

iMANAGEMENT BRAZIL®

The need for business protection: illegal timber exploration - investor endangered by own business culture

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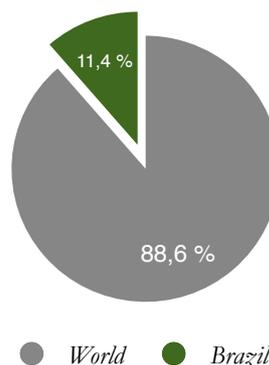
Preface

The business with illegal exploration of timber in the Brazilian Amazon area, Central Africa and the South-East Asia moves up to US\$ 100 billion per year and is responsible for 90% of the destruction of tropical rain forests in the world. The alert was launched by the administration office of the UN program PNUMA, Interpol and the Brazilian Federal Police during several conferences related to the same subject. The prime source for illegal timber or legalized timber from doubtful sources is the tropical forest with private ownership. Foreign investors with timber

exploration may prefer to choose a governmental prepared tropical forest for consortium exploration business models. It is vital to work with independent professionals which understand the culture of the foreign investor and no involvement with criminal structures from the very beginning.

iManagementBrazil executed projects in the region which were fundamental for the investment protection of our clients active with sustainable timber exploration in the Amazon basin and assisted the national police to fight organized crime which used corporate structures committing several delicts. Following the Interpol and the Brazilian Federal Police, approximately 90% of the timber exploration is executed by organized gangs, corresponding to 30% of global timber commerce. Out of the illegal portion, 11.4% confirms with Brazilian origin. The criminal groups use extortions, faked licenses, invasions of governmental areas and corporate internet sites totalizing 30 different individual criminal acts in order to get the illegal timber ready for international shipment. The main destinations of the commerce is Europe and North America.

China as a market is increasing, but not significant if the origin of lumber is Brazil. In the case of African timber, China might be considered as a strong absorber of legalized timber which comes from questionable sources.



Brazilian situation

Since 2008 professionally organized Brazilian hackers accessed the harvest licenses of IBAMA and further

governmental institutions responsible for harvest permits and transport liberations, causing a damage of approximately five million cubic meter of tropical timber per year. In this moment, more than hundred companies are under investigation or just processed; the total litigation is round about US\$ 5.0 billion. Following the Brazilian Federal Police, the illegal exploration of timber in the Amazon region is associated to the notable increase of violence, contract killing orders and aggressions against the local communities.



Local Amazon community

The Brazilian Federal Police alerts that a global coordination is required if a efficient reaction might cause effect. The main problem is that the illegal exploration of timber presents higher financial results compared with any legal exploration business model.

In order to understand the entire problem scenario, other aspects as, for example, the unsustainable legislation with clients markets, e.x. most European countries, weak local management of foreign investors and the acceptance of criminal (corrupt) elements within the local organization are fundamentals of growing illegal global timber business, specially in the case of foreign strategic investors of timber business. Furthermore, a lot of legal operating lumber exploration companies are mixing the certified timber extracted out of the tropical forest with legalized timber which has illegal background frequently - one should not be led astray by the wording.

The analysis of satellite surveillance in the Amazon region during one year showed that almost 50% of the timber extraction was illegal. The study shows that the indices of illegal extraction falls in the areas where governmental consortial contracts are implemented.

Almost 99% of all illegal timber exploration occurs in private owned forests or forest areas under legal dispute. Only 1% of illegal timber exploration corresponds to protected forest areas or other conservation areas. One of the main problems causing the illegal timber exploration in the Amazon region is associated to the illegal and irregular penetration and acquisition of forest areas in Brazil.



Illegal wood collection point

Another attention calling aspect of timber exploration is the constant reduction of this kind of economic activity. The legal timber exploration was reduced by almost 40% and the illegal exploration has fallen by almost 35%, compared with the annual base of 2009/2010. Only the Brazilian State of Acre shows a constant reduction of illegal timber exploration since a couple of years; the States of Pará and Mato Grosso present increasing numbers while the State of Amazon is relatively stable.

