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Peace River Pulp Division
Forest Resources Business Unit
Postal Bag 6500, Pulp Mill Site
Peace River, Alberta
T8S 1V5

September 8, 2006

Dear Al:

**Re: 2006 ISO PEFC Chain of Custody Audit Report for Daishowa-Marubeni International Ltd.
– Peace River Pulp Division**

Our 2006 PEFC Chain of Custody Audit Report for Daishowa-Marubeni International Ltd. – Peace River Pulp Division (DMI-PRPD) is attached. The report documents the results of the audit that took place during the period September 6 – September 8, 2006.

As communicated to you in the audit notification letter, you are required to submit corrective action plans to address all identified non-conformities within 30 days of the date of the closing meeting. Upon receipt by KPMG PRI, these will be reviewed to verify that they adequately address the root cause(s) of the non-conformities identified during the audit, and either approved or returned to you for revision.

We value the ongoing working relationship that we have with DMI-PRPD, and appreciate the assistance provided to the audit team by Company staff and contractors during the audit process.

If you have any questions regarding the results of the audit or what is required in the way of corrective actions, please call me at the phone number listed below.

Yours truly,

Dave Bebb, RPF (BC & Alta), CEA(SFM), EMS(LA)
Vice president, Registration Operations
KPMG Performance Registrar Inc.
604-691-3451

Enc: 2006 PEFC Chain of Custody Audit Report



**2006 PEFC Chain of Custody Audit Report
for
Daishowa-Marubeni International Ltd.
Peace River Pulp Division**

September 8, 2006

The information in this audit report is confidential and may be legally privileged. It is intended solely for the use of the intended recipient, Daishowa-Marubeni International Ltd. Access to this audit report by anyone else is unauthorized. If you are not the intended recipient, any disclosure, copying, distribution or any action taken or omitted to be taken in reliance on it, is prohibited and may be unlawful. Any opinions contained in this audit report are subject to the terms and conditions expressed in the governing KPMG PRI client engagement contract.



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A. Client Information

Client Name:	Daishowa-Marubeni International Ltd. – Peace River Pulp Division (DMI-PRPD)
Audit Criteria:	PEFC Chain of Custody Standard (Annex 4)
Scope of Registration:	The PEFC chain of custody system developed and maintained by DMI-PRPD to track and report on the certified content of the softwood chips procured from third parties and the associated softwood pulp products produced from those softwood chips.
Client Representative:	Al Schneider, Advisor, Continuous Improvement
Assessment Number:	#2438.1 – PEFC Chain of Custody

B. Document Review Findings

No formal document review was completed in advance of the audit. As a result, there were no document review findings that required follow-up by the audit team.

C. Audit Details

Type of Audit:	Implementation Assessment
Date(s) of Document Review:	NA
Date(s) of Audit:	Implementation Assessment: September 6-8, 2006
Date of Next Assessment:	To be determined (maximum of 6 months from the date of the audit exit meeting)
Audit team:	Lead auditor: Dave Bebb Audit team members: NA
Audit Report Distribution:	Daishowa-Marubeni International Ltd. KPMG PRI audit files
Audit objective(s):	The objective of the audit was to evaluate the chain of custody system at Daishowa-Marubeni International Ltd. – Peace River Pulp Division, its implementation, effectiveness and conformance with the requirements of PEFC Annex 4.
Audit scope:	The scope of the audit included: The elements of PEFC Annex 4 outlined in the audit plan. Activities conducted under the Company’s chain of custody system during the period January 1, 2006 – September 8, 2006. Visits to the following Company operations: Site 1. DMI-PRPD corporate/woodlands office Site 2. DMI-PRPD pulpmill

D. Audit Findings

Good Practices

The following good practices were noted during the audit:

1. Formal documentation of the chain of custody system in the DMI-PRPD PEFC chain of custody document.
2. Completion of a detailed PEFC chain of custody gap analysis in advance of the formal certification audit.
3. Prior existence of comprehensive woodlands environmental management system (EMS) and pulpmill quality management system (QMS) procedures that can be relied upon to satisfy the management system requirements of the PEFC chain of custody standard.

Follow-up on open non-conformities and opportunities for improvement from previous audits

There were no open non-conformities or opportunities for improvement from previous audits that required follow-up by the audit team.

Major non-conformities

The following 2 major non-conformities were identified during the audit:

1. **Major non-conformity: 2438.1-NC-IA-01**

Standard/Element(s): 4.6.1 – Internal Audit

Client Procedure: DMI-PRPD PEFC CoC Document, Internal Audit

The PEFC CoC standard requires that the organization conduct internal audits at intervals of at least one year covering all requirements of the standard and establish corrective and preventive measures if required. The DMI-PRPD PEFC CoC Document (section 5.6) outlines the operation's commitment to meet this requirement of the standard. However, the operations internal audit procedures (e.g., EMSP-4.5.5 – Draft Internal Audits, EMSF-4.5.5.1 – EMS Audit Checklist, EMSF-4.5.5.2 – Summary Audit Report, etc.) have yet to be revised to incorporate an evaluation of the chain of custody system within the scope of the internal audit. In addition, although a recent PEFC CoC gap analysis of the system was completed by an external consultant, a full-scope internal audit of the chain of custody system has yet to be completed.

