

CHAPTER 6

Trade and Industry Department

Trade support and facilitation

**Audit Commission
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TRADE SUPPORT AND FACILITATION

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PART 1: INTRODUCTION

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

Background

1.2 One of the programmes of the **Trade and Industry Department (TID)** is trade support and facilitation. The aim of the programme is mainly to optimise the benefits to Hong Kong flowing from international and bilateral trade agreements and to fulfil Hong Kong's obligations under such agreements by providing licensing and certification services.

Licensing service

1.3 According to the TID, Hong Kong is a free port which thrives on free trade and does not normally maintain barriers on importation or exportation of goods. Import and export licensing controls are only imposed when there is a genuine need to fulfil obligations undertaken by Hong Kong to its trading partners, or to meet public health, safety or internal security needs. Under the Import and Export Ordinance (Cap. 60) and the Reserved Commodities Ordinance (Cap. 296) and their subsidiary legislations, imports and exports of certain goods such as textiles and clothing (hereinafter collectively referred to as textiles) are subject to licensing controls by the TID.

Certification service

1.4 The TID also administers a certification system to establish the origin of the goods which Hong Kong exports for meeting the requirements of the importing authorities. Goods are accepted to be of Hong Kong origin if they are natural products of Hong Kong or they have undergone in Hong Kong a manufacturing process which has changed permanently and substantially the shape, nature, form or utility of the materials used in the manufacture. A Certificate of Origin is issued to facilitate customs clearance in the importing ends and to satisfy the requirements of overseas importers. The issue of Certificates of Origin is governed by the Export (Certificates of Origin) Regulations (Cap. 60H) of the Import and Export Ordinance and the Protection of Non-Government Certificates of Origin Ordinance (Cap. 324). Depending on the types of certificates, manufacturers should first be registered with the TID as registered factories before they are eligible to apply for the certificates.

1.5 For 2011-12, the estimated expenditure and revenue for the trade support and facilitation programme are \$115.4 million and \$21.7 million respectively. Various divisions of the TID are responsible for the implementation of the programme (see Appendix A). The **Commerce and Economic Development Bureau (CEDB)** is the policy bureau of the TID.

Audit review

1.6 The Audit Commission (Audit) has recently conducted a review of the TID's trade support and facilitation programme. The audit has focused on the following areas:

- (a) provision of licensing service (PART 2);
- (b) manifest checking (PART 3);
- (c) provision of certification service (PART 4);
- (d) review of fees and charges (PART 5); and
- (e) performance management (PART 6).

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

Acknowledgement

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

PART 2: PROVISION OF LICENSING SERVICE

2.1 This PART examines issues relating to the TID's provision of licensing service.

Licensing control for import and export of textiles

2.2 Textiles licence is the most common type of licences issued by the TID under its trade support and facilitation programme. The TID's Textiles Licensing Branch, headed by a Principal Trade Officer, is responsible for the provision of licensing service for import and export of textiles. As at 31 December 2011, the Branch had 44 staff, comprising 1 Principal Trade Officer, 2 Trade Officers, 3 Assistant Trade Officers, 33 clerical staff and 5 non-civil service contract staff. In 2010-11, the Branch issued 16,500 and 11,900 consignment-specific import and export licences respectively, and 502,000 and 2,476,000 comprehensive import and export licences respectively (Note 1). Traders registered under the Textiles Trader Registration Scheme (Note 2) may lodge import and export notifications, instead of applying for licences. As at 31 March 2011, there were 15,900 registered traders. In 2010-11, registered traders lodged 1,335,000 import notifications and 1,350,000 export notifications.

Licensing control before 2005

2.3 Before 1 January 2005, Hong Kong's export of textiles to Canada, the European Union and the United States was subject to quotas. To control the quotas, the TID implemented a textiles control system to license the import and export of textiles.

Note 1: *Comprehensive licences covered the issue of multiple licences for multiple shipments to/from markets other than "sensitive markets" (shipments involving "sensitive markets" refer to exports to the United States as well as imports from and exports to the Mainland). After the partial liberalisation of the textiles control system in May 2011 (see paras. 2.6 and 2.7), comprehensive licences were no longer used.*

Note 2: *The Textiles Trader Registration Scheme has been in operation since July 1993. Under the Scheme, instead of applying for licences for their textiles imports and exports, registered traders may submit to the TID self-completed notifications to cover their imports and exports.*

Licensing control since 2005

2.4 In accordance with the World Trade Organisation (WTO) Agreement on Textiles and Clothing, all quotas on textiles were eliminated globally by 1 January 2005. However, under its Accession Protocol (Note 3) to the WTO, the Mainland continues to be subject to two special time-limited provisions. Under them, a WTO member may impose special textiles and product-specific safeguard measures up to December 2008 and December 2013 respectively, if it is determined that increased imports of textiles have caused or threatened market disruption to the WTO member's domestic industry.

2.5 According to the Administration (the CEDB and the TID), because of the geographical proximity and close economic integration between Hong Kong and the Mainland, there might be temptation for traders to circumvent safeguard measures on Mainland textiles by illegally exporting textiles manufactured in the Mainland through Hong Kong as Hong Kong-made products. To demonstrate to trading partners that Hong Kong has a well-established system which can effectively guard against the circumvention and to protect the legitimate interests of Hong Kong's textiles trade, the Administration has since January 2005 maintained a streamlined textiles control system.

Partial liberalisation of textiles licensing control

2.6 In July 2009, the Administration considered the option of dispensing with the textiles control system in view of the global elimination of textiles quotas since January 2005 and the expiry of special textiles safeguard measures on Mainland textiles in December 2008. However, in September 2009, the Government of the United States decided to impose precedent-setting product-specific safeguard measures, in the form of duty, on imports of certain passenger vehicle and light truck tires from the Mainland. The Administration considered that this might encourage other similar petitions from the textiles sector leading to instigation of such safeguard measures against Mainland textiles. Taking into account this factor as well as the concerns expressed by the local textiles trade over the United States' safeguard measures and the trade's request for maintaining the textiles control system, the Administration proposed to partially liberalise the textiles licensing control, whereby textiles trade involving "sensitive markets" (i.e. exports to the United States as well as imports from and exports to the Mainland) would still be subject to licensing control, while textiles trade involving all other markets and textiles trans-shipments would no longer be subject to licensing control.

