5.1 Regaining investor trust through enhanced transparency

JUSTIN WHALEN, MARTIJN SNOEP, MAARTEN DEN UIJL and REMCO VAN WIJK

Sustainable forest plantations
Sustainable forest plantations (SFPs) can be important in taking pressure off natural forests, sequestering carbon emissions, enhancing biodiversity and empowering local foresters in developing countries to attract foreign investment. Such investment can also provide healthy financial returns. Social-minded investors are increasingly interested in SFPs, yet this interest does not seem to translate into much-needed investment.

The main barrier to investment is the gap between the level of transparency required by investors and that currently provided by forest managers. The underlying causes of this transparency gap are described in Table 1. In order for sustainable forestry projects to attract more investors, it will be necessary to create trust between investors and forest managers through enhanced transparency.

Enhancing transparency through innovation
Face the Future and Thauris are developing a single audit tool to improve transparency in forestry initiatives in an efficient manner. Here is how it works: Forest managers who seek investment capital in their proposed SFP project can input all SFP data into a set of easy-to-use forms that are accessible via the internet and hosted on secure servers (i.e., a cloud-hosted platform). These forms provide all the data required for the proposed investment to undergo a comprehensive financial valuation and risk assessment.

Data can be entered into the system only if it meets predefined guidelines. Once the data enters the system, further checks are run internally. Key assumptions are cross-referenced against literature and other forms of available data for similar SFP projects; this flags any omissions or inconstancies. After the data is fully validated and accepted, it is used to create a comprehensive valuation and preliminary risk assessment that will meet investors’ requirements and expectations.

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Table 1. Causes of the transparency gap in forestry projects

| Lack of mutual understanding | Since plantation forestry is a relatively new asset class, many investors are unfamiliar with its risks and must put a lot of trust in forest managers. Forest managers do not always understand investor requirements and therefore do not structure their projects in a way that will attract investors. |
| Diverse and conflicting interests | In addition to forest managers and investors, other actors also have a stake in SFP projects. Government agencies, the local population and other participants in the forest products supply chain all exercise influence. The interests of these stakeholders are not always aligned and a lack of transparency may benefit some parties. Non-transparent forest management practices and irregular business schemes have damaged investors’ trust in plantation forestry. |
| Lack of information | The current level of reporting by forest companies does not often meet the needs of investors.* The information that is available is often outdated, difficult to obtain and non-standardized (and therefore subject to multiple interpretations). |
| Ineffective audit and control approaches | Current audit approaches are largely paper-based and therefore vulnerable to manipulation, forgery and physical loss or damage. Audits are performed only occasionally, typically once a year, and provide only a summary of the SFP. |
| High costs of assurance | The costs involved in obtaining assurance (against financial, legality or sustainability standards) are high, due to labour-intensive audit practices and the lack of coordination between auditors and regulators. Auditors rely only to a very limited degree on each other’s work. |

* See also www.pwc.com/gx/en/forest-paper-packaging/publications/ias41-fair-value-timber.jhtml.

This assures investors that data provided by the forest manager is complete and that it has been processed using standard industry protocols for forest and agricultural valuation and forestry risk assessment. Furthermore, investors can easily browse through all the uploaded data, assumptions and supporting evidence from anywhere in the world using an internet connection. The forester can also use the platform to pre-evaluate the proposed investment and optimize the offering before contacting investors. Both investors and foresters can view, evaluate and monitor the investment through indicators that can be customized to meet their needs.

The platform will continue to add value to foresters and ensure transparency to investors for the duration of the investment. The platform requires the forest manager to transparently update information on the SFP several times a year so that the investors can monitor the project in real time; this allows them to make informed decisions. For example,
as the trees grow, the forest manager must monitor their growth and mortality using standard industry monitoring techniques and sampling and upload this data to the platform.

Before data is accepted by the platform, supporting evidence is required so that the integrity of the information is maintained. For example, the growth of trees is checked against both predicted growth models and against other models for similar SFPs. Since there is a direct relationship between tree growth and revenue, the manager will be able to monitor the investment’s financial health in real time. Having up-to-date information helps investors and forest managers make informed decisions and allows them to take greater control of their venture.

