

Systems for Verification of Legality in the Forest Sector, Malaysia: Domestic Timber Production and Timber Imports

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List of abbreviations and acronyms

AAC	Annual Allowable Cut
C&I	Criteria and Indicators for Sustainable Forest Management
CoC	Chain of Custody
CPET	Central Point of Expertise in Timber for UK government procurement policy
DFO	District Forest Office
EU	European Union
FD	Forestry Department
FLEG(T)	Forest Law Enforcement Government (and Trade)
FERN	Campaigning NGO for environmental and social justice, with a focus on forests and forests peoples' rights, in the policies and practices of the European Union
FMU	Forest Management Unit
FSC	Forest Stewardship Council
GFS	Global Forestry Services
GMO	Genetically modified organisation
GTZ	Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ)
Harwood	Harwood Timber Sdn. Bhd.
HCVF	High conservation value forest
ISO	International Standards Organisation
ITTO	International Tropical Timber Organisation
KPK	Kelantan Integrated Timber Complex
KPKKT	Terengganu Integrated Timber Complex
NFC	National Forestry Council
NLC	National Land Council
NSC	National Steering Committee for the development of Malaysian Criteria and Indicators for Sustainable Forest Management
NTTA	Netherlands Timber Trade Association
MAMPU	Malaysian Administrative Modernisation and Management Planning Unit of the Prime Minister's Office
MC&I	Malaysian Criteria and Indicators
MTCC	Malaysian Timber Certification Council
MTIB	Malaysian Timber Industry Board
PITC	Perak Integrated Timber Complex
PNG	Papua New Guinea
PRF	Permanent Reserved Forest
RCoC	MTCC Requirements on Chain of Custody
RM	Malaysian Ringgit
Sdn. Bhd.	Sendirian Berhad (Company Limited)
SFC	Sarawak Forestry Corporation
SF&C	Sustainable Forestry and Compliance Business Unit, Sarawak Forestry Corporation
SAPU	Security and Asset Protection Business Unit, Sarawak Forestry Corporation
SFM	Sustainable Forest Management
SFMLA	Sustainable Forest Management License Agreement (Sabah)
SKSHH	Indonesian timber transport permits
STIDC	Sarawak Timber Industry Development Corporation
TID	Tree identity number (Sarawak)
TRP	Transit Removal Pass
UNCED	United Nations Conference on Environmental and Development
VERIFOR	Multi-partner programme on verification of legality in the forest sector
WWF	World Wide Fund for Nature

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1. Executive summary

Forest cover in Malaysia constitutes 19.52 million hectares (59.5% of land area). Of this, 14.93 million hectares have been designated as Permanent Reserved Forests (PRFs), including 11.18 million hectares of production forests. In 2003, the Malaysian timber industry accounted for 3.4% of GDP and 4.3% of total export earnings. That year, Malaysia was also the world's third leading exporter of logs after Russia and the US; the second largest exporter of plywood after Indonesia; and eighth leading exporter of sawn timber. As supplies of domestic timber decline, and with around 1000 sawmills in operation, a growing proportion of Malaysia's exports consist of timber originally sourced from a variety of neighbouring countries including Indonesia, Papua New Guinea and Myanmar.

In line with the Federal Constitution, Malaysia's 13 States have jurisdiction over land as well as forest gazettelement, management and licensing. Malaysia does not, therefore, constitute a single entity for the purposes of legal verification in the forest sector. While uniformity of practice has been achieved amongst timber-producing States in Peninsular Malaysia, verification systems in Sabah and Sarawak have evolved separately. These reflect:

- Differences in licensing, e.g. in the Peninsula, concessions are generally issued on a short-term basis, while Sabah has moved to a system of 100-year Sustainable Forest Management License Agreements;
- Differing policy objectives – e.g. Sarawak's monitoring and verification systems ensure compliance with log reservation quotas for processing within the State.

All three systems stand out as examples of state-based verification of legality, relying (amongst others) on routine monitoring of harvest practices, paper-based timber administration and periodic audits of District Forest Offices and license holders. Even in Sarawak, where the State has outsourced monitoring of log reservation quotas, this was to a wholly owned subsidiary of a State corporation (Harwood Timber Sdn. Bhd.).

Forestry agencies argue that third-party oversight of legal compliance is provided *de facto* through two unrelated, but complementary, policy initiatives:

- (i) Quality Management System audits under the ISO 9000 family of standards. These have been applied to routine timber administration systems, in line with a Prime Ministerial drive on administrative efficiency.
- (ii) Certification under the Malaysian Timber Certification Council (MTCC) and FSC. MTCC certification has been applied on a State-wide basis in the Peninsula, as well as to one license holder in Sarawak (Samling Corp.). Sabah has one FSC-certified model concession (Deramakot).

But in so far as MTCC remains under the authority of the Ministry of Plantation Industries and Commodities, questions remain over its independence as a form of third-party oversight. Steps to address this include the establishment of an endowment fund to cover MTCC's operational costs.

The Sabah Forestry Department has also brought in an independent auditor to complement its own General Procedure for SFM Audit of licensees, but only in respect of one case. Third-party auditors have not been introduced as a general requirement in Sabah. This is partly justified on grounds of cost.

Within defined parameters, e.g. revenue collection, the administration of transport permits ('Removal Passes'), and monitoring of domestic log movements, there is strong commitment to effective implementation. This has been enhanced by the introduction of ISO standards to specific procedures, as well as (to a more limited extent) computerised tracking systems.

There are, however, a number of measures that could be taken to further enhance the impact and credibility of verification systems.

A shift to 100% tree-tagging and computer tracking under mandatory Chain-of-Custody is essential in guaranteeing both legal origin as well as better control of harvesting. Sabah is already committed to making this transition. The Peninsula tags at stump but timber administration remains paper-based. Sarawak has introduced 100% tagging and computer tracking but for only 30% of its production. It remains a priority for the remainder, not least given the need to strengthen harvest control.

Adequate resourcing of monitoring and enforcement is essential. Where this has been squeezed due to necessity to cut costs and headcount (as in Sarawak), there may be a case for greater use of technologies such as remote sensing, and/or for identifying functions that can be viably outsourced in order to devote more resources to forest control.

Attention is also needed to structures and standards for administration of timber imports. Options include:

- bilateral instruments (e.g. Malaysia – Indonesia) to secure chain-of-custody, including links between import licensing and validation of legality by source countries;
- an extension of Malaysia's import ban in respect of Indonesia's export ban on small-dimension timber (to limit liability);
- prior notification of customs authorities on imports of timber;
- issuances of transport permits (Transit Removal Passes) for imported sawn timber from all sources, in the same way as imported logs to enhance traceability to specific mills.

Where verification of legality depends on cross-checks between different monitoring and audit processes, it is important that they complement each other in terms of scope, sampling, frequency and protocols for comparative evaluation. Amongst others:

- SFM audits of State Forestry Departments by the Federal level in the Peninsula apply MTCC standards of performance, and follow up on Corrective Actions Requests identified by MTCC auditors. However, they have not yet incorporated the latest Malaysian Criteria and Indicators (2002) for SFM which MTCC began to apply in 2006.
- In all cases mills self-report through-put, subject to only occasional spot checks. On-line reconciliation of data collected by different agencies on imported timber, domestic log production as well as mill throughput may be a necessary step to prevent leakage of unregistered timber into the production chain.
- The application of ISO standards has helped to structure and 'routinise' internal monitoring and reporting by State Forest Departments. However, more attention is needed to ensuring the designation of procedures for ISO certification meshes with and supports parallel SFM audits.

The credibility of current systems might be further enhanced by:

- Establishing an accreditation system to enhance MTCC's independence, whereby MTCC would step back from issuing certificates.
- Issuing guidance on public access to (and confidentially of) the results of Federal and State audits, as well as the verification decisions by State Executive Committees.
- Criteria determining when third-party auditors may be brought to bear in complementing mandatory Federal- and State audits. The Sabah Forestry Department's General Procedure for SFM Audit is the only one to do so, but on a purely *ad hoc* basis.

Verifiability is complicated by debate over legal standards. Forestry officials point to the need to separate major infringements which render an operator or consignment 'illegal' from minor infringements which can be managed through corrective actions. Civil society groups also raise the need for the existing legal framework to better accommodate the rights and interests of forest-dependent, aboriginal/native communities. Amongst others, steps could be taken develop:

- clearer guidance and standards on public notice, and the settlement of aboriginal/native claims in forest gazettement processes;
- mechanisms to manage and disburse compensation payments; as well as
- effective public oversight and arbitration.

However, the issue ultimately depends on resolution of outstanding case law on the scope of admissible claims (in particular over the wider forest domain), and the evidence base needed to establish these.

2. The purpose of this case study

The VERIFOR programme is a multi-partner initiative co-funded by the European Commission and the Government of the Netherlands. VERIFOR's partners are the Regional Community Forestry Training Centre (RECOFTC) for Southeast Asia, the Centre for International Forestry Research (CIFOR) for West and Central Africa, and the Tropical Agricultural Research and Higher Education Centre (CATIE) for Central and South America. The VERIFOR programme is coordinated by the Overseas Development Institute (ODI) in London.

VERIFOR is designed as a facility to share best practice and comparative analysis between timber-producing nations in the field of forest-sector verification – with the objective of ensuring legal compliance in forest management, as well as in the harvesting and trade of timber and other forest products. The project aims to support partner countries in developing and strengthening forest verification systems with high national and international credibility.

VERIFOR's focus is on the institutional mechanisms for verification. Under Phase I of the project (2005 – 2006), VERIFOR is working to compile existing country and extra-sectoral experience with the design and operation of verification systems. Malaysia has been identified as one of a number of timber-producing countries with functioning verification systems of potential interest to the VERIFOR project. Malaysia was selected given its prominence in international trade in tropical timber, as well as its long-standing experience in the development and application of standards-based management.

This case study documents and analyses Malaysia's existing legal and institutional arrangements for verification of legal compliance in the forest sector, as an input to comparative analysis and sharing of best practice under Phase II of the VERIFOR project. Key areas of analysis include:

- The design of monitoring systems as the basis for audit.
- The process, scope and frequency of routine audits (including the extent to which voluntary certification and mandatory verification are mutually supportive).
- Mechanisms for arriving at a verification decision, based on audit results.
- Safeguards on impartiality, transparency.
- The degree to which institutional resourcing and compliance measures (including penalty setting) adequately support verification.

The analysis spans the legal and policy framework governing the forest sector, as well as institutional arrangements and procedures for monitoring and audit in Peninsular Malaysia, Sabah and Sarawak. The case study also examines measures for control of timber imports. The case study highlights particular strengths of these systems, as well as possible measures to enhance their credibility and impact.

This case draws on three visits to Malaysia (September 2005, March 2006 and July 2006). These included interviews with key informants as well as document searches.

3. Law and policy governing forest management

3.1 Forests under the Federal Constitution

Malaysia is a federation of thirteen States and three Federal Territories. Eleven States and the Federal Territories of Kuala Lumpur and Putrajaya are located in Peninsular Malaysia. The States of Sabah and Sarawak, together with the Federal Territory of Labuan, are located on the island of Borneo.

Under Article 74 (2) of the Federal Constitution, land and natural resources are a State matter. All forest land is owned by the State, with the exception of a few hundred thousand hectares of privately owned plantations of agricultural tree crops. Each State is empowered to enact laws and policy on forestry independently. Each State also appoints a State Forestry Director. In the Peninsula, candidates are recommended by Forestry Department Headquarters at Federal level. The State Forestry Director is responsible for the administration and regulation of forest harvesting and revenue collection, the management and development of forest resources, as well as planning and co-ordination of the development of forest-based industries.

The executive authority of the Federal Government only extends to the provision of advice and technical assistance to the States, training, research, and the maintenance of experimental and demonstration stations. Federal authority for forest management rests with the Federal Forestry Department, headed by the Director-General of Forestry, under the purview of the Ministry of Natural Resources and Environment. Responsibility for the regulation, development and training of the wood-based industries and trade in Peninsular Malaysia and Sabah rests with the Malaysian Timber Industry Board, a statutory body under the purview of the Ministry of Plantation Industries and Commodities. Responsibility for the same in Sarawak rests with the Sarawak Timber Industry Development Corporation (STIDC), a statutory body under the purview of the Sarawak Ministry of Planning and Resource Management.

A National Forestry Council (NFC) was established in 1971 under the authority of the National Land Council (NLC) to facilitate co-ordination between the Federal and State Governments in the formulation and implementation of policies and programmes on the conservation, development and sustainable management of the nation's forests.¹ This included the National Forestry Policy, 1978 (see Box 1). The NFC is chaired by the Deputy Prime Minister, and comprises the Chief Ministers of the thirteen States. Also represented are the heads of the forestry services of Peninsular Malaysia, Sabah and Sarawak, and the relevant Federal Ministers (Natural Resources and Environment, Finance, Trade, Agriculture and Agro-based Industry, Plantation Industries and Commodities, as well as Science, Technology and Innovations).

As a forum bringing together the States and the Federal level, the NFC also agrees to the annual allowable cut (AAC) for each State in Malaysia on a five-yearly basis, in line with States' five-year development plans. The AAC is based on the extent of production forests within Permanent Reserved Forests as well as standing timber stock.

¹ Coordination at a State level is facilitated by the State Development Council/Committees and the State Executive Council/State Cabinet.

Box 1: The National Forestry Policy 1978 (revised 1992)

A National Forestry Policy was developed within the mandate of the National Forestry Council (NFC). This was endorsed by the National Land Council (NLC) on 19 April 1978. Amongst others, the Policy covers the constitution of sufficient areas of Permanent Reserved Forests; principles for sustainable forest management; forest harvesting, regeneration and rehabilitation; the establishment of downstream processing industries taking into account the availability of raw material from Permanent Reserved Forests; the management of non-wood forest products (rattan and bamboo); as well as research, training and extension. The Policy was revised in 1992 to reflect the United Nations Conference on Environment and Development (UNCED) commitments on the conservation of biological diversity, the sustainable use of forest genetic resources, as well as the role of local communities in forest development. The Policy envisages community participation in agro-forestry around the fringes of the forests, as well as the development of community forestry for recreation and tourism.² This Policy is being implemented by all the States in Malaysia.

3.2 Forest management by the States

In line with the National Forestry Policy 1978, and with the objective of promoting uniformity of laws of the States of Malaysia for the administration, management and conservation of forests, a National Forestry Act was passed by the Federal Parliament in October 1984. This built on the existing body of State enactments and ordinances dating back to the early 1900s.³ The National Forestry Policy calls for the judicious implementation of the National Forestry Act 1984, in support of the sustainable management and conservation of forest resources.

Federal law may not come into force in any State unless adopted by the State Legislature. The National Forestry Act has now been adopted by all States in the Peninsula. However, pursuant to their terms of accession to the Malaysian Federation, Sabah and Sarawak continue to regulate their forestry sectors under their own enactments and ordinances. These include the Sabah Forest Enactment 1968 (amended 1992) and Forest Rules (1969); as well as the Sarawak Forest Ordinance 1954 (amended 1999). There are consequently three separate forest-sector jurisdictions in Malaysia – the Peninsula, Sabah and Sarawak.

The National Forestry Act and its equivalent Enactments and Ordinances in Sabah and Sarawak provide the State the power to constitute permanent reserved forests; and to classify these for a range of purposes. Purposes include timber production under sustained yield, water catchment and soil protection, as well as the constitution of wildlife sanctuaries, virgin jungle reserves and amenity forests. As such, the National Forestry Act, the Sabah Forest Enactment and the Sarawak Forest Ordinance provide for the designation of a Permanent Forest Estate, in line with the National Forestry Policy. Forests outside of permanent reserved forests either constitute State land (effectively a ‘land bank’ for future gazettment as permanent reserved forests or for alienation and conversion), or national parks (which, in Peninsula, come under Federal control).

In all three jurisdictions, all forest produce originating from Permanent Reserved Forest or State land is considered the property of the State Authority, and all exploitation of forest

² National Forestry Policy 1978, para 3.9 and 3.15.

³ Related Federal laws include the Water Enactment 1935, Land Conservation Act 1960, Environmental Quality Act 1974, Protection of Wildlife Act 1972, and the National Parks Act 1980.

produce must be licensed and administered by the State Authority. Licensees in permanent reserved forests are in turn, required, to develop and implement forest management, harvesting and reforestation plans. Forest officers are invested with powers of arrest, search, seizure and investigation, and State Forestry Directors may stipulate fines and/or pursue prosecution of offenders.

The multi-stakeholder process for the development of standards for sustainable forest management (SFM) in Malaysia (see Box 4) has, however, given voice to long-standing conflict over the recognition of aboriginal or native claims in forest lands. It has been argued that, in many areas, aboriginal or native claims over forest areas have not been exhaustively demarcated and settled prior to their designation as permanent reserved forest (or indeed alienation for conversion). The regulation of aboriginal and native rights in forests differs between the three jurisdictions and is set out under Section 3.3 below.

3.3 Key jurisdictional differences between the Peninsula, Sabah and Sarawak

Though governed by broadly similar legal instruments, forest sector regulation in Sabah, Sarawak and the Peninsula differs in some important respects. These differences have significant implications for the design and scope of verification systems that have subsequently evolved under each of these jurisdictions (see Section 6). Differences include:

- the organisational structure of forestry agencies, and the degree of oversight this permits;
- the duration of concession licenses, and the relative role of State Forestry Departments in forest management and control;
- the regulation of aboriginal and native rights;
- timber administration, and the traceability this permits along the production chain.

3.3.1 Administrative structures

With the adoption of the National Forestry Act in the Peninsula, State Forestry Departments in the Peninsula are required to submit annual reports to both the State Authority and the Federal Forestry Department (Section 4f). Furthermore, professional and sub-professional foresters within the State Forestry Departments in the Peninsula are effectively Federal officers on secondment, and fall under the line management of the Federal Director-General of Forestry. This enables the Federal Director-General of Forestry to exercise a degree of supervision with respect to forest sector planning and management in the Peninsular States, including annual audits of the State Forestry Departments against standards of performance for sustainable forest management (SFM).

By contrast, both Sabah and Sarawak are governed by their own forest enactments and ordinances. This means that the forestry services of both States remain entirely accountable to their respective State Authorities. Audits of these States are not undertaken by the Federal Forestry Department. Furthermore, whereas responsibility for the management, development and regulation of the forest sector lies with the State Forestry Directors in the Peninsula and Sabah, Sarawak took the unique step of devolving powers of the State Forest Department to the Sarawak Forestry Corporation (SFC) Sdn. Bhd. (fully operational as of 2004). The SFC is responsible for the management of forest resources in Sarawak, including timber administration. This leaves the Forest Department of Sarawak to concentrate on forest policy planning and regulation.⁴ The devolution of functions was undertaken to enhance capacity,

⁴ Pers. comm., Thang Hooi Chiew, 27-09-05.

and builds on the findings of an ITTO report which recommended rationalisation of the Forest Department, greater efficiency and a separation of functions. The separation of functions in theory introduces an additional level of oversight and control with respect to forestry administration that does not exist in Sabah and the Peninsula.

3.3.2 Licensing systems

For the Peninsular States that have adopted the National Forestry Act, licenses may be issued for a term of 12 months, subject to renewal and unless otherwise prescribed (Sec. 21.1). Each State in the Peninsula is considered a single Forest Management Unit.⁵ All Permanent Reserved Forests within a State are managed under a single 10-year Forest Management Plan.

As such, the State Forestry Departments are responsible for sustainable forest management and protection. Amongst others, District Forest Offices are required to prepare 5-year working plans and annual plans for harvesting and silvicultural operations. Licenses for felling are issued for each harvesting block, typically for 12 months.⁶ In total, around 25000–40000ha are licensed every year in the Peninsula. Licensees may then subcontract operations to one or more contractors with the necessary capital and equipment. Some long-term concessions have been granted in the Peninsula, including the Integrated Timber Complexes of the States of Perak (PITC), Kelantan (KPK) and Terengganu (KPKKT). However cutting is still licensed annually, subject to management plans approved by the State Forestry Departments.

In contrast to the Peninsula, Sabah and Sarawak have adopted longer-term licensing systems under their own forest ordinances and enactments. Sarawak typically issues Forest Timber Concession Agreements of 25 years duration, subject to renewal. Licensees are required to prepare 25-year Forest Management Plans. This includes delineation of annual coupes of around 2000ha (depending on size of concession area), for which detailed annual plans are prepared. The longer-term licensing system has supported the development of integrated harvesting and downstream processing operations under the control of a limited number of industry groups.⁷ This contrasts with the much greater diversity of operators in the Peninsula.

Sabah previously operated a short-term licensing scheme but has now abandoned this in favour of 100-year Sustainable Forest Management License Agreements (SFMLAs). These were introduced in 1997, on the understanding that long-term security of land tenure provides an incentive to licensees to build up forest resources over time. The change was facilitated by a change in government in Sabah, and was driven by an interest in tackling rapid exhaustion of forest resources, forest degradation, dwindling productivity and decreasing revenue. The 100 year period, covering two investment cycles, was seen as the minimum necessary to attract investment, and to allow logged-over forests sufficient time to recover and regenerate after the first harvest. As such, licensees are required to bear the burden of ensuring sustainable forest management and protection, including the preparation of 10-year and annual work plans, as well as detailed comprehensive harvesting plans for each compartment. The role of the State Forestry Department is to provide guidance and

⁵ As each Peninsular State is considered a single FMU, MTCC certification in the Peninsula now applies to entire States as opposed to individual licensees.

⁶ GFS, *Review of Programmes on Traceability of Timber Material*, Draft Report for the Workplan Legality, Asia Forest Partnership pp. 5 - 7

⁷ These include the Ta Ann, KTS, WTK, Shin Yang, Rimbunan Hijau, and Samling industry groups.

capacity-building, and to monitor the operations of SFM licensees.⁸ 18 such SFM Licence Agreements have been issued to date. Of these, 3 have been withdrawn on grounds of non-compliance.^{9, 10}

3.3.3 Timber administration

Timber administration in the Peninsula, Sabah and Sarawak is broadly similar. This includes: marking of forest produce by license holders; payment of deposits, royalties, premium, cess¹¹ and other charges; measurement of forest produce in respect of charges payable; and issuance/cancellation of removal (transport) passes. Timber administration systems in all three jurisdictions are currently paper-based; though States in the Peninsula and Sabah have begun to enter scaling data onto a centralised database in order to validate royalty payments against initial deposits.

Amongst the key differences in timber administration, is that only the Peninsular States currently undertake 100% tree tagging (of both trees for felling, as well as those to be left as seed trees). This is undertaken by Forestry Department staff, using printed plastic tags. For any one tree, both the stump and all corresponding log sections are tagged with the same number. In combination with pre-harvest inventories, this enables both compliance control of harvest plans, as well as relatively good traceability of logs from stump to mill.

Forest administrations in Sabah and Sarawak do not presently conduct 100% tree tagging. Both rely on pre-felling inventories and companies' own log numbering systems at least until timber arrives at stumping points. Forest rangers will then issue Removal Passes for timber to be transported from concession areas.¹² As such, logs can only be traced back to the harvest block from which they came, but not to the stump. The introduction of tree identity numbers under computer based systems is however being examined, enabling 100% log tracking. In Sarawak, this has been piloted in the Rajang River Basin, accounting for around 30% of production. In Sabah, the Forestry Department will shortly be introducing a centralised computer based system.¹³

3.3.4 Laws governing aboriginal and native rights

In the Peninsula, current laws preclude an aboriginal interest in land in areas gazetted as Permanent Reserved Forest. The National Forestry Act consequently makes no provision for involving communities in the management of Permanent Reserved Forest. The National Forestry Policy merely calls for the promotion and intensification of agroforestry and community forestry programmes "along the fringes of the Permanent Forest Estate" (Elements 3.9 and 3.15).

In Sabah and Sarawak, the regulatory framework also precludes a native interest in land within Permanent Reserved Forest, and will seek to excise or extinguish such claims in return

⁸ Sabah State Government, February 1998, *Forestry in Sabah, Status, Policy and Action*.

⁹ Personal communication, Sabah Forestry Department, 22-09-05.

¹⁰ The biggest single license holder is Sabah Foundation, a statutory body with a number of wholly-owned subsidiaries involved in upstream and downstream operations in the forest sector.

¹¹ A forest development cess is payable to the State Authority in respect of any forest produce removed from the Permanent Reserved Forest, State land, reserved land, mining land or alienated land (Section 60, National Forestry Act, 1984).

¹² The difference lies in the long-term concession system in Sabah and Sarawak, whereas in the Peninsula Forestry Departments are the direct managers.

¹³ Pers. comm., Sabah Forestry Department, 22-03-06.

for compensation. But, unlike the Peninsula, current laws also provide that the constitution of forest reserves may also admit certain rights and privileges, e.g. to collect forest products for own use or to continue to cultivate secondary forest areas.

- In Sabah, this is provided for under S.14 of the Sabah Forest Enactment 1968. It is also reflected in the terms of Sabah's 100-year SFM License Agreements, placing certain duties on license holders with respect to native rights and community development in concessions areas (see Box 2). The Head of the State may however choose to "rescind, modify or add" to such rights and privileges. They are also subject to cancellation if not exercised for three years.
- The Sarawak Forest Ordinance (1958) allows for native rights or privileges to be admitted and allowed to subsist in the constitution of Protected Forests and Forest Reserves.¹⁴ Under S.16 and S.35 of the Forest Ordinance, the exercise of such rights or privileges is subject to the control of the Director of Forests. Under S.17 and S.39 they can also be revoked or extinguished by public notice. Subsisting rights and privileges are entered into the boundary register maintained by the District Forest Office (DFO). Companies must then compensate any violation or disturbance of traditional rights or agricultural areas belonging to local communities (e.g. planted fruit trees) assuming such interests have been established.¹⁵

Box 2 – SFM License Agreements in Sabah; duties on licensees with respect to native law and community development in licensed areas.

Unlike concession licences in either the Peninsula or Sarawak, Sabah's 100-year SFM License Agreements places certain duties on license holders with respect to native customary rights and privileges as may have been admitted during the gazettment process. This includes rights to collect forest products for subsistence, the designation of community forestry areas, as well as support to government in the delivery of health and education facilities. This reflects the policy intent of 100-year SFM License Agreements as a basis for progress towards (Forest Stewardship Council) FSC certification. The 125 clauses of the License Agreements build on the 10 FSC Principles, including FSC principles 2, 3 and 4 on tenure, native rights and community development.

