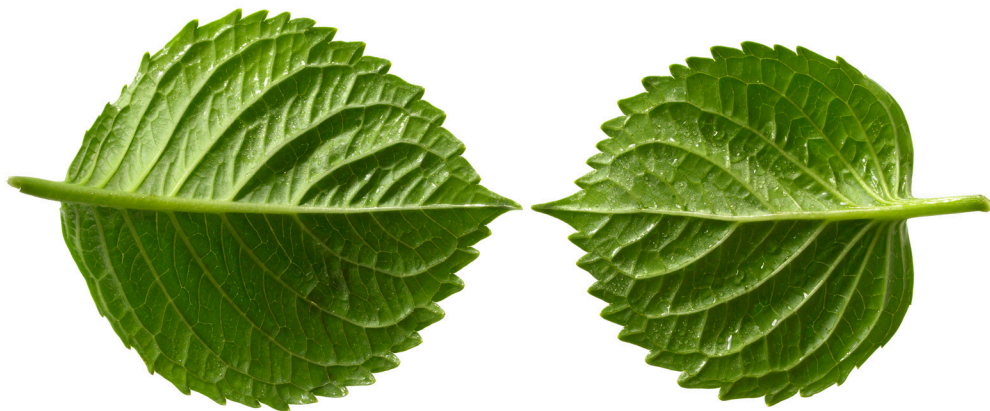


Avoiding Fraud
It's not always easy being
green



Vigilance is
needed to
mitigate fraud
risk in the green
market

Corporate sustainability and greening efforts have been gaining attention as Americans become more committed to helping protect the environment. As consumers, we are encouraged to purchase green products, such as items made from renewable or recycled materials, to stay at ecofriendly hotels that use water and energy conservation, and purchase homes that are LEED (Leadership in Energy and Environmental Design) certified in their construction.

Companies across several industries have also begun to commit themselves to addressing corporate sustainability and the impact of climate change on their respective businesses. Some have created management positions, such as chief energy officer, to champion the cause of environmental initiatives. Others have announced programs to reduce energy consumption; seek alternative energy sources, such as investments in wind farms; or become carbon-neutral by both reducing energy consumption and counterbalancing its remaining consumption with the purchase of carbon offsets, a technique for reducing greenhouse gas emissions.

Today, purchasing carbon offsets or obtaining green energy credits have become some of the

most common techniques companies utilize in reducing their carbon footprint. The carbon footprint, a scorecard of the total greenhouse gases (including carbon dioxide and emissions of five other gases) produced directly or indirectly to support a company's operation, has become a common indicator to measure a company's greening and sustainability efforts. Companies are also realizing that environmentally sound practices not only help the environment, but they can lead to business expansion and profit growth as consumers seek out eco-friendly products and services. Although the green energy/carbon offset business is primarily an ethical business, even here there is potential for fraud.

Fraud in the green market can take many forms – from intentionally inaccurate carbon footprint measurements to misleading green marketing claims to the double counting of carbon offset credits. In addition to these “environmental” fraud risks, there is another set of fraud risks that companies should be aware of, especially if they are thinking about entering into the carbon offset market. These are considered “transactional” fraud risks, examples of which are explained below.

Bribery and Corruption

The first of these risks relate to bribery and corruption surrounding a company's entrance into the greening market. For example, a company's investment in a wind farm may be a technique used to obtain green energy credits. However, the development of a wind farm generally requires large parcels of land, as large turbines are required to generate the amount of alternative energy needed to create a carbon offset. Recently, there have been investigations into companies for alleged improper dealings with public officials in securing land to develop wind farms.

In July 2008, New York Attorney General Andrew M. Cuomo launched an investigation into two companies developing and operating wind farms in New York State. These companies were alleged to have improperly sought or obtained land-use agreements with citizens and public officials by offering improper benefits to public officials to influence their actions, and to have entered into anticompetitive agreements

or practices. According to Cuomo, “The use of wind power, like all renewable energy sources, should be encouraged to help clean our air and end our reliance on fossil fuels. However, public integrity remains a top priority of my office, and if dirty tricks are used to facilitate even clean-energy projects, my office will put a stop to it.” Companies are therefore driven to implement an effective compliance program to mitigate risk for corruption and bribery, and subsequent investigations by regulators and law enforcement officials.

In addition, companies entering into the carbon offset market should be aware of potential violations of the Foreign Corrupt Practices Act (FCPA). The FCPA makes it illegal for companies to corruptly offer (or give) money or anything of value, directly or indirectly through agents or intermediaries, to foreign officials in order to obtain a business advantage or to retain business. According to the United Nations Framework Convention on Climate Change, current carbon offset projects are being developed in countries in Central and South America (such as Brazil and Argentina), as well as in Southeast Asia and the general Asia-Pacific region (including China and India). According to the Transparency International Corruption Perception Index, these regions (and countries) generally have among the largest perceived levels of corruption. Companies should design, implement and monitor the effectiveness of anti-corruption controls and perform the necessary due diligence before entering into such carbon offset projects. This will help ensure that funds are not being diverted either directly or indirectly to third parties to bribe government officials for the rights to develop and operate a carbon offset project.

Money Laundering

Besides potentially violating the FCPA, companies should also be aware that third parties developing and operating these offset projects might use the project as a mechanism to filter illegally obtained funds. For example, a money launderer could use illegally obtained funds to purchase wind turbines for an offset project, especially those projects occurring in developing nations. The launderer would then seek reimbursement for the wind turbines from a company seeking to purchase carbon offsets. The launderer would use the sale

of the wind turbines to re-monetize the investment via an apparent legitimate business purpose, thus concealing the wealth obtained from illegal sources. Companies entering into these transactions should perform the necessary investigative due diligence on carbon offset projects. This information can help the company determine whether to pursue the investment and avoid negative publicity or damage to corporate reputation as a result of associating with criminal activity.

Intentional Round-Trip Transactions

Companies should also be aware of the potential for revenue manipulation and intentional “round-tripping” transactions related to carbon offset projects. A round-trip transaction is one in which a company sells an unused asset to a third party and agrees to buy back the same or similar asset for the same price. In the carbon market, for example, a company seeking to purchase carbon offsets may need to contribute \$90 million to a third party to develop and construct a rural electrification project that might be built using solar panels. However, there is the risk that the company and third party will collude to artificially inflate the cost to \$100 million, and the \$10 million difference (potentially less after a “cut” is given to the third party for participating in the fraud) will be refunded back to the company and recorded as revenue. In this example, by transferring excess cash between the company and the third party, the company would be able to fraudulently record a higher revenue amount. Companies entering into these transactions should be aware of this risk, and then design, implement and monitor controls to mitigate the potential for intentional round-trip transactions.

Consumer Fraud

Finally, many companies, especially in the tourism, hospitality and leisure industries have entered into arrangements with third-party partners to offer individual customers an opportunity to purchase carbon offsets designed to reduce the environmental impact of their miles flown, nights stayed at hotels or miles driven in a rental vehicle. These programs pose a risk of fraud. For example, the

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determination of the cost of an offset for an airline might include the average amount of fuel consumed, the flight pattern, weight of the plane, number of passengers and plane type. With these estimates comes the potential for manipulation. Once the amount of carbon emissions is determined based on the estimates described above, the third-party partner prices and facilitates the sale of the carbon offset to the customer. There is risk of collusion between the company and the third-party partner to manipulate these estimates so individual consumers pay a higher amount than would have been necessary to offset the actual environmental impact of the travel. The company and the third-party partner then split the excess money for their own corporate purposes. Proper controls on estimates should be implemented by the company and its third-party partners to ensure

estimates used for the carbon offset program are appropriate and are not being manipulated. Without controls in place to mitigate fraud, companies put themselves at risk for class-action lawsuits by consumers if a scheme is perpetrated.

As companies move forward in their attempts to champion environmental and sustainability efforts, they should also be aware of the associated threat of fraud and/or illegal acts. Companies should consider developing a fraud and corruption risk assessment for going green and implement the appropriate level of green controls to mitigate fraud risk. With the necessary controls in place and proper monitoring of the effectiveness of such controls, green companies have the tools necessary to be eco-friendly without polluting their brand, and can effectively deter, detect and prevent fraud.

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