A. Introduction

The Audit Commission ("Audit") conducted a review on the Administration's support and monitoring of charities.

2. Hon Abraham SHEK Lai-him declared that he was a director of the Absolutely Fabulous Theatre Connection and the Heifer International Hong Kong Limited respectively, a founder member of the Construction Industry Charity Fund and a board member of the Construction Industry Skills Training Centre Limited. He was also a member of the School Council of St. Stephen's Girls' College. In addition, he was involved in the construction of the new headquarters of Scout Association of Hong Kong. Hon Paul TSE Wai-chun declared that he was a member of Scout Association of Hong Kong and was involved in the work of a number of charities. Hon SHIU Ka-fai declared that he was a member of the Assessment Committee of the Liberal Party Caring Foundation.

Background

3. As at September 2016, there were 8 923 charitable organizations recognized under the Inland Revenue Ordinance (Cap. 112) ("IRO") to be generally not liable to tax, and donations made to such organizations are tax deductible.[1] At present, the statutory definition of "charitable purpose" in Hong Kong is based upon the common law interpretation of English legislation dating back hundreds of years. The Inland Revenue Department ("IRD") has to refer to the case law in determining whether an organization is established for "charitable purposes".[2]

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1 Tax deduction for charitable donations has been provided since 1970 under IRO (first enacted in 1947). 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 2008-2009).

2 The leading common law authority on the definition of charity is the case of *Income Tax Special Purposes Commissioner v Pemsel* [1891] AC 531 (HL). In that case "*four principal divisions*" of charitable purposes were listed as follows:
(1) trusts for the relief of poverty;
(2) trusts for the advancement of education;
(3) trusts for the advancement of religion; and
(4) trusts for other purposes beneficial to the community. The list was itself based on English legislation dating back to 1601, namely, the preamble to the *Charitable Uses Act 1601* in England. Also see *Halsbury's Law of England*, Vol 8, 5th ed, (2010), at para 2, footnote 25.

4. The charitable donations allowed for tax deduction by IRD had increased by 126% from $5.25 billion for the year of assessment 2005-2006 to $11.84 billion for 2014-2015. The number of taxpayers with tax deduction allowed for approved charitable donations totaled 588 000 in 2014-2015 with tax revenue foregone estimated to be over $1.5 billion.

5. There is no overall statutory scheme for the registration and regulation of charities in Hong Kong. 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 operations in achieving their charitable causes.[3] Depending on their legal forms and whether they have sought recognition of tax-exempt status and government support, charities are subject to the monitoring and/or registration framework of different government bureaux/departments ("B/Ds") as follows:

- IRD processes applications for the recognition of tax-exempt status of charities under section 88 ("s88") of IRO.[4] As administrative procedures, IRD calls for accounts, annual reports or other documents from time to time from tax-exempt charities to review whether their objects still meet the eligibility criteria of "charitable purposes" and their activities are compatible with their objects. Subject to the consent of tax-exempt charities, IRD maintains a list of such institutions or trusts of a public character on its website ("s88 list");

- Lands Department ("LandsD") grants land by way of a private treaty grant ("PTG") at nominal or concessionary premium or short term tenancy at nominal or concessionary rent to some charitable organizations for operating schools, hospitals, and social welfare and community facilities. The charitable organizations are regulated by LandsD and supporting B/Ds to ensure their compliance with the conditions of land grant and policy intention of granting the land;

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[3] Of the 8 923 tax-exempt charities in the IRD's records as at 30 September 2016, 6 622 (74%) were companies, 813 (9%) were societies (including three companies and two societies which had been deregistered as at 30 September 2016 but had not been reflected in the IRD's records), 772 (8.7%) were incorporated management committees of school, 540 (6%) were trusts, 147 (2%) were statutory bodies and 29 (0.3%) were other forms.

[4] According to the legal advice obtained by IRD in 2003, s88 of IRO does not confer on it the power to grant tax-exempt status. What s88 provides is that charitable institutions or trusts of a public character are exempt from tax and they can seek recognition of such exemption by IRD if they like.

- Companies Registry ("CR") is responsible for administering and enforcing the Companies Ordinance (Cap. 622) for some 1.34 million limited companies, including charities incorporated as companies on the Companies Register. As at September 2016, there were 6 619 registered companies which obtained tax-exempt status under s88 of IRO;

- the Societies Office of Hong Kong Police Force ("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-exempt status under s88 of IRO;

- 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-exempt status under s88 of IRO; and

- Home Affairs Bureau ("HAB"): The Chinese Temple Ordinance (Cap. 153) ("CTO") 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 Secretary for Home Affairs as the Chairman, to regulate Chinese temples. As at September 2016, 347 of around 600 Chinese temples were registered with CTC under CTO, of which 45 were administered directly or indirectly by CTC with the remaining 302 managed by individuals or organizations. Of the 347 registered temples, 129 were managed by tax-exempt charities.

6. At the request of the Chief Justice and Secretary for Justice, the Law Reform Commission ("LRC") reviewed the subject on monitoring of charitable organizations and published a Report on Charities ("LRC Report") in December 2013, after completing a public consultation on the subject. LRC made a number of recommendations in its Report, including the definition and registration of charities, facilitation of good practice, financial reporting by charities and filing requirements for charitable fund-raising activities. In particular, LRC is of the view that IRD's s88 list does not constitute a formal "register" of charitable organizations. It is not a comprehensive or conclusive list of all charities in Hong Kong, and there may be a

danger that the public and charity donors may perceive that the s88 list confers on those charities the semblance of official sanction not intended by IRO. In addition, IRD fulfills a highly important function of reviewing the accounts of tax-exempt charities to ensure that only charities which carry out activities in compliance with their objects should continue to be granted tax-exempt status, underpinning to a large extent the confidence of the public in the charity sector.

7. Given that the recommendations touched on areas which fell within the policy responsibilities of several bureaux, HAB has been tasked to coordinate inputs from relevant B/Ds for formulating a response to LRC's recommendations for the Administration's consideration.

The Committee's Report

8. The Committee's Report sets out the evidence gathered from witnesses. The Report is divided into the following parts:

- Introduction (Part A) (paragraphs 1 to 13);
- Administration of tax exemption of charities and tax-deductible donations (Part B) (paragraphs 14 to 35);
- Administration of land granted to charities for operating welfare/social services (Part C) (paragraphs 36 to 76);
- Filing and disclosure requirements of charities incorporated/ established under three ordinances (Part D) (paragraphs 77 to 100);
- Regulation of Chinese temples (Part E) (paragraphs 101 to 114);
- Way forward (Part F) (paragraphs 115 to 116); and
- Conclusions and recommendations (Part G) (paragraphs 117 to 119).

Public hearings

9. The Committee held four public hearings on 6, 19 and 27 May and 27 June 2017 respectively to receive evidence on the findings and observations of the Director of Audit's Report ("Audit Report").

Speech by Director of Audit

10. **Mr David SUN Tak-kei, Director of Audit**, gave a brief account of the subject at the beginning of the Committee's public hearing held on 6 May 2017. The full text of his speech is in ***Appendix 4***.

Opening statement by Secretary for Home Affairs

11. **Mr LAU Kong-wah, Secretary for Home Affairs**, made an opening statement at the beginning of the Committee's public hearing held on 6 May 2017, the summary of which is as follows:

- as the support to and the monitoring of charities involved the work of a number of B/Ds, it was necessary for them to consider LRC's recommendations thoroughly and carefully as many of the recommendations carried substantial implications on charities in Hong Kong in terms of their definition, approval criteria and their operation;

- HAB had convened two inter-departmental co-ordination meetings since the release of the LRC Report to consolidate views of various B/Ds on enhancing the monitoring of charitable organizations and exploring ways to improve the procedures and arrangements for charities to apply for holding fund-raising activities;

- at least nine bureaux and quite a number of executive departments were currently involved in the legislation, licensing and land allocation work relating to charitable organizations and their fund-raising activities. Substantial integration work including policy co-ordination, resources allocation and even re-organization might be required for the B/Ds to consolidate all the relevant legislation and powers before a single policy bureau or department could be designated to administer and carry out the work. It took time for the Administration to study thoroughly and deliberate carefully;

- in the light of LRC's recommendations, HAB was exploring with the relevant departments some feasible administrative measures that might be introduced in the short term to enhance the transparency of charities and charitable fund-raising activities, so as to safeguard the public's right to information; and

- HAB would continue to co-ordinate inputs from B/Ds with regard to their responses to LRC's recommendations for overall consideration by the Administration, and would make reference to the recommendations in the Audit Report as well as the advice of the Committee on improving the monitoring of charities and fund-raising activities.

The full text of Secretary for Home Affair's opening statement is in ***Appendix 5***.

12. **Professor K C Chan, Secretary for Financial Services and the Treasury** made an opening statement at the beginning of the Committee's public hearing held on 6 May 2017, the summary of which is as follows:

- IRD would endeavor to implement the recommendations made in the Audit Report as follows:

  (a) a performance pledge had been set on the processing of applications for recognition of tax-exempt status of charities, and IRD would endeavor to give a reply to the applicants within four months, provided that all necessary information and documents had been supplied;

  (b) to enhance the monitoring of review cases, the Charitable Donations Section ("CDS") of IRD had included the number of uncompleted review cases with their age profile and their position in its monthly work report since February this year to facilitate the management to monitor the progress of these cases in a holistic manner;

  (c) an enhanced notification arrangement with CR and HKPF had been put in place for the timely updating of the list of tax-exempt charities recognized under s88 of IRO. Both CR and HKPF would relay the information of deregistered companies or societies to IRD on a regular basis; and

  (d) Commissioner of Inland Revenue had requested the responsible officers to check the validity of donation receipts more carefully and follow up with the taxpayers concerned when necessary; and

- the key responsibility of IRD was to make tax assessment and collect taxes so as to protect government revenue. As regards the recognition of tax-exempt status of charities, IRD had all along been adhering to

the principle of protecting government revenue in processing new applications and reviewing cases.

The full text of Secretary for Financial Services and the Treasury's opening statement is in ***Appendix 6***.

13. **Ms Bernadette LINN, Director of Lands** also made an opening statement at the beginning of the Committee's public hearing held on 6 May 2017, the summary of which is as follows:

- as land leases were executed in different periods and under different policies and social circumstances, even when the grantees involved were all charitable or non-profit-making organizations, the conditions of the leases were not the same;

- for 14 cases cited in the Audit Report, some leases were not cases of PTG or the user restriction clauses had a rather broad sense. As for the remaining cases, although "hostel" (translated as "旅舍" in Chinese) use was stated under the user clauses, there were no provisions in the leases to govern such aspects as the clientele, services and charges of the hostels in question;

- according to legal advice, there was no breach of the user restriction under land leases for the hostels or hotels involved in the relevant cases. However, as the land on which the hostels were located was generally granted to the relevant bodies for non-profit-making purposes, the crux of the matter was that the revenues derived from commercial operations of the hostels or hotels should be used on the charitable or social affairs of the organizations. In this regard, if a "submission of accounts" clause and a "no-profit-distribution" clause were included in the relevant land leases, the Administration would follow up on the matter according to the lease conditions. If there were no such clauses, but it was stipulated in the leases that the facilities should be of a non-profit-making nature and/or the operation of such facilities should meet the requirements of government departments, LandsD would seek legal advice and ask the grantees to provide the required information under these clauses if necessary; and

- LandsD agreed with the recommendations in the Audit Report that consideration should be given to incorporating the relevant clauses in line with the prevailing social circumstances and policy requirements

when granting land to charities or non-profit-making organizations at nominal premium in the future, or upon expiry of current leases or on receipt of applications for lease modification. In processing applications for land grant by way of PTG for welfare or social service uses in the future, LandsD would continue, in collaboration with the relevant policy bureaux, to make sure that land grant conditions would suitably reflect the policy objectives and requirements at that time.

The full text of Director of Land's opening statement is in ***Appendix 7***.

B. Administration of tax exemption of charities and tax-deductible donations

14. Given that the role of IRD was to protect the Government's revenue raised through taxes and recognition of tax-exempt status of charities would have a direct impact on the tax revenue, the Committee enquired about the measures that had been taken by IRD to ensure that charities' objects were meeting the eligibility criteria of "charitable purposes" and that their activities were compatible with their objects in accordance with the relevant provisions of s88 of IRO.

15. **Mr WONG Kuen-fai, Commissioner of Inland Revenue** replied at the public hearing on 6 May 2017 and **Secretary for Financial Services and the Treasury** supplemented in his letter dated 16 May 2017 (***Appendix 8***) that:

- IRD had been performing its role in accordance with IRO. Any organization wishing to seek recognition of tax-exempt status under s88 of IRO was required to submit an application to IRD with a copy of the governing instrument, lists of activities which had been carried out in the past 12 months as well as planned for the next 12 months. Where the organization had been established for 18 months or more, a copy of its financial statements for the last financial year was also required;

- when considering an application under s88 of IRO, IRD would examine, among other things, the governing instrument of the organization. In particular, IRD would scrutinize the object clause, income clause and dissolution clause to ensure that all the objects of the organization were charitable in nature and that there were adequate safeguards to prevent the channeling of funds for non-charitable

purposes. If the organization failed to meet the requirement, IRD would not approve the application; and

- the tax-exempt status of each approved charitable institution was subject to review regularly, normally on a cycle of four years, so as to ensure its objects were still charitable and its activities were compatible with its objects. IRD would ask the organizations to submit its annual report and financial statements, and seek clarification with the organizations if necessary. IRD might withdraw the recognition of tax-exempt status in accordance with the reasons stated in the Staff Handbook of CDS.

Tables showing the number of applications not approved by IRD in the financial years from 2012-2013 to 2016-2017 (up to 30 September 2016), as well as the number of review questionnaires issued by IRD in the review years from 2012 to 2016 (up to 30 September 2016) were provided in Appendix 8. At the request of the Committee, **Secretary for Financial Services and the Treasury** provided a copy of the Staff Handbook in Appendix 8, which set out the practices and work procedures of CDS of IRD.

16. At the request of the Committee, **Secretary for Financial Services and the Treasury** provided in his letter dated 16 May 2017 (Appendix 8) a breakdown of charities with their tax-exempt status withdrawn by IRD from 2012-2013 to 2016-2017 (up to September 2016). He supplemented that when a charity amended its objects in the governing instrument in a way that it was no longer exclusively charitable, it would not qualify for the status of a charitable institution or trust of a public character, i.e. the reason mentioned in paragraph 2.4(c)(iii) of the Audit Report.

17. According to paragraphs 2.2 and 2.16 of the Audit Report, IRD was not empowered under IRO to determine whether an organization was a charity or not and to overturn a charity's tax-exempt status solely because the charity had not complied with any obligations, whether statutory or not, and it had no authority to demand a charity to refund any items of expenditure which were not paid for the furtherance of its charitable objects. IRD had sought legal advice in 2003 relating to its power to take enforcement actions when a charity's act contravened its governing instrument. The Committee enquired:

- whether guidelines had been issued to CDS staff on the handling of tax-exempt status of a charity if it had breached its governing instrument; and

- given the limitations of IRO, whether IRD sought further legal advice after 2003 to ascertain its power and authority, and conveyed to the Financial Services and the Treasury Bureau ("FSTB") or other relevant B/Ds about such limitation and requested that amendments be made to IRO in order for it to take necessary enforcement actions.

18. **Commissioner of Inland Revenue** replied at the public hearing on 6 May 2017 and **Secretary for Financial Services and the Treasury** supplemented in his letters dated 16 and 26 May 2017 (***Appendices 8*** and ***9*** respectively) that:

- in view of public concerns regarding the control of charitable fund-raising activities, IRD sought the advice of the Department of Justice in September 2003. The legal advice was sought in a general policy context without reference to a specific case;

- CDS updated from time to time the Staff Handbook which mainly set out the work procedures of the section. Since CDS was a small section, its staff-members were aware of the details of the legal advice in 2003 through discussion, debriefing and experience sharing; and

- since the legal advice had been sought in 2003, IRD did not seek legal advice again on this matter. For meeting the legislative intent of s88 of IRO, IRD considered that there was no imminent need to review the relevant provisions of IRO. The key responsibility of IRD, as a tax administration, was the assessment and collection of taxes.

19. The Committee requested Commissioner of Inland Revenue to provide the full version of the legal advice. Commissioner of Inland Revenue provided the gist of the legal advice in his letter dated 4 May 2017 in ***Appendix 10***. A sanitized version of the legal advice was subsequently provided for members' reference only.

