

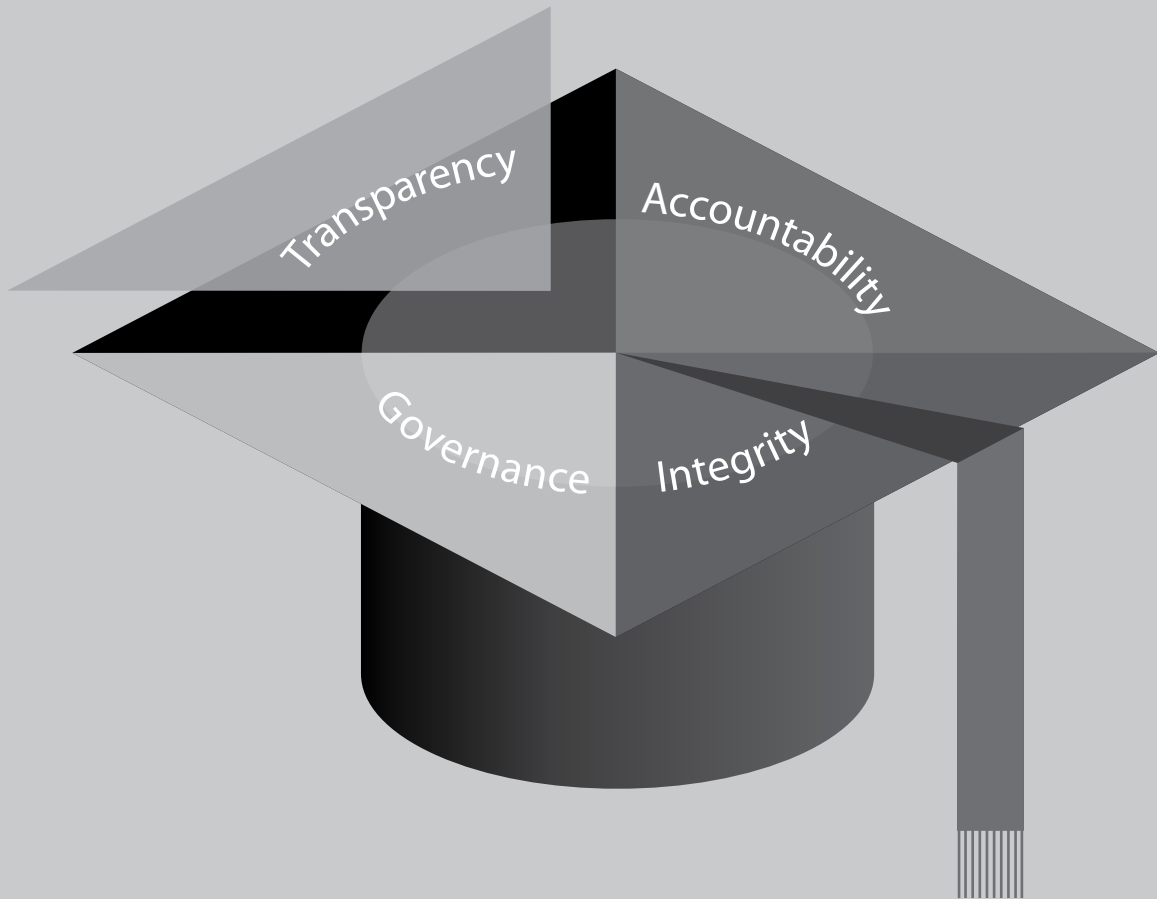
# Partner for Excellence



## Financial Reporting



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***Excellence***



***Financial Reporting***

# Introduction

The tertiary education institutions (TEIs) are statutorily autonomous corporations with substantial freedom in the control of curricula and academic standards, the selection of staff and students, initiation and acceptance of research, and the internal allocation of resources. Nevertheless, because the TEIs are also entrusted with significant public and private resources, and in view of their pivotal role in the development of higher education in Hong Kong, the Government and the community at large expect that TEIs are providing the highest possible standards of education in the most cost-effective way and managing their affairs in an accountable and transparent manner.

In early 2011, the Independent Commission Against Corruption (ICAC) joined hands with all the 11 TEIs to set up a Working Group to address public concerns on a number of issues pertaining to the governance of TEIs, including administration of donations, technology transfer and commercialization, procurement, outside practice and financial reporting. The Working Group agreed to conduct reviews by the ICAC Corruption Prevention Department (CPD) on these five identified areas with a view to further strengthening institutional governance and corruption prevention safeguards in TEIs' procedures and guidelines. Based on the findings of the reviews, the Working Group has produced this Corruption Prevention Guide (the Guide), comprising a set of five modules which consolidate the good practices and corruption prevention measures being in force by individual local and overseas institutions. The Guide is designed as reference for TEIs for the purpose of corruption prevention and is not mandatory in nature. TEIs are encouraged to suitably adapt and adopt the good practices and corruption prevention safeguards recommended in the Guide with regard to their unique character, cultural heritage, size, organizational structure and resource capability.