The relevant clauses are:

Clause 5 *The Licensee shall clearly demarcate within the Licensed Area, areas proposed for Community Forestry. The Licensee shall obtain explicit approval from the Director in regard to the quantum of area to be earmarked for Community Forestry.*

Clause 23 *The rights and privileges of the natives under the existing laws and regulations, including Customary Law, are not affected or limited in any respect under this Agreement. The Licensee shall recognize such rights and privileges including, without limitation to those relating to entry into the Licensed Area to collect certain wood species and exploit Minor Forest Produce (as allowed and defined in the Forest Enactment 1968 and Forest Rules 1969) for its own personal*

¹⁴ Examples include G,N,S 881/1951 constituting the Lemiting Protected, under which natives were allowed to continue to farm their secondary forests, as well as L.N. 971/1951 constituting the Binatang Forest Reserve, under which natives were allowed to remove forest produce for their own use. Sarawak Attorney General's Office (2007).

¹⁵ GFS, *Review of Programmes on Traceability of Timber Material*, Draft Report for the Workplan Legality, Asia Forest Partnership Draft, March 2005, Appendix 6.

use and not for business purposes.

Clause 24 *The Licensee shall assist the Government in the implementation of community/labour welfare schemes within or adjacent to the Licensed area. The welfare scheme would, inter alia, include: (a) establishment of work place for the community; (b) development of education and medical facilities; (c) provision of communication facilities; and (d) active participation in the community development projects.*

Clause 49 *The Licensed Area shall for management purposes be zoned as Conservation Area, Production Area, Community Area, or Recreation Area, if applicable. The forest zones shall be designated according to the following criteria: ... (iii) Community Area: Area which may encompass Conservation Area and Production Forest in the direct vicinity of settlements where the local population exercises customary rights (timber, non-timber forest produce, hunting etc.). Permitted uses shall be limited to community use.*

Source: Sabah Forestry Department, copy of SFMLA provided on 22-09-05.

Notwithstanding the admission of rights and privileges in the constitution of forest reserves, forest gazettement processes remain highly contentious given: (a) legal disputes over basis for establishing an aboriginal or native interest in land; and (b) whether there is adequate provision for public notice. Laws and related case law on these issues differ between the Peninsula, Sabah and Sarawak.

(a) *The Peninsula*

The National Land Code (which only applies to the Peninsula) does not yet recognise collective ownership, foreclosing aboriginals from securing title. Rather, s.6 & 7 of the Aboriginal Peoples' Act 1954 provide for the recognition of 'aboriginal areas' and the gazettement of 'aboriginal reserves'. A mere 75 square miles has so far been gazetted as aboriginal reserves under the Act. Further areas are pending gazettement while others are still under consideration.

Permanent Reserved Forest may not be gazetted in aboriginal reserves. And although the Aboriginal Peoples' Act does not preclude the gazettement of Permanent Reserved Forest over aboriginal areas, an unrecorded case *Koperasi Kijang Mas & 3 Ors v. the State Government of Perak* suggests that aboriginals nevertheless have first rights in such areas.

The Peninsular States have tended to regard aboriginal reserves and areas in much the same way as any other land use, i.e. at the pleasure of the State. The Court of Appeal's landmark ruling in *Kerajaan Negeri Selangor v Sagong Tasi* (2005) nevertheless affirms that aboriginal groups have a proprietary interest at common law in areas where proof of continuous occupation (including settlements, agriculture and planted trees) can be established. As such, the States bear a fiduciary duty to gazette all areas in which such interests can be established. The Court ruled that failure to gazette such lands is not a defence in respect of compensation not having been paid by the State where that land has been taken for another purpose.

A fiduciary duty to gazette areas in which aboriginals have interest in land would (amongst others) apply to processes for constituting Permanent Reserved Forest. Yet neither the 1984 National Forest Act nor the National Land Code makes any provision for public notice in forest gazettement processes. Provisions on public notice are reportedly contained in

individual State ordinances, and it may be necessary to take stock of these in the interests of greater uniformity of practice across the Peninsula.

While the test for a legal interest in land is proof of continuous occupation, as established in Common Law, what constitutes such proof remains a moot point. The Court of Appeal in *Sagong Tasi* accepted evidence such as settlements, fruit trees and cultivated areas. But it also stated that it was not logical for an interest in land to extend to the wider forest domain over which aboriginals may roam for hunting and gathering. Commentators argue that the opinion of the Court in this regard was extraneous to the case, given that it was not forest land at issue.

Interestingly, the Court of Appeal in *Adong bin Kuwau* affirmed a duty to compensate (but not necessarily a duty to gazette) in respect of aboriginal usufruct rights within the forest domain. One implication might be that adequate procedures for compensation should now be established with respect to logging in Permanent Reserved Forest which aboriginal groups currently use for hunting and gathering.

(b) Sarawak

The Sarawak Land Code provides for:

- Native Communal Reserves under S.6(1) governed by customary law. These remain state land, and have only been implemented to a limited extent.¹⁶
- Native Customary Rights (NCR) under S.5. These constitute an interest in land. The 2000 Land Code Amendment allows for the registration of NCR and Native Reserve Land in accordance with S.213 of the Code. NCR may be extinguished upon notice in return for compensation, provided such a claim has been submitted with a 60-day notice period under S.5(3)(c).

To qualify as NCR, rights must have been in existence before 1 January 1958 and no new claims can be established without a permit in writing from the Superintendent of Land S.5(1). S.5(2) sets out the tests for establishing an NCR including felling of virgin jungle. So while in the Peninsula establishing an aboriginal interest in land remains a matter of Common Law, in Sarawak it is now also governed by statute.

The Sarawak Forest Ordinance 1954 prevents natives from creating customary rights in Forest Reserves and Protected Forest (i.e. by felling virgin jungle) without prior authorisation of the District Officer. So when forest areas are first gazetted, the Forest Ordinance states that those with NCR from before 1 January 1954 must register them within 60 days of public notification (in the Government Gazette and by the District Officer) or be deemed to have waived them without right of payment or compensation. An enquiry is then conducted by the Regional Forest Officer within 60 days of receipt of claims, whereupon the Forest Director will assess compensation in order to extinguish NCR claims, or realign boundaries so as to exclude them, or refer appeals to the Section Court. The process for constituting Forest Reserves (FR) and Protected Forest (PF) in Sarawak is summarised in Figure 1.

¹⁶ Examples of Native Communal Reserve orders include: (i) Native Communal (Agricultural) Reserve Order 2001 (Swk. L. N. 77/2001); (ii) Native Communal (Kampong) Reserve Order 2001 (Swk. L. N. 65/2001); (iii) Native Communal (Community Hall) Reserve Order 2001 (Swk. L. N. 28/2001); (iv) Native Communal (Surau) Reserve Order 2001 (Swk. L. N. 93/2001); and (v) Native Communal (Agriculture) Reserve Order 1992 (Swk. L. N. 21(1992)). State Attorney General's Chambers (2007).

This, however, leaves a small window of opportunity for aboriginal or native groups to register claims, especially for those in remoter areas with limited access to information – though the Forest Department does claim to do more than is required of it in the Forest Ordinance by distributing information to long houses.

The basis on which NCR claims may be admitted under gazettelement processes is also contested – in terms of what (a) constitutes continuous occupation sufficient to establish NCR; and (b) what evidence must be submitted in support of such a claim. These questions are now the subject of a slew of litigation, exacerbated by issuances of Provisional Leases for plantation development where the State has not fully determined, compensated and excluded NCR prior to issuing such leases.

In respect of what constitutes continuous occupation, a recent amendment to the Land Code removed S5(2)(f) on creation of NCR by ‘any other lawful means’. Some argue that this effectively restricts the test of continuous occupation from applying to the wider forest domain. However, the Sarawak Attorney General has subsequently argued that:

- ‘any other lawful means’ does not in any case apply to fishing or the collection of jungle produce, but only to NCR acquired by gift or inheritance – as specified in codified customary law in the Appendix to the Tusun Tunggu (Third Division) Order;
- pursuant to S. 5(1) of the Land Code, a valid claim in NCR must subsist, not simply in unwritten rules of native custom, but rather in customary law codified by the Native Affairs Council or *Majlis Adat Istiadat* under the Native Customs (Declaration) Ordinance 1996; and,
- and, even if S5(2) of the Land Code only applies to NCR created after 1 January 1958,¹⁷ NCR created before that time was itself restricted by colonial executive orders, which provided (amongst others) that: (i) a claim in land is contingent on continuous occupation or cultivation on or within 3 years; and (ii) no native may hold up land without title in excess of requirements.¹⁸

These arguments are pertinent to the case of *Nor Nyawai v. Borneo Pulp Plantation Sdn Bhd* (2001) in which the Judge at first instance upheld a claim by the natives of Rumah Nor over land subject to a Provisional License. The learned Judge established that NCR may be created in respect of cleared areas (*temuda*) as well as in respect of areas used for hunting and fishing (*pulau galau*) within the wider area used by a longhouse (*pemakai menoa*).

This decision was subsequently appealed on grounds that (among others): the natives in this case could not establish claims in respect of ‘*pulau galau*’ or ‘*pemakai menoa*’ as neither are specified in codified customary law; and that, pre-1958 orders also made no mention of either category, with the implication that such practices were not part of the customary law of Sarawak during and after the colonial period.

The people of Ruman Nor in the end lost on the facts of the case, but the ruling of Court of Appeal in *Borneo Pulp Plantation Sdn Bhd v Nor Nyawai* (2005) also affirmed that:

- NCR does not owe its existence to statute but to common law;

¹⁷ As affirmed by Clement Skinner J. in *Madelli Salleh v Superintendent of Land & Surveys & Anor* [Civil Appeal No. Q-01-94-00].

¹⁸The Attorney General cites (amongst others) the 1899 Fruit Trees Order, Rajah’s Order L-7 1933 (Land Settlement Order), Rajah’s Order No. VIII 1920, the Appendix to the Tusun Tunggu (Third Division) Order, as well as Secretariat Circular No 12/1939. State Attorney General’s Chambers (2007)

- That legislation is only relevant to determine how much of those native customary rights have been extinguished; and,
- Establishing NCR is a matter of proof based on the evidence adduced and the application of the relevant statutory provisions.

This arguably upholds the view of the Judge at first instance that the fact that ‘*pulau galau*’ or ‘*pemakai menoa*’ are not incorporated into a body of written law does not mean that it is no longer to be recognised or regarded as proof of continuous occupation for purposes of NCR.¹⁹

Advocates acting for native groups also point to the submissions of the Sarawak Attorney-General to the Court of Appeal. These appear to suggest that NCR may be established over areas used for hunting and fishing (*pulau galau*) if there is also clearing of land (*temuda*) within the wider area used by a longhouse (*pemakai menoa*). This issue has now been submitted by the people of Rumah Nor for determination by the Federal Court. The appeal includes questions ‘to the public advantage’ to affirm (amongst others) whether, for the purposes of establishing pre-1958 NCR in areas used for hunting and fishing, it is necessary also to have proof of *temuda* and *pemakai menoa*. Clement Skinner J. in *Madelli Salleh v Superintendent of Land & Surveys & Anor* [Civil Appeal No. Q-01-94-00] in fact affirms that ‘actual physical presence’ need not be equated with occupation for purposes of establishing NCR.

However, the case of *Nor Nyawai* also demonstrates the difficulty of obtaining corroborative evidence of pre-1958 claims. This includes interpretation of aerial photography to determine whether the area constituted primary or secondary jungle at the time. The Appeal to the Federal Court therefore asks “whether it is correct in law in cases involving claims to native title by indigenous people without a tradition of written records to seek corroborative evidence of the claim other than by oral testimony?” The Court of Appeal found that such evidence was necessary where oral testimonies were otherwise self-serving.

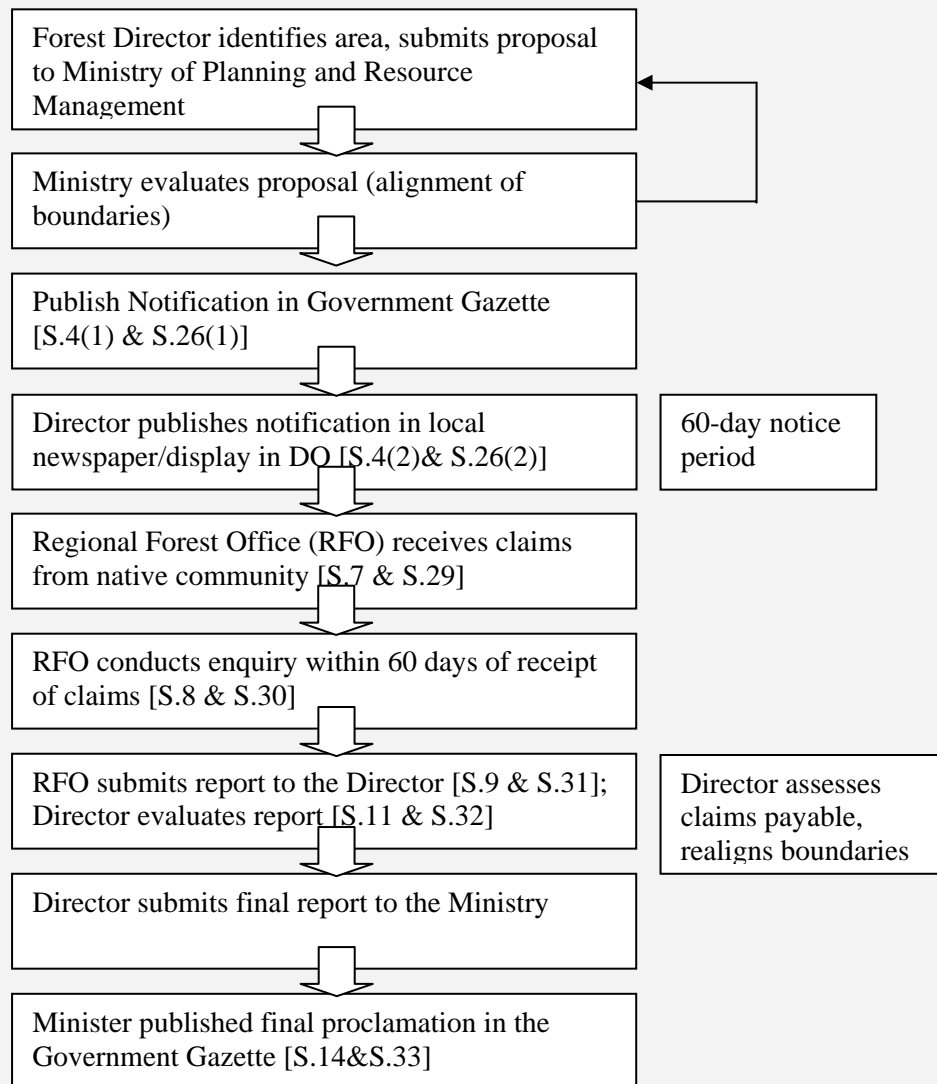
Resolution of these outstanding legal issues is essential in clarifying the legal basis on which to establish NCR for purposes of gazetting Permanent Forest Estate.

It is also important in light of the Land Code Amendment 2000 which allows for the registration of NCR and Native Reserve Land in accordance with S.213 of the Code. This specifically targets land mobilization for plantation development in partnership with native groups (*Konsep Baru*).²⁰ The presumption here is that NCR applies only to areas outside of Permanent Reserved Forest.

¹⁹ Outline and written submission in response to the appellants’ memorandum of appeal, Mahkamah Rayuan Malaysia, (Bidang Kuasa Rayuan), Rayuan Sivil No. Q-01-42-2001 & Q-02-504-2001) <http://www.rengah.c2o.org/assets/pdf/de0093a.pdf>

²⁰ Some 58 NCR land areas have been identified for development under *Konsep Baru*. 31 have been verified by the Department for Land and Surveys amounting to 292,247 ha. A total of 11,952 landowners are now participating in 23 projects.

Figure 1 Procedure for constituting Forest Reserves (FR) and Protected Forest (PF) in accordance with S.3 Part II and S. 25 Part III of the Forest Ordinance [CAP 126] Sarawak



Source: Sarawak Forests Department, 24-07-06.

(c) Sabah

As in Sarawak, forest gazettement processes provide a relatively small window of opportunity within which to submit claims, especially for remote and illiterate communities. The Sabah Forest Enactment provides 3 months from date of first publication in the Gazette for submission of objections or applications for the admission of certain rights and privileges in the constitution of forest reserves. Such rights and privileges are otherwise considered extinguished under S.12(6). Furthermore, the Forests (Constitution of Forest Reserves and Amendment) Enactment 1984 appears also to have constituted a whole series of forest reserves, without appearing to have gone through these steps.

Native tenure is governed under Part IV of the Sabah Land Ordinance. This defines customary land as that in lawful possession by natives by continuous occupation or cultivation for three or more consecutive years (S.65), or by titling – under a register of native titles (S.67).

There are two means of registering native title:

- (a) The Head of State may issue proclamations for land settlement under S.81, whereupon all natives with claims are required to submit these in verbal or written form within the time period specified (S.82). S. 85 provides for compulsory registration. This, however, raises similar problems to forest gazettement in terms of the window of opportunity available to native groups to submit claims. Claims not subject to a documentary title may be resumed by Government upon payment of compensation in line with the Land Acquisition Ordinance (S.83).
- (b) Under S.70 a native can also apply for a native title to untitled state land (for agriculture plots up to 20 hectares). Transactions in native land are expressly forbidden, but a native title may be sub-leased to non-natives for a term not exceed 99 years (s.5).

The Ordinance also provides for registration of communal title in the name of the Collector of Land Revenue on trust (S76); as well as proclamations of native reserves, but no title can be issue in respect of such land (s.78).

4. Law and policy on wood-based industries and the timber trade

The timber industry is amongst the strongest growth sectors in Malaysia, and is currently the fifth largest generator of export earnings (4.3% in 2003). It is reported that export earnings from timber grew 5%-6% to over RM17 billion in 2004 from RM16.3 billion in 2003.²¹

About 337,000 workers are directly employed in the sector accounting for 3.6% of the country's workforce.²² It is reported that strong growth is currently being fuelled by the Japanese economic recovery, as well as increasing demand for wood-based products from India and China. It also reflects a track record of substantial investment in installed processing capacity, driven by a strong policy commitment to enhancing local value-added products for export.

Amongst others, the National Forestry Policy 1978 called for the establishment of new primary processing industries “*according to the availability of raw material supply from the Permanent Forest Estate and other sources*”. It also called for operational efficiency through modernization and integration; wider utilisation of lesser-used species; and downstream processing through the establishment of integrated processing complexes “*to create an integrated production base for export and growth*”. In line with the 2nd Industrial Master Plan, emphasis is now being placed on value-added downstream activities.

Responsibility for promoting the development of wood-based industries lies with the Ministry of Plantation Industries and Commodities.²³ The Ministry's functions in this respect are delegated to the Malaysian Timber Industry Board (MTIB), a statutory body established by the *Malaysia Timber Industry Board (Incorporation) Act 1973 (Act 105)*. The objectives of MTIB include: the further industrialisation and upgrading of the timber industry with emphasis on value-added processing; promotion and marketing of timber and timber products; the development of small- and medium-scale enterprises; the development and promotion of standards in quality timber products; and the promotion of orderliness within the timber trade. Under Section 14 of Act 105, MTIB regulates the registration of timber exporters, suppliers, timber graders, jetty operators and processors. MTIB's jurisdiction covers the Peninsula and Sabah, though Sarawak has its own equivalent – the Sarawak Timber Industry Development Corporation (STIDC), established by State Ordinance in June 1973, and which fulfils similar functions.

Measures in support of enhanced local processing include the progressive imposition of log export bans. A total ban on log exports from the Peninsula was enforced in 1985 and from Sabah in 1993 (though this has now been lifted for 40% of its production). Sarawak operates a similar system of log reservation quotas, where around 60% of production is reserved for domestic processing.

Increasing dependency on imported timber

One outcome of the promotion of wood-based industries is that, with around 1000 licensed wood mills,²⁴ installed industrial capacity has now exceeded the domestic log quota.²⁵ In

²¹ The Star, “Timber industry at early stage of boom”, Saturday January 22, 2005

²² Pers. comm., MTC, 30-03-06

²³ Pers. comm., Thang Hooi Chiew, 27-09-05.

²⁴ The Star, “Timber industry at early stage of boom”, Saturday January 22, 2005

2002, mill consumption in Peninsular Malaysia exceeded domestic log supply by approximately 1 million m³. The same pattern was reported for 1999, 2000 and 2001.²⁶ The excess timber going for mill consumption mostly comes from small diameter log and poles which is not accounted for in the log production statistics. Although the National Forestry Policy raises the need to ensure an adequate support of raw material for local processing, the supply of domestic timber from natural forests is declining. In the Peninsula, the shortfall reflects measures to ensure the implementation of sustainable forest management (including crack-downs on illegal logging - see Box 3), a dwindling supply of timber from outside of permanent reserved forest area as State 'land banks' are converted to plantation agriculture, as well as the effectiveness of law enforcement.

While the shortfall is increasingly made up with substitutes such as rubber wood and oil palm trunk, the future of the timber industry with respect to higher-value hardwoods depends, not only on achieving sustainability within remaining forests areas (e.g. through the introduction of certification), but also on timber imports. Malaysia in fact became a net importer of logs in 1995 to supplement the supply of domestic logs for processing, especially in the Peninsula and Sabah.²⁷ ITTO figures from 2004 indicate that the largest proportion of imports now consists of sawn timber (830,000m³ compared to 120,000m³ of logs in 2004).²⁸ Key suppliers include Indonesia (for sawn timber), Myanmar, Papua New Guinea (PNG), and the central Africa region (for logs), as well as some non-tropical sources such New Zealand, Australia and Russia.²⁹

²⁵ Note, however, that installed capacity is not necessarily the largest driver of illegal logging and does not automatically equate to volume consumed. Depending on the availability of raw material as well as orders received, many mills do not operate continuously. Pers. comm., Chen Hin Keong, TRAFFIC SEA Asia, 29-03-06.

²⁶ Lim Teck Win, Tonny Soeharto, and Chen Hin Keong (2004) p. 34

²⁷ Lim Teck Win, Tonny Soeharto, and Chen Hin Keong (2004) p. 34

²⁸ ITTO (2004) Annual Review and Assessment of the World Timber Situation.

²⁹ Pers comm., MTIB 4 August 2006

5. Responses to illegality in the forest sector

5.1 Control of domestic timber production

Some commentators suggest that illegality in domestic timber production is relatively minor, at least in terms of unlicensed harvesting and illegal transport. According to the World Bank/WWF Malaysia, the number of illegal logging cases in Peninsular Malaysia fell from an average of 223 per year for the period 1987-1993, to about 28 for the period 1994-1999.³⁰ This in large part reflects measures to crack down on illegal logging including an amendment in 1993 raising penalty levels in the National Forestry Act (see Box 4). The equivalent report for East Malaysia states that around 300 forest law offences are detected annually in Sabah and Sarawak, with seizures of 20 – 50,000m³ per year compared to annual harvests of 5 million m³ in Sabah and 11 million m³ in Sarawak (1998).³¹ Though affecting 1% or less of Sabah's production, a higher number of offences in 2004 compared to 2001³² suggests that illegality remains a threat; not least because a certain amount may also remain undetected. Illegality is consequently taken seriously by Forestry Departments in the Peninsula, Sabah and Sarawak.

5.1.1 Prevention

With respect to the Peninsula, timber administration generally works in securing traceability from stump to mill, and in ensuring compliance with the log harvest quotas. There might be some scope for the illicit transfer of logs between permanent reserved forest and neighbouring alienated lands undergoing conversion, but 100% tree tagging and the administration of transport permits (Removal Passes) is considered sufficiently secure to prevent this happening on any significant scale.³³ Equivalent systems in Sabah and Sarawak enable traceability back to individual harvest blocks. In both these cases, however, the proposed introduction of tree identity tags under centralised, computer-based systems may strengthen chain-of-custody where timber administration currently relies on pre-harvest inventories and a company's own log numbering systems prescribed by SFC. This is especially important in Sarawak where log inspections are currently conducted at log ponds which may be some considerable distance from harvesting blocks.³⁴ A computer-based system would, amongst others, prevent the transfer of logs from 'over-quota' to 'under-quota' operations before reaching log ponds.

5.1.2 Detection and suppression

In all three jurisdictions, offences are detected and dealt with by forest officers responsible for monitoring of license holders and log administration (tackling in most part management offences), as well as dedicated mobile enforcement units (tackling individual incidences of illegal harvesting, transport and export). In addition, Forestry Departments rely on public informants (in return for rewards) and anti-corruption agents; and will enlist the support of the police in enforcement operations. In the Peninsula, the National Forestry Act 1984 also allows Forestry Departments to enlist the support of the Armed Forces.

³⁰ The World Bank/WWF Malaysia, *Overview of Forest Law Enforcement in Peninsular Malaysia*, March 2001, p. 10.

³¹ The World Bank/WWF Malaysia, *Overview of Forest Law Enforcement in East Malaysia*, March 2001, pp. 10 and 14.

³² Sabah Forestry Department Annual report 2004, p. 91.

³³ Pers. comm., Apannah, FAO, 14-09-05.

