

## **CHAPTER 2**

### **Education Bureau**

<p><b>Governance and administration of Direct Subsidy Scheme schools</b></p>
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**Audit Commission  
Hong Kong  
25 October 2010**

*This audit review was carried out under a set of guidelines tabled in the Provisional Legislative Council by the Chairman of the Public Accounts Committee on 11 February 1998. The guidelines were agreed between the Public Accounts Committee and the Director of Audit and accepted by the Government of the Hong Kong Special Administrative Region.*

Report No. 55 of the Director of Audit contains 11 Chapters which are available on our website at <http://www.aud.gov.hk>.

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# GOVERNANCE AND ADMINISTRATION OF DIRECT SUBSIDY SCHEME SCHOOLS

## Contents

	<b>Paragraph</b>
<b>PART 1: INTRODUCTION</b>	1.1
Background	1.2 – 1.4
Conditions for admission to the Direct Subsidy Scheme	1.5 – 1.6
Direct Subsidy Scheme subsidy	1.7
Monitoring of Direct Subsidy Scheme schools	1.8 – 1.14
Audit review	1.15 – 1.16
General response from the Administration	1.17 – 1.18
Acknowledgement	1.19
<b>PART 2: GOVERNANCE OF DIRECT SUBSIDY SCHEME SCHOOLS</b>	2.1
Incorporation of school governing body	2.2
Composition of school governing body	2.3
Audit observations and recommendations	2.4 – 2.8
Response from the Administration	2.9
Registration of school managers	2.10
Audit observations and recommendations	2.11 – 2.15
Response from the Administration	2.16

	<b>Paragraph</b>
Meetings of school governing bodies	2.17
Audit observations and recommendations	2.18 – 2.23
Response from the Administration	2.24
Declaration of interest	2.25 – 2.26
Audit observations and recommendations	2.27 – 2.28
Response from the Administration	2.29
 <b>PART 3: SCHOOL FEE REMISSION/SCHOLARSHIP SCHEMES</b>	 3.1
Funding of school fee remission/scholarship schemes	3.2
Audit observations and recommendations	3.3 – 3.9
Response from the Administration	3.10
Administration of fee remission/scholarship schemes by schools	3.11
Audit observations and recommendations	3.12 – 3.17
Response from the Administration	3.18
 <b>PART 4: REVISION OF SCHOOL FEES</b>	 4.1
Approval for revision of school fees	4.2 – 4.3
Consultation with parents	4.4
Audit observations and recommendations	4.5 – 4.7
Response from the Administration	4.8
Financial projections in applications	4.9
Audit observations and recommendation	4.10 – 4.14
Response from the Administration	4.15

	<b>Paragraph</b>
<b>PART 5: FINANCIAL MANAGEMENT</b>	5.1
Government and non-government funds	5.2
Reserve balances	5.3
Audit observations and recommendations	5.4 – 5.8
Response from the Administration	5.9 – 5.10
Maintenance of sufficient operating reserve	5.11
Audit observations and recommendations	5.12 – 5.13
Response from the Administration	5.14
Private classes	5.15
Audit observations and recommendations	5.16 – 5.17
Response from the Administration	5.18 – 5.19
Non-local students	5.20
Audit observations and recommendation	5.21 – 5.22
Response from the Administration	5.23 – 5.24
Audited accounts	5.25
Audit observations and recommendations	5.26 – 5.28
Response from the Administration	5.29
Interest income from government funds	5.30
Audit observations and recommendation	5.31 – 5.32
Response from the Administration	5.33
Use of government funds	5.34
Audit observations and recommendation	5.35 – 5.36
Response from the Administration	5.37

	<b>Paragraph</b>
Use of non-government funds	5.38
Audit observations and recommendations	5.39 – 5.44
Response from the Administration	5.45
Investment of surplus funds	5.46
Audit observations and recommendation	5.47 – 5.48
Response from the Administration	5.49
Fixed asset management	5.50
Audit observations and recommendations	5.51 – 5.52
Response from the Administration	5.53
Fund raising activities	5.54
Audit observations and recommendations	5.55 – 5.60
Response from the Administration	5.61
<b>PART 6: HUMAN RESOURCE MANAGEMENT</b>	<b>6.1</b>
Staff recruitment	6.2
Audit observations and recommendations	6.3 – 6.12
Response from the Administration	6.13
Staff remuneration	6.14 – 6.15
Audit observations and recommendations	6.16 – 6.17
Response from the Administration	6.18
Performance management	6.19
Audit observations and recommendations	6.20 – 6.21
Response from the Administration	6.22

	<b>Paragraph</b>
Staff contract renewal	6.23
Audit observations and recommendations	6.24 – 6.25
Response from the Administration	6.26
 <b>PART 7: GENERAL ADMINISTRATION</b>	 7.1
Procurement of goods and services	7.2
Audit observations and recommendations	7.3 – 7.12
Response from the Administration	7.13
Trading operations	7.14 – 7.15
Audit observations and recommendations	7.16 – 7.23
Response from the Administration	7.24
	 <b>Page</b>
<b>Appendix:</b> Acronyms and abbreviations	60





## **PART 1: INTRODUCTION**

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

### **Background**

1.2 In June 1988, the Education Commission (Note 1) published its Report No. 3. The Commission recommended the introduction of a Direct Subsidy Scheme (DSS), under which schools would receive a recurrent subsidy based on the number of students enrolled. The objective of introducing such a Scheme was to inject diversity to the school system through the growth of a strong private school sector so that parents would have greater choice in finding suitable schools for their children. The Government accepted the recommendation, and in May 1990, announced the introduction of the DSS with effect from the 1991/92 school year (Note 2).

1.3 To meet the policy objective of giving more choices to parents, DSS schools are allowed to have greater flexibility in various areas including school management, resources deployment, staff appointment, curriculum design, student admission and fees collection so that they can cater for the diverse needs of their students in a more responsive manner.

1.4 In 1998, the Government reviewed its private school policy with the aim of fostering a more vibrant and diverse private school sector and providing parents with greater choice. To provide expansion in the private school sector, especially DSS schools, the Chief Executive announced in his 1998 Policy Address the following improvement measures:

- (a) to enhance the capital and recurrent assistance for DSS schools; and
- (b) to allocate to sponsoring bodies government-built school premises for the operation of non-profit-making DSS schools.

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**Note 1:** *The Education Commission advises the Secretary for Education on the overall educational objectives and policies, and the priorities for implementation of its recommendations having regard to the resources available.*

**Note 2:** *Unless otherwise specified, all years mentioned hereinafter refer to school years which start on 1 September of a year and end on 31 August of the following year.*

## Conditions for admission to the Direct Subsidy Scheme

- 1.5 At present, schools admitted to the DSS:
- (a) must have self-owned school premises;
  - (b) must be non-profit-making;
  - (c) should be in sound financial situation with accumulated operating reserve sufficient to meet at least two months' operating expenses;
  - (d) are not allowed to operate private classes without prior approval from the Education Bureau (EDB);
  - (e) should issue an annual prospectus and ensure that its contents are updated and factually correct;
  - (f) are required to offer principally a curriculum targeted at local students and prepare them to sit for the relevant local public examinations;
  - (g) are required to enter into a 10-year service agreement with the Government. The objective is to enhance the schools' accountability and to facilitate the development of performance-based school management; and
  - (h) should be prepared to abide by new rules concerning the DSS.

1.6 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.

### Direct Subsidy Scheme subsidy

1.7 DSS subsidy is payable on a per student basis. The amount is derived with reference to the average unit cost of an aided school place, the operating history of the school (Note 3) and the school fees charged by the school. For 2009/10, the DSS subsidy ranged from \$28,134 (for Primary One school places) to \$56,371 (for Secondary Seven

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**Note 3:** *DSS schools which have been established for 16 years or more will receive additional recurrent subsidy per student per year. For 2009/10, the annual additional recurrent subsidy per student ranged from \$3,135 (for primary schools) to \$6,869 (for sixth form classes of secondary schools).*

school places). A DSS school will receive full subsidy until its fee level reaches two and one-third of the average unit cost of an aided school place. Beyond this level, no recurrent subsidy will be provided. To make DSS schools more accessible to students from less well-off families, DSS schools are required to set aside at least 10% of their fee income for a fee remission/scholarship scheme with a set of eligibility benchmarks no less favourable than the student financial assistance schemes offered by the Government.

### **Monitoring of Direct Subsidy Scheme schools**

1.8 DSS schools are accountable to the public for the quality of their education services and the proper use of the government and school funds. They are required to adhere to the following guiding principles issued by the EDB for the proper and effective operation of schools:

- (a) complying with laws and regulations;
- (b) putting the interests of students as the first priority;
- (c) operating the school in a fair, just and open manner;
- (d) maintaining transparency in school management;
- (e) taking key stakeholders' concerns into consideration in the decision making process;
- (f) deploying resources properly and effectively; and
- (g) making reflections and improvement through continuous evaluation.

1.9 To ensure that DSS schools meet the service and operation standards required, the EDB has instituted a control and monitoring mechanism, which comprises both compliance vetting and quality assurance assessment.

#### ***Compliance vetting***

1.10 The purpose of compliance vetting is to check, by way of information collected regularly through different channels (e.g. annual school plans, school inspections, and audited accounts), whether there is any breach of the school operating requirements, particularly in the following areas:

- (a) admission conditions and requirements;

- (b) statutory requirements; and
- (c) financial management.

1.11 Appropriate actions (including termination of subsidies) could be taken if a DSS school does not pass the compliance vetting. Follow-up reviews by the EDB will be carried out to ensure timely rectification of the situation.

*Quality assurance assessment*

1.12 The purpose of the quality assurance assessment of a DSS school is to provide an external review on the performance of the school as a whole. The EDB may assess the performance of the school by conducting:

- (a) full inspections along areas such as management and organisation, teaching and learning, support for students and school ethos, and attainment and achievement;
- (b) focus inspections on one of the areas (e.g. discipline, home-school cooperation, medium of instruction, and teaching and learning of a subject);
- (c) external school review; or
- (d) other new performance measures to be introduced in the future.

1.13 Assessment in the form of a comprehensive review will be made after the first five-year period of the school's admission into the DSS. After the assessment, the EDB may:

- (a) require the school to draw up and implement an action plan to overcome the identified problems within a reasonable period;
- (b) monitor the progress of implementation of the action plan; and
- (c) conduct follow-up inspections.

