



cutting through complexity

Independent Review of the impact of the illegal logging regulations on small business

Department of Agriculture

28 March 2015

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Senator the Hon. Richard Colbeck

Parliamentary Secretary to the Minister for Agriculture
Senate
Parliament House
Canberra ACT 2600

28 March 2015

Dear Senator,

Independent Review of the impact of the illegal logging regulations on small business

We were engaged to provide an independent review of the impact of the illegal logging regulations over the ten weeks from 22 January 2015 to 28 March 2015.

Scope of work

Our work has been performed in accordance with the terms of reference of the review that you, the Minister for Small Business, and then Parliamentary Secretary to the Prime Minister jointly announced on 1 December 2014, and the scope of work outlined in our proposal to your Department dated 18 December 2014.

Information

In undertaking our work we had access to information provided by your Department, ABARES and the ABS, stakeholder organisations, businesses whom we interviewed, and publicly available sources. We have indicated in this report the sources of the information presented, but have not independently validated or audited information provided to us. We have not undertaken to update this report for events or circumstances arising after 28 March 2015.

Acknowledgements

It would not have been possible to undertake such a short and sharp review without a high degree of cooperation from those businesses we interviewed, other stakeholder organisations, and your own Department. We would like to acknowledge their contribution to delivering this review under tight timelines.

Distribution

We understand that this report has been prepared only for the purpose of informing the deliberations of Government, and may be publicly released to assist this process, but has not been provided for the use of other parties or for any other purpose. We trust that this independent review will assist you and your colleagues' deliberations.

Yours sincerely,

Brendan Rynne
Partner

Simon Corden
Director

Acronyms and definitions

<i>ABARES</i>	Australian Bureau of Agricultural and Resource Economics and Sciences
<i>ABS</i>	Australian Bureau of Statistics
<i>AEF</i>	Australian Environment Foundation
<i>ASEAN</i>	Association of Southeast Asian Nations
<i>ATIF</i>	Australian Timber Importers Federation
<i>APEC</i>	Asia-Pacific Economic Cooperation
<i>Broker</i>	A professional agent that acts as a conduit between source country suppliers and Australian importers
<i>Consignment</i>	Generally defined as arriving goods from the same consignor for one consignee that arrived in Australia on the same ship/aircraft, and are part of the same order.
<i>CIE</i>	Centre of International Economics
<i>CITES</i>	Convention on International Trade in Endangered Species of Wild Flora and Fauna
<i>CPQ</i>	Community Protection Question
<i>CSG</i>	Country Specific Guidelines
<i>Department</i>	Commonwealth Department of Agriculture
<i>EU</i>	European Union
<i>EUTR</i>	European Union Timber Regulation
<i>FLEGT</i>	Forest Law Enforcement Governance and Trade
<i>FSA</i>	Financial Service Authority (United Kingdom)
<i>FSC</i>	Forest Stewardship Council
<i>FWPA</i>	Forest and Wood Products Australia
<i>Higher risk country</i>	As defined by the ATIF toolkit - a country with a Corruption Perception Index rating less than 50 or at any stage of VPA negotiations with EU and/or that has known armed conflict
<i>Importer</i>	A business or individual that imports timber products
<i>ICS Data</i>	Integrated Cargo System Data is information supplied to the Australian Customs and Border Protection Service regarding cargo imported and exported.
<i>Medium to large business</i>	Business with turnover in excess of \$10 million
<i>Micro business</i>	Business with a turnover of under \$2 million
<i>NMO</i>	National Measurement Office (United Kingdom)
<i>No data</i>	Refers to importers where ABS were unable to identify either business size or annual turnover
<i>NPW Act</i>	National Parks and Wildlife Act

<i>PEFC</i>	The Programme for Endorsement of Forest Certifications
<i>PNGFIA</i>	Papua New Guinea Forest Industries Association
<i>Processor</i>	A business that processes raw logs into other forms/products
<i>Product chapter</i>	Tariff codes consistent with Schedule 3 of the Customs Tariff Act 1995. This is inclusive of products within product chapter 44 (wood articles), 47 (pulp), 48 (paper) and 94 (furniture) ¹
<i>Product line</i>	Each individual product of good within a consignment
<i>RAFT</i>	Responsible Asia Forestry and Trade; a partnership of countries including Australia providing funding sustainable forestry initiatives
<i>Review</i>	<i>Independent Review of the impact of the illegal logging regulations on small business</i>
<i>RH PNG</i>	Rimbunan Hijau Papua New Guinea
<i>RIS</i>	Regulation Impact Statement
<i>Small business</i>	Refers to a business with turnover over \$2 million but under \$10 million ²
<i>SSG</i>	State Specific Guidelines
<i>SVLK</i>	Sistem Verifikasi Legalitas Kayu
<i>TDA</i>	Timber Development Association
<i>The Act</i>	<i>Illegal Logging Prohibition Act 2012</i>
<i>The Regulations</i>	<i>Illegal Logging Prohibition Regulation 2012. The Illegal Logging Prohibition Amendment Regulation 2013 introduced the definition of regulated timber, the due diligence requirements, and the treatment of timber legality frameworks and Country/State Specific Guidelines and was subsequently consolidated into the 2012 Regulation.</i>
<i>The regulated community</i>	All businesses (both importers and processors) and individuals subject to the Regulations
<i>TLF</i>	Timber Legality Framework
<i>US</i>	United States of America
<i>USD</i>	United States of America Dollars (all dollar values not prefixed by USD are in Australian dollars)
<i>VPA</i>	Voluntary Partnership Agreement
<i>WHS Act</i>	Work Health and Safety Act
<i>WTO</i>	World Trade Organisation

¹ Applicability of the Act and Regulations to chapter 94 has exceptions for some furniture and prefabricated buildings.

² For the 'Options Assessment' and 'Recommendations' components of this report, small business includes micro business and thus refers to any business with a turnover of less than \$10 million. This is a result of confidentiality issues present within ABARES analysis.

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Executive Summary

This report represents the outcome of an independent Review, commissioned by the Department of Agriculture, to investigate the impact of the *Illegal Logging Prohibition Regulation 2012* (the Regulations) on small business (the Review).

Context for this Review

The Australian Government is committed to combatting the trade of illegally logged timber, which it describes as 'the most significant (by value) environmental crime in the world'.³ Estimates of the global cost of illegal logging vary but one estimate suggested the economic costs could amount to between US\$30 and US\$100 billion annually, or 10–30 per cent of global wood trade.⁴ Another estimate suggested it could comprise:

- Economic costs of approximately USD\$46 billion per annum (losses to producers of legal products in source and destination countries); and
- Social and environmental costs of approximately USD\$60 billion per annum (such as greenhouse gas emissions, wasted resources, loss of ecosystems, and impact on local communities).⁵

While Australia's share of this global cost is an uncertain and contentious issue, the estimates available suggest the problem is significant, with around 9 per cent of timber imports thought to be illegally logged.⁶ The scale of the problem is further supported by the substantial proportion of Australian timber imports sourced from countries considered to be of higher risk.

The Australian Government's commitment to addressing this problem is demonstrated by the *Illegal Logging Prohibition Act 2012* (which commenced in November 2012), and the *Illegal Logging Prohibition Amendment Regulation 2013* (which commenced in November 2014). The regulatory approach adopted is broadly consistent with measures already in place in the European Union (EU) and the United States of America (US), with Australian timber importers and processors required to assess and manage the risk that their timber has been illegally logged.

The current Regulations are broad in their coverage, applying to all businesses importing regulated products (wood articles, pulp products, paper products and furniture), where

³ Senator Richard Colbeck (undated), "Our plan to combat illegal logging" Accessed 10 March 2015 at <http://www.richardcolbeck.com.au/home_page_sub_articles/our_plan_to_combat_illegal_logging>

⁴ Nellemann, C., INTERPOL Environmental Crime Programme (eds). (2012), *Green Carbon, Black Trade: Illegal Logging, Tax Fraud and Laundering in the World's Tropical Forests*. A Rapid Response Assessment. United Nations Environment Programme, GRIDArendal Accessed 25 March 2015 at <<http://www.grida.no/publications/rr/green-carbon-black-trade/>>

⁵ Centre of International Economics (2010), *A Final Report to inform a Regulation Impact Statement for the proposed new policy on illegally logged timber*, p. 60.

⁶ Pöyry (2005), 'Overview of Illegal Logging', p.12. Accessed on 2 March 2015 at <http://www.agriculture.gov.au/SiteCollectionDocuments/forestry/international/illegal-logging/illegal_logging_report.pdf>

the combined value of the product within a consignment exceeds \$1,000, and all processors of raw logs.

Given it is now understood that each year more than 17,000 businesses are likely to be subject to the requirements of the new Regulations, it is appropriate within the context of the Government's broader deregulation agenda to investigate further whether the current arrangements are achieving an appropriate balance between the cost of compliance for small businesses, and effectiveness in reducing the risk of illegally logged timber entering Australia and/or being processed by domestic processors.

While the Review sought to engage with businesses and their representative bodies in the processor sector, there was very limited engagement from these businesses compared to importers, which is likely reflective of the absolute number of businesses in each sector. It was very clear that most of the focus should be devoted to the issues around import arrangements that affect timber and timber products, recognising that the impact of any changes to importing arrangements on the domestic sector would need to be carefully considered.

The role of small business in the regulated community

The Review's first terms of reference asked to develop a better understanding of the role played by small business within the 'regulated community' (Appendix A).

A 2013 ABARES report, which was based on 2012 data, indicated 17,254 importers and 468 processors would have been within the scope of the Regulations for that year.⁷ A breakdown of the importer figure by size is provided below.

Table 1 – The regulated community

Annual turnover	Number of businesses		Value of imported product	
	Number	Percentage	Value (\$m)	Percentage
Micro (\$0 - \$2m)	6,633	38%	344	6%
Small (\$2m - \$10m)	3,426	20%	731	13%
Medium and Large (\$10m+)	3,108	18%	4,444	77%
No data ⁸	4,087	24%	126	2%
Total	17,254	100%	5,784	100%

Source: ABARES analysis of ABS data set

This data indicates that nearly 60 per cent of regulated businesses would be classified as 'micro' or 'small', with these business responsible for importing only around 20 per cent of the regulated product by value. The disproportionate share of micro and small businesses within the regulated community is likely to be even higher, with a large

⁷ Gupta, M. and Hug, B. (2013), *Illegal logging regulation: the affected community*, ABARES, report to client prepared for the Department of Agriculture, Canberra, November. CC BY 3.0.

⁸ As not all businesses provide turnover data to the ABS, they were not able to data match all imports to businesses of known turnover. This figure also includes individuals and overseas companies, and so overestimates the number of Australian businesses covered by the Regulations. ABARES analysis indicated that approximately 38 per cent (1,554) of this cohort, in 2012, represented Australian businesses that would have fallen above the \$1,000 individual consignment threshold.

proportion of those businesses where size is unknown (i.e. 'no data') likely to be of smaller scale (based on their share of imported product and the majority of this cohort only importing one consignment in 2012).

Further analysis of this data by product code and source country provides the following insights:

- Compared to medium and large businesses, a higher proportion of micro and small businesses imported wood and/or furniture products, with a smaller proportion importing paper products;
- By value, micro and small businesses (19 per cent of product value) import a disproportionately high share of furniture products (27 per cent), and smaller share of paper products (11 per cent);

Most importers brought in less than \$75,000 in total consignments of regulated timber products in 2012. In understanding the role of small business, it is useful to distinguish between those which have substantial businesses involving timber products, and those where these products may only be a small part of their business. Under existing Regulations, approximately 10,000 micro and small businesses are captured by the \$1,000 individual consignment threshold. If this were to be replaced by a \$75,000 annual importer value threshold, approximately 8,000 fewer micro and small businesses would be required to comply with due diligence requirements. Among medium and large businesses that imported regulated timber products in 2012, approximately 3,100 would have fallen above the \$1,000 individual consignment threshold. Replacing this with a \$75,000 annual importer value threshold would see this number reduce by approximately 2,000.

This data provides new insight as to the structure and composition of the regulated community. It demonstrates that imported regulated timber products are disproportionately brought into Australia by medium and large businesses, with only a very small proportion of timber imports attributable to micro and small businesses.

Reducing the entry of illegally logged products

The Review's second terms of reference asked to assess whether the Regulation will make a material difference to reducing the entry of illegally logged timber products on the Australian market.

The Review identified some evidence that the Regulations, in their current form, are already contributing to reducing the risk of illegally logged products from entering Australia, but the timing of this Review means much of the substantive compliance work by Australian businesses is ongoing.

Specifically, the Review identified the following evidence as to the knowledge of, and effectiveness of the Regulations to date:

- Importers responded "Yes" to the Community Protection Question (CPQ) for 77 per cent of regulated product lines entering Australia;
- 14 per cent of businesses interviewed have limited, if any familiarity with the Regulations, and are yet to undertake any due diligence activities;

- 36 per cent of businesses interviewed have a high degree of familiarity with the Regulations, but have assessed their current due diligence processes as inadequate; and
- Of the 65 businesses interviewed, seven have changed suppliers as a result of the new requirements, and one has stopped importing a particular product.

The Regulations are intended to reduce market demand for the products of those suppliers who are unable to demonstrate there is a low risk that they are providing illegally logged timber products. The Responsible Asia Forestry and Trade (RAFT) partnership argues that the more stable the demand for verified legal products from countries such as Australia, the more suppliers will invest in assurance, resulting in an increase in supply of credibly verified legal wood and paper products, including from responsible suppliers in higher risk countries. However, this implies that it will take time for the implementation of the Regulations to drive substantive changes in supplier countries.

The Regulations in their current form take a comprehensive approach to reducing the risk of illegally logged timber entering Australia. This approach means that almost all timber products are within the scope of the Regulations, and it is thus likely to encompass all illegally logged timber that might be brought into Australia. However this creates practical issues in enforcing the requirements across a large and diverse regulated community. It also means that while requirements might be considered equitable across the regulated community, the capacity of businesses to absorb the compliance burden may vary (e.g. micro and small businesses).

In considering options for a more targeted regulatory approach, it is important to understand the factors likely to contribute to the risk of imported products being a result of illegal logging activity. These risk factors are contentious, but are broadly understood to include:

- the source country for the imported product, with some countries known to contribute more to the global market for illegally logged products;
- the product code, with furniture and pulp believed to be at higher risk of containing illegally logged product; and
- the supply chain for a particular product, with greater complexity and variation in suppliers creating practical issues for businesses in undertaking appropriate due diligence.

While there is limited evidence to suggest that business size is a determinant of risk, there is a perception among stakeholders that micro and small businesses are more likely to be highly price sensitive and have less developed due diligence systems and processes in place. Combined with quantitative data that shows micro and small businesses import a relatively higher proportion of furniture products, the Review concludes it is likely that these businesses contribute at least their share of illegally logged product to the Australian market.

Therefore, while it could be argued that the Regulations in their current form may not be a practical and equitable means to achieving the regulatory objectives, there is clearly

scope for further analysis of factors contributing to the risk of illegally logged product entering Australia.

The Review has concluded that it is not possible at this stage to assess whether applying the Regulations in their current form will make a material difference in reducing the entry of illegal logged timber products. This is partly due to implementation in Australia only being at a very early stage, and so it is not feasible to predict how Australian and international market participants will ultimately respond to the Australian Regulations. But as importantly, it is difficult to assess the Regulations' ultimate impact as this will be affected by the effectiveness of a wide range of complementary measures, including the implementation of European Union, United States of America, and other international initiatives that will affect trade, as well as a wide range of initiatives to improve enforcement in the higher risk source countries, many of which are also at an early stage of implementation. Given that these measures are intended to change market behaviour by a variety of participants, even when fully implemented it may not be feasible to isolate the impact of any one measure, including those undertaken by Australia.

Appropriateness of balance between compliance costs and risk mitigation

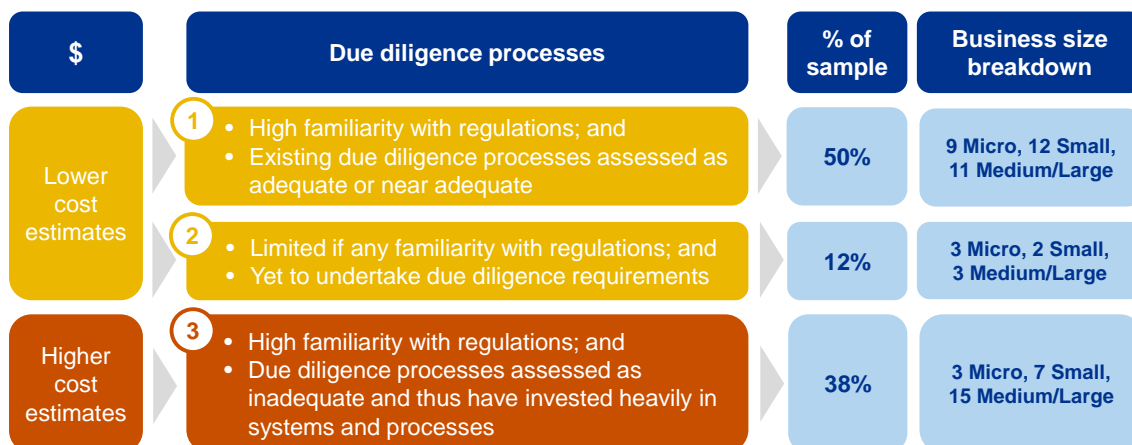
The Review's third terms of reference asked to assess whether the existing due diligence requirements achieve an appropriate balance between the cost of compliance and reducing the risk of illegally logged timber entering into the Australian market.

To develop indicative estimates of the one-off and ongoing compliance costs that would be associated with the Regulations as compliance activities increase across the industry, the Review drew upon a relatively small, albeit informed sample of regulated businesses. While this creates limitations in extrapolating and interpreting the data gathered, the analysis represents the most comprehensive assessment of likely business compliance costs to date.

In total 351 regulated business were invited to participate in the business interviews, with 65 businesses agreeing to participate. Businesses were primarily identified from live Customs data or through industry associations, with representation across different business sizes and product chapters sought in the interview sample.

The diagram below summarises the three categories that businesses were placed in based on their cost estimates and answers to qualitative questions.⁹

⁹ *Higher* cost estimates is a relative sample term, and does not necessarily indicate *High* costs. For the sample, higher cost estimates were defined as either a) more than 40 hours spent on either one-off or ongoing annual costs or b) combined one-off and one years' worth of ongoing costs of more than 90 hours.



These categories were used to better understand the median cost estimates derived from the business interviews. It is expected that over time, businesses in the second category (lower costs and low familiarity) will move into the third category as familiarity with the need to comply with the Regulations increases throughout the regulated community. As these businesses are made aware of the Regulations, or obtain a greater understanding of what is required of them, their costs are likely to increase as they place additional effort into due diligence activities.

As businesses in category one are already familiar with the Regulations and believe they are meeting the requirements at a low cost, the only scenario in which members of this category would transition to another category would be if their efforts are reviewed through a compliance assessment and deemed not to comply. Amending their due diligence systems could see such a business transition to category three, either temporarily or permanently.

The table below summarises the aggregated indicative estimates of one-off and ongoing compliance costs derived from the business interviews. These are based on the median time estimates provided by two types of businesses: businesses that were confident of their time spent on compliance and thus 'estimates were provided'; and the sub-set of those businesses who stated they had a 'high familiarity' of the Regulations.

Table 2 – Indicative compliance costs by business size

Annual turnover	Estimated one-off compliance costs (\$m)	Estimated ongoing compliance costs (\$m)
\$0 - \$2 million	1.2 – not available	not available
\$2 million - \$10 million	2.7 - 19.1	0.0 – 8.2
Over \$10 million	16.3 - 37.2	1.7 – 7.4
Total	20.2 – 56.3	1.7 – 15.6

Considering only businesses that were able to confidently provide time cost estimates, the industry one-off time costs were estimated to likely be in the order of \$20 million, with annual ongoing time costs estimated to be in the order of \$2 million per annum.

Considering only businesses that claimed to have a high familiarity of the Regulations, the industry one-off time costs were estimated to be in the order of \$56 million and the

industry annual ongoing time costs were estimated to be in the order of \$16 million per annum.

Comparing the estimates of these two sample segments suggests that as businesses become more familiar with the Regulations, they will recognise the need to increase their efforts towards due diligence activities.

With the enhanced understanding of the nature of compliance costs based on the Review's business interviews and new ABARES analysis of import data by business size, it was possible to examine the impact of two key threshold design elements in the Regulations to inform an assessment of whether the current arrangements achieve an appropriate balance between the costs of compliance for small business, and reducing the risk of illegally logged timber entering the Australian market.

The two design elements examined were the decision to apply the Regulations to all import consignments of \$1,000 or more (rather than adopt a higher threshold), and the decision not to restrict the Regulations to businesses importing more than a specified value of imports per annum.

The Review has concluded that existing application of the due diligence arrangements is not appropriate, as it is not sufficiently targeted. For example, based on analysis of the 2012 import data, the adoption of a \$10,000 rather than, for example, a \$1,000 threshold excludes \$262 million of imports (or 4.6 per cent) from the due diligence requirements. However, it would appear that the \$10,000 threshold (rather than \$1,000) leads to 5,500 fewer micro and small businesses being subject to the regulation¹⁰. Each of these excluded micro and small businesses imported on average only \$20,600 annually in timber products. The analysis of the impact of applying the due diligence requirements to all importing businesses irrespective of their annual volumes also highlighted the issues with targeting of the current arrangements.

Assessment of options to reduce the impact of the Regulations

The Review's fourth terms of reference asked to assess options to reduce the regulatory impacts of the due diligence requirements on small business, having regard to Australia's international trade obligations. The Regulations apply to both importers and domestic processors, but during the course of the Review the processors sector did not raise any substantive issues or concerns, and so the effort was targeted at the import sector.

Ten regulatory and non-regulatory reform options were identified and assessed against four criteria:

Regulatory cost to business – the number and size of the businesses impacted by the Regulations, the administrative costs associated with compliance, and the distribution of those costs across the regulated community;

¹⁰ This estimate excludes any micro or small businesses that may be present in the 'no data' group.

Coverage – the products covered by the requirements, their value and the source country;

Practicality – government implementation efficiency and cost, and monitoring and enforcement practicality; and

Consistency – consistency of application across business types, alignment with other international schemes and consistency with Australia's WTO obligations.¹¹

These criteria were developed and refined through the Review process and are intended to support the identification of the options offering the greatest net benefit.

While all regulatory options provide a benefit in terms of reducing regulatory costs, this needs to be balanced against a negative assessment against one or more of the other criteria. All non-regulatory options were assessed to have either a positive impact or no impact against all criteria. These are not mutually exclusive options and are all relevant considerations for Government in determining how to reduce the impact of the Regulations.

Recommendations

Based on the analysis undertaken through the Review, it is recommended that Government:

Increase the individual consignment value threshold in the Regulations to \$10,000.

This will provide substantial immediate savings in compliance costs by excluding a large number of businesses from the need to develop a due diligence system, although it will be accompanied by some reduction in total regulated value (approximately 4.6 per cent based on 2012 data) and some risk that the businesses excluded are more likely to trade in higher risk products. To mitigate the additional risk of gaming (i.e. businesses splitting imports into consignments valued below the higher threshold), the Department should monitor activity over a three year period, with evidence of any substantial increase in apparent splitting of import consignments used as an input to a review undertaken at this time. It should also develop its market intelligence to ascertain if there is any solid evidence that excluded businesses are likely to be involved in substantial trade in higher risk products, noting that these businesses will still be subject to the criminal provisions of the Act if they import illegally logged timber.

Establish simplified 'deemed to comply' arrangements by regulation. Imports and domestic timber that are supplied by certified suppliers or have the documentation required by Country or State Specific Guidelines should not be subject to additional due diligence requirements. The additional information and risk assessment currently required by the Regulations for these products adds costs without commensurate benefits.

¹¹ While WTO issues were considered, it was not possible for the Review to reach a firm view on the WTO-consistency of each option. The Review recognises that the Government may need to commission legal advice to support their deliberations.

Undertake voluntary compliance assessments that assess an individual business's compliance with the Regulations. This would involve a process of voluntary assessment, without penalty, over the 18 month transition period, which would partially address the concern of businesses regarding whether or not their efforts meet the requirements of the Regulations. To communicate this information to the regulated community, it would be critical that de-identified information on the practical approaches identified to compliance through the voluntary compliance assessments were published.

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'. Focus countries should 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.

Fund the development of better and more targeted guidance or training workshops. This is another non-regulatory approach aimed at increasing the quantity and quality of information available to businesses.

Any related matters

The Review's fifth terms of reference asked it to consider any related matters. The Review has captured matters raised that were not directly relevant to the Regulations, for example, those raising issues regarding the Act, and reported them in section 8 of this report.

1 Introduction

The Australian Government commissioned KPMG to conduct an independent review of the impact of the illegal logging Regulations on small business (the Review).¹² The Australian Government's commitment to combating trade in illegally logged timber is outlined in the *Illegal Logging Prohibition Act 2012* (the Act). The Government's commitment to an efficient regulatory framework was also highlighted in the joint ministerial media release announcing the Review.¹³

1.1 Scope of the Review

The scope of the Review is focused on how the *Illegal Logging Prohibition Regulation 2012* (the Regulations) can support the outcomes of the Act at the least cost possible. The key elements of the Review include:¹⁴

- A better understanding of the role played by small businesses within the 'regulated community'. This will include further detailing small businesses affected by the new requirements, the type and nature of the timber products they are dealing with, and their potential costs in complying with the new requirements.
- An assessment of whether applying the Regulations in their current form to small business will make a material difference in reducing the entry of illegally logged timber products onto the Australian market.
- An assessment of whether the existing due diligence requirements achieve an appropriate balance between the cost of compliance for small businesses and reducing the risk of illegally logged timber entering into the Australian market. Achieving an appropriate balance should have regard to broader global regulatory trends in combating illegal logging, Australia's international commitments and obligations and other economic considerations.
- If the balance is not considered to be appropriate, an assessment of, and recommendations on, appropriate options for reducing or removing the regulatory impacts of the due diligence requirements on small business, having regards to Australia's international trade obligations.
- Any related matters.

While important context, given that the focus is on the operation of the Regulations, the Review has not re-examined the wider policy rationale for Australia's response to

¹² Department of Agriculture (2014). 'Independent review of the impact of the illegal logging regulations on small business – Terms of Reference. The media release and terms of reference of the Review are in Appendix A of this report.

¹³ Billson (2014), Media Release, Taking care of small business a priority for logging review (1 December), Joint Media Release by Senator the Hon. Richard Colbeck, Parliamentary Secretary to the Minister for Agriculture; The Hon. Bruce Billson MP, Minister for Small Business and The Hon. Josh Frydenberg MP, Parliamentary Secretary to the Prime Minister.

¹⁴ Department of Agriculture (2014). 'Independent review of the impact of the illegal logging regulations on small business – Terms of Reference'.

address the problems associated with illegally logged timber or the key elements outlined in the *Illegal Logging Prohibition Act 2012*. For example, the Review has not assessed or made any findings in relation to the definition of illegally logged timber or the penalties outlined in the Act.

During the course of the consultation process, a number of issues that were out-of-scope were raised. The Review recognises that many stakeholders consider that these are substantial matters. While the Review did not analyse or make any recommendations in relation to these matters, for the purposes of transparency and completeness, a summary of these issues is outlined in section 8.

1.1.1 Definition of a small business

The joint media release announcing the Review defined small business as those businesses with an income of up to \$10 million per annum.¹⁵ The joint media release went on to state that the Review would examine the impacts of the Regulations on both micro and small businesses.

To meet these requirements, the Review has sought where possible to examine the impacts of the Regulations on businesses with an annual income of between \$0 to \$2 million (micro business), \$2 million to \$10 million (small businesses) and greater than \$10 million (medium and large business).

1.2 Approach

KPMG's approach to complete the Review included the following key stages:

Inception and literature review - this stage involved reviewing available existing literature regarding the broader problem of illegal logging and the European Union and United States of America's approach to addressing this issue which supported the design of the Australian Government's policy response. During this stage, the Review also completed preliminary consultations with selected key stakeholders as identified by the Government, including industry associations, environmental groups and other industry stakeholders.

Regulatory mapping - as outlined in the Terms of Reference, the Review's focus is on the Regulations and what businesses are doing in order to comply with the due diligence requirements. The regulatory mapping stage allowed the Review to develop a detailed understanding of the operational aspect of the Regulations and enabled the development of the business questionnaire that formed the basis of the discussions with impacted businesses.

Stakeholder engagement - the core element of the Review's stakeholder engagement strategy was structured interviews with impacted businesses. The business interviews gathered detailed information on the impacts of the Regulations as well as identifying

¹⁵ Billson (2014), Media Release, Taking care of small business a priority for logging review (1 December), Joint Media Release by Senator the Hon. Richard Colbeck, Parliamentary Secretary to the Minister for Agriculture; The Hon. Bruce Billson MP, Minister for Small Business and The Hon. Josh Frydenberg MP, Parliamentary Secretary to the Prime Minister. The media release and terms of reference of the Review are in Appendix A of this report.

potential reform options. The interviews were completed on a confidential basis, with only aggregated, de-identified information presented in the Review. The stakeholder engagement stage also included a series of feedback workshops to test the findings from the interviews and to gather additional insights from business groups and other stakeholders on reform options. An overview of the number of businesses approached to participate in the Review and those interviewed is outlined in section 4.

Analysis – this stage combined the findings from the stakeholder consultations with the detailed analysis of the regulated community developed by the Australian Bureau of Agricultural Resource Economics and Sciences (ABARES). Analysis provided by ABARES drew on both Australian Bureau of Statistics (ABS) and Australian Customs ICS data.¹⁶ The analysis formed the basis of section 3 (the regulated community) and is used extensively in section 6 (the options assessment) to assess the impacts of alternative regulatory approaches.

Reporting - the final stage of the Review was to prepare a report to the Parliamentary Secretary to the Minister for Agriculture, Senator Richard Colbeck. The Review was structured in accordance with the Australian Government's guidelines for structuring a Regulation Impact Statement (RIS).¹⁷ This would allow the Government to use the Review's analysis to support any decision to revise the Regulations, subject to an assessment that the Review was considered as meeting the requirement of the Office of Best Practice Regulation.

1.3 Stakeholder consultation

The stakeholder consultation process was a key phase through the engagement, enabling KPMG to understand the prevailing views throughout the regulated community. The establishment of these views enabled a robust analysis of options, and a platform to assess how to improve the balance between compliance cost and the risk of importing illegally sourced timber.

1.3.1 Breadth of consultation:

- **351 businesses were invited to participate in the one-on-one interview process**

Of these, 65 agreed to participate. These businesses spanned all product chapters, processors and business size categories.

In addition, KPMG conducted five one-on-one interviews with non-government organisations, as well as 14 industry bodies.

¹⁶ The analysis provided by ABARES built on previous research which was used in two ABARES reports: (i) Gupta, M., Davey, S., Townsend, P. and Cunningham, D. (2012), *Illegal logging regulations: Analysis of Australia's timber imports in 2007 and 2010*, ABARES report to client prepared for the Department of Agriculture, Fisheries and Forestry, Canberra, November and (ii) Gupta, M. and Hug, B. (2013), *Illegal logging regulation: the affected community*, ABARES, report to client prepared for the Department of Agriculture, Canberra, November. CC BY 3.0. More detailed analysis of characteristics by business size will be provided in the ABARES upcoming report (2015).

¹⁷ Australian Government (2014), *The Australian Government Guide to Regulation*.

- **6 stakeholder feedback workshops were held**

This included presentation of the preliminary results of the business interviews to validate the results and their interpretation with businesses and other non-government organisations. In order to give opportunity for participation across different geographies, KPMG held workshops in Sydney and Melbourne, where the greatest number of regulated businesses operate and the industry associations are mostly based, and offered stakeholder the opportunity to attend workshops in other state capitals. To supplement this, KPMG held a webinar for any businesses or organisation that were either unable to attend the face-to-face sessions or were located in other states.

- **A functional mailbox was set up to receive submissions from interested stakeholders**

KPMG received submissions from eight interested stakeholder groups, including industry bodies and non-government organisations through the functional mailbox. All submissions provide detailed input acknowledged within the Review. In addition, other stakeholders provided input by email, often followed up with phone discussions or suggestions on useful sources. The address for the mailbox was publicly available, enabling any regulated business to signal interest in the Review, ask for further information, or provide any other insight they deemed relevant for the Review's consideration.

See Appendix C for a list of stakeholder groups that provided submissions.

2 The problem

This section addresses item 3 of the Terms of Reference - An assessment of whether the existing due diligence requirements achieve an appropriate balance between cost of compliance for small business and risk reduction.

There is extensive published literature on the possible nature and extent of illegal logging and its associated economic, social and environmental impacts. Much of this literature has been relied on by governments (including Australia) to develop policy and regulatory responses to address the problem. The Review recognises that, while extensive, the available literature is not without criticism or challenge. These challenges would appear to be most acute when estimating Australia's share of the problem. While important to keep in mind, these challenges are not uncommon when policy makers design and implement measures to address complex and uncertain problems.

The Review, given its short timeframe and its focus on the compliance cost burden of the Regulations, has not undertaken additional primary research into the nature and extent of illegal logging and its associated impacts. The Review has considered the existing literature and feedback from stakeholders in the context of developing a better understanding of the balance between the cost of compliance with the Regulations and reducing the risk of illegally logged timber entering the Australian market.

The following sections provide an overview of the impacts of trade in illegally logged timber, both globally and in Australia.

2.1 Revisiting the broader problem

Illegal logging has wide-reaching impacts across ecosystems, communities and economies. The environmental impacts of unregulated logging are immediate, with loss of biodiversity, erosion and subsequent water pollution irrevocably changing the ecological balance of large swathes of forest areas.¹⁸ This damage is compounded by the associated threats to approximately "one billion forest dependent people", with additional stresses created as a result of criminal groups increasing instances of corruption, fraud, money laundering, extortion and murder in regions neighbouring forests.¹⁹

Economic costs of the trade are also material, with the Australian Government labelling it the "most significant (by value) environmental crime in the world".²⁰ This includes billions of dollars of lost revenue for governments, and a depressive impact on timber product prices harming business revenue across the supply chain.²¹ This depression has

¹⁸ Lawson, S and MacFaul, L (2010), *Illegal Logging and Related Trade: Indicators of the Global Response*, Chatham House, p. 1.

¹⁹ Nellemann, C., INTERPOL Environmental Crime Programme (eds). (2012), *Green Carbon, Black Trade: Illegal Logging, Tax Fraud and Laundering in the World's Tropical Forests. A Rapid Response Assessment* United Nations Environment Programme, GRIDArendal, p. 14.

