Revised Guidelines on Investment and Purchase of Properties

Extracted from EDBC No. 17/2012

Investment

1. As set out in the existing guidelines[1], investment by Direct Subsidy Scheme (DSS) schools is not recommended. Nevertheless, DSS schools may still do so should they have compelling and well-justified reasons. To ensure that their financial situation remains sound and healthy after the investment, DSS schools will have to observe closely the following guidelines when making any investment **<u>as from the 2012/13 school year</u>**:

(a) DSS schools are not allowed to use the funds in the operating reserve or the fee remission/scholarship reserve for investment;

(b) DSS schools have to seek their School Management Committee (SMC) / Incorporated Management Committee (IMC)'s approval before making investment decisions and such approval and factors for consideration must be clearly documented;

(c) the only funds that may be used for investment are the long service payment reserve, the reserve for donations with specific purposes and the reserve for construction, maintenance and upgrading of above-standard facilities; and

(d) DSS schools are only allowed to invest in (i) Hong Kong (HK) dollar bonds; or (ii) HK dollar certificates of deposits according to the prescribed criteria/conditions:

Type of Investment	Investment Criteria/Conditions
HK dollar bonds or certificates of deposits: ✧ short to medium term with a maturity period of one to five years.	✧ The credit rating of the issuer must not be lower than the rating of **A3** given by Moody's Investors Service Inc. or **A-** given by Standard & Poor's Corporation.

[1] Details of the existing guidelines on investment are set out in the EDB Circular No. 2/2003 on *The Choice of Bank Counterparties in the Investment of Public Assets* dated 1 March 2003.

	✧ The bank must be licensed under the Banking Ordinance, Cap. 155.

2. DSS schools should pay special attention to the liquidity constraints of the certificates of deposits and corporate bonds in the secondary markets and are advised to make allowance for contingencies in projecting the use of their designated reserves.

3. Existing investment products held by DSS schools which do not comply with the new investment guidelines above should be disposed of in a manner most beneficial to the schools. Realised loss, which is computed on a yearly basis irrespective of the type of investment, must not be charged to any of the school's accounts.

4. DSS schools are also reminded to refer to other requirements in respect of the choice of banks and investment as detailed in the prevailing Education Burera (EDB) circular on *The Choice of Bank Counterparties in the Investment of Public Assets*.

Purchase of Properties

5. All along, purchase of properties by DSS schools is discouraged as it carries substantial financial implications and the risk of financial loss. Nevertheless, if DSS schools have compelling and well-justified reasons for purchasing properties by using their non-government funds, they may still do so. To ensure their financial stability after the purchase of properties, DSS schools will have to observe the following two new requirements on top of the existing guidelines as from the 2012/13 school year:

(a) DSS schools are required to keep at least an amount equivalent to six months' operating expenditure in cash after the purchase of properties; and

(b) DSS schools are not allowed to purchase properties through mortgages or any other borrowing arrangements.

6. In this connection, the existing guidelines on the purchase of properties have been refined to incorporate the two new requirements in paragraph 5 above. The revised guidelines are at Annex 1. DSS schools are reminded to strictly follow the guidelines to ensure that decisions of property acquisition are well thought-through.

Annex 1

Guidelines on Purchase of Properties by Using Non-government Funds

Purchase of properties by using non-government funds in general is discouraged as it carries substantial financial implications and the risk of financial loss. Charging any loss to the school's accounts is not allowed. This is because the income of a school must be kept intact and utilised fully for educational purposes and school facilities. Accordingly, the liability for any financial loss arising from the purchase of properties shall strictly fall on the school management responsible for incurring such a loss and shall not be allowed to be recovered as a charge against the government or non-government funds of the school. Should a DSS school have compelling and well-justified reasons for purchasing properties and demonstrate suffice financial viability, the SMC [2]/ IMC should devise a school-based mechanism for regulating the practice by following the principles and procedures set out below:

A. Basic Principles and Requirements

1. Prudence
    a. DSS schools should only purchase properties for compelling and well-justified reasons (e.g. for accommodating expatriate teachers or providing accommodation for school staff in lieu of housing allowances, etc.) and with the prior approval of their SSB as well as their SMC/IMC. Purchase of properties for speculative purpose is disapproved. The SMC/IMC should fully assess and deliberate on the impact of the purchase of properties on school's development and finance in a prudent manner with proper documentation.

    b. DSS schools are required to keep at least an amount equivalent to six months' operating expenditure in cash after the purchase of properties.

    c. DSS schools are not allowed to purchase properties through

[2] As DSS schools managed by management committee formed by school managers registered under the Education Ordinance, Cap. 279 do not have a separate legal personality to own property, they should not purchase properties. These guidelines are only applicable to DSS schools managed by IMC established under the Education Ordinance, Cap. 279 and SMC established under its own ordinance or the Companies Ordinance, Cap. 32.

mortgages or any other borrowing arrangements[3].

