

## FINANCIAL CIRCULAR NO. 7/2017

### Capital Works Programme

(Note : Distribution of this Circular is **Scale C**. Directors of Bureaux, Controlling Officers and all officers dealing with capital works projects, as well as resource allocation, annual Estimates and procurement of stores and services for items under the Capital Works Reserve Fund should read it.)

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This Circular updates the requirements governing the administration of a capital works project under the Capital Works Programme (CWP). Financial Circular No. 3/2012 “Capital Works Programme” is hereby replaced. Financial Circular No. 4/2010 “User Guide on the Finance Committee, Establishment Subcommittee and Public Works Subcommittee” is hereby updated.

### CAPITAL WORKS PROGRAMME

2. CWP comprises works projects funded by the following Heads of Expenditure of the Capital Works Reserve Fund (CWRF) –

- (a) government works projects under Heads 702 to 707, 709 and 711 (collectively, they are called the Public Works Programme); and
- (b) capital subventions projects under Head 708<sup>1</sup>.

**/DELEGATIONS .....**

To: Directors of Bureaux  
Controlling Officers

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<sup>1</sup> Head 708 funds “Capital Subventions” and “Major Systems and Equipment” projects. Only the part of Head 708 relating to capital subventions forms part of the CWP.

## **DELEGATIONS FROM FINANCIAL SECRETARY TO CONTROLLING OFFICERS FOR THE ADMINISTRATION OF CWRP**

3. In accordance with the Legislative Council (LegCo) Resolution setting up CWRP, the Financial Secretary (FS) may delegate his power of administration to other public officers. By virtue of the Interpretation and General Clauses Ordinance (Cap. 1), the aforesaid reference to “Financial Secretary” also means the Secretary for Financial Services and the Treasury (SFST).

4. The Controlling Officer (CO) for each Head in CWRP is specified in the Memorandum Note on CWRP in the Annual Estimates. COs may administer the subhead(s) under delegated authority according to the approved scope and, where appropriate, the approved project estimate (APE). When exercising delegated authority, COs should observe Financial Circular No. 1/2004 “Responsibility of Controlling Officers”.

## **CATEGORIES OF CAPITAL WORKS PROJECTS**

5. There are four categories of capital works projects. Categories A, B and C reflect the different funding status of a project under the capital works resource allocation system, while Category D projects cover pre-construction activities (such as design studies and site investigations) for major projects and standalone minor works items each costing not more than the delegated financial limit. Details of the different categories are set out in the following paragraphs.

### ***CATEGORY C***

#### ***Pre-requisites for inclusion in Category C***

6. A project attains a Category C status any time of the year upon approval of its Technical Feasibility Statement (TFS) by the Works Branch (WB) of the Development Bureau. The requirements for the preparation of TFS are set out in Financial Circular No. 4/2012 “Requirements for Project Definition Statement and Technical Feasibility Statement for Capital Works Projects”<sup>2</sup>.

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<sup>2</sup> Part of Financial Circular No. 4/2012 has been amended by Financial Circular No. 4/2017 “Optimisation of Site Utilisation for Capital Works Projects”.

7. In case the scope of works and/or project estimate of a Category C project is revised and becomes substantially different from that in the approved TFS, a replacement TFS for consideration by WB and re-confirmation of the Category C status of the project by Treasury Branch of the Financial Services and the Treasury Bureau (TsyB) is required.

8. Directors of Bureaux (DoBs) may **not** incur any CWRF expenditure on any pre-construction activities<sup>3</sup> for any Category C project, except with the prior approval of SFST.

### ***Deletion from CWP register***

9. DoBs should, in collaboration with the relevant works directors, keep a close watch on Category C projects which have not been upgraded to Category B within three years from the date of entry into Category C, and should provide justification in writing to TsyB for the retention of Category C status prior to the expiry of the three-year validity period. In the absence of initiation by the relevant DoBs for retention of Category C status of the project (mainly by revisiting / updating the relevant TFS and submission to WB for approval), it will be followed up with a view to deletion of such project from CWP after three years. Reinstatement of deleted projects in Category C should follow the normal procedures outlined in paragraph 6 above.

### ***CATEGORY B***

10. Category B projects are divided into Categories B+ and B-. Only a project with Category B+ status has earmarked funding, and may proceed with –

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<sup>3</sup> Pre-construction activities, which usually include site investigation, feasibility studies, design and preparation of tender documents, ensure that a project will be ready in all respects to start works on site once funding for the construction works is approved. The costs of pre-construction activities can be charged to the appropriate works-related block allocations under the CWRF subject to their expenditure ceiling. Land acquisition, undertaken by the Director of Lands with funding met from block allocations under CWRF **Head 701 – Land Acquisition**, is regarded as an enabling factor for the project, but not as part of the pre-construction activities.

- (a) upgrading to Category A;
- (b) parallel tendering before upgrading of the project to Category A. It includes initiation of the prequalification exercise or consultants selection procedures; or
- (c) land acquisition before upgrading to Category A. It includes affixing or serving a notice of resumption.

***Pre-requisites for obtaining Category B status***

11. DoBs may seek to upgrade a Category C project to Category B+ or B- by submitting bids in the annual capital works Resource Allocation Exercise (RAE). Bids for upgrading to Category B must be supported by a TFS which has been approved by WB. For TFS completed three or more years ago, the information contained therein should be updated as appropriate.

***Pre-construction activities chargeable to block allocations***

12. Once a project has attained a Category B+ or B- status, the relevant works director(s), with the support of DoB, may undertake the necessary pre-construction activities so as to render the project ready for upgrading to Category A and commencement of construction works. If funding for a pre-construction activity is estimated to exceed the delegated financial limit of a Category D item and cannot therefore be charged to the relevant CWRF block allocation, part of the Category B+ or B- project would need to be upgraded to Category A for funding the pre-construction activity.