²⁰ Department of Agriculture (Undated). *Briefing for Government Members of Parliament: Implementation of the Australian Government's illegal logging laws*, p. 1.

²¹ Lawson, S and MacFaul, L (2010), *Illegal Logging and Related Trade*, Chatham House, p. 1.

additional impacts on domestic producer competitiveness, creating negative outcomes for both supplier and destination countries.²²

Estimates of the global cost of illegal logging vary but one estimate suggested the economic costs could amount to between US\$30 and US\$100 billion annually, or 10–30 per cent of global wood trade.²³ Another estimate suggests the global social and environmental costs, and the costs imposed on legitimate producers, arising from illegal logging could be approximately USD\$106.5 billion per annum.²⁴ This may be more acute in our region, with the Minister for the Environment, Greg Hunt, noting that “While reliable figures are obviously difficult to assess, I understand that around 30 to 40 per cent of total wood-based exports in the Asia-Pacific were derived from illegal sources in 2010.”²⁵ The World Bank illustrates the scale of the issue by stating “every two seconds, across the world, a forest the size of a football field is clear-cut by illegal loggers”, and that some countries’ timber exports include up to 90 per cent of illegally logged materials.²⁶

The Addendum Regulation Impact Statement prepared in 2012 and the Centre for International Economics (CIE) cost modelling unpack the financial, social and environmental, as well as intangible costs of illegal logging globally.

2.1.1 Economic costs

The CIE modelling developed the following estimates of the financial costs of illegal logging, taking into account losses to legitimate business operations in both supplier and importing countries. These estimates indicate material financial damage, particularly to legitimate producers in ‘high risk’ countries that struggle to export their timber products due to price competition from illegally logged timber.²⁷ The EU estimates the costs of legal log production were USD\$63-76 per cubic metre compared with USD\$19-29 for illegally logged materials.²⁸

²² Parliament of the Commonwealth of Australia (2012), *Illegal Logging Prohibition Bill 2012 – Revised Explanatory Memorandum*, p. 2.

²³ Nellemann, C., INTERPOL Environmental Crime Programme (eds). (2012), *Green Carbon, Black Trade: Illegal Logging, Tax Fraud and Laundering in the World's Tropical Forests*. A Rapid Response Assessment. United Nations Environment Programme, GRID-Arendal Accessed 25 March 2015 at <<http://www.grida.no/publications/rr/green-carbon-black-trade/>>

²⁴ Centre of International Economics (2010), *A Final Report to inform a Regulation Impact Statement for the proposed new policy on illegally logged timber*, p. 60.

²⁵ Hunt, Greg MP (2014), Minister for the Environment, *Opening Address to the Asia-Pacific Rainforest Summit*, 11 November
<http://www.greghunt.com.au/Home/LatestNews/tabid/133/articleType/ArticleView/articleId/3061/Opening-Address-to-the-Asia-Pacific-Rainforest-Summit.aspx>

UNEP & Interpol (2014), *The Environmental Crime Crisis: Threats to Sustainable Development from Illegal Exploitation and Trade in Wildlife and Forest Resources*, p. 8.

²⁶ World Bank (2012). *Justice for Forests: Improving Criminal Justice Efforts to Combat Illegal Logging*, p. vii.

²⁷ The Australian Government has not identified which countries it considers are ‘higher risk’. This Review has used the definition outlined by the ATIF in the ‘Acronyms and definitions’ section of this report.

²⁸ EU and Chatham House (2008). Analysis of the trade impact of the VPA for Indonesia. Accessed on 6 March 2015 at <www.illegal-logging.info/presentations/17-180108/micski.pdf>

Table 3 - Financial costs of illegal logging per annum

Financial costs of illegal logging to legal producers (USD\$ billions)	
Financial cost of illegal logging	46.0
Financial losses to producers of legal forest products in non-risk (high cost) countries (US, Europe, New Zealand)	15.0
Financial losses to legitimate legal producers in 'risk' countries (China, Indonesia, Russia, Malaysia)	31.0

Source: derived from CIE (2010) table 2.4, p.31 and p.27-28

However, in developing its estimates of the full economic costs, the CIE also attributed a financial benefit of USD\$92.0 to consumers (as they received lower priced products because of illegal logging), and to those engaged in illegal logging. The CIE thus argued that there was a net USD\$46 billion financial benefit from illegal logging.

In contrast, the World Bank estimates that the financial losses to developing countries from illegal logging on public land is approximately USD\$10 billion per annum, with government revenue losses in the region of USD\$5 billion.²⁹ The Addendum Regulation Impact Statement cautions these figures by stating that they are based on undeclared values and may "therefore represent a significant under-estimation of the global cost of illegal logging".³⁰

2.1.2 Social and environmental costs

CIE also modelled the estimated social and environmental cost of illegal logging, quantifying the cost of wasted resources, greenhouse gases and compromising of the ecological balance. The calculations suggested the impact of illegal logging on greenhouse gas emissions was USD\$43 billion per annum, while other environmental costs would also materially impinge on ecosystems and global liveability.

²⁹ World Bank (2006), *Strengthening Forest Law Enforcement and Governance: Addressing a Systemic Constraint to Sustainable Development*, p. 1.

These figures are based on undeclared values and may therefore represent a significant under-estimation of the global cost of illegal logging.

³⁰ Department of Agriculture (Undated). *Addendum to the Regulation Impact Statement on the Australian Government policy on illegal logging*, p. 7.

Table 4 - Social and environmental costs of illegal logging (per annum)

Social and environmental costs of illegal logging (USD\$ billions)	
Social and environmental cost of illegal logging	60.5
Social cost of illegal logging	8.0
Loss of non-wood forest products	<1
Wasted resources	7.5
Displacement of forest communities	<1
Environmental costs	52.5
Greenhouse gas emissions	43.0
Loss of ecosystem services (biodiversity)	4.5
Soil and water degradation	5.0

Source: derived from CIE (2010) table 2.4, p.31

The 2012 Addendum Regulation Impact Statement highlighted a further range of social impacts left unquantified by the CIE analysis, including:³¹

Uncompetitive Australian producers resulting from lower supplier country codes of conduct;

- Use of timber resources to support conflict or persecution;
- Corruption and conflict in supplier countries;
- Criminal organisations using heavy-handed tactics to reduce opposition to illegal forestry activity; and
- Profits from illegal logging not being shared with local and indigenous populations.

During consultation in the course of the Review both industry and other stakeholders emphasised that importation of illegal logged timber and timber products into Australia has the potential to both harm domestic producers and legitimate exports from higher risk sources through damaging the brand image of timber and related products. However, it is not possible to place a value on the extent to which current levels of illegal imports have a harmful impact at this time.

2.1.3 Intangible costs

Further, intangible costs associated with the illegal logging trade which are not encapsulated in the CIE analysis include:³²

- Reduction in the standard of living due to variety of criminal, economic and environmental problems associated with illegal logging;

³¹ Department of Agriculture (Undated). *Addendum to the Regulation Impact Statement on the Australian Government policy on illegal logging*, p. 8.

Coakes Consulting (2010), *A review of the social costs of illegal logging*, p. 1.

³² Department of Agriculture (Undated). *Addendum to the Regulation Impact Statement on the Australian Government policy on illegal logging*, p. 8.

- Erosion of sustainable livelihoods through environmental degradation;
- Destruction of customary, spiritual and heritage values of forest-dependent communities;
- Use and exploitation of foreign workers; and
- Food and water contamination.

With the additional consideration of these factors, the Addendum Regulation Impact Statement argues that the estimates of social and environmental costs would rise further.

2.1.4 Estimating Australia's share of the problem

As outlined at the start of this section, estimating Australia's share of the problem is challenging. Techniques used to estimate the value of illegally logged timber entering the Australian market have apportioned global estimates based on Australia's share of the timber trade. For example, according to a Pöyry Forest Industry report, Australia imported around USD\$400 million of illegally logged timber products per annum, or 9 per cent of total imports.³³ This figure is in part attributable to Australia trading in higher risk timber products or with higher risk countries, examples being:

- Approximately half of Australia's share of the problem relates to furniture (\$214 million), making it Australia's highest risk timber product chapter import.³⁴
- The World Bank provides estimates of illegally logged timber coming from Australia's major trading partners, some of which are among the higher risk countries for illegally logged timber exports (see Table 5).

Apportioning techniques have also been applied to estimate Australia's share of the global problem. The Addendum Regulation Impact Statement states that Australia's share of the global problem is USD\$21 million per annum,³⁵ which was calculated by multiplying Australia's share of global trade (0.034 per cent) by that study's estimated net global costs of illegal logging (USD\$60.5 billion).

While these approaches are reasonable for the purposes of outlining a broad and high-level estimate, they are not without their challenges. These challenges are most acute when governments are tasked with measuring how the size of the problem has changed over time or in response to a particular policy response. This Review has not sought to update the numbers based on a more recent analysis of Australia's share of the global timber trade and inflation, because this new estimate would not reflect the impact of recent industry and government-led actions to address the problem.

³³ Pöyry (2005), 'Overview of Illegal Logging', p.12. Accessed on 2 March 2015 at <http://www.agriculture.gov.au/SiteCollectionDocuments/forestry/international/illegal-logging/illegal_logging_report.pdf>

³⁴ Parliament of the Commonwealth of Australia (2012), *Illegal Logging Prohibition Bill 2012 – Revised Explanatory Memorandum*, p. 2.

³⁵ Department of Agriculture (Undated). *Addendum to the Regulation Impact Statement on the Australian Government policy on illegal logging*, p. 6.

2.1.5 Factors contributing to risk

Given the limited literature that exists around estimates of the value of illegally sourced timber in trade, both globally and within the Australian context, the Review has sought to consider a series of factors that might influence the risk of illegally sourced timber entering the Australian market.

Country of origin is one important characteristic that can be viewed as a proxy for risk, noting that in some cases the vast majority of logging may be legal in some regions of a country, while there is considered to be a higher risk that timber from other regions is illegal logged. As shown in Table 5, in 2006 the World Bank has estimated the percentage of total harvested timber that was illegally harvested for three of Australia's major trading partners.³⁶

Table 5 - Major Australian trading partners by the percentage of illegally logged timber estimated in their jurisdiction

Country of origin	Illegally Harvested Timber (%)	Import value (\$m)
Indonesia	70-80	419
Thailand	40	218
Malaysia	Up to 35	383

Source: World Bank (2006). Strengthening Forest Law, p. 9. ABARES calculations informed the import value calculations.

These countries are Australia's third, fourth and sixth largest trading partners by value respectively, and thus the illegal harvesting of timber in these countries would open Australian importers to risk.³⁷ For more information on origin of harvest, please see Appendix D.

Product type is another important characteristic that is viewed as a proxy for risk in this Review. In their report prepared for the Department of Agriculture based on 2003-04 import figures, Jaakko Pöyry Consulting estimated nine per cent of Australia's timber-based products by value to be sourced from illegally logged material.³⁸ Since this estimate was produced there have been developments in exporting countries, and the Act and Regulations having been introduced in Australia, the US and the EU, and consequently the current percentage of illegally logged timber in Australia may be lower than 2003-04 levels. Nonetheless, the breakdown of this estimate by product type (see Table 6) is useful in ascertaining what products potentially pose the highest risk of containing illegally sourced timber components.

³⁶ Noting the date of this study, it is important to interpret them with caution.

³⁷ The Australian Environment Foundation submission to the Review cited documents that suggested the levels of illegal logging in Indonesia and Malaysia halved between 2010 and 2013. If these trends are accurate and continue, Australia's proportion of the global problem will reduce (assuming no increases in illegal activities from other substantive countries of import). In contrast, the 2012 Interpol report, *Green Carbon, Black Trade: Illegal Logging, Tax Fraud and Laundering in the Worlds Tropical Forests* stated: "an apparent decline in illegal logging internationally is due to more advanced laundering operations masking criminal activities, and not necessarily due to an overall decline in illegal logging." (p.7)

³⁸ Jaakko Pöyry Consulting (2005) *Overview of illegal logging*. Accessed on 04 March 2015 at <http://www.agriculture.gov.au/SiteCollectionDocuments/forestry/international/illegal-logging/illegal_logging_report.pdf>

Table 6 - Suspected percentage of illegally logged product by value in Australia 2003-04

Product	Value (\$m)	Suspected component illegally logged (%)	Suspected value of illegally logged component (\$m)
Sawnwood	494	8	50
Miscellaneous forest products	584	14	83
Wood based panels	191	11	23
Paper and paperboard	2,014	1	71
Paper manufactures	369	3	11
Recovered paper	5	0	0
Pulp	235	0	0
Furniture	1,000	22	214
Australian total	4,893	9	452

Source: Jaakko Pöyry Consulting (2005) *Overview of illegal logging*, p. 12.

This 2005 analysis, based on 2003-04 data, suggested that 22 per cent of furniture imports at that time were suspected to contain illegally sourced timber.

The Australian Timber Importers Federation (ATIF) toolkit provides another insight into how risk can be defined, with the industry body providing a risk assessment matrix that delineates between types of wood materials that will justify risk mitigation activities. Examples of higher risk materials include:

- Any timber of unknown species;
- Any timber of unknown country of harvest;
- Any species harvested in a country with a high corruption rating; and/or
- Any species harvested in a country with known armed conflict.

ATIF cites the use of FSC and/or PEFC certification as requiring no further mitigation activity (although this it is unclear whether the current drafting of the Regulations support this approach, see section 4.5.5), while identifying a source country as having low corruption ratings and using relevant Country Specific Guidelines materials also offered evidence of due diligence.

Despite the variety of altering definitions of risk, several stakeholders provided submissions to the Review which argued that the existing data sources potentially overstated the problem. The Review recognises that this is a contested issue, with limited, dated data from various sources, but has taken the approach that it would only reconsider issues associated with evidence of the prevalence of illegal logging or the associated risks, if new evidence had emerged since November 2013, given these issues have been before the Government, and/or the Parliament, which agreed to proceed the Regulation at that time. In the absence of such information the Review has not considered it appropriate to re-assess those judgements.

2.2 Global responses

2.2.1 EU and US Legislative Frameworks

The European Union (EU), United States of America (US) and Australia have all taken formal action to legislate against the import and trade of illegal timber, although implementation of these reforms in each case is at an early stage.

The EU and US markets are two of the most substantial importers of timber product and therefore give important momentum to anti-illegal logging efforts. This began with the Lacey Act in the United States which, having begun as a wildlife trafficking protection law in 1900, was amended in 2008 to include plant products. The EU Timber Regulation emerged as a component of the Forest Law Enforcement Governance and Trade (FLEGT) Action Plan which seeks to “tackle the underlying causes of illegal logging”, including the establishment of Voluntary Partnership Agreements (VPAs) which commit EU trading partners to create a timber legality assurance system to ensure compliance with the EU Timber Regulation.

Key information regarding these documents can be seen below in Table 7.

These Regulations are intended to leverage off each other to ensure there is a consistent set of requirements for supplying countries to comply with, enhancing the simplicity of the systems. This is illustrated by the collaborative document published by the EU, US and Australian administrations, which state that the discretionary risk management approach adopted in the US is likely to map closely to the due diligence requirements in the EU.³⁹

2.2.2 EU implementation and compliance

A number of benefits have been observed as the Regulations have been implemented, with the EU suggesting that as of 2014 only one member country has made no progress towards implementation.⁴⁰ Further, there is some evidence that the process of negotiation of VPAs has created demonstrable improvement in forestry practices in Asia and Africa, with European importers implementing better supply chain controls.⁴¹ This progress is bolstered by what some argue is ‘firm industry support’ for the regulation through its ability to protect the environment and reputation of the EU importing market.⁴² One large timber importer stated that additional benefits have emerged

³⁹ Department of Agriculture (Undated). *All you need to know about the US Lacey Act, the EU Timber Regulation and the Australian Illegal Logging Prohibition*, p.5.

⁴⁰ Hungary is listed as having no progress on implementing ‘Competent Authorities’, ‘Penalties’ and ‘Checks’.

European Commission (2014). *State of Implementation of EU Timber Regulation in 28 Member States*. Accessed on 26 February 2015 at

<<http://ec.europa.eu/environment/forests/pdf/EUTR%20implementation%20scoreboard.pdf>>

⁴¹ Chatham House (2013). *Illegal Logging: Are We Making Progress?*, Accessed on 25 February 2015 at <<https://www.chathamhouse.org/node/13173>>

Six countries have begun implementing their legality assurance systems (as part of their VPA) but none have received FLEGT licensing.

⁴² Chatham House (2015). *Vandecasteele shows strong support for EUTR*, Accessed on 25 February 2015 at <<http://www.illegal-logging.info/content/vandecasteele-shows-strong-support-eutr>>

through implementing the Regulations, with due diligence processes strengthening relationships with suppliers and enhancing their business links internationally.⁴³

Despite this, the EU Timber Regulation has had issues in its implementation, with some countries more progressed in terms of compliance and enforcement measures than others.⁴⁴ As opposed to the US where a small, expert federal team enforces the Lacey Act, EU enforcement relies on an array of agencies responsible across national jurisdictions. Chatham House contends that the regulation is “as weak as its weakest national enforcement link”, creating a ‘serious problem’ for successful prohibition of illegally logged timber given the limited progress of some member nations.⁴⁵

Further, implementation of VPAs has been limited, with just six countries having started the process of developing systems to control, verify and licence legal timber, and another nine countries in negotiations with the EU to create such a framework.⁴⁶ While there has been evidence of behaviour change associated with VPAs, the limited number of countries engaging (and implementing) frameworks compromises the breadth of positive outcomes.⁴⁷

Implementation and compliance issues are further illustrated by a project conducted in the UK investigating the due diligence systems of importers of Chinese plywood. This showed that 14 of 16 companies reviewed did not comply with the EU Timber Regulation. According to the study, the failures stemmed from a lack of clarity regarding their procurement process and risk management strategies.⁴⁸ Business has also raised concerns regarding the Regulation’s unequal impact on small business given the smaller volumes the segment imports.⁴⁹

While some improvements have been attributed to the Regulations, substantial deficiencies still exist with synthesising equal levels of enforcement across each EU jurisdiction, and strengthening business understanding of what their due diligence systems should look like. Improvement strategies are anticipated to be outlined in the major review of the EU Timber Regulation (EUTR) and FLEGT Action Plan that will be undertaken in 2015.⁵⁰ Within scope for the European Union’s Review is the usefulness of the VPA system, the scope of EUTR applicable producer country timber and forestry

⁴³ *Ibid.*

⁴⁴ Chatham House (2014). *Weak Enforcement Holds Back EU’s Fight Against Illegal Logging*. Accessed on 25 February 2015 at <<https://www.chathamhouse.org/media/comment/view/197777#>>

⁴⁵ *Ibid.*

⁴⁶ EU FLEGT (2014). *Voluntary Partnership Agreements*. Accessed on 2 March 2015 at <<http://www.euflegt.efi.int/vpa>>

⁴⁷ Hoare, Alison (2014). *Europe’s Forest Strategy in the Next Decade: Options for the Voluntary Partnership Agreements*, Chatham House, p. 3. Accessed on 3 February 2015 at <http://www.chathamhouse.org/sites/files/chathamhouse/home/chatham/public_html/sites/default/files/20140414Europe%27sForestStrategyHoare.pdf>

⁴⁸ National Measurement Office (2015). *EUTR: Plywood imported from China*. Accessed on 25 February 2015 at <http://content.govdelivery.com/attachments/UKNMO/2015/02/09/file_attachments/363138/Chinese%2B Plywood%2BResearch%2BReport.pdf>

⁴⁹ IHB (2015). *Vandecasteele shows strong support for EUTR*. Accessed on 23 February 2015 at <<http://www.illegal-logging.info/content/vandecasteele-shows-strong-support-eutr>>

⁵⁰ IHB (2015). ‘Major review of FLEGT Action Plan and EUTR underway’. Accessed on 2/3/15 at <http://www.ihb.de/wood/news/EUTR_FLEGT_ETTF_EC_review_40529.html>

legislation, as well as ensuring more equal enforcement across member states. Given the 'wide-ranging' nature of the review, there is potential for an EU policy shift in the immediate future.⁵¹

Table 7 - Background information on the EU Timber Regulation 2013 and the US Lacey Act Amendment 2008

Criteria	EU Timber Regulation 2013	US Lacey Act Amendment 2008
Prohibition scope	Prohibition of the first placing of illegally harvested timber and related products on the EU market.	Prohibition of the import, export, transport, selling, receiving and acquiring of any plant taken or traded in violation of the law in the United States.
Regulated entities	Operators who are placing timber or timber products on the EU market for the first time must exercise 'due diligence' in their procurement.	All parties across the supply chain are equally liable under the law.
Products covered	Large range of timber products including furniture, pulp, paper, logs and sawn wood.	Applies to all products, except for certain scientific specimens and food crops. This includes raw logs, sawn timber, plywood, composite materials, furniture, pulp and paper.
Evidence standard ⁵²	<p><i>Proof of legality:</i></p> <ul style="list-style-type: none"> • FLEGT licence; or • CITES permit. <p><i>Evidence of legality to support risk assessment:</i></p> <ul style="list-style-type: none"> • FSC certification • PEFC certification; or • Other third party verification schemes achieved through Voluntary Partnership Agreements 	<p>The law is fact-based, not document-based, meaning that no certification and/or verification of legal origin is required, and equally these documents will not be accepted as final proof.</p> <p>The law is discretionary for business, and risk management is left to individual buyers to meet their own understanding of its risk profile and comfort with suppliers.</p>
Enforcement responsibility	Each country in the EU that is designated as a competent authority will be responsible for the enforcement of the Regulations.	The main implementation agency is the Animal Plant Health Inspection Service arm of the Department of Agriculture.

Source: Department of Agriculture (Undated). All you need to know about the US Lacey Act, the EU Timber Regulation and the Australian Illegal Logging Prohibition.

2.2.3 United States of America implementation

A 2014 US Forest Services report suggests that the implementation of the 2008 amendments to the Lacey Act has been responsible for a decrease in illegally logged

⁵¹ *Ibid.*

⁵² Section 2.2.4 provides greater detail on certification and verification schemes.

timber products in its jurisdiction.⁵³ The report also noted a price increase associated with the timber being imported since 2008, which is consistent with businesses paying a reputational premium for timber products.⁵⁴ A coalition of forest product companies, unions and conservationists successfully lobbied to cancel a vote on weakening the Regulations in 2012.⁵⁵

The Lacey Act also provided the first precedent of a prosecution under laws dealing with trade in illegal logging globally. In this controversial case, Gibson Guitar Corp. was found to have imported Madagascan ebony following continued warnings that it was likely to be illegally harvested. Following a multi-year investigation, the company settled with the US Department of Justice for a sum of USD\$300,000 and the forfeiture of over USD\$250,000 of wood products. The settlement also included an assurance that the company would implement a new risk management system to better prevent the import of illegally logged timber.

2.2.4 Further international initiatives

There are a number of international efforts outside of government that seek to address issues about timber legality and sustainability, many of which feed into the legislative and regulatory measures put in place by governments. These efforts include formalised certification and guidance systems, such as:

- Forest Stewardship Council's (FSC) Principles and Criteria for forest management;
- The Programme for Endorsement of Forest Certifications (PEFC) sustainable forest management certification systems; and
- Sistem Verifikasi Legalitas Kayu (SVLK) timber legality assurance system.

These frameworks work in conjunction with international agreements and funding initiatives to assist importers in understanding the legality of their suppliers' operations. Government regulations seek to leverage these initiatives to streamline the legality verification process. Initiatives include:

- Convention on International Trade in Endangered Species of Wild Flora and Fauna (CITES); and
- Responsible Asia Forestry and Trade (RAFT).

For further information on these frameworks or initiatives please see Appendix D.

⁵³ United States Forest Services (2014). *2008 Lacey Act Amendment Successful in Reducing US Imports of Illegally Logged Wood*. Accessed on 23 February 2015 at <<http://www.srs.fs.usda.gov/news/578>>

IHB (2015). *Vandecasteele shows strong support for EUTR*, Accessed on 23 February 2015 at <<http://www.illegal-logging.info/content/vandecasteele-shows-strong-support-eutr>>

⁵⁴ United States Forest Service (2014). *The impacts of the Lacey Act Amendment of 2008 on US hardwood lumber and hardwood plywood imports*, p.43.

⁵⁵ Forest Stewardship Council (2012). *The Lacey Act and FSC*. Accessed on 25 February 2015 at <<https://us.fsc.org/newsroom.239.526.htm>>

2.3 Australia's legislative response

Australia's illegal logging laws have had a long development period and can be traced back to a commitment made by the Howard Government as part of the 2004 federal election.⁵⁶ Since that time, the policy of seeking to reduce illegal logging has received bipartisan support, and ultimately culminated in legislative action, with:

- *Illegal Logging Prohibition Act 2012*
- *Illegal Logging Prohibition Regulation 2012*

A full timeline of events from 2004 to 2015 is outlined in Appendix E.

Australia's regulatory response is consistent with public commitments made to combat the trade in illegal timber at a regional level. At the Asia-Pacific Economic Cooperation (APEC) Leaders Summit in November 2011, former Prime Minister Julia Gillard made a declaration along with leaders from Canada, Indonesia, Malaysia, New Zealand, Papua New Guinea, United States, and China to '*implement measures to prohibit the trade in illegally harvested forest products and undertake activities in APEC to combat illegal logging and associated trade*'. This pledge was reconfirmed by Prime Minister Tony Abbott at the APEC Leaders Summit held in November 2014, and further supported by the Australian Government's commitment of \$6 million to help fund the third phase of the RAFT initiative.⁵⁷

2.3.1 The Act

The *Illegal Logging Prohibition Act 2012* (the Act) established the broad framework for illegal logging laws. Key elements of the Act can be seen in Table 8. The Act makes it a "*criminal offence to import illegally logged timber and timber products into Australia or to process domestically grown raw logs that have been illegally logged*."⁵⁸ For the purposes of the Act, illegally logged is defined as:

*"illegally logged, in relation to timber, means harvested in contravention of laws in force in the place (whether or not in Australia) where the timber was harvested."*⁵⁹

However, in their submission to KPMG, the Australian Environment Foundation highlighted that definitions of illegal logging are inconsistent and can range from a narrow focus on smuggled and stolen timber, to a broad scope covering the

⁵⁶Howard, J. (2004), A Stronger Economy, A Stronger Australia – the Howard Government Election 2004 Policy – A sustainable future for Tasmania.

⁵⁷ Minister for the Environment (2014), Media release: *Australian funding to combat illegal logging in Asia-Pacific*, 11 November. Accessed on 26 February 2015 at <<http://www.environment.gov.au/minister/hunt/2014/mr20141111b.html>>

⁵⁸ Department of Agriculture (2014), accessed 27 February 2015 <<http://www.agriculture.gov.au/forestry/policies/illegal-logging/faqs>>

⁵⁹ Department of Agriculture *Illegal Logging Prohibition Act 2012*, p. 4.

employment of workers with a criminal record.⁶⁰ The submission also notes that where NGOs are opposed to all commercial logging, the definition of illegal logging can be stretched to include a contravention of any law by a logging company.

Table 8 - Overview of the Illegal Logging Prohibition Act 2012

Illegal Logging Prohibition Act 2012	
Prohibition scope	Prohibition of the importation of illegally logged timber and processing of illegally logged domestic raw logs. This prohibition applies to all timber and timber products.
Regulated entities	The Act and associated Regulations affect all businesses that import timber or timber products, as well as Australian processors of domestically grown raw timber logs. ⁶¹
Enforcement responsibility	The Act and associated Regulations are managed and enforced by the Australian Government Department of Agriculture. The Department currently has 23 inspectors appointed under the Act. ⁶²
Penalties	Knowingly processing an illegally logged raw log or importing illegally logged timber or regulated timber products is a criminal offence and carries a maximum penalty of five years imprisonment and/or fine of up to 500 penalty units (based on current penalty unit values this is \$85,000 for an individual or \$425,000 for a corporation or body corporate). ⁶³ The test of negligence may also be applied if a regulated timber product being imported is proven to be illegally logged. ⁶⁴
Key requirements	Importers of regulated timber products and processors of raw logs to conduct due diligence, as prescribed by the Regulations. Importers of regulated timber products to provide declarations regarding the due diligence that they have undertaken to the Customs Minister at the time of importing. ⁶⁵

One business has interpreted the Act as also applying to timber that has been legally harvested, but then subsequently illegally exported (either as a log or as timber). Some countries have export bans on logs and sawn timber to encourage greater value-added activity in their country, such as furniture manufacturing. Even though the 2012 Act's definition related to whether the timber had been harvested illegally, this business considered a broader definition applied because the discussion in the Explanatory memorandum to the 2011 Bill. The Regulatory Impact Statement included in the Explanatory memorandum did discuss 'illegally logging and associated trade', and

⁶⁰ Australian Environment Foundation (2015), *Submission to the Independent review of the impact of the illegal logging regulations on small business conducted by KPMG*, p. 1.

⁶¹ Department of Agriculture (2014), accessed 24 February 2015
<<http://www.agriculture.gov.au/forestry/policies/illegal-logging/faqs>>

⁶² Department of Agriculture (2014), accessed 24 February 2015
<<http://www.agriculture.gov.au/forestry/policies/illegal-logging/faqs>>

⁶³ Department of Agriculture (2014), accessed 24 February 2015
<<http://www.agriculture.gov.au/forestry/policies/illegal-logging/faqs>>

⁶⁴ Department of Agriculture (2014), accessed 24 February 2015
<<http://www.agriculture.gov.au/forestry/policies/illegal-logging/faqs>>

⁶⁵ *Illegal Logging Prohibition Act 2012*, p. 3.

defined this as including illegal exports, imports and processing. But this broader definition is not in the Act itself, nor the notes on the clauses, nor mentioned in the Second Reading Speech which focused on illegal harvesting.⁶⁶ As a result of the text in the Explanatory memorandum, this business has been undertaking research on export bans as part of their compliance activity.

2.4 The problem addressed by this Review - the impact of the Regulations that supported the Act⁶⁷

As outlined in section 1.11.1, the scope of this Review is focused on the impact of what are now the *Illegal Logging Prohibition Regulation 2012* (the Regulations). The Regulations seek to achieve the broader policy objectives of the Act at an appropriate cost that achieves the highest net benefit for the community.

As such, the problem that the Review, and any resulting Government intervention, is seeking to solve is that the current regulatory scheme *may* not strike an appropriate balance between reducing the risk that timber and timber products are illegal sourced and the cost to small business, and in particular the due diligence arrangements *may* not be the most efficient and effective way of achieving this balance for small business.

2.4.1 Objectives of any government intervention arising from the Review

The objectives being sought by government intervention, given that the Act and Regulations are now in place and being implemented, is to 'ensure compliance costs of the Regulations do not unduly impact on small businesses.'⁶⁸

As such the goal of Government would be to implement measures that would achieve a higher net benefit for the community, either by retaining the current benefits at a lower cost (particularly for small businesses), or by reducing the costs substantially more than any reduction in community benefits.

2.5 The scope of the Regulations that support the Act

The scope for such changes is constrained by what the Act prescribes that must be set out in the sub-ordinate Regulations. The most notable of these is the requirement for due diligence when importing timber and timber products or processing domestic raw saw logs. This section will provide a high level overview of some of the key elements and concepts of the Regulations.

⁶⁶ Ludwig (2011), *Illegal Logging Prohibition Bill 2011*, Explanatory Memorandum, p.40

⁶⁷ The report of the Review is intended to form the basis of the supplementary Regulatory Impact Statement that would be required if the Government was to implement any of the regulatory options proposed. As such, this section represents the problem and objectives section of the Regulatory Impact Statement.

⁶⁸ Billson (2014), Media Release: Taking care of small business a priority for logging review, accessed 13 March 2015 <<http://bfb.ministers.treasury.gov.au/media-release/064-2014/>>

2.5.1 Product coverage

Products covered by the Regulations fall under the following tariff codes, as consistent with Schedule 3 of the Customs Tariff Act 1995:

- Chapter 44 – wood articles;
- Chapter 47 - pulp products;
- Chapter 48 - paper products; and
- Chapter 94 - furniture.⁶⁹

Some exemptions within these product categories exist; however, these are generally consistent with the scope of the US and EU regulations. Timber products made entirely out of recycled materials are exempt from due diligence requirements. Where a timber product is partially made of recycled materials, only the non-recycled components are subject to due diligence requirements. Stakeholders were consulted when considering the exemption of other product categories (e.g. antique timber products) and so have been involved in product coverage decisions from the beginning.

Importers are exempt from due diligence requirements where the combined value of regulated timber products within a consignment does not exceed \$1,000.⁷⁰ At present, Australian Customs import declaration forms are only required where the consignment is worth over \$1,000, as is consistent with the current GST and tariff exemption thresholds.⁷¹ During stakeholder working groups conducted by the Department of Agriculture, concerns were raised that the threshold exemption created a loophole that could act as an incentive for importers to break consignments into multiple smaller consignments to avoid due diligence obligations.⁷² Neither the US or EU regulations include a threshold below which importers are exempt from the equivalent due diligence requirements. In the US, the Lacey Act covers the entire supply chain and only certain scientific specimens and food crops are exempt from due care⁷³ requirements.⁷⁴ Under the EU Timber Regulation, any operator placing timber or timber products on the market is obliged to meet due diligence requirements regardless of consignment value.⁷⁵

⁶⁹ *Illegal Logging Prohibition Act 2012*, p. 23.

⁷⁰ *Illegal Logging Prohibition Regulation 2012*, p. 2.

⁷¹ Department of Agriculture (2012) *Illegal logging stakeholder working group workshop discussion paper regulated timber products*, p. 8.

⁷² Department of Agriculture (2012), *Illegal logging stakeholder working group regulated timber products workshop summary*, p. 8.

⁷³ "due care means that degree of care which a reasonably prudent person would exercise under the same or similar circumstances" Arnold & Porter LLP (2012), *Interpreting The Lacey Act's "Due Care" Standard after the Settlement of the Gibson Guitar Environmental Enforcement Case*

⁷⁴ Handbook, Lacey Act, EU and Australian logging laws.

⁷⁵ Handbook, Lacey Act, EU and Australian logging laws.

