

CHAPTER 7

**Commerce and Economic Development Bureau
Trade and Industry Department
Hong Kong Productivity Council**

**Dedicated Fund on Branding,
Upgrading and Domestic Sales**

**Audit Commission
Hong Kong
5 April 2016**

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. 66 of the Director of Audit contains 8 Chapters which are available on our website at <http://www.aud.gov.hk>

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DEDICATED FUND ON BRANDING, UPGRADING AND DOMESTIC SALES

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DEDICATED FUND ON BRANDING, UPGRADING AND DOMESTIC SALES

Executive Summary

1. The Dedicated Fund on Branding, Upgrading and Domestic Sales (BUD Fund) was established in June 2012 to assist enterprises in exploring and developing the Mainland market through developing brands, upgrading and restructuring their operations, and promoting domestic sales in the Mainland. It has a non-recurrent commitment of \$1,000 million and is open for applications for five years. The application period may be reviewed and extended, if necessary. The Commerce and Economic Development Bureau (CEDB) and the Trade and Industry Department (TID) are responsible for administering the BUD Fund.

2. The BUD Fund comprises two programmes: (a) the Organisation Support Programme (OSP), which provides funding support to non-profit-distributing organisations (e.g. trade and industrial organisations) to undertake projects in relevant areas which can assist Hong Kong enterprises in general or in specific sectors; and (b) the Enterprise Support Programme (ESP), which provides funding support to individual Hong Kong non-listed enterprises to assist them in undertaking projects. The CEDB has engaged the Hong Kong Productivity Council (HKPC) as a partner to implement the ESP and to act as the ESP Secretariat. The Government would disburse a total of \$60 million over a period of 7.5 years to the HKPC for the implementation of the ESP. The HKPC would contribute \$17 million in terms of professional manpower support and other support services. The Audit Commission (Audit) has recently conducted a review of the BUD Fund.

Overall management

3. *Performance of the BUD Fund.* According to the funding paper submitted to the Finance Committee (FC) of the Legislative Council in May 2012, the Government estimated that about 1,000 enterprises could directly benefit from the ESP and around 90 projects could be undertaken under the OSP by non-profit-distributing organisations. Audit noted that, as at October 2015 (more than three years after the commencement of the BUD Fund), the number of

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approved OSP and ESP projects (45 and 349 respectively), and the amount of approved funding for the OSP and ESP (\$147 million and \$157 million respectively) were lower than estimated. Audit also noted that, during the period June 2012 to June 2015: (a) the number of applications received for both the OSP and ESP showed a downward trend; and (b) the overall success rates of OSP and ESP applications were 38% and 33% respectively. The TID and the HKPC need to encourage more applications and to improve the application success rates (paras. 2.2, 2.3, 2.5, 2.9 and 2.18).

4. ***Engagement of the HKPC as implementation partner and Secretariat of the ESP.*** In response to the Financial Services and the Treasury Bureau's concerns on the selection of the HKPC as the implementation partner, the CEDB explained that it considered the HKPC as a partner in implementing the ESP and the engagement was not a procurement of services. The implementation fee charged by the HKPC was calculated at the HKPC's highest staff cost rates. According to the CEDB, there were discussions and negotiations between the Government and the HKPC on the overall level of charge. However, Audit noted that there was no documentation indicating whether the CEDB had discussed with the HKPC on the feasibility of using lower charging rates and why lower rates were not applicable. Up to October 2015, the cost for administering the ESP had amounted to some \$55.3 million, representing about 35% of the \$157 million approved project funding. According to the FC paper, the total cost of administering the \$500 million of the ESP was estimated to be \$77 million (15%). Furthermore, notwithstanding that the numbers of applications and approved projects were low and were decreasing, the actual number of full-time staff of the ESP Secretariat remained at about 15 to 16 (except for the first year of operation, i.e. 2012-13), which was some 50% more than that estimated in the FC paper (paras. 2.26, 2.28, 2.29, 2.33, 2.35, 2.37, 2.42, 2.43 and 2.45).

Management of Organisation Support Programme projects

5. ***Use of implementation agents.*** It was common for the grantees to engage implementation agents for carrying out OSP projects. Of the 45 approved projects, 30 (67%) had engaged seven implementation agents in total. The total approved consultancy fee paid to these seven implementation agents amounted to \$29.4 million, or 31% of the approved funding of \$96.2 million for these 30 projects. Audit examined 6 completed projects which had engaged implementation agents and noted that: (a) for 3 (50%) projects, the proposed

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consultancy fees were lump sum fees without detailed breakdown; and (b) for 3 (50%) projects, details were not provided regarding what services had been provided by the implementation agents (paras. 3.5 and 3.8).

6. ***In-kind contribution.*** OSP grantees are required to contribute at least 10% of the total project expenditure by themselves or in the form of sponsorship from any third parties other than the Government, which may be in cash or in-kind (in-kind contribution). Of the 45 approved projects, in-kind contribution amounted to \$10.8 million (64% of total contribution from the grantees and third parties). The OSP Secretariat requires the grantee to provide a letter listing out the nature and the amount of in-kind contribution as documentary proof. Apart from this requirement, the grantee does not need to provide other documents to support the valuation of the in-kind contribution. Audit examined six completed projects with in-kind contribution and noted that the OSP Secretariat had not raised queries on the value of in-kind contribution or required the grantees to provide documentary proof of the value (paras. 3.14 to 3.17).

7. ***Monitoring of project progress.*** The OSP Secretariat monitors project progress mainly by reviewing the reports and audited accounts submitted by the grantees, clarifying ambiguities, raising queries and conducting site visits for events held in Hong Kong to observe the conduct of project activities. Audit examined three completed projects and noted that: (a) for two projects, recruitment records could not be obtained by the OSP Secretariat for Audit's examination; and (b) for one project, non-allowable costs amounting to \$160,000 charged to the project were not discovered by the OSP Secretariat until some eight months after the submission of final report and accounts (paras. 3.21 to 3.23, 3.25 and 3.27).

Management of Enterprise Support Programme projects

8. ***Monitoring of project progress.*** To facilitate the monitoring and evaluation of approved ESP projects, grantees are required to submit progress reports, final reports and audited accounts to the ESP Secretariat. Audit examined 20 completed projects (involving 11 progress reports and 20 final reports) and noted that: (a) 9 (82%) of the 11 progress reports and all the 20 final reports required resubmissions; and (b) based on the final submission date, 9 (82%) progress reports and 4 (20%) final reports were submitted more than 3 months late (paras. 4.11 and 4.13).

Executive Summary

9. ***Termination of projects.*** As of October 2015, 45 (13%) of the 349 approved ESP projects were terminated before completion. Audit's analysis of the terminated projects by batch (13 batches in total up to October 2015) indicated that the termination rates (i.e. number of terminated projects ÷ number of approved projects × 100%) were higher in earlier batches (e.g. 26.5% and 30.2% for Batch 1 and Batch 2 respectively). As time progresses, more projects may become unsuccessful, hence the overall termination rate may also increase (paras. 4.23 and 4.24).

Way forward

10. As at February 2016, the BUD Fund has been in operation for over three years. The Fund has provided over \$300 million to support about 400 projects under the OSP and ESP. Some 100 projects have been completed. Audit considers that it is an opportune time for the Government to conduct a comprehensive review of the BUD Fund to assess the performance of the Fund in meeting its objectives, analyse benefits brought by the Fund, identify improvement areas and decide the way forward (paras. 5.2 and 5.3).

Audit recommendations

11. **Audit recommendations are made in the respective sections of this Audit Report. Only the key ones are highlighted in this Executive Summary. Audit has *recommended* that the Secretary for Commerce and Economic Development and the Director-General of Trade and Industry should, in collaboration with the Executive Director, Hong Kong Productivity Council where appropriate:**

Overall management

- (a) **take measures to improve the utilisation of the BUD Fund (para. 2.22(a));**
- (b) **for future engagements of non-government partners to administer projects, ensure that records relating to the compliance with relevant Financial Circulars are properly kept and the pertinent approvals are properly documented (para. 2.39(a));**

Executive Summary

- (c) **closely monitor the manpower deployment of the ESP Secretariat and take effective action to improve the economy in administering the ESP (para. 2.56(a));**

Management of Organisation Support Programme projects

- (d) **step up control over the payment of fees to implementation agents of OSP projects (para. 3.12);**
- (e) **tighten control on in-kind contribution of OSP projects (para. 3.19);**
- (f) **strengthen the monitoring of OSP projects, particularly on the checking of books and records and grantees' compliance with project agreements and guidelines (para. 3.29);**

Management of Enterprise Support Programme projects

- (g) **take measures to facilitate ESP grantees in the submission of reports with a view to improving the monitoring process (para. 4.20(a));**
- (h) **closely monitor the termination rate of ESP projects and consider conducting a review on the terminated projects with a view to identifying ways to minimise the termination rate as far as possible (para. 4.25); and**

Way forward

- (i) **consider conducting a review on the BUD Fund, taking on board the audit findings in this Audit Report (para. 5.6).**

Response from the Government

12. The Secretary for Commerce and Economic Development and the Director-General of Trade and Industry, with the support of the Executive Director, Hong Kong Productivity Council, generally agree with the audit recommendations.

PART 1: INTRODUCTION

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

Background

1.2 The Chief Executive of the Hong Kong Special Administrative Region announced in the 2011-12 Policy Address a proposal to set up a dedicated fund of \$1,000 million to assist enterprises in exploring and developing the Mainland market through developing brands, upgrading and restructuring their operations, and promoting domestic sales in the Mainland.

1.3 In May 2012, the Government sought the approval of the Finance Committee (FC) of the Legislative Council to create a non-recurrent commitment of \$1,000 million to set up the Dedicated Fund on Branding, Upgrading and Domestic Sales (BUD Fund). According to the FC paper, the Fund is open for applications for five years. The application period may be reviewed and extended, if necessary. The BUD Fund was established in June 2012. The Commerce and Economic Development Bureau (CEDB) and the Trade and Industry Department (TID) are responsible for administering the BUD Fund.

BUD Fund

1.4 The BUD Fund comprises two programmes, namely the Organisation Support Programme (OSP) and the Enterprise Support Programme (ESP).

Organisation Support Programme

1.5 The BUD Fund provides funding support under the OSP to non-profit-distributing organisations (e.g. trade and industrial organisations,

Introduction

professional bodies or research institutes — Note 1) to undertake projects which can assist Hong Kong enterprises in general or in specific sectors in developing their brands, upgrading and restructuring their business operations, and promoting domestic sales in the Mainland so as to enhance their overall competitiveness in the Mainland market. Activities undertaken by the projects may include seminars, workshops, conferences, exhibitions and research studies, for example:

Branding

- (a) setting up a Hong Kong pavilion in exhibitions held in the Mainland and organising roadshows in the Mainland to build up quality brand image of Hong Kong products and services;

Upgrading and restructuring

- (b) organising training workshops to enhance the competitiveness of the industries; and

Domestic sales

- (c) organising business matching sessions targeted at the Mainland market and setting up interactive websites to promote Hong Kong products and services.

1.6 The maximum duration of an OSP project is three years. The maximum amount of grant for each approved OSP project is \$5 million, or 90% of the total project expenditure, whichever is less. The successful applicant has to contribute the remaining balance of the total project expenditure, which may be in cash, in-kind or in the form of sponsorship from third parties.

Note 1: *Eligible non-profit-distributing organisations shall either be statutory organisations or organisations registered under the laws of the Hong Kong Special Administrative Region which do not distribute profits to their directors, members, employees or any other persons.*

1.7 A Vetting Committee, chaired by the Director-General of Trade and Industry and comprising non-official members from various sectors, assesses applications (Note 2), formulates funding decisions and monitors project progress. Successful applicants are required to sign a project agreement with the Government and comply with the terms and conditions laid down in the agreement. They are also required to submit progress reports, final reports, audited accounts and post-project evaluation reports to the Vetting Committee for consideration, and share the results and deliverables of the projects widely with the industry.

1.8 The Industries Support Division of the TID is responsible for the implementation of the OSP. There are 17 staff involved in the OSP, of whom two work full-time. Total manpower working on the OSP is equivalent to 7.37 full-time staff. These include Administrative Officer grade staff, Treasury Accountant grade staff, Trade Officer grade staff, clerical grade staff and non-civil service contract staff. An extract of the organisation chart of the Industries Support Division is at Appendix A.

Enterprise Support Programme

1.9 The ESP provides funding support to individual Hong Kong enterprises (Note 3) to assist them in undertaking projects to develop brands, upgrade and restructure their business operations, and promote sales in the Mainland. Examples that fall within the scope of these areas are:

Note 2: *Criteria used by the Vetting Committee in assessing applications include: (a) usefulness of project (e.g. the result of the project shall be of practical use to Hong Kong enterprises); (b) cost-effectiveness (e.g. the number of enterprises which may benefit from the project); and (c) project implementation (e.g. the applicant and the project team shall have good technical and management capability).*

Note 3: *All non-listed enterprises registered in Hong Kong under the Business Registration Ordinance (Cap. 310) with substantive business operations in Hong Kong are eligible to apply, irrespective of whether they belong to the manufacturing or service sector and whether they already have any business operations in the Mainland.*

Introduction

Branding

- (a) *Brand strategy and positioning* — corporate brand visioning, product and service planning;
- (b) *Brand building, design and communication* — brand identity and development, and rebranding;
- (c) *Brand management* — brand assessment and brand protection;

Upgrading and restructuring

- (d) *Product innovation and repositioning* — product strategy and new product development;
- (e) *Material management* — supply chain planning and execution;
- (f) *Technology upgrading* — manufacturing technology upgrading, and process and business automation;

Domestic sales

- (g) *Domestic sales strategic planning* — visioning process and strategy formulation;
- (h) *Domestic sales business operation management* — operation transformation; and
- (i) *Domestic sales channel management* — marketing strategy and research, and sales and distribution development.

1.10 Funding would be provided on a matching basis, i.e. the Government will cover a maximum of 50% of the total approved project cost and the enterprise has to contribute not less than 50% of the total approved project cost in cash. Each enterprise may obtain funding for a maximum of three approved projects, subject to a cumulative funding ceiling of \$500,000 per enterprise. Each project should be completed within two years.

1.11 Since June 2012, the CEDB has engaged the Hong Kong Productivity Council (HKPC) to act as the Secretariat of the ESP for assisting the Government to implement the ESP. According to the FC paper of May 2012 (see para. 1.3):

- (a) the Government would disburse a total of \$60 million over a period of 7.5 years to the HKPC to cover the majority of the expenses incurred for implementing the ESP. The amount included a total of \$56 million for staff and other operating costs of a dedicated team to be set up for programme management, administrative support and project monitoring, and a total of \$4 million for various publicity and promotional activities and other expenses. An amount, based on an annual budget, would be paid annually out of the total committed funding of \$60 million as an implementation fee out of the BUD Fund; and
- (b) the HKPC would be responsible for the rest of the relevant expenditure, which amounted to about \$17 million for professional manpower support to supervise, monitor and review the work of the secretariat, venue rentals and other ancillary technical and support services.

1.12 The work of the ESP Secretariat includes planning and organising publicity and promotional activities, receiving and undertaking initial vetting of applications, coordinating the further vetting of project applications by an Inter-departmental Committee (IDC) and a Programme Management Committee (PMC) (see para. 1.13), monitoring the progress of approved projects, disbursing funds for approved projects, and providing general advice on the application procedures to enterprises. As at 31 October 2015, the ESP Secretariat had 15 dedicated full-time staff and two part-time staff from the HKPC (see para. 1.11). An organisation chart of the ESP Secretariat is at Appendix B.

Introduction

1.13 The ESP Secretariat conducts initial assessments on all applications. The IDC, which comprises members from relevant government bureaux/departments (Note 4), assesses all applications having regard to the initial assessment and makes recommendations to the PMC. The PMC is chaired by the Permanent Secretary for Commerce and Economic Development (Commerce, Industry and Tourism) and comprises ex-officio members and non-official members from the trade. It further assesses all applications having regard to the recommendations of the IDC and advises the Government on the approval or otherwise of the applications (Note 5). The PMC also oversees the implementation of the ESP, including:

- (a) considering the progress reports and final reports of approved projects;
- (b) evaluating the outcome of approved projects and the effectiveness of the programme; and
- (c) overseeing the work of the ESP Secretariat.

