APPENDIX 14

中華人民共和國香港特別行政區政府總部教育局
Education Bureau
Government Secretariat, Government of the Hong Kong Special Administrative Region
The People's Republic of China

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8 December 2010

Ms Miranda HON
Clerk to Public Accounts Committee
Legislative Council
8 Jackson Road
Central
Hong Kong

Urgent by post and fax
(Fax No. 2537 1204)

Dear Ms Hon,

The Director of Audit's Report on the
Results of Value for Money Audits (Report No. 55)

Administration of the Direct Subsidy Scheme (Chapter 1)
And Governance and administration of Direct Subsidy Scheme schools
(Chapter 2)

With reference to your letter dated 1 December 2010, please find enclosed information pertaining to items (a) to (d) set out in your letter at **Annex A** to **Annex D**.

As mentioned in our reply letter of 7 December, responses to items (e) to (h) will be provided together with other related information in one go on 10 December 2010.

Yours sincerely,

(Mrs. Michelle WONG)
for Secretary for Education

c.c. Secretary for Financial Services and the Treasury (Fax no.: 2147 5239)
Director of Audit (Fax no.: 2583 9063)

Annex A

Response to the letter of 1 December 2010 from Public Accounts Committee regarding paragraph 1(a)

(a) regarding the five schools mentioned in para. 2.11 of Chapter 1, the detailed reasons for the long time taken since January 2006 to sort out the issues relating to their change to the non-profit-making status, and in particular, how the internal guidelines issued by the EDB in 2008 concerning the change of operation right of schools had affected the process, and the date of issuing the internal guidelines.

1. The five schools mentioned in the Report are ex-Bought Place Scheme (BPS) schools operated by two profit-making companies limited respectively. The two school operators borrowed BPS loan from the government at a total amount of HK$247M for purchasing the five school premises in the 90s and in this connection five Loan Agreements and Legal Charges were signed and registered with the Lands Department. As the two school operators are registered under Company Limited by Shares, they set up five Companies with non-profit-making status to serve as the school sponsoring bodies (SSB) of the schools and suggested to process the change of operation right from the existing school operators to the new SSBs by way of the signing of "novation agreement".

2. Due to the uniqueness and complexity of the case, which involves not only the transfer of school operation right, but also the transfer of property ownership (Legal Charge) and the liability under the Loan Agreement, the Education Bureau (EDB) has adopted a prudent approach and sought legal advice from the Department of Justice (DoJ) and Legal Advisory and Conveyancing Office (LACO) from time to time so as to ensure that the interest of the government is properly protected.

3. In early 2007, EDB started a review of the Standard Clauses and Articles of Memorandum and Articles of Association (M&AA) for SSB under the Company Registration. At the same time, the Bureau was preparing a Procedural Guide on Transfer of SSB of Aided Schools for internal reference. It was considered that in handling of these five cases, EDB

should take the former into consideration and make reference to the latter to ensure consistency. Relevant Standard Clauses and Articles of M&AA were updated and made available for school use in 2007. The compilation of the Procedural Guide on Transfer of SSB of Aided Schools was completed in 2008.

4. In 2009, EDB devised a workflow for processing the transfer of operation right between the old and new SSBs of these five schools with reference to the Procedural Guide on Transfer of SSB of Aided Schools . At the same time, we requested the new SSBs to provide their existing M&AA for our checking. We received the M&AA in January 2010. The new SSBs were requested in June 2010 to revise their M&AA in order to meet the latest requirements. The schools submitted the revised M&AA to EDB for comment in September 2010. Subject to further amendments by the SSBs, they would submit the amended M&AAs to the Companies Registry and Inland Revenue for endorsement.

5. This case that involves complex legal issues is unprecedented. As the Direct Subsidy Scheme (DSS) is a comparatively new system and some of the implementation details have to be fine tuned in the process to cater for different scenarios in practice, we have taken much time in resolving the matter. We admit that the progress has not been satisfactory. On 22 November 2010, EDB held a meeting with representatives of the five schools to discuss the content of the Assignment. Once the Deed of Novation and Assignment were agreed by the schools, DoJ, LACO and EDB, EDB will proceed with the task according to the relevant procedure.

Annex B

Response to the letter of 1 December 2010 from Public Accounts Committee regarding paragraph 1(b)

(b) the detailed reasons why the SMC/IMCs of the 3 schools mentioned in paragraph 3.19 of Chapter 1 had not yet acquired the tax exemption status under the Inland Revenue Ordinance up to 30 June 2010, including when the EDB became aware that they had not acquired the tax exemption status and the actions that had been taken by EDB to ensure that they would acquire the status without delay

Paragraph 3.19 of Chapter 1 mentions that up to 30 June 2010, the SMCs/IMCs of three schools had not yet acquired the tax exemption status under the Inland Revenue Ordinance. The updated situation of their application for tax exemption status is as follows:

<u>School A</u>

- The School turned into a DSS school in September 2008. The person who assisted in drafting the M&AA of the SMC worked on a voluntary basis and thus, spent a long time studying and revising the related documents. Also, the SMC had spent much time on discussing and amending the M&AA in its meetings. EDB had all along maintained dialogue with the school, reiterating the requirement for the SMC to conclude the SMC SA by 31 August 2009.
- EDB has also been communicating with the School with regard to its establishment of an incorporated SMC and acquisition of the tax exemption status. According to the information provided by the School to EDB in August 2010, the SMC of the School had acquired the tax exemption status with effect from 7 June 2010. The SMC subsequently signed the SMC SA with the Bureau on 10 September 2010.

