

## **CHAPTER 8**

### **Government Logistics Department**

**Procurement and supplies services provided  
by the Government Logistics Department**

**Audit Commission  
Hong Kong  
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*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. 59 of the Director of Audit contains 10 Chapters which are available on our website at <http://www.aud.gov.hk>

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# **PROCUREMENT AND SUPPLIES SERVICES PROVIDED BY THE GOVERNMENT LOGISTICS DEPARTMENT**

## **Contents**

	<b>Paragraph</b>
<b>EXECUTIVE SUMMARY</b>	
<b>PART 1: INTRODUCTION</b>	<b>1.1 – 1.5</b>
The 2001 audit	1.6
Audit review	1.7
General response from the Administration	1.8 – 1.9
Acknowledgement	1.10
<b>PART 2: PROCURING STORES AND SERVICES</b>	<b>2.1</b>
Procuring stores and services by tender	2.2 – 2.9
Audit recommendations	2.10
Response from the Administration	2.11
Procuring stores by quotation	2.12 – 2.17
Audit recommendations	2.18
Response from the Administration	2.19 – 2.20

	<b>Paragraph</b>
Use of online tools for procurement	2.21 – 2.22
Audit recommendation	2.23
Response from the Administration	2.24 – 2.26
<b>PART 3: SUPPLYING COMMON-USER ITEMS</b>	<b>3.1 – 3.3</b>
Forecasting demand	3.4 – 3.7
Audit recommendations	3.8
Response from the Administration	3.9
Inspecting items	3.10 – 3.14
Audit recommendations	3.15
Response from the Administration	3.16
<b>PART 4: SUPPLYING ESSENTIAL AND EMERGENCY ITEMS</b>	<b>4.1 – 4.2</b>
Replenishing stocks	4.3 – 4.6
Audit recommendations	4.7
Response from the Administration	4.8 – 4.9
Return of stores from bureaux/departments	4.10 – 4.14
Audit recommendations	4.15 – 4.16
Response from the Administration	4.17 – 4.18

	<b>Paragraph</b>
<b>PART 5: COORDINATING THE PURCHASING CARD PROGRAMME</b>	5.1 – 5.4
Service-wide surveys on purchasing card programme	5.5 – 5.13
Audit recommendations	5.14 – 5.15
Response from the Administration	5.16 – 5.19
<b>PART 6: MONITORING COMPLIANCE WITH STORES AND PROCUREMENT REGULATIONS</b>	6.1 – 6.3
Stores verifications	6.4 – 6.7
Audit recommendations	6.8
Response from the Administration	6.9 – 6.10
System surveys	6.11 – 6.13
Audit recommendations	6.14
Response from the Administration	6.15
<b>PART 7: OTHER SERVICES</b>	7.1
Public auctions for disposal of confiscated/unclaimed goods and surplus stores	7.2 – 7.3
Audit recommendations	7.4
Response from the Administration	7.5
Introducing electronic auctions	7.6 – 7.10
Audit recommendation	7.11
Response from the Administration	7.12 – 7.14

	<b>Paragraph</b>
Providing temporary storage space to bureaux/departments	7.15 – 7.16
Audit recommendation	7.17
Response from the Administration	7.18
Storing surplus stores and personal effects	7.19 – 7.20
Audit recommendations	7.21
Response from the Administration	7.22

<b>Appendices</b>	<b>Page</b>
A : Government Logistics Department: Organisation chart (30 June 2012)	67
B : Acronyms and abbreviations	68

# PROCUREMENT AND SUPPLIES SERVICES PROVIDED BY THE GOVERNMENT LOGISTICS DEPARTMENT

## Executive Summary

1. The Government Logistics Department (GLD) provides bureaux/departments (B/Ds) with procurement and supplies services, which include procuring stores that exceed their direct purchase authority limits and coordinating the purchasing card programme for low value purchases. In 2011, the GLD handled some 450 contracts on procurement of stores and services on behalf of B/Ds at a total value of \$5,385 million, representing one third, in value, of stores and general services purchased by the Government. The remaining two thirds were procured by the B/Ds without going through the GLD. About 260 posts in the GLD are involved in providing the procurement and supplies services. The Audit Commission (Audit) has recently conducted a review of the GLD's provision of these services.

### Procuring stores and services

2. Roughly 70% of the contracts handled by the GLD were awarded by tender which required the GLD and B/Ds to follow a set of prescribed procedures that on average took 211 days to complete. The remaining 30% of the contracts were awarded by quotation, which involved only selected suppliers and less elaborate procedures. The average time of completing procurement by quotation was 87 days. Because of the long time it takes to complete an open tender exercise, there may be a tendency to find ways to do the procurement by quotation even when open tendering is desirable for obtaining more competitive bidding. In Audit's view, the GLD, together with the respective originating B/Ds, needs to better plan and explore ways to shorten the time required to complete the tender exercises.

3. *Use of tender procedures.* Achieving best value for money and maintaining open and fair competition are the twin policy objectives for government procurement. In this respect, the Government Stores and Procurement Regulations (SPRs) require that B/Ds shall follow tender procedures when making purchases of

## Executive Summary

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stores and services exceeding \$1.43 million which is a requirement set by the Financial Services and the Treasury Bureau in reference to the Agreement on Government Procurement of the World Trade Organization. However, Audit sample check of purchases made for B/Ds by the GLD has revealed cases of non-compliance with these SPR requirements (i.e. making repeated purchases of less than \$1.43 million each by quotation instead of adopting tender procedures for bulk purchase).

4. *Use of online tools.* Audit has found that some public sectors of overseas countries have adopted electronic auctions for suppliers to bid via the Internet for a contract to provide goods or services. Electronic auctions are recommended when the contract specifications are clear cut and the contract values are large enough to attract competition. Electronic auctions can achieve cost savings and other benefits, including higher procurement efficiency, enhanced transparency by disclosing all bids in real time and provision of comprehensive audit trails by electronic records. The GLD handles some 270 tenders a year, with the majority over \$3 million in value each. It has the potential to adopt electronic auctions.

### Coordinating the purchasing card programme

5. The GLD is the coordinator of the purchasing card programme. The programme, introduced in 2000, requires B/Ds to use purchasing cards as the normal means to purchase low value stores and services not exceeding \$50,000 in accordance with the SPRs and the GLD's guidelines. The programme objectives are to streamline the procurement and payment processes and improve administrative control over low value purchases.

6. Audit examination revealed that the purchasing card programme had still not been fully implemented service-wide. In 2011, seven B/Ds spent a total of \$290 million on low value purchases which were made without approvals for not using purchasing cards. According to the GLD's guidelines, B/Ds should review cardholders' activities regularly to identify inactive cardholders, rejected transactions and other issues for taking appropriate follow-up actions. However, Audit found that in 2011 there were many inactive cards and many rejected transactions, suggesting room for improvement in B/Ds' management of the purchasing cards issued to their staff. In addition, Audit review of two selected departments (namely the Department of Health and the Electrical and Mechanical



## Executive Summary

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Services Department) has identified problems (such as purchases exceeding \$50,000) in their use of purchasing cards.

### **Monitoring compliance with Stores and Procurement Regulations**

7. According to the SPRs, Controlling Officers are responsible for the general supervision and control of stores and stores accounts and the services procured under their control, ensuring that the activities are conducted within financial limits and are in strict accordance with the SPRs. The GLD conducts stores verifications of B/Ds at least once every three years to verify stocks of government stores held by them and check whether they comply with the SPRs on the management and procurement of government stores and services.

8. Audit review of the results of the GLD's stores verifications of B/Ds in the past three years (2009-10 to 2011-12) revealed that many B/Ds had not strictly complied with the SPRs. For example, 44 B/Ds were found to have excessive/dormant stocks. In addition, 30 B/Ds had not taken proper follow-up actions on the recommendations in the GLD stores verification reports.

### **Audit recommendations**

9. **Audit recommendations are made in the respective sections of this Audit Report. Only the key ones are highlighted in this Executive Summary. Audit has *recommended* that the Director of Government Logistics should:**

#### *Procuring stores and services*

- (a) **explore ways to shorten the time required to complete a tender exercise;**
- (b) **uphold a culture of compliance with SPR requirements and remind B/Ds to closely monitor their staff's compliance in adopting tender procedures when the procurement requirements of stores of a similar nature exceed \$1.43 million;**

## Executive Summary

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- (c) establish procedures to monitor user B/Ds' repeated requests for procuring stores of a similar nature by quotation and promptly advise those B/Ds with procurement requirements exceeding \$1.43 million to adopt tender procedures for the bulk purchase of these stores;
- (d) in consultation with the Government Chief Information Officer, explore the feasibility of introducing electronic auctions for procuring goods and services, taking into account overseas experience;

### *Coordinating the purchasing card programme*

- (e) conduct further studies of the administrative problems commonly encountered by B/Ds and seek the support of the Secretary for Financial Services and the Treasury to implement other improvement measures as appropriate;
- (f) regularly remind B/Ds of the need to comply with the SPRs and the GLD's guidelines in their use of purchasing cards, including the need to review cardholders' activities to identify issues such as inactive cards for appropriate follow-up actions; and

### *Monitoring compliance with Stores and Procurement Regulations*

- (g) closely monitor B/Ds' compliance with the SPRs in respect of the general supervision and control of stores and services.

10. Audit has also *recommended* that the Director of Health and the Director of Electrical and Mechanical Services should, with the assistance of the GLD, implement appropriate measures to address the problems identified by Audit in their use of purchasing cards.

## Response from the Administration

11. The Administration agrees with the audit recommendations.

## **PART 1: INTRODUCTION**

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

### ***Background***

1.2 ***Government procurement policy.*** According to the Guide to Procurement issued by the Financial Services and the Treasury Bureau (FSTB), achieving best value for money and maintaining open and fair competition are the twin policy objectives for government procurement. The two objectives are complementary: by encouraging participation through open, fair and transparent procurement procedures and practices, the Government obtains responsive and competitive tenders from which it determines the most advantageous one which best serves the public interest.

1.3 ***Stores and Procurement Regulations.*** The Government Stores and Procurement Regulations (SPRs) are made by the Financial Secretary/Secretary for Financial Services and the Treasury under the Public Finance Ordinance (Cap. 2) to regulate matters relating to the management and procurement of government stores and services. According to the SPRs:

#### ***Procurement procedures***

- (a) tender procedures should be adopted when making purchases of stores and general services exceeding \$1.43 million (Note 1). For lower value purchases, the specified number of quotations should be invited;

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**Note 1:** *According to the FSTB, the financial limit is kept under constant review taking into account factors including the need to maintain a balance between providing procurement flexibility to bureaux/departments and keeping appropriate controls in place to ensure value for money purchasing, and the value of relevant thresholds under the Agreement on Government Procurement of the World Trade Organization in Hong Kong dollars. Having regard to these factors, the financial limit was last adjusted from \$1.3 million to \$1.43 million with effect from 1 February 2009.*

## Introduction

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### *Procurement by bureaux/departments directly*

- (b) bureaux/departments (B/Ds) may make purchases of stores and services on their own without going through the Government Logistics Department (GLD), as follows:
  - (i) **Stores.** B/Ds may make purchases of stores not exceeding their direct purchase authority limits ranging from \$500,000 to \$1.43 million (Note 2); and
  - (ii) **Services.** B/Ds may make purchases of services irrespective of value in accordance with the SPRs. These include general services (e.g. cleansing and security services), services for construction and engineering works, and consultancy services; and

### *Procurement by GLD for B/Ds*

- (c) the GLD normally acts as the purchasing agent for B/Ds for stores exceeding their direct purchase authority limits. In addition, it procures services needed by multiple B/Ds.

In 2011, the GLD handled 449 contracts on the procurement of stores and services on behalf of B/Ds at a total value of \$5,385 million (comprising \$5,317 million procurement by tender and \$68 million by quotation). Of the 449 contracts, 310 (roughly 70%) were awarded by tender and 139 (30%) by quotation. The total value of stores and general services purchased by B/Ds directly was \$10,823 million (comprising \$4,291 million procurement by tender and \$6,532 million by quotation) (Note 3).

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**Note 2:** *The lowest direct purchase authority limit is \$500,000. It is raised to \$750,000 for B/Ds with Supplies Officers, \$1 million for B/Ds with Senior Supplies Officers and \$1.43 million for B/Ds with Chief Supplies Officers or above.*

**Note 3:** *The figures were compiled by the GLD according to the returns from B/Ds. Such returns did not include services for construction and engineering works, and consultancy services.*

1.4 ***Procurement and supplies services provided by GLD.*** One of the GLD's main responsibilities is to provide B/Ds with the following procurement and supplies services in accordance with the government procurement policy and the SPRs (Note 4):

- (a) ***Procuring stores and services.*** The GLD procures for B/Ds stores exceeding their direct purchase authority limits. It also procures services needed by multiple B/Ds;
- (b) ***Supplying common-user items.*** The GLD arranges term contracts so that B/Ds can purchase common-user items (e.g. bottled drinking water, photocopying paper and office sundries) directly from the contractors as and when required;
- (c) ***Supplying essential and emergency items.*** The GLD purchases essential items (Note 5) and emergency items (Note 6) in bulk and stores them centrally for acquisition by B/Ds as and when required;
- (d) ***Coordinating the purchasing card programme.*** The GLD coordinates the purchasing card programme for B/Ds to use purchasing cards for low value purchases of stores and services;
- (e) ***Monitoring compliance with SPRs.*** The GLD regularly verifies stocks of government stores held by B/Ds and checks whether they comply with the SPRs; and
- (f) ***Other services.*** The GLD holds regular public auctions for disposal of confiscated/unclaimed goods and surplus stores of B/Ds. It also provides them with temporary storage space.

