

Chapter 6

Funding of tertiary education

As part of the on-going value for money audits on the University Grants Committee (UGC) funded institutions, Audit conducted a review to examine the funding of tertiary education.

2. At the public hearing, **Prof Hon Arthur LI Kwok-cheung, Secretary for Education and Manpower**, made an opening statement. He said that:

- the Education and Manpower Bureau (EMB) welcomed Audit's recommendations that, based on the principles of prudent financial management and effective use of resources, appropriate measures should be taken to enhance the transparency of the funding methodology adopted by the UGC and to ensure the best use of public funds on the higher-education sector;
- the EMB agreed that in conducting the review on the appropriateness of using the current student unit cost as the basis for funding the UGC sector, reference should be made to the student unit cost in similar higher-education institutions in overseas countries. However, when drawing reference from overseas institutions, the differences in the socio-economic conditions and the higher-education system in the countries concerned should be taken into account;
- under the existing mechanism, funds were distributed to the institutions by the UGC in the form of block grants. This funding methodology aimed at providing the institutions with a high degree of autonomy and flexibility in their internal allocation of resources in a way that could best meet their development needs. The EMB believed that further enhancement in the transparency of the UGC's funding methodology could enable the institutions to better understand how funds were distributed to them. Besides, it could enhance the institutions' accountability in the use of public funds;
- on the Research Assessment Exercise (RAE) and implementation of research projects, the EMB considered that the recommendations put forward by Audit would help enhance transparency and promote more efficient use of resources by the institutions;
- the EMB considered that as a matter of principle, there should be no hidden subsidy to the self-financing activities operated by the institutions so as not to dilute resources intended for the UGC funded endeavours, and to avoid unfair competition with the private sector; and

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- as regards the Government's policy on refund of government rents and rates, any non-profit-making institutions the premises of which were occupied for educational purpose were eligible for such refund. The EMB agreed that this policy should be promulgated to all educational institutions in Hong Kong.

UGC's endeavours in benchmarking the cost of tertiary education

3. The Committee noted that in Hong Kong, the established practice was to adopt a crude average student unit cost in determining the funding of the UGC sector. This student unit cost, which was historical-based, had been adjusted to take into account the changes in price levels over the years. There had been public concerns about whether the student unit cost of tertiary education in Hong Kong was on the high side, compared to those in advanced countries. However, the UGC's endeavours in benchmarking the student unit cost in Hong Kong against those in overseas countries had not been successful. Despite the failure in the benchmarking exercise, the Government/UGC had not conducted any major review to ascertain whether the crude average student unit cost would continue to serve as the appropriate basis for funding tertiary education.

4. According to paragraphs 2.3 to 2.6 of the Audit Report, in 1999, the UGC conducted a crude analysis by comparing the Hong Kong student unit cost with those of 56 institutions in the USA. The exercise concluded that the average student unit cost of the UGC sector was comparable to that of similar institutions in the USA. In 2002, a management consultant was commissioned to conduct a more precise assessment of how the student unit cost in Hong Kong compared to that of similar institutions overseas. It was intended that the data collected would be used for determining the level of funding for the local tertiary education sector.

5. Phase I of the consultancy study was completed in late 2002. After studying the findings of the Consultancy Report, the UGC expressed considerable reservations over the appropriateness of some of the benchmarking partners nominated for the institutions in Hong Kong. Taking into account the difficulties in the interpretation of student unit cost data of different countries as revealed by the Phase I Consultancy Report, the UGC decided not to proceed further with other phase of the consultancy. The Committee also noted that The University of Hong Kong (HKU) and the Hong Kong Baptist University (HKBU) had expressed some reservations about the comparison of the local student unit cost with those in overseas countries due to the unique circumstances in Hong Kong.

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6. Against the above background, the Committee enquired:
- about the cost of the consultancy study, and the justifications for discontinuing the study; and
 - whether the Government considered it worthwhile to conduct a comparison of the student unit cost in Hong Kong with those in overseas countries; if so, when the benchmarking exercise would be further pursued; if not, the reasons for that.
7. **Mr Michael STONE, Secretary-General of the UGC**, said that:
- the consultancy study was designed to be carried out in two phases. The first phase was a feasibility study, which involved the setting of the peer group and the nomination of the benchmarking partners. The feasibility study aimed at helping the UGC to assess the prospect of having reliable results before proceeding to the second phase, i.e. the actual benchmarking exercise against institutions of the selected countries; and
 - after studying the findings of the Phase I Consultancy Report, the UGC considered that the benchmarking partners nominated did not provide a good basis for making sound judgment. Hence, in order not to commit further resources, the UGC decided not to proceed to Phase II of the study. The costs of the consultancy study were approximately \$0.25 million for Phase I, and \$1 million for Phase II if the study were conducted.
8. **The Secretary for Education and Manpower** said that:
- he considered it worthwhile to conduct a comparison of the local student unit cost with those in overseas countries, so as to ascertain whether the cost of tertiary education in Hong Kong was low, reasonable or expensive;
 - there was a general comment that the cost of tertiary education in Hong Kong was more expensive than that of Harvard University. However, it should be noted that Harvard University had received numerous endowments to subsidise many of its student programmes, but this kind of subsidy was not reflected in its student unit cost. Consequently, comparing Hong Kong's student unit cost with that of Harvard University might result in the former's student unit cost being more expensive; and

