

Report of the Working Group on Direct Subsidy Scheme

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Chapter One

Introduction

The Audit Commission (AC) conducted a value for money audit on the Direct Subsidy Scheme (DSS) covering the administration of the scheme and the governance and administration of DSS schools in 2010. Audit's findings were contained in Chapters 1 and 2 of Report No. 55 of the Director of Audit (Audit Report) published in October 2010.

1.2 The Public Accounts Committee (PAC) of the Legislative Council held four public hearings on 29 November and 2, 13 and 20 December 2010 to receive evidence on the findings and observations in the above-mentioned two chapters of the Audit Report. In February 2011, the PAC released the PAC Report No. 55 (PAC Report) setting out, among other things, its conclusions and recommendations on the DSS.

1.3 To follow up the recommendations made by the AC and PAC, the Education Bureau (EDB) set up a Working Group on Direct Subsidy Scheme (Working Group) chaired by the Permanent Secretary for Education in February 2011. Its terms of reference are to review the administration of the DSS as well as the governance and administration systems of DSS schools, and to put forward recommendations on measures for continuous improvement. The membership of the Working Group is set out at Annex 1.

1.4 Before embarking on its discussion on improvement measures, the Working Group was fully briefed on the policy objectives of the Scheme, as well as the characteristics and special features of DSS schools. It also visited a number of DSS schools in March and April 2011 with a view to better understanding the operations of DSS schools, which would facilitate the Working Group in making practical and feasible recommendations to suitably address the problems identified by the AC and the PAC.

1.5 To ensure that the original policy objectives of enhancing parental choice and enriching our education system through increasing the diversity in our school system will continue to be achieved, the Working Group has adopted the following guiding principles in the course of its deliberation:

- (a) The EDB should maintain a proper balance between regulatory oversight of and flexibility for DSS schools;
- (b) The EDB's monitoring and oversight should be

complemented by DSS schools' own governance and internal accountability;

- (c) The EDB should refrain from micro-managing DSS schools; and
- (d) DSS schools should be supported with proper training that facilitates their implementation of the improvement measures.

1.6 The Working Group is keenly aware that sound governance and management of DSS schools involve a diverse range of stakeholders. To help ensure that the recommendations take account of the perspectives of different key stakeholder groups within a DSS school, the Working Group has, since July 2011, conducted a series of consultation sessions to gauge the views of the DSS schools sector on the proposed improvement measures. The parties consulted include the Hong Kong DSS Schools Council, School Management Committee (SMC)/Incorporated Management Committee (IMC) members, some school sponsors, parents, principals as well as senior administrative staff of DSS schools. The Working Group then deliberated and refined the improvement measures as appropriate with due regard to the views thus gauged. In the run-up to the finalization of the Working Group's recommendations, the Working Group invited DSS school principals, the Hong Kong DSS Schools Council as well as SMC/IMC members to meetings and sharing sessions in late November to mid-December to seek their further views on three major areas of the proposed improvement measures, namely the school fee remission criteria; the school fee income set aside for construction, maintenance and upgrading of above-standard facilities; and the setting up of a functional mechanism under the SMC/IMC for governance review. A summary of the consultations and sharing sessions that the EDB and the Working Group have held is set out at Annex 2.

1.7 Making recommendations which meet the full expectations of all stakeholders is nearly impossible as the perspectives of different stakeholders may not fully coincide. Nevertheless, having held iterative sharing sessions with different key stakeholder groups, the Working Group is satisfied that the recommendations have been as sensitive and empathetic to the concerns and interests of different stakeholder groups as possible while adhering to the principles identified in paragraph 1.5 above. We look forward to the endorsement of the recommendations by the Secretary for Education and trust that, with the implementation of the recommendations, the DSS sector, after an initial period adapting to the guidelines on enhanced internal transparency and governance, would

benefit from a much improved administration and management.

Chapter Two

Operation of Schools under the Direct Subsidy Scheme

Pursuant to recommendations of the *Education Commission Report No. 3* published in June 1988, the DSS was introduced in 1991. The DSS aims to inject more variety into our school system and to give parents more choices¹. In the 2011/12 school year, there are 74 DSS schools, comprising 11 primary, 53 secondary and 10 primary cum secondary schools. Together, they account for about 9% of publicly funded schools and school places provided by them account for about 10% of publicly funded school places.

2.2 DSS Schools are paid a recurrent government subsidy in form of a block grant which schools can flexibly deploy according to their own needs. The amount of the subsidy is based on the average unit cost of an aided school place at comparable levels. Apart from receiving a recurrent subsidy from the Government, DSS schools may also collect school fees as a source of income to provide additional and quality support services for students so as to allow them to develop their characteristics according to their own vision and mission. Starting from the 2001/02 school year, a DSS school will continue to receive full subsidy from the Government until its school fee level reaches $2\frac{1}{3}$ of the average unit cost of an aided school place. Beyond this level, the Government will not provide any recurrent subsidy.

Flexibility of DSS Schools

2.3 To meet the policy objective of promoting diversity, DSS schools are allowed to have greater flexibility in various areas including resources deployment, curriculum design within the broad framework of the local curriculum and student admission so that they can cater for the diverse needs of their student intakes in a more responsive manner.

2.4 ***On resources deployment***, compared with their aided counterparts, DSS schools have been given much greater flexibility in deploying their

¹ *Education Commission Report No. 3* states that “The concept of the DSS is of a scheme under which the Government can subsidize and encourage the growth of a strong private school sector, while allowing schools the maximum freedom with regard to curricula, fees and entrance requirements that is consistent with basic educational standards.”

resources. Contrary to aided schools which must follow the standardized teachers' pay scale and establishment structure (and with teachers' pay credited by the Government to teachers' bank accounts via their serving schools), DSS schools may employ more teachers to improve the teacher-to-student ratio, determine the number and rank of teaching and non-teaching staff to be employed, devise school-based staff remuneration packages as well as the subsequent salary adjustment mechanism (covering elements such as qualifications, experience, performance and expertise, and approving authority for determining the remuneration package of an appointee and any subsequent salary adjustment). Instead of crediting remuneration into teachers' bank accounts, the Government includes such salaries in the block grant to a DSS school. The government and non-government funds at DSS schools' disposal are much greater than those at the disposal of their aided counterparts. Take a 29-class secondary school as an example, the amount of government and non-government funds that can be flexibly deployed by a DSS secondary school of this school size annually is about \$60 million while the amount of annual operating funds that can be deployed flexibly by an aided secondary school of the same size is just about \$8 million.

2.5 **On curriculum design,** DSS schools can provide diversified curriculum to cater for different needs of students and cope with the fast-changing demand of society. At present, DSS schools are required to offer principally a curriculum targeted at local students and prepare their students to sit for the relevant local public examinations. Within this broad parameter, DSS schools are given maximum freedom on the design and content of its curriculum. With EDB's prior approval, DSS secondary schools may offer a non-local curriculum stream at S5 and S6 levels as an additional curriculum choice for some students. In addition, DSS schools may also choose, according to the abilities of their students, what they consider to be the most suitable medium of instruction for different subjects in their curriculum for the benefits of their students.

2.6 **On student admission,** autonomy and flexibility in student admission is one of the most distinguished features of DSS schools. DSS schools are required to establish reasonable and professionally sound admission criteria that are consistent with their own tradition and educational objectives. DSS schools should, however, ensure that parents are well aware of these admission criteria. DSS primary schools do not participate in the Primary One Admission System. Instead, they recruit Primary One students according to their own admission criteria. As from 2006, secondary schools newly admitted to DSS are no longer allowed to participate in the Secondary School Places Allocation (SSPA) System. At

present, about two thirds of DSS secondary schools do not participate in the SSPA. Even for those participating in the SSPA, they enjoy greater flexibility compared with other participating schools. They can determine the number of S1 places for discretionary places and central allocation. Students will not be allocated to them unless the students have included them in their school choices in central allocation.

School governance of DSS Schools

2.7 Currently, there are three types of school governing bodies for DSS schools, namely IMC, SMC and Management Committee (MC).

2.8 It is at DSS schools' discretion to establish an IMC. At present, there are 18 DSS with IMC established. An IMC shall consist of all specified key stakeholders, viz. representatives of the school sponsoring body (SSB), the principal, elected representatives of teachers, parents and alumni as well as independent member(s) as required by the Education Ordinance.

2.9 DSS schools with an SMC can broadly be categorized into two groups. First, schools with an SMC established under the Companies Ordinance (Cap. 32) and which have signed the SMC Service Agreement with the Government. An SMC in this category comprises the principal, representatives from the SSB, parents, teachers, other community members/professionals and, where appropriate, alumni. Currently there are 35 DSS schools with this kind of school governing body. Second, DSS schools with their SSBs approved to play a dual role of both SSB and SMC. They have their own ordinances with provisions on, among other things, the composition of their governing bodies which does not necessarily include representatives of parents and teachers. Currently there are 6 DSS schools of this kind.

2.10 For MC formed by school managers registered under the Education Ordinance, its composition is not specified. Currently there are 15 DSS schools each with a MC. These 15 schools joined the DSS before the 2000/01 school year, i.e. prior to the introduction of the concept of a time-limited service agreement signed with the EDB, and are therefore not required to set up either an IMC or an incorporated SMC. There is no requirement for these 15 schools to include representatives of schools' stakeholders in their MC. To meet the public expectation of increased accountability, these DSS schools have been encouraged to include representatives of key stakeholders in their school governing bodies and

increase as far as possible the transparency of their operation.

Monitoring of DSS Schools

2.11 Notwithstanding the greater autonomy given to DSS schools, regulatory oversight is still necessary. The community and the parents would regard the EDB as the ultimate custodian of their interests in ensuring that DSS schools abide by the terms of operation as defined by the relevant laws, regulations and policies, the funding mandate approved by the Finance Committee of the Legislative Council and the service agreements concluded between the schools and the EDB. To monitor DSS schools, the EDB has been relying primarily on DSS schools' internal control effected through a participatory governance framework involving key stakeholders of schools as well as the School Development and Accountability (SDA) framework introduced by the EDB under which schools are required to prepare and make public their school development plans, annual school plans and school reports to enhance their accountability and transparency for continuous improvement.

2.12 To complement the internal control of DSS schools, the EDB has instituted a monitoring mechanism. It comprises both compliance vetting and quality assurance. The major means of compliance vetting are scrutinizing schools' audited accounts annually and conducting audit inspection once every few years. With public funds constituting a key source of income, DSS schools are also subject to the value for money audit conducted by the AC. In respect of quality assurance regarding learning and teaching, DSS schools can access all the instruments applicable to aided schools including Basic Competency Assessments, Key Performance Measures, Stakeholder Survey, Assessment Program for Affective and Social Outcomes (APASO), Schools Value-added Information System, E-platform for SDA, etc. The objective is to provide schools with data which facilitates an assessment of whether the quality of education provided has met the required standard and the areas in need of focused attention. Intervention by the EDB will be taken if so warranted. Similar to aided schools, DSS schools are also subject to quality assessment conducted by the EDB such as the Comprehensive Review (CR), External School Review (ESR) and Focus Inspection.

2.13 On top of the above monitoring mechanism, DSS schools have to comply with the terms and conditions as stipulated in the SSB Service Agreement and the SMC/IMC Service Agreement signed with the Government. The EDB will renew the SMC/IMC Service Agreement for

a five-year term if the school's performance is considered satisfactory. DSS schools are also required to adhere to the statutory requirements as stipulated in the Education Ordinance, Education Regulations, other related legislations and such other requirements applicable to DSS schools.

2.14 As on-going practices relating to DSS monitoring, in case complaints are received or malpractices identified, investigation will be carried out. Under normal circumstances, if the malpractices are substantiated, the EDB would issue advisory or warning letters to the responsible persons demanding rectification within a specified time. In addition to the issuance of advisory and warning letters, the EDB may appoint school managers to the SMC.

2.15 If the concerned malpractices continue even after warning has been given repeatedly and if further intervention at a senior level has been administered with no avail, the EDB may withdraw the subsidy payable to the school thus resulting in the school's loss of DSS status. That said, experience so far is that even for the most intransigent non-compliance cases, the EDB has never withdrawn the subsidy payable to a DSS school or cancel the registration even though it is legally empowered to do so. The EDB has been reluctant to take such a drastic action having regard to the negative impact on students' interests that would arise from withdrawal of subsidy and DSS status.

Considerations of the Working Group

2.16 The Working Group is well aware of the uniqueness and characteristics of DSS schools. While by policy design, they are given enhanced operational flexibility, they nonetheless receive recurrent government subsidy and collect school fees from parents. Therefore, it is imperative that there should be greater transparency and accountability to their stakeholders and the community for their performance and proper use of funds. The community and stakeholders (especially the parents) would expect the EDB, as the overseer of school education, would ensure that there are, at the school level, mechanisms for sufficient transparency and accountability. In discharging its Terms of Reference, the Working Group is keenly aware of the need to strike a sensible balance between monitoring and flexibility for DSS schools; hence explains the guiding principles in paragraph 1.5.

2.17 Set out in Chapters 3 to 8 are the Working Group's recommendations for the consideration of the Secretary for Education. A

summary of the recommendations is at Annex 3. To prepare DSS schools to progressively implement the enhanced measures, the Working Group has also recommended that relevant training should be provided for DSS schools. The Working Group is also of the view that the EDB should be flexible yet prudent in drawing up the implementation time table. It should neither be unduly protracted as to frustrate enhancement to internal school governance nor be overly ambitious as to ignore practicality issues and diverse readiness of DSS schools.

Chapter Three

Improvement Measures for the Fee Remission/Scholarship Schemes

Background

In order that pupils will not be deprived of the opportunity to attend DSS schools solely because of their inability to pay fees, DSS schools are required to provide a fee remission scheme with eligibility criteria no less favourable than the Government's student financial assistance schemes. In assessing the students' eligibility for fee remission, no factors except the financial situation of the students' family should be taken into consideration. Nevertheless, noting that the socio-economic background of students would not be within the control of DSS schools, government policy also allows some flexibility in that the income set aside may also be used for grant of scholarship, in addition to providing fee remission. For transparency and to facilitate application, DSS schools are required to set out the details of their fee remission/scholarship schemes in the schools' prospectuses and upload them onto the schools' websites.

3.2 The EDB requires DSS schools to set aside *at least* 10% of their total school fee income to provide fee remission/scholarship for eligible/deserving students. If a DSS school charges a fee between $\frac{2}{3}$ and $2\frac{1}{3}$ of the average unit cost of an aided school place, for every additional dollar charged over and above $\frac{2}{3}$ of the average unit cost of an aided school place, the school is required to set aside 50 cents for fee remission/scholarship scheme. When the reserve for fee remission/scholarship scheme of a DSS school has reached a cumulative amount which exceeds the school's half-year total fee income due to low utilization of the fee remission/scholarship scheme, the school should forward to the EDB a plan on how this specific reserve will be effectively deployed. Acceptable options for usages of the excessive reserve include:

- (a) relaxing the criteria for awarding fee remission/scholarship;
- (b) reducing the school fees;
- (c) subsidizing eligible students in their purchase of textbooks/reference books/stationery; and
- (d) sponsoring eligible students for joining extra-curricular activities, such as overseas educational visits and exchange study programmes, etc.

