

SEWAGE SERVICES CHARGING SCHEME

Executive Summary

1. Hong Kong has established an extensive public sewerage system, which covers areas inhabited by 93% of the population. Every day, 2.7 million cubic metres (m³) of sewage produced from residential, commercial and industrial premises is disposed of through the public sewerage system. Under the policy directives of the Environment Bureau, the Drainage Services Department (DSD) is responsible for managing the public sewerage system for the collection, treatment and disposal of sewage.

2. In April 1995, the Sewage Services Charging Scheme (SSCS) was introduced, under which a water consumer whose premises are connected to a public sewer needs to pay a sewage charge (SC), and a trade effluent surcharge (TES) if he operates one of the 27 designated trades. The Sewage Services Branch (SS Branch) of the DSD is responsible for administrating the SSCS. Furthermore, the Water Supplies Department (WSD) collects SC and TES on behalf of the DSD, which are included in water bills issued to water consumers. As of 31 March 2013, there were 2.79 million water accounts, of which 2.61 million were SC accounts (of which 22,000 were also TES accounts) and 180,000 were non-SC accounts. In 2012-13, the DSD collected \$776 million of SC and \$207 million of TES. In 2011-12, the Sewage Services Operating Accounts prepared by the DSD recorded an operating deficit of \$536 million. The Audit Commission (Audit) has recently conducted a review of the SSCS with a view to identifying areas for improvement.

Recovery of sewage services operating costs

3. In launching the SSCS in April 1995, the SC rate was set at \$1.2 per m³ of water supplied, and the TES rates were set ranging from \$0.11 to \$5.98 per m³ of water supplied, depending on the average sewage pollution strength of individual TES trades. In May 2007, the Legislative Council (LegCo) approved increases in the SC rate by 9.3% per annum from April 2008 to April 2017 (the ten-year SC-rate increment scheme). Furthermore, the TES rates for individual trades were revised in August 2008 and August 2009. On the expenditure side, the DSD has projected

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that the operating costs and operating deficits would increase in the coming years because of the completion and launch of additional sewage treatment facilities, to be offset somewhat by increased operational efficiency and certain cost savings (paras. 2.5 to 2.10).

4. *Target cost recovery rates not achieved.* In May 2008, the Chief Executive-in-Council endorsed that: (a) the projected operating cost recovery rate for SC would be around 70% after implementing the ten-year SC-rate increment scheme by 2017-18; and (b) the Government aimed to achieve a 100% cost recovery rate for TES by 2009-10. However, Audit notes that the DSD's SC cost recovery rate of 57% in 2011-12 is projected to improve to 60% in 2017-18, which will fall short of the Government's target of 70%, and the TES cost recovery rate of 95% in 2011-12 is projected to deteriorate to 62% in 2017-18, which will also fall short of the Government's target of 100% (paras. 2.12 and 2.14).

Collection of sewage charges

5. *Omissions and long time taken in levying SC on premises.* SC is chargeable on all water accounts except those of premises located in unsewered areas or developments. For the purpose of levying SC, all water accounts are classified as either SC chargeable or non-SC chargeable. Upon receipt of an application for a change of the account holder of an existing non-SC account, the DSD will check related information in the WSD's Customer Care and Billing System (CCBS) to determine whether the non-SC status of the account address has been changed. The DSD will conduct investigations and take necessary SC recovery action if the address falls within the sewerred areas (paras. 3.3, 3.7 and 3.8).

6. Audit examination revealed two cases where the DSD had taken a long time before identifying the omissions in levying SC on premises which had been connected to public sewers. In one case, the SS Branch had not promptly updated the sewer connection information of 18 households in Estate A because they had different address formats. In another case, since noting a potential SC-omission case in Estate B in March 2011, the SS Branch had taken more than two years to identify 215 SC-omission cases in the Estate. This had resulted in a loss of Government revenue (para. 3.9).

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7. ***Inadequate checking of SC-omission cases.*** In 2012-13, of the 8,944 new non-SC accounts, 1,868 (21%) accounts were suspected SC-omission cases. However, Audit noted that, up to July 2013, of the 1,868 suspected SC-omission cases, the SS Branch had only selected and completed investigation of 55 cases (3%). Of these 55 cases, 40 (73%) were found to be SC chargeable. After conducting investigations of non-SC accounts in the nearby areas of the 40 cases, the DSD found additional 377 non-SC accounts which were SC chargeable. The DSD needs to task the SS Branch to carry out a one-off exercise to examine the SC status of all the non-SC accounts (paras. 3.10 to 3.12).

Collection of trade effluent surcharges

8. In applying for a new non-domestic water account, an applicant is required to choose 1 of 102 business classifications that corresponds most precisely to the account category at the service address, and fill in the business classification and its code in the application form. Of the 102 business classifications, 30 are chargeable to TES. Based on the classifications indicated by the applicants, TES is levied on pertinent water accounts through the CCBS (para. 4.2).