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- therefore, when making reference to the student unit cost in higher-education institutions overseas, the differences in the socio-economic conditions and the higher-education system between the countries concerned should be duly taken into account.

9. According to paragraph 2.15 of the Audit Report, the Vice-Chancellor of the HKU stated that the use of the crude average student unit cost as a basis for funding was outmoded and could not meet the rapidly changing environment in which higher-education institutions had to operate. The HKU had introduced a funding methodology that was based on measurement of performance and a strategic development plan. The HKU considered that this methodology was superior to the one based predominantly on student unit cost. The Committee asked about the UGC's and the Administration's views on the HKU's statement.

10. In response, the **Secretary-General of the UGC** and the **Secretary for Education and Manpower** said that:

- the HKU's funding methodology was used for its internal allocation of resources, while the crude average student unit cost was used as the basis for funding the entire UGC sector;
- following the Higher Education Review in 2002, the UGC was reviewing its funding methodology with a view to encouraging role differentiation among institutions, rewarding performance in accordance with role, and promoting competition among institutions on the basis of merit in teaching, research, governance, management and community service. The new methodology was intended to be adopted with effect from the 2005-08 triennium. As the recommendations arising from the Higher Education Review entailed considerable changes to existing systems and took time to implement, the 2001-02 to 2003-04 triennium would roll-over for one year to cover the 2004-05 academic year, thus postponing the new triennium to 2005-06 to 2007-08; and
- it was envisaged that the higher-education sector would be facing further funding reductions in the coming years, especially the 2004-05 academic year for which a 10% reduction was expected, and the funding methodology that determined the level of funding for the UGC sector might also be changed. Against this background, it was not opportune to review the crude average student unit cost at this point. The more appropriate time-frame for conducting the review would be during the 2005-08 triennium when the situation became more stable.

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11. Given that the level of recurrent grants to individual institutions would, in future, be determined on the basis of the institutions' performance rather than the student unit cost, the Committee enquired whether the review of the crude average student unit cost recommended by Audit in paragraph 2.12 of the Audit Report was still necessary.

12. **Mr David LEUNG Moon-tong, Assistant Director of Audit**, said that the student unit cost served as a useful indicator for ascertaining whether the cost of tertiary education in Hong Kong was high, reasonable or low as compared with those in advanced countries. Hence, there was a need to work out the student unit cost in Hong Kong, irrespective of whether other indicators would be developed for use by the local tertiary education sector.

13. In response to the Committee's enquiry as to whether the institutions agreed to conduct a review on the appropriateness of using the current crude average student unit cost as the basis for funding the UGC sector, the **Secretary-General of the UGC** responded in his letter of 31 December 2003, in *Appendix 34*, that the institutions agreed that the review should be conducted but regarded that this was a matter for the UGC to take forward in consultation with the institutions. In the light of the many reforms underway in the sector, a meaningful review could only be started during the 2005-08 triennium when the situation became more settled.

14. In paragraph 2.12(b) of the Audit Report, Audit recommended that the UGC should consider carrying out an in-depth review of the budgets of the institutions. In his letter of 8 December 2003 in *Appendix 35*, **Prof NG Ching-fai, President and Vice-Chancellor of the HKBU**, expressed reservation about this recommendation. He considered that such a review went against the principle of institutional autonomy and the rules of the existing block grant system. The information on the expenditure of the institutions filed periodically with the UGC Secretariat should enable the carrying out of an in-depth review of the expenditure incurred by each institution.

15. In the light of the HKBU's comments, the Committee asked whether the UGC still considered it necessary to carry out an in-depth review of the budgets of the institutions. In response, the **Secretary-General of the UGC** said that he agreed that institutional autonomy should not in any way be compromised. But there were merits if the UGC knew, on a broad basis, how the institutions spent their money. With such information, the UGC was able to ascertain whether the institutions were focusing their work on their pre-defined roles and missions and whether they were spending their funds in the best way. Under the new performance-based funding methodology, this kind of information could

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provide useful reference to the UGC in determining the appropriate level of recurrent grants to individual institutions.