<u>School B</u>

- The School (a primary school) turned from an aided school to a DSS school on 1 September 2008.

- EDB has all along maintained close contact with the School with regard to the establishment of an incorporated management committee, signing of the SA and application for the tax exemption status.
- Regarding the SMC Service Agreement (SA), the SSB requested that the alumni manager(s) of the (primary) School be nominated by the Alumni Association of the secondary section of the School, instead of by the Alumni Association of the (primary) School. EDB and the SSB had quite a number of discussions on the issue and hence, the progress of completing the drafting of the Memorandum and Articles of Association (M&AA) and acquiring tax exemption status by its SMC was delayed.
- The SSB finally accepted EDB's suggestion that the alumni manager must be an alumnus of the School and submitted in August 2010 the M&AA to IRD to apply for tax exemption status for the SMC. The M&AA was further revised in November 2010. Upon obtaining the tax exemption status, the SSB will submit the M&AA to the Companies Registry to incorporate the SMC.

<u>School C</u>

- The School commenced operation on 1 September 2004. Consensus could not be reached on the draft SSB SA since the School had reservation about the conditions related to the SMC therein. After series of communication and negotiation, the School executed the SSB SA with the Government on 15 July 2009.
- In the course of the negotiation on the SSB SA, EDB had maintained contact with the SSB for the signing of the SMC SA. EDB has also urged it to complete the preparation of the M&AA for incorporation and application for tax exemption status.
- After the conclusion of the SSB SA, the School indicated that it was drafting the M&AA and committed to completing the task within the 2009/10 school year. EDB had liaised with the school many times and urged it to expedite.
- Finally, the SMC was incorporated under the Companies Ordinance on 9 November 2010. The SMC has also submitted an application to IRD for tax exemption status. The School anticipated that approval would be granted in December 2010.

Annex C

Ref. : L/M (2) to EDB(SAS1)/DSS/FIN/7(I)C

Government of the HKSAR
Education Bureau

5 November 2010

Education Bureau Circular No. 12/2010

Use of Non-government Funds in
Direct Subsidy Scheme (DSS) Schools

[Note: This circular should be read by –
(a) Supervisors and Heads of Direct Subsidy Scheme Schools – for action; and
(b) Heads of Sections – for information.]

SUMMARY

This circular recapitulates and elaborates on, where necessary, the prevailing rules and regulations as well as guidelines on the proper use of non-government funds for compliance or reference of DSS schools as appropriate.

DETAILS

Fundamental Principles

2. The non-government funds, which include school fee income, donations, proceeds of trading operations and any other incomes derived from other non-government sources, constitute an integral part of DSS schools' available resources. DSS schools are required to exercise their professional judgement to deploy the non-government funds flexibly and diligently for educational and school needs only in the best interest of their students. DSS schools should also ensure that the use of non-government funds complies with the Education Ordinance, the Education Regulations, the School Sponsoring Body and School Management Committee Service Agreements signed between the schools and the Education Bureau where applicable, other relevant legislations and such other requirements as specified from time to time by the Education Bureau (EDB).

3. The basic principles and implementation mechanisms on the use of non-government funds are the same as those on the use of government funds. DSS schools should therefore read this circular in conjunction with the Education Bureau Circular (EDBC) No. 4/2010 on *Use of Government Funds in Direct Subsidy Scheme (DSS) Schools* dated 29 April 2010. In gist, the Government considers it essential that subvented organisations attain, and maintain, high standards of corporate governance. To this end, DSS schools are required to

strengthen their governance structure by including all key stakeholders as members of the School Management Committees (SMC) / Incorporated Management Committees (IMC), to have sound financial planning and good budgeting, and to put in place a proper internal control and reporting mechanism with rigorous checks and balances in order to ensure that the government and non-government funds are used in a prudent, cost-effective, timely and value-for-money manner. For establishing a good governance structure and adopting effective internal control measures, DSS schools are strongly advised to adapt the recommended measures set out in the document issued by the Independent Commission Against Corruption on "*Best Practice Checklist: Governance and Internal Control in Schools*"; and the "*Guide to Corporate Governance for Subvented Organisations*" published by the Efficiency Unit of the HKSAR Government to suit their respective organizational structure, resource capability and operational needs.

4. In view of the public expectation for increased accountability and transparency, there is absolute merit and need for DSS schools to disclose information regarding the SMC/IMC for public information, including the number of school managers in each category (i.e. sponsoring body manager, teacher manager, parent manager, alumni manager and independent manager as appropriate) and where the managers' consent is available, their name and tenure of office. The SMC/IMC should also ensure that the use of non-government funds is justified and publicly defensible through a mechanism with adequate built-in control measures to avert any possible abuses. To avoid any actual or perceived conflict of interest, DSS schools should draw up guidelines on declaration of conflict of interest, including examples of conflict of interest situations, the procedures for making declarations and the follow-up action to take upon receipt of any declarations. For guidelines on handling conflict of interest, DSS schools should refer to Appendix 2 of EDBC No. 4/2010 on *Use of Government Funds in Direct Subsidy Scheme (DSS) Schools*. As subvented organizations, DSS schools should keep proper administrative and financial records and provide them for the examination of the EDB and the Director of Audit when required.

