# Dealing with fraud in the forest sector

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Forest Trends

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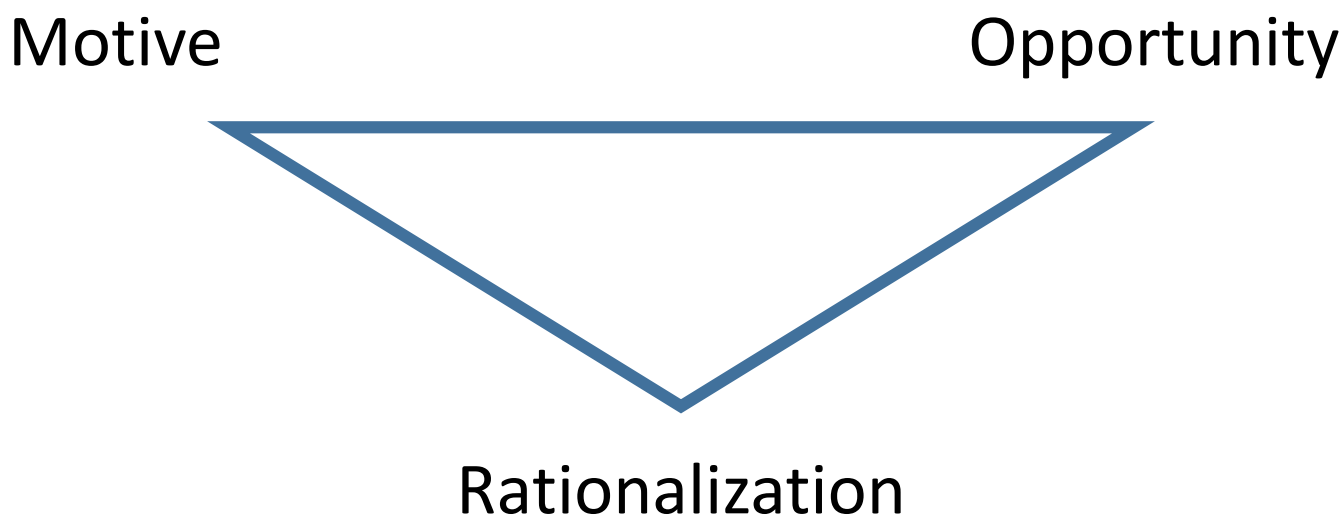
# Fraud

- deception intended to result in personal gain
  - act or omission
  - knowingly or recklessly
  - financial or other benefit
  - or to avoid an obligation

# Fraud

- deception intended to result in personal gain



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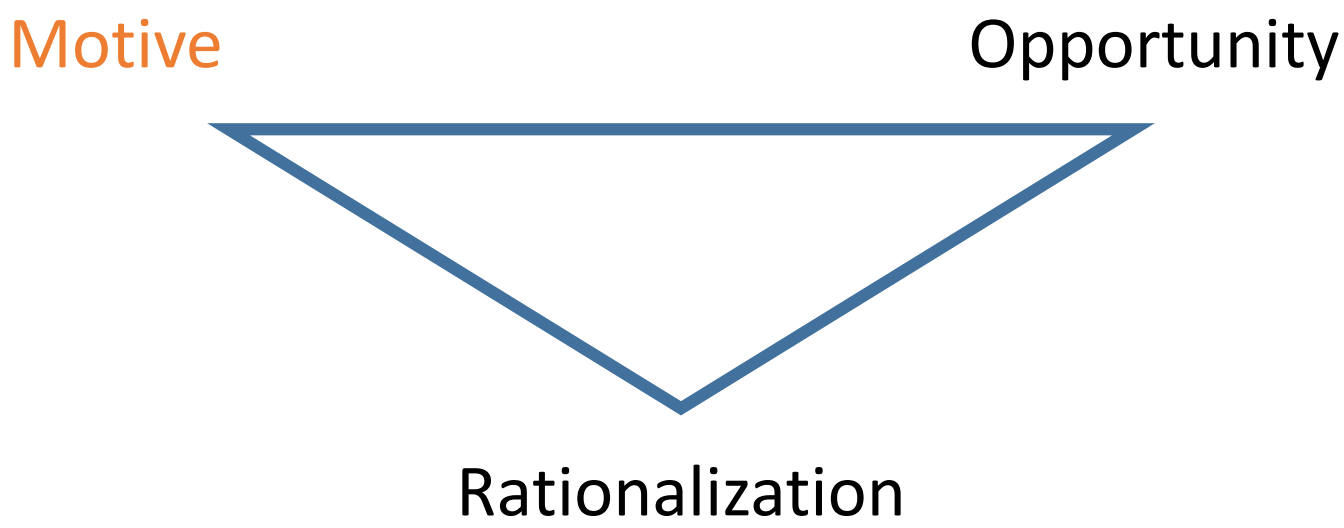
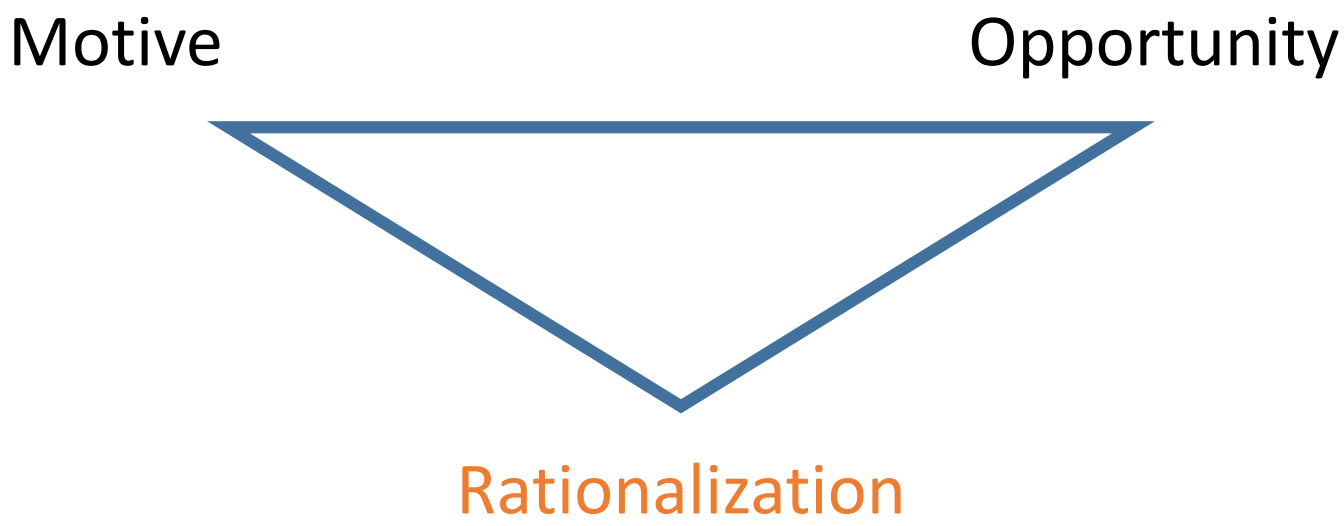