We hope TEIs will find the Guide useful, informative and stimulating. CPD stands ready to provide free, confidential and tailor-made corruption prevention services to help TEIs implement the recommended measures in the Guide. CPD could be contacted by telephone at 2826 3198, by fax at 2521 8479, or by email at [cpd@icac.org.hk](mailto:cpd@icac.org.hk).

Working Group on Tertiary Education Institutions Governance  
December 2011

## **DISCLAIMER**

The recommendations as contained in this Guide including the sample forms or documents are for general guidance only. The sample forms and documents should be modified and adapted as appropriate to suit individual organizations' operational needs before use. The ICAC will not accept any liability, legal or otherwise, for loss occasioned to any person acting or refraining from action as a result of any material including the sample forms or documents in the Guide.

Throughout this Guide, the male pronoun is used to cover references to both the male and female. No gender preference is intended.

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## CHAPTER 1

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# Background

To many TEIs, financial reporting is both a statutory duty (**Chapter 2.2**) and a requirement from the University Grants Committee (UGC), through which they present their financial data, operating performance and funds flow for a financial year. Financial statements along with related information may be contained in various forms for users both within the TEI and external parties (e.g. UGC and donors). It is the responsibility of the governing body and senior management of a TEI to ensure that its financial reporting is accurate and adequate to meet the varying information needs of the users. While the level of details for disclosure may vary with the nature and operations of the TEI, a good financial reporting system should inevitably fulfill the basic principles of transparency, accountability, clarity and accuracy.

To meet the increasing public expectation on TEIs' governance to higher levels, this Module aims to provide some good practices for TEIs to strengthen their financial reporting, focusing on four areas: administration of donations, technology transfer and commercialization, outside practice and procurement. Some of these good practices are modeled on Hong Kong professional accounting standards and overseas practices. This Module should be read in conjunction with the other Modules of the Guide where the corruption risks and the relevant corruption prevention safeguards in the respective areas have been spelt out in details.

## CHAPTER 2

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# Framework of a Financial Reporting System

### 2.1 Introduction

Like other statutory organizations, all TEIs are set up by their enabling legislations<sup>1</sup> under which they are subject to financial audit. Those funded by the UGC are also required to comply with its funding terms and conditions, including financial reporting requirements. Additionally, there are a number of statutory and professional accounting requirements and financial conditions (e.g. terms imposed by the donors) for compliance by TEIs having regard to their operations. In view of the importance of financial reporting and hence the role of the auditor, this Chapter sets out and explains the key components of a financial reporting framework in TEIs and how they could adapt the good practices to further enhance their own system.

### 2.2 Statutory Audit Requirements

It is a statutory duty for all TEIs to conduct an annual audit after the end of each financial year, summarizing the financial data of the TEI's position, operating performance and funds flow. For the audit, TEIs are required to appoint auditors for examining the operating procedures, including their financial records, vouchers and books of account, to obtain audit evidence about the amounts and disclosures in the financial statements (**Chapter 2.3.1**). To uphold impartiality in the audit and avoid any perceived conflict of interest, TEIs should appoint an auditor who is not a member of their governing body to perform the duty. The audit firm, the engagement partner and the audit team members are also required to comply with the "independence requirements" imposed by the Hong Kong Institute of Certified Public Accountants (HKICPA), e.g. members of the audit team should not be a director or officer of the client.

### 2.3 Professional Accounting Standards

To achieve convergence with the International Financial Reporting Standards issued by the International Accounting Standards Board, the HKICPA has issued the Hong Kong Financial Reporting Standards (HKFRS) setting out various accounting and disclosure requirements. On completion of an audit for a TEI, the auditor expresses his opinion as to whether the financial statements give a "true and fair view" of the state of affairs of the TEI and of its results and cash flows in accordance with HKFRS.

<sup>1</sup> All TEIs are established under their own ordinances, except Hong Kong Shue Yan University and Chu Hai College of Higher Education which are registered under the Post Secondary College Ordinance (Cap. 320).

### 2.3.1 Financial Statements

Normally issued together with the Annual Report, a complete set of financial statements should include the following major financial data and information:

- A statement of the financial position;
- A statement of the comprehensive income;
- A statement of changes in fund balances;
- A statement of cash flows; and
- Supplementary notes, summarizing the significant accounting policies and other explanatory information.

To enhance transparency and facilitate meaningful understanding by their users (**Chapter 5.2**), TEIs should present the financial statements with the following qualitative characteristics:

- **Relevance** – information which is capable of making a difference in the decision-making by users.
- **Materiality** – information which is so significant that any omission or misstatement would affect the decisions of the information users.
- **Comparability** – data that would enable the information users to identify and understand similarities in, and differences among, items.
- **Verifiability** – information that assures its users of the faithful representation of the economic phenomena it purports to represent.
- **Timeliness** – information that is available on time to influence a decision-making.
- **Understandability** – the information so presented are clearly and concisely classified, characterized and understood.