5. As non-government funds should be used directly benefiting the students of the schools, under no circumstances should DSS schools distribute surplus to the school sponsoring body (SSB) or third parties in any forms, including donations or loans to the SSB or any third parties. DSS schools are reminded that they should publish the School Reports with a financial summary annually for reference of the SMC/IMC as well as members of the public. The financial summary should include the major items funded by government and non-government funds, the value and purpose of the donations received, etc. DSS schools should refer to the guidelines on compiling the School Reports posted on the EDB's Homepage via the path below and adapt the template of the School Report to suit their own needs:

EDB Homepage > Kindergarten, Primary and Secondary Education > Quality Assurance for Schools > School Development and Accountability (SDA)

Sources of Non-Government Funds

School Fees and Other Collections

6. DSS schools are required to comply with the relevant Education Regulations and circulars issued by the EDB regarding school fees and other collections. Prior approval must be sought from the EDB for any fee adjustment or new charges. Unless with the EDB's prior approval, DSS schools shall not charge or accept fees other than the inclusive fees.

7. DSS schools should formulate an appropriate mechanism to examine and review their level of school fees and other collections as well as to communicate well with parents on the matters. When adjusting the level of school fees and other collections, schools should take into consideration the affordability of their students and make efforts to address any genuine hardship possibly caused to their existing students. The financial projections made by DSS schools in their applications for school fee increases should be justified and reasonable. In projecting their operating reserves or deficits for applications for fee increase, DSS schools should exercise due care to ensure that each and every income / expenditure item is justifiable to avoid overestimate of their deficits or underestimate of their reserves that lead to unnecessary fee increase. If schools with a large surplus / reserve intend to apply for school fee increase or that a drastic increase in school fees is required, consultation with parents should be conducted through established means. During the consultation, parents' concerns should be properly addressed. For specific arrangements and procedures on annual school fee revision including parent consultation, DSS schools should refer to the call letter on fee revision issued by the EDB around March every year.

Trading Operations

8. DSS schools are required to follow the principles as set out in EDBC No. 24/2008 on *Trading Operations in Schools* in operating trading activities. Schools' attention is drawn in particular to the following:

(a) the profits or net income generated from the trading operations should be applied for the purpose directly benefiting the students of the school;

(b) proper procedures to obtain competitive tenders / quotations for trading operation should be followed;

(c) no SMC/IMC member, school head or member of staff of any school should derive any advantage, financial or otherwise, from the purchase by students, either on the school premises or elsewhere, of any item needed by students to pursue the school curriculum;

(d) no purchase should be compulsory and parents should be informed accordingly;

(e) the costs of items needed by students to pursue their course of study should be kept as low as possible;

(f) prices should be negotiated with suppliers annually, where appropriate, and items should be sold at the minimum feasible price;

(g) the profit from the sale of exercise books and other items should not exceed a maximum of 15% of the cost price, except for sale of textbooks which should not generate any profit;

(h) the selection of an operator or supplier must be conducted on a fair and competitive basis, through proper tendering procedures;

(i) appropriate action should be taken to avoid any conflict of interest; and

(j) a fair and transparent mechanism should be in place to monitor and steer all business or trading activities in schools.

Hire of Accommodation

9. In hiring out their premises to support meaningful events, DSS schools should ensure that the hire of accommodation does not affect school operation and undermine its educational services for students. Schools should formulate their school-based policy on hire of accommodation with reference to EDBC No. 9/2005 on *Hire of Accommodation in Aided Schools*.

10. DSS schools should credit the hire charges levied from accommodation and relevant overhead expenses to the non-government fund accounts.

Fund-raising Activities

11. DSS schools should ensure that fund-raising activities held are lawful and in compliance with the requirements stipulated by the EDB or other government departments. Donations and participation by students in all fund-raising activities must be on an entirely free and voluntary basis. The intended purposes of the fund-raising activity should be explicitly specified and parents should be informed accordingly. DSS schools should prepare a financial statement for each fund-raising activity and display the statement for a reasonable period of time on the schools' notice board for the information of teachers, parents and students. Financial statements for fund-raising activities should be retained for audit purposes. Written permission from the EDB should be sought for fund-raising activities held for other organisations which are not approved charitable

institutions, or not specifically approved by the EDB. A school-based fund-raising policy with proper procedural guidelines should be formulated for the compliance of their staff. In this regard, DSS schools should refer to the guidelines on conducting fund-raising activities uploaded onto the EDB's Homepage via the path below:

EDB Homepage > School Administration > Administration > Fund-raising Activities in Schools

Donations and Sponsorships

12. DSS schools are required to comply with the principles of acceptance of donations as promulgated in EDBC No. 14/2003 on *Acceptance of Advantages and Donations by Schools and their Staff*. Schools' attention is drawn in particular to the following:

(a) all donations to the school should be expended on the school and for educational purposes only;

(b) the acceptance of donations by schools should be approved by the SMC/IMC;

(c) schools should maintain a register of all donations received; and

(d) in no circumstances may a school suggest to the suppliers and contractors that the school will provide an advantage in return for their donations. Donations from suppliers and contractors should only be accepted in exceptional circumstances with compelling reasons, with proper documentation and approval by the SMC/IMC in advance.

