcement actions. As revealed in the 1982 Squatter Survey, as of June 1982, there were 1,049 squatter areas comprising 578,000 SS structures in Hong Kong. Mainly due to the Government's clearance operations, the number of squatter structures has decreased over the years. Since April 2006, the Lands D has taken over the squatter control (SC) responsibilities from the HD. According to the Lands D's Squatter Control Quarterly Statistics, as of March 2016, there were 772 squatter areas comprising 388,497 SS structures erected on unleased government land and private agricultural land. Details are shown in Table 1.

Table 1
SS structures in Hong Kong
(March 2016)

Use	SS structures erected on		
	Government land (No.)	Private agricultural land (No.)	Total (No.)
Domestic use	32,575	51,794	84,369
Non-domestic use	93,794	210,334	304,128
Total	126,369	262,128	388,497

Source: Lands D records

Note 1: *Before December 1981, the then New Territories Administration was the land authority in the New Territories. With the re-organisation of the Government Secretariat in December 1981, the then City and New Territories Administration became the land authority. Since its establishment in April 1982, the Lands D has been responsible for all land administration matters. For simplicity, the New Territories Administration and the City and New Territories Administration are also referred to as the Lands D in this Audit Report.*

1.4 In 1984 and 1985, the HD conducted a territory-wide squatter occupancy survey (hereinafter referred to as the 1984/85 Occupancy Survey) to register the personal particulars of persons residing in SS structures covered in the 1982 Squatter Survey. The 1984/85 Occupancy Survey revealed that there were 477,184 squatter occupants at that time. Thereafter, no territory-wide squatter occupancy survey has been conducted for the purpose of implementing the SC Policy (see paras. 1.7 to 1.9).

Licensed structures

1.5 Under the Land (Miscellaneous Provisions) Ordinance (Cap. 28 — the Cap. 28 Ordinance (Note 2)), on payment of a prescribed fee, the Lands D may issue a Government Land Licence (GLL — Note 3) permitting a licensee to occupy a piece of unleased government land. Under the Ordinance, a GLL is valid for a specified period and may be renewed or terminated at the Lands D's discretion. Prior to mid-1970s, the Government had issued GLLs for erection of some domestic and non-domestic structures on government land. The structures covered by GLLs are hereinafter referred to as licensed structures in this Audit Report.

1.6 According to the Lands D, some of the licensed structures were also covered in the 1982 Squatter Survey, but the Lands D has not maintained records on the number and details of such licensed structures. Since mid-1970s, except for cancellation and re-issue cases, the Lands D has not issued new GLLs. Instead, the Lands D has issued short-term tenancies (STTs) for temporary use of unleased government land. As of March 2016, 15,214 GLLs (comprising 10,481 domestic and 4,733 non-domestic GLLs) were in force.

Note 2: *Before July 1997, the Cap. 28 Ordinance was named "Crown Land Ordinance". In July 1997, the Ordinance was renamed "Land (Miscellaneous Provisions) Ordinance". For simplicity, the Crown Land Ordinance (before July 1997) and the Land (Miscellaneous Provisions) Ordinance (since July 1997) are referred to as the Cap. 28 Ordinance in this Audit Report.*

Note 3: *Before July 1997, GLLs were known as "Crown Land Licences" issued under the then Crown Land Ordinance. For simplicity, GLLs and Crown Land Licences are collectively referred to as GLLs in this Audit Report.*

Introduction

Lands D's Squatter Control Policy

- 1.7 According to the Lands D's SC Policy published on its website:
- (a) SS structures constitute unauthorised occupation of government land or erection of unauthorised structures on private agricultural land, and these acts are temporarily tolerated by the Government. Such tolerance does not create any legal rights or interests or obligations, and does not confer on any person the right of occupation of the land involved;
 - (b) although there is no legal restriction on the sale or renting of squatter structures, members of the general public are advised not to purchase or rent squatter structures given their “temporarily tolerated” nature;
 - (c) SS structures are allowed to remain in existence on a “temporary” basis:
 - (i) provided that the location, dimensions, building materials and use of each structure are the same as those recorded in the 1982 Squatter Survey (hereinafter referred to as the 1982 Survey Records); and
 - (ii) until they are cleared for development, safety or environmental reasons, or until they are phased out through natural wastage (e.g. when they are not occupied or cease to exist); and
 - (d) new squatter structures erected after the 1982 Squatter Survey and SS structures having their locations, dimensions, building materials or use being at variance with the 1982 Survey Records are subject to enforcement actions taken by the Lands D. For those erected on unleased government land, the Lands D may take enforcement actions under the Cap. 28 Ordinance (e.g. demolishing unauthorised structures on government land). For those erected on private agricultural land, the Lands D may take lease enforcement actions (Note 4).

Note 4: *According to the Lands D, such actions might include registering warning letters at the Land Registry and, for serious cases, re-entry of the private land.*

1.8 In June 2016, the Lands D informed the public through a press release that it would improve its SC measures, including:

- (a) tightening its discretionary arrangements to allow the occupants to rectify irregularities for SS structures with unauthorised extensions. If there was evidence showing that a new extension had been completed after 22 June 2016, actions would be taken such as cancelling the squatter survey number instantly and demolishing the whole unauthorised structure erected on government land immediately upon detection without giving the occupant any opportunity to rectify, or taking lease enforcement actions against cases involving newly extended structures erected on private land as appropriate; and
- (b) stepping up its investigation and information gathering efforts through the use of unmanned aerial systems and aerial photographs to actively identify suspected illegal extensions or rebuilding of SS structures.

The progress of implementing the Lands D's improved SC measures since June 2016 is shown in Appendix A.

1.9 According to the Lands D, under the prevailing SC Policy, the Government does not exercise controls over occupants residing in SS structures.

Conditions of licensed structures

1.10 The licence conditions of a GLL include:

- (a) the Lands D permits the licensee to occupy a piece of government land for a specified temporary period, and only structures complying with the purposes and dimensions specified in the GLL are allowed to be erected on the piece of government land concerned;
- (b) the Lands D may cancel a GLL if there is a breach of any licence conditions. With the cancellation of a GLL, the related structures erected on the government land concerned have to be removed at the licensee's cost; and

Introduction

- (c) a GLL is not transferrable, and the Lands D may at its discretion cancel a GLL by giving three months' notice to the licensee.

Re-housing of occupants upon clearance of squatter and licensed structures

1.11 It has been the Government's policy not to render anyone homeless as a result of its clearance operations. The Government primarily makes use of the records of the 1982 Squatter Survey for exercising controls over squatter structures, and the 1984/85 Occupancy Survey for determining the eligibility of occupants for re-housing and allowances upon clearance of squatter and licensed structures (S&L structures).

1.12 In December 2002, in relation to clearance operations, the Hong Kong Housing Authority (HA — Note 5) adopted a policy for re-housing occupants of SS structures not having been covered in the 1984/85 Occupancy Survey, under which occupants who have lived in affected SS structures for two years prior to the date of announcement of a clearance operation are eligible for the HA's re-housing scheme, provided that other public rental housing (PRH) eligibility criteria are met.

Key responsible government bureau and departments

1.13 The Development Bureau (DEVB — Note 6) is responsible for the policy matters on the control of S&L structures. Vested with the statutory power under the

Note 5: *The HA is a statutory body established in April 1973 under the Housing Ordinance (Cap. 283). As the executive arm of the HA, the HD provides secretarial and executive support for the HA.*

Note 6: *In July 2007, the DEVB was formed to take up the policy matters on S&L structures. Before July 2007, the policy responsibility had been taken up by the then Housing, Planning and Lands Bureau (July 2002 to June 2007). Before July 2002, the policy responsibility on squatter structures had been taken up by the then Housing Bureau (July 1997 to June 2002), whereas the policy responsibility on licensed structures had been taken up by the then Planning and Lands Bureau (January 2000 to June 2002) and the then Planning, Environment and Lands Bureau (July 1997 to December 1999). For simplicity, all previous policy bureaux responsible for the policy matters on S&L structures are referred to as the DEVB in this Audit Report.*

Cap. 28 Ordinance, the Lands D is responsible for discharging SC functions (through its SC Unit), carrying out clearance of affected structures (through its Clearance Unit, Non-development Clearance Unit and 12 District Lands Offices (DLOs)) and administering licensed structures (through its 12 DLOs). Appendix B shows an extract of the organisation chart of the Lands D relevant to the management of S&L structures.

1.14 Squatter structures erected on private agricultural land are chargeable to rates under the Rating Ordinance (Cap. 116) as well as to government rent under the Government Rent (Assessment and Collection) Ordinance (Cap. 515 — hereinafter referred to as the Rent Ordinance). Moreover, licensed structures are chargeable to rates under the Rating Ordinance. The Rating and Valuation Department (RVD) is responsible for the assessment and charging of rates and government rent on pertinent S&L structures.

1.15 The Civil Engineering and Development Department (CEDD — Note 7) is responsible for assessing and improving the safety of slopes, and for making recommendations to the Lands D on clearance of S&L structures on slope-safety grounds.

Audit review

1.16 In 1996, the Audit Commission (Audit) conducted a review of the HD's SC operations, the results of which were included in Chapter 12 of the Director of Audit's Report No. 26 of March 1996. In 1997, Audit conducted a follow-up review of the same subject, the results of which were included in Chapter 9 of the Director of Audit's Report No. 29 of October 1997. In 2012, Audit conducted a review of unlawful occupation of government land including, among others, a case study relating to S&L structures, the results of which were included in Chapter 7 of the Director of Audit's Report No. 58 of March 2012.

Note 7: *The CEDD was formed in July 2004 upon the merging of the former Civil Engineering Department (including the Geotechnical Engineering Office) and the former Territory Development Department. For simplicity, the former Civil Engineering Department is referred to as the CEDD in this Audit Report.*

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1.17 In recent years, there have been media reports and public complaints on unauthorised extensions and alterations of S&L structures, as well as conversions of non-domestic structures into domestic ones. Furthermore, some squatter areas situated near hillsides are prone to landslide risks, and landslides had resulted in serious casualties in some squatter areas in the past decades.

1.18 In October 2016, Audit commenced a review to examine the Government's management of S&L structures. The review focuses on the following areas:

- (a) monitoring of S&L structures (PART 2);
- (b) rates, government rent and licence fees on S&L structures (PART 3); and
- (c) clearance of S&L structures (PART 4).

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

Acknowledgement

1.19 Audit would like to acknowledge with gratitude the full cooperation of the staff of the DEVB, the Lands D, the RVD, the HD, the CEDD and the Buildings Department (BD) during the course of the audit review.

PART 2: MONITORING OF SQUATTER AND LICENSED STRUCTURES

2.1 This PART examines the Lands D's actions in monitoring S&L structures, focusing on:

- (a) monitoring of squatter structures (see paras. 2.2 to 2.44); and
- (b) monitoring of licensed structures (see paras. 2.45 to 2.56).

Monitoring of squatter structures

Lands D's SC Policy

2.2 From 2002 to 2006, the Lands D took over SC responsibilities from the HD in two phases, with the first phase involving the transfer of SC work in the urban areas and the Islands District effective from April 2002, and the second phase involving the transfer of SC work in the New Territories from April 2006. In April 2006, the Lands D set up the SC Unit comprising 421 staff (actual staff strength), which were transferred from the HD and through the Lands D's internal staff redeployment, to monitor squatter structures.

2.3 The salient elements of the Lands D's SC Policy (see para. 1.7) as published on its website include the following:

- (a) after the 1982 Squatter Survey, new squatter structures or unauthorised extensions of squatter structures are not allowed to be erected on either government land or private agricultural land;
- (b) all squatter structures existing on unleased government land and private agricultural land covered under the 1982 Squatter Survey are temporarily tolerated to exist until such time as they are cleared for development, safety or environmental reasons, or until they are phased out through natural wastage;
- (c) the locations, dimensions, building materials and use of the SS structures cannot be changed without government approval;

Monitoring of squatter and licensed structures

- (d) repairs of SS structures are allowed so long as government approval is first obtained, and the locations, dimensions, building materials and use of the repaired SS structures are in conformity with the 1982 Survey Records; and
- (e) in the urban areas (Note 8), rebuilding of both domestic and non-domestic SS structures is not allowed. In the New Territories areas, rebuilding of non-domestic SS structures is not allowed while rebuilding of domestic SS structures using temporary building materials is allowed provided that government approval is first obtained, and the locations, dimensions, building materials and use of the rebuilt SS structures are in conformity with the 1982 Survey Records.

According to the Lands D, the above SC Policy aims to phase out SS structures over a period of time.

2.4 New squatter structures erected after the 1982 Squatter Survey or SS structures that are in breach of the SC Policy are subject to enforcement actions taken by the Lands D. The Lands D may require the occupants to carry out rectification works, cancel the squatter survey number of an SS structure in breach of the SC Policy and order the structure to be demolished. From January 2015 to September 2016, the Lands D had cancelled the squatter survey numbers of 2,432 SS structures due to various reasons, including SS structures not complying with the SC Policy and squatter clearance for development or safety reasons. The Lands D had not maintained statistics on the 2,432 SS structures showing those related to non-compliance with the SC Policy and other reasons.

2.5 From January 2015 to September 2016, the Lands D had received 57 applications for the repair of SS structures, of which 53 applications were approved and 4 applications were rejected. During the same period, the Lands D did not receive any application for the rebuilding of SS structures. According to the Lands D, the time normally required for processing an application for repairing an SS structure was about 10 working days, and that for rebuilding an SS structure was about 48 weeks.

Note 8: *For SC purposes, Hong Kong areas are classified into urban and New Territories areas, and the latter include Tuen Mun, Yuen Long, Fanling, Sheung Shui, Tai Po, Sha Tin, Sai Kung and Islands.*

Lands D's monitoring of squatter structures

2.6 The approved staff establishment of the SC Unit as of April 2006 and March 2016 were 434 staff and 426 staff respectively. As of March 2016, the SC Unit comprised a Headquarters Office and seven Squatter Control Offices (SCOs) with 358 staff (actual staff strength — including 11 staff in the Headquarters Office and 347 staff (comprising 35 clerical staff and 312 operation staff) in the seven SCOs). In 2016-17, the estimated personal emoluments of the SC Unit amounted to \$120.9 million. The seven SCOs were responsible for monitoring 99 patrol areas, which covered 388,497 SS structures as of March 2016 (see Table 2).

Table 2

**Number of SC staff, patrol areas and SS structures
(March 2016)**

SCO	Clerical staff (No.)	SC operation staff (No.)	Patrol area (No.)	SS structure (No.)
Hong Kong and Lei Yue Mun (HK&LYM)	4	37	13	5,642
Kowloon, Tsuen Wan and Kwai Tsing (K,TW&KT)	5	46	12	11,115
Islands	5	35	9	23,004
New Territories East (1)	5	58	19	56,856
New Territories East (2)	6	49	16	108,863
New Territories West (1)	4	38	12	65,827
New Territories West (2)	6	49	18	117,190
Total	35	312	99	388,497

Source: Lands D records

2.7 SC operation staff of the SCOs are responsible for patrolling squatter areas and taking control actions against illegal squatting activities on unleased government land and private agricultural land. A total of 97 patrol teams are responsible for patrolling 99 patrol areas, with each team responsible for patrolling one area except for two teams in the SCO/HK&LYM. Each patrol team is headed

Monitoring of squatter and licensed structures

by a Squatter Control Officer and comprises one to two Workmen/Artisans. According to the Squatter Control Operational Manual included in the SC Unit Technical Memorandum of August 2006, there are two types of patrols, namely routine patrols and hut-to-hut checks (Note 9).

2.8 ***Routine patrols.*** According to the Squatter Control Operational Manual, staff presence is crucial to deter any attempts in carrying out new squatting activities, and the purpose of routine patrols is to detect any new illegal structures and unauthorised extensions to SS structures. As stipulated in the Manual, a tri-colour system should be adopted to determine the level of control over different squatter areas. Under the tri-colour system, squatter areas are classified into red, yellow and green areas in descending order of vulnerability to new squatting activities, and the time of completing a cycle of routine patrol ranges from one to four working days. Details are shown in Appendix C.

2.9 ***Hut-to-hut checks.*** According to the Squatter Control Operational Manual, the purpose of hut-to-hut checks is to detect any irregularities (e.g. change of use or dimensions) of SS structures, and the time of completing a cycle of check ranges from 12 to 24 months, depending on the number of SS structures in each patrol area. Details are shown in Appendix C.

2.10 As of March 2016, according to Lands D records, of the 388,497 SS structures erected on unleased government land or private agricultural land, 4,170 SS structures (1%) were located in red areas under the tri-colour routine-patrol system. As all red areas under the system were located on Hong Kong Island and in Lei Yue Mun, Audit selected the SCO/HK&LYM for carrying out a review of the SCO's SC work.

Note 9: *In March 2017, the Lands D informed Audit that, following the transfer of SC responsibilities from the HD to the Lands D by phases from 2002 to 2006, the Lands D had adopted a revised SC approach for SC monitoring actions (see para. 2.33(b) and (c)).*

Non-compliant SS structures not detected

2.11 In December 2016, Audit conducted a site visit (covering about 200 SS structures) together with the Lands D staff to a village (Village A) on Hong Kong Island, which was classified as a red area under the tri-colour system according to Lands D records, to observe the routine patrols carried out by two patrol teams (namely Teams A and B) of the SCO/HK&LYM. During the site visit, Audit noted that 50 structures might not have complied with the SC Policy and referred them to the Lands D for investigations. According to the Lands D, of the 50 cases, the structures of 5 cases located on private land were not SS structures. As of January 2017, the Lands D's findings on the remaining 45 cases were as follows:

- (a) 7 new non-compliant cases (15%): the Lands D was not aware of these irregularities before Audit's site visit in December 2016. SC staff's further site inspections and on-site measurements of the SS structures confirmed that these SS structures did not comply with the SC Policy;
- (b) 12 existing non-compliant cases (27%): the Lands D was aware of these non-compliant SS structures (through SC patrols, public complaints or referrals from other government bureaux or departments (B/Ds)) before Audit's site visit, and was taking enforcement actions on these SS structures;
- (c) 5 cases (11%): no irregularities were found in respect of these SS structures; and
- (d) 21 cases (47%): the Lands D's investigations on these SS structures were still ongoing and the Lands D had not confirmed as to whether or not they complied with the SC Policy.

Monitoring of squatter and licensed structures

2.12 Each of the 19 (7 + 12) cases involved non-compliance with one or more requirements of the SC Policy. Details are shown in Appendix D. Audit selected 2 of the 7 cases mentioned in paragraph 2.11(a) and 1 of the 12 cases mentioned in paragraph 2.11(b) for review. Details of the 3 selected cases are as follows:

Related to paragraph 2.11(a)

- (a) unauthorised rebuilding of SS structure (see Case 1);
- (b) unauthorised change of use, dimensions and building materials of SS structure (see Case 2); and

Related to paragraph 2.11(b)

- (c) unauthorised extension of SS structure (see Case 3).

Case 1

Unauthorised rebuilding of SS structure (SS Structure A) (December 2014 to January 2017)

1. During the preliminary audit planning work in December 2014, Audit's site visit to Village A noted that construction works at a squatter structure (SS Structure A — see Photographs 2 and 3) were in progress. SS Structure A was located adjacent to a promenade.

Photographs 2 and 3

SS Structure A (December 2014)

Photograph 2 (side view)



Photograph 3 (front view)



Source: Photographs taken by Audit in December 2014

2. In December 2016, Audit conducted another site visit to SS Structure A and noted that the construction works had been completed (see Photographs 4 and 5).

Photographs 4 and 5

SS Structure A (December 2016)

Photograph 4 (side view)



Photograph 5 (front view)



Source: Photographs taken by Audit in December 2016

Monitoring of squatter and licensed structures

Case 1 (Cont'd)

3. In January 2017, upon Audit's referral, the SCO/HK&LYM found that, according to the 1982 Survey Records, SS Structure A consisted of two squatter survey numbers (SS Structures A1 and A2). Hence, SS Structure A should originally be two structures instead of one. The SC staff also conducted a site inspection and carried out an on-site measurement of SS Structure A. The on-site measurement revealed that there had been extensions and heightening of SS Structure A as compared with the aggregate dimensions of SS Structures A1 and A2 as indicated in the 1982 Survey Records. Details of the 1982 Survey Records and the Lands D's inspection results in January 2017 are as follows:

Particulars	1982 Survey Records		Lands D's inspection results in January 2017
	SS Structure A1	SS Structure A2	SS Structure A
Dimension:			
- Length (foot)	19	18	16
- Width (foot)	24	13	50
- Height (foot)	11	9	27
Use	Bath/storage	Domestic	Domestic
Building materials	Brick/wood	Concrete/brick	Concrete/brick

Audit comments

4. According to Lands D records, SS Structure A was located on government land and in the urban area. According to the SC Policy, rebuilding of SS Structure A, which is located in the urban area, is not allowed (see para. 2.3(e)). However, the photographs taken during Audit's site visit in December 2014 showed that construction works were in progress at SS Structure A. Audit noted that the Lands D had not maintained records on the number of SC patrols covering SS Structure A in recent years. Audit considers it unsatisfactory that:

- (a) the total area of SS Structures A1 and A2 had expanded from 690 square feet (ft²) (19 feet (ft) × 24 ft + 18 ft × 13 ft) to 800 ft² (16 ft × 50 ft), representing a 16% increase, and the height of the two structures of 11 ft and 9 ft respectively had increased to 27 ft, on average representing a 170% increase; and

Case 1 (Cont'd)

- (b) despite the significant construction works being carried out in late 2014 (see Photographs 2 and 3 in para. 1), the responsible patrol team was unable to detect the unauthorised construction works of SS Structures A1 and A2 during its routine patrols. It was not until Audit's referral in December 2016 that the SC staff started an investigation into the case.

5. According to the Lands D, if rebuilding of SS structures without government approval is found, the squatter survey numbers of these structures will be cancelled instantly and enforcement actions will be taken. Audit considers that the Lands D needs to:

- (a) take appropriate enforcement actions on SS Structures A1 and A2 in a timely manner; and
- (b) take actions to investigate why the responsible patrol team was unable to detect the unauthorised construction works in late 2014 and the unauthorised extensions and heightening of SS Structures A1 and A2 during its routine patrols, and take necessary improvement measures.

Source: Lands D records and Audit's site visits

Case 2

Unauthorised change of use, dimensions and building materials of SS structure (SS Structure B) (December 2016 to January 2017)

1. In December 2016, Audit's site visit to Village A revealed that a squatter structure was associated with suspected changes of building materials (SS Structure B — see Photograph 6). SS Structure B was located adjacent to a promenade.

Photograph 6

**SS Structure B
(December 2016)**



Source: Photograph taken by Audit in December 2016

2. In January 2017, upon Audit's referral, the SCO/HK&LYM found that, according to the 1982 Survey Records, SS Structure B consisted of two squatter survey numbers (SS Structures B1 and B2). Hence, SS Structure B should originally be two structures instead of one. The SC staff also conducted a site inspection and carried out an on-site measurement of SS Structure B. The inspection results revealed that the dimensions, use and building materials of the structure did not conform with those of SS Structures B1 and B2 in the 1982 Survey Records. Details are as follows:

Monitoring of squatter and licensed structures

Case 2 (Cont'd)

Particulars	1982 Survey Records		Lands D's inspection results in January 2017
	SS Structure B1	SS Structure B2	SS Structure B
Dimension:			
- Length (foot)	10	16	23
- Width (foot)	7	10	20
- Height (foot)	5	6	12
Use	Storage	Storage	Domestic
Building materials	Wood	Wood	Concrete/wood

Audit comments

3. According to the SC Policy, the dimensions, building materials and use of SS structures cannot be changed as compared with those in the 1982 Survey Records without government approval (see para. 2.3(c)). According to Lands D records, SS Structure B was located on government land and in the urban area. Audit noted that the Lands D had not maintained records on the number of SC patrols covering SS Structure B in recent years. Audit considers it unsatisfactory that:

- (a) the total area of SS Structures B1 and B2 had significantly expanded from 230 ft² (10 ft × 7 ft + 16 ft × 10 ft) to 460 ft² (23 ft × 20 ft), representing a 100% increase, and the height of the two structures had increased from 5 ft and 6 ft respectively to 12 ft, on average representing a 118% increase;
- (b) use of the structures had been changed from storage to domestic; and
- (c) building materials of the two structures had been changed from wood to concrete/wood.

However, the responsible patrol team was unable to detect the above unauthorised changes during its routine patrols. It was not until Audit's referral in December 2016 that the SC staff started an investigation into the irregularities of SS Structures B1 and B2.

Case 2 (Cont'd)

4. Audit considers that the Lands D needs to:
 - (a) take appropriate enforcement actions on SS Structures B1 and B2 in a timely manner; and
 - (b) take actions to investigate why the responsible patrol team was unable to detect the irregularities of SS Structures B1 and B2 during its routine patrols, and take necessary improvement measures.

Source: Lands D records and Audit's site visit

Case 3

Unauthorised extension of SS structure (SS Structure C) (December 2014 to January 2017)

1. During the preliminary audit planning work in December 2014, Audit's site visit to Village A noted a squatter structure (SS Structure C — see Photograph 7). SS Structure C was adjacent to a main road and opposite to a bus terminal.

Photograph 7

SS Structure C (December 2014)



Source: Photograph taken by Audit in December 2014

Case 3 (Cont'd)

2. In April 2015, the SCO/HK&LYM received a complaint on suspected unauthorised extensions of SS Structure C. According to the complainant (Complainant A), the suspected unauthorised building works had been carried out in 2014 and 2015, and two photographs showing the situations of SS Structure C before and after the building works were provided. According to the photographs supplied by Complainant A:

- (a) before the building works, SS Structure C comprised a ground floor and a rooftop where the latter did not have any enclosed structures; and
- (b) after the building works, SS Structure C became a two-floor structure. The original rooftop had become the second floor which was an enclosed concrete structure with windows, and a new rooftop with glass and metal railings was constructed.

3. In May 2015, the SC staff conducted site inspections of SS Structure C. According to the results of inspections, a small brick-built structure had been erected on the new rooftop.

4. In June 2015, the SCO/HK&LYM issued a warning letter informing the occupant that SS Structure C did not conform with the 1982 Survey Records and requested him to rectify the irregularities. In the same month, the SCO/HK&LYM received a complaint from another complainant (Complainant B) claiming that a new floor had been constructed on SS Structure C. In November 2015, the SC staff conducted a site inspection of SS Structure C. According to the results of inspection, the small brick-built structure on the new rooftop had been demolished. Accordingly, the case was closed.

5. In June 2016, Complainant A lodged another complaint raising a query on the lack of actions taken against the irregularities of SS Structure C over the years. In the same month, the SC staff conducted a site inspection of SS Structure C. According to the results of inspection, the SC staff reminded the occupant that the enclosed concrete structure on the second floor constituted an unauthorised extension. The SCO/HK&LYM issued a warning letter to the occupant requesting him to rectify the irregularities.

Case 3 (Cont'd)

6. In September 2016, the Lands D's Survey and Mapping Office provided the SCO/HK&LYM with aerial photographs and measurements of SS Structure C.

7. In December 2016, Audit conducted another site visit to SS Structure C, and noted that the enclosed concrete structure located on the second floor had not yet been removed (see Photograph 8).

Photograph 8

**SS Structure C
(December 2016)**



Source: Photograph taken by Audit in December 2016

8. In January 2017, the SCO/HK&LYM issued a warning letter to the occupant requesting him to rectify the irregularities of SS Structure C by February 2017.

9. According to the 1982 Survey Records, SS Structure C consisted of two squatter survey numbers (SS Structures C1 and C2). Details of SS Structures C1 and C2 as shown in the 1982 Survey Records and January 2017 are as follows:

Monitoring of squatter and licensed structures

Case 3 (Cont'd)

Particulars	1982 Survey Records		Lands D's inspection results in January 2017	
	SS Structure C1	SS Structure C2	SS Structure C1	SS Structure C2
Dimension:				
– Length (foot)	43	30	43	30
– Width (foot)	28	11	28	11
– Height (foot)	19	11	19	19
Use	Domestic/shop	Shop	Domestic/shop	Shop
Building materials	Wood/tin/brick	Concrete/wood/tin	Wood/tin/brick	Concrete/wood/tin

Audit comments

10. According to Lands D records, SS Structure C was located on government land and in the urban area. Audit noted that the Lands D had not maintained records on the number of SC patrols covering SS Structure C in recent years. Audit considers it unsatisfactory that:

- (a) despite a warning letter issued in June 2016, the irregularities had not been rectified up to January 2017; and
- (b) the height of SS Structure C2 had increased from 11 ft to 19 ft, representing a 73% increase, and it was situated at a prominent location adjacent to a main road. However, the responsible patrol team was unable to detect the irregularities during its routine patrols.

11. In Audit's view, the Lands D needs to:

- (a) take appropriate enforcement actions on SS Structure C2 in a timely manner;
- (b) step up actions against squatter occupants not complying with warning letters issued by the Lands D; and
- (c) take actions to investigate why the responsible patrol team was unable to detect the irregularities of SS Structure C2 during its routine patrols, and take necessary improvement measures.

Source: Lands D records and Audit's site visits

Monitoring of squatter and licensed structures

2.13 In late February 2017, Audit extended the audit work to conduct site visits to the following two squatter areas:

- (a) a squatter area under the monitoring of SCO/K,TW&KT, which was classified as a yellow area under the tri-colour system according to Lands D records; and
- (b) a squatter area under the monitoring of SCO/New Territories East (2), which was classified as a green area under the tri-colour system according to Lands D records.

2.14 During the site visits, Audit noted that 40 structures might not have complied with the SC Policy (30 cases for SCO/K,TW&KT and 10 cases for SCO/New Territories East (2)) and referred them to the Lands D for investigations. According to the Lands D, of the 40 cases, the structures of 3 cases were not SS structures. Of these 3 cases, the structure of one case was located on government land and covered by a GLL, and the structures of the other two cases were located on private land. As of March 2017, the Lands D's findings on the remaining 37 cases were as follows:

- (a) 9 new non-compliant cases (24%): the Lands D was not aware of these irregularities before Audit's site visit in February 2017. SC staff's further site inspections and on-site measurements of the SS structures confirmed that these SS structures did not comply with the SC Policy;
- (b) 5 cases (14%): no irregularities were found in respect of these SS structures; and
- (c) 23 cases (62%): the Lands D's investigations on these SS structures were still ongoing and the Lands D had not confirmed as to whether or not they complied with the SC Policy.

In Audit's view, given that the SCO patrol teams were unable to detect some significant non-compliances with the SC Policy during their patrols, the Lands D needs to conduct a review of the effectiveness of the squatter structure monitoring system.

***Non-compliant SS structures mainly identified
through complaints or referrals***

2.15 Upon receipt of complaints from the public or referrals from other B/Ds, SC staff will conduct site inspections of the concerned squatter structures to ascertain if any non-compliance with the SC Policy exists. From January 2015 to September 2016, after conducting site inspections, SC staff of the seven SCOs had identified 939 confirmed cases of SS structures not complying with the SC Policy. Details are as follows:

SCO	Confirmed cases of SS structures not complying with SC Policy (No.)
(a) HK&LYM	164
(b) K,TW&KT	117
(c) Islands	44
(d) New Territories East (1)	206
(e) New Territories East (2)	168
(f) New Territories West (1)	34
(g) New Territories West (2)	206
Total	939

2.16 Of the seven SCOs, only the SCO/New Territories East (1) maintained information on the source of identifying the 206 cases (see para. 2.15(d)) associated with non-compliant SS structures. Of these 206 cases:

- (a) 181 cases (88%) were originated from public complaints or B/D referrals;
and
- (b) 25 cases (12%) were detected during SC patrols.

Monitoring of squatter and licensed structures

2.17 In Audit's view, for each SS structure case reported by the public or referred by other B/Ds which was subsequently confirmed to be not complying with the SC Policy, the Lands D needs to take actions to investigate why the responsible patrol team was unable to detect the non-compliance during its routine patrols, and take necessary improvement measures. The Lands D also needs to require SCOs to maintain management information on the number of cases arising from different sources leading to identifying non-compliant SS structures.

2.18 Since June 2016, each SCO has been required to hold bi-monthly Case Monitoring Meetings and prepare Case Monitoring Reports for monitoring the progress of enforcement actions taken on SS structures not complying with the SC Policy. Audit examination of the SCO/HK&LYM's Case Monitoring Report of October 2016 revealed that enforcement actions on 35 cases involving non-compliant SS structures were in progress. Of these 35 cases:

- (a) 28 cases (80%) were originated from public complaints (including media enquiries) or B/D referrals; and
- (b) 7 cases (20%) were detected during SC patrols.

2.19 Audit selected 4 of the 28 cases mentioned in paragraph 2.18(a) for review. Details of the 4 selected cases are as follows:

- (a) a de-registered SS structure being re-occupied (see Case 4);
- (b) repeated complaints on a non-compliant SS structure (see Case 5);
- (c) lack of action taken on non-compliant SS structures (see Case 6); and
- (d) de-registered SS structures not being demolished (see Case 7).

Case 4

De-registered SS structure (SS Structure D) being re-occupied (January 2001 to February 2017)

1. In July 2015, the SCO/HK&LYM received a complaint on illegal re-occupation of a de-registered SS structure (SS Structure D) located in a village (Village B) in Kowloon, which should have been vacated and boarded up during a non-development clearance (NDC) exercise in 2001. In the same month, the SCO/HK&LYM conducted a site inspection which revealed that SS Structure D was illegally re-occupied.

2. According to Lands D records:

- (a) SS Structure D was located on government land and in the urban area;
- (b) the SCO/HK&LYM considered that the control and management of the NDC structures, including the illegal re-occupation activity, were outside its purview; and
- (c) the Lands D Clearance Unit considered that its core business was to re-house clearances affected by an NDC exercise and it had never been its business to deal with illegal re-occupation of vacant structures.

3. Audit's site visit in February 2017 noted that there were signs of re-occupation of SS Structure D (see Photograph 9).

Case 4 (Cont'd)

Photograph 9

SS Structure D (February 2017)



Source: Photograph taken by Audit in February 2017

Audit comments

4. Audit considers it unsatisfactory that the Lands D had not taken enforcement actions to rectify the illegal re-occupation of SS Structure D since July 2015. In this regard, the Lands D needs to:

- (a) take appropriate enforcement actions on SS Structure D in a timely manner; and
- (b) take measures to prevent recurrence of delays in taking enforcement actions due to unclear responsibilities among different Lands D units.

Source: Lands D records and Audit's site visit

Case 5

Repeated complaints on a non-compliant SS structure (SS Structure E) (May 2013 to March 2017)

1. In May 2013, the SCO/HK&LYM received a complaint on unauthorised building works at an SS structure (SS Structure E) situated in Village A. The building works ceased upon the request of the SCO/HK&LYM.
2. In August 2014, the SCO/HK&LYM received another complaint on unauthorised building works at SS Structure E. In the same month, the SCO/HK&LYM conducted a site inspection and issued a warning letter to request the occupant to rectify the irregularities. According to Lands D records, the irregularities were rectified in May 2015.
3. In July 2016, during its routine patrols, the SCO/HK&LYM noted an unauthorised structure on the second floor of SS Structure E (see Photograph 10). In August 2016, the SCO/HK&LYM issued a warning letter to the occupant of SS Structure E requesting him to rectify the irregularities within 28 days.

Photograph 10

SS Structure E (July 2016)



Unauthorised
structure

Source: Lands D records

Case 5 (Cont'd)

4. In December 2016, noting that the irregularities of SS Structure E were not rectified, the SCO/HK&LYM issued a warning letter to the occupant stating that SC action, including de-registering the squatter survey number, would be taken if no rectification works were taken, and if the squatter survey number was cancelled, the structure would not be allowed to exist on government land. However, as of January 2017, the irregularities were still not rectified.

5. Details of SS Structure E as shown in the 1982 Survey Records and January 2017 are as follows:

Particulars	1982 Survey Records	Lands D's inspection results in January 2017
Dimension:		
- Length (foot)	26	26
- Width (foot)	22	22
- Height (foot)	8	14
Use	Shop	Shop
Building materials	Wood/tin/brick	Wood/tin/brick

Lands D responses

6. In March 2017, the Lands D informed Audit that:

- (a) an occupant of SS Structure E was interviewed by the SCO/HK&LYM staff in December 2016. In January 2017, the occupant raised a request for a suspension of enforcement action on the grounds of financial hardship, and the difficulty in taking care of her 93-year-old father (who was one of the occupants); and
- (b) in February 2017, the SCO/HK&LYM turned down the request of the occupant, and the occupant raised another request for an extension of time to August 2017 owing to financial hardship. The SCO/HK&LYM rejected the request again in mid-February 2017.

Case 5 (Cont'd)

Audit comments

7. Audit noted that SS Structure E was situated at a prominent location (near a public carpark and a store) in Village A. According to Lands D records, SS Structure E was located on government land and in the urban area. Audit noted that the Lands D had not maintained records on the number of SC patrols covering SS Structure E in recent years. Audit considers it unsatisfactory that:

- (a) the repeated control actions taken in 2013 and 2014 had failed to deter the recurrence of the unauthorised works and extension of SS Structure E; and
- (b) irregularities detected in July 2016 had not been rectified up to February 2017.

8. Audit considers that the Lands D needs to:

- (a) take effective enforcement actions on SS Structure E in a timely manner; and
- (b) strengthen actions on SS structures associated with repeated complaints and Lands D warning letters.

Source: Lands D records

Case 6

Lack of action taken on non-compliant SS structures (October 2015 to March 2017)

1. In October 2015, the SCO/HK&LYM received a complaint on unauthorised building works of an SS structure (SS Structure F) situated in Village A. In response, the SCO/HK&LYM conducted a site inspection which revealed that an unauthorised rooftop structure was built on SS Structure F and the dimensions of the structure did not conform with the 1982 Survey Records. In November 2015 and January 2016, the SCO/HK&LYM issued warning letters to the occupant requiring him to rectify the irregularities.

2. In February 2016, the occupant of SS Structure F complained that he was being treated differently from his neighbours who had similar irregularities. In this connection, the occupant informed the SCO/HK&LYM of these cases and provided photographs relating to squatter structures adjoining and adjacent to SS Structure F.

3. In June and October 2016, noting that the progress of rectification works of SS Structure F was not satisfactory, the SCO/HK&LYM issued warning letters to the occupant requiring him to complete all the rectification works, failing which SC action (including de-registering the squatter survey number) would be taken. However, as of January 2017, the irregularities were still not rectified.

Case 6 (Cont'd)

4. According to the 1982 Survey Records, SS Structure F consisted of two squatter survey numbers (SS Structures F1 and F2). Details of SS Structures F1 and F2 as shown in the 1982 Survey Records and January 2017 are as follows:

Particulars	1982 Survey Records		Lands D's inspection results in January 2017	
	SS Structure F1	SS Structure F2	SS Structure F1	SS Structure F2
Dimension:				
– Length (foot)	13	4	13	4
– Width (foot)	16	9	16	9
– Height (foot)	11	7	18	18
Use	Domestic	Storage	Domestic	Domestic
Building materials	Brick	Brick	Brick	Brick

Lands D responses

5. In March 2017, the Lands D informed Audit that:
- (a) for SS Structure F, the concerned occupants (an elderly couple aged over 87) were seeking advice from a structural engineer on rectification works with a view to meeting the SC Policy requirements; and
 - (b) Village A had been designated as a black spot for patrolling, and the SCO/HK&LYM had commenced intensive investigations of the SS structures in the village by phases. Since SCO/HK&LYM's investigations would eventually cover all SS structures in Village A, it had not responded to the general complaint made by the occupant of SS Structure F.

Case 6 (Cont'd)

Audit comments

6. According to Lands D records, SS Structure F was located on government land and in the urban area. Audit noted that the Lands D had not maintained records on the number of SC patrols covering SS Structure F in recent years. Audit considers it unsatisfactory that:

- (a) the height of SS Structures F1 and F2 had increased from 11 ft and 7 ft respectively to 18 ft, on average representing a 100% increase. However, the responsible patrol team was unable to detect the irregularities during its routine patrols;
- (b) despite being informed of the suspected irregularities of squatter structures adjoining and adjacent to SS Structure F in February 2016, the SCO/HK&LYM did not conduct investigations of the aforementioned squatter structures in a timely manner; and
- (c) notwithstanding repeated actions taken in November 2015 as well as January, June and October 2016, the irregularities had not been rectified.

7. Audit considers that the Lands D needs to:

- (a) conduct investigations of the squatter structures referred by the occupant of SS Structure F to ascertain if non-compliances with the SC Policy exist and take necessary enforcement actions; and
- (b) take effective enforcement actions on SS Structures F1 and F2 in a timely manner.

Source: Lands D records

Case 7

De-registered SS structures (SS Structures G, H and I) not being demolished (July 2016 to March 2017)

1. In July 2016, the SCO/HK&LYM received a media enquiry on some squatter structures (operating as restaurants) located along the seafront in Kowloon. After site inspections conducted by the SC staff, three SS structures (SS Structures G, H and I) were confirmed to have been rebuilt without the Lands D's approval. In the event, the Lands D cancelled the squatter survey numbers of these SS structures and issued demolition notices. Details are as follows:

SS structure	Date of cancellation of squatter survey number	Action taken under the Cap. 28 Ordinance		
		Date of issuing demolition notice	Date of expiry of demolition notice	Position as of January 2017
G	30.8.2016	30.8.2016 (see Photograph 11)	31.10.2016	Demolition not yet carried out
H	8.9.2016	8.9.2016 (see Photograph 12)	8.11.2016	
I	8.9.2016	8.9.2016 (see Photograph 13)	8.11.2016	

Photograph 11

**SS Structure G (a structure located on an upper level of a restaurant)
(August 2016)**



Lands D
demolition
notice

Source: Lands D records

Case 7 (Cont'd)

Photograph 12

**SS Structure H (operating as a restaurant)
(September 2016)**



Source: Lands D records

Photograph 13

**SS Structure I (operating as a restaurant)
(September 2016)**



Source: Lands D records

2. Audit's site visit in February 2017 found that the two restaurants operating at SS Structures H and I were open for business. (Audit could not get access to the upper level of the restaurant relating to SS Structure G.)

3. From August to December 2016, in the light of the irregularities of SS Structures G, H and I, the Lands D conducted site inspections of 133 SS structures occupied for commercial purposes along the seafront at which SS Structures G, H and I situated. The results of inspection of the 133 SS structures as of December 2016 were as follows:

Monitoring of squatter and licensed structures

Case 7 (Cont'd)

Inspection results		SS structure (No.)
Confirmed having irregularities:	Rebuilt without approval	29
	Change of dimensions	8
	Change of use	11
		} 48
Confirmed having no irregularities		8
Inspection not yet carried out due to cooperation not rendered by occupants		77
Total		133

Lands D responses

4. In March 2017, the Lands D informed Audit that:
- (a) in October 2016, a Legislative Council (LegCo) Member requested the Government to formulate appropriate policies to allow the continued operation of the existing shops and restaurants located along the seafront in Kowloon; and
 - (b) the Lands D considered that, in addition to a land-control issue, Case 7 was also related to tourism, local development and people's livelihood.

Audit comments

5. According to Lands D records, SS Structures G, H and I were located on government land and in the urban area. Audit noted that the Lands D had not maintained records on the number of SC patrols covering SS Structures G, H and I in recent years. Audit considers it unsatisfactory that, during the routine patrols, the SC staff were unable to detect the unauthorised rebuilding of SS Structures G, H and I, as well as the irregularities of the other 48 SS structures located along the seafront in Kowloon. Moreover, the demolition notices issued by the Lands D in August/September 2016 had not been complied with up to January 2017. In Audit's view, the Lands D needs to expedite:

- (a) enforcement actions on SS Structures G, H and I in accordance with the demolition notices, as well as the 48 SS structures located along the seafront at which SS Structures G, H and I situate; and
- (b) inspections of the 77 SS structures located along the seafront at which SS Structures G, H and I situate.

Source: Lands D records

Ineffective squatter structure monitoring system

2.20 The Lands D's seven SCOs with 312 operation staff conducted patrols of the squatter areas on a routine basis. To facilitate the SC work, the Lands D has implemented an Electronic Team Patrol Monitoring System (ETPM System) to record details of routine patrols conducted in squatter areas. Under the ETPM System, a number of check-points at strategic locations in each patrol area are installed with electronic devices. When a patrol team visits a check-point, it would apply a control clock to the electronic device and the ETPM System would record the time of the patrol team visiting the check-point. The ETPM System would generate a daily patrol report of each patrol team showing the time of visiting each check-point, and the team is required to indicate in the report whether or not new illegal structures were noted during the patrol and document in the report any new illegal structures noted.

2.21 One of the seven SCOs, namely the SCO/HK&LYM, had 11 patrol teams (each comprising two to three staff) which were responsible for patrolling 13 patrol areas. Audit selected 2 of the 13 patrol areas which were patrolled by Teams A and B (see para. 2.11) for review. Details are shown in Table 3.

Table 3

**Patrol work of Teams A and B of SCO/HK&LYM
(March 2016)**

Team	Patrol Area	Check-point (a) (No.)	SS structure (b) (No.)	Average number of SS structures covered by each check-point (c) = (b) ÷ (a)
A (2 staff)	A	24	454	19
B (3 staff)	B	25	442	18
Overall		49	896	18

Source: Audit analysis of Lands D records

Monitoring of squatter and licensed structures

2.22 According to Lands D records, Patrol Areas A and B were located in the red area under the tri-colour system in the urban area. From January 2015 to September 2016 (21 months with 432 working days), according to the ETPM System records, Teams A and B together paid 2,502 visits to the 49 check-points. Details are as follows:

Team	Visit to check-point (No.)
A	1,406
B	1,096
Total	2,502

2.23 Accordingly, each check-point on average should have been visited 51 times ($2,502 \div 49$) by the two teams during the 21-month period. However, Audit examination revealed that the number of visits to each of these 49 check-points during the 21-month period varied significantly. Details are shown in Table 4.

Table 4

**Number of visits to each check-point in
Patrol Areas A and B
(January 2015 to September 2016)**

Number of times a check-point was visited during the 21-month period	Number of check-points involved
5	1
17 to 20	5
21 to 30	12
31 to 40	10
41 to 50	4
51 to 100	11
101 to 130	6
Total	49

Source: Audit analysis of Lands D records

Monitoring of squatter and licensed structures

2.24 Audit could not find records showing the justifications for the significant variations in the frequency of patrol visits among different check-points conducted by Teams A and B during the 21-month period. For example, during the 21-month period, while one check-point was only visited 5 times, six check-points were each visited 101 to 130 times. In March 2017, the Lands D informed Audit that:

- (a) infrequent visits to some check-points were due to:
 - (i) the check-points being located in remote areas. The Lands D had adopted a risk-based approach for SC patrols and some areas being not prone to illegal squatting activities due to their remoteness would not be patrolled frequently; and
 - (ii) electronic devices installed at some check-points had broken down resulting in the time of patrol visits not being recorded in the ETPM System;
- (b) frequent visits to some check-points were due to the check-points being located in areas subject to frequent in-depth investigations (see para. 2.33(d)); and
- (c) the presence of the SC patrol teams had a deterrent effect against illegal squatting activities, similar to the police patrol on the street aiming to deter crimes.

2.25 Regarding paragraph 2.24(a)(i), given that all the 49 check-points under the patrol of Teams A and B were located in the red area under the tri-colour system which were most vulnerable to new squatting activities (see para. 2.8), each of the 49 check-points should be subject to the same level of monitoring, and the remoteness of a check-point should not be a factor for consideration in taking land-control enforcement actions. Regarding 2.24(a)(ii), given that the objective of the ETPM System was to monitor the site attendance of patrol teams (see para. 2.29(a)), any breakdown of a check-point electronic device not being timely repaired would defeat the objective of the System. In Audit's view, the Lands D needs to take improvement measures on the above shortcomings. The Lands D also needs to, based on available staff resources, formulate an inspection programme for every inspection team covering all SS structures within an inspection area over a certain period of time.

Monitoring of squatter and licensed structures

2.26 According to the Lands D, the daily patrol reports recording the time of visiting each check-point and irregularities observed were kept by individual teams. From January 2015 to September 2016 (comprising 432 working days), Teams A and B had conducted routine patrols to Patrol Areas A and B on 257 and 208 working days respectively. Based on the 465 (257 + 208) daily patrol reports provided by the SCO/HK&LYM, Audit noted that only two of the reports recorded irregularities found during the patrols. Details are as follows:

Date of patrol	Team	Non-compliant SS structure detected	Follow-up action taken
27 June 2016	B	J	• Issuing warning letter in August 2016 • Irregularities not yet rectified as of January 2017
		K	• Issuing warning letters in August and December 2016 • Irregularities not yet rectified as of January 2017
15 July 2016	B	L	• Irregularities rectified by the occupant in August 2016
		E	(see Case 5 in para. 2.19) • Issuing warning letters in August and December 2016 • Irregularities not yet rectified as of February 2017
		M	• Issuing warning letters in August and November 2016, cancelling the squatter survey number and issuing demolition notice in December 2016 (requesting rectification by March 2017)

2.27 Audit examination of the daily patrol reports also revealed that the patrol teams normally spent little time at each check-point. Examples are shown in Table 5.

Monitoring of squatter and licensed structures

Table 5

Time of visiting check-points

Date	Team	Time of departing office	Time recorded at check-point									Time of returning office
			1	2	3	4	5	6	7	8	9	
10 April 2015	A	9:59	10:25	10:29	10:30	10:34	10:35	10:36	10:37	10:39	-	11:34
18 November 2015	A	9:51	10:19	10:20	10:22	10:25	10:26	10:27	10:28	10:30	-	10:54
22 April 2016	A	10:26	10:43	10:44	10:45	10:48	10:48	10:49	10:50	10:51	-	11:31
24 February 2015	B	10:00	10:24	10:25	10:27	10:28	10:29	10:30	-	-	-	10:53
2 November 2015	B	9:54	10:22	10:24	10:26	10:27	10:28	10:29	-	-	-	11:20
29 September 2016	B	10:05	10:22	10:24	10:27	10:28	10:29	10:30	10:34	10:34	10:36	10:55

Source: Lands D records

2.28 According to the Squatter Control Operational Manual, staff presence is crucial to deter any attempts in carrying out new squatting activities, and the purpose of routine patrols is to detect any new illegal structures and unauthorised extensions to SS structures (see para. 2.8). As shown in Table 5 in paragraph 2.27, Teams A and B often spent one to two minutes between visiting two check-points. Given the short time spent on conducting inspections of areas covered by check-points (on average one check-point covered 18 SS structures — see Table 3 in para. 2.21), it was unlikely that the patrol teams could effectively carry out their patrol functions.

2.29 In March 2017, the Lands D informed Audit that:

- (a) the ETPM System was implemented in 1996 to monitor the site attendance of patrol teams according to the Squatter Control Operational Manual. The daily patrol reports recorded the site attendance of patrol teams and plausible new squatting activities. These reports did not record suspected irregularities observed during patrols;
- (b) any suspected irregularity found during a patrol was subject to verification against the 1982 Survey Records, plans and other related documents. If a non-compliant case was confirmed, a case file would be opened for keeping records of detailed investigations and follow-up actions. The patrol teams seldom recorded such suspected irregularities in daily patrol reports; and

- (c) the set up of check-points was to provide patrol data for analysis of site attendance of patrol teams. The patrol time and pattern could not fully reflect all the field work. In practice, the route, sequence and frequency of visiting check-points were arranged by the patrol team leader of a team for accomplishment of his/her daily objectives in order of priority. The duration of a patrol between check-point visits depended on the daily job target, the nature and scale, the distance between check-points, the visiting sequence of different targeted spots, geographical limitations, the visit priority and safety concern.

2.30 Regarding paragraph 2.29(a) and (b), according to the standard daily patrol report, each patrol team was required to indicate in the report whether or not new illegal structures were noted during a patrol, and document in the report any new illegal structures noted (see para. 2.20). In Audit's view, the patrol teams should be knowledgeable about structures not complying with the SC Policy and they should have recorded all suspected illegal structures in the daily patrol reports for follow-up actions, including checking against the 1982 Survey Records and issuing warning letters.

2.31 According to the Government policy on SS structures, all SS structures need to comply with the SC Policy (see para. 2.3) and the Lands D would take enforcement actions on all SS structures associated with non-compliances with the SC Policy (see para. 2.4). In Audit's view, the deployment of 312 operation staff (in the seven SCOs as of March 2016) to conduct patrols and other squatter structure monitoring work but many non-compliant SS structures were not detected is unsatisfactory. Cases 1 to 7 in paragraphs 2.12 and 2.19 illustrate that the patrol teams had not been effective in detecting significant non-compliances with the SC Policy during their visits to check-points. The Lands D needs to review the objective, approach and effectiveness of the squatter structure monitoring system.

2.32 According to the Squatter Control Operational Manual, the time of completing a cycle of routine patrol under the tri-colour system ranges from one to four working days (see para. 2.8), and the time of completing a cycle of hut-to-hut check for SS structures located in each patrol area ranges from 12 to 24 months (see para. 2.9).

Monitoring of squatter and licensed structures

2.33 In December 2016, Audit requested the Lands D to advise whether the requirements under the tri-colour routine-patrol system and the hut-to-hut checks as stipulated in the Squatter Control Operational Manual had been complied with by each SCO and to provide information about the actual practice if it was different from the requirements as stipulated in the Manual. In March 2017, the Lands D informed Audit that:

- (a) following the transfer of SC responsibilities from the HD to the Lands D by phases from 2002 to 2006, the number of SC staff was reduced from 658 to 358 (as of March 2016);
- (b) due to the large reduction in manpower when the Lands D took over the SC responsibilities from the HD and the onerous workloads, the tri-colour system used to be adopted by the HD could no longer be adopted, and the hut-to-hut check previously adopted by the HD was considered no longer sustainable;
- (c) the Lands D had over the years adopted a different approach where routine patrols were deployed to deter and detect new illegal structures as well as unauthorised extensions to SS structures, while a proactive inspection of an SS structure was mainly conducted upon receipt of a public complaint or B/D referral. Moreover, the number of complaints and referral cases had increased over the years, and much effort was needed to establish whether a squatter structure under a complaint was in breach of the SC Policy;
- (d) the Lands D's checking of SS structures was conducted mainly through patrol teams' regular patrols in the squatter areas by visual inspections and taking immediate SC actions when noting illegal structures, extensions of SS structures or related works-in-progress. In addition, when a public complaint or B/D referral was received, the patrol team would carry out an in-depth investigation and at the same time conduct routine patrols;
- (e) the Lands D adopted a risk-based approach to combat breaches of the SC Policy. Some squatter areas vulnerable to illegal squatting activities were selected as black spots for intensive checking and bi-monthly progress reports had to be submitted to the Lands D's Headquarters. From time to time, the management would review the conditions of a

patrol area and if the conditions deteriorated (as reflected by the number of complaints and illegal structures detected), the area would be classified as a black spot until the conditions had been improved and under control. As of February 2017, there were 15 designated black-spot areas;

- (f) following the announcement of implementation of strengthened and improved SC measures in June 2016, the SCOs were required to hold bi-monthly Case Monitoring Meetings and report each individual case associated with SC actions in the Case Monitoring Reports for checking by the responsible manager and the Lands D's Headquarters. The said monitoring system ensured that all patrol teams would report and follow up promptly all cases associated with SC actions; and
- (g) the Squatter Control Operational Manual should have been updated to reflect the development.

2.34 However, the Lands D could not provide Audit with records showing the time and details of adopting the revised patrol practice for monitoring squatter structures (see para. 2.33(b) and (c)). Audit considers it unsatisfactory that the Lands D has adopted a patrol practice which is significantly different from the requirements stipulated in the Squatter Control Operational Manual, and the revised practice has not been properly promulgated and documented. Regarding patrol teams' regular patrols (see para. 2.33(d)) and intensive checking conducted at black-spot areas (see para. 2.33(e)), the Lands D could not provide Audit with information on the frequency of regular patrols conducted at individual squatter areas and inspections conducted at individual black-spot areas in recent years.

2.35 According to the Lands D, some squatter areas had been selected as black spots for intensive checking (see para. 2.33(e)). Audit noted that the black-spot system was introduced in April 2012. Although Village A had been designated as a black-spot area since July 2013, Cases 1 to 3 in paragraph 2.12 illustrated that the black-spot system had not been effective in detecting significant non-compliances with the SC Policy. Audit considers that the Lands D needs to conduct a review of the effectiveness of the squatter structure monitoring system with a view to improving the system.

Complaint register not maintained by SCO

2.36 Under the Lands D's instructions, each SCO needs to maintain a complaint register recording dates and details of complaints received. However, Audit noted that the SCO/HK&LYM did not maintain such a register. Audit considers that the Lands D needs to take measures to ensure that each SCO maintains a complaint register.

Omissions in reporting cases of non-compliance with SC Policy

2.37 Since June 2016, each SCO has been required to prepare bi-monthly Case Monitoring Reports for submission to the Lands D's Headquarters showing follow-up actions taken on cases of non-compliance with the SC Policy. Each SCO also holds bi-monthly Case Monitoring Meetings to follow up actions on non-compliant cases. However, the Case Monitoring Report of the SCO/HK&LYM of October 2016 only included 35 cases but omitted to include 3 cases (3 of the 12 cases noted by the Lands D before Audit's site visit (see para. 2.11(b))). Audit considers that the Lands D needs to take measures to ensure that SCOs include all outstanding cases in the bi-monthly Case Monitoring Reports.

Need to adopt a better system for ensuring compliance with SC Policy

2.38 The 1982 Survey Records are maintained in manual form, and the Lands D's Headquarters and each SCO separately maintains one set of the pertinent manual survey records. The daily patrol reports (also recorded any irregularity in manual form) only recorded the time of visiting each check-point. Owing to the limitation of the ETPM System, the time of inspecting each SS structure located in a patrol area was not available. According to the Lands D, information on SS structures not complying with the SC Policy and the follow-up actions taken was kept in individual case files by the seven SCOs, and before June 2016 (see para. 2.37) centralised information was not readily available for review by the Lands D's Headquarters or for Audit examination.

2.39 Furthermore, the daily patrol reports only show the check-points visited but not the SS structures inspected. Hence, a patrol team might not be fully held accountable for irregularities subsequently found on SS structures located in its patrol area. This arrangement is not conducive to good management and accountability.

2.40 Given the above-mentioned system limitations, the Lands D's system on monitoring compliance of SS structures with the SC Policy is not effective and efficient, and there is no assurance that the SC Policy has been satisfactorily complied with. Therefore, the Lands D needs to improve the system and consider implementing a new system, which includes, for example, the following salient features:

- (a) each inspection team should be assigned to monitor designated SS structures within an inspection area for ensuring compliance with the SC Policy;
- (b) based on the available staff resources, an inspection programme should be formulated for each inspection team such that each SS structure is subject to inspection within a specified period of time, with the inspection interval being determined taking into account the risks of non-compliance with the SC Policy;
- (c) details of each SS structure in the 1982 Survey Records should be uploaded onto a computer database which would be used to check against each SS structure during an inspection;
- (d) details of and irregularities observed during each inspection, with photographs, should be recorded in the database for future reference, together with details of follow-up actions taken;
- (e) details of public complaints and B/D referrals relating to individual SS structure should be recorded in the database, together with details of follow-up actions taken; and

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- (f) periodic management reports should be generated to highlight SS structures not having been inspected for a specified period of time, and long-outstanding cases where follow-up actions on irregularities have not been completed within a specified period of time.

2.41 The Lands D may also consider providing hand-held computers storing the inspection programmes and details of each SS structure to facilitate the inspection teams' inspections as well as recording and updating onto the database results of inspections and follow-up actions taken. The Lands D also needs to strengthen guidance to operation staff on following up and dealing with long-outstanding non-compliant cases.

Audit recommendations

2.42 **Audit has *recommended* that, in monitoring squatter structures, the Director of Lands should:**

- (a) **take appropriate enforcement actions on SS Structures A1, A2, B1, B2, C2, D, E, F1, F2, G, H and I as well as the 48 SS structures located along the seafront in Kowloon in a timely manner;**
- (b) **require SCOs to maintain management information on the number of cases arising from different sources leading to identifying non-compliant SS structures;**
- (c) **take measures to prevent recurrence of delays in taking enforcement actions due to unclear responsibilities among different Lands D units;**
- (d) **strengthen actions on SS structures associated with repeated complaints and Lands D warning letters;**
- (e) **expedite actions to inspect the 77 SS structures located along the seafront at which SS Structures G, H and I situate;**
- (f) **take measures to ensure that any breakdown of a check-point electronic device is repaired in a timely manner;**

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- (g) based on available staff resources, formulate an inspection programme for every inspection team covering all SS structures within an inspection area over a certain period of time;**
- (h) take measures to ensure that each SCO maintains a complaint register;**
- (i) take measures to ensure that SCOs include all outstanding cases in the bi-monthly Case Monitoring Reports;**
- (j) conduct a review of the effectiveness of the squatter structure monitoring system and consider implementing an improved system, which includes, for example, the following salient features:**
 - (i) each inspection team should be assigned to monitor designated SS structures within an inspection area for ensuring compliance with the SC Policy;**
 - (ii) based on the available staff resources, an inspection programme should be formulated for each inspection team such that each SS structure is subject to inspection within a specified period of time, with the inspection interval being determined taking into account the risks of non-compliance with the SC Policy;**
 - (iii) details of each SS structure in the 1982 Survey Records should be uploaded onto a computer database which would be used to check against each SS structure during an inspection;**
 - (iv) details of and irregularities observed during each inspection, with photographs, should be recorded in the database for future reference, together with details of follow-up actions taken;**
 - (v) details of public complaints and B/D referrals relating to individual SS structure should be recorded in the database, together with details of follow-up actions taken; and**

Monitoring of squatter and licensed structures

- (vi) **periodic management reports should be generated to highlight SS structures not having been inspected for a specified period of time, and long-outstanding cases where follow-up actions on irregularities have not been completed within a specified period of time;**
- (k) **consider providing hand-held computers storing the inspection programmes and details of each SS structure to facilitate the inspection teams' inspections as well as recording and updating onto the database results of inspections and follow-up actions taken; and**
- (l) **strengthen guidance to operation staff on following up and dealing with long-outstanding non-compliant cases.**

Response from the Government

2.43 The Director of Lands agrees with the audit recommendations. She has said that:

- (a) the Lands D will strengthen monitoring of SCOs' routine patrols and assess their effectiveness, taking into account the high percentage of cases involving irregularities being detected through public complaints and B/D referrals;
- (b) regarding paragraph 2.42(h), all SCOs have now maintained complaint registers;
- (c) regarding paragraph 2.42(i), the Lands D has reminded case officers to include all confirmed non-compliant cases in the Case Monitoring Reports within two weeks, and will continue to ensure that SCOs will include all outstanding cases in the Case Monitoring Reports within the designated timeframe;
- (d) the Lands D promulgated SC instructions in September 2016 to set out clearly the SC actions and the related timeframes. The introduction of a new computer-based system will involve considerable resources in terms of manpower and time. The Lands D will consider implementing a system to maintain information of 1982 Survey Records on SS structures

and to digitise maps showing locations of SS structures to facilitate site patrolling; and

- (e) since June 2016, the Lands D has implemented a strengthened strategy on SC monitoring work, and will continue to look for ways to improve the work and follow-up actions on cases with irregularities.

2.44 The Secretary for Development has said that the Lands D has deployed available resources to tackle the relevant work since it took over the SC responsibilities, and the Lands D has put in sincere efforts to strengthen related work in recent years.

Monitoring of licensed structures

2.45 Under the Cap. 28 Ordinance, on payment of a prescribed fee, the Lands D may issue a GLL permitting a licensee to occupy a piece of unleased government land, and a GLL is valid for a specified period and may be renewed or terminated at the Lands D's discretion. Prior to mid-1970s, the Government had issued GLLs for erection of some domestic and non-domestic structures on government land. Under the licence conditions, only licensed structures complying with the purposes and dimensions specified in a GLL are allowed to be erected on a piece of designated government land, and the Lands D may cancel a GLL if there is a breach of any licence conditions.

2.46 The Lands D's Lands Administration Office oversees 12 DLOs (Note 10), which are responsible for, among others, administering unleased and unallocated government land, including licensed structures situated on government land within their districts. As of March 2016, 216 staff in 12 DLOs were responsible for land administration duties including monitoring of structures covered under 15,214 GLLs to ensure their compliance with the licence conditions.

Note 10: *The 12 DLOs are DLO/Hong Kong East, DLO/Hong Kong West and South, DLO/Kowloon East, DLO/Kowloon West, DLO/Islands, DLO/North, DLO/Sai Kung, DLO/Shau Tin, DLO/Tai Po, DLO/Tsuen Wan and Kwai Tsing, DLO/Tuen Mun and DLO/Yuen Long.*

Licensed structures not complying with licence conditions

2.47 According to the Lands D, information on licensed structures not complying with licence conditions and follow-up actions taken was kept in individual case files by the 12 DLOs, and centralised information was not readily available for Audit examination. Given the absence of a centralised database on licensed structures, Audit selected an outlying island and scrutinised case files of licensed structures covered under 30 GLLs located on the island. Based on the addresses, uses and dimensions of the licensed structures as recorded in the 30 GLLs, Audit conducted a site visit in January 2017 to the structures of 30 cases and noted two cases of suspected non-compliance with the licence conditions (see Cases 8 and 9).

Case 8

Lack of effective enforcement actions on licensed structure (Licensed Structure A) (January 2005 to January 2017)

1. In 1993, a licensee (Licensee A — Note) was permitted to use a piece of government land (of 15.6 square metres (m²)) on an outlying island for erecting a licensed structure (Licensed Structure A) for the following purposes:

Use	Dimension		
	Length (metre)	Width (metre)	Height (metre)
Accommodation	5.18	2.44	4.11
Latrine	1.22	1.07	4.11
Balcony	1.22	1.37	4.11

2. In January 2005, the DLO/Islands received a complaint on an unauthorised erection of a rooftop structure on Licensed Structure A. In February 2005, the DLO/Islands issued a warning letter to Licensee A to require him to demolish the unauthorised structure as soon as possible, and would consider cancelling the GLL if the requirement was not complied with.

3. In March and July 2005, the DLO/Islands carried out site inspections and noted that no rectification works had been conducted on Licensed Structure A.

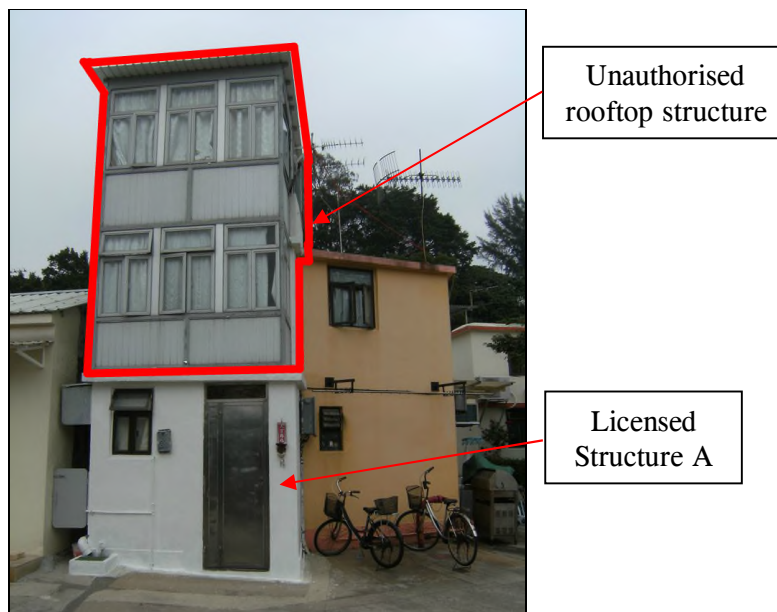
Case 8 (Cont'd)

4. In February 2009, the DLO/Islands received another complaint on an unauthorised erection of a rooftop structure on Licensed Structure A. In March 2009, the DLO/Islands issued a warning letter to Licensee A to require him to demolish the unauthorised structure as soon as possible, and would consider cancelling the GLL if the requirement was not complied with.

5. From August 2005 to January 2009 (42 months) and from April 2009 to January 2017 (94 months), Audit could not find records showing that the DLO/Islands had taken any follow-up actions on the case. As of January 2017, Audit's site visit noted that the unauthorised rooftop structure had not been demolished (see Photograph 14).

Photograph 14

**Unauthorised rooftop structure on Licensed Structure A
(January 2017)**



Source: Photograph taken by Audit in January 2017

Case 8 (Cont'd)

Audit comments

6. According to the Lands D's instructions, the licensee of a licensed structure being found to have constructed unauthorised structures and violating the licence conditions should be informed in writing of the need to rectify the irregularities within a certain period, normally in 28 days, failing which the licence may be cancelled and actions would be taken to clear the licence area. Audit considers it unsatisfactory that, despite a warning letter being issued in February 2005, after 12 years in January 2017, the DLO/Islands had not taken effective actions on Licensed Structure A which had breached a licence condition by constructing an unauthorised rooftop structure. In Audit's view, the Lands D needs to:

- (a) take effective enforcement actions on Licensed Structure A, such as cancelling the relevant licence in a timely manner; and
- (b) take effective measures to ensure that licensed structures comply with licence conditions.

Source: Lands D records and Audit's site visit

Note: In 1993, a licence for Licensee A was issued to replace a cancelled licence issued in 1975.

Case 9**Occupation of licensed structure without Lands D approval
(Licensed Structure B)
(September 2000 to January 2017)**

1. In 1969, a licensee (Licensee B) was permitted under a GLL (GLL B) to use a piece of government land (of 313.5 ft²) on an outlying island for erecting a licensed structure (Licensed Structure B) for the following purposes:

Use	Dimension		
	Length (foot)	Width (foot)	Height (foot)
Accommodation	19.0	10.5	12.0
Kitchen	6.0	8.5	12.0
Kitchen	6.0	10.5	12.0

2. In November 2011, upon enquiry by the DLO/Islands, the Immigration Department confirmed that Licensee B had passed away in September 2000. According to the Lands D's instructions, a GLL may be cancelled upon the death of a licensee is made known to the Lands D unless a licensee's immediate family member has applied and being approved to become a new licensee. However, Audit could not find records showing an approved transfer of GLL B to another person. In January 2017, Audit's site visit noted that there were signs of occupation of Licensed Structure B (see Photograph 15).

Case 9 (Cont'd)

Photograph 15

Licensed Structure B (January 2017)



Source: Photograph taken by Audit in January 2017

Audit comments

3. Audit considers it unsatisfactory that, despite the death of Licensee B in September 2000 being made known to the DLO/Islands in November 2011, and in the absence of an application and approval of a transfer of GLL B, the Lands D had not taken licence enforcement actions up to January 2017. The Lands D needs to take appropriate enforcement actions on Licensed Structure B. It also needs to take measures to cancel a GLL upon the death of a licensee being made known to the Lands D if there is no approved transfer of the GLL. The Lands D also needs to, in collaboration with the Immigration Department, ascertain whether any of the GLL licensees has passed away and take necessary licence enforcement actions.

Source: Lands D records and Audit's site visit

Lack of inspection programmes and inspection information on licensed structures

2.48 Pursuant to the Lands D's instructions, each licensed structure should be inspected at least once a year, and the inspection interval may be changed subject to not less than once every three years after considering work priorities. According to the Lands D:

- (a) none of the 12 DLOs has prepared an inspection programme on inspecting licensed structures. Licensed structures would be inspected on a need basis, such as upon receipt of a complaint, an application for transfer of a GLL, and an application for repair or rebuilding of a structure; and
- (b) none of the 12 DLOs has maintained a centralised database to record the time of inspecting each licensed structure, the irregularities observed and follow-up actions taken.

2.49 The absence of a system to consolidate the information on inspections conducted on licensed structures and follow-up actions taken on licensed structures not complying with licence conditions has impeded the Lands D management's monitoring of the DLO's inspection actions and Audit's examination of the efficiency and effectiveness of the Lands D's monitoring actions on licensed structures. Therefore, there is no assurance that the structures covered under the 15,214 GLLs have satisfactorily complied with the licence conditions. To improve the situation, the Lands D needs to consider implementing a system for monitoring licensed structures, which includes, for example, the following salient features:

- (a) based on the available staff resources, an inspection programme should be formulated for each DLO such that each licensed structure is subject to inspection within a specified period of time, with the inspection interval being determined taking into account the risks of non-compliance with the licence conditions;
- (b) details of each licensed structure and its licence conditions should be uploaded onto a computer database which would be used to check against each licensed structure during an inspection;

Monitoring of squatter and licensed structures

- (c) details of and irregularities observed during each inspection, with photographs, should be recorded in the database for future reference, together with details of follow-up actions taken;
- (d) details of public complaints and B/D referrals relating to individual licensed structure should be recorded in the database, together with details of follow-up actions taken; and
- (e) periodic management reports should be generated to highlight licensed structures not having been inspected for a specified period of time, and long-outstanding cases where follow-up actions on irregularities have not been completed within a specified period of time.

The Lands D may also consider providing hand-held computers storing the inspection programmes and details of each licensed structure to facilitate the inspection teams' inspections as well as recording and updating onto the database results of inspections and follow-up actions taken.

Need to expedite actions on setting up Central Action Team

2.50 In December 2005 and March 2006, before the second phase of the transfer of SC responsibilities from the HD to the Lands D (see para. 2.2), the then Housing, Planning and Lands Bureau and the Lands D informed (through submission of information papers) the then Panel on Planning, Lands and Works of LegCo that:

- (a) the transfer arrangement would benefit from unity of command over land control and lease enforcement which were often related, thus achieving greater efficiency and effectiveness in land control work and in dealing with enforcement cases straddling both government land and private land;
- (b) the Lands D planned to set up a Central Action Team to tackle land control, including SC and lease enforcement work for the whole territory, as soon as possible; and
- (c) the effectiveness of the new arrangement would be reviewed after its implementation.

2.51 However, Audit noted that, as of January 2017:

- (a) monitoring of squatter structures was carried out by the 7 SCOs while monitoring of licensed structures by the 12 DLOs; and
- (b) the proposed Central Action Team (see para. 2.50(b)) had not been set up.

2.52 In Audit's view, there could be synergy in integrating the carrying out of monitoring work of squatter structures by the 7 SCOs and licensed structures by the 12 DLOs. Therefore, the Lands D needs to expedite actions on setting up the Central Action Team.

2.53 In March 2017, the Lands D informed Audit that:

- (a) the proposed Central Action Team was a concept and any proposed changes in the staff establishment and redeployment were subject to staff consultations; and
- (b) the Lands D would consider to give serious thoughts to setting up the Central Action Team.

Audit recommendations

2.54 Audit has *recommended* that, in monitoring licensed structures, the Director of Lands should:

- (a) **take effective measures to ensure that licensed structures comply with licence conditions;**
- (b) **take effective enforcement actions on Licensed Structures A and B in a timely manner;**

Monitoring of squatter and licensed structures

- (c) take measures to cancel a GLL upon the death of a licensee being made known to the Lands D if there is no approved transfer of the GLL;**
- (d) in collaboration with the Director of Immigration, ascertain whether any of the GLL licensees has passed away and take necessary licence enforcement actions;**
- (e) consider implementing an improved system for monitoring licensed structures, which includes, for example, the following salient features:**
 - (i) based on the available staff resources, an inspection programme should be formulated for each DLO such that each licensed structure is subject to inspection within a specified period of time, with the inspection interval being determined taking into account the risks of non-compliance with the licence conditions;**
 - (ii) details of each licensed structure and its licence conditions should be uploaded onto a computer database which would be used to check against each licensed structure during an inspection;**
 - (iii) details of and irregularities observed during each inspection, with photographs, should be recorded in the database for future reference, together with details of follow-up actions taken;**
 - (iv) details of public complaints and B/D referrals relating to individual licensed structure should be recorded in the database, together with details of follow-up actions taken; and**
 - (v) periodic management reports should be generated to highlight licensed structures not having been inspected for a specified period of time, and long-outstanding cases where follow-up actions on irregularities have not been completed within a specified period of time; and**

- (f) **consider providing hand-held computers storing the inspection programmes and details of each licensed structure to facilitate the inspection teams' inspections as well as recording and updating onto the database results of inspections and follow-up actions taken.**

Response from the Government

2.55 The Director of Lands agrees with the audit recommendations. She has said that the Lands D will consider asking DLOs to set up District Review Boards to set priorities and work plans for GLL patrol work and follow-up enforcement actions.

2.56 The Director of Immigration has said that the Immigration Department has been timely acceding to the Lands D's requests for death-record checks on GLL licensees and will continue to assist the Lands D as far as practicable.

PART 3: RATES, GOVERNMENT RENT AND LICENCE FEES ON SQUATTER AND LICENSED STRUCTURES

3.1 This PART examines the actions taken by the RVD and the Lands D in the assessment and collection of rates, government rent and licence fees on S&L structures, focusing on:

- (a) rates and government rent on S&L structures (see paras. 3.2 to 3.14); and
- (b) licence fees on licensed structures (see paras. 3.15 to 3.27).

Rates and government rent on squatter and licensed structures

3.2 Under the Rating Ordinance and the Rent Ordinance, a tenement refers to any land or any building or structure or a part of a building or structure, which is held or occupied as a distinct or separate tenancy or holding or under any licence. In this connection:

- (a) under the Rating Ordinance, rates are charged at a percentage (currently at 5% per annum — Note 11) of the rateable value which is the estimated annual rental value of a tenement; and
- (b) under the Rent Ordinance, government rent is charged at 3% per annum of the rateable value of a tenement situated on a piece of leased land chargeable to government rent (i.e. land held under a land lease: (i) extended under the New Territories Leases (Extension) Ordinance (Cap. 150); or (ii) under which there is an express obligation to pay that annual rent).

According to the RVD, the chargeability of S&L structures to rates and government rent is shown in Table 6.

Note 11: *This percentage, subject to LegCo's approval under the Rating Ordinance, has remained unchanged since April 1999.*

**Rates, government rent and licence fees
on squatter and licensed structures**

Table 6

**Chargeability of S&L structures to
rates and government rent**

Chargeability	Squatter structures erected on		Licensed structures erected on	
	Government land	Private agricultural land (Note 1)	Government land	Private agricultural land
Rates	Not chargeable	Chargeable (Note 2)	Chargeable (Note 2)	Not applicable (Note 4)
Government rent	Not chargeable	Chargeable (Note 3)	Not chargeable	Not applicable (Note 4)

Source: Audit analysis of RVD records

Note 1: According to the RVD: (a) if a squatter structure is partly erected on private agricultural land and partly on government land, the RVD would assess the rateable value of the entire structure for the purposes of charging rates and government rent; and (b) if a squatter structure being erected on private agricultural land is transient in nature, it would not be chargeable to rates and government rent.

Note 2: Under the Rating Ordinance, certain tenements are exempted from assessment to rates, including: (a) non-domestic S&L structures erected on agricultural land used for agricultural purposes; (b) domestic S&L structures in the New Territories occupied as dwellings by persons engaged in carrying out agricultural operations; and (c) S&L structures where the estimated rateable value does not exceed the prescribed amount (currently at \$3,000 per annum).

Note 3: Under the Rent Ordinance, subject to meeting specified criteria, an indigenous villager is exempted from the liability to pay government rent for an interest in land held by him. An indigenous villager is a male person at least 18 years old who is a descendent through the male line from a resident in 1898 of a recognised village.

Note 4: No licensed structure is erected on private agricultural land.

***Omissions in charging rates and government rent on
S&L structures***

3.3 As shown in Table 6:

- (a) squatter structures erected on private agricultural land are chargeable to both rates and government rent (subject to some exemptions — see Notes 2 and 3 to Table 6); and
- (b) licensed structures erected on government land are chargeable to rates (subject to some exemptions — see Note 2 to Table 6).

3.4 According to the Lands D and the RVD:

- (a) the Lands D has not provided the RVD with information on 262,128 SS structures erected on private agricultural land (see Table 1 in para. 1.3) for the latter to assess and charge rates and government rent; and
- (b) while Lands D records have maintained the squatter survey number of each SS structure (which does not normally have a proper address), the RVD's computer system has not maintained information on such squatter survey numbers because such numbers are not relevant to assessment and charging of rates. For the purposes of assessing and charging rates and government rent on 262,128 SS structures erected on private agricultural land, the RVD and the Lands D need to carry out manual matching of addresses of the SS structures.

3.5 In early 2017, with a view to assessing the quantum of rates assessments relating to the 262,128 SS structures erected on private agricultural land, the RVD selected 3 squatter areas (namely Tai O, Lei Yue Mun and Kau Wa Keng) for investigation. In response to the RVD's request, the Lands D randomly selected 10 SS structures in each of the 3 squatter areas and provided the RVD with the addresses and map locations of the 30 SS structures. Based on the Lands D information, the RVD found that, of the 30 SS structures:

Rates, government rent and licence fees on squatter and licensed structures

- (a) 27 SS structures had been assessed to rates with the median rateable value being \$27,120 per annum and the median rates collectable being about \$680 per annum in 2015-16. Majority of these structures were not subject to payment of rates in 2016-17 because of rates concessions;
- (b) the remaining 3 SS structures were either for agricultural purposes or of a rateable value not exceeding the prescribed amount (currently at \$3,000 per annum), and were therefore exempted from assessment to rates under the Rating Ordinance; and
- (c) all the 30 structures had been either assessed to government rent or exempted from payment of government rent under the Rent Ordinance.

3.6 Owing to the fact that the RVD's database has not maintained information on the squatter survey numbers of SS structures (which do not normally bear proper addresses for rates and government rent purposes), and that data matching between records of the RVD and the Lands D has not been carried out, there is no assurance that rates and government rent have been properly charged on all pertinent SS structures.

3.7 Regarding licensed structures, according to the Lands D:

- (a) since 2000, it has provided the RVD with information on licensed structures for the latter to assess and charge rates; and
- (b) however, given time constraints, the Lands D could not readily compile and provide Audit with information on licensed structures which has been provided to the RVD over the years for assessing and charging rates.

Rates, government rent and licence fees on squatter and licensed structures

3.8 In February 2017, Audit selected 30 (1%) of the 3,326 GLLs associated with licensed structures under the monitoring of DLO/Islands (Note 12) and forwarded these cases to the RVD for verification as to whether or not rates had been properly charged on these structures. After conducting verifications, the RVD found that, as of March 2017, of the licensed structures covered under the 30 GLLs, the structures of:

- (a) 7 (23%) GLLs were exempted from rates assessment (see Note 2 to Table 6 in para. 3.2);
- (b) 5 (17%) GLLs had already been assessed and charged rates; and
- (c) 18 (60%) GLLs were chargeable to rates, but rates had not been assessed and charged on these structures. According to the RVD, these 18 cases related to tenements located in remote areas involving relatively low rateable values and were accorded a lower priority for assessment and charging of rates. Details of these 18 cases are shown in Table 7.