In addition, TEIs should adhere to the following principles and requirements when preparing the financial statements:

- **Full compliance with HKFRS** – the application of HKFRS is presumed to result in financial statements that achieve a “true and fair view”. Hence, the financial statements should contain an explicit and unreserved statement of such compliance in the notes to the financial statements.
- **Going concern** – the TEI should be regarded on a “going concern” basis with an ability to continue functioning as a business entity. When the auditor is aware of any material uncertainties related to events or conditions that may cast significant doubt upon the TEI’s ability to continue as a going concern, he has a duty to disclose those uncertainties.

- **Accrual basis of accounting** – the principle requiring the TEI to recognize the revenues and expenses when they are earned or incurred (rather than when the cash is received or paid) should be adopted in the financial statements, except for cash flow information.
- **Materiality and aggregation** – information of similar items of the same category should be grouped together and the material items should be separately presented and disclosed.
- **Offsetting** – there should not be any offsets of assets and liabilities or income and expenses, unless as required or permitted by the HKFRS.
- **Frequency of reporting** – a complete set of financial statements should be presented at least annually.
- **Comparative information** – there should be disclosure of comparative information in respect of the previous period for all amounts reported in the current period's financial statements, including narrative and descriptive information which helps understanding of the current period's financial statements.
- **Consistency of presentation** – there should be consistency in the presentation and classification of items in the financial statements from one period to the next.

## 2.4 Companies Ordinance (Cap. 32) Requirements

As discussed in the **Module on Technology Transfer and Commercialization** of the Guide, TEIs normally establish wholly-owned subsidiaries as their business arms for entering into contractual agreements with business partners in commercialization activities and holding shares of the joint ventures (JVs). These business arms are usually private companies incorporated under the Hong Kong Companies Ordinance (Cap. 32). Hence, it is their duty to fulfill the statutory requirements by engaging an auditor and presenting their audited financial statements in the same manner as described in **Chapters 2.2** and **2.3** above.

### 2.4.1 Disclosure of Directors' Interests

It is common for TEIs engaging in commercialization activities to deploy members of their governing body (e.g. Council) and/or their staff members to sit on the Management Board of these subsidiaries and JVs to oversee the TEIs' investments (**Chapter 5.3.3**). Since it is a statutory requirement under the Companies Ordinance to disclose the directors' interests (e.g. directors' emoluments and contracts with the company) in the financial statements or directors' reports of these subsidiaries and JVs, it is advisable for TEIs to set out a policy from the outset to help monitor the stewardship of these directors.

## 2.5 Inland Revenue Department Requirements

All TEIs and some of their subsidiaries are exempted from Hong Kong profits tax under Section 88 of the Inland Revenue Ordinance (Cap. 112) by reason of their being an approved charitable institution meeting the following conditions:

- Established for public benefit;
- Being under the jurisdiction of Hong Kong courts;

- Established exclusively for charitable purposes which include advancement of education; and
- Established by a written governing instrument (e.g. a company incorporated under the Companies Ordinance or a statutory body established by the Hong Kong legislature) which contains clauses, among others, prohibiting distribution of its incomes and properties amongst its shareholders, prohibiting directors from receiving remuneration and specifying how the assets should be dealt with upon its dissolution (e.g. donate to other charities).

Under the Inland Revenue Ordinance, tax-exempt TEIs and their subsidiaries may be required to submit their annual financial statements for review by the Inland Revenue Department to ensure that their activities continue to meet the tax exemption status. While such status could save the subsidiaries and JVs from tax liability with the profits so saved retained for the pursuits of their businesses, it may attract allegations of mismanagement and even tax evasion with corrupt motive unless the charitable status is properly managed and maintained. TEIs are therefore advised to:

- lay down a clear policy on whether tax exemption would be applied for their subsidiaries and JVs; and
- if the tax exemption status is preferred, devise a mechanism to ensure full compliance with the charitable conditions.

## 2.6 University Grants Committee Requirements

UGC has issued the Notes on Procedures, which require UGC-funded TEIs to:

- follow, where appropriate, the guidelines in the Statement of Recommended Accounting Practice for UGC-funded Institutions<sup>2</sup> specifying the accounting and disclosure requirements for transactions that are peculiar in nature to TEIs and are not covered by HKFRS;
- make reasonable arrangements to make copies of their audited financial statements publicly available;
- provide UGC with copies of their audited financial statements within four months after each financial year end; and
- submit, within four months after each financial year end, a return showing the income and expenditure of the UGC-funded activities, and appoint the auditor (**Chapter 2.2**) to conduct a separate assurance engagement on the return.

<sup>2</sup> This set of guidelines is drawn up by the eight UGC-funded institutions altogether.

## CHAPTER 3

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# Financial Planning and Budgetary Control

### 3.1 Introduction

To implement their annual strategic and operational plans, TEIs draw up budgets to estimate the revenues available and the expenditures that are required for the programmes in the financial year. While the preparation and control of budgets may differ from TEI to TEI, a well-planned and properly controlled budget not only provides a systematic road map with the necessary financial information to achieve the budgeted performance, but also serves as a useful management tool for monitoring progress of the programmes and detecting any irregularities or red flags of malpractice in a timely manner. This Chapter aims to highlight the good practices in financial planning and budgetary control that are crucial to enhance TEIs' financial management and internal control systems.