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**Note 4:** *The other main responsibilities of the GLD are to provide B/Ds with land transport and printing services.*

**Note 5:** *According to the GLD, essential items are those essential to operations of B/Ds and not readily available in the market. Examples include serially numbered government forms and national/regional flags.*

**Note 6:** *Emergency items include cleansing and medical stores (e.g. face masks, household bleach and disinfectant fluid). According to the GLD, it has drawn up the list of emergency items having regard to the needs of various contingency plans, such as an avian influenza pandemic and natural disasters.*

## **Introduction**

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1.5 In 2012-13, of the 713 posts in the GLD's establishment, 257 posts in three divisions (i.e. Management Services Division, Procurement Division and Supplies Management Division) are for providing procurement and supplies services. The estimated expenditure is \$125 million for 2012-13. Appendix A shows the organisation chart of the GLD.

## **The 2001 audit**

1.6 In 2001, the Audit Commission (Audit) completed an audit review of the procurement and management of government supplies (Note 7). The results were included in Chapter 3 of the Director of Audit's Report No. 37 of October 2001 and examined by the Public Accounts Committee of the Legislative Council. In its Report No. 37 of February 2002, the Committee made a number of recommendations for improvement in various areas. The Administration agreed with the recommendations and took action to implement them.

## **Audit review**

1.7 Audit has recently conducted a review of the GLD's procurement and supplies services to follow up the issues examined in the 2001 audit and examine new developments, focusing on the following areas:

- (a) procuring stores and services (PART 2);
- (b) supplying common-user items (PART 3);
- (c) supplying essential and emergency items (PART 4);
- (d) coordinating the purchasing card programme (PART 5);
- (e) monitoring compliance with SPRs (PART 6); and
- (f) other services (PART 7).

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**Note 7:** *The former Government Supplies Department was then responsible for providing procurement and supplies services to B/Ds. In July 2003, it was merged with the former Government Land Transport Agency and Printing Department to form the GLD.*

As part of the audit work on (d) above, Audit has also reviewed the use of purchasing cards in two selected departments, namely the Electrical and Mechanical Services Department (EMSD) and the Department of Health (Note 8). Audit has found room for improvement in the above areas and has made a number of recommendations to address the issues.

### General response from the Administration

1.8 The Director of Government Logistics agrees with the audit recommendations.

1.9 The Secretary for Financial Services and the Treasury agrees with the audit recommendations. He has said that:

- (a) the FSTB and the GLD are prepared to consider measures that can further improve the efficiency of the procurement procedures and help B/Ds obtain better value for money in their purchases. The GLD will continue to render every assistance to procuring B/Ds to ensure timely completion of tender evaluation before the tender validity period;
- (b) it is the GLD's duty to maintain a sufficient stock of emergency stores (such as face masks and personal protective gear) to help B/Ds respond to emergencies effectively. Replenishment of emergency stores often calls for shorter procurement cycles and greater procurement flexibility. Rigid adherence to normal tender procedures may not always be in the best overall interest of the Government and the public. However, exceptions have to be justified and proper approval has to be sought; and
- (c) the FSTB and the GLD will consider what more can be done to help B/Ds fully reap the benefits of the purchasing card programme in making low value purchases. They will also consider how best to facilitate the discharge of stores management functions by B/Ds under the SPRs.

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**Note 8:** *The EMSD and the Department of Health have been selected because in 2011, among all B/Ds, the former spent the most on low value purchases using purchasing cards while the latter spent the most on non-card purchases (without approvals for not using purchasing cards) (see paras. 5.10 and 5.11).*

## **Introduction**

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### **Acknowledgement**

1.10      Audit would like to acknowledge with gratitude the full cooperation of the staff of the GLD, the Department of Health and the EMSD during the course of the audit review.



## **PART 2: PROCURING STORES AND SERVICES**

2.1 This PART examines issues relating to the GLD's procurement for B/Ds of stores exceeding their direct purchase authority limits and services needed by multiple B/Ds. For procurement by open tender, all interested suppliers are free to submit their tenders (Note 9). For procurement by quotation, only selected suppliers are invited for quotations. The following issues are discussed:

- (a) procuring stores and services by tender (paras. 2.2 to 2.11);
- (b) procuring stores by quotation (paras. 2.12 to 2.20); and
- (c) use of online tools for procurement (paras. 2.21 to 2.26).

### **Procuring stores and services by tender**

2.2 *Tender procedures.* SPR 220 specifies that B/Ds shall follow tender procedures when making purchases of stores and services exceeding \$1.43 million. The GLD has provided its staff with a manual and a checklist setting out the detailed procedures for conducting tender exercises. The main tender procedures used by the GLD for procuring stores and services for B/Ds are as follows:

- (a) *Submitting tender request.* The originating B/D submits a tender request to the GLD setting out the requirements, specifications, estimated contract sum, potential suppliers and proposed tender validity period;
- (b) *Preparing tender documents.* The GLD, in consultation with the originating B/D, prepares the tender documents, including the specifications, terms and conditions;

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**Note 9:** *Under special circumstances and where approvals from the authorities concerned have been obtained, B/Ds may invite tenders in alternative ways. For example, when open tendering would not be an effective means of obtaining the requisite stores or services for reasons of extreme urgency brought about by unforeseeable events, restricted tendering (i.e. only a limited number of suppliers are invited to submit tenders) could be used.*

## Procuring stores and services

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- (c) ***Inviting tenders.*** The GLD publishes a tender notice in the Government Gazette and on its website to invite suppliers to submit tenders. It will open the tenders received and send them to the originating B/D for evaluation;
- (d) ***Evaluating tenders.*** The originating B/D forms an assessment panel to examine whether the tenders conform to the specifications, terms and conditions. The panel will rank the tenders (according to the tender prices or the overall scores when a marking scheme is used) and submit to the GLD an evaluation report stating its evaluation results and recommendation on the tender to be accepted;
- (e) ***Preparing tender report.*** The GLD vets the originating B/D's evaluation report. Where considered appropriate, the GLD will conduct negotiations with the tenderers. In consultation with the originating B/D, the GLD will prepare a tender report containing a clear recommendation for the relevant Tender Board's approval (Note 10); and
- (f) ***Awarding contract.*** Upon receipt of the relevant Tender Board's approval of tender acceptance, the GLD awards the contract to the successful tenderer on behalf of the originating B/D.

On legal issues, where necessary, the GLD will seek advice from the Department of Justice.

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**Note 10:** *The GLD Tender Board, chaired by the Director of Government Logistics, considers and decides on the acceptance of tenders not exceeding \$10 million in value in respect of any one contract, provided these tenders do not fall within the ambit of other subsidiary tender boards (e.g. the Public Works Tender Board). The Central Tender Board, chaired by the Permanent Secretary for Financial Services and the Treasury (Treasury), deals with tenders exceeding \$10 million, with the exception of those tenders dealt with by subsidiary tender boards. In 2011, the GLD Tender Board and the Central Tender Board respectively held 42 meetings and 36 meetings to deal with the tenders.*

2.3 Between 2008 and 2011, each year the GLD on average conducted 270 tender exercises to procure stores and services for B/Ds. The total value of the awarded contracts averaged \$5,360 million each year. Audit sample check has revealed room for improvement in conducting the tender exercises (see paras. 2.4 to 2.11 for details).

### *Speeding up tender exercises*

2.4 For each tender exercise, in consultation with the originating B/D and having regard to the target completion date, the GLD sets a tender validity period (Note 11). According to the GLD guidelines, all tenders received should be evaluated as soon as possible, so as to avoid any unnecessary requests for extending the tender validity period and the risk of tenderers withdrawing their tenders due to an unduly long validity period. Audit checked 48 tender cases (Note 12) to see if there were delays in completing the tender exercises. Audit found that in three cases, the GLD had to request the tenderers to extend the original tender validity periods because more time was needed to complete the tender exercises. Table 1 shows the details.

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**Note 11:** *The GLD has advised B/Ds to work out a realistic tender validity period, counted from the tender closing date. A short period might not be practical. If too long a period is set, tenderers might be reluctant to submit an offer or might submit an offer with price escalation built-in.*

**Note 12:** *Audit selected tender cases between 2008 and 2011 for checking, focusing on those which had a value exceeding \$5 million or had taken more than four months (after the tender closing dates) to complete.*

**Table 1**

**Tender exercises not completed  
within the original tender validity periods**

Case	Tender validity period		Contract value (\$ million)	Reasons for extending the tender validity periods
	Original (Day)	Extension (Day)		
1	180	49	6.9	In January 2010, the GLD received the originating department (EMSD)'s evaluation report. After conducting several rounds of clarifications with the EMSD, the GLD identified the need to seek the advice of the Department of Justice on certain legal issues (when 120 days had elapsed since receiving the evaluation report).
2	150	76	7.6	In August 2010, 57 days after receiving the originating department (Correctional Services Department)'s evaluation report, the GLD identified the need to seek the advice of the Department of Justice on the tender evaluation. It sought the legal advice 27 days later.
3	150	184	7.8	In May 2009, the GLD received the originating department (Efficiency Unit)'s evaluation report. It agreed there was a need to conduct negotiation with a tenderer 69 days later after consulting the Efficiency Unit. The negotiation commenced a week later and took 169 days to complete.

*Source: GLD records*

*Remarks: The legal issues in Cases 1 and 2 were mainly related to determining whether the recommended tenders were conforming offers.*

2.5 Delays in completing a tender exercise might cause disruptions of the supply of stores and/or services to the originating B/D and adversely affect its operation. In Audit's view, the GLD needs to review Cases 1 to 3 and take improvement measures to ensure the timely completion of tender exercises within the tender validity period. In the three cases, Audit noted that GLD staff (at Supplies Officer level) took 57 to 120 days (after receiving evaluation reports) to clarify issues with the originating departments and/or identify the need to seek legal advice or conduct tender negotiation in these cases. However, senior staff input was only sought at a late stage. The GLD may consider issuing guidelines to assist its staff in handling similar cases in future (e.g. requiring them to consult in good time their seniors on complicated issues).

2.6 According to GLD records, in 2011, the average times taken to complete an open tender exercise and a purchase by quotation were 211 days and 87 days respectively (counting from the date of tender/quotation request received by the GLD to the contract approval date). Because of the long time it takes to complete an open tender exercise, there may be a tendency to find ways to do the procurement by quotation even when open tendering is desirable for obtaining more competitive bidding. In Audit's view, the GLD, together with the respective originating B/Ds, needs to better plan and explore ways to shorten the time required to complete the tender exercises.

### ***Timely collection of contract deposits***

2.7 SPR 361 states that successful tenderers may be required to pay a contract deposit (Note 13) within a specified period before contract signing as security for the due and faithful performance of the contract. In practice, where the contract value is \$1.43 million or more, the GLD normally requires the successful tenderer to pay a contract deposit equivalent to 2% of the contract value within 21 days of tender acceptance. When the contractor fails to pay the contract deposit within the stipulated time, the GLD will issue reminders to the contractor. According to the GLD's Procedure Manual, if the contractor still fails to pay the contract deposit, the GLD may take action against the contractor in default (e.g. terminating the contract).

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**Note 13:** *The contract deposit may be in cash or in the form of a banker's guarantee.*

## Procuring stores and services

2.8 Audit analysis of the contracts awarded by the GLD in 2010 and 2011 revealed that for 422 contracts, the contractors were required to pay contract deposits within 21 days of tender acceptance. However, many of them had delays in paying the deposits. Table 2 shows the details.

**Table 2**  
**Contractors' delays in paying contract deposits**  
**(contracts awarded in 2010 and 2011)**

Number of days of delay	Amount involved (\$ million)	Number of contracts
No delay	92.4	267 (63%)
1 - 30	68.0	114 (27%)
31 - 60	38.9	21 (5%)
61 - 90	2.4	8 (2%)
91 - 229	5.6	12 (3%)
Total	207.3	422 (100%)

} 155 (37%)

*Source: GLD records*

*Remarks: Of all the cases with delays: (a) eight involved contract deposits of \$5 million or more each with delays ranging from 9 to 50 days; and (b) 74 were repeated delay cases involving 21 contractors.*

2.9 Table 2 shows that for 155 (37%) contracts, the contractors had delays in paying contract deposits, including 12 (3%) contracts with delays of 91 to 229 days. This suggested that the GLD did not have effective controls over the timely collection of contract deposits to safeguard the Government's interests. In particular, there was no specific control to deal with the repeated delay and high value cases. In Audit's view, the GLD needs to consider adopting control measures such as taking into account contractors' compliance with the contract deposit requirement in evaluating their future tenders.