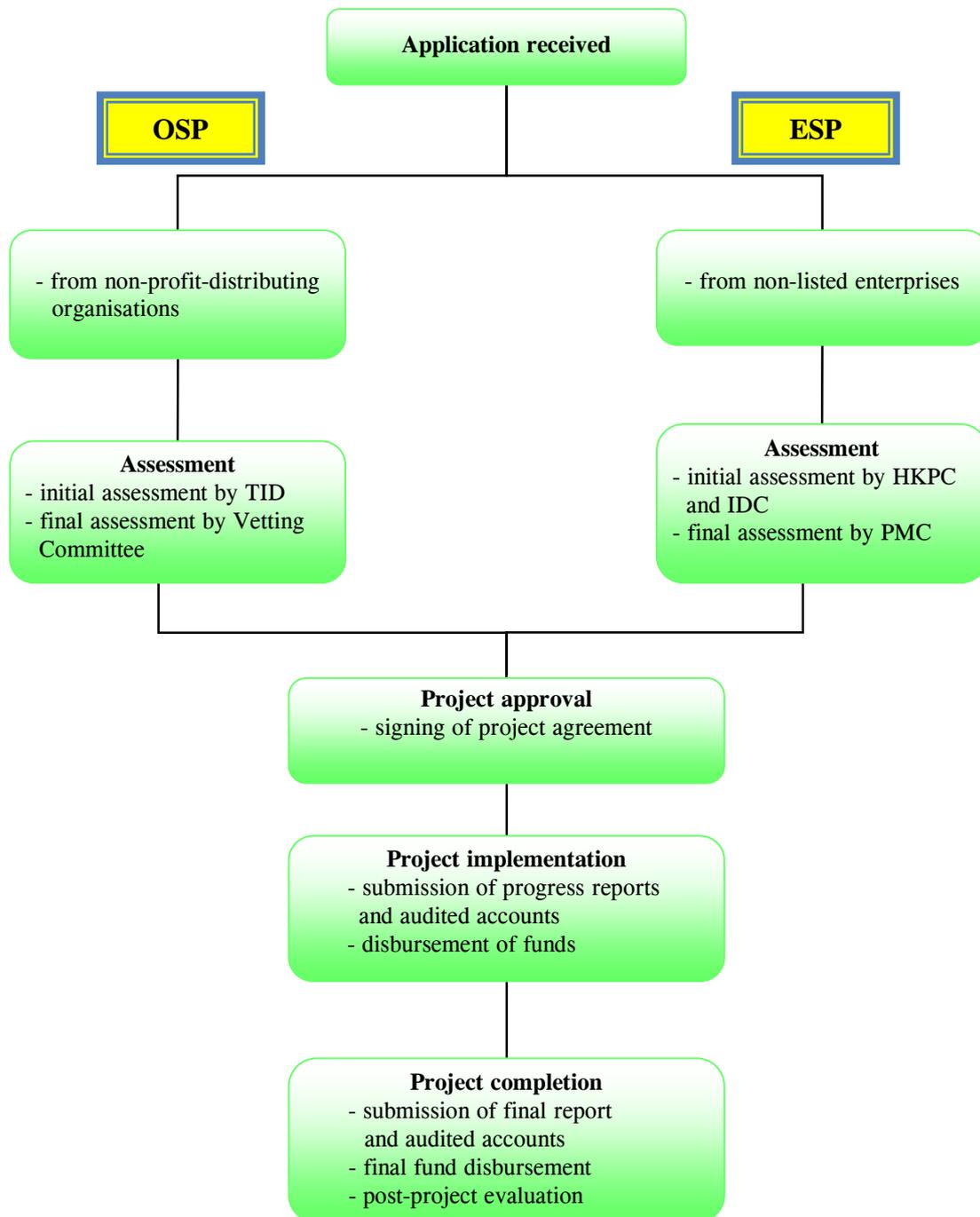
1.14 Figure 1 shows a general overview of the processing of BUD Fund applications and the monitoring of BUD Fund projects.

Note 4: *These bureaux/departments include the CEDB, Create Hong Kong, Environmental Protection Department, Information Services Department, Innovation and Technology Commission, and TID.*

Note 5: *A set of guiding principles was used for assessing project applications. For instance, the project should lead to immediate or long-term business development of the applicant in the Mainland in specific areas of branding, upgrading and restructuring and/or domestic sales, and the project should have good prospects of improving the competitive advantage of the applicant or its product/service in the Mainland.*

Figure 1

Processing of BUD Fund applications and monitoring of BUD Fund projects



Source: Audit analysis of TID and HKPC records

Introduction

Audit review

1.15 In October 2015, the Audit Commission (Audit) commenced a review of the BUD Fund. The review has focused on the following areas:

- (a) overall management (PART 2);
- (b) management of OSP projects (PART 3);
- (c) management of ESP projects (PART 4); and
- (d) way forward (PART 5).

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

Acknowledgement

1.16 Audit would like to acknowledge with gratitude the assistance and full cooperation of the staff of the CEDB, TID and HKPC during the course of the audit review.

PART 2: OVERALL MANAGEMENT

2.1 This PART examines the overall management of the BUD Fund, focusing on the following issues:

- (a) performance of the BUD Fund (paras. 2.2 to 2.23);
- (b) engagement of the HKPC as implementation partner and Secretariat of the ESP (paras. 2.24 to 2.40); and
- (c) financial management of the ESP (paras. 2.41 to 2.57).

Performance of the BUD Fund

2.2 According to the FC paper of May 2012 (see para. 1.3), to maximise the flexibility of the use of the BUD Fund, the Government proposed not to set separate funding ceilings for the OSP and ESP. For budgetary planning purpose, of the \$1,000 million total provision, after taking into account the \$60 million that would be disbursed to the HKPC for the implementation of the ESP, about \$500 million would be provided for the ESP and the remaining \$440 million would be provided for the OSP.

2.3 Regarding the number of projects to be funded, the Government did not set targets on the number of beneficiaries but estimated in the FC paper that, with the \$1,000 million provision, about 1,000 enterprises could directly benefit from the ESP and around 90 projects could be undertaken under the OSP by non-profit-distributing organisations (Note 6). Furthermore, for the ESP, according to the first annual implementation plan (AIP) (see Note 9 to para. 2.24) for 2012-13 submitted by the HKPC to the PMC in June 2012, for budgetary planning purpose,

Note 6: *According to the FC paper, the number of enterprises to be benefitted and projects approved would depend on various factors including the number of applications approved, and the nature, scale and amount of funding of approved projects. Nevertheless, the Government estimated that, when assuming the maximum amount of funding support of \$500,000 per enterprise under the ESP, and \$5 million per project under the OSP, the ESP could benefit about 1,000 enterprises and the OSP could fund about 90 projects.*

Overall management

it was assumed that over the five-year period from 2012-13 to 2016-17, 1,500 applications would be approved. The 1,500 applications were derived by assuming that 500 enterprises would submit two projects and 500 enterprises would submit one project over the five-year application period.

Number of approved projects and amount of funds used were lower than estimated

2.4 As at 31 October 2015, the number of approved projects under the OSP and ESP were 45 and 349 respectively. Table 1 shows the nature of these projects (see paras. 1.5 and 1.9).

Table 1
Nature of approved OSP and ESP projects
(31 October 2015)

Project nature	No. of OSP projects	No. of ESP projects
Branding	4 (9%)	16 (5%)
Upgrading and restructuring	— —	23 (7%)
Domestic sales	8 (18%)	48 (14%)
Branding + Upgrading and restructuring	3 (7%)	4 (1%)
Branding + Domestic sales	25 (55%)	99 (28%)
Upgrading and restructuring + Domestic sales	3 (7%)	60 (17%)
Branding + Upgrading and restructuring + Domestic sales	2 (4%)	99 (28%)
Total	45 (100%)	349 (100%)

Source: Audit analysis of TID and HKPC records

2.5 Audit noted that as at 31 October 2015, more than three years after the commencement of the BUD Fund in June 2012, the number of approved projects and the amount of approved funding for both the OSP and ESP were lower than estimated (see para. 2.3 and Tables 2 and 3).

Table 2

**Approved funding for OSP and ESP projects
(31 October 2015)**

Programme	Approved projects	Approved funding	Funding provision approved by the FC	Usage
	(number)	(a)	(b)	(c) = (a) ÷ (b) × 100%
		(\$ million)	(\$ million)	(percentage)
OSP	45	147	440	33 %
ESP	349	157	500	31 %
Overall	394	304	940	32 %

Source: Audit analysis of TID and HKPC records

Overall management

Table 3

**Actual and estimated number of approved projects
(31 October 2015)**

Application period	Actual no. of projects (Note 1) (a)	Estimated no. of projects (Note 2) (b)	Difference	
			(c) = (a) – (b) (number)	(d) = (c) ÷ (b) × 100% (percentage)
OSP				
6/2012 to 6/2015 (Note 3)	45	—	—	—
ESP				
6/2012 to 3/2013	144	225	(81)	(36%)
4/2013 to 3/2014	97	375	(278)	(74%)
4/2014 to 3/2015	78	375	(297)	(79%)
4/2015 to 6/2015 (Note 3)	30	75	(45)	(60%)
Total	349	1,050	(701)	(67%)

Source: Audit analysis of TID and HKPC records

Note 1: The figures referred to the numbers of approved projects with applications received during the relevant periods irrespective of the approval date.

Note 2: For OSP, the TID did not estimate the number of projects for individual years. For ESP, the stated numbers of projects were based on the numbers stated in the AIP 2012-13. For the three-month period from April to June 2015, the number of projects is derived on a pro rata basis (1/4 of the 300 projects for 2015-16).

Note 3: As at 31 October 2015, seven applications for OSP and 90 applications for ESP received during the period from July to September 2015 were under processing and were not included in the analysis.

- 2.6 Audit's analysis indicated that for both the OSP and ESP:
- (a) the numbers of applications received were decreasing (paras. 2.7 to 2.16); and
 - (b) there is a need to take measures to help organisations/enterprises to improve the success rates of their applications (paras. 2.17 and 2.18).

Decreasing numbers of applications received

2.7 Application for support under the BUD Fund is open all year round. Applications received for the OSP and ESP will be batched on a quarterly basis for consideration by the Vetting Committee and the PMC respectively. The committees usually hold a meeting two to three months after the closing date of a batch (e.g. 31 March) to consider the applications. From the commencement of the BUD Fund in June 2012 to June 2015, 13 batches of applications have been considered by the Vetting Committee of the OSP and the PMC of the ESP (Note 7).

2.8 To enhance the awareness and recognition of the BUD Fund in the business community and encourage eligible organisations and enterprises to apply, the TID and the HKPC had undertaken promotion and publicity activities, including:

- (a) ***promotion events.*** From June 2012 to September 2015, the TID organised nine seminars and issued invitation letters to promote the BUD Fund. The BUD Fund is also promoted through seminars and events organised by other bureaux/departments and the HKPC held in Hong Kong and the Mainland. The HKPC organised many free promotion seminars and symposia in Hong Kong and the Pearl River Delta region and produced booklets to introduce success cases. From June 2012 to June 2015, there were 109 promotion events attended by 7,375 participants. The HKPC also introduced the ESP to various trade associations and quasi-government organisations;

Note 7: *Batch 1 covered the period from 25 June to 31 July 2012. Batch 2 covered the period from 1 August to 30 September 2012. Thereafter each batch covers a three-month period ending in March, June, September and December each year. Batch 13 covered the period from April to June 2015.*

Overall management

- (b) *other media channels.* The HKPC employed various media channels to promote the ESP (such as newspapers and radio broadcasting), social media networks and the HKPC e-newsletter, as well as a bulletin for the small and medium enterprises (SMEs) published by the TID. Videos for disseminating the success stories of the approved projects were also uploaded onto the ESP website;
- (c) *collaboration with non-governmental organisations.* The HKPC enlisted the support of non-governmental organisations to provide concessions (e.g. fee discount and free buyer credit checks) to enterprises which had obtained funding support from the BUD Fund; and
- (d) *other support measures.* The HKPC held one-to-one consultation sessions for interested enterprises to provide detailed advice to enterprises on making applications under the ESP. A mock application form is also available on the ESP website to facilitate enterprises to make applications. The OSP Secretariat also held one-to-one consultation meetings with trade and industrial organisations, professional bodies or research institutes who are interested in submitting applications.

2.9 Notwithstanding these promotion efforts, the numbers of OSP and ESP applications received showed a downward trend (see Table 4).

Table 4

**Numbers of OSP and ESP applications received
(June 2012 to June 2015)**

Batch number	No. of applications received					
	OSP			ESP		
	Received (a)	Withdrawn before assessment (Note) (b)	Submitted for assessment (c) = (a) – (b)	Received (d)	Withdrawn before assessment (Note) (e)	Submitted for assessment (f) = (d) – (e)
1	19	1	18	118	14	104
2	18	2	16	179	49	130
3	17	4	13	222	47	175
4	18	3	15	147	44	103
5	15	4	11	121	24	97
6	15	2	13	84	11	73
7	2	0	2	78	8	70
8	4	0	4	78	11	67
9	8	2	6	74	13	61
10	7	0	7	57	13	44
11	9	3	6	45	11	34
12	7	2	5	53	11	42
13	2	0	2	77	25	52
Total	141	23	118	1,333	281	1,052

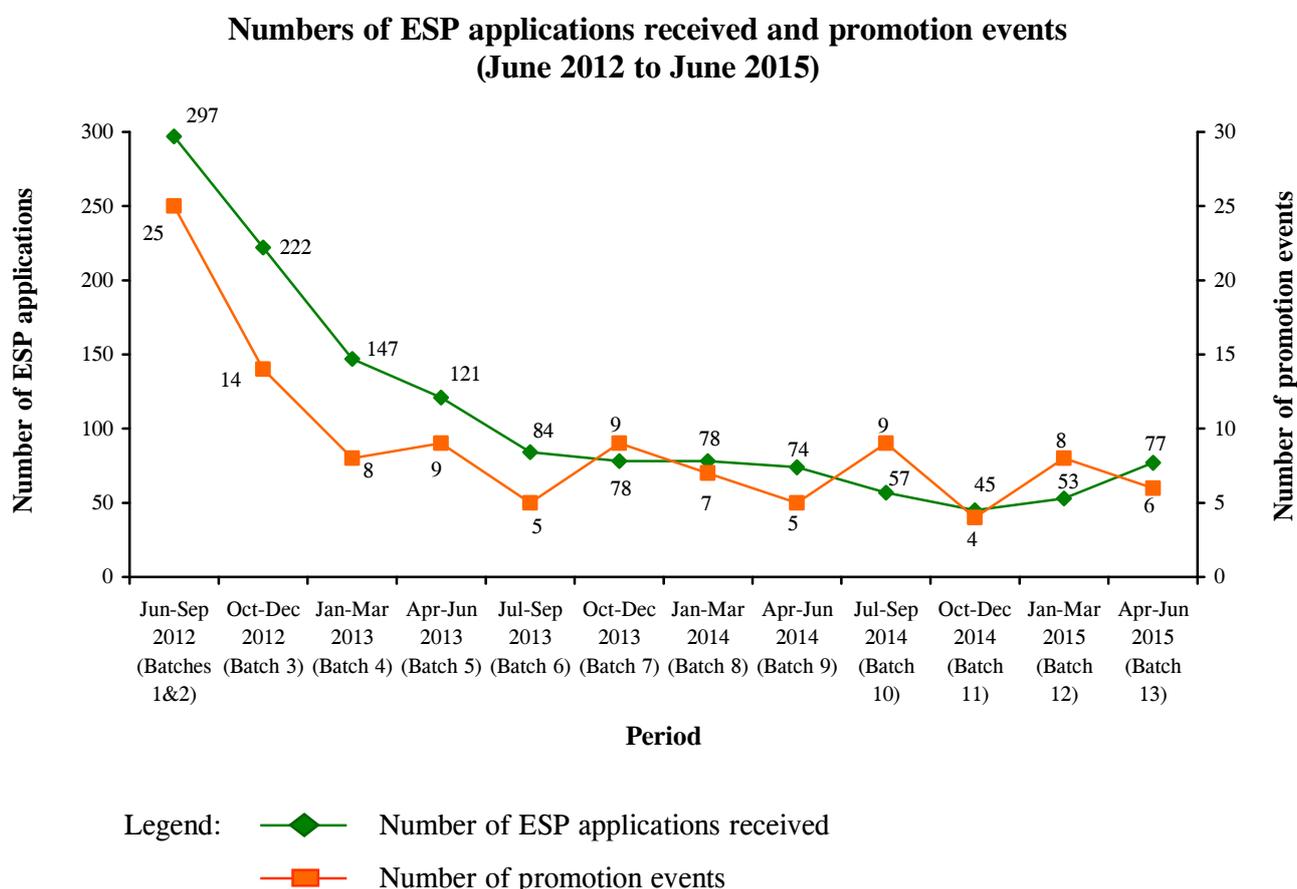
Source: Audit analysis of TID and HKPC records

Note: The figures are the numbers of applications withdrawn before assessment by the Vetting Committee (for OSP) and PMC (for ESP). According to the HKPC, there were various reasons for the withdrawals, such as enterprises not fully meeting the objectives and requirements of the ESP, or not able to provide the required supplementary information. The HKPC had implemented various initiatives to assist enterprises, in particular SMEs, in applying for the ESP (see para. 2.17).

