

Report No. 55 of the Director of Audit — Chapter 2

GOVERNANCE AND ADMINISTRATION OF DIRECT SUBSIDY SCHEME SCHOOLS

Summary

1. The Direct Subsidy Scheme (DSS) was introduced in the 1991/92 school year (all years mentioned hereinafter refer to school years) to inject diversity to the school system through the growth of a strong private school sector. Under the Scheme, schools were allowed to have greater flexibility in various areas including school management, curriculum design, student admission and fees collection so that they can cater for the diverse needs of their students in a more responsive manner.
2. For 2009/10, there were 72 DSS schools, comprising 11 primary, 52 secondary and 9 primary-cum-secondary schools. The enrolments of DSS secondary and primary schools were 51,123 (11% of secondary students) and 12,589 (4% of primary students) respectively. The budget for recurrent DSS subsidy was \$2,422 million.
3. **Audit review.** The Audit Commission (Audit) has recently conducted a review of the DSS covering the administration of the Scheme and the governance and administrative matters of DSS schools. The audit findings are contained in two separate reports, namely: (a) administration of the Direct Subsidy Scheme (Chapter 1 of the Director of Audit's Report No. 55); and (b) governance and administration of Direct Subsidy Scheme schools (the subject matter of this summary).

Governance of Direct Subsidy Scheme schools

4. **Composition of school governing body.** In 2009/10, six DSS schools were managed by school governing bodies incorporated under their respective incorporation ordinances. The composition of these six school governing bodies did not include representatives of parents and teachers as school managers. *Audit has recommended that the Secretary for Education should urge all DSS schools to include representatives of key stakeholders in their school governing bodies.*
5. **Registration of school managers.** Under the Education Ordinance (Cap. 279), no person shall act as a school manager unless he is registered with the Education Bureau (EDB) as a school manager. The registration of any person of 70 years of age or over may be refused if he fails to produce a medical certificate certifying his fitness to perform the functions of a school manager. On the other hand, schools are required to inform the EDB within a month after a person ceases to be a school manager. Audit noted that two school

managers of a school were not registered. They had attained the age of 70 and were reluctant to submit medical certificates for registration. Audit also noted that, as of June 2010, a school did not inform the EDB to cancel the registration of three school managers who had ceased to be school managers for more than three months. *Audit has recommended that the Secretary for Education should remind DSS schools to: (a) ensure that all school managers are registered; and (b) inform the EDB within a month after a person ceases to be a school manager.*

6. ***Meetings of school governing bodies.*** Audit visited four DSS schools in May and June 2010. Audit examination of the records of school governing body meetings of the four schools revealed that: (a) the attendance rates of some school managers were low; and (b) at a number of meetings, the required quorum was not present. *Audit has recommended that the Secretary for Education should remind DSS schools to: (a) monitor the attendance of school managers at school governing body meetings; and (b) ensure that, in future, a quorum is present at every school governing body meeting.*

7. ***Declaration of interests.*** Of the four schools visited, Audit noted that: (a) in two schools, the School Management Committees (SMCs) had not drawn up any guidelines on declaration of interests by school managers and kept any record of the declarations made; (b) in another school, annual declarations of interests were not submitted by two school managers; and (c) in the remaining school, the Incorporated Management Committee (IMC) did not maintain a register of declarations made by its school managers, contrary to the requirement under the Education Ordinance. *Audit has recommended that the Secretary for Education should remind DSS schools to ensure that: (a) a proper system is put in place for managing potential conflict of interest of school managers; and (b) the procedures for managing conflict of interest of school managers are complied with.*

School fee remission/scholarship schemes

8. ***Funding of school fee remission/scholarship schemes.*** To ensure that students will not be deprived of the chance to study at DSS schools, DSS schools are required to adopt a fee remission/scholarship scheme funded from school fee income. Audit examination of the 2008/09 audited accounts of 67 DSS schools revealed that: (a) the fee remission/scholarship schemes of 5 schools were not funded from school fee income; and (b) in 14 schools, the utilisation of the fee remission/scholarship schemes was 50% or less. *Audit has recommended that the Secretary for Education should: (a) ensure that DSS schools set aside the required amounts of school fee income for the fee remission/scholarship schemes; and (b) follow up with DSS schools to look into the causes of the low utilisation of their fee remission/scholarship schemes.*

9. ***Administration of fee remission/scholarship schemes by schools.*** DSS schools are required to provide full details of the fee remission/scholarship schemes in their prospectuses. Furthermore, the eligibility criteria of their schemes should not be less favourable than the government financial assistance schemes to students. Of the four schools visited by Audit, only two had mentioned the fee remission/scholarship schemes in their prospectuses. However, full details of the schemes were not provided. Audit scrutiny of the websites of all the 72 DSS schools revealed that: (a) only 47 (65%) schools

had mentioned on their websites that fee remission/scholarship schemes were available to students; and (b) only 23 of these 47 schools had provided details of the schemes. Audit also noted that the eligibility criteria adopted by 2 of these 23 schools were less favourable than the government financial assistance schemes to students. *Audit has recommended that the Secretary for Education should: (a) monitor the DSS schools' implementation and publicity of their fee remission/scholarship schemes; and (b) remind DSS schools to provide full details of the schemes in their school prospectuses and upload details of the schemes to their websites.*

