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ESG Reporting Issues Perpetuating Fraud Litigation

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Introduction

As consumers and regulators demand more sustainable and environmentally friendly products, companies have poured considerable time and millions of dollars into embedding sustainability into their reporting. Sustainability is considered the big umbrella, and environmental, social, and governance (ESG) are subcategories. While Whelan (2022) indicates that ESG metrics reporting is not a real replacement for sustainability strategic initiatives, investors are nonetheless interested in the methodology that companies are using to address ESG issues as they directly affect shareholder value.

A PwC Global Investor Survey in 2023 found that investors want to know how companies are managing sustainability, but the investors lack confidence in much of the information provided today. Investors "want better information, including the cost of meeting sustainability commitments and a clear road map for achieving them, combined with a view of what it means for financial statement assumptions" (Chalmers and Picard, 2023). A report by the law firm Latham & Watkins (2020, p. 3) indicates that these broad range of issues include:

- Environmental issues such as biodiversity degradation and long-term availability of resources (including water).
- Social issues such as supply-chain issues (including modern slavery and working conditions at supplier locations) and diversity in the workplace.
- Governance issues such as corporate reporting and audit and assurance.

A plethora of evidence indicates that ESG measures taken by companies elicit favorable reactions. Dating back from the 1970s until around 2015, Friede, Busch, and Bassen (2015) indicate that 90 percent of the 2,000 articles published about ESG and Carbon Footprint of Products (CFP) report a nonnegative ESG to CFP relation, and a large majority of these studies report positive findings. Subsequently, Whelan, Atz, Van Holt, and Hart (2021) reviewed over 1,000 studies published between 2015 and 2020 and found a positive relationship between compliance with ESG measures and financial performance for 58 percent of the corporate studies focusing on operational metrics such as ROE, ROA, or stock price. In examining investment studies, the researchers found further that 59 percent of those typically focused on risk-adjusted attributes such as alpha or the Sharpe ratio in stock portfolios showed similar or better performances relative to conventional investment approaches (only 14 percent found negative results).

Adherence to ESG reporting positively impacts brand attractiveness, which serves as an enticing motivation for company adoption. Using Nielsen Retail Scorner's over the period from 2008–2016, Meier, Servaes, Wei, and Xiao (2023) found that brand owner is economic and social (E&S) ratings were positively related to local product sales. Similarly, Frey, Bar Am, Doshi, Malik, and Noble (2023) found that products making ESG-related claims averaged 28 percent cumulative growth over the past five-year period versus 20 percent for products that made no such claims. This data provides direct evidence that E&S efforts affect consumer demand; the cash flow side of ESG. A 2023 U.S. Brand Sustainability Benchmark (Glow) SRS Industry Report found that one in two food and grocery customers changed brands based on perceptions of a brand's ESG performance, and 64 percent of consumers will pay more for products supporting communities and vulnerable groups. Further, nine out of 10 consumers believe it is important for businesses to act in a socially and environmentally responsible way (Clover, 2023).

Despite its increasing importance within the marketplace, regulators, such as the Securities and Exchange Commission (SEC) and the Federal Trade Commission (FTC) are struggling to impose robust, standardized ESG reporting methods. Concurrently, litigators are shifting some of their attention away from fraud in climate change litigation towards

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sustainability and ESG reporting. Mishra (2021) indicates that event-driven security class action lawsuits are increasing in numbers and capturing a broader range of global brands on a variety of different topics. As suggested by Latham & Watkins (2020, p. 3):

> "As ESG continues to grow in importance, the number of ESG litigation matters will become self-perpetuating. ESG-related disclosures will likely trigger claims based on public reporting (or the absence of reporting) and as companies continue to commit to voluntary standards, 'soft law' fora will continue to prove popular low-cost alternatives to formal proceedings."

This statement highlights the inherent conundrum regarding violations of ESG practices; since there are often no enforceable, legally binding regulations (such as an international treaty), a body of "soft law" is blossoming and setting precedent with respect to investor grievances against companies' fraudulent behavior in the ESG space.

The purpose of this study is to discuss this controversial practice with emphasis on the impact of shareholder class action suits against companies. Specifically, lawsuits alleging company misconduct within the environmental branch of ESG are highlighted; these infractions are commonly referred to as greenwashing. The positions of regulatory bodies, such as the SEC, the FTC, the International Accounting Standards Board (IASB), the Financial Accounting Standards Board (FASB), and the Financial Accounting Foundation (FAF) regarding standardized methods for qualifying the sustainability claims are also discussed. Additionally, the role of audit committees in curbing fraudulent company ESG practices is considered.