Note 12: *As of March 2016, the DLO/Islands was responsible for managing the highest number of GLLs (3,326 (22%) of the total 15,214 GLLs).*

**Rates, government rent and licence fees
on squatter and licensed structures**

Table 7

**Omissions in charging rates on structures under 18 GLLs
(March 2017)**

GLL	Location	Use of licensed structure	Size (m²)	RVD estimated annual rates
C	Tai O, Lantau Island	Accommodation	47	\$492
D	Tung O, Lamma Island		44	\$264
E	Mui Wo, Lantau Island		44	\$462
F	Tai O, Lantau Island		38	\$294
G	Tai O, Lantau Island		37	\$288
H	Mui Wo, Lantau Island		35	\$510
I	Tai O, Lantau Island		33	\$216
J	Tong Fuk, Lantau Island		32	\$246
K	Tung Chung, Lantau Island		31	\$372
L	Tai O, Lantau Island	Accommodation and storage	29	\$228
M	Tai O, Lantau Island	Accommodation	28	\$216
N	Tai O, Lantau Island		26	\$204
O	Tai O, Lantau Island		24	\$186
P	Tai O, Lantau Island		23	\$180
Q	Tai O, Lantau Island		23	\$180
R	Tai O, Lantau Island		22	\$174
S	Tai O, Lantau Island		20	\$156
T	Tai O, Lantau Island		17	\$132

Source: Lands D and RVD records

Remarks: According to the RVD, after allowing for rates concessions, the estimated average rates collectable from the structures covered under each of the 18 GLLs in 2015-16 was about \$135.

Rates, government rent and licence fees on squatter and licensed structures

3.9 In March 2017, the RVD informed Audit that:

- (a) the RVD's computer system had maintained information on tenements (based on building addresses and land-lot details) chargeable to rates and government rent. As of March 2017, its computer system maintained the rates assessment records of structures covered by 6,659 GLLs. In 2015-16, the median rateable value of each of these 6,659 GLLs was about \$24,000 per annum and the median rates of each GLL collectable was about \$600 per annum after allowing for rates concession. In 2015-16, the RVD collected a total revenue of \$22,733 million from rates, and the rates revenue from GLLs was \$7.6 million (0.03% of \$22,733 million). As the Government waived rates for four quarters of 2016-17 (subject to a ceiling of \$1,000 per quarter for each rateable property), majority of GLLs were not subject to payment of rates in that year. For those GLLs that were not included in the RVD's system, some of the licensed structures might be exempted from rates assessment under the Rating Ordinance (e.g. see Note 2 to Table 6 in para. 3.2), some might involve ruined structures without beneficial occupation and hence not liable to assessment to rates, some might involve structures having been assessed together with adjoining tenements, and some were of low rateable values and hence being accorded a lower priority for the RVD's action;
- (b) the RVD had to prioritise its work in order not to compromise the performance of its various statutory functions, including the updating of the Valuation List and the Government Rent Roll from time to time (involving about 32,000 new assessments in 2015-16), as well as the annual General Revaluations (involving some 2.5 million assessments). Valuations of structures located in remote areas covered by GLLs having low rateable values would be accorded a lower priority;
- (c) to make the best use of the RVD's available resources and protect the Government's revenue, it had been the RVD's established practice to give priority to structures of a relatively higher rateable value when assessing the rates and/or government rent of licensed structures erected on government land and squatter structures erected on private agricultural land; and

- (d) based on the RVD's findings in paragraph 3.5 and the historical background of squatter structures, data matching between the records of the Lands D and the RVD on the 262,128 SS structures erected on private agricultural land would unlikely be a cost-effective exercise where the resource requirement would not be justified by the expected outcome. The RVD had to ascertain the addresses or the exact locations of these structures before checking their rating records. The additional workload arising from the matching exercise was significant given the huge volume of records involved. The RVD needed to seriously evaluate the cost-effectiveness of obtaining the information on these structures for matching before committing to any follow-up action.

3.10 Audit noted that, of the 15,214 GLLs managed by the Lands D, the RVD's computer system only maintained the rates assessment records of 6,659 (44% of 15,214) GLLs as of March 2017 (see para. 3.9(a)). Moreover, of the 262,128 SS structures erected on private agricultural land, the RVD has conducted investigation on only 30 (0.01% of 262,128) SS structures (according to the RVD and the Lands D, these 30 structures were selected on a random basis) to ascertain whether rates and government rent had been assessed on them (see para. 3.5). Therefore, there is a risk that relevant rates and government rent on S&L structures have not been fully assessed and charged. With a view to ensuring proper charging of rates and government rent on S&L structures, Audit considers that the Lands D needs to provide the RVD with information of all pertinent S&L structures for the latter to assess and charge rates and government rent where appropriate. The RVD also needs to take actions to recover and charge rates and government rent on pertinent S&L structures for which charging of such rates and rent has been omitted in the past.

Audit recommendations

3.11 Audit has *recommended* that the Director of Lands should provide the Commissioner of Rating and Valuation with information of all pertinent S&L structures for the latter to assess and charge rates and government rent where appropriate.

Rates, government rent and licence fees on squatter and licensed structures

3.12 Audit has *recommended* that the Commissioner of Rating and Valuation should:

- (a) take actions to charge rates on licensed structures covered under 18 GLLs identified by Audit (see para. 3.8(c)); and
- (b) based on information on S&L structures provided by the Lands D, take actions to charge rates and government rent on pertinent S&L structures, and recover rates and government rent on such structures for which charging has been omitted in the past.

Response from the Government

3.13 The Director of Lands agrees with the audit recommendation in paragraph 3.11. She has said that the Lands D will follow up with the RVD on the issue accordingly.

3.14 The Commissioner of Rating and Valuation agrees with the audit recommendations in paragraph 3.12. He has said that:

- (a) the RVD has been closely monitoring the rates assessments of licensed structures covered by GLLs. In 2003, the RVD set up a computer system to monitor the assessment of licensed structures in the New Territories based on information provided by the Lands D. Up to March 2017, the RVD had received information on 2,650 GLLs (relating to structures located in the New Territories) from the Lands D and had taken follow-up action on these GLLs. Having regard to resource availability and work priority, the RVD will assess the outstanding licensed structures by phases based on the Lands D's information, including the 18 cases identified by Audit (see para. 3.8(c)); and
- (b) upon receipt of the addresses, locations and boundaries of the 262,128 SS structures erected on private agricultural land from the Lands D, the RVD will be able to conduct data matching and check whether the pertinent SS structures have been assessed or exempted from assessment to rates and/or government rent.

Licence fees on licensed structures

3.15 In October 1972, upon enactment of the Cap. 28 Ordinance, licence fees for occupying government land for erecting different types of licensed structures were specified in the Ordinance. For example:

- (a) licence fees for occupying government land were stipulated for 18 types of specific structures in the urban areas (e.g. \$3,000 per annum for a petrol filling station located in the city centre), and 17 types in the New Territories;
- (b) licence fees for occupying government land were stipulated for other types of structures including domestic structures. For domestic licensed structures, the licence fee for occupying land located in:
 - (i) the urban areas ranged from \$0.1 to \$1 per ft² per annum; and
 - (ii) the New Territories was \$0.03 per ft² per annum; and
- (c) the minimum licence fee in the urban areas was \$10 and that in the New Territories was \$5.

3.16 In January 1977, the Cap. 28 Ordinance was amended to give effect to the adoption of the metric system. As a result, the licence fees for occupying government land for erecting licensed structures were revised. For domestic structures, the licence fee for occupying land located in:

- (a) the urban areas ranged from \$1 to \$10 per m² per annum; and
- (b) the New Territories was \$0.3 per m² per annum.

3.17 As of March 2016, 15,214 GLLs (comprising 10,481 domestic GLLs and 4,733 non-domestic GLLs) were in force (see para. 1.6). In 2015-16, the total revenue collected in respect of GLL fees was \$445,000.

Lack of review and revision of GLL fees since 1972

3.18 According to the Lands D:

- (a) the licence fees set up under the Cap. 28 Ordinance in 1972 were based on the fees of the then Crown Land Permits which had been set up under the previous Summary Offences (Licences and Fees) Regulations. From 1950s to early 1970s, the fees of Crown Land Permits and the licence fees under the Cap. 28 Ordinance were intended to be relatively nominal compared to the land value, and were charged as a means to control land use rather than for the purpose of raising revenue. Such fees were intended to become obsolete gradually when Crown Land Permits or GLLs were being replaced by STTs which would have proper tenancy arrangements and charges; and
- (b) based on the Lands D's research on the market rent in the New Territories in 1970s (i.e. around the time when the Cap. 28 Ordinance was enacted in 1972), the licence fees prescribed under the Cap. 28 Ordinance represented about 1% or less of the prevailing market rent of the exempted houses in the New Territories.

3.19 Audit noted that licence fees for occupying government land for erecting licensed structures had not been revised since enactment of the Cap. 28 Ordinance in 1972. The licence fee revisions in January 1977 were merely to give effect to the adoption of the metric system to replace the previous non-metric system. Based on RVD records on the average annual rent of tenement premises and village-type houses in the third quarter of 2016, Audit noted that the licence fees for domestic licensed structures were significantly lower than the market rent of similar premises (see Table 8).

**Rates, government rent and licence fees
on squatter and licensed structures**

Table 8

**Licence fees for occupying land for erecting domestic licensed structures
vis-a-vis market rent
(third quarter of 2016)**

Location	Licence fee (per m² per annum)	Market rent (per m² per annum) (Note)
Urban areas	\$1 to \$10 (depending on districts)	\$2,844
New Territories	\$0.3	\$1,896

Source: Cap. 28 Ordinance and RVD records

Note: According to the RVD, market rent in the urban areas and the New Territories refers to the average annual rent of tenement premises and village-type houses respectively.

3.20 Audit examination revealed that the subject on the review of the licence fees had been brought up on the following occasions:

- (a) in 1972, when proposing the enactment of the Cap. 28 Ordinance, the then Director of Lands and Survey said that the Government would consider revision of the licence fees in 12 months' time;
- (b) in 1977, when reporting the progress of converting non-domestic licensed structures into STTs (see para. 3.22), the Government said that considerable number of licensees paying low licence fees had enjoyed rents from sub-lessees which should have accrued to public revenue;
- (c) in June 1999, the Lands D proposed to the then Planning, Environment and Lands Bureau that the fees prescribed under the Cap. 28 Ordinance should be updated. In August 1999, the Bureau requested the Lands D to advise which items of the prescribed fees should be deleted, updated and retained; and

Rates, government rent and licence fees on squatter and licensed structures

- (d) in December 2006, the Lands D informed the then Housing, Planning and Lands Bureau that, since the Lands D was working on the legislative amendment to increase the penalties under the Cap 28 Ordinance, the updating of licence fees prescribed under the Ordinance was not recommended as the problems of outdated prescribed fees could be overcome by the issue of STTs.

3.21 In Audit's view, given that 10,481 domestic GLLs and 4,733 non-domestic GLLs had not been converted into STTs as of March 2016, the Lands D needs to expedite actions on conducting a review of the licence fee levels.

Need to convert suitable non-domestic GLLs into STTs

3.22 According to the Lands D:

- (a) since the mid-1970s, the Government has adopted a policy to convert non-domestic GLLs into STTs for effecting better control and securing a better financial return for the Government;
- (b) for STTs in urban areas converted from GLLs, the rents are charged at fair market rent and reviewed once every three years; and
- (c) for STTs in the New Territories converted from GLLs, the rents are generally charged at the prevailing STT standard rates, which are determined with reference to the STT locations and the coverage of buildings on the STT sites. The STT standard rates were derived originally from market rents reflecting the average rental level for temporary occupation of land. Such rates have been reviewed regularly to reflect market changes.

3.23 While the Government has adopted a policy to convert non-domestic GLLs into STTs since mid-1970s, as of March 2016, 4,733 non-domestic GLLs had not been converted into STTs. According to the Lands D's instructions, certain types of non-domestic GLLs (such as agricultural land and associated structures, playgrounds and mobile boat kiosks) need not be converted into STTs. However, of the 4,733 non-domestic GLLs, the Lands D has not maintained information on the number of GLLs suitable for conversion into STTs. In this connection, Audit noted

Rates, government rent and licence fees on squatter and licensed structures

that the licence fees for non-domestic licensed structures were significantly lower than the STT standard rates. For example, as of January 2017:

- (a) the STT standard rates ranged from \$68.8 to \$771.1 per m² per annum; and
- (b) the corresponding licence fees under the Cap. 28 Ordinance only ranged from \$0.1 to \$0.3 per m² per annum.

3.24 In Audit's view, the Lands D needs to conduct a review to ascertain non-domestic GLLs suitable for conversion into STTs, and take conversion actions in a timely manner.

Audit recommendations

3.25 **Audit has *recommended* that the Director of Lands should:**

- (a) **expedite actions on conducting a review of the GLL fee levels; and**
- (b) **ascertain non-domestic GLLs suitable for conversion into STTs, and take conversion actions in a timely manner.**

Response from the government

3.26 The Director of Lands agrees with the audit recommendations. She has said that, in 2015, the Lands D commenced internal discussions and research into the need for a review of the licence fee levels under the Cap. 28 Ordinance.

3.27 The Secretary for Development has said that the licence fee levels under the Cap. 28 Ordinance are relatively low compared to market values due to various historical reasons, reflecting the policy intention when the fees were first introduced, and the Lands D will expedite the process of reviewing the licence fee levels.

PART 4: CLEARANCE OF SQUATTER AND LICENSED STRUCTURES

4.1 This PART examines actions taken by the Lands D, the CEDD and the BD on S&L structures subject to clearance and prone to landslide risks, focusing on:

- (a) development clearance of S&L structures (see paras. 4.4 to 4.15); and
- (b) dangerous slopes posing landslide risks to S&L structures (see paras. 4.16 to 4.36).

Government's clearance operations

4.2 In general, clearance of S&L structures involves:

- (a) development clearance to make land available for public works projects; and
- (b) NDC on slope-safety grounds.

4.3 For each clearance operation, the Lands D is responsible for:

- (a) conducting a pre-clearance survey to ascertain the Government's commitments on re-housing and ex-gratia allowances;
- (b) checking re-housing eligibility of occupants of the affected S&L structures;
- (c) processing and payment of ex-gratia allowances to eligible persons; and
- (d) undertaking works on affected S&L structures to render them uninhabitable.

Development clearance of squatter and licensed structures

4.4 The general compensation and re-housing arrangements under the Government's development clearance operations include the following:

- (a) ***Re-housing to PRH.*** Affected occupants meeting the following criteria may be re-housed to PRH upon clearance of S&L structures:
 - (i) a household affected by a clearance operation should have been covered in the pre-clearance survey;
 - (ii) the affected household should have resided in a domestic SS structure covered in the 1982 Squatter Survey and it should be covered in the 1984/85 Occupancy Survey, or have resided in a domestic licensed structure;
 - (iii) if the affected household is not covered in the 1984/85 Occupancy Survey, in case it could provide evidence of 2-year residence in the premises in (ii) above immediately preceding the announcement date of clearance, it would be allotted a notional PRH application number with a 2-year waiting time; and
 - (iv) the affected household has to meet other eligibility criteria for PRH (e.g. having lived in Hong Kong for at least 7 years, not owning any domestic property in Hong Kong and satisfying the comprehensive means test);
- (b) ***Village Resites.*** An indigenous villager (see Note 3 to Table 6 in para. 3.2) affected by a clearance operation may be provided with a village resite; and
- (c) ***Ex-gratia allowance for permitted occupiers.*** Permitted occupiers residing in domestic licensed structures or domestic SS structures for at least 10 years immediately preceding the date of a pre-clearance survey are eligible for the ex-gratia allowance.

Clearance of squatter and licensed structures

4.5 From 2012 to 2016, 5,606 structures were cleared under the Government's development clearance operations (Note 13). Among these operations, a works project (Project A) involved clearance of the largest number of 1,669 (30% of 5,606) structures. Audit selected Project A for examination.

4.6 In 2012, when seeking funding approval from LegCo Finance Committee (FC), the DEVB informed the FC that Project A would have strategic significance for Hong Kong's future development, and to ensure smooth clearance of land for the timely completion of Project A, special arrangements would be offered to affected households on top of the general compensation and re-housing arrangements (see para. 4.4), including:

- (a) ***Cottage House Option.*** Eligible non-indigenous villagers (see key eligibility criteria at Appendix E) residing in a domestic structure located in one of two villages affected by Project A would be offered a right to build a two-storey domestic cottage house (with a maximum roofed-over area of 500 ft²) on a piece of leased private agricultural land in an adjoining resite area on a "structure-for-structure" basis by way of an in-situ land exchange (subject to the payment for additional land premiums);
- (b) ***Special Ex-gratia Cash Allowance (SEGCA).*** To meet the special re-housing needs of affected persons, a qualified household affected by the clearance operation for Project A might be offered an SEGCA up to a maximum amount of \$600,000, subject to meeting the stipulated eligibility criteria (see key criteria at Appendix E). Persons eligible for the Cottage House Option (see (a) above) may also be eligible for SEGCA provided that the pertinent eligibility criteria were also met; and

Note 13: *According to the Lands D, 68 operations were conducted from 2014 to 2016. The Lands D has not maintained information on the number of operations conducted in 2012 and 2013.*

- (c) *Secretary for Development's discretion.* To provide flexibility in this clearance operation to address the special re-housing needs of households who did not fully meet the eligibility criteria for the Cottage House Option and/or SEGCA, on the advice of an Inter-departmental Advisory Panel (IDA Panel — Note 14), the Secretary for Development was authorised to determine whether a reduced SEGCA and/or the Cottage House Option would be provided to the concerned persons.

4.7 In July 2012, the DEVB informed the FC that 344 households would be affected by Project A clearance operation and that the total estimated cost of SEGCA would be \$206.4 million. In the same month, the FC approved funding of \$211 million for Project A clearance operation, including \$206.4 million for SEGCA.

4.8 In September 2016, Project A clearance operation was completed, under which 1,669 structures (comprising 178 domestic and 1,491 non-domestic structures) had been cleared. Of the total 221 households affected (claimed to be residing in the 178 domestic structures), 147 were provided with various re-housing arrangements and/or ex-gratia allowances (see Table 9), and the remaining 74 households were not provided with any compensation or re-housing because they did not meet the related requirements.

Note 14: *The IDA Panel, chaired by the Permanent Secretary for Development (Planning and Lands), comprised representatives from the DEVB, the CEDD, the Home Affairs Department and the Social Welfare Department.*

Clearance of squatter and licensed structures

Table 9

**Re-housing arrangements and/or ex-gratia allowances
provided to 147 households under Project A clearance operation**

Re-housing arrangements and/or ex-gratia allowances provided	Households (No.)	
(a) PRH flat (see para. 4.4(a))	65	
(b) SEGCA only (see para. 4.6(b))	31	} 60
(c) Cottage House and SEGCA (see para. 4.6(a) and (b))	29	
(d) Resited village house (only for indigenous villagers — see para. 4.4(b))	12	
(e) Cottage House only (see para. 4.6(a))	8	
(f) Ex-gratia allowance for permitted occupiers (see para. 4.4(c))	2 (Note)	
Total	147	

Source: Audit analysis of Lands D records

Note: Under the Government's general compensation re-housing arrangements, for permitted occupiers of a domestic squatter covered in the 1982 Squatter Survey or a domestic licensed structure, if they are not eligible for PRH flats but being offered interim housing by the HD, they may opt for ex-gratia allowance in lieu of interim housing. The two households opted for this allowance.

4.9 SEGCA granted to 60 households totalled \$32.18 million, representing 16% of the FC-approved amount of \$206.4 million (see para. 4.7). According to the Lands D, the fact that only 16% of the approved fund was spent on SEGCA might be due to 65 households choosing to be re-housed to PRH flats instead of applying for SEGCA, and not all the affected persons being eligible for SEGCA.

***Household not meeting PRH re-housing criteria
referred to HD for allocation of PRH flat***

4.10 Audit examination revealed that a household had been allocated a PRH flat although it did not meet the PRH re-housing criteria (see Case 10).

Case 10

**A household not meeting PRH re-housing criteria
referred to HD for allocation of PRH flat
(November 2010 to March 2014)**

1. In the pre-clearance survey conducted for Phase 2 of Project A on 12 November 2010, the Lands D officers omitted to identify a squatter structure within the clearance boundary which had been assigned a squatter survey number. In April 2011, the Lands D officers re-inspected the site and identified this squatter structure, and found that the structure was vacant and dilapidated.

2. In July 2012, a 2-person household (Household A) submitted an application to the Lands D for SEGCA and provided copies of electricity bills as evidence of residence in the SS structure.

3. According to the DEVB records, in January 2013, the IDA Panel for Project A (see para. 4.6(c)) noted that: (a) Household A was not covered in the 1984/85 Occupancy Survey; (b) there was no documentary proof to support Household A's claim of residence in the squatter structure from 1984 to 2008; and (c) the electricity bills issued from 2008 to 2010 indicated that there was no electricity consumption during that period. The IDA Panel: (a) concluded that Household A had not resided in the squatter structure from 1984 to 2010; (b) considered that there were no other special circumstances warranting special consideration on Household A's application for SEGCA; and (c) recommended that the Secretary for Development should not offer SEGCA to Household A. In the same month, the Secretary for Development rejected Household A's SEGCA application.

Case 10 (Cont'd)

4. In October 2013, Household A made an application to the Lands D for re-housing to PRH. According to the Lands D: (a) the responsible officers noted from Household A's letters that the squatter structure had been damaged by a landslide in 1997, and Household A had been advised not to rebuild the structure because it had been covered within the clearance boundary of a development project; and (b) considering that the structure was not fit for occupation after the landslide in 1997 (which was beyond the control of Household A), the Lands D officers considered that Household A had fulfilled the 2-year residence requirement under the PRH re-housing criteria (see para. 4.4(a)(iii)), and forwarded the case to the HD for further checking on other eligibility criteria for PRH (see para. 4.4(a)(iv)). In March 2014, based on the Lands D's information and checking results on other eligibility criteria, the HD allocated a PRH flat to Household A.

Audit comments

5. Based on the meter readings recorded in electricity bills kept in the Lands D's case file, there was no electricity consumption at the squatter structure from December 2007 to March 2012. Given that the IDA Panel for Project A concluded that Household A had not resided in the squatter structure from 1984 to 2010, Household A did not meet the requirement on 2-year residence immediately before the announcement date of clearance under Project A on 12 November 2010, thus not fulfilling the eligibility criteria for re-housing to PRH (see para. 4.4(a)(iii)).

6. In Audit's view, the Lands D needs to take measures to ensure that only eligible households affected by a clearance operation are referred to the HD for PRH re-housing.

Lands D responses

7. In March 2017, the Lands D informed Audit that:

- (a) the Lands D officers processing the application for PRH re-housing were unaware of the reasons based on which the SEGCA application was rejected by the Secretary for Development (see para. 3 above); and
- (b) with hindsight, given the peculiar history of the case and the DEVB's decision to reject the SEGCA application, the application for PRH re-housing should have been escalated to a higher-level Lands D officer for consideration.

Source: DEVB, Lands D and HD records

Affected structures not being identified in pre-clearance surveys

4.11 The clearance operation for Project A was implemented in three phases. The Lands D's Clearance Unit and SC Unit (see Appendix B) conducted the pre-clearance surveys in September 2008, November 2010 and September 2011 respectively in order to ascertain the Government's commitments on re-housing and ex-gratia allowances. However, Audit noted that, of the 1,669 structures having been cleared under Project A, the two Lands D units had not identified 68 (4%) affected structures during the pre-clearance surveys from September 2008 to September 2011 (these structures were subsequently identified). Audit examination revealed that, of the 68 affected structures not being identified in pre-clearance surveys, 8 (12%) had been recorded in the 1982 Squatter Survey and each being assigned with a squatter survey number, the records of which were maintained by the Lands D's SC Unit. Case 10 in paragraph 4.10 is an example of the 8 cases.

4.12 According to the Lands D's internal review, some affected structures were not identified in the pre-clearance survey because they had been covered by overgrown grass, and they could only be identified after grass cutting. In March 2017, the Lands D informed Audit that:

- (a) Project A was a very large-scale project involving around 60 hectares of land and about 1,700 structures. In addition, the structures were scattered and some of them were in inconspicuous position. Owing to these circumstances and the target to complete the pre-clearance survey within one day, some structures were not identified; and
- (b) there were no practical implications as all claims for re-housing were subject to eligibility checking.

4.13 Audit considers that the Lands D needs to take measures to ensure that all structures covered by a clearance operation are identified during pre-clearance surveys.

Audit recommendations

4.14 **Audit has *recommended* that the Director of Lands should, in carrying out a clearance operation for S&L structures in future:**

- (a) **take measures to ensure that only eligible households affected by the clearance operation are referred to the HD for PRH re-housing; and**
- (b) **take measures to ensure that all structures covered by the clearance operation are identified during pre-clearance surveys.**

Response from the Government

4.15 The Director of Lands agrees with the audit recommendations. She has said that doubtful cases for PRH re-housing will be referred to the Lands D's senior-level officers for consideration in future.

Dangerous slopes posing landslide risks to squatter and licensed structures

4.16 From mid-1940s to late 1970s, with the growing population and shortage in housing supply, thousands of people erected squatter structures for accommodation purposes on hillsides. According to the CEDD:

- (a) cutting steep into hillsides and dumping of loose excavated soils to form building platforms for constructing squatter structures was normal at that time and virtually without any control, resulting in the illegal formation of sub-standard man-made slopes and disturbance of steep natural terrain;
- (b) there were hardly any surface drainage provisions and surface protection to the illegally formed slopes and disturbed natural terrain, which have been particularly prone to landslide risks; and
- (c) having been constructed with scrap materials, many squatter structures were flimsy, and in some cases their floors and rear walls were constructed from bare excavated earth. Therefore, even relatively minor landslides could be very damaging.

4.17 In past decades, landslides had resulted in serious casualties at some squatter areas (see Photograph 16), causing 30 deaths since 1980s.

Photograph 16

**A landslide destroying a squatter structure at Kau Wa Keng, Lai Chi Kok
(4 June 1997)**



Source: CEDD records

Clearance of squatter and licensed structures

4.18 From 1997 to 2016, 5 fatal landslides had occurred in the territory, with 4 of them related to S&L structures (see Table 10).

Table 10

**Fatal landslides affecting S&L structures
(1997 to 2016)**

Date of landslide	Landslide location	Casualties
4 June 1997	Kau Wa Keng, Lai Chi Kok	1 death and 5 injuries
23 August 1999	Sham Tseng, Tsuen Wan	1 death and 13 injuries
20 August 2005	Fu Yung Shan, Tsuen Wan	1 death
7 June 2008	Cafeteria Old Beach, Tuen Mun	2 deaths

Source: CEDD records

NDC programme on slope-safety grounds

4.19 In 1984, owing to the flimsy nature of squatter structures and the serious casualties of squatter occupants caused by landslides, the Government implemented the NDC programme on slope-safety grounds for clearing squatter structures prone to landslide risks. Under the NDC programme, if the CEDD's inspections revealed landslide risks to squatter structures, the Lands D (or the HD before 2006) would advise the affected squatter occupants of the landslide risks and propose re-housing arrangements for them. From 1984 to 1992, 64,200 squatter occupants who had been recommended to move out from squatter structures on slope-safety grounds were re-housed to PRH flats or interim housing.

Clearance of squatter and licensed structures

4.20 In October 1995, the Government adopted a new NDC policy for the following two categories of cases:

- (a) ***Compulsory clearance.*** Squatter structures under this category were exposed to immediate and obvious danger such that the CEDD would recommend the HD/Lands D to initiate compulsory clearance of the related structures; and
- (b) ***Voluntary clearance.*** Squatter structures under this category were especially vulnerable to landslides, and clearance of the related structures would be implemented on a voluntary basis through persuasion.

4.21 In early 2015, of the total 772 squatter areas, 472 (61%) had been inspected by the CEDD to assess the landslide risks which had made recommendations for improvement. In June 2015, the CEDD engaged a consultant for conducting inspections of the remaining 300 (772 less 472) squatter areas, with the consultancy targeted for completion in April 2020.

4.22 Table 11 shows the progress of re-housing squatter occupants prone to landslide risks.

Table 11

**Progress of re-housing squatter occupants prone to landslide risks
(October 2016)**

Squatter inspections conducted by CEDD	No. of squatter occupants			Percentage of squatter occupants opting not to relocate (Note 2) $(d) = \frac{(c)}{(a)} \times 100\%$
	recommended for re-housing (a)	being re-housed (Note 1) (b)	opting not to relocate (c) = (a) – (b)	
Jan 1993 to Sep 1995	8,798	7,344	1,454	17%
Oct 1995 to Dec 2000	11,063	5,209	5,854	53%
Jan 2001 to Dec 2005	3,693	107	3,586	97%
Jan 2006 to Dec 2010	598	28	570	95%
Jan 2011 to Oct 2016	626	6	620	99%
Overall	24,778	12,694	12,084	49%

Source: Audit analysis of Lands D records

Note 1: Squatter occupants were normally offered PRH re-housing if they met the relevant eligibility criteria (see para. 4.4(a)).

Note 2: Before October 1995, most squatter occupants were compelled to move out from squatter structures prone to landslide risks. From October 1995, clearance of some squatter structures vulnerable to landslides has been implemented on a voluntary basis (see para. 4.20(b)).

***Need to monitor and report progress of upgrading works for
public slopes affecting S&L structures***

4.23 In October 2009, the DEVB informed LegCo that:

- (a) for compulsory clearance cases, as the danger was self-evident, there had been no major problem in clearing squatter structures under this category;
- (b) for voluntary clearance cases, great difficulty had been encountered in clearing squatter structures under this category, as the vast majority of

occupants had opted not to relocate from the affected squatter structures, especially for those who were ineligible for PRH re-housing;

- (c) to better address public concerns on slope safety, there was a need to carry out landslide prevention works to government man-made slopes (Note 15) affecting squatter structures. The DEVB and the CEDD estimated that about 1,600 government man-made slopes would require upgrading works to be carried out to deal with landslide risks on voluntary clearance cases, as follows:
 - (i) with necessary access and working space, upgrading works could be carried out on about 800 government man-made slopes affecting some 2,400 squatter structures. The related works would be implemented under the Landslip Prevention and Mitigation Programme (LPMit Programme — Note 16) to be launched in 2010, and the estimated works cost was in the order of \$1 billion; and
 - (ii) for the other 800 government man-made slopes where carrying out of works was difficult due to the lack of access or working space, the Government would strive to seek the cooperation of the squatter occupants to facilitate the implementation of slope upgrading works in order to mitigate the landslide risks; and
- (d) for squatter structures prone to landslide risks of both government man-made slopes and natural terrain hazards (Note 17), flexibility could be built into the LPMit Programme to enable the CEDD to exercise professional judgement to tackle the problem from a cost-effectiveness viewpoint pursuant to the “react-to-known-hazard” principle.

Note 15: *According to the CEDD, man-made slopes are slopes having been significantly modified by human activities, such as installation of drainage channels, weepholes and impermeable cover on the slope surface.*

Note 16: *According to the CEDD, the LPMit Programme is implemented on a rolling basis with the following annual targets: (a) upgrading 150 government man-made slopes; (b) conducting safety-screening studies for 100 private man-made slopes; and (c) implementing risk mitigation works for 30 natural hillside catchments.*

Note 17: *Natural terrain is natural ground that has not been modified significantly by human activities.*

Clearance of squatter and licensed structures

4.24 In November 2015, the DEVB informed LegCo Panel on Development that a review of the LPMit Programme had been completed and the Programme was found to be implementing in a satisfactory manner.

4.25 The progress of implementing upgrading works for 1,582 government man-made slopes (see para. 4.23(c)) as of February 2017 is shown in Table 12.

Table 12

Progress of upgrading works for 1,582 government man-made slopes posing landslide risks to S&L structures (February 2017)

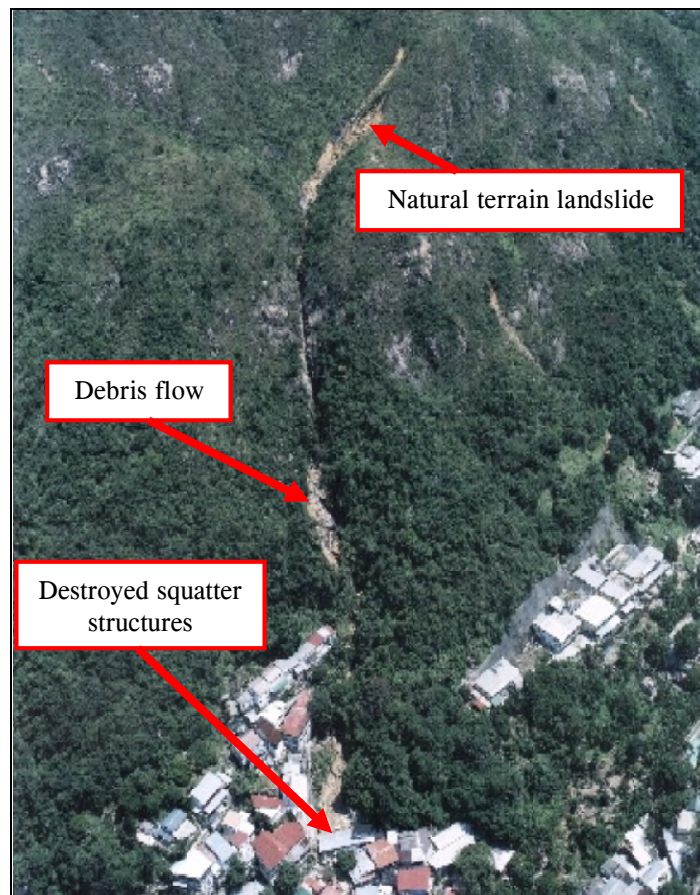
Progress of upgrading works	Government man-made slope (No.)
Works completed or in progress	
(a) Works completed under other government projects	372
(b) Works completed under LPMit Programme	133
(c) Works in progress under LPMit Programme	16
(d) Works in progress under other government projects	15
Study in progress	
(e) Study in progress under LPMit Programme	73
(f) Study in progress under other government projects	33
Works not yet commenced	
(g) Works to be carried out under LPMit Programme pending confirmation that voluntary clearance is not successful (see para. 4.23(b))	32
(h) Works might be carried out under other government projects	3
(i) Awaiting selection under LPMit Programme	905
Total	1,582

Source: CEDD records

4.26 Moreover, from 1980 to 2016, of the 16 fatalities arising from natural terrain landslides, 13 (81%) occurred at squatter areas (see photograph 17).

Photograph 17

**A natural terrain landslide
destroying squatter structures at Sham Tseng, Tsuen Wan
(23 August 1999)**



Source: CEDD records

4.27 Audit noted that, as of January 2016, natural terrains were posing potential landslide risk to 199 squatter structures which had been recommended by the CEDD for clearance on slope-safety grounds, but the related squatter occupants had opted not to relocate from the affected areas. Natural terrain hazard studies had not been conducted for these squatter structures to identify any required mitigation measures. While the LegCo paper in November 2015 (see para. 4.24) reported the overall progress of the LPMit Programme, the paper did not specifically report the

Clearance of squatter and licensed structures

progress of implementing upgrading works for government man-made slopes and natural terrains posing landslide risks to S&L structures. Given the landslide risks being posed to S&L structures, Audit considers that the DEVB and the CEDD need to monitor the progress of upgrading works for public slopes affecting S&L structures and periodically report the pertinent works progress to LegCo.

Need to strengthen actions to upgrade private slopes posing landslide risks to S&L structures

4.28 Under the Buildings Ordinance (Cap. 123), the BD (Note 18) may issue a Dangerous Hillside Order (DHO) to a private-slope owner requiring him to conduct an investigation, submit an upgrading works proposal for approval and carry out slope upgrading works within a specified period. As of January 2017, owners of 165 private slopes posing landslide risks to S&L structures had been issued with 210 DHOs (Note 19) which had not been satisfactorily complied with (see Table 13).

Table 13

**210 outstanding DHOs relating to private slopes
posing landslide risks to S&L structures
(January 2017)**

Number of years since issue of DHO	Number (Percentage) of DHOs
< 5 years	119 (57%)
5 to < 10 years	57 (27%)
10 to < 15 years	24 (11%)
15 to < 20 years	9 (4%)
21 years	1 (1%)
Total	210 (100%)

Source: Audit analysis of BD and CEDD records

Note 18: *Under the Buildings Ordinance, the authority to issue a Dangerous Hillside Order is vested in the Building Authority, who is the Director of Buildings. For simplicity, the Building Authority is referred to as the BD in this Audit Report.*

Note 19: *A private slope may be divided into two or more distinct portions owned by different persons, and a DHO would be issued to the owner of each portion of a private slope.*

4.29 Under the Buildings Ordinance, the BD may take the following DHO enforcement actions:

- (a) if a private-slope owner does not carry out the required tasks by the dates specified in a DHO, the BD may, under the Buildings Ordinance, carry out the investigation and any subsequent works (namely default works) and recover the costs plus supervision charges and surcharges from the owner; and
- (b) a person who fails to comply with the requirements under a DHO without reasonable justifications may be subject to prosecution under the Buildings Ordinance. The person is liable, on conviction, to a maximum fine of \$50,000 and to imprisonment for one year, and to a daily maximum fine of \$5,000 for each day during which the failure to comply with the DHO has continued.

4.30 Regarding the 34 DHOs being outstanding for 10 to 21 years (see Table 13 in para. 4.28), Audit examination revealed that, as of January 2017:

- (a) regarding slope upgrading works relating to 18 DHOs undertaken by the private-slope owners, works relating to 2 DHOs were in progress and 16 DHOs had not commenced; and
- (b) the BD had taken actions to arrange default works relating to the remaining 16 DHOs, of which slope upgrading works relating to 2 DHOs were completed, 2 DHOs in progress and the remaining 12 DHOs at the investigation and design stage.

Case 11 shows the progress of actions on a DHO that has been outstanding for 21 years (see Table 13).

Case 11

A long-outstanding DHO (January 1996 to January 2017)

1. In January 1996, the BD issued a DHO (covering 11 private slopes posing landslide risks to 15 squatter structures) requiring a land-lot owner to submit an upgrading works proposal for the private slopes by May 1996 to the BD for approval. However, the owner did not submit the works proposal by the specified time.
2. In July 1997, landslides occurred at 2 private slopes covered under the DHO. In October 1999, the BD initiated default-works actions and engaged a consultant to carry out the design for the required slope works. From 2000 to 2004, the private-slope owner requested the BD to withhold the default works on the grounds that legal proceedings on the ownership of the land (Note) with the land-lot occupants were in progress.
3. In June 2005, landslides occurred at 2 other private slopes covered under the DHO, causing damage to 2 squatter structures. In December 2005, the BD engaged another consultant to update the remedial works proposals and take up the required slope works. According to the BD, despite repeated liaisons with the land-lot occupants, they refused to provide access for the BD to carry out the slope upgrading works. In January 2014, the BD informed the CEDD that the occupants of the land lot objected to the slope works and the BD was exploring ways to solicit their cooperation.
4. As of January 2017, the DHO was still outstanding and the related slope upgrading works had not been satisfactorily carried out. According to the BD, the prolonged legal proceeding on the ownership of land, uncooperative land-lot occupants and unexpected changes in the remedial works proposal had adversely affected the carrying out of the default works.

Case 11 (Cont'd)

Audit comments

5. The slope upgrading works under the DHO had not been satisfactorily carried out during 21 years from January 1996 to January 2017. In the meantime, two landslides occurred each involving 2 private slopes covered under the DHO, causing damage to 2 squatter structures. These incidents indicate that slopes found to be requiring upgrading works could pose high landslide risks to nearby S&L structures.

Source: BD and CEDD records

Note: According to the BD, the result of legal proceeding might invalidate the DHO issued by the BD.

4.31 In 2011, Audit conducted a review of the safety and maintenance of private slopes, including the administration of DHOs by the BD. The results of the review were included in Chapter 11 of the Director of Audit's Report No. 57 of October 2011. In response to Audit's recommendations, the BD agreed to consider carrying out default works or taking prosecution action (see para. 4.29(a) and (b)) on long-outstanding DHO cases at an earlier time, and it would endeavour to make the best use of its available resources to instigate enforcement action as far as possible.

4.32 In view of the high landslide risks posed to S&L structures (see paras. 4.16 to 4.18), Audit considers that the BD needs to strengthen actions on private slopes for which the required upgrading works specified in DHOs have not been satisfactorily carried out over a long period of time.

Audit recommendations

4.33 Audit has *recommended* that the Secretary for Development and the Director of Civil Engineering and Development should monitor and periodically inform LegCo of the progress of implementing upgrading works for government man-made slopes and natural terrains posing landslide risks to S&L structures.

4.34 Audit has *recommended* that the Director of Buildings should strengthen actions on private slopes for which the required upgrading works specified in DHOs have not been satisfactorily carried out over a long period of time.

Response from the Government

4.35 The Secretary for Development and the Director of Civil Engineering and Development agree with the audit recommendation in paragraph 4.33. They have said that the CEDD has planned to report the progress of related upgrading works for slopes and natural terrains in the Controlling Officer's Report of the CEDD, which forms part of the annual Estimates submitted to LegCo.

4.36 The Director of Buildings agrees with the audit recommendation in paragraph 4.34. He has said that:

- (a) for long-outstanding DHOs, the BD will continue to closely monitor the progress of upgrading works undertaken by private-slope owners, as well as default works undertaken by the BD's consultants and term contractors; and
- (b) should there be unreasonable delays in carrying out upgrading works by private-slope owners, the BD will consider taking appropriate enforcement actions under the Buildings Ordinance, including prosecution.

**Lands Department's progress in implementing
improved squatter control measures since June 2016
(June 2016 to March 2017)**

In March 2017, the Lands D informed the Audit Commission that, since the announcement of the improved SC measures on 22 June 2016:

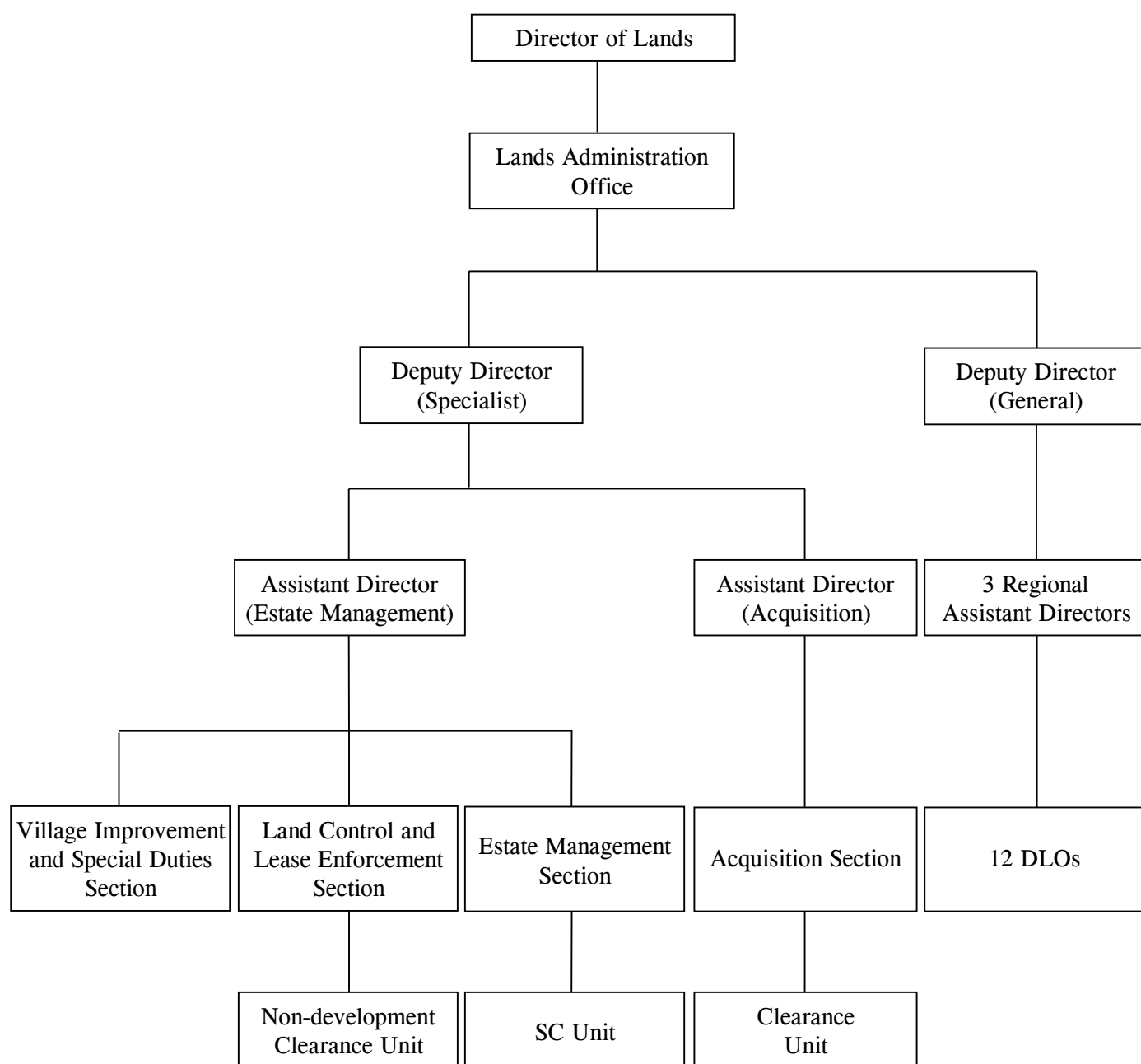
- (a) all Squatter Control Offices and District Lands Offices had taken actions to implement the improved SC measures (see para. 1.8(a) and (b));
- (b) as of February 2017, the Lands D had cancelled the squatter survey numbers of 21 SS structures in Tai Po and Yuen Long, which were found to have constructed with unauthorised extensions after 22 June 2016;
- (c) the Lands D had drawn up a specific timetable for the enforcement work. In this connection, in September 2016, the Lands D's instructions were updated to include a "Squatter Control Workflow Chart", under which SS structure occupants having unauthorised extensions completed on or before 22 June 2016 would in general be given a period of 28 days to rectify the irregularities. Approvals from Lands D supervisors (e.g. Assistant Manager, Manager or Senior Estate Surveyor) had to be obtained for any discretionary extension of the 28-day period;
- (d) all Squatter Control Offices were required to hold bi-monthly Case Monitoring Meetings and report to the Lands D's Headquarters regularly on the progress of their SC actions through submissions of Case Monitoring Reports;
- (e) since June 2016, the Lands D had used unmanned aerial systems and large-format digital aerial cameras to take photographs of squatter areas by phases with a view to stepping up investigations and information collection. These photographs, which were helpful to Squatter Control Offices in verifying whether detected unauthorised structures were newly constructed, would facilitate the implementation of the initiatives mentioned in paragraph 1.8(a) and (b). As of March 2017, the Survey and Mapping Office had completed the first round of aerial-photograph taking work and the photographs had been dispatched to Squatter Control Offices for follow-up actions;

Appendix A
(Cont'd)
(para. 1.8 refers)

- (f) the Survey and Mapping Office had taken initiatives to actively identify squatter structures with irregularities by comparing aerial photographs of different periods. In November 2016, the Survey and Mapping Office found a total of 16 suspected illegal structures on government land in Tuen Mun and the information had been referred to the concerned Squatter Control Office for investigation; and
- (g) since 22 June 2016, the Squatter Control Offices had started to keep records on the number of cases with non-compliant SS structures detected during SC patrols, and the SC patrols had detected 104 related cases from 22 June 2016 to 28 February 2017.

Source: Lands D records

**Lands Department:
Organisation chart (extract)
(December 2016)**



Source: Lands D records

Time of completing a cycle of routine patrol and hut-to-hut check

(A) Routine patrol

According to the Squatter Control Operational Manual, under the tri-colour system, squatter areas are classified into red, yellow and green areas in descending order of vulnerability to new squatting activities, and the time of completing a cycle of routine patrol is as follows:

Area classification	Area in hectare (or number of SS structures)	Time of completing a cycle of routine patrol
Red	150 to 300 hectares	• Daily for black spots • Two working days for others
Yellow	301 to 550 hectares (or more than 2,500 SS structures if the size of a patrol area is below 301 hectares)	• Two working days for black spots • Three working days for others
Green	Above 550 hectares	• Four working days

(B) Hut-to-hut check

According to the Squatter Control Operational Manual, the time of completing a cycle of hut-to-hut check ranges from 12 to 24 months, depending on the number of SS structures in each patrol area. Details are as follows:

Number of SS structures within a patrol area	Time of completing a cycle of hut-to-hut check
Not exceeding 2,500	12 months
Between 2,501 and 4,000	18 months
Exceeding 4,000	24 months

Source: Lands D records

**Non-compliant surveyed squatter structures
identified in December 2016**

SS structure	Non-compliance with SC Policy		
	Unauthorised rebuilding	Unauthorised change of use, dimensions or building materials	Unauthorised extension
<i>New cases detected during Audit's site visit</i>			
A (see Case 1 in para. 2.12)	✓	✓	✓
B (see Case 2 in para. 2.12)	✓	✓	✓
N		✓	✓
O		✓	✓
P	✓	✓	
Q		✓	✓
R		✓	
<i>Cases under enforcement actions of Lands D before Audit's site visit</i>			
C (see Case 3 in para. 2.12)		✓	✓
E (see Case 5 in para. 2.19)	✓	✓	✓
F (see Case 6 in para. 2.19)		✓	✓
S	✓	✓	✓
T		✓	✓
U		✓	✓
V	✓	✓	✓
W		✓	✓
X		✓	✓
Y	✓	✓	✓
Z	✓	✓	✓
AA	✓	✓	

Source: Audit analysis of Lands D records

**Key eligibility criteria for Cottage House Option and
Special Ex-gratia Cash Allowance under Project A**

Key eligibility criteria	Applicable to	
	Cottage House Option	SEGCA
The affected domestic structure was located in one of two villages affected by Project A and the occupants were non-indigenous villagers.	✓	
The affected occupants resided in an affected structure at the date of the pre-clearance survey.	✓	✓
The affected structure was either a domestic structure covered in the 1982 Squatter Survey or a domestic licensed structure.	✓	✓
The affected occupants were covered by the 1984/85 Occupancy Survey, or could produce evidence showing that they had resided in an affected structure from 1984/85 to the date of the pre-clearance survey.	✓	✓
No occupants should own or co-own any domestic property in Hong Kong.	✓	✓
No occupants should be enjoying any form of subsidised housing or related benefits at time of application.	✓	✓

Source: DEVB records

Acronyms and abbreviations

Audit	Audit Commission
BD	Buildings Department
B/Ds	Government bureaux or departments
CEDD	Civil Engineering and Development Department
DEVB	Development Bureau
DHO	Dangerous Hillside Order
DLO	District Lands Office
ETPM System	Electronic Team Patrol Monitoring System
FC	Finance Committee
ft	Feet
ft ²	Square feet
GLL	Government Land Licence
HA	Hong Kong Housing Authority
HD	Housing Department
HK&LYM	Hong Kong and Lei Yue Mun
IDA Panel	Inter-departmental Advisory Panel
K,TW&KT	Kowloon, Tsuen Wan and Kwai Tsing
Lands D	Lands Department
LegCo	Legislative Council
LPMit Programme	Landslip Prevention and Mitigation Programme
m ²	Square metres
NDC	Non-development clearance
PRH	Public rental housing
RVD	Rating and Valuation Department
SC	Squatter control
SCO	Squatter Control Office
SEGCA	Special Ex-gratia Cash Allowance
S&L structures	Squatter and licensed structures
SS structure	Surveyed squatter structure
STTs	Short-term tenancies

CHAPTER 4

Home Affairs Department

Provision of district council funds for community involvement projects

**Audit Commission
Hong Kong
3 April 2017**

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

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PROVISION OF DISTRICT COUNCIL FUNDS FOR COMMUNITY INVOLVEMENT PROJECTS

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PROVISION OF DISTRICT COUNCIL FUNDS FOR COMMUNITY INVOLVEMENT PROJECTS

Executive Summary

1. It has been the Government's long-standing policy to foster a sense of belonging and mutual care among the people of Hong Kong. To this end, the Home Affairs Department (HAD) formulates and develops initiatives in respect of community building. An important vehicle for community building is community involvement projects (CI projects). CI projects aim at enhancing community spirit and social cohesion and promoting well-being of the people in the 18 districts of Hong Kong. Examples of CI projects organised included district festivals, activities to promote sports and culture, and activities to care for the disadvantaged groups. CI projects are implemented through District Councils (DCs). The HAD provides funds to DCs for implementing CI projects in districts annually (DC-CIP funds).

2. In 2015-16, the provision of DC-CIP funds amounted to \$361.6 million. Implementation parties, such as government departments (mainly the Leisure and Cultural Services Department (LCSD)) and non-governmental organisations (NGOs), can apply to DCs for DC-CIP funds to carry out CI projects. The number of CI projects implemented in 2015 was 37,827, which had a total of 18.6 million participants. The Audit Commission (Audit) has recently conducted a review of the provision of DC-CIP funds by the HAD.

Allocation and use of district council funds for community involvement projects

3. *Allocation of funds to DCs.* The HAD allocated DC-CIP funds to DCs through a mechanism: (a) a portion was allocated to individual DCs as basic allocation on a historical/equal basis; (b) a portion was allocated to individual DCs taking into account a number of factors (e.g. population and socio-economic factors); and (c) a small remaining portion was kept by the HAD as central reserve for contingency. Audit found that the factors adopted by the HAD in allocating the relevant portion of DC-CIP funds (see (b) above) had been subject to changes

Executive Summary

since 2008-09 (e.g. the population of the Sai Kung District had increased from 5.9% (420,100) of the 18 districts' total population in 2008-09 to 6.3% (463,700) in 2015-16). The HAD, however, had not taken into account changes in the factors in allocating the relevant portion. For example, in allocating the relevant portion of \$256.11 million in 2015-16, the allocation was based on the old data (e.g. district population) of 2008-09, 2012-13 and 2013-14. Audit also noted that it had been announced in the 2017 Policy Address that the annual provision of DC-CIP funds would be increased by \$100 million starting from 2017-18. The HAD needs to review the allocation of DC-CIP funds taking into account this additional annual provision as well as changes in the factors (paras. 2.2 to 2.5).

4. *Use of funds by DCs.* The number of CI projects and the number of participants in CI projects are key performance indicators of the HAD. Audit noted that: (a) for the period 2011 to 2015, the number of projects decreased by 3.3% from 39,127 to 37,827 and the number of participants decreased by 13.3% from 21.49 million to 18.63 million, whereas the expenditure of projects increased by 17% from \$272.35 million to \$319.52 million; (b) Audit's analysis of the \$205.63 million of DC-CIP funds spent in 2015-16 on the 15 categories of DC projects indicated that \$146.27 million (71%) were spent on the three categories of arts and cultural activities, recreational and sports activities, and festival celebrations and district festivals. The funds spent on some other categories were small. For example, each of the categories of civic education (\$2.42 million) and building management (\$1.7 million) incurred a spending of less than 2% of the \$205.63 million; (c) for some DC projects targeting specific groups of people, the number of projects and participants was low. For example, of the some 6,900 DC projects in total, there were only 133 (1.9%) projects for people with disabilities or special needs, and of the some 15 million participants, there were only 19,000 (0.1%) ethnic minorities; (d) the HAD had not made use of its data on DC-CIP funds and CI projects to conduct analyses to facilitate the management of the funds and projects; and (e) the annual provision of DC-CIP funds included funds which were designated for arts and cultural activities pursuant to the 2013 and 2015 Policy Addresses. However, 10 of the 18 DCs had used the designated funds on other activities, involving amounts ranging from \$220,000 to \$1.09 million (paras. 2.9, 2.10, 2.18, 2.20, 2.23, 2.25 and 2.27).

Management of conflicts of interest in community involvement projects

5. ***Declaration of interests.*** It is not unusual for members of DCs and DC committees to be associated with implementation parties (see para. 2) of CI projects. DC standing orders concerning management of conflicts of interest in CI projects require members to make a first-tier declaration of interests by reporting their registrable interests (e.g. remunerated directorships and “other declarable interests”) at the commencement of each DC/committee term or upon changes in the interests. Members shall also make a second-tier declaration of interests (e.g. at meetings) before dealing with matters on DC-CIP funds. Audit noted that: (a) as “other declarable interests” had not been clearly defined in DC standing orders, of the 129 second-tier declarations made by members at meetings in 2016, in 122 (95%) declarations (made by 76 members), positions (e.g. president or chairperson) held by members in implementation parties had not been reported in the first-tier declaration; (b) in seven meetings where members considered the earmarking of funding for implementation parties, 34 members had not declared connections with the implementation parties (e.g. as board members); and (c) for the nine DCs examined by Audit, their standing orders had not spelt out how declarations were to be made when matters were handled through circulation of papers (paras. 3.2, 3.3, 3.5 to 3.8).

6. ***Handling of interests declared.*** For the 129 cases of declaration of interests at meetings (see para. 5(a)), the related minutes of meetings indicated that in 73 (57%) cases (involving three DCs), contrary to the requirements of DC standing orders, rulings (e.g. a member may remain in the meeting as an observer) had not been made and recorded on the interests declared. Those who had declared interests continued their attendance in the meetings (para. 3.13).

7. ***Management of conflicts of interest in working groups.*** DCs and their committees have appointed working groups to help carry out specified functions. Audit noted that while DC standing orders have stipulated the procedures for managing conflicts of interest, the procedures are not applicable to working group meetings. Furthermore, of the nine DCs examined by Audit, there were three working groups (under three DCs) that endorsed applications for CI projects on behalf of DCs/committees. Audit noted that once project applications were endorsed by the working groups, CI projects could be implemented without DCs’ further endorsements. However, according to the District Councils Ordinance

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(Cap. 547), a DC may delegate its functions to a committee only (paras. 3.16, and 3.18 to 3.20).

Implementation of community involvement projects

8. *Selection of NGOs for implementing projects.* Audit examined the practices of four DCs in implementing CI projects. Audit noted that: (a) designated NGOs (i.e. those which have a long-term working relationship with DCs) are earmarked with funds by DCs in their annual budgets for carrying out CI projects. Of the four DCs examined, one DC last reviewed its list of designated NGOs more than 10 years ago; and (b) it is a usual practice that partner NGOs are selected for implementing CI projects in partnership with committees/working groups of DCs through invitation (e.g. by posting an open invitation on the DC's website). However, for one DC, partner NGOs are nominated by DC members in charge of CI projects. There is scope for enhancing the openness and transparency of this selection process (paras. 4.2, 4.3, 4.6, 4.8 and 4.9).

9. *Performance management of projects.* According to the HAD Manual on the use of DC-CIP funds, a DC should have an evaluation system in place to monitor the effectiveness of CI projects. Audit noted that, of the four DCs examined by Audit (see para. 8): (a) one DC had discontinued the use of any evaluation systems in the six-year period 2011-12 to 2016-17; (b) another DC had not set any criteria for selecting projects for evaluation purpose. It only conducted project evaluations upon request by the HAD's district office concerned; (c) there were cases where the ratings given in evaluations of CI projects were not reflecting the actual situation. For example, in one project, the rating for the assessment item of number of participants was "Very Satisfactory", while the actual number of participants was only 33% of the expected number; and (d) Audit's examination of 38 projects held in 2015-16 at performance venues of the LCSD revealed that in 30 (79%) projects, the audience size reported by the implementation parties was higher than that recorded by the LCSD venue management, with variances ranging from 3% to 323% and averaging 71% (paras. 4.12 to 4.14, 4.16 and 4.18).

Executive Summary

Audit recommendations

10. 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 Home Affairs should:

*Allocation and use of district council funds for
community involvement projects*

- (a) taking into account changes in the factors (e.g. population and socio-economic factors) and the additional annual provision of DC-CIP funds, conduct a review of the allocation of the funds to ensure that they are allocated in the most appropriate manner (para. 2.6);
- (b) keep under review the number of CI projects and participants in the projects vis-à-vis the expenditure of the projects and take improvement measures as appropriate (para. 2.28(a));
- (c) produce analyses of DC projects to individual DCs to facilitate them to review whether their existing spending patterns best meet the needs of their districts (para. 2.28(b));
- (d) produce analyses of DC projects targeting specific groups of people to individual DCs to facilitate them to assess the need to initiate more such projects (para. 2.28(c));
- (e) periodically generate data and conduct different analyses for HAD management information purposes and for dissemination to DCs to facilitate their management of DC-CIP funds and CI projects (para. 2.28(d));
- (f) take measures to ensure that the funds for arts and cultural activities are spent as designated (para. 2.28(f));

Executive Summary

Management of conflicts of interest in community involvement projects

- (g) **provide guidelines with broad principles of what constitute “other declarable interests” to DC/committee members as appropriate to facilitate the reporting of “other declarable interests”, and remind them to make more efforts in declaring their interests (para. 3.9(a));**
- (h) **take more measures to ensure that DC/committee members declare their interests before earmarking funding for implementation parties (para. 3.9(b));**
- (i) **provide guidelines to DCs on how declarations of interests could best be made in handling matters through circulation of papers (para. 3.9(c));**
- (j) **remind DCs that rulings should be made and recorded on interests declared by members in DC/committee meetings (para. 3.14);**
- (k) **ensure that the stipulated procedures for handling conflicts of interest applicable to DC/committee meetings also apply to working group meetings (para. 3.21(a));**
- (l) **ascertain whether DCs’ practice of delegating functions to their working groups is in line with the District Councils Ordinance and take remedial action as appropriate (para. 3.21(b));**

Implementation of community involvement projects

- (m) **provide DCs with suitable guidelines to facilitate their reviewing of designated NGOs and incorporate the guidelines into the HAD Manual (para. 4.10(a));**
- (n) **set out in the HAD Manual, for DCs’ reference, good practice guidelines on the selection of partner NGOs as adopted by most DCs (para. 4.10(b));**
- (o) **advise the DC concerned (see para. 8(b)) to review its existing practice of selecting NGOs with a view to enhancing the openness and**

Executive Summary

transparency of the selection process, taking account of the good practice guidelines mentioned in (n) above (para. 4.10(c));

- (p) take measures to ensure that DCs set up a system for evaluating CI projects (para. 4.20(a));**
- (q) take measures to ensure that DCs set proper criteria for selecting CI projects for evaluation, and that CI projects meeting the criteria are evaluated (para. 4.20(b) and (c));**
- (r) remind DC secretariats to follow up with evaluators in cases where the ratings given by them in evaluation of CI projects are not in line with the actual situation (para. 4.20(e));**
- (s) ascertain the discrepancies between the size of audience reported and that recorded by the LCSD venue management, and take measures to ensure the accuracy of the number of participants reported (para. 4.20(g)); and**
- (t) consider reviewing the existing methods adopted by implementation parties for counting the number of participants (para. 4.20(h)).**

Response from the Government

11. The Director of Home Affairs 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

Community involvement projects

1.2 It has been the Government's long-standing policy to foster a sense of belonging and mutual care among the people of Hong Kong. The Government strives to maintain Hong Kong as an integrated and harmonious society, with broad public participation in community affairs and a strong sense of commitment to the well-being of the community. To this end, the Home Affairs Department (HAD) formulates and develops initiatives in respect of community building.

1.3 An important vehicle for community building is community involvement projects (CI projects). CI projects aim at enhancing community spirit and social cohesion and promoting well-being of the people in the 18 districts of Hong Kong. Examples of CI projects organised included district festivals, activities to promote sports and culture, activities to care for the disadvantaged groups, and activities to foster inter-cultural understanding.

Implementation of CI projects through District Councils

1.4 CI projects are implemented through District Councils (DCs). DCs are established under the District Councils Ordinance (Cap. 547). There are 18 DCs (9 in urban areas and 9 in the New Territories) in Hong Kong. The main functions of a DC are to advise the Government on matters affecting the well-being of the people living and working in the district, on the provision and use of public facilities and services within the district, on the adequacy and priorities of government programmes for the district, and on the use of public funds allocated to the district for community activities and local public works. For the present DC term of

Introduction

2016-19 (from 1 January 2016 to 31 December 2019), the 18 DCs have a total of 458 DC members (Note 1).

1.5 The HAD provides funds to DCs for implementing CI projects in districts annually (hereinafter funds for implementing CI projects are referred to as DC-CIP funds). In 2015-16, the provision of DC-CIP funds amounted to \$361.6 million (Note 2) while the actual spending was \$361.38 million.

Provision of DC-CIP funds

1.6 DC-CIP funds are provided to DCs as follows:

- (a) the funds are approved annually by the Legislative Council under the General Revenue Account in the context of the Estimates. The provision of DC-CIP funds to individual DCs for 2015-16 is at Appendix A. The HAD allocates the approved funds to individual DCs having regard to a number of factors (e.g. population size and land area of the district);
- (b) with the allocated funds, DCs identify and initiate CI projects for implementation (see paras. 1.9 to 1.12); and
- (c) DCs monitor the progress of CI projects. Any unspent DC-CIP funds at the end of a financial year will lapse, and cannot be carried forward to the next financial year.

1.7 In 2006, the Government conducted a review on the role and functions of DCs. As recommended by the review, the following changes regarding DC-CIP funds were made in 2008-09:

Note 1: *DC members are paid honoraria, allowances and reimbursements by the HAD, totalling \$424.7 million in 2016-17.*

Note 2: *The provision of DC-CIP funds forms part of the HAD's overall spending on community building (see para. 1.2). For 2016-17, the estimated spending on community building was \$1,086.9 million.*

- (a) leisure and cultural activities carried out at district facilities by the Leisure and Cultural Services Department (LCSD) (previously funded by the LCSD) should be regarded as CI projects and covered by DC-CIP funds. The LCSD would apply to DCs for DC-CIP funds to carry out such activities (i.e. recreational and sports activities, cultural and entertainment activities, and library extension activities); and
- (b) the annual provision of DC-CIP funds was increased to \$300 million (Note 3).

1.8 Table 1 shows the provision of DC-CIP funds and the actual spending on CI projects in the period 2008-09 to 2015-16.

Note 3: *The provision for 2008-09 of \$300 million comprised the amount of DC-CIP funds provided in the preceding year (\$147.5 million), an amount transferred from the LCSD's budget for funding LCSD activities to be covered by DC-CIP funds (\$68.0 million), and an increase in the provision of DC-CIP funds (\$84.5 million).*

Table 1

**Provision of DC-CIP funds and actual spending on CI projects
(2008-09 to 2015-16)**

Year	Provision (a) (\$ million)	Actual spending (b) (\$ million)	Spending rate (c) = (b)/(a) × 100%
2008-09	300.00	298.92	99.64 %
2009-10	300.00	299.08	99.69 %
2010-11	300.00	298.73	99.58 %
2011-12	300.00	299.14	99.71 %
2012-13	320.00	319.58	99.87 %
2013-14	340.80 (Note 1)	340.49	99.91 %
2014-15	340.80	340.66	99.96 %
2015-16	361.60 (Note 2)	361.38	99.94 %

Source: HAD records

Note 1: The annual provision was increased by \$20.8 million to \$340.8 million for 2013-14 and the ensuing years for the promotion of arts and cultural activities.

Note 2: The annual provision was increased by another \$20.8 million to \$361.6 million for the five years 2015-16 to 2019-20 for the further promotion of arts and cultural activities. According to the 2017 Policy Address, the annual provision would be increased by \$100 million from 2017-18 onwards.

Implementation of CI projects

1.9 The HAD has set up a district office in each of the 18 districts. A DC secretariat is set up under each district office to provide secretariat services to the DC concerned. Other functions of district offices include acting as a link between DCs and government departments, and helping DCs implement CI projects.

1.10 To provide guidelines on the implementation of CI projects, the HAD has compiled a Manual on the Use of District Council Funds (the HAD Manual). The key procedures for implementing CI projects are outlined in paragraphs 1.11 to 1.16.

1.11 ***Ambit of DC-CIP funds.*** The funds are used for meeting district needs, for example, in the following categories of projects/activities:

- (a) district leisure and sports activities (e.g. sports competitions — see Photograph 1);
- (b) district cultural and entertainment activities (e.g. concerts — see Photograph 2);
- (c) activities undertaken at district facilities (e.g. carnivals — see Photograph 3); and
- (d) activities to promote community building, social harmony and public participation in community affairs (e.g. seminars — see Photograph 4).

Photograph 1

A sports competition financed by DC-CIP funds



Source: HAD records

Photograph 2

A concert financed by DC-CIP funds



Source: HAD records

Photograph 3

A carnival financed by DC-CIP funds



Source: Photograph taken by Audit Commission

Photograph 4

A seminar financed by DC-CIP funds



Source: HAD records

1.12 **Implementation parties.** The following parties can apply to DCs for DC-CIP funds to carry out CI projects:

- (a) **Government departments.** Government departments, mainly the LCSD (Note 4), can apply for funds to carry out CI projects;
- (b) **Non-governmental organisations (NGOs).** NGOs, particularly district-based organisations (e.g. kaifong associations), can apply for funds; and

Note 4: Occasionally, some other government departments (e.g. the Independent Commission Against Corruption) may apply for DC-CIP funds. The amount involved is, however, not significant. For example, for 2015-16, it accounted for about 1% (\$4.48 million) of the actual spending (\$361.38 million) on CI projects.

(c) ***Committees/working groups under DCs/district offices (Note 5).*** Committees/working groups under DCs/district offices can apply for DC-CIP funds. They can carry out CI projects as follows:

- (i) ***In partnership with NGOs.*** Committees/working groups under DCs/district offices can carry out projects in partnership with NGOs. For example, committees responsible for enhancing social harmony may carry out projects benefitting disadvantaged people in partnership with NGOs from relevant sectors; and
- (ii) ***With assistance of district offices.*** Committees/working groups under DCs/district offices can carry out projects with the assistance of district offices concerned (see para. 1.9). For example, district offices may help committees responsible for publicity matters carry out projects on producing and distributing calendars.

1.13 ***Permissible expenditure.*** For each CI project, DCs can provide a grant of up to \$2.5 million. The grant can only be used to meet expenditure which is permissible and is wholly and necessarily incurred for the project. The HAD Manual has specified a list of permissible expenditure items (e.g. employment of project staff including temporary or casual workers), with limits imposed on some of them (e.g. 25% of the approved project sum for staff cost).

1.14 ***Processing of applications.*** An application for DC-CIP funds is firstly processed by the responsible DC secretariat, which examines the application to ensure that various requirements are met (e.g. the project is within the ambit of DC-CIP funds (see para. 1.11) and the applicant is eligible for the funds (see para. 1.12)). The application is then submitted to the DC for consideration and endorsement (Note 6). The Director of Home Affairs or any officer authorised by

Note 5: *DCs have set up committees (ranging from four to seven committees — see para. 3.2) to help discharge their functions. Similarly, district offices have also set up committees, for example, area committees for promoting district administration.*

Note 6: *According to DC standing orders (see para. 3.3), where a committee is delegated the authority by the DC, the committee may endorse CI projects for the DC.*

the Director (usually the District Officer or the Assistant District Officer concerned) then approves the funding of the project if he/she is satisfied that the project falls within the ambit of DC-CIP funds.

1.15 ***Payment arrangements.*** There are different arrangements for CI project payments, as follows:

- (a) for CI projects carried out by government departments, the HAD transfers funds in advance to the departments;
- (b) for CI projects carried out by NGOs (including projects carried out by committees/working groups under DCs/district offices in partnership with NGOs — see para. 1.12(c)(i)), the district offices concerned arrange reimbursements to NGOs upon completion of projects. Nevertheless, NGOs can apply for advance payments and partial reimbursements before project completion; and
- (c) for CI projects carried out by committees/working groups under DCs/district offices with the assistance of district offices (see para. 1.12(c)(ii)), the district offices concerned use DC-CIP funds to directly settle the expenditure incurred.

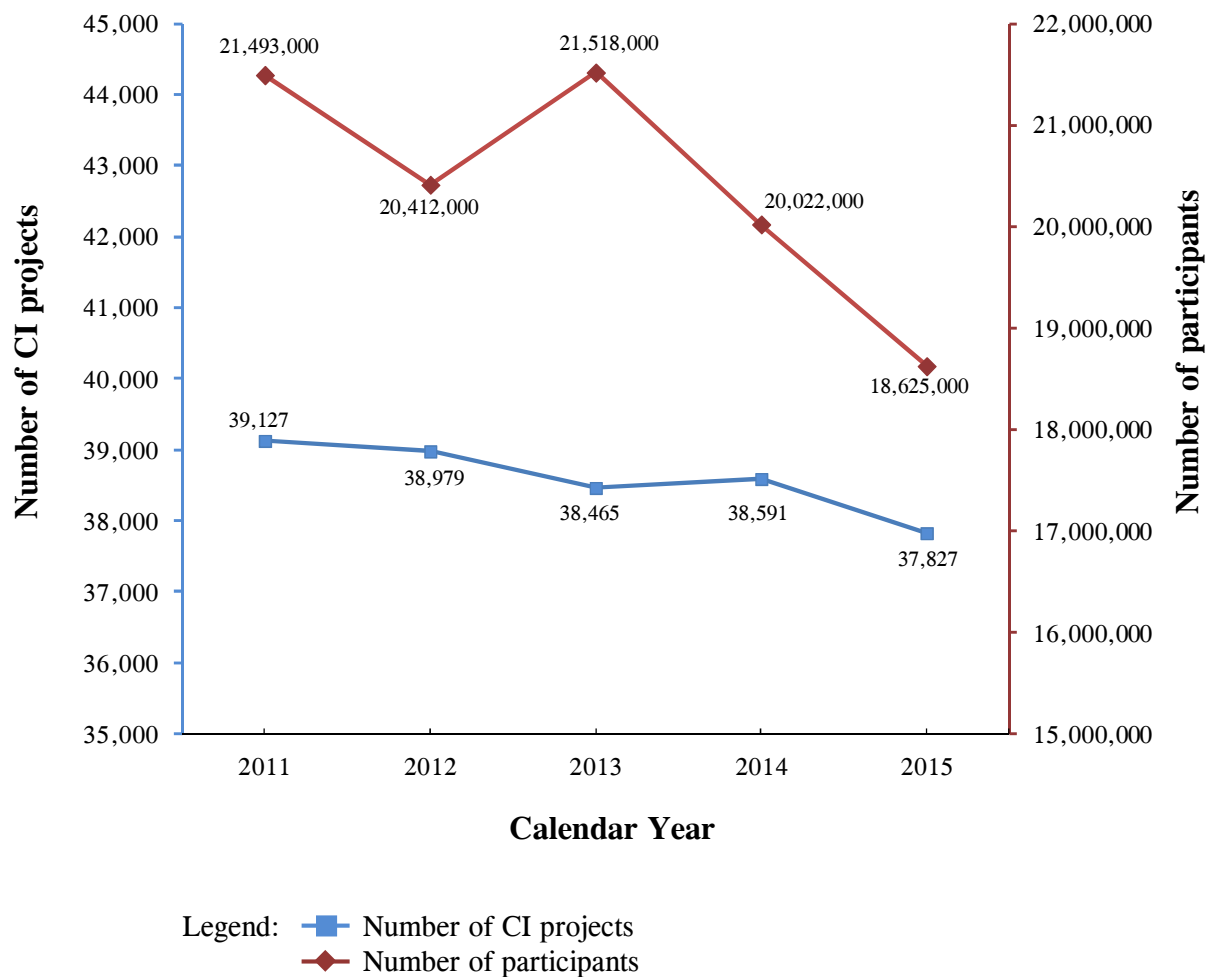
1.16 ***Monitoring arrangements.*** Implementation parties (see para. 1.12) are required to submit a final report for each CI project, providing information such as total expenditure, scheduled and actual dates of activities, expected and actual number of participants, participants' response and results of evaluation of project achievement. The final report needs to be submitted to the DC secretariat concerned within two months of project completion.

Number of CI projects and participants

1.17 Figure 1 shows the number of CI projects and participants in the period 2011 to 2015.

Figure 1

Number of CI projects and participants (2011 to 2015)



Source: HAD records

Audit review

1.18 In September 2016, the Audit Commission (Audit) commenced a review to examine the provision of DC-CIP funds by the HAD. The review focused on the following areas:

- (a) allocation and use of DC funds for CI projects (PART 2);

- (b) management of conflicts of interest in CI projects (PART 3); and
- (c) implementation of CI projects (PART 4).

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

Acknowledgement

1.20 Audit would like to acknowledge with gratitude the assistance and full cooperation of the staff of the HAD during the course of the review.

PART 2: ALLOCATION AND USE OF DISTRICT COUNCIL FUNDS FOR COMMUNITY INVOLVEMENT PROJECTS

2.1 This PART examines the allocation and use of DC-CIP funds, focusing on the following issues:

- (a) allocation of funds to DCs (paras. 2.2 to 2.7); and
- (b) use of funds by DCs (paras. 2.8 to 2.31).

Allocation of funds to District Councils

Mechanism of allocating DC-CIP funds

2.2 As shown in Table 1 in paragraph 1.8, the annual provision of DC-CIP funds was \$300 million in 2008-09. It was increased by \$20 million to \$320 million in 2012-13, by \$20.8 million to \$340.8 million in 2013-14, and by another \$20.8 million to \$361.6 million in 2015-16. The HAD allocated the \$300 million and the subsequent increases through the following mechanism:

- (a) a portion was allocated to individual DCs as basic allocation on a historical/equal basis;
- (b) a portion was allocated to individual DCs taking into account a number of factors including population, socio-economic factors, land area and past pattern of fund utilisation of individual DCs; and
- (c) a small remaining portion was kept by the HAD as central reserve for contingency (e.g. to cover the situation where a DC needed to spend more than its allocation).

2.3 Table 2 illustrates, using 2015-16 as an example, the HAD's allocation of DC-CIP funds based on the above mechanism.

**Allocation and use of district council funds
for community involvement projects**

Table 2

**HAD's allocation of DC-CIP funds
(2015-16)**

Provision of DC-CIP funds (see para. 2.2) (\$ million)	Allocated as basic allocation (see para. 2.2(a)) (\$ million)	Allocated according to a number of factors (see para. 2.2(b)) (\$ million)	Kept by HAD as central reserve (see para. 2.2(c)) (\$ million)
300.0	73.59 (Note 1)	223.51	2.9
20.0	9.00 (Note 2)	9.00	2.0
20.8	9.00 (Note 2)	11.80	Nil
20.8	9.00 (Note 2)	11.80	Nil
361.6	100.59	256.11	4.9

Source: HAD records

Note 1: The \$73.59 million was allocated on a historical basis, whereby each DC received an amount equal to the 2006-07 expenditure of leisure and cultural activities carried out at facilities of the district concerned by the LCSD (such activities were subsequently regarded as CI projects — see para. 1.7(a)).

Note 2: The \$9 million was allocated on an equal basis whereby each DC received \$0.5 million.

Need to review the allocation of DC-CIP funds

2.4 Audit examined the HAD's allocation of DC-CIP funds. Audit found that the factors taken into account by the HAD in allocating the funds (see para. 2.2(b)) had been subject to changes since 2008-09. For example, the population of the Sai Kung District had increased from 420,100 in 2008-09 to 463,700 in 2015-16 (or from 5.9% to 6.3% of the 18 districts' total population), while that of the Kwai Tsing District had decreased from 528,700 to 514,600 (or from 7.4% to 7% of the 18 districts' total population) in the same period.

Allocation and use of district council funds for community involvement projects

2.5 Audit noted that the HAD had not taken into account changes in the factors in allocating the DC-CIP funds. For example, for the allocation of DC-CIP funds in 2015-16, the amount of \$256.11 million (see Table 2 in para. 2.3) was allocated based on the old data (such as the district population) of 2008-09, 2012-13 and 2013-14. Audit considers that the HAD needs to review the allocation of DC-CIP funds taking into account changes in the factors so as to ensure that the funds are allocated in the most appropriate manner. In this connection, Audit noted that it had been announced in the 2017 Policy Address that the annual provision of DC-CIP funds would be increased by \$100 million starting from 2017-18. In reviewing the allocation, the HAD therefore also needs to take into account this additional annual provision.

Audit recommendation

2.6 Audit has *recommended* that the Director of Home Affairs should, taking into account changes in the factors (e.g. population and socio-economic factors) and the additional annual provision of DC-CIP funds, conduct a review of the allocation of DC-CIP funds to ensure that the funds are allocated in the most appropriate manner.

Response from the Government

2.7 The Director of Home Affairs agrees with the audit recommendation.

Use of funds by District Councils

2.8 Around the beginning of a financial year, the LCSD submits plans for implementing CI projects (generally one plan for one type of activities, i.e. recreational and sports activities, cultural and entertainment activities, and library extension activities — see para. 1.7(a)) for endorsement by DCs (these projects are hereinafter referred to as LCSD projects). On the other hand, during a financial year, other government departments, NGOs and committees/working groups under DCs/district offices (see para. 1.12(a) to (c)) submit individual CI project applications for endorsement by DCs (these projects are hereinafter referred to as DC projects). For LCSD projects, the LCSD submits regularly papers to DCs reporting the progress and achievements of projects. For DC projects, they are subject to individual project evaluations (see para. 4.12). For

Allocation and use of district council funds for community involvement projects

the five years from 2011 to 2015, the DC-CIP funds spent for LCSD projects and DC projects averaged \$298 million per year. Of this amount, \$105 million (35%) and \$193 million (65%) were incurred on LCSD projects and DC projects respectively.

Need to ascertain the reasons for decline in the number of projects and participants

2.9 The number of CI projects (comprising LCSD projects and DC projects) and the number of participants in CI projects are the two key performance indicators shown in the HAD's Controlling Officer's Report. Audit analysed the performance indicators for the period 2011 to 2015. Audit found that:

- (a) the number of projects had been on the decrease. Altogether, it decreased by 3.3% from 39,127 in 2011 to 37,827 in 2015; and
- (b) the number of participants had also been on the decrease. Altogether, it decreased by 13.3% from 21.49 million in 2011 to 18.63 million in 2015.

2.10 Audit, nevertheless, also found that the expenditure of CI projects had increased by 17% from \$272.35 million in 2011 to \$319.52 million in 2015, while the expenditure per participant had increased by 35% from \$12.7 to \$17.2 in the same period. Table 3 shows the details of Audit's analysis.

**Allocation and use of district council funds
for community involvement projects**

Table 3

**CI projects
(2011-2015)**

	2011	2012	2013	2014	2015
No. of projects	39,127	38,979	38,465	38,591	37,827
No. of participants (million)	21.49	20.41	21.52	20.02	18.63
Expenditure (Note) (\$ million)	272.35	289.77	306.36	303.88	319.52
Expenditure per participant (\$)	12.7	14.2	14.2	15.2	17.2

Source: HAD's Controlling Officer's Reports and Audit analysis of HAD records

Note: The expenditure of CI projects was only available in financial year. The financial year expenditure was therefore taken as approximate figures for the calendar year expenditure.

Remarks: As the number of projects and participants was in calendar year while the expenditure of projects was in financial year, the figures shown in the Table are only indicative figures to show the trends.

2.11 Upon enquiry, the HAD informed Audit in February 2017 that:

- (a) DCs might identify and initiate projects for implementation to meet the needs of their districts. Depending on the scale and nature of projects, the number of projects and participants might vary from year to year. The Government had not set a target for DCs to carry out a certain number of CI projects and the number of projects and participants to be on an increasing trend;
- (b) the increases in funding in 2013-14 and 2015-16 (see paras. 2.2 and 2.25) were for the dedicated purpose of promoting arts and culture at district level. Generally speaking, the cost of organising arts and cultural activities might be higher; and

Allocation and use of district council funds for community involvement projects

- (c) the implementation of CI projects involved the procurement of goods and services as well as the engagement of project staff. The increase in price level and staff cost over the years would also have a bearing on the number and nature of projects organised. It was therefore natural that the cost per participant would increase over the years.

