

CHAPTER 3

Education and Manpower Bureau

Government subsidies to the English Schools Foundation

**Audit Commission
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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.

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GOVERNMENT SUBSIDIES TO THE ENGLISH SCHOOLS FOUNDATION

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PART 1: INTRODUCTION

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

Background

1.2 The English Schools Foundation (ESF — Note 1) was established under the English Schools Foundation Ordinance (Cap. 1117) in 1967. The main object of the ESF is to administer and operate within Hong Kong schools offering a modern liberal education through the medium of the English language to boys and girls who are able to benefit from such an education. As stated in its 2002-03 audited financial statements (Note 2), the ESF had a total income of \$1,051 million, of which \$719 million (68%) were school fees, \$299 million (29%) were government subsidies (Note 3) and \$33 million (3%) were other income.

The Foundation

1.3 The membership of the Foundation and its subordinating committees includes representatives from the Government, the community, parents of ESF students, and ESF teachers and management. As at 1 April 2004, the Foundation comprised a Chairman and 131 members (Note 4). The Foundation has established an Executive Committee comprising a Chairman and eight members (Note 5). The Foundation is supported by a Foundation Office, which is headed by the Chief Executive of the ESF. As laid down in the English Schools Foundation Ordinance, the Secretary of the Foundation is the principal academic and administrative officer of the ESF. The Secretary of the Foundation also holds the post of the Chief Executive of the ESF.

Note 1: *For clarity, throughout this report, ESF will be used to refer to the ESF as an organisation and the Foundation as its supreme governing body.*

Note 2: *ESF financial year covers the period 1 September to 31 August.*

Note 3: *These government subsidies did not include \$7 million hardship allowances for ESF students and refund of \$6 million rates and government rents to the ESF.*

Note 4: *As at 1 April 2004, there were four membership vacancies.*

Note 5: *As laid down in the English Schools Foundation Ordinance, the Chairman of the Foundation shall preside at all meetings of the Foundation and of its Executive Committee.*

English Schools Foundation schools

- 1.4 In September 2003, the ESF operated:
- (a) 15 schools receiving recurrent government subsidies (hereinafter referred to as ESF schools), including nine primary schools (with 5,481 students enrolled), five secondary schools (with 5,785 students enrolled) and one special education school (with 57 students enrolled); and
 - (b) one primary school (with 324 students enrolled) without recurrent government subsidies (Note 6).

1.5 ESF primary and secondary schools are co-educational day schools and provide education similar in content and method to that available in schools in the United Kingdom but adapted to the Hong Kong context. In the 2003-04 school year (Note 7), the annual ESF school fees were \$47,300 for each primary-school student and \$78,600 for each secondary-school student.

1.6 In 1994, the ESF established the ESF Educational Services Limited (Note 8) under the Companies Ordinance (Cap. 32). In September 2003, the ESF Educational Services Limited administered three kindergartens (with 662 students enrolled) and one primary-cum-secondary school (with 345 students enrolled) without government subsidies. In 2001, the Education and Manpower Bureau (EMB) granted two sites (one in Ma On Shan and another in Discovery Bay) to the ESF for operating

Note 6: *The student numbers shown in this paragraph were based on ESF data. Government subsidies to the ESF were based on the number of ESF students in November every year. In November 2003, the nine ESF primary schools enrolled 5,598 students, the five ESF secondary schools enrolled 5,793 students, the ESF special education school enrolled 59 students, and the primary school operated by the ESF without recurrent government subsidies enrolled 328 students.*

Note 7: *A school year covers the period 1 September to 31 August.*

Note 8: *The ESF Educational Services Limited (the company) is limited by guarantee. In the event that the company is wound up, each member's guaranteed contribution to the assets of the company is limited to \$100. As at 1 April 2004, the company had three members (comprising the Chairman, the Vice-chairman and a member of the Executive Committee of the Foundation) and three directors (comprising the Acting Chief Executive of the ESF, and the Human Resources Director and the School Improvement Officer (Secondary) of the Foundation Office).*

two primary-cum-secondary schools under the Private Independent School Scheme (Note 9) by 2007. These two schools are to be operated by the ESF Educational Services Limited.

Authority for conducting value for money audit of the English Schools Foundation

1.7 According to the Value for Money (VFM) Audit Guidelines tabled in the Provisional Legislative Council on 11 February 1998, the term “audited organisation” shall include any organisation which receives more than half its income from public moneys. The Guidelines also state that the Director of Audit may carry out a VFM audit of an organisation which receives less than half its income from public moneys by virtue of an agreement made as a condition of subvention.

1.8 On 24 March 2004, the Chairman of the Foundation informed the Secretary for Education and Manpower that the Executive Committee of the Foundation had decided, by way of mutual agreement with the Government and as a condition of subvention, to welcome the Director of Audit to perform VFM audits of the ESF. On 29 March 2004, the Secretary confirmed to the Chairman that the ESF would become an audited organisation under the VFM Audit Guidelines.

Value for money audit of the English Schools Foundation

1.9 Against the above background, the Audit Commission (Audit) has recently conducted a VFM audit of the ESF. Since this is a broad subject, the scope of this audit review is divided into three topics. The audit findings are contained in three separate reports, as follows:

- (a) government subsidies to the English Schools Foundation (the subject matter of this report);

Note 9: *Schools operated under the Private Independent School Scheme do not receive recurrent government subsidies. They are eligible for land grant at a nominal premium and for one-off capital grant from the Government. There is a requirement that at least 70% of their students should be Hong Kong permanent residents. They may adopt either a local or an overseas curriculum.*

- (b) corporate governance and Headquarters administration of the English Schools Foundation (see Chapter 4 of the Director of Audit's Report No. 43); and
- (c) school administration of the English Schools Foundation (see Chapter 5 of the Director of Audit's Report No. 43).

Audit review of government subsidies to the English Schools Foundation

1.10 As laid down in the 1965 Education Policy White Paper, the Government would provide the same level of subsidy to schools for English-speaking children as that to local aided primary or secondary schools under the **parity of subsidy principle**.

1.11 When the Government's policy on subsidising schools for English-speaking children was made in 1965, in addition to one secondary school and five primary schools for English-speaking children which were run by the then Education Department, there was only one private school providing education for these children. In September 2003, the number of ESF schools had increased to 15 (with a total of 11,323 students) and the number of other international schools to 38 (with a total of 16,660 students). In contrast to ESF schools, the Government does not provide annual recurrent subsidies to other international schools.

1.12 In recent years, some private international schools raised concerns on the appropriateness of the Government providing annual recurrent subsidies to ESF schools only but not to other international schools. The EMB conducted a number of reviews of government subsidies to ESF schools and other international schools.

1.13 Audit has recently conducted a review of government subsidies to ESF schools. The audit objectives are to examine the evolution of government subsidies to ESF schools vis-à-vis other international schools, and the EMB's reviews of the subsidies in recent years. The audit has focused on the following areas:

- (a) reviews of government subsidies to ESF schools and international schools (see PART 2); and

- (b) freezing government subsidies to ESF schools and the recent fact-finding exercise (PART 3).

1.14 Audit has found that there is room for improvement in various areas and has made a number of recommendations to address the related issues.

General response from the Administration

1.15 The **Secretary for Education and Manpower** generally agrees with Audit findings in this report. He has said that:

- (a) the EMB appreciates Audit effort in speedily completing the VFM audit of the three major topics relating to the ESF, namely government subsidies to the ESF, corporate governance and Headquarters administration of the ESF, and school administration of the ESF. The audit commenced only after the ESF was made an audited organisation in late March 2004. The tight time-frame within which Audit has been working highlights Audit commitment to its quality service for the promotion of public interest; and
- (b) given the independence of Audit and the expertise and experience it possesses, the EMB believes that the audit findings would provide a useful reference to the Government, the ESF, other stakeholders and the community at large in respect of the ongoing review of government recurrent subsidies to the ESF.

Acknowledgement

1.16 Audit would like to acknowledge with gratitude the full cooperation of the staff of the EMB and the ESF during the course of the audit review.

PART 2: REVIEWS OF GOVERNMENT SUBSIDIES TO ENGLISH SCHOOLS FOUNDATION SCHOOLS AND INTERNATIONAL SCHOOLS

2.1 This PART examines the EMB's reviews of government subsidies to ESF schools and other international schools since the setting of the Government's policy on subsidising schools for English-speaking children in 1965.

1965 Education Policy White Paper on education for English-speaking children

2.2 In 1965, based on the Report of the Education Commission 1963 (Note 10) and the Report of the Working Party on the Provision of Education for English-speaking Children, the Government issued an Education Policy White Paper, which was to be used as a basis for planning the development of education. In the White Paper, it was stated that:

- (a) there was a demand for education of the kind hitherto provided in the government junior English schools and in the King George V School;
- (b) if Hong Kong's economy continued to depend in part upon the services of persons from other countries, for whom education in the English medium and, for the most part, in the pattern of English-state education was a necessity, then the need must be filled;
- (c) the above need was best filled by aided schools rather than by government schools wherever this was possible;
- (d) the general principle was that, where such education was more costly than the type of education provided for the majority, the difference in cost should be passed on to those enjoying these particular standards of provision, so that the general level of subsidy remained the same in all sections of the community; and
- (e) in the special circumstances of Hong Kong, where the majority of overseas parents were British and where many other overseas parents appeared satisfied with the British system of education, education provided for English-speaking children should be similar in content and method to that available in state schools in Britain.