³⁴ GFS, *Review of Programmes on Traceability of Timber Material*, Draft Report for the Workplan Legality, Asia Forest Partnership, p. 9

5.1.3 Penalties

Both the National Forestry Act 1984 (as amended 1993) and the Sabah Forest Enactment 1968 (as amended 1992) establish a maximum penalty of RM50,000 and/or imprisonment not exceeding 5 years for unlawful possession of forest produce; as well as a maximum penalty of RM500,000 and/or imprisonment not exceeding 20 years for (amongst others) counterfeiting or defacing marks on trees and logs. Under the Sarawak Forest Ordinance the penalty can be as high as payment of 10 times the value of the timber, a RM50,000 fine and 2 – 5 years imprisonment for illegal timber export.³⁵

Within these limits, penalty-setting is commensurate with the offence. In Sabah, for example, fines for breaches of license conditions will vary depending on the volume of timber involved, and the duration of the breach. They will also vary depending on the nature of the breach – from RM100 per log for unlawfully removing timber without a property mark or Removal Pass, to RM5000 per month for failure to submit a logging progress map.³⁶

In all three jurisdictions, the offence can either be prosecuted in court or compounded (settled) by the State Forestry Director – depending on the severity of the infraction, the availability of the evidence and the advice of the State or Forestry Department legal advisor.³⁷ In Sarawak, for example, if a case is compounded between the offender and the forest agency, the fine is typically twice the value of the timber plus the incurred royalty. If the case goes to court, then the maximum penalty of 10 times the value of the timber, RM50,000 fine and up to 5 years imprisonment may then apply.³⁸

Compounds accrue to State coffers, whereas in the Peninsula fines determined by the courts accrue to the Federal level. Where, however, there may be discretion in the hands of State Forestry Directors to compound or prosecute cases; from August 2005, the National Forestry Council has recommended that all cases under Section 15 of the National Forestry Act (unlicensed removal of forest produce from Permanent Reserved Forests and State land) must now go to Court. That said, prosecution through the courts implies a relatively lengthy procedure.³⁹ As it is, fines are difficult to collect. Offenders may be hard to apprehend, requiring rapid follow-up on detected cases.⁴⁰

³⁵ The World Bank/WWF Malaysia, Overview of Forest Law Enforcement in East Malaysia, March 2001, p. 8.

³⁶ *Ibid.*, p. 13.

³⁷ Section 101, NFA; Section 35 Sabah Forest Enactment.

³⁸ The World Bank/WWF Malaysia, Overview of Forest Law Enforcement in East Malaysia, March 2001, p. 8.

³⁹ Pers. comm., Enforcement Unit, Federal Forestry Department, 20-09-05.

⁴⁰ The World Bank/WWF Malaysia, Overview of Forest Law Enforcement in East Malaysia, March 2001, p. 9.

Box 4 Cracking down on uncontrolled cutting in the Peninsula

By the early 1990s, uncontrolled cutting in the Peninsula had become cause for concern. Investigations at the time revealed how the short-term licensing system has become a ready means for State elites to secure political loyalties, and to boost the collection of royalties and premiums; with little incentive to control the activities of license holders and their contractors. Political interference in the issuance and oversight of concessions was compounded by the grant of logging rights to the traditional rulers of some of the Peninsular States. Rulers were able to secure licenses more easily because of their position (nine of the Peninsular States currently constitute Sultanates or Principalities).

By 1990, the annual allowable coupe for the Peninsula was exceeded by 70% within permanent reserved forests. This led to measures by the Federal government to bring individual States to heel and crack down on excess and illegal cutting. Measures included:

- (i) Changes to the constitution aimed at removing the personal immunity of the royalty and withdrawing their privileges (though these were aimed at tackling a broader governance issue as opposed to just illegal logging).
- (ii) Tighter guidance by the National Forestry Council to the States on the issuance of licenses and concessions, as well as the volume of timber harvested.
- (iii) Amendments to the 1984 National Forestry Act in 1993 under which:
 - illegal logging became the joint liability of license holders and contractors;
 - penalties for illegal logging were increased from a maximum of RM10,000 or imprisonment for a term not exceeding three years or both, to a maximum penalty of RM500,000 and imprisonment not exceeding 20 years with a mandatory imprisonment of not less than one year or both (making it too costly for many contractors to operate illegally); and,
 - the police and armed forces were empowered to undertake surveillance of forestry activities.

Political pressure on State governments by the ruling party encouraged adoption of these measures. While it is uncertain whether these measures have managed to tackle political interference, they did result in a dramatic drop in illegal logging from 810 cases in the Peninsula in 1991, to 41 in 1994.

Source: J. Kathirithamby-Wells (2005) *Nature and Nation. Forests and Development in Peninsular Malaysia*, University of Hawaii Press, pp.372 - 381.

5.1.4 The introduction of standards-based management

Given that most domestic timber production is in large part legal with respect to licensing and transport, commentators' concerns lie not so much with legality but with the determination and oversight of what should/ should not be logged and implementation of proper forest harvest practices (i.e. sustainability). Sources indicate that individual States may license in excess of what is sustainable, given that the links between research and forest administration are not strong, as well as instances of political pressure on State forest authorities to release areas of permanent forest estate for logging and conversion.

Government and industry have worked to address these concerns through the introduction of standards-based management systems. These fall into two broad categories – standards for Sustainable Forest Management (SFM), and ISO Quality Management standards for conformity of timber administration. The introduction of standards-based management reflects in part serious concern for maintaining market reputation in higher-value markets such as Japan, the EU and North America. Such markets are seen as important to maintaining the strategic position of the timber sector in industrial and export growth strategies.

(i) *Standards for Sustainable Forest Management*

There have been a number of initiatives to develop standards for independent certification of SFM in the Peninsula, Sabah and Sarawak (see Box 5). Two sets of standards are currently in operation:

- Malaysian Criteria and Indicators, Activities and Standards of Performance for Forest Management Certification (MC&I), as implemented by the Malaysian Timber Certification Council (MTCC).
- Principles and Criteria of the Forest Stewardship Council (FSC).

By end 2005, MTCC had certified 4.67 million hectares of permanent reserved forest. This covers all eight timber-producing States in the Peninsula. Each State is designated as a single Forest Management Unit (FMU) for purposes of MTCC certification. This accommodates the existing legal and administrative arrangement under which Peninsular State Forestry Departments are responsible for the preparation and implementation of management plans. MTCC has also certified 55,949 hectares of the Sela'an Linau FMU in Sarawak, which is managed by Samling Plywood (Baramas) Sdn. Bhd.⁴¹

By comparison, only two FMUs have secured FSC certification in Malaysia: Deramakot in Sabah, an initiative of the Malaysian-German Sustainable Forest Management Project, certified as of July 1997; and the Perak Integrated Timber Complex (a long-term lease in the Peninsula), certified as of July 2002. MTCC has not submitted its certification scheme for endorsement by FSC. Forest managers are therefore at liberty to choose either FSC or MTCC certification.

Notwithstanding differences between MTCC and FSC, an important outcome of the drive for certification has been the incorporation of SFM standards into routine government audits of FMUs:

- MC&I Standards of Performance have been adopted under annual audits of State Forestry Departments by the Federal level in the Peninsula, and will follow up on corrective actions identified by 3rd party MTCC auditors.
- The FSC Principles now also form the basis of 100-year SFM License Agreements in Sabah; providing a template for annual compliance audits and a framework for progressing license holders towards full FSC certification in future.

The incorporation of SFM standards into government audits effectively mirrors the voluntary audits of certification agencies.

⁴¹ Pers. comm., between Thang Hooi Chiew and Harnarinder Singh, March 2006.

(ii) *ISO International Quality Management Standards & Guidelines*

All three forestry jurisdictions (the Peninsula, Sabah and Sarawak) have introduced ISO 9000 quality management standards and guidelines to components of their forest management systems. This reflects a broader drive on administrative efficiency under the Malaysian Administrative Modernisation and Management Planning Unit (MAMPU) of the Prime Minister's Office. ISO 9000 standards specify requirements for management systems needed to demonstrate consistency with customer or regulatory specifications, and aims to enhance customer satisfaction. Key principles include customer-orientation, involvement of people at all levels, a process approach, continual improvement and a factual approach to decision making. All three forestry jurisdictions in Malaysia have identified their own sets of procedures for application of ISO standards. The Federal Forestry Department, with the involvement of the eight major timber-producing Peninsular States, initially introduced ISO 9002:1994 to administrative processes governing "Sustainable Timber Production from Inland Natural Forests in Permanent Reserved Forests". This has since been updated in line with ISO9001:2000.

The Sabah Forestry Department also introduced the ISO9002:1994 standard (later updated to ISO9001:2000), but to a more restricted set of procedures – including royalty collection and preparation of comprehensive harvesting plans. In Sarawak, ISO9001:2000 has been applied to monitoring of log reserve quotas and enforcement.

ISO 9000 standards are, however, purely procedural. Audits rely on documentary evidence rather than outcomes in the field. While the standard provides a framework by which to establish a management system it does not specify acceptable levels of performance. As such, SFM and ISO 9000 standards serve different but complementary purposes.

Box 5 The development of SFM certification in Malaysia

Malaysian Criteria and Indicators, Activities and Standards of Performance for Forest Management Certification (MC&I), cover the economic, social and environmental aspects of sustainable forest management. The development of MC&I reflected the interest of the Forestry Departments of the Peninsula, Sabah and Sarawak in implementing the *ITTO Guidelines for the Sustainable Management of Natural Tropical Forests* and *Criteria and Indicators for Sustainable Management of Natural Tropical Forests*. Commitment to the ITTO Guidelines and C&I were seen as a step towards bringing forest management within sustainable limits and securing the reputation of Malaysia's timber industry on international markets. This included long-term access to higher-value markets in Europe, the US and Japan; where Malaysia's share in less environmentally-sensitive markets such as China, Taiwan and South Korea may be undercut by lower-cost Indonesian plywood, amongst others.

The development of MC&I was built on three ongoing certification initiatives in Malaysia. In the Peninsula, a Joint Working Group study on timber certification was established by the Malaysian Timber Industry Board and the Netherlands Timber Trade Association (NTTA), under which timber began entering the Dutch market under the Keurhout Hallmark System. In Sabah, the Forestry Department worked with Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ) to develop a model concession at Deramakot. 55,084ha were subsequently certified by FSC in 1997. In Sarawak, certification efforts were also initiated by the Sarawak Forest Department with the support of the Sarawak Timber Association, including joint work with MTCC and ITTO.

The decision to promote a national certification system reflected an interest in building on

the existing Selective Management System and local land laws. Government took a strong lead in their development with the support of the private sector. The process also opened up a critical space for NGO engagement in forest management policy. NGOs such as WWF saw forest certification as an opportunity to demonstrate good forest management, while rights groups saw certification as an opportunity to address indigenous land claims. Both sets of NGOs actively participated at the outset, and came to have significant influence on the process.

A process was established to formulate management specifications and activities at national and FMU levels. Draft MC&I for sustainable forest management were finally tabled in 1999. The Malaysian Timber Certification Council was established in 1998 to oversee the implementation of a voluntary certification scheme; and to provide independent assessment of forest management practices. Though nominally an independent organisation established under the Companies Act 1965, MTCC remains under the authority of the Federal Ministry of Plantation Industries and Commodities. MTCC received initial funding from the Ministry to cover the cost of its operations during the first few years of its establishment. It now operates on the interest generated by an endowment provided by the Ministry from the collection of export levies on timber and timber products.

MTCC facilitated national consultations on the draft MC&I in October 1999, involving 85 organisations and companies – spanning industry, social and environmental NGOs, trade unions, women’s organisations, academic research institutions, as well as universities. MTCC began operating its certification scheme in October 2001, pending the development of a new standard (MC&I 2002) for implementation under a subsequent phase of the scheme. This essentially restructured existing standards (MC&I 2001) in line with the 9 FSC Principles and their attended criteria for certifying natural forests. The development of the revised standard took place under the leadership of a multi-stakeholder National Steering Committee (NSC), with MTCC acting as secretariat. This met for the first time in April 2001.

However, by July of that year 3 indigenous peoples’ organisations that were members of the NSC decided not to continue to participate in the process in protest that their views and opinions had not been taken into consideration, including with respect to native customary land claims. Amongst others, they had proposed amendments to State land codes. Though MTCC was of the view that this lay outside of its remit, this issue is likely to remain a challenge for the certification process. While Criteria 2 and 3 of the MC&I(2002) require assessment of disputes, documentation of dispute settlement as well as communication with local communities, it has been argued that the indicators and means of assessing compliance are not sufficiently specific or performance based. They include documentary evidence of native/aboriginal areas which may not exist. They also specify records of disputes and “appropriate mechanisms” to resolve them without further guidance (FERN, 2003). In light of recent court rulings on aboriginal and native rights, it may in fact be contingent on Government to establish clear guidelines on assessment of customary claims, and the measures taken to act on these such as compensation – see Box 2.

In early 2002, WWF Malaysia, an important player in lending legitimacy to the process, also felt compelled to resign from the MTCC’s Board over concerns that the MC&I 2001 did not adequately reflect the outcome of consultations, as well as the lack of a clear road map for achieving endorsement by FSC. That said, endorsement would not have been possible short

of establishing a new working group. The National Steering Committee originally set up to develop MC&I 2001 was never submitted for FSC endorsement. Nor did it follow rules prescribed by FSC in its national initiatives manual.

MTCC has nevertheless maintained an ongoing programme of cooperation with FSC since 1999, and a nine-member *pro tem* National Working Group on FSC was eventually established on 16 February 2006 to develop the organisational structure and operational rules (constitution) of an FSC-style working group. This would then develop and finalise certification standards that could be submitted to FSC for endorsement. The *pro tem* working group includes regional working groups for the Peninsula, Sabah and Sarawak. The work is currently being co-ordinated by WWF Malaysia and has support and buy-in from relevant social NGOs. The working group that is eventually established may either choose to update MC&I(2002) or start over afresh.

Separately, an assessment of MTCC by the Central Point of Expertise in Timber (CPET) for UK procurement policy recommended that requirements under the MTCC scheme were not adequate to ensure that certified forest meet UK government requirements for “sustainable timber” (CPET, 2004). Despite MTCC’s attempts at broad-based participation, CPET’s main reservation related to the lack of a formal mechanism to ensure balanced representation between groups. CPET argues that the process did not follow any clear procedures relating to the influence of different interest categories.

Sources: MTCC, *Involvement of Indigenous Communities and Social/ Environmental NGOs in Meetings/Consultations on Certification*, 20 November 2002; FSC International Center, *Statement of Clarification on the Relationship between FSC and MTCC*, Bonn, Germany, 18 July 2005; pers. comm. MTCC 30-03-06; Central Point of Expertise in Timber, *UK Government Timber Procurement Policy, Assessment of Five Forest Certification Schemes*, Phase 1 Final Report, November 2004, p. 12; pers. comm. Gini Ng 19-09-05; pers. comm. Tor Moi See, WWF, March 2006; MTCC, *MTCC Timber Certification Scheme*; Wong Meng Chiu *A Report on the Malaysian Timber Certification Scheme* – FERN Sept. 2003.

5.2 Control of timber imports

5.2.1 The problem of smuggled timber

At the time that they were designed, neither existing policy nor the institutional structures established to regulate wood-based industries, anticipated increasing dependency on imported timber; let alone the prospect that a significant proportion of imports from countries such as Indonesia or Papua New Guinea might be in illegal in origin. According to TRAFFIC research, the Forestry Department’s statistics for log imports to Peninsular Malaysia account for less than 10% of the shortfall in domestic timber supply in 2001. Notwithstanding the fact that MTIB and customs are in fact responsible for data collection on log imports, TRAFFIC suggest the shortfall could be accounted for by unrecorded domestic production and, more probably, by unrecorded imports.⁴² A prominent example has been the alleged smuggling of illegal ‘Ramin’ (*Gonystylus*) timber from Indonesia (see Box 6).

⁴² Lim Teck Win, Tonny Soeharto, and Chen Hin Keong (2004) p. 35

Box 6 The illegal trade in Ramin (*Gonystylus spp.*)

Ramin (*Gonystylus*) is highly prized for its versatility, and is used in the manufacture of (amongst others) doors, mouldings, dowels and furniture. Ramin has declined significantly as a result of habitat loss and logging of peat swamp forests. Annual production of 1.5 million m³ in the 1970s declined to just 137,512m³ in Malaysia and 131,407m³ in Indonesia, in 2000. Investigations by the environmental watchdog group EIA – Telapak drew attention to increasing encroachment into Indonesia national parks as sources of Ramin dwindled elsewhere. In June 2000, the Indonesian Ministry of Forest alleged that 70,000m³ of timber were being smuggled from Riau, Sumatra to Peninsular Malaysia every month. This allegation corresponds with research by TRAFFIC Southeast Asia which suggests that significant quantities were moving through Malaysian markets over 1998 – 2002. In 2001, the round-wood equivalent of exports of Ramin sawn timber from Peninsular Malaysia were 177% domestic Ramin production; and this does not account for the Ramin consumed domestically.

In 2001, following concerns over rampant illegal logging, Indonesia placed Ramin on CITES Appendix III as well as an export ban on the timber (with the exception of one certified concession in Sumatra). However, while CITES listing helped to increase the transparency of the trade, TRAFFIC Southeast Asia suggests that illegal Ramin has continued to enter the world trade - despite an increase in seizures of smuggled Indonesian Ramin (logs and, in particular, sawnwood) over the 2002 to 2004 period, as reported by the Malaysian Timber Industry Board (MTIB). TRAFFIC suggests that this could either reflect more effective enforcement and/or an increase in shipments. EIA – Telapak and TRAFFIC have also alleged the continuing movement of undeclared timber (including Ramin) into Malaysian free trade zones as well as barter trade centres. Barter trade centres have been established in the Peninsula and Sabah under bilateral agreements with Indonesia, and TRAFFIC alleges that Malaysian authorities have interpreted these agreements as not requiring customs clearance documentation from Indonesia. However, as of 15 January 2005 any import of CITES Appendix II-listed Ramin requires an import permit from MTIB/STIDC. This is contingent on a corresponding CITES export permit from Indonesia. Immediately prior to the introduction of this measure, a circular order was issued to all ports of entry including Barter Trade Centres requiring CITES documentation for Ramin imports. Where customs are uncertain of the species, the consignment may be seized pending MTIB/STIDC verification.

TRAFFIC highlights a number of challenges in controlling the trade, including: chain-of-custody, verification of origin and pre-CITES stocks. TRAFFIC argue that these require resolution at national or tri-national levels, regardless of CITES Appendix III listing. Amongst others, TRAFFIC has recommended: information exchange mechanisms between CITES Management Authorities and customs; data capture systems to enable cross-checking of production volumes as well as domestic and bilateral trade; and harmonised customs codes. In April 2004, the Government of Malaysia, Singapore and Indonesia committed to establishing a Tri-National Task Force in implementing some of these measures. Malaysia is now developing the Terms of Reference for the Task Force, and courses on Ramin identification for custom officers have been conducted, including those from Singapore.

Sources: TRAFFIC Briefing Document August 2004 “Ramin and the Thirteenth Meeting of the Conference of Parties to CITES” http://www.traffic.org/news/press-releases/Ramin_brief.pdf; Lim Teck

Win, Tonny Soeharto, and Chen Hin Keong 'Framing the Picture. An assessment of the Ramin trade in Indonesia, Malaysia and Singapore' TRAFFIC Southeast Asia http://www.traffic.org/news/press-releases/Ramin_report.pdf; EIA – Telapak How Malaysia Smuggles Endangered Wood <http://www.eia-international.org/files/reports67-1.pdf>

5.2.3 Measures to regulate timber imports

In response to evidence of illegal imports in around 2000, a number of additional measures have been taken to supplement standard procedures for customs clearance.

(i) Under an amendment to the Customs (Prohibition of Imports) Order 1998, imports of rounds logs as well as large scantling and squares (LSS) of 60 square inches and over, require the prior authorisation of the Malaysian Timber Industry Board (MTIB). Initially applicable only to normal ports of entry, the scope of this Prohibition Order has since been extended under Customs (Prohibition of Imports) (amendment) (No 4) Order 2006 to cover Free Trade Zones and transshipment areas.

(ii) MTIB/STIDC licensing of logs and LSS is subject to proof of *bona fide* source, as verified by the Malaysian embassy in the source country.

(iii) Imports of Indonesian logs and LSS have been banned as of 25 June 2002 and 1 June 2003 respectively, in line with a corresponding Indonesian export ban; MTIB and STIDC will not now issue an import license on these products. Initially an administrative measure, the ban has now been incorporated into the Customs Prohibition (Amendment) Order 2006 effective from 1 June, making it an offence to import Indonesian logs and LLS into Malaysia.

(iv) MTIB/SFC have also been appointed as the Management Authorities to issue CITES permits for Ramin logs, sawn timber derivatives, following the listing of Ramin on CITES Appendix II by Indonesia starting January 2005. Under the 2006 Prohibition Order MTIB will now only issue CITES import permits for Ramin based on export permits issued by the source country.

In fulfilling these duties, MTIB/STIDC conduct regular inspections/visits to ports and private jetties alongside Royal Malaysian Customs and Port Authorities. Procedures vary depending on the category of port or border crossings.⁴³ E.g. Imports into Barter Trade Centres also require only minimal customs documentation.⁴⁴

The Customs Prohibition Order does not apply to small-dimension timber from any source (including Indonesia). The STIDC has, however, begun to monitor and administer small-dimension timber imports under trans-border agreements with West Kalimantan Province in Indonesia. Measures have been taken to step up border controls with Indonesia, and to restrict the trans-boundary movement of timber to designated points of entry.

These measures are discussed in more detail in Section 6.5

⁴³ Pers. comm., MTIB, 30-03-06.

⁴⁴ Pers. comm., Chen Hing Keong, TRAFFIC, 29-03-06.

6. Institutional structures for legal verification of timber production and imports

6.1 Overview

As discussed in Section 5 of this report, Malaysia's systems for legal verification constitute complex, multi-agency structures, providing oversight of domestic production and timber imports. Existing systems straddle mandatory audits as well as audits under voluntary certification schemes. They have evolved incrementally and reflect a number of factors (amongst others):

- A strong interest in safeguarding Malaysia's presence in high-value markets, and related technical cooperation initiatives with ITTO, GTZ, Keurhout and FSC, has facilitated the introduction of standards-based management. The parallel introduction of ISO standards reflects a Prime Ministerial drive to improve administrative efficiency.
- An interest in maximising revenue generation amongst State governments and preventing illegal logging, as well as an interest in curbing excessive opening of forest areas for logging and over-harvesting by the States in the early 1990s.
- Scrutiny by international NGOs including TRAFFIC Southeast Asia and EIA – Telapak which has arguably led to the introduction of tighter controls on timber imports.

Composite verification systems have also evolved along different trajectories in the Peninsula, Sabah and Sarawak, depending on institutional arrangements for forest management in each of the three jurisdictions, as well as key differences in licensing systems, terms of licences and timber administration (see Section 3).

This section describes structures for legal verification as they have developed in each of these jurisdictions, and with respect to timber imports.

6.2 Peninsular Malaysia

Unlike Sabah and Sarawak, systems for monitoring and verification have been largely harmonised for the eight timber-producing States of Peninsular Malaysia (Johor, Kedah, Kelantan, Negeri Sembilan, Pahang, Perak, Selangor and Terengganu). All eight States have adopted the National Forestry Act 1984 as the basis for their forest management and administration systems.

In the Peninsula, each State qualifies as a single FMU with responsibility for the preparation and implementation of management plans, under which short-term cutting licenses are issued. As such, verification straddles:

- Monitoring of licensees by District Forest Officers (DFOs) reporting to State Forestry Departments.
- Mandatory audits of State FMUs by the Federal Forestry Department, against MC&I for SFM;
- Voluntary audits of State FMUs against MTCC and ISO standards.
- Voluntary audits of licensees against FSC standards, in the case of the Perak Integrated Timber Complex.

6.2.1 Monitoring and enforcement

Day-to-day monitoring of legal compliance by licensees is primarily the responsibility of District Forest Officers (DFOs), reporting to State Forestry Departments. The essential building blocks of current monitoring systems include:

- pre-harvest planning and licensing;
- tree-marking;
- administration of charges and Removal Passes (transport permits) on log consignments;
- monitoring of harvest practices and post-harvest inspections;
- mobile enforcement units; and,
- reporting and spot-checks by DFO and State Forestry Department.

Requirements for cutting and transport licensing, the collection of royalty and premium, post-harvest inspections, enforcement and penalty-setting are prescribed in the National Forestry Act 1984 (as amended 1993). Related administrative procedures (including standard documentation) are set out in guidelines established by Forestry Department Headquarters in Kuala Lumpur.⁴⁵

(i) Pre-harvest planning

In line with Section 4 of the National Forestry Act, State Governments are required to prepare State forest management plans, prescribing allowable cut in volume or area terms, in accordance with the principle of sustained yield on 30 – 55 year cutting cycles. The Annual Allowable Cut (AAC) for each State is agreed by the National Forestry Council on a five-yearly basis. This takes into account a ten-yearly National Forest Inventory as well as information submitted by the States to the Federal Forestry Department on the extent of production forests and standing timber stocks.

State governments currently formulate 10-year forest management plans, under which DFOs establish 5-year working plans and annual plans for harvesting and silvicultural operations. In planning harvesting operations in permanent reserved forests, DFOs are responsible for:

- Identifying and demarcating compartment and sub-compartment boundaries for licensing.
- 10% pre-harvest inventory based on systematic line-plot sampling to determine standing timber stocks and appropriate cutting limits.

Typically, a cutting license is issued for an individual compartment or sub-compartment for a duration of 12 months. All harvest licenses of more than 500ha require an Environmental Impact Assessment. Before licensing can take place by the State Director of Forestry, license holders are required to prepare a comprehensive harvest plan, including proposed road alignment. License holders are also responsible for boundary surveys, which are then verified by the District Forest Office (DFO).

⁴⁵ Manual Perhutanan, Jilid II

The DFO itself will mark and tag 100% of harvest trees, as well as seed and other protection trees, using individually numbered plastic tree tags. Portioned tree tags are provided for the stump, and for up to five log sections depending on the size of the tree.⁴⁶ Tagging data is then compiled into a register, which is maintained at checking stations just outside the logging area. The tagging process facilitates control of cutting and volume limits, determination of buffer zones along watercourses, as well as planning of felling direction and road alignment. Individually numbered tree tags are essential in securing chain-of-custody.