2.12 In March 2017, the LCSD informed Audit that:

- (a) over the years, in order to attract and retain professional coaches and trainers for the LCSD's recreation and sports programmes, which accounted for more than 90% of the DC-CIP funds spent on LCSD projects, the LCSD had to offer a decent and competitive remuneration package. Every year the LCSD would adjust the remuneration of part-time staff (i.e. instructors), which constituted a major part of the cost of organising these programmes. Except for 2014-15 where there was no increase, there had been an increase ranging from 2% to 5.3% in the remuneration of part-time staff in the past five years;
- (b) the LCSD strove to enhance the quality and variety of its recreation and sports programmes offered to the public. Many of the new programmes had higher operational costs. For example, the track and BMX cycling training courses made use of the LCSD's new Hong Kong Velodrome. The expenditures for organising the newly introduced Track Cycling Training and BMX fun days were about \$10,000 and \$9,000 respectively; and
- (c) the LCSD's recreation and sports programmes were mostly small-to-medium-sized regular training classes that lasted from 10 to 48 hours and involved professional instructors. Because of the nature of these programmes, they could not be compared directly with one-off large-scale events (e.g. carnivals and festivals), which would inevitably have lower expenditure per participant per project.

2.13 Audit considers that the HAD needs to keep under review the number of CI projects and participants in the projects vis-à-vis the expenditure of the projects and take improvement measures as appropriate.

Allocation and use of district council funds for community involvement projects

2.14 In March 2017, the HAD and the LCSD informed Audit that they were verifying the accuracy of the CI project statistics (i.e. the number of CI projects and the number of participants in CI projects) so as to ensure that the statistics were correct. Audit considers that the HAD and the LCSD need to complete the verification as soon as possible and take measures to ensure the accuracy of the project statistics.

Need to analyse the use of DC-CIP funds

2.15 District offices use the District Council Funds Information System (DCFIS) to manage DC-CIP funds and CI projects. The DCFIS contains data such as the number of approved projects, the number of project participants, the types of people benefitted from projects (e.g. the elderly and people with disabilities), and the project expenditure. The DCFIS is primarily for managing DC projects (Note 7).

2.16 Audit extracted data from the DCFIS and analysed the use of funds by DCs in 2015-16. Results of Audit's analyses are shown in paragraphs 2.17 to 2.22.

2.17 ***Spending of funds on different project categories.*** The HAD classifies DC projects into 15 project categories, for example, arts and cultural activities, recreational and sports activities, and festival celebrations and district festivals. Audit conducted an analysis of the project categories, which is shown in Table 4.

Note 7: *LCSD projects are recorded in the DCFIS in a collective manner (e.g. a group of recreational and sports projects are recorded as one recreational and sports project), while DC projects are recorded individually in the system.*

**Allocation and use of district council funds
for community involvement projects**

Table 4

**DC projects under different project categories
(2015-16)**

Project category	No. of projects (a)	No. of participants (b) (million)	Expenditure (c) (\$ million)	Expenditure per participant (d) = (c)/(b) (\$)
1. Arts and cultural activities	989	2.92	66.43	22.8
2. Recreational and sports activities	3,311	1.29	45.98	35.6
3. Festival celebrations and district festivals	592	2.45	33.86	13.8
4. Social services	648	0.58	17.99	31.0
5. Health and public hygiene	198	0.81	9.11	11.2
6. Crime-fighting and corruption prevention	209	1.28	7.27	5.7
7. District administration	123	2.07	6.70	3.2
8. Environmental improvement and protection	91	1.12	3.58	3.2
9. Fire prevention	87	0.28	3.43	12.3
10. Transport and road safety	44	0.15	2.61	17.4
11. Civic education	59	0.56	2.42	4.3
12. Education	85	0.27	2.14	7.9
13. Heritage preservation and promotion	36	0.36	1.81	5.0
14. Building management	38	0.53	1.70	3.2
15. Library activities	18	0.13	0.60	4.6
Overall	6,528	14.80	205.63	13.9

Source: Audit analysis of HAD records

Allocation and use of district council funds for community involvement projects

2.18 As can be seen from Table 4:

- (a) of the \$205.63 million of funds spent in 2015-16 on the 15 project categories, \$146.27 million (71%) were spent on the three categories of arts and cultural activities, recreational and sports activities, and festival celebrations and district festivals. Projects under these categories included carnivals, variety shows and performances, exhibitions and festival decoration and lighting, tea gatherings and banquets, contests and competitions, and day-tours;
- (b) \$59.36 million (29%) were spent on the other 12 project categories. The funds spent on some project categories were small. For example, each of civic education (\$2.42 million) and building management (\$1.7 million) incurred a spending of less than 2% of the \$205.63 million spent on the 15 project categories; and
- (c) for the three project categories mentioned in (a) above, the average expenditure per participant was \$21.96 (\$146.27 million/6.66 million). For the other 12 project categories, the average expenditure per participant was \$7.29 (\$59.36 million/8.14 million), which was about one-third of the average expenditure per participant of the three project categories.

2.19 According to the HAD's Controlling Officer's Report, CI projects aim to achieve a wide spectrum of social objectives. Audit considers that the HAD needs to produce similar analyses of DC projects (see Table 4 above) to individual DCs. This would facilitate DCs to review whether their existing spending patterns best meet the needs of their districts. In this connection, Audit noted that LCSD projects were already focusing on leisure and cultural activities (see para. 1.7(a)), which might be similar in nature to those of the aforesaid three project categories.

2.20 *Projects targeting specific groups of people.* Some DC projects target specific groups of people. Such projects include, for example, "cricket training" for ethnic minorities, "adaptation to living in the territory" for new arrivals, and "leadership training" for women. Audit analysed the 2015-16 DC projects and found that for some projects targeting specific groups of people, the number of projects and participants was low (see Table 5). For example:

**Allocation and use of district council funds
for community involvement projects**

- (a) of the some 6,900 projects in total, there were only 32 (0.5%) projects for women and 133 (1.9%) projects for people with disabilities or special needs; and
- (b) of the some 15 million participants, there were only 15,000 (0.1%) new arrivals from the Mainland and 19,000 (0.1%) ethnic minorities.

Table 5

**DC projects and target participants
(2015-16)**

Target group	Project		Participant	
	No.	Percentage	No.	Percentage
District residents	3,630	52.8%	13,247,000	86.3%
Youth	678	9.9%	944,000	6.1%
Elderly	898	13.1%	522,000	3.4%
Building occupants/ owners	1,259	18.3%	367,000	2.4%
People with disabilities or special needs	133	1.9%	171,000	1.1%
Members of DCs/NGOs	153	2.2%	44,000	0.3%
Women	32	0.5%	24,000	0.2%
Ethnic minorities	49	0.7%	19,000	0.1%
New arrivals from Mainland	45	0.6%	15,000	0.1%
Total (Note)	6,877	100.0%	15,353,000	100.0%

Source: Audit analysis of HAD records

Note: A DC project may target more than one specific group of people (e.g. middle-aged women and newly arrived women from the Mainland), and therefore there could be duplicate counting of the number of projects and participants in Audit's analysis. In 2015-16, the total number of DC projects was 6,528 and that of participants was 14.8 million (see Table 4 in para. 2.17).

Allocation and use of district council funds for community involvement projects

2.21 Audit conducted a further analysis and found that there is scope for DCs to increase the number of projects targeting people of specific groups so that more of these people could participate in and benefit from these specific projects. For example, in 2015-16, only 19,000 ethnic minorities participated in DC projects while there were some 63,000 of them in Hong Kong (see Table 6).

Table 6
DC projects targeting specific groups of people
(2015-16)

Target group	No. of projects	No. of participants (Note)	Population of target participants in Hong Kong
Elderly	898	522,000	1,117,300
People with disabilities or special needs	133	171,000	578,600
Ethnic minorities	49	19,000	63,200
New arrivals from Mainland	45	15,000	38,300

Source: Audit analysis of HAD records and statistics published by the Census and Statistics Department

Note: As the same person might have participated in a number of projects, the actual number of participants could be smaller than that shown in the Table.

2.22 In February 2017, the HAD informed Audit that people of specific groups could also participate in activities targeting district residents in general (see Table 5 above), and that government bureaux/departments also granted funding to NGOs to provide support services for these specific groups. Nevertheless, Audit considers that there is room for organising more events that cater for the needs of specific groups (e.g. ethnic minorities) as well as promoting diversity and inclusiveness in the community. The HAD needs to produce similar analyses (see Table 6 above) to individual DCs to facilitate them to assess the need to initiate more such projects.

Allocation and use of district council funds for community involvement projects

2.23 *Need to analyse data on a periodic basis.* In conducting the audit analyses, Audit noted that while the DCFIS contained useful data on DC-CIP funds and CI projects, the HAD had not made use of the data to conduct analyses periodically to facilitate the management of the funds and projects. Audit considers that the HAD needs to periodically generate data from the DCFIS and conduct different analyses for HAD management information purposes and for dissemination to individual DCs to facilitate their management of DC-CIP funds and CI projects.

Need to improve data accuracy

2.24 In carrying out the audit analyses, Audit noted cases where inaccurate and incomplete information had been input by district offices into the DCFIS. The irregularities are summarised below:

- (a) *Lack of prompt update of the number of participants.* As at 25 November 2016, of the 6,528 DC projects which had all been completed, in 385 (5.9%) projects, the number of participants had not been input into the DCFIS. In another 24 (0.4%) projects, the number of participants was input as zero. Furthermore, one district office had not input the number of participants for any of the DC projects (678 projects in total) completed in the period 2011-12 to 2014-15. The district office only started to input the number of participants for DC projects in 2015-16; and
- (b) *Improper classification of projects and incorrect input of project names.* Of the 6,528 projects:
 - (i) 238 (3.6%) projects were classified as “others”. Audit reviewed the project records and found that these projects could have been classified into the 15 project categories (see para. 2.17);
 - (ii) 477 (7.3%) projects were wrongly classified; and
 - (iii) for 225 (3.4%) projects, the names of project applicants were input as project names.

The HAD needs to rectify the above irregularities and take measures to ensure the accuracy and completeness of the information input into the DCFIS in future.

Allocation and use of district council funds for community involvement projects

Need to monitor the use of DC-CIP funds for arts and cultural activities

2.25 In the 2013 Policy Address, the Government planned to provide an additional \$20.8 million a year for CI projects to enhance the work of DCs in promoting arts and cultural activities at the district level. In the 2015 Policy Address, the Government decided to provide, in the coming five financial years, an additional annual funding of \$20.8 million for CI projects to further strengthen the support for DCs in promoting arts and cultural activities in the districts. The annual provision of DC-CIP funds has thus increased by \$20.8 million since 2013-14, and by another \$20.8 million since 2015-16 (see Table 1 in para. 1.8). These two new amounts of funds are designated for arts and cultural activities.

2.26 Since the provision of the additional funds in 2013-14, the HAD has required DCs to ensure that they spend in each year an amount no less than the amount spent by them on arts and cultural activities in 2012-13 (i.e. before the introduction of the designated funds in 2013-14), and that the two new designated funds are spent solely for such activities.

2.27 Audit examined the use of funds by DCs for arts and cultural activities in 2015-16 and found that 10 of the 18 DCs had used funds designated for these activities on other activities, involving amounts ranging from \$220,000 to \$1.09 million (see Table 7 below). Audit considers that the HAD needs to take measures to ensure that the funds for arts and cultural activities are spent as designated.

**Allocation and use of district council funds
for community involvement projects**

Table 7

**Use of funds designated for arts and cultural activities
on other activities for 10 DCs
(2015-16)**

DC (Note)	Spending on arts and cultural activities in 2012-13	Amount of two new designated funds allocated to DC	Amount that should have been spent on arts and cultural activities	Spending on arts and cultural activities in 2015-16	Amount not spent on arts and cultural activities but on other activities	
	(a)	(b)	(c) = (a) + (b)	(d)	(e) = (d) - (c)	(e)/(c) × 100%
	(\$ million)					Percentage
A	1.98	1.80	3.78	2.69	(1.09)	(29%)
B	2.74	2.60	5.34	4.38	(0.96)	(18%)
C	1.22	1.60	2.82	1.96	(0.86)	(30%)
D	3.47	2.60	6.07	5.31	(0.76)	(13%)
E	4.48	2.80	7.28	6.53	(0.75)	(10%)
F	1.53	2.00	3.53	2.78	(0.75)	(21%)
G	2.17	2.00	4.17	3.57	(0.60)	(14%)
H	1.13	2.00	3.13	2.64	(0.49)	(16%)
I	1.20	2.20	3.40	3.08	(0.32)	(9%)
J	2.29	2.40	4.69	4.47	(0.22)	(5%)
Overall	22.21	22.00	44.21	37.41	(6.80)	(15%)

Source: Audit analysis of HAD records

Note: DCs denoted by the alphabets in this Table may not be the same as those denoted by the same alphabets in other Tables of this Audit Report.

Remarks: Arts and cultural activities comprised activities of both DC projects and LCSD projects.

Audit recommendations

2.28 Audit has *recommended* that the Director of Home Affairs should:

- (a) keep under review the number of CI projects and participants in the projects vis-à-vis the expenditure of the projects and take improvement measures as appropriate;**
- (b) produce analyses of DC projects to individual DCs to facilitate them to review whether their existing spending patterns best meet the needs of their districts;**
- (c) produce analyses of DC projects targeting specific groups of people to individual DCs to facilitate them to assess the need to initiate more such projects;**
- (d) periodically generate data from the DCFIS and conduct different analyses for HAD management information purposes and for dissemination to DCs to facilitate their management of DC-CIP funds and CI projects;**
- (e) rectify the irregularities stated in paragraph 2.24 and take measures to ensure the accuracy and completeness of the information input into the DCFIS in future; and**
- (f) take measures to ensure that the funds for arts and cultural activities are spent as designated.**

2.29 Audit has *recommended* that the Director of Home Affairs and the Director of Leisure and Cultural Services should:

- (a) complete the verification of the CI project statistics (i.e. the number of CI projects and the number of participants in CI projects) as soon as possible; and**
- (b) take measures to ensure the accuracy of the project statistics.**

Response from the Government

2.30 The Director of Home Affairs agrees with the audit recommendations.

2.31 The Director of Leisure and Cultural Services agrees with the audit recommendations in paragraph 2.29.

PART 3: MANAGEMENT OF CONFLICTS OF INTEREST IN COMMUNITY INVOLVEMENT PROJECTS

3.1 This PART examines the management of conflicts of interest in CI projects, focusing on:

- (a) declaration of interests (paras. 3.2 to 3.10);
- (b) handling of interests declared (paras. 3.11 to 3.15); and
- (c) management of conflicts of interest in working groups (paras. 3.16 to 3.22).

Declaration of interests

3.2 The 18 DCs have each appointed different committees (e.g. finance committee and culture, recreation and sports committee) to help carry out DC functions, including deciding on matters relating to CI projects. Individual DC members, as well as persons who are not DC members, may be appointed to serve as members of a committee. It is not unusual for DC/committee members to be associated with many CI projects (e.g. being chairpersons or other office bearers of the implementation parties).

Management of conflicts of interest in community involvement projects

3.3 Under the District Councils Ordinance, a DC may make standing orders for regulating its procedures and those of its committees, including procedures for managing conflicts of interest in CI projects. The HAD has provided a model text of standing orders for DCs' reference. DCs have generally adopted the model text, with variations to suit their individual needs. The standing orders of individual DCs stipulate similar procedures for managing conflicts of interest and all the 18 DCs adopt a two-tier declaration system (Note 8), as follows:

- (a) ***First-tier declaration.*** Every member of the DC or its committees shall, using the registration form provided by the relevant district office, furnish the district office with particulars of the member's registrable interests. Registrable interests shall include remunerated proprietorships, partnerships or directorships in public or private companies; remunerated employments, offices, trades or professions; shareholdings (more than 1% of the company's issued share capital); financial sponsorships; overseas visits; land and property held in Hong Kong; names of clients (to whom a member of the Council or its committees renders personal services in his or her capacity as such); and other declarable interests. The particulars should be furnished:
 - (i) within one month from the commencement of each DC/committee term; and
 - (ii) within 14 clear working days of any change in the member's registrable interests.

Note 8: *According to a memorandum issued by the Secretary for Home Affairs in August 2005, government bureaux and departments should introduce one of the following systems for declaration of interests for each of the advisory and statutory bodies under their purview:*

- (a) ***One-tier reporting system.*** *A member should make full declaration on his/her interests whenever he/she perceives a potential conflict of interest in a matter placed before the board or committee; and*
- (b) ***Two-tier reporting system.*** *This system applies to certain boards and committees such as those responsible for the control and disbursement of substantial public funds. Under this system, in addition to reporting conflicts of interest as and when they arise (see (a) above), members should disclose their general pecuniary interests on appointment to these boards and committees and annually thereafter.*

Management of conflicts of interest in community involvement projects

When finding that a member has direct pecuniary interests in a matter under consideration, the district office shall refer this to the chairperson of the DC or the relevant committee, who shall then decide whether relevant papers (e.g. meeting papers) shall be sent to the member concerned;

- (b) ***Second-tier declaration.*** Any member of the DC or its committees shall declare interests before dealing with matters on tender, quotation and DC-CIP funds if the member has any pecuniary or other interests in such matters, or has any links with the benefitted party or potential benefitted party;
- (c) ***Public accountability.*** Registration forms of the first-tier declaration, as well as minutes of meetings of the DC and its committees (containing information on the second-tier declaration), will be uploaded onto the homepage of the DC for public viewing; and
- (d) ***Non-compliance with requirements.*** DC/committee members who fail to comply with the requirements on declaration of interests may be admonished or reprimanded by the DCs concerned. Such admonishment or reprimand will be recorded in the minutes of meetings.

3.4 Of the 18 DCs in Hong Kong, Audit examined the practices on managing conflicts of interest in nine DCs (Note 9).

Need to make more efforts on reporting interests

3.5 Audit examined 129 declarations of interests made by DC/committee members at meetings (i.e. in the second-tier declaration — see para. 3.3(b)) in 2016 to ascertain whether these interests had also been reported in the first-tier declaration (see para. 3.3(a)) (Note 10). The meetings were held by seven DCs or

Note 9: *The nine DCs comprised two DCs on Hong Kong Island, three DCs in Kowloon and four DCs in the New Territories.*

Note 10: *Audit compared the interests declared in the meetings by the members with those stated in their most updated registration forms (see para. 3.3(a)).*

Management of conflicts of interest in community involvement projects

their committees (Note 11). Audit noted that, as at 31 January 2017, of the 129 declarations:

- (a) for seven (5%) declarations (made by six members), the interests had been reported in the first-tier declaration;
- (b) for the remaining 122 (95%) declarations (made by 76 members), the interests had not been reported in the first-tier declaration (see Table 8); and

Note 11: *Implementation parties' (see para. 1.12) applications for CI projects were usually deliberated at DC/committee meetings. Audit examined a total of 31 applications which were deliberated at DC/committee meetings in 2016. These 31 applications involved 129 declarations of interests made by DC/committee members (each declaration was made by a DC/committee member in attendance at the meeting). The 31 applications comprised:*

- (a) *30 applications of six DCs (i.e. five applications for each DC); and*
- (b) *the only application of a DC which had interests declared during deliberation (there were no other applications with interests declared during deliberation).*

For the remaining two DCs (i.e. the nine DCs examined by Audit less the seven DCs mentioned above), implementation parties' applications for CI projects were considered through circulation of papers.

Table 8

**Reporting of interests in 129 cases
(31 January 2017)**

DC (Note)	No. of declarations	
	Made in meetings in 2016	With interests not reported in first-tier declaration
A	24	24
B	2	2
C	38	37
D	25	25
E	18	17
F	11	7
G	11	10
Total	129	122

Source: Audit analysis of HAD records

Note: DCs denoted by the alphabets in this Table may not be the same as those denoted by the same alphabets in other Tables of this Audit Report.

- (c) in the 122 declarations where the interests had not been reported, there were incidents in which the interests had been in existence for a long time (see Case 1 below for an example).

Case 1

Reporting of interests

1. At a meeting in mid-2016, a DC committee deliberated an NGO's application for a CI project amounted to some \$111,000. The committee was responsible for handling culture, recreation and sports matters for the DC.

2. Of the 33 members in attendance at the meeting, 16 members made declarations of interests. The 16 declarations revealed interests that the members concerned were holding positions in the NGO as:

- (a) presidents (two members) and an honorary president (one member);
- (b) a chairperson (one member) and vice chairpersons (two members);
- (c) executive committee members (four members); and
- (d) executives (six members).

3. Minutes of a previous committee meeting in 2015 indicated that, of the 16 members, eight members were already holding the NGO positions in mid-2015. As at 31 January 2017, these members together with the other eight members had not reported the interests declared in the meeting in the first-tier declaration.

Source: Audit analysis of HAD records

3.6 The 122 interests noted by Audit (see para. 3.5(b)) were the holding of positions in implementation parties. Regarding the reasons that many members did not report such positions in the first-tier declaration, the HAD informed Audit in February and March 2017 that:

- (a) the interests referred to in the first-tier declaration emphasised pecuniary interests. Therefore, while DC standing orders required the reporting of "other declarable interests" in the first-tier declaration (see para. 3.3(a)), members might not regard their non-remunerated positions in implementation parties as "other declarable interests"; and

Management of conflicts of interest in community involvement projects

- (b) it is not necessarily the case that the declarations made in the meetings (i.e. second-tier declaration) must appear in the first-tier declaration, as the second-tier declaration concerns members having to make a declaration on the interests they have on a “matter under consideration” by the DC concerned.

3.7 Audit considers that there is a need for the HAD to clearly define “other declarable interests” in DC standing orders. In this connection, it should be noted that the positions held by some members in the implementation parties could be perceived to be the key decision-making or influential positions (e.g. a president or chairperson — see Case 1 in para. 3.5(c)). The HAD needs to provide guidelines (e.g. what kind of and the circumstances under which “other declarable interests” should be reported) to DC/committee members to facilitate a more consistent reporting of “other declarable interests”. It also needs to remind them to make more efforts in declaring their interests.

Scope for improving second-tier declaration

3.8 For the second-tier declaration, DC standing orders require that interests shall be declared before dealing with matters on DC-CIP funds (see para. 3.3(b)). However, the requirement had not been adequately observed in some situations, as follows:

- (a) ***Declarations not made when earmarking funding.*** At the beginning of every financial year, DCs might earmark funding for a number of implementation parties for budgetary purpose. Audit examined the minutes of eight meetings (involving eight DCs) in 2016 (Note 12) that considered the earmarking of funding, and noted that declarations of interests were only made in one meeting (involving one DC). For the other seven meetings (involving seven DCs), none of the 145 DC/committee members in attendance declared connections with the 63 implementation parties concerned. Audit, however, noted from examination of CI project applications (see Note 11 to para. 3.5) that in meetings where project applications were considered, 34 (23%) of the

Note 12: *In 2016, of the nine DCs examined by Audit (see para. 3.4), eight DCs had earmarked funding for implementation parties individually. Audit examined the minutes of the relevant meeting for each of the eight DCs.*

Management of conflicts of interest in community involvement projects

145 DC/committee members did declare connections with 14 of the 63 implementation parties (e.g. as vice-chairmen or board members of the implementation parties). This indicated that these 34 members might have overlooked the need to declare connections when considering the earmarking of funding. Audit considers that the HAD needs to take more measures to ensure that DC/committee members declare their interests before earmarking funding for implementation parties each year; and

- (b) *Need to provide guidelines on making declarations when handling matters through circulation of papers.* Audit noted that, for the nine DCs examined, while their standing orders required members to declare interests before handling DC matters, the standing orders did not spell out how declarations were to be made when matters were handled not in meetings but through circulation of papers. Furthermore, Audit noted that for two of the nine DCs, applications for CI projects were frequently endorsed by DC/committee members through circulation of papers. The practices of declaring interests, however, varied between the two DCs:
 - (i) for one DC, the feedback slips attached to the circulation papers requested members to declare interests and not to make views on the project applications after declaring interests; and
 - (ii) for the other DC, the feedback slips attached to the circulation papers did not request members to declare interests. Upon enquiry, the HAD informed Audit in February 2017 that although the DC members were not reminded of the declaration requirement every time there was a paper circulation, they had been reminded of the requirement at a DC meeting held in September 2016.

Audit considers that the HAD needs to provide guidelines to DCs on how declarations of interests could best be made in handling matters through paper circulation.

Audit recommendations

- 3.9 **Audit has *recommended* that the Director of Home Affairs should:**
- (a) **provide guidelines with broad principles of what constitute “other declarable interests” to DC/committee members as appropriate to facilitate the reporting of “other declarable interests”, and remind them to make more efforts in declaring their interests;**
 - (b) **take more measures to ensure that DC/committee members declare their interests before earmarking funding for implementation parties; and**
 - (c) **provide guidelines to DCs on how declarations of interests could best be made in handling matters through circulation of papers.**

Response from the Government

- 3.10 **The Director of Home Affairs agrees with the audit recommendations.**

Handling of interests declared

- 3.11 **The standing orders of each DC stipulate similar procedures for handling interests declared, as follows:**

- (a) **when a member of the DC or a committee declares an interest in a matter, the chairperson of the DC or the committee shall decide (Note 13) whether the member:**
 - (i) **may speak or vote on the matter;**

Note 13: *When the chairperson of the DC declares an interest in a matter, the vice chairperson shall decide. When the chairperson of a committee declares an interest in a matter, all other members without interests declared shall decide.*

Management of conflicts of interest in community involvement projects

- (ii) may remain in the meeting as an observer; or
 - (iii) should withdraw from the meeting; and
- (b) all cases of declaration of interests shall be recorded in the minutes of the DC/committee meetings.

3.12 Furthermore, according to the HAD Manual, all declarations of interests should be recorded in the minutes of the meeting, stating the nature of interests declared, the decisions of the meeting and the rationale behind the decisions as appropriate.

Rulings not made and recorded on interests declared

3.13 For the 129 cases of declaration of interests at meetings (see para. 3.5), the related minutes of meetings indicated that in 73 (57%) cases (involving three DCs), contrary to the standing order requirement (see para. 3.11(a)), rulings had not been made and recorded on the interests declared (Note 14). In the circumstances, those who had declared the interests continued their attendance in the meetings (see Case 2 for an example).

Note 14: *For the remaining 56 (43%) cases (involving four DCs), the related minutes of meetings indicated that rulings had been made on the interests declared. In 44 (79%) out of the 56 cases, the members concerned remained as observers or withdrew from the meetings. In the other 12 (21%) cases, the members concerned were allowed to speak or vote in the meetings.*

Case 2

Members continued to participate in a meeting after declaring interests

1. At a meeting in mid-2016, a DC committee considered an NGO's application for a CI project amounted to \$20,000. The committee was responsible for handling finance and economic affairs for the DC.
2. Of the 13 members in attendance at the meeting, three members made declarations of interests. The three members were holding offices in the NGO, i.e. a chairperson, a vice-chairperson and an executive of the NGO.
3. Minutes of the meeting did not indicate that the chairperson of the meeting had made rulings on the interests declared. The three members continued to participate in the deliberation of the NGO's application.
4. The meeting endorsed the NGO's application for the CI project.

Audit comments

5. It was unsatisfactory that in a large proportion (57%) of cases (including this case), rulings on interests declared by members had not been made and recorded in the minutes of meetings.

Source: Audit analysis of HAD records

Audit recommendations

3.14 Audit has *recommended* that the Director of Home Affairs should remind DCs that:

- (a) rulings should be made on interests declared by members in DC/committee meetings; and
- (b) the rulings made and the rationale behind the rulings should be recorded in the minutes of the meetings as appropriate in accordance with the HAD Manual.

Response from the Government

3.15 The Director of Home Affairs agrees with the audit recommendations.

Management of conflicts of interest in working groups

3.16 DCs and their committees have appointed working groups to help carry out specified functions. The standing orders of the nine DCs examined by Audit have stipulated similar arrangements for the operation of working groups, as follows:

- (a) any decision made by a working group shall not be regarded as the decision of the DC unless it is endorsed by the DC or the committee concerned; and
- (b) minutes of meetings of a working group shall record the final decisions of the discussion only. They shall be uploaded onto the homepage of the DC except for closed-door meetings.

Inadequate procedures for managing conflicts of interest

3.17 Some working groups had been assigned the duties of considering applications for CI projects. The working groups recommended the applications for further consideration by DCs/committees, or endorsed the applications on behalf of DCs/committees.

3.18 Of the nine DCs examined, there were three working groups (under three DCs) that endorsed applications for CI projects on behalf of DCs/committees. Audit examined their 2016 minutes of meetings and found that of the three working groups:

- (a) in one working group, the minutes of meetings disclosed only the final decisions of project applications. Other information, such as members in attendance, interests declared and rulings on interests declared, had not been disclosed; and

Management of conflicts of interest in community involvement projects

- (b) in the other two working groups, the minutes of meetings disclosed more information including interests declared. However, the minutes of meetings did not indicate that rulings had been made on the interests declared. The members concerned continued to participate in the meetings.

3.19 Audit noted that while DC standing orders have stipulated the procedures for managing conflicts of interest (see para. 3.11) as well as the need to publicise minutes of DC/committee meetings (containing information on declaration of interests) for public viewing (see para. 3.3(c)), the procedures are not applicable to working group meetings. There are no laid-down procedures for handling conflicts of interest in working groups. In this regard, the HAD informed Audit in February 2017 that:

- (a) the principle of requiring DC members to declare interests as appropriate applies to DC, committee, and working group meetings, though “working group” is not explicitly mentioned in DC standing orders; and
- (b) working group members are either DC members or co-opted members. According to the HAD Manual, DC members (including co-opted members) should, as far as practicable, make a declaration of interests before a matter is discussed. This would have governed the declaration of interests by members of working groups when handling CI projects.

Nevertheless, the HAD also informed Audit that it was prepared to consider adding “working group” to DC standing orders.

Working groups’ practices not in line with District Councils Ordinance

3.20 In reviewing the minutes of meetings of the three working groups, Audit noted that once project applications were endorsed by the working groups, CI projects could be implemented. The working groups did not seek their DCs’ further endorsements for the CI projects. Audit further noted that the three working groups had been delegated by their respective DCs with the authority to endorse a project application not exceeding \$24,500, \$100,000 and \$200,000 respectively. For projects exceeding the funding ceilings, the working groups would need to seek endorsement of their respective DCs/committees. Audit

Management of conflicts of interest in community involvement projects

considers that such delegation arrangements may not be entirely proper as according to the District Councils Ordinance, a DC may delegate its functions to a committee only.

Audit recommendations

3.21 **Audit has *recommended* that the Director of Home Affairs should:**

- (a) **ensure that the stipulated procedures for handling conflicts of interest applicable to DC/committee meetings also apply to working group meetings; and**
- (b) **ascertain whether DCs' practice of delegating functions to their working groups is in line with the District Councils Ordinance and take remedial action as appropriate.**

Response from the Government

3.22 The Director of Home Affairs agrees with the audit recommendations.

PART 4: IMPLEMENTATION OF COMMUNITY INVOLVEMENT PROJECTS

4.1 This PART examines the implementation of CI projects, focusing on the following issues:

- (a) selection of NGOs for implementing projects (paras. 4.3 to 4.11); and
- (b) performance management of projects (paras. 4.12 to 4.21).

4.2 In examining the implementation of CI projects, Audit selected four DCs (one on Hong Kong Island, one in Kowloon and two in the New Territories) for examining the practices and procedures.

Selection of NGOs for implementing projects

4.3 As mentioned in paragraph 1.12, implementation parties, which include the LCSD, NGOs and committees/working groups under DCs/district offices, can apply to DCs to carry out CI projects. In respect of NGOs, there are three ways that NGOs can carry out CI projects:

- (a) NGOs can submit applications for CI projects for DCs' consideration and endorsement;
- (b) NGOs, which have a long-term working relationship with DCs, are earmarked with funds by DCs in their annual budgets for carrying out CI projects (hereinafter these NGOs are referred to as designated NGOs). These designated NGOs can later submit applications for using the earmarked funds in CI projects; and
- (c) NGOs can carry out CI projects in partnership with committees/working groups under DCs/district offices.

Implementation of community involvement projects

4.4 Table 9 shows the amounts of DC-CIP funds paid to implementation parties in 2015-16.

Table 9

**Amounts of DC-CIP funds paid to implementation parties
(2015-16)**

Implementation party	DC-CIP funds	
	Amount (\$ million)	Percentage
Government departments (mainly the LCSD)	119.78	37%
NGOs (see para. 4.3(a))	67.69	21%
Designated NGOs (see para. 4.3(b))	26.37	8%
NGOs in partnership with committees/working groups under DCs/district offices (see para. 4.3(c))	50.27	16%
Committees/working groups under DCs/district offices	57.99	18%
Total	322.10 (Note)	100%

Source: Audit analysis of HAD records

Note: According to the HAD Manual, a DC is allowed to use DC-CIP funds to employ a pool of dedicated staff to help implement CI projects of various implementation parties. In 2015-16, the amount paid for employing such staff was \$39.28 million. As this amount was not paid to implementation parties, it is not included in the Table. When included, the total amount of DC-CIP funds spent in 2015-16 was \$361.38 million (see Table 1 in para. 1.8).

Implementation of community involvement projects

Need to establish guidelines for reviewing designated NGOs

4.5 As shown in Table 9, in 2015-16, the amount of \$26.37 million paid to designated NGOs accounted for 8% of the total amount of DC-CIP funds paid to implementation parties. Table 10 further shows a breakdown of the \$26.37 million paid by individual DCs to designated NGOs.

Table 10

DC-CIP funds paid to designated NGOs (2015-16)

DC (Note)	No. of designated NGOs	No. of projects carried out by designated NGOs	DC-CIP funds paid to designated NGOs (\$ million)
A	7	47	4.12
B	8	100	2.98
C	6	34	2.32
D	4	20	2.16
E	5	44	2.11
F	6	39	1.78
G	5	61	1.60
H	4	30	1.55
I	7	30	1.37
J	5	143	1.23
K	8	36	0.99
L	6	42	0.97
M	4	21	0.83
N	3	19	0.78
O	10	21	0.57
P	1	27	0.53
Q	5	15	0.48
R	0	0	0.00
Total	94	729	26.37

Source: Audit analysis of HAD records

Note: DCs denoted by the alphabets in this Table may not be the same as those denoted by the same alphabets in other Tables of this Audit Report.

4.6 Audit noted that of the four DCs examined (see para. 4.2), in the period 2011-12 to 2016-17:

- (a) two DCs had reviewed their lists of designated NGOs on an annual basis;
- (b) another DC had reviewed its list of designated NGOs on a biennial basis; and
- (c) the remaining DC had not reviewed its list of designated NGOs in the period 2011-12 to 2016-17. The HAD informed Audit in February 2017 that the DC had reviewed the arrangement of designated NGOs in 2005-06 (more than 10 years ago) and DC members had been informed that the arrangement remained unchanged in the current DC term (i.e. in March 2016).

Audit further noted that there were no laid-down guidelines (e.g. the frequency of reviews, the factors to be considered for review purposes, and the need to document reviews) on how reviews of designated NGOs should be conducted.

4.7 Audit considers that to enhance public accountability in the use of DC-CIP funds, there is merit for DCs to regularly review their lists of designated NGOs to ensure that only NGOs with good performance are included in the lists. The HAD needs to provide DCs with suitable guidelines to facilitate their reviewing of designated NGOs.

Inadequacy in the selection of partner NGOs

4.8 As shown in Table 9 in paragraph 4.4, in 2015-16, the amount paid to NGOs for implementing CI projects in partnership with committees/working groups under DCs/district offices accounted for 16% (\$50.27 million) of the total amount of DC-CIP funds paid to implementation parties. It is a usual practice that partner NGOs are selected with the assistance of DC secretariats, i.e. a DC secretariat issues an open invitation (e.g. by posting the invitation on the DC's website) or a restricted invitation (e.g. by mailing invitation letters to a number of NGOs in the district) and interested NGOs submit applications to the DC for consideration.

Implementation of community involvement projects

4.9 Of the four DCs examined, Audit noted that with the exception of one DC, the other three DCs followed the aforesaid practice in selecting partner NGOs. For that DC, it does not invite, through the DC secretariat concerned, NGOs to submit applications for implementing CI projects as partner NGOs. Instead, working groups are formed under the DC's committees for implementing CI projects. In the first meeting of a working group tasked with implementing CI projects, members are appointed to take charge of the projects (hereinafter referred to as members-in-charge). At the same time, partner NGOs are nominated by the members-in-charge (Note 15). With the majority votes of the members of the working group in the meeting, the partner NGOs are selected and will later be invited by the members-in-charge to submit project applications. Case 3 describes the practice of the DC concerned.

Note 15: *Members-in-charge were usually connected to the partner NGOs nominated by them (see PART 3 for separate audit findings on conflicts of interest).*

Case 3

A DC's practice of selecting partner NGOs

1. In March 2015, the working group (of 35 members) for road safety formed under a committee of a DC held its first meeting. In the meeting, the following matters were resolved:

- (a) the 2015-16 plan and budget for implementing five CI projects for promoting road safety in the district;
- (b) the appointment of members-in-charge for the planned projects (for each project, one DC member was nominated and appointed as the member-in-charge); and
- (c) the selection of partner NGOs (for each project, one NGO was nominated by the member-in-charge and selected as the partner NGO).

2. After the meeting, the selected partner NGOs submitted applications for their respective CI projects to the Vetting Working Group, which was responsible for vetting project applications, for approval.

Audit comments

3. Of the four DCs examined, this was the only DC that did not invite, through the DC secretariat concerned, NGOs to submit applications for implementing CI projects as partner NGOs. In 2015-16, the DC implemented 152 CI projects with its partner NGOs, involving a total project expenditure of \$8.32 million. To enhance the openness and transparency of the selection process, the HAD needs to advise the DC to review its practice of selecting partner NGOs. The HAD also needs to set out in the HAD Manual good practice guidelines on the selection of partner NGOs.

Source: Audit analysis of HAD records

Audit recommendations

- 4.10 **Audit has *recommended* that the Director of Home Affairs should:**
- (a) **provide DCs with suitable guidelines to facilitate their reviewing of designated NGOs and incorporate the guidelines into the HAD Manual;**
 - (b) **set out in the HAD Manual, for DCs' reference, good practice guidelines on the selection of partner NGOs as adopted by most DCs; and**
 - (c) **advise the DC in Case 3 to review its existing practice of selecting NGOs with a view to enhancing the openness and transparency of the selection process, taking account of the good practice guidelines mentioned in (b) above.**

Response from the Government

- 4.11 The Director of Home Affairs agrees with the audit recommendations.

Performance management of projects

4.12 According to the HAD Manual, apart from the submission of final reports by implementation parties (see para. 1.16), a DC should have an evaluation system in place to monitor the effectiveness of CI projects. DCs are given the flexibility to devise their own evaluation systems. In practice:

- (a) DCs evaluate DC projects (but not LCSD projects — see para. 2.8); and

- (b) DCs adopt an evaluation system whereby if a project meets the criteria set by the DC for evaluation (e.g. projects with an approved project grant of \$10,000 or above, or projects involving a ceremony), the project will be evaluated by an evaluator (Note 16) by filling in a standard evaluation form prescribed by the HAD. The completed evaluation form will be submitted by the evaluator to the DC secretariat concerned.

Scope for improvement in performance management of projects

4.13 *Absence of an evaluation system.* Audit examined the four DCs' evaluation systems and noted that of the four DCs, one DC had discontinued the use of any evaluation systems in the period 2011-12 to 2016-17. It was only in November 2016 that the DC planned to re-introduce a system in 2017-18.

4.14 *Projects not evaluated.* Of the three DCs that adopted the aforesaid evaluation system (see para. 4.12(b)), Audit noted that in 2015-16:

- (a) one DC had evaluated all the 250 projects that met its criteria for evaluation;
- (b) another DC had evaluated 85 of the 91 projects that met its criteria for evaluation, leaving six projects not evaluated; and
- (c) the remaining DC had adopted the evaluation system (i.e. it intended to have an evaluator conducting an evaluation if the project met the evaluation criteria), but it had not set any criteria for evaluation purpose. After the DC secretariat concerned found in the final reports (see para. 1.16) that 180 of the 440 projects of the DC would require evaluation (as the project activities had been attended by DC members), evaluation forms were completed for the 180 projects.

Note 16: *The evaluator is usually a DC member who is not involved in the administration of the project and who does not have an interest in the implementation party (e.g. an NGO) under evaluation. As part of the evaluation, the evaluator needs to attend the project activities. Sometimes, the evaluator is an HAD staff.*

Implementation of community involvement projects

4.15 ***Evaluation results not input into DCFIS.*** The above audit findings were based on the results of examination of evaluation forms. Audit further noted that for some of the above projects, the evaluation results as contained in the evaluation forms had not been input into the DCFIS by the DC secretariats concerned. Details are as follows:

- (a) of the 250 evaluated projects of the DC mentioned in paragraph 4.14(a), the results of 47 (19%) projects had not been input into the DCFIS (i.e. 203 had been input); and
- (b) of the 85 evaluated projects of the DC mentioned in paragraph 4.14(b), the results of four (5%) projects had not been input into the DCFIS (i.e. 81 had been input).

The evaluation results of the 180 evaluated projects of the DC mentioned in paragraph 4.14(c) had all been input into the DCFIS.

4.16 ***Ratings not reflecting the actual situation.*** In the standard evaluation form (see para. 4.12(b)), among other assessment items (Note 17), an evaluator is required to rate an assessment item known as “No. of participants as compared with the estimated no. of participants” by choosing one of the four ratings of “Very Satisfactory”, “Satisfactory”, “Acceptable” and “Unsatisfactory”. For the three DCs that adopted the evaluation system (see para. 4.14), Audit analysed the evaluation results maintained in the DCFIS and noted that there were cases where the ratings given by evaluators were not reflecting the actual situation. For example:

- (a) of the 464 projects of the three DCs (203 + 81 + 180, see para. 4.15), in five projects, while the actual number of participants was below 50% of the expected number of participants, the rating was “Very Satisfactory”. For example in one project of one DC, while the actual number of participants was only 33% of the expected number, the rating was “Very Satisfactory”; and

Note 17: *Other assessment items include “Objectives of the activity met”, “Expected benefits achieved”, “Response of the participants”, “Effectiveness of the use of funds”, and “Acknowledgement given to the (District) Council”.*

- (b) in two projects of another DC, while the actual number of participants was 100% of the expected number in one project and 123% in the other project, the rating was only “Acceptable”.

4.17 ***Completed evaluation forms not directly submitted to DC secretariats.*** For the three DCs that adopted the evaluation system (see para. 4.14), Audit noted that after conducting an evaluation, it was a usual practice that the evaluator submitted the completed evaluation form to the DC secretariat concerned through the implementation party (e.g. an NGO). To maintain impartiality in evaluations, a better arrangement would be for the evaluator to submit the completed evaluation form directly to the DC secretariat.

4.18 ***Number of participants overstated.*** Audit conducted a checking to ascertain the accuracy of the number of participants disclosed in final reports. For the four DCs, Audit examined 38 projects held in 2015-16 at LCSD performance venues. For each of these projects, Audit compared the audience size as disclosed in the final report with that recorded by the LCSD venue management. Audit found that in 30 (79%) projects, the audience size disclosed in the final report was higher than that recorded by the LCSD venue management (with variances ranging from 3% to 323% and averaging 71%). Case 4 shows an example.

Case 4

Number of participants overstated in a final report

1. According to the implementation party's final report for a project of a DC held in January 2016 at an LCSD performance venue, there was an audience of 900 people, 250 performers and four guests. These figures were the same as the expected numbers of audience, performers and guests stated in the project application.

2. According to the information provided by the LCSD venue management to Audit, the audience size was 213 instead of 900 (i.e. a variance of 323 %).

Audit comments

3. The HAD needs to ascertain the discrepancy by, for example, making enquiries with the implementation party and the LCSD, and to take measures to ensure the accuracy of the number of participants disclosed in the final report. Furthermore, in view of the many projects involved (30 projects or 79% of those examined by Audit — see para. 4.18), the HAD also needs to consider reviewing the existing methods adopted by implementation parties for counting the number of participants.

Source: Audit analysis of HAD records and information provided by the LCSD

4.19 ***Need to improve the efficiency of reporting achievement of performance pledge.*** The HAD has pledged to release the reimbursement of a project within 30 working days after receiving all documents and information necessary for supporting the reimbursement. This performance pledge is posted on the HAD's website. On a quarterly basis, the HAD needs to compile manually management information to find out the extent that the pledge has been met. Audit noted that, certain data of projects (e.g. the project approval date, the project commencement date, and the project completion date) are recorded by the DCFIS. Audit considers that the efficiency of reporting the achievement of the performance pledge could be improved if the following data of projects are also captured by the DCFIS so that the relevant information can be generated electronically:

- (a) the date that all documents and information necessary for supporting the reimbursement (e.g. the final report and the reimbursement claim) are submitted; and
- (b) the date that the reimbursement is released.

Audit recommendations

4.20 **Audit has *recommended* that the Director of Home Affairs should:**

- (a) **take measures to ensure that DCs set up a system for evaluating CI projects;**
- (b) **take measures to ensure that DCs set proper criteria for selecting CI projects for evaluation;**
- (c) **take measures to ensure that CI projects meeting the criteria set by DCs are evaluated and that evaluation forms are completed for projects evaluated;**
- (d) **take measures to ensure that evaluation results contained in project evaluation forms are input into the DCFIS in a timely manner;**
- (e) **remind DC secretariats to follow up with evaluators in cases where the ratings given by them in evaluation of CI projects are not in line with the actual situation;**
- (f) **take measures to ensure that evaluators submit completed evaluation forms directly to the DC secretariats concerned;**
- (g) **ascertain the discrepancies between the size of audience disclosed in final reports and that recorded by the LCSO venue management, and take measures to ensure the accuracy of the number of participants disclosed in final reports;**
- (h) **consider reviewing the existing methods adopted by implementation parties for counting the number of participants; and**

Implementation of community involvement projects

- (i) **consider making use of the DCFIS to improve the efficiency of reporting the achievement of the performance pledge relating to the release of reimbursements.**

Response from the Government

4.21 The Director of Home Affairs agrees with the audit recommendations.

**Provision of DC-CIP funds to individual District Councils
(2015-16)**

DC	Funds allocated (\$ million)
Kwun Tong	25.80
Yuen Long	25.70
Sha Tin	24.50
Tuen Mun	24.40
Kwai Tsing	23.70
Eastern	22.70
Wong Tai Sin	22.20
Sham Shui Po	21.40
Yau Tsim Mong	19.90
North	19.10
Sai Kung	18.00
Tai Po	17.70
Tsuen Wan	16.40
Kowloon City	16.30
Central and Western	15.90
Islands	15.80
Southern	14.90
Wan Chai	12.30
HAD central reserve (Note)	4.90
Total	361.60

Source: HAD records

Note: This amount was kept by the HAD for contingency (e.g. to cover the situation where a DC needed to spend more than its allocation — see para. 2.2(c)).

Acronyms and abbreviations

Audit	Audit Commission
CI projects	Community involvement projects
DCs	District Councils
DCFIS	District Council Funds Information System
HAD	Home Affairs Department
LCSD	Leisure and Cultural Services Department
NGOs	Non-governmental organisations

CHAPTER 5

**Commerce and Economic Development Bureau
Tourism Commission**

Kai Tak Cruise Terminal

**Audit Commission
Hong Kong
3 April 2017**

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

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KAI TAK CRUISE TERMINAL

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KAI TAK CRUISE TERMINAL

Executive Summary

1. In October 2006, the Government informed the Legislative Council (LegCo) that the Government was committed to developing Hong Kong into a regional cruise hub. In November 2009, the Finance Committee (FC) of LegCo approved the site formation works for the new cruise terminal at Kai Tak at an estimated cost of \$2,304 million. The FC further approved in April 2010 the construction of the cruise terminal building and ancillary facilities at an estimated cost of \$5,852 million. The terminal building and the first berth of the Kai Tak Cruise Terminal (KTCT) commenced operation in June 2013. The second berth commenced operation in September 2014. In its first full year of operation in 2014, the KTCT received 28 ship calls involving 48 days of operation and passenger throughput of 130,608. The number of ship calls increased to 95 involving 105 days of operation and passenger throughput of 424,868 in 2016. As at 28 February 2017, the total actual project expenditure for the KTCT was \$6,613 million.

2. The KTCT has a total floor area of 188,952 square metres (m²). In March 2012, the Government awarded a ten-year Tenancy Agreement (TA) to a terminal operator through an open tender. The Government has leased 120,402 m² of the KTCT to the terminal operator for operation and management for ten years commencing in June 2013. Under the TA, the terminal operator is required to pay a fixed rent of \$13 million for the ten-year operation and a variable rent (ranging from 7.3% to 34% of the annual gross receipts of the operator). The communal areas, government offices and the KTCT Park have not been leased to the terminal operator. The facility management services for the communal areas and government offices are outsourced to a contractor. The KTCT Park is managed by the Leisure and Cultural Services Department. Operation and maintenance services for certain electrical and mechanical systems and equipment in various parts of the KTCT are provided by the Electrical and Mechanical Services Trading Fund (EMSTF). The Tourism Commission (TC) under the Commerce and Economic Development Bureau is responsible for monitoring the operation of the KTCT and works closely with the Advisory Committee on Cruise Industry (ACCI) in developing Hong Kong into a leading regional cruise hub. The Audit Commission (Audit) has recently conducted a review of the KTCT.

Developing Hong Kong into a leading regional cruise hub

3. *Achievement of expected economic benefits brought by the cruise industry.* In November 2008, the Government informed LegCo that the economic benefits to be brought by the cruise industry would range from \$859 million to \$1.1 billion per annum by 2013 and \$1.5 billion to \$2.5 billion per annum by 2016. In November 2009 and April 2010, the Government informed the FC in the funding applications that with the availability of the new cruise terminal facilities and appropriate market strategies, the economic benefits to be brought by the cruise industry under different growth scenarios would range from \$1.5 billion to \$2.6 billion per annum and around 5,300 to 8,900 additional jobs would be generated by 2023. The economic benefits to be brought by the cruise industry were estimated by an economic model taking into account various factors, including the estimated number of ship calls and passenger throughput, and the estimated spending by cruise passengers and cruise operators. Audit compared the actual number of ship calls and passenger throughput and average per-passenger spending with the estimated figures used in making the estimation. Audit found that: (a) the actual number of ship calls of 191 in 2016 was 5% and 31.3% lower than the estimated numbers under the low and high growth scenarios respectively. According to the TC, the average passenger carrying capacity of the cruise ships berthed at the KTCT in 2016 was larger than the capacity used in the economic model; (b) the actual cruise passenger throughput of 677,031 in 2016 was 25% higher than the estimated throughput under the low growth scenario and was 33.5% lower than the estimate under the high growth scenario; and (c) the average per-passenger spending of cruise passengers visiting Hong Kong was short of the spending assumed in the economic model (paras. 2.7, 2.8 and 2.10 to 2.12).

4. *Driving ship calls to Hong Kong.* To develop Hong Kong into a leading regional cruise hub, one of the strategies adopted by the TC is to drive more ship calls to Hong Kong. The utilisation rates of the KTCT during the peak seasons (i.e. January to March and October to December) of 2014 to 2016 were 18.1%, 22.5% and 38.3% respectively. Audit noted that the KTCT had the capacity to receive more cruise vessels even at the peak seasons. For the peak seasons of 2015 and 2016, the total number of days when both berths were utilised were only 5 and 14 respectively (paras. 2.17 to 2.19).

Monitoring performance of terminal operator

5. ***Vibrancy of the KTCT.*** The TA stipulates that the terminal operator shall use its best endeavours to keep the ancillary commercial area fully let or occupied. Audit noted that, as at 1 March 2017, of the 5,601 m² of ancillary commercial area, 2,695 m² (48.1%) was let and open for business. The remaining 2,906 m² (51.9%) was not open for business. Of the 2,906 m², the sub-tenancy of 2,196 m² (39.2%) was terminated and was under legal proceedings, 355 m² (6.3%) had not been leased out, and 355 m² (6.3%) was leased out in January 2017 for the first time and was currently under renovation. Audit visited the KTCT on three ship call days on 4 November 2016, 6 December 2016 and 17 January 2017, and found that the visitor traffic to the ancillary commercial area was not high. The TC informed LegCo in November 2014 that the KTCT was also used as an event venue during non-cruise days with a view to better utilising the terminal facilities and increasing number of visitors. In the period from its commissioning in June 2013 to December 2016, 38 non-cruise events (involving 67 event days and 85 days for setting up and dismantling) were held at the KTCT. The TC needs to continue to urge the terminal operator to promote the use of the KTCT as a venue for non-cruise events with a view to bringing more visitors to the KTCT (paras. 3.6, 3.7 and 3.11 to 3.13).

6. ***Performance monitoring of the terminal operator.*** The TC monitors the performance of the terminal operator through a set of service pledges and performance indicators specified in the TA. The TA stipulates that the terminal operator shall propose the service pledges for the approval of the TC, publish the approved service pledges within one month prior to the commencement date of the business, and prepare a report on compliance with the service pledges annually within two months after the end of each calendar year. Audit found that the service pledges had not been approved. The terminal operator had not published the service pledges until January 2017 and had not submitted annual reports on compliance with the service pledges for 2013, 2014 and 2015 until 30 December 2016. Furthermore, Audit reviewed the existing service pledges and found room for improvement. The TC may consider expanding the coverage of the service pledges to include, for example, satisfaction of cruise passengers, embarkation and disembarkation arrangements for turnaround call passengers, and baggage handling process. Service pledges should be reviewed periodically to ensure that they are challenging. The terminal operator had met and exceeded all the service pledges since 2013. For instance, one of the service pledges is that disembarking port-of-call passengers should spend less than 20 minutes to traverse the distance

Executive Summary

from shipside to kerbside, but the actual time spent by passengers in 2013 to 2015 was only 4.5 minutes. Audit also found that the terminal operator had not fulfilled four TA requirements related to market consultation forum, operation and maintenance reports submission, written report on ancillary commercial area submission and information dissemination on website (paras. 3.16 to 3.18 and 3.20 to 3.22).

Administrative issues

7. *Transport connectivity.* Audit found that there was room for improvement for transport connectivity. The number of malls providing free shuttle bus services connecting the KTCT to the malls near Mass Transit Railway stations in Kowloon East had decreased from three in 2013 to two in 2015. It was likely that the free shuttle bus service provided by a mall in Diamond Hill might not be able to sustain in the long run. The franchised buses departing from the KTCT with stops at Mass Transit Railway Ngau Tau Kok Station and Kwun Tong were not equipped with luggage storage facilities and the patronage was not high. Audit made a site visit to the KTCT on 17 January 2017 and observed that while there were a large number of cruise passengers waiting for taxi, there were also many taxis waiting for passengers at the taxi queuing spaces. Only 6 of the 18 taxi pick-up points were available for boarding. The TC needs to review whether more pick-up points can be made available during peak hours. Under the TA, the terminal operator is required to submit a traffic management plan to the Government for approval. The terminal operator informed the TC that prior to the opening of the second berth, the traffic management plan would be updated. However, the terminal operator had not submitted the updated traffic management plan for the TC's approval until 27 February 2017 (paras. 4.3, 4.4 and 4.6).

8. *Usage of KTCT facilities.* There is a video wall (measuring 60 metres by 3.7 metres) installed on the external wall of the terminal building for displaying messages and advertisements. Since the commissioning of the KTCT in 2013, the video wall has not been let out and has not generated any income. Moreover, Audit conducted site visits on 4 November 2016 and 17 January 2017 and found that the video wall was not functioning properly. Two plant rooms (occupying a total area of 1,100 m²) are reserved at the KTCT for setting up the on-shore power supply system. In June 2015, the installation of the system was put on hold. The plant rooms have been used temporarily by the EMSTF since 2015. There is a need to review the optimal use of the two rooms (paras. 4.11 to 4.15).

Executive Summary

9. ***Monitoring performance of contractor on facility management services.***

According to the contracts, the TC may carry out joint site inspections with the contractor to inspect the quality of services provided. Audit noted that no joint site inspections were carried out under the first contract. The first joint site inspection under the current contract (commencing June 2015) was carried out in February 2016. Audit review of the joint site inspection records revealed that during the inspections, only the attendance of contractor staff was checked instead of the quality of services. Furthermore, the TC had not issued any guidelines or checklists for site inspections to ensure that the site inspections are carried out effectively and consistently to monitor the quality of the services provided by the contractor (para. 4.22).

10. ***Maintenance of KTCT facilities.*** The TC and the EMSTF signed a service level agreement for ten years from 1 June 2013. According to the agreement, the EMSTF is required to submit half-yearly performance reports on the actual performance of the engineering systems compared with the specified targets. However, the EMSTF had only submitted five reports for the seven half-yearly periods from 1 June 2013 to 31 December 2016. There were 256 maintenance cases reported to the Architectural Services Department and the EMSTF during the period from January 2015 to December 2016 relating to water leakage/seepage, representing 22% of all maintenance cases. Audit analysed 83 water leakage/seepage cases reported by the terminal operator in 2016 and noted that 67 locations were involved. For 12 of the 67 locations, water leakage/seepage occurred more than once and for 3 of the 12 locations, water leakage/seepage occurred more than twice. Audit analysed the 98 fault cases of lifts/escalators reported in 2015 and 2016 and noted that fault cases had been reported for 21 (27%) of the 78 lifts/escalators, although many were caused by improper operation. Of the 78 lifts/escalators, 7 (9%) had fault cases more than 5 times. One of them had fault cases 17 times during the period (paras. 4.25 to 4.27 and 4.29 to 4.31).

11. ***Attendance at ACCI meetings.*** The ACCI advises the Government on measures to enhance the development of Hong Kong as a regional cruise hub. Audit examination of the attendance records up to February 2017 of the 12 current ACCI members during their tenures revealed that the attendance rates of some members were on the low side. Three members had average attendance rates below 50%. Audit also noted that the two members with the lowest attendance rates had each been reappointed twice despite their low attendance rates in their previous terms (paras. 4.36 to 4.38).

Executive Summary

12. ***Strategic planning.*** A structured strategic planning process could be a useful means of soliciting advice and securing support from key stakeholders in the cruise and tourism industry. From time to time, the TC analysed the situations of the cruise industry and the possible strategic directions for developing Hong Kong into a leading regional cruise hub. There is merit for the TC to produce a document in the form of a Strategic Plan, incorporating all the elements of strategic planning (paras. 4.43 and 4.44).

Audit recommendations

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

Developing Hong Kong into a leading regional cruise hub

- (a) **as soon as the KTCT has gathered sufficient operational experience, conduct a mid-term assessment on the progress made by the cruise industry in achieving the expected economic benefits and the prospect of realising the expected benefits by 2023 (para. 2.15(a));**
- (b) **take further measures to drive more ship calls to the KTCT (para. 2.20(a));**

Monitoring performance of terminal operator

- (c) **urge the terminal operator to continue its efforts to lease out the unlet ancillary commercial area at the KTCT (para. 3.14(a));**
- (d) **continue to urge the terminal operator to promote the use of the KTCT as a venue for non-cruise events (para. 3.14(d));**
- (e) **ensure that the service pledges on the performance of the terminal operator are approved by the TC (para. 3.23(a));**

Executive Summary

- (f) ensure that the terminal operator complies with all the requirements under the TA (para. 3.23(b));
- (g) ensure that comprehensive service pledges covering all major areas of operation and management of the KTCT are set to facilitate the monitoring of the performance of the terminal operator (para. 3.23(c));
- (h) review the service pledges on the performance of the terminal operator periodically to ensure that they are meaningful, challenging and achievable (para. 3.23(d));

Administrative issues

- (i) in collaboration with the terminal operator, continue to critically review the overall transport arrangement to ensure that effective and efficient transport services are provided (para. 4.8(g));
- (j) ensure that the traffic management plan is updated regularly by the terminal operator and is approved by the TC (para. 4.8(f));
- (k) urge the terminal operator to endeavour to let out the video wall (para. 4.16(a));
- (l) monitor the proper functioning of the video wall regularly and ensure that repair work for the video wall is carried out in a timely manner (para. 4.16(c));
- (m) review whether the current temporary use of the two spare on-shore power supply system plant rooms by the EMSTF represents the optimal use (para. 4.16(d));
- (n) ensure that joint site inspections are carried out in a way that is effective in monitoring the quality of the services provided by the contractor (para. 4.23(c));

Executive Summary

- (o) ensure that the EMSTF submits half-yearly performance reports in a timely manner, and include in the reports the actual performance (para. 4.32(a));
- (p) in collaboration with the Architectural Services Department, take effective measures to address the water leakage and seepage problem (para. 4.32(b));
- (q) in collaboration with the EMSTF, take effective measures to address the problem of lifts/escalators fault cases (para. 4.32(d));
- (r) take measures to improve the attendance rates of ACCI members with low attendance records and in future give due consideration to the attendance records of members when considering their reappointments (para. 4.40);
- (s) develop a Strategic Plan incorporating elements such as strategic objectives, strategic directions and strategic actions (para. 4.45(b)); and
- (t) review and update the Strategic Plan periodically to take into account changes in the cruise industry (para. 4.45(c)).

Response from the Government

14. The Government 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 The development of a new cruise terminal in Hong Kong was first mooted in 1999. Studies commissioned by the Tourism Commission (TC) and the Hong Kong Tourism Board (HKTB) in the 2000's found that:

- (a) the cruise industry was one of the fastest growing segments of the worldwide travel and leisure industry;
- (b) Hong Kong was well placed to become a regional cruise hub because of its world-class infrastructure and tourism facilities; and
- (c) the berthing facilities at the Ocean Terminal were inadequate to meet the growing demand, in particular during peak seasons and in accommodating cruise vessels with displacement tonnage over 50,000, which could not be berthed at the Ocean Terminal because of their sizes.

The studies concluded that Hong Kong would require an additional berth between 2009 and 2015, and one to two further berths beyond 2015 to sustain its development as a regional cruise hub.

1.3 In October 2006, the Government informed the Legislative Council (LegCo) that:

- (a) the Government was committed to developing Hong Kong into a regional cruise hub;
- (b) a new cruise terminal would be developed on the 7.6 hectares of land at the southern end of the former runway at Kai Tak Development through an open land tender;

Introduction

- (c) the new cruise terminal facilities would be important for Hong Kong to capture the growth of the cruise industry in the Asia Pacific Region, and sustain its development as a regional cruise hub; and
- (d) with the availability of the new cruise terminal facilities and appropriate marketing strategies, it was estimated in a consultancy study commissioned by the Government that under different growth scenarios, the economic benefits would be \$1.4 billion to \$2.2 billion per annum by 2020, and some 6,900 to 10,900 employment opportunities would be generated by 2020.

1.4 In November 2007, the Government issued an open land tender requiring that the successful tenderer would, at its own cost, form the site as well as design, build and operate the berths, ancillary facilities and commercial areas of the new cruise terminal. Since none of the tender submissions fully conformed with the tender requirements, the Government subsequently cancelled the tender.

1.5 On the grounds that the requirement for the successful tenderer to fund the site formation works, the Government facilities and the landscaped deck would undermine the business viability of the project, the Government decided in September 2008 to fund, design and build the new cruise terminal and lease it to a terminal operator after completion.

1.6 In November 2009, the Finance Committee (FC) of LegCo approved the site formation works for the new cruise terminal at Kai Tak at an estimated cost of \$2,304 million. The FC further approved in April 2010 the construction of the cruise terminal building and ancillary facilities at an estimated cost of \$5,852 million. In October 2012, the new cruise terminal development was officially named Kai Tak Cruise Terminal (KTCT — see Photograph 1). The terminal building and the first berth commenced operation in June 2013. The second berth commenced operation in September 2014. To accommodate the world's largest cruise vessels in both berths simultaneously, further dredging works for the second berth commenced in March 2015 and were completed in December 2015. As at 28 February 2017, the total actual project expenditure of the KTCT was \$6,613 million (see Table 1), and the actual recurrent expenditure for 2015-16 was about \$130 million.

Photograph 1

KTCT



Source: TC records

Table 1

Development and construction costs of the KTCT
(28 February 2017)

Works	Date of FC approval	Approved expenditure (\$ million)	Actual expenditure (\$ million)
Site formation	20 November 2009	2,304	1,360
Cruise terminal building and ancillary facilities	30 April 2010	5,852	5,253
Total		8,156	6,613

Source: TC records

Remarks: As at 28 February 2017, the project accounts for the site formation works and the cruise terminal building and ancillary facilities works had not been finalised pending the completion of settlement of claims and variation orders.

Introduction

Facilities at the KTCT

1.7 The KTCT has a total floor area of 188,952 square metres (m²) shared among the following facilities:

Managed by the terminal operator (120,402 m²)

- (a) ***Apron area (28,263 m²)***. The apron area (see Photograph 2) is part of the berthing facilities to facilitate embarkation and disembarkation of cruise passengers, loading and unloading of cruise supplies and provision, and provision of other supporting services. Facilities installed thereon include passenger boarding bridges, apron lighting system, on-shore fresh water supply and on-shore sewage collection systems. Two plant rooms are reserved for installation of on-shore power supply system;

Photograph 2

Apron area



Source: Photograph taken by Audit Commission on 4 November 2016

- (b) ***Terminal operation area (30,685 m²).*** The terminal operation area (see Photograph 3) accommodates the supporting facilities such as security screening, baggage handling, ticketing, check-in, passenger waiting and queuing areas, and concourse;

Photograph 3

Passenger waiting area at terminal operation area



Source: TC records

Introduction

- (c) *Ancillary commercial area (5,601 m²).* Facilities at the ancillary commercial area (see Photograph 4) are retail shops, a money exchange shop, the visitor information services counter of the HKTB, and a Chinese restaurant and other eateries;

Photograph 4

An eatery at the ancillary commercial area

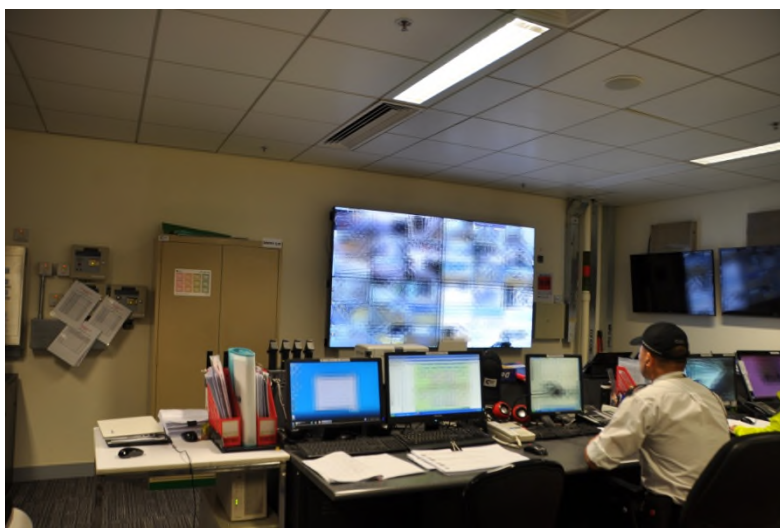


Source: Photograph taken by Audit Commission on 4 November 2016

- (d) *Ancillary office area (843 m²).* The ancillary office area (see Photograph 5) is used for office ancillary to cruise terminal operation, security operations centres, maintenance office, stevedores' offices and equipment room;

Photograph 5

Office of the terminal operator at ancillary office area



Source: Photograph taken by Audit Commission on 4 November 2016

Introduction

- (e) *Transportation area (50,215 m²).* The transportation area (see Photograph 6) includes the driveways, spaces for circulation and queuing, as well as pick-up and drop-off areas for various types of vehicles;

Photograph 6

Waiting area for taxi at transportation area



Source: Photograph taken by Audit Commission on 4 November 2016

- (f) ***Parking area (4,795 m²).*** There are 132 parking spaces and 11 loading/unloading spaces in the parking area (see Photograph 7);

Photograph 7

Parking spaces at parking area



Source: TC records

Introduction

Managed by the Government (68,550 m²)

- (g) ***Communal area (36,570 m²).*** The communal area mainly comprises space for the public and for circulation (e.g. podium gardens (see Photograph 8), public colonnade, etc.);

Photograph 8

Communal area



Source: TC records

- (h) ***Government offices (8,980 m²).*** They include the Customs, Immigration, Quarantine and Police facilities (see Photograph 9) for the cruise terminal operation and the offices of the Immigration Department, the Customs and Excise Department, the Hong Kong Police Force, the Department of Health, the Marine Department and the Leisure and Cultural Services Department (LCSD); and

Photograph 9

Office of Department of Health for body temperature check



Source: Photograph taken by Audit Commission on 4 November 2016

Introduction

- (i) ***KTCT Park (23,000 m²).*** The KTCT Park (see Photograph 10) is a landscaped deck with passive amenities. It is located on the roof of the terminal building. The KTCT Park is managed by the LCSD. It is equipped with various amenity facilities including a central lawn, a viewing platform, a water garden and a fountain plaza.

Photograph 10

KTCT Park



Source: Photograph taken by Audit Commission on 4 November 2016

Operation and management of the KTCT

1.8 The Government originally planned to adopt a design, build and operate approach for the development of the KTCT. Under this approach, the successful tenderer was expected to design, build and operate the new cruise terminal for 50 years. However, on the grounds that this would undermine the business viability of the project, the Government decided in September 2008 to fund, design and build the new cruise terminal and lease it to a terminal operator after completion (see paras. 1.4 and 1.5).

1.9 In March 2012, the Government awarded a ten-year Tenancy Agreement (TA) to a terminal operator through an open tender. About 70% of the area of the KTCT (Note 1) has been leased to the terminal operator for operation and management for ten years commencing in June 2013. Under the TA, the Government has the rights to extend the tenancy for another five years, subject to the operator's satisfactory performance, and to terminate the TA for any breach or non-performance of the tenancy. The terminal operator is required to pay a fixed rent of \$13 million for the ten-year operation and a variable rent (ranging from 7.3% to 34% of the annual gross receipts of the operator — see Appendix A). For the period from June 2014 to May 2015 and June 2015 to May 2016, the total rental income from the KTCT was \$4.6 million and \$9.6 million respectively. The Government monitors the performance of the terminal operator through, among others, a set of service pledges. A Management Committee, comprising representatives from the Government (Note 2) and the terminal operator, was established to monitor the performance of the operator.

1.10 The remaining 30% of the area (see para. 1.7(g) and (h)) of the KTCT comprises communal areas and government offices that are not leased to the terminal operator. The facility management services for the communal areas (see para. 1.7(g)) and government offices (see para. 1.7(h)) are outsourced to a contractor. Operation and maintenance services for certain electrical and mechanical systems and equipment in various parts of the KTCT are provided by the Electrical and Mechanical Services Trading Fund (EMSTF). The KTCT Park (see para. 1.7(i)) is under the purview of the LCSD.

Note 1: *The total area leased to the terminal operator was 120,402 m² (see para. 1.7(a) to (f)), around 70% of the total area of the KTCT, excluding the KTCT Park which is under the management of the LCSD (i.e. 165,952 m² (188,952 m² - 23,000 m²)).*

Note 2: *The representatives from the Government are those from the TC, Customs and Excise Department, Department of Health, Hong Kong Police Force, Immigration Department, Marine Department, LCSD, Transport Department, Architectural Services Department, Civil Engineering and Development Department and Electrical and Mechanical Services Department.*

Introduction

Tourism Commission

1.11 The TC was established in May 1999. It is under the Commerce, Industry and Tourism Branch of the Commerce and Economic Development Bureau. The Controlling Officer for the expenditure of the TC is the Permanent Secretary for Commerce and Economic Development (Commerce, Industry and Tourism). The TC is headed by the Commissioner for Tourism, who is tasked to map out the Government's tourism development policy and strategy, to provide a focal point for liaison with the tourism industry and to enhance coordination in developing tourism. The Cruise Team (Note 3) of the TC, headed by an Assistant Commissioner for Tourism, is responsible for monitoring the operation of the KTCT and works closely with the Advisory Committee on Cruise Industry (ACCI — see para. 1.12) in developing Hong Kong into a leading regional cruise hub. An organisation chart of the Cruise Team of the TC as at 31 December 2016 is shown at Appendix B.

ACCI

1.12 The ACCI was established in January 2008 to advise the Government on measures to enhance the development of Hong Kong as a regional cruise hub. Members of the ACCI are appointed by the Secretary for Commerce and Economic Development. The membership of the ACCI for 2016-18 comprises the Commissioner for Tourism as the Chairman and 12 members from the cruise market, tourism industry and the HKTb. The ACCI defined its matters of priorities as:

- (a) developing cruise tourism in Hong Kong and the region;
- (b) fostering cooperation with neighbouring coastal ports in the Mainland and in Asia for cruise itinerary development;
- (c) driving market demand for cruise tourism and expanding Hong Kong's cruise passenger source markets; and
- (d) enhancing manpower supply to cater for the needs of the cruise market.

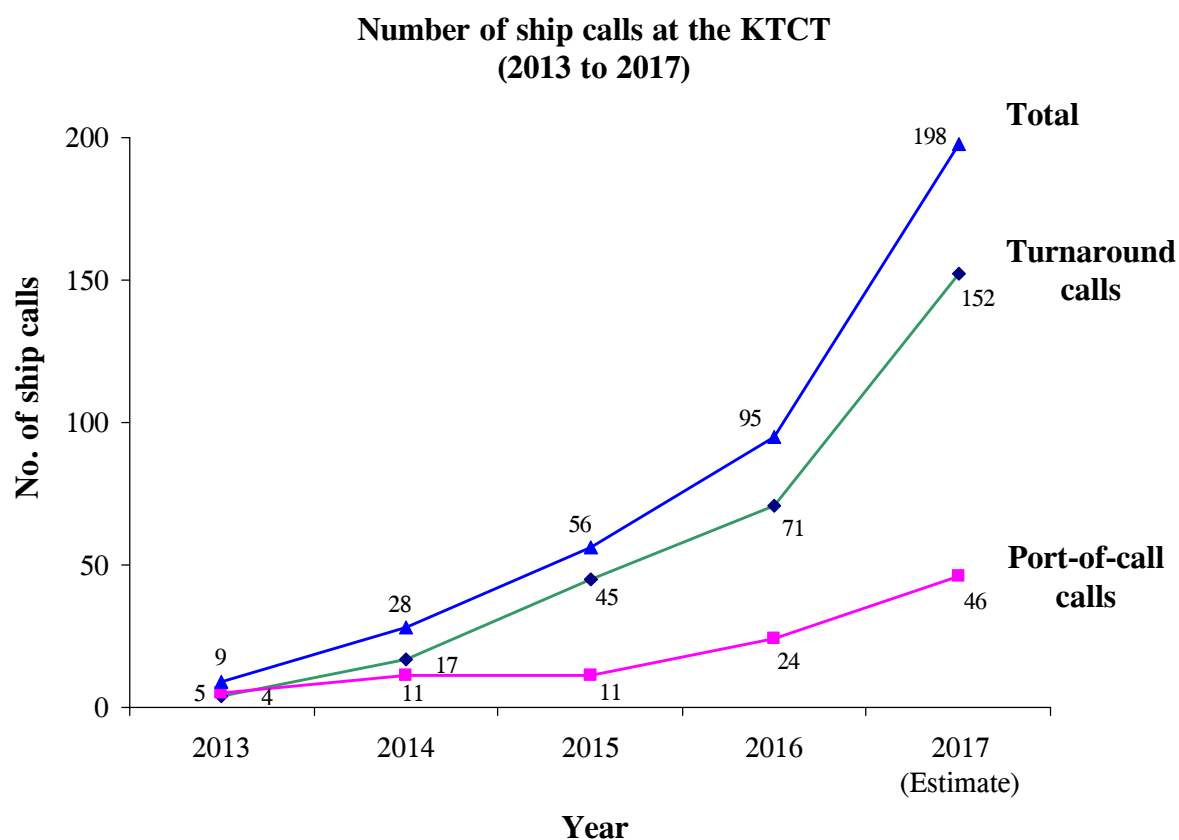
Note 3: *As at 31 December 2016, the Cruise Team of the TC had a staff establishment of 11 (9 civil service posts and 2 non-civil service contract posts). In 2015-16, the recurrent expenditure (including costs of maintenance of electrical and mechanical facilities of the terminal, property management services for communal areas, public utility charges and staff cost) incurred by the TC relating to the KTCT was \$71 million.*

Utilisation of the KTCT

1.13 Figure 1 and Figure 2 show the number of ship calls (Note 4) and the passenger throughput of the KTCT in the period from the commencement of operation in June 2013 to December 2016. In its first full year of operation in 2014, the KTCT received 28 ship calls involving 48 days of operation and passenger throughput of 130,608. The number of ship calls increased to 95 involving 105 days of operation and passenger throughput of 424,868 in 2016. According to the latest booking situation (as at 8 February 2017), the number of ship calls in 2017 is estimated to be 198 (an increase of 108% over 2016), involving 158 days of operation (an increase of 50% over 2016).

Note 4: *The number of ship calls is the sum of the number of turnaround calls and that of port-of-call calls. A turnaround port is the port where a cruise begins and/or ends. For turnaround calls with cruise itineraries that begin and end at Hong Kong, they are also homeport calls at Hong Kong. A port-of-call is one of the several intermediate ports visited by a cruise for a period from a few hours to a few days.*

Figure 1

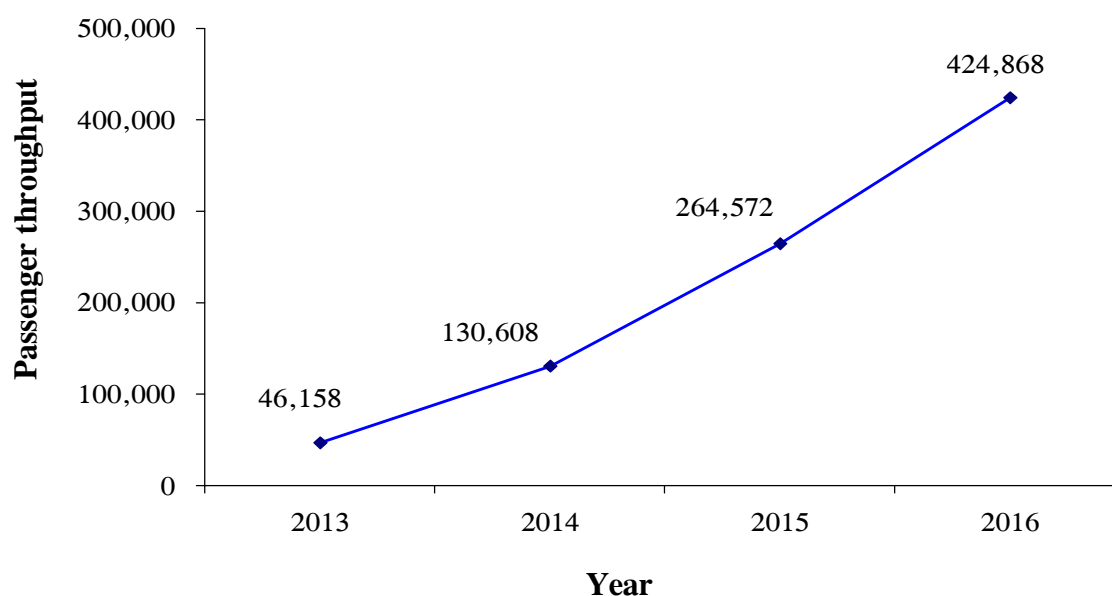


Source: TC records

- Remarks:
1. The KTCT commenced its operation in June 2013.
 2. The number of ship calls for 2017 is based on the booking situation as at 8 February 2017.
 3. The total number of ship calls for Hong Kong (including the other cruise terminal in Tsim Sha Tsui) were 89, 140, 142 and 191 for the period from 2013 to 2016. The estimated number for 2017 is not available.

Figure 2

**Passenger throughput of the KTCT
(2013 to 2016)**



Source: TC records

Remarks: 1. The KTCT commenced its operation in June 2013.

2. The total passenger throughput for Hong Kong (including the other cruise terminal in Tsim Sha Tsui) were 191,062, 366,981, 452,768 and 677,031 for the period from 2013 to 2016.

Audit review

1.14 In October 2016, the Audit Commission (Audit) commenced a review of the KTCT. The audit has focused on the following areas:

- (a) developing Hong Kong into a leading regional cruise hub (PART 2);
- (b) monitoring performance of terminal operator (PART 3); and
- (c) administrative issues (PART 4).

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 co-operation of the staff of the TC during the course of the audit review.

PART 2: DEVELOPING HONG KONG INTO A LEADING REGIONAL CRUISE HUB

2.1 This PART examines the progress of developing Hong Kong into a leading regional cruise hub, focusing on the following areas:

- (a) achievement of expected economic benefits brought by the cruise industry (paras. 2.7 to 2.16); and
- (b) driving ship calls to Hong Kong (paras. 2.17 to 2.21).

The cruise industry is changing rapidly

2.2 *The cruise industry in Asia is growing rapidly.* According to the studies published in 2014 and 2016 by an international cruise trade association:

- (a) the cruise passenger capacity in Asia increased by 78% from 1.81 million in 2014 to 3.23 million in 2016;
- (b) the number of Asian cruise calls increased by 46% from 3,814 in 2014 to 5,570 in 2016; and
- (c) Hong Kong had benefited from the growing cruise market. The number of ship calls to Hong Kong had increased by 36% from 140 in 2014 to 191 in 2016, while the passenger throughput in Hong Kong had increased by 23% from 366,981 in 2014 to 452,768 in 2015 (see Tables 2 and 3).

