



ESG and the Failure to Prevent Fraud Offence:

What firms need to know

ESG voices podcast series

Host

Hello, and welcome to another episode of ESG Voices. This podcast series addresses the opportunities and challenges within ESG through interviews with ESG specialists from KPMG and beyond.

Throughout this series, we will discuss a broad range of environmental, social, and governance issues, aiming to support governments, businesses, and communities in creating an equitable and prosperous future.

In our episode today, we are joined by Annabel Reoch, Global Head of Ethics and Compliance, KPMG International, and Partner, KPMG in the UK, Simon Stiggear, Director, Forensic, KPMG in the UK, Michael Pollitt, Senior Manager, Forensic, KPMG in the UK and finally Ethan Salathiel, Senior Manager, Forensic, also at KPMG in the UK as they discuss the UK's new "failure to prevent fraud" offence, its implications for corporate accountability, and its intersection with ESG reporting. They will also highlight the need for organizations to enhance their fraud risk assessments and controls, particularly regarding sustainability claims and legal repercussions.

Now, let's jump straight into the conversation with Michael.

To start, can you give us a brief overview of the "failure to prevent fraud" offence and why it is of interest to private sector organisations around the world?

Michael Pollitt

Absolutely. So the new corporate criminal offense of failure to prevent fraud was introduced as part of the Economic, Crime and Corporate Transparency Act 2023. It's intended to hold large organizations to account if they benefit from fraud. Under the offense, large organizations may be held liable where an employee, an agent, a subsidiary, or another associated person commits an act of fraud, intending to benefit that organization. Now, although this is a UK law, its reach is highly extraterritorial. If an employee or an associated person of an overseas based organization commits fraud in the UK or targeting victims in the UK, that organization could be prosecuted despite the fact that it's based overseas. The failure to

prevent fraud offense has a famous parent in the form of the 2017 Failure to Prevent Facilitation of Tax Evasion offense. However, it's grandparents the 2010 Failure to Prevent bribery offense has perhaps drawn the most attention for its ability to cause significant financial and reputational damage. So since its enforcement, the UK's failure to prevent bribery offense has led to a string of successful enforcement cases, with several highly publicized nine figure sums agreed in the context of corporate criminal failures to prevent bribery both in the UK and abroad. In terms of impacts, we're expecting the failure to prevent fraud offense to go even further than its precedents in the area of bribery and facilitation of tax evasion, and this is partly because of the ESG angle. The types of fraud that are covered under the failure to prevent fraud offense include fraud by false representation, for example. Now, this constitutes situations in which the defendant makes a false statement dishonestly knowing that the statement was or might be untrue or misleading with the intent to make a gain for themselves or another. Now, private sector organizations are under increasing pressure, as every listener of this podcast will know, to report on their sustainability performance as part of ESG regulation and ESG good practice. In this context, we've seen terms like greenwashing and blue washing emerge as buzzwords for the process of making inaccurate or exaggerated ESG claims, which may deceive consumers or other stakeholders into believing that an organization's sustainability performance is better than it actually is in order to gain a competitive advantage. Now under the new failure to prevent fraud offense, this could all get a lot more serious. Commentators on the new offense are already arguing that its false representation component could be used as a new tool against organizations who falsely represent the sustainability performance of their products, their services, their operations, or their supply chains. Now, ESG, sustainability and non-financial statements. There are already subject to a significant amount of scrutiny by third sector and civil society organizations who might be looking to take private sector organizations to account for their claims. This new offense of failing to prevent fraud by false representation will give these organizations a new way to take greenwashing firms to

task in litigation. We could therefore see more cases brought under this failure to prevent fraud offense than we've seen previously under the failure to prevent bribery and the failure to prevent facilitation of tax evasion offenses precisely because of its overlap with ESG reporting.

Host

Annabel, can you tell us how the new failure to prevent fraud offense is likely to affect an organization's approach to ESG reporting?

