

29 August 2012

Education Bureau Circular No. 16/2012

Delineation of Reserves and Reserve Ceiling for the Operating Reserve of Direct Subsidy Scheme (DSS) Schools

[Note: This circular should be read by –

- (a) Supervisors and Heads of Direct Subsidy Scheme Schools – for action; and
- (b) Heads of Sections – for information.]

SUMMARY

This circular sets out the implementation details of the recommendations put forward by the Working Group on DSS¹ (Working Group) in respect of the delineation of reserves, the reserve ceiling for the operating reserve and the special one-off arrangement for surplus in excess of the reserve ceiling.

DETAILS

Clear delineation between the operating reserve and the designated reserve

2. Reserves of DSS schools will be classified into two categories, namely the operating reserve and the designated reserve, with a view to facilitating DSS schools' financial management and helping their stakeholders understand the financial situation of the schools.

3. Accumulated surplus arising from both government and non-government funds (except for those in the designated reserve) will be classified as the operating reserve. As for the designated reserves, they include (i) school fee remission/scholarship reserve, (ii) long service payment reserve, (iii) reserve for donations with specific purposes and (iv) reserve for constructing, maintaining and upgrading above-standard facilities.

¹ In response to the recommendations in the Director of Audit's Report No.55 by the Audit Commission and the Public Accounts Committee (PAC) Report No.55 by the PAC of the Legislative Council about DSS schools, the EDB set up the Working Group on DSS in February 2011 to review the administration of the DSS as well as the governance and administration systems of DSS schools. The Working Group submitted its recommendations to the Secretary for Education in December 2011, and the Secretary for Education accepted all the recommendations on 17 February 2012.

Setting up of the reserves

4. In this connection, the balance of the accumulated surplus of schools **as at the end of the 2011/12 school year** will be used as the basis for delineation between the operating reserve and the four designated reserves. Requirements of these five reserves are set out in the ensuing paragraphs.

Operating Reserve

5. All the surplus other than those in the designated reserves as set out in paragraphs 6 - 23 below are recorded under the operating reserve.

Designated Reserve – (i) School Fee Remission/Scholarship Reserve

6. All unspent balances of the provisions for the school fee remission/scholarship scheme accumulated in or before the 2011/12 school year, if any, should be recorded under the school fee remission/scholarship reserve.

7. There is no change regarding the requirements for setting aside school fee income for school fee remission/scholarship scheme, i.e. at least 10% of a school's total school fee income or 50 cents for the school fee remission/scholarship scheme for every additional dollar of school fee charged over and above 2/3 of the DSS unit subsidy rate, whichever is greater, should be set aside.

8. For schools having used up all the provisions and the accumulated reserve of the school fee remission/scholarship scheme in a school year, they can continue to top up their school fee remission/scholarship reserve by transferring the non-government funds in the operating reserve to this reserve on an actual need basis.

9. Transfer of funds in the school fee remission/scholarship reserve out to other reserves is prohibited unless with the special approval of the Education Bureau (EDB).

10. Under the existing requirement, when the reserve of school fee remission/scholarship scheme has reached a cumulative amount which exceeds a school's half-year total school fee income due to low utilisation of the school fee remission/scholarship provision, the school should forward to the EDB a plan on how this specific reserve could be effectively deployed. This standing requirement will continue.

11. Only non-government funds can be recorded under/transferred to this reserve.

Designated Reserve – (ii) Long Service Payment Reserve

12. **As from the 2012/13 school year**, DSS schools may transfer funds from the operating reserve to this reserve equivalent to the amount required to meet the level of minimum requirements under the Employment Ordinance after taking into account the employees' Mandatory Provident Fund (MPF)/retirement scheme benefits already provided.

13. For transfer of funds above the level of minimum requirements under the Employment Ordinance, the corresponding long service payment policy should be endorsed by their School Management Committee (SMC)/Incorporated Management Committee (IMC) with proper documentation kept for checking by the EDB on a need basis.

14. If the required long service payments can be offset by employees' MPF/retirement scheme benefits in accordance with the Employment Ordinance or guidelines issued by the Labour Department, the relevant amount already set aside in this reserve has to be transferred back to the operating reserve. Schools may make such rectifications annually or at least once every three years in their audited accounts. The rectifications should be certified by the schools' auditors and the details should be kept for checking by the EDB on a need basis.

15. If DSS schools have already set aside funds in or before the 2011/12 school year for long service payment, they may record those funds under this reserve in the 2011/12 audited accounts. In this connection, the schools concerned will be required to keep relevant records/proof of their funds already set aside, e.g. list of relevant reserves as at the end of the 2010/11 school year as shown in the audited accounts, list of staff with their entitled long service payment, for checking by the EDB on a need basis.

