

For information
on 7 February 1996

PWSC(95-96)35

NOTE FOR PUBLIC WORKS SUBCOMMITTEE OF FINANCE COMMITTEE

CAPITAL WORKS RESERVE FUND

HEAD 701 - LAND ACQUISITION

HEAD 702 - PORT AND AIRPORT DEVELOPMENT

HEAD 703 - BUILDINGS

HEAD 704 - DRAINAGE

HEAD 705 - CIVIL ENGINEERING

HEAD 706 - HIGHWAYS

HEAD 707 - NEW TOWNS AND URBAN AREA DEVELOPMENT

**HEAD 708 - CAPITAL SUBVENTIONS AND MAJOR SYSTEMS AND
EQUIPMENT**

HEAD 709 - WATERWORKS

HEAD 710 - COMPUTERISATION

HEAD 711 - HOUSING

Block allocations

INTRODUCTION

The block allocations under the Capital Works Reserve Fund (CWRF) Heads of expenditure need funding in 1996-97 for existing and new projects to proceed on schedule.

2. Individual proposals for each of the block allocations under the CWRF Heads of expenditure accompany this paper, so as to allow Members to consider each Head of expenditure separately. Many of the recommendations in the papers arise as a result of problems which are common to all block allocations. The purpose of this paper is to provide further background on the proposals in general.

/BACKGROUND

BACKGROUND

3. When Members considered the proposals for the funding of the CWRP block allocations for 1995-96, comments were made about the drafting style of the single omnibus paper. Members complained that it was difficult to readily understand what was proposed and they were unable to consider each Head of expenditure separately. In drafting the proposals for the block allocations in 1996-97, we have endeavoured to respond to Members' comments. We have thus drafted individual papers for each of the CWRP Heads of expenditure. We have also endeavoured to make each of the papers comprehensive and stand-alone. The present paper tries to deal with a number of common issues.

EXPLANATIONS

4. For those new Members who may not be wholly familiar with the operation of the block allocations under the CWRP, set out below are simple explanations of some key questions.

What are block allocations?

5. Finance Committee's approval to expenditure under the CWRP does not form part of the Appropriation Bill, the passage of which is part of the Government's annual budgetary exercise. Expenditure under the CWRP is governed by the terms of the Resolution made by the Legislative Council in establishing the CWRP.

6. Normally in respect of items funded under the CWRP, particularly projects in the Public Works Programme, the Finance Committee gives its approval on the basis of the total expenditure commitment on the item. Thus if we estimate it will cost a total of \$100 million to construct a public works project, we would seek the Finance Committee's approval, via the PWSC, to the full amount of \$100 million, even though actual expenditure on the project might be spread over a number of financial years. This practice, known as upgrading the project to Category A, is applied to all public works and subvented building projects costing more than \$15 million each.

7. For items costing less than \$15 million each, we would normally use funds from one of the block allocations.¹ The Finance Committee approves funds for the block allocations as lump sums to cover expenditure on a multitude of small items. The basis of approval by the Finance Committee is our estimate of total expenditure on such items in the next financial year only, regardless of whether actual expenditure on each of the individual items spreads over a number of years or not. The Finance Committee has previously accepted that it will allow a limited over-commitment level for all block allocations to enable the Administration to sign contractual agreements straddling more than one financial year.² Within the lump sum approved for each block allocation and the scope of works permitted under those block allocations, the Finance Committee has delegated to the Secretary for the Treasury the power to approve expenditure on individual projects.³

What kind of works may be funded from block allocations?

8. The memorandum notes of Volume III of the Estimates dealing with the CWRP describe in detail the scope of each block allocation. Details are also provided in the enclosures to the various papers dealing with the block allocations under the separate Heads. For those block allocations dealing with public works, usually we may use them to cover expenditure on site investigations, consultancy fees for studies and detailed design of projects in Category B of the Public Works Programme and on the construction works for small projects.

9. Historically, about two thirds of all expenditure under block allocations usually arises from those found under Head 701 of the CWRP.⁴ These block allocations provide funds for expenditure on land acquisition and clearance of land, particularly for public works projects. We fund land acquisition from a block allocation rather than seek the Finance Committee's approval to each individual acquisition or clearance exercise because of the difficulty in forecasting accurately the actual expenditure required and the time-frame of that expenditure.⁵

¹ Block allocations are sometimes called block votes.

