

PROCUREMENT OF GOODS AND SERVICES BY THE IMMIGRATION DEPARTMENT

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1. The Immigration Department (ImmD) is responsible for two main areas of work, namely control of people moving into and out of Hong Kong by land, sea and air; and documentation of local residents (including the processing of applications relating to the Nationality Law of the People's Republic of China and claims to right of abode under the Basic Law, the issue of travel documents and identity cards, and the registration of births, deaths and marriages). For day-to-day immigration control operations, staff of ImmD administer 16 control points covering air, land and sea travel. As at 30 June 2019, ImmD had an establishment of 8,907 posts (comprising 7,233 (81%) service grade posts and 1,674 (19%) civilian grade posts).

2. ImmD's operation involves the procurement of information and communications technology (ICT) systems, vehicles, vessels, and other goods (such as uniform and accoutrement) and services (such as transport and security services). In 2018-19, ImmD incurred \$874 million under the General Revenue Account and \$340 million under the Capital Works Reserve Fund (CWRP) on the procurement of various goods and services. Similar to other government departments, ImmD's procurement of goods and services is governed by the Stores and Procurement Regulations (SPRs), relevant Financial Circulars, and Government Logistics Department (GLD) guidelines. The Audit Commission (Audit) has recently conducted a review to examine ImmD's work on the procurement of goods and services with a view to identifying areas for improvement.

Procurement of information and communications technology systems

Financial and administrative control of ICT projects

3. ImmD's ICT systems are instrumental to its vital operation for delivering services to the public. For each major ICT project, normally a project organisation

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with three-tier project governance structure, which includes a Project Steering Committee, a Project Working Group and a Project Team, is adopted. ICT projects funded under CWRP often involve substantial public money. Requirements on expenditure control are set out in the Financial and Accounting Regulations (F&ARs) and relevant Financial Circulars issued by the Financial Services and the Treasury Bureau (FSTB) (paras. 2.2, 2.5 and 2.6).

4. ***Project subheads not closed after project completion.*** As shown in the CWRP project expenditure report of the Government Financial Management Information System of June 2019, ImmD had a total of 14 ICT projects with unspent balance amounting to \$3,500.8 million. According to the annual reports on implementation of major ICT projects of May and December 2010, March 2016 and October 2018 (showing the positions as of March 2009, 2010, 2015 and 2018 respectively) submitted to the Finance Committee (FC) of the Legislative Council by the Office of the Government Chief Information Officer (OGCIO), 13 of the 14 projects were included in the annual reports, with eight reported as having been completed and five ongoing (para. 2.8). Audit examination has revealed the following areas for improvement:

- (a) ***Need to continue reporting project activities to OGCIO and FC until closure of project subheads.*** For the eight completed ICT projects included in the annual reports on ICT projects, they were reported as having been completed from March 2009 to March 2018 (i.e. for about 1 to 10 years, averaging 7.8 years). However, project expenditure totalling \$209.1 million relating to additional work was charged to seven completed projects (ranging from \$1.8 million to \$69.9 million) after reporting of project completion to OGCIO and FC. In Audit's view, while project activities are on-going, ImmD should continue to report such project activities to OGCIO for its preparation and submission of the annual reports to FC until the closure of the project subheads (paras. 2.9 to 2.11);
- (b) ***Need to timely close project subheads after settlement of project expenditures.*** Audit noted that up to June 2019, the subheads of the eight completed projects had not been closed, of which five had not incurred any expenditures for four to nine years. For good financial control of ICT projects in future, ImmD needs to initiate actions to close the subheads when all the project expenditures are settled after completion of the projects (paras. 2.12 and 2.13); and