***Initiating works-related tendering and consultants selection procedures for Category B+ projects***

13. COs are reminded that they must **not award** a contract unless and until funding has been secured, even though they may **invite** tenders or initiate consultants selection exercises for Category B+ works contracts before funding is secured in accordance with Financial Circular No. 5/2016 “Parallel Tendering for All Contracts”.

*/Changes .....*

### ***Changes prior to upgrading to Category A***

14. DoBs who intend to substantially vary the scope<sup>4</sup>, project estimate or programme of a Category B+ project should consult TsyB as early as possible, irrespective of whether there will be consequential capital and recurrent cost implications. Star Chamber may need to be consulted depending on the degree of variation, particularly when the change involves an increase in the project estimate and raises the issue of whether it is justifiable to pursue the project. If additional resources are required, the DoB concerned is expected to first meet them from within the total resources allocated for Category A projects under his policy portfolio. Failing that, a RAE bid should be submitted to seek additional resources.

### ***Downgrading from Category B***

15. If there is a change in policy, user requirement and/or the delivery programme which necessitates a revised TFS, or if there is no longer any justification for a project (or the remainder of a partially-upgraded project) to retain its Category B status (i.e. the project may be downgraded to Category C or deleted from CWP), the responsible DoB, in consultation with the works director concerned, should notify TsyB as soon as possible. Where the pre-construction activities of the to-be-deleted project have been outsourced to consultants, the CO of the project should take steps to discontinue the related consultancy agreements as early as practicable. If the CO does not consider it appropriate to do so, he should consult the relevant DoB(s), WB, TsyB and where appropriate the relevant consultants selection board.

***/CATEGORY .....***

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<sup>4</sup> Please refer to Environment, Transport and Works Bureau Technical Circular (Works) No. 30/2003 “Control of Client-Initiated Changes for Capital Works Projects” for details of the procedures on the control of changes in scope of works.

## **CATEGORY A**

### ***Upgrading to Category A***

16. DoBs may seek the support of the Public Works Subcommittee (PWSC) and approval of FC to upgrade a Category B+ project to Category A when all necessary pre-construction activities have been completed or substantially completed. Statutory procedures and public consultation required for a project should have been completed before putting forth the funding proposal to PWSC and FC. Guidelines for preparing PWSC submissions are set out in Financial Circular No. 4/2010 “User Guide on the Finance Committee, Establishment Subcommittee and Public Works Subcommittee”.

17. For projects costing up to \$15 million each to be funded under **Head 708 (part) – Capital Subventions**, their upgrading to Category A can be approved by TsyB under delegated authority from FC.

### ***Money-of-the-day project estimates***

18. All PWSC/FC papers on CWP projects should provide estimates in money-of-the-day (MOD) prices<sup>5</sup>. For the avoidance of doubt, PWSC submissions should no longer present project estimates in constant prices. Financial Circular No. 4/2010 has been amended accordingly. Once approved by FC, the project estimate in MOD prices will form the APE of the project. TsyB will announce price adjustment factors to be used for converting constant prices into MOD prices regularly.

19. The relevant rules in using MOD estimates and the method in deriving MOD prices are set out in **Annex A**.

### ***LegCo Panel consultation***

20. DoBs should consult the relevant LegCo panels prior to submitting a funding proposal to PWSC. Prior discussion at Panel meetings enables the Government to be apprised of LegCo Members’ concerns and to provide clarification and supporting information in the PWSC submission as necessary. **Panel papers on capital works projects should be cleared with TsyB.**

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<sup>5</sup> The same requirement applies to funding proposals submitted to TsyB for approval under delegated authority.

21. For non-controversial proposals with low project estimates, DoBs may consider circulating such proposals to the relevant Panels for Members' comments with an offer to discuss at panel meetings before putting them to PWSC/FC for consideration.

### *Approval from FC*

22. FC is the ultimate authority for approving the project estimate (which becomes the APE after approval) and scope of works of a capital works project. PWSC assists FC in examining capital works proposals. Even if PWSC has clearly expressed support for an upgrading application, unless FC has formally approved it, the relevant DoB or works director should not commit any expenditure on the project. Likewise, for projects which can be upgraded under delegated authority (see paragraph 17), DoBs or works directors concerned should not commit any expenditure before securing TsyB's approval for upgrading.

23. After the upgrading of a project to Category A, the relevant works director should apply to TsyB for release of funds and/or creation of a subhead for the project. To ensure timely delivery of capital works projects, DoBs should adhere to the works commencement date as specified in the PWSC submission in general. Where possible, DoBs should strive to commence works as soon as practicable.

24. DoBs and works directors must ensure that works expenditure stays strictly within the APE for each Category A works project and in strict accordance with the scope of the project as approved by FC or under delegated authority. CO of a project should seek to increase the APE once he is aware that the latest estimated project expenditure is expected to exceed the APE. He should also alert TsyB once an increase in APE or change in the approved project scope appears likely. SFST may approve, under delegated authority from FC, minor changes to project scope or increase in APE which does not exceed \$15 million. No contractual commitments may be entered into prior to obtaining the necessary FC approval or approval under delegated authority for an increase in APE and/or any substantial change in the approved project scope<sup>6</sup>.

*/Completion .....*

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<sup>6</sup> A substantial change refers to one which may cause an increase in APE by more than \$15 million or which, albeit not increasing the APE by more than \$15 million, may constitute a significant deviation from the scope of the project approved by FC.

### ***Completion of projects, finalisation of accounts and deletion from CWP register***

25. DoBs and their works directors should finalise project accounts as soon as possible and in any event no later than three years after commissioning of the facilities<sup>7</sup>. Works directors must consult TsyB when this timeframe could not be met due to special circumstances. Upon settlement of all outstanding balances and finalisation of accounts, works directors should confirm with TsyB in writing the readiness of the projects for deletion from CWP. In turn, TsyB will notify the Treasury of the deletion of the project vote, and include the project in the annual report to PWSC of projects with finalised accounts and the respective outturn expenditure.