# Fraud

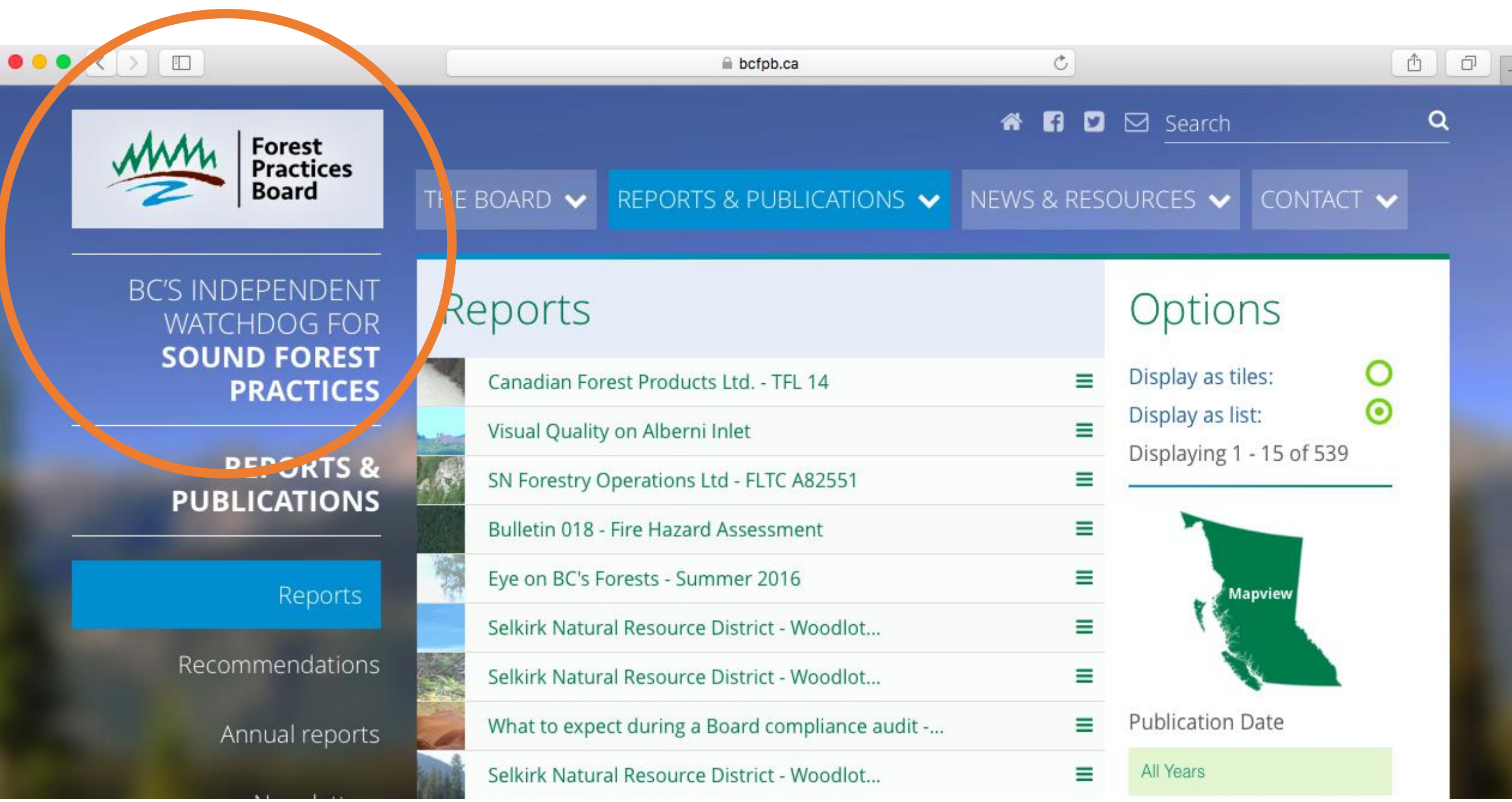
Legal does not differ in quality from illegal,
so customer derives no additional benefit despite increased cost

Public good, often seen as “no-one is harmed”….



# British Columbia, Canada

- Logging → gov’t revenue $1.3 billion / year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# Enforcement in BC logging industry

- Gov’t revenue $1.3 billion / yr
- Enforcement
  - > 2000 inspections
  - ~15% out of compliance
  - < 5% fines

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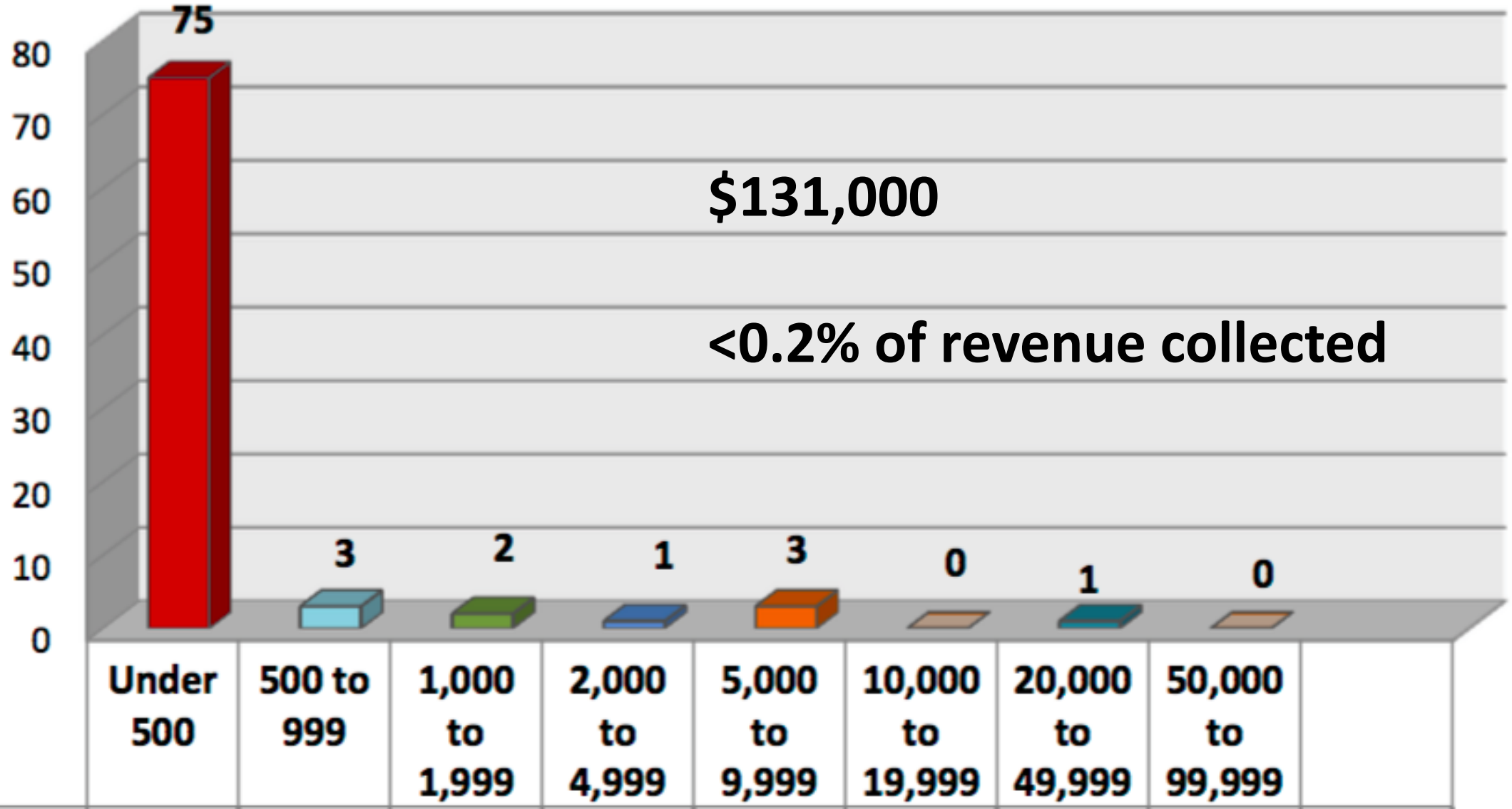
Print Friendly Version
Ministry of Forests, Lands and Natural Resource Operations
The Role of Compliance & Enforcement

# Monetary Penalties by Case
## Total: 85



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## Environmental Violations Database (EVD)

Name of Company:
Location:
Enforcement Action:
From Year: 2011 Quarter: 1
To Year: 2016 Quarter: 1
Act: Forest Practices Code of British Columbia Act Act Section:
Reg: Reg Section:
Report Type: HTML: (view on screen) CSV: (export as file)

Submit

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Ministry of Environment EVD application

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## Environmental Violations Database (EVD)

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Report Type: HTML: (view on screen) CSV: (export as file)

Submit

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# Enforcement in BC logging industry

- Govt revenue $1.3 billion
- Enforcement
  - < 5% fines
    - Maximum fines = $131,000
    - 5% = $65 million