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- (c) ***Need to inform FSTB to reserve surplus funds.*** According to F&AR 320, where Controlling Officers have reason to believe that funds surplus to requirements exist under a subhead, they shall immediately inform the Secretary for Financial Services and the Treasury so that the surplus may be reserved. Up to June 2019, no expenditure had been incurred for seven projects for one to nine years and the total unspent balance of the project subheads amounted to \$581.7 million. In future, for projects approved in October 2019 and thereafter, ImmD needs to comply with the requirement to inform FSTB of the excess funds in the project subheads (para. 2.14).
5. ***Financial control over the use of surplus project funds.*** Audit examination of 30 payment records of the eight completed projects revealed that five payments of \$2.3 million had been made in June to September 2013 relating to capital expenditures incurred in providing computer systems in a new control point at Kai Tak Cruise Terminal. They had been charged to project votes of Phases I and II of the updated Information Systems Strategy (ISS-2) after project closures as reported by ImmD to OGCIO in March 2010. In this connection, Audit noted that ImmD withdrew a new funding bid of \$68.58 million in September 2010 and decided to make use of the existing project votes under ISS-2 to fund the one-off cost of the computer equipment items. While the original scope of these projects had not covered the computer systems of the new control point at Kai Tak Cruise Terminal, the charging of expenditures on extension work (i.e. computer systems in the control point at Kai Tak Cruise Terminal) was within the wide ambit of the pertinent project votes (i.e. Phases I and II of ISS-2). In order to tighten the financial control on the use of surplus project funds, Audit considers that ImmD needs to clearly define the scope of ICT projects (e.g. including the number and location of control points to be covered) in the funding applications and state clearly in the funding papers if any surplus funds would be used for implementing new ICT systems of new control points in future (paras. 2.15 and 2.16).
6. ***Tenders with significant variances between pre-tender estimates (PTEs) and contract prices.*** Audit scrutinised ImmD's tender list from 2014-15 to 2018-19 and found that, in 14 of 16 contracts awarded, the contract prices were lower than the corresponding PTEs. In particular, five tenders recorded significant variances between PTEs (comprising mainly a one-off capital cost and/or maintenance cost) and the contract prices, ranging from 31% to 60%. The unrealistic PTEs could not form a good reference for considering whether the tender sums were fair and reasonable. Audit examination of two tender exercises in 2017 revealed that in working out PTE,

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for the tender of the Next Generation Smart Identity Card System, ImmD had only made reference to a market research in October 2014 and latest prices of major system components provided by certain vendors (not including the existing contractor which was a major vendor in the industry) in August 2016. For the tender of the Next Generation Electronic Passport System, ImmD had not followed up with the vendors to obtain the required price information on recurrent maintenance price in the 2017 market research exercise. In Audit's view, to work out realistic PTEs in future tender exercises, ImmD should take into account relevant factors including the market condition and economy of scale, and make efforts to follow up with vendors to obtain the required information as far as practicable (paras. 2.17 to 2.21).

Procurement issues identified in three ICT projects

7. Of the eight completed ICT projects from March 2009 to March 2018, Audit selected three projects with delays and/or significant unspent balance as compared with the approved project estimate for examination and noted areas for improvement as elaborated in paragraphs 8 and 9.

8. ***Phase III of ISS-2: Application and Investigation Easy System (APPLIES) and Electronic Records Programme.*** In May 2004, ImmD obtained funding approval of \$336.8 million for implementing Phase III of ISS-2 which would cover APPLIES to support processing of applications for visas, permits, and travel passes, and registration matters relating to births, deaths, and marriage as well as the Electronic Records Programme to enable transactions in ImmD to be conducted digitally. A tender was issued by GLD on behalf of ImmD in October 2004 for the project. In July 2005, the contract was awarded to a contractor at a total cost of \$308.5 million (paras. 2.24 and 2.25). Audit examination has revealed the following areas for improvement:

- (a) ***Delay in rolling-out the system and programme.*** The actual roll-out date of APPLIES and Electronic Records Programme was December 2008, a two-year delay as compared to the target roll-out date of December 2006. According to ImmD, the delay was caused by: (i) long tendering process and contract negotiation process; (ii) extension of system design and development stage to cope with changes in immigration policy; (iii) project complexity in the implementation process; and (iv) contractor's substandard performance. The two-year delay not only led to the slippage of two years in achieving the intended benefits of savings in staff costs, but

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also resulted in incurring additional expenditures to clear the backlog of file conversion (paras. 2.26, 2.29 and 2.30); and

- (b) ***Savings in staff costs not fully realised.*** According to the funding paper submitted to FC in May 2004, the implementation of APPLIES and Electronic Records Programme would bring about a saving of 159 posts (with annual recurrent savings in staff cost of \$49.8 million). In the Post Implementation Departmental Return submitted to OGCIO, ImmD reported that a saving of 33 posts (with an annual staff cost of \$9.6 million (19%)) could not be realised because of operational and technological constraints (para. 2.31).

Audit considers that in developing similar systems in future, ImmD needs to improve its market research to ascertain the latest developments in operational requirements and information technologies. ImmD also needs to be vigilant in estimating realisable savings to ensure that such savings quantified in FC papers are achievable (para. 2.32).

