ESG Fraud & Misconduct Survey 2023

Responding to the emerging risk of ESG fraud & misconduct
April 2024

Our first Environmental, Social and Governance (ESG) fraud and misconduct survey shows the growing risk that ESG fraud and misconduct poses to companies. It highlights the challenges arising from emerging regulations and changing expectations from stakeholders. Positively, existing compliance programmes can be adapted to mitigate these risks.

As organisations' ESG strategy and performance comes under ever closer customer, investor and regulatory scrutiny, the risk of ESG fraud and misconduct is rising.

A complex landscape of relevant laws and regulations is emerging, from those designed to address ESG fraud and misconduct, like the Financial Conduct Authority's 2024 Anti-Greenwashing Rule, to those that include ESG fraud in a wider definition of fraudulent behaviour, like the 2023 Economic Crime and Corporate Transparency Act.

Recognising this emerging area of risk, in August 2023, PwC surveyed employees from 77 companies across 16 countries and territories on the emerging ESG risks their organisations face. The companies surveyed were spread across all industries, from consumer markets to financial services, and were a mix of small, medium and large, multinational companies.

Key highlights from the survey

Greenwashing was viewed as the most significant risk by a narrow margin across all ESG areas.
This perception is driven by growing focus on greenwashing from a wide range of stakeholders, and several pieces of emerging regulation.

Employees are most likely to raise concerns about ESG business conduct.
However, a wide range of stakeholders, from regulators to activists, are engaging with businesses on this topic, and their expectations may be very different.

ESG fraud is most likely to be detected through whistleblowing or internal audit.
This emphasises the importance of adapting existing compliance programmes in response to the emerging risk of ESG fraud.

ESG fraud and misconduct

Risk of ESG fraud or misconduct

ESG represents a broad range of topics. We asked businesses which specific areas presented the biggest risk of ESG fraud or misconduct to their organisation.

41% Environmental

19% Social

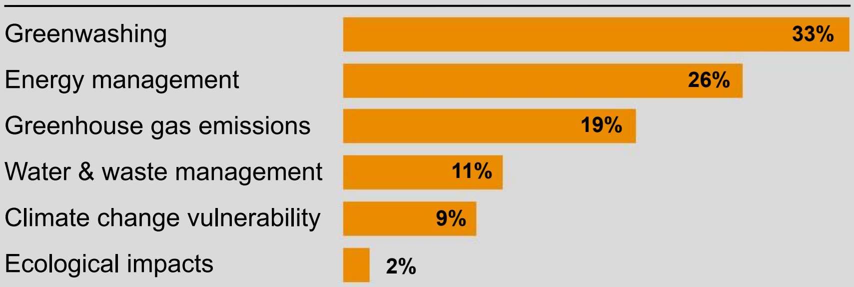
41% Governance

The risk of social-related matters leading to ESG fraud or misconduct lagged significantly behind those related to the environment or governance.

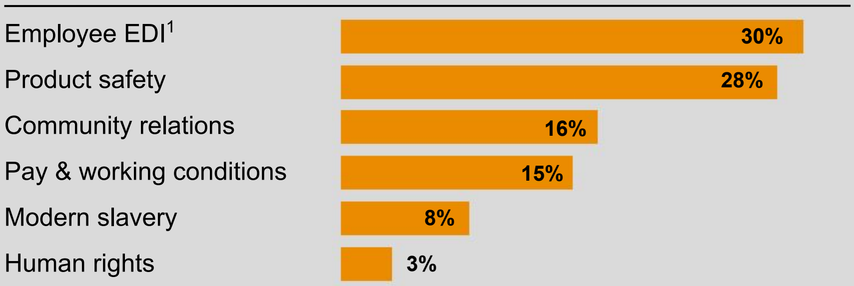
This is likely because regulations in this domain focus on disclosure. For example, the UK's Modern Slavery Act 2015 requires companies to publish a modern slavery statement, but historically there have been no financial penalties associated with a failure to do so.

Greenwashing viewed as the most significant environmental risk and the highest risk by a narrow margin across all ESG areas. Regulatory compliance and cyber security risk top the governance risks and the top social risk was employee diversity, equality and inclusion.

