FASB ACCOUNTING STANDARDS UPDATE

No. 2026-02
May 2026

Environmental Credits and Environmental Credit Obligations (Topic 818)

An Amendment of the *FASB Accounting Standards Codification*®

Financial Accounting Standards Board

The *FASB Accounting Standards Codification*® is the source of authoritative generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. An Accounting Standards Update is not authoritative; rather, it is a document that communicates how the Accounting Standards Codification is being amended. It also provides other information to help a user of GAAP understand how and why GAAP is changing and when the changes will be effective.

FASB

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Financial Accounting Standards Board
801 Main Avenue ▪ Norwalk, CT ▪ 06851

Accounting Standards Update 2026-02

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Summary

Why Is the FASB Issuing This Accounting Standards Update (Update)?

The Board is issuing this Update to improve the financial accounting for and disclosure of environmental credits and environmental credit obligations. This Update provides recognition, measurement, presentation, and disclosure requirements for all entities that generate, purchase, or receive environmental credits or have a regulatory compliance obligation that may be settled with environmental credits.

Stakeholder feedback, including from respondents to the 2021 FASB Invitation to Comment (ITC), *Agenda Consultation,* indicated that entities are increasingly subject to government mandates and regulatory compliance programs related to emissions, which often result in obligations that may be settled with environmental credits. Additionally, some entities that voluntarily commit to reducing their emissions by a future date (for example, voluntary "net zero" and "carbon neutral" initiatives) use environmental credits to partially offset their emissions.

Stakeholders emphasized that generally accepted accounting principles (GAAP) do not provide specific authoritative guidance on how to recognize and measure environmental credits or the related obligations that result from regulatory compliance programs. As a result, entities typically account for environmental credits and environmental credit obligations by analogy to Topic 330, Inventory, Subtopic 350-30, Intangibles—Goodwill and Other—General Intangibles Other Than Goodwill, and Topic 450, Contingencies, resulting in diversity in practice.

The following are examples of environmental credits and the associated regulatory compliance program that are subject to the amendments in this Update (these examples are not all-inclusive):

1. Emissions allowances originating from domestic and global cap-and-trade programs

2. Renewable identification numbers originating from the U.S. Renewable Fuel Standard
3. Renewable energy certificates originating from U.S. State Renewable Portfolio Standards.

Additionally, carbon offsets, which often are generated by projects represented to reduce or remove carbon dioxide from the atmosphere, are typically used by entities to meet voluntary initiatives to reduce net emissions and also are subject to the amendments in this Update.

The amendments in this Update are expected to provide investors with additional decision-useful information by improving the (1) understandability of financial accounting and reporting information about environmental credits and environmental credit obligations associated with regulatory compliance programs and (2) comparability of that information by reducing diversity in practice.

The FASB's mission is to establish and improve financial accounting and reporting standards; therefore, the amendments in this Update are intended to address only amounts reported in financial statements. As a result, measuring or tracking an entity's voluntary net zero emissions initiatives or the entity's actual greenhouse gas emissions are beyond the scope of the FASB's mission and are not addressed by the FASB or by these amendments.

Who Is Affected by the Amendments in This Update?

The amendments in this Update apply to all entities and affect entities that:

1. Buy or receive transferable environmental credits and use those credits:
    a. To settle environmental credit obligations arising from regulatory compliance programs
    b. To transfer in an exchange transaction
    c. In a nonreciprocal transfer (for example, to distribute to an investor)
    d. To meet voluntary environmental initiatives, such as carbon neutral or net zero initiatives.
2. Generate environmental credits.
3. Have enforceable obligations resulting from regulatory compliance programs represented to prevent, control, reduce, or remove emissions or other pollution that may be settled with environmental credits.

How Do the Main Provisions Differ from Current Generally Accepted Accounting Principles (GAAP) and Why Are They an Improvement?

The amendments in this Update improve GAAP by providing specific authoritative guidance for environmental credits and environmental credit obligations.

Environmental Credits

Broadly, environmental credits as defined by the amendments in this Update are enforceable rights represented to prevent, control, reduce, or remove emissions or other pollution that are separately transferable in an exchange transaction. Entities can acquire environmental credits in an exchange transaction, receive environmental credits through a grant from a regulator or its designee(s) as part of a regulatory compliance program, internally generate environmental credits, or receive environmental credits in a nonreciprocal transfer that is not a grant from a regulator or its designee(s).