**Overdue book fines at the Vancouver Public Library $713,685**

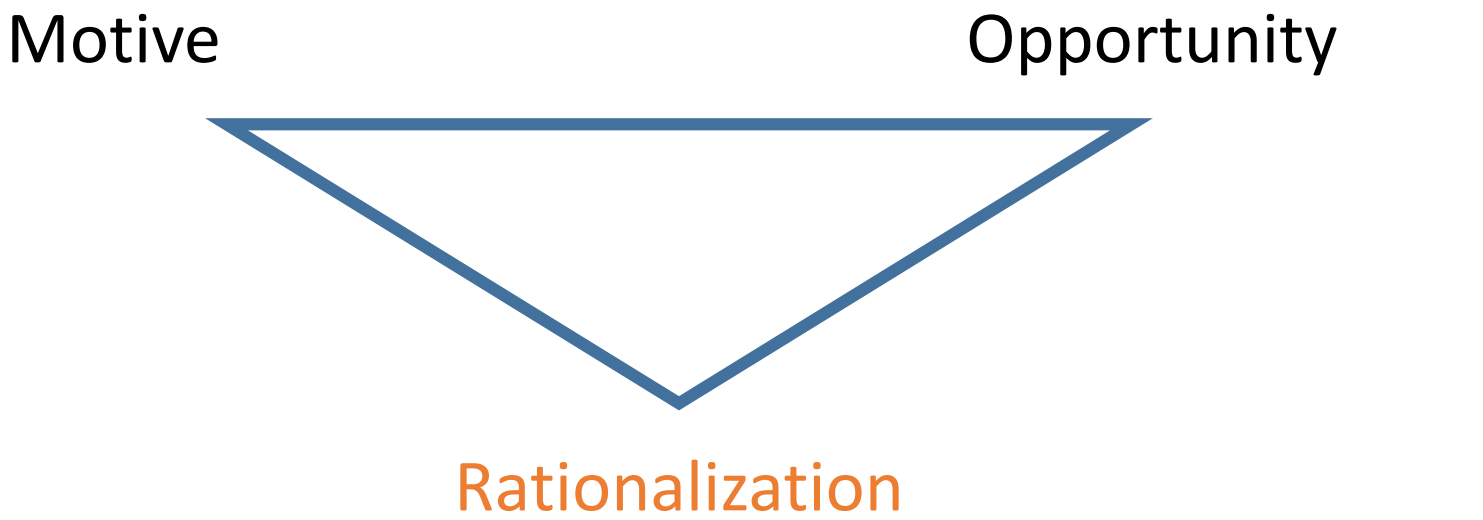
# Fraud

Education:

- Social harm
- Criminal activity
  - Conflict
- Eco-harm
- ↓ taxes
- ↓ price

- $30-$100B ~1/3rd of trade

Confidential informants



JMHT Vol. 21, (3): 184–191, December 2015
EISSN: 2089-2063
DOI: 10.7226/jtfm.21.3.184

Scientific Article
ISSN: 2087-0469

# Transaction Cost of Forest Utilization Licenses: Institutional Issues

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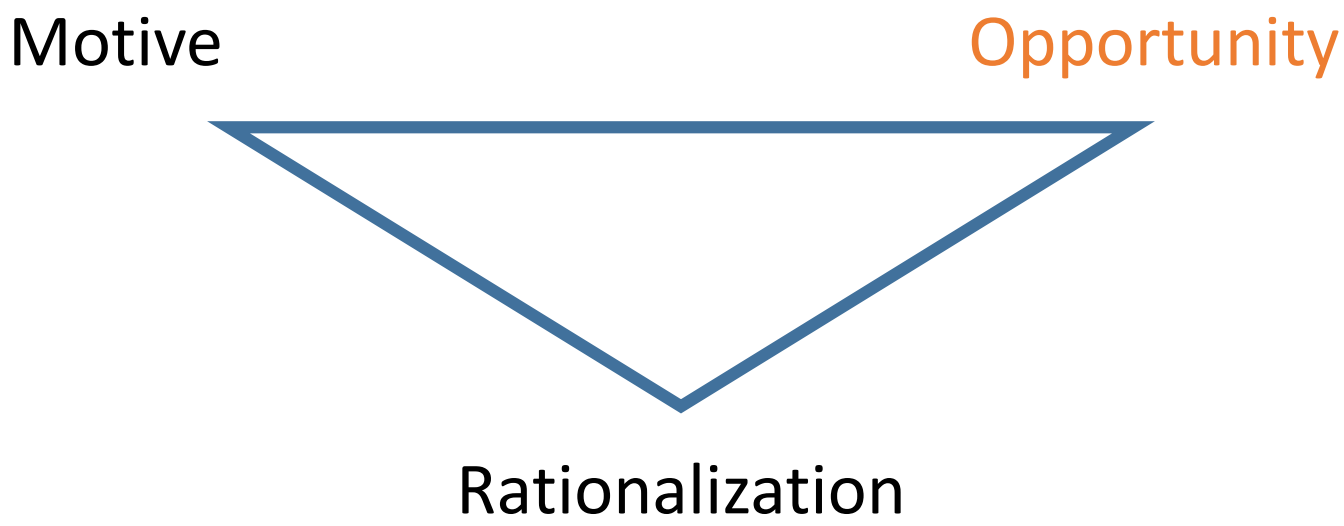
**Received August 11, 2015/Accepted December 6, 2015**

***Abstract***

*Forest resource management has a characteristic of high transaction cost particularly due to lack of valid information and policy process. Such characteristic requires unique institution to ensure an effective policy implementation. This study shows that state has inadequate control over forests and forest governance, extra-legal access, as well as patron-client relationships as the causes of the high transaction costs. Consequently, more and more the natural production forests are degraded and this does not only cause loss of state revenue from natural resources, but also a bankruptcy of corporations which exploit natural production forests. Most of those natural forest assets turned into resources for producing and reproducing a rival institution or extra-legal power, rendering official state institutions incapable of controlling transaction costs. Therefore, changes and improvements of the licensing arrangements need to be supported by the political elites and elite government officials in order to break the historical influence as well as to serve as a new platform for mid-level employees and government officers in implementing the national forest utilization policy.*

# Fraud

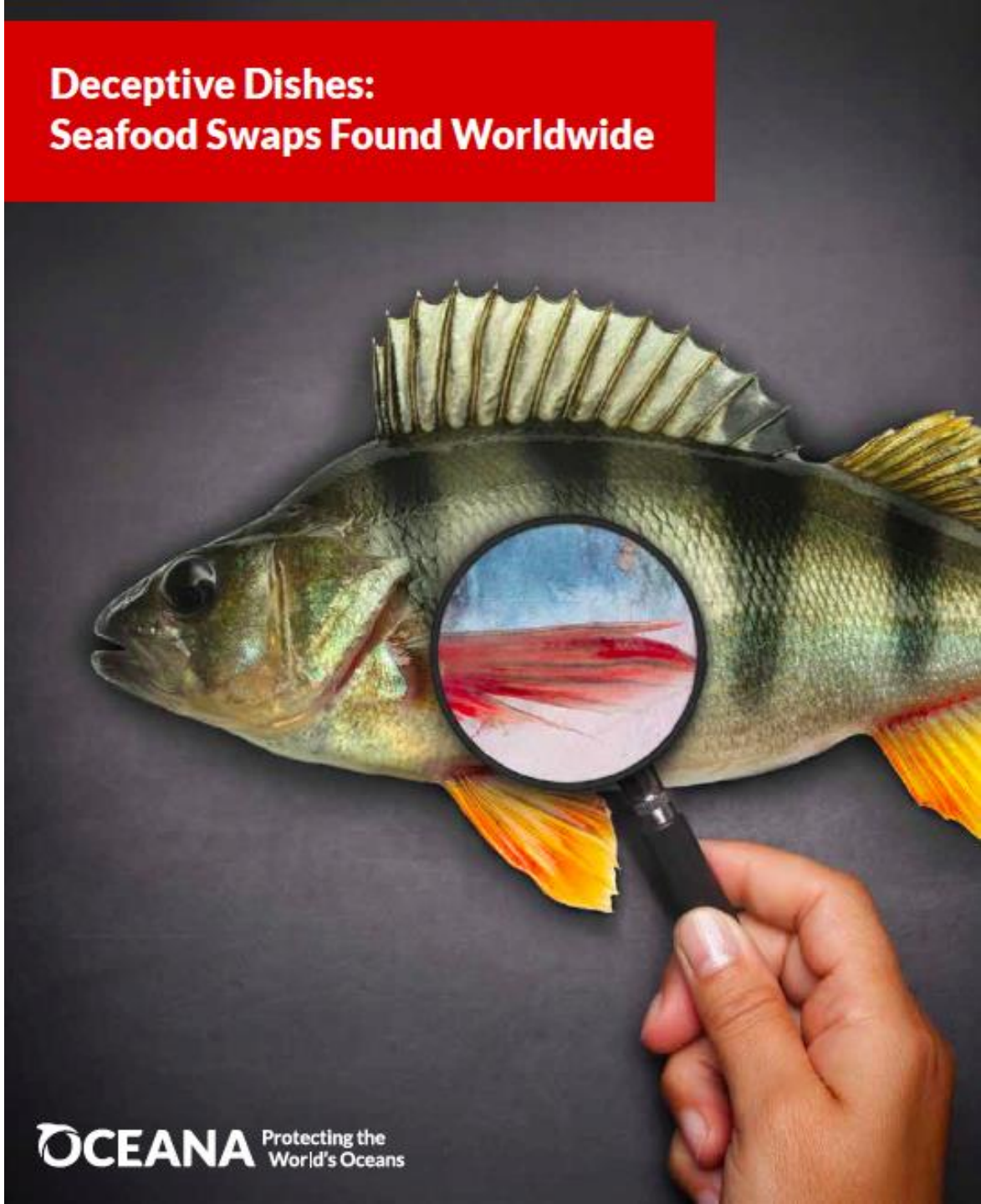
- Removing opportunity
  - What can authorities do?
  - **What can authorities ask companies to do…?**