16. Both government and non-government funds can be recorded under/transferred to this reserve.

Designated Reserve – (iii) Reserve for Donations with Specific Purposes

17. Only donations with specific purposes² could be recorded under this reserve. Donations without specific purposes should be recorded under the operating reserve.

18. DSS schools will be required to keep details of the donations with specific purposes and proof of the intended uses as specified by the donors or planned uses as endorsed by their SMC/IMC including timeframes for planned projects/activities where appropriate for checking by the EDB on a need basis.

² These refer to donations with intended uses as specified by the donors OR planned uses as endorsed by the SMC/IMC.

19. Only non-government funds can be recorded under/transferred to this reserve.

Designated Reserve – (iv) Reserve for Construction, Maintenance and Upgrading of Above-standard Facilities

20. **As from the 2012/13 school year**, it will be at DSS schools' own discretion to start transferring up to 10% of the school fee income to the reserve for above-standard facilities when they prepare the 2012/13 audited accounts if they have fully met the following requirements with proper documentation kept:

- (a) concrete plans with purposes, timeframe/cashflow and funds required have to be deliberated and approved by the SMC/IMC;
- (b) Parent-Teacher Associations have to be consulted about the plans (all parents have to be consulted if the reserve is used for new above-standard capital works); and
- (c) there remains cash in the operating reserve equivalent to six months' or more of the schools' expenses after the transfer of funds.

21. For transfer of more than 10% of the school fee income to the reserve or if after the transfer, the cash in the operating reserve account falls below six months' expenses of the schools, DSS schools will be required to seek prior approval from the EDB. Applications for such transfer, which have to include the justifications and the documents as set out in paragraph 20 (a) and (b) above, should be sent to schools' respective Senior School Development Officers three months before the deadline for schools' submission of the audited accounts in which the proposed transfer of funds is made. Applications will not be approved should the cash in the operating reserve account of the schools fall below three months' expenses after the proposed transfer.

22. If DSS schools have already set aside funds in or before the 2011/12 school year for above-standard facilities with the approval of the SMC/IMC, they may record those funds under this reserve in the 2011/12 audited accounts. In this connection, the schools concerned will be required to keep relevant proof of their projects and the amount already set aside, e.g. records of decisions at SMC/IMC meetings, for checking by the EDB on a need basis.

23. Only non-government funds can be recorded under/transferred to this reserve.

Submission of the allocation of the reserves

24. DSS schools will be required to reflect their allocation of the above five reserves in the 2011/12 audited accounts, and to return the completed 2011/12 audited accounts to the EDB by **end-March 2013**. A proforma for such purpose is at Annex 1 for advance information of schools. The funds in the operating reserve and designated reserves have to be certified by schools' auditors. Details

will be provided in our circular memorandum for 2011/12 audited accounts to be issued to schools later.

Reserve ceiling

25. In line with the requirements promulgated by the Administration for setting an appropriate reserve ceiling of surpluses kept by subvented organisations including DSS schools and in consideration of the need to enable DSS schools to put in place longer-term development strategies, the ceiling on the operating reserve will be set at an amount equal to 100% of the annual total expenditure of the school, i.e. 12 months' operating expenditure as reflected in the audited accounts of the same school year.

26. The reserve ceiling will be implemented **as from the 2013/14 school year** with a view to giving DSS schools sufficient time for planning. In other words, the accumulated total balance of the operating reserve (excluding the grandfathered amount, details of which being set out in paragraphs 30-33 below) and the annual expenditure as reflected in the 2013/14 audited accounts will be used to determine whether a DSS school's operating reserve has exceeded the reserve ceiling for the first time. For example, if the operating reserve (excluding the grandfathered amount) and the annual expenditure of a DSS school in the 2013/14 school year are \$55 million and \$50 million respectively, the amount in excess of the reserve ceiling (i.e. \$55 million - \$50 million = \$5 million) will be subject to the arrangements as set out in paragraph 27 below.

27. For DSS schools with accumulated operating reserve exceeding the ceiling as reflected in the audited accounts as from the 2013/14 school year, they will be given the following options to rectify the situation:

- (a) schools may choose to submit a plan on how to reduce school fees in the forthcoming school year so that the accumulated operating reserve will drop to below the ceiling taking into account their own long-term financial considerations;
- (b) schools may choose to receive less DSS subsidy in the forthcoming school year, i.e. the amount exceeding the ceiling will be deducted from the DSS subsidy to be paid to the school in the next payment;
- (c) schools may choose to return the surplus in excess of the ceiling to the Government in a specified timeframe; or
- (d) schools may choose to transfer the surplus in excess of the ceiling to the school fee remission/scholarship reserve subject to the following conditions being met:
 - there is no surplus in the school fee remission/scholarship reserve as reflected in the latest audited accounts;
 - the utilization rates of the school fee remission/scholarship provisions are 100% or more in the past three consecutive

years; and

- the amount that can be transferred to the school fee remission/scholarship reserve is subject to EDB's approval.

