# Fraudcast: stories of tricks & treachery

## Episode 8: Behind the green screen: ESG Fraud

**Jazz Clemente**

Hello everyone and welcome to the KPMG Fraudcast, where we unravel fraud cases in the news to uncover what happened and explore lessons learned. My name is Jazz Clemente.

**Frédéric LeBlond**

And I'm Frédéric LeBlond.

**Jazz Clemente**

We are both Senior Consultants within the KPMG in Canada's Forensic practice.

**Frédéric LeBlond**

The stories we'll cover in this series are true events, but the names have been changed to aliases for the privacy of everyone involved. Although KPMG was not involved in these cases, we work on cases similar to the ones of public knowledge we discuss. In this episode, we will be discussing stories of ESG fraud and its many consequences.

**Frédéric LeBlond**

Before we get into our stories, I want to give a quick refresher about ESG. ESG stands for environmental, social and governance, and represents issues that pertain to these topics. The term is mostly used in the corporate world where it relates to corporations' environmental stewardship, social responsibility and accountability and governance. It's often dismissed as another buzzword, but it has a very real impact on society. As a matter of fact, we could say that ESG has been important for as long as society has concerned itself with equity, accountability and our environment. These stories may focus more on corporations than individuals, but they all have a very real impact on the population at large.

**Frédéric LeBlond**

The first story that I'd like to discuss is that of the infamous 2010 oil spill that also managed to attract the attention of the SEC. An incident at the Clearview Mission Offshore oil rig operated by Sunrise Petroleum caused an explosion that took the lives of 11 workers at the rig, and also resulted in an oil spill that lasted three months, when it was successfully plugged by a cap. By that point, 750 million liters of oil had been spilled in the Gulf. I believe that this event is still familiar to most people in 2023, as one of the most severe environmental incidents of the 21st century. The environmental consequences of this oil spill were catastrophic, and the Gulf is still undergoing restoration efforts until this day.

**Jazz Clemente**

As mentioned earlier in this story, this oil spill cost 11 people to lose their lives, but that was just the beginning of it. The damage to nature caused by oil spills is truly immense. Oil spills are harmful to all marine life, fish, as well as birds and mammals. Often, for these animals to survive, they have to be taken away from their natural habitats, and they have to be rehabilitated before they could be returned to their homes.

**Frédéric LeBlond**

The ESG connection and importance here is clear, but there is actually more to the story, something I didn't know myself. In 2012, the SEC brought forward charges against Sunrise Petroleum for misleading investors by significantly understating the flow rate of the oil and multiple reports filed with the SEC. During the course of the oil spill, Sunrise made fraudulent statements that the flow rate estimate of the spill was 5,000 barrels of oil per day. Despite its own internal data showing the flow rate could be as high as 146,000 barrels per day. Numerous public statements were made to support this 5,000 figure. Months later, a government task force determined the estimate was more likely at 52,700 to 62,200 barrels of oil per day. Yet Sunrise never made corrections to its filings.

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### Jazz Clemente

So not only were they responsible for this spill, but they also defrauded their investors by lying to them about the extent of the damage they caused.

### Frédéric LeBlond

Exactly. Sunrise Petroleum was eventually fined a multimillion-dollar penalty on top of the billions of dollars it had to pay to the US government and several US states for the pollution it was responsible for. I believe this proves my point. ESG may be a new term, but in reality, it's always been around.

### Frédéric LeBlond

With the rising concern over ESG matters, many investors now look into how their investment decisions impact the environment and favor companies that have better environmental values and policies. Conveniently, many financial institutions now release investment vehicles and selections that are built around ESG concerns.

### Jazz Clemente

This is called green investing or eco-investing, a way of exercising social responsibility by investing in green companies and funds. Green investors favor businesses with practices that are environmentally friendly.

### Frédéric LeBlond

Our second story is about an asset management firm and how it misled its investors into investing against their ESG interests. This asset management firm, SilverLeaf Financial, had financial investment offerings that they were marketing as ESG investments, but the SEC found that it had several policy and procedure failures in designating and managing them as ESG from the period of 2017 to 2020.

SilverLeaf failed to have any written policies or procedures until 2018 and even after when it had established them, it failed to follow them consistently. For example, SilverLeaf personnel were required to complete a questionnaire for each company they would include in the investment portfolio, but it was found that questionnaires were actually completed after securities were selected and included and relied on research that wasn't compliant with its policies. SilverLeaf shared info about their policies and procedures that they weren't following to intermediaries and the fund's trustees, the SEC fined SilverLeaf with a multimillion-dollar penalty as a result of these actions. I think this story should serve as a reminder for investors to always perform their due diligence and invest in what makes sense.