Note 10: *The Report was produced in 1963 by the then Education Commission, which was set up to undertake the specific task of examining the policy on provision of education in Hong Kong. The present Education Commission, which was established in 1984, is a standing advisory committee on education-related issues. The two Commissions are different.*

Establishment of the English Schools Foundation in 1967

2.3 In the light of the recommendations of the 1965 Education Policy White Paper, in 1967, the ESF was incorporated by statute, through the enactment of the English Schools Foundation Ordinance. Upon its inception in 1967, the ESF opened two schools. Two more schools were opened in 1975 and a fifth in 1977. In 1979, the ESF accepted the transfer of five government junior English schools and one government secondary English school from the then Education Department. In the 2003-04 school year, there were 15 ESF schools. Recurrent government subsidies to ESF schools and aided schools in the 1999-2000 to 2003-04 school years are shown in Table 1.

Table 1

**Recurrent government subsidies to ESF schools and aided schools
(1999-2000 to 2003-04 school years)**

School year (Note 1)	ESF schools			Aided schools	
	Total (Note 2)	Average per student (Note 3)		Average per student (Note 3)	
		Primary school	Secondary school	Primary school	Secondary school
	(\$ million)	(\$)	(\$)	(\$)	(\$)
1999-2000	297	23,505	32,205	20,197	31,780
2000-01	303	22,916	30,942	21,761	33,182
2001-02	312	22,615	31,218	22,828	34,921
2002-03	312	22,194	31,118	24,291	34,495
2003-04	301	21,097	29,678	23,592	33,637

Source: EMB records

Note 1: In the 1999-2000 school year and before, the average per-student recurrent government subsidies to ESF schools were generally higher than those to aided schools. This was mainly due to the fact that ESF teachers were more experienced teachers who attained higher salary points of teachers' pay scale. Since the 2000-01 school year, due to the freezing arrangements on government subsidies to ESF schools (for efficiency savings purpose), the per-student recurrent government subsidies to them have become less than those to aided schools.

Note 2: These included hardship allowances granted to ESF students and refunds of rates and government rents to the ESF.

Note 3: These excluded subsidies to students of special education schools.

Reviews of government subsidies to English Schools Foundation schools in 1979 and 1995

2.4 After the establishment of the ESF in 1967, the EMB carried out three major reviews of government subsidies to the ESF in 1979, 1995 and 1999. The first two reviews led to reductions in annual recurrent subsidies of \$40,000 from the 1980-81 school year and \$12.6 million from the 1996-97 school year to the ESF (see Appendix A).

Review of government subsidies to international schools in 1995

2.5 In November 1994, in response to the request from expatriate communities for the provision of more international school places, the EMB formed a Working Group on the Provision of International School Places (Note 11). In October 1995, the Executive Council approved the following Working Group's recommendations on the provision of government subsidies to international schools:

- (a) the government policy of providing no recurrent government subsidies to international schools should continue;
- (b) the Government should enable the establishment of appropriate international school places through assistance in the form of:
 - (i) land grant at nominal premium according to a revised application procedure; and
 - (ii) an interest-free loan up to 100% of the cost of building a standard-design primary or secondary public-sector school, as appropriate; and
- (c) the four international schools operated under the Direct Subsidy Scheme (Note 12) should be phased out from the Scheme as and when the affected students left the schools or graduated, whichever was the earlier (Note 13).

Note 11: *The Working Group comprised representatives from the EMB, the then Education Department, the Financial Services and the Treasury Bureau, the Commerce, Industry and Technology Bureau, the Census and Statistics Department and the Lands Department.*

Note 12: *Schools joining the Direct Subsidy Scheme are free to decide on their curricula, fees and entrance requirements, but they must prepare their students for local public examinations. The amount of government subsidies for a school operated under the Scheme is based on the average unit cost of an aided-school place for each eligible child enrolled.*

Note 13: *The four international schools have been phased out from the Direct Subsidy Scheme.*

2.6 **As defined by the Working Group on the Provision of International School Places, international schools are schools which follow a non-local curriculum and whose students do not sit for local examinations.** They are operated with curricula designed for the needs of a particular cultural, racial or linguistic group or for students wishing to pursue their studies overseas.

Review of government subsidies to English Schools Foundation schools in 1999

2.7 In 1999, prompted by a desire for policy rationalisation, the EMB conducted another review of government subsidies to the ESF. In January 2000, in its report submitted to the Social Service Policy Group chaired by the Chief Secretary for Administration, the EMB stated that:

- (a) **ESF schools were not different in nature, in terms of both curriculum offered and student mix, from other international schools.** However, government subsidies provided for ESF schools were much more favourable than those for other international schools;
- (b) following the Reunification in 1997, it was difficult to justify providing recurrent government subsidies to schools that offered the British curriculum only;
- (c) because of the subsidies provided, ESF schools had been able to keep their school fees low vis-à-vis other international schools. This had provided an unfair advantage to ESF schools in competing with other international schools. The lower school fees charged by the ESF built up a demand for additional ESF school places which in turn had led to more capital and recurrent government subsidies to ESF schools. Some international schools had requested equal treatment in terms of recurrent subsidies in order that they could compete on a fair basis with ESF schools; and
- (d) **legal advice was that there did not appear to be any legal impediment to the proposal to withdraw recurrent subsidies from the ESF by adopting a phased approach.** The Government had withdrawn subsidies from international schools before. Following a review of the international school policy in 1995, all international schools joining the Direct Subsidy Scheme were gradually phased out from the Scheme.

2.8 In the same report, the EMB recommended that the Government should:

- (a) put ESF schools on par with other international schools in terms of government subsidies;
- (b) **adopt a phased approach to withdrawing recurrent subsidies, namely phasing out the recurrent subsidies for ESF primary schools (from Primary One) and secondary schools (from Secondary One) from the 2001-02 school year. Hence, recurrent subsidies would be completely withdrawn from all ESF primary schools by the end of the 2006-07 school year and from all ESF secondary schools by the end of the 2007-08 school year;**
- (c) in advance of the phased withdrawal of subsidies, freeze the amount of recurrent government subsidies to the ESF from the 2000-01 school year at the 1999-2000 school year level; and
- (d) continue providing subsidies to ESF special education school which provided educational services to English-speaking children with severe learning difficulties.

2.9 In early 2000, after deliberation, the Social Service Policy Group directed that the EMB should discuss with the ESF on the need to gradually phase out government subsidies while exploring with it in parallel the possibility of greater flexibility in the use of its land for other income-generating educational activities.

2.10 During the EMB's consultations on the possible withdrawal of government subsidies to the ESF, the Chairman of the Foundation and the Chief Executive of the ESF:

- (a) indicated their willingness to work with the Government for a smooth transition; and
- (b) suggested that the Government should allow the ESF to modify its land lease conditions so that it could redevelop the school sites and expand its services, such as operating kindergartens. They said that this would help generate additional income to compensate for the withdrawal of subsidies.

A summary of the exchange of views between the EMB and the ESF on the Government's proposed withdrawal of recurrent subsidies to the ESF is at Appendix B.

Disparities in government subsidies between English Schools Foundation schools and other international schools

2.11 In terms of government subsidies, international schools can be classified into four groups, namely:

- (a) ESF schools;
- (b) international schools operated under the Private Independent School Scheme;
- (c) other non-profit-making international schools (Note 14); and
- (d) profit-making international schools.

2.12 ESF schools offer the British curriculum leading to the General Certificate of Secondary Education Examination in Year 11 and the General Certificate of Education Advanced Level Examination in Year 13. The other international schools offer a variety of different curricula. As at 15 September 2003, of the total 27,983 students studying in international schools (including ESF schools), 11,323 (40%) were ESF students studying the British curriculum (see Appendix C).

2.13 Priority for admission to ESF schools is given to expatriate children with fluency in English as a pre-requisite. Local children who are fluent in English could also be admitted.

2.14 As at 15 September 2003, there were 53 international schools (including ESF schools) which had 27,983 students (see Table 2).

Note 14: *Non-profit-making schools are those schools which have been granted tax-exemption status under section 88 of the Inland Revenue Ordinance (Cap. 112).*

Table 2

**Student enrolment of international schools
(15 September 2003)**

School type	Number of schools	Number of students
ESF schools	15	11,323
Schools operated under the Private Independent School Scheme	1	54
Other non-profit-making schools	26	15,351
Profit-making schools	11	1,255
Total	53	27,983