Greenwashing and Related Litigation

Greenwashing occurs "when companies make false and inflated claims about the environmentally beneficial nature of their products, services, or their business generally" (Hupart, Baumstein, Briones, and McKitterick, 2023, p. 3). The term greenwashing was coined in 1986 by environmentalist Jay Westerveld when he complained about hotels starting to ask guests to reuse towels to conserve energy (Watson, 2016). Owing to their misrepresentative claims of doing more to protect the environment than they actually are, companies are foisting steeper costs on potentially unsuspecting consumers. The PwC 2023 Global Investor Survey indicates that 94 percent of investors believe corporate reporting on sustainability performance contains at least some unsupported claims, an increase from their last survey (Chalmers and Picard, 2023).

Robinson (2022) provides sweeping examples within various industries of greenwashing activities. For instance, major banks advertise green investment opportunities but lend enormous sums to industries that contribute to global warming, and fashion brand textile companies tout "green clothing" although 80 percent of their clothing is incinerated or landfill-bound (not reused or recycled). Table 1 lists specific company alleged greenwashing activities reported by Robinson:

Table 1: Company Examples of Greenwashing Issues

Company	Industry	Greenwashing Issue
BP	Oil and gas	Changing its name in the mid-2000 to Beyond Petroleum and publicly adding solar panels on its gas stations. After its $71 billion Deepwater Horizon disaster, the company abandoned the rebrand (See also Crumbley and Ariail, 2021).
Coca-Cola	Beverages	Advertising "break free from plastic," although the company is ranked as a significant plastic polluter.
ExxonMobil	Oil and Gas	Advertising that its experimental algae biofuels could reduce transport emission targets, while not having any such targets.
IKEA	Furniture Manufacturer	Consorting with the Forest Stewardship Council, accused of failure to catch illegal logging in Ukraine.
Nestlé	Food and Beverage	Asserting that its packaging would be 100 percent recyclable or reusable by 2025, although it has not released any target or timeline.
Poland Springs	Bottled Water	Using the term "natural" on water bottle labeling, even though the bottles are only single use.
Starbucks	Beverage	Releasing a "straw-less lid," even though it contained more plastic than the original lid and straw combined.
Volkswagen	Automotive	Installing a defeat mechanism in their vehicles to cheat governmental emissions testing; the engines were emitting up to

		40 times the allowed limit for nitrogen oxide pollutants. The company had advertised their cars as low-emission and eco-friendly, and VW had to pay at least $38 million in fines, penalties, and other costs (See also Ariail, Cobb, and Crumbley, 2019).

Currently, greenwashing lawsuits targeting companies within a wide array of industries (e.g., footwear, apparel, food, and beverages), are accusing them of fake advertising (Millar, Walker, and Rahman, 2022). RepRisk (2023) reports that both public and private companies are being linked to misleading communication, and greenwashing has accelerated in Europe and the Americas, with Banking Financial Services particularly exposed (70 percent increase). From September 2022 to September 2023, one in four climate-related risk incidents have been connected to greenwashing.

Courts have been willing to accept greenwashing cases because a number of such cases have survived the motion to dismiss. Hupart et al. (2023) found that of the 17 such cases decided two years before June 2023, 11 had progressed to a motion to dismiss, with eight partially surviving. For example, on May 12, 2023, a lawsuit against H&M (Hennes and Mauritz), for false and misleading advertising for its "sustainability profiles" products, was dismissed *(Abraham Lizama v. HandM*, 2022); however, Keurig Green Mountain, Inc. agreed to pay $10 million to settle a recyclability claim about its K-cup coffee pods, as well as to pay $2.3 million to Competition Bureau Canada. The company further incurred $68,000 for the Bureau's investigation along with an $800,000 donation pledge to the Polypropylene Recycling Coalition to settle their sustainability problems (Gore-Langton, 2022).

As another example demonstrating divergent outcomes, a motion to dismiss was upheld against claims that an oat milk company made materially false and misleading sustainability statements (*Jochims v. Oatly Group AB*, 2021); however, a Texas court denied a motion to dismiss claims against ExxonMobil that it made material misstatements about proxy costs for carbon (*Ramirez v. ExxonMobil Corp*., 2018). These wide-ranging litigious events signal some measure of success in engaging in legal redress against alleged fraudulent ESG activities. The next several sections present the particulars of some high-profile ESG legislative actions.

Verizon's ESG Lawsuits

In Verizon's ESG Report for 2022 (Verizon, 2022a), the company explains its ESG strategy as consisting of four pillars: governance (robust governance and a firm commitment to accountability), integration (leveraging dedicated expertise as well as existing sustainability, ESG, and human rights frameworks), engagement (pursuit of building ESG considerations into its core business strategy), and reporting (building trust through transparency). Using a third-party consultant, the company conducts an ESG impact assessment to identify the ESG issues that are most relevant and impactful to its business and stakeholders. An important aspect of ESG is environmental sustainability (managing waste in a responsible manner-reducing, reusing, and recycling). Among the company's climate protection activities are a green team to raise awareness around resource use and conservation, community recycling rallies, tree planting, and investing in community solar programs. There is nothing in the ESG report pertaining to Verizon's cables being covered with toxic lead.

