

## **CHAPTER 3**

### **THE GOVERNMENT OF THE HONG KONG SPECIAL ADMINISTRATIVE REGION**

#### **GENERAL REVENUE ACCOUNT**

#### **CAPITAL WORKS RESERVE FUND**

#### **GOVERNMENT DEPARTMENTS**

#### **Government Supplies Department**

#### **Information Technology Services Department**

<b>Procurement and management of government supplies</b>
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# PROCUREMENT AND MANAGEMENT OF GOVERNMENT SUPPLIES

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# PROCUREMENT AND MANAGEMENT OF GOVERNMENT SUPPLIES

## Summary and key findings

A. **Introduction.** The Government Supplies Department (GSD) is the central procurement agent for goods required by government departments and certain non-government public bodies (e.g. the Hospital Authority). Audit has recently conducted a review of the procurement of goods commonly required by departments and the effectiveness of the GSD in assisting departments to manage their supplies activities. Audit has found that there is room for improvement in a number of areas (paras. 1.1 and 1.4).

B. **Need for review of procurement of common-user items.** Since February 1995, the GSD has conducted price comparison studies of common-user items. The more recent studies indicated that the GSD's purchase prices of all selected items were lower than the middle retail prices obtained by the GSD. Audit noted that the GSD examined the prices of only 316 items in the last five price comparison studies (i.e. 19.4% of the total of 1,631 items held in the GSD's warehouse as at 31 March 2001). For 1,303 items or 79.9% of all items, the target stock turnover rate of five times a year was not achieved in 2000-01. The amount of money tied up in the average stockholding for these 1,303 items would have been reduced by \$35.3 million in 2000-01, had the GSD achieved the target stock turnover rate of five times a year. In particular, for 568 items with stockholding totalling \$15.2 million as at 31 March 2001 and with a stock turnover rate of lower than 0.5 time a year in 2000-01, the GSD's average stockholding would meet users' requirements for up to 100 years or more. The Government will suffer losses if these dormant or slow-moving items become obsolete or unwanted by users (paras. 2.8, 2.11 and 2.15 to 2.17).

C. **Need for review of procurement of microcomputer/network systems.** The Information Technology Services Department (ITSD) is the Government's information technology adviser and service provider. Audit's analyses of the findings of the ITSD's price benchmark studies revealed that certain microcomputer/network systems and related products were purchased at higher than market prices by departments during the period January 1998 to March 2001 (paras. 3.1 and 3.11). Audit notes that the flexible procurement procedures adopted by the GSD since January 2000 do not provide adequate assurance that products are purchased at the lowest market prices because:

- (a) there is inadequate competition as departments are only required to obtain at least five quotations from the selected contractors (para. 3.13(a));
- (b) departments are not required to advise the GSD what they intend to buy so as to enable the GSD to aggregate their requirements and to obtain better offers from the contractors (para. 3.13(b)); and

- (c) for some purchases, departments did not obtain the required number of at least five quotations. This was because there were only a small number of contractors and some of them did not respond to the departments' invitations for quotation (para. 3.13(c)).

**D. Need to improve the ITSD's Product Selection Guide.** Audit notes that departments are free to choose any particular microcomputer/network systems and related products in the market which they consider appropriate provided that they have the required funds. However, the ITSD's Product Selection Guide does not provide sufficient guidelines to help departments purchase hardware products cost-effectively. For example, the Guide does not say under what circumstances a liquid crystal display (LCD) monitor should be acquired, instead of a cathode ray tube (CRT) monitor. In 2000-01, the average price of a 15-inch LCD monitor was \$5,851, whereas that of a CRT monitor was only \$905. If departments had only purchased CRT 15-inch monitors instead of LCD 15-inch monitors, the total expenditure in 2000-01 for computer monitors would have been reduced by \$19 million (paras. 3.21 and 3.22).

**E. Need to enhance supplies management in departments.** During the period 1998-99 to 2000-01, the GSD found cases of non-compliance with the Stores and Procurement Regulations (SPR). For example, departmental store or administrative units had not followed the required procedures for direct purchases of stores, or had not performed the required stock verifications. The Finance Bureau of the Government Secretariat and the GSD did not receive all the half-yearly returns on losses or deficiencies of stores from departments. Some officers had been surcharged in a number of cases of loss of stores but not others in similar cases. Audit considers that there is a need for the GSD to ensure compliance with the SPR by departments. There is also a need to provide departments with more detailed guidelines on the processing of cases of loss of stores (paras. 4.12 to 4.23).

**F. Audit recommendations.** Audit has made the following main recommendations:

(a) the Director of Government Supplies should:

- (i) improve the effectiveness of the GSD's price comparison studies on the common-user items (para. 2.19(a));
- (ii) for those stores items with low stock turnover rates, ascertain the reasons and implement measures to achieve the target stock turnover rate (para. 2.19(c));
- (iii) investigate the circumstances leading to the keeping of excessive stocks for the dormant or slow-moving stores items and improve the provisioning procedures to prevent similar recurrence in future (para. 2.19(d));
- (iv) for the dormant or slow-moving stores items, review the demand for them with the users and dispose of any unwanted items as soon as possible (para. 2.19(e));
- (v) provide adequate training and instructions to the Supplies Grade staff to enable them to manage the departmental supplies activities more effectively in accordance with the SPR (para. 4.24(a));

- (vi) regularly remind Controlling Officers of the importance of ensuring compliance with the SPR and draw their attention to the common non-compliance cases (para. 4.24(b)); and
  - (vii) adopt a risk-based approach in conducting stores verifications of departments by inspecting more frequently those store units with unsatisfactory past performance. This will help ensure that effective and timely improvement measures are taken (para. 4.24(c));
- (b) the Director of Government Supplies and the Director of Information Technology Services should:
- (i) establish procedures for aggregating departmental requirements for microcomputer/network systems in order to obtain bulk purchase discounts (para. 3.25(a));
  - (ii) in warranted cases (e.g. major upgrading and replacement of computer equipment), conduct an open and separate tendering exercise for bulk purchases of microcomputer/network systems in order to increase competition among suppliers and to obtain the best prices available from the market (para. 3.25(b));
  - (iii) issue guidelines to departments indicating the circumstances under which they should negotiate with the contractors for better offers (para. 3.25(c));
  - (iv) take action to ensure that all contractors submit their quotations within the time limit specified in the contract upon receipt of requests from departments (para. 3.25(d));
  - (v) if Standing Offer Agreements similar to the existing ones are to be adopted in the next open tendering exercise, increase the number of contractors in each category of microcomputer/network system products in order to further increase competition among the contractors (para. 3.25(e)); and
  - (vi) enhance the ITSD's Product Selection Guide so that departments are fully informed about the practical functions of similar hardware products (e.g. LCD vis-à-vis CRT monitors) and to enable departments to select products with due regard to their practical functions and cost-effectiveness (para. 3.25(h)); and
- (c) the Secretary for the Treasury and the Director of Government Supplies should implement checking procedures to ensure that departments have exercised properly their delegated authority for writing off losses or deficiencies of stores (para. 4.25).

G. **Response from the Administration.** The Administration generally accepts the audit recommendations.



## **PART 1: INTRODUCTION**

### **Functions of the Government Supplies Department**

1.1 The Government Supplies Department (GSD), with an establishment of 439 posts as at 31 March 2001, is the central procurement agent for goods required by government departments and certain non-government public bodies such as the Hospital Authority. The GSD prepares tender documents, formulates tendering strategies, calls tenders, evaluates tenders in conjunction with the users, negotiates with tenderers for better offers where appropriate, awards contracts and monitors contractors' performance. In 2000-01, the GSD procured a total of \$5,454 million of goods for the users.

1.2 Apart from the procurement of goods required by specific users, the GSD is responsible for the provisioning, storage and distribution of a wide range of common-user items used in the public service. These items, known as "unallocated stores", are purchased in bulk and kept in the GSD's warehouse for acquisition by users as and when required.

1.3 The GSD is responsible for the management, including the recruitment, posting, promotion and training, of Supplies Grade staff. As at 31 March 2001, 1,133 Supplies Grade staff were posted to 64 departments to help them manage their supplies activities. The GSD conducts regular examinations of the supplies activities in departments to ensure that they are effectively managed in accordance with the Stores and Procurement Regulations (SPR) made by the Financial Secretary under section 11(1) of the Public Finance Ordinance (Cap. 2).

### **Audit review**

1.4 Audit recently conducted a review of the procurement of goods commonly required by departments, including the common-user items purchased in bulk by the GSD and the microcomputer/network systems purchased by departments under the special procurement arrangements made by the GSD. The audit also examined the effectiveness of the GSD in assisting other departments to manage their supplies activities. The results of the audit indicate that there is room for improvement in a number of areas. The audit findings are given in PARTS 2 to 4 of this report.

## PART 2: PROCUREMENT OF COMMON-USER ITEMS

### Background

2.1 Common-user items purchased by the GSD are firstly paid for from a suspense account. The purchased items are delivered by suppliers to the GSD's warehouse in Chai Wan. After completing the inspection procedures, the items are stored in the warehouse.

2.2 Upon receipt of orders for common-user items from government departments, the GSD delivers the items to them. The cost of the items is recovered from the users' departmental expenses vote. In 2000-01, the GSD purchased \$314 million of common-user items, and the users acquired \$331 million of such items from the GSD. Table 1 below shows the different types of common-user items held in the GSD's warehouse as at 31 March 2001.

Table 1

Common-user items held in the GSD's warehouse as at 31 March 2001

Type of stores	Number of items	As percentage of total number of items	Value (\$ million)	As percentage of total value
Medical stores	377	23.1%	33.7	50.5%
Electrical stores	220	13.5%	9.6	14.4%
Printed stationery stores	531	32.5%	6.6	9.9%
Textiles and uniform	117	7.2%	5.7	8.6%
Household and cleansing materials	111	6.8%	3.3	4.9%
Office sundries	91	5.6%	3.2	4.8%
Civil and light engineering stores	83	5.1%	2.1	3.1%
Paper stationery	14	0.9%	1.7	2.6%
Furniture and equipment stores	87	5.3%	0.8	1.2%
<b>Total</b>	<b><u>1,631</u></b>	<b><u>100.0%</u></b>	<b><u>66.7</u></b>	<b><u>100.0%</u></b>

Source: GSD's records

## **Benefits of having a central store**

2.3 The GSD considers that maintaining a central store of common-user items can provide the Government with the following benefits:

- (a) the Government can obtain more competitive prices from suppliers through bulk purchasing;
- (b) purchases can be made directly from overseas suppliers who do not have storage and distribution facilities in Hong Kong;
- (c) a higher stock turnover rate (Note 1) can be achieved through central storage, thus minimising government-wide stock investment, storage space and potential obsolescence; and
- (d) it provides opportunities for standardisation, thus reducing the amount of spare parts to be maintained.

## **Oncosts of maintaining a central store**

2.4 The following oncosts, including the staff costs, are incurred by the GSD for providing a central store of common-user items:

- (a) **Procurement costs.** These include tendering, inspection and other related costs;
- (b) **Storage costs.** These are the costs of operating the warehouse, costs of the storage space and other overheads; and
- (c) **Distribution costs.** These are the costs of taking the items from the warehouse and delivering them to users.

## **Justifications for maintaining a central store**

2.5 In the Director of Audit's Report No. 21 of October 1993, Audit reported that the GSD had not carried out any full-cost comparison to determine whether the provision of central storage by the GSD was economically sound. Audit recommended that, for a proper assessment of the

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**Note 1:** *The stock turnover rate of an item is the number of times the stock of the item has flowed through a warehouse in a year. It is calculated by dividing the total value of stock issued for the item in a year by the average value of stockholding for the item.*

central storage function of the GSD, a review including a full-cost comparison between the provision of central storage and direct delivery by suppliers of stores to departments should be conducted. The audit observations were endorsed by the Public Accounts Committee who made similar recommendations in their Report No. 21 of January 1994.