Developing Hong Kong into a leading regional cruise hub

Table 2

**Number of ship calls to Hong Kong and
major neighbouring ports in Asia
(2014 and 2016)**

Port	2014 (No.)	2016 (No.)	Increase (%)
Jeju	218	460	111.0%
Baoshan, Shanghai	254	437	72.0%
Hong Kong	140	191	36.4%
Kee Lung	147	199	35.4%
Singapore	335	391	16.7%

Source: Cruise Lines International Association 2014 Asia Cruise Trends Report, Cruise Lines International Association 2016 Asia Cruise Trends Report and TC records

Table 3

**Passenger throughput of Hong Kong and
major neighbouring ports in Asia
(2014 and 2015)**

Port	2014 (No.)	2015 (No.)	Increase (%)
Baoshan, Shanghai	1,110,000	1,500,000	35.1%
Kee Lung	448,839	558,080	24.3%
Hong Kong	366,981	452,768	23.4%
Singapore	890,000	1,017,048	14.3%
Jeju	590,400	622,068	5.4%

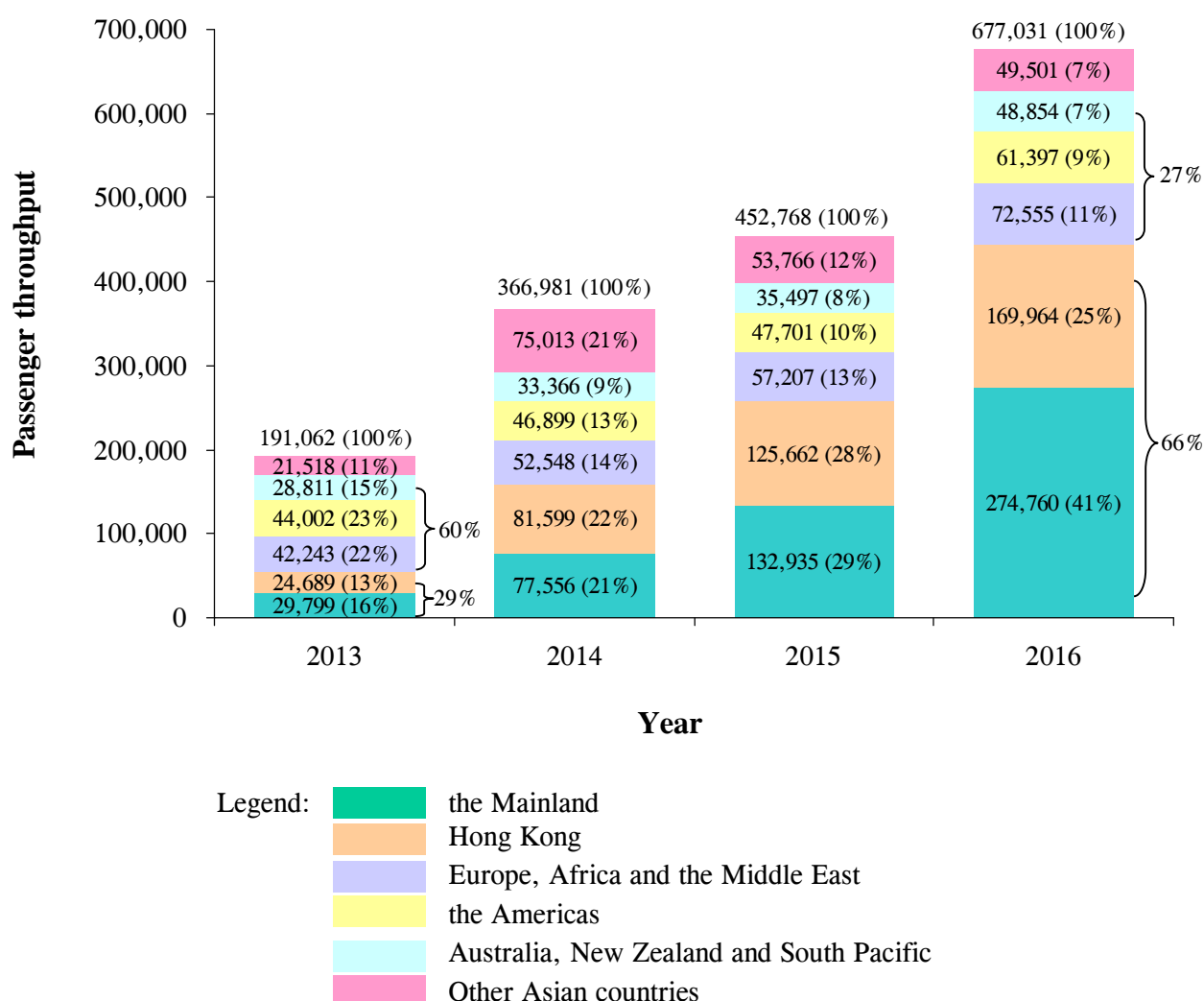
Source: Cruise Industry News 2016-17 Annual Report and TC records

Remarks: Passenger throughput for 2016 was not available for the ports other than Hong Kong. The 2016 passenger throughput for Hong Kong was 677,031 (a 50% increase over 2015 passenger throughput).

2.3 **Changing passenger mix.** Audit noted that since the commissioning of the KTCT in 2013, while the total number of cruise passenger throughput in Hong Kong had increased by 254% from 191,062 in 2013 to 677,031 in 2016, the mix of cruise passengers visiting Hong Kong had changed significantly. For instance, in 2013, 29% of the cruise passengers were from the Mainland and Hong Kong. The percentage increased to 66% in 2016 (see Figure 3). In the same period, the share of passengers from Europe, Africa and the Middle East, the Americas, Australia, New Zealand and South Pacific decreased from 60% to 27%, although the total number of passengers from these areas had increased from 115,056 in 2013 to 182,806 in 2016.

Figure 3

**Analysis of mix of cruise passenger throughput in Hong Kong
(2013 to 2016)**



Source: Audit analysis of TC records

Developing Hong Kong into a leading regional cruise hub

2.4 *Turnaround port/port-of-call consideration.* The findings of a study conducted by the Research Office of LegCo in 2015 indicated that:

- (a) Hong Kong appeared to be more popular as a turnaround port for a round-trip itinerary to Taiwan, and as a turnaround port for a cruise trip departing from Hong Kong to Vietnam, Thailand and Singapore;
- (b) for longer itineraries with more visit points from Southeast Asia to Northeast Asia (or vice versa), Hong Kong was more likely a port-of-call visited by cruise passengers; and
- (c) a well-developed cruise turnaround port should be equipped with dedicated infrastructures and facilities and easily accessible to an international airport. A port-of-call would require passenger-friendly land transportation.

The positioning of Hong Kong as turnaround port or port-of-call is important for the future development of ancillary and supporting facilities at the KTCT and for the formulation of strategies for developing Hong Kong into a leading regional cruise hub. Audit analysed the number of ship calls at the KTCT in the period from 2014 to 2017 (see Table 4) and noted that the majority of ship calls were turnaround calls. In 2016, 75% of ship calls at the KTCT were turnaround calls while 25% were port-of-calls.

Table 4

**Analysis of ship calls at KTCT
(2014 to 2017)**

Ship call	2014 (No.)	2015 (No.)	2016 (No.)	2017 (Estimate) (No.)
Turnaround	17 (61%)	45 (80%)	71 (75%)	152 (77%)
Port-of-call	11 (39%)	11 (20%)	24 (25%)	46 (23%)
Total	28 (100%)	56 (100%)	95 (100%)	198 (100%)

Source: Audit analysis of TC records

2.5 *Developments of new cruise terminal facilities at neighbouring ports.*

There have been recent developments of new cruise terminal facilities at neighbouring ports. In particular, the cruise terminal at Shenzhen Shekou Port commenced operation in November 2016, and the Guangzhou Nansha Port is undergoing expansion with the construction of two new berths with target completion in 2019. While these neighbouring ports will pose competition to the terminal facilities in Hong Kong, they may give rise to the development of new itineraries and attract more cruise passengers to Hong Kong.

2.6 *Recent promotion efforts.* Audit noted that the Government and the HKTb had made various efforts to promote the cruise industry of Hong Kong. For instance:

- (a) in 2014, with the funding support of the Government, the HKTb and the tourism authority of Taiwan set up the Asia Cruise Fund to promote co-operation among ports in the region; and
- (b) in 2015, with a view to diversifying the source markets of the cruise industry, the Government allocated \$10 million to the HKTb in the 2016-17 Budget for launching the “fly-cruise” initiative. In 2017, to further support the development of the cruise industry, the Government has allocated \$16 million to the HKTb to implement a series of initiatives. These include the continuation of “fly-cruise”, and new initiatives to cultivate source markets in Southern China and encourage development of on-shore excursion products.

Achievement of expected economic benefits brought by the cruise industry

2.7 At the meeting of LegCo Panel on Economic Development held in October 2008 regarding the Government’s plan to fund, design and build a new cruise terminal at Kai Tak, members asked for details of the economic benefits brought by the cruise industry. In response, the Government informed the Panel in November 2008 that the economic benefits to be brought by the cruise industry would range from \$859 million to \$1.1 billion per annum by 2013 and \$1.5 billion to \$2.5 billion per annum by 2016. In November 2009 and April 2010, the Government informed the FC in the funding applications for the development of the KTCT that with the availability of the new cruise terminal facilities and appropriate

Developing Hong Kong into a leading regional cruise hub

market strategies, the economic benefits to be brought by the cruise industry under different growth scenarios would range from \$1.5 billion to \$2.6 billion per annum and around 5,300 to 8,900 additional jobs would be generated by 2023.

2.8 According to the TC, the economic benefits under different growth scenarios to be brought by the cruise industry were estimated by an economic model taking into account various factors, including:

- (a) estimated number of ship calls and passenger throughput; and
- (b) estimated spending by cruise passengers and cruise operators, and the multiplier effect on the spending (Note 5).

Table 5 shows the estimated economic benefits brought by the cruise industry and the related assumptions.

Note 5: *The multiplier effect refers to the effect in economics in which an increase in spending may produce an increase in national income and consumption greater than the initial amount spent. For example, money spent by a tourist in a hotel creates jobs directly in that hotel and also creates jobs indirectly elsewhere in the economy. The total benefits to the economy so generated, in terms of value added to the economy, may be greater than the initial value added that the sum spent by the tourist brought to the economy.*

Table 5

**Estimated economic benefits to be brought by
the cruise industry and the related assumptions
(2013, 2016 and 2023)**

Year	Average spending per passenger (\$)	Low growth scenario			High growth scenario		
		Ship calls (No.)	Passenger throughput (No.)	Economic benefits (\$ million)	Ship calls (No.)	Passenger throughput (No.)	Economic benefits (\$ million)
2013	1,712 to 20,155 (Note)	162	387,800	859	175	522,480	1,094
2016		201	541,702	1,462	278	1,018,630	2,537
2023		181	564,102	1,517	258	1,041,031	2,562

Source: TC records

Note: The range represented the average spending of different categories of passengers. The turnaround call international passengers had the highest average spending of \$20,155. Their spending included \$7,860 for cruise package. The port-of-call international passengers had the lowest average spending of \$1,712. They had no spending on cruise package because they bought their packages not in Hong Kong.

Need to monitor expected economic benefits

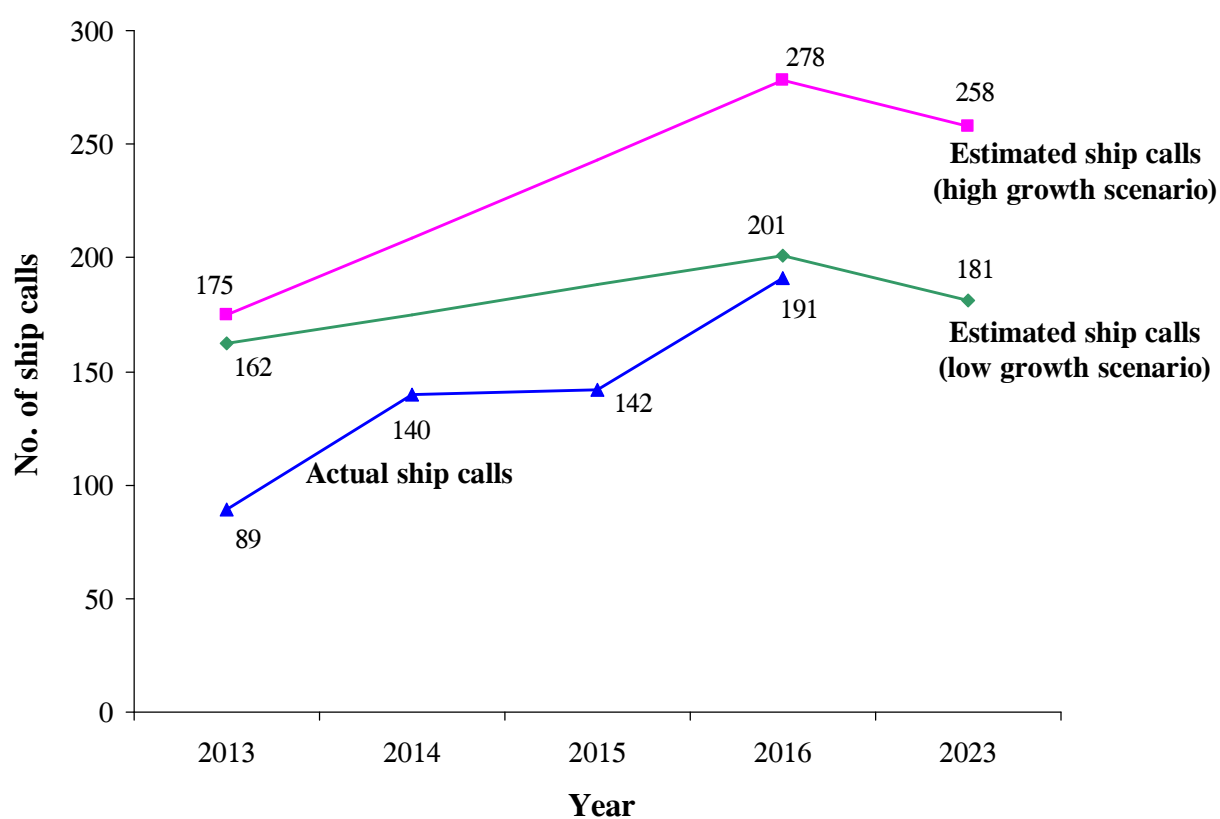
2.9 To support the funding applications for the development of the KTCT, the Government informed the FC that the development of the KTCT was critical to the development of Hong Kong into a leading cruise hub in the region thereby capturing economic benefits from the cruise industry. Audit noted that the Government had monitored and reported to LegCo from time to time some of the key parameters of the economic model, namely the number of ship calls, passenger throughput and passenger spending. So far, the TC had not assessed the progress made in achieving the projected economic benefits and the prospect of realising the expected benefits in the years to come. The assessment would require information on passenger spending and the multiplier effect of their spending.

Developing Hong Kong into a leading regional cruise hub

2.10 To ascertain the progress made in achieving the expected economic benefits, Audit compared the actual number of ship calls and passenger throughput with the estimated figures used by the consultant in making the estimation (see Table 5 in para. 2.8). The results are shown in Figure 4 and Figure 5.

Figure 4

Estimated and actual ship calls to Hong Kong (2013 to 2023)

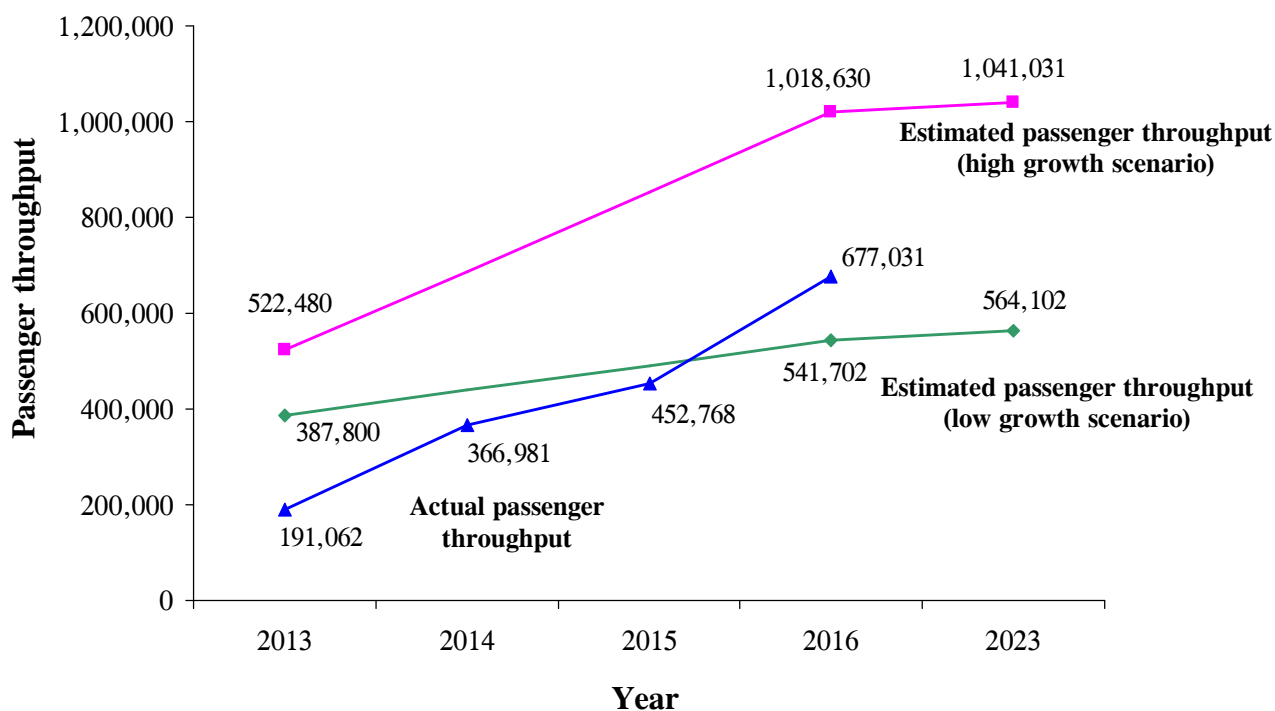


Source: Audit analysis of TC records

Remarks: The KTCT commenced its operation in June 2013.

Figure 5

**Estimated and actual passenger throughput in Hong Kong
(2013 to 2023)**



Source: Audit analysis of TC records

Remarks: The KTCT commenced its operation in June 2013.

2.11 Figures 4 and 5 show that:

- (a) the actual number of ship calls showed a growing trend. However, the number of ship calls of 191 in 2016 was 5% and 31.3% lower than the estimated numbers under the low and high growth scenarios respectively. According to the TC, the average passenger carrying capacity of the cruise ships berthed at the KTCT in 2016 was larger than the capacity used in the economic model; and
- (b) the actual passenger throughput showed a growing trend. The actual passenger throughput of 677,031 in 2016 was within the projected range. It was higher than the estimated throughput of 541,702 under the low

Developing Hong Kong into a leading regional cruise hub

growth scenario by 135,329 (25%) and was lower than the estimate of 1,018,630 under the high growth scenario by 341,599 (33.5%).

2.12 In the economic model used by the Government in making the estimates of expected economic benefits, it was assumed that the average spending of different categories of passengers (excluding cruise packages) ranged from \$1,712 to \$12,295 (\$20,155 – \$7,860 = \$12,295) (see Note to Table 5 in para. 2.8). Audit examination of the TC records revealed that the average per-passenger spending of cruise passengers visiting Hong Kong was short of the spending assumed in the economic model. The average per-passenger spending of cruise vessels using Hong Kong as their turnaround port decreased by 37% from \$4,699 in 2013 to \$2,950 in 2015, whilst the average per-passenger spending of cruise vessels using Hong Kong as a port-of-call increased slightly by 3% (see Table 6).

Table 6

**Comparison of average spending of cruise passengers
and the related assumptions in the economic model
(2013 to 2015)**

Ship call	Average spending of cruise passenger assumed in the economic model (a) (\$)	Average spending of cruise passenger			
		2013 (b) (\$)	2014 (c) (\$)	2015 (d) (\$)	Increase (+) /Decrease (–) from 2013 to 2015 (e) = (d) – (b) (\$)
Turnaround	6,985 to 12,295	4,699	3,480	2,950	-1,749 (-37%)
Port-of-call	1,712	1,545	1,312	1,597	+52 (+3%)

Source: Audit analysis of TC records

Remarks: According to the TC, the amounts in this Table did not include the spending on cruise packages.

2.13 In response to Audit's enquiry, the TC informed Audit in March 2017 that:

- (a) the TC monitored the progress made in achieving the projected economic benefits by 2023 by monitoring three of the four key parameters for the economic model of the cruise industry in Hong Kong very closely, namely the number of ship calls, passenger throughput and passenger spending. The TC had reported to LegCo the number of ship calls and passenger throughput from time to time;
- (b) the fourth key parameter (i.e. the economic multipliers) has a time lag of about two years because it involved collection and collation of data by the Census and Statistics Department, and further estimation work with the data by the Government Economist. The latest available multipliers were only up to 2014. Hence in the absence of all relevant information, the TC could not assess the progress made in achieving the projected economic benefits by 2023 in money terms by using the economic model;
- (c) the KTCT was opened in mid-2013 and that it was the cruise trade's practice to schedule major deployments only after the actual commissioning of a cruise terminal as they had to know for certain the operational readiness of the terminal before making deployments. Moreover, they normally need two years to plan for major deployments. Hence, the KTCT started to receive major deployments in 2015, two years after its commissioning in mid-2013. In the circumstance, an assessment of the economic benefits brought by the whole cruise tourism industry in the initial years of the commissioning of the KTCT (i.e. from mid-2015 to now) would unlikely be as adequate and representative as they should be, given the short duration (less than two years) since the KTCT became fully operational; and

- (d) the KTCT is a relatively young cruise terminal (first berth and second berth opened in June 2013 and September 2014 respectively). It is the TC's plan to conduct a mid-term assessment on the progress in achieving the expected economic benefits of the whole cruise industry in Hong Kong by 2023 at a suitable juncture, say around 2018, after gaining sufficient operational experience. During the process, the projected number of ship calls and passenger throughput in 2013 and 2016 would be used as tracking reference.

2.14 In Audit's view, with the experience gained in the performance of the KTCT since its commencement of operation in 2013, the TC needs to assess whether the cruise industry is making good progress in achieving the expected economic benefits and the prospect of realising the expected benefits.

Audit recommendations

2.15 **Audit has *recommended* that the Commissioner for Tourism should:**

- (a) **as soon as the KTCT has gathered sufficient operational experience, conduct a mid-term assessment on the progress made by the cruise industry in achieving the expected economic benefits and the prospect of realising the expected benefits by 2023; and**
- (b) **submit the results of the mid-term assessment of the economic benefits to LegCo when ready.**

Response from the Government

2.16 The Commissioner for Tourism agrees with the audit recommendations. She has said that the TC has been closely monitoring the number of ship calls, passenger throughput and passenger spending in Hong Kong. The TC notes that the total cruise passenger throughput in Hong Kong in 2016 was 677,031, which has reached the projected range of throughput for 2023. The TC will continue to make available the key parameters on the performance of the cruise industry to LegCo from time to time, and will share the outcome of the mid-term assessment with LegCo once ready.

Driving ship calls to Hong Kong

Need to drive more ship calls to the KTCT

2.17 To develop Hong Kong into a leading regional cruise hub, one of the strategies adopted by the TC is to drive more ship calls to Hong Kong.

2.18 According to the TC:

- (a) many international leading cruise hubs have many berths. For instance, Everglades in Florida has 9, Shanghai, Miami in Florida and St. Petersburg each has 7, New York has 6 and Southampton has 5. All these ports aim at creating capacity for their peak seasons. During their peak seasons, some berths can be in full use, while they are not in full use or are left idle at off-peak seasons; and
- (b) the utilisation rates of the KTCT (i.e. percentage of days with a cruise vessel at one or both of the two berths) during the peak seasons (i.e. January to March and October to December) of 2014 to 2016 were 18.1%, 22.5% and 38.3% respectively (see Table 7).

Table 7

**Utilisation rate of KTCT during peak seasons
(2014 to 2016)**

Month	No. of days with a ship at one or both of the two berths	Utilisation rate of KTCT (Note) (%)
January 2014	3	9.7%
February 2014	7	25.0%
March 2014	7	22.6%
October 2014	5	16.1%
November 2014	8	26.7%
December 2014	3	9.7%
Overall	33	18.1%
January 2015	2	6.5%
February 2015	6	21.4%
March 2015	15	48.4%
October 2015	7	22.6%
November 2015	6	20.0%
December 2015	5	16.1%
Overall	41	22.5%
January 2016	3	9.7%
February 2016	12	41.4%
March 2016	18	58.1%
October 2016	10	32.3%
November 2016	13	43.3%
December 2016	14	45.2%
Overall	70	38.3%

Source: TC records

Note: The utilisation rate was calculated by dividing the number of days with a ship at one or both of the two berths by the number of days in a month. For example, the utilisation rate of December 2016 was 45.2% (i.e. 14 days ÷ 31 days × 100%).

Remarks: According to the reservation requests received up to 8 February 2017, there will be 198 ship calls involving 158 days of operation in 2017. The average utilisation rate during the peak season (i.e. January to March and October to December) in 2017 will be 49%.

2.19 The utilisation rate of the KTCT calculated by the TC was based on the number of days when at least one of the two berths were utilised. Audit examination of TC records revealed that the KTCT had the capacity to receive more cruise vessels:

- (a) for the peak seasons (January to March and October to December) of 2015 and 2016, the total number of days when both berths were utilised were only 5 and 14 respectively; and
- (b) for non-peak seasons (April to September) of 2015 and 2016, the total number of days with a ship at one or both of the two berths were 29 and 35 respectively, representing utilisation rates of 15.8% and 19.1% respectively.

Audit considers that the TC needs to drive more ship calls to the KTCT.

Audit recommendations

2.20 **Audit has *recommended* that the Commissioner for Tourism should:**

- (a) **take further measures to drive more ship calls to the KTCT; and**
- (b) **monitor the effectiveness of the measures taken and step up the TC's efforts to drive more ship calls to the KTCT where necessary.**

Response from the Government

2.21 The Commissioner for Tourism agrees with the audit recommendations. She has said that:

- (a) the TC is committed to and has been making proactive efforts in getting more ship calls to Hong Kong. The TC formulates the strategic directions and initiatives for developing Hong Kong into a leading cruise hub. The Government has launched new initiatives to drive cruise tourism and has allocated increased funding to the HKTb for promotion. Examples of the Government's initiatives include the setting up of the Asia Cruise Fund, streamlining immigration arrangements for Mainland cruise passengers, launching "fly-cruise" programmes to diversify source markets outside the Mainland, and initiatives to deepen market penetration in Southern China and to encourage more spending by cruise passengers;
- (b) with the introduction of new initiatives, the number of ship calls at the KTCT increased by 239% from 28 in 2014 to 95 in 2016, bringing the total number of ship calls to Hong Kong to 191. This is a record high figure which has reached the projected range of ship calls to Hong Kong for 2023 (i.e. 181 to 258) under the economic model. The number of ship calls at the KTCT alone in 2017 is expected to go further up to 198 (an increase of 108% over 2016);
- (c) the average number of passengers per ship in 2016 was 3,545, which is higher than the average number of 2,695 in the low growth scenario of the economic model. This shows that Hong Kong has been moving fast towards accommodating ships with larger capacity as envisaged in the model by 2023. This also explains why the number of ship calls in 2016 is slightly below that estimated by the model;
- (d) the cruise passenger throughput in Hong Kong in 2016 was 677,031, which has reached the projected range for 2023 (i.e. 564,102 to 1,041,031) under the economic model. It has also exceeded the estimated throughput of 541,702 in 2016 in the low growth scenario by around 25%;

- (e) the second berth of the KTCT was not available for use from March to December 2015 because of the dredging works carried out in the period. In 2016, there were 16 days on which both berths were occupied. This is comparable to 18 days in 2016 for the Marina Bay Cruise Centre Singapore (which also has two berths) although the KTCT was commissioned one year later than its Singapore counterpart. It is expected that there will be 60 days in 2017 with more than one cruise ship at berth, representing an increase of 275% over 2016; and
- (f) the TC is committed to continuing to strengthen Hong Kong's competitive edge through regular reviews of its strategic directions and introducing new initiatives where necessary in collaboration with the trade to drive more ship calls and passenger throughput to Hong Kong.

PART 3: MONITORING PERFORMANCE OF TERMINAL OPERATOR

3.1 This PART examines the TC's monitoring of the performance of the terminal operator, focusing on the following areas:

- (a) vibrancy of the KTCT (paras. 3.6 to 3.15); and
- (b) performance monitoring of the terminal operator (paras. 3.16 to 3.24).

Operation and management of the KTCT

3.2 In March 2012, the Government, through an open tender exercise, awarded a ten-year TA to a terminal operator for the operation and management of the KTCT. The TA provides the rights to the Government to extend the TA for another five years, subject to the operator's satisfactory performance, and to terminate the TA for any breach or non-performance of the tenancy.

3.3 Under the TA, the terminal operator is required to pay a fixed rent of \$13 million for the ten-year operation and a variable rent (based on the annual gross receipts from terminal operation, the rates of variable rents ranged from 7.3% to 34% — see Appendix A).

3.4 According to the TA, the responsibility of the terminal operator includes:

- (a) arranging the berthing of cruise vessels as well as embarkation and disembarkation of passengers;
- (b) letting of the ancillary commercial area;
- (c) managing traffic and security matters;
- (d) attracting the deployment of cruise vessels to the KTCT; and

- (e) engaging the industry (i.e. organising and conducting a market consultation forum as well as attending and participating in the ACCI) and promoting Hong Kong as a leading regional cruise hub.

3.5 The TC is responsible for monitoring the operation of the KTCT and the performance of the terminal operator. A Management Committee, comprising representatives from the Government and the terminal operator, was established to monitor the performance of the operator (see para. 1.9). To facilitate the TC's monitoring of the KTCT operation, the terminal operator is required to submit:

- (a) a set of service pledges within 12 months after the signing of the TA (i.e. before the commencement of the KTCT operation); and
- (b) an annual operation and maintenance report on various aspects of the KTCT operation, including the business performance, fulfilment of the service pledges, etc.

Vibrancy of the KTCT

Need to endeavour to fully lease out the ancillary commercial area

3.6 According to the TA, the terminal operator is responsible for the letting of the ancillary commercial area of the KTCT. The TA stipulates that:

- (a) the terminal operator shall use its best endeavours to keep the ancillary commercial area fully let or occupied; and
- (b) the ancillary commercial area shall not be used for any purpose other than retail shops, banks, restaurants, money exchange shops, tourist information centre and other purposes as may be approved by the Government.

Monitoring performance of terminal operator

3.7 *Ancillary commercial area not fully let.* The total area of the ancillary commercial area of the KTCT was 5,601 m². Audit noted that as at 1 March 2017, 2,695 m² (48.1%) was let and open for business. The remaining 2,906 m² (51.9%) was not open for business. Details are as follows:

- (a) two shops on the rooftop (see Photographs 11 and 12) with a total area of 709 m² (12.7% of the ancillary commercial area) had not been able to be leased out and had been left vacant since their handover to the terminal operator in March and April 2014 respectively. According to the TC, the terminal operator had been actively promoting the shops available for sublease, including through sales calls. Also, newspaper advertisements for subletting the two rooftop shops had been made periodically since the commissioning of the KTCT. The terminal operator had also posted advertisements on its website to sublet the two rooftop shops. One shop (355 m²) was leased out in January 2017 (see para. 3.9). Up to 1 March 2017, the shop was under renovation and the other shop had not been sublet; and

Photograph 11

A vacant shop on rooftop of KTCT



Source: Photograph taken by Audit on 4 November 2016

Photograph 12

Interior of a vacant shop on rooftop of the KTCT



Source: TC records

- (b) two shops on the second floor (see Photographs 13 and 14) with a total area of 2,196 m² (39.2% of the ancillary commercial area) had been leased out and operated as a retail outlet since October 2013. The sub-tenant had failed to pay its rent since March 2015. Thereafter, the terminal operator had followed up with the sub-tenant and entered into legal disputes with the sub-tenant on the outstanding rents and recovery of possession of the shops after the terminal operator terminated the sub-tenancy in April 2016. Subsequently, the shops ceased operation from June 2016 onwards. Meanwhile, the other creditors (other than the terminal operator) of the sub-tenant filed winding-up petitions against the sub-tenant, and the terminal operator was not able to recover the vacant possession of the two shops pending the outcome of the legal proceedings (Note 6).

Note 6: *The rent default did not affect the variable rent paid by the terminal operator to the Government because the variable rent was calculated according to the rent receivable rather than rent received. Although the dates of availability of the two shops are still uncertain, the terminal operator advertised the letting of the two shops on the second floor in June 2016.*

Photograph 13

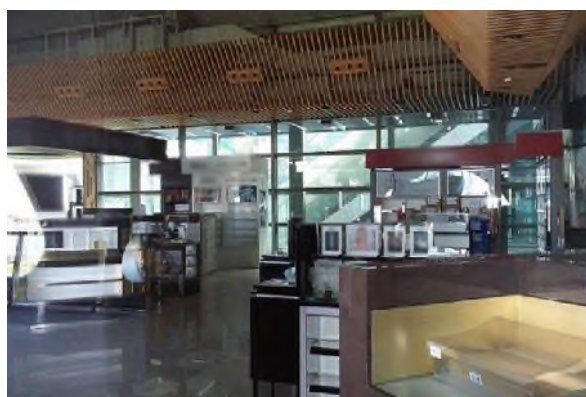
A shop on 2/F which had ceased operation since June 2016



Source: Photograph taken by Audit on 4 November 2016

Photograph 14

Interior of a shop on 2/F which had ceased operation since June 2016



Source: TC records

3.8 Audit considers that the TC needs to continue to urge the terminal operator to endeavour to lease out the remaining vacant shop on the rooftop, and keep in view the development of the legal proceedings with a view to recovering the vacant possession of the two shops on the second floor and leasing them out as soon as possible.

3.9 *Ancillary commercial area leased as an office and training centre.* The TA stipulates that the ancillary commercial area shall not be used for any purposes other than retail shops, banks, restaurants, money exchange shops, tourist information centre and other purposes as may be approved by the Government. In January 2017, one of the vacant rooftop shops with an area of 355 m² (6.3% of the ancillary commercial area — see para. 3.7(a)) was leased to a cruise academy as an office and training centre for a fixed term of three years. The lease was approved by the TC in November 2016, taking into account the following:

- (a) leaving the two shops at the rooftop garden vacant was not conducive to bringing more visitors to the KTCT;
- (b) under the current condition of the retail market, the two shops were not expected to be leased out in the near future for retail of food and beverage uses; and
- (c) the training provided by the sub-tenant was very relevant to the KTCT.

3.10 The letting of the ancillary commercial area of the KTCT as an office and training centre helps improve the occupancy of the KTCT. However, the use of the shop as office and training centre would not help attract visitor flow to the KTCT very much or serve the cruise passengers. The TC needs to urge the terminal operator to endeavour to lease the shop out after the current sub-tenancy for purposes that can best attract visitors or serve the cruise passengers.

Need to bring more visitors to the KTCT

3.11 Apart from being used for berthing of cruise ships, the KTCT also provides ancillary commercial area that is open to public seven days a week all year round. Audit visited the KTCT on three ship call days on 4 November 2016, 6 December 2016 and 17 January 2017, and found that the visitor traffic to the ancillary commercial area was not high.

3.12 The TC informed LegCo in November 2014 that the KTCT was also used as an event venue during non-cruise days with a view to better utilising the terminal facilities and increasing number of visitors. In the period from its commissioning in

Monitoring performance of terminal operator

June 2013 to December 2016, 38 non-cruise events (involving 67 event days and 85 days for setting up and dismantling) were held at the KTCT (see Table 8).

Table 8

**Number of attendees for non-cruise events at the KTCT
(June 2013 to December 2016)**

No. of attendees for each event	No. of events
100 or below	3 (7.9%)
101 - 999	16 (42.1%)
1,000 - 3,999	8 (21.1%)
4,000 - 7,999	4 (10.5%)
8,000 - 11,999	1 (2.6%)
12,000 - 15,999	0 (0%)
16,000 or above	6 (15.8%)
Total	38 (100.0%)

Source: Audit analysis of TC records

3.13 The TC needs to continue to urge the terminal operator to promote the use of the KTCT as a venue for non-cruise events with a view to bringing more visitors to the KTCT.

Audit recommendations

3.14 **Audit has *recommended* that the Commissioner for Tourism should:**

- (a) **urge the terminal operator to continue its efforts to lease out the unlet ancillary commercial area at the KTCT;**
- (b) **keep in view the process of the winding-up petitions against the sub-tenant of the two shops with terminated sub-tenancy and urge the terminal operator to take action to lease out the vacant shops on the**

second floor as soon as they are available after the completion of the legal proceedings;

- (c) regarding the shop currently used as an office and training centre, urge the terminal operator to endeavour to lease it out after the current sub-tenancy for purposes that can best attract visitors or serve the cruise passengers; and
- (d) continue to urge the terminal operator to promote the use of the KTCT as a venue for non-cruise events.

Response from the Government

3.15 The Commissioner for Tourism agrees with the audit recommendations. She has said that:

- (a) the terminal operator has been making efforts in leasing out the ancillary commercial areas. Over 87% of the floor area was leased out until one merchant occupying 2,196 m² (39.2%) of the area ceased operation in June 2016;
- (b) the terminal operator is taking legal action to repossess the premises from the merchant concerned. The Government's rental income has not been affected, as the terminal operator continues to pay rent to the Government under the TA. The TC has already urged the terminal operator to expedite the recovery of vacant possession of the premises for re-letting the premises as soon as practicable;
- (c) the TC will continue to urge the terminal operator to lease out the remaining two shops to merchants that can bring more visitors to the KTCT. The TC also notes that other tenants (like restaurants and eateries) in the ancillary commercial area are popular during meal hours and that the money exchange is highly patronised by cruise passengers; and
- (d) cruise operation is always the core function of the KTCT. Unlike other cruise terminals which are usually closed during non-cruise days, the KTCT is one of the few cruise terminals in the world which is working to make available the terminal for hosting non-cruise events as long as cruise

Monitoring performance of terminal operator

operation is not affected. With the terminal operator gaining more experience in this respect and the positive feedback of event organisers, the TC will urge the terminal operator to leverage on the KTCT's reputation now established as a good event venue and step up efforts to attract more non-cruise events.

Performance monitoring of the terminal operator

Non-compliances with requirements on service pledges stipulated in TA

3.16 The TC monitors the performance of the terminal operator through a set of service pledges and performance indicators specified in the TA, such as satisfaction of cruise passengers, embarkation and disembarkation arrangements, baggage handling process, etc. The TA stipulates that the terminal operator shall:

- (a) within 12 months after the execution of the TA, propose the service pledges for the approval of the TC;
- (b) publish the approved service pledges within one month prior to the commencement date of the business; and
- (c) prepare a report on compliance with the service pledges annually within two months after the end of each calendar year.

3.17 Audit noted that the service pledges had not been approved. The first set of service pledges was submitted by the terminal operator to the TC in February 2013. The service pledges were tabled at the first Management Committee meeting held in December 2013. At the meeting, the terminal operator was asked to revise and resubmit the service pledges at the next Management Committee meeting. The terminal operator submitted the revised service pledges at the following Management Committee meeting held in May 2014. The revised service pledges were subsequently used by the TC to monitor the performance of the terminal operator.

3.18 However, Audit found that up to December 2016, the terminal operator had not published the service pledges and had not prepared annual reports on compliance with the service pledges. In early December 2016, Audit discussed this finding with the TC. On 30 December 2016 (i.e. about 3.5 years after the commissioning of the KTCT in June 2013), the terminal operator submitted operation reports to the TC for 2013, 2014 and 2015 (see para. 3.22(b)(i)), which stated that the terminal operator had met all the service pledges. The revised service pledges submitted for discussion at the second Management Committee meeting held in May 2014 (see para. 3.17) were subsequently published in January 2017.

Coverage of service pledges needs to be expanded

3.19 In January 2011, the Government informed LegCo that the terminal operator would be required to draw up a set of service pledges and performance indicators to cover major areas of the KTCT operation, for example, satisfaction of cruise passengers, embarkation and disembarkation arrangements and baggage handling process. In April 2013, the Government informed LegCo that the Government would monitor the operation of the terminal through a set of service pledges and performance indicators, such as the time taken for embarkation and disembarkation of passengers.

3.20 Audit reviewed the existing service pledges and found room for improvement in the coverage of the pledges. For instance, the TC may consider expanding the coverage of the service pledges to include:

- (a) satisfaction of cruise passengers with the facilities of the KTCT;
- (b) embarkation and disembarkation arrangements for turnaround call passengers in addition to port-of-call passengers, baggage handling process (e.g. handling at kerbside, baggage loading onto vessel and baggage claim) and stevedore deployment;
- (c) transportation arrangements for passengers; and
- (d) engagement with the tourism industry to promote Hong Kong as a leading regional cruise hub and the setting up of a market consultation forum.

Service pledges need to be periodically reviewed

3.21 Service pledges should be reviewed and revised periodically to ensure they are challenging and meaningful. Audit examination of the annual operation and maintenance reports for 2013 to 2015 submitted by the terminal operator in December 2016 (see para. 3.18) revealed that the terminal operator had met and exceeded all the service pledges since 2013. For instance, one of the service pledges is that disembarking port-of-call passengers should spend less than 20 minutes to traverse the distance from shipside to kerbside. The actual time spent by the passengers in 2013 to 2015 was only 4.5 minutes.

Departures from TA requirements

3.22 Audit noted that the terminal operator had not fulfilled the following requirements under the TA:

- (a) ***Market consultation forum not organised.*** Under the TA, the terminal operator was required to organise and conduct market consultation forum on a quarterly basis. According to the TA, the scope of the market consultation forum is to discuss the key operation and management issue related to the KTCT, consult the cruise market and tourism industry on proposed changes to arrangement for fees and charges and berthing slots allocation, and discuss cooperation efforts with the HKTB and the tourism industry for marketing the facilities and services offered by the KTCT. The first meeting of the forum should be held on or before 31 December 2012. However, up to December 2016, the terminal operator had not conducted or organised such market consultation forum. The TC informed Audit in March 2017 that the terminal operator considered that it would be more useful to engage the cruise trade through overseas sales calls and attendance at ACCI, instead of conducting local market consultation forum. A market consultation forum might not be the most effective means in engaging the trade as cruise lines were competitors. The terminal operator had made a lot of sales calls and had met the intended objectives of market consultation forum;

- (b) *Late submission of annual operation and maintenance reports.* Under the TA, the terminal operator was required to submit an annual operation and maintenance report within two calendar months after the end of each calendar year. Apart from information on compliance with the service pledges, the annual operation and maintenance report should also provide information on the change in management team, industry engagement activities, promotion of cruise tourism, terminal security and traffic management, building condition of the premises, and condition of the engineering and mechanical facilities maintained by the terminal operator, and their maintenance schedule. Instead of submitting operation and maintenance reports, the terminal operator submitted separate operation reports and maintenance reports, as follows:
- (i) the operation reports for 2013, 2014 and 2015 had not been submitted until late December 2016 in one go after Audit discussed with the TC on this issue;
 - (ii) the maintenance report for the period from the commencement of operation in June 2013 to December 2013 had not been submitted. The maintenance reports for 2014 and 2015 were submitted three and five months respectively after the year end (i.e. one and three months after the submission due dates); and
 - (iii) the terminal operator had submitted the annual operation report and maintenance report for 2016 before the deadline.

The TC informed Audit in March 2017 that in view of the need to ensure that the operations of the KTCT under different scenarios would be smooth, the terminal operator was therefore requested to submit various types of reports on its operation almost every week. These reports provided more timely information that facilitated the TC's daily supervision of the terminal operator's performance and served as a more useful tool in monitoring the performance of the terminal operator than the annual operation report. In addition, the TC held Management Committee Meetings and frequently conducted other meetings and site walks to monitor closely the performance of the terminal operator;

Monitoring performance of terminal operator

(c) ***Written report on ancillary commercial area not submitted.*** Under the TA, the terminal operator was required to ensure that:

- (i) not less than 30% of the floor area of the ancillary commercial area would be open for business within six months from the possession date of the ancillary commercial area; and
- (ii) not less than 60% of the floor area of the ancillary commercial area would be open for business within 18 months from the possession date of the ancillary commercial area.

The terminal operator was also required to prepare and submit written reports by seven months and 19 months from the possession date (the date varied for different shops, ranging from September 2013 to April 2014) of the ancillary commercial area to certify the achievement of the above requirements. Audit noted that the requirements on opening of the ancillary commercial area for business had been met. However, no written reports on the achievement of the requirements were submitted by the terminal operator. The TC informed Audit in March 2017 that the terminal operator had submitted notices of leasing which set out the commencement dates of the sub-leases. The TC was also informed prior to the opening dates of the shops; and

(d) ***Disclosure on the website.*** The TA required the terminal operator to upload certain information onto its website and update the information on a monthly basis. Audit examination revealed that as at 31 December 2016, amongst a total of 18 items listed in the TA, the terminal operator had not uploaded the following eight items onto the website:

- (i) general safety and security arrangements;
- (ii) berth utilisation rate;
- (iii) monthly passenger throughput;
- (iv) schedules of prevailing fees and charges (including dockage fee and passenger fee);

- (v) detailed berth-allocation policies;
- (vi) compliance report on service pledges;
- (vii) accident and incident records; and
- (viii) summary of market consultation forum.

Audit recommendations

3.23 **Audit has *recommended* that the Commissioner for Tourism should:**

- (a) **ensure that the service pledges on the performance of the terminal operator are approved by the TC;**
- (b) **ensure that the terminal operator complies with all the requirements under the TA, including submitting the annual reports on compliance with the service pledges in a timely manner;**
- (c) **ensure that comprehensive service pledges covering all major areas of operation and management of the KTCT are set to facilitate the monitoring of the performance of the terminal operator; and**
- (d) **review the service pledges on the performance of the terminal operator periodically to ensure that they are meaningful, challenging and achievable.**

Response from the Government

3.24 The Commissioner for Tourism agrees with the audit recommendations. She has said that:

- (a) apart from requiring the terminal operator to submit different types of reports, the TC will continue to closely monitor the performance of the terminal operator through Management Committee meetings as well as day-to-day meetings and site walks;

Monitoring performance of terminal operator

- (b) the TC will ensure that the approval of service pledges will be explicitly documented;
- (c) of a total of over 40 obligations with which the terminal operator has to comply under the TA, the operator has complied with all of them, except the four items identified by Audit. The TC has already reminded the operator to ensure full compliance with them in future; and
- (d) the current set of service pledges has covered the fundamental areas necessary for the operation of the KTCT. The TC welcomes the suggestion on expanding the service pledges to cover passenger satisfaction, arrangements for turnaround calls, transportation arrangements and engagement with the trade, to make the service pledges even more comprehensive. The TC is committed to reviewing the service pledges periodically with the terminal operator to ensure that the KTCT will continue to meet the needs of cruise passengers and cruise operation.

PART 4: ADMINISTRATIVE ISSUES

4.1 This PART examines administrative issues, focusing on the following areas:

- (a) transport connectivity (paras. 4.2 to 4.10);
- (b) usage of KTCT facilities (paras. 4.11 to 4.19);
- (c) monitoring performance of contractor on facility management services (paras. 4.20 to 4.24);
- (d) maintenance of KTCT facilities (paras. 4.25 to 4.35);
- (e) attendance at ACCI meetings (paras. 4.36 to 4.41); and
- (f) strategic planning (paras. 4.42 to 4.46).

Transport connectivity

4.2 Cruise passengers using the KTCT may use the following transport means:

- (a) specific transport services arranged by the cruise companies, e.g. shore excursion coaches, limousine service and chartered ferry services;
- (b) free mall shuttle buses on ship call days arranged by the terminal operator and operated by the nearby shopping malls connecting the KTCT to the malls near Mass Transit Railway stations;
- (c) paid shuttle service to airport express stations as well as popular hotel areas provided by the terminal operator for turnaround calls;

Administrative issues

- (d) green minibuses (Route No. 86) operated between the KTCT and Kowloon Bay (Telford Gardens) daily from 6:30 hours to 23:00 hours at intervals of 8 minutes to 20 minutes;
- (e) franchised bus service (Route No. 5R) run between the KTCT and Mass Transit Railway Ngau Tau Kok Station from 11:00 hours to 16:00 hours on weekdays, and 11:00 hours to 19:00 hours on weekends and public holidays, at intervals of 30 minutes;
- (f) licensed ferry service run between North Point and Kwun Tong via Kai Tak Runway Park Pier (four sailings daily on weekdays, 24 sailings on Saturdays, and 26 sailings on Sundays and public holidays); and
- (g) taxi service.

The green minibuses, franchised bus service and licensed ferry service are intended mainly for passengers other than cruise passengers.

Areas for improvement

4.3 Audit examination of the TC records has revealed that there is room for improvement in the following areas:

- (a) ***Mall shuttle buses.*** Since June 2013, on every ship call day, free mall shuttle bus services have been provided by nearby shopping malls connecting the KTCT to the malls near Mass Transit Railway stations in Kowloon East. However, the number of malls providing free shuttle bus services on a regular basis had decreased from three in 2013 to two in 2015. According to the TC, the total number of shuttle buses provided remained more or less the same. In April 2016, the terminal operator informed the Management Committee that it was likely that the free shuttle bus service provided by a mall in Diamond Hill might not be able to sustain in the long run as there were frequent complaints by residents near the mall about the location of the drop-off point near the mall. According to the TC, mall shuttle bus services were popular. Around 20% to 40% of the cruise passengers took mall shuttle buses for transport to and from the KTCT. The TC needs to urge the terminal operator to encourage more shopping malls to provide mall shuttle bus services to the

KTCT. Moreover, in view of the possibility that the malls may discontinue their free shuttle bus services, the TC also needs to:

- (i) urge the terminal operator to discuss with the malls to address their problems; and
 - (ii) make contingency planning for the discontinuation of the mall shuttle bus services;
- (b) **Franchised bus service.** The bus service (Route No. 5R) is a circular route departing from the KTCT with stops at Mass Transit Railway Ngau Tau Kok Station and Kwun Tong from 11:00 hours to 16:00 hours on weekdays, and 11:00 hours to 19:00 hours on weekends and public holidays, at intervals of 30 minutes. The bus service is a recreational route to cater primarily for the transport needs of the locals commuting to and from the KTCT Park and a park near the KTCT. According to the TC, the average daily patronage of the franchised bus for 2016 was 237 (17 passengers per bus). Audit noted that the buses used for the route were not equipped with luggage storage facilities (see Photograph 15);

Photograph 15

**Luggage compartment not provided
in franchised bus route No. 5R**



Source: TC records

- (c) **Ferry service.** The licensed ferry service runs between North Point and Kwun Tong via Kai Tak Runway Park Pier. The average daily patronage as reported by the TC (i.e. 3 on weekdays and 233 on weekends and public holidays in January 2017) was low. Audit noted that one of the cruise companies using the KTCT as homeport provided chartered ferry services running between Tsim Sha Tsui and the KTCT and between Central and the KTCT for passengers of its cruise ships. According to the TC, the chartered ferry services were popular. Audit considers that the TC and the terminal operator need to encourage the other cruise companies to provide chartered ferry services; and

- (d) **Taxi service.** According to the results of surveys conducted by the TC, the taxi waiting time by cruise passengers disembarked from the KTCT between October 2016 and January 2017 ranged from 0 to 36 minutes. Audit made a site visit to the KTCT on 17 January 2017 (ship call day). Audit observed that from 9:25 am to 10:25 am, while there were a large number of cruise passengers waiting for taxi (see Photograph 16), there were also many taxis waiting for passengers at the taxi queuing spaces (see Photograph 17). However, only 6 of the 18 taxi pick-up points were made available for boarding (see Photograph 16). Audit considers that the TC needs to, in collaboration with the terminal operator, review whether more taxi pick-up points can be made available for boarding during peak hours.

Photograph 16

Taxi pick-up points



Source: Photograph taken by Audit on 17 January 2017

Photograph 17

Taxis waiting at the taxi queuing spaces



Source: Photograph taken by Audit on 17 January 2017

Traffic management plan

4.4 Under the TA, the terminal operator is required to submit a traffic management plan to the Government for approval not less than five months before the commissioning of the KTCT. The traffic management plan should include sketches/drawings showing the road layout, road marking, location of signs, queuing spaces, drop-off, pick-up, loading and unloading spaces, and all traffic and pedestrian control measures. The terminal operator is also required to implement the traffic management plan to the satisfaction of the Government, and provide sufficient personnel and equipment for carrying out all traffic measures contained in the plan.

4.5 *Departments' comments not fully reflected in the traffic management plan.* The terminal operator submitted a traffic management plan to the TC in December 2012. After incorporating the comments from related government departments, the revised plan was resubmitted to the TC in March 2013. The Immigration Department, the Civil Engineering and Development Department and the Hong Kong Police Force made comments (which were mainly suggestions on improving the presentation of the plan and on including further details on routings) on the revised plan. However, their comments were not incorporated. Furthermore, although the TC said that the plan was accepted and had been put into practice, there was no documentary evidence showing that the plan was approved by the TC.

4.6 *Traffic management plan not updated in a timely manner.* The traffic management plan submitted by the terminal operator in 2012 was prepared by referring to the experience of ship crew and ship agents, observations at the Ocean Terminal and Kwai Chung Cargo Container facilities and data from a consultancy study conducted by the TC. The terminal operator informed the TC that prior to the opening of the second berth, the plan would be updated. In May 2014, the TC asked the terminal operator to review and update the traffic management plan based on the experience in managing traffic at the KTCT. The second berth commenced operation in September 2014. Notwithstanding this, the terminal operator had not updated the plan. In December 2016, the TC told the terminal operator that as the mode of transport at the KTCT had changed with the improvement in water connectivity around the KTCT, it should, with the experiences gained in the past few years, prepare and submit an updated traffic management plan for the TC's approval in three months' time. Eventually, the

terminal operator submitted the updated traffic management plan for the TC's approval on 27 February 2017.

4.7 ***Need to review overall traffic management.*** According to the TC, the number of ship calls is expected to increase to 198 in 2017 and the annual passenger throughput, including the crew, can be as high as 1,400,000. Audit considers that the TC needs to, in collaboration with the terminal operator, critically review the overall transport arrangement to ensure that effective and efficient transport services are provided.

Audit recommendations

4.8 **Audit has recommended that the Commissioner for Tourism should:**

- (a) **urge the terminal operator to:**
 - (i) **discuss with the shopping malls near Mass Transit Railway stations to encourage more malls to provide mall shuttle bus services to the KTCT; and**
 - (ii) **discuss with the shopping mall that is encountering problems in providing shuttle bus services in order to help maintain their services as far as possible;**
- (b) **in consultation with the Transport Department and the terminal operator, make contingency planning for the discontinuation of the mall shuttle bus services;**
- (c) **discuss with the Transport Department to improve the franchised bus service;**
- (d) **urge the terminal operator to encourage the other cruise companies to provide chartered ferry services;**
- (e) **in collaboration with the terminal operator, review whether more taxi pick-up points can be made available for boarding during peak hours;**

- (f) **ensure that the traffic management plan is updated regularly by the terminal operator and is approved by the TC; and**
- (g) **in collaboration with the terminal operator, continue to critically review the overall transport arrangement to ensure that effective and efficient transport services are provided.**

Response from the Government

4.9 The Commissioner for Tourism agrees with the audit recommendations. She has said that:

- (a) the shopping malls in the vicinity of the KTCT have already provided mall shuttle bus services to the KTCT. The TC will continue to urge the terminal operator to explore with shopping malls farther away to provide mall shuttle bus services to the KTCT. The TC will also urge the terminal operator to prepare necessary contingency in the event of discontinuation of mall shuttle bus services;
- (b) while the franchised bus service is mainly for the park users, the service provider has extended its service to cover the disembarkation time of cruise passengers on certain occasions (e.g. more ship deployments at the KTCT) in response to the request of the TC and the terminal operator;
- (c) the TC will make it a requirement for the terminal operator to update the traffic management plan annually with immediate effect. Moreover, the TC has been requesting, and will continue to request the terminal operator to provide, on top of the requirement of the TA, dedicated traffic plans for special occasions (double or more berthings on the same day) to ensure that proper transport arrangements are in place for such occasions;
- (d) the terminal operator has provided more than six taxi pick-up points when the actual circumstances, such as the number of taxis available and the number of passengers waiting, so warranted. The TC will continue to urge the terminal operator to be flexible and provide more taxi pick-up points at the KTCT when necessary; and

- (e) the TC will continue to collaborate with the terminal operator and the Transport Department, and in the process, to seek the views of the cruise trade to regularly review the transport services provided at the KTCT for cruise passengers. For instance, a new bus route connecting the KTCT and Kowloon Tong is planned to be introduced in 2018. Meanwhile, the frequency of minibus service and franchised bus service was increased in 2016. The TC will also continue to urge the terminal operator to invite more cruise lines to provide chartered ferry services as an additional means of transport for their passengers.

4.10 The Commissioner for Transport agrees with the audit recommendations in paragraph 4.8(b) and (c). She has said that:

- (a) the green minibuses, franchised bus service and licensed ferry service are intended mainly to serve locals other than cruise passengers;
- (b) the existing franchised bus service (Route No. 5R), as an exceptional arrangement, had extended its service to help disperse cruise passengers on previous occasions. Based on the Transport Department's observation, only 1.5% of the cruise passengers used the existing franchised bus route (Route No. 5R), indicating a very low passenger demand from cruise passengers;
- (c) any long term enhancement plan and proposal to existing franchised bus route services has to be carefully examined, under the prevailing guidelines, by taking into account various factors such as the demand from cruise passengers, the local views and the resources of the public transport services providers, etc.; and
- (d) the Transport Department is planning to introduce a new bus route connecting the KTCT in 2018.

Usage of KTCT facilities

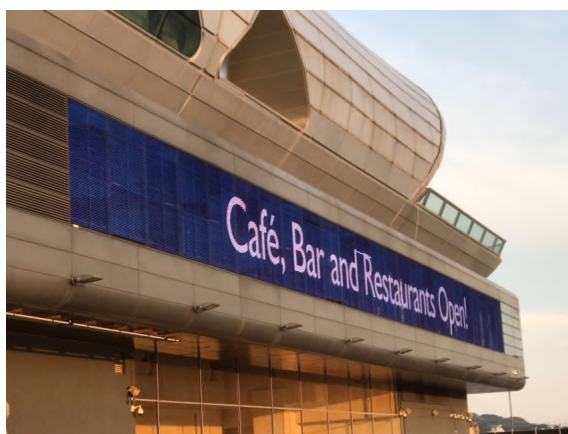
Video wall not let out

4.11 There is a video wall (measuring 60 metres by 3.7 metres) installed on the external wall of the terminal building facing the Hong Kong Island. The video wall was intended for displaying messages and advertisements. According to the TA, the terminal operator is responsible for the maintenance of the video wall and the letting of the video wall. Income generated from the video wall forms part of the gross receipt of the terminal operator in the calculation of the variable rent payable to the Government (see Appendix A).

4.12 Since the commissioning of the KTCT in 2013, the video wall has not been let out and has not generated any income. The video wall has sometimes been used by the terminal operator for displaying messages to cruise passengers on ship call days (see Photograph 18). On special occasions, the HKTB would also use it to display special messages for guests of their events (see Photograph 19). The TC could not provide the number of days that the TC or the HKTB had used the video wall for displaying messages. According to the TA, the terminal operator shall allocate air-time of the video wall to the Government for promotion of Hong Kong tourism and the Government's events and activities without payment of any fee. Audit considers that the TC needs to urge the terminal operator to endeavour to let out the video wall and encourage the use of video wall by other government departments when it is not let to outside parties.

Photograph 18

**Message displayed on the video wall
to cruise passengers on ship call day**



Source: TC records

Photograph 19

**Special message displayed on the video wall
for guests on event day**

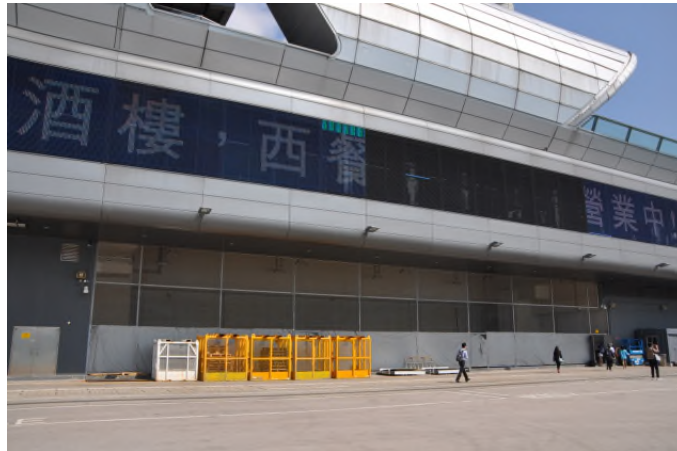


Source: TC records

4.13 According to the TA, the terminal operator shall perform repair and remedial work to the video wall in order to ensure that all parts of the video wall are safe and fit for display and advertisement at all times throughout the term. Audit conducted site visits on 4 November 2016 and 17 January 2017 and found that the video wall was not functioning properly (see Photographs 20 and 21). The repair work on the video wall was completed on 14 February 2017. Audit considers that the TC needs to urge the terminal operator to ensure that repair work on the video wall is carried out in a timely manner and monitor the proper functioning of the video wall regularly.

Photograph 20

The video wall on 4 November 2016



Source: Photograph taken by Audit on 4 November 2016

Photograph 21

The video wall on 17 January 2017



Source: Photograph taken by Audit on 17 January 2017

Need to optimise the use of space reserved for on-shore power supply system

4.14 Spaces are reserved in the KTCT project for the installation of an on-shore power supply (OPS) system. Two plant rooms (occupying a total area of 1,100 m²) are reserved at the KTCT for setting up the system. In November 2013, the Environmental Protection Department (EPD) engaged the Electrical and Mechanical Services Department (EMSD) to study the technical feasibility of installing OPS system at the KTCT, including gauging the readiness of cruise terminals and cruise liners to use OPS system. In July 2014, the EMSD submitted to the EPD its report which confirmed the technical feasibility of installing the OPS system at the KTCT. The EPD and the EMSD carried out follow-up survey in 2015 and found that:

- (a) while the installation of the OPS system at the KTCT was technically feasible, OPS-capable ships were not common worldwide;
- (b) no Asian cruise terminal was providing OPS system, and only a few OPS-capable ships were deployed to the Asian region; and
- (c) in 2014, globally only 32 international cruises were OPS-capable. Three cruise ships would be retrofitted with OPS equipment in 2015, raising the total number of OPS-capable cruise ships to 35, accounting for about 16% of the international cruises in 2015.

The EPD reported the findings of the feasibility study and survey results to the Panel on Environmental Affairs of LegCo in June 2015. Having regard to the above considerations and that an increasing number of cruise ships were fitted with scrubbers (instead of adopting OPS-technology) to comply with the fuel sulphur cap, the Panel supported the EPD's recommendations to put the installation of OPS system at the KTCT on hold, while keeping a close watch of developments on OPS-capable cruise ships to review whether it was appropriate to take forward the installation of OPS at the KTCT.

Administrative issues

4.15 Consequently, the two plant rooms are not equipped with the OPS system. The plant rooms have been used temporarily by the EMSTF since 2015. The usage of the plant rooms in June 2015 and November 2016 was shown in Photographs 22 and 23 respectively. There is a need to review the optimal use of the two rooms with the Government Property Agency's assistance.

Photograph 22

**Use of the switch room inside one of the
OPS system plant rooms in June 2015**



Source: TC records

Photograph 23

Use of one of the OPS system plant rooms in November 2016



Source: Photograph taken by Audit on 4 November 2016

Audit recommendations

- 4.16 **Audit has *recommended* that the Commissioner for Tourism should:**
- (a) **urge the terminal operator to endeavour to let out the video wall;**
 - (b) **encourage the use of video wall by other government departments for promotion of Hong Kong tourism and the Government's events and activities;**
 - (c) **monitor the proper functioning of the video wall regularly and ensure that repair work for the video wall is carried out in a timely manner;**
 - (d) **review whether the current temporary use of the two spare OPS system plant rooms by the EMSTF represents the optimal use; and**
 - (e) **in the light of the result of the review, seek the Government Property Agency's assistance, if necessary, and put the two plant rooms, or part thereof as appropriate, to optimal use.**

Response from the Government

4.17 The Commissioner for Tourism generally agrees with the audit recommendations. She has said that:

- (a) the terminal operator has been making efforts (e.g. site walks with potential clients, invitations for proposals, etc.) to identify an advertising agency or a media company to make use of the video wall for commercial advertisements. The market response has been lukewarm so far. Nonetheless, the video wall has been used in some non-cruise events or by government departments/public bodies. The TC will continue to urge the terminal operator to make vigorous efforts in ensuring the proper functioning of the video wall and letting it out; and
- (b) the spaces reserved for installing the OPS system are of limited accessibility because they are located within the restricted area of the KTCT and can only be accessed through the apron which is also within the restricted area. Such spaces cannot be accessed freely without approval, and they are currently put to gainful use by the EMSTF as a maintenance workshop. The TC will invite the Government Property Agency to explore the optimal use of the spaces having regard to their limited accessibility and the need to protect the integrity of the restricted area.

4.18 The Director of Electrical and Mechanical Services agrees with the audit recommendations in paragraph 4.16(d) and (e).

4.19 Regarding paragraphs 4.14 to 4.16, the Government Property Administrator has said that:

- (a) the KTCT was developed and is managed as a Specialist/Departmental Building. According to the Accommodation Regulations, the management responsibility of a Specialist/Departmental Building rests with its owner department (i.e. the TC in this case), which should, inter alia, take expeditious action to ensure its own government accommodation is put to optimal use and report any surplus accommodation in the annual Stewardship Statement Exercise;

- (b) any change of use of its accommodation (i.e. other than its intended use) by the department will be subject to the approval of the Property Vetting Committee;
- (c) if the owner department is unable to fully utilise its accommodation in supporting its operation and services, it may liaise with the Government Property Agency, which will help identify suitable bureau/department (subject to the agreement of the owner department concerned) to take up the surplus accommodation or its part. If no suitable bureau/department can be identified, the possibility of leasing out the surplus accommodation will be explored with a view to putting the space to gainful use; and
- (d) if the TC has any enquiries on or encounters problems in accommodation issue, the Government Property Agency stands ready to provide accommodation advice and assistance as appropriate with regard to relevant principles and mechanism under the Accommodation Regulations for dealing with government accommodation, or in the event of existence of surplus space, with a view to making appropriate and gainful use of property resources.

Monitoring performance of contractor on facility management services

4.20 Since the commissioning of the KTCT, the facility management services for the government offices and the communal areas in the KTCT have been outsourced through open tender to a contractor. The first contract covered the two-year period from 1 June 2013 to 31 May 2015. The current three-year contract (from 1 June 2015 to 31 May 2018) was awarded in May 2015, with a contract sum of \$25.5 million. The facility management services include site management, security, cleansing, pest control and landscaping maintenance. Site management services include the assistance rendered to ensure the smooth flow of passengers and crowd management during special events.

Areas for improvement

4.21 *Need to set a reasonable timeframe for the submission of yearly report.* Under the first contract, the contractor was not required to submit yearly reports. According to the current contract, the contractor should submit yearly reports to the TC covering various matters on the services provided, including significant matters (e.g. fire accident, breakdown of building service equipment, etc.) that occurred in the year, improvement required and plans for the forthcoming year. Audit noted that:

- (a) the contract had not specified the deadline for the submission of yearly report; and
- (b) the yearly report for the year ended on 31 May 2016 was submitted on 18 January 2017, 7.5 months after the end of the period covered.

The TC sent an email to the contractor in January 2017 requiring the contractor to submit future yearly reports within three months after the end of the period covered.

4.22 *Inadequate coverage of joint site inspections.* According to the contracts, the TC may carry out joint site inspections with the contractor to inspect the quality of services provided. Audit noted that no joint site inspections were carried out under the first contract. The first joint site inspection under the current contract (commencing June 2015) was carried out in February 2016. Since then, joint site inspections have been carried out monthly. Audit review of the joint site inspection records revealed that during the inspections, only the attendance of contractor staff was checked instead of the quality of services. A joint site inspection form was used to record the inspection date, inspection time, name of staff checked, assigned duty location, and the signatures of two inspecting officers from the TC and one staff from the contractor. During the site inspections, the TC staff obtained the roster of the contractor's security guard team and the cleaner team for that day. Then the TC staff, accompanied by the contractor's staff, walked through the locations (e.g. podium, roof garden and immigration hall) where the security guards and the cleaners were supposed to be on duty and checked their presence. The TC staff only checked the attendance of contractor staff of the cleaner team, but did not check the cleanliness and hygiene level achieved. Furthermore, the TC had not issued any guidelines or checklists for site inspections to ensure that the site inspections are carried out effectively and consistently to monitor the quality of the services provided by the contractor.

Audit recommendations

4.23 **Audit has *recommended* that the Commissioner for Tourism should:**

- (a) **take action to ensure that yearly reports are submitted by the contractor in a timely manner;**
- (b) **consider setting guidelines and checklists for joint site inspections to ensure effective monitoring of the quality of services provided by the contractor; and**
- (c) **ensure that joint site inspections are carried out in a way that is effective in monitoring the quality of the services provided by the contractor.**

Response from the Government

4.24 The Commissioner for Tourism agrees with the audit recommendations. She has said that:

- (a) apart from the requirement to submit yearly reports, the TC has been closely monitoring the performance of the contractor on facility management services through a wide range of measures including the submission of different types of monthly reports, site inspections, monthly operation meetings, half-yearly management meetings and half-yearly user satisfaction surveys; and
- (b) the TC has already required the contractor to submit yearly reports within the specified timeframe of three months after the end of the period covered. The TC will also set guidelines and checklists for joint site inspections to facilitate the monitoring of the quality of services provided by the contractor.

Maintenance of KTCT facilities

4.25 The EMSTF is responsible for, amongst others, providing operation services of air-conditioning system, emergency generator sets and electrical supply system, and maintenance services for the electrical and mechanical engineering systems and equipment at the KTCT. In May 2013, the TC and the EMSTF signed a service level agreement (SLA) for ten years from 1 June 2013 to 31 May 2023. Under the SLA, the EMSTF provides operation and maintenance services to ensure that the KTCT's engineering systems and equipment (e.g. Seaport Passenger Boarding Bridges and Electrical Supply System) are in a safe, efficient and good working condition, and in compliance with relevant statutory requirements and manufacturers' specifications and recommendations as well as satisfying the operational needs of various users of the KTCT. Operation and maintenance costs charged by the EMSTF for the services provided in the contract period from June 2013 to May 2017 are summarised in Table 9.

Table 9

**Operation and maintenance costs charged by EMSTF
(June 2013 to May 2017)**

	1 June 2013 to 31 May 2014 (\$ million)	1 June 2014 to 31 May 2015 (\$ million)	1 June 2015 to 31 May 2016 (\$ million)	1 June 2016 to 31 May 2017 (\$ million)
Annual basic fee	25.6	57.9	59.3	62.8
Ad hoc fee outside the scope of SLA	0	0.2	2.4	0.8 (Note)
Total	25.6	58.1	61.7	63.6

Source: Audit analysis of TC records

Note: The ad hoc fee of \$0.8 million was charged for the services provided by the EMSTF for the period from 1 June to 31 December 2016.

Need to improve performance reporting

4.26 Under the SLA, 28 performance targets have been specified. Areas covered include:

- (a) services availability of major systems;
- (b) response time to fault calls;
- (c) fault rectifications; and
- (d) technical advice on projects and procurement services.

The EMSTF is required to submit half-yearly performance reports on the actual performance of the engineering systems compared with the specified targets.

4.27 According to the SLA, the EMSTF should submit seven performance reports for the seven half-yearly periods from 1 June 2013 to 31 December 2016. However, the EMSTF had only submitted five reports covering the period from 1 January 2014 to 31 December 2016 (see Table 10).

Table 10

**Submission of half-yearly performance reports by the EMSTF
(June 2013 to December 2016)**

Period covered	No. of months covered	Submission date
Jun 2013 to Dec 2013	7	Not submitted
Jan 2014 to Oct 2014	10	28.11.2014
Nov 2014 to Jun 2015 (Note)	8	16.7.2015
Jun 2015 to Dec 2015 (Note)	7	12.1.2016
Jan 2016 to May 2016	5	15.7.2016
Jun 2016 to Dec 2016	7	24.1.2017

Source: Audit analysis of TC records

Note: Both the performance reports submitted on 16 July 2015 and 12 January 2016 covered the performance in June 2015.

4.28 Although the EMSTF reported in all the performance reports that all the performance targets were met, no information on its actual performance was provided.

Need to address water leakage and seepage problem

4.29 The Architectural Services Department (ArchSD) is responsible for the majority of the maintenance and repair of the KTCT building and facilities other than electrical and mechanical engineering systems and equipment. There were 256 maintenance cases reported to the ArchSD and the EMSTF (see para. 4.25) during the period from January 2015 to December 2016 relating to water leakage/seepage, representing 22% of all maintenance cases. The number of reported cases related to water leakage/seepage at the KTCT was 110 in 2015 and 146 in 2016.

4.30 The 146 water leakage/seepage cases reported in 2016 involved 83 cases reported by the terminal operator, and 63 cases reported by the user departments and the facility management contractor. Audit analysed these 83 cases and noted that:

- (a) for the 83 cases, 67 locations were involved; and
- (b) for 12 of the 67 locations, water leakage/seepage occurred more than once, and for 3 of the 12 locations, water leakage/seepage occurred more than twice (see Table 11). On second floor, for one location in the Waiting Hall A, there were four water leakage/seepage cases. For another location at the commercial area, there were three water leakage/seepage cases. On ground floor, there were three water leakage/seepage cases at one location in the Baggage Hall B.

Photograph 24 shows an example of water leakage/seepage location.

Table 11

Analysis of locations with more than one water leakage/seepage case reported by the terminal operator (2016)

No. of cases	No. of locations (Note)
2	9
3 — 4	3
Total	12

Source: Audit analysis of TC records

Note: Generally, the size of a location of the terminal building measures approximately 12 metres by 42 metres.

Photograph 24

A location with repeated water leakage/seepage problem at Waiting Hall A on the second floor



Source: TC records

Repeated fault cases of lifts/escalators

4.31 At the KTCT, 46 lifts and 32 escalators were installed. Repeated malfunctioning of lifts/escalators would be a safety concern and cause inconvenience to passengers and business operators. Audit analysed the 98 fault cases of lifts/escalators reported in 2015 and 2016 and noted that fault cases had been reported for 21 (27%) of the 78 lifts/escalators. Of the 78 lifts/escalators, 7 (9%) had fault cases more than 5 times. One of them had fault cases 17 times during the period (see Table 12).

Table 12

Analysis of fault cases of lifts/escalators (2015 and 2016)

No. of times involved in fault cases	No. of lifts/escalators	Total no. of fault cases involved	Cause of fault cases		
			Equipment failure	Improper operation	Others (Note)
0	57 (73%)	0	0	0	0
1 – 5	14 (18%)	25	9	6	10
6 – 10	4 (5%)	31	11	14	6
11 – 15	2 (3%)	25	8	9	8
16 – 20	1 (1%)	17	2	11	4
Total	78 (100%)	98	30	40	28

Source: Audit analysis of TC records

Note: Other causes of fault cases included power supply interruption, high ambient temperature, foreign objects and water ingress.

Audit recommendations

4.32 **Audit has recommended that the Commissioner for Tourism should:**

- (a) **ensure that the EMSTF submits half-yearly performance reports in a timely manner, and include in the reports the actual performance;**

- (b) **in collaboration with the ArchSD, take effective measures to address the water leakage and seepage problem;**
- (c) **monitor the effectiveness of the action taken to address the water leakage and seepage problem and, if necessary, step up the action;**
- (d) **in collaboration with the EMSTF, take effective measures to address the problem of lifts/escalators fault cases; and**
- (e) **monitor the effectiveness of the action taken to address the problem of repeated fault cases of lifts/escalators and, if necessary, step up the action.**

Response from the Government

4.33 The Commissioner for Tourism agrees with the audit recommendations. She has said that:

- (a) since mid-2015, the EMSTF has submitted half-yearly reports regularly in January and July each year. The TC will urge the EMSTF to submit reports, covering six-month periods and with information on its actual performance, in a timely manner;
- (b) according to the ArchSD, of the 146 reported leakage/seepage cases in 2016, about 33 cases (23%) were reported during three periods of exceptionally heavy rainfall and typhoon on 2 and 3 August 2016, 18 to 21 August 2016 and 17 to 21 October 2016. The ArchSD explained that of all the reported leakage/seepage cases in 2015, around 85% were minor cases. In 2016, around 93% were minor cases, demonstrating that the situation in terms of severity of the cases has improved;
- (c) the ArchSD will continue to step up actions with relevant parties, including both maintenance and preventive measures, to mitigate the water leakage/seepage issue at the KTCT; and

- (d) of the fault call cases of lifts/escalators received, the EMSTF pointed out that the majority were caused by improper operation mainly related to misuse of keyswitch and external influence such as by foreign objects. Equipment failure constituted a small portion, namely 12 lifts/escalators (out of a total of 78 lifts/escalators installed at the KTCT) in a time span of two years (i.e. 2015 and 2016). The EMSTF will explore ways to further improve the performance of the lifts and escalators and educate users on the proper use of lifts and escalators.

4.34 Regarding paragraphs 4.29 and 4.30, the Director of Architectural Services has said that:

- (a) the main reason for the increase in the number of reported leakage/seepage cases in 2016 was the much higher annual rainfall, super typhoon and severe rainstorm in 2016. The annual total rainfall in 2015 and 2016 were 1,875 millimetres and 3,027 millimetres respectively. In 2015 and 2016, there were 3 occasions and 9 occasions of tropical cyclones, and 26 occasions and 41 occasions of rainstorms respectively. Of the 146 reported leakage/seepage cases in 2016, about 107 cases were reported during the periods of exceptionally heavy rainfall associated with rainstorms or tropical cyclones; and
- (b) of all the reported leakage/seepage cases, around 85% in 2015 were minor cases and around 93% in 2016 were minor cases, demonstrating that the situation in terms of severity of the cases have indeed improved.

4.35 The Director of Electrical and Mechanical Services agrees with the audit recommendations in paragraph 4.32(a), (d) and (e). He has said that:

- (a) the EMSTF will submit future half-yearly performance reports in January and July each year, and will coordinate with the TC and provide more information on the actual performance in future reports;
- (b) causes of fault cases include equipment failure, improper operation and other causes such as power supply interruption and foreign objects. No lifts/escalators were involved in more than two cases of equipment failure for each of 2015 and 2016; and

- (c) the EMSTF will collaborate with the TC to explore ways to further improve the performance of the lifts/escalators. For instance, in addition to the basic operator training already in place, an enhancement training has been provided in March 2017 to strengthen the knowledge of the operators in operation of lifts and escalators at the KTCT with a view to reducing the occurrence of fault cases arising from improper operation and external influence. Similar enhancement training will be organised regularly in future.

Attendance at ACCI meetings

Attendance rates of some ACCI members on the low side

4.36 The ACCI was established on 28 January 2008 to advise the Government on measures to enhance the development of Hong Kong as a regional cruise hub. The membership of the ACCI for the current term (i.e. 2016-18) comprises the Commissioner for Tourism as the Chairman and 12 members from the cruise market, tourism industry and the HKTB.

4.37 Audit examination of the attendance records up to February 2017 of the 12 current ACCI members during their tenures (Note 7) revealed that the attendance rates of some members were on the low side. Three members had average attendance rates below 50% over their tenures. In particular:

- (a) two members had each attended 1 (10%) out of 10 meetings since their first appointments in January 2012; and
- (b) one member had attended 5 (38%) out of 13 meetings since his first appointment in January 2011.

4.38 Audit noted that the two members with the lowest attendance rates (see para. 4.37(a)) had each been reappointed twice despite their low attendance rates in their previous terms. Notwithstanding that they had each attended only one of the four meetings held during their first term (i.e. from 28 January 2012

Note 7: *The latest ACCI meeting for the current term was held on 15 February 2017.*

Administrative issues

to 27 January 2014), they were reappointed for a second term (i.e. from 28 January 2014 to 27 January 2016) in December 2013. Though they had not attended any of the three ACCI meetings held during their second term, they were reappointed in January 2016 for a third term. They had not attended any of the three ACCI meetings held under the current term.

4.39 Audit considers that the TC needs to take measures to improve the attendance rates of ACCI members with low attendance records. For future reappointment of ACCI members, the TC needs to take into account members' previous attendance records.

Audit recommendations

4.40 **Audit has *recommended* that the Commissioner for Tourism should:**

- (a) **take measures to improve the attendance rates of ACCI members with low attendance records; and**
- (b) **in future give due consideration to the attendance records of members at ACCI meetings when considering their reappointments.**

Response from the Government

4.41 The Commissioner for Tourism agrees with the audit recommendations. She has said that while noting that the low attendance of the members concerned was due to their busy flying schedule, the TC will inform individual members of their attendance as a reminder of the importance of their attendance. To facilitate members' participation, the TC will also arrange facilities for conference calls during meetings and in case members are not available for the meetings, will encourage them to provide written comments. On the whole, the ACCI has been well served by industry representatives and others. That said, the TC will take into account members' involvement and attendance at the ACCI when considering their future reappointments.

Strategic planning

Need to develop a Strategic Plan

4.42 Effective strategic planning is vital for meeting new demands and the challenges of a changing environment. The Strategic Plan should generally set out the strengths, weaknesses, opportunities and threats, as well as strategic objectives, operational goals, strategic actions for achieving the goals and outcome indicators for measuring the performance. The Strategic Plan would also serve to provide new stakeholders an overview of the strategic direction. Furthermore, implementation plans should be prepared to set out the initiatives and targets for achieving the strategic objectives and operational goals stated in the Plan. An annual review process should also be established for examining the extent to which the targets have been attained.

4.43 Audit noted that some overseas tourism authorities (e.g. a tourism authority in Australia) prepare Strategic Plans for cruise tourism to lead the authorities achieve their goals. It is the Government's goal to develop Hong Kong into a leading regional cruise hub through, amongst others, the development of the KTCT with modern facilities which are user-friendly and capable of providing efficient and quality services. The KTCT is one of the key strategic elements in achieving such goal. In March 2017, the TC informed Audit that, from time to time, the TC analysed the situations of the cruise industry and the possible strategic directions for developing Hong Kong into a leading regional cruise hub. For instance:

- (a) in April 2014, the Asia Cruise Fund was established to demonstrate Hong Kong's commitment to encourage regional cooperation among neighbouring ports and incentivise cruise lines to include Hong Kong and the participating ports in their ship itineraries;
- (b) in October 2015, the TC set out a plan on how to further drive demand for fly-cruise products with cruise itineraries embarking from/disembarking in Hong Kong;
- (c) in December 2016, the TC discussed with industry stakeholders its analysis of the current position of Hong Kong in the development of cruise tourism in the region, with an assessment of the strengths,

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weaknesses, opportunities and threats of Hong Kong with reference to neighbouring ports in the region, and considered possible strategic directions to drive more ships to Hong Kong and to cultivate source markets; and

- (d) in February 2017, in view of the changing cruise industry environment, the TC updated its strategies to develop Hong Kong into a leading regional cruise hub as follows:
 - (i) diversifying cruise tourism by cultivating and activating the growth of various source markets;
 - (ii) bringing in more high-spending/overnight visitors to Hong Kong;
 - (iii) driving more ship deployments to Hong Kong; and
 - (iv) elevating Hong Kong's profile in the international cruise tourism trade.

4.44 In Audit's view, a structured strategic planning process could be a useful means of soliciting advice and securing support from key stakeholders in the cruise and tourism industry. There is merit for the TC to produce a document in the form of a Strategic Plan, incorporating all the elements of strategic planning (such as strengths, weaknesses, opportunities and threats, as well as strategic objectives, operational goals, strategic actions for achieving the goals and outcome indicators for measuring its performance).