9. ***Misclassifications leading to omissions in levying TES.*** The DSD is aware of the fact that some TES traders have not properly filled in their business classifications when applying for water accounts, resulting in their accounts being incorrectly treated as non-TES accounts. With a view to identifying these TES-omission cases, the DSD has since May 2005 requested the Food and Environmental Hygiene Department (FEHD) to periodically provide it with information of the newly licensed food premises for it to review and ascertain whether TES has been levied on the water accounts of pertinent premises. Furthermore, the DSD has since 2001-02 requested the WSD to provide it with information of non-TES trade accounts with high water consumption to determine whether they are chargeable to TES (paras. 4.4, 4.6 and 4.10).

10. ***Self-classification mechanism not effective.*** In the three years from 2010-11 to 2012-13, the DSD had taken action to verify 3,155 non-TES accounts of newly licensed food premises. The results revealed that 72% of these accounts were in fact TES chargeable, and the DSD took action to recover TES of \$10.5 million from the pertinent traders. A high percentage of TES-omission cases may be the result of (a) TES traders' lack of knowledge of the TES requirements; and

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(b) the lack of deterrence on TES traders who knowingly provide incorrect information on their business classifications because there is no related penalty clause provided in the Sewage Services Ordinance. In view of the high percentage of TES-omission cases, the DSD needs to, in collaboration with the WSD, remind TES traders of the need to provide correct business-classification information. Amendments to the Sewage Services Ordinance may also be required to provide the appropriate penalty clauses (paras. 4.8, 4.9, 4.15 and 4.16).

11. ***Insufficient guidance on classifying TES-related businesses.*** The DSD mainly relies on the business-classification information provided by TES traders to levy TES on the pertinent water accounts. However, Audit notes that the WSD has not clearly stated in the water-account application form that the business classification information will be used for determining whether a trader will be charged TES. Furthermore, the 30 TES-related business classifications are not explicitly made known in the application form. In the circumstance, a TES trader may find more than one business classification that matches his business and may select a non-TES-related classification in the application form, resulting in an omission in levying TES (para. 4.17).

12. ***DSD's examination not covering food premises licensed before 2005.*** Based on the FEHD's records, as of June 2013, there were 7,692 licensed food premises which had been in operation before May 2005. However, most of these 7,692 food premises have not been examined by the DSD regarding the correctness of their business classifications for TES purposes. Audit examination of 70 such food premises revealed that 9 (13%) premises originally registered with non-TES trade accounts were in fact chargeable to TES (paras. 4.19 and 4.20).

13. ***TES not levied on some unlicensed food premises.*** In the three years from 2010 to 2012, there were 7,961 convicted cases of premises operating as unlicensed restaurants or food factories. However, the DSD had not requested the FEHD to provide it with the pertinent information for checking and identifying any TES-omission cases (paras. 4.22 and 4.23).

14. ***TES not levied on catering services operated by some private clubs.*** As of June 2013, there were 672 private clubs licensed by the Home Affairs Department. These clubs serving food to their members and guests are exempt from the requirement of obtaining a restaurant licence from the FEHD. However,

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the DSD had not conducted investigations of private clubs having non-TES accounts with a view to identifying any TES-omission cases. Audit examination of 50 licensed private clubs revealed that 17 clubs had not been levied TES, and 11 (65%) of these 17 clubs were providing catering services and should be chargeable to TES (paras. 4.24 and 4.26).

Audit recommendations

15. **Audit recommendations are provided in the respective sections of this Audit Report. This Executive Summary only highlights the key recommendations. Audit has *recommended* that the Director of Drainage Services should:**

Recovery of sewage services operating costs

- (a) **conduct a review to ascertain the reasons for not achieving the Government's cost recovery targets on SC and TES, and devise strategies and action plans to address the issue (para. 2.16);**

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- (b) **take necessary measures with a view to preventing recurrence of SC omissions and any delay in taking SC recovery actions (para. 3.18(b) and (c));**
- (c) **take necessary measures with a view to preventing recurrence of cases of loss of Government revenue owing to any delay in taking SC recovery action, with due regard to the six-year debt-recovery limitation period (para. 3.18(d));**
- (d) **task the SS Branch to carry out a one-off exercise to examine the SC status of all non-SC accounts (para. 3.18(f));**

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- (e) **enhance publicity efforts on TES traders to remind them of the need to provide correct business-classification information to the DSD and the WSD (para. 4.41(a));**
- (f) **consider seeking legislative support to make amendments to the Sewage Services Ordinance for providing appropriate penalty clauses to deter TES traders from intentionally providing false business-classification information to the WSD and the DSD for the purpose of evading TES (para. 4.41(c));**
- (g) **make amendments to the water-account application form to the effect that applicants are required to declare in the form as to whether or not their businesses are chargeable to TES (para. 4.41(d)); and**
- (h) **with a view to identifying TES-omission cases for taking recovery actions:**
 - (i) **conduct examinations of 7,692 licensed food premises which had been in operation before May 2005 (para. 4.41(e)(i));**
 - (ii) **request the FEHD to provide the DSD with information of convicted cases of unlicensed restaurants or food factories for examination (para. 4.41(e)(ii)); and**
 - (iii) **conduct examinations of all licensed private clubs having non-TES accounts (para. 4.41(e)(iii)).**

Response from the Administration

16. The Administration agrees with the audit recommendations.