

Chapter 3

Corporate governance and Headquarters administration of the English Schools Foundation

The objective of this audit review was to examine the corporate governance of the English Schools Foundation (ESF) as well as the financial and administrative controls of the ESF Headquarters in the provision of education services.

2. The Committee held three public hearings on 10 December 2004 and 10 and 11 January 2005 to receive evidence from the witnesses.

3. **Prof Hon Arthur LI Kwok-cheung, Secretary for Education and Manpower**, made an opening statement at each of the Committee's first two public hearings. His statements are in *Appendices 19 and 20* respectively.

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4. Noting that the Education and Manpower Bureau (EMB) had representation on both the Foundation, i.e. the supreme governing body of the ESF, and the Executive Committee (ExCom), i.e. the executive body of the Foundation, the Committee enquired about:

- the role of the EMB in the Foundation and the ExCom respectively; and
- the reasons for the EMB not monitoring the operation of the ESF.

5. The **Secretary for Education and Manpower** stated at the hearing and in the letter of 8 January 2005, in *Appendix 21*, that:

- the ESF was established by law and enjoyed the powers and privileges conferred on it by The English Schools Foundation Ordinance (the ESF Ordinance). In accordance with the Ordinance, the membership of the Foundation comprised 132 representatives from a wide cross-section of the community, including government officials. The role of these representatives was intended to be advisory in order to allow the ESF the benefit of the views of different community sectors. Had it been envisaged that the Government should play a watchdog role, the ESF Ordinance would not have been introduced by a private Member, and the Government would have been given the necessary statutory powers to direct and monitor the operation of the ESF. As a matter of fact, the ratio of EMB representatives to other representatives on the Foundation was only 3:132. The influence of EMB representatives on the Foundation was indeed very small;

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- for historical reasons, the EMB had one representative on the ExCom. This was a unique arrangement. The Government did not sit on the management committee of any other aided schools or the executive committee of their sponsoring bodies. This suggested that the EMB's ExCom membership was intended to serve a liaison and advisory function, ensuring that the interests of British civil servants with children attending the ESF schools were well served and that relevant policy decisions were adequately communicated. From the way the ESF Ordinance was couched, it was never intended that the Government should micro-manage or monitor the ESF; and
- on many occasions, members of the Foundation and the ExCom had not been provided with all the information that they needed to know in order to discharge their duties effectively. For instance, the ExCom had not been consulted or even informed of the details of the golden handshake packages that the ESF had offered to three of its senior staff upon their leaving the ESF. Under the circumstances, the ExCom would not know that there were cases that had departed from the established practices.

6. It appeared to the Committee that since the EMB had representation on both the Foundation and the ExCom, it had a duty to ensure that the ESF would adopt a high standard of corporate governance. Same as all other members of the Foundation and the ExCom, the EMB representatives had the right as well as the responsibility to request the ESF to provide the necessary information to enable them to discharge their duties effectively. In this connection, the Committee enquired:

- whether the EMB representatives had ever requested the ESF to provide information, where necessary, to enable them to discharge their duties effectively; and
- what action the EMB had taken to ensure cost-effectiveness of the ESF operation, especially after knowing that there might be cost-effectiveness problems in the ESF since late 2002.

7. **The Secretary for Education and Manpower and Mrs Cherry TSE, Deputy Secretary for Education and Manpower**, said that:

- according to law, the ESF might deny the EMB's access to its books and accounts as it received less than half of its income from public money. As the EMB did not have the legal right to have access to the ESF's records, the EMB representatives had encountered great difficulties in obtaining

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information to enable them to discharge their duties effectively. An example was that the ExCom had only been informed of the resignation of the former Chief Executive of the ESF, i.e. Staff C in the Director of Audit's Report (the Audit Report), but not the extra payment made to him upon his departure. The EMB had asked the ESF for details of this case on a number of occasions but in vain;

- the EMB's participation in the ESF operation was on the basis of trust and co-operation. For an organisation which had repeatedly emphasised the outstanding calibre of its staff, and with a successful business person in the chair, it was not reasonable to expect that the ExCom members should, at every ExCom meeting held monthly, take the initiative to ask if there had been any golden handshake proposals, inappropriate payments of entertainment or claims for taxi fare that had not been supported by receipts in the previous month. The EMB did not believe that the ExCom should be occupied with this kind of micro operational matters; and
- in the EMB's view, it should be for the ESF Headquarters senior executive management to bring up to the ExCom for approval cases which were not in line with established policies and/or financial management rules but which merited exceptional treatment. Members of the ExCom should be provided with all relevant information to enable them to make decisions in an intelligent and fully informed manner. As the ESF Headquarters had failed to do so, it was unfair to put the onus on the ExCom members.

8. Given that Prof Felice Lieh MAK had only assumed the ESF chairmanship for nine months, the Committee invited the former Chairman of the ESF to provide a written response on the following:

- his comments on the observations and recommendations of the Audit Commission (Audit) on the various aspects raised in the Audit Report, in particular the part on "Corporate governance";
- during his tenure as the ESF Chairman, whether the government representatives on the Foundation and the ExCom had put forward any views or suggestions on the various aspects covered in the Audit Report. In particular, whether they had raised any concerns about the inadequacy of the corporate governance and Headquarters administration of the ESF; and

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- during his tenure as the ESF Chairman, whether he had discussed with relevant government officials problems relating to the corporate governance of the ESF; if so, the contents of the discussions, the officials with whom he had discussed, and the occasions when the discussions were held; and if not, why not.

9. In his replies of 7 and 17 January 2005, in *Appendices 22 and 16* respectively, **Mr Jal Shroff, former Chairman, ESF**, stated that:

- the large membership size of the Foundation was not conducive to making decisions efficiently. Over the past many years, the Foundation had seldom made any decisions of importance. Important decision-making had been left in the hands of the nine members of the ExCom;
- external members appointed to the Foundation often did not have time or were not interested in attending the Foundation meetings. In his view, the ratio of external members to internal members should be at least 3:1, if the present situation that external members did not always constitute a majority at the Foundation meetings was to be changed;
- the ESF needed to totally review the Regulations of the English Schools Foundation (the ESF Regulations) to ensure that they reflected the changes in the multi-cultural intake of its students as well as the latest educational developments and to ensure that they were in line with the best practices;
- there was an acute need to establish an active audit committee, with one of its representatives from the Government, to monitor and advise the ExCom on all financial matters;
- he did not consider it necessary to establish an advisory body similar to those established by the University Grants Committee funded institutions, as the current four standing committees of the ESF might well serve the advisory function;
- in his opinion, the EMB should play a much more active role to exercise its influence on decisions made at the ExCom meetings dealing with financial matters. To the best of his knowledge, the minutes of the Foundation meetings and the ExCom meetings reflected that no government representative had brought up the question of corporate governance over the last ten odd years;

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- he had been the ESF Chairman for over nine years. During the period, he had met many government officials and had discussed with them various aspects relating to the acquisition of new sites for additional ESF schools, finances of the ESF, lack of school places within the ESF system to cater for children of new arrivals, problems associated with the composition of the Foundation, corporate governance of the ESF, etc. In fact, during his tenure as the ESF Chairman, he had had private discussions with the Permanent Secretary for Education and Manpower on a number of occasions on the composition of the Foundation and the need to make changes at an appropriate time; and
- every single draft budget prepared by the ESF over the last 40 odd years had to be approved by the then Education Department, currently the EMB, before it was implemented. The budget had reflected salaries, school fees, and projected surpluses or deficits.