(ii) Timber administration

The unique identity number given to each tree constitutes the basis for what is still a paper-based timber administration system. This tracks the movement of logs from stump to the first point of processing where logs are broken down. Upon felling, license holders are required to nail tags to stumps and their corresponding logs, to complete daily 'tree felling control forms', as well as to mark each log with a 'classification mark' denoting origin/source. Removal Passes are issued by the Forest Ranger in charge of the licensed area⁴⁷ at check stations ('stumping points') exiting the forest. Each checking station maintains a record book of pre-tagged harvest trees, including their unique number, and the number of predicted log sections from each. The forest ranger will check each log against the tag number and classification mark, and will scale each log to assess royalty⁴⁸ and forest development cess.⁴⁹ Subject to adequate pre-payment by deposit the forest ranger will hammer mark each log and issue an individually numbered Removal Pass for each consignment. This will list the license, hammer mark, log numbers, species, dimensions, total royalty and cess paid, as well as log destination and lorry information. Data from checking stations is compiled into 2 – weekly and monthly reports by the Head Ranger for submission to the District Forest Officer.

Mills are required to maintain a daily record of logs received against each Removal Pass. Forest rangers will inspect mill log yards and log books on a monthly basis to verify receipt of logs, whereupon Removal Passes are cancelled. This ensures that each consignment has been accounted for at the registered destination. To ensure consignments reach their declared destinations, State Forestry Departments will issue Exchange Removal Passes both at random road blocks, as well as when consignments cross into another State. The original Removal Pass is then sent back to the issuing District Forest Office as a means to monitor log movements. The receiving State will not, however, seek to verify the validity of a Removal Pass issued by another State unless there are grounds for suspicion.⁵⁰

In addition, mills are required to record when each log has been broken down, and the volume produced. This is an administrative requirement of the State Forestry Department; although reported throughput and recovery rates are not verified by forest rangers. This information is submitted to the DFO, State and Federal Forestry Departments (Shuttle 4), and enters national production statistics (amongst others on the efficiency and recovery rate of processing facilities).

⁴⁶ 4 seed trees per hectare, as well as trees to be cleared for road construction are also tagged.

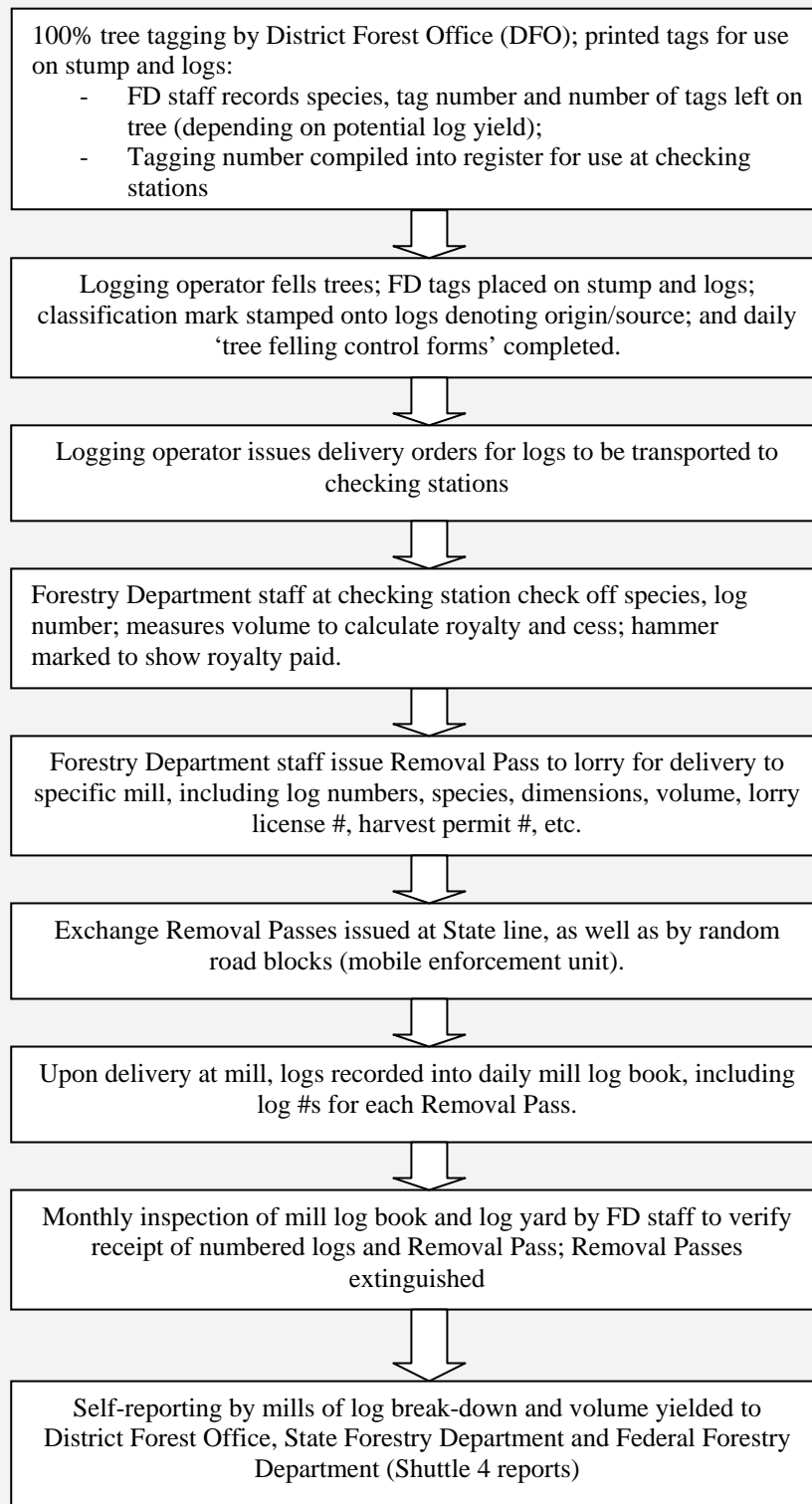
⁴⁷ Cutting licenses are issued by compartment or sub-compartment.

⁴⁸ At rates set down in the *Gazette* published by the State Authority (Section 61 National Forestry Act).

⁴⁹ Under Chapter 8 of the National Forestry Act 1984, States are required to establish a Forest Development Fund for the purposes of preparing and implementing forest management and reforestation plans. In addition to royalty, license holders are required to pay a forest development cess on any forest product removed from permanent reserved forest, or State, alienated and reserved land.

⁵⁰ Pers. comm.. Enforcement Unit, Federal Forestry Department, 20-09-05.

Figure 2: Timber administration in Permanent Reserved Forests in Peninsular Malaysia



Source: GFS, *Review of Programmes on Traceability of Timber Material*, Draft Report for the Workplan Legality, Asia Forest Partnership, p. 8; pers. comm., District Forest Office, Rawang, Selangor, 20-09-05; pers. comm., Enforcement Unit, Federal Forestry Department, 20-09-05

(iii) Monitoring of harvest practices and post-harvest inspections

Forest rangers in charge of each licensed area will conduct monthly inspections during harvesting to ensure that boundaries, buffer zones and cutting limits are respected. Data is entered into 'Forest Harvesting Control and Monitoring Forms'. Along with data from checking stations, this will be compiled in the form of 'Monthly Forest Harvesting Progress Reports, by the Head Ranger for submission to the District Forest Officer.

Post harvest inspections are conducted to assess damage to residuals and royalty on short logs and tops (within 6 months of felling), followed by a post-felling forest inventory (10% sampling intensity) using systematic-line-plots to determine residual stocking and appropriate silvicultural treatments.

(iv) Mobile enforcement units

In addition to routine timber administration and harvest monitoring, District Forest Offices may deploy Special Units for regular inspection of compartment boundaries, as well as twice-monthly road blocks and inspection of mill log yards. Assuming a timber consignment tallies with a Removal Pass, forest rangers stationed at road blocks will typically issue an Exchange Removal Pass to facilitate monitoring of log movements. Special Units may also be deployed in response to information regarding illegal logging or log transport, including reports by public informants under a reward system. Assistance from the police and the armed forces may be sought if needed, especially in conducting road blocks.

(iv) Public informants

The role of public informants in supporting enforcement has been enhanced by increased media attention to environmental degradation, as well as the introduction of a system for 'e-complaints'. In 2005, the Forestry Department received up to 170 reports of alleged illegalities from members of the public, 80 of which proved to be substantive. Rewards are paid commensurate with the fine issued, or quantity of timber seized.⁵¹

(v) Reporting and spot-checks by DFO, State Forestry Department

District Forest Officers will receive check point data every 15 days, as well as 'Monthly Forest Harvesting Progress Reports' submitted by Forest Rangers. Subject to spot-checks by the DFO, this information will be compiled into monthly reports to the State Forestry Department. The State Forestry Department may conduct spot-checks of operations though typically only when there is specific cause for concern. A 100% check is sometimes conducted if it is deemed necessary.

6.2.2 Mandatory audits of State FMUs

Building on its programme of collaboration with Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ) on Sustainable Forest Management and Conservation in Peninsular Malaysia, the Federal Forestry Department has introduced mandatory annual audits of SFM compliance by individual State Forest Management Units in the Peninsula. This was made possible by:

⁵¹ Pers. comm.. Enforcement Unit, Forestry Department Peninsular Malaysia 30-03-06.

- the development of a set of internal assessment procedures for monitoring, assessing and reporting performance based on the MC&I for SFM, with the support of GTZ in 1999;
- harmonisation of Peninsular State forestry law under the 1984 National Forestry Act;
- the fact that professional and sub-professional foresters within the State Forestry Departments in the Peninsula are effectively Federal officers on secondment, falling under the line management of the Federal Director-General of Forestry.

Annual audits are conducted by an “Internal Auditor Team” within the Federal Forestry Department against 53 Indicators, 162 Activities and 142 Standards of Performance,⁵² using MTCC assessment procedures. The audit spans both examination of documentation such as routine monthly reports as well as field-based spot-checks of management practices in selected forest areas. The procedure includes evaluation of steps taken by State FMU to tackle Corrective Action Requests identified under MTCC assessments for forest certification. As such, mandatory audits by the Federal Forestry Department complement voluntary audits against MTCC standards. Together they constitute an important check on individual State’s performance.

State Forest Departments are also subject to routine financial audits by the Federal Accountant General but there are not described for the purposes of this report.

6.2.3 External audits of State FMUs under voluntary certification schemes

In addition to internal SFM audits by the Federal level, there are currently two complementary but unrelated voluntary audits relating to forest management and timber administration in the Peninsular States – Malaysian Timber Certification Council (MTCC) and ISO 9001:2000. The Perak Integrated Timber Complex is also audited against FSC standards but this is not addressed in this report.

(i) *Malaysian Timber Certification Council (MTCC)*

As described in Section 5.1.4, MTCC had certified 4.67 million ha of permanent reserved forest by end 2005 spanning all eight timber producing States in Peninsula, with each designated as a single FMU for purposes of MTCC certification. In 2006, it is envisaged that certification will be conducted using the newly developed Malaysian Criteria and Indicators, for Forest Management Certification (MC&I 2002). In addition, MTCC has established Assessment Procedures relating to Requirements for Chain-of-Custody (RCOC).

Assessments are conducted by registered organisations or companies, appointed by MTCC. To qualify, assessors must be technically competent, and not have a financial, business or other conflict of interest in the FMU or licensee under review. MTCC-appointed certification bodies include SIRIM QAS, SGS and Global Forest Systems (GFS). However, in an effort to secure mutual recognition from Pan-European Forest Certification (PEFC), MTCC is considering stepping back from issuing certificates and to instead act as a ‘guardian of the standard’. Under such a mechanism, MTCC’s current assessors would accredit as certification bodies with the Department of Standards, Malaysia. This would introduce greater institutional separation between: standard-setting, certification, accreditation and applicants. It is envisaged that this will be in place by end 2006.⁵³

⁵² Based on the ITTO Guidelines, Criteria & Indicators for Sustainable Forest Management.

⁵³ Pers. comm., MTCC, 30 March 2006.

- *MTCC Forest Management Certification*

MTCC audits of State FMUs are conducted against 29 Indicators, 87 Activities and 49 Standards of Performance.⁵⁴ FMUs audits have so far been conducted annually. Assessment procedures span documentary reviews (including government monitoring reports), as well as interviews and random field-based spot checks of forest management outcomes. Peer review by independent experts is also invited for first main assessments of FMUs.

- *MTCC Chain-of-Custody Certification*

Individual timber processors and exporters may apply for MTCC Chain-of-Custody Certification. Operators typically define the scope of the assessment in terms of the timber products to be certified. MTCC Requirements for Chain-of-Custody Certification relate to (amongst others):

- *Purchasing*, including: signed self-declarations from suppliers that wood-based raw material has not been obtained from controversial sources (e.g. unknown origin, sourced through illegal or unauthorised harvesting and trading, GMOs, HCVPs, sourced in clear violation of traditional, customary or civil rights, or from areas of ongoing dispute with indigenous peoples and other local stakeholders).
- *Processing* of certified materials, including: an assurance that raw materials are from Permanent Reserved Forests certified by MTCC or an equivalent (operators must keep and maintain records of all Removal Passes to determine origin); physical separation (use of tags, colour-coding or unique identification numbers/makers); minimum average percentage certified content (70%); and input/output systems (verifiable information on the proportion of certified/uncertified material used in any given batch).
- *Monthly record-keeping* of suppliers, purchases, inputs, processing and outputs of certified products.

The initial assessment process includes:

- A review of all records and reconciliation of findings, including spot checks of products on the ground.
- Inspection of mechanisms for segregation of certified wood products.
- Reconciliation of documented procedures with actual practices.

CoC Certification is typically valid for five years, subject to annual surveillance visits. Surveillance visits focus on areas of non-compliance identified in the Assessment Report or previous surveillance report (where applicable), as well as on stakeholder complaints and changes to systems since the previous visit.⁵⁵

CoC Certification does not, however, extend to logging contractors responsible for timber extraction and transportation from stump to first point of processing. Instead MTCC relies on the administration of Removal Passes by State Forest Administrations. As a guarantee on

⁵⁴ This compares to 53 indicators, 162 activities and 142 standards of performance as used by Federal Audits of SFM. The decision to begin with a smaller range of key indicators and standards of performance reflects MTCC's decision to phase adoption of SFM standards under the Keurhout Hallmark System. Phase I of this scheme will be superseded by MC&I 2002 in late 2006 which follows the FSC template. Pers. comm.. Thang Hooi Chiew, 28 March 2006.

⁵⁵ MTCC Requirements for Chain-of-Custody Certification, 13 January 2005.

the integrity of the Removal Pass system, the MTCC Requirements for Chain-of-Custody now require random visits by assessors to Forestry Department checking stations to confirm that Removal Passes received by MTCC-certified primary processing mills (i.e. sawmills or plywood mills) have been issued by the checking stations in question and that the details match.⁵⁶

(ii) ISO 9002 (1994) Quality Control for “Sustainable Timber Extraction from Natural Forest in the PFE”

As described in Section 5.1.4, the Federal Forestry Department has introduced ISO management systems standards to ensure conformity with administrative procedures for “Sustainable Timber Production from Inland Natural Forests in Permanent Reserved Forests”. Initially designated under ISO 9001: 1994 these have since been upgraded in conformity with ISO9001:2000. These now apply to all eight timber-producing States in the Peninsula.

The assessment procedure as established by the Federal Forestry Department is purely output based, focusing on completion of forms and other documentation related to the seven activities covered by the process. These provide the basis for Selective Management Systems as applied to natural forests in Peninsular Malaysia:

- establishing and monitoring the annual allowable cut;
- demarcation and authorisation of areas for harvesting;
- pre-harvest inventories and determination of cutting limits;
- tree marking;
- harvesting;
- post-harvest inventories and determination of silvicultural treatment; and
- silvicultural treatment.

Audits of compliance by State Forestry Departments against designated procedures are conducted annually by SIRIM QAS. However, not every DFO in each State will be covered in any one year.

6.2.4 Key strengths

In the case of the Peninsula, there is potentially strong complementary between mandatory and voluntary audits:

- Voluntary (MTCC) and mandatory (Federal Forestry Department) audits of SFM are mutually supportive, given the use of common indicators and Standards of Performance. Amongst others, Federal SFM audits provide a means to follow-up on and secure closure on Corrective Action Requests (CARs) identified by MTCC assessors.
- MTCC Requirements for Chain-of-Custody Certification provide critical oversight of mill processing, where mandatory systems otherwise rely on self-reporting of throughput and recovery rates by mill operators.
- Whereas MTCC and Federal audits look to SFM outcomes, audits against ISO9001:2000 Standards of Performance ensure consistency and transparency in

⁵⁶ MTCC, comments on draft report, 30-03-06.

administrative procedures, including internal monitoring and reporting by State Forestry Departments.

Other strengths of the system include:

- 100% tagging of harvestable trees with unique serial numbers, enabling both traceability to stump as well as greater control of volumes and species extracted in line with the Annual Allowable Cut.⁵⁷
- Issuances of Removal Passes at checking stations (stumping points) and their cancellation at the mill yard. With the additional use of Mobile Enforcement Units (involving both forest rangers and the police), this largely works to prevent illicit movements of timber. In the absence of a computerised data base, issuances of Exchange Removal Passes at State boundaries and by random road blocks enable the District Forest Office responsible for authorising a consignment to ensure that it reaches its stated destination.
- Both the promise of rewards as well as the relative ease of submitting complaints has meant that public informants now play an important role in supporting enforcement efforts.

Finally, although the Federal Forestry Department has limited powers to penalise States for failure to meet Corrective Action Requests, individual States may be called to account by the National Forestry Council (albeit limited to moral suasion). Further, Staff of State Forestry Departments who fall under Federal line management may also be disciplined and States that fail to meet standards risk losing MTCC certification. Indeed, the Certificate for Forest Management issued to the Terengganu FMU was suspended for just under a year, from 1 November 2002, for failure to address major Corrective Active Requests.

6.2.5 Issues arising

UK and Danish procurement policies, as well as the Dutch Keurhout system, have now judged MTCC as sufficient for purposes of determining legality. This determination does not, however, look to the overall institutional architecture for delivery of forest monitoring and audit in the Peninsula. This includes the extent to which MTCC itself relies on existing administrative processes, as well as parallel mandatory and voluntary audits. One case in point is the administration of Removal Passes by the State Forestry Departments. While MTCC assessors will make random visits to checking stations to verify issuances of Removal Passes, the integrity of the Removal Pass system is also partly dependent on compliance by State Forestry Departments with ISO9001:2000 Quality Management Standards. The introduction of ISO9000 standards in theory facilitates assessment by MTCC by ensuring greater consistency and transparency in the implementation of administrative procedures.

A review of the institutional framework for monitoring and audit of the Peninsular forestry sector raises the following sets of issues:

(i) *Oversight of harvest practices*

- Whereas MTCC and Federal SFM audits are now conducted annually, it may be difficult for auditors to provide sufficient coverage of large FMUs such as the State of

⁵⁷ 100% tree tagging could be further enhanced by the introduction of tree location maps as part of comprehensive harvest planning, as a step towards Reduced Impact Logging.

Pahang (itself at over a million hectares of Permanent Reserved Forest) with respect to forest management practices and timber administration. Proposals to subdivide large States into smaller FMUs should be further examined as a means to enhance audit delivery.

- As a step towards enhancing oversight of harvest practices, as well as the movement of timber from stump to mill, it may be appropriate to introduce a system of “certificates of competence” for contractors.⁵⁸ Such a system was in fact proposed by the Ministry of Natural Resources and Environment to the National Forestry Council in 2002 and received broad support. The introduction of mobile training units by the Federal Forestry Department for chainsaw operators (amongst others) constitutes a step towards this. There is, however, still an insufficient pool of trainers to enable a complete switch to mandatory certification without further resourcing.

(ii) *Chain-of-custody*

- Whereas the Peninsula has already moved to adopting 100% tagging of harvestable trees with unique serial numbers, the administration of Removal Passes remains entirely paper-based. A shift to a centralised computer-based approach would:
 - a. facilitate tracking of individual consignments, including confirmation that Removal Passes are in fact cancelled off at their stated destinations (especially where timber may have crossed into another State).
 - b. address concerns over MTCC’s reliance on paper-based timber administration to track logs from stump to first point of processing.
 - c. complement a drive on continual improvement and computerisation of administrative systems, as promoted by the Malaysian Administrative Modernisation and Management Planning Unit (MAMPU) of the Prime Minister’s Office.
- The Central Point of Expertise in Timber (CPET) for UK procurement policy highlighted the 30% uncertified component permitted in MTCC Requirements on Chain-of-Custody (RCOC). While this mirrors FSC for purposes of sustainability, CPET considers that the 30% component should at least be of guaranteed legal origin.⁵⁹ There are two potential problems here. First, although Removal Passes may constitute proof of legality with respect to timber from State and alienated lands, MTCC, Federal SFM and ISO9001:2000 audits are restricted to the Permanent Reserved Forest. No equivalent mandatory or voluntary audits exist for timber extraction and administration with respect to neighbouring State and alienated lands undergoing conversion. Second, while Section 3.4 of MTCC’s Requirements on CoC provide that suppliers sign a self-declaration that non-certified raw material or products do not contain wood raw material from controversial sources, mechanisms are not yet in place to verify suppliers’ declarations with respect to timber imports.
- Forest rangers are not permanently stationed at mills, and current systems rely on self-reporting (in the form of Shuttle Report to State Forestry Departments) by mills to monitor throughput and recovery rates. While Shuttle reports may be examined by State Forestry Department for obvious inconsistencies, information provided by mills is not routinely verified by District Forest Officers. This constitutes a potential loophole for timber from controversial sources (domestic or imported) to enter the production chain

⁵⁸ Pers. comm. Bill Maynard, GFS, 27-03-06.

⁵⁹ Environmental Quality Act 1974 and the Protection of Wildlife Act 1972 (CPET, 2004 pp 55)

where the latter is not subject to MTCC Requirements for Chain-of-Custody Certification, especially if mill operators choose to under-declare recovery rates.

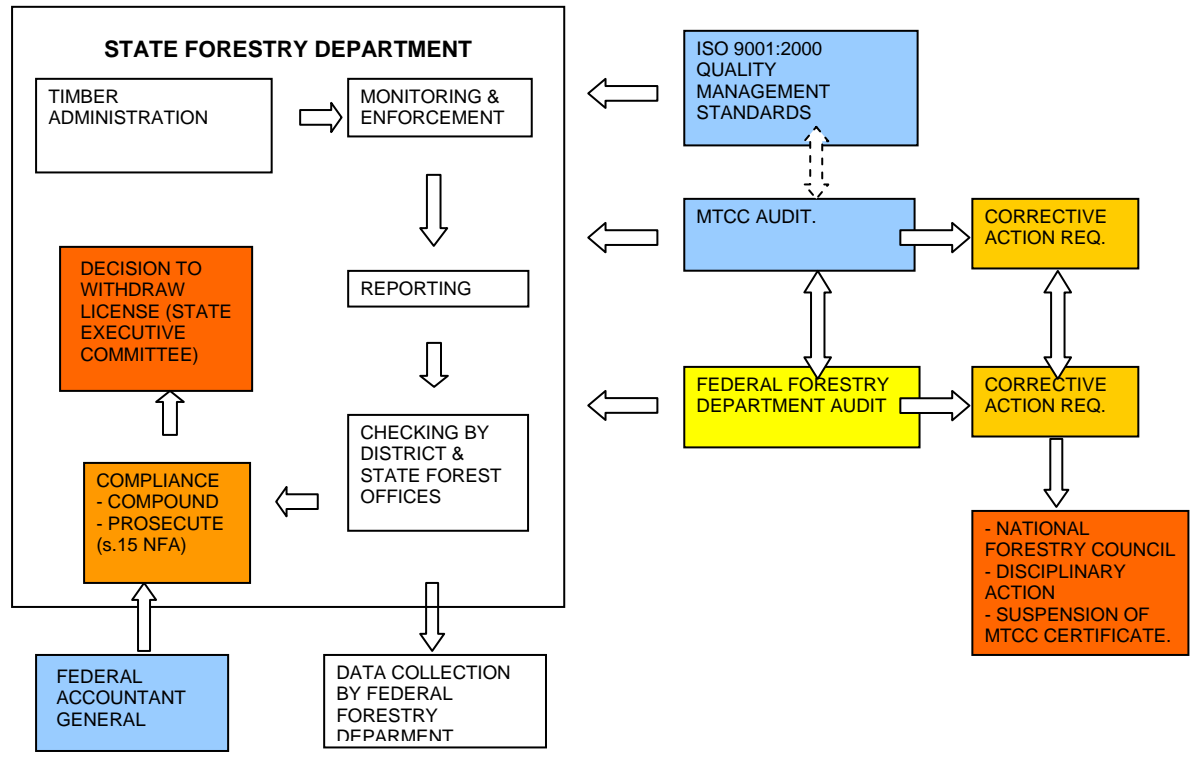
(iii) Independence

- Whereas MTCC does now operate on the basis of the interest generated from a separate endowment fund, it remains under the authority of the Federal Ministry of Plantation Industries and Commodities. Whether or not this does in fact constitute a conflict of interest, MTCC's perceived independence could be further enhanced by proposals to develop an accreditation system. Here, the 6 certification bodies currently registered with MTCC to conduct FMU audits (e.g. SGS, GFS) would need to register with the Department of Standards to enable them to issue MTCC certificates. MTCC would itself step back from this role, and instead focus on overseeing the standard.

(iv) Compliance

- The decision to withdraw licenses for severe infractions remains in the hands of the State Executive Committee (effectively the State cabinet). There are, however, currently no published guidelines on the criteria for license withdrawal. Nor are summaries of the State Executive's decision made public.

Figure 3 Forest Monitoring, Audit and Compliance in Peninsular Malaysia



6.3 Sabah

Under the Federal Constitution, as well as the Sabah Forest Enactment 1968 (amended 1992) and Forest Rules (1969), the State of Sabah has evolved a *sui generis* system for monitoring and verification of the forest sector. Measures for forest monitoring and timber administration are broadly similar to those in the Peninsula. However, with respect to the audit of forest management and administration, the State operates two separate systems:

- (i) *Mandatory audits of licensees*, specifically 100-year Sustainable Forest Management License Agreements (SFMLAs) introduced in 1997, each of which constitutes an individual Forest Management Unit. Audits of individual SFMLAs consist of:
 - Annual Compliance Audits by the State Forestry Department.
 - *Ad hoc* third-party audits where the outcomes of Annual Compliance Audits are in dispute.

