

**SUPPLEMENTAL REPORT OF THE  
PUBLIC ACCOUNTS COMMITTEE  
ON  
REPORT NO. 33 OF THE DIRECTOR OF AUDIT  
ON  
THE RESULTS OF  
VALUE FOR MONEY AUDITS**

*April 2000*

*P.A.C. Report No. 33B*

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## I. INTRODUCTION

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**The Establishment of the Committee** The Public Accounts Committee are established under Rule 72 of the Rules of Procedure of the Legislative Council of the Hong Kong Special Administrative Region, a copy of which is attached in *Appendix 1* to this Report.

2. **Membership of the Committee** The following Members are appointed by the President under Rule 72(3) of the Rules of Procedure to serve on the Committee:

<b>Chairman</b>	The Hon Eric LI Ka-cheung, JP
<b>Deputy Chairman</b>	The Hon Fred LI Wah-ming, JP
<b>Members</b>	The Hon David CHU Yu-lin The Hon NG Leung-sing The Hon Mrs Sophie LEUNG LAU Yau-fun, JP The Hon LAU Kong-wah The Hon Emily LAU Wai-hing, JP
<b>Clerk</b>	Mrs Florence LAM IP Mo-fee
<b>Legal Adviser</b>	Mr Jimmy MA Yiu-tim, JP

## II. PROCEDURE

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**The Committee's Procedure** The Committee's practice and procedure, as determined by the Committee in accordance with Rule 72 of the Rules of Procedure, are as follows:

- (a) the public officers called before the Committee in accordance with Rule 72 of the Rules of Procedure, shall normally be the Controlling Officers of the Heads of Revenue or Expenditure to which the Director of Audit has referred in his Report except where the matter under consideration affects more than one such Head or involves a question of policy or of principle in which case the relevant Bureau Secretary of the Government or other appropriate officers shall be called. Appearance before the Committee shall be a personal responsibility of the public officer called and whilst he may be accompanied by members of his staff to assist him with points of detail, the responsibility for the information or the production of records or documents required by the Committee shall rest with him alone;
- (b) where any matter referred to in the Director of Audit's Report on the accounts of the Government relates to the affairs of an organisation subvented by the Government, the person normally required to appear before the Committee shall be the Controlling Officer of the vote from which the relevant subvention has been paid, but the Committee shall not preclude the calling of a representative of the subvented body concerned where it is considered that such a representative can assist the Committee in its deliberations;
- (c) the Director of Audit and the Secretary for the Treasury shall be called upon to assist the Committee when Controlling Officers or other persons are providing information or explanations to the Committee;
- (d) the Committee shall take evidence from any parties outside the civil service and the subvented sector before making reference to them in a report;
- (e) the Committee shall not normally make recommendations on a case on the basis solely of the Director of Audit's presentation;
- (f) the Committee shall not allow written submissions from Controlling Officers other than as an adjunct to their personal appearance before the Committee; and

## PROCEDURE

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- (g) the Committee shall hold informal consultations with the Director of Audit from time to time, so that the Committee can suggest fruitful areas for value for money study by the Director of Audit.

2. **The Committee's Report** This Report contains the Public Accounts Committee's supplemental report on Chapters 1, 4 and 12 of Report No. 33 of the Director of Audit on the results of value for money audits which was tabled in the Legislative Council on 17 November 1999. Value for money audits are conducted in accordance with the guidelines and procedures set out in the Paper on Scope of Government Audit in the Hong Kong Special Administrative Region - 'Value for Money Audits' which was tabled in the Provisional Legislative Council on 11 February 1998. A copy of the Paper is attached in *Appendix 2*. The Committee's Report No. 33 was tabled in the Legislative Council on 16 February 2000.

3. **The Government's Response** The Government's response to the Committee's Report is contained in the Government Minute, which comments as appropriate on the Committee's conclusions and recommendations, indicates what action the Government proposes to take to rectify any irregularities which have been brought to notice by the Committee or by the Director of Audit and, if necessary, explains why it does not intend to take action. It is the Government's stated intention that the Government Minute should be laid on the table of the Legislative Council within three months of the laying of the Report of the Committee to which it relates.

### III. COMMITTEE PROCEEDINGS

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**Meetings** The Committee held 21 meetings, including six public hearings. During the public hearings, the Committee heard evidence from a total of 17 witnesses including three Bureau Secretaries. The names of the witnesses are listed in *Appendix 3* to this Report.

2. **Arrangement of the Report** The evidence of the witnesses who appeared before the Committee, and the Committee's specific conclusions and recommendations, based on the evidence and on their deliberations on the relevant chapters of the Director of Audit's Reports, are set out in Chapters 1 to 3 below.

3. A verbatim transcript of the Committee's public proceedings will be placed in the Library of the Legislative Council for inspection by the public.

4. **Acknowledgements** The Committee wish to record their appreciation of the co-operative approach adopted by all the persons who were invited to give evidence. In addition, the Committee are grateful for the assistance and constructive advice given by the Secretary for the Treasury, the Legal Adviser and the Clerk. The Committee also wish to thank the Director of Audit for the objective and professional manner in which he completed his Report, and for the many services which he and his staff have rendered to the Committee throughout their deliberations.

**SIGNATURES OF THE CHAIRMAN, DEPUTY CHAIRMAN AND  
MEMBERS OF THE COMMITTEE**

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Eric LI Ka-cheung  
(*Chairman*)

Fred LI Wah-ming  
(*Deputy Chairman*)

David CHU Yu-lin

NG Leung-sing

Sophie LEUNG LAU Yau-fun

LAU Kong-wah

Emily LAU Wai-hing

30 March 2000

**CHAPTERS IN THE DIRECTOR OF AUDIT'S REPORT NO. 33 DEALT WITH  
IN THE PUBLIC ACCOUNTS COMMITTEE'S SUPPLEMENTAL REPORT**

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<b>Director of Audit's Report No. 33 Chapter _____</b>	<b>Subject</b>	<b>P.A.C. Report No. 33B Chapter _____</b>
1	The refuse collection service of the Urban Services Department	1
4	Management practices of the Vocational Training Council	2
12	Water purchased from Guangdong Province	3

**RULES OF PROCEDURE OF  
THE LEGISLATIVE COUNCIL OF  
THE HONG KONG SPECIAL ADMINISTRATIVE REGION**

**72. Public Accounts Committee**

(1) There shall be a standing committee, to be called the Public Accounts Committee, to consider reports of the Director of Audit –

- (a) on the accounts of the Government;
- (b) on such other accounts required to be laid before the Council as the committee may think fit; and
- (c) on any matter incidental to the performance of his duties or the exercise of his powers as the committee may think fit.

(2) The committee shall also consider any report of the Director of Audit laid on the Table of the Council which deals with examinations (value for money audit) carried out by the Director relating to the economy, efficiency and effectiveness of any Government department or public body or any organization to which his functions as Director of Audit extend by virtue of any Ordinance or which receives public moneys by way of subvention.

(3) The committee shall consist of a chairman, deputy chairman and 5 members who shall be Members appointed by the President in accordance with an election procedure determined by the House Committee. In the event of the temporary absence of the chairman and deputy chairman, the committee may elect a chairman to act during such absence. The chairman and 2 other members shall constitute a quorum.

(4) A report mentioned in subrules (1) and (2) shall be deemed to have been referred by the Council to the committee when it is laid on the Table of the Council.

(5) Unless the chairman otherwise orders, members of the press and of the public shall be admitted as spectators at meetings of the committee attended by any person invited by the committee under subrule (8).

(6) The committee shall meet at the time and the place determined by the chairman. Written notice of every meeting shall be given to the members and to any person invited to attend a meeting at least 5 clear days before the day of the meeting but shorter notice may be given in any case where the chairman so directs.

(7) All matters before the committee shall be decided by a majority of the members voting. Neither the chairman nor any other member presiding shall vote, unless the votes of the other members are equally divided, in which case he shall have a casting vote.

(8) The chairman or the committee may invite any public officer, or, in the case of a report on the accounts of or relating to a non-government body or organization, any member or employee of that body or organization, to give information or any explanation or to produce any records or documents which the committee may require in the performance of its duties; and the committee may also invite any other person to assist the committee in relation to any such information, explanation, records or documents.

(9) The committee shall make their report upon the report of the Director of Audit on the accounts of the Government within 3 months (or such longer period as may be determined under section 12 of the Audit Ordinance (Cap. 122)) of the date on which the Director's report is laid on the Table of the Council.

(10) The committee shall make their report upon the report of the Director of Audit mentioned in subrule (2) within 3 months (or such longer period as may be determined by the Council) of the date on which the Director's report is laid on the Table of the Council.

(11) Subject to these Rules of Procedure, the practice and procedure of the committee shall be determined by the committee.

**Paper presented to the Provisional Legislative Council  
by the Chairman of the Public Accounts Committee  
at the meeting on 11 February 1998 on  
Scope of Government Audit in the  
Hong Kong Special Administrative Region -  
'Value for Money Audits'**

**SCOPE OF WORK**

1. The Director of Audit may carry out examinations into the economy, efficiency and effectiveness with which any bureau, department, agency, other public body, public office, or audited organisation has discharged its functions.
  
2. The term "audited organisation" shall include -
  - (i) any person, body corporate or other body whose accounts the Director of Audit is empowered under any Ordinance to audit;
  - (ii) any organisation which receives more than half its income from public moneys (this should not preclude the Director from carrying out similar examinations in any organisation which receives less than half its income from public moneys by virtue of an agreement made as a condition of subvention); and
  - (iii) any organisation the accounts and records of which the Director is authorised in writing by the Chief Executive to audit in the public interest under section 15 of the Audit Ordinance (Cap. 122).
  
3. This definition of scope of work shall not be construed as entitling the Director of Audit to question the merits of the policy objectives of any bureau, department, agency, other public body, public office, or audited organisation in respect of which an examination is being carried out or, subject to the following Guidelines, the methods by which such policy objectives have been sought, but he may question the economy, efficiency and effectiveness of the means used to achieve them.

## GUIDELINES

4. The Director of Audit should have great freedom in presenting his reports to the Legislative Council. He may draw attention to any circumstance which comes to his knowledge in the course of audit, and point out its financial implications. Subject to these Guidelines, he will not comment on policy decisions of the Executive Council and the Legislative Council, save from the point of view of their effect on the public purse.

5. In the event that the Director of Audit, during the course of carrying out an examination into the implementation of policy objectives, reasonably believes that at the time policy objectives were set and decisions made there may have been a lack of sufficient, relevant and reliable financial and other data available upon which to set such policy objectives or to make such decisions, and that critical underlying assumptions may not have been made explicit, he may carry out an investigation as to whether that belief is well founded. If it appears to be so, he should bring the matter to the attention of the Legislative Council with a view to further inquiry by the Public Accounts Committee. As such an investigation may involve consideration of the methods by which policy objectives have been sought, the Director should, in his report to the Legislative Council on the matter in question, not make any judgement on the issue, but rather present facts upon which the Public Accounts Committee may make inquiry.

6. The Director of Audit may also -

- (i) consider as to whether policy objectives have been determined, and policy decisions taken, with appropriate authority;
- (ii) consider whether there are satisfactory arrangements for considering alternative options in the implementation of policy, including the identification, selection and evaluation of such options;
- (iii) consider as to whether established policy aims and objectives have been clearly set out; whether subsequent decisions on the implementation of policy are consistent with the approved aims and objectives, and have been taken with proper authority at the appropriate level; and whether the resultant instructions to staff accord with the approved policy aims and decisions and are clearly understood by those concerned;

- (iv) consider as to whether there is conflict or potential conflict between different policy aims or objectives, or between the means chosen to implement them;
- (v) consider how far, and how effectively, policy aims and objectives have been translated into operational targets and measures of performance and whether the costs of alternative levels of service and other relevant factors have been considered, and are reviewed as costs change; and
- (vi) be entitled to exercise the powers given to him under section 9 of the Audit Ordinance (Cap. 122).

## **PROCEDURES**

7. The Director of Audit shall report his findings on value for money audits in the Legislative Council twice each year. The first report shall be submitted to the President of the Legislative Council within seven months of the end of the financial year, or such longer period as the Chief Executive may determine. Within one month, or such longer period as the President may determine, copies shall be laid before the Legislative Council. The second report shall be submitted to the President of the Legislative Council by the 7th of April each year, or such date as the Chief Executive may determine. By the 30th April, or such date as the President may determine, copies shall be laid before the Legislative Council.

8. The Director's report shall be referred to the Public Accounts Committee for consideration when it is laid on the table of the Legislative Council. The Public Accounts Committee shall follow the rules governing the procedures of the Legislative Council in considering the Director's reports.

9. A Government minute commenting on the action Government proposes to take in respect of the Public Accounts Committee's report shall be laid on the table of the Legislative Council within three months of the laying of the report of the Committee to which it relates.

10. In this paper, reference to the Legislative Council shall, during the existence of the Provisional Legislative Council, be construed as the Provisional Legislative Council.

**Witnesses who appeared before the Committee  
(in order of appearance)**

Mr YEUNG Kai-yin, CBE, JP	Chairman, Vocational Training Council
Prof LEE Ngok, JP	Executive Director, Vocational Training Council
Mrs Amy LO	Finance Officer, Vocational Training Council
Dr John CHAN	Estates Officer, Vocational Training Council
Mr Joseph WONG Wing-ping, GBS, JP	Secretary for Education and Manpower
Mr Philip CHOK	Deputy Secretary for Education and Manpower
Mr Ivan LEE	Principal Assistant Secretary (Education and Manpower)
Mr PAU Siu-hung, JP	Director of Architectural Services
Mr LEE Shing-see, JP	Secretary for Works
Mr H B Phillipson, JP	Director of Water Supplies
Mr CHAN Pui-wah, JP	Deputy Director of Water Supplies
Mr KU Chi-chung	Assistant Director of Water Supplies
Mr CHEUNG Tze-leung	Chief Chemist, Water Supplies Department
Dr CHAN FUNG Fu-chun, JP	Director of Health
Mrs Lily YAM, JP	Secretary for the Environment and Food
Mrs Rita LAU, JP	Director of Food and Environmental Hygiene
Ms Elaine L K CHUNG, JP	Deputy Secretary for Housing <i>(Former Director of Urban Services during the period February 1997 to July 1999)</i>



## Chapter 1

### The refuse collection service of the Urban Services Department

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The Committee noted that Audit, in reviewing the efficiency of the refuse collection service of the Urban Services Department (USD)<sup>1</sup>, had the following findings:

- during the official working hours, the USD's refuse collection teams (RCTs) were not fully engaged in collecting refuse. In 1997 and 1998, the weighted average non-productive time was about two hours per shift for the RCTs working in the day shift and about three hours per shift for the RCTs working in the evening shift;
- about 26% of the RCTs working on single refuse collection vehicle (RCV) refuse collection routes and about 28% of the RCTs working on refuse collection routes operated with a tractor and one or more trailers were surplus to requirement. Accordingly, about 18% of the RCVs and 25% of the tractors were surplus to requirement;
- the USD had not contracted out any of its refuse collection service;
- the RCVs were frequently overloaded; and
- the USD did not adhere to the 25% agreed relief ratio (i.e. the ratio between the number of relief RCVs and the size of RCV fleet) (ARR) for the provision of relief RCVs.

2. At the public hearing, **Mrs Lily YAM, Secretary for the Environment and Food**, made an opening statement and said that:

- the Audit Report provided important information for the Environment and Food Bureau, which had been established for less than two months, to improve the refuse collection service formerly provided by the USD;
- the task and finish habit (i.e. the RCTs left their places of work as soon as they had finished their scheduled tasks), which had existed since 1981, was abolished in November 1997;
- starting from October 1998, the USD had gradually reduced the number of refuse collection routes. Twenty-two routes were deleted at the time when the Audit Report was finalised. As at February 2000, a total of 47 routes had

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<sup>1</sup> The Food and Environmental Hygiene Department has taken over some of the functions of the Urban Services Department with effect from 1 January 2000.

## The refuse collection service of the Urban Services Department

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been deleted;

- the newly-established Food and Environmental Hygiene Department (FEHD) was determined to carry out reforms with a view to improving the quality and cost-effectiveness of the refuse collection service. It had accepted all of the Audit recommendations except that it was still examining the contracting out of cleansing services including refuse collection service. A timetable could not be established immediately because a substantial amount of work had to be carried out to enable the new department to move from a district-based organisation to one which was function-based. There were other considerations, for example, the need for a further reduction of the refuse collection routes to optimise cost-effectiveness and how the large number of staff members could be fully utilised;
- in March 2000, the FEHD would implement a plan of the former Regional Services Department (RSD) to contract out some cleansing services. The FEHD would require some more time to establish the timetable for contracting out the refuse collection service in Hong Kong and Kowloon Regions; and
- as the Policy Secretary responsible for the subject matter, she would closely monitor the quality of the refuse collection service and ensure that the service was cost-effective. She would also keep the Committee informed of developments.

3. The Committee noted from paragraphs 7 and 8 of the Audit Report that a significant amount of non-productive time in the RCTs had been identified as early as 1986. A review conducted at that time found that for an eight-hour shift, the average non-productive time was 1.67 hours for the day shift and 3.37 hours for the evening shift. This was considered unacceptably high by the USD's Transport Manager (Hong Kong). According to paragraph 9, the weighted average non-productive time of the RCTs was 1.64 hours for the day shift and 2.89 hours for the evening shift in 1997. The Committee were concerned about the persistently high level of non-productive time and asked:

- why no action had been taken to rectify the situation even though the problem had been identified as early as 1986;
- whether the USD had applied for funds from the Provisional Urban Council (Pro UC) to purchase new RCVs and to increase the number of RCTs during the period 1986 to 1997; and
- how the funding applications were processed.

## The refuse collection service of the Urban Services Department

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4. The **Secretary for the Environment and Food** said that she had asked the same question about the follow-up action taken after 1986, but it was found that there was no record to show the action taken.

5. **Ms Elaine L K CHUNG, Deputy Secretary for Housing**<sup>2</sup>, informed the Committee that:

- when she assumed office as Director of Urban Services in 1997, the Pro UC had an estimated deficit of \$3.8 billion. Much effort had been devoted to balancing the budget. As a result, savings amounting to \$1.8 billion were achieved for the period 1997 to 1999;
- the contracting out of the USD's cleansing services had been discussed. However, priorities at that time were accorded to closing the Cheung Sha Wan Abattoir and privatising the abattoir services;
- the USD welcomed the Audit Report because it served as a catalyst for taking the matter forward. A consultant was commissioned to review the contracting out of cleansing services including the refuse collection service. Further to the discussion with Audit in late 1998, the refuse collection routes were re-organised and resources were redeployed. In early 1999, all overtime work was stopped and 22 refuse collection routes were deleted; and
- regarding the application for funds to purchase new RCVs, the normal procedure was for the district staff to review the downtime rates of the existing RCVs and to estimate the number of relief RCVs required. A request would be forwarded to the USD Headquarters for consideration. The Transport Manager of the Region concerned, who was seconded from the Government Land Transport Agency, was responsible for determining the number of RCVs to be purchased, after taking into consideration the recommendations of the district staff and other relevant factors such as the age, workload and usage time of the RCVs. His proposal would then be vetted by his supervisor i.e. the Assistant Director of the Region concerned. If it was considered acceptable, the proposal would be submitted to the Pro UC for approval.

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<sup>2</sup> Former Director of Urban Services during the period February 1997 to July 1999

## The refuse collection service of the Urban Services Department

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6. **Mrs Rita LAU, Director of Food and Environmental Hygiene<sup>3</sup>**, also said that:
- apart from the two Assistant Directors who were responsible for vetting the proposals within their respective Regions, there was another Assistant Director in the USD Headquarters who had overall responsibility for the cleansing services in both Hong Kong and Kowloon Regions;
  - the Pro UC had always vetted the proposals from the USD very strictly, especially when financial resources were involved. Proposals relating to environmental hygiene would first be submitted to the Public Health Select Committee for consideration. Its recommendations would then be passed to the Finance Select Committee for approval;
  - in applying for funding for the purchase of new RCVs, the conditions of existing RCVs had to be assessed by professionals and accompanying evidence supporting the applications was required. This procedure also applied to funding applications for additional RCTs. In all cases, the Pro UC was responsible for determining the policies and making the final decisions;
  - in 1998, the Pro UC had instructed the USD to freeze the procurement of RCVs; and
  - she would review the USD's records to ascertain the information relating to the procurement and replacement of RCVs and the increase in the number of RCTs during the period 1986 to 1997.

The **Secretary for the Environment and Food** also undertook to search the records kept by the USD and to provide the Committee with the relevant information.

7. With reference to paragraph 42 of the Audit Report, the Committee noted that in 1985, a USD working group on transport matters had, after reviewing the downtime rates of RCVs of Hong Kong Region, proposed that the ARR be revised downwards from 25% to 20% with effect from March 1985. However, the working group's proposal was not implemented. According to paragraph 43, the USD agreed in 1986 that it was reasonable to reduce the ARR from 25% to 20% for both Hong Kong and Kowloon Regions. But the USD did not reduce the size of its RCV fleet accordingly. During the audit, the ARR remained at 25%. The Committee asked why the proposal had not been implemented and whether any action had been taken since 1986 to take it forward. The Committee also asked

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<sup>3</sup> Former Director of Urban Services during the period July to December 1999

## The refuse collection service of the Urban Services Department

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whether the Pro UC's decision to suspend the procurement of RCVs was still effective and when the freeze would end.