Audit recommendations

4.45 **Audit has *recommended* that the Commissioner for Tourism should:**

- (a) **establish a strategic planning mechanism for formulating strategies and initiatives of developing Hong Kong into a leading regional cruise hub;**

- (b) **develop a Strategic Plan incorporating elements such as strategic objectives, strategic directions and strategic actions; and**
- (c) **review and update the Strategic Plan periodically to take into account changes in the cruise industry.**

Response from the Government

4.46 The Commissioner for Tourism agrees with the audit recommendations. She has said that:

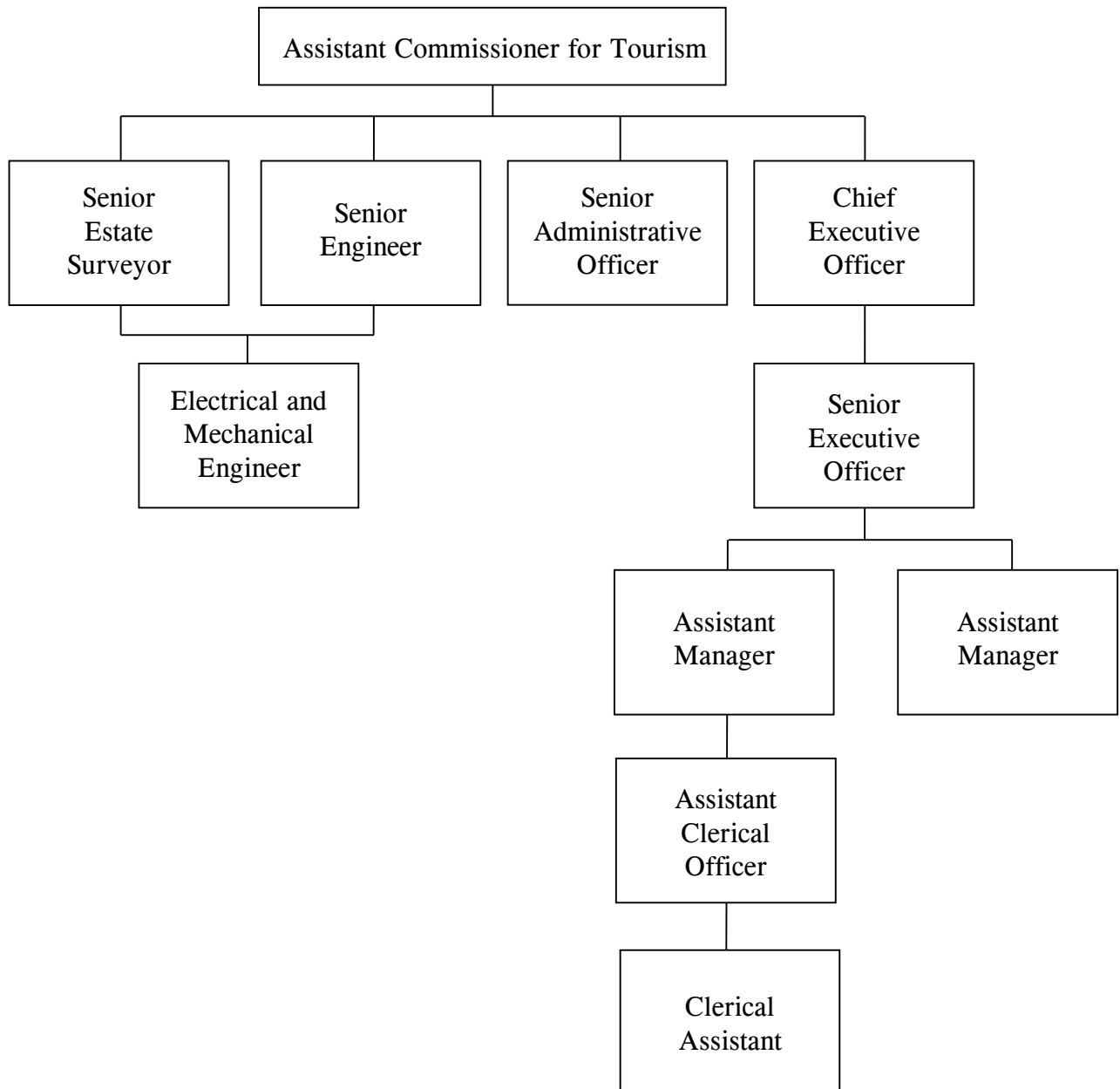
- (a) the TC is committed to continuing the strengthening of strategic planning for developing Hong Kong into a leading cruise hub, including the necessary strategic directions and initiatives. In the past years, these strategic directions and initiatives on cruise tourism development in Hong Kong were reflected and promulgated every year in the Government's Policy Addresses, Policy Agendas as well as Budget Speeches. The TC has been seeing positive results, with the number of ship calls increased by 115% and the total passenger throughput by 254% from 2013 to 2016. Also, the cruise vessels calling at the KTCT have also become more diversified, with the number of international cruise brands doubled from 9 in 2015 to 18 in 2016; and
- (b) the TC has consulted the ACCI in the process of formulating the strategic directions and initiatives on cruise tourism development. The TC will extend such consultation in its strategic planning process to cover tourist attractions, hotels and the retail sector starting this year. The TC will also formalise this engagement process and consolidate the various strategies and initiatives into a single document entitled "Strategic Plan for Cruise Tourism" for easy reference.

**Schedule of variable rent (as percentage of annual gross receipt)
payable by the terminal operator to the Government**

Annual gross receipt	Percentage
Such part of annual gross receipt ≤ \$30 million	7.3 %
Such part of annual gross receipt > \$30 million to ≤ \$60 million	18 %
Such part of annual gross receipt > \$60 million to ≤ \$90 million	23 %
Such part of annual gross receipt > \$90 million	34 %

Source: TC records

**Cruise Team of the Tourism Commission:
Organisation chart
(31 December 2016)**



Source: TC records

Remarks: Apart from overseeing the Cruise Team's work, the Assistant Commissioner for Tourism is also responsible for other duties under the purview of the TC, including overseeing the work of Disney Team.

Acronyms and abbreviations

ACCI	Advisory Committee on Cruise Industry
ArchSD	Architectural Services Department
Audit	Audit Commission
EMSD	Electrical and Mechanical Services Department
EMSTF	Electrical and Mechanical Services Trading Fund
EPD	Environmental Protection Department
FC	Finance Committee
HKTB	Hong Kong Tourism Board
KTCT	Kai Tak Cruise Terminal
LCSD	Leisure and Cultural Services Department
LegCo	Legislative Council
m ²	Square metres
OPS	On-shore power supply
SLA	Service Level Agreement
TA	Tenancy Agreement
TC	Tourism Commission

CHAPTER 6

**Labour and Welfare Bureau
Social Welfare Department**

**Management of projects
financed by the Lotteries Fund**

**Audit Commission
Hong Kong
3 April 2017**

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. 68 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 PROJECTS FINANCED BY THE LOTTERIES FUND

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MANAGEMENT OF PROJECTS FINANCED BY THE LOTTERIES FUND

Executive Summary

1. The Lotteries Fund (LF) was established in 1965 by resolution of the Legislative Council (LegCo) for the purpose of financing the support and development of social welfare services in Hong Kong by way of providing grants, loans and advances. Under the Betting Duty Ordinance (Cap. 108) and the Road Traffic (Registration and Licensing of Vehicles) Regulations (Cap. 374E), 15% of the Mark Six Lottery proceeds and net proceeds from the sale of special vehicle registration marks by auction are allocated to the LF respectively. In 2015-16, the LF recorded receipts of \$1,331 million and payments of \$937 million. As of March 2016, the LF had a fund balance of \$22 billion which was placed with the Exchange Fund.

2. An non-governmental organisation (NGO) or a government bureau or department (B/D) may apply for an LF grant to finance 5 major categories of social-welfare related expenditures, including: (a) those incurred for premises renovation and construction; (b) an experimental project; (c) subvention-linked minor expenditures; (d) Social Welfare Development Fund expenditures; and (e) fitting-out works and furniture and equipment (F&E) expenditures for new/reprovisioned premises. For the 5-year period 2011-12 to 2015-16, 3,234 grants totalling \$10,104 million had been approved.

3. The Lotteries Fund Project Section of the Social Welfare Department (SWD) is responsible for administering the LF. As of December 2016, the Section had 17 staff members. Audit has recently conducted a review to examine the SWD's management of projects financed by the LF.

Administration of funding applications

4. An NGO is eligible to apply for an LF grant if it is recognised by the SWD, the Department of Health or the Education Bureau as a non-profit-making organisation providing a valuable service to the community (para. 2.2).

Executive Summary

5. *Application processing time exceeding target time.* According to the SWD, the target time for processing an application for an LF grant with a value exceeding \$400,000 (known as a major grant) is 9 months and with a value of \$400,000 or below (known as a minor grant) is 4 months. For the 5.5 years from April 2011 to September 2016, the SWD had processed and approved 1,251 applications for major grants and 1,087 applications for minor grants. Audit examination revealed that the time taken to process 236 (19% of 1,251) applications for major grants and 245 (23% of 1,087) applications for minor grants had exceeded the target time of 9 months and 4 months respectively. In particular, the SWD had taken 2 to 7.5 years to complete processing 82 major-grant applications and 1 to 3.6 years to complete processing 30 minor-grant applications (para. 2.6).

6. *Commencement and completion of an LF-funded project without funding approval.* An LF grant exceeding \$4 million required the funding approval of the Financial Services and the Treasury Bureau (FSTB). For a project financed by an LF grant of \$35.7 million to construct three welfare facilities for, among others, provision of 120 service places for the elderly at a private development, the FSTB granted an in-principle approval for the grant in December 2004, subject to the submission of an accurate and detailed technical appraisal of the construction cost. However, the FSTB's approval for the LF grant was not obtained until May 2012, 10 months after the completion of the construction of the welfare facilities in July 2011 (para. 1.8 and Case 1 in para. 2.7).

7. *Need to strengthen assistance to NGOs for early implementation of Special Scheme projects.* In his 2013 Policy Address, the Chief Executive of the Hong Kong Special Administrative Region announced that the Government would seek to use the LF more flexibly and make better use of the land owned by NGOs through redevelopment or expansion to provide diversified subvented and self-financing facilities. In February 2014, the Finance Committee of LegCo approved the allocation of \$10 billion from the General Revenue to the LF to ensure that the LF would have sufficient resources to implement feasible projects under the Special Scheme on Privately Owned Sites for Welfare Uses (the Special Scheme). In November 2013, upon closing of submission of preliminary proposals for grants under the Special Scheme, 43 NGOs had submitted 63 preliminary proposals. In February 2014, the Labour and Welfare Bureau (LWB) and the SWD informed LegCo that, if all the proposals were technically feasible and could be implemented smoothly, about 9,000 additional service places for the elderly and 8,000 additional places for rehabilitation services for persons with disabilities would be provided,

Executive Summary

and the amount of LF allocation required for implementing the projects was estimated to be in the order of \$20 billion (paras. 1.12 and 1.14).

8. As of November 2016, of the 63 preliminary proposals targeting to provide 17,000 service places, only 1 project providing 100 service places had been completed, and 11 projects that would provide 3,609 service places were at different implementation stages. However, the remaining 51 projects were at different planning stages. As of September 2016, LF grants for the 12 (1 completed project + 11 projects at different implementation stages) projects amounted to \$227 million, only representing 1% of the total estimated grant amount of \$20 billion (para. 2.24).

Administration of project implementation

9. *Long-outstanding projects and long time taken in finalising project accounts.* As of September 2016, 1,198 LF-funded projects were in progress and approved commitments totalling \$7.5 billion had not been disbursed to related NGOs or B/Ds. Of these 1,198 projects, funding approvals for 280 (23%) projects had been granted 5 to 25 years ago. Of these 280 projects, 5 projects (2%) for which funding approvals had been granted 5 to 8 years ago had not commenced any works, 16 projects (6%) for which funding approvals had been granted 5 to 7 years ago had not completed the works, and 259 projects (92%) for which funding approvals had been granted 5 to 25 years ago had had the works completed but the project accounts had not been finalised and submitted to the SWD. Approved commitments totalling \$690 million had not been disbursed for these 259 projects. Approved LF commitments not required for LF projects could be released for funding other projects upon finalisation of the project accounts (paras. 3.3 to 3.6).

10. The long time taken in finalising project accounts was attributed to a variety of reasons. In one example where an LF grant of \$1.46 million was approved in February 1993 for the construction and fitting-out works of a social centre for the elderly, the project account could not be finalised 19 years after the substantial completion of the works in December 1997, because the assignment of the title of the social centre to the Government had not been finalised (Case 7 in para. 3.6).

Executive Summary

11. *Lack of information on NGO board approvals for departures from procurement requirements.* In 2015-16, grant payments totalling \$937 million were made under 641 LF grants for implementing capital works, or procurement of F&E or services. As specified under the LF Manual, the Board of an NGO may approve departures from LF requirements on procurement of goods and services. However, NGOs were not required to report to the SWD details and justifications of their board approvals for departures from LF procurement requirements. The absence of this information has weakened the SWD's monitoring of the procurement of goods and services financed by LF grants (paras. 3.8 to 3.10).

Governance and management issues

12. The Lotteries Fund Advisory Committee (LFAC), an advisory body to the SWD on considering applications for LF grants and fund-raising activities (such as the allocation of flag days), is chaired by the Director of Social Welfare and comprises 11 members including a representative from the LWB and 10 non-official members from the social welfare, academic and business sectors. Members are appointed on a two-year term by the Secretary for Labour and Welfare (para. 4.2).

13. *Some LFAC members not declaring potential conflicts of interest.* Audit's examination of SWD records revealed that two LFAC members had not made declarations of potential conflicts of interest on 2 and 1 agenda items respectively discussed at LFAC meetings (paras. 4.8 to 4.11).

14. *Some LFAC members who were also paid executive staff of NGOs attended meetings involving discussion of related agenda items.* According to the Standing Orders of the LFAC, if an LFAC member is a paid executive staff of an agency of which a matter would be considered by the LFAC, the member normally would not be issued the relevant committee paper of the agenda item concerned. However, Audit examination revealed that two LFAC members, who were paid executive staff of two NGOs respectively, were issued relevant LFAC papers and attended meetings involving discussion of 3 and 1 grant applications which were respectively related to the two NGOs concerned (paras. 4.12 and 4.13).

Executive Summary

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 Government should:

Administration of funding applications

- (a) strengthen measures with a view to processing grant applications within the target completion time of 9 months for major grants and 4 months for minor grants (para. 2.15(f));
- (b) take measures to ensure that an LF-funded project will not commence without obtaining funding approval for the project (para. 2.15(a));
- (c) sustain and strengthen actions to coordinate with the applicant organisations and related B/Ds with a view to implementing projects under the Special Scheme as early as possible (para. 2.27);

Administration of project implementation

- (d) take measures to provide assistance to NGOs of LF-funded projects to commence works in a timely manner (para. 3.19(a));
- (e) take measures to ensure that works-project accounts are finalised in a timely manner after works completion, with a view to releasing unpaid commitments not required for LF projects for funding other projects (para. 3.19(c));
- (f) expedite actions to follow up the assignment of the social centre for the elderly in Case 7 to the Government (para. 3.19(f));
- (g) consider requiring NGOs to submit to the SWD annual returns showing details and justifications of their board approvals for departures from the LF procurement requirements (para. 3.19(g));

Executive Summary

Governance and management issues

- (h) **strengthen measures to periodically remind LFAC members of the need to fully make declarations of potential conflicts of interest for agenda items discussed at LFAC meetings (para. 4.18(a)); and**
- (i) **critically consider whether an LFAC member who is also a paid executive staff of an NGO needs to be issued relevant LFAC papers (para. 4.18(c)).**

Response from the Government

- 16. The Government 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 The Lotteries Fund (LF) was established in 1965 by resolution of the Legislative Council (LegCo) for the purpose of financing the support and development of social welfare services in Hong Kong by way of providing grants, loans and advances (Note 1).

1.3 Under the Betting Duty Ordinance (Cap. 108), 15% of the Mark Six Lottery (Note 2) proceeds are allocated to the LF. Moreover, under the Road Traffic (Registration and Licensing of Vehicles) Regulations (Cap. 374E), net proceeds from the sale of special vehicle registration marks by auction are also allocated to the LF. In 2015-16, relevant proceeds from the Mark Six Lottery and sale of special vehicle registration marks being allocated to the LF were \$1,219 million and \$103 million respectively.

1.4 In 2015-16, LF provided grants totalling \$937 million for the support and development of social welfare services. The total receipts and payments of the LF as well as its fund balances from 2011-12 to 2015-16 are shown in Table 1. As of March 2016, the LF had a fund balance of \$22 billion which was placed with the Exchange Fund (Note 3).

Note 1: *According to the Social Welfare Department, the LF had not approved any loan or advance from 2007 to 2016.*

Note 2: *The Mark Six Lottery is a 6 out of 49 lottery game conducted by the HKJC Lotteries Limited, a subsidiary of The Hong Kong Jockey Club.*

Note 3: *The Exchange Fund is established under the Exchange Fund Ordinance (Cap. 66). The principal objectives of the Fund are safeguarding the exchange value of the currency of Hong Kong and maintaining the stability and integrity of Hong Kong's monetary and financial systems.*

Introduction

Table 1

**Receipts, payments and fund balances of the LF
(2011-12 to 2015-16)**

Particulars	Financial year				
	2011-12 (\$ million)	2012-13 (\$ million)	2013-14 (\$ million)	2014-15 (\$ million)	2015-16 (\$ million)
(a) Receipts					
(i) Mark Six Lottery	1,208	1,172	1,159	1,182	1,219
(ii) Investment income	514	530	518	– (Note 1)	– (Note 1)
(iii) Auction of vehicle registration marks	62	77	77	71	103
(iv) Allocated from the General Revenue	–	–	10,000 (Note 2)	–	–
(v) Donation and others	33	1	3	69	9
Total	1,817	1,780	11,757	1,322	1,331
(b) Total payments	916	881	812	875	937
(c) Fund balance at year end	9,329	10,228	21,173	21,620	22,014

Source: Social Welfare Department records

Note 1: According to the Financial Secretary's directives, investment income of \$700 million for 2014-15 and \$1,197 million for 2015-16 were set aside and retained in the Exchange Fund as the housing reserve to provide financial resources to meet the ten-year public housing supply target.

Note 2: In March 2014, the Government allocated \$10 billion from the General Revenue to the LF (see para. 1.12).

LF grants

1.5 An non-governmental organisation (NGO) or a government bureau or department (B/D) may apply for an LF grant to finance expenditures of the following:

- (a) ***Premises renovation and construction.*** This includes, for example, construction of new premises, renovation and maintenance of existing premises, as well as slope inspection and remedial works. A B/D may be allocated an LF grant to carry out a project of the above-mentioned nature with an NGO being the target user or beneficiary;
- (b) ***An experimental project.*** This refers to a project which is experimental or innovative in nature with a duration not exceeding four years;
- (c) ***Subvention-linked minor expenditures.*** An NGO receiving annual subventions from the Social Welfare Department (SWD) may apply for an annual LF grant (also known as a Block Grant) which is equivalent to 1.5% of the amount of the SWD recurrent subvention provided to the NGO. The grant could be used for purchase of furniture and equipment (F&E) subject to each item costing \$50,000 or below, and for carrying out repairs and maintenance works subject to each project not exceeding \$500,000;
- (d) ***Social Welfare Development Fund (SWDF) expenditures.*** In 2009, pursuant to the recommendations of the Lump Sum Grant Independent Review Committee (Note 4), \$1 billion was earmarked under the LF to set up the SWDF over a period of nine years from 2010-11 to 2018-19 to support NGOs receiving subventions from the SWD to provide training for their board members, management and staff, as well as upgrading their business systems and conducting studies aiming at enhancing their service delivery;

Note 4: *The Committee, appointed by the Secretary for Labour and Welfare in January 2008, is chaired by a person from the business sector and comprises four members from the academic and professional sectors.*

Introduction

- (e) ***Fitting-out works and F&E for new/reprovisioned premises.*** For a newly constructed government-owned welfare service premises, the SWD may apply for an LF grant on behalf of a future operator to meet the costs of fitting-out works and F&E. For a reprovisioned project, the NGO concerned may apply for an LF grant to meet the costs of fitting-out works and F&E; and
- (f) ***Others.*** This includes, for example, expenditures relating to implementation of an information technology project or purchase of vehicles.

1.6 Table 2 shows the amounts and numbers of LF grants approved from 2011-12 to 2015-16.

Table 2
Amounts and numbers of LF grants approved
(2011-12 to 2015-16)

LF grant purpose	2011-12	2012-13	2013-14	2014-15	2015-16
	\$ million (no. of grants)				
Premises renovation and construction (see para. 1.5(a))	323 (118)	516 (104)	512 (109)	434 (83)	2,881 (126) (Note 1)
Experimental project (see para. 1.5(b))	367 (9)	380 (2)	120 (11)	107 (6)	1,120 (9) (Note 2)
Subvention-linked minor expenditures (see para. 1.5(c)) (Note 3)	126 (154)	139 (199)	148 (237)	162 (296)	177 (150)
SWDF expenditures (see para. 1.5(d)) (Note 4)	– (–)	330 (1)	– (–)	– (–)	460 (1)
Fitting-out works and F&E (see para. 1.5(e))	196 (56)	321 (91)	304 (138)	287 (138)	229 (91)
Others (see para. 1.5(f))	99 (367)	107 (199)	71 (153)	89 (206)	99 (180)
Total	1,111 (704)	1,793 (596)	1,155 (648)	1,079 (729)	4,966 (557)

Source: Audit analysis of SWD records

Note 1: In 2015-16, two works projects, namely construction of an integrated rehabilitation services complex each at the site of ex-Siu Lam Hospital in Tuen Mun costing \$1,854 million and the ex-Kai Nang Sheltered Workshop and Hostel in Kwun Tong costing \$502 million, were approved. Excluding the two projects, the average project grant was \$4.2 million.

Note 2: In 2015-16, two experimental projects initiated by the SWD, namely a pilot scheme each on on-site pre-school rehabilitation services costing \$422 million and the community care service vouchers for the elderly costing \$559 million, were approved. Excluding the two projects, the average project grant was \$19.9 million.

Note 3: In 2012-13, 2013-14 and 2014-15, supplementary LF grants for subvention-linked minor expenditures were approved for some NGOs.

Note 4: Of the \$1 billion SWDF (see para. 1.5(d)), \$330 million and \$460 million were allocated to the SWD in 2012-13 and 2015-16 respectively. As of January 2017, SWDF disbursements totalling \$577 million had been made to NGOs for implementing approved projects.

Remarks: For the 6-month period April to September 2016, 289 applications for a total of \$661 million grants were approved.

Grant approving authority

1.7 Under section 6(4) of the Government Lotteries Ordinance (Cap. 334), the Financial Secretary of the Hong Kong Special Administrative Region (HKSAR) may appropriate moneys from the LF for the purpose of financing the support and development of social welfare services in Hong Kong.

1.8 ***Before August 2016.*** Before 4 August 2016, the Financial Secretary had delegated the approving authority to the Director of Social Welfare to approve the following LF grants:

- (a) grants for minor fitting-out works, renovations and purchase of additional or replacement F&E costing between \$10,000 and \$400,000 each;
- (b) grants disbursed on an agency basis for minor capital works costing below \$500,000 for each service unit and minor capital expenditure on F&E and vehicles with the cost not exceeding \$50,000 per item on the advice of the Lotteries Fund Advisory Committee (LFAC — Note 5); and
- (c) grants for non-experimental/experimental projects not exceeding \$4 million each on the advice of the LFAC.

Commitments for non-experimental/experimental projects exceeding \$4 million each were subject to the approval of the Financial Services and the Treasury Bureau (FSTB) on the advice of the LFAC.

Note 5: *The Committee, an advisory body to the SWD on considering applications for LF grants and conducting charitable fund-raising activities, is chaired by the Director of Social Welfare and comprises 11 members including a representative from the Labour and Welfare Bureau and 10 non-official members from the social welfare, academic and business sectors, who are appointed by the Secretary for Labour and Welfare. The Committee holds meetings once every two months.*

1.9 ***From August 2016.*** Under Financial Circular No. 7/2016, with effect from 4 August 2016, the Financial Secretary has delegated the approving authority to the Director of Social Welfare to approve the following LF grants:

- (a) grants for minor fitting-out works, renovations and purchase of additional or replacement F&E costing between \$10,000 and \$400,000 each;
- (b) grants disbursed on an agency basis for minor capital works costing below \$500,000 for each service unit and minor capital expenditure on F&E and vehicles with the cost not exceeding \$50,000 per item on the advice of the LFAC; and
- (c) grants for non-experimental projects costing below \$15 million each, and for experimental projects costing below \$4 million each on the advice of the LFAC.

Non-experimental projects each with a value of \$15 million or above, and experimental projects each with a value of \$4 million or above are subject to the approval of the FSTB on the advice of the LFAC.

1.10 LF grants may be approved for projects within the scope of work of the Education Bureau and the Department of Health having social welfare contents. From 2011-12 to 2015-16, 38 LF grants totalling \$49 million had been approved for projects within the scope of the Education Bureau having social welfare contents, and no LF grant had been approved for projects within the scope of the Department of Health.

1.11 The Lotteries Fund Projects (LFP) Section of the SWD is responsible for administering the LF. As of December 2016, the LFP Section had 17 staff members who were responsible for processing LF applications. An extract of the SWD's organisation chart relevant to the operation of the LF is shown in Appendix A.

Projects under the Special Scheme financed by the LF

1.12 In his 2013 Policy Address, the Chief Executive of the HKSAR announced that the Government would seek to use the LF more flexibly and make better use of the land owned by NGOs through redevelopment or expansion to provide diversified subvented and self-financing facilities. The Government would also provide targeted assistance to NGO land owners during the planning or development process. In February 2014, the Finance Committee of LegCo approved the allocation of \$10 billion from the General Revenue to the LF to ensure that the LF would have sufficient resources to implement feasible projects under the Special Scheme on Privately Owned Sites for Welfare Uses (the Special Scheme — Note 6). According to the Labour and Welfare Bureau (LWB), if necessary, the Government would flexibly deploy the allocated funds to support other projects within the remit of the LF.

1.13 The Special Scheme, launched by the LWB in September 2013, seeks to encourage welfare NGOs to provide or increase on their own sites those welfare facilities considered by the Government as being in acute demand, in particular elderly and rehabilitation facilities, through in-situ expansion, redevelopment or new development. The Special Scheme would support the capital costs of feasible projects. Under the Special Scheme, an applicant organisation has to make available on a site under its ownership, through expansion, redevelopment or new development, a net increase in the provision of one or more than one type of elderly or rehabilitation service specified by the Government.

1.14 Upon closing of the submission of preliminary proposals under the Special Scheme in November 2013, 43 welfare NGOs had submitted 63 preliminary proposals. According to information provided to LegCo in February 2014, based on the rough estimation of the applicant organisations, if all the proposals received under the Special Scheme were technically feasible and could be implemented smoothly:

Note 6: *From 2008-09 to 2012-13, the average revenue and expenditure of the LF amounted to about \$1.6 billion and \$800 million per year respectively.*

- (a) about 9,000 additional service places for the elderly and 8,000 additional places for rehabilitation services for persons with disabilities would be provided;
- (b) the amount of LF allocation required for implementing the projects was estimated to be in the order of \$20 billion; and
- (c) the LWB was co-ordinating the examination and implementation of the preliminary proposals received under the Special Scheme.

Audit review

1.15 In 2002, the Audit Commission (Audit) completed a review on administration of grants from government funds (see Chapter 3 of the Director of Audit's Report No. 38 of March 2002).

1.16 In October 2016, Audit commenced a review to examine the SWD's management of projects financed by the LF. The review focuses on the following areas:

- (a) administration of funding applications (PART 2);
- (b) administration of project implementation (PART 3); and
- (c) governance and management issues (PART 4).

Audit has identified areas where improvements can be made by the Government in the above areas, and has made a number of recommendations to address the issues.

General response from the Government

1.17 The Director of Social Welfare welcomes this audit review and agrees with the audit recommendations with a view to improving the administration of funding applications, project implementation, and governance and management issues of the LF.

Introduction

1.18 The Secretary for Financial Services and the Treasury welcomes this audit review and supports the audit recommendations with a view to improving the administration of funding applications, project implementation and other management issues identified. He trusts that the Director of Social Welfare, being the Controlling Officer for the LF, will take the lead and work with relevant parties to take necessary follow-up actions.

Acknowledgement

1.19 Audit would like to acknowledge with gratitude the full cooperation of the staff of the LWB and the SWD during the course of the audit review.

PART 2: ADMINISTRATION OF FUNDING APPLICATIONS

2.1 This PART examines actions taken by the SWD in administering LF funding applications (paras. 2.2 to 2.17) and the Special Scheme on Privately Owned Sites for Welfare Uses (paras. 2.18 to 2.29).

Funding applications

2.2 The LFP Section of the SWD is responsible for processing LF funding applications before submitting them to the Director of Social Welfare or the Secretary for Financial Services and the Treasury for approval (see paras. 1.8 and 1.9). Under the LF Manual (Note 7), an NGO is eligible to apply for an LF grant if it is recognised by the SWD, the Department of Health or the Education Bureau as a non-profit-making organisation providing a valuable service to the community.

2.3 In 2015-16, a total of 557 LF grants amounting to \$4,966 million were approved. Details are shown in Table 3.

Note 7: *The LF Manual was issued by the SWD for regulating matters related to the use of LF grants. It stipulated procedures for applications, payments and controls of the grants.*

Table 3
Approved LF grants
(2015-16)

LF grant	LF grant approved	
	(Number)	(\$ million)
Provided to NGOs receiving SWD annual subventions	525	710
Provided to NGOs not receiving SWD annual subventions	10	46
Provided to B/Ds as works agents (Note) for constructing new welfare-service premises	12	2,630
Provided for experimental projects and SWDF (see para. 1.5(b) and (d))	10	1,580
Total	557	4,966

Source: Audit analysis of SWD records

Note: For example, the Hong Kong Housing Authority (with the Housing Department as its executive arm) is the works agent for projects located in public housing developments.

2.4 According to the SWD, the general procedures for processing LF grant applications are as follows:

- (a) ***Initial screening.*** Upon receiving an application from an NGO or a B/D, the LFP Section will issue an acknowledgement letter, conduct initial screening of the application and liaise with the applicant for supplementary information to ensure that the application information is complete and the application is ready for service assessment and technical vetting;
- (b) ***Service assessment.*** Upon receipt of an application after initial screening by the LFP Section, the relevant SWD service branch (Note 8 — see Appendix A) and/or other B/Ds (e.g. Education Bureau, Department of Health and Home Affairs Department) will assess and provide comments on the support-worthiness of the application from the policy or service point of view and confirm whether the application is within the ambit of the LF;
- (c) ***Technical assessment (for projects related to works or purchase of vehicles).*** If an application for an LF grant for meeting the costs of construction, renovation and fitting-out works exceeds \$500,000, the Architectural Services Department (ArchSD) (or the Architectural Section of the SWD for a related LF funding application of \$500,000 or below) will conduct the technical vetting (including assessing the feasibility, specifications, requirements and cost estimates) of the project. For procurement of vehicles, the Electrical and Mechanical Services Department will assess and provide comments on the application from the technical perspective;
- (d) ***Clarification and revision of application.*** Upon receipt of comments relating to service and/or technical assessments, the applicant NGO or B/D needs to make clarifications and provide supplementary information for further assessments. For an application requiring major changes to the scope of a project, the applicant organisation may need to substantially revise the original application, which will require going through the procedures stated in items (a) to (c) above;

Note 8: *LF applications are mainly vetted by four SWD service branches, namely Elderly Branch, Family and Child Welfare Branch, Rehabilitation and Medical Social Services Branch, and Youth and Corrections Branch.*

Administration of funding applications

- (e) ***Consultation with different stakeholders.*** For projects having impacts on the environment, transport or society, the SWD will conduct consultations with stakeholders including District Councils, Incorporated Owners and related groups. For projects having policy and financial implications, the SWD will also seek the endorsement of relevant B/Ds. For projects involving significant resources from the LF and the Government, the SWD will consult the relevant LegCo Panels; and
- (f) ***Funding approval.*** The SWD will seek funding approval from the relevant approving authority (see paras. 1.8 and 1.9) for an eligible application. For a project incurring recurrent government expenditure exceeding \$10 million a year, the SWD will consult the relevant LegCo Panel before proceeding to seek funding approval.

The specific procedures for processing LF grants for different purposes are summarised in Appendix B.

2.5 In 2015-16, 557 LF applications were approved and 19 applications were not approved. Of the 19 unsuccessful applications:

- (a) 9 applications were withdrawn by NGOs; and
- (b) 10 applications were not approved on the grounds of inadequate justifications or not falling within the ambit of the LF.

Application processing time exceeding target time

2.6 According to the SWD, the target time for processing an application for an LF grant with a value exceeding \$400,000 (hereinafter referred to as a major grant) and a grant with a value of \$400,000 or below (hereinafter referred to as a minor grant) is 9 months and 4 months respectively. From April 2011 to September 2016, the SWD had processed and approved 1,251 applications for major grants and 1,087 applications for minor grants. Audit examination revealed that, of these 1,251 and 1,087 applications, the time respectively taken to process 236 (19%) and 245 (23%) applications had respectively exceeded the SWD's target time of 9 months for major grants and 4 months for minor grants. Analyses of the time taken in processing approved applications are shown in Table 4.

Table 4

**Time taken in processing applications
(April 2011 to September 2016)**

Time taken from grant application to approval	Applications approved	
	(No.)	(Percentage)
(a) Major grants		
Within 9 months	1,015	81 %
More than 9 months to 1 year	53	4 %
More than 1 year to 2 years	101	8 %
More than 2 years to 3 years	46	4 %
More than 3 years to 7.5 years	36	3 %
Total	1,251	100 %
(b) Minor grants		
Within 4 months	842	77 %
More than 4 months to 1 year	215	20 %
More than 1 year to 2 years	24	2 %
More than 2 years to 3.6 years	6	1 %
Total	1,087	100 %

Source: Audit analysis of SWD records

2.7 Audit selected two approved applications with the longest processing time, namely Case 1 for a major grant and Case 2 for a minor grant, for examination.

Case 1

Commencement and completion of a premises-construction project (Project A) without funding approval (October 2004 to May 2012)

1. In October 2004, after endorsement by the LFAC, the SWD sought the FSTB's approval for a premises-construction grant (see para. 1.5(a)) of \$35.7 million (comprising \$32.5 million construction cost and \$3.2 million for contingencies) to meet the construction costs of three welfare facilities (Project A) for, among others, provision of 120 service places for the elderly in a private development.

2. According to the proposed land lease conditions of the land grant for the private development, a developer was required to construct the proposed welfare facilities at the cost of the Government. The ArchSD was the technical adviser responsible for estimating the cost of the proposed welfare facilities for inclusion in the conditions of the land grant. According to the ArchSD, in the absence of a design for the facilities, the estimate was a rough indication of the related cost.

3. In December 2004, the FSTB granted an in-principle approval for the LF grant subject to the submission of a more accurate and detailed technical appraisal of the \$32.5 million construction cost. The FSTB also suggested that LF fund of \$35.7 million should be reserved for Project A.

4. In the same month, the ArchSD advised the SWD to approach the developer, who would be entrusted this project as the works agent, to undertake a more accurate and detailed technical appraisal requested by the FSTB.

5. In January 2005, the SWD requested the Lands Department (Lands D) to add a clause in the land lease to require the developer to undertake a more accurate and detailed technical appraisal of the \$32.5 million construction cost. In response, the Lands D said that the SWD and ArchSD should have carried out the cost appraisal before advising it to incorporate in the land lease the maximum construction cost of \$32.5 million payable by the Government, and the Lands D did not see the need or rationale to require the developer to separately undertake a detailed technical appraisal of the construction cost. According to the Lands D, given the potential conflict of interest involved, it would not be appropriate for the developer, being the beneficiary of the reimbursement arrangement, to undertake the detailed appraisal of the construction cost. According to the SWD, it would not be feasible for the ArchSD to conduct a more accurate and detailed technical appraisal of the project construction cost before the completion of a detailed design, which would only be prepared by the developer after the execution of the land grant.

Case 1 (Cont'd)

6. In February 2005, the SWD informed the FSTB that: (a) as the developer would be the works agent for the project, the ArchSD was unable to fulfil the condition as mentioned in paragraph 3; and (b) according to the Lands D, the Government was considered to have already reserved considerable control since the eventual payment made by the Government to the developer would be either the consideration cost stated in the land grant (i.e. \$32.5 million) or the actual cost of the construction of the social welfare facilities as determined by the Director of Lands, whichever was less, and the Director of Lands' decision should be final and binding on the developer. In response, the FSTB restated the requirement for more information and elaborations in connection with the in-principle approval (see para. 3). According to the FSTB, it expected the SWD to take follow-up actions on the issue.

7. In December 2005, before execution of the land grant, the ArchSD issued a memo to the SWD, copied to the Lands D, reminding the SWD to secure funding for the welfare facilities. In the event, the land grant was executed in July 2006, under which construction of the welfare facilities concerned was targeted for completion by July 2011.

8. Between March 2005 and February 2009, the SWD LFP Section repeatedly requested the SWD Project Planning Unit to follow up with the FSTB on the funding approval for Project A.

9. In February 2009, the SWD informed the FSTB that the developer would complete construction of the welfare facilities by July 2011 in accordance with the land lease condition and sought the FSTB's approval for the LF grant before the project works commencement.

10. In August 2009, in response to the FSTB's further request raised in February 2009 for a detailed breakdown of the construction cost of the welfare facilities, the SWD informed the FSTB of the calculation basis of the estimated total construction cost of \$32.5 million, which had been incorporated into the land grant as the maximum amount payable by the Government. In response, the FSTB asked whether there was a detailed breakdown of the construction cost.

11. In July 2011, the construction of the welfare facilities was completed. In March 2012, the SWD informed the FSTB that the developer would hand over the welfare facilities to the Government in May 2012, and sought the FSTB's approval for the LF grant.

Case 1 (Cont'd)

12. In May 2012, the FSTB approved an LF grant of \$35.7 million for the project, 7.5 years after the SWD first sought funding approval in October 2004, and 10 months after the completion of the works in July 2011.

Audit comments

13. Audit considers it unsatisfactory that, while the land grant was executed in July 2006 under which the Government was committed to reimbursing \$32.5 million to the developer for constructing three welfare facilities at the private development, the related LF grant of \$35.7 million was not approved by the FSTB until May 2012, 7.5 years after the FSTB's approval for the grant was first sought in October 2004. At the time of grant approval, the construction of the welfare facilities had already been completed in July 2011 and subsequently handed over to the Government in May 2012. In Audit's view, the SWD needs to take measures to ensure that an LF-funded project will not commence without obtaining funding approval for the project.

Source: Audit analysis of SWD records

Case 2

**Repeated revisions of grant application for vehicle purchase
(Project B)
(November 2011 to July 2015)**

1. In November 2011, an NGO (NGO 1) made an application for a vehicle-purchase grant (see para. 1.5(f)) of \$754,000 to replace an existing 7-seater van with a 14-seater light bus for its integrated home-care services for the elderly (Project B).

2. Under the SWD's requirement, a centre providing integrated home-care services for the elderly may apply for an LF grant for replacement of not more than half of its existing vehicle fleet by 16-seater vans with the remaining vehicles being 5-seater or 6-seater vans. In January 2012, since an LF grant had already been allocated to NGO 1 for replacing one of its three 7-seater vans by a 16-seater light bus in January 2008, the SWD informed NGO 1 that the application was not supported and the SWD reiterated its requirement as mentioned above.

3. In August 2013, NGO 1 submitted a revised application for an LF grant to replace an existing 7-seater van with a 4-seater car. Given that the 4-seater car was not the standard SWD-supported provision, the application again was not supported by the SWD.

4. In November 2014, NGO 1 resubmitted an application for a 5-seater van. In July 2015, an LF grant of \$341,000 was approved for NGO 1, 3.6 years after NGO 1 first sought funding approval for a 14-seater light bus in November 2011.

Audit comments

5. Audit noted that NGO 1 had repeatedly revised the grant application from November 2011 to November 2014. In Audit's view, in order to facilitate management of long-outstanding cases, the SWD needs to consider a revised application involving a significant change of scope as a new application.

Source: Audit analysis of SWD records

Administration of funding applications

2.8 In February 2017, after carrying out an examination of the 82 applications for major grants with processing time exceeding 2 years and the 30 applications for minor grants with processing time exceeding 1 year (see Table 4 in para. 2.6), the SWD noted that:

- (a) 66 (80% of 82) applications for major grants and 20 (67% of 30) applications for minor grants involved re-submissions of applications due to complexities and changes of scope of the funding applications;
- (b) the dates of 12 (15% of 82) applications for major grants and 1 (3% of 30) application for a minor grant had been mistakenly inputted into the database;
- (c) 3 (4% of 82) applications for major grants and 7 (23% of 30) applications for minor grants involved NGOs' delays in submitting supplementary information; and
- (d) 1 (1% of 82) application for a major grant and 2 (7% of 30) applications for minor grants involved other reasons (such as a B/D taking a long time to vet an application due to its complexities).

2.9 Furthermore, of the 272 applications for major grants and 51 applications for minor grants which were under processing, as of September 2016, the time used for handling 179 (66%) applications for major grants and 36 (71%) applications for minor grants had exceeded their corresponding target processing time. Analyses of the time taken in processing the applications as of September 2016 are shown in Table 5.

Table 5

**Time taken in processing applications in progress
(September 2016)**

Time taken from grant application to 30 September 2016	Applications in progress	
	(No.)	(Percentage)
(a) Major grants		
Within 9 months	93	34 %
More than 9 months to 2 years	62	23 %
More than 2 years to 3 years	48	18 %
More than 3 years to 4 years	18	7 %
More than 4 years to 5 years	39	14 %
More than 5 years to 8.5 years	12	4 %
Total	272	100 %
(b) Minor grants		
Within 4 months	15	29 %
More than 4 months to 1 year	20	39 %
More than 1 year to 3 years	8	16 %
More than 3 years to 5 years	3	6 %
More than 5 years to 6.9 years	5	10 %
Total	51	100 %

Source: Audit analysis of SWD records

2.10 Audit selected two applications with the longest processing time as of September 2016, namely Case 3 for a major grant and Case 4 for a minor grant, for examination.

Case 3

Long time taken by an NGO to satisfy funding requirements (Project C) (March 2008 to September 2016)

1. In March 2008, an applicant NGO (NGO 2) submitted an application for a premises-renovation grant (see para. 1.5(a)) of \$4.5 million to carry out renovation works and purchase of F&E items for an elderly home (Project C). In September 2008, after the initial screening conducted by the LFP Section, the application was forwarded to the SWD Elderly Branch for vetting. Photographs 1 and 2 show the deteriorated conditions of the elderly home when NGO 2 made the application.

Photographs 1 and 2

Deteriorated conditions of the elderly home (October 2008)



Source: SWD records

2. From November 2009 to June 2011, in response to comments of the SWD Elderly Branch and Licensing Office on the proposed layout plan, NGO 2 made repeated revisions to the application.

3. In September 2011, the application was forwarded to the ArchSD for technical vetting. In response to the technical comments, NGO 2 revised the application in December 2011. In February 2012, the SWD forwarded the ArchSD's further technical comments to NGO 2.

4. From February 2012 to May 2013, the SWD had issued several email reminders to urge NGO 2 to revise the application and submit a list of F&E items to support the funding application.

Case 3 (Cont'd)

5. In March 2015, the SWD contacted NGO 2 again to follow up the application. In September 2015, NGO 2 made a revised application to apply for a grant of \$42.9 million.

6. In August 2016, the application was forwarded to the ArchSD for technical vetting. As of September 2016, processing of the application was in progress, 8.5 years after NGO 2 first sought funding approval in March 2008.

Audit comments

7. As revealed in this case, NGO 2 had taken a long time from March 2008 to March 2015 to respond to enquiries and comments of the SWD and the ArchSD with a view to satisfying the funding requirements. Moreover, NGO 2 had significantly revised the project scope from works costing \$4.5 million to \$42.9 million (part of the cost increase was due to inflation). In order to facilitate management of long-outstanding cases, the SWD needs to identify long-outstanding cases where the NGOs have difficulties in meeting funding requirements and provide necessary assistance to them. It also needs to consider a revised application involving a significant change of scope as a new application.

Source: Audit analysis of SWD records

Case 4

Lack of follow-up actions on a long-outstanding application (Project D) (October 2009 to September 2016)

1. In October 2009, an applicant NGO (NGO 3) submitted an application for a premises-renovation grant (see para. 1.5(a)) of \$197,900 to carry out repair works on slopes and retaining walls adjacent to an elderly home (Project D).

2. In December 2009, the SWD informed NGO 3 that the application would not be approved because the elderly home would soon be redeveloped, with the remaining life span probably be less than three years. The SWD requested NGO 3 to provide justifications and more information to support the application if the repair works were considered necessary.

3. In March 2010, the SWD issued a letter to NGO 3 and asked if the application was still required. There was no file record showing any SWD action taken from April 2010 to September 2016 on the \$197,900 grant application. Audit noted that a premises-construction grant of \$179 million was approved in January 2011 and a supplementary grant of \$119 million was approved in October 2013 for the redevelopment of the elderly home into a service complex, and the works were completed in 2016.

Audit comments

4. Audit noted that, as of September 2016, this application was still in progress, 6.9 years after NGO 3 first sought funding approval in October 2009. In Audit's view, the SWD needs to follow up with NGO 3 to ascertain if the LF grant of \$197,900 for carrying out repair works on slopes and retaining walls is still required. The SWD also needs to strengthen measures on following up long-outstanding cases (including coordinating different funding requests by the same NGO in the same location) and remove from SWD database those no longer in need of LF grants.

Source: Audit analysis of SWD records

2.11 In February 2017, after carrying out an examination of the 117 applications for major grants with processing time exceeding 2 years and the 16 applications for minor grants with processing time exceeding 1 year (see Table 5 in para. 2.9), the SWD noted that:

- (a) 82 (70% of 117) applications for major grants and 9 (56% of 16) applications for minor grants involved re-submissions of applications due to complexities and changes of scope of the works;
- (b) 13 (11% of 117) applications for major grants involved NGO consultants taking a long time to prepare and revise the LF applications for the works projects;
- (c) 3 (3% of 117) applications for major grants and 1 (6% of 16) application for a minor grant involved NGOs' delays in submitting supplementary information;
- (d) in 3 (3% of 117) applications for major grants and 2 (13% of 16) applications for minor grants, each of the NGO applicants was found to have submitted more than one LF application for a works project with the same scope (e.g. renovation or redevelopment of premises) for the same premises;
- (e) 12 (10% of 117) applications for major grants and 3 (19% of 16) applications for minor grants involved other reasons (such as a B/D taking a long time to vet an application due to its complexities); and
- (f) 4 (3% of 117) applications for major grants and 1 (6% of 16) application for a minor grant involved data input errors (including incorrect file references and duplicated records of the same application). These cases should have been removed from SWD database.

Administration of funding applications

2.12 According to the SWD:

- (a) the SWD's existing database was designed to record the total time taken in processing a grant application from the date of receipt of the application to the date of granting funding approval. A re-submission of an application involving a major change of the scope will not be re-classified as a new application;
- (b) the long processing time was normally not caused by delays on the part of SWD staff involved. Factors contributing to the delays included insufficient and incomplete information provided by NGO applicants, revisions of project scopes, and time taken on consultations with B/Ds; and
- (c) from April 2011 to September 2016, despite an upsurge of LF applications in terms of the number and complexities, there were improvements in meeting the target processing time. In particular, 81% and 77% of applications for major grants and minor grants respectively had been processed within the target processing time, as compared to 77% and 70% respectively in 2000-01.

2.13 In Audit's view, in order to facilitate management of long-outstanding cases, the SWD needs to consider a revised application involving a significant change of scope as a new application. Moreover, the SWD also needs to take measures to ensure the accuracy of data in SWD database.

2.14 Audit noted that the long time taken to process applications for LF grants would lead to delays in providing improved welfare services and facilities to persons in need of the services. The SWD needs to strengthen measures with a view to processing grant applications within the target completion time of 9 months for major grants and 4 months for minor grants. The SWD also needs to consider promulgating performance pledges on the time of processing applications for LF grants.

Audit recommendations

2.15 **Audit has *recommended* that, in processing applications for LF grants, the Director of Social Welfare should:**

- (a) take measures to ensure that an LF-funded project will not commence without obtaining funding approval for the project;**
- (b) identify long-outstanding cases where the NGOs have difficulties in meeting funding requirements and provide necessary assistance to them;**
- (c) strengthen measures on following up long-outstanding cases and remove from SWD database those no longer in need of LF grants;**
- (d) consider a revised application involving a significant change of scope as a new application;**
- (e) take measures to ensure the accuracy of data in SWD database;**
- (f) strengthen measures with a view to processing grant applications within the target completion time of 9 months for major grants and 4 months for minor grants; and**
- (g) consider promulgating performance pledges on the time of processing applications for LF grants.**

Response from the Government

2.16 The Director of Social Welfare agrees with the audit recommendations. She has said that:

- (a) the SWD has strengthened procedural requirements to ensure that B/Ds involved complete technical work and assessments before seeking funding approvals;
- (b) the SWD will liaise closely and provide assistance to NGOs having difficulties in meeting funding application requirements;
- (c) the SWD will examine the target processing time to take into account the complexity of a project, the need for revisions of the scope of a project, the need for consultation with different stakeholders and other B/Ds, and the upsurge in the number of LF applications. The SWD will revamp the database to better reflect the time taken to process applications; and
- (d) for Case 4 in paragraph 2.10, in February 2017, NGO 3 formally withdrew the grant application for carrying out repair works on slopes and retaining walls because the required works had been carried out under another redevelopment project which had been completed.

2.17 The Director of Architectural Services has said that the ArchSD will continue to provide necessary assistance and technical advice to the SWD upon request with a view to ensuring that an LF-funded project will not commence before obtaining funding approval for the project.

Special Scheme on Privately Owned Sites for Welfare Uses

2.18 Under the Special Scheme (see paras. 1.12 to 1.14), a participating NGO needs to make available a net increase in the provision of one or more than one type of elderly or rehabilitation service as specified by the Government on a site under its ownership through expansion or redevelopment of an existing premises, or undertaking a new development. An NGO may apply for an LF grant to finance the related technical feasibility studies as well as the construction and fitting-out costs.

2.19 In February 2014, when seeking \$10 billion funding approval for the Special Scheme, the LWB and the SWD informed LegCo:

- (a) that the Government had received 63 preliminary proposals submitted by 43 NGOs, which comprised proposals for:
 - (i) 42 redevelopment projects;
 - (ii) 9 expansion projects; and
 - (iii) 12 new development projects;
- (b) that if all the projects under the Special Scheme could be implemented smoothly, these 63 projects would create about 9,000 and 8,000 additional places for elderly services and rehabilitation services respectively;
- (c) that the estimated amount required under the LF would be around \$20 billion; and
- (d) of the details of the distribution of the 17,000 (9,000 plus 8,000) additional service places among the 18 District Council districts in terms of four broad service types (namely residential care services for the elderly, day care services for the elderly, residential care services for persons with disabilities, and day care/vocational rehabilitation services for persons with disabilities).

Administration of funding applications

2.20 According to the SWD, whilst an applicant NGO may apply for an LF grant under the Special Scheme to meet the non-recurrent costs of an eligible project, it may also seek other funding sources (such as private trust funds) for the project.

2.21 In January 2017, the SWD informed Audit that the estimated cost of \$20 billion of the 63 projects was based on a rough estimate of an average of \$300 million cost of each project.

Need to strengthen assistance to NGOs for early implementation of Special Scheme projects

2.22 After receiving preliminary proposals submitted by NGOs under the Special Scheme in November 2013 (see para. 1.14), relevant B/Ds (including the SWD, Planning Department, Lands D and Buildings Department) conducted preliminary examination of the proposals.

2.23 According to the LWB, subject to the general agreement of the SWD on a preliminary proposal (such as types of services and floor area requirements) and no insurmountable development constraints as advised by relevant B/Ds, the applicant NGO needs to conduct a technical feasibility study (Note 9) for the project with a view to making a more accurate cost estimate before applying for an LF grant for the capital cost of the project.

2.24 In December 2016, the LWB and the SWD informed the LegCo Panel on Welfare Services that, as of November 2016, the progress of the Special Scheme was as follows:

- (a) 1 project providing 100 additional service places had been completed;

Note 9: *The study covers areas such as the definition of the scope of the project, topographical surveys, site investigations, assessments of the need for environmental impact assessments and risk assessments at the detailed design stage, site constraints, cost estimates, preliminary schematic designs, works programmes, as well as assessments of site accessibility and availability of utility services.*

- (b) 2 projects providing 321 additional service places had been approved with LF grants for the capital works, and the works were in progress;
- (c) 1 project providing 160 additional service places was having the capital works in progress and the LF grant application for the cost of F&E items was under processing;
- (d) 2 projects providing 690 additional service places were having the capital works in progress and the NGOs concerned were preparing to apply for LF grants for the cost of F&E items;
- (e) 6 projects providing 2,438 additional service places had had LF grants approved for conducting technical feasibility studies for the projects, including one project providing 1,400 additional service places of which the technical feasibility study had been completed; and
- (f) the remaining projects were at different planning stages.

Audit noted that, as of September 2016, the 12 projects in items (a) to (e) above involved LF grants totalling \$227 million, only representing 1% of the total estimated amount of \$20 billion targeted for the Special Scheme.

2.25 In February 2017, the LWB informed Audit that:

- (a) the preliminary proposals submitted by applicant NGOs would be subject to reviews by the SWD on the proposed services and further assessments of the site and development issues and constraints by other B/Ds concerned. The time required for implementing these project proposals would hinge on many factors including the scale and complexity of the projects, comments received from B/Ds concerned, views and sentiments of local stakeholders, and the necessary development and planning procedures involved (e.g. outline zoning plan amendments, planning permissions and lease modifications); and

Administration of funding applications

- (b) the LWB and the SWD had been making sustained efforts in monitoring the progress of the project proposals and in facilitating their implementation. For example:
 - (i) the SWD had been compiling monthly progress reports in respect of the project proposals received under the Special Scheme and the LWB had been conducting housekeeping meetings to keep track of the implementation of the Scheme and the progress of individual project proposals;
 - (ii) the SWD had held meetings with all the applicant NGOs individually, shortly after receiving their preliminary proposals, to discuss how their proposals might be refined to better meet the welfare demand and how the respective technical issues could be resolved to optimise the site utilisation and augment service provision. Liaison and follow-up actions with NGOs, including meetings to provide them with suitable assistance to proceed with the project proposals, had been ongoing;
 - (iii) for some projects, the LWB and the SWD had conducted site visits and held meetings with the B/Ds concerned with a view to resolving site issues and constraints; and
 - (iv) six information-exchange sessions had been conducted with the applicant NGOs to update them on the salient issues and progress of the Scheme, and advise the NGOs of the clarifications and refinements about the various arrangements under the Scheme.

2.26 Given that timely implementation of projects under the Special Scheme would substantially improve the provision of welfare services to persons in need of the services, the LWB and the SWD need to sustain and strengthen actions to coordinate with the applicant organisations and related B/Ds (such as the Planning Department, Lands D and the Buildings Department) with a view to implementing the projects as early as possible.

Audit recommendation

2.27 Audit has *recommended* that the Secretary for Labour and Welfare and the Director of Social Welfare should sustain and strengthen actions to coordinate with the applicant organisations and related B/Ds with a view to implementing projects under the Special Scheme as early as possible.

Response from the Government

2.28 The Secretary for Labour and Welfare and the Director of Social Welfare agree with the audit recommendation. The Secretary for Labour and Welfare has said that the LWB will sustain and strengthen, if deemed necessary, efforts on related issues.

2.29 The Director of Planning has said that the Planning Department would provide necessary planning advice as required to facilitate implementation of projects under the Special Scheme.

PART 3: ADMINISTRATION OF PROJECT IMPLEMENTATION

3.1 This PART examines the SWD's administration of the implementation of LF-funded projects.

Project implementation

3.2 After approval of LF grants, details of the implementation of different types of LF-funded projects are as follows:

- (a) ***Premises renovation and construction projects.*** From 2011-12 to 2015-16, 540 works projects on premises renovation and construction with estimated costs totalling \$4,666 million had been approved. In implementing a works project, an NGO might employ a consultant for preparing the detailed design, tender documents and the pre-tender estimate, and submit them to the SWD's Architectural Section or the ArchSD for technical vetting (see para. 2.4(c)). The consultant would then invite tender submissions and submit a tender report for the SWD's approval. The SWD would seek the ArchSD's advice if necessary. The consultant supervises the progress of works. Grant payments are made to the NGO on a reimbursement basis up to 95% of the contract sum. The payment for the remaining balance of 5% of the grant is subject to the SWD's approval of the final accounts of the project. The SWD would seek the ArchSD's advice if necessary;
- (b) ***Experimental projects.*** From 2011-12 to 2015-16, 37 experimental projects with estimated costs totalling \$2,094 million had been approved. For the implementation of an experimental project, the related NGO has to comply with the programme and conditions endorsed by the SWD. Grant payments are made to the NGO in accordance with a pre-set payment schedule or on a quarterly basis after commencement of the project. A percentage of the grant (normally 5%) will normally be withheld until completion of the project and the NGO has submitted to the SWD the audited financial statements of the project. The NGO is required to perform an evaluation of the project after its completion;

- (c) ***Subvention-linked minor expenditures (or Block Grant).*** From 2011-12 to 2015-16, 1,036 grants for subvention-linked minor expenditures totalling \$752 million had been approved. Grant payments are normally made on a quarterly basis. Within 7 months after the end of a financial year, an NGO in receipt of the grant needs to submit to the SWD a summary showing the nature of expenditures financed by the grant in the previous year, and any unspent grant balance would be carried forward to the ensuing year;
- (d) ***SWDF expenditures.*** From 2011-12 to 2015-16, 2 grants totalling \$790 million had been approved under phases 2 and 3 of the SWDF for disbursement to approved NGOs. Unallocated SWDF would be refunded to the LF. As of January 2017, disbursements totalling \$577 million had been made to NGOs for implementing approved projects. Grant payments to an NGO are made according to an approved payment schedule. After completion of a related project, the NGO concerned needs to submit to the SWD a project evaluation report. Any unspent disbursement should be refunded to the SWDF;
- (e) ***Fitting-out works and F&E for new/reprovisioned premises.*** From 2011-12 to 2015-16, 514 related grants totalling \$1,337 million had been approved. For fitting-out works, the payment procedures are similar to those of works projects as stated in item (a) above, except that the SWD's Architectural Section would act as the technical adviser to carry out technical vetting of the tender documents, monitor the works progress and ensure satisfactory completion of works. Payments for purchase of F&E are made on a reimbursement basis; and
- (f) ***Others.*** From 2011-12 to 2015-16, 1,105 other grants totalling \$465 million had been approved. Grant payments are made on a reimbursement basis.

Administration of project implementation

Long-outstanding projects

3.3 As of September 2016, 1,198 LF-funded projects with approved commitments totalling \$12.4 billion were in progress and commitments totalling \$7.5 billion (60%) were yet to be disbursed to related NGOs or B/Ds (hereinafter referred to as unpaid commitments). Details are shown in Table 6.

Table 6

**LF-funded projects in progress
(September 2016)**

Time taken from grant approval to September 2016	Projects (No.)	Approved grants (\$ million)	Unpaid commitments (\$ million)
Within 3 years	717	6,500	5,802
More than 3 to 5 years	201	1,932	856
More than 5 to 10 years	191	2,147	586
More than 10 to 15 years	33	1,171	47
More than 15 to 20 years	38	521	141
More than 20 to 25 years	18	172	28
Total	1,198	12,443	7,460

Source: Audit analysis of SWD records

3.4 As shown in Table 6, as of September 2016, more than 5 years after grant approvals, the accounts of 280 projects involving unpaid commitments totalling \$802 million had not been finalised. Audit examination revealed that, as of September 2016, of these 280 projects:

- (a) 5 projects (2%) involving unpaid commitments of \$15 million had not commenced works (see para. 3.5);
- (b) 16 projects (6%) involving unpaid commitments of \$97 million had not completed the works. The time taken for these projects from grant approval to September 2016 ranged from 5 to 7 years; and

- (c) 259 projects (92%) involving unpaid commitments of \$690 million had works completed but the project accounts had not been finalised and submitted to the SWD (see para. 3.6).

Long time taken before commencing LF-funded project works

3.5 According to the LWB, the timely delivery of welfare projects is of paramount importance to the community. However, as of September 2016, works for 5 LF-funded works projects with approved LF grants totalling \$15 million had not commenced 5 to 8 years after approval of the LF grants. As of September 2016, of the total \$15 million grants, only \$0.2 million (1%) had been paid to 2 NGOs concerned. Audit considers that the SWD needs to take measures to provide assistance to NGOs of LF-funded projects to commence works in a timely manner. Case 5 shows details of the longest outstanding project.

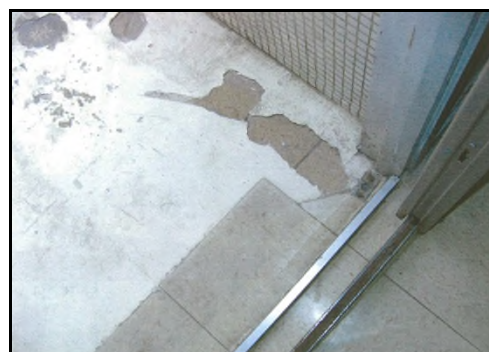
Case 5

Unsatisfactory performance of NGO consultants for a works project (Project E) (July 2008 to January 2017)

1. In July 2008, a premises-renovation grant (see para. 1.5(a)) of \$0.98 million was approved for an NGO (NGO 4) to carry out renovation works for a social service centre (Project E). Photographs 3 and 4 show the deteriorated conditions of the social service centre when NGO 4 made the application.

Photographs 3 and 4

Deteriorated conditions of the social service centre (December 2007)



Source: SWD records

Case 5 (Cont'd)

2. In April 2009, NGO 4 obtained approval from the SWD to engage a consultant (Consultant E1) for the project.

3. In November 2009, February 2010 and May 2010, Consultant E1 respectively submitted to the SWD and the ArchSD draft tender documents for employment of a contractor for the works. The ArchSD asked for additional information regarding each submission. In August 2010, Consultant E1 withdrew from providing services for Project E.

4. In June 2011, NGO 4 obtained approval from the SWD to engage another consultant (Consultant E2) for Project E. Between December 2011 and June 2015, in response to the ArchSD's comments, Consultant E2 made eight rounds of submissions on the draft tender documents. In August 2015, the SWD informed NGO 4 that the latter could proceed with the tender exercise for employment of a contractor for the works.

5. In September 2016, NGO 4 decided not to proceed with the tender exercise and informed the SWD that it would terminate the service of Consultant E2 due to his sub-standard performance.

6. As of January 2017, more than 8 years after the approval of the LF grant, related works under Project E had not yet commenced.

Audit comments

7. As revealed in this case, the unsatisfactory performance of consultants engaged by NGO 4 had significantly delayed the commencement of the renovation works for the social service centre. Audit considers that the SWD, in collaboration with the ArchSD, needs to strengthen actions on providing necessary assistance to NGOs on engaging works consultants.

Source: Audit analysis of SWD records

Long time taken in finalising project accounts after works completion

3.6 As of September 2016, 259 projects had been completed but the NGOs and B/Ds involved had not finalised and submitted the project accounts to the SWD, where approvals for these grants had been made 5 to 25 years ago. The 259 projects involved unpaid LF commitments totalling \$690 million. According to SWD records, of the 259 projects, the Hong Kong Housing Authority (HKHA) and the ArchSD were respectively the works agent and technical adviser for 39 and 20 projects. These 59 (39 plus 20) works projects involved unpaid LF commitments totalling \$175 million. In Audit's view, the SWD, in collaboration with related B/Ds, needs to take measures to ensure that accounts of works projects are finalised in a timely manner after works completion, with a view to releasing unpaid commitments not required for LF projects for funding other projects. Audit selected the longest outstanding project with the related works design and supervision being entrusted to the HKHA (see Case 6) and the longest outstanding project of which the ArchSD was the technical adviser (see Case 7) for examination.

Case 6

Incorrect charging of project expenditures and overspending of a completed works project (Project F) (October 1991 to January 2017)

1. In October 1991, a premises-renovation grant (see para. 1.5(a)) of \$0.58 million was approved as an interim funding measure for the HKHA to carry out fitting-out works for a child care centre located in a public housing estate (Project F).

2. In November 1993, the fitting-out works were substantially completed and the child care centre commenced operation. At that time, the HKHA informed the SWD that the estimated final project cost of the project would exceed the approved grant of \$0.58 million. In 1995, the then Finance Branch (now the FSTB) agreed that the project cost of \$0.58 million would be funded by the Capital Works Reserve Fund (CWRP) instead of the LF, and the sum having been disbursed from the LF would be reimbursed from the CWRP to the LF.

3. In March 1999, the HKHA informed the SWD that Project F's cost of \$0.84 million had been charged to the accounts of two projects, comprising \$0.27 million to Project F and \$0.57 million wrongly charged to another LF-funded project entrusted to the HKHA, and the project account of the latter project had been finalised. In April 2004, the HKHA advised the SWD that the final cost of Project F should be \$0.86 million. In September 2006, the SWD sought the HKHA's clarification on the reason for the difference of \$20,000 (between \$0.84 million and \$0.86 million) in the final project cost, and the HKHA clarified that \$20,000 was part of the cost of Project F.

4. As of January 2017, of the \$0.86 million expenditures under Project F having been disbursed from the LF, a total sum of \$0.84 million had been reimbursed from the CWRP to the LF (on 4 occasions in March 1997, May 1998, February 2006 and October 2006), with an outstanding sum of \$20,000 yet to be reimbursed to the LF.

Audit comments

5. Audit considers it unsatisfactory that, more than 23 years after the substantial completion of the works in November 1993, although Project F should be financed by the CWRP instead of the LF, expenditures of about \$20,000 under Project F having been disbursed from the LF had not been reimbursed to the LF. Furthermore, the HKHA had wrongly charged the cost of Project F to another LF-funded project account. The SWD and the HKHA need to, in collaboration with NGOs and B/Ds, strengthen controls over project expenditures to prevent recurrence of similar errors in future. The SWD also needs to take follow-up actions on the reimbursement of about \$20,000 to the LF.

Case 6 (Cont'd)

HKHA response

6. According to the HKHA:
- (a) since 2007, the HKHA has enhanced its computer system on recording funding approvals and expenditures of entrusted projects to avoid erroneous accounting entries and expenditures exceeding approved commitments;
 - (b) for this case, the error was due to the HKHA's incorrect charging of expenditures to another project account. The HKHA would collaborate with the SWD to strengthen controls over charging of project expenditures;
 - (c) the HKHA will take follow-up actions with the SWD on the reimbursement of \$20,000 to the LF; and
 - (d) as of March 2017, of the 39 completed projects for which the HKHA was the works agent, the project accounts of 12 projects had been finalised, and the HKHA will expedite actions to finalise the project accounts of the remaining 27 projects as soon as possible. Of the 39 projects, the unpaid commitments totalling \$58 million, and with the finalisation of project accounts of the 12 projects, the total unpaid commitment was reduced to \$39 million. To prevent long delays in finalising accounts after completion of works projects, the HKHA will collaborate with the SWD for implementation of the SWD's enhancement measures.

Source: Audit analysis of SWD records

Case 7

A social centre for the elderly not being assigned to the Government 19 years after works completion (Project G) (October 1993 to January 2017)

1. In February 1993, a premises-construction grant (see para. 1.5(a)) of \$1.46 million (estimated construction cost of \$1.22 million (based on the ArchSD's rough indication of cost) plus 20% on-cost) was approved for the construction and fitting-out works for a social centre for the elderly located in a private development (Project G). Under a land exchange document executed in October 1993, a developer was required to construct a social centre for the elderly within the subject land lot and to assign the premises to the Government after works completion when the premises was fit for occupation and operation and directed by the Government. The LF would reimburse to the developer the cost incurred subject to a ceiling of \$1.22 million (the consideration sum). The ArchSD was the technical adviser to the SWD and the developer was the works agent responsible for designing, constructing and supervising works for the centre.

2. In December 1997, the construction and fitting-out works were substantially completed. In August 1998, the social centre for the elderly was handed over to the SWD which subsequently leased the premises at nominal value to an NGO (NGO 5) to commence operation of the centre.

3. From July 1998 to December 2008, the SWD, the Lands D and the ArchSD had repeatedly requested the developer to provide them with information on the cost of Project G. In March 2009, after receipt of related information from the developer in January 2009, the ArchSD and the SWD agreed that the construction cost of \$1.22 million of Project G should be reimbursed to the developer.

4. As of January 2017, the Government Property Agency (GPA) and the developer had not completed the assignment of the social centre for the elderly to the Government. According to the SWD, as stipulated under the related land exchange document, the \$1.22 million construction cost would only be reimbursed to the developer upon assignment of the centre to the Government.

Audit comments

5. Audit considers it unsatisfactory that, more than 19 years after the substantial completion of the works in December 1997, owing to the social centre for the elderly not having been assigned to the Government, the account of Project G could not be finalised. In Audit's view, the SWD and the ArchSD need to take measures to prevent long delays in finalising project accounts after works completion. The SWD also needs to, in collaboration with the GPA and the Lands D, expedite actions to follow up with the developer on completing the assignment of the social centre for the elderly to the Government.

Source: Audit analysis of SWD records

Lack of information on NGO board approvals for departures from procurement requirements

3.7 The LF Manual has specified general requirements on procurement of goods and services by NGOs. For example, for a works project costing:

- (a) between \$5,000 and \$50,000, 2 quotations are required;
- (b) between \$50,001 and \$1 million, 5 quotations are required; and
- (c) over \$1 million, open tendering is required.

3.8 Nevertheless, as specified under the LF Manual, the Board of an NGO may approve the following departures from the general procurement requirements laid down in the LF Manual (known as Exception Authority):

- (a) for procurement with a value not exceeding \$1 million for works, \$500,000 for services and \$200,000 for stores, inviting or accepting quotations/tenders from less than the specified number of suppliers, or not accepting the lowest conforming quotation or tender;
- (b) for procurement with a value not exceeding \$500,000 for works, \$250,000 for services and \$100,000 for stores, in writing delegating authority to staff members of appropriate levels or to quotation/tender boards to approve inviting or accepting quotations/tenders from less than the specified number of suppliers, or not accepting the lowest conforming quotation or tender; and
- (c) except for engaging a consultant for a works project funded by a grant for subvention-linked minor expenditures (see para. 1.5(c)) or for fitting-out works and F&E for new/reprovisioned premises (see para. 1.5(e)), the justifications for the exercise of the Exception Authority by the Board or staff of an NGO must be properly documented on each occasion.

Administration of project implementation

3.9 In 2015-16, grant payments totalling \$937 million were made under 641 LF grants for implementing capital works or procurement of F&E or services. According to the SWD, NGOs have not provided it with information on the amounts of LF grants being incurred by invoking the Exception Authority because there is no requirement under the LF Manual for NGOs to do so.

3.10 Audit considers it unsatisfactory that the SWD has not required NGOs to provide it with information on the departures from general procurement requirements and the amounts of LF grants incurred by NGOs invoking the Exception Authority. The absence of this information has weakened the SWD's monitoring of the procurement of goods and services financed by LF grants and has impeded Audit examination of the justifications for the exercise of the Exception Authority. With a view to enhancing the SWD's monitoring and public accountability of the use of LF grants, the SWD needs to consider requiring NGOs to submit to the SWD annual returns showing details and justifications of their board approvals for departures from the LF procurement requirements.

Lack of effective control over advance payments

3.11 Under the LF Manual:

- (a) an NGO being approved with a grant for premises renovation and construction, fitting-out works and F&E for new/reprovisioned premises, or other uses (see para. 1.5(a), (e) and (f)) may apply for an advance payment from the LF to meet the expenditures;
- (b) the NGO should submit to the SWD documents to support expenditures incurred by using the advance payment no later than one month after the receipt of an advance payment; and
- (c) any unpaid commitment may be reverted to the LF if the NGO could not submit the related documents within the one-month period.

3.12 In relation to advance payments under the LF, according to the SWD:

- (a) it has been its long established practice on the monitoring and control of an advance payment through the use of a project-based control sheet which is kept in each LF project file for keeping track of advance payments and receipts of documents to support related expenditures incurred; and
- (b) it has not maintained a summary register for monitoring advance payments for LF projects.

3.13 Advance payments not being substantiated by expenditure evidence should be repaid by NGOs. In Audit's view, the absence of an effective system for centrally monitoring advance payments under the LF is unsatisfactory as the SWD could not provide assurance that NGOs in receipt of advance payments have fully and properly provided documents to support related expenditures incurred within the one-month period as required under the LF Manual. It has also impeded the SWD's monitoring of such advance payments. With a view to enhancing controls over advance payments under the LF, the SWD needs to maintain a summary register for the purpose.

Lack of evaluation of some LF-funded projects

3.14 Under the LF Manual, after completion of an experimental project or a project under the SWDF (see para. 3.2(b) and (d)):

- (a) the NGO concerned is required to submit to the SWD an evaluation report on the impact of the project, specifying whether it has achieved its original objectives and whether the project implementation was cost effective; and
- (b) SWD staff and members of the LFAC may pay visits to the NGO to review the implementation of the project.

Administration of project implementation

3.15 According to the SWD:

- (a) LF-funded experimental and information technology projects are monitored by relevant advisory bodies including the LFAC, and specific project steering committees set up for experimental projects. As and when necessary, details of these projects would be reported to the relevant LegCo Panels; and
- (b) regular LF progress reports are submitted to LFAC members, and SWD staff would conduct site inspections of completed capital works projects when necessary.

3.16 Audit noted that, except for experimental projects and projects under the SWDF, the SWD did not require NGOs in receipt of LF grants to provide project evaluation reports. Audit examination of 10 works projects (other than experimental and SWDF projects) with the highest estimated costs having been completed between April 2011 and March 2016 revealed that only 2 of the 10 NGOs involved had submitted project evaluation reports to the SWD after project completion. For the two NGOs having provided project evaluation reports, the submission of the evaluation reports was one of the requirements specified by a trust fund which co-financed the projects.

3.17 In March 2002, in response to Audit's recommendation on establishing procedures to evaluate the performance of projects financed by the LF (see para. 1.15), the Director of Social Welfare said that:

- (a) the SWD agreed that the utilisation of grants of the LF should be evaluated and reported since the LF was mainly funded from community resources; and
- (b) since the revamping of procedures of the LF in September 2001, the LFAC had taken a more active role in the evaluation and monitoring of LF-funded projects. Apart from receiving regular progress reports, members of LFAC made visits to the funded projects from time to time.

3.18 In Audit's view, in order to improve evaluation of effectiveness of LF-funded projects and enhance public accountability, the SWD needs to consider requiring NGOs in receipt of LF grants to submit a project evaluation report after project completion, and to conduct satisfaction surveys of stakeholders where appropriate. The SWD also needs to conduct an evaluation of the extent of achieving the objectives of experimental projects and publish the evaluation results on SWD website.

Audit recommendations

3.19 Audit has *recommended* that, in administering LF-funded project implementation, the Director of Social Welfare should:

- (a) take measures to provide assistance to NGOs of LF-funded projects to commence works in a timely manner;
- (b) in collaboration with the Director of Architectural Services, strengthen actions on providing necessary assistance to NGOs on engaging works consultants;
- (c) in collaboration with related B/Ds, take measures to ensure that works-project accounts are finalised in a timely manner after works completion, with a view to releasing unpaid commitments not required for LF projects for funding other projects;
- (d) in collaboration with NGOs and B/Ds, take measures to strengthen controls over project expenditures to ensure correct charging of the expenditures;
- (e) take follow-up actions on long-outstanding cases and on the reimbursement of Project F expenditures of about \$20,000 to the LF;
- (f) in collaboration with the Government Property Administrator and the Director of Lands, expedite actions to follow up the assignment of the social centre for the elderly in Case 7 to the Government;

Administration of project implementation

- (g) **consider requiring NGOs to submit to the SWD annual returns showing details and justifications of their board approvals for departures from the LF procurement requirements;**
- (h) **maintain a summary register for advance payments under the LF showing the dates of advance payments and receiving documents to support related expenditures;**
- (i) **consider requiring NGOs in receipt of LF grants to submit a project evaluation report after project completion, and to conduct satisfaction surveys of stakeholders where appropriate; and**
- (j) **conduct an evaluation of the extent of achieving the objectives of experimental projects and publish the evaluation results on SWD website.**

Response from the Government

3.20 The Director of Social Welfare agrees with the audit recommendations. She has said that the SWD will:

- (a) remind relevant B/Ds and NGOs to expedite finalisation of project accounts;
- (b) consider requiring NGOs who have invoked the Exception Authority in procurement of goods and services to submit annual returns with pertinent details and justifications;
- (c) maintain a register for advance payments under the LF; and
- (d) consider the ways to publish the evaluation results of experimental projects. In addition, as endorsed by the LFAC in January 2017, enhancement measures on post-service evaluations of LF projects would be implemented in 2017-18, such as seeking confirmations from grantees on meeting funding requirements, and advice from SWD service branches on satisfactory delivery of social welfare services after project completion.

3.21 For paragraph 3.19(b) and (c), the Director of Architectural Services has said that the ArchSD would provide assistance/technical advice to the SWD on measures:

- (a) necessary to assist NGOs on hiring works consultants such as promulgating related guidelines and practice notes; and
- (b) to prevent long delays in finalising project accounts after works completion.

PART 4: GOVERNANCE AND MANAGEMENT ISSUES

4.1 This PART examines governance and management issues of the LF, focusing on:

- (a) management of potential conflicts of interest (paras. 4.2 to 4.21); and
- (b) revamp of management information system (paras. 4.22 to 4.28).

Management of potential conflicts of interest

4.2 The LFAC, an advisory body to the SWD on considering applications for LF grants and conducting charitable fund-raising activities including the allocation of flag days, is chaired by the Director of Social Welfare and comprises 11 members including a representative from the LWB and 10 non-official members from the social welfare, academic and business sectors who are appointed by the Secretary for Labour and Welfare. LFAC non-official members are appointed on a two-year term, with the current term commencing in September 2015.

4.3 According to a memorandum issued by the Secretary for Home Affairs in August 2005:

- (a) B/Ds should introduce one of the following systems for declaration of interest for each of the advisory and statutory bodies under their purview:
 - (i) ***One-tier reporting system.*** When a member of a board or committee perceives a potential conflict of interest in a matter placed before the board or committee, he/she should make a full disclosure of his/her interest. In this connection, it is the responsibility of the member to judge and decide if the situation warrants a declaration, and to seek a ruling from the chairman in case of doubt; and
 - (ii) ***Two-tier reporting system.*** This system applies to boards and committees with extensive powers over policy or financial matters. To maintain public confidence in the integrity of members, as well

as in the impartiality of their advice tendered to the board or committee, members should disclose their general pecuniary interests on appointment to these boards and committees and annually thereafter, in addition to the report of conflicts of interest as and when they arise;

- (b) if a member (including the chairman) has any direct personal or pecuniary interest in any matter under consideration by the committee, he must, as soon as practicable after he has become aware of it, disclose to the chairman (or the committee) prior to the discussion of the item;
- (c) the chairman (or committee) shall decide whether the member disclosing an interest may speak or vote on the matter, may remain in the meeting as an observer, or should withdraw from the meeting;
- (d) if the chairman declares an interest in a matter under consideration, the chairmanship may be temporarily taken over by a vice-chairman;
- (e) when a known direct pecuniary interest exists, the secretary may withhold circulation of relevant papers to the member concerned. Where a member is in receipt of a paper for discussion which he knows presents a direct conflict of interest, he should immediately inform the secretary and return the paper; and
- (f) all cases of declaration of interests shall be recorded in the minutes of the meeting.

LFAC practice on declaration of potential conflicts of interest

4.4 Before 2017, the LFAC adopted the one-tier reporting system (see para. 4.3(a)(i)) for members' declaration of potential conflicts of interests. At its meeting held on 19 January 2017, the LFAC decided that, instead of the previously adopted one-tier reporting system, the LFAC would adopt the two-tier reporting system (see para. 4.3(a)(ii)) for members' declaration of interests. According to the SWD, the change was due to the revision of the LF grant approving authority of the Director of Social Welfare effective from August 2016 (see para. 1.9), and the promulgation of the Best Practice Checklist on Strengthening Integrity and

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Accountability — Administration of Government Funding Schemes by the Independent Commission Against Corruption in late 2016.

4.5 According to the Standing Orders of the LFAC:

- (a) a member who has a potential conflict of interest in a matter placed before the LFAC should make full disclosure of his/her interest before the matter is discussed; and
- (b) potential conflict-of-interest situations include a significant connection with an organisation which is the subject of a matter under consideration by the LFAC.

4.6 According to SWD records as of December 2016, about one week before an LFAC meeting, the LFAC Secretariat would circulate papers for agenda items to be discussed at the meeting together with a declaration of interest form to each LFAC member for him/her to complete and return it to the Secretariat to indicate whether he/she has:

- (a) no conflict of interest in all agenda items of the meeting; or
- (b) potential conflicts of interest in certain agenda items of the meeting. He/she should specify each relevant item and the interest involved.

4.7 According to the SWD:

- (a) the LFAC Secretariat would remind members vide a letter to make declaration of potential conflicts of interest for each meeting. The Secretariat would also remind members by phone who have not returned the declaration form. Before commencement of a meeting, the Secretariat would also remind members who have not returned the declaration form to make declarations if necessary; and
- (b) at the beginning of each meeting, the Secretariat would report the potential conflicts of interest so declared by members and ask if supplementary information on declaration of potential conflicts of interest would be made.

Some LFAC members not declaring potential conflicts of interest

4.8 From September 2015 to July 2016, the LFAC held 7 meetings (comprising 6 regular meetings and one special meeting). Based on their engagements in NGOs as reflected in their declaration forms (some members had made declarations of potential conflicts of interest in relation to some agenda items), Audit's research and SWD records, Audit noted that two LFAC members, namely Members A and B, who had attended pertinent LFAC meetings from September 2015 to July 2016 and had returned the declaration forms (see para. 4.6) had not made declarations of potential conflicts of interest for some agenda items discussed at LFAC meetings. Details are as follows:

- (a) Member A, who was the vice-chairman of one of an NGO (NGO 6)'s district branches as well as the chairman of one of another NGO (NGO 7)'s district associations, attended LFAC meeting on 30 September 2015 involving consideration, among others, of endorsement of a list of eligible applicant organisations (including NGOs 6 and 7) for flag-day lots-drawing for 2016-17 (see para. 4.9). However, Member A did not make declarations of potential conflicts of interest in relation to association with NGOs 6 and 7 (Note 10); and
- (b) Member B, who was the non-executive director of an NGO (NGO 8), attended LFAC meeting on 25 November 2015 involving consideration, among others, of an \$11-million grant for NGO 8, acting as the Government's works agent, to carry out construction works of an elderly centre. However, Member B did not make a declaration of a potential conflict of interest in relation to association with NGO 8.

