

# **Report No. 53 of the Director of Audit — Chapter 7**

## **HONG KONG PRODUCTIVITY COUNCIL: CORPORATE GOVERNANCE AND ADMINISTRATIVE ISSUES**

### **Summary**

1. The Hong Kong Productivity Council (HKPC) was established under the HKPC Ordinance (Cap. 1116) in 1967. In 2008-09, the total income of the HKPC was \$478 million, which included government subvention of \$170 million and project funding of \$37 million from the Innovation and Technology Fund (ITF). In the same year, the HKPC's total expenditure was \$468 million. The Commissioner for Innovation and Technology is the Controlling Officer of the subvention granted to the HKPC.

2. **Audit review.** 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, namely: (a) HKPC: Corporate governance and administrative issues (the subject matter of this summary); and (b) HKPC: Management of projects and services (Chapter 8 of the Director of Audit's Report No. 53).

#### **Corporate governance**

3. **Council and Committee meetings.** Audit noted that: (a) the attendance rates of six Council members at Council/Committee meetings held from 2005 to 2008 were low, but two of them were reappointed in January 2009; (b) despite the Government Economist's low attendance at Council/Committee meetings, no arrangement was made for appointing an alternate member until April 2009; (c) no target was set to ensure that draft minutes of meetings would be issued in a timely manner; and (d) the Finance Committee meetings were held jointly with the Council meetings, but there was no documentation showing that such arrangement was formally discussed and approved by the Council and the Committee. Audit also noted that there were delays in the submission of declarations of interests by Council members. According to good corporate governance practices, audit committee should be independent of the organisation's executive management. However, according to the HKPC Ordinance, the Executive Director (ED) has been a member of the Audit Committee since its establishment in October 2005. *Audit has recommended that the HKPC should:* (a) consider taking action to improve the attendance of members at Council/Committee meetings; (b) consider setting an early target time for the issuance of draft minutes after the Council/Committee meetings; (c) review the appropriateness of the current arrangement of holding joint meetings of the Council and the Finance Committee; and (d) take action to ensure that declarations of interests by members are made in a timely manner. *Audit has also 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; (b) ensure that the arrangement for appointing alternate member is made to ensure attendance of public officers at Council/Committee meetings; and (c) consider amending the HKPC Ordinance to follow good corporate governance practices that the ED should not be a member of the Audit Committee.*

4. **Strategic planning.** In March 2004, the Council approved a five-year strategic plan for 2004-05 to 2008-09. However, the management had not regularly updated the plan. 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. *Audit has recommended that the HKPC should 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.*

5. **Monitoring of the operation of subsidiaries in the Mainland.** The HKPC incorporated three Wholly Foreign Owned Enterprises (WFOEs) and a joint-venture company in the Pearl River Delta. Audit noted that: (a) about 51% and 22% of the capital of two WFOEs had depleted because of accumulated losses; and (b) the WFOEs' operating results were not regularly reported to the Council. 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. However, the HKPC only recovered 58% of the project staff cost and overheads for projects undertaken for the subsidiaries. *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 Mainland, in particular, the WFOEs which have accumulated operating losses; (b) report the operating results of its subsidiaries to the Council regularly; and (c) ensure that projects undertaken for the subsidiaries outside Hong Kong are carried out on a full-cost recovery basis.*

## **Human resource management**

6. **Performance Pay Scheme.** Under the Performance Pay Scheme (PPS), a "one-off" discretionary variable pay would be paid at the end of each financial year to reward staff who had made the greatest contributions. Audit found that: (a) the budgets for 2007-08 and 2008-09 submitted by the HKPC to the Innovation and Technology Commission (ITC) did not include the variable pay; (b) the decisions on variable pay for 2007-08 and 2008-09 were made before the actual operating results were available; (c) for 2007-08, there were inconsistencies between the performance results of individual staff and the variable pay awarded to them; (d) the HKPC had not sought prior approval from the Commissioner for Innovation and Technology for making variable pay for 2007-08; and (e) the variable pay was increased from \$0.4 million in 2007-08 by over 10 times to \$4.9 million in 2008-09. In this connection, the estimated operating losses for 2009-10 to 2011-12 would amount to \$17 million, \$21 million and \$26 million respectively. *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 variable pay after the annual financial results are available; (c) ensure that the variable pay awarded to individual staff is consistent with their performance; (d) ensure that all changes to the staff salary scales (including scale of allowances) are properly approved; and (e) ensure that the amount of variable pay is reasonable and moderate.*

7. ***Recruitment of staff.*** In a recruitment exercise conducted for filling a newly created senior post, the HKPC obtained the approval of the Staffing Committee to change the appointment terms of the post from contract terms to permanent terms after selecting a serving permanent staff to fill it. In another recruitment exercise conducted for filling another post, only one of the eleven candidates who met all the qualification requirements was invited to attend the selection interview, together with four other candidates who did not meet all the requirements. Contrary to the requirements of the HKPC's Standard Practices, there was no documentation of the justifications for not inviting the other ten qualified candidates and for inviting the four unqualified candidates. *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; and (b) the requirements on short-listing of candidates for job interview are complied with.*

8. ***Non-accountable Cash Allowance.*** The Standard Practices stipulate that if a staff or his/her spouse has received housing benefits from the Government or other publicly-funded organisations, his/her entitlements to the Non-accountable Cash Allowance (NCA) may be reduced or limited. 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. Moreover, detailed and complete information was not provided to the Staffing Committee when seeking its approval to offer the staff concerned full entitlement of the NCA. *Audit has recommended that the HKPC should: (a) ensure that the requirements of the Standard Practices on NCA are strictly complied with unless there is a very exceptional need; and (b) provide detailed and complete information to the Staffing Committee, in seeking its exceptional approval for offering full entitlement of the NCA to the candidate whose entitlement should have been reduced or limited.*