Source: EMB records

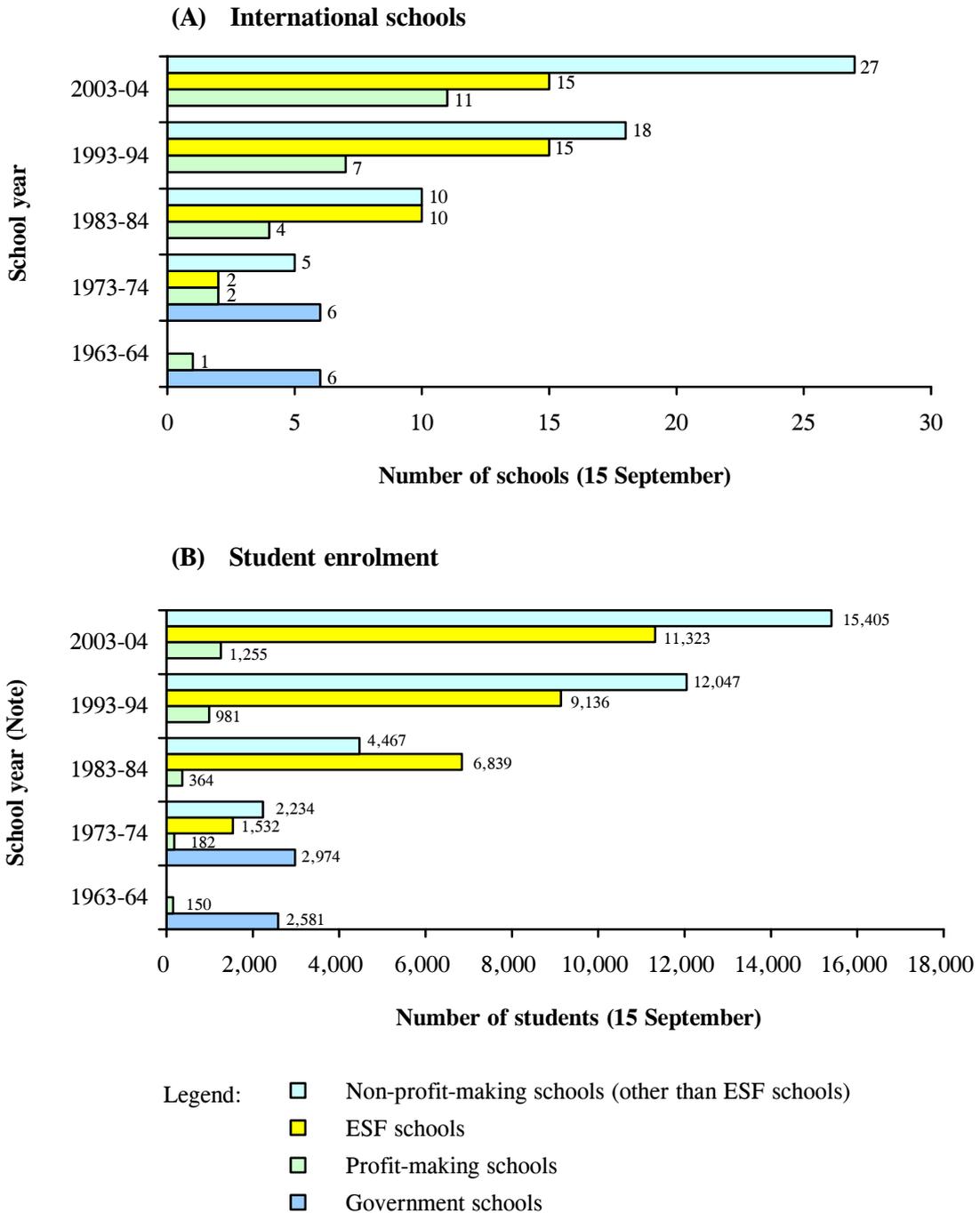
2.15 As shown in Appendix D, ESF schools receive much more favourable government subsidies than international schools operated under the Private Independent School Scheme and other non-profit-making international schools. More significantly, among the three types of international schools receiving government subsidies, ESF schools are the only international schools which receive recurrent government subsidies. In the 2003-04 school year, the recurrent government subsidies averaged \$21,097 for each ESF primary-school student and \$29,678 for each ESF secondary-school student. The total recurrent government subsidies to the ESF in that year amounted to \$301 million (see Appendix E).

Changes in the number of international schools and students

2.16 Audit notes that, at the time of formulating the government policy on subsidising education for English-speaking children in 1965 (see para. 2.2), there were five primary schools and one secondary school for English-speaking children directly run by the then Education Department. In that year, there was only one private profit-making international school providing educational services for English-speaking children. In the 2003-04 school year, the number of international schools increased to 53, including 15 ESF schools (see Figure 1).

Figure 1

**Number of international schools and their student enrolment
(1963-64 to 2003-04 school years)**



Source: EMB records and Audit estimates

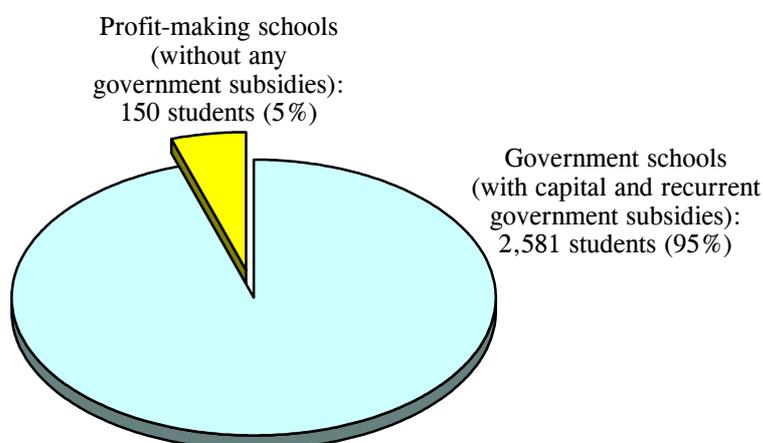
Note: The EMB does not have records of the student enrolment numbers of non-profit-making schools and profit-making schools for the 1963-64, 1973-74 and 1983-84 school years. Based on the number of these schools in these three school years and their student numbers in the 1993-94 school year, Audit made estimates of these student enrolment numbers.

2.17 The Government's policy on subsidising education for English-speaking children set in 1965 was based on the provision of government subsidies to international schools in the 1963-64 school year and before. As shown in Figure 2, the percentage of students studying in international schools receiving recurrent government subsidies decreased from 95% in the 1963-64 school year to 40% in the 2003-04 school year. In the 2003-04 school year, the majority of international-school students (55%) were studying in non-profit-making schools which did not receive any recurrent government subsidies. In contrast, in the 1963-64 school year, there was no such type of international school.

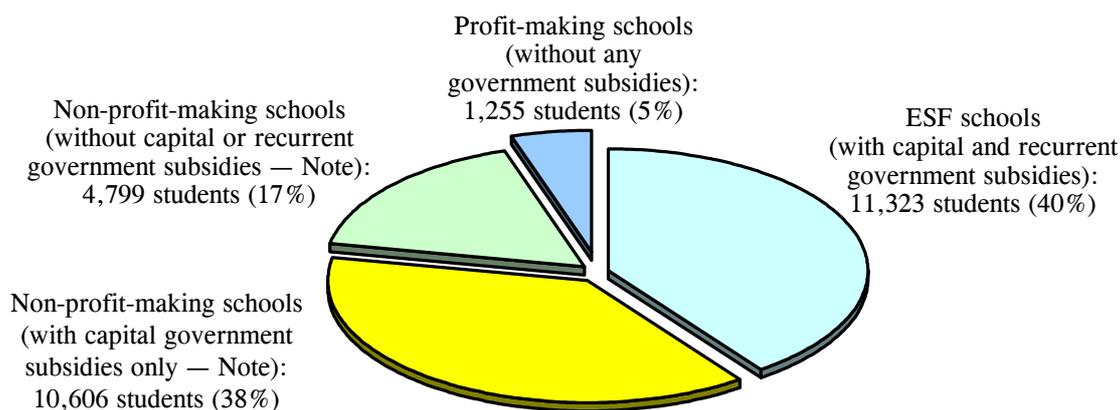
Figure 2

Number of students studying in different types of international schools

(A) 1963-64 school year (as at 15 September 1963)



(B) 2003-04 school year (as at 15 September 2003)



Source: EMB records and Audit estimates

Note: Unlike profit-making schools, these schools would be reimbursed rates and government rents. The policy on providing capital government subsidies to non-profit-making international schools was set in 1995. Schools established before 1995 might not have benefited from the subsidies on school buildings. In addition, subject to proven demand, the EMB would, upon application from international schools, examine their student admission and fee policies, management and financial background, operating standards and quality assurance mechanism before granting approval for them to receive government subsidies.

2.18 In August 2004, in response to Audit findings in paragraphs 2.16 and 2.17, the EMB stated that:

- (a) in the 1960s, the local school system was not as established and well-developed as the present system. There was a lack of international education services in Hong Kong catering for the English-speaking and expatriate community;
- (b) since then, Hong Kong had developed into an international hub with a sizeable expatriate population and a concomitant significant expansion of the provision of private international school places;
- (c) the Government had also progressively adopted nine-year compulsory education for all local children. There were schools which used English as the medium of instruction to cater for the needs of English-speaking children who wished to follow the local curriculum; and
- (d) these changes over the past decades had led to:
 - (i) a growing diversity in school funding arrangements, curricula, and modes of operation; and
 - (ii) the evolvement of the current government policy that the demand for international education should primarily be met by private service providers without government subsidies.