Verizon is facing several environmental lawsuits. In August 2023, George Meehan filed a class action lawsuit against Verizon Communication, Inc., Hans Vestberg (CEO), and Matthew Ellis (CFO) to seek to recover compensable damages for violations of the Federal securities law under the Securities Exchange Act of 1934. The plaintiffs claimed that Verizon issued materially false and misleading statements during the class period February 4, 2020, and July 26, 2023, inclusive. On February 4, 2020, Verizon issued an Environmental, Health, and Safety (EHS) Policy which stated the following (*George Meechan v. Verizon Communications et al.*, 2023, p. 5):

> "Verizon is committed to protecting the environment and the safety and health of its employees, customers, and the communities where we operate. Our commitment goes beyond maintaining compliance with laws, regulations, and policies. Verizon's overreaching sustainability mission is to use and promote sustainable business practices that reflect our commitment to the economic, environmental, and social responsibilities we have to our employees, customers, shareholders, and society."

The plaintiffs claim that this statement was materially false and misleading, because "Verizon owned cables that were covered in toxic lead around the United States, and which were harming employees and non-employees alike" (*George Meechan v. Verizon Communications et al.*, 2023).

In Verizon's 2020 10-K (Verizon, 2021) report issued on February 21, 2021, for the year ended December 31, 2020, the company stated, "we are creating business value by earning customers', employees', and shareholders' trust, limiting our environmental impact and continuing our customer base growth while creating social benefits through our products and services." This statement was repeated in all of the 10-Q reports for 2021 and 2022, and in the 2021 (Verizon, 2022b) and 2022 (Verizon, 2023) 10-K reports as well as the first quarter 2023 10-Q report. The plaintiffs claim this statement was materially false for the reasons stated above and that the failure to disclose the company's ownership of these cables did not create business value by earning anyone's trust.

The 2020 10-K report also stated, in regard to the identification of the COVID-19 threat, that Verizon was "enhancing safety protocols for employees working outside their homes." The plaintiffs claim this statement is misleading, because of the company's failure to adequately warn the employees who were exposed to dangerous levels of toxic lead while handling the company's lead-covered cables.

Verizon's website in 2022 included its 2021 Environmental, Social, and Governance Report for the 2021 calendar year (the 2021 ESG Report), which stated the following:

> "Our practice is to require lead-acid batteries from our U.S. operations to be sent to Verizon-approved recycling facilities in the U.S. or Canada and to require vendors to provide certificates of recycling for the batteries."

This statement also appeared in the 2022 ESG report. The plaintiffs claim that while that statement may be true, it is still materially false due to the existence of lead-covered cables. For the same reason, the plaintiffs claimed that the statement in the 2022 10-K report was misleading in that the company is subject to a substantial amount of litigation for personal injury, property, and environmental claims and that its wireless business faces personal injury and wrongful death lawsuits related to alleged health effects.

The plaintiffs summarized a series of articles by the *Wall Street Journal* in July 2023, about the toxic lead found all over the country. Some of these findings are listed below:

- The toxic lead in cables can be found in the water, soil, and poles.
- Lead levels in sediment and soil in numerous tested locations exceeded safely recommendations.
- Although aware of the potential risk to workers from lead-covered cables, telecom companies have not acted to address the issue.
- Children have experienced elevated levels of lead in their blood after playing in yards and fields.
- Many underwater cable locations are in source water protection areas that contribute to the drinking-water supply.
- It is difficult to track the current owners of old cables after regional phone companies become independent competitors that later consolidated to become Verizon and AT&T.
- In Coal Center, Pennsylvania, lead-sheathed cables droop almost down to be reached by hand, resulting in high levels of lead in the area.
- Verizon and others do not believe cables they own are a public health hazard when responding to the *Wall Street Journal* reporting.
- A New York Congressman said the Environmental Protection Agency (EPA) should compel the telecom companies to clean up any contamination caused by their cables. The EPA is considering what action, if any, it should take.
- The EPA subsequently directed Verizon to inspect, investigate, and provide environmental sampling data about their lead-sheathed telecom cables.

The plaintiffs therefore argued that (1) the defendants made false statements that they knew were misleading and failed to disclose material facts necessary to make their statements not misleading and (2) the two officers had a duty to issue truthful information about the company's financial condition and results of operations and to correct any materially false misleading statements. Because of these infractions, the plaintiffs claim that the company's stock prices were artificially inflated during the Class Period.