3.3 The AC and the PAC have recommended that the EDB should look into the causes of the low utilization of fee remission/scholarship schemes in some DSS schools, enhance public awareness of the schemes so that parents can take them into account when considering whether to apply for their children's admission to DSS schools, and step up the monitoring of DSS schools' compliance with its requirements on fee remission/scholarship schemes. Details of the AC's and the PAC's recommendations are at [Annex 4](#) and [Annex 5](#) respectively.

Deliberations and Recommendations of the Working Group

Enhancing transparency and access of information

3.4 In the course of deliberating the improvement measures for fee remission/scholarship schemes in DSS schools, the Working Group considers that transparency is the prerequisite to ensuring a fair chance of admission to DSS schools for students from different strata. Enhancing the accessibility of information of fee remission/scholarship schemes in individual DSS schools can help parents understand the schemes and facilitate an informed assessment of their children's eligibility for remission/scholarship. Insofar as parents of prospective students are concerned, this can facilitate them to make an informed choice of schools for their children, which would in turn help ensure that students from all strata of the society will have a fair chance of admission to DSS schools. The Working Group is therefore of the view that measures of this kind should be put in place at the earliest opportunity. To this end, with the approval of the Secretary for Education, the EDB issued a circular in early July 2011 setting out the following new measures:

- (a) DSS schools are required to consult their SMC/IMC or parent-teacher associations on the operation of their school fee remission/scholarship schemes and how the related information should be presented to ensure that it can be easily understood by parents and prospective parents of the schools;
- (b) DSS schools are required to clearly indicate in the application form for admission and the School Profile published by the Committee on Home-School Co-operation that needy students, including those from families receiving the Comprehensive Social Security Assistance (CSSA) and students receiving financial assistance provided by the Student Finance Assistance Agency (SFAA), could apply for school fee

remission. DSS schools are also required to provide in the admission application form details of their school fee remission/scholarship schemes and in the School Profile, a hyper-link through which details of the school fee remission/scholarship schemes can be obtained on the schools' websites;

- (c) DSS schools are required to provide details of their fee remission/scholarship schemes to all students newly admitted to the schools by enclosing such details with the letter offering admission;
- (d) subject to the availability of funds under the school fee remission/scholarship schemes, in principle, DSS schools are required to offer fee remission to students from families receiving the CSSA and those receiving assistance from the SFAA. This should be clearly set out in the details of the school fee remission/scholarship schemes for information of parents/prospective parents;
- (e) when notifying students of the application results for assistance from the SFAA, DSS schools are required to provide an application form for the school fee remission/scholarship schemes to each of the eligible students as well;
- (f) DSS schools should as far as possible complete processing the applications for school fee remission schemes from newly admitted students before the new school year begins so that those eligible students will not be required to pay the school fee in advance. Likewise, if applications are received during the school year, they should be processed as early as possible;
- (g) DSS schools are *encouraged* to provide a simulation test for school fee remission on their websites so that parents will know in advance the precise level of school fee remission their children will be granted. This will facilitate decision on school choice and/or whether to apply for remission; and
- (h) the EDB will provide on its website hotlinks to the school fee remission/scholarship schemes of individual DSS schools to facilitate interested parents to get the information they need easily.

Recommendation(s)

3.5 The Working Group recommends that the EDB should keep in

view the implementation of the above improvement measures and provide advice or intervention to schools concerned where necessary.

Providing additional financial subsidy to needy students

3.6 The PAC has recommended that the EDB should consider requiring DSS schools to provide sufficient financial subsidy to needy students for meeting ancillary expenses in addition to school fees. The Working Group has discussed the feasibility of making it a mandatory requirement for DSS schools to provide all students from CSSA families or granted SFAA full assistance with, for example, additional financial assistance for participating in extra-curricular activities (ECA) including exchange programmes.

3.7 The Working Group applauds the intention behind the PAC recommendation. Having studied the utilization of the fee remission/scholarship reserve in different DSS schools, the Working Group notes that the situation is perhaps too diverse to afford a one-size-fits-all approach. The latest audited accounts of DSS schools show that about 40% of the schools have used more than the amount required to be set aside for fee remission/scholarship. The extent of over-provision can be up to 700% of the required amount set aside. In fact, some schools are already providing needy students with assistance (in areas such as textbooks, lunch, ECA, etc.) in addition to school fee remission. Noteworthy is that any additional requirement may exert an upward pressure on school fees. Since the school fee remission/scholarship reserve cannot be used for any other purpose, the Working Group is of the view that schools should have every incentive to facilitate their students to have the best value-added. After all, students' good learning outcome could be a valuable publicity and alumni resource for the schools.

Recommendation(s)

3.8 The Working Group recommends that DSS schools should continue to be given the flexibility to devise their school-based arrangements to offer financial assistance to needy students over and above the current requirements outlined in paragraphs 3.1, 3.2 and 3.4 above.

Exploring the possibility of setting up a centralized fund for fee remission/scholarship purposes

3.9 Despite efforts made by some DSS schools to attract applications from students of needy background, the fee remission/scholarship reserve remains sizeable. To improve the utilization rates of the fee remission/scholarship of these schools, some Legislative Council Members have made a suggestion that a centralized fund be set up, such that DSS schools with a large amount of fee remission/scholarship reserve be required to contribute a certain percentage of their reserve to the new centralized fund for the grant of remissions to students from other DSS schools which have depleted funds in their fee remission/scholarship reserve.

3.10 The Working Group assesses the proposal from the perspectives of different stakeholders, including the school management and parents of the schools contributing to and receiving funds from the centralized fund. It has identified the following possible implications:

Pros

- (a) The idle funds can be deployed to help needy students in other schools.
- (b) A possible redistribution of reserve to the centralized fund may serve as an incentive for schools with huge fee remission/scholarship reserve to actively explore ways to use their reserve.
- (c) Schools with the remission/scholarship reserve depleted need not feel inhibited in accepting more students from needy background.

Cons

- (d) Some schools which are currently providing more school fee income for their fee remission/scholarship schemes than required may discontinue doing so. (At present, the expenditure on fee remission/scholarship in about 40% of DSS schools far exceeds the amount set aside as required.)
- (e) The distribution of the funds will create equity problems and implementation difficulties. Should funds be given as a percentage of school fees or the actual school fee amounts of the recipient schools? What if the demands for the funds outstrip the funds available? To reduce moral hazard in the use of the funds, should there be additional requirements imposed on applicant schools, e.g. no scholarship should be given and no financial assistance over and above school fee remission should be given?

- (f) Parents of the contributing schools may question the fairness of the proposal to them. Instead, they may put pressure on the schools to reduce school fees or distribute the funds for scholarship purposes to an extent more generously than the schools' professional judgment would consider desirable.

3.11 The Working Group also acknowledges that some DSS schools have been actively exploring ways to increase the utilization rates of their fee remission/scholarship schemes after the release of the Audit Report and the PAC Report. For example, some have relaxed the eligibility criteria. Some have proactively invited primary schools/kindergartens to recommend needy students meeting their admission criteria. Noting the receptiveness of the schools and their proactive approach, the Working Group considers it premature for the Administration to adopt measures such as the setting up of a centralized fund which entail unintended implications.

Recommendation(s)

3.12 The Working Group therefore recommends that:

- (a) DSS schools be encouraged to continue to explore ways to better utilize their fee remission/scholarship reserve; and
- (b) the proposal of setting up a centralized fund for fee remission/scholarship purposes be shelved and only be revisited if the situation of under-utilization of fee remission/scholarship reserve by DSS schools persists.

Use of funds between fee remission and scholarship

3.13 The primary objective of setting up the fee remission/scholarship reserve is to enable students lacking means to study in DSS schools. To better ensure the attainment of this objective, the Working Group has discussed the need to set a cap on the percentage of funds used for scholarship purpose.

3.14 The Working Group notes that DSS schools have all along been given the flexibility to use their fee remission/scholarship funds on fee remission and/or scholarship, with no further stipulation on the distribution between the two. The Working Group also notes that schools define "scholarship" differently. While some award scholarship solely on a merit basis without regard to needs, some include in the category of

“scholarship” financial assistance to needy students to participate in overseas visits/programmes. Unless and until the Government has received complaints or unearthed evidence suggesting schools’ deliberate attempts to displace fee remission with scholarship, the Working Group prefers to respect the discretion of the schools to determine their own fee remission and scholarship criteria having regard to their mix of students admitted through a needs-blind admission process, subject of course to their observation of the existing requirements in paragraphs 3.1, 3.2 and 3.4 above.

Recommendation(s)

3.15 The Working Group therefore does not recommend setting a cap for scholarship.

Surrender of school places for central allocation

3.16 During the course of the PAC hearings, a suggestion was made that DSS schools should set aside a certain percentage of their school places for central allocation through EDB’s school places allocation systems in order to facilitate access to DSS schools by students from grassroots families.

3.17 The Working Group considers the proposal an erosion of the guiding principle that DSS schools enjoy flexibility in student admission. In addition, the school places allocation systems cannot guarantee the placement to DSS schools of students from grassroots families. Instead, the Working Group considers it only prudent to monitor the implementation of the improvement measures before deciding if further tightening is warranted.

Recommendation(s)

3.18 The Working Group does not recommend mandating DSS schools to surrender a percentage of their school places for central allocation by the EDB.

Uncertainties faced by schools with utilization of fee remission/scholarship far exceeding the reserves set aside as required

3.19 As mentioned in paragraph 3.1 above, DSS schools are required

to provide a fee remission scheme with eligibility criteria no less favourable than the Government's student financial assistance schemes. Some DSS schools have indicated that their expenditures on fee remission/scholarship far exceed their reserves set aside for the purpose because they have admitted a significant number of needy students. Though they are still able to top up their fee remission/scholarship reserves by using their non-government funds, they are concerned about the long-term sustainability of this approach since they are obliged to administer a needs-blind admission. In addition, unless the family circumstances of a needy student improve significantly, the schools may need to provide him/her with fee remission for six or even 12 years. They therefore request flexibility to revise their fee remission eligibility criteria to a threshold less favourable than those of the government financial assistance schemes to needy students.

3.20 The Working Group notes that the circumstances of different DSS schools are very diverse. While some have a large fee remission/scholarship reserve, some (30 schools or about 40%) have used more than 100% of the amount required with the percentage of one school reaching as high as 700% of the amount required to be set aside. For schools in the latter category, the Working Group agrees that the rigid application of the "no less favourable" requirement may pose difficulties to some schools, create pressure for tuition fee increase and/or unduly affect the quality of the educational services provided for students.

3.21 The Working Group empathizes with the concern about long-term financial sustainability of those DSS schools which have admitted a large number of needy students. On the other hand, noting that making fee remission available in terms no less favourable than those of government schemes is one of the cardinal principles of DSS policy, the Working Group sees the need to stipulate some parameters to forestall abuse of the flexibility to set remission criteria which depart from the "no less favourable" requirement.

3.22 Guided by the consideration in paragraph 3.21 above, the Working Group favours the adoption of the following measures:

- (a) DSS schools meeting the following criteria should be allowed to apply² to the EDB for exemption from the

² The EDB will examine the schools' applications with reference to their financial positions, the proposed levels of reduced remissions and so on with a view to ensuring that the needy students will still be able to receive fee remission under the revised eligibility criteria though at a different remission level as compared to the government financial schemes.

requirement of adopting eligibility criteria no less favourable than those of the government financial assistance schemes to needy students:

- (i) the utilization rates of their fee remission/scholarship provisions are 100% or more as reflected in the audited accounts of the past three consecutive years; and
- (ii) in overall terms, during the three years in question, two thirds of their fee remission/scholarship provisions or more have been used for fee remission purposes as confirmed by the schools.

(b) DSS schools given exemption should ensure that:

- (i) students receiving fee remission before the schools adopt the revised eligibility criteria will not be affected, i.e. they will continue to receive fee remission under the previous eligibility criteria until they graduate from the schools; and
- (ii) sufficient notice must be given to prospective parents/students before implementing the new eligibility criteria; and in any case, the revision must be made available for public consumption as per the measures set out in paragraph 3.4 above;

(c) the exemption to DSS schools would be cancelled once:

- (i) the average utilization rate of their fee remission/scholarship provisions under the revised eligibility criteria in the past three years is less than 80%;
or
- (ii) in the past three years, on average, less than two thirds of their fee remission/scholarship provisions under the revised eligibility criteria are used for fee remission purposes.

3.23 In the course of the discussions with DSS schools, a few DSS schools have suggested that the requisite share between fee remission and scholarship utilization for triggering the flexibility be set at either “51%” or an unspecified “majority share”. The Working Group has discussed this

in detail and come to a considered view that, to forestall grey area in this issue of great community concern, clarity would be desirable. In addition, a “two-thirds” share between remission/scholarship utilization would help ensure accessibility of DSS places to students from grassroots backgrounds.

Recommendation(s)

3.24 For reasons stated in paragraphs 3.20, 3.21 and 3.23 above, the Working Group recommends the adoption of the measures set out in paragraph 3.22.

Better utilization of fee remission/scholarship reserves in through-train secondary and primary schools

3.25 Currently, the utilization rates of the fee remission/scholarship provisions are generally lower in primary schools. This situation is also common in through-train secondary and primary schools. Currently, we require such schools to segregate the administration of their fee remission/scholarship schemes. Despite the efforts of some through-train schools to proactively attract applicants from needy backgrounds, the utilization of their fee remission remains low, though improved. They therefore request greater flexibility for deployment of the fee remission/scholarship reserves between the through-train primary and secondary schools.

3.26 The Working Group notes that while it is easier for a secondary school to admit students from needy background based on their performance in primary schools, it is more difficult for a primary school to do likewise as the interview performance of a five-year old may reflect more socio-economic background of his/her family than the child’s own potential or attributes. In addition, given the close connection between the through-train primary and secondary schools, enabling the linked secondary school to admit more needy students by utilizing the consistently under-utilized fee remission/scholarship reserve of the linked primary school should help enhance the accessibility of DSS school places to students from grassroots backgrounds. Nevertheless, the Working Group also considers it essential that any additional flexibility must not be provided against the wishes of the linked primary school. Nor should the interests of needy students in the linked primary school be affected. Seen from a broader perspective, this is also in line with the spirit of the existing arrangement generally applicable to all DSS schools whereby the use of the

fee remission/scholarship reserve between different class levels in a DSS school is not subject to any restriction.

Recommendation(s)

3.27 The Working Group recommends that through-train secondary and primary schools be allowed to transfer a maximum of 50% of the fee remission/scholarship reserves of the linked primary school to the linked secondary school should they meet the following conditions and obtain prior approval from the SMC/IMC:

- (a) the utilization rates of the fee remission/scholarship provisions of the linked secondary school are 100% or more as reflected in the audited accounts of the past three consecutive years; and
- (b) two thirds of the fee remission/scholarship provisions or more of the linked secondary school are used for fee remission purposes as confirmed by the schools.