8. The **Secretary for the Environment and Food** said that owing to the long lapse of time and the changes in the officers involved, it would be difficult at this stage to ascertain the reasons for not implementing the proposal. She undertook to search the relevant records to ascertain the facts. The **Director of Food and Environmental Hygiene** added that:

- the Management Services Unit (MSU) of the USD had conducted a time and motion study to review the ARR. Immediately following the completion of the study in July 1999, the ARR was revised downwards to below 20%. The duration of time required for collecting refuse was also reviewed. This had resulted in a reduction of 47 refuse collection routes since July 1999 and savings of \$80 million in recurrent expenditure;
- for the past three years, the USD had not procured any RCVs. Over 20% of the RCVs were over eight years old. Despite the increase in the number of refuse collection routes arising from new residential developments and new demands for refuse collection, the present fleet was still able to maintain an acceptable level of service. This indicated that the USD had already implemented the Audit recommendations, including revising the ARR and reducing the number of refuse collection routes; and
- after the re-organisation of the provision of municipal services, the boundary between the urban and rural areas no longer existed and the new FEHD was also responsible for the refuse collection service in the New Territories. She would need to consider how the existing resources could be flexibly utilised to achieve maximum results before making any recommendations for the procurement of new RCVs to replace the old ones.

9. The **Deputy Secretary for Housing** provided the Committee with two tables (in *Appendix 4*) which set out the latest figures in the number of refuse collection routes according to districts. She pointed out that upon Audit's recommendations, the work values of the refuse collection tasks (i.e. the time required for a qualified worker to carry out the task at a standard level of performance) had been revised. The latest figures in the tables were arrived at after taking into consideration the actual situation and the new work values. Reducing 47 refuse collection routes had resulted in annual savings amounting to \$80 million and suspending the procurement of 142 RCVs had resulted in savings amounting to \$170 million.

## The refuse collection service of the Urban Services Department

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10. From the table in Annex A, the Committee noted that for the evening shift, the number of refuse collection routes in Kwun Tong had been reduced from ten in 1997-98 to four as at 17 January 2000, which was even lower than that agreed by the USD and Audit in May 1999. The Committee asked how the number could be so drastically reduced and whether this indicated that there had been over-provision in the past. The **Director of Food and Environmental Hygiene** said that the number of refuse collection routes for a particular district was worked out to achieve maximum cost-effectiveness for the service. For Kwun Tong, there were 20 refuse collection routes for the day shift and four for the evening shift. By comparison, the reduction for the day shift was less significant and the number was actually higher than that agreed with Audit. These numbers were determined according to the pattern of demand in the district and would be adjusted according to prevailing circumstances.

11. In her subsequent letter of 15 March 2000 in *Appendix 5*, the **Secretary for the Environment and Food** informed the Committee that:

- Transport Manager (Hong Kong) carried out a study on the control of refuse and cleansing vehicle operations from January to May 1986. Based on the findings of the study (in Enclosure 1), the Transport Manager concluded that the RCVs had substantial spare capacity. However, he also pointed out in his report that the trials conducted in the study had a number of limitations;
- on receiving the Transport Manager's report, the USD set up a Working Party to improve the utilisation of vehicles and to reduce the size of the vehicle fleet. The Working Party agreed in principle to a reduction of the ARR for the RCVs from 25% to 20%. However, in his response to a separate report produced by the then Finance Branch of the Government Secretariat in July 1986 on vehicle maintenance, the same Transport Manager observed that there was a shortage of operational vehicles "on a significant number of occasions". This could possibly explain why the ARR was not revised in 1986. However, the Administration could not trace any documents to this effect; and
- it could be seen, from the table which set out the provision of RCVs and RCTs from 1986 to 1998 (in Enclosure 4), that the number of RCVs had dropped in 1998 despite an increase in the number of RCTs by 10% to meet the demand for refuse collection service arising from new housing developments. This was partly due to the efforts made by the USD to optimise the use of RCVs by operating night shifts and through the rescheduling of refuse collection routes.

12. The Committee were concerned as to whether the failure to follow up the various

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issues raised since the mid-1980s was due to the huge establishment of the USD, which had resulted in a situation where the lines of accountability were unclear and the views of the front-line staff could not be properly channelled upwards to enable the management to make informed policy decisions. In reply to the Committee's question about the organisation structure of the USD and how decisions were made, the **Deputy Secretary for Housing** said that:

- during her term of office, an officer of the Health Inspector rank was responsible for drawing up the refuse collection routes by making reference to the prevailing work values. His plan would be endorsed by the Chief Health Inspector and tested out in the districts concerned. If the routings were found to be acceptable, they would be submitted to the Assistant Director for approval and would be implemented accordingly;
- in addition to the two Assistant Directors who were responsible for the provision of services in their respective Regions and the Assistant Director who was responsible for co-ordinating the cleansing services, the USD also had a Deputy Director who was responsible for environmental hygiene. The Director of Urban Services oversaw management of the department; and
- the USD was a huge organisation and powers had to be delegated. The Director had to rely on front-line staff to provide her with information on any problems detected in the operation of the RCTs. At the same time, the supervisors were duty-bound to monitor the work of their subordinates and were empowered to adjust their work schedules if necessary.

13. The **Secretary for the Environment and Food** also said that:

- the USD had a large number of employees providing a wide range of public services. However, the management was ultimately responsible for overseeing the provision of the services; and
- a re-organisation of the department would be implemented in due course. Though there was some concern about this exercise, the management was determined to address the problems which had surfaced previously. It was hoped that solutions to these problems would eventually be identified.

14. At the request of the Committee, the **Secretary for the Environment and Food**

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provided in Enclosure 7 of her letter dated 15 March 2000 in *Appendix 5* copies of the organisation charts of the USD and the relevant job descriptions of the different ranks as at 1 August 1986 and 1 August 1998.

15. From paragraph 21 of the Audit Report, the Committee noted that most of the work values determined in 1985 were no longer applicable and staff of the USD's Environmental Hygiene Section in districts determined their work values arbitrarily when planning refuse collection routes. The Committee also noted that although the MSU had been requested repeatedly to revise the work values in 1995 and 1997, up to October 1998, the work values had not been revised. The Committee were concerned that the work values were outdated and were arbitrarily determined by staff members in the districts. The Committee asked why:

- despite repeated requests to the MSU, the work values had not been revised; and
- the number of refuse collection routes had not been reduced according to the recommendation in paragraph 15 of the Audit Report i.e. reducing a total of 62 routes.

16. The **Deputy Secretary for Housing** said that:

- when she assumed office in 1997, she had asked the MSU to revise the work values. However, the MSU was asked at the same time to review other subject matters which had been accorded a higher priority. These included the contracting out of the library services, the management of clerical staff seconded to the USD, the contracting out of the street cleansing service and the implementation of the electronic filing system;
- as the MSU was only a small unit with nine staff members, it had to conduct its work according to priority; and
- the USD started to revise the work values in 1998 and completed the task in early 1999. It was based on the new work values that 47 refuse collection routes were eventually deleted.

17. The **Director of Food and Environmental Hygiene** also said that:

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- the recommendations of the time and motion studies conducted by the MSU were implemented from August 1999 onwards. Based on the revised work values, the USD was able to increase the productivity of various refuse collection routes by 14% to 32%; and
- as regards the reduction of refuse collection routes, it was agreed with Audit after the completion of the Audit Report that the number of routes should be set at 180. As a result, 47 routes were deleted.

18. **Mr Dominic CHAN Yin-tat, Director of Audit**, said that Audit had originally proposed to delete 62 routes, having had regard to the overtime work performed by USD staff. As the amount of overtime had subsequently been reduced, Audit was agreeable to reducing the number of refuse collection routes by 47.

19. The Committee noted that in paragraph 49(f) of the Audit Report, the Director of Urban Services had stated that overtime should be the exception and not the norm when planning work schedules. Having regard to the practice in the private sector whereby workers were often required to work overtime, the Committee asked why overtime should be regarded as the exception in the public sector. The **Director of Food and Environmental Hygiene** said that:

- in planning the work schedules, the Administration had to take into account all relevant factors such as the terms and conditions of service, the number of conditioned hours of work and the arrangement of shifts. The present policy was to maximise departmental resources by requiring staff members to work within their normal working hours as far as possible. Overtime work would be required only if there was an operational need; and
- for some services, overtime work was inevitable, especially when dealing with contingencies. Refuse collection was one such example. As there were seasonal fluctuations, the staff members concerned were required to work overtime. The present policy was to compensate them in the form of time off in lieu. Owing to financial constraints, overtime allowance would only be paid if time off in lieu could not be arranged within a month.

20. At the request of the Committee, the **Secretary for the Environment and Food**

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submitted a table setting out the various recommendations put forward by the MSU on environmental hygiene services from 1995 to 1998 and the progress made. The relevant table is in Enclosure of 8 of her letter dated 15 March 2000 in *Appendix 5*. The Secretary also informed the Committee that:

- between 1995 and 1998, the MSU had completed 16 studies. These included contracting out of street cleansing services and a review of the organisation of the hawker control teams; and
- due to competing demands and priorities, the MSU had not been able to study the refuse collection service until 1999. Following the completion of its time and motion studies on refuse collection in 1999, new work values were adopted in late 1999.

21. The Committee noted from paragraph 50(f) of the Audit Report that the USD had commissioned a consultant for six months to undertake a fundamental and comprehensive review of the department's cleansing services including refuse collection service. Considering that the USD should have the knowledge and expertise to conduct the review itself, the Committee asked:

- why the consultancy was commissioned;
- whether the Pro UC was involved in making the decision; and
- whether the MSU had been involved in the exercise.

The Committee also asked whether the Pro UC had been informed of the outcome of the consultancy and whether the recommendations of the report had been implemented.

22. The **Deputy Secretary for Housing** said that:

- the consultancy was undertaken by a retired senior officer of the USD at a reasonable cost. At the end of 1998, staff members of the USD were fully occupied and there was no surplus staff within the USD to conduct the study. It was therefore hoped that by commissioning the consultancy, the review on the cleansing services could be carried out within a short period of time;
- the proposal to commission the consultancy was first endorsed by the Public

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Health Select Committee and later by the full Pro UC;

- the MSU had worked closely with the consultant in conducting the study. However, there was no duplication in their work; and
- the study was completed in early 1999. One of the recommendations made in the report was to contract out the refuse collection service. However, the recommendations of the report had not been implemented.

23. The **Director of Food and Environmental Hygiene** also said that:

- the decision to commission the consultancy was made by her predecessor who considered this to be the best approach for taking the matter forward. As this had been approved by the Pro UC, it was not for her to comment on the appropriateness of the approach taken nor on the qualification of the consultant;
- when she assumed office in mid-1999, she found that the scope of the review was not comprehensive enough and the quality of the report was not satisfactory. As its recommendations would effect major changes to the existing policies of the USD and had far-reaching financial implications, it was decided that the report should be further studied before it was submitted to the Pro UC. The recommendations were therefore not implemented;
- furthermore, at that time, the bill on the Re-organisation of the Provision of the Municipal Services had been submitted to the Legislative Council. Any major policy changes such as the contracting out of the USD's cleansing services would warrant a cautious approach. Furthermore, there were other issues at that time which had to be dealt with. The implementation of the recommendations in the report was therefore not a high priority item; and
- during her term of office as the Director of Urban Services, she was still studying the report and had to vet it thoroughly so as to prepare a detailed progress report to the Pro UC. Hence, it was not true that she had intended not to submit the report to the Pro UC.

24. On the same question, the **Secretary for the Environment and Food** said that:

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- the commissioning of the consultancy was probably the result of the audit on the USD's refuse collection service. Funding was approved by the Pro UC to carry out the study with a view to improving the efficiency of the service and assessing the option of contracting out the service. All this happened in late 1998 and early 1999, which was one year away from the proposed re-organisation of the municipal services;
- when the Director of Food and Environmental Hygiene assumed the post of Director of Urban Services at the end of July 1999, the proposed re-organisation was less than six months away. At that time, the Director of Urban Services, in consultation with the Finance Bureau and the Civil Service Bureau, came to the view that the consultancy report, which made recommendations on the delivery of services in future, was not sufficiently comprehensive to enable the USD to initiate any major policy changes;
- irrespective of the usefulness of the report, the Administration had to have regard to the impending re-organisation. The Director and Deputy Director of Urban Services were involved in this exercise and hence were not in a position to explain to the Pro UC how the re-organisation was to proceed; and
- it should be noted that among all of the Audit recommendations, the contracting out of the refuse collection service was the only item outstanding and a timetable had yet to be drawn up.

25. The Committee were concerned about the conflicting roles of the then Director of Urban Services and the difficult situation in which she was placed in the re-organisation exercise. The Committee asked:

- whether the Director of Urban Services was accountable to the Special Administrative Region (SAR) Government or to the Pro UC; and
- whether the Director of Urban Services had been given so much power that she could bypass the Pro UC and withhold the consultancy report.

26. The **Director of Food and Environmental Hygiene** replied that:

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- the Director of Urban Services had to be accountable to both the SAR Government and the Pro UC. As the Director of Urban Services, she was the ultimate person responsible for the work of the USD;
- she could not accept the proposition that her power was so great that she could withhold the report from the Pro UC. The fact was that before submitting the consultancy report to the Pro UC, she had to ensure that the recommendations of the report were comprehensive and sound and that she would be in a position to answer any questions raised by the Pro UC Members. However, she was not satisfied that the report had covered such areas as human resources, financial resources and the actual implementation of services. As the report was not comprehensive enough to enable the USD to initiate any major policy changes, she therefore considered that it was not ready for submission to the Pro UC for approval;
- in fact, the Pro UC and the USD had worked as partners. The USD acted according to instructions given by the Pro UC and was expected to put forth mature and considered recommendations/proposals with sound justifications. The Pro UC made the final decisions. During the process, the Pro UC could ask for progress reports on various subjects. Had it asked for the consultancy report then, the USD would have submitted it. However, no Member had asked about the progress of the study and the matter had not been included as an item in the agenda of the relevant Select Committee; and
- if the Pro UC were still in existence, she would still be responsible for implementing the recommendations of the report and for executing the Council's policies. Hence, her assessment of the report had not been affected by the re-organisation exercise. It was made in the light of the recommendations therein.

27. The **Secretary for the Environment and Food** reiterated that it was not the case that the Director of Food and Environmental Hygiene had deliberately not acted on the report during her term of office as the Director of Urban Services. The question was whether at that time the Director of Urban Services had the time to polish the report before submitting it to the Pro UC. However, she understood the concern of the Committee and undertook to review the relevant files and to provide the Committee with further information on the consultancy study.

28. In her letter of 15 March 2000 in *Appendix 5*, the **Secretary for the**

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**Environment and Food** provided the Committee with the following information on the consultancy study:

- the scope of the study was set out in Enclosure 9 of the letter;
- the cost involved was \$458,910;
- a retired Senior Superintendent of Environmental Health was appointed to carry out the study. During his more than 30 years of service with the USD, he had acquired considerable knowledge and experience in cleansing services, front-line operations and general and staff management;
- the focus of the consultant's study was to improve the overall cleanliness of the urban area and to ensure cost-effective delivery of cleansing services. The MSU's time and motion studies were mainly concerned with details of street cleansing and refuse collection operations. The MSU carried out its studies having regard to the input from the consultant. It also provided the consultant with its findings. In view of the heavy commitments at the time, it was not possible for the MSU to examine and comment on the findings in the consultant's study;
- although the consultant submitted his report to the then Director of Urban Services in July 1999, the MSU's time and motion studies, which formed part of the overall review of cleansing services, were not finalised until mid-October 1999. On receiving the consultant's report, the then Deputy Director (Environmental Health) convened a meeting to examine its findings. Initial assessment of the report revealed that its recommendations, particularly those on contracting out the refuse collection service and a review of the grade, had far-reaching staffing and resource implications. These implications would have to be carefully studied in the light of the impending major structural change of the department. At the same time, the re-organisation of municipal services had already reached a very advanced stage. It was considered that it would not be appropriate to make recommendations to the Pro UC on a study whose findings would have to be reviewed in the light of a re-organisation which was expected to take effect in about two months; and
- the FEHD would take account of the study's recommendations in its review of cleansing and refuse collection services.

29. With reference to paragraphs 31 to 36 of the Audit Report, the Committee noted

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that as early as in 1986, the then UC, having been informed that there could be possible savings of 30% if the refuse collection service was contracted out, endorsed the USD's proposal that the option was worth exploring. However, the USD stated in a paper in 1988 that it was prudent not to venture into large-scale privatisation schemes (such as street sweeping and refuse collection) which would lead to staff redundancy. In 1994, it was estimated that \$15 million (i.e. 50% of the USD's associated operating costs) could be saved if 19 refuse collection routes were contracted out. However, the plan was shelved pending the results of the RSD's review on the contracting out of the refuse collection service. In 1998, the Director of Urban Services pointed out that Members of the Pro UC were generally opposed to the collection of refuse by contractors because there was a scarcity of cleansing companies operating in the UC areas. Against this background, the Committee asked:

- whether the concern about staff redundancy was the main reason for not taking forward the proposal to contract out the refuse collection service and whether there were other constraints;
- whether the 50% savings could still be achieved if the proposal were to be implemented in the near future; and
- how the matter would be taken forward.

30. The **Director of Food and Environmental Hygiene** said that:

- the Administration had not given up the option of contracting out the refuse collection service. Though this had not been implemented in the urban areas, about 30% of the refuse collection service in the New Territories had been contracted out;
- the following services had also been contracted out:
  - (i) the repair and maintenance of the RCVs since 1991. In 1999, a contract was signed to contract out the maintenance of one-third of the RCVs;
  - (ii) 30% of the street cleansing service; and
  - (iii) 100% of the cleansing of markets and public toilets;
- the new FEHD had to conduct an overall review of the services for Hong

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Kong, Kowloon and the New Territories. Reference would be made to the experience in the New Territories before a comprehensive strategy could be drawn up for the whole territory;

- in order to make the option viable, the cleansing companies concerned had to be given some lead time to arrange for the delivery of service such as procuring RCVs and recruiting suitable staff;
- consideration had to be given to the deployment of staff following the contracting out of the refuse collection service. The objectives were to retain flexibility for staff deployment and to avoid staff redundancy as far as possible. Consultation with the staff side would be necessary and the timing was critical; and
- she agreed that the direction ahead was to contract out the refuse collection service. However, it was not simply a matter of achieving savings. Careful consideration had to be given to all relevant factors before a timetable could be drawn up. The ultimate objective was to provide value-added service while retaining its quality.

31. The **Secretary for the Environment and Food** also said that:

- it had to be ascertained whether the 1994 estimate, i.e. to achieve a saving of 50%, was still valid in the present-day circumstances. The major considerations in taking forward any proposal to contract out the refuse collection service were cost-effectiveness and service quality. Staff reaction would not be the sole consideration, though it was an important one; and
- as the FEHD was still in the early stages of establishment, it would take some time to initiate changes in areas including supervision and management systems. Any changes would have an impact on staff who had been put under a lot of stress because of recent developments in the re-organisation exercise. As these people were providing front-line service to the public, the Administration had a responsibility to maintain staff morale and stability. Hence, it would be advisable to take into account all relevant factors including staff reaction and not to make any hasty decisions.

32. Having regard to the difficulties experienced by the RSD in transferring some of

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its staff to the civil service upon the contracting out of its refuse collection service, the Committee asked whether the FEHD had foreseen any similar problems. The **Director of Food and Environmental Hygiene** said that:

- the RCTs were composed of staff members who belonged to different grades. There was a problem with RCV drivers because they belonged to the grade of special drivers and accounted for 50% of the total number of special drivers employed by the Government. That was why a cautious approach would be desirable; and
- the Finance Bureau and the Civil Service Bureau had given the department full support. More resources would be made available if necessary.

33. As regards the redeployment of the staff members resulting from the reduction of 47 refuse collection routes, the **Secretary for the Environment and Food** informed the Committee in her letter of 15 March 2000 in *Appendix 5* that all 115 surplus staff, including 47 special drivers and 68 loaders, had been redeployed to take up other duties such as street washing or to fill existing vacancies in the FEHD. In her letter of 27 March 2000 in *Appendix 6*, the Secretary also provided the Committee with a detailed breakdown of the posts which the 115 surplus staff members had taken up in the redeployment exercise.

34. The Committee noted Audit's observation in paragraph 38 of the Audit Report that the USD's RCVs were frequently overloaded. According to the records checked by Audit on two occasions, about 20% of the RCVs were overloaded and in more than 15% of these overloading cases, the weight of the refuse exceeded the maximum capacity of the RCVs by more than 20%. The Committee were concerned about the situation and the fact that a government department had knowingly contravened the law. The Committee asked whether any prosecutions had been taken against the RCVs which were overloaded and whether any action had been taken to address the overloading problem.

35. The **Deputy Secretary for Housing** said that:

- the USD was aware of the overloading problem and had issued clear instructions to its staff not to overload the RCVs;
- the USD also conducted a trial scheme in February 1998 to install an on-board weighing device on the RCVs. However, there were several drawbacks:
  - (i) the device could only be installed in old vehicles at a very high cost

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i.e. between \$69,000 to \$75,000 per vehicle;

- (ii) it was not user-friendly as the instructions were in English;
  - (iii) an additional staff member had to be deployed to operate it; and
  - (iv) it could only measure the weight of refuse at the refuse collection point; and
- it was therefore decided that the device would only be installed in those RCVs which were suspected of overloading. The RCTs concerned would be warned if overloading was detected.

36. On remedial measures taken by the FEHD, the **Director of Food and Environmental Hygiene** said that the weighing device was still in use. In addition, the weight of the refuse dumped into the RCVs was being assessed by counting the number of refuse bins and bags. The RCVs were weighed before and after they had disposed of the refuse at the disposal sites. Guidelines had also been issued to the RCTs.

37. The **Secretary for the Environment and Food** informed the Committee in her letter of 15 March 2000 in *Appendix 5* that there was one prosecution against an overloading RCV in January 1997 and the defendant was acquitted.

