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Your ref. CB(3)/PAC/R44

Our ref. F/6/7 Pt. 3

18 May 2005

Clerk, Public Accounts Committee
Legislative Council
Legislative Council Building
8 Jackson Road
Central
Hong Kong
(Attn: Ms Dora WAI)

Dear Ms WAI,

**The Director of Audit's Report on the
results of value for money audits (Report No. 44)**

Chapter 7: The Postal Mechanisation System at the Air Mail Centre

Thank you for your letter of 12 May 2005. The additional information requested by the Public Accounts Committee at the hearing is as follows. Due to time constraint, we regret that Chinese translations of attachments could not be made available at this stage.

(a) A copy of the Contract between the Government and the Consultant and provisions for remedies

2. A copy of the Consultancy Agreement is enclosed. There were provisions for remedies in case of deviation from or non-compliance with the contractual requirements in the Consultancy Agreement and they may be found in Clause 14.

(b) Reasons for revising the consultancy fee from \$7.1 million to \$10.1 million and the party initiated the increase

3. The additional fees (with breakdown at Appendix) covered the following work done by the Consultant :



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- (i) Prolonged project management work before machine installation arising from a postponement of the Airport opening date from 30.6.1997 to 1.4.1998

As a result of the postponement, the installation of the POMS was deferred from May 1996 to January 1997. During this period, the Consultant had to continue to manage the POMS contract, coordinate the preparation work with all parties concerned, and attend project meetings in Hong Kong. Work in a period extended by 8 months would entail additional cost because the Consultant was paid by man-days incurred. Clause 6.2 of the Consultancy Agreement provides that where additional work was required of the Consultant, the Consultant was to provide such work at the additional fees chargeable in Part 1 of Annex G to the Agreement. Additional work equivalent to 6 man-weeks from the project director and 10 man-weeks from the project engineer, were required.

- (ii) Prolonged supervision work for machine installation and testing arising from a postponement of the Airport opening date from 30.6.1997 to 1.4.1998

Also as a result of the postponement, the agreed duration of the project engineer's stay in Hong Kong to oversee the machine installation and testing, originally scheduled as mid-January 1997 – mid-March 1998, had to be extended to mid-January 1997 – end June 1998 to accommodate the 90 days' confidence trial following the commencement of the operation of the New Air Mail Centre. This necessitated work equivalent to 3 man-weeks from the non-resident project director and 14 man-weeks from the resident project engineer.

- (iii) Prolonged supervision work for machine installation and testing arising from further postponement of the Airport opening date from 1.4.1998 to 6.7.1998

Similar to (ii) above, the further postponement necessitated work equivalent to 4 man-weeks from the non-resident project director and 18 man-weeks from the resident project engineer.

- (iv) Claims for reimbursement for airfares not included in the contract fees

The Consultant has to travel to the works of the Contractor and sub-contractors of the POMS to carry out the necessary inspections and tests to ensure compliance with the requirements of the specifications for the POMS. Although this work requirement was set out in the Consultancy Agreement, the airfares for this job were not included in the consultancy fee stated in the contract because the country of manufacture of the POMS was not known when the Agreement was drawn up. Thus in July 1997 the Consultant submitted to the Post Office a claim for the airfares incurred by the Consultant staff between April 1996 and May 1997 for carrying out the works visits and factory tests at the works of the Contractor and sub-contractors in Europe.



4. The total additional costs added up to HK\$2,973,000. The rates on manpower, overseas allowance and accommodation were set out in the Consultancy Agreement and additional travelling expenses were charged by the Consultant at cost against invoices. The Consultant submitted a request to the Post Office in July 1997 for the costs described in (i), (ii) and (iv). For the cost described in (iii) the Post Office saw the need for the additional cost when the postponement of opening of the new airport was known in January 1998.

5. The increase of the contract value from \$7.1 million to \$10.1 million was approved by the then Secretary for Treasury in March 1998.

(c) A copy of the Contract between the Government and the Contractor for the supply and installation of the POMS

6. The Contract contains detailed information on the operations of the Air Mail Centre. Its complete disclosure could compromise airmail security and postage-revenue protection. Also, the Contractor has indicated their objection to disclosure of the Contract, as it might put them in a disadvantageous position to their competitors for future similar projects. In the circumstances and upon DoJ's advice, we are supplying the Contract for perusal by **PAC members only**, and on condition they would be kept confidential and not be published for public information.

(d) Reports that reflected the performance of the Consultant, in particular its work relating to the inspections and testing of the POMS, did not meet the contractual requirements

7. We have gone through the reports submitted by the Consultant in connection with the installation, testing and commissioning of the POMS. We note that the Consultant had agreed with the Contractor that factory acceptance tests were not required for the Elevating Transfer Vehicle, Container Storage and Retrieval System, tractor units and scissor lifts. These are the only deviations we have found, apart from those already pointed out by Audit. They are annotated in the enclosed copies of relevant extracts of the reports.

(e) When the Post Office was formally informed of the postponement of the opening of the Hong Kong International Airport from June 1997 to July 1998

8. The Post Office was informed of the postponement of the opening of the new airport from June 1997 to July 1998 at different times:

- On 12 April 1995, NAPCO responded to our enquiry in writing that the opening of the new airport would be postponed from 30 June 1997 to 30 September 1997.
- On 12 July 1995, at a meeting convened by NAPCO on the programme of construction of the New Air Mail Centre, we were informed by NAPCO that the opening of the new airport would be further postponed to 1 April 1998.

- On 13 January 1998, the Government announced that the new airport would open on 6 July 1998.

(f) The Contractor tested the speed of the conveyor belts of the Packet Sorting System (PKTSM) and computed the throughput. What was the throughput computed?