2.5.2 Due diligence

The due diligence element of the illegal logging laws came into effect on 30 November, 2014. The Regulations divide due diligence into four steps for processors of domestically grown saw logs and importers of regulated products.⁷⁶ The steps are:

1. *Gathering relevant information.* Some of this information would need to already be collected by importers (or processors) for customs (or normal business) purposes. However other information, such as common name, genus, or scientific name of the timber is additional. Some of the information, such as the country, the region of the country and the harvesting unit in which the timber product was harvested, would be more difficult to collect;
2. *Use of timber legality frameworks and/or Country Specific Guidelines* to better understand the product origin. If the product has been certified under a timber legality framework, or comes from a country (or State) with a country (or State) specific guideline, then the Regulations contain specific (optional) provisions that are intended to make compliance less burdensome;
3. *Assessing risk.* The importer (or processor) must then assess the risk that the product is, is made from, or includes illegally logged timber (logs) based on factors outlined in the Regulations and document this assessment; and
4. *Risk mitigation.* If the importer (or processor) assesses there is a risk that the product is illegally logged, then they must conduct a risk mitigation process that is 'adequate and proportionate' to the identified risk, and document this process.

To support in robust implementation of these steps, both importers and processors must have a due diligence system that is:

- Documented in writing;
- Contains information about their business operations; and
- Contains details of the person responsible for maintaining the system.⁷⁷

While the due diligence requirements are not designed to unduly burden business, experiences are likely to vary dependent on the business, particularly where supply chains are long or otherwise complex.

The legal concept of due diligence is adopted in a number of regulatory frameworks. The *Anti-Money Laundering and Counter-Terrorism Financing Act 2006*, which covers more than 10,000 businesses, requires customer due diligence to be conducted, which it defines as:

- consideration of the risks associated with customers;
- collection and verification of information in relation to customers; and

⁷⁶ The Department of Agriculture has outlined the four steps of due diligence as i) gathering information; ii) use of Timber Legality Frameworks, Country Specific Guidelines or State Specific Guidelines to identify and assess risk (optional step); iii) undertaking a risk assessment; and iv) risk mitigation.

⁷⁷ *Illegal Logging Prohibition Regulation 2012*, p. 4.

- ongoing monitoring of customer due diligence including scrutiny of transactions.⁷⁸
- An Australian Institute of Criminology survey indicated that only 10 per cent of the businesses covered by this regime had a turnover of greater than \$10 million per annum.⁷⁹
- The concept of due diligence also features in Australian legislation protecting Aboriginal heritage. The Western Australian Government published Cultural Heritage Due Diligence Guidelines to assist land users comply with the *Aboriginal Heritage Act 1972* (WA), which was enacted to protect and preserve Aboriginal cultural heritage. The Guidelines indicate due diligence may involve one or all of the following steps:
- assessing the landscape where an activity is to take place;
 - assessing the proposed activity and potential impact on the landscape;
 - searching the Register of Aboriginal Sites and the Aboriginal Heritage Inquiry System;
 - consulting with the relevant Aboriginal people; and
 - agreeing to an Aboriginal heritage survey or other heritage management strategies.⁸⁰
- In New South Wales, the National Parks and Wildlife Regulation 2009, made under the *National Parks and Wildlife Act 1974* (NSW) (NPW Act), established the Due Diligence Code of Practice for the Protection of Aboriginal Objects in New South Wales. The Code, in the context of Aboriginal cultural heritage, describes due diligence as the undertaking of “*reasonable and practicable steps to protect Aboriginal objects.*”⁸¹ The Code adopts a self-described ‘generic due diligence process’ represented visually using a flowchart to set out recommended steps similar to those of the Western Australian Guidelines for individuals and businesses conducting due diligence. Where a person follows the prescribed due diligence steps to determine that their actions will not harm Aboriginal objects, they have a defence against prosecution for the strict liability offence under the NPW Act if they later unknowingly harm an object without an Aboriginal Heritage Impact Permit.

2.5.3 ‘Reasonably practicable’

In order to minimise the risk of illegally logged timber entering the Australian market, the Regulations require that:

*“An importer (processor) must, before importing (processing) a regulated timber product (raw log), **obtain as much of the information about the product mentioned in subsection (2) as it is reasonably practicable** for the importer (processor) to obtain”.*⁸²

⁷⁸ Australian Transaction Reports and Analysis Centre *Customer Due Diligence* accessed at <<http://www.austrac.gov.au/businesses/obligations-and-compliance/customer-due-diligence>>

⁷⁹ Walters et. al. (2012), *The anti-money laundering and counter-terrorism financing regime in Australia: Perceptions of regulated businesses in Australia*, Australian Institute of Criminology

⁸⁰ Department of Aboriginal Affairs & Department of the Premier and Cabinet Western Australia (2013) *Aboriginal Heritage Due Diligence Guidelines* p. 7.

⁸¹ Department of Environment, Climate Change and Water New South Wales (2010), *Due Diligence Code of Practice for the Protection of Aboriginal Objects in New South Wales* p. 8.

⁸² *Illegal Logging Prohibition Regulation 2012*, p. 5, 14.

Importers and processors are not required to prove the legality of their timber, but rather must “*undertake reasonable steps and ask suitable questions about the origin of the timber*”.^{83,84} Such information may include:

The product type or trade name;

- The common name or scientific name of the tree from which the timber is derived;
- Country of harvest or region within the country / state of harvest;
- Documentation provided by supplier; and
- Evidence that the timber in the product was legally harvested.⁸⁵

Interpretations of reasonably practicable

The legal term ‘reasonably practicable’ has long featured in occupational health and safety legislation in Australia and is key concept in the Australian *Work Health and Safety Act 2011* (the WHS Act) and the associated regulations. In its published interpretive guidance, Safe Work Australia defines ‘reasonably practicable’ as “*that which is, or was at a particular time, reasonably able to be done to ensure health and safety, taking into account and weighing up all relevant matters.*”⁸⁶ Despite the availability of interpretive guidance, the term has still been subject to controversial interpretation,⁸⁷ highlighting the role of the legal system in objectively assessing what can be considered ‘reasonably practicable’ on a case-by-case basis.

In their compliance toolkit, the Australian Timber Importers Federation (ATIF) states that what is ‘reasonably practicable’ in terms of information gathering will vary depending on the individual circumstances of an importer. ATIF considers that “*importers need to balance the likelihood that the timber product they are proposing to import has been illegally logged against the time, cost and resources required to gather information needed to justify a conclusion that the risk is low*”.⁸⁸

2.5.4 Supporting documents for due diligence compliance

Due diligence requirements have been designed with the intention of being flexible for a variety of businesses. Approved Timber Legality Frameworks, Country Specific Guidelines and State Specific Guidelines have been embedded into the Regulations giving importers and processors the option of using pre-tested practices to streamline risk identification and assessment (Table 9).⁸⁹ It is the intent of the Government that

⁸³ Department of Agriculture (2014) Frequently asked questions accessed on 25 February 2015 at <http://www.agriculture.gov.au/forestry/policies/illegal-logging/faqs>.

⁸⁴ While businesses general found this guidance overly vague, other stakeholders such as the World Wildlife Fund believed the Regulations built in “sufficient flexibility”.

⁸⁵ *Illegal Logging Prohibition Regulation 2012*

⁸⁶ Safe Work Australia (2011) *Interpretive Guideline – model Work Health and Safety Act – the meaning of ‘reasonably practicable’*.

⁸⁷ Jones, K. (2012) *Woodchipper decision could set a worrying safety precedent* Safety at Work Blog accessed 25 February 2015 at <http://safetyatworkblog.com/2012/07/24/woodchipper-decision-could-set-a-worrying-safety-precedent/>.

⁸⁸ ATIF (2014) *Legality Compliance Toolkit* p. 10.

⁸⁹ Department of Agriculture (undated) Fact sheet 2.3 Due diligence – use of timber legality frameworks (importers).

many businesses should be able to rely on these frameworks and guidelines to conduct due diligence through business-as-usual practices. Where frameworks or guidelines have been employed to conclude that there is a low risk of illegally logged timber being present, businesses can proceed with the import or begin to process without undertaking further due diligence steps.

Table 9 - Supporting documents for due diligence compliance

State Specific Guidelines (SSGs)	SSGs have been developed in collaboration with each of the Australian State Governments with the aim of providing information to processors on the laws in operation at the place of harvest.
Country Specific Guidelines (CSGs)	CSGs have been prepared with the aim of assisting importers to better understand the legal framework of the country from which timber has been harvested from. ⁹⁰ Australia has developed CSGs in collaboration with Canada, Finland, Indonesia, Italy, New Zealand and the Solomon Islands for the importation of timber, covering approximately 32 per cent of Australian timber imports by consignment value. ⁹¹
Timber Legality Frameworks	The Regulations recognise three Timber Legality Frameworks (TLFs) as providing a high level of assurance that wood products traded within the scope of their respective programs are legally logged for Australian purposes: <ul style="list-style-type: none"> • Forest Law Enforcement Governance and Trade (FLEGT) licensing scheme; • Forest Stewardship Council (FSC) forest management certification standard and chain of custody standard; and • Programme for the Endorsement of Forest Certification (PEFC) sustainable forest management certification standard and chain of custody standard.⁹²
Industry-developed guidelines for due diligence	The Timber Development Association (TDA), with funding from the Australian Government has developed a range tools including a training seminar aimed at all importers of regulated products. The Australian Timber Importers Federation (ATIF) has also produced a Legality Compliance Toolkit (the Toolkit) to assist timber product importers in understanding and meeting the due diligence steps required. There appears to be little targeted industry guidance available to businesses importing pulp, paper or complex timber furniture products.

⁹⁰ Department of Agriculture (2015) *Further information and resources – Country Specific Guidelines and State Specific Guidelines* accessed 25 February 2015 at <
<http://www.agriculture.gov.au/forestry/policies/illegal-logging/information-resources>>

⁹¹ Department of Agriculture analysis

⁹² Department of Agriculture (undated) *Due diligence – use of Timber Legality Frameworks (importers)*.

2.5.5 Community Protection Question

The due diligence activities undertaken by the importer (typically by the broker on the authority of the importer) is attested to through the Community Protection Question at the point of import:

"Has the importer complied with the due diligence requirements of the Illegal Logging Prohibition Act 2012 and associated regulations? (if product is exempt or does not contain timber, answer yes)."

The answer to this question is intended to enable the Department to distinguish between consignments that the importer considers to have been subject to due diligence, and those that have not. This subsequently allows for enforcement actions and analysis of the regulated community.

The Community Protection Question step is unique and differs from other jurisdictions where due diligence is limited to the completion of separate import declaration forms (e.g. the Plant and Plant Product Declaration Form under the Lacey Act in the US).⁹³ The question functions as a reminder to businesses of their obligation to comply with due diligence requirements when importing timber products. Asking businesses to answer this question may also enable better monitoring and enforcement of requirements. See section 3.5 for analysis of responses to the community protection question since the Regulations came into effect on 30 November, 2014.

2.6 Summary

Australia's share of the trade in the products of illegal logging is uncertain (as it is with all illegal products); however, given its strong trading relationships with what are considered by many to be higher risk areas, estimates suggest that Australia's contribution to the issue is approximately \$400 million per annum in traded goods (excluding furniture).⁹⁴

Along with the EU Timber Regulation and the US Lacey Act, the Australian *Illegal Logging Prohibition Act 2012* seeks to curb importing of illegally logged timber through the implementation of a due diligence system on relevant businesses. The Australian framework is supported by the *Illegal Logging Prohibition Regulation 2012* and its relevant amendments, which specifically outline the due diligence processes. The Regulations impose these requirements across importers of four different product chapters, specifically those covering wood articles, paper, pulp and furniture. The only major exemptions are for consignments with less than \$1,000 in value of regulated timber products or for recycled products. Thus, these compliance activities are required

⁹³ US Customs and Border Protection (2008) *Lacey Act* accessed on 25 February 2015 at <<http://www.cbp.gov/trade/entry-summary/public-laws-impacting-trade/public-law-110-246/amended-lacey-act/lacey-act>>

⁹⁴ Pöyry (2005), 'Overview of Illegal Logging', p.12. Accessed on 2 March 2015 at <http://www.agriculture.gov.au/SiteCollectionDocuments/forestry/international/illegal-logging/illegal_logging_report.pdf>

of businesses regardless of their size, risk of product chapter and/or risk of supplier country.

Given the current Government's deregulatory agenda, and its focus on minimising undue burden on business, this Review was commissioned to determine whether the current illegal logging prohibition system is achieving an appropriate balance between the cost of compliance for small businesses and reducing the risk of illegally logged timber entering into the Australian market.⁹⁵

⁹⁵ Department of Prime Minister and Cabinet (undated). 'Whole of Government deregulation agenda'. Accessed 10 March 2015 at <<http://www.dpmc.gov.au/office-deregulation/whole-government-deregulation-agenda>>

3 The regulated community

This section addresses item 1 of the Terms of Reference – A better understanding of the ‘regulated community’; the type and nature of the timber products they are dealing with; and their potential costs in complying with the new requirements.

ABARES have assessed large quantities of information that assists in understanding the community affected by the *Illegal Logging Prohibition Regulation 2012*. Their 2013 report, *Illegal logging regulation: the affected community*, looks at the characteristics of importers, processors, brokers and overseas suppliers affected by the Regulations.⁹⁶ This section of the Review focuses on their findings regarding the regulated community – Australian importers and processors. The data included in this section is from 2012 and includes an assessment of the following variables by business size:⁹⁷

- Number of businesses impacted by the Regulations; and
- Value of imports impacted by the Regulations.⁹⁸

This information is supplemented by additional data on supplier relationships and consignment sizes, which are assessed briefly here and more fully analysed in Appendix D.

Overall, the vast majority of value is generated by medium to large businesses, despite this cohort often being the smallest in number. The key findings by business size are described below.⁹⁹

3.1.1 Micro business (annual turnover between \$0-2m)

Of the regulated businesses that would have been captured by the \$1,000 individual consignment threshold for which turnover data was available, 6,633 (in 2012) were ‘micro’ businesses, making it the largest importer cohort. The largest product chapter imported by these businesses was furniture, which is in contrast with the overarching trend, where the paper industry had the greatest number of businesses.

Despite being the largest cohort by number, micro businesses imported the least in terms of value (at \$344 million) as compared with other business sizes, with furniture imports accounting for approximately half of this value (54 per cent).

⁹⁶ Gupta, M. and Hug, B. (2013), *Illegal logging regulation: the affected community*, ABARES, report to client prepared for the Department of Agriculture, Canberra, November. CC BY 3.0.

⁹⁷ 2012 was selected because it was the baseline dataset used in the 2013 ABARES report (*Ibid.*) to assess the Regulations. Given the limited timeframe of this Review, the 2012 dataset was also more readily available.

⁹⁸ ABARES analysed ABS business size data and Customs ICS data that contained information for consignments import into Australia with timber products. This allowed ABARES to analyse for the first time the consignments of timber products (by type of product, origin, and consignment size) by size of firm. However, not all importers could be matched the ABS data based for business size.

⁹⁹ See Appendix D for a more detailed breakdown of supplier relationships and consignment sizes by business size.

3.1.2 Small business (annual turnover between \$2-10m)

Small businesses that would have been captured by the \$1,000 individual consignment threshold formed a smaller cohort than micro businesses (with 3,426 businesses), but larger than the medium to large cohort. 62 per cent of these businesses imported paper products. While small business only imported 13 per cent¹⁰⁰ of the overall value imported to Australia (\$730 million) they imported approximately double the value of micro business imports.¹⁰¹

Furniture product imports (\$332 million) accounted for the largest share by value of small business imports, echoing micro business. Timber and paper product imports both accounted for approximately \$200 million.

3.1.3 Medium to large business (annual turnover between \$10m+)

In 2012, there would have been approximately 300 less regulated medium to large businesses captured by the \$1,000 individual consignment threshold operating than small businesses (3,108 businesses in total), making it the smallest cohort. Despite this, these businesses accounted for \$4.4 billion of the \$5.8 billion that was imported in 2012. The paper product chapter accounted for \$2.1 billion of this total, in contrast to the smaller business sizes which had their largest contributions from the furniture industry.

3.2 Number of importers impacted

The total number of importers of regulated timber products in 2012 was 26,992.¹⁰² Of this, 9,754 businesses would not have been subject to the illegal logging Regulations due to importing products below the \$1,000 threshold, leaving in excess of 17,000 importers within the Regulations' jurisdiction.

Key findings of number of importers by business size (and product chapter) include:

- There were at least 10,059 micro and small importers (76 per cent of the total number of businesses where size is known);
- The number of paper and furniture importers was substantial when compared with timber and pulp (approximately 17,000 businesses import paper and/or furniture); and
- While micro and small businesses represented similar proportions of total business counts across each of the major product chapters, large businesses were especially concentrated in the paper market, representing 26 per cent of paper imports.

The number of businesses that imported individual product chapters do not match the total number of businesses in the table below. This is attributable to 2,256 companies

¹⁰⁰ ABARES (upcoming)

¹⁰¹ It is expected that both of these business sizes imported slightly higher proportions of total value than calculated as the two percent of total value that the 'no data' group represents is likely to include primarily smaller businesses.

¹⁰² Gupta, M. and Hug, B. (2013), *Illegal logging regulation: the affected community*, ABARES, report to client prepared for the Department of Agriculture, Canberra, November. CC BY 3.0.

importing two product chapters, and 386 businesses importing three product chapters.¹⁰³

Further, ABARES notes that there were 30 pulp importers as at 2012 which are included in the total column in the table below.¹⁰⁴

Table 10 - Number of regulated timber product importers by business size in 2012

Business size	Wood	Paper	Furniture	Total ¹⁰⁵
Micro (\$0 - \$2m)	1,108	3,294	3,371	6,633
Small (\$2m - \$10m)	560	2,131	1,333	3,426
Medium and Large (\$10m+)	457	2,378	983	3,108
No data ¹⁰⁶	603	1,267	2,783	4,087
Total number of importers	2,728	9,070	8,470	17,254

Source: ABARES analysis of ABS and Customs data set.

ABS notes: Business size relates to the 2012 calendar year and is sourced from the ABS Common Frame. Total column includes Chapter 47. Importers can import multiple difference 4 digit products over the 2012 calendar year, therefore the sum of the components will not add to the totals at the end.

¹⁰³ ABARES analysis

¹⁰⁴ Gupta, M. and Hug, B. (2013), *Illegal logging regulation: the affected community*, ABARES, report to client prepared for the Department of Agriculture, Canberra, November. CC BY 3.0. p. 2,19

¹⁰⁶ This group also contains individuals and overseas businesses. ABARES analysis indicated that approximately 38 per cent (1,554) of this cohort, in 2012, was made up of Australian businesses that had individual consignments above the \$1,000 regulated timber product threshold.

3.3 Value of imports impacted

The total value of regulated imported timber products was \$5.8 billion in 2012, with medium and large businesses importing \$4.4 billion or 77 per cent of the overall total. As expected, while there were substantially fewer medium and large businesses, they import the most value. Micro and small business imported \$1.1 billion worth of regulated timber product. Key findings of value of imports by business size (and product chapter) include:

- Paper businesses imported the greatest amount of regulated timber products by value in 2012, importing \$2.4 billion;
- Over \$2.1 billion of this came from medium and large businesses;
- The medium and large business figure is disproportionately high for paper. It is over \$700 million more than the next largest chapter (furniture) for this cohort; and
- Micro and small businesses combined receive 48 per cent of their import value in the furniture industry.

Total value of pulp imports was \$140 million, materially lower than the other chapters.¹⁰⁷ This figure has been included in the overall import total figure (\$5,784 million).

Table 11 - Value of regulated timber product imports by business size in 2012 (\$m)

Business size	Wood	Paper	Furniture	Total ¹⁰⁸
Micro (\$0 - \$2m)	78	80	187	344
Small (\$2m - \$10m)	196	203	332	730
Medium and Large (\$10m+)	943	2,117	1,384	4,444
No data ¹⁰⁹	33	28	66	126
Total value of imports	1,249	2,428	1,968	5,784

Source: ABARES analysis of ABS and Customs data set.

ABS notes: Business size relates to the 2012 calendar year and is sourced from the ABS Common Frame. Where ICS value data was greater than the turnover category based on ABS common frame data, ICS value data was used as a proxy to determine a more appropriate turnover category.

3.4 Australia's sources for imported timber products

Australia's main trading partners are listed below, with China representing the largest trading partner. As discussed in section 2.1.4, higher risk supplier countries feature in this list, with illegal logging activity known to be more widespread in Indonesia (third

¹⁰⁷ ABARES analysis of ABS data set.

¹⁰⁸ 'Total value of imports' includes Pulp product import value of \$140 million.

¹⁰⁹ This group also contains individuals and overseas businesses.

largest trading partner), Malaysia (fourth largest trading partner) and Thailand (sixth largest trading partner).¹¹⁰

Table 12 - Top 10 Australian trading partners above the \$1,000 consignment value threshold in 2012 (excluding chapter 47, pulp products)

Country	Wood	Paper	Furniture	Across all chapters
China	153.1	628.3	1,161.3	1,942.8
New Zealand	296.7	218.8	14.6	530.1
Indonesia	231.0	134.6	53.2	418.8
Malaysia	140.6	85.8	156.4	382.8
United States	99.6	173.5	14.5	287.6
Thailand	3.3	71.2	143.2	217.7
Finland	6.6	203.2	.5	210.3
Germany	34.0	112.3	26.1	172.4
Italy	9.6	88.3	58.7	156.7
Korea, Rep. of	1.7	132.6	15.6	150.0
All other countries	273.0	578.8	323.6	1,175.4
Total value of imports across all countries	1,249.2	2,427.5	1,967.7	5,644.4

Source: Gupta, M. and Hug, B. (2013), *Illegal logging regulation: the affected community, ABARES, report to client prepared for the Department of Agriculture, Canberra, November. CC BY 3.0., p. 9.*

ABS notes: Business size relates to the 2012 calendar year and is sourced from the ABS Common Frame. Where ICS value data was greater than the turnover category reported from the ABS Common Frame, ICS value data was used as a proxy to determine a more appropriate turnover category. Data excludes Chapter 47 but includes value of imports for Category 5 ('no data' group) importers. The 'Total value of imports across all countries' row contains data for the top 10 countries listed, plus all other countries that were captured in the scope of this request.

Micro and small businesses import a greater proportion of their regulated timber product, by value, from China (54 per cent and 44 per cent) when compared to medium and large businesses (31 per cent). Smaller businesses also import a greater value of regulated timber products from Malaysia (micro – seven per cent, small – nine per cent) than medium and large businesses (six per cent).

This trend is reversed when considering another 'higher risk'¹¹¹ country, Thailand. Regulated timber products from this country make up 4 per cent of the total value of regulated timber product imports from medium and large businesses, whereas Thailand

¹¹⁰ World Bank (2006), *Strengthening Forest Law Enforcement and Governance: Addressing a Systemic Constraint to Sustainable Development*

¹¹¹ As defined by the ATIF toolkit - a country with a Corruption Perception Index rating less than 50 or at any stage of VPA negotiations with EU and/or that has known armed conflict. The Australian Government has not categorised individual countries as higher or lower risk.

does not feature on the top 10 list of regulated timber product import sources by value for either micro or small businesses.

Further analysis on source of import can be found at Appendix D.3.

3.5 Processors

In addition to importers, domestic processors are impacted by the illegal logging Regulations. There were 468¹¹² processors as at 2012, with a notable declining trend; ABARES stated that there was a decline in hardwood mills of 60 per cent and in softwood mills of 25 per cent since 2006-07.¹¹³ In 2012, there were 232 hardwood mills in Australia, making up approximately half of the domestic processing population.

3.6 The regulatory activity since 30 November 2014

Between 30 November 2014, when the Regulations came into effect, and 19 February 2015, a total of 8,422 businesses imported consignments of regulated timber goods over the \$1,000 threshold which required due diligence to be performed.¹¹⁴

- These products have been imported from 88 different countries, with the greatest value of imports coming from China (\$597 million, 39 per cent), New Zealand (\$123 million, 8 per cent) and Indonesia (\$108 million, 7 per cent).
- The key regulated timber products being imported include Paper (36 per cent), Furniture (33 per cent), Sawnwood (6 per cent) and Continuously shaped timber (6 per cent).
- Importers responded “Yes” to the Community Protection Question (CPQ) for 77 per cent of regulated product lines entering Australia; during this period. This may overstate the proportion of businesses undertaking any form of due diligence as when the Review contacted over 350 businesses seeking an interview, approximately 10 per cent contacted indicated they were not aware of the new Regulations applying to timber imports.

¹¹² Gupta, M. and Hug, B. (2013), *Illegal logging regulation: the affected community*, ABARES, report to client prepared for the Department of Agriculture, Canberra, November. CC BY 3.0., p. 23-24

¹¹³ ABARES (2014). ‘ABARES National Wood Processing Survey 2012-13’, p.5. Accessed on 3/3/15 at http://data.daff.gov.au/data/warehouse/9aaf/9aafe/2014/NatWdSur/NatWdSur201408_v1.0.0.pdf.

¹¹⁴ This data was provided by the Department and was originally sourced from live Customs data.

- At the same time, 55 per cent of importers have at some time answered “No” for at least one product. This may also not be an accurate reflection of the current activity, as some feedback workshop participants indicated they were answering “No” to the CPQ despite performing some due diligence activities. They plan to answer “Yes” when they are completely satisfied that their due diligence processes would pass the requirements.
- As a percentage of their total product lines, the countries that are most frequently associated with a declaration of “Yes” to the CPQ are Portugal (99 per cent), Slovakia (99 per cent), Poland (98 per cent), and Sweden (98 per cent).
- As a percentage of their total product lines, the countries that are most frequently associated with a declaration of “No” to the CPQ are India (52 per cent), Taiwan (36 per cent) and USA (36 per cent).

4 Businesses experiences with the Regulations

This section addresses item 2 of the Terms of Reference - An assessment of whether applying the Regulations in their current form to small business will make a material difference in reducing the entry of illegally logged timber products onto the Australian market. To respond to this, KPMG undertook 65 businesses interviews and held six stakeholder workshops to test the preliminary findings of the interviews. This section describes who we spoke to and provides both quantitative and qualitative analysis around the information we gathered.

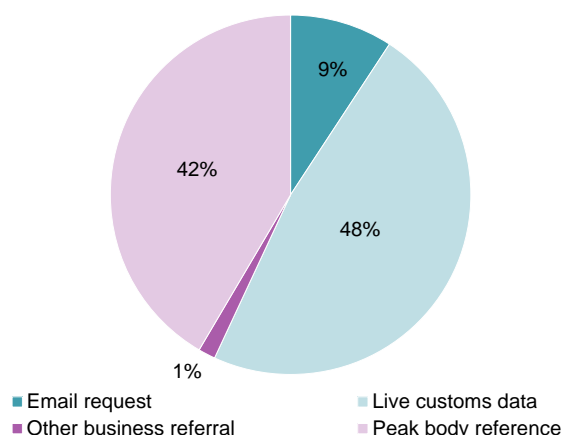
4.1 Profile of the businesses consulted

Given the timelines associated with this Review it has been necessary to draw on a small, albeit informed, sample of regulated businesses. There are clearly limitations to the extrapolation and interpretation of the data collected, but the analysis is the most comprehensive assessment of business compliance costs to date, and is the first ex-post analysis of the impact of the Regulations. The following section describes the characteristics of the sample of businesses interviewed.

4.1.1 How businesses were identified

A total of 351 regulated businesses were invited to participate in the business interviews. Of the 65 businesses that agreed to be interviewed, most were identified through either data on recent importers of products provided by the Department, or referred to KPMG from peak bodies (see Figure 1). The data on recent importing businesses related to those that had selected 'Yes' for the CPQ question, indicating they were attesting that they had undertaken due diligence on regulated timber product/s that were imported between 30 November 2014 and 11 February 2015.

Figure 1 – How businesses were identified



Source: KPMG

All of the recruitment methods described in Figure 1 are likely to have captured businesses with greater awareness of the Regulations (as reflected in their willingness to participate), meaning the sample is potentially skewed towards ‘early adopters’ of the requirements. The impacts of this potential bias are discussed further in section 4.2.

4.1.2 Business profiles

The 65 businesses interviewed covered importers of all four product chapters as well as domestic processors (Table 13). Additionally, focus was placed on ensuring all three business size categories were represented (where practical).

Table 13 – Business interview sample by annual turnover and product

Annual turnover	Wood	Pulp	Paper	Furniture	Processor	Total ¹¹⁵
Micro (\$0 - \$2m)	7	0	1	8	1	15
Small (\$2m - \$10m)	11	0	2	6	3	21
Medium and Large (\$10m+)	15	2	12	8	4	29
Total	33	2	15	22	8	65

The sample of interviewed businesses broadly reflected the proportions of the market each product chapter represents (see section 3.1), with the exception of chapter 44 – wood articles, which was over-represented in the sample. This cohort of businesses displayed a higher willingness to participate which, based on the consultation process, is likely due to a higher awareness of the Regulations.

Table 14 outlines the primary jurisdictions of the businesses called and those interviewed.

Table 14 – Business interview sample primary jurisdiction

State	All called	Completed
New South Wales	145	15
Victoria	110	29
Queensland	47	14
Western Australia	29	3
South Australia	11	2
Tasmania	5	1
Northern Territory	2	1
Australian Capital Territory	2	0
Total	351	65

¹¹⁵ As per Table 11, these totals are the discrete totals for each business size and do not represent the sum of the row due to businesses importing multiple product chapters or operating as both importers and processors.

The vast majority of total businesses called (87 per cent) were identified through live Customs data which indicated the business had recently imported regulated timber product. As such, the figures in Table 14 reflect the concentration of businesses in the larger jurisdictions. A more targeted approach to calling was taken towards the end of the consultation period to ensure businesses in the smaller states and territories had the opportunity to express their views.

The businesses interviewed imported regulated product from 28 countries, as shown in Table 15.

Table 15 – Import countries of business sample

Country	No. of sample businesses importing from this country	Percentage of sample businesses importing from this country
China	33	51 %
Indonesia	20	32 %
Malaysia	20	32 %
New Zealand	10	17 %
United States	11	17 %
Vietnam	7	11 %
Chile	5	9 %
Other (21 countries)	36	55 %

The most frequent country of import was China, with over half of the sample businesses importing from this country. The top six most frequent countries of import from the sample match the top six industry countries of import by total value, with the ordering also being broadly reflective of the market.

Demonstrating the variety of import countries; 12 businesses within the sample were importing from *unique* countries (not a source of imports for any of the other businesses consulted).

4.2 Limitations of the sample

The purpose of the quantitative analysis was to capture the current experiences of businesses at a particular point in time. The following sections discuss the limitations of applying cost estimates derived from this sample of businesses to the broader regulated population, or in claiming they are a reasonable representation of the eventual compliance costs that businesses will incur in years to come.

4.2.1 Early adopter bias

As touched upon earlier, it is anticipated that, due to the nature of the interviews (which focused on those who had already considered that they had started undertaking due diligence) and the way they were sourced, the sample of businesses interviewed is likely to largely consist of early adopters. Therefore, insights drawn from this sample are

unlikely to precisely mirror the broader regulated community¹¹⁶, but instead provide an indication of the experiences facing the broader community as familiarity with the Regulations continues to increase.

Further evidence to support the hypothesis of the sample largely consisting of early adopters is that:

1. 88 per cent claimed to be either 'somewhat familiar', 'familiar' or 'very familiar' with the Regulations. This represents a higher degree of familiarity compared to the broader population contacted; and
2. 38 per cent had at least one of either a Forestry Stewardship Council (FSC) certification or a Programme for the Endorsement of Forest Certification (PEFC). This highlights the increased awareness and participation of the business in relation to quality assurance matters.

4.2.2 Duration since introduction of Regulations

Given the relative short time period since the commencement of the Regulations on 30 November 2014, many businesses were unable to provide accurate (or in some cases any) estimates of ongoing compliance costs as they were yet to experience those costs. For five businesses that agreed to participate, they were also yet to establish their broader due diligence system (one-off cost) and so the Review was also unable to provide estimates of these costs. Businesses that were unable to provide time cost estimates were removed from the relevant samples for analysis in order to provide a more accurate representation of businesses' current experiences, however the time cost accuracy limitation remains throughout the analysed sample. It is noted that these calculations will likely under-estimate the future costs to business which will grow as more businesses begin to update or create their due diligence systems.

The duration between commencement of the Regulations and the initiation of the Review was also a key point of feedback from stakeholder workshops, where concern was expressed as to the value of any analysis performed so soon after implementation. One stakeholder group, The World Wildlife Fund, suggested delaying any regulatory changes until the five year review period provided for in Section 84 of the Act.

4.2.3 Compliance staff

The business interviews were largely conducted with compliance staff in each business as these were the individuals most likely to be dealing with due diligence activities on a day-to-day basis. While for smaller businesses, the business owner may also be the person responsible for handling due diligence activities, it was most often the case that another staff member was responsible.

It is possible that compliance staff have a greater appreciation for the rationale of the Regulations given their greater familiarity with the Regulations. As such, it may be the case that answers to various qualitative questions (such as the appropriateness between the level of cost and risk) were overly favourable.

¹¹⁶ As discussed in section 3, this was estimated by ABARES to be almost 27,000 importers based on 2012 data.

4.2.4 Understanding the incremental costs

As with any interview based around data collection, there is a risk that participant responses may reflect a misunderstanding of a question or lack of clarity about the specific context of the answer, particularly where a regulatory regime affects individual businesses differently. This risk is the primary reason that a survey, with the benefits of a potentially higher sample size, was avoided. Unlike surveys, one-on-one interviews allowed questions to be further explained and responses to be tested. Despite this added level of scrutiny, as pointed out by the Australian Environment Foundation in their submission to the Review, estimates will still to some degree represent “self-reported perception of the costs that they have incurred”.

4.3 Previous estimates of compliance costs

A range of studies have sought to estimate business compliance costs associated with the illegal logging Regulation’s due diligence requirements.

The CIE prepared a Regulatory Impact Statement (RIS) for the Department of Agriculture, Fisheries and Forestry in January 2010.¹¹⁷ This report fed into the Department’s final RIS in May 2010 and estimated the compliance costs for Australian import businesses to be between USD\$13-USD\$168 million per annum, depending on the legality verification system used and the range of products to be covered. Compliance costs were modelled using information from a range of sources, including stakeholders consulted in the early stages of this RIS process.

The Department also sought to calculate the cost to industry, with initial estimates indicating an approximate cost of around \$11.9 million in the first year, falling to \$8.1 million in the following years.¹¹⁸ These estimates were developed as part of the government’s regulatory reporting process and were developed using the government’s mandatory regulatory costing model.

