

**Extract from Chapter 3 of
the Report of the Public Accounts Committee No. 43 dated February 2005**

**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.

Corporate governance

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;

- 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 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
- 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;
- 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;
- 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.

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

- 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;
- 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 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;
- 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 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 there structuring 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.

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.

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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:

- (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;
 - 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;
 - (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;

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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.

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School administration of the English Schools Foundation

The objective of this audit review was to examine the administration of the English Schools Foundation (ESF) schools. The Audit Commission (Audit) had identified areas where school administrative practices could be improved.

2. At the beginning of the Committee's public hearing, **Hon Albert Jinghan CHENG** declared that he had recently been nominated by the House Committee of the Legislative Council to serve on the Foundation, i.e. the supreme governing body of the ESF, on behalf of the Council with effect from 29 October 2004. He was also an ESF school parent. He had not participated in the activities of the ESF. In order to safeguard the impartiality and integrity of the Committee, he decided that he would not take part in the examination of the three chapters in the Director of Audit's Report No. 43 relating to the ESF. He would not participate in the public hearing, nor in the discussion and compilation of the Committee's Report on these chapters. He then withdrew from the hearing.

3. **Hon Abraham SHEK Lai-him** declared that he was appointed a school council member of the South Island School of the ESF from late November 2004. As the appointment had just taken effect, he had not attended any meeting of the school council. In order that he could take part in the examination of the three chapters relating to the ESF without compromising the impartiality and integrity of the Committee, he had already resigned from the membership of the school council.

4. **Prof Hon Arthur LI Kwok-cheung, Secretary for Education and Manpower**, declared that his son had studied at an ESF school 28 years ago. **Mrs Fanny LAW, Permanent Secretary for Education and Manpower**, also declared that her two sons had attended ESF schools.

5. The **Secretary for Education and Manpower** and **Prof Felice Lieh MAK, Chairman, ESF**, respectively made an opening statement at the Committee's public hearing. Their statements are in *Appendices 32 and 33* respectively.

Corporate governance of schools

6. Paragraph 2.24 of the Director of Audit's Report (the Audit Report) stated that a school council was responsible for the overall governance of a school. To discharge their duties, school council members needed to attend regularly school council meetings. The Committee was concerned that, as revealed in paragraphs 2.26 to 2.28, in the 2001-02 and 2002-03 school years, councils of eight schools held meetings three times a year, which was the minimum number of meetings required by the ESF. The council of one school (School 1) had not held any meetings for a period of 23 months from 13 December 2000 to 13 November 2002.

7. Paragraph 2.32 of the Audit Report further revealed that, notwithstanding the guidance notes issued by the ESF, 12 of the 15 ESF schools did not require council members to declare their personal interests, financial or otherwise, which might conflict with their roles. The other three schools had not documented the declarations made by their council members. The Committee questioned whether the ESF agreed that these cases reflected that the administration of the ESF schools was chaotic.

8. The **Chairman, ESF** responded that:

- the ESF considered it seriously negligent on the part of some schools not to have required council members to declare their personal interests which might conflict with their roles. The ESF recognised that school councils played an important role in school governance. In the reform to be carried out, the ESF would require all school council members to declare such personal interests. It would also require all school councils to meet at least three times a year; and
- the ESF knew that there were problems with the administration of School 1 and the school principal had been dismissed in 2003. As a matter of fact, both the former ESF Chief Executive and former ESF Chairman had already resigned, thus fulfilling the requirement for accountability.

9. The Committee noted that as ESF schools were subsidised by the Government, the public were more concerned about the possible conflict of interests on the part of its school council members. The Committee asked whether the ESF had already required all school council members to declare their interests so as to ascertain whether there was any conflict of interests.

10. **Mr John Bohan, Acting Secretary and Chief Executive, ESF**, said that:

- the ESF had already sought guidance on issues such as conflict of interests through the ICAC investigations. A report had been received and three further reports were being awaited; and
- about one-quarter of the membership of each school council were members of the school management, viz. the chairman of the council, the principal and the Secretary of the Foundation or his representative. The other constituencies were community representatives, parent representatives and teacher representatives. Therefore, even without declaring an interest directly, a member's interest was obvious as he represented his constituency.

