Exploring due diligence: what does it mean in practice?

Autumn 2017

Funded by the LIFE programme of the European Union and UK Aid from the UK government. The European Commission support for the production of this publication does not constitute endorsement of the contents which reflects 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.
Contents

• Operators’ obligations
• Explaining due diligence
• The role and limitations of documents
• 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?

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
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

**Origin = Country, and if applicable, region or concession**

Supply chain information is key!
2. Access to information

Important!

“\textit{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
- Web searches
- Information Databases
- Reports (NGOs, Govt., CBs, etc)
- Audits
- Lab Testing
- Industry Knowledge
- Stakeholder consultation
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.
Audits & On-site visits

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

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.
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!

https://nepcon.org/library/guide/eutr-supplier-relations-leaflet
## Case Study

### Origin Testing for Oak Furniture

<table>
<thead>
<tr>
<th>Tier</th>
<th>Tier 0</th>
<th>Tier 1</th>
<th>Tier 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Location</td>
<td>Germany</td>
<td>Shanghai, China</td>
<td>North-East China</td>
</tr>
<tr>
<td>Certification</td>
<td>None</td>
<td>Unknown</td>
<td>Unknown</td>
</tr>
<tr>
<td>Species</td>
<td>(Oak) <em>Quercus mongolica</em></td>
<td>(Oak) <em>Quercus mongolica</em></td>
<td>(Oak) <em>Quercus mongolica</em></td>
</tr>
</tbody>
</table>
**Timber Transportation Licence**

- **License No.:** 2000511454
- **Province:**
- **County/City:**
- **No.:**

<table>
<thead>
<tr>
<th>Details</th>
<th>Information</th>
</tr>
</thead>
<tbody>
<tr>
<td>Owner of timber</td>
<td>[Details]</td>
</tr>
<tr>
<td>Responsible person for transport harvesting</td>
<td>[Details]</td>
</tr>
<tr>
<td>Place of origin</td>
<td>[Details]</td>
</tr>
<tr>
<td>Place of harvesting</td>
<td>[Details]</td>
</tr>
<tr>
<td>Place of destination</td>
<td>[Details]</td>
</tr>
<tr>
<td>Volume</td>
<td>[Details]</td>
</tr>
<tr>
<td>Species</td>
<td>[Details]</td>
</tr>
<tr>
<td>Type</td>
<td>[Details]</td>
</tr>
<tr>
<td>Specification</td>
<td>[Details]</td>
</tr>
<tr>
<td>Volume</td>
<td>[Details]</td>
</tr>
<tr>
<td>Number of trees</td>
<td>[Details]</td>
</tr>
<tr>
<td>Date of issue</td>
<td>[Details]</td>
</tr>
<tr>
<td>Date of expiry</td>
<td>[Details]</td>
</tr>
</tbody>
</table>

**Delivery Note**

<table>
<thead>
<tr>
<th>Species</th>
<th>Thickness of board</th>
<th>Length of board</th>
<th>Volume</th>
<th>Price</th>
<th>Total price</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oak</td>
<td>5.0 cm</td>
<td>2 m</td>
<td>15</td>
<td>13.58</td>
<td></td>
</tr>
<tr>
<td>Oak</td>
<td>5.5 cm</td>
<td>2 m</td>
<td>22</td>
<td>21.11</td>
<td></td>
</tr>
<tr>
<td>Oak</td>
<td>4.0 cm</td>
<td>2 m</td>
<td>6</td>
<td>6.45</td>
<td></td>
</tr>
<tr>
<td>Oak</td>
<td>4.5 cm</td>
<td>2 m</td>
<td>9</td>
<td>9.22</td>
<td></td>
</tr>
<tr>
<td>Oak</td>
<td>5.0 cm</td>
<td>2 m</td>
<td>12</td>
<td>11.58</td>
<td></td>
</tr>
<tr>
<td>Oak</td>
<td>5.5 cm</td>
<td>2 m</td>
<td>18</td>
<td>18.18</td>
<td></td>
</tr>
</tbody>
</table>

**Total price: ** [Details]
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

No

Control risk
- Change procedures
- Collect additional information
- Conduct supplier audit

Risk identified

- Use certified material
- Use noncertified, low risk material
- Collect additional documents
- Conduct timber testing
- Consult stakeholders
Information gathering

Mitigate risk

Assess 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?
Fake Documents

How to spot them and what to do about them

Thematic article series no. 2
Published July 2017

Developed by NEPCo, under the project “Supporting Local Farmer Trade” funded by the DFID programme, of the European Union and UK Aid from the UK government.