38. **Conclusions and recommendations**      The Committee:

### **Excess capacity of RCTs**

- express grave concern that for the refuse collection routes operated with a single refuse collection vehicle (RCV), 26% of the refuse collection teams (RCTs) and 18% of the RCVs were surplus to requirement, and for the refuse collection routes operated with a tractor and one or more trailers, 28% of the RCTs and 25% of the RCVs were surplus to requirement;
- express astonishment that the Urban Services Department (USD) was able to delete 47 RCTs and stop purchasing 142 RCVs, thus achieving savings of annual recurrent costs amounting to \$80 million and capital costs amounting to \$170 million respectively, upon the implementation of the Audit recommendations;

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- express dismay that, in spite of the concern expressed by the USD's Transport Manager (Hong Kong) in 1986 that the non-productive time of the RCTs was unacceptably high and many RCVs had substantial excess capacity, the USD had not implemented any effective measures to reduce the non-productive time of the RCTs and the excess capacity of the RCVs;
- express serious dissatisfaction and disappointment that the USD had failed to stem the task and finish practice until November 1997 and that the USD had not fully taken into account the following changes to monitor the work of its RCTs:
  - (i) the refuse yield;
  - (ii) the modus operandi of refuse collection;
  - (iii) the types of RCVs deployed;
  - (iv) the design and quality of refuse bins, and the refuse contents;
  - (v) the speed limit, the road network and the traffic condition; and
  - (vi) the location of the disposal sites;
- note that the Provisional Urban Council (Pro UC), based on Audit's findings, had conducted its own inquiry into the refuse collection service provided by the USD;
- note that the USD had:
  - (i) frozen the procurement of RCVs until the excess capacity of its RCVs was fully utilised;
  - (ii) re-examined the work values of refuse collection tasks for planning refuse collection routes;
  - (iii) revised the refuse collection routes to rectify the situation of over-estimating the workload of the RCTs;
  - (iv) rearranged the refuse collection routes to minimise the balance time of the RCTs; and

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- (v) installed vehicle monitoring devices on eleven RCVs for trial;
- note that the Food and Environmental Hygiene Department (FEHD) will:
  - (i) monitor the weight of refuse collected and revise the refuse collection route schedules regularly; and
  - (ii) continue to explore modern equipment available for monitoring effectively the operation of its RCVs;
- urge the FEHD to closely monitor:
  - (i) the work of its RCTs to ensure that no excess capacity exists; and
  - (ii) the remedial measures taken by the USD and to assess whether they are effective;

### **Contracting out of the refuse collection service**

- express serious dismay that, although the USD had been aware for a long time of the significant non-productive time of the RCTs and had recognised as early as 1986 that contracting out the refuse collection service would bring about substantial cost savings, it had not contracted out any of its refuse collection service while the Regional Services Department (RSD) had been contracting out part of its refuse collection service since 1993 with proven satisfactory results;
- note that the FEHD:
  - (i) is studying the feasibility of contracting out its refuse collection service in the Hong Kong and Kowloon Regions with reference to the experience of the former RSD; and
  - (ii) has stopped recruiting permanent Workmen II;
- urge the FEHD to:
  - (i) speed up its action in contracting out its refuse collection service; and
  - (ii) plan ahead and liaise closely with the Secretary for the Civil Service, so as to reduce the lead time for transferring surplus staff back to the civil

## **The refuse collection service of the Urban Services Department**

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- service;
- urge the Secretary for the Civil Service to provide support and assistance to the FEHD to ensure that it can manage its workforce with maximum flexibility;
- wish to be kept informed of the progress made by the FEHD in contracting out its refuse collection service;

### **Overloading of RCVs**

- express serious concern that RCVs were frequently overloaded;
- express astonishment that only one prosecution had been taken against the RCVs which were overloaded and even this prosecution was unsuccessful;
- note that the USD had installed six electronic on-board weighing devices on selected RCVs in a trial scheme to monitor the weight of refuse carried by the RCVs;
- urge the FEHD to take vigorous action to ensure that the RCVs will comply with the Road Traffic (Traffic Control) Regulations;
- wish to be kept informed of the results of the trial scheme to monitor the weight of refuse carried by the RCVs;

### **Excessive relief RCVs**

- express concern that the USD did not adhere to the agreed relief ratio (ARR) for the provision of relief RCVs and, as a result, the estimated replacement cost of the resultant surplus relief RCVs as at 1 April 1998 was \$8.9 million;
- note that:
  - (i) ARR which have taken into account the prevailing downtime rates for each category of RCVs have been worked out for both Hong Kong Region and Kowloon Region and that the ARR will be reviewed annually;
  - (ii) the USD has reviewed the downtime rates of RCVs for Hong Kong Region and Kowloon Region and standardised the method of calculating the downtime rates for both Regions; and

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- (iii) the FEHD will adhere to the ARR in providing relief RCVs;

### **Commissioning of the consultancy review**

- note the statement made by the Director of Food and Environmental Hygiene that the consultancy report on the USD's cleansing services was not comprehensive enough to enable the USD to initiate any major changes to the existing policies; and
- express serious dismay that:
  - (i) the consultancy report was shelved and that the matter had not been reported nor explained to the Pro UC, even though the Director of Food and Environmental Hygiene had expressed concern about the usefulness of the report during her term of office as Director of Urban Services; and
  - (ii) both public money and time have been wasted, as the consultancy report has served no useful purpose towards finding the way forward for the refuse collection service.

## **The refuse collection service of the Urban Services Department**

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## Chapter 2

### Management practices of the Vocational Training Council

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The Committee noted Audit's review on the management practices of the Vocational Training Council (VTC) in the following areas:

- finalisation of a framework agreement between the Administration and the VTC and setting of performance indicators;
- administration of remuneration and fringe benefits;
- procurement of goods and services; and
- building and use of senior staff quarters.

#### **Framework agreement between the Administration and the VTC**

2. Noting that the Audit Report had revealed a number of inadequacies in the management of the VTC, the Committee enquired into the causes of the problems.

3. **Mr Joseph WONG Wing-ping, Secretary for Education and Manpower**, said that:

- the Education and Manpower Bureau (EMB), being the bureau responsible for the subvention to the VTC, was very concerned about the management and administrative structure of the VTC; and
- in 1996, the Administration commissioned a management consultant to review the administrative structure and management of the VTC. A number of the recommendations made by the consultant had already been implemented. The EMB would follow up the implementation of the recommendations by the VTC.

4. **Mr YEUNG Kai-yin, Chairman, VTC** stated that:

- the consultant had criticised the VTC for not performing well and being out of touch with the pulse of the manpower market and the economy. Having considered the consultancy report and the Audit report, he believed that the crux of the problem was the mode of funding for the VTC;

## Management practices of the Vocational Training Council

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- at present, the Government's subvention to the VTC was on a deficiency grant basis. Under this arrangement, the salary and fringe benefits of VTC's staff could not be superior to those provided by the Government to comparable grades in the civil service. The Government had the ultimate authority for approving the revenue and expenditure of the Council. If the subvention for a year was not fully spent, the amount of subvention for the following year would be adjusted. The savings would not be kept by the VTC. In the circumstances, the VTC might have the mentality that no matter what they approved, the EMB would make the decision and the Finance Bureau (FB) would be the funding body. Hence, the Council might have a weaker sense of responsibility;
- the deficiency grant approach was more suitable for educational institutions which provided basic education because such service was so important that the Government would want to exercise a high degree of control. This is the mode of funding for all subsidised primary and secondary schools;
- on the other hand, all tertiary institutions were funded through a discretionary grant. Under this arrangement, the annual subvention provided by the Government to the subvented organisations was the ceiling under which the organisations had the flexibility to deploy its financial resources. As the councils of these institutions had greater control over the allocation of resources, they had a greater sense of responsibility; and
- since the VTC was already a mature organisation, he considered that the subvention mode should be changed from the deficiency grant to the discretionary grant.

5. The Committee understood from paragraph 5.8 of the Audit Report that back in May 1993, the Secretary for Education and Manpower had prepared a draft framework agreement for the VTC's consideration. The agreement aimed to amplify the statutory provisions of the VTC Ordinance. Paragraph 5.10 revealed that in August 1993, the VTC returned a revised draft framework agreement to the Secretary. However, the framework agreement had still not been finalised. Against this background, the Committee enquired:

- what the comments given by the VTC on the draft framework agreement were;
- why it had taken so long to finalise the framework agreement; and
- whether the inadequacies in the management of the VTC could have been prevented had the framework been concluded.

## Management practices of the Vocational Training Council

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6. The **Chairman, VTC** said that since the establishment of the VTC, there was already a Memorandum of Administrative Arrangements (MAA), which was in an abridged format, between the Government and the VTC. The MAA set out the arrangements for the VTC's transition from a Government department to a statutory body.

7. The **Secretary for Education and Manpower** said that:

- even without the framework agreement or the MAA, the Administration still had to monitor the use of resources and the performance of the VTC. Being a statutory body, the VTC's structure, functions and roles were stipulated in the VTC Ordinance. The Council, by way of its budget, had to inform the Administration of its business plan for the coming year and how resources would be allocated. Its budget was also subject to the vetting of the Legislative Council. Should there be any problem, the EMB would report it to the Legislative Council Panel on Manpower. Nevertheless, a MAA was still needed as it would set out the roles and responsibilities of the Administration and the VTC in greater detail;
- the framework agreement drafted in 1993 was rather general. It covered the Government's policy, the terms of reference of the VTC and the conditions of service for its staff, etc. After assuming office in August 1995 as the Secretary for Education and Manpower, he had examined the issue and came to the view that, rather than signing the framework agreement immediately, a comprehensive review on the organisation of the VTC should be conducted first. Hence, a consultancy study was commissioned; and
- the Administration was discussing with the VTC a new MAA. He understood that the VTC wished to have more flexibility in allocating its resources. If a discretionary grant approach was adopted, the EMB would like to have a basis for assessing the performance of the VTC. The new MAA or the framework agreement would thus cover the mode of funding and the VTC's performance indicators. With the indicators, it would be easier for the Legislative Council and the Administration to objectively assess the input and output of the VTC.

8. Regarding the VTC's comments on the draft framework agreement in 1993 and how the EMB dealt with the agreement after receiving the comments, the **Secretary for Education and Manpower**, in his letter of 21 December 1999 in *Appendix 7*, informed the Committee that:

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- on 6 May 1993, the then Secretary for Education and Manpower sent a draft framework agreement to the then VTC Chairman. On 24 August 1993, the then Executive Director, VTC reverted with a revised draft which was considerably shorter. In brief, the VTC commented that it was not necessary to include in the agreement matters which had already been laid down in the VTC Ordinance and other matters where there was no room for disagreement;
- the then Secretary for Education and Manpower held two meetings with the then VTC Chairman in November 1993 and August 1994. One of the issues covered was the draft framework agreement. It was emphasized that the purpose of the document was to enable the parties concerned and other outside readers to understand clearly the duties of the VTC, and their accountability to the public. The document should therefore be comprehensive and informative. After discussion, it was agreed that the original draft by the EMB should be used as the basis for technical refinements to be sorted out at the working level between the EMB and the VTC; and
- on 31 August 1994, the VTC Chairman sent a letter to the Secretary for Education and Manpower confirming the understanding reached at the earlier meeting in August 1994. The suggested approach was endorsed by the Council at its meeting on 8 September 1994. It was eventually decided in September 1995 that the subject should be put on hold until after the VTC consultancy review.

9. As for the actions taken by the Administration after the consultancy review, the **Secretary for Education and Manpower**, in his letter of 8 January 2000 in *Appendix 8*, stated that:

- the consultancy review was completed in August 1996. The Administration subsequently sought comments from a number of concerned organisations and interested parties. The Panel on Manpower was briefed on the results of the consultation exercise and the Administration's initial assessment of the recommendations in December 1996 and June 1997 respectively. A Legislative Council Brief was issued in June 1997 to inform Members of the Executive Council's decision that the VTC should proceed along the broad lines of the major review recommendations;

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- in early 1998, a discussion was held with the VTC on various subjects including its mode of funding. In March 1998, a letter was issued to the VTC Chairman setting out in general terms the Administration's views on the role and future direction of the VTC. A meeting was held with the Chairman and senior management of the VTC in late March 1998 to discuss various subjects including the framework agreement. In May 1998, a letter was sent to the VTC Chairman outlining the relationship between the Government and the VTC and the Administration's expectation of the VTC; and
- in the latter part of 1998 and the first quarter of 1999, discussions with the VTC were focused on a possible new funding mechanism. The issue of the framework agreement was discussed at a meeting with the VTC and the FB in July 1999. A further meeting was held in August 1999 to discuss a draft prepared by the VTC. The EMB, in consultation with the FB, was now working on a revised draft. The agreement would cover, among other things, the financial arrangement and the aims of and services provided by the VTC.

10. On the contents of the revised framework agreement or the revised MAA, the **Secretary for Education and Manpower** said that the Administration would set performance indicators for the VTC's various courses and programmes. For example, indicators would be set for the number of graduates, the number of graduates who could find a job and those who could find a job in his own profession. If the employment rate in a profession was below the level set by the indicator, the VTC would be requested to conduct a review.

11. Regarding the progress in devising the revised MAA, **Mrs Carrie LAM CHENG Yuet-ngor, Deputy Secretary for the Treasury**, said that:

- the FB, in collaboration with the EMB, was actively working on the issue. The FB considered that it was now high time to revise the MAA because since the launching of the Enhanced Productivity Programme in 1998, many subvented organisations had requested greater flexibility in the use of resources so as to enhance productivity; and
- it was agreed that priority should be given to finalising the revised MAA for the VTC. The MAA would set out clearly the relationship between VTC and the Government, the performance indicators in respect of subvented services and the subvention arrangements. Once the performance indicators had been set, the MAA could be finalised and signed.

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12. In this connection, **Professor LEE Ngok, Executive Director, VTC**, also informed the Committee that:

- since he assumed the office of Executive Director, VTC in June 1997, he had been pursuing the consultant's recommendations. The consultant had urged the drawing up of a framework agreement between the VTC and the Government; and
- for more than six months, the Chairman, VTC and he himself had been involved in discussions with the EMB and the FB about the new MAA. The discussions had been going on very smoothly. One of the most important issues being discussed was whether the mode of funding for the VTC should be changed from a deficiency grant to a discretionary grant. He was confident that a formal and detailed MAA would be concluded in the coming couple of months.

13. Responding to the Committee's question, the **Secretary for Education and Manpower** confirmed that he aimed to finalise the MAA towards the end of April 2000.

14. The Committee noted that on the one hand the Administration considered it necessary to have a more detailed MAA to ensure the financial control of the VTC, on the other hand the Committee understood that the VTC was a non-government organisation which enjoyed a certain degree of flexibility and discretionary power. It was not required to adhere to government rules and regulations. In the absence of a MAA or an agreement with the VTC on financial arrangements, the Committee queried how the Administration could make sure that the VTC would comply with the Government's subvention rules.

15. In response, the **Deputy Secretary for the Treasury** said that:

- the VTC was bound by the VTC Ordinance. Moreover, the Government's financial support for the VTC was based on an Executive Council memorandum. There was also a document setting out the financial arrangements for the VTC; and
- similar to other subvented organisations, the VTC was covered and regulated by a general subvention policy of the Government. For instance, under the policy, the terms of service for subvented posts might not be superior to those offered by the Government to comparable grades in the civil service. Savings achieved in a year would be netted off in the following year's

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subvention. There were circumstances under which the VTC should seek approval from the Administration before it made the decisions. Hence, in accordance with the prevailing subvention policy, the FB could exercise some control over the VTC.

16. The Committee considered that without a detailed MAA, the situation was far from satisfactory. While the VTC's vote controller was not a civil servant, he had to understand all the Government's subvention rules before he could comply with the subvention policy. The Committee asked whether:

- the lack of a detailed MAA had given rise to the inadequacies identified in the Audit Report; and
- consideration would be given to setting out clearly in the revised MAA the matters which were subject to the approval of the Government.

17. The **Deputy Secretary for the Treasury** said that:

- even if there was a revised MAA, it would not cover every detail because that would not be in line with the Government's intention to give the VTC autonomy and flexibility. A lot of subvented organisations had received subventions from the Government in the past decade. The Administration had all along relied on a general subvention policy or the historical relationship between the Government and the organisations, rather than contractual documents, for regulating the organisations;
- the VTC, being a statutory body, had a governing council. The Council had to put in place proper arrangements to make sure that it was transparent and accountable in the use of public funds;
- as the VTC was funded by a deficiency grant which was the most vigorous mode of regulation for subvented organisations, any action by the VTC which might have an implicit or explicit financial implication would require the approval of the controlling officer who, in turn, had to seek approval from the FB. The criterion was whether public expenditure would be involved. Under this principle, some issues revealed in the Audit Report, such as the encashment of vacation leave and the increased project estimate for the building of the senior staff quarters, should have required the FB's prior approval in the first place. The deficiency grant arrangements were already adequate for regulating the VTC's activities; and

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- the subvention policy had been evolving all the time. The Administration agreed that improvements could be made to the policy and the Government could set out clearer guidelines for subvented organisations. Actually, more than 180 non-government social service organisations were being consulted on the subvention policy.

18. The **Secretary for Education and Manpower** agreed with the views of the Deputy Secretary for the Treasury. He said that:

- in the new framework agreement, the EMB and the FB were not going to regulate each and every detail of the VTC because that would violate the purpose of establishing the VTC. The VTC was established as a statutory body because the Government wished to give it some degree of flexibility. The Administration did not expect the VTC to follow all the practices of the Government; and
- while the Government wanted to allow flexibility, it also wanted to ensure that public money was spent in a worthwhile and accountable manner. Hence, the general financial arrangements of the VTC should not be too out of line with government practice. However, it did not mean that all details had to be rigidly controlled by the Government.

19. The Committee asked about the yardstick used by Audit in examining the management practices of the VTC and whether Audit had taken into account the fact that the VTC was given some flexibility and it was not required to follow government rules and regulations. In response, **Mr Dominic CHAN Yin-tat, Director of Audit**, said that Audit did not criticise that the VTC had breached government rules. Nor did Audit expect the VTC to adhere to all government rules. Audit had only recommended that the VTC should follow best practices which, in terms of value for money studies, meant obtaining efficiency, effectiveness and economy. These were in fact international practices. Under these principles, for instance, tendering exercises should be open and competitive.

### **Administration of remuneration and fringe benefits**

#### All-in pay package

20. According to paragraphs 2.36 and 2.37 of the Audit Report, in October 1998 the VTC recruited a senior staff member (i.e. the Director of Marketing and Public Relations) by offering an all-in pay package of \$145,000 a month, which was made up of a monthly

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basic salary of \$92,650 (equivalent to an officer at D1 of the Directorate Pay Scale of the civil service) and a monthly cash allowance in lieu of contract gratuity, housing benefits, medical, dental and hospitalisation benefits, education allowance for children and leave passage. This was not the normal remuneration arrangement for VTC staff.

21. Audit commented in paragraph 2.38 that the all-in pay package was inappropriate because:

- despite the fact that there were vacant staff quarters, the senior staff member concerned was not required to live in the quarters. Instead, the housing benefits were encashed and paid as a monthly allowance to the staff member; and
- the payment of contract gratuity in the form of a monthly cash allowance breached the principle that contract gratuity was payable only upon the satisfactory completion of a contract.

22. The Committee noted from paragraph 2.40 of the Audit Report that the Executive Director, VTC had said that there were difficulties in recruiting a person of the right calibre to fill the position and therefore an all-in pay package was offered. Noting that the VTC had not conducted a recruitment exercise for the post offering the usual terms, the Committee asked how the Executive Director had arrived at the conclusion that there would be recruiting difficulties, particularly at the time when there was an economic downturn.

23. In response, the **Executive Director, VTC** said that the 1996 consultancy had commented that enhancement of the corporate image of the VTC should be given prior consideration if enrolment and placement of students and trainees were to improve. Some head-hunting companies had been contacted and it was suggested that in order to attract candidates of the right calibre, an all-in pay package would be more desirable. Hence, a proposal to recruit a Director of Marketing and Public Relations on the basis of an all-in pay package was put up to the Council for approval. After obtaining the Council's approval, an open recruitment exercise was conducted.

24. Upon the Committee's request, the **Executive Director, VTC** provided, in his letter of 20 December 1999 in *Appendix 9*, the relevant VTC papers and minutes of the VTC meeting approving the offer of an all-in pay package for the appointment of the Director of Marketing and Public Relations. In the letter, the **Executive Director, VTC** informed the Committee that:

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- it was stated in Paper VTC 35/98 that the post “may prove attractive to high-calibre candidates with a proven record and relevant credentials” if an appropriate package was offered; and
- he explained at the time that the above statement reflected the advice he had received from recruitment consultants and others experienced in the field about recruiting such persons. As a result, the VTC approved the all-in pay package in June 1998. The Council would review the all-in pay package when the contract for the staff member concerned was due for renewal.

25. At the Committee’s invitation, the **Director of Audit**, in his letter of 7 January 2000 in *Appendix 10*, commented that:

- Audit could not find evidence to support the assumption that there would be difficulties in recruiting a person of the right calibre for the post if the usual terms of remuneration package were offered; and
- in fact, a total of 92 candidates applied for the post in the recruitment exercise offering the all-in pay package. Five candidates were short-listed for the interviews. The response to the recruitment exercise indicated that the competition for the post was keen.

26. The Committee noted that it was stated in Paper VTC 35/98 that “It is felt however that the post ranked at A1 (actual annual salary \$1.11 million) may not attract candidates of the right calibre.” The Committee were concerned whether the Executive Director, VTC had handled the issue in an objective and fair manner and therefore asked:

- for the details of the consultation which gave the Executive Director the feeling that the normal conditions of service might not be attractive enough; and
- whether the Executive Director agreed that there was a waste of resources by leaving the VTC’s staff quarters vacant on the one hand and not requiring the senior staff member concerned to live in the quarters on the other hand.

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27. The **Executive Director, VTC** responded that:
- apart from his personal views, he had collected information from other parties. He had consulted some head hunting companies informally, but he could not disclose the names of the companies. He had also sought advice from people in the public relations field and had consulted the marketing consultant commissioned by the VTC for enhancing the VTC's overall public relations machinery; and
  - in the process of selecting the marketing consultant, parties concerned were invited to make presentations. At the time he took the opportunity to ask them what kind of pay package should be offered to attract suitable candidates for the post of Director of Marketing and Public Relations.
28. Referring to the fact that there were 92 applicants for the recruitment exercise offering the all-in pay package, the Committee asked the Executive Director whether, with hindsight, he agreed that he had been over-pessimistic and whether he would have come to the same conclusion. In response, the **Executive Director, VTC** said that he accepted the Committee's criticism that he had been subjective and with hindsight, he should have re-considered the offer of an all-in pay package, particularly after receiving 92 applications for the post.
29. In response to the Committee's question on how the management of the VTC had handled the matter, **Mrs Amy LO, Finance Officer, VTC** said that:
- the remuneration package that should be offered to the post of Director of Marketing and Public Relations had been discussed several times at the senior management meeting of the VTC. Although there were opposing opinions, it was finally agreed that an all-in pay package should be offered. The proposal was then put up to the Council for consideration; and
  - regarding the issue of the availability of vacant quarters, providing an all-in pay package to the staff member concerned was more economical if compared to the cost of the salary package for the officer under normal conditions of service.