Interestingly, the plaintiffs voluntarily dismissed the lawsuit against Verizon and the two officers on October 9, 2023. However, Verizon is the defendant in several other class action lawsuits involving its lead-sheathed cables. Two ongoing class action lawsuits allege that the cables pose a hazard to utility workers and two others allege that Verizon did not inform shareholders about the risks that the cables posed (Furman, 2023). On July 9, 2023, The *Wall Street Journal* broke a story that AT&T has been hit by similar shareholder suits, and the utilities workers' attorney says his firm intends to go after other utilities as well (Pulliam, Ramachandran, Jones, and Gryta 2023).

Nike's Greenwashing Lawsuit

A significant greenwashing shareholder lawsuit (*Maria G. Ellis v. Nike USA, Inc*.) was filed on May 10, 2023, in Missouri against Nike's Sustainability Collection Products using two pages of the FTC's Green Guides and Missouri's Merchandising Practices Act as evidence. The complaint asserts that Nike engaged in unlawful, unfair, deceptive, and misleading business practices with respect to their marketing and sales. The plaintiff's 47-page class action complaint alleges that (paragraph 42):

> "The limited number of 'Sustainability' Collection Products that actually contain any recycled materials are primarily made of recycled polyester and recycled nylon. But neither of those materials are sustainable and/or environmentally friendly. Recycled polyester and recycled nylon are still plastic, so they are not biodegradable. Once you dispose of the materials, they sit in a landfill for hundreds of years. They are not 'sustainable' and do not 'reduce waste and our carbon footprint.' Nor do they support a 'Move to Zero carbon and zero waste.'"

The complaint asserts that Nike "greenwashes" its products by deceptive labeling, suggesting that its clothing products are made by sustainable materials and are environmentally friendly. Nike's clothing products made from recycled fibers give the misleading and false impression that the clothing is less harmful or more beneficial to the environment than it really is. Nike's marketing, advertisements, and social media for their sustainability collection clothing centers around green imagery with models and cartoon characters surrounded by flowers and green plants. The complaint argues that 90 percent of the "sustainability collection" is not made with recycled fibers that reduce waste and the carbon footprint. The complaint quoted the Stern Center for Sustainable Business of New York University that products highlighted as sustainable sell much faster than products which are not (paragraph 56).

The plaintiffs assert that customers would not have purchased the product if they knew the truth that the product was not sustainable nor environmentally friendly. Further, Nike has profited from its misleading representations that: 1) its products are made with recycled fibers that reduce waste and the company's carbon footprint, 2) the company is moving to zero carbon and zero waste, and 3) it is an environmentally friendly company. The purpose of the legal action is to force Nike to undertake a corrective advertising campaign and to provide consumers with monetary relief for Nike's deceptive and misleading product claims.

Kohl's and Walmart Bamboo Product Deception

The FTC has been active in bringing green and sustainability claims against companies. The Textile Labeling Act and the Textile Fiber Rule require companies to disclose fiber content. The FTC's penalty offense authority allows the FTC to seek civil penalties against companies provided a company knows the conduct is unfair or deceptive, and the FTC has issued a written decision that the conduct is unfair or deceptive. Called Notice of Penalty Offenses, the FTC had notified Kohl's and Walmart that they were falsely marketing dozens of rayon textile products as bamboo textiles using ecofriendly processes. In fact, the companies were converting the bamboo into rayon using toxic chemicals that resulted in hazardous pollutants (FTC Release, 2022a).

As a result of these greenwashing activities, the two companies were ordered to stop making deceptive claims and improper labeling and advertising claims. Further, Walmart and Kohl's agreed to pay penalties of $3 million and $3.5 million respectively (FTC Release, 2022a). The FTC has brought more than 75 warning letters to other retailers (Davis and Gilbert, 2020).

Goldman Sachs/Deutsche Bank ESG Settlements

The SEC proposed new rules mandating companies to disclose certain climate-related information in their SEC filings in March 2022. In November 2022, before these new rules were finalized, the SEC charged Goldman Sachs Asset Management (GSAM) for failures involving two mutual funds and one managed account marketed as ESG investments. Goldman Sachs did not have written policies and procedures for one ESG product, and once policies and procedures were established, they did not follow them consistently. GSAM's employees were supposed to complete a questionnaire for each company they planned to include in each product investment portfolio before selection; however, employees prepared the questionnaires after the securities were selected (SEC Press Release 2022–209). The November 2022 SEC Release indicates that when companies market ESG products, “they must establish reasonable policies and procedures governing how the ESG factors will be evaluated as part of the investment process, and then follow these policies and procedures …” (SEC Press Release 2022–209). GSAM agreed to settle the charge with payment of a $4 million penalty.

Deutsche Bank’s DWS investment firm had to pay $25 million September 2023, for misstatements regarding ESG investments and money laundering violations to the SEC. The SEC held that DWS made materially misleading statements about its controls for incorporating ESG factors into research and investment recommendations for ESG integrated products. DWS failed to adequately implement certain provisions of its global ESG integration policy as was promised to clients and investors (SEC Press Release 2023–194).

