

CHAPTER 8

Hongkong Post

<h4>Provision of postal services</h4>
--

**Audit Commission
Hong Kong
29 March 2010**

This audit review was carried out under a set of guidelines tabled in the Provisional Legislative Council by the Chairman of the Public Accounts Committee on 11 February 1998. The guidelines were agreed between the Public Accounts Committee and the Director of Audit and accepted by the Government of the Hong Kong Special Administrative Region.

Report No. 54 of the Director of Audit contains 8 Chapters which are available on our website at <http://www.aud.gov.hk>.

Audit Commission
26th floor, Immigration Tower
7 Gloucester Road
Wan Chai
Hong Kong

Tel : (852) 2829 4210
Fax : (852) 2824 2087
E-mail : enquiry@aud.gov.hk

PROVISION OF POSTAL SERVICES

Contents

	Paragraph
PART 1: INTRODUCTION	1.1
Background	1.2
The Post Office Trading Fund	1.3 – 1.8
Director of Audit’s Reports on the Hongkong Post	1.9
Audit review	1.10
Acknowledgement	1.11
PART 2: BUSINESS PLANNING	2.1
Annual business planning of the Hongkong Post	2.2
Audit observations and recommendations	2.3 – 2.6
Response from the Administration	2.7 – 2.8
PART 3: POSTAL OPERATIONS	3.1
Background	3.2 – 3.4
Financial viability of post offices	3.5 – 3.8
Audit observations and recommendations	3.9 – 3.13
Response from the Administration	3.14
Underpayment of postage	3.15

	Paragraph
Audit observations and recommendations	3.16 – 3.19
Response from the Administration	3.20
Revision of the Local Bulk Mail Scheme	3.21 – 3.26
Audit observations and recommendation	3.27 – 3.28
Response from the Administration	3.29
Testing and maintenance of postal scales	3.30
Audit observations and recommendations	3.31 – 3.34
Response from the Administration	3.35
Supervisory checks on mail	3.36
Audit observations and recommendations	3.37 – 3.43
Response from the Administration	3.44
Post office box service	3.45
Audit observations and recommendation	3.46 – 3.48
Response from the Administration	3.49
Sorting of letters	3.50 – 3.51
Audit observations and recommendations	3.52 – 3.55
Response from the Administration	3.56
Transportation of mail	3.57 – 3.58
Audit observations and recommendations	3.59 – 3.63
Response from the Administration	3.64

	Paragraph
PART 4: FINANCIAL PERFORMANCE	4.1
Financial performance of the Hongkong Post	4.2
Audit observations and recommendations	4.3 – 4.6
Response from the Administration	4.7
Determination of postage rates	4.8
Audit observations and recommendations	4.9 – 4.11
Response from the Administration	4.12
Revision of postage rates	4.13 – 4.14
Audit observations and recommendation	4.15 – 4.16
Response from the Administration	4.17
 PART 5: PERFORMANCE MANAGEMENT AND REPORTING	 5.1
Performance pledges	5.2 – 5.3
Audit observations and recommendations	5.4 – 5.15
Response from the Administration	5.16
	 Page
Appendix : Acronyms and abbreviations	42

PART 1: INTRODUCTION

1.1 This PART describes the background to the audit and outlines the audit objectives and scope.

Background

1.2 The aims of the Hongkong Post (HKP) are to meet Hong Kong's postal needs and fulfil Hong Kong's international postal obligations by providing reliable, efficient and universal postal services at reasonable and affordable prices. The HKP, headed by the Postmaster General, operates under the Post Office Ordinance (Cap. 98). The Commerce and Economic Development Bureau (CEDB) is responsible for formulating policies in relation to postal services.

The Post Office Trading Fund

1.3 The Post Office Trading Fund (POTF) was established by a Resolution of the Legislative Council passed on 19 July 1995 under the Trading Funds Ordinance (Cap. 430). In August 1995, the HKP began operating as a trading fund. A trading fund is an accounting framework established under the Trading Funds Ordinance to enable a government department to operate on a self-financing basis. The trading fund arrangement is designed primarily for improving the operational efficiency and service quality of those government departments which meet the conditions set out in the Ordinance. The main feature of a trading fund department is that all revenue generated from its services is paid into the fund and all expenditure incurred in providing the services is paid out of the fund.

1.4 As a trading fund department, the HKP is expected to:

- (a) respond more effectively to changes in its markets and operating environment;
- (b) improve productivity, cost efficiency and customer service standards by having greater flexibility in resource management; and
- (c) plough back a portion of its profits into the business, allowing it to upgrade the services to its customers.

On the other hand, the HKP has to assume a higher degree of financial accountability and management responsibility, and is required to meet a financial performance target set by the Government. The HKP is expected to provide its services on a self-financing basis plus a reasonable return, as determined by the Financial Secretary, on the fixed assets employed.

Since 1 April 2006, the target rate of return has been set at 8.4% on the POTF's average net fixed assets (ANFA — Note 1).

1.5 Since the establishment of the POTF, a regulatory framework in the form of a framework agreement, a corporate plan and a business plan has been put in place to ensure that the HKP exercises its increased autonomy responsibly and that the interests of its customers are safeguarded. A Framework Agreement was signed by the then Secretary for Economic Services and the Postmaster General on 1 August 1995. It sets out the responsibilities of the Secretary and the Postmaster General, the aims, functions and objectives, and the financial planning and control matters of the HKP. Every year, the HKP prepares a Medium Range Corporate Plan and an Annual Business Plan.

1.6 As at 31 December 2009, the HKP employed 7,254 staff, comprising 5,037 (69.4%) civil service staff, 2,088 (28.8%) non-civil service contract (NCSC) staff and 129 (1.8%) part-time staff. In addition, the HKP had the following postal infrastructure to support the provision of postal services:

- (a) a retail network of 125 post offices and two mobile post offices;
- (b) about 1,000 street posting boxes;
- (c) three mail processing centres, namely the General Post Office (GPO) at Central which handles local mail and inward air mail, the International Mail Centre (IMC) at Hunghom which handles local and surface mail, and the Air Mail Centre (AMC) at Chek Lap Kok which handles outward air mail;
- (d) 29 delivery offices with a total of about 1,700 postmen's delivery beats; and
- (e) a fleet of about 300 vehicles.

1.7 Postal services provided by the HKP include the receiving and collecting of mail, the delivering of local mail and inward mail to 2.9 million residential and business addresses (including about 50,000 post office boxes), and the despatching of outward mail to carriers for sending the mail to about 230 destinations outside Hong Kong. In 2008-09, the HKP handled 1,379 million mail, of which local mail accounted for 86.2% and inward/outward mail 13.8%.

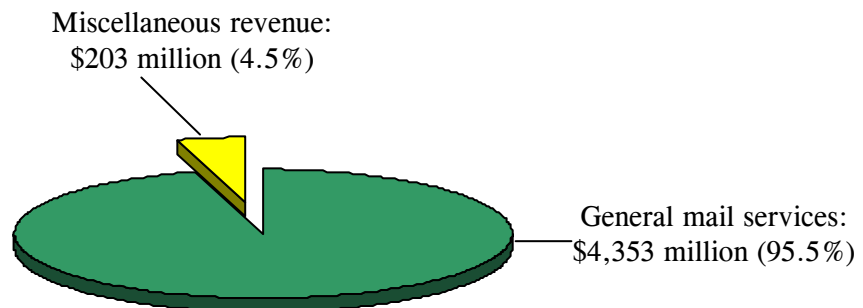
Note 1: *The rate of return on ANFA is defined as the POTF's profit after tax (excluding interest income, interest expenses and net realised and revaluation gains or losses on derivative financial instruments) divided by its ANFA (i.e. the average of the net fixed assets at the beginning and at the end of the financial year).*

1.8 In 2008-09, the revenue and operating costs of the POTF were \$4,556 million and \$4,207 million respectively (see Figure 1), resulting in an operating profit of \$349 million. The rate of return was 9.9% on ANFA.