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30. In the light of the Finance Officer's remark, the Committee asked whether the VTC would consider offering all-in pay packages to all its staff members if such arrangements were indeed more economical and attractive. The **Executive Director, VTC** replied that he had never considered doing so because the VTC still had vacant quarters and all-in pay packages should be an exception rather than a norm. Moreover, the remuneration structure of the VTC was largely based on that of the civil service.

31. The Committee enquired whether the VTC should have consulted the Administration before deciding to recruit a staff member on the basis of an all-in pay package and whether it was desirable for the FB to be represented on the Council. The **Deputy Secretary for the Treasury** commented that:

- according to the usual practice and the subvention policy, the Administration should have been informed of the matter. This would enable the Administration to have the opportunity to comment whether agreement from the Administration would be required. Normally, staff of subvented organisations would not enjoy a higher pay package than civil servants. Although subvented organisations were given flexibility, the Administration should still be allowed a chance to comment on exceptional arrangements and to consider whether discretion should be exercised;
- the FB was the ultimate authority to explain and interpret the subvention policy. The Bureau also had to make sure that subvented organisations dealt with similar matters in a consistent way. However, it would not be practicable for the FB to be represented on the councils of all subvented organisations; and
- it was understandable that sometimes government officials sitting on the councils of subvented organisations might not have full knowledge of the subvention rules. Hence, to err on the safe side, when they spotted any problems they should refer the case to the FB or request the organisation to seek formal approval from the Administration.

32. Noting that there were Government officials including the representative of the EMB sitting on the VTC, the Committee queried why they had not reminded the Council to refer the proposal of offering an all-in pay package to the Administration for consideration. The Committee also asked about the officials' role and functions and whether they had monitored the VTC effectively.

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33. The **Secretary for Education and Manpower** said that:

- he did not object to the view that the VTC should have consulted the FB before approving the all-in pay package. Nevertheless, he appreciated that under certain circumstances, statutory bodies like the VTC might, subject to the decision of the Council, want to change the conditions and terms of service for their staff, such as by offering an all-in pay package. If the organisation considered that it was the best way to gain flexibility so as to attract staff of the right calibre, as a matter of principle, he would not object to such an arrangement. The overall requirement was that the terms and conditions of subvented posts should not exceed those of the civil service. Subvented organisations must be given flexibility for the conduct of their business. Otherwise, they should all have been absorbed back into the Government;
- he understood that when a subvented organisation sought approval from the FB on some special arrangements, the FB would consult the respective policy bureau for its views. If the VTC had sought approval from the FB for the present case, he would have commented that under some circumstances the proposal might be appropriate; and
- the representative of the EMB sitting on the VTC would explain Government policies and arrangements to the Council. However, the representative was not superior to other members of the Council and did not have the authority to veto the Council's decisions. The Council was the ultimate power organ. The Council was presented with relevant information in the Council papers and if the members believed that the proposal was the best arrangement for the VTC, the EMB representative would not object to the proposal. He would not find it unacceptable if the representative had not objected to the arrangement.

34. The **Chairman, VTC** said that:

- he understood that one of the main principles under the subvention policy was that the total benefits available to the staff of subvented organisations might not exceed those that would be made available to civil servants of comparable grades. This did not mean that an organisation could not change its remuneration structure; and

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- he agreed that in the case of the all-in pay package, the VTC had departed from the arrangements of the deficiency grant. Under the arrangements of the deficiency grant, every case which had financial implication should be approved by the FB. Although the VTC had given its consent to the all-in pay package, advice should also be sought from the Administration. He was confident that the Administration would give the approval if it had been consulted.

35. The **Deputy Secretary for the Treasury** added that:

- as the VTC was subject to the Government's control under the deficiency grant, any proposal that had possible financial implication would need the FB's advice and consent. The FB would then consult the relevant bureau; and
- while the FB was the bureau with the ultimate authority for approving the offer of an all-in pay package, it did not mean that the FB would have definitely opposed the proposal. It acknowledged that many subvented bodies were offering all-in pay packages nowadays. Hence, the present problem was just a matter of procedure.

36. On the role of the Government officials appointed to the VTC and the working relationship between the VTC and the Government, the **Secretary for Education and Manpower** informed the Committee in his letter of 21 December 1999 in *Appendix 7* that:

- under the VTC Ordinance, the VTC was required to submit to the Chief Executive for approval each year a programme of its proposed activities and estimates of its income and expenditure for the following financial year. The power to approve the programme of activities and the draft estimates had been delegated to the Secretary for Education and Manpower. The VTC was also required to submit to the Chief Executive an annual report of its activities after each financial year. The report would subsequently be tabled at the Legislative Council;
- the VTC Ordinance stipulated that the Council should consist of up to 23 members with a maximum of four public officers. All members were to be appointed by the Chief Executive. Under section 9 of the Ordinance, the Council might appoint an Executive Director to be the chief executive of the Council. His duty was to ensure proper and efficient functioning and daily operation of the VTC;

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- the four public officers appointed to the VTC had the same status as other non-public officer members. Their main role was to provide input from the Government's perspective, explain Government policies and ensure that the activities undertaken by the VTC and known to the Council complied with the prevailing Government policies and procedures. They also helped to bring to the attention of the relevant Government bureaux and departments at an early stage any important matters requiring further consideration and approval by the Government. However, it was not the role of the public officer members to oversee or manage the day-to-day operation of the VTC, which was an autonomous statutory body; and
- on important matters involving Government policies or having financial implications on the Government, the VTC would need to seek formal approval from the Government, after any discussion by the Council.

### Staff Loan Scheme

37. Paragraph 2.17 of the Audit Report revealed that starting from March 1999, VTC staff were no longer required to state in their loan applications the purposes of the loans under the Staff Loan Scheme (SLS). The VTC would routinely approve the loan applications. The Committee asked about:

- the reasons for such an arrangement; and
- the VTC's view on Audit's comment that the SLS might not be in the staff's interest as a significant portion of the accumulated provident fund originally provided for retirement would have to be used to repay the outstanding loan principal.

38. The **Executive Director, VTC** responded that the requirement to state the purposes of the loans on the application forms was removed by the administration staff without his knowledge because they thought that it was only a minor amendment to the application form.

39. The **Chairman, VTC** said that:

- no public money was involved in the SLS as the loan was provided by a bank with the VTC acting as the guarantor. The VTC only needed to confirm that there was a certain amount of money in the applicant's accounts under the VTC's provident fund scheme to serve as the collateral;

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- as the bank was the lender, it was up to the bank to decide whether the applicants should be required to state the purposes of the loans. The VTC should not take over the function of the bank to assess whether the loan applications should be approved; and
- the VTC had accepted Audit's comment that it was not desirable to allow staff to repay only monthly interest and not the principal because by doing so, by the time a staff member retired, a large portion of his provident fund would be deducted for repaying the outstanding principal. Hence, a review would be conducted on the SLS.

40. In his letter of 7 January 2000 in *Appendix 10*, the **Director of Audit** commented that:

- while the SLS itself did not involve public funds, the Scheme was nevertheless administered by VTC staff who were remunerated by public funds; and
- the VTC should practise prudent personal financial management so as to safeguard the retirement benefits of the staff.

### Encashment of vacation leave

41. The Committee noted that under Part VIII A of the Employment Ordinance, staff members of the VTC could request encashment of their annual leave which had not been taken. The Committee also noted that Audit commented in paragraph 2.33 of the Audit Report that the implementation of the encashment of vacation leave scheme had breached the Government's subvention principle that the terms and conditions of service of their staff should not be superior to those provided by the Government to comparable grades in the civil service. The Committee asked whether, under the circumstances, it was possible for the VTC to adhere strictly to the subvention principle while complying with the Employment Ordinance.

42. The **Secretary for Education and Manpower**, in his letter of 7 March 2000 in *Appendix 11* said that:

- the Department of Justice had advised that the provisions in Part VIII A of the Employment Ordinance were not applicable to the leave arrangement which exceeded the statutory minimum. Under the leave encashment scheme,

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VTC's non-teaching staff were given an option to encash 30 days (out of a total of 90 days) of their vacation entitlement in a two-year tour of service. The 30 days under the scheme fell within that part of the benefits which exceeded the statutory minimum and were therefore governed by the contract between the VTC and the employees, not by the Employment Ordinance. Any variations to the terms of the contract were subject to mutual consent; and

- actually, there were other options available to the VTC apart from the leave encashment scheme, i.e. acting appointment by other staff and employing additional staff as leave reserve. In the end, the then VTC management opted for the leave encashment scheme after considering the financial implications and impact on operational efficiency of the other two options.

### Contract gratuity

43. According to paragraph 2.6 of the Audit Report, since May 1995, six out of the seven tertiary institutions in Hong Kong had already reduced the contract gratuity rate for their staff from 25% to 15%. However, it was not until March 1999 that the VTC decided that the rate for its staff would be reduced from 25% to 15% with effect from July 1999. The reduction was made as a cost saving measure required by the Government's Enhanced Productivity Programme. In this connection, the Committee asked why the VTC had not reduced the rate at an earlier date.

44. The **Chairman, VTC** said that:

- the circumstances facing the tertiary institutions and the VTC were different. By 1995, the tertiary institutions had stopped expansion. In that year, the University Grants Committee asked the institutions to reduce the cost. Hence, the institutions reduced their gratuity rate to save cost; and
- the VTC's activities were still expanding in 1995 as it had to take over the sub-degree courses from the then City Polytechnic and the then Hong Kong Polytechnic. Therefore, the VTC considered that it was necessary to retain the 25% gratuity rate in order to keep its remuneration packages competitive and to attract staff of appropriate calibre.

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45. The **Executive Director, VTC**, in his letter of 20 December 1999 in *Appendix 9*, added that:

- as the VTC was subvented through a deficiency grant, its annual estimates of expenditure and income must have explicit approval from the Government. Consequently, the terms and conditions of service of the VTC (which could equate with, but not be better than those of civil servants) were approved by the Government. As a result, the VTC had little room for manoeuvre on rates such as the level of gratuity which followed those of the civil service;
- in order to produce savings to meet the demand for new and additional services required by the public, the VTC decided of its own volition in March 1999 to reduce the contract gratuity rate to 15%. The revised rate was applicable to both new recruits and existing staff who were on gratuity-bearing terms. It was understood that existing civil servants and employees of subvented organisations who were on gratuity-earning terms of service might continue to receive contract gratuity at the rate of 25% on contract renewal; and
- the VTC considered that it had taken prompt action to review its conditions of service and there had been no delay in implementing a change in contract gratuity, which it did two months in advance of the Government.

46. The **Director of Audit**, in his letter of 7 January 2000 in *Appendix 10*, commented that:

- the VTC had not tested the market by offering the 15% gratuity rate, even at a time when there was an economic downturn in early 1998. There was no evidence to support that by offering the 15% gratuity rate, the VTC would not have been able to attract staff of good calibre;
- Audit did not agree that the VTC had little room for manoeuvre on rates such as the level of gratuity. As the terms and conditions of service of the VTC were required to be no better than those of civil servants, it followed that the VTC could offer to their staff less favourable terms than the Government's. In fact, as informed by the VTC, the VTC had decided of its own volition in March 1999 to reduce the contract gratuity rate to 15%; and
- Audit maintained the view that the VTC could have taken the initiative of deciding earlier to reduce the contract gratuity rate.

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### Procurement of goods and services

#### Financial control on procurement of goods and services

47. The Committee noted that the VTC had made its Financial Rules which did allow exceptions to be made, and the Council had the authority to approve exceptional cases. However, the Financial Rules did not specify under what circumstances the VTC had to seek approval from the Government. Sometimes, even the controlling officer and public officers did not know when the FB should be consulted. As a result, omissions might occur. The Committee therefore asked whether the FB would review the VTC's Financial Rules to identify any deficiencies and to ensure that they were in line with best practices.

48. The **Deputy Secretary for the Treasury** agreed with the suggestion. She said that as the FB was the policy bureau responsible for the Government's tendering matters, she would be happy to provide professional advice when the VTC reviewed its tendering procedures and rules.

49. As to whether there were deficiencies in the VTC's Financial Rules, the **Finance Officer, VTC** said that the VTC's rules and regulations had been changing with time. As the Director of Audit had been the VTC's financial auditor, like other auditors, he audited the Council's accounts every year. He would have brought to the attention of the Council any deficiencies or weaknesses he identified in the Council's Financial Rules or systems.

50. The Committee asked why the D of A, when performing financial audit on the VTC, had not revealed the fact that matters which were subject to the approval of the Government were not set out in the VTC Financial Rules. In his letter of 17 March 2000 in *Appendix 12*, the **Director of Audit** replied that:

- he had been appointed the auditor for the financial audit of the VTC's financial statements from 1982 to 1998 (accounts for the year ended on 31 March 1998);
- external approval procedures were outside the scope of a financial audit which essentially required the auditor to express an opinion as to whether the financial statements showed a true and fair view of the state of affairs. While the financial audit included a review of the internal control system, unless there were specific requirements, it did not normally cover a review of external approval procedures;

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- hence, as the financial auditor of the VTC, in the audit report to the Council, the Audit Commission did not raise issues on those matters that required approval from the FB which were not stipulated in the VTC Financial Rules. However, the Audit Commission was entitled to raise such issues when conducting value for money audits of the VTC; and
- the relationship between the VTC and the Government, including the circumstances under which the VTC had to seek authority from the FB, should preferably be set out in a framework agreement or a MAA.

### Appointment of consultants for the construction of an annex to the Shatin Campus

51. Paragraphs 3.5 to 3.7 of the Audit Report revealed that the VTC had not conducted a tendering exercise to select a project consultant for the construction of an annex to the Shatin Campus. According to paragraph 3.6, the Estates Officer suggested that a decision be made on whether a firm recommendation be submitted to the VTC Estates Committee for approval, or whether the Estates Committee be requested to choose from a list. The Committee asked why the Executive Director, VTC had not asked the Estates Committee to choose from a short list of firms, thereby creating an impression that the project was tailor-made for a particular firm.

52. The **Executive Director, VTC** stated that:

- for similar projects, since the establishment of the VTC in 1982 up to the end of 1998, the VTC had never adopted tendering for the appointment of consultants. Clause 11(1)(a) of the VTC Financial Rules stated that “the Council may generally or specially authorise the making of any purchase or the obtaining of any service for the Council without recourse to tender”. The usual practice was not to put such projects to tender; and
- the Architectural Services Department (ASD) had confirmed that it was not necessary for the VTC to follow the Government’s tendering procedures.

53. The **Executive Director, VTC**, in his letter of 20 December 1999 in *Appendix 9*, supplemented that:

- it had been the practice of the VTC to delegate to its Estates Committee the authority to select consulting architects. It was for the Estates Committee to decide whether a single nomination should be accepted or it might request

## Management practices of the Vocational Training Council

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VTC staff to provide information and recommendations about a number of firms. A single nomination was accepted as long as the Estates Committee considered that the firm was technically competent to carry out the particular job, taking into account the nature of the project; and

- in the case of a small project, such as the construction of an annex to the Shatin Campus, it was quite typical to nominate only one firm, particularly if the firm had the appropriate experience and characteristics.

54. As regards the details of the process for the selection and appointment of the consultant and the role played by the Executive Director, VTC in making a decision, the **Executive Director, VTC** informed the Committee in his letter of 20 December 1999 in *Appendix 9* that:

- the Estates Officer sent the Executive Director a memorandum on 3 June 1998 about the selection of a design consultant for the Shatin Annex identifying five firms he had approached to express interest, but he recommended only three of them for further consideration;
- the matter had been discussed at a senior management meeting, following which, after further consultation with the Chief Technical Adviser and the Director of Architectural Services, one firm was recommended to the Executive Director by the Estates Officer for approval by the Estates Committee. In approving the Estates Committee paper drafted by the Estates Officer, the Executive Director had sought confirmation from the Estates Officer whether the single nomination practice was in line with the Council's internal procedures and the answer was in the positive; and
- as stated in the Estates Committee paper, the recommended firm had "undertaken a number of educational and institutional buildings, and the size and nature of the project is well-suited to this small practice of about 20 staff". Hence, the firm was recommended to the Estates Committee.

55. In his letter of 7 January 2000 in *Appendix 10*, the **Director of Audit** commented that:

- although the Estates Committee had been delegated the authority to decide whether or not a single nomination should be accepted, Audit considered that single or restrictive tender procedures should only be used in circumstances where open competitive tendering would not be an effective means of obtaining the requisite supplies or services. This was to ensure that the tender process was open, fair and competitive;

## Management practices of the Vocational Training Council

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- in the case in question, the value of the consultancy services for the project was estimated at \$7.5 million, which could not be regarded as small. Also, there was no evidence to show that there were special circumstances which warranted single tender procedures; and
- Audit maintained the view that, in order to obtain value for money, competitive tenders should be the norm and single tenders should only be used in exceptional circumstances.

56. The Committee noted from paragraph 3.7 of the Audit Report that the consultancy fee was based on a scale of fees on the value of the project, which was not in line with the prevailing practice of remuneration for similar consultancy work, which was normally on a lump sum basis subject to competitive bidding. The Committee queried why the lump sum fee bidding system was not adopted and whether the ASD had been consulted.

57. **Mr PAU Siu-hung, Director of Architectural Services**, said that:

- before February 1999 the Government did not require subvented organisations to adopt the fees bidding system. These organisations only followed the scale of fees of the professional bodies. In February 1999, as a result of a query from the Legislative Council, the ASD discussed with the Works Bureau and the FB and it was decided that the fees bidding system should be adopted; and
- as the construction of an annex to the Shatin Campus was committed before February 1999, it was not necessary for the VTC to adopt the fees bidding system. The VTC had full power to decide on the system to use.

58. In his letter of 3 March 2000 in *Appendix 13*, the **Director of Architectural Services** supplemented that:

- the VTC's capital works projects were normally funded from Head 708 - Capital Subventions and Major Systems and Equipment. Although capital subvention projects had been subject to examination by the Public Works Subcommittee of the Legislative Council since the 1996-97 legislative session in the same way as other Public Works Programme projects, the Public Works Programme procedures for Government projects did not apply to them;

## Management practices of the Vocational Training Council

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- as subvented organisations were not Government departments, the Government had given them some flexibility in their operation. They had not been required to adhere to Government departments' lump sum comparative technical/fees proposals selection system;
- the Government reviewed the appointment system in February 1999 and decided that subvented organisations should also adopt the competitive comparative selection system similar to that used by Government departments. The Secretary for Education and Manpower had subsequently informed the VTC about the fees bidding system for new subvented projects; and
- he confirmed that the VTC was not required in mid-1998 to use the fees bidding system when they selected consultants for the project.

59. In the light of the remarks of the Director of Architectural Services, the Committee considered that the VTC had not contravened any Government rules and regulations. In response, the **Director of Audit** said that Audit was not criticising the VTC for deviating from Government rules and regulations. Audit only pointed out that the best practice was fees bidding system and hoped that the VTC would adopt the new system in future.

60. In his letter of 7 January 2000 in *Appendix 10*, the **Director of Audit** added that a lump sum fee had the advantages of being subject to competitive bidding and providing a better basis of financial control. The lump sum comparative technical/fee proposals system had been in use for Government projects since 1994. In Audit's view, the VTC should have taken the initiative of identifying and following the best practice in remunerating consultancy work.

### Award of contracts for security services for VTC buildings

61. According to paragraph 3.11 of the Audit Report, the security services contract for VTC buildings had been renewed for six times and most of the security services had not been put out to tender since November 1989. In this connection, the Committee asked why the security services contract had been renewed without tendering and whether the Independent Commission Against Corruption (ICAC) had raised any query on the issue.

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62. The **Executive Director, VTC** responded that:
- it was true that from 1989 to 1996 the security services contract had been renewed with Company A without recourse to tender. In 1996, before deciding whether the contract should be renewed, the Council's Supplies Tender Board had deliberated as to whether the prices could be lowered. Hence, the security services for some campuses and training centre complexes were put out to open tender. The contract was awarded to another company, i.e. Company B;
  - upon the expiry of the contract, the services were tendered out again in 1998. The Supplies Tender Board accepted the second lowest bid although Company B submitted the lowest bid. That was because the performance of Company B was not satisfactory; and
  - there had not been any ICAC query on the matter.
63. In his letter of 20 December 1999 in *Appendix 9*, the **Executive Director, VTC** supplemented that:
- the main purpose of renewing the security services contract with Company A in the earlier years was to secure the continuity of satisfactory services based on the positive comments received from the Security Services Committee and campuses/centres on the company's performance. Such arrangements would cause minimum interruption to the operation of these centres; and
  - prior to each contract renewal, price negotiations were conducted by the Supplies Section to ensure that the VTC could obtain the best value for money.
64. The **Chairman, VTC** commented that the VTC might need a set of more sound and standardised rules for procurement. He would discuss with the Executive Director to ascertain if the Council's Financial Rules could be updated and improved.
65. In response to the Committee's question about the involvement of the VTC's Supplies Tender Board in the renewal of the contracts, the **Executive Director, VTC** advised the Committee in his letter of 20 December 1999 in *Appendix 9* that:

## Management practices of the Vocational Training Council

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- the Supplies Tender Board was responsible for the vetting of all non-works tenders of a value exceeding \$500,000 and was empowered by the Council to approve all non-works tenders of a value up to and including \$10,000,000. The Board did not take part in any price negotiation with tenderers/contractors. That was the responsibility of the Council's Supplies Section; and
- in the context of renewal of the security services contracts for VTC buildings, negotiations of contract prices were conducted by the Head of the Supplies Section and his procurement team. Price negotiations and comparisons for each contract renewal were presented in the papers seeking approval of the Supplies Tender Board and the Council.