Note 3: *The Accession Protocol for each new member of the WTO contains the terms it has negotiated to become a member, which have been accepted by all other members. The Protocol includes annexes for the commitments made by the new member for trade in goods and in services.*

Developments in 2011

2.7 In March 2011, the CEDB tabled in the Legislative Council the proposed legislative amendments to the Import and Export (General) Regulations (Cap. 60A) to effect the partial liberalisation mentioned in paragraph 2.6. In May 2011, the new textiles licensing control arrangements came into operation. In July 2011, the TID informed the CEDB that it would conduct a review in late 2011 on the way forward of the textiles control system.

Audit observations and recommendations

2.8 In December 2011, the TID started the review on the way forward of the textiles control system with a view to completing it within 2012. Given that the threat of product-specific safeguard measures on Mainland textiles will end by December 2013 (see para. 2.4), and on the principle that appropriate licensing controls on imports and exports should only be imposed when there is such a genuine need (see para. 1.3), Audit considers that the TID needs to complete the review as soon as possible and prepare an action plan for the abolition of the textiles control system, if appropriate.

2.9 As at January 2012, the Textiles Licensing Branch had a workforce of 44, involving an annual staff cost of \$18.8 million. In the period 2005 to 2011, the TID deleted/redeployed a total of 271 posts as a result of the global elimination of textiles quotas, the partial liberalisation of the textiles licensing control and other streamlining efforts. Whilst the TID's efforts in significantly adjusting the staff resources are appreciated, Audit would like to urge the Department to continue keeping in view the development of the textiles trading environment, and look for further opportunities, where appropriate, to rationalise the size of the Branch.

Audit recommendations

2.10 **Audit has recommended that the Director-General of Trade and Industry should:**

- (a) **complete the review on the textiles control system as soon as possible;**
- (b) **if the system is to be abolished after December 2013, work out an action plan to effect the abolition in a timely manner; and**
- (c) **continue keeping in view the development of the textiles trading environment, and identify further opportunities, where appropriate, to rationalise the size of the Textiles Licensing Branch.**

Response from the Administration

2.11 The **Director-General of Trade and Industry** agrees with the audit recommendations.

Administration of textiles control system

2.12 Audit examined the textiles control system and found that there is scope for improving its efficiency and effectiveness.

Audit observations and recommendations

Issuing of retrospective textiles licences

2.13 According to the Import and Export Ordinance and its subsidiary legislations:

- (a) import or export of textiles without a licence (Note 4) is an offence and upon conviction, the offender may be liable to a fine of \$500,000 and imprisonment of two years; and
- (b) releasing imported textiles or accepting textiles for export without a licence is an offence and upon conviction, the carrier may be liable to a fine of \$500,000 and imprisonment of one year.

2.14 The TID does not normally accept applications for licences submitted after the textiles have been imported or exported (i.e. retrospective textiles licences). Late applications may be considered only if the applicants can provide a letter giving reasons for the late applications together with relevant supporting documents. In the period April to September 2011, the TID issued 2,288 retrospective textiles licences.

2.15 Audit selected all the 59 retrospective textiles licences (for import and export) issued in the week of 12 to 16 September 2011 and examined the traders' reasons for applying such licences. Audit has reservations on the supporting reasons for 35 (59%) of the licences:

Note 4: *Under the Import and Export Ordinance, all import/export of textiles, unless exempted, must be covered by import/export licences or import/export notifications under the Textiles Trader Registration Scheme. After the partial liberalisation of the textiles control system in May 2011, textiles import/export involving "sensitive markets" (see paras. 2.6 and 2.7) still requires a consignment-specific licence or an import/export notification.*

- (a) in 23 (39%) cases, the traders indicated that they had not applied for licences before shipments and therefore applied for retrospective licences; and
- (b) in 12 (20%) cases, the traders mentioned that they needed to wait for product information or shipping documents.

2.16 Audit has concern about the situation stated in paragraph 2.15(a) above. Import or export of textiles without licences may risk undermining the effectiveness of the system to guard against circumvention of safeguard measures on Mainland textiles (see para. 2.5). Nevertheless, the TID did not take enforcement actions (such as issuing warning letters or initiating prosecutions) against the traders in the 23 cases.

2.17 Furthermore, Audit examination of the 12 retrospective licences (see para. 2.15(b)) indicated that the TID approved the applications without questioning why the traders needed to wait for the product information or shipping documents (see Case 1 for an example). Audit also noted that the TID had not provided guidelines to its clerical staff for processing the applications. There were also no supervisory checks on the work of the clerical staff. After Audit's enquiry in October 2011, the TID instigated such checks by Assistant Trade Officers or above in November 2011.

Case 1

Handling of an application for retrospective textiles licence

1. On 15 September 2011, a trader applied for a retrospective licence for textiles already imported into Hong Kong on 28 August 2011. The reason provided by the trader in his application was that his supplier had not yet confirmed details of the product information, and therefore he could not apply for a licence before import. The documentation he submitted to support his application was an invoice dated 20 August 2011 for the textiles (which contained the product information) and a shipping document with import date of 28 August 2011.

2. On the same day, the TID approved the application.

Audit comments

3. Before approving the application, the TID should have asked the trader for more information to support his application, such as evidence showing why he could not receive detailed product information from his supplier earlier.

Source: Audit analysis of TID records

2.18 In examining the 35 cases mentioned in paragraph 2.15, Audit also noted that in 28 cases, despite the lack of import or export licences, the carriers had already released the imported textiles to the traders or had accepted the traders' textiles for export (see para. 2.13(b)). The TID did not take enforcement actions against any of these carriers.

Use of electronic notifications

2.19 In 2003, to enhance operational efficiency, the TID introduced, in addition to paper notifications, the electronic service under the Textiles Trader Registration Scheme (see para. 2.2) to enable registered traders to lodge notifications electronically. Since 23 December 2011, the TID has charged each trader an annual registration fee of \$349 for joining the Scheme to lodge paper and electronic notifications. For lodging electronic notifications, he has to pay an additional annual fee of \$800 to Tradelink Electronic Commerce Limited (Tradelink), a company which has provided the electronic service since 2003.

2.20 In June 2007, in view of the low take-up rate (12%) of electronic lodging of notifications, a new fee structure for the Scheme was introduced to promote electronic notifications. Under the new structure:

- (a) the annual registration fee was reduced from \$2,825 to \$718 (and further to \$349 in 2011 — see para. 2.19); and
- (b) a new handling fee of \$4.3 (reduced to \$3.4 with effect from 23 December 2011) was charged for lodging a paper notification whereas the transaction fee for lodging an electronic notification was maintained at \$0.5.

As a result of the promotion efforts, the usage of electronic notifications increased. Nevertheless, Audit found that the usage of electronic notifications remained stable at about 60% in the three years from 2009-10 to 2011-12 (up to September 2011). Table 1 shows the details.