Revision of school fees

10. ***Consultation with parents.*** In 2009/10, a DSS school intending to apply for school fee increase was required to obtain consent from the majority of the parents if: (a) it applied for a fee increase exceeding 7%; or (b) its accumulated operating reserve exceeded its annual operating expenses. Audit examination of the records of the 18 approved school fee increase applications for 2009/10 revealed that, in one of the six applications that required consent from the majority of the parents, supporting documents were not provided. In the remaining five applications, relevant financial information of the schools was not provided to the parents. *Audit has recommended that the Secretary for Education should: (a) consider requiring all schools to follow the practice of submitting records of the majority consent of the parents in their applications for school fee increases; and (b) require schools to provide relevant financial information to the parents during the consultation process for school fee increases.*

11. ***Financial projections in applications.*** A school applying for school fee increase is required to project how its financial viability would be improved by the proposed school fee increases. In 14 of the 30 approved applications for fee increases in 2008/09, the schools projected that their accumulated operating reserves would not be sufficient to meet two months' operating expenses by the end of 2008/09. Audit examination of these 14 schools' 2008/09 audited accounts revealed that: (a) in 8 schools, the actual accumulated operating reserves turned out to have exceeded their projected reserves by more than 100%; and (b) in 3 schools, the projected deficit in accumulated operating reserves turned out to be surplus. *Audit has recommended that the Secretary for Education should ensure that the financial projections made by DSS schools in their applications for school fee increases are properly justified and reasonable.*

Financial management

12. ***Reserve balances.*** According to Financial Circular No. 9/2004, government bureaux/departments should set an appropriate reserve ceiling for surpluses of subvented organisations (including DSS schools) arising from subvented programmes. Any surplus in excess of the ceiling should be returned to the Government, or dealt with in accordance with the arrangements agreed between the Government and the organisations. Audit noted that the EDB had not set a reserve ceiling for the DSS schools which commenced operation in or after 2005/06. *Audit has recommended that the Secretary for Education should in consultation with the Financial Services and the Treasury Bureau, consider the need for setting a reserve ceiling for the accumulated operating reserves of DSS schools, and requiring the schools to return any surplus in excess of the ceiling to the Government.*

13. **Private classes.** According to Financial Circular No. 9/2004, subvented organisations (including DSS schools) are required to keep separate accounts for their self-financing activities and ensure that there is no cross-subsidisation of these activities by subvented programmes in money or in kind. The 2008/09 audited accounts of the six schools which operated private classes revealed that the requirement of keeping separate accounts was not fully complied with. *Audit has recommended that the Secretary for Education should require DSS schools to keep separate accounts for their private classes and to ensure that there is no cross-subsidisation of the private classes by the DSS classes.*

14. **Non-local students.** Non-local students refer to persons entering Hong Kong for the purpose of education with a student visa/entry permit. These students are not eligible for government subsidy. As at 30 September 2008, 162 non-local students were admitted by 17 DSS schools. The school fees paid by both the local and non-local students at these schools were the same. They attended the same classes and had access to the same facilities. *Audit has recommended that the Secretary for Education should consider requiring DSS schools to ensure that their non-local students are not cross-subsidised by the government subsidy for local students.*

15. **Audited accounts.** A DSS school is required to: (a) submit to the EDB its annual audited accounts by the end of March in the following school year; and (b) ensure that the external auditor's report will include a statement that the school has used the government subsidies in accordance with the rules promulgated by the EDB for the DSS. Audit noted that: (a) up to the end of June 2010, there were delays in the submission of the 2007/08 and 2008/09 audited accounts by 30 and 28 schools respectively; and (b) for the 2008/09 audited accounts submitted by 67 DSS schools, the requirement on auditor's report was not complied with by 18 schools. *Audit has recommended that the Secretary for Education should ensure that DSS schools: (a) submit their annual audited accounts in a timely manner; and (b) comply with the requirement to include a statement in their auditor's reports stating whether they have used the government subsidies in accordance with the rules promulgated for the DSS.*

16. **Use of government funds.** Some DSS schools charged non-approved expenditure items to their government fund accounts for 2008/09 and 2009/10. Such expenditure items included: (a) travelling expenses of \$8,400 incurred by 3 teachers in an exchange visit; (b) an expenditure of about \$29,000 incurred for holding an annual dinner for staff; (c) an expenditure of \$42,000 for renting a piece of land for a kennel; and (d) a tax payment of \$4.1 million and a donation payment of \$5.1 million. *Audit has recommended that the Secretary for Education should remind DSS schools to ensure that only approved expenditure items are charged to the government fund accounts.*