1.14 If the EDB considers that the school fails to improve, the EDB may:

- (a) appoint additional school managers to the school for such a period as it thinks fit;

- (b) not renew the School Management Committee (SMC)/Incorporated Management Committee (IMC) Service Agreement by giving the SMC/IMC nine months' notice before that Agreement expires;
- (c) terminate the SMC/IMC Service Agreement at any time before its expiry by giving the SMC/IMC nine months' notice to that effect; or
- (d) take any other measures as it thinks fit.

### **Audit review**

1.15 The Audit Commission (Audit) has recently conducted a value for money audit on the DSS covering the administration of the Scheme and the governance and administrative matters of the DSS schools. Audit reviewed the files and records of the EDB and visited four DSS schools to obtain a better understanding of their operation. The audit findings are contained in two separate reports, as follows:

- (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 report).

1.16 Audit's review of the governance and administration of DSS schools focused on the following areas:

- (a) governance of Direct Subsidy Scheme schools (PART 2);
- (b) school fee remission/scholarship schemes (PART 3);
- (c) revision of school fees (PART 4);
- (d) financial management (PART 5);
- (e) human resource management (PART 6); and
- (f) general administration (PART 7).

Audit has identified a number of areas where there is room for improvement and has made a number of recommendations to address the issues.

## General response from the Administration

1.17 The **Secretary for Education** fully appreciates Audit's efforts in conducting this study and making recommendations to improve the governance and administration of DSS schools. He has said that the EDB:

- (a) appreciates the observations and recommendations made by Audit in the study, which evidently point out the areas for improvement for both the EDB and DSS schools;
- (b) has to play an appropriate monitoring role to enhance the governance, accountability and transparency of the operation of DSS schools, and sees the imminent needs to facilitate DSS schools to strengthen their governance structure as well as their internal control mechanism with a view to enhancing accountability and transparency;
- (c) will consider the preventive measures to minimise the possibility of non-compliance, and systematise the intervention measures to ensure timely rectification;
- (d) will work together with the DSS schools to strengthen the management of DSS schools, and will facilitate DSS schools to put in place a proper governance structure with appropriate composition to oversee the management of the school and a sound mechanism for internal control with adequate built-in control measures to avert any possible abuses; and
- (e) while refraining from micro-managing, will issue clear guidelines and render timely and effective intervention and support to DSS schools.

1.18 The **Secretary for Education** has also said that:

- (a) DSS schools should demonstrate to the public that they are delivering quality school education service in an accountable and transparent manner;
- (b) flexibility enjoyed by DSS schools is not boundless. To ensure that DSS schools exercise their flexibility in an accountable manner, the EDB has all along attached paramount importance to facilitating DSS schools put in place a sound and proper participatory governance framework with proper internal control mechanism, which would in turn help enhance transparency and accountability of the operation of schools;

- (c) the EDB considers that autonomy should go hand in hand with accountability. While the EDB has to play an appropriate monitoring role to enhance the governance, accountability and transparency of the operation of DSS schools, the EDB is not involved in the day-to-day operation of DSS schools;
- (d) the SMC/IMC of a DSS school should be properly set up with appropriate composition and full awareness of its role in the management and oversight of the school. In addition, a control and monitoring mechanism, which comprises both compliance vetting and quality assurance has been instituted by the EDB for DSS schools;
- (e) if non-compliance of requirements is identified or malpractices are substantiated, the EDB would issue advisory or warning letters to the responsible persons demanding rectification within a specified time. Follow-up investigation visits or reviews will be conducted to ensure timely rectification of the situation. If the non-compliance persists or systemic problems have been identified in schools, the EDB will render appropriate support/intervention to the schools concerned. Depending on the gravity of the problems, the EDB may appoint school managers to the SMC/IMC, take punitive measures such as withholding or withdrawing part of the DSS subsidy where appropriate, and report to relevant law enforcement agencies should there be suspected illegal and corruption cases; and
- (f) if non-compliance of requirements or malpractices continue even after warning has been given and intervention been administered, the EDB may withdraw the subsidy payable to the school with a resultant loss of DSS status. In exceptional cases, the EDB may terminate the SMC/IMC Service Agreement at any time before the expiry of the Agreement.

## **Acknowledgement**

1.19 Audit would like to acknowledge with gratitude the full cooperation of the staff of the EDB and the four DSS schools during the course of the audit review.

## **PART 2: GOVERNANCE OF DIRECT SUBSIDY SCHEME SCHOOLS**

2.1 This PART examines issues relating to the governance of DSS schools.

### **Incorporation of school governing body**

2.2 With effect from 2000/01, the governing body of a school joining the DSS must be incorporated under:

- (a) the Education Ordinance (Cap. 279) as an IMC;
- (b) the Companies Ordinance (Cap. 32) as an SMC; or
- (c) the school's own incorporation ordinance.

### **Composition of school governing body**

2.3 The school governing body consists of school managers. It is accountable for the management and operation of the school. It is therefore important that the school governing body comprises school managers representing the school's key stakeholders (e.g. representatives of the School Sponsoring Body (SSB), the principal, parents, teachers, members of the community and, when appropriate, alumni). The required composition of:

- (a) the IMCs is stipulated in the Education Ordinance; and
- (b) the SMCs is specified in the service agreements signed between the SSBs and the EDB.

### **Audit observations and recommendations**

#### ***School managers representing parents and teachers***

2.4 In 2009/10, six DSS schools were managed by school governing bodies incorporated under their respective incorporation ordinances. The compositions of these six school governing bodies were not subject to the requirements laid down in the Education Ordinance and the service agreements signed between the SSBs and the EDB.



2.5 Audit examination of the composition of the six school governing bodies revealed that they did not include representatives of parents and teachers as school managers. Audit noted that the incorporation ordinances of these schools were enacted in the 1960s or earlier, when many modern corporate governance practices (e.g. the practice of having representatives of key stakeholders in the governing body to enhance transparency and accountability) were not yet developed. To ensure that the governance of DSS schools is in line with the modern good practices, the EDB should urge DSS schools to include representatives of key stakeholders in their school governing bodies.

#### *Disclosure of school manager information*

2.6 Under the Education Ordinance, the Permanent Secretary for Education is required to maintain a register of IMCs, in which the name, tenure of office and category of each manager of the IMCs shall be entered and shall be made available for public inspection. There is no such disclosure requirement for school managers of school governing bodies other than the IMCs.

2.7 Audit considers that the disclosure requirement stipulated in the Education Ordinance is essential to enhancing the transparency of a school governing body. The EDB should consider extending the disclosure requirement to all DSS schools.

#### *Audit recommendations*

2.8 **Audit has recommended that the Secretary for Education should urge all DSS schools to:**

- (a) **include representatives of key stakeholders in their school governing bodies; and**
- (b) **disclose to the public information of their governing bodies, including the name, tenure of office and category of each school manager.**

#### **Response from the Administration**

2.9 The **Secretary for Education** welcomes and agrees with the audit recommendations. He has said that:

- (a) the EDB will encourage schools of different backgrounds, including those having their own incorporation ordinance, to take into account the latest policy development and consider the recommendations that will better facilitate their effective operation of the school with increased accountability and transparency; and

- (b) the EDB has reminded DSS schools in circulars and instructions that governing bodies of DSS schools should be properly set up with appropriate composition and full awareness of its role in the management and oversight of the school. To meet the public expectation and/or specific composition requirements applicable to individual schools, DSS schools should include all key stakeholders, including the principal, representatives from the SSBs, parents, teachers, other community members or professionals, and where appropriate, alumni, as school managers.

### **Registration of school managers**

2.10 Under the Education Ordinance, no person shall act as a manager of a school unless he is registered with the EDB as a school manager.

### **Audit observations and recommendations**

#### *Nomination and election of parent school manager*

2.11 The Education Ordinance stipulates that an IMC must have at least one parent school manager. Parent school managers must be elected through a secret-ballot election conducted by the parent-teacher association (PTA) of the school, in which all parents can participate. Audit noted that the PTA of a school had nominated its chairman as the parent school manager. There was no record showing that an election had been conducted.

#### *Submission of medical certificate*

2.12 According to the Education Ordinance, any person of 70 years of age or over applying for registration as a school manager may be refused, if he fails to produce a medical certificate certifying that he is physically fit to perform the functions of a school manager.

2.13 Audit examined the records of 20 DSS schools and noted that two school managers of a school were not registered. In response to Audit enquiry, in June 2010, the school informed Audit that the two managers had attained the age of 70 and were reluctant to submit medical certificates for registration. Therefore, they did not apply for registration.

*Cancellation of registration of school managers*

2.14 The supervisor of a school is required under the Education Ordinance to inform the EDB within a month after a person ceases to be a school manager to cancel the registration of the manager. As of June 2010, Audit noted that the supervisor of a school did not inform the EDB to cancel the registration of the following school managers:

- (a) a school manager who had not attended any SMC meeting of the school since 2002;
- (b) another school manager whose tenure of office ended in August 2009; and
- (c) the ex-principal who had resigned with effect from March 2010.

*Audit recommendations*

2.15 **Audit has recommended that the Secretary for Education should remind DSS schools to:**

- (a) **ensure that parent school managers of the IMC are elected through a secret-ballot election conducted by the PTA of the school, in which all parents can participate, and keep proper records of the election;**
- (b) **ensure that all school managers are registered; and**
- (c) **inform the EDB within a month after a person ceases to be a school manager.**

**Response from the Administration**

2.16 The **Secretary for Education** agrees with the audit recommendations. He has said that:

- (a) all schools, including DSS schools, are liable for the compliance of the relevant provisions of the Education Ordinance related to the registration of school managers;
- (b) the EDB will remind DSS schools with IMC to observe the stipulations of the Education Ordinance about the IMC, including the election of different categories of managers; and
- (c) the EDB will also strengthen internal procedures to ensure that, in approving the registration of managers, schools have complied with the relevant requirements of the Education Ordinance.

## **Meetings of school governing bodies**

2.17 Audit visited four DSS schools in May and June 2010 and examined the records of school governing body meetings. Audit noted that there was room for improvement in matters relating to meetings.

## **Audit observations and recommendations**

### *Attendance at meetings*

2.18 In August 2006, the EDB issued a School Managers' Handbook. According to the good practices set out in the Handbook, a school manager should have commitment and set aside time to be involved in and well acquainted with the school. This includes preparing for and attending meetings, contributing to discussions and taking part in agreed actions after meetings.

