

**Director of Audit's speech at CPA Australia Forum 2008
held at Conrad Hotel, Hong Kong on 24 October 2008**

Performance Audit of the Public Sector

Professor Chan, Mr Luck, President Malley, President Ho, fellow members of CPA Australia and Ladies and Gentlemen,

Introduction

It is my great honour, as a member of the CPA Australia, to speak at our 2008 Forum on the session "Performance Audit of the Public Sector".

First of all, I would like to extend my warmest welcome to the two distinguished public sector auditors, Mr Glenn Poole, Auditor-General of Queensland, and Mr Chee Khiang Teo, Deputy Auditor-General of Singapore. These two gentlemen are very experienced public sector auditors. Later on, they are going to share with us their valuable experience and practices of public sector auditing from their respective countries.

I shall therefore confine my presentation this morning on "Performance Audit" to the Hong Kong experience. It consists of five parts:

- Mission of the Audit Commission
- Accountability process
- Performance audit
- Performance audit cycle
- Performance audit case study: Hong Kong Tourism Board

Mission of the Audit Commission

Over the past decades, the public sector has undergone greater demand of the community to strive for improved efficiency and accountability in the delivery of public services. As the Hong Kong Government's external auditor, the Director of Audit's role is to ensure that the Government is spending wisely and getting value for money from its expenditure. The mission of the Audit Commission is:

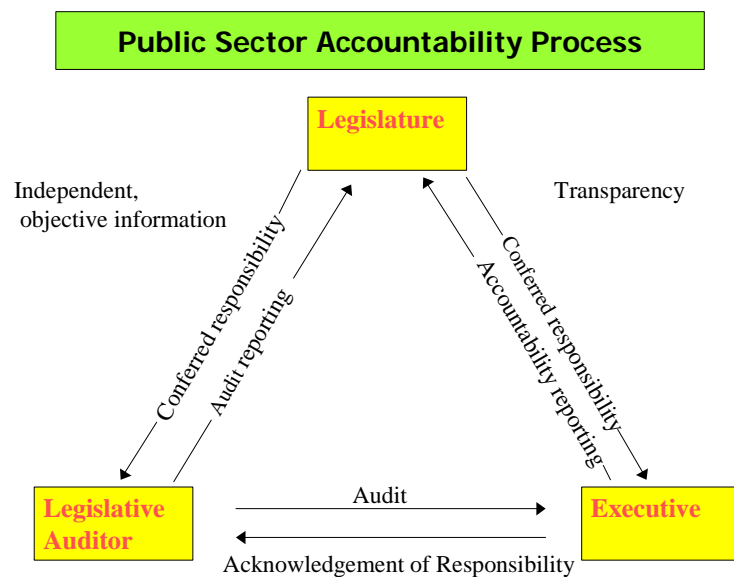
“To provide independent, professional and quality audit services to the Legislative Council and public sector organisations in order to help the Government enhance public sector performance and accountability in Hong Kong”

Accountability Process

Reliable, fairly presented and audited financial statements are a key aspect of good governance and accountability. It is my statutory responsibility in certifying the annual accounts of the Government. Besides, I also conduct performance audits (also known as value for money audits) to promote the efficient and effective use of government resources and spending, and the accountability of the Government. The Government is responsible for the formulation and implementation of a wide range of policies and programmes for the delivery of public services. Performance auditing therefore plays an important role in public sector governance and accountability because the auditor independently examines the way in which public money is used to deliver these services. The auditor’s findings and recommendations, which are tabled in the legislature, help ensure that the government has properly discharged its duties, and stimulate improvement in public sector performance.

As many of you are from the private sector, so I would like to briefly discuss the public sector accountability process first. As mentioned earlier, performance audit is closely related to the issue of accountability of the Government. “Accountability” is a complex and imprecise term. According to the International Federation of Accountants, accountability of the public sector is the process whereby public sector entities, and the individuals within them, are responsible for their decisions and actions, including their stewardship of public funds and all aspects of performance, and submit themselves to appropriate external scrutiny. In simple terms, it is about “Who is responsible to whom for what with what performance information and what rewards or sanctions for good or bad performance.”