Table 1
Number of electronic notifications and paper notifications
(2007-08 to 2011-12)

Notification	2007-08	2008-09	2009-10	2010-11	2011-12 (up to September 2011)
Electronic	1,668,800 (31 %)	2,285,500 (47 %)	1,740,400 (60 %)	1,682,000 (63 %)	825,200 (66 %)
Paper	3,666,400 (69 %)	2,602,900 (53 %)	1,178,700 (40 %)	1,002,700 (37 %)	418,000 (34 %)
Total	5,335,200 (100%)	4,888,400 (100%)	2,919,100 (100%)	2,684,700 (100%)	1,243,200 (100%)

Source: TID records

2.21 Comparing with paper notifications, electronic notifications help enhance the efficiency and effectiveness of the TID's processing work as they are automatically validated by the computer system of Tradelink upon lodging by traders. On the other hand, the TID has to manually test check the validity of paper notifications lodged by traders. These paper notifications are sometimes found to have irregularities such as incorrect trader registration numbers and expired registrations, and the TID has to take follow-up actions. The TID has to deploy a team of some 10 staff to check the validity of the paper notifications. Given these, Audit considers that the TID needs to investigate the reasons (such as through telephone surveys with traders) for the sluggish increase in the usage of electronic notifications in recent years and take actions to further promote the usage.

Audit recommendations

2.22 **Audit has recommended that the Director-General of Trade and Industry should:**

- (a) **ensure that only applications for retrospective textiles licences with proper justifications are approved;**
- (b) **provide guidelines on the processing of retrospective licence applications to the TID's staff;**

- (c) **take enforcement actions (e.g. issue of warning letters) against traders who have applied for retrospective licences without proper justifications;**
- (d) **take enforcement actions against carriers who have released imported textiles or accepted textiles for export without licences or notifications; and**
- (e) **investigate the reasons for the sluggish increase in the usage of electronic notifications and take actions to further promote the usage.**

Response from the Administration

2.23 The **Director-General of Trade and Industry** agrees with the audit recommendations. She has said that:

- (a) the arrangement for issuing retrospective licences is for trade facilitation purpose. In examining retrospective licence applications, the TID would examine all supporting documents, seek clarification from the applicants and/or exercise judgment where appropriate. The TID would approve only applications with no suspected fraudulent intent. For cases with suspected fraudulent intent, they are referred to the Customs and Excise Department (C&ED) for investigation;
- (b) it would generally be more convenient for an applicant registered under the Textiles Trader Registration Scheme to lodge a notification on his own before shipment than applying for a retrospective licence. Hence, the chance of traders registered under the Scheme trying to circumvent the licensing control through retrospective licences should not be high;
- (c) as far as Case 1 is concerned, the TID noted that the relevant trader was registered under the Scheme and apparently the benefit of the doubt was given to the applicant's explanation that detailed product information was not available to him at the time of shipment; and
- (d) the TID will investigate the reasons for the sluggish increase in the usage of electronic notifications, and consider whether and what actions are called for to encourage wider use of electronic notifications, taking into account the possible lifespan of the textiles control system.

PART 3: MANIFEST CHECKING

3.1 This PART examines the TID's manifest checking.

Manifest requirement

3.2 For goods which are subject to licensing control, carriers (e.g. shipping companies and airlines) are required to submit to the TID the manifests and the relevant import/export licences. Manifests can be submitted by electronic means or in paper form, while licences can only be submitted in paper form:

- (a) *Electronic manifests and paper licences.* For transport by air and sea, carriers have to submit the manifests electronically to the TID through the Government's computerised manifest system, and the paper licences at the TID's designated collection points; and
- (b) *Paper manifests and licences.* For road transport, carriers have to submit the paper manifests, together with the paper licences, at the land boundary control points of the C&ED. The manifests and the licences will then be sent by the C&ED to the TID.

Manifest checking by TID

3.3 In 2010, the TID received some 5.4 million manifests (Note 5). It performs manifest checking of goods which are subject to licensing control. According to the TID, manifest checking is a part of Hong Kong's licensing control system to help ensure that the manifests are free from discrepancies (i.e. the import and export of such goods are covered by licences, and the shipment details on the manifests match with those in the licences).

Audit observations and recommendations

Manifest checking rate

3.4 In 2004, taking into account the discrepancy rate of the manifest checking conducted in 2003, the TID revised downwards the percentage of manifests selected for checking. However, Audit noted that since 2004, the TID has not kept track of the discrepancy rates. Audit considers that the TID needs to closely monitor the discrepancy rates and to conduct regular reviews on the checking rate, so as to ensure that the effectiveness of manifest checking is not compromised.

Note 5: *The 5.4 million manifests covered all goods, whether or not they were subject to licensing control.*

Checking of electronic manifests

3.5 When submitting an electronic manifest for goods which are subject to licensing control, a carrier is required to input an indication in the computerised manifest system to show that the goods need a licence. The TID's Manifest Checking Unit will mark off the case upon receipt of the licence. For cases that have not been marked off after the statutory time limits for submission of licences by carriers, reminders are sent automatically by the system to the carriers. Table 2 shows the number of electronic manifests which had not been marked off in the past three years.

Table 2
Number of electronic manifests not marked off
(13 February 2012)

Year of submission of manifests	Number of manifests not marked off
2009	11,781
2010	13,585
2011 (up to September 2011)	12,656

Source: TID records

3.6 Audit noted that apart from the automatic issue of reminders (see para. 3.5), the TID did not take any further follow-up actions to ensure that the carriers subsequently submitted the licences. Audit considers that the TID needs to follow up these cases of non-submission of licences because they have the potential of breaching the law. Furthermore, sending reminders to the carriers without further follow-up actions may give an impression to the carriers that it is easy to circumvent the requirement of submitting licences to the TID, and may spark off more non-submission cases.

Detailed manifest checking

3.7 For all electronic and paper manifests selected for checking, the Manifest Checking Unit will check the product information stated on the manifests and cross-check it against the licences. The purpose is to ensure that licences are submitted for products which are subject to licensing control, and that the licences are proper, for example, the product particulars shown on the manifest agree with those on the licence. The Unit will

issue queries to carriers if necessary. If the carriers do not reply satisfactorily, it will refer the cases to the relevant licensing sections for follow-up actions.

3.8 Audit examined the follow-up of 159 discrepancy cases identified during detailed manifest checking in August and September 2010. For 140 (88%) cases, the TID could not show documentary evidence that it had adequately followed up the cases (e.g. initiating follow-up actions after the issue of reminders). Although the TID informed Audit in February 2012 that it had in fact taken adequate follow-up actions on all these cases, the follow-up actions had not been documented.