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https://nepcon.org/library/guide/thematic-article-fake-documents
6. 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
## Timber testing

<table>
<thead>
<tr>
<th>Company</th>
<th>Face declaration</th>
<th>Face tested</th>
<th>Core declaration</th>
<th>Core tested</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Palaquium</td>
<td>Palaquium</td>
<td>Eucalyptus</td>
<td>Eucalyptus</td>
</tr>
<tr>
<td>2</td>
<td>Betula</td>
<td>Betula</td>
<td>Eucalyptus</td>
<td>Kedongdong</td>
</tr>
<tr>
<td>3</td>
<td>Sapeli</td>
<td>Sapeli</td>
<td>Poplar</td>
<td>Poplar</td>
</tr>
<tr>
<td>4</td>
<td>Palaquium</td>
<td>Palaquium</td>
<td>Poplar</td>
<td>Poplar</td>
</tr>
<tr>
<td>5</td>
<td>Bitangor</td>
<td>Palaquium</td>
<td>Poplar</td>
<td>Poplar</td>
</tr>
<tr>
<td>6</td>
<td>Lotofa</td>
<td>Sapeli</td>
<td>Poplar</td>
<td>Eucalyptus</td>
</tr>
<tr>
<td>7</td>
<td>Beech</td>
<td>Beech</td>
<td>Eucalyptus</td>
<td>Eucalyptus</td>
</tr>
<tr>
<td>8</td>
<td>Eucalyptus</td>
<td>Ozigo</td>
<td>Eucalyptus</td>
<td>Eucalyptus</td>
</tr>
<tr>
<td>9</td>
<td>-</td>
<td>Phenolic resin</td>
<td>Poplar</td>
<td>Poplar</td>
</tr>
<tr>
<td>10</td>
<td>Sapeli</td>
<td>Sapeli</td>
<td>Poplar</td>
<td>Poplar</td>
</tr>
<tr>
<td>11</td>
<td>Palaquium</td>
<td>Palaquium</td>
<td>Eucalyptus</td>
<td>Red Meranti</td>
</tr>
<tr>
<td>12</td>
<td>Eucalyptus</td>
<td>Bitangor</td>
<td>Eucalyptus</td>
<td>Eucalyptus</td>
</tr>
<tr>
<td>13</td>
<td>Bitangor</td>
<td>Bitangor</td>
<td>Poplar</td>
<td>Kasai</td>
</tr>
</tbody>
</table>

14 out of 16 companies supplied an **insufficient due diligence procedure** (88%).

Further issues arose with testing...
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

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 Legitimacy: Timber Trade" funded by the JSI LERF programmes and UK Aid from the UK government.

https://nepcon.org/library/guide/thematic-article-no-1-timber-testing-techniques
7. Certification
Certification plays a key role in mitigating risk of illegal harvesting for many importers.
Certification

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
• Does the standard 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

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

1. Which country/measure the timber was harvested?
2. What species the product contains - common name will suffice, however, it is advisable to specify the scientific name, as well.
3. Documents or other information indicating compliance of these 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 you with information about country of measure or species they are obliged to if you ask them for it (according to FSC Forest Management Certification schemes). Therefore, the information indicating compliance is the certificate itself. One area not covered by the FSC Forest Management Scheme are Trade and Custom laws. If your supplier does not automatically provide you with information about compliance with trade and customs laws, they are obliged to do so if you ask them for it (according to AD/ICF-4004-11: Trade and customs laws).

Regarding the documents or other information indicating compliance of those timber and timber products with the applicable legislation, some of the applicable legislation is covered by the FSC Forest Management Certification schemes. Therefore, the information indicating compliance is the certificate itself. One area not covered by the FSC Forest Management Scheme are Trade and Custom laws.

NEPCon Sourcing Hub was developed in partnership with the Forest Stewardship Council

With support from

Ministry of Foreign Affairs of Denmark
DANIDA

International Development Cooperation

LIFE

UKaid

from the British people

NEPCon Sourcing Hub is funded by UK Aid from the UK government, the LIFE programme of the European Union and DANIDA, Ministry of Foreign Affairs of Denmark. Donors are not responsible for any claims or views presented in this material. The European Commission support for the production of this publication does not constitute endorsement of the contents 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. The views expressed do not necessarily reflect the UK government’s or DANIDA’s official policies.