## **Audit recommendations**

2.10 **Audit has recommended that the Director of Government Logistics should:**

- (a) **review Cases 1 to 3 to identify any procedural deficiencies leading to the delays of GLD staff in carrying out their tender evaluation and negotiation work;**
- (b) **based on the review results in (a) above, take improvement measures to ensure the timely completion of tender exercises within the tender validity period;**
- (c) **explore ways to shorten the time required to complete a tender exercise; and**
- (d) **establish effective controls over the timely collection of contract deposits from contractors in accordance with the contract conditions.**

## **Response from the Administration**

2.11 The Director of Government Logistics agrees with the audit recommendations. He has said that:

### ***Speeding up tender exercises***

- (a) the GLD accords much importance to the timely processing of tender cases on the part of both the GLD and the originating B/Ds. Since 2009, the GLD has adopted the practice of working out tender timelines with the originating B/Ds at the tender preparation stage for high value tenders for better monitoring of progress by both the originating B/Ds and the GLD. The GLD has extended this practice to all new tenders with effect from August 2012;
- (b) other measures being implemented to ensure timely completion of tender exercises include stepping up the internal monitoring of individual tenders and the tendering process in general, improving the guidelines for B/Ds on tender evaluation and launching new electronic platform for B/Ds to perform various procurement functions on time;

## **Procuring stores and services**

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- (c) the GLD has reviewed Cases 1 to 3 with a view to identifying areas of improvement. Among other things, it will enhance communication and cooperation with B/Ds in carrying out future tender evaluation and negotiation work;
- (d) the GLD has also reviewed the time taken to complete an open tender exercise. The GLD notes that sometimes more time is required to complete a tender exercise due to the complexity of tender requirements, use of marking scheme and/or more elaborate criteria for technical assessment by B/Ds such as product demonstrations, benchmark tests, factory visits and sample testing. Additional time may also be required to conduct tender negotiations for better conditions and price terms to the Government. Nevertheless, the GLD will continue to look for ways to improve the procurement process with a view to facilitating the timely completion of tender exercises and shortening the procurement lead time required where possible;

### ***Timely collection of contract deposits***

- (e) contracts are normally awarded after submission of contract deposits. However, in order to ensure the continuity of operations/service or due to the urgency of the supplies/service required by the originating B/Ds concerned, the GLD may need to award the contracts while taking actions in parallel to chase up the contract deposits;
- (f) the GLD agrees that every action should be taken to ensure timely submission of contract deposits by contractors and has been implementing a number of improvement measures since early 2011. For example, the standard terms of tender and contract conditions now include a provision for contract payment to be withheld if the contract deposit has not been made. The GLD has also made it clear in the reminders to contractors that the Government is entitled to terminate the contract in case the contractor fails to submit the required contract deposit;
- (g) all delayed contract deposits shown in Table 2 in paragraph 2.8 had been fully settled by 2 May 2012. None of the late submission cases involved any actual loss to the Government;



- (h) the situation in 2012 (up to 31 August 2012) has improved. About 73% of contractors had submitted contract deposits in time. The longest delay period for contractors failing to submit contract deposits in any form after the deadline was 45 days. As at 31 August 2012, there was no overdue contract deposit case;
- (i) to further tighten the system, the GLD has since August 2012 adopted an advance reminder system by issuing reminders to contractors seven days before the due date. The GLD has also instituted a mechanism to facilitate more targeted follow-up actions, such as classifying the contract deposits into different categories for monitoring the submission of contract deposits by contractors; and
- (j) the GLD will continue to look for ways to improve the collection of contract deposits.

### Procuring stores by quotation

2.12 **Quotation procedures.** SPR 240 specifies that, when procuring for B/Ds stores exceeding their direct purchase authority limits (see para. 1.3(c)) but not exceeding \$1.43 million, the GLD will invite quotations from a minimum of five suppliers and accept the lowest conforming offer. The GLD has not issued a manual on quotation procedures. In practice, the main procedures used by the GLD are as follows:

- (a) **Submitting procurement request.** The originating B/D submits a procurement request to the GLD setting out the requirements, specifications, estimated total value, potential suppliers and expected completion date;
- (b) **Preparing quotation documents.** The GLD, in consultation with the originating B/D, prepares the quotation documents, including the specifications, terms and conditions;
- (c) **Inviting quotations.** The GLD invites selected suppliers for quotations. It will open the quotations received and send them to the originating B/D for evaluation;
- (d) **Evaluating offers.** The originating B/D forms an evaluation panel to examine whether the offers conform to the specifications, terms and conditions. The panel will rank them according to the offered prices and submit to the GLD an evaluation report stating its evaluation results and recommendation on the offer to be accepted;
- (e) **Vetting evaluation report.** The GLD vets the originating B/D's evaluation report. Where considered appropriate, the GLD will conduct negotiations with the suppliers; and
- (f) **Accepting offer.** The GLD approves the acceptance of offer and issues a letter of acceptance to the successful supplier on behalf of the originating B/D.

2.13 Between 2008 and 2011, each year there were on average 120 cases of the GLD procuring stores for B/Ds by quotation. The total value of the purchases

averaged \$85 million each year. Audit sample check has revealed areas where improvement can be made (see paras. 2.14 to 2.20 for details).

### *Providing GLD staff with a procedure manual*

2.14 The GLD has provided its staff with a manual setting out the detailed procedures on handling procurement by tender. However, it has not issued a similar manual for procurement by quotation. In Audit's view, a manual for procurement by quotation will help ensure that GLD staff adopt consistent procedures (e.g. the selection of suppliers for inviting quotations) that meet the requirements of GLD management.

### *Ensuring B/Ds adopt tender procedures in accordance with SPRs*

2.15 As mentioned in paragraph 1.2, the Government aims to achieve best value for money in procurement by maintaining open and fair competition among suppliers (i.e. adopting tender procedures). In this respect, SPR 220 specifies that B/Ds shall follow tender procedures when making purchases of stores and services exceeding \$1.43 million. In addition, SPR 205 specifies that Controlling Officers shall ensure that their staff do not evade the \$1.43 million limit by dividing procurement requirements into instalments (Note 14). Audit checked 28 purchases by quotation (Note 15) to see if they had complied with these two SPRs. Audit found that, between February 2009 and November 2010, the GLD made seven repeated purchases by quotation of commemorative gold medals for the Civil Service Bureau (Note 16). Table 3 shows the details.

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**Note 14:** *The \$1.43 million limit refers to the total value of stores or services of a similar nature which, in normal practice, are obtained in a single purchase. For the GLD, according to SPR 246, it may only make repeated purchases of the same items within 12 months by quotation if the cumulative value of the purchases does not exceed \$1.43 million (see para. 4.6).*

**Note 15:** *Audit selected purchases of stores with similar descriptions (for the period 2008 to July 2012) for checking.*

**Note 16:** *The Civil Service Bureau has to purchase commemorative gold medals regularly for awarding to civil servants with 30 years' meritorious service.*

## Procuring stores and services

Table 3

### Repeated purchases by quotation of gold medals for Civil Service Bureau

Purchase	Date when Civil Service Bureau made request	Date when GLD awarded contract	Estimated number of medals required	Contract value (\$ million)
1	19 December 2008	3 February 2009	1,000	1.053
2	26 June 2009	1 September 2009	1,000	1.160
3	16 October 2009	30 December 2009	927	1.429
Sub-total for 2009 purchases			2,927	3.642
4	1 February 2010	7 April 2010	900	1.388
5	11 May 2010	15 July 2010	810	1.428
6	16 July 2010	16 September 2010	825	1.429
7	20 September 2010	17 November 2010	755	1.429
Sub-total for 2010 purchases			3,290	5.674
Total			6,217	9.316

Source: GLD records

Remarks: For each of the seven purchases, the GLD invited quotations from suppliers in accordance with SPR 240. It turned out that the same supplier (submitting the lowest or only conforming offer) was selected in all the seven cases.

2.16 Table 3 shows that the Civil Service Bureau's total procurement requirements were about \$9.3 million for 2009 and 2010, or \$3.6 million for 2009 and \$5.7 million for 2010 (both exceeding \$1.43 million). According to SPR 220, tender procedures should have been adopted, instead of making seven repeated purchases of less than \$1.43 million each. In this regard, Audit found that:

- (a) the GLD did not advise the Civil Service Bureau to adopt tender procedures for the bulk purchase of gold medals until 29 September 2010, after receiving the Bureau's procurement request of 20 September 2010 (Note 17); and
- (b) in May 2011, at the Bureau's request, the GLD awarded by tender a one-year contract for supplying 4,300 gold medals at \$6.5 million. In March 2012, another one-year contract for supplying the same number of gold medals at \$7.6 million was also awarded by tender.

2.17 Audit considers that the GLD, as the Government's central procurement agent, has an important role in ensuring that the twin policy objectives of achieving best value for money and maintaining open and fair competition are met, and the SPRs are complied with, for government procurement. In particular, the \$1.43 million limit for adopting tender procedures should not be evaded by dividing procurement requirements. The GLD needs to take measures to ensure that B/Ds adopt tender procedures in accordance with the SPRs. This will help B/Ds save the administrative costs of making repeated purchases and enjoy the benefits of bulk purchase, thus achieving best value for money.

## **Audit recommendations**

2.18 **Audit has recommended that the Director of Government Logistics should:**

- (a) **uphold a culture of compliance with SPR requirements and remind B/Ds to closely monitor their staff's compliance in adopting tender procedures when the procurement requirements of stores of a similar nature exceed \$1.43 million to ensure that they do not evade the limit by dividing procurement requirements;**

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**Note 17:** *The GLD eventually met the request on 17 November 2010 (see Purchase 7 in Table 3 in para. 2.15) because the Civil Service Bureau said that it was facing heavy demand for the gold medals and a tender exercise might take nine months to complete.*

## **Procuring stores and services**

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- (b) **establish procedures to monitor user B/Ds' repeated requests for procuring stores of a similar nature by quotation and promptly advise those B/Ds with procurement requirements exceeding \$1.43 million to adopt tender procedures for the bulk purchase of these stores; and**
- (c) **provide GLD staff with a manual on quotation procedures to ensure that they adopt consistent procedures that meet the requirements of GLD management.**

## **Response from the Administration**

2.19 The Director of Government Logistics agrees with the audit recommendations. He has said that:

- (a) the GLD regularly reminds B/Ds of the need to fully comply with the SPRs in making purchases, including the need to avoid artificially splitting purchases. The GLD will continue to do so. The GLD has also reminded its relevant staff that they should be more alert to repeated purchase requests from B/Ds and should advise them to bundle the purchases whenever applicable;
- (b) to tighten the procedures, the GLD has introduced measures to better detect originating B/Ds' repeated purchases, including seeking their confirmation that they have not made purchases of a similar nature in the past 12 months and do not plan to do so in the next 12 months. The GLD will promptly advise those B/Ds with procurement requirements exceeding \$1.43 million to adopt tender procedures for the bulk purchase of these stores; and
- (c) the procedures for handling tender and quotation exercises are very similar. In practice, GLD staff have been following the procedures set out in the "Procurement Division Procedural Manual" when arranging both tender and quotation exercises. The GLD agrees that the practice should be regularised. The GLD refined the Manual in August 2012 to make it clear that, except where stated expressly, the procedures are equally applicable to quotation exercises. The GLD will continue to keep in view the need to provide its staff with appropriate guidance on handling procurement.

- 2.20 The Secretary for the Civil Service has said that:
- (a) the purchases of gold medals in 2009 and 2010 through quotation exercises were temporary arrangements. Due to the fluctuation of gold price during these years, suppliers were reluctant to submit offers valid longer than 30 days, while open tendering required a tender validity period of at least three months. The Civil Service Bureau therefore continued to purchase gold medals by quotation, pending the preparation of open tendering with a new price variation clause for calculating the unit price of a gold medal so that tenderers would not need to speculate on the gold price and could submit realistic offers; and
  - (b) after much study and negotiation, the price variation clause was worked out in end 2010 and adopted in the 2011 and 2012 tender exercises.

### Use of online tools for procurement

2.21 The GLD has made use of online tools to facilitate the procurement processes. For example, it maintains a Procurement and Contract Management System for B/Ds to submit their tender requests. It also operates an e-Tender Box system for suppliers to view tender notices, terms and conditions for tenders, and submit their tender offers electronically.

2.22 Audit conducted Internet search of overseas practices in the use of online facilities for procurement. Audit has found that some public sectors of overseas countries have adopted electronic auctions for suppliers to bid via the Internet for a contract to provide goods or services. Generally, electronic auctions are recommended where the contract specifications are clear cut, strong competition among suppliers is in existence (e.g. more than four suppliers) and the contract values are large enough to attract competition (e.g. over \$3 million). Electronic auctions can achieve cost savings and other benefits, including higher procurement efficiency, enhanced transparency by disclosing all bids in real time and provision of comprehensive audit trails by electronic records (Note 18). The GLD, as the Government's central purchasing agent (handling some 270 tenders a year of which 190 were over \$3 million in value each in the past four years), has the potential to make use of electronic auctions for procurement to achieve cost savings and other benefits.