Audit recommendations

3.9 Audit has *recommended* that the Director-General of Trade and Industry should:

- (a) closely monitor the discrepancy rates of manifest checking and conduct regular reviews on the extent of manifest checking that should be adopted taking into account the discrepancy rates;
- (b) take follow-up actions with carriers who have failed to submit the import or export licences to the TID; and
- (c) keep proper documentation of actions taken (e.g. risk assessment and case review) on the discrepancy cases identified in manifest checking, and if it is decided that no follow-up actions are necessary, the justifications for the decisions.

Response from the Administration

3.10 The Director-General of Trade and Industry agrees with the audit recommendations.

PART 4: PROVISION OF CERTIFICATION SERVICE

4.1 This PART examines the following issues relating to the TID's provision of certification service:

- (a) role of the Certification Co-ordination Committee (paras. 4.4 to 4.9);
- (b) monitoring of certification work of the Government Approved Certification Organisations (GACOs — paras. 4.10 to 4.17); and
- (c) Certificates of Origin (certificates) issued by non-GACOs (paras. 4.18 to 4.23).

Certification service

4.2 The Factory Registration and Origin Certification Branch of the TID is responsible for the provision of certification service to facilitate exports and to support goods of Hong Kong origin (see para. 1.4) claiming preferential tariffs. As at 31 December 2011, the Branch had 42 staff. Certificates are issued by the TID and the five GACOs (GACO 1 to GACO 5) designated by the Government under the Protection of Non-Government Certificates of Origin Ordinance.

4.3 There are seven types of certificate:

- (a) Certificate of Hong Kong Origin (Certificate A);
- (b) Certificate of Origin — Processing (Certificate B);
- (c) Certificate of Hong Kong Origin — Mainland and Hong Kong Closer Economic Partnership Arrangement (Certificate C);
- (d) Certificate of Hong Kong Origin — New Zealand (Certificate D);
- (e) Certificate of Origin — Form A (Certificate E);
- (f) Certificate of Origin — Re-export (Certificate F); and
- (g) Certificate of Origin — Without Transit/With Trans-shipment (Certificate G).

Details of these certificates are shown at Appendix B. The vast majority (99%) of the certificates in 2010-11 and 2011-12 (up to September 2011) was issued by GACOs (see Appendix C).

Role of Certification Co-ordination Committee

4.4 The Certification Co-ordination Committee was set up in 1963 as a forum for the TID and GACOs to discuss and co-ordinate matters relating to the certification service. The Committee:

- (a) standardises and co-ordinates the practices of the TID and GACOs in certification matters; and
- (b) advises the Director-General of Trade and Industry on matters relating to the operation of the certification system, with a view to maintaining and enhancing its integrity.

The Committee is chaired by an Assistant Director-General of Trade and Industry and has members from the TID, the C&ED and GACOs.

Audit observations and recommendations

4.5 In June 1989, the TID completed a full-scale review of the certification system. The review recommended that the TID should work towards strengthening the role of the Committee and developing a code of practice on certification. Thus terms of reference, modus operandi and code of practice have been adopted by the Committee since October 1989. After 1989, there has been no further full-scale review of the certification system.

4.6 Audit noted that since the completion of the review in June 1989, the Committee had held 25 meetings up to August 1999. However, following the August 1999 meeting, the Committee did not hold any meetings until April 2006. In the period April 2006 to December 2011, five meetings were held. In February 2012, the TID informed Audit that there was no rigid meeting schedule for the Committee and meetings were convened on a need basis. Furthermore, the Committee also discussed and handled issues through correspondence as appropriate.

4.7 Audit considers that the Committee needs to convene meetings more frequently to enhance communication and cooperation between the TID and GACOs because:

- (a) the Committee is the major forum for discussion and co-ordination between the TID and GACOs on matters relating to the certification service; and
- (b) the vast majority of certificates is issued by GACOs (see Appendix C) and there are discrepancies found on GACOs' certification work (see paras. 4.11 and 4.12).

As the last full-scale review of the certification system was carried out in 1989, Audit also considers that the TID should conduct another full-scale review of the certification system.

Audit recommendations

4.8 **Audit has recommended that the Director-General of Trade and Industry should:**

- (a) **ensure that the Certification Co-ordination Committee convenes meetings more frequently to enhance communication and cooperation between the TID and GACOs; and**
- (b) **consider conducting a full-scale review of the certification system.**

Response from the Administration

4.9 The **Director-General of Trade and Industry** agrees with the audit recommendations.

Monitoring of certification work of GACOs

4.10 The TID monitors GACOs' certification work through the following means:

- (a) ***TID's sample checks on certificates.*** The TID conducts sample checks on Certificates A to F (Note 6) issued by GACOs to ascertain whether the certificates are issued in accordance with the relevant requirements and guidelines; and
- (b) ***Consignment checks conducted by GACOs.*** Under a risk-based surveillance mechanism (Note 7), in addition to the C&ED's checking, the TID and GACOs have agreed that each GACO should conduct consignment checks on an agreed percentage of the applications for Certificates A, B, E and F (Note 8) it

Note 6: *According to the TID, Certificate G involves goods not produced, manufactured or processed in Hong Kong, and is not covered by the laws of Hong Kong. Therefore, the TID does not monitor the certification work of GACOs on Certificate G.*

Note 7: *Under a risk-based surveillance mechanism, the C&ED conducts consignment checks on selected certificate applications and these checks are complemented by consignment checks performed by GACOs.*

Note 8: *According to the TID, GACOs are not required to conduct consignment checks for Certificates C, D and G because:*
(a) *consignment checks for Certificates C and D are conducted by the C&ED; and*
(b) *Certificate G is not covered by the laws of Hong Kong.*

received. The TID oversees GACOs' compliance with the agreed rate and, if necessary, requests GACOs to provide inspection reports on the results of their checks.

Audit observations and recommendations

TID's sample checks on certificates

4.11 Audit examined the TID's sample checks on certificates issued by GACOs in the period April 2010 to August 2011. Audit noted that discrepancies were mostly found on Certificates A and F (see Table 3).

Table 3

**TID's sample checks on certificates issued by GACOs
(April 2010 to August 2011)**

Certificate	No. of certificates checked	Percentage of certificates with discrepancies found
A	5,105	7.9%
B	180	1.7%
C	3,504	0.2%
D (Note 1)	0	N/A
E (Note 2)	0	N/A
F	5,103	6.6%
Overall	13,892	5.4%

Source: Audit analysis of TID records

Note 1: Certificate D was introduced in January 2011. Up to 31 August 2011, no such certificate had been issued.

