



GOVERNMENT RESPONSE TO THE ‘INDEPENDENT REVIEW OF THE IMPACT OF THE ILLEGAL LOGGING REGULATIONS ON SMALL BUSINESS’

The Government welcomes the findings of KPMG’s Report on the ‘*Independent review of the impacts of the illegal logging regulations on small business*’.

The Government is committed to combating the trade in illegally logged timber, which has significant environmental, economic and social costs on both a regional and global basis. In Australia, the trade in illegal timber disadvantages legitimate Australian businesses by undercutting market prices and threatening local investment, profitability and jobs.

The Government is also committed to creating an efficient regulatory framework and ensuring that its regulations do not burden Australian businesses any more than absolutely necessary.

AUSTRALIA’S ILLEGAL LOGGING LEGISLATION

Australia’s illegal logging legislative framework is broadly consistent with similar measures already in place in the European Union and the United States of America and that are being explored by other key timber trading nations.

The *Illegal Logging Prohibition Act 2012* (the Act) came into operation in November 2012. It makes it a criminal offence for a person or business to import a product containing timber, or to process a domestically grown raw log, that has been illegally logged. The Act is supported by the *Illegal Logging Prohibition Regulation 2012* (the Regulation), key elements of which commenced on 30 November 2014. The Regulation requires affected businesses to assess and manage the risk that the timber they are dealing with has been illegally logged. This is known as undertaking ‘due diligence’.

The due diligence requirements affect a wide range of Australian businesses, with approximately 17,200 importers and 460 domestic timber processors falling within the Regulation’s scope. A large percentage of these businesses are also likely to be small businesses (ie a business with an annual turn over of less than \$10 million per annum).

KEY FINDINGS

In its final report to the Government, KPMG found that

- nearly 60 per cent of businesses affected by the Regulation are likely to fall within the government’s definition of a small business, with these businesses responsible for importing around 20 per cent of regulated timber products¹ by value
- there is some preliminary evidence to suggest the Regulation may be helping to reduce the risk of illegally logged products entering Australia, but due to the early stage of the Regulation’s implementation much of the compliance work by Australian businesses is still ongoing
- while there is limited evidence to suggest that business size is a key determinant of risk, it is likely that Australian small businesses contribute at least their share of illegally logged product to the domestic market
- the Regulation’s current requirements are likely to encompass all sources of illegally logged timber entering Australia. However, they do not account for the varying capacity of individual businesses, particularly small businesses, to absorb the associated compliance burden
- there is an opportunity to amend the Regulation to strike a better balance between the cost of compliance to small business and the risk of illegal timber entering the Australian market

¹ Regulated timber products are listed in Schedule 1 of the *Illegal Logging Prohibition Regulation 2012*. They include a variety of products in the following tariff code chapters: 44 (wood and articles of wood), 47 (pulp of wood), 48 (paper and paperboard) and 94 (furniture).

- the Australian Government should progress a package of regulatory and non-regulatory reforms to minimise the cost of compliance to small businesses.

A copy of the KPMG Report can be found at: www.agriculture.gov.au/illegallogging/KPMG-Report

WAY FORWARD

In line with the recommendations made in the KPMG Report, the Government will progress a package of regulatory and non-regulatory reforms. These reforms will seek to minimise the cost to Australian businesses of complying with the Regulation, while also improving certainty within the businesses community as to what is expected of them when carrying out 'due diligence'.

While the KPMG Report specifically examined the potential impact of the Regulation on small businesses, the Government recognises that the due diligence requirements also affect medium and large sized businesses. This response has been developed in this broader context and the Government recognises that the measures it will take forward will have potential benefits for all regulated businesses, regardless of their size.

The Government's final decision on any changes to the regulatory arrangements will be informed through the preparation of a suitable Regulation Impact Statement (RIS). The RIS, which will be progressed by the Government in the first half of 2016, will be prepared in line with the requirements set out in 'The Australian Government Guide to Regulation' and consider the potential cost impact of the KPMG Report's regulatory recommendations. The RIS process will ensure that the Regulation strikes a suitable balance between reducing the risk of illegal timber entering Australia and the cost of compliance to Australian businesses.

The Government recognises that it will take some time to progress the RIS and implement any amendments to the Regulations. In light of this, and the need to promote a broader understanding of the due diligence requirements, the Government will extend its current 18 month 'soft -start' compliance period (currently scheduled to finish in May 2016) until any associated amendments are in place. During this 'soft-start' period, the Government will not issue penalties to a business if their due diligence practices are found to be non-compliant with the Regulation. However, if during this period the Government becomes aware of serious and deliberate breaches of the Act, it will pursue them.

For the purposes of this response a summarised version of the key points accompanying the KPMG Report's recommendations has been included in the boxed sections. This additional text has been included to provide some context for each recommendation.

The Australian Government's response to the KPMG Report's recommendations are as follows:

RECOMMENDATION 1 – Increase the individual consignment value threshold in the Regulation to \$10,000.