Currently, there is limited information on the growth characteristics of timber species suitable for plantations, especially data about how these are affecting specific environmental conditions. The growth monitoring data provided by the plantation managers will allow valuable site-specific benchmarks to be developed for timber species. Data on soil and climate will also be recorded. The checking of the reliability of data will greatly improve over time, based on the input of the users. Plantation managers will use this feedback to steer expectations of future yields; investors can also rely on yield figures instead of having to rely on overly optimistic projections.

The integrated risk assessment provides accurate information about risks for investors and forest managers. The tool used assesses physical risk, project risk, political risk, environmental risk and social risk. The risk assessment tool is designed using industry-standard risk assessment techniques used in forest insurance.

Sustainability — economic, social and environmental — is a key issue for timber plantations. The long-term viability of timber plantations can be achieved only if there are no negative or unmitigated negative impacts on people and the environment. Therefore, it is crucial for plantation managers and owners to communicate the sustainability of their plantation to investors, regulators and the society as a whole.

Ideally, sustainable management is rewarded. By having a transparent mechanism that demonstrates sustainability, investors can select those plantations that fit their sustainability standard. The integrated risk assessment provides a rating of the project’s sustainability based on self-assessment by plantation managers. This includes such factors as social and environmental impacts, conversion of High Conservation Value Forests, compliance with laws and regulations and the use of chemicals and pesticides. A better performance in terms of social and environmental sustainability reduces the risk of conflicts, environmental degradation and harm to reputations.
Investors and other SFP stakeholders increasingly request non-financial information, predominantly related to compliance with legal standards and certification standards. Although this platform is not intended to replace third-party certification, it can facilitate the certification process by providing certifiers the evidence of compliance that they require. A lot of time is spent doing double duty due to these overlapping requests. The platform can reduce the costs of certification, since the same validated data can be used to fulfill a range of reporting requirements. Any tool that lessens the burden of data handling and processing in certification would be welcomed.

Although there is an increased interest in SFP investments, investors are hesitant to participate. Forestry is a very technical science and investors need to feel that they understand the key issues and the risks. This platform gives foresters many useful insights into investor’s requirements and allows investors to learn about what is needed to grow healthy trees. This will bring foresters and investors closer together and foster the level of trust needed to encourage more investment in SFPs.

**Platform design**

The platform’s underlying single-audit approach was developed by Thauris and is already operational in the Dutch food industry (Table 2). The approach is endorsed by several public regulators (e.g., the Netherlands Food and Consumer Product Safety Authority). The underlying design principles collectively provide continuous control of information (Figure 1).

**Table 2. Traditional audits vs. single audit**

<table>
<thead>
<tr>
<th>Traditional audit</th>
<th>Single audit approach</th>
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<tbody>
<tr>
<td>• paper-based and therefore vulnerable to manipulation, forgery and physical loss or damage</td>
<td>• largely standardized and automated</td>
</tr>
<tr>
<td>• summary of the situation at a certain point in time</td>
<td>• continuous control of SFP performance</td>
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<td>• information is generally not up to date</td>
<td>• timely and easy access to management information</td>
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<tr>
<td>• data collection efforts overlap</td>
<td>• efficient re-use of information, and customized reports can be generated for various stakeholders</td>
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<tr>
<td>• verification requires expensive external auditors to be flown in</td>
<td>• external reliability checks provide highly reliable information.</td>
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<td></td>
<td>• information is collected at the source by the foresters themselves</td>
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Generally, third-party audits aim to obtain some level of assurance over information on an initiative such as a forestry organization or project. An SFP’s performance is usually audited against a set of financial and non-financial standards and norms. The auditor
gives his or her opinion on the reliability of information and thereby assesses the level of transparency. The single audit approach integrates, standardizes and verifies information gathering and assessment (Table 2).

A more transparent future
A single audit can be a pivotal step towards greater transparency in SFP investments. But why stop there? The single audit approach could be applied more broadly within the forest product supply chain. For example, various participants’ data could be linked to provide integrated, efficient and effective Chain of Custody solutions, as required by both public and private legislators. This could provide additional benefits to investors, who often provide capital to various actors in the same supply chain. Other chain stakeholders would also benefit from higher transparency at lower costs.

Chain actors can improve their management if they have access to more reliable and easily available information. In addition, they will find it easier to comply with public and private standards. This will provide them with greater access to premium export markets for sustainably and legally produced products. Improved transparency also benefits the general public: it reduces corruption and tax evasion, and more sustainable timber production contributes to a healthier environment.

Figure 1. Single audit design principles

Source: Thauris