- (ii) *Voluntary Audits of the State Forestry Department itself*, for:
 - Areas under its direct management, specifically the FSC-certified model concession at Deramakot.
 - Administrative procedures designated for audits against ISO quality management standards.

The fact that Sabah constitutes a separate legal jurisdiction with respect to forestry means that the Sabah Forestry Department is not itself subject to SFM audits by the Federal Forestry Department.

6.3.1 Monitoring and enforcement

As in the Peninsula, District Forest Officers are primarily responsible for monitoring legal compliance by licensees on a day-to-day basis, reporting to the State Forestry Department.

The essential building blocks consist of:

- Preparation of Comprehensive Harvesting Plan;
- Administration of charges and Removal Passes for movement of log consignments from forest to mill.
- Mobile units/ check points, in some cases responding to public informants
- Monitoring the performance of license-holders against Annual Work Plans and terms of SFMLAs (drawing on quarterly, annual compliance and DFO reports).
- Compilation of data based on DFO reports by the State Forestry Department.
- Evaluation of data under annual compliance audits of SMFLAs by the Sabah Forestry Department (General Procedure for SFM Auditing), including use of *ad hoc* third-party auditors.

To enable traceability to stump, the Sabah Forestry Department is currently developing measures for computerised log tracking incorporating bar-coded tags, Timber Disposal Permits and Removal Passes.⁶⁰

⁶⁰ Pers. comm.. Sabah Forestry Department, 22-09-05,

(i) Pre-harvest planning

In line with Art. 28A of the Sabah Forest Enactment 1968 (amended 1992), holders of 100-year Sustainable Forest Management License Agreements (SFMLAs) are required to prepare 10-year forest management plans to be approved by the Sabah Forestry Department. SFMLA license holders are also required to develop Annual Work Plans incorporating stock inventories of harvestable trees permitted under license conditions (over 60 cm diameter at breast height), boundary demarcation, road alignment as well as Environmental Impact Assessments for harvest areas of 500ha or more, based on guidelines issued by the Sabah Department of Environment and Conservation. Comprehensive Harvesting Plans are also required for individual logging compartments. These contain tree harvest lists, areas for production and conservation, tree location maps, and related road access.

Within the framework of SFMLAs, the Sabah Forestry Department will issue harvest licenses for a duration not exceeding five years according to Art. 24(3) of the Sabah Forest Enactment 1968 (amended 1992). This is subject to approval of Annual Work Plans and Comprehensive Harvesting Plans. While the Forestry Department is considering introducing 100% computerised tree tagging, it currently relies on tree harvest lists and maps as provided by SFMLA license holders, to enable control of cutting and volume limits. Stock inventories prepared by license holders are verified by Forest District Officers before approval of plans.

(ii) Timber administration

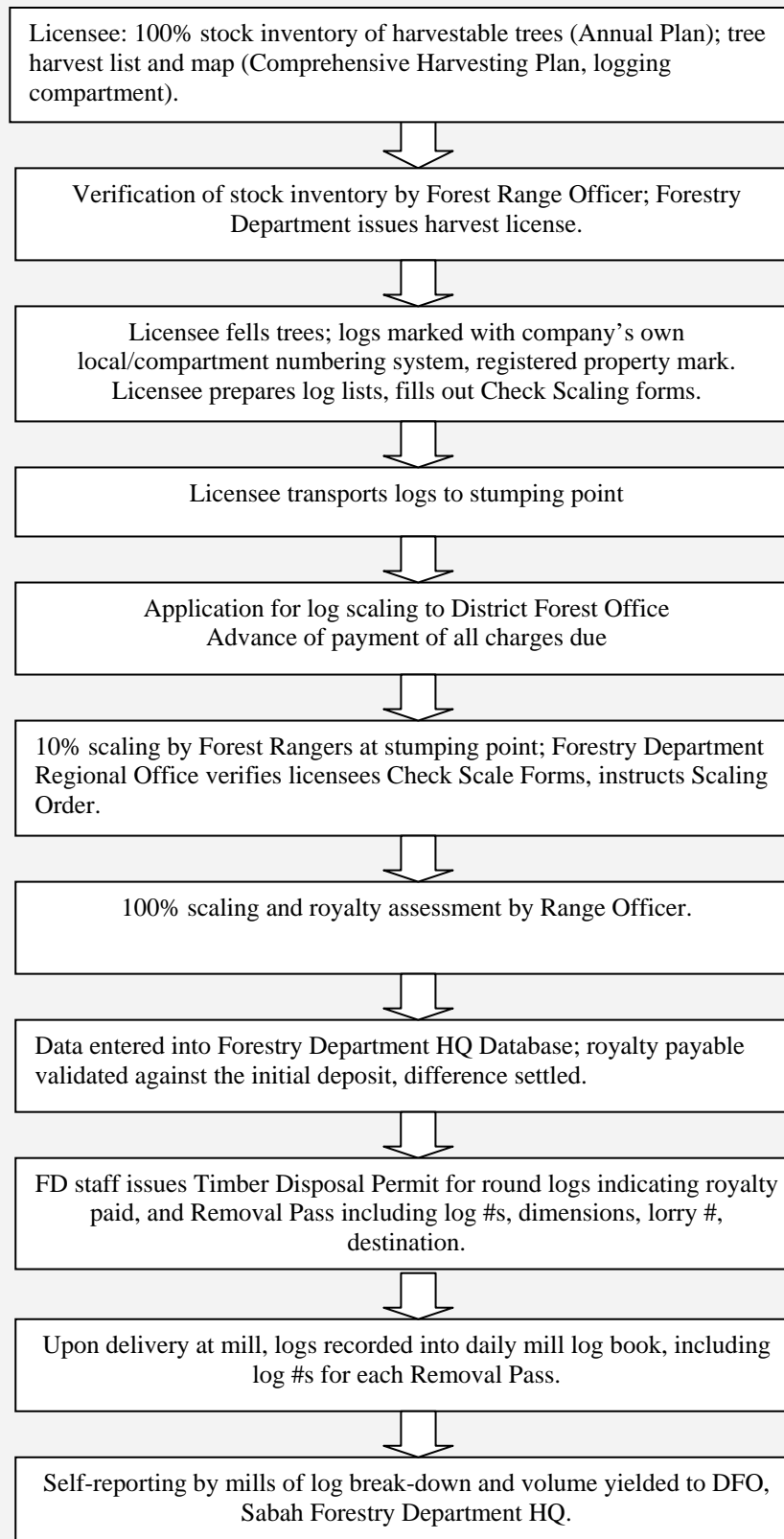
Timber administration in Sabah consists of three main steps: log identification by licensees, scaling and settlement of royalty payments; and administration of Removal Passes (see also fig. 4).

In the absence of 100% tree tagging, the Sabah Forestry Department relies on license holders' own systems for log and compartment numbering for purposes of log identification. Log and compartment numbers are painted or carved on to logs by license holders at landing points within each compartment. License holders will hammer mark logs with a registered property mark. License holders will also prepare log lists and fill out check scaling forms. These are inspected by the Forest Ranger, who will then apply the Sabah Forestry Department hammer mark. This indicates that a log has been inspected prior to royalty collection. Logs are then delivered to a stumping point within the coupe.

For purposes of royalty payment, license holders will apply for log scaling to the District Forest Officer, accompanied by advance payment of all charges due. Payments include royalty, premium, Forest Management and Development Charge, Forest Rehabilitation Fee, plus 5% for domestic logs and 10% for export logs. Forest Rangers at the stumping point will scale approximately 10% of logs and the application is passed to the Forestry Department Regional Office. The Regional Office will verify licensees' Check Scale Forms against species and girth restrictions, and will then instruct 100% scaling upon receipt of advance payment for all charges due (Scaling Order). Sabah Forestry Department Headquarters will enter scaling data into a central database and the royalty payable is validated against the advance paid. Any refunds or extra payments are calculated, and logs hammer marked with the Forestry Department Royalty Mark to indicate that payments have been settled.⁶¹

⁶¹ Source: GFS, *Review of Programmes on Traceability of Timber Material*, Draft Report for the Workplan Legality, Asia Forest Partnership, p. 12; Sabah Forestry Department, presentation given on 22-09-05.

Figure 4: Timber administration for SFMLAs in Sabah



Source: GFS, *Review of Programmes on Traceability of Timber Material*, Draft Report for the Workplan Legality, Asia Forest Partnership, p. 12; pers. comm., Sabah Forestry Department, 22-09-05.

Following confirmation of check scale volumes and prepayment of royalties to the Forestry Department, the District Forest Officer will issue a Timber Disposal Permit allowing transport to the buyer, as well as a Removal Pass for each consignment. The Removal Pass contains log numbers and dimensions, log destination as well as lorry information. Unlike Peninsular Malaysia, the Sabah Forestry Department permanently stations Receiving Forest Rangers at mills to record, verify and cancel off Removal Passes for each log consignment. However, mills will then self-report break-down of logs and volumes yielded to Sabah Forestry Department Headquarters.⁶²

(iii) Harvest monitoring

The introduction of 100-year licenses places the onus on managed compliance with the State laws and terms of SFMLAs by license holders. Withdrawal of licenses can only take place in very exceptional circumstances of non-performance. As such, District Forest Officers (DFOs) are responsible for both field-based monitoring and control (with a focus on prevention) as well as providing technical advice and support to license holders, working with licensees as a long-term partner in progressing towards SFM. Specifically, DFOs will:

- Assist SFMLA license holders in the development of Annual Work Plans for submission to the Forestry Department Director. These include details of proposed working areas, timber harvesting, silvicultural treatment and enrichment planting, as well as projected manpower and budgets.
- Assist licensees in the preparation of Quarterly Progress Reports, for submission to the Director of Forests. Licensees' are required to prepare pre-formatted reports on employment, planting, silvicultural treatment, log production and equipment records.
- Ground-truth licensees' Annual Compliance Reports as an input to compliance audits by Forestry Department Headquarters. Compliance Reports are submitted to the Forestry Department Director on 1st December each year, specifying: (i) fulfilment of rights and responsibilities specified in the SFMLA; (ii) fulfilment of SFM standards; and (iii) performance against the licensee's Annual Work Plan.⁶³

DFOs will also monitor licensees' performance against key operational areas of the SFMLA, including:

- Demarcation and surveillance of outer boundaries - the DFO will assist the SFMLA holder in the even of boundary disputes with local communities (Clause 4).
- Forest conservation, including establishment and monitoring of conservation coups (Clauses 43, 45, 49).
- Ongoing inspection of timber harvesting to ensure compliance with restrictions on slope, buffer zones, diameter, species and yarding; requirements for tree marking and royalty payments; as well as with Reduced Impact Logging Standards (Clauses 61-68 and 104-105).

⁶² Pers. comm. DFO Sandakan, Sabah Forestry Department, 24-09-05.

⁶³ Sabah Forestry Department, *SFMLA Coaching 2003*, presentation given on 22-09-05.

- Plantation development including demarcation of plantation boundaries; and control of forest conversion including burning and retention of natural forest bands (Clauses 80, 85, 86, 89 and 90).
- Silvicultural treatment and rehabilitation as specified in licensees Annual Work Plan and in line with targets in the Forest Management Plan (Clauses 76 & 77).
- Forest protection, including protection from illegal logging, poaching, encroachment and fire, protection of riparian areas as well as Environmental Impact Assessments (Clauses, 17, 18, 19 and 71).
- Community forestry, including employment and training, as well as community development (Clauses 24 – 27).⁶⁴

(iv) Enforcement

The Sabah Forestry Department established a new Enforcement and Investigation Division in August 2002 in order to enforce the Sabah Forest Enactment 1968 and Forest Rules 1969, and to investigate reports of potential offences. The Division works in collaboration with the Anti Illegal Logging Unit of the Chief Minister's Office, as well as with the police and armed forces. Through provision of in-house training in investigation, as well as monitoring, control and enforcement by Operational units and DFOs, the Division's work has led to a dramatic increase in convictions for illegal logging (194 in 2004 compared to 12 in 2001).⁶⁵

6.3.2 Mandatory audits of licensed operations

(i) Audits by the Sabah Forest Department

With a focus on managed compliance by 100-year SFMLAs, the Sabah State Forestry Department has instituted a General Procedure for SFM audit similar to audits under voluntary SFM certification schemes. This combines identification of and technical support in addressing corrective actions. Within the framework of the 125 clauses of the standard SFMLA (framed around the 10 FSC Principles), the General Procedure for SFM Audit has the specific intention of both performance control as well as supporting licensees into certification processes.

The General Procedure for SFM auditing is implemented by a designated audit team within the Sabah Forestry Department. The procedure builds on monitoring and reporting systems including preparation and submission of Annual Work Plans and Quarterly Progress Reports, as well as ground-truthing by DFOs of Annual Compliance Reports by SFMLA holders.

The procedure, summarised in Fig. 5, consists of the following key steps:

- The audit team will undertake a preliminary review of licensees' Annual Compliance Reports, DFO's assessments of performance, as well as other sources of information such as harvest permits and quarterly records. The purpose is to identify areas requiring further investigation and to plan additional evidence collection.

⁶⁴ Sabah Forestry Department, *SFMLA Coaching 2003*, presentation given on 22-09-05.

⁶⁵ Sabah Forestry Department Annual report 2004, p. 90.

- Based on the preliminary review, the Forestry Department audit team will undertake a detailed review of documentation, consultations with SFMLA staff and contractors, as well as field checks.
- The audit team will then assess consistency of DFO and licensee reports with the team's own investigations. Where necessary, additional evidence may be collected, including documentation, interviews and further field checks.
- This will enable an assessment of compliance against specifications in the SFMLA contract and the licensee's Annual Work Plan, as well as identification of Corrective Action Requests and areas requiring improvement.⁶⁶

Based on these steps, the audit team will report an overall assessment of sustainability to the Sabah Forestry Department Director. The Forestry Department Director may either issue a Compliance Certificate (subject to Corrective Action Requests)⁶⁷ or, where licensees have consistently failed to meet the terms of the SFMLA, may submit a recommendation for suspension to the State Executive Committee. The decision to withdraw or uphold a license rests with the Executive Committee, including the Chief Minister and the State Attorney General. Audit reports are not made available to the public, unless there is a specific request for access. In the absence of established guidelines on confidentiality of the audit process, the Sabah Forestry Department will make its own determination as to the merit of individual requests for access.⁶⁸ The focus on managed compliance (including capacity building of license holders to "close the gap on legality"), means that license withdrawal has only taken place in exceptional cases. Since 1997, two licences have been withdrawn for non-performance, and another case remains pending. In a fourth case, the license was upheld, following the use of 3rd-party independent auditors (see below).⁶⁹

(ii) Ad hoc third-party audits of licensed operations

SFMLA holders are not currently subject to voluntary certification schemes. Nevertheless, the Sabah Forestry Department has resorted to third-party independent auditors selected by competitive bidding to complement its own General Procedure for SFM Audit. This took place in one instance where significant inconsistencies had been identified between a licensee's Compliance Report and the assessment of the DFO. The 3rd party auditor undertook its own assessment of compliance with the terms of the SFMLA. Based on this, the Sabah Forestry Department judged the DFO's report to be problematic and the license was upheld. Nevertheless, the use of a 3rd party auditor also reflects pressure from industry to introduce greater transparency into the audit and verification decision process. While no procedure has yet been established on when resort to third-party auditors may be permitted, the Sabah Forestry Department do see this as a learning process with a view to improving the General Procedure for SFM audit over time.⁷⁰

⁶⁶ Pers. comm. Audit Division, Sabah Forestry Department, 23-09-05; *SFMLA Coaching 2003*, presentation given on 22-09-05.

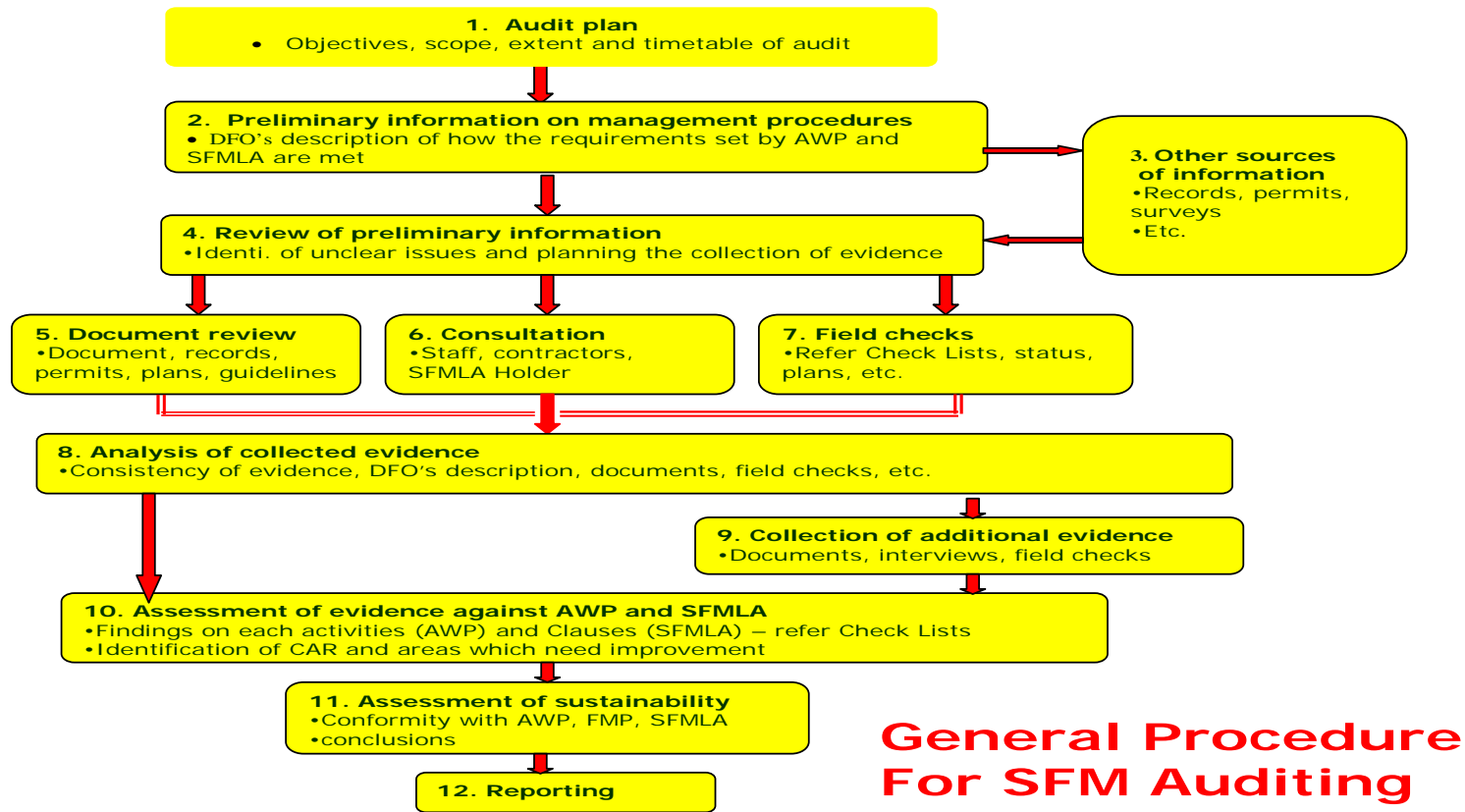
⁶⁷ A compliance certification may be issued if work has been completed and complies with specifications in the Forest Management Plan, Annual Work Plan as well as Comprehensive Harvest Plan (including standards for Reduced Impact Logging).

⁶⁸ Pers. Comm. Audit Division, Sabah Forestry Department, 23-09-05.

⁶⁹ Ibid.

⁷⁰ Ibid.

Figure 5. General Procedure for SFM Auditing



Source: Audit Division, Sabah Forestry Department, 23-09-05.

6.3.3 Audits of the Sabah Forestry Department under voluntary certification schemes

Sabah constitutes a separate jurisdiction with respect to land and natural resources. Nor are staff of the Sabah Forestry Department under the line management of the Federal Forestry Department. Sabah is not subject to SFM audits by the Federal level and the Forest Department reports entirely to the Chief Minister. It is, however, subject to oversight in two key areas: the introduction of ISO9002:1994 Quality Management Standards, to designated administrative procedures, as well as monitoring and audit of the FSC-certified model concession at Deramakot under the direct management of the Forestry Department. The Forest Department is also subject to routine financial audits by the Federal Accountant General but these are not described for the purposes of this report.

(i) ISO 9001:2000 Quality Management Standards

To date, the Sabah Forestry Department has designated a handful of processes for assessment against ISO9001:2000 standards of performance. As in the Peninsula, this reflects a drive on administrative efficiency under the Malaysian Administrative Modernisation and Management Planning Unit (MAMPU) of the Prime Minister's Office. However, the scope of application of ISO9000 Quality Management Standards is less comprehensive than that in the Peninsula. With respect to monitoring and audit, the Sabah Forestry Department has so far designated procedures for royalty collection and preparation of Comprehensive Harvesting Plans, but has not yet included the General Procedure for SFM auditing.⁷¹

(ii) The Deramakot model concession

The 55,000ha FSC-certified Deramakot concession is the result of a 10-year collaboration under the Malaysian-German Sustainable Forest Management Project, between the Sabah Government and Deutsche Gesellschaft fur Technische Zusammenarbeit (GTZ). Now under the direct management of the Sabah Forestry Department, the Deramakot concession is intended to provide a model for long-term SFMLA licensees to progress towards FSC-certified status. However, as a concession under State management, monitoring and audit systems differ from those applied to SFMLAs.

At Deramakot, the Sabah Forestry Department has introduced 100% harvest tree mapping to enable traceability to stump, not merely to individual compartments. This is done on the basis of road and skid track alignment to limit damage to residual stands. In an effort to progress SFMLAs towards certification, as well as to enhance royalty capture, the Forestry Department plans to extend tagging to all license holders under a computerised system. The key difference between Deramakot and SFMLAs lies, however, in the auction system. Following grading and sorting according to species, preparation of a log list, and marking with a Compartment Hammer Mark, timber is then sorted into lots and sold by public auction at the stumping point. A Form IIB license to collect and remove auctioned timber, as well as Royalty Hammer Marks for local and export consumption, are issued following

⁷¹ Pers. Comm. Audit Division, Sabah Forestry Department, 23-09-05; Sabah Forestry Department Annual Report 1994, p. 35.

payment in full by the successful bidder. Removal Passes are then issued for transport of individual consignments by the buyer. The process is summarised in Fig 6.⁷²

The auction has enabled the Sabah Forestry Department to secure a 43% premium on certified timber and underpins the economic viability of the Deramakot model concession. Public roundtable auctions are announced at least 2 weeks in advance on the SFD web www.deramakot.sabah.gov.my and in local newspapers. Announcements include details of approximate volume and species available, as well as the upset prices of each lot. Bidders are required to pay a registration fee of RM50 to the Sandakan Regional Accounts Unit of the Forestry Department, as well as a deposit of RM10,000. The balance due, consisting of the bid price + royalty + community forestry cess (set at 0.83RM/m³) has to be paid within one month for international bidders and within two weeks for local bidders failing which the deposit paid will be forfeited. The deposit is returned to unsuccessful bidders. Observers are allowed to attend the auction.⁷³

Being under the direct management of the Sabah Forestry Department, Deramakot is not subject to the General Procedure for SFM Audits. As an FSC-certified concession, forest management practices at Deramakot are instead audited annually by an accredited 3rd party auditor, Global Forest Systems (GFS), including the identification of corrective actions and areas requiring improvement.

So far, Deramakot is the only concession in Sabah currently subject to audits under voluntary certification schemes. This, however, is likely to expand for two reasons:

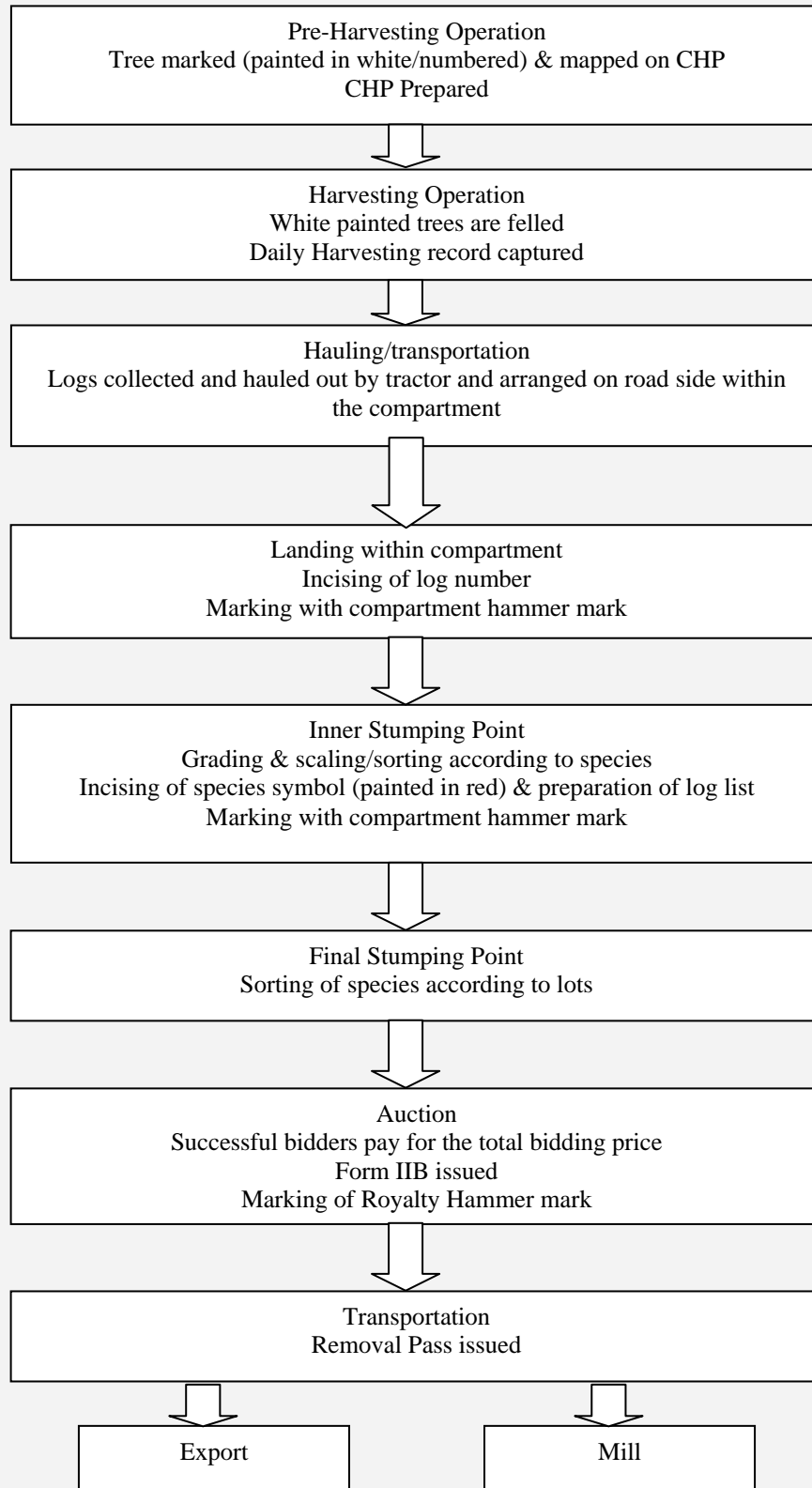
- First, as the Deramakot experience demonstrates the viability of certification, a number of SFMLA holders are beginning to express interest in entering into certification processes.⁷⁴ In these cases, audits under voluntary certification schemes will provide an important complement to the Sabah Forestry Department's General Procedure for SFM Audit, not least in guaranteeing transparency and integrity.
- Second, further SFMLA licenses may be withdrawn for non-performance given the exceptionally long period of investment envisaged. There is a possibility these FMUs will fall back under the direct management of the Sabah Forestry Department and (like Deramakot) progressed to certified status.