3.28 Following the same logic, the Working Group also recommends that similar flexibility under identical terms be allowed for the transfer of fee remission/scholarship reserves of the secondary school to the linked primary school.

Chapter Four

Strengthening the Governance and Internal Control of Direct Subsidy Scheme Schools

Background

Born out of a conscious Government decision to enhance diversity in the school system, DSS schools are given a greater operational flexibility to better enable them to develop their characteristics. A list of the key areas in which DSS schools enjoy greater flexibility in resources deployment when compared with their aided counterparts is set out at Annex 6. Arising from this greater flexibility are also greater financial resources at their disposal. With teachers' pay which constitutes around 80% of the government's subvention to aided schools credited by the Government to teachers' bank accounts via their serving schools, the annual operating funds that can be deployed flexibly by an aided 24-class primary school, the typical size of aided primary schools, are about \$4 million. Those for an aided 29-class secondary school, the typical size of aided secondary schools, are about \$8 million. In respect of DSS schools, when Government subvention and tuition fees income are added together, the recurrent incomes at the disposal of a DSS primary school with the same size, i.e. 24 classes, are about \$30 million. The corresponding amounts for a DSS secondary school with the same size, i.e. 29 classes, are about \$60 million. A few DSS schools comprise both the primary and secondary sections, thus implying an even greater financial responsibility.

4.2 Schools are financed mainly by community resources, be they taxpayers' money or tuition fees. With more funds at their disposal, there come greater responsibilities and a greater need for accountability. Having regard to the policy design allowing DSS schools greater flexibility, the EDB has always refrained from micro-managing DSS schools. Yet, the EDB is aware that the community and the parents would understandably regard the EDB as the custodian of their interests insofar as schools' operation is concerned. Hence, the EDB has devised a host of guidelines on DSS schools' operation.³ The guidelines are premised on a trusting relationship between the EDB and the schools as well as a reliance on schools' internal governance framework to ensure the proper

³ EDB Circular No. 4/2010 on *Use of Government Funds in DSS Schools* and EDB Circular No. 12/2010 on *Use of Non-government Funds in DSS Schools* issued in 2010 encapsulate the regulations and requirements applicable to DSS schools.

management and administration of DSS schools. The AC's findings reveal that there are some practices associated with the governance and administration of some DSS schools which have fallen short of expectations. Of note is that most if not all of the AC's findings cover areas already included in the requirements in the guidelines promulgated. Please see the major recommendations for improvement put forward by the AC and the PAC at [Annex 4](#) and [Annex 5](#) respectively.

Deliberations and Recommendations of the Working Group

4.3 The Working Group believes that the EDB should take a serious view of the custodian role that the community expects of it. Broadly speaking, there are two ways to ensure that DSS schools are administered and managed well and make good the areas in need of rectification as identified by the AC and PAC – *either* the EDB monitors directly each and every detailed aspect of every school's operation *or* the EDB continues to rely on DSS schools' internal governance. Between the two approaches, the Working Group unanimously favours the latter which it believes helps underline the diversity enhancement objective behind the DSS policy. The Working Group also believes that good internal governance can help ensure effectiveness, credibility, and long-term sustainability of DSS schools. However, the AC and PAC findings do reveal that the EDB can continue to rely on schools' internal governance *only if* it is able to identify a way to ensure that the internal governance is *sound*.

4.4 Sound internal governance, we believe, must be premised on a few essential ingredients. Transparency of important management information to key stakeholders is one of them as this could in turn ensure that decisions are made on an informed basis and in the overall interest of the students. Also essential is a healthy management structure and culture to ensure accountability, checks and balances as well as a readiness to identify and address areas in need of improvement. The management structure of a school comprises the governing body in the form of an SMC/IMC⁴ and the Executive led by the principal. The SMC/IMC sets direction and strategy and entrusts the implementation of the direction and strategy as well as the day-to-day operation of the school to the principal who is in turn supported by a team of teaching and management staff. The principal should be accountable to the SMC/IMC and has a fiduciary

⁴ Following the implementation of school-based management, key stakeholder groups are represented on IMCs. Though some schools have been exempted for various reasons from the requirement to form IMCs, they are nevertheless encouraged to include on their SMCs key stakeholder groups that are normally represented on IMCs or, at least, to consult such key stakeholder groups on major decisions.

duty to consult the SMC/IMC on key decisions. This entrusting and accountability relationship is not unique to DSS schools and can in fact be found in any modern day organizations in the public, non-government as well as private sectors. The SMC/IMC is not extraneous to the school; rather, like the Executive led by the principal, it is an integral part of the school. Hence, a healthy system of internal school governance must be premised on the proper exercise of the respective roles of the SMC/IMC and the school Executive. This consideration underlies the recommendations of the Working Group which are elaborated in the sections to follow.

Enhancing transparency of school governing bodies

4.5 As the governing bodies, the SMC/IMC sets the direction and strategy of schools. The community especially parents of prospective and current students of a school have a legitimate interest in knowing who sit on the SMC/IMC. Experience suggests that most schools do not mind making the composition of their governing bodies public. During PAC hearings, this disclosure issue did attract some discussion. In respect of the very few schools which then refused disclosure, the community especially the media did express significant misgivings.

4.6 The Working Group favours requiring all DSS schools to make transparent the composition of their school governing bodies. To draw a sensible balance between meeting public expectation for increased accountability and transparency of DSS schools and school managers' right to privacy, the Working Group considers that the particulars to be disclosed should be confined to their name, tenure of office and category of manager to which they belong. In this connection, DSS schools with IMC are already obliged to do so under the Education Ordinance. Noting that this disclosure obligation does not cover DSS schools governed by SMC/MC, the Working Group has taken note of the need to take account of the relevant provisions in the Personal Data (Privacy) Ordinance (Cap. 486) when making recommendation *encouraging* disclosure. Legal advice has been sought in the course of the deliberation.

Recommendation(s)

4.7 In respect of DSS schools governed by SMC/MC, the Working Group recommends the following:

- (a) at school level, the EDB to consult schools on disclosure of

their composition on the EDB's homepage;

- (b) at individual school manager level, the EDB to add a checkbox to the application form for registration as a manager with a view to seeking his/her consent of the EDB's disclosure of his/her information including the name, tenure of office/date of registration and category of school manager. As for serving managers of SMC/MC, the EDB should seek their consent to similar disclosure through an ad hoc exercise; and
- (c) for schools with managers who refuse to give consent to the proposed disclosure, the EDB to add a remark indicating the number and categories, if applicable, of managers who have not given such consent on the relevant part of the EDB's homepage.

Enhancing internal control mechanism

4.8 As explained in paragraphs 4.3 and 4.4 above, ***sound*** internal governance can be assured only upon the availability of important management information and the existence of systems and processes which make accountability a reality rather than an empty pledge. The Working Group deliberated in great detail the regulatory framework that should be put in place ***within*** DSS schools to facilitate internal governance enhancement while respecting the diversity of DSS schools and obviating the need for the EDB to micro-manage DSS schools' day-to-day operation. In the course of the deliberation, a series of iterative sessions have been held with different stakeholder groups in the DSS sector – the Hong Kong DSS Schools Council, principals, supervisors, school managers and parents – with a view to gauging what the elements of a non-intrusive yet effective governance framework may be. The framework that the Working Group eventually recommends comprises three inter-related aspects, viz. a self-evaluation checklist, the setting up of a functional mechanism under the SMC/IMC to assist the governing body in ensuring the integrity and faithful implementation of various key management and financial systems, and a list of essential items to be discussed at SMC/IMC meetings. These are elaborated in the sections to follow.

(1) Self-evaluation Checklist

4.9 The day-to-day operation of a DSS school is a shared

responsibility of the paid staff. Each management system comprises a series of processes, the partial omission of which could significantly undermine the integrity of the system, irrespective of whether the omission is inadvertent. Examples highlighted in the AC's report include the omission of tendering in procurement and of advertising for vacant teaching posts. By setting out the processes which are considered essential to the integrity of a management system, a checklist can greatly facilitate compliance. It should also help insure against important omissions occasionally associated with turnover of school managers, principals and other supporting staff. It cannot be over-emphasized that the proposed self-evaluation checklist (Checklist) is meant to facilitate DSS schools' *internal* monitoring. The proposed Checklist should cover four important areas of school operations, including:

- (a) general administration of school governing body;
- (b) operation of school fee remission / scholarship schemes;
- (c) human resources management matters, including but not limited to the following aspects:
 - (i) staff recruitment;
 - (ii) staff remuneration;
 - (iii) staff performance management; and
 - (iv) staff development;
- (d) financial management matters, including but not limited to the following aspects:
 - (i) revision of school fees;
 - (ii) use of government funds and non-government funds;
 - (iii) accounting practices;
 - (iv) procurement procedures;
 - (v) trading operation;
 - (vi) investment;
 - (vii) probity requirements;
 - (viii) fund raising activity; and
 - (ix) internal control.

4.10 The Working Group considers that this proposed measure is conducive to the enhancement of DSS schools' internal control mechanism. Through completing the Checklist, DSS schools will increase their awareness of the need, and be guided, to put in place checks and balances

for self improvement. The Checklist will also facilitate DSS schools' preparation of the forthcoming management and financial audit as set out in paragraphs 4.20 and 4.21 below. To ensure that the Checklist would be fit for purpose and neither too brief to be effective nor too detailed to cause an unreasonable administrative burden, the Hong Kong DSS Schools Council has been invited to develop the Checklist in collaboration with the EDB. Discussions have already commenced at the time of drafting this Report.

Recommendation(s)

4.11 The Working Group recommends that:

- (a) all DSS schools be required to conduct self-assessment by completing the Checklist regularly;
- (b) while the EDB would collaborate with the Hong Kong DSS Schools Council in the development of the Checklist, individual DSS schools should be given flexibility in adapting or modifying the Checklist to suit their own needs given that their needs do vary; and
- (c) relevant training be provided to DSS schools to facilitate the effective use of the Checklist with a view to promoting over time the internalization of a self-evaluation culture in DSS schools.

(2) Mechanism under the SMC/IMC to conduct governance review on a regular basis

4.12 The second aspect of the framework to facilitate enhanced internal governance of DSS schools proposed by the Working Group is to set up, under the SMC/IMC, a governance review sub-committee (or any other name the SMC/IMC sees fit) for conducting system review of various key management and financial control systems and processes including whether the various checks and balances are working as intended. An SMC/IMC normally comprises more than 10 persons meeting for a few hours a few times every year. Given that DSS schools are fee charging and granted with greater flexibility and autonomy, the Working Group considers that the proposed governance review sub-committee is of critical importance to the sound administration and management of DSS schools. Given the potential liability of an SMC/IMC for mishaps in its school, it is only fair that it has at its disposal a mechanism to help it assure the proper and

effective administration and management of the school.

4.13 The Working Group is also of the view that the operation and composition of the governance review sub-committee should basically follow the good practices of audit committees that are common in the private sector and in organizations receiving recurrent government subsidies, e.g. government-subsented non-government organizations. Details of the proposed governance review sub-committee are as follows:

- (a) A governance review sub-committee (or any other name the SMC/IMC sees fit) responsible for conducting regular system reviews of various key management and financial control systems and processes has to be set up by DSS schools by the 2013/14 school year;
- (b) Specifically, the governance review sub-committee should review school-based policies and processes in respect of the following aspects:
 - (i) human resources management matters including staff recruitment, promotion, remuneration, etc;
 - (ii) financial management matters including school budgeting, financial reporting, procurement, investment, transfer of funds from the operating reserve to designated reserves, etc;
 - (iii) operation of school fee remission/scholarship schemes;

Other management functions can be assigned to the governance review sub-committee as individual SMC/IMC deems appropriate;

- (c) Having regard to the sub-committee's operational needs in terms of a viable quorum for a meeting and for the sake of continuity, the governance review sub-committee should have a minimum of three members, with one member preferably with experience and qualification in accounting/financial management and one member being a manager of the school. To avoid conflict of interests, parents of students studying in the school should not be invited as a member of the sub-committee. In addition, all the members should not be among the paid staff of the school;

- (d) In principle, the governance review sub-committee is required to complete a comprehensive review of the school-based policies and processes as set out in paragraph 4.13 (b) (i), (ii) and (iii) and submit a comprehensive report to the SMC/IMC within a three-year cycle. Within the three-year cycle, the SMC/IMC should determine the focus of its annual review each year and the governance review sub-committee should then submit a focused review report to the SMC/IMC annually; and
- (e) While paid staff of a DSS school including the principal and senior teachers/heads of functional committees of the school should not serve as member(s) of the governance review sub-committee, they may, at the discretion of the governance review sub-committee, attend meetings or serve as resource persons to facilitate the internal review. Nevertheless, at the review sub-committee meeting(s) where the annual focused report or the comprehensive report is to be finalized before submission to the SMC/IMC, attendance should be confined to official members of the governance review sub-committee only.

4.14 The Working Group acknowledges that some DSS schools may have difficulty in enlisting a suitable candidate with accounting or financial management background to serve on the governance review sub-committee. In this regard, the EDB will discuss with the Hong Kong Institute of Certified Public Accountants and the relevant professional bodies the feasibility of compiling a list of potential candidates who are willing to serve as members of governance review sub-committees for DSS schools' consideration.

4.15 Some schools have suggested that schools with their SSBs having already set up similar committees or with an independent audit department to carry out similar duties should be exempted from the requirement. The Working Group is of the opinion that variations in the means to achieve the same function of the proposed governance review sub-committee should be allowed. Nevertheless, the relevant committees of the SSBs should in principle follow the basic requirements of the proposed governance review sub-committee as set out in paragraphs 4.13 above. For example, they should co-opt one manager of the SMC/IMC of the DSS schools as a member when reviewing schools' policies and processes, which will facilitate more fruitful reviews with inputs from personnel who are familiar with the schools. The EDB could discuss with the SSBs which have

similar committees or audit departments in place the optimal means and set-up to achieve the function of the proposed governance review sub-committee.

4.16 During the various consultation sessions, though some stakeholders such as school sponsors, SMC/IMC and some principals welcome and support the recommended measure, the Working Group also notes that there is strong resistance from some DSS schools to this recommended measure. Some DSS school principals consider the set up of an independent sub-committee on internal control unnecessary since the Checklist should have already met the needs for an internal system audit. They also consider the proposed set-up detrimental to the mutual trust between the SMC/IMC and the Executive led by the principal. Having mulled over such views, the Working Group, while appreciative of the anxiety of the principals, considers such sentiments rather misguided and unnecessary. While the proposed Checklist should greatly facilitate the system review, a Checklist per se would not safeguard system integrity especially if the Checklist has been completed in a perfunctory manner. To put simply, the proposed system review is no more than a health check. And the proposed governance review sub-committee, as a dedicated functional set-up accountable directly to the SMC/IMC, is no more than a medical practitioner engaged by the school to ensure its own healthy functioning. After all, the school's Executive should be held accountable to its governing body. As a matter of fact, such internal system review mechanism is in fact quite common in private sector organizations, higher education institutions and sizeable non-government organizations. After careful and thorough deliberation, the Working Group remains of the view that a governance review sub-committee which aims to enhance DSS schools' internal governance is necessary should respecting the diversity of, and refraining from micro-managing, DSS schools remain the EDB's policy objective.