4.9 The LFAC has set up a vetting panel comprising three LFAC members and two NGO representatives (together with SWD staff) to scrutinise applications and make recommendations on whether applicant organisations for flag-day allocations meet the eligibility criteria. Thereafter, a list of applicant organisations

Note 10: *According to the minutes of an LFAC meeting held in January 2017, among others, on endorsement of a list of applicant organisations eligible for allocation of 2017-18 flag days, in view of an LFAC member's close association with an NGO, the LFAC Secretariat did not issue related LFAC paper to the member. Moreover, the LFAC member abstained from the meeting during the discussion of the related item to avoid conflict of interest.*

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meeting the eligibility criteria would be submitted to the LFAC for endorsement before carrying out lots-drawing for determining priorities for selection of flag days.

4.10 In Audit's view, the SWD needs to strengthen measures to periodically remind LFAC members of the need to fully make declarations of potential conflicts of interest for agenda items discussed at LFAC meetings. To facilitate members making declarations of potential conflicts of interest, the SWD needs to consider requiring the LFAC Secretariat to prepare a list of NGOs involved at each LFAC meeting for members' reference for making declarations of potential conflicts of interest.

4.11 According to a circular issued in August 1999 on appointment of members of advisory and statutory bodies, B/Ds should regularly evaluate the performance and commitment of the members of the bodies to facilitate consideration of their suitability for re-appointment. In Audit's view, the LWB needs to take into account any omission by an LFAC member in declaring potential conflicts of interest when considering his/her suitability for re-appointment upon expiry of his/her term of appointment.

Some LFAC members who were also paid executive staff of NGOs attended meetings involving discussion of related agenda items

4.12 According to the Standing Orders of the LFAC, if a member is a paid executive staff of an agency of which a matter would be considered by the committee, the member normally would not be issued the relevant committee paper and should abstain from the discussion of the agenda item concerned.

4.13 Audit examination of the declaration forms completed and returned by LFAC members for the 7 meetings held between September 2015 and July 2016 revealed that two LFAC members, namely Members C and D, were respectively paid executive staff of two NGOs, namely the director of an NGO (NGO 9) and executive director of another NGO (NGO 10) respectively. However, the two members were issued relevant LFAC papers and attended LFAC meetings involving discussion of grant applications related to the NGOs for which they worked. Details are as follows:

(a) Member C, who was the director and paid staff of NGO 9, attended LFAC meetings on 25 November 2015 (for 1 agenda item), 28 January 2016 (for 1 agenda item) and 30 March 2016 (for 1 agenda item) involving discussions of grant applications of NGO 9. Member C had made declarations of potential conflicts of interest for the 3 agenda items, as follows:

- (i) for the agenda item discussed at the meeting of 25 November 2015 involving applications by 8 NGOs (including NGO 9) to purchase 16 vehicles, an LF grant of \$916,000 was approved for NGO 9 to purchase a vehicle;
- (ii) for the agenda item discussed at the meeting of 28 January 2016 involving applications by 6 NGOs (including NGO 9) to purchase 9 vehicles, an LF grant of \$2,437,000 was approved for NGO 9 to purchase four vehicles; and
- (iii) for the agenda item discussed at the meeting of 30 March 2016 involving applications for subvention-linked minor expenditures (see para. 1.5(c)) by 149 NGOs (including NGO 9) for 2016-17, an LF grant of \$4,637,000 for NGO 9 was approved; and

(b) Member D, who was the executive director and paid staff of NGO 10, attended LFAC meeting on 30 March 2016 (for 1 agenda item) involving discussion of applications for subvention-linked minor expenditures by 149 NGOs (including NGO 10) for 2016-17. Member D had made a declaration of a potential conflict of interest for the agenda item. In the event, an LF grant of \$3,724,000 for NGO 10 was approved.

4.14 In March 2017, the SWD informed Audit that:

- (a) at the pertinent meetings, Members C and D had not participated in the discussion of the pertinent 3 agenda items (see para. 4.13(a)) and 1 agenda item respectively (see para. 4.13(b));
- (b) for paragraph 4.13(a)(i) and (ii), the allocation of an LF grant to an NGO for purchase of a vehicle for service use was based on standard service operation entitlements applicable to all relevant service units, regardless of the NGO providing the service; and

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- (c) for paragraph 4.13(a)(iii) and (b), every SWD-subvented NGO was entitled to an annual non-recurrent Block Grant (calculated at 1.5% of the SWD recurrent subvention) to meet the costs of routine replenishment of F&E, and minor repairs and maintenance works.

4.15 In Audit's view, the Director of Social Welfare needs to critically consider whether an LFAC member who is also a paid executive staff of an NGO needs to:

- (a) abstain from attending an LFAC meeting involving discussion of an agenda item relating to that NGO (see para. 4.3(c)); and
- (b) be issued relevant LFAC papers (see para. 4.3(e)).

Low attendance of some members

4.16 Audit noted that, for the 7 LFAC meetings held between September 2015 and July 2016, the attendance of some members was low. For example, of the 7 meetings:

- (a) Member E had only attended 1 meeting;
- (b) Member F had only attended 3 meetings; and
- (c) Member G had only attended 4 meetings.

4.17 In Audit's view, the LWB needs to take into account an LFAC member's attendance at LFAC meetings when considering his/her suitability for re-appointment upon expiry of his/her term of appointment.

Audit recommendations

4.18 **Audit has *recommended* that the Director of Social Welfare should:**

- (a) **strengthen measures to periodically remind LFAC members of the need to fully make declarations of potential conflicts of interest for agenda items discussed at LFAC meetings;**
- (b) **consider requiring the LFAC Secretariat to prepare a list of NGOs involved at each LFAC meeting for members' reference for making declarations of potential conflicts of interest; and**
- (c) **critically consider whether an LFAC member who is also a paid executive staff of an NGO needs to be issued relevant LFAC papers.**

4.19 **Audit has also *recommended* that the Secretary for Labour and Welfare should take into account any omission by an LFAC member in declaring potential conflicts of interest and his/her attendance at LFAC meetings when considering his/her suitability for re-appointment upon expiry of his/her term of appointment.**

Response from the Government

4.20 The Director of Social Welfare agrees with the audit recommendations in paragraph 4.18. She has said that:

- (a) the LFAC Secretariat will continue to remind LFAC members to make declarations of potential conflicts of interest;
- (b) the LFAC Secretariat will prepare a list of NGOs relating to agenda items at each LFAC meeting for members' reference to facilitate their making of declarations of potential conflicts of interest; and
- (c) when circulating papers and inviting members to attend meetings, the LFAC Secretariat will examine whether a member, who is also a paid executive staff of a related NGO, should be issued with the papers concerned.

4.21 The Secretary for Labour and Welfare agrees with the audit recommendation in paragraph 4.19.

Revamp of management information system

4.22 Since 2003, the SWD has maintained a management information system, namely the Lotteries Fund Project Information System (LFPIS), for maintaining some information of each LF project, including:

- (a) the name of the NGO involved, description of the project nature, the grant type and the amount of grant approved; and
- (b) the grant approval date and project completion date.

4.23 In September 2009, the SWD obtained the policy support of the LWB for the revamp of the LFPIS. In November 2011, after obtaining further information from the SWD, the Office of the Government Chief Information Officer (OGCIO) approved funding of \$6 million for the work. In July 2013, the SWD engaged a contractor to develop a revamped LFPIS (Note 11). In March 2016, the revamped LFPIS was implemented. Under the revamped LFPIS, in addition to maintaining some information for each LF project (see para. 4.22), the revamped system would also provide the following functions:

- (a) **Searching.** Searching could be conducted on a more flexible basis;
- (b) **Reporting.** Reports would be generated in different formats based on the parameters inputted by users;
- (c) **Guiding users to accomplish the required tasks.** In monitoring an LF project, 20 main stages from pre-approval to project completion were involved. At each stage, a user would be notified and guided by the system to accomplish the required tasks; and
- (d) **Bring-up.** Bring-up functions would be provided to alert users about specific or critical events or tasks due for completion.

Note 11: *A contractor was engaged for the revamp of the LFPIS and the set up of the Public Subscription Permit System, the latter was for monitoring applications for raising charity donations in public places, at a total cost of \$5.4 million.*

Delay in implementing revamp of the LFPIS

4.24 In November 2011, the OGCI0 approved funding of \$6 million from a block vote of the CWRF under the OGCI0's control for implementing a 19-month project which included the revamp of the LFPIS and setting up of the new Public Subscription Permit System (see Note 11 to para. 4.23). Of the \$6 million estimated cost, \$3.8 million was for meeting contract staff cost, cost of hardware, software and contingency, and \$2.2 million for system implementation, which were targeted for completion in May 2013. In October 2012, the SWD issued an invitation of quotation for system implementation where the lowest tender meeting the technical requirements received was \$5.5 million, which exceeded the SWD's estimated cost of \$2.2 million. As a result, the tender exercise was cancelled. In February 2013, the SWD issued another invitation of quotation for the project where the lowest tender meeting the technical requirements received was \$5.4 million. In July 2013, after obtaining supplementary funding approval of \$3.7 million from the OGCI0, the SWD awarded a contract to the lowest tenderer for carrying out the project, targetting for completion in April 2014. In the event, the project was completed and implemented in March 2016, 2 years and 10 months (or 34 months) later than the original target completion date of May 2013, or 24 months later than the target completion date of April 2014 as specified in the contract.

4.25 In February/March 2017, the SWD informed Audit that the delay in implementing the revamped LFPIS was mainly due to:

- (a) 11 months being spent in dealing with a system breakdown of the LFPIS. In early February 2012, there was a system breakdown, giving rise to a sudden urgent task to recover the LFPIS. The SWD considered it necessary to first determine whether the LFPIS could be recovered before setting the user requirements for the revamped LFPIS. The contract to recover the LFPIS was awarded on 19 October 2012, followed by the issuance of the invitation of quotation for the revamped LFPIS in the same month; and
- (b) the contractor had taken additional 8 months to complete the system analysis and design, and additional 10 months to complete the user acceptance test before the revamped system was accepted by the SWD.

Governance and management issues

4.26 In Audit's view, in implementing a project under a contract, the SWD needs to strengthen measures to ensure that a contractor completes tasks in a timely manner according to the time specified in the contract. Furthermore, in order to minimise cancellation and re-performance of a tender exercise due to under-estimation of the project cost, the SWD needs to strengthen actions with a view to making accurate project cost estimates as far as possible.

Audit recommendations

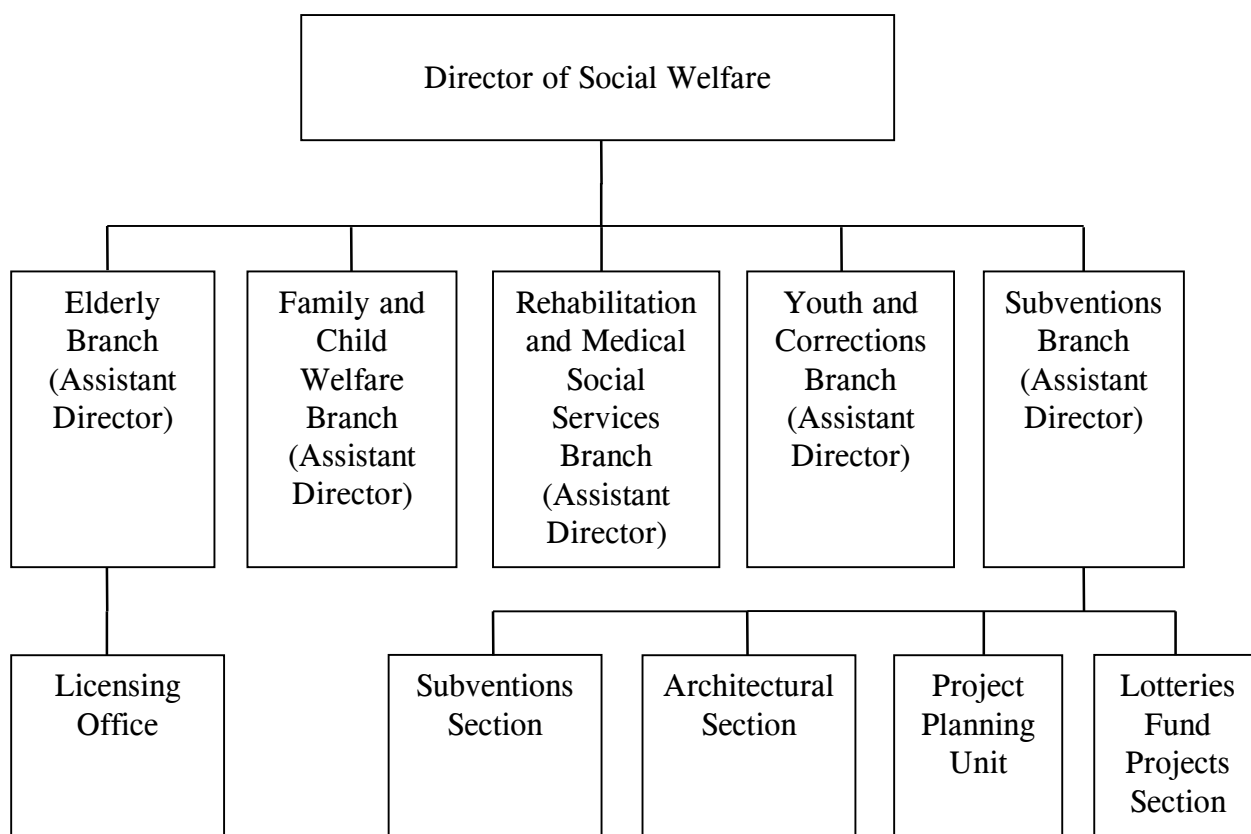
4.27 Audit has *recommended* that, in implementing a project under a contract in future, the Director of Social Welfare should:

- (a) **strengthen measures to ensure that a contractor completes tasks in a timely manner according to the time specified in the contract; and**
- (b) **strengthen actions with a view to making accurate project cost estimates as far as possible.**

Response from the Government

4.28 The Director of Social Welfare agrees with the audit recommendations.

**Social Welfare Department:
Organisation chart (extract)
(December 2016)**



Source: SWD records

SWD procedures for processing LF grants

- (a) ***Grants for premises renovation and construction.*** The grants could be used for:
- (i) ***Renovation of existing premises.*** The relevant SWD service branches and/or other relevant B/Ds as appropriate will assess the eligibility and support-worthiness of applications from the service point of view. Meanwhile, for an application meeting the licensing requirements, the SWD Licensing Office will vet the application against the licensing requirements (e.g. for Residential Care Homes for Persons with Disabilities, Residential Care Homes for the Elderly and Drug Dependents Treatment Centres) as appropriate, the relevant Code of Practice, and the related Ordinance and Regulation; and
 - (ii) ***Construction of new welfare premises.*** This includes the construction, redevelopment and expansion of welfare facilities in private developments, government public housing developments and joint-Government user developments initiated by the Government, and projects undertaken by NGOs on their own sites. The SWD Project Planning Unit, which acts as the coordinator for B/Ds and the applicant NGOs, will ensure that a development plan for a project is formulated together with a cost estimate for preparing the funding application. Furthermore, for a project that may have impacts on the environment or transport, the SWD will consult local stakeholders, such as the related District Council, Incorporated Owners and related concern groups, on the proposed project and on whether the scale and design of the project will need to be adjusted;
- (b) ***Grants for experimental projects.*** Experimental projects are mostly initiated by the Government. For experimental projects proposed by NGOs, they need supports from the respective SWD service branches. Prior endorsement has to be secured from the LWB and the FSTB on these funding applications from the policy and financial implication perspective before they are submitted for approval;

- (c) ***Grants for subvention-linked minor expenditures.*** Every year, the LFP Section invites NGOs receiving SWD annual subventions to apply for subvention-linked minor expenditures for the ensuing financial year;
- (d) ***Grants for SWDF expenditures.*** Grants for SWDF were approved in three 3-year phases for allocating to eligible NGOs over the period 2010-11 to 2018-19. A lump sum of \$330 million was approved for phase 1 in 2009-10, \$330 million for phase 2 in 2012-13, and \$460 million (Note) for phase 3 in 2015-16. Before the beginning of each phase, the SWD would invite NGOs receiving annual subventions to apply for the grants. All applications submitted with the related proposals (together with the estimated costs) would be processed on a first-come-first-served basis. The SWD would vet the applications submitted by NGOs and, upon the endorsement by the LFAC, disburse the funding to eligible NGOs. As of January 2017, the LF had allocated \$263 million under phase 1 to 150 NGOs and \$277 million under phase 2 to 154 NGOs to implement approved projects, and the SWD was processing applications under phase 3;
- (e) ***Grants for fitting-out works and F&E for new/reprovisioned premises.*** The related LF grants could be used for:
 - (i) ***New premises.*** For new premises provided by the Government for leasing to NGOs, at the time the premises are ready for leasing, the responsible SWD service branch would submit an application to seek a grant from the LF for disbursement to the future operator to meet the costs of fitting-out works and purchase of F&E (the grant would first be approved and allocated to the SWD and then disbursed to the selected operator at a later stage). In addition, the SWD's Architectural Section would conduct site inspections at the subject premises and prepare a cost estimate for fitting-out works, and the SWD would estimate the amount of grant for purchase of F&E by referring to the SWD standard reference list of F&E items; and

- (ii) ***Reprovisioned premises.*** Grants for reprovisioned premises would be directly allocated to the existing service operator concerned; and
- (f) ***Others.*** An NGO may apply for an LF grant for purchase of F&E and vehicles not covered in items (c) and (e) above. For purchase of F&E (excluding vehicles), the relevant SWD service branch would make reference to the SWD standard reference list of F&E items when vetting the applications. For purchase of vehicles, the Electrical and Mechanical Services Department will conduct technical vetting upon request from the relevant SWD service branch and/or B/Ds.

Source: SWD records

Note: \$120 million unspent fund of phases 1 and 2 (i.e. \$67 million (\$330 million minus \$263 million) for phase 1, and \$53 million (\$330 million minus \$277 million) for phase 2) were transferred to phase 3.

Acronyms and abbreviations

ArchSD	Architectural Services Department
Audit	Audit Commission
B/D	Government bureau or department
CWRF	Capital Works Reserve Fund
F&E	Furniture and equipment
FSTB	Financial Services and the Treasury Bureau
GPA	Government Property Agency
HKHA	Hong Kong Housing Authority
HKSAR	Hong Kong Special Administrative Region
Lands D	Lands Department
LegCo	Legislative Council
LF	Lotteries Fund
LFAC	Lotteries Fund Advisory Committee
LFP Section	Lotteries Fund Projects Section
LFPIIS	Lotteries Fund Project Information System
LWB	Labour and Welfare Bureau
NGO	Non-governmental organisation
OGCIO	Office of the Government Chief Information Officer
SWD	Social Welfare Department
SWDF	Social Welfare Development Fund

CHAPTER 7

**Department of Health
Food and Health Bureau**

Provision of dental services

**Audit Commission
Hong Kong
3 April 2017**

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

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PROVISION OF DENTAL SERVICES

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PROVISION OF DENTAL SERVICES

Executive Summary

1. In Hong Kong, it is the Government's policy to seek to raise public awareness of oral health and encourage proper oral health habits through promotion and education. School Dental Care Service, comprising basic and preventive dental care, is also provided by the Department of Health (DH) to primary school students. As part of the conditions of service, the Government provides comprehensive dental services to civil service eligible persons (CSEPs) (e.g. civil servants and their family members). While the Government is mindful of the substantial financial resources required if it were to provide comprehensive dental services to all, it recognises the need to provide some essential dental services to the public (e.g. emergency dental services and dental services for the elderly). Government dental services are mainly provided through the DH's 47 dental clinics/units over the territory. In addition, specific dental services subsidised by the Community Care Fund (CCF) and the Food and Health Bureau (FHB) are provided to patients with special needs.

2. In 2015-16, the expenditure on dental services totalled \$1,018 million. The total number of attendance for such services (including publicity activities, dental check-ups, dental treatments, etc.) was some 1.5 million. The Audit Commission (Audit) has recently conducted a review of the provision of dental services by the Government.

Provision of promotive and preventive services

3. *Educational and publicity programmes.* The DH's Oral Health Education Unit conducted 20 educational and publicity programmes in 2015-16 to help students establish good oral care habits and promote oral health to the public at large. Each programme was free and aimed to serve a specific target group. Audit noted that: (a) over 80% of the participants were kindergarten and nursery students and over 10% were primary school students. For the other target groups, the attendance at programme activities were comparatively low and fluctuated considerably from year to year. For example, secondary school students' attendance at programme activities fluctuated from 210 in 2013-14 to 1,849 in

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2015-16. The DH needs to monitor the programme coverage of target groups; (b) for the Brighter Smiles Playland programme, the number of students who did not join the programme had increased from 13,414 in the 2011/12 school year to 16,332 in the 2015/16 school year. There were kindergartens/nurseries which had not enrolled in the programme and therefore their students could not use the programme services; and (c) for the Bright Smiles Mobile Classroom programme, 526 primary schools did not use its services in the 2015/16 school year (paras. 2.2, 2.4 and 2.6 to 2.9).

4. ***School Dental Care Service.*** All primary schools and their students can join the School Dental Care Service on a voluntary basis. Students made about 500,000 dental appointments per year. Audit noted that: (a) many students did not show up to receive dental services as scheduled. The number of unattended appointments increased by 14,260 from 60,703 in the 2011/12 service year to 74,963 in the 2015/16 service year; (b) in the 2015/16 service year, the proportion of Primary 6 students not attending scheduled appointments was the highest at 26%; and (c) appropriate measures could be explored to encourage students' attendance (e.g. reminding students to attend appointments through mobile messaging applications) (paras. 2.13, 2.14, 2.15(a) and 2.18).

Provision of dental services for civil service eligible persons

5. ***Provision of general dental services.*** Comprehensive dental services (comprising general dental services and specialised dental services) were provided to CSEPs as a condition of service. In 2015-16, the total number of attendance was some 720,000. Audit noted that for the provision of general dental services: (a) the DH has set a target that "appointment time for new dental cases within six months" should be met in more than 90% of the cases. For government dental clinics which had a waiting time of more than six months for first-time appointments, the clinics concerned would refer their new cases to other clinics which had shorter waiting time. However, the proportion of CSEPs who declined referrals had increased from 82% as at 1 January 2013 to 90% as at 1 January 2016. The proportion of new cases with waiting time more than six months had increased from 34% as at 1 January 2013 to 46% as at 1 January 2016; (b) in four clinics, as at 1 January 2016, the waiting time for annual check-ups was 13 to 14 months; and (c) there were wide variations in waiting time for dental treatments at different clinics, which ranged from 2 months to 18 months as at 1 January 2016 (paras. 1.4, 1.8, 3.2, 3.4, 3.5 and 3.8).

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6. ***Provision of new surgeries at dental clinics.*** To meet service needs, the DH had planned to provide 64 new dental surgeries, which would commence operation in the period 2011-12 to 2015-16. However, there were delays in fitting out some surgeries, and that sufficient Dental Officers could not be recruited to operate the completed surgeries. Of the 64 planned new surgeries, 11 (17%) had not commenced operation as at 30 October 2016. For four surgeries, the delay in operation was over one year (paras. 3.15 and 3.16).

Provision of specific dental services for the public

7. ***Emergency dental services for the public.*** The Government provides emergency dental services (e.g. pain relief and tooth extraction) in General Public Sessions at 11 government dental clinics. Patients seeking emergency dental services are required to obtain a disc from one of these dental clinics. The Sessions had a total quota of about 40,000 discs a year, which are given out on a first-come-first-served basis. Audit noted that the utilisation of General Public Sessions was yet to be maximised. According to a survey conducted by the DH in 2014, some 23% of the respondents seeking emergency dental services had the experience of failing to obtain a disc from a government dental clinic and were turned away. On the other hand, the disc quota was not always fully utilised. For example, in 2015-16, the unutilised disc quota for the year totalled 5,480 discs representing 13.7% of the total disc quota of 40,060 (paras. 1.9 and 4.2 to 4.4).

8. ***Outreach Dental Care Programme for the Elderly.*** The DH has engaged 11 non-governmental organisations (NGOs) to provide outreach dental services to eligible service users at residential care homes and day care centres for the elderly under the Programme. Audit noted that: (a) of the 944 residential care homes/day care centres eligible for services, 182 (19%) homes/centres did not participate in the Programme in the 2015/16 service year; (b) through on-site oral health assessment in the 2015/16 service year, the NGOs found that 32,950 elderly persons at residential care homes/day care centres needed dental treatments. However, 13,324 (40%) of them refused to receive treatment, notwithstanding that they were physically fit for treatments; and (c) to monitor performance, the DH has requested the NGOs to adopt the Dental Clinic Management System (DCMS) to plan and record dental services for individual elderly persons. The DH can view the data input by the participating NGOs and generate service statistics reports through another designated system called DCMS-Outreach Reporting Management Service (DCMS-ORMS). However, it was not the DH's practice to verify NGOs' claims for reimbursement of dental treatments against service statistics reports generated by

Executive Summary

the DCMS-ORMS. In 10 of 40 cases examined by Audit, the records in the DCMS had not been accurately and promptly updated for the DH's monitoring purposes (paras. 4.8, 4.9, 4.11(a), 4.13 to 4.15 and 4.18 to 4.21).

9. ***Elderly Dental Assistance Programme.*** In September 2012, the Programme was launched under the CCF. The Programme provides free removable dentures and related dental services to low-income eligible elderly persons. Audit noted that: (a) as at 30 September 2016, of the 134,000 elderly persons eligible for the Programme, only 10,733 (8%) elderly persons had participated in the Programme; (b) through an implementing agent (Organisation A), patients (i.e. elderly persons) were surveyed by telephone to ascertain the dental services they had received. Of the 155 cases surveyed in the period March to September 2016, in 45 cases, potential discrepancies were identified between the services received by patients and the dentists' claims for services provided. In four of the 45 cases, the justifications for not taking further action could be better documented; and (c) as a general rule, the administration cost of a programme of the CCF is capped within 5% of the estimated total disbursement of the programme. However, in the period 2012-13 to 2015-16, the total administration cost spent by Organisation A was equivalent to 18.8% of the Programme's total disbursement of \$56.9 million. The FHB needs to work with Organisation A to improve the economy of scale (paras. 4.25, 4.28, 4.32, 4.33 and 4.35 to 4.37).

Attainment of oral health

10. ***Oral health goals of the Government.*** In March 1991, the Dental Sub-Committee of the Medical Development Advisory Committee recommended the setting of a range of oral health goals to be accomplished by 2010 and 2025. Audit noted that: (a) results of the DH's 2011 Oral Health Survey indicated that some oral health goals for 2010 had not been attained (e.g. 49.3% against a goal of 70% of the 5-year-old people surveyed were caries-free); (b) the DH had not published the level of attainment of the oral health goals; and (c) the existing oral health goals, which were set some 26 years ago in 1991, were likely outdated and should be reviewed (paras. 5.2, 5.4, 5.5 and 5.6(a)).

Executive Summary

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 Director of Health should:

Provision of promotive and preventive services

- (a) consider setting targets for attendance at activities of educational and publicity programmes involving physical participation of the target groups to facilitate measurement of the adequacy of the programmes and identifying room for improvement (para. 2.11(a));
- (b) explore means to encourage kindergartens/nurseries, which have not enrolled in the Brighter Smiles Playland, to join the Playland so that more students could benefit from Playland activity sessions (para. 2.11(b));
- (c) further promote the services of the Bright Smiles Mobile Classroom with a view to benefiting more schools (para. 2.11(c));
- (d) explore appropriate measures to encourage Primary 6 students' attendance at appointments of the School Dental Care Service (para. 2.23(a));
- (e) in consultation with the FHB, determine whether the fees for the School Dental Care Service should be revised (para. 2.23(b));

Provision of dental services for CSEPs

- (f) investigate the reasons for the increasing proportion of CSEPs declining referrals to other clinics with shorter waiting time for new cases, and explore the feasibility of shortening the waiting time for first-time dental appointments (para. 3.13(a));
- (g) monitor the waiting time for subsequent dental appointments and take further action to shorten the waiting time (para. 3.13(b));

Executive Summary

- (h) closely monitor the progress of the provision of new surgeries, and take prompt remedial action where warranted (para. 3.18(a));

Provision of specific dental services for the public

- (i) explore ways to maximise the utilisation of General Public Sessions to better meet the public demand with existing resources (para. 4.6);
- (j) look into the reasons why many residential care homes/day care centres had declined the outreach dental services for the elderly, and take measures to encourage their participation (para. 4.23(a));
- (k) take measures (e.g. enhancing promotional activities) to encourage elderly persons to receive necessary dental treatments (para. 4.23(d));
- (l) remind NGOs of the need to accurately and promptly update records of dental services in the DCMS (para. 4.23(f));
- (m) consider making use of the DCMS-ORMS to substantiate NGOs' claims before making payments to them (para. 4.23(g));

Attainment of oral health

- (n) conduct a review of the oral health goals (para. 5.7(a)); and
- (o) after reviewing the oral health goals, consider publishing the level of attainment against the goals (para. 5.7(c)).

12. Audit has *recommended* that the Secretary for Food and Health should:

- (a) take measures to encourage participation of elderly persons in the Elderly Dental Assistance Programme (para. 4.38(a));
- (b) improve the documentation of the justifications for not taking further action on cases with discrepancies identified in telephone surveys of elderly persons (para. 4.38(b)); and

Executive Summary

- (c) **work with Organisation A to further reduce the administration cost with a view to meeting the requirement set by the CCF (para. 4.38(c)).**

Response from the Government

- 13. The Secretary for Food and Health and the Director of Health agree 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 Oral health is essential to general health and quality of life. According to the World Health Organization, oral health is a state of being free from chronic mouth and facial pain, as well as being free from diseases and disorders such as gum disease, tooth decay and tooth loss.

Government policy on dental care

1.3 For dental care, prevention has more long-lasting benefits and is more cost-effective than cure. In Hong Kong, it is the Government's policy to seek to raise public awareness of oral health and encourage proper oral health habits through promotion and education. To this end, the Government provides promotive and preventive services for dental care. Not only can effective prevention improve the overall level of oral health, it can also mitigate the community's financial burden in providing expensive dental treatments.

Introduction

1.4 As part of the conditions of service, the Government provides comprehensive dental services to civil service eligible persons (CSEPs — Note 1).

1.5 The Government is mindful of the substantial financial resources involved in providing comprehensive dental services to the community. Dental services are provided to members of the public mainly by registered dentists working in the private sector and non-governmental organisations (NGOs). Nevertheless, the Government recognises the need to provide some essential dental services to the public, namely, emergency dental services, specialised dental services that are essential for certain people (e.g. oral and maxillofacial surgery), and dental services required by people who may have limited knowledge about oral health or are unable to take care of their teeth properly (i.e. the elderly and people with intellectual disability). Accordingly, in addition to promotion and education, the Government also provides these essential dental services.

Note 1: CSEPs are:

- (a) *monthly paid officers and their family members;*
- (b) *retired Government officers in receipt of a pension and their family members living in Hong Kong;*
- (c) *family members of officers killed on duty and living in Hong Kong;*
- (d) *family members living in Hong Kong and in receipt of a pension under the Widows and Orphans Pension Scheme or Surviving Spouses' and Children's Pensions Scheme following the death of officers while in service or after retirement; and*
- (e) *other persons who are eligible for civil service medical benefits by way of their terms of appointment.*

Family members refer to an officer's spouse and children who are unmarried and under the age of 21. For children aged 19 or 20, they must also be in full time education or in full time vocational training, or dependent on the officer as a result of physical or mental infirmity.

1.6 Government dental services are mainly provided through the Department of Health (DH — Note 2) as follows:

- (a) promotive and preventive services (see para. 1.7);
- (b) dental services for CSEPs (see para. 1.8); and
- (c) specific dental services for the public (see paras. 1.9 to 1.11(a)).

In addition, services are also provided by participating NGOs/organisations/private dentists to patients with special needs. These services are subsidised by the Community Care Fund (CCF — Note 3) (see para. 1.11(b)) and the Food and Health Bureau (FHB — see para. 1.11(c)).

Promotive and preventive services

1.7 The DH runs the following programmes to provide promotive and preventive services to different sectors of the community:

Note 2: *The Hospital Authority also provides dental services at selected hospitals. Such services include hospital dental services as well as specialist dental services (mainly specialist oral-maxillofacial surgery) for hospital patients, and patients with special oral health care needs and dental emergency (such as trauma, tumor and cleft deformities) via internal referral. In 2015-16, the Hospital Authority had eight Dental Officers and 14 ancillary dental personnel for its provision of dental services. This audit review does not cover the Hospital Authority's dental services.*

Note 3: *The CCF is a trust fund established in 2011 under the Secretary for Home Affairs Incorporation Ordinance (Cap. 1044) with the Secretary for Home Affairs Incorporated as its trustee. Its objective is to provide assistance to people with financial difficulties, in particular those who fall outside the social safety net or those within the safety net but still have special circumstances that are not covered. In addition, the CCF may consider introducing programmes on a pilot basis to help the Government identify those measures that can be considered for incorporation into its regular assistance and service programmes. The CCF runs a number of assistance programmes, which include dental services for low-income elderly persons.*

Introduction

- (a) ***Educational and publicity programmes.*** Through its Oral Health Education Unit, the DH runs various programmes for students (e.g. arranging interactive activities at DH venues to help pre-primary school students learn good oral care habits) and for the public at large (e.g. launching publicity campaign to promote oral health). All the programmes are free. In the financial year 2015-16, some 1,300 events were held under 20 programmes. Appendix A shows the key programmes run in 2015-16; and

- (b) ***School Dental Care Service.*** Through its eight school dental clinics (see Appendix B), the DH has been running the School Dental Care Service for primary school students since 1980. Participating students are scheduled to visit school dental clinics to receive basic and preventive dental care, which are provided by Dental Therapists under the supervision of Dental Officers (see para. 1.14(a) and (c)). For students with permanent resident status, an annual fee of \$20 is charged (Note 4). In the 2015/16 service year (Note 5), about 96% of primary school students in Hong Kong participated in the service. Since the 2013/14 service year, the Government has expanded the service to cover students with intellectual disability and/or physical disabilities studying in special schools irrespective of their grades until they reach the age of 18.

Dental services for CSEPs

1.8 As part of civil servants' conditions of service, the Government provides dental services for CSEPs. Services are provided through the DH's 47 clinics/units over the territory, which comprise 38 government dental clinics, 2 orthodontic clinics and 7 Oral Maxillofacial Surgery and Dental Units (OMSDUs):

- (a) ***General dental services.*** Dental treatments and annual dental check-ups are provided through government dental clinics (see Photograph 1); and

Note 4: *For students without permanent resident status, the annual fee is \$605.*

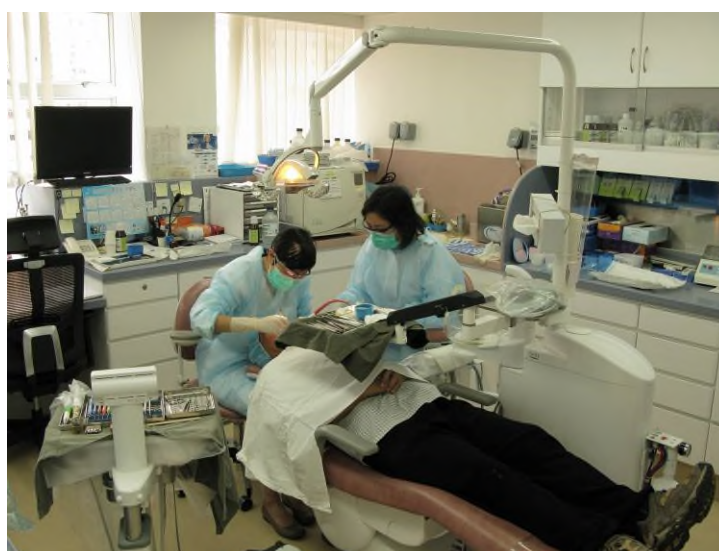
Note 5: *A service year for the School Dental Care Service starts in November and ends in October of the ensuing calendar year.*

- (b) ***Specialised dental services.*** Specialised services (e.g. oral and maxillofacial surgery, and restorative dental services) are provided through specific government dental clinics, the orthodontic clinics and the OMSDUs (see Photograph 2). To receive the services, CSEPs need to have the referral of government dental clinics.

General dental services are free of charge. For specialised dental services, CSEPs are required to pay fees according to their monthly salaries (see Appendix C). Details of the clinics and OMSDUs are at Appendix D.

Photograph 1

Provision of general dental services at a government dental clinic



Source: DH records

Photograph 2

Provision of specialised dental services at an OMSDU



Source: DH records

Specific dental services for the public

1.9 ***Emergency dental services for the public.*** Since 1947, emergency dental treatments (e.g. pain relief and tooth extraction) have been provided to the public who have acute dental problems. Necessary professional advice is also provided to those receiving the emergency treatments. Emergency dental services (i.e. emergency treatments and the related professional advice) are provided through designated sessions in 11 government dental clinics of the DH (see Appendix D). For eligible people, emergency dental services are free of charge (Note 6).

1.10 ***Specialised dental services for the public.*** The DH's 7 OMSDUs which serve CSEPs (see para. 1.8) also provide specialised dental services for the public (see Appendix D). Members of the public need to have the referral of the Hospital Authority, government dental clinics or private dentists in order to receive

Note 6: *Eligible people include holders of Hong Kong Identity Card and children who are Hong Kong residents and under 11 years of age. For non-eligible people, the emergency dental services are charged \$1,110 per consultation.*

specialised dental services. People are charged a consultation fee (i.e. \$100 for the first attendance and \$60 for subsequent attendance) and the fees of treatments provided (see Appendix C).

1.11 ***Dental services for people with special needs.*** The Government provides the following specific dental services for people with special needs (i.e. the elderly and people with intellectual disability):

- (a) ***DH's Outreach Dental Care Programme for the Elderly.*** This Programme was launched as a regular programme in 2014. Under the Programme, NGOs are engaged to provide on-site primary dental care services (e.g. oral health assessment and care planning) to the eligible elderly residing in residential care homes or using services in day care centres (see Appendix E). For curative treatments which cannot be done on-site, the NGOs will arrange escort service for the elderly to receive treatments at NGO dental clinics. On-site training on oral care is also provided to the elderly, their caregivers and families. For the provision of the Programme, the DH has engaged 11 NGOs under a three-year Funding and Service Agreement, covering the period from October 2014 to September 2017;
- (b) ***CCF's Elderly Dental Assistance Programme.*** The Programme, launched in September 2012 under the CCF, provides free removable dentures and other related dental services (including oral examination, scaling and polishing, fillings, tooth extractions and X-ray examination) to low-income eligible elderly persons (see Appendix E). As at 30 September 2016, 415 private dentists and 98 dentists from dental clinics operated by NGOs had participated in the Programme as service providers (i.e. providing dentures and the related dental services). The CCF reimburses the participating dentists and NGOs for the services provided; and
- (c) ***FHB's pilot project on dental service for patients with intellectual disability.*** In August 2013, the FHB launched the pilot project which was scheduled to end in August 2017. Under the pilot project, eligible persons aged 18 or above with intellectual disability (see Appendix E) can receive dental check-ups, dental treatments as well as oral health education at dental clinics of participating organisations. The FHB provides subsidy, subject to an established cap of \$19,000 for each

Introduction

eligible patient (see Appendix E), to the participating organisations for the services provided. In March 2017, the participating organisations comprised a private hospital and three organisations. The FHB was working with the participating organisations to evaluate the overall effectiveness of the pilot project, with a view to formulating an appropriate operational model to continue providing dental services to adults with intellectual disability.

A summary of the dental programmes is at Appendix E (Note 7).

Expenditure on dental services and number of attendance

1.12 In 2015-16, the expenditure on dental services totalled \$1,018 million (Note 8). The total number of attendance for dental services (including publicity activities, dental check-ups, dental treatments, etc.) was some 1.5 million (see Table 1 for details). Figures 1 and 2 also show the expenditure and the attendance over the past five years from 2011-12 to 2015-16.

Note 7: *People with special needs may also receive government subsidised dental services under the following two schemes:*

- (a) **Comprehensive Social Security Assistance Scheme.** *The Scheme, run by the Social Welfare Department, is not a dental programme. However, for recipients of social security assistance aged 60 or above, dental grants may also be provided to those who are disabled or medically certified to be in ill-health. In 2015-16, the number of dental grant cases was 12,466 and the amount of dental grants was about \$73 million. This audit review does not cover the Comprehensive Social Security Assistance Scheme which is not a dental programme per se; and*
- (b) **Elderly Health Care Voucher Scheme.** *The Scheme, run by the DH, provides financial subsidies for elderly persons aged 70 or above to use primary care services in the private sector, including dental services. In 2015-16, about 114,000 claims were made by dentists for services provided under the Scheme, involving about \$103 million. An audit review of the Scheme was conducted in 2014, results of which were included in Chapter 2 of the Director of Audit's Report No. 63 of October 2014.*

Note 8: *The amount did not include expenditure on the Hospital Authority's dental services, dental grants under the Comprehensive Social Security Assistance Scheme and claims by dentists under the Elderly Health Care Voucher Scheme.*

Table 1

**Expenditure on dental services and number of attendance
(2015-16)**

Dental service	Provided by	Expenditure (\$ million)	Number of attendance
<i>Promotive and preventive services</i>			
Educational and publicity programmes	DH	31	217,422
School Dental Care Service (Note 1)	DH	240	426,826
Sub-total		271	644,248
<i>Dental services for CSEPs</i>			
General dental services	DH	543	648,901
Specialised dental services	DH	55	72,013
Sub-total		598	720,914
<i>Specific dental services for the public</i>			
Emergency dental services (Note 2)	DH	5	39,196
Specialised dental services	DH	53	56,346
Outreach Dental Care Programme for the Elderly	DH	33	48,351
Elderly Dental Assistance Programme (Note 3)	CCF	54	4,959
Pilot project on dental service for patients with intellectual disability (Note 3)	FHB	4	557
Sub-total		149	149,409
Total		1,018	1,514,571

Source: DH and FHB records

Table 1 (Cont'd)

Note 1: The attendance of School Dental Care Service comprised:

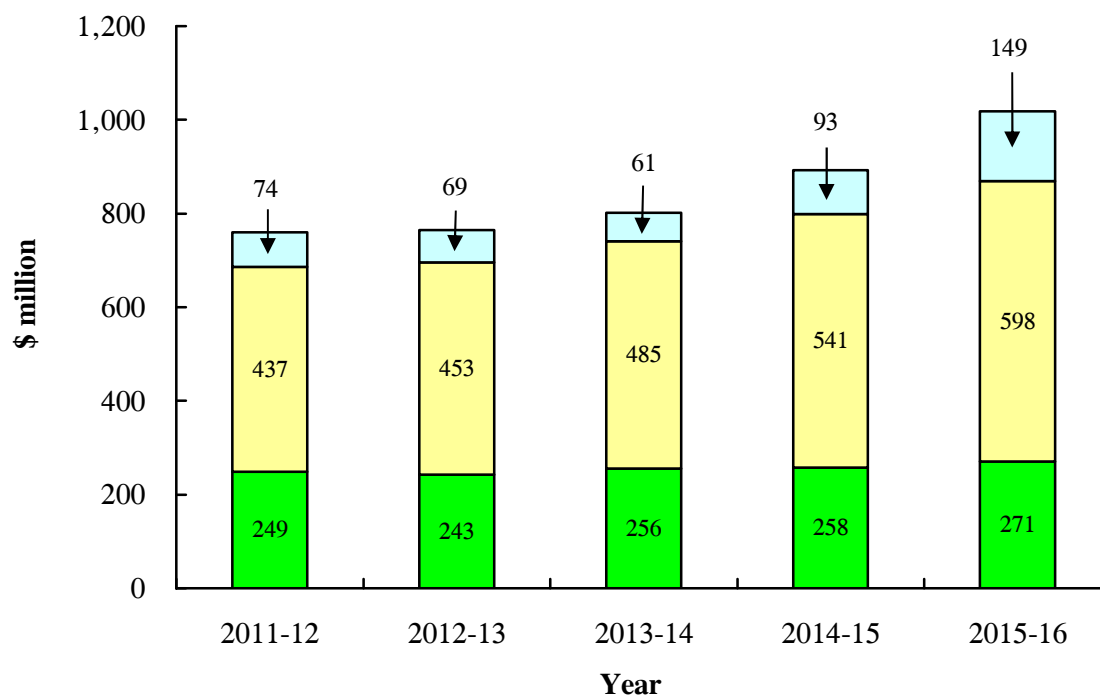
	No.
<i>Primary school students (500,459 less 74,963 — see items (a) & (b) of Table 5 in para. 2.14)</i>	425,496
<i>Children (aged under 18) of CSEPs and the Hospital Authority's staff and retirees</i>	1,330
	<u>426,826</u>

Note 2: The attendance for emergency dental services comprised:

	No.
<i>General Public Session attendance (see Table 10 in para. 4.4)</i>	34,580
<i>Attendance for follow-up treatment (e.g. removing stitches)</i>	1,699
<i>Inmates' dental attendance</i>	2,917
	<u>39,196</u>

Note 3: The programme/project had a higher cost per attendance due to their unique features, i.e. dentures and services were provided by private dentists to elderly persons under the Elderly Dental Assistance Programme, and provision of dental services by a private hospital and three organisations under the pilot project for patients with intellectual disability generally required the use of anesthetics.

Figure 1

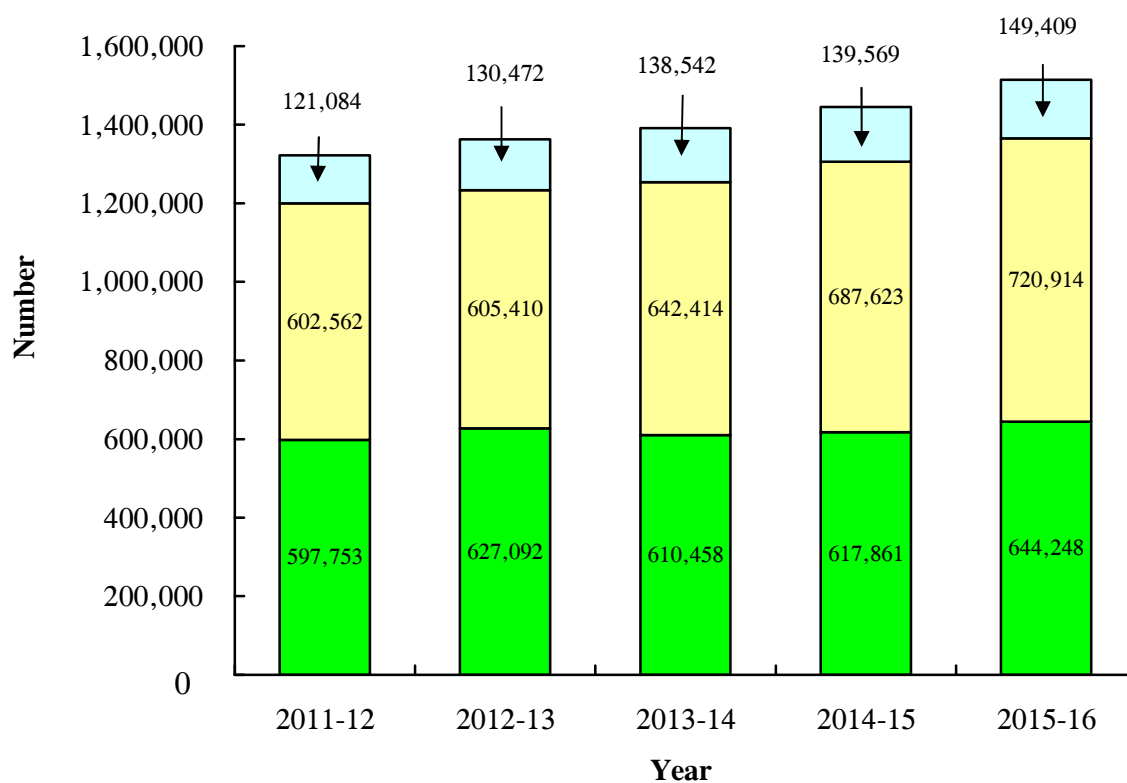
**Expenditure on dental services
(2011-12 to 2015-16)**

Legend: ■ Specific dental services for the public
■ Dental services for CSEPs
■ Promotive and preventive services

Source: DH and FHB records

Figure 2

Attendance for dental services
(2011-12 to 2015-16)



Legend: ■ Specific dental services for the public
■ Dental services for CSEPs
■ Promotive and preventive services

Source: DH and FHB records

Staff for the provision of dental services by the DH

1.13 The clinics and OMSDUs mentioned in paragraph 1.8 belong to the DH's Dental Service. An extract of the DH organisation chart (showing the Service) is at Appendix F. As at 30 September 2016, the Service had 1,319 staff comprising 982 dental personnel and 337 administrative and supporting staff (see Appendix G).

1.14 The 982 dental personnel comprised staff of five different grades:

- (a) ***Dental Officer grade (316 staff).*** Dental Officers are dentists who possess a practising certificate issued by the Dental Council of Hong Kong (Note 9). They provide dental treatment to patients and deal with emergency cases;
- (b) ***Dental Technician grade (47 staff).*** Dental Technicians work in dental laboratories. They are responsible for the fabrication of dental prostheses;
- (c) ***Dental Therapist grade (268 staff).*** Dental Therapists carry out, under the supervision of Dental Officers, simple operative dental work (e.g. simple extraction and preventive measures) on patients below the age of 18. They also provide oral health education;
- (d) ***Dental Surgery Assistant grade (338 staff).*** Dental Surgery Assistants assist dentists at the chair side in the treatment and care of patients; and
- (e) ***Dental Hygienist grade (13 staff).*** Dental Hygienists undertake, under the supervision of Dental Officers, dental work such as cleaning and polishing of teeth, scaling of teeth, and providing oral health education.

Staff in the Dental Officer grade ((a) above) are dental professional staff. Other staff ((b) to (e) above) are ancillary dental personnel.

Note 9: *The Dental Council of Hong Kong, established under the Dentists Registration Ordinance (Cap. 156), is responsible for the registration of dentists, the conduct of the licensing examination, the maintenance of ethics, professional standards and discipline of the profession. As at February 2017, there were some 2,400 dentists registered under the Council's General Register of Dentists.*

Oral health surveys

1.15 In 2001, the DH conducted a territory-wide oral health survey to collect information in relation to oral health condition of the people in Hong Kong. The survey indicated that the oral health in Hong Kong was found to be in the same ranking as if not better than most developed countries. In 2011, the DH conducted the second oral health survey, which focused on two preventable diseases, namely, tooth decay and gum disease. The 2011 survey showed that the level of oral health in Hong Kong in terms of the degree of tooth loss was among the best compared with many developed countries.

Audit review

1.16 In October 2016, the Audit Commission (Audit) commenced a review to examine the provision of dental services by the Government. The audit has focused on the following areas:

- (a) provision of promotive and preventive services (PART 2);
- (b) provision of dental services for CSEPs (PART 3);
- (c) provision of specific dental services for the public (PART 4); and
- (d) attainment of oral health (PART 5).

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

Acknowledgement

1.17 Audit would like to acknowledge with gratitude the full cooperation of the staff of the DH, the FHB and the Home Affairs Bureau during the course of the audit review.

PART 2: PROVISION OF PROMOTIVE AND PREVENTIVE SERVICES

2.1 This PART examines the provision of promotive and preventive services for oral health, focusing on the DH's:

- (a) educational and publicity programmes (paras. 2.2 to 2.12); and
- (b) School Dental Care Service (paras. 2.13 to 2.24).

Educational and publicity programmes

2.2 The DH's Oral Health Education Unit leads and supports oral health education as well as oral health promotion in the territory. The Unit conducted 20 educational and publicity programmes in 2015-16 to help students establish good oral care habits and promote oral health to the public at large. The programmes were free, each of which aimed to serve a specific target group (see Photographs 3 and 4). Appendix A shows the key programmes.

Photographs 3 and 4

Examples of educational and publicity programmes on oral health

Photograph 3

Poster of a programme for the general public



Photograph 4

A programme for kindergarten students



Source: DH records

Need to monitor the coverage of target groups

2.3 The DH adopted target-specific methods to promote oral health awareness and disseminate oral health messages to target groups. For example:

- (a) for kindergarten students, face-to-face activities were arranged for free. The activities were welcomed by schools because oral health practice was a part of their curricula;
- (b) for the general public, the Love Teeth Campaign aimed to reach them through different channels (TV advertisements, carnivals and other activities). According to the latest telephone evaluation survey conducted in 2016, 83% of the respondents in a representative sample were aware of the DH's promotional materials and for some messages, over 50% of the

respondents could recall the oral health information after one year. The Campaign provided a seeding effect for disseminating the oral health information and heightening public awareness. Events and activities organised under the Campaign were designed to radiate oral health care messages through the participants and the media, so that they could help spread the messages to the community; and

- (c) for primary and secondary school students, the DH adopted the “train-the-trainer” approach, i.e. there were programmes which would nurture oral health promoters at school level who would in turn educate their peers. From 2012 to 2016, there were a total of 336 primary schools participating in the programmes (accounting for 50% of the total number of schools).

2.4 Table 2 shows, for each target group, the attendance at activities of educational and publicity programmes in the period 2011-12 to 2015-16.

Provision of promotive and preventive services

Table 2

**Attendance of educational and publicity programmes
(2011-12 to 2015-16)**

Target group	Attendance at programme activities (No. of people)					Range of attendance (No. of people)	
	2011-12	2012-13	2013-14	2014-15	2015-16	From	To
Kindergarten and nursery students	153,217	185,384	172,427	172,532	177,589	153,217	185,384
Special school students	35	361	89	395	4,768	35	4,768
Primary school students	33,245	29,929	23,235	22,285	25,056	22,285	33,245
Secondary school students	414	333	210	255	1,849	210	1,849
General public	421	1,241	524	6,085	8,160	421	8,160
Overall	187,332	217,248	196,485	201,552	217,422	187,332	217,422

Source: Audit analysis of DH records

As shown in Table 2, the attendance at programme activities fluctuated from year to year. Over 80% of the participants were kindergarten and nursery students and over 10% were primary school students. For the other target groups, the number of participants were comparatively low and fluctuation was considerable. For example, secondary school students' attendance at programme activities fluctuated from 210 people in 2013-14 to 1,849 people in 2015-16.

2.5 Upon enquiry, the DH informed Audit in March 2017 that:

- (a) attendance should not be the only measurement of the overall effectiveness of educational and publicity programmes. There are other activities which aim to reach out to the target groups through mass media and electronic means; and
- (b) not all educational and publicity programmes involve attendance of the target groups.

2.6 Audit considers that there is a need for the DH to monitor the coverage of target groups by the educational and publicity programmes. In particular, the DH needs to consider setting targets for attendance of the programmes involving physical participation of the target groups, to facilitate measurement of the adequacy of the programmes and identifying room for improvement.

Room for encouraging more kindergartens/nurseries to join Brighter Smiles Playland

2.7 The Brighter Smiles Playland (the Playland) programme provides interactive activities (e.g. role-playing as dentists and learning the use of oral health cleaning aids) for kindergarten 2 (K2) students and nursery 3 (N3) students (i.e. children of four years old). More than 2,200 activity sessions are available for booking by schools every year (Note 10). Audit noted that while the utilisation rates of the Playland had increased from 89% to 92% from 2011/12 to 2015/16 school years respectively (Note 11), the number of K2 and N3 students who did not join the programme had increased from 13,414 in 2011/12 to 16,332 in 2015/16 (see Table 3).

Note 10: *Each activity session, facilitated by DH staff, is conducted in an activity room which can accommodate 30 students. The Playland has altogether three activity rooms (sized 330 square metres in total) which are located in a school dental clinic.*

Note 11: *A school year refers to the period from 1 September to 30 June of the ensuing calendar year.*

Table 3

**Utilisation of the Playland activity sessions
and number of K2 and N3 students
(2011/12 to 2015/16 school years)**

	2011/12	2012/13	2013/14	2014/15	2015/16
No. of sessions available (a)	2,316	2,253	2,283	2,265	2,292
No. of sessions booked (b)	2,070	2,067	2,055	2,091	2,112
No. of sessions not utilised (c) = (a) – (b)	246	186	228	174	180
Utilisation rate (d) = (b)/(a) × 100%	89%	92%	90%	92%	92%
No. of K2 and N3 students in Hong Kong (e)	53,977	56,483	56,699	58,738	63,315
No. of K2 and N3 students using Playland (f)	40,563	42,734	42,886	44,281	46,983
No. of K2 and N3 students not using Playland (g) = (e) – (f)	13,414	13,749	13,813	14,457	16,332

Source: Audit analysis of DH records

2.8 In February 2017, the DH informed Audit that there were kindergartens/nurseries which had not enrolled in the Playland and therefore their K2/N3 students could not use the Playland services. Audit considers that the DH needs to explore means to encourage those kindergartens/nurseries, which have not enrolled in the Playland, to join the programme so that more students could benefit from Playland activity sessions.

Room for improving utilisation of Bright Smiles Mobile Classroom

2.9 Under the Bright Smiles Mobile Classroom programme, a roving oral health education bus visits different primary schools to enrich the oral health

Provision of promotive and preventive services

knowledge of students. Schools can apply for programme services through the Internet. Audit noted that in the 2011/12 to 2015/16 school years, the overall utilisation rate of the programme services was 84%. The number of service days (Note 12) unutilised in the 2011/12 to 2015/16 school years averaged 23 days a year. Nevertheless, 526 primary schools did not use the services in 2015/16 (see Table 4).

Table 4

Utilisation of Bright Smiles Mobile Classroom services and number of primary schools in Hong Kong (2011/12 to 2015/16 school years)

	2011/12	2012/13	2013/14	2014/15	2015/16
No. of service days (a)	161	148	137	117	159
No. of booked days (b)	145	119	118	88	137
No. of service days not utilised (c) = (a) - (b)	16	29	19	29	22
Utilisation rate (d) = (b)/(a) × 100%	90%	80%	86%	75%	86%
No. of primary schools in Hong Kong (Note) (e)	568	569	569	571	572
No. of primary schools using programme services (f)	50	46	38	32	46
No. of primary schools not using programme services (g) = (e) - (f)	518	523	531	539	526

Source: Audit analysis of DH records

Note: The figures refer to the number of primary schools published by the Education Bureau.

Note 12: Service days exclude non-working days, school holidays and maintenance days of the roving oral health education bus.

Provision of promotive and preventive services

2.10 Audit considers that the DH needs to further promote the services of the Bright Smiles Mobile Classroom, with a view to maximising its utilisation and benefiting more schools.

Audit recommendations

2.11 Audit has *recommended* that the Director of Health should:

- (a) **consider setting targets for attendance at activities of educational and publicity programmes involving physical participation of the target groups to facilitate measurement of the adequacy of the programmes and identifying room for improvement;**
- (b) **explore means to encourage those kindergartens/nurseries, which have not enrolled in the Playland, to join the Playland so that more students could benefit from Playland activity sessions; and**
- (c) **further promote the services of the Bright Smiles Mobile Classroom, with a view to maximising its utilisation and benefiting more schools.**

Response from the Government

2.12 The Director of Health generally agrees with the audit recommendations. She has said that target(s) for attendance can be set for educational and publicity activities involving physical participation of the target groups. Such target(s) will serve as one of the benchmarks for evaluating the effectiveness of activities concerned.

School Dental Care Service

2.13 The School Dental Care Service aims to promote good oral hygiene and prevent common dental diseases. All primary schools (including special schools) and their students can join the Service on a voluntary basis (Note 13). Key services provided include oral health education (see Photograph 5), annual dental check-ups (see Photograph 6), and basic and preventive dental treatments (e.g. scaling and filling). In the 2015/16 service year, 623 schools and some 325,000 students joined the Service.

Photographs 5 and 6

Examples of services provided under the School Dental Care Service

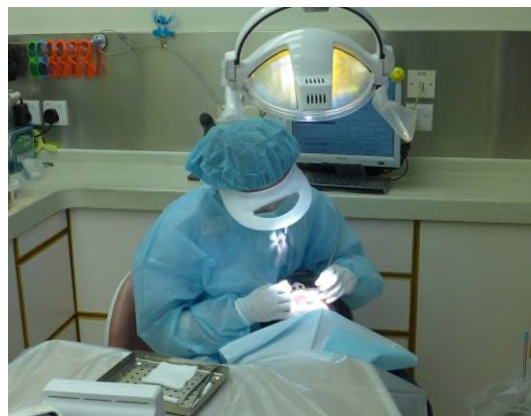
Photograph 5

Oral health education



Photograph 6

A dental check-up



Source: DH records

Note 13: *Primary school students, as well as special school students with intellectual disability and/or physical disabilities under the age of 18 are eligible to join the programme. Students of participating schools can join the programme through their schools. Students of non-participating schools can also join the programme directly with the DH.*

Provision of promotive and preventive services

Appointments not attended as scheduled

2.14 Under the School Dental Care Service, students made about 500,000 dental appointments a year. Audit noted that many students did not show up at the appointments to receive the dental services as scheduled. In the 2011/12 to 2015/16 service years, the number of unattended appointments increased by 14,260 from 60,703 in 2011/12 to 74,963 in 2015/16. Moreover, the proportion of appointments which were left unattended had also increased from 12.9% in 2011/12 to 15% in 2015/16 (see Table 5).

Table 5

**Dental appointments of the School Dental Care Service
(2011/12 to 2015/16 service years)**

	2011/12	2012/13	2013/14	2014/15	2015/16
No. of appointments made (a)	469,591	469,146	474,846	481,671	500,459
No. of appointments unattended (b)	60,703	60,843	62,384	66,679	74,963
Proportion of appointments unattended (c) = (b)/(a) × 100 %	12.9%	13.0%	13.1%	13.8%	15.0%

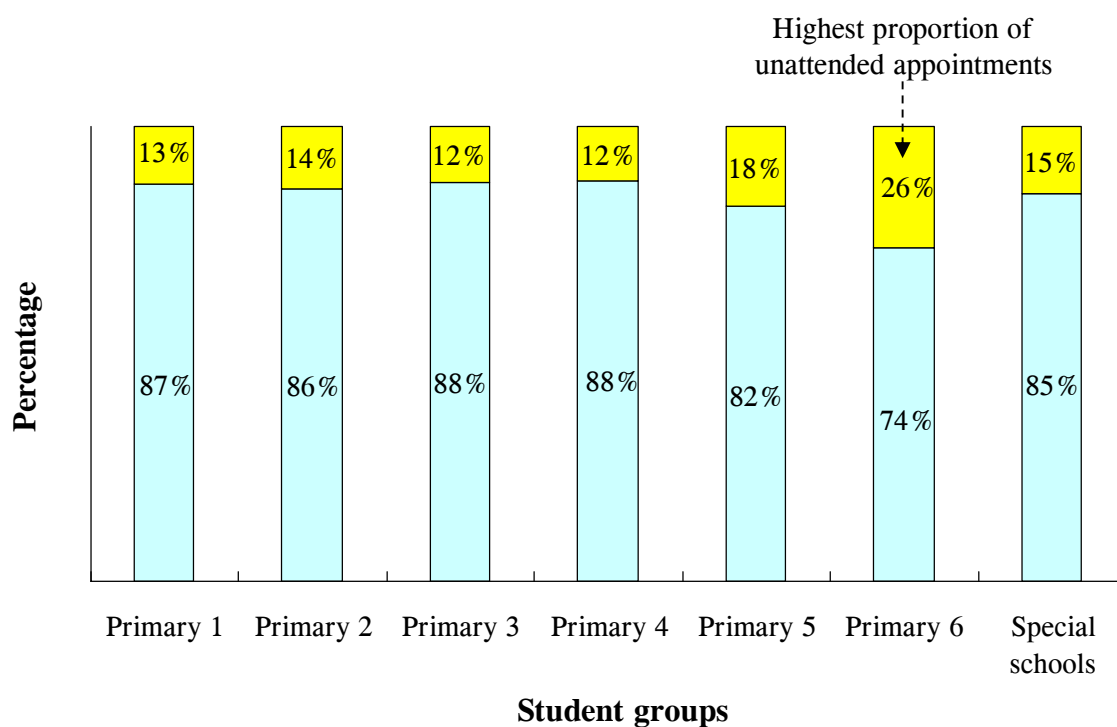
Source: Audit analysis of DH records

2.15 Audit analysed the dental appointments made under the Service in 2015/16 and found that:

- (a) the proportion of Primary 6 students not attending scheduled appointments was the highest at 26%. For other students, the proportion ranged from 12% to 18% (see Figure 3); and

Figure 3

**Dental appointments of different student groups
(2015/16 service year)**



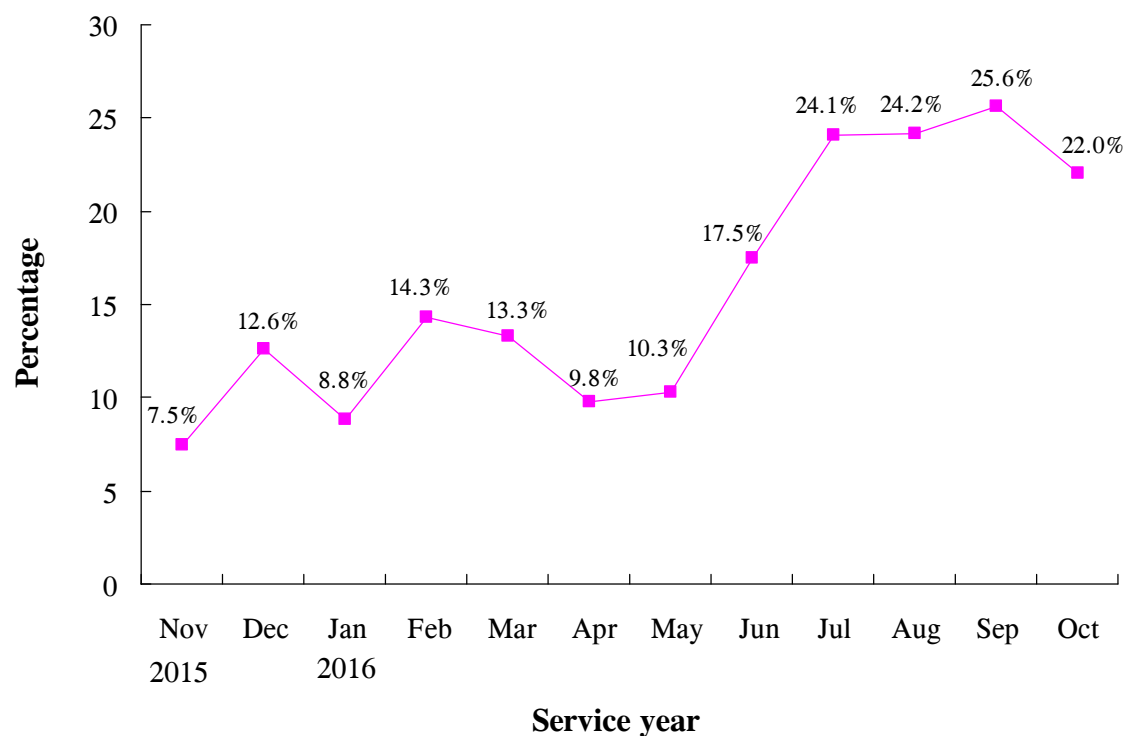
Legend: ■ Appointments unattended
■ Appointments attended

Source: Audit analysis of DH records

- (b) appointments were more likely to be unattended as the service year went by, with seasonal peaks in months where there were school examinations (e.g. June) and long holidays (e.g. December, February, July and August) (see Figure 4).

Figure 4

**Monthly percentage of dental appointments unattended
(2015/16 service year)**



Source: Audit analysis of DH records

2.16 During the course of audit, the DH informed Audit that the DH was well aware of the proportions of unattended appointments as mentioned in paragraphs 2.14 and 2.15. The situation was actually mitigated to a certain extent by over-booking so that unattended slots would be filled up as far as possible. The unattended slots would also be filled up by unscheduled walk-in appointments.

2.17 Audit also noted that some practices might not have provided students sufficient incentives to not miss their scheduled dental appointments:

- (a) the School Dental Care Service provided round-trip transport for Primary 1 to 5 students to attend scheduled appointments for dental check-ups during school hours. According to the DH, school examinations and academic activities might have priority over attending dental consultations for Primary 6 students. Dental appointments were therefore scheduled outside school hours for them. Primary 6 students had to make their own transportation arrangements to attend the appointments (Note 14);
- (b) the School Dental Care Service had an appointment reminder service via e-mail, which was available through registration on its website. However, registration for the service was made on a voluntary basis and utilisation of the service was not high. As at 1 February 2017, the number of registered users was only about 16,000 (out of a total of 325,000 eligible students); and
- (c) students were charged a low nominal annual fee of \$20 for the School Dental Care Service. The fee had not been revised for some time and students were heavily subsidised (see paras. 2.19 to 2.22).

2.18 According to the DH, regular dental check-ups (which were on a voluntary basis) were recommended for maintaining good oral health. In Audit's view, the particularly high proportion of Primary 6 students not attending scheduled appointments for dental check-ups is a cause for concern. The DH needs to explore appropriate measures to encourage students' attendance, such as providing bus services for Primary 6 students, promoting on-line registration for the appointment reminder service, and reminding students to attend appointments through mobile messaging applications.

Note 14: *For special school students, to meet their special needs, transport arrangements were made by the schools concerned.*

Provision of promotive and preventive services

Target levels of cost recovery not achieved

2.19 The annual fee for the School Dental Care Service is \$20 for eligible students and \$605 for non-eligible students (Note 15). These fees were set in 1993 and 2003 respectively. The Service is heavily subsidised by the Government (Note 16). Audit noted that:

- (a) while the Service was mainly preventive in nature, it also had a curative element. As agreed between the DH and the Financial Services and the Treasury Bureau (FSTB), 70% of the cost of School Dental Care Service was for preventive treatments whereas the remaining 30% was for curative treatments. For eligible students, preventive treatments were not to be charged, and the target level of cost recovery for curative treatments was 20%. Non-eligible students were to be fully charged for both preventive treatments and curative treatments;
- (b) based on the aforesaid principles, the DH prepared a costing statement in April 2014. The statement indicated that the target cost to be recovered from an eligible student was \$64 (i.e. full cost of \$1,061 $\times$ 30% for curative treatments $\times$ 20% cost recovery rate), against the existing fee of \$20. Moreover, the cost to be recovered from a non-eligible student was \$1,061, against the existing fee of \$605; and
- (c) the fees, however, had not been revised. Accordingly, the target levels of cost recovery had not been achieved. The percentage of target cost recovered was only 31% (i.e. \$20 out of \$64) for eligible students and 57% (i.e. \$605 out of \$1,061) for non-eligible students.

Note 15: *Non-eligible students include the following persons:*

- (a) *students who were born in Hong Kong but their permanent resident status is not established; and*
- (b) *students who were not born in Hong Kong and are holding valid travel documents with a “visitor” or “two-way permit holder” status.*

Note 16: *In 2015-16, revenue from annual fees of the programme was about \$6.4 million while the total programme expenditure was \$240 million.*

2.20 According to Financial Circular No. 6/2016, Directors of Bureaux and Controlling Officers should aim at achieving the agreed targets for cost recovery as early as possible. Moreover, according to the 2013-14 Budget Speech, to prevent cost-recovery items from turning into heavily subsidised items, fees and charges should be reviewed, in particular those that had not been revised for many years and did not directly affect people's livelihood, as well as those that had low cost-recovery rates.

2.21 Upon enquiry, the DH informed Audit in February 2017 that:

- (a) the DH had reviewed regularly the annual fee for the School Dental Care Service;
- (b) about revising the fees, as stated in the 2013-14 Budget Speech and the 2014-15 Budget Speech, the Government would first deal with fees that did not directly affect people's livelihood. Against this background, it was the DH's understanding that fee reviews of the School Dental Care Service should be completed after the reviews of other non-livelihood items; and
- (c) the DH had from time to time consulted with the FHB and the FSTB about fee-related matters. The DH and the FHB planned to further seek the FSTB's clarification on handling reviews of livelihood-related fees based on prudence principle.

In this connection, Audit noted that as mentioned in the 2015-16 Budget Speech, the Government had also started to review livelihood-related fees and charges from 2015-16.

2.22 Audit considers that the DH needs to, in consultation with the FHB, determine whether the fees for the School Dental Care Service should be revised.

Audit recommendations

- 2.23 **Audit has *recommended* that the Director of Health should:**
- (a) **explore appropriate measures to encourage Primary 6 students' attendance at appointments of the School Dental Care Service; and**
 - (b) **in consultation with the FHB, determine whether the fees for the School Dental Care Service should be revised.**

Response from the Government

- 2.24 **The Director of Health generally agrees with the audit recommendations.**

PART 3: PROVISION OF DENTAL SERVICES FOR CIVIL SERVICE ELIGIBLE PERSONS

3.1 This PART examines the provision of dental services for CSEPs, focusing on:

- (a) provision of general dental services (paras. 3.2 to 3.14); and
- (b) provision of new surgeries at dental clinics (paras. 3.15 to 3.19).

Provision of general dental services

3.2 The Government has been providing dental services for CSEPs as a condition of service since the 1940s. As at 29 February 2016, the total number of CSEPs was 532,163 (Note 17). These persons, if in need of general dental services (e.g. annual check-ups), are required to book an appointment with one of the 38 government dental clinics.

3.3 The DH monitors the waiting time for general dental services provided to CSEPs. For this purpose, waiting time refers to the period of time that a dental appointment has to be booked in advance.

Waiting more than six months for first-time appointments

3.4 In its Controlling Officer's Report, for new cases (i.e. first-time appointment) of general dental services, the DH has set a target that "appointment time for new dental cases within six months" should be met in more than 90% of the cases. Records indicated that, for the years from 2013 to 2016, the DH was

Note 17: *In the ten-year period from 2007 to 2016, the total number of CSEPs increased by 9% from 489,471 to 532,163. According to a projection submitted by the Civil Service Bureau to the Legislative Council Panel on Public Service in May 2015, some 86,000 civil servants would be retiring in the 15-year period from 2017-18 to 2031-32. The increasing trend in the number of CSEPs will likely continue in the coming years.*

Provision of dental services for civil service eligible persons

able to meet this performance target. Upon enquiry, the DH informed Audit in February 2017 that:

- (a) for more than 90% of new dental cases, the DH was able to offer a first-time appointment to CSEPs at clinics with a waiting time of not longer than six months. For clinics which had a waiting time of more than six months, the clinics concerned would refer their new cases to other clinics which had shorter waiting time; and
- (b) some CSEPs, however, might decline to take up the DH's referral offers and opt for appointments at some other dental clinics that they preferred. In determining whether the performance target was met, the DH adopted an approach where patients who declined to take up appointments at dental clinics with a waiting time within six months would be regarded as refusal cases. These cases would not be counted in assessing the DH's performance in meeting the performance target. This approach had been agreed with the Civil Service Bureau.

3.5 To ascertain how long CSEPs had actually waited for their first-time appointments, Audit analysed the new cases which were yet to be served as at 1 January 2013 and 1 January 2016. Table 6 shows that for a large proportion of cases, the waiting time for first-time appointments was more than six months. The number of new cases waiting to be served had increased from 943 as at 1 January 2013 to 1,501 as at 1 January 2016 (a 59% increase), and the proportion of cases with waiting time more than six months had increased from 34% as at 1 January 2013 to 46% as at 1 January 2016. Audit noted that 82% of the CSEPs who were offered a referral to other clinics on 1 January 2013 had declined the referral. For those offered a referral on 1 January 2016, 90% of them had declined the referral.

Table 6

**Waiting time for first-time appointments
(1 January 2013 and 1 January 2016)**

Waiting time	New cases waiting to be served			
	1 January 2013 (No. of cases)		1 January 2016 (No. of cases)	
≤ 3 months	0	} 618 (66%)	1	} 804 (54%)
> 3 months to ≤ 6 months	618		803	
> 6 months to ≤ 9 months	74	} 325 (34%)	211	} 697 (46%)
> 9 months to ≤ 12 months	105		76	
> 12 months	146		410	
Total	943	100%	1,501	100%

Source: Audit analysis of DH records

3.6 The DH needs to investigate the reasons for the increasing proportion of CSEPs declining referrals to other clinics with shorter waiting time for new cases (see para. 3.5) and, taking into account the results of the investigation, explore the feasibility of shortening the waiting time for first-time dental appointments.

Scope for shortening the waiting time for subsequent appointments

3.7 Subsequent to first-time appointments, CSEPs may book further appointments for dental services. Such services comprise dental treatments and annual check-ups.

3.8 Audit analysed the waiting time for subsequent dental appointments. The analysis covered individual government dental clinics, namely, the 36 clinics as at 1 January 2013 and the 37 clinics as at 1 January 2016. Audit's analysis indicated that in general there were improvements in waiting time. The average waiting time for dental treatments had decreased from 10.2 months as at 1 January 2013 to 8.5 months as at 1 January 2016, and that for annual check-ups had decreased from 12.7 months as at 1 January 2013 to 11.7 months as at 1 January 2016. Upon enquiry, the DH informed Audit in February 2017 that over the years, the DH had

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implemented a number of measures with a view to improving the waiting time. For example, clinics of longer waiting time had been paired up with those of shorter waiting time for transferring CSEPs from the former to the latter. Another example was the issuing of letters to CSEPs inviting them to switch to other clinics with less demand for dental services. Audit, however, noted that:

- (a) ***Waiting time for annual check-ups exceeding one year.*** In four clinics, the waiting time for annual check-ups as at 1 January 2016 was still over one year (13 to 14 months — see Table 7); and

Table 7

**Waiting time of over one year for annual check-ups at four clinics
(As at 1 January 2013 and 1 January 2016)**

Clinic	As at 1.1.2013	As at 1.1.2016	Improvement over 1.1.2013
	Waiting time (Note) (No. of months)		
Yan Oi Dental Clinic	15	14	1 (6.7%)
Yuen Long Jockey Club Dental Clinic	13	13	0 (0%)
Fanling Health Centre Dental Clinic	14	13	1 (7.1%)
Tai Po Wong Siu Ching Dental Clinic	14	13	1 (7.1%)

Source: Audit analysis of DH records

Note: According to the DH, an interval of 12 months between dental check-ups is generally satisfactory. However, for those whose oral condition is at risk and for those having special needs, a shorter interval (e.g. 6 months) between dental check-ups may be necessary.

- (b) ***Wide variations in waiting time.*** As at 1 January 2016, the waiting time for dental treatments at different clinics ranged from 2 months to 18 months, and that for annual check-ups ranged from 9 months to 14 months. Table 8 shows the waiting time among clinics.

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Table 8

Waiting time for dental treatments and annual check-ups (1 January 2016)

Waiting time (No. of months)	Dental treatment	Annual check-up
	(No. of clinics)	
1 to 3	2 (5%) (Note 1)	0 (0%)
4 to 6	10 (27%)	0 (0%)
7 to 9	14 (38%)	1 (3%)
10 to 12	7 (19%)	31 (86%)
13 to 15	1 (3%)	4 (11%) (Note 2)
16 to 18	3 (8%) (Note 3)	0 (0%)
Total	37 (100%)	36 (100%) (Note 4)

Source: Audit analysis of DH records

Note 1: The two clinics were the Western Dental Clinic (2-month waiting time) and the Tai O Dental Clinic (2-month waiting time).

Note 2: The four clinics were the Yan Oi Dental Clinic (14-month waiting time), the Yuen Long Jockey Club Dental Clinic (13-month waiting time), the Fanling Health Centre Dental Clinic (13-month waiting time) and the Tai Po Wong Siu Ching Dental Clinic (13-month waiting time).

Note 3: The three clinics were the Yuen Long Jockey Club Dental Clinic (18-month waiting time), the Yan Oi Dental Clinic (17-month waiting time) and the Fanling Health Centre Dental Clinic (16-month waiting time).

Note 4: Of the 37 clinics, only 36 provided the annual check-up service.

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3.9 The long waiting time for subsequent dental appointments at some clinics was less than satisfactory. The DH needs to monitor the waiting time for subsequent dental appointments and take further action to shorten the waiting time as appropriate (e.g. consider relocating services among clinics to improve the service capacity of clinics with high service demand). The DH also needs to explore ways to further encourage CSEPs to switch to dental clinics with less demand for subsequent dental appointments.

Need to consider extending a trial scheme

3.10 Against the wide variations in waiting time among clinics, in May 2016, the DH implemented a trial scheme to cease the intake of new cases by two clinics (i.e. the Tai Po Wong Siu Ching Dental Clinic and the Yan Oi Dental Clinic). CSEPs approaching the two clinics for the first time would be redirected to other clinics which had a shorter waiting time.

3.11 Audit noted that apart from the two clinics included in the trial scheme, there were also other clinics that had long service queues. For example, as at 1 January 2016:

- (a) the Yuen Long Jockey Club Dental Clinic had a 13-month waiting time for annual check-ups and an 18-month waiting time for dental treatments; and
- (b) the Fanling Health Centre Dental Clinic had a 13-month waiting time for annual check-ups and a 16-month waiting time for dental treatments.

3.12 Upon enquiry, the DH informed Audit in February 2017 that it was the DH's plan to implement the trial scheme for six months from May 2016. As a prudent approach, only two clinics were involved as a start. Based on the initial results, the DH was of the view that the trial scheme should be continued to operate at the two clinics (see para. 3.10), subject to review in another six months' time. The DH also informed Audit that it would consider, in consultation with the Civil Service Bureau, the need to extend the trial scheme to other clinics.

Audit recommendations

3.13 **Audit has *recommended* that the Director of Health should:**

- (a) **investigate the reasons for the increasing proportion of CSEPs declining referrals to other clinics with shorter waiting time for new cases and, taking into account the results of the investigation, explore the feasibility of shortening the waiting time for first-time dental appointments;**
- (b) **monitor the waiting time for subsequent dental appointments and take further action to shorten the waiting time as appropriate;**
- (c) **explore ways to further encourage CSEPs to switch to dental clinics with less demand for subsequent dental appointments; and**
- (d) **keep in view the results of the trial scheme to stop the intake of new cases at selected clinics, with a view to determining in a timely manner whether to extend the trial scheme to other clinics.**

Response from the Government

3.14 The Director of Health agrees with the audit recommendations. She has said that:

- (a) CSEPs have different preferences for attending dental clinics. The DH has used different strategies to address the different demands and waiting time among the dental clinics. The DH will keep monitoring the waiting time for the provision of dental services to CSEPs and continue the efforts to identify suitable locations for the provision of dental services to them, with a view to meeting the high demand for dental services in specific districts; and
- (b) the DH attaches great importance to the dental care of CSEPs. The waiting time of scheduled appointments will not adversely affect their need for immediate dental treatments. The DH has accorded priority to providing treatments to CSEPs with urgent conditions. All government

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dental clinics will provide emergency dental services to them and they could normally receive treatments within the same sessions of attendance.

Provision of new surgeries at dental clinics

3.15 To meet service needs, the DH has planned to provide additional dental surgeries at 11 government dental clinics. The new surgeries aim to provide general dental services for CSEPs. According to the DH's plan, a total of 64 new surgeries would commence operation in the period 2011-12 to 2015-16 (Note 18).

