

CHAPTER 7

**Commerce and Economic Development Bureau
Innovation and Technology Commission**

**Hong Kong Productivity Council:
Corporate governance and administrative issues**

**Audit Commission
Hong Kong
27 October 2009**

This audit review was carried out under a set of guidelines tabled in the Provisional Legislative Council by the Chairman of the Public Accounts Committee on 11 February 1998. The guidelines were agreed between the Public Accounts Committee and the Director of Audit and accepted by the Government of the Hong Kong Special Administrative Region.

Report No. 53 of the Director of Audit contains 11 Chapters which are available on our website at <http://www.aud.gov.hk>.

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HONG KONG PRODUCTIVITY COUNCIL: CORPORATE GOVERNANCE AND ADMINISTRATIVE ISSUES

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PART 1: INTRODUCTION

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

Background

1.2 In 1967, the Hong Kong Productivity Council (HKPC) was established as a statutory body under the HKPC Ordinance (Cap. 1116). The HKPC Ordinance stipulates that the functions of the HKPC should be:

- (a) to promote the increased productivity of industry in Hong Kong and to encourage the more efficient utilisation of resources therein;
- (b) to consider matters affecting the productivity of industry in Hong Kong;
- (c) to advise the Chief Executive (CE) concerning the productivity of industry in Hong Kong and measures designed to increase it;
- (d) to consult with, coordinate and assist the activities of persons or organisations engaged in the study, development or dissemination of programmes, methods or techniques designed to increase the productivity in industry; and
- (e) to take on productivity related assignments elsewhere than in Hong Kong subject to the conditions that:
 - (i) the assignment can be carried out without prejudice to the performance of the functions referred to in (a) to (d) above; and
 - (ii) the minimum rate charged by the HKPC for the assignment is sufficient to recover all costs incurred in carrying out that assignment, which costs shall include direct costs (recurrent and capital) and overhead costs.

Organisation of the HKPC

1.3 According to the HKPC Ordinance, the Council shall consist of not more than 23 members appointed by the CE (Note 1). Of these members:

- (a) one member shall be appointed as Chairman of the Council;

Note 1: *The authority of the CE to appoint members of the Council, other than the Chairman, has been delegated to the Secretary for Commerce and Economic Development.*

- (b) not more than 17 shall be appointed to represent management, labour and professional or academic interests; and
- (c) not more than 5 shall be public officers.

1.4 As at 1 July 2009, the five public officers appointed as Council members were:

- (a) the Permanent Secretary for Commerce and Economic Development (Communications and Technology);
- (b) the Commissioner for Innovation and Technology;
- (c) the Director-General of Trade and Industry;
- (d) the Government Economist; and
- (e) the Deputy Commissioner for Labour.

1.5 Under the HKPC Ordinance, the Council is given the power to appoint an Executive Director (ED) to be the chief administrative officer, other officers, servants and agents. As at 31 March 2009, the HKPC had a total of 542 staff, comprising 250 professional and 292 general staff. They were organised into three branches, namely the Technology Development Branch, the Business Consulting Branch and the Corporate Services Branch. The organisation chart of the HKPC as at 31 March 2009 is shown at Appendix A.

Income and expenditure

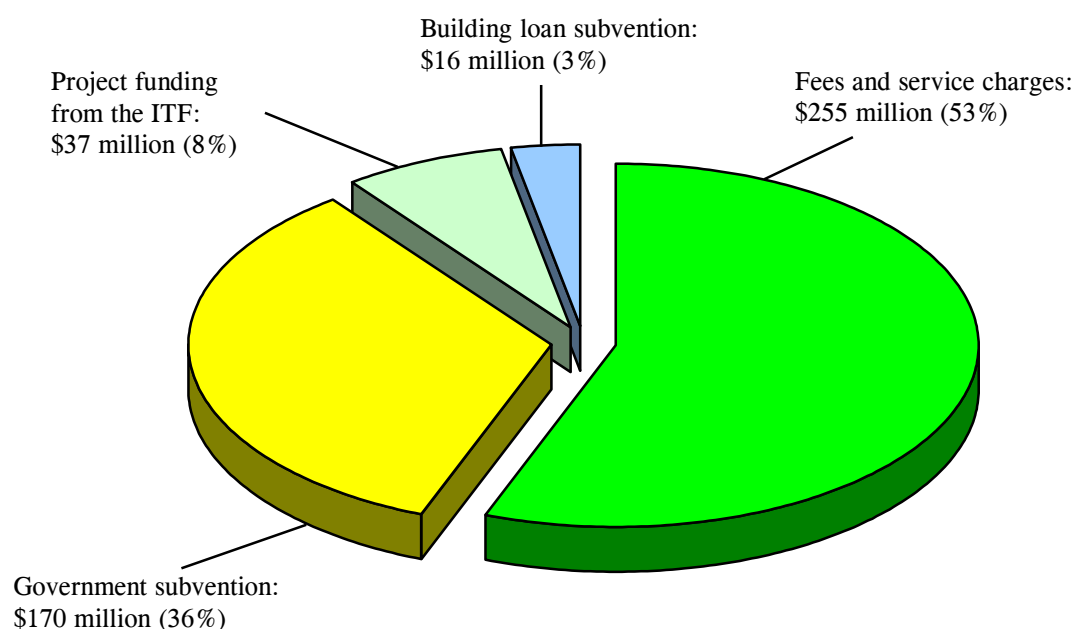
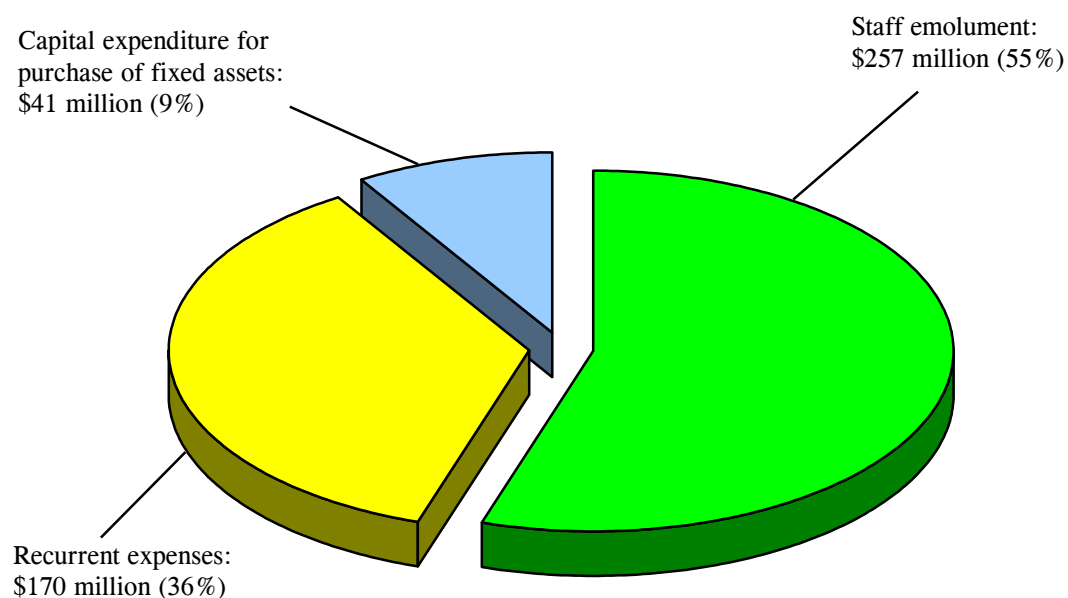
1.6 In 2008-09, the total income of the HKPC was \$478 million, which comprised:

- (a) fees and service charges of \$255 million (53%);
- (b) government subvention of \$170 million (36%);
- (c) project funding of \$37 million (8%) from the Innovation and Technology Fund (ITF); and
- (d) building loan subvention (Note 2) of \$16 million (3%).

In the same year, the HKPC's total expenditure was \$468 million (see Figure 1).

Note 2: *The building loan subvention was provided to the HKPC for repaying a loan of \$249.4 million, which was drawn from the Loan Fund in the late 1980s for constructing the HKPC Building.*

Figure 1

**Income and expenditure of the HKPC
(2008-09)****(A) Income: \$478 million****(B) Expenditure: \$468 million**

Source: HKPC records

Role of the Commissioner for Innovation and Technology

1.7 The Commissioner for Innovation and Technology is the Controlling Officer of the subvention granted to the HKPC. As the Controlling Officer, the Commissioner is responsible for ensuring that the HKPC's activities accord with its objectives and relevant public policies and priorities, and that the HKPC's policy objectives are appropriate. The Commissioner may also advise the HKPC on the need to review these objectives in the light of changes in the economic environment.

1.8 To provide a framework for the relationship between the Government and the HKPC and to set out the responsibilities of each party in detail, the Government and the HKPC entered into a Memorandum of Administrative Arrangements (MAA) in 2003. The MAA states that:

- (a) the service focus of the HKPC is to provide integrated support to innovative and growth oriented Hong Kong firms across the value chain, with sectoral focus on manufacturing, particularly in Hong Kong's foundation industries, and related service activities;
- (b) the main geographical focus is Hong Kong and the Pearl River Delta (PRD);
- (c) the HKPC should have autonomy and flexibility in utilising its funds and resources insofar as it is not inconsistent with the provisions of the HKPC Ordinance;
- (d) the HKPC may keep as reserves any savings from its annual block grant arising from any reasons other than a curtailment or cessation of activity stated in its Annual Programme and Estimates, or reduction in remuneration for its staff as a consequence of any civil service's pay adjustment; and
- (e) at any one point in time the level of reserves shall not exceed 15% of the HKPC's annual block grant in the current financial year. Amount in excess of the limit shall be returned to the Government in the following financial year.

Reporting arrangements

1.9 According to the MAA, the HKPC is required to submit to the Innovation and Technology Commission (ITC) annually a Three-year Forecast and an Annual Programme and Estimates. The Three-year Forecast should set out the strategic targets of the HKPC, the plans to be adopted in achieving these targets and an assessment of their resource implications. On the other hand, the Annual Programme and Estimates should include proposed activities categorised in different programme areas and estimates of income and expenditure for the forthcoming financial year for the Government's approval.

1.10 The HKPC is also required, under the HKPC Ordinance, to submit:

- (a) a report on its activities; and
- (b) a copy of its audited accounts

to the Government within six months after the end of each financial year, for tabling in the Legislative Council.

Standard Practices

1.11 To provide guidance to staff for the proper administration and functioning of the HKPC, the policies, regulations and procedures governing the HKPC's operation (e.g. human resource and procurement management) are specified in a set of Standard Practices issued by the ED. The Standard Practices stipulate that all staff should follow the requirements of the Practices.

Audit review

1.12 The Audit Commission (Audit) has recently carried out a value for money audit of the HKPC. The audit findings are contained in two separate reports, as follows:

- (a) HKPC: Corporate governance and administrative issues (the subject matter of this report); and
- (b) HKPC: Management of projects and services (Chapter 8 of the Director of Audit's Report No. 53).

1.13 Audit's review of the corporate governance and administrative issues of the HKPC has focused on the following areas:

- (a) corporate governance (PART 2);
- (b) human resource management (PART 3);
- (c) administrative issues (PART 4); and
- (d) performance measurement and reporting (PART 5).

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

General response from the Administration

1.15 The **Secretary for Commerce and Economic Development** and the **Commissioner for Innovation and Technology** agree with the audit recommendations. They welcome the value for money audit on the operation of the HKPC, which helps improve the HKPC's financial control and operational effectiveness. They have said that:

- (a) the audit observations and recommendations are timely to assist the HKPC in furthering the ongoing reforms and improvements which have commenced following the two consultancy studies in 2006 (see para. 1.17(b)). These are vital to help a 40-year-old industry support organisation to continue to update itself, to remain relevant and to meet the challenges ahead; and
- (b) the Administration will work closely with the HKPC to ensure the prompt implementation of improvement measures as appropriate.

General response from the HKPC

1.16 The HKPC agrees with the audit recommendations. The **ED, HKPC** has said that:

- (a) the HKPC fully appreciates the efforts made by Audit in conducting this review. The areas covered are comprehensive and the recommendations made are useful and productive;
- (b) the timely audit exercise has highlighted many areas where further improvements could be made. It has also provided renewed impetus for the HKPC to continue its ongoing reform;
- (c) the HKPC has drawn up a concrete action plan and consulted the Council fully on it. Swift action has already been taken in respect of some audit recommendations;
- (d) the HKPC is confident that further concrete actions would be taken later in the year; and
- (e) the HKPC should be able to report solid progress for the rest of the audit recommendations thereafter.