10. The Committee invited the EMB to comment on the former ESF Chairman's response. The **Secretary for Education and Manpower, Mrs Fanny LAW, Permanent Secretary for Education and Manpower**, and the **Deputy Secretary for Education and Manpower** said, at the hearing and in the letter of 24 January 2005 (in *Appendix 17*), that:

- as regards the suggestion that the EMB should play a much more active role in the ExCom, the EMB was of the view that if the public considered that the EMB should micro-manage the ESF given the recurrent government subsidies provided to it, then the same, if not more stringent, level of control must apply to all aided schools which were almost completely funded by the Government, as well as other subvented organisations in general. This clearly deviated from the policy of not micro-managing subvented organisations, and also went against the policy of school-based management;
- as regards the statement that no government representative had brought up the question of corporate governance at any of the Foundation meetings and the ExCom meetings over the last ten odd years, it should be noted that it was the EMB's practice, as a matter of courtesy and respect to the ESF management, to first bring up its views or proposals to the ESF management for informal discussion. This would allow the ESF sufficient time to examine the proposals, so that well thought out proposals would be raised at the formal meetings of the Foundation or the ExCom at an appropriate time;

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- the EMB had expressed its views on the corporate governance of the ESF on many occasions. An example of this was the pay review process. The EMB had offered its views to the ESF on the composition and terms of reference of the ESF Pay Review Body. Indeed, the EMB had kept informal exchanges with the ESF management on a wide spectrum of issues through channels outside the Foundation and the ExCom. Most of these informal meetings had been attended by the former ESF Chairman and the discussions at those meetings were frank;
- during the course of the informal discussions on a variety of issues between the EMB and the former ESF Chairman, it had been realised that the root of the problem lay on the governance and management structure of the ESF. Unfortunately, due to the various competing priorities and the manpower constraints in the EMB, it had focused its strength on pursuing the education reform over the past few years. For this reason, the EMB had not been able to actively address the problems relating to the governance and management structure of the ESF;
- soon after the current ESF Chairman had assumed her chairmanship, the EMB had discussed with her the problems relating to the governance and management of the ESF. With her agreement, a proposal to reform the governance and management structure of the ESF had been submitted to the Foundation for consideration at its meeting in December 2004. This had demonstrated that the EMB's contribution to the ESF operation was multi-channelled, not confined to formal meetings of the Foundation and the ExCom; and
- on the question of draft ESF budget, there was no requirement under the Education Ordinance or the ESF Ordinance for the ESF to submit its annual estimates for approval by the Government. Although it had been the ESF's understanding that its past submissions were intended for the Government's approval, the EMB had only examined such estimates when considering the level of school fees, calculating grants or in contexts for similar requirements. This generally applied to all categories of schools including aided schools. It was the primary obligation of individual schools to exercise proper financial control and maintain their financial viability.

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11. At the request of the Committee, **Mr John Bohan, Acting Secretary and Chief Secretary, ESF**, provided, via his letter of 4 January 2005 in *Appendix 23*, the attendance of the government representatives at five Foundation meetings and 42 ExCom meetings held in the past five years. In the same letter, he informed the Committee that after examining the relevant minutes of meetings, there had been no mention of the corporate governance and Headquarters administration of the ESF by the government representatives at any of the Foundation meetings and the ExCom meetings held in the past five years.

12. The Committee invited the Director of Audit to comment on the Acting ESF Secretary and Chief Executive's response of 4 January 2005. In his letter of 7 January 2005 in *Appendix 24*, the **Director of Audit** advised that:

- as stated in paragraph 2.19 of the Audit Report, the failure of members to attend Foundation meetings reduced their opportunities to contribute to the ESF. The ESF Regulations prescribed that there were four government representatives on the Foundation. According to the minutes of the five Foundation meetings:
 - (a) all the four government representatives had not attended the two Foundation meetings in December 2000 and December 2001;
 - (b) only one of the four government representatives had attended each of the two Foundation meetings in December 2002 and December 2003; and
 - (c) three of the four government representatives had attended the Foundation meeting in March 2004;
- the government representatives' attendance rate of 25% at the above five Foundation meetings was unsatisfactory;
- according to Appendix 3 to the Acting ESF Secretary and Chief Executive's letter of 4 January 2005, of the 42 ExCom meetings held between March 1999 and October 2004, the government representative had attended 35 of them, representing an attendance rate of 83%. Audit considered this attendance rate acceptable; and

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- Audit's examination of the minutes of the Foundation meetings and the ExCom meetings covering the period September 2000 to April 2004 revealed that there were no recorded views of the government representatives on the corporate governance of the ESF at either the Foundation meetings or the ExCom meetings. There were also no recorded views of the government representatives on the Headquarters administration of the ESF at the Foundation meetings. However, on some occasions, the government representative had expressed views on the Headquarters administration of the ESF at meetings of the ExCom.

13. According to the Acting ESF Secretary and Chief Executive's response of 4 January 2005, the Chief Secretary for Administration (CS) had not attended any of the Foundation meetings in December 2002, December 2003 and March 2004. Of these three Foundation meetings, the Permanent Secretary for Education and Manpower had only attended the one in March 2004. The attendance of other EMB representatives at the two Foundation meetings in December 2002 and December 2003 was also not high. As regards the three ExCom meetings on 28 September 2004, 12 October 2004 and 26 October 2004, the EMB representative had only attended the one on 26 October 2004. According to the minutes of that ExCom meeting, there had been no mention of the corporate governance of the ESF by the attending EMB representative.

14. Based on the above findings, it appeared to the Committee that the level of the EMB's participation in the ESF operation was not as great as that claimed by the EMB. The Committee questioned whether the EMB had been too lax in monitoring the operation of the ESF.

15. The **Secretary for Education and Manpower**, the **Permanent Secretary for Education and Manpower** and the **Deputy Secretary for Education and Manpower** stated, at the hearing and in the Secretary for Education and Manpower's letters of 8 January 2005 and 11 January 2005 (in *Appendix 25*), that:

- contrary to the Acting ESF Secretary and Chief Executive's response of 4 January 2005, the EMB had been represented by Mr Samson LAI, in his capacity as Acting Principal Assistant Secretary for Education and Manpower, at the ExCom meeting on 28 September 2004 while the incumbent Principal Assistant Secretary was on leave;

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- on some occasions, it was the EMB's deliberate decision not to attend certain meetings of the Foundation or the ExCom. For example, the EMB deliberately decided not to attend the ExCom meeting on 12 October 2004 because the meeting was convened to consider the ESF's fund-raising strategy which was squarely an internal matter of the ESF. Moreover, against the background of its discussion with the ESF on the future of the subvention arrangement, the EMB considered its absence at that meeting desirable in order to forestall any unnecessary speculation and accusation of conflict of interests;
- as the minutes of ExCom meetings had not been prepared in a verbatim format, the absence of express reference to comments made by any one member could not be used to deduce that such member had made no contribution to the deliberations at the ExCom meetings;
- the membership of the ExCom included the Permanent Secretary for Education and Manpower or her appointed representative. It had been a long established practice that such representative was the Principal Assistant Secretary for Education and Manpower, or the Assistant Director of Education before the merger. Unless the circumstances required otherwise, this representative would attend the ExCom meetings on behalf of the Permanent Secretary;
- the Government's role on the Foundation had all along been carried out by the then Director of Education, currently the Permanent Secretary for Education and Manpower or her appointed representative. Indeed, all the Foundation meetings in the past five years, except the two most recent ones (i.e. the one on 9 December 2004 which was not included in the ESF's response of 4 January 2005, and the one on 1 March 2004), had been convened to consider routine reports such as the ESF Secretary's reports and the ESF's annual accounts. The EMB was of the view that it would make a bigger contribution by offering advice to the ExCom rather than by receiving routine reports at the Foundation meetings. Hence, in the Government's view, as far as Foundation meetings were concerned, the attendance of one government representative would suffice unless the circumstances required otherwise;
- when important issues were considered by the Foundation or the ExCom, however, the EMB would step up its representation at the respective meetings. For instance, when the Foundation elected its Chairman upon the resignation of the former Chairman, the Permanent Secretary for Education and Manpower and her two designated advisers had all attended the relevant Foundation meeting. Another example was that when the governance