Note 2: Only four Certificate Es were issued by GACOs.

4.12 Audit further examined the TID's sample checks on Certificates A and F. Audit found that certificates issued by one GACO (GACO 1) were more prone to discrepancies (see Table 4).

Table 4
TID's sample checks on Certificates A and F issued by GACOs
(April 2010 to August 2011)

GACO	Certificate	No. of certificates checked	Percentage of certificates with discrepancies found
1	A	1,696	15.0%
	F	1,303	18.8%
2	A	2,362	3.8%
	F	2,383	3.3%
3	A	952	5.7%
	F	1,020	0.9%
4	A	85	5.9%
	F	212	0%
5	A	10	0%
	F	185	2.7%
Overall	A	5,105	7.9%
	F	5,103	6.6%

Source: Audit analysis of TID records

Consignment checks conducted by GACOs

4.13 Audit examination of the TID's records on consignment checks conducted by GACOs in the period April 2010 to August 2011 revealed that two GACOs' consignment checking rates were less than the rate agreed between the TID and GACOs:

- (a) a GACO did not conduct any consignment checks; and

- (b) during the 17-month period, another GACO did not conduct any consignment checks in 11 months. In 4 of the remaining 6 months, the checking rates were less than the agreed rate.

Improvement measures taken by TID

4.14 In February 2012, the TID informed Audit that:

- (a) it had taken the following actions to improve GACOs' certification work:
 - (i) monthly reports were issued to GACOs. GACOs were urged to follow up the discrepancies identified in the TID's sample checks on certificates, and to make efforts to achieve the agreed consignment checking rate;
 - (ii) seminars were organised annually for staff of the TID and GACOs to share experience on certification work. In the seminars, the TID also discussed with GACOs about the common discrepancies identified in sample checks and the importance of compliance with the agreed consignment checking rate; and
 - (iii) guidelines on certification practices were issued to GACOs when necessary. In addition, the TID was in close contact with GACOs' certification staff and provides assistance to them from time to time;
- (b) applications for some types of certificate were processed electronically. The system had a built-in checking function to ensure that all necessary information was provided by applicants and all key procedures were followed in issuing the certificates;
- (c) the discrepancies identified in the sample checks were mostly technical or minor errors (e.g. incorrect product code or incomplete product description) which did not affect the eligibility of the applicants for the certificates;
- (d) in recent years, no importing countries had raised any concerns about the quality of the certificates issued by GACOs; and
- (e) under the risk-based surveillance mechanism, the C&ED conducted consignment checks on selected certificate applications and the consignment checks performed by GACOs were complementary to the C&ED's checks. That said, the TID had been in discussions with GACOs concerned on how to improve the checking on the certificates.

Scope for further improvement

4.15 Audit noted the TID's efforts taken to improve GACOs' certification work. Nevertheless, Audit considers that the TID can do more to further enhance its monitoring of GACOs' certification work. For example, the TID may consider:

- (a) further examining the reasons for GACOs' repeatedly issuing certificates with discrepancies and assisting them to make improvements;
- (b) reviewing and revising the basis for its sample checks on certificates. For example, the TID may examine the basis for determining the percentages of certificates selected for checking. These percentages should be commensurate with the standards of GACOs' certification work (see Table 5); and

Table 5

**Percentages of GACO certificates checked by TID
and certificates with discrepancies found
(April 2010 to August 2011)**

Certificate	GACO	Percentage of certificates checked (a)	Percentage of certificates with discrepancies found (b)
A	1	13.5%	15.0%
	2	25.1%	3.8%
F	1	2.4%	18.8%
	2	2.2%	3.3%

Source: Audit analysis of TID records

Remarks: The percentages of certificates checked by the TID (see (a) above) were not commensurate with the percentages of certificates with discrepancies found (see (b) above). For instance, although certificates issued by GACO 1 were more prone to discrepancies, the TID checked a much lower percentage of Certificate As issued by GACO 1.

- (c) stepping up efforts (such as issuing warning letters) to ensure that GACOs comply with the agreed consignment checking rate.

Audit recommendations

4.16 **Audit has *recommended* that the Director-General of Trade and Industry should make efforts to enhance the integrity of the certification system by:**

- (a) **assisting GACOs to improve their certification work; and**
- (b) **strengthening the TID's monitoring of GACOs' certification work.**

Response from the Administration

4.17 The **Director-General of Trade and Industry** agrees with the audit recommendations. She has said that the C&ED conducts pre-registration inspections and regular post-registration inspections on factories under a factory registration system. It also conducts consignment checks on certificate applications (see Note 7 to para. 4.10(b)). GACO's consignment checks are complementary to the C&ED's consignment checks.

Certificates of Origin issued by non-GACOs

4.18 In April 2009, GACOs expressed to the TID their concern on the legitimacy of Certificate F issued by a non-GACO. To protect the integrity of the certification system, GACOs requested the TID to stop the non-GACO from issuing such certificates.

4.19 In June 2009, to address GACOs' concern, the TID issued to traders a circular highlighting that:

- (a) certificates issued by the TID and the five GACOs (apart from Certificate G — see Note 6 to para. 4.10(a)) are protected by the laws of Hong Kong; and
- (b) non-GACOs may issue their own certificates, but these certificates do not carry any legal status recognised by the laws of Hong Kong (Note 9).

The circular was posted onto the TID's website.

Note 9: *According to legal advice obtained by the TID, while the Protection of Non-Government Certificates of Origin Ordinance protects the official status of certificates issued by GACOs, the Ordinance does not prevent non-GACOs from issuing their own certification documents.*

Audit observations and recommendations

4.20 According to the TID's records, there were at least two non-GACOs issuing certificates. The TID informed Audit in December 2011 that it did not have statistics on certificates issued by non-GACOs because these certificates did not carry any legal status, and were not covered by the enforcement system of the C&ED.

4.21 Audit however notes that:

- (a) the Government has an international responsibility for the integrity of the certification system. To fulfil this responsibility, the TID maintains proper control of GACOs (for example, by providing training to GACOs and requiring them to adopt the same practices and procedures in the issue of certificates) to ensure that they adopt a uniform standard of integrity. However, non-GACOs are not monitored by the TID;
- (b) according to the TID, certification should remain as a government function with appropriate level of delegation, and the existing number of GACOs is adequate to meet the present and foreseen demand; and
- (c) the International Convention relating to the Simplification of Customs Formalities is an international treaty which Hong Kong has to observe. According to the Convention, certificates may be issued not only by the official authorities of the contracting states (i.e. the TID), but also by any other organisations which possess the necessary authority and offer the necessary guarantees and are previously approved for this purpose by each of the states concerned (i.e. GACOs). Each contracting state shall communicate as soon as possible to the Secretariat of the United Nations a list of organisations which it has designated for the purpose of delivering the certificates. In accordance with the Convention, the TID has communicated to the United Nations the list of the five GACOs. However, it is uncertain whether the situation of non-GACOs issuing certificates in Hong Kong is appropriate in the context of the Convention.