9. ***Remuneration package of the Executive Director.*** Audit noted that in seeking the Council's approval of the remuneration package to be offered to the ED, the ITC had not provided full information to the Council. In August 2008, an addendum to the ED's employment contract was signed stipulating that the salary of the ED would be adjusted in accordance with the PPS. However, the Council had not discussed or approved the revision of the contract term regarding the ED's salary adjustment mechanism. In June 2009, the ITC sought the Council's approval for the renewal of the ED's contract with an increased rate for contract gratuity, but had not given all the relevant information to the Council. *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 and financial implications of the remuneration package; (b) prior approval from the Council is obtained for any changes in the terms of appointment 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 proposed changes.*

## **Administrative issues**

10. ***Fixed asset management.*** In a full-scale stocktake conducted in 2005, 8,726 (34%) of the 26,045 items recorded in the Fixed Asset Register could not be located. In a partial stocktake conducted in April 2009, 250 (13%) of the 1,955 items selected for

checking could not be located. In a stocktake of desktop and notebook computers conducted in June 2009, 109 (7%) of the 1,572 computers could not be located. There was no record showing that the HKPC had investigated each case of loss and ascertained the causes for the loss, and whether any criminal act and negligence was involved. *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; and (b) find out the causes for each case of loss and investigate whether any criminal act and negligence is involved.*

11. ***Inventory control of laboratory equipment.*** A system to control the utilisation and disposal of the laboratory equipment was specified in the Standard Practices. However, the system did not cover 2,560 (98%) pieces of laboratory equipment at a total purchase cost of \$50.7 million (54%), and the requirements of the system were not fully complied with. *Audit has recommended that the HKPC should: (a) revise the Standard Practices so that more laboratory equipment will be covered by the inventory control system; and (b) ensure that the requirements of the system are strictly complied with.*

12. ***Procurement matters.*** 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. 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. *Audit has recommended that the HKPC should consider arranging direct subscription to newspapers and magazines from the publishers.*

13. ***Entertainment expenses.*** 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 reimbursements, 4 were made to staff without obtaining special approval from the ED. In August 2008, the spending limits were increased substantially, ranging from 14% to 108%. However, the justifications for the increases were not documented. In March 1991, the HKPC entered into an agreement with a private club to facilitate the entertainment of the HKPC's guests. The annual fee for 2008-09 was \$15,000. However, of all the entertainment claims made in 2008-09, only 29 (7%) official entertainments totalling \$16,000 (6%) were held at the private club. *Audit has recommended that the HKPC should: (a) ensure that all entertainment expenses exceeding the spending limits are properly justified and approved; (b) ensure that the justifications for raising the entertainment limits are properly documented; and (c) review the need to continue the agreement with the private club when it is due for renewal.*

14. ***Vacant office space at the HKPC Building.*** As at 30 June 2009, 13,600 square feet (sq. ft.) (15%) of the 91,000 sq. ft. office space used as the HKPC's office were left vacant, of which 5,200 sq. ft. (38%) had been vacant for 12 months or more. About 400 sq. ft. (6%) of the 7,000 sq. ft. office space set aside for licensing to industries were also left vacant. The vacant period of these office space ranged from five to six months. *Audit has recommended that the HKPC should: (a) closely monitor the utilisation of office space; and (b) take speedy action to ensure that the vacant office space is gainfully used.*

15. ***Provision of building management service.*** A subsidiary of the HKPC, BMM Limited, provides building management services at the HKPC Building. The total operating cost was \$6 million in 2008-09. In 2006, the HKPC invited building management companies to submit proposals on the provision of building management services at the HKPC Building, and found that the annual operating cost of BMM Limited was higher than the companies. However, the management decided to continue the operation of BMM Limited to avoid sensitive staff issues and severance payment. *Audit has recommended that the HKPC should: (a) periodically benchmark the cost-effectiveness of BMM Limited to other building management services providers and take action to improve its cost-effectiveness; and (b) critically reconsider the feasibility of outsourcing the provision of building management services at the HKPC Building.*

16. ***Accounting of inter-division transactions.*** An examination of the HKPC's accounts for 2008-09 revealed that: (a) some inter-division transactions had not been eliminated, resulting in overstatements of both the income and expenditure by \$2.4 million; and (b) the internal project fundings from the Commercial Research and Development Fund were accounted for as income and expenditure, causing overstatements of both the income and expenditure by \$3.4 million. *Audit has recommended that the HKPC should: (a) make necessary adjustments to the accounts; and (b) ensure that generally accepted accounting principles are strictly followed in preparing its accounts.*

### **Performance measurement and reporting**

17. ***Performance indicators used by the HKPC and ITC.*** Audit noted that: (a) according to the Memorandum of Administrative Arrangement (MAA), performance indicators used by the HKPC should be approved by the Commissioner for Innovation and Technology. However, documentation was not available showing that such approval had been obtained; (b) the MAA also stipulated that the HKPC should set performance targets. However, the HKPC had not set such targets; and (c) the performance indicators used by the HKPC and the ITC for reporting the performance of the HKPC were mainly output indicators. *Audit has recommended that the HKPC should: (a) establish a set of performance indicators and targets for the approval of the Commissioner; and (b) establish more outcome indicators to better report the effectiveness of its performance. Audit has also 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; and (b) urge the HKPC to establish a set of performance targets.*

### **Response from the Administration and the HKPC**

18. The Secretary for Commerce and Economic Development, the Commissioner for Innovation and Technology, and the HKPC agree with the audit recommendations.