66. The Committee further enquired:

- about the justifications for the VTC's statement that Company B's performance had not been satisfactory; and
- whether it was in line with general tendering procedures for the VTC to reject Company B only after it had submitted the bid but not earlier, such as during the pre-qualification stage.

67. In response, the **Chairman, VTC** said that although in most cases the lowest bid would be accepted in Government departments' tendering exercises, this was not a standard requirement. The departments still had to make sure that the lowest bidder met their requirements.

68. The **Executive Director, VTC** informed the Committee in his letter of 20 December 1999 in *Appendix 9* that:

- a public tender exercise for security services was carried out in 1998 and an advertisement was placed in four newspapers on 9 and 10 December 1998. Tender pre-qualification procedures were not applicable in this public tender exercise and any company/contractor was free to submit offers. By the tender closing date, a total of 15 bids were received and the lowest offer was from Company B; and

## Management practices of the Vocational Training Council

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- the performance of Company B was considered unsatisfactory based on the feedback and complaints from the management of campuses and training centres. Both written and oral complaints against Company B had been received by the Supplies Section during the contract period from 1996 to 1998. The complaints included failure to provide relief guards for absentees, aged guards without adequate training, guards required to work for two consecutive shifts, poor punctuality and inadequate site visits of patrolling officers. A number of review meetings with the management of the company had been conducted and seven warning letters had been issued during the contract period.

69. The **Director of Audit**, in his letters of 22 December 1999 and 7 January 2000 in *Appendices 14 and 10*, stated that:

- in normal circumstances, open tendering would be used by the Government. All interested contractors were free to submit their tenders, but the Government was not bound to accept the lowest tender. There might be circumstances which warranted the pre-qualification of a list of tenderers, such as when the projects were of a complex nature or when the products were critical to the user departments. The provision of security services for government buildings did not normally fall into this category;
- in circumstances where there was a frequent need to invite tenders for particular services but not all contractors in the market were capable of providing the required services, Government departments might establish lists of qualified contractors for such services. In the case of security services for VTC buildings, the tendering exercises were not frequent. The VTC did not establish a list of qualified contractors. As the performance of Company B was not considered satisfactory, it was in line with general tendering procedures for the VTC to reject the company's tender even though its bid was the lowest; and
- Audit did not question the tender exercise in 1998. Instead, Audit was concerned that the security services contract had been renewed six times and most of the procurement of the security services had not been put out to tender since November 1989. Without going through a tender process, there was insufficient assurance that the VTC had obtained the best value for money.

## Management practices of the Vocational Training Council

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### Advertising of VTC courses

70. Paragraphs of 3.12 and 3.13 of the Audit Report revealed that the Director of Marketing and Public Relations had acquired directly a package of advertising services from a television broadcasting company, despite the fact that the advertising services should have been procured by open tender in accordance with the Financial Rules. Subsequently, a covering approval was obtained from the Council to rectify the anomaly. The Committee asked for the Council's justifications for giving the covering approval.

71. The **Executive Director, VTC**, in his letter of 20 December 1999 in *Appendix 9*, informed the Committee that:

- the acquisition of four three-minute, mini-segments on prime time TVB-Jade at a total cost of \$320,000 inclusive of production, air time and licensing rights for one year was considered by the VTC to be the most cost-effective way to achieve marketing objectives based on a comparison of the ratings and cost-per-thousand analysis of the television channels; and
- owing to the lack of knowledge of the tendering procedures, the Director of Marketing and Public Relations, a newcomer to the VTC, had allowed the staff to acquire the service from TVB without recourse to tender.

### **Building and use of senior staff quarters**

#### Increase in project estimate in the construction of senior staff quarters

72. According to paragraphs 4.7 and 4.8 of the Audit Report, the project estimate for constructing the VTC's senior staff quarters was increased from \$170 million in September 1993 to \$255 million in May 1994 without approval from the Administration. The Committee asked why the VTC did not seek approval from the Administration for the significant increase in project cost.

73. The **Executive Director, VTC**, in his letter of 20 December 1999 in *Appendix 9*, and the **Chairman, VTC** said that:

- the amount of \$170 million was only an initial indicative cost estimated during the feasibility study and was not expected to be the final cost of the project as the detailed design was not yet available at that time. Eventually, upon completion of the detailed design, the Council approved the amount of \$255 million. Hence, there was no overrun in the project cost;

## Management practices of the Vocational Training Council

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- the variation of \$85 million between the indicative cost and the approved estimate was largely due to the provision for further price fluctuations, and noise mitigation measures to satisfy the requirements of the Environmental Protection Department plus contingency; and
- it was agreed that the VTC should have notified the Government of the increase and it was an oversight that this had not been done. The VTC would seek approval from the Government for any significant increase in the project cost of future building projects.

### Vacant quarters and the Home Financing Scheme

74. The Committee noted from Table 4 in paragraph 4.24 of the Audit Report that out of the 100 quarters, 15 were vacant. According to paragraph 4.39, the Executive Director, VTC said that he would take action to deal with the surplus quarters. In this regard, the Committee asked what actions had been taken.

75. The **Executive Director, VTC** responded that all VTC staff, irrespective of whether they were eligible for housing subsidy, had been approached to see if they were interested in renting the vacant quarters. The VTC was also consulting the Administration to ascertain whether the quarters could be rented out to members of the public.

76. The **Chairman, VTC** added that the above were only short-term measures. At present, the FB was considering the introduction of a Home Financing Scheme (HFS) for VTC staff. If the Administration eventually agreed to implement the Scheme, many staff members would opt for the HFS instead of the staff quarters. Then, the vacancy rate of the quarters would further increase. In that case, he would suggest that all the quarters be returned to the Administration.

77. On the HFS, the Committee noted from paragraph 4.46 of the Audit Report that the FB was conducting an assessment on the viability and financial implications of implementing the HFS for the staff of the VTC. The Committee enquired about the progress of the assessment.

## Management practices of the Vocational Training Council

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78. In response to the Committee's enquiry, the **Secretary for the Treasury**, in her letter of 13 March 2000 in *Appendix 15*, stated that:

- the FB had no in-principle objection to introducing a HFS for eligible staff of the VTC in place of existing housing benefits, on the understanding that this would produce long-term cost savings as in the case of similar schemes for the civil service and the institutions funded by the University Grants Committee;
- to take the matter forward, the FB had prepared a set of preliminary financial analysis based on the VTC's input and a number of assumptions relating to the take-up rate and inflation rate. The figures were being updated in the light of the downward adjustment to the rates of the Home Financing Allowance and the reduction in the rates of the Private Tenancy Allowance from 1 April 2000;
- apart from the cost and benefit analysis, a more fundamental issue that needed to be resolved before the Administration could come to a clearer view on the viability of a HFS for the VTC was the disposal of the VTC's senior staff quarters. The quarters were financed by a private bank loan to be repaid, among other things, by installment through the Government's recurrent grant to the VTC. The outstanding loan amount was about \$100 million. Moreover, there was an understanding between the Government and the VTC that as and when the loan had been fully repaid, benefits would accrue to the Government through a reduction in recurrent grants; and
- the FB would continue discussions with the EMB and the VTC on the revised financial analysis and possible disposal arrangements that would yield the most benefits in the public interest. The FB would keep the Committee informed of developments and if a financially viable case existed, it would approach the Finance Committee for the necessary approval.

### Utilisation of swimming pools

79. According to paragraph 4.20 of the Audit Report, the utilisation rates of the swimming pools in the Institute of Vocational Education, Chai Wan and Tsing Yi campuses were low. The Committee therefore asked what measures the VTC had taken to increase the utilisation rate and to reduce the operation costs of the swimming pools.

## Management practices of the Vocational Training Council

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80. The **Executive Director, VTC**, in his letters of 20 December 1999 and 6 March 2000 in *Appendices 9 and 16*, replied that:

- during the opening session of the swimming pools in the Chai Wan and Tsing Yi campuses in 1999, the average number of users per day was 42. The average running cost per swimming pool for the year 1999-2000 was around \$1.2 million; and
- the measures to increase the utilisation rates of the pools included renting out the facilities to local schools, aquatic clubs and other local community organisations, organising aquatic activities with associated campuses like Nexus Swimming Gala, allowing part-time students to use the facilities and encouraging students and staff to bring guests.

81. **Conclusions and recommendations** The Committee:

### **Framework agreement and performance indicators**

- express concern that despite the fact that the Vocational Training Council (VTC) was established in 1982, a detailed Memorandum of Administrative Arrangement or a framework agreement between the VTC and the Government has still not been drawn up;
- note the Secretary for Education and Manpower's undertaking that he aims to finalise the framework agreement with the VTC towards the end of April 2000;
- recommend that the Administration and the Executive Director, VTC should:
  - (i) include in the framework agreement key output and outcome performance indicators for planning and measuring the results of vocational education and training services; and
  - (ii) promulgate such indicators in the Annual Estimates;
- wish to be kept informed of the progress in drawing up the framework agreement;

## Management practices of the Vocational Training Council

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- express concern that:
  - (i) the Government's subvention rules provide only broad guiding principles for the operation of the VTC;
  - (ii) the VTC was not placed in a position to judge what are the best practices expected of it by the Government in relation to matters such as the leave encashment scheme and the all-in pay package which the Government has an interest to know or may wish to express a view on; and
  - (iii) the public officers appointed to the VTC did not have a specific role to play insofar as advising the VTC as to what were the matters for which approval of the Government should be sought;
- acknowledge that the VTC is given a high degree of autonomy and not required to adhere to the financial rules of the Government, and its Financial Rules allow exceptions to be made;
- expect the VTC to follow voluntarily the best practices of corporate governance, in particular to examine the justifications put up for its approval critically and to approve exceptions sparingly;
- recommend that:
  - (i) the Secretary for the Treasury should review the Financial Rules of the VTC to ensure compliance with the new framework agreement and the relevant subvention rules. In particular, matters which are subject to the approval of the Government should be clearly set out;
  - (ii) since the VTC Ordinance does not require the appointment of a representative of the Finance Bureau to the VTC, the Administration should arrange for one of the public officers appointed to the Council to be responsible for reminding the Council of the Government's subvention rules; and
  - (iii) the Executive Director, VTC, as the vote controller, should then observe the requirement to seek prior approval from the Government where necessary in the light of the review and the new framework agreement;

## Management practices of the Vocational Training Council

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### Administration of remuneration and fringe benefits

- note that the Executive Director, VTC has agreed that he will take account of the conditions of service of staff in other tertiary institutions, subvented bodies and the Government, and that he will take prompt action to implement changes in conditions of service with the approval of the VTC;
- note that the Executive Director, VTC has undertaken to review the Staff Loan Scheme with the objective of introducing a requirement for an appropriate purpose for the loan and introducing repayments to be made on an interest plus principal basis;
- wish to be kept informed of the results of the review of the Staff Loan Scheme;
- express concern that despite the lack of a similar leave encashment scheme in the civil service and despite the fact that the scheme would involve additional public funding, the scheme had been implemented by the VTC without prior approval from the Government;
- express dismay that:
  - (i) the Executive Director, VTC had only relied on the findings of a casual enquiry when proposing to the Council to change the normal remuneration arrangement to an all-in pay package (including a monthly cash allowance in lieu of housing benefits, contract gratuity, etc.) in respect of a vacant senior staff position which was going to be filled by open recruitment, notwithstanding that there were vacant quarters and that the payment of contract gratuity should normally be made upon the satisfactory completion of a contract; and
  - (ii) having received 92 applications for the position in the recruitment exercise, the Executive Director, VTC still proceeded with the exercise without realising that the all-in package might have been too generous and the exceptional arrangement might not, therefore, be justified;
- express concern that the VTC, in granting approval for offering the all-in pay package, has not critically examined the justifications;
- wish to be kept informed of the results of the review when the contract with the senior staff member concerned is due for renewal;

## **Management practices of the Vocational Training Council**

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### **Procurement of goods and services**

- express concern that the VTC has acquired directly a package of advertising services from a television broadcasting company despite the fact that the services should have been procured by open tender in accordance with the Financial Rules;
- note the admission by the Executive Director, VTC that owing to the lack of knowledge of the tendering procedures, the Director of Marketing and Public Relations, who was a newly recruited staff member of the VTC, allowed the acquisition of advertising services without recourse to tender;

### **Building and use of senior staff quarters**

- express serious concern that despite the significant increase in the project cost of senior staff quarters, the VTC did not seek approval from the Secretary for Education and Manpower for the increase in project cost;
- note that the Executive Director, VTC has undertaken to seek approval from the Administration for significant changes in project cost in future building projects;
- express concern that the utilisation rate of the two swimming pools at the Chai Wan and Tsing Yi campuses was very low;
- acknowledge that the VTC has taken measures to increase the utilisation rate of the swimming pools, and urge the VTC to make the facilities available to local schools and community organisations;
- wish to be kept informed of the results of the action taken to increase the utilisation rate of the swimming pools;
- express grave concern that 15 of the 100 senior staff quarters were vacant and the notional rents for the vacant period are estimated at \$10 million;
- recommend that the Executive Director, VTC should take prompt and effective measures to deal with the problem of surplus quarters, having regard to the future demand for quarters by eligible staff; and
- wish to be kept informed of the cost and benefit analysis conducted by the Administration on the introduction of a Home Financing Scheme for the staff of the VTC, and the possible disposal arrangements for the VTC's senior staff quarters.

## **Management practices of the Vocational Training Council**

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## Chapter 3

### Water purchased from Guangdong Province

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The Committee noted that Audit had conducted a review to ascertain whether there was room for improvement in the planning of the purchase of water from Guangdong Province and whether the quality of Dongjiang raw water and that of treated water complied with the required standards. The major findings of the review were:

- since 1994, there had been an excess water supply from Guangdong Province mainly because water consumption in Hong Kong had increased at rates lower than those forecast. As supply exceeded demand, the water in the reservoirs often reached a high level, resulting in reservoir overflow whenever there was heavy rainfall. From 1994 to 1998, the overflow quantity was 716 million cubic metres (MCM). The financial implications could amount to \$1,718 million;
- the 1989 Water Supply Agreement (the 1989 Agreement), which was signed with the Guangdong Authority in December 1989, only provided that the Dongjiang water supplied to Hong Kong would meet the water quality standard of Guangdong Province currently in force and would not be inferior to the Environmental Quality Standard for Surface Water GB3838-83 Class II (the 1983 Standard). No agreement had been reached to include a provision in the 1989 Agreement requiring the supplier to comply with the Environmental Quality Standard for Surface Water GB3838-88 Type II (the 1988 Standard) which was comparable to other international standards and which had been used in the Mainland since 1 June 1988;
- in the 1998 Loan Agreement, which the Hong Kong Government signed with the Guangdong Authority to help finance a works project in Guangdong to improve the quality of Dongjiang water, there was no specific provision which required that the water supplied to Hong Kong should meet the 1988 Standard;
- the quality of Dongjiang water did not fully comply with the Mainland's quality standards for surface water;
- both the 1989 Agreement and the 1998 Loan Agreement did not contain a dispute resolution clause and a provision for penalty or compensation in case of non-compliance by either party with the terms of the agreements entered into, despite the fact that this was suggested by the Secretary for Justice in 1997;
- there was no agreed mechanism between the Water Supplies Department (WSD) and the Guangdong Authority for monitoring and reporting on the quality of Dongjiang water;

## Water purchased from Guangdong Province

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- additional recurrent costs of \$104 million were incurred for the years 1996-97 to 1998-99 for remedial measures undertaken to tackle the substandard quality of Dongjiang water. Capital costs of \$35 million had been incurred to upgrade the water treatment works; and
- the treated water quality did not fully comply with the aesthetic levels of residual chlorine of the 1993 World Health Organisation Guidelines for Drinking Water Quality (the WHO Guidelines) and the WSD's Final Treated Water Quality Targets for turbidity, aluminium and residual chlorine. The increase in chlorine dosage to treat water had resulted in an increase in the formation of Trihalomethanes (THMs) in the treated water.

### Quantity of Dongjiang water purchased

2. The Committee noted from paragraph 1.6 of the Audit Report that one of the provisions of the 1989 Agreement stated that:

“From 1995 onwards, upon completion of the extension works of the Dongshen Water Supply System (DWSS), the water quantity would be increased annually by 30 MCM, from 690 MCM in 1995 to 840 MCM in 2000, with the maximum annual supply of 1,100 MCM planned to be reached by 2008. Both sides would review the water supply situation each year. If there was a need for an ad hoc increase in supply to Hong Kong, the Guangdong Authority would do its best to accommodate such a request.”

While the 1989 Agreement had included a mechanism to increase the supply of Dongjiang water if necessary, there was no provision for a reduction in water supply if the growth rate of water consumption were to decline in Hong Kong. The Committee asked why no such provision was included and whether the Government had tried to request more flexibility in the water supply arrangement during the negotiation of the 1989 Agreement with the Guangdong Authority. The Committee asked whether the Government had made a wrong decision in signing an agreement which would last for 20 years and which had limited flexibility.

3. **Mr LEE Shing-see, Secretary for Works**, said that:

- prior to 1989, Hong Kong had gone through many periods of water restriction. Even a few years after 1989, Hong Kong still suffered from a shortage of water supply. With this background, it was clear that a long-term agreement

## Water purchased from Guangdong Province

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providing for regular supply of water to Hong Kong was necessary;

- a long-term water supply agreement was required because the quantity of water supply could not be adjusted readily. Additional water supply involved the provision of infrastructure which required considerable lead time for planning and implementation. Therefore, even if the quantity of water supply could be adjusted, there was little flexibility in the provision of infrastructure; and
- in formulating water supply strategies, the Administration could either adopt a lower-bound or an average demand forecast. Taking into account the situation in 1989, it had adopted the more conservative approach. The 1989 Agreement was therefore based on the lower-bound demand forecasts.

4. **Mr H B Phillipson, Director of Water Supplies**, also said that:

- Hong Kong needed the 1989 Agreement because it had to secure a long-term and reliable supply of water. The Guangdong Authority also asked for a long-term agreement because of their huge investments in infrastructure;
- when the 1989 Agreement was discussed, the growth rate of water consumption was estimated to be 3.5%. This was a lower-bound demand forecast because the trend at that time was 6%. The estimate of a 3.5% growth rate with the option of purchasing additional water at an increased cost of 10% was considered to be a pragmatic approach at the time. The fact that the Government had to purchase additional water for the first few years in the 1990s showed that the proposal was sensible; and
- the reason for not including a greater degree of flexibility in the 1989 Agreement was that the Guangdong Authority, which had already invested heavily in infrastructure for supplying water to Hong Kong, required a guaranteed return for a fixed period on its investment in Stage 3 of the DWSS.

5. In his letter of 23 December 1999 in *Appendix 17*, the **Secretary for Works** informed the Committee that:

- in the negotiation of the 1989 Agreement, the Government had requested more flexibility in the water supply arrangement such that the maximum and the minimum annual supply quantities could be specified to cope with fluctuations in annual rainfall and uncertainties in the long-term growth of

## Water purchased from Guangdong Province

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demand. The Government had also proposed that the Guangdong Authority would be notified in November every year of the actual quantity of water to be drawn from May to April in the following year. The Guangdong Authority rejected the proposal, as this would create major problems in planning their electricity requirements and other resources; and

- the 1989 Agreement was eventually signed on the basis that the supply quantities would match the lower demand projection, i.e. 3.5% with options for additional quantities to match the upper demand projection. In effect, a flexible arrangement had been provided.

6. According to paragraphs 2.14 to 2.16 of the Audit Report, the WSD had concluded in the 1992 Water Demand Forecast that the forecast water consumption would be less than the quantity supplied from Guangdong Province plus the mean rainfall yield from 1993 onwards, and that action should be taken to draw up a strategy to review in due course the water quantity to be supplied from Guangdong Province. The Administration then informed the Executive Council (ExCo) in 1993 that the growth rate of water consumption had declined due to the relocation of major water-consuming industries from Hong Kong to the Mainland. The WSD also estimated in the Water Demand Forecast, completed in December 1993, that the average growth rate of water consumption from 1994 to 2002 was 1.73%, which was 50% lower than the original estimate of 3.5%. The Committee asked:

- why, in spite of these developments, the Administration did not request the Guangdong Authority to reduce the supply of Dongjiang water at the business meetings held in July 1993 and May 1994 respectively; and
- whether the Administration had drawn up any strategy to review the water quantity to be supplied from Guangdong Province.

7. The **Director of Water Supplies** said that:

- in 1994, Hong Kong had just come out of several very dry years during which additional Dongjiang water had to be purchased. When the business meeting was held in May 1994, the yield from local rainfall had been less than average. The issue was therefore not raised at the meeting. However, there was very heavy rainfall later in the year;

## Water purchased from Guangdong Province

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- rainfall was a very unreliable source of water supply. The average yield in a normal year was 280 MCM. In an extremely wet year, there could be 500 MCM. In a very dry year, there could be as little as 70 or 80 MCM. Given this huge difference in the yield from rainfall, it was appropriate for the WSD to adopt a conservative approach;
- the primary objective of the WSD was to guarantee a reliable and safe water supply. The Director of Water Supplies had to ensure that there would be adequate water supply to meet the short-term needs and to establish the water consumption trend for long-term planning. As the water situation was not at all secure on a year-to-year basis in the early 1990s, it was decided in 1993 and 1994 that the short-term fluctuations did not justify a request for a reduction in water supply;
- it could be seen from Table 1 of the Audit Report that the actual water consumption in 1994 was 923 MCM. However, the agreed quantity supplied to Hong Kong was only 660 MCM. There was a difference of 263 MCM which had to be met by the yield from rainfall. Hong Kong would face a desperate situation if there were a drought year, because the level of reservoir storage was not high at that time; and
- in considering the accuracy of the forecast, one should not lose sight of the fact that the past seven years had been very wet. If it had been seven dry years, all of the water supplied to Hong Kong would have been consumed and there would not have been any overflow from reservoirs.