While in the private sector, companies are more accountable in terms of their “bottom line”, accountability requirements in the public sector are generally more stringent, particularly with regard to process and policy. This figure, which is adapted from a study of the International Federation of Accountants (in 2001), illustrates the public sector accountability framework in general. As many of you are professional accountants who are well acquainted with financial auditing, I will confine my discussion to performance auditing aspects.



Source: International Federation of Accountants

The Legislature (in Hong Kong, it is the Legislative Council) exercises control over the expenditure of public money made available to the Executive (the Government of the Hong Kong Special Administrative Region) by approving the annual budget of the Government and authorising the Government to make expenditures within the approved levels.

The Government is responsible for planning and executing projects and operations, with due regard to economy and efficiency, and within the Legislative Council's authorised expenditure levels. It has to maintain adequate internal controls, comply with relevant authorities and guidelines, safeguard assets, measure program effectiveness, and report on their performance to the Legislative Council and stakeholders (e.g. the public).

Since the Legislature approves the Government's spending, it has the right and responsibility to hold the Government accountable for the management of the financial affairs and resources, and the achieved results. One of the means is the performance audits conducted by the Legislative Auditor (the Director of Audit).

The Legislature requires the Legislative Auditor to provide it with independent and objective information and assurance on the performance of the Government. The Legislative Auditor meets the request of the Legislature mainly through the conduct of performance audits on the public sector. A Public Accounts Committee (PAC) of the

Legislature will review the performance audit reports submitted by the Legislative Auditor.

Performance audit

So, what is performance audit? And how is it being carried out?

Performance audit can be said to be “an examination into the economy, efficiency and effectiveness with which any government bureau or department or public body has used its resources in discharging its functions.” The auditor examines the activities of the Government with a view to help improving the performance of the Government and enhancing its accountability to the public.

- (a) **Economy** is concerned with minimising the cost of inputs used for an activity having regard to appropriate quality (e.g. Does the purchase of school equipment and stationery at the cheapest price by using bulk purchase option?);
- (b) **Efficiency** is concerned with improving productivity. It is the relationship between outputs (e.g. in terms of goods or services) and inputs used to produce them. An efficient activity maximises output for a given input, or minimises input to a given output and, in so doing, pays due regard to appropriate quality (e.g. Can the response time of answering emergency requests be reduced at no extra cost while maintaining the service level?); and
- (c) **Effectiveness** is concerned with the extent to which objectives have been achieved. It is the relationship between objectives (or intended impacts) and outcomes (actual impacts) of an activity. (e.g. Has the department achieved the objectives of reducing waste, and does the programme has a positive impact on environmental protection?)

Performance audit cycle

Each performance audit will go through the following stages:

- (a) **Planning stage.** It involves the identification of subjects having regard to factors such as materiality, timeliness, auditability, value added and the assessed risk to value for money (e.g. excess expenditure over budget, significant project delay). The Auditor will collect background information, for example, from high level business plans and annual reports of the audited bodies, media reports and Internet research, to identify audit issues for detailed studies;

- (b) **Investigation stage.** In this stage, the auditor collects evidence which is relevant, sufficient and reliable, based on planned methodologies (e.g. examination of documents, interviews, surveys, etc.)
- (c) **Reporting stage.** The auditor drafts the audit report containing audit findings and recommendations. The content of the audit report should be accurate, complete, balanced, fair and constructive.
- (d) **Consultation stage.** The auditor forwards the drafts audit report to the audited body and seeks its comments and responses on the audit findings and recommendations.
- (e) **Publication stage.** The auditor tables the final audit report, which incorporates the responses from the audited body, in the Legislature.
- (f) **PAC stage.** The PAC conducts public hearings on the audit reports. It invites government officials and senior staff of the public bodies to attend the public hearings and provide explanation and information. The Committee will draw up its own conclusions and recommendations, and publish its own reports.
- (g) **Government response stage.** The Government will respond to the PAC report through a Government Minute on what action it will take, or reasons for not taking action, in response to the recommendations of the PAC.
- (h) **Follow-up stage.** The auditor will follow-up on the implementation of audit recommendations and the extent of benefits/impacts achieved. In case the progress or the results of implementation is unsatisfactory, a follow-up performance audit might be initiated.