⁷² Sabah Forestry Department, *Current log movement/monitoring for logs from forest reserve (Deramakot)*, presentation given on 22-09-05.

⁷³ Sabah Forestry Department, *Log Auction and Chain-of-Custody with reference to Deramakot*, presentation given on 22-09-05.

⁷⁴ Pers Comm, MJ Steel, 24-09-05.

Fig. 6 Timber administration at the Deramakot Concession



Source: Sabah Forestry Department, *Current log movement/monitoring for logs from forest reserve (Deramakot)*, presentation given on 22-09-05.

6.3.4 Strengths of the system

Like the Peninsula, Sabah has developed a composite forest verification system, spanning both mandatory and voluntary audits of licensees and the State Forest Administration. As with Federal and MTCC SFM audits in the Peninsula, the emphasis here is largely on managed compliance (i.e. identification of corrective actions, and building capacity of forest managers to “close the gap on legality”).

A key strength in Sabah’s monitoring and verification systems is a commitment to continual improvement, including the planned introduction of 100% tree tagging under a computerised system to enable traceability to stump (where timber administration currently relies on Comprehensive Harvesting Plans and companies’ own harvest systems). This would provide greater control over volume and species cut, as well as implementation of Reduced Impact Logging standards.

Another particular strength is the use of permanently stationed Receiving Forest Rangers at mills to cancel off Removal Passes on incoming consignments, with the potential to verify the origin of all incoming timber (domestic and imported).

Furthermore, in the same way as MTCC and Federal Forestry Department audits of SFM in the Peninsula work to common standards, Sabah’s General Procedure for SFM Audits of SFMLAs build on the 10 FSC principles. While SFMLAs have yet to enter into certification processes progressing towards FSC, the potential exists for mutually supportive mandatory and voluntary audits in securing compliance by license holders.

6.3.5 Issues arising

With mandatory audits focusing on licensees (SFMLAs), the Sabah Forestry Department has much greater power to penalise forest managers compared to Federal SFM audits of individual States in the Peninsula.

That said, audits of performance against voluntary SFM and ISO Quality Management Standards currently play less of a role than in the Peninsula. Deramakot remains the only (FSC) certified concession in the State. Only components of the timber administration systems have been designated for assessment against ISO standards. Furthermore, so long as a computerised system of 100% tree tagging is not in place, the link between timber administration and harvest control is potentially weaker than in the Peninsula.

An assessment of whether current systems in Sabah do constitute a guarantee on compliance requires a comprehensive review of the existing institutional architecture for forest monitoring and verification. This includes looking at both horizontal and vertical checks and balances between different institutions and forms of oversight, as well as their perceived credibility (in terms of independence, transparency and accountability).

Specific issues include:

- (i) *Enhancing the scope and complementarity of audit systems*

- The integrity of forest administrative systems in Sabah could be further enhanced by expanding the scope of application of ISO Quality Management Standards; including the entire production chain from harvest planning through to oversight of mill throughput, as well as the General Procedure for SFM Audit.
- Furthermore, whereas ISO9001:2000 looks to consistency in administrative procedures, potential may exist to upgrade assessment of Forestry Department procedures to incorporate ISO 14000 and ISO19000 on environmental management and systems monitoring. This has the potential to complement and support both the mandatory General Procedure for SFM Audit as well as audits under voluntary FSC schemes.

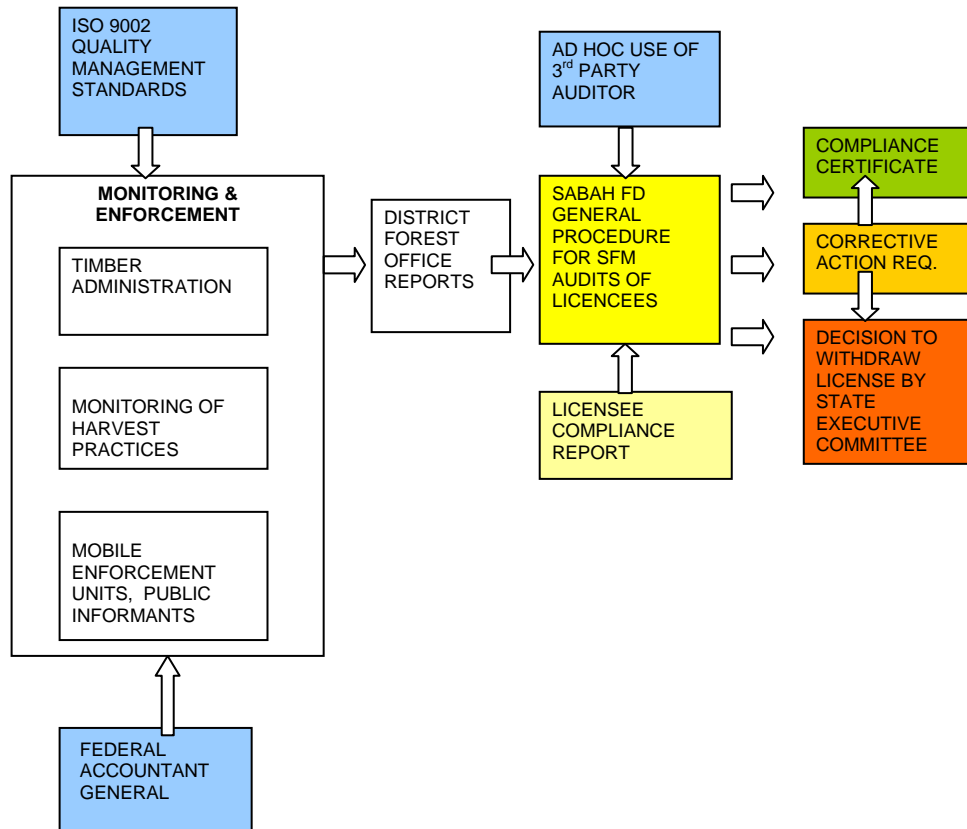
(iii) Enhancing independence and transparency

While the Sabah Forestry Department has demonstrated strong commitment to tackling performance failure by licensees under the General Procedure for SFM Audit of licensees, measures could be introduced to enhance transparency. This is essential in limiting the Forestry Department's liability in penalising licensees, as well as in securing the credibility of the General Procedure (getting the right balance between "compliance management" and "compliance enforcement"). The latter is especially important in relation to SFM audits of the Sabah Foundation (Yayasan Sabah), a statutory body and the largest single concessionaire in Sabah. Possible measures to improve public oversight of the audit process include:

- Establishment of clear guidance on public access to and confidentiality of audit reports, as well as the verification decisions of the Forestry Department and State Executive Committee.
- Establishment of clear guidance on resort to 3rd party independent auditors in the event of disagreement over the assessment of the Forestry Department.
- Expansion of ISO Quality Management and Environmental Systems Standards to cover the General Procedure.

The credibility and impact of the General Procedure on SFM Audit would be further enhanced by the graduation of SFMLA license holders into (FSC) certification processes. This would enable 3rd party independent audits against equivalent standards, as well as additional support to license holders in tackling corrective actions.

Figure 7 Monitoring, Audit and Compliance with respect to sustainable forest management license agreements (SFMLAS) in Sabah



6.4 Sarawak

Within the framework of the Federal Constitution as well as the Sarawak Forest Ordinance 1958 (amended 1999), Sarawak (like Sabah) has worked to develop its own systems for verification of legal compliance within the forest sector. The key difference with Sarawak lies in its composite multi-agency structure for policy setting, regulation, monitoring and enforcement under the overall authority of the Sarawak Ministry for Planning and Resources Management.⁷⁵ As such, Sarawak has the most comprehensive systems of checks and balances between different agencies. But at the same time, all elements of the forest control system fall under the authority of the Sarawak Minister for Planning and Resource Management (MPRM), who is also the Chief Minister of the State. Unlike the Peninsula and Sabah, there is no element of mandatory Federal auditing. Nor is there any element of auditing against voluntary SFM standards, with the sole exception of MTCC in the Sela'an Linau Forest Management Unit. With both upstream and downstream operations consolidated into a limited number of main industry groupings⁷⁶, this structure enables close control of the timber sector by the State Government.

6.4.1 Monitoring and enforcement

(i) Institutional arrangements for monitoring

While measures for harvest monitoring and timber administration are broadly similar to the Peninsula and Sabah, the structures for delivering these set Sarawak apart:

First, harvest monitoring and timber administration (including collection of royalty payments and issuances of Removal Passes) now fall under jurisdiction of the Sarawak Forestry Corporation Sdn. Bhd. (SFC). SFC is a private company fully owned by the Government established with the intent of outsourcing core functions of the Sarawak Forest Department, and introducing greater efficiency into the system. The Forest Department now focuses on policy setting and implementation of the Sarawak Forest Ordinance, including regulation and licensing. The Sarawak Forestry Corporation has established a number of dedicated Business Units. These include the Sustainable Forestry and Compliance Business Unit (SF&C) responsible (amongst others) for harvest planning and monitoring, as well as the Security and Asset Protection Business Unit (SAPU) responsible for enforcement.⁷⁷

Second, Sarawak has introduced an additional component to its monitoring systems, to secure a reservation quota on logs for domestic processing. This is currently set at 60%, with the intention of ensuring sufficient supplies of raw material to Sarawakian mills. The remaining 40% is permitted for export. On 1 February 1994, the Chief Minister outsourced responsibility for monitoring compliance with the quota to Harwood Timber Sdn. Bhd, the sole authorised agent for the discharge of functions under Section 67A (5) of the Sarawak Forest Ordinance. Harwood Timber Sdn. Bhd. charges companies a fee of RM3/hoppus ton for its services (or RM1.66/M3 for companies with mills). In addition to log tracking, Harwood Timber Sdn. Bhd.'s businesses include the management of depots for imports of

⁷⁵ The Chief Minister of Sarawak is also the Minister for Planning and Resource management.

⁷⁶ Key industry groups in Sarawak include Ta Ann, KTS, WTK, Shin Yang, Rimbunan Hijau and Samling.

⁷⁷ <http://www.sarawakforestry.com/htm/faq/index.htm>

timber from Indonesia (pending inspection and clearance by customs and STIDC), and also owns its own processing plant.⁷⁸

Harwood Timber Sdn. Bhd. is itself a wholly owned subsidiary of the Sarawak Timber Industry Development Corporation (STIDC). Like the Malaysian Timber Industry Board (MTIB) whose jurisdiction is limited to the Peninsula and Sabah, STIDC is a statutory body⁷⁹ responsible for the development, registration,⁸⁰ regulation and promotion of the Sarawakian Timber Sector – including import and export licensing.

(ii) Pre-harvest planning, post-harvest inspections

The Director of Forest Department will approve the Forest Management Plan (FMP) if it meets the required technical standards. FMPs focus largely on the orderly removal of timber stocks from the forest in accordance with the principles of sustainable forest management. This includes road alignment and construction, guidelines on logging operations, construction of camp quarters, as well as identification of forest types and canopy density classes and inoperable areas. A General Harvesting Plan is prepared prior to the commencement of operations on the ground. This is followed by a Detailed Harvesting Plan for individual blocks. Once the detailed Harvesting Plan is approved, the licensee can then commence ground works. This includes demarcation of coupe and block boundaries, a 10% enumeration of standing stock, which is then extrapolated for the entire block. Approvals for infrastructure development and harvesting are given to licensees according to their operational progress. If any of the required steps are not carried out, SFC will issue a request for corrective action before work can proceed.

SF&C has also established procedures for logging inspection and issuance of coupe clearance certificates, as well as monitoring and reporting on progress with harvesting and block closure.⁸¹ However, the emphasis is on post-harvest inspection rather than monitoring of ongoing harvest operations. Upon receipt of an application for block closure by the licensee, SF&C will carry out post logging block inspection. Of these, damages are assessed on the basis of a 100% survey along all skid trails. Amongst others, damages are assessed for high stumps, logging damage, remnants, logs not removed, felling of undersized trees etc. Post harvest inspections are not, however, conducted for helicopter logging given the steep terrain on which this usually takes place. The company will accompany SF&C officers during the assessment and whatever is recorded is acknowledged by the company.

The procedure for harvest planning and monitoring is summarised in Fig. 8 below.

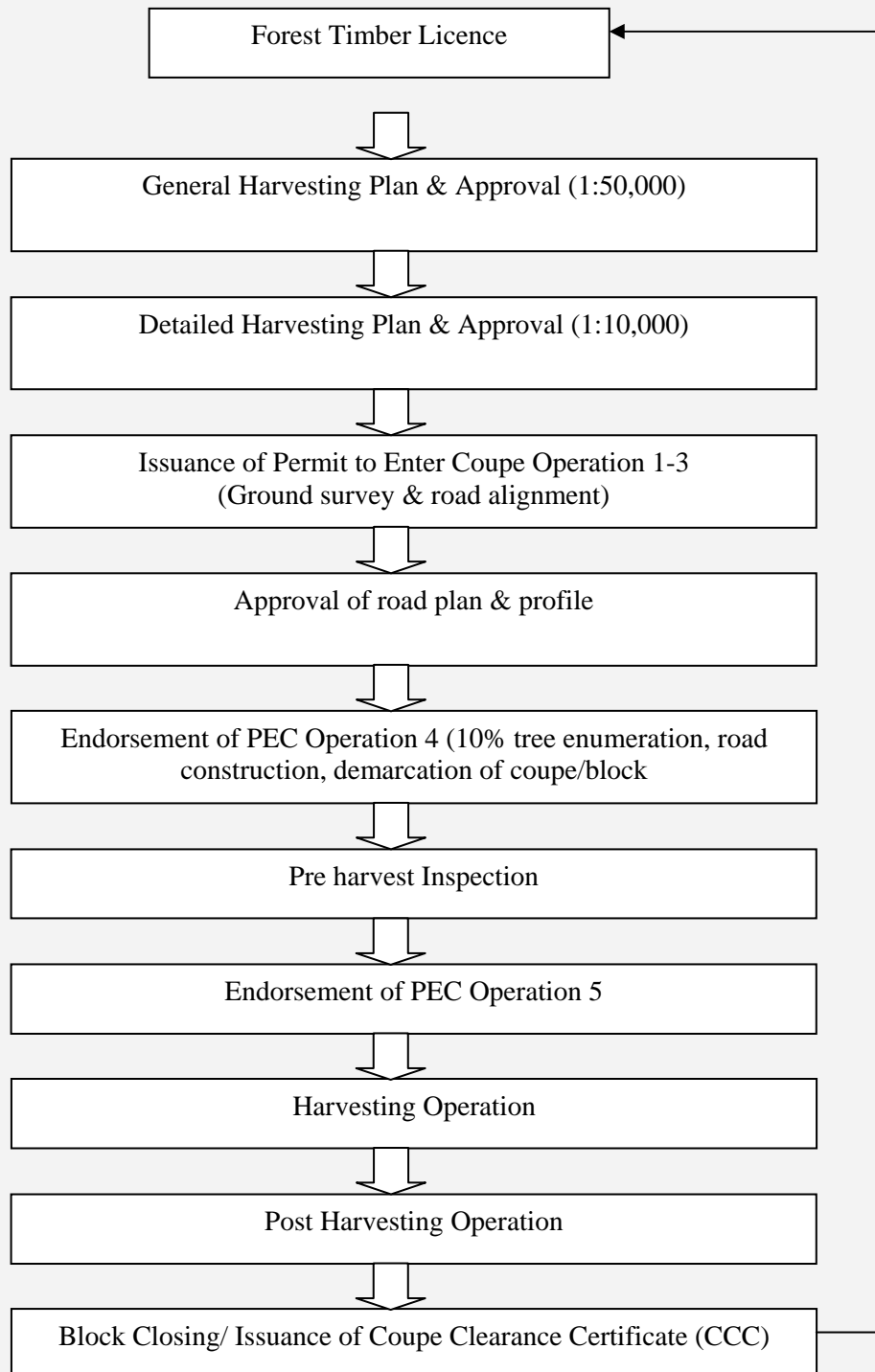
⁷⁸ Pers. comm., Harwood Sdn. Bhd., 27-09-05.

⁷⁹ Established by the STIDC Ordinance 1973 (as amended 1999).

⁸⁰ The Sarawak Timber Industry (Registration) Regulations, 1983 (as amended 1999) require persons engaged in or associated with the manufacture, sales, distribution and marketing of timber to register with STIDC. Pers. comm. STIDC 26-09-05.

⁸¹ GFS, *Review of Programmes on Traceability of Timber Material*, Draft Report for the Workplan Legality, Asia Forest Partnership, Appendix 6, Sarawak;

Figure 8 Harvest planning and monitoring in Sarawak



Source: Sarawak Forestry Corporation, 24-07-06 and comments on VERIFOR draft 05-04-07

(iii) Timber administration

As in the Peninsula and Sabah, timber administration in Sarawak consists of three main steps: log identification; measurement and settlement of royalty payments; and the administration of Removal Passes (see also fig. 9). The system is currently administered in two different ways. The first, standard system applies to around 70% of production. The second, computer-based system covers around 30% of production. In both cases, however, companies are themselves responsible for log tagging.

- *Standard timber administration*

Under the standard system, log tagging (showing coupe and block number) is conducted by companies at the log landing. Following tagging, logs are transported to the company log pond which may be as much as 100km away. Logs are measured, identified, property marked, tagged with log serial number, and entered into the log specification form, whereupon the Licensee applies for royalty marking. The SFC District Customer Office will check and re-measure logs, before royalty marking and issuance of a Removal Pass to indicate that royalty has been paid. The log serial numbers must be used sequentially. These are later entered into SFC Royalty Billing System. This will automatically reject an entry should there be duplication of serial numbers.

Without tagging at stump, control of harvest volume is determined on the basis of 10% intensity pre-harvest inventories, and logs may only be traceable to an individual block. The licensee will then require a Transit Removal Pass (TRP) for transport of each consignment of logs by barge, raft or truck. The volume of timber recorded by the SFC District Service Centre at log ponds is entered into the electronic database for billing by SFC Regional Offices. SF&C will monitor the accumulated harvesting volume for each licensee.⁸² Once a log consignment is delivered to first point of processing or point of export, the nearest SFC Regional Office (Security and Asset Protection Business Unit – SAPU) is notified to inspect and cancel off Transit Removal Passes. Export logs are issued a new TRP prior to authorisation by STIDC.

- *Computerised log tracking*

Sarawak is also trialling the development of a computer-based log tracking system within the Rajang river basin. Under this system, each log is allocated a unique number known as a Log Production Identity (LPI) number. This LPI number must be approved by the SF&C Regional Office and registered in the computer system, before trees are allowed to be felled. During harvesting operations, the licensees will affix this LPI tag and the coupe/block tag to the log at the landing site. Property marking and scaling is done at the central log yard/transit camp. The licensee will prepare hard and soft (diskette) copies of the daily log production record and submit this for entry into SFC's database by a District Customer Service Centres. Before royalty marking is done or a subsequent removal pass issued, the District Customer

⁸² GFS, *Review of Programmes on Traceability of Timber Material*, Draft Report for the Workplan Legality, Asia Forest Partnership, pp. 9 and 10; pers. comm. Sarawak Forestry Corporation, 24-07-06.

Service Centre will log on to the system to verify and validate the log specifications (diskettes) submitted by the licensee against what is contained in the database. Only LPI logs which have been registered and verified by the system may be allowed for royalty marking and removal.

This enables detection of any losses of timber along the transport chain. The entire system is computerised enabling on-line tracking by the SFC District Service Centres and Regional Offices.⁸³

- *Outsourced monitoring of log reserve quota for domestic processing*

Harwood Timber Sdn. Bhd. (Harwood) works in tandem with the Sarawak State Government's timber administration policy to ensure that licensees comply with the 60% reservation quota on logs for domestic milling. Harwood submits monthly reports to the Permanent Secretary of the Ministry of Planning and Resource Management, the Director of Forests (Forest Department), the General Manager of STIDC and the General Manager of SFC. These report on log movements within the State, as well as on timber licensees' compliance with established reservation and export quotas.

Once logs have been royalty marked and a Royalty Removal Pass issued by the SFC officer at the log pond, the logging company requests Harwood to inspect log consignments ready for transport. Harwood's log inspections involve a 100% tally of pieces as well as a physical inspection (at 10% sampling intensity) to check species, log serial numbers, property and Forest Department hammer marks against details stated in the Log Specification Form. All inspections are recorded in the Inspection Report. Information is also keyed into the Harwood computerized system, HENDIS. This is to facilitate checking of logs to ensure quota compliance and to prevent the illegal movement of logs.⁸⁴

Upon satisfactory inspection at the log pond, an Endorsement Clearance Certificate (ECC) is issued to the SFC officer who will then issue the Transit Removal Pass (TRP). All movements of logs for milling require an ECC before a TRP can be issued.⁸⁵ If in the process Harwood identifies any discrepancies, the company will be asked to correct these. With more major discrepancies, e.g. under-declaring to reduce royalty payments, Harwood will withhold endorsement and will notify SFC headquarters.⁸⁶

Harwood will then monitor individual log consignments at all shipment/transit points to their final destination i.e. licensed mills or export points. The movement of logs from camp log ponds to local processors and export points is typically done by barge. Harwood also conducts a 100% tally when logs are loaded onto barges. A Shipping Pass will be issued upon satisfactory inspection. For logs transported by road, the TRP will only be issued by SFC upon issuance of an ECC by Harwood.⁸⁷

⁸³ GFS, *Review of Programmes on Traceability of Timber Material*, Draft Report for the Workplan Legality, Asia Forest Partnership, pp. 9 and 10.

⁸⁴ Pers. Comm.. Harwood Timber Sdn, Bhd. comments on draft VERIFOR report, 21-03-07.

⁸⁵ Ibid.

⁸⁶ Pers. comm., Harwood Timber Sdn. Bhd, 27-09-05.

⁸⁷ Pers. Comm.. Harwood Timber Sdn, Bhd. comments on draft VERIFOR report, 21-03-07.

With respect to the 60% domestic processing quota, a separate team of Harwood officers will verify whether log consignments have arrived at designated, licensed mills. Inspections once again consist of a 100% tally of pieces and physical inspection (at 10% sampling intensity) of species, log serial numbers, property and Forest Department hammer marks. These are checked against the log details stated in the Log Specification Form, to which the relevant TRP should be attached. Upon satisfactory inspection, Harwood will complete an Inspection Report (IR) which is then counter-signed by the mill's authorised personnel. Harwood will then update records in its computerised system (HENDIS). Harwood provides a monthly report to all timber companies on logs inspected at mills. The SFC Security and Asset Protection Business Unit (SAPU) may also check logs at the mill.⁸⁸

With respect to the 40% export quota, Harwood issues an Export Clearance Certificate after satisfactory joint inspections with SFC (SAPU) officers at approved export points. The SFC officer will in turn issue a TRP for shipment.⁸⁹

(iv) Mill throughput

Under a recent amendment to the Sarawak Timber Industry Development Corporation Ordinance (Ord. 3 of 1973), STIDC now has the full power to both license mills and to monitor mill throughput. SAPU and Harwood Timber Sdn. Bhd. remain responsible for checking log consignments entering mills, however STIDC will check off consignments of imported sawn timber from Indonesia and all logs imported from other sources. Mills are required to submit Shuttle reports to STIDC on a monthly basis. Taking into account each mill's productive factor, STIDC will then check reported throughput against SFC and Harwood Timber Sdn. Bhd. figures, as well as STIDC export permits for both logs and sawn timber. However there is still a need to build up a system of on-line reconciliation. In all, STIDC is responsible for monitoring 230 mills including 23 plywood mills.

(v) Enforcement

Mobile police brigades routinely establish road blocks and monitor border areas for possible movements of illegal timber. Marine and river police are also active. Both the SFC Security and Asset Protection Unit (SAPU) and STIDC enforcement officers will spot check mills and individual timber consignments. The powers of SFC and STIDC do, however, differ in respect of sanctioning. SFC can administer management offences but the decision to refer a case to the State Attorney General for prosecution rests with the State Forests Director in the SFD. In the case of STIDC, that decision remains with the General Manager. The General Manager may order business activities to cease in respect of unregistered mills, or mills that have committed an offence under either the Forests or STIDC Ordinances. Under the 2006 amendment to the STIDC Ordinance, failure to comply with such an order may incur a fine of between RM100,000 and RM300,000 and up to four years imprisonment.