DWS said ESG was in its DNA, but the firm failed to follow the ESG investment processes that it marketed. In May 2022, prompted by BaFin (Germany’s financial regulatory authority) and Frankfurt prosecutors, German police raided DWS and Deutsche Bank as part of a whistleblower complaint investigation (Reuters, 2022). The investigation of DWS’s former CEO Asoka Woehrmann is still ongoing.

Brazilian Vale Mining Company Deadly Dam Collapse

The SEC formed a Climate and ESG Task Force in 2021 to develop initiatives to proactively identify ESG-related misconduct consistent with increased investor reliance on climate and ESG-related disclosure and investment. In December 2023, the SEC website provided a non-exhaustive list of actions taken against 16 companies since 2008. One such company is Vale S.A. (Vale), a company that purports to practice sustainable mining is several countries. The Brazilian judicial system may be described as slow and heavily under-resourced; therefore, as a proactive effort, the SEC charged Vale, which is listed on the New York Stock Exchange, with making false and misleading statements about the safety of its dam.

The Vale lawsuit was the first brought by the SEC against a publicly traded company for making misleading or false statements about climate-related disclosures. One of the largest iron ore producers, Vale’s Brumadlinho dam collapsed in January 2019, killing 270 people. Since 2016, the company manipulated multiple dam safety audits, obtained fraudulent stability certificates, and misled local governments about the safety of the Brumadlinho dam. When the dam broke, toxic waste flowed into a nearby river.

The SEC alleged that the company knew that the dam, built to contain toxic products from mining operations, did not meet internationally recognized safety standards (Bulsara, 2022). Conversely, the company’s Sustainability Report and public filings assured investors of the dam’s safety, and that 100 percent of its dams were in stable condition (SEC Press Release 2022–72). On March 28, 2023, the SEC announced that Vale agreed to pay $55.9 million to settle the SEC charges against them. The total charge included a civil penalty of $25 million and disgorgement and pre-judgment interest of $30.9 million. A disgorgement penalty forces a guilty party to give up any profits they made as a result of wrongful or illegal conduct (SEC Press Release 2023-63).

Several shareholder class action lawsuits have also been brought against Vale. On May 15, 2019, they were consolidated, and Kaplan Fox & Kilsheimer were appointed as lead counsel. According to the lawsuit, Vale’s statements concerning Dam 1 (the Brumadlinho dam) in 2016 and 2017 were materially false and misleading because they misrepresented or failed to disclose that (1) Dam 1 had a high probability of failure; (2) Vale’s dam risk management and sustainability practices and policies were insufficient and/or insufficiently implemented in light of the known risks to human life and the environment pose by Dam 1; (3) Vale systematically acted to get Stability Condition Statements for dams that were not stable and/or did not meet Vale’s own purported safety standards (*Kaplan Fox & Kilsheimer v. Vale S.A. et al.*, 2019, p. 45). Vale’s third - party dam safety audit had a financial conflict of interest and issued Stability Condition Statement under fear of reprisal from Vale (*Kaplan Fox & Kilsheimer v. Vale S.A. et al.,* 2019, p. 77).

These class action lawsuits are ongoing. But one of the largest class action lawsuits in Canada was filed by residents of Port Colborne against Inco (later Vale) for environmental heavy metal soil damage. Eventually the courts held in favor of Inco/Vale, and the residents had to pay Inco/Vale $100,000 for court costs.

Standard-Setting in the ESG Space

According to Sulkowski and Jebe (2022), a host of non-profit organizations have produced ESG frameworks in an effort to foster comparable sustainability practices. Since adherence to these frameworks are voluntary, fractured, and inconsistent ESG reporting results. Furthermore, significant divergencies exist among the reporting practices across geographical areas;

for example, the European Union and the United States. Whereas the standard-setters have recently agreed to streamline the ESG reporting rules, various obstacles are creating delays.

Most Popular Standard Frameworks

Several standard setting bodies produce popularly instituted reporting frameworks. For one, the Global Reporting Initiative (GRI) purports that 10,000 firms utilize its framework in their sustainability reporting efforts (Sulkwoski and Jebe, 2022). According to the organization's website, it offers "the world's most widely used sustainability reporting standards," covering a breadth of topics such as biodiversity, emissions, equality, and health and safety (globalreporting.org). Another widely used sustainability indicator is the Dow Jones Sustainability Indices (DJSI), formed in 1999 and leader in the S&P Global top 2,500 companies (https://www.spglobal.com/spdji/en/indices/esg/dow-jones-sustainability-world-index/#overview). In May 2022, the S&P Global kicked Tesla out of the S&P ESG index because of the company's lack of low-carbon strategy and codes of business conduct. Elon Musk has called ESG metrics the Devil Incarnate (Kolodny, 2022). Recently, in August 2023, S&P Global stopped grading borrowers' ESG credit risk as a result of the political backlash over 'woke capitalism' (Hetzner, 2023).