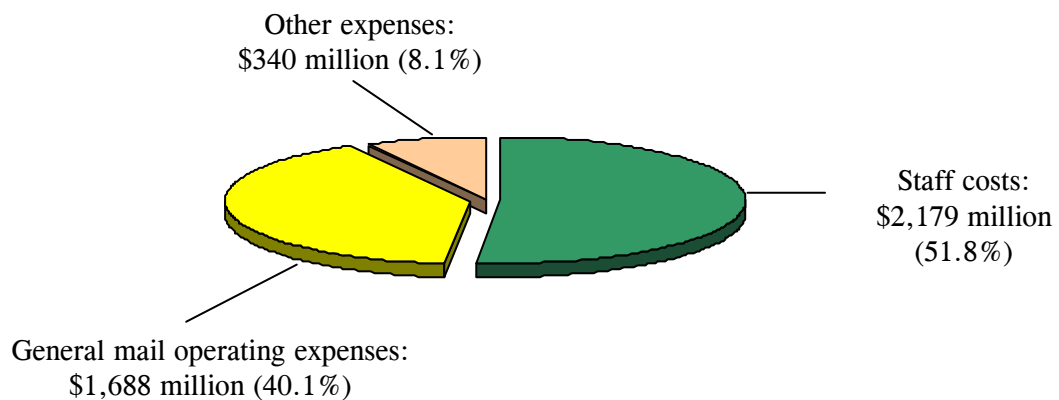
Figure 1

**Revenue and operating costs of the Post Office Trading Fund
(2008-09)**

(A) Revenue: \$4,556 million



(B) Operating costs: \$4,207 million



Source: HKP records

Director of Audit's Reports on the Hongkong Post

1.9 In the following Director of Audit's Reports, the Audit Commission (Audit) reported observations on different aspects of the HKP:

- (a) The Postal Mechanisation System at the Air Mail Centre (Chapter 7 of the Director of Audit's Report No. 44 of March 2005); and
- (b) Administration of the Hongkong Post Certification Authority (Chapter 2 of the Director of Audit's Report No. 49 of October 2007).

In these audit reviews, Audit made a number of recommendations for improvement. The Administration accepted the audit recommendations and subsequently implemented them.

Audit review

1.10 Audit has recently conducted a review of the HKP's provision of postal services, focusing on the following areas:

- (a) business planning (PART 2);
- (b) postal operations (PART 3);
- (c) financial performance (PART 4); and
- (d) performance management and reporting (PART 5).

Audit has found that there is room for improvement in the above areas, and has made a number of recommendations to address the issues.

Acknowledgement

1.11 Audit would like to acknowledge with gratitude the full cooperation of the staff of the HKP during the course of the audit review.

PART 2: BUSINESS PLANNING

2.1 This PART examines the business planning process of the HKP.

Annual business planning of the Hongkong Post

2.2 The objective of the HKP's annual planning exercise is to facilitate the HKP to look ahead in conducting its business and allocating its resources, to focus on key factors and to prepare for challenges and opportunities. According to the Framework Agreement signed in August 1995 (see para. 1.5):

- (a) the HKP will prepare each year a Medium Range Corporate Plan and an Annual Business Plan;
- (b) the Plans will be submitted each year at the beginning of October for approval, subject to amendments as necessary, not later than the end of January in the following year; and
- (c) the CEDB will, after due discussion with the HKP and with the approval of the Financial Services and the Treasury Bureau (FSTB), authorise the HKP to proceed in accordance with those Plans as submitted or suitably amended.

Audit observations and recommendations

2.3 It is important for the HKP to obtain the CEDB's authorisation to proceed in accordance with the Medium Range Corporate Plan and the Annual Business Plan before the commencement of the relevant financial year. Without such authorisation, it is uncertain whether funds should be committed to implement its planned business activities. The efficiency of the HKP's operation could thus be adversely affected. In this regard, the Framework Agreement provides that the HKP will submit the Plans at the beginning of October for approval not later than the end of January in the following year (see para. 2.2(b)). However, Audit noted that the Plans for the year 2007-08 was only submitted on 27 February 2007. Approval of the Plans was given by the FSTB on 4 April 2007 and the CEDB's authorisation for the HKP to proceed with the Plans was given on 2 May 2007.

2.4 In October 2007, the HKP sought the CEDB's agreement to revise the submission time of the Plans to the end of January with effect from 2008-09 for the following reasons:

- (a) the postal services were subject to ever-increasing keen competition in the market, a more commercial-like approach should be adopted in the HKP's

business planning process. In formulating business strategy and practical business programmes, the HKP needed to keep abreast of the latest market situation and collect customer intelligence; and

- (b) as most of the HKP's customers would only conduct their own business planning in around November/December each year, the HKP would not be able to incorporate the most up-to-date market information in its Plans if they were to be submitted in October. The submission time should be revised to take into account the practical situation in the market and to make the Plans as realistic as possible. The proposed submission time would also allow a reasonable period for the FSTB and the CEDB to review the Plans.

2.5 In October 2007, the CEDB and the FSTB agreed to use the 2008-09 business planning exercise as a pilot arrangement to see whether a submission deadline of end of January would enable the approval/authorisation to be given to the HKP before the commencement of the financial year. **Audit noted that in 2008-09 and 2009-10, the FSTB approved the Plans 37 and 8 days respectively after the relevant financial year had commenced. Authorisations for the HKP to proceed in accordance with the Plans were given by the CEDB 93 and 104 days respectively after the relevant financial year had commenced (see Table 1). The HKP, the CEDB and the FSTB need to further improve the arrangements for the submission and approval/authorisation of the Plans.**

Table 1

**Elapsed time from 1 April to CEDB's authorisation
(2008-09 and 2009-10)**

Year	Date of submission of Plans by HKP	Date of FSTB's approval	Elapsed time from 1 April to FSTB's approval (Day)	Date of CEDB's authorisation	Elapsed time from 1 April to CEDB's authorisation (Day)
2008-09	28.1.2008	8.5.2008	37	3.7.2008	93
2009-10	29.1.2009 (Note 1)	9.4.2009	8	14.7.2009 (Note 2)	104

Source: HKP records

Note 1: The Plans were subsequently revised at the request of the FSTB and were resubmitted on 6 March 2009.

Note 2: On 12 June 2009, the CEDB informed the HKP of the Secretary for Commerce and Economic Development's agreement for HKP to proceed in accordance with the Plans, subject to further clarifications.

Audit recommendations

- 2.6 **Audit has recommended that the Postmaster General should:**
- (a) **in consultation with the CEDB and the FSTB, determine a practical submission time of the Medium Range Corporate Plan and the Annual Business Plan so that the necessary approval and authorisation can be given to the HKP before the commencement of the relevant financial year; and**
 - (b) **consider amending the Framework Agreement to reflect the new arrangements for the submission and approval/authorisation of the Medium Range Corporate Plan and the Annual Business Plan.**

Response from the Administration

2.7 The **Postmaster General** agrees with the audit recommendations. He has said that:

- (a) the Medium Range Corporate Plan and the Annual Business Plan are important tools for management control and strategic development of the HKP. As such, they should be compiled with updated data and emerging trends, the availability of which places a serious constraint on the time frame. On this premise, the HKP will, in consultation with the relevant parties, iron out a realistic timetable that could allow sufficient time for completing the approval and authorisation process before the commencement of the relevant financial year; and
- (b) the HKP will seek agreement of the CEDB to reflect in the Framework Agreement the new arrangements for the submission and approval/authorisation of the Medium Range Corporate Plan and the Annual Business Plan.

2.8 The **Secretary for Financial Services and the Treasury** agrees with the audit recommendation that a practical submission time needed to be determined to ensure that approval and authorisation of the Medium Range Corporate Plan and the Annual Business Plan are given to the HKP before the commencement of the relevant financial year.

PART 3: POSTAL OPERATIONS

3.1 This PART examines the HKP's postal operations.

Background

3.2 The services that the POTF may provide are set out in Schedule 1 of the Resolution of the Legislative Council passed under the Trading Funds Ordinance on 19 July 1995. Most of the services are mail services. In 2008-09, revenue earned by the POTF from mail services accounted for 95.5% of its total revenue (see Figure 1 in para. 1.8).

3.3 In general, mail processing involves the following operations:

- (a) locally posted mail is received at the post office counters or collected from posting boxes, and inward mail is received at the AMC (air mail) and the IMC (surface mail);
- (b) mail with local addresses is processed at the GPO and the IMC. Outward mail is processed at the AMC and the IMC; and
- (c) mail with local addresses is delivered to the addressees by the postmen of the delivery offices serving the respective districts, and outward mail is delivered to destinations outside Hong Kong.