2.19 Audit examination of the attendance records of school governing body meetings of the four DSS schools revealed that in two schools, the attendance rates of some school managers were low. Details are as follows:

- (a) a school manager of a school attended only one of the four meetings in 2008/09 and one of the three meetings in 2009/10 (up to February 2010); and
- (b) three school managers of another school did not attend any of the two meetings in 2009/10 (up to February 2010). One of them also did not attend any meetings in 2007/08 and 2008/09.

### *Quorum at school governing body meetings*

2.20 No business shall be transacted at any school governing body meetings unless a quorum is present. If a quorum is not present, the meeting should be adjourned. Audit examination of the minutes of meetings of the four DSS schools revealed that, in the following two schools, a quorum was not present at some meetings:

- (a) the Memorandum and Articles of Association of the SMC of one school stipulated that the quorum for an SMC meeting should include not less than seven SSB school managers. Audit noted that, of the 15 meetings held in the period 2006/07 to 2009/10 (up to February 2010), a quorum was not present at 9 meetings; and

- (b) according to the constitution of the IMC of another school, the quorum for an IMC meeting is not less than half of all the managers, five of which shall be SSB school managers. Audit noted that at the IMC meeting held in November 2009, only four SSB school managers were present.

### *Minutes of meetings*

2.21 The School Managers' Handbook issued by the EDB states that:

- (a) the draft minutes should be checked by the supervisor before circulation among managers for comments and endorsement, preferably within one month of each meeting; and
- (b) the minutes of meetings should record briefly the main points made in the discussion, the decisions and the persons responsible for follow-up actions.

2.22 During the visits to the four DSS schools, Audit noted that:

- (a) for the SMC meetings held in 2008/09 and 2009/10 (up to February 2010), the average time taken by two schools to issue the draft minutes was 63 and 77 days respectively. No time target was set by these two schools to ensure that draft SMC meeting minutes were issued in a timely manner; and
- (b) the SMC meeting minutes of another school only briefly recorded the decisions made by the SMC. No record was kept for the discussions at the meetings. For example, the minutes of the meeting held in August 2008 recorded the SMC's approval for the purchase of two to three properties to be used as staff quarters. The discussions on the matter and the person responsible for follow-up actions were not recorded in the minutes.

### *Audit recommendations*

2.23 **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 take action, where necessary, to improve the attendance rate;**
- (b) **rectify the decisions made at their school governing body meetings where a quorum was not present;**

- (c) **take necessary measures to ensure that, in future, a quorum is present at every school governing body meeting; and**
- (d) **issue draft minutes of school governing body meetings in a timely manner and to properly record the deliberations and decisions made at these meetings.**

### **Response from the Administration**

2.24 The **Secretary for Education** agrees with the audit recommendations. He has said that the EDB will facilitate DSS schools to strengthen their internal control mechanism for SMC/IMC meeting procedures.

### **Declaration of interests**

2.25 According to the EDB's guidelines on school administration, the SMCs should:

- (a) put in place proper procedures to require school personnel, including school managers, to declare any conflict of interest that might influence their judgement in the performance of their duties; and
- (b) properly record the declarations, preferably on a standard form, or in the notes of meeting as appropriate.

2.26 On the other hand, the IMCs are required to follow the procedures outlined in the Education Ordinance for managing conflict of interest. Under the Ordinance:

- (a) school managers are required to make to the IMCs a written declaration, at least once in every 12 months, to state the particulars of any pecuniary or other personal interest that they have in any matter that raises or may raise a conflict with their duties as school managers; and
- (b) the IMCs should maintain a register of the declarations made by the school managers.

### **Audit observations and recommendations**

2.27 During the visits to the four DSS schools, Audit noted that:

- (a) in two schools, contrary to the EDB's guidelines, the SMC had not drawn up any guidelines on declaration of interests and kept any record of the declarations made;
- (b) in one school, annual declaration of interests was not submitted by a school manager in 2007/08 and by another one in 2009/10; and
- (c) in the remaining school, contrary to the requirement under the Education Ordinance, the IMC did not maintain a register of declarations made by its school managers.

*Audit recommendations*

2.28 **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.**

**Response from the Administration**

2.29 The **Secretary for Education** agrees with the audit recommendations. He has said that:

- (a) the EDB will facilitate DSS schools to improve their systems and procedures relating to declaration of interests by school managers;
- (b) DSS schools have been reminded in the EDB circulars and instructions that they should draw up guidelines on declaration of conflict of interest and take appropriate actions upon receipt of such declarations; and
- (c) a set of guidelines on handling conflict of interest is already available for schools' necessary action.

## **PART 3: SCHOOL FEE REMISSION/SCHOLARSHIP SCHEMES**

3.1 This PART examines issues relating to the school fee remission/scholarship schemes of DSS schools.

### **Funding of school fee remission/scholarship schemes**

3.2 DSS schools are required to adopt a fee remission/scholarship scheme in order that students will not be deprived of the chance to study at DSS schools solely because of their inability to pay school fees. For the purpose of running a fee remission/scholarship scheme, DSS schools are required to set aside:

- (a) 10% of the school fee income; or
- (b) if the school fees are between the range of two-thirds, and two and one-third of the DSS subsidy rate, 50% of the school fees over and above two-thirds of the subsidy rate,

whichever is the greater.

### **Audit observations and recommendations**

#### *School fee income set aside for fee remission/scholarship schemes*

3.3 Audit examination of the 2008/09 audited accounts submitted by 67 (Note 4) DSS schools to the EDB revealed that:

- (a) the fee remission/scholarship schemes of five schools were not funded from school fee income, contrary to the EDB's requirement. One of them used government funds for running its scholarship scheme; and
- (b) the amounts of school fee income set aside by 22 (33%) schools for their fee remission/scholarship schemes were less than those required according to the levels of their school fees (see Table 1).

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**Note 4:** *In 2008/09, there were 71 DSS schools. Up to June 2010, only 67 schools had submitted their audited accounts for 2008/09.*



**Table 1**  
**Underprovision for fee remission/scholarship schemes**  
**(2008/09)**

Underprovided amount	Number of schools
\$1 to < \$50,000	10
\$50,000 to < \$250,000	5
\$250,000 to < \$500,000	2
\$500,000 to < \$750,000	2
\$750,000 to < \$1 million	2
\$1 million and above (Note)	1
<b>Total</b>	<b>22</b>

*Source: Audit analysis of EDB records*

*Note: The underprovided amount was \$3 million.*

3.4 The EDB would remind the schools to set aside sufficient school fee income for running fee remission/scholarship schemes when it was aware that the amount set aside was insufficient. Audit noted that one of the 22 schools mentioned in paragraph 3.3(b) had been reminded repeatedly by the EDB since September 2005 to set aside sufficient amount for running its fee remission/scholarship scheme. However, no action had been taken by the school up to June 2010.

3.5 In September 2010, the EDB informed Audit that it would consider taking more vigorous action (e.g. issue of a warning letter) against DSS schools' non-responsiveness to the EDB's repeated advice.

*Utilisation of amount set aside for fee remission*

3.6 Audit examination of the 2008/09 audited accounts submitted by 62 DSS schools (Note 5) revealed that in 14 schools, the utilisation of the fee remission/scholarship schemes was 50% or less (see Table 2).

**Table 2**  
**Utilisation of fee remission/scholarship schemes**  
**(2008/09)**

Utilisation rate (Note) (%)	Number of schools
0	1
1 to 20	3
21 to 50	10
51 to 70	7
71 and above	41
<b>Total</b>	<b>62</b>

*Source:* Audit analysis of EDB records

*Note:* The utilisation rate is calculated by comparing the amount of fee remission/scholarship approved during the year to that of the school fee income set aside by the schools for the scheme.

*Follow-up action on excessive fee remission reserve*

3.7 According to the EDB's current practices, when a DSS school's reserve for the fee remission/scholarship scheme accumulated to an amount that exceeded half of its annual school fee income, the school would be required to submit to the EDB a deployment plan on how the reserve could be more effectively deployed for its intended purposes.

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**Note 5:** The five DSS schools mentioned in paragraph 3.3(a) were excluded from this analysis.

3.8 Based on the examination of the 2007/08 audited accounts submitted by DSS schools, the EDB identified that the reserves for fee remission of six DSS schools had exceeded half of their annual school fee income. Audit noted that, up to June 2010:

- (a) the EDB had only required four of the six schools to submit a deployment plan; and
- (b) no deployment plan was submitted by two of the four schools.

#### *Audit recommendations*

3.9 **Audit has recommended that the Secretary for Education should:**

- (a) **take action to ensure that DSS schools set aside the required amounts of school fee income according to the levels of their school fees for the fee remission/scholarship schemes;**
- (b) **follow up with DSS schools to look into the causes of the low utilisation of their fee remission/scholarship schemes and advise them to make improvement, where appropriate; and**
- (c) **ensure that DSS schools submit deployment plans on the excessive reserves for their fee remission/scholarship schemes.**

#### **Response from the Administration**

3.10 The **Secretary for Education** agrees with the audit recommendations and will take follow-up action. He has said that for the school reported in paragraph 3.3(a), which had wrongly charged its 2008/09 scholarship expenditure to the government funds, it has agreed to rectify the mistake upon the EDB's advice.

#### **Administration of fee remission/scholarship schemes by schools**

3.11 DSS schools are required to provide details of the fee remission/scholarship schemes in the service agreements signed by the school governing bodies and in the school prospectuses. Audit review of the service agreements and school prospectuses of the four schools visited in May and June 2010 and scrutiny of the websites of all DSS schools revealed that there was room for improvement in administering the fee remission/scholarship schemes.

## **Audit observations and recommendations**

### ***Implementing fee remission schemes***

3.12 Audit review of the service agreements of the four DSS schools revealed that one school had committed that it would:

- (a) set up a fee remission committee and draw up procedural guidelines for processing and approving fee remission applications; and
- (b) review the fee remission scheme from time to time.

3.13 The school joined the DSS in 2006 and had set up its fee remission schemes. However, up to June 2010, it had not set up the fee remission committee and drawn up the procedural guidelines. Audit considers that the EDB should:

- (a) require DSS schools to ensure that fee remission schemes outlined in their service agreements would be satisfactorily implemented; and
- (b) monitor the implementation of the fee remission schemes by the schools.