### 3.2 Key Parties Involved in Financial Management

An effective financial management and budgetary control mechanism requires the collaborated effort of various parties in the TEI. A brief account of the roles and responsibilities of the key parties involved is given below:

#### 3.2.1 Budget Controllers

Each of the TEI's faculties, departments, research centres, central administration units, etc. (collectively referred to as "cost centres") is allocated a portion of the institution's overall budget to support its daily operation and programmes. The heads of these cost centres (e.g. Head of Department) (hereafter referred to as "budget controllers") are entrusted with the responsibility to draw up budgets for their respective cost centres based on the approved work plan and execute the budgets after endorsement by the senior management and governing body (**Chapters 3.2.2 & 3.2.3**). Budget controllers are held responsible and accountable for the accuracy and completeness of their respective budgets (e.g. to make sure that all events that could reasonably be foreseen should be included). They are expected to closely monitor the financial position of the cost centres under their charge and ensure that their staff involving in financial operations have complied with the TEI's relevant guidelines. ICAC cases indicated that staff involved in financial operations might cover up malpractice (e.g. misappropriation of funds) if they stay in the same post for a prolonged period of time. To mitigate this risk and for staff's career development, TEIs should consider rotating the staff concerned between cost centres.

### 3.2.2 Senior Management

The senior management team of a TEI, usually comprising the President, Vice Presidents and other heads of central administration units (e.g. Finance Office (**Chapter 3.2.4**)), assumes a supervisory role in monitoring the financial performance of the cost centres under their charge as well as the overall financial status of the TEI, including allocation and re-distribution of resources among cost centres where necessary.

### 3.2.3 Governing Body

The governing body (e.g. the Council) has an overall responsibility for the TEI's activities and finances, including the endorsement of the TEI's priorities and annual work plans, allocation of resources based on these approved programmes, and approval of the final budget. As the highest authority, it should commit the TEI to the principles of transparency and accountability when making disclosures and reporting to the institution's various stakeholders which include donors, students, UGC and the public (**Chapter 5.2**). To better perform its oversight functions, the governing body normally sets up functional committees and delegates to them specific functions. The committees may include the following:

- **Finance Committee** – oversees and endorses matters relating to the financial affairs of the TEI, including any material changes to the approved budget.
- **Donation Committee** – oversees the TEI's donation strategies and allocation of donations received as proposed by the TEI's donation administration office<sup>3</sup>.
- **Investment Committee**<sup>4</sup> – advises the TEI on investment policies/approaches and monitors the investment performance.
- **Technology Transfer Committee**<sup>5</sup> – advises the TEI on matters relating to commercialization activities and monitors the business entities established under the TEI.
- **Audit Committee** – oversees all internal and external audit activities, scrutinizes the audit results and recommendations, and brings to the attention of the governing body any potential areas of concern (e.g. fraud, malpractice). To enhance checks and balances, the Chairman of the Audit Committee should preferably be a professional independent of the TEI.

<sup>3</sup> For details of the Donation Committee and donation administration office, please refer to **Chapters 2.2 and 2.3** of the **Module on Administration of Donations** of the Guide.

<sup>4</sup> Depending on the size and operational need of individual TEIs, the functions of the Investment Committee may be subsumed in the Finance Committee.

<sup>5</sup> For details of the Technology Transfer Committee, please refer to **Chapter 2.4** of the **Module on Technology Transfer and Commercialization** of the Guide.

### 3.2.4 Finance Office

Headed by a Director, the Finance Office serves as the central administrator and gatekeeper of the TEI's financial operations. It is responsible for, among other things, formulating the financial policies and procedures, consolidating the budget estimates from individual cost centres, ensuring their compliance with the laid down procedures (**Chapter 3.3.1**), monitoring the propriety of expenses made by them, and preparing various management reports (**Chapter 4**). In addition, the Finance Office coordinates the TEI's procurement activities, and oversees the financial aspects of the TEI's subsidiaries and JVs.

## 3.3 Preparation of Budgets

### 3.3.1 Guidelines and Instructions

To ensure accuracy of the budget prepared by individual cost centres (**Chapter 3.2.1**) and consistency in the information provided therein, it is essential for the Finance Office, upon endorsement by the TEI's governing body (or the Finance Committee) (**Chapter 3.2.3**), to provide the budget controllers (**Chapter 3.2.1**) with adequate procedural guidance, including but not limited to the following:

- Basic financial principles (e.g. to have a balanced budget) and objectives (e.g. to meet the TEI's mission of providing teaching and research services to the public);
- Roles and responsibilities of different levels of staff of the cost centres and the Finance Office;
- Main considerations and basis for estimating income and expenditure (**Chapter 3.3.2**);
- Standard format for reporting budget items and sub-items (e.g. salary, employee benefits, contract-end gratuity should be grouped under the budget item of "personal emolument");
- Timeframe for preparing the budget (e.g. submission deadline); and
- Preparation procedures, and a schedule of approving authorities for endorsing the budgets so prepared and the subsequent changes after budget approval (e.g. virement/transfer of funds from one budget item to another (**Chapter 3.5**)) when situation arises.

