Exploring due diligence: what does it mean in practice?

October 2017
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- The use of timber testing
- The role of certification
Operator’s Obligations recap

1. Placing on the market of illegally harvested timber or timber products shall be prohibited

2. Exercise due diligence through system and procedures

3. Maintain and regularly evaluate the due diligence system
What is due diligence?
What is due diligence?

...through systems and procedures enabling:
   1. Access to information
   2. Risk assessment
   3. Risk mitigation

“A ‘due diligence system’ can be described as a documented, tested, step-by-step method, including controls, aimed at producing a consistent desired outcome in a business process”

Source: EU Guidance document
What is due diligence?
What is due diligence?

1. Quality Management
   - Commit to legal sourcing
   - Establish responsibilities & assure competence
   - Establish procedures
   - Initiate performance monitoring
   - Define scope of supply chain & products

2. Access to Information
   - Evaluate supply chain info
   - Identify risks:
     - forest management level
     - supplier level
     - risks of mixing and substitution
   - Specify risks where identified

3. Risk assessment
   - Record supply chain info:
     - origin
     - suppliers
     - species
     - legality documentation
   - Collect additional supply chain info

4. Risk mitigation
   - Mitigation options
     - Additional documentation
     - Replace supplier
     - Source certified material
     - Supply chain verification audits
1. Quality management
Why are procedures needed?

• To provide a **systematic framework** for exercising due diligence and making it functional

• Enable systematic implementation and **external evaluation** of the system

UK Competent Authority (2015):

"...a lack of narrative explaining how the combination of document gathering, risk assessment and mitigation... enable the company to reach a conclusion of negligible risk"
2. Access to information
2. Access to information

- Product type
- Species
- Origin
- Quantity
- Supplier (tier 1)
- Documents or other information indicating legal compliance

Supply chain information is key

Origin = Country, and if applicable, region or concession
"It should be stressed from the outset that collecting documentation must be done for the purposes of the risk assessment and should not be viewed as a self-standing requirement."

Source: EU Guidance document
2. Access to information

Information Sources

Supply Chain Documents

- Stakeholder consultation
- Industry Knowledge
- Lab Testing
- Audits
- Web searches
- Information Databases
- Reports (NGOs, Govt., CBs, etc)
Released August 2017... v1.0

www.nepcon.org/sourcinghub
2. Access to information

Mapping supply chains

• First step in most risk assessments is to map the supply chain.

• Purpose of supply chain mapping is to:
  • gather information on your supply chain and products; and/or
  • verify that supplier claims are accurate.
2. Access to information

Supply chain documents
Observation of the supplier facilities, practices and supply chains may occur during on-site visits or formal legality audits.

Let’s look at some examples...
2. Access to information

Timber testing

- Identify species to genus level (e.g. *Quercus* spp.)
- Identify species to species level (e.g. *Quercus robur*)
- Identify geographic origin
- Identify geographic origin
2. Access to information

Industry knowledge

- Utilise *your own* experience

- Knowledge of species, supply chain structures, common practice, origins, etc.

- Don’t rely on ‘long-term relationships’ and ‘trusted supplier’

- Be critical and provide evidence
2. Access to information

Stakeholder consultation

- At forest management (FM) level, this may involve consulting local inhabitants and indigenous groups.

- At FM and supply chain level, this may involve:
  - NGOs
  - Government authorities (issuing authorities)
  - Certification bodies
  - Workers
  - Other suppliers
  - Other importers
  - Etc.
2. Access to information

Information to a **level of detail that allows** you to:

1. Conclude that the materials originate from forest sources with low risk of legal violations or that potential risks have already been mitigated;

OR

1. effectively specify and mitigate risk that materials have been illegally harvested, transported or traded.
2. Access to information

Supply chain management

- inform suppliers about policy and requirements
- acquire consent from suppliers to allow audits
- ensure suppliers appoint a responsible person

Maintenance

- Information must be kept up-to-date
- ensure that suppliers notify you if they plan to change supply chains
3. Risk assessment
3. Risk Assessment

Objectives

• Evaluate the risk that forest products are:
  • Illegally *harvested*,
  • Illegally *transported/traded*, or
  • *Mixed* with material with illegal or unknown origin.

