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APPRAISAL REPORT II  
“Topic 2 issues”

CAO Appraisal for Audit of IFC

CAO Compliance

C-I-R6-Y08-F096

March 11, 2009

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**Wilmar Group  
Indonesia**

**Case of  
Forest Peoples Programme**

***Summary***

In 2007, IFC had three investments with the Wilmar Group—none directly in Wilmar’s palm oil plantations in Indonesia, but in palm oil trade facilities and refinery. In 2007, 19 representatives of civil society organizations (CSOs) under the lead of Forest Peoples Programme filed a complaint with the CAO, claiming that the Wilmar Group’s plantation activities in Indonesia violated a number of IFC standards and requirements.

In November 2007, CAO Ombudsman disclosed a “Preliminary Stakeholder Assessment” report. Based on division of topics made in this report, CAO Ombudsman transferred IFC-related allegations to CAO Compliance for a compliance appraisal at two different occasions: in March 2008 the transfer of what was defined as “Topic 3”, and in December 2008 the transfer of what was defined as “Topic 2”. For details on how CAO Ombudsman divided the complaint into three different topic areas, see the November 2007 CAO Ombudsman “Preliminary Stakeholder Assessment” report available on [www.cao-ombudsman.org](http://www.cao-ombudsman.org).

On September 4, 2008, CAO Compliance concluded that the issues transferred from CAO Ombudsman in March 2008 merited an audit. The CAO finds no difference in the IFC approach to the appraisal of the “Topic 2” issues, compared to the issues addressed in the September report, that changes CAO’s decision.

Consistent with CAO Operational Guidelines, the CAO will expand the December 3, 2008 Terms of Reference for the audit of IFC on supply chain issues, and the related categorization, of IFC’s involvement in the Wilmar Group, to include the “Topic 2” issues.

Office of the Compliance Advisor/Ombudsman (CAO)  
*for the*  
International Finance Corporation (IFC)  
Multilateral Investment Guarantee Agency (MIGA)  
Members of the World Bank Group



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## **About the CAO**

*The CAO's mission is to serve as a fair, trusted, and effective independent recourse mechanism and to improve the environmental and social accountability of IFC and MIGA.*

The CAO (Office of the Compliance Advisor/Ombudsman) is an independent post that reports directly to the President of the World Bank Group. The CAO reviews complaints from communities affected by development projects undertaken by the two private sector lending arms of the World Bank Group: the International Finance Corporation (IFC) and the Multilateral Investment Guarantee Agency (MIGA).

For more information about the CAO, please visit [www.cao-ombudsman.org](http://www.cao-ombudsman.org)



## 1. Overview of the CAO Compliance Appraisal Process

When the CAO receives a complaint about an IFC or MIGA project, the complaint is first referred to the CAO Ombudsman, which works to respond quickly and effectively to complaints through facilitated settlements, if appropriate. If the CAO Ombudsman concludes that the parties are not willing or able to reach a facilitated solution, the case will be transferred to the compliance arm of CAO, CAO Compliance, to appraise the concerns raised in the complaint for a compliance audit of IFC or MIGA. Alternatively, a compliance audit can be initiated by request from the President of the World Bank Group, the senior management of IFC or MIGA, or at the discretion of the CAO Vice President.

A CAO Compliance appraisal is a preliminary investigation to determine whether the CAO should proceed to a compliance audit of IFC or MIGA. Through CAO Compliance appraisals, the CAO ensures that compliance audits of IFC or MIGA are initiated only for those cases with substantial concerns regarding social or environmental outcomes.

A compliance audit is concerned with assessing the application of relevant policy provisions and related guidelines and procedures to determine whether IFC and MIGA are in compliance. The primary focus of compliance auditing is on IFC and MIGA, but the role of the sponsor may also be considered.

A compliance audit appraisal, and any audit that ensues, must remain within the scope of the original complaint or request. It cannot go beyond the confines of the complaint or request to address other issues. In such cases, the complainant or requestor should consider a new complaint or request.

The CAO compliance appraisal will consider how IFC/MIGA assured itself/themselves of compliance with national law, reflecting international legal commitments, along with other audit criteria. The CAO has no authority with respect to judicial processes. The CAO is not an appeals court or a legal enforcement mechanism, nor is the CAO a substitute for international court systems or court systems in host countries.