13. Acceptance of donations, especially from those parties who have business dealings with the school (e.g. suppliers), may easily give rise to perception of favouritism or "friendly deals". DSS schools should:

(a) establish a mechanism to handle donations with reference to the guidelines issued by the EDB, including the principles of accepting donations and the mechanism for disbursement of funds; and

(b) make transparent the donations they have received and disclose the value and purpose of the donations received in the School Reports.

Use of Non-government Funds

Student Financial Assistance

14. It is of paramount importance that DSS schools draw up clear and open criteria for awarding the needy students fee remission and sufficient financial assistance (e.g. the eligibility criteria and the maximum percentage of fee remission) so that students will not be deprived of the option of attending DSS schools solely because of their inability to pay fees. DSS schools are required to offer to parents a fee remission / scholarship scheme with a set of eligibility benchmarks no less favourable than the government financial assistance schemes. It should be noted that in assessing the students' eligibility for fee remission, no factors except the parents' financial situation should be taken into consideration. At least 10% of the school's total school fee income should be set aside to provide fee remission / scholarship for deserving students. If a DSS school charges a school fee between 2/3 (two-third) and 2 1/3 (two and one-third) of the DSS unit subsidy rate, then for every additional dollar charged over and above 2/3 (two-third) of the DSS unit subsidy rate, the school should set aside 50 cents for the scholarship/financial assistance scheme. Details of the fee remission / scholarship scheme should be shown in the school's prospectus and uploaded onto the school's website.

15. When the reserve for scholarship / financial assistance has reached a cumulative amount which exceeds the school's half-year total fee income due to low utilisation of the fee remission / scholarship scheme, the school should forward to the EDB a plan on how this specific reserve could be effectively deployed. Acceptable options or usages of these excessive reserve include but not limit to: (i) extending the scholarships/fee assistance schemes by relaxing the awarding criteria; (ii) reducing the school fees; (iii) subsidizing eligible students in their purchase of textbooks / reference books / stationery; and (iv) funding students' extra-curricular activities, including the expenses for their joining overseas educational visits and exchange study programmes, etc.

Above-standard Educational Services and Facilities

16. DSS schools may use non-government funds to provide additional and high quality support services for students, such as employing more teachers to improve the teacher to student ratio, organizing more student enrichment programmes, designing more diversified curricula to develop the multiple intelligence of students and to cater for their needs, etc.

17. DSS schools may also use non-government funds to finance above-standard facilities[1] for the purpose of enhancing the quality of education, having regard to the benefits for the students, impact on the school's financial situation and key stakeholders' concerns. No virement of surplus of government funds, if any, should be arranged to finance any above-standard projects/facilities/services.

[1] Taking reference to the standard provisions of the aided schools, any facilities which are normally not provided in an aided school are treated as above-standard facilities, e.g. swimming pool, school bus, etc.

18. As no additional recurrent or non-recurrent government funds will be provided for the above-standard services and facilities, DSS schools should have a comprehensive budgeting on all running costs including maintenance and repair costs incurred by the facilities in the long run and should charge such recurrent costs to non-government funds. Undue pressure on the schools' finance caused by the provision of above-standard services and facilities, which may induce an increase in the school fees, should be avoided.

Investment

19. To protect the interest of schools, all incomes derived by schools should be kept in a manner that involves the minimum risk regardless of whether such income is derived from the government or any other sources. Surplus funds which are not immediately required for use by schools may be put in time deposits or savings account with banks licensed under the Banking Ordinance. Any other form of speculative investment (e.g. local equities) is not recommended because of the risk of financial loss. Any such financial loss will not be allowed to be charged to any of the school's accounts. This is because the income of a school must be kept intact and utilised fully for educational purposes and school facilities. Accordingly, the liability for any financial loss arising from other cause shall strictly fall on the school management responsible for incurring such a loss and shall not be allowed to be recovered as a charge against the income of the school. DSS schools should refer to EDBC No. 2/2003 on *The Choice of Bank Counterparties in the Investment of Public Asset* for details.

20. It is noteworthy that DSS schools are dissuaded from making speculative investment because of the risk of financial loss. Those intending to invest by using non-government funds must have compelling and well-justified reasons which are solely for meeting educational and school needs. Moreover, they must consult the schools' key stakeholders and seek prior approval of their SSB as well as their SMC/IMC. A school-based mechanism should be devised and followed. For instance, should DSS schools have compelling justifications for purchasing properties for educational and school needs (e.g. for accommodating expatriate teachers or providing accommodation for school staff in lieu of housing allowances, etc.), they are required to devise a school-based mechanism by adopting the guidelines in **Appendix 1** for regulating the practice. If the purchase of properties involves borrowing or mortgage loan, the schools should justify the stream of income available for loan repayments. The basic principles and implementation mechanisms of the said guidelines are also applicable to other well-justified investment activities.

21. To ensure that the school fees of DSS schools would not be unduly affected by the schools' investment activities, the EDB would strengthen the vetting procedures for approving their school fee increase applications. For instance, expenditures on or relating to the purchase of properties including monthly repayments of mortgage loans and those arising from the depreciation or

interest loss, if any, of the properties purchased as well as repair and maintenance expenses would be excluded when the EDB considers schools' applications for fee increase. In no circumstances should the purchase or sale of properties lead to an increase of school fees.