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reform proposal was raised for discussion at the Foundation meeting on 9 December 2004, both the Deputy Secretary and the Principal Assistant Secretary of the EMB had attended the meeting;

- moreover, since late 2002 when the EMB had suspected significant cost-effectiveness problems within the ESF, the EMB had also stepped up its attention to the ESF operation. This was evidenced by the EMB's initiation to conduct the fact-finding exercise jointly with the ESF, which aimed at reviewing the ESF cost structure with a view to identifying possible areas for savings;
- other than meetings, the EMB had also maintained exchanges with the ESF through electronic mails, correspondence and telephone calls. The EMB representative on the ExCom had, from time to time and outside the formal channel, raised questions on the operation of the ESF; and
- the EMB would review its long-term role in the Foundation and the ExCom, including the position currently held by the CS in the Foundation, having regard to the usual practice of not getting involved in the management of individual schools or their sponsoring bodies. The EMB would follow the principle of school-based management, which aimed at devolving more responsibilities to schools and providing them with enhanced flexibility and autonomy in managing their own operation and resources according to the needs of their students, with increased transparency and accountability in their use of public funds at the same time.

16. As revealed in paragraphs 2.16 and 2.20 of the Audit Report, of the nine members of the ExCom, three were ESF staff. Furthermore, the external members of the Foundation had not constituted a majority at any of the Foundation's four annual general meetings held in the 2000-01 to 2003-04 ESF financial years. The Committee was concerned that when decisions relating to ESF staff benefits were required to be made at meetings of the Foundation, there might have been an over-reliance on the internal members.

17. **Prof Felice Lieh MAK, Chairman, ESF**, said that:

- there had been a case in the past in which the proposal to reduce the pay of teaching staff was vetoed by the ExCom at its meeting when the internal members present outnumbered the external members;

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- to avoid possible conflict of interest, a mechanism for declaration of personal interests had already been put in place in the ESF; and
- at present, only non-ESF staff members of the ExCom would be invited to participate in the discussion of staff-related issues.

18. In response to the Committee's enquiry about the details of the reform to be undertaken by the ESF in restructuring its governance and management, the **Chairman, ESF** said at the hearing and the **Acting Secretary and Chief Executive, ESF**, in his letter of 10 December 2004 in *Appendix 26*, advised that:

- at its meeting on 9 December 2004, the Foundation had approved the Draft Guidelines for the Restructuring of the Governance and Management of the ESF. This exercise might necessitate amendments to the ESF Ordinance and its regulations;
- the most fundamental change to be effected was the separation of governance and management roles. In future, the ESF would not operate at two levels, i.e. the Foundation and the ExCom. An ESF Council would be set up to replace the Foundation as the ESF's supreme governing body. The Council would comprise no more than 25 members with a 2:1 ratio of external members to internal members;
- each of the members would serve on an ad personam basis, not representing any constituency. The members would sign a code of conduct and would undertake to abide by it. There would be a register of members' interest. The staff members elected would not concurrently hold office in staff associations. The members of the Council would elect a chairman, a vice-chairman and a treasurer from amongst its external members. The Council would review its effectiveness every six years and the results of the review would be published in the ESF annual reports;
- there would be a number of standing committees of the Council. They might include an audit committee, a management committee, an academic committee, a staff council, and a joint council of parent and teacher associations;
- an audit committee had been set up to help the ESF monitor its finances and improve the cost-effectiveness of its operation. The audit committee comprised three members, the Chairman of which had been appointed by the ExCom from amongst its external members with sound audit, financial and

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accounting experience. The audit committee would report to the ExCom. Indeed, it had already held four meetings to follow up on the recommendations put forward by Audit and the Independent Commission Against Corruption; and

- a task force appointed by the ExCom would work out the details of the restructuring in consultation with the new Chief Executive who would assume office in February 2005. Open consultation would also be conducted. A timetable for implementing the proposed restructuring had been drawn up and provided in the Draft Guidelines. Hopefully, the new governance and management structure would be approved by the Foundation in July 2005.

19. In response to the Committee's further enquiry as to whether the ESF would expect the Government to play a monitoring role in the ESF Council in the future, the **Acting Secretary and Chief Executive, ESF**, in his letter of 18 January 2005 in *Appendix 27*, said that the ESF would welcome the EMB to appoint one to two members to the new ESF Council. The precise role of the EMB representative(s) would be worked out by the ESF task force in consultation with the EMB.

20. In view of the changing circumstances in the ESF, the Committee doubted the need for the continued existence of the Foundation Office. The Committee asked whether each ESF school should, in line with modern practice, be given the responsibility to manage its own operation instead of relying on a central management system which was quite costly. The Committee also enquired about the percentage of the total expenditure on the Foundation Office to the total expenditure on the entire ESF.

21. In response, the **Chairman, ESF** said that:

- the total expenditure on the Foundation Office accounted for 4.2% of the total expenditure on the entire ESF; and
- in deciding whether the Foundation Office should be retained, there were two major considerations. First, in the absence of the Foundation Office, whether the ESF as a whole would be able to achieve the best use of resources. Second, how the education quality of individual ESF schools could be maintained. The ESF needed to carefully consider the likely implications before a decision on the matter could be taken.

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22. The Committee noted that section 10(1) of the ESF Ordinance empowered the ESF to make regulations for the composition, internal management, operation, administration and control of the Foundation and ESF schools. Section 10(2) further provided that it was not necessary for any regulations made under this section to be published or laid on the table of the Legislative Council.

23. According to the legal adviser to the Committee, the legislative status of the ESF Regulations had been put in issue in the case of English Schools Foundation & Anor v Bird ([1997] 3 HKC). The court held that the regulations were subsidiary legislation despite section 10(2). This implied that the regulations made under this section should be published in the Gazette and tabled in the Legislative Council as other subsidiary legislation. Given that the reform of governance and management structure currently undertaken by the ESF might necessitate amendments to the ESF Ordinance and its regulations, it was advisable that the ESF took the opportunity to consider repealing section 10(2) of the ESF Ordinance so that subsidiary legislation in the form of regulations made under the Ordinance was required to be published in the Gazette and tabled in the Legislative Council.

Financial management

24. Paragraph 3.3 of the Audit Report stated that, as shown in the audited financial statements of the ESF for its past three financial years, the ESF had surpluses of \$40 million in 2000-01, \$46 million in 2001-02 and \$18 million in 2002-03. However, its liabilities significantly exceeded its current assets at the end of each of these financial years.

25. In his opening statement made at the first hearing, the **Secretary for Education and Manpower** raised the following questions:

- since cashflow of schools with a long history should be quite stable and predictable, what were the special circumstances that had kept recurring every year to have barred the ESF from better managing its income and expenditure pattern to smoothen its cashflow? and
- while the ESF had been able to run on surplus towards year end, where had the money gone during the year when the ESF was receiving tuition fees from parents?

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26. The Committee asked about the ESF's comments on the above questions. In his letter of 4 January 2005, the **Acting Secretary and Chief Executive, ESF** explained that:

- day-to-day income and expenditure was predictable from year to year. However, capital expenditure did not necessarily have a smooth pattern. The ESF funded capital expenditure was investment in new and refurbished facilities that would directly benefit students. This was over and above the amounts provided by the Government for the provision of new facilities. The Foundation's position on this was set out in paragraph 3.5 of the Audit Report. This was further exemplified on page 9 of the ESF's submission of 10 December 2004 (in *Appendix 18*); and
- it would be possible for the Foundation to arrange its finances so that an overdraft was never incurred. However, this would be contrary to usual commercial practice because no commercial organisation would deny itself access to credit. In the absence of such an overdraft facility, projects that would benefit ESF students would be delayed unnecessarily. This would not be value for money for stakeholders.