• Identify *where* risks may exist in supply chains

• *Specify* risks to a level that enables effective risk mitigation.
3. Risk Assessment

Criteria shall include:

- assurance of compliance with applicable legislation which may include certification or other third-party verified schemes which cover compliance with applicable legislation

- prevalence of illegal harvesting of specific tree species

- prevalence of illegal harvesting or practices in the area of origin, including consideration of the prevalence of armed conflict

- UN Security Council or the Council of the EU sanctions on timber imports or exports

- complexity of the supply chain of timber and timber products
3. Risk Assessment

Risk conclusion

Negligible risk (low risk)

OR

Non-negligible risk (specified risk)
3. Risk Assessment

Key concepts

- Risk can be low but can never be absent
- No threshold is defined
- Operator must define the threshold when to mitigate risk
- There needs to be a clear and comprehensive justification for this conclusion
4. Risk mitigation
4. Risk Mitigation

If the risk of placing illegal timber on the market is not negligible, risk must be mitigated.

Risk mitigation measures may include:

• requiring additional information and documents from suppliers
• agreeing mitigation actions in collaboration with suppliers
• third party verification/certification
• Carry out supplier or forest verification audits to verify legal conformance
• replacing suppliers
4. Risk Mitigation

Identifying the appropriate action

- Mitigating measures shall address the specific risks identified
  - e.g. risk of lack of health & safety training for forest workers → request and verify training records, evidence of external audits

- Justify effectiveness
- Verify effectiveness
4. Risk mitigation

Good supplier relations is key
Mongolian oak from Jilin Province, China

Mongolian oak from Primorsky Province, Russian Far East
4. Risk mitigation

Case Study
Origin Testing for Oak Furniture

Risk Assessment
✓ Sent products to Agroisolab
✓ Tested for origin
✓ Results showed more likely origin is Russian Far East (RFE)

Mitigation Actions:
✓ EUTR & Risk training to factory staff
✓ Change source to US Oak
✓ Implement document checking procedure
✓ Help supplier implement CoC system
✓ Regular re-testing to ensure only US Oak present
4. Risk mitigation

Process can take different paths: **avoidance or mitigation**

Can the risk be avoided?

- **Yes**
  - Avoid risk
    - Replace supply chain
    - Replace supplier
  - Control risk
    - Change procedures
    - Collect additional information
    - Conduct supplier audit

- **No**
  - Use certified material
  - Use noncertified, low risk material
  - Collect additional documents
  - Conduct timber testing
  - Consult stakeholders
Information gathering

Assess risk

Mitigate risk
Some key topics...
5. Documents
"Is this enough?"
Wrong question!

1. **Relevance**: What does the information tell you about risk of illegality?

2. **Validity**: Is the information genuine?

3. **Relatedness**: Does the information apply to your supply chain or shipment?
Quick quiz!

采伐类型：立伐  采伐方式：  采伐强度：
采伐面积：231.96 公顷（株数：9332 株）
采伐蓄积：2115 立方米（出材量：  立方米）
采伐期限：2016 年 4 月 16 日至 2016 年 6 月 16 日
更新期限：年 月 日
更新面积： 公顷（株数： 株）
□占限额  □不占限额
Documents

Checking for fake documents:
• Obvious mistakes
• Spelling mistakes and inconsistencies
• Formatting or text that’s more blurry than the rest
• Check documents against an official database
• Check that information tallies across
• Use computer software to help check PDFs
Fake Documents

How to spot them and what to do about them

Thematic article series no. 2
Published July 2017

The European Commission support for the production of this publication does not constitute endorsement of the statements which reflect the views only of the authors, and the Commission cannot be held responsible for any use which may be made of the information contained therein.

This material has been funded by UK aid from the UK government; however, the views expressed do not necessarily reflect the UK government’s official policies.
Key challenge...corruption

In countries with high level of corruption you can get any stamp and any signature – it is just a matter of payment.
5. Timber testing
In February 2015, the UK CA released a report on the *Chinese Plywood Enforcement Project*.

Why Chinese plywood?
- High value veneer & low value core
- Complex supply chains
- Cheap
- High risk of corruption
- Evidence of illegal timber being imported into China
14 out of 16 companies supplied an insufficient due diligence procedure (88%)
Timber testing

• “Testing has become an essential tool in EUTR projects as it allows... to establish if a potential offence has been committed.”
  