Reduction of School Fees

22. When DSS schools have accumulated an excessive surplus, provided that there would be no adverse impact on the schools' finance, they should consider the feasibility of reducing their schools fees so that parents and students can benefit directly and immediately. Reduction of school fees should be accorded higher priority than any other considerations, e.g. provision of unnecessary above-standard facilities.

Accumulated Surplus / Reserve

23. Since school funds should be used primarily to provide quality education services to incumbent students, DSS schools are advised not to accumulate excessive surplus of both government and non-government funds, or to maintain large amount in other reserves without good reasons. Surplus[2], taking both government fund and non-government fund accounts together, should be used to enhance educational services and/or to alleviate the pressure for school fee increase. If a DSS school is found to have maintained excessive surplus or large reserve, i.e. with accumulated surplus of government and non-government funds exceeding the annual total expenditure or with accumulated surplus of government funds equal to 30% or more of the total annual expenditure, the EDB will request the school to submit a development plan in three months for the former or a written explanation in two months for the latter setting out how the operating surplus would be used for school development.

24. The development plan for using non-government funds and other reserves should be endorsed by the SMC/IMC and accepted by the EDB. It should set out the use of the accumulated surplus of non-government funds for school development, either immediate or long-term. DSS schools would be given the maximum discretion and flexibility in deploying their operating surplus for school development as long as this fund is spent on educational purposes. Some examples are: (i) enhancing operational efficiency and school management; (ii) improving teaching and learning, pastoral care, and enriching the curriculum of the school; (iii) upgrading school facilities and environment; (iv) developing enhanced programmes of student extra-curricular activities, organizing education related overseas visits and student exchange programmes, etc.

[2] The "surplus" in schools should refer to the amount after offsetting the operating deficit in the government fund account, instead of the entire amount of gross surplus in the non-government fund account. In other words, the accounting arrangement should reflect the policy intention that any deficit in the government fund account should be offset by the surplus in the non-government fund account in each financial year, such that there should not be any cumulative deficit in the government fund account.

Making Donations to Other Parties

25. DSS schools should always put students' interest on top priority in the use of their resources. They should also ensure that all the expenditures from non-government funds are necessary for educational or school purposes. To this end, DSS schools are reminded not to make donations out of non-government funds to other parties. If there are strong justifications relating to the educational needs of their own students, such intended donation should be deliberated and approved by the SMC/IMC with proper documentation and disclosure of information to the stakeholders including parents.

Internal Control and Reporting Mechanism

26. To enhance internal control of schools, DSS schools are encouraged to establish an independent committee with auditing roles to assist the SMC/IMC in monitoring the effectiveness of the internal check and balance mechanisms for major administration policies and financial controls, e.g. staff remuneration, the use of non-government funds for investment, etc. For effective operation of the committee, the terms of reference and responsibilities of the committee should be clearly defined and endorsed by the SMC/IMC. The committee should meet as frequently as necessary to carry out its responsibilities, and submit reports to the SMC/IMC on a regular basis.

27. DSS schools should keep a Fixed Assets Register to record the existing items of fixed assets under schools' control, showing separately where the fixed assets are purchased through government or non-government funds. The register should clearly state description of items, date of purchase, quantity, location, date and reasons of write-off, the approval signature of write off, etc. Proper arrangements for the safe custody of school assets, cash and other valuables under schools' control are also required. DSS schools should conduct physical stocktake at least once a year and investigate any discrepancies found, and report the results of the stocktake to the SMC/IMC.

Accounting Arrangements

28. DSS schools are required to keep proper accounts in respect of all their income and expenditure. Separate bank accounts for government and non-government funds should be maintained in the name of the school. Only approved expenditure under the ambits of government funds should be paid from the government fund accounts. The non-government fund accounts should be used for meeting educational and school needs. Accounts in respect of transactions (income and expenditure) relating to government funds, e.g. interests derived from government funds, and transactions (income and expenditure) relating to non-government funds, e.g. proceeds arising from trading operations, should be recorded and kept separately.

29. To safeguard the proper use of public funds, proper accounting arrangements should be taken to avoid cross-subsidisation of any self-financing activities without government subventions. For any DSS schools that are approved to operate private classes on individual merits, they should keep separate accounts for their private classes and ensure that there is no cross-subsidisation of the private classes by the DSS classes in money or in kind.

30. With a view to further enhancing the transparency of the financial information related to investment, schools are required to keep additional subsidiary ledgers to record detailed transactions of each type of investment activities including purchase of properties, such as date of purchase, cost of acquisition, annual mortgage loan repayment, annual mortgage interest payment, annual depreciation, revaluation, disposal, income and expenses other than the accounts as set out in paragraph 28 above. In view of the huge amount of money involved in purchasing property, individual subsidiary ledger is required for each purchase. For the template of audited accounts, DSS schools should refer to the latest version attached to the relevant circular memorandum on submission of annual audited accounts issued in December every year.

