GUIDE TO CORPORATE GOVERNANCE FOR SUBVENTED ORGANISATIONS

Executive Summary

June 2015
Second Edition

效率促進組
EFFICIENCY UNIT

服務市民
SERVING THE COMMUNITY

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.

The Guide

1. The Guide to Corporate Governance for Subvented Organisations (the Guide) available at http://www.eu.gov.hk is intended to help board members and senior executives of these organisations. By setting out the principles and best practices relating to corporate governance, advising on matters that have raised concern, and providing checklists, it will help organisations to assess their current performance and decide whether changes need to be made and what these should be. The goal is to help sustain public trust in bodies which receive public funds.

2. The Guide does not have a binding effect on subvented organisations. However, subvented organisations are encouraged to draw on the advice and best practice contained in the Guide to establish their own arrangements. Common sense and judgement should be used to apply the principles set out in the Guide to their own circumstances.

3. To render any part(s) of the Guide binding over a subvented organisation, a specific requirement should be contained in an agreement between a specific subvented organisation and its government oversight bureau/department.

What is Corporate Governance?

4. 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.

Why is Corporate Governance Important?

5. 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, arts and sports bodies, youth groups, and district and rural associations. About 40% of recurrent government expenditure is channelled through subvented organisations each year. These organisations are accountable to both

the Government and the community for the public value they create through their activities and performance.

6. Recent reviews conducted by the Director of Audit have revealed varying degrees of inadequacies in subvented organisations' corporate governance systems, processes and practices.
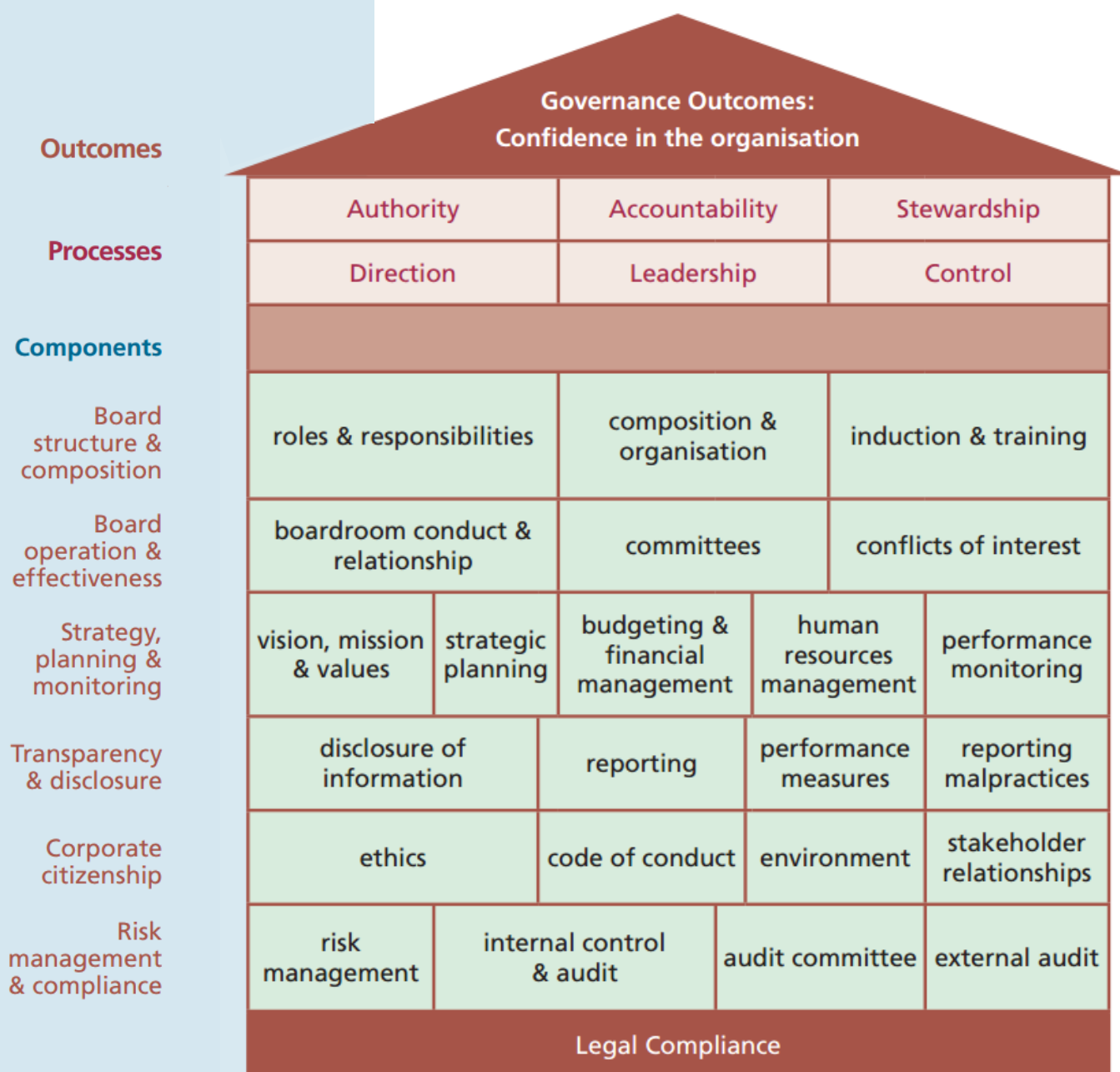
Key Principles of Good Corporate Governance