Surgeries not commencing operation as planned

3.16 Of the 64 planned new surgeries, 11 (17%) had not commenced operation as at 30 October 2016. For four surgeries, the delay in operation was over one year (see Table 9). Upon enquiry, in December 2016 and March 2017, the DH informed Audit that seven of the 11 surgeries did not commence operation as scheduled because the premises were being occupied by other user departments and pending handover to the DH. For the remaining four surgeries, there were unexpected delays in fitting out some surgeries (e.g. due to site constraints and technical problems), and that sufficient Dental Officers could not be recruited to operate the completed surgeries. In this connection, Audit noted that the DH conducted one recruitment exercise in each of the three years between 2014 and 2016, but not all the vacancies of Dental Officers could be filled. The DH also informed Audit in February 2017 that it had strategically redeployed manpower to man the surgeries where service demand was high, and had deferred the opening of certain new surgeries where service demand was low. The DH was also exploring other means to supplement the workforce of Dental Officers (Note 19). According to the DH, it was its plan that the four surgeries would commence operation in March 2017.

Note 18: *As at 31 January 2017, of the 64 planned new surgeries, the estimated project cost (including, for example, expenditure for fitting-out and furniture and equipment) of 43 surgeries totalled \$68 million. DH records did not provide the estimated project cost of the remaining 21 surgeries.*

Note 19: *According to the DH, in addition to civil service recruitment, it was exploring other means such as hiring part-time/full time contract Dental Officers.*

Table 9

**Delay in operation of surgeries
(30 October 2016)**

Year within which operation was planned to commence (Note)	No. of new surgeries		Delay (No. of years)
2012-13	2	} 4 surgeries with delay over 1 year	3 to 4
2014-15	2		1 to 2
2015-16	7		Less than 1
Total	11		

Source: DH records

Note: The DH's plan (see para. 3.15) stated the year of planned commencement of operation, but did not state the exact date of commencement. For audit analysis, the planned commencement date was taken to be the end of the financial year concerned.

3.17 In view of the long waiting time for dental services (see paras. 3.4 to 3.9), there is a need for new surgeries to commence operation in a timely manner. The DH needs to closely monitor the progress of the provision of the new surgeries, and take prompt remedial action where warranted. The DH also needs to continue to explore effective means to meet the manpower requirements for the new surgeries.

Audit recommendations

3.18 Audit has *recommended* that the Director of Health should:

- (a) closely monitor the progress of the provision of new surgeries, and take prompt remedial action where warranted; and

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- (b) continue to explore effective means to meet the manpower requirements for the new surgeries.

Response from the Government

- 3.19 The Director of Health agrees with the audit recommendations.

PART 4: PROVISION OF SPECIFIC DENTAL SERVICES FOR THE PUBLIC

4.1 This PART examines the provision of specific dental services for the public, focusing on:

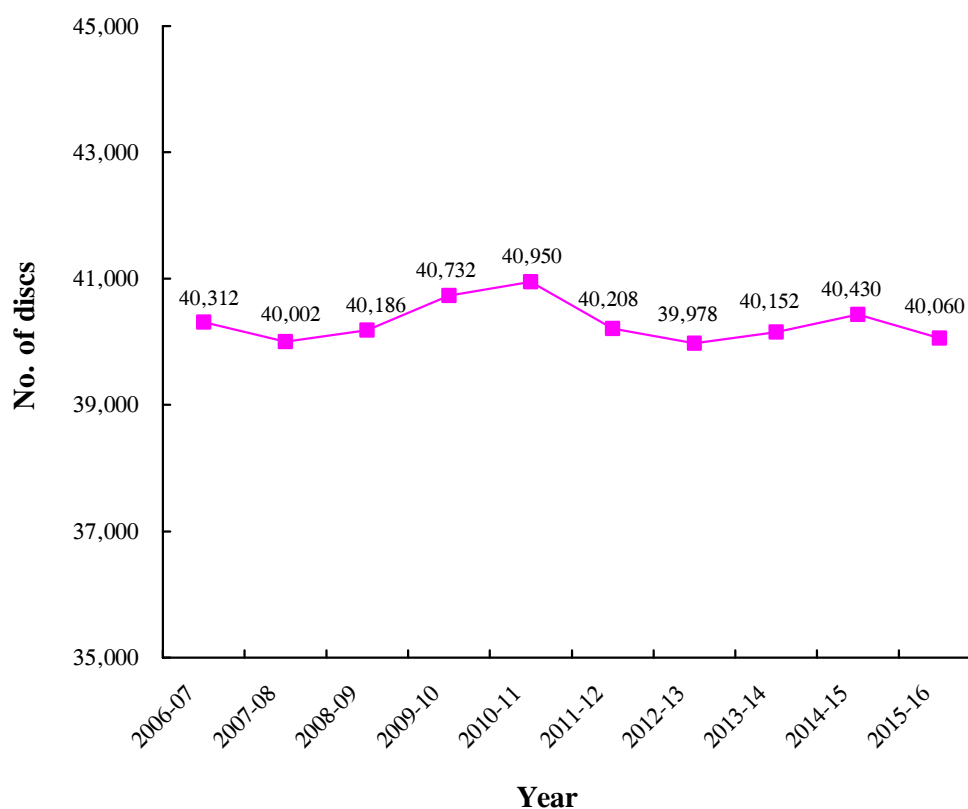
- (a) emergency dental services for the public (paras. 4.2 to 4.7);
- (b) Outreach Dental Care Programme for the Elderly (paras. 4.8 to 4.24);
and
- (c) Elderly Dental Assistance Programme (paras. 4.25 to 4.39).

Emergency dental services for the public

4.2 The Government provides emergency dental services in designated sessions on designated days of the week (hereinafter referred to as General Public Sessions) at 11 government dental clinics (see Appendix D). A quota has been set for each General Public Session (see Appendix H). Patients seeking emergency dental services are treated on a first-come-first-served basis. They are required to obtain a disc from one of these government dental clinics. Disc distribution stops when all discs are given out. In the past ten years from 2006-07 to 2015-16, the General Public Sessions of the 11 government dental clinics had a total quota of about 40,000 discs a year (see Figure 5).

Figure 5

**DH's disc quota for General Public Sessions
(2006-07 to 2015-16)**



Source: Audit analysis of DH records

Utilisation of General Public Sessions to be maximised

4.3 According to a survey conducted by the DH in 2014 concerning the General Public Sessions (Note 20), some 23% of the respondents seeking emergency dental services had the experience of failing to obtain a disc from a government dental clinic and were turned away.

Note 20: *The survey, which covered 1,278 respondents, was the latest one conducted by the DH about the utilisation pattern of the General Public Sessions.*

Provision of specific dental services for the public

4.4 On the other hand, the disc quota was not always fully utilised. For example, in 2015-16, the General Public Sessions had an overall utilisation rate of 86.3%. The unutilised disc quota for the year totalled 5,480 discs, representing 13.7% of the total disc quota of 40,060. Three of the 11 dental clinics had a high percentage (25.2% to 74.7%) of unutilised disc quota (see Table 10).

Table 10

Utilisation of disc quotas for General Public Sessions (2015-16)

Government dental clinic	Disc quota (No. of discs)				
	Total	Utilised		Unutilised	
Tai O Dental Clinic	384	97	25.3%	287	74.7%
Cheung Chau Dental Clinic	384	192	50.0%	192	50.0%
Kennedy Town Community Complex Dental Clinic	7,896	5,905	74.8%	1,991	25.2%
Kowloon City Dental Clinic	6,090	5,177	85.0%	913	15.0%
Tsuen Wan Government Offices Dental Clinic	8,148	7,193	88.3%	955	11.7%
Fanling Health Centre Dental Clinic	2,500	2,218	88.7%	282	11.3%
Mona Fong Dental Clinic	2,142	1,952	91.1%	190	8.9%
Tai Po Wong Siu Ching Dental Clinic	2,142	1,978	92.3%	164	7.7%
Yuen Long Jockey Club Dental Clinic	4,074	3,769	92.5%	305	7.5%
Kwun Tong Dental Clinic	4,200	4,028	95.9%	172	4.1%
Yan Oi Dental Clinic	2,100	2,071	98.6%	29	1.4%
Overall	40,060	34,580	86.3%	5,480	13.7%

Source: Audit analysis of DH records

Provision of specific dental services for the public

4.5 The total unutilised quota of 5,480 discs (see Table 10) was a matter of concern. It was particularly unsatisfactory that the three dental clinics mentioned in paragraph 4.4 accounted for 2,470 (287 + 192 + 1,991) unutilised discs (i.e. 45% of the total 5,480 unutilised quota).

Audit recommendation

4.6 **Audit has recommended that the Director of Health should explore ways to maximise the utilisation of General Public Sessions to better meet the public demand with existing resources.**

Response from the Government

4.7 The Director of Health agrees with the audit recommendation.

Outreach Dental Care Programme for the Elderly

4.8 Since April 2011, the Government has promoted the Outreach Dental Care Programme for the Elderly (Note 21). Under the Programme, NGOs are engaged to provide outreach dental services to eligible service users at residential care homes for the elderly and day care centres for the elderly (see Appendix E). The NGOs conduct the Programme through their outreach dental teams, whose team members are NGO staff including dentists. Services of the Programme include on-site oral health assessment (see Photograph 7) and provision of oral care training (e.g. oral health talks) to caregivers (see Photograph 8). For curative treatments that cannot be performed on-site, the NGOs shall arrange escort service for the elderly persons to receive treatments at the NGOs' dental clinics.

Note 21: *During April 2011 to September 2014, the Government provided outreach dental services to the elderly through the FHB's "Pilot Project on Outreach Primary Dental Care Services for the Elderly in Residential Care Homes and Day Care Centres". In October 2014, the DH's Outreach Dental Care Programme for the Elderly was launched as a regular programme to replace the FHB's pilot project.*

Photographs 7 and 8

**Examples of services provided under
the Outreach Dental Care Programme for the Elderly**

Photograph 7

An on-site oral health assessment



Photograph 8

An oral care training activity



Source: DH records

4.9 For the period October 2014 to September 2017, the DH has engaged 11 NGOs (22 teams in total, each comprising at least a dentist and a dental assistant) each under a three-year Funding and Service Agreement to provide the elderly persons concerned with services covered by the Programme (Note 22). The DH has assigned to each NGO a list of residential care homes/day care centres that the NGO would need to provide outreach dental services during the period. All residential care homes, day care centres and their respective service users may join the Programme on a voluntary basis.

Need to improve service coverage

4.10 A service year for the Outreach Dental Care Programme for the Elderly starts on 1 October and ends on 30 September of the ensuing calendar year. According to the service requirements, for each service year:

Note 22: *The DH conducted an open invitation and received applications from 11 NGOs, all of which were assessed to be suitable for providing the Programme.*

Provision of specific dental services for the public

- (a) an NGO needs to invite all its responsible residential care homes and day care centres to participate in the Programme; and
- (b) each outreach dental team needs to meet the target of providing on-site services to at least 1,000 elderly persons.

4.11 Audit examined the provision of services by the NGOs in the 2015/16 service year and noted that:

- (a) *Some residential care homes/day care centres did not participate in the Programme.* Of the 944 residential care homes/day care centres that had been assigned to the 11 NGOs, 182 (19%) homes/centres did not participate in the Programme in the 2015/16 service year. For three NGOs (NGOs A, B and C), more than 30% of the homes/centres which had been assigned to them did not participate in the Programme in the service year (see Table 11). According to the DH, these residential care homes/day care centres declined to participate in the Programme notwithstanding that the NGOs had introduced the Programme to them;

Table 11

Residential care homes/day care centres not participating in the Outreach Dental Care Programme for the Elderly (2015/16 service year)

NGO	No. of homes/centres		
	Assigned to the NGO	Participated in the Programme	Not participated in the Programme
A	45	20 (44 %)	25 (56 %)
B	40	21 (53 %)	19 (47 %)
C	99	67 (68 %)	32 (32 %)
D	61	47 (77 %)	14 (23 %)
E	64	52 (81 %)	12 (19 %)
F	104	87 (84 %)	17 (16 %)
G	56	47 (84 %)	9 (16 %)
H	354	308 (87 %)	46 (13 %)
I	25	22 (88 %)	3 (12 %)
J	75	71 (95 %)	4 (5 %)
K	21	20 (95 %)	1 (5 %)
Overall	944	762 (81 %)	182 (19 %) (Note)

Source: Audit analysis of DH records

Note: Of the 182 homes/centres, 127 (70%) also did not participate in the Programme in the 2014/15 service year.

Provision of specific dental services for the public

- (b) ***Oral care training not provided.*** The outreach dental teams visited the 762 residential care homes/day care centres which participated in the Programme in the 2015/16 service year. Returns of the NGOs submitted to the DH indicated that, during the visits to 76 (10%) homes/centres, no oral care training was provided. This was mainly because, according to the DH, many homes/centres declined the offer to receive training; and
- (c) ***Target number of elderly persons not served.*** The 22 outreach dental teams served (i.e. providing on-site services — see para. 4.10(b)) a total of 46,337 elderly persons, averaging 2,106 per team, in the 2015/16 service year. For one team, only 868 elderly persons were served, falling short of the required number of 1,000 persons by 132 (13.2%) (Note 23).

4.12 Participation in the Programme is on a voluntary basis (see para. 4.9). Audit considers that the DH needs to look into the reasons why many residential care homes/day care centres declined to receive outreach dental services, and take measures to encourage their participation in the Programme. The DH also needs to ensure that each outreach dental team serves not less than 1,000 elderly persons as required for the effective use of resources.

Many elderly persons did not receive the required treatments

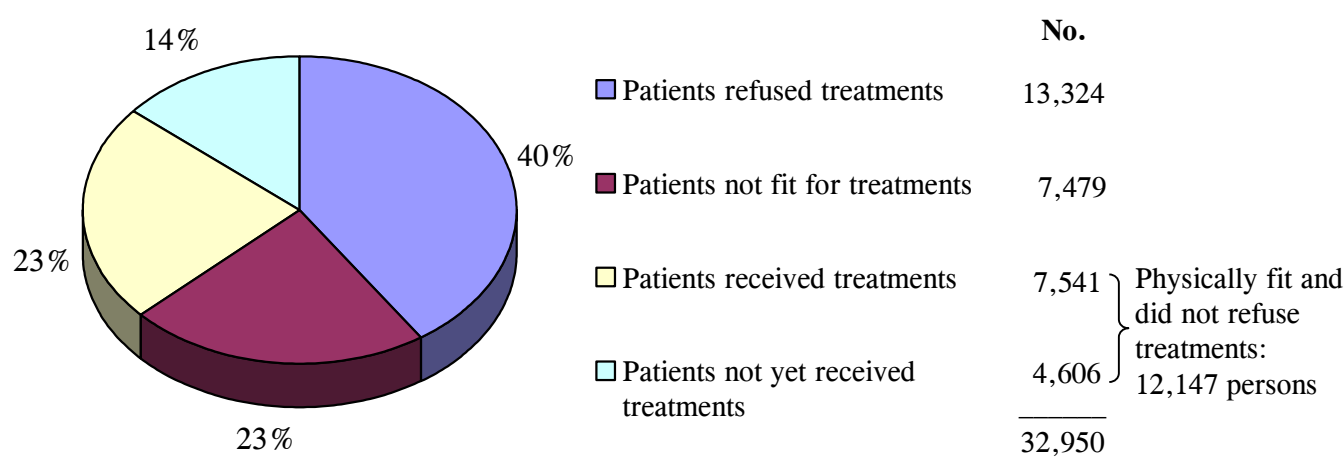
4.13 In the 2015/16 service year, the outreach dental teams served 46,337 elderly persons, and provided on-site oral health assessment to them.

4.14 Through the oral health assessment, the outreach dental teams found that 32,950 elderly persons needed dental treatments. However, many of them refused to receive treatments (13,324 persons) or were not physically fit for treatments (7,479 persons), leaving 12,147 (37%) of the elderly persons who could be provided with dental treatments. As at 31 December 2016, only 7,541 (62%) of the 12,147 elderly persons had received treatments. The remaining 4,606 of the 12,147 elderly persons had not yet received treatments (see Figure 6).

Note 23: *For outreach dental teams of other NGOs, the number of elderly persons served by each team ranged from 1,397 to 2,751.*

Figure 6

**Provision of dental treatments to
32,950 elderly persons who needed dental treatments
(31 December 2016)**



Source: Audit analysis of DH records

4.15 The large number of elderly persons (40%) who refused to accept treatments, notwithstanding that they were physically fit, warrants additional enquiry. Audit also noted that, for the 4,606 patients who were yet to receive treatments, the reasons for not yet providing them with the treatments had not been documented.

4.16 Upon enquiry, the DH informed Audit in February 2017 that:

- (a) of the 4,606 patients mentioned in paragraph 4.15 who had not yet received treatments, treatments had been planned for in 4,372 cases. These cases were at different stages of being followed up such as awaiting patients' consent or patients hospitalised. Real-time updating and documentation for these cases was not feasible. For the remaining 234 cases, records showed that treatments were not planned due to other reasons. The exact reasons for these 234 cases, however, had not been documented; and

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- (b) as already stated in the Oral Health Surveys conducted by the DH in both 2001 and 2011, consideration of dental treatments for frail older people should be balanced between potential harm and benefits. It was an international professional consensus that for treating frail elderly persons, the focus should be on maintaining comfort and functions rather than treating all oral problems.

4.17 Audit considers that there is a need for the DH to ascertain the underlying reasons why many elderly persons who were physically fit had refused to accept treatments under the Programme, and to enhance promotional activities to encourage elderly persons to receive the necessary dental treatments. The DH also needs to closely monitor those cases for which treatments were yet to be provided under the Programme (4,372 cases for the 2015/16 service year — see para. 4.16(a)), so as to ensure that necessary treatments are provided in a timely manner.

Records of dental services not accurately and promptly updated

4.18 For monitoring purposes, the DH has requested the NGOs to adopt the Dental Clinic Management System (DCMS). The DCMS serves as a platform for NGO dentists to plan and record dental services for individual elderly persons (e.g. for recording the results of oral health assessment conducted, dental treatments planned, and dental treatments actually provided). The DH can view the data input by the participating NGOs and generate service statistics reports through another designated system called DCMS-Outreach Reporting Management Service (DCMS-ORMS).

4.19 From time to time, NGOs submitted claims to the DH for reimbursement of dental treatments. Audit selected 40 claims totalling \$367,690 submitted in the 2014/15 and 2015/16 service years, and checked against the service statistics reports generated by the DCMS-ORMS. Audit found discrepancies in 10 (25%) cases involving claims of \$89,680. Details are as follows:

- (a) in 9 cases, the dates of treatment recorded in the DCMS did not match with the information in the claim forms; and
- (b) in 1 case, the DCMS indicated that the treatment had been “planned” only, but it did not indicate that the treatment had been performed.

4.20 Upon enquiry, the DH informed Audit in February 2017 that it had verified with the NGOs concerned. The discrepancies in the 10 cases were mainly due to input errors committed by NGO staff (Note 24). Audit considers that records in the DCMS are prime records of dental services rendered by the NGOs. It is important that the records are accurately and promptly updated by the NGOs for the DH's monitoring purposes.

4.21 As at the time of audit in November 2016, Audit also noted that it was not the DH's practice to verify NGOs' claims for payments against records in the DCMS-ORMS. The DH paid NGOs according to their claims and verified their claims later on a sample basis through on-site examinations (see para. 4.22).

Follow-up actions on on-site examinations took considerable time

4.22 After making payments to NGOs, the DH conducts on-site oral examinations of elderly persons to verify NGOs' claims for payments. The examinations are conducted on a sample basis. Audit noted that, for one NGO, follow-up actions on on-site examinations were still in progress after considerable time had elapsed (see Case 1).

Note 24: *According to the DH, for each of the nine cases mentioned in paragraph 4.19(a), the date of entering data into the DCMS had been wrongly recorded as "date of treatment" by NGO staff, which therefore did not match the treatment date in the claim forms. For the case mentioned in paragraph 4.19(b), the NGO did not update the DCMS to indicate that the treatment had been subsequently performed.*

Provision of specific dental services for the public

Case 1

Follow-up actions on on-site examinations

1. In the 2014/15 and 2015/16 service years, an NGO provided dental treatments (e.g. fillings for teeth) to elderly persons under the Outreach Dental Care Programme for the Elderly. The DH made payments (averaging \$2,507 per case) to the NGO basing on its claims for payments.

2. In November 2015, the DH selected eight claims from the NGO for verification. The DH conducted on-site oral examinations of the elderly persons concerned, and found that the services claimed to have been provided to two elderly persons could not be verified:

Elderly person	Service claimed	Amount claimed (\$)	The DH's finding	Response of the NGO
1	Filling for 1 tooth	350	No filling was found in the tooth concerned	The NGO explained that the services had been planned (and hence payment claimed) but subsequently other treatments were provided instead as the oral health condition of the elderly persons had changed.
2	Fillings for 6 teeth	2,100	All the teeth concerned were missing	

3. The NGO acknowledged that its staff had made a mistake in submitting claims for the originally prescribed treatments, without realising that the treatments actually provided was different due to changes of oral condition of the elderly persons concerned. The DH accepted that changes of oral condition among frail older people were common, and that the discrepancies were caused by manual errors without any fraudulent intentions.

4. In December 2015, as a follow-up action to ascertain whether there were other cases of similar errors, the DH requested the NGO to review all its claims and report the review results by January 2016. In March 2016, upon the DH's request, the NGO met with the DH to follow up the matters. In June 2016, the NGO informed the DH that an independent auditor had been engaged to review the claims.

5. In January 2017, the DH received the review results from the NGO. In February 2017, the DH was verifying the results.

Case 1 (Cont'd)

Audit comments

6. While the DH was verifying the review results from the NGO, it was not entirely satisfactory that follow-up actions were not completed over one year after the claims were selected for verification in November 2015. The DH needs to take prompt action to recover any payments for services that have not been provided (e.g. due to changes of oral condition and treatment plans of the elderly persons concerned).

Source: Audit analysis of DH records

Audit recommendations

4.23 **Audit has recommended that the Director of Health should:**

- (a) **look into the reasons why many residential care homes/day care centres had declined the outreach dental services, and take measures to encourage their participation in the Outreach Dental Care Programme for the Elderly;**
- (b) **ensure that each outreach dental team serves not less than 1,000 elderly persons as required by the Funding and Service Agreement;**
- (c) **ascertain the underlying reasons why elderly persons who were physically fit had refused treatments under the Outreach Dental Care Programme for the Elderly;**
- (d) **take measures (e.g. enhancing promotional activities) to encourage elderly persons to receive necessary dental treatments;**
- (e) **closely monitor those cases for which treatments were yet to be provided under the Outreach Dental Care Programme for the Elderly, so as to ensure that necessary treatments are provided in a timely manner;**

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- (f) **remind NGOs of the need to accurately and promptly update records of dental services in the DCMS;**
- (g) **consider making use of the DCMS-ORMS to substantiate NGOs' claims before making payments to them; and**
- (h) **follow up closely the results of the claims review being carried out by the NGO concerned (see Case 1 in para. 4.22), and take prompt action to recover any payments for services that have not been provided.**

Response from the Government

4.24 The Director of Health agrees with the audit recommendations. She has said that:

- (a) the DH will study the reasons for non-participation of residential care homes/day care centres in the Outreach Dental Care Programme for the Elderly and continue to promote their participation;
- (b) the DH will encourage the NGOs concerned to provide comprehensive professional advice on the pros and cons of dental treatments to their service users, while respecting the international professional consensus in treating frail elderly persons which is to provide patient-centred dental services, and the informed decision of the patients to refuse treatment after comprehensive explanations; and
- (c) the DH had commenced the verification of the NGOs' claims against records in the DCMS-ORMS since December 2016.

Elderly Dental Assistance Programme

4.25 In September 2012, the Elderly Dental Assistance Programme was launched under the CCF. The Programme provides free removable dentures and related dental services (including oral examinations, scaling and polishing, fillings, tooth extractions and X-ray examinations) to low-income eligible elderly persons. On behalf of the former Steering Committee on Community Care Fund (Note 25), the Government appointed Organisation A as the implementing agent of the Programme. Through organising seminars and exhibitions and sending invitation letters, Organisation A invited registered dentists in Hong Kong to join the Programme.

4.26 As at 30 September 2016, 415 private dentists and 98 dentists from dental clinics operated by NGOs participated in the Programme as service providers (i.e. providing dentures and other related dental services). Through Organisation A, the CCF reimburses participating dentists and NGOs for the services provided. Administratively, the FHB helps the CCF oversee the Programme implementation.

Need to encourage participation

4.27 When the Elderly Dental Assistance Programme was launched in September 2012, only recipients of Home Based Services (see Note 2 to Appendix E) were covered. Over the years, coverage of the Programme has been expanded:

Note 25: *In 2013, the CCF was integrated into the work of the Commission on Poverty which replaced the role of the former Steering Committee on Community Care Fund. The CCF Task Force, set up under the Commission on Poverty as chaired by the Chief Secretary for Administration, is responsible for advising the Commission on Poverty on the CCF's various arrangements (including investment, finance and administrative operations), as well as the formulation of assistance programmes, the coordination and overseeing of the implementation of assistance programmes and the evaluation of their effectiveness. Currently, the CCF Task Force comprises 7 members (including the Chairperson) of the Commission on Poverty, 1 vice-chairperson, 14 co-opted members and 6 ex-officio members. The ex-officio members are representatives from the Education Bureau, the FHB, the Home Affairs Bureau, the Home Affairs Department, the Labour and Welfare Bureau and the Social Welfare Department.*

Provision of specific dental services for the public

- (a) **May 2013.** In September 2012, the eligibility criterion was that the elderly persons were using the Home Based Services as at 31 December 2011 (the cut-off date). The cut-off date was extended to 31 December 2012 in May 2013;
- (b) **June 2014.** The cut-off date was further extended to 31 December 2013;
- (c) **December 2014.** The cut-off date was removed;
- (d) **September 2015.** The Programme was expanded to include recipients of Old Age Living Allowance aged 80 or above; and
- (e) **October 2016.** The age criterion for recipients of Old Age Living Allowance was relaxed from “80 or above” to “75 or above”.

4.28 As at 30 September 2016, given the expanded coverage of the Programme, it was estimated that 134,000 elderly persons would be eligible for the Programme (Note 26). However, Audit noted that only 10,733 elderly persons had participated in the Programme, with an overall participation rate of 8% (see Table 12).

Note 26: *Persons eligible for the Programme are those aged 60 or above, being users of the Home Based Services (see Note 2 to Appendix E) who are not receiving assistance under the Comprehensive Social Security Assistance Scheme, or those aged 80 or above (with age criterion relaxed to 75 or above in October 2016) who are receiving Old Age Living Allowance.*

Table 12

**Participants of the Elderly Dental Assistance Programme
(30 September 2016)**

Target participant	Estimated no. of eligible elderly persons (a)	No. of elderly persons who had participated (b)	Participation rate (c) = (b)/(a) × 100%
Users of Home Based Services	14,000	1,743	12.5%
Recipients of Old Age Living Allowance	120,000	8,990	7.5%
Overall	134,000	10,733	8.0%

Source: Audit analysis of FHB records

4.29 Upon enquiry, the FHB informed Audit in February and March 2017 that:

- (a) a number of factors had affected the participation of the Programme. According to the DH's Oral Health Survey conducted in 2011 (see para. 1.15), while about 25% of the elderly persons living in the community (i.e. non-institutionalised elderly persons) had the need to replace missing teeth, only 7% of them perceived the need. This tallied with the actual participation rate of the Programme, and might indicate that the participation rate of elderly persons depended much on their response and willingness to receiving denture services. Furthermore, the participation rate was also subject to other factors such as the service capacity of participating dentists and the matching of elderly persons requiring dental services with participating dentists;
- (b) participation of elderly persons in the Programme was on a voluntary basis. The FHB had engaged around 180 district elderly centres/community centres/NGO dental clinics throughout the territory to publicise the Programme to eligible elderly persons on a targeted basis,

Provision of specific dental services for the public

and to process applications from elderly persons who were interested in the Programme. Whether or not these elderly persons would eventually choose to participate in the Programme was entirely a personal choice; and

- (c) similarly, participation of dentists in the Programme was also on a voluntary basis. Even for those who were willing to participate in the Programme to provide denture services, the caseload they were willing to take up was of their own accord.

4.30 To benefit more elderly persons, Audit considers that there is a need for the FHB to take measures to encourage participation of elderly persons in the Programme.

Need to improve documentation

4.31 Participating dentists and NGO dental clinics submit claims to the CCF for payments on dental services from time to time. Through Organisation A, the CCF pays the participating dentists and NGO dental clinics the dental fees on a reimbursement basis. Currently, the maximum subsidy is \$14,390 per patient, which will be adjusted in accordance with the dental grant under the Comprehensive Social Security Assistance Scheme (see Note 7(a) to para. 1.11).

4.32 In September 2015, the Programme coverage was expanded to include recipients of Old Age Living Allowance (see para. 4.27(d)). The pool of beneficiary cases involved were relatively large. Organisation A, in consultation with the FHB, took the initiative to introduce new measures to enhance the verification of claims for payments. Audit noted that the following key measures had been implemented since March 2016:

- (a) ***Surveys of elderly persons who had received services.*** A sample of patients (i.e. elderly persons) were surveyed by telephone to ascertain the dental services they had received; and
- (b) ***Follow-up action.*** Survey results were compared with the dentists' claims to identify any discrepancies. If irregularities were detected, follow-up

action would be taken (e.g. prima facie cases with fraudulent claims would be referred to the relevant law enforcement authorities).

4.33 In the period March to September 2016, Organisation A conducted surveys in 155 cases. Of the 155 cases, potential discrepancies were identified in 45 cases (29%). Audit noted that of these 45 cases:

- (a) for six cases, follow-up action had been taken; and
- (b) for the other 39 cases, follow-up action had been considered not necessary. In four of these 39 cases, the justifications for not taking further action could be better documented.

Upon Audit's enquiry, in January and February 2017, Organisation A provided Audit with the justifications for not taking further action on the four cases. Audit considers that, to enhance public accountability, there is a need to improve the documentation of justifications for not taking further action on cases with discrepancies identified in telephone surveys of elderly persons.

High administration cost

4.34 As the implementing agent of the Elderly Dental Assistance Programme, Organisation A received reimbursements from the CCF for administration cost incurred for the Programme. The administration cost is for covering various expenditures, namely:

- (a) disbursement of handling fees of \$50 per case for processing applications by NGOs;
- (b) staff costs incurred in implementing the Programme, such as verifying and arranging payments to participating dentists, handling complaints and enquiries, and conducting random check on claims (as at 30 November 2016, Organisation A employed 18 staff); and
- (c) office expenses, such as maintenance of a dental appointment system and related computer services.

Provision of specific dental services for the public

4.35 As a general rule, the administration cost of a programme of the CCF is capped within 5% of the estimated total disbursement of the programme. The target is to limit the average administrative cost to less than 5% of the total disbursement on a long-term basis. In this regard, the Commission on Poverty had approved a budget for the Programme whereby the administration cost to be incurred by Organisation A was limited to 5% of the estimated total disbursement of the Programme.

4.36 Audit noted that in the period 2012-13 to 2015-16, the total administration cost spent by Organisation A amounted to \$10,700,000, which was equivalent to 18.8% of the Programme's total disbursement of \$56,916,000 for the period. Upon enquiry, the FHB informed Audit in February 2017 that:

- (a) the administration cost spent by Organisation A as a percentage of disbursement exceeded 5% in the first few years because it included set-up costs (e.g. design and printing of publicity materials, procurement of office equipment, and staffing support for the planning and implementation). With the increase of the number of participants following expansion of the Programme, the share of the administration cost was substantially reduced; and
- (b) the unique role played by Organisation A could not be replaced by other agents. As set out in the paper of the former Steering Committee on Community Care Fund, Organisation A, being a non-profit making professional organisation with a vast majority of locally registered dentists as members, was invited to serve as the implementing agent of the Programme. Organisation A was entrusted with the responsibility to co-ordinate with private dentists and NGO dental clinics for active participation in the Programme.

4.37 Nevertheless, given that the total administration cost for the Programme from 2012-13 to 2015-16 was equivalent to 18.8% of the total disbursement, Audit considers that there is a need to further reduce the administration cost with a view to meeting the requirement set by the CCF and improving the economy of scale.

Audit recommendations

4.38 Audit has *recommended* that the Secretary for Food and Health should:

- (a) take measures to encourage participation of elderly persons in the Elderly Dental Assistance Programme;
- (b) improve the documentation of the justifications for not taking further action on cases with discrepancies identified in telephone surveys of elderly persons; and
- (c) work with Organisation A to further reduce the administration cost with a view to meeting the requirement set by the CCF.

Response from the Government

4.39 The Secretary for Food and Health generally agrees with the audit recommendations.

PART 5: ATTAINMENT OF ORAL HEALTH

5.1 This PART examines the attainment of oral health in the community.

Oral health goals of the Government

5.2 In March 1989, the Dental Sub-Committee of the Medical Development Advisory Committee was established (Note 27). The Dental Sub-Committee monitored and reviewed factors affecting the provision of oral health services in Hong Kong. In March 1991, the Dental Sub-Committee completed a review on oral health. Recommendations of the review included the setting of a range of oral health goals for different age groups of the community, namely, people who are 5-year-old, 12-year-old, 18-year-old and 35 to 44-year-old. Table 13 shows examples of the oral health goals recommended to be accomplished by 2010 and 2025.

Note 27: *The Medical Development Advisory Committee was appointed by the then Governor of Hong Kong to advise the Government on medical and health services. Members of its Dental Sub-Committee included academics, dentists and government representatives (e.g. officials of the DH).*

Table 13

Examples of oral health goals to be accomplished by 2010 and 2025

Age group	Goal for 2010	Goal for 2025
5-year-old	70% people are caries-free (i.e. the teeth show no evidence of decay) - A maximum of 10% people having more than 3 decayed, extracted, filled teeth	90% people are caries-free - A maximum of 10% people having more than 3 decayed, extracted, filled teeth
12-year-old	70% people are caries-free in their permanent dentition - Decayed, missing and filled teeth (DMF) index (Note) is 1 or less	85% people are caries-free in their permanent dentition - DMF index is less than 1
18-year-old	60% people are caries-free - DMF index is 2 or less	85% people are caries-free - DMF index is less than 1
35 to 44-year-old	20% people are caries-free - DMF index is less than 6	30% people are caries-free - DMF index is less than 5
Elderly persons (over 65-year-old)	No goals set	No goals set

Source: DH records

Note: The DMF index measures the prevalence of dental caries in an individual. The index is the sum of the number of decayed/missing/filled teeth. In general, the lower the index, the better the oral condition.

5.3 According to a Medical Development Advisory Committee paper issued in 1991 by the then Health and Welfare Branch of the Government Secretariat, the Government had agreed with the recommendations of the Dental Sub-Committee and had the implementation planned.

Oral health goals not totally attained

5.4 Government dental services are mainly provided through the DH (see para. 1.6). The DH leads and supports oral health education as well as oral health promotion in the territory (see para. 2.2). The DH last conducted an Oral Health

Attainment of oral health

Survey in 2011. Audit noted that the survey results indicated that some oral health goals for 2010 had not been attained:

- (a) **5-year-old people.** Of the 5-year-old people surveyed:
 - (i) 49.3% were caries-free, thereby not attaining the goal of “70% people are caries-free”; and
 - (ii) 26.2% had 4 or more “decayed, missing, filled teeth”, thereby not attaining the goal of “a maximum of 10% people having more than 3 decayed, extracted, filled teeth”; and
- (b) **35 to 44-year-old people.** Of the 35 to 44-year-old people surveyed:
 - (i) 3.9% were caries-free, thereby not attaining the goal of “20% people are caries-free”; and
 - (ii) the DMF index was 6.9 on the whole, thereby not attaining the goal of “DMF index is less than 6”.

5.5 Upon enquiry, the DH informed Audit in February and March 2017 that:

- (a) while the DH was aware of the recommendations regarding operational oral health goals proposed by the Dental Sub-Committee of the Medical Development Advisory Committee, the DH internally assessed in 1990 that among all recommendations, some would have direct resources implication which had to be costed. The DH recognised the fact that implementation of some of these proposals may contribute to some improvement in or achievement of the operational oral health goals, although the DH did not actively measure the effectiveness of programmes against the proposed oral health goals;
- (b) the DH had focused only on comparing the results of the 2011 Oral Health Survey with those of the previous survey conducted in 2001. Given the change in social factors, it might not be meaningful to draw reference from the oral health goals set 20 years ago. The DH hence did not publish the level of attainment with reference to the oral health goals;

- (c) a goal was only the direction whereas assessment of achievement could not rely on goals only because it involved provision of different services; and
- (d) survey findings revealed that the oral health condition in Hong Kong was comparable to other developed countries.

Nevertheless, Audit noted that the existing oral health goals had yet to be reviewed and better set (see para. 5.6(a) and (b)).

Room for improving goal setting and evaluation

5.6 The 2010 and 2025 oral health goals were set in March 1991. Audit noted room for improving the setting and evaluation of oral health goals:

- (a) ***Oral health goals not reviewed.*** In May 2001 and January 2003, the Legislative Council Panel on Health Services was informed that the Government would review and formulate long-term oral health strategies and goals for the community. As at 31 December 2016, 13 years had elapsed since January 2003, the oral health goals had still not been reviewed. In fact, these goals which were set some 26 years ago in 1991, were likely outdated;
- (b) ***Oral health goals not set for elderly persons.*** While elderly persons are a key target group of dental programmes (see paras. 4.8 to 4.39), no oral health goals had been set for them (see Table 13 of para. 5.2). According to the DH, this could possibly be due to the difficulty in setting realistic goals for them (e.g. difficulty in collecting sufficient data from elderly persons might be anticipated at that time), and that there were so many factors which could not be controlled; and
- (c) ***Long interval between surveys.*** The DH conducted the first oral health survey in 2001 and the second one in 2011 after an interval of 10 years. Subsequent to these surveys, new international guidelines were published in 2013, suggesting that surveys should be conducted every

five to six years (Note 28). According to the DH, the new international guidelines were only a suggestion and the frequency of surveys should vary depending on individual situations of different countries and territories. Nevertheless, in March 2017, the DH informed Audit that it was about to prepare and conduct the 2021 survey at the 10 years' interval as planned.

Audit recommendations

5.7 Audit has *recommended* that the Director of Health should:

- (a) **conduct a review of the oral health goals;**
- (b) **review the conduct of oral health surveys in the future, taking into account the international good practices, the need to provide adequate coverage as well as other factors (e.g. availability of resources) relevant to the situation of Hong Kong; and**
- (c) **to enhance public accountability and transparency, after reviewing the oral health goals, consider publishing the level of attainment against the goals.**

Response from the Government

5.8 The Director of Health generally agrees with the audit recommendations. She has said that the DH will consider publishing the level of attainment against goals in future.

Note 28: *According to the “Oral Health Surveys — Basic Methods” issued by the World Health Organization in 2013, oral health surveys should be conducted regularly every five to six years in the same community or setting.*

Appendix A
(paras. 1.7(a) and
2.2 refer)

**Educational and publicity programmes of
Department of Health's Oral Health Education Unit
(Key programmes in 2015-16)**

Target group	Programme	Detail
Pre-primary school students	Brighter Smiles for the New Generation	The programme helped children establish good tooth-brushing and smart diet habits for the prevention of dental disease. A wide range of education materials was developed and distributed to kindergartens and nurseries, including a cartoon DVD and picture books.
	Brighter Smiles Playland	The programme was specially designed for 4-year-old children (studying at Kindergarten 2/Nursery 3) to help them learn good oral care habits through interactive games and activities in the Playland.
Primary school students	Bright Smiles Mobile Classroom	A roving oral health education bus visited different primary schools. It served as an extra-curricular supplementary classroom to enrich the oral health knowledge of primary school students. It also helped enhance their ability to master oral care skills.
	Bright Smiles Campus Programme	This was a school-based oral health promotion programme for primary school students. Senior grade students (studying at Primary 4 to 6) were trained as "bright smiles ambassadors" to show the importance of clean teeth.
Secondary school students	Teens Teeth Programme	This was a school-based oral health promotion programme for secondary school students. A peer-led approach was adopted in promoting oral health to students of Secondary 1, with a view to reducing gum bleeding and nurturing flossing habits.
Special school students	Dandelion Oral Care Action	The programme promoted systematic tooth-brushing and flossing techniques. It was developed in collaboration with a special school for moderate intellectual disabled children.
All (including adults and the elderly)	Love Teeth Campaign	The Campaign, with a specific theme each year, promoted oral health to the public via mass media (e.g. television, radio and newspapers) and advertisement at MTR stations.

Source: DH records

School dental clinics

Clinic	Serving district	Name
1	Hong Kong and Islands	Tang Shiu Kin School Dental Clinic • 1/F, MacLehose Dental Centre • 5/F, MacLehose Dental Centre
2	Kowloon	1/F, Argyle Street Jockey Club School Dental Clinic
3	Kowloon	3/F, Argyle Street Jockey Club School Dental Clinic
4	Kowloon	Lam Tin School Dental Clinic
5	New Territories East	Fanling School Dental Clinic
6	New Territories East	Pamela Youde School Dental Clinic
7	New Territories West and Islands	Ha Kwai Chung School Dental Clinic
8	New Territories West	Tuen Mun School Dental Clinic

Source: DH records

**Charges for dentures and dental appliances
payable by civil service eligible persons and the public
(2016)**

Payable by CSEPs

Partial/full dentures/dental appliances

Monthly salary (of Master Pay Scale)	New denture/ appliance (Each tooth)	Modification of existing denture/ appliance (Remodel, reline, repair, or each additional tooth)	Obturator	Maximum charge for restorations in both jaws	Maximum charge for restorations in one jaw	Bridge per retainer/ pontic (for Maryland bridgework charges are halved)
	(\$)	(\$)	(\$)	(\$)	(\$)	(\$)
Point 6 and below or equivalent	8	8	15	181	92	64
Points 7 to 21 or equivalent	37	17	92	273	138	102
Points 22 to 33 or equivalent	74	37	181	549	273	201
Points 34 or equivalent and over	147	74	365	1,097	549	412

Source: Civil Service Regulations

Appendix C
(Cont'd)
(paras. 1.8 and 1.10 refer)

Payable by the public

		(\$)
Eligible persons (see also Note 6 to para. 1.9)		
1	Acrylic denture, per tooth (Note)	43
	Maximum for one jaw denture of more than 5 teeth	375
	Minimum for one jaw denture of one to five teeth	190
2	Remodelling of denture	80
3	Repair/relining of denture	73
4	Addition of teeth, per tooth	43
	Maximum for one jaw denture	80
5	Obturator (Note)	43 per tooth plus 125
6	Maxillofacial prostheses	280 - 545
7	Other maxillofacial prostheses (Splints, applicators for radiotherapy, occlusion appliances, etc.)	No charge
Non-eligible persons		
1	Fixed appliance	
	Gold (Crown/Inlay/Onlay/Bridge) per unit	1,430
	Porcelain (Crown/Bridge) per unit	1,840
	Maryland Bridge	
	— Per porcelain unit	1,840
	— Per metal unit	520
2	Removable appliances	
	Chrome-Cobalt Denture - Metal Frame	2,420 plus 50 per tooth
	Acrylic Denture-Base	1,060 plus 50 per tooth
	Obtulators - Base	1,260 plus 50 per tooth
	Repair/Reline/Addition	255 plus 50 per tooth
3	Implantology	
	Infrastructure – per implant	2,100
	Suprastructure	
	— Per crown unit	2,540
	— Per denture	4,180
4	Maxillofacial prostheses and other maxillofacial appliances	At cost as determined by the Dental Officer attending the patient

Source: DH records

Note: For chrome-cobalt appliances, the charges are doubled.

Appendix D
(paras. 1.8 to 1.10 and
4.2 refer)

**Government dental clinics, orthodontic clinics and
Oral Maxillofacial Surgery and Dental Units**

Clinic	District	Name	Dental services provided for			
			CSEPs		Public	
			General	Specialised (Note)	Emergency	Specialised (Note)
Government dental clinics						
1	Central and Western	Harbour Building Dental Clinic	✓			
2	Central and Western	Kennedy Town Community Complex Dental Clinic	✓		✓	
3	Central and Western	Queensway Government Offices Dental Clinic	✓			
4	Central and Western	Sai Ying Pun Dental Clinic 3/F	✓			
5	Central and Western	Sai Ying Pun Dental Clinic 8/F	✓	✓		
6	Central and Western	Victoria Road Dental Clinic	✓			
7	Central and Western	Western Dental Clinic	✓	✓		
8	Eastern	Chai Wan Government Dental Clinic	✓			
9	Eastern	Tang Shiu Kin Dental Clinic	✓			
10	Islands	Cheung Chau Dental Clinic	✓		✓	
11	Islands	Tai O Dental Clinic	✓		✓	
12	Islands	Tung Chung Dental Clinic	✓			
13	Kowloon City	Kowloon City Dental Clinic	✓		✓	
14	Kwai Tsing	Ha Kwai Chung Government Dental Clinic	✓			
15	Kwai Tsing	Kwai Chung Hospital Dental Clinic	✓			

Appendix D
(Cont'd)
(paras. 1.8 to 1.10 and
4.2 refer)

Clinic	District	Name	Dental services provided for			
			CSEPs		Public	
			General	Specialised (Note)	Emergency	Specialised (Note)
16	Kwai Tsing	Sheung Kwai Chung Government Dental Clinic	✓			
17	Kwun Tong	Kwun Tong Dental Clinic	✓		✓	
18	Kwun Tong	Kwun Tong Yung Fung Shee Dental Clinic	✓			
19	North	Fanling Health Centre Dental Clinic	✓		✓	
20	Sai Kung	Mona Fong Dental Clinic	✓		✓	
21	Sai Kung	Tseung Kwan O Dental Clinic	✓			
22	Sha Tin	Ma On Shan Dental Clinic	✓			
23	Sha Tin	Pamela Youde Government Dental Clinic	✓			
24	Sham Shui Po	Cheung Sha Wan Government Offices Dental Clinic	✓	✓		
25	Southern	Aberdeen Jockey Club Dental Clinic	✓			
26	Southern	Hong Kong Police College Dental Clinic	✓			
27	Tai Po	Tai Po Wong Siu Ching Dental Clinic	✓		✓	
28	Tsuen Wan	Tsuen Wan Dental Clinic	✓			
29	Tsuen Wan	Tsuen Wan Government Offices Dental Clinic	✓		✓	
30	Tuen Mun	Castle Peak Hospital Dental Clinic	✓			
31	Tuen Mun	Yan Oi Dental Clinic	✓		✓	
32	Wan Chai	MacLehose Dental Clinic 2/F	✓	✓		
33	Wan Chai	MacLehose Dental Clinic 6/F	✓			

Appendix D
(Cont'd)
(paras. 1.8 to 1.10 and
4.2 refer)

Clinic	District	Name	Dental services provided for			
			CSEPs		Public	
			General	Specialised (Note)	Emergency	Specialised (Note)
34	Wan Chai	Wan Chai Dental Clinic	✓			
35	Yau Tsim Mong	Li Po Chun Dental Clinic	✓			
36	Yau Tsim Mong	Yau Ma Tei Dental Clinic	✓			
37	Yuen Long	Yuen Long Jockey Club Dental Clinic	✓		✓	
38	Yuen Long	Yuen Long Madam Yung Fung Shee Dental Clinic	✓			
Orthodontic clinics						
1	Central and Western	Harbour Building Orthodontic Clinic		✓		
2	Yau Tsim Mong	Yau Ma Tei Orthodontic Clinic		✓		
OMSDUs						
1	Eastern	Pamela Youde Nethersole Eastern Hospital OMSDU		✓		✓
2	Kwai Tsing	Princess Margaret Hospital OMSDU		✓		✓
3	North	North District Hospital OMSDU		✓		✓
4	Sha Tin	Prince of Wales Hospital OMSDU		✓		✓
5	Southern	Queen Mary Hospital OMSDU		✓		✓
6	Tuen Mun	Tuen Mun Hospital OMSDU		✓		✓
7	Yau Tsim Mong	Queen Elizabeth Hospital OMSDU		✓		✓

Source: DH records

Note: Specialised dental services include Endodontics, Oral & Maxillofacial Surgery, Orthodontics, Paediatric, Periodontology, Prosthodontics and Restorative Dentistry.

**Dental services for people with special needs
(30 September 2016)**

Eligibility	Services provided	Payment to participating organisation
<i>DH: Outreach Dental Care Programme for the Elderly</i>		
Elderly persons aged 60 or above holding a Hong Kong identity card who are residing in Residential Care Homes or using services in day care centres (Note 1)	• On-site primary dental care services • Further curative treatments carried out on-site or at dental clinics operated by NGOs • On-site training for caregivers, the elderly and their families on oral care	• Annual grant of \$550 per elderly person served • Reimbursement of curative treatments cost based on dental grant under Comprehensive Social Security Assistance Scheme • Escort subsidy of \$200 per session of actual service • Transport subsidy of \$300 per session of actual service • Dental equipment and facilities grant capped at 50% of the costs and not more than \$180,000 per outreach dental team
<i>CCF: Elderly Dental Assistance Programme</i>		
• Elderly persons aged 60 or above, being users of the Home Based Services (Note 2) who are not receiving Comprehensive Social Security Assistance • Elderly persons aged 80 or above who are receiving Old Age Living Allowance	• Removable dentures and other related necessary dental services (scaling and polishing, fillings, tooth extractions and X-ray examination)	• Actual administration costs of the Programme paid to Organisation A • A maximum subsidy of \$14,390 for each beneficiary reimbursed to the participating dentists and NGO dental clinics

Appendix E
(Cont'd)
(paras. 1.11, 4.8,
4.27 and 4.28 refer)

Eligibility	Services provided	Payment to participating organisation
<i>FHB: Pilot project on dental service for patients with intellectual disability</i>		
Persons with intellectual disabilities aged 18 or above, who are also receiving Comprehensive Social Security Assistance, Disability Allowance or Waiver for medical fees issued by the Hospital Authority	Dental services supplemented with special support measures	• Actual administration costs of the project paid to Organisation A • A maximum subsidy of \$19,000 for each beneficiary reimbursed to the participating organisations

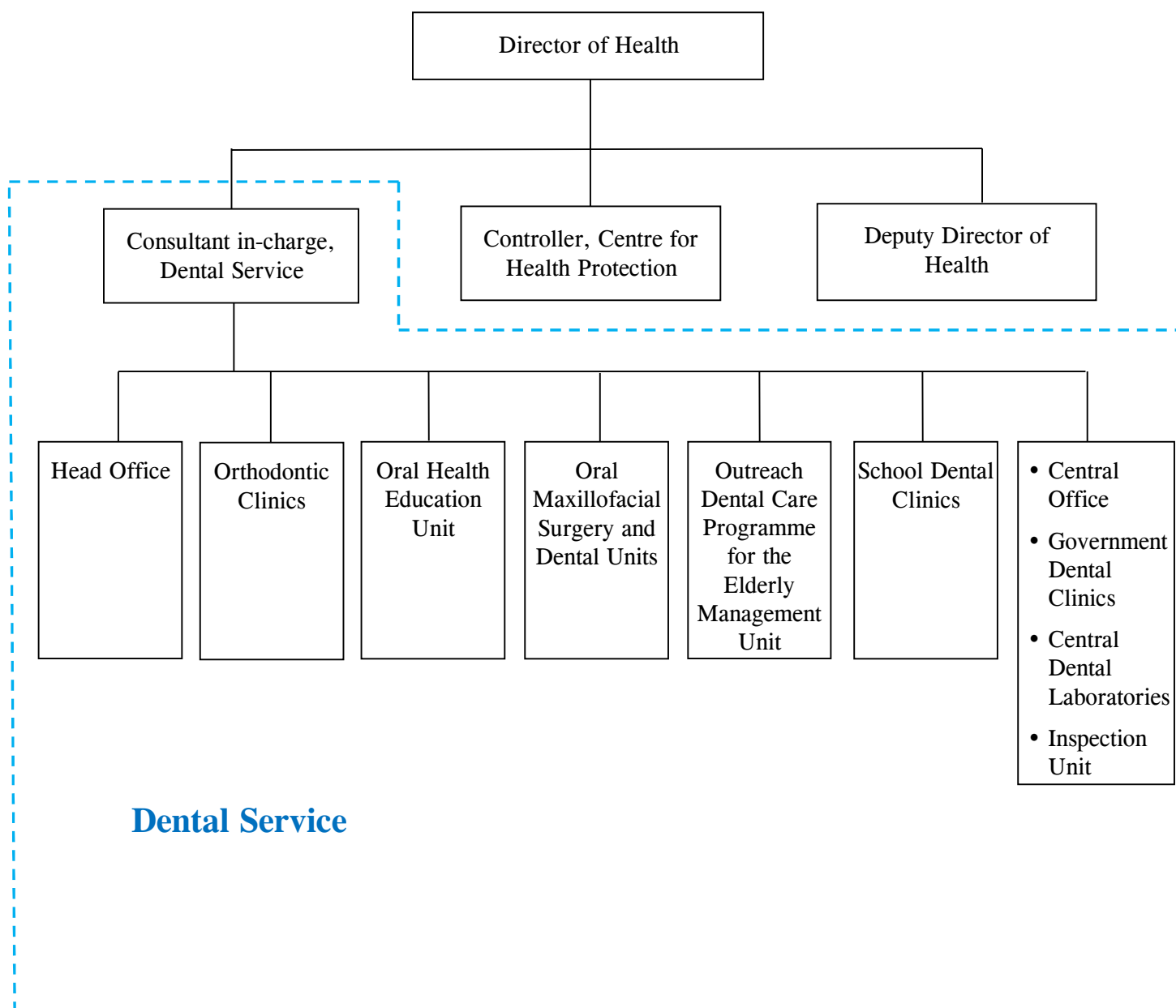
Source: DH and FHB records

Note 1: Day care centres are run by NGOs, including those with subventions of the Social Welfare Department. The centres provide care and support services during daytime to frail and demented elderly persons. The centres also provide various kinds of support and assistance to carers of the elderly persons.

Note 2: Home Based Services include:

- (a) enhanced home and community care services which provide integrated services to enable frail elderly persons aged 60 or above to receive nursing and care services in their familiar home and community environment and to maintain their maximum level of functioning;*
- (b) integrated home care services which provide enhanced support, care and rehabilitation services to enable elderly persons aged 60 or above, people with disabilities, and individuals with social needs to continue living in the community; and*
- (c) home help service which provides general personal care service, escort service and household cleaning services to elderly persons aged 60 or above, people with disabilities, and individuals living in Tung Chung areas who are incapable of looking after themselves.*

**Department of Health
Organisation chart (extract)
(30 September 2016)**



Source: DH records

Department of Health
Staff for the provision of dental services
(30 September 2016)

Rank	Staff strength (No.)
<i>Dental personnel</i>	
Consultant	8
Principal Dental Officer	1
Senior Dental Officer	57
Dental Officer	250
Senior Dental Technologist	1
Dental Technologist	2
Dental Technician I	31
Dental Technician II	13
Tutor Dental Therapist	1
Senior Dental Therapist	27
Dental Therapist	240
Senior Dental Surgery Assistant	54
Dental Surgery Assistant	284
Dental Hygienist	13
Sub-total	982
<i>Administrative and supporting staff</i>	337
Total	1,319

Source: DH records

**Quotas of General Public Sessions
(2015-16)**

Clinic	Available sessions	Quota per session (No. of discs)
Cheung Chau Dental Clinic	1 st Friday of the month (AM)	32
Fanling Health Centre Dental Clinic	Tuesday (AM)	50
Kennedy Town Community Complex Dental Clinic	Monday (AM)	84
	Friday (AM)	84
Kowloon City Dental Clinic	Monday (AM)	84
	Thursday (AM)	42
Kwun Tong Dental Clinic	Wednesday (AM)	84
Mona Fong Dental Clinic	Thursday (PM)	42
Tai O Dental Clinic	2 nd Thursday of the month (AM)	32
Tai Po Wong Siu Ching Dental Clinic	Thursday (AM)	42
Tsuen Wan Government Offices Dental Clinic	Tuesday (AM)	84
	Friday (AM)	84
Yan Oi Dental Clinic	Wednesday (AM)	42
Yuen Long Jockey Club Dental Clinic	Tuesday (AM)	42
	Friday (AM)	42

Source: DH records

Acronyms and abbreviations

Audit	Audit Commission
CCF	Community Care Fund
CSEPs	Civil service eligible persons
DCMS	Dental Clinic Management System
DCMS-ORMS	Dental Clinic Management System — Outreach Reporting Management Service
DH	Department of Health
DMF	Decayed, missing and filled teeth
FHB	Food and Health Bureau
FSTB	Financial Services and the Treasury Bureau
K2	Kindergarten 2
NGOs	Non-governmental organisations
N3	Nursery 3
OMSDUs	Oral Maxillofacial Surgery and Dental Units

CHAPTER 8

Education Bureau

The Language Fund

**Audit Commission
Hong Kong
3 April 2017**

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

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THE LANGUAGE FUND

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THE LANGUAGE FUND

Executive Summary

1. The Language Fund (LF) was set up in March 1994 and held in trust by the Permanent Secretary for Education Incorporated as the Trustee to provide financial support for initiatives aiming at improving Hong Kong people's proficiency in Chinese (including Putonghua) and English languages. The Standing Committee on Language Education and Research (SCOLAR) was established in 1996 to advise the Government on the use of the LF and language education issues in general. SCOLAR is supported by the SCOLAR Secretariat, which is the Language Education and SCOLAR Section of the Education Bureau (EDB).

2. In the 23-year period from February 1994 to February 2017, the Finance Committee of the Legislative Council (LegCo) approved seven capital injections into the LF totalling \$8,000 million. For the first six injections (\$3,000 million in total), both the principal and accrued interest were used to support initiatives funded by the LF. For the seventh injection, \$5,000 million was injected into the LF in the form of seed capital to provide a stable stream of investment income to facilitate a longer term strategic planning and development for language education.

3. Initiatives funded by the LF can be classified by nature into three broad categories: (a) support measures to schools and teachers; (b) language education community projects; and (c) research and development (R&D) projects. In the 22-year period from the establishment of the LF in March 1994 to June 2016, the Trustee of the LF approved \$3,703 million to fund 544 initiatives. As at 30 June 2016, the actual expenditure of these 544 initiatives was \$2,754 million. In October 2016, the Audit Commission (Audit) commenced a review of the LF.

Management of initiatives

4. *Management of support measures to schools and teachers.* In the period from March 1994 to June 2016, the Trustee approved \$2,978 million for 47 initiatives to support schools and teachers. Audit examined the management and achievements of five key initiatives, which accounted for \$2,226 million (75%) of

Executive Summary

the total approved funding of \$2,978 million. Audit found a number of areas for improvement, including:

- (a) in July 2007, the Trustee approved funding of \$225 million to launch the Scheme to Support Schools in using Putonghua to teach the Chinese Language Subject. This six-year pilot scheme aimed to assist schools in the implementation of using Putonghua as the medium of instruction for teaching the Chinese Language subject (PMIC), and a total of 160 schools (132 primary schools and 28 secondary schools) participated in the Scheme. For the four years beginning from 2008/09 academic year (all years mentioned hereinafter refer to academic years), 40 schools were selected each year to participate in the pilot scheme. The funds were disbursed primarily as grants for schools to help teachers implement their school plans on using PMIC and attend relevant professional development programmes. In 2012, the SCOLAR Secretariat commissioned an evaluative study of the Scheme. Among the 160 participating schools, only four schools that participated in the last phase of the six-year pilot scheme were selected for the study. The findings were inconclusive as to whether using PMIC was more effective than using Cantonese as the medium of instruction. The study recommended that more resources and assistance should be given to facilitate the implementation of using PMIC. It has been more than 16 years since the Government adopted the long-term vision of using PMIC for all schools. Further research that provides more conclusive findings is needed;
- (b) to support secondary schools in strengthening the teaching and learning in English, in February 2006 and October 2010, \$880 million and \$323 million were earmarked for the English Enhancement Scheme (EES) and the Refined English Enhancement Scheme (REES) respectively. From 2006/07 to 2013/14, 439 secondary schools participated in the EES over an eight-year period (3 schools subsequently withdrew) and from 2010/11 to 2013/14, 386 secondary schools participated in the REES over a four-year period (1 school subsequently withdrew). The funds were used to purchase teaching and learning materials, and employ additional teachers and assistants. The EES and the REES were administered by the Education Commission and Planning Division (ECPD) of the EDB, instead of by the SCOLAR Secretariat. Audit noted that the ECPD had neither provided implementation information nor submitted the evaluation report of the EES and the REES to SCOLAR. According to the evaluation report, 177 (41%) schools participated in the EES and

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175 (45%) schools participated in the REES did not show satisfactory performance in meeting the pledged targets;

- (c) to prepare primary school students for their needs of learning English in secondary schools, an allocation of \$270 million was approved in January 2010 for the English Enhancement Grant Scheme (EEGS), a four-year grant scheme that lasted from 2010/11 to 2013/14. Audit examined 20 EEGS projects and found that there were delays in the submission of progress reports and final reports, and delays in the return of unspent funds. In addition, many targets set were not easily measurable; and
- (d) in February 2003 and March 2005, a total of \$528 million was earmarked for the Professional Development Incentive Grant Scheme for Language Teachers (PDIGS). Since 2004/05, all new language teachers are required to have qualifications recommended by SCOLAR. Serving language teachers who joined the teaching profession before 2004/05 without the recommended qualifications are encouraged to acquire the relevant qualifications as soon as possible. In this regard, the PDIGS was launched under the LF in 2003/04 to provide financial incentive to encourage language teachers to pursue recognised programmes of studies for enhancing their subject knowledge and pedagogy in the language they taught. Audit noted that the number of applications for the PDIGS has been decreasing since its launch. As at 30 June 2016, \$311 million (59%) of the \$528 million earmarked for the PDIGS remained unspent (paras. 2.2, 2.4 to 2.16, 2.18, 2.19 and 2.21).

5. *Management of language education community projects.* Through language education community projects, the LF aims to promote the importance of language education through nurturing closer partnership and forming stronger alliance with various stakeholders such as non-governmental organisations, private sectors and the community at large. In the period from March 1994 to June 2016, the Trustee approved \$558 million for 378 language education community projects. The funding represented 15% of the total approved funding of \$3,703 million for the period. Up to 30 June 2016, of the \$558 million, \$536 million was approved for 345 promotional projects (which were fully-funded by the LF) and \$22 million for 33 sponsorship projects (which were partially-funded by the LF). Audit found that: (a) of 63 project reports submitted by project grantees for ten completed promotional projects, 45 (71%) were submitted late. The delays were over

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3 months (94 days) on average, ranging from 3 to 432 days. In one project (a writing programme), among the awards given out were 26 book coupons issued by a publisher, who was related to the grantee. The face values of the 26 coupons were then charged by the grantee to the project vote. Audit noted that the project agreement did not stipulate the measures to be taken by the grantee in managing related party transactions. In four of the ten projects examined by Audit, there were non-compliances of procurement requirements stipulated in the project agreement; and (b) over the years, sponsorship projects have not been popular for a variety of reasons (paras. 2.24, 2.29 to 2.32 and 2.34).

6. ***Management of R&D projects.*** In the period from March 1994 to June 2016, the Trustee approved \$167 million for 119 R&D projects, representing 5% of the total approved funding of \$3,703 million. Starting from March 2014, apart from the top-down approach, SCOLAR has also adopted a bottom-up approach of inviting applications for R&D projects. Each application for bottom-up R&D projects was assessed by three members of the Vetting Committee by each completing a standard vetting form indicating whether or not to recommend the application for funding approval. Audit examined all the 24 projects approved from March 2014 to June 2016. Audit found that in one project applying for funding of \$7.5 million, the three members of the Vetting Committee recommended the project for approval, but their recommendations were subject to reservations or conditions on making the budget more realistic and providing further justification of certain expenditures. There was no documentary evidence showing that the SCOLAR Secretariat had taken follow-up action on the reservations. Measures are needed to distinguish and deal with qualified recommendations (paras. 2.37 to 2.39).

Governance and administrative issues

7. ***Governance of SCOLAR.*** As at 30 November 2016, SCOLAR comprised a non-official chairman, 12 non-official members and six ex-officio members. The term of each SCOLAR membership is two years. The current term of membership is from 1 July 2015 to 30 June 2017. Since July 2015, SCOLAR has adopted a two-tier reporting system to manage conflicts of interest. Audit found a number of areas for improvement, including: (a) the SCOLAR Secretariat only sent Declaration Forms to members after the commencement of the term. Nine members returned the Forms more than 30 days after the commencement of the term; (b) the annual declaration for the second year of the current term should have been returned by 1 July 2016. However, up to 31 January 2017, four members had

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not returned the declarations; and (c) for the five SCOLAR meetings held between 1 July 2015 and 31 October 2016, the average attendance rate of the 19 members was 74%. However, the attendance rates of four members were below 50% (paras. 3.2 to 3.6, 3.8 and 3.9).

8. ***Administrative issues.*** In January 2014, the LF received the seventh fund injection of \$5,000 million and in March 2014 placed the entire amount with the Exchange Fund (see para. 2). To make use of the injection of \$5,000 million, the EDB identified six strategic areas and proposed short-term initiatives and medium-and-long-term initiatives under each strategic area. In November 2015 and July 2016, the EDB reported to LegCo the progress of the planning and implementation of the initiatives. Audit noted that: (a) the EDB did not report the impact and achievements of the initiatives. Up to January 2017, no performance indicators had been developed to monitor the effectiveness of the LF; (b) after an initiative was approved, the funding allocated would be earmarked to a project account. Any unused balance of the earmarked funding would be ploughed back to support other initiatives after the completion of the initiative and the closure of the project account. As at 30 June 2016, there were 68 initiatives recorded as “ongoing” in the project database. Audit examination revealed that 13 (19%) of the 68 initiatives had been completed/terminated. Of these 13 initiatives, 6 had been completed/terminated for over 1 year and their unspent balance amounted to \$61.1 million; and (c) there is a need to identify and fund more worthwhile initiatives. Audit found that the amount of funding approved by the LF to support new initiatives decreased from \$159 million in 2014 (from March to December) to \$7 million in 2016 (from January to June). The interest income of \$513.3 million earned from the Exchange Fund far exceeded the actual funding of \$262 million approved for the period from March 2014 to June 2016 (paras. 3.14, 3.16, 3.19 to 3.21 and 3.24).

Language proficiency of students and working adults

9. ***Language proficiency of students.*** The EDB uses the Territory-wide System Assessment (TSA) and the Hong Kong Diploma of Secondary Education Examination (HKDSEE) to assess the Chinese and English language proficiency of students at Primary 3, Primary 6, Secondary 3 and Secondary 6. According to the TSA results in the period from 2007 to 2016, over 20% and over 30% of Secondary 3 students did not meet the basic competencies in Chinese Language and English Language respectively. For the HKDSEE, there were about 15% and 20% of Secondary 6 students who did not attain “Level 2” or above in Chinese Language

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and English Language (i.e. the minimum language requirement for articulation to sub-degree programmes) respectively in 2016. On the other hand, since the Hong Kong Certificate of Education Examination was discontinued in 2012, no tools have been available to measure the Putonghua proficiency of students (paras. 4.2 to 4.4).

Audit recommendations

10. **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 Education should:**

Management of support measures to schools and teachers

- (a) **take measures to improve evaluation studies (such as the scope and the timing) for future LF schemes with a view to enhancing the applicability of their findings (para. 2.22(a));**
- (b) **in relation to the use of PMIC, consider ways to facilitate schools adopting PMIC to implement the recommendations of the evaluative study of the PMIC Support Scheme, and conduct research which would provide more conclusive findings, and determine the way forward (para. 2.22(b));**
- (c) **ensure that management information (e.g. the implementation progress and effectiveness) of LF schemes not administered by the SCOLAR Secretariat is reported to SCOLAR on a regular basis (para. 2.22(c));**
- (d) **strengthen the project monitoring of future LF schemes (para. 2.22(d));**
- (e) **take measures to encourage more applications for the PDIGS (para. 2.22(e));**
- (f) **review the level of funding earmarked for the PDIGS (para. 2.22(f));**

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Management of language education community projects

- (g) take measures to ensure timely submission of project reports by grantees (para. 2.35(c));
- (h) take measures to ensure that expenditures charged to projects are proper (para. 2.35(d));
- (i) take measures to ensure that the grantees comply with the procurement requirements (para. 2.35(e));
- (j) take further measures to enhance the appeal of sponsorship projects (para. 2.35(g));

Management of R&D projects

- (k) take measures to ensure that recommendations subject to reservations or conditions, especially those concerning project costs, are clarified and followed up (para. 2.40(a));
- (l) document the results of the follow-up action to support the recommendations of the Vetting Committee (para. 2.40(b));

Governance of SCOLAR

- (m) take measures to ensure that Declaration Forms on conflicts of interest are submitted by members in a timely manner (para. 3.12(a));
- (n) take measures to improve the attendance rates of SCOLAR members with low attendance records (para. 3.12(b));

Executive Summary

Administrative issues

- (o) **step up efforts in developing suitable performance indicators for the LF and provide more details of the effectiveness of the LF in the progress reports to LegCo (para. 3.25(a));**
- (p) **expedite the closure of project accounts of completed/terminated initiatives with a view to releasing unspent earmarked funding to support other new initiatives (para. 3.25(b));**
- (q) **endeavour to identify and fund more worthwhile initiatives with a view to enhancing the language proficiency of Hong Kong people (para. 3.25(d));**

Language proficiency of students

- (r) **monitor the Chinese and English language proficiency of students and, if necessary, seek advice from SCOLAR on the improvement measures (para. 4.5(a)); and**
- (s) **seek advice from SCOLAR on the development of a set of assessment instruments for gauging Putonghua proficiency of students (para. 4.5(b)).**

Response from the Government

11. The Government generally 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 The Language Fund (LF) was set up in March 1994 with an initial allocation of \$300 million, held in trust under the Permanent Secretary for Education Incorporation Ordinance (Cap. 1098). The Permanent Secretary for Education Incorporated is the Trustee of the LF (Trustee). The LF provides financial support for initiatives aiming at improving Hong Kong people's proficiency in Chinese (including Putonghua) and English languages.

1.3 The LF is operated in accordance with a Trust Deed, which sets out the following:

- (a) ***Ambit.*** The Trustee should apply the LF to:
 - (i) support, directly or indirectly, proficiency in the use of the Chinese (including Putonghua) and English languages by the people of Hong Kong; and
 - (ii) fund programmes, projects, research, textbooks, reference materials, teaching aids, language teachers, language experts, educationalists, education and training institutions, courses, training, publications and publicity directed towards the enhancements in the use of Chinese (including Putonghua) and English languages by the people of Hong Kong; and
- (b) ***Grant disbursement principles.*** Disbursements from the LF have to observe the following principles:
 - (i) equal importance should be given to improving proficiency in Chinese and English;

Introduction

- (ii) a balance should be maintained between meeting the specific needs of schools and those of the community at large;
- (iii) for school children, emphasis should be put on increasing opportunities for language learning, in particular through extra-curricular activities;
- (iv) innovative ideas and learner-friendly, pragmatic approaches should be encouraged; and
- (v) a positive attitude towards learning and acquiring proficiency in the languages should be cultivated.

Standing Committee on Language Education and Research

1.4 The Standing Committee on Language Education and Research (SCOLAR) was established in 1996 to advise the Government on the use of the LF and language education issues in general. Its terms of reference are to:

- (a) advise the Trustee on policies and procedures governing the operation of the LF, and to provide such assistance as the Trustee may require to support, directly or indirectly, the enhancement of the language proficiency of the community;
- (b) advise on the overall policy on language education, including the medium of instruction;
- (c) advise on the setting of language standards, including general goals for language learning at different levels of education and specific language attainment targets at each stage of education, and measures to be adopted to attain such standards;
- (d) identify research and development (R&D) projects which are necessary for the enhancement of language proficiency and language in education, and to implement or oversee the satisfactory completion of such projects;

- (e) co-ordinate all R&D activities relating to language proficiency by relevant agencies, monitor their progress, evaluate their effectiveness, and make recommendations to the Government accordingly; and
- (f) develop and promote a public education and information programme in respect of language proficiency issues.

Organisation structure of SCOLAR

1.5 SCOLAR members are appointed by the Secretary for Education under the delegated authority of the Chief Executive of the Hong Kong Special Administrative Region. The current term of the membership is from 1 July 2015 to 30 June 2017. As at 30 November 2016, SCOLAR comprised a non-official chairman, 12 non-official members and six ex-officio members (Note 1).

1.6 The term of each SCOLAR membership is two years. SCOLAR has established eight working groups (WGs) to assist its work (see Appendix A). SCOLAR members are free to join the WGs at the beginning of the membership term.

1.7 SCOLAR is supported by the SCOLAR Secretariat, which is the Language Education and SCOLAR Section of the Education Bureau (EDB). The SCOLAR Secretariat is headed by an Assistant Secretary of the EDB. As at 31 December 2016, the SCOLAR Secretariat had a staff establishment of 39. The organisation chart of the SCOLAR Secretariat is shown at Appendix B.

Note 1: *Non-official members are appointed on an ad personam basis. They are either from the education sector or from the community at large. The six ex-officio members are a Deputy Secretary for Education, the Chairperson of the Committee on Professional Development of Teachers and Principals, the Secretary-General of the Hong Kong Examinations and Assessment Authority or his representative, and the Chairperson of three of the Committees of the Curriculum Development Council, namely the Committee on Chinese Language Education, the Committee on English Language Education and the Committee on Early Childhood Education.*

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Capital injections

1.8 In the 23-year period from February 1994 to February 2017, the Finance Committee (FC) of the Legislative Council (LegCo) approved seven capital injections into the LF totalling \$8,000 million (see Table 1).

Table 1

**Capital injections into the LF approved by the FC
(February 1994 to February 2017)**

Round	Date	Amount (\$ million)	} \$3,000 million
1	February 1994	300	
2	February 2001	200	
3	February 2003	400	
4	March 2005	500	
5	January 2006	1,100	
6	June 2010	500	
7	January 2014	5,000	
Total		8,000	

Source: EDB records

1.9 For the first six rounds of injection (\$3,000 million in total), both the principal and accrued interest were used to support initiatives funded by the LF. For the seventh round of injection, the LF changed its financing mode. The \$5,000 million was injected into the LF in the form of seed capital to provide a stable stream of investment income to facilitate a longer term strategic planning and development for language education. Expenditure is met by the investment returns of the LF. In March 2014, the LF placed the \$5,000 million with the Exchange Fund managed by the Hong Kong Monetary Authority for six years, during which the principal amount cannot be withdrawn.

Initiatives funded by LF

1.10 Initiatives funded by the LF can be classified by nature into three broad categories:

- (a) ***Support measures to schools and teachers.*** The LF provides funding for support measures to schools and teachers. Examples of initiatives include:
 - (i) the Scheme to Support Schools in using Putonghua to teach the Chinese Language Subject. The Scheme aimed to assist schools in using Putonghua as the medium of instruction for teaching the Chinese Language subject (PMIC). The Scheme is hereinafter referred to as PMIC Support Scheme; and
 - (ii) the Professional Development Incentive Grant Scheme for Language Teachers (PDIGS);
- (b) ***Language education community projects.*** The LF aims to promote the importance of language education through nurturing closer partnership and forming stronger alliance with various stakeholders such as non-governmental organisations, the private sectors and the community at large; and
- (c) ***R&D projects.*** The LF supports R&D projects with a view to facilitating the formulation of language education policies by focusing on areas such as language use, teaching approaches and resources development.

1.11 Initiatives funded by the LF can also be classified into four categories according to languages:

- (a) promotion of Chinese;
- (b) promotion of English;
- (c) promotion of cross-languages (i.e. Chinese and English); and
- (d) promotion of Putonghua.

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1.12 Upon approval of the injection of \$5,000 million into the LF in January 2014, with a view to further enhancing the Chinese (including Putonghua) and English language proficiency of students and the workforce of Hong Kong, SCOLAR identified six strategic areas and deliberated short-term initiatives and medium-and-long-term initiatives under each of the six strategic areas. The six strategic areas are:

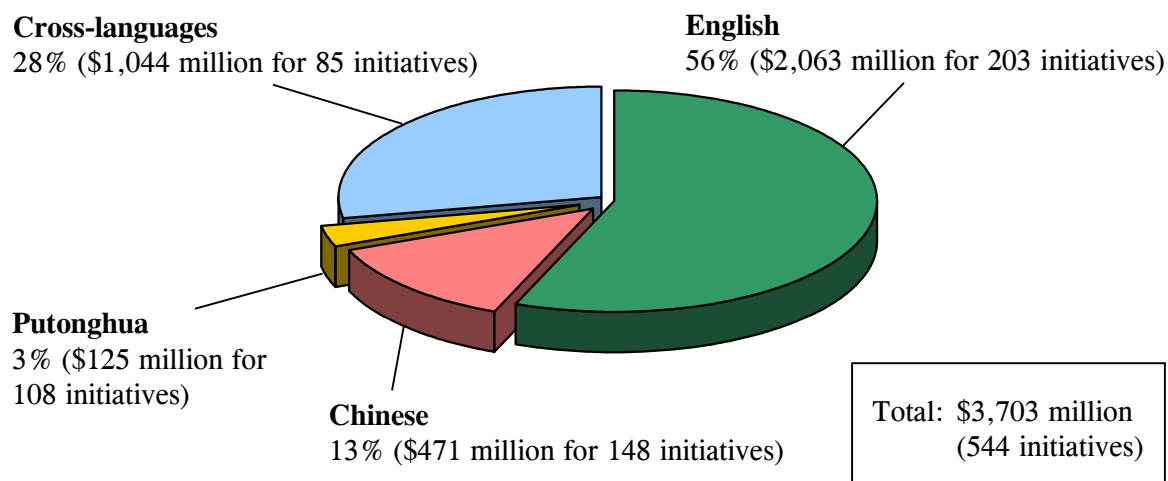
- (a) facilitating effective language education policy formulation and implementation through initiating longitudinal research and comparative studies in local and international settings;
- (b) strengthening support of language learning in Chinese and English in very early years;
- (c) enhancing professional preparation and continuing development of language teachers;
- (d) catering for learner diversity, including the needs of non-Chinese speaking students;
- (e) creating and nurturing a facilitating language learning environment for students in and beyond school settings through partnership with relevant stakeholders, in particular the community; and
- (f) raising language proficiency of Hong Kong's workforce in response to the changing language landscape.

Short-term initiatives were implemented in 2014 and 2015. The implementation of some of the medium-and-long-term initiatives started in 2016.

1.13 In the 22-year period from the establishment of the LF in March 1994 to June 2016, the Trustee approved \$3,703 million to fund 544 initiatives. As at 30 June 2016, the actual expenditure of these 544 initiatives was \$2,754 million. Of the 544 initiatives, 482 (89%) were completed, 55 (10%) were ongoing and 7 (1%) were terminated. Figures 1 and 2 show the distribution of initiatives categorised by languages and by nature respectively. Appendices C and D show the allocations of funding in the period from March 1994 to June 2016 analysed by languages and by nature respectively.

Figure 1

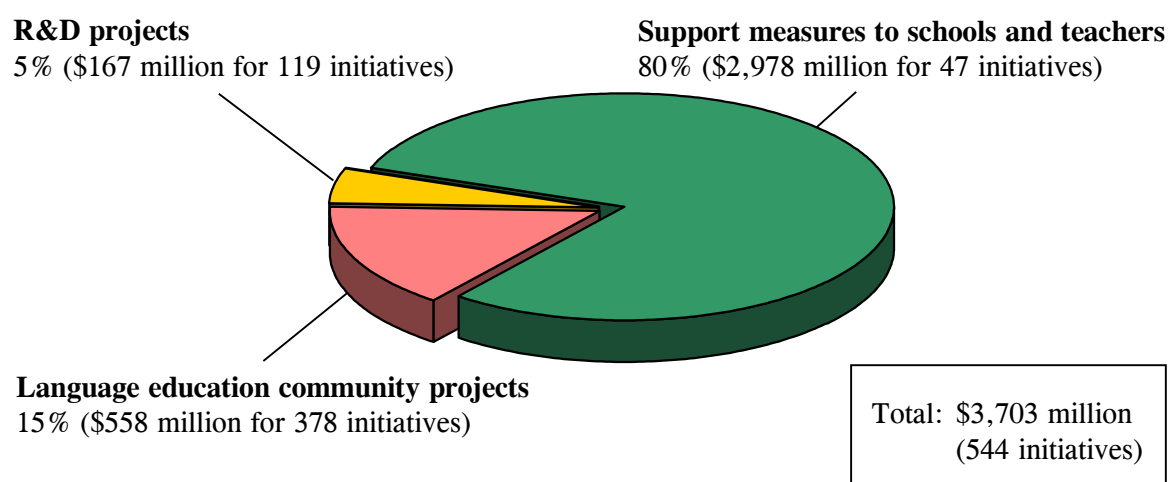
**Analysis of approved funding of initiatives by languages
(March 1994 to June 2016)**



Source: Audit analysis of EDB records

Figure 2

**Analysis of approved funding of initiatives by nature
(March 1994 to June 2016)**



Source: Audit analysis of EDB records

Introduction

Audit review

1.14 In October 2016, the Audit Commission (Audit) commenced a review of the LF. The review has focused on the following areas:

- (a) management of initiatives (PART 2);
- (b) governance and administrative issues (PART 3); and
- (c) language proficiency of students and working adults (PART 4).

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

General response from the Government

1.15 The Secretary for Education generally agrees with the audit recommendations and will consider appropriate follow-up actions. He fully appreciates Audit's efforts in conducting the review and making recommendations to help improve the operation of the LF.

Acknowledgement

1.16 Audit would like to acknowledge with gratitude the full cooperation of the staff of the EDB during the course of the audit review.

PART 2: MANAGEMENT OF INITIATIVES

2.1 This PART examines the management of the initiatives funded by the LF. Audit found room for improvement in the following areas:

- (a) management of support measures to schools and teachers (paras. 2.2 to 2.23);
- (b) management of language education community projects (paras. 2.24 to 2.36); and
- (c) management of R&D projects (paras. 2.37 to 2.41).

Management of support measures to schools and teachers

2.2 The LF provides funding for support measures to schools and teachers. In the period from March 1994 to June 2016, the Trustee approved \$2,978 million for 47 initiatives to support schools and teachers (see Figure 2 in para. 1.13). Audit examined the management and achievements of five key initiatives and identified areas for improvement (see Table 2). The total approved funding (\$2,226 million) of the five initiatives accounted for 75% of the total approved funding (\$2,978 million) for support measures to schools and teachers.

