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Mr Geoff Gleeson
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Australian Customs and Border Protection Service
Customs House
5 Constitution Avenue
CANBERRA ACT 2601
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Dear Geoff

Re: Advice required on certain aspects of structural timber anti-dumping

Background

The Australian Customs and Border Protection Service (C&BP) is conducting an investigation into allegations that certain structural timber has been exported to Australia at dumped prices and that this dumping has caused material injury to the Australian manufacturers of like goods. The investigation covers structural timber exported to Australia from Austria, Canada, Czech Republic, Germany, Estonia, Lithuania, Sweden and the USA.

Dumping occurs when the export price of goods is lower than the normal value of like goods sold in the country of export. Normal value is often established on the basis of domestic selling prices¹ that are reasonably profitable². It is important that Customs and Border Protection identify profitable sales of like goods³ that can be reasonably compared with the exported goods. An alternative is to construct normal values based on the costs of production and an amount for administrative, selling and general expenses, and an amount for profit⁴. In either case, the complete, relevant and accurate calculation of the cost to make and sell (CTMS) is critical to normal value calculations, and consequently to dumping margin calculations.

C&BP teams have conducted on-site exporter visits where those teams verified the cost and price data submitted by exporters in verification meetings at the premises of the exporters.

¹Section 269TAC(1) of the *Customs Act 1901*.

²The legislation provides for profitability tests as a measure of 'ordinary course of trade' – refer section 269TAAD of the *Customs Act 1901*.

³Customs and Border Protection tests for likeness by examining the physical, commercial, and production similarities, and by considering the nature and degree of substitutability.

⁴Section 269TAC(2)(c) of the *Customs Act 1901*.

In broad terms, its verification exercise sought to link the cost and sales data to management reports and audited financial statements, and also to source documents. Verification teams traced the detailed cost and price data 'upwards' to management reports and audited financial statements to establish completeness and relevance. The teams also traced the detailed data 'downwards' to source documents to establish accuracy⁵.

Objective

C&BP has now sought independent expertise from cost accounting and timber industry experts (Experts) in relation to structural timber to

- assess whether the cost data verified by C&BP is reasonable and reliable for the purposes of determining dumping margins
- provide an opinion as to whether C&BP has made reasonable assessments of which goods sold domestically by the exporters, if any, can reasonably be regarded as like goods to the structural timber exported to Australia.

Our opinion should be read in conjunction with the disclaimer in Appendix 1.

Scope

The scope of this engagement is to examine C&BP's verification reports and supporting papers/data to assess whether the cost data is reasonable and reliable for the purposes of assessing normal values and dumping margins, and to develop an opinion as to whether the teams' like goods findings were reasonable, and if not, why not.

We reviewed exporter data relating to 70% of volumes imported into Australia under review by C&BP as part of this investigation during the Investigation Period (1 July 2010 to 30 June 2011) with specific review of:

Country	Export Manufacturer	Location of Operation
Czech Republic	Stora Enso Wood Products Planá S.R.O. Stora Enso Wood Products S.R.O.	Planá Ždírec
Austria	Stora Enso Wood Products GMBH	Brand
Germany	EggerSägewerk Brilon GMBH	Brilon
Estonia	Stora Enso Eesti AS	Napi
Lithuania	Stora Enso Lietuva UAB	Alytus
USA	Vaagen Bros. Lumber, Inc.	Coleville, WA

In reviewing these mills we covered the mills in the Czech Republic, Lithuania and Austria at a greater level of detail than those in Germany, Estonia and USA.

Scope Limitations

We did not examine areas that were covered by the KPMG report (refer to footnote 7) nor did we examine procedures performed by C&BP during exporter visits (e.g. verification of data to source documents).

Approach

We have undertaken this engagement by:

- Reviewing the exporter visit reports for all identified exporters

⁵Customs and Border Protection has a set of verification guidelines (Customs-in-confidence) which outlines the expectations of verification planning and conduct.