The appraisal criteria are set forth in CAO's Operational Guidelines. The criteria are framed as a series of questions to test the value of undertaking a compliance audit of IFC or MIGA. The criteria are as follows:

- Is there evidence (or perceived risk) of adverse social and environmental outcomes that indicates that policy provisions (or other audit criteria) may not have been adhered to or properly applied?
- Is there evidence of risk of significant adverse social and environmental outcomes that indicates that policy provisions, whether or not complied with, have failed to provide an adequate level of protection?



- Is there evidence (or perceived risk) of significant adverse social and environmental outcomes where policy provisions, standards (or other audit criteria), were not thought to be applicable but perhaps should have been applied?
- Is there evidence that the application of some aspect of a policy, standard, guideline or procedure resulted in adverse social and environmental outcomes?
- Can the cause of adverse social and environmental outcomes not be readily identified and corrected through the intervention of the project team without a detailed investigation of the underlying causes or circumstances?
- Could a compliance audit yield information or findings that might better inform the application of policies (or other audit criteria) to future projects?

During appraisal, CAO Compliance holds discussions with the IFC or MIGA project team and other relevant parties to understand the validity of the concerns and to explore whether an audit would be warranted.

After a compliance appraisal has been completed, the CAO can choose only one of two options: to close the case, or to initiate a compliance audit of IFC or MIGA.

The CAO will report and disclose the findings and decision of the CAO compliance appraisal in an appraisal report in order to inform the President of the World Bank Group, the Boards of the World Bank Group, senior management of IFC or MIGA, and the public in writing about its decision.

If the CAO decides to initiate a compliance audit as a result of the compliance appraisal, the CAO will draw up a Terms of Reference for the audit in accordance with CAO's Operational Guidelines.



## 2. Background and Concerns that Led to the Appraisal

As of March 2009, IFC has undertaken four investments with the Wilmar Group: Wilmar Trading (IFC No. 20348), Delta – Wilmar CIS (IFC No. 24644), Wilmar WCap (IFC No. 25532), and Delta-Wilmar Expansion (IFC No. 26271).

IFC's involvement in Wilmar Group started in 2003 with its first investment, followed by two further investments in 2006. On October 2008, IFC approved a fourth investment, the Delta–Wilmar CIS Expansion.

In July 2007, nineteen representatives of civil society organizations (CSOs) filed a complaint under the lead of Forest Peoples Programme, claiming that Wilmar Group's activities in Indonesia violated a number of IFC standards and requirements.

CAO Ombudsman disclosed in November 2007 a "Preliminary Stakeholder Assessment" report. Based on division of topics made in the CAO Ombudsman report, CAO Ombudsman transferred IFC-related allegations to CAO Compliance for a compliance appraisal at two different occasions; in March 2008 CAO Ombudsman transferred what was defined as "Topic 3", and in December 2008, CAO Ombudsman transferred what was defined as "Topic 2". For details on how CAO Ombudsman divided the complaint into three different topic areas, see the November 2007 CAO Ombudsman "Preliminary Stakeholder Assessment" report available on [www.cao-ombudsman.org](http://www.cao-ombudsman.org).

CAO Compliance concluded on September 4, 2008 that the issues transferred from CAO Ombudsman in March 2008 merited an audit. See the CAO Compliance Appraisal report on [www.cao-ombudsman.org](http://www.cao-ombudsman.org) for details. CAO Compliance disclosed Terms of Reference for the audit on December 3, 2008. The Delta–Wilmar CIS Expansion approved in October 2008 was not within the scope of the audit at the time when the first Terms of Reference was released on December 3, 2008.

<b>Actions by CAO Compliance</b>	
2007	
July 18	Complaint received by the CAO from 19 CSO representatives under the lead of Forest Peoples Programme. The complaint was dated July 18, 2007.
2008	
March 26	CAO Ombudsman transfers issues related to IFC under what is referred to as "Topic 3" in CAO Ombudsman Preliminary Stakeholder Assessment report.
September 4	Appraisal report disclosed by CAO Compliance.
December 3	CAO Compliance discloses the Terms of Reference for the audit.
December 17	CAO Ombudsman transfers issues related to IFC under what is referred to as "Topic 2" in CAO Ombudsman Preliminary Stakeholder Assessment report.
March 11	CAO Compliance discloses appraisal report addressing the issues transferred December 17.



