

Why carbon offset should almost never be a part of audi...

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Over the last day there appears to have been a pile-on of commentators on this blog all saying that my arguments on carbon offsetting implicit in sustainable cost accounting are wrong. Many have offered stereotypically climate-change-denying fare dressed up to look as if there is still an argument to be had on the climate-change issue, and have been deleted as a consequence. But I have posted some of the comments submitted as the offset issue is one that is worth addressing again, which I do here.

The message from these commentators appears to be:

- * Business cannot be net-zero carbon: it is technically impossible;
- * Offset lets business claim it is net-zero even when it is not, so offset is what is required;
- * After offset business is net-zero carbon;
- * Unless we allow this pretence then many existing businesses will go bust;
- * If those businesses go bust that will be the end of the economy as we know it;
- * We neither know or have any other economy, so we must not let the one we have end;
- * If we do let it end we are all doomed anyway, so any attempt to tackle climate change mitigation would have been a waste of time;
- * Therefore offsetting is good, and I am wrong to oppose it.

I genuinely think the above is a fair summary although I am sure some will suggest otherwise: that is the way of life.

Let me address the obvious first, which is to say that I do not oppose carbon offsetting, *per se*, even though that is what my critics have suggested when setting up a straw-man argument. Very clearly the 'net' in net-zero recognises that there will be offsetting. In other words, offsetting will happen and I have always recognised that fact, within constraints.

However, the context of my argument has to be understood. [Sustainable cost accounting](#) suggests that a provision is required within the accounts of the large companies to which it would apply for the cost of eliminating carbon from their activities. I stress, that means carbon elimination from their scope 1, 2 and 3 activities, or in other words from their own activities; from their bought-in energy supplies and from their supply and customer chains, however far they reach.

It is important to understand what a provision is in this context. Provisions measure the best estimate, reflecting the risks and uncertainties that exist at a point in time, of the expenditure required to settle a cost that it is known must be settled and which is unavoidable as a result of an event that has already happened. In other words, given that we know business has to be net-zero carbon in the future because it is becoming a legal obligation for countries to be so and it therefore follows that businesses must be as well, the provision in question is that which reflects the current best estimate of the cost of meeting this goal of eliminating carbon from the processes of the business which it has no choice but do if it is to still be a going concern i.e. it wishes to perpetuate the business that it has.

I stress two things from this definition. The first is that the event requiring a provision has happened. All large companies have, without exception, built their activities on the basis of a business model that is unsustainable. As a result they now have no choice - because governments are not giving them any other option - but change that business model if they want to be a going concern and so operate in the future. Confirming that the business is a going concern is something that they must do when preparing their accounts unless they say that they are planning to cease to trade, when a provision for the cost of doing that is required instead. It, therefore, follows that a provision is going to be required by every business.

Second, the estimate is made in the present and provided in the accounts now. There is nothing unusual about this. As example, if a business decides to close one of its activities because it is no longer viable then, as a consequence of that decision having been taken now the full estimated costs of closure of that activity must be included in the accounts at the time that that decision is made and not at the time when they are incurred. This example is completely apposite. Climate change is demanding that all large companies close down their current business activities, and open new ones that are net-zero carbon compliant. If a provision for closure costs is required in any other case, then it most certainly is in this one.

To estimate this provision a number of things are required:

- * Good estimates of the carbon produced in all aspects of scopes 1, 2 and 3, although the material issues to be addressed will in most businesses be glaringly obvious.
- * Realistic plans to eliminate these emissions by adapting the existing business model or, where that is not possible, abandoning it;

- * A best estimate of the cost of these actions that then comprises the provision;
- * A best estimate of the capital required for the replacement business model that is net-zero carbon based as this estimate is required for disclosure purposes if the entity is still to be considered a going concern.
- * A viable plan for offset if that is to be part of the model for being a going concern.

What it is important to understand is that this is data to be included in audited financial statements. It has therefore to be verifiable. That need for verifiability will extend to carbon offsetting. In that case what is the data that the auditor might require to include a claim for carbon offset in the accounts? I suggest:

- * Evidence that the technology planned for use in offset actually exists;
- * Evidence that the technology in question exists at scale i.e. if the company being audited is one of many suggesting this offset will be used that there is the capacity for all to make that claim;
- * The offset cost is plausible not just at present but given the likely demand for offset when that is to be claimed;
- * The entity can command the resources to pay that offset price;
- * The offset is itself sustainable i.e. it has an enduring quality;
- * If the supply of offset opportunities is to be rationed by a government to ensure it is used by those with the greatest social as well as economic justification, as I think is likely to happen, then the company that they are looking at is likely to secure a part of that ration.

I could, no doubt, elaborate further. I think the above sufficient conditions at this moment.

Let's then look at an example. Take a low-cost airline. They are major emitters. As it stands we know of no viable alternative fuel on which they can rely. That may happen, but prudence will require any auditor to dismiss that claim for now. Accounts have to be audited on the basis of facts, not make-believe. Offset is, then, their only option.