31. While DSS schools enjoy great flexibility in charging their expenditure to either government or non-government funds subject to the nature and requirements of different subsidies/grants, the year-end balances of government funds should be either a surplus or zero. Any spending in excess of the government funds should be covered by the non-government funds. For proper accounting arrangements, DSS schools should refer to the relevant circular memorandum on submission of annual audited accounts issued in December every year. For reference of the SMC/IMC as well as independent committee(s) with auditing roles under the SMC/IMC, a list highlighting the tips on proper handling and use of non-government funds is prepared in **Appendix 2**. Schools, however, should note that the list is by no means exhaustive. It will be uploaded onto the EDB website and updated as and when appropriate.

ENQUIRY

32. For enquiries, please contact the respective Senior School Development Officers.

Miss P L WU
for Permanent Secretary for Education

Appendix 1

Guidelines for Devising a School-based Mechanism on Investment by Using Non-government Funds

According to EDBC No. 2/2003 on *The Choice of Bank Counterparties in the Investment of Public Asset*, any form of speculative investment is not recommended because of the risk of financial loss. Therefore, DSS schools are dissuaded from making any speculative investment. All incomes derived by DSS schools should be kept in a manner that involves the minimum risk regardless of whether such income is derived from the government or any other sources.

Notwithstanding that, DSS schools may find themselves fully justified to make certain investment by using non-government funds. In this connection, DSS schools are hereby reminded that there must be compelling and well-justified reasons for their intended investment(s) and they are required to ensure that such investment is for meeting educational and school needs. To minimize financial risks and to forestall possible malpractices, DSS schools should put in place a proper and sound school-based mechanism to regulate and monitor their investment activities. With a view to facilitating DSS schools in devising a proper school-based mechanism, a set of guidelines on purchasing properties is compiled below as an illustration for schools' reference and necessary action. In other words, the basic principles and implementation mechanisms of this set of guidelines are also applicable to other well-justified investment activities.

Guidelines on Purchase of Properties

Purchase of properties by using non-government funds in general is disapproved as it carries substantial financial implications and the risk of financial loss. Charging any loss to the school's accounts is not allowed. This is because the income of a school must be kept intact and utilised fully for educational purposes and school facilities. Accordingly, the liability for any financial loss arising from any other cause shall strictly fall on the school management responsible for incurring such a loss and shall not be allowed to be recovered as a charge against the income of the school. Should a DSS school have compelling and well-justified reasons for purchasing properties and demonstrate suffice financial viability, the School Management Committee (SMC) [3]/Incorporated Management Committee (IMC) should devise a school-based mechanism for regulating the practice by following the principles and procedures set out below:

[3] As DSS schools managed by management committee formed by school managers registered under the Education Ordinance, Cap. 279 do not have a separate legal personality to own property, they should not purchase properties. These guidelines are only applicable to DSS schools managed by IMC established under the Education Ordinance, Cap. 279 and SMC incorporated under the Companies Ordinance, Cap. 32.

A. Basic Principles

1. Prudence
   DSS schools should only purchase properties for compelling and well-justified reasons (e.g. for accommodating expatriate teachers or providing accommodation for school staff in lieu of housing allowances, etc.) and with the prior approval of their SSB as well as their SMC/IMC. Purchase of properties for speculative purpose is disapproved. If purchase of properties involves borrowing or mortgage loan, the school should justify the stream of income which is available for loan repayments. The SMC/IMC should fully assess and deliberate on the impact of the purchase of properties on school's development and finance in a prudent manner with proper documentation.

2. Genuine Necessity
   The SMC/IMC should ensure that the purchase of properties is for meeting genuine educational and school needs in the best interest of the students.

3. Involvement of Key Stakeholders
   To enhance school's accountability and transparency, the SMC/IMC should put in place a proper consultative and reporting mechanism to engage key stakeholders, including parents and alumni where appropriate, in making the decision to purchase or sell properties. Details of the properties, financial situations of the school before and after the purchase/sale of properties, and the risk that the value of the properties may be worth substantially less than the original amount the school has invested should be made known to all stakeholders.

4. Value for Money
   The SMC/IMC should ensure that properties are purchased in a cost-effective and value-for-money manner to the benefit of the students.

5. Sustainability of School Development
   a. The SMC/IMC should ensure that the financial situation of the school will remain sound and healthy after the purchase of properties, e.g. with accumulated surplus to cover six months' operating expenses (including those on the properties concerned) and no deficit in all funds. Before the purchase, the school should critically assess and evaluate its short to long term financial position and prepare cashflow forecast for stakeholders' consideration.

   b. In no circumstances should the purchase or sale of properties lead to an increase of school fees.

6. Transparency
   DSS schools should make transparent the decisions to purchase or sell properties and details of the properties purchased for the information of key stakeholders regularly as far as possible. There must be proper declaration of

interest among the SMC/IMC members throughout all processes.

B. Procedures

1. Formulation of Policy

    a. The SMC/IMC should formulate a school-based policy on purchase of properties in accordance with the school vision and mission and the general educational policies and principles set by the SSB. The policy should set out the principles, considerations including risk assessment and procedures to be observed in the purchase of properties, and the management and sale of properties thereafter.

    b. The policy should also include a contingency plan (e.g. selling the properties) for dealing with situations such as stringent financial situations, low utilization rate of the properties or other situations which warrant selling of the properties.

    c. The policy has to be approved by the SSB as well as the SMC/IMC with proper deliberation and documentation.