² A more detailed explanation of what is meant by over-commitment is given later in the paper.

³ In practice, the Secretary for the Treasury further delegates his authority to other officers, either in Finance Branch or in those branches and departments dealing with capital works projects. Normally, we would only allow Directorate grade officers to approve expenditure.

⁴ For 1996-97 this is forecast to drop to about half of all expenditure because we have adopted a more conservative estimating approach than used in previous years.

⁵ Land acquisition often involves a lengthy and complex process of negotiation which, if agreement cannot be reached, may require resolution by the Lands Tribunal or through the courts. Also not all land holders can be contacted, many for example having emigrated or died. The rate at which land holders (or their legitimate heirs) come forward to collect compensation is thus difficult to determine. Were we to use individual project votes such as those used to fund public works projects, we would have to tie up large sums of money under each vote, pending all land holders coming forward to collect their compensation. In order to release funds for other items of expenditure under the CWRP, we do not use individual project votes. Instead, we estimate the annual rate of expenditure that we forecast to incur on various land acquisition projects and seek approval to this level of annual expenditure rather than to the total commitment on the projects which would be far larger and perhaps never needed.

How important are the block allocations?

10. Although they comprise less than a fifth of all expenditure on the CWRF, the block allocations are in many ways the most important items of expenditure. Block allocations underpin and hold together the Government's capital works programme.

11. Without use of the funds under the block allocations, we would face difficulties creating new capital works projects. We need the block allocations to fund preliminary feasibility studies for new projects. Without ready access to the funds available under the block allocations, we would need to make separate funding submissions to the Finance Committee to cover the costs of any works required to examine the feasibility of potential new capital works projects. With well over 100 new projects being created every year, not only would the increased number of submissions add significantly to the current workload of Members and the Administration, it would inevitably slow down the rate at which we can process new projects to decide whether they should be included in Category B of the capital works programme.

12. Moreover, after projects are placed in Category B, we also need funds to carry out more in-depth site investigations and where we must employ consultants, to pay their fees to undertake detailed design and preparation of tender documents, so that we can make the projects ready to go to Finance Committee, via PWSC, for upgrading to Category A. Again, without ready access to the funds under the block allocations, we would need to make a further significantly increased number of funding submissions to the Finance Committee.

13. Large capital works projects only meet a proportion of the community's needs. At a district level, many local residents are more concerned about the provision of minor improvement projects than those of a larger territorially planned nature. Such works consist of, for example, better street lighting, improvements to road junctions and pedestrian crossing facilities, improvements to local surface water drainage to stop local flooding problems, the provision and fitting out of local social welfare and other similar community facilities, etc. The block allocations often provide the source of funds for such works.

14. Large development projects can also often give rise to the need to carry out a host of subsidiary minor works to take account of the impact of the projects on their surroundings. When a new shopping development is built, for example, this frequently gives rise to the need for small improvement projects because of changes to traffic and pedestrian flows in the surrounding area. We would often expect to fund these minor works from the block allocations, if we could not make them a charge to the developer.

How many items of expenditure are funded by block allocations?

15. There are currently more than 3,600 items funded under the block allocations⁶.

How can Members decide on an appropriate level of expenditure for each block allocation?

16. In order to assist Members to decide whether the lump sum that we require for each block allocation is an appropriate amount, we endeavour to provide a forecast of the key items of expenditure. It is not possible to provide a totally comprehensive list in all cases. This is because we cannot always forecast precisely what new items of minor expenditure will arise during the next twelve months. We need to set aside contingency sums under the block allocations to cover any unforeseen urgent items.

17. As a general forecasting tool, we normally expect expenditure under the block allocations to rise at about the same average rate as total expenditure on the CWRP as a whole. This is to be expected as many of the items under the block allocations consist of preparatory works for larger projects in Category B of the Public Works Programme to enable them to be upgraded to Category A. At the present time expenditure on the capital works programme is rising at about 10% per year in real terms and about 18% to 19% per year in dollar terms when the impact of inflation is added.

/18.

⁶ This figure of 3,600 does not include a further considerable number of items under subhead 3006GX, Alterations, additions and improvements to government-owned or leased accommodation and subhead 3009GX, Consultants' fees for buildings projects.