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2.10 Audit compared the number of ESP applications received with the number of promotion events organised by the HKPC (see Figure 2) and noted that both showed a decreasing trend.

Figure 2



Source: Audit analysis of HKPC records

2.11 To address the decline in applications received and feedback from the trade on the tedious application procedures of the ESP, the ESP Secretariat obtained the PMC's approval in early August 2015 to introduce a "ESP Easy — Simplified Application Track" (ESP Easy), which was launched in late August 2015. Enterprises can make use of the ESP Easy to apply for funding to implement specified projects (Note 8) which can enhance their competitiveness in the

Note 8: *These projects include participation in Mainland exhibitions, establishment or enhancement of online shops or websites, undertaking testing and certification for products for domestic sales, design and production of publicity materials for distribution in the Mainland, and application for registration of patent, trademark, design and utility model in the Mainland.*

Mainland. Applicants need to fill in a simplified application form to apply for ESP Easy. Funding under ESP Easy is provided on a matching basis after completion of the projects, which should be completed within 12 months, and the funding ceiling for each project is \$170,000. For Batch 14 (July to September 2015), there were 90 applications (61 submitted through regular channel and 29 through ESP Easy) as compared to 53 and 77 applications in Batches 12 and 13 respectively.

2.12 In response to Audit's enquiry, the CEDB informed Audit in March 2016 that the ESP Secretariat had stepped up its promotion efforts since the third quarter of 2015, and had made intensive promotion efforts such as participating in exhibitions, conducting telephone and email marketing work as well as conducting one-to-one consultation sessions with interested enterprises, etc. Till the end of 2015, these promotion events attracted over 500 participants (for promotion efforts) and close to 800 participants (for one-to-one consultation), much higher than the corresponding number of participants of about 460 and 300 in the preceding two quarters of January to March and April to June 2015 respectively. As a result, the total number of applications received in the two quarters of July to September and October to December 2015 went up to 90 and 184 respectively.

2.13 The HKPC would continue its promotion efforts to encourage more applications to the ESP (e.g. by organising more promotion events). The HKPC would also monitor the applications of ESP Easy and assess its effectiveness in streamlining the application process and increasing the number of applications for the ESP.

2.14 For the OSP, the CEDB informed Audit in March 2016 that as of end-December 2015, the OSP Secretariat had handled over 2,020 enquiries and conducted about 130 one-to-one consultation meetings with trade and industrial organisations, professional bodies and research institutes interested in submitting applications. Besides, the BUD Fund had been promoted through seminars/events conducted by the TID and the HKPC. Dedicated OSP promotional letters were sent in May 2014 to trade and industrial organisations with rejected or withdrawn applications.

Overall management

2.15 Regarding the decline in the number of OSP applications received since Batch 7 (October to December 2013) onwards, the TID explained that this was due to the fact that many trade or industry organisations were still implementing one or more OSP projects approved since the inception of the Fund in mid-2012. Some of these projects have a duration of up to three years and the organisations concerned had limited capacity to organise new projects.

2.16 Audit noted that, of some 400 local trade and industrial organisations, only about 100 (25%) had submitted applications to the OSP. Audit considers that the TID needs to encourage more organisations to promote their industries' products, services and expertise. In this regard, in late January 2016, the TID sent out another round of invitation letters to trade and industrial organisations inviting them to consider applying for funding support under the OSP. Audit welcomes the TID's initiative, and considers that it should monitor the response and proactively contact these organisations to promote the OSP to them.

Need to take measures to help organisations/enterprises improve the success rates of their applications

2.17 The TID and the HKPC have implemented various initiatives to assist organisations and enterprises in applying for the BUD Fund. For example:

- (a) dedicated websites on the OSP and the ESP were launched to provide guidelines and assistance and important points to note when making applications. The ESP application form had been improved by incorporating clearer guidelines;
- (b) seminars and symposia were organised for interested organisations and enterprises to introduce the application criteria and procedures, explain matters requiring attention in making applications, and present cases of successful and unsuccessful applications;
- (c) one-to-one consultation sessions/meetings with interested organisations and enterprises were held to explain the programmes in detail and provide advice on applications;

- (d) unsuccessful applicants would be informed of the reasons of rejection to help them revise and resubmit their applications if they so wished; and
- (e) a guidebook was prepared on the experiences of enterprises from various industries and in implementing the funded projects.

2.18 For the period from June 2012 to June 2015, the overall success rates of OSP and ESP applications were 38% and 33% respectively, notwithstanding that the success rate of ESP applications had increased from 28% in 2012-13 to 58% in 2015-16 (up to June 2015) (see Table 5). According to the TID and HKPC, reasons for rejecting the applications include:

for OSP

- (a) project content is not clear enough or not in line with the objectives of the BUD Fund;
- (b) implementation plans lack details or are not effective to achieve project objectives;

for ESP

- (c) the applicants could not demonstrate that the projects could enhance their competitiveness and facilitate their business development in the Mainland; and
- (d) the applicants cannot show that they have sufficient ability to implement the proposed projects.

The TID and the HKPC need to closely monitor the situation and consider effective measures to encourage and support more worthwhile projects.

Overall management

Table 5

**Success rates of OSP and ESP applications
(June 2012 to June 2015)**

Year received	No. of applications					
	OSP			ESP		
	Submitted for assessment (a)	Approved (b)	Success rate (c) = (b) ÷ (a) × 100%	Submitted for assessment (d)	Approved (e)	Success rate (f) = (e) ÷ (d) × 100%
2012-13	62	23	37%	512	144	28%
2013-14	30	15	50%	307	97	32%
2014-15	24	7	29%	181	78	43%
2015-16 (April to June) (Note)	2	0	0%	52	30	58%
Overall	118	45	38%	1,052	349	33%

Source: Audit analysis of TID and HKPC records

Note: Only Batch 13 (April to June 2015) was included in the analysis because applications received after June 2015 were under processing at the time of Audit fieldwork.

Remarks: Two OSP applications and 41 ESP applications withdrawn after approval were not included in the analysis. If these applications were included, the overall success rates of OSP and ESP applications would be 40% and 37% respectively.

Performance reporting

2.19 The Director-General of Trade and Industry is the Controlling Officer of the BUD Fund. In the Controlling Officer's Reports (CORs), the TID reports the following target and indicators for the OSP:

- (a) percentage of the applications for grant processed within 60 working days upon receipt of all necessary documents and information (the processing time is counted from the closing date of a batch (e.g. 31 March) to the date of assessment reports submitted to the Vetting Committee);
- (b) number of applications received and processed; and
- (c) amount of government grants approved.

Besides, the TID also provides the number of applications received, approved, rejected and withdrawn, the total amount of government grants approved and the details of individual approved projects on the OSP website.

2.20 For the ESP, Audit noted that similar performance target and indicators were not reported by the TID or the CEDB in their CORs, nor by the HKPC as the ESP Secretariat, on the ESP website.

2.21 In this regard, Audit noted that in examining the Government's Annual Estimates, Members of the Legislative Council ask for performance information of the BUD Fund (e.g. the number of applications received and approved, and the amount of funds granted). Audit also noted that the operation of the Fund is reported to the Panel on Commerce and Industry of the Legislative Council every year (see para. 5.4). Audit considers that the CEDB and the TID, in collaboration with the HKPC, should take measures to improve the performance reporting of the BUD Fund, particularly for the ESP.

Audit recommendations

2.22 Audit has *recommended* that the Secretary for Commerce and Economic Development and the Director-General of Trade and Industry should, in collaboration with the Executive Director, Hong Kong Productivity Council:

- (a) take measures to improve the utilisation of the BUD Fund, including:
 - (i) stepping up promotion efforts to attract more applications to the BUD Fund;
 - (ii) monitoring the applications of ESP Easy and assessing the effectiveness of the ESP Easy in increasing the number of applications for ESP; and
 - (iii) continuing to monitor the success rates of the applications and consider devising effective measures to help organisations/enterprises improve the success rates of their applications as far as possible; and
- (b) take measures to improve the performance reporting of the BUD Fund (particularly for the ESP), including:
 - (i) setting more performance targets and indicators; and
 - (ii) reporting the targets and indicators, for example, in the CORs of the CEDB/TID and the OSP and ESP websites.

Response from the Government

2.23 The Secretary for Commerce and Economic Development and the Director-General of Trade and Industry, with the support of the Executive Director, Hong Kong Productivity Council, generally agree with the audit recommendations. The Secretary for Commerce and Economic Development has said that:

- (a) while the Government has not set any target on the number of enterprises/organisations to be benefitted from the BUD Fund (see para. 2.3), the CEDB, the TID and the HKPC as the ESP Secretariat have all along been monitoring the number of applications received under the BUD Fund and have undertaken various robust promotion efforts and support measures with a view to encouraging more applications (see paras. 2.8, 2.12 and 2.14). In the light of the audit recommendations, the TID will make even more promotion efforts by sending promotional letters more frequently, outreaching to trade and industrial organisations which have not applied before, and adopting a more targeted approach to discuss with applicants with rejected applications in order that proposals can be revised and resubmitted quickly;

- (b) since the launch of the ESP Easy in late August 2015 to encourage more applications, feedback from the trade has been positive. The number of ESP Easy applications received in the third and fourth quarters of 2015 were respectively 29 and 129, totalling 158. The CEDB, the TID and the HKPC will closely monitor its operation and assess its effectiveness in increasing the number of ESP applications;

- (c) to safeguard the use of public money, applications under the BUD Fund have to be examined against a set of objective criteria. That said:
 - (i) the ESP Secretariat has been assisting applicants in submitting applications with a view to improving the quality of applications, such as providing even clearer guidelines on application form, organising seminars and symposia, and conducting one-to-one consultation sessions to advise interested enterprises on making applications (see para. 2.17). The overall success rate for ESP applications has thus been improving (see Table 5) and the success rate for applications received in 2015-16 has increased to 74% (up to end-January 2016) from 58% (up to end-June 2015); and

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- (ii) as for the OSP, the OSP Secretariat has been providing one-to-one consultation to potential applicants (see para. 2.17(c)). Detailed rejection reasons are also provided to unsuccessful applicants. It has received 12 resubmissions from rejected projects so far, and seven of them have been approved. It will highlight the one-to-one consultation in future promotion. It will also adopt a more targeted approach to discuss with applicants with rejected applications in order that proposals can be revised and resubmitted quickly; and

- (d) the CEDB and the TID will work closely with the ESP Secretariat to set more performance targets and indicators for the BUD Fund, and report them, for example, in the CORs and the OSP and the ESP websites. They will also continue with the current practice of reporting the operations of the Fund to the Panel on Commerce and Industry of the Legislative Council.

Engagement of the HKPC as implementation partner and Secretariat of the ESP

2.24 According to the CEDB, the HKPC was engaged as a partner to implement the ESP with the HKPC acting as the Secretariat of the ESP. Under the agreement signed in June 2012 between the CEDB and the HKPC, the HKPC would provide services for the implementation of the ESP, including:

- (a) assisting eligible enterprises in making applications;

- (b) conducting initial vetting of all applications, providing recommendations and coordinating the further vetting by the IDC and the PMC;

- (c) monitoring the implementation progress and evaluating the results of projects;

- (d) disbursing funds to successful applicants;

- (e) providing secretariat services for the IDC and PMC; and

- (f) planning and organising promotion activities.

The HKPC is also required to produce, for each financial year, AIP (Note 9), annual report and audited accounts of the preceding year for acceptance by the PMC and the Government. The HKPC would also bear the cost of the Secretariat's manpower support and other overheads to the extent of \$17 million (see para. 1.11(b)). The Government would pay the HKPC an annual implementation fee and the estimated amount of project funding required for the year.

2.25 Audit examined the engagement of the HKPC as the ESP Secretariat, focusing on the following issues:

- (a) selection of implementation partner (paras. 2.26 to 2.29); and
- (b) charging rates used for calculating the implementation fee (paras. 2.30 to 2.38).

Selection of implementation partner

2.26 In early 2012 when the Financial Services and the Treasury Bureau (FSTB) vetted the FC paper for the BUD Fund, it expressed its concerns to the CEDB on:

- (a) the use of an outside party instead of the TID for the implementation of the ESP; and
- (b) the selection of the HKPC as the implementation partner.

The FSTB also advised the CEDB to consider if the arrangement of engaging the HKPC was a procurement of services subject to the Stores and Procurement Regulations (SPRs) and tendering procedures.

Note 9: *The AIP should, among others, comprise information including: (a) proposed activities to be undertaken; (b) the estimated number of successful applicants and amount of grants payable to these applicants; (c) a detailed budget listing out the expenditure items; (d) the amount of implementation fee; (e) the estimated amount of project funding required; and (f) performance indicators to gauge the performance of the HKPC in implementing the ESP.*

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2.27 In response, the CEDB informed the FSTB in April 2012 that:

- (a) experience and expertise was required in assisting Hong Kong enterprises in developing brands, upgrading and restructuring operations and promoting domestic sales in the Mainland. The TID did not have the necessary experience and expertise in vetting applications and in monitoring project progress effectively. It required the assistance from a non-government partner with such expertise and experience like the HKPC;
- (b) even if the TID had the expertise and experience in carrying the relevant tasks, the total staff costs, net of overheads, would be around \$96 million, which was much higher than the amount mentioned in the FC paper; and
- (c) the engagement of the HKPC as the Secretariat of the ESP was not a procurement of service. The HKPC was the partner in implementing the ESP of the BUD Fund and for this purpose, it would contribute around \$17 million in terms of professional manpower support, venue rentals and other ancillary technical and support services. The arrangement was similar to another government funding scheme, namely the Cleaner Production Partnership Programme (CPPP — Note 10) administered by the Environmental Protection Department.

2.28 Financial Circular No. 8/2004 “Non-works projects funded by the Government”, which was then in force, stipulated that:

- (a) bureaux/departments had to observe the need to preserve a level playing field in government procurement and in partnering arrangements involving non-government entities, by adhering as far as possible to a fair, open and/or competitive selection process; and

Note 10: *The Environmental Protection Department had engaged the HKPC as the implementation agent for its CPPP for promoting cleaner production technologies and practices to industries in the Pearl River Delta region. The funding request was approved by the FC in January 2008. Prior to that, the HKPC was commissioned by the Department to launch a Cleaner Production Technical Support Pilot Project in November 2006 under restricted tendering.*

- (b) if the project was primarily owned, organised and funded by the Government, and the Controlling Officer needed to procure a service or good from a non-government partner, the Controlling Officer should generally follow an open, fair and competitive bidding process. If an exception was required, the Controlling Officer should seek separate approval from the Treasury Branch (of the FSTB) in accordance with the SPRs (Note 11).