8. **Mr CHAN Pui-wah, Deputy Director of Water Supplies<sup>1</sup>**, added that:

- the original forecast of a growth rate of 3.5% was proven to be accurate in the first few years following the signing of the 1989 Agreement because additional water had to be purchased from the Guangdong Authority. It was not until 1992-93 that a surplus supply began to surface. The strategy that the WSD had adopted at that time was to closely monitor the trend of water consumption by conducting detailed reviews of the water demand forecasts;

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<sup>1</sup> Mr CHAN Pui-wah also attended the third public hearing on 25 February 2000 in his capacity as Acting Director of Water Supplies.

## Water purchased from Guangdong Province

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- the Administration notified the Guangdong Authority at the business meeting held in July 1993 that the growth rate of water consumption was declining. It had not made a formal request for a reduction in water supply because the declining trend of water consumption could not be established at that time. Although there was a decrease in industrial water consumption, the general public still required a reliable water supply. Moreover, any adjustment in quantity would affect the price of water. The WSD therefore decided to adopt a cautious approach in deciding whether the quantity of water supply should be reduced; and
- the local rainfall was lower than average in the first six months of 1994. As a result of a heavy downpour in July, the yield in that month was almost 50% of the total rainfall for the whole year. However, the long-term water consumption trend was still not clear in 1994.

9. With reference to Appendix D of the Audit Report, the Committee noted that the long-term annual mean rainfall was 2,214 millimetres and there was no substantial deviation from this figure in the two years preceding 1994. The recorded annual rainfall was 2,679 millimetres for 1992 and 2,344 millimetres for 1993. Taking into account the stable rain water supply and the increasing decline in the growth rate of water consumption, the Committee asked why the Administration had still not raised the issue with the Guangdong Authority in 1994. The Committee also asked whether the business meetings, which had for years been held in May/June, could be held after the rainy season so that more up-to-date information on the annual rainfall would be made available for discussion at those meetings.

10. The **Director of Water Supplies** said that:

- although the figures did not show a substantial variation in the yield from rainfall, there had been a continual problem of water shortage prior to and in the first few years of the 1990s;
- in 1988, the Administration had adopted a new target that there should be 99% reliability of water supply, which meant that the water supply system could cope with the worst drought scenario, i.e. a drought of 1 in 100 years. This new target was one of the considerations in the planning for water resources in the early 1990s;

## Water purchased from Guangdong Province

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- the Government had to purchase additional water from Guangdong Province and to build extra water supply facilities up until 1994. It only became clear in the latter part of 1994 and early 1995 that there was surplus water supply; and
- as regards the timing of the business meetings, the WSD had asked for this to be put back to the later months of the calendar year. The Guangdong Authority had not been enthusiastic about holding the meetings in the middle of the rainy season because they were fully occupied during that period. Whether the meetings could be held after the wet season was worth exploring.

11. Noting the above information, the Committee asked whether they could be provided with the relevant documents which set out:

- the conclusions made by ExCo after it had been informed of the decline in the growth rate of water consumption in May 1993;
- the recorded monthly rainfall for 1993 and 1994; and
- the conclusions of the WSD's studies, conducted in 1994, on the need for requesting extra supply from Guangdong Province.

12. In respect of the 1994 studies, the **Director of Water Supplies** said that these were internal studies conducted by the WSD to assess the latest water supply situation. The conclusion of the studies was that if the rainfall later in the year was not above-average, a drought situation would emerge and there would be a need to request extra water supply from the Guangdong Authority. However, the heavy rain in June 1994 quickly reversed the position.

13. In his letter of 23 December 1999 in *Appendix 17*, the **Secretary for Works** provided the Committee with the following information:

- it was a long-standing principle that ExCo papers and records of proceedings should be kept confidential to ensure the effective functioning and free exchange of views at the ExCo meetings. It had previously been accepted by the courts in Hong Kong that ExCo papers were analogous to Cabinet papers

## Water purchased from Guangdong Province

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and were therefore entitled to a high degree of protection from disclosure;

- the Finance Committee Paper No. FCC (89-90)8 (in *Appendix 18*) had summarised the proposals considered by ExCo at its meeting on 7 November 1989. There was no inconsistency between the information provided to ExCo and the Finance Committee;
- ExCo was informed in May 1993 that a decline in the growth rate of water consumption had been detected. This was due mainly to the relocation of major water-intensive industries to the Mainland. However, the trend of demand was still erratic at the time and the persistence of the decline had yet to be ascertained and quantified. Together with the difficulties involved in forecasting the yield from rainfall, it was considered premature to re-enter discussions on the 1989 Agreement on water supply quantities at that time;
- the monthly and annual rainfall from January 1989 to November 1999 together with the long-term mean rainfall was provided in Annex I of the letter; and
- in the first five months of 1994, the yield from rainfall was relatively low (only 43% of the long-term mean rainfall for the same period). Prior to the annual business meeting scheduled for May 1994, a review was conducted to assess the water storage situation and the demand projection at the time. It was concluded that there was no need to increase the 1994 supply quantities. There was exceptionally high rainfall in July and August, resulting in overflow from reservoirs in 1994.

14. The Committee noted from paragraphs 2.21 to 2.25 of the Audit Report that during the negotiations from 1995 to 1997, the Guangdong Authority had declined the Government's request for a reduction in water supply. The reasons which had been put forward were that any reduction would adversely affect the Guangdong Authority's plans and deny them a reasonable return, as the DWSS had been expanded to 1,100 MCM in 1994 based on the annual supply quantities proposed by the WSD in 1989 and would only produce a reasonable return 13 years after it had been in operation. Notwithstanding the fact that the 1989 Agreement did not provide a mechanism for the Administration to request a reduction in water supply, the Committee asked whether the Guangdong Authority's response was justified and whether the Administration had verified their claim about obtaining a reasonable return in 13 years.

## Water purchased from Guangdong Province

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15. The **Secretary for Works** said that:

- as far as the 1989 Agreement was concerned, there was flexibility in terms of an upward adjustment. However, there was no provision for any downward adjustment. As any revision to the agreement would have to be decided by both sides through mutual consultation, the Guangdong Authority had no obligation to respond to the Government's request;
- however, in the light of the discrepancy between the original and the subsequent forecasts and the prospect of excess water supply, it was appropriate for the Administration, as a responsible government, to raise the issue with the Guangdong Authority. The discussion had been conducted in an amicable manner. In fact, the Guangdong Authority had made some concessions. For example, it had agreed to reduce the daily supply rate in the event of overflow in Hong Kong due to heavy rainfall; and
- the 1989 Agreement did not contain any provision for a reasonable return. However, the Administration recognised that infrastructure required substantial investments and that it would take time for a return to materialise. In general terms, the Guangdong Authority's projection of a return in 13 years was reasonable.

16. The **Director of Water Supplies** also said that as far as he was aware, the Guangdong Authority had provided the Government with cost estimates of the projects which were to be shared between Hong Kong and Shenzhen. For a major investment which involved billions of dollars, this was a standard practice and the period of return was considered to be reasonable.

17. From paragraph 1.8 of the Audit Report, the Committee noted that in July 1998, the Government signed a loan agreement with the Guangdong Authority, i.e. the 1998 Loan Agreement. One of the provisions of the agreement was that the annual increase of water quantity would be reduced from 30 MCM to 10 MCM from 1998 to 2004. The Guangdong Authority also undertook to take into account the future water demand growth and the reservoir storage situation in Hong Kong in considering the future supply and not to insist on reaching the annual supply quantity of 1,100 MCM by 2008. The Committee were concerned about the bargaining power of the Government and asked:

## Water purchased from Guangdong Province

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- whether the above agreement had served to illustrate that the Guangdong Authority would agree to a reduction in water supply only if it could obtain an interest-free loan of \$2,364 million for the construction of the closed aqueduct;
- whether the Government had missed a golden opportunity to request more flexibility in the new agreement, as it had been known at that time that the total quantity of overflow from 1994 to 1998 was 716 MCM and that the potential overflow from 1999 to 2004 would be 596 MCM; and
- whether the Government would continue to negotiate for greater flexibility in annual water supply quantities to minimise the extent of overflow.

18. The **Secretary for Works** said that:

- the Government did not have much bargaining power in the negotiations with the Guangdong Authority over the reduction in water supply because there was no such provision in the 1989 Agreement. The Government had tried very hard to negotiate for a reduction, but failed;
- however, the provision in the 1989 Agreement about revising the terms of the agreement by mutual consultation had enabled the two sides to agree to alter the annual water supply quantities in the 1998 Loan Agreement. Though the reduction was not significant, it was better than nothing. Moreover, the water supply quantities after 2004 were still open to negotiation; and
- the Government would have another round of consultation with the Guangdong Authority soon. He would raise the issue with the Guangdong Authority again to consider how it could be resolved. However, a contract was a contract. It could only be altered with agreement by both sides.

19. Responding to the same questions, the **Director of Water Supplies** said that:

- it was not the case that there would be no overflow if the water supply quantity had been reduced. In the rainy season, overflow from reservoirs would inevitably occur when there was very heavy rainfall, because a certain level of reservoir storage would have been maintained to tide Hong Kong over

## Water purchased from Guangdong Province

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dry periods;

- although he agreed that it would be desirable to include more flexibility in the water supply agreement, the matter had to be considered very carefully. If the degree of flexibility was too high, there would be a risk of Hong Kong not getting the agreed quantity in the event of a drought occurring in Guangdong Province; and
- some flexibility in the daily supply had already been agreed upon. The ceiling for the reduction was 25% of the total quantity in a wet month.

20. The Committee noted that the Director of Water Supplies had pointed out in paragraph 2.40(e) of the Audit Report that limitations of the reservoir system also had a significant effect on the issue of reservoir overflow. The Committee asked whether there was an optimum level for reservoir storage and whether the Administration would consider increasing the capacity of the reservoirs so that there would be less overflow. The **Secretary for Works** said that:

- it would be difficult to determine an optimum level for reservoir storage because it varied from one season to another and according to the yield from rainfall. Generally, it would be desirable to keep a high storage level before the dry season began so as to maintain an adequate supply to the public;
- as the forecast on the growth rate of water consumption was on the high side, the reservoir storage level had always been high. The reservoirs overflowed when there was heavy rain. Some reservoirs could easily overflow especially during the rainy season because of their limited capacity;
- suitable sites had been identified in the past for the construction of reservoirs. However, there was a limited supply of these sites because of the topography of Hong Kong;
- in anticipation of a shortage of water resources in the longer run, the Administration would closely monitor the trend of water consumption. It would also continue to discuss with the Guangdong Authority the best arrangements for supplying water to Hong Kong; and
- the Administration was undertaking a study to find out whether there could be alternative sources of water supply other than Dongjiang and to ensure that water resources would be adequate to meet the growing demand in the long

## Water purchased from Guangdong Province

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term. The intention was to complete the study in 2000.

21. The **Director of Water Supplies** supplemented that:

- in view of the importance of having as much capacity as possible, the WSD had tried to exploit all possibilities for reservoir storage. The current strategy was to top up the storage at the end of each year so that there would be adequate supply for six months. This would tide Hong Kong over during the dry season from October to April; and
- within the limitations of the water storage system, the WSD had tried to minimise the quantity of overflow. This would be further improved if there was more flexibility in water supply.

22. Referring to paragraph 2.40(f) of the Audit Report, the Committee asked whether the Director of Audit would agree with the Director of Water Supplies' statement that the estimated costs of reservoir overflow in money terms were notional losses as they did not represent a real financial loss of the amounts stated. In reply, **Mr Dominic CHAN Yin-tat, Director of Audit**, said that this was a matter of how reservoir overflow was looked at. Savings could be achieved if less water had been purchased. It was a matter of judgement as to how much money could be saved. As regards the possibility that the unit price would have to be adjusted if greater flexibility were to be incorporated in the water supply agreement, he considered that it was a matter subject to negotiations.

23. The Committee noted from paragraphs 2.26 and 2.27 of the Audit Report that in June 1997, the WSD stopped drawing unneeded water from Guangdong Province in order to avoid wasting water due to overflow. In doing so, the WSD achieved some savings in the electricity cost of pumping operations although full charges for the agreed total annual supply were paid to the Guangdong Authority. However, the WSD did not take the same measure to reduce the overflow in 1998. The Committee asked why this was the case. The **Director of Water Supplies** said that if the reservoirs were not full, it would be prudent to accept the agreed quantity of water at the end of the calendar year. In the case of 1998, the drawing of the full amount of water had only increased the storage capacity of the reservoirs to the maximum level.

24. At the request of the Committee, the **Secretary for Works** provided, in his letter of 23 December 2000 in *Appendix 17*, information on the reservoir storage level in 1998. He also advised the Committee that the minimum storage which needed to be maintained

## Water purchased from Guangdong Province

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depended on a number of factors, such as water demand, the time of the year and the supply quantity of Dongjiang water. If the storage level fell below 200 MCM at any time, or below 300 MCM by the end of October, it would be regarded as a high risk level leading to possible supply failure. Owing to the erratic pattern of rainfall, the level of reservoir storage should be kept as high as possible to overcome any possible drought and to ensure a reliable supply to customers.

25. At the second public hearing on 4 January 2000, the **Secretary for Works** informed the Committee that the subject of incorporating a greater degree of flexibility in water supply had been discussed at the meeting held with the Guangdong Authority in mid-December 1999. The Guangdong Authority showed understanding of the situation in Hong Kong. They agreed to consider the matter further at the working group level and on the basis that any proposed scheme should be practicable and should not affect the return on investments.

26. At the request of the Committee, the **Director of Audit** reviewed the relevant documents kept by the Works Bureau and the WSD to ascertain the information provided by the Secretary for Works in relation to the efforts made by the Government in requesting a flexible approach in supply quantities during the negotiation with the Guangdong Authority. His observations were set out in his letter of 21 February 2000 in *Appendix 19*.

27. At the suggestion of the Committee, the **Secretary for Works** provided, in Annex A of his letter of 9 March 2000 in *Appendix 20*, further information to demonstrate the Administration's effort in negotiating with the Guangdong Authority for flexibility in the supply quantities of Dongjiang water and in seeking improvements in the water quality.

28. The **Director of Audit's** further comments on the additional information provided by the Secretary for Works were set out in his letter of 16 March 2000 in *Appendix 21*.

### Quality of raw water from Dongjiang

29. The Committee noted from paragraph 3.3 of the Audit Report that the 1989 Agreement stated that the water supplied to Hong Kong should meet the water quality standard of Guangdong Province currently in force and should not be inferior to the 1983 Standard. Noting that the Mainland had in June 1988 already adopted a more

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comprehensive and stringent standard, i.e. the 1988 Standard, the Committee asked why the Government did not ask for the 1988 Standard to be adopted in the 1989 Agreement.

30. The **Secretary for Works** said that according to his understanding, the 1989 Agreement was a product of negotiations over an extensive period of time, and the 1983 Standard was the water quality standard currently in force in the Mainland during the period. The **Director of Water Supplies** added that the 1983 Standard was a standard for raw water which required normal treatment process, and as such there was nothing wrong with adopting this standard in the 1989 Agreement. The **Deputy Director of Water Supplies** also said that during the negotiation with the Guangdong Authority and when the 1989 Agreement was signed, the Guangdong Province had not yet adopted the 1988 Standard. The 1983 Standard was therefore included in the 1989 Agreement.

31. The Committee noted that in the Finance Committee Paper on “Advance payment of water charges” dated 17 November 1989 (in *Appendix 18*), the quality of Dongjiang water and the stipulation of the 1983 Standard in the 1989 Agreement were not mentioned. According to the Notes on Decisions taken in Finance Committee on 17 November 1989 (in *Appendix 22*), the then Director of Water Supplies had provided Members with the following information:

“The Chinese authorities had re-affirmed that pollution control and any expenses related to it were the responsibility of China. A technical sub-group would be formed to discuss progress and make site visits to ensure that the project was progressing. The water to be supplied would be of a quality comparable to international standards and this would be monitored, but there was no safeguarding clause in the Memorandum of Understanding to allow for the repayment of the loan if the water quality became unacceptable. The Chinese authorities had guaranteed that they would do everything to keep the water quality up to standard and this was duly recorded in the verbatim record of meetings with them. The present quality was very acceptable. In the event of dissatisfaction, there could be an appeal to Beijing.”

In the light of the above, the Committee asked:

- whether the undertakings given by the Mainland authorities in 1989 had served to illustrate that the quality of Dongjiang water had been deteriorating;
- whether the Government had relied on those undertakings and requested the Guangdong Authority to protect and improve the quality of Dongjiang water; and

## Water purchased from Guangdong Province

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- whether there had been any appeal to Beijing.

32. The **Secretary for Works** said that:

- in the past few years, the quality of Dongjiang water had failed to comply with some of the parameters of the 1983 Standard. However, the quality of treated water had complied with the WHO Guidelines and the water was safe for consumption;
- the Guangdong Authority had been responsible for all expenses incurred for installing the treatment facilities in Guangdong Province. They had been kept up-to-date about the quality of Dongjiang water supplied to Hong Kong and had taken corresponding measures to improve the situation;
- the mechanism for appealing to Beijing had never been used because there was no need to do so; and
- the current situation was that the quality of Dongjiang water had improved significantly. With the completion of the closed aqueduct, expected to be in 2002, the Administration was confident that the water quality would be further improved.

33. In respect of the information provided by the then Director of Water Supplies at the Finance Committee meeting on 17 November 1989, the **Secretary for Works** further informed the Committee in his letter of 17 January 2000 in *Appendix 23* that:

- pollution control within Guangdong was always the responsibility of the Guangdong side. The costs of implementing the improvement measures were all borne by the Guangdong side;
- the 1983 Standard was comparable to the equivalent European standards at the time. The water quality was monitored through the water quality sub-group established under the provision of the 1989 Agreement; and
- it was the intention at the time to resolve any difference by mutual consultation. If there were any matter which could not be resolved through negotiation, it would be necessary to resolve it at the political level between the Central Governments.

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34. At the request of the Committee, Audit had reviewed the relevant records of meetings to ascertain the undertakings given by the Chinese authorities, as recorded in the Notes on Decisions taken in Finance Committee on 17 November 1989. In his letter of 21 February 2000 in *Appendix 19*, the **Director of Audit** pointed out, among others, that according to the notes of the first preliminary meeting of 28 January 1989 and the records of meetings with the Guangdong Authority held from 10 to 13 October 1989, there was no record of any discussion about the option of appealing to Beijing. According to the WSD's explanation, the statement that "in the event of dissatisfaction, there could be an appeal to Beijing" was based on the WSD's interpretation of the legal advice given by the then Attorney General's Chambers in 1989 that "In the event of breach of the agreement, the matter would be referred to and resolved by negotiations between the respective Governments at the political level."

35. With reference to paragraph 3.4 of the Audit Report, the Committee noted that for the 1998 Loan Agreement signed in July 1998, there was again no stipulation that the quality of Dongjiang water should comply with the 1988 Standard, despite the fact that this had been in force in the Mainland for eleven years. The Guangdong Authority only agreed to strive to improve the water quality to the 1988 Standard after the completion of the closed aqueduct project. Having regard to Audit's observation that the quality of Dongjiang water had been deteriorating due to rapid industrial and urban development in the DWSS drainage basin and along Dongjiang, the Committee asked:

- why the Administration had not made use of the opportunity in 1998 to require the water quality to comply with the 1988 Standard; and
- whether the quality of Dongjiang water supplied to Hong Kong had complied with the parameters specified in the 1983 Standard.

36. The **Secretary for Works** said that:

- as the quality of Dongjiang water had already failed to meet some of the parameters of the 1983 Standard at the time when the 1998 Loan Agreement was signed, the Administration, therefore, had to accept the fact that the 1988 Standard, which was more stringent, could not be achieved; and

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- as it would take time to combat pollution, the most important consideration was whether Guangdong Province had recognised the problem and adopted appropriate remedial measures. In the past few years, Guangdong Province had acted vigorously to improve the quality of Dongjiang water. The measures taken included building a biological nitrification plant in Shenzhen, moving Hong Kong's water intake point upstream to Tai Yuen, and constructing new sewage treatment works in the Dongjiang Valley area. Together with the construction of the closed aqueduct, the Guangdong Authority was confident that compliance with the 1988 Standard was attainable.

37. The **Director of Water Supplies** also said that:

- in 1989, the quality of Dongjiang water was satisfactory. It was only after the relocation of the industries from Hong Kong to Guangdong Province that the water quality began to deteriorate;
- except for two occasions in 1998 where the quantity of Dongjiang water had to be reduced because of substandard quality, the water treatment works in Hong Kong had always been able to treat the water received at the Muk Wu Pumping Stations to meet the safety standards for consumption by the public;
- there were very few raw water standards in the world. There was a European standard and there was not any in the United States. The water industry had accepted the fact that water had to be treated according to different standards. The key consideration was whether the water quality could meet the safety standards for consumption, and this had never been compromised;
- there had been continuous liaison with the Guangdong Authority at the working level to discuss issues relating to the quality of Dongjiang water. These included the annual business meetings and meetings of the Operation and Management Technical Sub-group. As a result of the discussions at these meetings, the Guangdong Authority had taken various measures to improve the quality of Dongjiang water; and
- the quality of Dongjiang water had improved significantly. This was demonstrated by the fact that the level of ammonia and manganese decreased by 73% and 46% respectively in 1999. This led to a reduction of 40% in chlorine dosage for treating water. After the completion of the closed

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aqueduct, there would be less contamination along the Dongjiang Valley and the Shima Valley. The water quality would then be further improved.