9. ***Computer systems at Shenzhen Bay Control Point and at Lok Ma Chau (LMC) Spur Line Control Point.*** ImmD obtained funding approval of \$176.6 million in April 2004 to install computer systems (including the Automated Passenger Clearance System (APCS) and Automated Vehicle Clearance System (AVCS)) at Shenzhen Bay Control Point. In May 2005, ImmD also obtained funding approval of \$93.3 million for installing computer systems at LMC Spur Line Control Point. A tender for the supply and installation of APCS and AVCS at the two control points was prepared and issued in November 2005. When the tender closed in January 2006, four offers from four tenderers were received (paras. 2.33 and 2.35). Audit examination has revealed the following areas for improvement:

- (a) ***Need to consider setting a price ceiling as a reserve price.*** For APCS, of the three offers received, two offers submitted by Tenderer D and Tenderer E were conforming. Although Tenderer D obtained a higher combined score than Tenderer E, its tender price was higher than PTE. After obtaining a reference price (which was lower than PTE) of supplying the service from an existing contractor (i.e. Contractor C) under existing contract terms, ImmD conducted tender negotiations with Tenderer D but the reduced tender price offered by Tenderer D was still higher than PTE. In view of the tight time frame to commission the LMC Spur Line Control Point, ImmD sought the approval of the Central Tender Board (CTB) in

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July 2006 to cancel the tender on the grounds of public interest. After obtaining the Board's approval on cancelling the tender, ImmD requested Contractor C to supply the required APCS under the existing Contract C. Given the financial and time constraints and the availability of an alternative to supply the service under Contract C, Audit considers that a better option could be setting a price ceiling equal to Contractor C's reference price as a reserve price for internal reference at the outset (i.e. the tender exercise would be cancelled if the price of the most advantageous tender was higher than the reserve price) (paras. 2.35 to 2.38, 2.40 and 2.41); and

- (b) *Need to critically review the need for including stringent tender requirements as mandatory requirements.* For AVCS, as only one offer was received in the tender exercise and it was non-conforming, the tender exercise had to be cancelled. In this connection, in August 2006, before issuing the new tender, GLD requested ImmD to review the tender requirements with a view to drawing up the revised requirements with pragmatic terms. In response, ImmD re-classified some mandatory tender requirements (which had not been implemented in the then existing control points) to optional tender requirements with a view to attracting more bidders. In the second tender exercise of September 2006, three offers were received and they were all conforming offers. According to SPR 109(c), over-specification and over-prescription in product requirements or mode of service delivery should be avoided. In future tender exercises, ImmD needs to include only essential requirements and avoid imposing stringent requirements in the tender documents which may deter suppliers to submit their bids (paras. 2.39, 2.42 and 2.43).

Procurement of other goods and services

10. *Procurement by tender.* From 2014-15 to 2018-19, ImmD conducted 58 service tenders with a total contract value of \$689.2 million. Audit examined two service contracts in relation to the provision of transport and catering services for the Castle Peak Bay Immigration Centre (CIC), and found the following areas for improvement in the tendering process (paras. 3.2 and 3.3):

- (a) *Provision of transport services to CIC.* In August 2017, a transport service contract mainly for escorting detainees outside CIC for different purposes was awarded to the lower conforming bidder at an estimated total amount of \$2.79 million for a period of 36 months commencing from

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September 2017. In approving the award of the contract, the Departmental Tender Committee noted that there was a significant over-estimation of PTE. It commented that the mark up of PTE by 15% per year with an additional 7.5% for contingency was not well justified. The Committee also suggested that apart from wage, other relevant factors (such as the recent market trend, the demand and supply of the transport services, the oil prices and the projected inflation rate) should also be taken into account as appropriate. Audit considers that ImmD needs to take measures to improve the accuracy of PTE (paras. 3.4, 3.5 and 3.9); and

- (b) ***Provision of catering services at CIC.*** In March 2019, a contract was awarded to the lowest conforming offer from Contractor F at an estimated contract price of \$43.1 million for the provision of catering services to detainees at CIC for 36 months (from 15 April 2019 to 14 April 2022). In approving the award of the contract to Contractor F, CTB commented that ImmD had substantially increased the value of contract for counting tenderer's experience in providing catering services with a contract period of not less than 12 months, from \$1.43 million in the previous tender exercise to \$10 million in the current exercise. Such a high threshold of annual contract value for the subject contract was over-stringent and uncommon in other government tenders involving catering services. CTB commented that ImmD would need to remove the experience essential requirements for future tender exercises in line with the new pro-innovation government procurement policy to be effective from 1 April 2019 (paras. 3.16 and 3.17(a)).