Yet another popular sustainability framework was promulgated by the Climate Disclosure Standards Board (CDSB), which has been recently subsumed as part of the newly created International Sustainability Standards Board (ISSB). The standards (https://www.ifrs.org/groups/international-sustainability-standards-board/) are now under the purview of the International Financial Reporting Standards (IFRS) Foundation. The ISSB issued its first two voluntary disclosure standards on June 30, 2023, with an effective date for annual reporting periods beginning on or after January 1, 2024.

IFRS S1, General Requirements for Disclosure of Sustainability-related Financial Information, provides the general requirements for companies to disclose information about their sustainability-related risks and opportunities that are useful to investors of general-purpose financial reports in making decisions relating to providing resources to the company (IFRS, 2023). IFRS S2, Climate-related Disclosures, provides the voluntary requirements for companies to disclose information about their climate-related risks and opportunities, while building on the requirements described in IFRS S1. IFRS S2 integrates the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) and requires the disclosure of information about both cross-industry and industry-specific climate-related risks and opportunities (IFRS, 2023). The TCFD framework is now under the oversight of the ISSB standards in 2024.

Activities of the SEC

The SEC has no legislative authority to make rules for the U.S. financial markets to further societal goals such as environmental sustainability, but the SEC is increasing its attention on ESG matters (Roisman, 2021). Dating back to February 8, 2010, the SEC released guidance regarding disclosures related to climate change and regulatory developments to address climate change. Covering the interim, in a 2021 article, Christensen, Hail, and Leuz reviewed the literature in accounting journals with regard to voluntary reporting on corporate social responsibility and sustainability topics. They found that firm size, public scrutiny, corporate governance structure, and certain managerial characteristics are positively associated with such disclosures.

More recently, in March 2021, the SEC's Division of Enforcement formed a Climate and ESG Task Force. On September 22, 2021, the SEC staff sent a sample comment letter to public companies regarding climate-related disclosures or lack thereof. The SEC is asking companies to provide information so that the Commission can understand the company's disclosures. The obligations of companies to require their suppliers to undertake the same ESG obligations they have may become more aggressive. Full supply chain mapping is contemplated by the Uyghur Forced Labor Prevention Act and some greenhouse reporting protocols (Delikhat, Kray, and Frantz, 2023).

Finally, on March 21, 2022, the SEC proposed new mandatory climate-related disclosure rules requiring companies to include certain climate-related disclosures in their financial statements, such as governance of climate related risks, risk management strategies, and metrics used to manage and evaluate their climate-related risks. These disclosure rules track with the TCFD and will require audited emission information such as direct greenhouse gas and indirect emissions from purchased electricity to be included in financial statements. Disclosures must be independently reviewed, and the standards will require companies to include a note in their financial statements about the quantitative and financial impacts of climate changes on the business.

The rules would not apply to ESG registered investment companies. SEC Chair Gary Gensler posted a video on Twitter on March 1, 2022, indicating skepticism that many ESG investment funds are as green or socially conscious as they advise. He suggested "if it is easy to tell if milk is fat-free by looking at the nutrition label, it might be time to make it easier to tell if 'green' or 'sustainable' funds are really what they say they are" (Gensler, 2022).

Attorney Jon McGowan believes that the SEC may not have the authority to issue rules related to climate related disclosures. The current Supreme Court has in two recent cases—*West Virginia v. Environmental Protection Agency* (the agency overstepped its authority in regard to regulation of greenhouse emissions relating to the Clean Air Act) and *Biden v. Nebraska* (regarding the student loan forgiveness plan)—stated that only Congress can take these actions (McGowan, 2023). More recently, the SEC Division of Examinations released its 2023 examination priorities, and ESG was not on the list (it was in 2021–2023). This action could be viewed as a shifting of priorities away from ESG or a temporary pause awaiting new ESG regulations. In September 2023, the SEC amended the Names Rule that funds must now invest 80 percent of their assets in investments of the name of the fund. This rule applies to funds named "growth," "value," or names that suggest it incorporates ESG. In other words, the name of the investment must match 80 percent of the fund's investment portfolio (SEC Press Release 2023-188).

Concurrently, there has been considerable pushback regarding ESG regulation in the United States. Over 20 state attorney generals and treasurers from "red states" have sent letters to the SEC criticizing ESG factors and their use in proxy and investment decisions (Horvath, Bourgeois, and Perlow, 2023). The SEC may scale back some of its proposed greenhouse gas emissions disclosure requirements. One item is the disclosure of greenhouse gases of a company's suppliers and customers. Companies are against this requirement; some SEC officials believe such disclosures could make the rule more vulnerable to legal challenges (Renshaw, Binnie, and Gillson, 2023).