- Reviewing in detail documents, operational data and cost data provided by C&BP for four exporter operations
- Reviewing C&BP's 'like goods' assessments and findings for all identified exporters
- Testing of selected data, calculations and models prepared by exporters and C&BP, including cost allocations and arm's-length transactions
- Interviewing C&BP staff who conducted exporter visits and who prepared the exporter visit reports
- Comparing selected areas of sawmill operations and cost accumulation to industry benchmarks and industry practices.

To enable us to conduct this engagement we were provided access to:

- commercial-in-confidence documents⁶
- confidential verification reports
- staff that conducted the verification visits
- cost models for comparative purposes
- independent cost benchmarking reports
- independent expert cost accounting advice by KPMG⁷ relating to certain verifications by C&BP.

Findings

1. Like goods

In our opinion C&BP has made reasonable assessments of goods sold domestically by the exporters, which can reasonably be regarded as like goods to structural timber exported to Australia.

While there were effectively no identical products sold domestically in any of the exporting countries, a number of mills produced products that had similar product characteristics which were used for similar structural applications in their domestic markets. However, different building codes and construction methods called for different product requirements, which accounted for some differences in these like products.

Like goods were identified at all mills, except Brand. At Planá and Ždírec the volumes of like goods were less than 5% of the structural volumes exported to Australia. At Napi and Alytus the like products were sufficiently different to the products exported to Australia, which made appropriate adjustments problematic when calculating the normal value. At all of these mills C&BP adopted cost to make and sell (CTMS) as the basis for determining their normal value for calculating dumping margins.

At Coleville (Vaagen) C&BP identified like goods. They used both domestic prices for those like goods and CTMS in calculating the normal value for determining dumping margins.

⁶Subject to a confidentiality undertaking.

⁷KPMG examined whether the Customs and Border protection verification was adequate and whether the cost data verified was reasonable and reliable for the purposes of determining dumping margins in relation to the Stora exporters from the Czech Republic and from Estonia.

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We noted that C&BP identified these like goods in accordance their guidelines and our review concurred with these conclusions.

2. Costs

It is our opinion that the cost data used by C&BP for determining dumping margins is reasonable and reliable for this purpose. Our opinion is qualified by the comments below.

In reaching this opinion we considered the following:

a. Arms-length transactions

i. Log purchases:

We identified whether any sawlogs were purchased from related parties, and where purchases were made from related parties we verified that those purchases were made at market or arms-length prices.

ii. Residue sales:

We identified whether any residues were sold to related parties, and where such sales were made to related parties we confirmed that those sales were made at market or arms-length prices.

In our review of the Napi sawmill we noted that selling prices of wood chip to external customers were approximately XX% lower than sales to a related party. C&BP considered that this difference was not material in the determination of an arms-length transaction. We recommend that C&BP review this assessment.

iii. Other internally traded items:

We noted that at the Brilon (Egger) sawmill, XXXXXXXXXXXXXXXXXXXXXXXX
XX
XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX [comments re Egger electricity sourcing
arrangements and satisfaction that these arrangements did not distort
the reported costs of production].

b. Operational costs and recoveries

i. Log costs:

As log values comprise a significant proportion of total manufactured product costs, we reviewed log costs in some detail and did not identify any material issues which adversely affected the calculation of CTMS.

ii. Treatment of residue revenues:

Apart from Coleville (Vaagen, USA) and the Czech Republic sawmills, all mills included residue revenues as a reduction in the cost of fibre when calculating CTMS. This is common industry practice (including in Australia).

Vaagen XXX
XX
XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX [treatment of residue
revenue]. However, for product costing purposes, residue revenues are

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offset against fibre cost to determine a 'true cost of production'. This costing data was used by C&BP to calculate normal values.