Recommendation(s)

4.17 The Working Group therefore recommends that all DSS schools be required to set up a governance review sub-committee (or any name the SMC/IMC sees fit) to assist the SMC/IMC in reviewing the system integrity of various management and financial control processes with regard to the requirements mentioned in paragraph 4.13 above.

(3) Essential Items to be discussed at SMC/IMC Meetings

4.18 In principle, all important matters of the operation of schools should be thoroughly deliberated at SMC/IMC meetings to ensure that the decisions made are in the best interests of students and in accordance with the mission, strategy and direction of the schools. Nevertheless, the AC and PAC findings suggest that there were incidences of important school matters implemented before they were deliberated by the SMC/IMC. To help minimize such incidences, the Working Group considers that a list of essential items that should normally be covered in an annual cycle of SMC/IMC meetings will help enhance accountability and governance such as forestalling the inadvertent oversight of important administrative and management issues. Of note is that it is rather normal that not all managers of an SMC/IMC are au fait with the operation of schools. And it is also rather common for an SMC/IMC to meet for just a few hours a few times every year. Having a list of essential items would help ensure the efficient and proper operation of the SMC/IMC.

Recommendation(s)

4.19 The Working Group recommends making it a mandatory requirement for DSS schools to put up essential matters as set out below for discussion and approval at SMC / IMC meetings:

- (a) the human resource policies for senior teaching and administrative posts such as the recruitment, appointment, promotion and remuneration packages of senior teaching and administrative staff;
- (b) annual school budgets and financial report/audited account including acceptance of donations and fund raising activities;
- (c) large-scale capital works (including the SMC/IMC's determination of what constitutes "large-scale" works);
- (d) procurement of services or goods through tendering with significant financial implications (including the SMC/IMC's determination of the thresholds for different modes of procurement);
- (e) operation of the fee remission/scholarship scheme including an annual operational summary and criteria for the schemes;
- (f) fee revision proposals;

- (g) investment policy and update;
- (h) advisory letter(s) specifying for the attention of the SMC/IMC and/or any warning letter(s) (e.g. the management letter from EDB's School Audit Section); and
- (i) self-evaluation on schools' academic as well as non-academic performance under the School Development and Accountability Framework, including the endorsement of School Development Plan, Annual School Plan and School Report.

Strengthening the monitoring of school performance

Management and Financial Audit

4.20 To the Working Group, internal governance by DSS schools and macro external oversight by the EDB as a regulator are complementary measures. Hitherto, the EDB's audit inspections focus on the financial aspects of DSS school operations only. The AC and PAC findings point out the inadequacy of such an approach. Without covering the management aspects, the financial audit alone would not be able to assure the prudent use of DSS schools' resources which should include not only funds but also other forms of resources available such as human resources. The Working Group shares the views of the AC and PAC and favours the extension of EDB's regulatory oversight to management aspects also.

Recommendation(s)

4.21 The Working Group recommends that:

- (a) the existing audit inspection of DSS schools should be replaced by a management and financial audit;
- (b) relevant training be provided for DSS schools before the commencement of the management and financial audit from the 2014/15 school year to allow DSS schools to acquire sufficient know-how and have ample time to prepare for the enhanced audit; and
- (c) a review be conducted upon the completion of the first round of the management and financial audit of DSS

schools to determine whether the management and financial audit should become an on-going measure; and if so, how.

Chapter Five

Strengthening the Financial Management of Direct Subsidy Scheme Schools

Background

In its report released on 16 February 2011, the PAC has expressed great concern about AC's findings as regards the financial management of DSS schools and recommended measures for improvement. The major recommendations put forward by the AC and the PAC are at Annex 4 and Annex 5 respectively.

5.2 DSS schools' available resources can be divided into two categories, namely, the government and non-government funds. The government funds mainly come from a recurrent per capita government subsidy based on the average unit cost of an aided school place. Only approved expenditure items of educational nature as stipulated in Annex 7 can be charged against the government fund account. The non-government funds, which include school fee income, donations, proceeds of trading operations and any other incomes derived from other non-government sources, also constitute an integral part of DSS schools' available resources. DSS schools are required to exercise their professional judgment to deploy the non-government funds flexibly and diligently for meeting educational and school needs only.

5.3 Proper use of funds is fundamental and conducive to school effectiveness, credibility and viability. Being in receipt of public funds, DSS schools are accountable to the public and their stakeholders, including parents, for the proper use of resources for providing quality education in the best interest of the students. The onus of resource deployment of DSS schools is greater than that of their aided counterparts because they may also collect school fees and enjoy greater flexibility in the use of funds. Concomitant with a greater onus and greater responsibility is a higher expectation of accountability and transparency. Such may include, for example, the clear delineation of different sources of incomes and different purposes of expenditures as well as procedural propriety in the processing and documentation of incomes and expenditures to forestall abuse and perception of abuse.

5.4 Quite a number of DSS schools have adopted a practice rather prevalent in aided schools, and that is the lumping together of funds meant

for different purposes. This sometimes creates unnecessary perception and management problems. For example, a DSS school wishing to raise tuition fee would likely meet with parental objection if it has sizeable reserves. The objection may have been obviated had the school separately accounted for the reserves a fair portion of which may have been donations pledged to support future upgrading of schools facilities. In addition, irregularities in respect of the use of their funds are detected through EDB's prevailing mechanism such as audit inspections from time to time. The AC and PAC findings also reveal similar irregularities, e.g. charging unapproved expenditure items to the government subsidy, school-based tendering and procurement policy not properly implemented, collecting fees and charges without the EDB's prior approval, etc. Though most of the irregularities are oversights rather than of systemic significance, their frequency of occurrences does beg questions regarding the efficacy of the EDB's monitoring of schools' compliance and raise the need to enhance DSS schools' financial management.

5.5 To better monitor the financial management in DSS schools and enforce the prevailing requirements on the use of schools' resources, the EDB has introduced the following measures since the release of the Audit Report in October 2010:

- (a) As from the 2010/11 school year, the Task Force on DSS⁵ chaired by a Deputy Secretary for Education will discuss the annual summary of findings on the annual audited accounts submitted by DSS schools and the audit inspections conducted by the EDB officers, so that the EDB can have a holistic review of the financial management of DSS schools and ensure effective follow-up of various improvement measures in addition to timely and full compliance of relevant requirements by schools;
- (b) The reporting requirements in the 2009/10 DSS school audited accounts have been enhanced with a view to facilitating an early detection of and timely follow-up of possible irregularities; and
- (c) A systematic risk analysis mechanism for selecting DSS schools for audit inspections has been adopted.

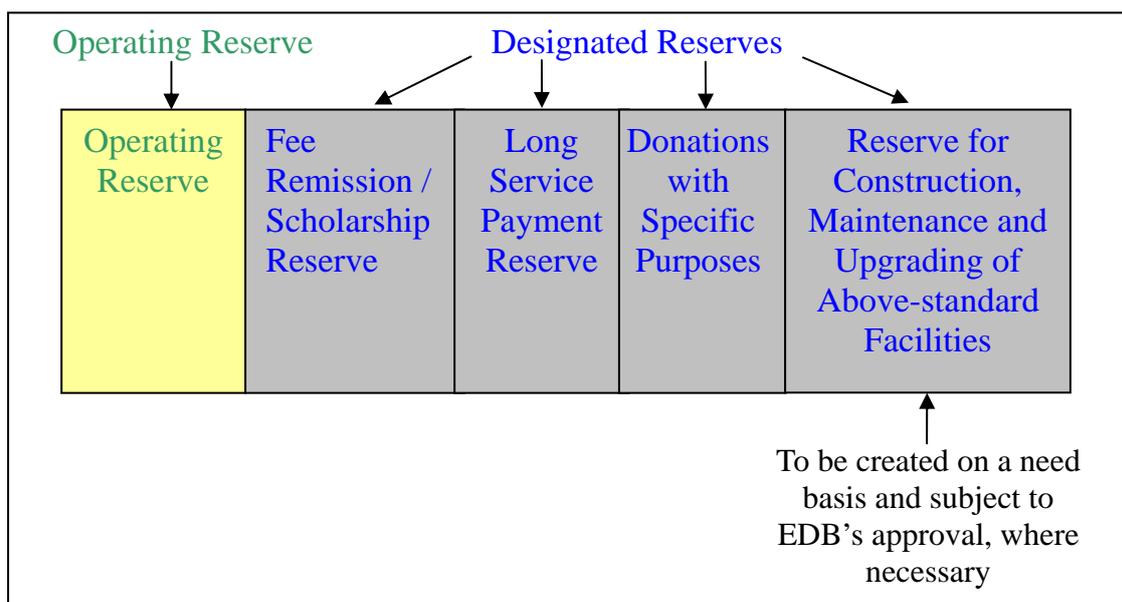
⁵ The Task Force on DSS is a standing task force on DSS within the EDB responsible for monitoring the implementation of the DSS. It is chaired by a Deputy Secretary for Education.

Deliberations and Recommendations of the Working Group

5.6 The Working Group takes note of the improvement measures outlined in paragraph 5.5 above and has, further to the measures, discussed various proposals to enhance DSS schools' financial management. Details are in the ensuing paragraphs.

Clear delineation between the operating reserve and the designated reserve

5.7 With a view to facilitating DSS schools' financial management and helping their stakeholders understand clearly the financial situation of the schools, DSS schools' reserves should be classified into two categories, namely the operating reserve and the designated reserve. Such demarcation is also necessary for the implementation of the proposed measures as set out in paragraphs 5.8 to 5.31 below. The arrangement is illustrated in the table below:



5.8 Accumulated surplus⁶ arising from both government and non-government funds (except for those in the designated reserves) in DSS schools will be classified as the operating reserve of DSS schools. The reserves that DSS schools are allowed to keep separately are classified as designated reserves which may include (i) fee remission/scholarship reserve, (ii) long service payment reserve, (iii) donations with specific

⁶ "Accumulated surplus" is the excess of income over expenditure over the years concerned which is retained in the form of assets net of liabilities. Assets include fixed assets, accounts receivable and cash, among others.

purposes and (iv) a new reserve for constructing, maintaining and upgrading above-standard facilities. The new reserve for use relating to above-standard facilities may only be created on a need basis with the approval first by the SMC/IMC and then by the EDB where necessary.

Setting a ceiling for schools' operating reserve

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

5.10 Notwithstanding the requirements in Financial Circular No. 9/2004, to give DSS schools flexibility in deploying their resources to achieve their own development objectives, DSS schools have all along been allowed to keep all the accumulated reserves of both the government and the non-government funds. In case 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. The AC and PAC asked the EDB to review such practice as it was considered out of line with the practice generally applicable to subsidized organizations.

5.11 Government subsidy and school fees constitute the key income sources of DSS schools and both are payable at regular intervals. For most schools, their activities seldom fluctuate drastically between adjacent years. DSS schools should, on the whole, be operating within a fairly stable environment. Therefore, the Working Group sees no strong grounds for DSS schools to accumulate a large operating reserve. Their resources should primarily be used on teaching and learning in the interests of the students. Setting a reserve ceiling for the accumulated operating

reserve of DSS schools will encourage DSS schools to make better planning on deployment of their resources including a timely review of the school fee levels they charge. In determining the appropriate level at which the ceiling should be set, the Working Group has made reference to the following existing practices:

- (a) the existing ceiling of accumulated reserves above which DSS schools are required to submit a development plan setting out how the operating surplus would be used for school development, i.e. 12 months' operating expenditure; and
- (b) the existing arrangement adopted for aided schools, i.e. they are allowed to retain unspent funds up to a ceiling equivalent to 12 months' provision of the Operating Expenses Block Grant⁷.

5.12 In addition, the Working Group has also taken into account the following principles in determining the appropriate level of the reserve ceiling:

- (a) the proposed ceiling should allow ample room for DSS schools to cater for teachers' promotion in the years to come, additional teachers' salary increase, as well as routine repairs and maintenance expenses for standard facilities; and
- (b) the proposed ceiling should enable DSS schools to deal with possible contingencies.

Recommendation(s)

5.13 To enable DSS schools to put in place longer-term development strategies, the Working Group recommends that the following measures in respect of the ceiling on accumulated operating reserve be adopted:

- (a) the ceiling on the operating reserve which may contain both government funds and non-government funds should be set at an amount equal to 100% of the annual total expenditure, i.e. 12 months' operating expenditure as reflected in the audited accounts of the same school year;

⁷ The Operating Expenses Block Grant includes nearly all the existing recurrent grants to aided schools, with the exception of the Salaries Grants and grants disbursed on an actual claim or reimbursement basis such as rents and rates.

- (b) only the balance in the operating reserve should be used to assess whether the schools' operating reserve exceeds the ceiling, taking into account the fact that funds in the designated reserves have specific purposes;
- (c) schools with accumulated operating reserve exceeding the ceiling as reflected in the latest audited accounts should be given the following options to rectify the situation and they should be required to indicate the option they choose in their submission of the audited accounts:
 - (i) schools may choose to submit a plan on how to reduce school fees in the forthcoming school year so that the accumulated operating reserve will drop to below the ceiling taking into account their own long-term financial considerations;
 - (ii) schools may choose to receive less DSS subsidy in the forthcoming school year, i.e. the amount exceeding the ceiling will be deducted from the DSS subsidy to be paid to the school in the next payment;
 - (iii) schools may choose to return the surplus in excess of the ceiling to the Government in a specified timeframe; or
 - (iv) schools may choose to transfer the surplus in excess of the ceiling to the fee remission/scholarship reserve subject to the following conditions being met:
 - there is no surplus in the fee remission/scholarship reserve as reflected in the latest audited accounts;
 - the utilization rates of the fee remission/scholarship provisions are 100% or more in the past three consecutive years; and
 - the amount that can be transferred to the fee remission/scholarship reserve is subject to EDB's approval.

Special one-off arrangement

5.14 Given that DSS schools have all along been allowed to keep all the accumulated reserves of both government and non-government funds, it is understandable that there exist some DSS schools with significant sums in their reserves of government and non-government funds that exceed 12 months' operating expenditure. The Working Group considers that it may not be fair to apply the options listed in paragraph 5.13 (c) to these DSS schools right after the new measure of reserve ceiling is introduced.

Recommendation(s)

5.15 The Working Group therefore recommends that DSS schools be allowed to grandfather the reserve including assets in excess of the reserve ceiling accumulated before the implementation of the recommendation concerning reserve ceiling. This notwithstanding, the grandfather arrangement is subject to the following conditions being complied with:

- (a) schools submit to the EDB plans with detailed accounts of their reserves including their types, proposed usage and, where necessary, timeframe for deployment endorsed at SMC/IMC meetings within a specified timeframe to be set by the EDB; and
- (b) the plans are approved by the EDB.

5.16 The Working Group also recommends that the EDB should take into account schools' grandfathered reserve when processing any applications from schools for tuition fee increase or for setting up a designated reserve for construction, maintenance and upgrading of above-standard facilities as set out in paragraphs 5.17 to 5.23 below.

