anew

anewclimate.com

April 10, 2025

Via electronic submission

Financial Accounting Standards Board (FASB)

Re: COMMENTS on the FASB Exposure Draft, dated December 17, 2024, covering the Proposed Accounting Standards Update regarding Environmental Credits and Environmental Credit Obligations (Topic 818)

Anew Climate LLC ("Anew") is one of the largest climate solutions companies in North America, engaged in the development, generation, and marketing of multiple types of voluntary and compliance environmental credits. We have a successful track record within the markets for voluntary and compliance carbon credits, renewable natural gas, renewable identification numbers (RINs), low carbon fuels, electric vehicle credits, emission reduction credits, and renewable energy certificates. For example, we have been an active participant in California's cap-and-trade program since its inception, with a particular focus on nature-based forestry projects. Within the scope of our marketing activities, we engage in purchase and sale transactions, involving the types of environmental credits referenced above, with public and private companies of various sizes that purchase such credits to either address voluntary sustainability commitments or pursue subsequent resale opportunities. Through these interactions, as well as our extensive experience as a credit generator, we have developed a profound understanding of the financial reporting implications of such transactions.

We truly appreciate FASB's leadership in issuing the FASB Exposure Draft, dated December 17, 2024, covering the Proposed Accounting Standards Update regarding Environmental Credits and Environmental Credit Obligations (Topic 818). This proposed standard offers much needed and helpful industry-specific authoritative accounting guidance, which will foster greater recognition of the legal nature of carbon credits and promote enhanced financial reporting clarity and consistency. We believe, however, that several areas within the Exposure Draft warrant further consideration, so as to appropriately reflect the underlying economic fundamentals of the different types of transactions involving environmental credits. These issues, our recommendations, and our underlying rationale are discussed in detail below.

First, the proposed standard requires companies who purchase environmental credits for their voluntary sustainability commitments to immediately expense the cost of such purchases, as incurred. This accounting treatment also extends to non-refundable deposits for future purchases of such credits.

Instead, we believe that it would be more appropriate to allow companies to record credits purchased for future voluntary sustainability commitments as <u>intangible assets</u>

that are subject to amortization in proportion to their use to address such commitments. Similarly, in our view, non-refundable deposits for future purchases of such credits should be recorded as deposits and reclassified to intangible assets when credits are received by the purchasing entity.

The costs contemplated in our supporting arguments below include the purchase price of acquired environmental credits, along with related transaction costs, such as brokerage, transfer, and registry fees, as well as any other costs directly related to the acquisition of the credits.

The intangible asset presentation and disclosure approach, proposed by Anew, would yield several benefits to financial statement readers. Notably, it would afford companies the opportunity to recognize on the balance sheet and disclose information that is useful to investors, regarding the Company's sustainability commitments and proactive investment towards the fulfilment of such commitments. This is particularly relevant to the Environmental and Social Governance (ESG) segment of the investor community, who make important investment decisions based upon such information.

In addition, the intangible asset approach would allow the balance sheet to show the value of proactive investments toward the fulfillment of future corporate sustainability commitments for companies that choose to make such investments, in contrast to those that have not taken action toward their commitments. All else equal, a company that has chosen to make such investments would be in a meaningfully different economic position than a company that may have made identical sustainability commitments but not purchased any environmental credits to address these commitments. Furthermore, as indicated by a number of studies, companies that purchase credits, also tend to conduct more extensive internal emission mitigation than companies that do not, which is also relevant to investors.[1,2] This approach allows the balance sheet and related financial statement disclosures to communicate these differences, so that investors can assess the following parameters:

- Future cash flow risks, as such risks are mitigated to the extent an entity has made investments in environmental credits in an effort to achieve their sustainability goals. For example, two reporting entities that have made similar sustainability commitments would face different future cash flow risks, if one entity has already made meaningful purchases of such credits while the other has not. This difference in cash flow risk would not be apparent to financial statement users, if credits purchased for voluntary commitments were expensed immediately;

[1] Ecosystem Marketplace (2023) found that businesses using carbon credits were 1.8 times more likely to be decarbonizing year-over-year, investing 3 times more in emission reduction efforts within their value chain, and 3.4 times more likely to have an approved science-based climate target.

[2] Bain & Company (2024) found that 71% of companies they studied would take additional climate action if they were allowed to use the voluntary carbon market.

- Predictability of the costs associated with addressing such commitments versus the risks of increasing environmental credit prices and constrained environmental credit supply availability, as the 2030 and 2050 sustainability commitments due, that can also reasonably be expected to increase future cash flow risks;

- Management's proactiveness in addressing such commitments and related risks; and most importantly;

- The credibility of the company's sustainability commitments.