### ***Publicity of fee remission/scholarship schemes***

3.14 Under the DSS, schools are required to provide full details of the fee remission/ scholarship schemes in their prospectuses. Audit review of the four DSS schools revealed that only two schools had mentioned their fee remission/scholarship schemes in their prospectuses. However, full details of the schemes (e.g. the eligibility criteria and the maximum percentage of fee remission) were not provided.

3.15 Audit scrutiny of the websites of all the 72 DSS schools also 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.

To improve the publicity of the fee remission/scholarship schemes, it is desirable for DSS schools to upload details of the schemes to their websites.

*Eligibility criteria of fee remission/scholarship schemes*

3.16 Under the DSS, the eligibility criteria of the fee remission/scholarship schemes offered by DSS schools should not be less favourable than the government financial assistance schemes to students (e.g. grants schemes operated by the Student Financial Assistance Agency). Of the fee remission/scholarship schemes offered by the 23 DSS schools mentioned in paragraph 3.15(b), Audit noted that:

- (a) a school only offered full fee remission to students receiving Comprehensive Social Security Assistance. The fee remission for other eligible students was capped at 50%; and
- (b) a school only offered fee remission to students who had attained a pass in all three core subjects and with good conduct (grade B or above).

*Audit recommendations*

3.17 **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:**
  - (i) **establish a mechanism for monitoring the proper implementation of their fee remission/scholarship schemes;**
  - (ii) **provide full details (e.g. the eligibility criteria and the maximum percentage of fee remission) of their fee remission/scholarship schemes in their school prospectuses;**
  - (iii) **upload details of their fee remission/scholarship schemes to their websites; and**
  - (iv) **ensure that the eligibility criteria of their fee remission/scholarship schemes are not less favourable than the government financial assistance schemes to students.**

**Response from the Administration**

3.18 The **Secretary for Education** agrees with the audit recommendations and will take follow-up action. He has said that for the school reported in paragraph 3.13, the fee remission committee was set up in August 2010 to process students' applications in accordance with the procedural guidelines.

## **PART 4: REVISION OF SCHOOL FEES**

4.1 This PART examines issues relating to the revision of school fees.

### **Approval for revision of school fees**

4.2 According to the EDB, DSS school fees should cover tuition fees and other subscriptions collected from students to meet operational expenses for educational purposes. DSS schools are required to seek the EDB's approval if they revise their school fees. In 2009/10, the annual school fees charged by DSS schools ranged from \$0 to \$110,000 (see Table 3).

**Table 3**

**Annual school fees  
(2009/10)**

<b>Class level</b>	<b>Amount (\$)</b>
Primary 1 to 6	6,930 – 60,000
Secondary 1 to 3	0 – 52,000
Secondary 4 and 5	3,000 – 52,000
Secondary 6 and 7	3,000 – 110,000

*Source: EDB records*

4.3 For 2008/09 and 2009/10, the EDB approved 30 and 18 applications respectively for school fee increases. For these two years, the approved school fee increases ranged from \$500 to \$17,500 and from \$100 to \$12,000 respectively.

### **Consultation with parents**

4.4 In 2009/10, a school intending to apply for school fee increase was required by the EDB to consult the parents and obtain consent from the majority of them, if:

- (a) it applied for a fee increase exceeding 7%; or

- (b) the accumulated operating reserve of its government and non-government fund accounts at the end of the previous year exceeded its annual operating expenses.

If a school applied for a fee increase not exceeding 7%, and its accumulated operating reserve at the end of the previous year did not exceed its annual operating expenses, the school was required to consult either its PTA or parent representatives.

## **Audit observations and recommendations**

### ***Records of majority consent of parents obtained***

4.5 Audit examination of the records of the 18 approved school fee increase applications for 2009/10 revealed that in 6 (33%) applications, the schools were required to obtain consent from the majority of the parents. All these six schools informed the EDB in their applications that they had obtained the consent. However, in one application, supporting documents (e.g. letters to obtain consent from parents) were not provided.

### ***Disclosure of relevant financial information***

4.6 Audit examined the records of the five applications which were supported by documentary evidence of obtaining majority consent from the parents. Audit noted that for all these applications, relevant financial information (e.g. major items of income and expenditure in audited accounts for the previous school year or budget for the coming school year) of the schools was not provided to the parents. For example, in one application, the parents were informed that the school would be operating in deficit from 2009/10 onwards and the school proposed to increase its school fees by 25% for 2009/10. However, the parents were not informed that the school's estimated accumulated operating reserve up to 2008/09 was about \$15 million, which was sufficient to cover 27% of the school's estimated total operating expenses for 2009/10.

### ***Audit recommendations***

- 4.7 **Audit has recommended that the Secretary for Education should:**
- (a) **consider requiring all schools to follow the practice of some schools to submit records of the majority consent of the parents or the consultation with the PTA/parent representatives, as appropriate, in their applications for school fee increases; and**
  - (b) **require schools to provide relevant financial information (e.g. major items of income and expenditure in the audited accounts or the budget) to the parents or the PTA/parent representatives during the consultation process for school fee increases.**

## **Response from the Administration**

4.8 The **Secretary for Education** agrees with the audit recommendations. He has said that:

- (a) in processing school fee revision applications, it is the EDB's usual practice to ask schools to furnish the EDB with any records or information, where appropriate, of parent consultation for consideration. The EDB will continue to exercise professional judgement during the processing exercise; and
- (b) the EDB will require DSS schools to provide relevant financial information to the parents or the PTA/parent representatives during the consultation process for school fee increases.

## **Financial projections in applications**

4.9 DSS schools are required to maintain sufficient accumulated operating reserves to meet at least two months' operating expenses. Financial viability is one of the justifications that will be accepted by the EDB for approving an application for school fee increases. A school applying for school fee increases is required to project, by taking into account the proposed school fee increases, its year-end accumulated operating reserve to demonstrate how the school's financial viability will be improved by the school fee increases.

## **Audit observations and recommendation**

4.10 In 14 of the 30 approved applications for fee increases in 2008/09, the schools projected that their accumulated operating reserves (ranging from a deficit of \$6.8 million to a surplus of \$6.9 million) would not be sufficient to meet two months' operating expenses by the end of 2008/09. However, 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% (see Table 4); and



Table 4

**Projected and actual year-end  
accumulated operating reserves of 8 DSS schools  
(31.8.2009)**

<b>Projected reserve (a) (\$ million)</b>	<b>Actual reserve (b) (\$ million)</b>	<b>Difference (c) = (b) – (a) (\$ million)</b>
4.5	31.7	27.2 (604%)
0.3	1.8	1.5 (500%)
6.9	26.7	19.8 (287%)
6.7	17.5	10.8 (161%)
2.0	4.8	2.8 (140%)
4.1	9.7	5.6 (137%)
2.3	5.4	3.1 (135%)
4.4	9.3	4.9 (111%)

*Source: Audit analysis of EDB records*

- (b) in 3 schools, the projected deficit in accumulated operating reserves turned out to be surplus (see Table 5).

Table 5

**Projected and actual year-end  
accumulated operating reserves of 3 DSS schools  
(31.8.2009)**

<b>Projected surplus/(deficit) (\$ million)</b>	<b>Actual surplus/(deficit) (\$ million)</b>
(6.7)	0.8
(1.4)	4.1
(1.0)	3.7

*Source: Audit analysis of EDB records*

4.11 Underestimation of accumulated operating reserves was also found in 15 of the remaining 16 applications. The largest underestimation was made by a school which estimated that its accumulated operating reserve by the end of 2008/09 would be about \$20 million. However, the actual reserve turned out to be \$81 million.

4.12 Audit noted that in one application, the operating deficit was grossly overestimated. In the application for school fee increases for 2008/09, the school stated that:

- (a) the depreciation expenses of the new school building for 2008/09 would be about \$12 million (22% of the estimated cost of \$54 million); and
- (b) after taking into account the additional income of school fee increases, the school's deficit would be about \$7.5 million for 2008/09.

4.13 If the school had followed the normal practice to provide for the depreciation of its school building over a longer period of say, 50 years, the depreciation expenses of the new school building would have been about \$1 million (i.e. 2% of the estimated cost of \$54 million). Thus, an operating surplus should have been projected, which might have obviated the need to apply for the school fee increases.

#### *Audit recommendation*

4.14 **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.**

#### **Response from the Administration**

4.15 The **Secretary for Education** agrees with the audit recommendation. He has said that the EDB will continue to ensure that the financial projections made by DSS schools in their applications for school fee increases are properly justified and reasonable.

## **PART 5: FINANCIAL MANAGEMENT**

5.1 This PART examines issues of financial management of DSS schools.

### **Government and non-government funds**

5.2 While DSS schools are given flexibility in their funding, they are required to be accountable for the proper use of school funds in the best interest of their students and the schools. Government funds of DSS schools consist of all subsidies (e.g. DSS subsidy and reimbursement of rates) they receive from the Government. Non-government funds consist of incomes received by them from other sources. Examples of non-government funds include school fees, donations, rental income, and profits from trading operations. DSS schools are required to:

- (a) keep separate accounts for transactions relating to government funds and non-government funds;
- (b) charge only approved expenditures to government funds;
- (c) if the funds are not exhausted, retain the balance of government funds for educational use in subsequent years, subject to clawback provision for individual grants, e.g. Capacity Enhancement Grant; and
- (d) submit annual audited accounts to the EDB.

### **Reserve balances**

5.3 DSS schools are allowed to retain their operating surpluses and have them rolled over in reserve accounts. An analysis of the 2008/09 audited accounts of 67 DSS schools (see Note 4 to para. 3.3) indicated that, as at 31 August 2009, the accumulated operating reserves of:

- (a) 3 schools were in deficit, ranging from \$50,000 to \$11 million; and
- (b) 64 schools were in surplus, ranging from \$430,000 to \$220 million (see Table 6).

**Table 6**  
**Accumulated operating reserves of 64 DSS schools**  
**(31.8.2009)**

Accumulated operating reserve	Number of schools
More than \$90 million (Note)	1
More than \$70 million to \$90 million	4
More than \$50 million to \$70 million	6
More than \$30 million to \$50 million	11
More than \$10 million to \$30 million	26
\$0 to \$10 million	16
<b>Total</b>	<b>64</b>

*Source: Audit analysis of EDB records*

*Note: The accumulated operating reserve of the school was \$220 million including that from non-subvented programmes.*

## **Audit observations and recommendations**

### ***Reserve ceiling for DSS schools***

5.4 According to Financial Circular No. 9/2004 promulgated in September 2004, subvented organisations, including DSS schools, may place surpluses arising from subvented programmes into a reserve. The surpluses may come from unspent subvention or unspent income from other sources supporting a subvented programme. Government bureaux/departments should, in consultation with the Financial Services and the Treasury Bureau (FSTB), set an appropriate reserve ceiling for such surpluses. Any surplus in excess of the ceiling should be returned to the Government (e.g. by way of offsetting from next year's subvention), or dealt with in accordance with the arrangements agreed between the Government and the organisations. In this connection, Audit noted that:

- (a) the EDB had not set a reserve ceiling for the DSS schools which commenced operation in or after 2005/06 (i.e. after the promulgation of the Financial Circular in September 2004); and

- (b) no record was available showing that the EDB had consulted the FSTB for not complying with the guidelines to set a reserve ceiling for the operating surpluses of these schools.