2. Implementation of Policy

    Purchase or Sale of Properties

    a. The SMC/IMC should deliberate on the purchase or sale of properties in accordance with the principles, considerations and procedures as set out in the school-based policy. The purchase or sale of the properties has to be approved by the SSB and the SMC/IMC with proper documentation.

    b. Before endorsement, the SMC/IMC should formally consult stakeholders, parents in particular, about the purchase or sale of the properties and address their concerns. Details of the properties including usage of the properties, source of funding, cost of acquisition/selling price and financial situations of the school before and after the purchase/sale of properties should be made known to all the stakeholders. The SMC/IMC should ensure that the purchase or sale of the properties is justified and publicly defensible.

    c. Members of the SMC/IMC and the school should be required to report any situations where they or their immediate family or personal friends have an interest, financial or otherwise, in the purchase of the properties. The SMC/IMC should properly record any declarations (with the use of a standard form) or disclosures made and necessary action taken to avoid any actual or perceived conflict of interest. The SMC/IMC should ensure that the purchase/sale is at arm’s length transaction.

d. The legal and beneficial ownership of any property purchased using non-government funds must vest in the SMC/IMC of the school. Under no circumstances should the property be legally or beneficially held by or in the name of a natural person or persons.

e. When there is suspicion of corruption or other criminal offence, the SMC/IMC should refer the case to relevant law enforcement agencies for further investigation.

Management of Properties

f. The SMC/IMC should ensure that the contingency plan as set out in the school-based policy is implemented at all times and monitor its proper implementation.

g. The SMC/IMC should conduct continuous assessment on the cost-effectiveness of the properties purchased, for instance, whether the utilization rate of the properties is well justified.

h. There should be no cross-subsidization from government subsidy on the properties purchased. Charging recurrent expenditure of the properties, including government rent and rates, utility charges, revaluation charge, depreciation charge, loan interest, etc. and mortgage loan repayments as well as its non-recurrent expenditure to government funds is not allowed.

C. Accounting Arrangement

1. Schools are required to keep additional subsidiary ledgers to record detailed transactions of each purchase of property. The information includes date of purchase, cost of acquisition, annual mortgage loan repayment, annual mortgage interest payment, annual depreciation, revaluation, disposal, income and expenses, etc. Any "deficit" for a year (i.e. annual income less expenditure) in operating the property should not be borne by the school. The gain or loss on revaluation of the property, if any, should be reflected in the school's non-government fund account[4].

2. In addition to the disclosure requirements as required by the relevant Hong Kong Accounting Standards, the details of each property purchased including date of purchase/sale, usage of the property, source of funding used (exact items under non-government funds), cost of acquisition and subsequent changes in carrying amount (i.e. revaluation and depreciation) should also be disclosed in the audited accounts.

[4] The revaluation gain/loss is an unrealised gain/loss as the gain/loss will only be realized after sale of the property. Hence, the unrealized revaluation gain/loss would not be considered in the assessment of the school's financial performance during the fee revision exercise.

3. The gains derived from the sale of properties should be reflected in the school’s non-government fund account.

4. The loss arising from the sale of properties should not be charged to any of the school’s accounts and should not be borne by the school.

Notes:

1. *In handling donation designated by the donor for purchase of properties, the above guidelines should still be followed in principle.*
2. *The SMC/IMC shall immediately upon closure of schools transfer to the Government at the SMC/IMC’s own cost and expense all properties purchased with non-government funds or other funds generated by the schools, unless otherwise approved by the Education Bureau.*

<u>Appendix 2</u>

Tips on Handling and Use of Non-government Funds in DSS Schools

For facilitating DSS schools' proper use of non-government funds, a list of common concerns, highlighting the tips on proper handling and use of non-government funds, is compiled for schools' reference. DSS schools should note that the list is by no means exhaustive. It will be uploaded onto the EDB website and updated as and when appropriate.

<table>
<tr><th></th><th>Hypothetical Cases</th><th>Tips</th></tr>
<tr><td>1</td><td><u>Fees and Collection</u>
A school collected fees other than the inclusive fees without prior approval from the EDB, including air-conditioning fees and administrative charges for issuing student cards and parent cards.</td><td>Unless with the EDB's prior approval, DSS schools shall not charge or accept fees other than the inclusive fees. Also, for any adjustment of approved fees, prior approval from the EDB must be sought. DSS schools should comply with regulation 61 of the Education Regulations, Cap 279A in this regard.</td></tr>
<tr><td>2</td><td><u>Trading Operations</u>
A school operated and permitted to operate on school premises business or trading undertaking without the prior approval from the EDB, including provision of school bus and lunch box services, supply of school uniforms, textbooks, exercise books and school ties at the school bookstore and operation of school tuckshop. The profit margin of some items had exceeded the allowed profit ceiling.</td><td>According to EDBC No. 24/2008 on Trading Operations in Schools, unless with the EDB's prior approval, DSS schools without incorporated management committees (IMC) shall not -
(a) operate or permit to operate on school premises any business or trading undertaking; or
(b) enter into any business or trading arrangement, directly or indirectly, with any person for the supply of food, drinks, books, stationery, uniforms or any other thing that is required by such school to be possessed or used by students of the school.

For IMC schools, trading operations should be approved by the IMC and the tendering procedures for acquisition of services as stipulated in the EDBC No.15/2007 on Tendering and Purchasing Procedures in Aided Schools should be followed.