Funding and resource allocation

16. The Committee noted that in February 2001, when seeking commitment of funding for the 2001-02 to 2003-04 triennium, it was clearly stated in the Finance Committee (FC) paper that the triennial recurrent grants comprised about 75% for teaching, 23% for research and 2% for professional activities. Recurrent grants covered the block grant, which was the major component of the recurrent grants, and earmarked grants, which were for specific purposes such as the Earmarked Research Grants and the Language Enhancement Grants. Based on the information provided in the FC paper, there was a general expectation that the UGC should allocate the recurrent grants broadly in the proportion of 75% for teaching, and 25% for research (including the 2% for professional activities). However, the UGC had “top-sliced” 5% of the funds for subsequent allocation to the institutions as earmarked grants which were largely for research purpose. The effect of allocating “top-sliced funds” of more than 25% for research had had the result of increasing the overall proportion of recurrent funds allocated for research. The actual allocations exceeded the funding intention of 25% for research by 2.57 percentage points.

17. The Committee also noted from Note 8 in paragraph 3.19 of the Audit Report that, in response to the invitation by the Chairman of the UGC for comments on the funding of the 2001-02 to 2003-04 triennium, seven institutions had expressed their views in August 1999 that there was a need to:

- make the funding methodology more transparent;
- disclose the funding split between teaching and research; and
- disclose more detailed information about the relative cost weightings for different programmes and different levels of study.

On that occasion, some institutions had also pointed out that due to the lack of transparency, they could make no meaningful suggestion on how the funding methodology could be improved.

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18. According to paragraph 3.20 of the Audit Report, the Chairman of the UGC advised the Secretary for Education and Manpower that the methodology for assessing the institutions' recurrent funding requirements was essentially very simple and transparent. It was not transparent only in two respects: the specific weightings used for different disciplines and levels of study, and the exercise of judgment by the UGC after the calculations had been done. However, the UGC firmly believed that further transparency in these respects would be counter-productive and would actually undermine the institutions' autonomy in the use of their eventual allocations. The matter was, therefore, not pursued further when allocating funding for the 2001-02 to 2003-04 triennium.

19. Against the above background, the Committee questioned why:

- in allocating recurrent grants to the institutions, the UGC had not adhered to the funding intention of 75% for teaching and 25% for research, but instead had "top-sliced" 5% of the recurrent funding for subsequent allocation to the institutions as earmarked grants, resulting in the actual allocations exceeding the funding intention of 25% for research;
- the institutions were not given clear and full information on how the recurrent grants for teaching and research were allocated by the UGC; and
- the UGC had not followed the practice in the UK and Australia where the full details of the funding arrangements for the higher-education sector were disclosed in public reports and made available on the Internet.

20. On the question of the 75:25 funding split, **Ms Irene YOUNG Bik-kwan, Principal Assistant Secretary for Education and Manpower (Higher Education)** referred the Committee to the response given by the Secretary for Financial Services and the Treasury in paragraph 3.25 of the Audit Report, which stated that:

- in all three FC papers for the last three triennia, the FC was asked to accept the total recurrent funding requirement of all the institutions in a triennium. The approval was not in respect of funding requirements broken down into teaching and research funding; and
- this understanding was most explicitly stated in the FC paper on recurrent funding for the 2001-02 to 2003-04 triennium (reference: FCR(2000-01)73), which clearly indicated that the FC's approval was sought for the overall amount of the Government's subvention to the UGC. Issues such as how the UGC intended to apportion the Government's subvention among the

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institutions, how resources were utilised within the institutions, and how individual institutions made their management and academic decisions were separate from, and beyond the remit of, that proposal.

21. The **Secretary-General of the UGC** clarified that:

- the existing 75:25 funding split assumed in the UGC funding model was intended to apply only to the calculation of the recurrent funding of the institutions and was, therefore, not intended to be applicable to the earmarked grants which were set aside for allocation to the institutions for specific purposes;
- in practice, it was difficult to separate teaching from research because, in many circumstances, academic staff members in the institutions were performing both teaching and research duties. Besides, as not all institutions were research-led institutions, the volume of research conducted, and the amount of time and resources devoted to research varied from one institution to another. Hence, the research allocations for different institutions would also be different. The level of funding to individual institutions for research purpose was determined by the RAE last conducted in 1999 which assessed the research performance of different institutions, having regard to their number of active research workers and their cost of research in respective fields;
- the distribution of research funding under the current funding methodology was performance based, the purpose of which was to reward institutions' performance rather than to limit their resource input for research. While the UGC's funding methodology had become more performance based, it was, however, not the UGC's intention to change the block grant system of allowing the institutions to decide the internal allocation of resources on their own, which underpinned the academic freedom of the institutions; and
- on the question concerning disclosure of full details of the funding arrangements to the public, the UGC and the institutions generally agreed that there should be more transparency in this respect, in particular the funding split between teaching and research. In their view, this endeavour should be pursued in a measured way so as to ensure that the information to be disclosed could really serve the intended purpose of providing useful and meaningful reference to members of the public as well as the UGC sector. However, there were differing views among the institutions on the extent of the information to be disclosed and the pace of pursuing the matter.