#### *Development plan for excessive accumulated operating reserve*

5.5 The EDB requires DSS schools to submit development plans when their accumulated operating reserves exceed an amount equivalent to a full year's operating expenses. The plans should set out how their accumulated operating reserves will be used for school development.

5.6 Audit examination of the 2007/08 audited accounts submitted by 65 DSS schools (Note 6) revealed that, as at 31 August 2008, the accumulated operating reserves of 13 schools (ranging from \$23 million to \$212 million) exceeded the level equivalent to a full year's operating expenses. Of these 13 schools:

- (a) 5 (38%) schools were not required by the EDB to submit a development plan. No record was available showing the reasons why the EDB had not done so; and
- (b) one school refused to submit a development plan. It informed the EDB that most of its operating reserve was generated from the assets of its SSB, and thus did not belong to the school. No follow-up action was taken by the EDB. Further examination of the EDB records revealed that the school's accumulated operating reserve as at 31 August 2007 also exceeded the level equivalent to a full year's operating expenses. The school refused to submit a development plan to the EDB for the same reason.

#### *Information provided in development plan*

5.7 Audit examination of the development plans submitted by seven schools revealed that the plans submitted by five schools did not provide detailed information (e.g. implementation timetables, budgets, performance targets and expected impacts) on the activities or programmes outlined therein. An example is given in Case 1.

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**Note 6:** *Up to June 2010, of the 66 DSS schools in 2007/08, 65 schools had submitted the 2007/08 audited accounts to the EDB.*

### Case 1

In the development plan submitted by a school, it was stated that the accumulated operating reserve would be used to:

- (a) further enhance the teacher-to-class ratio;
- (b) improve teaching facilities;
- (c) provide additional assistance and further improve services to students under the new 3-3-4 academic structure; and
- (d) enhance the fee remission/scholarship schemes.

#### *Audit comments*

While the development plan set out the broad directions of how the accumulated operating reserve would be used for school development, key information (such as the timetables, budgets, targets and expected impacts) on how these broad directions would be implemented was not provided. Audit considers that the school should have been required to provide the information on how the broad directions in the development plan were to be implemented.

*Source: Audit analysis of EDB records*

#### *Audit recommendations*

5.8 **Audit has recommended that the Secretary for Education should:**

- (a) **in consultation with the FSTB, 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 according to Financial Circular No. 9/2004;**
- (b) **take necessary action to ensure that DSS schools with accumulated operating reserves exceeding an amount equivalent to a full year's operating expenses submit development plans setting out how the reserves will be used for school development; and**
- (c) **take necessary action to ensure that sufficient information is provided in the development plans submitted by the schools to facilitate the EDB's monitoring of the implementation of the development plans.**

## Response from the Administration

5.9 The **Secretary for Education** agrees with the audit recommendations. He has said that:

- (a) the EDB will critically assess the pros and cons of setting a reserve ceiling and consult DSS schools and the FSTB in this respect;
- (b) though there is no reserve ceiling set for DSS schools, it is the EDB's prevailing practice that DSS schools with huge surpluses are required to forward to the EDB a plan on the intended use of surpluses for school and educational purposes;
- (c) DSS schools may need to accumulate financial resources for long term development, for instance, improving school facilities or expanding/enhancing staff team/structure for various educational programmes under planning;
- (d) the existing practice aims to safeguard the flexibility for DSS schools to have longer term financial planning for their development, while dissuading them from keeping huge surpluses in the absence of any prudent school development plan to meet the students' needs; and
- (e) for the five schools reported in paragraph 5.6(a), the EDB has been liaising with them for the formulation of a development plan.

5.10 The **Secretary for Financial Services and the Treasury** agrees with the audit recommendations. He has said that the FSTB will work with the EDB on setting a reserve ceiling for the accumulated operating reserve of DSS schools.

## Maintenance of sufficient operating reserve

5.11 One of the EDB requirements for admitting a school to the DSS is that it should be in a sound financial position with an accumulated operating reserve sufficient to meet at least two months' operating expenses. The SSB of a DSS school is required to finance any possible deficit and to ensure that the school will meet the operating reserve requirement.

## Audit observations and recommendations

5.12 Audit examination of the 2007/08 audited accounts of DSS schools revealed that six schools did not follow the EDB's requirement on maintaining sufficient accumulated operating reserves. The SSBs of three of the six schools did not provide additional funding to the schools to top up the reserves. As at 31 August 2009, the accumulated operating reserves of two of these three schools were still below the level of two months' operating expenses.

### *Audit recommendations*

5.13 **Audit has recommended that the Secretary for Education should take necessary measures to ensure that:**

- (a) **DSS schools maintain sufficient operating reserves to meet at least two months' operating expenses; and**
- (b) **the SSBs finance any possible deficit of the schools so that the schools will meet the operating reserve requirement.**

### **Response from the Administration**

5.14 The **Secretary for Education** agrees with the audit recommendations. He has said that the EDB will continue to monitor the financial operating reserve levels of DSS schools according to the EDB's prevailing guidelines and procedures.

### **Private classes**

5.15 In 2008/09, six DSS schools obtained prior approval from the EDB for operating private classes. According to Financial Circular No. 9/2004, subvented organisations (including DSS schools) running self-financing activities without any subvention from the Government are required to:

- (a) keep a separate set of accounts for these activities; and
- (b) ensure that there is no cross-subsidisation of self-financing activities by subvented programmes in money or in kind.

### **Audit observations and recommendations**

5.16 Audit examination of the 2008/09 audited accounts of the six schools which operated private classes revealed that:

- (a) two schools did not have separate accounts for their private classes;
- (b) three schools had separate accounts for the expenditure of their private classes, but not for the income and accumulated operating reserves; and
- (c) the remaining school had separate accounts for the income and expenditure of its private classes, but not for the accumulated operating reserve.



### *Audit recommendations*

- 5.17 **Audit has recommended that the Secretary for Education should:**
- (a) **remind DSS schools of the requirements relating to self-financing activities stipulated in Financial Circular No. 9/2004; and**
  - (b) **require them 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 in money or in kind.**

### **Response from the Administration**

5.18 The **Secretary for Education** agrees with the audit recommendations. He has said that the EDB will:

- (a) remind DSS schools of the requirements stipulated in Financial Circular No. 9/2004; and
- (b) require DSS schools to keep separate accounts for their private classes and report in the audited accounts to ensure that there is no cross-subsidisation of the private classes in money or in kind.

5.19 The **Secretary for Financial Services and the Treasury** agrees with the audit recommendations.

### **Non-local students**

5.20 Non-local students refer to persons entering Hong Kong for the purpose of education with a student visa/entry permit issued by the Director of Immigration. The existing policy is that these students are not eligible for government subsidy.

### **Audit observations and recommendation**

5.21 Audit noted that as at 30 September 2008, 162 non-local students were admitted by 17 DSS schools. The EDB records indicated that no DSS subsidy was paid to these 17 schools for their non-local students. However, Audit noted that:

- (a) the school fees paid by both the local and non-local students at these schools were the same; and

- (b) no separate accounts were kept for the non-local students by these schools as revealed in their audited accounts for 2008/09.

The non-local students attended the same classes together with the local students and had access to the same facilities. Since no separate accounts were prepared for the non-local students, it was difficult to ascertain whether they were cross-subsidised by the DSS subsidy for the local students.

### *Audit recommendation*

5.22 **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. For example, the EDB may require those schools which admit non-local students to collect from the non-local students an amount of school fees not less than the DSS unit subsidy plus the approved school fees for local students.**

### **Response from the Administration**

5.23 The **Secretary for Education** agrees with the audit recommendation. He has said that the EDB will consider feasible means to ensure that non-local students are not cross-subsidised by the government subsidy for local students as soon as practicable.

5.24 The **Secretary for Financial Services and the Treasury** agrees with the audit recommendation.

### **Audited accounts**

5.25 DSS schools are required to submit to the EDB their annual audited accounts, which should be prepared in the formats prescribed by the EDB, by the end of March in the following school year.

### **Audit observations and recommendations**

#### *Submission of audited accounts*

5.26 Audit reviewed the submission of the 2007/08 and 2008/09 audited accounts by DSS schools and noted that, up to the end of June 2010, there were delays in submission by some schools (see Table 7).

**Table 7**  
**Delays in submission of audited accounts**  
**(30.6.2010)**

Delay in submission	Number of schools	
	2007/08 audited accounts	2008/09 audited accounts
Not yet submitted	1	4
13 months	1	0
Over 2 months to 3 months	4	0
Over 1 month to 2 months	4	5
1 month or below	20	19
<b>Total</b>	<b>30</b>	<b>28</b>

*Source: Audit analysis of EDB records*

#### ***Auditor's report***

5.27 Under the DSS, a school is required to ensure that its external auditor's report on the school's accounts will include a statement that the school has used the government subsidies in accordance with the rules promulgated by the EDB for the DSS. For the 2008/09 audited accounts submitted by 67 DSS schools, Audit noted that the requirement was not complied with in the auditor's reports of 18 schools:

- (a) in 9 (50%) reports, the auditors stated that the schools had complied with the accounting requirements promulgated by the EDB for aided schools; and
- (b) in the other 9 (50%) reports, the auditors did not make any reference to any rules promulgated by the EDB.

#### ***Audit recommendations***

5.28 **Audit has recommended that the Secretary for Education should take necessary measures to 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.

### Response from the Administration

5.29 The **Secretary for Education** agrees with the audit recommendations. He has said that the EDB will:

- (a) remind DSS schools of the requirements relating to audited accounts; and
- (b) issue advisory letters to DSS schools not submitting their audited accounts after the final reminder, requesting them to give explanation of the delay and inform the EDB of their target date of submission.