20. The Committee expressed concern about the role of IRD to effectively discharge its function in protecting tax revenue and performing its duties in relation to s88 of IRO, including the authority it had and legality of the actions taken, having regard to section 40(1) of the Interpretation and General Clauses Ordinance (Cap. 1)

about powers to be conferred to do or enforce the doing of any act or thing under any ordinance.

21. **Commissioner of Inland Revenue** responded at the public hearing on 6 May 2017 and **Secretary for Financial Services and the Treasury** supplemented in his letter dated 16 May 2017 (Appendix 8) that:

- in administering s88 of IRO, IRD carefully considered whether an organization fell within the meaning of "charitable institution" and had met the conditions for exemption set out under s88, taking into account all the circumstances; and

- the legislature had specifically set out the conditions for exemption under s88 of IRO. Section 40(1) of the Interpretation and General Clauses Ordinance did not confer upon IRD the power to add extra conditions for exemption, or to impose the same on an institution, in addition to those conditions which were specifically set out by the legislature under s88 of IRO.

22. Having regard to one of the recommendations in the LRC Report that IRD should maintain a robust role in overseeing the activities of charities for tax-exempt purposes by conducting more frequent reviews of the accounts of tax-exempt charities to ascertain whether the activities of these charities were compatible with their charitable objects, and that more resources be allocated to enabling the conduct of these more frequent reviews as this administrative measure, which could be implemented relatively quickly, would promote greater accountability among charities and improve their governance, the Committee enquired about:

- IRD's response to LRC's recommendations and actions/measures that had been taken/implemented by IRD to address LRC recommendations, in particular the ascertaining of charities' activities being compatible with their objects;

- given the limitations mentioned by IRD in taking enforcement actions against charities breaching their governing instruments or charities' objects, whether IRD considered its current actions taken on suspected breach cases fell short of LRC's recommendation in respect of IRD's role;

- whether the conduct of review and calling for financial reports of charities in a four-year interval sufficient in ascertaining charities remained charitable; and

- given that the number of charities had more than doubled from 4 435 in 2006 to 8 923 in September 2016 (paragraph 1.5 of the Audit Report), whether manpower of CDS was sufficient to cope with the workload arising from processing applications for tax-exempt status and conducting periodic reviews of charities.

23. **Commissioner of Inland Revenue** responded at the public hearing on 6 May 2017 and **Secretary for Financial Services and the Treasury** supplemented in his letter dated 16 May 2017 (Appendix 8) that:

- having regard to the relevant facts and circumstances of the case concerned and making reference to information obtained from other channels, IRD determined the frequency of review for individual tax-exempt charity. IRD conducted reviews on tax-exempt charities once every four years as a general practice, but IRD would initiate actions (e.g. early review on tax-exempt charities) if available information (e.g. from media, past record of the charity, third party information, etc.) indicated that suspected non-charitable activities had been carried out. Additional and sufficient attention would be given to tackle the "high risk" cases as necessary;

- to cope with the steadily-increasing number of charities applying for recognition of tax-exempt status as well as cases subject to review, the number of staff working in CDS increased from five to eight in April 2013. IRD considered that the current manpower resources of CDS could cope with the existing workload. IRD would consider seeking additional manpower resources through established mechanism if necessary;

- IRD issued on average 1 300 to 1 600 review questionnaires per year to tax-exempt charities from 2012 to 2015. Table 2 and Figure 4 of the Audit Report showed that the average processing time to complete a review and the number of cases and correspondence pending for attention of CDS both recorded a substantial drop in recent years; and

- in the periodic reviews, IRD examined the information provided in the review questionnaires, financial statements and list of activities to

identify suspected breaches and raised enquiries with the relevant parties. IRD considered the current review mechanism adequate.

24. The Committee enquired about an updated progress on Case C as mentioned in paragraph 2.12(c) of the Audit Report and the reasons for the long periods of inaction ranging from 9 to 16 months by IRD.

25. **Secretary for Financial Services and the Treasury** provided details regarding the case in his letter dated 16 May 2017 (Appendix 8) that:

- in response to IRD's enquiry, Organization C replied in June 2014 that the yearly rental payment of $480,000 was a fair amount for the premises with floor area about 20 000 square feet and a rateable value of $288,000 for the year ended 31 March 2009;

- IRD noticed that a related party transaction involving rental payment was disclosed in the financial statements for the year ended 31 July 2014 and enquired for the particulars of the owner of the premises and the relationship between the owner and the directors of Organization C. Organization C replied in June 2016 that owner of the premises were two individuals who did not have any relationship with Organization C;

- IRD then asked Organization C why the rental payment in respect of the premises was stated as a related party transaction. In October 2016, Organization C confirmed that the owners had never been its directors and that they operated a kindergarten which had been taken over by Organization C. IRD accepted that the rental payments, though higher than the rateable value, were not non-arm's length. As the objects of Organization C remained charitable and its activities were compatible with its stated charitable objects, IRD considered that it was a charitable institution; and

- the long periods of inactions for this case were due to the heavy workload of the subject officer and his inadvertence. Since 2016, follow-up actions were speeded up and IRD responded within one to four months from the receipt of the correspondence from Organization C.

26. Referring to the four cases (Cases D to G) highlighted in paragraph 2.14 of the Audit Report regarding charities' breach of directors' remuneration clause of their governing instrument, the Committee enquired:

- follow-up actions taken by IRD and whether IRD would withdraw a charity's tax-exempt status if it breached the clause of their governing instrument prohibiting directors from receiving remuneration, as in Cases D to G;

- on what basis IRD was satisfied with the remedial actions taken by the four charities, which were different in individual cases; and

- the stance of IRD in enforcing s88 of IRO in relation to the four cases, and follow-up actions that IRD could take if reviews by IRD had revealed irregularities.

27. **Secretary for Financial Services and the Treasury** provided details regarding the four cases in his letters dated 16 and 26 May 2017 (Appendices 8 and 9 respectively) that:

Case D

- IRD was of the view that the Executive Committee members of Organization D received remuneration in the capacity of an employee and that their remuneration did not appear to be excessive, though it might be a technical breach of the director's remuneration provision of its governing instrument as the governing instrument of the organization did not allow members of its Executive Committee or governing body to be appointed to any salaried office of the organization, the act did not affect its charitable status. No refund was made by the nine Executive Committee members to Organization D;

Case E

- in 1999, Organization E paid donations, described as "顧念款" totalling at $11,000 to a trustee, a monthly payment of $600 (totalling $7,200) and $2,500 to two Executive Committee members of the organization for their rendering of services, subsidization of their travelling expenses and as a subsidy to meet their financial difficulties. Upon IRD's enquiry, Organization E provided evidence to show that all the

payments totaling $20,700 had been fully repaid. Having regard to all relevant facts and circumstances, IRD considered that Organization E was a charitable institution and continued recognizing its tax-exempt status;

- in 2007, IRD found that one Executive Committee member was paid $21,400 for the year ended 31 March 2006 and received monthly payments totaling $22,100 for the year ended 31 March 2007. In reply to IRD's enquiry, Organization E provided evidence showing payments of $43,500 in total had been fully repaid and undertook not to make such payments in future. IRD considered that Organization E was a charitable institution and continued recognizing its tax-exempt status;

Case F

- Organization F's tax-exempt status was withdrawn in 2003 due to its failure to reply to IRD's enquiry letters. In 2011, Organization F requested to reinstate its recognition of tax-exempt status. IRD noticed from Organization F's audited financial statements for the years ended 30 June 2003 to 30 June 2013 that it had paid love gifts ranging from $3,773 to $53,582 to a pastor who was also a member of the Board of Elders as a gratuity to the pastor and not as remuneration. Upon advice by the IRD of the potential contravention of the clause relating to payment of remuneration to members of the Board of Elders in Organization F's governing instrument, the pastor returned the love gifts received in the past two years, i.e. $3,773 (for 2012) and $9,400 (for 2013) to Organization F. Having regard to all the relevant facts and circumstances, IRD considered that Organization F was a charitable institution and reinstated the recognition of its tax-exempt status in 2015;

Case G

- Organization G's tax-exempt status was withdrawn in 2006 due to its failure in responding to IRD's review questionnaire. In 2012, it requested reinstatement of its tax-exempt status. Organization G's audited financial statements for the years ended 31 December 2008, 2009 and 2010 had recorded directors' remuneration of $30,000, $130,000 and $80,000 respectively. Upon IRD's enquiry, Organization G advised that a director was paid because of his rendering of services to the organization. Upon advice by IRD of the

potential contravention of the clause relating to payment of remuneration to directors in its governing instrument, the director resigned from the Board of Directors in April 2013 and agreed to repay half of his remuneration for the years 2008 to 2012 to the organization. Having regard to all the relevant facts and circumstances, IRD considered that Organization G was a charitable institution and reinstated the recognition of its tax-exempt status in 2015;

- IRD examined, among other things, the governing instrument of an organization to ascertain if its objects fell within the meaning of "charitable purposes". In case a charity breached a clause of the governing instrument, it was a question of fact and degree whether such breach would fundamentally affect its charitable status;

- in each of the four cases, the charity's objects in its governing instrument remained exclusively charitable and its activities were at large compatible with its stated objects. There was no evidence that the members of their governing body had blatantly sought private advantages from the charities. Some of their trustees or directors had received remuneration or benefits in the capacity of other than director or trustee, i.e. an employee (in Cases D, F and G) or being old and needy members of the church (in Case E) and that the amount of remuneration or benefits received by them did not appear to be excessive. Having regard to all the relevant facts and circumstances including the scale and mode of operations of the charities, IRD considered that such breaches were technical breaches and did not fundamentally change the charitable status of the charities. Hence the recognition of their tax-exempt status was not withdrawn by IRD;

- if a charity blatantly breached the provisions of its governing instrument and IRD, after taking a holistic view, considered that such breach fundamentally changed its charitable status, it would withdraw the recognition of the tax-exempt status. There were no precedent cases in this regard; and

- in these four cases, IRD did not prescribe the form of remedial actions. The remedial actions were proposed by the charities concerned and could take different forms. So long as a charity's non-compliance with the clause relating to payment of remuneration to members of governing body did not fundamentally change its charitable status, IRD did not consider that it was legally defensible to withdraw tax-exempt status of the charity.

28. The Committee noted from paragraph 2.4(d) of the Audit Report that a charity whose tax-exempt status was removed because it was untraceable or failed to give reply to IRD's enquiries might apply for reinstatement of the recognition. The Committee enquired about the basis for IRD to reinstate the tax-exempt status of Charities F and G.

29. **Secretary for Financial Services and the Treasury** replied in his letter dated 26 May 2017 (Appendix 9) that:

- as indicated in paragraph 6.6.3 of the Staff Handbook of the CDS, in processing a reinstatement application from a charity, IRD had been adopting an approach similar to handling new applications and would examine all the necessary submissions from the charity afresh; and

- like handling new applications for tax-exempt recognition, IRD sought the necessary information in order to determine whether Organization F and Organization G were charities at law. After examining the relevant facts including their effort to rectify the breach in the past and their commitment to adhere to the provisions in the governing instruments in future, IRD considered that the object of both Organizations F and G remained charitable. The payment of love gifts by Organization F and remuneration by Organization G to members of their governing body was not material enough to fundamentally change their charitable status. As such, IRD reinstated the tax-exempt recognition of Organizations F and G in 2015.

30. **Commissioner of Inland Revenue** stated at the public hearing of 6 May 2017 that prior to the publication of the Audit Report No. 29 and the Public Accounts Committee Report No. 29 in 1997 and 1998 respectively, IRD had not required charities to include clauses prohibiting members of its governing body from receiving remuneration in their governing instruments. The Committee enquired whether some charities which were established before 1997 did not have such director remuneration clauses in their government instruments, and whether IRD would take follow-up actions against such charities if members of their governing bodies received remuneration.

31. **Commissioner of Inland Revenue** responded at the public hearing on 6 May 2017 and **Secretary for Financial Services and the Treasury** supplemented in his letter dated 16 May 2017 (Appendix 8) that:

- in the Audit Report No. 29, Director of Audit noted that, in 1987, IRD found that an approved charity had paid remuneration to its directors. Subsequently, IRD required charities to include a provision if they allowed payment of remuneration to directors who had special qualifications not otherwise available to the charities. The audit review revealed that seven approved charities, which were granted tax-exempt status before 1988, had a provision in their governing instruments permitting the payment of remuneration to directors in return for services actually rendered to the organizations, but the provision on the conditions for remuneration to directors had not been included. Although the seven approved charities were granted the exemption status prior to 1988 in accordance with the practice prevailing at that time, Director of Audit considered that, as the control on remuneration to directors would help guard against misappropriation of charities' income for the private gain of individuals, it was necessary that all approved charities should be subject to this control;

- for charities recognized by IRD as tax-exempt bodies before 1988, some of them might not contain the clause for the control on remuneration to directors. In response to the Audit Report, IRD had sought legal advice in 1997 as to whether it was legally proper to request existing charities to consider amending their governing documents in order to incorporate a provision relating to the remuneration to directors. According to the legal advice at that time, such provision was not vital to the recognition of tax-exempt status and IRD was not entitled to withdraw the tax-exempt recognition of those organizations which failed to accede to the request; and

- since 1988, all organizations applying for recognition of tax-exempt status under s88 of IRO had been required to have the director remuneration prohibition clause in their governing instruments. Such practice had been consistently implemented. For those tax-exempt charities which did not have such clause in their government instruments, when they notified IRD that they intended to revise some other clauses in their governing instruments, IRD would request them to incorporate or update the director remuneration clause.

32. The Committee enquired about follow-up actions taken by IRD in respect of Cases H and I highlighted in paragraph 2.15 of the Audit Report and whether the allocation of expenses not in furtherance of charitable objects already constituted a

breach of s88 of IRO which warranted a withdrawal of their tax-exempt status under the reason that "the charity no longer qualifies the status of a charitable institution or trust of a public character".

33. **Commissioner of Inland Revenue** responded at the public hearing on 6 May 2017 and **Secretary for Financial Services and the Treasury** supplemented in his letter dated 16 May 2017 (Appendix 8) that:

- upon IRD's enquiry, Organization H stated that the travelling expenses of $704,519 were expenses on flight tickets of overseas disciples to attend the funeral services of the master of the monastery in Hong Kong. IRD pointed out to Organization H that the travelling expenses did not appear to be expenses in furtherance of its charitable object, and asked about the remedial actions it would take. Organization H replied that to fulfill the public benefit requirement, it had resolved to claim back the travelling expenses from the disciples and so far $500,000 had been recovered and the balance would be recovered in due course. Having regard to all the relevant facts and circumstances and that Organization H had taken remedial actions, IRD considered that it remained a charitable institution with its tax-exempt status unaffected;

- IRD noticed that there was a grant for repairing the ancestral tomb and graveyard and asked Organization I in November 2009 how such activity was compatible with its charitable objects. The IRD withdrew the recognition of its tax-exempt status in 2011 after Organization I did not respond to its repeated enquiry;

- in 2014, Organization I requested IRD to reinstate the recognition of its tax-exempt status. Having examined the information provided by Organization I, IRD considered two payments of $236,223 in total appeared not to be expenses in furtherance of its charitable objects nor for public benefit. Organization I explained that the two payments were made as a donation to finance part of the construction cost of an ancestral temple and to repair the ancestral tomb and graveyard. Organization I was of the view that the payments were relevant in fostering education of the Confucian doctrine of filial piety for the advancement and improvement of standards of living of humans and their social, moral and physical well-being, and were compatible with its charitable objects. IRD did not share Organization I's view. Organization I, though still maintained its views regarding the two

payments, confirmed that it would not make similar donations/payments in future. Having regard to all the relevant facts and circumstances including the absence of other irregularities and the charity's undertaking of not making similar donations/payments in future, IRD considered that Organization I was a charitable institution and reinstated the recognition of its tax-exempt status in 2015; and

- insofar as Organizations H and I were concerned, there was no indication that they had carried on any trade or business and even if they had, profits derived from such trade or business should be chargeable to profits tax. The IRD considered that withdrawal of recognition of tax-exempt status was not warranted.

34. The Committee enquired about the follow-up actions taken on Case L (paragraph 2.19 of the Audit Report) and whether IRD had referred or would consider referring the case to other relevant enforcement authorities for further investigation in view of the conflicting information provided to IRD and that available from CR.