2.6 In March 1994, the Management Services Agency completed a review of the procurement, storage and distribution operation of the GSD. The review concluded that there was “some anecdotal evidence” that local suppliers would be more competitive than the GSD in supplying stores direct to departments. However, the central storage and distribution operation of the GSD should be maintained in view of the likely costs and risks involved in closing it down, including:

- (a) the benefit to the Government of the lower offers from overseas suppliers who did not have a local agent;
- (b) the risk of losing security of supply, particularly in areas where there was a need to maintain critical services (e.g. medical items);
- (c) the danger of a supply and distribution cartel or monopoly emerging, which could then raise costs significantly; and
- (d) the risk of a reduction in service levels and/or higher costs due to weak contract management.

The review also concluded that changes in policy and practice were required to improve the efficiency and effectiveness of the GSD’s operations, in particular in procurement, stock management and distribution.

### **Implementation of improvement measures**

2.7 Following the Management Services Agency’s review, the GSD had implemented a number of improvement measures, including computerisation of the filing systems, simplification and streamlining of operational procedures, strengthening of customer liaison and delegation of higher levels of direct purchase authority to departments. Since the commencement of operation of the new centralised warehouse in Chai Wan in November 1996, the storage area has been substantially reduced due to the use of space-intensive storage techniques. In February 1998, a new computerised system for warehouse operations, stock management and stores requisition, known as “Goods On-line Ordering, Distribution, Stock Management and Accounting Network (GOODSMAN)”, was fully implemented. The average stock turnover rate was raised from 2.8 times a year in 1993 to 4.3 times a year in 2000, and the value of the average stockholding was reduced from \$104 million in 1993 to \$78 million in 2000. The cost-effectiveness of the GSD’s delivery service has also been improved by better load utilisation of delivery vehicles and by reducing the size of delivery teams from 6 to 4 staff members.

## GSD price comparison studies of common-user items

2.8 Since February 1995, the GSD has conducted studies at half-yearly intervals to compare the GSD's purchase prices of selected common-user items (Note 2) with the retail prices obtained by GSD staff at various retail outlets including department stores, supermarkets, book shops and pharmacies. Since 1998, instead of obtaining only one retail price, three retail prices have been obtained for each item, and the middle price has been used for price comparison. The more recent GSD price comparison studies indicated that the GSD's purchase prices of all selected items were lower than the middle retail prices, as shown in Table 2 below.

**Table 2**

### Results of GSD price comparison studies of selected common-user items

<b>Time of study</b>	<b>Number of selected items</b>	<b>Average percentage by which the GSD's purchase prices were lower than the middle retail prices obtained by the GSD</b>
April 1999	196	226%
November 1999	197	251%
April 2000	265	184%
November 2000	277	192%
May 2001	281	183%

*Source: GSD's records*

*Note: For each selected item, the GSD calculated the difference between the middle retail price and the GSD's purchase price by the following formula:*

$$\frac{\text{Middle retail price} - \text{GSD's purchase price}}{\text{GSD's purchase price}} \times 100\%$$

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**Note 2:** *The GSD's purchase price of a common-user item is the weighted average GSD's purchase cost, including acquisition costs such as transportation cost.*

## **Audit observations on procurement of common-user items**

### **No follow-up action on items not achieving net savings**

2.9 The GSD has since 1994-95 worked out its total oncosts for the supply of common-user items and the average oncost rates. Details are given at Appendix A. **Generally speaking, if the price saving (i.e. the percentage difference between the middle retail price and the GSD's purchase price) for an item is less than the oncost rate, net saving may not be achieved by using central procurement (Note 3).** Audit noted that, in at least one of the GSD's last five price comparison studies, 63 items were found to have price savings which were less than the oncost rate. Of these 63 items, Audit also noted that:

- (a) four items were repeatedly found to have price savings which were less than the oncost rate in the four studies carried out between November 1999 and May 2001. However, up to the end of July 2001, the GSD had not taken any follow-up action; and
- (b) 11 items in the April 2000 study and 1 item in the November 2000 study were found to have price savings which were less than the oncost rate. However, up to the end of July 2001, no follow-up action had been taken on these 12 items. They had also not been selected for further price comparison in the later studies.

2.10 **Audit considers that, for those items found to have price savings which were less than the oncost rate in a price comparison study, the underlying reasons should be identified and ways should be found to procure them more cost-effectively.** For a particular common-user item, if the GSD's purchase price or the retail price is affected by certain short-term factors, follow-up action should be taken to make another price comparison in the next price comparison study. Consideration could be given to deleting from the central store those common-user items which, in the longer term, could be procured more cost-effectively by the users direct from the suppliers, or by the GSD through alternative means (e.g. direct delivery by the suppliers to the end-users through term contracts).

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**Note 3:** *Strictly speaking, there are other costs involved (such as the additional procurement costs which may be incurred by departments in making direct purchases from retail outlets). However, there are no readily available data of these costs and such costs are relatively insignificant. For the sake of simplicity, such costs have not been taken into account in this review.*

### **Majority of common-user items not included in GSD price comparison studies**

2.11 As shown in Table 2 in paragraph 2.8 above, about two hundred to three hundred items were selected in each of the last five price comparison studies (Note 4). In this review, Audit noted that, in terms of coverage, the GSD examined the prices of only 316 items in the last five price comparison studies (i.e. 19.4% of the total of 1,631 items held in the GSD's warehouse as at 31 March 2001). In 2000-01, the value of stock issued for these 316 items amounted to only 26.1% of the total value of stock issued for all items.

2.12 **Audit considers that there is a need to extend the scope of the price comparison studies to ensure that all common-user items are purchased cost-effectively through central procurement and storage. This can be done by performing price comparisons of all items on a cyclical basis.**

### **Majority of common-user items not achieving the target stock turnover rate**

2.13 The GSD considers that the maintenance of a central store of common-user items can achieve a higher stock turnover rate, thus minimising government-wide stock investment, storage space and potential obsolescence. The GSD's target stock turnover rate for 2000-01 was five times a year. In 2000-01, the GSD achieved an average stock turnover rate of 4.5 times a year (Note 5). This means that, on average, the quantity of stock held in the warehouse would meet users' requirements for 2.7 months (i.e. 12 months ÷ 4.5).

2.14 However, the GSD did not calculate the stock turnover rates for individual common-user items. Audit used a computer program to calculate the stock turnover rate in 2000-01 for each of the 1,631 items held in the GSD's warehouse as at 31 March 2001. The results are summarised in Table 3 below.

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**Note 4:** *The GSD has set up a show room at its warehouse in which the more popular common-user items are displayed to enable departments to have better knowledge of such items before placing orders. From 1995 to 1999, the items selected for price comparison studies were those displayed in the GSD's show room. Since 2000, in addition to the show room items, other items have been selected for price comparison.*

**Note 5:** *The average stock turnover rate is calculated by dividing the total value of stock issued for all items in a year by the average value of stockholding for all items.*

Table 3

Stock turnover rates of 1,631 common-user items in 2000-01

Stock turnover rate	Equivalent to months of users' requirements	Number of items	As percentage of total number of items	Value as at 31 March 2001	As percentage of total value
(a)	(b) = $\frac{12}{(a)}$	(c)	(d)	(e)	(f)
(Times a year)				(\$ million)	
Lower than 0.5	Over 24	568	34.8%	15.2	23.0%
0.5 or higher but lower than 1	Over 12 to 24	133	8.2%	3.0	4.6%
1 or higher but lower than 2	Over 6 to 12	175	10.7%	6.1	9.3%
2 or higher but lower than 3	Over 4 to 6	211	12.9%	11.7	17.7%
3 or higher but lower than 5	Over 2.4 to 4	216	13.3%	15.4	23.3%
<b>Sub-total for lower than 5</b>		<b>1,303</b>	<b>79.9%</b>	<b>51.4</b>	<b>77.9%</b>
5 or higher	2.4 or less	328	20.1%	14.6	22.1%
<b>Total</b>		<b>1,631</b>	<b>100.0%</b>	<b>66.0</b>	<b>100.0%</b>

Source: GSD's records

Note: This analysis excludes \$0.7 million of stockholding for 15 items earmarked by the GSD as emergency stock for natural disasters.

2.15 Table 3 above shows that for 328 items or 20.1% of all common-user items, the stock turnover rate in 2000-01 was equal to or higher than the GSD's target stock turnover rate of five times a year. However, for 1,303 items or 79.9% of all common-user items, the target stock turnover rate of five times a year was not achieved. Audit estimated that the amount of money tied up in the average stockholding for these 1,303 items would have been reduced by \$35.3 million in 2000-01, had these items also achieved the target stock turnover rate of five times a year. Details are at Appendix B. In Audit's view, the GSD should ascertain the reasons as to why these items could not achieve the target stock turnover rate with a view to implementing necessary improvement measures.

## Many dormant or slow-moving items

2.16 Audit noted that many common-user items had a very low stock turnover rate in 2000-01. A detailed analysis of those items with a stock turnover rate of lower than 0.5 time a year is shown in Table 4 below.

**Table 4**  
**Analysis of common-user items**  
**with a stock turnover rate of lower than 0.5 time a year in 2000-01**

Stock turnover rate	Equivalent to months of users' requirements	Number of items	As percentage of total number of items	Value as at 31 March 2001	As percentage of total value
(a)	$(b) = \frac{12}{(a)}$	(c)	(d)	(e)	(f)
(Time a year)				(\$ million)	
<b>Lower than 0.01</b>	<b>Over 1,200</b>	<b><u>194</u></b>	<b><u>11.9%</u></b>	<b><u>4.4</u></b>	<b><u>6.6%</u></b>
0.01 or higher but lower than 0.1	Over 120 to 1,200	154	9.4%	6.0	9.1%
0.1 or higher but lower than 0.2	Over 60 to 120	65	4.0%	1.5	2.3%
0.2 or higher but lower than 0.5	Over 24 to 60	155	9.5%	3.3	5.0%
<b>Sub-total for 0.01 or higher but lower than 0.5</b>		<b><u>374</u></b>	<b><u>22.9%</u></b>	<b><u>10.8</u></b>	<b><u>16.4%</u></b>
<b>Total</b>		<b><u><u>568</u></u></b>	<b><u><u>34.8%</u></u></b>	<b><u><u>15.2</u></u></b>	<b><u><u>23.0%</u></u></b>

Source: GSD's records

2.17 As shown in Table 4 above, for the 194 items with stockholding totalling \$4.4 million and with a stock turnover rate of lower than 0.01 time a year in 2000-01, the GSD's average stockholding would meet users' requirements for more than 100 years. For the other 374 items with stockholding totalling \$10.8 million and with a higher stock turnover rate (i.e. 0.01 or higher but lower than 0.5 time a year), the GSD's average stockholding would meet users' requirements from 2 to 100 years. A list of these dormant or slow-moving items is at Appendix C. The Government ties up money and incurs storage costs for these items, and will suffer losses if these items become obsolete or unwanted by users for reasons beyond the GSD's control. **Audit considers that there is a need for the GSD to investigate the circumstances leading to the**

**maintenance of excessive stocks for these dormant or slow-moving items and identify deficiencies in the provisioning procedures. The GSD should also closely monitor the future acquisition of these items, review their demand with the users and dispose of any unwanted items.**