The Amazon region keeps approximately 5,5% of the global biodiversity, corresponding to almost 50% of the entire Brazilian natural heritage. Considering the global bio-environment, the region habitats 15% of all plant species, 23% of all apes, 9% of all mammals, 23% of all fishes, 13% of all birds, 5% of all amphibians and 6% of all ants - a real human treasure, attracting unethical business models.

The project mission

The client of iManagementBrazil in the Amazon region was a European strategic investor active with sustainable timber exploration. The business was guided by a extremely high level of *moral self-pretense* and a advanced standard of corporate governance and highest level of *political correctness*. The company presented constant negative figures since the start-up of the operation. Among frantic internal process problems and the lack of confident management information, the main problem of the local Brazilian organization was the deeply hidden and juried presence of criminal structures within the Amazon-based company. The criminal individuals were active with illegal timber exploration, *covered by* a certified business model. Furthermore, criminal executives acted in a ample range of criminal organizations, involved with other delicts as e.x. drug traffic, trafficking in human beings, child prostitution and cyber crimes.

The hunt for the numbers begins.

After a thorough analysis of the figures, processes and existing contracts with customers and suppliers, the

„The worst nature of injustice is the played and simulated justice.“

- PLATON, GREEK PHILOSOPHER -

individual ad-hoc measures were defined. At the same time, another iMB project member was requested - one of our best number squeezers.

We noticed a completely unexplainable inconsistency in the monthly harvest, production and delivery figures. The satellite monitored felled logs, marked with electronic chips, in 2-7% of cases did not correspond to the harvest plans of the season submitted to the Brazilian environmental authority. A historical analysis of the figures for the past years gave the same picture - the deviations were constant in the range of 5% with seasonal ups and downs.

We also cross-checked these figures with all truck accidents in the rainforest harvest zone, collected the figures for the wood rescued from the accidents and checked the corresponding figures in the sawmill. The European investor's own sawmill was not state of the art and the plant therefore operated at reduced productivity. The same applied to the drying ovens.

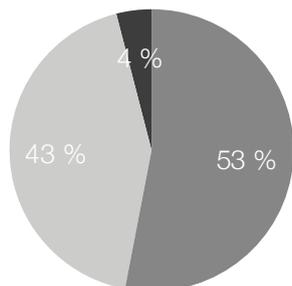


Truck accident in the legal exploitation site

These figures were also compared month by month and year by year. In order to compensate for the reduced productivity, the European investor had purchased capacities in the region's sawmills. The figures for these sawmills, which were to process the harvested wood for our client, were also conspicuous.

The key factor - local communities

iMB's philosophy is also to dive deep into the structure of our clients and the entire local business environment. In this specific case, this also included the demarcation of



- Operational
- Middle management
- C-level and board members

geographical areas, which had to be transferred to the local population and Indian tribes in accordance with Brazilian environmental legislation. During his visits to these communities, iMB's interim CEO gained more detailed knowledge of the criminal activities of our client's senior staff in the management of native forests.



Local community house

The overall figures in Brazil, following the study performed by KPMG, show that almost 2/3 of all criminal acts within a company are committed by own employees, independently from the industrial sector.

iManagementBrazil detected the criminal structures and worked on the elimination, together with national police forces. One of the leading individual was localized by international police in Surinam, criminal business misconducts were identified in the Port of Manaus and Santarém, as well as in the home continent of our client.

The danger of „old Brazil“ and the loss of sensitivity.

It is not unusual that unethical business structures are generated by individuals which gained experience as expatriates in Brazil decades ago. During this period of time, illegal structures were present with corporations in Brazil and the executive was convinced that a *certain* level of criminal activity is not avoidable in Brazil losing the sensibility of today's business reality and law frame in Brazil. The corporations acting in Brazil are mainly affected by fraud committed by the operational and middle management level. The middle management includes the local management of the operations either.

Brazil has changed, a lot.