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22. The Committee then enquired about the actions to be taken by the UGC and the institutions and the timetable for implementing Audit's recommendations in paragraph 3.23 of the Audit Report concerning the enhancement of the transparency of the funding split between teaching and research. After consulting the institutions, the **Secretary-General of the UGC** advised, in his letter of 31 December 2003, that as a new funding methodology was being developed by the UGC for the assessment exercise of the 2005-06 to 2007-08 triennium, institutions supported that more transparency regarding the funding split between teaching and research should be made when the new assessment exercise was completed in early 2005, with institutions retaining the autonomy in the internal deployment of resources.

RAE and implementation of research projects

23. The Committee noted that the RAE was an important tool by which public funds for higher education were allocated, with due regard to research performance. It aimed to measure the output and quality of research of the institutions by cost centres for the purpose of allocating some of the research portion of recurrent grants in a publicly accountable way. So far, three RAEs had been conducted, in 1993, 1996 and 1999. The next one was planned to be conducted in 2005-06.

24. The Committee understood that Hong Kong had broadly followed the UK system of funding research at tertiary institutions. In the UK, the full results of the RAE were posted on the Internet. However, in Hong Kong, the UGC had not disclosed the full results of the 1999 RAE to the institutions and the public. Indeed, the RAE panels and their individual members had offered valuable comments on a wide range of issues, including those which might affect the planning and the strategies for academic research in Hong Kong. These valuable comments were, however, not disclosed to the public.

25. The Committee referred to paragraph 4.16 of the Audit Report in which the Secretary-General of the UGC said that the UGC shared the general spirit of Audit's recommendation on disclosure of RAE results. This was in line with the UGC's decision for a greater degree of transparency when conducting the next RAE in 2005-06. But the need for greater transparency should be carefully weighed against the possible danger of misinterpretation or misuse of data. In principle, the UGC was prepared to consider publishing more details regarding the RAE results, but it should guard against unwarranted and superficial institutional comparisons which would not contribute to the healthy development of research in Hong Kong. The Committee queried who might misinterpret or misuse the data, and enquired about the basis for the UGC to hold these views.

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26. The **Secretary for Education and Manpower** said that he might be one of the parties who would misinterpret or misuse the data. He explained that:

- each and every institution had its own strengths and should nurture those strengths. It was not uncommon that an institution was outstanding in only one or two areas of research. If the full results of the RAE of all institutions were published as a league table, those institutions which were outstanding in only one single area of research might be rated much lower down in terms of their overall performance. This was unfair to the researchers in that area and was undesirable from the morale point of view. The practice of disclosing full RAE results to the public in the UK had also aroused a lot of controversy; and
- therefore, caution had to be exercised when deciding on the method of publishing this kind of information. It was prudent to ensure that the public understood how to interpret the data and judge the institutions fairly before the information was disclosed.

27. In his letter of 31 December 2003, the **Secretary-General of the UGC** informed the Committee that in the UGC's Higher Education Review Report published in March 2002, it was proposed that the RAE should be refined to promote higher levels of excellence in university research. The UGC had been actively working on a refined methodology for the next exercise due for completion in 2006 and had decided that the results of the new exercise, together with the comments made by the RAE panels, should be suitably disclosed in due course. The institutions would work with the UGC to determine on exactly what, how and when to disclose.

28. The Committee noted that the Competitive Earmarked Research Grant (CERG) represented the largest portion of the Earmarked Research Grants which were administered by the Research Grants Council (RGC) of the UGC. According to Audit's findings in paragraphs 4.29 to 4.32 of the Audit Report, between 1995-96 and 2002-03, the CERG awarded funding for a total of 4,671 research projects. As at 23 July 2003, of these 4,671 projects, 4,452 (95.3%) were on-going or completed, and 219 (4.7%) were terminated before completion. In this connection, Audit examined the 57 CERG projects approved between 2000-01 and 2002-03 which had subsequently been terminated. Audit's findings indicated that the \$9.2 million spent on the direct costs of 54 of these terminated projects was largely nugatory. For the remaining three terminated projects, their accounts were not finalised at the time of audit. Audit also found that of these 57 projects, 45 had been terminated due to the departure of the Principal Investigators (PIs). Of these 45 PIs, 20 left the institutions within six months after commencement of the project and 10 left between six and 12 months.

