Guide to Corporate Governance for Subvented Organisations

June 2015
Second Edition

效率促進組
EFFICIENCY UNIT

服務市民
SERVING THE COMMUNITY

CONTENTS

Preface to Second Edition

The first edition of this guide was published in May 2010 to provide user-friendly advice on good practice in corporate governance for all those responsible for management and oversight of subvented agencies. The guide was produced with the help of expert practitioners in the private sector, academia and the public sector.

With the new Companies Ordinance (Cap. 622) having come into effect in March 2014, this second edition is being issued to update *Chapter 8: Legal Issues*, and revise related sections in other chapters.

Foreword

In Hong Kong, a myriad of quality public services have been put in place to benefit the whole community. While some of such services are directly delivered by the Government, many are provided by numerous subvented organisations, ranging from large statutory bodies to small associations that offer education, health, welfare, sports, cultural and other support services at city-wide as well as neighbourhood level. They are our valuable partners and through this partnership, the Government seeks to give opportunities for the talented and skilled from various backgrounds so that they can help provide effective and flexible services for the community. Good governance is essential for these organisations to ensure proper use of public resources to the benefit of the people they serve.

I welcome the timely issue of this revised Guide to Corporate Governance for Subvented Organisations. I believe that those who hold responsibility for the governance of subvented organisations have continuously assessed their organisations' achievement in good governance since publication of the first edition in 2010. I sincerely hope that with this updated version, they will map out the next steps to implement effective governance practices with an innovative mindset, thereby furthering the cause of building a better society.

Carrie Lam
Chief Secretary for Administration

Foreword

Good governance is needed in every area of activity to which public funds are applied. The public has a right to know that their money is being put towards purposes of public value and that the organisations through which these funds flow are conducted in a manner that inspires confidence that the money is being used wisely and well for the public benefit.

With about 40% of recurrent government expenditure being channelled through subvented organisations each year, the need for careful attention to this matter is obvious.

I welcome the production of this guide and trust that it will prove helpful to all those who hold responsibilities for the governance of subvented organisations.

John C Tsang
Financial Secretary

IF YOU READ NOTHING ELSE, READ THIS —

KEY POINTS

- Corporate Governance refers to the processes by which organisations are directed, controlled and held to account. It encompasses authority, accountability, stewardship, leadership, direction and control exercised in the organization.
- The Government considers it essential that subvented organisations attain, and maintain, high standards of corporate governance.
- Many subvented organisations receive substantial recurrent funding from the public purse, and so must be accountable to both the Government and the community.
- The board of each subvented organisation is responsible for its activities and performance.
- The board and individual board members of subvented organisations have important responsibilities for corporate governance. They need to discharge their responsibilities with a serious, professional, committed and honest approach.
- There is no “one-size-fits-all” corporate governance model.
- Subvented organisations should establish effective and appropriate arrangements for their board of directors, to ensure that it has the necessary skills and experience available to it, that board meetings are conducted in a professional manner, and that board decisions are implemented in a timely and effective way.
- Boards need to consider the various arrangements necessary and appropriate to the subvented organisation’s circumstances, then implement, monitor and review these arrangements. Of particular importance are –

- compliance with relevant legislation and common law requirements;
- compliance with Memorandum of Administrative Arrangements or other funding agreements with the Government;
- compliance with the organisation's Articles of Association, if one exists (The Memorandum of Association of a company incorporated before 3 March 2014 is deemed to be part of the Articles of Association under the Companies Ordinance (Cap. 622));
- sound budgetary and financial management;
- internal and external auditing arrangements;
- effective performance monitoring;
- appropriate levels of transparency within the organisation, and between the organisation and its stakeholders;
- proper management of conflicts of interest and establishment of codes of conduct; and
- maintenance of effective communication between the board and its stakeholders including its staff.

• Subvented organisations need to establish a clear working relationship between the chairperson and the Chief Executive Officer, and between the board and the senior management. There should be a clear understanding of the relevant roles, responsibilities, delegations of authority, checks and balances and so on.

• The Government is responsible and accountable for the proper use of public funds, and is duty bound to monitor the activities and performance of publicly funded bodies to ensure that public monies are properly used for their intended purposes. Subvented organisations are obliged to cooperate with the Government's monitoring.

• Subvented organisations should aim to introduce the best practices outlined in this Guide. Where this is not appropriate, the organisation should be prepared to explain to its members and stakeholders why not– the "comply or explain" principle.

INTRODUCTION

(1) This Guide to Corporate Governance for Subvented Organisations (the Guide) is intended to help board members and senior executives of these organisations. By setting out principles and best practices relating to the corporate governance of such organisations, advising on matters that have raised concern, and providing checklists, it is intended to help individuals and organisations to assess the way in which they are discharging their duties and decide whether changes need to be made. The goal is to help sustain public trust in bodies which receive public funds.

(2) The Guide is aimed primarily at organisations that receive recurrent subventions from the Government to cover part or all of their operational expenses. Nevertheless, organisations that receive capital grants, non-cash concessions or one-off payments, and companies in which Government holds shares are also encouraged to refer to the best practices promulgated in the Guide.

(3) The primary responsibility for the behaviour and performance of any subvented organisation lies with the board of that organisation.

(4) Subvented organisations are diverse in size, purpose and the extent of public funding provided. There are over 1 000 organisations receiving recurrent subventions from the Government, including schools, welfare non-governmental organisations (NGOs), hospitals and clinics, National Sports Associations, statutory organisations such as the Consumer Council, arts and sports bodies, youth groups, and district and rural associations.

(5) Clearly, there is no "one-size-fits-all" corporate governance arrangement that is appropriate to all. Subvented organisations are encouraged to draw on the advice and guidance contained herein to establish their own directives. Common sense and judgement should be used to apply the basic expectations and principles set out in the Guide to each organisation's circumstances.

An organisation may not find it appropriate to adopt a particular practice suggested in the Guide, or may not be able to do so. In either case it is important to understand and be ready to explain the reason why this is so.

Proper planning and training so that any necessary changes are implemented effectively is also advisable. Identifying priorities and a practical timetable for phasing in new practices is better than hasty reaction.

(6) The Guide does not have a binding effect on subvented organisations. To render the Guide or any government regulations binding over a subvented organisation, a specific requirement of compliance should be contained in an agreement, such as a Memorandum of Administrative Arrangements (MAA), or funding agreement with a specified subvented organisation.

(7) High standards of corporate governance are critical for public trust in subvented organisations. Failure to meet such standards is damaging to reputations and calls into question continued public funding.

(8) The Guide does not compromise, or limit the effect of statutory provisions, decisions of the Chief Executive in Council or the Finance Committee of the Legislative Council governing the operation and control of a subvented organisation. Those provisions or decisions prevail until they are superseded, updated or amended. Similarly, the terms of existing MAA and other tailor-made instruments such as the relevant codes of aid for aided schools, the Lump Sum Grant (LSG) Manual for Welfare Services, University Grants Committee (UGC) Notes on Procedures, terms and conditions of the Direct Subsidy Scheme, terms and conditions for subsidies to subsidised schools, and various grant agreements between departments and organisations, continue to take precedence. Internal circulars or memoranda issued by individual departments should also be observed in the event of conflict with this Guide.

(9) Corporate governance is an evolving concept. Many of the good practices set out in this Guide are recent developments. Some dated legislation, MAA or other tailor made instruments may need to be reviewed and amended in light of these developments. Readers are also advised to conduct regular reviews of their corporate governance practices to take account of changes in need and expectation. This Guide will be reviewed and updated from time to time to assist subvented organisations with relevant new practices.

(10) Subvented organisations have a wide range of structures, sizes and complexity. No single Guide can prescribe what is appropriate for all of them. Nor can legislation, regulations, funding agreements or codes dictate how people will think, act or behave. The most important thing is that all concerned adhere to the spirit and ethics of good corporate governance. The United Kingdom Independent Commission on Good Corporate Governance in Public Services[1] identifies the key principles of good governance:

- Focusing on the organisation's purpose and on outcomes for citizens and service users
  - being clear about the organisation's purpose and its intended outcomes for citizens and service users
  - making sure that users receive a high quality service
  - making sure that taxpayers receive value for money

- Performing effectively in clearly defined functions and roles
  - being clear about the functions of the board
  - being clear about the responsibilities of directors and the staff, and making sure that those responsibilities are carried out
  - being clear about relationships between directors and the public

- Promoting values for the whole organisation and demonstrating the values of good governance through behaviour
  - putting organisational values into practice
  - individual directors behaving in ways that uphold and exemplify effective governance

- Taking informed, transparent decisions and managing risk
  - being rigorous and transparent about how decisions are taken
  - having and using good quality information, advice and support
  - making sure that an effective risk management system is in operation

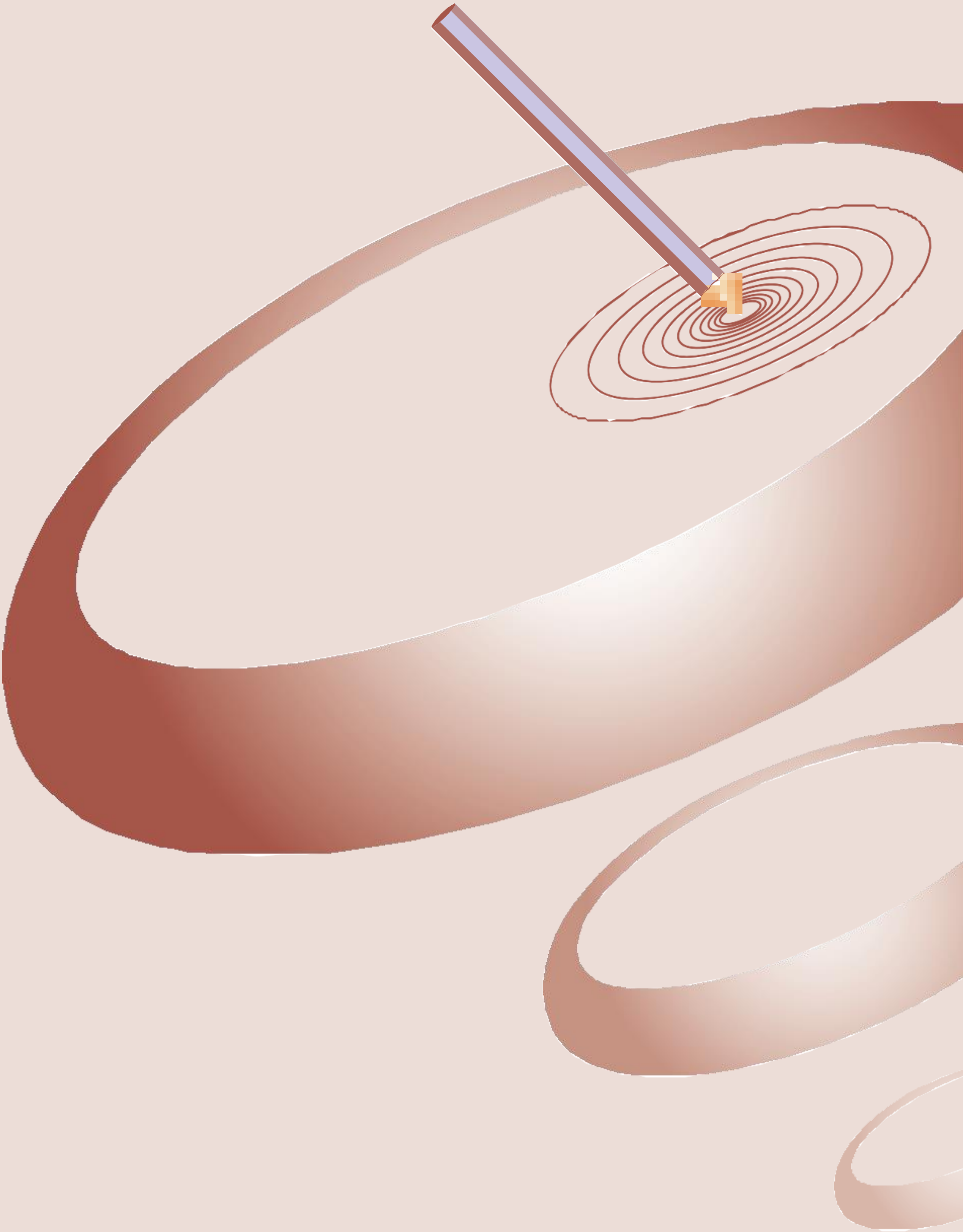
- Developing the capacity and capability of the board to be effective
  - making sure that directors have the skills, knowledge and experience they need to perform well
  - developing the capability of people with governance responsibilities and evaluating their performance, as individuals and as a group
  - striking a balance, in the membership of the board, between continuity and renewal

- Engaging stakeholders and making accountability real
  - understanding accountability relationships
  - taking an active and planned approach to dialogue with and accountability to the public
  - taking an active and planned approach to responsibility to staff
  - engaging effectively with institutional stakeholders

(11) A checklist to assess whether suitable administrative arrangements are in place is at Annex 1.

CHAPTER 1

OVERVIEW OF CORPORATE GOVERNANCE



What is Corporate Governance?

1.1 Corporate governance refers to the processes by which organisations are directed, controlled and held to account. It encompasses authority, accountability, stewardship, leadership, direction and control exercised in the organisation[2].

1.2 An organisation exists to achieve certain objectives on behalf of its stakeholders (key stakeholders could be individual service users, the community as a whole, government as regulator, government and other funding sources, sponsors, staff and, if applicable, volunteers). The goal of corporate governance is to create safeguards[3] enabling these objectives to be achieved. For this purpose, the organisation should be managed and controlled, and should be accountable for its activities to its stakeholders through a board of directors (board) or supervisor appointed on behalf of the stakeholders. Corporate governance concerns the principles and practices adopted by a board that assure its key stakeholders that the organisation is being managed effectively.

1.3 The concept of corporate governance originated in the private sector, but is very relevant to the public sector. Good corporate governance means that the organisation's stakeholders can rely on the organisation to do its work well, with integrity, transparency and accountability.

1.4 It is most important that subvented organisations, even if of a voluntary nature, understand that they are publicly accountable bodies and conduct themselves accordingly.

Why is Corporate Governance Important?

1.5 The Government provides subventions to a large number of non-departmental public bodies and NGOs to deliver public services. The non-departmental public bodies are usually statutory organisations such as the Hospital Authority or the Trade Development Council. NGOs are usually incorporated under the Companies Ordinance (Cap. 622, or Cap. 32 before 3 March 2014) as limited companies or as societies registered under the Societies Ordinance (Cap. 151). In some cases large amounts of public assets, funds and resources are governed by the boards of these organisations. Furthermore, users of their services often have little or no option to go elsewhere to obtain such services. It is particularly important, therefore, that appropriate steps are taken to ensure that high quality services are provided.

1.6 There are other organisations which receive one-off capital grants or non-cash concessions such as free or concessionary land from the Government. There are also entities which receive grants under various funds, e.g. the funds established by the Innovation and Technology Commission or the Sustainable Development Fund. Whilst strictly speaking these are not covered by this Guide, these and other entities may also consider whether their corporate governance arrangements would stand up to public scrutiny, and whether they would benefit from following this Guide.

1.7 In the past few years the Director of Audit has conducted a number of reviews on subvented organisations[4]. Varying degrees of inadequacies in their corporate governance systems, processes and practices have been found in all cases. Issues as fundamental as basic accounting practices have been found wanting.

KEY QUOTE

"Good Corporate Governance is essential to the credibility, success and sustainability of an organisation, whether it is in the private or public sector. While achieving good corporate governance may not guarantee success, without it, failure is almost certain".

Benjamin Tang, Director of Audit (2003-2012)

Examples of Inadequacies among Subvented Organisations[5]

(1) Board structure and composition

- ☹ Poor composition and mix of board membership and too many board members
- ☹ The posts of chairperson and Chief Executive Officer (CEO) are filled by the same person
- ☹ Reappointing board members with low attendance rates

(2) Board operation and effectiveness

- ☹ Lack of guidelines/manual on meeting proceedings
- ☹ Lack of records on votes taken at board/committee meetings
- ☹ Late submission of papers to board/committee members
- ☹ No declaration of interests by board members

(3) Strategy, planning and monitoring

- ☹ Not preparing strategic plans in a timely manner
- ☹ No annual business plan
- ☹ Lack of budgetary control requirements, processes and management systems

(4) Transparency and disclosure

- ☹ Non-disclosure of performance measures
- ☹ No periodic reviews of performance measures
- ☹ Lack of outcome indicators

(5) Risk management and compliance

- ☹ Non-compliance with rules on management of investments
- ☹ Requirements for submitting annual reports to oversight departments not followed
- ☹ Reporting errors in organisation's annual accounts, e.g. ineligible expenditure claims, spending limits exceeded

(6) Corporate citizenship

- ☹ Not providing community services in the organisation's area of expertise
- ☹ Register of directors' interests not available for public inspection

Corporate Governance Model

1.8 The Guide follows the generic structure outlined in the following corporate governance model. There is no single structure or practice that is applicable to all organisations. Readers should not blindly follow all the practices promulgated in the Guide but adapt them as appropriate. Readers should take into consideration the size, nature and activities of an organisation when adapting the best practices set out in this Guide.

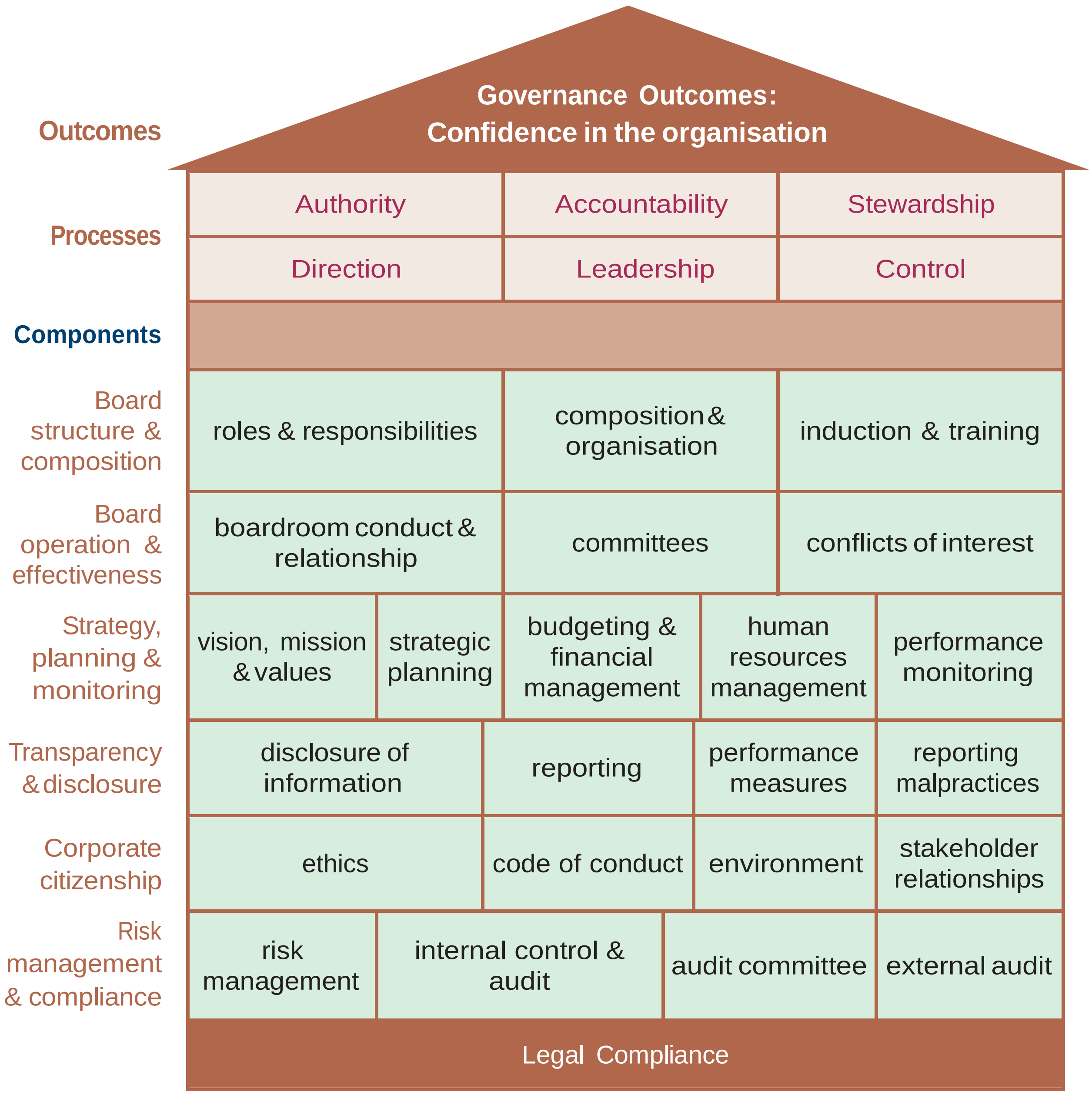


Figure 1.1
The House of Corporate Governance

KEY QUOTE[2]

"Good corporate governance is more than just prescribing particular corporate structures and complying with a number of accepted rules. Instead, it is about a range of broad principles which should be applied flexibly to the varying circumstances of individual organisations in a way that facilitates appropriate accountability and performance."

Australian National Audit Office (1999)

Managing the Relationship

1.9 The successful delivery of subvented services hinges on the clarity of the subvention agreement and the quality of the relationship between the three related parties, i.e. sponsoring department, subvented organisation and service users.

- **Sponsoring department –** Departments should not micro-manage any subvented organisation. Nor should they take any action inconsistent with a statutory body's legislation, or interfere with the substance of an oversight agency's tasks. However, it is proper that they should take into account the quality of corporate governance in a subvented organisation and the evidence of its commitment to achieve and sustain good standards when considering the allocation of public funds. Officers with oversight responsibilities are obliged to follow the guidelines and broad principles laid down by:

– Administration Wing Circular Memorandum "No. 2/2003 - Internal Review of Remunerations of Senior Executives of Government-funded Bodies and New Guidelines Arising from the Review" and "CSO/AW L/M 1/2011 - Sharing Good Records Management Practices with Government-owned or Funded Statutory Bodies"

– Financial Circular No. 9/2004 - Guidelines on the Management and Control of Government Funding for Subvented Organisations

– General Circular No. 8/2008 - Governance of Government-owned or Funded Statutory Bodies

– Other relevant departmental circulars

- **Subvented organisation –** An organisation should deliver services to its end users in accordance with the agreed service requirements. It must also satisfy the department and the public that it is achieving acceptable standards of corporate governance and is being prudent in its expenditure of public funds. The organisation should understand that the department must monitor the use of public funds for public accountability's sake, and it should cooperate with government officials who have oversight responsibilities.

- **Service users –** End users play an important role in monitoring the quality of service delivery. The organisation concerned should put in place mechanisms to encourage regular and structured feedback.

