

ITEM FOR FINANCE COMMITTEE

CAPITAL WORKS RESERVE FUND

HEAD 710 – COMPUTERISATION

Customs and Excise Department

New Subhead “Development of Dutiable Commodities System”

Members are invited to approve a new commitment of \$33 million for the development of the Dutiable Commodities System of the Customs and Excise Department.

PROBLEM

The Customs and Excise Department (C&ED) needs to replace the Customs Control System (CCS) to sustain the services in conducting customs operations under the Dutiable Commodities Ordinance (DCO) (Cap. 109) and enhance the services by introducing electronic licence applications.

PROPOSAL

2. The Commissioner of Customs and Excise, with the support of the Secretary for Financial Services and the Treasury and the Government Chief Information Officer, proposes to create a new commitment of \$33 million to implement a Dutiable Commodities System (DCS) to offer trade facilitation by allowing electronic mode of both licence and permit applications, and to provide more efficient and reliable dutiable commodities (DC) related services.

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JUSTIFICATION

Licences and Permits for DC

3. C&ED is empowered under the DCO to administer a licence and permit system for the regulation of the import, export, storage, manufacture and movement of DC. In accordance with section 17 of the DCO, a licence is required for the import, export, manufacture or storage of DC, which mean alcoholic liquors (with an alcoholic strength above 30% by volume measured at the temperature of 20°C), tobacco, hydrocarbon oil and methyl alcohol. Different types of licence are required for the handling and storage of DC, notable ones being the Import and Export Licence, Manufacturer's Licence and Bonded Warehouse Licence. For every instance of movement of DC for import, export, and transfer between bonded warehouses before duty payment, a DC licensee must apply for a permit in advance.

4. C&ED is responsible for the licensing of the import, export, manufacture and storage of DC; assessment and collection of duties and related fees and charges on DC; and regulation of the movement of DC by permits. Duties are levied on the DC mentioned in paragraph 3 above to be consumed locally, irrespective of whether they are manufactured locally or imported.

5. Since 1998, C&ED has been using the computer system CCS to assist in carrying out the above responsibilities and other non-DC related Customs operations. The CCS has three major DC-related functions as follows –

- (a) to process DC licence applications submitted in paper form and maintain the licensee information;
- (b) to serve as the Government's back-end system for processing DC permit applications submitted by DC traders by electronic means via the Electronic Data Interchange platform of electronic service providers specified under the DCO; and
- (c) to facilitate the collection of duty and compounding fines at Duty Collection Offices at control points.

Trade Facilitation

6. Currently, the CCS only supports applications for DC permits (not DC licences) in electronic format. Thus, while DC traders apply for DC permits through electronic means, they still need to lodge their DC licence applications in paper form as required under the Dutiable Commodities Regulations (Cap. 109A). Given that the electronic permit system has been in operation for over ten years and is widely accepted by the trade, as a trade facilitation measure, the Government

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considers it opportune to extend the current electronic mode of operations for permit applications to make it applicable to licence applications as well. To this end, we propose to implement an electronic licensing (e-licensing) system for DC traders.

Enhancement of Current Electronic Permit System and Related Operations

7. Studies conducted by C&ED between September 2011 and June 2013 revealed that the existing computer system is deficient. The CCS does not support full automation in processing DC permit applications (e.g. data validation) and other DC-related operations (e.g. DC sampling for examination by the Government Laboratory). Furthermore, the existing client-server architecture has been in use for more than 15 years since its launch in 1998. While it was upgraded in 2002 and 2004, some components have become obsolete and there are technical limitations in the system for integrating with C&ED's corporate portal, providing electronic services and meeting business demands. It is therefore essential to pursue new information technology (IT) infrastructure and upgrade both hardware and software for up-to-date services.

The Proposed DCS and its Benefits

8. To implement the proposed e-licensing system and revamp the existing system to facilitate trade, the Government proposes to implement a new electronic platform called the DCS managed by C&ED. The proposed e-licensing system will be built into the new DCS, which is scheduled to come into operation in January 2017. In March 2014, the Dutiable Commodities (Amendment) Regulation 2014 was made under section 6 of the DCO to provide for the legal framework for the proposed e-licensing system. We will publish in the Gazette the exact date on which the e-licensing system will come into operation.