3.4 Audit has reviewed the postal operations and has identified room for improvement in the following areas:

- (a) financial viability of post offices (paras. 3.5 to 3.14);
- (b) underpayment of postage (paras. 3.15 to 3.20);
- (c) revision of the Local Bulk Mail Scheme (LBMS) (paras. 3.21 to 3.29);
- (d) testing and maintenance of postal scales (paras. 3.30 to 3.35);
- (e) supervisory checks on mail (paras. 3.36 to 3.44);
- (f) post office box service (paras. 3.45 to 3.49);
- (g) sorting of letters (paras. 3.50 to 3.56); and
- (h) transportation of mail (paras. 3.57 to 3.64).

Financial viability of post offices

3.5 Post offices are primarily set up to meet the Government's social objective of providing postal services within easy reach of the population living or working in a locality. **The HKP considers that financial viability is one of the factors which it should take into account in the provision of post offices.**

3.6 As at 31 December 2009, the HKP operated 125 post offices (31 on Hong Kong Island, 37 in Kowloon, 49 in the New Territories and 8 on outlying islands) to provide services, such as counter sales of stamps and acceptance of parcels and registered mail. According to the HKP, it inherited from its vote-funded predecessor the post office network established to provide postal services as a social service with little regard to the financial viability of many of the post offices. Since the establishment of the POTF, the HKP had introduced a number of revenue-generating and cost-cutting measures in relation to the operation of the post office network with a view to maintaining the sustainability of the POTF.

3.7 The introduction of the PayThruPost service in April 2000 (see Photograph 1) is one of the revenue-generating measures. The PayThruPost service provides the public with convenient one-stop service to make both government and utility bill payments at post offices. The HKP receives from its customers (i.e. the Government and the utility companies) fees for the bill payment service.

Photograph 1

Counters at a post office providing PayThruPost service



Source: HKP records

3.8 One of the cost-cutting measures is the closure of loss-making post offices. In 2007-08, the HKP closed down four post offices (three on Hong Kong Island and one in Kowloon). These post offices had very low demand of service, and had sustained heavy losses. According to the HKP, the services provided by these post offices were taken over by other post offices in the vicinity. In May 2008, due to significant rent increase and the existence of alternative post offices in the vicinity, the HKP closed another post office, the North Point Post Office.

Audit observations and recommendations

3.9 Despite the introduction of the PayThruPost service to increase the revenue of the post offices and the closure of the loss-making post offices, a large number of post offices still operated at a loss. According to the HKP's profitability analysis (Note 2) for 2008-09, 97 (77.6%) of the 125 post offices incurred a loss ranging from \$13,000 to \$6.8 million. The losses totalled \$117.2 million. Details are summarised in Table 2.

Table 2
Post offices incurring a loss
(2008-09)

Loss	Number of post offices	Total amount of losses (\$ million)
Over \$5 million	1	6.8
Over \$4 million to \$5 million	1	4.7
Over \$3 million to \$4 million	1	3.4
Over \$2 million to \$3 million	6	13.0
Over \$1 million to \$2 million	48	61.0
\$1 million or less	40	28.3
Total	97	117.2

Source: Audit analysis of HKP records

Note 2: *The profit/loss of a post office is the difference between the revenue apportioned to it and its costs (including staff costs, rental of premises, and other direct and indirect costs such as stationery, uniform, maintenance, and managerial and headquarters expenses allocated to it).*

3.10 Audit noted that the revenue generated from the PayThruPost service decreased from \$68 million in 2006-07 by \$11 million (16.2%) to \$57 million in 2008-09 (see Table 3). The decrease was mainly due to the reduction in bill payments resulting from the Government's rates concession in 2007-08 and 2008-09, and electricity charge subsidy to domestic households from September 2008. According to the HKP, there was also a risk that the revenue might decrease further because of keen competition from electronic payment channels and other alternative bill payment outlets, such as convenience stores and Mass Transit Railway station offices.

Table 3

**Revenue from PayThruPost service
(2006-07 to 2008-09)**

Year	Revenue from PayThruPost service (\$ million)
2006-07	68
2007-08	62
2008-09	57

Source: HKP records

- 3.11 Audit reviewed the HKP's profitability analysis for 2008-09. Audit noted that:
- (a) 18 of the 97 loss-making post offices earned revenue of less than \$500,000 each and incurred operating loss of more than \$1 million each;
 - (b) the total revenue of the 18 post offices was \$6.5 million, representing only 3.4% of the total revenue of the 97 post offices;
 - (c) the total loss incurred by the 18 post offices was \$22.4 million, representing 19.1% of the total loss of the 97 post offices; and
 - (d) of the 18 post offices, 7 were located on Hong Kong Island, 3 in Kowloon, 5 in the New Territories and 3 on outlying islands.

3.12 Audit considers that the HKP needs to conduct regular evaluation of the public's demand for the postal services provided by individual post offices. In particular, the HKP needs to critically explore the feasibility of closing down some of these 18 post offices.

Audit recommendations

3.13 **Audit has recommended that the Postmaster General should:**

- (a) **conduct regular evaluation of the demand for the postal services of individual post offices and their financial viability to ensure that the operation of each post office is justified; and**
- (b) **critically explore the feasibility of closing down loss-making post offices with low demand for postal services.**

Response from the Administration

3.14 The **Postmaster General** agrees with the audit recommendations. He has said that:

- (a) being a trading fund department, the HKP is acutely aware of the need to strive for better cost-effectiveness. It has maintained tight vigilance on the financial performance of individual post offices, making every effort to enhance productivity and open up new revenue streams. On the other hand, the HKP is also mindful of its mission of meeting Hong Kong's postal needs and the duty of providing quality service to the public in terms of receiving, collecting and delivering postal articles; and
- (b) given the community impact and potential strong public reactions to the closure of individual post offices, the HKP will explore the feasibility of closing down some loss-making facilities subject to the availability of alternative means to serve the affected neighbourhood.

Underpayment of postage

3.15 Locally posted mail is posted either by handing in at post office counters or putting into posting boxes for collection by the HKP. For mail handed in at post office counters, the amounts of the postage are usually checked on the spot by HKP staff. Therefore, the risk of underpaid postage by the senders may not be high. However, for mail placed directly into posting boxes, there is a risk that the senders may not have affixed stamps of the correct amounts on the mail. According to its Departmental Rules, the HKP will recover the correct amount of postage for underpaid mail identified, plus surcharges, from the senders/addressees.

Audit observations and recommendations

3.16 All mail collected from posting boxes and post offices on Hong Kong Island and outlying islands is processed at the GPO, while those collected in Kowloon and the New Territories are processed at the IMC. According to the HKP, during the processing and delivery of the mail and the daily supervisory checks (see para. 3.36) on 20 mail items collected from posting boxes, HKP staff should identify noticeable underpaid mail items.

3.17 In 2008-09, the HKP processed 127.4 million mail items posted through posting boxes. To ascertain the extent of the problem of underpaid postage, in December 2009 and January 2010, Audit selected 1,299 mail items from 30 posting boxes on 4 working days, and checked whether the stamps affixed on them were sufficient. The results of the checking are shown in Table 4.

Table 4

**Underpaid mail identified by Audit
(December 2009 and January 2010)**

Mail processing centre	Number of mail items checked (a)	Underpaid mail		Underpaid postage		
		Number (b)	Correct postage (c) (\$)	Amount (d) (\$)	Per underpaid mail (e) = (d) ÷ (b) (\$)	As percentage of correct postage (f) = (d) ÷ (c) × 100% (%)
GPO	699	55 (7.9%)	426.3	161.4	2.9	37.9%
IMC	600	38 (6.3%)	129.1	48	1.3	37.2%
Overall	1,299	93 (7.2%)	555.4	209.4	2.3	37.7%

Source: Audit checking of mail items

3.18 According to the audit check, the amount of underpaid postage was as high as 37.7% of the correct postage. Since a significant proportion of the HKP's revenue is derived from postage for mail posted through posting boxes, even though the underpaid mail items made up only 7.2% of such mail, their financial impact on the operating result of the HKP could be substantial. The setting up of proper control procedures to detect and deter underpaid mail would prevent senders from underpaying postage and better protect the HKP's revenue.