1.17 The **ED, HKPC** has also said that:

- (a) the HKPC considers the audit review very timely as it has very usefully supplemented those areas where further improvements should be made. The HKPC attaches great importance to the audit recommendations and will make its best endeavors to implement them as soon as possible;
- (b) with over 40 years of history, many of the HKPC past policies and practices may not measure entirely up to modern-day best standards. In 2006, the HKPC took the initiative to commission two consultancy studies to review and make recommendations on how the HKPC's practices in the key areas of purchasing, administration and human resources could be improved. In the last three years, the HKPC has embarked on a journey of major internal reform towards implementing such recommendations;
- (c) in addition to the reforms arising from the two consultancy studies mentioned above, the HKPC has also introduced other internal reforms to strengthen its corporate and human resources structure. These reforms include the following:
 - (i) in 2007, HKPC introduced a new performance appraisal system that provides a more systematic, transparent and open way of assessing the overall performance of each staff;
 - (ii) the new performance appraisal system has laid down the necessary foundation for the HKPC to introduce a new Performance Pay Scheme (PPS — see para. 3.3) in 2008, enabling the HKPC to effect a seamless transition from a civil service linked pay structure to a market-oriented one; and
 - (iii) in October 2005, the Council set up an Audit Committee. An internal audit team, reporting directly to the Audit Committee, conducts internal audits according to an annual programme approved by the Audit Committee and compliance checking on a regular basis;
- (d) the HKPC carries an important public mission of supporting industries in enhancing their productivity. While this public mission requires heavy investment in both capital and human resources, the HKPC's reliance on government subvention has been reduced over the years;
- (e) at present, the annual recurrent government subvention represents roughly about one-third of the HKPC's operating expenses (reducing from over 60% in the late 1970s). Separately, the total amount of merit-based project funding obtained from various government schemes had been reduced, from nearly \$80 million in 1998-99 to \$36.8 million in 2008-09 (a drop of 54%);

- (f) the increasing proportion of revenue coming from fee-based services demonstrates the fact that the operation of the HKPC has become very market and client oriented over the years;
- (g) the market-oriented business practice is no excuse for less than stringent control and full documentation. The HKPC will make every effort to improve its policies and practices in this regard; and
- (h) in the course of implementing the audit recommendations, the HKPC will try its best to strike a balance between imposing additional control and documentation and maintaining responsiveness and greater cost-effectiveness in service delivery.

Acknowledgement

1.18 Audit would like to acknowledge with gratitude the full cooperation of the staff of the HKPC and the ITC during the course of the audit review.

PART 2: CORPORATE GOVERNANCE

2.1 This PART examines the corporate governance issues of the HKPC and identifies areas for improvement.

Governance structure of the HKPC

2.2 The HKPC is governed by the Council comprising a Chairman and 22 members. Four Standing Committees have been appointed for assisting the Council to oversee various aspects of the HKPC's operation. They are the Staffing Committee, Business Development Committee, Finance Committee and Audit Committee. Each committee consists of Council members, a representative of the ITC and the ED (Note 3). The ED is responsible to the Council for the overall management of the HKPC. The terms of reference of the Standing Committees are shown at Appendix B.

2.3 Audit examined the HKPC's corporate governance issues and found that there was room for improvement in the following areas:

- (a) Council and Committee meetings (paras. 2.4 to 2.28);
- (b) strategic planning (paras. 2.29 to 2.36); and
- (c) monitoring of the operation of subsidiaries in the Mainland (paras. 2.37 to 2.45).

Council and Committee meetings

2.4 The effectiveness of the governing body of an organisation to fulfil its responsibilities is largely dependent on its members' knowledge, experience, competency and, most important of all, their commitment. The Council/Committee members take part in deliberations and decision-making at Council/Committee meetings to achieve the mission of the HKPC.

Note 3: *According to the HKPC Ordinance, the ED shall be an ex-officio member of the Standing Committees.*

Audit observations and recommendations

Attendance of members at Council/Committee meetings

2.5 An audit examination of the attendance records of Council/Committee meetings held during the period 2005 to 2008 revealed that the average attendance rates of members, other than the public officers and the ED, ranged from 57% to 89%. Details are given in Table 1.

Table 1
Attendance rates at Council/Committee meetings
(2005 to 2008)

Year	Council	Staffing Committee	Business Development Committee	Finance Committee	Audit Committee
2005	69%	100%	43%	63%	75%
2006	70%	81%	63%	63%	67%
2007	76%	95%	64%	92%	92%
2008	76%	81%	58%	83%	67%
Average	73%	89%	57%	75%	75%

Source: Audit analysis of HKPC records

2.6 The examination also revealed that the attendance rates of six members at the Council/Committee meetings during this period were low. They attended 33% or less of the Council meetings (see Table 2).

Table 2
Members with low attendance rates at Council/Committee meetings
(2005 to 2008)

Member	Council	Staffing Committee	Business Development Committee	Finance Committee	Audit Committee
A	33 %	—	—	—	—
B	33 %	—	20 %	—	—
C	33 %	—	20 %	—	—
D	17 %	—	—	—	—
E (Note 1)	0 %	100 %	40 %	—	—
F (Note 2)	0 %	—	50 %	—	—

Source: Audit analysis of HKPC records

Note 1: Member E resigned from the Council in August 2006. The attendance rates were for the period January 2005 to August 2006.

Note 2: Member F retired from the Council in December 2005. The attendance rates were for the year 2005.

2.7 The low attendance of some members at Council/Committee meetings is a matter of concern. Without their participation and contribution in the deliberation of the business of the Council/Committees, the effectiveness of the Council/Committees might be affected.

2.8 The HKPC usually consults its members about one month in advance for fixing the dates of the Council/Committee meetings. Audit considers that giving members information on the tentative dates of future meetings in advance will facilitate members to plan their work schedules and improve their attendance rates at meetings. In this connection, Audit noted that some organisations had adopted a practice of informing board members of the next year's tentative board meeting dates at the last meeting of every year. This would provide members ample time to plan their schedules and would be conducive to higher attendance rates.

Reappointment of Council members with low attendance

2.9 In August 1999, the Government issued a set of guidelines on the appointment of members of advisory and statutory bodies. The guidelines stipulate that:

- (a) only those who are competent and committed to the work of the advisory and statutory bodies should be appointed as members; and
- (b) government bureaux and departments should regularly evaluate the performance and commitment of the chairman and members of the bodies, including their attendance records, to facilitate consideration of their suitability for reappointments.

2.10 Of the six Council members (see para. 2.6) who had attended 33% or less of the Council meetings held during the period 2005 to 2008, Council Members A and B were reappointed in January 2009. Audit noted that in September 2008, the Commissioner for Innovation and Technology made a recommendation to the Secretary for Commerce and Economic Development for reappointing Council Members A and B. For the period January 2007 to September 2008, the attendance rates of both members at Council meetings were 40% and the attendance rate of Member B at Business Development Committee meetings was 25%. **In making the recommendation, the Commissioner commented that they performed well in Council proceedings and rendered strong support to the work and development of the HKPC. Their continuous service on the HKPC would be of particular help to the new Council Chairman. The Commissioner also considered that their attendance was overall satisfactory.**

Appointment of alternate member

2.11 In order to facilitate effective and continuous discharge of government officials' duties as council members of statutory bodies, government bureaux should make arrangement for alternate council members. The objective is to ensure attendance by government representatives at council meetings when the substantive council members are unable to attend.

2.12 The Government Economist, who was a member of the Council and the Finance Committee, attended only 58% of the Council meetings and 40% of the Finance Committee meetings held during the period 2005 to 2008. **Despite his low attendance, the arrangement for appointing an alternate member to ensure higher attendance at Council/Committee meetings was not made until April 2009, i.e. about two months after the commencement of this audit.**

Minutes of Council/Committee meetings

2.13 It is a good practice that the minutes of Council/Committee meetings are issued to members as soon as possible after each meeting. This would enable members to comment on the minutes or suggest amendments while their memory of the meeting is still fresh.

2.14 An examination of the records of all the 30 Council/Committee meetings held in 2007 and 2008 revealed that, on average, the HKPC issued draft minutes to members 31 days after the meetings. In four cases, the minutes were issued after about 60 days. **Audit also noted that the HKPC had not set any target (e.g. the number of days after a meeting) to ensure that draft minutes of meetings would be issued in a timely manner.**

2.15 A number of statutory bodies (e.g. the Equal Opportunities Commission, the Housing Authority, the Independent Police Complaints Council and the Urban Renewal Authority) have adopted the practice of posting the minutes of their meetings on their websites. Apart from enhancing the accountability and transparency of the organisations concerned, such a practice could also provide a means for stakeholders and the public to monitor the performance of the councils/committees of the organisations. The HKPC may consider posting the minutes of its Council/Committee meetings on its website.

Joint-meeting arrangement for the Council and Finance Committee

2.16 Since November 1995, the Finance Committee meetings were held jointly with the Council meetings. In September 2005, the Commissioner for Innovation and Technology raised his concerns over such joint-meeting arrangement with the Council Chairman. The joint-meeting arrangement was subsequently stopped. However, the joint-meeting arrangement was resumed in November 2007. Audit noted that during the period when the Council and Finance Committee meetings were held jointly, members were informed of the arrangement by the notice of the meeting. Although no objection on the joint-meeting arrangement had been raised, there was no documentation showing that such arrangement was formally discussed and approved by the Council and the Finance Committee.

2.17 Two Finance Committee members (i.e. the ED and the representative of the ITC) were not Council members. Their participation at the joint meetings, where Council business was discussed, might not be appropriate. The Council and the Finance Committee are two separate bodies in the HKPC's governance structure. The Finance Committee has been appointed by the Council under the HKPC Ordinance for better regulating and managing the financial matters of the HKPC.

2.18 According to the Finance Committee's terms of reference (see Appendix B), it has a special role (e.g. the approval of the HKPC's Three-year Forecast and making recommendations on the Annual Programmes and Estimates) to play. Under the joint-meeting arrangement, the deliberation of all Finance Committee business involves the full Council. **This might have affected the efficiency of the Council and undermined the role of the Finance Committee in the governance of the HKPC.**

Management of conflicts of interest

2.19 The HKPC operates in an environment where any actual or perceived conflicts of interest can undermine its reputation. At a meeting in July 2007, the Council decided to adopt a two-tier reporting system for the management of conflicts of interest. Under the system, each member is required to submit a declaration of his general interests, direct or indirect, pecuniary or otherwise, on appointment/reappointment and at the beginning of each year.

2.20 In 2008, five of the 23 members submitted their declarations of interests late. The delays ranged from 5 to 39 days. One member, who retired in December 2008, had not submitted the declaration. In 2009, again there were five members who submitted their declarations late. The delays ranged from 2 to 40 days.

The ED's membership of the Audit Committee

2.21 According to the HKPC Ordinance, the ED shall be an ex-officio member of the Standing Committees. The ED has been a member of the Audit Committee since its establishment in October 2005. According to the good practices promulgated in "Corporate Governance for Public Bodies — A Basic Framework", issued in May 2004 by the Hong Kong Institute of Certified Public Accountants (HKICPA), audit committee should be a high level committee that is independent of the organisation's executive management. Membership should be confined to non-executive board members. **Members of the executive management should only be invited to attend committee meetings as necessary.**

2.22 The HKPC Ordinance was enacted in the 1960s when many modern-day good management practices were not yet developed. To ensure that good corporate governance practices are followed, the ED should only be invited to attend meetings of the Audit Committee as and when necessary. The HKPC and the ITC should consider amending the relevant section of the HKPC Ordinance to ensure that the ED would cease to be a member of the Audit Committee.

*Audit recommendations***2.23 Audit has recommended that the HKPC should:***Attendance of members at Council/Committee meetings*

- (a) monitor the attendance of members at Council/Committee meetings;
- (b) consider taking action to improve the attendance of members at Council/Committee meetings, for example, by setting tentative dates for Council/Committee meetings well in advance to facilitate members to plan their schedules and increase their attendance;

Minutes of Council/Committee meetings

- (c) ensure that the draft minutes of meetings are issued to members in a timely manner;
- (d) consider setting an early target time for the issuance of draft minutes after the meetings;
- (e) consider posting the minutes of the Council/Committee meetings, other than those parts with sensitive information, on its website to enhance the transparency and accountability of the Council and the Committees;

Joint-meeting arrangement for the Council and Finance Committee

- (f) review the appropriateness of the current arrangement of holding joint meetings of the Council and the Finance Committee;
- (g) ensure that proper documentation of the justifications and approval is kept if a joint-meeting arrangement is adopted for Council/Committee meetings; and

Management of conflicts of interest

- (h) take action to ensure that declarations of interests by members are made in a timely manner.

2.24 Audit has recommended that the Secretary for Commerce and Economic Development and the Commissioner for Innovation and Technology should:

- (a) give due consideration to the attendance records of members at Council/Committee meetings in assessing their suitability for reappointments to the Council;

- (b) properly document the justifications for those cases where members with low attendance are recommended for reappointment;
- (c) ensure that the arrangement for appointing alternate members is made to ensure attendance of public officers at Council/Committee meetings; and
- (d) consider amending the HKPC Ordinance in order to follow the generally accepted good corporate governance practices that the ED should not be a member of the Audit Committee.

Response from the HKPC

2.25 The HKPC agrees with the audit recommendations. The **ED, HKPC** has said that, at the Council meeting held on 16 September 2009, the Council decided that:

- (a) in addition to its regular reminders to members, the Council Secretariat will at each meeting of the Council/Committees provide a note informing all members of their up-to-date attendance rates;
- (b) the Council Secretariat will draw up an annual tentative schedule of Council/Committee meetings at the beginning of each year so that members can better plan in advance;
- (c) the Council Secretariat will issue draft minutes of meetings of the Council/Committees within three weeks of the meetings and any proposed amendments within two weeks thereafter;
- (d) the minutes of Council/Committee meetings will be made available on the HKPC's website, except discussion items containing commercially sensitive or confidential information; and
- (e) the Council Secretariat will issue written reminders to members when declarations of interests are due.

2.26 The **ED, HKPC** has also said that the HKPC will review the joint-meeting arrangement between the Council and its Finance Committee. Should any change be warranted, full documentation of the justifications will be made.