#### **Revision of SPR to allow direct purchases of common-user items**

2.18 Before June 2001, departments were not allowed to make direct purchases of common-user items held in the GSD's warehouse. In June 2001, SPR 245 was revised to allow departments to make direct purchases of such items after seeking the GSD's prior consent having regard to value for money considerations. Audit considers that this revision should help ensure that the Government obtains competitive prices in the procurement of common-user items. **To facilitate the process, there is a need for the GSD to issue guidelines to assist departments in seeking the GSD's prior consent. For example, information about the direct purchases made by one department approved by the GSD can be made available to all departments to enable them to consider whether it is also cost-effective to do the same. The reasons as to why these direct purchases, instead of central procurement and storage, obtain better value for money should also be ascertained. This would help the GSD decide whether future procurement of such items through the central store should cease.**

#### **Audit recommendations on procurement of common-user items**

2.19 **Audit has recommended that the Director of Government Supplies should:**

- (a) **improve the effectiveness of the GSD's price comparison studies on the common-user items by:**
  - (i) **identifying the underlying reasons for those items which do not achieve net savings and finding ways of procuring them more cost-effectively;**
  - (ii) **ensuring that, for those items which do not achieve net savings, a follow-up price comparison is carried out; and**
  - (iii) **extending the scope of the price comparison studies by reviewing the prices of all items on a cyclical basis;**
- (b) **calculate the stock turnover rates of individual common-user items and compare the stock turnover rates with the GSD's target stock turnover rate at regular intervals;**

- (c) **for those stores items with low stock turnover rates, ascertain the reasons and implement measures to achieve the target stock turnover rate;**
- (d) **investigate the circumstances leading to the keeping of excessive stocks for the dormant or slow-moving stores items and improve the provisioning procedures to prevent similar recurrence in future;**
- (e) **for the dormant or slow-moving stores items, review the demand for them with the users and dispose of any unwanted items as soon as possible;**
- (f) **issue guidelines to departments to assist them in seeking the GSD's prior consent to make direct purchases of common-user items. In doing so, the GSD should make available to all departments details of direct purchases approved by the GSD; and**
- (g) **ascertain the circumstances in which departments are able to make direct purchases of common-user items at prices lower than those of the GSD and consider whether the procurement of such items through the central store should cease.**

### **Response from the Administration**

2.20 The **Director of Government Supplies** agrees that the GSD should extend the coverage of the price comparison studies of common-user items. He agrees that there is a need to calculate and maintain the stock turnover rates of individual items and, in cases where the target stock turnover rate is not achieved, to implement measures to minimise stock investment. He also agrees that there is a need to regularly review the consumption patterns to avoid maintenance of excessive stocks and to delete unwanted items from the stockholding list. He has said that:

#### *Price comparison studies*

- (a) the GSD will in future seek out the underlying reasons in cases where the purchase prices fail to achieve savings and ensure that these cases would be followed up in subsequent price comparison studies;
- (b) the GSD will extend the coverage of the price comparison studies to as many items as possible and review the prices on a cyclical basis. In this connection, it is relevant to point out that many items do not have a retail price in the market. These include the printed stationery, which are mainly government forms, and many pharmaceutical items, because of different packaging;

### *Target stock turnover rate*

- (c) despite the best estimate made prior to tendering, at times, the consumption level and pattern may change during the course of a contract. When this happens, the GSD would negotiate with the suppliers to rearrange the delivery schedule or quantities within contractual constraints to avoid over or under-stocking;

### *Dormant or slow-moving items*

- (d) the GSD will monitor the consumption pattern of different items, identify the dormant or slow-moving items, review the need for these items to remain on the GSD's stock list and make arrangements, where necessary, to delete them from the list and to dispose of the unwanted items. Priority for disposal will be given to the bulky items which take up much storage space;
- (e) the deletion process takes some time to complete. The first step is to categorise the dormant or slow-moving items as "Not-to-be-reordered". To avoid wastage, the remaining quantity of the items will still be maintained in the store for withdrawal by users. Disposal action will be taken and the items will be removed from the stockholding list only when there are clear indications that there is no longer any use for them. Currently, 635 items have already been categorised as "Not-to-be-reordered" and will be deleted from the stockholding list in due course;

### *Direct purchases*

- (f) the GSD will review the present procedure for departments to obtain the GSD's prior consent for direct purchases. The GSD's purchase prices reflect the best offers obtained at the time of tendering through open competition and bulk purchasing. In those cases where there is evidence that the GSD's purchase prices are not more favourable than those in the market, the GSD would investigate and review what improvements should be made to ensure good value for money; and
- (g) the GSD will review, at regular intervals, the procurement strategy for common-user items and ascertain whether it remains cost-effective to purchase an item through the central storage arrangement. Where justified, the GSD will change over to other modes of procurement which can bring better value for money.

2.21 The **Secretary for the Treasury** accepts the audit recommendations.

## PART 3: PROCUREMENT OF MICROCOMPUTER/NETWORK SYSTEMS

### Background

3.1 It is the Government's established policy to take full advantage of information technology (IT) in order to improve the efficiency, quality of service and cost-effectiveness of departments. Microcomputer/network system products, including computer hardware, software, printers and network devices, are common items required by departments to meet their IT needs. For procurement of IT products, the GSD is the central procurement agent, and the Information Technology Services Department (ITSD) is the Government's IT adviser and service provider. The ITSD is responsible for ensuring that departments' IT needs are met in an efficient and cost-effective manner, having regard to technological developments and available resources. It is also responsible for setting IT standards for compliance by departments.

3.2 Due to the substantial value involved, decisions on significant tender or contract matters relating to the procurement of microcomputer/network systems have been made by the Secretary for the Treasury on the recommendations of the Central Tender Board. The total value of microcomputer/network systems purchased by departments under the contracts arranged by the GSD was \$460 million in 1998-99, \$400 million in 1999-2000 and \$568 million in 2000-01.

### Bulk procurement of microcomputer/network systems before January 2000

3.3 Before January 2000, departments purchased microcomputer/network systems under the bulk contracts arranged by the GSD. The key features of such bulk contracts were as follows:

- (a) **Bulk purchasing.** The requirements of individual departments were tendered in aggregate in order to obtain bulk purchase discounts. A percentage of the estimated value, usually 20% to 35%, of the total requirement was committed as the Government's minimum total purchase amount. Since 1996, due to the substantial volume of the total requirement and the need to ensure service quality, the total requirement had been split into a number of contracts such that each successful tenderer would serve a group of departments;
- (b) **Open tendering.** The open tendering approach was adopted to enable the Government to receive competitive tenders from all interested suppliers;
- (c) **Tender negotiations.** In view of the substantial contract values, the GSD conducted negotiations with the successful tenderers to obtain better prices;
- (d) **Contract prices.** Each contract lasted for 12 to 18 months. During the contract period, departments could place orders for any of the contract items with the contractors on an "as and when required" basis. The price of each contract item was specified in the contract. However, the contracts provided that the contractors should, on a quarterly

basis, review the contract prices together with the Government to ensure that the contract prices were constantly more favourable than the prevailing market prices; and

- (e) ***New or upgraded products.*** The contracts provided that, subject to the agreement of the GSD, the contractors might substitute particular contract items with new or upgraded products.

3.4 User departments advised the GSD that the bulk contracts arrangement in use before January 2000 had the following drawbacks:

- (a) ***Long procurement lead time.*** It could take up to 9 to 12 months to complete all stages of the procurement process;
- (b) ***Inflexibility in the selection of suppliers.*** Departments were deprived of the choice of supplier. This was because only one supplier was allocated to a department throughout the contract period. In the absence of competition, the contractors had little incentive to reduce prices and improve services after the award of contracts; and
- (c) ***Failure to obtain advanced products.*** The items included in the contracts soon became outdated as more advanced products emerged during the contract period. Due to the lack of competition, the contractors were generally slow in proposing new or upgraded products.

### **Flexible procedures for procurement of microcomputer/network systems from January 2000**

3.5 In order to provide departments with more flexibility in ordering, and to provide an incentive to the contractors to reduce prices and improve services during the contract period, the GSD has since January 2000 adopted a new and more flexible procurement approach for procuring microcomputer/network systems. The new acquisition procedures prepared by the GSD and the ITSD are as follows:

- (a) ***Standing Offer Agreements.*** Instead of splitting the total requirement into a number of contracts, and assigning each contract to a successful tenderer who would serve a group of departments, the requirements of departments were classified into six categories for tendering as follows:
  - (i) Category A — total system (i.e. the full product range comprising the individual component items in Categories B to F below);
  - (ii) Category B — computer hardware and peripherals;

- (iii) Category C — computer software;
- (iv) Category D — printers;
- (v) Category E — network devices; and
- (vi) Category F — system integration services and support services.

Separate contracts in the form of Standing Offer Agreements were entered into with five successful tenderers for Category A, and with three successful tenderers for each category for Categories B to F. The Government was not committed to any minimum purchase amount with any of these contractors;

- (b) ***Open tendering.*** The open tendering approach was adopted to enable the Government to receive competitive tenders from all interested suppliers;
- (c) ***Price quotations.*** The contract period for the Standing Offer Agreements, originally from January 2000 to June 2001, had been extended up to June 2002. Instead of fixing the selling prices of the contract items during the contract period, the tender prices represent ceiling prices. The contractors are required to submit a new set of selling prices of the contract items periodically, and these selling prices must not exceed the ceiling prices. When departments wish to purchase products of a certain category, they are required to state their requirements and select a specified number of contractors, from those in that category or in Category A (see para. 3.5(a) above), for obtaining product proposals and price quotations. The contractors' price quotations for any product must not exceed their prevailing selling prices. In this way, the contractors have to compete with one another for orders from departments after the award of contracts; and
- (d) ***New or upgraded products.*** To enable departments to have a wider choice, there are no restrictions on the addition of new or upgraded products to the contracts.

### **GSD review**

3.6 In October 2000, the GSD completed a review of the implementation of the flexible procurement approach for procuring microcomputer/network systems for the period January to June 2000. In this review, the GSD conducted a survey of the purchases of microcomputer/network systems made by departments and asked them for their comments on the effectiveness of the contract arrangements. The survey found that departments were able to obtain more advanced products under the flexible procurement approach. However, departments expressed concern about the long processing time and the additional administrative efforts required for obtaining quotations, particularly for small value purchases. To address this concern, the requirements for obtaining quotations were revised in January 2001. Departments have since

January 2001 been allowed to obtain only one quotation for any purchase with a value not exceeding \$5,000. The revised requirements are shown in Table 5 below.

**Table 5**  
**Requirements to obtain quotations**  
**for procurement of microcomputer/network systems**  
**(as from January 2001)**

Value of purchase	Number of quotations required	Approving officer
Not exceeding \$5,000	1 (Note)	Assistant Supplies Officer or Executive Officer II or equivalent
Over \$5,000 to \$50,000	At least 2	Assistant Supplies Officer or Executive Officer II or equivalent
Over \$50,000 to \$750,000	At least 5	Supplies Officer or Executive Officer I or equivalent
Over \$750,000 to \$1,000,000	At least 5	Senior Supplies Officer or Senior Executive Officer or equivalent
Over \$1 million to \$1.3 million	At least 5	Chief Supplies Officer or Chief Executive Officer or equivalent
Over \$1.3 million	At least 5	Directorate officer

*Source: GSD's records*

*Note: Before January 2001, at least two quotations were required for any purchase with a value not exceeding \$5,000.*

### **ITSD price benchmark studies**

3.7 Since April 1995, the ITSD has conducted quarterly price benchmark studies to assess whether the Government had obtained favourable prices in purchasing microcomputer/network systems under the contracts arranged by the GSD. The studies are conducted in accordance with the following procedures:

- (a) before the start of each quarterly price benchmark study, the ITSD specifies the configuration of a typical microcomputer system, the configuration of a typical network system and certain other items (such as notebook computers) to be covered by the study;
- (b) a sample of the more reputable vendors in the market is contacted for quotations which include free delivery and installation of the items, and one-year on-site warranty. (For microcomputer system units and network servers, only quotations for products of reputable brands are obtained.) The prices so obtained are used to compute the “average market prices”; and
- (c) the average market prices are used for comparison with the contractors’ selling prices of the same items in the orders placed by departments in the quarter concerned (Note 6).

