

Factsheet

# Financial Accounting For Carbon Finance: A New Standard For A New Paradigm

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# Financial Accounting for Carbon Finance: A New Standard for a New Paradigm

This policy paper offers new insights into carbon financial accounting and extends our published overarching [COP26 Green Finance Report](#), drawing on industry contributions from leading financial institutions, and former senior officials.

The report is addressed to policymakers, regulators, and the financial industry, and aims to help to understand the global carbon markets' financial accounting regulatory framework, identify its gaps and related policymaking challenges coming out with policy recommendations.

The report focuses on certified carbon offset credits (i.e., carbon offsets) as transferable and tradable financial instruments based on IFRS definitions. It addresses the lack of transparency and faithful financial accounting representation, concluding with the need to establish a specific standard and revisit the definition of financial instruments for carbon offsets.

## Executive Summary

The new investable assets through certified carbon offset credits created in the evolving global carbon markets require reviewing and expanding the existing financial instruments definition for this new asset class ("carbon offsets") calling for a specific standard.

While it is important to highlight the efforts of the [IFRS Foundation](#) to improve the [sustainability standards focused on reporting \(ISSB\)](#) these efforts have not yet encompassed financial accounting. Thus, there is still a strong need for a project that addresses how to reflect the financial accounting of these new instruments in the financial statements.

The [International Accounting Standard Board \(IASB\)](#) is the most appropriate regulatory body to tackle this project. We advocate the IASB, as the accounting standard-setting board of the IFRS Foundation, to retake the "[Emissions Trading Schemes Project](#)" and finally, to provide clear and consistent guidance on its carbon markets accounting rules.

## Key findings

- Carbon offsets should not be considered intangible assets or inventories, but rather, investable assets used within the bank's offering for its corporate clients as derivatives or other financial instruments for offsetting and hedging purposes.
- A specific standard for carbon offsets is required to establish a level playing field in the carbon market's financial accounting framework. Regulators should also revisit the definition of "financial instruments" under [IAS 32 as financial assets](#) for carbon markets.

- Based on the “faithful representation principle”, good reporting on these products would mean including them among the financial instruments at [“fair value criteria” as defined in IFRS 13](#) as a separate reported line item in both the balance sheet and within the P&L.
- The current lack of clarity about carbon markets’ financial accounting has [implications for banks in their role as intermediaries in the global emissions trading system \(ETS\)](#) through the Fundamental Review of the Trading Book (FRTB) which includes higher capital charges for carbon trading under the standardised approach to market risk.

### **Policy recommendations**

- To create a new specific standard in financial accounting for carbon offsets and/or revisit the definition of financial instruments to classify carbon offsets as investable assets.
- To foster the “Sustainability Standards Initiative” to promote better disclosure and tackle a project that addresses how to reflect the financial accounting of these new instruments in the financial statements.
- To amplify the definition of financial instrument for carbon offsets aligned with [MiFID II](#) or develop a new category of financial instruments at fair value with a specific reported line.
- To improve the assessment of capital charges for carbon certificates based on the correlation observed for EU allowances (EUAs), alongside the [ISDA proposal for correlations of “carry positions”](#) which means around 40% reduction in the capital charges.

### **Report Contributors**

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### **Industry Contributors**

Especially BBVA; and strategic insights from Fullerton Fund Management; SMBC; and Schroders. Also Sam Gill, President & Co-founder of Sylvera; Grace Hui, former Head of Green and Sustainable Finance, HKEX; and one of the carbon exchanges from China.

Please see link to report from **Imperial College Business School** [here](#)

Please see link to report from **Singapore Green Finance Centre** [here](#)