Response from the Administration

2.27 The **Secretary for Commerce and Economic Development and the Commissioner for Innovation and Technology** agree with the audit recommendations. They have said that in respect of the reappointment of members, reference will definitely be made to their attendance at Council meetings. Except in very special circumstances (e.g. to provide for continuity of membership where a significant number of serving members are retiring from the Council), members with low attendance will not be reappointed. Any exceptions will be properly documented and full justifications given.

2.28 The **Commissioner for Innovation and Technology** has also said that:

- (a) when making recommendations on the reappointment of Council members, due consideration has been given to the performance of the members concerned, including their attendance records;
- (b) the recommendation for reappointing Council Members A and B was made in September 2008 on the basis that both members had an attendance rate of 50% between January 2007 and September 2008, if their attendance at the brainstorming session held during the period was also included. Besides, their continuous service on the HKPC would be of particular help at the time given the expected changes in the chairmanship of the Council and the Staffing Committee by end 2008;
- (c) all public officers on the Council have made arrangements on the appointment of alternate members to facilitate attendance at Council meetings; and
- (d) the ED's presence in the Audit Committee is to facilitate the Audit Committee to better understand the governance issues of the HKPC, to respond to Council members' queries and to implement the improvement measures endorsed by the Committee. Having discussed with the Council Chairman and Chairman of the Audit Committee, it is agreed that, while the ED should continue to attend meetings of the Audit Committee in future to perform this role, he will refrain from taking part in voting in this committee. He should also be excused from the discussion of sensitive issues if the Chairman of the Audit Committee sees such a need.

Strategic planning

2.29 According to the corporate governance guidelines issued by the HKICPA (see para. 2.21), the governing board of a public organisation should adopt a strategic planning process, which involves:

- (a) defining and keeping under review the mission and the annual and longer term objectives, and agreeing plans to achieve them; and
- (b) overseeing the delivery of the planned results by monitoring performance against the objectives and targets and ensuring corrective action is taken where necessary.

Audit observations and recommendations

Strategic plan not updated and progress not reported to the Council

2.30 In March 2004, the Council approved a five-year strategic plan for 2004-05 to 2008-09. At the meeting, the Council Chairman commented that "... as long as the HKPC has to ensure relevance of its support services to the changing needs of industries, it is necessary to revisit from time to time the direction of its strategies on industry support for a clear understanding of where the HKPC is heading".

2.31 After the approval of the strategic plan in March 2004, the management had not regularly updated the strategic plan. At the four Council meetings held during the period July 2004 to December 2005, the management reported to the Council the progress of the implementation of the plan. **However, no progress report had been made by the management and strategic planning was not discussed at Council meetings since January 2006. Up to September 2009, no new strategic plan had been prepared for 2009-10 and beyond.**

2.32 In April 2009, about two months after the commencement of this audit, the management proposed and the Council agreed that there was no need to prepare future strategic plans. The management considered that as it had regular meetings with the ITC and the chairmen of the Council/Committees, there was a standing mechanism for consultation on the HKPC's strategies.

Need to involve the whole Council in preparing a strategic plan

2.33 A strategic plan, which usually covers a five-year period, is an important document in corporate governance. Through this document, an organisation defines where it is now and where it wants to be sometime in the future. It provides a clear direction and a written record to all members of the organisation and facilitates the monitoring and evaluation of the organisation's achievements by its stakeholders.

2.34 While the meetings among the management, the ITC and the chairmen of the Council/Committees on the strategic direction of the HKPC might be useful, it cannot replace the strategic planning process. Apart from taking into account the views of the stakeholders (e.g. the ITC and the industries to which the HKPC provides its support services), the whole Council should be involved in the strategic planning process according to good corporate governance practices.

Audit recommendations

2.35 **Audit has recommended that the HKPC should follow the good corporate governance practices and ensure that:**

- (a) **the whole Council is involved in the strategic planning process;**
- (b) **a strategic plan is prepared and regularly updated; and**
- (c) **the progress of implementation of the strategic plan is reported to the Council regularly.**

Response from the HKPC

2.36 The HKPC agrees with Audit on the importance of strategic planning, and will carefully consider the audit recommendations. The **ED, HKPC** has said that:

- (a) the HKPC's decision in April 2009 to dispense with the five-year strategic plan was made after consideration of the fact that a Three-year Forecast had all along been prepared alongside the Annual Programme and Estimates, coupled with the rapid changes in technology and the operating environment of the industries, and the introduction of more structured and frequent consultations with the ITC;
- (b) the rolling Three-year Forecast maps out in detail the direction and activities planned for the HKPC over a three-year period, which serves essentially the same function as a strategic plan, albeit of a slightly shorter time span; and
- (c) the HKPC will revisit the need for a five-year strategic plan and other viable alternatives that would serve the same purpose.

Monitoring of the operation of subsidiaries in the Mainland

2.37 According to the HKPC Ordinance, the HKPC may operate outside Hong Kong. However, the minimum rate charged by the HKPC for the work involved must be sufficient to recover all costs incurred, including direct costs and overhead costs (see para. 1.2(e)(ii)).

2.38 In 2003, the HKPC incorporated the Productivity (Holdings) Limited as the vehicle to hold the Wholly Foreign Owned Enterprises (WFOEs — Note 4) incorporated in the PRD. The objective of setting up the WFOEs was to promote productivity excellence across the value chain of Hong Kong firms operating in the PRD. In 2003 and 2004, three WFOEs were incorporated:

- (a) Productivity (Guangzhou) Consulting Company Limited (GZ-WFOE);
- (b) Productivity (Dongguan) Consulting Company Limited (DG-WFOE); and
- (c) Productivity (Shenzhen) Consulting Company Limited (SZ-WFOE).

2.39 In May 2005, the SZ-WFOE formed a joint-venture company, namely the Shenzhen SZ-HK Productivity Foundation Company Limited (SZ-JV), with a subsidiary of the Shenzhen Municipal Government. The SZ-WFOE owned 65% of the shares of the joint venture company. The objective of setting up the SZ-JV was to provide a platform to strengthen technology and business development between Hong Kong and Shenzhen. Table 3 compares the operating results of the HKPC's subsidiaries in the Mainland to their paid-up capital during the period from their incorporations to March 2009.

Note 4: *A WFOE is a common investment vehicle for business operating in the Mainland. A unique feature of the WFOE is that involvement of a local partner is not required.*

Table 3
Operating results of subsidiaries in the Mainland
(2003-04 to 2008-09)

		GZ-WFOE (\$)	DG-WFOE (\$)	SZ-WFOE (\$)	SZ-JV (\$)
Operating (loss)/gain	2003-04	(92,857)	—	—	—
	2004-05	2,823	1,538	320,330	—
	2005-06	(696,104)	(1,370,015)	(18,609)	(1,301)
	2006-07	(510,752)	(55,216)	203,838	(29,015)
	2007-08	1,774	(593,542)	8,486	35,910
	2008-09	76,230	897,718	1,281,718	133,518
Accumulated (loss)/gain (a)		(1,218,886)	(1,119,517)	1,795,763	139,112
Paid-up capital (b)		2,400,000	5,000,000	1,610,000	RMB1,540,000
Percentage of accumulated loss to paid-up capital (c) = (a)/(b) x 100%		51 %	22 %	NA	NA

Source: Audit analysis of HKPC records

Audit observations and recommendations

Accumulated loss

2.40 Table 3 showed that the GZ-WFOE and DG-WFOE had accumulated losses. About 51 % and 22 % of the capital of the GZ-WFOE and DG-WFOE were depleted because of the accumulated losses. The HKPC should conduct a thorough strategic review of the long-term sustainability and operation of the WFOEs, in particular, the financial viability of the GZ-WFOE and DG-WFOE.

Reporting operating results of the subsidiaries to the Council

2.41 Audit noted that the operating results of the three WFOEs and SZ-JV were not regularly reported to the Council. Up to 30 June 2009, the HKPC:

- (a) had not reported the operating results of the SZ-JV to the Council; and
- (b) had only reported the operating results of the three WFOEs at the Council meetings held in June 2005, November 2006 and April 2009.

Charging rate of projects undertaken for the Mainland subsidiaries

2.42 According to the HKPC Ordinance, all projects undertaken by the HKPC elsewhere than in Hong Kong should be carried out on a full-cost recovery basis (see para. 1.2(e)(ii)). However, the HKPC adopted a discount policy for projects undertaken for its Mainland subsidiaries, whereby only 58% of the project staff cost and overheads incurred were recovered from the subsidiaries. The total discounts provided to the subsidiaries in 2008-09 are shown in Table 4.

Table 4
Discounts of project costs given to subsidiaries in PRD
(2008-09)

WFOE	Total project staff cost and overheads incurred	Total project staff cost and overheads recovered	Discount
	(a)	(b)	(c) = (a) - (b)
	(\$'000)	(\$'000)	(\$'000)
GZ-WFOE	2,638	1,530	1,108
DG-WFOE	1,152	668	484
SZ-WFOE	1,298	753	545
SZ-JV	84	49	35
Total	5,172	3,000	2,172

Source: Audit analysis of HKPC records

2.43 **Audit has recommended that the HKPC should:**

- (a) **conduct a thorough strategic review on the long-term sustainability and operation of the subsidiaries in the PRD, in particular, the GZ-WFOE and the DG-WFOE which have accumulated operating losses;**
- (b) **report the operating results of its subsidiaries to the Council regularly;**
- (c) **ensure that projects undertaken for the subsidiaries outside Hong Kong are carried out on a full-cost recovery basis; and**
- (d) **consider taking actions to recover any amount undercharged from the subsidiaries operating outside Hong Kong.**

Response from the HKPC

2.44 The HKPC agrees with the audit recommendations to conduct a thorough strategic review on the long-term sustainability and operation of the subsidiaries in the PRD. At the Council meeting on 16 September 2009, the HKPC undertook to report the operating results of the Mainland subsidiaries to the Council at least once a year.

2.45 Regarding the audit recommendations on full-cost recovery of projects undertaken for the WFOEs, the **ED, HKPC** has said that:

- (a) the WFOEs were set up to accomplish the HKPC's public mission of providing support to Hong Kong industries in the Mainland to move up the value chain for greater competitiveness;
- (b) there were marked improvements in the financial performance of the WFOEs in the last two years, and the accumulated loss of the three WFOEs and SZ-JV over the past six years was only about \$404,000 (less than 3.8% of the total paid-up capital);
- (c) the HKPC considers the financial results of the WFOEs and SZ-JV in these initial years reasonable, given the industry support nature of their businesses, and would strive to achieve full-cost recovery in the long term; and
- (d) the HKPC considers that the WFOEs are instrumental in extending the HKPC's services to Hong Kong industries in the Mainland. With the migration of Hong Kong industries to the Mainland in the last three decades, the industries would welcome services from the WFOEs to be provided on the same subvented basis as they are provided by the HKPC from Hong Kong.

PART 3: HUMAN RESOURCE MANAGEMENT

3.1 This PART examines the human resource management of the HKPC and suggests areas where improvements can be made.

Pay structure

3.2 According to section 6 of the HKPC Ordinance:

- (a) the HKPC shall, before establishing or varying any salary scale (including any scale of allowances and other pecuniary benefits) for its staff, submit particulars thereof for the approval of the CE; and
- (b) no staff shall be paid any salary other than a salary in the appropriate scale approved by the CE.

The approving authority was delegated to the Commissioner for Innovation and Technology in 2000.

Performance Pay Scheme

3.3 According to the “Miscellaneous Subventions — Guidelines on the Management and Control of Government Subventions” issued by the Government in 1988, subvented organisations were required to offer terms of service not superior to those offered to comparable civil service grade. In 2003, the Government removed this “no better than” requirement. Subvented organisations including the HKPC were allowed to make reference to market practice in determining the remuneration packages for their staff. In January 2008, the HKPC introduced the PPS. The salient features of the PPS included:

- (a) the basic salary of staff would remain unchanged;
- (b) in addition to the basic salary, a “one-off” discretionary variable pay would be paid at the end of each financial year to reward staff of the Principal Consultant rank or below who had made the greatest contributions to the HKPC in respect of financial contributions, outstanding performance in enhancing the HKPC’s productivity and business referrals to other divisions, etc.;
- (c) a Variable Pay Committee (VPC) would be set up to make annual recommendations to the Staffing Committee on the variable pay;
- (d) the HKPC’s overall financial performance and position in any given year would be one of the factors for determining the amount of the variable pay;

- (e) annual pay adjustment would be determined by making reference to the representative and authoritative pay-trend surveys available in the market, instead of making reference to the annual salary adjustment of the civil service; and
- (f) the annual salary adjustment for staff who opted not to join the PPS would be determined by making reference to the annual salary adjustment of the civil service.

As at 1 January 2009, 362 staff had joined the PPS.

Audit observations and recommendations

Variable pay not included in budget

3.4 It was stated in Financial Circular No. 9/2004 “Guidelines on the Management and Control of Government Funding for Subvented Organisations” that:

- (a) Controlling Officer should require the subvented organisation to produce annually a budget for subvented programmes undertaken by the organisation; and
- (b) in the budget, a breakdown of staff expenses by items should be included. Typical items include salaries, contract gratuity, bonuses and job-related allowances.

Audit found that the budgets for 2007-08 and 2008-09 submitted by the HKPC to the ITC did not include the variable pay.