On March 6, 2024, the SEC issued climate disclosure rules for companies whose stock trades on the U.S. national stock exchanges (SEC Press Release 2024-31). To the extent that the company believes these disclosures would materially impact a reasonable investor's decision-making, the rules require that large companies disclose greenhouse gas emissions resulting directly from business activity (Scope 1 emissions) and emissions resulting from power purchases (Scope 2 emissions). Companies also need to report the risks they face from extreme weather and how such risk would be managed. The majority of U.S. companies are small enough to meet exemption from reporting greenhouse emissions.

The SEC received the most comments ever for a proposed rule. The comments were both pro (strong public interest in information on climate risk exposure and greenhouse emissions) and con (the burdensome costs that the companies would incur). The compliance costs for these disclosures would, according to the SEC's initial estimates in 2022, nearly double for the average publicly listed company (Kim, 2024).

Notably in the final three to two vote, indirect greenhouse emissions generated throughout a company's supply chain and the use of the company's products by its customers (Scope 3 emissions) were eliminated in the spirit of compromise. The SEC is aware of the Supreme Court's ruling in the *West Virginia v. EPA* case (Ho, 2022), and such disclosure compromise was an attempt to thwart probable future legal actions. However, on April 4, 2024, the SEC issued a voluntary stay on the new rules, pending on the review of the Eighth Circuit Court of Appeals, which is a consolidation of disputes across six different circuit courts.

Of course, certain parties are also unhappy with the perceived inadequacy of the new rules. "Without mandates for Scope 3 disclosure, investors are getting an incomplete picture of an organization's sustainability progress; the value chain produces the majority of most business' emissions," opines Sarah Merricks, former chief of staff at the U.S. Green Building Council and current co-founder and chief of strategy for The Global Network for Zero (Gerut, 2024).

On March 15, 2024, the 5th U.S. Circuit Court of Appeals, based in New Orleans, stayed the SEC's climate disclosure rules. The court issued this pause in response to a lawsuit filed by Liberty Energy and Nomad Proppant Services on the basis that the company would likely prevail and in the meantime would incur unrecoverable compliance costs of over $4 billion. The company argued that the SEC does not have the authority to issue rulings on climate disclosures. Other lawsuits have been filed in the 6th, 8th, and 11th U.S. Circuit Courts of Appeals. These cases are expected to be consolidated, and the venue chosen by lottery. The SEC claims that the climate disclosure rules are covered under the agency's authority to require disclosure of information that is important to investors (Mindock, 2024).

According to Ceresney et al. (2024), those opposed to the SEC's climate disclosure ruling may challenge it on numerous bases, including the Administrative Procedures Act (APA), the Major Questions Doctrine (MQD), and the First

Amendment. Under the APA, the court can rule against agency action found to be arbitrary and capricious. In specific, arguments might include that (1) the SEC failed to sufficiently take public comments into account, justify the benefits of the rules, or conduct adequate cost benefit analyses; (2) the requirements, which are detailed and extensive, exceed the SEC's authority; (3) the SEC's rules substantially changed relative to the original proposal and did not represent a logical outgrowth of such.

Under the MQD, agency efforts to regulate matters which have such widespread economic and political significance should have clear congressional authorization. Congress has not clearly given the SEC the authority to require reporting on climate-related information, as such authority rests with the Environmental Protection Agency. Finally, under the First Amendment challenge, such disclosures may be defined as unconstitutional compelled speech since they are subjective and potentially disparaging, rather than factual and uncontroversial. Climate-related information disclosures are not a substantial governmental interest, and less restrictive means are available to meet the public's demand for increased information. A D.C. Circuit Court's decision in 2014 held that an SEC conflict minerals rule was speculative and therefore violated the First Amendment (Ceresney et al., 2024).

Activities of Other Authorities

The FTC's Green Guides for the Use of Environment Claims was issued in 1992 to help marketers avoid making environmental marketing claims that are unfair or deceptive. The Guides were revised in 1996, 1998, and 2012. On December 14, 2022, the FTC (FTC Release, 2022b) asked for public comments about possible upgrades to the current Green Guides, such as

- Providing more information on renewable energy claims and issues.
- Changing the current threshold that guides marketers on when they can make unqualified recyclable claims and address in more detail claims for products that are collected at curbside by recycling programs (but not ultimately recycled).
- Providing alternative methods to help consumers understand unqualified claims about recycled content and whether alternative methods of substantiating recycled content claims may be appropriate.
- Enhancing compostable, degradable, ozone friendly, organic, and sustainable product descriptions.