KEY QUOTE

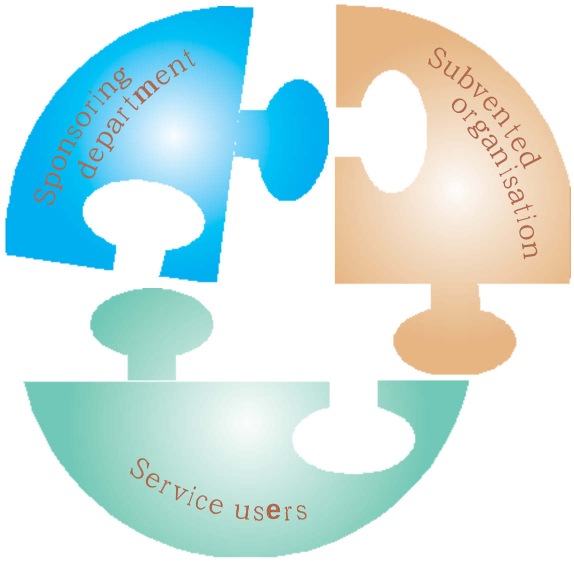
"It is important that we are clear about what kind of a role we want to define for ourselves. Do we want to be a micro-manager or do we want to take a macro view of how a subvented organisation is delivering its services? The bureau's role should be commonly understood by all concerned."

Ms Sandra Lee, Permanent Secretary for Food & Health (Health) (2007-2011)

1.10 It is important that the relationship between the three parties is properly managed.

- **Managing expectations.** To avoid unnecessary disputes, both the organisation and the department must cooperate and manage each other's expectations. The department must explain to the subvented organisation how the department operates and how to work effectively within its environment. For example, the organisation should be notified of how long it will take to obtain approval from the department for changes to the agreed service delivery standards.

  The subvented organisation on the other hand must inform the department of how it is going to meet the service requirements.



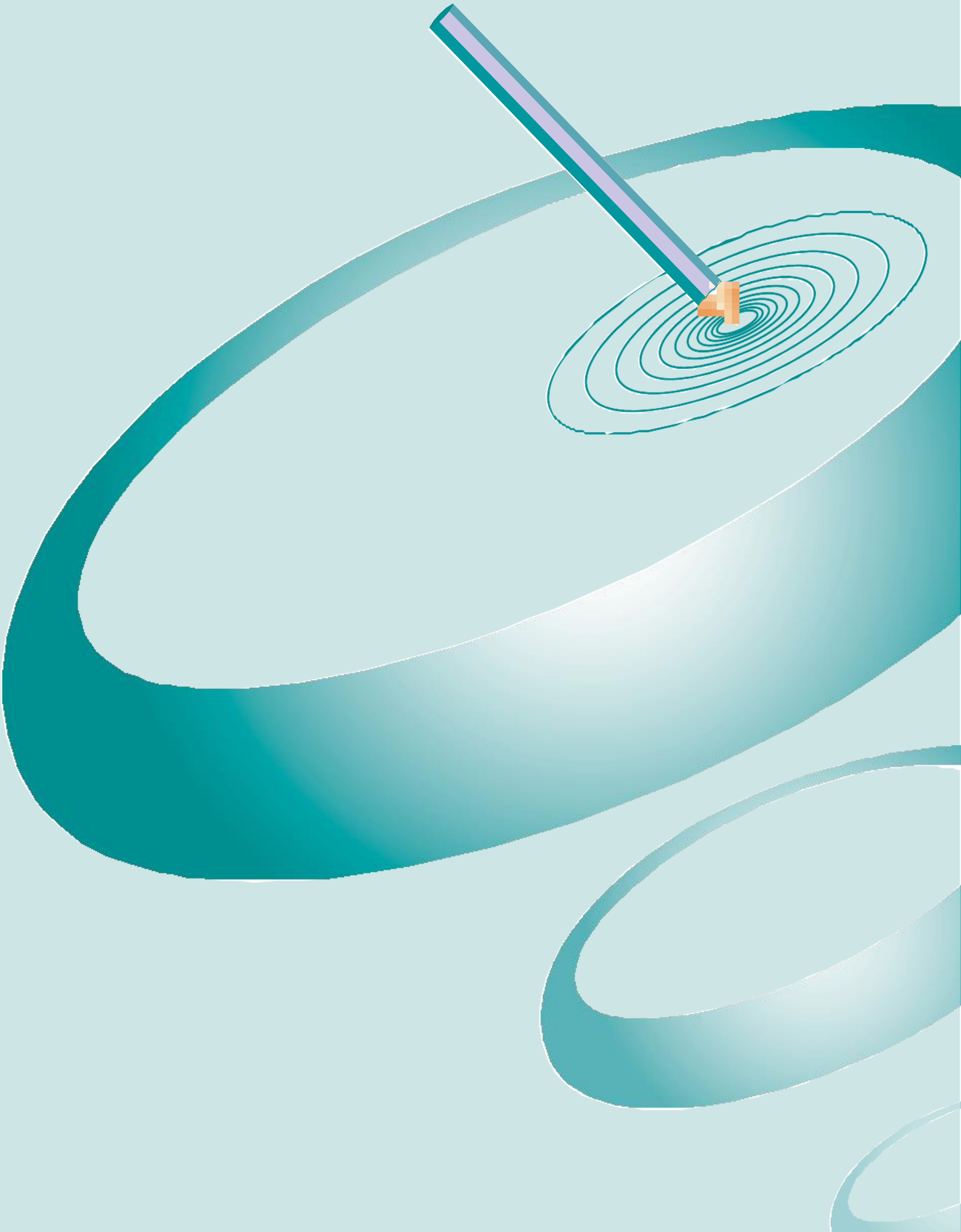
- **Keeping to defined roles.** The sponsoring department's role is to allocate funding, monitor whether the service provider delivers the agreed outputs and outcomes, manage the service delivery relationship and monitor resources being spent.

  The subvented organisation should act within the scope of its service requirements. Any change in the scope of its role must be agreed through a formal process. Otherwise, the organisation may find itself performing tasks outside its scope for no recompense. This may adversely affect its ability to deliver the services originally agreed. Formal variation processes are required even where the parties are only seeking to substitute different activities for the same amount of service payment.

- **Achieving and maintaining a partnership.** While well-drafted service requirements lay the foundation for success, there is no substitute for maintaining a constructive partnering relationship between the department and the subvented organisation. The objective of a partnering relationship is to ensure that both parties work towards the common goal of achieving agreed service outcomes. If the relationship is not well maintained, both parties may be distracted from achieving the desired outcomes and spend time and energy in unproductive arguments and exchanges, or worse.

CHAPTER 2

BOARD STRUCTURE AND COMPOSITION



Roles and Responsibilities

2.1 The general role of the board is to:

- Provide the organisation with strategic guidance, leadership and overall direction, and monitor organisational and managerial performance;
- Ensure appropriate stewardship of the organisation's financial resources;
- Provide guidance in balancing competing demands on the organisation in the pursuit of its mission;
- Ensure that the organisation fulfils its objectives of being open, solvent, and efficient, and works for the best long-term interests of its stakeholders; and
- Ensure that public funds and assets are used in an appropriate and transparent manner.

Responsibility of the Board

2.2 Generally speaking the board is responsible for:

- Establishing and maintaining an up-to-date framework of delegated or reserved powers, including a formal schedule of:
  - – those matters specifically reserved for the board (see the box below for details); and
  - – those matters delegated to the management. The board may delegate many powers to the management if it so wishes.
- Adopting a strategic planning process (including setting out and regularly reviewing the mission and the annual and longer term objectives, approving and monitoring plans to achieve them, and ensuring that corrective action is taken when necessary);
- Overseeing the appointment, performance evaluation, compensation, and dismissal of senior executives;
- Dealing with complaints from staff/ public against the senior executives of the organisation;
- Ensuring the integrity of the organisation's financial and non-financial reporting systems and formally approving and adopting the financial statements and the annual report;
- Ensuring that high standards of corporate governance are observed at all times;
- Ensuring that the organisation complies with any statutory or administrative requirements for the use of public funds and that the board itself operates within the limits of its statutory and /or delegated authority;
- Ensuring effective systems are in place for the identification and management of risk, internal control activity and its review, promulgation of codes of conduct and complying with legal requirements; and
- Ensuring that an effective communication policy is in place for both internal and external communications, and that these communications are monitored.

Best Practices[6]

Matters reserved for the board

1. Appointments
   - Appointment of the CEO and senior management.
   - Appointment or removal of the Secretary to the Board.
   - Membership and terms of reference of board committees.

2. Matters concerning board and senior management
   - Delegations of authority to the CEO.
   - Ratification of the organisation chart.
   - Approval of remuneration and incentive policies.
   - Management contracts.
   - Overseas visit approvals.
   - Approval of succession plans.
   - Disclosure of conflicts of interest.
   - Assessment of the organisation's and CEO's performance.
   - Assessment of board performance.
   - Matters concerning the governance of the organisation.

3. Relations with the members and stakeholders
   - Arrangements for the Annual General Meeting (AGM) and other members' meetings [if any].
   - Matters relating to reports as required by the Law.
   - Suggestions for nomination of directors for election by the members.

4. Financial matters
   - Approval of annual financial statements and directors' reports.
   - Approval of accounting policies.
   - Approval of the internal audit plan.

- Any question of borrowing or giving security over assets.
- Treasury policies, e.g. foreign currency and interest rates.
- Bank accounts and signatories.
- Acceptance of audit reports including management letters.

5. Business strategy
   - Approval of strategic objectives and strategic plan.
   - Approval of proposals for major expansion or closures.
   - Approval of budgets.
   - Approval of priorities and performance indicators/measures.

6. Capital expenditure
   - Approval of the capital expenditure budget.
   - Approval of priorities.
   - Approval of individual expenditure items above $....

7. Lease or purchase of buildings

8. Major transactions not included in the budget

9. Actions or transactions involving legality or propriety

10. Internal control and reporting systems
    - Risk assessment and insurance.
    - Risk management policies, e.g. hedging.
    - Approval of company policies, including legal compliance.
    - Approval of reporting systems.

11. Use of the seal, if any

12. Donations and sponsorships above approved limits

2.3 Most of the roles and responsibilities and matters reserved for the board are not requirements of law, but in the case of a limited company, a matter for its members to determine when agreeing on the Articles of Association of the company.

Board Charter

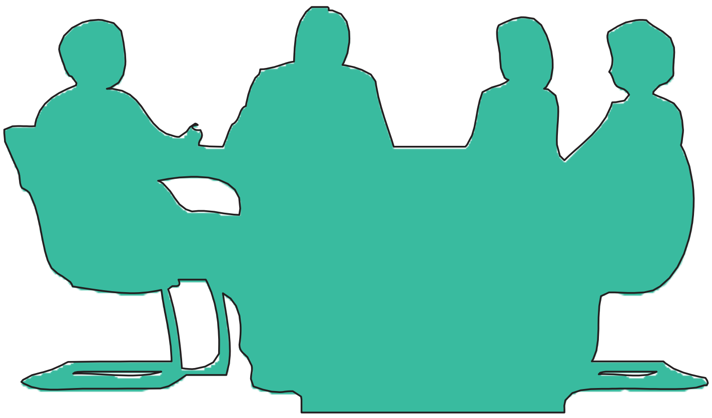
2.4 Every board is encouraged to have a board charter/terms of reference, outlining its roles and responsibilities, which is accessible by the public and may include:

- A general description of the board's purpose;
- An overview of the board's monitoring role;
- Structure and membership, including any requirement of the mix and composition of board members (e.g. number or proportion of Non-executive Directors (NEDs));
- Matters reserved for the board, delegations to committees and executives and authority levels;
- A position description of the role of the chairperson, CEO, senior executives, Executive Directors (EDs) and NEDs;
- Appointment of board committees;
- Board member's induction and training programme;
- Agreed procedure for taking independent professional advice (whether as a board or in an individual capacity) on matters where there may be material risk to the organisation, or where the board members may be in breach of their duties; and
- The board's policy on transparency/ disclosure.

Composition and Organisation

Board Structure

2.5 In Hong Kong, the unitary board structure, in which one single board comprises both EDs and NEDs, is most common. Companies incorporated under the Companies Ordinance (the majority of subvented organisations) are required to have a unitary board. The Guide will not elaborate on other board structures.



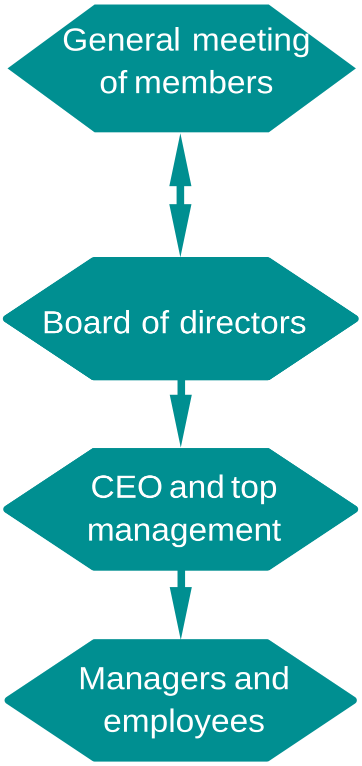


Figure 2.1
Key features of unitary board

- The board usually consists of a majority of NEDs.
- EDs and NEDs are both integral to the board as they work together, often with the NEDs providing the necessary and healthy questions and challenges to suggestions and plans proposed by EDs.

Size of the Board

2.6 There is no guideline about the optimal size of a board but legislation, for example, establishing a statutory body may specify the maximum or minimum number of directors allowed. A subvented organisation should consider the following factors when determining the appropriate board size:

- The size of the organisation;
- The scope and complexity of activities (e.g. diversity of stakeholders);
- The desired ratio of EDs to NEDs;
- Independence requirements of NEDs;
- Board diversity in terms of professional experience, gender, age, technical expertise/knowledge, and level of experience in the board;
- Number of board committees and their compositions (e.g. if committees include members of the board); and
- Other specific requirements, e.g. those specified in funding agreements.

2.7 As a general principle, the number of board members should be kept to a minimum. Practical experience suggests that board management, achieving consensus, making decisions and arranging for board meetings is more difficult with larger boards.

Case Studies[5]

Board Structure and Composition

Inadequacies

One subvented organisation operated 15 subsidiary service units to provide public services to over 10 000 beneficiaries. Its board comprised over 100 members from the Government, the community, service recipients, staff and management within the organisation. It had the following inadequacies –

- The board was too large and was not conducive to effective decision making;
- Over 40% of the board members were staff of the organisation; and
- Three members of a nine-member Executive Committee were staff members, who should abstain from voting on matters concerning staff benefits.

Audit recommended that the organisation should –

- Reduce the size of its board;
- Review the composition of the board with a view to creating a majority of external members (independent NEDs); and
- Ensure that staff members of the Ex-Com abstained from voting on matters concerning staff benefits.

Improvements made

- The organisation established a new board of 25 members, with a substantial majority being independent members, service recipients and chairpersons of subsidiary service units. Directors were required to declare possible conflicts of interest at the beginning of each board meeting. No staff members would be appointed to committees on audit, finance and remuneration.

Key members of the Board

Chairperson

2.8 The chairperson is responsible for leading the board and must demonstrate the ability to manage the board, obtain the support and confidence of the board members and stakeholders, and devote sufficient time to the organisation's affairs. The responsibilities of the chairperson include:

- Chairing AGMs and board meetings. The chairperson must ensure that every board member contributes to the functioning of the board. Decisions should only be made with due reference to views expressed by board members. Dissenting views should be fully explored with discussion focusing on the best outcome;
- Providing leadership to the board;
- Upholding the highest standards of integrity and probity;
- Promoting the highest standards of corporate governance;
- Dealing with conflict or disagreement within the board;
- Establishing an effective working relationship with the CEO, providing support and advice while respecting executive responsibility, and ensuring that board decisions are carried out;
- Building an effective and complementary board, initiating change and planning succession in board appointments, subject to board and stakeholders' approval;
- Ensuring the appropriate induction of new board members, making sure that they are fully briefed on their duties and responsibilities;
- Setting the agenda, style and tone of board discussions to promote effective decision-making and constructive debate;
- Ensuring that there is an effective performance review process for individual board members and for the board as a whole;
- Ensuring that the board takes proper account of statutory and other requirements and makes decisions based on a full consideration of all relevant issues;
- Ensuring that the board meets regularly and that minutes of meetings accurately record decisions taken, interests declared, views expressed and, where appropriate, the attribution of views to individual board members;
- Ensuring that key issues are discussed by the board in a timely manner, that the board has adequate support and resources and is provided with all the necessary information on which to make decisions;
- Taking decisions between meetings where necessary and within parameters agreed by the board;
- Ensuring that the organisation communicates effectively with its stakeholders; and
- Communicating with external stakeholders.

2.9 A checklist for the chairperson is at Annex 2.

2.10 Day-to-day management of the organisation is not the role of the chairperson. In order to strengthen the structural checks and balances, the roles of chairperson and CEO should be separated and fulfilled by different persons.

BEST PRACTICE

Main Responsibilities of a CEO

- ☑ Provide strategic vision and high-level business judgement and wisdom to facilitate the board's decisions;
- ☑ Oversee the day-to-day running of the business and executing the board's decisions/instructions;
- ☑ Provide leadership to achieve the organisation's purposes and objectives;
- ☑ Develop rules and procedures within which the executive carries out its operations;
- ☑ Meet performance targets;
- ☑ Build necessary internal infrastructure to ensure the cost effectiveness of operations; and
- ☑ Maintain good relationships with the organisation's stakeholders.

Best Practice[7]

The chairperson's relationship with the CEO

It is important for the chairperson and CEO to discuss and agree between them their respective roles, to ensure the organisation provides a united and coordinated front and to avoid potential friction.

More broadly, the chairperson will need to agree with the CEO how they are going to work together. This will include:

1. Agreeing the key things they need to achieve;
2. Confirming the expectations each has of the other;
3. Confirming how the board will interact with and assist the organisation and the CEO:
   - What support and advice does the CEO want
   - What are the protocols for board-staff communication
4. Confirming how the CEO will report to the board and how the CEO's performance will be reviewed;
5. Discussing how board meetings will be organised/serviced:
   - How to prepare board agendas
   - What are the key areas the board needs to focus on
   - What papers will be prepared and in what format
   - Who will minute the meetings and in what detail
6. Clarifying the role of the CEO in making the board effective, including recruitment of future board members;
7. Clarifying what information the chair wants/doesn't want; and
8. Confirming who will be the principal external spokesperson for the organisation.

2.11 Directors of an organisation are collectively responsible for corporate governance and make the decisions that determine the organisation's prosperity and integrity.

The legal duties of directors are explained in Chapter 8. Some additional considerations specific to EDs and NEDs are shown in the following box:

Additional considerations relevant to EDs and NEDs

ED Specific	NED Specific
• In cases where EDs are current employees of the organisation, they must leave their functional responsibilities at the boardroom door. • Ensure appropriate staff and infrastructure systems are in place. • Know when to call on NEDs' support or involvement in a specific activity. • Must balance the detailed day-to-day business operations with the board's overall strategy.	• Scrutinise the organisation's performance in achieving agreed corporate goals and objectives and monitor performance reporting. • Satisfy themselves that financial information is accurate, and that financial controls and systems of risk management are robust and defensible. • Provide an independent view on strategy, policy, performance, accountability, resources, key appointments and standards of conduct. • May need to question the judgement of executives or make a stand against them. • Serve on audit and other committees as custodians of the governance process. • Monitor the executive activity and contribute to the development of strategy. • Address succession planning and other sensitive Human Resources (HR) matters.

BEST PRACTICE

The effective non-executive director

- Upholds the highest ethical standards of integrity and probity;
- Supports executives in their leadership of the organisation while monitoring their conduct;
- Questions intelligently, debates constructively, challenges rigorously and decides dispassionately;
- Listens sensitively to the views of others, inside and outside the board;
- Gains the trust and respect of other board members; and
- Promotes the highest standards of corporate governance.

Source: Adapted from Derek Higgs (Jan 2003)[8]

2.12 A sample appointment letter for a NED is at Annex 3.

Personal and Ethical Attributes of Board Members

2.13 Board members should have the following personal and ethical attributes:

- Selflessness – board members should take decisions in the interest of the organisation, not to gain financial or other material benefits for themselves, their family, or their friends.
- Integrity – board members should not place themselves under any obligation to outside individuals or organisations that might influence the performance of their board duties.
- Objectivity – board members should make board business choices purely on merit.
- Accountability – board members are accountable for their decisions and actions and must submit themselves to the appropriate level of scrutiny.

- Openness – board members should be as open as possible about the decisions and actions that they take.
- Honesty – board members have a duty to declare any private interests relating to their board duties.
- Leadership – board members should promote and support these principles by leadership and example.
- Commitment – board members who do not attend meetings and other tasks regularly cannot fulfil their roles.

2.14 A checklist for the board is at Annex 4.

Induction and Training

2.15 New board members should undergo a full induction, in which they receive the training and information they need to carry out their new role. They should also meet key staff, service users and beneficiaries, and other stakeholders.

2.16 Training should enable board members to understand both the public sector context in which the organisation operates and its specific operations and environment.

2.17 Information provided to new board members should include the organisation's aims and objectives, control environment, organisational risks and risk management practices, key personnel, delegation arrangements, board and staff structure, and budget planning and performance management processes.

2.18 The training should explain the expected standards of integrity and accountability. Board members need to understand their legal duties (see Chapter 8) to the organisation.

2.19 The board should have a strategy for the support and personal development of board members so that they can keep abreast of the knowledge and skills they need. This can include training / familiarisation in areas such as public sector developments, governance practices, financial literacy and risk management.

2.20 Board members should continue to visit the organisation's facilities regularly. This serves both to ensure that they remain familiar with the organisation's operations and staff as well as helping them to perform their oversight function.

Succession Planning

2.21 In many statutory bodies, it is Government that makes the appointments. In other circumstances, the board should ensure timely replacement of directors resigning or reaching the end of their terms. Attention should be given to:

- Determining an appropriate length of service so as to balance the need for a retention of corporate knowledge with a healthy turn-over of board members; and
- Succession planning for replacement of the chairperson and other directors.

2.22 Before new board members are appointed, the board (perhaps on the advice of a Nomination Committee) should determine what attributes and knowledge are needed, and document these in the form of a role description or profile. All board members including government representatives should be appointed for their relevant skills and experience. The board should ensure that the recruitment process is able to attract a wide range of candidates who possess the necessary skill sets to support the board. Under the new Companies Ordinance Cap 622, employment of a director for a term that exceeds or may exceed three years requires approval of the members of the company.

2.23 It is particularly important that individual board members realise that an invitation to join the board of a statutory body or NGO is not merely an honour. Such a role carries real responsibilities and should be treated seriously.