The low-cost airline could then make two claims. One might be that they could capture the carbon that they emit. Let's be clear though: there is no viable or scaleable carbon capture and storage system anywhere as yet, let alone for airline emissions. No auditor should agree any such claims by anyone right now in that case, I suggest. It would be straightforward negligence for them to do so, in my opinion.

Then there is the potential for on-the-ground offset. Forests seem to be the favourite for this. But when considering this remember that any claim to offset has to create additional forest. It's my suggestion that until the world stops deforestation - and there may be hope for that today - no such claims for additional forest can easily be made.

Climate change is a macro and not a micro issue. The capacity to offset is not proven as yet.

Then there is the timing issue. Buying up existing forest to prevent it being cut down is not offset if there is no threat to cut it down. So, the offset has to come from new planting. But remember the offset has to be available in relatively short order. How is that possible when saplings are what are planted? I do not despite that saplings are required - by the trillion - but for offset they may not be great for a while, especially if the offset need is in the short term. So how can an auditor verify the offset exists in that situation? I suggest that they could not.

But in any case, the question has to be asked as to whether there will be enough land for this use? How is an auditor to know that? All they can know is that this supply of land is finite, most especially given both demand and the threat climate change itself imposes to land use as a result of temperature change. Which then gives rise to the reasonable question as to how long offset might be available? It may not be that long. In other words, its own sustainability might be in doubt.

Perhaps as importantly, the question must be asked as to why are low cost flights for second home owners that important, economically? I suggest in the case of rationing priority they might come very close to the bottom when it comes to need. Any auditor would need to consider that.

So, assuming we have a diligent auditor, what can they say about the offset plan? I would suggest that they could at best say it unproven, uncosted and highly likely to be unreliable for offset purposes, let alone for financial ones. So, if the low-cost airline based their claim to be net-zero carbon this basis I suggest that the auditor would have to qualify their accounts.

So I come back to my claim that offset is acceptable if:

- * The technology is proven;
- * The technology is scaleable;
- * The resources to do the offset, both financial and physical are already under the control of the organisation, directly or contracted.

This is what I actually say in sustainable cost accounting. All that I am suggesting is that if we are to have prudent, reliable and comparable financial statements from companies then we must have a reliable baseline for estimating carbon impact, and as I see it offsetting cannot deliver that except in the situations I outline.

All this being said, I have not as yet come to the most important aspects of my reasoning. There are three dimensions to this.

First, offsetting is not an acceptable accounting practise. We do not, for example, show

the turnover of a company net of the cost of making those sales. We do instead show the total value of those sales, and then the cost of making them, with the consequent gross profit margin being disclosed as the difference between the two. There is good reason for this. We want to separately appraise the company's ability to both price product, and to manage its production process efficiently, which other information in the accounts helps us do. For precisely that reason offsetting is not allowed.

I suggest that we have exactly the same situation when it comes to carbon offsetting. We will always need to know the gross emissions that a company makes, whether by itself or through its bought in energy or through its supply and customer chains. This gross figure is vital. If we are to achieve climate targets we have to know who has responsibility for pumping carbon into the atmosphere, and that is only indicated in the case of a company by its gross emissions. If the company then claims offset, whether its auditors agree with the claim or not, then we do also, in turn, need data to appraise whether that claim is credible, or not. What would always be wholly unacceptable is that one is offset against the other without us ever having the ability to appraise them both. The idea that a net figure is available, which is implicit in many current claims, is as a consequence bad accounting.

Second, the costs of eliminating carbon and the costs of offsets are different. The skills in managing them are also quite different. Eliminating carbon requires product process reengineering. In contrast, carbon offset is simply a purchasing activity when reduced to its basics. We know that product process reengineering is critical to beating the planet change. We do not even know that offset is sustainable in itself. It is in that case vital that the two be separated for disclosure purposes if the activity of a company is to be properly appraised.

Third, this then takes us to the very core purpose of accounting data, which according to the International Financial Reporting Standards Foundation (who on this occasion I will not argue with) is about decision-making on the efficient allocation of available capital. I suspect I define capital rather more broadly than they do, but with that point being noted what any user of a set of financial statements will in the future, require is the data to appraise whether or not a company is actually capable of becoming net zero carbon without offset given the difficulty that the offset process is are very likely to impose. Put quite simply, the companies to whom capital should be allocated in the future are not in that case those who can fudge this issue by offset, but are instead those who can actually reimagine their business processes to the point that they can eliminate carbon. If we are, as a consequence, to survive, making sure that offset does not complicate or confuse this issue is absolutely vital.

To summarise then, I do not think offset an appropriate basis for claiming that a company might be net-zero carbon because of all the estimates that must be made to achieve that goal this, to me, seems the one that is always most likely to be imprudent, unprovable, and almost certainly unsustainable. What is more, offset could seriously confuse issues with regards to effective capital allocation at the time when making

those decisions appropriately is vital. For all these reasons I suggest that the ability to include offset in audited financial statements, whether those accounts use sustainable cost accounting methods or not, should be severely curtailed, because offset always appears to have the chance of material misstatement inherent within it.