Audit recommendations

3.19 In order to prevent the loss of postage revenue, Audit has *recommended* that the Postmaster General should:

- (a) devise an effective system to detect and deter the underpayment of postage by identifying the underpaid mail and recovering the correct postage and surcharges from the senders/addressees; and
- (b) step up the HKP's publicity efforts to remind the public of their responsibility to pay sufficient postage for their mail.

Response from the Administration

3.20 The Postmaster General agrees with the audit recommendations. He has said that:

- (a) the HKP has stepped up the frequency of checking underpayment of postage at all mail processing centres. While continuous efforts will be made to detect and deter the underpayment of postage, the HKP will take into account the practicality and administration costs involved when considering appropriate actions to recover underpayment; and
- (b) additional publicity in the form of notices placed at post offices, newspaper feature articles and Internet banners/pop-ups will also be launched to remind the public of their responsibility to pay sufficient postage.

Revision of the Local Bulk Mail Scheme

3.21 In July 1997, the HKP introduced the LBMS to offer discounts in the postage rates of certain categories of local mail posted in bulk volume (minimum quantity of 2,000 items per posting sent by the same sender with items identical in shape, size and weight). The LBMS was introduced when the POTF had achieved higher than expected rate of return due to the upsurge in demand on special stamps and other philatelic products (Note 3). At that time, the HKP considered that discounts should be offered as an incentive to bulk senders who prepared their mail in accordance with certain service conditions and/or sorted letters into a particular order. The HKP expected that the LBMS could relieve the HKP's pressure on processing mail and help improve operational efficiency.

Note 3: *The exceptionally high profit of \$730 million in 1996-97 and \$1,218 million in 1997-98 from philately increased the HKP's operating profit to over \$1,000 million for each of these two years. However, income from philately had decreased significantly since 1998-99.*

3.22 The bulk senders are from the business sector and the largest ones are banks and insurance companies. Under the LBMS, discounts are given to:

- (a) standard mail (i.e. mail amenable to processing by the Mechanised Letter Sorting System (MLSS) of the HKP);
- (b) bulk economy mail (i.e. mail with delivery time standard of three working days — Note 4); and
- (c) pre-sorted mail (i.e. mail pre-sorted according to the post office delivery districts or the postmen's delivery beats by the bulk senders).

Proposed revision of the LBMS

3.23 In June 2009, the HKP's new MLSS replaced the old one. Before replacement, the old MLSS was installed at the GPO, the IMC and eight large delivery offices. Primary sorting of letters according to the delivery offices was conducted at the GPO and the IMC, and secondary sorting according to the delivery beats was conducted at the delivery offices. The new MLSS installed at the GPO and the IMC can directly sort the letters down to the delivery beat level. Furthermore, the new MLSS can handle a larger volume of mail traffic per hour than the old one.

3.24 With the enhanced efficiency of the new MLSS in processing mail and the increased capacity, the HKP found that the standard mail, bulk economy mail and pre-sorted mail under the LBMS no longer generated sufficient operational savings to justify the discounts given to the bulk senders. The HKP also found that the discounts offered to them did not serve the original objective of relieving its pressure on processing mail and achieving better operational efficiency. The HKP considered that if the LBMS was to continue, it would be using public funds to subsidise the bulk senders and the operational capacity of the new MLSS would not be fully utilised. In June 2008, the HKP sought the CEDB's endorsement on a proposal to revise the LBMS by withdrawing and/or reducing the discounts with effect from 1 October 2008.

3.25 In August 2008, the CEDB informed the HKP that it agreed in principle with the proposed revision of the LBMS. However, the CEDB made a number of comments and observations on the HKP's proposal. In November 2008, after taking into account the CEDB's comments, the HKP resubmitted the proposal to the CEDB to revise the LBMS with effect from 1 April 2009. The HKP also informed the CEDB that:

Note 4: *Contrary to bulk economy mail, ordinary mail is delivered on the next working day.*

- (a) the proposed revision of the LBMS did not involve revision of the postage rates;
- (b) it would only affect some bulk senders. The impact on the operating costs of the bulk senders was insignificant as the discounts provided to major bulk senders were around 8.8% of their postage paid; and
- (c) the discounts enjoyed by the bulk senders over the years should have more than covered any investment they had put in on their mail pre-sort systems.

3.26 The HKP estimated that the revised LBMS would increase the revenue of the POTF by \$88 million a year. However, Audit noted that no action had been taken to proceed with the proposal. In response to Audit's enquiry in February 2010, the CEDB said that Hong Kong businesses, including many users of the LBMS such as banks and insurance companies, were hard hit by the global financial crisis which broke out in the third quarter of 2008. In line with the Government's priority to help the business sector tide over the financial difficulties, the CEDB and the HKP agreed that it was not an appropriate time to take forward the proposal. The proposal was therefore shelved for the time being.

Audit observations and recommendation

3.27 **According to the HKP, for 2009-10, the estimated increase of revenue of \$88 million arising from the revised LBMS would increase the POTF's rate of return on ANFA from 3.2% to 5.6%. The revision would improve substantially the financial performance of the HKP. It would also help alleviate the pressure for an imminent postage rate revision. Audit notes that:**

- (a) the revised LBMS will avoid subsidising the bulk senders, who are from the business sector, with public funds;
- (b) the revised LBMS will help fully utilise the enhanced capacity of the MLSS; and
- (c) the delay in the implementation of the revised LBMS will result in substantial revenue forgone of up to \$88 million a year to the HKP.

In view of the substantial financial implication and the recent improvement in the economic climate, the HKP and the CEDB need to revisit the proposal.

Audit recommendation

3.28 **Audit has recommended that the Postmaster General should, in consultation with the CEDB, revisit the proposed revision of the LBMS submitted by the HKP in November 2008.**

Response from the Administration

3.29 The **Postmaster General** agrees with the audit recommendation. He has said that the HKP will, in consultation with the CEDB, revisit the proposed revision of the LBMS having regard to all relevant factors including the prevailing economic climate and business environment.

Testing and maintenance of postal scales

3.30 Post offices use postal scales to weigh mail for determining the postage required. According to the Departmental Rules:

- (a) every week, all scales should be tested at the commencement of duty on the first working day;
- (b) scales used for weighing letters should be tested at weighing points of zero, 250 grams (g), 500g, 750g, 1 kilogram (kg) and 2kg;
- (c) scales used for weighing parcels and Speedpost items (Note 5) should be tested at weighing points of zero, 1kg, 3kg, 5kg, 10kg, 15kg and 20kg; and
- (d) the maintenance contractor should clean and inspect all scales every three months, or at other times as directed. Safety test on electronic scales should be carried out by the contractor once every six months.

Audit observations and recommendations

Testing of scales on the first working day

3.31 Audit reviewed the testing records of King's Road Post Office and Lam Tin Post Office for 24 weeks (6 July to 18 December 2009). Audit found that:

- (a) in six weeks and one week respectively, King's Road Post Office and Lam Tin Post Office did not test the scales on the first working days of the weeks; and
- (b) in one week, King's Road Post Office did not carry out any testing of the scales.

Note 5: *Speedpost is the international courier service provided by the HKP.*

Method of testing

3.32 In December 2009, Audit visited King's Road Post Office and discussed with its staff the method they used in testing the scales. Audit found that the staff used one of the scales to make up packs of paper of different weights. Then the staff used these packs of paper as weights to test the other scales. Audit informed the staff that this method of testing might not be able to actually test the accuracy of the scales. Subsequent to the Audit visit, King's Road Post Office started using standard metal weights to test the scales in January 2010. Audit subsequently reviewed the records of the testing performed on 4 and 11 January 2010 and found that the weighing points of 10kg, 15kg and 20kg specified in the Departmental Rules were omitted from the testing of the scales used for parcels and Speedpost items. Moreover, Audit noted that the Post Office's testing did not cover a scale which was placed in its hall for use by senders to weigh mail themselves.

Regular maintenance of scales

3.33 Regular maintenance of scales is important to ensure that they function properly so that the weights of mail items and their postage are correctly determined. Lack of proper maintenance could also shorten the serviceable life of the scales. However, documentary evidence was not available to show that regular maintenance was performed as required by the Departmental Rules.