### Audit recommendation

2.23 **Audit has recommended that the Director of Government Logistics should, in consultation with the Government Chief Information Officer, explore the feasibility of introducing electronic auctions for procuring goods and services, taking into account overseas experience.**

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**Note 18:** *For example, in 2010, the Office of Government Commerce of the United Kingdom set out a Forward Plan on electronic auctions in the public sector for 2010-11 and 2011-12, involving contracts with a total value of £900 million. Subject to market conditions, the Office anticipated that overall cost savings of around £270 million could be achieved.*



## Response from the Administration

2.24 The Director of Government Logistics agrees with the audit recommendation. He has said that the GLD will, in consultation with the relevant parties, study the desirability of introducing electronic auctions into the Government's procurement regime.

2.25 The Secretary for Financial Services and the Treasury agrees with the audit recommendation. He has said that:

- (a) the proposal involves a host of policy and practical issues that need to be examined carefully. For example, there is a need to consider whether electronic auctions can fit in well with the tendering regime without undermining key procurement principles such as level playing field and minimising tendering costs to bidders, and whether electronic auctions can considerably drive down the bidding price to the extent that savings from contract prices will outweigh the costs to the Government of creating a new electronic platform for price bidding; and
- (b) while overseas experience may be relevant, it is also important to consider the viability of the proposal against local context. Issues to be examined include whether the additional costs to our bidders (mostly being small and medium-sized enterprises) would be prohibitive thereby limiting competition and the acceptance of the bidders who have been accustomed to a paper-based tendering system that protects bidders' anonymity and commercial sensitivities.

2.26 The Government Chief Information Officer agrees with and supports the audit recommendation.

## **PART 3: SUPPLYING COMMON-USER ITEMS**

3.1 This PART examines the following issues relating to the GLD's supply of common-user items to B/Ds through term contracts:

- (a) forecasting demand (paras. 3.4 to 3.9); and
- (b) inspecting items (paras. 3.10 to 3.16).

3.2 The former Government Supplies Department purchased in bulk a wide range of common-user items (1,631 items as at 31 March 2001) required by B/Ds and certain public bodies such as the Hospital Authority, and stored the items centrally for acquisition by users as and when required. In the 2001 audit, Audit found areas for improvement, including the maintenance of excessive stocks. In its Report of February 2002, the Public Accounts Committee recommended implementing arrangements for users to purchase and store the items they required. Subsequently, changes were made to the Government's stockholding policy as follows:

- (a) storing only essential and emergency items centrally for B/Ds (60 essential items and 50 emergency items as at 30 June 2012 — see para. 4.2); and
- (b) arranging term contracts for B/Ds to purchase other common-user items directly from the contractors as and when required.

3.3 The GLD generally follows tender procedures to arrange term contracts for supplying common-user items to B/Ds, mostly two-year contracts. As at 30 June 2012, there were 57 term contracts for supplying various items. The total value of these 57 contracts was \$1,200 million.

### **Forecasting demand**

3.4 Before inviting tenders for a term contract, the GLD asks B/Ds to forecast their demand in the contract period so as to estimate the total quantities of the items required. Most term contracts specify the estimated quantities and allow a  $\pm 30\%$  variation in the contract quantities/total estimated contract value. Thus contractors can claim compensation from the Government if the draw-off rate is less than 70%.

3.5 Audit found that for a term contract for supplying pens, pencils and pencil sharpeners, which expired in April 2011, the draw-off rate was only 67%. The GLD had to seek the contractor's agreement for a contract variation so as to avoid the possible need to pay compensation. Audit analysis revealed that the actual consumption of four major user B/Ds was substantially below their original forecast demand (i.e. their draw-off rates ranged from 22% to 67%).

3.6 According to the GLD, it performs a high-level check on B/Ds' forecast demand and clarifies exceptions with them, if any, before inviting tenders. However, in 2011, for a term contract for supplying bottled drinking water, the GLD's high-level check could not detect a significant error made by the Department of Justice in forecasting demand. After the contract had been awarded, the Department indicated that it had incorrectly reported its monthly demand as annual demand and needed to revise its forecast demand from 1,400 to 16,800 carboys.

3.7 Specifying accurate estimated quantities of the items required in a term contract helps ensure that, while enjoying the benefits of bulk purchase, the Government can meet the contractual requirement on the draw-off rate and thus avoiding the contractor's compensation claim. In Audit's view, the GLD needs to ensure that B/Ds provide more accurate demand forecasts of their required contract quantities.

### **Audit recommendations**

3.8 **Audit has recommended that the Director of Government Logistics should:**

- (a) **remind those major user B/Ds of common-user items with past records of lower actual consumption than their forecasts to review their forecasting basis and make improvement in future; and**
- (b) **require GLD staff to perform a reasonableness check on B/Ds' forecast demand (e.g. comparing the forecast demand with the quantities ordered in previous years) for detecting significant errors, paying particular attention to those B/Ds which have repeatedly provided inaccurate forecasts.**

### Response from the Administration

3.9 The Director of Government Logistics agrees with the audit recommendations. He has said that:

- (a) the GLD has for some years implemented various measures to monitor the forecast requirements and subsequent draw-off rates from B/Ds. These include performing a high-level check on B/Ds' forecast requirements and making clarification, if necessary, before inviting tenders, close monitoring of the monthly draw-off rates of the contracts and following up with user B/Ds, and arranging for contract variation to reflect revised requirement forecasts. The GLD will continue to do so;
- (b) the GLD has standardised the practice of performing high-level check with a threshold of specified variance level and will clarify with user B/Ds exceeding the threshold as part of its standing procedures for all its term contracts;
- (c) the GLD closely monitors the draw-off rates. User B/Ds are reminded that they are liable to pay for their share of compensation if the total contract quantity/value falls below the minimum draw-off level of the contractual obligations; and
- (d) term contracts usually run for two years. For the 57 term contracts managed by the GLD with expiry dates in the years 2010 and 2011, only one (1.8%) had a draw-off rate below the minimum draw-off level. The GLD will continue to carry out its checks and monitoring, and impress upon user B/Ds of the importance to provide accurate forecasts.

### Inspecting items

3.10 *Inspections by B/Ds.* According to the GLD, B/Ds are responsible for carrying out inspections upon receipt of common-user items supplied by term contractors to see if they comply with the contract specifications. The GLD has provided B/Ds with guidelines setting out inspection methods such as physical count, visual inspection, hand-feel, smell, practical test and use of measuring equipment.

3.11 *GLD inspection programme.* Since 2008, the Supplies Management Division of the GLD has conducted field inspections of B/Ds on a cyclical basis, annually for eight larger departments and every two years for other B/Ds. In each inspection, it checks a random sample of common-user items for compliance with the contract specifications.

### *Extending the inspection programme*

3.12 Audit notes that besides the Supplies Management Division, the Procurement Division of the GLD is also responsible for administering some common-user items. However, unlike the Supplies Management Division, the Procurement Division does not have an inspection programme for common-user items under its administration. In Audit's view, the GLD needs to extend the inspection programme to the Procurement Division to cover all common-user items supplied under the term contracts.

### *Enhancing quality assurance measures*

3.13 In 2010, after terminating a term contract for supplying bottled drinking water because of non-compliance with the quality specifications (e.g. failed sample tests on water quality, water leakage problems and one case of an ant found in the supplied water), the GLD enhanced the quality assurance measures in conducting a subsequent tender exercise, as follows:

- (a) not accepting tender from any supplier whose contract for supplying bottled drinking water to the Government has been terminated prematurely due to unsatisfactory performance during the preceding 12 months;

## Supplying common-user items

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- (b) revising the tender marking scheme to add marks to tenderers having contingency plans to maintain a stable supply; and
- (c) revising the contract conditions to include new quality assurance requirements (e.g. submission of bi-monthly test reports).

3.14 Audit welcomes the enhanced quality assurance measures. In Audit's view, the GLD needs to consider introducing similar measures for other term contracts.

## Audit recommendations

3.15 **Audit has recommended that the Director of Government Logistics should:**

- (a) **consider extending the Supplies Management Division's inspection programme to the Procurement Division to cover all common-user items; and**
- (b) **consider the need to introduce quality assurance measures for other term contracts similar to those arranged for the term contract for supplying bottled drinking water.**

## Response from the Administration

3.16 The Director of Government Logistics agrees with the audit recommendations. He has said that:

- (a) where applicable, the inspection programme will be extended to cover all common-user items; and
- (b) as for the introduction of quality assurance measures in other term contracts, the GLD considers the need for, and the form of, such measures on a case-by-case basis, taking into account the nature of the item and the size of the contract. For example, if the quality may be easily established through visual inspection and simple measurement, laboratory tests may not be called for. If the contract size is relatively small, mandating frequent and elaborate tests may jack up the tender price. The GLD will continue to strike a balance in deciding the appropriate quality assurance measures for term contracts.

## **PART 4: SUPPLYING ESSENTIAL AND EMERGENCY ITEMS**

4.1 This PART examines issues relating to the GLD's supply of essential and emergency items to B/Ds. The following issues are discussed:

- (a) replenishing stocks (paras. 4.3 to 4.9); and
- (b) return of stores from B/Ds (paras. 4.10 to 4.18).

4.2 The GLD purchases essential and emergency items (see Notes 5 and 6 to para. 1.4(c)) in bulk and stores them centrally in the Government Logistics Centre (GLC — see Photograph 1) in Chai Wan. After receiving a B/D's order for any items, the GLD delivers the items to the B/D and recovers the cost from it. In 2011-12, the GLD purchased items totalling \$17 million and delivered items totalling \$15.7 million to B/Ds. As at 30 June 2012, the GLD stocked 60 essential items and 50 emergency items in the GLC, totalling \$8.9 million.

### **Photograph 1**

#### **The Government Logistics Centre**



*Source: Photograph taken by Audit on 11 July 2012*

### Replenishing stocks

4.3 According to the GLD's Operation Manual, when an essential or emergency item is required to be replenished, the GLD will review the stocks of the whole range of stores of the same nature so as to make bulk purchases where appropriate. For determining the quantities to be purchased, the GLD will request B/Ds to submit their requirements for the next two years and consolidate them. The GLD will normally award two-year term contracts to purchase items in bulk.

### *Reviewing half-yearly stock replenishment practice and complying with SPRs*

4.4 Audit found that for 40 emergency items, the GLD's practice was to ask B/Ds to submit their requirements for the next six months, consolidate them and then make purchases half-yearly. This was at variance with the biennial stock replenishment guidelines in the GLD's Operation Manual. In June 2012, upon Audit enquiry, the GLD explained that:

- (a) the demand for emergency items might be unstable. A half-yearly replenishment would allow the GLD to review the demand more frequently to meet the operational requirements of B/Ds; and
- (b) for some emergency items with a shelf life, purchasing them in bulk through two-year contracts would be inappropriate.

4.5 Audit notes the GLD's explanations, but considers that contracts with an appropriate quantity variation clause and flexible delivery schedules could address the issues concerned. Audit also notes that where the total annual requirement of B/Ds for an item exceeds \$1.43 million, adopting the half-yearly stock replenishment practice will result in a breach of SPR 246 (which specifies that B/Ds may only make repeated purchases of the same items within 12 months if the cumulative value of the purchases does not exceed their purchase limit, which is \$1.43 million for the GLD). Table 4 shows cases of breach of SPR 246 as revealed by Audit examination of the GLD's purchases of the 40 items between 2009-10 and 2011-12.



## Supplying essential and emergency items

**Table 4**

**Repeated purchases of same emergency items  
by quotation with a total value exceeding \$1.43 million**

Purchase	Date when GLD made purchase	Quantity of items purchased	Total value (\$ million)
<i>Surgical gloves</i>			
I	1 December 2009	476,640 pairs	1.38
II	2 November 2010	116,880 pairs	0.36
Total		593,520 pairs	1.74
<i>Alcohol swab</i>			
III	20 October 2009	5,500,000 pieces	1.16
IV	13 May 2010	3,892,500 pieces	0.73
Total		9,392,500 pieces	1.89
<i>N95 face mask</i>			
V	29 August 2011	13,500 boxes	1.34
VI	9 February 2012	13,760 boxes	1.35
Total		27,260 boxes	2.69

*Source: GLD records*

*Remarks: After evaluating quotations from suppliers, it turned out that the GLD selected the same supplier for Purchases I and II, two different suppliers for Purchases III and IV and the same supplier for Purchases V and VI. These four suppliers submitted the lowest or only conforming offer in the quotation exercises concerned.*

## Supplying essential and emergency items

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4.6 In Audit's view, the GLD needs to review the half-yearly stock replenishment practice to determine whether it should purchase the 40 items through term contracts with longer contract duration, adopting tender procedures where the total purchase value exceeds \$1.43 million. In all cases, the GLD needs to ensure that it complies with SPR 246 by not making repeated purchases exceeding \$1.43 million within 12 months, or has obtained the approval of the Permanent Secretary for Financial Services and the Treasury (Treasury) under SPR 275 before doing so in justifiable cases.