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29. The Committee further referred to the UGC's response in paragraph 4.35(b) of the Audit Report which stated that under the present RGC policy, a change of PI was strictly not allowed within the first 12 months of the project's duration. Its response in paragraph 4.35(c) also stated that the existing application procedures required the institutions to confirm at the time of application that a staff member employed on a fixed-term contract would be eligible for at least the first year of the project's planned duration. There was also a clear stipulation in the explanatory notes accompanying the application form to remind the institutions that they should, to the best of their knowledge, satisfy themselves that the PI was available to complete the project if funded. The Committee questioned why, with the RGC policy and the above procedures in place, the situation where 30 PIs had left the institutions within the first year after project commencement had occurred.

30. The **Secretary-General of the UGC** explained that:

- there were many reasons accounting for the early departure of the PIs and, in many cases, the circumstances were beyond the control of the PIs and the institutions and were unforeseen. Even for a long-term contract, there was no way to predict or prevent a staff member from giving notice to terminate his/her employment, especially in the case of local institutions where their academic staff mix was fairly international, which implied that there were higher chances of their academic staff moving in and out of Hong Kong. Contract renewal was basically a personnel decision involving complex considerations, such as finance and performance. While such information, if known and available, was a valid consideration, it was not appropriate to attach undue weight to the "certainty" of employment; and
- when examining the subject, one should avoid conveniently equating "terminated" projects with "failure" or "waste of money". Research was usually done in stages and, depending on progress, some results, though partial or limited, were available in some terminated projects. These results would add to existing knowledge and contribute to future research. Furthermore, for research, both the results and the process were valuable and, in this regard, the training and educational benefits which could be derived from the process should not be ignored.

31. In respect of the 30 projects which had been terminated due to the departure of the PIs within 12 months after the commencement of the projects, the Committee invited Audit to provide further information to ascertain whether there were any PIs who departed the institutions due to expiry of their employment contracts and, if so:

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- the number of such PIs and the names of the institutions concerned; and
 - the remaining duration of their employment contracts with the institutions:
 - (a) at the time of application and the reasons for the institutions' submitting the application although they knew that the remaining duration of the PI's employment contract was 12 months or less;
 - (b) at the time of research grant award and the reasons for not withdrawing the project proposals although the institutions knew that the remaining duration of the PI's employment contract was 12 months or less; and
 - (c) at the time of commencement of the project and the reasons for commencing the project although the institutions knew that the remaining duration of the PI's employment contract was 12 months or less.

32. The **Director of Audit** provided the information in his letter of 5 January 2004, in **Appendix 36**. According to his response, there were five projects, involving three institutions, which had been terminated due to expiry of the employment contracts of the PIs. Details of the response are summarised as follows:

Table 1

**Breakdown of the five projects terminated
due to expiry of employment contracts of PIs**

| | PI left <u>within six months</u> after project commencement | PI left <u>between six and 12 months</u> after project commencement |
|--|---|---|
| | No. of project(s) | |
| HKU | 1 | 2 |
| City University of Hong Kong (CityU) | | 1 |
| The Hong Kong University of Science and Technology (HKUST) | | 1 |
| | Total: 5 projects | |

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Table 2

**Remaining duration of employment contract of the PI
who left within six months after commencement of the project**

| | Remaining duration of PI's employment contract | | | Remarks |
|-----|--|-------------------------------------|-------------------------------------|---|
| | at the time of application | at the time of research grant award | at the time of project commencement | |
| HKU | 13 months | 5 months | 3 months | The PI left in December 2002 after commencement of the project in September 2002. |

33. In the case cited in Table 2 above, the HKU explained that due to unforeseen circumstances, the PI was not able to accept the renewal of contract and left for Europe to resume a tenure position as Professor. The PI had proposed to continue the project as a Co-Investigator, but this was rejected by the HKU in conformity with the CERG regulations.

Table 3

**Remaining duration of employment contracts of PIs
who left between six and 12 months after commencement of the project**

| | Remaining duration of PI's employment contract | | | Remarks |
|-------------|--|-------------------------------------|-------------------------------------|---|
| | at the time of application | at the time of research grant award | at the time of project commencement | |
| HKU: | | | | |
| - Project A | 21 months | 13 months | 11 months | The PI left in July 2001 after commencement of the project in September 2000. |
| - Project B | 22 months | 14 months | 12 months | The PI left in August 2002 after commencement of the project in September 2001. |
| CityU | 20 months | 12 months | 7 months | The PI left in June 2001 after commencement of the project in December 2000. |
| HKUST | 14 months | 6 months | 6 months | The PI left in January 2002 after commencement of the project in July 2001. |

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34. As to why the HKU had proceeded with the two projects cited in Table 3 above, the HKU advised that:

