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13 June 2005

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

Dear Ms Wai,

**Public Accounts Committee's Public Hearing on
Chapter 7 "The Postal Mechanisation System at the Air Mail Centre"**

Thank you for your letter of 9 June 2005.

I attach herewith at Appendix A a factual account of the involvement of the then Government Supplies Department in the tendering, acceptance and implementation stages of the supply of the Postal Mechanisation System at the Air Mail Centre.

With reference to paragraph 4 of your letter, please note that GLD's comments (as set out in paragraph 2.23(C) of the Director of Audit's Report) was made in response to the recommendation of the Director of Audit (ref. para 2.21 of the Report) that "(c) in future, (Postmaster General should) seek the advice of the Department of Justice and the Director of Government Logistics in handling cases of deviation from and non-compliance with the conditions of contracts." Similarly,

the other comments made by GLD as recorded in paragraphs 3.43 and 4.25 of the Director of Audit's Report were also responses to specific recommendations made by the Director of Audit. Please see attached table at Appendix B for ease of reference.

Yours sincerely,



(Tommy Yuen)

for Director of Government Logistics

c.c. Secretary for Economic Development and Labour
Secretary for Financial Services and the Treasury
Postmaster General
Director of Audit
Director of Electrical and Mechanical Services
Director of Architectural Services

**Involvement of the then Government Supplies Department (GSD)
in the administration of the Postal Mechanisation System (POMS) Contract**

Stage	Involvement of GSD/GLD (Note)
(a) Tendering Stage	
(i) Tender preparation	<p>In preparing the tender document, a sample tender document was forwarded by GSD to the Post Office (PO) in November 1993 for its reference.</p> <p>Based on the sample tender document, PO together with its Consultant prepared the first draft tender document.</p> <p>GSD provided PO with comments and advice on the proposed tender terms and contract conditions in the first draft so as to ensure they were in line with the government procurement policy and standard terms and conditions.</p> <p>GSD also referred the set of terms and conditions to the Department of Justice (DoJ) [previously known as Attorney General Chamber] for legal clearance.</p> <p>GSD was, however, not involved in the preparation of the system specifications of the POMS.</p>
(ii) Tender issue	<p>When the tender document was finalised, GSD arranged for the issue of the tender document to potential tenderers and the publication of the tender notification in the Government Gazette and local newspapers.</p> <p>During the tender issuing stage, the then GSD was responsible for answering enquiries from potential tenderers on the tender arrangements, and terms and conditions, whilst the PO was responsible for answering enquiries on the system specifications.</p> <p>On request of PO, two tender addenda were issued by GSD. Revised user specifications contained in the tender addenda were prepared by PO.</p>
(iii) Tender evaluation/ recommendation	<p>Technical evaluation, steered by PO began with the preparation of a tender evaluation report by the Consultant, in consultation with Electrical & Mechanical Services Department (EMSD), Information Technology Services Department (ITSD) [currently known as Office of Government Chief Information Officer] and Architectural Services Department (ArchSD). The report concluded that the lowest offer submitted by the supplier concerned was technically acceptable and was the most cost-effective offer.</p>

Stage	Involvement of GSD/GLD (Note)
	<p>A Tender Evaluation Committee, chaired by PO, comprising representatives from EMSD, ITSD, ArchSD and GSD was formed to decide on the recommendation to be made as regards tender award. GSD was represented at the meetings of the Tender Evaluation Committee to render advice on the procurement process and the tender terms and conditions.</p> <p>The Tender Evaluation Committee endorsed the consultant's recommendation for the acceptance of the lowest offer.</p>
(iv) Tender negotiation	<p>A negotiation team led by the then Director of Government Supplies (DGS) conducted negotiation with the recommended tenderer to improve the offer. The role played by each of the parties of the negotiation team was as follows :</p> <p>(a) GSD - on commercial aspects</p> <p>(b) PO, assisted by the Consultant - on user requirements and on technical aspects; and</p> <p>(c) DoJ - on legal aspects</p>
(v) Tender award	<p>Based on the recommendation of the Tender Evaluation Committee, GSD sought approval from the Central Tender Board (CTB) for the award of a contract to AEG.</p> <p>Upon CTB's approval, GSD issued a letter to AEG informing them of the acceptance of the offer.</p>
(b) Contract Stage	
(i) Contract signing	<p>The contract was signed by the DGS on behalf of the Government.</p>
(ii) Contract administration and monitoring	<p>PO, in consultation of its Consultant, was responsible for the day-to-day contract administration and monitoring which included :</p> <p>(a) the progress of the project; and</p> <p>(b) the signing off of the deliverables, such as detailed functional specification and design, the system layout, and the test schedule and procedures for Factory Acceptance Tests and Site Acceptance Test.</p> <p>EMSD and ArchSD also attended the New Airmail Centre Co-ordination Meeting, which was chaired by PO and dealt with the coordination and progress of the POMS Contract with the</p>