27. According to paragraph 3.4 of the Audit Report, the net current liabilities of the ESF increased by 74% from \$186 million as at 31 August 2001 to \$324 million as at 31 August 2003. At the same date, the ESF used a bank overdraft of \$99 million to finance its expenditure. Given that the EMB had a copy of the ESF's audited accounts, the Committee asked whether the EMB had been aware of the ESF's cashflow position and overdraft problem.

28. The **Deputy Secretary for Education and Manpower** replied at the hearing and in her letter of 24 January 2005 that:

- the EMB was aware of the ESF's overdraft problem. Upon receiving the routine estimates from the ESF, the EMB had indicated to the ESF the need to maintain a smooth cashflow; and
- in more recent years, the EMB had also noted that due to some non-recurrent reasons, e.g. lower income arising from the SARS outbreak and the commissioning of capital upgrading works in some ESF schools, the negative cashflow in the ESF at the end of its financial year had increased. This was an issue that the EMB had looked into in the context of its examination of the ESF's estimates and audited accounts. The EMB had also, during its informal exchanges with the ESF management, referred to the scope for

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evening out the ESF's cashflow, especially given the rather stable and predictable spending patterns of educational establishments.

29. The Committee noted from paragraph 3.16 of the Audit Report that the ESF had accepted that it was necessary to make improvement to the arrangement for individual ESF schools to maintain bank balances. The Committee asked about the details of the improvement measures and the timing for implementation.

30. In his letter of 10 January 2005 in *Appendix 28*, the **Acting Secretary and Chief Executive, ESF** provided a summary of the updated progress of the actions taken by the ESF in response to Audit's various recommendations. Regarding the arrangement for individual ESF schools to maintain bank balances, the Committee was advised that:

- the Foundation had entered into an alternative arrangement with its bankers in January 2005 to offset credit balances on its accounts with any debit balances on other accounts; and
- the ESF was examining the adoption of a central cash management and payment system similar to those adopted by large commercial organisations, without the need for each ESF school to maintain its own bank account.

Staff remuneration and recruitment

31. According to Figure 5 in paragraph 4.2 of the Audit Report, the total amount of responsibility allowances paid to ESF teaching staff in the 2002-03 ESF financial year was as high as \$37 million. Apart from salary, ESF teaching staff had also received other staff benefits such as contract gratuities, and housing and medical benefits. Moreover, according to Figure 7 in paragraph 4.20, the 25% contract gratuities received by ESF teaching staff were the highest when compared to those of the teaching staff of the seven largest private international schools in terms of student number. Table 2 in paragraph 4.22 of the Audit Report also revealed that, compared to the seven largest private international schools, the ESF also had the highest percentage (66%) of teaching staff receiving responsibility allowances. Besides, ESF teaching staff in receipt of such allowances received the highest average amount (\$98,600 a year). The Committee:

- questioned the need for paying the responsibility allowances; and
- enquired whether the ESF would review the remuneration packages of its teaching staff so as to ensure that they were broadly in line with those of its counterparts in Hong Kong.

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32. The **Acting Secretary and Chief Executive, ESF** advised that:

- responsibility allowance was given to a staff member appointed to take up responsibilities in addition to the primary responsibilities of the post he was holding. Higher responsibility allowances were normally given to department heads in important subjects like English and Science;
- the salaries of ESF teaching staff were set 14 years ago based on those of the teaching staff in the United Kingdom. Their subsequent salary adjustments had followed those of the local civil service. Since 2002, following a decision in 2000 to stop the overseas packages, remuneration levels of ESF teaching staff had been based on the need for recruiting and retaining staff of the highest quality. To secure and retain highest quality staff, the ESF had to compete in the international market, thus requiring it to offer internationally competitive terms and conditions to its teaching staff;
- the competition for the highest quality staff sought by ESF schools was fierce. It was highly desirable for ESF schools to have a stable teaching force, as excessive turnover of teaching staff was detrimental to the effectiveness of schools and caused additional expenditure and extra workload on recruitment. As revealed in Table 3 in paragraph 4.25 of the Audit Report, the turnover of ESF teaching staff had increased against the background of the 4.42% salary reduction effected in 2004; and
- as a matter of fact, the percentage of ESF staff employed on old terms and conditions of service, i.e. overseas terms, had reduced substantially in recent years and the staff employed on new terms, i.e. local terms, cost about 10% less than the average figures cited in the Audit Report. There would be continued financial savings as a result of the teaching staff on overseas terms leaving the ESF.

33. The **Chairman, ESF** informed the Committee that:

- the ESF had established a Remuneration Study Group (RSG) to conduct comprehensive reviews of the remuneration packages of its teaching staff. The RSG had met five times and would report to the ExCom in June 2005;
- given that most of the ESF teaching staff were recruited from overseas, and in order to ensure that their remuneration packages remained competitive and were in line with comparable levels in both local and overseas markets, in January 2005, the RSG had appointed an independent consultant to conduct a

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research on the remuneration of teaching staff in overseas countries. The scope of the research had already been agreed upon. The consultant would start work in February 2005 and would submit its report to the RSG in June 2005; and

- the level of contract gratuities and responsibility allowances for ESF teaching staff would be examined in the context of the review conducted by the RSG. In her view, each component, say the 25% gratuity, should not be examined on its own but should rather be considered as part of the total package. In reviewing the remuneration level, one of the most important considerations was to ensure that the totality of the remuneration packages was sufficient to attract and retain the internationally accomplished staff sought by the ESF.

34. **The Secretary for Education and Manpower, the Permanent Secretary for Education and Manpower and the Deputy Secretary for Education and Manpower** responded that:

- similar to the ESF, local international schools also had to recruit their teaching staff from overseas. Therefore, they should be facing the same situation as the ESF. In the EMB's view, the remuneration packages of the teaching staff of local international schools could provide useful reference to the ESF in its review of the remuneration packages of its teaching staff;
- the membership of the RSG comprised one ESF school principal, three ESF teaching or non-teaching staff members, two parent representatives and two community representatives;
- over the past few years, the Government had implemented a total salary reduction of over 10% (i.e. 4.42% + 3% + 3%). The second 3% cut had just taken effect from 1 January 2005. However, the pay cut effected in the ESF over the same period was only 4.42%. In late 2002, the ESF had initially planned to implement a 10% pay cut. The plan had subsequently been abandoned because of insufficient staff support; and
- the EMB did not understand why the review of the remuneration packages of ESF teaching staff had only started recently, which was two years after the initial 10% pay cut proposal was put forward. The EMB also doubted the need for the ESF to spend some four months on conducting a research on the overseas recruitment market, given the availability of local remuneration data.

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35. **Mrs Gloria NG WONG Yee-man, Parents Representative, ESF**, stated that of the 763 ESF teaching staff, only 143 were still on overseas terms. She had seen the progress made by the ESF in respect of teaching staff remuneration packages. She cautioned that a drastic reduction of the remuneration level would create conflicts between staff, which would in turn affect the education quality and the effectiveness of schools. While supporting a review of the remuneration packages of ESF teaching staff, she hoped that the matter would be handled in a gradual and orderly manner.

36. In response to the Committee's question as to whether the RSG's consultant could expedite its work, the **Chairman, ESF** said that:

- as the consultant had conducted a number of similar reviews in the past for large organisations, such as the Hospital Authority and some local universities, it might already have some information on hand that might help expedite the ESF's review. She would convey the Committee's request to the consultant;
- as in any other large organisations, the implementation of a pay cut proposal was no easy task. To achieve success, the whole process must be conducted in an open and fair manner; and
- in her view, whether the recommendations in the RSG's report would be adopted would not simply be the decision of the RSG and the ExCom. Parents and even the public might also participate in the process as the report would be open to all stakeholders. Therefore, the composition of the RSG should not be an issue.

37. The Committee asked whether the contract gratuities and responsibility allowances for new ESF teaching staff, or existing ESF teaching staff upon renewal of their contracts, would be adjusted downwards and, if so, when.