- as at the end of November 2003, about 45% of full-time, paid academic staff (excluding honorary, visiting and temporary appointees) holding the ranks of Assistant Lecturers to Professors were placed on contract terms. Such contractual arrangements were introduced to enable the HKU to react effectively to a declining budgetary situation. As uncertainty about the following year's budget level grew, Heads of Departments found themselves increasingly being unable to plan proactively and decisively about staff contracts. Therefore, at the time of submitting CERG applications, i.e. in October each year, a degree of uncertainty surrounded the status of a number of contracts;
- the HKU, however, would not discourage its academic staff from submitting CERG proposals in October as it was precisely the staff's duty to seek outside sources to support their research work, unless it was already certain by the following June that certain staff would not have the requisite period of service remaining in their contract to make them eligible for CERG grants. Institutions could, however, be expected to withdraw or accept a CERG grant when the outcome of previous year's prepared submissions was announced;
- in an atmosphere of funding uncertainty which militated against prudent financial and academic planning, the HKU's Research Services Section had the established practice of reminding Heads of Departments annually of the need to consider whether contracts of CERG applicants would be renewed or otherwise. The administration was, however, careful to emphasise that no implications were attached to a renewal or otherwise due to a CERG grant. Such reminders were issued only to enable the HKU to discharge its duty and obligation to the RGC by way of ensuring that a CERG applicant's appointment status must be in conformity with the RGC rules; and
- the HKU currently had in total more than 680 funded and on-going CERG projects. It must be accepted that not all cases were within the institution's control. These terminated projects only represented a very small percentage of the pool of projects.

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35. As to why the CityU had proceeded with the project cited in Table 3 above, the CityU advised that:

- the project was approved in June 2000. The PI was the sole investigator of the project. In the absence of a Co-Investigator, according to the RGC rules, the project had to be terminated upon departure of the PI a year after project approval. Approval of CERG projects was usually announced by the RGC in late June or early July every year. To allow for preparatory work before the start of the project, e.g. recruitment of research staff or acquisition of specialised equipment items, the commencement date of the project reported to the RGC was usually three to six months from the approval date, and this was acceptable to the RGC. In reality, CERG projects started from the date of approval of the award in June. Counting from the project commencement date might not accurately reflect the situation;
- the issue of termination of CERG projects arising from staff departure shortly after granting of approval/commencement was related to the CERG application schedule and the CityU's internal personnel decisions cycle. PIs prepared their CERG applications and submitted them by the end of October every year when decisions on contract renewal/substantiation of appointments for contracts due to expire in July of the following year were not yet confirmed. There were also cases where the employment contracts ended in January or February, or where more lengthy performance assessments were involved. The process could end in as late as May or June, shortly before award announcement. In deciding whether to submit an application at the time, the institution and the PI could only consider the existence of a reasonable expectation and an intention of further employment;
- the CityU always endeavoured to report on the latest development and/or to request withdrawal for confirmed cases of staff departure, during the project updates to the RGC in April; and
- staff departure was a personnel decision which involved a number of factors and it was difficult to ascertain these expectations/intentions. In most of the cases where projects were terminated within six months of commencement, they involved late confirmation of such decisions and, hence, withdrawal of the PI and return of the grant to the RGC.

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36. As to why the HKUST had proceeded with the project cited in Table 3 above, the HKUST advised that contract renewal was under review at the time of research grant award and project commencement. The PI left between six and 12 months after commencement of the project, with project funding fully returned to the RGC.

37. The Committee then enquired about the feasibility of putting in place further administrative safeguards to ensure completion of research projects, such as:

- disbursing research grants in phases based on the progress made, so as to minimise the risk of not completing the research projects due to various reasons;
- requiring the applicant to assign an additional investigator who, in case of the departure of the PI within the first year of the project's duration, would also be able to complete the project; and
- requiring the applicant to submit a contingency plan, at the time of application, stating how the project would be completed in case of the departure of the PI within the first year of the project's duration.

38. In response, the **Secretary-General of the UGC** said that:

- the funding involved in each CERG project was on average about \$0.6 million, and was disbursed to the institution concerned on a lump sum basis. The administration of CERG projects was indeed quite a time-consuming and expensive exercise compared to the amount invested in these projects. It was necessary to strike a reasonable balance between the amount of resources spent on running the projects and on monitoring them;
- the vetting and approving of a research project had gone through a rigorous process of internal screening and vetting by the institutions concerned before submission to the RGC for approval. There were also sufficient administrative safeguards as part of the eligibility rules to ensure that research grants were only awarded to projects for which there was reasonable assurance about the PIs' availability to complete the projects. Furthermore, before actually releasing the grants, as a standing practice, the institutions were requested again to confirm if there were any projects that need to be withdrawn due to the ineligibility, including early departure, of the PI;