### Audit recommendations

4.7 **Audit has recommended that the Director of Government Logistics should:**

- (a) **review the half-yearly stock replenishment practice for the 40 emergency items and, where appropriate, purchase them through term contracts with longer contract duration, with a view to saving administrative costs and achieving the benefits of bulk purchase;**
- (b) **adopt tender procedures for purchases of items exceeding \$1.43 million in accordance with SPR 220; and**
- (c) **where exceptionally justified that there is a need to make purchases of the same items within 12 months with a total value exceeding \$1.43 million, seek the approval of the Permanent Secretary for Financial Services and the Treasury (Treasury).**

### Response from the Administration

4.8 The Director of Government Logistics agrees with the audit recommendations. He has said that:

- (a) in purchasing emergency items, the primary consideration is to ensure that there is sufficient supply to meet B/Ds' needs in case of emergencies or contingencies;
- (b) the frequency of stock replenishment has to take into account factors such as the committed stock levels (i.e. the pre-set quantities that must be

## Supplying essential and emergency items

available for various contingency plans), procurement and delivery lead time, and shelf life. In addition to meeting B/Ds' operational needs in emergencies, the GLD endeavours to maintain a healthy turnover of such items in normal times;

- (c) subject to the considerations in (a) and (b) above, where feasible, the GLD will arrange term contracts for emergency items on a two-year or three-year basis, as appropriate;
- (d) the stock replenishment arrangements for emergency items are regularly reviewed by the GLD at senior level meetings. The GLD has updated the Operation Manual on stock replenishment arrangements to provide guidance on replenishment of emergency items and stock replenishment practice in the event of outbreak of influenza pandemic; and
- (e) where there is a need to make purchases of the same items within 12 months with a total value exceeding \$1.43 million, the GLD will conduct a tender exercise for the purchase. Where urgent purchases brought about by unforeseeable events cannot be met by conducting a tender exercise under normal procedures, the GLD will seek the approval of the Permanent Secretary for Financial Services and the Treasury (Treasury) for exceptions to the SPRs.

4.9 The Secretary for Financial Services and the Treasury agrees with the audit recommendations. He has said that:

- (a) within the Government, the GLD acts as the purchasing agent for emergency stores such as face masks and personal protective gear. It is the GLD's duty to ensure a sufficient supply of emergency stores to meet B/Ds' needs in case of emergencies or contingencies. Responding to this challenge very often calls for greater procurement flexibility, particularly when there is an immediate need to replenish or increase the stock to equip B/Ds dealing with emergencies effectively (such as the Human Swine Influenza pandemic in mid-2009); and
- (b) if circumstances permit, the GLD will conduct tender exercises for the procurement of emergency stores. But, if due to unforeseen events, urgent purchases are necessary and cannot be met by normal tender procedures, the GLD will seek approval under the SPRs to make the procurement through other means (such as direct purchase or quotation).

### Return of stores from bureaux/departments

4.10 SPR 875 states that if serviceable stores received from the GLD are no longer required, the B/D should return them to the GLD provided that they are not obsolete or surplus to the Government requirements, in a condition acceptable to the GLD and suitable for reissue to other B/Ds, and in complete units of quantity. The GLD will take the returned stores on charge at the current stock price. For stores surplus to the Government requirements, the B/D should take disposal action in accordance with the SPRs.

4.11 Audit found that the Education Bureau had stored 1.2 million surgical masks (costing \$470,000) as emergency stock in the GLC for nine years. The key events are as follows:

- (a) in July 2003, the GLD issued the masks to the Education Bureau (Note 19) after procuring them for the Bureau. The Bureau requested the masks to be stored in the GLC pending its collection;
- (b) in August 2005, after making enquiries with two major manufacturers of surgical masks (not the manufacturer of the Education Bureau's stock), the GLD advised all B/Ds that there was no shelf life for the surgical masks obtained from the GLC;
- (c) in April 2009, in response to the Education Bureau's enquiry about the use of its 1.2 million masks stored in the GLC, the GLD said that, as advised by the manufacturer of face masks, masks kept in good storage condition literally had no expiry date;
- (d) in May 2009 and again in December 2010, the GLD urged the Education Bureau to collect the masks;
- (e) in response, in January 2011 the Education Bureau arranged an inspection and noted that the production date of the masks was May 2003. After the site visit, to play safe, the Bureau made an enquiry with the supplier direct. In February 2011, the supplier advised that the manufacturer had indicated that masks stored in a clean and dry place were good for use within five years of their production (i.e. before May 2008);

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**Note 19:** *The Education Bureau was known as the Education and Manpower Bureau at that time. For simplicity, both are referred to as the Education Bureau in this Audit Report.*

## Supplying essential and emergency items

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- (f) in March 2012, the GLD reminded the Education Bureau again and then learnt about the shelf life of the masks; and
- (g) as at 31 July 2012, the masks were still stored in the GLC (see Photograph 2).

### Photograph 2

#### Education Bureau's surgical masks stored in the Government Logistics Centre



*Source: Photograph taken by Audit on 11 July 2012*

4.12 Audit is concerned that in July 2003 when the GLD procured the 1.2 million surgical masks for the Education Bureau as emergency stock, both the GLD and the Bureau did not ascertain from the supplier the shelf life of the masks. Subsequently, the GLD, based on information from other manufacturers, had given incorrect advice that the masks had no expiry date and the Education Bureau found out only in February 2011 that the shelf life of its masks had already expired. In Audit's view, when procuring stores for B/Ds, the GLD needs to ascertain the expiry date with each and every supplier and advise the user B/Ds accordingly, particularly for stores that are purchased in bulk and serve as emergency stock with slow turnover.

## **Supplying essential and emergency items**

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4.13 Audit noted that the Education Bureau, having regard to the advice of the GLD (see para. 4.11(b) and (c)), continued to maintain the surgical masks as emergency stock. In Audit's view, the Bureau needs to review its requirement for emergency stock regularly. Where it is no longer necessary to maintain any emergency stock, the Bureau needs to take prompt action to seek the GLD's advice on how to deal with them (e.g. reissuing to other user B/Ds to minimise wastage). In this connection, Audit noted that the GLD issued 12 million surgical masks to other B/Ds in 2006-07 and 2007-08 (when the Education Bureau's masks were still serviceable).

4.14 It was May 2009 when the GLD urged for the first time the Education Bureau to deal with its surgical masks. Since the masks had all along been stored prominently in the GLC, GLD staff should have taken earlier action to urge the Bureau to deal with them.

### **Audit recommendations**

4.15 **Audit has recommended that the Director of Government Logistics should:**

- (a) **when procuring stores for B/Ds, ascertain the expiry date with each and every supplier and advise the user B/Ds accordingly, particularly for stores that are purchased in bulk and serve as emergency stock with slow turnover;**
- (b) **remind B/Ds to seek the GLD's advice on the return to it of stores no longer required or other disposal options as soon as possible, particularly for stores with a shelf life;**
- (c) **remind B/Ds regularly to collect the stores as soon as possible (well before the expiry of the shelf life, if any); and**
- (d) **assist the Secretary for Education to dispose of the unserviceable surgical masks stored in the GLC.**

4.16     **Audit has *recommended* that the Secretary for Education should keep the need for emergency stock under regular review and take early action to consult the GLD on the disposal of any stock no longer required.**

## **Response from the Administration**

4.17     The Director of Government Logistics agrees with the audit recommendations in paragraph 4.15. He has said that:

- (a)     in future, when procuring stores for B/Ds, the GLD will ascertain the expiry date with each and every supplier and advise the user B/Ds accordingly;
  
- (b)     in June 2009, the GLD issued a memorandum to B/Ds on the proper procedures for the stock management of emergency stores with a shelf life. The memorandum is re-circulated to all Departmental Stores Managers (Note 20) every six months. The GLD will continue to periodically remind B/Ds to seek the GLD's advice on the return of surplus stores to the GLD or other disposal options, particularly for stores with a shelf life;
  
- (c)     in future cases of B/Ds deferring the collection of stores issued to them, the GLD will remind them at six-month intervals to collect the stores as soon as possible; and
  
- (d)     the GLD assisted the Education Bureau in disposing of the unserviceable surgical masks in accordance with the SPRs in September 2012.

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**Note 20:** *The Departmental Stores Manager of a B/D is responsible for supervising all stores and procurement matters within his B/D.*

## **Supplying essential and emergency items**

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4.18 The Secretary for Education agrees with the audit recommendations in paragraph 4.16. He has said that:

- (a) taking into account that there are some 800,000 primary and secondary students and 66,000 teachers, it is necessary for the Education Bureau to keep a large quantity of surgical masks as emergency stock for use by schools in case of sudden spread of Severe Acute Respiratory Syndrome or other communicable diseases in schools. In reliance on the understanding that there would be no expiry date for surgical masks if they were kept in good storage condition, the Education Bureau has maintained the masks as emergency stock instead of reissuing them to other B/Ds or schools. Had the Education Bureau been informed earlier about the shelf life of the masks, it would have reviewed its requirement and taken earlier action to minimise wastage;
- (b) the Education Bureau will, in consultation with the GLD, keep the need for emergency stock under regular review and if needed, take early action to consult the GLD on the disposal of any emergency stock no longer required; and
- (c) as for the 1.2 million surgical masks, the Education Bureau has sought the assistance of the GLD to dispose of them (see para. 4.17(d)).



## **PART 5: COORDINATING THE PURCHASING CARD PROGRAMME**

5.1 This PART examines issues relating to the GLD's coordination of the purchasing card programme.

5.2 *Programme objectives.* The GLD is the coordinator of the service-wide purchasing card programme. The programme, introduced in March 2000, requires B/Ds to use purchasing cards as the normal means to purchase low value stores and services not exceeding \$50,000. It allows B/Ds to arrange payments to the card issuing banks on a monthly basis, instead of paying different suppliers at different times when purchases are made. The objectives of the programme are as follows:

- (a) streamlining the resources and workflow for processing payments;
- (b) streamlining the procurement process for low value purchases; and
- (c) improving administrative control over low value purchases.

5.3 *Guidelines on use of purchasing cards.* According to SPRs 260(a) and 280(b), procurement of stores and services not exceeding \$50,000 shall be made through purchasing cards unless the Controlling Officer, or a designated officer not lower than the rank of Chief Executive Officer or equivalent (director officer before 18 September 2012 — see para. 5.6), has authorised in writing otherwise. In addition, B/Ds are required to follow a set of guidelines on the use of purchasing cards (Note 21), including the following:

- (a) each B/D should appoint a senior officer, normally the Departmental Stores Manager (see Note 20 to para. 4.17(b)), to be the officer-in-charge of the purchasing card programme and ensure that purchasing cards are adopted as a norm for effecting low value purchases;

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**Note 21:** *The guidelines were previously included in Financial Circular No. 8/2003 of June 2003 which was superseded by Financial Circular No. 6/2012 of September 2012. Financial Circular No. 6/2012 promulgated three improvement measures (see para. 5.6) and the issue of updated operational guidelines on the use of purchasing cards by the GLD.*

## Coordinating the purchasing card programme

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- (b) purchasing cards should only be issued to officers who do purchasing on a regular basis and at a rank not lower than a Supplies Supervisor II or equivalent;
- (c) B/Ds should ask the banks to impose limits and restrictions on the use of cards as required, such as credit limits per transaction and per billing cycle. As a general guideline, the credit limit for a cardholder per billing cycle should not be more than four times his monthly salary (two times before 18 September 2012 — see para. 5.6). However, B/Ds may grant a higher credit limit when justified having regard to the B/Ds' purchasing requirements;
- (d) B/Ds should review cardholders' activities regularly to identify inactive cardholders, rejected transactions (i.e. attempts to make purchases beyond the imposed limits and restrictions) and other issues for taking appropriate follow-up actions (e.g. withdrawal of cards); and
- (e) Controlling Officers, or the designated officers not lower than the rank of Chief Executive Officer or equivalent (directorate officers before 18 September 2012 — see para. 5.6), may consider granting blanket approvals for not using purchasing cards where:
  - (i) the goods and services are to be provided by a sole supplier who does not accept card payment;
  - (ii) the purchase value does not exceed \$1,000 (\$300 before 18 September 2012 — see para. 5.6) and the suppliers do not accept card payment; or
  - (iii) it is a norm in the industry or trade that the providers of the goods and services do not accept card payment.

Besides, they may grant exemptions for not using purchasing cards on a case-by-case basis with sound justifications, having regard to overall cost effectiveness.

5.4 As at 31 March 2012, the two banks engaged for providing card services had issued a total of 8,600 purchasing cards. B/Ds are required to submit to the GLD annual returns on the use of the purchasing cards issued to their staff.

### Service-wide surveys on purchasing card programme

5.5 *2007 survey.* In November 2007, the GLD completed a survey to collect views from B/Ds on the purchasing card programme. In its report to the FSTB, the GLD concluded that the programme was successful, although some B/Ds had indicated problems in administering the programme such as the increase in administrative workload. Based on B/Ds' feedback, the GLD introduced some measures to improve the programme (Note 22).

5.6 *2011 survey.* In May 2011, in response to the FSTB's request for a full review, the GLD completed another survey on the purchasing card programme. Some key findings from the survey returns submitted by 71 B/Ds are as follows:

- (a) 69 (97%) B/Ds indicated that purchasing cards were useful and the programme should continue;
- (b) 13 (18%) B/Ds considered that the three programme objectives (see para. 5.2) had not been fully achieved, including 7 (10%) B/Ds which considered that all three objectives had not been achieved. The administrative problems indicated by these B/Ds were similar to those revealed in the 2007 survey;
- (c) 9 (13%) B/Ds commented that the three conditions for blanket exemptions (see para. 5.3(e)) were inappropriate; and
- (d) 4 (6%) B/Ds found some difficulties in following the GLD guidelines on the use of purchasing cards.