### Interest income from government funds

5.30 DSS schools are required to keep proper accounts for the income and expenditure of government funds, which should be separated from those of non-government funds. They are also required to maintain separate bank accounts for government funds and non-government funds.

### Audit observations and recommendation

5.31 Audit examination of the accounting records of a school for 2006/07 to 2008/09 revealed that some of the interest income from government funds was not recorded in the school's government fund accounts. The interest income for the three years was understated by about \$448,000 (see Table 8).

**Table 8**

**Understatement of interest income in government fund accounts  
(2006/07 to 2008/09)**

Interest income	2006/07 (\$)	2007/08 (\$)	2008/09 (\$)	Total (\$)
Actual (a)	228,738	208,521	45,689	<b>482,948</b>
Recorded in the government fund accounts (b)	24,670	9,115	1,437	<b>35,222</b>
Understatement (c) = (a) - (b)	204,068	199,406	44,252	<b>447,726</b>

*Source: Audit analysis of school records*

*Audit recommendation*

5.32 **Audit has recommended that the Secretary for Education should remind DSS schools to ensure that all interest income from government funds is recorded in the government fund accounts.**

**Response from the Administration**

5.33 The **Secretary for Education** agrees with the audit recommendation and will take follow-up action.

**Use of government funds**

5.34 Under the DSS, only approved expenditure items can be charged to the government funds. Other expenditure items (e.g. staff welfare, tax, donation and expenses incurred not for educational purposes) should not be charged.

**Audit observations and recommendation**

5.35 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 three teachers in an exchange visit to a sister school in Shanghai;
- (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 to keep dogs to guard against illegal immigrants entering the school premises; and
- (d) a tax payment of \$4.1 million and a donation payment of \$5.1 million.

*Audit recommendation*

5.36 **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.**

## **Response from the Administration**

5.37 The **Secretary for Education** agrees with the audit recommendation. He has said that:

- (a) DSS schools have been reminded in an EDB circular that only approved expenditure items of educational nature can be charged to the government fund accounts. Disallowable expenditure items, including fringe benefits for staff not included in the remuneration packages, expenses arising from schools' negligence, loans to staff or third parties, donations, losses of investment and self-financed building projects, should not be charged to the government fund accounts; and
- (b) the EDB will continue to remind DSS schools to ensure that only approved expenditure items are charged to the government fund accounts.

## **Use of non-government funds**

5.38 Under the DSS, schools are allowed flexibility in the use of non-government funds. According to the guidelines issued by the EDB in November 2007, in principle, only expenditure for educational and school needs should be charged to non-government funds.

## **Audit observations and recommendations**

5.39 While DSS schools are given great freedom in the use of non-government funds, they are accountable to the public to ensure that funds are used to provide quality education to students. DSS schools should be required to formulate school policies on the use of non-government funds, which should be made transparent to the stakeholders. To further enhance the accountability of DSS schools on the use of such funds, the EDB may also consider requesting DSS schools to disclose to their stakeholders major items of expenditure charged to non-government funds.

5.40 During the visits to the four DSS schools, Audit identified areas where there was room for improvement in the use of non-government funds. The audit findings are summarised in paragraphs 5.41 to 5.43.

***Purchase of properties***

5.41 During the period 2006 to 2009, a school used its non-government funds of \$10 million to purchase three properties as staff quarters for native-speaking English teachers. Audit found that:

- (a) one of the three properties was purchased in August 2006 without the prior approval of the SMC. Covering approval for the purchase was obtained in March 2007;
- (b) the school was not the registered owner of the properties. The properties were registered under the names of the supervisor and the principal. The supervisor and the principal signed a declaration of trust stating that they held the properties as trustees. In response to Audit enquiry, in September 2010, the EDB informed Audit that the trust arrangement was considered improper because:
  - (i) there was no written instrument to create the declaration of trust;
  - (ii) one of the declarations of trust was not presented for adjudication to the Stamp Duty Office promptly;
  - (iii) all declarations of trust were not registered at the Lands Registry; and
  - (iv) upon the establishment of the SMC, the properties should have been transferred back to the SMC the soonest possible; and
- (c) in August 2008, the SMC decided to dispose of one of the properties. However, no record was available showing that:
  - (i) the school had taken action to dispose of the property; and
  - (ii) the SMC had been informed of the progress of the disposal.

***Training programme for principals from the Mainland***

5.42 A school organised a training programme for school principals from the Mainland. Under the programme, seven-day training courses would be held in the period October 2009 to May 2011 for about 1,000 principals. In response to Audit enquiry, in June 2010, the school informed Audit that apart from providing trainers, the school also provided free accommodation, transportation and lunch to the participants. Up to May 2010, expenses of about \$151,000 were incurred for the programme and were charged to the school's non-government funds. Although considerable school resources would be devoted to the programme and the programme would not benefit the students of the school directly, Audit noted that:

- (a) the SMC was not informed of the details of the programme before its implementation;
- (b) the SMC's approval for the programme was not obtained;
- (c) a budget for the programme was not prepared; and
- (d) the SMC was not informed of the progress of the programme.

#### *Loans to a company*

5.43 The 2008/09 audited account of a school showed that as at 31 August 2009, a limited company owed the school \$250,800. In response to Audit enquiry, in June 2010, the school informed Audit that:

- (a) the school was a shareholder of the company, holding 200 (with a nominal value of \$200) of the 1,500 shares issued by the company;
- (b) the company repaid \$20,000 to the school in December 2009 and had committed to repay \$30,000 by December 2010; and
- (c) up to June 2010, no agreement was reached between the school and the company on the settlement of the outstanding balance of \$200,800.

#### *Audit recommendations*

5.44 **Audit has recommended that the Secretary for Education should:**

- (a) **require DSS schools to formulate guidelines on the use of non-government funds; and**
- (b) **consider requiring DSS schools to disclose to their stakeholders the major expenditure items funded by non-government funds with a view to improving their accountability and transparency.**

#### **Response from the Administration**

5.45 The **Secretary for Education** agrees with the audit recommendations. He has said that the EDB will:



- (a) issue a circular on the use of non-government funds by recapitulating the prevailing rules, regulations and guidelines for DSS schools, compliance or reference, as appropriate, to ensure proper use of non-government funds;
- (b) remind DSS schools of the prevailing requirement to publish an annual school report with a financial summary for public reference to enhance accountability and transparency; and
- (c) explore with DSS schools the detailed arrangements of disclosing the major expenditure items funded by non-government funds in the financial summary.

### **Investment of surplus funds**

5.46 According to EDB Circular No. 2/2003, surplus funds which are not immediately required for use by schools (including 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 because of the risk of financial loss.

### **Audit observations and recommendation**

5.47 Audit noted that, contrary to the EDB's guidelines, one of the four schools visited by Audit invested part of its surplus funds in financial instruments (e.g. local equities and investment funds) instead of placing them in time deposits or savings accounts. As at 27 February 2010, the market values of the investments in local equities and investment funds were \$28 million and \$43 million respectively. No record was available showing that the school had evaluated the risks involved and obtained approval from its SMC before making the investment.

#### ***Audit recommendation***

5.48 **Audit has recommended that the Secretary for Education should take necessary measures to ensure that the EDB's guidelines on investment of surplus funds of schools are complied with by DSS schools.**

### **Response from the Administration**

5.49 The **Secretary for Education** agrees with the audit recommendation. He has said that the EDB has been preparing guidelines on purchase of properties by using non-government funds and will include the guidelines into the proposed circular on the use of non-government funds to be issued soon (see para. 5.45(a)). The basic principles and

implementation mechanisms of the guidelines are also applicable to other well-justified investment activities.

### **Fixed asset management**

5.50 According to the EDB's guidelines, schools should:

- (a) keep a fixed asset register to record the fixed assets under the schools' control; and
- (b) conduct physical checking of assets at least once a year. The results and records of the checking should be retained. Any discrepancies found should be investigated and reported to the school governing bodies.

### **Audit observations and recommendations**

5.51 Audit examination of the fixed asset records of the four DSS schools revealed that:

- (a) the fixed asset register of a school:
  - (i) did not record the quantity of 322 categories of assets. For example, the quantity of African drums and file cabinets were not recorded in the register; and
  - (ii) included a vehicle which was sold in 2007; and
- (b) the fixed asset register of another school included 18 notebook computers which had actually been disposed of. In 2008/09, there was no stocktaking exercise.

### ***Audit recommendations***

5.52 **Audit has recommended that the Secretary for Education should remind DSS schools to:**

- (a) **correctly record the fixed assets under their control in a fixed asset register; and**
- (b) **conduct physical stocktake at least once a year and investigate any discrepancies found, and report the results of stocktake to the school governing bodies.**

## Response from the Administration

5.53 The **Secretary for Education** agrees with the audit recommendations. He has said that the EDB:

- (a) has required DSS schools to make proper arrangements for the safe custody of school assets, cash and other valuables under the schools' control;
- (b) will continue to remind DSS schools to correctly record the fixed assets under their control in a fixed asset register. The register should clearly state the description of items, date of purchase, quantity, location, date and reasons of write-off, and the approval signature of write-off; and
- (c) will require DSS schools to conduct physical stocktake at least once a year, investigate any discrepancies found, and report the results of the stocktake to the school governing bodies in the proposed circular on the use of non-government funds to be issued soon (see para. 5.45(a)).

## Fund raising activities

5.54 According to the EDB's guidelines, schools should prepare a financial statement for each fund raising activity and display such statement for a reasonable period of time on the schools' notice boards for the information of teachers, parents and students. The financial statement should also be retained for audit purposes. If the fund raising activities are held for other organisations which are not approved charitable institutions, or not specifically approved by the EDB, written permission from the EDB is required.

## Audit observations and recommendations

5.55 Of the four DSS schools visited by Audit, observations were noted in fund raising activities organised by two schools.

5.56 In June 2008, a fund raising activity was organised by a school jointly with the Parents Association to raise fund for Mainland schools affected by the Sichuan earthquake. About \$551,000 was raised. Audit found that:

- (a) no written permission was obtained from the EDB for the activity;
- (b) no financial statement for the activity was prepared; and
- (c) a sum of about \$160,000 from the fund raising activity was recorded as retained surplus in the school's accounts.

5.57 Audit also noted that the school held concerts every year. According to the school circulars, the net proceeds from the concert held in 2008 would be used for school expansion, and the net proceeds from the concert held in 2009 would be used for expanding the book collection of the school library. The net amounts raised in 2008 and 2009 were \$97,000 and \$78,000 respectively. However, financial statements for the concerts were not prepared for display on the school's notice board and for audit purposes.