In gist, bureaux/departments had to adhere as far as possible to a fair, open and/or competitive selection process for partnering arrangements involving non-government entities. Furthermore, for procuring service from a non-government partner, the Controlling Officer should generally follow an open, fair and competitive bidding process.

2.29 Audit noted that in the emails exchanged between the CEDB and the FSTB in March and April 2012, the CEDB explained that it considered the engagement of the HKPC was a partnership arrangement and the payment of implementation fee to secure the secretariat services of the HKPC was not procurement of services. The CEDB engaged the HKPC to provide secretariat services for the ESP and implementation fee was disbursed to the HKPC annually (see para. 2.24). In response to Audit's enquiry, the FSTB informed Audit in March 2016 that it had noted the CEDB's justifications for engaging the HKPC as a partner. The Controlling Officer was responsible for drawing up the engagement arrangements having regard to all relevant considerations set out in the then prevailing Financial Circular No. 8/2004. The FSTB had reminded the CEDB to properly document the considerations, justifications, specifications on deliverables as well as engagement agreement with the HKPC. The proposal that the HKPC would be engaged as the implementation partner and the partnership arrangement were set out in the subsequent FC paper on the establishment of the BUD Fund. The FSTB subsequently updated and revised Financial Circular No. 8/2004 and replaced it by Financial Circular No. 2/2015 issued in February 2015. In Financial Circular No. 2/2015, the FSTB:

Note 11: *For procurement of services, in general, bureaux/departments should follow the tender procedures laid down in the SPRs. Open tendering should normally be adopted. If single or restricted tendering is proposed, approval has to be sought from the FSTB with full justifications.*

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- (a) spells out a few overriding principles, including the need to preserve a level playing field in government procurement and in partnering arrangements involving non-government entities (including publicly-funded or subvented organisations), by adhering as far as possible to a fair, open and/or competitive selection process; and
- (b) stipulates that if the Controlling Officer needs to procure a service from a non-government partner, the Controlling Officer should generally follow an open, fair and competitive bidding process. If an exception is required, the Controlling Officer should seek separate approval from the FSTB. Where the Controlling Officer is satisfied that the engagement of a non-government partner to administer the project does not constitute procurement of service or good and is not subject to the SPRs, the relevant considerations and decisions should be clearly and properly recorded, and the FSTB should be consulted if in doubt.

Audit considers that, for similar engagements in future, the CEDB and the TID need to document the considerations and approvals obtained.

Charging rates used for calculating the implementation fee

2.30 The agreement between the CEDB and the HKPC does not specify how the implementation fee paid to the HKPC is derived. In response to Audit's enquiry, the HKPC provided in late December 2015 a calculation sheet showing, for each individual staff, the man-hours spent on the ESP and their respective staff charging rates.

2.31 The HKPC has a pricing policy in charging its consultancy services to recover staff cost, direct expenses and/or profit margin/contingency (for services at Level 3 rates only — see below). For staff cost, there are four levels of rates:

- (a) Level 1 (L1) rates: Staff basic salary plus provident fund plus fringe benefits;
- (b) Level 2 (L2) rates: L1 rates plus divisional overheads;

- (c) Level 3 (L3) rates: L2 rates plus corporate services supporting staff cost and overheads; and
- (d) Level 8 (L8) rates: Staff basic salary plus provident fund.

L3 rates are the highest charging rates among the four levels.

2.32 According to the HKPC pricing policy, normally consultancy services (including, among others, secretariat services) would be charged at L3 rates, but L1 and L2 rates can be used for companies with 100 employees or less. L8 rates should apply to all Government-funded projects for which there are funding guidelines requiring as such (see para. 2.34(b)). Staff rates are reviewed annually in August/September.

2.33 Audit noted that the HKPC charged the Government the implementation fee at L3 rates (see para. 2.31) instead of L8 rates. Staff rates of L3 are more than double those of L8. Every year, the HKPC calculated the implementation fee by using the charging rates at L3 and claimed the amount from the Government. The implementation fee calculated this way (i.e. using L3 rates) was included in each year's audited accounts to support the claim.

2.34 In response to Audit's enquiry, the HKPC informed Audit in January 2016 that:

- (a) the agreed service fee had been budgeted on a man-year basis for the dedicated secretariat team, and the breakdown of internal staff rates at L3 was for illustration only. L3 rates were applied to record the staff time usage on the ESP as the service provided fell within the scope of consultancy services;
- (b) as for the "Government-funded projects" referred to in the pricing guidelines (see para. 2.32), they referred to projects which were governed by the respective funding rules embodied in different Government funding schemes. "Government-funded projects" did not include consultancy services rendered by the HKPC to the Government for which the HKPC acted as a secretariat to administer and monitor funding programmes for the Government (the fee of which was determined by mutual agreement),

Overall management

or services rendered by the HKPC to the Government after succeeding in a bidding process (i.e. through tendering or quotation). All in all, the staff rates were for internal resources management purpose for recording staff time usage for the ESP; and

- (c) the relevant documents on the negotiation process with the Government for the provision of secretariat services could not be located.

2.35 Audit also noted that in early 2012 (before engaging HKPC's services), both the TID and the FSTB had commented on the charging of implementation fee:

- (a) in February 2012, the TID advised the CEDB that the hourly rates charged by the HKPC were on the high side. The charging rates were the highest cost rates (i.e. L3 rates) whereas L8 rates were much lower than L3 rates. Given that the BUD Fund was a Government-funded project, the TID wondered whether the HKPC should use its L8 rates instead of L3 rates in estimating its manpower cost for implementing the Fund. This would reduce the estimated manpower cost by more than half; and
- (b) the FSTB had also expressed concern on the high disbursement fee to the HKPC and requested the CEDB to provide an evaluation on the cost-effectiveness of engaging the HKPC as the implementation agent and explore the possibility of whether the cost could be further trimmed or absorbed by the HKPC (see para. 2.26).

2.36 In response to FSTB's concern, the CEDB informed the FSTB in April 2012 that:

- (a) as confirmed with the HKPC, the rates (full-cost basis including overheads) to cover the manpower required for secretariat services for the ESP were actually the same as those charged under the CPPP (see para. 2.27(c)); and
- (b) the CEDB was therefore of the view that the cost of engaging the HKPC as Secretariat of the ESP was reasonable.

2.37 In response to Audit's enquiry, the CEDB informed Audit in February 2016 that there were discussions and negotiations between the Government and the HKPC on the overall level of charge. However, Audit noted that there was no documentation indicating whether the CEDB had discussed with the HKPC on the feasibility of using lower charging rates (such as L8 rates) for the ESP and why lower rates were not applicable.

2.38 Both Financial Circulars No. 8/2004 and No. 2/2015 on funding of non-works projects stipulate the need for the Controlling Officer to strive to achieve maximum value for money. Audit considers that, for similar engagements in future, the CEDB should ensure economy in administration cost and document the negotiation process and justifications for the basis used in the calculation of administration cost involved.

Audit recommendations

2.39 **Audit has *recommended* that the Secretary for Commerce and Economic Development and the Director-General of Trade and Industry should, for future engagements of non-government partners to administer projects:**

- (a) **ensure that records relating to the compliance with relevant Financial Circulars are properly kept and the pertinent approvals are properly documented;**
- (b) **ensure economy in administration cost and document the justifications for the basis used in the calculation of the administration cost involved; and**
- (c) **ensure that documentation of the negotiation process is properly kept.**

Response from the Government

2.40 The Secretary for Commerce and Economic Development and the Director-General of Trade and Industry agree with the audit recommendations. The Secretary for Commerce and Economic Development has said that:

- (a) the CEDB has exchanged correspondence with the FSTB, explaining that the engagement of the HKPC was not a procurement of services. It was a partnership arrangement to implement the ESP in light of the HKPC's mission, and more importantly its expertise and experience in the Mainland market. After considering the justifications provided by the CEDB, the FSTB cleared the FC paper for issue (see para. 2.29). The CEDB will continue to ensure that proper records are kept and pertinent approvals are properly documented in future similar engagements; and
- (b) the implementation fee charged by the HKPC for the ESP is in accordance with its internal pricing guideline. Discussions and negotiations with the HKPC on the overall level of charge did take place (see para. 2.37). For future similar projects, the CEDB will continue to ensure economy in procurement and proper documentation.

Financial management of the ESP

2.41 Audit examined the financial management of the ESP and noted the following areas which call for attention:

- (a) need to closely monitor cost of administering ESP (paras. 2.42 to 2.46);
- (b) additional Government funding might be required (paras. 2.47 to 2.50);
and
- (c) over-estimation of project funding (paras. 2.51 to 2.55).

Need to closely monitor cost of administering ESP

2.42 According to the FC paper of May 2012, the cost for administering the ESP projects (mainly secretariat services on programme administration, application handling, project monitoring, as well as conducting promotional and publicity activities — see para. 4.2) would be some \$77 million in total, comprising implementation fee paid by the Government to the HKPC (\$60 million) and HKPC's contribution (\$17 million) (see para. 1.11). In other words, for the whole programme, the administration cost represents about 15% of the approved funding (i.e. $\$77 \text{ million} \div \$500 \text{ million} \times 100\%$).

2.43 Audit noted that, because the number of approved projects was less than that originally assumed, as at October 2015, approved funding for ESP projects was \$157 million, i.e. 31% of the \$500 million provided for the ESP (see para. 2.5). However, the cost for administering the ESP had already amounted to some \$55.3 million (including \$39.3 million, representing 66% of \$60 million from Government funding and \$16 million, representing 94% of \$17 million from HKPC's contribution), representing about 35% of the funding of \$157 million approved to-date.

2.44 Some 95% of the cost of administering the ESP was manpower cost. According to the FC paper, manpower arrangements for the secretariat services were as follows:

- (a) ***Funding by Government.*** 1 Senior Consultant, 7 Consultants and 2 Project Officers (total: 10 full-time staff at peak period); and
- (b) ***Contribution by HKPC.*** 1 General Manager, 1 Principal Consultant, 1 Senior Consultant, 2 Consultants and 1 Project Officer (total: 6 part-time staff).

The Government also informed the FC in the funding paper that the manpower arrangements would be reviewed and suitably adjusted as necessary having regard to the workload and other relevant factors.

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2.45 Audit noted that, notwithstanding that the numbers of applications and approved projects were low and decreasing (see paras. 2.9 and 2.18), the actual number of full-time staff of the ESP Secretariat remained at about 15 to 16 (except for the first year of operation, i.e. 2012-13), which was some 50% more than that estimated in the FC paper (details are shown in Table 6). According to the CEDB, this was because the workload of the ESP Secretariat had been increasing with a view to enhancing the effectiveness in the implementation and monitoring of projects.

Table 6

**Staff of ESP Secretariat
(2012-13 to 2015-16)**

Year	No. of staff funded by		Total number of staff
	Government	Contribution from HKPC	
2012-13	<ul style="list-style-type: none"> • 1 Senior Consultant • 6 Consultants • 1 Project Officer 	<ul style="list-style-type: none"> • 1 General Manager (part-time) • 1 Principal Consultant (part-time) • 1 Senior Consultant (part-time) • 1 Consultant (part-time) 	<ul style="list-style-type: none"> • 8 full-time • 4 part-time
2013-14	<ul style="list-style-type: none"> • 2 Senior Consultants • 8 Consultants • 1 Project Officer 	<ul style="list-style-type: none"> • 2 General Managers (part-time) • 1 Principal Consultant (part-time) • 1 Senior Consultant • 3 Consultants • 1 Project Officer 	<ul style="list-style-type: none"> • 16 full-time • 3 part-time
2014-15	<ul style="list-style-type: none"> • 2 Senior Consultants • 8 Consultants • 1 Project Officer 	<ul style="list-style-type: none"> • 1 General Manager (part-time) • 1 Principal Consultant (part-time) • 1 Senior Consultant • 3 Consultants • 1 Project Officer 	<ul style="list-style-type: none"> • 16 full-time • 2 part-time
2015-16 (Oct 2015)	<ul style="list-style-type: none"> • 1 Senior Consultant • 8 Consultants • 1 Project Officer 	<ul style="list-style-type: none"> • 1 General Manager (part-time) • 1 Principal Consultant (part-time) • 1 Senior Consultant • 3 Consultants (Note) • 1 Project Officer 	<ul style="list-style-type: none"> • 15 full-time • 2 part-time

Source: *Audit analysis of HKPC records*

Note: *In preparing the AIP 2015-16, the HKPC assumed that the Government would fund the three Consultant posts which were originally funded by the HKPC. The amount involved was included in the financial estimates of 2015-16 approved by the PMC in December 2014.*

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2.46 Audit considers that the CEDB and the HKPC need to closely monitor the manpower deployment of the ESP Secretariat and take effective action to improve the economy in administering the ESP.

Additional Government funding might be required

2.47 Up to 2014-15, the Government had disbursed \$32.7 million of the \$60 million as implementation fee to the HKPC (see Table 7).

Table 7

**Disbursement of implementation fee to HKPC
(2012-13 to 2014-15)**

Year	Amount disbursed (\$ million)
2012-13	7.1
2013-14	12.4
2014-15	13.2
Total	32.7

Source: HKPC records

2.48 In the AIP 2015-16 (see Note 9 to para. 2.24), the ESP Secretariat informed the PMC that:

- (a) having regard to the actual workload since the implementation of the ESP in applications handling and project monitoring, the Secretariat had engaged and would need to continue to engage additional resources to carry out these duties;

- (b) the Secretariat estimated that a shortfall in Government funding would arise in 2016-17, and additional resources would be required for running the ESP up to 2019-20 (Note 12); and
- (c) the Secretariat was discussing with the Government on how to meet the additional resource requirement.

2.49 The ESP Secretariat estimated that implementation fee of \$17.2 million would be required for 2015-16 (\$16.7 million for programme administration and monitoring, and \$0.5 million for promotion work). The 2015-16 budget was endorsed by the PMC and approved by the Government in December 2014, and \$16.9 million was disbursed to the HKPC in July 2015.

2.50 Audit considers that the CEDB needs to, in collaboration with the HKPC, closely monitor the expenditure of the Secretariat, and take measures to contain the expenditure within the FC approved amount as far as practicable. It should also consider informing the FC if the implementation fee exceeds the approved amount of \$60 million.

Over-estimation of ESP project funding

2.51 In each year's AIP, the ESP Secretariat would budget for the amount of project funding required for the ensuing year, taking into account the estimated number of new projects to be approved and the funding requirements of the newly approved projects and projects in progress. Audit noted that for the three years from 2012-13 to 2014-15, the budgeted amount significantly exceeded the actual amount disbursed (see Table 8).

Note 12: *In November 2014 when it was drawing up the financial estimates of 2015-16, the ESP Secretariat informed the CEDB that, assuming the Government would start funding the three Consultant posts in 2015-16 (which were previously funded by the HKPC — see Table 6), the total implementation fee required for the whole programme would be \$72.6 million, or \$12.6 million (21%) higher than the amount stated in the FC paper of May 2012 (see para. 1.11(a)).*

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Table 8
Funding for approved ESP projects
(2012-13 to 2014-15)

Year	Budgeted amount (a) (\$ million)	Actual amount disbursed (b) (\$ million)	Difference (c) = (a) – (b) (\$ million)
2012-13	18.7	2.3	16.4 (88%)
2013-14	41.5	14.6	26.9 (65%)
2014-15	66.0	17.5	48.5 (73%)

Source: Audit analysis of HKPC records

Remarks: The budgeted project funding for 2015-16 was \$59.4 million.

2.52 Audit's analysis revealed that the less-than-budget funding disbursement was mainly attributable to:

- (a) *over-estimation of the number of newly approved projects.* Audit noted that the actual number of projects approved was less than the number estimated in each year's AIP (see Table 9);

Table 9
Number of approved ESP projects
(2012-13 to 2014-15)

Year	Estimated number per AIP (a)	Actual number (b)	Over-estimation (c) = (a) – (b)
2012-13	225	144	81 (36%)
2013-14	110	97	13 (12%)
2014-15	120	78	42 (35%)

Source: Audit analysis of HKPC records

Remarks: The estimated number of newly approved projects in 2015-16 was 88. For the first three months of 2015-16 (April to June 2015), 30 projects were approved.