Stage	Involvement of GSD/GLD (Note)
	other contracts in the Air Mail Centre.
(iii) Change in requirement	<p>PO, in consultation with its Consultant, was required to work out the details of the technical requirements and to provide the justifications for any additional requirements or any change in requirements.</p> <p>During the period between 1996 and 1997, PO submitted to GSD, which was responsible for seeking approval for contract variations, a total of 4 requests for contract variation which included :</p> <ul style="list-style-type: none"> (a) enhancement of the POMS on both hardware and software to streamline the transfer and sorting of mail and change of maintenance agreement (approved date : 19.3.1996); (b) software enhancement of POMS to improve the detection and sorting of mail and acquisition of accessories (approved date : 23.10.1996); (c) purchase of enhancement item and modification of the POMS (approved date : 11.1.1997); and (d) installation of 5 sets of x-ray machines (approved date : 31.5.1997). <p>On the request of PO, GSD also informed the contractor that the change in the completion date due to the postponement of the opening of the new airport.</p>
(iv) Acceptance Tests	<p>The acceptance tests were conducted by PO and its Consultant.</p> <p>GSD was not involved in any of the acceptance tests of the POMS.</p>
(v) Payment	PO was responsible for arranging payments in accordance with terms and conditions of the contract.
(vi) Contractual claim	The contractual claim in relation to the issues of prolongation of contract period and delays and disruptions to the installation work as a result of the postponement of the opening of the New Airport was mainly dealt with by DoJ, PO and ArchSD. GSD's representative attended meetings to keep the department abreast of the development, as DGS was the signatory to the contract.

Note: The then Government Supplies Department (GSD) was merged with the Government Land Transport Agency and the Printing Department on 1 July 2003 to form the Government Logistics Department (GLD).

Director of Audit's observations and recommendations and GLD's comments

The Director of Audit (D of Audit)'s report (the Report) has focused on four areas, namely, (a) the acceptance test of the Postal Mechanisation System (POMS); (b) the performance of the POMS; (c) the utilisation of the POMS and (d) the payment of the POMS. D of Audit's observations and recommendation together with GLD's responses are summarised below.

D of Audit's observations	D of Audit's recommendations	GLD's responses
<p>Para. 2.5 to 2.18 of the Report</p> <p>(a) the acceptance test - the Post Office had not properly carried out the acceptance test in accordance with the contract provisions and had issued the acceptance certificate even though the test results were not up to the required standards</p>	<p>Para. 2.21 of the Report</p> <p>(a) ensure that in future, records relating to the results of the acceptance tests for all equipment (including postal equipment) are retained;</p> <p>(b) ensure that in future, acceptance tests for all equipment (including postal equipment) are conducted and acceptance certificate are issued strictly in accordance with the terms of contract; and</p> <p>(c) in future seek the advice of DoJ and GLD in handling cases of deviation from and non-compliance with the conditions of contract.</p>	<p>Para. 2.23 of the Report</p> <p>(a) staff were not involved in any of the acceptance tests of the POMS</p> <p>(b) GPO had not sought any advice from GLD in respect of the non-compliance identified during the acceptance test. GLD was not aware of such non-compliance</p> <p>(c) GLD stands ready to provide assistance and advice to the GPO if it encountered any difficulties in enforcing or handling cases of non-compliance with the conditions of contract by the contractor. If and when necessary, GLD will also provide assistance and advice to the GPO in the preparation of the tender document for future procurement of postal equipment at the pre-tender stage, such as the replacement of the letter sorting system at the GPO and the IMC in pipeline. [Note : This comment was made in response to Director of Audit's recommendations on future purchases.]</p>