### 3.3.2 Considerations in Preparing Estimates

To be effective in financial management, budget controllers should be reminded to set realistic budgets commensurate with the actual operation of their respective cost centres, taking into consideration the following factors:

- **For on-going activities** – actual income and expenditure in the previous year(s);
- **For new initiatives and improvements to existing programmes** – whether new funding sources would be available and whether additional resources are required (e.g. in organizing a large-scale fund-raising activity, more donation income may be received but extra manpower may also be needed to help in the activity);
- Advice from relevant administrative units and academic departments, if required (e.g. advice from the Human Resources Office on the comparable salary package to be offered to new staff);

- All other possible sources of income of the cost centre (e.g. grants from the Innovation and Technology Fund) and necessary expenses to maintain its daily operation (e.g. personal emoluments, office supplies, utility charges);
- The TEI's financial and accounting policies (e.g. different payment terms for goods purchased could affect the budget for cash outflow);
- Economic outlook and relevant indices announced by the government (e.g. the Consumer Price Index which may affect the cost of certain expenditure items); and
- The need to set aside a certain percentage of the budget as contingency resources for unforeseen events.

### 3.4 Monitoring Income and Expenditure

Upon approval of the budgets (**Chapter 3.2.3**), it is the duty of the budget controllers to exercise due care in monitoring the income received and the usage of the allocated funds under their charge with a view to detecting signs of irregularities and malpractice. To help budget controllers maintain their financial performance in good condition, the Finance Office should:

- provide them on a regular basis (e.g. monthly) an income and expenditure statement (with breakdown by the various categories of activities) comparing the actual and budgeted amounts to date, and separating the reporting of UGC-funded and self-financed activities;
- draw to the attention of the budget controllers and their supervisors any significant budget variances (e.g. non-receipt of pledged donations, over spending in a budget item); and
- require budget controllers to account for any variances and, if necessary, advise them of the possible course of remedial or follow-up actions in accordance with the laid down policies and procedures (e.g. to seek approval for virement of funds (**Chapter 3.5**)).

#### 3.4.1 Computerized Financial Management System

While periodic reporting of financial data could provide budget controllers with up-to-date information on the financial position of the funds under their control, such reporting is best done "online" where every party involved could have direct access to the latest financial data. As such, TEIs are recommended to develop, if resources permit, a computerized financial information management system with the capacity of keeping track of the financial data. Key features of the system should include:

- easy retrieval of data and records to allow comparison between budgets and actual financial performances of different financial years;
- generation of different types of management reports in specified formats to facilitate monitoring (e.g. a breakdown of the financial position by budget items and by individual cost centres);
- an alert mechanism to enable early identification of anomalies (e.g. automatic warning sent to the Finance Office and budget controller(s) concerned when the actual expenditure exceeds a specified percentage of the budget);

- access right with password control to protect the integrity of the system; and
- audit trail function to facilitate audit reviews.

### 3.5 Changes to the Approved Budget

Throughout the financial year, circumstances may emerge necessitating subsequent adjustments to the original budget (e.g. failure of a major donor to realize his donation commitment). As such, it is essential for TEIs to lay down the procedures for requesting transfer or virement of funds, which should include the following:

- Approval mechanism, including the approving authorities and their respective financial thresholds for different types of requests (e.g. changes within a specified percentage of the original budget, transfer of funds across budget items);
- Use of standard forms (or other prescribed formats) providing necessary particulars (e.g. amount of transfer, budget items or sub-items involved) and justifications for initiating the transfer; and
- Notification of the transfers so made by the Finance Office to the budget controllers concerned and their supervisors for information and verification.

## CHAPTER 4

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# Monitoring Financial Performance

## 4.1 Introduction

Timely and accurate financial management reports serve a very important function in enabling budget controllers (**Chapter 3.2.1**) of a TEI to make well-informed financial decisions and to detect abuse or even corrupt practices. At the same time, these reports are instrumental in enhancing the reliability and accuracy of the TEI's accounting and financial records, which are crucial for the preparation of "true and fair" financial statements (**Chapter 5**). While other Modules of this Guide set out the corruption prevention safeguards in the respective areas of concern, this Chapter recommends the key internal financial reporting measures that would strengthen the monitoring of the financial performance by the budget controllers and senior management (**Chapter 3.2.2**) of a TEI.

## 4.2 Compiling Periodic Management Reports

To keep track of the TEI's financial position and the performances of its various activities, the Finance Office (**Chapter 3.2.4**) should produce management reports in a timely manner for information and scrutiny of the budget controllers, senior management and governing body (**Chapter 3.2.3**). The frequency of submission of these reports (e.g. bi-weekly, monthly, quarterly, half-yearly) depends on the operational needs and resources of individual TEIs. Examples of the major management reports to be prepared are listed in the ensuing paragraphs but they are by no means exhaustive.