Views of international schools

2.19 Over the years, some international schools expressed concern over the disparities in government subsidies between ESF schools and other international schools on the following occasions:

- (a) in 1995, in a review of international schools conducted by the EMB, many international schools:
 - (i) suggested that there should be equitable treatment for all international schools in respect of recurrent government subsidies; and

- (ii) wished that the capital subsidies to ESF schools would be extended to other international schools;

- (b) in April 1999, five international schools suggested to include government subsidies to the ESF as an agenda item in their meeting with the then Director of Education. They questioned whether there was a level playing field between ESF schools and other international schools. They also stated that their original assumption was that the subsidies to the ESF would end with the Reunification in 1997; and

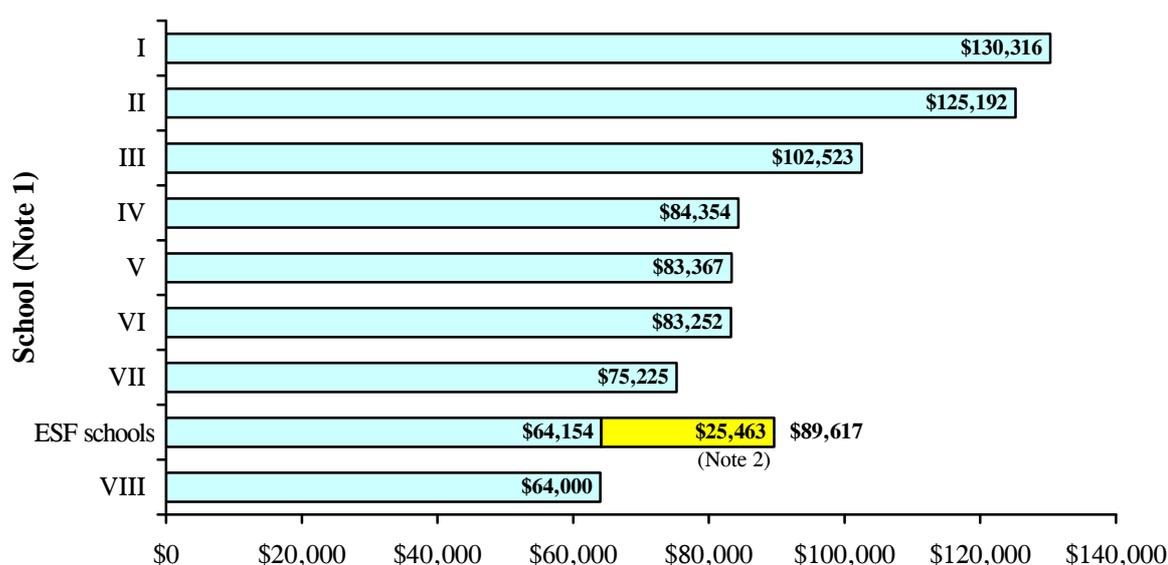
- (c) in March 2004, an international school wrote to the EMB, stating that the current practice of providing subsidies to the ESF had the effect of creating an unfair advantage for ESF schools in recruitment and retention of staff and students, as well as provision of educational resources.

Lower school fees charged by English Schools Foundation schools

2.20 In comparison with other international schools, recurrent government subsidies provided to the ESF have led to lower school fees charged by ESF schools (see para. 2.7(c)). This has led to an allegation that ESF schools have an unfair advantage in competing with other international schools in terms of both recruitment and retention of staff and students and provision of educational resources (see para. 2.19(c)). In this connection, Audit conducted a research on the average annual school fees of ESF schools and the other eight largest local international schools (in terms of student number) in the 2003-04 school year (see Figure 3).

Figure 3

**Average annual school fees of
ESF schools and eight largest local international schools
(2003-04 school year)**



**Average annual school fee (Note 3)/
recurrent government subsidy**

Legend: Average annual school fee
 Average annual recurrent government subsidy

Source: *Audit research*

Note 1: *As at 15 September 2003, there were 38 local international schools (excluding 15 ESF schools) which had a total of 16,660 students. In its research, Audit selected the eight largest schools in terms of student number, which had a total of 9,697 students (58%), for comparison.*

Note 2: *The recurrent government subsidies averaged \$21,097 for each ESF primary-school student and \$29,678 for each ESF secondary-school student. The weighted average of these two amounts of subsidies (based on student numbers) was \$25,463.*

Note 3: *Some schools charge different school fees for different primary/secondary classes. For simplicity, the average school fee of each school is used for comparison.*

2.21 As shown in Figure 3, the average annual ESF school fee was the second lowest when compared with the other eight largest local international schools. This was partly due to recurrent government subsidies provided to the ESF. If recurrent government subsidies are fully reflected in ESF school fees, the average annual ESF school fee of \$89,617 will be 69% of the average annual school fee (\$130,316) of the school with the highest average annual school fee, and 140% of that (\$64,000) of the school with the lowest average annual school fee.

Views of the English Schools Foundation

2.22 In September 2004, in response to Audit findings in paragraphs 2.6 to 2.21, the ESF stated that:

- (a) it did not accept that the Government's unilateral action to define ESF schools as international schools should affect their entitlement to recurrent government subsidies. The Government's definition could not be used as a reason to relinquish its financial obligations to ESF schools as they were part of the local educational system, which parents and teachers joined in good faith;
- (b) ESF schools were different from international schools because:
 - (i) they were an integral part of the local school system. The ESF was established by Ordinance in 1967 to meet the needs of the local educational system;
 - (ii) the ESF assumed the responsibility for six schools previously operated by the Government. It agreed to absorb government schools on the understanding that this would not jeopardise their funding arrangements. It managed a sector of the government-aided educational system;
 - (iii) their curriculum was specially adapted to the Hong Kong context;
 - (iv) they adopted a non-selective approach to student intake provided that students could demonstrate fluency in English;
 - (v) they catered for students of all abilities. About 10% of their students were provided with special-need support, including those with severe learning difficulties; and

- (vi) the ESF provided support to the local educational system by virtue of its subvented status, including its assistance in re-opening a failed international school at no cost to the Government and its initiatives in building two schools under the Private Independent School Scheme;

- (c) ESF curriculum was based on the British National Curriculum but was adjusted to the Hong Kong context. Along with the International Baccalaureate curriculum (Note 15) for ESF students between the age of 16 and 19, it offered an internationally accredited quality assurance standard, based on the most progressive ideas in pedagogy. The language of instruction in ESF schools was English because it remained one of Hong Kong's official languages and the world's language of business. In addition, United Kingdom examinations and certification provided ESF students with a channel to the world's best tertiary-education institutions. ESF curriculum was not designed to meet the needs of a foreign or racially exclusive culture. The ESF's mission was to serve Hong Kong children who could benefit from the education it provided. It was not beholden to a foreign culture. It was multi-cultural in its ethos. Its student profile was no longer mainly British, but mainly Chinese and East Asian. Increasingly, ESF graduates entered local universities as well as those around the world;

- (d) it catered for students of over 50 nationalities, not just for a particular group or those wishing to go overseas. More relevant measures of student profile included students' mother-tongue language and their permanent residence status. The ESF would conduct a research on ESF students' mother-tongue language and their permanent residence status, which would show that the majority of its students' families were local;

- (e) it made unique and distinctive contributions to the local educational system and provided it with an international dimension. It upheld excellence in the English usage, through the provision of high-quality English medium teaching by native English teachers;

- (f) there would be costs if the Government removed recurrent subsidies to ESF schools. The costs included:
 - (i) the need for parents of ESF students to find alternative schools for their children;

Note 15: *Since the 2001-02 school year, the ESF has implemented a pilot scheme of adopting the International Baccalaureate curriculum for Year 12 and Year 13 students in one of its secondary schools.*

- (ii) potential decrease in the quality and stability of ESF staff;
 - (iii) reduced enrolments in ESF schools;
 - (iv) reduction in the return of the Government's investment in ESF schools;
 - (v) potential damage to Hong Kong's target to become Asia's world city. The ESF believed that it made an important contribution to Hong Kong's positioning as an international city, by attracting foreign capital and expertise. ESF alumni made contributions in all professions in Hong Kong. The ESF considered it necessary to conduct a research on these contributions; and
 - (vi) foreign families relocating to other countries, and sending their children to schools outside Hong Kong or to schools in Hong Kong which did not provide the desired first-language education. The level of school fees was an important factor for consideration in businesses' decision to locate in Hong Kong, and in parents' decision to choose schools for their children. These would likely have effects on government expenditure, balance of payments and Gross Domestic Product;
- (g) Article 144 of the Basic Law of the Hong Kong Special Administrative Region of the People's Republic of China (the Basic Law) required that policies to support organisations subvented prior to 1997 be maintained. Article 144 of the Basic Law provided that:
- “The Government of the Hong Kong Special Administrative Region shall maintain the policy previously practised in Hong Kong in respect of subventions for non-governmental organisations in fields such as education, medicine and health, culture, art, recreation, sports, social welfare and social work. Staff members previously serving in subvented organisations in Hong Kong may remain in their employment in accordance with the previous system.”;*
- (h) the ESF's conservative fee policy was not predicated on a wish to create additional school places, but to provide value for money and affordable education for the families it served;
 - (i) the understanding reached between the ESF and the EMB in 1999 (see para. 2.10) involved reciprocal undertakings by the Government to review the ESF's ability to use its properties to create additional income, and a commitment not to cap the subsidies to additional ESF classes in future. The EMB was no

longer able to support these undertakings. While wishing to cooperate with the EMB on measures to make it more cost-effective, the ESF did not feel that undertakings made under different circumstances were binding on it. At present, the ESF's client base was considerably more local than it was in 1999. Its ability to derive income from sources alluded to in 1999 was no longer applicable;

- (j) since 1994, it had had a disciplined fee policy. Over the last six years, ESF school fees had increased only once (by less than 5%). This track record had been achieved during a period when government subsidies had been frozen or reduced. By comparison, some international schools had raised their school fees by 30% over the same period. As a subvented organisation, the ESF had been mindful of the need to provide affordable education in line with its mission of serving Hong Kong people;
- (k) it received no subsidies from other countries' governments or non-governmental organisations. It did not seek to promote an alternative national culture and had no religious affiliations. It was grateful for the support that the Government had given it, and believed that it had a strong case for retention of this support; and
- (l) the principle of parity of subsidy remained, until repealed, applicable to the funding of ESF schools. It supported the retention of the parity of subsidy principle and questioned whether the Government could unilaterally relinquish its responsibilities, and provision of public funding, to ESF schools without the consent of the Foundation and its stakeholders.