7. The key principles of good governance (http://www.cipfa. org) are:

- Focusing on the organisation's purpose and on outcomes for citizens and service users;

- Performing effectively in clearly defined functions and roles;

- Promoting values for the whole organisation and demonstrating the values of good governance through behaviour;

- Taking informed, transparent decisions and managing risk;

- Developing the capacity and capability of the board to be effective; and

- Engaging stakeholders and making accountability real.

Corporate Governance Model

8. The Guide follows the generic structure outlined in the following corporate governance model.

| Outcomes	Governance Outcomes: Confidence in the organisation		
	Authority	Accountability	Stewardship
Processes	Direction	Leadership	Control
Components			
Board structure & composition	roles & responsibilities	composition & organisation	induction & training
Board operation & effectiveness	boardroom conduct & relationship	committees	conflicts of interest
Strategy, planning & monitoring	vision, mission & values / strategic planning	budgeting & financial management / human resources management	performance monitoring
Transparency & disclosure	disclosure of information	reporting / performance measures	reporting malpractices
Corporate citizenship	ethics	code of conduct / environment	stakeholder relationships
Risk management & compliance	risk management / internal control & audit	audit committee	external audit
	Legal Compliance		

4

9.   There is no "one-size-fits-all" corporate governance model. Readers should take into consideration the size, nature and activities of an organisation when adapting the best practices set out in the Guide.

10.   **Roles and responsibilities** - The board of each subvented organisation is responsible for its activities and performance. 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.

11.   Boards need to implement, monitor and review various arrangements. Of particular importance are –

- Compliance with relevant legislation and common law requirements;

- Compliance with Memorandum of Administrative Arrangements (MAA) or other funding agreements with the Government;

- Compliance with the organisation's Articles of Association, if one exists;

5
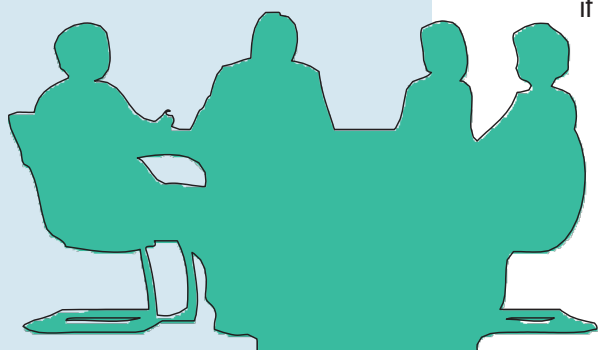
- Sound budgetary and financial management;

- 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.

12. **Composition and Organisation** - In Hong Kong, the unitary board structure, in which one single board comprises both Executive Directors and Non-executive Directors, is most common.

- There is no guideline about the optimal size of the board, although in practice, the smaller the better.

- A subvented organisation should consider factors like size of the organisation, scope and complexity of activities, the desired ratio of Executive Directors to Non-executive Directors and board diversity, etc. when determining the appropriate size of the board.

- 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.

13. Induction and Training

- 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.

- The board should have a strategy for the training support and personal development of board members so that they can keep abreast of the knowledge and skills they need.

Board Operation and Effectiveness

14. **Boardroom Conduct and Relationship** - 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.

15. **Committees** - The establishment of committees helps support the board on specific matters and provides internal checks and balances. Whether a particular committee is necessary depends on the unique circumstances of each organisation.

16. **Conflicts of Interest** – 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 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.

Strategy, Planning and Monitoring

17. **Vision, Mission and Values** - Organisations often summarise their business objectives into vision, mission and values. These are the cornerstones of sound strategic planning and good corporate governance.

18. **Strategic Planning** - Strategic planning broadly 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.

19. **Budgeting and Financial Management** - The board should ensure that effective and efficient budgeting and 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:

- **Budgeting**: 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.

- **Revenue Estimates**: A subvented organisation should allocate its sources of income into categories to facilitate effective management.

- **Expenditure Estimates**: A subvented organisation should provide detailed information on different expenditure items in support of its expenditure estimates.

- **Sensitive Expenditure**: Organisations must adopt a conservative and modest approach to expenditure on items such as entertainment, accommodation, travel and fringe benefits incurred by directors and staff.

- **Accounting Policies**: Organisations should adopt clear and consistent accounting policies and standards, and follow generally-accepted accounting practices.

- **Procurement Practice**: Organisations should adopt a procurement practice that is based on the principles of accountability, value for money, transparency and fair competition.