11. In his letters of 10 January 2005 and 1 February 2005, in *Appendices 28 and 34* respectively, the **Acting Secretary and Chief Executive, ESF**, provided a summary of the progress of the actions taken by the ESF in response to Audit's recommendations and the updated position. On the question of frequency of school council meetings and declaration of conflict of interests, the Committee was advised that:

- the ESF had issued letters to school councils/ school council members reminding them of the minimum requirement for meetings, and encouraging school councils to meet six times a year and set up sub-committees to help fulfil their roles and responsibilities. In addition, Audit's recommendations would be incorporated in the revised booklet "Guidance for School Councillors". After consultation with stakeholder groups, the revised guidance would be effective by 30 June 2005; and
- declaration registers had been prepared to record the interests of school council members.

12. The Committee further asked:

- whether the resignation of the former Chief Executive and former Chairman of the ESF was due to School 1's not holding any council meeting in 23 months or other reasons; and
- about the root of the chaos and negligence in the administration of some ESF schools.

13. The **Chairman, ESF** stated that:

- the resignation of the two persons was due to many other reasons, all of which were related to mismanagement; and
- the root of the problem was two-fold. First, there was no separation of management and governance functions in the management structure of the ESF, leading to a lack of checks and balances in the system. Second, there was a personnel problem. The lack of checks and balances had, in turn, resulted in a lack of accountability. People tended to think that they were always doing things right.

14. The **Acting Secretary and Chief Executive, ESF** supplemented that the ESF was established in 1967 with the enactment of The English Schools Foundation Ordinance (the ESF Ordinance). At that time, the ESF only had two schools which were managed according to the Ordinance and a set of regulations made under the Ordinance. The ESF had continued to grow in the past few decades, but the management structure had not changed. The management structure which had been suitable for a small organisation was no longer suitable for a big one. There was already a will within the ESF to change.

15. Given that the ESF received substantial government subsidies annually, the Committee enquired how the ESF ensured that there would be proper monitoring and control systems in future, thereby preventing the recurrence of chaos and negligence in school administration. The Committee also asked the Chairman, ESF whether, after assuming the ESF chairmanship for nine months, she was satisfied with the management of the ESF schools.

16. The **Chairman, ESF** responded that:

- as revealed in the Audit Report, the management standard of different schools varied. Some schools were well-managed while some were not. The ESF would step up its monitoring of individual schools. In addition, the principals of many schools had been changed and the new principals were very experienced in governance and management. For example, the administration of School 1 had seen significant improvement in the last 18 months after the change of its school principal. It scored high marks in the recent school review conducted by inspectors from the United Kingdom (UK);
- a reform of the ESF governance structure had begun following the Foundation's approval of the Draft Guidelines for the Restructuring of the Governance and Management of the ESF at its meeting on 9 December 2004. The most fundamental change to be effected was the separation of governance and management roles. An ESF Council was to be set up and it would replace the current 132-strong Foundation as the ESF's supreme governing body. The Council would comprise no more than 25 members with a clear majority of external members. Each of the members would serve on an ad personam basis, not representing any constituency. The Council would not participate in operational management. A Senior Management Team, headed by the Chief Executive and accountable to the Council, would be set up to take charge of the day-to-day running of the schools;
- a task force would be appointed by the ESF Executive Committee (ExCom) to work out the details of the restructuring in consultation with the Chief Executive designate who would assume office in February 2005. Consultation would also be held. Hopefully, the new management structure would be approved by the autumn of 2005. Amendments to the ESF Ordinance would also be necessary; and
- although there were deficiencies relating to school administration and management, ESF school teachers were of a high professional standard. ESF schools had consistently been providing high-quality education in the past 30 odd years and would continue to do so. The good examination results and high university entrance rates of ESF graduates were all evidence of the quality of education provided by ESF Schools.

17. As the Government provided a significant amount of recurrent subsidies (totalling \$299 million in the 2002-03 ESF school year) to the ESF, the Committee asked whether the Education and Manpower Bureau (EMB) had any representation on the councils of the 15 ESF schools and, if not, whether it would consider sending representatives to sit on the councils so as to step up monitoring of the schools.

18. The Committee also referred to paragraph 2.35(c) of the Audit Report in which the Secretary for Education and Manpower had said that he was concerned that the ESF Headquarters might not have given sufficient or sufficiently clear guidelines to ESF schools. The Committee enquired why the EMB had not been able to discover and rectify the ESF's management and governance problems earlier.

19. The **Secretary for Education and Manpower** and the **Permanent Secretary for Education and Manpower** stated that:

- the EMB had a representative on the ExCom but none in the school councils. The EMB did not participate in the school management committee of individual schools, nor their day-to-day operational management, be they ESF or aided schools; and
- it was not the EMB's intention to micro-manage schools. Moreover, as government subsidies constituted only about 30% of the ESF's income, the EMB had been declined access to the ESF's finances.