Views of the Education and Manpower Bureau

2.23 In August and September 2004, in response to Audit findings in paragraphs 2.6 to 2.21 and the ESF's views in paragraph 2.22, the EMB stated that:

- (a) ESF schools were not different in nature, both in terms of the curriculum offered and student mix, from private international schools in Hong Kong. However, due to historical reasons, ESF schools were eligible for recurrent government subsidies whereas private international schools were not. This represented a preferential treatment to the ESF and, as submitted repeatedly by various international schools, created unfair competition among international schools;
- (b) as shown in Appendix D, the ESF enjoyed preferential treatment not only vis-à-vis other international schools but also private independent schools (which

were not provided with recurrent government subsidies) and direct subsidy schools (which were subject to the EMB's various regulatory monitoring);

- (c) since 1999, it had been holding discussions with the ESF on the way to align the Government's relationship with the ESF with prevailing policies. This would include restoring the level playing field in the international school sector;
- (d) throughout the review process, the EMB had been mindful of the possible negative impact on the students studying in ESF schools (e.g. a compromise in the quality of education or a significant increase in tuition fees), and the need to have the ESF's full cooperation in ensuring the smooth implementation of any new arrangements. The EMB had therefore taken a measured pace and proposed alternative funding sources for the ESF, with a view to minimising the impact on it and its constituents;
- (e) in its letter of 16 March 2000, the ESF noted the Government's intention to reduce the recurrent subsidies gradually over a period of time under a phased programme. The ESF emphasised that the phasing-out programme should stretch over thirteen years. The ESF requested the Government to be as flexible as possible in considering future land use of its school and apartment sites so as to facilitate it to generate income to compensate for the removal of government subsidies;
- (f) in January 2003, the ESF made a submission to the Government highlighting its contributions towards the education in Hong Kong and urging for continued government subsidies. The ESF subsequently circulated a letter among parents of ESF students explaining its request to the Government and soliciting their continued support. None of these documents made reference to the ESF's in-principle agreement referred to in inset (e);
- (g) the fact-finding exercise (see paras. 3.14 to 3.16) aimed at reviewing the cost structure of the ESF and identifying possible areas for efficiency-savings. The EMB believed that, through enhancing cost-efficiency, ESF resources could be saved without erosion of education quality or increase in tuition fees. As shown by information obtained through the fact-finding exercise, there should be considerable scope for improvement in the cost-effectiveness of ESF operations; and
- (h) the Department of Justice had advised that:

- (i) Article 144 of the Basic Law should be read together with Article 136 of the Basic Law which provided that:

“On the basis of the previous educational system, the Government of the Hong Kong Special Administrative Region shall, on its own, formulate policies on the development and improvement of education, including policies regarding the educational system and its administration, the language of instruction, the allocation of funds, the examination system, the system of academic awards and the recognition of educational qualifications.

Community organisations and individuals may, in accordance with law, run educational undertakings of various kinds in the Hong Kong Special Administrative Region.”; and

- (ii) the proposal to withdraw recurrent subsidies from the ESF by adopting a phased approach was justifiable as a development and improvement of education under Article 136 of the Basic Law and was consistent with Article 144 read in the light of Article 136 of the Basic Law.

Audit observations

2.24 Audit considers that the EMB needs to expedite action to complete its review of government subsidies to ESF schools and other international schools (see paras. 2.7 to 2.10) for the following reasons:

- (a) **ESF schools receive much more favourable government subsidies than other similar international schools (see paras. 2.11 to 2.15);**
- (b) **the percentage of students studying in non-profit-making international schools without recurrent government subsidies has increased significantly (from nil in the 1963-64 school year to 55% in the 2003-04 school year) since the Government’s policy on subsidising education for English-speaking children was set in 1965 (see paras. 2.16 to 2.18);**
- (c) **over the years, international schools have raised concern about the disparities in government subsidies between ESF schools and other international schools (see para. 2.19); and**

- (d) **recurrent government subsidies provided to ESF schools have created an advantage for these schools over other international schools in terms of both recruitment and retention of staff and students and provision of educational resources (see paras. 2.20 and 2.21).**

2.25 **In the event that the Government decides to withdraw recurrent subsidies to ESF schools, Audit considers that the Government should adopt a phased approach for implementation.** This approach was accepted by the ESF in February 2000 (see Appendix B). Furthermore, the EMB has obtained legal advice that the proposed withdrawal of subsidies to the ESF could be best implemented using a phased approach (see para. 2.7(d)).

Audit recommendations

2.26 **Audit has recommended that the Secretary for Education and Manpower should:**

- (a) **expedite action to complete the review of government subsidies to ESF schools; and**
- (b) **if the recurrent government subsidies to ESF schools are to be withdrawn, implement the withdrawal using a phased approach so that the ESF, its staff and management, its students and their parents can plan well ahead.**

Response from the Administration

2.27 The **Secretary for Education and Manpower** accepts Audit recommendation that it should expedite action to complete the review of government subsidies to ESF schools. He has said that, over the past few years, the Government has been pursuing the review conscientiously through frequent discussions with the ESF.

PART 3: FREEZING GOVERNMENT SUBSIDIES TO ENGLISH SCHOOLS FOUNDATION SCHOOLS AND RECENT FACT-FINDING EXERCISE

3.1 This PART examines the EMB's actions to freeze recurrent government subsidies to ESF schools from the 2000-01 school year and the recent fact-finding exercise jointly conducted by the EMB and the ESF.

Freezing English Schools Foundation per-class subsidies

3.2 Since the 2000-01 school year, as an interim measure on policy rationalisation, the EMB had implemented an arrangement under which ESF per-class subsidies had been frozen at the 1999-2000 school year level. Furthermore, in order to meet its saving targets, the EMB recently made the following adjustments to government subsidies to the ESF:

- (a) ESF per-class subsidies (at the 1999-2000 school year level) were adjusted downwards by 1.8% from 1 April 2003 to 31 December 2003;
- (b) ESF per-class subsidies were adjusted downwards by 4.8% (inclusive of the 1.8% adjustment in inset (a)) from 1 January 2004 to 31 March 2004; and
- (c) ESF per-class subsidies were adjusted downwards by 6.44% (inclusive of the 4.8% adjustment in inset (b)) from 1 April 2004 to 31 March 2005.

Freezing the number of subsidised English Schools Foundation classes

3.3 In April 1997, the then Education Department informed the ESF that prior approval had to be obtained for any additional classes above its existing number of forms of entry in any level in any school if it wished to apply for recurrent government subsidies for such classes.

3.4 In April 2000, the EMB informed the ESF that:

- (a) in order to allow time for the ESF to establish alternative income sources, as an interim measure, the Government would only freeze ESF per-class subsidies at

the 1999-2000 school year level without inflation adjustment with effect from the 2000-01 school year; and

- (b) the number of eligible ESF classes, however, would not be capped.

3.5 In April 2001, the EMB informed the ESF that there would not be additional government subsidies for any increase in student numbers or classes in ESF schools. In April 2004, the EMB again informed the ESF that, in view of the stringent financial constraints, starting from the 2004-05 school year, the Government would not provide extra subsidies to the ESF in respect of any additional classes above the existing level (Note 16), irrespective of whether they fell under the government-approved class structure of the schools concerned (see Appendix F).

Views of the English Schools Foundation

3.6 In September 2004, in response to Audit findings in paragraphs 3.2 to 3.5, the ESF stated that:

- (a) on 3 April 2001, the EMB informed the ESF that “there will not be additional subvention for any increase in student number or classes at ESF schools”. This was a contradiction and reversal of the assurance given by the EMB on 13 April 2000, which stated that “the number of eligible ESF classes will not be capped” (see Appendix F);
- (b) in the last three ESF school years, the Government had not provided some ESF classes with recurrent government subsidies (see Appendix G); and
- (c) the capping of the number of subsidised ESF classes had been in place before 2004-05. The EMB extended the capping of subsidised ESF classes to the previously eligible classes. It did not accept EMB freezing arrangement. It was only informed of EMB decision on the arrangement.

Views of the Financial Services and the Treasury Bureau

3.7 In February 2000, in response to EMB enquiries on the approving authority for the changes in the policy/funding arrangements for government subsidies to the ESF (see

Note 16: *In the 2003-04 school year, the Government was subsidising 186 primary classes and 204 secondary classes in ESF schools, and 6 classes in its special education school.*

paras. 3.2 to 3.5), the Financial Services and the Treasury Bureau (FSTB — Note 17) advised that:

- (a) on its proposal for freezing the subsidies to ESF schools at the 1999-2000 school year level, the EMB would depart from the basis of the funding approval given by the Finance Committee of the Legislative Council at its meeting held on 17 December 1980, which stated that ESF subsidies were to be based on the notional cost of aided schools which were reviewed and adjusted annually;
- (b) however, such a departure did not materially alter the ambit of the Finance Committee's funding approval or give rise to additional financial implications. This was only a transitional measure pending the finalisation of permanent changes to the subsidy arrangements in the near future. Therefore, it was not necessary for the EMB to seek the Finance Committee's explicit approval for the freezing proposal;
- (c) the proposal for freezing the number of subsidised ESF classes despite possible expansion of the ESF sector would be tantamount to the Government unilaterally disqualifying selective ESF classes from subsidies, despite their eligibility under the arrangements approved by the Finance Committee. The FSTB would have reservation about the Government exercising discretion in this manner without reverting to the Finance Committee. Permanent changes to the subsidy arrangements for ESF schools must be formally approved by the Finance Committee; and
- (d) Members of the Legislative Council should be kept informed of the developments.