18. There are exceptions however. For example, the compensation rates for land acquisition have dropped by almost 24% over the last twelve months due to market price adjustments. As a result of this and a more realistic forecasting of expenditure on land acquisition costs in 1996-97, we forecast a drop in total expenditure on all block allocations from \$7.9 billion forecast in the 1995-96 estimates exercise to only about \$6.1 billion for 1996-97.⁷

How are minor projects approved?

19. Members' approval of the funds under each block allocation does not automatically give approval to the list of projects put forward for funding under that allocation. Departments and Branches must still follow a similar approval process to that which we adopt for larger capital works projects costing more than \$15 million each. The branch or department proposing a project must first prepare a paper or a memo, similar in content to that of a PWSC paper, containing a clear statement of the scope, cost and timing of, and justification for the project⁸. The Secretary for the Treasury, or a senior Directorate officer to whom the Secretary for the Treasury has further delegated his authority, must then consider the submission contained in the paper or memo and, only if he is satisfied that it is a justifiable use of public funds from the specific block allocation in question, give his approval in writing.

CHANGES TO BLOCK ALLOCATIONS IN 1996-97

20. As a result of Members' comments made last year, we have reviewed the block allocations to see whether we can simplify the system. We are also concerned that underspending is a common problem with the block allocations.

21. So far, we have focussed our efforts on reducing underspending on larger capital works projects costing more than \$15 million each, as such projects make up the bulk of expenditure under the CWRP. Having now reviewed expenditure on the block allocations, we have come to the conclusion that underspending has occurred mainly for the following reasons -

- (a) poor forecasting of the time needed to implement small projects, resulting in delays to the projects and slippage of expenditure;

/(b)

⁷ Further reasons for this drop in forecast expenditure on land acquisition are given in the paper dealing with block allocations under Head 701.

⁸ Projects funded from block allocations under Heads 708 and 710 do not form part of the Public Works Programme and follow similar procedures to those in respect of items funded under the General Revenue Account. Nevertheless, a similar justification must be given before expenditure can be incurred.

- (b) the limited scopes of some block allocations;
- (c) the inability to transfer unused funds from one block allocation to another where additional funds are urgently needed; and
- (d) too low an over-commitment level on some block allocations.

Poor Forecasting

22. There is a commonly held impression that simply because a project is minor in nature, the time taken to complete it should be far less than that required for a major project. This is often not the case. Because we must use public funds and obey the laws of Hong Kong, we must follow the same administrative and legal procedures to plan and implement all projects, regardless of their size or cost. Thus, for example if we were to reclaim an area of only 10 sq.m. of foreshore, we would have to follow exactly the same steps as we have taken to reclaim the 1,000 hectares of the site for the new airport.

23. Indeed, it is often the case that small projects are more difficult to implement than large projects. To carry out a small road improvement in the developed part of Central probably involves more time and effort than building a major new six lane highway on a newly reclaimed site. In Central the planner has to face multiple problems arising from the presence of existing buildings, residents and high volumes of pedestrians and traffic, whereas in a more remote 'greenfield site' his only concerns are straightforward ones related solely to practical construction issues.

24. There is tendency therefore to overlook some of the problems associated with minor projects and assume that they can be completed in a shorter time-frame than is actually the case. Inevitably, this results in delay to the project and underspending against the original forecast of expenditure.

25. With major projects, we have alleviated this problem by requiring the completion of a Preliminary Project Feasibility Study (PPFS) before the project is placed in Category B and detailed design allowed. The object of a PPFS is to clearly define the scope and cost of a project, the problems likely to be encountered in its implementation and as a result of the latter, the production of a realistic programme of

/works

works. We find it difficult, however, to apply the same requirement to small projects as the cost of the PPFs can often be as much as that of the minor project itself.⁹

26. Nevertheless, we have advised Branches and Departments that they should consider use of a PPFs for minor projects where the circumstances permit. In addition, the Secretary for Works has introduced the use of better risk analysis estimating techniques for both large and small projects. The object of this method of estimating is to better reflect in the project estimates and the cashflow forecasts for projects the various risks that projects may face in their implementation. This includes an assessment of the risks associated with potential delays to the projects. As with the results achieved in respect of reducing underspending on larger capital works projects, we hope to be able to similarly reduce underspending on minor projects.

The limited scopes of block allocations

27. Under the CWRP Resolution, we may only incur expenditure under a block allocation in strict accordance with the stated scope of that block allocation as set out in the memorandum notes in Volume III of the Estimates. Where the scope is silent or unclear, we cannot incur expenditure without first coming to the Finance Committee to obtain approval of an appropriate amendment to the scope.