Best Practice

Elements of a good succession planning process:

- A continuous process
- Driven and controlled by the board, with the CEO's participation
- Easily executable in the event of a crisis or any adverse event
- Considers succession requirements based on corporate strategy
- Geared towards finding the right leader at the right time
- Develops talent pools at lower levels

Appointment of Government Officials to a Board

2.24 The purpose of appointing government officials to the board of a subvented organisation differs from case to case. Each case should be considered on its merits, with regard to its circumstances and the legal implications of different arrangements. The role of a government official on a board, apart from his/her legal duties as a director of the organisation, is mainly to act as a link between the Government and the organisation. The intended role(s) of government officials should be clearly stipulated in writing. Their functions may include:

- Monitoring the performance of the organisation;
- Enhancing understanding of service delivery expectations;
- Ensuring that public funds are properly used;
- Safeguarding government investments;
- Looking after the public interest; and
- Offering advice on government policy.

2.25 There may be times when the government representatives should not be present in a board discussion, or receive the papers, for fear of breaching the legal duties owed to the organisation, e.g. in relation to the organisation's budget or bid for funding from the Government.

Legal Position of Government Representatives on Boards

2.26 The duties of any board members are governed by company law, unless modified by a relevant ordinance or the organisation's Articles of Association. Government officials appointed as board members are governed by company law when they discharge duties in this role, unless their duties as members are specifically modified by a relevant ordinance or the Articles of Association.

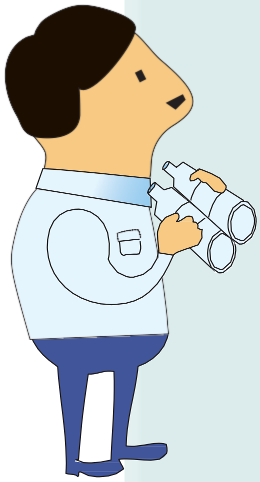
2.27 In the case of an organisation established by an ordinance, the duties of directors will depend on that ordinance. Where the ordinance does not vest specific duties on its directors the court would naturally extend the company law principles to the directors.

Other Forms of Government Representation in Subvented Organisations

2.28 Organisations may benefit from access to public sector decision makers. To avoid the potential difficulties involved in appointing government representatives to the board, other means are sometimes adopted. These include:

- Government officers attending board meetings as observers, and/or advisers. Such attendance should be based on prior agreement between the sponsoring department and the subvented organisation, e.g. documented in the MAA or funding agreement;
- Government officers chairing or sitting on the Advisory Board of the organisation; and
- Stipulating measures to protect the Government's interest in the MAA or funding agreement (e.g. having access to papers and minutes, and the right to conduct independent audits).

The role of observers



There may be times when observer status, or appointment as an adviser may be more appropriate for government representatives, allowing some of the advantages of membership of the organisation whilst avoiding the pitfalls.

Observers attend board meetings, but may not vote on matters.

Depending on the organisation/board and its understanding with the Government, observers may participate in discussions or may be expected to remain silent.

Observers may be excluded from meetings when their presence may potentially compromise the organisation's position, e.g. when the board is discussing sensitive personnel matters, strategic issues or litigation.

An observer should remove himself/herself from a discussion when there is a potential conflict of interest. For example, an observer representing the sponsoring department should not be involved in the board's budget decision process. Having said that, depending on the circumstances, there might be merit in the observer being involved in the initial discussion to learn about the development and rationale of a particular funding proposal.

In any case, a list of issues with potential for conflicts of interest should be identified early, and protocols for handling them should be developed.

Appointment by Government of Non-Officials to Boards

2.29 Where board members are appointed by the Government, the board should ensure that the Government is aware of the specific skills and experience required of new board members.

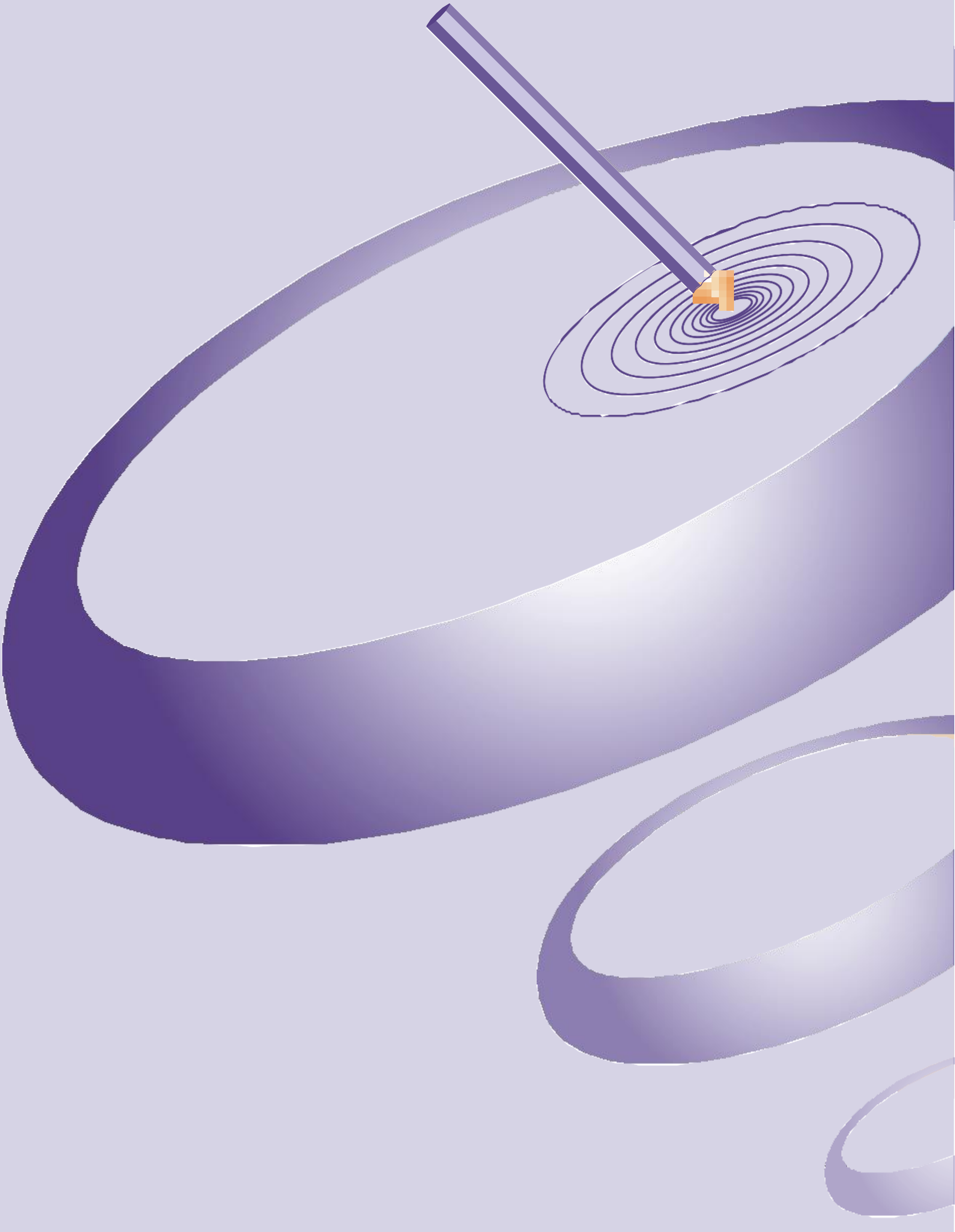
2.30 The Government aims to appoint the best available people, i.e. individuals who are willing, committed, competent, experienced and meet the specific needs of the board. Due regard will be given to ensure a good balance of expertise, experience and backgrounds among board members.

2.31 Women's participation in statutory bodies is encouraged. Where possible and appropriate, young "fresh blood" will be considered for appointment in order to bring in new ideas and broaden representation.

2.32 Non-officials are not normally appointed to serve on more than six advisory and statutory bodies at any one time or to sit on the same body for more than six years - the so-called "Six Year" and "Six Committee" rules. This is to ensure a reasonable distribution of workload and turnover of membership. Departments need to pay particular attention to the attendance record of board members being considered for re-appointment.

CHAPTER 3

BOARD OPERATION AND EFFECTIVENESS



Boardroom Conduct and Relationship

General

3.1 The board's responsibilities (see Chapter 2) are numerous, varied and onerous. Given that most boards schedule twelve meetings or less a year, it is important to have formal processes in place that facilitate effective operations and maximise value.

3.2 The board should have policies and procedures for conducting meetings, e.g. a timetable for consideration of key issues, quorum requirements and how decisions are made.

3.3 Since the board is ultimately responsible for the management of the organisation, the information it receives must be adequate for it to understand what is really going on and for it to be satisfied that the organisation is being managed properly. Therefore, board members must have a right to:

- Invite appropriate executives to make presentations and to answer questions at board meetings; and
- Identify the information they need and to receive it in a timely manner or in a prescribed format.

3.4 Board members' requests for information could involve a substantial amount of work and may disrupt the work of management. Therefore, the board should agree on a procedure by which a board member can obtain information in an efficient way without compromising his right to that information.

3.5 The board should specify under what circumstances members should declare conflicts of interests; excuse themselves from discussions and decisions, etc.

3.6 An annual agenda should be agreed by board members. This should set out all the major tasks the board proposes to carry out in the following year and their associated schedules. This does not preclude inclusion of new agenda items as the need arises. A set of pro forma agendas may be prepared, one for each of the meetings planned. The board's meeting dates should be arranged well in advance to facilitate board members' attendance.

3.7 Similar arrangements should apply to committees set up under the board.

Preparing for a Meeting

- The agenda for each board meeting should be approved by the chairperson and distributed to all board members sufficiently in advance (e.g. two weeks before the meeting);
- The agenda should include regular items on matters such as risk reporting and corporate citizenship;
- Discussions will be more effective if there is a paper for every agenda item, providing all necessary background information and drawing attention to any significant issues;
- Board members should declare (and the board should record) any conflict of interest in respect of any agenda item in advance of the meeting. If needed, the board member(s)

concerned should excuse themselves from the meeting (or relevant part thereof);

- Board members have the right and the duty to bring to the attention of the board any matters of serious concern, i.e. the chairperson should include them on the agenda;
- The chairperson needs to prioritise agenda items – matters of the greatest importance or deserving more discussion time should be placed at the top of the agenda; and
- The board should receive regular, timely reports and minutes from all its committees.

During the Meeting

- The chairperson leads the board and should:
  - Ensure the quorum is met before convening the meeting;
  - Control board meetings and ensure that the board works as a single and coherent unit;
  - Manage the right level of creative tension and encourage challenging and constructive debates;
  - Draw out the views of board members whilst steering the board as a whole to decide upon a solution;
  - Lead the board's discussions to clear conclusions; and
  - Ensure that each board member has the opportunity to express their opinions (i.e. board meetings are not dominated by particular board members).
- Decisions should be reached through discussion; and
- Attendance of board members should be recorded and monitored. The board should take action to improve the attendance of board members with low attendance, e.g. issue reminders.

Best Practice[9]

Companies tend to develop their own style in minute keeping: for example, some boards note the names of the key contributors to the discussion, others do not. In some cases, it has to be admitted, the minutes are no more than a staccato record of who attended and what was decided. At the other extreme, there are minutes that are almost a verbatim report of the proceedings, complete with stage directions. The ideal lies between the two. Minutes should contain sufficient information to capture the key threads of the discussion, any disclosures of personal interest, the alternatives considered, the agreement reached, and plans and responsibilities for action.

After the Meeting

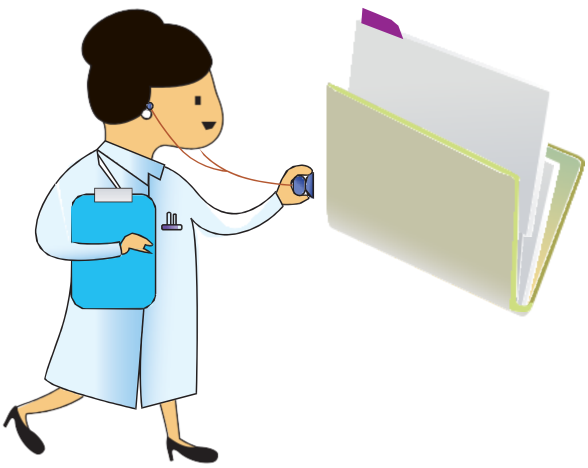
- Urgent items should be actioned, without waiting for drafting, circulation and approval of minutes;
- The minutes of board meetings should be clear, concise and complete. The draft minutes should be produced quickly and circulated to board members for comment as soon as possible. They should be distributed to all board members for formal endorsement at the next board meeting; and
- The board minutes should set out the responsible action party and the agreed date for completion for each action item. The board should check the status of each action item at each board meeting.

Director of Audit's Observations of Common Inadequacies on Board Operations[5]

- Poor monitoring of the attendance of members at board/ committee meetings;
- Failure to remind members with low attendance records to attend meetings;
- Failure to ensure a quorum was present throughout all board/committee meetings which cast doubts on decisions made;
- Not issuing minutes of meetings to members as soon as possible after meetings;
- Not recording declarations of interests reported by board /committee members in a central file; and
- Not adopting a two-tier reporting system for managing potential conflicts of interests of board/committee members.

Evaluation

- Boards should ensure that they have in place a process through which their collective and individual (including government representatives) performance can be evaluated and monitored. This may involve measuring the board's performance against widely accepted good corporate governance practices. Any shortcomings identified can be addressed in a timely, appropriate manner ensuring that the organisation's standards for accountability and corporate responsibility are maintained at a high level. Board evaluations typically involve a process of self-evaluation mixed with peer review.



Best Practice[10]

Boards can be evaluated in a lot of different ways and at different levels. Some boards have adopted (with good results) the simple measure of asking a member to comment on 'how the session went' at the end of each meeting.

However, a more formal approach to evaluation may be required, taking a more global look at board performance.

There are two main ways of collecting information:

Questionnaires

Questionnaires can be either paper- or web-based. They are quick and inexpensive. There are lots of 'canned' versions around. They have a wide reach and the results can often be quantified, which facilitates comparisons and provides an aura of objectivity to the results.

However, there are pitfalls. Questionnaires can yield superficial, and sometimes even false, insights because people sometimes fill out questionnaires by giving answers they consider appropriate. Problems may not come out in the questionnaire responses.

Interviews

These can be by phone or in person. Interviews avoid many of the problems associated with questionnaires. They can elicit nuances and provide opportunities to examine complex issues. As interviews progress and problems become clearer, later interviews can be used to test hypotheses and explore solutions. An experienced interviewer will usually be able to contribute constructively to discussions on how to deal with governance problems once the interview programme is over.

The main downside of interviews, however, is that they take more time than questionnaires, and they tend to be more costly. Much depends, too, on the skill of the interviewer.

Some organisations opt for evaluations by board members themselves. Under this approach, members may rate themselves or each other, either verbally or through some sort of questionnaire. Comments may be collated by a designated board member, such as the head of the nominating committee, or perhaps some knowledgeable individual who is now out of the fray, such as a past chair.

Self-evaluations have the virtue of being less costly, but they need to be handled with sensitivity. To work well, the board must possess that often-elusive attribute – a culture of candour and mutual trust.

Committees

3.8 The establishment of committees under the board could help support the board on specific matters and provide internal checks and balances. However, it may not be practical even for large subvented organisations to establish all the committees mentioned below. Whether a particular committee is necessary would depend on the unique circumstances of each organisation.

Executive Committee

3.9 In a commercial setting, an executive committee (Ex-Com) is commonly established and generally performs typical duties such as managing the organisation in between regular board meetings and reporting to the full board on progress against strategy and duties set by the board. Most of these Ex-Coms are made up of a majority of EDs. The actual power that the Ex-Com can exercise depends entirely on the extent of the board's delegation of power.

3.10 In some subvented organisations, the board may only have one ED and a number of NEDs. In such cases it may be better to leave the day-to-day running of the organisation to the CEO.

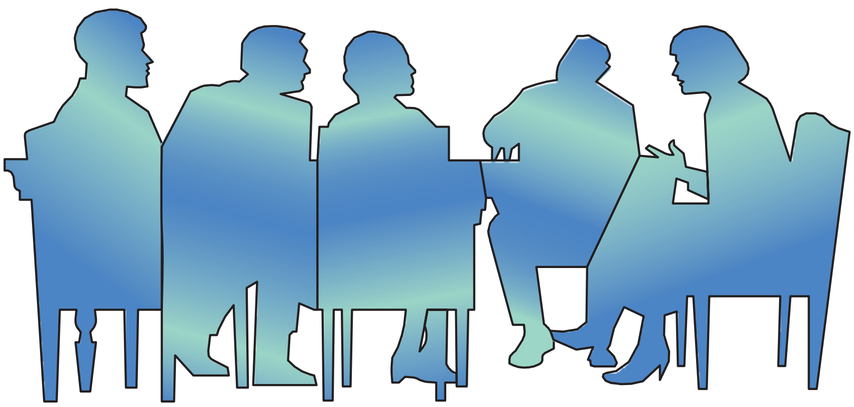
Nomination Committee

3.11 A Nomination Committee deals with the appointment of board members who are not appointed by the Government. The committee should ideally contain a majority of NEDs and be chaired by a NED. The committee should ensure that appointments to the board are made in accordance with specific criteria, which should have regard to competence and individual merit, in the light of the role the prospective candidate is expected to fulfil.

Remuneration Committee

3.12 To avoid potential conflicts of interest, the board may establish a Remuneration Committee composed of NEDs whose responsibilities include making recommendations to the board, or to Government, on remuneration-related matters.

3.13 In Hong Kong, remuneration of NEDs is less of an issue as NEDs typically work on a voluntary basis. In some cases, they may receive an honorarium as a gesture of appreciation for their time commitment.



Best Practice

When determining the board remuneration (especially for EDs):

- No member of the board or the management should participate in setting his own remuneration. Where appropriate, independent advice should be sought; and
- Formal and transparent procedures for setting the remuneration of individual directors should be established.

Audit Committee

3.14 The board may establish a separate Audit Committee to independently review financial information, the framework of control, the external audit process and compliance with applicable laws and regulations. See Chapter 7 for more details.

Other Committees

3.15 The board may consider establishing other committees dealing with corporate governance, finance, HR, risk management, business development, public complaints, staff appeals, information technology, investment, capital works, infrastructure planning etc., according to the business nature and requirements of the organisation. The structure, roles and responsibilities of these committees should be clearly defined and their authority should be properly delegated by the board. All committees should report regularly to the board.

BEST PRACTICE

Corporate Governance Committee

Purpose

- Develop, review and recommend to the board a set of corporate governance policies and guidelines
- Provide oversight for the annual evaluation of the performance of the board

Composition

- A majority of NEDs
- The chairperson, if possible, should be an NED

Responsibilities and Duties

- Develop, assess, periodically review and make recommendations to the board concerning appropriate corporate governance policies and guidelines
- Monitor and report to the board on adherence to corporate guidelines, committee activities and regulatory and compliance issues
- Receive comments from board members and review regularly the overall effectiveness of the board and recommend improvements where warranted

Conflicts of Interest

3.16 Boards must manage conflicts of interest properly. Failure to do so may have a serious impact on an organisation's reputation, giving rise to criticism of favouritism, abuse of authority or allegations of corruption. All decision-making should be guided by principles of integrity, honesty, transparency and good faith. Organisations should set out requirements to avoid conflicts of interest, and the course of action to be taken when a member faces a real or apparent conflict of interest situation.

3.17 Directors and employees must avoid any potential, perceived or real conflict of interest. All board members / employees should be required to declare any conflict of interest upon joining the organisation. When there is a special instance involving a probable threat of a conflict of interest, board members/employees should again be required to make a declaration. The general declaration of interest should be updated on a periodic (e.g. annual) basis.

What is a conflict of interest?

Conflicts of interest may arise when a board member or an employee has the opportunity to influence the organisation's business or other decisions in ways that could lead to personal gain or advantage of any kind, or benefit to their connections including family, personal friends, the clubs and societies to which they belong, and any person to whom they owe a favour or are obligated in any way.

Private interests include both financial and non-financial interests. Situations likely to give rise to conflicts of interest include where a director/employee:

- Conducts or has interest in business transactions involving goods or services, either directly or indirectly, with the subvented organisation;
- Is involved in a tendering exercise and gives advice to a contractor or supplier
- Has undeclared interests in suppliers and contractors that do business with the subvented organisation;
- Assists third parties providing goods or services to the subvented organisation by working for them part-time or by providing consultancy services;
- Is involved in a recruitment exercise in which a relative or friend has applied to join the organisation.

Conflicts of interest can arise when there are insufficient checks and balances established within an organisation. No board member or employee should be able to approve, on their own, decisions which will benefit them. Each subvented organisation should put in place and enforce policies, procedures and practices that ensure that such decisions are taken/reviewed and endorsed by appropriate third parties.

Organisations should be alert to conflicts of interest involving senior employees taking up outside employment either during their service with the organisation or in the period afterwards.

Management of Conflicts of Interest

Inadequacies

One subvented organisation met the criteria for adopting a “two-tier reporting system” as set out in a Home Affairs Bureau guideline on declaration of interests for advisory and statutory bodies. However, it adopted a “one-tier reporting system” which required a director to declare and report a conflict of interest only when he became aware of it.

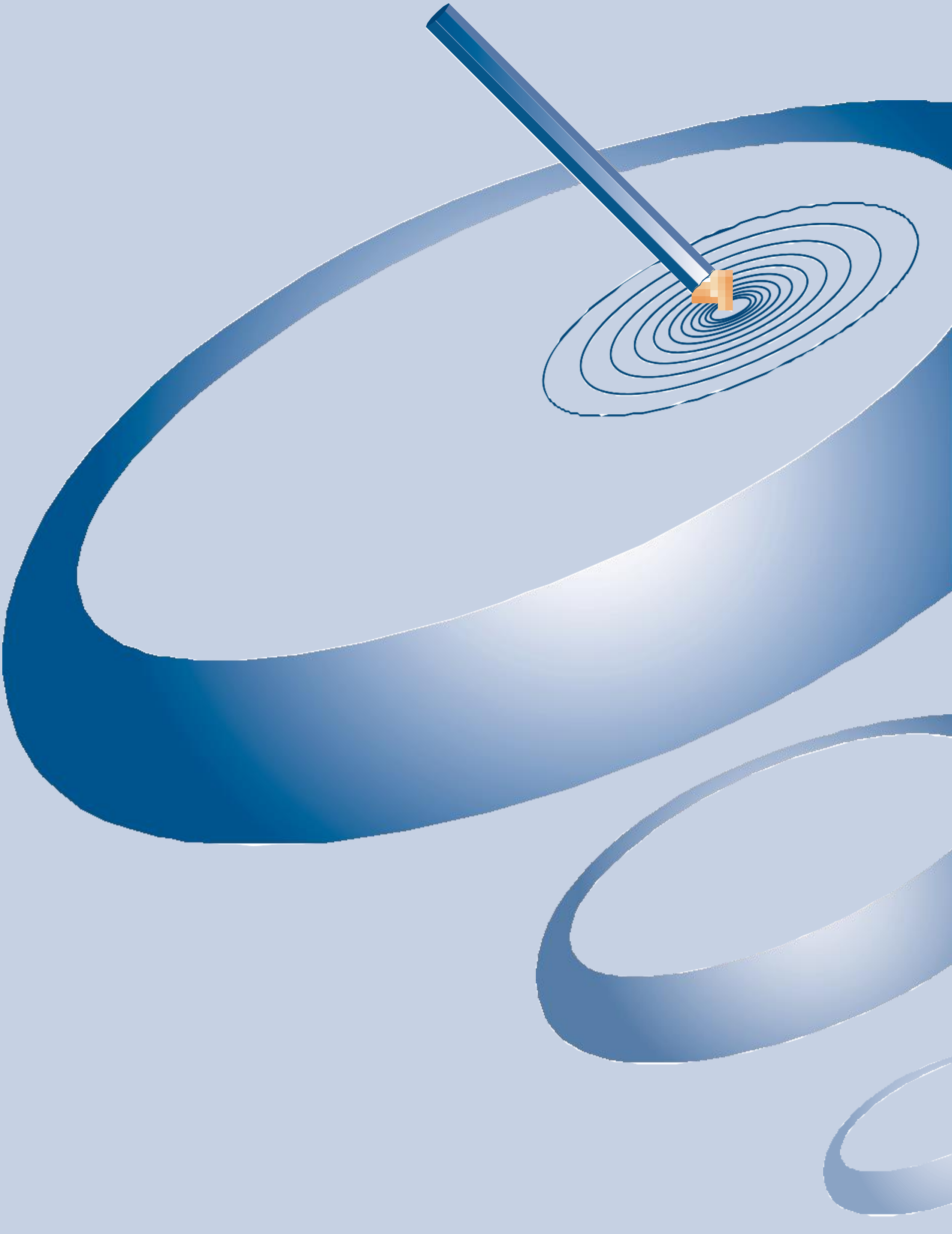
Audit recommended that the organisation should consider adopting a “two-tier reporting system”, whereby in addition to reporting conflicts of interest at board meetings as and when they arise, board members should disclose their general interest on appointment to the board. The declaration shall be made on a registration form, which should be made available for inspections by the public.