Audit recommendations

4.22 **Audit has recommended that the Director-General of Trade and Industry should:**

- (a) **keep in view the need to reassess the impact of non-GACOs on the integrity of certificates issued by the TID and GACOs (having regard to, inter alia, information available on the nature and volume of certificates issued by non-GACOs) and take appropriate actions to improve the certification system, where necessary; and**
- (b) **ascertain whether the existing arrangement of allowing non-GACOs to issue certificates is appropriate in the context of the International Convention relating to the Simplification of Customs Formalities.**

Response from the Administration

4.23 The **Director-General of Trade and Industry** agrees with the audit recommendations. Regarding paragraph 4.22(b), she has said that according to legal advice obtained, the terms of the Convention do not go so far as imposing on the state parties to the Convention an obligation to prevent or prohibit non-approved bodies from issuing certificates. The customs administrations will retain fully the right of verifying the real origin of goods and consequently also the power to demand, in spite of the production of certificates, any other proof they may deem necessary. Hence, the acceptance of a certificate ultimately lies upon the importing authority or the receiving party of the document. Moreover, the TID's responsibility under the Convention should be to safeguard the integrity of certificates issued by the TID and GACOs under the laws of Hong Kong. The TID has issued notifications to Consulates-General in Hong Kong to bring to their attention the recognised status of GACOs and certificates issued by them. In addition, the TID has also issued a general circular to the trade on the certification system, and alert traders to the recognised status of GACOs and certificates issued by them (Note 10).

Note 10: *Audit noted the TID's explanation. Nonetheless, Audit considers that the issuing of certificates by non-GACOs may have an impact on the integrity of the certification system. Therefore, the TID needs to continue monitoring the situation and consider taking appropriate action to improve the certification system, where necessary. Paragraph 4.22(a) is relevant.*

PART 5: REVIEW OF FEES AND CHARGES

5.1 This PART examines issues relating to the TID's review of fees and charges.

Government policy on fees and charges

5.2 It is the Government's policy that fees should be set at levels adequate to recover the full cost of providing the services. According to the relevant Financial Circular issued by the Financial Services and the Treasury Bureau (FSTB) in December 2006:

- (a) fees and charges should generally be reviewed and, where necessary, revised on an annual basis;
- (b) in reviewing the fees and charges, appropriate cost projection rates may be used to update the full costs of fee items. Nevertheless, a fresh costing exercise should be conducted at least once every four years;
- (c) to minimise delays and to prevent revenue loss, government bureaux/departments must ensure that fee reviews are conducted sufficiently early as to avoid delays in implementing revisions;
- (d) in preparing their fee proposals, government bureaux/departments should ensure that the fee structure and levels are conducive to achieving the target (such as full-cost recovery); and
- (e) fee proposals should be submitted by the relevant policy bureau or by the department after securing the relevant policy bureau's support.

Fees under the trade support and facilitation programme

5.3 Under the TID's trade support and facilitation programme, there are 27 fee items, 6 items of which related to import and export of textiles and 21 items to other services (such as application for a Certificate of Origin, a certified true copy or a statutory declaration of antiques certificate). For 2011-12, the estimated revenue is \$21.7 million.

Audit observations and recommendations

5.4 Audit examined the fee reviews conducted by the TID in the past three years from 2009 to 2011. Audit found that the TID completed a review of the 6 fee items relating to import and export of textiles and put up a fee revision proposal to the Legislative Council in July 2011. The fee revision was implemented in December 2011.

5.5 Regarding the 21 fee items not relating to textiles (see para. 5.3), the TID conducted fee reviews annually in each of the three years to update the costs of the fee items. A fresh costing exercise was also conducted in early 2011. However, up to February 2012, the fee revision exercise had not been completed. The position as at March 2012 was as follows:

For 19 fee items

- (a) during the period December 2009 to November 2010, the TID advised the FSTB that it intended to maintain certain fee items at their existing levels. The FSTB advised the TID that the latter's intended fee proposal would not be agreeable as it could not achieve the target of full-cost recovery;
- (b) based on the FSTB's advice, the TID submitted to the CEDB a fee revision proposal in October 2011 to revise certain fee items and obtained policy support on the proposal in December 2011. The FSTB agreed to the fee revision proposal;
- (c) the fee revision proposal would take effect on 30 March 2012; and

For the remaining two fee items

- (d) the FSTB was considering the TID's proposal of maintaining the nominal fee status of the two fee items. In February 2012, the FSTB advised the TID to conduct a fresh costing exercise on these two fee items. The TID would secure the CEDB's support on the proposal upon completion of the exercise.

Audit considers that the TID needs to ensure, in conjunction with the CEDB and the FSTB, that fee review exercises are always concluded in a timely manner so as to minimise any possible revenue forgone.

Audit recommendations

5.6 **Audit has recommended that the Director-General of Trade and Industry should:**

- (a) **in conjunction with the Secretary for Commerce and Economic Development and the Secretary for Financial Services and the Treasury, conclude the TID's review of fees for the services under the trade support and facilitation programme as soon as possible; and**

- (b) **take effective measures to ensure that fees are always reviewed and, where necessary, revised in a timely manner in future.**

Response from the Administration

5.7 The **Director-General of Trade and Industry** agrees with the audit recommendations. The **Secretary for Commerce and Economic Development** and the **Secretary for Financial Services and the Treasury** also agree with the audit recommendations.

Free licensing service

5.8 The TID has provided a free licensing service for import and export of strategic commodities since the introduction of the licensing control on these goods in the 1950s. In March 2008, the TID conducted a research to ascertain the reasons for providing the licensing service free of charge. The research revealed that in December 1997, the TID gave the CEDB and the FSTB the following explanations of the rationale behind the provision of free service:

- (a) Hong Kong was committed to the maintenance of an effective import and export control system to prevent it from being used as a conduit for the proliferation of weapons of mass destruction and to guarantee its continued access to high technology products of the advanced countries. For this reason, import and export controls were needed to thwart procurement efforts to obtain sensitive materials, equipment and technology much of which were capable of use for both industrial and military purposes. Strategic commodities therefore referred to a wide range of military products and dual-use industrial goods capable of, but not specifically designed for, military purposes; and
- (b) not all general traders had the technical expertise to determine whether the goods fell into the scope of the Import and Export (Strategic Commodities) Regulations (Cap. 60G) and were subject to licensing control. To uphold the integrity and comprehensiveness of Hong Kong's strategic trade control system, traders were encouraged to send in the applications together with the technical specifications to the TID for assessment whenever they had doubts. This would help traders ascertain the licensing requirements of the goods before effecting shipment.