2. Genuine Necessity
   The SMC/IMC should ensure that the purchase of properties is for meeting genuine educational and school needs in the best interest of the students.

3. Involvement of Key Stakeholders
   To enhance school's accountability and transparency, the SMC/IMC should put in place a proper consultative and reporting mechanism to engage key stakeholders, including parents and alumni where appropriate, in making the decision to purchase or sell properties. Details of the properties, financial situations of the school before and after the purchase/sale of properties, and the risk that the value of the properties may be worth substantially less than the original amount the school has invested should be made known to all stakeholders.

4. Value for Money
   The SMC/IMC should ensure that properties are purchased in a cost-effective and value-for-money manner to the benefit of the students.

5. Sustainability of School Development
   a. Before the purchase, the school should critically assess and evaluate its short to long term financial position and prepare cashflow forecast for stakeholders' consideration.

   b. In no circumstances should the purchase or sale of properties lead to an increase of school fees.

6. Transparency
   DSS schools should make transparent the decisions to purchase or sell properties and details of the properties purchased for the information of key stakeholders regularly as far as possible. There must be proper declaration of interest among the SMC/IMC members throughout all processes.

B. Procedures

1. Formulation of Policy
   a. The SMC/IMC should formulate a school-based policy on purchase of properties in accordance with the school vision and mission and the general educational policies and principles set by the SSB. The policy should set out the principles, considerations including risk assessment and procedures to be observed in the purchase of

[3] If the properties purchased before the issuance of this circular involve borrowing or mortgage loan, the school should ensure that the loan repayments will not bring any negative impact on the school's financial situation.

properties, and the management and sale of properties thereafter.

b. The policy should also include a contingency plan (e.g. selling the properties) for dealing with situations such as stringent financial situations, low utilisation rate of the properties or other situations which warrant selling of the properties.

c. The policy has to be approved by the SSB as well as the SMC/IMC with proper deliberation and documentation.

2. Implementation of Policy

Purchase or Sale of Properties

a. The SMC/IMC should deliberate on the purchase or sale of properties in accordance with the principles, considerations and procedures as set out in the school-based policy. The purchase or sale of the properties has to be approved by the SSB and the SMC/IMC with proper documentation.

b. Before endorsement, the SMC/IMC should formally consult stakeholders, parents in particular, about the purchase or sale of the properties and address their concerns. Details of the properties including usage of the properties, source of funding, cost of acquisition/selling price and financial situations of the school before and after the purchase/sale of properties should be made known to all the stakeholders. The SMC/IMC should ensure that the purchase or sale of the properties is justified and publicly defensible.

c. Members of the SMC/IMC and the school should be required to report any situations where they or their immediate family or personal friends have an interest, financial or otherwise, in the purchase of the properties. The SMC/IMC should properly record any declarations (with the use of a standard form) or disclosures made and necessary action taken to avoid any actual or perceived conflict of interest. The SMC/IMC should ensure that the purchase/sale is at arm’s length transaction.

d. The legal and beneficial ownership of any property purchased must vest in the SMC/IMC of the school. Under no circumstances should the property be legally or beneficially held by or in the name of a natural person or persons.

e. When there is suspicion of corruption or other criminal offence, the SMC/IMC should refer the case to relevant law enforcement agencies for further investigation.

Management of Properties

f. The SMC/IMC should ensure that the contingency plan as set out in the school-based policy is implemented at all times and monitor its proper implementation.

g. The SMC/IMC should conduct continuous assessment on the cost-effectiveness of the properties purchased, for instance, whether the utilisation rate of the properties is well justified.

h. There should be no cross-subsidisation from government subsidy on the properties purchased. Charging recurrent expenditure of the properties, including government rent and rates, utility charges, revaluation charge, depreciation charge, etc. as well as its non-recurrent expenditure to government funds is not allowed.

C. Accounting Arrangement

1. Schools are required to keep additional subsidiary ledgers to record detailed transactions of each property and the income and expenditure derived from each property. The information includes date of purchase, cost of acquisition, annual depreciation, revaluation, disposal, income and expenses, etc. The gain or loss on revaluation of the property, if any, should be reflected in the school's non-government fund account[4].

2. In addition to the disclosure requirements as required by the relevant Hong Kong Accounting Standards, the details of each property purchased including date of purchase/sale, usage of the property, source of funding used (exact items under non-government funds), cost of acquisition and subsequent changes in carrying amount (i.e. revaluation and depreciation) should also be disclosed in the audited accounts.

3. The gains derived from the sale of properties should be reflected in the school's non-government fund account.

4. The loss arising from the sale of properties should not be charged to any of the school's accounts and should not be borne by the school.

Note:
In handling donation designated by the donor for purchase of properties, the above guidelines should still be followed in principle.

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[4] The revaluation gain/loss is an unrealised gain/loss as the gain/loss will only be realised after sale of the property. Hence, the unrealised revaluation gain/loss would not be considered in the assessment of the school's financial performance during the fee revision exercise.