### ***Cancellation and curtailment of projects***

26. The Government has a good track record of completing virtually all projects in Category A. For projects whose approved scope of works can only be partially completed (i.e. curtailment) or cannot be completed at all (i.e. cancellation), DoBs and works directors should provide detailed explanations to TsyB and WB, apply to TsyB for deletion of the projects from the CWP register, and consider informing PWSC and/or FC of the cancellation or curtailment with justification.

### ***CATEGORY D***

27. Category D projects funded under various block allocation subheads cover thousands of standalone minor works items and pre-construction activities for Category B projects such as works-related studies and site investigations. There are at present 26 CWRP block allocation subheads. Every year, FC approves the provision for each block allocation subhead on a lump-sum basis. Slope works under Landslip Preventive Measures (**Subhead 5001BX**) and land acquisition items (**Subheads 1004CA and 1100CA**) have no expenditure ceiling. The Universal Accessibility Programme (**Subhead 6101TX**) has an expenditure ceiling of \$75 million per item. All other Category D items have an expenditure ceiling of \$30 million per item.

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<sup>7</sup> For a Design-Build-Operate contract (e.g. landfills), DoBs and works directors should finalise the accounts of the “Design and Build” portions of the contract as soon as possible and in any event not later than three years after the completion of the “Design and Build” portions.

28. For projects with estimates beyond the relevant threshold or outside the ambit of the existing block allocation subheads, DoBs have to go through RAE and then seek specific funding from FC for each project (by upgrading to Category A). To avoid nugatory expenditure, DoBs and works directors shall not create Category D items to fund detailed feasibility studies or advanced planning work for major projects before upgrading to Category B, unless with the prior approval of SFST as set out in paragraph 8 above. DoBs and works directors should observe the guidelines on the approval procedures and the conditions pertinent to the creation of Category D items in Financial Circular No. 3/2011 “Capital Works Reserve Fund – Delegated authorities in respect of block allocations”.

## **ANNUAL FORECAST OF PUBLIC WORKS SUBCOMMITTEE SUBMISSIONS AND YEAR-END REPORT**

29. At the request of PWSC, the Government has undertaken to provide an annual forecast of submissions at the beginning of each legislative session. Our target is to issue the forecast as early as practicable. DoBs are required to ensure that the items included or explanations given in the forecast are consistent with all relevant government commitments (e.g. Policy Address or papers to LegCo). The forecast will be circulated to all relevant LegCo Panels. Furthermore, we need to provide PWSC with a report by the end of each legislative session to account for deviations between actual submissions and the forecast. DoBs, client departments or subvented organisations are accountable for any slippage, be it due to changes in policies, priorities, programmes or user requirements.

## **LAND ACQUISITION**

30. Expenditure on land acquisition should only be incurred for projects in Categories A and B+.

31. For standalone Category D minor works items, the overall development cost (i.e. land acquisition cost and construction cost) should be assessed. If a proposed item involves a disproportionately high land acquisition cost compared with the construction cost, the DoB (who gives the policy support), Director of Lands (who controls the block allocations for land acquisition), and the relevant CO(s) of the block allocations funding the construction cost should scrutinise the item and make a conscious decision on whether to proceed with its implementation.

**/OPTIMISATION .....**

## **OPTIMISATION OF SITE UTILISATION**

32. Given the high demand for developable land, project proponents and works agents must ensure that the proposed projects will optimise the utilisation of the project sites. Project proponents and works agents should observe the requirements as set out in Financial Circular No. 4/2017 “Optimisation of Site Utilisation for Capital Works Projects”.

## **FURNITURE AND EQUIPMENT**

33. Approval from the appropriate authority is required for procurement of furniture and equipment (F&E) items for projects under CWP, notwithstanding that the provision of F&E of a project has already been approved by FC or under delegated authority. The detailed arrangement and the level of approval authority are set out in Financial Circular No. 3/2016 “Furniture and Equipment for CWP Funded under the CWRF”.

## **RESOURCE ALLOCATION MECHANISM**

### ***NORMAL CYCLE***

34. The annual capital works RAE normally takes place in the third quarter of the calendar year. All capital works RAE bids will be processed in one composite exercise so that Star Chamber can have a comprehensive overview of the funding requirements for all capital works projects. Detailed arrangement will be set out in the annual capital works RAE call memo.

### ***IN-YEAR BIDS***

35. To ensure fairness and preserve the integrity of the resource allocation system, in-year bids are **not** generally entertained. Only bids that are genuinely urgent, exceptional and/or unforeseen that merit upgrading between two RAE cycles would be considered. Such bids should be supported by an approved TFS. Unless otherwise justified, the resources required for the in-year bid should normally be met from within the total allocation for Category A projects within the lead DoB’s policy portfolio.

***/SAVINGS .....***

## ***SAVINGS AND ADMINISTRATIVE CAP***

36. If the contract for a Category A project is awarded at a price substantially lower than the provision earmarked for it in the APE, to avoid locking up resources unnecessarily, TsyB will “freeze” the savings. DoBs and works directors should not spend against such savings. For RAE purpose and monitoring of project spending, the updated requirement for the project (i.e. the reduced project estimate) will be the administrative cap on the project expenditure. Should there be any subsequent increase in the estimated project expenditure, DoBs/works directors can apply to TsyB for an additional allocation of funds within the APE or an increase in the APE. In considering such applications, TsyB will take into account the administrative cap of the relevant projects. Any increase in the project estimate (and the administrative cap) beyond the APE should normally be met by offsetting savings identified from within the administrative caps on other Category A projects. An increase in the APE exceeding \$15 million requires FC approval. Where the cost of a project turns out to be substantially lower than the APE, the DoB or the works director should apply to SFST to reduce the APE, or keep TsyB informed of the reasons for not applying for an immediate reduction in the APE. Please refer to **Annex B** for the mechanism for calculating the savings for offsetting the project cost increase and the administrative cap.

