

**Speech by Mr Benjamin Tang, JP, Director of Audit at the  
Hong Kong Institute of Directors Luncheon Meeting on 26 January 2005**

**Governance and Accountability — The Role of the Public Auditor**

(管治與問責 — 公共審計師的角色)

Mr Hui, Members of the Institute, Ladies and Gentlemen,

**Introduction**

1. I am delighted and honoured to have been invited by the Hong Kong Institute of Directors to this luncheon meeting and to have the opportunity to speak to you on the subject “Governance and Accountability — The Role of the Public Auditor”.

**Long history of the Audit Commission**

2. First of all, I would like to talk briefly about the work of the Audit Commission. The Audit Commission (which was known as Audit Department before July 1997) has a very long history. It is one of the oldest departments in the Government of the Hong Kong Special Administrative Region (SAR). **The year 2004 witnessed the 160th anniversary of the Audit Commission. I took up the post as the 22nd Director of Audit in December 2003. The first Director of Audit (or the Auditor-General as it was called at that time) was appointed in 1844.**

## **Mission to improve governance and accountability**

3. The mission of the Audit Commission is to provide independent, professional and quality audit services in order to ensure the efficient and effective use of public resources and to enhance public sector accountability in Hong Kong. **To put it in simple terms, our mission is to help the Government improve its governance and accountability.** The Audit Commission achieves its mission by conducting two types of audit: regularity audit and value for money audit.

### ***Regularity audit***

4. Regularity audit aims to provide an overall assurance that the Government's financial and accounting transactions are proper and that they conform to generally accepted accounting standards. It is similar to the financial audit conducted by private sector auditors. I think all of you are very familiar with this type of audit.

### ***Value for money audit***

5. Value for money audit (or VFM audit) aims to provide independent information, advice and assurance about the economy, efficiency and effectiveness with which any bureau or department of the Government, or audited organisation has discharged its functions. This type of audit is perhaps not so common in the private sector.

6. To put it in simple terms, VFM audit is about investigating and assessing the extent to which government bureaux and departments, in the process of spending public moneys entrusted to them, have paid due regard to the "three E's" for measuring performance:

- **The first E refers to “Economy”, which is the spending of less money subject to the maintenance of approved standards.**
- **The second E refers to “Efficiency”, which is about improving productivity.**
- **The third E refers to “Effectiveness”, which is about the extent to which stated objectives or targets are being achieved.**

### **Enhancing audit independence for governance and accountability**

#### ***Independence — the lifeblood of auditors***

7. In the auditing profession, it is a basic principle that an auditor must be independent of his audit clients. Audit independence requires a state of mind that permits the provision of an opinion without being affected by influences that compromise professional judgement, allowing an auditor to act with integrity, and exercise objectivity and professional scepticism. **To enhance credibility of his professional opinion, an auditor has to be, and be seen to be, independent.**

8. For a public auditor, independence is particularly important, as his main audit client is the Administration which owns a very powerful government machinery. As the French philosopher Voltaire said, “it is dangerous to be right when the government is wrong”. In the “*Lima Declaration of Guidelines on Auditing Precepts*” adopted in 1977 at the 9<sup>th</sup> Congress of the International Organisation of Supreme Audit Institutions in Peru, it was an international consensus to call for “*independent government auditing*”. A “*Supreme Audit*

*Institution*” which cannot live up to this demand does not come up to standard.

9. According to the Lima Declaration, “*Supreme Audit Institutions can accomplish their tasks objectively and effectively only if they are independent of the audited entity and are protected against outside influence.... The establishment of Supreme Audit Institutions and the necessary degree of their independence shall be laid down in the Constitution; details may be set out in legislation....*” **Compliance with this international standard on independence of government auditing is certainly a manifestation of good governance, which enhances public accountability.**

#### ***Independence of the Audit Commission***

10. **In line with the international best practice, the Hong Kong Audit Commission enjoys a high degree of independence.** The independence of the Audit Commission is enshrined in the Basic Law and the Audit Ordinance.

#### ***Provisions of the Basic Law***

11. **The Audit Commission was established under Article 58 of the Basic Law, which provides that the Commission shall function independently and be accountable to the Chief Executive of the HKSAR.** Functionally and organisationally, the Commission is independent of the bureaux and departments of the Government. In practice, the Chief Executive also gives me a free hand in running the Audit Commission.