  UK CA

• A due diligence system cannot be considered appropriate if the product on which it focuses does not contain the species that researched and risk assessed within it.
Timber testing

DNA analysis to identify origin

The White Oak Lottery: UK Mystery Shipment

Overall results, all samples (by continent of origin)

- More than half of white oak product samples declared as “U.S. white oak” were not from North America at all.
2. Information gathering

- Identify species to genus level (e.g. *Quercus* spp.)
- Identify species to species level (e.g. *Quercus robur*)
- Identify geographic origin
- Identify geographic origin
Timber testing

When to test?

- When new product lines are introduced
- When there are concerns about supplier claims
- When products contain different components or species
- When a company in the supply chain is changed
- When testing by 3rd parties has shown species/origin differs from your claims
Timber Testing Techniques

A guide to laboratory techniques to determine species and origin of timber products

Thematic article series no. 1
Published February 2017

Developed by NEPCon under the project "Supporting Local Timber Trade" funded by the EU LIFE programme and UK Aid from the UK government.
6. Certification
Certification plays a key role in mitigating risk of illegal harvesting for many importers.
EUTR definition of credible certification scheme:

- have a publicly available system of requirements

- specify that appropriate checks (incl. field-visits) are made by a third-party at regular intervals (no longer than 12 months)

- include means, verified by a third party, to trace timber at any point in the supply chain before such timber/timber products are placed on the market

- include controls, verified by a third-party

Ref: Implementing Reg. 607/2012
Certification

• Does the stand cover *all* the applicable legislation?
• ‘Controlled’ non-certified inputs
• Chain-of-custody
• Problems with the scheme in a specific country?

Ref: Commission Notice of 12.02.16, Guidance Document for the EU Timber Regulation
Certification

Do all schemes ensure legality?
Certification Evaluations by NEPCon

• NEPCon have started to conduct evaluations

• Produced under NEPCon’s EU-funded project work in Vietnam

• To increase publicly available information

• Help Operators by avoiding duplication of efforts and provide expert knowledge
Checking certificates online

- **Validity** – is the certificate still active?
- **Scope** – what sites, products and species does it cover?

PEFC: [http://www.pefc.org/find-certified/certified-certificates](http://www.pefc.org/find-certified/certified-certificates)

*Just because the organisation is certified, doesn’t mean the products are!*
Certification

Checking the documents

**FSC**

The sales invoice and delivery document should include:

- Certificate code in format XX-COC-XXXXXX
- FSC ‘Claim’ e.g. FSC 100%, FSC Mix Credit, FSC Mix 70%

**PEFC**

The sales invoice or delivery document should include:

- Certificate code e.g. NC-PEFC/COC-000084, CH12/0441
- PEFC ‘Claim’ e.g. x % PEFC certified
Certification

Buying Certified Timber

Buying certified timber is an important step you can take to verify the legality of your supply chain, and it will make it easier for you to obtain the necessary information about the origin of your timber products. It will also help your customer to assess and mitigate risk.

If I buy certified, what do I still need to do?

Even where you are able to provide your customer with certified timber, they are likely to still ask for information to help them carry out due diligence. In addition to your general sales information such as quantity (measured in volume, weight or number of units), your name and address and the name and address of the trader used, if applicable, they will also need the following information:

1. Which country/territory was the timber harvested?

2. What species is the product? Common names will suffice unless there is ambiguity. In these cases, scientific names will also be needed.

3. Documents or other information indicating compliance of those timber and timber products with the applicable legislation.

The FSC system will help you to provide the information about the country of harvest and the species to your customer. If your supplier does not automatically provide this information, you must make sure you have it for your records.

Regarding the documents or other information indicating compliance of those timber and timber products with the applicable regulations, some of the applicable regulations are covered by the FSC Forest Management Certification schemes. Therefore, the information indicating compliance is the certificate itself. If a certificate is not available, you will need to check the information on the certificate and your supplier’s name and contact details.

Does the certificate cover the product?

Check under 'Product Details' for travel rules. If the product has travel rules, you will be given a copy of the information required in the form of a certificate. Under 'Product Details' you will find information on product tips, timber species and values based on the certificate.

Click here to see the certificate. Is the company named? If the certificate is not available, check the information on the certificate.
Time for: