Supply Chain Control and Certification

Holzindustrie Schweighofer Timber Sourcing Report 2018

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In May 2018, HS published an updated version of its timber sourcing policy. In that document, the company made the commitment to review this policy annually and report on its implementation. The policy can be downloaded from the company's website[1]. This report will put together the main figures on the implementation of this policy at a group level, with a special focus on the situation in Romania. The report intends to serve as a basis for information and further discussions with stakeholders.

1. Log Procurement

In 2018, the HS Group purchased saw logs from 14 countries, 11 of which are EU countries. Less than 3% of the overall input was coming from outside the EU.
The group's operation in Romania sourced 54% of its input from the Romanian market, which means that 46% was imported to Romania.
In 2015, Romania introduced a legal provision preventing an economic operator or group of economic operators to acquire or process more than 30% of the volume of an industrial assortment of wood of each species, established as an average of the last 3 years, on the basis of authorized exploitation documents[2]; HS is therefore limited to buy only 30% of one wood category from the Romanian market. Due to uncompetitive price levels of Romanian wood in 2018, HS remained well below this 30% threshold. According to the National Forest Inventory, HS' 2018 purchases from Romania represent about 2% of the annual increment of stock of the Romanian forests (all species) [3] and about 6% of the overall annual harvested volume (all species and assortments according to SUMAL[4]).

1.1. Sawn timber purchase

In 2018, HS purchased sawn timber from eight countries, three of which come from outside the EU.

1.2. Standing timber and NON-EU purchased volume

According to the European Timber Regulation (EUTR), HS is an "operator" for all volumes purchased as standing timber in Romania and all imports that arrive in our mills from NON-EU countries. The legal qualification as "operator" remains with the company, even if HS does not perform harvesting activities itself, but relies on service providers (harvesting companies) in case of purchase of standing timber. Legal obligations resulting from this status are just given for 6.7% of saw logs purchased as standing timber in Romania which – by definition - the company puts on the market, as well as the group-wide 3% imports from outside the EU.
It is important to mention that EUTR requires HS as an operator to maintain a regularly updated Due Diligence System, just for the volumes presented above. However, HS also maintains its Due Diligence system for all suppliers and deliveries, in order to meet voluntary certification requirements.
Compliance with EUTR is regularly checked by the competent authorities in Romania. Until the end of 2018 HS mills had 14 EUTR checks by the competent authorities without any complaints; four of which were conducted at our production facilities in 2018.

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[1] https://www.schweighofer.at/en/purchase/timber-sourcing-policy.html
[2] CODUL SILVIC din 19 martie 2008, Legea nr. 46/2008, Publicat în MONITORUL OFICIAL nr. 611 din 12 august 2015
[3] https://roifn.ro/site/about-nfi/
[4] SUMAL is the official wood accounting and controlling system of the Romanian State

2. Certification target

HS holds PEFC Chain of Custody (CoC) single site certificates for all of its factories[5]. In its timber sourcing policy, HS states that sourcing from sustainably managed forests is of highest priority for the company: "We are committed to ensuring that all our timber is responsibly sourced from sustainably managed forests." Certification is an important tool to ensure that a given company applies sustainable forest management and wood trading. HS is committed to the target of supplying only from certified forests, by 2025.

HS decided to go beyond the requirements of certification standards and applies a system whereby all its input is subject to the verification rules described in the PEFC CoC standard and all output is sold applying the claim "PEFC Controlled Sources" (or 100% PEFC).

2.1. Certified Input in 2018

- From the total input of saw logs in 2018, 49% was certified;
- From the total input of sawn timber, 52% was certified;

In 2017, the total certified saw logs input was 43%. Sawn timber purchase only started in 2017, therefore there is no reference value to show a development.

HS was able to make progress towards this target – the share of certified saw log input increased slightly. However, in order to reach the target in 2025, the company will need to focus more intensely on certified input in future purchasing decisions. In 2018, HS ran a certification bonus system in order to encourage CoC and FM certification in Romania. Up to 2018, 1.6 Mio EUR was invested in this bonus system. In order to increase confidence in its supply chain, HS is currently reconsidering the system, to make it better targeted towards traceability.

HS lost its FSC certification and was disassociated in 2017, based on a decision by the FSC board, after having been set on probation for possible disassociation in 2016, for formal reasons. FSC and HS are in an ongoing dialogue process where HS shall demonstrate tangible and significant improvements in its forest management and timber trade operations, as required by FSC, to be eligible to regain FSC certification in the future.

2.2. HS Due Diligence System (DDS)

HS has developed and implemented a robust DDS for all its mills, to mitigate and remediate risks of purchasing and using controversial raw material. The different measures within the organisation´s DDS are set up to meet compliance requirements for:
- PEFC STD 2002:2013
- EUTR 995/2010
- (US) Lacey Act and
- (Japanese) Clean Wood Act.

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[5] https://www.pefc.org/find-certified/advanced?mode=advanced&company_name=holzindustrie+schweighofer&certificate_number=&logo_license_number=&product_name=&cb_notification=&country=&certificate_status=Valid&industry_sector=&product_category=&page=1

2.2.1. Information gathering

As a first step, HS collects information from its suppliers - starting with a supplier declaration. This declaration contains a commitment from the potential supplier not to source wood from controversial sources, as well as information on the origin of the wood at sub-supplier level, together with the delivered species. HS also collects supplier details, such as address, VAT number, as well as information about the administrator and, if applicable, information about the shareholders. HS also collects information on the certification status of the supplier. Based on this information, a legal due diligence is carried out, including a check on correct tax payments and supplier's compliance with the company's requirements from its timber sourcing policy. Suppliers which have been convicted for corruption or forest crimes are excluded from the supply chain. In 2017, HS introduced an internal web platform where the legal DDS explained above is conducted for each supplier; the platform is called "Suppliers Screening and Monitoring".

2.2.2. Assessment of risks

Using the information above, a risk assessment is conducted by the SCCC (Supply Chain Control & Certification) department in order to evaluate the risk mitigation tools which need to be applied on a case by case basis. This risk assessment is done on country and supplier level.

2.2.3. Risk mitigation tools

Based on this risk assessment, the company developed a set of measures which enable HS to mitigate a risk of controversial material inflow to a negligible level. Suppliers and deliveries for which the risk cannot be mitigated are not accepted in HS' supply chain. One of the most important risk mitigation tools is the on-site audit conducted by HS' SCCC staff.

2.2.3.1. Timflow – wood tracking system

Timflow is a system which collects, analyses and publishes data about log-truck based timber supply chains. It consists of four key-components:
- a GPS logger installed in the truck's circuitry and equipped with mobile data access;
- a mobile device app for the truck driver;
- an internal portal for the truck reception procedure;
- an external portal for publishing the Timflow datasets.

Starting April 2017, all harvesting companies and/or transport companies which supply HS have to comply with the Timflow requirements, and, during the last two years, no wood with Romanian origin was delivered to HS' mills without using the Timflow system. The Timflow process starts at the loading site (primary platform or forest logyard), where
- pictures are made of the truck load and uploaded to the system;
- the destination and registry plate numbers and delivery note number are recorded;
- the GPS logger records the location of the loading point.

This information is recorded within the truck's "black box" every 30 seconds and delivered to a cloud server immediately where cell phone network is available. Thus, the mill gate is aware of incoming

deliveries and can, at this point, check the accuracy of the delivery process along the way to the mill. Once the truck arrives at the mill gate, the gate staff registers the transport as "arrived". The Portal displays the registered data, including:

- name of transporting company;
- license plate, number of waybill and SUMAL-ID for both truck and trailer;
- the complete GPS track of the transport;
- the time stamps of start and end of the transports;
- a detailed map of the loading site region, where also conservation areas (natural work heritage forests, national parks, potential virgin forests) and the GPS coordinates of the registered loading site(s) are displayed;
- the pictures of the loaded truck (including timestamp on the pictures).

If all information is plausible, the gate staff registers the truck as "accepted" – if not, the transport is blocked and the delivery is downloaded in a separate area and marked as for "further investigation".

In 2018, HS accepted a total of 25,924 trucks in all its mills in Romania. Of those, 3,356 trucks required additional verification before being accepted for production. In the case of five trucks, HS rejected the delivery because of documented non-compliances with its timber sourcing policy (National Park issues, lack of, or unclear origin).
HS also uses Timflow in the collecting points in Maramureș county. In 2018, the company received 2,098 transports in both collecting points, 124 of which were further investigated.