Improvements made

The organisation adopted a “two-tier reporting system” for all its directors. Suggestions made by the Independent Commission Against Corruption (ICAC) have also been incorporated. A register of directors’ declaration of interests is maintained and is made available for inspection by the public.

CHAPTER 4

STRATEGY, PLANNING AND MONITORING



Overview

4.1 A key aim of managing an organisation is to achieve its defined business objectives. Organisations must have a clearly articulated and implementable strategy in order to achieve their business objectives. A business strategy is a plan that defines the range of business the organisation is to pursue, the kind of organisation it is or intends to be, and the nature of the contribution, economic and non-economic, it intends to make to its stakeholders.

Vision, Mission and Values

4.2 Organisations often summarise their business objectives into vision, mission and values. The vision, mission and values of an organisation are the cornerstones of sound strategic planning and good corporate governance.

- An organisation's vision statement describes its overall purpose and desired future ("where do we want to be?").
- The mission statement makes concrete the direction and purpose of an organisation ("why do we exist?").
- The values encompass the central beliefs of an organisation ("how do we conduct ourselves when accomplishing our mission?").

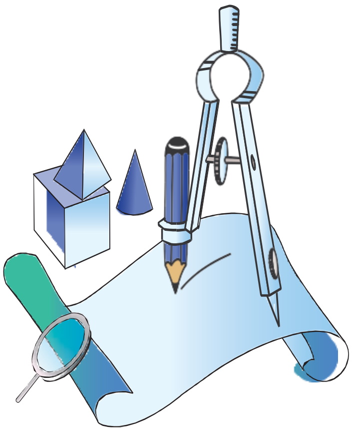
Best Practice[11]

Why Vision, Mission and Values are Critical to Success?

- The organisation is able to move forward and change without experiencing chaos because its overall direction is clear.
- They instil a sense of pride in the board and staff about the nature of the work they are doing.
- Mission, vision and values communicate the purpose of the organisation to its constituents and the community.

Strategic Planning

4.3 Strategic planning determines where an organisation is going over the next year or more, how it is going to get there and how it will know if it got there or not. The focus of a strategic plan is usually on the entire organisation, while the focus of a business plan is usually on a particular service or programme.



4.4 Strategic planning b roadly covers the formulation of one or more action /strategic plans to achieve the organisation's goals and objectives. It lays out the practical steps to accomplish the organisation's vision and mission. Without established plan(s) to guide the actions, valuable resources could be isused and the staff's efforts would be unfocused.

BEST PRACTICE[12]

Strategic Planning

The outcome of strategic planning includes:

- The establishment of a unique far-reaching vision
- Addressing critical issues
- The development of focused and clear strategies
- Differentiation from competitors
- The achievement of tangible benefits

The process of strategic planning involves:

- Pre-planning activities
- Encouraging effective participation
- Thinking strategically
- Managing implementation
- Managing strategically

An Appropriate Approach

4.5 The way that a strategic plan is developed depends on the nature of the organisation's leadership, its culture, complexity of its operating environment, size, expertise of its planners, etc. Strategic plans could cover a time span of one to ten years. Some plans include only top-level information and no action plans. Some plans are five to eight pages long, while others can be considerably longer. There exist a wide variety of models and approaches used in strategic planning.

4.6 Goals-based planning is probably the most common and starts with focus on the organisation's mission (and vision and /or values), goals to work toward the mission, strategies to achieve the goals, and action planning (who will do what and by when).

4.7 Issues-based planning often starts by examining issues facing the organisation, strategies to address those issues, and action plans.

4.8 Organic planning might start by articulating the organisation's vision and values and then action plans to achieve the vision while adhering to those values.

Understand the Environment

4.9 The first step in strategic planning is to understand the external environment at a macro level, to develop a basic understanding of the trends and issues that would significantly influence the organisation. A good understanding of the expectations and needs of various stakeholders will assist the board with evaluating its strategic direction, strategies and objectives and aligning them with the established mission and vision.

Implement the Strategy

4.10 It is important to communicate the strategy to all levels of the organisation and to translate the strategy into actual business plans for implementation.

Best Practice

Components of Strategic Planning

1. Where are we now?

(a) Conduct internal/external assessments via:

- a Situation Inventory, which assesses the organisation's current internal strengths and weaknesses; and
- an Environmental Scan, which analyses key external elements along with the opportunities and threats in the environment in which the organisation operates.

(b) Prepare a Mission Statement to define the organisation's unique reason for existence.

(c) Outline the Core Values, which describe how the organisation should conduct itself when carrying out its mission.

2. Where do we want to be?

(a) Write a Vision Statement, which forms a compelling and vivid conceptual image of the organisation's desired future.

(b) Prepare Goals for achieving the desired end results (generally this would encompass three or more years).

3. How do we get there?

(a) Draft an Action Plan or detailed description of the key strategies to be used to implement each objective.

4. How do we measure the progress?

Formulate and implement:

(a) Performance Measures to capture results and ensure accountability.

(b) Monitoring and Tracking Systems, which monitor progress, compile management information, and keep plans on course.

(c) Systems for Resource Allocation, which are necessary for carrying out the desired strategies and achieving prioritised objectives.

Source: Adapted from California State Department of Finance [13]

Best Practice

Communicate the strategy. Organisations need to translate the strategy into objectives and measures that will influence individual and team priorities. Three suggested mechanisms include:

- Communication and education programmes: Educate the organisation on the components of the strategy and reinforce this with feedback on actual performance.
- Goal-setting programmes: Translate the high-level strategic objectives into personal and team goals.
- Reward system: Link the organisation's incentive and reward systems to individual/team success in achieving the strategy.

Establish plans and targets; measure and reward performance. Middle management must translate strategic initiatives into smaller, digestible action plans and goals at the team and individual levels.

Develop a plan that defines how financial, human and other resources must be spent, to close the gap between the current performance and the targets to be achieved.

Organisations should continually test their strategies and how they are being implemented. This should involve the formulation of specific short-term targets, or milestones.

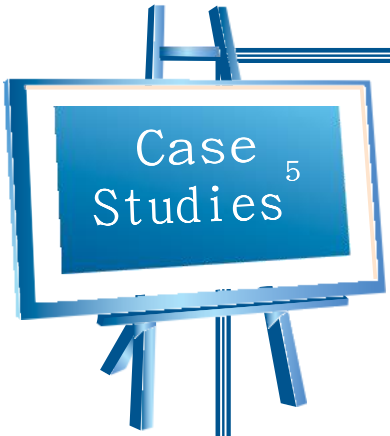
Maintain strategic flexibility. Strategies cannot be linear or stable:

- Strategies are incremental and emerge over time.
- Intended strategies can be superseded.
- Strategy formulation and implementation are intertwined.
- Strategic ideas can arise throughout the organisation.

An effective strategic learning process needs to be developed to maintain strategic flexibility. This can involve:

- A strategic framework that allows each participant to see how their activities contribute to the overall strategy.
- Feedback that collects performance data about the strategy.
- A team problem-solving process that analyses the performance data and adapts the strategy to emerging conditions.

Source: Adapted from Hong Kong Institute of Directors [14]



Strategic Planning

Inadequacies

The Audit conducted a review of a group of subvented organisations providing public services of a similar nature. One of them had prepared a vision statement but had no formal strategic plan for realising that vision. Some of the other subvented organisations had prepared strategic plans but did not have operational plans to implement the strategic plans, nor provided regular updates to report progress to their boards or public.

Audit recommended that the subvented organisations should –

- Expedite action to prepare strategic plans to set out strategic objectives, operational goals and strategic actions for achieving the goals; annual operational plans to set out clear targets and annual progress reports to present the extent of achieving those targets; and
- Publish those plans and reports on their websites.

Improvements made

The subvented organisation that did not have a formal strategic plan developed one, uploaded it onto its website and undertook to update it regularly. Those that had only prepared strategic plans also developed operational plans and compiled progress reports, and uploaded them to their websites to facilitate monitoring of performance.

Budgeting and Financial Management

4.11 Budgeting should be the subject of a continuous focus. There should be adequate oversight and procedures to ensure efficient and effective budgeting and financial management.

4.12 A budget should be prepared to show how an organisation will use its resources in the coming year for the approval of the board. Budgeting processes should be linked to short and long-term goals, policies and priorities, strategies for achieving objectives and the source of funding. Well-managed budgeting processes help enable proper forward planning, facilitate the best use of resources and explain the rationale for the organisation's proposed use of resources.

4.13 The board should ensure that effective and efficient financial management processes are established, to support the management in its deployment of limited resources, with the aim of maximising the economy and efficiency with which the organisation carries out its objectives. This process includes day-to-day cash management; reprioritisation and redeployment of resources; requirements for individual unit heads to account for expenditure and report to the 'Centre' periodically; as well as the formulation of longer-term financial objectives and strategies. It should encompass such areas as the planning of capital expenditure, the management of working capital, and funding and performance decisions.

4.14 Properly prepared revenue and expenditure estimates enhance the management team's ability to manage the organisation's day-to-day business and activities.

Revenue Estimates

4.15 A subvented organisation should allocate its sources of income into categories such as government subvention (recurrent), government subvention (one-off capital), fees and charges collected, investment/interest income, donations, etc.

4.16 It is important to explain the basis for estimating income from other sources, including the considerations for scale of fees for a subvented service and the assumed rate of return on investment (e.g. interest rate on fixed deposits), where applicable. This information will help the sponsoring department to consider whether there is a need to adjust the levels of subventions in the light of income from other sources.

4.17 Some subvented organisations run self-financing activities without any subvention from the Government. Such organisations should keep a separate set of accounts for these activities and ensure that there is no cross-subsidisation of self-financing activities by the subvented programmes in money or in kind.

Best Practice[15]

The key financial functions undertaken by the board are to:

(a) Approve a budget that reflects the NGO's priorities and that is based on realistic assumptions of funding, costs, and other factors;

(b) Monitor and control expenditures on the basis of appropriate accounting procedures – expect and receive up-to-date financial statements at each board meeting and allow adequate time for their full consideration;

(c) Oversee the stewardship of the NGO's assets and liabilities; and

(d) Approve annual reports, including financial statements.

The basic requirements for managing the financial responsibilities of the board are listed as follows:

(a) A NGO should operate in accordance with an annual budget that has been approved by the board.

(b) Financial reports should be created and maintained on a timely basis that accurately reflect the financial activity of the NGO and allow the board to monitor financial performance.

(c) The accuracy of financial reports should be subject to external audit by a Certified Public Accountant.

(d) Internal financial statements should be prepared no less frequently than quarterly, should be provided to the board, and should identify and explain any material variation between actual and budgeted revenues and expenses. The board must formally ratify any financial statements, or reject them if they are not appropriate.

(e) The Board should provide staff with a confidential means to report suspected financial impropriety or misuse of the NGO's resources.

(f) The Board should have written policies governing

- Investment of the assets of the NGO;
- Internal control procedures;
- Purchasing practices; and
- Reserve funds.

Expenditure Estimates

4.18 A subvented organisation should provide the following information in support of its expenditure estimates:

- Staff expenses. A breakdown of staff expenses by items (e.g. salaries, other benefits including the organisations' contribution to provident funds, contract gratuity, passages, housing allowances, cash allowances, bonuses, and job-related allowances). In addition to explaining variations in the total expenditure for staff expenses between the years, the organisation should provide supplementary information on staff size and the distribution by staff categories. If there are any changes in its staff size and in its policy on remuneration packages, the organisation should provide the necessary explanation.

- Other recurrent expenses. A detailed list of recurrent expenditure other than staff expenses, including –

  – administration, e.g. fuel, light and power, maintenance of computer systems, cleaning service;

  – accommodation, e.g. rent, management / maintenance fees;

  – stores and equipment;

  – transport, e.g. running expenses of vehicles, travelling expenses; and

  – training and development.

  To allow reasonable flexibility in managing minor operational expenses, certain non-recurrent expenditure items costing less than a prescribed amount (e.g. $150,000) may be regarded as recurrent expenditure.

- Non-recurrent expenditure. This covers, e.g. procurement/ replacement of equipment / systems / services, refurbishment of offices and facilities, one-off furnishing and equipping a facility.

4.19 A subvented organisation may show depreciation of capital assets in its income and expenditure accounts but such information must be shown separately.

4.20 Any post budget/in year revisions must also be dealt with properly. This should involve: (i) an appropriate, rigorous process of examining and approving post-budget revisions; (ii) adequate approval procedures; and (iii) clear documentation.

KEY QUOTE

"You do not spend public funds to bid farewell to colleagues."

Benjamin Tang, Director of Audit (2003-2012)

Expenditure on Overseas Duty Visits

Inadequacies

The management and monitoring of sensitive expenditure by board members and staff of one subvented organisation were inadequate –

- Expenditure involving business trips including hotel accommodation, hospitality and meal expenses, and courier charges was not "moderate and conservative";
- There were no guidelines or financial limits on hotel accommodation, hospitality and meal expenses;
- Funding a staff lunch out of public money before a duty visit;
- No prior approval was sought from the board for short business trips;
- Claims for duty visit expenses were not supported by invoices or bills, and no record was kept of employees and guests joining hospitality meals; and
- The board was not notified of significant programme changes, particularly the addition of hospitality items.

Audit recommended that the organisation should rectify the above deficiencies.

Improvements made

- Business trips outside Hong Kong require prior approval of the board; the "moderate and conservative" principle is strictly applied;
- Prescribed financial limits on individual expenditure items such as hotel accommodation, hospitality and meal expenses;
- Claims for private meals in relation to duty visits are disallowed; and
- Revised internal guidelines require –
  - Reimbursement claims of duty visit expenses to be supported by invoices or bills;
  - Records on personnel and guests attending hospitability meals to be properly maintained;
  - The most economic means available for courier services; and
  - Significant programme changes, particularly hospitality items, to be brought to the board's attention.

Sensitive Expenditure

4.21 Expenditure on items such as entertainment, accommodation, travel and fringe benefits incurred by directors and staff is sensitive in the eyes of the public. Organisations must adopt a conservative and modest approach to such matters.

Use and Disclosure of Appropriate Accounting Policies and Standards

4.22 Organisations should adopt clear and consistent accounting policies and standards, and follow generally-accepted accounting practices, unless there is any specific need to do otherwise. The adoption of accrual accounting can help to monitor performance against its objectives, and also provide the information needed for cash-management purposes.

Procurement Practice and Inventory Control

4.23 Procurement practice and inventory control are important elements of day-to-day management in conducting organisational business. A good procurement practice should be based on the principles of accountability, value for money, transparency and fair competition. A well set-up inventory control would enable organisations to maintain proper supervision and control over their assets and to well utilise their resources.

Human Resources Management

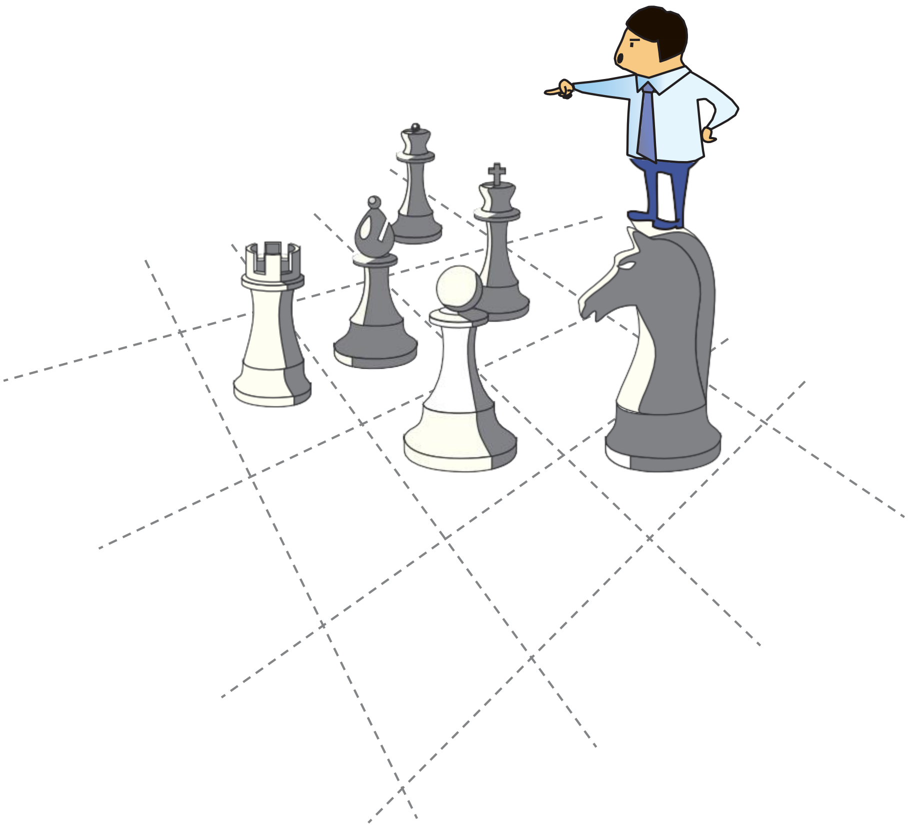
4.24 The accomplishment of a subvented organisation's mission is dependent on the commitment and ability of the staff it employs. The board, through its strategy and policy-making role, has to provide a proper framework to manage the staff as well as meeting the obligations of a responsible employer.

4.25 Organisations should establish appropriate recruitment, compensation, termination and performance management structures to manage their staff and, if applicable, volunteers. They should create healthy and safe working environments to minimise work-related illness, injury or fatalities, and contribute to maintaining a proper work-life balance through reasonable contractual working hours and vacation entitlements. An organisation should demonstrate its commitment to enhancing the competence of its staff through appropriate training and development programmes.

4.26 For those organisations which receive subventions to cover more than 50% of their operational expenses from the Government, comparison with the remuneration of civil servants at comparable ranks should be made when determining the appropriateness of remuneration packages for senior positions. In the absence of such comparable civil service ranks, reference should be made to market practices. The "moderate and conservative" principle should be observed at all times.

4.27 Organisations should communicate to staff the mechanism for the adjustment of remuneration upon appointment. The possibility of both upward and downward adjustments should be incorporated into contracts, having regard to the circumstances and requirements pertaining to their own organisations.

4.28 Successful communication between an organisation and its staff is critical to an organisation's performance. Staff opinions can help provide ideas for the board and the management to continuously refine its governance, improve management decision making and minimise conflicts. Effective consultation will improve staff commitment and support for management decisions and changes in practices.



Best Practice

An effective mechanism for workplace cooperation helps to minimise unnecessary misunderstandings, especially in times of change and uncertainty. Workplace cooperation can take various forms:

Information sharing

This is a two-way flow of information. It involves the regular provision by management of comprehensive information on a range of personnel, financial and other issues of concern to employees. It also involves employees reflecting staff concerns, providing feedback from customers and suggestions to improve organisational performance.

Consultation

Whereby management seeks the views of employees on certain issues, but retains the power to make decisions.

Joint decision-making

A process by which employees' and employers' representatives consider and take decisions together on matters of common interest.

Voluntary negotiation

Where employers and employees voluntarily discuss and negotiate matters of common concern and reach consensus.

Source: Adapted from Labour Department [16]

BEST PRACTICE

Setting up effective communication channels enables employers and employees to understand each other's needs, interests and difficulties and reach agreements which are beneficial to both sides. Employers should:

- consult employees when dealing with changes in working practices, procedures or employment arrangements which affect them; and
- consult staff associations, in-house unions or other consultative committees.

To be effective, employer-employee communication needs:

- – support from top management and employees;
- – objective, clear and concise communication of information;
- – to be regular and systematic; and
- – a two-way flow to allow a free exchange of ideas.

Source: Adapted from Labour Department [17]

4.29 The day-to-day management of staff is carried out by the CEO and the management team on behalf of the board. The board must oversee the establishment of an effective management team whom it can trust and to whom it can delegate authority.

4.30 The board may delegate to its management the responsibility to:

- Ensure the organisation complies with the Employment Ordinance (Cap. 57), workplace safety regulations and other regulations and requirements;
- Review its employment arrangements periodically to ensure that they comply with good practice;
- Ensure staff are provided with job descriptions, orientation, management, training and performance appraisals;
- Ensure that staff have the skills and tools to perform the job to which they have been assigned and comply with any statutory or professional requirements;
- Ensure that staff remuneration / rewards are made in accordance with established mechanisms and requirements;
- Ensure staff are openly, fairly and systematically recruited, appraised and promoted;
- Ensure that staff uphold a high standard of probity and integrity;
- Review periodically the organisation and staff structure, in the light of their effectiveness in accomplishing the organisation's mission; and
- Review the working relationship between the board and the management.

4.31 Delegating these responsibilities to the management team does not absolve the board from assuring itself that the organisation is fully compliant with regulatory requirements and good employment practices. The assurance can be achieved through internal/external reviews or entrusting the monitoring as part of an Audit Committee's remit.

Best Practice

Key Human Resource Management Policies and Practices

The board should agree the HR management policies and practices to be implemented so that the management knows clearly the parameters within which it operates. The following provides some pointers.

- There are documented written personnel policies and procedures covering recruitment and termination, remuneration, performance appraisal and standard work rules. They are regularly reviewed and updated.
- All staff have ready access to these policies and procedures, and are fully inducted on them when joining the organisation.
- Individual staff are provided with up-to-date job descriptions, including required qualifications, duties, reporting relationships and performance measures.
- Staff appraisals should be conducted and documented at least annually for each staff member. Staff appraisal may identify areas for performance improvement or training and development.
- The organisation has an effective and timely process for succession planning, aiming at filling vacant positions at the earliest instances and minimising disruptions to the organisation's services or operations.
- An appropriate training policy and plan exists to ensure that the staff are provided with the opportunity to acquire competencies to meet their current task requirements and take on development opportunities.
- There is a process to review and respond to ideas, suggestions, comments and perceptions from staff.
- Staff are consulted whenever they are affected by major changes in policies and practices.

Staff Integrity

4.32 Boards must pay attention to the integrity of their directors and staff to ensure that their policies, procedures and intended practices are implemented appropriately.

Staff Integrity [18 & 19]

A three-pronged approach can be adopted to enhance the core value of staff integrity.

Prevention

- Formulate a code of conduct to set out the standards of behaviour expected of the directors and employees;
- Establish an internal control mechanism to prevent and detect abuse, corruption and fraud at all levels;
- Issue guidelines on how to handle individuals suspected to be in serious debt, or experiencing financial difficulty;
- Provide counselling support to staff; and
- Promote a healthy lifestyle through board members/senior executives setting an example, organisational activities, newsletters, intranet, etc.

Education and Training

- Include sessions on integrity in induction courses;
- Provide integrity and corruption prevention courses at all levels on a regular basis;
- Conduct "experience-sharing sessions" using real-life case studies to illustrate how public officers may come across ethics/corruption pitfalls;
- Assign a senior officer as Ethics Officer to plan and oversee ethical/anti-corruption strategies; and
- Arrange the ICAC to visit the organisation to conduct presentations to all directors/staff.

Sanction

- Develop and implement a mechanism to ensure prompt handling of complaints and protection of complainants;
- Administer appropriate disciplinary sanctions; and
- Report suspected crime/corruption to the Police/ICAC.

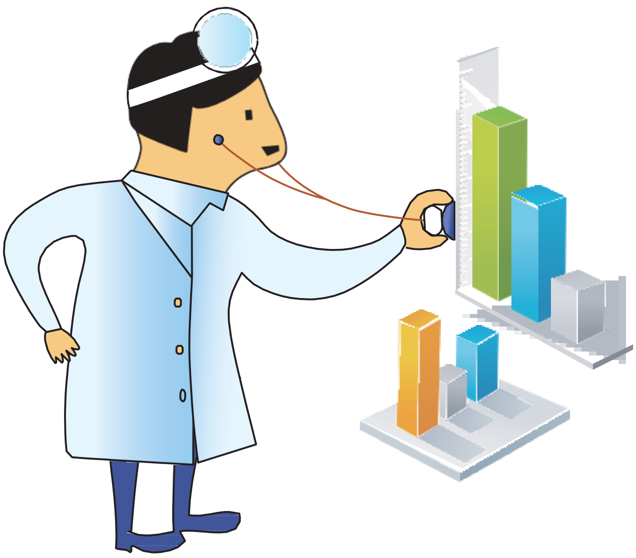
Performance Monitoring

4.33 Organisations should regularly evaluate their performance against their goals and objectives. The process of performance evaluation should be clearly defined and controls should be embedded within the business process. All relevant parties within the organisation should be clearly informed of the process.

4.34 The board should review performance against the organisation's strategic and business plan, including assessing financial and operating results to evaluate whether the organisation is being properly managed. If the board has delegated appropriate authority to management it should hold senior management accountable for the results achieved.

4.35 Management should report to the board periodically the progress towards the achievement of the organisation's goals and objectives and compliance with policies.

4.36 Management should provide the board with reasons for any significant deviations from the approved plans and policies and suggest updates to the plan that reflect the new direction for the board's approval.



Best Practice

Reliable and useful information enables proper evaluation of an organisation's performance. An information system and those who operate it should ensure that full and proper records are kept of the organisation's affairs.

All records that are created and received during the conduct of business, whether paper-based or electronic, should be properly captured in record keeping system(s) in accordance with the organisation's record-keeping policies, procedures and practices. A systematic approach to records management will enable the organisation to:

- ☑ Provide evidence of business conducted and decisions made
- ☑ Manage legal and other risks
- ☑ Meet its accountability obligations
- ☑ Facilitate future reference and queries
- ☑ Capture and share lessons learnt

Good and proper record-keeping is evidence of a well-governed organisation and should be seen as an integral part of, rather than incidental to, any business.

Best practice[5]

An effective performance management system involves:

- Selecting key aspects of performance to measure;
- Developing performance indicators and setting targets;
- Collecting performance information;
- Measuring and reporting actual performance against targets; and
- Striving for future improvements in performance.

Monitoring

4.37 Departments also have a monitoring role, and need to satisfy themselves that appropriate accounting and accountability systems are both in place and practised. Whilst there are a variety of factors that will affect what is appropriate in each case, subvented organisations can expect their oversight departments to check whether the organisation:

- Has adequate reporting and monitoring systems for internal control and transparency;
- Has a system to set clear, measurable objectives in relation to public funding;
- Reviews regularly its effectiveness in achieving these objectives;
- Prepares annual corporate/business plans on a timely basis;
- Has established mechanisms to set and agree performance targets and to evaluate performance against these targets;
- Prepares budget submissions (and any in-year revisions) for approval / endorsement;
- Has an appropriate system of cost control and monitoring to ensure prudent budgetary practices and discipline;
- Maintains a separate set of accounts for the government subvention, if the subvented organisation has other substantial sources of income;
- Submits audited financial statements to the Government on a timely basis;
- Follows rules and procedures on HR management, observing the principles of fairness and transparency;

- Adheres to procurement policies and practices that are transparent, fair and cost-effective;
- Has published its financial statements, the directors' report and the auditor's report;
- Allows the Director of Audit (where appropriate) unhindered access to its records and accounts;
- Allows the department (specified staff/post holders) unhindered access to the records and accounts, and to the facilities in which the subvented activities are taking place; and
- Allows no cross-subsidisation of other activities by the subvented programmes in money or in kind.

4.38 The cost of overzealous application of corporate governance compliance/monitoring/reporting requirements is potentially high. Ideal regimes will be appropriate, effective and cost-effective for all concerned. Organisations should feel free to suggest ways to improve the cost effectiveness and efficiency of the monitoring/reporting processes.

KEY QUOTE

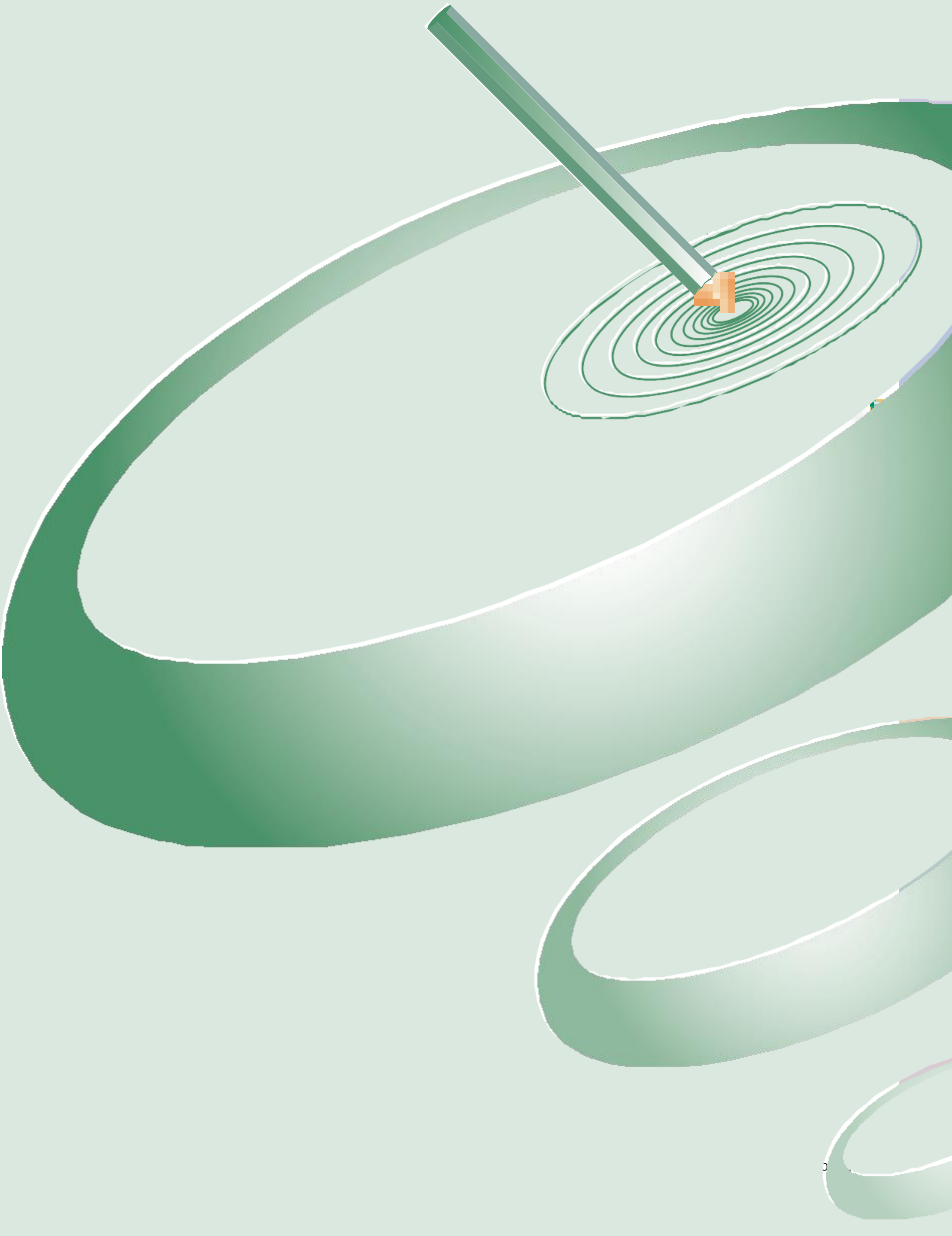
"We always need to strike a balance between adequate accountability and control and proper delegation to the organisation.

The administrative workload brought about by the necessary reporting requirement has always been a major concern of the subvented organisations. There is a need for intelligent monitoring."

Raymond Wong, Permanent Secretary for Education (2007-2010)

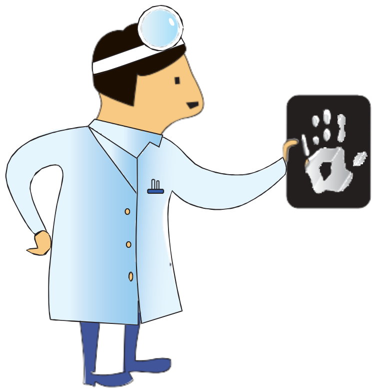
Chapter 5

TRANSPARENCY AND DISCLOSURE



Transparency and Disclosure in Subvented Organisations

5.1 Subvented organisations have an ethical obligation to be accountable and transparent. They should share relevant information with their stakeholders and use it to continually improve the quality of their processes, programmes and activities. Given board member's confidentiality requirements, discretion should be exercised on the promulgation of papers and minutes of the board having regard to the nature of the meeting and the items being discussed.



5.2 An adequate degree of transparency and disclosure of both the financial and non-financial measures that an organisation is taking are two cornerstones of any good corporate governance framework. This helps support the quality and reliability of the information that an organisation reports, which is important for maintaining awareness of its achievements and positioning.

Disclosure of Information

5.3 All relevant and material information, the omission or misstatement of which could influence a decision-maker, should be disclosed. Particular care should be taken with conflicts of interest. Transparency and disclosure may benefit an organisation by:

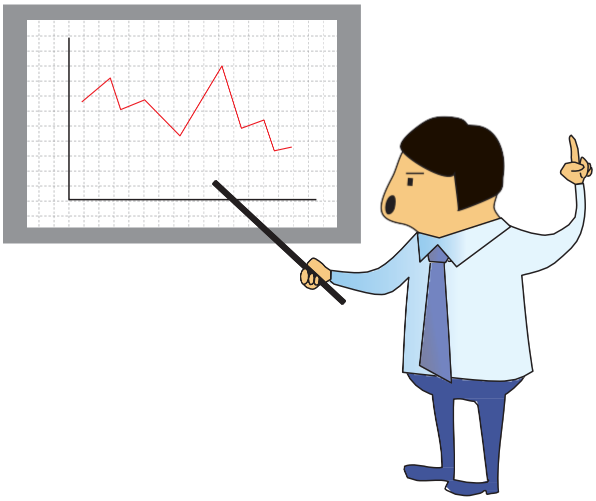
- Improving the ability of its management to make more-informed decisions;
- Giving greater confidence regarding its operations to its stakeholders;
- Showing stakeholders whether, and to what extent, it is meeting its legal responsibilities;
- Increasing public understanding of its activities, performance and overall financial health; and
- Deterring fraud and corruption.

Reporting

Internal Reporting by the Board

5.4 An organisation cannot benefit fully from the work of its board and committees unless their deliberations are reported appropriately within the organisation. The board should tell its management about the matters it has discussed. Reports and minutes of meetings should be formally circulated, having regard to confidentiality requirements.

5.5 Committee chairpersons should report to the board about the work and findings of their committees, and approved minutes of committee meetings should be circulated to members of the board on a regular basis.



Internal Reporting by Management

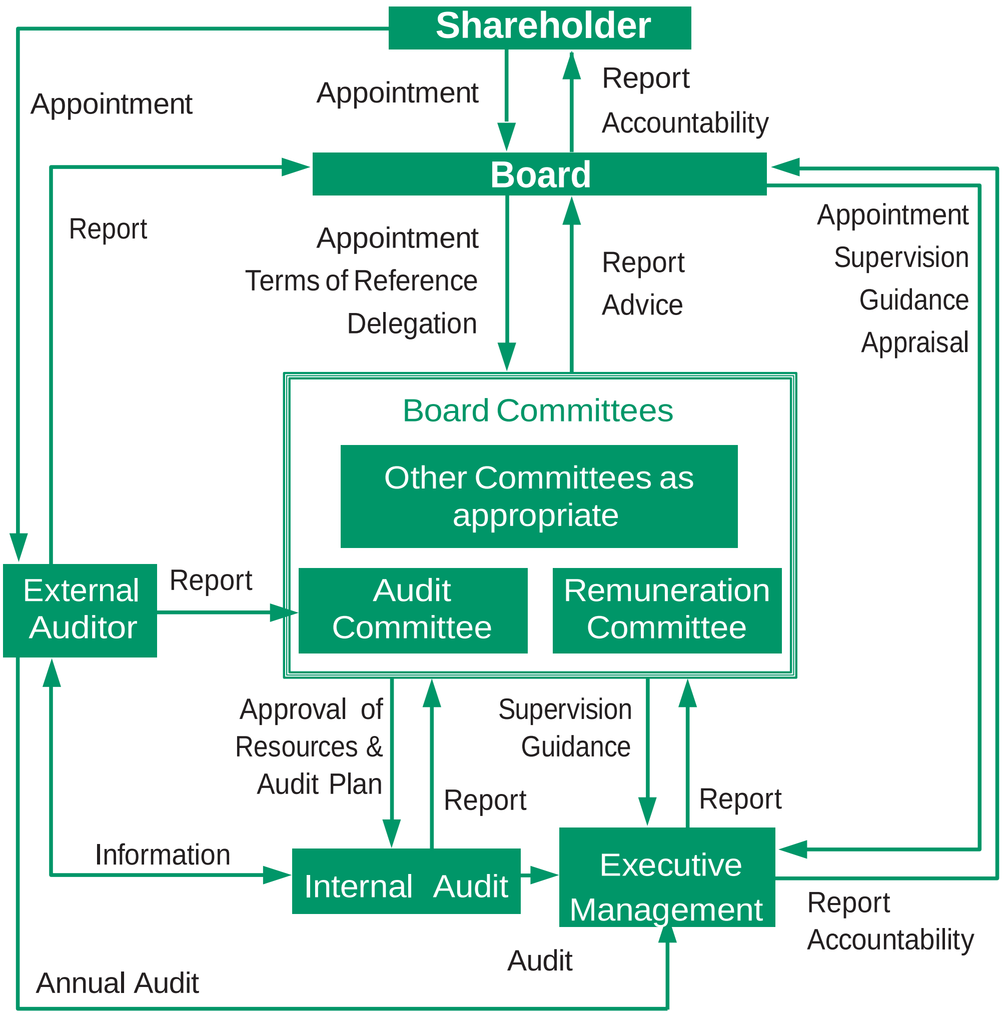
5.6 Management should draw to the attention of its board any major issues in a timely manner, and present all relevant information clearly and concisely. Financial and non-financial performance and other accountability information should be reported to the board or appropriate committee(s) regularly.

A number of statutory bodies (e.g. the Hospital Authority, the Equal Opportunities Commission, the Housing Authority, the Independent Police Complaints Council and the Urban Renewal Authority) have adopted the practice of posting the minutes of their meetings on their websites. Apart from enhancing the accountability and transparency of the organisations concerned, such a practice could also provide a means for stakeholders and the public to monitor the performance of the councils/committees of the organisations.

BEST PRACTICE[20]

Hong Kong Airport Authority's reporting and communication lines: winner of the Best Corporate Governance Disclosure Awards for Public Sector/Not-for-profit category consecutively from 2001 to 2009:

Corporate Governance Structure



External Reporting

5.7 Organisations may consider publishing an annual report containing financial statements within, say, three months of the end of the financial year. Larger organisations which account for a substantial amount of public resources may subject themselves to a greater degree of scrutiny. They may in addition consider reporting key information at least once every six months. Such data could be communicated via website postings or other suitable channels.

5.8 The purpose of the annual report should be to present a clear and objective picture of an organisation to its stakeholders. A good report would include the following general contents and disclosures:

The Organisation

- Its organisational structure;
- Statements of its mission, functions and values, and its strategic vision for accomplishing these;
- Management discussion and analysis concerning the environment in which it delivers its services, and the measures its board is taking to address threats and changes;
- An explanation of its capital and funding structure and stakeholders, and how its management structure supports the achievement of its strategic goals; and
- Annual highlights and key metrics that outline its main activities and accomplishments.

Board Structure

- The board's composition, including the qualifications of its members, and the key work it carried out during the year;
- The number of board meetings it held, and the attendance of individual board members;
- The establishment of any board committees, their terms of reference, the number of meetings held, the attendance of individual members, and the main tasks carried out;
- Disclosure of remuneration policies concerning board member s and senior executives;
- The total remuneration of board members and senior executives, including the numbers of board members and senior executives for each level whose remuneration exceeded a defined sum, expressed in bands;
- A statement concerning the method and terms of appointment of board members; whether board members were appointed pursuant to a specific statutory procedure or by an external nominating body, and whether they had any particular interests as a result of their appointment; and
- A statement concerning the management's role in leading the organisation to accomplish its goals under the board's direction.

Performance

- Audited financial statements, including the auditor's report, and the appointment of auditors for the coming year;

- A comparison of the organisation's financial and non-financial performance with performance measures that were established during the previous financial year; plus an indication of the financial and non-financial performance for the following year;
- A description of any support the organisation receives from the Government or other substantial sponsors;
- An honest and objective commentary concerning its financial and non-financial performance and position, and its ability to meet its future liabilities and commitments;
- The results of any independent reviews of its non-financial performance; and
- A statement outlining the board's responsibility for approving the budget and year-end financial statements, ensuring the adoption of appropriate accounting policies and standards, and maintenance of an effective control framework.

Case Studies[5]

Statement of Accounts

Inadequacies

Following the conclusion of a MAA between the Government and one subvented organisation, a new requirement was imposed, i.e. the auditor's report on its annual statement of accounts should contain an expression of opinion as to whether the organisation had complied with, in all material respects, the terms and conditions of the government subvention as specified in the MAA. This called for an additional audit service which was not covered in the then contract between the organisation and its auditor. For nearly nine months after the signing of the MAA, no action was taken by the organisation to comply with the new requirement.

Audit recommended that the organisation should make sure the audited reports contained an expression of opinion as to whether it had complied with the terms and conditions specified in the MAA.

Improvements made

The organisation confirmed that the auditor's report for the year in which the MAA was signed showed that it had complied with, in all material aspects, all the terms and conditions of the subvention as specified in the MAA. For subsequent financial years, the organisation signed a new audit contract to ensure compliance with the new MAA arrangement.

Internal Control and Risk Management

- Details of the standards or code of conduct the organisation has adopted;
- A statement concerning the board's accountability for the organisation's governance and overall risk management;
- A description of its risk-management and internal control processes;
- A statement of accounting policies and practices, including the standards the organisation has adopted;
- Whether the internal control system has been reviewed, and a report on the review results;
- The Audit Committee's terms of reference, its roles and authorities;
- Disclosure of the appointment, reappointment and removal of external auditors; and
- A statement of compliance with relevant legislation and regulations.

Corporate Citizenship

- A statement of the organisation's corporate citizenship measures and activities.

Performance Measures

5.9 To help assess whether it is achieving its objectives, and to ensure and demonstrate that it is using its resources efficiently and effectively, the board should establish and report on relevant financial and non-financial performance measures. Non-financial performance measurements are important to improve the organisation's operations and deliver high quality services at the lowest possible cost.

5.10 Key Performance Indicators (KPIs) are a useful tool for an organisation's management to assess its accountability, and they also help inform both its internal and external users. Internally, information about the organisation's effectiveness provides pointers for the organisation to improve its efficiency and service quality. Externally, the information can help sponsors to decide whether its performance warrants continued subvention and the levels of funding the organisation should receive.

Key Quote

"Some public sector and non-profit organisations could do more on the corporate governance sections of their annual reports. That was part of the reasons there was only one winner for the Best Corporate Governance Disclosure Award 2009 in the public sector."

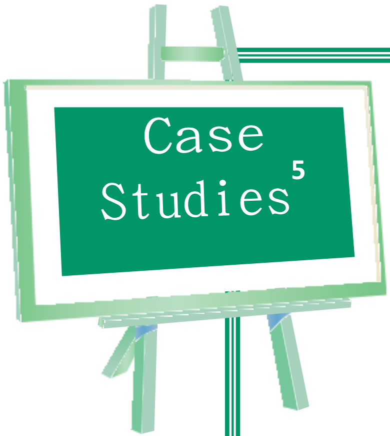
Paul Winkelman,
President of Hong Kong Institute of Certified Public Accountants (2009-2010)

5.11 Many subvented organisations are not profit-driven, unlike their private-sector counterparts, so their performance measurements need to be quantified in terms of identified goals and timeframes, and they should attempt to reflect both quantity and quality.

5.12 The most common bases of comparison for KPIs include:

- Comparison with the performance of previous years;
- Comparison with similar organisations, locally and/or internationally; and
- Comparison of actual performance against target performance.

