How to use the NEPCon Sourcing Hub in a due diligence process

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.
Firstly:
• Due diligence recap

NEPCon Sourcing Hub:
• Risk Assessments
• Tools for establishing a due diligence system
• Country-specific tools on the sourcing hub
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?

...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
Launched August 2017... v1.0

www.nepcon.org/sourcinghub
What about timber from Indonesia?

- Indonesia and the EU have agreed a Voluntary Partnership Agreement (VPA)
- FLEGT licences for Indonesian timber issued since November 2016
- FLEGT licensed timber and timber products are considered to comply with the requirements of the EUTR, so you do not need to exercise due diligence on these products.

For timber imports from Indonesia:
- You will receive a FLEGT Licence from your supplier prior to the export of the product from Indonesia.
- You must submit the electronic FLEGT licence to your Competent Authority for verification before the shipment arrives in the EU and before any customs declaration is made.
Everything you need for due diligence in one place

1. SELECT commodity
2. ACCESS an overview map of sourcing risks + SELECT country for details
3. VIEW country detailed risk data (e.g. risks related to each type of forest production...)
4. EXPLORE a suite of country guidance and due diligence tools to mitigate the risks
100+ free timber legality tools

Country specific guidance

- Full Timber Legality Risk Assessment for all 62 countries
- An overview of the relevant laws in a country from the List Applicable Legislation
- Risk Mitigation guide to help identify the risks in the supply chain and what to do about them for a supply country
- Document Guide to help determine exactly what type of documents to request from the suppliers, what they should look like and how to verify their authenticity

Due Diligence tools

- Supplier Letters
- Due Diligence Guidelines
- Supplier Managing Form
- Risk Checklists
- Policy template
- Supplier Information Form
- etc.
Risk assessments...

The heart of the Hub
Risk assessments – development process

DEVELOP
the risk assessment framework for the commodity, e.g. defining (sub)catergories

CONDUCT
risk assessments +
CONCLUDE
the risk for each of the sub-categories

CALCULATE
the score for each country +
COLOUR CODE
in the map

Comprehensive...
<table>
<thead>
<tr>
<th>Legality category</th>
<th>Legality Sub-Category</th>
</tr>
</thead>
</table>
| Legal rights to harvest | • Land tenure and management rights  
• Concession licenses  
**• Management and harvesting planning**  
• Harvesting permits |
| Taxes & fees | • Payment of royalties and harvesting fees  
• Value added taxes and other sales taxes  
• Income and profit taxes  
• Timber harvesting regulations  
• Protected sites and species  
• Environmental requirements  
• Health and safety  
• Legal employment  
**• Free, Prior and Informed Consent**  
• Indigenous peoples rights |
| Trade & transport | • Classification of species, quantities, qualities  
• Trade and transport  
• Offshore trading and transfer pricing  
• Custom regulations  
• CITES |

1. What does the law require?  
2. Who is the government authority responsible for that law/s?  
3. What are legal documents required?  
4. What are the risks that the law is not complied with?  
5. What risk mitigation actions can be taken to reduce the risk?  
6. Sources of information
A Due Diligence System
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”
1. Quality management

The Sourcing Hub contains extensive information about how to set up your due diligence system (DDS).

The NEPCon DDS includes several templates that may be used to ensure that systems and procedures are developed and implemented effectively.

You can download all the tools and templates you need to set up a due diligence system in your business on the Sourcing Hub.

What is due diligence?

'Due diligence' means taking reasonable care to avoid a negative outcome. In the case of the commodities we look at here:

For timber, we mean minimising the risk that you are placing timber on the market that was harvested, transported or traded illegally in its country of harvest. We have adopted this definition because this is what the EU Timber Regulation requires companies that place timber on the market in the EU to do.
1. Quality management

• Download the full NEPCon Due Diligence system on the Sourcing Hub

• http://www.nepcon.org/sourcinghub/info/what-due-diligence
2. Information gathering
2. Information gathering

• 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
2. Information gathering

Important!