### 3. Scope of the Appraisal for an Audit of IFC

1. The scope of this appraisal is identical to the scope defined in September 2008 CAO Compliance Appraisal Report with one exception: the scope of the appraisal of the issues transferred in March 2008 and addressed in the September 2008 Appraisal Report was limited to compliance with IFC's applicable policy provisions, and did not include an assessment of how IFC assured itself of compliance with applicable national laws. This limitation related to the grouping by the CAO Ombudsman of the concerns raised by the complainant in three topic groups.

The complainants raised the following specific issues in their July 2007 complaint. The list below is identical to the list in the September 2008 CAO Compliance Appraisal Report;

2. Incorrect categorization of the investments: IFC's involvement in Delta - Wilmar was classified as category B. The other two IFC investments were classified as category C. The complainants claim that the categorizations are incorrect, due to supply chain issues, among other matters.

3. Incorrect application of policies and standards: The complainants claim that the IFC Environmental and Social Review Procedures and IFC's Performance Standards and Policies that came into effect on April 30, 2006 should have been applied to the investments in Wilmar that were approved on or after that date.

4. Violation of IFC disclosure policy: Besides alleging subsequent violations of IFC's Disclosure Policy as a consequence of the incorrect categorization, the complainants claim that IFC violated the Disclosure Policy by refusing to provide any rationale for the categorization of the investment in Wilmar WCap, or contact details where the complainants could receive such an explanation, at a meeting held in May 2007.

5. Violations of IFC's policies and standards. The complainants claim that:

- The Wilmar subsidiaries are not complying with applicable national law, as stated as a requirement in IFC policies and standards.
- There are no social and environmental impact assessments or action plans publicly available for Wilmar subsidiaries, as required by IFC's standards.
- IFC gave no attention to Performance Standard 5, or to the prior policy on involuntary resettlement, when assessing the projects.
- IFC gave no attention to Performance Standard 6, or to the prior policies and guidelines concerned with preserving biodiversity, when assessing the projects.
- IFC gave no attention to Performance Standard 7, or to the prior policy on indigenous people, when assessing the projects.

6. Roundtable on Sustainable Palm Oil (RSPO): The complainants further state that IFC has repeatedly, explicitly and incorrectly claimed that Wilmar is compliant with principles and criteria adopted in 2005 by the Roundtable on Sustainable Palm Oil.

7. The complainants further state that the adverse impacts on the ground include:

- Illegal use of fire to clear lands



- Clearance of primary forests
- Clearance of areas of high conservation value
- Take over of indigenous peoples' customary lands without due process
- Failure to carry out free, prior, and informed consultations with indigenous peoples leading to broad community support
- Failure to negotiate with communities or abide by negotiated agreements
- Failure to establish agreed areas of smallholdings
- Social conflicts triggering repressive actions by companies and security forces
- Failure to carry out or wait for approval of legally required environmental impact assessments
- Clearance of tropical peat and forests without legally required permits.

#### 4. CAO Findings

The September 2008 CAO Appraisal Report found the following:

8. IFC investment in Wilmar Trading (IFC No. 20348) and Delta - Wilmar (IFC No. 24644)

8a. IFC categorized its investments in Wilmar Trading and Delta - Wilmar according to provisions that were applicable at that time: the 1998 Environmental and Social Review Procedures and the World Bank Group Safeguard Policies. These provisions did not require supply chain issues to be considered. For clarity: the categorization B given by IFC to the investment in Delta - Wilmar was not related to supply chain issues, but issues IFC identified as related to the specific project site location in Ukraine.

8b. IFC states in its response to the CAO that for the investment in Wilmar Trading, it went beyond usual practice and made a broader consideration of the associated risk. IFC also reviewed a Wilmar Group refinery as part of a broader review.

8c. IFC states in its response to the CAO that for the investment in Delta - Wilmar, it was aware of the external environmental and social concerns about palm oil supply chain issues, and that IFC went beyond the requirements applicable at the time by performing an additional review, visiting several plantations in West Kalimantan and West Sumatra, Indonesia.

8d. IFC states in the Summary of Project Information (SPI) for Delta - Wilmar that all potential impacts emanating from refinery operations may be avoided or mitigated by adhering to generally recognized standards, guidelines or design criteria.

