

Environmental Fraud: Tips for Auditors

Fraud is any act characterized by deceit, concealment, or violation of trust. It typically involves obtaining some type of gain at the expense of others. Audit functions (external/ financial and Internal Audits) typically think of fraud in terms of financial gain and reporting. Environmental and other “second line of defense” activities rarely think of it at all. **All lines of defense should have skills, resources, and procedures to detect environmental fraud.**



The Volkswagen diesel emissions scandal¹ has cost the company over \$30 billion as of the end of 2019. This is hardly the only case of environmental fraud. Companies have fraudulently claimed greenhouse gas emissions offsets for biofuels, falsified records of permits, and ‘green’ sourcing of dirty products.

Tips for auditors – of all lines of defense – for environmental fraud.

- 1. Learn more about Environmental Risk.** Environmental topics span all classic types of risk: compliance; operations; reporting (financial and non-financial); and business reputation. It extends beyond the organization into the supply chain. The Environmental Risk webinar is a timeless introduction to these concepts. Replay is free to all IIA North America members.
- 2. Recognize risks posed by disaggregation, and broader risks of Non-Financial Reporting.** Internal controls don’t reflect the needs of external stakeholders. If you’ve found one gap that could pose risk, you’re just getting started.
- 3. Do fraud risk assessment for every audit – and every [annual] audit plan.** Think expansively about how parties (including suppliers) can deceive on environmental matters. Perform fraud testing on every audit with relevant environmental issues. The nature and impact of risks are dynamic; include the environmental/ Non-Financial Reporting risk assessment in the annual risk assessment.
- 4. Get training on environmental fraud.** Fraud presentations and training often focuses on frauds that have been detected and investigated, with the consequences and perpetrators already known. It’s like a complete episode of CSI - but Audit lives in the first ten minutes. The nature of environmental risk varies by sector and organization; so will the risk of environmental fraud. Training can be beneficial. This is essential for organizations with in-house 2LOD environmental auditing programs. Management is relying on these programs to mitigate environmental risk, yet fraud awareness and testing remains uncommon.

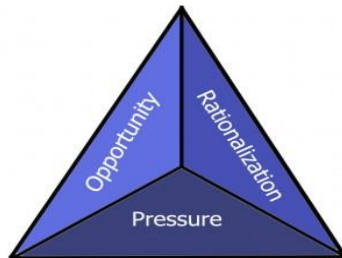
This Tip Sheet provides highlights of a webinar presented for the Institute of Internal Auditors on February 4, 2020. See www.theiia.org for a playback, and a related podcast.

See also the Environmental Risk webinar and Mr. Hileman’s Knowledge Brief on EHS Audit Program Performance Metrics.



Environmental Fraud: a “Cressey Trifecta”

The Fraud Triangle



The demand for non-financial reporting (including environmental, social and related areas) has exploded in the past decade. NFR is used for investment decisions, and as a factor for selecting suppliers and for college recruits considering job offers. These can create powerful incentives for deceit. Systems and controls are highly disaggregated and weak, especially if compared to those for financial reporting. There are ample reasons to justify deceit: “Nobody is looking” or “We can’t backtrack on our ‘green claims’ now”. The Cressey trifecta is all there.

About Douglas Hileman Consulting LLC

Douglas Hileman Consulting LLC (DHC) helps clients with compliance and risk management in environmental and non-financial reporting (NFR) issues. Mr. Hileman has deep experience in operations, corporate compliance, environmental/ sustainability auditing (“second line of defense” or 2LOD), Internal Audit (3LOD) and external assurance (supporting financial audits, and conflict minerals Independent Private Sector Audits). He has experience in a high-profile monitorship and has conducted dozens of audits to many different criteria and in a range of industry sectors.

Mr. Hileman is active in the Institute of Internal Auditors (www.theiia.org). He presented a webinar on Environmental Fraud in June 2019. He co-authored Practice Advisories for the IIA including “Internal Audit and the Second Line of Defense” and “Engagement Planning: Fraud Risk Assessments.” He is a co-chair of programming for the IIA’s 2019 International Conference.

Mr. Hileman worked at a Big 4 accounting firm for six years, supporting financial audits, enterprise risk management, internal audit and the Sustainable Business Solutions practice. Mr. Hileman holds credentials as a Certified Risk Management Assurance (CRMA) professional, a Certified Professional EHS Auditor (both administered by The Institute of Internal Auditors) and Fundamentals in Sustainability Accounting (administered by the Sustainability Accounting Standards Board).

More at www.douglashileman.com And www.environmentalfraud.com.

ⁱ **Disclaimer:** Mr. Hileman is on the Volkswagen Monitor Team. Nothing in this tip sheet, or the related webinar or podcast should be construed as being about Volkswagen. Mr. Hileman draws from 15+ years of experience in fraud risk assessment, testing, and improvement of related controls, in Environmental, Internal, and external audits (“2LOD, 3LOD and 4LOD”).