As noted above, these parameters would be of particular interest to all investors, including ESG-focused investors.

This approach is consistent with the "prudent business manager doctrine"/ "reasonable person doctrine," underlying many facets of financial reporting, since companies purchase such credits with the expectation of future economic benefits to the enterprise, in terms of enhanced brand image, consumer perception, and overall "corporate citizen" reputation, that are reasonably expected to translate into incremental returns through enhanced revenues and/ or lower expenses. Furthermore, as noted above, the purchase of environmental credits has another measurable future economic benefit associated with the entity's ability to publicly and credibly claim and quantify its progress towards stated sustainability goals, as well as avoid future cash outflows to purchase such credits or make other investment in order to achieve these goals.
The accounting model advocated by Anew affords investors the opportunity to evaluate these considerations, while the "Day 1 loss" treatment embedded in the proposed standard is inconsistent with the financial reporting benefits outlined above.

The approach proposed by Anew eliminates the perverse incentive to leverage the intent-based model of the proposed standard to initially designate environmental credits as being purchased for resale, rather than to address voluntary sustainability commitments, to avoid the need to immediately expense such costs, in the age of incentive-based compensation correlated to earnings. Such initial designation, followed by subsequent re-designation, as sustainability commitments become due, would introduce inconsistencies in financial reporting across companies and industries, as well as artificial volatility in operating results over time, thereby reducing the comparability and transparency of the financial reporting process.

Furthermore, Anew's proposed approach mitigates inconsistencies with International Financial Reporting Standards (IFRS) that may potentially be disadvantageous to companies reporting under US GAAP, as this issue, as well as the one below, do not exist under IFRS, thereby allowing multi-national companies reporting under IFRS, to defer the costs of such environmental credit purchases until the period(s) of their use. Similarly, under IFRS, companies generating such credits are able to follow an inventory accounting model that allows them to inventory related project development costs and expense such costs in conjunction with the sale of the

environmental credits generated from the project, which provides a compellingly meaningful presentation, as further described below.

Finally, the intangible asset presentation and disclosure approach, proposed by Anew, would eliminate potential unintended economic and behavioral consequences of the immediate expense recognition approach, contemplated in the proposed standard, that may disincentivize corporate support for sustainability projects that generate such environmental credits, thereby potentially undermining the economic fundamentals of the environmental credit markets.

Next, the proposed standard requires companies, that generate environmental credits for subsequent sale, to follow an intangible asset accounting model that does not allow for capitalization of credit-generation project development costs. Rather, such costs are to be expensed as incurred.

> **Instead, we believe that it would be more effective to allow companies that generate environmental credits for subsequent sale to follow an inventory accounting model that allows them to capture credit-generation project development costs as a component of inventory costs, which are expensed as the environmental credits are sold.**

Credit-generation projects can span significant periods of time and involve substantial costs. One example is an improved forest management (IFM) project, whereby the landowner agrees to reduce timber-harvesting activity in order to enhance the forest's capacity to remove carbon dioxide from the atmosphere, through natural photosynthesis. In order to quantify such carbon-removal capacity enhancement, so as to determine the number carbon credits that can be generated, the project incurs significant costs, associated with the actual measurement of carbon-absorption, over a period of at least two years, before any credits can be generated. These costs include dynamic assessment of the entire forest's carbon absorption performance versus baseline benchmarks over the life of the project, whereby such benchmarks are based upon historical growth rates, tree and vegetation species, and overall harvesting activity in the geographical region. Measurements are derived from high-frequency satellite monitoring, aerial imaging taken by drones, artificial intelligence (AI) models, and enhanced ground-level data collection, including extensive physical measurements of the density, height, trunks, branches, and foliage of trees. These data are collected in accordance with the applicable carbon credit methodology, so as to establish the integrity and additionality of the nature-based carbon credits to be generated. The vast amounts of data accumulated through these measurements are analyzed through various statistical computer models and compared to the carbon accumulation of nearby forests, not included in the project, by teams of scientists with extensive academic training and professional experience in this field, to determine the number of credits to be generated, and subsequently verified by an independent third party, registered, and issued.

The costs associated with this process are substantial, particularly considering that the landowner is also foregoing conventional revenue from the sale of timber, due to the reduction of harvesting activity. Thus, the ability to capture credit-generation project development costs as a component of carbon credit inventory costs would allow financial statements to more

meaningfully depict the economic consequences of the operational decisions made by the landowner, for the benefit of financial statement users, as further discussed below.

We believe that the inventory accounting model would yield significant benefits to financial statement readers, including the following:

- Allow companies to issue more meaningful financial statements, more effectively and accurately depicting the economic fundamentals of their environmental credit generation and subsequent monetization activities, as follows:

    - Inventory classification on the balance sheet appropriately captures the nature of these assets, especially considering that these environmental credits are generated for ultimate monetization through sales to companies that are subject to regulatorily imposed sustainability requirements or voluntary sustainability commitments;

    - Inventory costing allows for proper accumulation, on the balance sheet, of costs incurred to develop, verify, register, and issue environmental credits, so that the credits can be available for marketing and delivery to customers. In fact, companies that generate credits make meaningful operational modifications to shift the focus of their activities to credit generation, so as to pursue revenue opportunities associated with the marketing of such credits, as discussed above. In the course of this operational re-direction, these companies incur costs that are specifically related to the credit generation process, and the sole method of recovery of these costs would be predicated upon the monetization of the credits.

    Accordingly, the approach proposed by Anew aligns the financial reporting process with the economic realities of the environmental credit generation and marketing process, thereby ensuring a more meaningfully informative financial reporting process, for the benefit of the investing community.

- Essentially, the environmental credit generation process can be analogized to a manufacturing process that ultimately produces finished-goods inventory, following a costing approach that allows for the capture of all costs necessary for the production of inventory into the cost basis of the inventory units; similarly, it would be fitting to consistently afford environmental credits the same costing option;

- Income statement recognition and presentation would be enhanced, as these costs will be expensed within the scope of inventory derecognition, in conjunction with the sale of the credits, thereby resulting in proper matching of revenues and related expenses, honoring the fundamental principle of deferring costs that are incurred for the purpose of generating future economic benefits and expensing these costs as such economic benefits are realized, through the sale of the environmental credits, in this case;

- Under this approach, credit generating companies can avoid artificial and misleading volatility in their earnings, whereby significant costs are expensed as projects are developed, over a period that may span over more than two years, followed by windfall gains resulting from the sale of environmental credits with virtually no cost basis. This pattern of revenue and cost recognition distorts the underlying economic rationale, thereby reducing inter-period comparability and transparency.

These financial reporting enhancements would be beneficial to investors, as they evaluate the performance of credit generators.

As noted above, we also believe that this approach is consistent with the "prudent business manager doctrine"/ "reasonable person doctrine," underlying many facets of financial reporting, since companies develop such credits for the explicit purpose of generating future economic benefits to the enterprise, through the sale of these credits. The "Day 1 loss" treatment embedded in FASB's proposed standard is inconsistent with the financial reporting benefits outlined above.

In addition, we believe that the Inventory model is more consistent with the intent-based fundamentals of the proposed standard, appropriately following a different accounting model, based upon the intended purpose of the credits, whereby:

- Intangible asset accounting is applied to credits used to address voluntary sustainability commitments; and
- Inventory accounting is applied to credits generated for sale or purchased for resale.

Therefore, the approach hereby advocated by Anew is a natural extension of the intent-based foundation of the proposed standard, as the latter appears to have stopped short in its efforts to distinguish the treatment of environmental credits used for the two distinct purposes outlined above.

Finally, the inventory accounting model proposed by Anew would eliminate potential unintended economic and behavioral consequences of expensing project costs as incurred, as contemplated in the proposed standard. The requirement to expense project costs upfront may disincentivize and even financially preclude credit generators from embarking upon sustainability projects that produce environmental credits, thereby potentially undermining the economic fundamentals of the environmental credit markets. Incurring significant losses in the early stages of project development could be a deterrent in attracting financing, navigating through the project development stage, and persevering to the achievement of economic viability.

We sincerely appreciate the opportunity to submit these comments, in support of the promulgation of an accounting standard that truly captures the economic essence of transactions involving environmental credits, for the benefit of market participants and the investor

community. We are grateful for your generous consideration of our recommendations and welcome your feedback and questions.

I am available to discuss these comments, derived from the breadth and depth of our experience in the environmental credit markets at your convenience. Please feel free to reach me via e-mail, at: chahamski@anewclimate.com, or on my mobile phone, at (267) 879-9780.

Sincerely,

Cyril Hahamski

APPROVED
By Cyril Hahamski at 6:14 pm, Apr 14, 2025

Cyril Hahamski, CPA, MBA
Vice President, Accounting/ Finance
Anew Climate, LLC
3200 Southwest Freeway, Suite 1310
Houston, TX 77027