35. **Commissioner of Inland Revenue** responded at the public hearing on 6 May 2017 and **Secretary for Financial Services and the Treasury** supplemented in his letter dated 16 May 2017 (Appendix 8) that:

- two reviews were conducted in 2009 and 2014 and IRD considered the planned activities were compatible with Organization L's charitable object and concluded the reviews;

- Organization L provided a copy of audited financial statements for the year ended 31 March 2015 with two donation receipts dated 13 September 2015 and 31 July 2016 in the amount of $389.50 and $450 respectively, and an activity pamphlet to IRD. In March 2017, IRD asked Organization L to explain the inconsistencies between information previously provided by it and the audited financial statements for the year ended 31 March 2016. Organization L replied that it intended to, but had not yet carried out any church activity. The information previously submitted to IRD was activities that it planned to carry out and the donation receipts were merely sample receipts. Organization L stated that it did not maintain any bank account;

- when IRD conducted the review which started in 2014 and concluded in September 2016, the audited financial statements for the year ended 31 March 2016 were not available to IRD. The donation receipt dated 31 July 2016 fell outside the period covered by the audited financial statements ended 31 March 2016. As for the donation receipt dated 13 September 2015, though it fell within the period covered by the audited accounts ended 31 March 2016, there was no concrete evidence that the organization did receive the donation in question; and

- as Organization L had never carried on any activities over a long period of time, IRD withdrew the recognition of its tax-exempt status by a notice dated 15 May 2017.

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

36. The Committee noted from paragraphs 3.2 and 3.3 of the Audit Report regarding the land administration policy for PTG granted at nil, concessionary or full market premium which were laid down in papers submitted by the Administration to the Executive Council ("ExCo") in 1959 and 1981. The Committee asked Director of Lands to explain the policy intent of the 1959 and 1981 land administrative policy on PTG.

37. **Director of Lands** explained at the public hearing on 27 May 2017 and supplemented in her letter dated 16 June 2017 (***Appendix 11***) that:

- in the absence of file records going back to the 1950s, LandsD had tried to deduce the policy intent of the 1959 ExCo Memorandum by making reference to the contents of the paper. LandsD noted that the Memorandum was presented as an information paper, one that set out in general the context under which different types of PTGs subject to nil/nominal, concessionary and full market premium respectively would be applicable and the general land administration arrangements. As such, the paper did not, and was not meant to, prescribe the standard terms and conditions for inclusion into the relevant types of PTGs;

- the principle conveyed by the 1959 Memorandum was that it would be important for the facilities/services operating from the PTG sites granted at nil premium for non-profit-making purposes to be run to the satisfaction of the appropriate Head of Department; and that any profit

derived from the permitted facilities/services under the PTG should not be distributed, but ploughed back to facilities/services serving worthy causes on site or off site; and

- as regards the 1981 ExCo Memorandum, LandsD considered that it was mainly applicable to circumstances where the grantee of a PTG for social service purposes at nil or concessionary premia wished to enter into partnership with a private developer to redevelop the sites, and where the private developer would be allowed to share the profit from a "commercial", income-generating element to be included in the redevelopment. The policy intent of the policy framework set out therein was to facilitate early redevelopment by allowing the partnership, and to capitalize on the commercial element to finance the redevelopment and support the maintenance and running of the social services activities.

At the request of the Committee, **Director of Lands** provided a copy of the memoranda for and decisions of ExCo on Land Administration Policy and Redevelopment of Sites Granted at Nil or Concessionary Premium for Social Services Purposes in ***Appendix 12***.

38. Taking note of the policy intent of the 1959 and 1981 policy directives set out in ExCo paper, the Committee further enquired how they were applied to and implemented in the land leases of the 14 sites granted by way of PTG as highlighted in the Audit Report.

39. **Director of Lands** explained at the public hearing on 27 May 2017 and supplemented in her letter dated 16 June 2017 (Appendix 11) that:

- the land leases for the 14 sites were executed at different points in time, having regard to different circumstances as well as considerations prevailing then. LandsD provided a table in Appendix 11 which specified different lease conditions for the 14 sites;

- amongst the 14 sites highlighted in the Audit Report, Cases A, B and E with lease terms commencing between 1840s to 1880s held under virtually unrestricted leases were not PTGs. As such, both the 1959 and 1981 Memoranda should not be relevant. Cases C, D and K with lease terms/original lease terms commencing between 1920s to early 1950s were subject to very broad user restriction allowing much liberty

for the lessees, and no relevant information had been located so far about the existence or otherwise of specific policy intentions governing the three cases. In the circumstances, LandsD was not in a position to deduce whether the 1959 Memorandum was relevant;

- for the remaining 8 cases (Cases F, G, H, I, J, L, M and N) where the leases specifically permitted the running of hostel/dormitories, one or more of the following requirements had been stipulated in their lease conditions:

  (a) the permitted use(s) or operation should be run on a non-profit-making basis;

  (b) the operation should be conducted in all respects to the satisfaction of a certain head of department (usually the relevant monitoring department);

  (c) submission of accounts; and

  (d) no distribution of profit;

- LandsD considered that (a) and (d) above were different formulations supporting the principle conveyed in the 1959 Memorandum, i.e. that any profit derived from the permitted facilities/services under the PTG on nil/nominal premium should not be distributed, but ploughed back to facilities/services serving worthy causes on site or off site, according to the policy intention for the case in question. For (b) and (c) above, where included, they were also consistent with the principle of ensuring adequate control by the relevant government department(s); and

- since Case N involved the inclusion of the "commercial" elements of public vehicle parks and telephone exchange on full market value premium to facilitate the redevelopment of Grantee N's Headquarters, the 1981 Memorandum was relevant and was indeed mentioned in the relevant ExCo submission on the redevelopment project in Case N.

40. While the "no distribution of profits is allowed" condition was clearly stipulated in the land policy paper presented to ExCo in 1959, this clause was not specifically spelt out in the land leases granted by way of PTG except for Lease M. In addition, for those 11 sites highlighted in Table 5 of the Audit Report which had

hotels/serviced residence operation, submission of audited accounts were not required in Leases C, D, K, F, G, I and L. In this regard, the Committee enquired about:

- reasons for not specifically spelling out the clause "no distribution of profits is allowed" in the land leases granted by way of PTG;

- how LandsD could effectively monitor compliance by the organizations in the cases of the 13 sites (apart from Grantee M);

- how relevant supporting B/Ds could effectively monitor the distribution of profits derived from hotel operations were used to purposes acceptable to the Administration; and

- what remedial actions could be taken to address the problem.

41. **Director of Lands** explained at the public hearing on 27 May 2017 and supplemented in her letter dated 16 June 2017 (Appendix 11) that:

- LandsD considered that "no distribution of profits" was not applicable to Cases A, B, C, D, E and K, given their background as explained in paragraph 39 above;

- although the leases for the remaining seven cases, i.e. Case F, G, H, I, J, L and N, did not carry a specific clause on "non-distribution of profits", four cases, i.e. Cases F, G, J and L, carried a clause requiring the operation concerned to be run on a non-profit-making basis. Such a clause was another formulation of the "no profit distribution" requirement. For the remaining three cases, Cases H and N carried a clause requiring submission of accounts while the remaining Case I carried a clause requiring the operation to be run to the satisfaction of Government; these clauses would give room for the Administration to make enquiries and monitor compliance with the spirit of "no distribution of profits";

- likewise, for those leases which did not contain a "submission of audited accounts" requirement, the requirement for demonstration of operation on a "non-profit-making" basis and/or the requirement for operation to be run to Government's satisfaction would give room for the Administration to make enquiries regarding the financial accounts where it was considered that such enquiries would help the checking of

compliance with the stated "non-profit-making" requirement and/or the "to Government's satisfaction" requirement; and

- LandsD agreed that the inclusion of specific clauses on "submission of audited account" and "no distribution of profit" into the PTGs concerned would give greater clarity about the obligations under lease and facilitate the Administration's compliance checking. Looking forward, for the 11 PTGs named in the Audit report (excluding the three virtually unrestricted leases), where the opportunities arose (such as when lease modification application and lease renewal were received), LandsD would recommend to the concerned sponsoring B/Ds the imposition of "submission of audited account" and "no distribution of profit" requirements and requested justifications if the recommendation was not accepted. The same arrangement would apply to the processing of new PTGs.

42. Referring to the grantees listed in Table 5 of the Audit Report, the Committee enquired whether income generated from hotels/serviced residence/hostel operation would be taken into account when deciding the level of subvention offered, and whether the Social Welfare Department ("SWD") had required the Grantees (except Grantee N) to submit accounts and/or relevant information relating to hostel/serviced residence/hotel operations for its scrutiny to ensure that they complied with the lease conditions.

43. **Ms Carol YIP, Director of Social Welfare** replied at the public hearing on 27 June 2017 and supplemented in her letter dated 11 July 2017 (***Appendix 13***) that:

- except for Lease N, the other land leases were not subject to the requirement for reduction of subvention based on the surplus derived from the income-generating facilities (including dormitories/hostels) operated on the sites concerned. Therefore, for the land leases which were under SWD's monitoring (i.e. Leases F, G, H, I, J, K and L), SWD had no plan to consider reducing the subventions provided to these organizations, unless there was such requirement in the land leases concerned in future;

- SWD was aware that the organizations concerned would use the surplus derived from the dormitories/hostels towards supporting other charitable services in accordance with the non-profit-making principle, for example, supporting the non-subvented social, educational, medical

services, etc., or meeting the operating deficits of other service units or the expenditure on repair and maintenance of facilities under their purview and would not be used for distribution of profits. These organizations would publish their audited statements (covering those relating to dormitories/hostels) in their annual reports or on their own websites; and

- there might have been unclear distribution of work among departments on the monitoring of dormitories/hostels operated by the organizations concerned in the past. After the issuance of the Audit Report, SWD had already liaised with the organizations concerned with a view to understanding the operation and surplus arrangements of the facilities concerned. The land leases under SWD's monitoring (i.e. Leases F to L) were not subject to the requirement of submission of audited accounts, except for Leases H and J. On this, SWD would strictly enforce the land lease requirements for Grantees H and J to submit audited accounts. As for other leases, SWD would continue the liaison with the organizations concerned and would, where considered necessary, ask them to submit audited accounts for the dormitories/hostels to ensure that the use of the surplus derived was non-profit-making in nature.

44. Regarding the submission of accounts/relevant information relating to hostel/serviced residence/hotel operations to ensure that they comply with the lease conditions, **Director of Lands**[5] supplemented in his letter dated 27 July 2017 (***Appendix 14***) that:

- without knowing the policy intention for Cases C, D and K and the applicability of the 1959 and 1981 policy directives to these cases, LandsD considered that it might not be reasonable to demand the Grantees of the three cases to submit accounts and/or relevant information relating to the hostel/hotel operation;

- "Submission of Account Clause" was incorporated in Leases H, J and M. For Leases H and J, the respective Grantees were required to submit annual audited accounts to Director of Social Welfare. LandsD was recently informed by SWD that the Grantees had not submitted audited statements of accounts which were considered in contravention of "Submission of Accounts Clause" included in the land

[5] Mr Thomas CHAN Chung-ching took up the post of Director of Lands on 1 July 2017.

grant document. LandsD had written letters to the respective Grantees on 5 May 2017 asking them to submit to SWD the audited accounts of the operation on site including the hostel portion to SWD on or before 1 June 2017. Both Grantees had requested more time to prepare the required statements and asked for extension of time up to 31 July 2017. SWD had no objection to the Grantees' extension request. If SWD considered their operation was not to their satisfaction or they requested further information to facilitate their consideration, LandsD as the administrator of the lease would assist within the power conferred to the Administration under lease;

- for Case M where the monitoring role and responsibility within the Administration was not clear, LandsD had taken a proactive role and had demanded submission of audited accounts and relevant information from the Grantee and would continue to monitor the operation of the hostels. Grantee M had submitted audited annual accounts of the hostel for the year 2013 up to the year 2015 and certifications from independent accountants regarding the ploughing back of hostel income to Charity M for the year 2013 up to the year 2015. LandsD had recently issued another letter to Grantee M urging for the early submission of the audited account for the year 2016 with certification together with breakdowns of the hostel income ploughed back by categories of uses for all the audited accounts submitted or to be submitted;

- the department within the Administration responsible for monitoring Case L was not clear. Hence, LandsD had also taken a proactive role and issued a letter to Grantee L on 22 December 2014 asking them to keep documentary proof to demonstrate compliance with lease conditions, particularly the "non-profit making hostel". In reply to LandsD, Grantee L provided an audited account for year 2016 on 6 June 2017 and stated that the surplus derived from the hostel had not been distributed. LandsD would issue a further letter to Grantee L requesting a certification from an independent auditor for their above statement including a breakdown of the hostel income ploughed back by categories of uses, e.g. education, welfare, etc.; and

- for the remaining Cases F, G, and I, as provided under lease their operation should be to the satisfaction of Director of Social Welfare. LandsD had been liaising with SWD with regard to the compliance with the relevant conditions in the leases. LandsD so far had not yet been approached by SWD for assistance to take lease enforcement

actions nor any request for demanding the Grantees of these three cases for submission of accounts and other relevant information in order to facilitate SWD's consideration/monitoring of whether their operations of hostel were to their satisfaction. LandsD would closely liaise with SWD for any necessary action to be taken under the leases.

45. The Committee noted that LandsD issued "The Protocol on the delineation of responsibilities on monitoring PTGs between Lands Department and supporting Bureaux and Departments" ("the Protocol") in 2014 and enquired about:

- measures that had been/would be taken to remind supporting B/Ds of their responsibilities, in particular about monitoring and enforcement of lease conditions throughout lease term; and

- assistance provided by LandsD to support B/Ds for formulating guidelines or a mechanism on monitoring and enforcing the lease conditions under their respective purview and details of the assistance offered.

46. **Director of Lands** explained at the public hearing on 27 May 2017 and supplemented in her letter dated 16 June 2017 (Appendix 11) that:

- the Protocol issued in 2014 set out the general guidelines for B/Ds in considering matters concerning PTGs. LandsD believed that the Protocol, supplemented by the usual practice of researching into relevant precedents by both the sponsoring B/Ds and LandsD, would facilitate consideration of potential PTG cases;

- the Protocol itself served as an important reminder for B/Ds supporting the provision of facilities/services on PTGs. According to prevailing practice, LandsD would, after execution of the PTG, inform in writing all the concerned B/Ds so that they were aware of their respective monitoring role under lease;

- it was possible that relevant B/Ds might not have stock taken cases on the basis of the leases concerned and the specific provisions therein, particularly for leases executed years ago. To this end, LandsD would assist by taking stock of PTGs on nil or concessionary premia and key provisions therein by phases, taking into account resources available. The information would be shared with the relevant B/Ds. However,

LandsD would defer to the supporting B/Ds to set up their own guidelines for monitoring so as to achieve their policy intention in supporting the land grant on a case by case basis. But if any established breach of lease was identified by the responsible B/Ds, LandsD would follow up with appropriate lease enforcement action at their directives in the capacity of land agent of Government being the landlord; and

- where it was revealed that the monitoring role for individual lease conditions could not be attributed to a specific B/D due to the existence of grey areas, e.g. the hotel/hostel as an incoming-generating facility supported community/welfare services under the purview of different bureaux, LandsD would co-ordinate internally to arrive at a consensus and take a proactive role on monitoring if necessary.

At the request of the Committee, **Director of Lands** provided a copy of the Protocol in ***Appendix 15***.

47. The Committee enquired whether LandsD would consider specifying definitions on "hotel" and "hostel" in order to make such differentiation in future land leases for hotel operation on sites granted to non-governmental organizations at nil or concessionary premium.

48. **Director of Lands** explained at the public hearing on 27 May 2017 and supplemented in her letter dated 16 June 2017 (Appendix 11) that for land leases granted at nil or concessionary premium, LandsD supported greater precision in setting out the uses permissible to reflect the policy intention and minimize ambiguity, and in so doing to address modern day expectations. When processing new proposals for PTGs or lease modifications/land exchanges involving the provision of hotels or hostels in recent years, LandsD had been mindful of the desirability of stipulating specifications such as the mode of operation, target clientele, basis of fee to be charged etc. in the relevant leases or service agreements associated with the leases. For instance, the PTGs under HAB's Youth Hostel Scheme was a typical example of how "hostel" had been elaborated under the leases concerned.

49. Noting that LandsD had not requested Grantee M in Case 1 of the Audit Report to submit accounts until August 2013 in response to a complaint received in April 2011, although the submission of accounts condition was clearly stipulated in the land lease, the Committee enquired about the reasons for the delay for LandsD to

take relevant action to review the accounts of Grantee M, as well as follow-up actions that had been taken since August 2013.