Some industry stakeholders have also estimated the likely business compliance costs associated with the amended illegal logging Regulations. In their submission to the Parliamentary Standing Committee on the Environment’s Inquiry “Streamlining environmental regulation, ‘green tape’, and one stop shops”, the Timber Veneer Association of Australia and the Window and Door Industry Council estimated the new Regulations would impose a compliance cost of approximately \$340 million annually for Australian wood-products, furniture and timber importers. In speaking with these organisations, it was noted that they had revised the estimated anticipated compliance costs to be closer to \$300 million annually.¹¹⁹

This Review is the first ex-post analysis of the regulatory impact on affected businesses.

¹¹⁷ Centre for International Economics (2010), *A Final Report to inform a Regulation Impact Statement for the proposed new policy on illegally logged timber*.

¹¹⁸ Initial Department of Agriculture estimates generated as part of the Government’s broader de-regulation process. Estimates were cited in Financial Review (2014), *Time to chop down Labor’s approach to illegal logging* by Josh Frydenberg, 11 December 2014.

¹¹⁹ These estimates are substantially larger than those calculated by the analysis that forms part of this Review.

4.4 Estimated compliance costs

Businesses were asked to estimate one-off (establishment) and ongoing costs associated with completing due diligence tasks that were *above and beyond* what the business was previously doing. This section outlines the cost estimates provided, broken down across the three business sizes. It presents the quantitative findings of our business interview process by calculating median one-off and ongoing time costs associated with complying with the illegal logging due diligence requirements.¹²⁰

4.4.1 Cost types not captured by the analysis

While the analysis of this Review focuses on direct labour time costs (administrative and compliance costs) associated with completing due diligence activities, there are a range of other cost types not captured by the Review that could be experienced by some businesses.

Fees – Financial costs were sought through the business interview process and, when incurred, consisted largely of funding of staff training courses, contracting legal advice and travel. These costs were incurred by 15 per cent of the businesses interviewed and were generally much lower than the estimated labour time costs experienced by the business. Due to the infrequency and low magnitude of this cost type, it was not analysed further or extrapolated to an industry level for this Review. However, it should be noted that a portion of the industry are choosing to meet their due diligence requirements by these forms of investment.

Business decision costs – While delay costs¹²¹ were not experienced by any of the businesses consulted, there are other forms of potential costs that relate to business decision making. It is possible that:

- Businesses have decided not to import particular legal products as they were classified as high risk; and/or
- Businesses have decided not to import from particular suppliers of legal product as they were classified as high risk.

Both of these scenarios could result in additional time and money being spent in looking for another product or supplier that the business deems low risk. These costs were not captured as part of this Review.

¹²⁰ Given the small sample size of some business cohorts, median was chosen as a more reliable statistical representation compared to the mean which can be heavily influenced by outliers.

¹²¹ In this context, delay costs would be incurred if a business delayed a decision around selecting a supplier or importing a particular consignment due to their due diligence activities or concerns they might have around the risk of the imported product.

4.4.2 Understanding the cost estimates

Two key drivers were identified that heavily impacted the cost estimates derived from the business interviews:

1. Familiarity with the Regulations; and
2. Adequacy of existing systems and processes to meet the business' interpretation of the due diligence requirements.

Figure 2 describes the three categories in which businesses were placed based on their cost estimates and answers to the more qualitative questions.¹²²

Figure 2 – Interpretation of various time cost estimates

\$	Due diligence processes	% of sample	Business size breakdown
Lower cost estimates	1 <ul style="list-style-type: none"> High familiarity with regulations; and Existing due diligence processes assessed as adequate or near adequate 	50%	9 Micro, 12 Small, 11 Medium/Large
	2 <ul style="list-style-type: none"> Limited if any familiarity with regulations; and Yet to undertake due diligence requirements 	12%	3 Micro, 2 Small, 3 Medium/Large
Higher cost estimates	3 <ul style="list-style-type: none"> High familiarity with regulations; and Due diligence processes assessed as inadequate and thus have invested heavily in systems and processes 	38%	3 Micro, 7 Small, 15 Medium/Large

Category 1 – These businesses made up half of the sample and cited few marginal compliance costs associated with due diligence activities. These businesses tended to assess their existing systems and practices as compliant (or close to compliant) with the new Regulations and therefore minimal additional effort was required. The three business sizes were roughly equally represented within this category.

Category 2 – These businesses are either completely unaware of the Regulations or are still in the process of understanding the requirements and are yet to begin due diligence activity.¹²³ Only 12 per cent of the sample was made up of these businesses, further indicating the sample's bias towards early adopters. The three business sizes were roughly equally represented within this category.

Category 3 – Over one-third of the sample was made up of businesses with these characteristics. These businesses have either identified the need to significantly enhance their due diligence activities, or are taking a particularly strict interpretation of the Regulations and may ultimately be considered 'over compliant'. Larger businesses were over-represented for this third category.

¹²² Higher cost estimates is a relative sample term, and does not necessarily indicate High costs. For the sample, higher cost estimates were defined as either a) more than 40 hours spent on either one-off or ongoing annual costs or b) combined one-off and one year's worth of ongoing costs of more than 90 hours.

¹²³ One micro business within this category suggested they were somewhat aware of the Regulations but were choosing not to comply given the complexity of the Regulations.

As businesses in category two are made aware of the Regulations, or obtain a greater understanding of what is required of them, their costs are likely to increase as they place additional effort into due diligence activities, thus seeing them transition from category two to category three.

As businesses in category one are already familiar with the Regulations and believe they are meeting the requirements at a low cost, the only scenario in which members of this category would transition to another category would be if their efforts are reviewed through a compliance assessment and found not to comply. Amending their due diligence systems could see such a business transition to category three, either temporarily or permanently.

These categories help to better understand the median cost estimates presented in the following sections. It is expected that, over time, businesses in the second category (lower costs and low familiarity) will move into one of the other categories as familiarity with the Regulations increases throughout the regulated community. This is likely to result in fewer responses of 'zero costs', and thus increase the median time cost estimates of each business cohort.

4.4.3 Cost estimates – establishment costs

Given the small sample size of some business size / product chapter cohorts, cost estimates were assessed by applying only the primary filter (business size). Due to the limited sample, no conclusions could be made about material differences in time costs between different product chapters.¹²⁴

Common establishment tasks included:

- Familiarisation with the Regulations;
- Training and information seminars;
- Contacting suppliers; and
- Setting up systems and processes.

Table 16 outlines the median, one-off (establishment) costs gathered from businesses at each of the three business size categories. Median time cost estimates were calculated for two segments of the sample:

1. **Estimates provided** - businesses that could confidently estimate the one-off time cost impact to their business (sample of 54); and
2. **High familiarity** - businesses that stated they were 'very familiar' with the Regulations (sample of 20).

¹²⁴ Anecdotally, more complex products (with more complicated supply chains) such as pulp, paper and furniture, would require more time spent on due diligence.

A range of the cohort's estimates is also provided under each median value in brackets.

Table 16 – Median one-off time costs (hours)

Annual turnover	Estimates provided		High familiarity	
	Sample size	One-off costs (hrs)	Sample size	One-off costs (hrs)
\$0 - \$2 million	11	3 (0 – 115)	1	0 (0)
\$2 million - \$10 million	18	13 (0 – 193)	4	93 (4 – 193)
Over \$10 million	25	88 (0 – 1,016)	15	200 (0 – 1,016)

One-off time cost estimates for all three business size categories displayed significant ranges, demonstrating the large variation in both familiarity and interpretation with the Regulations. The three 'estimates provided' medians were accepted as broadly reflective of industry by the majority of feedback workshop participants, whereas the medians for businesses claiming high familiarity with the Regulations tended to be slightly higher than what workshop participants expected.

The trend of increased time costs as the business size grows is likely explained by two factors:

- Larger businesses have a higher familiarity with the Regulations and so are more likely to be early adopters (and thus experience costs earlier); and
- Businesses with higher product volumes/consignments will be required to set up more sophisticated due diligence systems to capture the larger amounts of product being imported. It may be the case that 'per consignment/product' compliance costs for larger businesses are no greater, or perhaps even lower, than those of smaller businesses.

Larger processors also provided higher cost estimates, with a median one-off cost of 52 hours compared to a median of zero hours for the smaller business categories.

4.4.4 Cost estimates – ongoing costs

Given the small sample size of some business size/product chapter cohorts, cost estimates were assessed by applying only the primary filter (business size). Due to the limited sample, no conclusions could be made about material differences in time costs between different product chapters.¹²⁵

¹²⁵ Anecdotally, more complex products (with more complicated supply chains) such as pulp, paper and furniture, would require more time spent on due diligence.

Common ongoing tasks included:

- Annual checks of supplier information; and
- Gathering information for new suppliers/products.

Table 17 outlines the median annual ongoing costs gathered from businesses at each of the three business size categories. Time cost estimates were calculated for two segments of the sample:

1. **Estimates provided** - businesses that were in a position to confidently estimate and extrapolate existing ongoing costs to an annual basis (sample of 53); and
2. **High familiarity** - businesses that stated they were 'very familiar' with the Regulations (sample of 20).

A range of the cohort's estimates is also provided under each median value in brackets. As the Regulations have been in effect for less than one year, these ongoing costs are projections rather than estimates of actual time spent.

Table 17 – Median annual ongoing time costs (hours)

Annual turnover	Estimates provided		High familiarity	
	Sample size	Ongoing costs (hrs)	Sample size	Ongoing costs (hrs)
\$0 - \$2 million	11	0 (0 – 120)	1	0 (0)
\$2 million - \$10 million	17	0 (0 – 120)	4	40 (0 – 120)
Over \$10 million	25	9 (0 – 2,086)	15	40 (0 – 2,080)

Most businesses felt that almost all of the costs associated with complying with the Regulations came in the form of one-off or establishment costs. These views are reflected in the ongoing time costs estimates, with 45 per cent of businesses that were confident in estimating ongoing annual costs providing an estimate of zero hours.

While smaller businesses tended to believe that no additional effort would be required to maintain their due diligence systems, larger businesses that answered 'zero marginal cost' did so because they already had existing systems in place prior to 30 November 2014 which they deemed to satisfy the requirements of the Regulations. This trend was also observed for processors.

4.4.5 Cost drivers

While the tasks performed by each business remained relatively constant for both one-off and ongoing activities, each business size category produced large time estimate ranges. In addition to the two key cost drivers referred to in section 4.4.2, the following observations and analysis further assist in understanding the key drivers behind these variations:

- **Number of import countries/suppliers:** Median one-off time costs for businesses that import from up to three countries, regardless of business size, are low, however

as businesses increase the number of countries from which they import to four or more, their costs begin to increase substantially.

Anecdotally, this trend also appeared relevant for businesses with multiple suppliers (regardless of country). Businesses that change suppliers fewer than once a year were found to have significantly lower median one-off time costs compared to businesses that change supplier more than once a year.

- **Required system changes:** Large and medium businesses are most likely to have an entirely new or enhanced due diligence system as a result of the Regulations. Conversely, many micro businesses have experienced no change to their existing due diligence systems. This was largely reflected in the median cost estimates, which captures the difference of interpretation between the cohorts of what is required under the Regulations. While some micro businesses were yet to become suitably familiar with the Regulations, most that said they implemented 'no change' to their due diligence systems because they did not feel their systems required enhancing.
- **Broker assistance:** Smaller businesses tended to state that their brokers/agents were responsible for completing their due diligence requirements. Of the interviewed businesses, eight relied on their broker to complete their due diligence tasks, with four of them being micro businesses. The eight businesses that used a broker incurred materially lower one-off and ongoing costs, demonstrating that brokers are absorbing the cost of the due diligence efforts.

While the Regulations do not explicitly state that brokers cannot perform due diligence on behalf of a business, it is important the businesses recognise that the liability stills falls on them.

- **Experience of Processors:** Five of the eight processors interviewed required enhancements to, or entirely new, systems to meet their due diligence requirements. One-off and ongoing costs were generally much lower than those gathered from importers, which may reflect processors' decreased level of dependency on suppliers. Of the processors that did report material cost changes, they were all businesses that also imported regulated timber product.

As most businesses that were interviewed did not perform due diligence activities per consignment, the number of consignments alone does not appear to have a material impact on costs.

Similarly, there does not appear to be a correlation between a business being FSC or PEFC certified and costs, however anecdotally, it was suggested that businesses importing regulated product from suppliers with these forms of certification *would* experience lower costs (although the issue of whether these businesses are actually complying with the current regulatory requirements is discussed in section 4.5.5).

In light of all of these potential cost drivers and various business characteristics, the **variation and uncertainty in the interpretation of 'reasonably practical'** was a consistent insight gathered from the business consultation process and is likely to be a key driver to the range in time spent on due diligence activities.

4.4.6 Estimate of total regulated community compliance costs

Using the median costs outlined in the previous section and the baseline business counts for each regulated cohort (from Table 17), the following tables present the estimated, one-off and ongoing costs for all regulated businesses within Australia.¹²⁶ As Table 17 pertains to 2012 business count data, these regulated business counts and subsequent compliance cost estimates must be taken as approximations.

As any single business can import product from multiple product chapters, extrapolating the costs for each product chapter separately would lead to double-counting of some businesses. As such, the extrapolation of median cost data has again only considered the business size filter. Removing the product filter also increases the sample size per cohort, providing greater confidence in the figures.

Table 18 and Table 19 report estimates based on the businesses interviewed that considered they were able to confidently provide time cost estimates (54 businesses for one-off costs and 53 for ongoing costs). The industry one-off time costs based on this sample of businesses were estimated to likely be in the order of \$20 million when all businesses are complying, and the industry annual ongoing time costs were estimated to be in the order of \$2 million per annum. Given the even smaller sample size, and the early stage of implementation, these estimates are only indicative, and should be used with caution.

Table 18 – Extrapolated one-off time costs for businesses that were able to confidently provide time cost estimates ('estimates provided' sample)

Annual turnover	Median time cost (hrs)	Estimated number of regulated businesses	Estimated total compliance cost (\$m)
\$0 - \$2 million	3.0	6,633	1.2
\$2 million - \$10 million	13.0	3,426	2.7
Over \$10 million	88.0	3,108	16.3
Total		13,167	20.2

¹²⁶ This analysis does not cover the impact on Australian businesses for which no turnover data was available, as median time costs could not be captured for the 'no data' group. Furthermore, many of the 'no data' group relate to individuals and overseas businesses which are not the focus of this Review. While this will result in an underestimate of compliance cost impacts, this category of businesses only represents 2 per cent of the value of imported regulated product and so is not expected to impact the findings materially.

Table 19 – Extrapolated annual ongoing time costs for businesses that were able to confidently provide time cost estimates ('estimates provided' sample)

Annual turnover	Median time cost (hrs)	Estimated number of regulated businesses	Estimated total compliance cost (\$m) ¹²⁷
\$0 - \$2 million	0.0	6,633	0.0
\$2 million - \$10 million	0.0	3,426	0.0
Over \$10 million	9.0	3,108	1.7
Total		13,167	1.7

Table 20 and Table 21 report estimates based on only the 20 businesses that claimed to have a high familiarity of the Regulations (and thus be potentially more diligent about compliance). The industry one-off time costs based on this sample of businesses were estimated to likely be in the order of \$56 million when all businesses are complying, and the industry annual ongoing time costs were estimated to be in the order of \$16 million per annum. Given the even smaller sample size, and the early stage of implementation, these estimates are only indicative, and should be used with caution.

Table 20 – Extrapolated one-off time costs for businesses that stated high familiarity with the Regulations ('high familiarity' sample)

Annual turnover	Median time cost (hrs)	Estimated number of regulated businesses	Estimated total compliance cost (\$m) ¹²⁸
\$0 - \$2 million	not available ¹²⁹	6,633	not available
\$2 million - \$10 million	93.0	3,426	19.1
Over \$10 million	200.0	3,108	37.2
Total		13,167	56.3

¹²⁷ While the estimated costs reflect those that were confidently provided by businesses to KPMG, it is noted that this is a very small sample of businesses, and an industry wide estimate of zero ongoing costs for certain business size categories is not plausible. In reality, while the cost may be low, these figures are expected to be greater than zero.

¹²⁸ As per Table 19, while the estimated costs reflect those that were confidently provided by businesses to KPMG, it is noted that this is a very small sample of businesses, and an industry wide estimate of zero one-off costs for the micro business category is not plausible. In reality, while the cost may be low, these figures are expected to be greater than zero.

¹²⁹ As noted in Table 18, only one micro business when interviewed described itself as highly familiar with the regulations. Consequently, it was not possible to derive an indicative estimate for this group. However, that the indicative estimate based on the 'estimates provided' sample of 11 micro businesses was \$1.2 million. The total costs incurred by micro businesses is likely to be substantially higher than this estimate, as those with greater familiarity with the requirements typically had higher compliance cost estimates.

Table 21 – Extrapolated annual ongoing time costs for businesses that stated high familiarity with the Regulations ('high familiarity' sample)

Annual turnover	Median time cost (hrs)	Estimated number of regulated businesses	Estimated total compliance cost (\$m) ¹³⁰
\$0 - \$2 million	not available ¹³¹	6,633	not available
\$2 million - \$10 million	40.0	3,426	8.2
Over \$10 million	40.0	3,108	7.4
Total		13,167	15.6

The high sensitivity of the results to changes in sample segment reveals the large range of experiences that businesses, of all sizes, have had to date. By removing those businesses that were unable to provide time cost estimates at the early stage, or that stated they had lower levels of familiarity with the Regulations, these extrapolated figures represent an estimate of future industry compliance costs (based on the experience of 'early adopters'). These extrapolations would be a substantial over-estimate of the current industry compliance costs, given that many business appear not yet to be complying.

Comparing the estimates of these two sample segments suggests that as businesses become more familiar with the Regulations, they will feel the need to increase their efforts towards due diligence activities.

4.4.7 Is the compliance burden higher on growing businesses?

Governments are naturally keen to avoid regulatory imposts that hinder small businesses growing to become medium and large business, particularly if that constrains opportunities to create more jobs.

The nature of this regulatory regime is that the total regulatory costs are a function of the number of suppliers (and potentially the number of different products they supply), the country of origin of the timber products purchased, and whether or not the supplier is certified under one of the timber legality frameworks or a country specific guideline exists for that country. The costs of compliance as a proportion of the value of imports could be lower for a small business that purchases comparatively large quantities from a few suppliers from lower risk countries, than a larger business that imports smaller quantities from a large number of different suppliers, from higher risk countries. However, as many small businesses are likely to purchase lower quantities of any one product than the largest businesses, the costs as a proportion of the value of imports are likely to be higher for many small businesses.

¹³⁰ As per Table 20, while the estimated costs reflect those that were confidently provided by businesses to KPMG, it is noted that this is a very small sample of businesses, and an industry wide estimate of zero ongoing costs for certain business size categories is not plausible. In reality, while the cost may be low, these figures are expected to be greater than zero.

¹³¹ As noted in Table 18, only one micro business when interviewed described itself as highly familiar with the regulations, and so it was not possible to derive an estimate for this group.

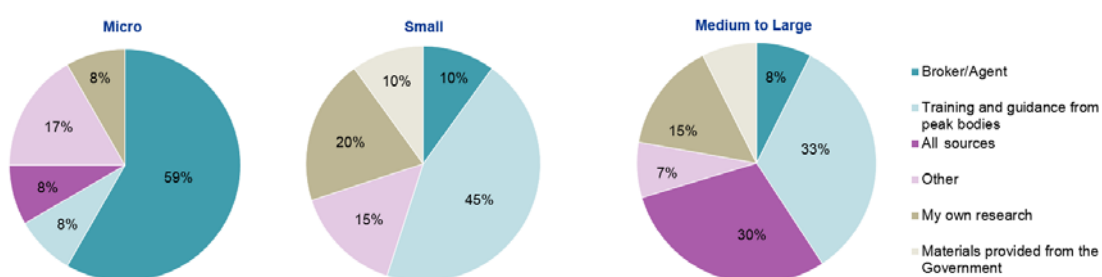
However, there was no evidence identified that additional compliance burdens arise as businesses transition from having revenues below \$10 million (the definition of small business for the purposes of this Review) to higher revenues.

4.5 Other findings

This section covers the more qualitative findings from the business interviews and provides an overview of current business views and experiences with the Regulations. Where appropriate, these findings have been broken down by the three business size categories: micro, small and medium to large.

4.5.1 How businesses became aware of the regulations

Figure 3 – How businesses became aware of the Regulations



Micro businesses in the sample were far more likely to have been made aware of the Regulations through their broker/agent than the other two business size cohorts, with around 60 per cent of micro businesses stating this as their primary source of information. For the other two business size cohorts, training and guidance from industry bodies was the most frequently cited source making them aware of the Regulations.

The source of business identification was also related to how the business became aware of the Regulations. In comparing the two most common sources of business (live Customs data and peak body referrals) there was a substantial difference in the most commonly cited source of information, however the remaining sources of information were largely unaffected. For businesses identified through live Customs data, most (44 per cent) became aware of the Regulations through their broker/agent, with only 16 per cent being made aware of the Regulations through training and guidance from peak bodies. Conversely, for businesses identified through peak body referrals, awareness primarily came through training and guidance from peak bodies (48 per cent), with no businesses in this category claiming to have been made aware of the Regulations through their broker/agent.

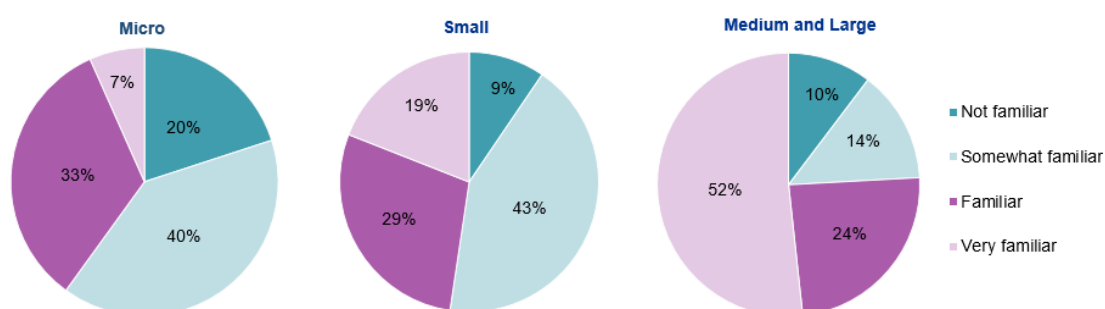
While brokers and industry bodies appeared to be primary sources of information for most businesses, 15 per cent of all businesses interviewed claimed that 'all sources' of the sources analysed were their primary information source. This suggests that many businesses were finding a combination of information sources useful – including materials provided by the Government and their own research.

Anecdotal evidence collected through the industry workshops suggested that an even larger portion of businesses were likely to be made aware of the Regulations through their brokers. It was suggested by workshop participants that this additional share of

businesses was most likely taken from those who stated 'training and guidance from peak bodies' and 'my own research' as their primary source of information.

4.5.2 Familiarity with the Regulations

Figure 4 – Familiarity with the Regulations



Larger sample businesses were far more likely to be 'very familiar' with the Regulations compared to smaller businesses. Conversely, smaller businesses (particularly those with an annual turnover of less than \$2 million) were more likely to be 'not familiar' with the Regulations. These varying levels of familiarity are consistent with the time cost estimates of the business size categories. The less familiar, smaller businesses, tended to have lower costs as they were more likely to feel that their existing systems were enough to meet the requirements.

Overall, 88 per cent of businesses interviewed claimed they had some level of familiarity with the Regulations.

4.5.3 The challenge of understanding what is required by the Regulations

In the course of interviews with both large and small businesses, and during industry stakeholder discussions, two key issues emerged: the lack of clarity about the interpretation of 'reasonably practicable', and the lack of authoritative guidance from Government regarding which source countries are considered higher risk.

Guidance issued by the Department of Agriculture states:

"...you are only required to undertake suitable actions to minimise the risk that the timber has been illegally logged. It is important to note that you are only required to obtain information about the timber where it is 'reasonably practicable' to do so. The laws do not require you to become 'amateur detectives' investigating the legality of your timber in minute detail, only that you take reasonable steps and ask suitable questions about the origin of the timber. "¹³²

¹³² Department of Agriculture (Undated), *Frequently Asked Questions: Do I have to prove the timber I am dealing with is legal?* Accessed 13 March 2015 <<http://www.agriculture.gov.au/forestry/policies/illegal-logging/faqs>>

During the Review's business interviews, a wide range of responses were provided as to how individual businesses were approaching 'reasonably practicable' including:

"We approach things differently based on volume, the higher the volume the more due diligence"

"Our due diligence system is based on developing a level of comfort"

"We approach reasonably practicable based on our supplier's chain of custody certification, if certified then we are confident it's ok"¹³³

"We just do the best we can based on publicly and readily available information"

In the absence of authoritative guidance from Government as to which countries are considered higher risk, some businesses have outlined that they undertake their own careful and time consuming examination of the circumstance in each country from whom they import. Others are adopting a much more pragmatic approach as outlined by ATIF of using Transparency International's corruptions index as a proxy for the risk of illegal logging, and assessing all those with index scores above 50 of being low risk.

Australian businesses are not alone in seeking more specific guidance about which countries are higher risk. However, as Forest Trends and Forest Industries Intelligence noted:

Listing countries as high risk for illegal timber can become politically sensitive. It is therefore unlikely that specific listings of high risk countries and trade patterns will ever be published, even though such listing of controversial sources and routes would help operators and competent authorities create risk profiles for the legality of timber arriving in the EU.¹³⁴

The approach that businesses appear to be taking regarding certified products is discussed further in 4.5.5. Options to address these issue are discussed in 5.2.

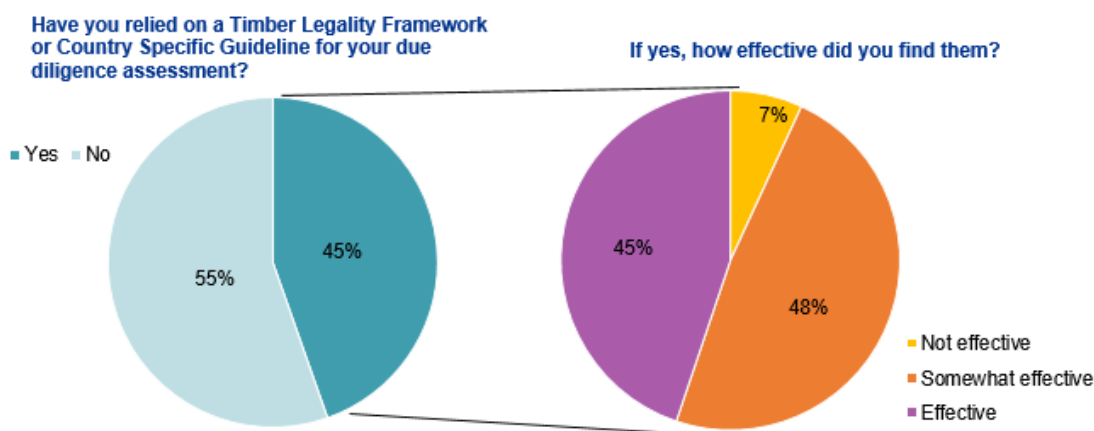
4.5.4 Timber Legality Frameworks and Country Specific Guidelines

Figure 5 highlights that of the businesses interviewed, 45 per cent used either a Timber Legality Framework or a Country Specific Guideline (CSG). Of those that did not (55 per cent), 61 per cent were importing only from countries without Guidelines and so could not have chosen to use them.

¹³³ The practical issues associated with this approach is discussed in more detail in 4.5.6.

¹³⁴ Forest Trends and Forest Industries Intelligence (2013), *European Trade Flows and Risk*, p.3 Accessed 13 March 2015 <http://www.forest-trends.org/documents/files/doc_4085.pdf>

Figure 5 – Use of Timber Legality Frameworks and Country Specific Guidelines



Of those using Guidelines, the vast majority (93 per cent) found them at least somewhat effective. This analysis indicates that increasing the number of Guidelines available, and improving the quality of existing Guidelines, would assist businesses in completing their due diligence processes. These options are discussed in more detail in the following chapters.

Some stakeholders raised concerns about the impact of the absence of Guidelines for some countries and States, and the variability of those that are in place. A joint submission from the Timber Veneer Association, Window and Door Industry Council and the Timber Merchants Association contended that it was important that the same set of rules applied to all countries and States of supply. They argued that the use of different conformance models under the current Country Specific Guidelines mean the terms of regulation of imports of the same product from different jurisdictions constitutes differential treatment, and thus they believed the current arrangements conflict with WTO obligations. ITS Global noted similar concerns regarding the partial coverage of Country Specific Guidelines.

4.5.5 Do timber legality frameworks provide a 'safe harbour' or 'deemed-to-comply' provision?

Many of the large and small businesses interviewed indicated that they considered they were meeting their due diligence requirements by confirming that:

1. their supplier was Forest Stewardship Council (FSC) or the Programme for the Endorsement of Forest Certification (PEFC) certified;
2. the product they were purchasing was covered by this certification; and
3. the certificate was valid by searching the certification body's website.¹³⁵

¹³⁵ Data was not collected on the proportion of businesses that indicated that they took this approach as the issue emerged during the course of the subsequent analysis. However, discussions with the interviewing team suggest as many as a third of businesses may be taking this approach regarding the certified products that they import.

These businesses considered this was a 'reasonably practicable' level of information collection and risk assessment.

Other stakeholders, recognising that solely relying on such a timber legality framework was not formally consistent with the current Regulations, suggested that the Regulations should contain explicit 'safe harbour' or 'deemed to comply' provisions based on these frameworks.

In other regulation schemes, such as the occupational health and safety legislation, or the National Construction Code, such 'safe harbour' or 'deemed to comply' provisions typically complement an over-arching framework that is designed to provide a flexible or performance-based definition of compliance. The 'safe harbour' or 'deemed to comply' option provides duty holders with a simple, specific but typically more rigid alternative to demonstrate compliance. This can be particularly attractive for small businesses, or other businesses which do not consider that they need to take advantage of the scheme's more flexible options for compliance methods.

The Illegal Logging Prohibition Regulations recognise three timber legality frameworks (the frameworks administered by the FSC and the PEFC, and the planned European Union licensing scheme). The Department notes that:

"the frameworks that have been listed in the Regulation have a high level of rigour and robustness, and provide a high level of assurance that wood products traded under the banner of their respective programs are legally logged for the purpose of Australia's illegal logging laws (p.1)." ¹³⁶

Despite this assessment of the frameworks, the Regulations do not contain associated explicit and simple 'safe harbour' or 'deemed to comply' provisions, even though, as noted earlier, this is what the Review's business interviews indicated was the practice of many businesses.

Informed stakeholders advised the Review that it is not simple to use these frameworks as provided for in the Regulations. Even though the supplier of a certified timber product will have provided the importer with a copy of the relevant and valid certificate, Section 10 (2) of the Regulations requires the importer to obtain as much of the information outlined below (as is reasonably practicable). The Review recognises that of the information listed on Section 10(2), the following would not be an additional burden, as it constitutes information to be collected in any event for customs purposes:

- (a) (i) a description of the regulated timber product, including the type of product, and the trade name of the product;
- (c) the country in which the product was manufactured;
- (d) the name, address, trading name, business and company registration number (if any) of the supplier of the product;
- (e) the quantity of the shipment of the product, expressed in volume, weight or number of units; and

¹³⁶ Department of Agriculture (2014) *Due Diligence – Use of Timber Legality Frameworks (importers)*, Fact sheet 2.3

(f) the documentation provided, or that will be provided, by the supplier in relation to the purchase of the product

However, other information required (as is reasonably practicable to obtain) under Section 10 (2), may not normally be collected by the importer, over and above the relevant certificate; this includes:

(a) (ii) the common name, genus or scientific name of the tree from which the timber in the product is derived;¹³⁷

(b) the country, the region of the country and the forest harvesting unit in which the timber in the product was harvested;

(i) evidence that the product has not been illegally logged, which, without limiting the evidence, may include evidence about:

(i) whether the harvesting of the species of tree from which the timber in the product is derived is prohibited in the place where the timber has been harvested; and

(ii) if the harvesting of the timber in the place is authorised by legislation (including regulations) — whether the requirements of the legislation have been met for the harvesting of the timber; and

(iii) if payment is required for the right to harvest the timber—whether that payment has been made; and

(iv) if a person has legal rights of use and tenure in relation to the place in which the timber is harvested—whether the harvest of the timber is inconsistent with the law establishing or protecting those rights.

Furthermore, under Section 11 of the Regulations, which details how importers are to identify and assess risk against a timber legality framework, an importer that is purchasing from an FSC or PEFC certified supplier is also required to undertake significantly more investigative work than just confirming that the certificate covers the product being imported and that it is a valid certificate for the supplier. Rather, under Section 11 (2), the importer must, before importing the product:

(b.) identify and assess, by the use of the framework and consideration of the information gathered in accordance with subsection 10(1), whether there is a risk that the product is, is made from, or includes, illegally logged timber.

This appears to require undertaking additional analysis of the information outlined earlier as required by Section 10 (2).

Under Section 11 (2) (c) the importer has to consider other information the importer knows, or ought reasonably to know, that may indicate whether the product is, is made from, or includes, illegally logged timber. This appears to be asking the importer to second-guess the relevant accreditation body which oversees the certification bodies

¹³⁷ Stakeholder advised that this information would normally be collected for logs or sawn timber, but not for some other timber products, such as paper products or furniture.

providing assurance that the timber or timber product meets the requirements of the applicable legality framework.

Under Section 11 (2) (d) the importer is required to develop additional documentation evidencing this identification and risk assessment. This again seems to be far more than the simple process that some businesses are applying - that satisfactory 'due diligence' occurs automatically when purchasing certified products.

The Review's analysis indicates that similar issues arise in the application of country specific guidelines, and the state specific guidelines and timber legality frameworks applying to processors.

4.5.6 Striking the appropriate balance between cost of compliance and risk of illegally logged timber entering Australia

Overall, 46 per cent of the businesses interviewed said that the Regulations in their current form strike an appropriate balance between the compliance costs and reducing the risk of illegally logged timber products entering the Australian market.¹³⁸ Of the remainder of the sample, 32 per cent indicated they did not believe an appropriate balance was struck, while 22 per cent were not sure.

Figure 6 indicates that as businesses increased in size, the general perception of whether the Regulations strike an appropriate balance between compliance cost and risk moved from 'on balance yes' to 'on balance no'.

Figure 6 – Do the Regulations reach an appropriate balance between compliance cost and risk of illegally logged timber products entering the Australian market, by business size?