6.4.2 Mandatory audits

A range of mandatory audits exists in respect of components of the forest control system.⁹⁰ These include:

⁸⁸ Pers. Comm.. Harwood Timber Sdn, Bhd. comments on draft VERIFOR report, 21-03-07.

⁸⁹ Ibid.

- (i) *SFC and STIDC corporation-wide audits* for internal oversight of (amongst others) quality, health and safety. In respect of SFC, headquarter will audit individual Regional Offices.
- (ii) *Cross-regional audits by SF&C*. This began in 2005 and is still being trialled. The audits focus on *both* the operations of SFC Regional Offices as well as compliance by the major industry groups operating in any one region. The latter includes inspection of log ponds. A full audit structure and procedures are still under development.
- (iii) *Harwood Timber Sdn Bhd's Task Force and Internal Audit Units*, which ensure compliance with procedures as established in the Log Endorsement Manual. The Internal Audit Unit carries out its functions quarterly, through the State.⁹¹
- (iv) *Audits by the State Internal Audit Department in the Chief Minister's Office* – this includes system and financial audits, including oversight of royalty billing.
- (v) *Financial Audits by the Federal Accountant General*.

As in Sabah, there are no Federal audits for SFM.

6.4.3 Audits under voluntary certification schemes

Unlike the Peninsula and Sabah, voluntary audits against SFM standards are restricted to the 55,949ha MTCC-certified Sela'an Linau Forest Management Unit managed by Samling Plywood (Baramas) Sdn. Bhd..

The only other audits under voluntary certification relate to ISO-certified management systems, including consistency and transparency in administration and information management. All SF&C and SAPU processes are ISO9001:2000 and ISO 14001:1996 certified.⁹² Harwood Timber Sdn. Bhd.'s log monitoring systems are also subject to routine audits against the ISO9001:2000 Standard.⁹³

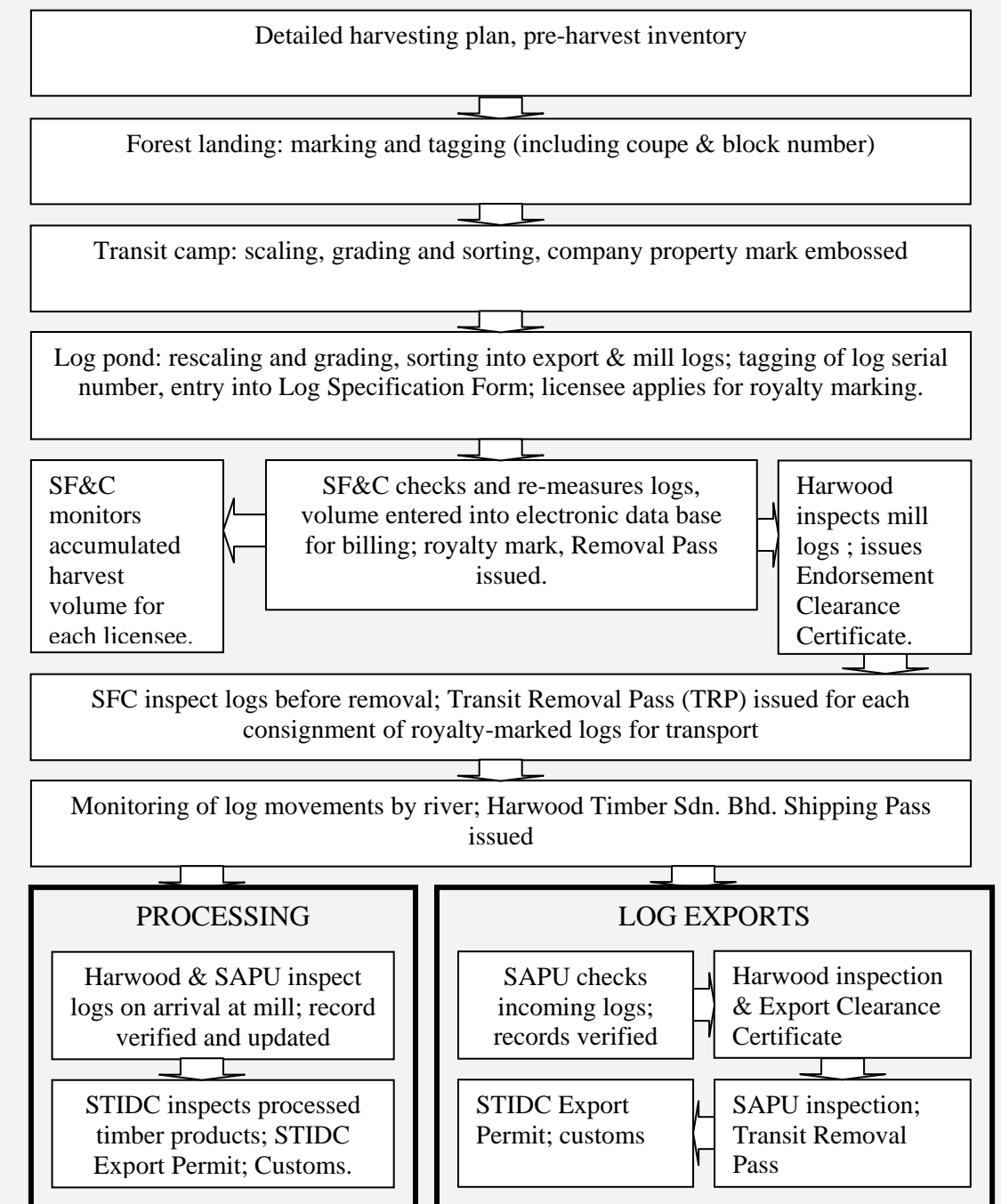
⁹⁰ Pers. comm., Sarawak Forests Department and Sarawak Forestry Corporation, 24-07-06.

⁹¹ Pers. Comm. Harwood Timber Sdn, Bhd. comments on draft VERIFOR report, 21-03-07.

⁹² <http://www.sarawakforestry.com/htm/award/index.htm>

⁹³ Ibid.

Fig. 9 Standard timber administration in Sarawak



Source: GFS, *Review of Programmes on Traceability of Timber Material*, Draft Report for the Workplan Legality, Asia Forest Partnership, p. 9; pers. comm., Harwood Timber Sdn. Bhd, 27-09-05; pers. comm. Sarawak Forest Department and Sarawak Forestry Corporation 24-07-06.

6.4.4 Strengths of the system

(i) *Efficiency gains*

Elements of Sarawak's forest monitoring and verification systems enable effective log tracking. Monitoring of domestic reservation and export quotas by Harwood Timber Sdn. Bhd. highlights the efficiency gains of outsourcing – in terms of both securing the domestic log reservation quota as well as in assisting companies' own supply chain management. As a wholly owned subsidiary of STIDC, Harwood Timber Sdn. Bhd.'s role in monitoring compliance with log reserve quotas arguably constitutes delegation of functions within the State administrative structure, as opposed to outsourcing to a third party. It is not within the scope of this report to assess whether this impinges on Harwood Timber Sdn. Bhd.'s efficacy. Harwood maintains that its log endorsement activities are totally independent from STIDC.⁹⁴

(ii) *Verification through cross-checks*

With cross-regional audits still being conducted on a trial basis, verification is largely delivered through a system of cross-checks within the timber administration system - between SFC, Harwood Timber Sdn. Bhd. and STIDC. In this context, Harwood states that its inspections create a check and balance inspection process, and help to secure the transparency, accountability and effectiveness of timber administration in the State.⁹⁵ If, for example, Harwood Timber Sdn. Bhd.'s computerised tracking system detects discrepancies with respect to individual log consignments these are automatically detected and reported to SFC for investigation.⁹⁶ And with tagging of Indonesian sawn timber imports, measures for verifying the legality of mill consumption are arguably more comprehensive than in either the Peninsula or Sabah. The rapid development of a system for on-line reconciliation of imports, domestic production, mill production factors and exports would certainly assist STIDC in this task.

6.4.5 Issues arising

(i) *Gaps in chain of custody?*

But it is precisely in the absence of a comprehensive system of complementary mandatory and voluntary audits that the existing system of cross-checks may not serve to verify harvest practices and legal origin. Of specific concern is the absence of tagging at stump for 70% of Sarawak's timber production. This has implications in two respects:

- The system potentially limits control of harvest volumes and practice. Where control is delivered mainly through post-harvest inspections, tagging at stump could serve to pre-empt harvest infractions.
- Without tagging at stump the current system of timber administration functions more as a means for log tallying than a guarantee on legal origin. This opens up opportunities for the illicit transfers of timber from over-quota to under-quota coupes. It may even create opportunities to launder timber from outside the licensed area and from across the Indonesian border where this is adjacent. This report has not found evidence to suggest

⁹⁴ Pers. Comm., Harwood Timber Sdn, Bhd. comments on draft VERIFOR report, 21-03-07.

⁹⁵ Ibid.

⁹⁶ Pers. comm., Harwood Timber Sdn. Bhd, 27-09-05.

that any of this takes place. But with SFC log inspections only at log ponds, it remains an area requiring further attention.

The development of a computer-based tagging and log tracking system constitutes an important step towards addressing these concerns, but steps have yet to be taken to apply this beyond the Rajang basin.

(ii) *Strengthening harvest monitoring*

Current monitoring and control of harvest operation is delivered chiefly through pre-harvest planning and post-harvest inspections. While the latter will assess damages based on a 100% inspection of harvested blocks, it makes the assumption that payments for damages constitute an effective enough deterrent against violations of harvest regulations. Penalties may in fact be sufficiently low for companies to consider them part of their standard operating costs.

Yet a shift away from punitive assessments of post-harvest damages towards pre-emptive harvest control through 100% tagging at stump may assist the SFD in achieving its vision of progressive realisation of reduced impact logging (RIL) by 2013. In the absence of a complete resource inventory for Sarawak, an annual off-take of 9.2 million m³/year from Permanent Forest Estates, and the fact that damages are not even assessed for helicopter logging, 100% tagging at stump is arguably essential if this vision is ever to be fulfilled.

Pre-emptive harvest control could also be strengthened by stepping up monitoring during harvest operations. This, however, must take into account the impact that government cost-cutting has had on SFC headcount. It has also placed SFC under strong pressure to recoup its own costs.

Before the SFD was restructured in 2003, it had over 2000 staff. At present, the SFC headcount is just 722 – for control of the same or a possibly larger land area depending on final gazettment of a Permanent Forest Estate in Sarawak. There are currently 86 staff in SAPU, stationed mainly in the four SFC Regional Offices. There are also 281 staff in SF&C, of which 70% are also spread across the four Regional Offices and the 16 District Service Centres. Not all these staff are necessarily functional. A number are on secondment from the SFD after the latter down-sized, pending early retirement - so as not to lose entitlement to a permanent pension.

With a target Permanent Forest Estate (PFE) of 6 million ha, this leaves the SFC at risk of over-stretch in terms of its ability to monitor activities on the ground – not least given the need to support progressive realisation of RIL, and to guard against illicit timber movements into and within licensed areas. This raises two sets of issues:

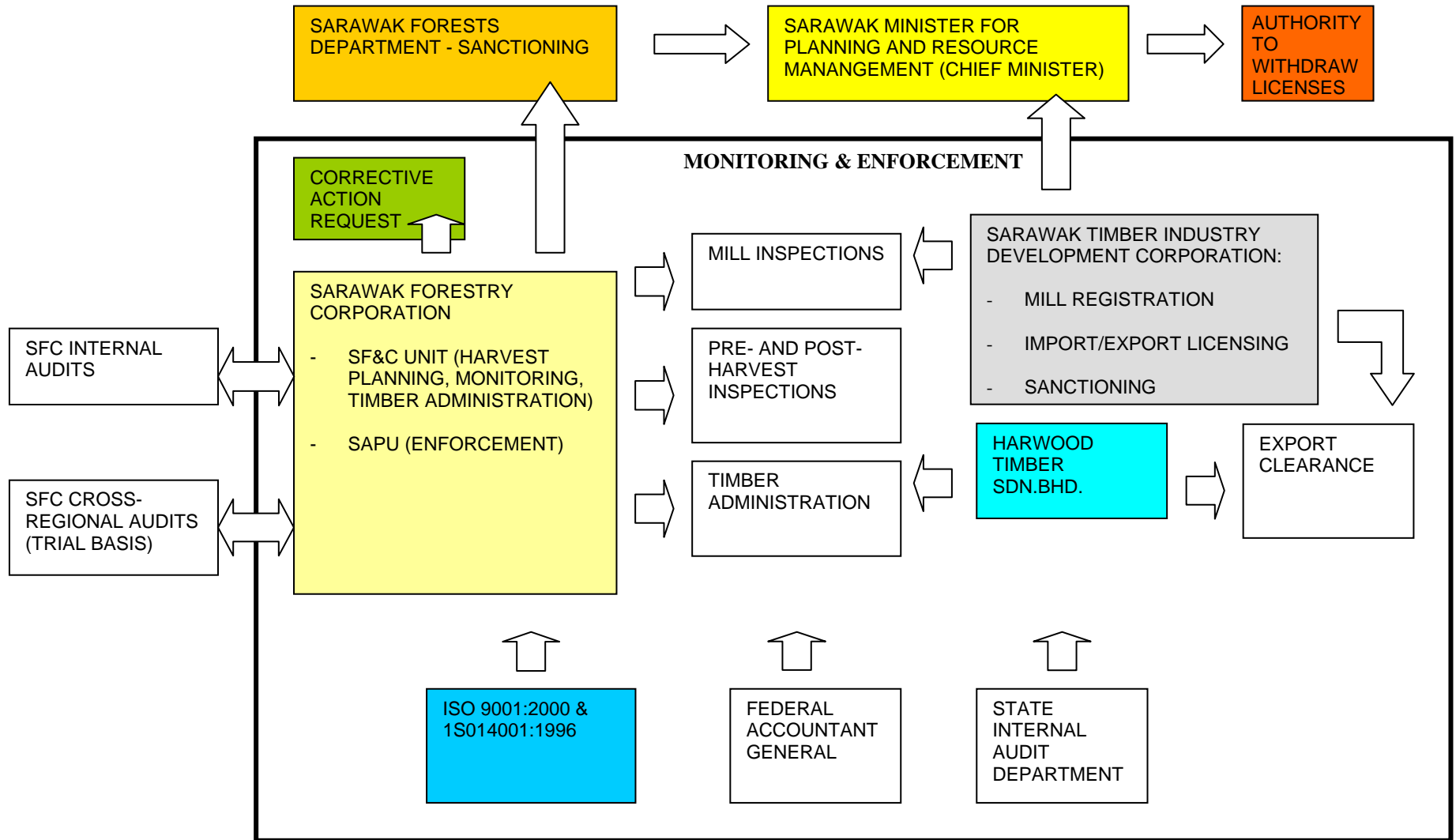
- Greater onus on the use of technologies. According to SFD and SFC, remote sensing is used in overseeing harvesting but this report did not verify the extent to which this has been incorporated into routine monitoring or cross-regional audits, or how it then translates into enforcement operations on the ground.
- Whether monitoring and enforcement is an activity that can be made to pay for itself under the SFC business model. Further attention is needed to the allocation of core functions between the SFD and the SFC, and options for re-allocating or further

outsourcing these to ensure monitoring and enforcement gets the investment that it needs.

(iv) Routinisation of cross-regional audits

The credibility of harvest monitoring may in any case be assisted with the rapid completion of procedures for routine cross-regional audits, with adequate safeguards on the transparency of audit processes and reports.

Figure. 10 Forest monitoring and audit in Sarawak



6.5 Timber imports

Structures for verification of timber imports have been substantially strengthened in response to recent reports of an increase in timber smuggling. However, with the possible exception of Sarawak, the traceability of imported small-dimension sawn timber once it enters Malaysia remains relatively weak.

6.5.1 Import licensing

Under the Customs Act 1967, all imported timber is subject to standard Customs clearance procedures, including the submission and verification of written declarations of value, quantity as well as Country of Origin. Supporting documents include:

- a. Delivery Orders
- b. Log List (Packing List)
- c. Original Invoice
- d. Bills of Lading
- e. Certificate of Origin
- f. Import License (JK69)

A number of additional measures have been taken to regulate timber imports.

(i) Import licensing of logs and large-dimension sawn timber by MTIB/STIDC

Through an amendment to the Customs (Prohibition of Imports) Order 1998,⁹⁷ all imports of round logs, as well as large scantling and squares (60 square inches and over), require the prior authorisation of the Ministry of Plantation Industries and Commodities or its equivalent in Sarawak, the Ministry of Planning and Resource Management. Under Customs (Prohibition of Imports) (amendment) (No4) Order 2006 this requirement now also applies to Free Trade Zones and transshipment areas.

MTIB/STIDC offices will first inspect timber based on the importer's customs declaration. Under MTIB procedures, inspectors will submit written reports to MTIB headquarters before an import authorisation can be issued. This includes information on sizes, species, and phytosanitary requirements. Also MTIB/STIDC will now only authorise imports of logs and LSS subject to proof of *bona fide* source (as verified by the Malaysian embassy in the source country) and in accordance with its import/export guidelines. The relevant embassy will endorse the issuing authority in the source country, e.g. the Myanmar Timber Enterprise, in respect of every shipment. This applies for all tropical and some non-tropical producers. Once approved by MTIB/STIDC, the timber is permitted to clear customs.

⁹⁷ Customs (Prohibition of Imports) Order 1998, Second Schedule, Section 15.

Box 7 STIDC log import procedure

Amendments to the Customs (Prohibition of Imports) Order 1998 requires that an application to import logs should be supported by the following documents:

- a. Letter of Approval from the Ministry of Planning and Resource Management.
- b. Customs Forms K1 and JK69 (Pin 1/2000)
- c. Certificate of Origin (CoC)
- d. Phytosanitary Certificate
- e. Bill of Lading
- f. Trade Invoice
- g. Dispatch Note
- h. Log List (Packing List)

When the vessel arrives the following procedures are undertaken:

- a. Upon arrival of the vessel, the importer submits form JK69 and original copy of Customs Declaration Form K1 to STIDC.
- b. Before endorsement of Form K1 by STIDC, STIDC will inspect the consignment based on information submitted in JK69.
- c. If the consignments confirm to the specifications submitted in JK69/K1, STIDC will endorse form K1 for customs declaration.
- d. Only then will logs be unloaded, hammer-marked and tagged by STIDC for issuance of Removal Pass.
- e. STIDC will carry out inspections to ensure that logs are delivered to the mill, as specified in the Removal Passes.
- f. The importer surrenders original Removal Pass to STIDC.

Source: STIDC

(ii) Import ban on Indonesian logs and large-dimension sawn timber

On 25 June 2002, the Government of Malaysia, through the Ministry of Primary Industries (currently known as the Ministry of Plantation Industries and Commodities), also banned imports of Indonesian round logs (in response to a corresponding Indonesian export ban), and subsequently extended this to include large scantling and squares (>60 sq inches diameter) as of 1 June 2003. As such, MTIB/STIDC will *not* issue a license for import of any these products from Indonesia.

(iii) Administration of small-dimension timber imports

Small-dimension timber, including that from Indonesia, does not fall within the scope of the Customs Prohibition Order. Customs may, however, request verification of consignments by MTIB/STIDC where there may be uncertainty over timber species or dimensions.

But with growing concern over the provenance of small-dimension timber imports from Indonesia, STIDC has taken the additional step of administering imports of small-dimension timber under trans-boundary agreements with neighbouring West Kalimantan. Timber

imports are now restricted to five designated points of entry into Sarawak.⁹⁸ In this case, STIDC authorisation of imports is subject to proof of valid Indonesian transport permits (SKSHH) and customs documentation (PEB). Prior to STIDC inspections, consignments are bundled by Harwood Timber Sdn. Bhd.⁹⁹ Upon approval of each bundle, STIDC will issue a Form A hammer mark as well as a Form B Transit Removal Pass for transport to mills.

(iii) CITES certificates for Ramin

Ramin has been included under Appendix II, requiring an export quota by the exporting country based on a non-detriment statement. The Appointed Management Authorities are MTIB (in the Peninsula and Sabah) and the SFD and SFC. Other CITES Appendix II-listed timber species under the remit of these management authorities include Podocarpus and Gaharu (*Aquilaria, Gyrinops*).

6.5.2 Enforcement

Section 135 of the Customs Act 1967 grants customs powers of seizure and prosecution with respect to scheduled items imported without the prior approval of MTIB/STIDC. MTIB/STIDC are also empowered under Section 27 of the Customs Act to enter premises, carry out inspections and examinations, and prohibit sale or export of timber. MTIB/STIDC conduct regular inspections/visits to entry points including ports and private jetties alongside Royal Malaysian Customs and Port Authorities. Inspections are audited against ISO 9001:2000 Quality Management Standards.

Malaysia and Indonesia have also established a General Border Committee to oversee the movement of people and agricultural products (including timber). The two countries also agreed to step up joint patrols along the Indonesia – Malaysia border, under an initiative of the Deputy Prime Minister. Measures specifically to control the movement of illegal timber include: a restriction on the entry of sawntimber to five designated/ gazetted points along the Kalimantan/ Sarawak border as identified by the Sarawak State Government; as well as an increase in surveillance of illegal landing points in the Peninsula. Malaysia and Indonesia are also developing a Memorandum of Understanding on control of the illegal timber trade, the latest meeting of which was scheduled for April 2006.

6.5.3 Issues arising

Though import controls provide for cross-checking between MTIB/STIDC, customs and even Malaysian embassies in source countries, there are a number of caveats on the efficacy of these measures:

(i) Endorsement by Malaysian Embassies

- While Malaysian embassies in source countries are required to verify the good standing of suppliers in order to qualify for MTIB/STIDC import licensing, this cannot provide a guarantee on the legality of individual consignments.

⁹⁸ Sematan (sea port), Biawak, Tebedu, Batu Lintang and Lubok Antu.

⁹⁹ In addition to log monitoring, Harwood also holds the concession for depot management at border crossing points.

- Checks of *bona fide* by Malaysian embassies are not conducted for imports of small-dimension timber given that these fall outside the scope of the MTIB/STIDC import licensing scheme.

(ii) *Imports of small-dimension sawn timber*

- Small-dimension timber (<60 sq inches diameter) does not currently require the prior authorisation of MTIB/STIDC. At the same time State Forestry Departments will only issue Removal Passes on imported logs and LSS, for purposes of royalty collection.¹⁰⁰ Removal Passes are not issued for consignments of smaller-dimension timber, making it difficult to trace where it goes in the country. Where existing systems rely on mills to self-report throughput and recovery rates, this permits mixing of timber from potentially illegal sources into the production chain.
- The exception to this rule is Sarawak, with STIDC authorisation and tagging of imported small-dimension timber from Kalimantan. This makes it possible to track volumes and consignments entering domestic processing chains. But, even here, there is currently no mechanism for STIDC, customs or port authorities to verify the credibility of Indonesian documentation.
- In all cases, current imports of small-dimension timber does not match an expansion of the Indonesian export ban to cover all categories of sawn timber as of 24 September 2004. The expansion was endorsed by joint declaration of the Indonesian Ministries of Industry, Trade and Forestry on 1 February 2006. Yet in the absence of a binding agreement between the two countries, Malaysia is under no legal obligation to do so.¹⁰¹ Furthermore, continuing imports under trans-boundary agreements between Sarawak and West Kalimantan point to substantial policy divergence between central and regional government within Indonesia.

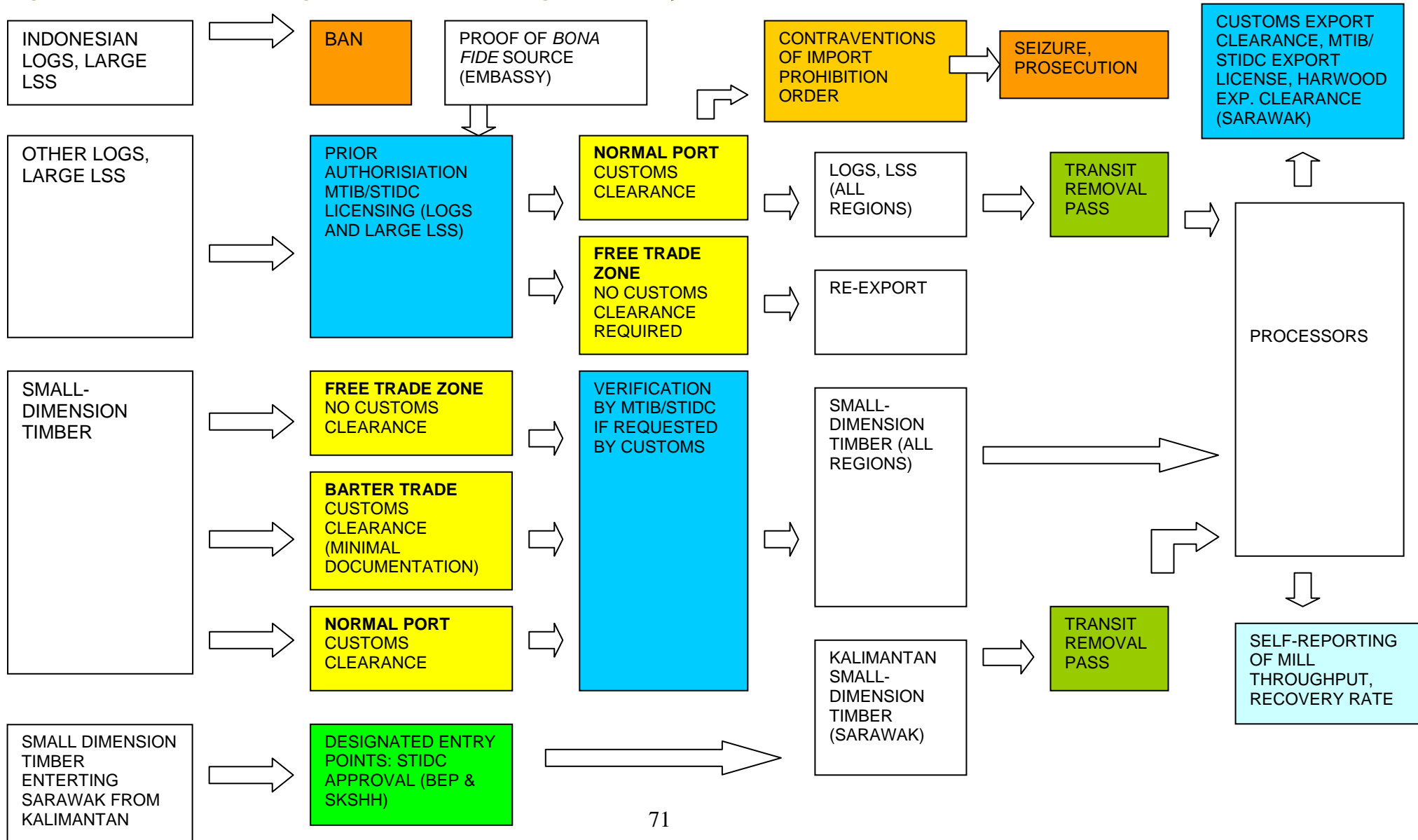
(iii) *Information systems*

- While import statistics are collected by MTIB/STIDC and Customs, systems are not yet in place to enable on-line reconciliation of import data with domestic production and reported mill output, to assess likely levels of smuggled timber entering Malaysia's production and export stream. STIDC has begun to look into this; less progress appears to have been made in the Peninsula and Sabah. In all three jurisdictions, computerised log tracking would also greatly assist with on-line reconciliation.