In its report to the FSTB of 31 May 2011, the GLD recommended improvement measures for the purchasing card programme (i.e. raising the \$300 exemption limit to \$500 and the credit limit for a cardholder per billing cycle from two times to four times his monthly salary). On 18 September 2012, the FSTB issued Financial Circular No. 6/2012 to implement three improvement measures (i.e. raising the

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**Note 22:** *These included providing an online enquiry function to facilitate B/Ds' monitoring of the cardholders' credit limits and electronic statements to assist B/Ds to check their purchase orders and payment transactions.*

## Coordinating the purchasing card programme

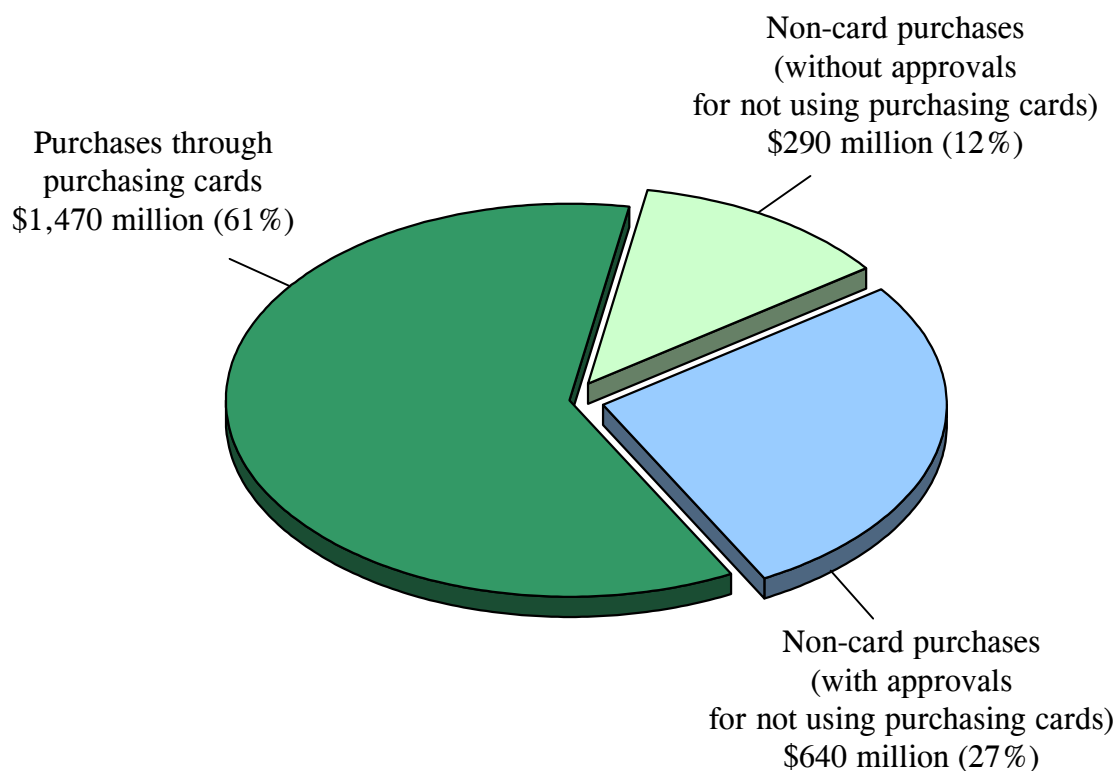
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exemption limit to \$1,000 and the credit limit to four times a cardholder's monthly salary, and allowing designated officers at the Chief Executive Officer or equivalent ranks (instead of only directorate officers) to approve requests for not using purchasing cards).

5.7 Audit examination revealed that in 2011 B/Ds spent a total of \$2,400 million on purchasing low value stores and services, of which \$930 million (39%) were non-card purchases (i.e. purchases not using purchasing cards). In particular, for \$290 million (12%) purchases made by seven B/Ds, there were no approvals for not using purchasing cards, contrary to the SPRs. Figure 1 shows the details.

**Figure 1**

**Low value purchases ( $\leq$ \$50,000) of stores and services made by B/Ds  
(2011)**



Source: B/Ds' 2011 returns to the GLD

## **Coordinating the purchasing card programme**

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5.8 According to the guidelines on the use of purchasing cards, B/Ds should review cardholders' activities regularly to identify inactive cardholders, rejected transactions and other issues for taking appropriate follow-up actions (see para. 5.3(d)). However, Audit found from GLD records (Note 23) that in 2011 there were many inactive cards and many rejected transactions, as follows:

- (a) ***Inactive cards.*** 266 cards (6% of the 4,274 cards issued by one card issuing bank) issued to officers in 25 B/Ds were not used for conducting any transaction; and
- (b) ***Rejected transactions.*** There were 11,400 rejected transactions (mostly related to cumulative spending exceeding credit limits) with a total amount of \$235 million in 68 B/Ds.

The audit findings suggested that there was room for improvement in B/Ds' management of the purchasing cards issued to their staff.

5.9 Audit has selected the Department of Health and the EMSD to review their use of purchasing cards (see para. 1.7). The review findings are in paragraphs 5.10 and 5.11.

5.10 ***Department of Health.*** In 2011, of the total \$290 million purchases without approvals for not using purchasing cards (see para. 5.7), the Department of Health accounted for \$113 million, the most among all B/Ds. Audit found that the Department had not fully implemented the purchasing card programme. As at 31 March 2012, only 16 purchasing cards had been issued to officers of the Department. In particular, no purchasing cards had been issued to the Department's Public Health Laboratory Services Branch, which made \$31 million low value purchases in 2011. According to the Branch's records, in 2005 it suggested deferring the implementation of the purchasing card programme because of heavy workload. However, up to 31 July 2012, the Branch had not yet taken follow-up actions.

5.11 ***EMSD.*** In 2011, the EMSD made \$323 million purchases using purchasing cards, the most among all B/Ds. Audit has selected seven EMSD

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**Note 23:** *Only one of the two card issuing banks provided the GLD with overall information on card usage and details of B/Ds' rejected transactions.*

## Coordinating the purchasing card programme

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divisions (with the largest number of cardholders) to review their use of purchasing cards in 2011-12. Audit identified the following areas for improvement:

- (a) ***Purchases exceeding \$50,000.*** The purchase values were \$60,000 in one case and \$78,000 in another, both exceeding the limit of \$50,000 specified in the SPRs. For both cases, the EMSD had not specified any maximum spending limit in the card application forms;
- (b) ***No restrictions on products.*** According to the guidelines on the use of purchasing cards, a cardholder may be barred from using the card to purchase certain lines of products which fall outside his usual scope of purchases, such as jewellery. For one case, there were no such restrictions imposed on the cardholder;
- (c) ***Credit limits set too high.*** For one case, a cardholder was issued two purchasing cards, each with a credit limit of \$500,000 per billing cycle. The total credit limit of \$1 million was 44 times her monthly salary (whereas the then prevailing limit was two times the cardholder's salary unless exceptionally justified — see para. 5.3(c)). Her spending per billing cycle in 2011-12 ranged from \$1,100 to \$92,800 only;
- (d) ***Inactive cards.*** For one sub-division with 37 purchasing cards issued, 23 cards were not used in 2011-12 (including 12 cards which had never been used since they were issued). In addition, for another sub-division, cardholders' average total spending per billing cycle amounted to only 5% of their total credit limit in 2011-12. The number of cards issued in these sub-divisions could have been excessive; and
- (e) ***Repeated purchases.*** One division made 19 repeated purchases of similar items at a total value of \$765,000 in 2011-12. There was scope to aggregate the requirements to purchase in bulk with a view to obtaining more competitive prices.

### ***Implementing comprehensive improvement measures service-wide***

5.12 Audit welcomes the GLD's efforts to conduct the 2007 and 2011 service-wide surveys of the purchasing card programme. The survey results, coupled with the results of this audit of the use of purchasing cards by B/Ds, have highlighted some issues that need to be addressed. Audit is particularly concerned that:

## Coordinating the purchasing card programme

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- (a) 13 of 71 B/Ds considered that all or some of the programme objectives had not been achieved. They encountered similar administrative problems in using purchasing cards; and
- (b) statistics showed that the purchasing card programme had still not been fully implemented service-wide. In 2011, seven B/Ds spent a total of \$290 million on low value purchases which were made without approvals for not using purchasing cards.

In Audit's view, the GLD needs to conduct further studies of the administrative problems commonly encountered by B/Ds to determine whether other improvement measures should be implemented service-wide, with a view to fully implementing the purchasing card programme and achieving all the benefits.

### *Assisting individual B/Ds to address specific problems*

5.13 Audit examination has also revealed the need to assist individual B/Ds to address specific problems in their use of purchasing cards (e.g. problems of management of inactive cards and rejected transactions, and problems similar to those identified with the Department of Health and the EMSD). In conducting regular stores verifications of B/Ds (see para. 6.4), the GLD needs to pay attention to their use of purchasing cards, with a view to providing them with necessary advice, training and assistance to address their specific problems.

## **Audit recommendations**

5.14 **Audit has *recommended* that the Director of Government Logistics should:**

- (a) **conduct further studies of the administrative problems commonly encountered by B/Ds and seek the support of the Secretary for Financial Services and the Treasury to implement other improvement measures as appropriate, with a view to fully implementing the purchasing card programme and achieving all the benefits;**
- (b) **regularly remind B/Ds of the need to comply with the SPRs and the GLD's guidelines in their use of purchasing cards, including the need to review cardholders' activities to identify inactive cards, rejected transactions and other issues for appropriate follow-up actions;**

## **Coordinating the purchasing card programme**

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- (c) **in conducting regular stores verifications of B/Ds, pay attention to their use of purchasing cards, with a view to providing them with necessary advice, training and assistance to address their specific problems; and**
- (d) **in view of the problems identified in Audit's review of the Department of Health and the EMSD, consider giving priority to reviewing their use of purchasing cards so as to help them address the problems as soon as possible.**

5.15 **Audit has *recommended* that the Director of Health and the Director of Electrical and Mechanical Services should, with the assistance of the GLD, implement appropriate measures to address the problems identified by Audit in their use of purchasing cards.**

## **Response from the Administration**

5.16 The Director of Government Logistics agrees with the audit recommendations in paragraph 5.14. He has said that:

- (a) the GLD has provided various services to facilitate B/Ds' compliance with the SPRs on the use of purchasing cards for low value purchases since 2000. These include arranging seminars for B/Ds, providing a help desk service, and preparing and disseminating reference materials such as common questions and answers and training materials. The GLD also liaises periodically with the card issuing banks for providing B/Ds with more user-friendly reports and for generating information for B/Ds' management review. The GLD will continue to support B/Ds on these fronts;
- (b) the three improvement measures mentioned in paragraph 5.6 should address most of the administrative problems raised by B/Ds in the 2011 survey. The GLD will continue to consider in consultation with the FSTB whether there is scope for further improving the purchasing card programme; and
- (c) for B/D-specific problems, the GLD has approached the B/Ds concerned to offer advice and assistance. The GLD also announced to B/Ds in August 2012 that it would strengthen its monitoring of the purchasing



## **Coordinating the purchasing card programme**

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card programme. Starting from the year ending December 2012, B/Ds are requested to provide the GLD with more information on their use of purchasing cards with regard to compliance, non-compliance and performance of card issuing banks on a yearly basis.

5.17 The Secretary for Financial Services and the Treasury agrees with the audit recommendations in paragraph 5.14. He has said that:

- (a) he is satisfied that the purchasing card programme has grown considerably since roll out in 2000 and has become the normal means for pursuing low value stores and services. The number of cards issued increased from 1,115 in 2000 to 8,506 in 2011, and the total transaction value increased from \$51 million to \$1,468 million;
- (b) he is also satisfied that compared with use of purchase orders, the purchasing card programme has continued to produce for the GLD savings of 9.8 minutes of staff time and \$41 per transaction in terms of notional staff cost according to the GLD's 2011 survey on the programme; and
- (c) the three improvement measures mentioned in paragraph 5.6 should be able to improve the user experience of the purchasing card programme. That said, the FSTB and the GLD stand ready to consider what more can be done to streamline the procurement process and help B/Ds fully reap the benefits of the programme in making low value purchases.

5.18 The Director of Health agrees with the audit recommendation in paragraph 5.15. She has said that:

- (a) the Department of Health initiated a comprehensive review on the purchasing card programme in early 2012 and anticipates to have a widely implemented programme in the coming months; and
- (b) the Public Health Laboratory Services Branch had in fact taken preparatory actions for the implementation of the purchasing card programme. Between 2005 and late 2007, the Branch had urged the card issuing bank to recruit suitable suppliers for the supply of laboratory items but the results had been unsatisfactory.