To enable performance audit achieve its objectives, there are certain essential requirements. I will use the case of the Hong Kong Audit Commission to illustrate these requirements.

- (a) **Independence of Auditor.** To add credibility to his report, it is desirable that the auditor should be independent from the audited body.
 - Under Article 58 of the Basic Law, the Audit Commission functions independently (of the Administration) and is accountable to the Chief Executive of the Hong Kong Special Administrative Region.

- Functionally and organisationally, the Audit Commission does not work under any government bureau.
 - In carrying out performance audit, I am not subject to the direction or control of any authority or body.
- (b) **Sufficiently broad audit mandate.** The auditor should have sufficiently broad audit mandate and discretion in the discharge of duties relating to the conduct of performance audits. The auditor should be free from the direction or interference of the Legislature and the Government in the selection of audit subjects and in the conduct of performance audits.
- According to a paper tabled at the Legislature (Provisional Legislative Council) in February 1998 (an earlier version of the paper was tabled in November 1986), a set of guidelines on the conduct of performance audit was agreed between the PAC and the Director of Audit, and had been accepted by the Administration. Under the guidelines, the Director of Audit can conduct performance audit on the Government and many public bodies. He has great freedom in determining the audit scope, except that he cannot comment on the merits of government policies and decisions.
- (c) **Unrestricted access to information.** The auditor should be able to obtain timely and unfettered documents and information freely when carrying out performance audits.
- In this regard, the Administration has not imposed any restriction on the Director of Audit in the access to information.
 - Furthermore, under the 1998 Legislative Council paper, the Director of Audit can exercise the powers given to him under section 9 of the Audit Ordinance, which states that he can access government documents and seek explanation from public officers.
- (d) **Right and obligation to report audit findings.** The auditor should be required to report the results of his audit work to the Legislature. He should not be restricted from reporting his audit findings.
- Under the same paper tabled in the Legislature in 1998, the Director of Audit has to submit the results of performance audit to

the President of the Legislative Council twice a year, in April and in October. My audit reports are tabled at the Legislative Council.

- All my performance audit reports are public documents. They are available in full on the website of the Audit Commission. This enhances transparency of my work, and promote accountability of the Government.

Performance audit case study: Hong Kong Tourism Board

My performance audit covers a wide range of government activities, including works, education, housing, social welfare and environmental protection. In recent years, I have adopted a whole-of-organisation approach in the audit of public bodies, which is more than just focusing the attention on a specific area. In this type of audit, I undertook a thorough examination of the corporate governance arrangement as well as the performance of the key activities of the audited body, and drew up recommendations to address the audit findings. Examples of this type of audit carried out by the Audit Commission in recent years include those on the English Schools Foundation, Hong Kong Applied Science and Technology Research Institute, Society for the Aid and Rehabilitation of Drug Abusers, and Hong Kong Tourism Board (HKTb).

The performance audit reports on the HKTb were published in October last year. They were widely reported by the media and had hit the headlines for several months. It is a record-breaking audit, as the PAC held 15 public hearings in three months (between December 2007 to February 2008), totally 46 hours, to receive evidence on its findings and observations. In its report on this subject, the PAC used very strong words in criticising the Governing Board and top management of the HKTb (e.g. The PAC condemned the Governing Board and top management of the HKTb for the lack of good corporate governance and good management, and the former Executive Director for failure in her duties as the chief executive officer of the HKTb).

I would like to briefly share with you some of the audit observations and the lessons learnt.

The tourism industry is one of the major pillars of Hong Kong economy. Each year over 20 million visitors come to Hong Kong. Inbound tourism expenditure amounted to some HK\$ 110 billion a year.

The HKTb is a government-subsidised body. It was founded in 2001. It

was reconstituted from and replaced the Hong Kong Tourist Association. The main objective of the HKTB is to promote inbound tourism. It receives about HK\$ 500 million subvention a year from the Government.