Audit recommendations

3.34 **Audit has recommended that the Postmaster General should:**

- (a) **ensure that the requirements relating to the testing and maintenance of postal scales stipulated in the Departmental Rules are complied with; and**
- (b) **issue guidelines to post offices on the proper method of scale testing with a view to ensuring that scales are effectively tested and the testing includes all the scales used in the post offices.**

Response from the Administration

3.35 The **Postmaster General** agrees with the audit recommendations. He has said that:

- (a) the HKP has promulgated a set of guidelines and instructed all post offices to adhere to the established method, frequency and modality for testing of postal scales; and

- (b) records will be maintained to ensure that all scales are tested properly and regularly.

Supervisory checks on mail

3.36 According to the Departmental Rules, daily supervisory checks at mail processing centres and post offices should be conducted on specified types of mail (such as parcels and Speedpost items) in respect of the correctness of postage paid and customs declaration forms, adequacy of packing, and availability of the required service. The Departmental Rules also specify the number of items of each type of mail to be selected for daily supervisory checks.

Audit observations and recommendations

3.37 Audit reviewed the records of supervisory checks performed at the AMC and the GPO for the period 1 December 2009 to 15 January 2010. Audit findings are given in paragraphs 3.38 to 3.42.

Supervisory checks at AMC

3.38 According to the Departmental Rules, responsible officers at the AMC have to conduct daily supervisory checks on 10 Speedpost items posted to destinations other than the Mainland and Macau, 10 ordinary air parcels, 5 insured air parcels, 10 registered air mail items and 10 air packets. Audit reviewed the AMC records of supervisory checks performed for the 37 working days during the period. **Audit found cases in which the numbers of items checked were less than those required (see Table 5).**

Table 5

**Supervisory checks at AMC
(1.12.2009 to 15.1.2010)**

	Speedpost items		Ordinary air parcels		Insured air parcels		Registered air mail		Air packets	
	(Day)	(%)	(Day)	(%)	(Day)	(%)	(Day)	(%)	(Day)	(%)
No checks conducted	7	18.9%	21	56.8%	34	91.9%	7	18.9%	0	0%
Number of items checked less than that required	0	0%	13	35.1%	1	2.7%	2	5.4%	0	0%
Checks properly conducted	30	81.1%	3	8.1%	2	5.4%	28	75.7%	37	100%
Total	37	100%	37	100%	37	100%	37	100%	37	100%

Source: Audit analysis of HKP records

Supervisory checks at GPO

3.39 According to the Departmental Rules, for the control of mail accepted at the GPO counters, responsible officers have to conduct daily supervisory checks on 10 parcels, 10 Speedpost items, 5 small packets, and 5 insured and registered items. Audit reviewed the records of supervisory checks performed at the GPO for the 46 working days during the period (Saturdays, Sundays and public holidays are working days for the GPO). **Audit found cases in which the numbers of items checked were less than those required (see Table 6).**

Table 6
Supervisory checks at GPO
(1.12.2009 to 15.1.2010)

	Parcels		Speedpost items		Small packets		Insured & registered items	
	(Day)	(%)	(Day)	(%)	(Day)	(%)	(Day)	(%)
No checks conducted	9	19.6%	9	19.6%	9	19.6%	9	19.6%
Number of items checked less than that required	7	15.2%	8	17.4%	0	0%	0	0%
Checks properly conducted	30	65.2%	29	63%	37	80.4%	37	80.4%
Total	46	100%	46	100%	46	100%	46	100%

Source: Audit analysis of HKP records

Supervisory checks on bulk posting

3.40 For bulk posting (i.e. consignment of over 20 mail items), the Departmental Rules specify that supervisory checks should be conducted by post offices on 5 mail items selected from 1 in every 20 consignments. However, the supervisory check requirements specified in the HKP's Bulk Mail Checking Manual are different from those specified in the Departmental Rules.

3.41 The Bulk Mail Checking Manual specifies that:

- (a) for consignments with postage paid not by franking machines, supervisory checks should be conducted on at least three consignments; and
- (b) for consignments which were paid by franking machines and enjoyed discounts under the LBMS, supervisory checks should be conducted on at least three consignments.

The Manual does not specify the number of consignments that should be checked for consignments which were paid by franking machines and did not enjoy discounts under the LBMS.

3.42 Audit noted that on 33 of the 46 working days reviewed by Audit, supervisory checks at the GPO were conducted on 5 consignments only. Since there were more than 100 consignments received on each of these 33 working days, the checks were less than the requirements specified in the Departmental Rules (according to the Rules, 1 in every 20 consignments should have been checked). Audit also noted that the 5 consignments checked did not include consignments which were paid by franking machines and enjoyed discounts. Therefore, the requirements of the Bulk Mail Checking Manual were not fully complied with.

Audit recommendations

- 3.43 **Audit has recommended that the Postmaster General should ensure that:**
- (a) **the requirements specified in the Departmental Rules and the Bulk Mail Checking Manual are consistent with each other; and**
 - (b) **supervisory checks are conducted according to the requirements of the Departmental Rules and the Bulk Mail Checking Manual.**

Response from the Administration

- 3.44 The **Postmaster General** agrees with the audit recommendations. He has said that:
- (a) inconsistencies in the requirements specified in the Departmental Rules and those in the Bulk Mail Checking Manual have now been rectified; and
 - (b) measures will be strengthened to ensure that supervisory checks are conducted in accordance with the requirements.

Post office box service

3.45 As at 31 December 2009, the HKP had 49,565 post office boxes available for letting to the public at 44 post offices and 1 delivery office. Of these post office boxes, 13,800 (27.8%) boxes were provided at the GPO.

Audit observations and recommendation

3.46 In July 2008, the HKP conducted a review on the operation of the post office box service. The review found that the HKP incurred a loss of \$4 million in 2007-08 in providing the service (see Table 7).

Table 7
Loss incurred in providing post office box service
(2007-08)

	Amount (\$ million)
<i>Revenue</i>	16.2
<i>Costs</i>	
Accommodation costs	16.0
Direct staff costs	2.3
Other direct and indirect costs	1.9
	20.2
(Loss)	(4.0)

Source: HKP records

3.47 In 2008-09, the loss incurred in providing the post office box service increased to \$4.9 million. Audit reviewed the letting of post office boxes as at 31 December 2009. Audit found that 3,437 (6.9%) of the total 49,565 post office boxes were vacant, and that three post offices with more than 200 post office boxes had a vacancy rate higher than 10%. These post offices were the GPO, To Kwa Wan Post Office and Kowloon East Post Office (see Table 8). **To minimise the loss in the provision of the post office box service, action should be taken to increase the letting of these vacant boxes and/or remove them so as to cut down the accommodation costs.**

Table 8

**Post office boxes provided in three post offices
(31.12.2009)**

Post Office	Number of boxes	Number of vacant boxes	Vacancy rate (%)
GPO	13,800	2,450	17.8%
To Kwa Wan	500	60	12%
Kowloon East	780	89	11.4%

Source: HKP records

Audit recommendation

3.48 **Audit has recommended that the Postmaster General should take expeditious measures to reduce the loss incurred for the post office box service. For example, action should be taken to boost the letting and/or remove the vacant boxes, particularly those provided at the GPO, To Kwa Wan Post Office and Kowloon East Post Office.**

Response from the Administration

3.49 The **Postmaster General** agrees with the audit recommendation. He has said that:

- (a) the rate of utilisation and profitability of the post office box service have been closely monitored by the HKP;
- (b) in light of falling usage, 2,810 post office boxes will be removed in 2010-11; and
- (c) the HKP will explore possible ways to boost the utilisation rate of the post office box service.

Sorting of letters

3.50 The old MLSS, installed at the GPO, the IMC and eight large delivery offices, had been used since 1990 to sort letters using the optical character recognition and video coding technology. In around 2005, the old MLSS was approaching the end of its serviceable life and some essential spare parts became obsolete. To sustain efficiency in mail processing and to upgrade the letter sorting technology, the HKP started in June 2008 to install the new MLSS at the GPO and the IMC in phases to replace the old MLSS at a capital cost of \$243 million. Full implementation of the new MLSS (see Photograph 2) was completed in June 2009. The GPO and the IMC use the new MLSS to sort letters down to the delivery beat level in areas covered by all the delivery offices.