38. **Mr CHEUNG Tze-leung, Chief Chemist, Water Supplies Department,** supplemented that:

- after the commissioning of the biological nitrification plant at the end of 1998, the water samples taken at the Muk Wu Pumping Stations showed that the water quality had improved substantially, though it still failed to meet some parameters of the 1983 Standard in mid-1999. In terms of chlorine dosage, there had been a significant improvement. The total amount of chlorine used had decreased by 2,000 tons during the period April to November 1999; and
- the Guangdong Authority had been informed of the occurrence of substandard Dongjiang water in mid-1999. As the biological nitrification plant was the first and the biggest project of this nature in the world, the Guangdong Authority admitted that they had to gather more experience in monitoring the day-to-day operation of the plant, and undertook to improve the efficiency of the plant.

39. In his letter of 11 January 2000 in *Appendix 24*, the **Secretary for Works** provided the Committee with two charts showing the improvement in the levels of ammoniacal nitrogen and manganese in Dongjiang water at the Muk Wu Pumping Stations in 1999. This was indicative of the efforts made by the Guangdong Authority in improving the raw water quality.

40. At the request of the Committee, the **Director of Audit** commented in his letter of 19 January 2000 in *Appendix 25* that:

- the data provided in the two charts tallied with Audit's analysis of the daily water quality test data collected by the WSD at the Muk Wu Pumping Stations from 1989 to 1999; and
- to ascertain whether the quality of raw water from Dongjiang had improved, Audit had analysed the latest water quality test data of ammoniacal nitrogen and total manganese collected by the WSD at the Muk Wu Pumping Stations from January to December 1999. Audit's analysis revealed that the quality of Dongjiang water had improved when the data were compared with those in 1998 for ammoniacal nitrogen and total manganese. However, the water quality still failed to comply with the 1988 Standard for total manganese and

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the Guangdong Province's water quality control index value for ammoniacal nitrogen.

41. The Committee noted that in the Final Report of the East River Water Quality Study, which was conducted by the WSD and completed in 1996, the consultant had the following observation:

“The water from DWSS, however, will continue to be contaminated and its water quality will continue to deteriorate. Such phenomenon is common for water resources all over China. Pollution to environment is rampant and is uncontrolled.”

In the light of the consultant's observation, the Committee asked whether the construction of the closed aqueduct was the best measure to protect the quality of Dongjiang water and whether any other measures had been taken to ensure that the water would not be contaminated before it entered the closed aqueduct. The **Secretary for Works** said that:

- in dealing with the pollution problem, an integrated and comprehensive approach would be required. The Chief Executive had said in his recent Policy Address that an agreement had been reached with the Guangdong Provincial People's Government to make joint efforts to improve the environment;
- in order to improve the water quality, preventive measures should be carried out not only in the mid-stream or the downstream but also in the upstream of Dongjiang. The Guangdong Authority had expedited the implementation of the various treatment works projects, although more effective measures had to be adopted for better planning and control of land use;
- to avoid the pollution, the water intake point for Hong Kong had been moved upstream to Tai Yuen. There was a need to build the closed aqueduct because the Dongjiang water at mid-stream and downstream could be better protected even before the other measures were put in place; and
- according to the Administration's understanding, the water quality at the upstream of Dongjiang, where Hong Kong's water intake point was located, was up to standard.

42. Having regard to the fact that Shenzhen had moved its water intake point upstream to north of Huizhou which had been heavily polluted, the Committee asked why Hong Kong was getting water of poorer quality downstream near Huizhou while making

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substantial payments for the construction of the closed aqueduct and other treatment works along Dongjiang. Furthermore, as the Dongjiang water supplied to Hong Kong was of substandard quality and additional expenses had to be incurred to treat the water, the Committee asked whether the Administration had requested the Guangdong Authority to cover some of water treatment costs or, alternatively, requested the Guangdong Authority to reduce the quantity of water supply so that Hong Kong could correspondingly reduce some of the water treatment costs. The **Secretary for Works** said that:

- the issue should be viewed in a broader perspective. Other than to Hong Kong, Dongjiang was also supplying water to Shenzhen, Guangzhou and other parts of Guangdong with a population of twelve million. If Hong Kong were to move its water intake point further north, it would take away one-third of the Dongjiang water supply and there would be less water at mid-stream and downstream. This would affect the water distribution and supply system for the whole area. It was due to such considerations that the Guangdong Authority decided that it would not be feasible to move Hong Kong's water intake point further upstream and that it should remain at Tai Yuen;
- according to the Administration's understanding, Shenzhen and Guangzhou were equally concerned about the quality of Dongjiang water. The Guangdong Authority had given equal treatment to Hong Kong and had been very committed to protecting the water to be supplied to Hong Kong;
- as the improvement measures were undertaken by the Guangdong Authority, Hong Kong could only put forward suggestions. According to the Administration's understanding, the Guangdong Authority had devoted more resources to step up the various control measures. The existing treatment works projects, together with the closed aqueduct, should be adequate for protecting the quality of water to be supplied to Hong Kong. However, if the Guangdong Authority did not tackle other sources of pollution, the problem might worsen; and
- the Administration had raised the issue about the deterioration of water quality and the increase in water treatment costs during its recent meetings with the Guangdong Authority. The response which the Administration received was that it had to face the reality that the pollution could not be eliminated overnight. The most important step to be taken was to set reasonable and practicable targets, and the time-frame for achieving them. The Administration believed that the Guangdong Authority was working towards the right direction. However, the results of the measures to be taken had yet to be assessed.

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43. The **Director of Water Supplies** supplemented that:

- the cost of chemicals had decreased from \$30 million to \$20 million in 1999 because the water quality had improved. The cost of chemicals only accounted for less than 1% of the total costs of purchasing and treating the Dongjiang water, i.e. a few cents out of about \$5 per cubic metre. Hence, in comparison with the total costs, the expenses incurred for treating the Dongjiang water was not significant. However, there was no dispute that this should be reduced as much as possible; and
- the Guangdong Authority had invested heavily in various facilities to improve the water quality. The investments included \$200 million for the biological nitrification plant, \$70 million for the de-sludging project, over \$100 million for the sewage treatment works, \$500 million for the tunnel and sewage systems, and about \$300 million for the Tai Yuen Pumping Stations. These facilities were funded by the Guangdong Authority in response to the concerns expressed by Hong Kong. These investments were bearing fruits as the quality of water which Hong Kong received at the Muk Wu Pumping Stations was improving.

44. The **Secretary for Works** further advised the Committee in his letter of 19 January 2000 in *Appendix 26* that there should be clear distinction between the cost for pollution control within Guangdong and the cost of water treatment in Hong Kong. If it was considered that the quality of raw water was unacceptable for treatment, the Administration could demand a suitable reduction in the quantity of water supply and recoup the undrawn quantity when the water quality returned to the acceptable level. After the water was delivered to Hong Kong, it was the Administration's responsibility to treat the water up to the drinking water standard. There was no explicit provision under the 1989 Agreement for Hong Kong to claim any water treatment cost from the Guangdong side.

45. In his letters of 11 January 2000 and 19 January 2000 in *Appendices 24 and 26*, the **Secretary for Works** provided the Committee with a breakdown of the additional capital costs and recurrent costs incurred for upgrading the water treatment works in Hong Kong from 1993-94 to 1998-99. Detailed information on the various environmental protection measures adopted by the Guangdong Authority to protect the quality of Dongjiang water was set out in the Secretary for Works' letter of 17 January 2000 in *Appendix 23*.

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46. According to paragraphs 3.31, 3.32 and 3.38 of the Audit Report, there were discrepancies in the test results between the Guangdong Authority and the WSD and there was no legal remedy if the water supplied did not meet the stipulated quality standard. In paragraphs 3.42(g) and 3.42(h) of the Audit Report, Audit had recommended that the Director of Water Supplies should continue to negotiate with the Guangdong Authority a mechanism for testing the quality of Dongjiang water and an option of appointing an independent accredited body to monitor and report on the test results. In paragraph 3.42(b) of the Audit Report, Audit had also recommended that the Administration should consider the inclusion of a remedial clause in future water supply agreements which would state explicitly the rights of a party if the other party did not comply with the terms stipulated in the agreements, particularly those concerning water quality. The Committee asked whether any progress had been made in this regard and whether the Administration would publish on a regular basis the test results of both raw and treated water.

47. The **Secretary for Works** said that:

- the Guangdong Authority had never held back any test results from Hong Kong. The discrepancies in test results might be attributed to the fact that water samples had been taken at different locations and times. To overcome this problem, it had been agreed with the Guangdong Authority that water samples would be taken near the Tai Yuen Pumping Stations and at the Shenzhen Reservoir, and that the test results would be made available to the WSD on a regular basis. On the part of Hong Kong, water samples would be taken on a regular basis at the Muk Wu Pumping Stations for testing;
- the Administration was considering setting up an independent Advisory Committee to enhance transparency in monitoring and reporting on the quality of Dongjiang water and potable water in Hong Kong. Details on how the future test results should be published would be worked out by this new establishment which would comprise professionals and experts in monitoring water quality; and
- in respect of the inclusion of a remedial clause in the water supply agreement, the Administration had tried to strive for the best possible terms for Hong Kong during its negotiations with the Guangdong Authority. However, no agreement could be reached. At the meeting in mid-December 1999, the same request had been put forward, but was again rejected.

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48. The **Secretary for Works** further advised the Committee in his letter of 17 January 2000 in *Appendix 23* that the various established channels through which the water quality and improvement measures were discussed included the annual business meetings, the sub-group meetings and the Hong Kong/Guangdong Environmental Protection Liaison Group meetings. There were also other contacts at the working level. It was at these meetings that both sides exchanged the data for monitoring the water quality and discussed the protection and improvement measures to be followed up by the Guangdong Authority.

49. The Committee noted that in paragraph 3.43 of the Audit Report, the Secretary for Works had said that the Government had proposed the inclusion of a remedial provision for the reduction of the price for substandard Dongjiang water. However, the proposal had been rejected persistently by the Guangdong Authority. Having regard to the fact that the price of Dongjiang water had gone up considerably while the water quality had gone down in the past ten years, the Committee asked:

- whether the Administration would continue to request the Guangdong Authority to reduce the water price as a remedy for being provided with water of substandard quality;
- whether it would be practicable to peg the price to the quality of Dongjiang water so as to ensure good value for money; and
- whether the Guangdong Authority would ask for an increase in the price of water in return for providing Hong Kong with better quality Dongjiang water.

50. The **Secretary for Works** said that:

- a number of factors were involved in determining the price of Dongjiang water. As it was a subject under negotiation with the Guangdong Authority, it would not be desirable to comment on this aspect for the moment;
- the price of water had increased over the years. However, since 1999, the quality of Dongjiang water had improved. It should also be emphasised that the quality of treated water was up to international standards and was safe for consumption; and

## Water purchased from Guangdong Province

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- there was no dispute that the price of water should reflect the water quality. However, there were other considerations in determining the price of water. One of these was whether an alternative source of water supply was available to Hong Kong. According to the Administration's experience in negotiating the price of water, the Guangdong Authority had been very reasonable, the negotiations had always been conducted in an amicable manner, and the agreement reached was fair to both parties.

51. Referring to the statement made by the Chief Executive in his 1999 Policy Address that a Joint Working Group on Sustainable Development and Environmental Protection had been set up with the Guangdong Provincial People's Government, the Committee asked whether it would be appropriate for the Administration to bring the various issues relating to the deteriorating quality of Dongjiang water to this Joint Working Group so that any differences could be resolved at a higher level. The **Secretary for Works** said that:

- the quality of Dongjiang water had actually been included in the agenda of the Joint Working Group. However, the mode of operation of this Working Group was still under discussion; and
- the Administration would escalate the discussion on water quality to a higher level if it was considered appropriate to do so.

### Quality of treated water

52. Referring to Audit's observation in paragraph 3.40 of the Audit Report that the increase in chlorine dosage for treating water would result in an increase in the formation of THMs in the treated water, which allegedly would cause cancer, the Committee asked whether the Department of Health (DH) had been informed of the need to increase the chlorine dosage to treat the Dongjiang water and whether such information should be disclosed to the public. **Dr CHAN FUNG Fu-chun, Director of Health**, said that:

- as the DH was responsible for safeguarding public health and hygiene, it was concerned about the quality of potable water. The DH had maintained regular liaison with the WSD to ensure that the potable water could meet the required standards;

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- despite the fact that the chlorine dosage had to be increased to treat the raw water up to the WHO standards, the ratio of THMs in the treated water had not exceeded the level as stipulated in the 1993 WHO Guidelines. In fact, according to the data provided by the WHO, only one adult in a population of 100,000, who consumed two litres of water a day for 70 years, would contract cancer as a result of consuming water containing the THMs. However, the Administration would not be complacent and would monitor the trend closely;
- she would like to assure the public that the quality of potable water in Hong Kong could meet all the safety standards and was suitable for consumption. In the past, there had not been any major outbreak of diseases caused by poor water quality. Hence, the quality of potable water was not a matter of concern; and
- in respect of the disclosure of information, she understood that the independent Advisory Committee to be set up would consider how the data on water quality should be publicised.

53. In reply to the Committee's question on whether the quality standards of treated water should be specified in the Waterworks Ordinance, the **Director of Health** said that:

- although many countries had adopted the WHO Guidelines, the values specified therein were not mandatory limits. Care should be taken to select parameters for developing the local standards which would suit the local situation; and
- it would be desirable to include the quality standards in the relevant legislation because this could enhance transparency. However, as the WHO standards were public information and as the WSD was prepared to publicise the test results on a regular basis, the public would have no difficulty in monitoring the water quality. A higher degree of transparency would then be achieved.

54. On the same issues, the **Director of Water Supplies** said that:

- subject to the advice to be given by the independent Advisory Committee, the WSD was agreeable to increasing the transparency in disclosing the quality standards;

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- as the level of THMs in the treated water was substantially below the standards specified in the WHO Guidelines, which were very conservative, there was no cause for concern; and
- there was a need to legislate to give the quality standards legal effect in countries where the water authority was run privately. As a government department, the WSD was accountable to the public and there was no need to specify the quality standards in the Waterworks Ordinance.

55. The **Secretary for Works** also said that:

- he was not against legislating per se. However, the most important points to consider were whether the quality of treated water was up to the WHO standards and whether there was a high degree of transparency in the publication of the test results. As these issues would be monitored by the independent Advisory Committee, which would be formed in two to three months' time, there was no need to legislate at the present moment; and
- it was the responsibility of the Works Bureau and the WSD to ensure that the treated water could comply with the WHO standards. It would work with the Advisory Committee to monitor the quality of both raw water and treated water and to publish the test results.

56. The **Secretary for Works** supplemented in his letter of 11 January 2000 in *Appendix 24* that:

- at present, the Administration had the capability of ensuring that the treated water complied with the WHO Guidelines. As part of the continuous improvement exercise, the WSD regularly reviewed and updated their performance pledge and operational instructions;
- the Administration had planned to publish the pledged targets with regular announcements of key results on the quality of treated water. Transparency would be increased. The public could monitor the quality of treated water more effectively through this customer-oriented arrangement than specifying the quality standards in the legislation. The Administration therefore considered that it was not necessary to legislate on the quality of treated water at the present moment; and

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- however, the Administration would not totally rule out the possibility of legislating on the quality of treated water in the future should there be any change of circumstances warranting it.

57. The Committee noted that Audit had recommended in paragraph 4.23(d) of the Audit Report that the Director of Water Supplies should consider setting up a contingency plan for possible cryptosporidiosis and giardiasis outbreaks. The Committee asked whether any action had been taken in this regard. The **Secretary for Works** said that the WSD and the DH had formulated a contingency plan which were divided into two stages. In the first stage, if the parasites were detected but did not exceed the stipulated standards, then the treatment process would be reviewed and the water quality would be closely monitored. In the second stage, if the level had exceeded the standards, then the source of the problem would be identified and the public might be asked to boil the water before consumption. More detailed information on the contingency plan was provided by the **Secretary for Works** in his letter of 11 January 2000 in *Appendix 24*.

### Disclosure of information

58. At the third public hearing on 25 February 2000, the Committee pointed out that on three occasions (i.e. in the Committee's letters of 17 December 1999, 11 January 2000 and 22 January 2000), the Committee had asked to be provided with copies of the documents which were considered to be important documentary evidence which would demonstrate the efforts made by the Administration in striving for the best terms and conditions in the water supply agreements. However, the Secretary for Works had turned down the Committee's requests. The Committee asked why those documents could not be made available to the Committee and whether the decisions were made on the grounds of public interest.

59. The **Secretary for Works** said that:

- it was the practice for the Administration not to provide the public, including the Legislative Council (LegCo), with copies of ExCo Papers and records of meetings with the Guangdong Authority because they usually contained some information of a sensitive nature, for example, the strategies adopted by the Government in the negotiations of the water supply agreements with the Guangdong Authority. However, almost all of the information contained in those papers had been disclosed in the Administration's answers both at the

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public hearings and in the subsequent correspondence;

- he welcomed the Committee's suggestion of inviting Audit to review the relevant papers and make a report to the Committee afterwards; and
- he would seek legal advice to ascertain the relevance of the grounds of public interest to the Administration's decision not to provide the Committee with the relevant documents.

60. In reply to the Committee, the **Director of Audit** confirmed that Audit had reviewed all the relevant documents kept by the Works Bureau and the WSD.

61. The **Acting Director of Water Supplies** also said that the files which recorded the efforts made by the Administration in negotiating for the best agreements for Hong Kong were voluminous. Audit had access to all these files, though it was impossible for them to quote all the relevant information in the Audit Report.

62. From the Audit Report and the various information papers and minutes of meetings of the LegCo, the Committee noted the following sequence of events:

- the 1988 Standard, which replaced the 1983 Standard, took effect in the Mainland from 1 June 1988;
- in 1993, the Government raised its concern over the deteriorating quality of Dongjiang water with the Guangdong Authority;
- the former Secretary for Works had, under delegated authority, given approval to spend \$14.7 million in 1995 and \$13.8 million in 1997 to improve the chlorination facilities at various water treatment works (The relevant papers are in *Appendices 27 and 28*);
- the WSD commissioned a consultant in 1995 to study the deteriorating quality of Dongjiang water;
- in the Information Note for the meeting of the LegCo Panel on Environmental Affairs on 10 April 1997 (in *Appendix 29*), the Administration pointed out that:

“All our test results on the raw water from Guangdong have indicated that there is no quality trend change of any proportion that warrants material

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concern.....There is no indication of any significantly adverse change in quality.”

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Representatives of the Administration also said at the meeting that:

“the quality of raw water from Dongjiang had indeed stabilised. There was therefore no cause for alarm” (in *Appendix 30*);

- paragraph 3.16 of the Audit Report stated that:

“at the annual business meeting held in May 1997, the Guangdong Authority said that the quality of Dongjiang water was deteriorating and was a growing problem. Due to serious pollution along the DWSS, which was an open water channel, the Guangdong Authority planned to construct a closed aqueduct and sought financial assistance from the Government”;

- the Director of Water Supplies said at the Finance Committee meeting on 3 April 1998 that “the water supplied was clean at source, that it was up to the standard stipulated in the 1989 Agreement and was suitable for use and drinking” (in *Appendix 31*);
- the Deputy Secretary for Works said at the joint meeting of the LegCo Panels on Environmental Affairs and Planning, Lands and Works on 5 February 1999 that “the current quality of raw water from the main stream of Dongjiang water at the intake point was graded as meeting the national standard Class II, which was considered acceptable” (in *Appendix 32*);
- according to Audit’s analysis in Table 2 of the Audit Report, which was based on the water quality test data collected by the WSD at the Muk Wu Pumping Stations from 1989 to 1998, the quality of Dongjiang water, in general, failed to comply with some of the key parameters of the 1983 Standard; and
- a total of \$115 million of additional recurrent costs and \$35 million of capital costs had been incurred for water treatment since 1993.

With reference to the above, the Committee asked:

- why the Administration had not disclosed any information on the deterioration in the quality of Dongjiang water until the subject was first brought up at the LegCo Panel on Environmental Affairs Panel on 10 April 1997;
- whether the Administration had deliberately withheld the vital information on water quality from the LegCo and the public;

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- whether the Secretary for Works could assure the public that his former colleagues had tried their utmost to negotiate for the best terms and conditions in the water supply agreements; and
- whether the Administration had misled the LegCo and the public by stating at the various meetings that the quality of Dongjiang water was up to standard, even though there were clear indications at the time that the water quality had deteriorated.

63. The **Secretary for Works** said that:

- the quality of Dongjiang water at the intake point could basically comply with the 1983 Standard. The water quality deteriorated when it reached the reception point at the Muk Wu Pumping Stations because of the pollution along the way. As a responsible government, the Administration had to take remedial measures to treat the water. Additional expenditure had inevitably been incurred;
- the Administration had all along maintained that the quality of potable water in Hong Kong had complied with the WHO standards and was safe for consumption after treatment and, thus, there was no cause for concern;
- in deciding whether a document should be made public, the principle that had been adopted was whether the document contained sensitive information and whether the disclosure would affect future negotiations;
- in terms of providing information, the Administration had always been very forthcoming and had never hidden any information from the LegCo and the public. He believed that the specific information mentioned had been provided to the LegCo on various occasions such as the meetings of the relevant Panels and the Administration's replies to the LegCo questions. It was neither correct nor fair for anyone to make the comment that the Administration had not disclosed any information;
- in respect of the quality of Dongjiang water, the Guangdong Authority had never asked the Government not to disclose the relevant information; and
- he was satisfied that the departments concerned and the officers involved in the negotiations had tried their utmost to get the best possible agreements for Hong Kong.

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64. The **Acting Director of Water Supplies** also said that:

- at the Finance Committee meeting on 17 November 1989, the then Director of Water Supplies had rightly pointed out that the quality of the Dongjiang water supplied to Hong Kong was comparable to European standards. The 1988 Standard was not mentioned at the meeting because the Guangdong Province was still using the 1983 Standard at that time. It was only in 1991 that the Guangdong Authority officially adopted the 1988 Standard;
- it should be noted that water samples taken at different locations would show varying degrees of compliance with the water quality standards. Although the WSD's consultant had concluded that the quality of the raw water would continue to deteriorate, he had also pointed out in another part of his report that samples taken at the Shenzhen Reservoir indicated that the water quality was generally good. That was why the WSD's Assistant Director and Chief Chemist said at the meeting of the LegCo Panel on Environmental Affairs on 10 April 1997 that there was no cause for alarm;
- the Deputy Secretary for Works had correctly pointed out at the joint meeting of the LegCo Panels on Environmental Affairs and Planning, Lands and Works on 5 February 1999 that the quality of Dongjiang water at the intake point near Qiaotou, which was 80 kilometres away from Hong Kong, had complied with the 1983 Standard. It was during the delivery along the open channel that the water became polluted; and
- in respect of the provision of information, he was certain that the relevant information had been provided to the LegCo in the past. He would review the files and provide the Committee with the relevant documents.