The performance audit of HKTB was a comprehensive one. The audit had revealed the following inadequacies and improvement areas:

Corporate governance

The role and performance of the HKTB Governing Board in setting strategic direction, providing leadership, defining control mechanism, reporting performance, observing highest standards of conduct and taking overall accountability are crucial elements of good corporate governance. I found that:

- The HKTB needs to formalise its long-term strategic planning process and draw up a long-term Corporate Plan. It also needs to streamline the business and budget planning process to obtain timely approval by the Government.
- The attendance rates of some Board members were low (and in one case, a member was absent continuously for 15 meetings). Without the expertise and experience of members representing specific sectors, the effectiveness of the Board might be affected.
- There is a need to improve the administrative operation of the Board (e.g. timely submission of Board papers and declaration of interests).
- Performance measures used by the HKTB only measure the performance of the tourism industry. They do not directly measure the performance of the marketing activities of the HKTB. There were also delays in tabling its annual report at the Legislative Council (on average about one year after the year-end date).

Administrative issues

Having in place a corporate culture of complying with policy decisions and rules and regulations is an essential element of good management. The audit reviewed the following non-compliance cases:

- Following a consultancy study in 2003 on staff remuneration, the HKTB

Governing Board had decided to adjust downward the salary ranges to the market level and replace the 13th month pay by a performance-based variable payment. The audit found that some staff still received a salary higher than the maximum of their salary ranges, and that the performance-based variable payment were still not implemented (owing to staff side not supportive to the proposal).

- An executive medical scheme for the former Executive Director and her family had not been included in her employment contract and approval was not obtained for its introduction.
- The audit found (three) cases where prior approval had not been obtained for overseas business travel, and (seven) cases where air tickets had been purchased before approvals were given.
- There were problems and irregularities in the staff recruitment procedures such as inadequate documentation on number of applicants and number of shortlisted candidates for interview, and the shortlisting criteria. In one case involving the recruitment of a senior staff, no open recruitment was conducted. The staff was recruited by referral and the record of interview could not be located.

These non-compliance cases highlighted the importance of a fundamental principle in the conduct of public business: “the need to respect and care for the handling of public money.” Public sector is accountable to the public and must be cautious in utilising public resources. The society expects the highest standard of propriety (the way in which public business is conducted) from public sector officials. It is therefore not surprising that the PAC held lengthy public hearing sessions on these issues.

Another observation that I would like to mention here is that accountability remains even though you have left the post. It is the usual practice that the incumbent officers would attend the public hearings of, and provide information to, the PAC. But in the HKTb case, ex-senior staff, including the former Chairman and former Executive Director, were invited to the public hearings and answered most of the questions put forward by the PAC.

Planning, execution and evaluation of marketing activities

The success of marketing activities is crucial to the objectives and core business of the HKTb. The audit identified improvement areas in stakeholder

consultation, the setup and staffing of overseas marketing offices, and execution and evaluation of major promotion events.

Concluding remarks

As I have mentioned in the earlier part of my speech that performance audit aims to enhance the accountability of the public sector. According to Dr Alnoor Ebrahim, an Associate Professor of the Harvard Business School, accountability is both internal and external.

- Internal accountability means responsibility, and refers to officials taking the lead and responsibility of continuously shaping and scrutinizing organisation missions and goals, and improving the organisation's performance. Performance audit reports are means through which government officials can identify room for improvement and excel in their work.
- External accountability means answerability, and refers to officials being held externally to account for their actions and decisions in the use of public money. Performance audit reports provide independent and objective information to the Legislature about the performance of the Government to enable it hold the government officials accountable.

And before I conclude, I would like to say a few words about the role of the public sector auditor in the light of the recent global financial turmoil. To prevent the further deepening of the financial crisis, many countries and regions' governments have stepped up and played an active role in the financial markets. They have injected billions of capital to rescue banks and corporations who are teetering on the edge of collapse. They also guarantee bank deposits. These huge amount of capital are taxpayers' moneys. The public sector auditor, as the guardian of the public purse, has an important task of ensuring that there are adequate systems of checks and balances in place for the disbursement of funds, and that these public moneys are being used effectively and are properly accounted for in the financial statements. Performance audit plays an important role in today's public sector management by improving government's performance and promoting its accountability and transparency.

Thank you.