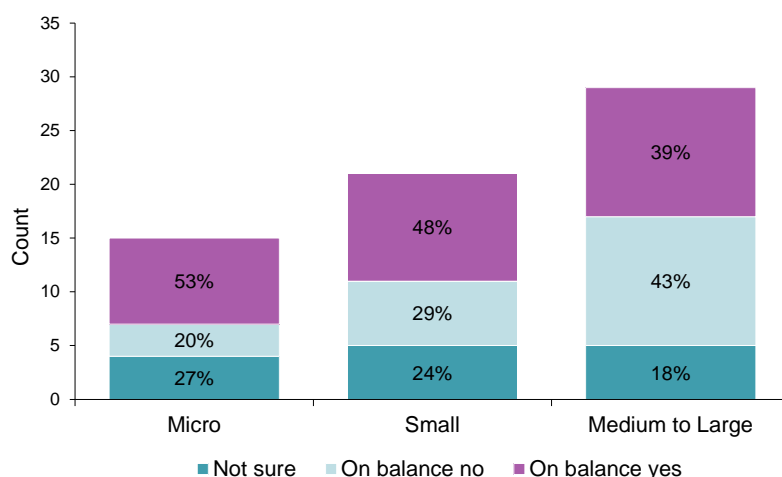
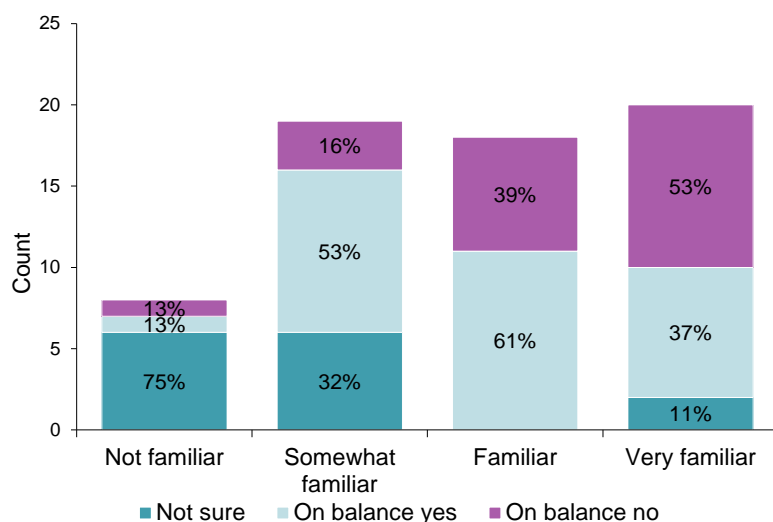


Figure 7 indicates that businesses that currently have a greater familiarity with the Regulations are less likely to believe the Regulations strike an appropriate balance.

¹³⁸ The World Wildlife Fund submission also supported the broader rationale of the Regulation, stating that they have "the potential to reinforce global efforts to combat illegal logging at its source" and provide "a practical framework and guidance for importers".

Having said that, the majority of businesses that are either 'somewhat familiar' or 'familiar' with the Regulations believe that they do strike the appropriate balance.

Figure 7 – Do the Regulations reach an appropriate balance between compliance cost and risk of illegally logged timber products entering the Australian market, by familiarity?



On the whole, businesses who responded 'on balance no' cited a lack of clarity around what the actual requirements were as the primary reason that the Regulations did not strike an appropriate balance. With this confusion came additional, and potentially unnecessary, time spent on due diligence activities which was commonly thought to overshadow any potential reduction in the risk of illegally sourced timber entering the Australian market. Furthermore, many of these businesses felt that the Regulations would not have a material impact on the amount of illegally sourced timber entering Australia.

A number of these businesses also suggested a more risk based approach to the Regulations would improve the balance, with the Department needing to focus the Regulations around higher risk products, regions and countries.

4.5.7 Additional risk mitigation steps to satisfy the requirements of the Regulations

The 65 businesses interviewed were asked "Has your business taken additional risk mitigation steps to satisfy the requirements of the regulations". This question was asked to better understand the extent to which the Regulations are driving behavior change (which *may* contribute to the outcome of the Act being achieved), as opposed to just additional regulatory and administrative tasks. While it is not possible to make a direct link between these additional risk mitigation steps and a reduction in illegal timber or timber products entering the Australian market (if any), the business responses do show that the Regulations are driving some behavioral change.

Of the 65 businesses interviewed:

- 29 businesses requested further information from their supplier after the initial information request was responded to;
- 19 businesses requested information beyond their immediate supplier;
- three businesses changed supplier within the same region after being dissatisfied with the supplier's response to information requests;
- four businesses moved to a supplier from another region after being dissatisfied with the supplier's response to information requests; and
- one businesses stopped importing a product entirely after being dissatisfied with the supplier's response to information requests.

While other factors were also influencing the businesses' change in supplier mix, the final three points on this list indicate that the due diligence requirements are already influencing businesses' decision-making away from suppliers who are unable or unwilling to assist the importer assess the risk that the timber product is illegally logged, which is the intent of this regulatory system.

At this stage it is not possible to assess whether these changes in suppliers are contributing to better forestry practices in source countries, and some concerns have been raised about the trade implications. ITS Global's submission to the Review included a brief by trade lawyer, Professor Andrew Mitchell of University of Melbourne. This brief raised concerns about the potential for revised sourcing decisions that started to favour some countries over others, purely due to the ease of complying with the due diligence requirements where a country-specific guideline is prescribed. The brief argued that this would discriminate between products that are 'like', and thus be inconsistent with WTO obligations.

5 Potential options

The Review's Terms of Reference requires an assessment of whether the existing due diligence requirements achieve an appropriate balance between the cost of compliance for small businesses and reducing the risk of illegally logged timber entering into the Australian market, and if the balance is not considered to be appropriate, an assessment of, and recommendations on, appropriate options for reducing or removing the regulatory impacts of the due diligence requirements on small business, having regards to Australia's international trade obligations.

Section 4 outlined a range of areas where the current Regulation and its implementation is creating problems for those businesses that are seeking to comply. This early evidence indicates that there is a case for Government to seriously consider options that have the potential to reduce the cost of compliance, while retaining the benefits for the community that the Act is seeking to achieve.

This section details evaluation criteria to assess potential options and a description of the options that have been identified during the course of the Review. The focus of the options is on reducing the regulatory burden associated with the current requirements (the problem that this Review is seeking to address as identified in section 2.4), with a particular focus on the burden imposed on importers, while achieving the broader policy objectives of the Act.

The Regulations also impose requirements on domestic processors, who were actively engaged as part of the Review. No substantive issues were raised regarding the operation of these provisions that were specific to processors, however the analysis of the options in section 6 also considers any flow-on impact on processors.

5.1 Regulatory options

The Review identified ten potential reform options that would affect importers. Seven of the ten options would require changes to the Regulations, while the remaining three options are considered non-regulatory measures. These options were initially developed based on the Review's analysis of the issues raised during the business interviews and stakeholder consultations and the Review team's past experience developing deregulatory reforms. The high level options were also tested with stakeholders, and some stakeholders proposed specific alternative options or outlined variations on options the Review developed. Those that were considered most promising in terms of addressing the problem identified in section 2.4 were further developed for more detailed analysis in section 6.

While the seven regulatory options alter the size and characteristics of the regulated community, all businesses remain governed by the overarching requirements of the Act. That is, the obligation to not willingly import illegal timber covers all importing businesses of timber product, regardless of the level of coverage of the Regulations.

This section outlines the rationale behind each option as well as their key design features.

5.1.1 Increase the individual consignment value threshold from \$1,000 to \$10,000

This option proposes to increase the individual consignment threshold from its current value of \$1,000 to \$10,000. Under this option, importers bringing in consignments where the combined value of the regulated products in the consignment does not exceed \$10,000, would not need to carry out due diligence on that consignment.

Other values, such as \$5,000 or \$15,000, could potentially be adopted. However, they were not able to be assessed due to the timelines of the Review, and the confidentiality issues associated with release of ABS data (the more permutations the ABS provides to external parties such as KPMG, the greater perceived risk that analysis of the data would permit identification of specific businesses confidential data).

Raising the consignment threshold is a potential way of reducing the total costs to the community of compliance while, depending on the nature of the product exempted, continuing to manage the risk of a significant quantity of illegally logged timber entering the Australian market.

The current consignment threshold of \$1,000 was based on the GST and tariff exemption thresholds for imports. This value has been chosen for consistency across legislation, and does not seek to manage any particular risks, nor does it aim to target a particular number of consignments or businesses. The earlier Regulatory Impact Statements did not examine the implementation issues at this level of detail and so did not assess alternative options for this threshold.

5.1.2 Applying a \$75,000 annual importer value threshold

This option proposes that a business that imported more than \$75,000 in regulated timber products in the previous financial year, or expects to do so in the current year, would need to be ready to demonstrate that it has a due diligence system in place, and be able to demonstrate it has gathered the appropriate information before importing a regulated product.

This would make the regulation more complex, but more targeted on those with substantial business related to importation of regulated timber products. Analysis by ABARES identified that most importers brought in less than \$75,000 in consignments of regulated timber products in 2012.¹³⁹

In understanding particularly the role of small business, under existing Regulations, approximately 10,000 micro and small businesses are captured by the \$1,000 individual consignment threshold. If this were to be replaced by a \$75,000 annual importer value threshold, approximately 8,000 fewer small businesses would be required to comply with due diligence requirements. Among medium and large businesses that imported regulated timber products in 2012, approximately 3,100 would have fallen above the \$1,000 individual consignment threshold. Replacing this with a \$75,000 annual importer value threshold would see this number reduce by approximately 2,000.

¹³⁹ Further detail about this cohort and the broader sensitivity analysis discussed will be available in the ABARES upcoming report (2015).

As it currently stands, the over-arching requirements of the Regulations apply equally to a business importing a \$1,000 consignment of regulated timber product as they do to a business importing a \$10 million or \$100 million consignment. Introducing an annual importer value threshold would be one method of ensuring the Regulations are more targeted to those businesses that bring in a material volume of regulated timber product. This option would allow businesses that only import small volumes of product, as well as individuals bringing in personal consignments valued at more than \$1,000, to not incur the associated due diligence requirements. Despite being exempt from these due diligence requirements, the Act still places a general prohibition on the importation of illegally logged timber products to which all importers must adhere.

Further rationale for introducing an annual combined consignment threshold is the ability to reduce the risk of businesses engaging in 'gaming', a concern voiced during stakeholder consultations. 'Gaming' occurs where a business imports multiple consignments valued below the applicable threshold (e.g. \$999 where the threshold is \$1,000) to avoid due diligence obligations.

Through consultation with ABARES, this Review investigated the possibility of an annual importer value threshold of \$75,000. Alternative threshold values of \$50,000 and \$100,000 were also assessed in consultation with ABARES officers who were able to review confidential ABS data. Based on consultations with those ABARES staff, the Review selected the \$75,000 threshold for detailed analysis as it was considered to have excluded a relatively larger number of businesses while not significantly impacting the total value of regulated product or product mix (two indicators of risk).

5.1.3 Removing specific products from the Regulations

This option would see the removal of certain tariff chapters or products within chapters from the regulated timber products list as outlined in the Regulations. This would have the effect of exempting importers of those previously regulated timber products from undertaking due diligence.

The specific products that might be removed from the Regulations could include a whole chapter (for example, furniture), or narrower product lines. Some stakeholders even suggested that all chapters could be removed, and only narrow product lines where the Government had identified a specific potential issue would be added to the Regulations (with some stakeholders suggesting in discussion that the Government could even nominate products from specific countries which represented higher risks).

As we were unable through the research or consultation to identify a robust criteria that could be applied to determine which specific products should be removed, this option is only assessed at a high level.

5.1.4 Create a safe harbour or deemed to comply provision based on approved timber legality frameworks and country/state specific guidelines

This option would explicitly simplify the arrangements in the Regulations relating to approved timber legality frameworks and country/state specific guidelines.

In this section the analysis focuses on the import of products from FSC, PEFC or FLEGT certified or licenced suppliers as this was the activity where the issue was raised with

the Review, but similar changes would need to be made to the application of timber legality frameworks and country/state specific guidelines for consistency.

With respect to implementing this change for imports, Sections 10 and 11 of the Regulations would need to be amended to implement this option.

The full due diligence requirements would explicitly just consist of the importer confirming that:

1. their supplier was Forest Stewardship Council (FSC) or the Programme for the Endorsement of Forest Certification (PEFC) certified or FLEGT licenced;
2. the product they were purchasing was covered by this certification or licence; and
3. the certificate was valid by searching the certification body's website.

The importer would need to document in writing that they had undertaken these three steps. An importer undertaking these three steps would be deemed to have complied with the due diligence requirements, and would not be required to undertake any further risk assessment or risk mitigation activity.

This would rely on the certification bodies taking timely action to address any intelligence they identify about any of their certificate holders being involved with illegally logged timber, suspending certificates while they investigate, and then enforcing the existing obligations on their certificate holders to notify their buyers if their certification is cancelled. There would be no other obligations on importers to identify any other information that may indicate the product is made from illegally logged timber.

As noted above, similar changes would need to be made to simplify the application of country-specific guidelines (through amending Section 10 and 12 of the Regulations) and to processors' application of timber legality frameworks (through amending Section 19 and 20 of the Regulations) and of state-specific guidelines (through amending Section 19 and 21 of the Regulations).

5.1.5 Approve a generic Country/State Guideline

This option would address the issue that some jurisdictions have Guidelines while others do not, and that there is variation in the content of those Guidelines by the approval of a generic Country/State Guideline,¹⁴⁰ applicable for all imports and domestic logs stating that the following documents are suitable to demonstrate legality:

1. A copy of a permit or licence to export issued by the Government of the Country or State; or
2. An attestation by a Government official¹⁴¹ or authorised person that the consignment was legal; or
3. A statement from the exporter that the timber was harvested in compliance with laws applicable in the place of harvest; or

¹⁴⁰ This option was proposed in a joint supplementary submission by the Timber Veneer Association of Australia, the Winder and Doors Industry Council, and the Timber Merchants Association.

¹⁴¹ The intent is that this would be an official who could reasonably be assumed to have the authority to make such an attestation, for example, a forestry or customs official or person holding a similar position.

4. A copy of the concession licence, harvest licence or harvest permit.

This would be an additional Country/State Guideline and applicable to all countries and states of harvest. Like the current Country/State guidelines, it would be voluntary for the importer/processor to choose this option.

This Guideline would also allow importers to rely on a statement from an exporter to demonstrate legality, in contrast to the current Guidelines which rely on the importer acquiring the appropriate official documentation as outlined by the exporting country.

Under this proposal, the proponents noted that information gathering requirements (particularly Section 10 (2) (i)), risk assessment (Section 12) and the risk mitigation requirements (Section 14) would still apply.

The Regulations would need to be amended to adopt this option.

A variation on this option, proposed by one stakeholder, was to put a stay on enforcement of the Regulation in relation to products imported by countries that did not yet have a Country Specific Guideline. Such an approach could delay the application of the Regulations for a long period with respect to those countries that have limited interest in negotiating a Guideline, including those which may be higher risk but have comparatively small volumes of trade with Australia (e.g. African and South American countries) and may even dull the incentives for some more substantial trading partners to finalise their guidelines if their exports were exempt from the Regulations until the guideline was developed.

5.1.6 Introduce an exemption for small businesses

Based on the ABS data from 2012, the regulated community includes at least 10,000 small and micro businesses (58 per cent of all importers of regulated timber products).¹⁴² One option investigated by this Review included introducing an exemption from the due diligence requirements for businesses with less than \$10 million per annum in turnover.

This definition of small business was outlined in the media release accompanying the announcement of the Review (see Appendix A). Alternative definitions could be used, such as the ABS definition of a business employing 0-19 employees.

5.1.7 Repeal the Regulations and rely on the Act alone

This option involves repealing the Regulations and relying solely on the Act to prohibit the importation and processing of illegally logged timber and timber products. Under this option, only the general prohibition and criminal provisions for contravening the Act would exist.¹⁴³

¹⁴² This figure is exclusive of processors as a breakdown of processors by business size is unavailable and does not include those importing business that ABS could not data match to identify their size.

¹⁴³ In their submission to the Review, the Australian Taxpayers' Alliance backed a "full repeal of the Regulations and dependence on an appropriately amended Act alone".

As it stands, the Act prescribes that the Regulations set out:

- Specific due diligence steps to be conducted when importing regulated timber products or processing raw logs;
- Regulated timber product categories; and
- Any product exemptions.

Relying solely on the Act and repealing the Regulations would see the removal of the above requirements. This would have the effect of creating more flexibility for businesses in how they conduct due diligence, as the Act only suggests risk identification, assessment and mitigation activities for inclusion in the Regulations.

5.2 Non-regulatory measures

5.2.1 Fund the development of better, more targeted guidance or training workshops to help businesses better understand their compliance obligations

This option involves the Government resourcing and funding additional measures to enhance businesses' awareness and understanding of their regulatory obligations.¹⁴⁴ Such measures could include:

- Improve the clarity of existing Departmental guidance, particularly the extent to which users can rely on the Department's advice and the impact of the disclaimers;¹⁴⁵
- Funding the free provision of more industry produced and product-specific due diligence information, with a particular focus on pulp, paper and furniture products to offer a similar function to the ATIF toolkit in the timber sector;¹⁴⁶
- Working further with peak bodies whose members include smaller businesses, businesses with more complex supply chains (e.g. furniture associations);

¹⁴⁴ The World Wildlife Fund suggested in their submission to the Review that the Government, over the next five years, "focus its efforts on education and capacity building, to support business – small and large – adapt to the new legislative framework".

¹⁴⁵ The standard disclaimer on current Country Specific Guidelines could be read by an importer as not providing any assurance that if they follow what is outlined that they will be found to be in compliance with the Act. In contrast, Safe Work Australia guidance appears to have no such disclaimers. For example, Safe Work Australia (2014), *General guide for managing risks in forestry operations* <<http://www.safeworkaustralia.gov.au/sites/SWA/about/Publications/Documents/860/Forestry-Operations-General-Guide.pdf>>

¹⁴⁶ Australian Timber Importers Federation (2014). *Legality Compliance Toolkit: Illegal Logging Prohibition Amendment Regulation 2013*.

- Run further information campaigns targeted at regulated businesses outlining the purpose and advantages of using Country Specific Guidelines and industry toolkits; and
- Collate more general information that is relevant to the information gathering, and risk assessment requirements under the Regulations.

To date, the Government has invested resources in developing its own guidelines and supporting fact sheets while concurrently funding industry in developing supporting toolkits. Business interviews indicated 32 per cent of those businesses became familiar with the Regulations through training and guidance provided by peak bodies.¹⁴⁷ This figure was significantly higher than familiarisation via other means, suggesting that funding peak bodies to educate impacted businesses is one of the more effective means of promoting the Regulations. Businesses indicated that they were finding the Australian Timber Importers Federation (ATIF) toolkit more informative and applicable than Government provided materials.¹⁴⁸ After assessing the respective materials, KPMG also found that the ATIF guidance provided much more practical assistance.

Additionally, familiarity with the Regulations varied by business size. Stakeholder consultations revealed that 20 per cent of 'micro businesses' were unfamiliar with the Regulations compared to 9 per cent and 11 per cent for 'small' and 'medium to large businesses' respectively. A further 40 per cent of micro businesses and 43 per cent of small businesses reported being only somewhat familiar with the Regulations. These results suggest more targeted guidance is required for businesses with smaller turnover.

Finally, as outlined in section 4.5.3, the business consultation process revealed significant variation and uncertainty surrounding what constitutes 'reasonably practicable' under due diligence, even among those businesses which considered themselves familiar with the requirements, and what countries (and regions) are considered 'higher risk'. It will be important for the guidance to provide very practical examples of what level of information collection is considered 'reasonable', and examples of where it would not be considered sufficient, and to outline how businesses can make simple assessments of risk.¹⁴⁹

The ATIF guidance uses country ratings of below 50 from the Transparency International's Corruption Perceptions Index, as a proxy for 'higher risk'.¹⁵⁰ However, the Department has not implicitly or explicitly indicated whether this is a reasonable approach. If some of the voluntary compliance assessments included businesses that

¹⁴⁷ Given that 42 per cent of the businesses that agreed to be interviewed were nominated by business associations, this is likely to overstate the role of this source of information.

¹⁴⁸ Guidance material produced by the Timber Development Association (also funded by the Department) was another source of useful material cited by business.

¹⁴⁹ KPMG notes that the low maturity of the Regulations is part of the reason for this uncertainty, and overtime some of the benefits associated with this option are likely to occur even if it is not implemented.

¹⁵⁰ Forest Trends and Forest Industries Intelligence (2013), *European Trade Flows and Risk*, also adopt this proxy measure to identify imports from 'high risk' countries.

adopted this approach then the Department would need to make an explicit decision on whether this acceptable, and if not, what is required.

5.2.2 Undertake voluntary compliance assessments that assess individual businesses' compliance with the Regulations

Throughout the consultation period, businesses reported that they were finding it difficult to assess whether their compliance activities would be sufficient to meet the requirements of the Regulations.

One measure identified by a number of businesses as potentially valuable, and already being planned by the Department, albeit with slightly different features, is to undertake a series of voluntary compliance assessments.

The Review considers that that key features of these assessments should be as follows:

- 1 The voluntary compliance assessments should be available to any business that seeks to participate. [The Department advised that current planning is for 40 voluntary assessments in an overall program of 500 assessments]¹⁵¹
- 2 The compliance assessments would cover the business's complete due-diligence system, not just its application to one product and should be conducted through site-visits rather than being purely desk-based. On-site visits are likely to assist both businesses and the Department to develop a deeper practical understanding of application of the Regulations, and how the burden can be reduced by identify practices that are robust while 'reasonably practical' because they can be integrated in the businesses' operations. It is also likely to yield more practical information about how businesses are developing their processes that may feed into additional guidance and support to all businesses. Given the intent of the regulatory scheme has been to provide flexibility so that businesses can integrate due diligence into their day to day business systems it would seem difficult to provide guidance and assess the overall approach based on desk assessments. [The Department's current planning is for desk-based assessments.]
- 3 The compliance assessments should be for educational purposes only and a formal undertaking would be given that no enforcement actions would be taken based on information collected. However, a non-compliant business could be re-assessed at the end of the 18 month transition period and subject to action if its systems were still in non-compliance. [This is consistent with the Department's current planning]
- 4 The Government should seek to complete an adequate number of voluntary compliance assessments in order to achieve sufficient coverage across all business sizes and sectors (likely to be somewhere around 60) within 12 months. The Department plans for a much larger number of total assessments, but mainly desk-based and targeted at larger importers.
- 5 Once all compliance assessments have been completed, the Government should report back on findings to each participating business with a clear assessment of their level of compliance, and specific areas for improvement. The reporting should be framed in such a way as to provide businesses certainty (i.e. if the business

¹⁵¹ Department of Agriculture pers. com. Received 24 March 2015

continues applying their current approach they would be found to be compliant with the Regulations).

- 6 The compliance advice from these voluntary compliance assessments should be published in a very user friendly de-identified report (that also protects any intellectual property of those assessed). The support of an industry organisation may be useful to ensure the guidance provides a practical business perspective, enabling other businesses to better understand what is and is not likely to constitute acceptable due diligence.

This option may require additional resources over and above what has been planned as part of the Department's compliance strategy, particularly if the recommendation of on-site assessments is accepted.

Somewhat similar compliance assessments have been used by the National Measurement Office (NMO) and the Financial Services Authority (FSA) in the UK to help provide illustrative examples of best practice when identifying, assessing and managing risk. The FSA published a report describing how financial institutions are managing money-laundering risk in higher risk situations.¹⁵² The report identified a number of common weaknesses across firms and also highlighted examples of good and poor practice. Likewise, the NMO conducted a review of the due diligence systems of businesses in the UK importing plywood from China. Their review indicated a high level on non-compliance with the EU Timber Regulation.¹⁵³

In both instances, such reviews were able to identify where businesses were failing in their risk management/due diligence requirements, while also identifying what is considered acceptable and non-acceptable compliance efforts with their respective regulatory requirements.¹⁵⁴ Publishing the results allows businesses to adapt and modify their own practices.

5.2.3 Fast track the development of additional Country Specific Guidelines

This option suggests making every effort to fast track the development of additional Country Specific Guidelines to cover a greater proportion of regulated timber products being imported to Australia. When businesses were asked during the Review's interviews what Government could do to provide better information, a common response was one word, 'China', referring to the demand for a Chinese Country Specific Guideline.

Throughout the consultation period, 86 per cent of businesses indicated Timber Legality Frameworks, State Specific Guidelines or Country Specific Guidelines were either effective or somewhat effective in helping them to undertake due diligence. Therefore, adding additional Country Specific Guidelines may help a broader range of businesses with their obligations under the illegal logging laws. This option recommends prioritising

¹⁵² Financial Services Authority (2011) *Banks' management of high money-laundering risk situations*.

¹⁵³ National Measurement Office (2015). 'EUTR: Plywood imported from China'. Accessed on 25/2/15 at http://content.govdelivery.com/attachments/UKNMO/2015/02/09/file_attachments/363138/Chinese%2BPlywood%2BResearch%2BReport.pdf.

¹⁵⁴ KPMG notes that the low maturity of the Regulations is part of the reason for this uncertainty, and overtime some of the benefits associated with this option are likely to occur even if it is not implemented.

the development of Guidelines with the highest value regulated timber products not yet covered by a Guideline, including China.

Guidelines currently cover only 32 per cent of all regulated timber products by value. The Department of Agriculture has indicated that in addition to the seven current Guidelines, an additional Guideline with Papua New Guinea is nearing finalisation. The Department has also advised that it has initiated discussions with several other trading partners including China, Vietnam, Thailand, Chile, South Korea and Germany.¹⁵⁵ Adding Guidelines with these seven countries would cover an additional 47 per cent of Australia's regulated timber trade.

¹⁵⁵ Some stakeholders argued that higher risk countries should be the priority, with lower risk countries, such as European Union members (such as Germany) being low priority.

6 Options assessment

This chapter assesses the eight potential regulatory and non-regulatory options as summarised in the previous chapter. All options will be assessed against the evaluation criteria outlined in section 5.1. Outcomes of the assessment of these options will be used to inform this Review's recommendations discussed in section 7.

6.1 Evaluation criteria

The Australian Government Guide to Regulation clearly outlines that “the policy (regulatory) option offering the greatest net benefit should always be the recommended option”.¹⁵⁶ The Review recognises that while ‘net benefits’ is the overarching criteria to assess potential reform options, more specific considerations can be factored in when evaluating options to inform the assessment of net benefit. Throughout the stakeholder engagement process, the Review has been refining the possible criteria to assess the options. Where possible a quantitative assessment has been used to assess the extent to which an option addresses a particular criteria. However, like many regulatory assessments, a considered qualitative assessment has been used to support the quantitative assessment. Evaluating the merits of each option requires detailed consideration of both the quantitative and qualitative assessments.

The Review has sought to identify both regulatory and non-regulatory options to address the policy problem, which as outlined earlier is to reduce the costs to the community imposed by the Regulations while achieving as far as possible the policy objectives of the Act of reducing the risk of illegal logged timber and products made from that timber being imported or processed in Australia.

Again, consistent with the Australian Government's regulatory impact statement requirements, each of the options is assessed against the ‘base case’, in this case the current Regulations.

The following table summarises the four criteria that have been used to assess the identified reform options.

¹⁵⁶ The Australian Government Guide to Regulation, 2014, page 2.

Table 22 – Evaluation criteria

Criteria	Key elements
Regulatory cost to business	<ul style="list-style-type: none"> The number and size of the businesses impacted by the Regulations The administrative costs associated with compliance (including one off and ongoing costs)¹⁵⁷ The distribution of the costs across the regulated community
Coverage ¹⁵⁸	<ul style="list-style-type: none"> The products (i.e. the tariff codes) covered by the requirements The value of the products covered by the requirements The source location of the products
Practicality	<ul style="list-style-type: none"> Government implementation efficiency and cost Government monitoring and enforcement practicality
Consistency	<ul style="list-style-type: none"> Consistency of application of the Regulations across business types (for example, domestic producers of finished or semi-finished goods verses importers of the same goods)¹⁵⁹ The practical alignment with the between the EUTR and the US Lacey Act¹⁶⁰ Consistency with Australia's World Trade Obligations

The regulatory cost to business and the consistency criteria explicitly relate to costs¹⁶¹, while the coverage and practicality criteria relate to the extent to which an option will deliver benefits.

Some of the assessments are able to be quantitative and others rely on more qualitative assessments of the available evidence.

Regulatory costs to business and coverage were able to be assessed more readily with quantitative data. The data on the number of businesses affected based, on the 2012 import data, as well as cost data developed through the business interviews allows indicative estimates to be made on the regulatory costs to business of various options. Data was also available for some options on the coverage impacts.

¹⁵⁷ Administrative costs are based on median cost estimates established in chapter 4.

¹⁵⁸ The impact on the key elements of coverage combine to provide a proxy for the impact on the risk of illegally logged timber entering Australia. The greater the volume of products that are potentially excluded from the regulatory regime, the greater the risk of illegally logged timber entering the Australian market. This would reduce the market share and prices received by those who import legally logged timber, and those involved in domestic timber production, and potentially damage the reputation of timber products more broadly.

¹⁵⁹ Consistency of application was included as a key element following extensive feedback from a number of stakeholders.

¹⁶⁰ The RAFT partnership submission argued that the needs of individual small importing businesses will carry more weight if their requirements (for credible assurances of legality) are consistent with others across the market.

¹⁶¹ For instances where the consistency criteria is met or improved upon by providing a more standardised set of requirements for businesses who operate in multiple jurisdictions, and therefore lower costs.

Assessing each option against the criteria of Practicality relied on a qualitative assessment, informed by crucial analysis of the advice from the Department as to the implementation issues.

The assessment of each option under the heading of consistency has relied on: a qualitative analysis various industry participants are likely to be affected, including domestic processors; an assessment of how each option compares to how the EUTR and US Lacey Act is currently operating; and a limited analysis of the potential WTO implications.

Assessing the WTO implications is particularly challenging for some options, noting that assessment is focused on the impact of varying the Regulations, not on WTO issues that may or may not arise due to the nature of the Act. As a general point, the Department of Foreign Affairs and Trade noted that:

WTO rules allow countries to regulate to protect exhaustible natural resources and the environment, including through import restrictions, so long as these measures are not applied in a manner which would constitute a means of unjustifiable discrimination between countries, or as a disguised restriction on international trade (General Agreement on Tariffs and Trade 1994, Article XX)¹⁶²

Some regulatory options can be more readily assessed as compliant or non-compliant, but there are varying views on the issues associated with other options. With several of the options it was not possible to reach a firm view on WTO-consistency as the jurisprudence on these issues is still formative. However, the Government will need to form its own view (supported by legal advice) on whether an option is compliant when developing its response to the Review's options.

In contrast, ITS Global's submission to the Review argued that 'like' products being imported from varying countries could be treated differently under the legislation due to the differences in logging laws across countries.

The evaluation criteria are applied in the following section to understand the impacts of each of the identified options. The following table under 6.2 provides a summary assessment of key options assessment against the four criteria.

¹⁶² Department of Foreign Affairs and Trade, pers. com. 24 March 2014.

6.2 Regulatory measures (summary assessment)

Option	Regulatory cost	Coverage	Practicality	Consistency
Status quo	<ul style="list-style-type: none"> One-off costs \$20.2m to \$56.3m Ongoing costs \$1.7m to \$15.6m 17,254 importers and 468 processors 	<ul style="list-style-type: none"> \$5,784m in imported regulated timber products 	<ul style="list-style-type: none"> Regulatory scheme implemented Monitoring and compliance strategy being finalised 	<ul style="list-style-type: none"> Substantially consistent
<i>Regulatory options</i>				
Option 1 - Increase the individual consignment value threshold from \$1,000 to \$10,000	<ul style="list-style-type: none"> One-off savings of \$9.9m to \$21.8m Ongoing savings of \$0.7m to \$3.3m 6,800 fewer regulated businesses (excl. 'no data' group) 	<ul style="list-style-type: none"> \$262m (4.6%) reduction in the value of regulated imports \$145m (7.5%) of Chinese imports excluded \$127m (6.4%) reduction in the value of furniture regulated 	<ul style="list-style-type: none"> Minor modifications to the proposed compliance strategy Straightforward amendment to the Regulations required 	<ul style="list-style-type: none"> Introduces some inconsistency in Regulations, if not in practice
Option 2 - Apply a \$75,000 annual importer value threshold	<ul style="list-style-type: none"> One-off savings of \$14.2m to \$31.2m Ongoing savings of \$1.1m to \$4.7m 9,900 fewer regulated businesses (excl. 'no data' group) 	<ul style="list-style-type: none"> \$178m (3.2%) reduction in the value of regulated imports \$94m (4.8%) of Chinese imports excluded \$83m (4.2%) reduction in the value of furniture regulated 	<ul style="list-style-type: none"> Administrative complexities and subsequent challenges in communicating change to regulated community More substantial amendments to the Regulations required than option 1 	<ul style="list-style-type: none"> Introduces some inconsistency
Option 3 - Remove specific products from the Regulations	<ul style="list-style-type: none"> Potential for substantial cost savings, depending on products selected for removal 	<ul style="list-style-type: none"> Potential to significantly reduce coverage levels depending on products selected for removal 	<ul style="list-style-type: none"> Complex and contentious judgement about what products to include and exclude Straightforward amendment to the Regulations required 	<ul style="list-style-type: none"> Introduces substantial inconsistency

Option	Regulatory cost	Coverage	Practicality	Consistency
Option 4 – Provide ‘safe harbours’ under timber legality frameworks and Country/State specific guidelines	<ul style="list-style-type: none"> Cost savings were not able to be estimated, however this option is likely to provide some level of saving 	<ul style="list-style-type: none"> Does not affect the scope of products or countries covered by the Regulations 	<ul style="list-style-type: none"> Simple to assess compliance 	<ul style="list-style-type: none"> Introduces inconsistency with EU requirements Many countries exporters will not have access to timber legality frameworks or country specific guidelines
Option 5 – Approve a generic Country/State Guideline	<ul style="list-style-type: none"> Cost savings were not able to be estimated. Further analysis would be required to ascertain how this option would provide substantial savings without compromising the Act’s intent. 	<ul style="list-style-type: none"> Does not affect the scope of products or countries covered by the Regulations 	<ul style="list-style-type: none"> Unclear how it would work in practice, particularly allowing exporter to attest to the legality of their products Significant concerns if combined with Option 4 Amendment to the Regulations and likely the Act required 	<ul style="list-style-type: none"> Less consistent with EU’s bilateral approach to exporting country licences and third party verified attestation Other jurisdictions do not rely on exporters to attest the legality of their products.
Option 6 - Introduce an exemption for small businesses	<ul style="list-style-type: none"> One-off savings of \$3.9m to \$19.1m Up to \$8.2m in ongoing savings 10,000 fewer regulated businesses (excl. ‘no data’ group) 	<ul style="list-style-type: none"> \$1.1b (19.0%) reduction in the value of regulated imports \$519m (26.4%) reduction in the value of furniture regulated 	<ul style="list-style-type: none"> Substantial amendment to the Regulations required Complexities around businesses moving in and out of ‘small business’ category from year to year. 	<ul style="list-style-type: none"> Introduces substantial inconsistency with EUTR and US Lacey Act
Option 7 - Repeal the Regulations and rely on the Act alone	<ul style="list-style-type: none"> Possible one-off savings of \$20.2m to \$56.3m Possible ongoing savings of \$1.7m to \$15.6m 17,254 importers and 468 processors excluded from existing specific due diligence requirements 	<ul style="list-style-type: none"> No timber products covered as the Act requires the Regulations to specify ‘regulated timber products’ Obligation of specific product chapters to follow prescribed due diligence steps would be removed 	<ul style="list-style-type: none"> Substantial amendment to the Regulations and the Act required Creates uncertainty as what is required to meet ‘due diligence’ provisions of the Act 	<ul style="list-style-type: none"> Lack of clarity of what products are covered would introduce inconsistency with EUTR Introduces substantial inconsistency with EUTR in terms of due diligence

Option	Regulatory cost	Coverage	Practicality	Consistency
<i>Non-regulatory options</i>				
Option 8 - Fund the development of more targeted guidance or training workshops to help businesses better understand their compliance obligations	<ul style="list-style-type: none"> Cost savings were not able to be estimated, however this option is likely to provide some level of saving 	<ul style="list-style-type: none"> No change 	<ul style="list-style-type: none"> No practicality issues identified 	<ul style="list-style-type: none"> Potential to improve consistency across industries
Option 9 - Undertake voluntary compliance assessments that assess individual businesses' compliance with the Regulations	<ul style="list-style-type: none"> Cost savings were not able to be estimated, however this option is likely to provide some level of saving if it results in clearer and more practical guidance and reduces the risk that some businesses are doing more than what is generally considered as 'reasonably practical' for the industry 	<ul style="list-style-type: none"> No change 	<ul style="list-style-type: none"> No practicality issues identified 	<ul style="list-style-type: none"> No significant consistency issues identified
Option 10 - Fast track the development of additional country specific guidelines	<ul style="list-style-type: none"> Cost savings were not able to be estimated, however this option is likely to provide some level of saving 	<ul style="list-style-type: none"> No change 	<ul style="list-style-type: none"> Heavily dependent on negotiation with supplier country governments 	<ul style="list-style-type: none"> Will make the requirements for countries with new guidelines more consistent with those already covered, but less consistent with those which continue to have not agreed a guideline.