- **Inventory Control**: A well set-up inventory control would enable organisations to maintain proper supervision and control over their assets and to well utilise their resources.

20. **Human Resources Management** - The board, through its strategy and policy-making role, has to provide a proper framework to manage its staff as well as meeting the obligations of a responsible employer:

- The board must oversee the establishment of an effective management team whom it can trust and to whom it can delegate authority.

- Organisations should establish appropriate recruitment, compensation, termination and performance management structures to manage their staff and, if applicable, volunteers.

- An effective mechanism for workplace cooperation, e.g. in the form of information sharing, consultation, joint decision-making and voluntary negotiation, helps to minimise unnecessary misunderstandings, especially in times of change and uncertainty.

21. **Performance Management** - Organisations should regularly evaluate their performance against their goals and objectives. Management should:

- Report to the board periodically the progress towards the achievement of the organisation's goals and objectives and compliance with policies.

- 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.

- Ensure reliable and useful information is available to enable proper evaluation of an organisation's performance.

Transparency and Disclosure

22. **Disclosure of Information** - Transparency and disclosure benefits 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.

23. **Reporting** – This includes internal and external reporting:

- **Internal Reporting by the Board**: The board should tell its management about the matters it has discussed through circulation of reports and minutes of meetings.

- **Internal Reporting by Management**: Financial and non-financial performance and other accountability information should be reported by the management to the board or appropriate committee(s) regularly.

- **External Reporting**: Organisations may consider publishing an annual report. A good report would include organisation structure, board structure, audited financial statements, organisation's financial and non-financial performance, code of conduct, risk-management and internal control processes, and statement of the organisation's corporate citizenship measures and activities.

24. **Performance Measures** - To help assess whether the organisation 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:

- **Key Performance Indicators (KPIs):**

  – Comparison with the performance of previous years;

  – Comparison with similar organisations, locally and/or internationally; and

  – Comparison of actual performance against target performance.

- **Benchmarking**: 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.

25. **Reporting Malpractices** - Apart from deterring malpractices, encouraging the reporting of malpractices also demonstrates to stakeholders and regulators that the organisation is accountable and well managed:

- **Policy**: Organisations may draw up their policy, including 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; and pledge that proper, fair investigations will be carried out and appropriate follow-up action taken.

- **Implementation**: The reporting channels and the relevant procedures should be set out clearly.

Corporate Citizenship

26. Corporate citizenship 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.

Organisations and their Stakeholders

27. **Ethics** - Ethics defines how an organisation integrates its core values, such as honesty, trust, respect and fairness, into its policies, practices and decision-making.

28. **Code of Conduct** - A well-designed code of conduct states clearly and concisely the organisation's expectations on ethical behaviour and basic standards of conduct. The major areas to be covered include: integrity; honesty; objectivity; impartiality; accountability; and dedication.

29. **Environment** - 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.

30. **Stakeholder Relationships** – Stakeholder relationships cover:

- Community involvement and development

- Occupational health and safety

- Human rights

Risk Management and Compliance

31. **Risk Management** - 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 ongoing process to identify, evaluate and manage risks. Developing a risk management programme involves:

13

- Determining the organisation's risk-taking appetite

- Risk identification

- Evaluating and prioritising risk

- Selecting appropriate risk mitigation tools

- Monitoring and updating the risk programme

32. **Internal Control & Audit** – Internal control is a process which helps to reduce certain risks to acceptable levels, and to enable management to identify any potential problems on a timely basis. Different types of internal controls include measures to detect, correct and prevent errors and irregularities. Internal audit is a tool used by management to identify and assess on an independent basis potential risks to the organisation's operations.

33. **Audit Committee** – The Audit Committee has an important role in monitoring the organisation's audit arrangements, and the internal control and risk management systems.

34. **External Audit** - External audits increase an organisation's credibility and provide an objective and independent review of its financial reporting.

Legal Issues

35. Subvented organisations may be established / registered / incorporated under different legislation. Most subvented organisations are companies limited by guarantee incorporated under the Companies Ordinance.

36. 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.

37. **Legal Duties of Directors** - Directors of non-profit organisations are subject to essentially the same legal duties as directors of commercial companies:

- The duty to act in good faith in the best interests of the objects of the organisation.
- The duty not to exercise powers for an improper purpose.
- The duty to serve with reasonable care, skill and diligence.

14

- The duty not to use their position or information improperly.

- The duty not to accept personal benefit from third parties.

- The duty to avoid any actual or potential conflicts between personal interests with those of the organisation.

38. **Legal Duties of the Organisation** - 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:

- The duty to keep proper accounting records.

- The duty to prepare annual financial statements and directors' report (and include a business review as appropriate).

- The duty to appoint an auditor for an annual audit.

- The duty to maintain registers.

- The duty to file documents with the Companies Registry.

- The duty to call an Annual General Meeting and General Meeting.

39. 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 Memorandum of Administrative Arrangements 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 paragraph 7)

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THE GOVERNMENT OF THE HONG KONG SPECIAL ADMINISTRATIVE REGION