28. The Finance Committee has approved the creation of block allocations on an ad hoc basis, usually in response to a particular problem facing the Administration at the time. Also, other than in respect of Category D items, we have generally not routinely sought the Finance Committee's approval to raise the financial ceilings for most items of expenditure under block allocations to cater for the effects of inflation. We thus have widely varying ceilings on expenditure, coupled with somewhat limited scopes in the case of some block allocations. Taking the block allocations under Head 704 as an example. We can spend only up to \$400,000 per project on minor investigations under subhead 4001CX, but up to \$15 million per project on identical minor investigations if we choose to use subhead 4003DX instead. Under subhead 4010CX we can only spend up to \$1.25 million per project on improvements to sewers, under subhead 4004DX up to \$1.5 million per project on submarine outfalls and yet again we can choose not to use either of these subheads and use subhead 4003DX spend up to \$15 million per project on either sewers or outfalls.

/29.

⁹ Indeed, one of the uses of block allocations is to provide the funds for PPFs.

29. The need to seek clear guidance on whether a subhead may be used for a particular purpose inevitably takes time and delays the implementation of projects. Sometimes we cannot decide whether a subhead is appropriate and rather than incorrectly authorise the use of funds, we may decide not to allow the project to proceed. If the project is clearly essential, we will seek the Finance Committee's approval to authorise the necessary expenditure. A recent example of this was our decision, as part of the Shenzhen River alignment works, to seek the Finance Committee's approval to make special ex-gratia payments to the owners of former private lots which are now located under the Shenzhen River as a result of the river having changed its course over the years. In that case we felt that the scope of the subheads under the Head 701 block allocations did not permit us to make such payments without the prior approval of the Finance Committee.

Inability to transfer funds between block allocations

30. Coupled with the restricted scope of block allocations is our inability to readily transfer funds between block allocations. The procedures governing expenditure under the CWRP require us to seek the Finance Committee's approval to increase the provision of funds under any block allocation should we anticipate that there will be shortfall during the remaining part of the year greater than \$15 million.¹⁰ Finance Committee has also delegated to the Secretary for the Treasury the power to reduce up to the whole amount the provision approved by the Finance Committee under any block allocation, should the Secretary decide that the funds are no longer required for their original purpose. However, the Secretary has no power to automatically transfer unused funds to make up a shortfall elsewhere. He must make a submission to the Finance Committee as if this were an increase in expenditure under the subhead where additional funds are required.

31. Most branches and departments operate in a conservative fashion and do not ask the Secretary for the Treasury to reduce funds under block allocations, even though they perhaps realise that they may not be able to spend the total amount that the Finance Committee has allocated. They are also reluctant to go to the effort of making a formal submission to Finance Committee for additional funds, even when they are aware of new projects that could benefit from an earlier start by obtaining an increase the level of approved expenditure under a block allocation. Often projects are put on one side until they can be included in the next annual funding exercise for the CWRP block allocations. The result of this is underspending on the block allocations as a whole.

/32.

¹⁰ Finance Committee has delegated to the Secretary for the Treasury the power to increase the provision any block allocation up to a maximum amount of \$15 million only.

32. In order to deal with this problem and that associated with restrictive scopes of block allocations, in the papers dealing with the individual Heads, we have proposed to reduce the number of block allocations under each Head by combining them into larger comprehensive block allocations. In essence, we propose that for projects under each Head estimated to cost more than \$15 million each, we should as now continue to seek the approval of the Finance Committee¹¹. For all projects estimated to cost less than \$15 million each, we propose that the Secretary for the Treasury should be delegated the power to authorise expenditure, subject to remaining within the total ceiling of expenditure approved by the Finance Committee for each of the new comprehensive block allocations.

Inadequate levels of over-commitment

33. Over-commitment may be a simple concept but is complex in operation. We cannot start most projects funded under the block allocations on 1 April and complete them in less than one financial year before 31 March of the following year. Many projects must start part way through a year and take two or three years to complete. The Finance Committee, however, only approves expenditure under the block allocations for one financial year. In order to sign contracts where the work will take longer than one year to complete, we must allow for the forecast of expenditure in future financial years.