6.3 Regulatory measures

In assessing the following options against the criteria set out in this chapter, ideally businesses would be broken down into small (less than \$10 million in annual turnover) and micro business (less than \$2 million in annual turnover). Due to data confidentiality issues identified by the ABS, ABARES could only provide information pertaining to micro and small businesses combined.¹⁶³ As such, this section will assess the impact of each option on two business size cohorts – small (less than \$10 million in annual turnover) and medium and large (more than \$10 million in annual turnover).

Additionally, the options assessed below do not include indicative cost estimates relating to the impact on businesses for which no turnover data was available, as median time costs could not be captured for this cohort. While this will result in an underestimate of compliance cost impacts, this category of businesses only represents two per cent of the value of imported regulated product and so is not expected to impact the findings materially.

6.3.1 Increase the individual consignment value threshold from \$1,000 to \$10,000

This option would increase the current individual consignment exemption threshold from \$1,000 to \$10,000. In raising the threshold, based on the 2012 import data, approximately 6,800 businesses would no longer be captured by the individual consignment threshold and therefore required to meet the requirements of due diligence.¹⁶⁴ This option will only impact on those businesses who import regulated timber products. Processors sourcing their inputs from Australian sources will not be impacted by this option.

Regulatory cost to business

Increasing the consignment value threshold to \$10,000 provides regulatory cost savings across all business sizes. By applying the median cost estimates from Chapter 4 to population changes provided by ABARES analysis, time cost savings were developed for each business size category and are outlined in Table 23 and Table 24.

¹⁶³ Small businesses were defined as businesses with an annual turnover of \$2 million - \$10 million in chapter 4. For the remainder of this Review, small business refers to all businesses with an annual turnover of less than \$10 million.

¹⁶⁴ This estimate does not include businesses and individuals in the 'no data' group. Including these businesses and individuals results in a total of 9,903 entities no longer falling above the individual consignment threshold.

Table 23 – Indicative one-off time cost savings for small and large businesses due to increasing the consignment value threshold to \$10,000

Annual turnover	'Estimated hours' sample (\$m)	'High familiarity' sample (\$m)
\$0 - \$10 million	2.6	5.2
Over \$10 million	7.3	16.6
Total savings	9.9	21.8

Table 24 – Indicative ongoing time cost savings for small and large businesses due to increasing the consignment value threshold to \$10,000

Annual turnover	'Estimated hours' sample	'High familiarity' sample
\$0 - \$10 million	-	-
Over \$10 million	0.7	3.3
Total savings	0.7	3.3

Increasing this threshold has a greater impact upon the number of small businesses covered by the Regulations, as compared to larger businesses. This option would see the number of small importers of regulated products decrease by approximately 5,400 businesses (54 per cent). By comparison, the number of regulated large businesses would decrease by approximately 1,400 (45 per cent).

When looking exclusively at small businesses, one-off cost savings vary significantly between the two samples tested. For the 'estimated hours' sample segment, which estimated total one-off compliance costs for small businesses to be \$3.9 million, the estimated saving was \$2.6 million (a saving of 67 per cent). In comparison, for the 'high familiarity' sample segment, which estimated total one-off compliance costs for small businesses to be \$19.1 million, the estimated saving was \$5.2 million (a saving of 27 per cent). This variation occurs because of the higher median time cost estimates within the 'high familiarity' sample, which excludes businesses who are less aware of the Regulations and so have spent less time to date on developing due diligence systems.

As both sample segments had a median of zero for small business ongoing costs, no savings could be captured for this business size category. Ongoing cost reductions calculated for large businesses represent a saving of \$0.7 million (36 per cent) and \$3.3 million (17 per cent) for the 'estimated hours' and 'high familiarity' samples respectively.

While due diligence requirements have only been in effect since late November 2014, many businesses have already spent considerable time and effort in creating their systems, as highlighted by businesses within the interview sample. These sunk costs, by definition, will not be influenced by this option or any other option assessed in this section. Although it is expected that most businesses within each business size category are yet to have spent significant time or finances on due diligence activities, it is noted that cost saving estimates will, at the margin, over-represent the potential savings due to the sunk costs of early adopters. On the other hand, each year new business will enter the market, and incur one-off costs. The Review has not sought to estimate the number of businesses this would affect annually, but it would be reduced by the higher consignment threshold. These costs are not captured in the ongoing costs.

Coverage¹⁶⁵

Increasing the individual consignment value threshold from \$1,000 to \$10,000 excludes 4.6 per cent (\$262 million) of the total value of regulated timber products that were previously covered by the illegal logging Regulations. In absolute value terms, almost 8 per cent of Chinese imports, valued at around \$145 million, will cease to be regulated. This constitutes the largest decrease across all import countries, with the vast majority of the decrease occurring across furniture and paper products (a combined \$136 million).

For importers operating within the small business category, increasing the individual consignment threshold results in a 10.5 per cent decrease in the value of regulated timber products subject to due diligence requirements. For small businesses, a decrease in value of regulated products is experienced across all product chapters, with the largest decrease occurring in paper products at around 17 per cent.

For large businesses, increasing the threshold sees the biggest reduction in the value of furniture products being regulated.¹⁶⁶ This finding is consistent when considering the industry as a whole.

With the introduction of a \$10,000 threshold, \$127 million worth of furniture would cease to be regulated. This equates to a six per cent reduction in the value of furniture regulated under the current threshold. In absolute value terms, the bulk of this furniture would come from China (approximately \$80 million). As a proportion of the current value of their regulated imports, 21 per cent of Indonesian furniture imports (\$11 million) would be excluded, making it the most impacted country of origin in percentage terms for furniture.¹⁶⁷

Due to the country's status as a manufacturer of finished goods, the illegal logging risks associated with China are largely unclear,¹⁶⁸ and anecdotally, this Review heard concerns voiced over various regions in China. These factors make it difficult to assess the impact of effectively removing substantial quantities of products of Chinese origin from regulatory obligations.

In terms of containing illegally logged material, it was previously estimated that furniture was the most high-risk product category while paper is rated low risk (refer to Table 6). Considering this, the drop out of regulated paper importers as discussed above does not pose significant concern; however, any decrease in the size of the regulated community must be considered carefully.

There is also the risk of some businesses gaming the system by splitting up their consignments into orders of less than \$10,000. Depending on the size and type of business, this may be easier to do for some products over others. This form of behavioural change would need to be monitored over time, and if any subsequent

¹⁶⁵ This section includes data on imports by the 4,000 importers which could not be matched to a business size. In total, this group accounted for around 2 per cent of the total value of regulated timber product imports in 2012.

¹⁶⁶ Due to sensitivity issues, ABARES analysis was unable to provide a figure to evidence this point.

¹⁶⁷ This amount only represents 3 per cent of imports from Indonesia.

¹⁶⁸ World Bank (2006), Strengthening Forest Law.

analysis found suspicious behaviour, the Government should seek to introduce anti-avoidance mechanisms to complement the Regulations.

Practicality

This option would require an amendment to section 6(1)(c) of the *Illegal Logging Prohibition Regulation 2012*.

From a compliance and administrative perspective, modifying the Department's compliance activities to reflect an increased consignment value threshold would not require substantial effort. As noted above, it would be important for the Department to do additional desk-top analysis of consignments under the threshold to detect any efforts to avoid compliance by gaming the higher threshold.

Consistency

At the margin, this option represents a move away from a uniform, market-wide approach, as importers of smaller consignments would not be required to collect the information for due diligence, in contrast to an importer of a consignment of more than \$10,000.

The RAFT partnership made the general point that:

If the requirements become fragmented in their application (e.g. with some regulations applying to some companies and others applying to all) the ability of Australian companies to influence the timber and wood products trade as a whole will be weakened substantially, making it even harder for any company – large or small – to reliably and consistently access credible assurances of legality.¹⁶⁹

At issue is how important is it that importers of these smaller consignments seek the same information as those purchasing larger consignments from suppliers. Given that 95 per cent of the value of imports will still require the same due diligence as currently, the impact is likely to be comparatively small.

This has to be balanced against the implications under this option of the number of small businesses subject to due diligence requirements being reduced by around 54 per cent. When considering the value of regulated timber products, small businesses will again be most impacted by the introduction of an increased threshold.

Processors of any size, assuming they do not also import regulated timber product, will not be impacted by this change in the Regulation as the threshold is only applicable to importers. The Government will need to carefully consider any equity implications (between importers and processors) of this option should it be progressed.

Increasing the value of the consignment threshold is inconsistent with the regulated coverage of the EU Timber Regulations and the Lacey Act in the US. As it stands, Australia's current threshold of \$1,000 is not mirrored in either of these systems, which require that almost all commercial imports of timber products regardless of consignment value, comply with due diligence/due care obligations (refer to section 2.2.2).¹⁷⁰

¹⁶⁹ RAFT Partnership, (2015), submission to the Independent Review, p.4

¹⁷⁰ The EUTR applies to 'operators' who placing timber or timber products on the market. The guidance clarifies that the term 'placing on the market': "means the supply by any means, irrespective of the selling technique used, of timber or timber products for the first time on the internal market for

However, in practical terms there may be less inconsistency in application as all jurisdictions are likely to focus their compliance and enforcement efforts on those businesses bringing in substantial import quantities, and it would be some time before there is strong compliance by the very smallest businesses or potentially for small consignments.

Option 1 summary

Regulatory cost	Coverage	Practicality	Consistency
<ul style="list-style-type: none"> One-off savings of \$9.9m to \$21.8m Ongoing savings of \$0.7m to \$3.3m 6,800 fewer regulated businesses (excl. 'no data' group) 	<ul style="list-style-type: none"> \$262m (4.6%) reduction in the value of regulated imports \$145m (7.5%) of Chinese imports excluded \$127m (6.4%) reduction in the value of furniture regulated 	<ul style="list-style-type: none"> Minor modifications to the proposed compliance strategy Straightforward amendment to the Regulations required 	<ul style="list-style-type: none"> Introduces some inconsistencies in Regulations, if not in practice

6.3.2 Applying a \$75,000 annual importer value threshold

This option proposes the introduction of a \$75,000 annual importer value threshold to replace the current individual consignment threshold of \$1,000. A business that imports more than \$75,000 of regulated products would need to be able to demonstrate that all its consignments were covered by its due diligence system, while one that had less than \$75,000 in imports of regulated timber products would not be required to undertake any due diligence but would still be subject to the criminal provisions of the Act applying to intentionally, knowingly or recklessly importing illegally logged timber or timber products.

Like option 1, applying a \$75,000 annual importer value threshold will only impact on those businesses who import regulated timber products. Processors solely sourcing their inputs from Australian sources will not be impacted by this option.

Regulatory cost to business

Replacing the existing threshold arrangements with an annual importer value threshold of \$75,000 provides regulatory cost savings across both business size categories. By applying the median cost estimates from Chapter 4 to population changes provided by the ABARES analysis, time cost savings were developed for each business size category and are outlined in Table 25 and Table 26.

distribution or use in the course of a commercial activity, whether in return for payment or free of charge." European Commission (2013), *Guidance document for the EU timber regulation*, p.2

Table 25 – Indicative one-off time cost savings for small and large businesses under an annual importer value threshold of \$75,000

Annual turnover	'Estimated hours' sample (\$m)	'High familiarity' sample (\$m)
\$0 - \$10 million	3.8	7.6
Over \$10 million	10.4	23.6
Total savings	14.2	31.2

Table 26 – Indicative ongoing time cost savings for small and large businesses under an annual importer value threshold of \$75,000

Annual turnover	'Estimated hours' sample (\$m)	'High familiarity' sample (\$m)
\$0 - \$10 million	-	-
Over \$10 million	1.1	4.7
Total savings	1.1	4.7

ABARES found that for importers with a turnover of less than \$10 million, an annual importer value threshold of \$75,000 reduced the number of small businesses affected by the requirements of the Regulations by approximately 8,000 (79 per cent), compared to the \$1,000 individual consignment threshold. Across the large business category, approximately 2,000 importers (63 per cent) would be exempted under this option.

As with option 1, one-off cost savings for small businesses vary significantly across the two samples tested. In comparison to the 'estimated hours' base case, which calculated total one-off compliance costs for small businesses to be \$3.9 million, the estimated saving is \$3.8 million (a 99 per cent saving). In comparison, the calculated total one-off compliance costs for small businesses in the 'high familiarity' sample segment was \$19.1 million, resulting in the estimated saving of \$7.6 million, being equivalent to a 40 per cent saving.

When the one-off costs are assessed industry-wide, the savings appear more consistent at \$14.2 million (a 41 per cent saving) and \$31.2 million (a 51 per cent saving) using the 'estimated hours' and 'high familiarity' samples respectively. As both sample segments had a median of zero for small business ongoing costs, no savings could be captured for this business size category. Ongoing cost savings for large businesses were identified as 51 per cent for the 'estimated hours' sample and 24 per cent using the 'high familiarity' sample.

Coverage¹⁷¹

Where a \$75,000 annual importer value threshold is implemented, 3.2 per cent of the total value of products (\$178 million) that were previously covered by the Regulations will be excluded. As is consistent with option 1, in absolute value terms, Chinese imports experience the most significant drop in value of products being regulated of 4.8 per cent (\$94 million). However, 95 per cent of China's currently regulated value would still be

¹⁷¹ This section includes data on imports by the 4,000 importers which could not be matched to a business size. In total, this group accounted for around 2 per cent of the total value of regulated timber product imports in 2012.

captured. The majority of the Chinese imports to be exempted will be paper and furniture products (totalling \$83 million).

Within the small business category, replacing the consignment threshold with an annual importer value threshold results in a 10.8 per cent decrease in the total value of timber products subject to the Regulations. As is seen in option 1, for small businesses, a decrease in value of regulated products is experienced across all product chapters, with the largest decrease occurring in paper products at around 17 per cent.

Across the regulated community as a whole, increasing the threshold sees the biggest reduction in the value of furniture products being regulated (4.2 per cent), however reductions in regulated product occurs across all product chapters (wood articles – 1.8 per cent, paper – 3.0 per cent).

Under this option, around \$83 million of furniture products would cease to be regulated, equating to a 4 per cent reduction in the value of furniture regulated under the current threshold. As with option 1, in absolute value terms, the bulk of this furniture would come from China (approximately \$44 million). As a proportion of the current value of their regulated imports, 27 per cent (\$3.9 million) of furniture imports coming from the United States would be excluded, making it the most impacted country of origin for products within this chapter.¹⁷²

Difficulties with assessing the risk posed by imports from China have been discussed previously in option 1. The reduction in regulated furniture products coming from the United States, whilst important to consider in terms of its effect on reducing the regulated community, is not considered a particularly high risk harvest country of origin.¹⁷³

The implications associated with furniture and paper products dropping out of the regulatory framework have previously been addressed in option 1.

As is seen in option 1, when considering the value of regulated timber products, a larger impact is felt by smaller businesses, for which almost 11 per cent of value would no longer be subject to due diligence requirements (compared to less than one per cent for large businesses).

Practicality

This option would likely require an amendment to section 6(1)(c) of the *Illegal Logging Prohibition Regulation 2012*. While the necessary changes would be more substantial than those required under option 1, they are still relatively minor.

Administering a combined value threshold is likely to be administratively complex, would be challenging to effectively communicate; and the Department has argued may lead to perverse compliance outcomes.¹⁷⁴

¹⁷² \$3.9 million represents 1 per cent of current total

¹⁷³ World Bank (2006), Strengthening Forest Law.

¹⁷⁴ Department of Agriculture, 'Initial Responses to Potential Regulatory Options', 11 March 2015, pers. com

There would also be issues regarding the risk that some businesses may split the value across sub-entities, particularly for timber or timber products from sources which have more costly due diligence requirements.

Furthermore, the Department noted that under the Act, infringement notices must be issued within 12 months of the offence; if the threshold is reached in June, offences committed in July of the previous calendar year could not be dealt with except through the courts.

From an importer perspective, complexities around tracking their value of imports could lead to uncertainty. For businesses that import around the \$75,000 annual threshold level, they are likely to drop in and out of coverage by the Regulations. To avoid re-establishing due diligence systems for the years they are covered, these businesses are likely to maintain their systems regardless of their annual value of consignments.

Consistency

Introducing an annual importer value threshold is inconsistent when compared with the EU Timber Regulations and the Lacey Act in the US, as all products regardless of consignment value, or the nature of the importer, are subject to due diligence or due care requirements.

Again, processors who do not also import would not be impacted by this Regulation as the threshold is only applicable to importers. This may lead to questions of equity across the two sectors (importers and processors).

Option 2 summary

Regulatory cost	Coverage	Practicality	Consistency
<ul style="list-style-type: none"> One-off savings of \$14.2m to \$31.2m Ongoing savings of \$1.1m to \$4.7m 9,900 fewer regulated businesses (excl. 'no data' group) 	<ul style="list-style-type: none"> \$178m (3.2%) reduction in the value of regulated imports \$94m (4.8%) of Chinese imports excluded \$83m (4.2%) reduction in the value of furniture regulated 	<ul style="list-style-type: none"> Administrative complexities and subsequent challenges in communicating change to regulated community More substantial amendments to the Regulations required than option 1 	<ul style="list-style-type: none"> Introduces some inconsistency

6.3.3 Remove specific products from the Regulations

This option proposes removing specific regulated product categories from the Regulations. Like options 1 and 2, removing specific products from the Regulations will directly impact on importers and processors who also import regulated product.

Regulatory cost to business

Given the limited sample size of the analysis, it was not possible to ascertain whether there was a substantial difference in compliance costs across importers of various products/product chapters. However, anecdotal evidence from the business interviews suggested it is reasonable to assume that the more complex the product or supply chain, the more costly businesses were finding compliance. Thus, the greatest regulatory cost

saving would potentially be realised by removing the more complex products (e.g. furniture) from the Regulations.

A major reduction in the scope of the products covered by the Regulations, such as that proposed Australian Taxpayers Alliance, would have a large impact on costs.

Coverage

While removing the most complex products from the Regulations would target the greatest share of regulatory costs, it is also likely to remove higher risk products from the coverage of the Regulations. It is easier for products containing multiple species of timber to consist, at least in part, of illegally sourced timber. It is also more difficult for importers to trace the multiple supply chains using their due diligence activities. As such, for any product being considered for removal from the Regulations, there is a trade-off between the regulatory cost and the risk of illegally sourced timber entering the Australian market.

Reducing the scope of the Regulations to only include products specifically classified as illegally harvested by the responsible government agency in the exporting country was proposed by the Australian Taxpayers Alliance. This would substantially reduce the coverage of the scheme.

Practicality

Implementing this option would require the Minister, on the advice of the Department, to make what are likely to be contentious judgements about what products to include and exclude. The Review understands there was significant consultation on the products that would be included in the Regulations during their development. However, there does not seem to be clear criteria that could be used to select products for exclusion from the current coverage, and the Review did not receive specific suggestions for products that might be removed.

This option would require amendments to the *Illegal Logging Prohibition Regulation 2012*, most likely as amendments to the list of regulated products in Schedule 2 of the Regulations.

Consistency

The four product chapters regulated in Australia were designed to be largely consistent with the EU Timber Regulation and the Lacey Act. The Department of Agriculture consulted with stakeholder working groups on what products should be regulated in the creation of the Act and Regulations when developing the product list, and so a substantial evidence base would be required to change these definitions.

Currently, the products already exempt (such as recycled products) are in line with the EU Timber Regulations and US Lacey Act. The removal of any entire product chapter would see the consistency with other jurisdictions substantially decline.

In their submission to the Review, ITS Global argued that any option that had the effect – intended or otherwise – of favouring imports from some countries over imports from others would most probably conflict with World Trade Obligations. Depending on the

products selected for removal, it is possible that a significant amount of imports from some countries could no longer fall under the coverage of the Regulations.

Like options 1 and 2, the Government would need to consider any equity issues (between importers and processors) should they progress with any form of option. Some business stakeholders, and the Department, have raised concerns about the extent to which removing certain products (particularly manufactured products e.g. furniture) may favour imports while disadvantaging domestic processors and manufacturers using imported inputs that would still be required to complete due diligence on their raw inputs.

Option 3 summary

Regulatory cost	Coverage	Practicality	Consistency
<ul style="list-style-type: none"> Potential for substantial cost savings, depending on products selected for removal 	<ul style="list-style-type: none"> Potential to significantly reduce coverage levels depending on products selected for removal 	<ul style="list-style-type: none"> Complex and contentious judgement about what products to include and exclude Straightforward amendment to the Regulations required 	<ul style="list-style-type: none"> Introduces substantial inconsistency

6.3.4 Providing 'safe harbours' under timber legality frameworks and country and state specific guidelines

This option proposes simplifying the application of timber legality frameworks and country and state specific guidelines.

Regulatory cost to business

This option would reduce the costs for those businesses that imported products that were covered by a timber legality framework or country specific guidelines, and processors which used logs covered by frameworks or guidelines. As outlined earlier, the business interviews conducted for the Review suggested that the approach in this option is consistent with current business practices, and in many cases what businesses (mistakenly it would seem) believe is required for compliance.

The significant number of businesses interviewed who already undertake these activities as part of their normal business would likely see this option as being a very practical approach to meeting the Act's intent.

However, it is not possible with the information available to the Review to provide indicative estimates of the cost savings associated with this option. The Review did not seek detailed cost estimates from businesses about their costs of assessing individual suppliers and/or products. Moreover, there is no data available on what proportion of products imported and processed are currently covered by these timber legality frameworks, although there is data on the level of imports from countries with country specific guidelines. In any event, many importers (although possibly not processors) would deal with both certified and non-certified products, and products covered by country specific guidelines and those which are not, so would still need to have the

more complex due diligence systems in place to deal with non-certified products or those imported from countries not covered by a guideline.

Coverage

This option would not reduce the coverage of the regulatory regime, as it would only reduce a simplified compliance option. In terms of impact on illegal logging, such a simplified process would be expected to increase demand for certified products, or those from countries that have made the effort to agree a country specific guideline.

Practicality

It would be easier to assess compliance with these simplified requirements.

Consistency

This option's treatment of county specific guidelines would appear to make the Australian regulations more consistent with the European Union arrangements that apply to FLEGT licences. The European Union guidance states:

The Regulation considers that timber and timber products covered by FLEGT licences or CITES certificates fully meet its requirements. This means:

- a) That operators who place products on the market covered by such documentation do not need to conduct due diligence on those products, apart from being able to demonstrate coverage by valid relevant documentation; and
- b) That any such product will be considered by Competent Authorities to have been legally harvested and will not carry any risk of breaching provisions of the Regulation, prohibiting placing illegal timber on the market.

This is because legality verification controls - and hence due diligence - will have been carried out in the exporting country in accordance with the Voluntary Partnership Agreements between those countries and the European Union, and the resulting timber can be considered risk-free by operators.¹⁷⁵

However, this option's treatment of timber legality schemes is not mirrored in the EU system, although there are already differences between Australia and the EU in that they don't explicitly approve specific schemes such as FSC and PEFC, nor give their certificates the same weight as FLEGT licences.

This option, by further reducing the costs of compliance for imports from countries where timber legality frameworks operate, effectively favours some country's imports over others. The same is true for country specific guidelines.

However, this is already true to some extent and was implicit in the Parliament's decision to create provision in the Act for:

The regulations may provide for due diligence requirements for importing regulated timber products to be satisfied, wholly or partly, by compliance with specified laws, rules or processes (Section 14 (5)).

How the WTO would assess such an arrangement is not clear.

¹⁷⁵ European Commission (2013), *Guidance document for the EU timber regulation*, p.2, Accessed 28 March 2015 <<http://ec.europa.eu/environment/forests/pdf/Final%20Guidance%20document.pdf>>

Option 4 summary

Regulatory cost	Coverage	Practicality	Consistency
<ul style="list-style-type: none"> Cost savings were not able to be estimated, however this option is likely to provide some level of saving 	<ul style="list-style-type: none"> Does not affect the scope of products or countries covered by the Regulations 	<ul style="list-style-type: none"> Simple to assess compliance 	<ul style="list-style-type: none"> Introduces inconsistency with EU requirements Many countries' exporters will not have access to timber legality frameworks or country specific guidelines do not cover

6.3.5 Approve a generic Country/State Guideline

This option involves approving a generic Country/State Guideline that would outline the minimum documentation required to establish legality for timber from any country or State/Territory of Australia.

Regulatory cost to business

This option may reduce regulatory costs, particularly for those businesses importing from countries where the certification schemes don't operate, and/or where a country specific guideline is not in place.

Importers from countries without country specific guidelines, or export licensing, or are unable to access documents from appropriate government officials attesting to legality, would have an Australian Government endorsement of relying on the exporter's attestation of legality under this option. However, particularly for higher risk countries this form of attestation is likely to be, in many cases, less robust and/or reliable and so would only seem to lead to a substantial cost reduction if was not accompanied by the collection of other information and a robust risk assessment. It is difficult to ascertain what the nature of the cost saving is if importer continued to balance cost and risk as they would otherwise.

It is unclear what benefits arise from allowing businesses importing from countries that have country specific guidelines to use the proposed generic guideline. Nor is it clear what cost savings there are from allowing importers to use an attestation from an exporter, even where a country does have a government system of attestation of legality. Consequently, it is unclear how this option reduces costs for such importers.

Importers who source products from countries that have an export licencing scheme, or are able to access documents from appropriate government officials attesting to legality, are able to use this information already in the risk identification and assessment outlined in Section 13. It would seem such documents would make the risk assessment much simpler, even without a country specific guideline. Consequently, it is unclear how this option reduces costs for such importers.

Moreover, as proposed by stakeholders, the importer would still need to comply with the information gathering requirements (particularly Section 10 (2) (i)), the risk

assessment requirements (Section 12 (1) (c) and (d)) and the risk mitigation requirements (Section 14 (2) (a) and (3) (a)).

It is not possible with the information available to the Review to provide indicative estimates of the cost savings associated with this option.

Coverage

This option would not reduce the coverage of the regulatory regime. In terms of impact on illegal logging, however, giving the same standing to an attestation from an exporter as that of an official government licence or permit, or a rigorously assessed international certification scheme would be expected to decrease demand for these more robust and reliable processes. It would also seem to dull the incentives for some exporting countries, who may feel their exports are hindered by the lack of country specific guidelines to devote effort to agreeing one.

Practicality

It is unclear how a compliance assessment would treat a due diligence process where the importer (or processor) deliberately chose not to use a country (or state) specific guideline, even though one was available, or to rely on an attestation by an exporters, even though the country had an export licencing or some other equivalent government scheme relating to legality of timber exports. The Australian Government's *Regulator Performance Framework* encourages regulators (such as the Department of Agriculture) to adopt a more risk-based approach to their enforcement activities.¹⁷⁶ An importer that chose to rely on an attestation of an exporter from a higher risk country may risk being subject to greater scrutiny from the regulator than an importer that chose to use exporting country documents.

This option would raise even greater concerns regarding the Government's ability to reduce the risk of imports of illegally logged products if it was implemented with the streamlined arrangements relating to timber legality frameworks and country/state specific guidelines as outlined in option 4. Option 4 is predicated on the assessment that the current arrangements (of approving specific legality frameworks and country/state guidelines) combines what are assessed as robust and reliable systems, with additional and unnecessary layer of information gathering and assessment (in Sections 10 and 11 of the Regulations for importers). A generic guideline, particularly one that relied on attestation from exporters, would not have the necessary underpinning of robust and reliable systems.

Consistency

This option would be inconsistent with the EUTR approach to undertaking due diligence by collecting the necessary information if it was associated with any reduction in the other information gathering and risk assessment steps. The EU emphasises the primacy of information gained through agreed bi-lateral (exporter-EU) arrangements regarding exporting government licences and of robust and reliable third party verification,

¹⁷⁶ Australian Government (2014), *Regulator Performance Framework*, p.2

whereas this proposal envisages neither bilaterally agreed country guidelines or verified attestation.

This option would provide for a generic attestation of legality that could be applied across all source of exports and logs processed domestically, thus provides more consistent treatment from a WTO perspective.

Option 5 summary

Regulatory cost	Coverage	Practicality	Consistency
<ul style="list-style-type: none"> Cost savings were not able to be estimated. Further analysis would be required to ascertain how this option would provide substantial savings without compromising the Act's intent. 	<ul style="list-style-type: none"> Does not affect the scope of products or countries covered by the Regulations 	<ul style="list-style-type: none"> Unclear how it would work in practice, particularly allowing exporter to attest to the legality of their products Significant concerns if combined with Option 4 Amendment to the Regulations and likely the Act required 	<ul style="list-style-type: none"> Less consistent with EU's bilateral approach to exporting country licences and third party verified attestation. Other jurisdictions do not rely on exporters to attest the legality of their products

6.3.6 Exempt small businesses from the requirements of the Regulations

Under this option, approximately 10,000 fewer businesses would be subject to the requirements of the Regulations in any one year. One-off regulatory cost savings were estimated to be in the range of \$3.9 - \$19.1 million, although if substantial numbers of businesses moved between the small and large category year-on-year, the savings would be smaller. Despite the savings, provisions for due diligence in the Act would remain, however exempted businesses would have more flexibility in how they approach this obligation. This option would equally apply to both importers and processors.

Regulatory cost to business

Table 27 – Indicative one-off and ongoing cost savings to small business due to their exclusion from the Regulations

Savings	'Estimated hours' sample	'High familiarity' sample
One-off costs	3.9	19.1
Ongoing costs	-	8.2

Exempting small businesses (i.e. those with an annual turnover of less than \$10 million) from the requirements of the Regulations reduces one-off regulatory costs incurred by those businesses by \$3.9 million using the 'estimated hours sample' and \$19.1 million using the 'high familiarity' sample.

Coverage

Up to \$1.1 billion (or 19 per cent) of regulated products would no longer be subject to due diligence requirements where an exemption is granted to small business. Of this,

more than one-quarter of all furniture imports (by value) would cease to be regulated. This poses concerns for the efficacy of the objectives of the illegal logging Regulations. Given one source estimated that 22 per cent of all furniture products coming into Australia are illegally logged (Table 6), it is likely this higher risk category would benefit from retaining due diligence requirements as prescribed by the Regulations.

By contrast, the vast majority of paper (by value) is imported by medium and large businesses (87 per cent), therefore this category would not be significantly impacted by exempting small businesses. Should an exemption be applied to small businesses, 22 per cent of regulated timber products (by value) would no longer be subject to the requirements of the Regulations.

Anecdotally, it is also expected that smaller businesses (which generally have less capacity to investigate and monitor their suppliers due to the lower total value of their imports) are more vulnerable to being sold illegally logged timber products. For this reason, removing all small businesses from the Regulations would move away from the policy objective and would require substantial regulatory cost savings to be considered.

Practicality

Implementing this option would require amendments to the *Illegal Logging Prohibition Regulation 2012*, most likely as amendments to the existing section 6(1), where businesses can self-nominate as being exempt from the requirements. It is also likely that this option would require a definition of small business to be included in the Act.

If this option was considered, the Department would need to look at how to define small business, as the definition used for this analysis may not be the most appropriate. For example, the ATO's standard definition of small business is a turnover less than \$2 million per annum, or alternatively the ABS definition of a business employing 0-19 employees.

The Department has no visibility of 'small businesses' within its compliance systems. As a result, any exemption would need to be based on a process of self-nomination, with the business having to show evidence that they meet the definition of a small business when approached as part of an assessment process. The Department argued that assessing such claims could be difficult, as it does not have access to independent sources of data for individual businesses' financial turnover or staffing data (due to its commercial sensitivity) to verify business size.¹⁷⁷ The Department could consider requesting profit and loss statement's from businesses or accepting sign-off from independent accounting firms to confirm business size.

There would also be additional complexities where businesses fall in and out of the defined business category over time.