Decision on variable pay made before actual financial results were available

3.5 In March 2008, the Staffing Committee accepted the VPC’s recommendation to make variable pay of a total amount not exceeding \$430,000 for 2007-08. In the submission to the Staffing Committee, it was stated that the estimated surplus for the year amounting to about \$2.4 million would be sufficient to cover the variable pay without affecting the HKPC’s financial position. Subsequently, the HKPC decided to increase the expenditure for capital equipment. As a result, the actual surplus before deducting the variable pay turned out to be \$900,000.

3.6 In March 2009, the Staffing Committee accepted the VPC’s recommendation to set a ceiling of \$5 million for the variable pay for 2008-09, representing about 83% of the expected surplus of at least \$6 million for the year. The actual surplus before deducting the variable pay for the year turned out to be \$14.5 million.

3.7 Audit observed that the actual operating results for each year might differ significantly from the estimated results. **From a prudent financial management point of view, variable pay should be determined after the actual operating results are available.**

Amount of variable pay not based on staff performance of the same year

3.8 Annual performance appraisal of staff was carried out after the end of each financial year. Performance appraisal results were normally available around June to July. In 2007-08 and 2008-09, the HKPC decided the variable pay in March before the performance appraisal results for the year were available. Consequently, the amount of variable pay was determined only by making reference to the comments of the heads of divisions of the staff concerned and the performance appraisal results of the previous year.

3.9 As the performance appraisal results for 2008-09 were not available at the time of the fieldwork of the audit, Audit examined the variable pay awarded for 2007-08. For 2007-08, 106 professional grade staff were awarded variable pay at three levels, namely \$1,000, \$3,000 or \$5,000, based on their performance appraisal results for 2006-07 and the comments of the heads of divisions. A comparison of the performance appraisal results with the variable pay awarded to individual staff for 2007-08 indicated that there were inconsistencies in awarding the variable pay. **For example, a staff of “best” performance was awarded the lowest variable pay but five staff of “steady” performance were awarded the highest variable pay.** Details of the audit findings are shown in Table 5.

Table 5

**Variable pay awarded to professional grade staff
(2007-08)**

Performance	Number of staff			
	Awarded \$1,000	Awarded \$3,000	Awarded \$5,000	Total
Best	1	4	13	18
Good	14	31	9	54
Steady	18	11	5	34
Total	33	46	27	106

Source: Audit analysis of HKPC records

3.10 In response to Audit's enquiry, the HKPC explained that the lowest variable pay was awarded to a staff of "best" performance in the 2007-08 performance appraisal because his performance was rated as "steady" in 2006-07. Similarly, the highest variable pay was awarded to five staff of "steady" performance in the 2007-08 performance appraisal because their performance was rated either as "best" or "good" in 2006-07. The HKPC added that two of these five staff were subsequently promoted in 2007-08.

3.11 Similar inconsistencies were also observed in the variable pay awarded to general grade staff. **For example, only 3 of the 15 staff of "best" performance were awarded the highest variable pay, whilst the second highest variable pay was awarded to a staff of "substandard" performance (see Table 6).**

Table 6
Variable pay awarded to general grade staff
(2007-08)

Performance	Number of staff			
	Awarded \$500	Awarded \$1,200	Awarded \$2,000	Total
Best	5	7	3	15
Good	28	20	2	50
Steady	63	4	1	68
Substandard	1	1	—	2
Total	97	32	6	135

Source: Audit analysis of HKPC records

3.12 The HKPC explained to Audit in August 2009 that the inconsistencies were mainly due to the differences in performance appraisal results between 2006-07 and 2007-08. The HKPC also explained that the staff of "substandard" performance, who was awarded the second highest variable pay, joined the HKPC in January 2007. No performance appraisal result for 2006-07 was available when the variable pay was awarded in March 2008.

Late approval from Government for making variable pay

3.13 The HKPC is required to seek approval from the Commissioner for Innovation and Technology if changes are made to its salary scales (including scale of allowances and other pecuniary benefits — see para. 3.2). Audit examination of the HKPC records revealed that the HKPC had not sought prior approval from the Commissioner for making the variable pay for 2007-08. Covering approval was obtained from the Commissioner in April 2009, about two months after this audit commenced.

Need for prudent financial management in setting variable pay

3.14 A summary of the HKPC's operating results and the amount of the variable pay for 2007-08 and 2008-09 is shown in Table 7. It can be seen that funding from the Government accounted for almost half of the HKPC's income (46% in 2007-08 and 47% in 2008-09).

Table 7
Operating results and variable pay
(2007-08 and 2008-09)

		2007-08 (\$ million)	2008-09 (\$ million)
Income	Government subvention	166.0 (37%)	170.2 (36%)
	Project funding from the ITF	23.9 (5%)	36.8 (8%)
	Building loan subvention from the Government	17.3 (4%)	15.6 (3%)
	Fees and service charges	243.1 (54%)	255.0 (53%)
	Total Income (a)	450.3 (100%)	477.6 (100%)
Total expenditure excluding variable pay (b)		449.4	463.1
Surplus before variable pay (c) = (a) - (b)		0.9	14.5
Variable pay (d)		0.4	4.9
Surplus after variable pay (e) = (c) - (d)		0.5	9.6

Source: Audit analysis of HKPC records

3.15 In its Three-year Forecast submitted to the ITC in November 2008, the HKPC included a deficit budget for the period 2009-10 to 2011-12. The estimated operating losses for these three financial years would amount to \$17 million, \$21 million and \$26 million respectively. Audit noted that the variable pay was increased from \$0.4 million in 2007-08 by over 10 times to \$4.9 million in 2008-09. From a prudent financial management point of view, Audit considers that the HKPC should ensure that the amount of the variable pay is reasonable and moderate to avoid aggravating the operating losses in future years.

Audit recommendations

3.16 **Audit has recommended that the HKPC should:**

- (a) **include the estimated amount of variable pay in the annual budget submitted to the ITC;**
- (b) **determine the amount of the variable pay after the annual financial results are available;**
- (c) **ensure that the variable pay awarded to individual staff is consistent with their performance as reflected in the annual performance appraisals of the same year;**
- (d) **ensure that all changes to the staff salary scales (including scale of allowances) are properly approved before implementation; and**
- (e) **ensure that the amount of the variable pay is reasonable and moderate, and would not aggravate the operating losses in future years.**

Response from the HKPC

3.17 The HKPC agrees with the audit recommendations. The **ED, HKPC** has said that:

- (a) the determination of variable pay has been strictly in accordance with the latest available performance appraisal results. The inconsistencies observed by Audit were merely due to the fact that, at present, the financial year cycle and the staff performance appraisal cycle do not synchronise in respect of determining variable pay for individual staff. The HKPC is fully satisfied that there is no question of any arbitrary award of variable pay; and
- (b) the variable pay determined in 2008 and 2009 were moderate and reasonable and had fully taken into account the HKPC's financial position. The HKPC will take further steps to synchronise the financial year cycle and the staff performance appraisal cycle for determining variable pay from 2009-10 onwards.

Recruitment of staff

3.18 According to the Standard Practices, it is the policy of the HKPC to maintain fairness in its recruitment, selection and appointment process. Recruitment, selection and appointment are based on the candidate's qualifications, experience and personal characteristics required for the job with a view to appointing the most suitable candidate. Audit selected a number of senior staff recruitment exercises for examination. The audit findings are reported in paragraphs 3.19 to 3.25.

Audit observations and recommendations

Late change to terms of appointment

3.19 In December 2006, the HKPC carried out a recruitment exercise to fill a newly created senior post. In the recruitment advertisement, it was stated that the successful candidate would be appointed on contract terms. In March 2007, the HKPC obtained the approval of the Staffing Committee to change the appointment terms of the post to permanent terms because the selected candidate was a serving HKPC permanent staff. The serving staff was eventually appointed to fill the new post on permanent terms.

3.20 Making significant changes to the appointment terms after the commencement of a recruitment exercise is undesirable unless flexibility (e.g. negotiable terms) is provided for in the recruitment advertisement. The fact that the senior post was advertised to be offered on contract terms might have discouraged other suitable candidates looking for permanent terms from applying. **Changing the terms of appointment to suit a particular candidate will give rise to suspicion that the recruitment exercise was not carried out in a fair and open manner.** Audit considers that the terms of appointment as stated in the recruitment advertisement should be strictly followed. Otherwise, the recruitment exercise should be held again.

Short-listing of candidates for job interview

3.21 According to the Standard Practices:

- (a) the HKPC will short-list candidates for selection interview from all candidates who meet the requirements for the post; and
- (b) the justifications for inviting or not inviting a qualified candidate should be recorded.

3.22 In October 2007, a recruitment exercise was conducted for filling a post of the Head of Corporate Communications. The qualifications required for the post, as stated in the advertisement, included:

- (a) a university degree; and
- (b) at least 15 years' experience at senior corporate communications and public relations positions gained largely with sizeable and/or multinational organisations.

3.23 A total of 26 candidates were short-listed. Eleven of them met all the qualification requirements. **However, only one of them, together with four other candidates who did not have 15 years' experience at senior corporate communications and public relations positions, were invited to attend the selection interview.** There was no documentation showing the justifications for not inviting the other ten qualified candidates to the selection interview. The justifications for inviting the four unqualified candidates were also not documented. The qualified candidate was subsequently appointed. She resigned after about one month, and one of the four candidates who did not have the required 15 years' experience was appointed to fill the vacancy.

Audit recommendations

3.24 **Audit has recommended that the HKPC should ensure that:**

- (a) **the terms of appointment offered to the selected candidate are consistent with those advertised for the post. If there is a change in the terms of appointment, the recruitment exercise should be held again in a fair and open manner;**
- (b) **the requirements on short-listing of candidates for job interview as stipulated in the Standard Practices are complied with; and**
- (c) **approval from the Staffing Committee is obtained for all deviations from the Standard Practices and the justifications for the approval are fully documented.**

Response from the HKPC

3.25 The HKPC agrees with the audit recommendations. The **ED, HKPC** has said that:

- (a) in respect of the recruitment exercise in October 2007, while ten of the candidates met the quantitative requirements of having 15 years of experience,

they were not short-listed for interview primarily because either part of their experiences were considered not relevant or their background/working experience had cast serious doubts as to their suitability;

- (b) the HKPC issued a revised Standard Practice in April 2008 to the effect that short-listing of candidates for interview should take into account both quantitative and qualitative requirements, and all considerations should be documented; and
- (c) the HKPC undertakes to comply fully with the Standard Practice.

Non-accountable Cash Allowance

3.26 According to the Standard Practices, eligible staff appointed on or after 12 June 2000 may apply for a monthly Non-accountable Cash Allowance (NCA), as a housing benefit, according to the terms and conditions of similar allowances offered to civil servants. The Standard Practices also stipulate that:

- (a) if a staff or his/her spouse has received any form of housing benefits from the Government or a publicly-funded organisation, his/her entitlement to the HKPC housing benefits may be reduced or limited; and
- (b) if a staff or his/her spouse has permanently ceased to be eligible for any housing benefits under the terms of employment in the Government or in a publicly-funded organisation, he/she will not be eligible for any HKPC housing or related benefits.

Audit observations and recommendations

3.27 Audit examination of the appointment of senior staff of the HKPC revealed that for three staff, despite the fact that they had received housing benefits from the Government or from publicly-funded organisations in their previous employment, their entitlements to the NCA were not reduced or limited as stipulated in the Standard Practices. Details of these three cases are reported in paragraphs 3.28 to 3.40.

Staff A

3.28 In November 2000, Staff A was appointed by the HKPC. He was previously an employee of a publicly-funded organisation. He had exhausted his housing benefit entitlement and was no longer eligible for any housing benefits under his employment with the publicly-funded organisation.

3.29 According to the Standard Practices, Staff A was not entitled to the NCA (see para. 3.26). However, the HKPC sought the Staffing Committee's approval to offer him full entitlement to the NCA. The Staffing Committee was informed that:

- (a) the benefit entitlements to be offered to Staff A would be less than those of his previous employment; and
- (b) in order to make a "comparable remuneration package" to Staff A, full entitlement to the NCA should be offered.

The Staffing Committee approved the package.

3.30 Based on a return provided to the HKPC by Staff A's previous employer in December 2000, Audit's comparison of Staff A's remuneration package of his previous employment with that offered by the HKPC revealed that:

- (a) the basic salary offered by the HKPC to Staff A was 21% higher than the last drawn salary in his previous employment;
- (b) Staff A was not receiving any allowances, including housing, education and school passage allowances, at the time when he left his previous employment; and
- (c) including the NCA, the salary offered by the HKPC was 49% higher than that received by Staff A in his previous employment.

3.31 According to the subvention guidelines in force when Staff A was appointed, subvented organisations were required to offer terms of service not superior to those offered to comparable civil service grade, and follow the "no double housing benefits" rule in offering housing benefits to their staff. Under the rule, if an officer or his/her spouse has received full housing entitlement from a subvented body, he/she is ineligible for further housing assistance. Including NCA in the remuneration package offered to Staff A was not in compliance with the "no double housing benefits" rule because:

- (a) Staff A had exhausted his housing benefit entitlement under his employment with the publicly-funded organisation before he joined the HKPC; and
- (b) the NCA is a form of housing benefits.

3.32 Audit noted that in response to the HKPC's proposal to offer Staff A full entitlement to the NCA, the ITC representative of the Staffing Committee commented that:

- (a) granting NCA in lieu of housing benefit would make his terms and conditions superior to his comparable grade in the civil service, which deviated from the general rules laid down in the Guidelines on the Management and Control of Government Subventions; and
- (b) having considered the special case of Staff A, the ITC had no objection to the proposal to grant NCA to Staff A in order to make the HKPC's offer comparable to his existing terms, on the condition that there were no financial implications on the HKPC's overall subvention.