Today, Brazil has a law which protects the investor; it is not easy to enforce the law, specially in the northern region, but the investment must be protected and the tools are in place. The Brazilian authorities are capable to assist the investor - it is very important not to accept criminal



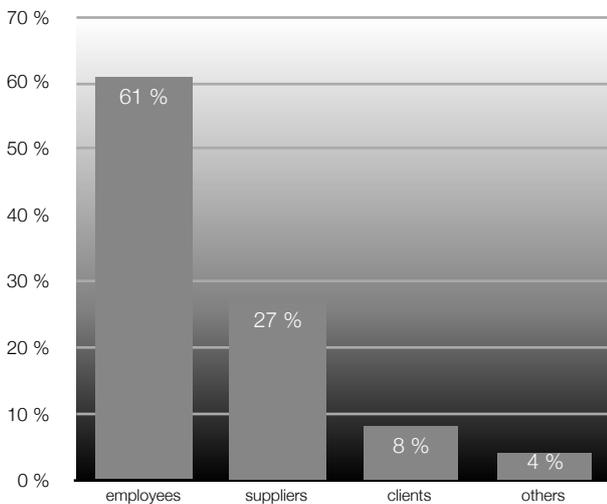
Pursuing a legalized timber supply from illegal sources.

structures within the organization. Whereas about three years ago Brazil was still in the last group of countries fighting corruption, today it has reached group two and is on a par with countries like Sweden, Iceland and Portugal.



Furthermore, the high level of *moral pretense* and the utter conviction of navigating and playing for yourself the business under *political correct guidelines* dazzles the management perception and decreases the intention to show resistance against criminal structures within the Brazilian organization - the sensibility is reduced. The political correctness that the European investor pretended was „like a mirror where he looked in and believed he sees the world“.

Following a study executed by KPMG in Brazil, more than 2/3 of all companies acting in Brazil were victim of fraud.



Basics to be followed

iManagementBrazil performed several restructuring projects where doubtful structures appeared during the execution. In order to protect the investments of our clients, we recommend:

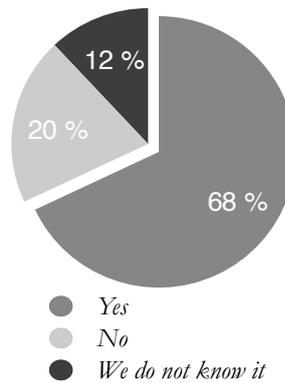
1. detailed CV audit of future executives before contract signing; execute a special and focused investigation; special focus on juridical (criminal, civil) suites,
2. develop the „radar sensibility“ with alerts from several internal areas, community groups, suppliers; become familiar with the local business environment,
3. open a direct and internal, but anonymous communication channel; select very carefully the people which attends the

information; be aware that the employees close to the operation has good chances reveal fraud; implement guarantees to conceal the information,

4. implement a policy in order to balance and impact fraud over the annual bonus of all executives,

5. implement a internal audit procedure reporting to investors' HQ; the audit team may call for help from independent professionals.

Following our own project experience in Brazil, the best channel to discover fraud structures in your local operation is the internal control and „be open minded to external information“, despite the employees and suppliers figuring out the best source for the first evidences.



Further tools to detect fraud structures in your organization is an internal audit with special purpose and the set-up of a special project mission in order to localize the structure and work strongly on their elimination. Very often, a rooting and mapping at the outside environment of the company is vital and shall be enforced either.

Considering all projects executed, we learned that almost 70% of all companies were aware of somehow fraud and/or criminal structures within their local entities. The main problem was how to safeguard the information, map the hidden structure, implement tools in order to keep the day-to-day business alive and tackle the problem, including the elimination of internal co-working fraud structure. almost 2/3 of all clients had no idea of hidden fraud structures or felt very insecure about the situation.

iManagementBrazil is experienced with those kind of restructuring projects and prepared to operate under tense business conditions in favor of our clients. We keep project managers with adequate and clear professional characteristics as well as strong and quick contact with specialized attorney offices as well as quick access to national authorities. (FN)