Photograph 2

Mechanised Letter Sorting System



Source: HKP records

3.51 The new MLSS combines the functions of the optical character readers, video coding machines and letter sorting machines of the old MLSS to streamline and optimise mail flow. Letters successfully read are sorted according to their delivery beats. If the MLSS fails to read any parts of the addresses (e.g. due to poor printing quality or incorrect address format), it will transmit the images of the addresses to its video coding stations. The staff manning the stations will key in the parts of the addresses not recognised by the MLSS. The MLSS will then sort the letters based on the complete address information.

Audit observations and recommendations

Limitation of the MLSS

3.52 At present, the MLSS can only handle letters with English addresses. Letters with Chinese addresses are sorted manually. According to the HKP, about 7% of the letters suitable for machine sorting (i.e. letters which meet the requirements on size, thickness and weight) are with Chinese addresses. **The HKP needs to continue to keep in view the latest development of technology in the mechanised sorting of letters with Chinese addresses and explore the feasibility of automating the sorting of such letters to further improve the efficiency to reduce operating costs.**

Video coding of letters

3.53 For letters with addresses not recognised by the MLSS, the HKP deploys Postmen and NCSC staff (Note 6) to operate the video coding stations to key in the required address information (see para. 3.51). This approach of deploying a mix of Postmen and NCSC staff to perform video coding has been adopted for the old MLSS and the new one. During the period June to November 2009, the HKP deployed an average of 7,580 man-hours each month (equivalent to 19 Postmen and 23 NCSC staff) to perform video coding.

3.54 According to the project consultant for the old MLSS, a high degree of postal knowledge was not necessary for performing video coding because with the help of established keying rules, the keying of address information was simple. The video coding function was further improved with the installation of the new MLSS. According to the contractor of the new MLSS, video coding requires virtually no training in postal operations nor complex knowledge of streets and buildings that comprise a delivery beat. The coding staff are only required to key in the text highlighted on the video screen. Therefore, the skill level required is even lower than that required for the old MLSS. **The HKP needs to review the cost-effectiveness of deploying Postmen and NCSC staff to perform the video coding function, and explore the feasibility of performing the function by more cost-effective alternatives (e.g. outsourcing).**

Note 6: *According to the Staff Cost Ready Reckoner issued by the Treasury, the annual staff cost for Postman in 2008-09 was \$283,800. The average annual staff cost of an NCSC staff performing video coding duty was \$126,252.*

Audit recommendations

3.55 **Audit has recommended that the Postmaster General should:**

- (a) continue to keep in view the latest development of technology in the mechanised sorting of letters with Chinese addresses and explore the feasibility of automating the sorting of such letters; and
- (b) review the cost-effectiveness of deploying Postmen and NCSC staff to perform video coding function, and explore the feasibility of performing the function by more cost-effective alternatives (e.g. outsourcing).

Response from the Administration

3.56 The **Postmaster General** agrees with the audit recommendations. He has said that:

- (a) after completing a study on the latest technological advances, the HKP has decided to pursue automated sorting of letters bearing Chinese addresses; and
- (b) the HKP will assess the merits and feasibility of outsourcing the video coding function. The existing manpower ratio of 45% Postmen and 55% NCSC staff for video coding is adopted having regard to the desired speed, reliability and flexibility in coping with the undulating mail traffic and changing market conditions.

Transportation of mail

3.57 As at 31 December 2009, the HKP had a fleet of 295 vehicles (see Photograph 3) to support its postal services. According to the HKP's analysis, the overall utilisation rate of the vehicle fleet for December 2009 was 78.8%.

Photograph 3
Hongkong Post's vehicles



Source: HKP records

3.58 To supplement its own fleet, the HKP hired commercial vehicles from contractors to meet the transportation need. The contractors offer flexible hiring mode to the HKP, such as 3-hour hiring or 8-hour hiring. In 2008-09, a total of 497,015 vehicle hours were hired at a cost of \$50 million.

Audit observations and recommendations

Need to conduct transport review

3.59 Audit analysed the HKP's transportation resources (vehicle fleet and vehicle hire) and the volume of mail traffic handled in the three years 2006-07 to 2008-09. The analysis revealed that the increase in transportation resources was more or less in line with the increase in mail volume during the period (see Table 9).

Table 9
Transportation resources and mail volume
(2006-07 to 2008-09)

	2006-07	2007-08	2008-09	Increase
	(a)	(b)	(c)	(d) = (c) – (a)
Size of vehicle fleet as at the end of the year (number of vehicles)	267	271	288	21 (7.9%)
Hiring of vehicle (hours)	426,501	479,362	497,015	70,514 (16.5%)
Mail volume measured by number of bags (million)	3.10	3.35	3.55	0.45 (14.5%)

Source: HKP records

3.60 In view of the large size of the vehicle fleet and the substantial number of hired vehicle hours, Audit considers that the HKP needs to conduct a comprehensive transport review covering the usage and the mode of operation of its vehicle fleet and the hiring of vehicles. In this connection, Audit notes that the Government Logistics Department (GLD) provides advice to departments on the use and operation of their vehicle fleets. The GLD also regularly conducts departmental transport reviews and makes recommendations to departments on the optimal fleet size, mix and use of their fleets. According to the GLD, nine departmental transport reviews were completed in the period 2003 to 2008 resulting in total savings of \$20 million. **A departmental transport review by the GLD of the HKP's vehicle fleet and the arrangements for the hiring of vehicles may be able to identify savings and room for improvement.**

Need to conduct cost comparison of using hired vehicles and HKP own vehicles

3.61 The costs of using an HKP vehicle include the capital cost and the running costs (such as fuel and maintenance) of the vehicle, and the staff cost of the driver. **Audit estimates that the HKP's costs of using hired vehicles are much lower than the costs of using its own vehicles.** For example, the staff cost of a Postman performing an 8-hour driving duty is \$1,280, whereas the charge of hiring a light goods vehicle for 8-hour (including the driver) is only \$545. Moreover, there are other advantages of using hired vehicles. For example, the 3-hour hiring mode provides flexibility, and the vehicle down time due to maintenance and repair is absorbed by the contractors.

3.62 In view of the large size of its vehicle fleet (295 vehicles as at 31 December 2009), **Audit considers that the HKP needs to conduct cost comparison of using hired vehicles and its own vehicles.** If the comparison indicates that the costs of using hired vehicles are lower than those of using its own vehicles, the HKP needs to examine the feasibility of using more hired vehicles to reduce the size of its own fleet.

Audit recommendations

3.63 **Audit has recommended that the Postmaster General should consider inviting the GLD to conduct a departmental transport review of the HKP's vehicle fleet and the arrangements for the hiring of vehicles to identify savings and room for improvement. The review should include:**

- (a) **the mode of operation of the HKP's vehicle fleet as well as the arrangements for the hiring of vehicles to ensure the efficient use of the transportation resources;**
- (b) **cost comparison of using hired vehicles and the HKP's own vehicles; and**
- (c) **the feasibility of using more hired vehicles to replace part of the HKP's vehicle fleet.**

Response from the Administration

3.64 The **Postmaster General** agrees with the audit recommendations. He has said that assistance will be sought from the GLD to conduct a departmental transport review to identify savings and room for improvement, although internal assessments are carried out by the HKP from time to time on the operational efficiency of its vehicle fleet.

PART 4: FINANCIAL PERFORMANCE

4.1 This PART examines the financial performance of the HKP.

Financial performance of the Hongkong Post

4.2 The Trading Funds Ordinance requires a trading fund to achieve a reasonable return, as determined by the Financial Secretary, on the fixed assets employed. The target rate of return on ANFA for the POTF was revised from 10.5% to 8.4% with effect from 1 April 2006 (see para. 1.4).

Audit observations and recommendations

Decreasing rate of return

4.3 The POTF was able to achieve the target rate of return of 8.4% in the three years 2006-07 to 2008-09. However, according to its financial budget/forecast, the POTF would not be able to achieve the target in the five years 2009-10 to 2013-14. Audit notes that:

- (a) although the HKP achieved the target rate of 8.4% in 2006-07 to 2008-09, the rate of return decreased from 12.7% in 2006-07 to 9.9% in 2008-09;
- (b) in 2009-10, there will be a further decrease in the rate of return to 3.2%, which is below the target rate of 8.4%; and
- (c) in 2010-11 to 2013-14, the HKP will incur operating loss and the rate of return will decrease from -2.1% in 2010-11 to -3.9% in 2013-14 (see Table 10).