Annabel Reoch

Absolutely. As I'm sure the listeners to this podcast are aware, in recent years, more organizations are going above and beyond mandatory disclosure requirements to share additional valuable information with regard to ESG metrics, targets and ambitions. And while this is great news both for the consumer and the interested stakeholders, these disclosures could be caught under the new failure to prevent fraud offense, as Michael just described. This leaves organizations open to scrutiny if they're caught, for example, greenwashing or ESG washing. And if they fail to demonstrate reasonable procedures to prevent fraud within their ESG reporting. Now, that being said, the last thing we need is for organizations to shy away from reporting ESG metrics in the face of the new offense. This is otherwise known as green hushing. This could, in fact, be caught under the failure to disclose component of the fraud offense. So there are some steps that organizations can take to understand the fraud risks in their approach to ESG reporting. Number one, understand your stakeholders. Organizations need to determine precisely who is taking accountability for their response to the failure to prevent fraud offense when it comes to ESG reporting. This individual should have effective oversight of the ESG reporting process and appropriate training to understand the consequences for the business of getting it wrong. Number two risk assessment. Now, one of the six principles of the reasonable procedures to prevent fraud, organizations will need to refresh their fraud risk assessment to consider how ESG washing or ESG fraud risk could occur. And to do this, organizations will need to have a clear picture of their end-to-end ESG reporting framework from the data input all the way to the end user. And it should go beyond the formal ESG reporting and also consider where sustainability claims are being made in for example, investor relations documents and proposals, marketing material, advertising or on product labels, or where certifications may be relied upon by third parties, and it should consider the risk exposure through the supply chain. Number three know your control environment. So once you've undertaken your risk assessment and identified where ESG fraud risk could manifest, you need to understand the controls they have in place to mitigate them and importantly, whether they need enhancing. You need to consider does the ESG reporting framework uphold the six principles of the reasonable procedures to prevent fraud offense. Do they have top level commitment monitoring and review? Communication and training? Once organizations can answer these questions, they should be in a strong position to remain effective ESG reporting

in the presence of the new offense. And with all of this in mind, if failure to prevent fraud pushes organizations to maintain strong anti-fraud controls in ESG reporting and disclosures, then this can only be good news in the long run. We should expect to see more accurate disclosures allowing investors, consumers and regulators to make more informed decisions when it comes to ESG.

Host

Thanks, Annabel and Simon can you give us some details on what tools organizations already have at their disposal to help them respond to the requirements of the new offense, for example, as part of their compliance with existing laws?

Michael Pollitt

Yes, of course, as Michael referenced earlier, firms have been here before with regards to failure to prevent bribery in 2010. And seven years later, with the failure to prevent facilitation of tax evasion in 2017. Now, as we fast forward a further seven years, it's certainly worth stopping to pause and reflect on what infrastructure is already in place so your organization doesn't spend precious time and resources in building out tools, processes, and capabilities that might exist in the firm already. So it's these three things of tools, processes, and capabilities that should certainly be dusted off and leveraged in the context of managing risk and ensuring compliance with the six principles of reasonable procedures. So firstly, tools now risk assessment is arguably the key to any compliance program, and organizations will likely be well versed in conducting a variety of business wide or targeted risk assessments. So therefore, it would be useful to leverage these as a starting point, such as existing financial crime, fraud, anti-bribery corruption or anti-tax evasion facilitation, risk assessments and this should not only be from the practical sense of completing the risk assessment and the natural synergies in the qualitative and quantitative question sets, but also from the well-trodden, tried and tested challenge and approval processes in place, which are important in the governance wrapper that sits around the risk assessment.

Secondly, processes now due diligence and proportionate procedures are called out as two of the guiding principles of reasonable procedures. And again, processes and frameworks will already be in place to manage broader adjacent risks. So if we take the example of due diligence for third parties, then enhancements to these existing processes for third party due diligence informed by appropriate scenario analysis and associated person mapping, they seem like proportionate and practical next steps to take. Finally, just on capabilities, it certainly does take a wide variety of teams with differing complementary skill sets to manage risks such as fraud. And that's no different here for failure to prevent fraud. The good news is that organizations will have colleagues in their organizations that have relevant skills to help manage this risk. Now, depending on the size and complexity of your organization, you may have colleagues across all three lines of defense, such as in legal, procurement and risk and compliance, such as anti-bribery corruption professionals and those individuals

will have experience in mitigating risk and managing regulator compliance obligations. Where organizations are able to utilize this experience and less institutional knowledge than they should be well set up for success.

Host

Thanks, Simon and Ethan coming to you. Can you share some of your key takeaways from helping global organizations undertake a failure to prevent fraud risk assessment, and how are ESG considerations factored into this process?