DSS schools should follow the principles</td></tr>
</table>

	Hypothetical Cases	Tips
		as set out in EDBC No. 24/2008 on *Trading Operations in Schools* in conducting trading activities.
3	<u>*Hire of Accommodation*</u> A school sub-let the school premises to another school sponsoring body for operating evening courses. The rental income received was not recorded in the school's bank and books of accounts and electricity charges relevant to the hiring of accommodation were charged to the government fund account.	DSS schools should formulate their school-based policy on hire of accommodation with reference to EDBC No. 9/2005 on *Hire of Accommodation in Aided Schools*. DSS schools should ensure that the hire of accommodation does not affect school operation and undermine its educational services for students. The hire charges levied from accommodation and relevant overhead expenses should be reflected in the non-government fund accounts.
4	<u>*Fund-raising Activities*</u> A school did not prepare and display financial statement for each and every fund-raising activity. The income and expenditure of each fund-raising activity were not properly recorded.	DSS schools should ensure that fund-raising activities held are lawful and in compliance with the requirements stipulated by the EDB or other Government departments. Donations and participation of students in all fund-raising activities must be on an entirely free and voluntary basis. The financial statement recording the income and expenditure of each fund-raising activity should be displayed for a reasonable period of time for the information of teachers, parents and students and then be retained for audit purposes. DSS schools should refer to the guidelines on conducting fund-raising activities uploaded onto the EDB's Homepage in organizing fund-raising activities.
5	<u>*Donations*</u> A school received donations from its suppliers. The school had not set out any criteria on the acceptance of advantages and donations to regulate the practice.	Receiving donations from suppliers may give rise to actual or perceived conflict of interest, and may be subject to criticism from the public. It may also unduly affect the price of the goods/services provided by suppliers. DSS schools should establish a mechanism to handle donations with reference to the guidelines issued by the

	Hypothetical Cases	Tips
		EDB, including the principles of accepting donations and the mechanism for disbursement of the funds. The principles of acceptance of donations as promulgated in EDBC No. 14/2003 on *Acceptance of Advantages and Donations by Schools and their Staff* should be complied with. The acceptance of donations by schools should be approved by the SMC/IMC.
6	<u>*Investment*</u> A school invested part of its non-government funds in high risk investments without thorough risk assessment and prior approval from the SMC/IMC.	Under SBM, the SMC/IMC is accountable for the use of the school funds and should ensure that the investment is justifiable and publicly defensible. Surplus funds which are not immediately required for use by the school may be placed in time deposits or savings accounts with banks licensed under the Banking Ordinance (Cap.155). Any other forms of speculative investment (e.g. local equities) are not recommended because of the risk of financial loss and charging any loss to the school's accounts is not allowed. DSS schools should refer to EDBC No. 2/2003 on *The Choice of Bank Counterparties in the Investment of Public Assets* in this regard. Schools should follow the guidelines as set out in Appendix 1 of EDBC No. 12/2010 on *Use of Non-government Funds in DSS Schools* for considering investments for educational and school needs.
7	<u>*Staff Remuneration*</u> A school provided exceptionally high salary and generous medical insurance to some of its staff.	Under SBM, DSS schools are held accountable to their stakeholders and the community for the use of public funds. They should establish a proper and transparent mechanism to determine the staff's remuneration packages and ensure that the mechanism is implemented properly with sufficient checks and balances. They should also ensure that the remuneration packages are fair and justifiable. The criteria such as qualifications, experience, performance and

	Hypothetical Cases	Tips
		expertise, and the approval authority for determining the remuneration package of an appointee and any subsequent salary adjustment should be clearly set out. DSS schools should refer to EDBC No. 4/2010 on *Use of Government Funds in Direct Subsidy Scheme (DSS) Schools* in this regard. As staff remuneration constitutes a major part of school's expenses, comparison with the remuneration of civil servants at comparable ranks should be made when determining the appropriateness of remuneration packages for senior positions. It is advisable to observe the "modest and conservative" principle at all times.
8	*Expenses on Meals and Presents for Staff* A school charged the expenses of the school's anniversary dinner for all of its staff as well as the expenses for the presents given to some of the staff on the same occasion to its non-government fund account.	Expenditure on items such as meal and presents and other fringe benefits for staff is sensitive in the eyes of the public. DSS schools are advised to adopt a conservative and modest approach to such matters. DSS schools need to ensure that such expenses fall within the scope of expenses of non-government funds as set by the SMC/IMC. Moreover, the SMC/IMC should approve such expenses according to the needs and policy priorities of the schools. The SMC/IMC should also consider setting limit of such expenses per occasion and/or per head. The tips as mentioned in point 7 are also applicable.
9	*Loan* A school provided a loan to the operator/supplier providing services or supplying commodities to students using non-government funds.	Non-government funds should be used for educational purposes benefited directly by students. DSS schools should not provide a loan to any third parties using non-government funds in any circumstances.

Annex D

Response to the letter of 1 December 2010 from Public Accounts Committee regarding paragraph 1(d)

- The Secretary for Education and Manpower who was involved in dealing with the matter of allowing School I to remain in the DSS in 1999 was Mr. WONG Wing-ping (Part 7 of Chapter 1 refers).