The Australian Government should increase the individual consignment value threshold in the Regulation to \$10,000. This will provide substantial savings in compliance costs by excluding a large number of businesses from needing to develop a due diligence system.

To mitigate the potential risk of businesses gaming the increased threshold (i.e. businesses splitting imports into consignments valued below the higher threshold), the Department of Agriculture and Water Resources should continue to monitor import activity over a three year period. Any evidence of a substantial increase in the 'splitting' of import consignments should feed into a review undertaken at this time.

The Department of Agriculture and Water Resources should also continue to develop its market intelligence to ascertain if there is any evidence that excluded businesses are likely to be importing higher risk products.

The Australian Government agrees in principle with this recommendation (subject to the outcomes of a RIS process).

The Government will, through a RIS process, test the utility of an increased \$10,000 individual consignment value threshold, as well as higher and lower alternative threshold levels.

The Government recognises that increasing the threshold (currently \$1,000) will not only assist small businesses, but also assist some medium and larger businesses who import regulated timber products in small quantities by excluding some, or all, of their consignments from the Regulation's scope.

The Government accepts that should there be a change to the consignment value threshold, there will be a need to monitor the potential impact of the change on import practices.

The Government also accepts KPMG's recommendation that the Department of Agriculture and Water Resources, and other relevant Commonwealth agencies, should continue to develop their understanding of the market for illegally logged timber, including the potential risks associated with certain timber products and supply chains.

RECOMMENDATION 2 – Establish simplified 'deemed to comply' arrangements in the Regulation.

The Australian Government should establish simplified 'deemed to comply' arrangements in the Regulation. Regulated timber imports and domestically grown raw logs that are supplied by suitably certified suppliers or have all of the necessary documentation required by a relevant Country or State Specific Guideline should not be subject to additional due diligence requirements.

The additional information and risk assessment requirements included in the Regulations for these products adds costs without commensurate benefits.

The Australian Government agrees in principle with this recommendation (subject to the outcomes of a RIS process).

The Government recognises that Timber Legality Frameworks (TLF), Country Specific Guidelines (CSGs) and State Specific Guidelines (SSGs) were included in the Regulation to provide regulated businesses with a robust and streamlined way of satisfying the due diligence obligations. The Government believes that the Regulation in its current form does not accurately reflect this intent and that improvements can be made to make it clear that parties who successfully apply these systems are 'deemed to comply' with the Regulation.

As part of the associated RIS process, the Government will progress options for the simplification of the Regulation to provide a more clearly defined 'deemed to comply' TLF, CSG or SSG pathway for businesses and to remove any additional obligations to undertake any un-necessary information gathering and risk assessment processes.

As highlighted in the response to Recommendation 4 (see below), the Government intends to work with key trading partners to develop additional CSGs. This will broaden the number of countries who have such arrangements in place and will increase the number of businesses who will have access to a simplified due diligence process.

RECOMMENDATION 3 – Undertake voluntary compliance assessments that assess an individual business's compliance with the Regulation.

The Australian Government should undertake voluntary on-site compliance assessments that assess an individual business's compliance with the Regulations. This would allow regulated businesses to participate in a process of voluntary assessment, without penalty, during the 18 month transition period following the commencement of the Regulation on 30 November 2014. This would partially address the concerns expressed by businesses regarding whether or not their efforts meet the Regulation's requirements.

To communicate this information to the broader regulated community, it would be critical that de-identified information on practical approaches to due diligence identified through the voluntary assessments is published.

The Australian Government agrees with this recommendation.

The Government recognises some businesses have expressed uncertainty about their due diligence obligations and whether their systems meet the Regulation's requirements. It also appreciates the potential benefits of allowing businesses to self-nominate for a compliance assessment, where no penalties are applied for non-compliance. The Department of Agriculture and Water Resources has already included a voluntary component within its monitoring and compliance framework and has worked with several businesses to provide voluntary compliance assessments.

The Government notes KPMG recommends that these voluntary assessments should be subject to an annual quota. The Government does not agree with this approach, instead believing the annual number of voluntary compliance assessments should be driven by industry demand. The number of voluntary assessments will also need to be balanced against available government resources.

KPMG also notes within its recommendation the need to undertake 'on-site' compliance assessments. As the process is largely a document-based exercise, it is likely to be more efficient and effective to conduct desktop-based compliance assessments. On-site assessments may be best considered on a case-by-case basis, taking into consideration the availability of suitable resources and the circumstances of the business involved with the assessment.

Since March 2015, the Department of Agriculture and Water Resources has been contacting a range of regulated businesses to assess their compliance with the due diligence requirements. The insights collected through these assessments will be used to develop further education and guidance materials.

In developing the new guidance materials, the Department of Agriculture and Water Resources will draw on lessons taken from both voluntary and targeted compliance assessments. The materials will also seek to draw on experiences taken from a range of regulated businesses (including both large and small businesses) and cover issues that are relevant to a large percentage of the regulated community.

RECOMMENDATION 4 – Fast track the development of additional country specific guidelines

The Australian Government should fast track the development of additional country specific guidelines. This would offer businesses increased guidance around what is expected of them or considered 'reasonably practical' in gathering information from suppliers located in key trading partner nations.