17. **Use of non-government funds.** According to the EDB's guidelines, only expenditure for educational and school needs should be charged to non-government funds. Audit noted that during the period 2006 to 2009, a school used non-government funds of \$10 million to purchase three properties, which were held under a trust arrangement. The trust arrangement was considered improper by the EDB. *Audit has recommended that the Secretary for Education should require DSS schools to formulate guidelines on the use of non-government funds.*

18. **Investment of surplus funds.** According to EDB Circular No. 2/2003, surplus funds which are not immediately required for use by DSS schools may be placed in time deposits or savings accounts with banks licensed under the Banking Ordinance (Cap. 155). Any other forms of speculative investment (e.g. in local equities) are not recommended. Contrary to the guidelines, one of the four schools visited by Audit invested part of its surplus funds in financial instruments. As at 27 February 2010, the market values of the investments in local equities and investment funds were \$28 million and \$43 million respectively. *Audit has recommended that the Secretary for Education should ensure that the EDB's guidelines on investment of surplus funds of schools are complied with by DSS schools.*

19. **Fixed assets management.** An examination of the fixed asset records of the four schools visited by Audit revealed that: (a) the fixed asset register of a school did not record the quantity of 322 categories of assets; and (b) the fixed asset register of another school included 18 notebook computers which had been disposed of. *Audit has recommended that the Secretary for Education should remind DSS schools to correctly record the fixed assets under their control in a fixed asset register.*

Human resource management

20. **Staff recruitment.** An examination of the recruitment records of the four schools visited by Audit revealed that: (a) a school had not explicitly laid down the policies and procedures for recruitment and remuneration of teaching staff; and (b) another school did not retain the recruitment records. Audit also noted that no open recruitment was carried out to fill a senior post and to appoint the new principal of one school and to recruit 36 new staff of another school. *Audit has recommended that the Secretary for Education should remind DSS schools to: (a) formulate a proper staff recruitment policy and keep all the recruitment records; and (b) carry out recruitment of staff in an open and fair manner.*

21. **Staff remuneration.** DSS schools should put in place a proper mechanism to ensure that the remuneration packages for individual staff are fair and justifiable. Audit noted that a school had not set up a mechanism for determining the remuneration packages for its non-teaching staff. *Audit has recommended that the Secretary for Education should remind DSS schools to put in place a proper mechanism for determining the remuneration packages for their staff to ensure that the packages are fair and justifiable.*

22. **Performance management.** Of the four schools visited, Audit noted that: (a) a school did not have a formal performance management system in place; (b) performance appraisal was carried out only for some staff of the second school; (c) of 15 staff appraisal reports selected from the third school for examination by Audit, 6 were not available; and (d) the performance management system of the remaining school did not require the appraiser to record the justifications of his assessment. *Audit has recommended that the Secretary for Education should remind DSS schools to: (a) establish and implement an effective performance management system for their staff; and (b) review the operation of the performance management system periodically by making reference to the EDB's guidelines.*

General administration

23. ***Procurement of goods and services.*** During the visits to the four schools, Audit noted that: (a) no formal procurement policy and procedures were laid down by a school; and (b) in another school, there were two different sets of procurement procedures. The set of procedures for making procurement with non-government funds was less stringent than that of the EDB's guidelines and had not been approved by the SMC. Audit examination of the procurement records of the four schools revealed that, contrary to the requirements/best practices promulgated by the EDB: (a) the number of quotations/tenders received by a school was less than that required; (b) tender evaluation criteria were not included in the tender documents in tender exercises carried out by two schools; and (c) no separate committees were established for tender vetting and approval by one school. *Audit has recommended that the Secretary for Education should remind DSS schools to follow the EDB's guidelines on procurement as far as possible.*

24. ***Trading operations.*** DSS schools are required to obtain prior approval from their IMCs or the EDB for carrying out trading operations. The profit from sale of trading items should be limited to 15%. Moreover, donations from trading operators/suppliers should not be accepted, unless in very exceptional circumstances with justification of compelling reasons. Audit noted that, of the four schools visited by Audit: (a) three schools had not sought prior approval from the EDB for their trading operations; (b) the profit of some of the items sold by three schools had exceeded the 15% ceiling; and (c) two schools had accepted donations from trading operators without any documented compelling reasons. *Audit has recommended that the Secretary for Education should remind DSS schools that: (a) prior approval from the EDB or the IMC is needed for trading operations; (b) profit from sale of trading items should be limited to 15%; and (c) acceptance of donations or advantages from trading operators/suppliers should be considered only in very exceptional circumstances with justification of compelling reasons.*

Response from the Administration

25. The Administration agrees with the audit recommendations.

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