Table 10
Financial performance of the HKP
(2006-07 to 2013-14)

Year	Revenue (a) (\$ million)	Operating costs (b) (\$ million)	Operating profit/(loss) (c) = (a) – (b) (\$ million)	Rate of return on ANFA (%)
2006-07	4,115	3,668	447	12.7%
2007-08	4,373	3,960	413	12.2%
2008-09	4,556	4,207	349	9.9%
2009-10	4,185	4,062	123	3.2%
2010-11	4,154	4,231	(77)	(2.1%)
2011-12	4,196	4,318	(122)	(3.2%)
2012-13	4,263	4,394	(131)	(3.5%)
2013-14	4,297	4,440	(143)	(3.9%)

Source: HKP records

Remarks: Figures for 2009-10 to 2013-14 are budgeted/forecasted figures.

Increasing operating costs

4.4 Although the HKP has implemented a number of cost-cutting measures through work process reviews and re-engineering, the HKP is still facing high operating costs. It can be observed from Table 10 that:

- (a) the operating costs of the HKP increased from \$3,668 million in 2006-07 by \$539 million (14.7%) to \$4,207 million in 2008-09; and
- (b) although the operating costs will drop to \$4,062 million in 2009-10, they will increase to \$4,231 million in 2010-11, and further to \$4,440 million in 2013-14.

4.5 Audit noted that the operating costs included three major components. In 2008-09, these three major components of operating costs, which amounted to \$3,269 million, accounted for 77.7% of the total operating costs of \$4,207 million. These three major components were:

- (a) **Staff costs.** The staff costs of \$2,179 million accounted for 51.8% of the total operating costs of the HKP. The staff costs for civil service staff, NCSC staff and part-time staff were \$1,920 million (88.1%), \$246 million (11.3%) and \$13 million (0.6%) respectively. As a result of the civil service pay adjustments in 2007-08 and 2008-09, staff costs increased from \$1,944 million in 2006-07 by \$235 million (12.1%) to \$2,179 million in 2008-09;
- (b) **Air conveyance charges.** Air conveyance is the conveyance charges paid to airline companies for mail. The amount of air conveyance expenditure in 2008-09 was \$575 million, which accounted for 13.7% of the total operating costs of the HKP. Due to the increase in air mail volume and fuel charge, air conveyance charges increased from \$430 million in 2006-07 by \$145 million (33.7%) to \$575 million in 2008-09; and
- (c) **Terminal dues.** Terminal dues are the payments made to destination postal administrations for delivery of mail under the terminal dues system administered by the Universal Postal Union, which sets the rules for international mail exchanges. The total amount of terminal dues paid in 2008-09 was \$515 million, representing 12.2% of the total operating costs. Owing to the upward revision of the rates of terminal dues and the increase in international mail volume, terminal dues increased from \$402 million in 2006-07 by \$113 million (28.1%) to \$515 million in 2008-09. With effect from 1 January 2010, the terminal dues system was revised, resulting in an increase in the rates of terminal dues payable to the destination postal administrations by the HKP. The HKP estimated that the revision would result in a net increase in its expenditure on terminal dues by about \$40 million a year.

Audit recommendations

4.6 **Audit has recommended that the Postmaster General should:**

- (a) **taking into account the deteriorating financial performance, review the sustainability of the POTF. Particular attention should be given to the threats brought about by the rise in the three operating cost components, namely staff costs, air conveyance charges and terminal dues; and**
- (b) **in consultation with the CEDB, formulate a viable plan to enhance the sustainability of the POTF with a view to ensuring that the target rate of return is achieved.**

Response from the Administration

4.7 The **Postmaster General** agrees with the audit recommendations. He has said that through its annual corporate and business planning process, the HKP will consult the CEDB and map out practical initiatives to enhance its financial sustainability by a combination of cost reduction and product innovation.

Determination of postage rates

4.8 Under the Post Office Ordinance, the Postmaster General may, subject to any direction of the Chief Executive in Council, determine the postage rates. The operation of the HKP as a trading fund department does not alter the mechanism, procedure and control over postage rate increases. Nevertheless, to provide assurance to the public, when the Government moved the Resolution of the Legislative Council for the establishment of the POTF, it undertook to maintain postage rates at levels reasonable and affordable to the public by keeping increases broadly in line with inflation. According to the Framework Agreement, before determining new postage rates, the HKP shall discuss and agree them with the CEDB.

Audit observations and recommendations

4.9 It is the Government's policy that fees charged by the Government should in general be set at levels sufficient to recover the full cost of providing the services. In addition to recovering the full cost of providing the services, trading funds are expected to achieve a reasonable return. According to the HKP, the existing local mail postage in Hong Kong is one of the lowest in the world. Owing to the low postage level, the HKP has not been able to recover the full cost of providing the local mail services. Local mail services have been operated at losses and cross-subsidised by other profitable services for many years. The services continued to incur operating losses after the postage rates were last increased in April 2002 (see para. 4.13).

4.10 The aims of the HKP are to meet Hong Kong's postal needs and fulfil Hong Kong's international postal obligations by providing reliable, efficient and universal postal services at reasonable and affordable prices. On the other hand, as a trading fund department, the HKP is expected to provide its services on a self-financing basis plus a reasonable return. The HKP needs to ensure the achievement of the postal policy objectives as well as its financial objectives. However, the HKP has not conducted a review to ensure that the postage rates are set at appropriate levels to achieve the long-term sustainability of the POTF.

Audit recommendations

- 4.11 **Audit has recommended that the Postmaster General should:**
- (a) **consider conducting a review to determine the postage rates that are considered reasonable and affordable to the public; and**
 - (b) **formulate a pricing strategy for the postal services which will ensure that:**
 - (i) **postage rates set are reasonable and affordable to the public; and**
 - (ii) **the POTF achieves the target rate of return on ANFA, and is sustainable in the long term.**

Response from the Administration

4.12 The **Postmaster General** agrees with the audit recommendations. He has said that the HKP will, in consultation with the CEDB, work out a long-term pricing strategy that strikes a fair balance between public acceptability and financial sustainability of the HKP's postal services.

Revision of postage rates

4.13 The postage rates were last revised in April 2002 with a weighted average increase of 6.5% (except a minor revision in 2006 — Note 7). In view of the increasing operating costs, in particular the salary increase of the civil service, in October 2007, the HKP submitted to the CEDB for its endorsement a proposal to increase the postage rates with effect from 1 October 2008. **The HKP considered that the postage rate revision, which would result in a weighted average increase of 9.4% over the existing postage rates, was crucial to the financial sustainability of the POTF.** It estimated that the proposed increase would bring about additional revenue of \$383 million a year. It also informed the CEDB that, in general, postage constituted only a small proportion of business costs and a tiny proportion of overall household expenditure. The postage rate revision would only increase the Composite Consumer Price Index by about 0.018%.

Note 7: *A minor postage rate revision was made in August 2006. The revision was on bulk posting of light-weight air and surface mail to Japan and Thailand and surface bulk bag service to all destinations. The postage rate increase was to recover the increase of costs for these services following the increase of handling and delivery charges levied by overseas postal administrations.*

4.14 In July 2008, the Government announced that it would freeze government fees and charges affecting the general public's daily lives for one year commencing from 16 July 2008. The freeze was subsequently extended until 31 March 2010. Although the freeze did not apply to services provided by trading funds, the CEDB considered that businesses and residents would not be receptive to the revision of postage during the global financial crisis. The CEDB and the HKP agreed that postage rates should be reviewed at a later stage.

Audit observations and recommendation

4.15 As over two years have elapsed since the HKP's proposal to increase the postage rates was submitted in October 2007, Audit considers that the HKP needs to submit to the CEDB a new proposal on postage rate revision. The new proposal should take into account the latest economic outlook and the various measures to improve the HKP's financial position as recommended in this audit report.

Audit recommendation

4.16 **Audit has recommended that the Postmaster General should take action to formulate a new proposal on postage rate revision for submission to the CEDB, taking into account the latest economic outlook and the improvement in the HKP's financial position brought about by the implementation of the audit recommendations in this report.**

Response from the Administration

4.17 The **Postmaster General** agrees with the audit recommendation. He has said that the HKP will submit, for the CEDB's consideration, a new package of proposals on postage rate revision taking into account all relevant factors including the HKP's financial position, the prevailing economic conditions, business environment and public sentiments.