50. **Director of Lands** explained at the public hearing on 27 May 2017 and supplemented in her letter dated 16 June 2017 (Appendix 11) that:

- the complaint received in April 2011 was related to the operation of a hotel on site and the suspicion that the running of a hotel on profit-making basis would be in breach of the PTG stipulating "hostel" as a permissible use, amongst others. In order to address the complainant's concern, LandsD focused initially on the alleged lease breach of the user restriction, seeking legal advice and liaising with relevant B/Ds to ascertain the policy intention;

- while Lease M carried a clause on the submission of accounts to LandsD, the clause specified that the grantee should submit the annual accounts "if so required". Until recent years, LandsD had been taking the view that the decision as to whether such submissions would be required should be taken by the B/Ds with policy responsibilities over the facilities on site, and when that decision was taken, LandsD would follow up accordingly by exercising its authority under the lease to require the accounts as the government's land agent. When following up on complaints concerning the case in recent years, LandsD had come to realize that the responsibility over that "submission of account" clause was not as clear cut as expected when the hostel as an incoming-generating facility on site supported community/welfare services both on site and off site under the purview of different bureaux. LandsD had therefore taken a more proactive role since 2013 by requesting audited accounts for the hostel from Grantee M in accordance with Special Condition No. (13) of the lease conditions;

- LandsD requested Grantee M to submit audited accounts for the hostel on the lot annually since 2013 and had so far received the annual audited accounts for 2013 up to 2015. LandsD had also received certifications by a Certified Public Accountant acting as Charity M's independent auditor that the hostel income for 2013 to 2015 had been applied by Charity M towards improvement and/or extension of charitable services provided by Charity M.[6] Meanwhile, LandsD was awaiting the submission of audited account for 2016 and the provision

[6] The certifications for 2014 and 2015 were received after the Public Accounts Committee's hearing on 27 May 2017.

of similar certification by an independent auditor regarding the ploughing back of hostel income to Charity M for the year 2016; and

- to further strengthen the Administration's monitoring over the ploughing back of hostel income, LandsD had recently requested Charity M and Grantee M to expand the certification by the independent auditors to include a breakdown of the hostel income ploughed back by categories of uses, e.g. education, welfare, church activities, etc. LandsD's intention was to share the information with the relevant bureaux to facilitate their monitoring of uses and relevant subventions under their purview.

51. As regards the provision of operating agreement between Grantee M and the operator in relation to the development and operation of the hotel, **Director of Lands** replied in her letter dated 16 June 2017 (Appendix 11) that LandsD requested Grantee M in August 2014 to provide the operating agreement but Grantee M expressed difficulties due to confidentiality with what was said to be a private contract between Grantee M and the hotel operator. LandsD made the request again in May 2017 and had recently urged Grantee M to make its best endeavours to overcome the concern with confidentiality by measures such as seeking the consent of the other party for disclosure, disclosing the agreement with sensitive information redacted or providing a summary of the provisions.

52. With reference to paragraph 4 of Case 1 of the Audit Report, $16 million of hostel/hotel operation income was earned and the same amount was paid to Charity M according to Grantee M's audited accounts for the year ended March 2013. The Committee enquired whether SWD would consider the $16 million paid to Charity M when deciding on the subvention amount for Charity M.

53. **Director of Social Welfare** replied at the public hearing on 19 May 2017 and supplemented in her letter dated 16 June 2017 (***Appendix 16***) that Grantee M was required under the land lease to conduct the facilities in accordance with the relevant Ordinances and Regulations in all respects to the satisfaction of the then Director of Buildings and Lands. As mentioned in paragraph 3.13 of the Audit Report, pursuant to a letter of June 1989 issued by the then Director of Buildings and Lands, approval was given to allow surplus derived from the facilities operated by Grantee M to be used towards the improvement and/or extension of all charitable services provided by Charity M. The land grant condition did not require the

surplus derived from the facilities to be used for adjustment of the amount of subvention granted to Charity M by SWD for the operation of the subvented services.

54. The Committee noted from paragraph 7 of Case 1 of the Audit Report that LandsD did not have the expertise or knowledge to scrutinize the accounts submitted or determine whether the profit had been used in a manner and for purposes acceptable to the Administration. The Committee asked about the measures taken by LandsD to address the situation and the lessons to be drawn from the case.

55. **Director of Lands** explained at the public hearing on 27 May 2017 and supplemented in her letter dated 16 June 2017 (Appendix 11) that:

- while LandsD did not possess the expertise or experience in scrutinizing financial accounts, it was hoped that measures, including the requirement for certification by independent auditors, request for the provision of breakdown and the sharing of breakdown with relevant B/Ds, would facilitate the monitoring of the principle of "no profit making"; and

- for new cases of PTGs on nil or concessionary premia, LandsD would ensure that responsibilities over the scrutiny of accounts were internally agreed and grey areas were removed before the leases were finalized, in order to facilitate the monitoring of compliance with no-distribution of profit requirement.

56. According to paragraph 3.15 of the Audit Report, ExCo approved Grantee N's application for granting a site for the construction of a new headquarters with income-generating facilities of a hostel and a canteen at nominal premium and a vehicle park at full premium based on the understanding that Grantee N's income was expected to exceed the amount of government subvention, thus reducing and eventually eliminating the annual subvention of Grantee N's activities. The Committee enquired about the justifications for Grantee N to operate the income-generating facilities, any restrictions on how the hotel/hostel should be operated and the relevant provisions in Lease N or other agreement between the Administration and Grantee N which gave effect to the above understanding.

57. **Secretary for Home Affairs** replied at the public hearing on 19 May 2017 and in his letter dated 22 June 2017 (***Appendix 17***) that:

- in granting Lease N, ExCo had taken into account that revenue would be generated from Grantee N's income-generating facilities, hence allowing for reduction and eventual elimination of the Administration's annual subvention for Grantee N. It was the intention of ExCo to allow the hostel to provide service to the general public so as to generate income for Grantee N; and

- Grantee N wrote to Director of Social Welfare in June 1985, indicating that "it is anticipated that the income generated will be employed to repay the loan…Thereafter, it would be possible for an appropriate reduction to be made to the Government's annual subvention". This had given effect to ExCo's understanding that income generated from the income generating facilities at Grantee N's headquarters would enable Grantee N to gradually cease to be reliant on the Administration's subvention.

58. According to paragraphs 3.19 and 3.20 of the Audit Report, the net profit from the income-generating facilities of Grantee N had reached a level of $829 million over 18 years of operation. However, Audit noted that HAB had not taken any action on the review of the subvention reduction issue after it took the oversight of uniformed group (including Grantee N) since April 2000 until 2010-2011 when it froze Grantee N's subvention. In this regard, the Committee enquired about:

- the change in the level of subvention each year since 2000;

- why HAB had not taken any action to review the subvention reduction issue with Grantee N;

- factors considered by HAB in reducing subvention to Grantee N and whether these factors were different from those adopted by SWD before 2000 when HAB took the oversight of uniformed groups; and

- timetable in taking forward follow-up actions as stated in paragraph 3.21(a) and (b) of the Audit Report.

59. Regarding factors considered in reducing subvention to Grantee N, **Director of Social Welfare** replied at the public hearing 19 May 2017 and in her letter dated 16 June 2017 (Appendix 16) that:

- after repayment of the development costs by Grantee N, continued subvention of Grantee N's activities by SWD would have regard to the level of income from the project. In 1997, after considering a number of factors, SWD negotiated with Grantee N and withheld part of the government rent and rates subsidy in respect of the welfare facilities operated on the site, totalling $1.1 million, for 1994-1995, 1995-1996 and 1996-1997 from its reimbursement of government rent and rates to Grantee N, as an interim arrangement for initial reduction of recurrent subvention; and

- in 1999, after examining Grantee N's financial situation from 1995-1996 to 1997-1998, SWD found that Grantee N had operating surpluses. On this basis, SWD envisaged that there was room for further reduction in its subvention to Grantee N. After discussion with Grantee N, SWD withheld part of the reimbursement of the government rent and rates amounting to $1.47 million each year for 1997-1998, 1998-1999 and 1999-2000, i.e. totalling $4.41 million, to Grantee N.

60. **Secretary for Home Affairs** replied at the public hearing on 19 May 2017 and in his letter dated 22 June 2017 (Appendix 17) that:

- in determining the level of subvention reduction, HAB would have regard to Grantee N's contribution to youth development in Hong Kong, its financial position and resources needed in the future;

- in 2004-2005 and 2005-2006, HAB reduced the subvention for most subvented youth uniformed groups, including reducing the subvention for Grantee N by $0.54 million and $0.67 million respectively. Apart from the general reduction in these two years, HAB agreed that it had not initiated negotiations with Grantee N to discuss additional subvention reduction specific to Grantee N during the period from 2000-2001 to 2009-2010; and

- the ExCo's decision did not specify a timeline for achieving the objective of eventual elimination of Grantee N's subvention. In light of the recommendations of the Audit Report, HAB had resumed the

negotiation with Grantee N with a view to agreeing on the level and timetable of further reducing Grantee N's subvention. In this process, HAB would take into account Grantee N's contribution to youth development in Hong Kong, its financial position and resources needed in the future. If HAB determined that the ExCo's understanding of eventual elimination of subvention could not be achieved, HAB would seek ExCo's endorsement for variation.

Secretary for Home Affairs provided information on the level of subvention provided to Grantee N from 2000-2001 to 2016-2017 in Appendix 17.

61. Regarding the operation of a canteen, a western restaurant and a lounge ("the three catering facilities") at Grantee N's headquarters, the Committee enquired about:

- the rationale of designating some catering facilities for the exclusive use of members of Grantee N;

- the difference between the handling of the canteen and the western restaurant and the lounge by the relevant authorities (i.e. HAB, LandsD and Planning Department ("PlanD")), in particular HAB's support for Grantee N's waiver application, and the definition of "ancillary accommodation and facilities" under the land lease;

- when HAB discovered that the three catering facilities had been open for public and whether HAB's investigation was initiated arising from public complaints or referrals from other government departments;

- whether HAB/SWD had been consulted before the western restaurant and the lounge obtained their respective licences; and

- follow-up actions taken by HAB in respect of the three catering facilities.

62. **Secretary for Home Affairs** replied at the public hearing on 19 May 2017 and in his letters dated 22 June 2017 and 18 July 2017 (***Appendices 17*** and ***18*** respectively) that:

- with regard to the three catering facilities, the canteen should be opened to members of Grantee N only. In June 2015, HAB was

alerted by the Food and Environmental Hygiene Department ("FEHD") that the canteen, which was open to the public, should comply with the relevant lease conditions. Upon the request of HAB, Grantee N took action subsequently to obtain planning permission from the Town Planning Board and a temporary waiver from LandsD to permit the use of the canteen for restaurant purpose. In January 2016, HAB informed LandsD that it supported Grantee N's waiver application subject to the imposition of full administrative fee and waiver fee. The planning permission and temporary waiver were granted in December 2016 and March 2017 respectively;

- in general, PlanD and LandsD were responsible for advising whether the provision of the catering facilities within the concerned development complies with the Outline Zoning Plan and land lease respectively, while HAB was responsible for considering proposals from Grantee N regarding operations requiring HAB's approval under the lease. Under Clause 6(i) of the Special Conditions of Lease N, Director of Social Welfare (now Secretary for Home Affairs) should decide on whether a use could be regarded as "ancillary accommodation and facilities". In doing so, HAB would take into account the nature of the use and whether it was incidental to and directly related to the use permitted under lease. According to Lease N, the canteen should be open to members of Grantee N only. Since Grantee N's canteen was not operated as part of the hostel and its current operation as a restaurant could not be regarded as an ancillary facility to Grantee N's headquarters, planning permission and a waiver application were needed for the canteen to be operated as a restaurant. On the other hand, the western restaurant and lounge were operated as part of the hostel and were therefore regarded as ancillary facilities to the hostel;

- in light of the recommendations in the Audit Report, HAB was ascertaining with LandsD and PlanD that the operation of the western restaurant and lounge complied with the relevant land administration and planning requirements; and

- the canteen commenced operation in July 1994 and obtained a General Restaurant Licence in February 1996. According to Grantee N's record, the canteen was not operated as a restaurant and open to the public until it obtained a General Restaurant Licence in February 1996. The western restaurant and lounge commenced operation in October

1993 and August 1995 respectively. Such uses were prescribed in clause (6)(i) of the Special Conditions of Lease N (Appendix 17).

Ms Karen CHAN Pui-yee, Acting Director of Lands confirmed at the public hearing on 27 June 2017 that the operation of the western restaurant and lounge complied with the relevant land administration and planning requirements and could be open to the public.

63. Regarding whether SWD had been consulted before the western restaurant and the lounge obtained their respective licences, **Director of Social Welfare** replied at the public hearing on 19 May 2017 and supplemented in her letter dated 16 June 2017 (Appendix 16) that:

- the western restaurant and the lounge on the mezzanine floor, as ancillary accommodation and facilities of the hostel, could be open to the public; and

- SWD did not have file record showing that Grantee N had consulted SWD on the application for the General Restaurant License for the restaurant. There was also no record in the minutes of the meetings of the Management Committee about the discussion on the operation of the restaurant, western restaurant and lounge.

64. The Committee enquired whether HAB/SWD had obtained the statement of accounts of Grantee N's income-generating facilities, and if not, the reasons why not.

65. **Secretary for Home Affairs** replied at the public hearing on 19 May 2017 and supplemented in his letter dated 22 June 2017 (Appendix 17) that since 2000, Grantee N had not submitted independent statement of accounts of the income-generating facilities of its headquarters and the vehicle park to HAB. However, the relevant accounts had been incorporated in Grantee N's annual financial reports, which were submitted to HAB annually. In light of the recommendations of the Audit Report, HAB asked Grantee N to reactivate the Management Committee in May 2017 and to submit independent statement of accounts of the income-generating facilities of its headquarters and the vehicle park. At the request of the Committee, **Secretary for Home Affairs** provided the income and expenditure of Grantee N's income-generating facilities at its headquarters and Grantee N's operation as a whole for the past three years in Appendix 18.

66. **Director of Social Welfare** replied at the public hearing on 19 May 2017 and supplemented in her letter dated 16 June 2017 (Appendix 16) that after 1997-1998, SWD obtained the statements of accounts of Grantee N's income-generating facilities for the following years:

Year	Date of receipt
1998-1999	22 July 1999
1999-2000	4 July 2000
2000-2001	9 July 2001
2001-2002	8 June 2002
2002-2003	10 April 2003

67. According to paragraph 3.16 of the Audit Report, Grantee N should establish a Management Committee comprising its own representatives, Director of Social Welfare 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. The Committee enquired about:

- any change in scope, terms of reference and membership of the Management Committee before and after HAB took over the management and subvention of Grantee N in April 2000; and

- whether SWD/HAB had asked Grantee N to convene meetings of the Management Committee according to the lease condition before and after the period April 2000 to early 2017.

68. **Secretary for Home Affairs** replied at the public hearing on 19 May 2017 and supplemented in his letter dated 22 June 2017 (Appendix 17) that:

- meetings of the Management Committee had not been convened since 1998. When Grantee N reactivated the Management Committee in May 2017 upon HAB's request, there was no change to the Management Committee's scope and terms of reference. There were slight updates to the membership to reflect the change of supporting bureau from SWD to HAB; and

- while HAB had not requested Grantee N to convene meetings of the Management Committee before early 2017, after HAB assumed the role of supporting bureau for Grantee N in 2000, the representative of HAB had been attending Grantee N's Executive Committee meetings,

which discussed Grantee N's financial matters as a standing item, as an observer.

69. **Director of Social Welfare** replied at the public hearing on 19 May 2017 and supplemented in her letter dated 16 June 2017 (Appendix 16) that:

- according to the record of minutes of the meetings of the Management Committee, Grantee N held five meetings from 1993 to 1998; and

- HAB took over from SWD the management of Grantee N in 2000. SWD had not been involved in the related management work since then.

Director of Social Welfare provided the scope, terms of reference and membership of the Management Committee in Appendix 16.

70. The Committee asked about details of meetings of the Executive Committee of Grantee N in which the operation of the income-generating facilities of the headquarters and the vehicle park had been discussed.

71. **Secretary for Home Affairs** replied at the public hearing on 19 May 2017 and in his letter dated 22 June 2017 (Appendix 17) that according to the Constitution of Grantee N, in between meetings of the Council of Grantee N, the Executive Committee should be the authority of Grantee N in respect of major policy decisions, coordination with the Chief Commissioner, control of funds and resources and financial support. A total of 105 meetings of the Executive Committee were held from January 2000 to May 2017. At all the meetings, the Executive Committee made regular reports on the operation of the income-generating facilities of the headquarters and vehicle park. The income and expenditure of the income-generating facilities were also discussed together with the annual budget of Grantee N.

72. Referring to Cases 2 and 3 highlighted in the Audit Report, the Committee enquired about the follow-up actions taken by SWD on the possible non-compliance of Leases G and H.