The main reasons for additional verifications in 2018 were breaches of internal regulations - e.g. the APV was not confirmed by our staff - or issues with the GPS devices - such as incomplete route or positioning errors showing loading locations other than what was expected.

2.2.3.2. Chain of Custody Auditing

The Chain of Custody Audit is designed to get more detailed information about the supply chain and the risk of mixing wood from different sources. It also aims to verify the information provided on the supplier declaration, check the legality of required documents and to get an overview of the supplier's operation. Starting 2018, the checklists for the audits are programmed in a mobile application (iAuditor). The iAuditor application collects timestamps and GPS coordinates of the audit in order to prove that the audit practically happened on site and was not desk based only.

During the on-site audit, the responsible SCCC officer checks information such APVs, harvesting permits, plot maps, but also information from logyards registries on the input and the sources of wood entering the logyards. HS staff also randomly cross-check delivery notes, as well as documents related to the origin of the input material, health & safety and fire protection measures. Pictures of the logyard, volume on stock, machinery, working conditions, fire protection measures, are also checked and documented in order to assure compliance.

2.2.3.3. Forest Management Unit office audit and plot visit

The Forest Management Unit (FMU) audit is designed to get more information related to the origin of the wood material on a general level, but also at specific plots level, this being possible by visiting the

office of the FMU where this information is voluntarily provided by the FMU staff. During these visits, a dedicated checklist is used to conduct the audit. The audit itself is also conducted with the iAuditor Application. During the FMU office audit, HS staff gathers additional information on the management plans, such as validity, total managed area, protected areas, etc. and information on selected plots to be visited. This information is then checked on the ground. Additionally, the harvesting activity is checked for compliance with legal requirements. It is important to mention that FMUs accept such on-site audits on a voluntary basis. In certified state-owned FMUs HS relies on publicly available certification reports.

2.2.3.4. Other risk mitigation tools

- Media monitoring – Holzindustrie Schweighofer has a media monitoring system, designed to collect and evaluate relevant news items from high risk countries where it purchases raw material. The scope of the monitoring is aligned to the countries' relevance. Therefore, it is pre-programmed in Romania and Ukraine only;
- Stakeholder consultation – The organisation implemented a stakeholder consultation process to ask and collect external information on planned supply. As established in the procedure, the opinion of relevant stakeholders is taken into account in sourcing activities and risk mitigation measures.
- Suspension of suppliers - HS as a rule disassociates from suppliers that have been convicted for corruption or forest crimes. This suspension can last up to three years.

2.2.4. Suppliers and verification program overview

In 2018, we had 797 suppliers at a Group level, out of which 700 delivered only to Romania.
We conducted a total of 630 audits of our supply chain, out of which 602 for suppliers delivering to the Romanian mills:

For Romanian mills:
- Chain of Custody audits = 447;
- Forest Management audits = 60;
- Harvesting plot audits = 120;

For the German sawmill:
- Chain of Custody audits = 28

3. Complaints on HS suppliers or about sourcing areas

The primary goal of the complaint management system is to monitor complaints, provide a framework for investigation of all complaints and integrate the learnings from the investigations in the improvement of the DDS, in order to prevent future incidents.

HS' complaint management system is set up to receive complaints from all possible sources, including
- direct information from stakeholders or published reports;
- indirect sources of information from media monitoring;
- internal complaints.

Findings from the regular supply chain verification process, especially from audits, but also irregularities in Timflow are not handled as complaints but as non-compliances, although they may also result in corrective actions, up to supplier suspension.

In 2018, HS SCCC handled altogether 35 complaints, 20 of which were reported internally. All in all, 12 cases turned out to be substantiated of which eight resulted in the temporary suspension of the supplier (3 month to 3 years). From external complaints, just one resulted in a suspension. Most of the complaints filed concerned Romania; three Ukraine and one Slovakia.

3.1. Case studies

In this section the company showcases some of the complaints it handled in 2018 and how it responded to the cases.