### 4.2.1 Receipt and Usage of Donations

To ensure timely receipt of the pledged donations and their proper use in accordance with the donation conditions, if any, the following reports should be made available:

- **For the donation administration office** (**Chapter 3.2.3**) – a consolidated list on each donation received providing particulars like the names of donors and amounts of donation received for cross checking. This could facilitate follow-up actions by the donation administration office if discrepancies between the pledged donation and the actual amount received are noted.
- **For the senior management and donation controllers<sup>6</sup>** – a financial statement of each donation fund (e.g. scholarship), including the income received from the donor, expenditures and investments, if any, made under the donation (**Chapter 4.2.2**) and the fund balance to date.

<sup>6</sup> A donation controller, usually a member of the senior management or a Dean of Faculty, is responsible for managing a specific fund and overseeing its performance.

- **For the governing body** – the total amount of donations received during the reporting period, with a breakdown on their allocation.
- **For the Donation Committee (Chapter 3.2.3)** – a summary list of low usage or dormant funds (e.g. no movement for a specified number of years, expiry of the sponsorship programme), including the opening balance, intended use, current situation and recommended actions (e.g. to explore with the donor the possibility of relaxing the grant criteria), to enable discussion and approval of follow-up actions.

#### 4.2.2 Investment of Donations

To leverage the donations received, it is common for TEIs to apportion part of the donations into some investment instruments upon approval of the Donation Committee or donors to generate dividends or interests, such as in the case of endowment funds<sup>7</sup>. To ensure effective management of such investments, the Finance Office should, based on the investment strategies formulated by the Investment Committee (**Chapter 3.2.3**), issue guidelines to staff responsible for investment operations. These key provisions should be set out:

- Investment objectives (e.g. specific goals the TEI would like to achieve, target return required, risk level involved);
- A list of the approved investment instruments (e.g. fixed deposit, equity, unit trust/mutual funds) and the asset allocation model<sup>8</sup> to be adopted if more than one type of instrument is selected;
- Operational procedures for conducting cash forecast, obtaining quotations for investment (e.g. bank deposits), settling deals, etc.;
- Standards or benchmarks for measuring the performance of investments (e.g. by comparing the actual and target return rate);
- If external fund managers are appointed to manage the investment portfolio, the procedures for selecting the managers and the control mechanism for monitoring their performance;
- Requirements for the staff concerned on avoidance and declaration of conflict of interest; and
- Regular reporting to the senior management and the Investment Committee on the investment portfolio and performance, including a consolidated statement on the financial position of the funds, and explanation on significant variances between current performance and targets.

<sup>7</sup> Initial funds donated to an endowment fund will not be spent but will be invested to generate recurrent income to support some specific programmes (e.g. scholarships) on a perpetual basis.

<sup>8</sup> As a tool for risk management, asset allocation involves defining the proportions of the fund to be placed in each of the investment vehicles in order to balance the risk and return.

### 4.2.3 Using Donations to Establish Independent Setups

Sometimes donors may initiate the establishment of independent setups in collaboration with a TEI for further research and development (e.g. academic research centres) or conducting training programmes for the benefits of students (e.g. professional development centres for clinical personnel). Such establishments are usually set up under a particular department or faculty of the TEI upon endorsement by the relevant approving authority. While the initial setup and maintenance cost is contributed by the donor(s), the TEI's resources (e.g. office accommodation and facilities) may be used in supporting the daily operation of these establishments. To ensure propriety in the use of donations and resources, TEIs should:

- draw up a policy requiring all incomes and donations derived from the setting up and maintenance of these independent establishments to be received through the Finance Office before disbursing to the cost centre(s) (**Chapter 3.2.1**) concerned;
- task the Finance Office to conduct periodic audit checks on the finances of the establishments;
- submit the audit findings to the relevant donors (**Chapter 5.3.2**) as well as the department/faculty concerned and the senior management;
- promptly follow up and rectify any irregularities identified; and
- as far as practicable, appoint personnel with accounting and financial management background to manage the daily financial operations of these establishments.

### 4.2.4 Performance of Commercialization Activities and Joint Venture Companies

Apart from receiving royalty income from technology licensees, a TEI may partner with outside companies or institutions in the Mainland/overseas to form JV companies when conducting commercialization activities. As these are regarded as the investments of the TEI (**Chapter 5.3.3**), the senior management should keep a close eye on these activities lest their maladministration or failure would affect the financial status and eventually the image of the TEI. To help senior management and the Technology Transfer Committee (**Chapter 3.2.3**) keep abreast of the JVs' financial performance, the Finance Office should prepare the following reports for their information:

- A statistical summary of the commercialization activities undertaken during the reporting period, and the income received and cost incurred (e.g. number of licences granted, cost for maintaining the patents, amount of royalties and dividends received).
- A gist illustrating the financial performance of each subsidiary and JV company, including its financial position, business outlook, and proposed way forward, if applicable.

### 4.2.5 Income from Outside Practice

While TEIs encourage staff to take up outside activities as a way to contribute to the community, it would be of concern to the TEI if the outside work commitment of a staff member unduly affects his normal academic and teaching duties, especially when the income generated from outside practice is substantial enough to divert devotion from his work in the TEI. To facilitate monitoring, the Finance Office should prepare the information described below:

- **For Heads of Departments/Deans of Faculties and the senior management** – a consolidated list showing the nature of outside practice undertaken by staff under their line of command, including the name of staff, the client and the amount of income earned.
- **For the senior management and governing body** – an exception report showing the names, departments and income generated of staff whose outside practice income exceeds a financial threshold prescribed by the TEI.