9. The throughput rate as computed by the Contractor was 10,374 items per hour, against the contractual requirement of 10,000 items per hour.

(g) Whether the deficiencies of the Integrated Mail Processors (IMP), PKTSM, and the Parcel Sorting System (PSM) were mentioned in the Factory Acceptance Certificates for follow-up and, if so, what were the deficiencies?

10. The issues indicated in paragraphs 2.7 to 2.9 of the Audit Report were not mentioned in the Factory Acceptance Certificates. However, they were noted in the factory test reports and had been followed up in subsequent tests. Also, the Consultant's comments on the follow-up action required by the Contractor for other aspects of the POMS were included in the factory tests reports.

(h) Legal Advice on pursuing a claim against the Contractor and the Consultant

11. The Post Office had discussed with the DoJ in various meetings on whether there had been breaches of contractual requirements in respect of the performance of the POMS. DoJ's view was that there appeared to be breaches of contractual requirements in light of the test results given in the Audit Report. However, DoJ did not advise us to lodge a claim against the Contractor and the Consultant mainly because there was insufficient evidential proof to pursue a claim.

12. Insofar as the claim against the Contractor was concerned, DoJ's briefed out Counsel had advised that it was a "weak" claim. There were difficulties in proving liability and quantum.

13. Regarding the claim against the Consultant, DoJ's view was that there was insufficient evidence to hold the Consultant liable in negligence. The burden of proving negligence is onerous.

14. We were advised that the records provided by the Consultant were not useful in a claim against the Contractor. We could not simply rely on the test results given in the audit report to hold the Contractor liable as there could be other factors affecting the performance of the POMS. In order to further consider the technical aspects, DoJ advised us that we would need to obtain expert advice, which might or might not assist the claim at the end of the day. In DoJ's view, much efforts and expenses would have to be incurred before a proper case could be made out. Furthermore, we had difficulties in quantifying the amount of damage as the calculation could only be based on assumptions. Given there were insufficient evidence, uncertainties in obtaining assistance from witnesses (some of the key persons involved in the project had already retired), difficulties in calculating quantum, and the efforts and expenses that might be incurred, as well as the risks in litigation, it was therefore considered that it would not be worthwhile to pursue a claim against the Contractor and/or the Consultant.



- (i) A coordination body tasked to monitor the work of the Consultant and the Contractor with meetings held on a frequent basis and records of the meetings kept.

15. The Coordination meetings were held monthly and chaired by the Post Office to monitor the progress of construction of the Air Mail Centre and the installation of the POMS. The Contractor objected to the disclosure of the minutes as it would potentially put them in a disadvantageous position to their competitors for future similar projects. In the circumstances and upon DoJ's advice, we are enclosing copies of the minutes (with personal particulars blackened to avoid infringement of Personal Data (Privacy) Ordinance) for perusal by PAC members only, and on condition that they would be kept confidential and not be published for public information.

Yours sincerely,

(Allan CHIANG)
Postmaster General

- c.c. Secretary for Economic Development and Labour (w/encl.)
(Attn. Ms Sandra LEE)
Director of Audit (Fax 2583 9063) (w/o encl.)
Secretary for Justice
(Attn. Ms Alison Cabrelli & Mr Francis Kwan) (Fax 2869 0670) (w/o encl.)
Secretary for Financial Services and the Treasury
(Attn. Mr Martin Glass) (Fax 2147 5770) (w/copy of PAC's original letter)

Encl.

Appendix

Breakdown of Additional Cost for the Consultancy Fee:										Sub-total
Project Director:					Project Engineer:					
Manpower Cost	Subsistence Cost (Incidental)	Air Fares to/from HK	Manpower Cost	Subsistence Cost (Incidental)	Subsistence Cost	Air Fares to/from HK	Manpower Cost	Subsistence Cost (Incidental)	Subsistence Cost	Air Fares to/from HK
Man-week x £ 2,400/ week	Number of days in HK x Rate/day in £	Number of trips x cost per trip in £	Man-week x £ 1,950/ week	Number of days in HK x Rate/day in £	Including: i.) Overseas Allowance @ £1,000/month & ii) Residency Cost @ HK\$ 70,000/month	Number of trips x cost per trip in £	Man-week x £ 1,950/ week	Number of days in HK x Rate/day in £	Including: i.) Overseas Allowance @ £1,000/month & ii) Residency Cost @ HK\$ 70,000/month	Number of trips x cost per trip in £
(i) (May 96- Jan 97)	6 x 2,150 = £ 12,900	20 x 170 = £ 3,400	4 x 2,400 = £ 9,600	10 x 1,700 = £ 17,000	NA	6 x 2,400 = £ 14,400	£ 65,800			
(ii) (Mid-Mar 98- Jun 98)	3 x 2,400 = £ 7,200	20 x 180 = £ 3,600	3 x 3,200 = £ 9,600	14 x 1,950 = £ 27,300	3.5 x 1,000 = £ 3,500 Plus 3.5 x 70,000 = HK\$ 245,000	NA	£ 51,200 Plus HK\$ 245,000			
(iii) (Jul 98- Oct 98)	4 x 2,400 = £ 9,600	28 x 180 = £ 5,040	4 x 3,200 = £ 12,800	18 x 1,950 = £ 35,100	4 x 1,000 = £ 4,000 Plus 4 x 70,000 = HK\$ 280,000	NA	£ 66,540 Plus HK\$ 280,000			
(iv) (Apr 96-May 97)	18 air trips by three Consultant's staff taken to Contractor's or sub-contractors' works in European destinations during April 1996-May 1997 : Total cost £ 7,860									
Overall Total:										£ 191,400 + HK\$ 525,000 = HK\$ 2,973,000 approx.