



Linking people Delivering business 傳心意 遞商機

22 January 2016

Mr Anthony Chu
 Clerk to Public Accounts Committee
 Legislative Council Secretariat
 Legislative Council Complex
 1 Legislative Council Road
 Central
 Hong Kong

Dear Mr Chu,

**Public Accounts Committee
 Consideration of Chapter 5 of the Director of Audit's Report No. 65
 Operation of the Hongkong Post**

Further to our letter dated 8 January 2016, we set out in the ensuing paragraphs the requested information under items (a) to (c).

Hongkong Post operating as a trading fund

On items (a) to (c)

2. The Post Office Trading Fund is unique among government departments and trading funds.
3. Operating as a trading fund, HKP is required to run its business on commercial principles. However, as a government department, HKP is subject to various institutional requirements related to manpower management (including the requirement to manage its civil servants in accordance with the Civil Service Regulations and all other rules and guidelines promulgated by the Civil Service Bureau (CSB) on the management of the civil service, and to strictly follow the civil service remuneration system such as the pay scales determined for the respective grades and ranks as well as the annual civil service pay adjustment), financial management (e.g. payment of civil service on-

costs¹ and payment of dividends to the Centre²), procurement (including procurement of stores and services as well as the conclusion of revenue contracts), etc. This constrains HKP's ability to respond to changes in market conditions and customer demands quickly.

4. Although under section 6(1) of the Post Office Ordinance (Cap. 98), HKP enjoys a monopoly over letters, which is intended to support the discharge of Government's universal service obligation, this monopoly has not been enforced for many years. While HKP's operation is subject to regulatory oversight, the postal and courier market in Hong Kong is entirely open with a low entry threshold and an absence of any requirement on regulatory compliance.

5. While HKP bears the responsibility to discharge Government's universal service obligation, its competitors may freely decide their service scope in terms of service type and geographical coverage. As a result, these competitors are diverse in their lines of business and scale of operation. Generally speaking, they tend to focus on profitable business areas (e.g. delivery to high density areas at relatively low charges due to lower costs, operating international delivery for a single destination/limited destinations for which cheaper air conveyance capacity is obtained, large couriers offering significant volume bulk discounts to selected customers, etc.). Non-profitable business, e.g. delivery to outlying islands which HKP has to serve under the universal service obligation, is left to HKP.

6. Although the proportion of social mail has dropped significantly in recent years due to e-substitution, the public generally still views HKP as providing a social service and resists it when HKP implements justified measures to improve its finances (e.g. closing loss-making post offices which have a lower service demand, adjusting postage rates and postal fees to improve costs recovery, etc.). At the same time, new services introduced by HKP could be quickly emulated at lower costs and lower prices. HKP also faces criticisms that it is competing with the market for profits.

7. HKP is essentially an industrial operation in a highly competitive market. While acknowledging the role of HKP in ensuring the continued provision of quality postal and related services at affordable prices to the community at large, in order to support its viable operation as a trading fund, there is scope for

¹ On-costs for civil servants refer to the expenditure on pensions and other fringe benefits such as housing benefits, medical and dental benefits, etc. Such expenditure is borne by the Centre centrally and HKP is required to pay on-costs to the Centre for the civil servants in its workforce. The on-costs attributable to pension payment is calculated based on the actuarial assessment, i.e. it is a contribution based on actuarial calculations to cover Government's future liability for pension payment. The rate of on-costs payment is adjusted by the Treasury periodically and is set at 34.39% of basic salary with effect from 1 August 2015.

² The POTF's dividend payment is based on its total comprehensive income and the dividend payment ratio is currently set at 50%.

providing a higher degree of institutional flexibility³ to HKP. In addition, when setting the target rate of return of the Post Office Trading Fund (POTF) and assessing its performance, due consideration should be given to its unique circumstances as outlined above and a holistic assessment should be made on the basis of HKP's overall operational and financial performance against the constraints inherent in its status as a government department.

8. During the last few years, HKP has made persistent effort to improve its operational and financial performance. As a result of such effort, operationally HKP fully achieved all its pledged performance standards in 2013-14 and 2014-15. Financially, through the implementation of a combination of measure to manage costs and generate revenue, the POTF's financial performance has improved significantly from an operating loss of \$114 million in 2012-13 to an operating profit of \$168.7 million (or a rate of return of 4.9% on ANFA) in 2014-15 albeit still falling short of its target rate of return of 5.9%.

9. In the process, we have made attempts to seek relaxation of some of the institutional limitations on HKP's operations. Such attempts in the past five years included:

- (a) In 2004, we obtained approval from the Financial Services and Treasury Bureau (FSTB) for waiving payment of dividend of \$21.5 million for 2003-04 so that the POTF could make continued investment for its future sustainable development by augmenting its reserve. We will continue to explore with FSTB whether there can be a modified arrangement that will better cater for the POTF's unique circumstances in FSTB's ongoing review on the optimum reserve level for trading funds;

³ The POTF:

- (a) is exempt from General Regulation (GR) 267, which provides that "Commercial transport may be hired for official journeys and approved home-to-office journeys only when no suitable departmental or pool transport is available. Heads of Departments must seek approval from the Director of Government Logistics before hiring vehicles other than taxis the use of which is governed by Civil Service Regulations 722(2)(e) and Civil Service Regulation 734(1)";
- (b) is exempt from GR 601, which provides that "Bureaux and Departments must channel all printing work through the Director of Government Logistics" (please see paragraph 9(e));
- (c) may negotiate for exemption from other procurement, supplies and financial regulations which are generally applicable to government departments; and
- (d) may negotiate to be untied from government departments which provide services to them.