#### 4.2.6 Procurement Activities

As procurement takes up a large part of TEIs' resources and is an area most vulnerable to malpractice and corruption, TEIs should exercise prudent control on such activities to ensure that public funds and private donations are properly accounted for. A robust financial reporting system not only helps monitor that the funds are spent prudently, but also unveils non-compliances with laid down procurement requirements and abnormalities in procurement transactions. To do so, the Finance Office should compile the following monitoring reports:

- **For the budget controllers and the Director of Finance** – a consolidated report showing the pattern of expenditures for scrutiny (e.g. whether there is any abnormality such as significant increase in expenditures when compared with that of previous years without proper justifications) and including the following details:
  - > purchase requisitions raised by individual cost centres and by procurement methods (e.g. telephone quotation, tender, etc.); and
  - > purchase orders issued by different categories of value (e.g. in bands of \$5,000) and the total amount spent on each category.
- **For the Director of Finance and senior management** – exception reports highlighting anomalies by cost centres such as:
  - > number of tender/quotation waivers granted and the amounts involved; and
  - > number of times that the lowest bid in a procurement exercise is not selected.
- **For the governing body** – a summary list of the major tender exercises (e.g. the amount of which exceeding \$500,000), containing a brief description of the tender items, the respective amounts awarded and the suppliers/contractors engaged.

### 4.3 Year-end Reporting

#### 4.3.1 Income and Expenditure Statement

At the end of a financial year, the Finance Office should prepare an annual income and expenditure statement showing the overall financial position of the TEI and that of individual cost centres for the senior management and governing body so as to let them have a full picture of the TEI's financial performances. For UGC-funded TEIs, the UGC-funded and self-financed activities should be separately reported to enhance monitoring (e.g. whether there is any indication of cross-subsidizing self-financed activities by UGC funds).

### 4.3.2 External Auditor's Report

Upon receipt of the annual audited accounts from the external auditor (**Chapter 2.2**), the senior management should:

- forward the audited accounts to the governing body for information and bring to its attention any weaknesses identified during the course of the audit in the internal control systems;
- task the Finance Office to follow up on the recommendations for improvement made by the external auditor, if any; and
- for UGC-funded TEIs, also forward the assurance report provided by the external auditor ensuring the TEI's appropriateness in using UGC funds (**Chapter 2.6**) and deal with any weaknesses identified by the auditor in the manner described above.

### 4.4 Internal Audit Checks

To enhance effectiveness of their internal control systems, TEIs should set up an independent audit unit reporting directly to the Audit Committee (**Chapter 3.2.3**). This in-house unit should draw up an audit programme and subject all operational areas of the institution to regular audit reviews, according to some pre-set risk factors (e.g. discrepancies detected in the previous audit(s), financial considerations). The audit programme and findings of all audit reviews should be submitted to the senior management and the Audit Committee for scrutiny and endorsement. The Finance Office should then follow up with the audit unit to take forward any recommended measures for improving the internal control systems. To facilitate effective detection of malpractice and even fraud, TEIs should also establish a whistle-blowing channel for staff to report cases of non-compliance or fraudulent act directly to the Chairman of the Audit Committee.

## CHAPTER 5

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# Disclosures in Financial Statements

### 5.1 Introduction

Different users may have different information needs and the level of details for disclosure in financial statements may vary with the nature and operations of the TEI. This Chapter highlights the corruption prevention safeguards that may go beyond the framework for financial reporting as mentioned in **Chapter 2** and helps TEIs enhance their governance which is essential for public confidence in their overall operation.

### 5.2 Major External Users of Financial Statements

The major external users of TEIs' financial statements include the following:

- **Government, UGC and Legislative Council** – for monitoring the stewardship of TEIs, including their compliance with the funding and legal requirements.
- **Resource providers (including bankers, suppliers, contractors, donors and business partners)** – for scrutinizing TEIs' financial capability, liquidity and credit worthiness, etc.
- **Constituent groups (including students, employees and alumni)** – for evaluating the prospects and developments of the TEI to which they have great social or moral attachment.
- **Comparable TEIs** – for benchmarking their own operating performance and achievements.
- **General public** – for general information and evaluation of the TEI's overall performance.

### 5.3 Areas for Disclosures

#### 5.3.1 Corporate Governance

A TEI establishes its governance structure in accordance with its enabling legislation. To assure TEIs are committed to the highest standard of corporate governance, it is advisable for the TEIs to disclose their governance structure in their Annual Reports, including the following information as much as practicable:

- Roles and responsibilities of the governing body, the key functional committees (e.g. Finance Committee, Audit Committee (**Chapter 3.2.3**)), their membership and frequency of meetings;
- Code of practice for members of the governing body, if any;

- An acknowledgement from the governing body of its responsibility for preparing the financial statements;
- Auditor's remuneration; and
- A statement by the auditors about their reporting responsibilities in the auditors' report on the financial statements.