If the contractors’ average selling prices have been found in a price benchmark study to be higher than the average market prices, the ITSD requests the GSD to follow up with the contractors to reduce their selling prices.

### **Audit observations on procurement of microcomputer/network systems**

3.8 According to the ITSD’s 12 price benchmark studies for the period January 1998 to March 2001, the Government had in general obtained favourable prices in the procurement of typical microcomputer/network systems. Audit’s analysis of the results of the 12 quarterly price benchmark studies (see Appendix D) shows that:

- (a) in the period covered by all 12 studies, the contractors’ average selling price of a typical microcomputer system was lower than the average market price; and
- (b) in the period covered by 1 study, for a typical network system, the contractors’ price was higher.

3.9 A typical microcomputer/network system is made up of component items such as microcomputer system units and network hardware. These component items may also be purchased separately by departments to meet particular needs. Audit’s further analysis of the results of the 12 price benchmark studies (see Appendix E) shows that:

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**Note 6:** *For a particular item, if no orders had been placed with a contractor in the quarter concerned, the contractor’s prevailing selling price would be used for comparison with the market price.*

- (a) in the period covered by 3 studies, the contractors' average selling price of a microcomputer system unit was higher than the average market price; and
- (b) in the period covered by 4 studies, for network hardware, the contractors' prices were higher.

3.10 Random access memory (RAM) was one of the main items included in the price benchmark studies. Audit's analysis of the results of the 12 price benchmark studies (see Appendix F) shows that:

- (a) in the period covered by 9 studies, the contractors' average selling prices of RAM for microcomputer systems were higher than the average market prices; and
- (b) in the period covered by all 12 studies, for RAM for network systems, the contractors' prices were higher.

3.11 The term contracts for the purchase of microcomputer/network systems were arranged by the GSD with the objective of securing more favourable prices than those obtainable by departments through direct purchases from the market. **However, certain microcomputer/network systems and related products were purchased at higher than the average market prices by departments during the period January 1998 to March 2001 (see Appendices D to F).** Audit has conducted a review of the use of the term contracts to ascertain if there are areas requiring improvement. The audit findings are given in paragraphs 3.12 to 3.24 below.

#### **Failure to enforce the contract price review provision in the bulk contracts before January 2000**

3.12 The contracts for the bulk procurement of microcomputer/network systems before January 2000 provided that the contractors should, on a quarterly basis, review the contract prices together with the Government to ensure that the contract prices were constantly more favourable than the prevailing market prices (see para. 3.3(d) above). As revealed in Audit's analyses at Appendices D to F, the contract prices had not always been more favourable. Audit noted that:

- (a) in many contract price reviews, the GSD and the ITSD accepted the prevailing contract prices or the revised contract prices proposed by the contractors, even though these prices were significantly higher than the market prices. Examples are at Appendix G; and

- (b) instead of performing reviews at quarterly intervals, one contractor did not perform the second review of the contract prices until eleven months after the first review. He did not perform a further review until five months after the second review.

**In Audit's view, the GSD and the ITSD should have taken action to enforce the contract price review provision (of the bulk contracts before January 2000), to ensure that the contract prices were constantly more favourable than the prevailing market prices.**

### **Need to improve the flexible procurement procedures**

3.13 The Standing Offer Agreements for the flexible procurement of microcomputer/network systems, which came into effect in January 2000, require departments to make purchases of microcomputer/network systems by inviting proposals from selected contractors. The selected contractors are free to propose any new items not previously included in their tenders. Up to 30 June 2001, the contractors had introduced some 7,800 new items. **While this arrangement could enable departments to obtain new or upgraded products that have emerged during the contract period, there is inadequate assurance that such products are purchased at the lowest market prices.** Audit has noted the following deficiencies:

- (a) ***Inadequate competition.*** For purchases of goods with a value exceeding \$1.3 million, SPR 220(a) states that departments should normally use open tendering procedures so as to obtain the best value for money. However, under the flexible procurement approach (see Table 5 in para. 3.6 above), departments are only required to obtain at least five quotations from the selected contractors;
- (b) ***No aggregation of requirements to obtain bulk purchase discounts.*** When the bulk procurement approach was used during the period 1996 to 1999, the GSD achieved savings estimated at \$50 million by negotiating the tender prices with the tenderers. **However, under the flexible procurement approach, departments are not required to advise the GSD what they intend to buy so as to enable the GSD to aggregate their requirements and to obtain better offers from the contractors; and**
- (c) ***Small number of contractors.*** The number of contractors for the supply of products in each product category ranges from five to eight, as shown at Appendix H. For purchases with a value exceeding \$50,000, departments are required to obtain at least five quotations (see Table 5 in para. 3.6 above). The GSD's survey (see para. 3.6 above) found that, during the period January to June 2000, departments had spent \$130 million on 426 purchases, each with a value exceeding \$50,000. Audit analysed the number of quotations obtained by the departments for these purchases. Details are shown in Table 6 below.

Table 6

**Analysis of the number of quotations  
obtained by departments for purchases of  
microcomputer/network systems with a value exceeding  
\$50,000 during the period January to June 2000**

Number of quotations obtained	Purchases with a value exceeding \$50,000	
	(Number)	(Percentage)
At least 5	143	33%
4	127	30%
3	80	19%
2	46	11%
1	30	7%
<b>Total</b>	<u><u>426</u></u>	<u><u>100%</u></u>

*Source: GSD's records*

As shown in Table 6 above, the departments concerned had obtained at least five quotations only for 33% of the purchases with a value exceeding \$50,000. **For the remaining 67% of the purchases, less than five quotations had been obtained. This was because there were only a small number of contractors and some of them did not respond to the departments' invitations for quotation.**

3.14 **Audit considers that there is a need for the GSD and the ITSD to establish procedures for aggregating departmental requirements in order to obtain bulk purchase discounts.** For example, the GSD may require departments to provide information about their upcoming IT projects with an estimated value exceeding a predetermined amount. The GSD would coordinate with the departments concerned when opportunities for aggregation are identified. **In warranted cases involving substantial amounts, such as the upgrading or replacement of major systems, an open and separate tendering exercise should be conducted to obtain the best prices available from the market. There is also a need for the GSD and the ITSD to issue guidelines indicating the circumstances under which departments should negotiate with the contractors for better offers.**

3.15 Under the Standing Offer Agreements, the contractors are required to respond to a department's request for proposal within one week unless otherwise specified. In view of the small number of contractors as shown at Appendix H (e.g. only five contractors for both Category A and Category C), there is a need to ensure that they promptly respond to departments' requests for proposal. This will enable departments to consider at least five quotations, especially for purchases with a value exceeding \$50,000. **If similar Standing Offer Agreements are to be used in the next open tendering exercise, in order to further increase competition, the number of contractors in each category would need to be increased.**

3.16 Before June 2001, departments were not allowed to make direct purchases of microcomputer/network systems because they had to use the term contractors arranged by the GSD. In June 2001, SPR 245 was revised to allow departments to make direct purchases of such systems after seeking the GSD's prior consent and having regard to value for money considerations. As the prices obtained under the Standing Offer Agreements may not always be more favourable than the market prices, Audit considers that departments should be able to benefit from the revised SPR 245. **The acquisition procedures prepared by the GSD and the ITSD (see para. 3.5 above) need to be updated to allow departments to make direct purchases of microcomputer/network systems. To let departments know which items can be purchased at lower prices through direct purchases, there is a need to make available to all departments details of the direct purchases approved by the GSD and the results of the ITSD's quarterly price benchmark studies.**

#### **Need to ensure economy is achieved in the selection of offers**

3.17 The acquisition procedures prepared by the GSD and the ITSD provide that departments should normally accept the lowest conforming offer unless otherwise justified. For purchases with values over \$50,000, the procedures also provide that, if it is considered that an offer of a higher price should be accepted, or less than five quotations were received, an officer of one rank higher than those specified in Table 5 in paragraph 3.6 above should approve the acceptance of the offer. Audit noted that, during the period January to June 2000, the lowest offer had not been accepted in 13% of the purchases with a value exceeding \$50,000. Details are provided in Table 7 below.

Table 7

**Analysis of the accepted offers for purchases of microcomputer/network systems with a value exceeding \$50,000 during the period January to June 2000**

Accepted offer	Purchases with a value exceeding \$50,000	
	(Number)	(Percentage)
Lowest	369	87%
Second lowest	34	8%
Third lowest	13	3%
Fourth lowest	7	2%
Fifth lowest	2	-
Sixth lowest	1	-
<b>Total</b>	<b><u>426</u></b>	<b><u>100%</u></b>

} 13%

Source: GSD's records

3.18 The reasons provided by the departments for not accepting the lowest offers were usually as follows:

- (a) the lowest offer did not comply with the specifications;
- (b) the lowest offer was incomplete;
- (c) the lowest offer did not meet the delivery requirement (e.g. the product was out of stock); and
- (d) the lowest offer provided a less reliable product.

3.19 Of the 426 purchases shown in Table 7 in paragraph 3.17 above, Audit noted that there were 63 purchases with a value exceeding \$500,000, involving a total amount of \$78 million. In 9 (or 14%) of these 63 purchases, the lowest offers were not accepted. Audit notes that for direct purchases with a value exceeding \$500,000, SPR 260(e) requires departments to provide to the GSD, in a return at half-yearly intervals, explanations if the number of quotations received is less than five and/or the lowest offer is not accepted. **To ensure that departments pay due regard to economy in the selection of offers when they purchase microcomputer/network systems under the Standing Offer Agreements, the GSD should include a similar reporting requirement in the acquisition procedures.**

### **ITSD's Product Selection Guide needs improvement**

3.20 To assist departments in the selection and implementation of microcomputer/network systems under the Standing Offer Agreements, the ITSD has issued and periodically updated a Product Selection Guide. The Guide describes the common microcomputer/network system products in the market, their useful features and the ITSD's advice. Departments are required to refer to the advice given in the Guide. For the purchase of microcomputer/network systems pre-endorsed by the ITSD (including those common hardware and software products, standalone microcomputer systems and network systems for a small work unit as specified in the Guide), departments do not need to obtain the ITSD's technical endorsement. However, for the purchase of other microcomputer/network systems, such as those to be connected to an existing computer system or the departmental network systems, SPR 210 requires departments to seek the ITSD's technical endorsement before making the purchase.

3.21 **For products pre-endorsed by the ITSD, departments are free to choose any particular items in the market which they consider appropriate so long as they have the required funds.** For example, in the Product Selection Guide, the ITSD has indicated the different features of cathode ray tube (CRT) and liquid crystal display (LCD) monitors with different available screen sizes, and that the choice between CRT and LCD "depends on a department's budget and needs". The Guide recommends a screen size of at least 15 inches for CRT monitors and at least 14 inches for LCD monitors. Table 8 below shows the main types of monitors purchased by departments in 2000-01.