## ***COST CONTROL MEASURES***

37. DoBs should ensure that the requirements for capital works projects are fit for purpose and strictly necessary having due regard to value-for-money considerations. COs should be satisfied that the delivery of the project is cost-effective. Every effort should be made to avoid cost over-run. Related measures are set out in the capital works RAE call memo.

## ***RECURRENT COST***

38. To best utilise available resources, DoBs should try to absorb the recurrent consequences arising from new capital works projects through redeployment of resources within their operating expenditure envelopes. If that is not possible, DoBs may seek funding for meeting recurrent costs in the RAE. The RAE bids would be considered taking into account the merits of the proposals as well as the Government’s affordability. Please refer to Financial Circular No. 2/2005 “Recurrent Consequences of Capital Projects” for details.

***/SHADOW .....***

### ***SHADOW BIDS***

39. There are times when the Government wishes non-government developers to fund and construct public facilities (e.g. a public open space) and surrender the facilities upon completion for management and maintenance by the Government. In such cases, policy bureaux of departments responsible for the management and maintenance of the facilities may submit a “shadow” bid (“shadow” in the sense that no capital funding by the Government is involved) for the recurrent cost required and such bid will be considered on a competitive basis along with other regular capital works RAE bids.

40. If the capital cost of the public facility concerned is \$30 million or less, the project proponents should absorb the recurrent cost from within their existing allocations as with other minor capital works projects funded under CWRP block allocations. Bureaux and departments must not commit the Government to shouldering the management and maintenance responsibility of any public facilities constructed and paid for by private developers without first confirming availability of the necessary recurrent resources either from within their own envelopes, or through RAE.

### **AUTHORITY FOR ENTRUSTMENT OF CAPITAL WORKS PROJECTS**

41. Any proposal to entrust a capital works project to a specified non-government party such as a private developer, a utility company or a public body (such as the Housing Authority and the MTR Corporation Limited) is in effect a request for waiving the tender procedures. Such a proposal requires the prior approval of TsyB. COs should submit justifications and details of the entrustment proposal to TsyB for consideration.

**/SIMPLIFIED .....**

## **SIMPLIFIED TENDERING ARRANGEMENT FOR CAPITAL WORKS PROJECTS**

42. To streamline procedures, we have introduced a simplified tendering arrangement for all works contracts. COs are authorised to personally approve the award of –

- (a) all works contracts not subject to the Agreement on Government Procurement of the World Trade Organization (WTO GPA) and not exceeding \$30 million; and
- (b) works contracts above \$30 million but not exceeding \$55 million each and not subject to WTO GPA, provided that they are awarded to the lowest conforming bidder or the highest combined scorer.

COs should follow the procedures set out in Chapter III of the Stores and Procurement Regulations where simplified tendering arrangement is applied. For details, please refer to Financial Circular No. 3/2009 “Simplified Tendering Arrangement for Capital Works”.

## **RELATED FINANCIAL CIRCULARS**

43. Financial Circulars relating to CWP are set out at **Annex C**. For an update of the Financial Circulars in force, please refer to the Financial Circular on “Retention of Financial Circulars” issued at the beginning of each calendar year.

## **ENQUIRIES**

44. Please contact ‘W’ Division of TsyB for capital works projects procedures, resource divisions on recurrent resources for capital works projects or shadow bids, ‘E’ Division on optimisation of site utilisation and procurement procedures under the simplified tendering arrangement, and Tender Division on entrustment covered in this circular.

James H. Lau Jr.  
Secretary for Financial Services and the Treasury

## **Money-of-the-day estimates**

### **Purpose**

This Annex sets out the rules in using money-of-the-day (MOD) estimates and the method in deriving MOD prices.

### **Rules in using MOD estimates**

2. Project estimate in MOD prices will form the approved project estimate (APE) for approval by the Finance Committee (FC) or under delegated authorities. It represents the total cash payments estimated for a project.

3. All Public Works Subcommittee (PWSC) submissions should provide project estimate in MOD prices. For the avoidance of doubt, PWSC submissions should no longer present project estimates in constant prices. The calculation for deriving MOD estimates from constant price estimates and phasing of expenditure should be submitted to the Treasury Branch (TsyB) of the Financial Services and the Treasury Bureau for vetting. The constant price base should be set at the price level prevailing at the financial year in which the PWSC session begins. The following rules will apply -

- (a) **all PWSC submissions** should quote the project estimate (including the contingency sum which should be broadly set at 10% of the total construction costs<sup>1</sup> in constant prices) as endorsed in the latest capital works Resource Allocation Exercise (RAE), subject to any changes agreed by the TsyB. MOD project estimates should be derived with reference to constant price estimates and the prevailing price adjustment factors as explained in paragraphs 5 and 6 below;
- (b) we can award contract(s) under a project only if the estimated cumulative total of all tender prices for the contract(s) plus allowance(s) for inflation<sup>2</sup> falls within the MOD APE; and
- (c) provision for price adjustment is designed to meet inflationary price increases and should be used primarily for this purpose. The Controlling Officers should refrain from using it as a secondary contingency item to pay for real increases in the project cost due to unforeseen works items as far as possible.

<sup>1</sup> Total construction costs are the amount of the project estimate less the contingency.

<sup>2</sup> Allowances for inflation mainly take the form of estimated contract price fluctuation payments.