3.8 In September 2004, in response to Audit findings in paragraphs 3.2 to 3.5, the FSTB stated that:

- (a) upon EMB enquiries, it advised the EMB in July 2004 that, on balance, it was not necessary for the EMB to seek the Finance Committee's approval in respect of EMB proposed arrangement to freeze the number of ESF classes eligible for recurrent government subsidies as from the 2004-05 school year. The FSTB's advice was provided on the understanding that the EMB's proposed arrangement:
 - (i) had been agreed with the ESF, apparently after much deliberation between the EMB and the ESF;

Note 17: *With the implementation of the Accountability System, with effect from 1 July 2002, the FSTB took over the statutory functions of the Finance Bureau.*

- (ii) represented the ESF's conscientious efforts to achieve productivity gains; and
 - (iii) did not carry additional financial implications for the Government; and
- (b) for transparency, it had advised that the EMB should brief the Panel on Education of the Legislative Council on the freezing arrangement.

Views of the Education and Manpower Bureau

3.9 In August/September 2004, in response to Audit findings (see paras. 3.2 to 3.5), the ESF's views (see para. 3.6) and the FSTB's views (see paras. 3.7 and 3.8), the EMB stated that:

- (a) in its letter dated 8 May 2000, the ESF agreed that ESF per-class subsidies should be frozen at the 1999-2000 school year level without inflation adjustment with effect from the 2000-01 school year. The freezing arrangement was intended to be an interim measure with the objective that the ESF would become totally self-financing in the long run. This was also the EMB's effort to help target increased government education spending on local schools;
- (b) since then, the EMB had explored with the ESF possible options for it to generate additional income to facilitate it to operate under a self-financing mode;
- (c) regarding EMB initiative to freeze the number of ESF classes eligible for recurrent government subsidies, the maximum number of subsidised ESF classes was last reviewed and agreed in 1997. Since then, the EMB had provided subsidies to additional ESF classes subject to the approved class structure of each ESF school. However, such approval was contingent upon the availability of resources. Faced with budgetary constraints, the EMB notified the ESF in early 2004 that it would cap the number of subsidised ESF classes; and
- (d) the EMB considered that it was not necessary for it to seek the approval of the Finance Committee on freezing the number of subsidised ESF classes at this stage because:
 - (i) the freezing arrangement was an interim measure pending the completion of the fact-finding exercise and the discussions with the ESF; and

- (ii) the freezing arrangement would not affect the ESF unless it was seeking to operate additional classes.

Audit observations

3.10 Regarding EMB actions to freeze the per-class subsidies to the ESF at the 1999-2000 school-year level from the 2000-01 school year (see para. 3.2), Audit shares the views of the FSTB that, if this is only a transitional measure (i.e. pending the finalisation of permanent changes to the subsidy arrangements in the near future), it may not be necessary for the EMB to seek the Finance Committee's explicit approval for the freezing arrangements (see para. 3.7(a) and (b)). However, it has been four years since the implementation of the freezing arrangements from the 2000-01 school year. **Audit considers that, if the EMB does not envisage that permanent changes to ESF subsidy arrangements can be finalised in the near future, the EMB should seek the Finance Committee's approval for freezing the ESF per-class subsidies.**

3.11 Regarding the EMB's decision to freeze the number of ESF classes eligible for recurrent government subsidies (see paras. 3.3 to 3.5), **Audit shares the views of the FSTB in paragraph 3.8(b) that, for transparency, the EMB should brief the Panel on Education of the Legislative Council on the freezing arrangement.**

Audit recommendations

3.12 **Audit has recommended that the Secretary for Education and Manpower should:**

- (a) **brief the Panel on Education of the Legislative Council on the interim measures of freezing the per-class subsidies to the ESF at the 1999-2000 school-year level, and the number of ESF classes eligible for recurrent government subsidies;**
- (b) **seek the authorisation of the Executive Council and the Legislative Council for the interim measures on providing recurrent government subsidies to the ESF if changes to ESF subsidy arrangements cannot be finalised in the near future; and**
- (c) **seek the approval of the Executive Council and the Legislative Council for changes resulting from EMB review of government subsidies to the ESF.**

Response from the Administration

- 3.13 The **Secretary for Education and Manpower** has said that:
- (a) for the purposes of policy rationalisation and bringing a level playing field between the ESF and other international schools, with the agreement of the ESF, the EMB has implemented interim measures, namely freezing ESF per-class subsidy rate and capping the number of subsidised ESF classes. These measures are to limit the problem of disparity of subsidies between ESF schools and other international schools, while the EMB is reviewing the long-term arrangements for subsidising the ESF;
 - (b) the EMB is aware of the need to seek authorisation for any permanent changes to ESF subsidy arrangements and shall do so as soon as it has reached a decision on the way to implement them; and
 - (c) the EMB plans to report to the Education Panel of the Legislative Council the progress of its review of government subsidies to the ESF.

Recent fact-finding exercise

3.14 In January 2003, the EMB and the ESF formed a joint-review team to conduct a fact-finding exercise to review the cost structure of the ESF and to identify possible areas for savings, with a view to assessing whether the current rate of ESF school fees and the current level of government subsidies are fully justified. At its last meeting held in early July 2003, the joint-review team agreed to set late July 2003 as the target completion date of the fact-finding exercise. Up to the completion of this audit in August 2004, the review had not yet been completed.

3.15 In January 2003, in his letter to a local newspaper, the Secretary for Education and Manpower said that:

- (a) the EMB would conduct a review of the ESF to examine whether the current rate of ESF school fees and the current level of government subsidies were justified;
- (b) if the ESF was found to be cost-efficient, the status quo would be maintained;

- (c) if greater cost savings and productivity gains could be achieved, there would be room for a reduction in school fees and in government subsidies; and
- (d) if the ESF was stretching beyond its limits and needed greater support, there would be a need to justify an increase in government subsidies or possibly in school fees.

3.16 In August 2004, in response to Audit findings in paragraphs 3.14 and 3.15, the EMB stated that:

- (a) the progress of the fact-finding exercise had been unsatisfactory. Nevertheless, the EMB had not spared any effort in pushing it ahead;
- (b) the exercise was originally scheduled for completion in July 2003. However, there was a delay due to the following reasons:
 - (i) it took almost two months for the EMB and the ESF to agree on the scope and terms of reference of the exercise;
 - (ii) during the meetings held between April and July 2003, the ESF provided information to facilitate the exercise. However, the information was not sufficient for completing the exercise;
 - (iii) in late July 2003, the EMB issued the first draft report of the exercise to the ESF for comments. The ESF took three months to respond; and
 - (iv) in late December 2003, the EMB issued the second draft report of the exercise to the ESF for comments. Since then, the EMB had not received a response from the ESF. Without ESF comments on the second draft report, the EMB was unable to complete the exercise unilaterally. As the EMB did not have direct access to ESF files and records, it needed to rely on the ESF to provide information for completing the exercise;
- (c) the EMB realised that the latter stage of the exercise coincided with a tumultuous period of the ESF during which its Chief Executive departed and its Chairman resigned; and
- (d) the EMB's dialogue with the ESF had led to the ESF's offer to make the ESF an organisation subject to VFM audits by Audit as a condition of government subvention.

Audit observations

3.17 The Secretary for Education and Manpower has said that the EMB's recent fact-finding exercise may lead to no change, a reduction or an increase in government subsidies to the ESF (see para. 3.15(b) to (d)). **Audit considers that, if the fact-finding exercise leads to a reduction or an increase in government subsidies to the ESF, this may be at variance with the Government's parity of subsidy principle in subsidising the ESF. The EMB needs to seek the approval of the Executive Council and the Finance Committee for making a variation to the principle.**

Audit recommendation

3.18 **Audit has recommended that the Secretary for Education and Manpower should seek the approval of the Executive Council and the Legislative Council for changes in the approach to providing recurrent government subsidies to the ESF.**

Response from the Administration

3.19 The Secretary for Education and Manpower has said that:

- (a) the fact-finding exercise jointly conducted by the EMB and the ESF aims at examining the scope for greater cost-efficiency in ESF operations; and
- (b) the EMB would revert to the authorising bodies with concrete proposals on the long-term funding arrangement for the ESF and the way leading to it.

Response from the English Schools Foundation

3.20 The ESF has stated that, at the conclusion of the three audit reviews conducted by Audit and upon completion of the associated work, it will expedite completion of the fact-finding exercise.