73. **Director of Social Welfare** replied at the public hearing at 27 June 2017 and supplemented in her letter dated 11 July 2017 (Appendix 13) that:

Lease G

- the organization indicated in 1968 that the dormitories were mainly to provide residential accommodation for students or young workers. After reviewing the service need arising from the shrinkage in demand for dormitories, lodge service was set up on the lot of Lease G with a view to providing on-the-job training for students of the adult education courses on hospitality services organized by the organization, and to equipping these students with adequate working experience to prepare for employment;

- SWD agreed that the use of the facilities concerned to provide lodge service was not appropriate. In June 2014, LandsD requested the Grantee to cease the operation of the lodge on the subject lot. In June 2016, the organization advised LandsD that the operation of the lodge on the subject lot had ceased in May 2016. Currently, the major service targets of the dormitories were students of the adjacent universities and tertiary institutions with residential needs, including referrals made by the universities or institutes concerned. The organization also planned to make use of the dormitories to meet the welfare needs of the society. The service targets under consideration were those who required short-term residential needs for various reasons. SWD would continue following up with the organization in ensuring that the use of the dormitories was compliant with the permitted uses under the land lease conditions and meanwhile help complement the contemporary welfare needs of the society; and

- there was no requirement for submission of audited accounts or the use of the surplus derived from the dormitories under the land lease concerned. Nevertheless, the Annual Reports of the organization had been covering the income and expenditure as well as the financial position of the hospitality services under its purview (including the dormitories on the subject lot). The information was also available on the internet. To SWD's understanding, the organization would transfer the surplus derived from the dormitories to a General Fund to support the operation of the non-subvented social, educational and medical services or the daily operation of the organization as well as its service/project development, or to meet the operating deficits of other service units. Part of the surplus would also be transferred to a

Maintenance Reserve Fund to meet the expenditure on maintenance items as required by law and/or due to the obsolescence of the facilities;

Lease H

- according to the organization, the service targets of the hostel currently included its co-operating partners, organizations and groups of the church body, students, visitors from overseas for conference purposes and tourists. As there was no explicit restriction about the users of the hostel facilities in the land lease, SWD considered that there was no non-compliant use of the hostel; and

- on the requirement to submit audited accounts, although Grantee H had not submitted the audited statements of accounts for the said centre according to the land lease requirement, SWD had exercised its monitoring of the SWD-subvented welfare facilities on the subject lot in accordance with the Funding and Services Agreement as executed with the organization. The organization had also, pursuant to the requirements under the Funding and Services Agreement, submitted the requisite financial reports to SWD for vetting. After the issue of the Audit Report, LandsD wrote to the organization requesting the latter to submit, as required under the land lease, the audited accounts covering the said centre to Director of Social Welfare by 1 June 2017. The organization responded earlier to LandsD, indicating that as they needed time to prepare for the audited accounts, they would like to apply for extension of the deadline for submission of the accounts until 30 July 2017. SWD would scrutinise the audited accounts to be received from the organization and would, where necessary, further follow up with the organization on how the surplus derived from the facilities operated on the subject lot should be used.

74. The Committee enquired about the guidelines or mechanism in place for HAB/SWD staff to monitor and enforce lease conditions throughout lease term under HAB/SWD's purview.

75. **Secretary for Home Affairs** replied at the public hearing on 27 May 2017 and in his letter dated 22 June 2017 (Appendix 17) that at present, HAB processed land applications and monitored and enforced lease conditions in accordance with the Protocol issued by LandsD in 2014. In light of the recommendations in the Audit

Report, HAB should consider the need of formulating further guidelines to assist HAB staff in monitoring and enforcing lease conditions.

76. **Director of Social Welfare** replied at the public hearing on 27 May 2017 and supplemented in her letter dated 16 June 2017 (Appendix 16) that for Lease N, in accordance with the land lease condition concerned, SWD appointed a representative to attend the meetings of the Management Committee from 1993 to 1998. Besides, a meeting was held between SWD and Grantee N in September 1999 to continue discussing the subvention reduction arrangement. Before HAB took over from SWD the management and subvention of uniformed groups in 2000, SWD monitored the uniformed group services provided by the grantee according to the prevailing Guide to Social Welfare Subventions, including review of service data information, service assessment visits and subvention inspection, etc.

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

77. According to paragraph 4.9 of the Audit Report, Audit's analysis found that 21 companies of the 263 non-compliant charities which were companies limited by guarantee had repeatedly failed to file annual returns for the period 2011 up to 2016 (i.e. 12 companies for 5 years and 9 companies for 6 years). The Committee enquired about:

- reasons for the charities' repeated breaches and follow-up actions that had been taken to address the problem;

- any bring-up system in place to facilitate the monitoring and enhancing the effectiveness of compliance checks on those repeated non-compliance cases, such as deployment of information technology; and

- latest progress on the two companies not identified by CR in its compliance check as highlighted in paragraph 4.9(a) and follow-up actions taken to prevent similar occurrence in future.

78. **Ms Ada CHUNG Lai-ling, Registrar of Companies** responded at the public hearing on 19 May 2017 and supplemented in her letter dated 29 May 2017 that (***Appendix 19***):

- when defaulting cases were identified during compliance checks carried out by CR, CR would issue notices-to-file to the companies concerned requesting rectification of the default within a specified period. If the non-compliance continued, CR would consider instituting prosecution and/or strike-off actions against the company concerned. In general, from past experience, most of the guarantee companies which were in default of filing obligations claimed that they did not have sufficient resources and/or manpower to prepare their annual financial statements on a timely basis, which in turn led to delays in the filing of annual returns to CR;

- actions taken against the 21 cases mentioned in paragraph 4.9 of the Audit Report and the latest progress were as follows:

Actions taken by CR	**Number of cases**
Already struck off from the Companies Register	2
Prosecuted and strike-off actions in progress	12
Strike-off actions in progress	5
Prosecution action in progress	1
Follow-up actions pending results of legal proceedings involving the Company	1
Total	**21**

- as referred to in paragraph 4.9(a) of the Audit Report, CR was enhancing the system for conducting compliance checks, including annual checks and weekly checks, to identify companies limited by guarantee which did not comply with the filing requirements of annual returns. As the requirement for the filing of annual returns by companies limited by guarantee had been streamlined under the present Companies Ordinance, this enabled CR to enhance its system by tracking the due date for the delivery of annual return by individual companies so as to take more timely follow-up actions.

79. The Committee noted from paragraph 4.10 and Table 6 of the Audit Report that 126 companies had filed their annual returns late for 2016, with 35 (28%) submitted their returns over 90 days with the longest delay being 229 days after the due date. The Committee asked about the actions taken on these charities, especially for long delay cases, in accordance with the relevant provisions of the Companies Ordinance.

80. **Registrar of Companies** responded at the public hearing on 19 May 2017 and supplemented in her letter dated 29 May 2017 (Appendix 19) that all the 126 companies mentioned in paragraph 4.10 and Table 6 of the Audit Report had delivered the outstanding annual returns for registration, among which 38 companies delivered the outstanding annual returns after CR had issued compliance notices; while 16 companies complied with the filing requirements after CR had instituted prosecution actions against them (including the case where the annual return was filed late for 229 days). Another 72 companies had delivered annual returns for registration after the due date for submission without being prompted by a notice-to-file, so CR considered that no further action was required.

81. The Committee enquired about the new measures and requirements on companies limited by guarantee under the new Companies Ordinance that replaced the old Companies Ordinance (Cap. 32) with effect from March 2014, and measures that had been implemented by CR to promote compliance with the filing requirements.

82. **Registrar of Companies** responded at the public hearing on 19 May 2017 and supplemented in her letter dated 29 May 2017 (Appendix 19) that:

- a company limited by guarantee must in respect of every financial year deliver an annual return together with certified copies of its financial statements for registration. The requirement to deliver certified copies of financial statements applied to all guarantee companies and was introduced to enhance transparency of company information;

- the requirements for filing annual returns had been streamlined. A company limited by guarantee must in respect of every financial year deliver an annual return together with certified copies of its financial statements for registration within 42 days after the company's return date. The return date was nine months after the end of the company's accounting reference period. Thus, the due date for the delivery of an annual return was determined with reference to a company's accounting reference date, which was more predictable when compared with the case under the old Companies Ordinance, making reference to the date of annual general meeting of the company concerned which might vary every year;

- an escalating scale of annual registration fees in the case of late filing of annual returns was introduced under the present Companies Ordinance to encourage timely compliance;

- to promote compliance with the filing requirements under the Companies Ordinance, CR would continue with their educational and promotional efforts. These included maintaining a thematic section on "Compliance" on CR's website which provided information on the obligation of a company and its officers, publication of posters, information pamphlets and circular letters, etc.; and

- CR's enforcement policy was premised on all of the companies on the Companies Register. As the Companies Ordinance did not have a separate category of companies which were charities, it was important to strike a reasonable balance between enforcement actions taken against charities which were incorporated as companies and other companies on the Companies Register.

83. Noting that there were 189 societies established for charity purposes as of September 2016 (paragraph 4.14 of the Audit Report), the Committee enquired how HKPF determined whether a local society was established for charity purposes.

84. **Mr Stephen LO Wai-chung, Commissioner of Police** replied at the public hearing on 19 May 2017 and supplemented in his letter dated 26 May 2017 (***Appendix 20***) that the Societies Ordinance contained no definition of "charity" or "charity purposes". Should a society seek in the application form for society registration or exemption from registration that its establishment was solely or partly for charity purposes, the society would be categorized as charitable organization or charity-related organization.

85. The Committee enquired about the differences in terms of legal liabilities and other statutory requirements between a registered and exempted society, and under what circumstances and conditions a society could apply for exemption for registration.

86. **Commissioner of Police** replied at the public hearing on 19 May 2017 and supplemented in his letter dated 26 May 2017 (Appendix 20) that:

- under section 5A(2) of the Societies Ordinance, a local society should apply to the Societies Officer for exemption for registration if the society was established "solely" for religious, charitable, social or recreational purposes or as a rural committee or a federation or other association of rural committee. If the Societies Officer exempted a society for registration, he would issue a certificate of exemption from registration;

- where a local society was established for purposes other than those set out in section 5A(2) of the Societies Ordinance listed above, it should register with the Societies Officer under section 5A(1) of the Societies Ordinance; and

- there was no difference in terms of the duties and powers of the Societies Officer vis-à-vis a registered society and an exempted society under the Societies Ordinance. Similarly, there was also no difference in terms of legal liabilities and other statutory requirements of a registered society and an exempted society under the Societies Ordinance.

87. According to paragraph 4.17 of the Audit Report, HKPF carried out regular reviews on those societies which had not contacted HKPF in the preceding 10 years. The Committee enquired whether HKPF would consider more effective measures in identifying inactive societies registered/exempted societies so as to keep the list posted on HKPF's website up-to-date.

88. **Commissioner of Police** replied at the public hearing on 19 May 2017 and supplemented in his letter dated 26 May 2017 (Appendix 20) that:

- as required by section 14 of the Societies Ordinance, if a registered or an exempted society had subsequently dissolved itself, the office-bearers had the responsibilities to notify the Societies Officer of such dissolution in writing, not later than the expiration of one month after the dissolution took effect. HKPF had reminded the office-bearers of this requirement in the acknowledgement letter issued to the office-bearers upon completion of society registration. A reminder message was also posted on the website of HKPF;

- the Societies Office had issued internal orders to formalize the present practice of conducting regular reviews to identify inactive societies.

The computer registration system of the Police Licensing Office would be upgraded by fourth quarter of 2018 whereby the identification of inactive societies and the management of the registered and exempted societies list would be further enhanced;

- the Societies Office would modify the application form for societies registration or exemption for registration to offer an option for a society to provide an email address for electronic communication; and

- HKPF would also study the feasibility of establishing an internal notification system to notify the Societies Office if a local society organized any activity that required an application to HKPF, e.g. public order events, lion dances, etc., so that the Societies Office knew that the society was still active.

89. The Committee enquired about the follow-up actions and improvement measures to be taken by HKPF to prevent the occurrence of irregularities as highlighted in paragraphs 4.17 (b), (c) and (d) of the Audit Report.

90. **Commissioner of Police** replied at the public hearing on 19 May 2017 and supplemented in his letter dated 26 May 2017 (Appendix 20) that:

- paragraphs 4.17 (b) and (c) stated that HKPF conducted no reviews of inactive societies in 2015 and 2016 due to the fact that the Societies Office was fully occupied by other pressing operational priorities in those two years; and

- paragraph 4.17 (d) stated that the registered/exempted societies list was not updated as 19 societies that had been marked cancelled were still included in the society list posted on HKPF's website. The oversight was due to error 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 registered/exempted societies list accordingly.

91. The Committee enquired about the number of new applications, withdrawal or strike off cases that HKPF normally handled in a year, and whether HKPF had enough manpower to handle such volume of cases each year.

92. **Commissioner of Police** replied at the public hearing on 19 May 2017 and supplemented in his letter dated 26 May 2017 (Appendix 20) that:

- the Societies Office handled a yearly average of around 9 000 to 10 000 applications, including 2 000 new applications for societies registration/exemption for registration. It further received a yearly average of around 100 notifications of dissolution of societies; a legal obligation which was placed on the office bearers pursuant to section 14 of the Societies Ordinance. For removal of societies from the registered/exempted societies list due to cessation of existence, the number of societies removed varied each year (ranged from 100 to 1 000); and

- in view of the increased workload, in 2011, one additional disciplined post was added to the Societies Office. The current manpower of six staff in the Societies Office was considered sufficient at this stage. The computer registration system of the Police Licensing Office would be upgraded by fourth quarter of 2018 whereby the efficiency and effectiveness of the Societies Office would be further enhanced.

93. The Committee noted that there was no provision under the Societies Ordinance requiring the submission of financial statements by a registered/exempted society, and hence requirement for submission of financial statements required of charities registered under the Societies Ordinance and Companies Ordinance, and incorporated management committees under the Education Ordinance was different. In this regard, the Committee enquired when the Societies Ordinance was last amended, and details of the amendments, and whether the Security Bureau planned to conduct a review of the Ordinance in the future.

94. **Secretary for Security** replied in his letter dated 29 May 2017 (***Appendix 21***) that:

- section 15 of the Societies Ordinance stated that the Societies Officer might, at any time, by notice in writing served on any society require the society to furnish him in writing with such information as he might reasonably require for the performance of his functions under the Ordinance. Such information required might include the income, the source of the income and the expenditure of the society or its branch. Failure to comply should be liable to a fine. The Societies Ordinance therefore did empower the Societies Officer to request a society to

provide information on the income, source of income and expenditure of the society or its branch; and

- the Administration from time to time reviewed the Societies Ordinance. Over the past 10 years, the Ordinance had been amended twice, namely, in 2008 in view of the Hong Kong Court of Final Appeal's judgement in *Leung Kwok Hung v HKSAR [2005] 3 HKLRD 164* and in 2012 as a result of consequential and related amendments to the Companies Ordinance.

95. According to paragraph 4.30 of the Audit Report, some IMC schools had repeatedly submitted their audited financial statements late for the 2010-2011 to 2014-2015 school years, i.e. 68, 41 and 70 IMC schools for three, four and five years respectively. For eight 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. The Committee enquired whether:

- EDB was aware of the above situation and reasons for the repeated non-compliance; and

- EDB had closely monitored IMC schools with repeated non-compliance and actions taken to address the problems, and the implementation timetable of such actions.

96. **Mr Kevin YEUNG Yun-hung, Under Secretary for Education** replied at the public hearing on 19 May 2017 and **Secretary for Education** supplemented in his letter dated 29 May 2017 (***Appendix 22***) that:

- EDB had put in place proper mechanism to follow up with IMC schools that failed to submit their annual audited financial statements by the deadline. According to the established mechanism, EDB would liaise with the schools concerned to understand the reasons for the late submission and offer assistance where appropriate. The late submission by schools was mainly due to high turnover of accounting staff, inexperienced staff, change in auditors and late submission of audited financial statements by auditors. Some schools however failed to accord due priority to ensure timely completion and submission of the audited financial statements; and

- for those IMC schools that failed to submit the annual audited financial statements by the submission deadline, EDB would issue reminders to the schools concerned within two months after the deadline and the responsible EDB regional officer would closely follow up with the schools. Bi-monthly emails would be issued to escalate the outstanding cases to senior EDB officers for taking follow-up action with the schools. If the outstanding audited financial statements had been overdue for more than 10 months, EDB would approach the sponsoring body of the school to request immediate submission. Nevertheless, it should be noted that late submission beyond three months after deadline for the school years from 2010-2011 to 2014-2015 was on average of 5%. There were no outstanding annual audited financial statements for the said school years. EDB considered the established mechanism had been working effectively.