34. This is done by allowing what is known as over-commitment. In practice, we set a limit on the total amount of expenditure that we can commit in future financial years as a result of signing contracts for works. If the Finance Committee has approved \$100 million for expenditure on a block allocation in 1996-97, we would generally allow up to a further \$100 million or \$150 million (depending on the block allocation concerned) to be committed in respect of contract payments in 1997-98 and subsequent financial years. These two figures would represent respectively over-commitment levels of 100% and 150%.

35. We currently restrict most block allocations to an over-commitment level of not more than 100%. We allow a higher level of over-commitment of up to 150% in respect of Category D items because the projects concerned are usually those involving longer contract periods where the expenditure is spread over up to three to four years.¹²

/36.

¹¹ There are two exceptions to this \$15 million limit, expenditure on land acquisition from the block allocations under Head 701 and expenditure on landslip preventive measures under block allocation subhead 5001BX under Head 705.

¹² Say 18 months to two years for the actual works plus the successful completion of a 12 months maintenance period, or the completion of remedial works, before the final payment of retention money is made.

36. Various branches and departments are pressing for the over-commitment level to be raised. They argue that the present levels of over-commitments give rise to underspending in the financial year for which the Finance Committee has specifically approved funds.

37. The basis of their argument is that they frequently find themselves having signed contracts, where the forecast of total expenditure in the financial year is less than that approved by the Finance Committee for the block allocation as a whole, whereas the forecast of total expenditure in subsequent financial years is equivalent to the maximum level of over-commitment allowed in respect of the block allocation. They argue that they are unable to use the funds remaining unallocated for the current financial year because they are unable to enter into any new contracts as these would give rise to further expenditure in subsequent financial years beyond that permitted by the over-commitment ceiling.

38. We have considered this issue and have concluded that while there is some validity in the departments' arguments, part of the problem occurs because of over optimistic forecasting of expenditure when branches and departments initially prepare the annual estimates for the block allocations. Subsequent delays in implementing projects originally forecast to start in the financial year in question give rise to slippage of expenditure into subsequent years. We must then accommodate the latter under the over-commitment ceiling. This has an impact on other projects forecast to start in the financial year in question. Because part of the over-commitment ceiling has been taken away by delayed projects, not all other planned projects with expenditure in subsequent years can start as this would cause us to breach the over-commitment ceiling. At the same time the delayed projects also release funds in the current financial year which we could use to start entirely new projects but for the restrictions again imposed by the over-commitment ceiling. The result is underspending and a failure to start planned projects even though funds appear to be available.

39. However, there are cases where the current over-commitment ceilings are inadequate to meet the forecast levels of expenditure if all projects are to proceed on time. We believe that the creation of the new comprehensive block allocations provides a suitable opportunity to make appropriate adjustments.

40. As mentioned earlier, we limit most block allocations to an over-commitment ceiling of 100%. We permit block allocations providing funds for Category D projects and landslip preventive measures to have a higher ceiling of 150%. The new comprehensive block allocations will absorb the Category D block allocations as well as those with a lower over-commitment ceiling. We intend to set the over-commitment ceiling for the new block allocations at the higher Category D level of 150% so as to permit the additional financial leeway sought by branches and departments. We will review the situation when we prepare the 1997-98 block allocation estimates.

BLOCK ALLOCATIONS UNDER HEAD 708 AND HEAD 710

41. The block allocations under Head 708, Capital subventions and major systems and equipment, and Head 710, Computerisation, do not form part of the Public Works Programme and thus, technically, are not a matter for PWSC to consider. However, we have always sought funding approval for all the CWRP block allocations as a single annual exercise in one PWSC submission. In previous years, Members have always indicated that they had no objection to the inclusion of funding requests for the block allocations under these two Heads as part of the Administration's PWSC recommendations for the remaining CWRP Heads.¹³ For administrative convenience, we would seek Members' agreement to continue this practice even though we have now produced separate papers for each of the CWRP Heads. Members may if they wish, however, decline to consider such papers and leave these to be considered separately by the Finance Committee.

(PINFO1)

¹³ Indeed, there is now an even stronger case for PWSC to consider the block allocations under Head 708. The block allocations under Head 708 cover expenditure on building projects for subvented organisations, costing less than \$15 million each. At the Finance Committee on 12 January 1996, Members asked the Secretary for the Treasury to consider submitting all building projects for subvented bodies, costing more than \$15 million each, via the PWSC instead of submitting them direct to the Finance Committee as has hitherto been the case.