

**Speech by the Director of Audit
on “Public Sector Governance: The Role of the Director of Audit”
to the Hong Kong Branch, Certified Management Accountants Society of
British Columbia, Canada
on 12 June 2007**

Dear Prof Chen, Members of the Hong Kong Branch of Certified Management Accountants Society of British Columbia, Canada, ladies and gentlemen,

It is my honour to be invited to your 2007 Annual Dinner and to address such a distinguished gathering. I am going to talk about the role of the Director of Audit in the public sector governance of Hong Kong.

Concepts of public sector governance

Corporate governance refers to the policies, decisions, strategies, structure and processes adopted by an organisation to achieve its objectives, to perform successfully and to be accountable to its stakeholders. It has been a hot topic in recent years. The concept of corporate governance originates from the private sector, but has been extended to the public sector as well. Public sector governance is concerned with a desire for greater economy, efficiency and effectiveness in the use of public resources. As the public sector plays a vital role in society, it is imperative to develop good public sector governance that is conducive to delivering high performance.

Role of the Director of Audit

Good public sector governance requires that the Government be held accountable to the stakeholders for the proper use and stewardship of public resources, and that there are effective checks and balances for monitoring the Government's performance. The Director of Audit, as the external auditor of the Government, has a duty to report to the Legislative Council on the financial propriety of the Government's accounts, as well as the economy, efficiency and effectiveness of its performance.

A key feature of an effective corporate governance framework is independent professional audit. The Director of Audit enjoys a high degree of statutory and functional independence.

Article 58 of the Basic Law provides that the Audit Commission shall function independently and be accountable to the Chief Executive of the Hong Kong Special Administrative Region. In performing his duties under the Audit Ordinance, the Director of Audit has wide powers of access to government records. He is not subject to the direction or control of any other person or authority.

The way in which the Audit Commission performs its functions further reinforces its independent status. The Audit Commission does not report to any government bureau, and it carries out audit work independent of the Administration. Also, under a set of value for money audit guidelines agreed among the Public Accounts Committee of the Legislative Council, the Administration and the Director of Audit, the Director has great freedom in

presenting his audit reports to the Legislative Council, except that he would not comment on the merits of policy objectives and decisions.

The Director of Audit has a dual role in contributing to good public sector governance:

- Firstly, in regularity or financial audit, the Audit Commission examines, and assures, the financial propriety of the accounts of the Government. It is similar to the financial audit conducted by private sector auditors. In the financial year 2005-06, the Audit Commission provided assurance on the proper reporting of accounts covering combined expenditure and revenue of some \$635 billion. The Audit Commission assesses the Government's internal control environment and recommends improvement measures; and
- Secondly, the Audit Commission conducts value for money or performance audit to examine the economy, efficiency and effectiveness with which government departments or audited organisations have discharged their functions, and recommends ways to improve their performance. In the financial year 2005-06, the Audit Commission made a total of some 500 recommendations that were accepted for implementation.

Hong Kong Applied Science and Technology Research Institute (ASTRI)

I would like to illustrate some of the key elements of good public sector governance practices by using one of my recent value for money audit reports on the Hong Kong Applied Science and Technology Research Institute,

or in short, ASTRI. This report was tabled in the Legislative Council in mid-April this year, and the Public Accounts Committee of the Legislative Council held four public hearings, with a total of about twelve hours, on this subject in April and May. Both the Public Accounts Committee and the media were very concerned with the governance of ASTRI. Strong words like “ASTRI is the subject of a scathing attack by the Audit Commission” and “Poor governance” appeared as headlines in the local newspapers.

ASTRI conducts research and development work for the benefits of Hong Kong industry. Each year, it receives funding of over \$100 million from the Government.

My audit on ASTRI focused on four key elements of good public sector governance.

The first key element is “**Oversight**”. This refers to the role and performance of the governing board in setting strategic direction, providing leadership, defining control mechanisms, reporting performance and taking overall accountability. The governing board should lead by example by making commitment and observing the highest standards of conduct. In my audit review, I note inadequacies such as low attendance rates at Board/Committee meetings, which could affect the effectiveness of the operations of the board, and poor documentation on the management of conflict of interest of Board members.

The second key element is “**Control**”. A strong system of internal control is essential to the efficiency and effectiveness of operations. The main business of ASTRI is to undertake research and development projects.

However, I observed that project proposals contained inadequate and inaccurate information, project reports were submitted late, and project final reports did not contain key information.

The third key element is “**Compliance**”. It requires the management and staff to cultivate and sustain a culture of compliance with the applicable statutory requirements and administrative and internal guidelines and procedures in the day-to-day operations. I noted that ASTRI, in the pay level adjustment of its staff and in its annual salary revision, did not follow the governing board’s decision or its internal staff remuneration guidelines, nor did its entertainment expenses adhere to its own guidelines.

The fourth key element is “**Transparency**”. The governing board needs to commit to openness and transparency in the operations and performance of the organisation. It should establish clear and effective communication channels with stakeholders to report its mission, objectives and performance. Transparency is particularly important in the public sector. Stakeholders, like the public and the Legislative Council, naturally have a high expectation. I have suggested to ASTRI and the Government that they improve the performance reporting by including additional performance measures and reporting to the Legislative Council at regular intervals.

I am glad that my recommendations to strengthen the corporate governance of ASTRI were accepted by the governing board and the Government.

Concluding remarks

To conclude, I would like to emphasise that good corporate governance is essential to the credibility, success and sustainability of an organisation, whether it is in the private or in the public sector. This requires a strong commitment from the governing board, management and staff at all levels. While achieving good corporate governance may not guarantee success, but if without it, failure is almost certain.

In closing, I would like to take this opportunity to wish the Hong Kong Branch of the Certified Management Accountants Society of British Columbia, Canada a very successful and prosperous year.

Thank you very much.