5.13 Benchmarking is an effective way to assess performance. Measuring against top-performing and similar organisations in Hong Kong or elsewhere can help an organisation to improve, develop better performance-measurement systems, and validate its operational position. Larger organisations may also use internal benchmarking to improve their performance.



Performance Measurement

Inadequacies

In the annual business plan and budget submitted to its board, one subvented organisation set out KPIs on its industry's performance. The Audit considered that these only measured the industry's performance, not the organisation's. The organisation also monitored a number of indicators to measure the performance of its marketing activities. However, some KPIs, and the extent to which they had been achieved, were not made known to the public.

Audit recommended the organisation should make reference to good practices and performance measures adopted by leading international organisations of a similar nature. It should also improve the reporting of performance measures by publishing them in its annual report.

Improvements made

The organisation has –

- Reviewed its KPIs in consultation with academics and the trade to enhance measurement of its marketing activities; and
- Included the KPIs in the Controlling Officer's Report, and the actual performance against these indicators, in its annual reports.

Service Performance (YTD Aug 2009) - Overall HA							
			Current Year	**Target**		**Prior Year**	
			YTD Aug 2009	*YTD Aug 2009*	*Variance*	*YTD Aug 2008*	*Variance*
			A	B	C = (A-B) or (A-B) / B	D	E = (A-D) or (A-D) / D
Inpatient services	Inpatient discharge episodes		382,183	380,832	+ 0.4%	374,394	+ 2.1%
	Bed occupancy rate (%)		80.9%	83.4%	- 2.5%pt	82.4%	- 1.4%pt
	Average length of stay (days) for general inpatients		5.9	6.0	- 2.0%	6.1	- 3.8%
	Unplanned readmission rate within 28 days for general inpatients (%)		10.9%	10.7%	+ 0.3%pt	10.7%	+ 0.2%pt
	Day patient discharge episodes		167,885	144,092	+ 16.5%	149,802	+ 12.1%
Day services	Geriatric day attd		60,094	53,545	+ 12.2%	54,796	+ 9.7%
	Psychiatric day attd		88,799	78,135	+ 13.6%	76,357	+ 16.3%
A&E services	Total attd		895,593	886,298	+ 1.0%	876,997	+ 2.1%
	% of A&E patients within target waiting time						
	triage category						
	I (critical)	(0 min)	100%	100%	0%pt	100%	0%pt
	II (emergency)	(<15 mins)	97.7%	95%	+ 2.7%pt	97.8%	- 0.1%pt
	III (urgent)	(<30 mins)	90.7%	90%	+0.7%pt	88.3%	+2.4%pt

Figures in Blue: >5% above target / prior year

Figure 5.1
Examples of Performance Highlights used by Hospital Authority[21]

Director of Audit's Recommendation on Performance Measures[5]

Subvented organisations should consider developing more performance targets /indicators to measure outcomes and productivity.

Reporting Malpractices

5.14 Typically, reporting malpractices involves one member of staff reporting a malpractice or misconduct by another, usually more senior, staff of an organisation to internal or external parties.

5.15 Apart from deterring malpractices, encouraging the reporting of malpractices also demonstrates to stakeholders and regulators that the organisation is accountable and well managed. This will help maintain and enhance the organisation's reputation.

Malpractices

These could take many forms, including:

- Conflicts of interest
- Bribery and corruption
- Abuse of position to obtain personal gain
- Improper procurement procedures
- Abuse of authority or the use of authority for improper purposes
- False expenses claims
- Embezzlement
- False or misleading financial reporting
- Misrepresentation in product or service advertisements
- Breach of environmental laws or standards
- Abuse/improper use of information technology systems
- Improper handling of personal data

5.16 Organisations should make clear to staff that if they come across any instances of alleged crimes, including fraud, bribery and corruption, they should immediately ensure that they are reported to the appropriate authorities, i.e. the Police in cases of criminal offences and the ICAC in cases of bribery and corruption. Individuals should not take any action or make enquiries as this could hinder or frustrate subsequent investigations.

Policy

5.17 Organisations may draw up their policy to include:

- A statement on the organisation's intolerance of any malpractices;
- Examples of the types of malpractice to which the policy is applicable and the level/ types of proof that should be provided;
- An assurance that reports made in good faith will be welcomed. On the other hand, malicious accusations may lead to disciplinary action or dismissal;
- Proper, fair investigations will be carried out and appropriate follow-up action taken;
- A statement that the identity of the person making the report will be kept confidential; and
- Acknowledgement/recognition of the courage of those making reports.

Implementation

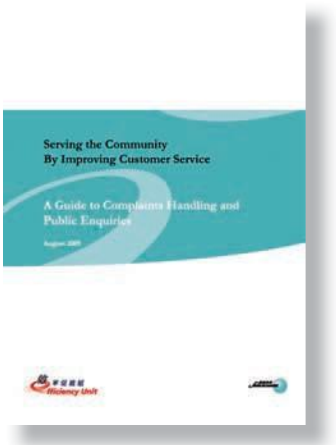
5.18 The reporting channels and the relevant procedures should be set out clearly. It is also important to spell out clearly the action and procedures which will be taken after a report is made, e.g. the investigation procedures, approximate time that the investigation will take and whether the one making a report will be notified of the progress and/or result of the investigation.

Anonymous Complaints

5.19 Many people would prefer to write anonymous complaints, for fear of retribution, etc. Allowing anonymous complaints, however, runs the risk of malicious, unfounded accusations being made. Various Ordinances do create an offence of making a false report, e.g. Prevention of Bribery Ordinance (Cap. 201).

5.20 Each organisation must decide whether to entertain anonymous complaints and under what circumstances. In Hong Kong, there are a number of different approaches:

- Section 10 of the Ombudsman Ordinance (Cap. 397) provides that the Ombudsman should not undertake or continue an investigation if the complaint was anonymous or the complainant cannot be identified or traced.
- Most other legislations leave it to the authority concerned, who will consider the seriousness of the case, whether sufficient detail is provided to conduct an investigation, etc.
- The Efficiency Unit's Guide to Complaints Handling and Public Enquiries states that anonymous complaints should be recorded and treated in the same way as signed/verbal complaints – even though it is not possible to acknowledge or reply to them.[22]
- After a comprehensive review on the LSG Subventions System in 2008, an Independent Complaint Handling Committee, composed of non-official members only, was established to handle all complaints against NGOs subvented by the Social Welfare Department. Anonymous complaints against NGOs are not handled, except those with identified areas/information provided by the complainants and that fall within the scope of misuse of subventions, and cases involving abuse of service users.



Chapter 6

CORPORATE CITIZENSHIP

What is Corporate Citizenship?

6.1 Corporate citizenship, which can also be termed "corporate social responsibility" or "sustainable responsible business", relates to the way an organisation uses a self-regulating mechanism to adhere to laws, ethical standards and leading practices regarding social, environmental and economic matters. It integrates with its values, strategies and daily activities, and concerns the relationships the organisation has with its stakeholders (Figure 6.1).

6.2 The objectives of corporate citizenship are to:

- Minimise Harm to stakeholders, such as by discrimination against particular groups, production of toxic products, generation of pollutants, etc.
- Maximise Benefits to society, the economy and environment, for example, by establishing safe working environments, encouraging ethical and fair business practices, promoting environment friendly measures, etc.; and
- Be Accountable and Responsive to stakeholders, through building relationships of trust and becoming more transparent.

Figure 6.1
Organisations and their Stakeholders

Best Practice[23]

The United Nations Global Compact asks companies to embrace, support and enact the following 10 Principles:

Human Rights

1. Businesses should support and respect the protection of internationally proclaimed human rights.
2. Make sure that they are not complicit in human rights abuses.

Labour

3. Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining.
4. The elimination of all forms of forced and compulsory labour.
5. The effective abolition of child labour.
6. The elimination of discrimination in respect of employment and occupation.

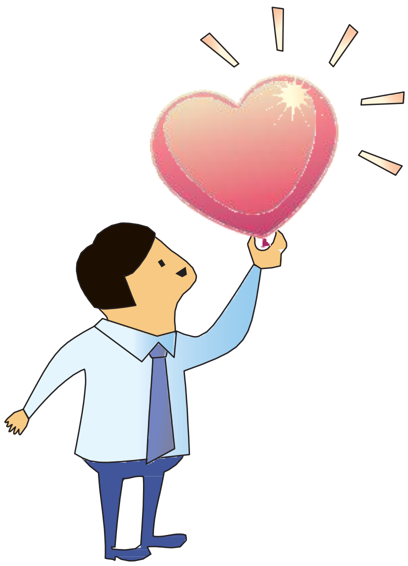
Environment

7. Businesses should support a precautionary approach to environmental challenges.
8. Undertake initiatives to promote greater environmental responsibility.
9. Encourage the development and diffusion of environmentally friendly technologies.

Anti-Corruption

10. Businesses should work against corruption in all its forms, including extortion and bribery.

Why Corporate Citizenship Matters



6.3 Subvented organisations receive funds from the Government to support their activities. Their standards of behaviour and operating activities therefore have a significant influence on the public, and they share responsibility for what happens in society. Increasing stakeholder expectations, heightened media attention and cases of misconduct have all increased public demands for organisations to demonstrate corporate citizenship. Stakeholders now show greater concern over organisations' business ethics and levels of transparency.

Survey [24]

A 2007 survey of over 10 000 companies found that:

- 23% were aware of the corporate citizenship concept
- 9% had institutional mechanisms to implement, monitor and evaluate corporate citizenship programmes
- 86% had policies to protect their customers
- 88% believed they have an obligation to supply safe and quality goods and services
- 95% had environmental protection measures
- 18% donated to charities in the last year

Benefits of Corporate Citizenship

6.4 Organisations that incorporate corporate citizenship into their values, strategies and daily activities can benefit from:

- Enhanced reputation and brand, i.e. being socially responsible is a powerful way to differentiate one organisation from another;
- Strengthened relationships with their stakeholders;
- Better risk management, e.g. by reducing the risks of sudden damage to reputation brought about by legal action;
- Improved attraction and retention of talent, i.e. a positive employer brand creates a strong, distinctive

and attractive identity with which current or potential employees can, themselves, identify;

- Improved operational and cost efficiency through reducing waste, using resources more efficiently and enjoying higher productivity from more motivated employees; and
- Creation of a secure and healthy working environment.

Main Issues in Corporate Citizenship

Ethics

6.5 Ethics applies to all aspects of business activity and to the conduct of both individuals and organisations. Ethics defines how an organisation integrates its core values, such as honesty, trust, respect and fairness, into its policies, practices and decision-making. The standard of ethics in organisations plays a critical role in influencing stakeholders' perceptions of them.

Code of Conduct

6.6 A code of conduct supports the ethical values of an organisation. It should be approved by the board/senior executives and communicated to and acknowledged by all relevant parties. It should be re-circulated to all concerned on a regular basis. A well-designed code of conduct states clearly and concisely the organisation's expectations on ethical behaviour and basic standards of conduct.

It could include an introductory message from the board defining the importance of ethics, integrity and compliance for all directors and employees, and the organisation's vision and mission statements, values and guiding principles. It could then state that directors and employees should behave according to the following principles:

In 1961 Texas Instruments designed a business card that its staff can carry with them and apply the ethics test when considering taking an action:

- ☐ Is it legal?
- ☐ Does it comply with our values?
- ☐ If you do it will you feel bad?
- ☐ How will it look on the newspaper?
- ☐ If you know it's wrong don't do it!
- ☐ If you're not sure, ask.
- ☐ Keep asking until you get an answer.

Integrity

- Conduct themselves personally and professionally in a way that instils and retains the confidence of all those with whom they have dealings.
- Not use their official position to further their personal interests or the private interests of others.
- Declare conflict of interests where an actual, perceived or potential situation arises.
- Protect personal data and commercially confidential information.

Honesty

- Use the organisation's information, documents and resources only for the authorised purposes for which they are provided.
- Admit and correct mistakes where they occur.

Objectivity

- Make decisions and provide advice according to facts and evidence.

Impartiality

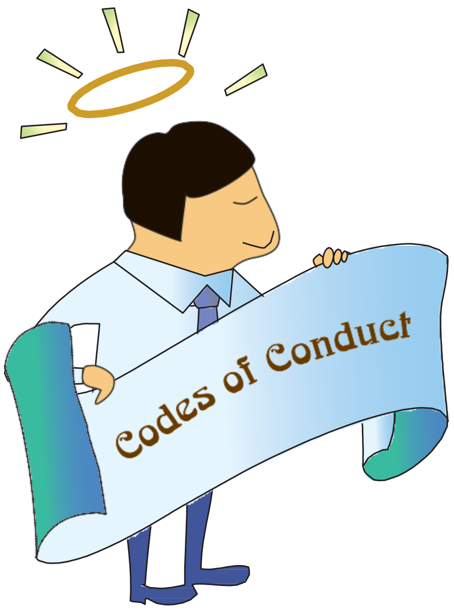
- Act according to the merits of each case and in line with the law and the organisation's policies and decisions.
- Deal with all members of the public, contractors and stakeholders fairly, efficiently, promptly, effectively and sensibly.
- Commit to equal opportunities and no tolerance of harassment or discrimination in the workplace.

Accountability

- Commit to maintaining and reporting accurate operational and financial records.
- Be responsible – individually and collectively – for decisions and actions taken.
- Be responsible for the appropriate, efficient and effective use of resources under their charge.

Dedication

- Act with a spirit of service to the community and in a professional manner.
- Fulfil their duties and obligations responsibly.



Key Quote

"To be successful, Codes of Ethics need to be specific, but not overwhelmingly detailed. They need to be understandable and aimed at helping individuals at all points of the organisation make good decisions."

Deborah Hopen (2002)[25]

Case Studies[26]

The Hospital Authority's Code of Conduct describes how the organisation as well as individual staff should behave in work relationships, dealings with external organisations and in the use of the public funds. The Code forms part of the expectations on all staff.

The Content of the Code covers:

- Our culture
- Vision, Mission and Values
- Personal code of conduct
- Relations with patients
- Relations with community
- Relations with suppliers and contractors
- Relations with Government
- Corporate practices
- Implementation of the code

Ethics Audit

6.7 One way to ensure the integrity of a code of conduct is to conduct periodic ethics audits, preferably by an arms-length auditor such as the Audit Committee. Typical questions to be covered in an ethics audit include those in the following box.

Best Practice[27]

Ethics Audit Questions

- ☐ Are there clear rules about how employees of the organisation should behave towards each other and towards external stakeholders?
- ☐ Is there a shared understanding of the types of behaviour that support the organisation's stated values?
- ☐ Do employees understand how decisions are taken within the organisation, especially those that affect them directly?
- ☐ Is the organisation's performance in relation to its stated values measured and reviewed at least annually?
- ☐ Does the behaviour of board members/senior executives reflect the organisation's stated values? (Do they "walk the talk"?)
- ☐ Have employees been introduced to the organisation's values and have they been instructed on how to approach possible ethical dilemmas?
- ☐ Is there management agreement on how the organisation should treat its people? Is compliance being measured?
- ☐ What is the state of employees' morale? Are there processes and systems in place allowing employees to raise ethical concerns without fear of reprisals? Are there formal grievance procedures, and are these known and used?
- ☐ Are clear, unequivocal sanctions applied to those who behave in breach of the organisation's values and ethics?
- ☐ Does the organisation's code of conduct adequately define matters pertaining to conflict of interest and board members' obligations on confidentiality of information?

Environment

6.8 All societies face environmental challenges. The decisions and activities of organisations can have a positive impact on the environment by, for example, their use of resources, improved efficiency in areas such as building management, operational processes and use of electronic equipment, reducing consumption of energy, water and other natural resources, reducing the generation and emission of wastes and hazardous substances by re-use and recycling of materials, etc.

6.9 Environmental policies and procedures should determine the actions to be taken to prevent, reduce or mitigate harm to the environment. Organisations should first understand and assess the environmental impacts of their activities and then determine the measures they will take to address these impacts and that will be included in their policies and procedures.

The Chinese University of Hong Kong seeks continually to improve the environmental quality of the campus to provide a congenial environment for teaching, learning and scholastic activities.

The University is committed to ensuring that all activities run by the University are conducted in an environmentally responsible manner and has adopted the following guidelines in pursuance of this commitment:

- We endeavour to build a clean and green campus congenial to the fulfilment of the purposes of the University;
- We seek to comply with all applicable environmental legislation, standards and regulations;
- We avoid, reduce or control environmental pollution arising from our activities and require our contractors to adopt and implement similar environmental measures;
- We seek continual improvement in the efficient use of energy and other natural resources;
- We raise environmental awareness among staff and students and set the University as a model in environmental education and environmental management;
- We ensure good management practices by reviewing them regularly and ensure that they are tuned to the changing internal and external circumstances.

Case Studies[29]

All government departments should appoint their own Green Managers, preferably at directorate level. Their responsibilities include:

- Implementing a programme of green housekeeping;
- Introducing measures to increase staff consciousness and improvement in relation to environmental issues; and
- Publicising the commitment to protecting the environment, formulating action plans and recording achievements.

Best practice[30]

The Guide to Corporate Environmental Performance Reporting aims to help organisations prepare their environmental performance reports. It gives an overview of the key steps involved in the production of an environmental performance report, and suggests some basic principles and options to be considered. It brings together selected examples, good practices and checklists for its users to plan and prepare their reports to suit circumstances that befit their organisations.

Stakeholder Relationships

Community Involvement and Development

6.10 The community is an important stakeholder for subvented organisations as both share common interests and responsibilities to enhance the public good and strengthen civil society. Consulting with representative local groups and associations to understand the needs of the community is the first step in determining the priorities for community involvement and development activity.

6.11 Taking part in volunteer work by staff of subvented organisations is important to demonstrate the organisation's community involvement efforts toward the sustainable development of the community.

Key Quote

"By taking part in volunteer work, companies can not only bring satisfaction to their staff, but also establish a positive image in the community.

The co-operation between the Government, the business and social welfare sectors can contribute to the sustainable development of the community and enhance its ability to ride out adversity."

Patrick Nip, Director of Social Welfare (2009-2013)

Case Studies 31

The Hong Kong Institute of Education was recognised as a Caring Organisation 2005/06 for the involvement of its students in developing and running courses and activities, providing opportunities for Tai Po's senior citizens to receive continuing education and for the students to practise their teaching and programme planning skills.

In 2002, the Hong Kong Council of Social Service introduced the "Caring Company Scheme", targeting government departments, statutory bodies, chambers of commerce, professional bodies, international service clubs, philanthropic foundations and non-profit hospitals. It recognises organisations which demonstrate a caring spirit and corporate citizenship through the contribution of resources and the expertise of their employees.

Occupational Health and Safety

6.12 An organisation should establish policies and procedures outlining its commitment to occupational health and safety. It should detail the responsibilities of all relevant parties for managing and improving measures for the prevention, reporting and investigation of work-related accidents, hazards and injuries.

Human Rights

6.13 Publicly funded organisations have a particular responsibility to uphold human rights. In recent years, Hong Kong has placed greater emphasis on equal opportunities and diversity, and anti-discrimination over sex, race, disability and family status. Organisations' policies and procedures should support principles of equal and fair treatment of employees and service users as well as compliance with legal and regulatory requirements.

Survey [32]

A 2009 survey of 756 small, medium and large companies across the United States found the following aspects were rated the most important:

- Operating with ethical business practices (91%)
- Treating employees well (81%)
- Managing and reporting company finances accurately (76%)

From Aspirations to Actual Practice

Understanding the Present

6.14 In order to strengthen its corporate citizenship, a subvented organisation has to understand its own circumstances. This involves the organisation:

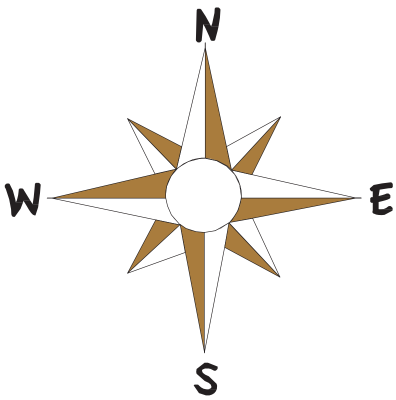
- Identifying its stakeholders and understanding their concerns;
- Gathering and examining information on the regulatory environment and industry best practices;
- Assessing its current values, ethics and decision making structure;
- Taking an inventory of its activities and programmes that fall under the scope of corporate citizenship;
- Revisiting its –
  - – Vision: What does the organisation want to be?
  - – Mission: Why does the organisation exist?
  - – Values: How does the organisation conduct itself when accomplishing its mission?
- Defining the organisation's specific aspirations for corporate citizenship.

Make it Happen

6.15 To translate the aspirations of corporate citizenship into action, organisations need to develop policies and procedures to govern their daily operations and practices.

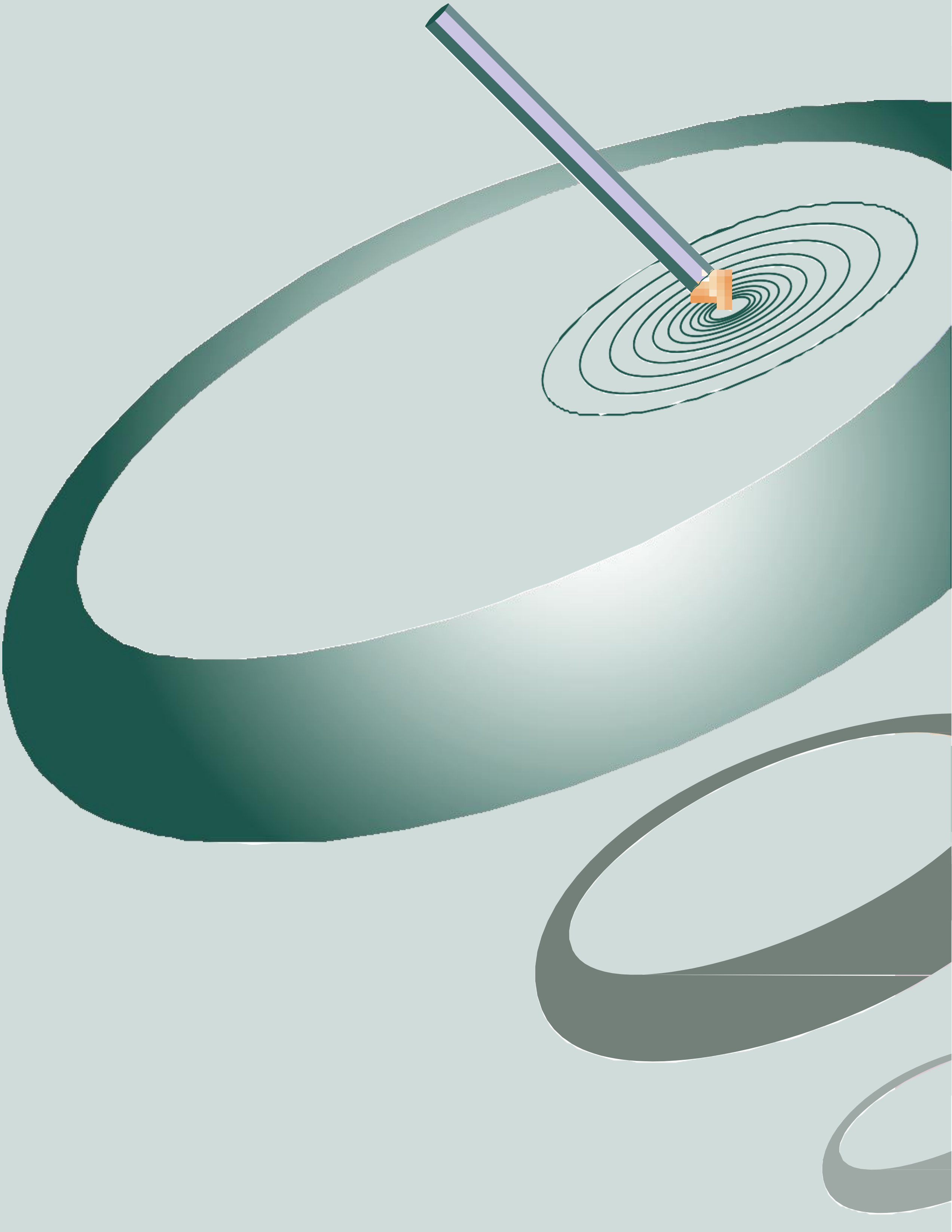
6.16 To achieve the best results, organisations should conduct initial and ongoing training to increase the awareness of corporate citizenship in the organisation and to equip staff with the necessary knowledge to implement the policies and procedures. Training also provides a channel for obtaining employees' feedback on relevant matters, which can facilitate the regular enhancement of the organisation's corporate citizenship practices.