3.1.1. External Complaints
3.1.1.1. Earthsight report on Ukraine

NGO Earthsight published a report in July 2018[6] which claimed that a significant part of Ukrainian wood export is illegal as it happens contrary to export ban regulations. While it is beyond HS control to address claims of high level corruption within the Ukraine's forest sector, HS has implemented measures to manage risks for Ukrainian supplies. In particular, HS does not purchase logs from the Ukraine and all suppliers in the Ukraine are subject to legality checks on their documentation as well as field visits to forest management units from which fiber is sourced.

3.1.1.2. EIA report on National Park Timber and Logyards

Environmental Investigation Agency (EIA), a Non-Governmental Organisation, issued a report in July 2018 claiming that HS' DDS is inadequate to verify the legality of depot deliveries and their origin and alleged that during a 1.5 year timeframe, some HS suppliers received 35,000 m^3 timber originating from National Parks buffer zones[7] and a part of this volume may have been delivered to HS mills. HS provided a report[8] following a detailed investigation that found no substantive evidence to support the claims. While there remains a risk of sourcing from illegal sources, existing measures to avoid such sources have

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[6] https://environmentalpaper.org/2018/07/earthsight-investigative-report-eu-mills-complicit-in-corruption-and-illegal-logging-in-ukraine/

[7] The exclusion of material from National Parks is a voluntary commitment from the company. Material that is harvested in management areas in National Parks (so-called Buffer zones) according to the management plan could be purchased with no limitation on the market.

[8] https://www.schweighofer.at/fileadmin/files/Responsibility/201808_HS_timber_supply_chain_explained_EN.pdf

been largely effective in identifying and excluding from the supply chain logs whose origin is not clear. In order to implement the companies voluntary Zero Timber from National Parks Policy HS also implemented an effective risk mitigation tool which enables the company to meet this commitment. The details are presented in the cited report.

3.1.1.3. Virgin Forests in the Făgăraș Mountains

On 12 January 2019, a report from the Department of Forest Ecology from the Faculty of Forestry and Wood Sciences (University of Life Sciences in Prague, the Czech Republic) came to our attention. The report highlighted the loss of primary forests in the Făgăraș Mountains. All areas are well documented in the report, including pictures, maps and GPS coordinates. HS staff carried out a detailed assessment of the claim, including the possibility that material from virgin forests might have reached HS mills. Based on this investigation, the following measures were taken:
- No deliveries were made from the identified areas in 2017 and 2018.
- The risk of receiving wood from these areas into HS' supply chain was/is low, due to species composition and diameter range (HS only processes coniferous logs with diameters below 50 cm).
- Following the precautionary approach, HS committed to avoid inputs from these areas, even if they are considered legal.
- Maintain contact with the authors of the study for information purposes.

3.1.2. Infringement of HS' Timber Sourcing policy

In July 2018, two transports coming from the Neamț area were identified as being from the Ceahlău National Park, after the verification of the APV database at our gates. This procedure is part of the regular DDS at the gate checks level. The transports were set "under investigation" and unloaded at the respective area inside the mill. After cross checking the origin with the coordinates, the origin from the NP was confirmed and the two transports were rejected. The reason for this was a human error during the participation at a forest road auction.

3.1.3. Suspended suppliers

HS does business only with partners whom it has reason to trust as acting with due diligence and professional prudence. Where executive managers or staff in similar functions is convicted by a final binding court decision for illegal wood harvesting or corruption, we, as a rule, exclude their companies from our supply chain for three years. In justified cases, we reserve the right to delist suppliers at any time appropriate.

In 2018, HS suspended eight companies, of which five were suspended for the maximum time, 3 years. Reasons for the suspension were the following:
- Conviction for illegal logging
- Transport issues: alleged multiple transports or transports without clear origin;
- Refusal of an on-site verification audit;
- Audit findings, applied corrective actions were not fulfilled.

3.1.3.1. Case study (unclear origin)

In August 2018, the verification of an incoming input has proven that the input arriving from a logyard of a supplier turned out not to be registered in the logyard's registry book. As such, the supply had no legal documented origin and, therefore, was considered to be without legal origin. The purchase of the given supply was refused and the supplier was suspended for four months starting 23.08.2018. The supplier can re-start a business relationship with HS only after a comprehensive on-site audit is conducted and the risk determined after this audit is low.