38. The **Acting Secretary and Chief Executive, ESF** replied that as the RSG had yet to complete its review of the remuneration packages of ESF teaching staff, the contract gratuities and responsibility allowances for teaching staff would remain at the current levels for the time being. Whether they needed to be reduced would depend on the outcome of the RSG's review.

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39. The **Secretary for Education and Manpower**, the **Permanent Secretary for Education and Manpower** and the **Deputy Secretary for Education and Manpower** stated that:

- the teaching staff of the primary-cum-secondary school operated by the ESF Educational Services Limited only received 10% gratuities. All the native English-speaking teachers employed by the Government received 15% gratuities. As regards local international schools, they normally offered 15% to 20% gratuities to their teaching staff; and
- according to the EMB's knowledge, many of the ESF staff were employed on contract. However, they would continue to receive 25% gratuity upon renewal of their contracts, regardless of the rates of gratuities offered by other comparable educational institutions.

40. The **Acting Secretary and Chief Executive, ESF** responded that:

- the ESF had more than 80% of its staff employed on finite contracts. He anticipated that there would be a strong adverse reaction from the ESF staff if their gratuities were to be reduced upon renewal of their contracts;
- according to the Employment Ordinance, under certain circumstances, finite contracts had the characteristics of a continuous contract of employment. Thus, the ESF would exercise caution in examining the matter; and
- the ESF was taking steps to re-draft the staff contracts to allow greater flexibility. In the revised contracts, the ESF management would be empowered to change the salary of a staff member once a year. Such change might take the form of increment or reduction.

41. In response to the Committee's enquiry, the **Chairman, ESF** confirmed that apart from teaching staff, the ESF would also review the remuneration packages of the staff of the Foundation Office.

42. According to paragraphs 4.29 and 4.30 of the Audit Report, the ESF made extra payments equivalent to 10 months' salaries to Staff A, Staff B and Staff C upon their leaving the ESF. Apart from Staff A, whose extra payment upon his leaving the ESF had been approved by the ExCom, Audit could not find records of the ExCom's decisions regarding the extra payments made to Staff B and Staff C upon their leaving the ESF. In

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this connection, the Committee asked whether the approval of the ExCom had been sought before making the extra payments to Staff B and Staff C and, if not, the reasons for that.

43. The **Acting Secretary and Chief Executive, ESF** replied at the hearing and in his letter of 4 January 2005 that:

- no formal policy had been set down concerning the making of extra payments to ESF staff upon their departure. In the three cases cited in Table 4 in paragraph 4.29 of the Audit Report, for the purpose of effective management of the Foundation and the ESF schools, the staff concerned had not been required to work during the respective notice periods;
- the decisions regarding Staff B and Staff C had been taken by officers of the Foundation pursuant to section 9 of the ESF Ordinance. These officers were ExCom members independent of any constituent groups; and
- the ESF had agreed that in future, the approval of the ExCom would be obtained before making extra payments to staff leaving the ESF and such approvals would be minuted.

44. The **Secretary for Education and Manpower** drew the Committee's attention to the following:

- after careful examination of the minutes of the relevant ExCom meetings, the EMB found that the ExCom had only been informed of the departure of the three staff in question. Only in one case, i.e. Staff A, had the ExCom been consulted on the extra payment made. In that particular case, the ExCom had been told that the resignation had been accepted "in accordance with the Conditions of Service" of the staff. However, the ExCom had not been informed that it should indeed be the resigned officer who should have paid compensation to the ESF for the short notice given for his departure; and
- in respect of Staff B and Staff C, the ExCom had only been informed of their resignations. No mention of the extra payments had been made. The EMB had only become aware of the golden handshake arrangement for Staff C through an anonymous letter to the press several months after the departure of the staff concerned. In respect of the payment to Staff B, the EMB believed that the ExCom members would have still been kept in the dark if not for the Audit Report.

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45. The **Acting Secretary and Chief Executive, ESF** informed the Committee of the following new information, which had come to his knowledge after his telephone conversations with Mr Jal Shroff, former Chairman of the ESF, on 7 January 2005:

- the ExCom had met on 23 June 2003 before the termination of the service of Staff C. Seven members of the ExCom had attended that meeting, during which two resolutions had been passed to the effect that the employment of Staff C be terminated and that Mr Shroff, in the capacity of ESF Chairman, be authorised to deal with such termination including but not limited to discussion with Staff C, giving the relevant notice, agreeing on the terms of cessation at Mr Shroff's discretion and generally all such acts as would be necessary to effect the termination; and
- the minutes of the above ExCom meeting had been circulated to all those who had attended the meeting.

46. He added that the minutes of the ExCom meeting on 23 June 2003 had not been entered in the ESF's minute books. This was the reason why Audit and he himself had not been aware of this ExCom meeting. The minutes of that meeting had only been provided to him by Mr Shroff on 7 January 2005. At the request of the Committee, the **Acting Secretary and Chief Executive, ESF** provided, via his facsimile message of 11 January 2005 in *Appendix 29*, a copy of the minutes of the ExCom meeting on 23 June 2003.

47. In response to the Committee's enquiry as to whether the terms of cessation of Staff C had been reported back to the ExCom subsequent to the discussion at the ExCom meeting on 23 June 2003, the **Secretary for Education and Manpower** advised, in his letter of 18 January 2005 in *Appendix 30*, that:

- according to the minutes of the ExCom meeting on 27 June 2003, the ExCom had only been informed of the resignation of Staff C. No report had been made on the terms of cessation of the staff member; and
- contrary to the advice of the Acting Secretary and Chief Executive of the ESF, the minutes of the ExCom meeting on 23 June 2003 had not been provided to those who had attended the meeting.

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48. The Committee also invited the former ESF Chairman to provide a written response on the following:

- details of his discussions with other ExCom members and/or ESF Headquarters senior executive management concerning the arrangements in regard to the extra payments made to Staff A, Staff B and Staff C, as well as the justifications for offering such payments to them; and
- whether the discussions had been held at meetings or outside meetings, and whether there had been any papers recording the details of the discussions.

49. In his reply of 17 January 2005, **Mr Jal Shroff, former Chairman, ESF**, advised the Committee that:

- in any “monetary” settlement made with senior staff, the ESF’s criteria had always been to keep a balance between the “cost” and the interest of its students and the reputation of the ESF;
- in every case where dismissal was involved, extensive consultation had been carried out not only with ExCom members but, where appropriate, with the respective school council members. In many cases, legal advice had also been sought to ensure that the interest of the ESF was protected and non-disclosure agreements had been signed; and
- his comments on each of the three cases were as follows:

Staff A: This involved a head office staff member. Dismissal negotiations had been finalised by the ESF Secretary and approved by the ExCom and minuted;

Staff B: This involved a head teacher who had resigned in the middle of an external inspection of the school. After due consultation, the ESF Secretary had decided that it was in the interest of the students that the officer should not continue in his post. In view of his 20 odd years of service in the ESF, a special case had been made for him to go on paid leave up to his last date of resignation. The Secretary was wrong not to have this minuted at one of the ExCom meetings; and

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Staff C: This involved the Chief Executive of the ESF. At its meeting on 23 June 2003, the ExCom had authorised him, in the capacity of ESF Chairman, to negotiate “as would be necessary to effect the termination”. The Chairman of the Management Committee had accompanied him in his discussions with Staff C to finalise details of the termination. He had nothing further to add regarding this case.

50. As the Committee has been provided with more information on the three cases concerning extra payments made to Staff A, Staff B and Staff C upon their leaving the ESF, it invited the Director of Audit to provide his latest comments on these cases after considering the new evidence.