3.33 The HKPC informed Audit in August 2009 that although Staff A was not receiving any education and school passage allowances when he left his previous employment, he was eligible to such allowances. The value of his entitlement to education and school passage allowances could amount to about \$430,000 a year. Taking this sum into account, the package (including the NCA) offered by the HKPC was only 2% better than that enjoyed by Staff A in his previous employment.

3.34 ***Audit comments.*** There are conditions which need to be fulfilled before a staff can claim education and school passage allowances. For example, the child must be educated in approved schools in the United Kingdom and of the age from 9 up to the end of the school terms in which the child becomes 19. At the time when Staff A left his previous employment, he was not receiving education and school passage allowances (see para. 3.30(b)). Converting the allowances not claimed by Staff A into non-time-limited cash remuneration of \$430,000 a year was an immediate significant improvement to the remuneration package. **Audit considers that full details of the two packages should be provided to the Staffing Committee and the ITC for their consideration in approving the deviation from the Standard Practices and the “no double housing benefits” rule.**

Staff B

3.35 In January 2008, Staff B who previously worked in a publicly-funded organisation was appointed to fill a senior post. In his employment with the publicly-funded organisation, Staff B received a basic salary and a non-time-limited cash allowance in lieu of fringe benefits on housing, passage and education. In December 2007, the HKPC sought the special approval from the Staffing Committee to offer Staff B the full entitlement to the NCA. The HKPC informed the Staffing Committee that:

- (a) Staff B was receiving a monthly non-time-limited “Lump Sum Payment of Cash Allowance in lieu of fringe benefits on housing, passage and education”;

- (b) the NCA of the HKPC was limited to a maximum of 120 monthly payments. The “entitlement period” was drawn up in relation to the old “Home Purchase Scheme” which was not offered to staff who joined the HKPC after June 2000;
- (c) it would be difficult to argue that the granting of NCA to Staff B would be in breach of the Standard Practices; and
- (d) without the full entitlement to the NCA, the remuneration package offered by the HKPC would be lower than the candidate’s existing one, and the candidate might not join the HKPC.

The Staffing Committee approved the remuneration package.

3.36 ***Audit comments.*** As Staff B received, in his previous employment with the publicly-funded organisation, a cash allowance in lieu of housing (and other) benefits, his entitlement to the NCA in the HKPC may be reduced according to the Standard Practices (see para. 3.26(a)). **The HKPC should have informed the Staffing Committee that the granting of full entitlement to the NCA to Staff B would be in breach of the Standard Practices.**

Staff C

3.37 In March 2009, the HKPC sought the approval from the Staffing Committee for appointing Staff C, a former civil servant, to fill a senior post. Specifically, the HKPC sought the Staffing Committee’s approval to offer Staff C a full entitlement to the NCA without any limitation or reduction, despite the fact that Staff C had once enjoyed housing benefits during his employment in the civil service. The HKPC informed the Staffing Committee that during the negotiation with Staff C, “it was obvious that in the absence of the NCA, the offer would not be sufficient to attract him to join the HKPC.” The HKPC did not have any record of the period Staff C had enjoyed housing benefit in the civil service. The Staffing Committee was requested to extend Staff C’s entitlement period of the NCA to 120 months without being informed of his entitlement period according to the Standard Practices. The HKPC did not keep any record of the negotiation with Staff C. The Staffing Committee was also not informed of the details of the negotiation.

3.38 An examination of the HKPC’s recruitment records showed that:

- (a) four candidates who gave remarkable presentation of their experience during the first interview were invited to attend the second interview;

- (b) Staff C and another candidate achieved almost the same high ratings at the second interview. Staff C was eventually selected as the most suitable candidate for the post. The other candidate was selected as a reserve appointee;
- (c) the basic salary (i.e. not including the NCA) offered by the HKPC was 20% higher than Staff C's last drawn salary in the civil service, and 6% lower than the expected salary stated by Staff C in his application. Including the NCA, the salary offered was 12% higher than the expected salary; and
- (d) there was no documentation showing that Staff C had requested a remuneration that was higher than the level of the expected salary stated in his application, or had indicated that he would decline the appointment offer unless a full entitlement to the NCA was offered.

3.39 The HKPC informed Audit in August 2009 that if the NCA was not included, the remuneration package offered by the HKPC to Staff C was 2% lower than his package in the Government. If the NCA was included, the HKPC remuneration package was 13% higher than the government package.

3.40 ***Audit comments.*** It might not be a valid justification to deviate from the Standard Practices simply because a remuneration package was not attractive enough to a particular candidate, especially when there was a reserve appointee who had achieved almost the same ratings as the appointee at the selection interview. Audit considers that deviation from the Standard Practices should be justified only on an exception basis when there is a real need, e.g. there is only one suitable candidate and it is not feasible to conduct another round of recruitment. **Moreover, in seeking exceptional approval from the Staffing Committee, full details (e.g. the candidate's existing remuneration package, his expected salary and the availability of a reserve appointee) should have been provided to help the Committee make a fully informed decision.**

Audit recommendations

3.41 **Audit has recommended that the HKPC should:**

- (a) **consider whether remedial action should be taken regarding the NCA offered to Staff A which was against the "no double housing benefits" rule in force when Staff A was appointed in November 2000;**
- (b) **ensure that the requirements of the Standard Practices on NCA are strictly complied with unless there is a very exceptional need; and**

- (c) provide detailed and complete information (including the candidate's existing remuneration package, his expected salary, and the availability of reserve appointees) to the Staffing Committee, in seeking its exceptional approval for offering the full entitlement of the NCA to the candidate whose entitlement should have been reduced or limited according to the Standard Practices.

Response from the HKPC

3.42 The HKPC agrees with the audit recommendations. The **ED, HKPC** has said that:

- (a) with the promulgation of the Government's policy in December 2003 to delink the pay structure of subvented organisations from that of the civil service and the removal of the "no better than" and "no double housing benefits" requirements, the HKPC introduced the PPS in January 2008 to migrate towards a more market-oriented pay structure;
- (b) the relevant provisions regarding the NCA under the Standard Practices should have been revised to reflect the new market-oriented pay policy framework. The HKPC has firm plans to do so; and
- (c) in taking forward the audit recommendation regarding Staff A, the HKPC will carefully take into account all considerations, including the contractual obligations, legal and staff management implications.

Remuneration package of the Executive Director

3.43 The incumbent ED was appointed by the Council in August 2006. His remuneration package comprised a lump sum monthly salary and an end-of-contract gratuity. The lump sum salary was made up of a basic salary (Note 5), and encashed NCA and passage allowance. The rate for calculating the end-of-contract gratuity was reduced from 15% (Note 6) to 12.5% to take into account the fact that the non-gratuity bearing NCA and passage allowance were included in the lump sum monthly salary and became gratuity bearing.

Note 5: *The basic salary of the ED was pitched at the level equivalent to Point D6 of the Directorate Pay Scale of the civil service.*

Note 6: *In the HKPC, the end-of-contract gratuity offered to contract staff is normally equivalent to 15% of the total basic salary received during the contract period.*

Audit observations and recommendations

Information not fully provided for Council's consideration

3.44 In seeking the Council's approval of the remuneration package to be offered to the ED, the ITC, as the Recruitment Committee Secretariat, informed the Council that the remuneration package offered was a negotiated package. It was kept broadly in line with the package applicable to the D6 rank in the civil service (with all allowances encashed), and with the HKPC's remuneration policy.

3.45 However, the Council was not explicitly informed that:

- (a) according to the Standard Practices, the incumbent ED might not be eligible for the NCA or his eligibility had to be reduced because he might have enjoyed civil service housing benefit during his employment with the Government;
- (b) the entitlement to the NCA was limited to ten years under the Standard Practices but the encashed NCA element in the ED's remuneration package was not time-limited; and
- (c) the encashed NCA and passage allowance would be adjusted in the annual salary adjustment while NCA and passage allowance of other staff were not subject to the same annual adjustment.

Revision of contract terms not approved by Council and Government

3.46 When the new PPS was introduced in January 2008 (see para. 3.3), it was decided that if there was a salary adjustment for 2008-09, the salary of staff who joined the PPS on or before 30 June 2008 would be adjusted retrospectively from April 2008. For staff who joined the PPS after 30 June 2008, their salary adjustment followed the civil service pay adjustment for 2008-09.

3.47 In August 2008, the Staffing Committee approved the 2008-09 salary adjustment of 5.29% to 6.48% for staff who joined the PPS on or before 30 June 2008, and salary adjustment of 5.29% to 6.3% (i.e. based on the civil service pay adjustment) for other staff. In the same month, the ED informed the Commissioner for Innovation and Technology and the Chairmen of the Council and the Staffing Committee that as the annual salary adjustment clause in his contract was linked to the civil service pay adjustment, his contract should be amended to break the civil service linkage in order to demonstrate his support for the PPS. Subsequently, an addendum to the ED's employment contract was signed by the ED and the Council Chairman stipulating that the salary of the ED would be adjusted in

accordance with the PPS. Therefore, the ED's salary was adjusted retrospectively from April 2008 (Note 7).

3.48 The ED was appointed by the Council under the HKPC Ordinance. Prior approval from the Council should be obtained for changes to the terms of the contract. **Audit examination of the HKPC records revealed that the Council had not discussed or approved the revision of the contract term regarding the ED's salary adjustment mechanism.**

Increased rate for contract gratuity on renewal of contract

3.49 The ED's current contract will expire in December 2009. In April 2009, the Council endorsed the performance appraisal of the ED and decided to offer a new three-year contract to him. On behalf of the Council, the ITC negotiated the terms of the new contract with the ED. During the negotiation, the ED said that he did not understand fully the rationale behind the adoption of 12.5% for the end-of-contract gratuity, which was not in line with the 15% applicable to all HKPC staff. In June 2009, the ITC recommended to the Council that the rate for calculating the end-of-contract gratuity should be adjusted from 12.5% to 15% "to align with the provision for other HKPC staff". The Council approved the recommendation.

3.50 Audit reviewed the paper submitted to the Council in June 2009 and noted that it had not included the background on the adoption of the lump sum approach in the ED's remuneration package which had resulted in reducing the gratuity rate from 15% to 12.5% in his first contract (see para. 3.43). **The Council therefore had not been given all the relevant information in approving the renewal of the ED's contract with an increased rate for contract gratuity.**

Audit recommendations

3.51 **Audit has recommended that the Commissioner for Innovation and Technology should ensure that:**

- (a) **in seeking the approval of the Council on the appointment of the ED, the Council is provided with all relevant information about the eligibility to the allowances included in the remuneration package, together with the financial implications of encashing the allowances for inclusion in the lump-sum monthly salary;**

Note 7: *Joining the PPS, the ED's salary adjustment for 2008-09 was increased from 6.3% (i.e. based on the civil service pay adjustment) to 6.46% (i.e. based on the PPS).*

- (b) **prior approval from the Council is obtained for any changes in the terms of appointment (e.g. salary adjustment mechanism) of the ED; and**
- (c) **in seeking the approval of the Council on renewal of the contract with the ED, the Council is informed of the implications of and justifications for all changes proposed in the new contract.**

Response from the Administration

3.52 The **Commissioner for Innovation and Technology** agrees with the audit recommendations. She has said that:

- (a) the remuneration package offered to the ED in 2006 was proposed by the Recruitment Committee which was chaired by the Council Chairman and comprised core Council members. When the proposed remuneration package was recommended to the Council for approval in August 2006, the ITC explained that the negotiated package followed a modernised, simplified approach, offering one lump sum monthly remuneration and a gratuity at the end of the contract, instead of following the package for the previous ED. A comparison of the new remuneration package with that of the previous ED was also provided to the Council for reference;
- (b) in respect of the addendum to the ED's contract executed in August 2008, it is a consequential amendment to reflect changes in circumstances (i.e. the introduction of the PPS in 2008). The salary adjustment mechanism for the ED remains largely the same. On this basis, the then Council Chairman considered it not necessary for a separate submission to the Council and the then Staffing Committee Chairman was kept informed of this. The ITC concurred with the arrangements; and
- (c) in early April 2009, the Council endorsed the annual performance appraisal of the ED and agreed unanimously to offer him a new contract. The Commissioner was asked to discuss the proposed terms with him on behalf of the Council. Following negotiation, it was agreed that the ED's contract should be renewed on the same terms and the prevailing monthly salary should be adopted. It was recommended that the contract gratuity rate should be adjusted from 12.5% to 15% to align with the provision for other HKPC staff, and that his salary should be reviewed in April 2010. The Council paper has reflected fully these considerations for the reference of the Council members.

PART 4: ADMINISTRATIVE ISSUES

4.1 This PART reports the audit findings concerning the administrative issues of the HKPC and suggests actions for improvement.

Fixed asset management

4.2 In fixed asset management, periodic stocktake is important to ensure that the assets are properly safeguarded against damage or loss.

Audit observations and recommendations

Stocktake in 2005

4.3 From September to December 2005, the HKPC carried out a full-scale stocktake. **It found that of the 26,045 items recorded in the Fixed Asset Register, 8,726 (34%) could not be located. The missing items included computers, audio-visual equipment and laboratory equipment (see Appendix C). The total purchase cost of the missing items was \$54.6 million (Note 8).** On the other hand, there were 4,450 items of stock that could not be traced to the Fixed Asset Register.