4. On paragraph 3(c) above, additional costs for unforeseen works items which are within the approved project scope should first be met from contingency and savings in construction costs. Only if there is a genuine surplus in the provision for price adjustment (e.g. lower-than-expected actual contract price fluctuation payments) and no other project sum (including the contingency) can be identified to meet additional cost should the provision for price adjustment be used for meeting the additional cost for unforeseen works items. If the combined effect of higher-than-expected contract fluctuation payment and construction costs is such that the original MOD APE will be exceeded, FC's approval (or TsyB's approval under delegated authority if the APE is increased by not more than \$15 million) should be sought.

### **Derivation of MOD prices**

5. The Government Economist forecasts the trend rate of change in the prices of public sector building and construction output, based on which the TsyB derives price adjustment factors for converting project costs at constant prices into MOD prices.

6. MOD prices are derived by -

- (a) splitting up a project estimate in constant price into a cashflow forecast showing the estimated expenditure in each financial year; and
- (b) multiplying the constant price forecast in a certain year by the price adjustment factor for the same financial year.

A sample of calculation is provided at **Enclosure**.

### **Presenting Project Estimate in MOD Prices**

7. There have been widespread reports that the project estimate shown in the PWSC and FC funding submissions are found much higher than those released initially. This has given rise to allegations of Government under-estimating project costs initially<sup>3</sup> or failing to provide accurate cost estimates for public works projects.

8. To lessen misunderstanding, if release of initial project estimate is inevitable, such should be presented in MOD prices based on a reasonably realistic project programme (i.e. Forecast Cost per Provisional Design (FCPD)). This approach can largely reduce the differences of the project estimate with those shown in the later LegCo submissions due to the price level changes.

<sup>3</sup> Or alternatively, cost overruns at the time when the projects are submitted to FC for funding applications.

Moreover, a clear statement should be made together with the release of project estimate for the purpose of qualifying that these initial figures are only based on an assumed project programme and preliminary project design, which are subject to change as the project development process progresses. A sample statement is as follows.

*The Forecast Cost per Provisional Design (FCPD) of the project is \$XXX million in MOD prices. The Project Estimate will be substantially higher or lower than the FCPD as a result of design development, programme change, construction price level changes, etc.*

### **Annual capital works RAE**

9. Although APEs approved by the FC are in MOD prices, the annual RAE for capital works projects will continue to be on a constant price basis. During RAEs, we will update constant price estimates for projects with reference to the constant price estimates approved in the previous RAE and the prevailing price adjustment factors.

## Sample Calculations

The following sample calculation illustrates how project estimate is presented in MOD prices in a PWSC submission –

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	<i>\$ million (in MOD prices)</i>
(a) <i>Site works</i>	7.4
(b) <i>Building works</i>	11.2
(c) <i>Building services</i>	10.6
(d) <i>Drainage</i>	6.9
(e) <i>External works</i>	40.4
(f) <i>Soft landscaping</i>	6.8
(g) <i>Demolition of existing SYSRG</i>	11.8
(h) <i>Energy conservation, green and recycled features</i>	1.4
(i) <i>Furniture and equipment</i>	0.1
(j) <i>Consultants' fees for geotechnical engineering services</i>	0.4
(k) <i>Contingencies</i>	9.7
<i>Total</i>	<hr/> 106.7 <hr/>

*We have derived the MOD estimates on the basis of the Government's latest set of assumptions on the trend rate of change in the prices of public sector building and construction output for the period of 2016 to 2022. We will deliver the construction works through a lump-sum contract because we can clearly define the scope of the works in advance.*

*Subject to approval, we plan to phase the expenditure as follows-*

<i>Year</i>	<i>\$ million (MOD)</i>
<i>2016 – 17</i>	<i>8.5</i>
<i>2017 – 18</i>	<i>31.4</i>
<i>2018 – 19</i>	<i>44.0</i>
<i>2019 – 20</i>	<i>10.1</i>
<i>2020 – 21</i>	<i>8.1</i>
<i>2021 – 22</i>	<i>4.6</i>
	<hr/>
	<i>106.7</i>
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2 The calculations for deriving MOD project estimates from constant price estimates and phasing of expenditure in the format below should be submitted to TsyB for vetting.

Year	\$ million (Sept 2015)	Price adjustment factor	\$ million (MOD)
2016 – 17	8.0	1.05775	8.5
2017 – 18	28.0	1.12122	31.4
2018 – 19	37.0	1.18849	44.0
2019 – 20	8.0	1.25980	10.1
2020 – 21	6.1	1.33539	8.1
2021 – 22	3.3	1.40549	4.6
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	90.4		106.7
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**Mechanism for calculating the savings for offsetting the project cost increase and administrative cap**

**Purpose**

This Annex sets out the mechanism for calculating the savings for offsetting the project cost increase and administrative cap.

**Savings**

2. To determine the amount of savings in constant prices available for funding new projects or covering increases in the approved project estimate (APE) of the project, Directors of Bureaux (DoBs) or works directors should determine the difference in dollar terms between the original APE and the latest forecast outturn MOD cost. DoBs or works directors should then apply deflation factors to deflate the MOD savings to the constant price base of the current Resource Allocation Exercise to determine the constant price savings that can be quoted to fund new projects or cover real cost increases of other projects.
3. In preparing proposals for APE increase, bureaux or departments should provide this branch with the calculation of savings for vetting.
4. Sample calculation of offsetting savings is provided at **Enclosure 1**.

**Administrative Cap**

5. To avoid locking up resources unnecessarily, TsyB will internally “freeze” all savings arising from contracts awarded at prices substantially lower than the provision earmarked for these contracts in the APE of the project. The DoBs or works directors should not spend against the savings. The updated requirement for the project (i.e. the reduced project estimate) will be the administrative cap on the project expenditure.

6. Savings from the following items in the awarded works contract will be clawed back –

- (a) cost of works items;
- (b) provision for contingency;
- (c) provision for price adjustment; and
- (d) resident site staff (RSS) costs.