# Fraud in the seafood trade

- 1 in 5 samples mislabeled
  - 63% clear economic motivation
  - 58% were spp. that pose a health risk

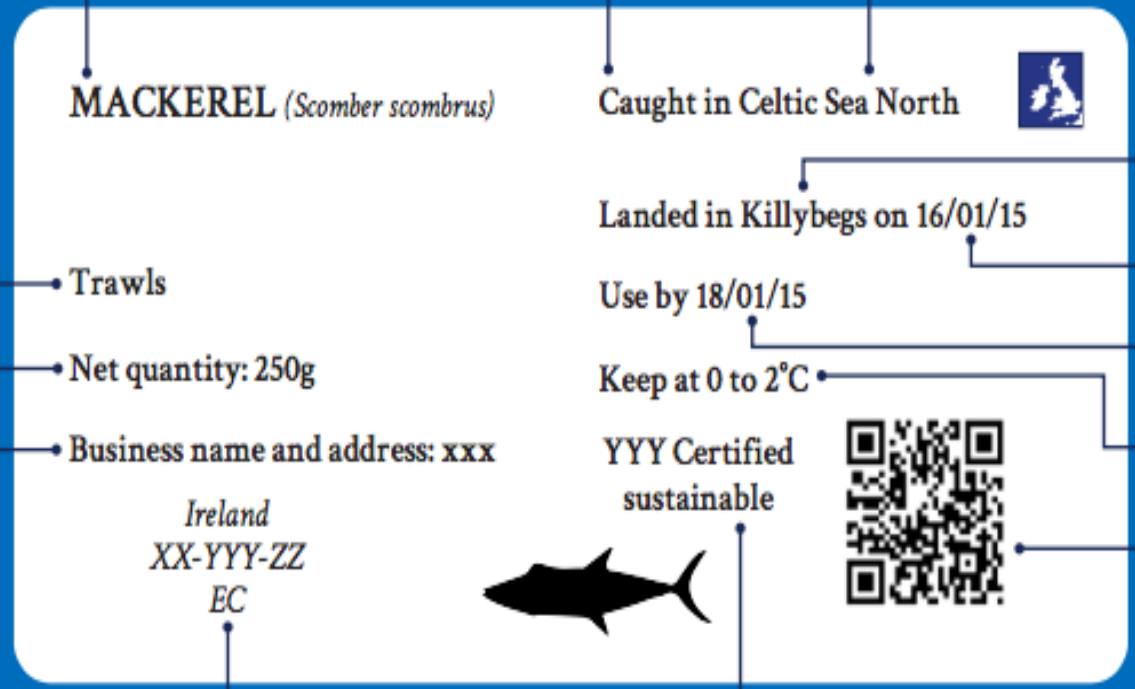
- Found at every level of the supply chain



# EU response

- Mandatory labelling

# Example of label for an unprocessed and prepacked fresh product



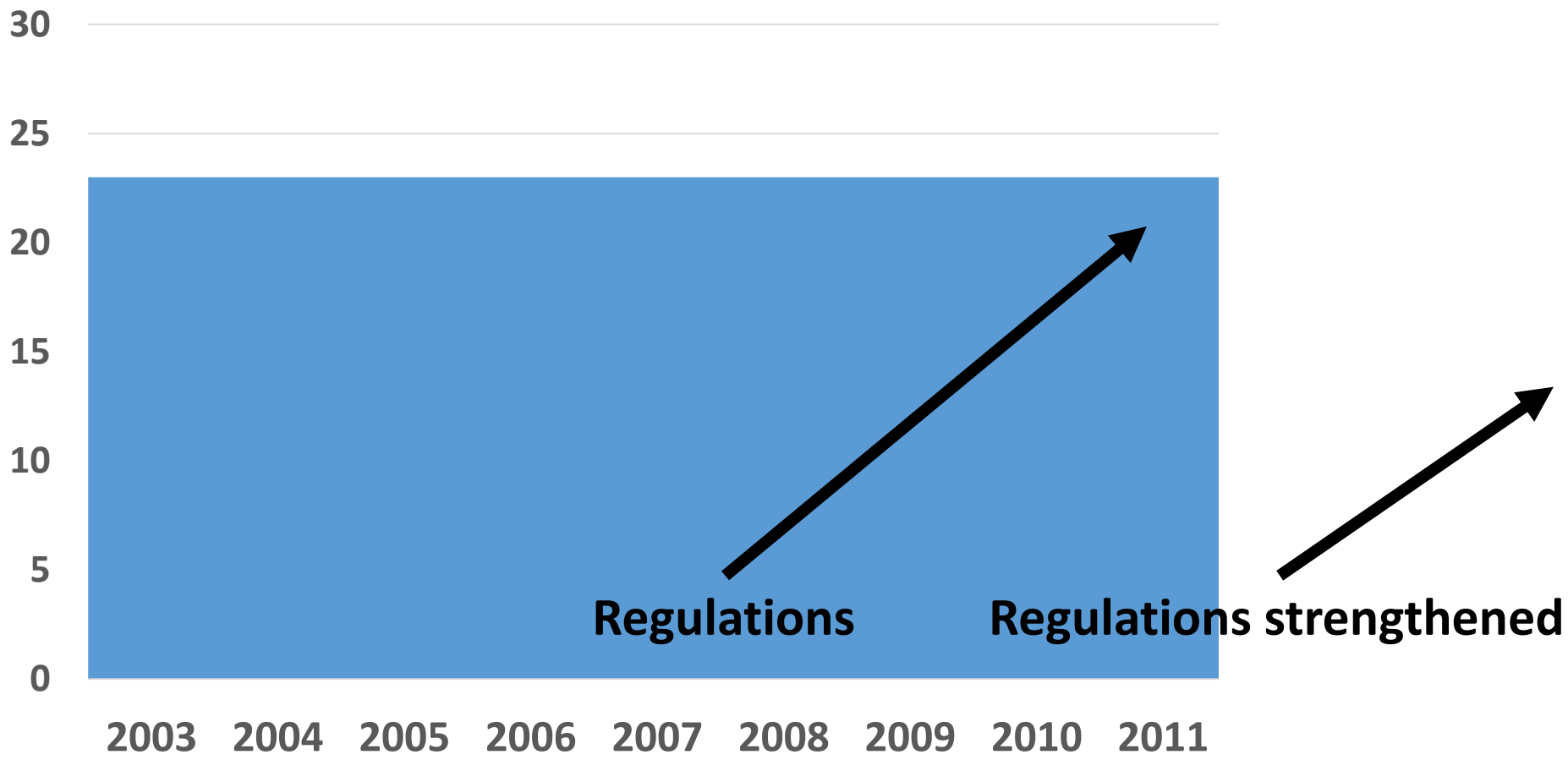

- Commercial designation and scientific name
- Production method
- Catch area
- Port of landing
- Date of landing
- "Best before" / "use by date"
- Storage conditions
- Quick Response Code
- Fishing gear category
- Net weight
- Food operator
- Identification mark
- Certification label

- Mandatory
- Voluntary
- Common Market Organization (CMO) Regulation
- Food Information for Consumers (FIC) Regulation