2. **Major non-conformity: 2438.1-NC-IA-02**

Standard/Element(s): 4.6.2 – Management Review

Client Procedure: DMI-PRPD PEFC CoC Document, Management Review

The PEFC CoC standard requires that the results of the internal audit of the chain of custody system be reviewed by the organization's top management at least annually. The DMI-PRPD PEFC CoC Document (section 5.6) outlines the operation's commitment to meet this requirement of the standard. However, the operation's management review procedures (e.g., EMS-4.6 – Management Review) have yet to be revised to include an evaluation of the results of the internal audit of the chain of custody system within the scope of the management review. In addition, a management review of the chain of custody system has yet to be conducted.

Minor non-conformities

The following 5 minor non-conformities were identified during the audit:

1. **Minor non-conformity: 2438.1-NC-IA-03**

Standard/Element(s): 3.2.2 – Identification at Supplier Level

Client Procedure: Request Letter for PEFC Cooperation

The PEFC CoC standard requires that the organization obtain information from all suppliers which proves that the criteria set for the supplier of the certified raw material have been met. The operation has addressed this requirement through its standard Request Letter for PEFC Cooperation which requires each supplier of certified raw material to provide: (1) a copy of the applicable certificate of registration, and (2) a letter of representation which outlines the proportion of softwood chips originating from certified forests and assigns all certification credits for the softwood supply to DMI-PRPD. To date, only Tolko High Level has supplied this information to the operation. However, although the copy of the Tolko CSA Z809-02 certificate of registration and representation letter dated July 7, 2006 address most of the above requirements, the representation letter does not specifically assign all certification credits for the softwood chips to DMI-PRPD. As such, it is not clear whether the certification credits associated with the softwood chips supplied by Tolko have actually been transferred to DMI-PRPD, or whether they have been used by Tolko and/or transferred to another party.

2. **Minor non-conformity: 2438.1-NC-IA-04**

Standard/Element(s): 4.2.1.1 – Management Responsibilities

Client Procedure: DMI-PRPD PEFC CoC Document

The PEFC CoC standard requires the organization's top management to appoint a member of the management group who, irrespective of other responsibilities, shall have overall responsibility and authority for the chain of custody. However, although the DMI-PRPD PEFC CoC Document outlines responsibilities and authorities for various components of the chain of custody system, overall responsibility for the system has yet to be formally assigned.

3. **Minor non-conformity: 2438.1-NC-IA-05**

Standard/Element(s): 4.3 – Documented Procedures

Client Procedure: DMI-PRPD PEFC CoC Document, Softwood Pulp from Certified Forest Procedure (SPD-QC.100-200)

The PEFC CoC standard requires that the organization's chain of custody procedures be documented. The operation has addressed this requirement through the development of the DMI-PRPD PEFC CoC Document. However, the audit found that the documented chain of custody procedures are not consistent with the actual chain of custody procedures that are being implemented at the operation. In particular, the DMI-PRPD PEFC CoC Document indicates (on page 14) that the volume credit method outlined under the PEFC CoC standard is not applicable to the operation's chain of custody system. However, interviews with key staff and a review of available records found that the operation is in fact using the volume credit method outlined under the standard. In addition, the DMI-PRPD PEFC CoC Document is inconsistent with the recently developed Softwood Pulp from Certified Forest Procedure (SPD-QC.100-200), which describes how certification credits are to be assigned to specific pulp lots (as required under the volume credit method).

4. **Minor non-conformity: 2438.1-NC-IA-06**

Standard/Element(s): 3.5.1 – Sale of Products

Client Procedure: Bill of Lading

The PEFC CoC standard requires the organization to provide customers with a document verifying compliance with PEFC chain of custody requirements. Discussions with DMI-PRPD staff indicated that the operation intends to meet this requirement through modifications to the Bill of Lading, which is currently produced through the Danbie system. However, the Bill of Lading has yet to be modified to meet this requirement.

5. **Minor non-conformity: 2438.1-NC-IA-07**

Standard/Element(s): 3.6.1 – Controversial Sources

Client Procedure: Letter of Representation

The PEFC CoC standard requires that the organization obtain a signed declaration from all of its suppliers that the raw materials supplied do not originate from controversial sources (e.g., illegal or unauthorized harvesting, harvesting within protected areas, etc.). In addition, this declaration must be included in formal fibre supply agreements with suppliers where such contracts exist. However, the operation has to date only obtained this declaration from one of its suppliers (Tolko High Level). In addition, requirements related to controversial sources have yet to be included in the operation's chip supply agreements.

Opportunities for improvement

The following 3 opportunities for improvement were identified during the audit:

1. **Opportunity for improvement: 2438.1-OFI-IA-01**

Standard/Element(s): Section 4 (Minimum Management System Requirements)
Client Procedure: DMI-PRPD PEFC CoC Document, Woodlands EMS, Pulpmill QMS

The PEFC CoC standard outlines minimum management system requirements to ensure the correct implementation and maintenance of its chain of custody process, and suggests that an organization's quality (ISO 9001) or environmental (ISO 14001) management system can be used to meet the minimum management system requirements outlined in the standard. The operation's chain of custody process is outlined in the DMI-PRPD PEFC CoC Document. However, this is currently a stand alone, uncontrolled and undated document which has yet to be formally incorporated within either the woodlands ISO 14001 EMS or pulpmill ISO 9001 QMS. In addition, discussions with key staff found that the operation has yet to decide whether the chain of custody process will be incorporated within the woodlands EMS or mill QMS.

2. **Opportunity for improvement: 2438.1-OFI-IA-02**

Standard/Element(s): 4.3 – Documented Procedures
Client Procedure: Softwood Pulp from Certified Forest Procedure (SPD-QC.100-200)

The Softwood Pulp from Certified Forest Procedure (SPD-QC.100-200) incorrectly states that "As per PEFC requirements, if more than 70% of the chips during a SW run are from certified sources the whole run can be considered certified". In the fact, the PEFC CoC standard (Annex 4) does not include any reference to the 70% certified content threshold alluded to in this procedure. In addition, although Annex 5 (the PEFC Logo Use Rules) provide for the use of an on-product PEFC label when the 70% certified content threshold has been reached, the organization is required to include a statement on the label that a minimum of 70% (and not 100%) of the raw material used to make the product was obtained from PEFC certified sources.

3. **Opportunity for improvement: 2438.1-OFI-IA-03**

Standard/Element(s): 3.4.2.3 and 3.4.2.4 – Volume Credit Method
Client Procedure: DMI-PRPD PEFC CoC Document

Under the volume credit method, an organization is allowed to set up a credit account to accumulate certified volume credits for up to a maximum of 12 months. However, the current volume credit methodology employed by the operation does not take advantage of this opportunity, and instead tracks the production and consumption of certification credits on a production batch-specific basis only. Using this approach, unused certification volume credits are not carried forward and hence are not available for allocation at a later date should the need arise.

Outstanding issues requiring further audit work

The PEFC CoC standard requires the organization to identify and verify the category of all procured raw material. To date, only Tolko has supplied the operation with certified (to CSA Z809-02) raw material. The Tolko High Level woodlands manager has provided the operation with a letter of representation indicating that approximately 77.7% of the raw material delivered to DMI-PRPD during the January 1, 2006 to July 7, 2007 period came from certified sources. However, we were unable to verify the accuracy of the information provided by Tolko to DMI-PRPD during the on-site audit. As such, additional audit work will be required before we can conclude on whether the estimate of certified raw material supplied by Tolko is accurate.

Audit conclusions

As noted above, 2 major non-conformities were identified during the implementation assessment. In addition, we were not able to conclude on the accuracy of the information supplied by Tolko High Level regarding the certified content of the softwood chips delivered to DMI-PRPD. Daishowa-Marubeni International Ltd. – Peace River Pulp Division will therefore not be recommended for registration to the PEFC CoC standard at this time. Once corrective action plans to address all of the major and minor non-conformances have been received and approved by KPMG PRI, we will schedule a follow-up visit to close out the outstanding issues.

Our assessment by its nature is a sample and is not intended to be as comprehensive as your internal audit. It is possible for nonconforming issues to remain undetected. Our next assessment will verify that your internal audits have continued to operate as the primary mechanism to ensure that your chain of custody system remains effectively implemented and continues to improve.

E. Corrective Action Plans

Written corrective action plans that are designed to address the root causes of all identified non-conformities are required within 30 days of the closing meeting. These will be reviewed by KPMG PRI for adequacy, and either approved or returned for revision.

A template for DMI-PRPD to develop the required corrective action plans will be provided to you for this purpose. Please complete the appropriate section of this template and e-mail your proposed corrective actions to the KPMG PRI lead auditor for review.

F. Focus Areas for Next Audit Visit

The following issues/potential concerns have been identified as focus areas for the next audit visit:

1. Follow-up on the implementation of action plans developed to address the non-conformities and opportunities for improvement identified during the September 2006 audit.
2. Verification of the accuracy of the certified content information supplied by Tolko High Level.
3. Progress towards the integration of the chain of custody process into either the woodlands EMS or the pulpmill QMS.