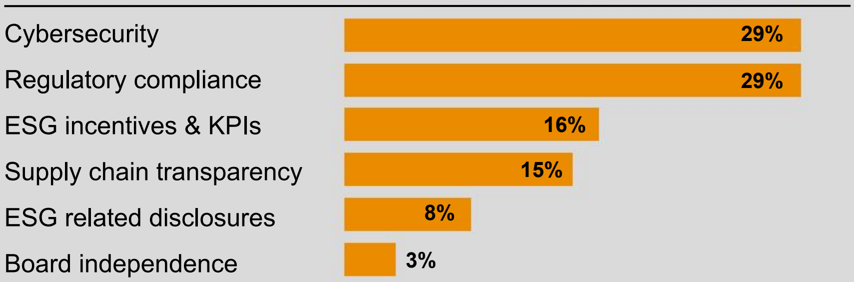
Environmental issues presenting the biggest risk of fraud or misconduct to respondents



Social issues presenting the biggest risk of fraud or misconduct to respondents



Governance issues presenting the biggest risk of fraud or misconduct to respondents



The areas of risk within Governance are well established areas that we have seen highlighted in our biannual Global Economic Crime Survey for many years. It is an area for which many businesses will have a robust compliance programme established. In contrast, those risks highlighted in Environment and Social are linked to emerging regulation and rapidly changing expectations from consumers, investors and regulators. It is these areas that will most benefit from further efforts to prevent and detect ESG fraud and misconduct.

1: Employee equality, diversity and inclusion

Stakeholders

A wide range of stakeholders are likely to raise concerns about potential ESG misconduct in businesses

We asked businesses which stakeholders are most likely to raise concerns about ESG business conduct. This generated a wide range of responses, with the five most common[2] being:

44% employees

33% regulators

30% customers

30% shareholders

21% activists

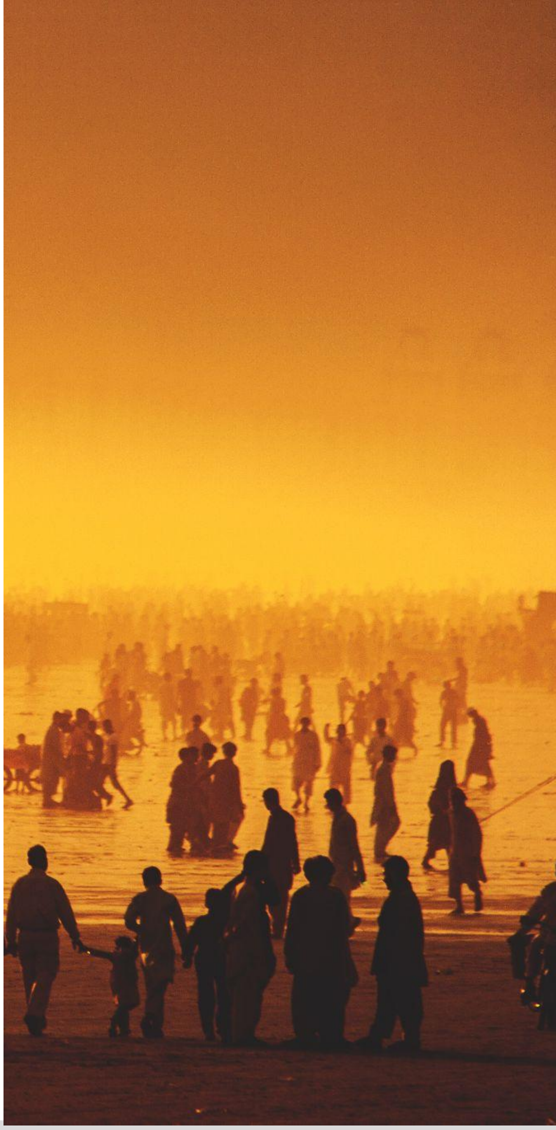
In contrast, distributors (3%) and non-governmental organisations (5%) were viewed as least likely to raise concerns.