7. For any single works contract to be tendered, works directors should advise Works Branch (WB) of the Development Bureau (DEVB) of the sum allowed for the individual component on “cost of works items”, “provision for contingency”, “provision for price adjustment” and “RSS costs” at least two weeks before inviting tenders for the works contract concerned. No further amendments can be made thereafter.

8. Savings from a works contract will be clawed back and frozen internally if the awarded tender price of the works contract for the component “cost of works items” is lower than its sum allowed reported to WB by more than \$15 million.

9. The savings to be clawed back are derived in accordance with the following formulae –

(a) Cost of works items

80% of the difference between the sum allowed and the awarded tender price for the works items will be frozen as savings.

(b) Provision for contingency

80% of the difference between the original provision and the adjusted provision for contingency will be frozen as savings. The adjusted provision for contingency is calculated by multiplying the original provision for contingency by the percentage change between the sum allowed and the awarded tender price for the works items.

(c) Provision for price adjustment

80% of the difference between the original provision and the adjusted provision for price adjustment will be frozen as savings. The adjusted provision for price adjustment is calculated by multiplying the original provision for price adjustment by the percentage change between the sum allowed and the awarded tender price for the works items.

(d) RSS costs

80% of the difference between the original provision and the revised provision for RSS costs will be frozen as savings. Works directors have to review and adjust the provision for RSS costs, having regard to the lower-than-expected tender price of the works contract. If it is proposed that the RSS costs cannot be adjusted downward, justifications should be provided.

10. The administrative cap of the project will be its APE minus the savings frozen as per paragraph 9(a) – (d) above. Updated cashflow requirements of the project (in both constant prices and money-of-the-day prices) based on the administrative cap (i.e. sum of cumulative expenditure of the project up to the last financial year and projected cashflow requirements of the project in MOD prices should equal to the administrative cap) should also be provided by works directors.

11. A flowchart showing the work flow of the administrative cap mechanism and an example illustrating how the mechanism works are at **Enclosure 2**.

**Enclosure 1 to Annex B**

**Enclosure 2 to Annex B**

## Enclosure 1 to Annex B

## Sample calculation

The following sample calculation illustrates how to determine the amount of savings in constant prices required for supporting a proposed increase in approved project estimate (APE) in money-of-the-day (MOD) prices.

### **I. Proposal on offsetting savings in September 2017 prices**

**\* Please update values for cells with yellow background ONLY**

Project Code		Total Cost	Change in total allocation	CapWex 22-23	Change in CapWex 22-23	Cum. Exp up to 31/3/2017	Exp 2017-18	Exp 2018-19	Exp 2019-20	Exp 2020-21	Exp 2021-22	Exp 2022-23	Exp 2023-24	Exp 2024-25	Exp 2025-26	Exp 2026-27	Exp Post 2026-27
A	original	122.43	12.38 ①	29.17	12.38	93.26	18.00	11.17									
	revised	134.81		41.55		93.26	16.00	25.55									
B	original	131.14	(12.38) ②	88.57	(12.38)	42.57	14.00	37.00	29.00	8.57							
	revised	118.76		76.19		42.57	14.00	33.00	21.00	8.19							
C	original	0.00	0.00	0.00	0.00												
	revised	0.00		0.00													
D	original	0.00	0.00	0.00	0.00												
	revised	0.00		0.00													
E	original	0.00	0.00	0.00	0.00												
	revised	0.00		0.00													
Net change			0.00		0.00												

Notes : # The above cashflow should be updated as approved in the 2017 CWRAE or subsequently revised by any approved offsetting saving proposals/approved funding proposal by FC or its delegated authority.

## **II. Adjustment of admin caps in MOD prices subsequent to the above offsetting saving proposal**

[illegible]

## Illustration

1. The original administrative cap (admin cap)<sup>1</sup> for Project A is \$123.00 million in MOD prices. An increase in admin cap to \$136.12 million in MOD prices is being sought.
2. To determine the amount of savings (at the constant price level of the current RAE)<sup>2</sup> that Project A needs to quote from other project(s) –
  - (a) applying the price adjustment factors to deflate the original and proposed cashflows in MOD prices to September 2017 prices; and
  - (b) determining the difference between the original and proposed project estimate in September 2017 prices i.e. \$12.38 million in September 2017 prices (① in the table).
3. On the other hand, the project estimate of Project B has been revised from \$137.66 million to \$124.13 million<sup>3</sup> in MOD prices. To determine whether sufficient savings can be quoted from Project B to cover the proposed increase in administrative cap for Project A (i.e. \$12.38 million in September 2017 prices) –
  - (a) applying the price adjustment factors to deflate the original and revised cashflows in MOD prices; and
  - (b) determining the difference between the original and revised project estimate in September 2017 prices (② in the table).
4. Hence, sufficient savings can be quoted from Project B to cover the proposed increase in APE for Project A.