### 5.3.2 Donations

Major donors (e.g. those for regular fund-raising programmes) may wish to have a full picture of how the donation income is spent. To enhance accountability to these donors and facilitate their monitoring against any misuse or abuse of their donations, the **Module on Administration of Donations** of the Guide recommends that TEIs should, where appropriate, issue acceptance letters to the donors concerned setting out the terms and reporting arrangements for reference. In this connection, progress and financial reports should then be submitted to them based on such pre-agreed arrangements. To meet the information needs of other users, TEIs are also advised to disclose the following information in the financial statements or Annual Reports:

- Donation recognition policy (e.g. donations in cash and cash equivalents are recognized as income at fair values).
- Donation income classified by their support nature (e.g. capital projects, scholarships, prizes and bursaries, and research activities).
- Movement of endowment fund (including opening and closing balances, inter-fund transfers and transfers to/from the income statement).
- Funds for UGC's matching grants schemes.
- Acknowledgement of receipt of donations from major donors (including their names, types of support and the amounts involved).

### 5.3.3 Investment in Joint Ventures

To many TEIs, the ever-increasing commercialization activities would foster closer cooperation with the industry and institutions in the Mainland or overseas as well as increased investments in JVs. These investments, if not properly managed and monitored, would not only give rise to financial loss to TEIs but also invite allegations of transfer of benefits, e.g. selling a JV at an unreasonably low price. TEIs should therefore make reference to **Chapter 7.4** of the **Module on Technology Transfer and Commercialization** of the Guide to devise a mechanism to assess the business performance of the JVs and determine the appropriate disposal action to be taken on them. To enhance transparency and enable scrutiny by the users about the nature and extent of the TEI's interests in the JVs, TEIs are further advised to disclose in the financial statements the following information:

- Investment in the JV;
- Name of the JV;

- Form of business structure (e.g. sino-foreign joint venture);
- Place or country of incorporation;
- Proportion of ownership interest (directly or indirectly held by the TEI);
- Principal activity;
- Any significant contractual arrangements requiring the TEI or its subsidiaries to provide financial support to the JV (e.g. the TEI has committed to provide financial resources to support a JV's operation in the next five years);
- Any restrictions on the ability of the JV to transfer funds to the TEI; and
- Gain/loss on the disposal of the JV and the name of the buyer.

#### 5.3.4 Directors' Interests in Joint Ventures

As it is a statutory requirement under the Companies Ordinance to disclose the directors' interests in the financial statements and directors' report of the companies concerned (**Chapter 2.4.1**), TEIs should make similar disclosures relating to the interests of TEIs' appointed directors in their own financial statements for public monitoring.

#### 5.3.5 Remuneration from Outside Practice

UGC requires TEIs to disclose in their financial statements the statistics, in bands of \$150,000, on the number of the highest paid staff whose total annual "equivalent remuneration" in that reporting year exceeds \$1,800,000, irrespective of the funding sources. However, it has not clearly defined the term "equivalent remuneration" and different TEIs may have different interpretations on what items should be included. To facilitate meaningful understanding by the users, it is recommended that TEIs should define the term clearly in their financial statements, e.g. whether it includes salary, gratuity, contribution to retirement schemes, housing benefit and/or income from outside practice.

#### 5.3.6 Procurement

Users may be keen to know how the public funds and private donations are spent by TEIs on procurement to ensure that these funds have not been misused. While the purchases from related parties would be separately disclosed (**Chapter 5.3.7**), the overall purchases and related transactions should be reflected or disclosed in different parts of the financial statements, which are summarized as follows:

- Aggregated amount of purchases of fixed assets by categories, e.g. furniture, equipment and fittings, library collections.
- Aggregated amount of gain/loss on disposal of fixed assets.
- Aggregated amount of different classes of expenditure items, e.g. cleaning and security, repair and maintenance, consultancy services, transport services.

### 5.3.7 Related Party Transactions

A related party generally includes a member of the TEI's governing body or senior management, and a company controlled by this member. As related party transactions (e.g. a TEI procures goods from a company controlled by its Council member or sells one of its JVs to a Council member) would give rise to actual or perceived conflict of interest, the disclosure of such transactions could help enhance the transparency and accountability of the management. Hence, apart from requiring members to declare conflict of interest in the manner described in **Chapter 2.3** of the **Module on Procurement** of the Guide, TEIs are also advised to make the following disclosures:

- Nature of the related party relationship and name of the related party, where appropriate;
- Whether the transaction is conducted in the normal course of business, and if not, reasons for not doing so;
- Amount of the transaction; and
- Amount of the outstanding balance, including commitment, the terms and conditions, and details of any guarantee.

### 5.4 Segment Reporting

With the increasing diversity in the operations of UGC-funded TEIs (e.g. collaborative research, fund-raising and self-financed study programmes), there have been concerns over the risk of cross-subsidization of public funds to their self-funded activities and impropriety in the use of donations. As a good practice for public scrutiny, TEIs should consider reporting their operations by way of “segment reporting” under which they should present their major lines of operations (say, those represent 10% or more of the TEI's total income) in the financial statements. This practice would achieve better understanding of the nature and financial performance of TEIs' individual operations.

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