Setting aside school fee income for construction, maintenance and upgrading for above-standard facilities

5.17 DSS schools have all along been given flexibility in using their operating reserve of non-government funds to finance above-standard facilities, such as construction of additional floors and swimming pools. Acknowledging that it is in the interest of both the DSS schools and the diversity of the school system for the DSS schools to develop their own characteristics, the Working Group is of view that DSS schools' flexibility in using operating reserve of non-government funds to finance above-standard capital works should be maintained. The Working Group

therefore considers that DSS schools should be allowed, on a need basis, to set aside a certain portion of their school fee income for constructing above-standard facilities as well as maintaining and/or upgrading such facilities.

5.18 Notwithstanding the needs of DSS schools as mentioned in paragraph 5.17 above, the Working Group is of the opinion that DSS schools should carry out projects relating to above-standard facilities in an orderly manner with sufficient advance planning given that the total expenses required may be quite colossal. Not only could this facilitate the evening out, over a long period of time, of the funding requirements, this could also greatly moderate the pressure for tuition fee increase. In addition, this could better ensure that schools will remain financially sound. Based on the above considerations, the Working Group proposes that the amount of school fee incomes that DSS schools can set aside each school year for the projects on above-standard facilities should be capped.

5.19 Despite the Working Group's empathetic stance towards some DSS schools' desire for above-standard facilities, it feels that such a desire should be pursued with caution. After all, DSS schools are in general operating in standard school premises, and any proposed upgrading should be regarded an exception rather than a norm. The Working Group therefore takes the view that DSS schools should be required to keep sufficient liquid reserve to maintain their normal operation without resorting to school fee increases after setting aside school fee incomes for the projects. If DSS schools have plans on new above-standard capital works, they should try to secure funds not only through setting aside tuition fee income for the purpose but also through other sources such as fund-raising/donation drives.

5.20 Given the impact of plans to construct/maintain/upgrade above-standard facilities on a school's finance, the Working Group feels that there must be thorough consultations within the school before it makes a firm decision to proceed.

5.21 Taking all considerations in mind, the Working Group's original recommendation is that DSS schools should –

- (a) be allowed to set aside reserve of non-government funds for expenses relating to above-standard facilities only if after the proposed transfer, there remains cash in the operating reserves equivalent to six months' or more of the school's expenses;

- (b) transfer not more than 10% of the school's annual tuition fee incomes; and
- (c) before proceeding, consult their parent bodies and secure first the approval of their SMC/IMC and then the EDB.

The Working Group consults the DSS school community on this original recommendation. Some DSS schools, especially those which charge a relatively low tuition fee, consider the recommendation too restrictive. They proposed instead lowering the six months' operating reserve requirement to two or three months and relaxing the 10% cap. The Working Group appreciates their sentiments and eventually agrees to moderate the limits yet without compromising the considerations set out in paragraphs 5.18 – 5.20 above. After all, a DSS school should not undertake plans with significant and long-term financial commitment at the expense of immediate and short term operational soundness. They should take into account the characteristics of their student mix, their positioning and possible impact on its appeal to prospective students and parents arising from an upward adjustment in tuition fees. The Working Group's eventual recommendations are set out in paragraph 5.23 below.

5.22 The Working Group has also discussed the need for defining projects for which the school fee income can be set aside, e.g. projects larger than \$10 million. After deliberation, it considers that such rigid requirements may not be warranted given DSS schools' diversity in levels of tuition fees and size of operation.

Recommendation(s)

5.23 The Working Group recommends that DSS schools with genuine needs for constructing, maintaining or upgrading above-standard facilities be allowed to set up a reserve for the purpose subject to the following conditions being met:

- (a) concrete plans with purposes, timeframe/cashflow and funds required have to be deliberated and approved by the SMC/IMC;
- (b) Parent-Teacher Associations have to be consulted about the plans (all parents have to be consulted if the reserve is used for new above-standard capital works);

- (c) the amount to be transferred to the reserve for above-standard facilities should be no more than 10% of the school fee incomes of each school year;
- (d) there is no need to consult the EDB beforehand if after the proposed transfer, there remains cash in the operating reserve equivalent in amount to at least six months' the school's expenses. Instead, such a transfer should be detailed in the audited accounts to be submitted to the EDB;
- (e) the EDB's *prior* approval should however be sought if the school intends to transfer more than 10% of the annual school fee income or if after the transfer, cashflow in the operating reserve account falls below six months' expenses of the school; and
- (f) the EDB should not give approval to the application should the cashflow in the operating reserve account fall below three months' expenses after the proposed transfer.

Modifying the prevailing guidelines on investment

5.24 At present, in order to protect the interest of both schools and students, DSS schools are advised to keep all their incomes derived in such a manner as to involve minimal 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. Nevertheless, DSS schools which have compelling and well-justified reasons may still invest with their non-government funds. Schools are required to go through due process in this regard. First of all, they must consult the schools' key stakeholders and seek prior approval of their SSB as well as their SMC/IMC. They are then required to devise and strictly follow a school-based mechanism for making investment. The liability for any financial loss arising from investment 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.

5.25 The Working Group agrees unanimously that DSS schools should concentrate their effort and resources on learning and teaching so that

students could benefit directly. DSS schools therefore should not indulge in making investment. While supporting the existing guideline that investment by DSS schools should not be encouraged, the Working Group appreciates that some schools may find themselves fully justified to make certain investments by using their own funds. To draw a fine balance between these considerations, the Working Group considers that permissible investment products should be clearly specified with corresponding guidelines drawn up. In this connection, the Working Group considers the guidelines prepared by the Social Welfare Department on investment using Lump Sum Grant by subvented organisations good references.

Recommendation(s)

5.26 The Working Group therefore recommends that the following measures be adopted with a view to enhancing the regulation of investment activities that DSS schools may conduct and ensuring that the financial situation of DSS schools remains sound and healthy after the investment:

- (a) under no circumstances should DSS schools be allowed to use the funds in the operating reserve or the fee remission/scholarship reserve for investment;
- (b) DSS schools should seek their SMC/IMC’s approval before making investment decisions and such approval and factors for consideration must be clearly documented;
- (c) the only funds that may be used for investment are the long service payment reserve, donations with specific purposes and the reserve for construction, maintenance and upgrading of above-standard facilities;
- (d) DSS schools should only be allowed to invest in (i) HK dollar bonds; and (ii) HK dollar certificates of deposits according to the prescribed criteria/conditions; and

Type of Investment	Investment Criteria/Conditions
HK dollar bonds or certificates of deposits (CD): ✧ short to medium term with a maturity period of one to five	✧ The credit rating of the issuer must not be lower than the rating of A3 given by Moody’s Investors Service Inc. or A- given by Standard & Poor’s Corporation.

years	✧ The bank must be licensed under the Banking Ordinance, Cap. 155.
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- (e) DSS schools should be alerted to the liquidity constraints of the certificates of deposits and corporate bonds in the secondary markets and be advised to make allowance for contingencies in projecting the use of their designated reserves.

Modifying the prevailing guidelines on purchase of properties

5.27 Given the liquidity constraints of and the high risk level associated with properties, the Working Group has great reservations about allowing DSS schools to purchase properties as an investment product. Though some schools indicate that they wish to purchase quarters for their non-local staff, the Working Group feels that caution is needed bearing in mind that different non-local staff may have different preferences for size and location of their accommodation, having regard to their own personal preference and family circumstances. Given the rate of return of rental income to the fixed investment that goes into the acquisition of property and the risk of depreciation and property market fluctuations, the Working Group feels that DSS schools should focus the deployment of resources on improving education quality rather than property acquisition. Nevertheless, respecting the DSS policy intention of promoting diversity, the Working Group has deliberately refrained from making prescriptive recommendations as far as possible. Therefore, instead of recommending the prohibition of the acquisition of properties, the Working Group prefers to focus on setting conditions to help ensure that the decisions in favour of property acquisition are well thought-through. First and foremost, prior approval of schools' SSB and SMC/IMC is required. In addition, the conditions for the purchase of properties should be further strengthened based on the following considerations to ensure the financial stability of DSS schools:

- (a) DSS schools should still have sufficient liquid reserve to maintain their normal operation without the need to resort to school fee increases after the purchase of properties; and
- (b) the purchase of properties should not lead to long-term financial burdens on DSS schools such as mortgage payments as interests rates may fluctuate widely.

Recommendation(s)

5.28 The Working Group therefore recommends that two requirements be added to existing requirements for the purchase of properties by DSS schools:

- (a) DSS schools should be required to keep at least an amount equivalent to six months' operating expenditure in cash after the purchase of properties; and
- (b) DSS schools should not be allowed to purchase properties through mortgages or any other borrowing arrangements.

Enhancing the transparency of schools' financial management

5.29 At present, under the School Development and Accountability Framework, DSS schools are required to upload their School Development Plan, Annual School Plans and School Reports (which include a financial summary) onto their websites for public reference. Nevertheless, the levels of details of financial information disclosed by DSS schools vary greatly among schools.

5.30 Sentiments expressed during the PAC deliberation suggested a public expectation for increased accountability and transparency in the operation of DSS schools especially on their major items of incomes and expenditures. The Working Group considers that DSS schools should enhance the transparency of schools' financial management as far as possible. However, the Working Group is also mindful of the difficulty that over-disclosure may pose to school operations.

Recommendation(s)

5.31 To strike a balance between meeting the public expectation for increased transparency of the use of school funding and addressing the practicality at school end, the Working Group recommends that the following measures be implemented:

- (a) DSS schools are required to disclose annually their major expenditures (including staff remuneration; repair & maintenance; fee remission/scholarship; learning and teaching resources; and miscellaneous expenditures) in terms

of percentages of their annual overall expenditures;

- (b) DSS schools are required to disclose annually the cumulative operating reserve in terms of equivalent months of operating expenditure as well; and
- (c) to ensure meaningful disclosure and comprehensibility of the data, a template for enhancing the transparency of schools' financial management should be developed. To further ensure that the disclosure will be fit-for-purpose and not over-burdensome, the EDB should develop the template in consultation with the Hong Kong DSS Schools Council.

Chapter Six

Training for School Personnel of the Direct Subsidy Scheme Schools

Background

The AC has expressed concern about the non-compliance of requirements relating to financial and human resources management of DSS schools. Though the majority of the problems unearthed by AC are rather technical in nature, the fact that only a handful of schools were in full compliance is a cause of concern. To address this general problem of non-compliance, the PAC has recommended that the Secretary for Education should provide training for staff of DSS schools to familiarize them with EDB's various requirements in financial management and human resources management. Details of the relevant views of the AC and PAC are at [Annex 4](#) and [Annex 5](#) respectively.

Deliberations and Recommendations of the Working Group

Training for DSS schools

6.2 Other than training for tackling the non-compliance problems, the Working Group considers that training is also essential to prepare DSS schools to take forward the new proposed improvement measures for enhancing the governance, management and administration of DSS schools.

6.3 To ensure that the training programmes will meet the practical needs of DSS schools, the Working Group takes the view that expertise from different professional sectors such as financial management and human resources management should be tapped in designing or even running the entirety or parts of the programmes.

Recommendation(s)

6.4 The Working Group recommends that the training programmes as set out in paragraphs 6.5 to 6.10 be adopted and a steering committee as detailed in paragraphs 6.11 to 6.12 be set up to oversee the design and implementation of the training programmes.

Programme objectives

- 6.5 The proposed training programmes should aim to:
- (a) familiarize school personnel with EDB's various requirements in financial management and human resources management; and
 - (b) equip and develop school personnel with the necessary knowledge and skills to take forward various improvement measures regarding the enhancement of school governance as well as the administration and management of DSS schools as recommended by the Working Group and endorsed by the Secretary for Education. These improvement measures are:
 - (i) schools will be required to conduct self-assessment according to a new set of self-evaluation checklists on major school policies and issues as recommended in paragraph 4.11;
 - (ii) schools will be required to set up a governance review sub-committee to assist their SMC/IMC in reviewing management and financial control systems and processes key to the schools' sound governance as recommended in paragraph 4.17;
 - (iii) schools will be required to put up major school policies and issues to their SMC/IMC for discussion and decision as recommended in paragraph 4.19; and
 - (iv) schools will be required to undergo management and financial audit as recommended in paragraph 4.21.

Programme framework

6.6 The proposed framework of the training programmes should consist of the following parts:

- (a) EDB's various requirements in financial management and human resources management;
- (b) essential components and formulation of implementation plans for the new improvement measures as set out in paragraphs 6.5(b) above ; and

- (c) other components considered essential by the proposed steering committee.

Design and delivery

6.7 Practicality and experiential approach should be the main strategy for designing the training programmes, including features to facilitate DSS schools to get the practical know-how on formulating their improvement plans:

- (a) at the end of the structured course, participants will be able to take home skeletons / outlines of implementable plans pertaining to the new improvement measures (including some samples of monitoring procedures with the elements of check-and-balance and documentations) with substantive contents to be filled up by respective schools through internal deliberations; and
- (b) as a follow-up to the above structured course, at the school level, respective schools may choose to identify training agencies/consultants to help empower their school personnel to design and formulate the detailed school-based implementation plans (including the necessary procedures and documentations) taking into account its vision, governance structure, general school-based policies and respective circumstantial conditions.

6.8 To facilitate collaboration of school personnel in the school improvement process, each school should be required to send a team consisting of the principal, management staff, supervisor or school manager (and other staff as considered appropriate by schools) to attend the training programmes.

6.9 Training agencies or consultants in the commercial and/or professional sectors may serve as course providers and the overall course designer. Veteran principals may also be invited to share their practical experience in certain areas. EDB officers should be involved in sessions explaining EDB requirements, policies and guidelines. Besides, visits to schools and private enterprises etc. whose practices are of useful reference could be arranged where appropriate.

6.10 A set of “tool kits” should be provided for school personnel of

DSS schools such as school managers to facilitate their daily operation.

Setting up a steering committee

6.11 A steering committee on training for DSS school personnel comprising representatives from the Hong Kong DSS Schools Council, non-school sector professionals and colleagues from different EDB Divisions should be set up. The steering committee should be accountable to the Permanent Secretary for Education.

6.12 One particular aspect that the steering committee should address is sustainability, e.g. how the training programmes can help internalize the enhanced governance framework. In this regard, the steering committee should, in the light of the evaluation of the first round of workshops, consider if training should be conducted at regular intervals and how new staff or staff who have newly assumed management positions may be imbued with the enhanced management culture.

Training for managers of DSS schools

6.13 The EDB has been organizing structured training programmes for school managers of aided schools. The Working Group is of the view that training sessions with topics relevant to DSS schools should also be open to participation by school managers of DSS schools.

Recommendation(s)

6.14 The Working Group therefore recommends that the existing practice of inviting school managers of DSS schools to the structured training programmes for school managers should continue. To cater for the special needs of managers of DSS schools, the Working Group has also recommended that an optional module on deployment of resources specifically for DSS school managers be added to the existing programmes.