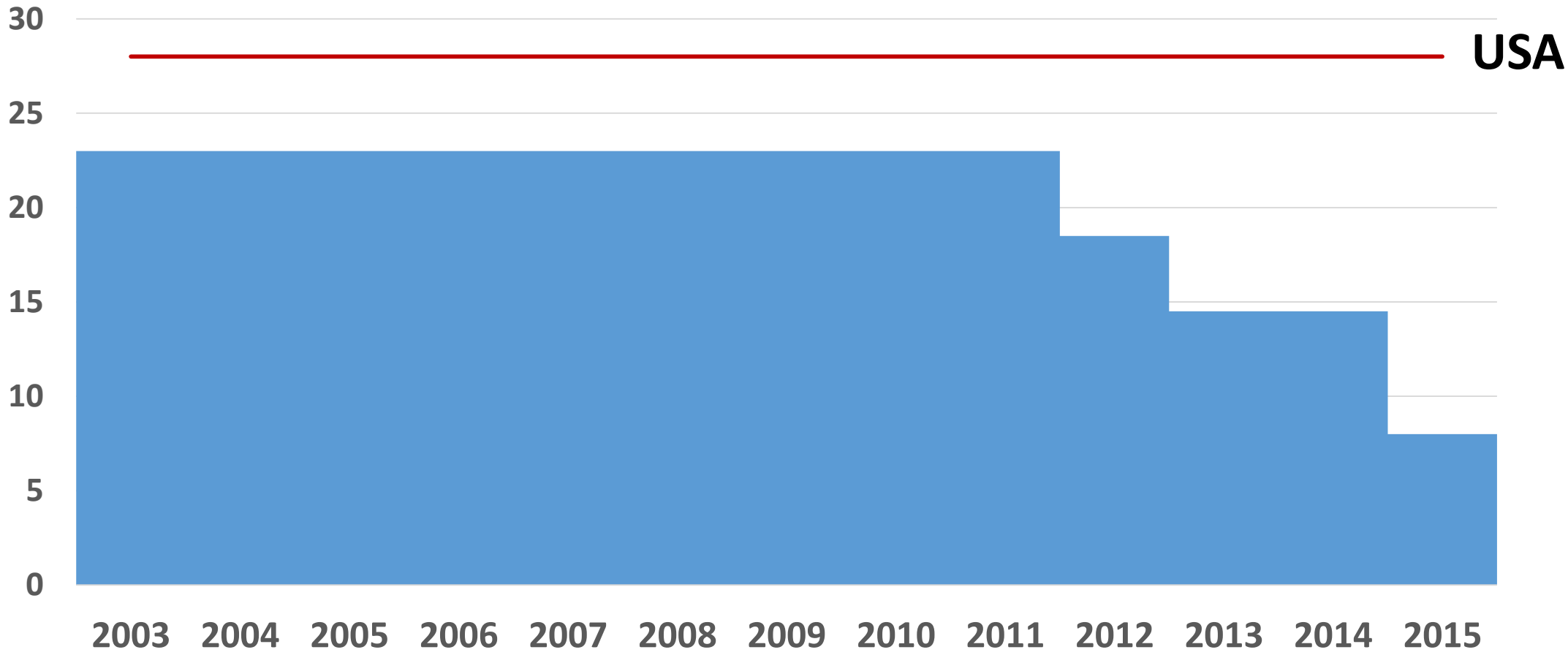
Note that for unprocessed and non-prepacked products, the mandatory information of the CMO Regulation must be displayed, amongst others, on billboards or posters

Based on the European Union's 2014 "A pocket guide to the EU's new fish and aquaculture consumer labels."

# % of fish mislabeled in the EU



# % of fish mislabeled



# Fraud in the timber sector

- If laundered, doesn't have to be smuggled
- Certification
  - Voluntary – *benefit of the doubt*
  - Paradox: only works when legal system is fairly good
    - ~10% in poorly governed countries
- Self-assessment/self-declaration

# Types of fraud in the timber sector

- Document fraud
  - Falsified permits (laundering)
    - Mislabeling (provenance; species; size/age…)
    - Concession license
    - Regulatory compliance
      - ESIA
      - Consultation + compensation to locals
    - Transportation; export; CITES; FLEGT-VPA

**Genuine, but:**

**- obtained through corruption**

**- recycled**

  - False invoicing (tax evasion)
    - Mislabeling (under-declaration of volumes; values...)
    - Transfer *mis*-pricing

# What can be done?

- Buyers have always questioned their suppliers
  - Cost
  - Quality
    - Consistency
    - Volumes
  - Delivery
- Risk
  - Contract-based
  - Reputation
  - History

**Risk =**
**Likelihood**
**X**
**Impact**

# What can be done?

- Understand risk
  - Product
    - Pulp *vs.* timber *vs.* finished products
    - Remoteness *vs.* mills
    - Traceability
  - Country
    - National-level risk index
      - ❖ Regional variation
      - ❖ Sector variation

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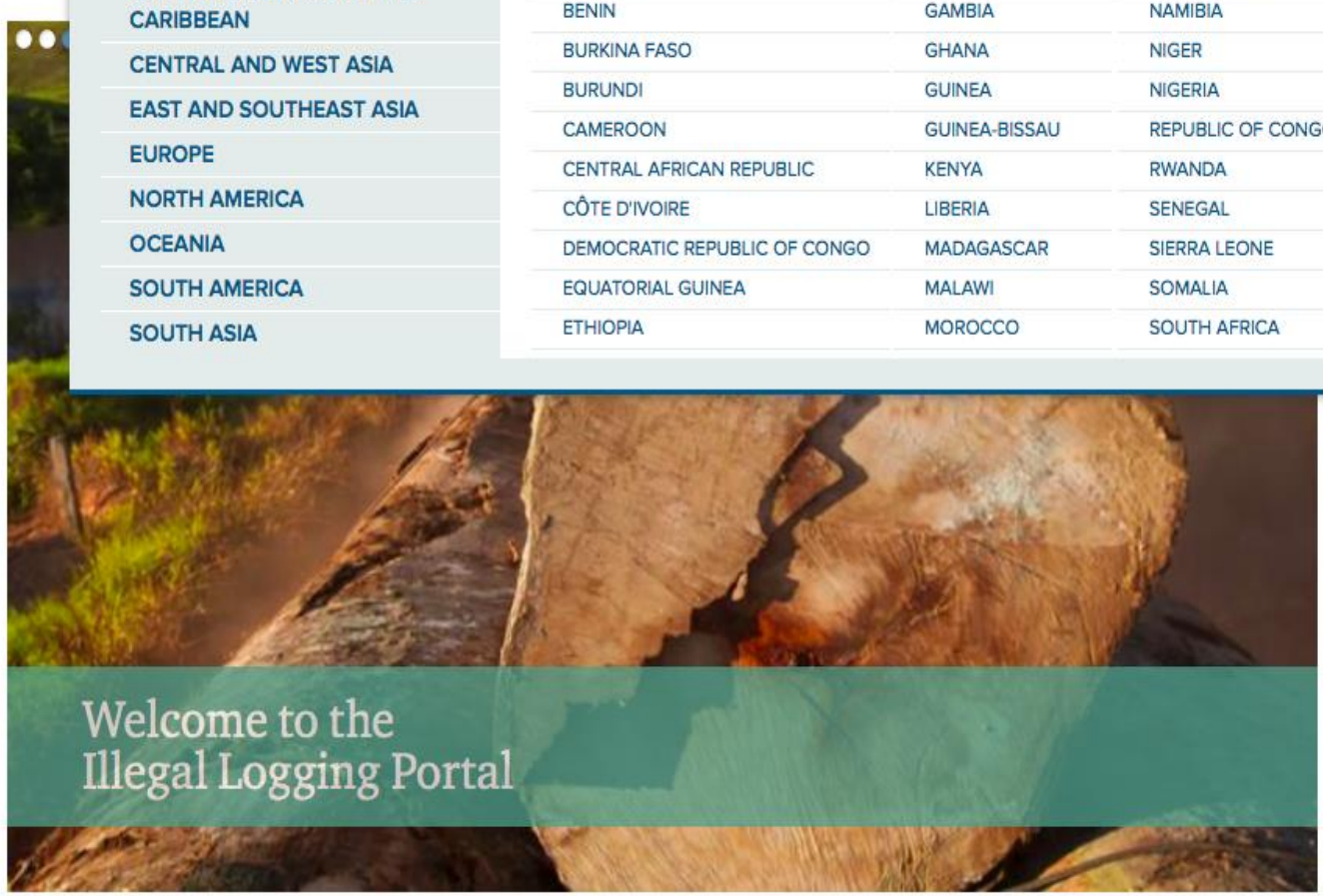


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# What can be done?