- (b) ***projects terminated/withdrawn during the year.*** As at October 2015, of the 349 approved projects, 45 projects (or 13%) were terminated (see para. 4.23). For these 45 projects (with total funding of \$19 million), approved funds were either not disbursed, or funds already disbursed were recouped. In addition to these 349 approved projects, 41 projects (with total funding of \$18 million) approved by the PMC were subsequently withdrawn before the signing of the project agreement (see para. 4.7);

- (c) ***delays in submission of progress reports and final reports.*** Funds were disbursed to grantees only upon the PMC's and the Government's acceptance of the progress reports and final reports. Audit found that there were delays in the submission of progress reports and final reports by grantees, and that resubmissions were common (see para. 4.13); and

- (d) ***delays in signing of project agreements and opening of bank accounts.*** Some grant payments were delayed due to the grantees' delays in the signing of the project agreements and in the opening of bank accounts for the projects.

2.53 After the AIP was endorsed by the PMC (normally in December), the TID would pay the estimated project funding to the HKPC in around July of the ensuing year, after offsetting any unspent project funding of the preceding financial year as reported in the audited accounts. For example, for 2014-15 project funding:

- (a) estimated project funding for 2014-15 (per AIP 2014-15) was \$66 million;

- (b) amount of unspent project funding as at 31 March 2014 (per audited accounts for 2013-14) was \$26.9 million; and

- (c) amount paid to the HKPC was therefore \$39.1 million (\$66 million – \$26.9 million).

2.54 Audit noted that, because the actual amounts disbursed to grantees were much less than those estimated (see Table 8), surplus funds were kept at the bank account of the HKPC for holding the project funding (see Table 10).

Table 10

**ESP project funding bank balance
(2012-13 to 2015-16)**

Year	Balance as at 31 March (\$ million)	Average month-end balance (\$ million)
2012-13	17.2	18.4
2013-14	28.6	18.8
2014-15	51.2	48.6
2015-16	50.9 (31 October 2015)	51.5 (7 months)

Source: Audit analysis of HKPC records

2.55 To avoid keeping excessive funds surplus to requirement, the CEDB needs to ensure that the ESP Secretariat makes accurate estimation on the project funding required in the AIPs. It should also consider ways to minimise the amount of surplus funds held in the bank account for holding project funding (e.g. releasing funds to the Secretariat by instalments after taking into account the amount of funds in the bank account).

Audit recommendations

2.56 **Audit has recommended that the Secretary for Commerce and Economic Development and the Director-General of Trade and Industry should, in collaboration with the Executive Director, Hong Kong Productivity Council:**

- (a) **closely monitor the manpower deployment of the ESP Secretariat and take effective action to improve the economy in administering the ESP;**
- (b) **closely monitor the expenditure of the ESP Secretariat, and take measures to contain the expenditure within the FC approved amount as far as practicable;**

- (c) **inform the FC if the implementation fee exceeds the approved amount of \$60 million;**
- (d) **ensure that the ESP Secretariat makes accurate estimation on the project funding required in the AIPs; and**
- (e) **review the requirements and disbursement of project funding and consider ways to minimise the amount of surplus funds held in the ESP Secretariat's bank account for holding project funding.**

Response from the Government

2.57 The Secretary for Commerce and Economic Development and the Director-General of Trade and Industry, with the support of the Executive Director, Hong Kong Productivity Council, generally agree with the audit recommendations. The Secretary for Commerce and Economic Development has said that:

- (a) the ESP Secretariat's responsibilities include, among others, promoting the BUD Fund, processing applications received, vetting applications, advising applicants in making applications, monitoring the progress of approved applications, and conducting promotion activities. The workload of the ESP Secretariat has been increasing with a view to enhancing the effectiveness in the implementation and monitoring of projects. To ensure that the ESP Secretariat's manpower deployment is appropriate, the Secretariat is required to submit an AIP to the PMC setting out, among others, the planned activities and proposed manpower arrangement taking into account the workload involved for the coming year. The CEDB, the TID and the PMC scrutinise the AIP carefully and will continue to closely monitor the manpower deployment of the ESP Secretariat;

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- (b) the CEDB and the TID have all along been monitoring closely the expenditure of the ESP Secretariat, the workload of which in implementing the ESP has been increasing. The latest estimate is that a shortfall in Government funding would not arise in 2016-17, as previously estimated by the ESP Secretariat. In any case, the CEDB and the TID will continue to closely monitor the situation and inform the FC if additional Government funding for the ESP Secretariat is required from the approved commitment of \$1,000 million;

- (c) the ESP Secretariat has improved the methodology in estimating the project funding required in the coming AIP 2016-17, which will be submitted to the PMC for consideration in end-March 2016. The revised methodology aims at providing a more accurate funding requirement projection; and

- (d) the CEDB, the TID and the HKPC agree that the amount of surplus funds held in the ESP Secretariat bank account could be minimised. The Government will henceforth pay to the ESP Secretariat the project funding by more than one instalment, instead of in one go, during a year to minimise the amount of surplus funds held in the bank account of the ESP Secretariat for holding project funding.

PART 3: MANAGEMENT OF ORGANISATION SUPPORT PROGRAMME PROJECTS

3.1 This PART examines audit issues relating to the management of OSP projects. Audit has found scope for improvement in the following areas:

- (a) use of implementation agents (paras. 3.4 to 3.13);
- (b) in-kind contribution (paras. 3.14 to 3.20);
- (c) monitoring of project progress (paras. 3.21 to 3.30);
- (d) submission of reports (paras. 3.31 to 3.36); and
- (e) dissemination of project results and deliverables (paras. 3.37 to 3.40).

Work of the OSP Secretariat

3.2 The OSP Secretariat under the Industries Support Division of the TID is responsible for promoting the OSP, assessing the applications of OSP projects, making recommendations to the Vetting Committee, and monitoring the implementation of approved projects. The monitoring work includes overseeing project activities and the grantees' submissions (such as progress reports, final reports and audited accounts), and return of residual funds by grantees. Upon project completion, the OSP Secretariat assesses the effectiveness of the project based on the project deliverables and results. The Treasury Team of the Industries Support Division would also assist in reviewing the audited accounts to ensure compliance with the relevant terms and conditions of the project agreement from the financial and accounting perspectives. The deliverables and the results of the projects will be submitted to the Vetting Committee to facilitate its monitoring of implementation and evaluating the effectiveness of the funded projects and the OSP.

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3.3 As at 31 October 2015, there were 45 approved OSP projects (approved project funding of \$147 million), of which 15 (33%) were completed with final reports and audited accounts submitted (see Appendix C for some examples). Audit selected 10 completed projects to examine the OSP Secretariat's assessment and monitoring work. The audit findings are in the ensuing paragraphs (Note 13).

Use of implementation agents

3.4 An OSP applicant is allowed to engage implementation agents to carry out the project in accordance with the proposal. Implementation agents directly participate in the project and provide services such as project administration, event organisation and professional consultancy. The implementation agents charge the grantee a consultancy fee for the services provided which forms part of the expenditure of the project.

3.5 It was common for the grantees to engage implementation agents for carrying out OSP projects. Of the 45 approved projects (see para. 3.3), 30 (67%) had engaged seven implementation agents in total. The total approved consultancy fee paid to these seven implementation agents amounted to \$29.4 million, or 31% of the approved funding of \$96.2 million for these 30 projects. Details are at Table 11.

Note 13: *During the course of audit work, the TID completed an internal review on the vetting and monitoring procedures of the OSP in October 2015 and the Operation Manual was updated in January 2016 to include the improvement measures. A briefing session on the enhancement measures to the Operation Manual was conducted in February 2016. According to the TID, regular meetings would be held to refresh staff of the operation procedures and brief them of any new and enhancement measures. The relevant measures are detailed in the respective paragraphs where the related audit findings are discussed.*

Table 11

**OSP projects with implementation agents
(31 October 2015)**

Implementation agent	Number of projects	Approved project funding (\$ million)	Approved consultancy fees paid to implementation agent (\$ million)
HKPC	22	65.0	19.8
Six other agents	8	31.2	9.6
Total	30	96.2	29.4

Source: Audit analysis of TID records

3.6 According to the OSP application guidelines, grantees have to observe procurement procedures (such as obtaining quotations and using tendering process) for the procurement of equipment, goods or services for the projects. However, such requirements do not apply to the engagement of implementation agents.

3.7 The OSP Secretariat informed Audit in January 2016 that:

- (a) it recognised that there were issues in determining appropriate level of fees for implementation agents in the absence of a competitive procurement process. However, many non-profit-distributing trade associations lacked the expertise and manpower resources to formulate detailed plans and deliverables for OSP projects. Without the assistance of an experienced and professional implementation agent, these trade associations would be unable to put forward well-thought-out proposals that could meet the requirements of the OSP. The implementation agent helped the applicant develop the project proposal including its detailed scope and deliverables. It would be impracticable for an applicant to procure by tender the service of an implementation agent before the detailed scope of the project was formulated;

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- (b) the OSP Secretariat had decided to permit applicants to designate an implementation agent in the application stage and to put forward proposed project costs for the implementation agent for vetting; and
- (c) applications were required to include, among others, curriculum vitae of key staff and detailed breakdown of consultancy fee of implementation agent. The OSP Secretariat would consider the suitability of the implementation agent in implementing the project based on its capabilities and past experience. The Secretariat would also take into account approved consultancy fees in similar past projects when examining the proposed consultancy fee.

3.8 Of the 10 projects selected by Audit (see para. 3.3), six had engaged implementation agents. Consultancy fees ranged from \$0.4 million to \$1.3 million, representing 26% to 63% of their respective approved project funding. Audit reviewed these six projects and noted that for some projects, details of the consultancy fees were not provided, for example:

- (a) for three (50%) projects, the proposed consultancy fees were lump sum fees without detailed breakdown;
- (b) for four (67%) projects, the OSP Secretariat had trimmed 24% to 33% off the proposed consultancy fee with brief explanations. There were no explanations for one project with 10% fee cut and one project without any fee cut; and
- (c) for three (50%) projects, details were not provided regarding what services had been provided by the agents.

3.9 In response to Audit's enquiry, the OSP Secretariat informed Audit in March 2016 that the six projects reviewed by Audit were approved before 2014. Since January 2014, the OSP Secretariat has required that for proposed consultancy fees to be charged by implementation agents, breakdown by services/project deliverables should be provided in the applications. With the introduction of this requirement, for projects approved in or after January 2014, OSP grantees were also required to provide breakdown by services/project deliverables on the payment of fees to implementation agents as shown in the approved budget in the audited accounts or final reports.

3.10 The OSP Secretariat also informed Audit that it had updated its Operation Manual in January 2016 (see Note 13 to para. 3.3) to clearly set out the current procedures for vetting budget. In gist, Secretariat staff make reference to approved projects of similar nature and deliverables when assessing project budgets, including consultancy fees of implementation agents. Secretariat staff were also required to document in the case files justifications and reference details. To facilitate the vetting process, the OSP Secretariat would develop a database to record the approved budget of individual cost items of approved projects.

3.11 Audit considers that the OSP Secretariat needs to ensure that its staff are fully acquainted with and comply with the new requirements. It should ensure that the applicants provide sufficient details on consultancy fees charged by the implementation agents to facilitate the assessment of the reasonableness of the fees. It should also require the grantees to provide supporting documents to substantiate the payments of fees to implementation agents.

Audit recommendations

3.12 **Audit has recommended that the Secretary for Commerce and Economic Development and the Director-General of Trade and Industry should step up control over the payment of fees to implementation agents, including:**

- (a) **ensuring that the staff of the OSP Secretariat are fully acquainted with and comply with the requirements on monitoring the consultancy fees of implementation agents;**
- (b) **ensuring that OSP applicants provide sufficient details on consultancy fees charged by implementation agents (e.g. cost breakdown and services provided) to facilitate the assessment of the reasonableness of the fees; and**
- (c) **requiring OSP grantees to provide detailed supporting documents to substantiate the payments of consultancy fees to implementation agents.**

Response from the Government

3.13 The Secretary for Commerce and Economic Development and the Director-General of Trade and Industry agree with the audit recommendations.

In-kind contribution

3.14 The maximum amount of grant for each approved OSP project is \$5 million, or 90% of the total expenditure, whichever is less. The successful applicant is required to contribute the remaining balance of the total project expenditure, which may be in cash (hereinafter referred to as “cash contribution”) or in-kind (hereinafter referred to as “in-kind contribution”), by himself or in the form of sponsorship from any third parties other than the Government.

3.15 Audit analysed the contribution made by the grantees of the 45 projects approved up to 31 October 2015 (see para. 3.3) and noted that the total contribution of \$16.8 million from the grantees and third parties comprised \$6 million (36%) cash contribution and \$10.8 million (64%) in-kind contribution (e.g. venues for holding seminars or workshops, advertisements and souvenirs for the activities). Details are shown in Table 12.

Table 12

**Cash and in-kind contributions of 45 approved OSP projects
(31 October 2015)**

Provider	Cash contribution (\$ million)	In-kind contribution (\$ million)	Total (\$ million)
Grantee	5.4	2.2	7.6
Third parties	0.6	8.6	9.2
Total	6.0 (36%)	10.8 (64%)	16.8 (100%)

Source: Audit analysis of TID records

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3.16 The OSP Secretariat requires the grantee to provide a letter listing out the nature and the amount of in-kind contribution (regardless of whether it is provided by the grantee or by third parties) as documentary proof. Audit noted that, apart from this requirement, the grantee does not need to provide other supporting documents, such as price lists or quotations, to support the valuation of the in-kind contribution. The OSP Operation Manual also does not contain guidelines on assessing the value of in-kind contribution or require the grantee to provide details of the usage of the in-kind contribution.

3.17 Of the 10 projects selected by Audit (see para. 3.3), six had in-kind contribution, with amounts ranged from \$91,100 to \$440,000. For four of the six projects, the grantees' contributions were all in the form of in-kind contribution. For the remaining two projects, in-kind contributions were 73% and 90% of the total contribution respectively. Audit noted that for these six projects, the OSP Secretariat and the Treasury Team had not raised queries on the value of in-kind contributions or required the grantees to provide documentary proof of the value. Case 1 is an example.

Case 1

1. Project A was a one-year project commenced in 2013. The project deliverables included the setting up of showrooms in the Mainland and organising workshops and seminars to interact with buyers, retailers and customers. The total expenditure was some \$2 million. According to the project agreement, the grantee had to contribute 10% of the total expenditure.

2. The grantee submitted to the OSP Secretariat two letters issued by two companies as documentary proof of in-kind contribution. These two letters stated that there were an in-kind sponsorship for the set up of venue in the Mainland, and an in-kind sponsorship for marketing promotion materials (souvenirs). According to the grantee, the total value of the two in-kind sponsorships was some \$200,000. There were no further details about the sponsorship. The OSP Secretariat accepted these letters as grantee's 10% contribution to the project without any queries on the valuation. There were also no queries to confirm that the sponsorship had actually been spent upon project completion.

Audit comments

3. The OSP Secretariat should take necessary action to verify the claimed value of sponsorship by requiring the grantee to provide documents such as quotations and price lists of the sponsored items and compare them with similar items in the market to ensure that the value of the in-kind sponsorship was reasonable and not overstated. The OSP Secretariat should also check the receipts or invoices to ensure that the sponsorship items had actually been used for the project.

Source: Audit analysis of TID records

3.18 The OSP Secretariat informed Audit in January 2016 that it had updated the Operation Manual (see Note 13 to para. 3.3) requiring applicants to produce supporting documents (such as price lists and quotations) demonstrating that the quoted value of the in-kind contribution did not exceed the market price. Its staff are also required to verify the value of the in-kind contribution. The OSP Secretariat needs to ensure that applicants furnish sufficient and reliable documentary proof on the valuation of in-kind contribution. It should also ensure that its staff conduct verification and document the results of verification. The OSP Secretariat should also require the grantees to submit documentary proof on the usage of in-kind contribution upon project completion.