Chapter Seven

Measures to Ensure Compliance of Requirements of the Direct Subsidy Scheme by Schools

Background

Currently, if a DSS school is found to be in breach of EDB's guidelines, the EDB will issue an advisory letter to the school demanding compliance or rectification within a specified time. If no action is taken or the school fails to comply with the guideline or rectify the malpractice within the specified time, the EDB will, depending on the gravity of the non-compliance or malpractice, issue a follow-up advisory letter or a warning letter to the school. Follow-up investigation visits or reviews will be conducted to ensure timely rectification of the situation.

7.2 In addition to the issuance of advisory and warning letters, the EDB may appoint school managers to the SMC, and report to relevant law enforcement agencies should there be suspected illegal and corruption cases. If non-compliance or malpractice continues even after warning has been given and intervention has been taken by senior EDB officers, then the EDB may withdraw the subsidy payable to the school, hence resulting in the school's loss of DSS status. In extreme situations, the EDB may also cancel the school's registration.

7.3 While it is lawful for the EDB to withdraw the subsidy payable to a DSS school thus depriving the school of DSS status or even cancel the registration of a school if it is not managed satisfactorily, the EDB has never done so. It has always exercised restraint and refrained from resorting to such extreme options taking into account the interest of the students studying in the school. Nevertheless, past experience indicates that there are occasionally a handful of DSS schools that have kept on ignoring EDB's advice and warnings. As a matter of fact, a sizeable majority of the malpractices included in the AC's report are no news to the EDB. They have been the subjects of advisory and/or warning letters issued to DSS schools.

Deliberations and Recommendations of the Working Group

7.4 The Working Group considers it necessary to enhance deterrence against persistent non-compliance and malpractice. In deliberating

measures to enhance the existing mechanism to deal with non-compliance or malpractice, it also shares the EDB's keen concern about the interests of the students and considers measures affecting students not something that should be taken lightly. In the event, the Working Group prefers transparency and greater deployment of schools' internal governance mechanism to address and deter non-compliance and malpractice.

Recommendation(s)

7.5 The Working Group recommends that on top of the existing measures as set out in paragraphs 7.2 and 7.3 above, the following new measures be put in place:

- (a) escalation of advisory letters to supervisors at the earliest opportunity – if a school, without any reasonable justification, fails to comply with a rule/guideline or rectify the malpractice within a given time-frame after the principal of the school is served with an advisory/warning letter, follow-up advisory/warning letters will be issued to the supervisor of the school, copied to the school principal;
- (b) escalation of warning letters to SMC/IMC members at the earliest opportunity – if a school, without any reasonable justification, fails to comply with a rule/guideline or rectify the malpractice within a given time-frame after a advisory/warning letter has been written to the supervisor of the school, follow-up advisory/warning letters will be sent to the supervisor again but this time, the letter will be copied to all the SMC/IMC members of the school as well;
- (c) disclosure of the non-compliance or malpractice – after exhaustion of the steps in paragraphs 7.5(a) and 7.5(b) above and if the malpractice remains to be rectified, the regional Principal Education Officers of the EDB may put up the case for discussion by the Task Force on DSS. With the Task Force's endorsement, the EDB will post the non-compliance (including a description of the malpractice) with the school concerned named on the EDB's website; and
- (d) suspension of DSS subsidy – if a school fails to comply with an important requirement or rectify serious malpractice after exhaustion of the steps mentioned in paragraphs 7.5(a) and 7.5 (b) above, the Task Force on DSS may decide to take the

measure in paragraph 7.5 (c) prior to, or in addition to, withholding part of the DSS subsidy of the school until rectification is made. In order to ensure that the interests of students are not unduly affected, the EDB will assess the financial situation of the school before withholding the school's DSS subsidy.

7.6 The Working Group expects that the options set out in paragraphs 7.5(a) and 7.5(b) above, which amount to drawing the malpractices and non-compliance to the attention of DSS schools' governance bodies, should be efficacious deterrent measures. They should enable the governing bodies to intervene and rectify the situation at an early opportunity. The Working Group anticipates that the circumstances necessitating resort to the measures in paragraphs 7.5(c) and 7.5(d) should be few and far between. The Working Group believes that the recommended sequence of measures can enhance enforcement efficacy by the EDB while respecting DSS schools' internal governance.

Chapter Eight

Status of Li Po Chun United World College of Hong Kong in the Direct Subsidy Scheme

Background

Li Po Chun United World College (LPCUWC) admitted to the DSS

When the DSS was introduced in 1991, international schools were eligible to join the scheme. There were altogether five schools of such background admitted to the DSS, including LPCUWC which was admitted in 1994.

Review of the DSS status of international schools

8.2 In July 1995, the then Education Department (ED) completed a review, which aimed to examine the demand for international school places in the following five years in the light of the need to maintain and develop Hong Kong as an international business and financial centre. The Working Group responsible for the review recommended that international schools should no longer remain in or be eligible for admission into the DSS having regard to the following considerations:

- (a) the students primarily served by international schools were non-local students of particular cultural, racial or linguistic groups who were different from those primarily served by DSS schools, i.e. local students; and
- (b) international schools⁸ would become eligible for additional financial assistance, i.e. capital assistance.

8.3 As to LPCUWC, the then ED and Education and Manpower Bureau (EMB) held the view that this school was unique in its nature and was different from other international schools. After careful deliberation in 1999, the then ED and EMB decided to allow LPCUWC to remain in the DSS while the other four international schools were to be gradually phased out from the DSS. LPCUWC was unique and different from other international schools in the following ways:

⁸ Before the review, international schools not under the DSS or English Schools Foundation were not eligible for any capital assistance.

- (a) the students of LPCUWC came from different parts of the world and were the “ elite” of their countries;
- (b) there was a reciprocal arrangement between various colleges run by the school sponsor, the United World Colleges. Under the arrangement, for every student admitted from another country to LPCUWC, Hong Kong could benefit by sending in return one local student to a college run by the School Sponsor of that country;
- (c) unlike other international schools, LPCUWC did not serve a particular ethnic or cultural group; and
- (d) the learning experience was quality education for our local students.

(LPCUWC was so informed by the then ED in writing in October 1999.)

Reconsidering the DSS status of LPCUWC

8.4 In June 2002, the then ED reconsidered the DSS status of LPCUWC. It confirmed the analysis recapitulated in paragraph 8.3 above. Given the unique nature of LPCUWC, the then ED ruled that the status quo should be maintained.

Recommendations put forward by the Audit Report & the PAC Report

8.5 In the Audit Report released in October 2010, the AC queried why LPCUWC was not phased out from the DSS as were the case for the other four international schools. The AC therefore recommended that the EDB should critically review the justifications for continuing to allow LPCUWC to remain in the DSS and take action to address the matter, if necessary. It was also recommended in the PAC Report released in February 2011 that the EDB should take appropriate measures to address the matter as necessary.

Deliberations and Recommendations of the Working Group

8.6 The Working Group has carefully reviewed the reasons put forward by the then ED and EMB justifying LPCUWC to remain in the DSS. After deliberation, the Working Group fully concurs with the views

of the then ED and EMB that LPCUWC is unique in nature. The Working Group also takes the view that most of the reasons put forward by the then ED and EMB are still sound and valid. It also notes that the school's uniqueness has remained unchanged since the two said reviews in 1999 and 2002. Considerations made by the Working Group are detailed in the ensuing paragraphs.

Need to sustain such provision of invaluable international perspectives and learning experiences for local students

8.7 Unlike other international secondary schools which usually offer a full secondary curriculum, LPCUWC has been offering two-year pre-university education, making it unique in this respect and not in direct competition with other international schools or local schools in Hong Kong. LPCUWC is also characterized by the breadth and depth of activities that students undertake outside of the “taught” curriculum. Students are involved in over 90 different activities based around the themes of Creativity, Action and Service. They also participate in at least one activities week either in China or the rest of the world per year. In this regard, the school policy is in line with the New Senior Secondary curriculum's spirit of providing necessary exposure of students for balanced and whole-person development.

8.8 More importantly, LPCUWC, being one of the United World Colleges⁹ (UWC), is unique with its students coming from different parts of the world and supported by various scholarships. Drawn from all nations, the non-local students are selected purely on merit, regardless of race, religion, nationality, background or financial means. The boarding education offered by LPCUWC for all students, local and foreign alike, also facilitates cultural exchanges among students not just in the learning process but also in their everyday life.

8.9 The sponsoring body of the school is running various colleges in the world with reciprocal arrangements in the admission of students and scholarship arrangements. Students in Hong Kong enjoy the benefits of attending various colleges in other education systems world-wide, which will undoubtedly help them broaden their horizon, explore and develop an

⁹ As of today, UWC has 13 colleges and schools (including LPCUWC) across five continents all with distinctive characters but sharing the same mission, ethos and values. At most schools and colleges, an average of 70 different nationalities are represented at any one time, and embracing the many nationalities present is an important feature of UWC life, helping students to explore and develop an international appreciation. Academic achievements are put into perspective with a demanding mix of community engagement, international affairs, physical activities and creative pursuits.

international appreciation. The benefits brought about by this unique arrangement to Hong Kong students are definitely enormous, and any changes upsetting these arrangements are not in the interest of Hong Kong students.

DSS being a suitable funding mode for LPCUWC

8.10 It is noteworthy that some UWC in other countries are also receiving some forms of subsidies from the governments / provincial governments of the countries / provinces in which the UWC are situated. In Hong Kong, there are basically two forms in which the Government provides subsidy to schools, viz. either aided or DSS. Obviously, the aided mode (which provides subsidy on a per class basis) would not be appropriate for LPCUWC given that at least half of its students are non-local students from other parts of the world. The admission of LPCUWC to the DSS enables the Government to provide per capita financial support to local students only.

8.11 By virtue of its status as a DSS school, LPCUWC has to comply with various requirements to help maximize benefits to local students. First, for other UWCs, they normally admit 25% to 30% of local students and the rest from other countries. As for LPCUWC, since its admission to DSS, it is required to admit over 40% of local students¹⁰. This admission arrangement enables more local students in Hong Kong to enjoy an invaluable opportunity to acquire an international perspective in a truly culturally diversified environment while still being physically in Hong Kong. Second, under the DSS, LPCUWC, being in receipt of recurrent government subsidies, has to set aside school income for fee remission/scholarship purposes in accordance with the DSS requirements, thus supporting many local students to study in such a culture-rich and diversified learning environment. All along, LPCUWC has been generous in providing assistance to its students. The Hong Kong UWC Committee and LPCUWC offer approximately 60 scholarships to each level of Hong Kong students including those going to study in UWCs in other countries each year. Among the local students in LPCUWC, about 70% of them were offered fee remission / scholarship in the past three school years.

¹⁰ Number and percentage of local and non-local students in the past three school years

School year	Local Students (%)	Non-local Students (%)	Total No. of Students
2010/11	116 (45%)	140 (55%)	256
2009/10	123 (48%)	133 (52%)	256
2008/09	125 (49%)	131 (51%)	256

8.12 The fact that LPCUWC is provided with recurrent government subsidies, coupled with the generous financial assistance provided by LPCUWC for its students as mentioned in paragraph 8.11 above, enables local students in Hong Kong to enjoy all the benefits brought about by LPCUWC at lower school fees.

8.13 To conclude, LPCUWC is an education institute that Hong Kong should value in consideration of its culturally diversified school environment and membership in a world league of UWC network. Any change in policy which may make the UWC feel unwelcome here or to erode the sustainability of LPCUWC would not be in the interest of Hong Kong. Instead, LPCUWC should be regarded as a much valued unique member of the Hong Kong school system. Should there be any change to its existing funding mode, fewer students would have the chance to enjoy such a multi-cultural and pluralistic learning environment. This would not be in the interest of local students. Moreover, Hong Kong will likely be criticised for withdrawing the financial support for such a renowned international education body. It in turn may undermine the image of Hong Kong as a metropolitan city. It also runs contrary to the vision of developing Hong Kong as an education hub.

Recommendation(s)

8.14 Having reviewed the justifications put forward by the then ED and EMB for allowing LPCUWC to remain in the DSS in 1999 and 2002, and taken into account the uniqueness of LPCUWC, the benefits it brings to students in Hong Kong and the downside of changing the funding mode of LPCUWC as set out in paragraphs 8.7 to 8.13 above, the Working Group recommends the continuation of the status quo, i.e. that LPCUWC be allowed to continue to remain in the DSS.

**Working Group on Direct Subsidy Scheme
Membership List**

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	Ms Virginia CHOI			
	Ms LAU Ka-shi			
	Mrs Justina LEUNG			
	Mr PANG Yiu-kai			
	Dr Carlye TSUI			
	Mrs Michelle WONG	Deputy Secretary for Education		
	Mr Steve LEE	Principal Assistant Secretary (School Development)		
	Mrs Lily TSANG	Principal Assistant Secretary (Finance)		
	Miss WU Po-ling	Principal Assistant Secretary (School Administration & Support)		
Secretary:	Mr WOO Chun-sing	Senior Education Officer (School Administration & Support)		

**Consultation Activities Conducted by
the Working Group on Direct Subsidy Scheme/
the Education Bureau**

	Date	Consultation Activities
1	24 February 2011	Luncheon meeting between Working Group members and representatives of the HK DSS Schools Council
2	22 March 2011	Seeking the HK DSS Schools Council's views on the initial proposed improvement measures during the regular meeting between the EDB and the Council
3	24 March 2011 (AM)	Visit to St Paul's Co-educational College by Working Group members
4	24 March 2011 (PM)	Visit to Good Hope School by Working Group members
5	1 April 2011 (AM)	Visit to Hong Kong Baptist University Affiliated School Wong Kam Fai Secondary and Primary School by Working Group members
6	1 April 2011 (PM)	Visit to The Hong Kong Chinese Christian Churches Union Logos Academy by Working Group members
7	7 April 2011 (AM)	Visit to Fanling Lutheran Secondary School by Working Group members
8	7 April 2011 (PM)	Visit to Fukien Secondary School by Working Group members
9	2 June 2011	Seeking the HK DSS Schools Council's views on the initial proposed improvement measures during the regular meeting between EDB and the Council
10	19 July 2011	Working Group's consultation meeting with members of the Executive Committee of the HK DSS Schools Council on the proposed improvement measures
11	7 September	Working Group's 1 st consultation session on the

	Date	Consultation Activities
	2011	proposed improvement measures - for SSBs/SMCs/IMCs representatives
12	8 September 2011	Working Group's 2 nd consultation session on the proposed improvement measures - for SSBs/SMCs/IMCs representatives
13	9 September 2011	Working Group's 3 rd consultation session on the proposed improvement measures - for principals/senior administrative staff
14	15 September 2011	Working Group's 4 th consultation session on the proposed improvement measures - for principals/senior administrative staff
15	16 September 2011	Working Group's 5 th consultation session on the proposed improvement measures - for principals/senior administrative staff
16	30 November 2011	EDB's consultation meeting with relevant members of the Committee on Home-School Co-operation on the proposed improvement measures
17	1 December 2011	EDB's consultation meeting with principals as well as members of the Executive Committee of the HK DSS Schools Council on the proposed improvement measures
18	16 December 2011	Working Group's consultation meeting with members of the Executive Committee the HK DSS Schools Council on three major areas of the proposed improvement measures
19	17 December 2011	Working Group's consultation meeting with SSBs/SMCs/IMCs representatives on three major areas of the proposed improvement measures