9. With the establishment of a more up-to-date and adaptable system infrastructure, the proposed DCS will have the following features and benefits –

(a) **Saving time, cost and manpower resources**

Under the proposed e-licensing arrangement, traders will submit licence applications through electronic means, thus saving their time and manpower resources spent in the current paper application process, which may require several rounds of despatch of documents to C&ED. At the same time, it will minimise manual input of data by C&ED. Automatic checking and cross referencing of records and information will become possible, which will in turn reduce C&ED's

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processing time of each application. For instance, the net processing time required for issue of a warehouse licence will be reduced by two working days, which will otherwise take about 12 working days under the current paper mode.

(b) Offering new services

The proposed DCS will bring about new and convenient services to traders. For example, traders will receive automatic reminders of licence renewal and electronic notification of payment of licence fees, thus facilitating their timely completion of formalities as required. The proposed system will also cater for electronic submission of monthly reports and returns by the licensees on the movement of DC under their accounts which are currently submitted in paper form.

(c) Adding value to the electronic permit system

The proposed DCS will align and simplify some of the procedures currently required under the electronic permit environment. For example, with the introduction of the proposed e-licensing system, the registration process of new permit holders will be substantially shortened from the current five working days to three working days.

(d) Enhancing system sustainability and operational efficiency

Timely replacement of the aging hardware and software will ensure the continuity and reliability in providing DC licence processing, permit processing and duty collection services. The updated IT infrastructure will be using web technology, enabling new functions to be developed more effectively. The proposed new automation functions will allow effective data retrieval and system interface with other information databases of C&ED, thereby enhancing the efficiency of C&ED in processing licence and permit applications, handling enquiries about licence and permit matters as well as carrying out duties regarding revenue control.

(e) Enhancing system reliability and security

With the adoption of up-to-date technology, the overall system reliability and security can be enhanced with protection against security threats and the encryption features will be strengthened for data security control.

Cost Savings

10. We estimate that the implementation of the DCS will bring about annual savings of \$5.6 million from 2017-18 onwards, comprising the following –

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- (a) Realisable savings of \$3.5 million per annum

The realisable savings represent savings mainly from the maintenance cost of the existing system. The savings will be used to cover part of the recurrent expenditure of the project.

- (b) Notional savings of \$2.1 million per annum

The notional savings will be achieved mainly through staff savings as a result of reduction of manual efforts and paper work in processing licence/permit due to the re-engineered workflow. The savings will be redeployed to support the DCS and other tasks of C&ED.

Encl. 11. A cost and benefit analysis for the DCS is set out at Enclosure.

FINANCIAL IMPLICATIONS

Non-recurrent Expenditure

12. We estimate that the proposed implementation of the DCS will incur a non-recurrent capital expenditure of \$33 million over a period of four years from 2014-15 to 2017-18, with breakdown as follows –

	2014-15	2015-16	2016-17	2017-18	Total
	\$'000	\$'000	\$'000	\$'000	\$'000
(a) Hardware	160	1,300	3,440	2,100	7,000
(b) Software	160	900	2,160	800	4,020
(c) Implementation services	2,200	7,480	7,200	1,100	17,980
(d) Training	-	-	1,000	-	1,000
(e) Contingency	250	970	1,380	400	3,000
Total	2,770	10,650	15,180	4,400	33,000

13. On paragraph 12(a) above, the estimate of \$7 million is for the acquisition of computer hardware, including servers and storage area network.

14. On paragraph 12(b) above, the estimate of \$4.02 million is for the acquisition of computer software, including operating system software and database management system software.

15. On paragraph 12(c) above, the estimate of \$17.98 million is for the acquisition of implementation services from external service providers and contract staff for project implementation, including system analysis and design, software development, system installation and configuration.

16. On paragraph 12(d) above, the estimate of \$1 million is for the training of C&ED staff and the briefing to traders.

17. On paragraph 12(e) above, the estimate of \$3 million represents a 10% contingency on the cost items set out in paragraphs 12(a) to 12(d) above.

