ESG Fraud

ESG fraud involves the deliberate misrepresentation of environmental, social, or governance claims. It includes false reporting, concealment of unethical practices, and manipulation of data to appear more sustainable, inclusive, or ethical than reality reflects. Fraud can be internal (by employees or executives) or external (by vendors, contractors, or data providers).

Role of Materiality
Materiality in ESG refers to what is significant to stakeholders, not just financial metrics. Organizations must clearly define ESG materiality, ensure accuracy, and prepare to correct misstatements rapidly.

The Fraud Triangle in ESG
- Pressure: Unrealistic ESG targets and reputational expectations
- Opportunity: Weak oversight, poor documentation, inconsistent definitions
- Rationalization: Belief that ESG ends justify deceptive means

Common ESG Fraud Schemes
- Environmental: Inflated carbon credits, falsified emissions, harvest mixing
- Social: Concealed labor abuses, falsified DEI metrics, exploitative supplier practices
- Governance: Executive compensation manipulation, audit committee conflicts, political bribery masked as ESG spending

Red Flags
- ESG disclosures that lack supporting documentation
- Inconsistent ESG claims across marketing, filings, and investment actions
- Third-party ESG verifications with limited transparency
- Whistleblower complaints or media scrutiny of sustainability claims

Key Regulations and Enforcement
- The SEC has issued ESG-specific Risk Alerts and created a Climate and ESG Task Force to investigate disclosure violations
- Proposed rule changes would require clearer ESG reporting under the Advisers Act and Investment Company Act
- Firms must demonstrate actual adherence to ESG strategies disclosed to clients or face legal action

Risk Mitigation Strategies
- Integrate ESG fraud risk into broader fraud governance programs (e.g., COSO/ACFE framework)
- Conduct targeted ESG fraud risk assessments and supply chain mapping
- Strengthen compliance policies, training, documentation, and reporting systems
- Ensure ESG claims are substantiated, updated, and aligned across all platforms

IAASB, IFRS, SASB, IIRC, ISSB, SEC
These bodies issue frameworks and standards for ESG-related assurance, reporting, and compliance