5.9 In June 2009, the TID checked with the licensing authorities of some of Hong Kong's trading partners (e.g. Australia and the United States) and found that they did not charge fees for the issue of their strategic commodity licences. The TID therefore considered that there was no need to change the existing arrangement of providing the licensing service for strategic commodities free of charge.

Audit observations and recommendations

5.10 Audit considers that the TID needs to revisit the existing arrangement of providing a free licensing service for strategic commodities. The reasons are as follows:

- (a) the free licensing service has been provided for a long time since the inception of the licensing control for strategic commodities in the 1950s;
- (b) the TID deploys 22 staff for the provision of the licensing service. The annual staff cost amounts to \$12.2 million;
- (c) some traders apply for a large number of licences irrespective of whether there are strategic commodities to be shipped (Note 11). According to the TID, there is a practical need for traders to take out "stand-by" licences to arrange their shipments with more flexibility. However, Audit has concern that the TID's resources have been used in processing a large number of applications for licences which are subsequently unused. The free-of-charge arrangement could have contributed to such a situation; and
- (d) the overseas practices of not charging fees for strategic commodity licences have had merits of their own. In the absence of a structured research on the rationale behind the practices of the overseas countries, it may not be a good benchmark for Hong Kong to follow.

Note 11: *The TID does not keep statistics on unused strategic commodity licences. According to the consignment inspection reports of the C&ED (the C&ED is responsible for performing consignment checks to verify the authenticity of information given in various types of licences), the C&ED conducted consignment checks on 338 strategic commodity licences in January 2011. Of these 338 licences, 117 (35%) licences were found unused.*

Audit recommendations

5.11 **Audit has recommended that the Director-General of Trade and Industry should:**

- (a) **revisit the existing arrangement of providing the licensing service for strategic commodities free of charge; and**
- (b) **seek the approval of the CEDB and the FSTB for a fee proposal or continuing to provide the free licensing service.**

Response from the Administration

5.12 The **Director-General of Trade and Industry** agrees with the audit recommendations. The **Secretary for Commerce and Economic Development** and the **Secretary for Financial Services and the Treasury** also agree with the audit recommendations.

PART 6: PERFORMANCE MANAGEMENT

6.1 This PART examines issues relating to the TID's performance management.

Performance management

6.2 Performance management, including setting performance pledges and indicators and their reporting, provides a means to measure how well an organisation has performed and helps improve its performance, transparency and accountability. The TID has compiled and published performance pledges and indicators pertaining to its trade support and facilitation programme on its website and in its Controlling Officer's Report (COR).

Audit observations and recommendations

Need to strengthen monitoring of compliance with performance pledges

6.3 Each of the TID's branches which provides services under the trade support and facilitation programme (e.g. the Textiles Licensing Branch) is required to conduct weekly surveys on compliance with the branch's performance pledges. Based on the results of weekly surveys, the TID's Administration Branch compiles a quarterly "Report on Monitoring of Compliance with Performance Pledge".

6.4 Audit examined the quarterly reports for the period January 2010 to September 2011, and found that some of the branches' performance pledges had not been met. For example, 5,988 applications for import and export licences for strategic commodities and 1,227 applications for pre-classification service for strategic commodities had not been processed within the target turnaround time of 2.5 and 2 working days respectively. According to the TID, these cases were either complicated cases or cases where the applicants had not submitted sufficient supporting documents.

6.5 Audit found that there was no documentation of the details of these cases which indicated that longer time was needed for processing. Furthermore, there was no documentation indicating that they had been brought to the attention of the senior management for instituting necessary remedial measures. In this connection, Audit notes that according to the 2009 Civil Service Bureau's guidelines for the implementation of performance pledges, a key to effective monitoring is the active involvement of senior management in the process. Government bureaux and departments should designate dedicated personnel at senior level, and preferably at directorate level, to oversee the

process of performance pledge implementation, address issues of specific concern to customers and monitor the effectiveness of enhancement measures.

6.6 In February 2012, the TID informed Audit that it concurred that there was room for improvement in the existing arrangements of monitoring compliance with its performance pledges. It would consider strengthening its monitoring work in the following areas:

- (a) the weekly surveys (according to the TID, these surveys were used mainly for general reference internally and not for assessing compliance directly) should be reviewed and used as a more effective management tool. These surveys should be brought to the attention of subject directorate officers if irregularities were detected;
- (b) more detailed information should be provided in writing to the Administration Branch for compilation of the quarterly reports;
- (c) the quarterly reports should be submitted to the Departmental Secretary (a directorate officer) who would follow up with the subject directorate officers as appropriate. The TID planned to put in place the new arrangements as soon as possible; and
- (d) in the case of the strategic commodities (see para. 6.4), the TID considered that the computer system should be upgraded to distinguish complicated cases from regular cases so that performance pledges could be better monitored. A technical feasibility study for this purpose had been started.

Need to improve reporting of achievements against performance pledges

6.7 The TID reported on its website and in the COR that all the TID's 41 performance pledges relating to the trade support and facilitation programme were achieved in 2010 (see Table 6).

Table 6

**Examples of TID's performance pledges and achievements
(2010 and 2011)**

Performance pledge		Target	Achievement	
Licence/certificate	Issue/complete within		2010 (Actual)	2011 (Plan)
Consignment-specific textiles import licence	2 working days	100%	100%	100%
Certificate of Hong Kong Origin	1.5 working days	100%	100%	100%
Import and export licence for strategic commodities	2.5 working days	100%	100%	100%

Source: TID's website and COR

However, Audit found that the information reported on the TID's website and in the COR was not consistent with that in the quarterly reports (see para. 6.4).

6.8 Audit examined the mechanism used by the TID in reporting achievements. Audit found that near the end of each year, the Administration Branch requests various branches to update their respective performance pledges, targets, actual and planned achievements. According to the TID, upon receipt of the updates, the Branch will make reference to the information acquired in the compilation of the quarterly reports and give comments on the updates. The Branch will then make arrangements for reporting the achievements. Audit noted the Branch's efforts, but considers that the existing procedures for reporting the achievements are not entirely satisfactory (see para. 6.7) and need to be improved.