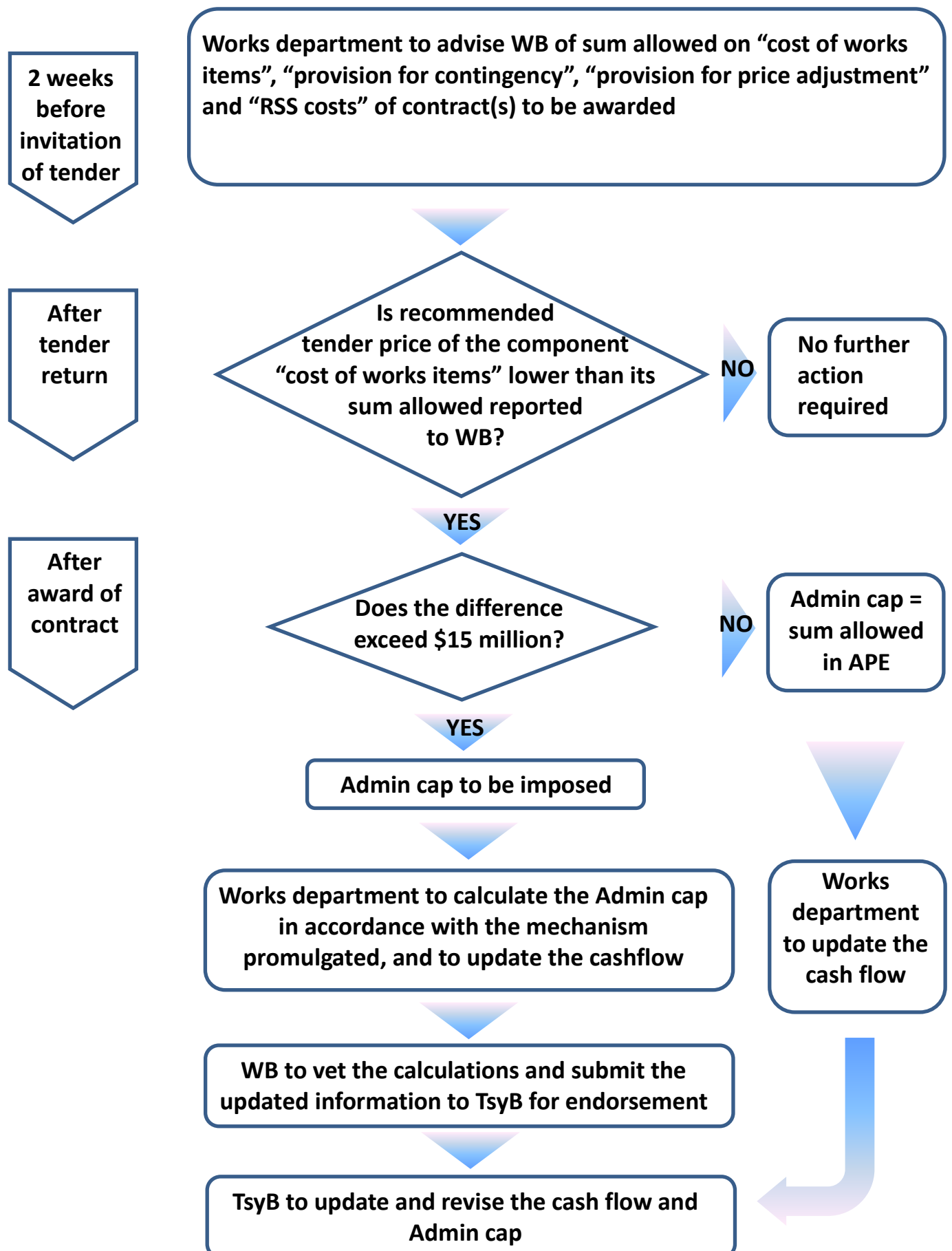
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<sup>1</sup> To avoid locking up resources unnecessarily, this branch will internally “freeze” all savings arising from contracts awarded at prices substantially lower than the provision earmarked for these contracts in the APE. DoB/works directors should not spend against the savings. The updated requirement for the project (i.e. the reduced project estimate) will be the admin cap on the project expenditure.

<sup>2</sup> The savings required should be deflated to the constant price level of the current RAE. For the present illustration, we have assumed the constant prices at September 2017 level.

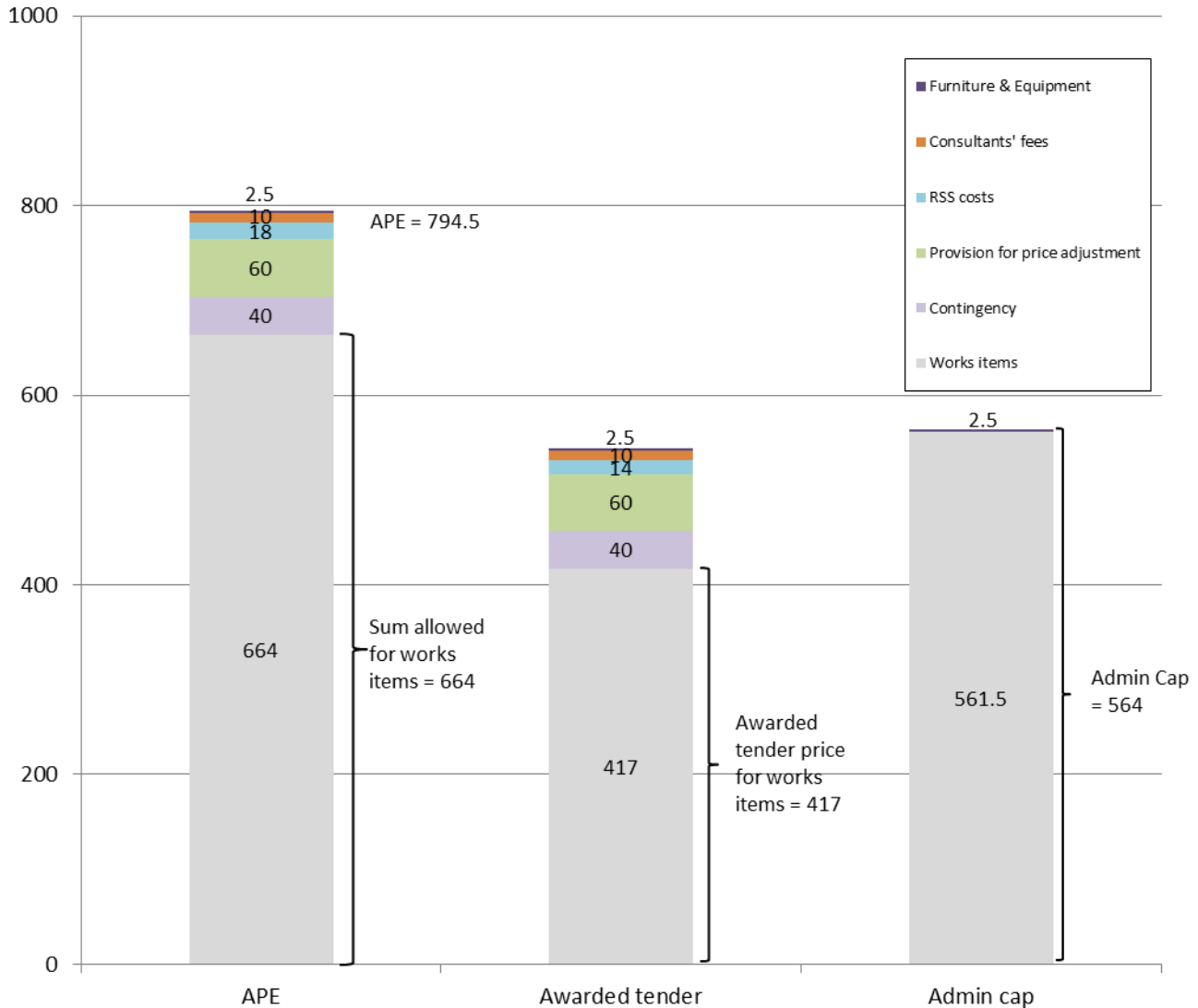
<sup>3</sup> \$124.13 million becomes the admin cap for Project B.