#### ***Provisions of the Audit Ordinance***

12. The statutory functions of the Director of Audit are governed by the Audit Ordinance. Under the Ordinance, the Director of Audit has wide powers of access to the

records of departments and can require any public officer to give an explanation and to furnish such information as the Director thinks fit to enable him to discharge his duties. **In the performance of my duties and the exercise of my powers under the Ordinance, I am not subject to the direction or control of any other person or authority.**

### ***Value for Money Audit Guidelines***

13. The independence of the Audit Commission in conducting VFM audit is also reinforced by a set of guidelines tabled in the Legislative Council (LegCo), which was agreed between the Public Accounts Committee (PAC) of LegCo, the Director of Audit and the Administration. In conducting VFM audit under the guidelines, I am entitled to exercise the powers given to me under the Audit Ordinance. **However, I will not question the merits of the policy objectives, though I may question the economy, efficiency and effectiveness of the means used to achieve them.**

### **PAC and Audit Commission: Key players of the governance and accountability system**

#### ***Partnership between PAC and Audit Commission***

14. I submit three reports to the President of LegCo each year. In October, I submit two reports, one on the certification of the accounts of the Government and the other on the results of VFM audits. In March, I submit another report on the results of VFM audits. These reports are considered by the PAC of LegCo. **The roles of the PAC and the Audit Commission complement each other.** The PAC relies on the findings of the Audit Commission as a starting point for its public hearings and subsequent reports, while the Commission's effectiveness is enhanced by the conclusions and recommendations of the PAC.

I am pleased that I have the full support of both the PAC and the Administration for my audit work. My audit conclusions and recommendations are generally accepted by the PAC and the Administration.

***“Hong Kong Inc” — its corporate governance structure***

15. If we see HKSAR as a large enterprise, called “Hong Kong Inc”, what is its corporate governance structure like? In my view, to govern such a complex “organisation” in a corporate manner, we would need a “board of management” which comprises, in a broad sense, the whole political structure, including the Executive Authorities, the Legislature, and the Judiciary. Obviously, the Administration is the executive management. **The Audit Commission plays the role of the external auditor. The role played by the PAC is similar to that of the audit committee.**

16. The establishment of an independent audit committee is an essential feature of good corporate governance. In order that the audit committee can effectively play its role to assist the board in providing an independent review of the effectiveness of the financial reporting process, internal control and risk management system, and overseeing the audit process of the organisation, it should comprise independent non-executive board members. It should also be empowered by a clearly written terms of reference setting out its authority and duties. Following this principle, the PAC is established as a standing committee of LegCo, and is responsible for considering the reports of the Director of Audit on the accounts and the results of VFM audits of the Government and other organisations which are within the purview of public audit. PAC Members are appointed by the President of LegCo in accordance with an election procedure determined by the House Committee. The current

practice is that the Chairman of the PAC is normally an Independent LegCo Member. The PAC may invite government officials and senior staff of public organisations to attend public hearings to give explanation, evidence or information, or any other person to assist it if deemed necessary. **Both the PAC and the Audit Commission are key elements of the governance structure of HKSAR. Together, they play an essential part in the financial accountability system of the public sector.**

### **Role of the public auditor in promoting good governance practices**

#### ***Development of the concept of corporate governance***

17. Before I share with you my work in promoting good governance practices, I want to talk briefly about the concept of corporate governance in general. There is no single universally accepted definition of corporate governance. It generally refers to how an organisation is being structured and managed in achieving its objectives. It also includes the organisation's policies and strategies, and the ways in which it is accountable to its various stakeholders. **It is important that those who govern need to be held accountable to the stakeholders. The concepts of governance and accountability are therefore very much related.**

18. The concept of corporate governance originated in the private sector, deriving primarily from a desire to improve the transparency and accountability of financial reporting by listed companies to their shareholders. In the past decade or more, the concept has developed very quickly, extending from the private sector to the public sector. In the public sector, the concept of governance has a clear focus on performance and accountability. **Public sector governance primarily originated from a general desire for greater**

**economy, efficiency and effectiveness in the use of public resources, as well as a higher expectation for openness and accountability in the public sector.**

***Principles of good governance in the public sector***

19. The public sector plays a vital role in society because the setting and implementation of government policies affects our well-being in all areas of daily life, from educating our children to the provision of healthcare. The effectiveness with which the public sector organisations provide their services, and the economy and efficiency with which they utilise the public resources entrusted to them, are matters of great public concerns. To address these concerns, it is imperative to develop good public sector governance that is conducive to delivering high performance in an accountable manner.