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- the existing monitoring policy required PIs to submit annual progress reports to account for the progress achieved with respect to the approved project objectives. Whenever irregularities were detected, comments were fed back and the PIs concerned were required to follow up as appropriate. Detailed explanations would be sought from the PIs if the projects had deviated from or failed to accomplish any of the objectives;
- at present, a change of the PI would only be approved under very exceptional circumstances. This policy was important to ensure that the PI, who was the “soul” of the project, was sufficiently committed to the work and could steer the project through to maturation. From the academic justification point of view, it was considered inappropriate to change the PI within the first 12 months after the commencement of the project; and
- in sum, the UGC believed that the present system had been working well. Nevertheless, it appreciated the arguments behind Audit’s recommendations on termination of funded research projects and recognised the need to keep the matter under constant review. It would take into account Audit’s recommendations in striving for improvements.

39. The Committee noted from Table 7 in paragraph 4.43, and paragraph 4.45 of the Audit Report that of the 2,604 projects approved between 1999-2000 and 2002-03, 1,835 had been granted extension of time by the institutions, which represented an average of 71% of the 2,604 approved projects. However, at present, there was no requirement, at the application stage of a project, to state the key milestones to be achieved at different stages of the project. The Committee asked whether the UGC would consider taking measures to tighten the control over the granting of extension of time by the institutions.

40. The **Secretary-General of the UGC** replied that:

- the RGC attached importance to timely completion of projects but acknowledged the need for flexibility in adjusting the timeline of research. The RGC would take into account Audit’s suggestions and consider if there was room to strengthen the existing monitoring mechanism. The RGC kept the policy under constant review and had, since 2001, tightened the relevant rules to cap all project extensions at the maximum of 18 months (the previous policy allowed up to 24 months). The RGC would continue to keep in view the situation and, where required, remind the institutions to adopt a consistently stringent standard in handling applications for extension; and

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- it must be stressed that project extension did not necessarily mean a delay of work in all cases. On the contrary, in many cases, project extension was well justified on the strength that the original work plan would need to be adjusted to take account of recent and unanticipated developments in the research fields. Such adjustment of the work plan and, hence, the timeline was needed for maximisation of outputs and value.

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41. The Committee noted that the UGC Notes on Procedures required that the institutions should aim to reflect the full costs of the activities concerned when determining the level of overhead charges to be levied on their self-financing activities. In 1998, the institutions agreed amongst themselves that they should normally charge overhead at a standard flat rate of 15% (on direct costs) for non-UGC-funded research projects. Around that time, the institutions already noticed that a costing exercise of university indirect expenses on each project had indicated that these indirect components would constitute around 38% in 1997-98. For the three-year period 1999-2000 to 2001-02, the overall weighted average overhead percentage (on direct costs) for all the institutions was 59.2%, which was equivalent to about 37.2% on total costs. This suggested that the standard overhead recovery rate of 15% set by the institutions was on the low side.

42. The Committee also noted that the HKBU and the HKUST had adopted overhead recovery rates below 15% for some of their self-financing activities. Moreover, nearly all institutions did not charge any overhead costs to their student hostels, despite the UGC Notes on Procedures which clearly stated that student hostels should be operated on a self-financing basis.

43. In his letter of 8 December 2003 in *Appendix 37*, the **President of the HKUST** provided an update on the University's overhead recovery rate referred to in Table 9 in paragraph 5.14 of the Audit Report. He informed the Committee that the HKUST had increased the floor overhead recovery rate for self-financing activities from 11% in 2002-03 to 18% in 2003-04 with effect from 1 September 2003.

44. In paragraph 5.20(f) of the Audit Report, the institutions pointed out that student hostel operation was part of a university's core activity. Student hostels were run as separate self-financing operations without the usual overheads of the regular academic and research activities of the universities. It was questionable to suggest charging the same overhead costs of the universities. In their view, charging full overhead to their student

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hostel operations would result in substantially higher hostel fees and was entirely contrary to the aim of encouraging students to participate in campus life as an integral part of university education.

45. While the Committee fully appreciated the great educational value of hostel life, it considered that the existing requirement as stipulated in paragraph 5.2 of the UGC Notes on Procedures that student hostels should be operated on a self-financing basis should be followed by the institutions as far as possible. In this connection, the Committee asked whether the UGC and the institutions would:

- reconsider whether or not student hostels should be subject to overhead charging. If it was decided in the negative, whether the UGC would revise the UGC Notes on Procedures accordingly; and
- conduct a thorough review to see whether the standard overhead recovery rate of 15% for self-financing activities was still appropriate, and whether the institutions would appoint external auditors to assist them in the review.