51. The **Director of Audit** provided, in his letter of 21 January 2005 in *Appendix 31*, the following latest comments on the three cases:

- Staff A: As stated in paragraph 4.30 of the Audit Report, the extra payment made to Staff A upon his leaving the ESF had been approved by the ExCom. This approval had been recorded in the minutes of the ExCom meeting. Audit considered this arrangement a good practice;
- Staff B: As stated in paragraph 4.30 of the Audit Report, Audit could not find records of the ExCom’s decisions regarding the extra payment made to Staff B upon his leaving the ESF. In his reply of 17 January 2005, the former ESF Chairman commented that the Secretary was wrong not to have this minuted at one of the ExCom meetings. It was not clear whether this extra payment had been approved by the ExCom. Audit’s observations and recommendations on this case were stated in paragraphs 4.31 and 4.32 of the Audit Report respectively; and
- Staff C: (a) As stated in paragraph 4.30 of the Audit Report, Audit could not find records of the ExCom’s decisions regarding the extra payment made to Staff C upon his leaving the ESF. Having regard to the new information relating to the departure of Staff C provided by the Acting Secretary and Chief Executive of the ESF at the hearing on 10 January 2005 and by the Secretary for Education and Manpower in his letter of 18 January 2005, Audit considered it unacceptable that the

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minutes of the ExCom meeting on 23 June 2003 had not been entered in the ESF's minute books. As stated in Regulation 2.3 of the ESF Regulations, minutes of the proceedings of every meeting of the Foundation, ExCom, Standing Committee, School Council or any committee shall be entered in a book kept for that purpose and after confirmation signed by the chairman of such meeting or of the following meeting, and shall when so entered and signed be prima facie evidence of the facts therein stated; and

- (b) so far, there was no evidence which showed that the contents of the minutes of the ExCom meeting on 23 June 2003 provided by the former ESF Chairman had been agreed by all those who had attended the meeting. Even if there was such evidence, Audit still considered it unacceptable that:
 - (i) the ExCom had authorised the former ESF Chairman to agree at his discretion with Staff C the terms of cessation, without the need to seek the ExCom's final approval; and
 - (ii) the former ESF Chairman had not reported at an ExCom meeting following the making of an extra payment to Staff C.

Staff housing benefits

52. According to paragraphs 5.3 and 5.7 of the Audit Report, as at 1 April 2004, the ESF owned 208 staff quarters and leased 11 staff quarters (10 for senior staff and 1 for teaching staff). The total annual rent of the 10 leased senior staff quarters paid by the ESF amounted to \$6.8 million. However, at the same date, the ESF had 13 vacant ESF-owned Teaching-staff Grade quarters with an estimated total annual rental value of \$2.6 million. The Committee wondered whether such arrangement had led to wastefulness. The Committee also asked whether the ESF had formulated any plan to dispose of its surplus staff quarters.

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53. The **Acting Secretary and Chief Executive, ESF** responded at the hearing and in his letters of 4 and 10 January 2005 that:

- the 208 ESF-owned staff quarters were mainly divided into two categories, namely Senior-staff Grade quarters and Teaching-staff Grade quarters, according to the size of the quarters. Allocation of these quarters was based on the grades of the staff concerned. Over the years, there had been occasions where a vacant staff quarters was not suitable to be taken up by a staff member of a different grade. For this reason, the ESF had leased quarters from the open market for some of its staff. He did not regard this arrangement as a “waste”;
- in September 2004, four newly-appointed ESF senior staff, whose predecessors had previously been accommodated in ESF-leased quarters, had been allocated ESF-owned quarters. These ESF-owned quarters had previously been occupied by ESF teaching staff. There would be more ESF-owned quarters available in September 2005, which would also be used to accommodate senior staff. This new arrangement would reduce the total rental cost of leased staff quarters paid by the ESF; and
- the ExCom would carefully review Audit’s recommendation in paragraph 5.31(a) of the Audit Report concerning disposal of ESF surplus staff quarters, having regard to the long-term needs of the ESF and the financial security conferred by the ownership of such fixed assets. A paper on this subject would be submitted to the ExCom by June 2005.

54. The Committee noted from paragraph 5.23 of the Audit Report that, as at 1 April 2004, the ESF had leased 30 of its surplus staff quarters to ineligible staff. Audit estimated that of these 30 quarters, 21 (70%) had been let below market rent. The Committee questioned whether the ESF had sought professional advice when benchmarking the rental values of its quarters for letting to ineligible staff.

55. The **Acting Secretary and Chief Executive, ESF** said that:

- at the initial stage, the ESF had only leased its surplus quarters to its staff. Thus, it had a limited knowledge of the open property market. As a result, the level of rents of the quarters leased out by the ESF had been rather low; and

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- the ESF had changed its policy and was now leasing out its surplus quarters on the open market through estate agents. It now had knowledge of the market rental values of its quarters. Clear guidelines had also been drawn up to ensure fairness in the leasing out and the sale of ESF staff quarters. Staff had been required to follow the guidelines to ensure that ESF staff quarters were leased out at market rates and that maximum rental income was derived.

56. Paragraph 5.28 of the Audit Report stated that Audit could not find records which showed that prior approval for the sale of four staff quarters in June and July 2002 had been given by the ExCom, or by the Chairman or the Vice-chairman of the ExCom, before the signing of the sales agreement by ESF staff. The Committee queried who had handled the sale of these quarters and whether it had been done without proper authorisation.

57. **The Acting Secretary and Chief Executive, ESF** said that:

- the sale of ESF staff quarters had been authorised by the ExCom in 1994, following its endorsement of the report of a consultancy study on the issue;
- of the six ESF quarters sold between the 2001-02 and 2003-04 ESF financial years, which included the four quarters mentioned in paragraph 5.28 of the Audit Report, only the approval records of two of the quarters had been missing. He believed that similar to the sale of the other four quarters, the sale of these two quarters should have also gone through the required process of obtaining approval from the Chairman and the Vice-chairman of the ExCom. The failure of the ESF to provide evidence in this regard might be due to misplacement of these approval records; and
- the ESF had put in place a better system for keeping its records. It would ensure that in future, all sales of ESF staff quarters would require the prior approval of the ExCom.

58. The Committee also invited the former ESF Chairman to explain why the sale of the four ESF surplus quarters without prior approval had occurred. In his reply of 17 January 2005, **Mr Jal Shroff, former Chairman, ESF**, stated that:

- to the best of his knowledge, the ExCom had discussed the possibility of selling off certain old properties at an appropriate time, as these properties had involved high maintenance and was becoming uneconomical to hold on to. The Chairman, the Vice-chairman, the Treasurer and the Secretary of the Foundation had been given authority to make the final decision;

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- the ESF had also employed the services of one or more estate agents to advise it on all property transactions; and
- the auditor of the ESF, KPMG, had audited the ESF's accounts annually. He understood that all contracts dealing with the sale or purchase of ESF's properties had been properly executed as per the requirements in section 12(4) of the ESF Ordinance.

59. Figure 5 in paragraph 4.2 of the Audit Report revealed that quarters expenses amounted to \$18 million, i.e. 2% of the total staff expenditure in the 2002-03 ESF financial year. In reply to the Committee's enquiry, in his letter of 18 January 2005, the **Acting Secretary and Chief Executive, ESF** advised that of the \$18 million, 22% were quarters expenses for the ESF Headquarters.

60. According to paragraph 5.2(b) of the Audit Report, the ESF still had 143 teaching staff employed on overseas terms who were entitled to staff quarters benefits. In view of the large amount of money spent on quarters by the ESF, the Committee asked whether the ESF would consider offering housing allowance to its staff instead of providing staff quarters.

61. The **Acting Secretary and Chief Executive, ESF** said that:

- it was the long-term goal of the ESF to lease out all its staff quarters on the open market in order to maximise its income;
- the ESF had introduced a Housing Allowance Scheme in 2001 for teaching staff employed on local terms. Under the Scheme, eligible staff were paid monthly allowances calculated as a percentage of the rents or mortgage interests paid by them. After the introduction of the Scheme, the ESF's financial commitment on staff quarters had decreased significantly; and
- as regards the 143 teaching staff who were still entitled to staff quarters benefits, it would be a matter for the ExCom to consider in consultation with the new Chief Executive of the ESF.