**Table 8**

**Main types of computer monitors purchased by departments in 2000-01**

Type and size	Total number of units purchased	Percentage	Total purchase value (Note 1)		Average price per unit
	(a)	(b)	(c)	(d)	(e) = $\frac{(c)}{(a)}$
			(\$)	(Percentage)	(\$)
<b>CRT</b>					
15 inches	11,976	66%	10,842,641	27%	905
17 inches	2,216	12%	3,906,781	10%	1,763
21 inches	144	1%	1,159,456	3%	8,052
<b>LCD</b>					
15 inches (Note 2)	3,856	21%	22,561,148	56%	5,851
18 inches	81	-	1,605,422	4%	19,820
<b>Total</b>	<b><u>18,273</u></b>	<b><u>100%</u></b>	<b><u>40,075,448</u></b>	<b><u>100%</u></b>	

Source: GSD's and ITSD's records

Note 1: This analysis includes those types of monitors with a total purchase value exceeding \$1 million in 2000-01.

Note 2: If CRT 15-inch monitors, instead of LCD 15-inch monitors, had been purchased, the total expenditure would have been reduced by \$19 million, i.e.  $(\$5,851 - \$905) \times 3,856$ .

3.22 Table 8 above shows the five main types of monitors purchased by departments in 2000-01. The ITSD's Product Selection Guide does not provide sufficient guidelines to help departments purchase hardware products cost-effectively. For example, the Guide does not say under what circumstances a LCD monitor should be acquired, instead of a CRT monitor, and under what circumstances a particular screen size should be selected. However, the average amount of \$5,851 spent in 2000-01 on one LCD 15-inch monitor could have been used to buy six CRT

15-inch monitors instead. If only CRT 15-inch monitors (instead of LCD 15-inch monitors) had been purchased in 2000-01, the total expenditure would have been reduced by \$19 million as shown in Table 8 in paragraph 3.21 above. **In Audit's view, the ITSD should consider improving the guidelines for particular microcomputer/network system products so that user departments can select them with due regard to their practical functions and cost-effectiveness.**

### **Need to provide departments with details of contractors' selling prices**

3.23 Under the Standing Offer Agreements, contractors are required to submit various management information reports, including a monthly order summary report giving, for each item, the total number of units and value ordered by departments in the month concerned and since the commencement of the contract. The order summary reports provide the ITSD with the contractors' selling prices for carrying out the quarterly price benchmark studies. For each contractor, summarised information about the average percentage difference between his selling prices and the average market prices of the items covered by the price benchmark studies is posted to the ITSD's dedicated web site for reference by departments.

3.24 Due to different cost structures and selling strategies, a particular item may be sold at different prices by different contractors. Audit's review of the contractors' order summary reports indicated that for some items the differences in selling prices among the contractors were significant. **Departments may not know such differences as the order summary reports are not made available to them (Note 7). They may not know which contractor is selling at the lowest price at that time. Audit considers that it would be useful for the ITSD to post the order summary reports to the ITSD's dedicated web site for access by departments. This would enable departments to make reference to these reports when selecting contractors for quotations, evaluating the reasonableness of the price quoted by a particular contractor and conducting price negotiations.**

### **Audit recommendations on procurement of microcomputer/network systems**

3.25 **Audit has recommended that the Director of Government Supplies and the Director of Information Technology Services should:**

#### *Flexible procurement procedures*

- (a) **establish procedures for aggregating departmental requirements for microcomputer/network systems in order to obtain bulk purchase discounts;**

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**Note 7:** *Since January 2001, the five contractors in Category A have published their updated product and price information in their web sites. However, departments have to ask for quotations to obtain the net selling prices after quantity discounts, if any.*

- (b) **in warranted cases (e.g. major upgrading and replacement of computer equipment), conduct an open and separate tendering exercise for bulk purchases of microcomputer/network systems in order to increase competition among suppliers and to obtain the best prices available from the market;**
- (c) **issue guidelines to departments indicating the circumstances under which they should negotiate with the contractors for better offers;**
- (d) **take action to ensure that all contractors submit their quotations within the time limit specified in the contract upon receipt of requests from departments;**
- (e) **if Standing Offer Agreements similar to the existing ones are to be adopted in the next open tendering exercise, increase the number of contractors in each category of microcomputer/network system products in order to further increase competition among the contractors;**

*Direct purchases*

- (f) **facilitate departments to make direct purchases of microcomputer/network systems from other suppliers whose selling prices are lower than the contractors' selling prices by:**
  - (i) **establishing procedures for seeking the GSD's prior consent to make direct purchases;**
  - (ii) **making available to all departments details of the direct purchases approved by the GSD to enable them to make similar direct purchases; and**
  - (iii) **providing departments with details of the results of the price benchmark studies;**

*Selection of offers*

- (g) **for purchases of microcomputer/network systems with a value exceeding \$500,000, require departments to submit half-yearly returns indicating, with detailed explanations, the purchases for which less than five quotations have been obtained. Departments should also report in the returns, with detailed explanations, those cases in which the lowest offers have not been accepted;**

### *ITSD's Product Selection Guide*

- (h) **enhance the ITSD's Product Selection Guide so that departments are fully informed about the practical functions of similar hardware products (e.g. LCD vis-à-vis CRT monitors) and to enable departments to select products with due regard to their practical functions and cost-effectiveness; and**

### *Contractors' order summary reports*

- (i) **post the contractors' order summary reports to the ITSD's dedicated web site for reference by departments. This would enable them to obtain lower prices in making purchases from the contractors under the existing Standing Offer Agreements.**

### **Response from the Administration**

3.26 The **Director of Government Supplies** has said that the GSD and the ITSD will continue to monitor the purchase prices of microcomputer/network systems in the light of the findings of the price benchmark studies, and initiate any necessary improvements to the flexible procurement arrangement. He has also said that:

### *Contract price review provision in the bulk contracts*

- (a) the GSD has been aware of the drawbacks of bulk contracts and the difficulty with price reviews, and has changed over to use the flexible procurement arrangement since January 2000;

### *Flexible procurement procedures*

- (b) the GSD will advise departments of the importance to aggregate, as far as practicable, their departmental requirements for microcomputer/network systems at the time of purchase in order to obtain bulk purchase discounts. Care must be taken to balance the potential price advantage with the possible adverse effects on office work resulting from the longer procurement lead time;
- (c) he agrees that there may be advantage in conducting separate and open tendering exercises for purchases of substantial value. This is an existing practice. The GSD will continue with this practice with a view to obtaining even better prices;

- (d) SPR 385 has set out in detail the circumstances under which departments may negotiate with the suppliers for better offers. The GSD will make available to departments relevant price information to facilitate departments' decisions and actions;
- (e) the GSD will consider increasing the number of contractors in the future in order to increase competition among the selected contractors. Care must be taken to ensure that the potential business volume for each contractor will remain substantial so as to attract sufficient contractors to offer competitive ceiling prices;

#### *Direct purchases*

- (f) the GSD will review the existing procedure for departments to obtain the GSD's prior consent to make direct purchases and make available to departments details of the approved direct purchases;

#### *ITSD's price benchmark studies*

- (g) the ITSD has published a summary of the results of the price benchmark studies on the ITSD's dedicated web site. In spite of the stringent terms and conditions attached to government purchases, the average selling prices obtained by departments from the contractors have been very competitive when compared to the average market prices obtained from the studies;
- (h) RAM is a relatively low-priced item on its own. However, the purchased product must be compatible with the user's existing system and the purchase also involves installation and testing. Comparison of the prices of RAM is a complex issue; and

#### *Selection of offers*

- (i) the acquisition procedures require departments to accept the lowest conforming offer based on the quotations received. In cases where the lowest offer is not accepted, departments must provide justifiable reasons. The GSD will introduce a reporting system to monitor the compliance with this rule.

3.27 The **Director of Information Technology Services** has said that the ITSD will continue to work with the GSD on the continuous improvement of the system of flexible procurement of microcomputer/network systems, and will proceed with enhancing the Product Selection Guide. He has also said that:

### ***Contract price review provision in the bulk contracts***

- (a) he notes Audit's observation that the GSD and the ITSD should have taken action to enforce the contract price review provision in the bulk contracts;

### ***Flexible procurement procedures***

- (b) under the current flexible procurement arrangement, departments obtain from the contractors the latest products at the most competitive prices at the time of each purchase. The prices are further subject to ceilings set for each contract;
- (c) it is an established practice for departments to conduct an open and separate tendering exercise in cases that involve substantial purchases such as replacement and upgrading of major systems;
- (d) he notes Audit's recommendations that the GSD and the ITSD should take action to ensure that all contractors submit their quotations within the time limit specified in the contract and increase the number of contractors in the next tendering exercise;

### ***Direct purchases***

- (e) the ITSD will work with the GSD to revise the acquisition procedures to reflect the latest SPR 245 and to post the revised procedures to the ITSD's dedicated web site for reference by departments. The ITSD will also make available details of approved direct purchases to all departments through the dedicated web site;

### ***ITSD's price benchmark studies***

- (f) the Government is protected by stringent requirements, terms and conditions attached to purchases under the government contracts. The price benchmark studies show that, generally speaking, purchases under the existing contracts with the added protection are more favourable to the Government than corresponding offers in the retail market without such protection;
- (g) in the case of RAM, which is a relatively low-priced item, the ITSD would not be able to ascertain the reason for the lower market prices because pricing is a commercial decision. However, it is reasonable to believe that the higher prices obtained by departments from the contractors only reflect the high cost of servicing purchases of

RAM on its own. When additional RAM is purchased to upgrade the existing system, there is an overhead cost of going to the government office, installing the RAM and testing the computer;

- (h) he notes Audit's observation that there is a need to make available details of the results of the price benchmark studies to all departments. The ITSD has already published the summary of the results of the price benchmark studies on the ITSD's dedicated web site;

#### *Selection of offers*

- (i) he notes Audit's recommendation that departments should be required to submit returns on purchases with a value exceeding \$500,000 for which less than five quotations have been obtained or the lowest offers have not been accepted;

#### *ITSD's Product Selection Guide*

- (j) the Product Selection Guide does provide guidelines on various microcomputer/network system products (e.g. printers) so that departments can select them with due regard to functional capability and cost-effectiveness. The ITSD will review and extend such guidelines to cover other products with large volumes of purchases; and

#### *Contractors' order summary reports*

- (k) the order summary reports provide useful management information to the GSD and the ITSD but do not provide any information of substantial added value to departments for individual purchases.

3.28 The **Secretary for the Treasury** has accepted most of the audit recommendations. She has said that aggregation of demand is inherent in the flexible procurement arrangement which confines the source of supply to the specific companies selected through open tender. There is also a limit to further aggregation of departmental purchases without prejudice to the objectives of responsiveness and flexibility for meeting departmental operational requirements.

3.29 The **Secretary for Information Technology and Broadcasting** supports the comments made by the Director of Information Technology Services.

## **PART 4: SUPPLIES MANAGEMENT IN DEPARTMENTS**

### **Background**

4.1 The SPR specify the procedures which departments should follow in managing their stores procured through either the GSD or direct purchases. According to SPR 250, purchasing and stores management functions should normally be assigned to staff of the Supplies Grades. Departments should ensure as far as possible that they have sufficient Supplies Grade staff to discharge these functions in an appropriate manner.

4.2 There are four grades in the Supplies Grades (i.e. Supplies Officer, Supplies Supervisor, Supplies Assistant and Supplies Attendant). The Director of Government Supplies is the Head of the Supplies Grades and is required to perform a grade management function. The GSD recruits Supplies Grade staff centrally, arranges for their postings in the GSD or in other departments, and provides training and career development opportunities so that they can perform their duties effectively and efficiently. As at 31 March 2001, of the 1,361 officers in the Supplies Grades, 228 officers were posted within the GSD and the remaining 1,133 officers were deployed to 64 departments to help them manage their supplies activities.