Calculating administrative cap for capital works projects



## Mechanism for calculating the administrative cap of capital works projects

### Example



#### (1) At least two weeks before inviting tenders for works contract

- Works department to advise WB of the sum allowed for the following components –

- (a) Cost of works items = \$664 million
- (b) Provision for contingency = \$40 million
- (c) Provision for price adjustment = \$60 million
- (d) RSS costs = \$18 million

#### (2) After award of works contract

- Works department to check if the awarded tender price for the component “cost of works items” is lower than its sum allowed reported to WB by more than \$ 15 million –

- |     |   |               |
|-----|---|---------------|
| (a) | Awarded tender price for the<br>“cost of works items” component =       | \$417 million |
| (b) | Sum allowed for the “cost of works items”<br>component reported to WB = | \$664 million |

**(3) Within two weeks after the award of works contract**

- Works department to derive and report to DEVB the administrative cap of the project in accordance with the rules under the mechanism –

(a) Cost of works items

- |      |                        |               |
|------|------------------------|---------------|
| (i)  | sum allowed =          | \$664 million |
| (ii) | awarded tender price = | \$417 million |

Difference between (i) and (ii) = \$247 million

**SAVINGS TO BE FROZEN** = 80% x \$247 million = \$197.6 million

(b) Provision for the contingency

- |      |                          |                |
|------|--------------------------|----------------|
| (i)  | original provision =     | \$40 million   |
| (ii) | adjusted provision =     | \$25.1 million |
|      | (\$40 million x 417/664) |                |

Difference between (i) and (ii) = \$14.9 million

**SAVINGS TO BE FROZEN** = 80% x \$14.9 million = \$11.9 million

(c) Provision for price adjustment

- |      |                          |                |
|------|--------------------------|----------------|
| (i)  | original provision =     | \$60 million   |
| (ii) | adjusted provision =     | \$37.7 million |
|      | (\$60 million x 417/664) |                |

Difference between (i) and (ii) = \$22.3 million

**SAVINGS TO BE FROZEN** = 80% x \$22.3 million = \$17.8 million

(d) RSS costs

- |      |   |              |
|------|---|--------------|
| (i)  | original provision =                                | \$18 million |
| (ii) | revised provision proposed<br>by works department = | \$14 million |

Difference between (i) and (ii) = \$4 million

**SAVINGS TO BE FROZEN** = 80% x \$4 million = \$3.2 million

**TOTAL SAVINGS TO BE FROZEN** = (\$197.6 million + \$11.9 million + \$17.8 million + \$3.2 million) = \$230.5 million

**Administrative cap of the project** = \$794.5 million (APE) – \$230.5 million  
= \$564 million

Works department to update and provide to DEVB the updated cashflow requirements of the project (in both constant price/MOD) based on the administrative cap \$564 million (i.e. \$561.5 million (for works) and \$2.5 million (for non-works)).

**List of Financial Circulars  
relating to the Capital Works Programme  
Now In Force**

<b>Financial Circular</b>	<b>Subject</b>
No. 1/2004	Responsibility of Controlling Officers
No. 9/2004	Guidelines on the Management and Control of Government Funding for Subvented Organisations
No. 2/2005	Recurrent Consequences of Capital Projects
No. 3/2009	Simplified Tendering Arrangement for Capital Works
No. 4/2010	User Guide on the Finance Committee, Establishment Subcommittee and Public Works Subcommittee
No. 3/2011	Capital Works Reserve Fund Delegated authorities in respect of block allocations
No. 2/2012	Procedures for making changes to the Estimates of the Capital Works Reserve Fund
No. 4/2012	Requirements for Project Definition Statement and Technical Feasibility Statement for Capital Works Projects
No. 3/2014	Correctional Services Industries
No. 5/2014	Consultants' Fees and Site Staff Costs for Works Projects
No. 7/2014	Guidelines for Procurement of Services Involving Trading Funds
No. 2/2016	Donation vs Sponsorship
No. 3/2016	Furniture and Equipment for Capital Works Projects Funded under the Capital Works Reserve Fund
No. 5/2016	Parallel Tendering for All Contracts
No. 6/2016	Fees and Charges
No. 4/2017	Optimisation of Site Utilisation for Capital Works Projects
No. 5/2017	Powers of Write-off