Summary of Working Group's Recommendations

No.	Recommendation
<i>Improvement Measures for the Fee Remission/Scholarship Schemes</i>	
1	<p><u>Paragraph 3.5</u> The Working Group recommends that the EDB should keep in view the implementation of the improvement measures of enhancing the transparency and accessibility of information on fee remission/scholarship schemes in individual DSS schools and provide advice or intervention to schools concerned where necessary.</p>
2	<p><u>Paragraph 3.8</u> The Working Group recommends that DSS schools should continue to be given the flexibility to devise their school-based arrangements to offer financial assistance to needy students over and above the current requirements outlined in paragraphs 3.1, 3.2 and 3.4.</p>
3	<p><u>Paragraph 3.12</u> The Working Group recommends that:</p> <ul style="list-style-type: none"> (a) DSS schools be encouraged to continue to explore ways to better utilize their fee remission/scholarship reserve; and (b) the proposal of setting up a centralized fund for fee remission/scholarship purposes be shelved and only be revisited if the situation of under-utilization of fee remission/scholarship reserve by DSS schools persists.
4	<p><u>Paragraph 3.15</u> The Working Group does not recommend setting a cap for scholarship.</p>
5	<p><u>Paragraph 3.18</u> The Working Group does not recommend mandating DSS schools to surrender a percentage of their school places for central allocation by the EDB.</p>
6	<p><u>Paragraph 3.24</u> The Working Group recommends the adoption of the measures set out below:</p>

No.	Recommendation
	<p>(a) DSS schools meeting the following criteria should be allowed to apply to the EDB for exemption from the requirement of adopting eligibility criteria no less favourable than those of the government financial assistance schemes to needy students:</p> <ul style="list-style-type: none"> (i) the utilization rates of their fee remission/scholarship provisions are 100% or more as reflected in the audited accounts of the past three consecutive years; and (ii) in overall terms, during the three years in question, two thirds of their fee remission/scholarship provisions or more have been used for fee remission purposes as confirmed by the schools. <p>(b) DSS schools given exemption should ensure that:</p> <ul style="list-style-type: none"> (i) students receiving fee remission before the schools adopt the revised eligibility criteria will not be affected, i.e. they will continue to receive fee remission under the previous eligibility criteria until they graduate from the schools; and (ii) sufficient notice must be given to prospective parents/students before implementing the new eligibility criteria; and in any case, the revision must be made available for public consumption as per the measures set out in paragraph 3.4; <p>(c) the exemption to DSS schools would be cancelled once:</p> <ul style="list-style-type: none"> (i) the average utilization rate of their fee remission/scholarship provisions under the revised eligibility criteria in the past three years is less than 80%; or (ii) in the past three years, on average, less than two thirds of their fee remission/scholarship provisions under the revised eligibility criteria are used for fee remission purposes.
7	<p><u>Paragraphs 3.27 & 3.28</u></p> <p>The Working Group recommends that through-train secondary and primary schools be allowed to transfer a maximum of 50% of the fee remission/scholarship reserves of the linked primary school to the linked secondary school should they meet the following conditions and obtain prior approval from the SMC/IMC:</p>

No.	Recommendation
	<p>(a) the utilization rates of the fee remission/scholarship provisions of the linked secondary school are 100% or more as reflected in the audited accounts of the past three consecutive years; and</p> <p>(b) two thirds of the fee remission/scholarship provisions or more of the linked secondary school are used for fee remission purposes as confirmed by the schools.</p> <p>Following the same logic, the Working Group also recommends that similar flexibility under identical terms be allowed for the transfer of fee remission/scholarship reserves of the secondary school to the linked primary school.</p>
<i>Strengthening the Governance and Internal Control of DSS Schools</i>	
8	<p><u>Paragraph 4.7</u> In respect of DSS schools governed by SMC/MC, the Working Group recommends the following:</p> <p>(a) at school level, the EDB to consult schools on disclosure of their composition on the EDB’s homepage;</p> <p>(b) at individual school manager level, the EDB to add a checkbox to the application form for registration as a manager with a view to seeking his/her consent of the EDB’s disclosure of his/her information including the name, tenure of office/date of registration and category of school manager. As for serving managers of SMC/MC, the EDB should seek their consent to similar disclosure through an ad hoc exercise; and</p> <p>(c) for schools with managers who refuse to give consent to the proposed disclosure, the EDB to add a remark indicating the number and categories, if applicable, of managers who have not given such consent on the relevant part of the EDB’s homepage.</p>
9	<p><u>Paragraph 4.11</u> The Working Group recommends that:</p> <p>(a) all DSS schools be required to conduct self-assessment by completing the Checklist regularly;</p> <p>(b) while the EDB would collaborate with the Hong Kong DSS Schools Council in the development of the Checklist, individual DSS schools should be given flexibility in adapting</p>

No.	Recommendation
	<p>or modifying the Checklist to suit their own needs given that their needs do vary; and</p> <p>(c) relevant training be provided to DSS schools to facilitate the effective use of the Checklist with a view to promoting over time the internalization of a self-evaluation culture in DSS schools.</p>
10	<p><u>Paragraph 4.17</u></p> <p>The Working Group recommends that all DSS schools be required to set up a governance review sub-committee (or any name the SMC/IMC sees fit) to assist the SMC/IMC in reviewing the system integrity of various management and financial control processes with regard to the requirements below:</p> <p>(a) A governance review sub-committee (or any other name the SMC/IMC sees fit) responsible for conducting regular system reviews of various key management and financial control systems and processes has to be set up by DSS schools by the 2013/14 school year;</p> <p>(b) Specifically, the governance review sub-committee should review school-based policies and processes in respect of the following aspects:</p> <p>(i) human resources management matters including staff recruitment, promotion, remuneration, etc;</p> <p>(ii) financial management matters including school budgeting, financial reporting, procurement, investment, transfer of funds from the operating reserve to designated reserves, etc;</p> <p>(iii) operation of school fee remission/scholarship schemes;</p> <p>Other management functions can be assigned to the governance review sub-committee as individual SMC/IMC deems appropriate;</p> <p>(c) Having regard to the sub-committee's operational needs in terms of a viable quorum for a meeting and for the sake of continuity, the governance review sub-committee should have a minimum of three members, with one member preferably with experience and qualification in accounting/financial management and one member being a manager of the school. To avoid conflict of interests, parents of students studying in</p>

No.	Recommendation
	<p>the school should not be invited as a member of the sub-committee. In addition, all the members should not be among the paid staff of the school;</p> <p>(d) In principle, the governance review sub-committee is required to complete a comprehensive review of the school-based policies and processes as set out in (b) (i), (ii) and (iii) and submit a comprehensive report to the SMC/IMC within a three-year cycle. Within the three-year cycle, the SMC/IMC should determine the focus of its annual review each year and the governance review sub-committee should then submit a focused review report to the SMC/IMC annually; and</p> <p>(e) While paid staff of a DSS school including the principal and senior teachers/heads of functional committees of the school should not serve as member(s) of the governance review sub-committee, they may, at the discretion of the governance review sub-committee, attend meetings or serve as resource persons to facilitate the internal review. Nevertheless, at the review sub-committee meeting(s) where the annual focused report or the comprehensive report is to be finalized before submission to the SMC/IMC, attendance should be confined to official members of the governance review sub-committee only.</p>
11	<p><u>Paragraph 4.19</u> The Working Group recommends making it a mandatory requirement for DSS schools to put up essential matters as set out below for discussion and approval at SMC/IMC meetings:</p> <p>(a) the human resource policies for senior teaching and administrative posts such as the recruitment, appointment, promotion and remuneration packages of senior teaching and administrative staff;</p> <p>(b) annual school budgets and financial report/audited account including acceptance of donations and fund raising activities;</p> <p>(c) large-scale capital works (including the SMC/IMC's determination of what constitutes "large-scale" works);</p> <p>(d) procurement of services or goods through tendering with significant financial implications (including the SMC/IMC's determination of the thresholds for different modes of procurement);</p>

No.	Recommendation
	<ul style="list-style-type: none"> (e) operation of the fee remission/scholarship scheme including an annual operational summary and criteria for the schemes; (f) fee revision proposals; (g) investment policy and update; (h) advisory letter(s) specifying for the attention of the SMC/IMC and/or any warning letter(s) (e.g. the management letter from EDB's School Audit Section); and (i) self-evaluation on schools' academic as well as non-academic performance under the School Development and Accountability Framework, including the endorsement of School Development Plan, Annual School Plan and School Report.
12	<p><u>Paragraph 4.21</u> The Working Group recommends that:</p> <ul style="list-style-type: none"> (a) the existing audit inspection of DSS schools should be replaced by a management and financial audit; (b) relevant training be provided for DSS schools before the commencement of the management and financial audit from the 2014/15 school year to allow DSS schools to acquire sufficient know-how and have ample time to prepare for the enhanced audit; and (c) a review be conducted upon the completion of the first round of the management and financial audit of DSS schools to determine whether the management and financial audit should become an on-going measure; and if so, how.
<i>Strengthening the Financial Management of DSS Schools</i>	
13	<p><u>Paragraph 5.13</u> To enable DSS schools to put in place longer-term development strategies, the Working Group recommends that the following measures in respect of the ceiling on accumulated operating reserve be adopted:</p> <ul style="list-style-type: none"> (a) the ceiling on the operating reserve which may contain both government funds and non-government funds should be set at an amount equal to 100% of the annual total expenditure, i.e. 12 months' operating expenditure as reflected in the audited accounts of the same school year;

No.	Recommendation
	<p>(b) only the balance in the operating reserve should be used to assess whether the schools’ operating reserve exceeds the ceiling, taking into account the fact that funds in the designated reserves have specific purposes;</p> <p>(c) schools with accumulated operating reserve exceeding the ceiling as reflected in the latest audited accounts should be given the following options to rectify the situation and they should be required to indicate the option they choose in their submission of the audited accounts:</p> <ul style="list-style-type: none"> (i) schools may choose to submit a plan on how to reduce school fees in the forthcoming school year so that the accumulated operating reserve will drop to below the ceiling taking into account their own long-term financial considerations; (ii) schools may choose to receive less DSS subsidy in the forthcoming school year - the amount exceeding the ceiling will be deducted from the DSS subsidy to be paid to the school in the next payment; (iii) schools may choose to return the surplus in excess of the ceiling to the Government in a specified timeframe; or (iv) schools may choose to transfer the surplus in excess of the ceiling to the fee remission/scholarship reserve subject to the following conditions being met: <ul style="list-style-type: none"> – there is no surplus in the fee remission/scholarship reserve as reflected in the latest audited accounts; – the utilization rates of the fee remission/scholarship provisions are 100% or more in the past three consecutive years; and – the amount that can be transferred to the fee remission/scholarship reserve is subject to EDB’s approval.
14	<p><u>Paragraphs 5.15 & 5.16</u></p> <p>The Working Group recommends that DSS schools be allowed to grandfather the reserve including assets in excess of the reserve ceiling accumulated before the implementation of the recommendation concerning reserve ceiling. This notwithstanding, the grandfather arrangement is subject to the</p>

No.	Recommendation
	<p>following conditions being complied with:</p> <ul style="list-style-type: none"> (a) schools submit to the EDB plans with detailed accounts of their reserves including their types, proposed usage and, where necessary, timeframe for deployment endorsed at SMC/IMC meetings within a specified timeframe to be set by the EDB; and (b) the plans are approved by the EDB. <p>The Working Group also recommends that the EDB should take into account schools' grandfathered reserve when processing any applications from schools for tuition fee increase or for setting up a designated reserve for construction, maintenance and upgrading of above-standard facilities as recommended in paragraph 5.23.</p>
15	<p><u>Paragraph 5.23</u></p> <p>The Working Group recommends that DSS schools with genuine needs for constructing, maintaining or upgrading above-standard facilities be allowed to set up a reserve for the purpose subject to the following conditions being met:</p> <ul style="list-style-type: none"> (a) concrete plans with purposes, timeframe/cashflow and funds required have to be deliberated and approved by the SMC/IMC; (b) Parent-Teacher Associations have to be consulted about the plans (all parents have to be consulted if the reserve is used for new above-standard capital works); (c) the amount to be transferred to the reserve for above-standard facilities should be no more than 10% of the school fee incomes of each school year; (d) there is no need to consult the EDB beforehand if after the proposed transfer, there remains cash in the operating reserve equivalent in amount to at least six months' the school's expenses. Instead, such a transfer should be detailed in the audited accounts to be submitted to the EDB; (e) the EDB's <i>prior</i> approval should however be sought if the school intends to transfer more than 10% of the annual school fee income or if after the transfer, cashflow in the operating reserve account falls below six months' expenses of the school; and (f) the EDB should not give approval to the application should the

No.	Recommendation				
	cashflow in the operating reserve account fall below three months' expenses after the proposed transfer.				
16	<p data-bbox="325 371 555 405"><u>Paragraph 5.26</u></p> <p data-bbox="325 416 1345 618">The Working Group recommends that the following measures be adopted with a view to enhancing the regulation of investment activities that DSS schools may conduct and ensuring that the financial situation of DSS schools remains sound and healthy after the investment:</p> <ul style="list-style-type: none"> <li data-bbox="325 645 1345 763">(a) under no circumstances should DSS schools be allowed to use the funds in the operating reserve or the fee remission/scholarship reserve for investment; <li data-bbox="325 790 1345 909">(b) DSS schools should seek their SMC/IMC's approval before making investment decisions and such approval and factors for consideration must be clearly documented; <li data-bbox="325 936 1345 1099">(c) the only funds that may be used for investment are the long service payment reserve, donations with specific purposes and the reserve for construction, maintenance and upgrading of above-standard facilities; <li data-bbox="325 1126 1345 1245">(d) DSS schools should only be allowed to invest in (i) HK dollar bonds; and (ii) HK dollar certificates of deposits according to the prescribed criteria/conditions; and <table border="1" data-bbox="392 1261 1323 1693"> <thead> <tr> <th data-bbox="392 1261 775 1301">Type of Investment</th> <th data-bbox="775 1261 1323 1301">Investment Criteria/Conditions</th> </tr> </thead> <tbody> <tr> <td data-bbox="392 1301 775 1693"> HK dollar bonds or certificates of deposits (CD): ✧ short to medium term with a maturity period of one to five years </td> <td data-bbox="775 1301 1323 1693"> ✧ The credit rating of the issuer must not be lower than the rating of A3 given by Moody's Investors Service Inc. or A- given by Standard & Poor's Corporation. ✧ The bank must be licensed under the Banking Ordinance, Cap. 155. </td> </tr> </tbody> </table> <ul style="list-style-type: none"> <li data-bbox="325 1720 1345 1921">(e) DSS schools should be alerted to the liquidity constraints of the certificates of deposits and corporate bonds in the secondary markets and be advised to make allowance for contingencies in projecting the use of their designated reserves. 	Type of Investment	Investment Criteria/Conditions	HK dollar bonds or certificates of deposits (CD): ✧ short to medium term with a maturity period of one to five years	✧ The credit rating of the issuer must not be lower than the rating of A3 given by Moody's Investors Service Inc. or A- given by Standard & Poor's Corporation. ✧ The bank must be licensed under the Banking Ordinance, Cap. 155.
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17	<u>Paragraph 5.28</u>				