A risk for businesses to consider are the different expectations that these stakeholders will have in relation to ESG fraud and misconduct.

An issue that may be viewed by one stakeholder as acceptable may be viewed by another as evidence of misconduct. For example, multiple financial institutions have been called upon by activists to immediately halt investments in fossil fuels, whereas many investors prefer a managed transition to reduce the financial impact. Such stakeholders may not have previously been considered as part of risk assessments.

To balance the risk of differing stakeholder expectations, businesses should be clear about their approach to ESG and ensure that behaviour and decisions align to their stated aims and claims.

2: This question allowed respondents to select multiple responses. The percentages show the proportion of total respondents that selected that option.



Data

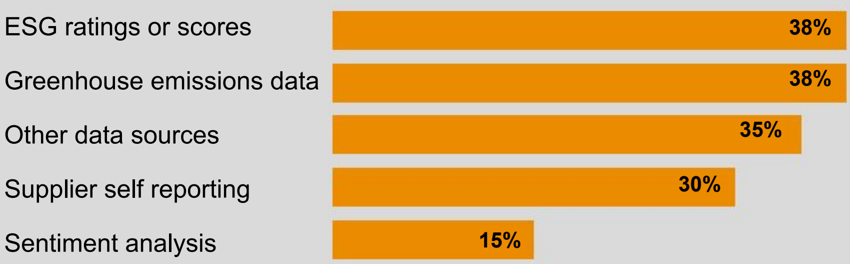
There is no single source of data that can be used to understand the risk of ESG fraud and misconduct in businesses and their supply chains

We asked businesses which external data sources they used to understand the risk of ESG fraud and misconduct in their organisation and its supply chain. Responses were varied and highlighted that there is no single source of data that can be relied upon to understand the risk of ESG fraud and misconduct.

In our experience, ESG data sources are of variable quality and often difficult to compare, making it challenging to identify trends and red flags that might indicate potential fraud or misconduct.

Whilst the ESG data landscape is improving, using multiple sources and having a clear understanding of data quality and limitations is essential when using it to prevent or detect ESG fraud.

External types of data companies are currently using to understand the risk of ESG fraud and misconduct in their organisation and supply chain



74%

of respondents told us that despite these challenges, they were confident or very confident that their ESG claims were supported by a robust evidence base.

It may be that as the number of legal challenges of ESG claims increase, this confidence level drops.

ESG fraud risk management

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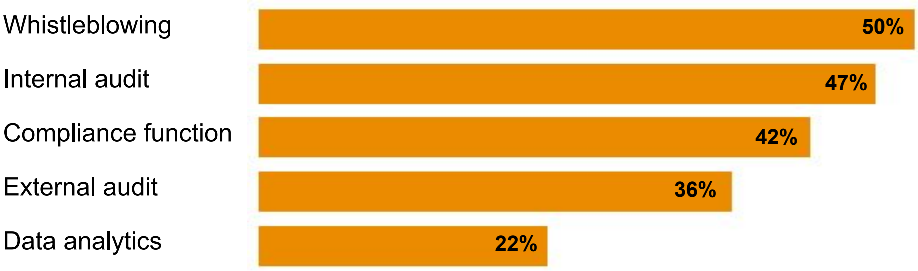
Better understanding of the risks will allow the adaptation of existing fraud risk management programmes, including raising awareness of the risk of ESG fraud and misconduct, and identifying new data sources and analytic approaches.

Detecting ESG fraud and misconduct issues

When asked about detection, survey responses demonstrated that existing processes and controls can be adapted to prevent and detect ESG fraud and misconduct.

To adapt these processes and controls effectively, the first step is to understand the full breadth of ESG fraud and misconduct risk. We recommend that any fraud risk assessment should fully consider this emerging area of risk, and to that end have prepared an ESG fraud taxonomy to prompt the discussion.

How do businesses detect fraud and misconduct issues[3]?



3: This question allowed respondents to select multiple responses. The percentages show the proportion of total respondents that selected that option.

If you would like to discuss the issues raised in this paper, and how you can adapt your fraud risk management approach to consider ESG fraud and misconduct, please contact us.

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