28. In this connection, starting from the exercise for submission of the **2013/14 audited accounts**, DSS schools with operating reserve (excluding grandfathered amount) exceeding the reserve ceiling will be asked to indicate their option to handle the surplus in excess of the reserve ceiling. Details of the arrangements will be set out in the annual circular memorandum on the submission of the audited accounts by DSS schools.

29. Under exceptional circumstances, DSS schools with operating reserve (excluding grandfathered amount) exceeding the reserve ceiling may apply to the EDB for exemption from the options as set out in paragraph 27 above and carrying forward the excess surplus to the next school year. For instance, a DSS school can demonstrate with evidence that the part of surplus in excess of the reserve ceiling is wholly due to the adjustment of DSS subsidy after the DSS unit subsidy rates are finalized in October. Such applications should be sent to schools' respective Senior School Development Officers within one month after the deadline for schools' submission of the audited accounts. In addition, to cater for the practical needs of schools with additional school buildings such as an extension block of classrooms within the school premises financed by non-government funds in the operating reserve, the net book value of such additional school buildings will not be counted when we determine whether schools' operating reserve has exceeded the reserve ceiling. In this connection, if a school finds that its surplus in excess of the reserve ceiling comes from the net book value of additional school buildings within the school premises in the operating reserve, it should provide such information when submitting its audited account. Such cases will be considered on their own merits.

Special one-off arrangement for surplus in excess of the reserve ceiling

30. As a special one-off arrangement, DSS schools will be allowed to grandfather the part of the operating reserve in excess of the reserve ceiling accumulated before the implementation of the reserve ceiling. This notwithstanding, the grandfather arrangement is subject to the following conditions being complied with:

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

31. In this connection, the balance of the operating reserve **as at the end of the 2011/12 school year** will be used as the basis for calculating the amount of reserves that can be grandfathered. After allocating their accumulated surplus to

the four designated reserves in the 2011/12 audited accounts (such should be prepared by schools in early 2013), DSS schools with accumulated surplus in the operating reserve (excluding the net book value of additional school buildings within the school premises financed by non-government funds) in excess of the reserve ceiling may temporarily record the excess surplus in the 2011/12 audited accounts as proposed reserve to be grandfathered and then apply to the EDB for grandfathering such excess surplus. An example of the calculation of the amount in the operating reserve that can be grandfathered is at Annex 2. Applications for grandfathering the excess surplus together with a plan (with details of their reserves including their types, proposed usage and timeframe for deployment approved at SMC/IMC meetings) should be sent to the School Administration 3 Section of the EDB at the following address by end-June 2013:

School Administration 3 Section
Education Bureau
5/F, East Wing, Central Government Offices,
2 Tim Mei Avenue, Tamar, Hong Kong

32. The grandfathered reserves, if any, should be expended to the benefits of the students within a reasonable timeframe according to the deployment plan approved by the EDB.

33. Given the amount of reserves in the operating reserve that can be grandfathered is to be calculated based on the accumulated balance standing in the audited accounts for the 2011/12 school year while the reserve ceiling is to come into effect from the audited accounts of the 2013/14 school year, DSS schools will be allowed to carry forward the surplus in excess of 12 months' operating expenses accumulated at the end of the 2012/13 school year, if any, to the 2013/14 school year as another one-off arrangement. DSS schools should make good and prudent use of the surplus to the benefit of the students.

ENQUIRY

34. For enquiries about the delineation of reserves, the reserve ceiling for the operating reserve and the special one-off arrangement for surplus in excess of the reserve ceiling, please contact the School Administration 3 Section of the EDB at 3509 7459 or 3509 7457. For enquiries about applications for transfer of school fee income to the reserve for above-standard facilities in paragraph 21 and exemption from the options as set out in paragraph 27 to handle the reserve in excess of the ceiling, please contact the respective Senior School Development Officers.

Miss Alice YU
for Permanent Secretary for Education

Allocation of Accumulated Funds and Other Reserves as at 31 August 2012 ^(Note 1)

(For comparison purpose)	Accumulated Funds / Other Reserves	2011/12 (as at 31.8.2012)	Allocation of Accumulated Funds and Other Reserves as at 31.8.2012 to Operating Reserve and Designated Reserves				
			Operating Reserve	School Fee Remission / Scholarship Reserve	Long Service Payment Reserve	Reserve for Donations with Specific Purposes	Reserve for Construction, Maintenance and Upgrading of Above-Standard Facilities
\$		\$	\$	\$	\$	\$	\$
()	Accumulated Funds						
()	-Government funds	()	()	N/A	()	N/A	N/A
()	-Non-government funds	()	()	()	()	()	()
()	Sub-total	()	()	()	()	()	()
()	Fee Remission Reserve	()	N/A	()	N/A	N/A	N/A
()	Other Reserves						
()	-Funded under Government Funds (please specify)	()	()	N/A	()	N/A	N/A
()	-Funded under Non-government Funds (please specify)	()	()	()	()	()	()
()	Sub-total	()	()	()	()	()	()
()	Total	()	(X)	()	()	()	()
(per Balance Sheet)	(per Balance Sheet)		(Note 2)				
			(Note 3)				