### Frédéric LeBlond

Certain industries happen to have a very strong connection with an impact on both the environment and their local communities. One such group of industries is out of natural resources, such as the mining industry. Our last story is about the importance of ESG responsibility and the drastic consequences there can be when things go wrong.

The first case we will look at is that of Polaris Minerals. Polaris had become aware that there was some concern over potential mercury contamination in an important river one of its factories was built along. Unfortunately, the SEC had found some issues with how they handled things. Polaris's deficient disclosure controls resulted in the company failing to properly assess the financial risks of mercury contamination of that river. They also covered up their misconduct by submitting inaccurate test reports to the local environmental authorities. Polaris had never assessed whether it needed to disclose the financial uncertainties of the misconduct. By failing to handle the matter properly, Polaris misled investors who believed their investments to be reliable and misled their government potentially delaying restoration efforts and causing much more environmental damage than there should have been.

### Jazz Clemente

The failure of Polaris to exercise due diligence in the matter caused damage to their investors and to the environment.

### Frédéric LeBlond

That's true, and it can get much worse than that, as you'll see in the next one.

Our second case is that of another mining company, Vigil SA. In Vigils case, they were found to have made false and misleading claims about the safety of their dams. One of their dams, which was built to contain potentially toxic byproducts from its mining operations, actually collapsed in 2019, killing 270 people and causing the loss of more than $4 billion in its market cap. Vigil had manipulated multiple dam safety audits, obtained numerous fraudulent stability certificates and misled local governments and investors about the safety of the dam through their ESG disclosures. Vigil knew that its DAM did not meet internationally recognized standards for dam safety, but they continued assuring investors that they adhere to the strictest international practices in evaluating dam safety. They also stated that 100% of their dams were certified to be stable.

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While concealing these risks, Vigil raised more than $1 billion in US debt markets while its security actively traded on the New York Stock Exchange. This story showcases how ESG concerns can be very serious and can even be a matter of life and death.

I hope you loved our stories for this episode.

### Frédéric LeBlond

I'm very excited to introduce our guest for this episode, Tony Lam. Tony Lam is a Manager in KPMG's Forensic practice based in Montreal, Canada. Tony specializes in fraud investigations, fraud prevention, internal audit, external audit, as well as quantification of financial damages in the context of litigation. In particular, he's experienced in using a variety of analytics, data mining, statistical and visualization tools, including designing complex data analytics procedures used for expert witness testimony, fraud investigation, and other types of mandates.

Tony's interest in ESG topics has enabled him to develop a thorough understanding on how ESG related fraud may be present, as well as how data and analytics techniques can be applied to identify these risks. He also presented at various regional and national conferences on ESG fraud. Tony leads KPMG Canada's ESG Forensic committee, which aims to develop forensic service offerings for ESG matters.

Tony, given how ESG fraud is emerging as an area of concern, how can we best ensure that our actions made towards our ESG goals have the intended impact?

### Tony Lam

Thank you, Frederic. I think in short, really what you have to is do your own research. There are really two perspectives into avoiding being tricked by ESG fraud. If I was a consumer, for example, I want to avoid products that may appear as being greenwashing. You want to understand what each label means and any implications. For example, some ESG labels are more permissive, in terms of percentage of content that is not ESG friendly and even less than half, some labels don't involve any additional efforts from the farm. For example, the farm or product may have a label, but in the end doesn't involve any extra efforts or work from the producer itself, and it just marketing costs. In the end, you want to encourage actual leaders that change or transform the industry that they're in, and you want to buy products from them.

You might also want to weigh the pros and cons of products that companies encourage. For example, some companies may offer water bottles that are made of aluminum, but since aluminum is recyclable but single-use, and cost a lot of energy to produce it, maybe it's not the best solution. In that case, in actuality, a better solution is to choose your own water bottle or have your own reusable water bottle or even drink from a fountain. Finally, you want to encourage truly transformative companies. You want to look at companies that encourage reusing products, which is the best solution from an ESG standpoint.

As an investor, you want to look at any red flags when you want to decide whether to invest in certain companies or not. You want to be aware of red flags, for example, and explain any unusual changes in calculation of metrics. Is there unbalanced or vague reporting of metrics that exist? Is the company having aggressive targets to reach carbon neutrality in five years, but they haven't enacted any significant strategy to reach them? In ESG reporting, most reporting is voluntary. However, what that means is that companies don't need to conform to a specific reporting standard, but some may choose to correspond to the new ISSB standards. In that case, you want to look for those mentions and even look if an auditor can give some sort of insurance under ESG reporting. Finally, you want to compare it to the industry and see if that company is actually performing better than the other companies in the industry you're targeting.