- Understand risk
  - Company
    - Policy
      - ❖ Does the company have a plan to deal with risk (avoid all but acceptable risk; then mitigate)
      - ❖ Is it board approved?
      - ❖ How is it implemented?
    - Due diligence
    - Chain of custody
      - ❖ Disclosure/reporting
    - Audits
    - 3rd party reports
      - ❖ Does the company take corrective actions?

# Due diligence

- Evaluate documents
  - Corroborate with issuing authority
    - ❖ Does the permit appear genuine?
      - Does it look right?
      - Is it merely a photocopy?
      - Can you confirm from issuer that the company has been assigned this permit?

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Certificate Search

# WELCOME TO THE FSC PUBLIC SEARCH

We have updated the look and feel of the public search. From now on this replaces the old certificate search. This is the one stop for inquiries about certificates and their status. **Updates to the data can take up to 24 hours.**

Search for license code (FSC-C/FSC-P/FSC-N followed by 6 digits)

Search

# Due diligence

- Evaluate documents
  - Corroborate with issuing authority
    - Does the issuer have internal controls to manage fraud?

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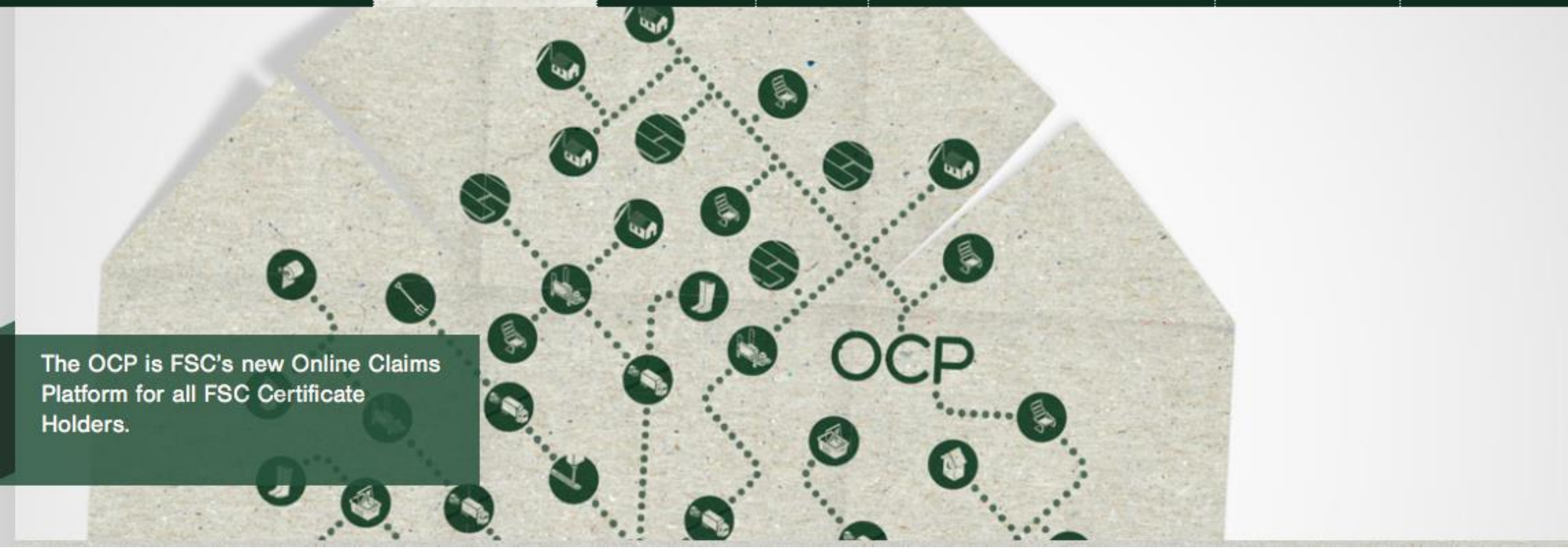


The OCP is FSC's new Online Claims Platform for all FSC Certificate Holders.

# Due diligence

- Evaluate documents
- Evaluate data
  - Provenance (range; density of trees;…)
    - Is this a new product/new supplier?
    - Is the tree species found in that country?
    - Does the supplier have more product (volume) than they should?
    - Are conversion rates (*e.g.,* wood chips → pulp; $m^3$ → veneer) too low?
  - Transport route (mills; ports;...)
    - Is it likely that the mill would have such a supply?
    - Does the transportation route make sense?
  - Price
    - Compare to (*e.g.,*) ITTO's market price for national marketplace