- (b) The POTF is required to pay notional market rental on premises leased from the Government. The notional market rental for the Airport Post Office has been waived by the Government since April 2006. Subject to annual approval by the Government, the notional market rental for Tsim Sha Tsui Post Office has been waived since 2009-10 and the notional market rentals for another six post offices have been waived since 2011-12. We will continue to discuss the longer-term arrangements with FSTB;
- (c) In 2013, we obtained agreement for HKP to adjust the bulk postage rates for Local Mail and Air Mail on its own having regard to its costs and market conditions so that HKP may make more diverse service offerings in response to customer needs and recover costs in a more timely manner;
- (d) In 2014, we obtained approval from FSTB to modify the investment guidelines applicable to the POTF so as to allow the POTF more flexibility when investing its surplus funds. In 2011 and 2014, we sought and obtained FSTB's policy support in making investment placements with the Hong Kong Monetary Authority to generate income from the POTF's surplus funds;
- (e) In 2014, we obtained approval from Government Logistics Department (GLD) to procure printing service directly from outside contractors for all our departmental forms and stationery as well as philately-related products of non-classified nature;
- (f) In 2014, we raised concerns about the prevailing arrangement governing the POTF's payment of on-costs for civil servants in HKP. Such payment imposes a significant financial burden on the POTF. HKP is pursuing the matter with Treasury; and
- (g) HKP pays market rents, which are set by reference to the rateable values of the premises concerned, for ten government premises taken up by various operational units. In 2015, we requested the Rating and Valuation Department (RVD) to review these rateable values taking account of the restrictions on land use and the nature of these premises as government property. To date, the rateable value of one of the premises has been reduced. We await the review outcome of the remaining nine premises.


10. In addition, in 2014 and 2015 we made headway with untying from the Electrical and Mechanical Services Trading Fund (EMSTF) for the provision of maintenance service for selected non-mission critical equipment as well as maintenance service for selected departmental vehicles. The process is taken forward in a step-by-step manner in order to ensure uninterrupted provision of essential services in HKP.

11. We will build on the effort made hitherto and pursue with relevant bureaux/departments additional measures to provide a conducive environment for the POTF's sustainable development in the long run. This is essentially through enhanced flexibility to assist HKP in (i) costs management so as to improve the price-competitiveness of its services; (ii) cost recovery with more streamlined procedures for adjusting postage rates and charges for miscellaneous services; and (iii) business development to generate revenue. Measures under our consideration include:

- (a) determination of the target rate of return of the POTF* – The existing target rate of return was set by reference to, among others, listed companies in the postal and courier sector worldwide (please refer to ~~Appendix 53 FSTB's reply to the PAC dated 4 January 2016~~). As HKP remains a government department and it carries the responsibility to discharge Government's universal service obligations for postal services, we will pursue with FSTB whether and how allowance could be made when setting the target rate of return of the POTF in view of the inherent constraints of such a status and responsibility on HKP's commercial operation in the review to be conducted this year on the target rates of return for trading funds;
- (b) streamlining the statutory provisions on the scope of HKP's service and the postage/postal fee adjustment mechanisms* – The Post Office Ordinance (Cap. 98) and the Post Office Regulations (Cap. 98A) predate the establishment of the POTF. They are too restrictive in places (e.g. detailed arrangements for the operation of some of HKP's services such as Post Office box service, mail redirection, philately, etc., as well as the service charges, are laid down by statute). Any adjustments to the service features in the light of evolving customer needs and any revisions of service charges in order to recover escalating costs can only be made by means of legislative amendments. We will conduct a review on these statutory provisions and identify room for improvement, if any;
- (c) human resource management* – As a government department, HKP is primarily staffed by civil servants and their management has to comply with service-wide rules and regulations. Although HKP has a long history of employing contract staff to cope with peak periods of mail traffic, even before the establishment of the POTF in 1995, the management of all contract staff in HKP was subsumed under the Non-Civil Service Contract (NCSC) Scheme upon its service-wide introduction in 1999. We will explore with CSB whether there are appropriate arrangements for engaging contract staff that are more attuned to the manpower requirements of HKP, and whether and how recruitment processes can be streamlined;

- (d) *financial management and procurement* – We will continue to explore with FSTB and other relevant departments measures to provide additional flexibility for the POTF, including those items stated in paragraph 9 above and this paragraph as appropriate; and
- (e) *review of the Framework Agreement concluded between the Secretary for Commerce and Economic Development and the Postmaster General* – The Framework Agreement is due for review in 2016. We will take the opportunity to examine if there is scope for enhanced flexibility to facilitate the POTF's operations, in addition to the matters raised in paragraph 11 (a) to (d).

Yours sincerely,



(Lorrience Chow)
for Postmaster General

c.c. Secretary for the Commerce and Economic Development
Secretary for Financial Services and the Treasury
Director of Audit