**The EMB's reviews of
government subsidies to the ESF in 1979 and 1995**

(A) Review in 1979

1. In 1973, in implementing the Government's policy on subsidising the ESF under **the parity of subsidy principle**, the EMB worked out a formula for the calculation of grants payable to ESF schools.
2. In the Director of Audit's Report issued in March 1978, Audit:
 - (a) reported that the general level of subsidies paid to an ESF school exceeded the average of the subsidies paid to two aided schools for Chinese-speaking children (of similar size and class structure) by approximately 18%, the primary factor being that the level of enrolment maintained by the ESF school was well below that of the two aided schools; and
 - (b) suggested that the formula for the calculation of the grants to ESF schools should be adjusted, in order to comply with the Government's policy of parity of subsidy.
3. In 1979, as a result of the ESF's desire for higher standard provisions in its schools and Audit observations on government subsidies to the ESF, the Government set up a committee to review the application of the parity of subsidy principle to the English-speaking schools. In September and December 1980, the Executive Council and the Finance Committee respectively approved the committee's following recommendations on revising the recurrent subsidies to the ESF:
 - (a) the recurrent grant to the ESF should be based on the notional subsidies per capita payable to standard-size aided primary and secondary schools. However, the calculation of the recurrent grant should be increased by a grossing-up factor of 17.6% for both primary-school and secondary-school students to provide for a much greater fluctuation in the number and distribution of students attending English-speaking schools compared to other public-sector schools; and
 - (b) there should be provision for relief of hardship for ESF primary-school and secondary-school students. This should be calculated on 2% and 3% of the basic grant to ESF primary and secondary schools respectively.
4. The changes in ESF subsidy arrangements in paragraph 3 led to a reduction of \$40,000 in annual recurrent subsidies to the ESF. The changes were implemented in the 1980-81 school year.

(B) Review in 1995

5. In early 1995, in response to Legislative Council Members' queries on the higher per capita subsidies for ESF students and better capital subsidy arrangements for ESF schools, the EMB set up a Working Group on Funding Arrangements for the ESF. The Working Group found that the average unit subsidy for ESF schools was higher than that for aided schools. The difference was mainly due to a larger salary grant, the grossing-up factor and the hardship grant. In September 1995, the Executive Council approved the Working Group's following recommendations on revising the subsidies to the ESF:

- (a) the basis for recurrent subsidies should be changed from a per capita basis to one based on the number of classes, adjusted to take into account the difference in class size between ESF schools and local aided schools. In the calculation of new subsidies, the grossing-up factor should be removed but the hardship grants retained; and
- (b) in line with the practice of the aided sector, the capital subsidies should be based on 100% of the construction cost of a standard local aided school adjusted downwards to take into account the smaller enrolment in ESF schools plus a professional fee and related cost (16%). As a variation and in order to enable ESF schools to meet the larger cash-flow requirements in their school building projects, ESF schools should be allowed to convert up to 50% of the capital grant into a loan at no overall additional cost to the Government.

6. The changes in paragraph 5(a) were implemented over a period of two years starting from September 1996. The changes in paragraph 5(b) took immediate effect and have been applied to ESF projects approved thereafter.

Source: EMB records

Exchange of views
 between the EMB and the ESF
 (1999 to 2004)

Date	EMB/ESF	Views
Late 1999	ESF	(a) The ESF was willing to work with the Government for a smooth transition. (b) The Government should allow the ESF to modify its land lease conditions so that it could redevelop the school sites and expand its services.
22 February 2000	EMB	(a) ESF schools were in a category entirely different from international schools and played an important role in providing parents with choice and diversity. (b) Some commercial developments were necessary within the framework of any changes in usage of ESF sites. (c) The Government intended to cap the subsidies to the ESF later and considered that the ESF should finance new classes in future in their entirety. (d) The Government was proposing a phasing programme whereby the subsidies would be gradually reduced over a period of time, with the start date yet to be agreed.
22 February 2000	ESF	(a) The period of phasing out the subsidies should stretch over thirteen years, i.e. the full programme of ESF education. (b) Such an arrangement would ensure that existing ESF students would not be affected by the change and that advance notice could be given to the parents of new students.

Date	EMB/ESF	Views
13 April 2000	EMB	<p>(a) The Government would have great difficulties in agreeing to the ESF's proposed redevelopment of the Borret Road site if it was no longer required for educational purposes.</p> <p>(b) In order to allow time for the ESF to establish alternative income sources, as an interim measure, the Government would only freeze ESF per-class subsidies at the 1999-2000 school year level without inflation adjustment with effect from the 2000-01 school year.</p> <p>(c) The number of eligible ESF classes, however, would not be capped.</p>
8 May 2000	ESF	<p>(a) The ESF agreed with the EMB's proposal on freezing ESF per-class subsidies.</p> <p>(b) The ESF had emphasised to its stakeholders that any phasing out of government subsidies would be carried out in a planned and orderly manner.</p>
15 January 2001	ESF	<p>(a) Unless a radical scheme was envisaged to involve commercial use of ESF leading school sites, it was highly unlikely that sufficient revenue could be raised to replace the one-third of the ESF's costs covered by government subsidies.</p> <p>(b) It was not the time to embark on the scheme on commercial use of ESF school sites in view of the political sensitivity and the property market condition at that time.</p>

Appendix B
(Cont'd)
(paras. 2.10
and 2.25 refer)

Date	EMB/ESF	Views
3 April 2001	EMB	<p>(a) There would not be additional government subsidies for any increase in student numbers or classes in ESF schools.</p> <p>(b) In the longer term, the EMB hoped to restore a level playing field for all international schools. There were various options for achieving this ultimate objective.</p>
29 January 2003	ESF	The ESF agreed to conduct a fact-finding exercise jointly with the EMB.
28 July 2003	EMB	The EMB issued the first draft report on the fact-finding exercise to the ESF for comments.
17 October 2003	ESF	The ESF forwarded its comments on the first draft report to the EMB.
23 December 2003	EMB	The EMB issued the second draft report to the ESF for comments.
24 March 2004	ESF	The ESF informed the EMB its decision that, as a condition of government subvention, the ESF would welcome Audit to perform VFM audits of the ESF.

Source: EMB records

**Curricula and student enrolment of international schools
(15 September 2003)**

Curriculum	Number of schools offering the curriculum (Note 1)	Number of students			
		Primary	Secondary	Total	Percentage of total
British (provided by ESF schools)	15	5,515	5,808	11,323	40%
British (provided by other international schools)	21 (Note 2)	3,815	2,030	5,845	21%
American	6	1,782	1,965	3,747	13%
Canadian	5 (Note 3)	1,603	1,302	2,905	10%
Japanese	2	1,280	331	1,611	6%
Australian	1	516	223	739	3%
French	1	382	242	624	2%
Singaporean	1	607	0	607	2%
German	1	170	134	304	1%
International Baccalaureate	3	225	0	225	1%
Korean	1	18	35	53	1%
Total	57	15,913	12,070	27,983	100%

Source: EMB records

Note 1: A school may offer two different streams of education (e.g. English and French).

Note 2: These include a primary school operated by the ESF without recurrent government subsidies.

Note 3: These include a school operated by the ESF Educational Services Limited.

**Government subsidies to different types of schools
 (2003-04 school year)**

	Government subsidies for construction of school premises	Recurrent government subsidies	Application of Code of Aid (Note 3)
ESF schools	<p>May be provided with:</p> <ul style="list-style-type: none"> — a capital grant for construction of school premises (Note 1); and — up to 50% of the capital grant may be converted into an interest-free loan, the amount of which will be such that the notional compound interest forgone is equal to the amount of the capital grant to be converted. 	<p>Reimbursement of rates and government rents.</p> <p>Recurrent government subsidies calculated on a per-class basis at a rate frozen at the 1999-2000 school year level.</p>	Not applicable
Schools under the Private Independent School Scheme (see Note 9 in para. 1.6)	May be provided with a capital grant for construction of school premises (Note 1).	<p>Reimbursement of rates and government rents.</p> <p>(No other form of recurrent government subsidies.)</p>	Not applicable
Non-profit-making international schools	May be provided with an interest-free loan for construction of school premises (Note 2).	<p>Reimbursement of rates and government rents.</p> <p>(No other form of recurrent government subsidies.)</p>	Not applicable

	Government subsidies for construction of school premises	Recurrent government subsidies	Application of Code of Aid (Note 3)
Aided schools	<p>May be provided with:</p> <ul style="list-style-type: none"> — a capital grant for construction of school premises; or — government-built standard-design school buildings for lease to the operator. 	<p>Reimbursement of rates and government rents.</p> <p>Recurrent government subsidies calculated on a per-class basis.</p>	Applicable
Schools under the Direct Subsidy Scheme (see Note 12 in para. 2.5(c))	<p>May be provided with:</p> <ul style="list-style-type: none"> — a capital grant for construction of school premises (Note 1); or — government-built standard-design school buildings for lease to the operator. 	<p>Reimbursement of rates and government rents.</p> <p>Recurrent government subsidies calculated on the basis of the average unit cost of an aided-school place for each eligible student enrolled and its operating history (Note 4). Non-local students are not eligible for Direct Subsidy Scheme subsidies.</p>	Not applicable, but subject to audit inspections by the EMB

Source: EMB records

Note 1: The amount of the capital grant equals 100% of the cost for building a standard-design public-sector school of the same student population.

Note 2: The amount of the interest-free loan equals 100% of the cost for building a standard-design public-sector school of the same student population.

Note 3: The Code of Aid governs, among other things, appointment and dismissal of staff; implementation of school-based management structure; tendering and purchasing procedures; use of premises; conditions on the use of various types of grants; and audit inspection by the EMB.

Note 4: Under the subsidy formula, a school will be denied of the Direct Subsidy Scheme subsidy if its school fees are beyond two and one-third (2 1/3) of the average unit cost of an aided-school place.