11. ***Procurement guidelines.*** ImmD has issued and updated departmental circulars to promulgate procedures for procurement (para. 3.25). Audit examination has revealed the following areas for improvement:

- (a) ***Need to consider including requirements of conducting a market research in departmental guidelines.*** One of the reasons for over-estimation of PTE was inadequate market research. Audit examination of 33 tender exercises found that ImmD had not approached potential tenderers for conducting market research work in 26 (79%) tender exercises. In this connection, Audit noted that according to SPR 350(e) and Financial Circular No. 2/2019, departments are encouraged to reach out to the market and conduct a market research to better understand the goods or services likely to be available in the market, technological trends, number of potential

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bidders, etc. To meet this requirement, ImmD needs to consider including the requirements of conducting a market research (where appropriate) in its guidelines with a view to improving the procurement process in future (para. 3.25(a)); and

- (b) ***Need to incorporate new requirements in procurement guidelines.*** In March 2019, FSTB issued Financial Circular No. 2/2019 to promulgate details of the new pro-innovation government procurement policy, revisions to SPRs and measures to facilitate the participation of market players in government procurement. In this connection, many new measures are related to procurement by tender, e.g. more extensive use of marking schemes and the concept of value for money in procurement. ImmD needs to incorporate the new requirements and formulate the relevant guidelines in its departmental circulars (para. 3.25(c)).

12. ***Procurement by quotation.*** There were 1,046 purchases of goods and services involving quotation exercises from 2016-17 to 2018-19 with values exceeding \$50,000 each and the total contract value involved was \$410.8 million (para. 3.29). Audit selected 200 purchases for examination and found the following areas for improvement:

- (a) ***Need to enhance competition in procurement by quotation.*** In 77 (38.5%) purchases, although bid invitations had been sent to 5 to 36 suppliers, only one bid was received. In 45 (22.5%) purchases, only two bids were received. In view of the limited competition in 61% (38.5% + 22.5%) of the 200 quotation exercises, ImmD needs to explore measures to enhance competition (paras. 3.29 and 3.30); and
- (b) ***Need to consolidate procurement requirements to achieve better economy of scale.*** According to SPR 205 requirements, Controlling Officers should consolidate requirements of stores and services of similar nature as far as possible to achieve better economy of scale. Audit examination found that seven items were purchased by quotation (3 quotation exercises for each item, totalling 21 quotation exercises) and the cumulative contract value for each item exceeded \$1.43 million within 24 months. Besides, 12 items were purchased by quotation (2 to 5 quotation exercises for each item, totalling 36 quotation exercises) within a short period. Audit considers that the requirements for the same or similar items could be bundled together to

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achieve better economy of scale and to save procurement efforts (para. 3.31).

Audit recommendations

13. **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 Immigration should:**

- (a) **after completion of main contracts of an ICT project, continue to report project activities to OGCIO until closure of the project subhead (para. 2.44(a));**
- (b) **initiate actions to close an ICT project subhead when all the project expenditures are settled after project completion and inform FSTB of funds surplus to requirements under an ICT project subhead (para. 2.44(b) and (c));**
- (c) **clearly define the scope of an ICT project in the funding application and state clearly in the funding paper if any surplus funds would be used for implementing new ICT systems at new control points in future (para. 2.44(e));**
- (d) **in future tender exercises of ICT projects:**
 - (i) **take into account relevant factors including market condition and economy of scale and follow up with major vendors to obtain the required information in determining PTEs (para. 2.44(f)(i) and (ii));**
 - (ii) **where there are financial and time constraints in project implementation and there is an alternative of requiring a contractor to provide the ICT systems under an existing contract, consider setting a price ceiling equal to the contractor's reference price as a reserve price for internal reference (para. 2.44(f)(iii)); and**

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- (iii) include only essential requirements in the tender documents and avoid imposing stringent requirements which may deter suppliers to submit their bids (para. 2.44(f)(iv));**

- (e) in developing ICT systems in future, improve market research to ascertain the latest developments in operational requirements and information technologies, and be vigilant in estimating realisable savings (para. 2.44(h) and (i));**

- (f) in future tender exercises, take into account CTB's comments on the removal of essential requirements on experience (para. 3.26(a)(iii));**

- (g) review and update ImmD's procurement guidelines where appropriate, including incorporating into the guidelines the new requirements on the new pro-innovation government procurement policy as laid down in Financial Circular No. 2/2019 (para. 3.26(c)); and**

- (h) explore measures to enhance competition in the procurement of goods and services by quotation and remind procuring staff to comply with SPR 205 requirements of consolidating requirements of stores and services of similar nature as far as possible to achieve better economy of scale (para. 3.33(a) and (c)).**

Response from the Government

14. The Government generally agrees with the audit recommendations.