4.4 In July 2006, the HKPC informed its Finance Committee of the results of the stocktake. In the Finance Committee Paper, the HKPC stated that the possible reasons for the discrepancies were:

- (a) fixed asset barcode labels were not properly affixed;
- (b) the Fixed Asset Register was not updated to reflect movements and disposals of assets; and
- (c) movements and storage of assets were not properly managed.

4.5 In January 2008, the Standard Practices on fixed asset management were revised. According to the revised Standard Practices, partial stocktake on a random sampling basis should be conducted annually and full-scale stocktake should be conducted every five years.

Note 8: *According to the HKPC, the total written down value of the missing items was \$6 million.*

Stocktakes conducted in 2009

4.6 In April 2009, the HKPC carried out a partial stocktake. **Of the 1,955 items selected for checking, 250 (13%) could not be located.** The total purchase cost of the missing items was \$1.7 million (the total written down value was \$32,000).

4.7 In June 2009, the HKPC conducted another stocktake of desktop and notebook computers. The HKPC informed Audit of the results of the stocktake, as follows:

- (a) 109 (7%) of the 1,572 computers could not be located. The total purchase cost of the missing items was \$762,000 (the total written down value was \$1,000); and
- (b) 163 computers could not be traced to the Fixed Asset Register because their barcode labels were peeled off or wrongly affixed.

Follow-up actions on losses identified in stocktakes

4.8 Regarding the losses of assets found in the three stocktakes performed in 2005 and 2009, **there was no record showing that the HKPC had investigated each case of loss** and ascertained:

- (a) the causes for the loss;
- (b) whether any criminal act was involved and whether it was necessary to report the loss to the Police; and
- (c) whether any negligence was involved and whether it was necessary to require the responsible officers to replace the lost items.

Annual stocktake not conducted

4.9 According to the Standard Practices promulgated in January 2008 (see para. 4.5), partial stocktake should be conducted annually. **However, no partial stocktake was conducted from January 2008 to March 2009.**

Audit recommendations

4.10 **Audit has recommended that the HKPC should:**

- (a) **take measures to ensure that fixed assets are always kept under proper custody to guard against damage or loss;**

- (b) **find out the causes for each case of loss, and investigate:**
 - (i) **whether any criminal act is involved and whether it is necessary to report the loss to the Police; and**
 - (ii) **whether any negligence is involved and whether it is necessary to require the responsible officers to replace the lost items;**
- (c) **ensure that the Fixed Asset Register records accurately all the fixed assets to facilitate efficient and effective management and maintenance; and**
- (d) **ensure that partial stocktakes and full-scale stocktakes are carried out according to the Standard Practices.**

Response from the HKPC

4.11 The HKPC agrees with the audit recommendations. The **ED, HKPC** has said that since June 2009, the HKPC has appointed a Fixed Asset Manager in each division to strengthen the safe custody of fixed assets.

Inventory control of laboratory equipment

4.12 The HKPC has ten laboratories which provide laboratory services to other business units of the HKPC and the industries. As at 31 March 2009, there were 2,603 pieces of laboratory equipment at a total purchase cost of \$93 million. The equipment was under the control of four divisions of the Technology Development Branch (see Appendix A).

4.13 A system to control the utilisation and disposal of the laboratory equipment was specified in the Standard Practices. According to the Standard Practices:

- (a) laboratory equipment of a purchase cost of \$500,000 or more should be classified into four types with four levels of expected utilisation (see Table 8);
- (b) justifications for the classification should be documented;
- (c) the classification lists should be reviewed annually; and
- (d) equipment on the classification lists should be considered for disposal if:

- (i) the technology of the equipment has become obsolete and it is not worthwhile to keep the equipment for further technology demonstration; or
- (ii) the utilisation rate of the equipment cannot be maintained at the minimum required level.

Table 8**Classification of laboratory equipment**

Type of equipment	Definition	Expected utilisation (Note)
A	State-of-the-art equipment for technology development, demonstration and dissemination	At least 5% or used 5 times a month
B	One of the key parts/elements of an integrated set of equipment	At least 5% or used 5 times a month
C	Available in the market but still important to serve the under-served or niche market	At least 15% or used 10 times a month
D	Widely available in the market but still has a high service demand	At least 30% or used 20 times a month

Source: HKPC records

Note: The HKPC calculates the utilisation rate of a piece of laboratory equipment by dividing the total amount of time when the equipment is in use by the total available time.

Audit observations and recommendations***Large number of equipment not covered by the control system***

4.14 Audit reviewed the inventory of laboratory equipment and found that only 43 (2%) of the 2,603 pieces of equipment were purchased at a cost of \$500,000 or more. Their utilisation and disposal were controlled by the system promulgated in the Standard Practices. **However, the utilisation and disposal of the remaining 2,560 (98%) pieces of laboratory equipment at a total purchase cost of \$50.7 million (54%) were not covered by the system (see Table 9).**

Table 9
Laboratory equipment
(31 March 2009)

Purchase cost	Number of items	Total purchase cost (\$'000)
\$1 — \$99,999	2,453 (94%)	25,219 (27%)
\$100,000 — \$499,999	107 (4%)	25,520 (27%)
	2,560 (98%)	50,739 (54%)
\$500,000 or more	43 (2%)	42,404 (46%)
Total	2,603 (100%)	93,143 (100%)

Source: Audit analysis of HKPC records

Requirements of Standard Practices not complied with

4.15 **Audit examination of the classification lists of the laboratory equipment revealed that the requirements stipulated in the Standard Practices were not fully complied with.** Details are as follows:

- (a) ***Annual review of classification lists.*** The classification lists of two divisions were not reviewed annually;
- (b) ***Equipment omitted from classification lists.*** Twenty (47%) of the 43 pieces of equipment, each with a purchase cost of \$500,000 or more, were not included on the lists;
- (c) ***Clients' equipment included on classification list.*** Three pieces of equipment purchased on behalf of the clients of consultancy projects were wrongly included on the classification list of a division;
- (d) ***Malfunctioned equipment not disposed of in a timely manner.*** One of the equipment was found malfunctioned and beyond repair in 2006. However, no action was taken to dispose of the equipment which was still included on one of the classification lists for 2008-09; and
- (e) ***Justifications for classification not documented.*** A division did not document the justifications for the classification of the equipment under its control.

Audit recommendations

4.16 **Audit has recommended that the HKPC should:**

- (a) **consider lowering the threshold of the equipment purchase cost of \$500,000 or more stated in the Standard Practices so that more laboratory equipment will be covered by the inventory control system;**
- (b) **take measures to ensure that the requirements stated in the Standard Practices in respect of the inventory control system of laboratory equipment are strictly complied with; and**
- (c) **take action to dispose of in a timely manner the equipment which is beyond repair or has an utilisation rate below the minimum required level.**

Response from the HKPC

4.17 The **HKPC** agrees with the audit recommendations.

Procurement matters

4.18 Good practice in procurements should be guided by the twin objectives of achieving best value for money and maintaining open and fair competition. Audit examination of the procurements of the HKPC revealed that there were areas where improvements could be made.

Audit observations and recommendations

Tender exercise for procuring a company car

4.19 According to the Standard Practices, information on evaluation criteria should be provided in the tender documents to facilitate the preparation of competitive and quality tender submission by tenderers. In February 2009, the HKPC carried out a tender exercise for procuring a company car. Contrary to the requirement stated in the Standard Practices, the following information related to the evaluation criteria was not provided in the tender documents:

- (a) the assigned technical marks for each of the assessment criteria;
- (b) the formula to be used to calculate technical/price scores; and
- (c) the technical and price assessment weightings.

Ordering of newspapers and magazines

4.20 For many years, the HKPC has ordered newspapers and magazines from a newsagent. In 2008-09, the total amount paid to the newsagent was about \$96,000.

4.21 Audit selected three newspapers and five magazines ordered by the HKPC for a comparison of their prices charged by the newsagent with the subscription rates quoted by the publishers. **It transpired that savings ranging from 9% to 81% could be obtained by subscribing direct from the publishers (see Table 10).** As large discounts on the retail prices of newspapers and magazines are usually offered to subscribers, the HKPC should always explore such means in its procurement to achieve greater economy.

Table 10
Potential savings on newspapers and magazines

	Price per copy (\$)		Savings per copy (\$) (c) = (a)-(b)
	Charged by newsagent (a)	Quoted by publisher (Note) (b)	
Newspaper A	5.3	4.8	0.5 (9%)
Newspaper B	5.3	4.8	0.5 (9%)
Newspaper C	13.2	7.7	5.5 (42%)
Magazine A	47.5	9.0	38.5 (81%)
Magazine B	47.5	27.2	20.3 (43%)
Magazine C	23.8	14.7	9.1 (38%)
Magazine D	47.5	27.5	20.0 (42%)
Magazine E	66.5	32.0	34.5 (52%)

Source: Audit analysis of HKPC records

Note: The quotations were obtained by Audit in June 2009 from the publishers.

Private post office box

4.22 The HKPC has rented a private post office box at the Tsim Sha Tsui Post Office for about 20 years. The annual rental for 2008-09 was \$650. Staff of the HKPC go to the Tsim Sha Tsui Post Office every working day to collect mails from the post office box and perform other duties using the postal services there.

4.23 It is not cost-effective to continue renting the private post office box and going to the Tsim Sha Tsui Post Office every working day because:

- (a) the HKPC has been using its address at the HKPC Building as the correspondence address for many years; and
- (b) there is a post office within walking distance from the HKPC Building.

Audit recommendations

4.24 **Audit has recommended that the HKPC should:**

- (a) **ensure that the requirements laid down in the Standard Practices on tender procedures are properly followed;**
- (b) **consider arranging direct subscription to newspapers and magazines from the publishers;**
- (c) **discontinue renting the private post office box at the Tsim Sha Tsui Post Office; and**
- (d) **make use of the postal services of the post office near the HKPC Building to minimise the need to travel to the Tsim Sha Tsui Post Office.**

Response from the HKPC

4.25 The HKPC agrees with the audit recommendations. The **ED, HKPC** has said that:

- (a) the Tsim Sha Tsui Post Office was notified in August 2009 of the discontinuation of renting the post office box; and
- (b) the HKPC will start subscribing magazines/newspapers direct from publishers, where appropriate, as soon as its current contract with the newsagent expires.

Entertainment expenses

4.26 According to the Standard Practices, staff may claim reimbursement for entertainment expenses incurred for official purposes subject to the cost-per-head spending limits stipulated therein. In 2008-09, the total reimbursement for entertainment expenses amounted to \$250,000.

Audit observations and recommendations

Entertainment expenses in excess of spending limits

4.27 In April 2008, the Audit Committee was informed that from April 2005 to October 2007, **there were 13 reimbursements for entertainment expenses where the cost-per-head spending limits were exceeded.** Of the 13 cases:

- (a) 2 reimbursements were made to staff who had obtained special approval from the ED for exceeding the spending limits;
- (b) 4 reimbursements were made to staff although special approval was not obtained from the ED; and
- (c) 7 reimbursements were made to the ED. The Standard Practices then in force did not require special approval for the ED's claims which exceeded the spending limits. The ED followed the practice of the former ED to approve his own entertainment expenses which exceeded the limits.

Substantial increase in spending limits for entertainment expenses

4.28 In August 2008, the Staffing Committee endorsed new Standard Practices stipulating a new set of increased spending limits for entertainment expenses. The new Practices also stipulated that if the ED's claim exceeded the spending limits, he should seek special approval from the Council Chairman. Table 11 shows a comparison of the new spending limits with the previous limits and those of the Government. **Although the spending limits were increased substantially, ranging from 14% to 108%, the justifications for the increases were not documented.** As entertainment expenses are generally regarded as sensitive expenditure, they should be **moderate and conservative**. The substantial increases should have been properly justified so that they can withstand stringent public scrutiny.

Table 11
Cost-per-head spending limits on entertainment expenses

	HKPC		Government (effective from April 2007) (\$)
	Prior to October 2008 (\$)	Effective from October 2008 (\$)	
(i) For ED and Branch Directors			
Breakfast	120	250 (+108%)	(Note)
Lunch	250	450 (+80%)	300
Dinner	350	500 (+43%)	400
(ii) For other staff			
Breakfast	120	150 (+25%)	(Note)
Lunch	250	300 (+20%)	300
Dinner	350	400 (+14%)	400

Source: HKPC and Government records

Note: The Government has not specified a spending limit for breakfast.

Entertainment at a private club

4.29 In March 1991, the HKPC entered into an agreement with a private club in Kowloon Tong near the HKPC Building. Under the agreement, the HKPC paid an annual fee, and HKPC staff of the Consultant rank and above were allowed to use the dining facilities of the private club on weekdays. The annual fee for 2008-09 was \$15,000. The objective of the agreement was to facilitate the entertainment of the HKPC's guests. However, the HKPC did not impose any restrictions on the use of the dining facilities. Eligible HKPC staff might use the facilities for non-official purposes.

4.30 An analysis of the entertainment claims made in 2008-09 revealed that only 29 (7%) of the 408 official entertainments were held at the private club (see Table 12). Such low utilisation gives rise to doubt whether the annual fee of \$15,000 paid by the HKPC was good value for money.