46. The **Secretary-General of the UGC** advised in his letters of 31 December 2003 and 18 February 2004, in *Appendix 38*, that:

- the institutions had formed a Working Group on Review of Overhead Recovery Practices on Self-financing Activities of UGC-funded Institutions, comprising the Directors of Finance of all the institutions, to conduct the review on the overhead recovery rates. The UGC expected that external auditors of the institutions would be consulted as and when necessary. Fair and appropriate overhead recovery rates would be worked out by individual institutions for each self-financed operation, having regard to the differences in the circumstances of the institution, the size of the self-financed operation concerned in relation to the institution's core activities and the variation in the administrative efforts incurred. Details of the Working Group's work plan were set out in the letter of 18 February 2004; and
- the UGC would revise the UGC Notes on Procedures should it be decided that the student hostels should not be subject to overhead charging.

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47. Conclusions and recommendations The Committee:

- expresses concern:
 - (a) that the higher-education institutions were not given clear and full information on how funds were distributed to them by the University Grants Committee (UGC);
 - (b) about the lack of objective criteria agreed among the institutions for the allocation of funds by the UGC;
 - (c) that the funding methodology adopted by the UGC is not well understood by the public; and
 - (d) about the views of the Secretary for Education and Manpower and the Secretary-General of the UGC that there is a possible danger of misinterpretation or misuse of data if the full results of the Research Assessment Exercise (RAE) are disclosed to the public;
- notes the institutions' view that the UGC's funding methodology should be made more transparent;

UGC's endeavours in benchmarking the cost of tertiary education

- expresses concern that:
 - (a) the UGC's endeavours in benchmarking the student unit cost of tertiary education in Hong Kong against that in overseas countries had not been successful; and
 - (b) the Government/UGC has not conducted any major review to ascertain whether the crude average student unit cost would continue to serve as the appropriate basis for funding tertiary education;
- concurs with Audit that the student unit cost serves as a useful indicator for ascertaining whether the cost of tertiary education in Hong Kong is high, reasonable or low as compared with those in advanced countries. Hence, there is a need to work out the student unit cost in Hong Kong, irrespective of whether other indicators will be developed for use by the local tertiary education sector;

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- notes that the Secretary-General of the UGC will implement Audit's recommendations mentioned in paragraph 2.12 of the Audit Report;

Funding and resource allocation

- expresses concern that:
 - (a) the effect of allocating "top-sliced funds" of more than 25% for research has had the result of increasing the overall proportion of recurrent funds allocated for research. The actual allocations exceeded the funding intention of 25% for research by 2.57 percentage points;
 - (b) the institutions were not given clear and full information on how the recurrent grants for teaching and research were allocated by the UGC; and
 - (c) in the Controlling Officer's Report of the Annual Estimates, only a single sum of the annual recurrent grants is shown, without any indicative breakdown for the provision of funding between teaching and research;
- notes that the Secretary-General of the UGC will implement Audit's recommendations mentioned in paragraphs 3.23 and 3.32 of the Audit Report;

Research Assessment Exercise and implementation of research projects

- expresses concern that:
 - (a) the full results of the RAE were not disclosed to the institutions and the public, and the RAE panels' comments were not disclosed to the public;
 - (b) there was little representation from the commercial and industrial sectors and other users of research to represent the users in the RAE panels;
 - (c) the major cause of project termination was that the Principal Investigators had left the institutions;
 - (d) on many occasions, the institutions granted extensions of time for completing research projects; and
 - (e) there is no requirement, at the application stage of a project, to state the key milestones to be achieved at different stages of the project;

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- notes that the Secretary-General of the UGC will implement Audit's recommendations mentioned in paragraphs 4.14, 4.22, 4.36 and 4.46 of the Audit Report;

Funding of self-financing activities

- expresses serious concern that:
 - (a) the standard overhead recovery rate of 15% set by the institutions is on the low side;
 - (b) nearly all institutions do not charge any overhead costs to their student hostels, despite the UGC Notes on Procedures which clearly state that student hostels should be operated on a self-financing basis; and
 - (c) non-compliance with the agreed standard rate of overhead recovery by some institutions has cast doubt on the effectiveness of the existing arrangements;
- notes that the Secretary-General of the UGC will implement Audit's recommendations mentioned in paragraph 5.17 of the Audit Report;

Refund of government rents and rates

- expresses concern that there is no clear UGC guideline on whether the self-financing commercial or quasi-commercial activities operated by the institutions are eligible for refund of government rents and rates;
- notes that:
 - (a) the Secretary for Education and Manpower will implement Audit's recommendation mentioned in paragraph 6.11 of the Audit Report; and
 - (b) the Secretary-General of the UGC will implement Audit's recommendations mentioned in paragraph 6.12 of the Audit Report; and

Follow-up action

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