### **Direct purchases of stores**

4.3 The GSD acts as the central procurement agent for the purchases of stores. However, according to SPR 245, departments may make direct purchases of stores of a value not exceeding \$500,000 (Note 8). The financial limit is \$750,000 for departments with Supplies Officers, \$1 million for departments with Senior Supplies Officers and \$1.3 million for departments with Chief Supplies Officers or above. Departments should normally obtain the number of quotations as shown in Table 9 below and accept the lowest offer to specification when making direct purchases of stores.

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**Note 8:** *As indicated in paragraphs 2.18 and 3.16 above, before June 2001, departments were not allowed to make direct purchases of common-user items held in the GSD's warehouse or already covered by a bulk contract arranged by the GSD. In June 2001, SPR 245 was revised to allow departments to make direct purchases of such items after seeking the GSD's prior consent having regard to value for money considerations.*

**Table 9**

**Number of quotations required for direct purchases of stores**

<b>Value of purchase</b>	<b>Number of quotations required</b>
Not exceeding \$5,000	1
Over \$5,000 to \$50,000	At least 2
Over \$50,000 to \$1,300,000	At least 5

*Source: SPR 260 and 265*

4.4 SPR 255, 260 and 265 specify the procedures and the ranks of the officers for approving the issue of invitations and/or selecting suppliers for quotations, contacting the suppliers for quotations, approving the acceptance of an offer and authorising the issue of a formal order. These SPR state that:

- (a) the officer who approves the issue of invitations and/or selects suppliers for quotations should not be the officer approving the acceptance of an offer;
- (b) before authorising the issue of a formal order, the responsible officer must ensure that all the required procedures have been duly complied with; and
- (c) departments normally should not make purchases before placing formal orders.

**Maintenance of stores records**

4.5 SPR 610 requires departments to keep complete records of the receipt and issue of all stores held in a departmental store unit in appropriate stores ledgers. SPR 620(c) states that departments should post all ledgers promptly and support each entry by a voucher. SPR 660 stipulates that departments should quote the relevant reference number, such as ledger folio reference number, on the voucher to facilitate cross-referencing.

4.6 Stores are classified into inventory items and non-inventory items. Inventory items are stores of a permanent nature whereas non-inventory items are stores generally of a consumable nature. SPR 720 requires departments to maintain records of all inventory items issued from stock for use by different departmental units. There is no requirement to keep records for non-inventory items after they have been issued from stock.

## Stock verifications by departments

4.7 SPR 1015 stipulates that departments should inspect and verify completely stocks of all items held on ledger charge in all stores under their control as follows:

- (a) **Large stores.** Departments should inspect and verify stores items progressively, ensuring that each item is checked at least once a year, or at such intervals of not exceeding three years; and
- (b) **Small stores.** Departments should inspect and verify completely all stores items at least once a year.

Departments should also check the inventory items at least once a year in accordance with SPR 715(b). In addition, SPR 140(b) requires surprise stock and security checks to be carried out in every store unit at irregular intervals at least once every three months.

## Losses or deficiencies of stores

4.8 As stated in SPR 150(i), an officer in charge of a store unit or a section of a store unit is personally responsible for preserving the security of the store unit. He must not delegate the responsibility of locking and unlocking the store unit and should ensure that it is always attended to when open. SPR 885 states that public officers are personally responsible for the safe custody of all stores received by them in the course of their duties. They may be surcharged under section 32 of the Public Finance Ordinance for any loss resulting from a failure to follow the SPR and/or any instructions issued by the GSD regarding the safe custody of stores (Note 9).

4.9 **Losses or deficiencies involving fraud, suspected fraud or negligence.** Under SPR 1035, a department has to report immediately to the GSD all cases of loss or deficiency of stores where fraud, suspected fraud or negligence is involved. The department should then investigate the case and forward to the GSD a report, including its recommendations for clearing the loss or deficiency, any necessary action taken against the officer(s) responsible and the steps taken to prevent a recurrence. Where appropriate, the GSD may conduct enquiries into the loss or deficiency and make recommendations to the Finance Bureau (FB) of the Government Secretariat. The procedures for the write-off of such losses or deficiencies are as follows:

- (a) **Losses not exceeding \$50,000 in value arising from theft or suspected theft (Note 10).** On completion of a departmental investigation, the department may write off the losses departmentally; and

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**Note 9:** *Section 32 of the Public Finance Ordinance provides that any person who is or was employed as a public officer may be surcharged if he is or was at the time of such employment responsible for any deficiency in or loss or destruction of or damage to any public moneys, stamps, securities, stores or other government property.*

**Note 10:** *SPR 1035(e) states that for the purposes of write-off, departments should “treat any loss arising from theft or suspected theft as a loss involving fraud or negligence on the part of an officer”.*

- (b) *Other losses or deficiencies.* The department should submit an application in respect of each case to the FB for the write-off of losses or deficiencies.

4.10 *Losses or deficiencies not involving fraud, suspected fraud or negligence.* Under SPR 1040, in respect of cases of loss or deficiency of stores where no fraud, suspected fraud or negligence is involved, a department has to take the following action:

- (a) *Losses or deficiencies not exceeding \$500,000 in value.* The department may write off the losses or deficiencies departmentally. In each case, the approving officer is required to certify that no fraud, suspected fraud or negligence is involved, an investigation and a record have been made of the circumstances, steps have been taken where appropriate to prevent a recurrence and he is satisfied that the stores are irrecoverable. A half-yearly return, showing the description and the amount written off in respect of each case, should be submitted to the FB in accordance with SPR 1040(c). A copy of the return is to be provided to the GSD. A nil return is required; and
- (b) *Losses or deficiencies exceeding \$500,000 in value.* The department has to submit an application to the FB as soon as possible for the write-off of the losses or deficiencies. In the application, the department has to give full particulars of the actions taken to effect recovery, certify that no fraud, suspected fraud or negligence is involved and confirm that the stores are irrecoverable and, where necessary, steps have been taken to prevent a recurrence.

### **Stores verifications and system surveys by the GSD**

4.11 The Supplies Surveys and Stock Verification Section (SS & SV Section) of the GSD performs regular stores verifications and system surveys of the supplies activities in departments. The objectives are to ensure that the purchasing and stores management functions are properly performed by departments in accordance with the SPR and to provide advice and information to departments to help achieve greater economy and effectiveness in resource management. Stores verifications involve the examination of the procurement activities, storehouse operations, stores accounting and stock control procedures in departments to ensure that they comply with the SPR. During system surveys, the SS & SV Section studies in depth the supplies procedures and practices adopted and appraises the establishment of the Supplies Grade staff in departments with a view to identifying areas for improvement. In addition, the SS & SV Section is responsible for carrying out investigations into write-off cases where fraud, suspected fraud or negligence is involved.

### **Audit observations on supplies management in departments**

#### **Audit's review of the results of the GSD's stores verifications and system surveys**

4.12 During the period 1998-99 to 2000-01, the SS & SV Section carried out 3,341 stores verifications and 17 system surveys as shown in Table 10 below.

**Table 10**

**Stores verifications and system surveys  
carried out by the SS & SV Section  
1998-99 to 2000-01**

	<b>1998-99</b>	<b>1999-2000</b>	<b>2000-01</b>	<b>Total</b>
<i>Stores verifications</i>				
Number of checking points surveyed (Note)	1,159	977	1,205	3,341
<i>System surveys</i>				
Number of departments surveyed	8	6	3	17

*Source: GSD's records*

*Note: The GSD defines a checking point as a departmental store unit or a departmental administrative unit which maintains stores records at a particular location.*

Audit reviewed the observations and recommendations of the SS & SV Section arising from these stores verifications and system surveys, and the responses from the departments concerned. The audit findings, relating to the period 1998-99 to 2000-01, are given in paragraphs 4.13 to 4.15 below.

***Required procedures for direct purchases of stores not followed***

4.13 The SS & SV Section found that the required procedures for direct purchases of stores under the SPR had not been strictly followed by many departments. Audit noted that:

- (a) in 152 departmental units, the SS & SV Section found cases in which the required procedures for obtaining quotations and accepting an offer had not been complied with. These cases included obtaining less than the required number of quotations, selecting suppliers for quotations and approving the acceptance of an offer by the same officer, inviting some suppliers for quotations more frequently than others, not forming a quotation opening team to handle suppliers' written quotations and not maintaining records of suppliers' telephone quotations; and
- (b) in 121 departmental units, the SS & SV Section found cases in which purchases had been made prior to the completion of the required procedures for the issue of a formal order.

Apart from cases of non-compliance with the SPR, the SS & SV Section also found cases in 99 departmental units where, instead of making bulk purchases to obtain discounts, the departments concerned had made frequent split purchases of the same or similar items from the same supplier on the same day or within a very short period of time.

#### *Stores records not properly maintained*

4.14 The SS & SV Section found cases in 252 departmental units where the stores vouchers had not included all the required details. In 139 departmental units, the stores ledgers had not been updated on a timely basis or had included entries not supported by a stores voucher. 694 departmental units had not maintained complete records of the inventories on hand or had maintained inventory records with unclear item descriptions or without references to the supporting vouchers.

#### *Required stock verifications not performed*

4.15 The SS & SV Section found that:

- (a) 33 departmental units had not performed stock verifications, contrary to SPR 1015;
- (b) 163 departmental units had not checked the inventory items at least once a year, contrary to SPR 715(b); and
- (c) 264 departmental units had not carried out surprise and security checks at irregular intervals at least once every three months, contrary to SPR 140(b).

#### **Need to take further actions to help departments manage their supplies activities**

4.16 The results of the stores verifications and system surveys performed by the SS & SV Section indicate that the GSD needs to take further actions to help departments manage their supplies activities effectively in accordance with the SPR. **Audit considers that the GSD should ensure that the Supplies Grade staff posted to other departments receive adequate training and instructions for performing their duties. In particular, the GSD should organise more intensive training courses for those staff who are responsible for managing the stores where many cases of non-compliance have been found.**

4.17 SPR 125(a) states that Controlling Officers are responsible for the general supervision and control of stores and stores accounts, and for ensuring that the activities are in strict accordance with the SPR. **There is a need for the GSD to regularly remind Controlling Officers of the importance of ensuring compliance with the SPR and draw their attention to the common non-compliance cases detected by the SS & SV Section.**

4.18 According to SPR 1005(a), the SS & SV Section should verify completely or randomly stocks of government stores held by departments according to prescribed criteria at least once a year (or at such intervals of not exceeding two years, as may be determined by the Director of Government Supplies). **Audit considers that, in order to further improve cost-effectiveness, the SS & SV Section should adopt a risk-based approach in conducting stores verifications. Store units with less than satisfactory past performance should be inspected more frequently to ensure that necessary improvements have been duly made.**

**Audit’s review of losses or deficiencies of stores**

4.19 During the period 1998-99 to 2000-01, the total losses or deficiencies of stores reported by departments amounted to \$7.64 million as shown in Table 11 below.

**Table 11**

**Losses or deficiencies of stores reported by departments  
1998-99 to 2000-01**

<b>Classification of losses or deficiencies of stores by departments</b>	<b>1998-99</b>	<b>1999-2000</b>	<b>2000-01</b>	<b>Total</b>
<i>Involving fraud, suspected fraud or negligence</i>				
Number of cases	19	12	5	36
Value (\$ million)	0.10	0.05	0.76	0.91 (Note)
<i>Not involving fraud, suspected fraud or negligence</i>				
Number of cases	599	620	615	1,834
Value (\$ million)	2.04	2.38	2.31	6.73
<b>Total number of cases</b>	<b>618</b>	<b>632</b>	<b>620</b>	<b>1,870</b>
<b>Total value (\$ million)</b>	<b>2.14</b>	<b>2.43</b>	<b>3.07</b>	<b>7.64</b>

Source: FB’s and GSD’s records

Note: The amount of \$0.91 million included losses totalling \$0.85 million in 16 burglary/theft cases.