"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. Information gathering

- Inform suppliers of DD requirements & request supply chain info (DD-06)
- Record supply chain info (DD-04)
- Analyse info and identify gaps
- Analyse info and identify gaps
- Where necessary, map supply chains (DD-07)
- Request any missing info from specific supplier (DD-05)
- Analyse info and identify gaps

(Note: The diagram shows a cycle with these steps, indicating a continuous process.)
What do we mean by ‘source type’?

• Forests in a country may face different levels and types of risks of illegality.

• Where the risks differ between different types we identify them.

• The different features of forests that we consider:
  ✓ Forest type
  ✓ Location
  ✓ Legal status
  ✓ Ownership
  ✓ Management
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

“negligible risk”

EUTR says “except where the risk identified in course of the risk assessment procedures is negligible” ... an Operator must mitigate the risks.

Negligible risk should be understood to apply to a supply when, following full assessment of both the product-specific and the general information, no cause for concern can be discerned.

EU Guidance Document
3. Risk assessment

Additional tools to assist with the risk assessment process:

- Annex 2 of **DD-01 The Due Diligence Guidelines** introduces the risk identification process.
- **DD-08 Risk Identification Checklist Template** provides a template to conduct risk identification on specific supply chains.
- Record the risk conclusion in the **Supplier Management Form DD-04** to provide an overview of risk across all supply chains.
- **The Supply Chain Mapping Tool DD-07** can be used to record supply chain information at a detailed level.
- Annex 3 of **DD-01 The Due Diligence Guidelines** provides guidance on how to specify risks.
- **The Certification System Evaluation Checklist DD-13** can be used to record the certification scheme assessment.
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 procedures [...] that are adequate and proportionate to minimise effectively that risk”

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

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

**Can the risk be avoided?**

- **Yes**
  - Avoid risk
    - Replace supply chain
    - Replace supplier
    - Use certified material
    - Use noncertified, low risk material

- **No**
  - Control risk
    - Change procedures
    - Collect additional documents
    - Conduct timber testing
    - Consult stakeholders
    - Collect additional information
    - Conduct supplier audit
Using 3rd party certification to mitigate risk

The European Timber Regulation does not include an automatic “green lane” for certified products ... BUT ... it does recognise the value of certification as a tool for risk assessment and mitigation.

EUTR Guidance Document says that companies ...

“may rate credibly certified products as having negligible risk of being illegal, i.e. suitable for placing on the market with no further risk mitigation measures, provided that the rest of the information gathered and the replies to the risk assessment questions do not contradict such a conclusion.”
Using 3rd party certification to mitigate risk

✓ Ensure the Certification system meets the requirements of the EUTR.

✓ Check whether the certification system adequately minimises the risk that illegal or unknown timber gets mixed in with your certified timber.

✓ Check that your certified material is covered by a certificate that is authentic and valid.
4. Risk mitigation

Good supplier relations is key

https://nepcon.org/library/guide/eutr-supplier-relations-leaflet
www.nepcon.org/sourcinghub
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>China, Honduras, Liberia</td>
<td>Now available</td>
<td>Now available</td>
<td>Now available</td>
<td>Now available</td>
</tr>
<tr>
<td>Ghana and DRC</td>
<td>Now available</td>
<td>Now available</td>
<td>Now available</td>
<td>Now available</td>
</tr>
<tr>
<td>Other 57 countries</td>
<td>Now available</td>
<td>Now available</td>
<td>Coming soon</td>
<td>Coming soon</td>
</tr>
<tr>
<td>Code</td>
<td>Name</td>
<td>French</td>
<td>German</td>
<td>Spanish</td>
</tr>
<tr>
<td>---------</td>
<td>-------------------------------------</td>
<td>--------</td>
<td>--------</td>
<td>---------</td>
</tr>
<tr>
<td>DD-01</td>
<td>Due diligence guidelines</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>DD-05</td>
<td>Supplier information form</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>DD-06</td>
<td>Supplier information letter</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>Timber Testing article</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
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**

The End

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.