97. The Committee noted that EDB's guidelines stated that IMC schools might consider uploading the annual audited accounts onto the school website to enhance transparency. Audit's sample check revealed that of the 30 IMC schools, 27 had uploaded their financial summaries onto their websites but none of them uploaded their annual audited accounts. The Committee enquired about the reasons IMC schools did not upload their annual audited accounts and measures that had been taken to encourage IMC schools to adopt this good practice.

98. **Under Secretary for Education** replied at the public hearing on 19 May 2017 and **Secretary for Education** supplemented in his letter dated 29 May 2017 (Appendix 22) that to enhance transparency, aided IMC schools were advised to give a financial summary in their annual school reports which had to be uploaded onto school websites. Schools might also consider uploading their audited accounts onto their websites. Whilst some schools concurred with EDB that the uploading of financial statistics onto their websites would enhance transparency, some did not consider it necessary. EDB would encourage more schools to adopt the good practice of uploading their financial summaries/annual audited accounts onto their websites by updating relevant guidelines before the commencement of the 2017-2018 school year and promulgated these messages in related seminars and briefings for IMC schools in January 2018.

99. According to paragraph 4.23 of the Audit Report, under the Education Ordinance, an IMC school should prepare statements of the accounts of the school to be audited by a Certified Public Account (Practising) for submission to EDB within

six months for aided schools/seven months for Direct Subsidy Scheme schools after the end date of a school year/financial year. The Committee enquired about the requirements on the format of the audited financial statements, and whether the format had been vetted or approved by EDB , relevant B/Ds or sought the advice of professional accounting bodies in formulating such requirements.

100. **Under Secretary for Education** replied at the public hearing on 19 May 2017 and **Secretary for Education** supplemented in his letter dated 29 May 2017 (Appendix 22) that according to Section 40BB of the Education Ordinance, IMC schools were required to submit annual audited financial statements to the Permanent Secretary for Education at such time and in such manner as the Permanent Secretary might specify. The annual audited financial statements should include an income and expenditure account and balance sheet, be authenticated by the signatures of the supervisor of the school and one other manager authorized by the IMC of the school to act for that purpose. In this connection, EDB issued circular memoranda annually to call for submission of annual audited financial statements by IMC schools within six/seven months after the close of the relevant school year. EDB would specify in the circular the detailed reporting requirements, specifically providing templates for IMC schools to report the financial position of each individual grant they received from EDB during the school year. EDB maintained contacts with the Hong Kong Institute of Certified Public Accountants which had issued a circular (to be updated from time to time) on reporting on the audit of schools, providing guidance to auditors in relation to audits of financial statements of aided and Direct Subsidy Scheme schools.

E. Regulation of Chinese temples

101. The Committee noted from paragraph 5.12 of the Audit Report that HAB and CTC conducted a review of the provisions of CTO during 2012 to 2015 with a view to making legislative amendments to better reflect current practices and serve current needs. The Committee enquired about the proposed legislative amendments, and the progress and timetable in implementing the recommendations set out in the review.

102. **Secretary for Home Affairs** replied at the public hearing on 19 May 2017 and supplemented in his letter dated 26 May 2017 (***Appendix 23***) that:

- CTO was enacted in 1928 in view of the mismanagement of some Chinese temples and abuses of donated funds prevailing at that time.

Taking account of the changes in social conditions over time, it might not be consistent with the current social conditions if Chinese temples were not allowed to operate unless they were registered under CTO;

- HAB and CTC had started reviewing CTO to update the regulatory regime for Chinese temples in order to meet the present social conditions and needs while striking an appropriate balance between respecting religious freedom and safeguarding public interests. Upon the initial review, a number of proposed amendments to the provisions of the CTO had been put forward in 2015. These included replacing the mandatory registration requirement with a voluntary registration scheme and adding to the Ordinance a provision to provide Secretary for Home Affairs with power to participate in legal proceedings against mismanagement of Chinese temples and abuses of temples' funds. During March to May 2015, HAB and CTC conducted a public consultation on the proposed amendments. The public consultation document on the review on the CTO is in Appendix 23; and

- the results of the public consultation indicated that there was no clear consensus in the community on the major proposed amendments. In August 2016, CTC set up the Chinese Temples Ordinance Review Task Force to study the suggestions and directions of the proposed legislative amendments. The task force conducted its first meeting in November 2016. HAB and CTC would continue to explore the establishment of a reasonable and up-to-date regulatory regime for Chinese temples. HAB would report further recommendations to the Legislative Council Panel on Home Affairs in due course.

103. The Committee noted that there were around 250 unregistered temples in Hong Kong as at March 2015 and CTC had not taken any action against them. The Committee enquired how the Administration could prevent the mismanagement of these unregistered temples and abuses of donated funds, and effectively encourage those unregistered temples to register voluntarily and whether the voluntary registration scheme could ensure the effective management and monitoring of Chinese temples in Hong Kong.

104. **Secretary for Home Affairs** replied at the public hearing on 19 May 2017 and supplemented in his letter dated 26 May 2017 (Appendix 23) that although further review of CTO was needed, there were various ordinances in place to safeguard the citizens and public interests against abuses of funds or mismanagement

of Chinese temples. If any temple contravened the requirements of the relevant ordinances, the government departments concerned would follow up in accordance with the ordinance(s). For example, the Theft Ordinance (Cap. 210) covered offences of fraudulent or deceitful solicitation of money. If a case concerned contention over a temple involving charitable interests or significant public interests, Secretary for Justice might, in accordance with the Trustee Ordinance (Cap. 29), performed his roles as the protector of public charities to safeguard public interests. The permitted uses of the land on which Chinese temples were situated were subject to the requirements in the relevant land leases.

105. In accordance with paragraphs 5.15 and 5.16 of the Audit Report, HAB would consider measures to enhance transparency and accountability of the temples' operation, including publishing audited accounts and financial statements for individual temples for public inspection. The Committee asked about actions that would be taken and timetable for implementation in this regard.

106. **Secretary for Home Affairs** replied at the public hearing on 27 June 2017 and supplemented in his letter dated 18 July 2017 (Appendix 18) that:

- currently, 45 temples were managed by CTC comprising 25 under direct administration (the "directly-administered temples") and 20 temples delegated to eight organizations for management (the "delegated temples") by means of signing of an agreement. Under the existing arrangements, the financial information of all directly-administered temples and nine delegated temples of CTC was included in the annual financial statement of the Chinese Temples Fund, which was audited by the Audit Commission and submitted to the Legislative Council every year for information and uploaded to the website of CTC for public inspection;

- in order to further enhance transparency, CTC planned to upload the relevant financial information of each directly-administered temple to the website of CTC by end of 2017. As for the delegated temples, CTC planned to include the new requirement of disclosing relevant financial information of the delegated temples upon renewal of the delegated agreements with the managing organizations. In the interim, the Secretariat of CTC would also discuss with the managing organizations and encourage them to disclose the relevant financial information of the temples as soon as practicable; and

- CTC would also encourage registered temples which received donations from the public to make reference to the Reference Guide on Best Practices for Charitable Fund-raising Activities promulgated by SWD with a view to enhancing the transparency of the operation of temples.

107. The Committee noted from paragraph 5.7(a) of the Audit Report that Organization A refused to enter into a new delegation agreement with CTC and as a result, Organization A continued to manage the temple and keep and use donations and revenues received without accountability to CTC. There was no record to show that CTC had followed up with Organization A since 2007. The Committee asked whether Secretary for Home Affairs was aware of the situation and what actions had been taken to address the issue.

108. **Secretary for Home Affairs** replied at the public hearing on 19 May 2017 that he had knowledge of this issue before he assumed office in July 2015. He said that HAB had been continuously following up with Organization A in respect of the renewal of the delegation agreement.

109. Referring to paragraph 5.7(a) of the Audit Report which stated that "there was no record to show that the CTC had followed up with Organization A since 2007", the Committee requested HAB to provide documents to substantiate the Secretary's statement made at the public hearing on 19 May 2017 that HAB had been continuously following up the issue with Organization A on the renewal of delegation agreement.

110. **Secretary for Home Affairs** provided the correspondence between CTC and Organization A in Appendix 23. He admitted at the public hearing held on 27 June 2017 that the last correspondence between CTC and Organization A was in October 2007. He advised in his letter dated 26 May 2017 (Appendix 23) that:

- according to the record of CTC, a delegation agreement between CTC and Organization A was officially signed in 1996 for managing the temple in accordance with the provisions set by CTC. Upon the expiry of the delegation agreement in July 2006, the two parties could not reach a consensus on the terms of the agreement and CTC agreed to extend the original agreement for a period of three months to October 2006 pursuant to the contractual terms in the original agreement. The

Secretariat of CTC subsequently issued four letters to Organization A in September and December 2006, and June and October 2007 respectively, requesting Organization A to sign the agreement (the correspondence between the Secretariat and Organization A are in Appendix 23), but received no reply from Organization A. As the two parties could not reach a consensus on the terms of the agreement, the CTC Secretariat had been suspending the signing of the agreement;

- CTC agreed that the existing arrangement was undesirable. Therefore, the Finance and Management Working Group of CTC took up the follow-up of the case of Organization A again in August 2016. At the general meeting held in November 2016, it was agreed that the case would be followed up by HAB and CTC Secretariat. In January 2017, a meeting was held among HAB, CTC Secretariat and the District Office of the district in which Organization A was based. The three parties agreed that the District Office could first discuss with Organization A the arrangement for signing a new agreement with CTC. In February 2017, the District Office made a request to Organization A to sign a new agreement with CTC. The District Office reported the situation of meeting with Organization A to the Secretariat through email in March 2017 (Appendix 23); and

- the CTC Secretariat issued a letter on 18 May 2017 to Organization A and requested Organization A to sign a new agreement with CTC as soon as possible, and stating that the Secretariat would consider other appropriate actions should there be no response received. Meanwhile, HAB was seeking legal advice on CTC's rights and possible actions under CTO or other ordinances to work out follow-up plans. HAB would report progress to the Public Accounts Committee on the follow-up actions for the case within one year.

111. Referring to paragraph 5.7(b) of the Audit Report, the Committee enquired about the latest progress of CTC's discussion with Organization B on renewal of a delegation agreement.

112. **Secretary for Home Affairs** replied at the public hearing on 19 May 2017 and supplemented in his letter dated 26 May 2017 (Appendix 23) that the CTC Secretariat had been negotiating with Organization B since November 2015 about signing a new delegation agreement. A copy of the new delegation agreement had been provided to Organization B in April 2017 to explain the requirements of the

terms. The CTC Secretariat would expedite negotiation with Organization B to sign the agreement and handle the additional storeroom built by Organization B in compliance with the laws and the requirements of the agreement.

113. According to paragraph 5.11 of the Audit Report, in Organization D's submitted accounts, a staff messing expenditure of about $380,000 was recorded and was disproportionate to the operational expenses of the temples. CTC had not sought clarifications from Organization D. The Committee enquired about:

- details of the staff messing expenditure of $380,000, and reasons for the huge increase of such expenditure over the previous year; and

- reasons why CTC had not sought clarifications from Organization D over details of the expenditure, and whether CTC had properly performed its role in managing the delegated temples to ensure their use of funds complied with the delegation agreement.

114. **Secretary for Home Affairs** replied at the public hearing on 19 May 2017 and supplemented in his letter dated 26 May 2017 (Appendix 23) that:

- according to the annual statement of accounts for the year ended December 2015 submitted by Organization D, the staff cost of Organization D (one full-time post and two part-time posts) in 2015 was $301,361;

- the staff messing expenditure of about $380,000 in the annual statement of accounts for the year ended December 2015 of Organization D was higher than the amount of $137,000 incurred in 2014. Organization D explained to the CTC Secretariat that the auditor had mistakenly included expenditure items unrelated to staff messing, such as cleansing expenses, offerings to deities, and repairs and maintenance expenses, in the "staff messing expenditure". In March 2017, Organization D submitted the re-audited annual statement of accounts for the year ended December 2015 to the Secretariat; and

- only about $154,484 out of the expenditure item of $380,000 should be counted as "staff messing expenditure", which was 13% higher than the expenditure of $137,143 as shown in the 2014 audited accounts and was considered acceptable. The staff messing expenditure was

actually meal and transport allowance provided to voluntary workers who rendered services to the temples. Three voluntary workers were providing long-term assistance to the temples including introducing the history of the temples to worshippers, providing fortune-telling service, selling joss sticks and cleansing the temples. Every year, Organization D organized activities during traditional festivals, and around 40 to 50 temporary voluntary workers would be recruited on each occasion and be provided with meal and transport allowance.

A breakdown of the re-audited expenditure item of about $380,000 was provided in Appendix 23.

F. Way forward

115. Noting that HAB had convened two meetings on 11 August 2015 and 4 October 2016 to discuss the LRC Report, the Committee enquired about the reasons for the Administration to take so long to respond to the recommendations made by LRC, short-term measures to be implemented and timetable in formulating medium and long-term measures.

116. **Secretary for Home Affairs** replied at the public hearing on 19 May 2017 and supplemented in his letter dated 26 May 2017 (Appendix 23) that:

- the Administration needed time to consider the recommendations of LRC thoroughly and carefully as they had significant implications on the definition and operation of charities in Hong Kong. HAB was co-ordinating inputs from the relevant B/Ds at meeting and through various communication channels in exploring possible way forward;

- upon release of the LRC Report in December 2013, HAB wrote to the following relevant B/Ds on 20 January 2014 inviting their consideration of LRC's recommendations:

  (a) eight bureaux (i.e. Constitutional and Mainland Affairs Bureau, EDB, Environment Bureau, FSTB, Food and Health Bureau, Labour and Welfare Bureau, Development Bureau and Security Bureau) and one department (i.e. Efficiency Unit) which HAB consulted in writing in January 2014;

(b) another seven executive departments (i.e. Agriculture, Fisheries and Conservation Department; CR; FEHD; Home Affairs Department ("HAD"); HKPF; IRD and SWD) which also provided comments to HAB; and

(c) Office of the Government Chief Information Officer which was responsible for the operation of the "GovHK" website; and

- on the basis of the responses from the relevant B/Ds, HAB made an initial assessment and considered that the challenges in implementing LRC's recommendations would come mainly from the LRC's three major recommendations, namely providing a statutory definition of "charitable organizations"; establishing and maintaining a register of charitable organizations by a single Government bureau or department; and delegating the same bureau or department to be responsible for co-ordinating the work of regulating charitable organizations and charitable fund-raising activities which were currently under the purview of different B/Ds. The major challenges were summarized below:

  (a) challenges in providing a statutory definition of "charitable organizations" or "charitable purposes":

    - one of the major recommendations of LRC was that a statutory definition should be provided for "charitable organizations" or "charitable purposes" covering 14 heads.[7]

[7] The 14 heads are:
(1) The prevention or relief of poverty;
(2) The advancement of education;
(3) The advancement of religion;
(4) The advancement of health;
(5) The saving of lives;
(6) The advancement of citizenship or community development, which includes (i) rural or urban regeneration and the promotion of civic responsibility, volunteering, the voluntary sector or the effectiveness or efficiency of charities;
(7) The advancement of arts, culture, heritage or science;
(8) The advancement of human rights, conflict resolution or reconciliation;
(9) The promotion of religious or racial harmony;
(10) The promotion of equality and diversity;
(11) The advancement of environmental protection or improvement;
(12) The relief of those in need by reasons of youth, age, ill-health, disability, financial hardship or other disadvantage;
(13) The advancement of animal welfare; and
(14) Any other purpose that is of benefit to the community.

The Administration should also establish a registration system for charitable organizations according to the definition proposed by the LRC; and

- clear objectives and purposes were required for providing a statutory definition of "charitable organizations" or "charitable purposes" and for establishing a registration system. In general, it was difficult for the Administration to introduce a new piece of legislation to provide merely a definition of "charitable purposes" or require charitable organization to register, without formulating a clear regulatory framework or enforcement arrangements. Owing to the diversity of these regulatory purposes, it was not easy to provide a definition of "charitable organizations" or "charitable purposes" which was applicable to various regulatory purposes and frameworks. No consensus in the community had been reached during LRC's public consultation exercise on whether some of the purposes (e.g. promoting human rights, resolving conflicts or settling disputes) should be considered as charitable purposes. Therefore, the Administration had to make a comprehensive assessment on different views expressed in the community when considering a statutory definition for charitable organizations;

(b) no consensus in the community on establishing and maintaining a register of charitable organizations by a single regulatory authority:

- as pointed out in the LRC Report, the findings of the public consultation revealed that no consensus in the community had been reached on the establishment of a single authority and the proposal of making an authority responsible for establishing a registration system, as well as co-ordinating the regulation of charitable organizations. Many charitable organizations even objected to the proposal as they worried that the charity commission would be given too much power without proper check-and-balance. They also considered that the administration cost of a commission might be shifted to charitable organizations, thus increasing their financial burden. For the religious sector, they even worried that the registration system would involve scrutiny of religious

organizations' charitable work, which might lead to interference with religious doctrines and activities and undermined the freedom of religion as enshrined in the Basic Law; and

- in view of the public views, LRC suggested that a register of charitable organizations be established and maintained by a single government department. However, the implementation of the registration system of charitable organizations without setting up a new independent regulatory authority was a highly complicated issue. HAB needed to consider further whether the worries of charitable organizations over financial burden and religious autonomy could be removed if the registration and regulation matters were handled by a government department or an organization instead of an independent charity commission; and

(c) a single bureau or department to co-ordinate the current work of B/Ds on the regulation of charitable organizations and charitable fund-raising activities:

- LRC recommended that the current work of different B/Ds involving the regulation of charitable organizations and charitable fund-raising activities should be delegated to one bureau or department. As a matter of fact, the current legislation, licensing and land allocation work relating to charitable organizations and fund-raising activities, as well as coverage of charitable purposes recommended by LRC, involved the duties of at least nine government bureaux and nine executive departments. Substantial integration work on, among other things, policy co-ordination, resources allocation and even re-organisation would be required for B/Ds concerned to consolidate all the relevant legislation and powers before a single policy bureau or department could be designated to administer and carry out the work;

- on 11 August 2015, HAB convened an inter-departmental meeting with eight other B/Ds (including FSTB, Labour and Welfare Bureau, Efficiency Unit, FEHD, HAD, HKPF, IRD and SWD), whose scopes of work under the current legislation and statute involved the monitoring of charitable organizations or charitable fund-raising activities, to discuss the approach to and the framework for regulation as proposed

in the LRC Report. Given the complexity of the issue, the B/Ds concerned agreed that the Administration should consider carefully the feasibility and implications of those recommendations from policy and practical implementation perspectives, as well as responses from relevant stakeholders; and

- one of the key rationales behind the recommendations made by LRC was to enhance the transparency of charitable organizations, especially those raising funds from the public, so as to protect the interests of donors. Relevant B/Ds agreed that departments currently responsible for issuance of permits or licenses relating to charitable fund-raising activities, i.e. FEHD, HAD and SWD, could consider how the regulation of charitable fund-raising activities under the existing regime could be enhanced.[8]

G. Conclusions and recommendations

Overall comments

117. The Committee:

- notes that:

(a) 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-exempt status and government support, charities are subject to the monitoring and/or registration framework of different government bureaux/departments ("B/Ds"). Charitable organizations may be recognized for tax-exempt purpose under section 88 ("s88") of the Inland Revenue Ordinance (Cap. 112) ("IRO") and the number of

[8] See Chapter 2 of Part 4 of the Committee's Report No. 68 on Monitoring of charitable fund-raising activities. In a reply dated 16 June 2017 to the Committee's enquiry on this Chapter, Secretary for Home Affairs replied that HAB would convene another inter-departmental meeting in end-June 2017 to examine how regulation of fund-raising activities for charitable causes could be strengthened and the transparency of public fund-raising activities be enhanced under the existing mechanism. Please refer to Appendix 14 of the Committee's Report No. 68. The meeting was subsequently held on 20 June 2017.

such organizations had grown rapidly from 4 435 in March 2006 to 8 923 in September 2016.[9] Charitable donations allowed for tax deduction under IRO had also increased by 126% from $5.25 billion for the year of assessment 2005-2006 to $11.84 billion for 2014-2015, amounting to tax revenue forgone of over $1.5 billion. The rapid rise in the number of philanthropies calls for the need of an effective monitoring framework to ensure that the charitable organizations exercise good governance, stewardship and ethical practices and uphold accountability and transparency to the public and for the donations they received; and

(b) the list of charitable institutions and trusts of a public character exempt from tax under s88 of IRO available on the Inland Revenue Department ("IRD") website for public information is not a comprehensive or conclusive list of all charities in Hong Kong. Without such a list, members of the public might not be able to ascertain the charitable status of an organization. In addition, IRO does not provide statutory definition of "charity" or "charitable purpose". Hence, what constitutes "charity" or "charitable purpose" in Hong Kong is for the courts to decide in individual cases in accordance with common law authorities;

Law Reform Commission Report on Charities

- notes that the Law Reform Commission ("LRC"), after conducting a public consultation in 2011, published a Report on Charities in December 2013 with a number of recommendations, some of which are related to the monitoring of charities,[10] including recommendations on the definition of charity, registration of charities, the framework for governance, accounting and reporting of charities, charities and tax, and the establishment of a charity commission. In particular, LRC is

[9] s88 of IRO provides tax exemption to charitable institutions or trusts of a public character. A charitable organization recognized under the provisions of IRO is not generally liable to tax, and donations to such an organization can be tax deductible.

[10] Other recommendations of the LRC Report are related to the Administration's monitoring of charitable fund-raising activities, including imposing certain filing requirements in applications for charitable fund-raising licences or permits, setting up centralized telephone hotline for public enquiries and complaints in relation to charitable fund-raising activities and requiring charitable organizations to display their registration numbers on any documents and message transmitted by any means through which appeals for charitable fund-raising are made, etc. Please refer to Chapter 2 of Part 4 of the Public Accounts Committee Report No. 68 for the Committee's conclusions and recommendations on this section.

of the view that the role of IRD with respect to reviewing the accounts of tax-exempt charities is important to ensure that only charities which carry out activities in compliance with their objects should continue to be granted tax-exempt status, and that IRD fulfills a highly important function, underpinning to a large extent the confidence of the public in the charity sector. It recommends that IRD should maintain a robust role in overseeing the activities of charities for tax-exempt purposes by conducting more frequent reviews of the accounts of individual tax-exempt charities as and when necessary to ascertain whether their activities are compatible with their charitable objects. LRC believes that this administrative measure, which could be implemented relatively quickly, would promote greater accountability among charities and improve their governance. The majority of the respondents were in support of the recommendations made by the LRC Charities Sub-committee in the Consultation Paper;

- expresses grave concern about the following deficiencies in the existing regulatory framework relating to charities in Hong Kong as identified by LRC:

  (a) while the IRD's s88 list does not constitute a formal "register" of charitable organization, there may be a danger that the public and charity donors may perceive that the recognition of tax-exempt status and inclusion on the s88 list confers on those charities the semblance of official sanction not intended by IRO;

  (b) charities of different legal forms established under different ordinances can be subject to different statutory controls. For instance, charitable organizations established under the Companies Ordinance (Cap. 622) are required to prepare audited accounts, but that is not the case for charitable organizations established as societies registered under the Societies Ordinance (Cap. 151). For charities which are neither statutory nor subvented, they may operate under their own governing bodies without any public supervision; and

  (c) the definition of "charitable purpose" in Hong Kong is based upon the common law interpretation of English legislation dating back

hundreds of years.[11] 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;

- expresses grave concern and dissatisfaction and finds it unacceptable that the Home Affairs Bureau ("HAB") has been making slow progress in providing a response to the LRC's recommendations as evidenced by the following:

  (a) notwithstanding the guidelines contained in the Administration's General Circular that a detailed public response to an LRC Report should be provided within 12 months of its publication, HAB had simply repeated that it was still coordinating comments from relevant B/Ds for consideration of the way forward more than three years after the publication of the LRC Report in 2013; and

  (b) there were inadequacies in the internal consultation on LRC's recommendations. For example, while HAB had commenced the internal consultation process in January 2014 and received B/Ds' feedback from February to April 2014, it did not consolidate the views into a preliminary assessment paper until June 2015 and convened only three inter-departmental meetings on 11 August 2015, 4 October 2016 and 20 June 2017 respectively with the last two meetings focused only on monitoring of charitable fund-raising activities;

- understands that some recommendations set out in the LRC Report on Charities regarding the regulation of charities carry significant implications for charities in Hong Kong in terms of their qualification as charities and operation, and diverse comments have been received by LRC from the public; and notes that HAB is the coordination bureau

[11] The leading common law authority on the definition of charity is the case of *Income Tax Special Purposes Commissioner v Pemsel* [1891] AC 531 (HL), in that case "*four principal divisions*" of charitable purposes were listed as follows:
(1) trusts for the relief of poverty;
(2) trusts for the advancement of education;
(3) trusts for the advancement of religion; and
(4) trusts for other purposes beneficial to the community.
The list was itself based on English legislation dating back to 1601, namely, the preamble to the *Charitable Uses Act 1601* in England. Also see *Halsbury's Law of England*, Vol 8, 5th ed, (2010), at para 2, footnote 25.

to collect views from relevant B/Ds in formulating responses to LRC's recommendations for the Administration's overall consideration;

- strongly urges HAB to:

  (a) expedite the consultation with relevant B/Ds to formulate a substantive response to all LRC's recommendations, taking into account the areas for improvement identified in this Report and the Director of Audit's Report ("Audit Report"); and

  (b) in the interim period, explore administrative measures to improve the transparency and accountability of charities with a view to providing better safeguards to the public;

- notes that Secretary for Home Affairs has generally accepted the Audit Commission ("Audit")'s recommendation in paragraph 6.6 of the Audit Report;

Inadequacies in the monitoring of charities

Administration of tax-exempt status of charities

- stresses that under the existing legislative framework, IRD plays a vital and unique role in recognizing tax-exempt status of charities and reviewing the accounts of tax-exempt charities to ensure the eligibility of charities for tax-exempt status;

- expresses grave concern and dissatisfaction and finds it unacceptable about IRD's inadequacies and limitations in ascertaining whether charities' activities or expenditures are compatible with their objects, as evidenced by the following:

  (a) there were delays in taking follow-up actions on review cases. In one case (Case C in the Audit Report), IRD took more than five years to follow up on the irregularities identified in a charity, and on three occasions during the five years, IRD only requested further explanations and documents after long periods of inaction ranging from nine to 16 months;

  (b) there were four cases identified by Audit (i.e. Cases D to G in the Audit Report) in which the four charities concerned had paid remunerations to directors in breach of the directors' remuneration

clause in their governing instruments. While IRD drew the four charities' attention to the breach and sought their remedial actions, the remedial actions taken by them varied significantly (no refund of the remuneration paid in Case D, full refund of the remuneration paid in Case E, 5% and 50% of the remuneration paid refunded in Cases F and G respectively), and their tax-exempt status was not affected; and

(c) there were two cases identified in the Audit Report (i.e. Cases H and I) in which the expenditures of the charities concerned were not in furtherance of the objects of the charities. In both cases, the tax-exempt status of the charities was not affected;

- expresses grave concern and dissatisfaction and finds it unacceptable that IRD had not acted proactively to review the existing provisions of IRO on tax-exempt status of charities and to address its limitations in effectively performing its role in administering tax-exempt status of charities. IRD noted from a legal advice obtained in 2003 about the following limitations of s88 of IRO provisions:

  (a) Commissioner of Inland Revenue was not empowered to overturn a charity's tax-exempt status solely because the charity had not complied with any obligations, whether statutory or not;

  (b) IRD was not empowered to determine whether an organization was a charity or not; and

  (c) IRD had no authority to demand a charity to refund (in full or in part) any items of expenditure which were not paid for the furtherance of the charitable objects of a charity (e.g. payment of remunerations made to its director(s) or member(s) of its governing body).

  Such limitations fall short of public expectation as well as LRC's recommendation of IRD's role in administering the tax-exempt status of charities;

- expresses grave concern that on matters involving serious regulatory concerns, such as the use of funds not in furtherance of charities' charitable objects and serious breach of charities' governing instruments, IRD has failed to proactively seek advice from relevant B/Ds, for example, the Department of Justice and the Financial

Services and the Treasury Bureau, to clarify its power and authority in relation to the regulation of the charities' operation, and there are no clear guidelines for its Charity Donation Section ("CDS") on the performance of its regulatory functions, for example, the conditions under which CDS could issue warning letters or even withdraw tax-exempt status of a charity which no longer qualifies for the status of a charitable institution or trust of a public character as required under s88 of IRO. IRD should consider setting out clear guidelines for CDS in administering the tax-exempt status of charities more stringently and consistently;

- strongly urges IRD to conduct more frequent reviews of the annual accounts of tax-exempt charities as recommended by LRC to ascertain whether the activities of these charities and their operations are compatible with their charitable objects; and to take improvement measures on follow-up actions relating to matters of regulatory concerns, including exploring the possibility of reviewing the provisions of IRO to enable it to effectively perform the role of administering the tax-exempt status of charities;

- strongly urges the Administration to review which B/D should be more appropriate to be responsible for the overall regulation and monitoring of the operation of charities, such as making sure the charities comply with their governing instruments, bearing in mind that IRD's main duty is to administer tax-related matters;

Monitoring and enforcement of lease conditions for sites granted by private treaty grant to charities

- notes from the papers submitted to the Executive Council ("ExCo") in 1959 and 1981 that for land granted by way of private treaty grant ("PTG") at nil or concessionary premium for welfare purposes, very stringent powers of control would be included in the lease conditions, including no distribution of profits be allowed and they must be applied to improving the welfare services provided by the grantee. In situation where there was profit-making commercial element for redevelopment or expansion of facilities on the site, such income derived should be used for purposes acceptable to the Administration. Furthermore, direct subvention from the Administration should be reduced. In any case, the grantee should be made accountable for the income derived;

- expresses great dissatisfaction and finds it unacceptable that the Lands Department ("LandsD"), as the Administration's land agent, and relevant supporting B/Ds, failed to include stringent powers of control in land lease conditions over the usage of land granted at nil or concessionary premium to charities, making it difficult for LandsD and relevant B/Ds to effectively exercise control over the charities concerned and their operations on the sites, as evidenced by the following:

  (a) for the 14 sites granted to non-governmental organizations at nil or concessionary premium[12] identified in the Audit Report to have alleged hotel operations on them, only eight of the 14 land leases specified hostel or dormitory use but without specific provisions governing aspects of such use, such as clientele, services standards, hostel charges, definition of and differences between the terms "hostel" and "hotel", and whether the operations could be run on a commercial basis;

  (b) of the 11 leases with hotel/serviced residence operated on a commercial basis (excluding the three sites with virtually unrestricted use) examined by Audit, only one lease contained the no-profit-distribution requirement; and

  (c) of the abovementioned 11 leases, only four leases contained conditions requiring the submission of accounts for the operation of the hostels so that the relevant B/Ds would be able to monitor and ensure that the profits so derived would have been applied to purposes acceptable to the Administration;

- expresses grave concern and finds it unacceptable that LandsD and relevant supporting B/Ds had failed their duties to monitor the application and proper use of income generated from hostel/serviced residence on sites granted by PTG, as evidenced by the following:

  (a) for the four leases (Leases H, J, M and N in the Audit Report) which contained submission of accounts requirement, no accounts

[12] According to the Administration, three of the 14 sites were held on virtually unrestricted leases for which LandsD was not in a position to exercise any control under the land leases concerned and three sites 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 organizations which might be governed by their respective Memoranda of Incorporation or incorporating ordinances.

on hostel operation had been received for Leases H and J by LandsD and Social Welfare Department ("SWD"). For Lease M, LandsD only requested the submission of accounts in August 2013 pursuant to a complaint received, 22 years after Grantee M had obtained an occupation permit for its redevelopment. For Lease N, no statement of accounts of Grantee N's income-generating facilities had been obtained since 2000 by HAB;[13] and

(b) Audit examination of Grantee M's statements of accounts revealed that for the years 2014 and 2015, notes to the accounts stated that the income derived from its hostel/hotel operation had been assigned to and belonged to Charity M, parent organization of Grantee M, and was not treated or accounted for as revenue of Grantee M. For three years from 2013 to 2015, payments totalling some $70 million had been made by Grantee M's appointed hotel/hostel operator in accordance with the agreed operating arrangement. Even though the then Director of Buildings and Lands had given a letter of approval in June 1989 that profits derived from the facilities were to be used towards the improvement and/or extension of all charitable services provided by Charity M, there was insufficient information to show that income derived from the hostel/hotel had been applied towards the social/charitable purposes in compliance with the lease condition and the 1989 letter of approval, apart from the assurance provided by Charity M's auditor in May 2014 and by Grantee M in March 2016. In addition, LandsD only requested Grantee M to submit its first statement of accounts in 2013, i.e. 22 years after the hostel came into operation;

- expresses concern that even though LandsD had issued a protocol in July 2014 delineating the responsibilities between LandsD and the B/Ds which supported various types of PTGs ("2014 Protocol"), there was still grey area in respect of the monitoring role in enforcing relevant lease conditions and other implementation difficulties. For example, in the case of Lease M, LandsD forwarded the statement of accounts for both the hostel/hotel and welfare facilities to SWD in May 2016 for comments on whether Grantee M had used profits derived from the facilities for the purposes as stated in the lease conditions and

[13] HAB took over from SWD the management of Grantee N in April 2000 and assumed the supporting B/D's role for Lease N. The income generating facilities of Grantee N came into operation in 1994.

the letter of approval of June 1989. SWD, however, was of the view that the hostel/hotel should not be treated as a welfare facility, and accordingly, would not comment in respect of the use of income derived from the hostel/hotel. LandsD, in response to Audit's enquiry, reckoned that it did not have the expertise or knowledge to scrutinize the accounts submitted or determine whether the profit had been used in a manner and for the purpose acceptable to the Administration. Monitoring of the income generated from Grantee M's hostel/hotel facilities might not be effectively carried out in ensuring its compliance with the relevant lease conditions;

- urges LandsD to review the implementation of the 2014 Protocol to examine whether there was room for improvement;

- notes that LandsD:

  (a) would, in consultation with the supporting B/Ds upon renewal of leases or on receipt of lease modification and when processing new PTG cases in future, consider including the no-profit-distribution and submission of accounts clauses to provide greater clarity regarding obligations under lease and facilitate the Administration's compliance checking;

  (b) is taking follow-up actions on Grantee M by requiring it to submit information, including statement of accounts for the hostel/hotel, the operating agreement between Grantee M and the operator in relation to the development and operation of the hotel, and has also requested Charity M and Grantee M to expand the certification by their independent auditors to include a breakdown of the hostel income ploughed back by categories of uses, e.g. education, welfare, church activities etc., so as to share the information with relevant B/Ds to facilitate their monitoring of uses of income and relevant subvention under their purview; and

  (c) would coordinate with relevant B/Ds to arrive at a consensus and take a proactive monitoring role in a situation where the monitoring role for individual lease conditions could not be attributed to a specific B/D due to the existence of grey areas, e.g. the hotel/hostel as an income-generating facility supporting community/welfare services under the purview of different B/Ds;

- notes that Secretary for Development and Director of Lands have agreed with Audit's recommendation in paragraph 6.7 of the Audit Report;

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

- notes that ExCo's approval for Grantee N to use the site for the construction of a new headquarters with income-generating facilities of hostel and a canteen at a nominal premium and the vehicle park at full premium was based on the understanding that Grantee N's income was expected to exceed the amount of subvention, and would gradually cease to be reliant on the subvention from the Administration. Grantee N should submit to the supporting B/Ds annually a complete statement of accounts and establish a Management Committee comprising Grantee N's members and representatives from the supporting B/D to ensure the proper and efficient operation of the income-generating facilities of the headquarters and the vehicle park;

Subvention reduction arrangement

- expresses serious dismay and finds it unacceptable that HAB, as the supporting government bureau for monitoring Grantee N since 2000, failed to properly manage the subvention reduction arrangement and monitor the operation of income-generating facilities on the site, as evidenced by the following:

  (a) the Management Committee only held five meetings from 1993 to 1998 with SWD's representatives attending the meeting, and had not held further meetings since then. Even though representatives of HAB had attended, as an observer, Grantee N's Executive Committee meetings which also discussed its financial matters, the Committee was not a designated forum for discussing the proper and efficient operation of the income-generating facilities;

  (b) there was no record showing that statements of accounts had been submitted to HAB since 2000 annually thereafter;

  (c) SWD had informed HAB in 1999 that, based on the financial situation of Grantee N from 1995-1996 to 1997-1998, it was expected that there was room for reduction in its subvention to

Grantee N.[14] However, HAB, after taking over the management of Grantee N, had not taken any action until 2010-2011 (10 years later) when it decided to freeze Grantee N's subvention;[15] and

(d) net profit from income-generating facilities of Grantee N had reached the level of $829 million from 1994 to 2011. From 1993-1994 to 2010-2011, the subvention level for Grantee N's activities totalled at $280 million. The agreement between HAB and Grantee N in February 2013 was that the annual subvention should be reduced from $17.28 million in 2012-2013 to $10.61 million in 2015-2016.[16] However, the agreed subvention reduction scheme had yet to give full effect to ExCo's understanding of eventual elimination of subvention and there was no record to show that HAB had taken follow-up action in this regard;

- notes that:

(a) HAB has asked Grantee N to reactivate the Management Committee in May 2017 and to submit independent statement of accounts of the income-generating facilities of its headquarters and vehicle park; and

(b) HAB has resumed the negotiation with Grantee N with a view to agreeing on the level and timetable of further reducing Grantee N's subvention. If HAB determines that ExCo's understanding of eventual elimination of subvention could not be achieved, it would seek ExCo's endorsement for variation;

Operation of catering facilities not complying with lease conditions

- expresses alarm and strong resentment, and finds it unacceptable that HAB and SWD had not exercised effective monitoring on the operation of catering facilities in the new headquarters of Grantee N, as evidenced by the following:

[14] SWD discussed with Grantee N and withheld part of the reimbursement of the government rent and rates amounting to $1.47 million each year for 1997-1998, 1998-1999 and 1999-2000, i.e. totalling $4.41 million to Grantee N.

[15] Annual subvention to Grantee N was frozen at $17.28 million from 2010-2011 to 2012-2013.

[16] HAB's subvention for Grantee N's activities was reduced to $15.06 million in 2013-2014 but increased to $25.66 million in 2014-2015 (due to the increase in subvention of all uniformed groups) and subsequently reduced to $23.44 million in 2015-2016.

(a) according to Lease N, Grantee N's canteen should form part of the headquarters and was for the exclusive use of members of Grantee N. However, the canteen had been operated as a restaurant open for general public on a commercial basis since 1996 without seeking planning permission by the Town Planning Board ("TPB"); and

(b) Grantee N had operated a western restaurant and a lounge open for general public. However, HAB and SWD had not ascertained with LandsD and the Planning Department ("PlanD") whether the operation of the two catering facilities was permitted use under Lease N and the relevant Outlining Zoning Plan;

- notes that:

(a) HAB has requested Grantee N to obtain planning permission from TPB and a temporary waiver from LandsD to permit the use of the canteen space for restaurant purpose. In December 2016, Grantee N obtained TPB's approval to use the canteen space for a temporary restaurant for three years. In March 2017, LandsD offered the waiver terms for Grantee N's acceptance; and

(b) HAB is ascertaining with PlanD whether the operation of the western restaurant and lounge complies with the relevant land administration and planning requirements. LandsD indicated at the public hearing that the western restaurant and lounge were permitted to operate as auxiliary facilities under the lease provisions and could be open to the public;

<u>Monitoring of Chinese temples</u>

- expresses grave concern and dissatisfaction and finds it unacceptable about the inadequacies in the regulation of Chinese temples by the Chinese Temples Committee ("CTC") in that Audit examination revealed that two temples had been managed by Organization A and Organization B after the expiry of the relevant delegation agreements in 2006 and 2007 respectively. Donations and other revenues were kept and used by the organizations concerned without accountability to CTC. There was no record showing that CTC had followed up with Organization A regarding the delegation agreement since October 2007. For Organization B, there was a breach of conditions of the agreement by erecting an unauthorized building structure at the temple

premises before the expiry of the agreement in 2007, but the issue dragged on for some 10 years and remained unresolved;

- expresses serious dissatisfaction and disappointment that Secretary for Home Affairs, in answering the Committee's enquiry about CTC's inaction in respect of the renewal of delegation agreement with Organization A for nearly 10 years since 2007, made an explicit statement at the public hearing on 19 May 2017 that he had knowledge of this issue before he assumed office in July 2015, and that HAB had been continuously following up the issue with Organization A, but he failed to provide any document to substantiate his statement, and later admitted at the public hearing on 27 June 2017 that the last correspondence between CTC and Organization A was in October 2007. As such, the later evidence from Secretary for Home Affairs is obviously inconsistent with the statement made by him at the public hearing on 19 May 2017;

- strongly stresses the importance that witnesses, when being invited to public hearings to provide evidence to the Committee, should be well-prepared and have thorough knowledge of the matters under investigation, and that they should provide accurate and complete information and should avoid giving misleading evidence to the Committee when responding to the Committee's enquiry;

- expresses serious dissatisfaction and disappointment that, in view of the diverse views received during the public consultation exercise, the review of the Chinese Temple Ordinance (Cap. 153) conducted in 2015 is still not yet finalized on the implementation of a proposed voluntary registration scheme. In view of reported cases of alleged mismanagement of Chinese temples and abuses of temple funds, there is a need for HAB to implement interim measures to safeguard the temple funds, and to enhance the transparency and accountability of temples' operation in general; and

- notes that:

  (a) HAB has taken follow-up actions on the case of Organizations A and B for signing a new agreement, and will take appropriate actions if no response is received; and

  (b) HAB, together with CTC, has set up the Chinese Temples Ordinance Review Task Force to study the suggestions on and

directions of the proposed legislative amendments to CTO, including the establishment of a reasonable and up-to-date regulatory regime for Chinese temples.

Specific comments

118. The Committee:

Administration of tax exemption of charities and tax-deductible donations

- expresses serious concern that there were inadequacies in IRD's monitoring of the progress of periodic reviews, taking follow-up actions on review cases and obtaining information on deregistration of tax-exempt charities, as follows:

  (a) notwithstanding that IRD carried out periodic reviews to ascertain the tax-exempt status of charities, there was no operative provision under IRO that required a charity to respond to IRD's requests for information and documents for the periodic reviews of its tax-exempt status within a specific time;

  (b) the monthly work reports prepared by CDS for IRD management could not provide a full picture of all the uncompleted review cases and their age profile because: (i) the reported figures did not cover those review cases where the charities concerned had not responded to CDS's queries; (ii) for review cases with several rounds of exchange of correspondence, the dates of the most recent correspondence pending attention did not reflect how long the cases had been in process; and (iii) there were omissions of uncompleted review cases in compiling the monthly reports. For example, while the monthly report showed that as at 30 September 2016, CDS had not attended to 60 submitted questionnaires and the waiting time for the earliest questionnaire was 42 days, Audit's analysis of IRD's database revealed that there were 635 reviews commenced or scheduled for commencement from 2006 to 2015 which had remained uncompleted as at 30 September 2016, of which 71 (11%) had remained uncompleted for over five years;

  (c) Audit sample check of 17 periodic review cases revealed delays by IRD in 15 (88%) cases, including in one case, IRD had not

attended to a questionnaire submitted by a charity in April 2009 until September 2016 (some 7.5 years later);

(d) 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, 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 donations received for the years;

(e) in three review cases, CDS had taken over two years to deal with dormant cases. In one of the three cases, the charity had not commenced operation for 12 years since it was recognized as a tax-exempt charity; and

(f) while IRD had made arrangements with the Companies Registry ("CR") whereby companies to be struck off by CR would be brought to IRD's attention for IRD to take timely action on updating the list of tax-exempt charities and making enquiry on the disposal of assets of such companies after dissolution, IRD had not made similar notification arrangements with relevant B/Ds for tax-exempt charities which were established under other ordinances;

- expresses serious concern that Audit's sample check on IRD's desk audits on charitable donation claims had revealed that in one profits tax case, the supporting schedule filed by the taxpayer did not show whether the donations 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 recognized tax-exempt charity in one case and the taxpayer's name did not match with the donor's name in another case;

- notes that:

(a) Commissioner of Inland Revenue has generally agreed with Audit's recommendations in paragraph 2.29 of the Audit Report, including incorporating the number of all uncompleted review cases with their age profile and their position in the monthly work report for management review, strengthening the control system

of charities' outstanding replies to enquiries raised by IRD and reminding staff of CDS to give due consideration to the materiality of the donation expenditures when deciding the extent of verification work; and

(b) Commissioner of Police has agreed with the Audit's recommendation in paragraph 2.29(f) of the Audit Report;

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

- notes LandsD's explanations that: (i) the land administration policy had evolved since 1959 with due regard to seven of the 11 cases which were submitted to ExCo for approval; (ii) the no-profit-distribution clause was not imposed in these seven cases which served as precedents for subsequent cases; and (iii) accordingly, the no-profit-distribution requirement in land granted for welfare purposes was no longer applicable;

- expresses concern that the current use of the hostels/dormitories under three leases (Leases G, H and N in the Audit Report) as hotels/serviced residence for the general public might not be in line with the policy intent based on which the supporting B/Ds recommended the land grants at nil or concessionary premium, i.e. the facilities were for meeting the grantee's purpose under Lease N and for meeting welfare purposes under Leases G and H;

- notes that:

  (a) Director of Lands has generally agreed with Audit's recommendations in paragraph 3.25 of the Audit Report;

  (b) Director of Social Welfare has agreed with Audit's recommendation in paragraph 3.26 of the Audit Report; and

  (c) Secretary for Home Affairs has agreed with Audit's recommendations in paragraph 3.27 of the Audit Report;

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

- expresses concern that:

  (a) while the timely filing of annual returns by charities which were companies with CR was important for donors to gain access to their financial information so as to make an informed choice when making donations, there were cases of non-compliance with the filing requirements. Up to November 2016, some 1 237 annual returns for the years from 2011 to 2016 had not been filed by charities which were companies limited by guarantee. In particular, 21 companies had repeatedly breached the filing requirements, i.e. 12 companies for five years and nine companies for six years. For the 2016 annual returns submitted by 3 219 charities, 126 (3.9%) were late submissions. The delays were over 90 days in 35 cases;

  (b) the list of registered/exempted societies had not always been kept up-to-date because the Hong Kong Police Force ("HKPF") had not: (i) conducted any reviews of inactive societies in 2015 and 2016; (ii) requested 53 charitable societies which had not contacted HKPF for 10 years or more at the time of the 2014 review to furnish proof of their existence; and (iii) updated the list of registered/exempted societies in respect of 19 societies with society status marked cancelled; and

  (c) while an incorporated management committee ("IMC") of aided schools established under the Education Ordinance (Cap. 279) was responsible for handling funds and assets received from the Administration and donations from the general public, there were cases of late submission of audited financial statements by some IMC schools. Of the 305 late submissions of audited financial statements by IMC schools for the 2014-2015 school year, 26 (9%) IMC schools had submitted their audited financial statements later than 120 days after the submission due date, thus impeding the timely monitoring of their financial affairs by the Education Bureau and the public. Moreover, for the 2010-2011 to 2014-2015 school years, 68, 41 and 70 IMC schools had repeatedly submitted their audited financial statements late for three, four and five years respectively;

- notes that:

  (a) Registrar of Companies has generally agreed with Audit's recommendations in paragraph 4.12 of the Audit Report;

  (b) Commissioner of Police has agreed with Audit's recommendations in paragraph 4.19 of the Audit Report; and

  (c) Secretary for Education has agreed with Audit's recommendations in paragraph 4.31 of the Audit Report;

Regulation of Chinese temples

- expresses grave concern that:

  (a) while both the temples directly administered by the CTC and the temples managed by organizations under delegated authority from the CTC received voluntary donations from the public, only the financial information of the 25 directly administered temples and 9 of the 20 delegated temples was accounted for in the financial statements of the Chinese Temples Fund, which were posted on CTC's website for public inspection. CTC had neither made available the audited accounts of the remaining 11 delegated temples for public inspection nor required the delegated organizations to do so, thus impeding the timely monitoring of their financial affairs by the public;

  (b) there were cases of non-compliance with the submission of audited accounts and administrative report requirements by four delegated organizations. In one case, up to January 2017, a delegated organization had not submitted the audited accounts of its managed temple for the previous three years and its administrative reports for the previous 11 years. There were delays in submissions of three other organizations which together managed 15 temples. For example, for the organization with five managed temples, the audited accounts due for submission in March 2014, 2015 and 2016 were not submitted until December 2016; and

  (c) CTC had not sought clarifications from a delegated organization concerned although its submitted accounts for the five temples under its management for the year ended December 2015 showed

a staff messing expenditure of about $380,000 which was disproportionate to the amount of $137,000 incurred in the previous year; and

- notes that Secretary for Home Affairs has generally accepted Audit's recommendations in paragraph 5.15 of the Audit Report.

Follow-up action

119. The Committee wishes to be kept informed of the progress made in implementing the various recommendations made by the Committee and Audit.