Audit recommendations

3.19 **Audit has recommended that the Secretary for Commerce and Economic Development and the Director-General of Trade and Industry should tighten control on in-kind contribution, including:**

- (a) **ensuring that OSP applicants furnish sufficient and reliable documentary proof on the valuation of in-kind contribution;**
- (b) **ensuring that the staff of OSP Secretariat conduct verification and document the results of verification; and**
- (c) **requiring OSP grantees to submit documentary proof on the usage of in-kind contribution for projects.**

Response from the Government

3.20 The Secretary for Commerce and Economic Development and the Director-General of Trade and Industry agree with the audit recommendations. The Director-General of Trade and Industry has said that:

- (a) the updated Operation Manual in January 2016 has set out the procedures for verifying the value of the in-kind contribution before project commencement, including for in-kind contribution to be provided by the grantee direct, proof from the grantee is required to demonstrate that the quoted value of the in-kind contribution does not exceed its market price.

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For in-kind contribution to be provided through sponsorship engaged by the grantee, in addition to the sponsorship letter issued by the sponsor, the grantee has to ensure that the quoted value of the sponsorship is in line with the market price and not inflated. Supporting documents such as price list, quotations, etc. should be obtained by the grantee to support the value of the in-kind contribution. The above requirements apply to all OSP projects approved after January 2016; and

- (b) in the light of the audit recommendations, the OSP Secretariat will request grantees to submit documentary proof on the usage of in-kind contribution for the projects and will add this requirement to the Operation Manual.

Monitoring of project progress

3.21 The OSP Secretariat monitors project progress mainly by reviewing the reports and audited accounts submitted by the grantees, clarifying ambiguities, raising queries and conducting site visits for events held in Hong Kong. Site visits were conducted for 7 of the 11 completed projects with events held in Hong Kong.

3.22 Among the 10 projects selected by Audit, site visits were conducted for 5 of the 7 projects involving events held in Hong Kong. Audit noted that during these site visits, Secretariat staff attended the events (such as seminars, workshops and exhibitions) to observe the conduct of project activities. This site visit was different from the on-site checking practice of ESP projects of which the offices/premises of the grantees were visited. During on-site checking of ESP projects, staff of ESP Secretariat would check the recruitment records, procurement records and expenditure, etc. The purposes of on-site checking are to verify the project progress and results, and compliance with project agreement and guidelines.

3.23 Audit examined 3 of the 10 projects selected by Audit for their compliance with the project agreements and guidelines. The following irregularities were found in 2 projects (Project B and Project C):

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- (a) staff recruitment requirements were not followed (paras. 3.24 and 3.25); and
- (b) non-allowable costs were charged to project account (paras. 3.26 to 3.28).

Staff recruitment requirements not followed

3.24 According to the OSP guidelines, grantees should observe the principles of openness, fairness and competitiveness when recruiting staff to carry out OSP projects. The OSP guidelines require the grantee to, among others, widely advertise job vacancies in local newspapers and/or other channels, and properly document the recruitment records (e.g. assessment of candidates and recommendations of recruitment panel members).

3.25 Audit noted that for Project B and Project C:

- (a) job vacancy advertisements were only placed on the grantees' websites and not widely advertised (say, in local newspapers); and
- (b) contrary to the requirement of the project agreement of keeping relevant records for seven years, for Project B, the recruitment records could not be obtained by the OSP Secretariat from the grantee for Audit's examination. For Project C, in response to the Treasury Team's enquiry in May 2014 on the retention of recruitment records, the grantee said that the recruitment records (except for the successful candidates) had been destroyed in early 2014, some twelve months after the completion of the recruitment exercise in early 2013.

Non-allowable costs charged to project account

3.26 According to the OSP guidelines, only the salary of the additional manpower directly incurred for the project will be funded. Overhead expenses (such as utility expenses), entertainment expenses and other administration costs were non-allowable.

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3.27 Audit noted that for Project B:

- (a) \$349,000 was approved for employing one Project Officer and two part-time Executive Officers as additional manpower. However, instead of employing two part-time Executive Officers, the Project Co-ordinator and Deputy Project Co-ordinator (both being staff of the grantee) took up the two posts of Executive Officer and charged \$87,000 and \$73,000 respectively as manpower cost for the two posts to the project accounts; and
- (b) the above non-allowable cost charged to the project accounts was discovered by the OSP Secretariat in February 2015 (some eight months after the submission of final report and accounts in June 2014). The grantee refunded the non-allowable cost of \$160,000 to the OSP Secretariat in May 2015. The OSP Secretariat considered that the grantee's management of project was below standard.

3.28 The above audit findings indicated that there was a need for OSP Secretariat to step up its monitoring of OSP projects. In this regard, the OSP Secretariat informed Audit in January 2016 that it had updated the OSP Operation Manual (see Note 13 to para. 3.3) to strengthen the controls on projects, including checking on books and records, existence of equipment and compliance with project agreements and guidelines. Audit considers that the OSP Secretariat needs to:

- (a) provide guidelines to its staff covering, among others, the timing for conducting checking and list of items to be checked;
- (b) remind its staff to conduct the checking in a timely manner; and
- (c) remind the grantees of their obligations to comply with project agreements and guidelines, and maintain proper books and records.

Audit recommendations

3.29 **Audit has recommended that the Secretary for Commerce and Economic Development and the Director-General of Trade and Industry should strengthen the monitoring of OSP projects, particularly on the checking of**

books and records and grantees' compliance with project agreements and guidelines, including:

- (a) providing guidelines to the staff of OSP Secretariat on the timing for conducting checking and list of items to be checked;**
- (b) reminding the staff of the OSP Secretariat to conduct the checking in a timely manner; and**
- (c) reminding OSP grantees of their obligations to comply with project agreements and guidelines and maintain proper books and records to facilitate checking.**

Response from the Government

3.30 The Secretary for Commerce and Economic Development and the Director-General of Trade and Industry agree with the audit recommendations. The Director-General of Trade and Industry has said that:

- (a) since the commencement of the OSP, grantees are informed through a briefing before the commencement of the project to observe, among others, the requirement of keeping books and records in a proper manner and that the books and records are subject to inspection by TID staff and other government officers. The updated Operation Manual in January 2016 has included the principles of checking of books and records; and
- (b) in the light of the audit recommendations, the Operation Manual will be further updated to include all the checking procedures to be performed by TID staff. OSP projects will be selected for checking of books and records based on a risk assessment approach. For the selected projects, TID will conduct site inspection to check books and records within six months after receipt of all reports and audited accounts. Moreover, the OSP Secretariat will include in the briefing before project commencement, correspondences/notifications to grantees (such as the letters attaching the project agreements and reminders to be issued before project completion, etc.) and a reminder of the requirement to keep proper books and records for an appropriate length of time.

Submission of reports

3.31 To facilitate the monitoring and evaluation of projects, grantees are required to submit progress reports, final reports and associated audited accounts to the OSP Secretariat as follows:

- (a) for projects not exceeding \$1 million and implementation period not exceeding one year, the grant will be disbursed in one lump-sum in advance. The grantee has to submit the final report and audited accounts within three months upon completion of project;

- (b) with the exception of projects mentioned in (a) above, for projects with implementation period one year or more but not exceeding two years, the grant will be disbursed in two instalments according to cash flow projection. The first instalment is normally paid within one month after the signing of the project agreement and the grantee has met TID's requirements (e.g. in-kind contribution). Thereafter, the grantee has to submit:
 - (i) the progress report together with audited accounts two months before the second instalment of payment; and
 - (ii) the final report together with final audited accounts within three months upon completion of the project; and

- (c) for projects with implementation period two years or more and up to three years, the grant will be disbursed in three instalments according to cash flow projection. The first instalment is normally paid within one month after the signing of the project agreement and the grantee has met TID's requirements (e.g. in-kind contribution). Thereafter, the grantee has to submit:
 - (i) the first progress report together with audited accounts two months before the second instalment of payment;
 - (ii) the second progress report together with audited accounts two months before the third instalment of payment; and

- (iii) the final report together with final audited accounts within three months upon completion of the project.

3.32 According to the OSP Secretariat, subject officers are required to issue reminders to grantees before the due date of submission, and warning letters to grantees if the submission is delayed. Termination of project/initiation of legal action for recouping grant will be considered for exceptionally long delays.

3.33 Audit examined the 10 projects (see para. 3.3) to ascertain the grantees' compliance with the submission requirements and found that 7 (70%) of the 10 projects had delays in the submission of reports or the associated audited accounts. The delays ranged from 7 days to 2 months for six projects, and was 4.8 months for the remaining one.

3.34 In Audit's view, the OSP Secretariat needs to continue its monitoring work and, where necessary, remind the grantees of their obligations to submit reports in a timely manner.

Audit recommendation

3.35 **Audit has *recommended* that the Secretary for Commerce and Economic Development and the Director-General of Trade and Industry should continue monitoring the submission of reports by OSP grantees and where necessary, remind them of their obligations in this regard.**

Response from the Government

3.36 The Secretary for Commerce and Economic Development and the Director-General of Trade and Industry agree with the audit recommendation. The Director-General of Trade and Industry has said that:

- (a) the OSP Secretariat has already put in place a mechanism for monitoring the submission of reports and return of residual funds by grantees. Details of the mechanism are set out in the Operation Manual. Since the commencement of the OSP, the OSP Secretariat has written to grantees

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before project completion to remind them of the need to submit reports and return residual funds. Follow up chasers will be issued in case of late submissions at designated intervals by staff pitched at different rankings depending on the magnitude of the delays. Payments to grantees will only be made upon the acceptance of reports with audited accounts by the Vetting Committee; and

- (b) in the light of the audit recommendations, the OSP Secretariat will take into account the timing of submission of reports and return of residual funds by grantees when giving the overall grading of projects for Vetting Committee's endorsement. The grading will also be reflected to the Vetting Committee when the grantee's future OSP applications are considered.

Dissemination of project results and deliverables

3.37 Under the project agreements, the grantees are required to share the project results and deliverables widely with the industry. In addition, the OSP Secretariat also posts the final reports (after endorsement by the Vetting Committee) and project deliverables (e.g. results of an information technology industry survey, a home appliances safety and selection guide, project website on software business promotion, materials for experience sharing of a lighting fair) onto the OSP website. Audit reviewed the information posted on the OSP website and noted that, as at late January 2016, of the 15 completed projects (see para. 3.3):

- (a) for 1 project, there was no information on the website; and
- (b) for the remaining 14 projects, while the final reports of 8 projects had been endorsed by the Vetting Committee, only 2 final reports were posted.

3.38 Audit also noted that the latest website review date was March 2015. The OSP Secretariat needs to ensure that updated and complete project information, including final reports and project deliverables, was posted onto the OSP website in a timely manner.

Audit recommendation

3.39 Audit has *recommended* that the Secretary for Commerce and Economic Development and the Director-General of Trade and Industry should ensure that all OSP project results and deliverables are posted onto the OSP website in a timely manner.

Response from the Government

3.40 The Secretary for Commerce and Economic Development and the Director-General of Trade and Industry agree with the audit recommendation. The Director-General of Trade and Industry has said that it is the OSP Secretariat's existing practice to upload project information (including deliverables and final reports endorsed by the Vetting Committee) onto the OSP website quarterly. To ensure compliance, the Secretariat is reviewing and considering enhancements to the mechanism, including cross-checking and computer generated reminders to prompt staff to take necessary action. It has already updated all available project information on the OSP website.

PART 4: MANAGEMENT OF ENTERPRISE SUPPORT PROGRAMME PROJECTS

4.1 This PART examines the management of ESP projects. Audit has found scope for improvement in the following areas:

- (a) vetting of projects (paras. 4.3 to 4.10);
- (b) monitoring of project progress (paras. 4.11 to 4.21);
- (c) termination of projects (paras. 4.22 to 4.26); and
- (d) performance reporting (paras. 4.27 to 4.33).

Work of the ESP Secretariat

4.2 Services provided by the Secretariat in administering the ESP include:

- (a) ***Application processing.*** The work includes providing consultation sessions to individual applicants, vetting application forms and obtaining supplementary information or clarifications from applicants, assessing applications and compiling assessment reports, and consolidating the IDC's recommendations for submission to the PMC. After vetting by the PMC, the ESP Secretariat would arrange for briefing and signing of agreement with successful applicants and follow up with applicants on the prescribed conditions for approved-with-conditions applications. It would also explain to unsuccessful applicants the reasons for rejection and provide guidance on how to revise and resubmit applications if needed;
- (b) ***Project monitoring.*** The work includes handling change requests, monitoring the submission status of and considering progress/final reports submitted by grantees, conducting on-site checking and providing consultation to grantees to facilitate them to submit progress/final reports, compiling assessment summaries on the progress/final reports, consolidating the IDC's recommendations for submission to the PMC, and arranging fund disbursements to grantees; and

- (c) *Promotion and publicity activities.* The work includes organising seminars and symposia, publishing guidebooks and producing videos for disseminating success stories, and providing enquiry support.

Vetting of projects

4.3 Applications for the ESP are accepted all the year round, and are processed by four batches each year with the closing dates set at the end of March, June, September and December. Applications received are initially assessed by the ESP Secretariat and the IDC, and then considered by the PMC, which advises the Government to approve or reject the applications.

4.4 The PMC meets once every three months (usually near the end of a quarter) to consider the applications. Taking into account the lead time required for the ESP Secretariat to perform initial vetting, applications received in a particular quarter would be considered by the PMC in the next quarter. Although about 90% of the applications were submitted a few days before the closing date, it could take as long as six months (for applications submitted at the start of a quarter and approved near the end of the next quarter) before an application is approved.

4.5 After an application is approved, the ESP Secretariat proceeds to sign the project agreement with the applicant. The agreement specifies the timeframe for conducting the project, including the project commencement date. Expenses incurred before project commencement will not be funded under the ESP.

Long time taken for project commencement

4.6 A project cannot be commenced until the project agreement was signed. Project expenses incurred before the signing of the project agreement are not funded. Audit's analysis indicated that in addition to the some three to six months taken for project approval (see para. 4.4), it usually takes, on average, another one to three months for projects approved without conditions attached, or four to seven months for projects approved with conditions attached, to the signing of the agreement for project commencement.

Management of Enterprise Support Programme projects

4.7 As at October 2015, the PMC had approved 349 projects with total funding of \$157 million (Batch 1 to Batch 13), of which 80 had been completed (see Appendix D for some examples). In addition to these 349 projects, the applications for 41 projects with total funding of \$18 million had also been approved by the PMC but were withdrawn before the signing of project agreements. Audit analysed the reasons of withdrawal and noted that the withdrawal of 15 (37%) of these 41 projects were due to changes of market conditions or business directions (Note 14). It indicated that the long time taken for project commencement might have affected the business viability of some projects which in turn led to their withdrawal. The ESP Secretariat needs to monitor the situation and work with the grantees with a view to finding out assistance that could be provided to the grantees to expedite the signing of project agreements so that projects can be commenced as soon as possible.

4.8 Audit noted that, to provide timely support to enterprises, for application made through the ESP Easy (see para. 2.11), all relevant expenditure incurred after the date of submission of application can be recognised and funded, provided that the application is subsequently approved by the PMC. The ESP Secretariat should consider whether it is feasible to adopt similar practice for applications not submitted through the ESP Easy.