6.17 Management can also consider establishing workgroups and committees and to promote specific aspects of corporate citizenship.



Chapter 7

Risk Management and Compliance



Risk Management

Risk Management Framework

7.1 Risk management, or enterprise risk management (ERM), should be considered as a key component of organisational strategy, as it reduces the likelihood of potential failures, increases the chances of success, and contributes to an organisation's sustainable growth and long-term prosperity[33]. Risk management forms part of the glue that holds corporate governance together.

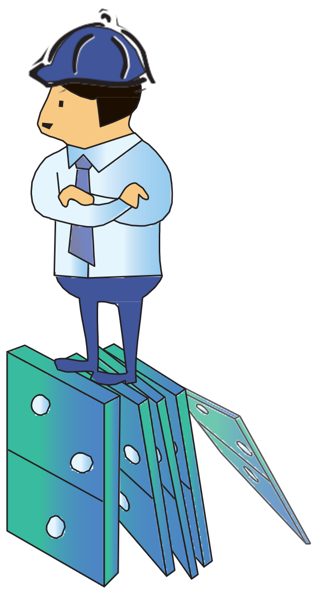
7.2 Risk management helps to anticipate and manage future events by incorporating a decision-making process to determine the best way(s) to deal with potential losses and pursue potential opportunities. It is an on-going process to identify, evaluate and manage risks. All organisations must accept varying degrees of risks in order to accomplish their missions, and should determine whether the type and the degree of risks they face are maintained within tolerable levels. Risk management cannot guarantee that risks would not materialise, but it can provide a reasonable basis for managing risk of failure to achieve business objectives.

Protecting Assets and Mitigating Impacts

7.3 The risk management system needs to be flexible enough to handle rapidly changing internal and external environments. To ensure continued effectiveness, it should be re-evaluated thoroughly on a regular basis.

7.4 Organisations may face litigation - even for frivolous reasons. Risk management can provide a series of processes and procedures to enable the organisation to demonstrate that it has followed the appropriate steps in its activities. It can also serve to provide evidence that could help the organisation to prevail in a lawsuit.

7.5 Boards may consider purchasing insurance to mitigate certain risks. Insurance can transfer some of the financial consequences of risk to another party but it does not eliminate all negative impacts particularly in non-financial areas.



Common Types of Organisational Risks [34]

(1) Strategic Risk:
Relating to high-level goals associated with the support of the organisation's mission

(2) Operational Risk:
Relating to the effective and efficient use of an organisation's resources and the delivery of its services

(3) Reporting Risk:
Relating to the reliability of the organisation's reporting procedures

(4) Compliance Risk:
Relating to the organisation's compliance with applicable laws and regulations

Risk Management Programme

7.6 Developing a risk management programme involves:

- Determining the organisation's risk-taking appetite so as to ascertain the nature of risks which the organisation is willing to take. Risk management is equally important irrespective of the organisation's risk appetite. An organisation that is more of a risk-taker may put in less stringent controls but it should, however, undergo the same risk management practices as a risk averse organisation.
- Risk identification considers and articulates any serious risks which the organisation faces. The organisation first has to identify risks by examining its functional areas, such as sourcing of funds, community service initiatives and administrative operations. The board should also perform a broader risk analysis based on understanding the expectations of various stakeholders. It can then identify what type of uncertainties would threaten the organisation's mission and operational plan.
- Evaluating and prioritising risk helps the organisation to make appropriate decisions about when and where to invest its time and resources. The organisation should develop criteria to prioritise risks according to their impact on the organisation and the likelihood of their occurrence. Not every risk faced is material and critical. The goal is to create a workable and practical list of significant risks on which to focus risk management efforts.
- Selecting appropriate risk mitigation tools is the process of developing strategies to minimise the possibility of risks materialising and how to handle them if they do occur. When determining the approach, the organisation can choose to change, transfer, avoid or retain the risks.

- Monitoring and updating the risk programme allows the organisation to learn from experience. Management should be responsible for reporting risk events and the performance of control to the board on a regular basis.

7.7 A checklist for a risk management framework is at Annex 5.

Internal Control and Audit

Internal Control

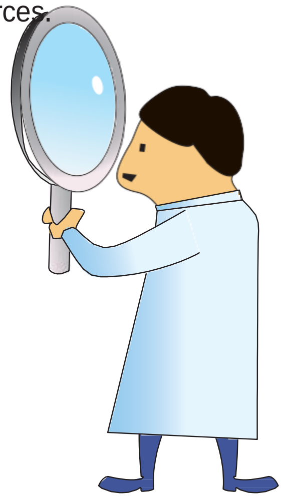
7.8 Internal control is a process, overseen by management, designed to provide reasonable assurance regarding the effectiveness and efficiency of operations in achieving objectives, reliability of financial reporting, and compliance with applicable laws and regulations.[35]

7.9 Controls help to reduce certain risks to acceptable levels, and to enable management to identify any potential problems on a timely basis. A review should take place at least once a year, covering all key controls, including financial, operational and compliance controls and risk-management functions.

Internal Audit

7.10 Internal audit is a tool used by management to identify and assess on an independent basis potential risks to the organisation's operations. The primary functions of internal audits are to review the adequacy of internal controls that are established to ensure compliance with regulations, policies, plans, procedures and business objectives. Ensuring completeness, accuracy and reliability of financial reporting, safe custody of assets, appraising activities and utilisation of resources are equally important functions of internal audit.

All these internal audit functions help assist management in achieving the organisation's objectives and ensuring the economical, efficient and effective use of resources.



Types of Internal Controls [36]

Detective: Designed to detect errors or irregularities that may have occurred.

Corrective: Designed to correct errors or irregularities that have been detected.

Preventive: Designed to keep errors or irregularities from occurring in the first place.

7.11 Internal auditors provide independent and objective advice on risks and controls related to business operations, and should not assume any executive responsibilities such as preparing, installing or engaging in any transactional processes. The internal auditor should be free of any undue influence from the executive in identifying areas of audit and selecting audit methodologies. Except for specialist audits which require professional knowledge of other disciplines (e.g. quantity survey in construction projects), internal audit staff should be trained in accountancy and proficient in applying auditing methods, procedures and techniques.

7.14 Audit reports should have restricted circulation and should not normally be issued to others without the approval of the Head of Internal Audit and the knowledge of the auditee. Every year, the internal auditor should submit both an annual audit plan and a report setting out the conclusions and recommendations arising from the internal audit direct to the Audit Committee (or board if no Audit Committee exists) for information.

7.15 The US Institute of Internal Auditors' best practice requires that the internal audit function itself should be reviewed at least once every five years.

Director of Audit's Recommendations on Compliance[5]

- Ensure compliance with the organisation's procurement procedures and requirements.
- Ensure all sensitive expenditure items, e.g. business trips outside Hong Kong, including trips to Macau, must have the Board's prior approval.

7.12 Internal auditors should be authorised to enter all areas of operations and have access to any documents and records considered necessary for their assigned responsibilities.

7.13 After conducting reviews, internal auditors should propose improvement opportunities and keep in view the implementation of their recommendations to ensure that accepted remedial actions are implemented effectively and efficiently.

Brisbane City Council improved its internal auditing by integrating the audit department into its corporate risk management framework. This was achieved by directly linking annual audit plans with its divisional and branch risk registers.

The internal auditors were able to promote risk management throughout the council by aligning risk analysis with the organisation's ERM framework. This alignment challenged and enhanced risk rankings and treatments, improved the identification and evaluation of controls. Additionally, it clarified the ownership of risks, reduced the number of disputes at the conclusion of audits, and aligned audit reports more effectively with the organisation's objectives.

Audit Committee

7.16 There is growing use of Audit Committees to oversee audit arrangements. The Audit Committee also has an important role in monitoring the organisation's internal control and risk management systems. To function effectively, the Audit Committee should:

- Have written terms of reference approved by the board;
- Be separate from and independent of the organisation's management, comprising of only NEDs who have the authority and the necessary skills and experience. There should be at least one independent NED with appropriate professional qualifications or accounting or related financial management expertise. The board chairperson should not chair the Audit Committee;
- Establish formal and transparent arrangements for considering how it would apply financial reporting and internal control principles and for maintaining an appropriate relationship with the organisation's auditors;
- Engage independent advisers when the need arises;
- Meet with the board and senior executives at least once a year to discuss the quality of financial statements;
- Meet the internal auditors privately at least once a year;
- Conduct self-evaluation every year; and
- Establish a mechanism to rotate members periodically.

7.17 Some organisations may require their Audit Committees to review the arrangements for staff who report malpractices (see Chapter 5), and conduct periodic ethics audits.

7.18 A practical guide on the formation of an Audit Committee was issued by the Hong Kong Institute of Certified Public Accountants.[38] The Code on Corporate Governance Practices of the Hong Kong Listing Rules also sets out best practices for Audit Committees.[39]

Audit Committee's Duties and Authorities

7.19 An Audit Committee should:

- Regularly review the organisation's internal control and risk management systems;
- Regularly review the approach to and extent of internal audit and external audit carried out over the course of the year;
- Discuss with management the effectiveness of internal control systems;
- Review and discuss with management the internal and external auditors' observations on the internal control systems;
- Manage and disclose its relationship with the external auditors;
- Review and monitor the external auditor's independence and objectivity and the effectiveness of the audit process;
- Monitor the integrity of the organisation's financial statements and review significant financial reporting judgements contained in them, focusing on:
  - changes in accounting policies and practices
  - major judgemental areas
  - significant adjustments resulting from audits
  - compliance with accounting standards and regulatory requirements
- Monitor management's responses to audit queries to ensure that they are timely and appropriate;
- Review and recommend the external auditor's engagement, reappointment or removal, and approve the remuneration and terms of engagement of the external auditor; and
- Ensure sufficient resources are available for internal and external audits.

Case Studies 5

Internal audit weaknesses

In conducting inspections, a quality assurance section (QAS) of a subvented organisation had identified some common internal control weaknesses and reporting errors in the organisation's annual accounts. However, the board took a long time to follow up on the QAS recommendation. The senior management of the organisation was not involved in monitoring the implementation of the QAS recommendation.

Another organisation relied on its audit team to vet the financial reports of almost all projects but the audit team did not have formal accounting and auditing training. The number of field audits conducted by the audit team decreased by 66% in 2008 and the organisation was not able to closely monitor their subsidised projects.

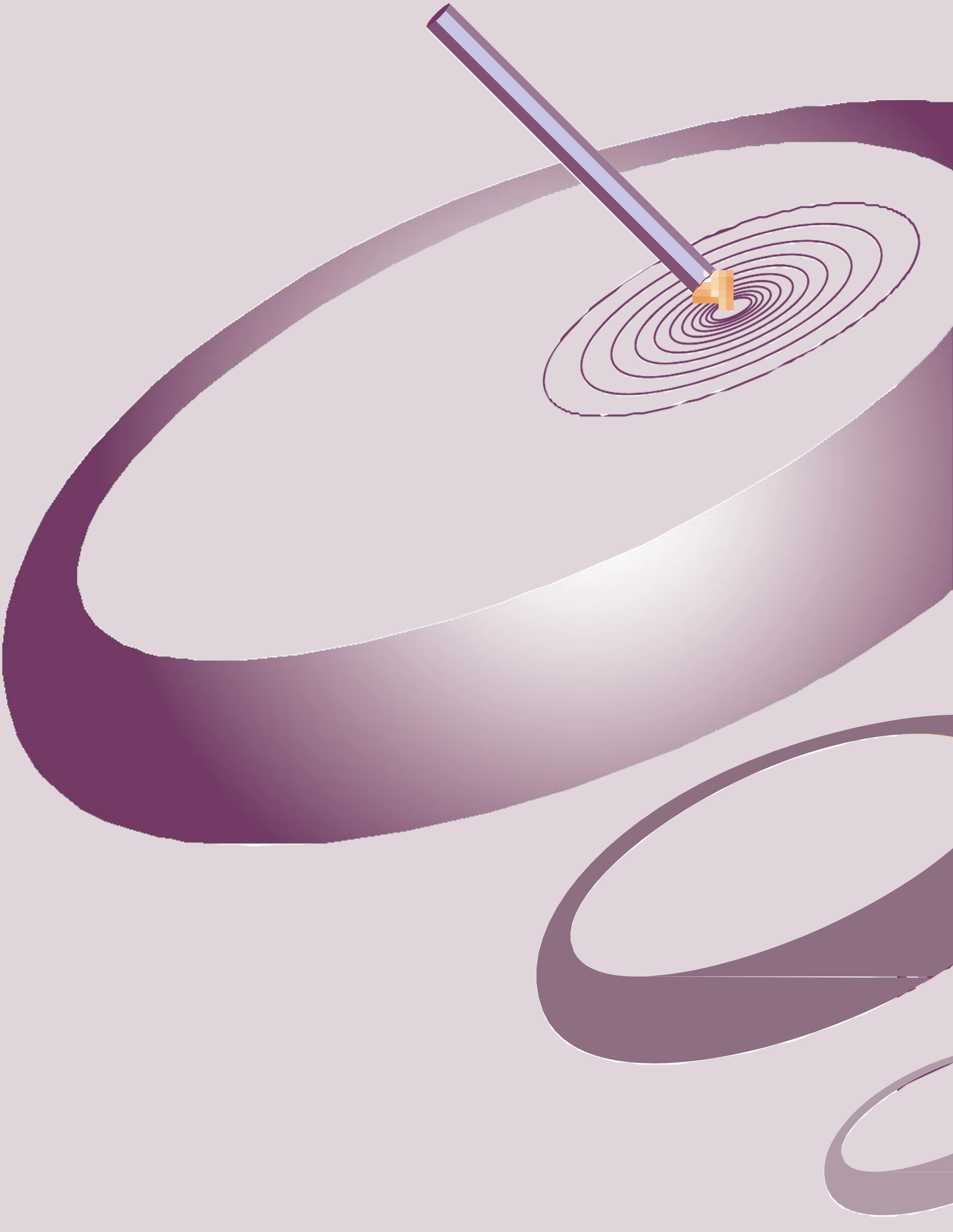
External Audit

7.20 It is a best practice for all organisations to engage an external auditor. External audits increase an organisation's credibility and provide an objective and independent review of its financial reporting. They also help to encourage its reporting to be consistent and reliable, and promote transparency and accountability in its use of financial resources.

7.21 External auditors may assist an organisation by reviewing its compliance and governance reporting or conducting efficiency studies. Independent third-party reviews of this nature can play an important role in enhancing an organisation's control system. The board must ensure that it maintains an objective and professional relationship with the organisation's external auditors. The Audit Committee should satisfy itself there are no conflicts of interest that might compromise the auditors' independence, including those that may arise from the proportion of fees that are attributable to non-audit work, compared with those for audit work.

CHAPTER 8

LEGAL ISSUES



8.1 Subvented organisations may be established under different legislation. Some organisations are registered under the Societies Ordinance. Organisations that are statutory bodies must ensure that they comply with the requirements of their own Ordinances. The majority of the subvented organisations are companies limited by guarantee incorporated under the Companies Ordinance. This chapter highlights some legal issues related to the Companies Ordinance, and to certain other Ordinances where specified. This Guide does not purport to give legal advice. Readers should refer to the relevant legislation and / or seek legal advice as appropriate. It is the duty of each board to be fully aware of the legal obligations of their organisations and the corresponding role and duties of key post holders.

Formation of Organisation

8.2 The board and management should be aware of the applicable laws and regulations and seek to ensure that a proper governance framework is in place in their organisations.

Obligations of Subvented Organisations As Limited Companies

8.3 A company incorporated under the Companies Ordinance is a separate legal entity, that is, it is a legal person in its own right and separate from its members.

8.4 The benefits of limited liability through operating as a limited company also bring with it the obligation to comply with the various provisions in the Ordinance. These obligations include the timely disclosure and reporting of specified information about the company, its directors and company secretary, and members, etc. and reporting any changes in such information to the Companies Registry.

Who is a Director?

"Director" includes any person occupying the position of director by whatever name called.[40]

8.5 A director is a member of the governing board of a company incorporated under the Companies Ordinance. A company limited by guarantee must have at least two directors, and all the directors must be natural persons. A private company must have at least one director, and at least one of the directors must be a natural person. It is important to know who directors are as they are the ultimate decision makers in a company and are accountable directly to it and indirectly to its members and stakeholders. Under the Articles of Association, the board of directors may be referred to as the board of governors, the council, etc. The highest governing body as provided under the Articles of Association, however named, shall be responsible in law as the board of directors and its members shall be responsible in law as directors.

Are you a director?[41]

"The law does nothing to control the growing and potentially misleading practice of giving employees the title of director, even though they perform none of the central management functions of a director and are thus not directors under the [Companies Ordinance]. On the other hand, a person who is a director, as meant by the [Companies Ordinance], need not be so called, for the term of director, as used in the legislation, includes any person occupying the position of director, by whatever name called, and directors of some guarantee companies are still called 'governors' or the like".

Legal Duties of Directors

8.6 Directors owe their legal duties to the organisation instead of the members and stakeholders of the organisation, even though generally the interests of the organisation should coincide with those of members and stakeholders. It is very important to note that directors of non-profit organisations are subject to essentially the same legal duties as directors of commercial companies. Regarding the enforcement of directors' duties, the court generally draws no distinction between commercial companies and non-profit organisations, or between executive and non-executive directors.

The following duties apply to all kinds of directors and those acting as directors:

(1) The duty to act in good faith in the best interests of the objects of the organisation

A director must ensure that the objects of the organisation, as set out in the Articles of Association, are actively pursued. Although directors should fully consider the feedback from members and stakeholders, they must act and make decisions based on what they genuinely believe are the best interests of the organisation.

Base decisions on what is best for the company [42]

Sometimes it is difficult to see the reasons why we favour a particular course of action. Habits develop. Directors may act as a rubber stamp for the wishes of the CEO. A strong chairperson may stifle the opportunity for real debate. A good habit to develop is that of asking yourself questions such as these before giving support to a decision:

- Do I have enough information about this issue?
- Do I understand the pros and cons?
- What is the short-term/long-term benefit to the company?
- Is the proposal envisaged by the objectives of the organisation?
- Is it in keeping with the ethos of the organisation?
- Will it cause a conflict of interest?
- Does it compromise the company in any way?

(2) The duty not to exercise powers for an improper purpose

A director must not exercise powers for any purpose other than for the objects of the organisation. The powers may only be exercised in the pursuance and carrying out of the objects.

(3) The duty to serve with reasonable care, skill and diligence

A director is required to exercise such care, skill and diligence that would be exercised by a reasonably diligent person with the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company, and the general knowledge, skill and experience that the director has. Therefore a director must make sure that he has time and relevant expertise to serve on a board (and committees such as the Audit Committee). As noted above, no distinction is to be drawn between EDs and NEDs. To discharge this duty, a diligent director should:

- as far as practical, attend all board meetings, board meetings of board committee(s) of which he is a member, the annual general meeting and any general meeting which may be called by the board of directors or members;
- read board papers and make sure that he is well-informed before decisions are made;
- inform the board of his views by written submission if he is not available for a meeting;
- take an active part in discussions and make constructive challenge if necessary, noting that liability may not be avoided by remaining silent on sensitive issues;
- put in place proper reporting and monitoring procedures (e.g. a whistle-blowing arrangement) to enable them to keep track of the performance of the organisation; and
- avoid blind reliance on given information without first considering whether it is reasonable to rely on the information.

(4) The duty not to use their position or information improperly

It is improper for a director to use his position or the organisation's information to gain a personal advantage (e.g. accepting gifts or commissions) or for the advantage of someone else.

- In law it is no defence that the organisation has not suffered any real loss as a result of the misuse of position or information.
- Without prior approval by the board, the directors must not disclose the board papers and the contents of any discussion at board meetings to any third party.

(5) The duty not to accept personal benefit from third parties

A director must not accept any benefit or gift from a third party who expects the director to exercise powers in his favour, no matter that the exercise of powers in that manner does not cause any actual harm to the organisation. It should also be noted that the receipt of such personal benefits may subject the director to a charge under the Prevention of Bribery Ordinance.

(6) The duty to avoid any actual or potential conflicts between personal interests with those of the organisation

A director must not allow himself to be put in a situation in which there is an actual conflict between his personal interests and the organisation's interests. A director would also be liable if it appears that the potential conflict may compromise his loyalty to the organisation (e.g. the director in question might not have fully considered the organisation's interests due to the potential conflict).

- A director must disclose any material personal interests (including "indirect" personal interests, for example, the interests of the family members of the director) in the organisation's contracts, arrangements or transactions, and any situation that would lead to a conflict of interests, prior to any discussion by the board on a matter which may relate to those interests.

- The Articles of Association or code of conduct (if any) may require a director in a conflict of interests not to be involved in the board discussion or the voting.

Legal Duties of the Organisation

8.7 In the case where the organisation is a company, the board of directors and the company secretary bear the major responsibility to ensure that the company has complied with all the applicable provisions of the Companies Ordinance. If a company fails to comply with the requirements of the Ordinance, the company as well as the officers mentioned below may be liable to prosecution. Below are some of the main requirements.

(1) The duty to keep proper accounting records

Directors must take all reasonable steps to secure that the company keep and preserve proper accounting records that show and explain the organisation's transactions, disclose its financial position and financial performance and enable the directors to ensure that the financial statements comply with the Companies Ordinance. The accounting records must be preserved by the company for at least seven years after the end of the financial year to which they relate. The accounting records shall record correctly and on a timely basis:

- daily entries of all sums of money received and expended by the organisation and the matters in respect of which the receipt and expenditure takes place; and

- the assets and liabilities of the organisation.

