FINANCIAL CRIMES RELATED TO BUYING AND SELLING TIMBER

Timber Security: fraud

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INTRODUCTION: It would be difficult to calculate the cash flow involved in buying and selling timber in the United States each year—I’m sure it exceeds hundreds of millions of dollars. These transactions occur as large “wood supply agreements,” smaller deals with non-industrial landowners, and all manner of transactions in between.

Organizations and individuals have diverse ideas about the proper and most effective manner for controlling and protecting these transactions. For many companies, internal audit and accounting professionals will be involved and have their input regarding process and documentation.

A very high percentage of people involved in buying and selling timber are both honest and conscientious. Scoundrels, however, can be extremely subtle; financial crimes can be insidious. Thus, it becomes imperative that these transactions be subject to thorough scrutiny. Such scrutiny includes “ground level auditing” of the sort that rarely occurs.

CONCEPTS:

1) Let me challenge the idea that you only work with honest people. While that might be entirely true, you have no way of knowing for sure. Real crooks have a lifetime of practice and no internal conflicts about deceiving you. Every person responsible for your cash flow, regardless of reputation, relationships, and your feelings, must be subject to the same kind of scrutiny and internal controls.

2) You can be cheated in any kind of transaction. Often, an experienced forest manager will express great relief regarding lump sum timber sales, since timber theft is not an issue. While “timber theft” is not an issue, you can certainly be cheated on a lump sum sale.

3) Documents in your office (contracts, cruises, title search, bid prospectus, and so forth) can appear to be in perfectly good order. Internal audit could be entirely satisfied, and yet significant errors could exist. If there is a discrepancy between what appears in your paper-trail and what exists on the ground, you could have a large problem.

POTENTIAL ANOMALIES: Anomalies in the sale or purchase of timber can occur in myriad ways—both simple and complex. Some could occur due to negligence (a sloppy and inaccurate cruise/appraisal) and others could be created intentionally to benefit someone controlling the transaction. Here are a few examples:

a) Manipulating the cruise data. A procurement manager in a Southern state negotiated a lump sum timber purchase with private landowners. He lied to the landowner and his company about the volume on the tract. Once the company’s investment had been recovered in the initial harvest, he moved that logger off the tract and harvested the remainder in his own name.

b) A conspiracy between the seller’s representative and the buyer’s representative. When one company buys or sells timber with another company, often they are each represented by one individual person. That person has great power and latitude in this transaction; agreements regularly occur through one-on-one negotiations. The potential for “gratuities” in the form of cash or extravagant gifts will always exist.
This kind of “quid pro quo” played out with a procurement manager in the South, responsible for raw material at a paper mill. He was close friends with an important wood dealer. Selected transactions, when presented to the procurement manager, would be referred to the wood dealer. The wood dealer would then take advantage of unsuspecting private landowners and would acquire great wealth in the process. When a private landowner trusts a timber buyer too much, a number of bad things can happen. The most common outcome occurs when the landowners accept less than market value for their timber. (If you will accept $5 per ton for plylogs on the stump, I can get very wealthy.) The procurement manager might be motivated by ‘friendship’, cash gratuities, or extravagant gifts.

c) **Transaction manipulated through an escrow account.** A timber buyer for a large corporation would occasionally request that payments to landowners be made through an attorney’s escrow account. He directly controlled disbursements from escrow. The landowner received the agreed amount; the timber buyer kept a ‘finder’s fee’ for himself.

**REMEDIES:** There are no perfect remedies. But the demeanor of an organization or an individual will determine the degree of risk that does accrue. If the owner or the senior managers are unconcerned about or oblivious to the risk, then the potential for financial crimes will be enhanced. *Your awareness and the awareness of the organization are critical to protecting assets and transactions.*

The “right” approach to internal controls is a careful, dynamic balance of efficiency and control. For example, you might prefer to conduct a 100% tally on a high-value stand prior to a sale, but that would be extravagantly expensive. So, you conduct a routine cruise instead.

It is absolutely essential to delegate authority and responsibility across an organization. “Trust but verify” is a good approach. Spot check the work and decisions of each person responsible for your cash flow.

**Fundamental Controls:** Decisions related to buying or selling timber must be made by persons with the training and experience commensurate with the job. A private landowner, for example, must often acquire or hire the knowledge required to manage a timber sale. There must be a good and complete paper-trail: cruise data, contracts, maps, prospectus, and bids must be part of the permanent record.

**Management Oversight:** Any time the buyer or seller is represented by an employee or a contractor (such as a consulting forester), someone else must be checking their work. If I sell your pine plylogs for a price way below market value and no one challenges my decisions, I can “get away with murder.”

**Ground Level Audits:** If your forester sells a stand of timber lump sum and reports the volume at 40 tons per acre, when the actual volume is much greater than that, a serious discrepancy (and a financial crime) could occur. You won’t catch that kind of problem in the office.

If your stumpage sale excludes SMZs and other buffer zones, but they are harvested anyway, you won’t identify that kind of problem in the office. If a logger is contracted to thin a pine plantation to 70 square feet of basal area, and the result is much lower than that, you won’t find that problem in the office.

In woodland operations, cash flow begins at the stump, right out there in the briar patch. That is where internal controls have to begin also.

**SUMMARY:** Almost everyone you work with will be conscientious and honest. Nevertheless, financial crimes can occur in the most unlikely and unexpected circumstances. *Spot checking a healthy sample of critical data throughout the process will help maintain disciplined internal controls.*

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