Audit recommendations

4.9 **Audit has recommended that the Secretary for Commerce and Economic Development and the Director-General of Trade and Industry should, in collaboration with the Executive Director, Hong Kong Productivity Council:**

- (a) **monitor the time taken for commencement of ESP projects;**

Note 14: *For the other 26 projects, the reasons for the withdrawal of 23 projects include: (a) applicants' internal issues; (b) lack of resources or manpower to complete the project; and (c) failure to meet the compliance requirements of project monitoring. The reasons for the remaining 3 projects were not known because there was no response from the applicants.*

- (b) **provide assistance to ESP grantees with a view to expediting project commencement; and**
- (c) **consider whether it is feasible to adopt the practice of ESP Easy of funding expenditure of approved projects incurred after the application submission date, instead of the date of signing project agreement, for all ESP projects.**

Response from the Government

4.10 The Secretary for Commerce and Economic Development and the Director-General of Trade and Industry, with the support of the Executive Director, Hong Kong Productivity Council, generally agree with the audit recommendations. The Secretary for Commerce and Economic Development has said that:

- (a) in general, the ESP Secretariat would contact applicants and make arrangements with grantees on signing of funding agreements as soon as the PMC has approved the applications and other post-approval procedures have been completed. In some cases, however, more time may be taken to arrange for signing the funding agreements because of the long time taken by the grantees to address conditions of approval, to open dedicated project accounts, or to produce proof of having made upfront funding payment to the projects on a matching basis, etc. In the light of the above, the process of arranging signing of funding agreements for ESP Easy projects has been streamlined such that grantees need not open dedicated project accounts as no initial disbursement of funds will be made to the grantees. The ESP Secretariat would continue to closely monitor the situation; and
- (b) the ESP Easy was introduced with a view to simplifying application procedures under which the funding scopes of projects are confined to a number of specified measures. Recognising that no initial disbursement of project funding is made to a grantee, it would be prudent to recognise expenditure incurred after the application submission provided that the application is subsequently approved by the PMC. For conventional ESP projects, the scope and complexities of the applications can be very varied. It may not be appropriate to fund expenditure incurred after application date and before the application is subsequently approved. Notwithstanding this, the CEDB, the TID and the ESP Secretariat will carefully review the matter, and consult the PMC accordingly.

Monitoring of project progress

Need to enhance the quality of progress reports and final reports

4.11 To facilitate the monitoring and evaluation of approved projects, grantees are required to submit reports to the ESP Secretariat for review. Depending on the project duration, the arrangement for the submission of reports as well as the audited accounts (Note 15) is as follows:

- (a) for projects with duration of 12 months or below, the grantee is required to submit a final report together with the final audited accounts within two months upon project completion; and
- (b) for projects with duration of more than 12 months and up to 24 months, the grantee is required to submit:
 - (i) a progress report every six months within one month after the relevant six-month period;
 - (ii) audited accounts for the first 12 months within one month after the relevant 12-month period; and
 - (iii) a final report together with the final audited accounts within two months upon project completion.

Initial funds (25% of approved funding) are paid to the grantee after the signing of the agreement and the grantee has produced evidence showing due contribution of funds on a matching basis. Mid-term payment on a reimbursement basis is made to the grantee only if the duration of the project is over 18 months.

Note 15: *Each progress/final report should include information such as any work and deliverables that have been completed and a statement of income and expenditure of the project for the reporting period.*

Management of Enterprise Support Programme projects

4.12 The ESP Secretariat will review the project progress and evaluate the project results by comparing the project progress/deliverables reported in the progress/final reports against its original objectives, implementation plan and deliverables stated in the project application. All progress reports and final reports will be submitted to the IDC and the PMC for consideration and the Government for endorsement. Mid-term payment and final payment to the grantee on a reimbursement basis will only be made when the progress/final reports and the audited accounts are accepted by the PMC and the Government.

4.13 Audit selected 20 completed projects (involving 11 progress reports and 20 final reports) to examine the timeliness of the submission of reports. Audit noted that:

- (a) 9 (82%) of the 11 progress reports and all the 20 final reports required resubmissions (Note 16);
- (b) based on the first submissions, 8 (73%) of the 11 progress reports and 5 (25%) of the 20 final reports were submitted late. The delay of submission of progress reports ranged from 4 days to 5.4 months, averaging 1.9 months, and the delay for final reports ranged from 7 days to 1.5 months, averaging 0.6 month; and
- (c) based on the final submissions, all 11 progress reports and 17 (85%) of the 20 final reports were submitted late. The delay of submission of progress reports ranged from 4 days to 14.3 months, averaging 6.1 months, and the delay for final reports ranged from 6 days to 4.5 months, averaging 2.1 months (see Table 13).

Note 16: *For the 9 progress reports which required resubmissions, all submitted twice. Of the 20 final reports which required resubmissions, 19 submitted twice and 1 submitted thrice.*

Management of Enterprise Support Programme projects

Table 13

**Timeliness of submission of progress and final reports
(based on final submissions)**

Delay	Progress report		Final report	
	Number	Percentage	Number	Percentage
No delay	0	0%	3	15%
≤ 1 month	2	18%	6	30%
> 1 month to 3 months	0	0%	7	35%
> 3 months to 6 months	3	27%	4	20%
> 6 months to 9 months	4	37%	0	0%
> 9 months to 12 months	1	9%	0	0%
> 12 months to 15 months	1	9%	0	0%
Total	11	100%	20	100%

Source: Audit analysis of HKPC records

4.14 According to the ESP Secretariat, for most of the projects, the grantees did not have enough manpower and experience to prepare the progress reports and final reports, and they needed much support from the ESP Secretariat in compiling the reports. Very often, the ESP Secretariat had to take substantial time to seek clarifications or supplementary information and supporting documents from the grantees.

4.15 In Audit's view, large number of reports requiring resubmission not only increase the administrative workload of both the ESP Secretariat and grantees, but also delay payments to grantees because funds will only be disbursed when the reports are accepted by the PMC and the Government. Moreover, resubmission of progress report and the resulting delay of its submission may affect the efficiency of the ESP Secretariat's and the PMC's project monitoring work (see Case 2 for illustration). The ESP Secretariat needs to take measures (such as issuing detailed guidelines and organising workshops) to facilitate the grantees in the submission of reports and to streamline the process.

Case 2

1. Project D was approved by the PMC in December 2012 with an approved funding of \$500,000, representing the maximum of 50% of the total approved project cost. The agreement was signed in January 2013. The project commenced in January 2013 and an amount of \$125,000 (or 25% of the approved funding) was disbursed in May 2013. The project was completed in July 2014 (i.e. the project duration was 18 months). The grantee was required to submit progress reports by end of August 2013 and February 2014 and a final report by end of September 2014. The reports were submitted on time, except for the second progress report which was submitted in mid-August 2014 (some six month's delay).

2. The ESP Secretariat required the grantee to resubmit once for each of the reports (i.e. the first progress report, second progress report and final report). All the reports were resubmitted in mid-November 2014, despite the ESP Secretariat had urged the grantee for the earlier resubmission of the first and second progress reports. As such, submission of the first progress report, second progress report and final report were delayed by 14.3 months, 8.5 months and 1.5 months respectively.

3. The three reports were approved by the PMC in March 2015 and the final payment of \$375,000 was disbursed to the grantee in May 2015.

Audit comments

4. The ESP Secretariat had to process three extra submissions by the grantee. It is also difficult for the ESP Secretariat to monitor the project progress because the resubmitted first and second progress reports were submitted together with the final report on the same date. As a result of the late submission of the final report, the final payment was made some ten months after project completion.

Source: Audit analysis of HKPC records

Need to provide more guidelines for on-site checking

4.16 The ESP Secretariat conducts on-site checking to verify the project progress and results, and compliance with project agreement and guidelines by the grantee, such as in the procurement of goods and services. It will follow up with the enterprises on anomalies identified during the checking. The ESP Secretariat will report the findings and result of follow-up actions and/or make recommendations on the required follow-up actions to the IDC or the PMC.

4.17 According to the ESP Secretariat's Operation Manual, a senior manager decides whether or not on-site checking should be conducted for a project, taking into account the following:

- (a) complexity/innovation and scale of the project implemented;
- (b) quality of the progress reports and final report submitted;
- (c) deviation of the project work and/or result from the project proposal approved by the PMC;
- (d) changes of the project under implementation; and
- (e) past performance of the service provider/applicant, if any, in delivering the approved project.

4.18 The Operation Manual does not stipulate the coverage and timing of conducting on-site checking. In this regard, Audit noted that:

- (a) of the 80 projects completed as at October 2015, on-site checking was not conducted for 12 (15%) projects, including 3 Type (i) projects (Note 17). There was no documentation on the reasons why on-site checking was not conducted for these 12 projects; and

Note 17: *There are two types of projects under the ESP. Type (i) project involves the engagement of service providers by the applicant to develop a holistic business plan in the areas of branding, upgrading and restructuring and/or domestic sales. Type (ii) project, which has to be supported by a holistic business plan in the areas of branding, upgrading and restructuring and/or domestic sales, involves the implementation of specific measures. Of the 349 approved ESP projects, 4 were Type (i) projects.*

- (b) there were different practices in the timing of conducting on-site checking. Of the 124 on-site checking conducted, 62 (50%) were conducted when the projects were in-progress, and 62 (50%) were conducted between project completion and fund disbursement (46 within three months after project completion and 16 between three to eleven months after project completion).

4.19 Audit considers that the ESP Secretariat needs to provide more specific instructions to its staff for conducting on-site checking, such as when to conduct the checking, and if no checking is needed, document the reasons and seek approval from a senior manager (see para. 4.17).

Audit recommendations

4.20 **Audit has *recommended* that the Secretary for Commerce and Economic Development and the Director-General of Trade and Industry should, in collaboration with the Executive Director, Hong Kong Productivity Council:**

- (a) **take measures to facilitate ESP grantees in the submission of reports with a view to improving the monitoring process; and**
- (b) **provide to the staff of the ESP Secretariat more specific instructions for conducting on-site checking.**

Response from the Government

4.21 The Secretary for Commerce and Economic Development and the Director-General of Trade and Industry, with the support of the Executive Director, Hong Kong Productivity Council, generally agree with the audit recommendations. The Secretary for Commerce and Economic Development has said that:

Management of Enterprise Support Programme projects

- (a) the ESP Secretariat has taken various measures to facilitate quality submissions of progress reports and final reports, such as briefing the grantees when signing agreements, holding one-to-one consultation sessions for report writing, launching sharing sessions, providing mock-up report templates and conducting on-site checking, etc.; and
- (b) the ESP Secretariat has drawn up a standard template for use during on-site checking since March 2013. In February 2016, the ESP Secretariat enhanced the template such that more specific instructions are given to ESP Secretariat staff on the checking they are to perform. The enhancements included better standardisation in assessment and more detailed lists of items to be checked, etc.

Termination of projects

4.22 According to the project agreement, the ESP Secretariat may at any time on the occurrence of specific events (Note 18) terminate the agreement with immediate effect by giving written notice to the grantee.

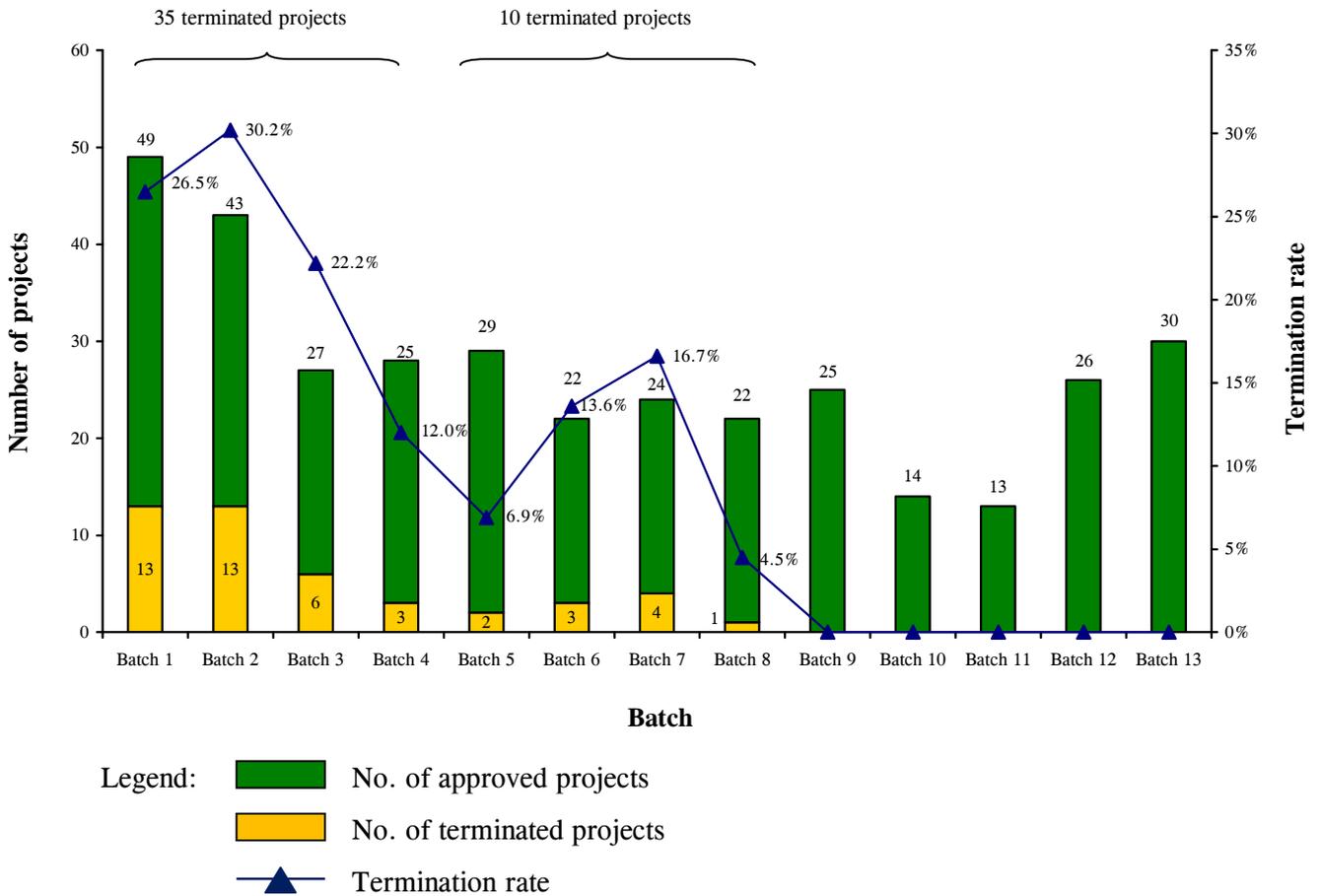
4.23 As of October 2015, 45 (13%) of the 349 approved projects were terminated before completion (Note 19). Audit's analysis of the terminated projects by batch indicated that the termination rates (i.e. number of terminated projects ÷ number of approved projects × 100%) were higher in earlier batches (see Figure 3).

Note 18: *Examples of specific events include: (a) the grantee failed to comply with any terms, conditions or undertakings in the project agreement and the grantee failed to remedy the breach to the satisfaction of the ESP Secretariat within a stipulated time; and (b) the grantee had abandoned the project agreement.*

Note 19: *According to the ESP Secretariat, there were various reasons for project termination, for example: (a) staff turnover or shortage of resources; (b) change in market conditions; (c) lack of project progress; and (d) repeated failure to submit reports.*

Figure 3

Approved projects subsequently terminated
(October 2015)



Source: Audit analysis of HKPC records

4.24 As time progresses, more projects may become unsuccessful, hence the overall termination rate may also increase. The ESP Secretariat needs to closely monitor the situation and consider conducting a review on the terminated projects with a view to identifying ways to minimise the termination rate as far as possible.

Audit recommendations

4.25 Audit has *recommended* that the Secretary for Commerce and Economic Development and the Director-General of Trade and Industry should, in collaboration with the Executive Director, Hong Kong Productivity Council:

- (a) closely monitor the termination rate of ESP projects; and
- (b) consider conducting a review on the terminated projects with a view to identifying ways to minimise the termination rate as far as possible.

Response from the Government

4.26 The Secretary for Commerce and Economic Development and the Director-General of Trade and Industry, with the support of the Executive Director, Hong Kong Productivity Council, generally agree with the audit recommendations. The Secretary for Commerce and Economic Development has said that the CEDB, the TID and the ESP Secretariat have all along been closely monitoring the termination rate of ESP projects and will continue to do so.