In the Czech Republic revenues from by-product sales were not offset against fibre cost in calculating CTMS. This was explained as being in line with Czech accounting standards. In its calculations of normal values, the C&BP report for the Czech Republic reflected this position. As a result, CTMS data for the Czech mills is inconsistent with the other mills reviewed. We recommend that C&BP review their calculation of CTMS as this could make a material difference to the calculation of normal values in determining dumping margins.

iii. *Cost allocations for processes required for exported products:*

In some mills costs were initially calculated based on average unit production cost for all finished products irrespective of what production process they went through. To ensure appropriate process costs were applied to products exported to Australia, C&BP requested that exporters recalculate these costs to ensure the costs of relevant processes (e.g. kiln-drying, planing) were assigned based on the relevant volumes of products that had been through those processes.

We reviewed this allocation process and agree that they account appropriately for the costs of manufacturing the goods exported to Australia.

iv. *Units of Measure (UOM):*

In reviewing the sawmill data, we confirmed that the product dimensions were consistently determined and applied in calculating normal values.

c. Adjustments included in normal values

We noted that C&BP made various adjustments when calculating the normal value, in order to reflect appropriate costs applicable to goods exported to Australia which were not captured in the standard product cost calculations for these mills. These included adjustments for export credit terms and other specific administrative and distribution costs.

d. Benchmarking

In conducting the review of CTMS we compared available cost benchmarking data (Global Timber/Sawmill/Lumber Cost Benchmarking Report - 2010 Annual Basis & Q1/2011) against actual mill costs to identify any material anomalies. This review provided direction for further investigation of exporter data. We noted no unexplained material variances. We also noted that the applicants' used the Global Timber/Sawmill/Lumber Cost Benchmarking Report in both their initial submissions to C&BP and in their response and analysis of C&BP's Alytus mill public record version of their export visit report.

Additional Comments

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In conducting our engagement we identified some areas which, while not considered material in terms of our findings, may warrant some additional consideration by C&BP. We have summarised these items below:

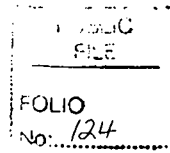
1. Alytus (Lithuania): We do not understand nor do we endorse the comment in exporter visit report relating to the value of small logs i.e. *"SE Lietuva said that smaller logs were used for the Australian timber that tended to be of smaller dimensions, the use of smaller logs meant less waste. In comparison larger logs were used for the European timber that was of larger dimensions. The use of larger logs for the Australian timber would be inefficient as this would mean more waste."* C&BP may wish to review and confirm this assertion as it runs counter to industry experience.
2. Czech mills: SEWP Czech does not appear to record the packaging costs separately for domestic and export sales. C&BP may wish to review container packaging and container cost differences between export sales to Australia and other sales.
3. Brand (Austria): C&BP may wish to confirm external nature of chip sales to third parties. It forms a high proportion of revenue (XX% per Appendix A4.3c), although it does appear consistent with benchmarking data.

Please advise if you would like us to discuss these in more detail.

Yours sincerely

Peter Zed

Tony Morse



Appendix 1 - Disclaimer

Limitations

This report has been prepared on the basis of the Scope described above.

The services provided in this engagement are of an advisory nature and do not represent an assurance.

No warranty is given in relation to the completeness, accuracy or reliability of the statements and representations made, and information and documentation provided, by C&BP personnel in the review process.

We have not sought to independently verify the sources of the information provided by C&BP unless specifically noted in this report.

We do not acknowledge any obligation to update this report for events occurring, or information provided, after the date of this report.

The findings of this report are formed on this basis.

Third Party Reliance

This report is prepared solely for the purpose described in the Objective, and is for the use of C&BP. It is not to be used for any other purpose.

This report has been prepared at the request of C&BP in accordance with the terms of contracts for services No's 125051 and 125034.

Other than our responsibility to C&BP, we undertake no responsibility arising in any way from reliance placed by a third party on this report. Any such third party reliance is that party's sole responsibility.