### Frédéric LeBlond

That's great, Tony. So how can companies avoid perpetuating ESG fraud

### Tony Lam

In that case, what I would recommend is looking at what we call the COSO framework from an internal control perspective and see how from a control environment perspective, risk assessment and other considerations, how can ESG controls lead to ESG reporting. If you look at the control environment, you want to make sure that there is an appropriate tone at the top and that leaders are transmitting the line that fraud is not acceptable in any forms, either financial or even on a reporting perspective on ESG KPIs.

In terms of risk assessment, you want to look at what are the possible risks and schemes for ESG misconduct and identify those possible risks. In terms of control activities, you want to make sure your controls are covered with the new risks related to ESG since now there's ESG reporting, there could

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be new motivation, new pressures from stakeholders that hadn't been considered before. Quality control owners in that case, and what kind of new controls we should have since there's new factors we need to consider. You need to communicate these to everybody. With new processes, you need to tell all stakeholders, communicate your expectations to employees, and provide training as needed. You also need to create channels of communications such as a whistleblower line to report potential ESG fraud.

Finally, you want to include monitoring activities into ESG fraud perspective. Can you use the analytics, for example, to identify fraud risks, especially since the source of those KPIs comes from non-traditional data sources such as carbon footprint, square footage and volume of waste. This is something that is not traditionally overseen by an internal control or fraud risk assessment framework.

### Frédéric LeBlond

Thanks Tony. And finally, so can you tell me a bit about what KPMG does or what we're working on in the ESG space in forensic?

### Tony Lam

Yes, of course. At KPMG, we really have many services that are either proactive or even reactive.

When we look at proactive services, we help companies establish an ESG strategy that is realistic to its goals, and we can help them maintain them. We can even help them calculate their greenhouse gas emissions and understand where their sources of emissions come from. In that case, establish an ESG strategy to reduce them and attain their goals.

We can also help assess how mature their systems are especially when we look at the data that is feeding their ESG carbon footprint. Are they using Excel files? Are they using data that comes from an ERP? What kind of controls comes from it, under different risk for fraud? We can assist companies by looking at the fraud risk management perspective. What is the potential fraud risk for those companies and how can we ensure that controls are appropriately implemented in that case?

Finally, we can help them on training to make sure from an ethical standpoint, all stakeholders are aware of what ESG fraud is from a reporting perspective, and they're clear about what is acceptable and not acceptable. We can help them on the reactive side, where if there's allegations of ESG fraud, we can investigate those allegations. If there's any litigation that comes from ESG fraud, such as financial losses due to misrepresentation of ESG KPIs or ESG information, we can help them quantify damages. Finally, if there's any class actions with ESG industry or any ESG metrics, we can assist them as well.

### Frédéric LeBlond

Awesome. Thanks Tony. And thanks so much for joining us today.

### Tony Lam

Thank you. My pleasure.

### Jazz Clemente

Each episode we'd like to leave you with a little something to help increase fraud awareness. Here's Fred with our fraud scheme of the week ESG washing.

### Frédéric LeBlond

Thanks Jazz. So, ESG washing occurs when companies try to oversell, embellish or perhaps even outright lie about their ESG efforts to make a better impression on investors who actually may end up being misled into investing in something that is against their interests. There are many types of washing all relating to different ESG aspects and how they may be toyed with to gain favor with stakeholders.

For example, greenwashing refers to a company misleading the public about their environmental impact or policies. While blue washing refers to the promotion of marine development initiatives that may actually harm aquatic environments. There are also examples of social washing, such as pinkwashing and purple washing and reference to misleading investors regarding 2SLGBTQIA+ initiatives and initiatives in the favor of the inclusion of women respectively.

### Jazz Clemente

So how do you manage this?

### Frédéric LeBlond

As an investor, you avoid falling victim to ESG washing by doing in-depth research before making any investment decision. But as an organization looking to accurately report on your ESG metrics and looking to avoid allegations of ESG washing, there are certain tips you can follow.

First off, you can ensure that your marketing claims are supported with concrete and credible evidence. Second, you can use sustainability certifications and standards for added credibility. Next, you can consider your overall environmental

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footprint, not just on isolated aspects of the business. You can perform audits of your supply chains to ensure your suppliers are as sustainable as you are. And finally, you can monitor your customer's perception by performing ongoing surveys.

KPMG Forensic professionals transform how clients identify, mitigate and respond to risk saving time and money. We help individuals and organizations stay on top of fraud, and we would love to help you too. On behalf of the whole KPMG Regions East Forensic team, thank you very much for tuning into this episode of the KPMG Fraudcast.

**Jazz Clemente**

And we hope you join us again next time.

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