The countries that the Australian Government should focus its efforts on include China (the highest priority), the United State of America, Thailand, Germany, South Korea and any 'higher risk' country that is keen to expedite a guideline.

The Australian Government agrees with this recommendation.

The Government recognises the importance of CSGs and SSGs in helping businesses to undertake their due diligence. This is reflected in the significant resources that have been invested into this process, resulting in CSGs being published for Malaysia, Indonesia, New Zealand, Italy, Canada, Solomon Islands and Finland. Together these seven countries historically account for around 32 per cent of Australia's total imports of regulated timber products. SSGs have also been published for New South Wales, Victoria, Queensland, Tasmania, South Australia and Western Australia.

The Government notes that the CSGs are co-developed with Australia's trading partners. While the Government can seek to fast track their development, the completion of these documents is reliant on the individual interests and priorities of Australia's trading partners. The Australian Government continues to work with our trading partners to develop new CSGs where there is an interest and an identified benefit to do so.

China is a key trading partner and the Government is already working with officials from the Chinese Government to develop a suitable CSG document. It is also working with Papua New Guinea, Chile, South Korea, Thailand and Vietnam to develop or progress similar documents. Once finalised, the CSGs will cover approximately 80 per cent of Australia's imports of regulated timber products.

The Government has had, and will continue to have, discussions with the United States of America and Germany about the development of relevant CSGs for these countries.

RECOMMENDATION 5 – Fund the development of better and more targeted guidance or training workshops.

The Australian Government should fund the development of better and more targeted guidance or training workshops.

The Australian Government agrees with this recommendation.

The Government recognises there is benefit in continuing to work with industry associations and the regulated community to develop targeted due diligence guidance materials. These materials will seek to improve the regulated community's awareness of the due diligence requirements and improve their understanding of what is expected of them in complying with the legislation.

As noted in the response to Recommendation 3, the Department of Agriculture and Water Resources intends to draw on the insights and lessons collected through the compliance assessment process to develop further education and guidance materials.

The Government also sees merit in continuing to work with industry associations to identify opportunities to deliver training and information sessions to businesses and their customs service providers. The Department of Agriculture and Water Resources will pursue opportunities to partner with relevant industry associations to further develop and deliver these materials.

OTHER ISSUES/OPTIONS RAISED IN THE KPMG REPORT

1) EXCLUDED OPTIONS

Five of the ten recommendations considered in the KPMG Report were assessed as not providing an overall 'net benefit'. As a result they were not recommended for further action. Table 31 on pages 105 and 106 of the KPMG Report outlines the key reasons for not pursuing these options.

These options included:

- *applying a \$75,000 annual importer value threshold;*
- *removing specific timber and wood-based products from the scope of the Regulation;*
- *developing a generic Country/State specific guideline;*
- *introducing a general exemption for small businesses;*
- *repealing the Regulation and relying on the act alone.*

The Australian Government notes KPMG's independent assessment that the excluded options are not viable and should not be progressed further at this time.

The Government believes that the KPMG Report provides a suitable assessment of the available options and accepts that not all of these options provide an overall 'net benefit'. In such a circumstance, the Government will not pursue these options as part of the associated RIS process.

Under section 84 of the *Illegal Logging Prohibition Act 2012*, a comprehensive review of the operation of the Act and supporting Regulation will be undertaken by the Government in late 2017.

The Government will use the statutory review to revisit all elements of the legislation and will draw on data collected from the first five years of the operation of the Act. This will ensure that any long term decisions on the future of the legislation are informed by a suitably robust and mature data set.

2) THE COST OF COMPLIANCE

To develop indicative estimates of the one-off and ongoing compliance costs that are associated with the Regulation, the KPMG Report drew upon a relatively small, albeit informed sample of regulated businesses.

While this creates limitations in interpreting the data gathered, the analysis represents the most comprehensive assessment of likely compliance costs to date.

The aggregated estimates provided by KPMG suggest the 'one-off' cost of compliance is likely to lie between \$20.2 to \$56.3 million and 'ongoing' costs of \$1.7 to \$15.6 million.

The significant difference between the two figures demonstrates the uncertainty that exists around the costs of complying with the Regulation and some of the challenges of trying to assess the cost at such an early stage of the Regulation's implementation.

The Government will continue to review and assess estimates of the costs of complying with the laws.

3) AUSTRALIA'S EXPOSURE TO THE ILLEGAL TRADE

The KPMG Report highlighted while there is extensive published literature on the possible nature and extent of illegal logging, it is not without criticism or challenge. They noted that these challenges appeared to be most acute when estimating Australia's share of the problem and would continue to pose challenges for the Government in trying to assess the impact of its illegal logging policies.

The Government recognises that any assessment of whether the Regulation strikes a suitable balance needs to be informed by robust data on Australia's exposure to the illegal timber trade.

In the lead up to the 2017 statutory review, the Government will consider additional work to develop a more comprehensive understanding of Australia's exposure to the illegal trade.