5.58 According to the guidelines of the other school, prior approval from the SMC is required for each fund raising activity. Unless exceptional approval was obtained, the school should not conduct more than three fund raising activities a year.

5.59 Audit noted that during the period 2007/08 to 2009/10 (up to May 2010), the school conducted 11 fund raising activities. The amount raised was about \$137,000. Audit also noted that:

- (a) in two activities, no approval was obtained from the SMC;
- (b) in another six activities, covering approvals instead of prior approvals were obtained from the SMC; and
- (c) in 2007/08 and 2009/10, more than three fund raising activities were carried out. No record was available showing that the SMC had given exceptional approval for these activities.

#### *Audit recommendations*

5.60 **Audit has recommended that the Secretary for Education should remind DSS schools to:**

- (a) **prepare a financial statement for each fund raising activity and display the statement for a reasonable period of time on the schools' notice boards for the information of teachers, parents and students;**
- (b) **retain the financial statements for fund raising activities for audit purposes;**
- (c) **seek written permission from the EDB for the fund raising activities held for other organisations which are not approved charitable institutions, or not specifically approved by the EDB; and**
- (d) **formulate guidelines on fund raising activities and require their staff to comply with the guidelines.**

## Response from the Administration

5.61 The **Secretary for Education** agrees with the audit recommendations. He has said that the EDB:

- (a) will facilitate DSS schools to strengthen their internal control mechanism for fund raising activities; and
- (b) has reminded DSS schools to ensure that fund raising activities held are lawful and in compliance with the requirements stipulated by the EDB or other government departments.

## **PART 6: HUMAN RESOURCE MANAGEMENT**

6.1 This PART reports the audit findings on human resource management of the four DSS schools visited by Audit in May and June 2010.

### **Staff recruitment**

6.2 DSS schools receive subsidy from public money. They are expected to follow the best practices in managing their operation. The EDB has issued a number of guidelines and circulars to advise DSS schools of the best practices in staff recruitment. The basic principle is that recruitment should be carried out in a fair and open manner. The selection process and the justifications for decisions made should be properly documented.

### **Audit observations and recommendations**

#### *Recruitment policies and retention of recruitment records*

6.3 According to the EDB guidelines issued in 2006, all schools, including DSS schools, should:

- (a) formulate their personnel and remuneration policies; and
- (b) set up guidelines and procedures for staff selection and ensure that the recruitment system is fair and open.

6.4 Schools are also advised that they should keep proper recruitment records, including the assessment forms and the recommendations of the selection panel, for a specified retention period.

6.5 Audit examination of the recruitment records of the four DSS schools 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. According to the school, all recruitment records were destroyed immediately after completing the recruitment process.

*Open recruitment and selection panel*

6.6 According to the EDB guidelines on best practices in staff selection, schools should:

- (a) advertise all job vacancies to ensure fairness and transparency in conducting recruitment exercises; and
- (b) ensure that applicants are interviewed by a selection panel.

Audit noted that the EDB guidelines were not followed by three of the four DSS schools visited. The audit findings are summarised in paragraphs 6.7 to 6.9.

6.7 Audit noted that no open recruitment was carried out by a school to:

- (a) fill a senior post that was equivalent to the rank of vice-principal in September 2008; and
- (b) appoint the new principal who would assume office in September 2010.

6.8 In another school, no open recruitment was carried out for 36 new staff recruited in 2008/09 and 2009/10. No selection panel was appointed to interview and select the 36 new staff. The school informed Audit in June 2010 that they were recruited directly by the principal, who had kept no record of the selection. The school also hired three consultants for non-teaching duties. Two of them were former staff of the school. Audit noted that:

- (a) the three consultants were not selected on a competitive basis as required by the school's policy on procurement of services;
- (b) no agreement was signed with the three consultants; and
- (c) no approval from the SMC had been sought and obtained for the creation of the three consultant posts.

6.9 In the remaining school, a clinical psychologist was appointed in August 2008 by referral instead of open recruitment.

***Reporting of recruitment results***

6.10 According to the EDB circular letter issued to DSS schools in May 2007, schools should report the results of staff recruitment to their school governing bodies. The report should include information such as the number of applications received, the number of applicants shortlisted and interviewed, and the selection criteria adopted to facilitate the governing body's consideration in approving the appointment of the selected candidates. Audit noted that, in 2008/09 and 2009/10, two schools did not report the results of their staff recruitments to their school governing bodies.

***Approval of appointment by school governing body***

6.11 According to the Education Regulations (Cap. 279A), the appointment of any teacher should be approved by the school governing body, except in cases where the teacher is appointed for less than six months. Audit noted that two teachers were appointed by a school for 2009/10 before prior approval from the SMC was obtained. Audit also noted that in seeking covering approval from the SMC, the school management understated the monthly salary of a teacher by about \$4,500 (18%).

***Audit recommendations***

6.12 **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 which are consistent with the best practices promulgated by the EDB;**
- (b) **carry out recruitment of staff in an open and fair manner;**
- (c) **ensure that applicants are interviewed by selection panels appointed by the school governing bodies;**
- (d) **report to their school governing bodies the results of staff recruitment;**
- (e) **ensure that approval from school governing bodies is obtained before a teacher is appointed for a term of not less than six months; and**
- (f) **provide accurate information to the school governing bodies in seeking their approval for appointing new teachers.**



## Response from the Administration

6.13 The **Secretary for Education** agrees with the audit recommendations. He has said that the EDB will facilitate DSS schools to strengthen their internal control mechanism for staff recruitment.

## Staff remuneration

6.14 According to the EDB guidelines issued to DSS schools in November 2007, they should put in place a proper mechanism to ensure that the remuneration packages for individual staff are fair and justifiable.

6.15 EDB Circular No. 4/2010 further requires:

- (a) DSS schools to clearly set out the criteria such as qualifications, experience, performance and expertise, and approval authority for determining the remuneration package of an appointee and any subsequent salary adjustment; and
- (b) DSS school governing bodies to ensure that all policies on staff remuneration and administration are endorsed, documented and properly implemented.

## Audit observations and recommendations

6.16 Audit noted that a school had not set up a mechanism for determining the remuneration packages for its non-teaching staff. Only one of the two non-teaching staff was awarded an incremental salary point upon the completion of one year's service in 2008/09. No record was available showing the justifications for not awarding an incremental salary point to the other staff.

### *Audit recommendations*

6.17 **Audit has recommended that the Secretary for Education should remind DSS schools to:**

- (a) **put in place a proper mechanism for determining the remuneration packages for their staff to ensure that the packages are fair and justifiable;**
- (b) **clearly set out the criteria (e.g. qualifications, experience, performance and expertise) and approval authority for determining the remuneration package of an appointee and any subsequent salary adjustment; and**

- (c) ensure that all policies and measures on staff remuneration and administration are properly endorsed, documented and implemented.

### **Response from the Administration**

6.18 The **Secretary for Education** agrees with the audit recommendations. He has said that the EDB will facilitate DSS schools to strengthen their internal control mechanism for staff remuneration.

### **Performance management**

6.19 Staff performance management is one of the most important functions in human resource management. Its objective is to maximise the staff's performance and potential with a view to attaining the organisational goals and enhancing overall effectiveness and productivity. A good staff performance management system would facilitate objective and fair assessment by the management and encourage frank and constructive feedback from the staff. These can be achieved by:

- (a) setting clear targets and standards of performance;
- (b) providing opportunities for supervisors to inform the staff of their performance regularly, to be accompanied by timely coaching and counselling;
- (c) permitting the staff to have access to the entire performance appraisal report and to review the appraisal before appraisal interview; and
- (d) forming an assessment panel where necessary to ensure fairness in the performance rating.

### **Audit observations and recommendations**

6.20 Audit reviewed the staff performance management of the four schools visited. Audit noted that:

- (a) a school did not have a formal performance management system in place. In June 2010, the school informed Audit that:
  - (i) appraisal of the teachers' performance was mainly based on classroom observations by the consultant and parents of the school. However, no record was kept for the classroom observations made by the consultant; and

- (ii) a formal staff appraisal system would be introduced for the staff of one of the four non-teaching divisions of the school by the end of 2009/10;
- (b) performance appraisal was carried out only for some staff of the second school. Performance appraisal reports were found in only 2 of the 15 personnel files selected for examination by Audit. In June 2010, the school informed Audit that its performance management policy had not yet been fully implemented and the performance appraisal of the 13 staff for 2008/09 had not yet been carried out;
- (c) of 15 staff appraisal reports for 2008/09 selected from the third school for examination by Audit, 6 were not available. The school explained that in these 6 cases, the staff did not agree with the assessments and refused to sign and return the appraisal reports; and
- (d) the performance management system of the remaining school did not require the appraiser to record the justifications of his assessment. The assessment made was often not supported by comments made by the appraiser. For example, the performance of a staff for 2008/09 was assessed to be “above the expectations”, however, no comment was recorded by the appraiser to substantiate the assessment.

#### *Audit recommendations*

6.21 **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 guidelines issued by the EDB.**

#### **Response from the Administration**

6.22 The **Secretary for Education** agrees with the audit recommendations. He has said that the EDB will facilitate DSS schools to strengthen their internal control mechanism for staff performance.

#### **Staff contract renewal**

6.23 Renewal of teaching staff contracts should be considered and approved by the school governing bodies. The decision should be based on staff performance appraisal results. Any other justifications affecting the decision of contract renewal should be properly documented to prevent allegations of favouritism or unfairness.

## Audit observations and recommendations

6.24 For the school in Case 2, the staff performance appraisal results were not submitted to the SMC for consideration. Therefore, the decisions on contract renewal of staff members were not based on performance appraisals.

### Case 2

1. In May 2008, the SMC approved that the employment contracts of four teaching staff should not be renewed for 2008/09 because their performance in 2007/08 was “below the expectations”. However, Audit examination of the school records revealed that the performance of three of the four teachers were rated “appropriate to the expectations” in their performance appraisal reports.

2. Audit also noted that the employment contracts of two other teachers for 2009/10 were renewed, despite the fact that their performance in 2008/09 was rated as “below the expectations”.

#### *Audit comments*

Audit considers that the school should have submitted the performance appraisal results of the staff for the SMC’s consideration. Furthermore, the justifications for the SMC’s decision on contract renewal should have been documented properly to prevent allegations of favouritism or unfairness.