20. In 1992, the UK Report of the Committee on the Financial Aspects of Corporate Governance (i.e. the Cadbury Report) identified three fundamental principles of good corporate governance, namely *Openness*, *Integrity* and *Accountability*. Although the Cadbury Report was primarily based on a private sector model of corporate governance, these fundamental principles are equally relevant to the public sector. The three fundamental principles of good governance for the public sector are:

- firstly, **openness**, which is required to ensure that stakeholders can have confidence in the decision-making processes and actions of public sector entities, in the management of their activities, and in the individuals within them;
- secondly, **integrity**, which is based upon honesty and objectivity, and high standards of propriety and probity in the stewardship of public funds and

resources, and management of an entity's affairs. It is dependent on the effectiveness of the control framework and on the personal standards and professionalism of the individuals within the entity; and

- thirdly, **accountability**, which is the process whereby public sector entities, and the individuals within them, are responsible for their decisions and actions, including their stewardship of public funds and all aspects of performance, and submit themselves to appropriate external scrutiny.

### ***The role of the Audit Commission***

21. The Audit Commission has a dual role in contributing to good governance in the public sector:

- Firstly, in regularity audits, public auditors examine the financial propriety of the accounts of the Government. **In the last financial year (2003-04), the Audit Commission provided assurance on the proper reporting of accounts covering combined expenditure and revenue of some \$650 billion.** As part of the regularity audit process, public auditors assess whether the Government's internal control environment comprises effective measures that contribute to good governance practices. Similar to the private sector practice, if internal control weaknesses are identified, public auditors will make recommendations for improvement in the management letters or audit memos issued to the bureaux and departments concerned. Compared with private sector auditors, public auditors put more emphasis on the regularity and probity aspects. This ensures that all

rules and regulations, which are set to ensure good governance practices, are always followed.

- Secondly, public auditors help the Government improve public sector performance and accountability by conducting VFM audits. **For example, in the last financial year (2003-2004), the Audit Commission had made a total of some 400 recommendations that were accepted by the Administration for implementation.** In particular, a number of VFM audits conducted in recent years focused specifically on corporate governance in the public sector. I am going to talk briefly about a few examples.

### **Examples of VFM audits that enhanced performance and accountability in the public sector**

#### ***Theme audits on education***

22. The first example is our education audits. Education is the greatest expenditure item of the Government. **In the past three years, we conducted a series of 11 audits on the theme of education, which had given rise to a large number of useful recommendations for improvement in the corporate governance of the educational institutions and had added value to the Government's education reforms.** Our theme audits produced three separate reports on primary education, one on secondary education, four on tertiary education, and three on the English Schools Foundation (ESF).

### *Harbour Fest review*

23. Another example of VFM audit that had attracted much media attention was the Harbour Fest review of March 2004. In this audit, we found that the Government, in its keenness to revive the economy of Hong Kong, had deviated from essential management principles in its monitoring of the Harbour Fest project. After four public hearings to consider this subject, the PAC recommended and the Administration accepted that disciplinary action be taken against the responsible government staff. **This case has highlighted the essence of public accountability — i.e. government officials, who are entrusted with public resources, are answerable for the fiscal, managerial and programme responsibilities that are conferred.**

### *Review of the grant of land at Discovery Bay and Yi Long Wan*

24. One last example is the review of the grant of land at Discovery Bay conducted in October 2004. You have probably read or heard a lot from media reports about this subject recently. As the PAC has not completed its deliberation of this subject, I do not intend to talk too much about it. **However, this interesting case has brought into the limelight governance issues on the decision-making process right at the most senior level of the Administration about a quarter of a century ago. It also shows that there may not be any time limit for public accountability.**

### **Concluding remarks**

25. The issue of corporate governance has been rigorously pursued in the private sector for quite a long time. In recent years, governments worldwide have also put governance issues high on their agenda, with a view to enhancing public sector performance

and accountability. In Hong Kong, governance has recently become a very topical subject. The Chief Executive, Mr Tung Chee Hwa, in his 2005 Policy Address, outlines among other things the policy agenda for “*improving governance*”. His policy initiatives are designed under a number of guiding principles, first and foremost of which is “*Effective Governance*”. **All of us, including all those in the public sector, the private sector, and all sectors of the community, should “*work to provide a sound foundation through effective governance to maintain and further develop Hong Kong’s position as a world city of Asia*”.**

26. I would wish to congratulate the Hong Kong Institute of Directors for the painstaking efforts in pursuing its mission “*to promote corporate governance and to contribute towards advancing the status of Hong Kong*”. As I have just explained, the Audit Commission also strives to promote good public governance. I see an opportunity for cooperation in our future endeavours. I wish to end by quoting from an article on corporate governance published by the Asian Development Bank in December 2003 which underlines this public/private partnership:

*“While good corporate governance is critical, it is important to realise that it goes hand in hand with public governance reform.... After all, it is not possible to create and run an island of good corporate governance in a sea of poor or underdeveloped public governance.”*

Thank you.