9. IFC investment in Wilmar WCap (IFC No. 25532)

9a. The Wilmar WCap investment was reviewed by IFC under the Performance Standards and the revised environmental and social review procedure that came into effect in April 2006. IFC correctly identifies that Performance Standard 1 notes the need to consider supply chain issues. IFC states that it did consider supply chain issues consistent with the requirement in Performance Standard 1 by conducting an overview of some of Wilmar's plantations. IFC states that at that time, overall, these operations were being



managed in the spirit of the draft Roundtable of Sustainable Palm Oil Principles and Criteria. IFC states in its presentation to the Board that it will work with Wilmar to develop an assistance program to promote sustainable on-plantation practices by the palm oil suppliers. IFC categorized its investment in Wilmar WCap as a category C as per IFC standard practice and current environmental and social review procedures for trade finance facilities.

9b. IFC states in the SPI for Wilmar WCap that the investment will have minimal or no direct, adverse social or environmental impacts, and that the client is committed to high standards of sustainability and corporate responsibility throughout its palm oil supply chains. The SPI for Wilmar WCap further addresses the performance of Wilmar International's Indonesian operations and of Wilmar's crude palm oil mills.

10. IFC states in its response to the CAO that it works proactively, and has initiated an internal reconsideration of how IFC categorizes trade finance facilities.

11. IFC correctly disclosed the information and rationale for categorization as required by the 1998 and 2006 Environmental and Social Review Procedures for category C and B investments.

12. In response to the lack of application of Performance Standards, or earlier policies, on involuntary resettlement, biodiversity, compliance with national law, and indigenous people relevant for Wilmar's plantations, IFC responded to the CAO that it has no investment in the Wilmar Group's plantation operations: Wilmar Trading and Wilmar WCAP are purely trading operations with no fixed assets; and the project site related to the Delta - Wilmar did not trigger any of the above-mentioned policies. IFC states that it therefore lacks formal legal leverage to implement any specific requirement on the plantation operations.

13. The CAO finds no IFC provision that a lack of formal legal leverage for IFC to implement Performance Standards should preclude such standards from being applicable.

In response to this appraisal of the "Topic 2" issues, IFC responded on March 4 2009 to CAO's appraisal questions.

14. IFC's response detailed how it assessed and worked with Wilmar on the specific issues related to burning in preparation of land for planting, the national requirements of Environmental Impact Assessments and issues related to harvesting and clearing forests.

15. IFC further reinforces its view that IFC focuses its due diligence on the specific legal entity which is receiving the IFC funds, and that a detailed appraisal of every plantation against the applicable Safeguard Policies or Performance Standards was not called for in IFC's procedures at that time.





## 5. The CAO Decision

The September 2008 CAO Appraisal Report concluded the following:

16. There is an inconsistency in IFC's approach to the supply chain issues. While, during its review process, IFC identifies potential impacts outside the legal entities that are the recipients of IFC investments, these potential impacts are not consistently addressed. IFC did assess the performance of the Wilmar Group's plantations, but not to any fixed, or agreed, set of standards. IFC states that it assured itself that the Wilmar Group's plantations were properly managed, but when challenged on actual applicability of IFC standards, IFC responded by referring to a lack of legal leverage to implement such standards.

17. There are no IFC provisions stating that a lack of formal legal leverage to implement requirements determines the applicability of performance standards. The reference to lack of leverage to implement IFC standards as a consequence of lack of a formal legal vehicle to do so is inconsistent with arguments used by IFC to defend other investments.<sup>1</sup>

18. The CAO finds that the current procedures for assessing supply chain issues related to IFC investments lack clarity and provide insufficient guidance for staff when conducting reviews. The CAO therefore finds that there is a *possible* failure in addressing social and environmental outcomes as part of the review process, and that this *might* lead to outcomes contrary to the desired effect of the policy provisions.

CAO does not find that the March 4 response from IFC changes CAO's decision made in September 2008.

19. The CAO finds no difference in the in IFC approach to the appraisal of the "Topic 2" issues compared to the issues addressed in the September report that changes CAO's decision.

20. Consistent with CAO Operational Guidelines, the CAO will expand the December 2008 Terms of Reference for the audit of IFC on supply chain issues, and the related categorization, of IFC's involvement in the Wilmar Group, to include the "Topic 2" issues.

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<sup>1</sup> IFC typically invests as a minority shareholder, with a promise to IFC's Board that IFC will implement its social and environmental standards without the formal legal leverage to ensure such implementation.