Other Non-recurrent Expenditure

18. The implementation of the proposal will entail an additional non-recurrent staff cost of \$15.6 million. The cost represents a total of 71.3 man-months of Inspector/Superintendent Grade staff of C&ED and 97 man-months of Analyst/Programmer Grade staff for project planning and coordination, system analysis and development, procurement and user acceptance tests.

Recurrent Expenditure

19. We estimate that the recurrent expenditure arising from the implementation of the proposal will remain at \$5.4 million per annum from 2019-20 onwards. Such requirements will be reflected in the Estimates of the relevant years, with breakdown as follows –

	2017-18	2018-19	2019-20 onwards
	\$'000	\$'000	\$'000
(a) Hardware maintenance	100	700	1,300
(b) Software maintenance	200	800	800
(c) On-going system support services	3,000	3,000	3,000
(d) Consumables and miscellaneous	300	300	300
Total	3,600	4,800	5,400

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20. On paragraph 19(a) above, the estimated annual expenditure of \$1.3 million is for the hardware maintenance services.

21. On paragraph 19(b) above, the estimated annual expenditure of \$0.8 million is for the maintenance services and licence fees of the computer software.

22. On paragraph 19(c) above, the estimated annual expenditure of \$3 million is for the hiring of contract staff to provide on-going system support and maintenance services.

23. On paragraph 19(d) above, the estimated annual expenditure of \$0.3 million is for the acquisition of consumables (such as backup tapes) and other miscellaneous items.

24. Taking into account the annual realisable savings of \$3.5 million mentioned in paragraph 10(a) above, the proposal will require a net increase in recurrent expenditure of \$1.3 million in 2018-19 and \$1.9 million per annum from 2019-20 onwards. The resources requirement will be reflected in the Estimates of the relevant years.

IMPLEMENTATION PLAN

25. We plan to implement the proposed DCS according to the following schedule –

Activity	Target completion date
(a) Project initiation and team formation	August 2014
(b) System analysis and design	February 2015
(c) Procurement and system development	March 2016
(d) User acceptance test	August 2016
(e) Training and system roll-out	November 2016

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PUBLIC CONSULTATION

26. In July and September 2013, C&ED consulted the trade (with some 1 700 DC licensees) about the proposal of e-licensing. Major stakeholders, including the Dutiable Commodities Customer Liaison Group^{Note}, in general support the proposal. No objection has been received. On 6 January 2014, we consulted the Legislative Council Panel on Financial Affairs on the proposed DCS. Members of the Panel in general supported the proposal.

BACKGROUND

27. In 2012, C&ED processed over 2 000 DC licence applications, 105 000 DC permit applications and 23 000 duty payments, with an estimated annual growth rate of 5%. The revenue collected for 2012-13 was \$8,977 million, which accounted for 3% of government revenue.

Financial Services and the Treasury Bureau
May 2014

^{Note} The Dutiable Commodities Customer Liaison Group comprises the Warehouses/Duty-free Shop Operators/Ship Stores Suppliers Sub-group, Hydrocarbon Oil Sub-group, Tobacco Sub-group and Liquor Sub-group.

Cost and Benefit Analysis for the Development of the Dutiable Commodities System

	Cash flow (\$ '000)						
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Cost							
Non-recurrent							
- Expenditure	2,770	10,650	15,180	4,400	-	-	33,000
- Staff cost	4,030	6,045	5,559	-	-	-	15,634
Sub-total	6,800	16,695	20,739	4,400	-	-	48,634
Recurrent							
- Expenditure	-	-	-	3,600	4,800	5,400	13,800
Sub-total	-	-	-	3,600	4,800	5,400	13,800
Total cost	6,800	16,695	20,739	8,000	4,800	5,400	62,434
Savings							
Recurrent							
- Realisable savings	-	-	-	3,540	3,540	3,540	10,620
- Notional savings	-	-	-	2,136	2,136	2,136	6,408
Total savings	-	-	-	5,676	5,676	5,676	17,028
Net savings	(6,800)	(16,695)	(20,739)	(2,324)	876	276	(45,406)
Net cumulative savings	(6,800)	(23,495)	(44,234)	(46,558)	(45,682)	(45,406)	-