(2) The duty to prepare annual financial statements and directors' report

Directors must prepare and lay at an AGM the directors' report, the organisation's audited financial statements made up to the end of the past financial year, and also the auditor's report. The directors' report (approved by the board and signed by a director or company secretary authorised by the board) must address certain matters, including among other things:

- the principal activities of the organisation and of its subsidiaries in the course of the financial year; and
- the particulars of any other matters so far as they are material for the appreciation of the state of the affairs of the company and its subsidiaries by its members, provided that such disclosure will not, in the opinion of the directors, be harmful to the business of the company and its subsidiaries; and the particulars required to be contained in a business review. A company needs not prepare a business review if it belongs to one of the categories of company which are allowed to prepare "simplified" financial statements under the Companies Ordinance (i.e. its financial statements can be prepared in accordance with The Small and Medium-sized Entity Financial Reporting Framework and Financial Reporting Standard). For example, a company limited by guarantee is so qualified if its annual revenue does not exceed $25 million.

What is a Business Review [43] ?

All companies (except those qualified for simplified reporting) are required to prepare, as part of the directors' report, a business review which is more analytical and forward-looking than the information required under the "old" Companies Ordinance.

The business review will provide additional information for members and help assess how the directors have performed their duties. In particular, the requirement to include information relating to environmental and employee matters that have a significant impact on the company is in line with international trends to promote corporate social responsibility. The business review consists of –

- a fair review of the company's business;
- a description of the principal risks and uncertainties facing the company;
- particulars of important events affecting the company that have occurred since the end of the financial year; and
- an indication of likely future development in the company's business.

To the extent necessary for an understanding of the development, performance or position of the company's business, a business review must include –

- an analysis using financial key performance indicators;
- a discussion on the company's environmental policies and performance and the company's compliance with the relevant laws and regulations that have a significant impact on the company; and
- an account of the company's key relationships with its employees, customers and suppliers and others that have a significant impact on the company on which the company's success depends.

(3) The duty to appoint an auditor for an annual audit

A company must have its financial statements audited by practising certified public accountants annually. The auditor is required to prepare a report for the members of the organisation on the financial statements to be laid before the AGM. The auditor must state whether the financial statements have been prepared in compliance with the Companies Ordinance, and whether they give a true and fair view of the financial position and financial performance of the organisation, unless the company falls within the reporting exemption i.e. it is allowed to prepare "simplified" financial statements.

(4) The duty to maintain registers

The board of directors and the company secretary must make sure that the specified books are maintained and updated and are open to its members for inspection. At least the first three items below should be open to the public for inspection; and the minutes books of general meetings should be open to the members for inspection. The required books include:

- Register of members
- Registers of directors and company secretaries;
- Register of charges; and
- Minutes books of board meetings and general meetings.

(5) The duty to file documents with the Companies Registry

The board of directors and company secretary must make sure that specified documents (e.g. annual return, special resolutions, etc.) are filed with the Registry on time.

(6) The duty to call an AGM and GM

The board of directors must ensure that the organisation has its AGM every financial year. A newly formed organisation which is a private company or company limited by guarantee is required to hold its first AGM within 9 months after the anniversary of its incorporation or 3 months after the end of the financial year, whichever is the later. A subsequent AGM of an organisation which is a private company or company limited by guarantee must be held within 9 months after the previous financial year. At least 21 days' notice of the AGM must be given to every member, every director and the auditors of the company in the manner as specified under the Articles of Association, subject to the provisions of the Companies Ordinance. A copy of the audited financial statements, which is to be laid before the company in AGM, together with a copy of the directors' report and a copy of the auditor's report must be sent to members of the company not less than 21 days before the date of the AGM. The board of directors must convene a general meeting (GM) on the requisition of members holding at least 5% of the total voting rights. Within 21 days after the date of receipt of request by such members the company must send out a notice to all members to convene a GM within 28 days after the date of giving of the notice.

Company Secretary

8.8 Company secretaries are employees occupying senior managerial positions in an organisation and are usually members of the board. Their basic role is to ensure the organisation's compliance with the relevant legislations and regulatory requirements. They are also responsible for advising the directors on good corporate governance practices.

Best Practice [44]

Role of Company Secretary

- Keeping under close review all legislative, regulatory and corporate governance developments that might affect the organisation's operations, and ensuring that the board is fully briefed on these and that it has regard to them when taking decisions;
- Ensuring compliance with all statutory filing requirements and regulatory disclosures;
- Ensuring the smooth running of the board's and board committees' activities by helping the chairperson to set agendas, preparing papers and presenting papers to the board and board committees, advising on board procedures and ensuring the board follows them;
- Establishing an effective working relationship with the chairperson and CEO;
- Acting as a primary point of contact and source of advice and guidance for, particularly, NEDs as regards the organisation and its activities in order to support the decision making process;
- To act as a confidential sounding board to the chairperson, NEDs and EDs on matters that may concern them, and to take a leading role in managing difficult interpersonal issues on the board;
- Inducting new directors into the organisation's business and explain their roles and responsibilities;
- Ensuring that the concept of stakeholders (particularly employees) is in the board's mind when important business decisions are being taken; and
- Advising the board in relation to its sustainability and environmental, social and governance policies and practices and its reporting.

Societies Ordinance

8.9 Apart from statutory bodies and those companies incorporated under the Companies Ordinance, some subvented organisations are registered under the Societies Ordinance. The Societies Ordinance was not drafted with corporate governance in mind and imposes very few such obligations on societies or their office bearers. Such organisations should comply with any corporate governance requirements contained in the MAA or other funding agreement with their oversight departments. They should also adhere to the spirit and ethics of good corporate governance enshrined in the key principles of corporate governance (see Introduction to this Guide).

Abbreviations and Glossary of Terms

Abbreviations and Glossary of Terms

AGM

Annual General Meeting is an annual meeting for an organisation's members. It is an opportunity to receive copies of the financial statements, review financial information for the past financial year and ask any questions regarding the directions the business will take in the future.

Benchmarking

Benchmarking is the process of measuring products, services or practices against the recognised industry/business leaders with a view to gaining information to improve an organisation's performance.

Board members

A board normally comprises one or more directors who are commonly referred to as board members. The term "directors" and "board members" are used synonymously. Please also see **Director**.

Board of directors

The governing board of an organisation. Other terms such as Executive Committee, Management Committee, Council may be used in different organisations.

CEO

Chief Executive Officer is the head of the management team of an organisation. The CEO reports to the board of directors and is responsible for the day-to-day operations of the organisation and meeting performance targets under the board's direction. The CEO may be member of the board. Some organisations use Executive Director or similar titles in place of CEO.

Code of conduct

An ethical framework for decision-making that sets out the principles covering appropriate conduct and outlines the minimum standards of behaviour expected.

Conflict of interest

A conflict of interest arises when a non-personal decision is influenced by personal interests. The appearance or perception of a conflict of interest can be as damaging as an actual conflict. All undermine public confidence in the integrity of the organisation involved, its staff and its board.

Department — The term refers to all types of government organisation such as bureaux, departments and agencies. It may be referred to as the "oversight department" or "sponsoring department", as appropriate.

Director — A director is a member of a board of directors and often is referred to as board member.
Directors are sometimes referred to as "executive directors" or "non-executive directors", depending on their respective backgrounds. Unless otherwise specified, the terms "director" and "board member" refer to both executive directors and non-executive directors.

ERM — Enterprise Risk Management is a key component of organisational strategy which consolidates and integrates risk management throughout an organisation.

Ex-Com — Executive Committee is one of the committees commonly established to support the board and generally performs duties such as managing the organisation in between regular board meetings.

ED — Executive Directors are members of the board of directors who also serve as members of the executive / management team of the organisation.

Hong Kong Institute of Education — The Hong Kong Institute of Education is a tertiary institution dedicated to professional teacher education in Hong Kong.
http://www.ied.edu.hk

HR — Human Resources

ICAC — Independent Commission Against Corruption
http://www.icac.org.hk

KPI — Key Performance Indicators are a set of measures focusing on those aspects of organisational performance that are the most critical for the current and future success of the organisation.

LSG — Lump Sum Grant is a subvention system administered by the Social Welfare Department.
http://www.swd.gov.hk

MAA	Memorandum of Administrative Arrangements is an agreement providing a framework for the working relationship between the Government and the subvented organisation.
Non-departmental public bodies	Organisations set up to perform tasks/deliver services to the public at arm's length from the Government. These bodies are established where a greater degree of freedom from government or flexibility is required or to effect major changes to management processes (e.g. Consumer Council, Trade Development Council and Hospital Authority, etc.). Not all non-departmental public bodies (e.g. the Airport Authority, the Housing Authority and the Urban Renewal Authority) receive recurrent subventions from the Government.
NED	Non-Executive Directors are members of the board of directors of a company who do not form part of the executive/ management team, are not employees of the company or affiliated with it in any other way. The term "non-executive director" includes independent non-executive directors, where appropriate.
NGO	Non-Governmental Organisations are independent and autonomous entities that are responsible for their own governance and are usually incorporated under the Companies Ordinance (Cap. 622, or Cap. 32 before 3 March 2014) as limited companies or as societies registered under the Societies Ordinance (Cap. 151).
QAS	Quality Assurance Section is a setup in an organisation which monitors and evaluates various aspects of the organisation's activities and services to ensure that standards of quality are being met.
Subvention	Government funding for a non-departmental public body or non-governmental organisation for the purpose of performing specified tasks or delivery of specified services to the public.
UGC	The University Grants Committee is responsible for advising the Government on the development and funding needs of higher education institutions in Hong Kong. *http://www.ugc.edu.hk*

ANNEXES

ANNEX 1

Checklist for Subvented Organisations

Purpose: to assess whether key administrative arrangements are in place to safeguard a subvented organisation's standard of corporate governance. The checklist does not attempt to include all arrangements for every aspect of corporate governance.

Intended for: directors/CEOs of subvented organisations

The administrative arrangements mentioned in the checklist are high-level practices and procedures. Organisations should maintain/introduce arrangements according to their circumstances.

Directors/CEOs should ask themselves "Does my organisation need the following arrangements?" If the answer is yes, then they should examine whether suitable, up-to-date arrangements are in place and practised.

Does my organisation need policies/rules/ guidelines on	
Financial Management	
1.	Budgeting processes, including: – Revenue estimates – Expenditure estimates
2.	Financial management, including: – Formulation of longer-term financial objectives and strategies – Reprioritisation and redeployment of resources – Delegation of authority – Accounting rules – Inventory control – Payments and receipts – Sensitive expenditure – Procurement practices – Reserve funds – Capital expenditure – Security arrangements

Human Resources Management, including volunteers, if any:	
3.	– Equal opportunities/anti-discrimination – Conflict of interest declarations – Recruitment and appointment – Conduct and discipline – Performance management – Termination of service – Salaries and allowances – Remuneration reviews – Travel and hotel allowances – Housing/rent allowances – Retirement benefits – Vacation – Medical and dental benefits – Training – Occupational safety and health
Premises and Transport Management	
4.	Premises management: – Space standards – Furniture and fittings standards – Minor maintenance and repair arrangements – Environmental protection (including water conservation, waste management, carbon footprint reduction, reduction of noise/air pollution)
5.	Transportation, including: – Vehicle standards – Authority to drive/use organisation's vehicles
Security Management	
6.	Security, including: – Building security – Organisation security officer – Fire safety – Organisation/building fire safety officer – Security of documents – Safes, locks, keys, etc. – Communications

7.	IT security, including: – Organisation IT security officers – Management responsibilities – Physical security – Access control security – Data security – Application security – Network and communication security – Security Risk Assessment and Auditing
Internal Control and Compliance	
8.	Internal control arrangements
9.	Internal and external auditing arrangements
10.	Compliance control, to review and ensure compliance with: – Relevant legislation and common law requirements – Organisation's Articles of Association (if it exists) – Organisation's MAA or funding agreement

ANNEX 2

Checklist for the Chairperson

Purpose: to assess the effectiveness of the chairperson in discharging his role and responsibilities during the previous 12 months

Intended for: chairperson (self-assessment)

This checklist is intended to assist a chairperson to understand his/her own performance and identify areas where improvements can be made. It will be of use only if the questions are answered honestly. There is no obligation to disclose the results to third parties.

The ratings are based on the following:

1 = Strongly disagree **2** = Disagree **3** = Undecided

4 = Agree **5** = Strongly agree

		1	2	3	4	5
1.	My roles and responsibilities as chairperson are: – Clearly defined in writing – Understood by me – Understood by the board – Understood by the CEO					
2.	I am fully committed to the vision, mission and values of this organisation.					
3.	I have devoted sufficient time to handle the organisation's affairs.					
4.	I am able to exercise sufficient degree of care, skill and diligence in carrying out the chairperson's duties.					

		1	2	3	4	5
5.	I am able to ensure that board members participate constructively in board affairs. For example board members are: – Briefed on their duties and responsibilities – Encouraged to participate actively in board meetings – Allowed to propose items for inclusion in agendas – Encouraged to share stakeholders' views and feedback at board meetings – Allowed sufficient time to discuss key issues – Involved in setting/reviewing the organisation's vision, mission and values – Asked to help prioritise the organisation's activities – Involved in establishing/monitoring the organisation's performance – Encouraged to put forward their views/suggestions for consideration in the decision making process					
6.	I have provided leadership for the board, e.g. – The board has clear policies and procedures governing its meetings – The policy and procedures are followed – Meetings are held regularly – The agenda is properly prepared – Papers are distributed to members in advance of meetings – The board takes into account its statutory (and other) requirements when making decisions – The minutes of meetings accurately record decisions – Actions are properly followed up					
7.	I have established an effective working relationship with the CEO, e.g. – I have provided support and advice to the CEO – I have respect for executive responsibility – Board decisions are carried out smoothly					

		1	2	3	4	5
8.	I have established good communication with external stakeholders and Government, e.g. I have – Developed channels of communication – Established disclosure policies – Sought and understood the views of stakeholders					
9.	I have guarded against conflicts of interest. – On my own part – On the part of other board members – On the part of senior executives					

Any other comments on your performance, challenges faced, etc.?

ANNEX 3

Sample letter for Non-executive Director Appointment

On [date], upon the recommendation of the nomination committee/board, the board of ['the Organisation'] has appointed you as a non-executive director. I am writing to set out the terms of your appointment. This is a contract for services and is not a contract of employment.

Appointment

Your appointment will be for an initial term of [ ] years commencing on [date], unless otherwise terminated earlier by and at the discretion of either party upon [one month's] written notice. Continuation of your contract of appointment is contingent on satisfactory performance and re-election at forthcoming Annual General Meetings (AGMs) of the Organisation. Non-executive directors are typically expected to serve two [three-year terms], although the board may invite you to serve for an additional period.

Time commitment

Overall we anticipate a time commitment of [number] days per month after the induction phase. This will include attendance at [monthly] board meetings, the AGM, and [at least one] site visit per year. In addition, you will be expected to devote appropriate preparation time ahead of each meeting.

By accepting this appointment, you have confirmed that you are able to allocate sufficient time to meet the expectations of your role. You should consult the chairperson before accepting additional commitments that might affect the time you are able to devote to your role as a non-executive director of the Organisation.

Role

Non-executive directors have the same general legal responsibilities to the Organisation as any other director. The board as a whole is collectively responsible for promoting the success of the Organisation by directing and supervising its affairs. The board:

- provides leadership of the organisation within a framework of prudent and effective controls which enable risk to be assessed and managed;
- sets the Organisation's strategic aims, ensures that the necessary financial and human resources are in place for the Organisation to meet its objectives, and reviews management performance; and
- sets the Organisation's values and standards and ensures that its obligations to its stakeholders and others are understood and met.

In addition to these requirements of all directors, the role of the non-executive has the following key elements:

- **Strategy**: Non-executive directors should constructively challenge and contribute to the development of strategy;
- **Performance**: Non-executive directors should scrutinise the performance of management in meeting agreed goals and objectives and monitor the reporting of performance;
- **Risk**: Non-executive directors should satisfy themselves that financial information is accurate and that financial controls and systems of risk management are robust and defensible; and
- **People**: Non-executive directors have a prime role in appointing, and where necessary removing, senior management and in succession planning.

Fees

You will be paid a fee of $[amount] gross per annum which will be paid monthly in arrears and will be subject to an annual review by the board. The Organisation will reimburse you for all reasonable and properly documented expenses you incur in performing the duties of your office.

Outside interests

It is accepted and acknowledged that you have business interests other than those of the Organisation and have declared any conflicts that are apparent at present. In the event that you become aware of any potential conflicts of interest, these should be disclosed to the chairperson as soon as apparent.

Confidentiality

All information acquired during your appointment is confidential to the Organisation and should not be released, either during your appointment or following termination (by whatever means), to third parties without prior clearance from the chairperson.

Induction

Immediately after appointment, the Organisation will provide you with a comprehensive, formal and tailored induction. We will arrange for site visits and meetings with senior and middle management and the Organisation's auditors.

Review process

The performance of individual directors and the whole board and its committees is evaluated annually. If, in the interim, there are any matters which cause you concern regarding your role you should discuss these with the chairperson as soon as is appropriate.

Insurance

The Organisation has directors' and officers' liability insurance and it is intended to maintain such cover for the full term of your appointment. The current indemnity limit is $[amount]; a copy of the policy document is attached.

Independent professional advice

Situations may arise in which you consider that you need professional advice in the furtherance of your duties as a director. Circumstances may occur when it will be appropriate for you to seek advice from independent advisors at the organisation's expense. A copy of the board's agreed procedure under which directors may obtain such independent advice is attached. The Organisation will reimburse the full cost of expenditure incurred in accordance with the attached policy.

Committees

This letter refers to your appointment as a non-executive director of the Organisation. In the event that you are also asked to serve on one or more of the board committees, this will be covered in a separate communication setting out the committee(s)'s terms of reference, and any specific responsibilities.

Source: Adapted from Derek Higgs (Jan 2003), Review of the roles and effectiveness of non-executive directors[8]

ANNEX 4

Checklist for Assessing the Performance of the Board

Purpose: to assess the overall performance of the board

Intended for: Board/self-assessment by individual board members

The ratings are based on the following:

1 = Strongly disagree **2** = Disagree **3** = Undecided

4 = Agree **5** = Strongly agree

		1	2	3	4	5
A. Board Structure and Composition						
1.	The roles and responsibilities of the board members are: – Clearly defined in writing – Understood by me – Understood by other board members					
2.	Board members are clear about the vision, mission and values of this organisation.					
3.	Board members are familiar enough with the organisation's business to make intelligent contributions to the board's work.					
4.	Board members have exercised sufficient levels of care, skill and diligence in carrying out their duties.					
5.	Collectively, the board comprises the appropriate mix of expertise, experience, connections, and personal attributes to meet the organisation's needs now and in the next few years.					

		1	2	3	4	5
B. Effectiveness of the Board						
6.	The board has contributed effectively to the formulation/review of the organisation's vision, mission, values, and strategy.					
7.	The organisation has adhered to its vision, mission, values and strategic plan.					
8.	The board has been doing very well in performing its role in risk management.					
9.	The board is given sufficient, clear and accurate information on costs and performance to exercise meaningful financial oversight.					
10.	The board has maintained good relationships with the organisation's stakeholders.					
C. Operation of the Board						
11.	The board: – Has clear policy and procedures for conducting meetings, e.g. how decisions are made, quorum requirements. – Follows the policy and procedures.					
12.	There is a timetable for consideration of key issues and activities (e.g. corporate plan, business plan, budgeting and planning).					
13.	The agenda is set and distributed (together with papers) well in advance of meetings.					
14.	Sufficient time is allowed for discussion of the most important agenda items.					
15.	Board members have sufficient and appropriate information to foster meaningful discussions/ make decisions at board meetings.					

		1	2	3	4	5
16.	The minutes: – Accurately summarise meetings – Record decisions – Record changes in decisions – Record dissent – Record responsible action parties					
17.	The draft minutes are circulated quickly following meetings.					
18.	Actions decided at meetings are put into effect by the executive.					
D. Committees of the Board						
19.	The current committee structure reflects the current needs/priorities of the organisation.					
20.	The committees' terms of reference clearly define each committee's: – Authority – Role and responsibilities – Activities					
21.	For each committee, the board has evaluated: – The workload – The member's time commitments – The performance of the committees					
22.	The committees report to the board sufficiently regularly.					
23.	The committee chairpersons provide sufficient information and clarity to the board.					

Do you have any comments/recommendations for improvements?

ANNEX 5

Checklist for a Risk Management Framework

Purpose: to assess the effectiveness of the governance, risk management and compliance framework and practices of the subvented organisation

Intended for: Chairperson, board members and senior executives of the subvented organisation

The ratings are based on the following:

1 = Strongly disagree

2 = Disagree

3 = Undecided

4 = Agree

5 = Strongly agree

		1	2	3	4	5
1.	The organisation has a clear risk management strategy, which, for example: – Identifies the key strategic, operational and financial risks likely to have a negative impact; – Includes the establishment of a common risk management framework supported by written policies and procedures; – Analyses each risk's relative threat; – Assesses the likely frequency of occurrences and severity of impacts; – Considers the full range of risk management responses (avoid, reduce, terminate, share, modify and accept) and internal control; – Evaluates and prioritises the risks; – Selects and prioritises the most threatening risks for active management; – Addresses risks through the creation of action plans; – Insures appropriate risks; and – Monitors to ensure that identified risks have been adequately addressed, and that any new risks are incorporated into the risk management plan.					
2.	The risk management strategy is clearly defined in writing.					

		1	2	3	4	5
3.	Laws and regulations are complied with.					
4.	Information used by the organisation is relevant, accurate, up-to-date and reliable.					
5.	Financial resources are well managed and monitored.					
6.	The organisation's financial and other statements are accurate.					
7.	Human and other resources are well managed and safeguarded.					
8.	Due diligence checks on the organisation's major existing/potential business partners are conducted to ensure that these entities and their senior staff have high standards of corporate governance, integrity, etc.					
9.	A compliance programme has been instituted to give the board confidence that relevant risks are being appropriately managed, e.g. – Effective internal control systems have been established; – Proper internal audit functions are in place; – Internal auditors are free of any undue influence; – Periodic reviews of efficient use of resources are conducted; and – The Audit Committee is separate from functions such as finance, investment, etc. and independent of the organisation's management.					
10.	There are reviews on the effectiveness of the: – Risk management framework; and – Compliance programme					
11.	The CEO reports regularly to the board on the implementation of the risk management programme.					

		1	2	3	4	5
12.	The organisation has established channels for the internal communication of information on the organisation's objectives, its potential risk and actual risk events arising (including reporting malpractices programme).					
13.	The organisation provides training on risk management and controls to management.					
14.	Risk management and performance management are integrated and linked to the organisation's KPIs.					

Do you have any comments/recommendations for improvements?

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