*Source: Audit analysis of school records*

#### *Audit recommendations*

6.25 **Audit has recommended that the Secretary for Education should remind DSS schools to:**

- (a) **submit the staff performance appraisal results for the school governing bodies’ consideration when seeking their decisions on matters of staff contract renewal; and**
- (b) **properly document the justifications for contract renewal decisions to prevent allegations of favouritism or unfairness.**

#### **Response from the Administration**

6.26 The **Secretary for Education** agrees with the audit recommendations. He has said that the EDB will facilitate DSS schools to strengthen their internal control mechanism for staff contract renewal.

## **PART 7: GENERAL ADMINISTRATION**

7.1 This PART reports the audit findings on general administration issues of the four DSS schools visited by Audit in May and June 2010.

### **Procurement of goods and services**

7.2 According to the EDB guidelines issued in November 2007, DSS schools are required to ensure that procurement is conducted on a fair, open and competitive basis. They should ensure that staff responsible for tendering and purchasing are familiar with the procedures and adhere to them strictly. DSS schools are advised to follow as far as possible the EDB's guidelines for aided schools on procurement and to adopt a sound control system, maintain proper records and conduct periodic inspections of all purchases. If a DSS school chooses not to follow the EDB's guidelines on procurement, it must obtain approval from the school governing body and inform the stakeholders of its decisions.

### **Audit observations and recommendations**

#### *Procurement guidelines*

7.3 During the visits to the four DSS schools, Audit noted that:

- (a) no formal procurement policy and procedure were laid down by a school; and
- (b) two different sets of procurement procedures were adopted by another school. The set of procedures for making procurement with non-government funds was less stringent than that of the EDB's guidelines for aided schools. For example, tendering was not required even for the procurement of high value items. The procedures also did not state clearly that the procurement should be conducted on a fair, open and competitive basis. No record was available showing that the adoption of a less stringent set of procedures for making procurement with non-government funds was approved by the SMC and made known to the stakeholders of the school.

#### *Number of quotations obtained*

7.4 The procurement policies of one of the four schools stated that at least:

- (a) three quotations should be obtained for procurement with non-government funds;

- (b) two written quotations should be obtained if the procurement with government funds is of \$30,000 to \$50,000; and
- (c) five tenders should be received if the procurement with government funds is above \$50,000.

7.5 Audit examined the records of 10 procurements made by the school in 2008/09 and 2009/10, and noted that in two procurements of about \$18,000 and \$45,000 made with non-government funds, the number of quotations obtained was less than three. The justifications and approvals for not obtaining at least three quotations were not documented.

7.6 In another two cases, where the procurements of about \$30,000 and \$186,000 were made with government funds, the number of written quotations obtained and tenders received was less than that required. Again, there was no documentation recording the justifications and approvals for not obtaining the sufficient number of written quotations/tenders.

#### *Tender documents*

7.7 According to the best practices promulgated by the EDB on its website, tender evaluation criteria should be determined before inviting tenders and included in the tender documents for the information of tenderers. Audit noted that in three tender exercises carried out in 2008/09 by two of the four schools visited, tender evaluation criteria were not included in the tender documents.

#### *Tender committees*

7.8 The EDB has promulgated the procurement guidelines/procedures for compliance of aided schools via EDB Circular No. 15/2007 to which DSS schools should make reference for handling procurements. According to EDB Circular No. 15/2007, in carrying out a tender exercise, schools are required to:

- (a) set up two committees, namely a tender opening and vetting committee (comprising two staff appointed by the principal), and a tender approving committee (comprising members appointed by the school governing bodies); and
- (b) maintain a history of appointment of the tender opening and vetting committee.

7.9 Audit examined the records of eight tender exercises carried out in 2008/09 and 2009/10 by one of the four schools visited and noted that:

- (a) no tender opening and vetting committee was set up in five of the eight cases. The tenders in the five cases were opened by a staff and vetted by the supervisor;
- (b) no tender approving committee was set up in all the eight cases. The selected tenders in the eight cases were approved by the supervisor; and
- (c) no appointment record of the tender opening and vetting committee was maintained by the school.

*Declaration of interests by staff*

7.10 According to EDB Circular No. 15/2007, staff involved in purchasing and supplies duties should be required to sign an undertaking that they would declare to the school governing body any current or future connections they or their immediate families have/will have with the suppliers. This requirement should be annually brought to the notice of the staff involved by means of a circular, which they should be required to sign to indicate that they have read and understood it.

7.11 No record was available from three schools showing that the staff involved in purchasing and supplies duties had signed the required undertaking, and that the requirement had been brought to the notice of the relevant staff annually.

*Audit recommendations*

7.12 **Audit has recommended that the Secretary for Education should remind DSS schools to follow the EDB's guidelines on procurement as far as possible to ensure that all procurements are carried out in a fair, open and transparent manner. In particular, the EDB should remind schools to:**

- (a) **obtain sufficient number of quotations or tenders and document the justification and approval for any departure from the procurement procedures;**
- (b) **include evaluation criteria in tender documents for information of the tenderers;**
- (c) **set up two separate committees for tender opening and vetting, and tender approval for all tender exercises;**
- (d) **maintain the history of the appointments of the tender opening and vetting committee; and**

- (e) **require staff involved in purchasing and supplies duties to sign an undertaking that they will declare to the school governing body any current or future connections they or their immediate families have/will have with the suppliers, and bring the requirement to the notice of the relevant staff annually.**

### **Response from the Administration**

7.13 The **Secretary for Education** agrees with the audit recommendations. He has said that the EDB will facilitate DSS schools to strengthen their internal control mechanism for procurement matters.

### **Trading operations**

7.14 According to EDB Circular No. 24/2008, a DSS school which wishes to carry out trading operations (e.g. sales of textbooks/exercise books/school uniforms, running of tuckshops, and provision of lunch box/school bus services) is required to obtain prior written approval from:

- (a) the IMC; or
- (b) the EDB, if its governing body is not an IMC.

7.15 The EDB circular also stipulates that profit from trading operations cannot be applied for any purpose that is not directly benefiting the students unless prior written permission is obtained from the EDB.

### **Audit observations and recommendations**

#### ***Prior approval from the EDB***

7.16 Three of the four schools visited by Audit were governed by SMCs. Audit noted that prior approval had not been sought from the EDB by:

- (a) one school for the provision of school bus service. The school decided in January 2009 to use part of the profits accumulated from the service to purchase two 28-seat school buses in 2009/10. The new buses were planned to be used by students, staff and other non-government organisations on request. Up to June 2010, the EDB's approval for applying part of the profits for such purpose had not yet been sought;



- (b) another school for designating a supplier to supply school uniforms for the period 2009/10 to 2011/12; and
- (c) the remaining school for the provision of school bus and lunch box services, supply of school uniforms and school ties, sales of bibles/textbooks/exercise books and the operation of a school tuckshop for the period 2006/07 to 2008/09.

### ***Profit ceiling for trading operations***

7.17 According to EDB Circular No. 24/2008, no profit shall be made from sale of textbooks. The profit from sale of other items (e.g. exercise books, school uniforms, stationery and equipment) should be limited to 15% of the cost of purchase from the suppliers. The profit limit of 15% should also cover paid services provided to students.

7.18 Audit noted that the profit of some of the items sold in 2009/10 by three of the four schools visited exceeded the 15% ceiling. The profit rates ranged from 20% to 150%.

### ***Selection of operators/suppliers***

7.19 According to EDB Circular No. 24/2008, schools should select the trading operators/suppliers through competitive tender/quotation exercises at regular intervals, preferably not exceeding three years. If PTAs or SSBs wish to undertake trading operations in the schools, they should be treated as one of the bidders, and subject to competitive bidding and the same selection procedures applicable to other bidders.

7.20 Audit noted that no tender/quotation exercise had been carried out by:

- (a) a school for the selection of the tuckshop operator. The tuckshop had been operated by the SSB of the school since the 1960s; and
- (b) another school for the selection of operators/suppliers for operating the school tuckshop, the provision of school bus service, and the supply of lunch boxes.

### ***Donation from trading operators/suppliers***

7.21 According to EDB Circular No. 24/2008, schools should:

- (a) not solicit or accept donations or advantages in any form from trading operators/suppliers;

- (b) only consider accepting donations or advantages from the trading operators/suppliers in very exceptional circumstances with justification of compelling reasons and approval from the school governing body; and
- (c) disclose details of donations accepted (e.g. the compelling reasons for accepting the donations) in the school reports.

7.22 Audit noted that there were two cases where donations were accepted from trading operators without any documented compelling reasons, and no disclosure was made in the school reports. Details of the two cases are as follows:

- (a) an operator was contracted to run the school tuckshop and supply lunch boxes to a school. The contract stipulated that the operator would donate \$52,000 annually to the school for the period 2007/08 to 2011/12; and
- (b) according to the records of another school, it had received donations from two suppliers during the period 2006/07 to 2008/09 (see Table 9).

**Table 9**

**Donations received from suppliers by a school  
(2006/07 to 2008/09)**

<b>Year</b>	<b>Supplier</b>	<b>Amount (\$)</b>
2006/07	Lunch box supplier	17,804
	Uniform supplier	5,000
2007/08	Lunch box supplier	19,406
	Uniform supplier	5,000
2008/09	Uniform supplier	5,000

*Source: School records*

*Audit recommendations*

7.23 **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 and that profits from trading operations should only be applied for the purposes of directly benefiting the students;**
- (b) **profit from sale of trading items (other than textbooks) should be limited to 15% of the cost of purchase;**
- (c) **trading operators/suppliers should be selected through competitive tender/quotation exercises at regular intervals, preferably not exceeding three years;**
- (d) **acceptance of donations or advantages from trading operators/suppliers should be considered only in very exceptional circumstances with justification of compelling reasons; and**
- (e) **details of donations received from trading operators/suppliers should be disclosed in the school reports.**

**Response from the Administration**

7.24 The **Secretary for Education** agrees with the audit recommendations. He has said that the EDB will facilitate DSS schools to strengthen their internal control mechanism for trading operations.

**Acronyms and abbreviations**

Audit	Audit Commission
DSS	Direct Subsidy Scheme
EDB	Education Bureau
FSTB	Financial Services and the Treasury Bureau
IMC	Incorporated Management Committee
PTA	Parent-teacher association
SMC	School Management Committee
SSB	School Sponsoring Body