D of Audit's observations	D of Audit's recommendations	GLD's responses
<p>Para. 3.5 to 3.12, para. 3.22 to 3.30 & para. 3.36 of the Report</p> <p>(b) the performance of the POMS was not up to the required standards</p>	<p>Para. 3.39 of the Report</p> <p>(a) continue to explore ways to further improve the performance of the POMS up to the required standards specified in the Contract and seek the assistance of the Contractor and the Consultant, if necessary;</p> <p>(b) consider introducing a postcode system to improve the performance of the POMS and the overall efficiency of the postal operation;</p> <p>(c) seek advice from DoJ to critically examine whether there are breaches of the contract in respect the performance and ascertain the remedies (e.g. compensation from the Consultant and the Contractor) available under the contract; and</p> <p>(d) in future purchases, ensure that</p> <ul style="list-style-type: none"> • the justification for the purchase is based on realistic and achievable performance; • only realistic and attainable requirements are specified in the contract; • the performance 	<p>Para. 3.43 of the Report</p> <p>(a) regarding the proposed installation of voice recognition device of the Packet SSs in 2002, no request for contract variation had been received by GLD [Note : This comment is made in relation to para. 3.33 of the Report where GPO advised that it had considered using a voice recognition device to improve the throughput of the Packet SSs but the proposal was shelved in January 2004 due to high cost.]</p> <p>(b) tender specifications in respect of the purchase of equipment including postal equipment, should be drawn up based on actual operational and functional requirements and the standards set should be realistic and achievable. Reference should be made to the Guidelines for Drawing up Tender Specifications stipulated in SPR. [Note : The comments were made in response to Director of Audit's recommendations on future purchases.]</p>

D of Audit's observations	D of Audit's recommendations	GLD's responses
	<p>requirements applicable to actual operation are explicitly stated in the contract; and</p> <ul style="list-style-type: none"> • the performance of the equipment fully complies with the contractual requirement 	
<p>Para. 4.5 to para. 4.18 of the Report</p> <p>(c) Utilisation - the utilisation rates were below the forecast volume and equipment were lying idle</p>	<p>Para. 4.23 of the Report</p> <p>(a) modify and tune the IMPs and Packet SSs so that the system would process the majority of the mail items and minimise the mail items requiring manual sorting;</p> <p>(b) transfer mail from the GPO and IMC to the AMC for sorting only when the GPO and IMC cannot cope with the workload;</p> <p>(c) explore ways to put the supporting system into beneficial use;</p> <p>(d) take into account the spare capacity of the POMS when planning replacement of mailing processing systems at GPO and IMC;</p> <p>(e) consider mothballing the idle equipment and reassess the schedule maintenance for such equipment with a view to minimising the</p>	<p>Para. 4.25 of the Report</p> <p>(a) in future procurement of high value and complex equipment where there is rapid technology advancement, consideration can be given to adopt a marking scheme to evaluate the tender offers. This would allow separate assessment of the technical and price aspects, with predetermined relative weights attached to particular features which would help ensure selection of a better value for money offer.</p>

D of Audit's observations	D of Audit's recommendations	GLD's responses
	<p>operation cost;</p> <p>(f) in future procurement, determine their expected utilisation rates and make use of the utilisation rates in evaluating the cost and benefit of the equipment.</p>	
<p>Para. 5.5 to para. 5.8 of the Report</p> <p>(d) payment - there were occasions where the payment discount provision in the contract was not exercised resulting in additional money spent</p>	<p>Para. 5.14 of the Report</p> <p>(a) strengthen the payment checking procedures to ensure that payment to the contractor is made only after deducting all discounts specified in the contract and is within the time limit specified in the contract in order to received the discounts.</p>	<p>No comment offered.</p>

13 June 2005