## **Coordinating the purchasing card programme**

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5.19 The Director of Electrical and Mechanical Services agrees with the audit recommendation in paragraph 5.15. He has said that:

- (a) noting that there were two cases identified with the purchasing card payment value exceeding \$50,000 each (see para. 5.11(a)), the EMSD has already implemented an enhanced function in its corporate computer system to control any usage of purchasing card exceeding \$50,000 with effect from 5 September 2012. It will also establish a control mechanism in the system in setting the maximum spending limits during the card application process;
- (b) the case identified with no restriction on products (see para. 5.11(b)) is being rectified with the bank. There was no misuse of the purchasing card for purchase of goods/products falling outside the operational needs. The EMSD will also enhance its corporate computer system to restrict products to be purchased during the card application process;
- (c) the case with the cardholder given too high a credit limit (see para. 5.11(c)) is being rectified with the bank. To further enhance its control, the EMSD will establish a control mechanism in its corporate computer system in setting the appropriate credit limits during the card application process;
- (d) the 23 inactive cards identified in 2011-12 (see para. 5.11(d)) are being reviewed for withdrawal. The EMSD will also establish a control mechanism to monitor card usage and identify inactive purchasing cards;
- (e) the EMSD has since 2010 established guidelines in its intranet that related to the purchasing card usage, covering the review of credit limits and the needs for use. Reminder on the subject was issued to staff in March 2012. The EMSD will continue reminding its staff to follow the guidelines on the use of purchasing cards on a regular basis; and
- (f) the identified 19 repeated purchases (see para. 5.11(e)) were made by different users at different times for procuring replacement spare parts for urgent repair in various venues. There is established guideline in the EMSD's Supplies Procedural Manual to regularly review the repeated purchases with an aim at ensuring the present process is discharged at the most efficient and cost-effective way. The EMSD has already taken action in February 2012 according to the guideline to consolidate repeated purchases for estimating future requirements for bulk purchase of the items concerned. It will also develop new function in its corporate computer system to facilitate early identification of such repeated orders for further action.

## **PART 6: MONITORING COMPLIANCE WITH STORES AND PROCUREMENT REGULATIONS**

6.1 This PART examines the following issues relating to the GLD's monitoring of B/Ds' compliance with the SPRs:

- (a) stores verifications (paras. 6.4 to 6.10); and
- (b) system surveys (paras. 6.11 to 6.15).

6.2 According to the SPRs, Controlling Officers are responsible for the general supervision and control of stores and stores accounts and the services procured under their control, ensuring that the activities are conducted within financial limits and are in strict accordance with the SPRs. Any public officer contravening any of the SPRs may be subject to disciplinary proceedings.

6.3 The Director of Government Logistics, as the Head of the Supplies Grades, is responsible for recruiting and posting Supplies Grades staff, and providing them with training so that they can discharge their purchasing and stores management functions effectively and efficiently (Note 24). As at 30 June 2012, there were 1,169 Supplies Grades staff, comprising 185 staff posted within the GLD and 984 staff posted to 57 other B/Ds.

### **Stores verifications**

6.4 In accordance with SPR 1005, the GLD conducts stores verifications of B/Ds at least once every three years to verify stocks of government stores held by them and check whether they comply with the SPRs on the management and procurement of government stores and services. On completion of a stores verification, the GLD will provide the B/D with a report detailing its findings and recommendations. The GLD will examine the B/D's follow-up actions in its next verification of the B/D.

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**Note 24:** *According to SPR 250, purchasing and stores management functions should normally be assigned to Supplies Grades staff. B/Ds should ensure as far as possible that they have sufficient Supplies Grades staff to discharge these functions in an appropriate manner.*

## **Monitoring compliance with Stores and Procurement Regulations**

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6.5 In the 2001 audit, Audit reported that the results of the stores verifications of B/Ds revealed many instances of non-compliance with the SPRs on direct purchases, stores and inventory records, and stock verifications. The then Government Supplies Department agreed to take measures to help staff perform their supplies functions effectively, including:

- (a) expanding its training programme to provide Supplies Grades staff with refresher courses on the SPRs once every two years and to organise special introductory course on the SPRs for non-Supplies Grades staff performing supplies functions;
- (b) issuing circulars and memoranda to announce, explain or clarify any new instructions or arrangements related to supplies activities;
- (c) introducing a help desk service to answer enquiries and provide assistance on supplies matters;
- (d) sending the stores verification reports to Controlling Officers personally;
- (e) through its training sessions, drawing the attention of attendees to the common mistakes in supplies work and ways to prevent their occurrence; and
- (f) rearranging its inspection programme to enable more frequent inspections to be conducted on store units with less than satisfactory past performance.

6.6 However, Audit review of the results of the GLD's stores verifications of 73 B/Ds in the past three years (2009-10 to 2011-12) revealed that:

- (a) many B/Ds still had not strictly complied with the SPRs (see Table 5); and
- (b) 30 (41%) B/Ds had not taken proper follow-up actions on the recommendations in the GLD stores verification reports.

## Monitoring compliance with Stores and Procurement Regulations

**Table 5**

**Non-compliance by bureaux/departments with  
Stores and Procurement Regulations  
(stores verifications completed between 2009-10 and 2011-12)**

Area of non-compliance	Non-compliant B/Ds	
	Number (Note)	Percentage
Stores records		
(a) excessive/dormant stock (e.g. forms, stationery and cleaning supplies)	44	60%
(b) stores records not duly completed (e.g. stores vouchers remained open for a long period and were not duly completed, and cross-references were not made in some stores vouchers/records)	52	71%
Direct purchases of stores and services (e.g. quotation record forms and purchase orders were not duly completed, and control indexes were not maintained on the use of quotation record forms)	52	71%
Inventory records (e.g. inventory items were not checked annually, some inventory items were not included in inventory records and inventory records were not duly completed)	44	60%
Stock verifications (e.g. discrepancies were found in stock verifications, and departmental stocktaking reports and supervisory stock inspection reports were not available for checking)	29	40%

*Source: GLD records*

*Note: Based on the GLD's criteria of selecting non-compliant B/Ds for follow-up stores verifications, only B/Ds with more serious non-compliance were included.*

*Remarks: The GLD's stores verifications covered 73 B/Ds in total.*

## **Monitoring compliance with Stores and Procurement Regulations**

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6.7 The audit findings suggest that the GLD needs to step up its efforts to help B/Ds always comply with the SPRs. In Audit's view, the GLD needs to consult the FSTB and take more stringent measures in collaboration with Controlling Officers.

### **Audit recommendations**

6.8 **Audit has recommended that the Director of Government Logistics should:**

- (a) **in consultation with the Secretary for Financial Services and the Treasury, take more stringent measures in collaboration with Controlling Officers to ensure that B/Ds always comply with the SPRs. Examples of such measures include:**
  - (i) **Controlling Officers regularly reminding all the staff concerned about the B/Ds' commitment to always comply with the SPRs;**
  - (ii) **B/Ds conducting regular self-assessments of their compliance with the SPRs and submitting compliance reports to the GLD;**
  - (iii) **B/Ds taking disciplinary proceedings against staff contravening any of the SPRs in warranted cases as a deterrent; and**
  - (iv) **B/Ds submitting to the GLD progress reports (endorsed by their directorate officers) on the follow-up actions on the recommendations made by the GLD in stores verifications; and**
- (b) **closely monitor B/Ds' compliance with the SPRs to assess the effectiveness of the more stringent measures in (a) above and the need to take further measures.**

### **Response from the Administration**

6.9 The Director of Government Logistics agrees with the audit recommendations. He has said that:

## **Monitoring compliance with Stores and Procurement Regulations**

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- (a) the GLD accords much importance to providing advice to and assisting B/Ds in their discharge of supplies-related responsibilities and has been on the lookout for improvement measures. The GLD's focus is to remind B/Ds to guard against technical breaches and more serious non-compliance;
- (b) the GLD has put in place a number of measures to monitor and facilitate B/Ds' compliance with the SPRs, as follows:
  - (i) the GLD keeps track of B/Ds' replies to its stores verification reports and sends regular reminders to urge B/Ds for prompt follow-up;
  - (ii) in addition to conducting stores verifications of B/Ds at least once every three years, the same team of 18 staff also conducts follow-up surveys on departmental store units with relatively unsatisfactory performance identified during the routine stores verifications to help bring about effective and timely improvement measures;
  - (iii) where common problem areas in procedures for handling procurement and stores matters are identified, the GLD issues or updates circulars and guidance notes for B/Ds' reference. It also maintains a list of common irregularities and frequently asked questions on procurement and stores management in the Government's intranet for reference by B/Ds. The list is reviewed on a regular basis with updates made having regard to the latest findings in the stores verifications;
  - (iv) the GLD provides help desk services for B/Ds on various aspects of procurement and supplies matters; and
  - (v) the GLD arranges SPR refresher courses for Supplies and non-Supplies Grades staff on a regular basis. It also arranges SPR training courses for special target groups from time to time; and
- (c) based on the above efforts, the GLD will, in consultation with the FSTB, consider how best to further assist B/Ds in complying with the SPRs.

## **Monitoring compliance with Stores and Procurement Regulations**

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6.10 The Secretary for Financial Services and the Treasury agrees with the audit recommendations. He has said that:

- (a) the GLD has been implementing a number of measures to help B/Ds better perform their supplies functions; and
- (b) the FSTB will consider, together with the GLD, what more can be done to facilitate B/Ds discharging their stores management functions in full compliance with the SPRs.



## **System surveys**

6.11 Subject to the availability of resources, the GLD may conduct an in-depth system survey for a B/D when:

- (a) the B/D invites it to do so;
- (b) the irregularities found in a stores verification of the B/D justify such a survey; or
- (c) a review conducted by Audit or the Independent Commission Against Corruption has identified issues relating to the B/D's supplies matters.

6.12 During a system survey of a B/D, GLD staff conduct field work to collect information about the B/D's management of the procurement and supplies functions. After completing the field work, GLD staff scrutinise and study the collected information, with a view to identifying areas for improvement. Upon completion of a survey, the GLD issues a report containing its findings and recommendations to the B/D for follow-up actions. Table 6 shows seven GLD system surveys with field work completed during 2009-10 to 2011-12.

## Monitoring compliance with Stores and Procurement Regulations

Table 6

GLD system surveys with field work completed during 2009-10 to 2011-12

Survey	Time of commencing field work (a)	Time of completing field work (b)	Time of issuing report (c)	Interval between completion of field work and issue of report (d) = (c) – (b) (Month)
1	February 2009	April 2009	August 2010	16
2	February 2009	June 2009	August 2010	14
3	December 2010	March 2011	April 2012	13
4	January 2011	April 2011	August 2012	16
5	January 2011	April 2011	September 2012	17
6	December 2011	March 2012	Not yet issued	Over 6 (Note)
7	March 2012	March 2012	Not yet issued	Over 6 (Note)

Source: GLD records

Note: For Surveys 6 and 7, as at 30 September 2012, the GLD had not yet issued its reports, after a lapse of 6 months since completing the field work.

6.13 Table 6 shows that for Surveys 1 to 5, the GLD has taken 13 to 17 months to issue its reports after completing the field work. In Audit's view, issuing reports promptly after completing the field work helps B/Ds take earlier actions to make improvements. The GLD needs to consider setting target completion times for motivating and measuring the performance of GLD staff.

## **Audit recommendations**

6.14 **Audit has recommended that the Director of Government Logistics should consider:**

- (a) **setting targets for the time taken to complete system surveys of B/Ds; and**
- (b) **establishing procedures to monitor the progress of each system survey against the targets.**

## **Response from the Administration**

6.15 The Director of Government Logistics agrees with the audit recommendations. He has said that:

- (a) system surveys are a value-added service provided to B/Ds subject to availability of resources. Currently, the same team of 18 staff responsible for conducting stores verifications of B/Ds is also responsible for conducting system surveys;
- (b) system surveys are highly interactive requiring input from both the GLD and the B/Ds concerned. Due to competing resources, it may take more time to prepare the detailed investigation reports; and
- (c) the GLD has recently set target timelines for completing the system surveys.

## **PART 7: OTHER SERVICES**

7.1 This PART examines issues relating to other services provided by the GLD. The following issues are discussed:

- (a) public auctions for disposal of confiscated/unclaimed goods and surplus stores (paras. 7.2 to 7.5);
- (b) introducing electronic auctions (paras. 7.6 to 7.14);
- (c) providing temporary storage space to B/Ds (paras. 7.15 to 7.18); and
- (d) storing surplus stores and personal effects (paras. 7.19 to 7.22).

### **Public auctions for disposal of confiscated/unclaimed goods and surplus stores**

7.2 The GLD holds public auctions fortnightly to dispose of confiscated/unclaimed goods and surplus stores not required within the Government (Note 25). The auctions are conducted at the GLC by contract auctioneers. For each auction, the GLD groups the goods into auction lots and sets a reserve price for each lot, making reference to the previous auction records and seeking advice from B/Ds requesting the disposal or manufacturers where necessary. During 2009 to 2011, proceeds from public auctions averaged \$28 million each year. According to the GLD, the goods were sold mostly to recycling operators.