Table 12
Analysis of claims for entertainment expenses
(2008-09)

Entertainment venue	Number of claims	Total amount (\$)
The private club	29 (7%)	16,000 (6%)
Other venues	379 (93%)	234,000 (94%)
Total	408 (100%)	250,000 (100%)

Source: Audit analysis of HKPC records

Audit recommendations

4.31 **Audit has recommended that the HKPC should:**

- (a) **ensure that all reimbursements for entertainment expenses exceeding the spending limits are properly justified and approved;**
- (b) **consider recovering the excess amount of entertainment expenses from the staff who had not obtained special approval for exceeding the spending limits;**
- (c) **ensure that the justifications for raising the cost-per-head entertainment limits are properly documented; and**
- (d) **given the low utilisation of the facilities for official purposes, review the need to continue the agreement with the private club when it is due for renewal.**

Response from the HKPC

4.32 The HKPC agrees with the audit recommendations. The **ED, HKPC** has said that:

- (a) the excess amount of entertainment expenses without approval (involving an amount of \$227) has been recovered in September 2009. The justifications for the entertainment limits have subsequently been documented; and

- (b) the HKPC considers that the private club offers immense value to the operations of the HKPC and there is no alternative in the vicinity. Therefore, in reviewing the need for the club, full considerations must also be given to the utilisation for official purposes that do not involve any official entertainment claims.

Disposal of fixed assets to staff

4.33 According to the Standard Practices, fixed assets (except equipment, computer software and training packages) that are surplus to operation may be disposed of through internal bidding from interested staff. In 2008-09, 95 fixed asset items were disposed of to staff through bidding. The total amount received was \$30,000.

Audit observations and recommendation

4.34 Of the 95 items sold to staff in 2008-09, 19 were used mobile phones. These phones were sold to staff through internal bidding. The successful bids ranged from \$0.1 to \$100 and the total sum received was \$879.2. Audit examined the bidding records and found that no reserve prices were set for the phones. Audit also noted that used phones of the same models of 17 (Note 9) of these 19 phones were available for sales on Internet auction sites. The prices on the Internet for such used phones in July 2009 ranged from \$99 to \$400. The difference between the prices on the Internet and the prices paid by the HKPC staff for the 17 phones amounted to \$2,724.9 (see Appendix D).

4.35 The practice of selling assets to staff, particularly without setting a reserve price to reflect the market value, may not be able to withstand public scrutiny. Such practice might be seen as unduly favouring the staff at the expense of the HKPC.

Audit recommendation

4.36 Audit has *recommended* that the HKPC should review the propriety of the practice of selling assets to staff through internal bidding without making reference to their market values.

Note 9: *The other two used phones' models were not available on the Internet. They were sold to staff for \$0.1 and \$1.*

Response from the HKPC

4.37 The HKPC agrees with the audit recommendation. The **ED, HKPC** has said that the HKPC has dispensed with the arrangement of selling assets to staff through internal bidding since September 2009.

Company cars

4.38 As at 31 March 2009, the HKPC had five company cars. One car was designated for use by the ED (ED's car), two were division cars for the Environmental Management Division and two were pool cars.

Audit observations and recommendations

4.39 It is important to maintain proper records of the usage of company cars to prevent abuses and misuse. The HKPC used three types of log sheets to record their usage. Audit's examination of the log sheets for journeys made in January 2009 revealed that there were areas where improvements could be made:

- (a) mileage meter readings before and after journeys were recorded only in the log sheets of one division car but not those of the other company cars;
- (b) purposes of journeys were not recorded in the log sheets of the division cars, and 45 of the 99 log sheets of the other company cars;
- (c) precise information on destinations were not always recorded in the log sheets. Only the districts of the destinations (e.g. Tsim Sha Tsui) were recorded; and
- (d) information about waiting (e.g. time, location and reasons) and fuel consumption was not recorded in any of the log sheets.

Audit recommendations

4.40 **Audit has recommended that the HKPC should:**

- (a) **standardise the log sheets for use by all company cars to facilitate monitoring and analysis of utilisation of the cars; and**
- (b) **ensure that the drivers record details of journeys properly in the log sheets, including the purposes of the journeys, the precise destinations, the waiting time and fuel consumption data.**

Response from the HKPC

4.41 The **HKPC** agrees with the audit recommendations.

Vacant office space at the HKPC Building

4.42 The HKPC Building is an eight-storey building with a total net floor area of 197,000 square feet (sq. ft. — Note 10). The floor area is used for three purposes:

- (a) 91,000 sq. ft. are used as the HKPC's office;
- (b) 99,000 sq. ft. are used for various facilities, such as training rooms, exhibition venues, laboratories, and workshops; and
- (c) the remaining 7,000 sq. ft. are set aside for licensing to industries as office space. The objective is to enhance the HKPC's integrated support to the industries. Tenants of the office space can enjoy free use of office facilities provided therein and obtain discounts on training courses offered by the HKPC. The licensing income for 2008-09 was \$1.4 million.

Audit observations and recommendations

4.43 As at 30 June 2009, 13,600 sq. ft. (15%) of the 91,000 sq. ft. office space used as the HKPC's office were left vacant. An analysis revealed that, up to 30 June 2009, 5,200 sq. ft. (38%) of these 13,600 sq. ft. had been vacant for 12 months or more. Based on the market rate as at 30 June 2009 of office space in Kowloon Tong where the HKPC Building is located, the annual rental value of the vacant space was about \$5.4 million (i.e. 13,600 sq. ft. × \$33/sq. ft. × 12).

4.44 On the other hand, about 400 sq. ft. (6%) of the 7,000 sq. ft. office space set aside for licensing to industries were left vacant as at 30 June 2009. The vacant period of these office space ranged from five to six months.

Audit recommendations

4.45 **Audit has recommended that the HKPC should:**

Note 10: 1 square foot equals 0.09 square metre.

- (a) **closely monitor the utilisation of office space at the HKPC Building; and**
- (b) **take speedy action to ensure that the vacant office space is gainfully used.**

Response from the HKPC

4.46 The HKPC agrees with the audit recommendations. The **ED, HKPC** has said that:

- (a) of the 13,600 sq. ft. vacant space, about 6,900 sq. ft. have already been designated for new laboratory facilities and accommodation for new staff; and
- (b) for the remaining vacant space, its use is limited by the HKPC's own needs and the requirement that any licensed use by outsiders must relate to the HKPC's public mission.

Provision of building management service

4.47 The HKPC Headquarters is located at the HKPC Building. In November 1992, the Council approved the establishment of a subsidiary to provide building management services at the HKPC Building. In November 1994, BMM Limited was incorporated as a subsidiary of the HKPC. Since April 1995, BMM Limited has provided building management services at the HKPC Building. As at 31 March 2009, BMM Limited had 26 staff. The total operating cost was \$6 million in 2008-09.

Audit observations and recommendations

4.48 In November 2006, the Council Chairman commented that the expenditure of BMM Limited was on the high side. **He doubted whether the HKPC was getting value for money in operating a subsidiary to provide building management services to itself.**

4.49 In response to the comments made by the Council Chairman, the HKPC invited three building management companies to submit proposals on the provision of building management services at the HKPC Building. The HKPC received proposals from two of the companies. The HKPC found that:

- (a) the two companies would employ about the same number of staff as BMM Limited in providing building management services at the HKPC Building; and
- (b) the annual operating cost of BMM Limited was \$1.1 million and \$26,000 higher than that of the two companies respectively.

4.50 However, after consulting the Council and Committee Chairmen, the management decided to continue the operation of BMM Limited because:

- (a) discontinuing its operation would give rise to sensitive staff issues; and
- (b) the HKPC would have to make severance payment of about \$3 million to BMM Limited staff.

Up to September 2009, no further review on the feasibility of outsourcing the provision of building management services at the HKPC Building had been carried out.

Audit recommendations

4.51 In view of the potential recurrent cost savings that may be achieved, Audit has *recommended* that the HKPC should:

- (a) periodically benchmark the cost-effectiveness of BMM Limited to other building management services providers in the market and take action to improve the cost-effectiveness of BMM Limited; and
- (b) critically reconsider the feasibility of outsourcing the provision of building management services at the HKPC Building.

Response from the HKPC

4.52 The HKPC agrees with the audit recommendations. The **ED, HKPC** has said that:

- (a) the HKPC will conduct a benchmarking exercise in 2010;
- (b) in 2007, the Council Chairman and Committee Chairmen had fully considered the cost-effectiveness and staff implications in outsourcing the management of the HKPC Building. They came to the view that maintaining the services from BMM Limited was the most viable option; and
- (c) the cost-effectiveness of BMM Limited has been improved. Its operating cost was reduced from \$7.68 million in 2001-02 to \$6.02 million in 2008-09, representing a decrease of 22%.

Cash advances

4.53 According to the Standard Practices, staff may apply for a cash advance for official expenses. All cash advances must be accounted for within 45 days from the date of application. For any cash advance that cannot be cleared within the time limit, special request for extension with justifications should be submitted to Branch Directors or the ED, where appropriate, for approval.

Audit observations and recommendation

4.54 In 2008-09, 293 cash advances amounting to \$2.4 million were approved. In 28 (10%) cases, the requirement of accounting for the approved advance within 45 days was not complied with and no approval for extension was obtained. In 25 (89%) of the 28 cases, the time taken by the staff concerned to account for the advance ranged from 46 days to 153 days. As at 31 March 2009, the remaining 3 (11%) cases were still outstanding.

Audit recommendation

4.55 **Audit has recommended that the HKPC should ensure that the requirements of the Standard Practices (e.g. all cash advances made must be accounted for within 45 days) governing cash advances are properly followed.**

Response from the HKPC

4.56 The HKPC agrees with the audit recommendation.

Accounting of inter-division transactions

4.57 To measure the financial performance of individual divisions, the fees for services (e.g. laboratory services and patent application services) rendered by a division to another for carrying out consultancy and research and development projects are recognised in the HKPC's accounts as income of the service-providing division and expenditure of the service-receiving division. According to generally accepted accounting principles, such inter-division transactions should be eliminated in the preparation of the financial statements of the HKPC. Otherwise, both the income and expenditure would be overstated.

4.58 In 1997-98, the HKPC established the Commercial Research and Development Fund for research and development projects of a smaller scale. Project fundings from the Fund represent internal allocation of funds. According to generally accepted accounting principles, they should not be recognised as the HKPC's income and expenditure.

Audit observations and recommendations

Inter-division transactions not eliminated

4.59 An examination of the HKPC's accounts for 2008-09 revealed that some inter-division transactions had not been eliminated. Audit noted that the failure to carry out inter-division eliminations had resulted in overstatements of both the income and expenditure by \$2.4 million.

Internal fundings recognised as income and expenditure

4.60 The examination of the HKPC's accounts for 2008-09 also revealed that the project fundings from the Commercial Research and Development Fund were accounted for as income and expenditure. As a result, both the HKPC's income and expenditure were overstated in the accounts by \$3.4 million.

Audit recommendations

4.61 **Audit has recommended that the HKPC should:**

- (a) **make necessary adjustments to the accounts to rectify the overstatements of the HKPC's income and expenditure; and**
- (b) **ensure that generally accepted accounting principles are strictly followed in preparing its accounts, in particular:**
 - (i) **inter-division transactions are eliminated; and**
 - (ii) **internal allocation of funds are not accounted for as income and expenditure of the HKPC.**

Response from the HKPC

4.62 The HKPC agrees with the audit recommendations. The **ED, HKPC** has said that:

- (a) the overstatement in the accounts as a result of inter-division transactions amounted only to 1.2% of the total income/expenditure; and
- (b) the HKPC will make the necessary adjustments to its annual accounts starting from 2009-10 and all inter-division transactions will be eliminated therefrom.

PART 5: PERFORMANCE MEASUREMENT AND REPORTING

5.1 This PART examines, and suggests improvement on, performance measurement and reporting of the HKPC to provide better accountability.

Background

5.2 To ensure that results are produced and public money is spent economically, prudently and wisely, performance management system has been widely adopted by the Government and publicly-funded organisations to measure and report performance.

5.3 An effective performance management system involves:

- (a) selecting key aspects of performance to measure;
- (b) developing performance indicators and setting targets;
- (c) collecting performance information;
- (d) measuring and reporting actual performance against targets; and
- (e) striving for future improvements in performance.

5.4 According to the MAA (see para. 1.8), the HKPC should:

- (a) propose, for the approval of the Commissioner for Innovation and Technology, a set of performance indicators for measuring the progress of its activities. Such performance indicators shall fall in the areas including service delivery, operating efficiency, financial results and effectiveness;
- (b) review and amend the performance indicators from time to time;
- (c) report annually its performance to the ITC using the performance indicators approved; and
- (d) provide explanations to the satisfaction of the Commissioner for Innovation and Technology, if the HKPC fails to achieve the agreed performance targets.

Performance indicators used by HKPC and ITC

5.5 In its performance report submitted to the ITC for 2008-09, the HKPC used various performance indicators to report its performance on four areas, namely service delivery, operating efficiency, financial results and effectiveness (see Appendix E).

5.6 In respect of the recurrent subvention provided to the HKPC, the Commissioner for Innovation and Technology has also set out the following performance indicators in her Controlling Officer's Report to report the performance of the HKPC:

- (a) overall income/expenditure ratio;
- (b) income from consultancy/technical assistance;
- (c) income from training courses;
- (d) income from exhibitions/study missions/conferences;
- (e) income from manufacturing support/process control;
- (f) number of people who attended the HKPC training courses;
- (g) number of people who attended the HKPC exhibitions; and
- (h) number of people who participated in the HKPC study missions/conferences.