mahogany (*Swietenia* spp.) sawnwood imports to the USA
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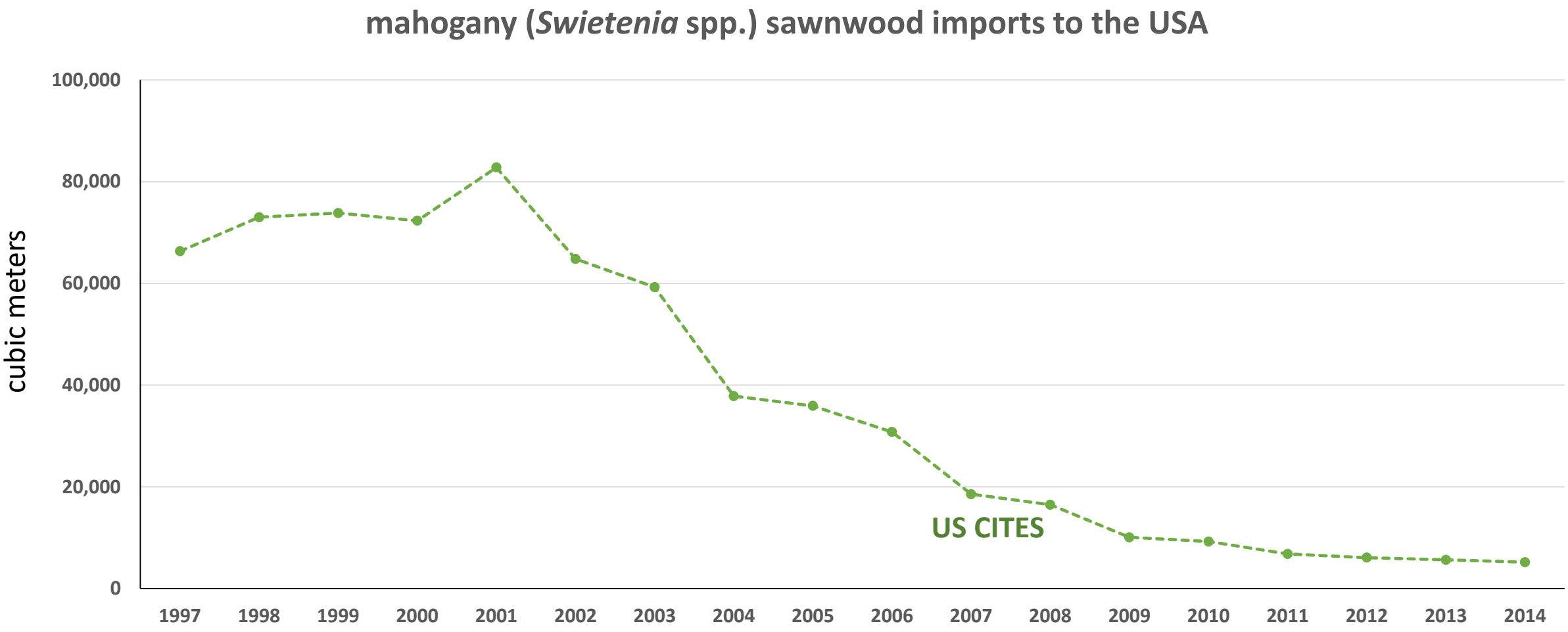
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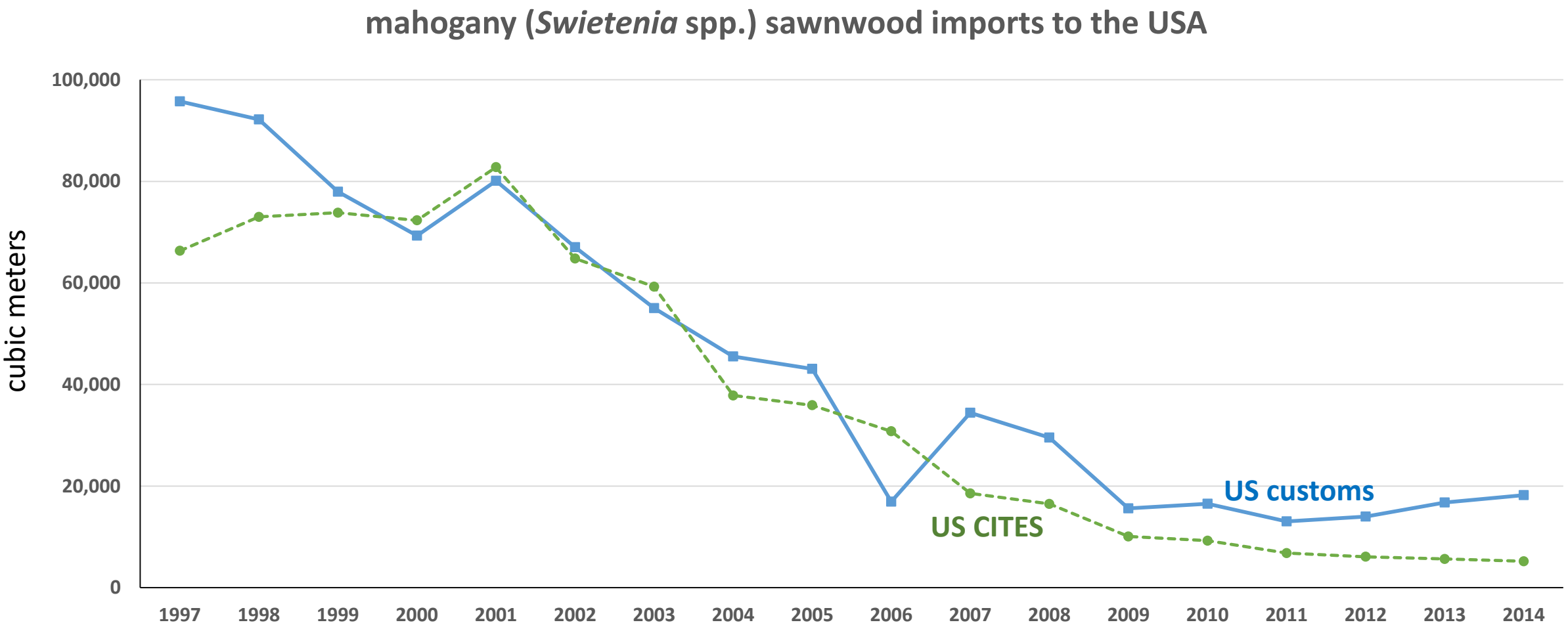
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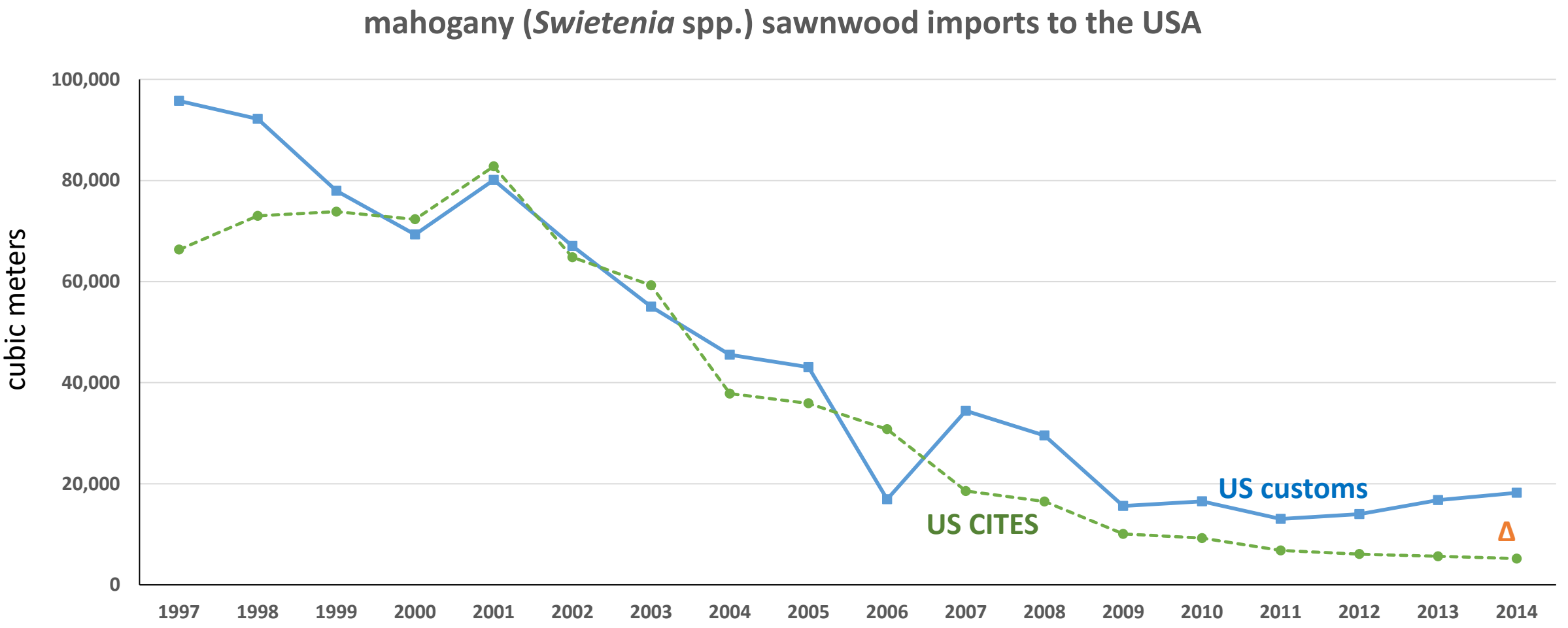
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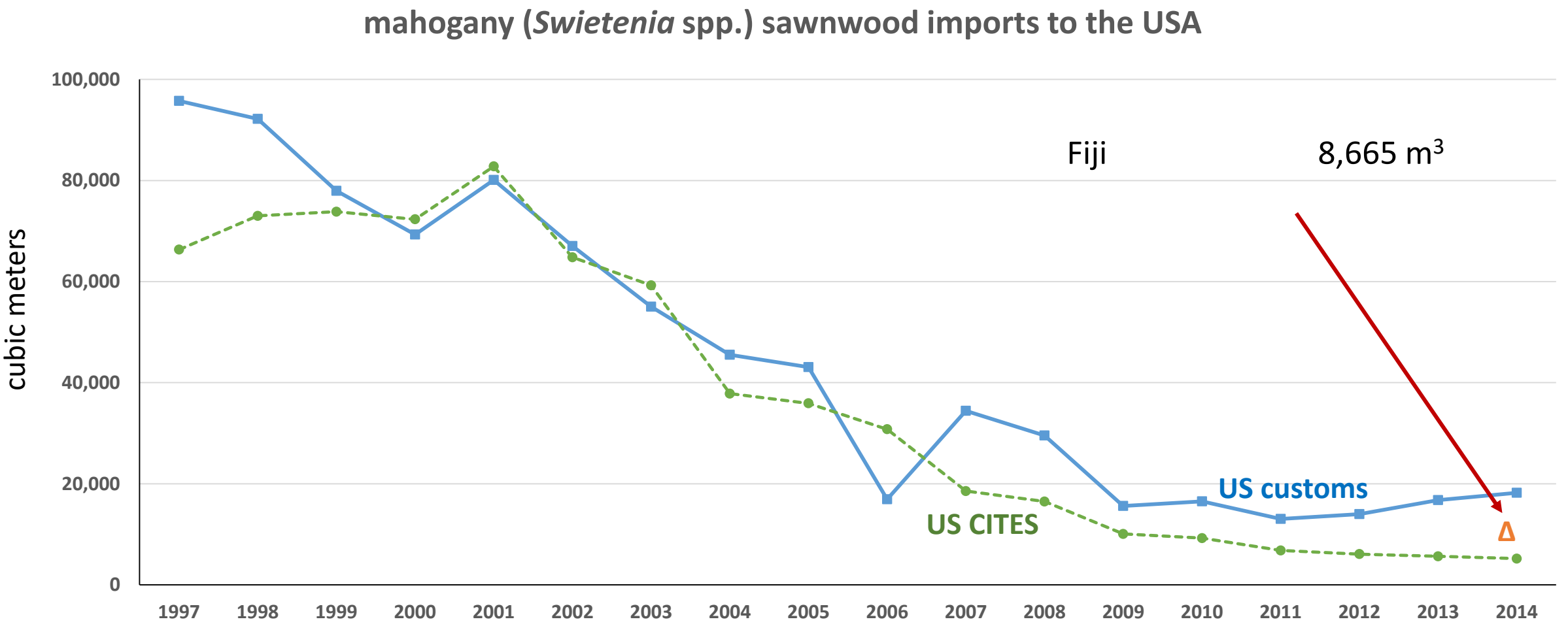
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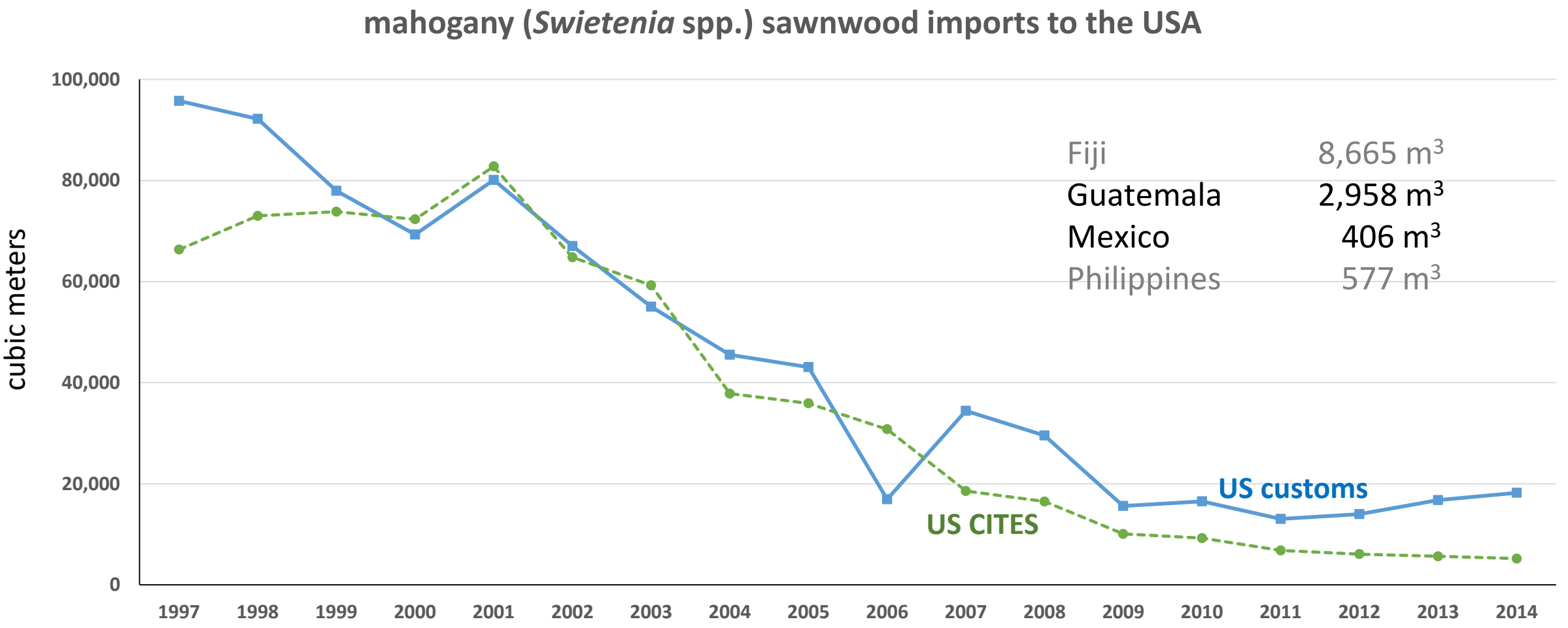
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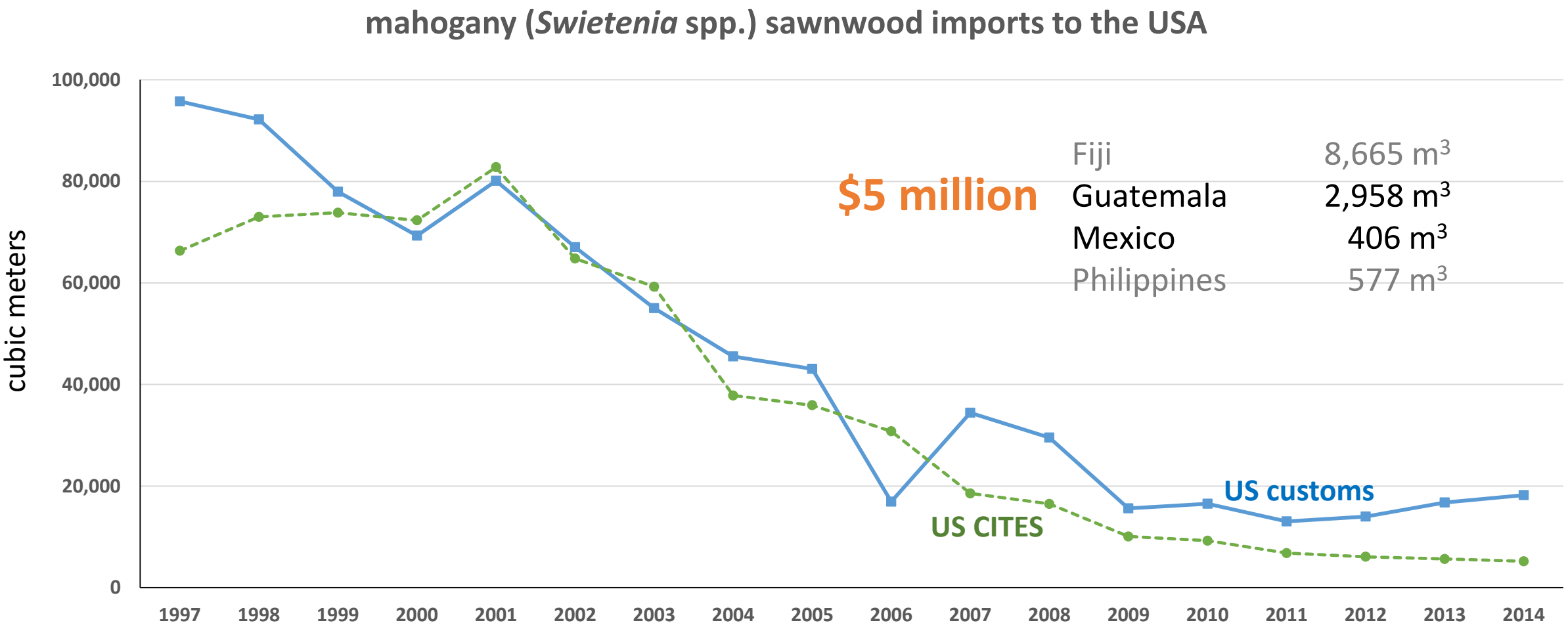
Philippines 577 m3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Guatemala 2,958 m3
Mexico 406 m3
Philippines 577 m3
US customs
US CITES

# Investigating fraud

Case theory

- analyze → hypothesize
  - informed assumptions
    - Past misconduct/prior complaints
    - Weak controls
    - High risk
    - Unusual patterns

Due diligence

# Investigating fraud

## Case theory

- test against the facts
  - elements of proof
    - Internal investigation:
      - evaluate the allegations
      - conduct background checks
    - External investigation:
      - interviews
      - confidential informants
      - interview the primary suspect

# Investigating fraud

Case theory

- refine until reasonable conclusions can be drawn

Remember: hypothesis → amend or abandon….

# Proving fraud

- Knowledge
  - Direct
    - Testimony of co-conspirators
    - Documentary evidence (incriminating email)
  - Circumstantially
    - Altered documents
    - Demonstrated lies
  - Pattern of ‘errors’