Audit reviewed the reports of losses or deficiencies of stores submitted by departments during the period 1998-99 to 2000-01. The audit findings are given in paragraphs 4.20 to 4.22 below.

*Departments' returns not checked for completeness*

4.20 SPR 1040(c) requires departments to submit half-yearly returns, including nil returns, on losses or deficiencies of stores to the FB, with a copy to the GSD (see para. 4.10(a) above). **However, Audit could not find the half-yearly returns of some departments from the files of the FB and the GSD.** A summary of the missing half-yearly returns is shown in Table 12 below.

**Table 12**  
**Summary of missing half-yearly returns**  
**on losses or deficiencies of stores**  
**1998-99 to 2000-01**

Half-year ended	Number of returns not received by the FB	Number of returns not received by the GSD
30 September 1998	7	9
31 March 1999	6	10
30 September 1999	5	10
31 March 2000	7	10
30 September 2000	6	9
31 March 2001	6	11
<b>Total</b>	<b>37</b>	<b>59</b>

*Source: FB's and GSD's records*

*Inconsistent treatments of losses of stores issued to officers*

4.21 According to SPR 1035(e), departments should “treat any loss arising from theft or suspected theft as a loss involving fraud or negligence on the part of an officer” (see Note 10 to para. 4.9(a) above). Also, SPR 885 states that public officers are personally responsible for the safe custody of all stores received by them in the course of their duties and may be surcharged for losses of these stores (see para. 4.8 above). Audit noted that there were seven cases of loss of stores issued to officers in which the officers concerned had been surcharged during the period 1998-99 to 2000-01, or with surcharge actions in progress as at 31 March 2001. Details are given in Table 13 below.

**Table 13**

**Cases of loss of stores with surcharge actions  
1998-99 to 2000-01**

<b>Reporting date</b>	<b>Department</b>	<b>Lost item</b>	<b>Circumstances of the loss</b>
<i>(A) Cases in which officers had been surcharged during 1998-99 to 2000-01</i>			
January 1999	Transport Department	A mobile phone	The item was lost when the officer was on his way to attend official duties.
January 1999	Transport Department	A mobile phone	The item was lost when the officer was on the way to work.
March 1999	Transport Bureau	A mobile phone	The officer placed the item on a desk in the office.
June 1999	Transport Department	A mobile phone	The officer lost the item during lunch time.
<i>(B) Cases with surcharge actions in progress as at 31 March 2001</i>			
February 1998	Intellectual Property Department	A notebook computer	The officer left the item in a workstation in the office.
September 2000	Independent Commission Against Corruption	A mobile phone	The officer left the item in the office.
November 2000	Rating and Valuation Department	A camera	The officer left the item in a taxi after official duties.

*Source: FB's records*

*Note: According to SPR 1080, surcharge should normally be the greater of the scrap value or the depreciated value of the lost item, plus an additional charge of 20% for overheads.*

In all the seven cases in Table 13 above, the departments concerned treated the cases as involving fraud, suspected fraud or negligence in accordance with SPR 1035(e) and considered that the officers were responsible for the losses.

4.22 Audit reviewed the reports of lost items in the half-yearly returns submitted by departments and noted that there were other cases of loss of stores (such as mobile phones, cameras, binoculars and notebook computers) issued to officers in the course of their duties. The departments concerned treated these cases as not involving fraud, suspected fraud or negligence, and wrote off the items departmentally in accordance with SPR 1040. The officers concerned had not been surcharged. During the period 1998-99 to 2000-01, for example, departments reported 184 cases of loss of mobile phone with a total value of \$410,916. **Audit examined a random sample of 20 of these 184 cases. Audit found that in the 20 cases the circumstances were similar to those outlined in Table 13 in paragraph 4.21 above. However, unlike the cases in Table 13, in these 20 cases the officers concerned had not been surcharged.**

#### **Need to examine returns submitted by departments**

4.23 The half-yearly returns submitted by departments under SPR 1040(c) enable the FB and the GSD to monitor the nature and extent of losses or deficiencies of stores in various departments to determine if improvement measures should be implemented to safeguard government property. Audit considers that there is a need for the FB and the GSD to implement checking procedures to ensure that all departments submit the half-yearly returns. The FB and the GSD should review these returns to determine if departments have followed the required procedures laid down in the SPR. In particular, there is a need to provide departments with more detailed guidelines on the processing of cases of loss of stores issued to officers, including the circumstances in which the officers concerned should be surcharged for the losses.

#### **Audit recommendations on supplies management in departments**

4.24 **Audit has *recommended* that the Director of Government Supplies should:**

- (a) **provide adequate training and instructions to the Supplies Grade staff to enable them to manage the departmental supplies activities more effectively in accordance with the SPR. In particular, the Director should organise intensive training courses for those staff who are responsible for managing the stores where many cases of non-compliance have been found;**
- (b) **regularly remind Controlling Officers of the importance of ensuring compliance with the SPR and draw their attention to the common non-compliance cases; and**

- (c) **adopt a risk-based approach in conducting stores verifications of departments by inspecting more frequently those store units with unsatisfactory past performance. This will help ensure that effective and timely improvement measures are taken.**

4.25 **Audit has *recommended* that the Secretary for the Treasury and the Director of Government Supplies should implement checking procedures to ensure that departments have exercised properly their delegated authority for writing off losses or deficiencies of stores. In particular, the Secretary for the Treasury and the Director of Government Supplies should:**

- (a) **take action to ensure that all departments submit to them on time the half-yearly returns required by SPR 1040(c);**
- (b) **issue more detailed guidelines on the treatment of losses or deficiencies of stores, including the circumstances in which the officers concerned should be surcharged for the losses or deficiencies; and**
- (c) **consider asking departments to examine the past cases of loss or deficiency of stores, as reported in their half-yearly returns, in order to find out whether there are cases which warrant surcharge action.**

### **Response from the Administration**

4.26 **The Director of Government Supplies has agreed that provision of training and appropriate instructions is the best means to help staff perform their supplies functions effectively. He has said that there is a need to introduce additional checking procedures to monitor if departments have followed the required procedures on treatment of losses or deficiencies of stores. He has also said that:**

#### ***Provision of training and instructions***

- (a) **the GSD will further expand its training programme. It will increase its refresher courses on the SPR and provide opportunity for all Supplies Grade staff to attend such courses once every two years. Priority will be given to those staff who work in store units where many cases of non-compliance with the SPR have been detected;**
- (b) **in some departments, the supplies functions or some of them are performed by non-Supplies Grade staff, who are not familiar with supplies work and have difficulty in**

handling supplies matters. The GSD will organise special introductory courses on the SPR and invite these non-Supplies Grade staff to attend;

- (c) from time to time, the GSD issues circulars and memoranda to announce, explain or clarify any new instructions or arrangements related to supplies activities. A help desk service has been introduced to answer enquiries and provide assistance on supplies matters;

#### ***Drawing the attention of Controlling Officers***

- (d) he agrees that there is a need for the GSD to regularly draw the attention of Controlling Officers to the importance of ensuring compliance with the SPR and to the common cases of non-compliance identified. In future, the GSD will send the stores verification/system survey reports to Controlling Officers personally;
- (e) through its training sessions, the GSD will draw the attention of attendees to the common mistakes in supplies work and ways to prevent their occurrence;

#### ***Adopting a risk-based approach in conducting stores verifications***

- (f) he agrees that there will be advantage in adopting a risk-based approach in conducting stores verifications. The GSD will rearrange its inspection programme to enable more frequent inspections to be conducted on store units with less than satisfactory past performance;

#### ***Losses or deficiencies of stores***

- (g) the GSD will put in place checking procedures to remind departments to submit on time their half-yearly returns required by SPR 1040(c). Action is in hand to chase up the departments concerned for the missing returns noted by Audit;
- (h) the GSD will consider issuing, for reference by Controlling Officers, some further guidelines on treatment of losses or deficiencies of stores, including the circumstances under which the officers concerned may be surcharged. It should be noted that no guidelines can be exhaustive and Controlling Officers will need to continue to evaluate each case on its own; and

- (i) no advantage may be gained by requesting Controlling Officers to review old cases which have been closed. Controlling Officers have already taken a decision on these past cases, and they must have, no doubt, taken into account all relevant factors known to them at the time, prior to making the decisions. To revisit these cases is undesirable from the staff relations point of view.

4.27 The **Secretary for the Treasury** accepts the audit recommendations. She has said that the FB will put in place a checking system and, as necessary, remind departments to submit their half-yearly returns. She agrees that departments should be asked to be more vigilant in examination of cases and to consider surcharge as circumstances warrant, and that some degree of consistency across departments would be desirable. She has also said that:

- (a) the FB will consider issuing guidelines for consistency of approach in treatment of losses and, as appropriate, surcharge of officers for losses. However, since circumstances of losses differ significantly among individual cases, it would not be possible for the guidelines to be exhaustive or prescriptive. The FB must properly rely on the judgement of Controlling Officers who are ultimately responsible for the management of resources within their departments; and
- (b) it would not be appropriate for any new measures to be applied retrospectively, nor therefore to reopen past cases which, in the judgement of the Controlling Officers, had been written off.

**Appendix A**  
(para. 2.9 refers)

**GSD oncosts for the supply of common-user items**

<b>Year</b>	<b>Value of items issued to users</b>	<b>Total GSD oncosts</b>	<b>Average oncost rate</b>
	<b>(a)</b>	<b>(b)</b>	<b>(c) = <math>\frac{(b)}{(a)} \times 100\%</math></b>
	<b>(\$ million)</b>	<b>(\$ million)</b>	<b>(Percentage)</b>
1994-95	344.2	133.8	38.9%
1995-96	395.3	136.5	34.5%
1996-97	436.8	121.5	27.8%
1997-98	388.0	102.3	26.4%
1998-99	369.4	108.5	29.4%
1999-2000	341.9	97.2	28.4%

*Source: GSD's records*

*Note: As a result of the implementation of improvement and efficiency measures, the total oncosts of the GSD for the supply of common-user items decreased from \$133.8 million in 1994-95 to \$97.2 million in 1999-2000. The average oncost rate also decreased from 38.9% in 1994-95 to 28.4% in 1999-2000.*

**Appendix B**  
(para. 2.15 refers)

**Audit estimate of reduction in average stockholding  
based on the target stock turnover rate of five times a year**

Type of stores	Average stockholding for items with a stock turnover rate lower than the target rate	Average stockholding based on the target rate (Note)	Reduction in average stockholding
	(a)	(b)	(a) – (b)
	(\$ million)	(\$ million)	(\$ million)
Medical stores	29.5	16.4	13.1
Electrical stores	9.2	1.0	8.2
Printed stationery stores	6.0	1.4	4.6
Textiles and uniform	6.0	1.6	4.4
Paper stationery	1.6	0.2	1.4
Civil and light engineering stores	1.7	0.4	1.3
Office sundries	2.4	1.2	1.2
Household and cleansing materials	2.2	1.2	1.0
Furniture and equipment stores	0.2	0.1	0.1
<b>Total</b>	<u><u>58.8</u></u>	<u><u>23.5</u></u>	<u><u>35.3</u></u>

Source: GSD's records

Note: For each item, the average stockholding based on the target rate of five times a year is computed by the following formula:

Value of stock issued in 2000-01

**Dormant or slow-moving common-user items  
with a stock turnover rate lower than 0.5 time a year in 2000-01**

Type of stores	Number of items	As percentage of total number of items	Value as at 31 March 2001 (\$ million)	As percentage of total value
<b>(A) Stock turnover rate lower than 0.01 time a year</b>				
Electrical stores	48	2.9%	1.54	2.3%
Medical stores	21	1.3%	0.97	1.5%
Paper stationery	2	0.1%	0.60	0.9%
Printed stationery stores	68	4.2%	0.54	0.8%
Textiles and uniform	18	1.1%	0.54	0.8%
Civil and light engineering stores	21	1.3%	0.17	0.3%
Household and cleansing materials	12	0.7%	0.01	-
Furniture and equipment stores	3	0.2%	-	-
Office sundries	1	0.1%	-	-
<b>Total</b>	<b><u>194</u></b>	<b><u>11.9%</u></b>	<b><u>4.37</u></b> (Note)	<b><u>6.6%</u></b>
<b>(B) Stock turnover rate of 0.01 or higher, but lower than 0.1 time a year</b>				
Electrical stores	25	1.5%	3.41	5.1%
Textiles and uniform	18	1.1%	1.12	1.7%
Printed stationery stores	97	6.0%	0.93	1.4%
Paper stationery	1	0.1%	0.26	0.4%
Household and cleansing materials	4	0.2%	0.15	0.2%
Medical stores	5	0.3%	0.11	0.2%
Civil and light engineering stores	4	0.2%	0.05	0.1%
<b>Total</b>	<b><u>154</u></b>	<b><u>9.4%</u></b>	<b><u>6.03</u></b>	<b><u>9.1%</u></b>

Type of stores	Number of items	As percentage of total number of items	Value as at 31 March 2001 (\$ million)	As percentage of total value
<i>(C) Stock turnover rate of 0.1 or higher, but lower than 0.2 time a year</i>				
Electrical stores	10	0.6%	0.85	1.3%
Printed stationery stores	43	2.7%	0.39	0.6%
Civil and light engineering stores	4	0.2%	0.12	0.2%
Household and cleansing materials	1	0.1%	0.06	0.1%
Office sundries	1	0.1%	0.05	0.1%
Textiles and uniform	4	0.2%	0.01	-
Medical stores	2	0.1%	0.01	-
<b>Total</b>	<b><u>65</u></b>	<b><u>4.0%</u></b>	<b><u>1.49</u></b>	<b><u>2.3%</u></b>
<i>(D) Stock turnover rate of 0.2 or higher, but lower than 0.5 time a year</i>				
Electrical stores	31	1.9%	1.07	1.6%
Printed stationery stores	103	6.3%	1.00	1.5%
Textiles and uniform	11	0.7%	0.78	1.2%
Civil and light engineering stores	5	0.3%	0.37	0.6%
Medical stores	3	0.2%	0.09	0.1%
Household and cleansing materials	2	0.1%	-	-
<b>Total</b>	<b><u>155</u></b>	<b><u>9.5%</u></b>	<b><u>3.31</u></b>	<b><u>5.0%</u></b>

Source: GSD's records

Note: Stores items with values exceeding \$100,000 as at 31 March 2001 were as follows:

<i>Item no.</i>	<i>Item description</i>	<i>Value</i> (\$)
<i>Electrical stores</i>		
24402300L	Gear control 750W mobile lamp	197,563
24404110F	Floodlighting fitting for 750W mobile lamp	352,843
24548210F	Light wall-mounted connected with shaver socket	149,264
<i>Medical stores</i>		
90101550E	Syrup ampicillin 500ml	667,730
<i>Paper stationery</i>		
12247010K	Stencil duplicating	598,250
<i>Textiles and uniform</i>		
11461040B	Dyed sheeting cotton apricot pink	133,071
11461010L	Dyed sheeting cotton light blue	124,298
11493010E	Twill blended cotton/polyester light blue	154,534
<b>Total</b>		<b><u>2,377,553</u></b>

**Comparison of the contractors' average selling prices  
of typical microcomputer/network systems with the average market prices  
for the period January 1998 to March 2001**

Period covered by ITSD's study	Saving (Note 1)	
	Typical microcomputer system (Note 2)  (Percentage)	Typical network system (Note 3)  (Percentage)
<b>Bulk procurement before January 2000</b>		
First quarter of 1998	11.9%	22.7%
Second quarter of 1998	11.0%	14.1%
Third quarter of 1998	8.9%	8.7%
Last quarter of 1998	7.3%	13.2%
First quarter of 1999	23.2%	18.5%
Second quarter of 1999	24.2%	17.9%
Third quarter of 1999 (Note 4)	0.7%	14.7%
<b>Flexible procurement from January 2000</b>		
First quarter of 2000	23.4%	18.0%
Second quarter of 2000	10.2%	13.3%
Third quarter of 2000	11.1%	<b>-4.1%</b>
Last quarter of 2000	17.9%	8.4%
First quarter of 2001	17.9%	18.0%

*Source: Audit's analysis based on ITSD's records*

*Note 1: Saving is computed as follows:*

$$\frac{\text{Average market price} - \text{Contractors' average selling price}}{\text{Average market price}} \cdot 100\%$$

*Note 2: In the first quarter of 2001, the contractors' average selling price of the typical microcomputer system specified by the ITSD (consisting of a microcomputer system unit, a personal printer and application software) was \$12,347.*

*Note 3: In the first quarter of 2001, the contractors' average selling price of the typical network system specified by the ITSD (consisting of network hardware, including mainly a network server and a network printer, and network software serving 25 users) was \$72,993.*

*Note 4: The price benchmark study for the last quarter of 1999 was not performed in view of the impending change to the flexible procurement approach in January 2000.*

**Comparison of the contractors' average selling prices of  
microcomputer system units and network hardware with the average market prices  
for the period January 1998 to March 2001**

Period covered by ITSD's study	Saving (Note 1)	
	Microcomputer system unit (Note 2)  (Percentage)	Network hardware (Note 3)  (Percentage)
<b>Bulk procurement before January 2000</b>		
First quarter of 1998	5.4%	15.9%
Second quarter of 1998	4.8%	2.6%
Third quarter of 1998	<b>-1.0%</b>	<b>-6.9%</b>
Last quarter of 1998	<b>-13.7%</b>	0.0%
First quarter of 1999	13.3%	1.2%
Second quarter of 1999	14.4%	3.9%
Third quarter of 1999 (Note 4)	<b>-41.2%</b>	<b>-6.3%</b>
<b>Flexible procurement from January 2000</b>		
First quarter of 2000	18.0%	2.9%
Second quarter of 2000	1.1%	<b>-1.9%</b>
Third quarter of 2000	10.9%	<b>-15.6%</b>
Last quarter of 2000	17.2%	0.4%
First quarter of 2001	9.1%	9.5%

*Source: Audit's analysis based on ITSD's records*

*Note 1: Saving is computed as follows:*

$$\frac{\text{Average market price} - \text{Contractors' average selling price}}{\text{Average market price}} \cdot 100\%$$

*Note 2: In the first quarter of 2001, the contractors' average selling price of the microcomputer system unit specified by the ITSD was \$6,382.*

*Note 3: In the first quarter of 2001, the contractors' average selling price of the network hardware specified by the ITSD was \$55,374.*

*Note 4: The price benchmark study for the last quarter of 1999 was not performed in view of the impending change to the flexible procurement approach in January 2000.*

**RAM purchased at higher than the average market prices  
for the period January 1998 to March 2001**

**Saving (Note 1)**

<b>Period covered by ITSD's study</b>	<b>RAM for microcomputer systems (Note 2)  (Percentage)</b>	<b>RAM for network systems (Note 3)  (Percentage)</b>
<b>Bulk procurement before January 2000</b>		
First quarter of 1998	-12.5%	-255.7%
Second quarter of 1998	-94.0%	-471.9%
Third quarter of 1998	-159.1%	-422.9%
Last quarter of 1998	-53.5%	-266.3%
First quarter of 1999	-2.2%	-57.1%
Second quarter of 1999	-1.1%	-40.5%
Third quarter of 1999 (Note 4)	14.1%	-53.6%
<b>Flexible procurement from January 2000</b>		
First quarter of 2000	-41.5%	-22.5%
Second quarter of 2000	-63.8%	-55.7%
Third quarter of 2000	-33.0%	-12.6%
Last quarter of 2000	1.5%	-61.6%
First quarter of 2001	19.2%	-41.6%

*Source: Audit's analysis based on ITSD's records*

*Note 1: Saving is computed as follows:*

$$\frac{\text{Average market price} - \text{Contractors' average selling price}}{\text{Average market price}} \cdot 100\%$$

*Note 2: In the first quarter of 2001, the contractors' average selling price of the most powerful RAM for microcomputer systems sold by them was \$600.*

*Note 3: In the first quarter of 2001, the contractors' average selling price of the most powerful RAM for network systems sold by them was \$3,521.*

*Note 4: The price benchmark study for the last quarter of 1999 was not performed in view of the impending change to the flexible procurement approach in January 2000.*

**Examples of contractors' revised contract prices of  
microcomputer/network systems which were higher than market prices**

Contractor	Contractor's prices		Average market price found in the price benchmark study for the third quarter of 1998 (Note 1)
	Prevailing contract price	Revised contract price	
	(\$)	(\$)	(\$)
<b>(A) Microcomputer system unit</b>			
Contractor B	11,763	11,718	10,847
Contractor C	10,667	12,035 (Note 2)	10,847
<b>(B) Network server</b>			
Contractor A	43,881	43,881	32,370
Contractor B	45,001	45,001 (Note 3)	32,370
Contractor C	40,487	40,487 (Note 4)	32,370
<b>(C) RAM for microcomputer systems</b>			
Contractor A	1,480	960	646
Contractor B	1,527	993	646
Contractor C	1,710	1,026	646

Contractor	Contractor's prices		Average market price found in the price benchmark study for the third quarter of 1998 (Note 1)
	Prevailing contract price	Revised contract price	
	(\$)	(\$)	(\$)
<i>(D) RAM for network systems</i>			
Contractor A	3,380	3,380	914
Contractor B	3,820	2,865	914
Contractor C	5,133	1,812	914

Source: GSD's and ITSD's records

Note 1: The price benchmark study for the third quarter of 1998 is selected for illustration purposes.

Note 2: A more powerful microcomputer system unit, bundled with free software, a training session and three-year on site warranty services, was offered by Contractor C.

Note 3: A more powerful network server was offered by Contractor B.

Note 4: A more powerful network server was offered by Contractor C.

**Appendix H**  
(para. 3.13(c) refers)

**Number of contractors for the supply of  
microcomputer/network systems under the Standing Offer Agreements  
(as from January 2000)**

<b>Product category</b>	<b>Description</b>	<b>Number of contractors in Categories A to F</b>	<b>Number of contractors in Category A from whom quotations for products in Categories B to F may also be obtained</b>	<b>Total number of contractors available for obtaining quotations</b>
		<b>(a)</b>	<b>(b)</b>	<b>(c) = (a) + (b)</b>
A	Total system	5	–	5
B	Computer hardware and peripherals	3	3	6
C	Computer software	3	2	5
D	Printers	3	4	7
E	Network devices	3	3	6
F	System integration services and support services	3	5	8

*Source: GSD's records*

## Appendix I

### Acronyms and abbreviations

CRT	Cathode ray tube
FB	Finance Bureau
GSD	Government Supplies Department
IT	Information technology
ITSD	Information Technology Services Department
LCD	Liquid crystal display
RAM	Random access memory
SPR	Stores and Procurement Regulations
SS & SV Section	Supplies Surveys and Stock Verification Section