Ethan Salathiel

Yes, sure. I've recently helped a number of clients to understand and complete detailed risk assessment in relation to the failure to prevent fraud offense. And as already referenced, this type of work involves identifying the key stakeholders across the organization up and down lines of defense. And those people need to be close enough to the key processes and controls to be able to articulate the inherent risks that could be faced. And this type of fraud is that which is committed by an associated person, as already outlined, and which benefits the organization. So it's actually a different way of thinking. Organizations are quite used to assessing fraud risk, whereby they are the victim of external fraud or are sometimes referred to it as inward fraud. But this is different. In order to unlock thinking, we've had to use some quite innovative ways of getting people to think like a fraudster. And this is somewhat of a creative process, which can seem a bit alien in the first instance. So there is an element of coaching, support and engagement required to get the most value out of this process. And also people do have a tendency to jump straight to, listing out the controls in place, because sometimes conversations about risk can feel a little bit uncomfortable. So certainly setting the tone about why this is important, why it's important to do a thorough job, and providing the context that by actually capturing all inherent risks, controls, and residual risks thoroughly and properly provides the organization with the opportunity to ultimately protect itself and build a well. It's sometimes referred to as a path to green to enhance or improve its control environment that is absolutely essential. And the second part of your question, ESG really came into the for a number of ways during recent work. Firstly, the actual ESG related risks were relatively high compared to others on a residual basis across the organizations that we've worked with. So already referred to greenwashing, greenhushing risks relating to both products, services and channels provided. So, for example, inflated performance disclosures relating to investment products were certainly there. But also statements about corporate sustainability came out of the workshops that we hosted. But often though, the issue arose similar to what Annabel outlined, to do with the lack of ownership of these types of risk, as they often straddle a process which, from an end to end perspective, cuts across a number of different teams and functions. For example, your frontline team might have the idea to create a new product and that will be passed to the product. Research and development team. And then once legal

terms, the conditions are in place and passed on, then to marketing for sales, distribution and communication. And then it might go full circle back to your frontline sales team for that onward distribution to clients. So it really does straddle a number of different teams. So there was also another overarching issue to do with the lack of documentation of both risks and controls. So the broader governance theme definitely emerged by virtue of conducting the fraud risk assessment. So it's all very well doing risk assessments but then the question is posed as to how also artifacts are signed off and approved at each stage of the process and really kept live as a dynamic risk management tool with strong organizational discipline as part of good governance. And this includes information sharing right up to the board level as within the legislation, top level commitment is absolutely vital.

Host

Thanks, Ethan, and for our final question, Michael, would you say that there are broader implications resulting from this offense that could impact other UK legislation focused on ESG issues within international reach?

Michael Pollitt

Well, we've talked a lot about the intersection between the failure to prevent fraud offense and ESG related legislation but one area where I think this could become especially interesting now is modern slavery. So as your listeners will be aware, currently private actors carrying out their business in the UK with an annual turnover of 36 million pounds, are required to report on the steps they've taken to identify and eradicate modern slavery in their operations and supply chains. Now this law is nearly ten years old. I started my career by working on it, which shows you how long I've been doing this, and it's come under various different forms of criticism, particularly for its lack of any meaningful measures that can be taken against private sector organizations who fail to report adequately or fail to report honestly, or fail to report at all.

There've been various attempts to add teeth to the UK's modern slavery reporting regime, not least in a recent report on the efficacy of the Modern Slavery Act, which was issued by the House of Lords a few weeks ago. And we just published a blog on this by UK finance, if listeners would like to learn more about that. However, until now, a lot of these efforts have been kicked into the long grass and modern slavery reporting, as it relates to the Modern Slavery Act has remained a highly under policed exercise ever since. Now again, the new fairly to prevent fraud offense has the potential to change this. Its underlying offenses include the issuance of false statements by company directors. This offense is targeted towards directors who are publishing or agreeing to the publication of a written statement, which they know to be misleading. And as much as the Modern Slavery Act requires modern slavery statements to be signed off by the board or equivalent, board members who sign off a modern slavery statement, which they know to be misleading, could be liable for causing a failure to prevent fraud offense, particularly if the statement is then

identified as being misleading by a third sector or a civil society organization who are reviewing it in the public domain. This is one of many factors that make the family to prevent fraud offense a significant new contributor to the global ESG reporting legislation and global ESG reporting standards. It's going to be fascinating, I think, to see how these theories, the theories that we've been talking about in today's episode, play out around the world. Now, as companies prepare for the enforcement of events between now and September 2025.

Host

Thanks Michael and thanks to you all for joining me on the podcast today.

Join us again next time for more insights from ESG leaders and innovators. You can also find the latest KPMG insights covering a range of ESG topics by visiting kpmg.com/ESG.

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