The FASB does not currently set standards for ESG reporting, since financial reporting requirements for public companies are established by the SEC. A FASB Staff Educational Paper (2021, p.2) suggests that "the application of many current accounting standards requires an entity to consider changes in its business and operating environment when these changes have a material direct or indirect effect on the financial statements and notes thereto." The paper presents a detailed list of where environmental matters intersect with financial accounting standards, including:

- Presentation of financial statements—going concern
- Risks and uncertainties
- Inventory
- Intangibles—goodwill
- Property, plant, and equipment
- Asset retirement and environmental obligations
- Income taxes
- Fair value measurement
- Various industry guidance

One would expect the FASB to take more constructive action once the SEC's ESG proposals are finalized.

Audit Oversight of ESG Reporting

As ESG disclosure becomes more important, audit committees have a critical role to play. To ensure that ESG information is accurate and reliable, policies, processes, and internal controls similar to those for financial information are required. Many companies are providing this information in sustainability reports and other ways (Parker, Brown, and Johnson, 2021).

In addition to the focus on fraud risk in regard to financial statements, audit committees are increasingly concerned with fraud risk in ESG disclosures. Companies need to evaluate whether ESG information provided in regulatory filings is consistent with their disclosures in sustainability reports and other ESG communications. Fraud risk assessments are needed to understand who is likely to perpetrate a fraud and the manner in which it is perpetrated. Audit committees should be aware of a company's processes to combat possible fraud risk in ESG reporting and how effective its antifraud programs are (Deloitte Center for Board Effectiveness, 2022).

As ESG reporting becomes increasingly more important, the risk of fraud is exacerbated. The audit committee needs to consider how a company can pretend to be implementing ESG practices when in actuality it is not (Harris, 2022). Table 2 presents a rational methodical strategy to prepare for implementation to comply with the SEC's anticipated ruling on ESG (from Soroosh, 2023):

Table 2: Steps to Implement SEC ESG Guidance

Step	Title	Description
Step 1	Recognition	Includes the research needed to become familiar with and understand the provisions of the SEC proposal and the extent to which a company is exposed to the provision of the disclosure requirements.
Step 2	Education	Necessary to ensure that appropriate climate-related risk data are collected and reported.
Step 3	Cooperation	Employee activities are part of the company's climate-related risk. To accurately measure and mitigate these risks and costs, it is necessary to have the employees' cooperation.
Step 4	Implementation	A plan for collecting and reporting all significant, relevant information is developed and implemented.
Step 5	Evaluation	Enterprise risk management and other strategic processes are adjusted in light of the new disclosure requirements to ensure the accuracy and reliability of the information.

In tandem with the audit committee, external auditors provide expertise in designing and evaluating internal controls over ESG information to assure that the information is not greenwashing but trustworthy (Baysden, 2021). Dennis (2021) quotes Richard Davisson, director of the Northeast Regional Professional Practice Office and chair of the Assurance Services Executive Committee ESG Working Group:

> Auditors should be aware of the need to improve their ability to identify the risk of material misstatement.
>
> Consideration of climate-related matters may be critical in relation to projections that may impact fair value or other accounting estimates.

Jim Burton, partner, and leader of Grant Thornton LLP's ESG and Sustainability Services, says, "the auditor is responsible for considering risks within the entity and its environment, which includes considering whether other information is consistent the financial statements," (Dennis, 2021). By following the money, the Big Four accounting firms are marketing their services to help companies prepare for the new disclosure requirements. They are training their own staff in how to audit the new disclosure requirements (Foley and West, 2023).

Conclusion

The inertia of ESG reporting is spreading throughout the business world, as evidence suggests consumers purchase from and invest in companies that adopt measures of sustainability. Although the altruistic nature of these sustainability measures is commendable, it appears that as ESG reporting intensifies, so do companies' attempt to obfuscate or fraudulently misrepresent their adherence to ESG measures. This paper provides several examples of companies that have allegedly engaged in fraudulent ESG reporting, with some companies bound by substantial settlement terms. Numerous other ongoing ESG litigation has yet to be resolved; however, increasing ESG reporting adoption suggests a proportional increase in ESG legislation on the horizon.

Complicating the landscape of ESG reporting, as indicated in this article, is the lack of agreed-upon reporting standards, which muddies the waters with respect to compliance and creates an expectation gap. Still in question, apparently, is the authority of the SEC to issue directives on ESG or sustainability reporting. Moreover, the last couple of years have produced a not insignificant backlash against ESG measures, prompting the SEC to stall in its formulation of rule setting. Notwithstanding these road bumps, ESG reporting is most likely to continue as a facet of company reporting—the questions remaining are to what extent and on whose authority? In the meantime, a soft body of law is being constructed that will no doubt impact subsequent future ESG lawsuits involving green and social washing.

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