4. New traceability projects

In 2018, Holzindustrie Schweighofer started a pilot project in order to facilitate the physical tracking of single logs. This could be a future means to track and trace timber even in complex (i.e. broken) supply chains. In order to track and trace individual logs through a supply chain, the single pieces have to be identifiable at each stage. Holzindustrie Schweighofer investigated a number of possible marking technologies – but came back to a well-established method: plastic tags. They have unique numbers and can be safely hammered onto the top-ends of the logs. The polymer itself is unproblematic for further processing, even in case of pulp and paper utilization of the by-products. The pilot project was discontinued ahead of schedule, because of ongoing problems with the mobile application. Due to an unresolved error in the database structure, the phone's processing time increased potentially with the number of logs for a given set of origin after entering the dimensional data of one log.
Until discontinuation, a volume of 1,500 m³ of logs was tagged and registered in the system (corresponding to more than 10,000 tags). More info about the project can be consulted on our website – "Stakeholder Platform" section: https://www.schweighofer.at/en/responsibility/stakeholder-platform.html
In 2019, HS will continue testing new projects and will try to find new ideas to ensure physical traceability of single logs through logyards, as we are aware this is the main concern of stakeholders and some NGOs. The company's target is to develop a traceability solution which is applicable at an industrial scale. An update on the future projects will be published on our website.

5.   Supply chain control improvements in 2018

It is not just a legal obligation to review the DDS on a regular basis, but also the company's self-conception to learn according to the company slogan "Getting better every day". Apart from a regular update of the risk assessments, there is a well-established process in place to improve the procedures and requirements from the DDS, as a result of internal investigation processes.
In the following, HS presents changes that were made in 2018:

5.1. Design changes

- Conversion from multi-site to single site PEFC certificates, new main assessments (dates);
- Revision of country-specific issues of supply chain control, emphasize country specific issues in documentation and risk assessment;
- Preparation of a risk matrix (predefined risk mitigation methods depending on input, certification status, method of delivery);
- New concept of low impact forestry, first assessment, key problem areas.

5.2. Risk assessment

- Assessment of CZ in light of the FSC CNRA, modifications in purchase contract, assessment of risk, organizing third party audit;
- Revision of risk assessment procedure (iAuditor);
- Initiation of input volume data handling project;
- Better handling of incoming certification claim declarations

5.3. Risk mitigation

- New suspension procedure, update of suspension status;
- External PEFC CoC training;
- EUTR audit, third party supplier audits;
- Revision of audit plan rules, selection of suppliers, frequency of visits;
- Revision of the role of certification as a risk mitigation tool in FM and CoC;
- Modification of the CoC audit form;
- Modification of the FM audit form;
- Modification of the plot visit audit form.

5.4. Documentation and reporting

- Revision of the Lacey Act procedure;
- Improved DDS reporting methods;
- Update of claim text on outgoing invoices, including reference to view HS' certificate;
- Logo use contract initiation with PEFC Romania to initiate the possibility to use on –product logos;
- Improved and simplified credit calculation sheet;
- Revision of the internal certification report;
- Complex update and unification of manuals, including body text and all annexes.

6. Directions of HS' DDS for 2019 – Outlook

In 2019, the issue of traceability will remain of major importance for the company. The cancelled logyard tracing project will be reviewed and restarted based on lessons learnt. In order to further increase trust in the company's procedures, HS will seek to establish closer collaboration with some of its suppliers in the field of traceability.

Many of the external audits HS underwent in 2018 by customers or third parties stressed the necessity to work on the issue of "Low Impact Forestry Training". Therefore, the company intends to set up a low impact forestry program and provide harvesting companies with training sessions jointly with the Fundația Pădurea de Mâine and external partners.

Learning from 2018 was also to readjust the role of certification as a risk mitigation instrument in the field of legality. As a consequence, e.g. for Ukraine, all suppliers will be audited on-site, regardless of their certification status.

HS also intends to continue implementing measures and actions to comply with the FSC "Conditions Framework" in 2019. Independent verification confirming HS' fulfillment of FSC's requirements, as stipulated in the "Conditions Framework" would be grounds for FSC to end its HS' disassociation status. On a structural basis, HS is working to develop a new internal management system for Due Diligence, the so-called "DDS hub", a data management tool. This will increase quality management in the field of Supply Chain Control. In terms of auditing frequency, the company will keep the absolute number but increase forest audits and also enhance collaboration with third parties when necessary.