Performance reporting

Need to improve response rate of survey

4.27 The ESP Secretariat posts videos of experience-sharing symposia and success cases, and a case-sharing guidebook onto the ESP website. The ESP Secretariat also conducts surveys with grantees upon project completion (completion survey). The survey would, inter alia, seek information/views on whether the measures in the project could enhance the grantee's competitiveness and development in the Mainland market, whether the grantee has employed/would employ additional staff in Hong Kong during/after the project, and whether the implementation of the project has benefitted other sectors of Hong Kong, etc.

4.28 In addition to the completion survey, with effective from August 2015, the ESP Secretariat has started a tracking survey with the grantees one year after project completion to enable the ESP Secretariat to evaluate the effectiveness of the ESP over a longer timeframe. The tracking survey asks the grantees, among others, whether they would continue their measures in branding, upgrading and restructuring, and domestic sales in the Mainland and whether additional staff had been employed.

4.29 Response to both the completion survey and the tracking survey were not mandatory. As of November 2015, of the 80 completed projects, 70 (88%) responded to the completion survey. However, only 11 projects (33%) out of 33 completed projects responded to the tracking survey. As the data collected from the surveys would help the ESP Secretariat assesses the effectiveness of the ESP, the ESP Secretariat should consider devising measures to encourage grantees to respond to the surveys (e.g. including such requirement in the project agreements or guidelines).

Need to improve evaluation of programme effectiveness

4.30 To facilitate the PMC to evaluate the effectiveness of the ESP, the ESP Secretariat stated in the AIPs of 2013-14 to 2015-16 that the following statistics would be included in the annual reports (see para. 2.24):

- (a) the types and number of brands, products and/or services developed/customised for exploring the Mainland market;
- (b) the type of advanced technologies and management systems adopted for enhancing the competitiveness of the enterprises, its product and/or services in the Mainland;
- (c) the effective promotion and sales channels established for promoting brand awareness and/or domestic sales in the Mainland;
- (d) how the projects have helped the enterprises better their business development in the Mainland;

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- (e) employment opportunities created in Hong Kong for implementing the approved projects and after project completion; and
- (f) the products/services of other Hong Kong enterprises that have been used/engaged by the funded enterprises in implementing the approved projects.

4.31 Audit noted that, while the information needed to compile the above statistics appears to be readily available in the surveys as well as the progress and final reports submitted by the grantees, only the number of employment opportunities created in Hong Kong (item (e) above) was reported (Note 20) in the annual reports. The ESP Secretariat needs to include all the statistics in its annual reports. Moreover, to increase transparency and for performance reporting, the ESP Secretariat should consider publishing these statistics on the ESP website (see para. 2.20).

Audit recommendations

4.32 **Audit has *recommended* that the Secretary for Commerce and Economic Development and the Director-General of Trade and Industry should, in collaboration with the Executive Director, Hong Kong Productivity Council:**

- (a) **consider devising measures to encourage ESP grantees to respond to the completion survey and tracking survey of projects; and**
- (b) **report in the annual reports of the ESP all the statistics stated in the AIPs and consider publishing these statistics on the ESP website.**

Note 20: *In the 2013-14 and 2014-15 annual reports, the ESP Secretariat reported that 6 job opportunities would be created by the grantees in 2013-14 and 17 in 2014-15 after the completion of the projects.*

Response from the Government

4.33 The Secretary for Commerce and Economic Development and the Director-General of Trade and Industry, with the support of the Executive Director, Hong Kong Productivity Council, generally agree with the audit recommendations. The Secretary for Commerce and Economic Development has said that:

- (a) the CEDB recognises that completion survey and tracking survey are useful for assessing the effectiveness of the ESP and the feedback received so far is encouraging. Grantees generally considered that their projects had helped them in various ways, e.g. enhancing the awareness of their brands, improving product quality, developing new products, establishing new domestic sales channels, enhancing the enterprises' overall competitiveness and increasing the competitive edge of their products, etc. The ESP Secretariat will continue to encourage ESP grantees to respond to the completion and tracking surveys; and

- (b) the ESP Secretariat will report in annual reports and on the ESP website information relating to the effectiveness of the programme before end-June 2016.

PART 5: WAY FORWARD

5.1 This PART examines the way forward of the BUD Fund.

Need to conduct a review on the effectiveness of the BUD Fund

5.2 According to the FC paper of May 2012, the BUD Fund is open for applications for a period of five years, which may be reviewed or extended, if necessary. As at February 2016, the BUD Fund has been in operation for over three years. In response to Audit's enquiry, the CEDB informed Audit in March 2016 that the following initiatives had been implemented to enhance the operation of the BUD Fund:

- (a) for the ESP, the CEDB has specifically:
 - (i) launched the ESP Easy in late August 2015 to address the trade's concern on the application procedures and to provide even more timely support to enterprises;
 - (ii) stepped up the collation and collection of information in respect of the funded projects since June 2015;
 - (iii) conducted an internal review on the operation of the ESP in October 2015 with the relevant enhancement measures being put in place in March 2016; and
 - (iv) held a brainstorming session in December 2015 and put in place enhancements to the ESP in March 2016; and
- (b) for the OSP, the TID had conducted an internal review on the vetting and monitoring procedures of the OSP before this audit review. The internal review was completed in end-October 2015 and improvement measures were incorporated in the latest update of the OSP Operation Manual in January 2016.

5.3 Since its commencement of operation in June 2012, the BUD Fund has provided over \$300 million to support about 400 projects under the OSP and ESP. Some 100 projects have been completed. Audit considers that it is an opportune time for the Government to conduct a comprehensive review of the BUD Fund to assess the performance of the Fund in meeting its objectives, analyse benefits brought by the Fund, identify improvement areas and decide the way forward.

5.4 The Government annually reports the progress of the implementation of the BUD Fund to the Legislative Council's Panel on Commerce and Industry. While the Panel members generally support the implementation of the BUD Fund, they have also asked the Government to conduct a mid-term review on the effectiveness of the BUD Fund and its benefits to the overall economy of Hong Kong. In response, the Government undertook to report to the Panel its assessment on the overall effectiveness of the BUD Fund when more projects were completed.

5.5 Moreover, under the agreement signed between the Government and the HKPC (see para. 2.24), the HKPC has to conduct a mid-term review at a time specified by the Government to evaluate the effectiveness of the ESP and the HKPC's performance and strategy in carrying out its work.

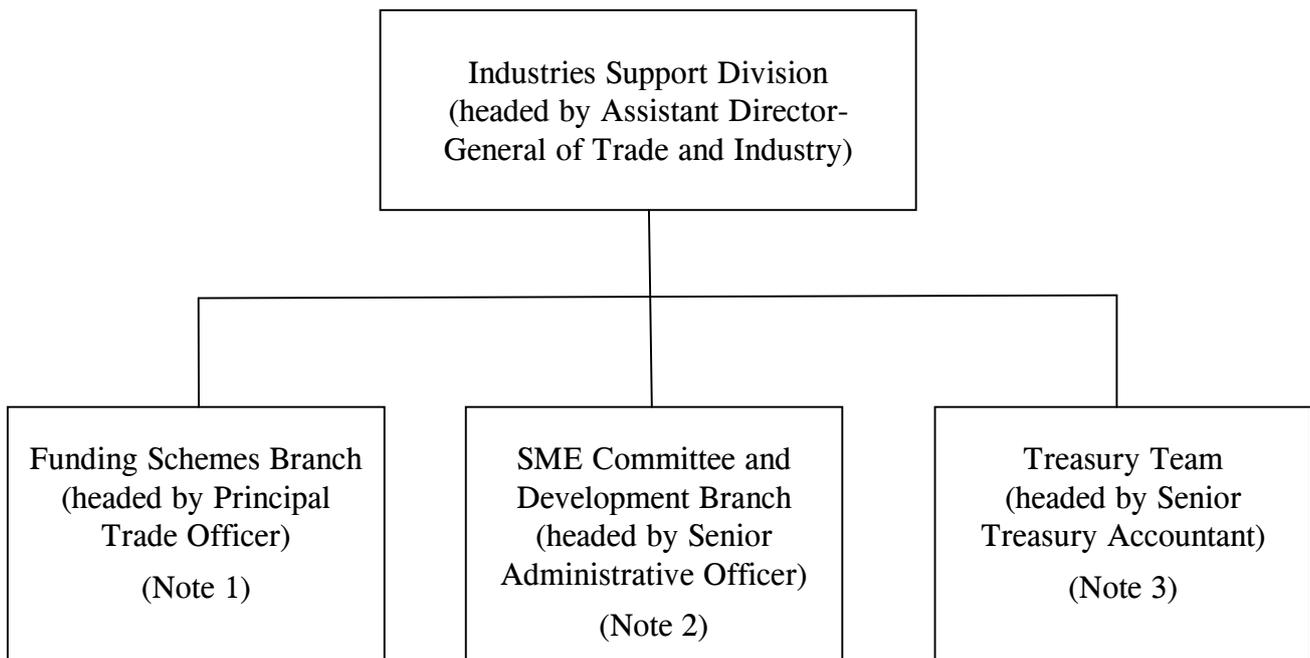
Audit recommendation

5.6 **Audit has *recommended* that the Secretary for Commerce and Economic Development and the Director-General of Trade and Industry should consider conducting a review on the BUD Fund, taking on board the audit findings in this Audit Report.**

Response from the Government

5.7 The Secretary for Commerce and Economic Development and the Director-General of Trade and Industry, with the support of the Executive Director, Hong Kong Productivity Council, generally agree with the audit recommendation. The Secretary for Commerce and Economic Development has said that the CEDB and the TID, with the support of the HKPC, have been reviewing the operation and implementation of the BUD Fund on an ongoing basis, with a view to enhancing its operation. With the benefits of the audit findings in this Audit Report, the Government will continuously review the operation of the BUD Fund on an ongoing basis and implement improvement measures, and will consider further review as appropriate.

Industries Support Division of TID
Organisation chart (extract)
(31 October 2015)



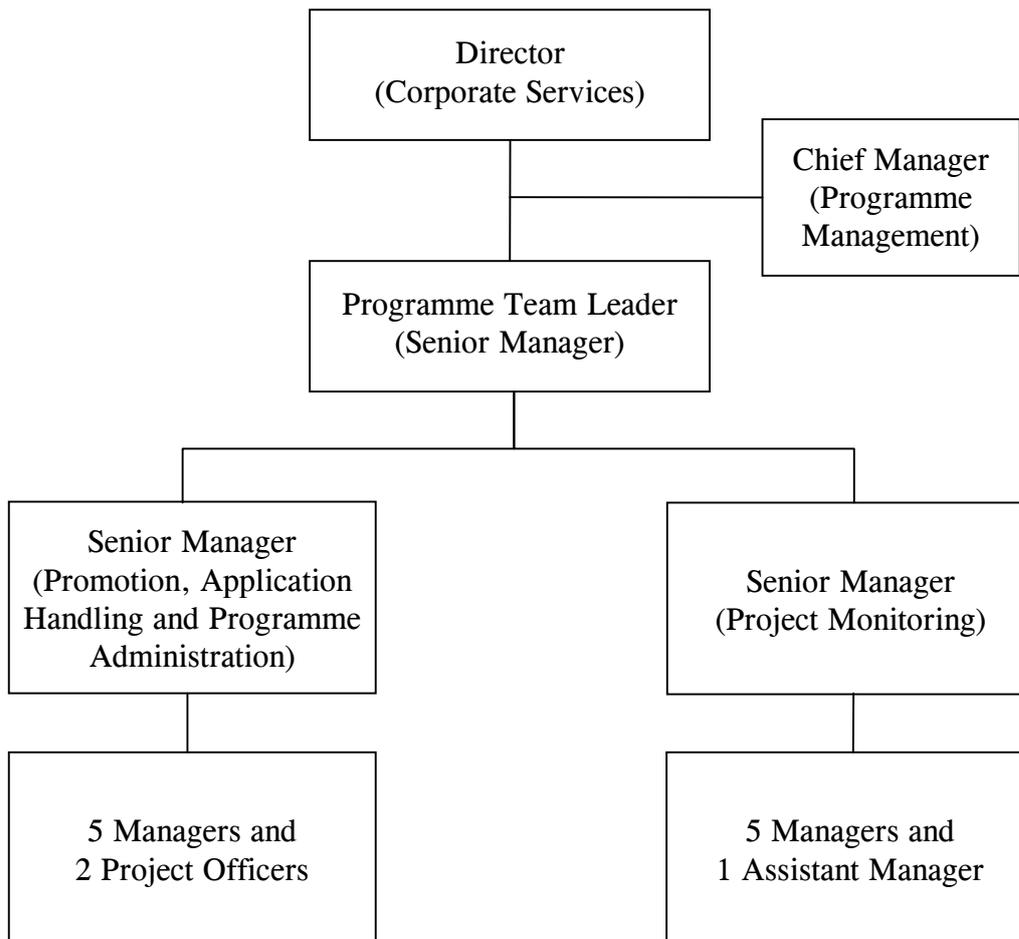
Source: TID records

Note 1: According to the TID, about 11% of the duties of the Branch are related to the ESP.

Note 2: According to the TID, about 38% of the duties of the Branch are related to the OSP.

Note 3: According to the TID, about 6% of the duties of the Team are related to the OSP and ESP.

**ESP Secretariat of HKPC
Organisation chart
(31 October 2015)**



Source: HKPC records

Remarks: The Director (Corporate Services) and the Chief Manager (Programme Management) work on a part-time basis. The Programme Team Leader (Senior Manager) also takes up the work of the Senior Manager (Promotion, Application Handling and Programme Administration).

Examples of completed OSP projects

Project	Project title
1	Hong Kong Logistics Practitioners Upgrading and Branding Program
2	Synergising Hong Kong ICT Hub with Mainland Businesses
3	“Quality Appliances — Hong Kong Appliances” — Building up the image of good quality and safe Hong Kong electrical appliances through a series of promotion activities
4	To establish a distinctive Hong Kong Manufacturers Pavilion in “Jewelry Shanghai” (May 2013) to showcase the image, quality and creativity of Hong Kong jewelry SMEs
5	To lead Hong Kong printing companies in upgrading to “Hong Kong Printing Modelling Enterprises”
6	To promote Hong Kong Automotive Parts and Accessory System Domestic Sales — Assisting Hong Kong Automotive Parts SMEs to enter the Mainland Automotive Market
7	Study of the Supply Chain of Fast Moving Consumer Goods in Guangdong
8	Exploring Mainland Toy Market for Hong Kong Toy Industry through Design, Upgrade and Branding
9	eCommerce for Domestic Sales Training Programme
10	Hong Kong Fashion SMEs in Mainland Stores

Source: TID records

Examples of completed ESP projects

Project	Project title
1	To expand the domestic sales in Mainland China through restructuring and upgrading the sales management process and setting up of new sales functions
2	Temperature Test System Upgrading
3	Supply Chain Improvement project to improve operation efficiency and 3 years business plan to develop Mainland market
4	Fixed Route Transportation Management System
5	Provide integrated services of product design and manufacturing, specialising in Law Enforcement Equipment and Electronic Accessories/Products
6	Agricultural Perishable Healthy Products Shelf Life Extension
7	Create a brand for ACP-6 entering the China market
8	Development of holistic business plan
9	Project X1 — Restructure Branding and Domestic Sales Development
10	Brand building and sales promotion for Mainland market

Source: HKPC records

Acronyms and abbreviations

AIP	Annual implementation plan
Audit	Audit Commission
BUD Fund	Dedicated Fund on Branding, Upgrading and Domestic Sales
CEDB	Commerce and Economic Development Bureau
COR	Controlling Officer's Report
CPPP	Cleaner Production Partnership Programme
ESP	Enterprise Support Programme
FC	Finance Committee
FSTB	Financial Services and the Treasury Bureau
HKPC	Hong Kong Productivity Council
IDC	Inter-departmental Committee
L1	Level 1
L2	Level 2
L3	Level 3
L8	Level 8
OSP	Organisation Support Programme
PMC	Programme Management Committee
SME	Small and medium enterprise
SPRs	Stores and Procurement Regulations
TID	Trade and Industry Department