65. In view of the fact that material information which indicated a deterioration in the quality of Dongjiang water was available at that time, the Committee asked the Acting Director of Water Supplies, if he were given another opportunity to participate in the discussion at the meeting of the LegCo Panel on Environmental Affairs on 10 April 1997, whether he would have presented the same information on the quality of Dongjiang water at the meeting. In reply, the **Acting Director of Water Supplies** said that the same information would have been presented at the meeting.

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66. Referring to the statement made by the then Director of Water Supplies at the Finance Committee on 17 November 1989 that in the event of dissatisfaction, there could be an appeal to Beijing, the Committee asked whether the then LegCo Members had been misled because the advice given by the Attorney General's Chambers only stated that "in the event of breach of the agreement, the matter will be referred to and resolved by negotiations between the respective Governments at the political level", and there was no provision of a mechanism for making an appeal to Beijing. The **Secretary for Works** said that:

- the 1989 Agreement was actually an agreement entered into by two regional governments because Hong Kong was still a British colony and Guangdong Province was a part of China. Hence, if any disputes arose, they should be resolved by the two governments at the national level. That was why reference had been made to Beijing; and
- it had been stated very clearly in the records that there could be an appeal to Beijing in the event of dissatisfaction. One could only rely on these records to guess what the intention was at that time.

67. The Committee were concerned that the failure to provide Members of the LegCo with accurate and complete information of a material nature might have affected the decisions made by Members in approving the relevant financial proposals, for example, the loan to the Guangdong Provincial People's Government for constructing the closed aqueduct. The Committee asked whether this had amounted to a dereliction of duty on the part of the officials concerned. The **Secretary for Works** said that:

- it all boiled down to a matter of transparency. The degree of transparency might be different at different times. It would be desirable for as much information as possible to be provided to the LegCo and the public so as to increase their understanding of the issues being discussed. There had been improvements over time and the Hong Kong Special Administrative Region Government had tried its best to be as transparent as possible. He agreed that all information which was relevant to a funding application should be disclosed;
- as regards the adequacy and relevance of the information as provided in the various papers and meetings in the past, he could only speculate on the intention of the officials concerned and the considerations that they had gone through in preparing the documents;

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- as to whether he would have disclosed more information if he were given the opportunity to go through the process again, he believed that there was no hard and fast rule and there was no one single answer. It all depended on the prevailing circumstances, the focus of the issue being discussed and the type of information which was required at the time. As a lot of information was available at that time, the officers concerned had to make a judgement as to whether certain information was relevant and therefore had to be disclosed. Ultimately, the decisions would rest with the judgement made by responsible officers in accordance with the circumstances of individual cases at the time; and
- he would review the relevant documents and provide the Committee with his views on whether more information should have been disclosed.

68. In his letters of 11 January 2000, 19 January 2000 and 9 March 2000 in *Appendices 24, 26 and 20*, the **Secretary for Works** supplemented that:

- the deterioration in the quality of Dongjiang water was first presented to the LegCo Panel on Environmental Affairs on 10 April 1997. It had not been brought up earlier because the water quality had not deteriorated to a level giving cause for significant concern;
- at both the meetings of the LegCo Panel on Environmental Affairs on 10 April 1997 and the Finance Committee meeting on 3 April 1998, the Administration advised Members that there was deterioration of the quality of Dongjiang water but the raw water could be treated to comply fully with the WHO standards. The Administration had never withheld any fact from the LegCo on the quality of Dongjiang water and had in no way misled the LegCo on these two occasions;
- the Administration had explained at the meeting of the LegCo Panel on Environmental Affairs on 10 April 1997 that the quality of Dongjiang water was found to have some deterioration. However, the problem was not serious. It had also been pointed out in the Information Paper that “although over the years, there have been some increases in the values of certain parameters, for example, turbidity, nitrate and chloride, they still remain well within acceptable levels”. However, as part of the forward planning to upgrade the water treatment capabilities in the longer term, the Administration considered it necessary to improve some of the chlorination facilities in good time. With such improvements, the Administration would be more capable of keeping the

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- quality of treated water fully within the required standards at all times even if the quality of raw water fluctuated;
- the Administration had not understated the situation in the Finance Committee Paper of 3 April 1998. The statement in paragraph 4 of the Paper that “the risk of pollution to the supply of water to Hong Kong has increased” appropriately reflected the prevailing situation at the time. Although there was a deteriorating trend in the quality of Dongjiang water, it was important to note that the treatment works continued to produce treated water in full compliance with the WHO standards. The treated water was always safe for consumption. It should also be noted that the Guangdong side had implemented mitigating measures to improve the quality of Dongjiang water. Initial improvements had been observed in 1999;
  - at the Finance Committee meeting on 3 April 1998, the Administration recommended the approval of a loan to help finance the closed aqueduct to be constructed by the Guangdong side. The assurance given by the Administration at the meeting was proper, as the raw water from the intake point at the Dongjiang mainstream, i.e. at source, was up to the standard stipulated in the 1989 Agreement. However, the water was vulnerable to contamination when it was delivered through the 80 kilometre long open channel. The closed aqueduct, when completed in 2002, would replace the open channel and prevent the deterioration of Dongjiang water during its delivery to Hong Kong;
  - the fact that Shenzhen was drawing water from Dongjiang near Huizhou was not mentioned at the Finance Committee meeting on 3 April 1998 because the project was only one of the local water resources schemes within Guangdong Province and was not directly related to Hong Kong;
  - the Administration had on various occasions explained to the LegCo that the quality of Dongjiang water actually varied at different locations along the transfer route starting from the intake point at Dongjiang mainstream through the 80 kilometre open transfer channel to Shenzhen Reservoir and subsequently to the reception point at Muk Wu Pumping Stations. Information on the quality of Dongjiang water was set out as follows:
    - (i) the quality of Dongjiang water at the mainstream intake point was in general up to the 1983 Standard;
    - (ii) due to pollution along the open transfer aqueduct in recent years, the Dongjiang water at Muk Wu Pumping Stations did not always comply

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with some of the parameters of the 1983 Standard; but

- (iii) the Dongjiang water received at Muk Wu was still in general acceptable for treatment, i.e. the water was safe for lifetime consumption after treatment to WHO standards. The Administration did on two occasions reduce temporarily the supply quantities because of unsatisfactory water quality. The undrawn quantities were subsequently recouped when the quality of Dongjiang water became acceptable for treatment;
- the grounds of public interest relevant to the present case were that the relevant documents contained negotiation strategies and commercially sensitive information which were highly confidential. Disclosure of the documents would undoubtedly jeopardize Government's position in future negotiations with the Guangdong Authority and inhibit free discussions between the parties over the purchase of water for Hong Kong which was an ongoing process in the years to come. The damage to public interest caused by the disclosure of the relevant documents therefore justified a claim for public interest immunity;
- as regards how much information should be included in the submission to the LegCo meetings, there was no hard and fast rule and there was no one single answer. It depended on the focus of the issue being pursued. Back in 1989, the Guangdong Authority had not adopted the 1988 Standard when the Administration submitted the funding application at the time. The 1988 Standard was only adopted in 1991. When the Administration sought funding to help finance the construction of the closed aqueduct in 1998, the LegCo was informed of the deterioration of Dongjiang water resulting from pollution along the transfer route;
- copies of the information papers presented to the LegCo Panels and the Administration's replies to the LegCo questions since 1997 on the quality of Dongjiang water were enclosed at Annex B of the letter of 9 March 2000; and
- the officers attending the relevant LegCo meetings were listed in Annex C of the letter of 9 March 2000. Their role was to present the relevant papers at the meetings and answer questions from Members. These officers were involved in preparing the papers which in fact represented the collective view of the Administration at the time.

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### The construction of the closed aqueduct

69. The Committee noted that in April 1998, the Provisional LegCo had approved a loan of HK\$2,364 million to the Guangdong Provincial People's Government to help finance the construction of a new closed aqueduct for conveying water from the Dongjiang to Hong Kong. (The relevant Finance Committee Paper is in *Appendix 33*.) The Committee asked why the Government had to provide a loan to the Guangdong Provincial People's Government.

70. The **Secretary for Works** said that the Guangdong Provincial People's Government was provided with the interest-free loan to help finance the closed aqueduct project to improve the quality of water supplied to Hong Kong. The loan had to be repaid in 20 equal yearly installments starting from the commissioning of the project or the year 2003, whichever was earlier. The total interest forgone from the loan was about HK\$2,000 million in money-of-the-day (MOD) prices. This amount would be more than offset by the total recurrent expenditure savings of some HK\$2,240 million in MOD prices achieved through the reduction in water purchased from Guangdong. Hence, on the whole, Hong Kong would benefit from this arrangement.

71. With reference to the findings of a research conducted by Dr HO Kin-chung of the Open University of Hong Kong in 1997 and 1998 (in *Appendix 34*), the Committee noted that the quality of Dongjiang water near Huizhou had failed to comply with some of the parameters of the 1983 Standard. The water quality had further deteriorated in 1998. The Committee were concerned that the effectiveness of the closed aqueduct would be undermined if the water upstream had been polluted and that this would result in a waste of resources. The Committee asked whether the Administration had requested the Guangdong Authority to improve the quality of the water near Huizhou.

72. The **Secretary for Works** said that:

- Dongjiang was a long river. The water intake point for Hong Kong was at Qiaotou where the water quality complied with the 1983 Standard. The quality of the water near Huizhou and Heyuan which were further north was even better and complied with the national Class I Standard. Pollution occurred in cities south of Huizhou. The test results were therefore dependent on where water samples were taken;

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- as Dongjiang water was also serving a population of 12 million in the Guangdong Province, the Guangdong Authority had been under pressure to ensure that the quality of Dongjiang water could meet the required standards. It had been very vigorous in implementing various environmental protection measures. However, it would take time for these measures to take effect; and
- as the quality of the water from Qiaotou was up to standard, it was necessary to build the closed aqueduct so as to ensure that the water from Qiaotou to Shenzhen was protected and was pollution-free.

73. As Qiaotou was south of Huizhou from where pollution started to occur, the Committee asked why the quality of the water at Qiaotou was still up to standard. The **Secretary for Works** said that water from the tributaries would dilute the water along the mainstream of Dongjiang and bring the water at Qiaotou up to standard.

74. According to paragraph 3.4 of the Audit Report, the Guangdong Authority had agreed to strive to improve the quality of Dongjiang water to the 1988 Standard after the completion of the closed aqueduct project. In this regard, the Committee asked whether there was a mechanism for the Administration to ensure that the Guangdong Authority would adhere to its undertaking. The **Secretary for Works** said that:

- the only way to improve the water quality was to implement environmental protection measures. The Guangdong Authority had shown much determination to improve the environment and had committed substantial resources to this cause;
- on the other hand, the Administration would monitor the water quality very closely and would provide the independent Advisory Committee with information on the test results so that it could consider ways of improving the water quality; and
- the Chief Executive of the Hong Kong Special Administrative Region and the Governor of Guangdong Province had made a Joint Statement in October 1999 to protect the environment and to set up a Joint Working Group on Sustainable Development and Environmental Protection. If substandard water were detected, the Chief Executive would be informed so that he could take it up with the Governor of Guangdong Province. At the same time, the LegCo

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would be provided with information on the situation. If the problem were very serious, the public would also be informed.

75. In his letters of 2 February 2000 and 9 March 2000 in *Appendices 35 and 20*, the **Secretary for Works** set out once more the Administration's comments on the closed aqueduct project and the efforts made by the Guangdong Authority to protect the quality of Dongjiang water in areas including Huizhou.

76. **Conclusions and recommendations**      The Committee:

- express dismay that, by agreeing to the terms and conditions contained in the 1989 Water Supply Agreement (the 1989 Agreement), the Administration had put itself in a disadvantaged position in its subsequent negotiations with the Guangdong Authority on both the quantity and quality of water which was to be supplied from Dongjiang, due to the fact that the Agreement committed Hong Kong to a long period of fixed supply quantity without:
  - (i) a mechanism for adjusting the annual supply quantities in the ensuing years which would take into account the reservoir storage level and the actual consumption level in the preceding year;
  - (ii) a mechanism for ensuring that the water supplied to Hong Kong would comply with the 1983 Standard and that the water quality standards would be reviewed and continue to be upgraded;
  - (iii) a mechanism for monitoring and reporting on the quality of Dongjiang water; and
  - (iv) a mechanism for dispute resolution and a provision for penalty or compensation in case of non-compliance with the terms of the Agreement by either party;
- express concern that prior to 1995, the Government had not raised with the Guangdong Authority the concern about the excess water supply with a view to setting up a mechanism to adjust the quantities of annual water supply, despite the fact that:
  - (i) there had been a drop in the growth rate of actual water consumption since 1990;
  - (ii) the industrial water consumption had decreased since 1990; and

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- (iii) the reservoir storage had continued to build up, resulting in reservoir overflow since 1992;
- express grave dismay and alarm at the statement made by the Secretary for Works at the public hearing on 4 January 2000 that, as the quality of Dongjiang water had already failed to meet some of the parameters of the 1983 Standard at the time when the 1998 Loan Agreement was signed, the Administration, therefore, had to accept as a fact that the 1988 Standard, which was more stringent, could not be achieved;
- express serious dismay that though the Government had attempted to negotiate with the Guangdong Authority for a reduction or a deferment of water supply since 1995, it had failed to capitalise on the opportunity to obtain more tangible results, when negotiating the 1998 Loan Agreement with the Guangdong Authority, by:
  - (i) insisting that the water supplied to Hong Kong complied with the 1988 Standard which had already been in use in the Mainland for eleven years and adopted by the Guangdong Authority since 1991;
  - (ii) requiring a remedial clause for substandard water, despite the fact that this had been suggested by the Secretary for Justice in 1997;
  - (iii) including a mechanism for monitoring and reporting on the water quality through an independent accredited body, so as to enhance effectiveness;
  - (iv) requesting an alternative source of water supply; and
  - (v) incorporating more flexibility in the Agreement for adjusting the annual supply quantities;
- express concern that the Water Supplies Department has cumulatively incurred additional recurrent costs of \$115 million since 1993 to tackle the problem of substandard quality of Dongjiang water, and another \$35 million as capital costs to upgrade the water treatment works;

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- condemn the Administration for having provided Members of the Legislative Council (LegCo) with inaccurate and incomplete information of a material nature, thereby influencing the direction of Members' discussion at the relevant meetings leading to the decisions to approve the financial proposals for making advance payment of water charges and a loan to the Guangdong Provincial People's Government for water quality improvement project. In arriving at this conclusion, the Committee have taken into account the following:
  - (i) the statement made by the Director of Water Supplies at the Finance Committee on 17 November 1989, that there could be an appeal to Beijing in the event of dissatisfaction with the quality of Dongjiang water, was factually incorrect;
  - (ii) material information relating to:
    - (a) the adoption of the 1988 Standard in the Mainland since 1 June 1988 and in Guangdong Province since 1991;
    - (b) the discussion with the Guangdong Authority on the deterioration of water quality as early as in 1993;
    - (c) the results of the consultancy study in 1996 which indicated that the quality of raw water would continue to deteriorate;
    - (d) the approval of \$14.7 million in 1995 and \$13.8 million in 1997 to improve the chlorination facilities at the various water treatment works; and
    - (e) a total of \$115 million of additional recurrent costs and \$35 million of capital costs having been incurred for water treatment since 1993,

was omitted from the papers submitted for discussion at the meetings of the LegCo Panel on Environmental Affairs on 10 April 1997 and 2 July 1999, the Finance Committee on 3 April 1998, and the joint meeting of the LegCo Panels on Environmental Affairs and Planning, Lands and Works on 5 February 1999; and

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- (iii) although the above material information was available at that time, the Administration still maintained at the Panel meeting on 10 April 1997, and subsequently at the Finance Committee meeting on 3 April 1998, that there was no trend in quality changes of any proportion which warranted material concern, that there was no cause for alarm and that the water supplied was clean at source and was up to the standard stipulated in the 1989 Agreement;
- express grave dismay and alarm at the statement made by the Acting Director of Water Supplies at the public hearing on 25 February 2000 that if he were given another opportunity to participate in the discussion at the meeting of the LegCo Panel on Environmental Affairs on 10 April 1997, he would have presented the same information on the quality of Dongjiang water at the meeting, even though the above material information which indicated a deterioration in the quality of Dongjiang water was available at that time;
- reject the explanation given by the Secretary for Works at the public hearing on 25 February 2000 and subsequently in the letter of 9 March 2000 that material information relating to the deterioration of Dongjiang water was not disclosed at the various LegCo meetings because it was not related to the focus of the issue being pursued;
- express concern that:
  - (i) the quality of the treated water did not fully comply with the aesthetic levels of residual chlorine of the 1993 World Health Organisation Guidelines for Drinking Water Quality (the WHO Guidelines) and the Water Supplies Department's Final Treated Water Quality Targets for turbidity, aluminium and residual chlorine;
  - (ii) notwithstanding the fact that the WHO Guidelines were revised in 1993, the Water Supplies Department's standards and Final Treated Water Quality Targets were based on the 1984 WHO Guidelines;
  - (iii) the monitoring of the quality of treated water is essentially a self-regulatory process of the Water Supplies Department because the Waterworks Ordinance or other legislation has not specified the parameters and the standards which the treated water should meet. This is not in line with international best practices; and

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- (iv) the Administration has not been more forthcoming in taking on the responsibility to publish test results of both raw water and treated water; instead, it has relegated this responsibility to the independent Advisory Committee on Water Supply which will be formed in early 2000 to discuss and make recommendations on issues related to water supplies;
- acknowledge that:
    - (i) the Secretary for Works and the Director of Water Supplies gave an assurance at the public hearing on 4 January 2000 that the quality of Dongjiang water had improved significantly since 1999;
    - (ii) through various channels and meetings, the Government will continue to urge the Guangdong Authority to step up measures to protect the quality of Dongjiang water;
    - (iii) the Government will continue to follow the WHO Guidelines including those relating to the level of residual chlorine in treated water;
    - (iv) the Water Supplies Department will regularly review and update the Department's performance standard;
    - (v) the Water Supplies Department, in consultation with the Department of Health, has formulated a contingency plan for possible Cryptosporidiosis and Giardiasis outbreaks; and
    - (vi) the subject on the quality of Dongjiang water had been discussed at the Hong Kong/Guangdong Environmental Protection Liaison Group Meetings held in November 1998 and March 1999;
  - urge the Administration to:
    - (i) continue to negotiate with the Guangdong Authority, with a view to:
      - (a) incorporating in future water supply agreements more flexibility in adjusting the annual supply quantities;
      - (b) stipulating a requirement that the water supplied to Hong Kong must comply with the 1988 Standard; and

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- (c) enabling Hong Kong to stop drawing unneeded water in order to avoid wasting water due to overflow and to achieve some savings in the electricity cost of pumping operations and treatment cost;
  - (ii) continue to discuss the subject of the quality of Dongjiang water at the Joint Working Group on Sustainable Development and Environmental Protection, and consider escalating the level of discussion to Beijing if the various issues raised cannot be resolved;
  - (iii) in line with international best practices, actively consider legislating on the standard of quality of treated water in accordance with the WHO Guidelines, so that consumers are given a statutory undertaking as to the quality of treated water;
  - (iv) publish on a timely basis the test results of both raw water and treated water and increase the transparency of the monitoring and reporting process through the establishment of the Advisory Committee on Water Supply at the earliest possible date;
  - (v) make public the presence of Cryptosporidiosis and Giardiasis in treated water if this has been confirmed by testing; and
  - (vi) expeditiously finalise the study on the local water storage level and alternative sources of water supply, and publish the study results as soon as available;
- recommend that the Administration should:
- (i) adopt a more pragmatic approach in determining a more reasonable storage level and formulating a strategy for planning water supply, in view of the exceptionally high reservoir storage level being maintained at present (99%). In doing so, factors such as the trend of water consumption, existing reservoir storage level and forecasts of future water demand should be taken into account;
  - (ii) explore alternative sources of water supply if the quality of Dongjiang water continues to deteriorate;

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- (iii) increase the local water storage capacity by enlarging the storage capacity of existing reservoirs and by building more reservoirs so as to reduce water overflow and to make better use of the cleaner water collected from rainfall;
  - (iv) include a dispute resolution clause and a provision for penalty or compensation in future water supply agreements;
  - (v) continue to explore with the Guangdong Authority the option of appointing an independent accredited body to monitor and report on the quality of Dongjiang water; and
  - (vi) shift the annual business meetings with the Guangdong Authority to the end of the wet season every year so that up-to-date information on the annual rainfall can be made available at the meetings;
- invite the Director of Audit to consider conducting a value for money study of the pricing mechanism for determining the price of Dongjiang water as a follow up to this report, taking into account the deterioration in water quality and the trend of rising prices; and
  - wish to be kept informed of the progress of:
    - (i) the project to build a closed aqueduct on a regular basis and its effectiveness in protecting the quality of Dongjiang water;
    - (ii) the establishment of the Advisory Committee on Water Supply;
    - (iii) the publication of the pledged targets and key results achieved on the quality of both raw water and treated water;
    - (iv) the study on the local water storage level and alternative sources of water supply;
    - (v) monitoring the quality of Dongjiang water near Huizhou;
    - (vi) the negotiations and discussions with the Guangdong Authority on the various issues relating to the quantity and quality of Dongjiang water supplied to Hong Kong; and

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- (vii) the discussion in the Joint Working Group on Sustainable Development and Environmental Protection on the quality of Dongjiang water.

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