Table 2**Five key initiatives for support measures to schools and teachers
examined by Audit
(30 June 2016)**

Initiative	Duration (Academic year)	Approved funding (\$ million)	Actual expenditure (\$ million)	Number of beneficiaries
PMIC Support Scheme	6 years (2008/09 to 2013/14)	225	202	132 primary schools and 28 secondary schools
English Enhancement Scheme (EES)	8 years (2006/07 to 2013/14)	880	722	439 secondary schools
Refined English Enhancement Scheme (REES)	4 years (2010/11 to 2013/14)	323	319	386 secondary schools
English Enhancement Grant Scheme (EEGS)	4 years (2010/11 to 2013/14)	270	229	475 primary schools
PDIGS (Note)	13 years (Since 2003/04)	528	217	8,252 teachers
Total		2,226	1,689	

Source: EDB records

Note: The PDIGS is an ongoing project. The amount of actual expenditure shown in this Table was the position up to 30 June 2016.

PMIC Support Scheme

2.3 Since November 2000, the Curriculum Development Council (Note 2) has stated that using PMIC is the Council's long-term goal. Three studies relating to using PMIC funded by the LF and the Quality Education Fund (Note 3) were completed in 2002. The studies found that:

- (a) students who learned Chinese Language in Putonghua showed improvement in Putonghua proficiency and were better in Chinese writing than their counterparts who learned the subject in Cantonese; and
- (b) there was no conclusive evidence to support the argument that students' general Chinese competence would be better if they learned Chinese Language in Putonghua.

In June 2003, SCOLAR completed a review on the Government's language education policies and measures, and published the report "Action Plan to Raise Language Standards in Hong Kong" (2003 Report). According to the 2003 Report, SCOLAR believed that using PMIC would help improve students' Chinese writing and Putonghua proficiency, and foresaw the growing use of written Chinese and Putonghua in both the official and business arenas. In the Report, SCOLAR stated that it endorsed the Curriculum Development Council's long-term vision to use PMIC. SCOLAR supported the recommendation of incorporating Putonghua learning elements into the Chinese Language Education Curriculum as one entity and in the long term adopting PMIC. In view of the inconclusive findings of studies, the Report stressed that the Government should better understand the conditions necessary for schools to make a successful switch to Putonghua and prevent possible negative outcomes, before formulating a firm policy and implementation timetable for all schools to adopt PMIC.

Note 2: *The Curriculum Development Council is a free-standing advisory body appointed by the Chief Executive to give advice to the Government on matters relating to curriculum development for the local school system.*

Note 3: *The Quality Education Fund was established in January 1998. It mainly caters for worthwhile non-profit-making initiatives within the ambit of basic education, i.e. kindergarten, primary, secondary and special education.*

2.4 ***Launching of the PMIC Support Scheme.*** SCOLAR commissioned a research study in the period from 2004 to 2006 to identify factors that were conducive to the implementation of using PMIC. Based on the research findings (Note 4), in July 2007, the Trustee approved funding of \$225 million to launch a six-year pilot PMIC Support Scheme, which started from 2008/09 academic year (unless otherwise specified, all years mentioned in this Audit Report refer to academic years starting in September of a year and ending in August of the following year). The Scheme aimed to assist schools in the implementation of using PMIC. Details of the Scheme are as follows:

- (a) the Support Scheme was carried out on a pilot basis in four years as four phases providing support to a maximum of 40 primary/secondary schools in each phase. In each of the four phases from 2008/09 to 2011/12, 40 schools were selected;
- (b) schools applying for the PMIC Support Scheme were vetted by a panel for their readiness to introduce or expand the use of PMIC. The panel was chaired by a SCOLAR member and comprised representatives from the EDB and the education sector. Only schools which had already possessed the basic preconditions or with viable plans would receive support; and
- (c) each selected school received support for three consecutive years. For example, the last batch selected in 2011/12 received support for the years from 2011/12 to 2013/14.

From 2008/09 to 2013/14, a total of 160 schools (132 primary schools and 28 secondary schools) participated in the Scheme. The funding spent was \$202 million, of which \$54 million was used for the provision of non-cash support measures (e.g. professional advice rendered by Mainland teaching experts to help the schools implement their plans on using PMIC) and \$148 million was used for the supply teacher grant which provided grants for schools to help teachers implement their school plans on using PMIC as well as to attend relevant professional development programmes.

Note 4: *The study identified six factors which would be conducive to the implementation of using PMIC, including: (a) teacher qualifications; (b) attitudes and strategies of school management; (c) language environment; (d) students' learning ability; (e) arrangements for curriculum, teaching methods and teaching materials; and (f) support for learning and teaching.*

2.5 *Evaluation of implementation of the PMIC Support Scheme.* In order to examine the issues of concerns in the course of implementing the use of PMIC, for ensuring the teaching effectiveness of the Chinese Language subject, the SCOLAR Secretariat implemented various measures to evaluate the PMIC Support Scheme. Annual surveys with participating schools and interviews of school heads and teachers of participating schools were conducted. The SCOLAR Secretariat also commissioned a tertiary education institution in March 2012 to conduct a longitudinal evaluative study to examine the process of, and the changes and impacts brought to the participating schools by the implementation of PMIC. The cost incurred for the study was \$1.42 million. The study adopted a case-study approach and selected four participating schools (two primary schools and two secondary schools) with different school backgrounds and experiences of implementing PMIC. The study also examined the effects of using PMIC by comparing the performance of students who studied Chinese Language subject in Putonghua and those in Cantonese. The report of the study was accepted by SCOLAR in October 2015. With respect to students' performance, the findings were inconclusive and reflected that PMIC had no negative impacts on the studying of Chinese Language subject of the students of the selected schools. In response to Audit's enquiry, in March 2017, the EDB said that:

- (a) the findings reflected that the PMIC Support Scheme had enhanced the platform for knowledge sharing of the teaching teams and helped teachers internalise the pedagogical knowledge of PMIC;
- (b) in general, PMIC classes performed better than classes using Cantonese as the medium of instruction for teaching the Chinese Language subject (CMIC). Taking into account the different entry points of students, it would be inappropriate to conclude that PMIC was more effective. Students' performance under PMIC and CMIC varied in different domains (listening, speaking, reading and writing) and stages of schooling. At junior secondary levels, CMIC classes performed better in speaking whilst PMIC classes outperformed CMIC classes in reading. Senior primary students in PMIC classes also performed better in writing whereas junior secondary students in CMIC classes fared better in writing;
- (c) SCOLAR advised the EDB to consolidate and disseminate good practices of schools under the PMIC Support Scheme through different platforms; and

- (d) the EDB informed LegCo in July 2016 that schools might consider whether PMIC should be adopted and the pace of implementation. The EDB would continue to give schools assistance and support for teaching the Chinese Language subject irrespective of whether the schools' medium of instruction was Putonghua or Cantonese, and to explore feasible options to enhance teachers' confidence and competence in PMIC.

2.6 *Need to draw lessons from the evaluative study.* Among the 160 participating schools, only four schools (two primary schools and two secondary schools) that participated in the last phase (i.e. from 2011/12 to 2013/14) were selected for the evaluative study. Limitations of the study were spelt out in the report of the study:

- (a) as only four schools were covered, the findings in the study might not be applicable to all schools implementing the use of PMIC;
- (b) the study was approved in March 2012. As such, the research team could only select schools participating in the last phase as study objects. There were limitations in the findings; and
- (c) all the four schools covered in the study assigned students to classes using PMIC based on the students' examination and interview results. Although students of PMIC classes were found performing better, after taking into account the different entry points of those students, it would be inappropriate to conclude that using Putonghua was more effective than using Cantonese to teach the Chinese Language subject.

Audit considers that the SCOLAR Secretariat needs to draw lessons from this study and improve the design and conduct of future evaluative studies. For example, the findings could have been more widely applicable, if the scope of the evaluative study covered more than only four schools. Moreover, as the evaluative study covered the last batch of schools, the results could only be available after the completion of the PMIC Support Scheme. If the evaluative study was conducted at an earlier stage, improvements could have been made to the Scheme in view of the findings of the study.

2.7 *Need to facilitate the implementation of using PMIC by schools and conduct more research to provide more conclusive findings on the effectiveness of using PMIC.* To facilitate the implementation of using PMIC by schools, the report of the evaluative study recommended that:

- (a) SCOLAR should consider publishing case studies of implementation of using PMIC for experience sharing by local teachers;
- (b) schools should deploy teachers with good subject and pedagogical knowledge in Chinese Language and Putonghua, and ability to teach classes using PMIC;
- (c) schools should commit sufficient resources for implementing the use of PMIC. School leaders should make appropriate arrangements to create room for setting up mechanisms which facilitate collaborative lesson planning, peer observations, feedback and experience sharing among teachers, so as to promote knowledge transfer and continuing professional development of the teaching force;
- (d) schools should provide supportive measures to enhance teachers' Putonghua proficiency, enabling them to provide appropriate language modeling, as well as guidance and constructive feedback for students; and
- (e) training courses for teachers should be improved to enable them to have a deeper and more comprehensive understanding on the use of PMIC.

While the EDB will continue to pursue the long-term vision of using PMIC for all schools, schools may use either Cantonese or Putonghua as the medium of instruction to teach the Chinese Language subject having regard to their own circumstances. According to the surveys conducted by SCOLAR, in the period from 2008/09 to 2015/16, the percentages of primary schools and secondary schools using PMIC had increased from 56% to 72% and from 32% to 37% respectively. While the EDB has disseminated good practices of schools under the PMIC Support Scheme and explored feasible options to enhance teachers' confidence and competence in PMIC, the EDB needs to consider ways to facilitate schools that choose to adopt PMIC to implement the recommendations of the evaluative study. Furthermore, according to the EDB, as the evaluative study only focused on examining the specific cases among the schools participated in the PMIC Support Scheme, there were limitations of its findings which might not be deemed as the

ultimate conclusion on the subject of using PMIC. It has been more than 16 years since the Government adopted the long-term vision of using PMIC for all schools. Over the years, researches carried out were not conclusive on the effectiveness of using PMIC. According to the EDB, it was probably because there were many factors affecting the efficacy of using PMIC. To shed light on the matter, the SCOLAR Secretariat needs to assist SCOLAR in making use of the LF to conduct further research to provide more conclusive findings on using PMIC.

Schemes to support schools in teaching and learning English

2.8 The LF funded the following schemes to support schools in strengthening the teaching and learning of English:

- (a) ***EES for secondary schools.*** In February 2006, \$880 million was earmarked for the EES, which aimed to strengthen the learning and teaching of English. Under the EES, eligible schools might apply in 2006 and 2007 to implement school-based English enhancement measures. Eligible schools comprised all public-sector secondary schools, secondary schools under the Direct Subsidy Scheme and special schools offering ordinary secondary curriculum. Approved schools using Chinese as the medium of instruction (CMI) generally received not more than \$3 million over a period of six years. They were required to commit to adopting the CMI mode for the entire duration of the Scheme. Approved schools using English as the medium of instruction (EMI) received about \$0.5 million in total over a period of six years. A total of 439 secondary schools (including three schools that withdrew from participation subsequently) participated in the EES and received funding of \$722 million. All school-based measures funded under the EES were completed by the end of 2013/14;
- (b) ***REES for secondary schools.*** Since the implementation of the Fine-tuning the Medium of Instruction for Secondary Schools in 2010/11, schools are no longer bifurcated into CMI and EMI schools. Against this background, \$323 million was earmarked in October 2010 for the implementation of the REES. The REES aimed at supporting schools to build on the foundation of the EES to adjust and refocus their plans to put in place their school-based fine-tuned medium of instruction arrangements. Schools eligible for the EES were also eligible for joining the REES. Under the REES, each approved school received not more

than \$1 million over a period of two years. A total of 386 secondary schools (including one school that withdrew from participation subsequently) participated in the REES and received funding of \$319 million. All school-based measures funded under the REES were completed by the end of 2013/14; and

- (c) ***EEGS for primary schools.*** In January 2010, an allocation of \$270 million from the LF was approved for the EEGS. The EEGS aimed at preparing students of primary schools for their needs of learning English in secondary schools. Under the EEGS, all aided (including special schools with primary section adopting ordinary school curriculum), government or Direct Subsidy Scheme primary schools were eligible to apply for a grant of not more than \$0.5 million to be disbursed over a period of two years for developing school-based English enhancement measures. The EEGS started in 2010/11 and all school-based measures were completed by the end of 2013/14. A total of 475 primary schools participated in the EEGS and received funding of \$229 million.

2.9 For all the three schemes, applicant schools were required to submit, among others, a holistic school-based plan covering strategy, implementation plans and expected targets of the projects. A panel comprising language education experts and representatives from the EDB was formed to assess applications and give advice on the appropriateness and feasibility of the enhancement measures (e.g. purchase of teaching and learning materials, employment of additional teachers and teaching assistants, and hire of services for conducting learning activities) proposed by each school. Successful schools were required to sign with the Government a performance contract in which the schools pledged qualitative and quantitative targets to be achieved within a specified timeframe.

Management of EES and REES

2.10 Following the launch of the EES and the REES, the Trustee agreed in February 2006 and October 2010 that the Education Commission and Planning Division (ECPD) of the EDB, instead of the SCOLAR Secretariat, would be responsible for the administration of the EES and the REES respectively, including the release of fund to project grantees (i.e. approved schools), monitoring of project progress and conducting evaluation of the schemes.

Management of initiatives

2.11 *Need to regularly report to SCOLAR progress information on the implementation of LF schemes.* When the ECPD was made responsible for the administration of the EES and the REES, no arrangements were made between the SCOLAR Secretariat and the ECPD on the reporting requirements to SCOLAR. Audit noted that:

- (a) the ECPD had not reported progress information to SCOLAR on the implementation of the schemes, such as the number of applications received, number of approved applications, and amount of funding approved; and
- (b) in December 2015, the ECPD completed an evaluation on the EES and the REES. Up to November 2016, the ECPD had not submitted any evaluation report to SCOLAR.

2.12 The evaluation on the EES and REES was completed in 2015 by the ECPD. The evaluation included self-evaluation by the schools. Based on self-evaluation by the schools and evaluation by the EDB, 177 (41%) of 436 schools participated in the EES (excluding 3 schools that subsequently withdrew) and 175 (45%) of 385 schools participated in the REES (excluding 1 school that subsequently withdrew) did not show satisfactory performance in meeting the pledged targets vis-a-vis objectives of the schools. The total funding earmarked for the two schemes was \$1,203 million and the actual funding disbursed was \$1,041 million. Audit noted that SCOLAR was not informed of the implementation progress and effectiveness of the EES and REES. In view of the significant amount of funding involved, Audit considers that it is important that SCOLAR was informed of the implementation progress and effectiveness of the schemes. The SCOLAR Secretariat needs to ensure that the management information (e.g. implementation progress and effectiveness) of all schemes including those not administered by the Secretariat is reported to SCOLAR regularly.

Management of EEGS

2.13 To prepare primary school students for their needs of learning English in secondary schools, an allocation of \$270 million was approved in January 2010 for the EEGS, a four-year grant scheme that lasted from 2010/11 to 2013/14. Audit examined the SCOLAR Secretariat's management of EEGS projects and identified areas for improvement, as detailed in paragraphs 2.14 to 2.16.

2.14 ***Submission of progress reports and final reports not timely.*** According to the EEGS application guidelines and the performance contract signed between the schools and the Government, participating schools were required to submit a progress report within three months after the first year of implementation and a final report (including the financial statement) within three months after completion of the project. Audit examined project files of 20 (4.2%) of the 475 projects (total amount of grant was \$9 million, involving 18 progress reports and 20 final reports) and found that some reports were submitted late (see Table 3):

- (a) for 4 (22%) of the 18 progress reports, the delays were more than 30 days, ranging from 59 to 206 days (averaging 105 days); and
- (b) for 1 (5%) of the 20 final reports, the delay was 65 days.

For future schemes, the SCOLAR Secretariat needs to take measures to ensure that the progress reports and final reports are submitted by participating schools on time as far as possible so that more timely evaluation of the projects can be conducted.

Table 3

**Late submission of progress reports and final reports
by participating schools of EEGS
(July 2013 to February 2015)**

Delay	Progress report		Final report	
	Number	Percentage	Number	Percentage
No delay	11	61%	18	90%
≤ 30 days	3	17%	1	5%
31 days to 90 days	3	17%	1	5%
91 days to 180 days	0	0%	0	0%
181 days to 210 days	1	5%	0	0%
Total	18	100%	20	100%

Source: Audit analysis of EDB records

Management of initiatives

2.15 *Late return of unspent funds.* Grants of not more than \$0.5 million were disbursed to each participating school over a period of two years. According to the performance contract, participating schools shall return to the Government the unspent funds upon project completion. Each participating school was required to submit a final report within three months after project completion. After it had accepted the final report of the project, the SCOLAR Secretariat issued an email to the participating school asking it to return the unspent funds. All the 20 projects examined by Audit had unspent funds, ranging from \$6,000 to \$103,372. Audit noted that the unspent funds of five projects were returned in a timely manner. The returns of unspent funds by the remaining 15 (75%) projects (see Table 4) took an average of 95 days (ranging from 28 days to 169 days) after the final report submission due date. For future schemes, the Secretariat needs to take measures to ensure the timely return of unspent funds (e.g. speeding up the acceptance of final report, and stepping up follow-up action on late return).

Table 4

**Time taken to return unspent funds by participating schools of EEGS
(February 2014 to April 2015)**

Number of days from the final report submission due date	Number of projects	Total amount (\$)
≤ 50 days	2	24,409
51 days to 100 days	7	170,823
101 days to 150 days	4	138,089
151 days to 200 days	2	118,643
Total	15	451,964

Source: Audit analysis of EDB records

2.16 *Many targets set by schools were not easily measurable.* In the circular memorandum issued by the EDB to schools inviting them to apply for grants under the EEGS, the EDB stated that schools applying for the EEGS should submit an implementation plan which sets out, among others, targets to be attained, which should preferably be measurable. Schools were also required to include in their proposals methods of progress monitoring and evaluation for ascertaining whether

the targets could be met. These targets were included as part of the terms and conditions of the performance contract signed between the school and the Government. The schools were required to submit final reports, including their evaluation of measures. Audit examination of the 20 projects revealed that few targets set by the schools were measurable (one example of measurable targets was “future Territory-wide System Assessment (TSA) results for reading and writing would show improvement”). Many targets set were not easily measurable (one example of targets that were not easily measurable was “students would show improvements in their reading and writing skills”). In September 2015, when reporting the review findings of the EEGS to SCOLAR, the SCOLAR Secretariat remarked that the findings of schools’ self-evaluations were mostly qualitative in nature and might not provide conclusive indicators with respect to the degree of value-added of the EEGS. For future schemes, the Secretariat needs to assist participating schools in setting targets that could better measure effectiveness as far as possible. The EDB informed Audit in March 2017 that taking into account the experience, in preparing for the launch of new grant scheme, the SCOLAR Secretariat would consider assisting schools in preparing their school-based implementation plan with targets, which should preferably be measurable.

PDIGS

2.17 In the 2003 Report (see para. 2.3), SCOLAR recommended that language teachers should be proficient in the language they taught, well grounded in knowledge and understanding of the language, and conversant with the latest theories and practices in language teaching and learning. SCOLAR considered that the possession of either of the following qualifications (known as “SCOLAR requirements”) was essential to ensuring adequate preparation of language teachers in proficiency, subject knowledge and pedagogy:

- (a) a Bachelor of Education degree majoring in the relevant language subject;
or
- (b) a first/higher degree majoring in the relevant language subject and a Postgraduate Diploma in Education or Postgraduate Certificate in Education majoring in that language subject.

2.18 Since 2004/05, all new language teachers have been required to meet the SCOLAR requirements. Serving language teachers who joined the teaching profession before 2004/05 without the recommended qualifications are encouraged to acquire the relevant qualifications as soon as possible. In this regard, the PDIGS was launched under the LF in 2003/04 to provide financial incentive to encourage language teachers to pursue recognised programmes of studies for enhancing their subject knowledge and pedagogy in the language they taught. Under the PDIGS, each approved language teacher may receive 50% of the tuition fee up to a maximum of \$50,000 upon successful completion of the approved programme. In February 2003 and March 2005, a total of \$528 million (\$226 million and \$302 million respectively) was earmarked for the PDIGS. In the period from September 2003 to June 2016, the PDIGS spent \$217 million. A total of 8,252 teachers received subsidies under the PDIGS.

2.19 *Decreasing number of applications.* In 2003/04, when the PDIGS was first launched, there were more than 3,000 applications. An additional injection for this Scheme was approved by the FC in 2005. Since then, the number of applications has been decreasing (see Table 5). To encourage more applications, SCOLAR modified the PDIGS in 2009 (e.g. relaxed the eligibility for application). Furthermore, with a view to increasing the attractiveness of the PDIGS and to aligning with the increase in the costs of programmes, the maximum subsidy for each applicant was increased from \$30,000 to \$50,000 in September 2014.

Table 5

**Decreasing number of applications for PDIGS
(2003/04 to 2015/16)**

Year	Number
2003/04	3,164
2004/05	2,421
2005/06	1,843
2006/07	1,038
2007/08	440
2008/09	321
2009/10	238
2010/11	157
2011/12	89
2012/13	28
2013/14	17
2014/15	13
2015/16 (up to June 2016)	15
Total	9,784

Source: EDB records

2.20 Need to take measures to encourage more applications under PDIGS.

Audit noted that the SCOLAR Secretariat had informed schools of updates of the PDIGS, including the relaxation of the eligibility criteria and the upward adjustment of the maximum grant. Nonetheless, as shown in Table 5, the increase in the maximum subsidy in September 2014 did not help improve the number of applications. In 2015/16, there were 15,246 language teachers who joined the teaching profession before 2004/05. Of them, 4,252 (28%) did not possess the qualifications outlined by SCOLAR in paragraph 2.17. Audit analysed these teachers by age groups and found that many of them could be teaching for many more years to come (see Table 6). Pursuing a recognised programme of studies for enhancing the subject knowledge and pedagogy of the language they teach would be useful to them in carrying out their work. The SCOLAR Secretariat needs to consider taking measures to encourage more applications for the PDIGS.

Table 6**Age groups of language teachers not meeting SCOLAR requirements
(2015/16)**

Age group	Number of teachers
< 40	491 (11.6%)
40 to 44	1,131 (26.6%)
45 to 49	1,003 (23.6%)
50 to 54	907 (21.3%)
55 to 59	618 (14.5%)
> 59	102 (2.4%)
Total	4,252 (100%)

Source: Audit analysis of EDB records

In March 2017, the EDB informed Audit that a questionnaire survey with the school heads had been conducted in late 2016 to seek their views on the PDIGS. Moreover, the SCOLAR Secretariat was preparing a review of the PDIGS.

2.21 *Need to review the level of unspent earmarked amount.* As at 30 June 2016, \$311 million (59%) of the \$528 million earmarked for the PDIGS remained unspent. Even if the 4,252 language teachers who did not meet the SCOLAR requirements would apply for the PDIGS and each application was subsidised with the maximum amount of \$50,000, the total funding required would be \$213 million ($\$50,000 \times 4,252$), i.e. still \$98 million (31.5%) less than the unspent amount of \$311 million. Audit considers that the SCOLAR Secretariat needs to review the level of unspent funding earmarked for the PDIGS with a view to releasing excessive earmarked funding to the LF for support of other new initiatives. In March 2017, the EDB informed Audit that in the coming review of the PDIGS, the SCOLAR Secretariat would recommend trimming down the level of the approved funding.

Audit recommendations

2.22 Audit has *recommended* that the Secretary for Education should:

- (a) take measures to improve evaluation studies (such as the scope and the timing) for future LF schemes with a view to enhancing the applicability of their findings;**
- (b) in relation to the use of PMIC:**
 - (i) seek advice from SCOLAR and consider ways to facilitate schools adopting PMIC to implement the recommendations of the evaluative study of the PMIC Support Scheme; and**
 - (ii) conduct research which would provide more conclusive findings, and determine the way forward;**
- (c) ensure that management information (e.g. the implementation progress and effectiveness) of LF schemes not administered by the SCOLAR Secretariat is reported to SCOLAR on a regular basis;**
- (d) strengthen the project monitoring of future LF schemes by taking measures to:**
 - (i) ensure the timely submission of project reports (e.g. progress reports and final reports) by participating schools;**
 - (ii) ensure that unspent funds are returned to the Government in a timely manner; and**
 - (iii) assist schools in setting measurable targets as far as possible;**
- (e) take measures to encourage more applications for the PDIGS; and**
- (f) review the level of funding earmarked for the PDIGS with a view to releasing excessive funding to the LF for support of other new initiatives.**

Response from the Government

2.23 The Secretary for Education generally agrees with the audit recommendations. He has said that:

- (a) while the case-study approach could provide detailed and contextual information for understanding the different processes, strengths and issues of schools under different conditions that could become references for schools with similar contexts, noting the limitations, the SCOLAR Secretariat will consider ways to improve the design of evaluative studies for future LF schemes with a view to enhancing the applicability of the study findings;
- (b) SCOLAR has advised the EDB and the EDB has agreed to consolidate and disseminate good practices of schools under the PMIC Support Scheme through different platforms. The EDB will also liaise with teacher education institutions to explore feasible options to enhance teachers' confidence and competence in PMIC;
- (c) the SCOLAR Secretariat will continue to collect relevant data to monitor the implementation of PMIC in schools in Hong Kong;
- (d) the SCOLAR Secretariat will work with relevant parties to ensure appropriate reporting of schemes to SCOLAR;
- (e) the SCOLAR Secretariat will consider appropriate measures to ensure timely submission of project reports by participating schools;
- (f) the SCOLAR Secretariat will consider appropriate measures to ensure that unspent funds are returned to the Government in a timely manner;
- (g) in the course of preparing for the new grant scheme, the SCOLAR Secretariat has considered assisting schools in preparing their school-based implementation plan including setting targets to be attained (preferably measurable);

- (h) the SCOLAR Secretariat will consider appropriate measures to encourage applications for the PDIGS; and
- (i) the SCOLAR Secretariat is planning for a scheduled review of the PDIGS. Subject to the findings, the SCOLAR Secretariat will consider recommending trimming down the level of the approved funding.

Management of language education community projects

2.24 Through language education community projects, the LF aims to promote the importance of language education through nurturing closer partnership and forming stronger alliance with various stakeholders such as non-governmental organisations, private sectors and the community at large. In the period from March 1994 to June 2016, the Trustee approved \$558 million for 378 language education community projects. The funding represented 15% of the total approved funding of \$3,703 million for the period (see Figure 2 in para. 1.13). These projects can be classified into:

- (a) **Promotional projects.** These projects are fully-funded by the LF with specific themes determined by SCOLAR (e.g. a project to organise a reading carnival in 2014/15 aiming at fostering local primary and secondary school students' interest in reading and using English for pleasure). Open-call exercises are conducted annually to invite organisations (including for-profit and not-for-profit organisations, government departments and education institutions) to submit project proposals. Up to 30 June 2016, \$536 million had been approved for 345 promotional projects; and
- (b) **Sponsorship projects.** These projects are partially-funded by the LF. For each project, the LF may fund up to 40% of the project budget or \$1 million (whichever is lower). Before 2015/16, organisations submitted proposals to SCOLAR for approval on a case-by-case basis. Starting from 2015/16, open-call exercises have been conducted annually to invite proposals. Up to 30 June 2016, \$22 million had been approved for 33 sponsorship projects.

Management of promotional projects

2.25 Applications for promotional projects are first assessed by the SCOLAR Secretariat, followed by the vetting of either the WG on Promotion of English or the WG on Promotion of Chinese. Applications recommended by the WG will be submitted to SCOLAR for endorsement and then the Trustee for approval. The SCOLAR Secretariat will arrange the signing of the project agreement between the Trustee and the grantee. The Secretariat monitors the progress of the projects. In the period from January 2012 to June 2016, the Trustee approved 68 promotional projects. Of the 68 projects, 42 were completed. Audit examined the management of 10 (23.8%) of the 42 completed projects and found areas for improvement.

2.26 *Need to promulgate guidelines on checks and visits.* According to the Work Manual of the LF, to monitor project progress, the SCOLAR Secretariat should conduct:

- (a) *Spot checks.* Such checks should be carried out particularly on large-scale projects covering a long duration; and
- (b) *Surprise visits.* Such visits should be made at appropriate intervals and visit reports should be prepared for supervisory review.

2.27 Audit examined the records of ten completed projects. Audit found that no spot checks or surprise visits were conducted for the ten projects. According to the SCOLAR Secretariat, spot checks and surprise visits were no longer conducted. Instead, the SCOLAR Secretariat conducted observation visits. No database was maintained to record the details of observation visits conducted. The visit records were kept in individual project files. There was no readily available management information on the number of visits conducted, the projects selected for visits, and the frequency and the dates of visits. Table 7 summarised the observation visits conducted for the ten projects. Audit considers that the SCOLAR Secretariat needs to update the Work Manual and promulgate guidelines on observation visits. The Work Manual should specify the selection criteria and the frequency that observation visits should be carried out.

Table 7

**Observation visits conducted for
ten promotional projects examined by Audit
(September 2012 to July 2014)**

Project	Nature of project	Project duration (Day)	Approved amount (\$)	Number of visits
A	Chinese writing workshops and competition for students	370	770,000	2
B	English learning through ball games and reading activities for students	360	500,000	1
C	Putonghua learning through a carnival on environmental protection for students	210	320,000	1
D	English literature learning through reading activities for students	360	2,070,000	1
E	Putonghua workshops on workplace communication for adults	360	290,000	4
F	To teach non-Chinese speaking children on learning Chinese characters and Chinese writing through storytelling, songs and role-playing	360	240,000	4
G	English film viewing and reading sessions for students	350	310,000	1
H	Putonghua public speaking competition for students	180	820,000	4
I	English workshops for students	390	910,000	1
J	To arouse the non-Chinese speaking children's interest in learning Chinese characters or vocabularies through games, creative arts and crafts	400	110,000	3

Source: Audit analysis of EDB records

2.28 Need to take measures to ensure timely submission of project reports.

Project grantees are required to submit project reports, namely progress reports, an end-of-project report, and financial reports in accordance with a reporting schedule stipulated in the project agreement. The reporting intervals vary by projects. Project grants are paid by instalments to grantees. The first instalments are paid to grantees upon signing of the project agreements. Subsequent instalments are paid to grantees after the SCOLAR Secretariat is satisfied with the reports submitted by them.

Management of initiatives

2.29 Of the ten projects examined by Audit, the project grantees were required to submit a total of 63 project reports (21 progress reports, 10 end-of-project reports and 32 financial reports). Audit analysed the date of report submissions and found that 45 (71%) of the 63 reports were submitted late. The delays were over 3 months (94 days) on average, ranging from 3 to 432 days (see Table 8). For example, for project B, the grantee was required to submit reports on four occasions (on 24 December 2013, 25 April 2014, 25 July 2014 and 3 October 2014). However, despite repeated reminders issued by the SCOLAR Secretariat, the grantee only submitted all the reports to the Secretariat in one go on 3 November 2014. To facilitate the monitoring of project progress by the SCOLAR Secretariat, Audit considers that the SCOLAR Secretariat needs to take measures to ensure that reports are submitted in a timely manner.

Table 8

**Delays in submission of project reports by grantees of
ten promotional projects examined by Audit
(January 2013 to December 2015)**

Project	Project duration	Number of reports submitted	Number of reports submitted late	Range of delays (Average)
A	370 days	4	4 (100%)	33 to 135 days (85 days)
B	360 days	8	8 (100%)	31 to 314 days (160 days)
C	210 days	6	4 (67%)	8 to 17 days (14 days)
D	360 days	8	4 (50%)	11 to 16 days (14 days)
E	360 days	7	5 (71%)	22 to 63 days (46 days)
F	360 days	4	0 (0%)	N.A.
G	350 days	8	4 (50%)	3 to 28 days (13 days)
H	180 days	6	6 (100%)	8 to 231 days (110 days)
I	390 days	8	8 (100%)	17 to 432 days (197 days)
J	400 days	4	2 (50%)	7 days (7 days)
Overall		63	45 (71%)	3 to 432 days (94 days)

Source: Audit analysis of EDB records

2.30 *Need to ensure that related party transactions are properly approved.* Funds of \$0.77 million were approved for Project A to organise a writing programme (see Table 7 in para. 2.27). Among the awards given to the outstanding contributors of proses were 26 book coupons issued by a publisher. The grantee and the publisher were two companies in the same company group. The grantee charged the total face value of \$9,100 for the 26 coupons to the project vote. The face value of each coupon ranged from \$200 to \$1,000. Audit noted that the project agreement did not stipulate the measures to be taken by the grantee in managing such related party transactions (e.g. seeking approval from the Secretariat in advance). Audit considers that the SCOLAR Secretariat needs to take measures to ensure that such transactions are properly approved.

2.31 *Need to step up measures against non-compliance with procurement requirements.* The project agreement stipulated the procurement requirements that should be adopted by project grantees. According to the agreement:

- (a) for purchase that is:
 - (i) less than \$5,000, no quotation is needed;
 - (ii) \$5,000 to \$50,000, more than one quotation should be obtained;
 - (iii) over \$50,000 to \$1,300,000, at least five quotations should be obtained; and
 - (iv) over \$1,300,000, tenders should be raised; and
- (b) cash payment should not be made in excess of \$1,000.

2.32 In checking the financial reports submitted by the project grantees, the SCOLAR Secretariat may inspect the grantees' vouchers to substantiate the nature of expenditure. Audit reviewed the records of inspections made by the Secretariat and noted that the Secretariat found non-compliances of procurement requirements in four of the ten projects (projects A, B, D and H), as follows:

Management of initiatives

- (a) three projects (projects A, B and H) did not comply with the quotation requirements. Single quotation was obtained for each procurement of the projects (see Table 9); and
- (b) one project (project D) made a cash payment of \$3,620 for the printing expenses of project material.

Table 9

Non-compliance with quotation requirements

Project	Product/service	Procurement amount	Quotation requirement not complied with
A	Rental of venue for activity	\$12,000	More than one quotation
B	Video production	\$83,000	At least five quotations
	Souvenir	\$69,000	More than one quotation
		\$10,350	
		\$12,350	
	Reader/log book with worksheet	\$35,500	
	Balls	\$26,660	
H	Rental of venue for activity	\$69,100	At least five quotations

Source: Audit analysis of EDB records

Remarks: Single quotation was obtained for each of the eight procurements.

The SCOLAR Secretariat raised queries with the four project grantees on the reasons for the non-compliance. Explanations given by the grantees were that the procurements were made from their designated suppliers or the procurements were urgent and there was no time to obtain quotations. Audit considers that the Secretariat needs to devise measures to ensure that the grantees comply with the procurement requirements (e.g. issuing verbal or written warnings to repeated or serious offenders).

2.33 *Need to promulgate measures for evaluation of projects.* The end-of-project reports submitted by project grantees were self-evaluation in nature. The Work Manual of the LF stated that:

- (a) apart from self-evaluation conducted by grantees, the SCOLAR Secretariat might also undertake an independent evaluation of the projects; and
- (b) the Secretariat should initiate an independent evaluation for:
 - (i) projects that have project duration longer than one year;
 - (ii) projects with approved grant exceeding \$1 million; and
 - (iii) projects that have a potential for wide dissemination.

Of the ten projects examined by Audit, one (project D) was over \$1 million and three (projects A, I and J) were over one year (see Table 7 in para. 2.27). However, no independent evaluations of these projects were conducted by the Secretariat. In March 2017, the EDB informed Audit that:

- (a) the criteria of undertaking independent evaluation were mainly for R&D projects on language learning and enhancing the learning environment;
- (b) for language education community projects, programme partners were required to conduct evaluation and collect feedback from participants. The projects were also monitored by the SCOLAR Secretariat through various reports and visits. WGs had been set up to plan and oversee the projects; and
- (c) the suitability of conducting independent evaluation for recent language education community projects was subject to review.

Management of sponsorship projects

2.34 *Need to take measures to enhance the appeal of sponsorship projects.* Before 2015/16, the LF did not call for applications for sponsorship projects. Organisations which would like to seek the LF's support submitted proposals to SCOLAR for approval on a case-by-case basis. Over the years, sponsorship projects have not been popular for a variety of reasons. For the three years from 2012/13 to 2014/15, there were only 15 applications for sponsorship projects (an average of 5 applications per year). Starting from 2015/16, an open-call exercise has been conducted annually to invite proposals aiming to attract more partners from the community. To promote sponsorship projects, the commencement of open-call exercises have been announced via different channels, including newspapers, the SCOLAR website and the Government online portal. Audit noted that the number of applications increased to seven and 12 for 2016/17 and 2017/18 respectively. The SCOLAR Secretariat needs to monitor the community's interest in the sponsorship projects and consider taking further measures to enhance their appeal.

Audit recommendations

2.35 *Audit has recommended that the Secretary for Education should:*

For promotional projects

- (a) **ensure that the requirements promulgated in the Work Manual relating to checks and visits are up-to-date;**
- (b) **update the Work Manual to promulgate guidelines on observation visits, specifying:**
 - (i) **the selection criteria and the frequency for visits; and**
 - (ii) **the requirement to conduct supervisory review on the visit results;**
- (c) **take measures to ensure timely submission of project reports by grantees;**

- (d) **take measures to ensure that expenditures charged to projects are proper;**
- (e) **take measures to ensure that the grantees comply with the procurement requirements;**
- (f) **ensure that the requirements promulgated in the Work Manual relating to independent project evaluation are up-to-date and are complied with; and**

For sponsorship projects

- (g) **take further measures to enhance the appeal of sponsorship projects.**

Response from the Government

2.36 The Secretary for Education generally agrees with the audit recommendations. He has said that:

For promotional projects

- (a) the SCOLAR Secretariat will ensure that the requirements promulgated in the Work Manual relating to checks and visits are up-to-date;
- (b) in carrying out observation visits for promotional projects, the SCOLAR Secretariat considers several factors such as the nature of an activity, experience of a programme partner, potential impacts of an activity, etc. The SCOLAR Secretariat will consider updating the Work Manual to promulgate clearer guidelines on the conduct and supervision of observation visits;
- (c) the SCOLAR Secretariat will consider measures to ensure timely submission of project reports by grantees;
- (d) the SCOLAR Secretariat will consider measures to ensure that expenditures charged to promotional projects are proper;

Management of initiatives

- (e) the SCOLAR Secretariat will consider measures to ensure that the grantees of promotional projects comply with the procurement requirements;
- (f) the SCOLAR Secretariat will ensure that the requirements promulgated in the Work Manual relating to independent project evaluation are up-to-date and are complied with; and

For sponsorship projects

- (g) the SCOLAR Secretariat will consider taking measures to further enhance the appeal of sponsorship projects.

Management of R&D projects

2.37 One of the terms of reference of SCOLAR is to identify R&D projects which are necessary for the enhancement of language proficiency and language in education, and to implement or oversee the satisfactory completion of such projects (see para. 1.4(d)). In the period from its establishment in March 1994 to June 2016, the Trustee approved \$167 million for 119 R&D projects, representing 5% of the total approved funding of \$3,703 million (see Figure 2 in para. 1.13). Of these 119 R&D projects, 86 (72%) were approved in the period from 1994 to 2002. In March 2014, with the new injection of \$5,000 million into the LF, conducting more longitudinal research and comparative studies was identified as one of the six strategic areas of the LF (see para. 1.12(a)).

2.38 R&D projects can be classified into the following two types:

- (a) ***Top-down R&D projects.*** The scope and duration of top-down R&D projects are determined by SCOLAR. Open or restricted tender exercises are conducted. Proposals are assessed by a designated vetting panel in accordance with the tendering procedures of the Government. In the period from March 2014 to June 2016, \$4 million was approved for two top-down projects; and
- (b) ***Bottom-up R&D projects.*** Starting from March 2014, apart from the top-down approach, SCOLAR has also adopted a bottom-up approach of inviting applications through open-call exercises. Proposals from

education institutions such as schools, tertiary education institutions and educational bodies are invited. Priority areas/themes on language learning/development and pedagogy are identified by SCOLAR whereas the actual topic, and scope and duration of the projects are proposed by the applicants. Proposals are assessed by a Vetting Committee (Note 5), taking into consideration the views of external language experts. In the period from March 2014 to June 2016, one round of open-call exercise was conducted for application for bottom-up projects. A total of 37 applications were received and 24 were approved. The aggregate funding approved for the 24 projects was \$48 million. As at 31 January 2017, 23 of the 24 projects were still in progress (one project was terminated). A new round of open-call exercise commenced in March 2017.

2.39 *Need to ensure that qualified or conditional recommendations of Vetting Committee members are properly followed up.* Each application for bottom-up R&D projects was assessed by three members of the Vetting Committee formed under the WG on Language Education Research by circulation. Each member had to complete a standard vetting form by choosing whether or not to recommend the application for funding approval. Applications with at least two votes of recommendation would then be recommended for funding approval. Audit examined the 24 approved projects. In one project applying for funding of \$7.5 million, although the three members recommended the project for funding approval, their recommendations were subject to the following reservations or conditions:

- (a) Member A said that the budget of \$7.5 million needed to be substantially revised. Items like teaching relief might have to be deleted, and the number of senior research assistants and research assistants as well as the number of conference attendance needed to be cut down to make the budget more realistic;
- (b) Member B said that the project was very expensive; and
- (c) Member C said that the project was a worthwhile project but cost too much, and the headcount and staff costs were not well justified.

Note 5: *The Vetting Committee comprised three SCOLAR members and three non-SCOLAR members who possessed language or language education research background and expertise.*

Management of initiatives

There is no documentary evidence showing that the SCOLAR Secretariat had taken follow-up action on the reservations. The SCOLAR Secretariat needs to take measures to ensure that recommendations subject to reservations or conditions, especially those concerning project costs, are clarified and followed up. In March 2017, the EDB said that the SCOLAR Secretariat had followed up with the three members concerned.

Audit recommendations

2.40 **Audit has recommended that the Secretary for Education should:**

- (a) **take measures to ensure that recommendations subject to reservations or conditions, especially those concerning project costs, are clarified and followed up; and**
- (b) **document the results of the follow-up action to support the recommendations of the Vetting Committee.**

Response from the Government

2.41 The Secretary for Education generally agrees with the audit recommendations. He has said that:

- (a) the SCOLAR Secretariat has already conducted the review of R&D projects (bottom-up) in September 2016 and reported the outcomes to SCOLAR in December 2016. Endorsed by SCOLAR, the Guide to Applicants has been revised to make clearer the principles for allowable and unallowable costs to assist applicants in preparing budget proposals. The SCOLAR Secretariat will take measures to ensure that recommendations subject to reservations or conditions, if any, are distinguished from clear recommendations and are followed up accordingly; and
- (b) the SCOLAR Secretariat will document the results of the follow-up action on recommendations subject to reservations or conditions, if any, to support the recommendations of the Vetting Committee.

PART 3: GOVERNANCE AND ADMINISTRATIVE ISSUES

3.1 This PART examines governance and administrative issues. Audit found room for improvement in the following areas:

- (a) governance of SCOLAR (paras. 3.2 to 3.13); and
- (b) administrative issues (paras. 3.14 to 3.26).

Governance of SCOLAR

3.2 SCOLAR was set up in 1996 to advise the Government on the use of the LF and language education policy and initiatives. As at 30 November 2016, SCOLAR comprised a non-official chairman, 12 non-official members and six ex-officio members. SCOLAR members are appointed by the Secretary for Education under the delegated authority of the Chief Executive. The term of each SCOLAR membership is two years. The current term of membership is from 1 July 2015 to 30 June 2017.

Need to improve management of conflicts of interest

3.3 Since July 2015, SCOLAR has adopted a two-tier reporting system to manage conflicts of interest. Under the two-tier reporting system:

- (a) at the first tier, members are required to submit a Declaration Form to register their personal interests, direct or indirect, pecuniary or otherwise, when they first join SCOLAR, and update the Forms annually. The Forms submitted by members are made available for inspection on request by public; and
- (b) at the second tier, if a member has any direct personal or pecuniary interest in any matter under consideration by SCOLAR, the member must disclose to the chairman prior to the discussion of the related item.

Governance and administrative issues

3.4 For the appointment of SCOLAR members for the term from 1 July 2015 to 30 June 2017, the SCOLAR Secretariat issued the appointment letters on 5 June 2015. However, the SCOLAR Secretariat did not send the Declaration Forms together with the appointment letters. The Secretariat only sent the Declaration Forms via emails to members on 3 July 2015 (i.e. two days after the commencement of the term).

3.5 The emails sent to members on 3 July 2015 stated that members should return the completed Declaration Forms by 17 July 2015. Audit noted that of the 18 members (Note 6), 9 members returned the Declaration Forms more than 30 days after the commencement of the term (see Table 10).

Table 10

**Analysis of late returns of Declaration Forms by SCOLAR members
(for the term from 1 July 2015 to 30 June 2017)**

Number of days after commencement of term	Number of members	} 9 members
1 to 30	9	
31 to 60	6	
61 to 90	2	
91 to 150	0	
151 to 180	1	
Total	18	

Source: Audit analysis of EDB records

Note 6: *One ex-officio member retired during the term. Her successor was appointed in October 2015. Audit did not include this member in the audit analysis.*

3.6 Under the two-tier reporting system, members are required to update annually their personal interests (see para. 3.3(a)). The annual declaration for the second year of the current term should be made by members on or before 1 July 2016. In response to Audit's enquiry in November 2016, the SCOLAR Secretariat sent out the Declaration Forms to members in the same month. Up to 31 January 2017, four members had not returned the Declaration Forms.

3.7 Audit considers that the SCOLAR Secretariat needs to urge members to submit their Declaration Forms in a timely manner by:

- (a) sending out the Declaration Forms to appointees in good time so that they can return the Forms in a timely manner; and
- (b) taking action (e.g. sending reminders to members) to follow up outstanding declarations.

Attendance rates of meetings and members

3.8 Audit examined the attendance rates of members at meetings of SCOLAR and its eight WGs from the commencement of the current term on 1 July 2015 up to 31 October 2016. Audit noted that the attendance rates of members in SCOLAR meetings and WG meetings were in general satisfactory. Many WGs only held one meeting during the period (see Table 11).

Table 11

**Average attendance rates of members at meetings of SCOLAR and WGs
(1 July 2015 to 31 October 2016)**

Meeting	Number of members	Number of meetings held	Average attendance of meeting(s) held
SCOLAR	19	5	74%
WG on Language Education Research	11	1	100%
WG on Promotion of English	7	2	93%
WG on Workplace English Campaign	3	1	67%
WG on Grant Schemes	5	1	80%
WG on Task Force on Language Support	4	1	100%
WG on Promotion of Chinese	5	2	70%
WG on Sponsorship and Partnership	4	1	50%
WG on Support Scheme on Early Language and Literacy Development	5	1	80%
Overall		15	79%

Source: Audit analysis of EDB records

3.9 Audit further examined the attendance rate of each member at SCOLAR meetings and WG meetings. The examination revealed that the attendance rates of some members were on the low side. Of the 19 members, the overall attendance rates of four members (Members D, E, F and G) were below 50% (see Table 12). They were all non-official members. Three (Members D, E and F) were reappointed members. Audit examined the attendance rates of the three reappointed members in their previous term. Audit found that the attendance rate of Member D in the previous term was also low (38%). Audit considers that the SCOLAR Secretariat needs to take measures to improve the attendance rates of those members with low attendance records, and to take into consideration members' attendance records when making recommendations to the Secretary for Education for their reappointment.

Table 12

**Four non-official members with overall attendance rates less than 50%
(1 July 2015 to 31 October 2016)**

Member	SCOLAR meeting		WG meeting		Overall	
	Number of meetings (a)	Attendance rate	Number of meetings (b)	Attendance rate	Number of meetings (c) = (a) + (b)	Attendance rate
D	5	20%	2	100%	7	43%
E		40%		50%		43%
F		40%		0%		29%
G		20%	3	33%	8	25%

Source: Audit analysis of EDB records

Quorum of meetings

3.10 Decisions made and agreements reached during SCOLAR meetings and WG meetings are important. For example, of the eight WGs, four WGs (namely the WGs on Language Education Research, Promotion of English, Promotion of Chinese, and Sponsorship and Partnership) are responsible for assessing applications of the LF initiatives and giving recommendations to SCOLAR for endorsement. For SCOLAR meetings, a quorum of 50% of all members was set. However, Audit noted that there was no laid-down quorum requirement for WG meetings. In March 2017, the EDB informed Audit that in practice there were quorum requirements for WG meetings and the requirements were observed. However, Audit noted that there was no documentary evidence showing that there were actually such requirements and what the requirements were. As a good governance practice, the SCOLAR Secretariat needs to specify quorum requirements for WG meetings and communicate them to members.

Composition of WGs

3.11 For the current term (from 1 July 2015 to 30 June 2017), SCOLAR comprises six ex-officio members and 13 non-official members (including the chairman). Of the 13 non-official members, five are from the education sector and

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eight (including the chairman) are from the community (e.g. business, vocational training and media). SCOLAR members are free to join any of the eight WGs at the beginning of the membership term (see para. 1.6). Audit analysed the composition of each WG and found that two of the WGs (WGs on Workplace English Campaign and Sponsorship and Partnership) did not have any non-official member from the education sector (see Table 13). In Audit's view, while there are fewer members from the education sector and they join the WG on a voluntary basis, there is merit for the SCOLAR Secretariat to invite non-official members from both the education sector and the community to join each WG so that issues are considered from different perspectives.

Table 13

**Background of WG members
(28 February 2017)**

WG	Number of ex-officio members (a)	Number of non-official members from the education sector (b)	Number of non-official members from the community (c)	Total (d) = (a) + (b) + (c)
Language Education Research	3	4	4	11
Promotion of English	1	2	4	7
Workplace English Campaign	1	0	2	3
Grant Schemes	2	2	1	5
Task Force on Language Support	2	1	1	4
Promotion of Chinese	1	1	3	5
Sponsorship and Partnership	1	0	3	4
Support Scheme on Early Language and Literacy Development	1	3	1	5

Source: Audit analysis of EDB records

Audit recommendations

- 3.12 **Audit has *recommended* that the Secretary for Education should:**
- (a) **take measures to ensure that Declaration Forms on conflicts of interest are submitted by members in a timely manner, including:**
 - (i) **sending out the Declaration Forms to appointees in good time before the membership term starts; and**
 - (ii) **taking action (e.g. sending reminders to members) to follow up outstanding declarations;**
 - (b) **take measures to improve the attendance rates of SCOLAR members with low attendance records;**
 - (c) **take into consideration SCOLAR members' attendance records in deciding their reappointment;**
 - (d) **set out the rules on quorum requirements for WG meetings in the Work Manual; and**
 - (e) **endeavour to include non-official members from both the education sector and the community in all WGs as far as possible.**

Response from the Government

3.13 The Secretary for Education generally agrees with the audit recommendations. He has said that:

- (a) the SCOLAR Secretariat will send out the forms for declaration of interests to members as soon as practicable, remind members concerned and follow up if there are outstanding declarations;
- (b) the SCOLAR Secretariat normally proposes a few options and informs members of tentative meeting dates about three months in advance. It

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would endeavour to arrange meeting time and date which suits members' schedule as far as possible, and send reminders to members before a meeting;

- (c) the EDB will regard attendance as one of the various factors in considering reappointment;
- (d) the SCOLAR Secretariat will include the quorum requirement for WG meetings when revising the Work Manual, although this requirement has all along been practised; and
- (e) the SCOLAR Secretariat will enlist members' support so that each WG will contain a suitable number of members representing the education sector and the community.

Administrative issues

Need to enhance monitoring of the effectiveness of the LF

3.14 Over the years, Members of the Panel on Education of LegCo have expressed concerns on whether the LF had helped enhance language education and promote the language proficiency of people in Hong Kong. In December 2013, the EDB submitted a paper to seek the views of the Panel on Education on the proposed seventh round of injection of \$5,000 million (see para. 1.9) into the LF. To make use of the proposed injection, the EDB identified six strategic areas and proposed short-term initiatives and medium-and-long-term initiatives under each of the six strategic areas (see para. 1.12).

3.15 When deliberating the proposed injection, some Members opined that giving a blanket approval for the one-off injection would weaken LegCo's ability to monitor the use of public resources on individual projects. On 10 January 2014, the EDB sought the approval from the FC of LegCo for the proposed injection. During the FC meeting, Members enquired whether the EDB would report to the Panel on Education each year the impact and achievements of the LF. Members also considered that the EDB needed to illustrate the effectiveness of the LF in meeting its objectives by using suitable performance indicators.

3.16 In November 2015 and July 2016, the EDB reported to the Panel on Education the progress of the planning and implementation of the short-term and medium-and-long-term initiatives under the six strategic areas. Audit noted that the EDB reported the general status of the initiatives (e.g. the time an initiative was launched) but did not report the impact and achievements of the initiatives, such as the funding allocated, funding spent and numbers of beneficiaries of the initiatives. Also, up to January 2017, the EDB had not developed performance indicators to monitor the effectiveness of the LF.

3.17 Performance indicators provide a means to measure how well the LF has performed and facilitate stakeholders to assess whether the LF has produced the desired outcomes in an efficient and cost-effective manner. In Audit's view, to enhance the accountability of the LF and to address the concerns of LegCo Members (see para. 3.15), the EDB needs to develop suitable performance indicators for the LF. It has been more than three years since the seventh round of injection in March 2014 and all the short-term initiatives were launched. In the coming progress reports to LegCo, the EDB needs to provide more details on the effectiveness of the LF in meeting its objectives.

3.18 In March 2017, the EDB informed Audit that:

- (a) there were already certain performance targets for projects, including the number of beneficiaries and budgets, set out in the papers submitted to LegCo. The EDB also reported the progress and achievements of projects at SCOLAR meetings where appropriate;
- (b) for those applications which were bottom-up initiatives, the number of approved projects in each year depended on the number of applications received, and most importantly, the quality of project proposals submitted by applicants. It was impractical to set outcome targets such as the number of approved projects and the number of beneficiaries for applications of these bottom-up initiatives; and
- (c) the EDB would continue to work with SCOLAR to consider how best to further improve the LF's performance measurement. The EDB would also consider providing more information on the LF projects in the progress reports to SCOLAR and LegCo.

Financial management of the LF

3.19 After an initiative is approved by the Trustee, the amount of funding allocated to the initiative will be earmarked to a project account created for the initiative in a project database maintained by the SCOLAR Secretariat. After the completion of the initiative and all expenditure has been charged to the project account, according to the procedures of the Secretariat, the Secretariat would close the project account and any unused balance of the earmarked funding would be ploughed back to the LF to support other initiatives.

3.20 *Need to expedite closure of project accounts.* As at 30 June 2016, there were 68 initiatives recorded as “ongoing” in the project database. Audit examination revealed that of the 68 initiatives, only 55 (81%) initiatives were in progress. For the remaining 13 (19%) initiatives, 12 had been completed and 1 had been terminated. Of these 13 initiatives, 6 had been completed/terminated for over 1 year and their unspent balance amounted to \$61.1 million (see Table 14). According to the SCOLAR Secretariat, the closure of project accounts hinges on a number of factors, for example, submission of final report, settlement of all payments, acceptance of audited report, and refund of unused balance from applicant school. Audit considers that the SCOLAR Secretariat needs to take effective measures to expedite the closure of project accounts of the completed/terminated initiatives with a view to releasing the unspent funding to support other new initiatives as soon as possible.

Table 14

**Ageing analysis of 13 completed/terminated initiatives
with project account not yet closed
(30 June 2016)**

Time elapsed after project completion/termination	Number of initiatives	Amount of unspent balance (\$ million)
≤ 3 months	3	1.5
> 3 months to 6 months	2	3.2
> 6 months to 12 months	2	1.8
> 12 months to 24 months	4	60.3
> 24 months to 48 months	1	0.7
> 48 months to 160 months	1	0.1
Total	13	67.6

} \$61.1 million

Source: Audit analysis of EDB records

Investment management of the LF

3.21 In the first six rounds of injection, both the principal and accrued interest were used to support initiatives launched by the LF. Due to the cashflow requirement and the relatively short time horizon, the investment strategy of the LF was to place funds into banks as saving/fixed deposits. With the change in its financing mode since the seventh round of injection, in March 2014, the LF placed the \$5,000 million obtained in the seventh round of injection with the Exchange Fund with a view to earning a higher return (Note 7).

Note 7: As a reference, the average annual return of placement with the Exchange Fund of the three-year period from 2011 to 2013 was 5.5% (ranged from 5% to 6%), whilst the interest rates on the fixed deposits placed by the LF as at 31 August 2013 (its financial year end date) only ranged from 0.88% to 1.31%. The average annual return of the Exchange Fund was higher than fixed deposits.

Need to report investment performance to SCOLAR

3.22 In December 2013, the EDB informed the Panel on Education that:

- (a) a 5% rate of return was assumed on the placement with the Exchange Fund;
- (b) in times of market volatilities, the LF might have to adjust the relevant expenditure in the light of the reduced investment income; and
- (c) some programmes might be scaled down or deferred for implementation.

3.23 Audit noted that the SCOLAR Secretariat only reported to SCOLAR the fund balance available for the LF to support new initiatives but did not report its investment performance. As poor investment performance may cause the LF to scale down or defer implementation of its initiatives, Audit considers that the investment return of the LF was an important piece of information to SCOLAR. The SCOLAR Secretariat needs to inform SCOLAR the investment performance of the LF on a regular basis. In March 2017, the EDB informed Audit that:

- (a) the return for placement with the Exchange Fund for the current year and the projected return were announced in the Medium Range Forecast when the Budget was announced. The investment performance was presented at SCOLAR meetings when appropriate and upon enquiry from SCOLAR members; and
- (b) the SCOLAR Secretariat would arrange to report such information to SCOLAR on a regular basis.

Need to identify and fund more worthwhile initiatives

3.24 In December 2013, the EDB informed the Panel on Education that the investment return from the placement with the Exchange Fund would be used to fund support measures to schools and teachers, R&D projects and language education community projects. In the period from the placement with the Exchange Fund in March 2014 to June 2016, the interest income earned from the

Exchange Fund was \$513.3 million. Audit analysed the funding approved by the LF since March 2014 and found that:

- (a) the amount of funding approved to support new initiatives decreased from \$159 million in 2014 (from March to December) to \$7 million in 2016 (from January to June) (see Table 15); and

Table 15

**Funding approved to support new initiatives
(March 2014 to June 2016)**

Year	Amount (\$ million)
2014 (from 1 March)	159
2015	96
2016 (up to 30 June)	7
Total	262

Source: Audit analysis of EDB records

- (b) the actual total funding of \$262 million approved for the period from March 2014 to June 2016 was \$251.3 million (49%) less than the interest income of \$513.3 million earned from the Exchange Fund.

Audit considers that the SCOLAR Secretariat needs to endeavour to identify more worthwhile initiatives and seek endorsement from SCOLAR on funding these initiatives with a view to enhancing the language proficiency of the people of Hong Kong.

Audit recommendations

3.25 Audit has recommended that the Secretary for Education should:

- (a) **step up efforts in developing suitable performance indicators for the LF and provide more details of the effectiveness of the LF in the progress reports to LegCo;**

- (b) expedite the closure of project accounts of completed/terminated initiatives with a view to releasing unspent earmarked funding to support other new initiatives;
- (c) report to SCOLAR the investment performance of the LF on a regular basis; and
- (d) endeavour to identify and fund more worthwhile initiatives with a view to enhancing the language proficiency of Hong Kong people.

Response from the Government

3.26 The Secretary for Education generally agrees with the audit recommendations. He has said that:

- (a) the SCOLAR Secretariat will seek to develop appropriate performance targets for LF projects and consider providing more information on the projects in progress reports to LegCo;
- (b) the closure of project accounts hinges on several factors, for example, submission of final report, settlement of all payments, acceptance of audited report, refund of unused balance from applicant school, etc., which may take time to complete. The SCOLAR Secretariat will continue to take necessary follow-up actions to close the accounts of completed projects;
- (c) the SCOLAR Secretariat will arrange to report the investment performance of the LF to SCOLAR on a regular basis; and
- (d) as reported to the Panel on Education of LegCo in June 2016, SCOLAR had already implemented various short-term learner-centred initiatives in 2014 and 2015 while some of the medium-and-long-term initiatives have started to be implemented since 2016. SCOLAR will continue to identify and fund worthwhile initiatives with a view to enhancing the language proficiency of Hong Kong people.

PART 4: LANGUAGE PROFICIENCY OF STUDENTS AND WORKING ADULTS

4.1 This PART examines the language proficiency of students and working adults. Audit found room for improvement in the following areas:

- (a) language proficiency of students (paras. 4.2 to 4.6); and
- (b) language proficiency of working adults (paras. 4.7 to 4.12).

Language proficiency of students

Need to keep in view the Chinese and English language proficiency of students

4.2 The EDB uses the following assessments to assess the Chinese and English language proficiency of students:

- (a) **TSA.** The TSA (Note 8) is an assessment administered at the territory level. It facilitates assessment for learning by providing schools with objective data on students' performances in the three subjects of Chinese, English and Mathematics at the end of Primary 3, Primary 6 and Secondary 3. The TSA results provide information about students' strengths and weaknesses against specific basic competencies (Note 9); and

Note 8: *In February 2016, a review of the operation and implementation arrangements of the TSA was completed. Based on the results of the review, the EDB adopted a number of changes to the TSA for Primary 3 students. A Tryout Study was subsequently conducted from May to December 2016, with the participation of about 50 primary schools. Based on the feedback collected in the Tryout Study, the EDB announced in January 2017 that a Basic Competency Assessment Research Study covering all primary schools would be carried out in 2017 with a view to further enhancing the arrangements for the TSA.*

Note 9: *Basic competency is the minimally acceptable level from which a student should be able to continue to the next key stage of learning without extra learning support.*

- (b) *Hong Kong Diploma of Secondary Education Examination (HKDSEE)*. In the HKDSEE, standards-referenced reporting is adopted to report candidates' assessment results. Candidates' levels of competencies are reported with reference to eight defined standards, namely "Unclassified" (worst), "Level 1", "Level 2", "Level 3", "Level 4", "Level 5", "Level 5*" and "Level 5**" (best). The HKDSEE is recognised by both local and overseas tertiary institutions for students' further study. HKDSEE results are also accepted for civil service appointment purpose from July 2012 onwards. For articulation to sub-degree programmes, a student should attain at least "Level 2" for Chinese and English Languages. For articulation to degree programmes, a student should attain at least "Level 3" for Chinese and English Languages.

Using the results of the Chinese and English Languages under the TSA and the HKDSEE, the EDB assesses the overall Chinese and English language proficiency of students at Primary 3, Primary 6, Secondary 3 and Secondary 6.

4.3 Audit analysed the TSA results from 2007 to 2016 and the HKDSEE results of the Chinese and English Languages from 2012 (since it has been introduced) to 2016, and noted that:

- (a) according to the TSA results in the period from 2007 to 2016, over 20% and over 30% of Secondary 3 students did not meet the basic competencies in Chinese Language and English Language respectively (see Tables 16 and 17); and
- (b) for the HKDSEE, although the percentage of students attaining "Level 3" and above increased from 50% in 2012 to 55.4% in 2016 in Chinese Language and from 50.1% in 2012 to 55.1% in 2016 in English Language, there were about 15% and 20% of students who did not attain "Level 2" or above in Chinese Language and English Language respectively in 2016 (see Tables 18 and 19).

Table 16

**TSA results for Chinese Language
(2007 to 2016)**

Year	Percentage of students not achieving basic competency (%)		
	Primary 3	Primary 6	Secondary 3
2007	15.1	23.3	23.8
2008	14.6	23.6	23.5
2009	—	—	23.5
2010	14.1	23.0	23.2
2011	13.6	22.8	23.3
2012	13.9	—	23.1
2013	13.4	21.9	22.9
2014	13.7	—	23.0
2015	13.6	22.3	22.8
2016	14.2	—	22.6

Source: Audit analysis of EDB records

Remarks: Due to the suspension of primary schools caused by Human Swine Influenza, the TSA for Primary 3 and Primary 6 students were not conducted in 2009. Also, starting from 2012, the TSA for Primary 6 students has been suspended in even years.

Table 17**TSA results for English Language
(2007 to 2016)**

Year	Percentage of students not achieving basic competency (%)		
	Primary 3	Primary 6	Secondary 3
2007	20.5	28.7	30.8
2008	20.7	28.5	31.1
2009	—	—	31.2
2010	20.8	28.4	30.8
2011	20.2	28.3	30.8
2012	20.3	—	30.9
2013	19.6	27.6	30.5
2014	19.7	—	30.7
2015	19.6	28.0	30.6
2016	18.9	—	30.4

Source: Audit analysis of EDB records

Remarks: Due to the suspension of primary schools caused by Human Swine Influenza, the TSA for Primary 3 and Primary 6 students were not conducted in 2009. Also, starting from 2012, the TSA for Primary 6 students has been suspended in even years.

Language proficiency of students and working adults

Table 18

HKDSEE results for Chinese Language (2012 to 2016)

Year	Percentage of Secondary 6 students attaining the defined standards (%)									
	Level 5**	Level 5*	Level 5	Level 4	Level 3	Level 3 and above	Level 2	Level 1	Unclassified	Total
2012	0.8	2.7	5.0	18.4	23.1	50.0	29.3	16.8	3.9	100
2013	0.9	2.7	5.2	18.7	24.8	52.3	28.4	15.7	3.6	100
2014	0.8	2.4	4.7	17.9	26.1	51.9	28.5	16.2	3.4	100
2015	0.8	2.2	4.6	17.9	27.2	52.7	29.2	15.4	2.7	100
2016	0.9	2.9	5.5	18.8	27.3	55.4	29.8	12.5	2.3	100

Source: Audit analysis of EDB records

Table 19

HKDSEE results for English Language (2012 to 2016)

Year	Percentage of Secondary 6 students attaining the defined standards (%)									
	Level 5**	Level 5*	Level 5	Level 4	Level 3	Level 3 and above	Level 2	Level 1	Unclassified	Total
2012	0.8	2.4	4.6	16.0	26.3	50.1	29.1	10.8	10.0	100
2013	1.0	2.9	5.7	16.0	23.2	48.8	29.0	13.1	9.1	100
2014	1.0	3.1	5.9	16.5	26.3	52.8	25.1	12.1	10.0	100
2015	0.9	2.7	5.3	17.2	26.3	52.4	26.9	12.6	8.1	100
2016	1.0	3.2	6.2	18.2	26.5	55.1	25.2	10.8	8.9	100

Source: Audit analysis of EDB records

In Audit's view, the EDB needs to keep in view the Chinese and English language proficiency of students and, when necessary, seek advice from SCOLAR on the improvement measures.

Need to develop assessment instruments for Putonghua proficiency of students

4.4 Before 2012, the Putonghua proficiency of Secondary 5 students could be assessed by making reference to the Hong Kong Certificate of Education Examination results in Putonghua. With the introduction of the New Senior Secondary academic structure in 2009, the Hong Kong Certificate of Education Examination was discontinued in 2012. Since then, no tools have been available to measure the Putonghua proficiency of students. In Audit's view, the EDB needs to seek advice from SCOLAR on the development of a set of assessment instruments for gauging Putonghua proficiency of students at various stages of education.

Audit recommendations

- 4.5 **Audit has recommended that the Secretary for Education should:**
- (a) **monitor the Chinese and English language proficiency of students and, if necessary, seek advice from SCOLAR on the improvement measures; and**
 - (b) **seek advice from SCOLAR on the development of a set of assessment instruments for gauging Putonghua proficiency of students.**

Response from the Government

4.6 The Secretary for Education generally agrees with the audit recommendations. He has said that SCOLAR will continue to advise the EDB on:

- (a) measures/initiatives for enhancing biliteracy and trilingualism of students in Hong Kong; and
- (b) different ways for gauging Putonghua proficiency of students.

Language proficiency of working adults

4.7 To evaluate the language competencies of working adults, SCOLAR refers to the results of various language landscape studies funded by the LF. These studies are mainly conducted through surveys and questionnaires in which information on the language proficiency is collected by self-evaluations of the respondents.

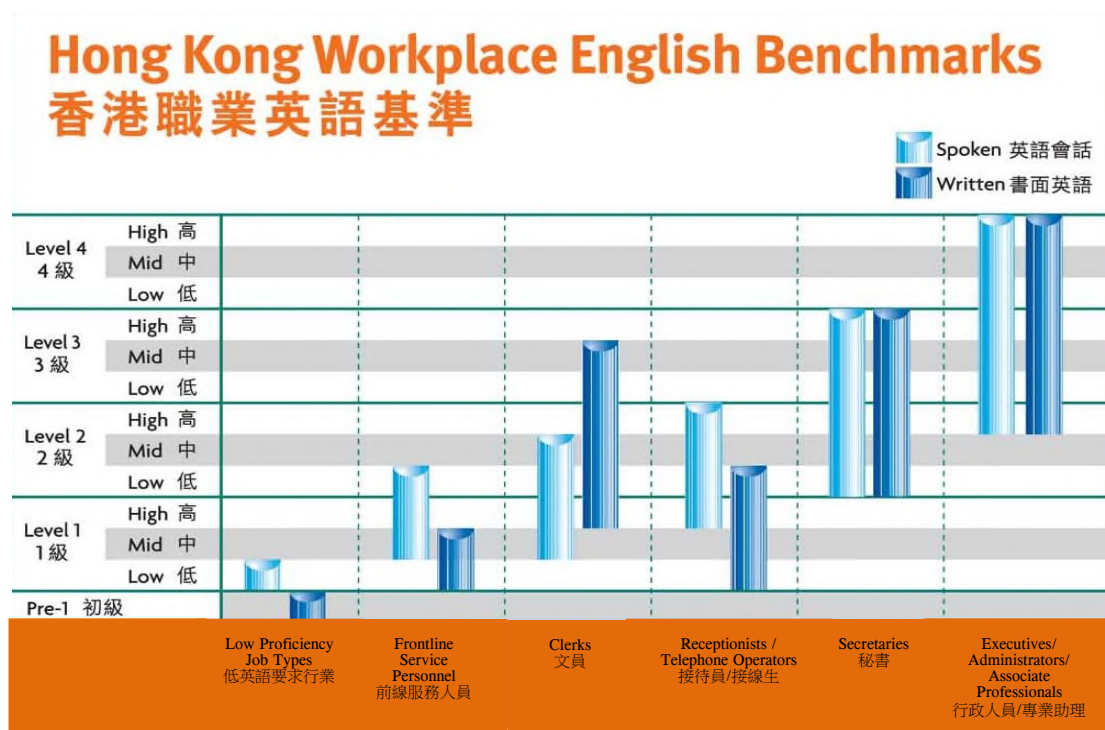
4.8 In 2000, the Workplace English Campaign (Note 10) developed the Hong Kong Workplace English Benchmarks (HKWEB) to help working adults evaluate if the expected English language competencies are achieved and to give them a clear target to work towards. HKWEB specified the standards of English in writing and speaking that employees of six job types (Note 11) should strive to attain. HKWEB has four proficiency levels (Level 4 being the highest). Each level is further sub-divided into three sub-levels (low, mid and high). For each job type, a specific range of proficiency level in spoken and written English is set separately to reflect the range of competency desired for employees in that job type. For example, the desired levels of competency in spoken and written English for secretaries are from Level 2 (low) to Level 3 (high) (see Figure 3).

Note 10: *The Workplace English Campaign is an initiative fully funded by the LF. It was launched in 2000 with the aims to heighten public awareness of the importance of having a good command of English in a workplace environment and to improve the knowledge of English among the working population in Hong Kong.*

Note 11: *The six job types are low proficiency job types, frontline service personnel, clerks, receptionists/telephone operators, secretaries and executives/administrators/associate professionals.*

Figure 3

HKWEB of six job types



Source: Workplace English Campaign website

4.9 HKWEB Levels are aligned with 17 international business English examinations administered by internationally recognised examination bodies, such as IELTS (International English Language Testing System — Note 12). Employees can convert the results of the 17 international business English examinations to the corresponding HKWEB Levels. For example, a score of 6.0 in IELTS is equivalent to Level 3 (mid) in HKWEB. Appendix E shows the list of the 17 international business English examinations aligned to HKWEB.

Note 12: *IELTS is an internationally validated English testing instrument. Its results are reported on a band scale from 0 to 9 (9 being the highest).*

4.10 Since 2011, SCOLAR has conducted several language landscape studies on the language use and expected language competency of Hong Kong people, including the Thematic Household Surveys 2012 and 2015 (Note 13). SCOLAR will start a gap analysis study in 2017 to examine the language competencies of employees and the language competencies expected by employers in Hong Kong and will conduct Thematic Household Survey 2018. The EDB needs to keep in view the results of the gap analysis study and the Thematic Household Survey to be conducted by the SCOLAR Secretariat on the English language proficiency of working adults and, in consultation with SCOLAR, take measures to facilitate working adults to assess how well their language proficiency meets the expectation of the employers.

Audit recommendation

4.11 **Audit has *recommended* that the Secretary for Education should keep in view the results of the gap analysis study and the Thematic Household Survey to be conducted by the SCOLAR Secretariat on the English language proficiency of working adults and, in consultation with SCOLAR, take measures to facilitate working adults to assess how well their language proficiency meets the expectation of the employers.**

Response from the Government

4.12 The Secretary for Education generally agrees with the audit recommendation. He has said that the Thematic Household Survey on the Use of Language in Hong Kong has been commissioned by SCOLAR every three years since 2012 to identify the trends, patterns or gaps in language competencies (spoken and written Chinese and English) of different age groups. The gap analysis study, which will commence in 2017, aims to examine the language competencies of employees and the language competencies expected by employers in Hong Kong. Findings of the Survey and the study will inform SCOLAR and the EDB the language competencies of working adults in Hong Kong.

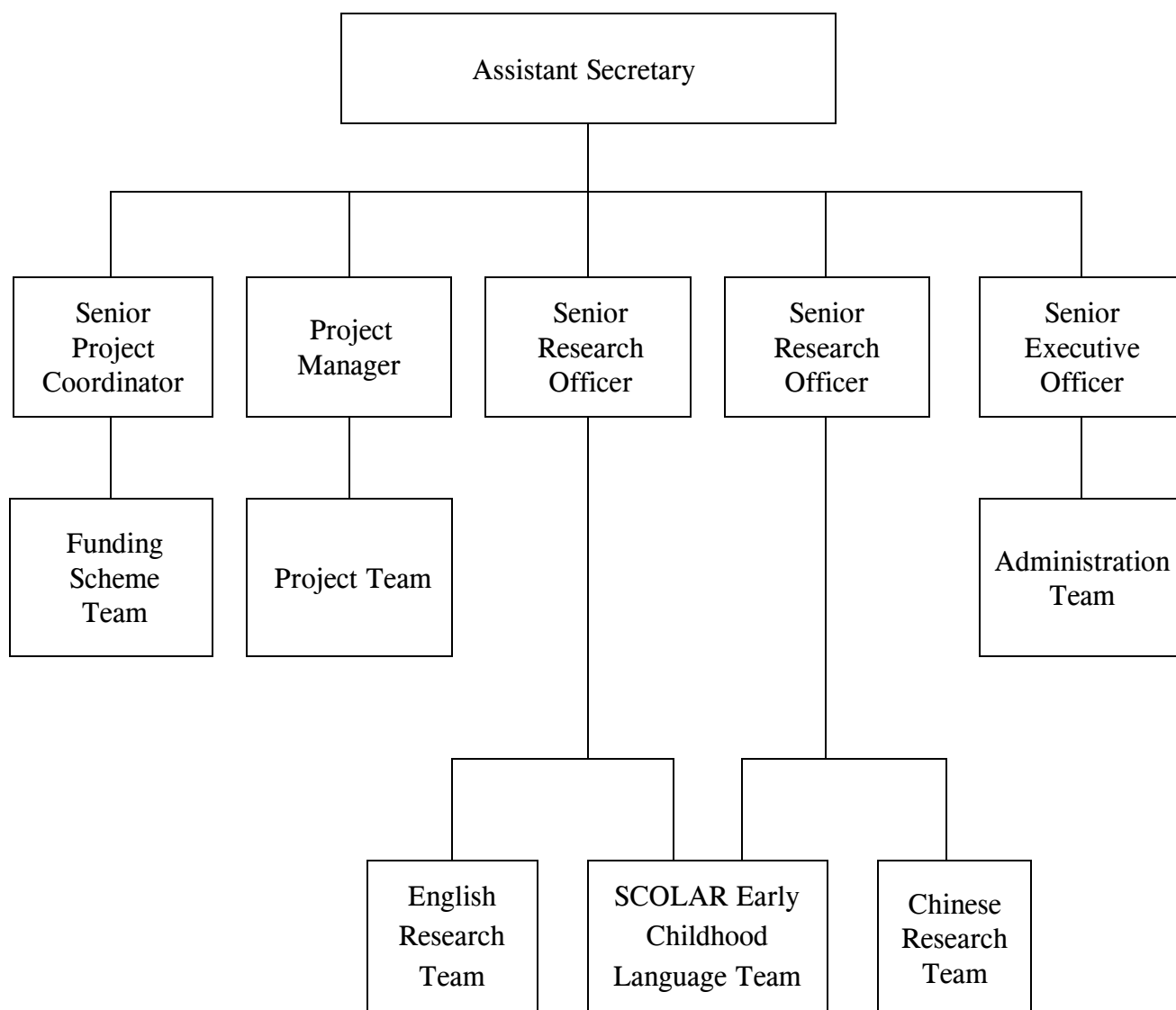
Note 13: *According to the Surveys 2012 and 2015, the percentages of economically active respondents (including employed persons and unemployed persons) who perceived having “very good” or “good” written English decreased from 26.8% in 2012 to 25.8% in 2015, and those who perceived having “very good” or “good” spoken English decreased from 26.4% in 2012 to 25.3% in 2015.*

Functions and compositions of SCOLAR WGs (28 February 2017)

WG		Function	Composition
1	Grant Schemes	to monitor the implementation of the PDIGS, the EEGS and the Professional Enhancement Grant Scheme for Chinese Teachers (Teaching Chinese as a Second Language), and to conduct review of the schemes, if necessary	3 non-official members and 2 ex-officio members
2	Language Education Research	- to recommend conducting language education researches that help provide useful insights to policy recommendation; and - to plan and oversee the implementation of various language-related research studies	8 non-official members and 3 ex-officio members
3	Promotion of Chinese	- to plan and oversee the promotion work on Chinese (including Putonghua); - to draw up and review the guidelines in approving funding applications from various organisations in carrying out Chinese language-related projects; and - to monitor the implementation of using Putonghua as the Medium of Instruction for Teaching the Chinese Language subject and to conduct review, if necessary	4 non-official members and 1 ex-officio member
4	Promotion of English	to plan and oversee the promotion work on English	6 non-official members and 1 ex-officio member
5	Sponsorship and Partnership	- to identify opportunities for networking with other organisations, leveraging their expertise and nurturing closer collaboration with them in the implementation of various language-related projects; and - to recommend the mode of cooperation with other organisations	3 non-official members and 1 ex-officio member
6	Support Scheme on Early Language and Literacy Development	to monitor the implementation of the Scheme on Early language and Literacy Development in Chinese and English Language of Young Children	4 non-official members and 1 ex-officio member
7	Task Force on Language Support	to monitor the implementation of the Task Force on Language Support	2 non-official members and 2 ex-officio members
8	Workplace English Campaign	to draw up and review the guidelines in approving funding applications from various organisations in carrying out English language-related projects	2 non-official members and 1 ex-officio member

Source: EDB records

SCOLAR Secretariat: Organisation chart (extract)
(31 December 2016)



Source: EDB records

**Allocation of funding to initiatives analysed by languages
(March 1994 to June 2016)**

Year	Amount of funding allocated to initiatives (\$ million)				
	Chinese	English	Cross- languages	Putonghua	Total
1994 (from March)	9	18	6	3	36
1995	15	36	1	3	55
1996	7	20	20	1	48
1997	3	4	1	3	11
1998	28	89	2	1	120
1999	1	95	1	3	100
2000	0	10	1	0	11
2001	0	17	1	0	18
2002	0	9	0	10	19
2003	9	6	808	25	848
2004	0	2	2	5	9
2005	3	12	2	3	20
2006	0	910	11	5	926
2007	233	102	1	5	341
2008	1	23	1	21	46
2009	0	5	9	4	18
2010	77	601	1	6	685
2011	1	22	3	5	31
2012	3	35	5	2	45
2013	42	5	1	6	54
2014	0	5	149	5	159
2015	39	30	18	9	96
2016 (up to June)	0	7	0	0	7
Total	471	2,063	1,044	125	3,703

Source: Audit analysis of EDB records

**Allocation of funding to initiatives analysed by nature
(March 1994 to June 2016)**

Year	Amount of funding allocated to initiatives (\$ million)			
	Support measures to schools and teachers	Language education community projects	R&D projects	Total
1994 (from March)	10	13	13	36
1995	11	34	10	55
1996	10	28	10	48
1997	0	10	1	11
1998	0	83	37	120
1999	3	92	5	100
2000	10	1	0	11
2001	2	16	0	18
2002	9	8	2	19
2003	827	10	11	848
2004	0	9	0	9
2005	2	18	0	20
2006	910	16	0	926
2007	322	19	0	341
2008	15	10	21	46
2009	0	18	0	18
2010	675	10	0	685
2011	0	29	2	31
2012	0	45	0	45
2013	29	25	0	54
2014	143	11	5	159
2015	0	46	50	96
2016 (up to June)	0	7	0	7
Total	2,978	558	167	3,703

Source: Audit analysis of EDB records

**List of 17 international business English examinations aligned to HKWEB
(30 June 2016)**

International business English examination	
1	IELTS (International English Language Testing System)
2	BEC (Business English Certificates)
3	BULATS (Business Language Testing Service)
4	EBC (English for Business Communications)
5	EOS (English for Office Skills)
6	IESOL (International English for Speakers of Other Languages)
7	ISESOL (International Spoken English for Speakers of Other Languages)
8	TOEIC (Test of English for International Communication)
9	TOEIC Bridge (Test of English for International Communication Bridge)
10	EFB (English for Business)
11	EFC (English for Commerce)
12	SEFIC (Spoken English for Industry & Commerce)
13	WEFT (Written English for Tourism)
14	ELSA (English Language Skills Assessment)
15	Versant for English with open questions
16	Trinity GESE (Trinity Graded Examinations in Spoken English for Speakers of Other Languages)
17	Trinity ISE (Trinity Integrated Skills in English Examination)

Source: Workplace English Campaign website

Acronyms and abbreviations

Audit	Audit Commission
CMI	Chinese as the medium of instruction
CMIC	Cantonese as the medium of instruction for teaching the Chinese Language subject
ECPD	Education Commission and Planning Division
EDB	Education Bureau
EEGS	English Enhancement Grant Scheme
EES	English Enhancement Scheme
EMI	English as the medium of instruction
FC	Finance Committee
HKDSEE	Hong Kong Diploma of Secondary Education Examination
HKWEB	Hong Kong Workplace English Benchmarks
LegCo	Legislative Council
LF	Language Fund
PDIGS	Professional Development Incentive Grant Scheme for Language Teachers
PMIC	Putonghua as the medium of instruction for teaching the Chinese Language subject
R&D	Research and development
REES	Refined English Enhancement Scheme
SCOLAR	Standing Committee on Language Education and Research
Trustee	Trustee of the Language Fund
TSA	Territory-wide System Assessment
WGs	Working Groups
2003 Report	Action Plan to Raise Language Standards in Hong Kong