Consistency

Exempting small businesses (less than \$10 million in annual turnover) would not be consistent across different types of businesses. It would see 10,059 small businesses

¹⁷⁷ Department of Agriculture, 'Initial Responses to Potential Regulatory Options', 11 March 2015, pers. com

exempt from the requirements of the Regulations out of a total number of 17,254 importers of regulated timber products.¹⁷⁸

Based on ABARES analysis, excluding small businesses from the requirements of the Regulations would see more than half of all regulated furniture importers (4,700 of 8,470) and more than half of all regulated paper importers (5,400 of 9,000) exempt from the requirements of the Act. Given furniture products are likely to represent a higher risk of containing illegally logged timber product (see Table 6), exempting a significant proportion of these importers from the Regulations is likely to hold negative repercussions for the efficacy of the illegal logging laws.

Excluding businesses with an annual turnover of less than \$10 million reduces the number of wood article importers with obligations under the Regulations by approximately 1,700. Products under this tariff code pose some risk of containing illegally logged material, however, the risk associated with exemption are lessened considering that the majority of wood article products by value, as with all products, are imported by medium to large businesses.

Neither the EU nor the US illegal logging legislative frameworks provide for exemptions based on business size. Exempting small businesses would be inconsistent with the EU Timber Regulations and the Lacey Act in the US, where business size is an irrelevant factor in determining if requirements of the respective regulatory frameworks apply.

The submission from ITS Global noted that this option would most probably conflict with the WTO if an exporting country could demonstrate that it had the effect – intended or not – of favouring imports from some countries over imports from another. While WTO compliance is an important issue, it is unclear how such an effect could be demonstrated.

More broadly, the notion of an even playing field was raised in most feedback workshops. Excluding all small businesses would provide them with a competitive advantage over medium and large businesses who would still be required to spend time and effort in setting up and maintaining due diligence systems.

Option 6 summary

Regulatory cost	Coverage	Practicality	Consistency
<ul style="list-style-type: none"> One-off savings of \$3.9m to \$19.1m Up to \$8.2m in ongoing savings 10,000 fewer regulated businesses (excl. 'no data' group) 	<ul style="list-style-type: none"> \$1.1b (19.0%) reduction in the value of regulated imports \$519m (26.4%) reduction in the value of furniture regulated 	<ul style="list-style-type: none"> Substantial amendment to the Regulations required Complexities around businesses moving in and out of 'small business' category from year to year. 	<ul style="list-style-type: none"> Introduces substantial inconsistency with EUTR

6.3.7 Repeal the Regulations and rely on the Act alone

This option proposes to repeal the Regulations and rely solely on the Act in combatting the importation and processing of illegally logged timber. This option would apply equally to both importers and processors.

¹⁷⁸ ABARES upcoming report (2015).

Regulatory cost to business

As the costs analysed in section 4 represent only those that were incurred due to the Regulations, the potential regulatory cost savings of this option are the estimated industry one-off and ongoing compliance costs.

Table 28 – Indicative one-off cost savings for businesses

Annual turnover	'Estimated hours' sample (\$m)	'High familiarity' sample (\$m)
\$0 - \$10 million	3.9	19.1
Over \$10 million	16.3	37.2
Total savings	20.2	56.3

Table 29 – Indicative ongoing cost savings for businesses

Annual turnover	'Estimated hours' sample (\$m)	'High familiarity' sample (\$m)
\$0 - \$10 million	-	8.2
Over \$10 million	1.7	7.4
Total savings	1.7	15.6

As it currently stands, repealing the Regulations provides the greatest potential cost saving of all options considered for businesses of all sizes. When considering the 'estimated hours' sample, one-off cost savings of over \$20 million and ongoing cost savings of around \$2 million will apply industry-wide if the Regulations are repealed. Using the 'high familiarity' sample, savings were estimated at over \$56 million in one-off costs, and around \$16 million in ongoing costs.

Coverage

Despite the cost savings, repealing the Regulations poses a number of issues surrounding product coverage. The Act stipulates that the Regulations are to prescribe what constitutes a regulated timber product. Consequently, repealing the Regulations also removes the obligations of importers of products in specific product chapters to follow prescribed due diligence steps. Instead, a general 'blanket' prohibition would apply to the importation of illegally logged timber and timber products. This scenario has the potential to create confusion for businesses concerning whether their products are affected by the Act. Furthermore, removing specified product categories may see businesses revert to business-as-usual practices. With no concrete requirements in place for importers or processors to conduct due diligence, some may choose to do what is minimally required, thus increasing the risk of illegally logged timber entering Australia.

Practicality

This option would require amendments to both the Act and the Regulations to remove all elements associated with the due diligence requirements. Certain elements of the Regulations, for example Part 4 which deals with monitoring, investigation and enforcement powers, would need to be retained.

This will leave section 8 of the Act (the general prohibition on the trade in illegal timber) as the Government's sole tool in combating the illegal trade. In such a circumstance, the

Department noted that the Government may need to change its compliance focus from working with industry to promote change in the supply chain to a more investigation and sanctions driven compliance model.¹⁷⁹ It argued that this is likely to have impacts on the overall relationship with industry and associated resourcing costs.

Relying on the Act alone would also pose challenges to pursuing prosecution under Section 8 of the Act. The Government would need to prove in a court of law that the timber had been logged in contravention to the relevant timber harvesting laws and that the defendant had intentionally, knowingly or recklessly traded in that product. The difficulty of doing so is likely to reduce the general deterrence effect of the legislation.

Consistency

Removing the Regulations would see no changes to the general prohibition on the importation and processing of illegally logged timber to which the Act gives rise. However, removing the Regulations would create an inconsistency when compared with the EU Timber Regulation and the Lacey Act in the United States. The change would also seem inconsistent with the Australian Government's commitment to combatting trade in illegal timber.

Furthermore, this option would create an uneven playing field for proactive businesses that already undertake due diligence processes.

Option 7 summary

Regulatory cost	Coverage	Practicality	Consistency
<ul style="list-style-type: none"> Possible one-off savings of \$20.2m to \$56.3m Possible ongoing savings of \$1.7m to \$15.6m 17,254 importers and 468 processors excluded from existing specific due diligence requirements 	<ul style="list-style-type: none"> No timber products covered as the Act requires the Regulations to specify 'regulated timber products' Obligation of specific product chapters to follow prescribed due diligence steps would be removed 	<ul style="list-style-type: none"> Substantial amendment to the Regulations and the Act required Creates uncertainty as what is required to meet 'due diligence' provisions of the Act 	<ul style="list-style-type: none"> Lack of clarity of what products are covered would introduce inconsistency with EUTR Introduces substantial inconsistency with EUTR in terms of due diligence

6.4 Non-regulatory measures

In addition to the regulatory measures which can reduce and reform the regulated community, there are opportunities for non-regulatory changes to develop business understanding of the due diligence requirements. These opportunities can reduce due diligence costs through an enhanced understanding of what compliance looks like. The three specific non-regulatory measures are outlined below.

¹⁷⁹ Department of Agriculture, 'Initial Responses to Potential Regulatory Options', 11 March 2015, pers. com

6.4.1 Fund the development of more targeted guidance or training workshops to help businesses better understand their compliance obligations

This measure pertains to additional Government funding of industry guidance materials in the mould of current TDA and ATIF toolkits and/or workshops, as well as further guidance from the Government themselves. The expansion in the number of these kinds of guidance can inform businesses of the requirements, and enhance their ability to comply. This option would potentially benefit both importers and processors.

Regulatory cost to business

The Department funded both the TDA and ATIF in the creation of their respective guidance materials, and have signalled potential willingness to expand this funding to include a greater number of materials (subject to resourcing).¹⁸⁰ As such, business would not incur any cost associated with the creation of these materials.

Better guidance could lead to some cost savings, although the savings have not been able to be costed. Simple and specific guidance for businesses could somewhat reduce the costs they incur seeking to understand the requirements of the Regulations. For example, Country Specific Guidelines could include upfront a very short summary that explicitly stated a small number of source Government documents that are required to show legality in that country. It appears that in some cases, critical and very useful information can be buried within these documents.¹⁸¹

Moreover, greater clarity on what is 'reasonable practicably' would assist many businesses which are currently devoting more effort to this task, by seeking additional information or validating the information they receive, than might ultimately be considered sufficient industry practice. As the regulatory scheme matures, particularly as the Department starts undertaking compliance assessments and industry standards will begin to develop, which will go part of the way towards realising some of the cost benefits associated with this option.

Coverage

The development of more targeted guidance or training workshops would have no impact on coverage of product chapters, value of imports or source countries. These materials would offer those in the regulated community a better understanding of the due diligence requirements, as opposed to reducing or removing the commitments.

Practicality

The Department has previous experience in working with industry bodies to provide guidance materials to the regulated community, including:

¹⁸⁰ KPMG consultation with the Department of Agriculture.

¹⁸¹ As an example the sentence on page 18 of the 36 page Country Specific Guideline for Malaysia (Sarawak), which stated "An Export Licence issued by STIDC demonstrates timber legality for products exported from Sarawak."

- **2012:** Providing \$77,700 to Forest and Wood Products Australia (FWPA) which ended in the funding of the TDA's suite of tools and guidance; and
- **2014:** Providing \$25,000 to ATIF to deliver training workshops on due diligence requirements to their industry, which is predominantly limited to importers of wood articles.

These precedents demonstrate a collaborative relationship between industry bodies and the Department, which can be continued and expanded subject to Department resourcing. The results of the business interviews suggest the role of customs brokers is critical, and helping them better advise their clients is likely to be useful.

The Department have also stated that they will continue to evolve and review the range of Government-published guidance materials as the due diligence requirements mature, and more is known regarding their implementation. These materials include factsheets, translated factsheets, FAQs, and website materials.

The Department may also consider increasing marketing/advertising around the Regulations to increase awareness, as well as developing electronic systems and tools to assist businesses with data collection.

Preparing improved guidance, and funding industry organisations to provide training will have a cost, and sufficient budget would need to be identified.

Consistency

The implementation of new frameworks and guidance materials will be of use to business regardless of size, however given the fact that KPMG's consultations suggested smaller businesses had less familiarity with the requirements, it is likely that additional guidance will be of greatest benefit to these businesses.

In terms of product coverage, ATIF provides wood article importers with tailored guidance on due diligence in the industry specifically.¹⁸² As such, introducing equivalent frameworks and materials for the paper, pulp and furniture industries would improve consistency across industries, and give all regulated businesses access to tailored information.

In terms of consistency with the EU and US, there are industry guidance materials and Government-sponsored explanatory publications across both jurisdictions to varying degrees of detail.¹⁸³ As such, increasing the number of guidance documents will have no impact on the consistency between Australia, the EU and US.

¹⁸² Australian Timber Importers Federation (2014). *Legality Compliance Toolkit: Illegal Logging Prohibition Amendment Regulation 2013*.

¹⁸³ Gould, Jim (Undated). *Continuing Wood Trade under The Lacey Act Amendments*. Accessed 13 March 2015 at <http://www.floorcoveringinstitute.com/files/Lacey_Act_Article15_2.pdf>

SGS (2015). *EU Timber Regulation Training*. Accessed 13 March 2015 at <<http://www.sgs.ru/en/Training-Services/Industry-Based-Training/Agriculture-and-Food/Forestry-and-Wood/EU-Timber-Regulations-Training.aspx>>

United States Department of Agriculture (2015). *Lacey Act*. Accessed 13 March 2015 at <http://www.aphis.usda.gov/wps/portal/aphis/ourfocus/planthealth?1dmy&urile=wcm%3apath%3a%2Faphis_content_library%2Fsa_our_focus%2Fsa_plant_health%2Fsa_import%2Fsa_lacey_act%2Fct_lacey_act>

Option 8 summary

Regulatory cost	Coverage	Practicality	Consistency
<ul style="list-style-type: none"> Cost savings were not able to be estimated, however this option is likely to provide some level of saving 	<ul style="list-style-type: none"> No change 	<ul style="list-style-type: none"> No practicality issues identified 	<ul style="list-style-type: none"> Potential to improve consistency across industries

6.4.2 Undertake voluntary compliance assessments that assess individual businesses' compliance with the Regulations

The implementation of voluntary compliance assessments of businesses will give participants a tailored understanding of their own due diligence operations. This will give businesses insight into what constitutes compliance and, where there is evidence of non-compliance, how to improve behaviour to become compliant. This option would potentially benefit both importers and processors equally, to the extent that businesses in both sectors take up the voluntary assessments.

Regulatory cost to business

Given the cost of the voluntary compliance assessments will be absorbed by Government, there will be no additional direct regulatory cost to business resulting from the compliance assessments. Businesses may wish to devote resources to refining due-diligence processes before a compliance assessment, however this is likely to be outweighed by the cost savings associated with increased information and understanding of the regulatory requirements. As the regulatory scheme matures, industry standards will begin to develop, which will go part of the way towards realising some of the cost benefits associated with this option.

Coverage

Voluntary compliance assessments would have no impact on coverage of product chapters, value of imports or source countries. These assessments would offer the regulated community a better understanding of the due diligence requirements, as opposed to reducing or removing the commitments.

Practicality

The Department is already in the process of building voluntary compliance assessments into its illegal logging compliance strategy (40 desk-top assessments currently anticipated). This suggests that not only does the Department see the option as practical from an implementation perspective, but there is already resourcing allocated to its creation.

The Department has advised that completing an additional 60 on-site voluntary compliance assessments is likely to cost an additional \$65,000.¹⁸⁴ While this is an additional cost to Government, it would seem justified given the existing level of

¹⁸⁴ This does not include the costs for any follow-up visits which would result in an additional cost to Government.

uncertainty in the business community and costs currently experienced by businesses in complying with the Regulations.

Consistency

The consistency of the voluntary compliance assessment program is dependent on how Government chooses to implement it. There are two potential options:

- Government could seek to distribute their compliance assessments across a range of products and business sizes to gain a more fulsome understanding of the regulated community's risk profile; or
- A more targeted set of assessments can give greater depth of analysis into one industry, product chapter or business type. This was demonstrated by the National Measurement Office (NMO) review of compliance by importers of Chinese plywood in the UK.¹⁸⁵

Greater consistency of application would be embodied by the first option.

As illustrated by the NMO review, compliance assessments occur under the EU Timber Regulation. It is likely that this review function will also set up an enforcement framework as the regulated community moves towards the end of the 18 month transition period.¹⁸⁶ This would enhance consistency with the EU and US given compliance assessments are a key enforcement tool in both jurisdictions.¹⁸⁷

Option 9 summary

Regulatory cost	Coverage	Practicality	Consistency
<ul style="list-style-type: none"> • Cost savings were not able to be estimated, however this option is likely to provide some level of saving if it results in clearer more practical guidance and reduces the risk that some business are doing more than what is generally considered as 'reasonably practical' for the industry 	<ul style="list-style-type: none"> • No change 	<ul style="list-style-type: none"> • No practicality issues identified 	<ul style="list-style-type: none"> • No significant consistency issues identified

6.4.3 Fast track the development of additional Country Specific Guidelines

The implementation of additional Country Specific Guidelines will seek to offer businesses a greater amount of guidance on what information they should seek from their suppliers in the Country Specific Guideline-relevant countries. In so doing, these materials will enhance the efficiency of due diligence processes. This option would only impact on importers.

¹⁸⁵ National Measurement Office (2015). *EUTR: Plywood imported from China*. Accessed on 25 February 2015 at

<http://content.govdelivery.com/attachments/UKNMO/2015/02/09/file_attachments/363138/Chinese%2BPlywood%2BResearch%2BReport.pdf>

¹⁸⁶ The Department has stated that for the initial 18 months of the Regulations, there will be no enforcement action taken against business, rather they will seek to educate business on how to improve their compliance.

¹⁸⁷ For a full discussion of enforcement activity in both the EU and US, See section 2.2.

Regulatory cost to business

Additional Country Specific Guidelines will allow more businesses to apply the simplified due diligence process and avoid any costs associated with the final two steps of the due diligence requirements – risk assessment and risk mitigation. Depending on the quality of the additional Guidelines, it is likely that they will also save businesses time in the information gathering stage by providing greater guidance.

The time cost estimates obtained through the business interviews suggested that the information gathering stage of the due diligence requirements was the most time consuming. Thus, to achieve the maximum regulatory cost saving for business, this option would need to generate quality Guidelines, not just more.

Coverage

Similar to the previous non-regulatory options, the fast-tracking of additional Country Specific Guidelines will have a negligible impact on coverage of product chapters or value of imports. However, the additional Guidelines do have the potential to alter the coverage of source countries given the mooted additional Guideline countries (China, Thailand, Vietnam, South Korea and Germany) account for 47 per cent of imports.¹⁸⁸ This will give more security to businesses importing from these countries, particularly importers dealing with China which accounts for 34 per cent of the total value of regulated product imported.¹⁸⁹ This percentage, along with feedback from industry stakeholders, suggests that China's Guideline will simplify due diligence requirements for a material number of businesses.

The Department also expects that the China Guideline is also likely to assist importers dealing with heavily manufactured or transformed goods, of which China is a major producer (often sourcing its timber from neighbouring countries throughout south-east Asia, Russia and the Pacific), which has been noted as a major deficiency in the current guidance.

The Department also noted that a number of other countries in the Asia-Pacific Economic Cooperation region are considering drawing on the Australian template as a means of communicating what is legal within their country. This may result in a larger percentage of this region having Guidelines in place in the future.

Practicality

The Department has stated that additional resources may be available to fast-track the development of the Guidelines. Despite this, the fast-tracking of Guidelines is heavily dependent on negotiation with the supplier country government, and thus is not entirely within the remit of the Department to expedite their development.

¹⁸⁸ KPMG consultation with the Department of Agriculture.

¹⁸⁹ Gupta, M. and Hug, B. (2013), *Illegal logging regulation: the affected community*, ABARES, report to client prepared for the Department of Agriculture, Canberra, November. CC BY 3.0., p12.

Consistency

Currently, only 32 per cent of imports are covered by Country Specific Guidelines (specifically, Guideline countries include Indonesia, Malaysia, New Zealand, Canada, Italy, Finland and the Solomon Islands). By expanding the Country Specific Guideline documents to cover an additional 47 per cent of imports, the program has a more consistent coverage. This avoids creating any undue advantage for the 32 per cent of businesses who would have reduced due diligence through the use of Guidelines. By adding the additional Guidelines, a total of 79 per cent of products would be covered, which does not alleviate the potential competitive advantages for importers with suppliers from covered countries, but the spread across the regulated community is more consistent.

Among product categories, the fast-tracking of additional Guidelines will have a material impact on the amount of imports covered by the guidance:

Table 30 - Total value covered across the additional Country Specific Guidelines (%)¹⁹⁰

	Wood	Paper	Furniture
Total value covered across the additional Guidelines	15	39	68

The additional Country Specific Guidelines have a notably more substantial impact on the furniture industry as opposed to paper, which again receives a greater percentage of coverage as opposed to wood articles. This is attributable to China having a more significant presence in supplying furniture, while having a considerably reduced presence in exporting wood articles.

In terms of consistency with EU and US systems, the Country Specific Guideline documents are unique and thus not directly consistent with the other jurisdictions' guidance. While both the EU and US have published FAQ documents, the bilateral agreements reached between Australia and other countries are a collaboration between both relevant governments and, depending on the particular CSG, can give a range of different documents that can provide evidence of legality.¹⁹¹

Option 10 summary

Regulatory cost	Coverage	Practicality	Consistency
<ul style="list-style-type: none"> Cost savings were not able to be estimated, however this option is likely to provide some level of saving 	<ul style="list-style-type: none"> No change 	<ul style="list-style-type: none"> Heavily dependent on negotiation with supplier country government 	<ul style="list-style-type: none"> Will make the requirements for countries with new guidelines more consistent with those already covered, but less consistent with those which continue to have not agreed a guideline.

¹⁹⁰ This assessment is based on using China, Thailand, Germany and South Korea as indicative of all additional CSGs (including Vietnam and Chile). This distinction was created to enable a calculation based on Australia's top ten trading partners, which excludes Vietnam and Chile.

¹⁹¹ While the EU's VPA system is similar in terms of the bilateral nature of the agreement, the end product is different, with signatory supplier countries required to set up a national certification system to assist in meeting the requirements of the EU Timber Regulation.

7 Recommendations

This section considers and compares the assessments from the previous chapter to put forward four recommended options. Each recommendation is accompanied by a discussion of various implementation considerations.

Australian Government guidelines require that a regulatory burden and cost offset estimate table must be populated and reproduced in a Regulation Impact Statement, including for matters that are solely deregulatory (such as this Review's recommendations).¹⁹² See Appendix G for the regulatory burden and cost offset estimate tables for each of the recommended options.

The analysis in section 6 identified that there are a range of changes that the Government could implement that would address the identified problem regarding the costs of the Regulation, relative to its benefits.

In this section, the Review outlines a recommended package of changes that would lower the costs faced by businesses (including small businesses), while still achieving the Government's broader policy objectives. The nature of the recommended changes is that they could be implemented separately, as no individual recommendation is dependent on the implementation of another. As a consequence, if the Government chooses to proceed it could implement all or some of these recommendations.

7.1 Options that were not considered to provide a net-benefit

5 of the 10 options assessed in the previous section are not being recommended as the Review's assessment is that they did not meet the overarching 'net benefit' criteria. While section 6 provided a detailed analysis of the strengths and weaknesses of each option, relative to the status quo, the table below summarises the key drivers behind excluding each of these options from the recommendations.

Table 31 – Options that were not considered to provide a net-benefit

Option	Key driver/s for exclusion from recommendations
Option 2 - Apply a \$75,000 annual importer value threshold	<ul style="list-style-type: none"> Administrative complexities exist regarding defining and identifying businesses that fall above/below an annual threshold. These complexities would make it difficult to communicate the change the businesses, which could increase uncertainty and thus costs.

¹⁹² Guidance Note, Regulatory Burden Measurement Framework, Australian Government, Department of the Prime Minister and Cabinet, Office of Best Practice Regulation, July 2014

Option 3 - Remove specific products from the Regulations	<ul style="list-style-type: none"> • There is insufficient evidence available at this time to accurately assess both the varying compliance costs across product types and the varying risk profiles across product types. • Removing more complex or manufactured products, which may be at greater risk of including illegally sourced timber due to their many components, would increase the risk of illegally logged timber entering Australia. • Inconsistent with EU Timber Regulation and the Lacey Act.
Option 5 – Approve a generic Country/State Guidelines	<ul style="list-style-type: none"> • Unclear how it would work in practice, particularly in relation to allowing exporters to attest to the legality of their products. • Inconsistent with EU Timber Regulation.
Option 6 - Introduce an exemption for small businesses	<ul style="list-style-type: none"> • This would see more than half of both furniture and paper imports exempt from the requirements of the Act, increasing the risk of illegally sourced timber entering Australia. • Using business size is not a robust metric. Some very large businesses only import a small amount of regulated timber product, and some small businesses deal exclusively in the importation of regulated timber product. • Inconsistent with EU Timber Regulation and the Lacey Act.
Option 7 - Repeal the Regulations and rely on the Act alone	<ul style="list-style-type: none"> • This option effectively removes the obligations of specific product chapters to follow prescribed due diligence steps. This scenario has the potential to create confusion for businesses concerning whether their products are affected by the Act. • With no concrete requirements, some businesses may default to lower levels of due diligence, thus increasing the risk of illegally logged timber entering Australia. • Challenges around prosecution would increase under this option. Business would have no guidance on what constitutes appropriate action to avoid importing or processing illegally logged products. • Inconsistent with EU Timber Regulation, Lacey Act, and the Government's commitment to combatting trade in illegal timber.

7.2 Recommendation 1 – Increase the individual consignment value threshold from \$1,000 to \$10,000

This recommendation involves increasing the individual consignment value threshold from \$1,000 to \$10,000.

KPMG considered two scenarios under this option:

1. Monitor compliance experiences under the current Regulations for three years before again reviewing the consignment threshold; and
2. Increase the threshold to \$10,000 as soon as practicable and re-assess after three years.

Each scenario has both strengths and weaknesses as outlined in Table 32.

Table 32 – Strength and weaknesses of individual consignment threshold scenarios

	Strengths	Weaknesses
<i>Scenario 1</i>	<p>Easy to implement as no change to either business or government</p> <p>Allows the Department to collect further data to either support or disprove the information collected as part of this Review</p>	<p>Would reduce the potential one-off cost savings (largest cost type) as businesses who would be excluded under scenario 2 would continue to establish due-diligence activities.</p> <p>Would reduce the potential ongoing cost savings as businesses who would be excluded under scenario 2 would continue to maintain due-diligence activities.</p>
<i>Scenario 2</i>	<p>Avoid incurring additional sunk costs and allows immediate realisation of cost savings</p>	<p>Would require Regulations to be updated</p> <p>May induce gaming</p> <p>May exclude businesses which have greater propensity to import potentially illegal logged products.</p>

It was determined that, on balance, scenario 2 provided the greatest net benefit to the regulated community, largely as a result of the cost savings that could be experienced immediately (post-Regulation amendment) without a substantial drop in total regulated value. As discussed, the businesses interviewed largely represented early adopters. Of these early adopters, many businesses were still dedicating time and effort towards understanding the Regulations and setting up their due diligence systems (one-off costs) and only 35 per cent claimed high familiarity with the Regulations. This suggests that there are still substantial one-off costs to be incurred by industry, and that any increase in individual consignment threshold could remove a selection of businesses from incurring these costs.

The cost saving analysis performed in the previous section does not consider behavioural change. One concern raised by stakeholders throughout the consultation process was that of gaming (businesses splitting up their imports into consignments valued below the \$10,000 threshold). It is recommended that, during the three year period before an implementation review (which would include the current 18 month transition period), the Department monitor businesses bringing in high numbers of consignments below a value of \$10,000, particularly from higher risk countries. Any

substantial increase in this form of activity, or change in the characteristics of the businesses bringing in multiple consignments under \$10,000, could be used as an input to a review at the three year mark and may be used as evidence to support reducing the individual consignment threshold back to a lower value. If any subsequent review found suspicious behaviour, the Government should seek to introduce anti-avoidance mechanisms to complement the Regulations.

Another potential risk associated with this recommendation is that a materially large amount of illegally logged timber is no longer regulated. Estimates discussed earlier in this report suggest 10 per cent of timber imported into Australia could be illegally sourced, however it may be the case that this percentage is higher for smaller businesses who import less frequently (and likely to be over-represented in consignments valued between \$1000 and \$9,900). However, the Review was not provided with any evidence that this is the case, but would be a useful area for further research and intelligence gathering as part of the compliance strategy over the next three years.

The costs of complying with the regulation may well reduce over time as suppliers in exporting countries get more accustomed to providing the information required for Australian, EU, and potentially other countries' due diligence. As the various accreditation systems in some higher risk countries also become more imbedded this too may reduce the costs of compliance. Should this occur, the Government could choose to lower the threshold again, at a lower cost than is currently likely to be experienced.

7.3 Recommendation 2 – Establish simplified 'deemed to comply' arrangements by regulation

This recommendation is in relation to another regulatory option and involves the development of an explicit 'safe harbour' or 'deemed to comply' arrangements. Imports and domestic timber that is supplied by certified suppliers or that has the documentation required by Country or State Specific Guidelines should not be subject to additional due diligence requirements. The additional information and risk assessment currently required by the Regulations for these products adds costs without commensurate benefits.

With respect to implementing this change for imports, Sections 10 and 11 of the Regulations would need to be amended to implement this option.

The full due diligence requirements would consist of the importer confirming that:

1. their supplier was Forest Stewardship Council (FSC) or the Programme for the Endorsement of Forest Certification (PEFC) certified or FLEGT licenced;
2. the product they were purchasing was covered by this certification or licence; and
3. the certificate was valid by searching the certification body's website.

The importer would need to document in writing that they had undertaken these three steps. An importer undertaking these three steps would be deemed to have complied with the due diligence requirements, and would not be required to undertake any

further risk assessment or risk mitigation activity. The application of such a safe harbour would allow these businesses to bypass the final two steps of the due diligence requirements.

This would rely on the certification bodies taking timely action to address any intelligence they identify about any of their certificate holders being involved with illegally logged timber, suspending certificates while they investigate, and then enforcing the existing obligations on their certificate holders to notify their buyers if their certification is cancelled. There would be no other obligations on importers to consider identify other information that may indicated the product is made from illegally logged timber.

Similar changes would need to be made to simplify the application of country specific guidelines (through amending Section 10 and 12 of the Regulations) and to processors' application of timber legality frameworks (through amending Section 19 and 20 of the Regulations) and of state-specific guidelines (through amending Section 19 and 21 of the Regulations).

7.4 Recommendation 3 – Fund the development of more targeted guidance or training workshops to help businesses better understand their compliance obligations

This recommendation is a non-regulatory approach aimed at increasing the level of information available to businesses. It would involve the Government resourcing and funding additional measures to enhance businesses' awareness and understanding of their regulatory obligations.

Business interviews indicated that 32 per cent of businesses became familiar with the Regulations through training and guidance provided by peak bodies, with guidance from ATIF frequently cited as a particularly useful set of documents. With the ATIF toolkit costing over \$1,000, many smaller businesses would opt not to purchase this information. The Government may look to leverage this existing material and subsidise its provision at a lower cost to businesses.

While the ATIF guidance is useful for importers of wood articles, the other three product chapters remain largely unrepresented regarding product specific guidance. As the primary benefit of the ATIF guidance was the practical nature of the information, it is recommended that the Department engage other industry bodies to co-develop guidance material for the other product categories.

It is also recommended that the Department leverage existing relationships with industry bodies to roll out additional training workshops on due diligence requirements, tailoring the training to specific product categories.

Whatever the form of the guidance material (hard copy or training workshops), it is important that the terms 'reasonably practical' and 'high risk' are defined in more specific

terms.¹⁹³ Uncertainty around these terms have been raised through all forms of consultation.¹⁹⁴ Additional guidance material could also be used to assist businesses in the research phase of their due diligence efforts. For example, the ILPA submission suggested providing information around the various timber products that are illegal to harvest or procure under foreign laws and international agreements.

7.5 Recommendation 4 – Undertake voluntary compliance assessments that assess individual businesses’ compliance with the Regulations

This recommendation has two key elements. The first involves the Department providing on-site compliance assessments, without penalty, over the 18 month transition period. It is suggested that approximately 60 businesses should be covered in the voluntary process over the next six months, so that the practical insights and lessons from these assessments can be widely disseminated before the conclusion of the transition period. This would address the existing concern of those businesses involved in the compliance assessments regarding whether or not their efforts meet the current less specific requirements outlined in the Department’s guidance on compliance with the Regulations.

Under this recommendation, businesses could self-nominate themselves for a site visit in which their due diligence systems would be assessed. With a specific commitment that no compliance action will be taken if the business is assessed as non-compliant (although acknowledging if issues remained after the 18 month transition period then action might be taken), businesses will be more likely to take up this offer.

The second element of this recommendation is the de-identified publishing of the practical insights and lessons from these voluntary compliance assessments.¹⁹⁵ These case studies should include clear reasoning as to why the business was deemed to be compliant or otherwise, and will also provide both Government and industry with an overview of common issues arising from the assessments. This will assist the broader regulated community in better understanding how the term ‘reasonably practical’ will be applied to businesses with similar characteristics to their own.

Given this, it is critical that the Department cover off all business sizes and product chapters in the voluntary compliance assessments and subsequent case studies. In order to cover all business types, including those businesses who are not proactive

¹⁹³ In their submission to the Review, the ATA suggested the uncertainty around these terms was best addressed by redefining them in the Regulations to “eliminate vagueness and increase clarity”. The ALRC submission furthers this point, stating “there is no objective standard for compliance”.

¹⁹⁴ The AEF submission to the Review notes that if the definition of ‘reasonably practical’ implies less due diligence effort is required for more complicated products (materials from multiple suppliers / complex supply chains), then importers of these product types gain a competitive advantage over others. This goes against the common wishes of stakeholders to have an even playing field

¹⁹⁵ An example of the practical lessons and guidance that be drawn from compliance activity is the United Kingdom’s Financial Services Authority 2011 publication, *Banks’ management of high money-laundering risk situations*, which outlines specific issues from its compliance assessments of a large number of small and large financial institutions.

enough to self-nominate, the Department may need to supplement the self-nominating business examples with other businesses. It is recommended that the Department seek to review a wide range of businesses, and so be broader than the NMO review in the UK which drilled down into a single product, to ensure a level playing field across product importers.

Undertaking such on-site compliance assessments is likely to involve some costs to Government, but they are likely to be a fraction of the estimated costs being incurred by businesses to comply with this new regulation. Moreover, these costs to Government are likely to hasten effective compliance, and thus the benefits of implementing this regime.

7.6 Recommendation 5 – Fast track the development of additional country specific guidelines

This recommendation would see the Department focusing on the development of specific Country Specific Guidelines. As with recommendation 2, this recommendation seeks to offer businesses a greater amount of guidance around what is expected of them or considered 'reasonably practical'.

Almost all businesses that were interviewed indicated that the publication of a Guideline would reduce their compliance burden, with the most frequently referenced country being China. This recommendation takes a broader approach, suggesting the Department focus on fast tracking the development of Guidelines for countries with the highest value of regulated timber products (of which China is at the top of the list).

In section 6, the assessment of this options included a discussion of the Guidelines currently in discussion or development by the Department, which would cover an additional 47 per cent of imports by value. The seven Guidelines currently available represent 32 per cent of all regulated timber products by value.

Table 33 lists the top 10 countries by value of regulated timber product in 2012. This list highlights the United States of America which is currently not a country of focus for the Department in relation to Guideline development. It is recommended that the Department use value of imports as a filter for focusing their efforts in the fast tracking of Guideline development, but be open to working with any higher risk country that is keen to expedite a guideline.

Table 33 – Value of regulated timber product imports by country

Country	Value (\$m) ¹⁹⁶	Country specific guidelines status
China	1 942.8	Department in discussions Recommend highest priority for fast tracking
New Zealand	530.1	Guideline currently available
Indonesia	418.8	Guideline currently available
Malaysia	382.8	Guideline currently available
United States	287.6	Recommend fast tracking
Thailand	217.7	Department in discussions Recommend fast tracking
Finland	210.3	Guideline currently available
Germany	172.4	Department in discussions Recommend fast tracking
Italy	156.7	Guideline currently available
Korea, Rep. of	150.0	Department in discussions Recommend fast tracking

Developing Guidelines for China, United States, Thailand, Germany and the Republic of Korea would see the percentage of regulated product by value covered by Country Specific Guidelines increase from 32 per cent to 81 per cent, with China making up 34 per cent of this increase. This will significantly increase the amount of more specific guidance available to importing businesses.