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Staff medical benefits

62. In response to the Committee's enquiry about the progress made by the ESF in taking forward Audit's recommendations in paragraph 6.14(a) to (c) of the Audit Report, the **Acting Secretary and Chief Executive, ESF** said at the hearing and in his letter of 10 January 2005 that:

- the ESF had proceeded with obtaining proposals from insurers on the following:
 - (a) engaging a medical insurance company to provide a medical scheme for its non-teaching staff and their dependants as well as a dental scheme for all ESF staff and their dependants, with reference to similar schemes of other local educational institutions; and
 - (b) setting an annual maximum amount of reimbursable dental expenses for each member of ESF senior staff and teaching staff and each of their dependants; and
- the exercise was scheduled for completion by 28 February 2005.

63. As requested by the Committee, the **Acting Secretary and Chief Executive, ESF** undertook to keep the Committee informed of the outcome of the above exercise.

64. **Conclusions and recommendations** The Committee:

Corporate governance

- expresses concern that the Education and Manpower Bureau (EMB) has not ensured that the English Schools Foundation (ESF), which receives substantial recurrent government subsidies, adopt a high standard of corporate governance, whilst noting that the EMB only has a small representation on the Foundation and its Executive Committee (ExCom) and that the Government's policy is to not micro-manage;
- condemns the ESF Headquarters senior executive management for its failure to ensure that the ESF and its schools adopt a high standard of corporate governance and to exercise proper financial and administrative controls to achieve value for money in the operations of the ESF and its schools, as evidenced by the following:

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- (a) the administration of some ESF schools was conducted in a chaotic and negligent manner, and the school administration guidelines provided by the ESF were fundamentally inadequate, as revealed in Chapter 4 of the Committee's Report on the subject "School administration of the English Schools Foundation";
 - (b) the ESF's existing arrangement for an internal auditor reporting directly to the Financial Controller is not sufficient to help the Foundation discharge its monitoring functions effectively;
 - (c) the approval of the ExCom was not sought for extra payments made to two senior staff upon their leaving the ESF in the 2002-03 ESF financial year, and the minutes of the ExCom meeting which discussed issues concerning the termination of the employment of a senior staff member had not been entered in the ESF's minute books;
 - (d) prior approval had not been sought from the ExCom for the sale of four ESF staff quarters in June and July 2002;
 - (e) the ESF leased 10 staff quarters for its senior staff at a total annual rent of \$6.8 million, when it had 13 vacant ESF-owned Teaching-staff Grade quarters of an estimated total annual rental value of \$2.6 million;
 - (f) the ESF had been paying the rates and management fees of leased staff quarters, as long as the monthly rent (excluding rates and management fees) of the quarters did not exceed the rent entitlement of the staff concerned;
 - (g) the ESF reimbursed a senior staff member for the expenses on treatment in a first-class ward at a hospital, when the staff member was only entitled to receive treatment in a second-class ward; and
 - (h) most of the ESF staff having an annual budget for entertainment expenses used up all, or a large portion of, their budgets. Of the total entertainment expenses reimbursed to staff in the 2002-03 ESF financial year, 77% were related to staff functions;
- expresses concern that the large size of the Foundation's membership, standing at 132, is not conducive to making decisions effectively;

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- expresses serious dismay that:
 - (a) the external members of the Foundation did not constitute a majority at any of the Foundation's four annual general meetings held in the 2000-01 to 2003-04 ESF financial years. As a result, when decisions relating to ESF staff benefits were required to be made at meetings of the Foundation, there might have been an over-reliance on the internal members; and
 - (b) large percentages of internal and external members failed to attend Foundation meetings;
- expresses serious dismay and finds it unacceptable that the ESF's existing arrangement for an internal auditor reporting directly to the Financial Controller is not sufficient to help the Foundation discharge its monitoring functions effectively;
- acknowledges that:
 - (a) the Foundation has approved the draft guidelines for restructuring the governance and management of the ESF, and a task force appointed by the ExCom has started work on the proposed restructuring. The major changes proposed include:
 - (i) separating the governance and management roles; and
 - (ii) replacing the Foundation by the ESF Council as the supreme governing body of no more than 25 members with a 2:1 ratio of external members to internal members; and
 - (b) the ESF has set up an audit committee, the Chairman of which is appointed by the ExCom from amongst external members with audit, financial and accounting experience. The audit committee will report to the ExCom;
- recommends that the ESF should:
 - (a) conduct a review on the role of the Foundation Office including the need for its continued existence;

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- (b) adopt measures to ensure that external members will constitute a majority at each of the respective meetings of the Foundation and the ExCom;
- (c) issue reminders to the related organisations if the attendance rates of their representatives at Foundation meetings are low;
- (d) amend the Regulations of the English Schools Foundation to the effect that ESF staff members of the ExCom would abstain from voting on matters concerning ESF staff benefits at its meetings;
- (e) consider repealing section 10(2) of The English Schools Foundation Ordinance so that subsidiary legislation in the form of regulations made under the Ordinance is required to be published in the Gazette and tabled in the Legislative Council;
- (f) ensure that its internal audit office is staffed by well qualified and experienced personnel reporting directly to the audit committee; and
- (g) require its internal audit office to prepare annual audit programmes, to be approved by the audit committee, for conducting reviews covering major and high-audit-risk activities of the ESF, including the ESF Educational Services Limited;

Financial management

- expresses serious concern that as at 31 August 2003:
 - (a) ESF current liabilities of \$355 million were more than 11 times its current assets of \$31 million; and
 - (b) while the ESF used a bank overdraft of \$99 million to finance its expenditure, its Foundation Office and schools held bank deposits of \$17 million;
- notes that:
 - (a) the Foundation entered into an alternative arrangement with its bankers in January 2005 to offset credit balances on its accounts with any debit balances on other accounts; and

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- (b) the ESF is examining the adoption of a central cash management and payment system similar to those adopted by large commercial organisations, without the need for each ESF school to maintain its own bank account;
- recommends that the ESF should:
 - (a) take action to reduce its net current liabilities; and
 - (b) adopt a more prudent method of budgeting and avoid relying on bank overdraft;

Staff remuneration and recruitment

- expresses serious concern and has reservations about the appropriateness of the following:
 - (a) the salaries of most of the senior staff of the Foundation Office were set on the basis of the salary of a Civil Service Directorate Grade officer, and the salary scale of ESF school principals was set 14 years ago based on a similar scale in the United Kingdom;
 - (b) in the 2003-04 school year, the estimated average annual remuneration of \$947,400 per ESF teaching staff member was the highest when compared with that of the teaching staff of the seven largest private international schools in terms of student number;
 - (c) ESF teaching staff received the highest contract gratuity and responsibility allowance benefits when compared with the seven largest private international schools;
 - (d) different ESF schools adopted different policies on the allocation of responsibility allowances; and
 - (e) half of the members of the Remuneration Study Group (RSG), which comprises one ESF school principal, three ESF teaching or non-teaching staff members, two parent representatives and two community representatives, established by the ESF to conduct reviews of the remuneration packages of its teaching staff are its own staff;

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- notes that:
 - (a) the RSG will report to the ExCom in June 2005; and
 - (b) the ESF will draw up central guidelines by 30 April 2005 on the payment of responsibility allowances to teaching staff for compliance by its schools, with reference to the practices adopted by private international schools;