20. **Mrs Cherry TSE, Deputy Secretary for Education and Manpower**, added that:

- as the EMB's representative, she attended the Foundation meeting on 9 December 2004. While the Foundation had approved the guidelines and principles for the new governance structure, the details of the restructuring were to be worked out by a task force; and
- according to section 7 of the ESF Ordinance, the Foundation should establish an ExCom and school councils. The Foundation should be the supreme governing body over the ExCom, the school councils, the schools and any committees established thereunder. The ExCom, the school councils, the schools and the other committees should comply with any resolutions made by the Foundation. Such provisions in the ESF Ordinance reflected that the ESF enjoyed a high degree of autonomy.

21. The Committee asked whether:

- after the establishment of the new governance structure of the ESF, the EMB could issue clear guidelines on school management to the ESF Headquarters to ensure that mistakes committed in the past would not recur; and
- the ESF considered it appropriate for the EMB to issue guidelines on governance and management to the ESF.

22. The **Secretary for Education and Manpower** said that the EMB would like to co-operate fully with all school sponsoring bodies, including the ESF. As a matter of fact, the EMB did not have the statutory power to issue guidelines on the monitoring and operation of the ESF. He hoped that the ESF would want to co-operate with the EMB.

23. The **Chairman, ESF** said that guidelines should be agreed by both parties. If, through discussion, the ESF and the EMB could draw up some guidelines which were agreeable to both parties, she would not rule out the possibility of accepting such guidelines.

24. The Committee noted Audit's recommendations in paragraph 2.22 of the Audit Report that the ESF should encourage its school councils to participate actively in the management and implementation of significant school activities and consider setting up appropriate sub-committees to further their involvement in key decisions on significant school matters. The Committee enquired about the progress made in implementing these recommendations.

25. The **Acting Secretary and Chief Executive, ESF** replied at the hearing and in his letter of 10 January 2005 that the recommendations would be implemented through the revision of the booklet "Guidance for School Councillors". To meet the training needs of school council members, the existing training programme for school councillors would be extended, beginning with the course on 22 January 2005.

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

- acknowledges that the objective of the audit review is to examine the administration of English Schools Foundation (ESF) schools, and the Committee has therefore focused on matters pertaining to that objective rather than the quality of education provided by ESF schools;

Overall audit observations

- expresses serious dismay that:
 - (a) there were chaos and negligence in the administration of some ESF schools; and
 - (b) the school administration guidelines provided by the ESF were fundamentally inadequate and that some schools had not taken more initiative to ensure propriety and to achieve value for money in their operation;
- acknowledges that:
 - (a) the ESF is revising the Schools' Circulars/Administrative Memoranda to help schools deal with various administrative matters;

- (b) the ESF will provide adequate support to schools in implementing its guidelines through more systematically programmed seminars and school visits; and
- (c) the newly created audit committee of the ESF will oversee the programme of internal audits;

Corporate governance of schools

- expresses serious concern that:
 - (a) with the exception of one school, the composition of school councils did not include alumni;
 - (b) most ESF school councils had not specifically set out their delegated decision-making powers; and
 - (c) some school councils did not participate in major school activities as recommended by the ESF, e.g. councils of most schools did not participate in formulating staff development policies and plans (11 councils) and in setting targets and priorities for curriculum development (8 councils);
- expresses dismay that:
 - (a) the council of one school did not hold any meetings during a period of 23 months when the post of Chairman of the school council was vacant; and
 - (b) most schools did not require council members to declare their personal interests which might conflict with their roles;
- acknowledges that:
 - (a) more alumni may be invited to join school councils once alumni lists are complete;
 - (b) each school council will itemise delegated decision-making powers, and a bi-annual agenda item will be initiated by ESF representative to review the delegated powers of the school council;
 - (c) the ESF will rewrite the roles of school council members so as to encourage them to participate actively in significant school activities;
 - (d) sub-committees will be set up to help school councils fulfil their roles and responsibilities more effectively;

- (e) the ESF has issued letters to school councils reminding them of the minimum requirement of meetings and encouraging them to meet six times a year; and
- (f) school council members will be required to declare their personal interests which may conflict with their roles, and declaration registers have been prepared to record the interests of the members;

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Follow-up action

- wishes to be kept informed of any further development and progress made in implementing the various recommendations made by Audit and other improvement measures.