Audit recommendations

6.9 **Audit has recommended that the Director-General of Trade and Industry should:**

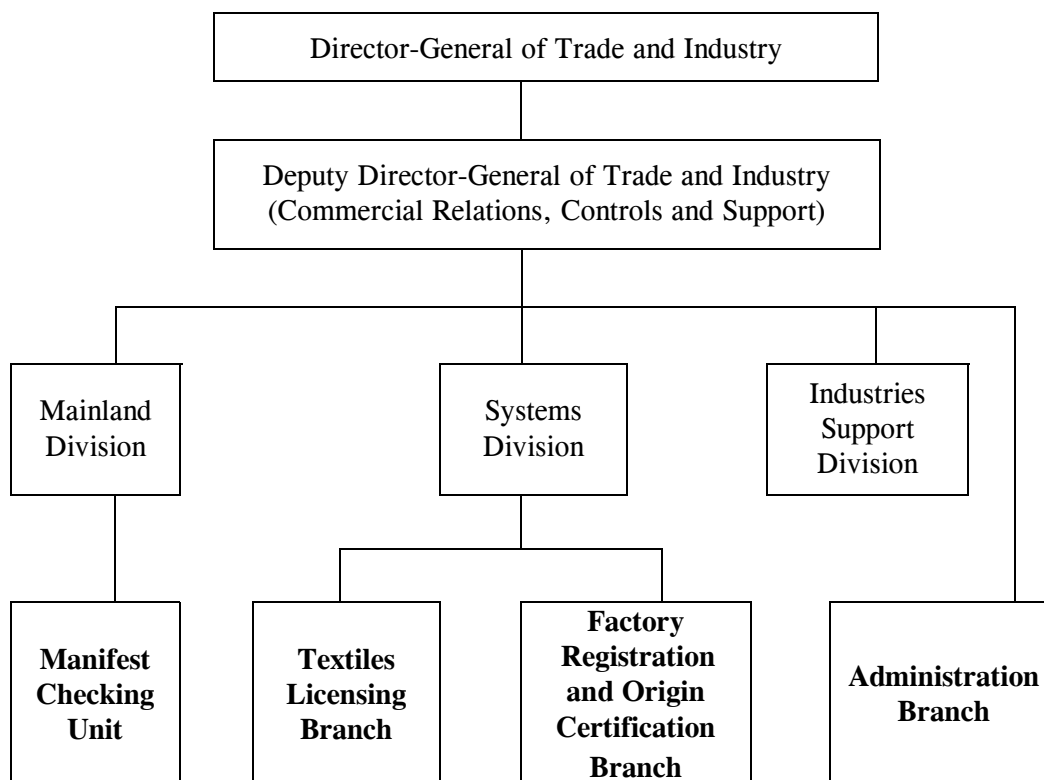
- (a) **strengthen the monitoring of compliance with the TID's performance pledges; and**

- (b) **improve the procedures for reporting achievements against the performance pledges.**

Response from the Administration

6.10 The **Director-General of Trade and Industry** agrees with the audit recommendations.

**Trade and Industry Department
Organisation chart (extract)
(31 December 2011)**



Source: TID records

Appendix B
(para. 4.3 refers)

Types of Certificate of Origin

Certificate	Name	Issued by
A	Certificate of Hong Kong Origin (for goods accepted to be of Hong Kong origin — see para. 1.4)	TID/GACOs
B	Certificate of Origin — Processing (for goods which have undergone manufacturing processes in Hong Kong)	TID/GACOs
C	Certificate of Hong Kong Origin — Mainland and Hong Kong Closer Economic Partnership Arrangement (for goods claiming preferential tariffs under Mainland and Hong Kong Closer Economic Partnership Arrangement)	TID/GACOs
D	Certificate of Hong Kong Origin — New Zealand (for goods claiming preferential tariffs under the Hong Kong-New Zealand Closer Economic Partnership Agreement)	TID/GACOs
E	Certificate of Origin — Form A (for goods claiming preferential tariffs offered by Canada and the Russian Federation)	TID/GACOs
F	Certificate of Origin — Re-export (for shipments which have been imported to Hong Kong and will be exported to overseas)	GACOs
G	Certificate of Origin — Without Transit/With Trans-shipment (for shipments which have been exported directly from an overseas country to another country, and are allowed to change carriers at Hong Kong or overseas en route)	GACOs

Source: TID records

Remarks 1: Certificates A to E are issued to certify products having undergone manufacturing processes in Hong Kong, but not for Certificates F and G which do not involve certification of products having undergone manufacturing processes in Hong Kong. Certificates C, D and E are issued specifically to support certain Hong Kong products as satisfying the origin rules for claiming preferential tariffs.

2: A factory registration system and a risk-based surveillance system are part and parcel of the certification system. Factories applying for Certificates A to E must first register with the TID in respect of the products they produce. According to the TID, when the factories apply for certificates, whether the applications are made to the TID or GACOs, they may be subject to consignment checks (which comprise physical inspection of the goods and checking of the manufacturers' books and records to verify the information stated in the applications). A risk-based surveillance mechanism is also in place whereby the C&ED conducts consignment checks on selected applications and these checks are complemented by consignment checks performed by GACOs (see para. 4.10(b)).

**Number of Certificates of Origin issued
(2010-11 and 2011-12)**

Year	Certificate	No. of certificates issued		
		By TID	By GACOs	Total
2010-11	A	587	18,253	18,840
	B	29	1,123	1,152
	C	1,430	11,550	12,980
	D (Note 1)	0	0	0
	E	0	4	4
	F	(Note 2)	136,199	136,199
	G	(Note 2)	65,424	65,424
	Total	2,046 (1%)	232,553 (99%)	234,599 (100%)
2011-12 (up to September 2011)	A	333	8,572	8,905
	B	25	502	527
	C	838	6,780	7,618
	D (Note 1)	0	0	0
	E	0	0	0
	F	(Note 2)	62,819	62,819
	G	(Note 2)	34,008	34,008
	Total	1,196 (1%)	112,681 (99%)	113,877 (100%)

Source: TID records

Note 1: Certificate D was introduced in January 2011. Up to 30 September 2011, no such certificate had been issued.

Note 2: Certificates F and G are issued by GACOs only.

Appendix D

Acronyms and abbreviations

Audit	Audit Commission
C&ED	Customs and Excise Department
CEDB	Commerce and Economic Development Bureau
CEPA	Mainland and Hong Kong Closer Economic Partnership Arrangement
COR	Controlling Officer's Report
FSTB	Financial Services and the Treasury Bureau
GACO	Government Approved Certification Organisation
TID	Trade and Industry Department
WTO	World Trade Organisation