Recurrent government subsidies to the ESF
(2003-04 school year)

ESF schools	No. of classes	Annual recurrent government subsidy per class	Total annual recurrent government subsidy
	(a)	(b)	(c) = (a) × (b)
		(\$)	(\$)
(A) 9 primary schools			
Basic grant			
— schools with special classes	72	674,952	48,596,544
— schools without special classes	114	611,370	69,696,180
Subject grant			88,932
Hardship grant			2,365,854
			120,747,510
(B) 5 secondary schools			
Basic grant			
— schools with special classes	87	876,054	76,216,698
— schools without special classes	117	798,731	93,451,527
Subject grant			1,137,363
Hardship grant			5,090,046
			175,895,634
(C) 1 special education school			
Basic grant			
— primary-school classes	3	1,711,061 (Note 1) 1,659,350 (Note 2)	5,029,761
— secondary-school classes	3	2,177,647 (Note 1) 2,111,910 (Note 2)	6,401,467
Hardship grant			292,639
			11,723,867
Refund of rates and government rents			6,342,344
Total subsidies before saving adjustments			314,709,355
Less: Saving adjustments			(13,299,500)
Total	396		301,409,855 Say \$301 million

Source: EMB records

Note 1: This covered the period from 1 September 2003 to 31 December 2003.

Note 2: This covered the period from 1 January 2004 to 31 August 2004.

**Chronology of events of freezing
 the number of subsidised ESF classes**

Date	Event
2 April 1997	The then Education Department informed the ESF that prior approval had to be obtained for any additional ESF classes above the existing number of approved forms of entry (i.e. number of subsidised classes in each grade of a school) in any grade of any ESF school if it wished to apply for recurrent government subsidies for such classes.
30 May 1997	The then Education Department informed the ESF that, if there was insufficient enrolment in ESF classes, the number of ESF classes eligible for recurrent government subsidies would be reduced according to the minimum fill-up rates (Note 1).
11 May 1999	In response to the ESF's proposed extension works in ESF School 3 (see Appendix H) for operating more classes, the then Education Department informed the ESF that: <ul style="list-style-type: none"> (a) it might operate a total of ten Year 7 classes in ESF School 3, but government recurrent subsidies would only cover eight classes as previously approved; and (b) the capital and future maintenance costs of the proposed extension works would be met by the ESF.

Note 1: *The minimum fill-up rates of ESF classes for the purpose of determining the number of ESF classes eligible for recurrent government subsidies are as follows:*

<i>Year</i>	<i>Number of classes in any one grade</i>	<i>Minimum fill-up rate</i>
<i>Year 1-11 (Class size 30)</i>	<i>2</i>	<i>60%</i>
	<i>3</i>	<i>75%</i>
	<i>4 and above</i>	<i>85%</i>
<i>Year 12-13 (Class size 25)</i>	<i>2</i>	<i>60%</i>
	<i>3 and above</i>	<i>80%</i>

Source: EMB records

Date	Event
13 April 2000	<p>The EMB informed the ESF that:</p> <ul style="list-style-type: none">(a) as an interim measure, the Government would only freeze ESF per-class subsidies at the 1999-2000 school year level without inflation adjustment with effect from the 2000-01 school year; and(b) the number of eligible ESF classes, however, would not be capped.
8 September 2000	<p>The ESF sought clarifications from the then Education Department regarding its decision to cap the number of forms of entry (for Year 7 to Year 10) of ESF School 3 and ESF School 4. It quoted the EMB's statement of "the number of eligible ESF classes will not be capped" in its letter of 13 April 2000.</p>
19 September 2000	<p>The then Education Department informed the ESF that:</p> <ul style="list-style-type: none">(a) as stated in its letter of 2 April 1997, prior approval had to be obtained for any additional classes above the existing number of approved forms of entry in any grade of any ESF school if it wished to apply for recurrent subsidies for such classes; and(b) additional classes that exceeded the number of approved forms of entry of ESF School 3, ESF School 4 and ESF School 6 could not be counted as eligible classes for government subsidy purpose (see Appendix H).
3 April 2001	<p>The EMB informed the ESF that there would not be additional government subsidies for any increase in student numbers or classes in ESF schools.</p>

Date	Event
19 December 2001	<p>The EMB informed the ESF that:</p> <ul style="list-style-type: none">(a) a separate school under the ESF would be operated at the Lai Yiu premises as from January 2002 (Note 2). This school would be merged with a new school in Ma On Shan under the Private Independent School Scheme in September 2004;(b) no government subsidies were involved for these arrangements; and(c) all new classes operated at the Lai Yiu premises would not attract any government subsidies.
24 June 2002	<p>The then Education Department reiterated to the ESF that the number of ESF classes eligible for recurrent government subsidies in any grade of an ESF school should not exceed the number of approved forms of entry in that grade of that school.</p>
1 April 2004	<p>The EMB informed the ESF that, in view of the stringent financial constraints, starting from the 2004-05 school year, the Government would not provide extra subsidies to the ESF in respect of any additional classes above the existing level, irrespective of whether they fell under the government-approved class structure of the schools concerned (Note 3).</p>

Source: EMB records

Note 2: *This is the school referred to in paragraph 1.4(b). The opening of the new school in Ma On Shan has been postponed to September 2006.*

Note 3: *The maximum number of subsidised ESF classes under the approved class structure of 14 ESF schools (excluding the ESF special education school) is 396. In these 14 schools, there were 376 subsidised ESF classes in the 2000-01 school year, and 390 subsidised ESF classes in the 2003-04 school year.*

**Number of classes operated by the ESF
not being provided with recurrent government subsidies
(2001-02 to 2003-04 school years — Note 1)**

School year	No. of such classes in five ESF schools	No. of such classes in a primary school operated by the ESF at the Lai Yiu premises (Note 2)
2001-02	9	6
2002-03	16	9
2003-04	21 (Note 3)	12

Source: ESF records and ESF estimates

Note 1: The ESF has estimated that the potential recurrent government subsidies on the 15 classes not being provided with the subsidies in the 2001-02 school year amounted to \$10.2 million, on the 25 classes in the 2002-03 school year amounted to \$17.9 million, and on the 33 classes in the 2003-04 school year amounted to \$22.4 million.

Note 2: This is the school referred to in paragraph 1.4(b). Audit notes that, in December 2001, the EMB informed the ESF that classes in a primary school operated by the ESF at the Lai Yiu premises (i.e. the school at issue) would not attract any government subsidies (see Appendix F).

Note 3: Audit notes that, according to EMB records, in the 2003-04 school year, the number of ESF classes in operation (after fill-up rate adjustment) exceeded the number of approved forms of entry by 21 (see Appendix H).

**Number of approved ESF forms of entry and classes in operation
(2003-04 school year)**

ESF school	No. of approved forms of entry	No. of classes in operation (after fill-up rate adjustment)	No. of classes in operation exceeding no. of approved forms of entry	No. of classes in operation below no. of approved forms of entry
	(a)	(b)	(c) = (b) - (a)	(d) = (a) - (b)
(A) School 1				
Year 1	3	5	2	N/A
Year 2	3	4	1	N/A
Year 3	3	4	1	N/A
Year 4	3	4	1	N/A
Year 5	3	4	1	N/A
Year 6	3	4	1	N/A
Subtotal			7	N/A
(B) School 2				
Year 7	6	6	0	0
Year 8	6	6	0	0
Year 9	6	6	0	0
Year 10	6	6	0	0
Year 11	6	5	N/A	1
Year 12	6	6	0	0
Year 13	6	6	0	0
Subtotal			0	1
(C) School 3				
Year 7	8	9	1	N/A
Year 8	8	9	1	N/A
Year 9	8	9	1	N/A
Year 10	8	8	0	0
Year 11	8	9	1	N/A
Year 12	8	7	N/A	1
Year 13	8	6	N/A	2
Subtotal			4	3

Appendix H
(Cont'd)
(Appendix F and
Appendix G refer)

ESF school	No. of approved forms of entry	No. of classes in operation (after fill-up rate adjustment)	No. of classes in operation exceeding no. of approved forms of entry	No. of classes in operation below no. of approved forms of entry
	(a)	(b)	(c) = (b) - (a)	(d) = (a) - (b)
(D) School 4				
Year 7	5	7	2	N/A
Year 8	5	6	1	N/A
Year 9	5	6	1	N/A
Year 10	5	5	0	0
Year 11	5	5	0	0
Year 12	5	5	0	0
Year 13	5	4	N/A	1
Subtotal			4	1
(E) School 5				
Year 7	6	6	0	0
Year 8	6	6	0	0
Year 9	6	6	0	0
Year 10	6	6	0	0
Year 11	6	6	0	0
Year 12	6	7	1	N/A
Year 13	6	7	1	N/A
Subtotal			2	0
(F) School 6				
Year 7	5	6	1	N/A
Year 8	5	6	1	N/A
Year 9	5	5	0	0
Year 10	5	6	1	N/A
Year 11	5	5	0	0
Year 12	5	6	1	N/A
Year 13	5	4	N/A	1
Subtotal			4	1
Total			21	6

Source: EMB records

Remarks: Of the 15 ESF schools, the number of classes in each year (after fill-up rate adjustment) of 9 schools was equal to the corresponding number of approved forms of entry. These schools are not shown in this Appendix.

Acronyms and abbreviations

Audit	Audit Commission
EMB	Education and Manpower Bureau
ESF	English Schools Foundation
FSTB	Financial Services and the Treasury Bureau
VFM	Value for money