7.3 Audit has reviewed the public auctions conducted by the GLD and found room for improvement in the following areas:

- (a) ***Verifying bidders' addresses.*** An individual wishing to participate in auctions is required to produce for registration with the GLD his Hong Kong identity card or passport and documentary proof of

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**Note 25:** *Examples of the goods include air-conditioners, electrical appliances, audio, video and computer equipment, office equipment, furniture, vehicles, vessels and spare parts.*

his residential address in Hong Kong (Note 26). However, Audit has randomly selected 250 of the 4,000 accepted registration forms between 2004 and 2012 (up to May) in GLD files for examination, and found 85 (34%) registered bidders not providing documentary proof of their residential addresses;

- (b) ***Checking with inactive bidders.*** According to the GLD's Auction Manual, after each auction, GLD staff should check with those registered bidders not participating in six consecutive auctions to find out whether they still wish to be registered. However, there is no documentary evidence to indicate that GLD staff have done so; and
- (c) ***Dealing with unsold goods.*** The Auction Manual states that if any lots of goods cannot be sold in an auction, GLD staff should review the strategy and consider other cost-effective disposal options. However, the Manual does not provide further guidance on other disposal options and only gives an example (i.e. mixing unattractive items with popular items to form an attractive lot in a future auction). In practice, GLD staff usually adjust the reserve prices of unsold goods in the next auction without adopting other options.

In Audit's view, the GLD needs to take appropriate measures to address these issues.

## Audit recommendations

7.4 **Audit has recommended that the Director of Government Logistics should:**

- (a) **remind GLD staff to check that individuals applying for registration as bidders in public auctions have submitted documentary proof of their residential addresses before accepting their registration;**
- (b) **remind GLD staff to comply with the Auction Manual requirement on checking with inactive bidders; and**

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**Note 26:** *The GLD will use the information to take follow-up actions (e.g. initiating legal proceedings) if a bidder fails to pay for any auction lot he has bid successfully.*

- (c) **provide GLD staff with more guidance on the disposal options for dealing with goods unsold in an auction.**

## Response from the Administration

7.5 The Director of Government Logistics agrees with the audit recommendations. He has said that:

- (a) since May 2009 bidders have only been allowed to participate in auctions after completing all the registration requirements, including providing the necessary address proof. To rectify those incomplete registrations received prior to May 2009, the GLD has issued written notifications reminding bidders concerned to submit address proof within one month. If no address proof is received after the one-month period, their registrations will be voided. They would need to apply for new registrations if they want to participate in future auctions;
- (b) hitherto the registration details of bidders have been input manually into a computer file which does not facilitate management review. In March 2012, the GLD decided to establish an electronic system on bidder details to provide timely management information and facilitate effective management of the bidder registration system, including identification of inactive potential bidders and weeding inactive entries from the register. The target commissioning date of the new system is December 2012;
- (c) to dispose of confiscated/unclaimed goods and surplus stores, the GLD will map out the appropriate disposal strategy (e.g. by auction or sale by tender). For goods that cannot be sold at one auction, the first recourse is normally to sell them at another auction. For goods carrying high saleable value, the GLD will review the reserve price having regard to the latest market information. Where appropriate, other disposal options would be pursued. For those goods with low residual value and unlikely to attract any bid, B/Ds requesting the disposal will be advised to consider other options (e.g. donation, alternative use and dumping); and
- (d) the GLD has reviewed the Auction Manual to provide more guidelines for its staff on how to deal with goods unsold in an auction.

## Introducing electronic auctions

7.6 In paragraph 2.22, Audit has pointed out that electronic auctions can achieve cost savings and other benefits, and the GLD has the potential to adopt electronic auctions for procurement. As early as 2002, the Efficiency Unit also commissioned a consultancy study on reengineering departmental processes for selling confiscated goods. The consultant recommended introducing electronic auctions via the Internet because the benefits would outweigh the cost of implementation.

7.7 In July 2002, a working group with members from the Efficiency Unit, the Customs and Excise Department and the then Government Supplies Department was set up to assess the business models, user requirements, costs and benefits of electronic auctions.

7.8 In December 2002, the Efficiency Unit issued an interim situation report on implementing electronic auctions for selling confiscated goods, indicating that various overseas governments had adopted electronic auctions for disposing of their confiscated goods or surplus stores (Note 27). It recommended that the project should be taken forward.

7.9 On 21 July 2003, the Customs and Excise Department indicated that it had resource difficulties to take up the project coordinator role. Similarly, on 25 July 2003, the GLD informed the Efficiency Unit that as it had just been established (see Note 7 to para. 1.6) and was consolidating to cope with all the changes, it did not have the resources to act as the project coordinator. Up to 31 July 2012, there had been no further progress in implementing electronic auctions.

7.10 Audit is concerned about the lack of progress in the project of introducing electronic auctions for selling confiscated goods since 2003. As the benefits would outweigh the cost of implementation (see para. 7.6), Audit shares the Efficiency Unit's view that the project should be taken forward.

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**Note 27:** *For example, the General Services Administration of the United States Government launched its own auction site in 2001.*

## **Audit recommendation**

7.11 **Audit has *recommended* that the Director of Government Logistics should, in collaboration with the Head, Efficiency Unit, the Commissioner of Customs and Excise and the Government Chief Information Officer, resume exploring introducing electronic auctions for selling confiscated and other goods without further delays.**

## **Response from the Administration**

7.12 The Director of Government Logistics agrees with the audit recommendation. He has said that the 2002 Efficiency Unit report recommended implementing electronic auctions for selling confiscated goods. According to the GLD's experience, confiscated goods constitute the bulk of high value goods sold at auctions. In deciding on the scope for introducing electronic auctions, consideration will have to be given to the cost vis-à-vis the revenue likely to be generated.

7.13 The Head, Efficiency Unit agrees with the audit recommendation. He has said that the Efficiency Unit is ready to assist, such as by way of providing advice to a project steering committee to be established to take the matter forward.

7.14 The Government Chief Information Officer agrees with and supports the audit recommendation.



## **Providing temporary storage space to bureaux/departments**

7.15 The GLC comprises a 14-storey high block and a three-storey low block (Note 28). At the inception of the GLC in 1996, the GLD stored some 2,000 common-user items in the GLC for B/Ds. After the changes in the Government's stockholding policy (see para. 3.2), the GLD has stored only essential and emergency items. The GLD has used part of the released storage space in the high block for keeping its Printing Division's paper stocks and provided the remaining to some B/Ds as temporary storage space (Note 29).

7.16 The GLD has 13 store rooms in the low block of the GLC for storing dangerous goods (e.g. household bleach and disinfectant fluid). Audit has found that, due to the reduction in the number of items kept, five store rooms (totalling 190 square metres) have been left vacant since 2006. In Audit's view, the GLD needs to put the surplus store rooms into beneficial uses.

## **Audit recommendation**

7.17 **Audit has recommended that the Director of Government Logistics should put the surplus store rooms in the low block of the GLC into beneficial uses (e.g. providing them to other B/Ds as temporary storage space or converting them to other suitable uses).**

## **Response from the Administration**

7.18 The Director of Government Logistics agrees with the audit recommendation. He has said that:

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**Note 28:** *The GLC is a multi-user government building. Besides the GLD, other users include the Customs and Excise Department, the Department of Health and the Inland Revenue Department.*

**Note 29:** *The GLD has planned to resume the space for reprovisioning its Printing Division (presently located in Quarry Bay).*

## Other services

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- (a) prior to 2006, the Hospital Authority was one of the major users of the dangerous goods store rooms in the low block of the GLC. Five of these store rooms have been vacant since 2006 after the Hospital Authority ceased to use the Government's store rooms for their dangerous goods. The GLD has advertised the availability of the vacant storage space but the take-up rate remained low, probably because of the special requirements related to the transportation of dangerous goods; and
- (b) the Government is now actively pursuing the relocation of the Printing Division of the GLD from Quarry Bay to the GLC. It will consider how best to put the store rooms into gainful use in the context of the relocation exercise. In the meantime, the GLD will continue to advertise the availability of the storage space in the dangerous goods store rooms.

## Storing surplus stores and personal effects

7.19 Audit examination of the GLD's provision of space for storing surplus stores and personal effects revealed the following issues:

- (a) as at 30 June 2012, the GLD provided spaces totalling 104 square metres for storing the Shanghai Expo commodities and some surplus stores (i.e. souvenirs for the celebration of the establishment of the Hong Kong Special Administrative Region). The commodities had been stored in the GLC since December 2010 while the surplus stores had been kept for 12 years; and
- (b) according to the Civil Service Regulations and the External Service Regulations, the GLD is responsible for providing space for storing the personal effects of officers required to vacate their government quarters or posted outside Hong Kong. However, GLD records showed that it had previously provided, upon request, space for storing the personal effects of three officers not meeting the criteria specified in the Regulations.

7.20 In Audit's view, the GLD needs to ensure that stores are disposed of expeditiously in accordance with the SPRs if they have become surplus to requirements. The GLD also needs to ensure that only eligible officers are provided with space for storing their personal effects.

## Audit recommendations

7.21 **Audit has *recommended* that the Director of Government Logistics should:**

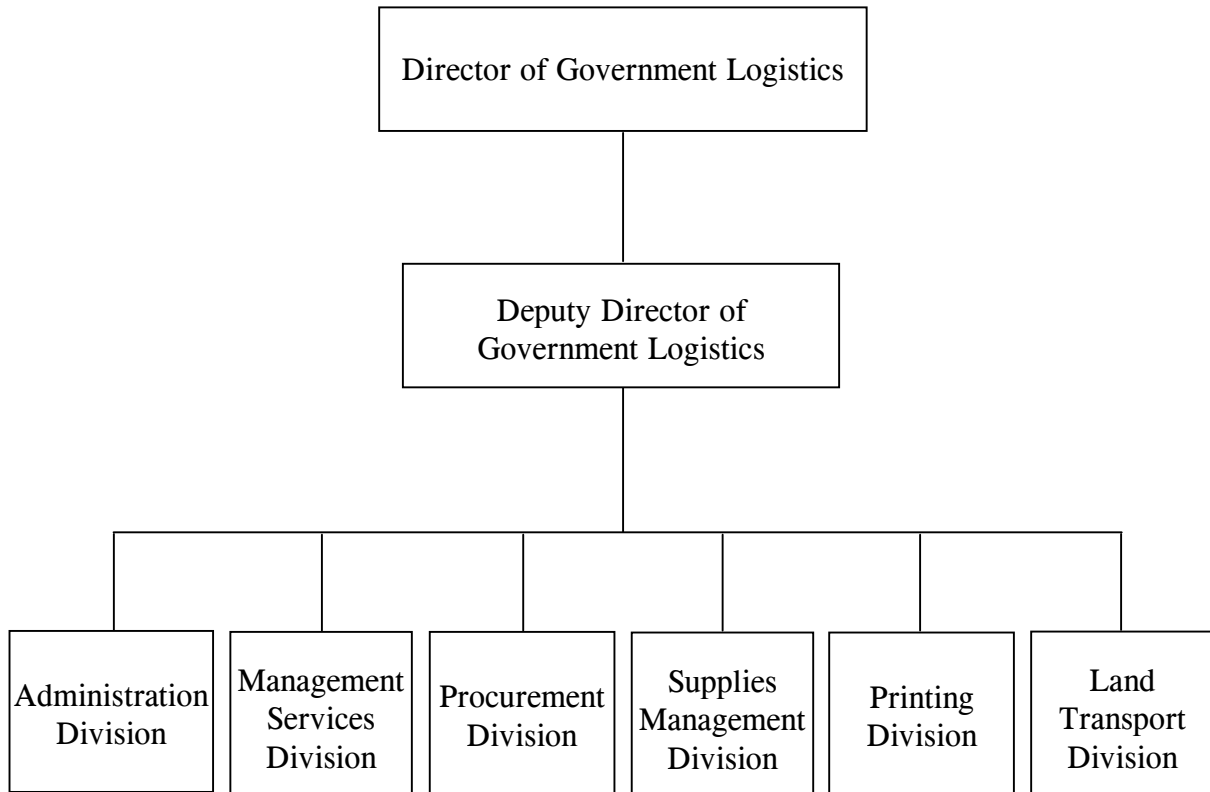
- (a) **for the Shanghai Expo commodities and surplus stores stored in the GLC, request the B/Ds concerned to determine whether they are no longer required and, if so, dispose of them in accordance with the SPRs; and**
- (b) **remind GLD staff to comply strictly with the requirements of the Civil Service Regulations and the External Service Regulations on the provision of space for storing the personal effects of eligible officers.**

## **Response from the Administration**

7.22 The Director of Government Logistics agrees with the audit recommendations. He has said that:

- (a) the Shanghai Expo commodities were disposed of through auction in August 2012. As regards the surplus stores stored in the GLC, the GLD had liaised with the relevant B/D, which subsequently collected them in August 2012; and
- (b) the GLD will continue to remind staff to comply strictly with the requirements of the Civil Service Regulations, the External Service Regulations and relevant policy directives on the provision of space for storing the personal effects of eligible officers.

**Government Logistics Department  
Organisation chart  
(30 June 2012)**



*Source: GLD records*

**Acronyms and abbreviations**

Audit	Audit Commission
B/Ds	Bureaux/departments
EMSD	Electrical and Mechanical Services Department
FSTB	Financial Services and the Treasury Bureau
GLC	Government Logistics Centre
GLD	Government Logistics Department
SPRs	Stores and Procurement Regulations