¹⁰⁰ Pers. comm. Sabah Forestry Department 23-09-05.

¹⁰¹ The expanded Indonesian export ban could also be construed as a measure not merely to tackle the illegal timber trade, but also to enhance value-added benefits for its own processing industries.

Figure 11 Monitoring, verification and tracking of timber imports



7. The strengths of existing verification systems

7.1 Support for verification

Malaysia's existing forest monitoring and audit systems enjoy strong governmental support. The active participation of public informants suggests that these systems do enjoy broader societal support as well.

Given the historical importance of the forest sector to State coffers, current forest monitoring and timber administration systems reflect a strong interest by State governments in maximising revenue streams. In the Peninsula, they also reflect an interest by the Federal level in curbing abuses by the State including excess opening of forest areas for logging, as well as over-harvesting.

Commitment to standards-based management, including the incorporation of SFM standards into mandatory audits, reflects a number concerns:

- the future continuity of revenue streams;
- security of raw material supplies for down-stream processing industries; as well as
- access to high-value European and North American markets.

These interests are shared by industry, concerned over market-competition from cheaper producers, as well as scrutiny by international NGOs.

The parallel introduction of ISO standards to designated administrative procedures for forest harvesting reflect a broader Prime Ministerial drive on enhanced efficiency and economic competitiveness.

7.2 Monitoring

The Peninsula has introduced 100% tree-tagging by District Forest Offices throughout the Permanent Reserved Forest. Sabah and Sarawak are also taking steps in this direction. At least in the Peninsula, this enables more effective control of both harvest levels, as well as log movements. All States also issue Removal Passes at checking stations (stumping points), which are then cancelled off once logs arrive at the first point of processing. In Sabah, Receiving Forest Rangers are stationed permanently at mills specifically for this purpose. In the Peninsula, Mobile Enforcement Units (involving both forest rangers and the police) may also issue Exchange Removal Passes in exchange for Removal Passes issued at stumping points as a guarantee against fraud. Though largely paper-based and administratively heavy, this system largely works to prevent illicit movements of timber from Permanent Reserved Forest.

In all three jurisdictions, monitoring is further enhanced by public informants. In the Peninsula, their role is growing with increased media attention to environmental degradation, as well as the introduction of a system for 'e-complaints'. Rewards are paid commensurate with the fine issued, or quantity of timber seized.

7.3 Standards-based management

As a rule, forest-sector oversight is contained within existing administrative structures. The only exception has been resort to third-party auditors by the Sabah Forestry Department in one instance of potential dispute over its own General Procedure for auditing of licensees. In Sarawak, monitoring of log quotas for domestic processing and export have been outsourced to the company Harwood Timber Sdn. Bhd. Yet the fact that Harwood Timber Sdn. Bhd. is a wholly-owned subsidiary of the Sarawak Timber Industry Development Corporation (itself a State enterprise) suggests that outsourcing was simply a measure aimed at enhancing administrative efficiency as opposed to third-party oversight.

The introduction of standards-based management, either through mandatory audits and/or voluntary audits under certification initiatives, is therefore important to the credibility of existing verification systems in Malaysia:

- MTCC audits work to secure additional oversight of legal compliance with respect to licensing, harvesting and timber administration. Amongst others, MTCC requires compliance with relevant local and national laws and codes on forest management, the environment, labour and welfare, as well as health and safety of forest workers. The use of common standards by voluntary (MTCC) and mandatory (Federal) audits of SFM helps to guarantee follow-up and closure on Corrective Action Requests (CARs).¹⁰²
- SFM standards have now been incorporated into compliance audits by the Sabah Forest Department for 100-year SMFLAs (based on the 10 FSC principles) as well as of individual States by the Federal Forestry Department in the Peninsula (based on MC&I).
- Though not performance-related, the introduction of ISO Quality Management Standards to core administrative procedures has helped to structure and ‘routinise’ internal monitoring and reporting by State Forestry Departments. This potentially facilitates their assessment by Federal and MTCC auditors.

7.4 Compliance

(i) Compliance management

Where forest managers are the State or long-term licensees, forest monitoring and audit emphasise “compliance management” (building the capacity of forest managers to comply) as opposed to “compliance enforcement” (fines and prosecution) – at least in the Peninsula and Sabah. In the Peninsula, this reflects the limited powers of the Federal level to hold States to account with respect to Federal SFM audits. In Sabah, security of tenure is essential to the objectives of 100-year SFMLAs. License withdrawal can only take place in cases of outright non-performance. In both these cases, compliance management works to “close the gap on legality” with the focus on capacity building as well as progress towards/ retention of SFM certification.¹⁰³

¹⁰² The incorporation of FSC principles into Sabah’s General Procedure for SFM Audit provides similar complementarity between mandatory and voluntary audits where licensees choose to enter FSC certification schemes.

¹⁰³ Sarawak currently appears to have taken the opposite approach, with most of the emphasis on post-harvest assessment of damages as opposed to intensive monitoring and coaching of harvest operations. But with a commitment to progressive realisation of RIL by 2013, and the possibility that companies may treat fines as little more than operating costs,

The credibility of compliance management by mandatory SFM audits does, however, depend on the willingness of forestry services to impose penalties for failure to address Corrective Action Requests. To date, Sabah has withdrawn 3 out of 18 SFMLAs since 1998 for non-performance. In the Peninsula, States that do not meet Corrective Action Requests are held to account by the National Forestry Council, though this is confined to moral suasion. Professional and sub-professional staff of State Forestry Departments that fall under Federal line management may be disciplined. Failure to address Corrective Action Requests also risks suspension of MTCC certification - as happened with the State of Terengganu in 2002.

(ii) Compliance enforcement

Compliance measures are rather different for short-term licensees and timber administration, with the emphasis on fines or prosecution. In the Peninsula, enforcement has been substantially strengthened since the crack down on illegal logging in the early 1990s. Under amendments to the National Forestry Act in 1993, for example, illegal logging became the joint liability of license holders and contractors, penalties were much increased, and the police and armed forces were empowered to undertake surveillance of forestry activities. Offences can either be prosecuted in court or compounded (settled) by the State Forestry Director.¹⁰⁴ In both Sabah and Sarawak, the State forestry services have both established new, dedicated enforcement units. In Sabah this has led to a dramatic increase in the rate of convictions since 2002, under joint operations involving the Sabah Forestry Department, the Anti-Illegal Logging Unit in the Chief Minister's office, as well as the Malaysian police and armed forces.

With respect to timber imports, the Customs (Prohibition of Imports) Order 1998 enables confiscation and prosecution where scheduled timber is imported without prior authorisation by MTIB and STIDC. MTIB and STIDC are also empowered under the Customs Act 1967 to enter premises in order to carry out inspections and examinations, and to prohibit sale or export of timber. Under the Customs Prohibition (amendment) Order 2006, it is now also a criminal offence to import logs and LSS in contravention of the ban on imports of Indonesia logs and LSS. The expansion of MTIB's and STIDC's respective remits to include import licensing has been reinforced by bilateral agreements between Malaysia and Indonesia to strengthen border patrols.

there may be an argument for shifting the balance in favour of compliance management, while also raising penalties and better financing routine monitoring.

¹⁰⁴ Section 101, NFA; Section 35 Sabah Forest Enactment.

8. Enhancing verifiability and impact

8.1 Standards for legal compliance

(i) Resolving native and aboriginal claims

The development of mandatory C&I for SFM, including the MC&I(2002) have to date provided the principal basis for assessment of legal compliance under both mandatory and voluntary audits. 100-year SFMLAs in Sabah, Federal SFM in the Peninsula, as well as corresponding audits by MTCC, all incorporate Standards of Performance relating to laws on forest management, the environment, labour and welfare, as well as health and safety of forest workers.

However existing SFM standards are contested as an adequate basis for addressing outstanding legal claims by aboriginal and native in relation to Permanent Reserved Forests. The solution can only lie in legal reform and the development of mandatory standards guiding administrative decisions making.

First, there is a need for clear guidance and standards on public notice and the arbitration, admission, compensation and/or incorporation of aboriginal/native claims to ensure greater equity in respect of forest gazettement and land alienation for conversion. Amongst others, the Court of Appeal has affirmed a fiduciary duty on the Peninsular States to gazette areas where aboriginals are able to establish an interest in land, and to compensate these as well as usufruct rights should they be withdrawn (see Box 3).

Second, the scope of aboriginal/ native interests in land in respect of the wider forest domain, and the standards of evidence necessary to establish this remain contested. Both sets of issues are before the Federal Courts arising out of cases in both the Peninsula and Sarawak.

Third, it has been argued that the indicators and means of assessing compliance in the MC&I are not sufficiently specific or performance based to address disputes with local communities. Amongst others, mechanisms do not yet exist for the management and disbursement of compensation to aboriginal or native communities.

Fourth, apart from District Officers, there is currently no independent, third-party referee to oversee and adjudicate claims with credibility amongst all parties.

The lack of adequate standards and mechanisms for resolution of claims may be one reason why parties have often had to resort to the civil courts where settlement might otherwise have been achieved through negotiation or arbitration. Not only is this highly inefficient, implying significant transaction costs for all parties involved, but the lack of a funded legal aid system also means that communities have to rely on *pro bono* legal assistance.

(ii) Establishing thresholds of compliance

Within the context of a possible Voluntary Partnership Agreement with the EU, forestry officials raised the need to clearly differentiate offences that would render a consignment of timber illegal for purposes of trade from more minor infractions that can be resolved through

Corrective Action Requests. Clearer guidance is also needed on the threshold beyond which failure to address Corrective Action Requests may incur penalties including fines, prosecution and license withdrawal.¹⁰⁵

8.2 Harvest monitoring

The ability of District Forest Offices to effectively monitor licensees depends on adequate resourcing. In some cases, forest rangers depend on concessionaires for access, hampering their ability to provide critical independent oversight of operations.¹⁰⁶ This is a particular problem in relation to larger, remoter concessions in Sarawak and Sabah. In the Peninsula, there are also concerns over the ability of MTCC and Federal SFM audits to provide sufficient oversight of large FMUs such as the State of Pahang (itself at over a million hectares of Permanent Reserved Forests) with respect to forest management practices and timber administration. One solution might be to subdivide large States into smaller FMUs to enhance audit delivery.

Furthermore, whereas licensees in all three jurisdictions currently may make use of contractors in conducting cutting operations, contractors are not directly accountable for management outcomes. Proposals to introduce a system of “certificates of competence” for contractors could therefore enhance oversight of harvest practice and log movements.¹⁰⁷ Such a system was proposed by the Ministry of Natural Resources and Environment to the National Forestry Council in 2002 and received broad support. There is, however, still an insufficient pool of trainers to enable a complete switch to mandatory certification without further resourcing.¹⁰⁸

Pressure to reduce head-count and save cost is a particular concern in Sarawak but may equally apply to the Peninsula and Sabah in respect of resourcing for effective monitoring. This raises the need to:

- (i) make more consistent use of technologies, include remote sensing as the basis for compliance management and enforcement;
- (ii) review the core functions of forest administrations, in respect of those which can be expected to pay for themselves (e.g. through outsourcing) to ensure core monitoring and enforcement functions receive the resources they need to be credible.

8.3 Chain-of-Custody

In Sabah and Sarawak key elements of the chain-of-custody still rely on pre-harvest inventories as well as companies own log numbering systems. This implies weaker control of both harvest levels as well as the transfer of timber from and between coupes. In the Peninsula, concerns were also raised over MTCC’s reliance on paper-based timber administration by State Forestry Department to track logs from stump to first point of processing.

MTCC’s voluntary Requirements on Chain-of-Custody (RCOC) now require random visits by MTCC assessors to Forestry Department checking stations to confirm that Removal

¹⁰⁵ Meeting with Federal Forestry Department, MTCC, MTC, MTIB, 21-09-05.

¹⁰⁶ The World Bank/WWF Malaysia, Overview of Forest Law Enforcement in East Malaysia, March 2001.

¹⁰⁷ Pers. comm., Bill Maynard, GFS, 27-03-06.

¹⁰⁸ Pers. comm., Zulkefli Mokhtar, Enforcement Unit, Federal Forestry Department, 30-03-06.

Passes received by MTCC-certified primary processing mills (i.e. sawmills or plywood mills) have been issued by the checking stations in question and that the details match.¹⁰⁹ A strong case can, however, be made for replacing paper-based timber administration with mandatory Chain-of-Custody based on computerised log tracking in all three jurisdictions. This would complement ongoing efforts by the Prime Minister's Office¹¹⁰ to secure continuous improvements in and computerise administrative systems. The Sabah Forestry Department is already committed to establishing computerised log tracking, including 100% tree-tagging. Sarawak has trialled computer-based log tagging in the Rajang river basin (covering about 30% of the State's production) but no steps have yet been taken to extend its coverage.

Computerised tracking under a mandatory Chain-of-Custody would need to cover both timber from Permanent Reserved Forests as well as timber from State and alienated lands undergoing conversion. This would help to segregate domestic production from imported raw material (the legal provenance may be difficult to verify), providing assurance to purchasers that products are of guaranteed legal origin. Amongst others, the Central Point of Expertise in Timber (CPET) for UK procurement policy has questioned the provenance of the 30% uncertified component permitted under MTCC voluntary Requirements on Chain-of-Custody (RCOC).¹¹¹ Although the RCOC require suppliers to self-declare that uncertified raw material or products are not from controversial sources, mechanisms are not yet in place to verify these declarations.

The credibility of a mandatory Chain-of-Custody also depends on effective monitoring of mill throughput and recovery rates. State Forestry Departments in the Peninsula currently rely on self-reporting by mill operators in the form of 'Shuttle 4' reports. While State Forestry Departments may examine these reports for obvious inconsistencies, the information they contain is not routinely verified by District Forest Offices. This constitutes a potential loop hole for timber from controversial sources to enter the production chain, where the latter is not already subject to MTCC's RCOC.

¹⁰⁹ MTCC, comments on draft report, 30-03-06.

¹¹⁰ Malaysian Administrative Modernisation and Management Planning Unit (MAMPU)

¹¹¹ Environmental Quality Act 1974 and the Protection of Wildlife Act 1972 (CPET, 2004 pp 55)

8.4 Import controls

The introduction of mandatory import licensing by MTIB and STIDC under an amendment to the Customs (Prohibition of Imports) Order 1998, as well as bilateral agreements to step-up border controls, have brought greater control over timber smuggling into Malaysia. That said, Section 6.5.4 of this report highlights a number of challenges.

(i) Expanding the scope of import licensing; links to validation of legality by source countries

With the exception of the Kalimantan/ Sarawak border, imports of smaller-dimension sawn timber (<60 square inches) do not require import licensing by MTIB or STIDC, nor do they fall within the scope of the import ban on Indonesian timber (though Indonesia has subsequently moved to extend its own export ban). As such, no checks are undertaken on *bona fide* source with Malaysian embassies in source countries. Nor is customs documentation of the exporting country required for timber imported into Barter Trade Centres and Free Trade Zones. This makes it especially hard to verify the legal provenance of such material. Yet ITTO statistics indicate that the largest proportion of imports into Malaysia now consists of sawn timber (830,000m³ compared to 120,000m³ of logs in 2004).¹¹² Compare this to a source country such as PNG whose exports of sawn timber are also rising exponentially but with minimum administration to ensure legal provenance (processed timber does not fall within the scope of PNG's outsource log export monitoring scheme).

Extending the scope of MTIB and STIDC import licensing to cover all small-dimension sawn timber from all sources may be one measure to enhance data collection and control. Rather than relying on embassies to verify proof of *bona fide* source, it may also be more effective to link import licensing to validation of legality by source countries under bilateral agreements (e.g. Malaysia – Indonesia MoU). While, for example, Indonesian transport permits (SKSHH) are required for entry of small-dimension sawn timber from Kalimantan into Sarawak, there is currently no means to verify the credibility of such documentation.

Requiring source countries to validate legality of timber consignments is especially important in light of a proposed licensing scheme for exports of legal timber from Malaysia to the European Union under the Forest Law Enforcement, Governance and Trade (FLEGT) initiative. Such a scheme may mean that Malaysia becomes a target for laundering of illegal timber for re-export to the EU. Requiring source country validation of legality would therefore limit Malaysia's own liability under this scheme, should imported material enter Malaysia's processing and export stream. But this also implies that Malaysia should now extend its own import ban to mirror Indonesia's recent export ban on small-dimension sawn timber.

(ii) Customs harmonisation

Prior authorisation of MTIB/STIDC is now required for all log and LSS shipments passing through Free Trade Zones and transit areas. And as explained above, STIDC authorisation is

¹¹² ITTO (2004) Annual Review and Assessment of the World Timber Situation.

also required for shipments of small-dimension sawn timber from Kalimantan. But as far as all other consignments of small-dimension timber is concerned MTIB/STIDC relies on prior notification of customs to undertake inspections in these areas. This in turn depends on customs identifying timber that might fall within the scope of the Customs (Prohibition of Imports) Order 1998 or be CITES-listed species. The capacity of customs to do this could be enhanced through harmonisation of HS codes and/or a prior notification of timber consignments by customs authorities in exporting countries. These measures have been discussed by the Tri-National Task Force on Ramin (see Box 6) as well as in the context of East-Asia and Pacific FLEG - including a TRAFFIC workshop for national customs agencies in November 2005. Specific steps have not yet been taken.¹¹³

(iii) Transit Removal Passes for imports of small-dimension timber

State Forestry Departments only issue Transit Removal Passes on imported round and LSS. Passes are not, however, issued on consignments of smaller-dimension timber – again with the exception of imports of small-dimension timber from Kalimantan into Sarawak. This means that, once they enter the country, there is no means of tracking where they go. This makes it extremely difficult to distinguish smuggled from legally imported timber once it is inside the country. It also makes it difficult to verify the relative quantities of imported material and plantation timber (e.g. rubber wood) when examining data provided by mills, as neither category falls within the timber administration system. Extending the issuance of Removal Passes to all consignments of imported timber is arguably justified given the growing importance of smaller-dimension timber to domestic processing facilities (ITTO, 2004); as well as pressure from consumers for guaranteed legal origin.

Closely linked to the need to extend Transit Removal Passes to imported small-dimension timber, is the need to develop a composite data monitoring system to reconcile imports with domestic production and mill throughput. This is essential to track the quantity of unregistered (and possibly illegal) material entering the production chain. At present, MTIB/STIDC and Customs both collect statistics on timber imports. But so long as systems rely on mills to self-report throughput and recovery rates without verification, data reconciliation cannot be undertaken with any degree of certainty giving scope for under- and mis-declaring. STIDC has taken steps to address this, including attempts to reconcile different sources of data and monitoring mills for sudden surges in production. Less progress has been made in the Peninsula and Sabah.

8.5 Links between mandatory and voluntary audits

The credibility of forest verification systems in Malaysia is arguably delivered through a combination of mandatory and voluntary audits spanning Federal audits of States in the Peninsula, SFMLA audits in Sabah, audits of State Forestry Departments against ISO9000 and ISO14000 standards, as well as audits by MTCC and FSC. Yet, not all these audits are necessarily linked and mutually dependent in providing oversight of forest management and timber administration.

¹¹³ Chen Hin Keong (2005) *Promoting co-operation to reduce trade in illegal wood products in Asia*, TRAFFIC Dispatches, Number 25 December 2005.

In the Peninsula, Federal SFM audits have yet to incorporate MC&I(2002) which now provides the basis for MTCC audits. Effective oversight of State Forestry Departments also depends on consistency in the frequency of these two types of audit, as well as in the intensity of sampling undertaken. This is important in securing closure of Corrective Action Requests, as well as in addressing concerns that annual MTCC audits may not in themselves be able to provide adequate coverage of large States such as Pahang. Yet attempts to increasing the intensity of audits, e.g. by subdividing States into smaller FMUs, potentially conflicts with government policy to downsize administration.

Equally, while ISO 9000 standards focus on systems design as opposed to acceptable levels of performance, the links between ISO and legal compliance in the field could nevertheless be strengthened by:

- incorporating both ISO 14000 standards on environmental management systems, as well as ISO19011 on monitoring systems performance, into existing administrative procedures (the Sarawak Forestry Corporation is already accredited against ISO14001:1996);
- extending the scope of application of ISO 9000 standards to other core processes such as MTIB import licensing, implementation of mandatory audits such as the General Procedure for SFM Auditing in Sabah, as well as enforcement procedures.

8.6 Safeguards on independence and transparency

Whereas the credibility of existing verification systems in part depends on voluntary audits against MTCC, FSC and ISO standards, even these may fall within the sphere of government influence.

Specially, MTCC falls under the authority of the Federal Ministry of Plantation Industries and Commodities and had previously depended on the Ministry for funding. Measures are being taken to address this potential conflict of interest. A separate endowment fund has now been established to cover MTCC's operational costs. An accreditation system is also being considered to secure mutual recognition from PEFC. This would allow MTCC to step back from issuing certificates and instead focus on overseeing the standard. Whether these measures are sufficient to give MTCC the perceived neutrality that it needs to develop and oversee national standards for SFM remains to be seen.

The credibility of existing verification structures also depend on clear rules of the game governing access to information and related complaints mechanisms. While MTCC publishes audit reports on its website, guidelines do not exist on access to the outcomes of mandatory, mandatory audits by forestry agencies. In Sabah, for example, public access to audits reports under the General Procedure for SFM Audit remains within the discretion of the Sabah Forestry Department. Yet guidelines on public access, with appropriate guarantees on the contractual confidentiality of licensee, would substantially enhance the credibility of the audit process.

Equally, and specifically in the case of Sabah, clearer guidance on resort to 3rd party independent auditors in the event of disagreement over the assessment of the Forestry

Department would work to enhance confidence in the audit process; and would again work to limit liability where the Sabah Forestry Department has recommended license withdrawal.

Finally, procedures for license withdrawal by State Executive Committees on the basis of monitoring and audit, and the reasons for doing so, are also not made public. While the National Forestry Council has issued tighter guidance on the issuance of licenses and concessions, there is little public oversight of license withdrawal. Greater transparency in this respect would work to limit the liability of States in penalising licensees as well as the risk of political interference.

8.7 Compliance

The success of standards-based management as a guarantee on legality in large part depends on whether current penalties for illegality, as provided for in the law, continue to provide a strong enough deterrent.¹¹⁴ This is a particular concern where State Forestry Directors enjoy significant discretion in choosing to compound or prosecute cases. Although the National Forestry Council has recommended that all infractions under Section 15 of the National Forestry Act should now be prosecuted in court, this only applies to the Peninsula. There is also a risk that judges can be too lenient, dismissing cases on technicalities.¹¹⁵

8.8 Costing and prioritising improvements

There are concerns that augmenting existing monitoring and verification systems will increase transaction costs. Measures will need to be analysed in terms of their cost to licensees and State administrative structures; the availability of existing financial resources (e.g. forest development cess); as well as the development of new and additional funding mechanisms (e.g. levies, endowment funds). Yet, the fact that verification systems are largely in place also means that the cost of incremental improvements may be relatively small; and would be justified in terms of, both greater societal buy-in, as well as increased market confidence in the legality of Malaysian timber exports. In this respect, actions to prioritise include:

- **mandatory Chain-of-Custody** based on computerised tree tagging and log tracking;
- mechanisms to verify mill throughput and recovery rates to enable **on-line reconciliation of import data with domestic production and processing statistics**;
- measures to tighten administration of timber imports, including links to **legal validation by source countries** and issuances of **Transit Removal Passes for small-dimension timber from all sources**;
- **consistency in sampling and standards** between complementary monitoring and audit processes, to provide more effective oversight;
- rapid implementation of an **accreditation system for MTCC** to safeguard its independence; and,
- guarantees on **public access to mandatory audit reports as well as verification decisions** by State Executive Committees.

¹¹⁴ Pers comm., Appanah, FAO Bangkok, 14-09-05; The World Bank/WWF Malaysia, Overview of Forest Law Enforcement in Peninsular Malaysia, March 2001, pp. 7.

<http://www.forestandtradeasia.org/files/Forest%20Law%20Enforcement%20in%20Eastern%20Malaysia.pdf>

¹¹⁵ The World Bank/WWF Malaysia, Overview of Forest Law Enforcement in Peninsular Malaysia, March 2001, p. 16. <http://www.forestandtradeasia.org/files/Forest%20Law%20Enforcement%20in%20Eastern%20Malaysia.pdf>

However, the most complex challenge lies with aboriginal/native rights in land and forest resources. This requires:

- **resolution of outstanding case law** on the scope of claims and the evidence needed to establish a claim;
- clearer **standards that ensure equity in forest gazettement**, that amongst others affirm judicial rulings;
- and **effective public oversight and dispute resolution mechanisms** where few currently exist outside of the courts.

As an issue which draws significant international attention, and is only likely to become more acute, the resolution of aboriginal/native claims in law requires serious engagement by all stakeholders.

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