No.	Recommendation
	<p>The Working Group recommends that two requirements be added to existing requirements for the purchase of properties by DSS schools:</p> <p>(a) DSS schools should be required to keep at least an amount equivalent to six months' operating expenditure in cash after the purchase of properties; and</p> <p>(b) DSS schools should not be allowed to purchase properties through mortgages or any other borrowing arrangements.</p>
18	<p><u>Paragraph 5.31</u></p> <p>To strike a balance between meeting the public expectation for increased transparency of the use of school funding and addressing the practicality at school end, the Working Group recommends that the following measures be implemented:</p> <p>(a) DSS schools are required to disclose annually their major expenditures (including staff remuneration; repair & maintenance; fee remission/scholarship; learning and teaching resources; and miscellaneous expenditures) in terms of percentages of their annual overall expenditures;</p> <p>(b) DSS schools are required to disclose annually the cumulative operating reserve in terms of equivalent months of operating expenditure as well; and</p> <p>(c) to ensure meaningful disclosure and comprehensibility of the data, a template for enhancing the transparency of school's financial management should be developed. To further ensure that the disclosure will be fit-for-purpose and not over-burdensome, EDB should develop the template in consultation with the Hong Kong DSS Schools Council.</p>
<i>Training for School Personnel of the DSS Schools</i>	
19	<p><u>Paragraph 6.4</u></p> <p>To prepare DSS schools to take forward the new proposed improvement measures for enhancing the governance, management and administration of DSS schools and to tackle the non-compliance problems, the Working Group recommends that the training programmes as set out in paragraphs 6.5 to 6.10 be adopted and a steering committee as detailed in paragraphs 6.11 to 6.12 be set up to oversee the design and implementation of the training programmes.</p>

No.	Recommendation
20	<p><u>Paragraph 6.14</u></p> <p>The Working Group recommends that the existing practice of inviting school managers of DSS schools to the structured training programmes for school managers should continue. To cater for the special needs of managers of DSS schools, the Working Group has also recommended that an optional module on deployment of resources specifically for DSS school managers be added to the existing programmes.</p>
<i>Measures to Ensure Compliance of Requirements of the Direct Subsidy Scheme by Schools</i>	
21	<p><u>Paragraph 7.5</u></p> <p>The Working Group recommends that on top of the existing measures as set out in paragraphs 7.2 and 7.3, the following new measures be put in place:</p> <ul style="list-style-type: none"> (a) escalation of advisory letters to supervisors at the earliest opportunity – if a school, without any reasonable justification, fails to comply with a rule/guideline or rectify the malpractice within a given time-frame after the principal of the school is served with an advisory/warning letter, follow-up advisory/warning letters will be issued to the supervisor of the school, copied to the school principal; (b) escalation of warning letters to SMC/IMC members at the earliest opportunity – if a school, without any reasonable justification, fails to comply with a rule/guideline or rectify the malpractice within a given time-frame after a advisory/warning letter has been written to the supervisor of the school, follow-up advisory/warning letters will be sent to the supervisor again but this time, the letter will be copied to all the SMC/IMC members of the school as well; (c) disclosure of the non-compliance or malpractice – after exhaustion of the steps in paragraphs 7.5(a) and 7.5(b) above and if the malpractice remains to be rectified, the regional Principal Education Officers of the EDB may put up the case for discussion by the Task Force on DSS. With the Task Force’s endorsement, the EDB will post the non-compliance (including a description of the malpractice) with the school concerned named on the EDB’s website; and (d) suspension of DSS subsidy – if a school fails to comply with an important requirement or rectify serious malpractice after

No.	Recommendation
	<p>exhaustion of the steps mentioned in paragraphs 7.5(a) and 7.5(b) above, the Task Force on DSS may decide to take the measure in paragraph 7.5(c) prior to, or in addition to, withholding part of the DSS subsidy of the school until rectification is made. In order to ensure that the interests of students are not unduly affected, the EDB will assess the financial situation of the school before withholding the school's DSS subsidy.</p>
<p><i>Status of Li Po Chun United World College of Hong Kong in the Direct Subsidy Scheme</i></p>	
22	<p><u>Paragraph 8.14</u> Having reviewed the justifications put forward by the then ED and EMB for allowing Li Po Chun United World College of Hong Kong (LPCUWC) to remain in the DSS in 1999 and 2002, and taken into account the uniqueness of LPCUWC, the benefits it brings to students in Hong Kong and the downside of changing the funding mode of LPCUWC as set out in paragraphs 8.7 to 8.13, the Working Group recommends the continuation of the status quo, i.e. that LPCUWC be allowed to continue to remain in the DSS.</p>

Major Recommendations put forward by the Audit Commission

I. Relating to Fee Remission/Scholarship Schemes

Para. 3.9

Audit has recommended that the Secretary for Education should:

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

Para. 3.17

Audit has recommended that the Secretary for Education should:

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

II. Relating to Governance and Internal Control of DSS Schools

Para. 2.8

Audit has recommended that the Secretary for Education should urge

all DSS schools to:

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

Para. 2.15

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

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

Para. 2.23

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

- (a) monitor the attendance of school managers at school governing body meetings and take action, where necessary, to improve the attendance rate;
- (b) rectify the decisions made at their school governing body meetings where a quorum was not present;
- (c) take necessary measures to ensure that, in future, a quorum is present at every school governing body meeting; and
- (d) issue draft minutes of school governing body meetings in a timely manner and to properly record the deliberations and decisions made at these meetings.

Para. 2.28

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

- (a) a proper system is put in place for managing potential conflict of interest of school managers; and
- (b) the procedures for managing conflict of interest of school

managers are complied with.

III. Relating to Financial Management of DSS Schools

Para. 5.8

Audit has recommended that the Secretary for Education should:

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

Para. 5.13

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

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

Para. 5.17

Audit has recommended that the Secretary for Education should:

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

Para. 5.22

Audit has recommended that the Secretary for Education should consider requiring DSS schools to ensure that their non-local students are not cross-subsidized by the government subsidy for local students. For example, the EDB may require those schools which admit non-local students to collect from the non-local students an amount of school fees not less than the DSS unit subsidy plus the approved school fees for local students.

Para. 5.28

Audit has recommended that the Secretary for Education should take necessary measures to ensure that DSS schools:

- (a) submit their annual audited accounts in a timely manner; and
- (b) comply with the requirement to include a statement in their auditor's reports stating whether they have used the government subsidies in accordance with the rules promulgated for the DSS.

Para. 5.32

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

Para. 5.36

Audit has recommended that the Secretary for Education should remind DSS schools to ensure that only approved expenditure items are charged to the government fund accounts.

Para. 5.44

Audit has recommended that the Secretary for Education should:

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

Para. 5.48

Audit has recommended that the Secretary for Education should take

necessary measures to ensure that the EDB's guidelines on investment of surplus funds of schools are complied with by DSS schools.

Para. 5.52

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

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

Para. 5.60

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

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

IV. Relating to Non-compliance Problems in the Aspects of Financial Management and Human Resources Management of DSS schools

Para. 5.13

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

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

Para. 5.17

Audit has recommended that the Secretary for Education should:

- (a) remind DSS schools of the requirements relating to self-financing activities stipulated in Financial Circular No. 9/2004; and
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- (b) retain the financial statements for fund raising activities for audit purposes;
- (c) seek written permission from the EDB for the fund raising activities held for other organizations which are not approved charitable institutions, or not specifically approved by the EDB; and
- (d) formulate guidelines on fund raising activities and require their staff to comply with the guidelines.

Para. 6.12

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

- (a) formulate a proper staff recruitment policy and keep all the recruitment records which are consistent with the best practices promulgated by the EDB;
- (b) carry out recruitment of staff in an open and fair manner;

- (c) ensure that applicants are interviewed by selection panels appointed by the school governing bodies;
- (d) report to their school governing bodies the results of staff recruitment;
- (e) ensure that approval from school governing bodies is obtained before a teacher is appointed for a term of not less than six months; and
- (f) provide accurate information to the school governing bodies in seeking their approval for appointing new teachers.

Para. 6.17

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

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

Para. 6.21

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

- (a) establish and implement an effective performance management system for their staff; and
- (b) review the operation of the performance management system periodically by making reference to the guidelines issued by the EDB.

Para. 6.25

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

- (a) submit the staff performance appraisal results for the school governing bodies' consideration when seeking their decisions

- on matters of staff contract renewal; and
- (b) properly document the justifications for contract renewal decisions to prevent allegations of favouritism or unfairness.

**Major Recommendations put forward by
the Public Accounts Committee of the Legislative Council**

I. Relating to Fee Remission/Scholarship Schemes

The PAC strongly urges the Secretary for Education to:

- apart from requiring DSS schools to improve their fee remission/scholarship schemes, conduct a comprehensive review to explore effective measures to ensure that students from grassroots families will have a fair chance of studying in DSS schools, such as providing sufficient financial subsidy to needy students for meeting the necessary expenses of studying in such schools other than school fees, and consult the Panel on Education in the review;
- step up the EDB's monitoring of DSS schools' compliance with its requirements on fee remission/scholarship schemes and to enhance public awareness of the schemes, so that parents can take them into account when considering whether to apply for their children's admission to DSS schools; and
- take measures to ensure that DSS schools will not discriminate against Comprehensive Social Security Assistance (CSSA) students in administering their fee remission/scholarship schemes.

II. Relating to Governance and Internal Control of DSS Schools

The PAC strongly urges/urges the Secretary for Education to:

- put in place measures to enhance the internal control of DSS schools and take effective intervention measures to ensure timely rectification of identified cases of non-compliance;
- require the Working Group to accord top priority to reviewing the EDB's control and monitoring mechanism instituted for DSS schools to ensure that it is sound and effective, so that non-compliance with the EDB's requirements and malpractices will be detected in a timely manner, rigorous actions will be taken to enforce compliance and rectification, and appropriate punitive measures commensurate with the gravity of the

problems will be taken against the schools concerned;

- consider devising a self-assessment system for DSS schools to declare if they have complied with various financial management requirements of the EDB and request the schools to document the justifications for not complying with the requirements; and
- expeditiously implement the following audit recommendations:

The Secretary for Education should urge/remind DSS schools to:

- include representatives of key stakeholders in their school governing bodies;
- disclose to the public information of their governing bodies, including the name, tenure of office and category of each school manager;
- ensure that parent school managers of the IMC are elected through a secret-ballot election conducted by the PTA of the school, in which all parents can participate, and keep proper records of the election;
- ensure that all school managers are registered;
- inform the EDB within a month after a person ceases to be a school manager;
- monitor the attendance of school managers at school governing body meetings and take action, where necessary, to improve the attendance rate;
- rectify the decisions made at their school governing body meetings where a quorum was not present;
- take necessary measures to ensure that, in future, a quorum is present at every school governing body meeting;
- issue draft minutes of school governing body meetings in a timely manner and to properly record the deliberations and decisions made at these meetings;

- ensure that a proper system is put in place for managing potential conflict of interest of school managers; and
- ensure that the procedures for managing conflict of interest of school managers are complied with.

III. Relating to Financial Management of DSS Schools

The PAC urges the Secretary for Education to:

- closely monitor the progress made by the school concerned in transferring the three properties to the SMC to ensure that the transfer would be completed without delay;
- put in place measures to enhance the internal control of DSS schools and take effective intervention measures to ensure timely rectification of identified cases of non-compliance;
- consider devising a self-assessment system for DSS schools to declare if they have complied with the various financial management requirements of the EDB and request the schools to document the justifications for not complying with the requirements;
- provide more training for staff of DSS schools to familiarize them with the EDB's various requirements in financial management to help ensure compliance; and
- accord a high priority to exploring measures to ensure that the planning and undertaking of large-scale capital works by DSS schools will not cause undue impact on their level of school fee and parents' affordability.

IV. Training for School Personnel of the DSS Schools

The PAC urges the Secretary for Education to:

- provide more training for staff of DSS schools to familiarize them with the EDB's various requirements in financial management to help ensure compliance; and
- provide more training for staff of DSS schools to familiarize them with the EDB's various requirements in human resource

management to help strengthen the schools' internal control mechanism.

**Comparison of Resources Deployment
between Aided Schools and Direct Subsidy Scheme Schools**

		Aided Schools	DSS Schools
1	Salary of teachers	<ul style="list-style-type: none"> ✧ The salary of teachers is governed by the Code of Aid. ✧ Teachers' salary credited by the government to teachers' bank accounts via their serving schools. 	<ul style="list-style-type: none"> ✧ The salary scale of DSS schools needs not follow that of aided schools and DSS schools can devise school-based remuneration packages for their teachers. ✧ Teachers' salary is included in the block grant disbursed to schools which can be flexibly deployed by them.
2	Staff establishment	The staff establishment is governed by the Code of Aid.	DSS schools are given autonomy in determining the number and rank of teaching and non-teaching staff to be employed. Nevertheless, the teacher to class ratio and the ratio of graduate to non-graduate teachers in DSS schools should not be lower than the prevailing standards in aided schools.
3	Procurement of goods and services	Schools have to observe the tendering and purchasing procedures including the tendering and quotation limits issued by the EDB.	While DSS schools should follow as far as possible EDB's guidelines on procurement procedures for aided schools, they can devise

		Aided Schools	DSS Schools
			their own tendering and purchasing procedures so long as they are fair, open and transparent.
4	School fee	Small amount of Tong Fai (from senior secondary students) and other collections are allowed on a pre-approved basis.	With EDB's prior approval, schools can charge their students school fees for provision of additional and 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.

**List of Approved Items of Expenditure for the
Direct Subsidy Scheme Government Subsidy¹¹**

Advertising
Audit fee
Bank charges
Bank interest and overdraft interest
Approved repayment of loan and interest thereon
Curriculum development
Depreciation
Insurance for fire, theft, public liability and employee compensation
Postage and stamp duty
Newspaper and magazines
Telephones
Celebrations and entertainment
Wreaths, flower-baskets and similar tributes on behalf of the school
Professional fees for essential professional advice of a legal, architectural, or similar nature
Travelling allowances, meals or light refreshments for occasional guest speakers
Expenditure on supplementary teaching staff
Expenditure on staff training
Repairs and maintenance
Transport and travelling expenses wholly incurred on school business, excluding travel between home and school
Teachers' textbooks, maps, etc.
Consumable stores
Fuel, light and power
Cleaning materials
Prizes
Long service payment/severance pay (In accordance with the Employment Ordinance)
Non-teaching staff salaries
Teaching staff salaries
Provident fund for teaching and non-teaching staff
Retirement or death benefits for staff not eligible for any other scheme, provided that such benefits do not exceed those available to similar staff eligible for another scheme, such as provident fund
Government rates and rent

¹¹ Not for the depreciation, maintenance and running cost of above-standard facilities such as swimming pool, school bus, etc.

Water charges
First-aid facilities
Sports
Extra-curricular activities
Printing and stationery
Library books for students
Miscellaneous items for educational purposes