The China Country Specific Guideline is likely to assist importers of heavily manufactured or transformed goods, of which China is a major producer. Given the higher risk of such products, the significant number of businesses importing from China, and the lack of existing guidance for these product types, it is recommended that the Department focus on this Guideline as a priority.

In their submission to the Review, ITS Global highlighted that importers may make sourcing decisions based on how easy it is to comply with due diligence requirements from certain countries. As the Country Specific Guidelines make it easier for importers

¹⁹⁶ ABARES analysis and upcoming ABARES report (2015), excludes Chapter 47 – Pulp.

to understand how to comply with the Regulations for certain countries, it is important that no business is disadvantaged due to their country of import not having an available Guideline. By targeting and fast tracking the development of Guidelines for countries with the highest value of imports, this recommendation attempts to reduce any existing comparative advantage held by businesses importing from the seven countries that currently have Guidelines.

8 Other matters

During the course of the Review stakeholders raised a number of concerns, which, while potentially important issues, were not matters specifically related to the Regulations that support implementation of the Act.

The Review has also not sought to revisit the judgements relating to evidence that was available to the Government or the current Parliament when it was decided at the end of 2013 not to disallow the current Regulation. The Review's focus is on new information or analysis that might inform the development or assessment of alternative approaches.

8.1 Is the size of the illegal logging problem over-stated?

A 2004 Seneca Creek study estimated that 8 – 10 per cent of globally traded wood products are illegally logged.¹⁹⁷ The AEF submission criticised the use of this estimate in subsequent policy decisions, stating it was flawed in several ways, including:

- The report was commissioned by the American Forest and Paper Association, which have 'a history of advocating protectionist trade measures';
- The data used is over ten years old, and thus not indicative of current illegal logging patterns; and
- The data is based on selected countries' illegal logging activities, which are extrapolated globally assuming that the sample countries are indicative.

The AEF also contended that since the Seneca Creek findings, trade in illegally logged timber in China has reduced steadily since 2000, while illegal logging halved in Indonesia between 2010 and 2013 (which AEF stating the 2013 level was approximately 35 per cent). Therefore, AEF considers these figures are out of date and inaccurate.

A small number of businesses that were interviewed were also of the belief that the problem of illegal logging, particularly Australia's share of the problem, has been over-stated.

The Review notes that the terms of reference of this Review reiterate the Government's view that the trade in illegal timber has significant environmental, economic and social costs on both a regional and global basis.

¹⁹⁷ Seneca Creek Associates (2004), "Illegal" Logging and Global Wood Markets": The Competitive Impacts on the U.S. Wood Products Industry.

8.2 Should governments impose an obligation on businesses to assess the legal compliance of their suppliers?

The Australian Environment Foundation argued that:

...[the] current form [of] the Regulation puts an unprecedented and unacceptable burden on businesses, requiring them to perform a policing and regulating function that is unquestionably in pursuit of a public policy objective, which is the domain of government and not the private sector¹⁹⁸.

Other business stakeholders, including the Windows and Doors Industry Council, raised similar concerns during consultations and in other input into the Review, noting that, in contrast to legislation such as that covering occupational health and safety, under this regulatory regime, businesses were being asked to take responsibility for risks associated with their supplier that they felt they could not control.

The Review notes that obligation imposed on importers derives from the Act which:

.... requires importers of regulated timber products and processors of raw logs to conduct due diligence in order to reduce the risk that illegally logged timber is imported or processed (Part 1, Section 6)

Consequently this is not a matter that the Review is able to address.

8.3 Will trade-based measures be effective in reducing the prevalence of illegal logging?

As highlighted by the AEF in their submission to the Review, the end goal of the *Illegal Logging Prohibition Act 2012* "is *not* to reduce the entry of illegally logged timber into Australia. It is to reduce rates of illegal logging." The submission points out that the former may not necessarily result in the latter.

Given estimates that place Australian imports at 0.34 per cent of illegal global timber production¹⁹⁹, the submission suggests that import controls in Australia are unlikely to materially change the behaviour of illegal loggers in other countries.

The Review notes that these concerns related largely to key features of the Act (and the regulatory arrangements in place in the European Union), and thus not a matter that the Review is able to address.

¹⁹⁸ One businesses supported this position by stating "a person cannot be expected to know of and understand all the relevant foreign laws, regulations and codes."

¹⁹⁹ CIE (2010), *A Final Report to inform a Regulation Impact Statement for the proposed new policy on illegally logged timber*, p10

8.4 Is a trade-based approach consistent with WTO obligations?

ITS Global, on behalf of its clients, Rimbunan Hijau PNG (RH PNG) and the PNG Forest Industries Association (PNGFIA), made a submission that cast doubt on whether the Act and associated Regulations are in conflict with WTO rules, and Australia's obligations under ASEAN Australia NZ Free Trade Agreement.

The submission also stated that both the Indonesian and PNG Governments advised the Australian Government at various times they considered the measures in breach of Australia's WTO obligations.

In contrast, the World Wildlife Fund submission cited several Indonesian officials that it suggested were supportive of the impact of trade-based measures.

The Review notes that these concerns related largely to key features of the Act (and the regulatory arrangements in place in the European Union), and thus not a matter that the Review is able to address.

8.5 The 2017 Review of the Act

Section 84 of the Act contains a provision that requires a review of the operation of the first five years of the Act. The 2017 review would provide an opportunity to examine the issues raised in the course of this Review which were out-of-scope.

Appendix A: Media release announcing review and terms of reference

Media Release, 1 December 2014:

"Taking care of small business a priority for logging review"²⁰⁰

Released by The Hon. Bruce Billson MP, Minister for Small Business,

The Hon. Senator Richard Colbeck, Senator for Tasmania, Parliamentary Secretary to the Minister for Agriculture, and

The Hon. Josh Frydenberg MP, Parliamentary Secretary to the Prime Minister

An independent review into the impact of the Illegal Logging Prohibition Amendment Regulation 2013 on small business was announced today by the Minister for Small Business, Bruce Billson MP, Parliamentary Secretary to the Minister for Agriculture, Senator Richard Colbeck, and Parliamentary Secretary to the Prime Minister, Josh Frydenberg MP.

"Small Businesses are often time and resource poor. They may not have compliance departments to deal with the heavy regulatory burdens placed on them. They are too busy focussing on building their businesses and growing our economy," Minister Billson explained.

"We are committed to reversing the deterioration in the small business environment experienced under six years of Labor and six Labor Small Business Ministers. Removing red-tape and reducing compliance burdens are both important elements of this effort".

"The review will focus on businesses with an income of up to \$10 million, which will ensure the review examines the impact logging industry regulations on micro and small businesses".

Senator Colbeck said the independent review will ensure compliance costs of the new Regulations do not unduly impact small businesses.

"We've been working hard on the implementation phase to ensure these Regulations have the least possible burden on Australian businesses," he said.

"The Regulations are designed to protect responsible producers and markets – it's important that we get this right."

The Government will also develop an associated Regulatory Impact Statement.

²⁰⁰ Billson (2014), Media Release: *Taking care of small business a priority for logging review*, accessed 13 March 2015 <<http://bfb.ministers.treasury.gov.au/media-release/064-2014/>>

Mr Frydenberg said the Government is committed to an ambitious deregulation agenda that aims to reduce regulatory burden on businesses, community organisations and individuals by at least \$1 billion a year.

"A balance must be struck between reducing the risk that timber and timber products for sale in Australia have been illegally logged and the cost to small business," Mr Frydenberg said.

"A major focus of the assessment will be looking at whether the current due diligence arrangements strike that balance in the most efficient and effective way for small business."

"The review will report to government by March and will include targeted consultations with small business representatives throughout the process."

The new Regulations commenced 30 November 2014 and require Australian timber importers to carry out due diligence on imported regulated timber products.

The Department of Agriculture's website contains a range of information to help businesses understand and comply with the illegal logging Regulations. For the first 18 months the Government's focus will be on raising awareness and promoting compliance.

The Australian Government is committed to combating the trade in illegally logged timber, a practice that undermines legitimate operators in Australia and overseas.

It is a significant issue and Interpol and the United Nations Environment Program estimate the global trade in illegally logged timber could be as much as USD\$100 billion annually.

The Terms of Reference for the implementation analysis is available at www.agriculture.gov.au/illegallogging

Terms of Reference²⁰¹

Independent review of the impact of the illegal logging regulations on small business

The Australian 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. In light of these impacts, the Government has established an illegal logging legislative framework.

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. This is particularly true for small businesses, which are often time and resource poor and unlike large organisations do not have dedicated compliance staff to deal with the regulatory burden placed on them.

The Illegal Logging Prohibition Amendment Regulation 2013, made under the Illegal Logging Prohibition Act 2012, was registered as a legislative amendment in May 2013. The Regulation came into effect on 30 November 2014 and requires affected businesses to assess and manage the risk that the timber they are dealing with has been illegally logged. This is known as carrying out 'due diligence'.

The illegal logging legislative framework continues to be an important part of the Government's overarching strategy to foster a competitive and sustainable domestic forest industry, recognising that forestry plays a vital role in many regional economies.

Scope of the review

The illegal logging legislative framework seeks to achieve an appropriate balance between ensuring that illegally sourced products do not enter the Australian market and achieving a compliance process that imposes only as much burden as is necessary on business.

The new due diligence requirements affect a wide range of businesses, with up to 17,000 importers and 460 domestic timber processors having to carry out due diligence. A significant proportion of these are likely to be small businesses, with regulatory costs potentially impacting more strongly on the sector.

To ensure that the compliance costs of the new requirements do not unduly impact on small business, the Government has commissioned an independent review of the impact of illegal logging regulations on small business. Key elements of the review will include:

1. A better understanding of the role played by small businesses within the 'regulated community'. This will include further detailing small businesses affected by the new requirements; the type and nature of the timber products

²⁰¹ Australian Government (2014), *Terms of Reference: Independent review of the impact of the illegal logging regulations on small business*, Accessed 13 March 2015
<<http://www.agriculture.gov.au/forestry/policies/illegal-logging/tor>>

they are dealing with; and their potential costs in complying with the new requirements.

2. An assessment of whether applying the Regulation in its current form to small business will make a material difference in reducing the entry of illegally logged timber products onto the Australian market.
3. An assessment of whether the existing due diligence requirements achieve an appropriate balance between the cost of compliance for small businesses and reducing the risk of illegally logged timber entering into the Australian market. Achieving an appropriate balance should have regard to broader global regulatory trends in combating illegal logging, Australia's international commitments and obligations and other economic considerations.
4. If the balance is not considered to be appropriate, an assessment of, and recommendations on, appropriate options for reducing or removing the regulatory impacts of the due diligence requirements on small business, having regards to Australia's international trade obligations.
5. Any related matters.

Implementation of the review

The review will be conducted by an independent consultant and will report back to the Parliamentary Secretary to the Minister of Agriculture, Senator the Hon. Richard Colbeck, by March 2015.

The review will undertake targeted consultations with small business and other relevant stakeholders throughout this process.

The Government will also develop in parallel a supplementary Regulation Impact Statement.

All members of the 'regulated community' (including small businesses) will still need to comply with the Regulation's due diligence requirements while the review is being undertaken.

The Government recognises that it may take time for some businesses to transition to the new requirements. For this reason, for the 18 months following the Regulation's commencement, the Government's focus will be on raising awareness and promoting compliance.

Appendix B: Business interview questionnaire

Illegal logging questionnaire

KPMG has been engaged to complete the *Independent review of the impact of the illegal logging regulations on small business* by the Department of Agriculture. This review has been commissioned to ensure that the compliance costs of the new illegal logging due diligence measures do not unduly impact on business.

As part of this, KPMG is seeking to understand how businesses undertake their due diligence, and whether the current process is proving optimal. We anticipate that this interview will take less than one hour and the discussion will be completely confidential.

Business details

1. Business name
2. Business type [importer, processor, both]
3. Years importing (or buying) regulated timber products
4. Business size [annual turnover: \$0 - \$2m, \$2m - \$5m, \$5m - \$10m, \$10m - \$50m, \$50m+]
5. Is your business FSC (Forest Stewardship Council) and/or PEFC (Programme for the Endorsement of Forest Certification) certified?
6. If you import regulated timber products, what are the primary countries you import from, what types of products and typical number of consignments per annum?

Country	Product chapter	Typical number of annual consignments
<i>e.g. China</i>	<i>e.g. Pulp</i>	<i>e.g. 10</i>

7. Do your suppliers also provide products to clients in the United States or Europe?

Familiarity with the Illegal Logging Regulations 2012

8. How familiar are you with the requirements of the *Illegal Logging Regulations 2012*? [not familiar, somewhat familiar, familiar or very familiar]
9. If you are familiar with the requirements, how did you learn about the requirements [my own research, materials provided from the Government, training and guidance from peak bodies, other]
10. Who is primarily responsible for maintaining and handling your due diligence process? (Broker/Agent, Manager level staff, Director level staff)

Due diligence set-up (one off costs)

11. Did your business need to set up a new system or process to meet the requirements of the regulations, or could you rely on existing processes and practices? [Entirely new system and processes, enhancements to existing systems and practices, no change]
12. Please outline the key one off tasks and estimated time (if relevant) your business went through to establish your due diligence system.

One off costs (tasks and time)	Unit (hours)	duration	Fees (\$)
<i>For example setting up systems and procedures, training staff (internal/external), understanding requirements, requesting information from suppliers, seeking advice.</i>			

13. Are you able to apply a single due diligence framework to all your regulated products? [Yes/No, and comment]
14. What, if any, additional measures could have been put in place to reduce the one off costs?
15. If yes, how would this have impacted your business?

Costs (ongoing costs)

16. Please outline the key activities and costs your business experiences in maintaining its due diligence systems:

Task	Unit duration (hours)	Annual frequency	Fees (\$)
Step 1 – Gathering information (NB. Only capture ongoing costs)			
<i>For example, Establishing the code your regulated product/s is/are listed under, identifying relevant information or contacting a supplier</i>			
Step 2 – Risk assessment framework			
<i>For example, identify where the timber is certified under a timber legality framework</i>			
Step 3 – Risk assessment			
<i>For example, this may include investigating prevalence of illegal logging in the area, the prevalence of illegal logging for the particular product etc, making records, updating systems, etc</i>			
Step 4 – Risk mitigation			
<i>For example, request additional information from a supplier, requested information beyond your immediate supplier, change supplier within the same country or region, change supplier to another country or region, stopped importing/purchasing a particular product, other</i>			
Have you incurred any other ongoing costs associated with your due diligence requirements			
<i>For example, external audits, travel, legal advice, etc</i>			

17. Are you able to rely on the use of a timber legality framework, country specific guideline (or State Specific Guidelines if you are a processor) for your due diligence assessment? [Yes/no]
18. How effective are these guidelines at helping you navigate your due diligence requirements? [not effective, somewhat effective, effective]
19. If not effective, how could these guidelines be improved to assist your business navigate the due diligence requirements more efficiently?
20. Has your business taken additional risk mitigation steps to satisfy the requirements of the regulations (for example, requested additional information from a supplier, requested information beyond your immediate supplier, changed supplier within the same country or region, changed supplier to another country or region, stopped importing a particular product, other)?
21. If yes, how much time was spent completing these additional risk mitigation tasks and how do you think they have impacted your risk levels?
22. Are you aware of any changes your suppliers have made in response to additional requests for information or in response to the introduction of the regulations in Australia?

Cost drivers

23. In a typical year how often would your business complete the following tasks? Please provide an estimate of the annual frequency and margin cost for each in relation to complying with the regulations (if any)?

Cost driver	Annual frequency	Marginal cost (hours)
New suppliers		
New species of timber		
New country of origin		
New product		
Growth in your businesses turnover		
Other		

Options

One of the elements of the review is to identify, if appropriate, options for reducing or removing the regulatory impacts of the due diligence requirements on small business, having regard to Australian and global trends in combating illegal logging and Australia's international trade obligations.

24. Overall, do you think the regulations achieve an appropriate balance between the cost of compliance and reducing the risk of illegally logged timber entering into the Australian market? (on balance yes, on balance no, not sure)
25. If no, can you identify options that would deliver a more suitable balance?
26. What would the impacts of these options be on your business?

Close

27. Are there any other comments you would like to make? (comment box)
28. Would you be happy for a member of our team to make contact with you if there are any follow-up questions or matters for clarification? (yes/no)

Appendix C: List of submissions

The following organisations provided written submissions for the Review.

Australian Environment Foundation

Australian Taxpayers' Alliance

ITS Global

The Responsible Asia Forestry and Trade (RAFT) Partnership

Timber Merchants Association*

Timber Veneer Association of Australia*

Windows and Doors Industry Council*

World Wildlife Fund

* these three organisations put in joint submissions

Appendix D: Further information on the regulated community

D.1 Supplier relationships by business size

In addition to which country regulated timber products are sourced from, the nature of a company's supplier relationships influences the complexity of supply chains. The majority of importers have one supplier (11,832), with approximately half of this figure having more than one supplier (5,422).²⁰² Key findings of supplier relationships by business size include:

As business gets larger, they are more likely to take on more than one supplier, with 51 per cent of medium and large importers using more than one supplier compared with 29 per cent of micro business and 43 per cent of small business; and

A disproportionate number of businesses without turnover data have one supplier (89 per cent of importers), largely due to many only importing a single consignment (79 per cent²⁰³).

Table 34 - Supplier relationship by business size

	Number of importers with just 1 supplier	Number of importers with more than 1 supplier	Total number of importers
Micro (\$0 - \$2m)	4,719	1,914	6,633
Small (\$2m - \$10m)	1,949	1,477	3,426
Medium and Large (\$10m+)	1,528	1,580	3,108
No data	3,636	451	4,087
Total	11,832	5,422	17,254

Source: ABARES analysis

D.2 Consignment size by business size

The table below illustrates how many consignments sit below the \$1,000 individual consignment threshold. Key findings for consignment size by business size include:

²⁰² Gupta, M. and Hug, B. (2013), *Illegal logging regulation: the affected community*, ABARES, report to client prepared for the Department of Agriculture, Canberra, November. CC BY 3.0.,

²⁰³ ABARES analysis of ABS data set.

Micro businesses have the largest percentage of their consignments under the value threshold, at 30.7 per cent.

In percentage terms, there is marginal difference between the number of consignments under the consignment value threshold for small business as compared with medium to large business (both 22 per cent of their respective totals)

Table 35 - Consignment size by business size

	Number of consignments in 2012 with combined value <\$1000	Number of consignments in 2012 with combined value ≥ \$1000	Total Consignments
Micro (\$0 - \$2m)	10,600	23,925	34,525
Small (\$2m - \$10m)	9,928	34,769	44,697
Medium and Large (\$10m+)	32,403	116,033	148,436
No data	4,697	8,548	13,245
Total	57,628	183,275	240,903

Source: ABARES analysis

D.3 Source country by business size

ABARES provided analysis of the top 10 source countries of import, by value, for each of the three business sizes assessed in the Review. Table 36 shows the percentage of imports of regulated timber product that each top 10 country represents, for each business size.

Table 36 – Source country by business size

Country	Micro	Small	Medium and Large	All businesses
China	54%	44%	31%	34%
New Zealand	2%	5%	11%	9%
Indonesia	9%	7%	7%	7%
Malaysia	7%	9%	6%	7%
United States	2%	4%	6%	5%
Finland			5%	4%
Thailand			4%	4%
Italy	2%	3%	3%	3%
Germany	2%	2%	3%	3%
Korea, Rep. of			3%	3%
France	4%	3%		
Vietnam	4%	4%		
Hong Kong	1%			
Canada		2%		

This analysis suggests that, in relation to importation of regulated timber product, smaller businesses import a greater share of value from China, Indonesia and Malaysia compared to larger businesses.

Appendix E: Further information on international anti-illegal logging initiatives

There are a number of international efforts outside of the Australian Government that seek to address issues about timber legality and sustainability, many of which feed into the legislative and regulatory measures put in place by governments. These efforts include formalised certification and guidance systems, as well as international agreements and funding initiatives to assist importers in understanding the legality of their suppliers' operations. Government regulations seek to leverage these initiatives to streamline the legality verification process.

E.1 Global verification schemes

A supplier's approval under any of the global verification schemes is a tool that can be used through a risk assessment process, and should simplify the due diligence process for business. The most prominent internationally approved frameworks used by suppliers are:

Table 37 - Global verification schemes

Forest Stewardship Council's (FSC) Principles & Criteria for forest management²⁰⁴	<p>The FSC's Principles and Criteria were developed to provide a ten-point framework to establish whether a forest is being managed sustainably. As at 2013, 168 million hectares of forest have been certified. The FSC has sought to complement the regulations introduced by governments globally to assist business in their due diligence. Established 1993.</p>
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²⁰⁴ URS (2013). *Legal Forest Products Assurance: Supplementary report on selected timber legality assurance frameworks*, p.5.

The Programme for Endorsement of Forest Certifications (PEFC) sustainable forest management certification systems²⁰⁵	<p>PEFC endorses national certification systems, which can assist businesses in distinguishing lower risk supplier countries. Currently there are over 30 national certification systems and more than 240 million hectares of certified forests. Established 1999.</p>
Sistem Verifikasi Legalitas Kayu (SVLK) timber legality assurance system²⁰⁶	<p>SVLK is the Indonesian legality verification system, which is required by Indonesian law for all wood product exporters from Indonesia. This requires the provision of a business' documentation to the National Accreditation Committee, as well as a compulsory on-site audit.</p>

E.2 Other international initiatives

Building capability in legislative frameworks and verification systems is complex, and there are a number of different initiatives that seek to assist in this process. The two international governmental efforts listed below contribute in different ways:

²⁰⁵ URS (2013). *Legal Forest Products Assurance: Supplementary report on selected timber legality assurance frameworks*, p.7.

²⁰⁶ CITES, 'What is CITES?' Accessed on 12/2/15 at <<http://www.cites.org/eng/disc/what.php>>

Table 38 - Other international initiatives

Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES)²⁰⁷	<p>CITES is an international agreement between 180 governments, which seeks to ensure that trade of animals and plants does not risk the survival of endangered species. It is 'increasingly being used by states to ensure that trade in listed timber species is legal, sustainable and traceable'.²⁰⁸ As at 2012, CITES covered 350 different specimen. Agreed in 1973 and enacted 1975.</p>
Responsible Asia Forestry and Trade (RAFT)	<p>RAFT is a Government funded initiative that seeks to provide resources to boost environmental conservation in the Asia-Pacific region. The third phase of RAFT will begin in July 2015, with \$6 million committed by the Australian Government to 'work with business, land-owners and regional processors to develop certification systems to better measure, price and market certified timber and to conduct due diligence for sourcing legally logged timber'.²⁰⁹</p>

²⁰⁷ Ibid.

²⁰⁸ Nellemann, C., INTERPOL Environmental Crime Programme (eds). (2012), *Green Carbon, Black Trade: Illegal Logging, Tax Fraud and Laundering in the Worlds Tropical Forests*. A Rapid Response Assessment, United Nations Environment Programme, GRIDArendal, p. 6.

²⁰⁹ Minister for the Environment, *Australian funding to combat illegal logging in Asia-Pacific*, media release 11 November 2014. Accessed on 26 February 2015 at <http://www.environment.gov.au/minister/hunt/2014/mr20141111b.html>

Appendix F: Further information on the Australian regulatory context

F.1 Timeline of illegal logging legislation in Australia

The timeline below highlights the bi-partisan support for the establishment of Australian illegal logging laws is presented below:

Table 39 - Timeline of illegal logging legislation in Australia

Timeline of illegal logging legislation in Australia	
October 2007	Howard Government releases its 'Bringing down the axe on illegal logging' policy statement.
2009 – 2010	Rudd Government commissions a series of projects to inform the development of a new illegal logging policy and Regulation Impact Statement (RIS).
May 2010	RIS is released, recommending a co-regulation option that incorporates a prohibition element and a requirement for due diligence as the most effective means of fulfilling Government's election commitment.
March 2011	Illegal Logging Prohibition Bill 'exposure draft' featuring a co-regulatory approach is referred to the Senate Standing Committee on Rural Affairs and Transport (the Committee). The Committee recommends the Government reconsider the role of the proposed timber industry certifiers and investigate options to better align the legislation with the US and EU legislative frameworks. ²¹⁰ The Government responds by reducing the administrative complexity of the proposed laws and the costs of compliance; and also elects to introduce a mandatory import declaration at the border.
November 2011	The Illegal Logging Prohibition Bill is introduced to Parliament and is again referred to the Committee who recommend the Bill be passed.
March 2012	The Joint Standing Committee on Foreign Affairs, Defence and Trade is asked by the House of Representatives to inquire into and report on the Bill following concerns raised by Canada, Indonesia, Malaysia, New Zealand and Papua New Guinea about the implications of the Bill during earlier public inquiries.
June 2012	The Joint Standing Committee recommends the passage of the Bill but with continued consultation during the implementation of the Bill, and the inclusion of Malaysia and Papua New Guinea in a Department working group. ²¹¹

²¹⁰ Rural Affairs and Transport Legislation Committee (2011), *Exposure draft and explanatory memorandum of the Illegal Logging Prohibition Bill 2011*, p. ix.

²¹¹ Joint Standing Committee on Foreign Affairs, Defence and Trade (2012), *Advisory Report on the Illegal Logging Prohibition Bill 2011*.

Timeline of illegal logging legislation in Australia	
November 2012	<i>Illegal Logging Prohibition Act 2012</i> receives Royal Assent
May 2013	<i>Illegal Logging Prohibition Amendment Regulation 2013</i> registered as a legislative instrument
June 2013	<i>Illegal Logging Prohibition Amendment Regulation 2013</i> tabled in both houses of the Australian Parliament.
December 2013	Regulation completed 15 day disallowance period in Parliament (the Senate and House of Representatives)
November 2014	The due diligence requirements for importers and processors came into effect.

Source: Department of Agriculture

F.2 Further information on supporting documentation for due diligence in Australia

Below is a fulsome account of the supporting documentation available to Australian businesses to assist in the completion of their due diligence requirements:

State Specific Guidelines (SSGs)

SSGs have been developed in collaboration with each of the Australian State Governments with the aim of providing information to processors on the laws in operation at the place of harvest. SSGs specify documents required in the relevant state to prove the legality of harvested timber, which can be used by processors to prove due diligence has been undertaken.

F.3 Country Specific Guidelines (CSGs)

The CSGs have been prepared with the aim of assisting importers to better understand the legal framework of the country from which timber has been harvested from.²¹² Australia has developed CSGs in collaboration with Canada, Finland, Indonesia, Italy, New Zealand and the Solomon Islands for the importation of timber, covering 32 per cent of Australian timber imports by consignment value.²¹³ With the introduction of new Guidelines for China, Thailand and Vietnam in 2015, an additional 40 per cent of all Australian timber imports will be covered by CSGs.²¹⁴ By prescribing what documentation is required for the legal importation of timber and timber products, CSGs may function to reduce barriers posed by language and a general lack of information that could otherwise hinder businesses from importing. The establishment of additional CSGs has the potential to significantly reduce the due diligence burden on businesses that are currently required to undertake a broader risk assessment.

²¹² Department of Agriculture (2015), *Further information and resources – Country Specific Guidelines and State Specific Guidelines* accessed 25 February 2015 at <
<http://www.agriculture.gov.au/forestry/policies/illegal-logging/information-resources>>

²¹³ Department of Agriculture analysis

²¹⁴ *Ibid.*

F.4 Timber Legality Frameworks

The Regulation recognises three Timber Legality Frameworks (TLFs) as providing a high level of assurance that wood products traded within the scope of their respective programs are legally logged for Australian purposes:

1. Forest Law Enforcement Governance and Trade (FLEGT) licensing scheme;
2. Forest Stewardship Council (FSC) forest management certification standard and chain of custody standard; and
3. Programme for the Endorsement of Forest Certification (PEFC) sustainable forest management certification standard and chain of custody standard.²¹⁵

The supporting documentation needed to demonstrate compliance with the specified standards under these schemes can be used by businesses to undertake an optional due diligence step within the Regulation. As is consistent with EU regulations, producing the supporting documentation does not absolve operators of due diligence requirements;²¹⁶ however, if the documentation can be used to reasonably conclude the risk of illegally logged timber being present is low, importers and processors are exempt from conducting further due diligence steps.

F.5 Industry-developed guidance for due diligence

The Timber Development Association (TDA), with funding from the Australian Government has developed a range of tools and guidance for businesses wanting to meet their due diligence obligations. The TDA in conjunction with the Forest Trust has developed a training seminar aimed at all importers of regulated products covering “*who the Regulation applies to, what the Regulation requires and how to undertake due diligence for illegally logged timber*”.²¹⁷

The Australian Timber Importers Federation (ATIF) has produced a Legality Compliance Toolkit (the Toolkit) to assist timber product importers to comply with the Regulations. ATIF also offers an audit service to assess the due diligence undertakings of businesses. The Toolkit outlines the due diligence steps required for importers of solid timber products. In their guidance, ATIF acknowledges that further advice may be required for importers of products with long manufacturing or supply chains and complex products with multiple components, such as furniture.²¹⁸ This limits use of ATIF’s Toolkit mostly to stakeholders importing simple solid timber products.

²¹⁵ Department of Agriculture (undated) *Due diligence – use of Timber Legality Frameworks (importers)*.

²¹⁶ Under the EU Timber Regulation, certificates from third party verified schemes including PEFC and FSC can only be used as tools in the risk assessment and mitigation process. Businesses are still required to collect information and assess all risk mitigation factors. (Handbook, Lacey Act, EU and Australian logging laws p. 13.)

²¹⁷ Timber Development Association (2015), accessed 24 Feb 2015
<<http://www.timberduediligence.com.au>>

²¹⁸ Australian Timber Importers Federation (2014). *Legality Compliance Toolkit: Illegal Logging Prohibition Amendment Regulation 2013*.

There appears to be little targeted industry guidance available to those importing pulp, paper or complex timber furniture products.

Appendix G: Regulatory burden and cost offset estimate tables

For the purposes of the regulatory burden and cost offset estimate tables, the average of the annual savings has been reported for each recommended option. Section 6 presents a cost saving range which is more appropriate given the uncertain nature of the savings. Nevertheless to meet the requirements of the Regulatory Burden Measurement Framework, an average of the range has been used. All measures are considered deregulatory and as a result no cost offsets are required.

Given the timeframes of the Review it has not been possible to have these estimates formerly assessed by the Office of Best Practice Regulation. This would be required before a final Regulatory Impact Statement is prepared for government decision making.

G.1 Recommendation 1 – Increase the individual consignment value threshold from \$1,000 to \$10,000

Average annual regulatory costs (from business as usual)				
Change in costs (\$ million)	Business	Community organisations	Individuals	Total change in costs
Total, by sector	(\$3.4) ²¹⁹	\$0	\$0	(\$3.4)
Cost offset (\$ million)	Business	Community organisations	Individuals	Total, by source
Agency	n/a	n/a	n/a	n/a
Are all new costs offset?				
<input type="checkbox"/> Yes, costs are offset <input type="checkbox"/> No, costs are not offset <input checked="" type="checkbox"/> Deregulatory—no offsets required				
Total (Change in costs – Cost offset) (\$ million) = (\$3.4). ²²⁰				

²¹⁹ These savings are based on the average of the 'estimated hours' and 'high familiarity' estimates of the savings in costs to complete the one-off and ongoing activities, as outlined in Tables 23 and 24. The average annual regulatory cost estimate was then calculated as [(the average of the expected one-off saving) + (average of ongoing savings multiplied by nine years)] divided by ten years. This is consistent with the methodology outlined in OBPR (2015), *Regulatory Burden Measurement Framework*, Guidance Note. The estimate does not include the one-off costs of any new entrants over the nine years, but nor does it discount the one-off costs for any that might already be sunk.

²²⁰ This is arguably a conservative estimate of the savings to the extent that the 'high familiarity' businesses' current activity is closer to what is required for full compliance. If the 'high familiarity' estimates were used, the average annual regulatory savings would be \$5.2 million.

G.2 Recommendation 2 – Establish simplified ‘deemed to comply’ arrangements by regulation

Average annual regulatory costs (from business as usual)				
Change in costs (\$ million)	Business	Community organisations	Individuals	Total change in costs
Total, by sector	Saving not quantified	\$0	\$0	Saving not quantified
Cost offset (\$ million)	Business	Community organisations	Individuals	Total, by source
Agency	n/a	n/a	n/a	n/a
Are all new costs offset?				
<input type="checkbox"/> Yes, costs are offset <input type="checkbox"/> No, costs are not offset <input checked="" type="checkbox"/> Deregulatory—no offsets required				
Total (Change in costs – Cost offset) (\$ million) = Annual savings to business not quantified.				

G.3 Recommendation 3 – Fund the development of more targeted guidance or training workshops to help businesses better understand their compliance obligations

Average annual regulatory costs (from business as usual)				
Change in costs (\$ million)	Business	Community organisations	Individuals	Total change in costs
Total, by sector	Saving not quantified	\$0	\$0	Saving not quantified
Cost offset (\$ million)	Business	Community organisations	Individuals	Total, by source
Agency	n/a	n/a	n/a	n/a
Are all new costs offset?				
<input type="checkbox"/> Yes, costs are offset <input type="checkbox"/> No, costs are not offset <input checked="" type="checkbox"/> Deregulatory—no offsets required				
Total (Change in costs – Cost offset) (\$ million) = \$				

G.4 Recommendation 4 – Undertake voluntary reviews that assess individual businesses’ compliance with the Regulations

Average annual regulatory costs (from business as usual)				
Change in costs (\$ million)	Business	Community organisations	Individuals	Total change in costs
Total, by sector	Saving not quantified	\$0	\$0	Saving not quantified
Cost offset (\$ million)	Business	Community organisations	Individuals	Total, by source
Agency	n/a	n/a	n/a	n/a
Are all new costs offset?				
<input type="checkbox"/> Yes, costs are offset <input type="checkbox"/> No, costs are not offset <input checked="" type="checkbox"/> Deregulatory—no offsets required				
Total (Change in costs – Cost offset) (\$ million) = \$				

G.5 Recommendation 5 – Fast track the development of additional country specific guidelines

Average annual regulatory costs (from business as usual)				
Change in costs (\$ million)	Business	Community organisations	Individuals	Total change in costs
Total, by sector	Saving not quantified	\$0	\$0	Saving not quantified
Cost offset (\$ million)	Business	Community organisations	Individuals	Total, by source
Agency	n/a	n/a	n/a	n/a
Are all new costs offset?				
<input type="checkbox"/> Yes, costs are offset <input type="checkbox"/> No, costs are not offset <input checked="" type="checkbox"/> Deregulatory—no offsets required				
Total (Change in costs – Cost offset) (\$ million) = \$				



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