- recommends that:
 - (a) the ESF should take into consideration Audit's findings on the remuneration of the teaching staff of the seven largest private international schools, and immediately conduct a review of the remuneration packages of its senior staff with a view to ensuring that they are broadly in line with those of similar posts in other local educational organisations;
 - (b) the membership of the RSG should not be drawn from ESF's own teaching and non-teaching staff; and
 - (c) the ESF should implement as soon as possible new remuneration packages on newly recruited teaching staff, and on existing teaching staff over a period of time, taking into account the effects of the new remuneration packages on their financial commitments;

- asks the ESF to forward the report of the RSG to the Committee. The Committee will then invite the Director of Audit to review the report and to inform the Committee of his comments;

- expresses alarm and strong resentment over the following:
 - (a) the minutes of the ExCom meeting held on 23 June 2003, during which two resolutions were passed to the effect that the employment of Staff C be terminated and that the former Chairman of the ESF be authorised to deal with such termination, had not been entered in the ESF's minute books;
 - (b) the ExCom authorised the former Chairman of the ESF to agree at his discretion with Staff C the terms of cessation, without the need to seek the ExCom's final approval;

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- (c) the former Chairman of the ESF did not report at an ExCom meeting following the making of an extra payment to Staff C; and
 - (d) the approval of the ExCom was not sought for extra payments made to two senior staff, i.e. Staff B and Staff C, upon their leaving the ESF in the 2002-03 ESF financial year;
- urges the ESF to:
- (a) record, if given, the approval of the ExCom in its meeting minutes regarding extra payments to ESF senior staff upon their leaving the ESF;
 - (b) enter all minutes of ExCom meetings in its minute books;
 - (c) refrain from delegating to any person the authority to agree on the terms of cessation of a senior staff member without the approval of the ExCom; and
 - (d) ensure that the approval of the ExCom is obtained before making extra payments to its senior staff upon their leaving the ESF;
- expresses serious concern that in the 2002-03 and 2003-04 ESF financial years, eight ESF interview teams travelled to the United Kingdom and Australia to conduct interviews for recruiting ESF school principals and teaching staff;
- notes that the ESF:
- (a) will reduce the number of its school principals travelling overseas to interview applicants; and
 - (b) will reduce the time spent by its interview-team members overseas by conducting more video-conference interviews;

Staff housing and medical benefits

- expresses dismay that:
- (a) as at 1 April 2004, the ESF leased 10 staff quarters for its senior staff at a total annual rent of \$6.8 million. However, at the same date, it had 13 vacant ESF-owned Teaching-staff Grade quarters with an estimated total annual rental value of \$2.6 million; and

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- (b) in addition to the rent, the ESF had been paying the rates and management fees (without a specified maximum amount) of the quarters, irrespective of the rent entitlement of the staff member, so long as the monthly rent (excluding rates and management fees) of a leased quarters did not exceed the rent entitlement of the staff member concerned;
- notes that the ESF:
 - (a) has taken action in respect of Audit's recommendations on:
 - (i) accommodating eligible staff in its own staff quarters, instead of leasing quarters for them, as far as possible;
 - (ii) leasing the vacant staff quarters to its staff and outsiders to generate rental income; and
 - (iii) selecting those appropriate ESF-owned Teaching-staff Grade quarters for re-grading as Senior-staff Grade quarters for allocation to its senior staff; and
 - (b) will take action in respect of Audit's recommendations on:
 - (i) seeking the approval of the ExCom for paying the rates and management fees of ESF-leased quarters for its senior staff, irrespective of their rent entitlements; and
 - (ii) conducting a review of the rental-value level of staff quarters for its senior staff with reference to the housing benefits provided by other local educational institutions;
- recommends that the ESF should:
 - (a) consider offering housing allowance to its staff instead of providing staff quarters; and
 - (b) strictly adhere to the maximum monthly rent entitlement of its staff;

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- expresses serious concern that:
 - (a) if the ESF does not take action to reduce its surplus quarters, the number surplus to requirements will progressively increase to 199 in the 2030-31 school year, due to the retirement of teaching staff eligible for staff quarters; and
 - (b) as at 1 April 2004, of the 30 ESF-owned staff quarters leased to ineligible staff, 21 (70%) were let below market rent. Audit's estimates showed that the difference between the market rent and actual rent of these 21 staff quarters amounted to \$1.1 million a year;
- expresses astonishment and finds it unacceptable that prior approval had not been sought from the ExCom before the sale of four ESF staff quarters in June and July 2002;
- notes that:
 - (a) the ESF will negotiate with the Government on the removal of the non-assignment clauses in the government leases of its staff quarters at the Braemar Heights and at the Beacon Hill School;
 - (b) it is ESF practice to seek professional advice when benchmarking market rental values of its staff quarters for letting to ineligible staff, and the ESF will file and retain such advice; and
 - (c) in future, all sales of ESF staff quarters will require the prior approval of the ExCom;
- recommends that the ESF should formulate a policy and a plan for disposing of its surplus staff quarters;
- expresses serious concern that:
 - (a) the staff of the Foundation Office do not have the medical expertise to assess the medical claims under its in-house medical scheme for its non-teaching staff and their dependants, and under its in-house dental scheme for all its staff and their dependants, and that the two schemes require substantial staff resources; and

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- (b) the ESF does not set an annual maximum amount of reimbursable dental expenses for each of its senior staff and teaching staff and their dependants;
- expresses astonishment and finds it unacceptable that in mid-2001, an ESF senior staff member was reimbursed the expenses on treatment in a first-class ward at a hospital. However, this staff member was not entitled to receive the treatment in this hospital without the written confirmation from the doctor concerned and without the approval from the Foundation Office, and he was only entitled to receive the treatment in a second-class ward;
- notes that the ESF:
 - (a) has proceeded with obtaining proposals from insurers on the following, and the exercise is scheduled for completion by 28 February 2005:
 - (i) engaging a medical insurance company to provide a medical scheme for its non-teaching staff and their dependants and a dental scheme for all ESF staff and their dependants, with reference to similar schemes of other local educational institutions; and
 - (ii) setting an annual maximum amount of reimbursable dental expenses for each member of ESF senior staff and teaching staff and each of their dependants; and
 - (b) has agreed to seek and record the prior approval of the ExCom if the medical benefits received by an ESF staff member exceed his entitlement. In emergency cases, the ESF will seek delegated authority for the Chief Executive or the Human Resources Director to approve emergency treatment;

Entertainment expenses

- expresses serious dismay that:
 - (a) in the 2002-03 ESF financial year, most of ESF staff having an annual budget for entertainment expenses used up all, or a large portion of, their budgets. Of the total \$291,639 entertainment expenses reimbursed to these staff, 77% were related to staff functions; and

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- (b) the ESF has not set a maximum limit on reimbursable entertainment expenses allowed for each participant in each function. As a result, the amount of entertainment expenses reimbursed for each participant in a function was as high as \$1,000;
- notes that the ESF has implemented Audit's recommendations on strictly enforcing its revised policy on reimbursement of entertainment expenses which:
 - (a) prohibits reimbursement of entertainment expenses relating to staff functions; and
 - (b) requires ESF staff submitting claims to clearly state the name of each ESF participant and his capacity; for guests, their names and the organisations they represent; and the purpose of the function;
- recommends that the ESF should set up a new system so that only designated staff of the ESF may submit claims for reimbursement of entertainment expenses on a need basis; and

Follow-up actions

- wishes to be kept informed of:
 - (a) the progress of the ESF's review on the role of the Foundation Office including the need for its continued existence;
 - (b) measures adopted by the ESF to ensure that external members will constitute a majority at each of the respective meetings of the Foundation and the ExCom;
 - (c) the progress of implementing the restructuring of the governance and management of the ESF;
 - (d) Audit's comments on the RSG's report on the review of the remuneration packages of ESF teaching staff;
 - (e) the ESF's decision as to whether housing allowance will be offered to its staff instead of providing staff quarters; and
 - (f) any further development and progress made in implementing the other recommendations put forward by Audit and the Committee as well as related improvement measures.