PART 5: PERFORMANCE MANAGEMENT AND REPORTING

5.1 This PART examines the performance management and reporting of the HKP.

Performance pledges

5.2 Performance pledges were introduced as an initiative in the government management framework in 1992 with a view to engendering a customer service culture within the civil service and improving the standards across the full range of government services. Reviewed and updated regularly, performance pledges help government bureaux and departments monitor their performances in service delivery and enhance the performances where practicable. To the public, performance pledges inform them of the standards of service that they can expect from the Government, and what they can do if the services they receive fall short of such standards. In September 2009, the Civil Service Bureau (CSB) issued CSB Circular No. 7/2009 which set out the guidelines and good practices for the implementation of performance pledges in the civil service. In its annual reports, the HKP publishes its performance pledges, targets and achievements in respect of the provision of postal services.

5.3 In 2008-09, the HKP's performance pledges included 19 items on the provision of postal services. The HKP had established a set of Measuring Procedures to provide guidance to its staff to measure the actual performance. Audit reviewed the HKP's extent in achieving the performance targets and the measuring of the actual performance. The objectives were to ascertain whether HKP staff had complied with the Measuring Procedures and whether the Procedures provided sufficient guidance to them.

Audit observations and recommendations

Extent in achieving performance targets

5.4 Audit reviewed the HKP's extent in achieving the targets in 2005-06 to 2008-09. Audit found that the HKP had consistently exceeded the targets of six services. Details are shown in Table 11.

Table 11

**Extent in achieving performance targets
(2005-06 to 2008-09)**

Performance pledge of service	Target (%)	Actual performance (%)			
		2005-06	2006-07	2007-08	2008-09
1. Deliver locally posted letters to addressees by the following working day	98	99.8	99.9	99.8	99.9
2. Deliver bulk economy letters to addressees within 3 working days	99	100	100	100	100
3. Deliver HKP Circular Service items within 4 working days	99	100	100	100	100
4. Deliver inward airmail items within 2 working days after arrival in Hong Kong	99	100	100	100	99.9
5. Deliver outward air parcels, posted before the advertised latest time for posting, to the first available air carrier, either within the same day or the following working day	99	99.9	100	100	99.9
6. Serve customers within 25 minutes during peak hours or periods	98	99.9	100	99.9	100

Source: HKP records

5.5 According to the good practices promulgated in the CSB Circular, performance targets should be challenging enough to drive continuous improvement but realistic and achievable. As the performance targets of the six services have been consistently achieved and exceeded over the last four years, the HKP may need to consider whether more challenging targets should be set.

Performance measuring procedures

5.6 Audit found that the Measuring Procedures only covered 18 of the 19 services. **There was no documentation on the measuring procedures for the processing of applications for redirection service.**

Delivery of local mail

5.7 The HKP reported that it achieved the following targets in 2008-09:

- (a) 98% of locally posted letters were delivered to addressees by the following working day (see Item 1 in Table 11); and
- (b) 99% of bulk economy letters were delivered to addressees within three working days (see Item 2 in Table 11).

5.8 According to the Measuring Procedures, the HKP should measure the delivery performance of four delivery offices and two post offices every month. Audit reviewed the measurement records and found that:

- (a) **in 2008-09, the HKP did not select any of the seven delivery offices on outlying islands for measurement; and**
- (b) **in August 2008, the HKP only measured the performance of three delivery offices instead of four as required by the Measuring Procedures.**

Waiting time for over-the-counter services

5.9 The HKP reported that it achieved the following targets in 2008-09:

- (a) 98% of customers were served within 10 minutes during non-peak hours; and
- (b) 98% of customers were served within 25 minutes during peak hours or periods (see Item 6 in Table 11).

5.10 According to the Measuring Procedures, the HKP should measure the performance of five to six post offices every month. The Measuring Procedures did not specify the working days that should be selected for measurement. **Audit found that in 2008-09, the HKP measured the performance on Monday to Friday only.** The exclusion of the HKP's working days on Saturdays, Sundays and public holidays (see para. 3.39) in its performance measurement may have led to biased results.

Answering telephone calls

5.11 The HKP operated 14 telephone hotlines for its customers to make enquiries about postal services. The HKP reported that in 2008-09, it achieved the target that 90% of the calls to HKP hotlines were answered within three rings, i.e. within 12 seconds. **Audit found that the performance reported by the HKP did not cover 7 of the 14 hotlines. It did not cover the performance of 5 customer care hotlines, 1 Speedpost general enquiries hotline, and 1 Track and Trace System enquiry hotline.**

5.12 Audit noted that many of the calls to the hotlines were answered by automatic response systems instead of by HKP staff. The calls were regarded as answered once they were connected to such systems. If the performance relating to calls answered by HKP staff was separately measured, the HKP might not have achieved the target. A sample check performed by the HKP in 2007-08 showed that only 68% of the calls were answered by HKP staff within three rings. In April 2008, the Postmaster General directed that the situation should be improved. However, up to December 2009, action had not been taken to improve the situation.

Processing applications for HKP Circular Service

5.13 The HKP reported that in 2008-09, it achieved the target that 100% of the applications for HKP Circular Service (Note 8) were processed within one working day. **However, Audit noted that the 32 post offices which accepted applications for the service did not keep information on the actual time taken in processing the applications.**

Reporting arrangement

5.14 On its website, the HKP published the targets and actual performance of the services covered in the performance pledges. In its 2004-05 to 2006-07 Annual Reports, the HKP published both the targets and the actual performance of the relevant year. However, in the 2007-08 and 2008-09 Annual Reports, only the actual performance of the current year and the performance targets of the ensuing year were reported. **They did not disclose the performance targets of the current year.** According to the good practices promulgated in the CSB Circular, performance achievements should be published alongside performance targets.

Audit recommendations

5.15 **Audit has recommended that the Postmaster General should:**

Note 8: *The HKP Circular Service is a service through which the HKP delivers unaddressed mail, largely commercial advertisements, on a massive scale.*

- (a) **consider setting more challenging targets for services in the HKP's performance pledges which it has consistently achieved and exceeded;**
- (b) **review the Measuring Procedures so that they cover all the services in the HKP's performance pledges;**
- (c) **ensure that the performance relating to the delivery of local mail by delivery offices on outlying islands is covered in the measurement;**
- (d) **ensure that the measurement of the performance relating to the waiting time for over-the-counter services includes the HKP's working days on Saturdays, Sundays and public holidays;**
- (e) **ensure that the measurement of the performance relating to the answering of telephone calls covers all hotlines of the HKP, and expedite the action to improve the performance of answering such calls by HKP staff;**
- (f) **ensure that documentary evidence is kept showing the actual time taken in processing the applications for HKP Circular Service; and**
- (g) **include both the performance targets and the actual performance of the current year, and the targets of the ensuing year, in the HKP's Annual Report.**

Response from the Administration

5.16 The **Postmaster General** agrees with the audit recommendations. He has said that:

- (a) on performance pledges, the HKP will evaluate the existing targets by making reference to historical outcomes and revise them as appropriate. These pledges, together with the actual outturns of the current year and the targets of the ensuing year, will be included in the HKP's Annual Report;
- (b) the performance of delivery offices on outlying islands relating to the delivery of local mail has now been included in the performance measurement;
- (c) customer waiting time for over-the-counter services on Saturdays, Sundays and public holidays will be included in the performance measurement;
- (d) the measurement of the performance relating to the answering of telephone calls will cover all hotlines of the HKP; and
- (e) the HKP has modified the record format to capture the actual time taken in processing the applications for HKP Circular Service.

Acronyms and abbreviations

AMC	Air Mail Centre
ANFA	Average net fixed assets
Audit	Audit Commission
CEDB	Commerce and Economic Development Bureau
CSB	Civil Service Bureau
FSTB	Financial Services and the Treasury Bureau
g	Gram(s)
GLD	Government Logistics Department
GPO	General Post Office
HKP	Hongkong Post
IMC	International Mail Centre
kg	Kilogram(s)
LBMS	Local Bulk Mail Scheme
MLSS	Mechanised Letter Sorting System
NCSC	Non-civil service contract
POTF	Post Office Trading Fund