Audit observations and recommendations

Performance indicators not formally approved

5.7 According to the MAA, performance indicators used by the HKPC to report its performance should be approved by the Commissioner for Innovation and Technology. **However, Audit noted that documentation was not available showing that such approval had been obtained.**

Setting performance targets

5.8 In addition to performance indicators, the MAA also stipulated that the HKPC should set performance targets for performance management and that the targets should be agreed by the Commissioner for Innovation and Technology. **Audit noted that the HKPC had not set such performance targets.** Without performance targets, the ITC might have difficulties in assessing the performance of the HKPC in a fair and objective manner.

Outcome indicators

5.9 Apart from a few indicators, such as customer satisfaction index, percentage of customers reporting satisfaction, number of patents/licences/royalties and number and value of products commercialised, **the performance indicators used by the HKPC and the ITC for reporting the performance of the HKPC are mainly output indicators (see Appendix E and para. 5.6).** Audit considers that, in order to enhance the reporting of the HKPC's effectiveness in the delivery of services, the HKPC and the ITC should establish more outcome indicators (e.g. turnover of new services/products introduced and number of new jobs created by services/products commercialised).

Reporting arrangement

5.10 Currently, the HKPC reports its performance annually only to the ITC. However, the HKPC does not include performance indicators in its annual report or website to report its performance. To enhance transparency and accountability, the HKPC should consider including performance indicators in its annual report and website to inform the stakeholders and the public of its performance.

Audit recommendations

5.11 **Audit has recommended that the HKPC should:**

- (a) **establish a set of performance indicators and targets for the approval of the Commissioner for Innovation and Technology;**
- (b) **establish more outcome indicators to better report the effectiveness of its performance; and**
- (c) **report its performance to stakeholders and the public (e.g. actual performance against performance targets) in its annual report and on its website.**

5.12 **Audit has recommended that the Commissioner for Innovation and Technology should:**

- (a) **ensure that the performance indicators of the HKPC are adequate and effective in reporting its performance and are formally approved in accordance with the MAA; and**
- (b) **urge the HKPC to establish a set of performance targets, and seek explanations from the HKPC if its performance falls short of such targets.**

Response from the HKPC

5.13 The HKPC agrees with the audit recommendations. The **ED, HKPC** has said that:

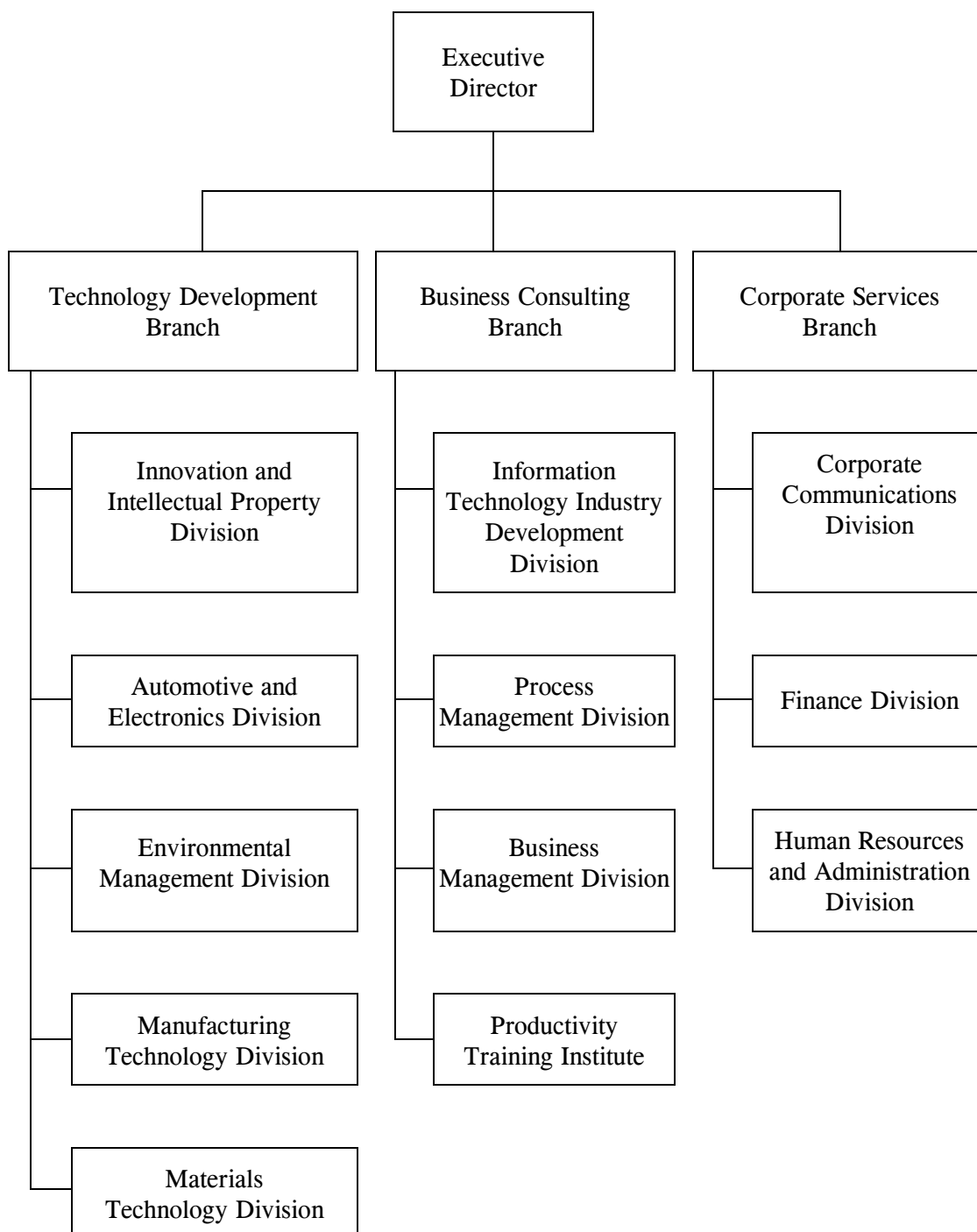
- (a) the HKPC will work closely with the ITC to finalise the 2010-11 performance indicators and targets in accordance with the MAA; and
- (b) a number of performance targets are already embedded in the Annual Programme and Estimates.

Response from the Administration

5.14 The **Commissioner for Innovation and Technology** agrees with the audit recommendations. She has said that:

- (a) the ITC and the HKPC will work on the performance indicators and targets for 2010-11 in accordance with the procedures in the MAA; and
- (b) the Council and the ITC together have been monitoring the performance and operation of the HKPC through the drawing up of a Three-year Forecast and an Annual Programme and Estimates and various performance management systems.

**Hong Kong Productivity Council
Organisation chart
(31 March 2009)**



Source: HKPC records

Terms of reference of the HKPC's Standing Committees

Staffing Committee

- to approve the appointment/promotion of senior staff above D1 level of the HKPC's Pay Scale (with the exception of the appointment of the ED and the Deputy Executive Director, which requires the approval of the Council);
- to monitor the staffing position and staffing structure of the HKPC and to recommend changes to the Council where appropriate;
- to monitor the HKPC's General Terms and Conditions of Service and to ensure that the Terms and Conditions of Service are adequate for recruiting and retaining competent staff;
- to recommend changes in the General Terms and Conditions of Service to the Council for consideration as and when appropriate;
- to provide a channel for consultation and communication between the Council and the staff members of the HKPC if they have grievances on the General Terms and Conditions of Service applied to each grade of staff. This channel of communication should only be used if the said grievances cannot be successfully resolved after consultation with the Staffing Committee and the ED; and
- to advise the Council on the HKPC's human resources development policies.

Business Development Committee

- to receive periodic progress reports and to monitor the performance of subsidiary companies;
- to recommend for approval the appointment of the Chairmen of subsidiary companies;
- to endorse the annual budgets of subsidiary companies and to incorporate these budgets, where there are subvention implications, into the HKPC Programme and Estimates for the Council's consideration;
- to review existing activities and to explore new business opportunities; and

- to advise the Council on the business development of the HKPC having regard to the HKPC's role in the changing industrial environment.

Finance Committee

- to monitor the financial performance of the HKPC and to ensure that the funds made available to the HKPC are properly accounted for;
- to approve the HKPC's Three-year Forecast and to circulate it to the Council for information;
- to recommend an Annual Programme and Estimates to the Council for consideration;
- to advise the Council on the financial framework of the HKPC and on matters relating to the HKPC's financial policies; and
- to advise the Council on the transfer of funds between major Heads of expenditure in accordance with the HKPC Ordinance.

Audit Committee

- to consider the appointment of the HKPC's external auditor for the Council's approval;
- to discuss with the HKPC's external auditor the nature and scope of the audit before the audit commences, if necessary;
- to review the interim and annual financial statements (as audited) to ensure adequate disclosure and compliance with relevant standards and regulations before presentation to the Finance Committee and the Council;
- to discuss problems and reservations arising from the interim and final audits and any matters the HKPC's external auditor may wish to discuss (in the absence of management where necessary);
- to review the management letter from the HKPC's external auditor and management's response;

Appendix B
(Cont'd)
(paras. 2.2
and 2.18 refer)

- to oversee the Internal Audit function in the HKPC through the review and approval of the internal audit programme and to ensure that the internal audit function is adequately resourced and has appropriate standing within the organisation;
- to consider the major findings of internal investigations and management's response; and
- to monitor the implementation and compliance of the HKPC's corporate governance policies and procedures and make recommendations to management for any improvement to such policies and procedures.

Source: HKPC records

Examples of stock items not located in the 2005 stocktake

Item	Type	Date of purchase	Cost (\$)
Networking system of HKPC Building	IT equipment	31.3.1996	1,231,891
Inductively coupled plasma mass spectrometry system	Laboratory equipment	31.3.2000	848,966
Computer server	IT equipment	25.7.1995	775,586
Computer server	IT equipment	3.2.1998	650,515
Data storage system	IT equipment	21.1.2005	429,800
Network/spectrum analyzer	Laboratory equipment	31.3.1994	420,145
Signal generator	Laboratory equipment	28.3.1994	385,217
Turbomolecular Drag Pump	Laboratory equipment	26.9.2002	165,945
Network security system	IT equipment	31.3.2004	147,038
Protocol analyzer	Laboratory equipment	31.3.2002	141,058
Laser printer	IT equipment	31.3.2005	82,800
Colour laser printer	IT equipment	31.3.2005	73,500
50" Plasma display	Audio-visual equipment	31.3.2005	41,910
Video conferencing system	Audio-visual equipment	31.3.2005	41,910
Projector	Audio-visual equipment	31.3.2005	19,090
Notebook computer	IT equipment	15.6.2005	11,100
19" LCD monitor	IT equipment	31.3.2005	6,180
Desktop computer	IT equipment	5.8.2005	5,900
17" LCD monitor	IT equipment	31.3.2005	4,800
Scanner	IT equipment	20.4.2005	3,611

Source: HKPC records

Price differences of 17 phones sold to staff

Phone	Price on the Internet	Price paid by HKPC staff	Difference
	(a)	(b)	(c) = (a) - (b)
	(\$)	(\$)	(\$)
1	400	25	375
2	300	0.1	299.9
3	250	11	239
4	220	100	120
5	190	100	90
6	190	100	90
7	190	8	182
8	180	100	80
9	180	100	80
10	120	100	20
11	120	100	20
12	120	30	90
13	99	100	(1)
14	180	1	179
15	400	1	399
16	210	1	209
17	254	1	253
Total	3,603	878.1	2,724.9

Source: Audit analysis of HKPC records and Internet auction sites

**Performance indicators used by the HKPC
(2008-09)**

Area	Indicator
Service delivery	<ul style="list-style-type: none"> • number of customers served • number of customer projects completed • percentage of customers reporting satisfaction
Operating efficiency	<ul style="list-style-type: none"> • total expenses per customer served • percentage of employee hours charged to customer projects • number of customer projects completed per employee
Financial results	<ul style="list-style-type: none"> • revenue from fee-for-service • sales revenue per employee • sales revenue per customer served • sales revenue as a percentage of total expenses
Effectiveness	<ul style="list-style-type: none"> • industry sectors served • number of events organised and association relationship/networking • number of positive/neutral and negative media coverage • number of new services/products introduced • number of and funding approved for commercial research and development projects • number of patents/licences/royalties • number of new government funded projects approved • number and value of products commercialised • number and value of training and consultancy projects • number of conferences, exhibitions, seminars organised • number of participants • customer satisfaction index • number of repeated projects

Source: HKPC records

Acronyms and abbreviations

Audit	Audit Commission
CE	Chief Executive
DG-WFOE	Productivity (Dongguan) Consulting Company Limited
ED	Executive Director
GZ-WFOE	Productivity (Guangzhou) Consulting Company Limited
HKICPA	Hong Kong Institute of Certified Public Accountants
HKPC	Hong Kong Productivity Council
ITC	Innovation and Technology Commission
ITF	Innovation and Technology Fund
MAA	Memorandum of Administrative Arrangements
NCA	Non-accountable Cash Allowance
PPS	Performance Pay Scheme
PRD	Pearl River Delta
sq. ft.	square feet
SZ-JV	Shenzhen SZ-HK Productivity Foundation Company Limited
SZ-WFOE	Productivity (Shenzhen) Consulting Company Limited
VPC	Variable Pay Committee
WFOEs	Wholly Foreign Owned Enterprises