N/A – Not applicable

() = Information to be supplied by schools

Notes:

- (1) This schedule will form part of the audited accounts for the 2011/12 school year.
- (2) If the total operating reserve as at 31 August 2012 exceeds the annual total expenditure of 2011/12, please provide the following breakdown. The total operating reserve as adjusted to exclude the net book value of additional school buildings within the school premises, if any, would be used solely for the purpose of determining whether the adjusted total would exceed the applicable reserve ceiling and the amount to be grandfathered.

	Total	Comprising :	
		Government funds	Non-government funds
Total operating reserve as at 31.8.2012	\$ (X) (per above)	\$ ()	\$ ()
<u>Less:</u> Net book value of additional school buildings, if any, as at 31.8.2012	(Y)	()	()
Adjusted total operating reserve as at 31.8.2012	(Z)	()	()
Comprising :			
(i) Amount equivalent to or less than the annual total expenditure of the 2011/12 school year	()	()	()
(ii) Amount in excess of the annual total expenditure of the 2011/12 school year (i.e. (i) above) and to be grandfathered	()	()	()
Total	(Z)	()	()
Annual total expenditure of 2011/12 school year	()		

- (3) These balances will form the opening balances for respective reserves in 2012/13 accounts.

**Examples of Calculation of Grandfathered Reserve
(Based on the Accumulated Surplus in the 2011/12 School Year)**

**Example 1: WITHOUT Net Book Value of Additional School Buildings
Financed by Non-government Funds in the Operating Reserve**

A. Accumulated Surplus and Annual Expenditure in the 2011/12 School Year

1	Accumulated surplus as at end of the 2011/12 school year:	\$88 million
2	Annual expenditure of the 2011/12 school year, i.e. reserve ceiling:	\$60 million

B. Setting Up of the Operating Reserve and Designated Reserves

3	Operating Reserve, i.e. Accumulated surplus as at end of the 2011/12 school year in (1) above <i>minus</i> Designated reserves in (4), (5), (6) and (7) below (\$88m – \$2m – \$1m – \$5m – \$10m):	\$70 million
4	Designated Reserve – (i) Fee Remission/Scholarship Reserve:	\$2 million
5	Designated Reserve – (ii) Long Service Payment Reserve:	\$1 million
6	Designated Reserve – (iii) Reserve for Donations with Specific Purposes:	\$5 million
7	Designated Reserve – (iv) Reserve for Construction, Maintenance and Upgrading of Above-standard Facilities:	\$10 million

C. “Excess” Reserve that can be Grandfathered

The amount that the school may apply for grandfathering is equal to the funds in the operating reserve in excess of the reserve ceiling, i.e. \$70 million *minus* \$60 million = \$10 million.

Example 2: WITH Net Book Value of Additional School Buildings Financed by Non-government Funds in the Operating Reserve

A. Accumulated Surplus and Annual Expenditure in the 2011/12 School Year

1	Accumulated surplus as at end of the 2011/12 school year:	\$129* million
2	Annual expenditure of the 2011/12 school year, i.e. reserve ceiling:	\$60 million

* Including the net book value of additional school buildings of \$30 million.

B. Setting Up of the Operating Reserve and Designated Reserves

3	Operating Reserve, i.e. Accumulated surplus as at end of the 2011/12 school year in (1) above <i>minus</i> Designated reserves in (4), (5), (6) and (7) below (\$129m – \$2m – \$1m – \$5m – \$10m):	\$111# million
4	Designated Reserve – (i) Fee Remission/Scholarship Reserve:	\$2 million
5	Designated Reserve – (ii) Long Service Payment Reserve:	\$1 million
6	Designated Reserve – (iii) Reserve for Donations with Specific Purposes:	\$5 million
7	Designated Reserve – (iv) Reserve for Construction, Maintenance and Upgrading of Above-standard Facilities:	\$10 million

Including the net book value of additional school buildings of \$30 million. The operating reserve used for calculation of the grandfathered reserve is therefore equal to \$81 million, i.e. \$111 million *minus* \$30 million.

C. “Excess” Reserve that can be Grandfathered

The amount that the school may apply for grandfathering is equal to the funds in the operating reserve (excluding the net book value of additional school buildings within the school premises) in excess of the reserve ceiling, i.e. \$81 million *minus* \$60 million = \$21 million.