Recognition and Measurement

An entity is required to recognize an environmental credit as an asset when it is probable that the environmental credit will be (1) used to settle an environmental credit obligation, (2) transferred in an exchange transaction, or (3) used in a nonreciprocal transfer. An entity is required to recognize costs to obtain all other environmental credits as an expense when incurred (for example, environmental credits acquired to satisfy a voluntary net zero emission initiative).

Environmental credits received through a grant from a regulator or internally generated by an entity initially should be measured at the amount of transaction costs incurred to obtain those environmental credits, if any. Environmental credits that are obtained in a transaction initially measured in accordance with a Topic other than Topic 818 should follow the requirements of that Topic. All other environmental credits should be initially measured at cost in accordance with the guidance on asset acquisitions in Subtopic 805-50, Business Combinations—Related Issues.

At each reporting date, an entity is required to subsequently measure its environmental credits recognized as assets considering its intended use of those environmental credits. Specifically:

1. Compliance environmental credits. Environmental credits that an entity is probable of using to settle an environmental credit obligation should be subsequently measured at cost and not tested for impairment at each reporting date.
2. Noncompliance environmental credits. All other environmental credits owned by an entity should be subsequently measured at cost, less impairment losses, if any. Noncompliance environmental credits should be tested for impairment at each reporting date. Impairment expense should be recognized when the carrying value of a noncompliance environmental credit exceeds its fair value, measured as the excess of the carrying value over fair value. Subsequent reversal of a previously recognized impairment loss is prohibited.

Additionally, an entity is permitted to elect an accounting policy to measure eligible classes of noncompliance environmental credits at fair value, with subsequent changes recognized in earnings.

Presentation

An entity is required to present its compliance environmental credit assets separately from its environmental credit obligation liabilities on the balance sheet.

Disclosure

An entity is required to disclose in annual reporting periods qualitative information about how it obtained and intends to use its environmental credits, the accounting policies used to account for environmental credits, and significant estimates and judgments used in applying the guidance.

An entity also is required to disclose in annual reporting periods the current and noncurrent amounts of compliance environmental credits and noncompliance environmental credits (if not separately presented on a classified balance sheet), the total expense for voluntary environmental credits, and the total impairment expense.

If an entity changes its use, or intended use, of its environmental credits, it is required for annual reporting periods to disclose the nature of that change as of the date that it occurs and the related effect on earnings on that date, if any.

Environmental Credit Obligations

Environmental credit obligations as defined by the amendments in this Update are enforceable obligations resulting from regulatory compliance programs represented to prevent, control, reduce, or remove emissions or other pollution that may be settled with environmental credits. As a result, voluntary initiatives and similar statements of intent do not constitute an environmental credit obligation.

Recognition and Measurement

An entity is required to recognize an environmental credit obligation liability when events (for example, emissions) occurring on or before the reporting date result in an environmental credit obligation. In determining whether a liability should be recognized, the amendments in this Update require that an entity assume that the reporting date is the end of the compliance period regardless of whether the compliance period ends on that date.

An entity is required to initially and subsequently measure an environmental credit obligation liability at each reporting date using the carrying amount of the compliance environmental credits that the entity holds and expects to use to settle that obligation at the reporting date (referred to as the funded portion of the liability). If an entity has insufficient compliance environmental credits at the reporting date to satisfy the liability, that unfunded portion should be initially and subsequently measured at the fair value of the environmental credits necessary to settle the unfunded portion at the reporting date, with certain exceptions. An environmental credit obligation liability should be derecognized when an entity remits the necessary environmental credits to a regulator.

Disclosure

An entity is required to disclose in annual reporting periods all of the following about regulatory compliance programs that result in the entity's environmental credit obligation liabilities:

1. The activities or events that result in environmental credit obligation liabilities under those programs, including the nature and timing of settlement provisions
2. The accounting policies used to account for the environmental credit obligations
3. How the unfunded portion of an environmental credit obligation liability is measured
4. Significant estimates and judgments used in applying the guidance.

An entity also is required to disclose in annual reporting periods:

1. The current and noncurrent amounts of the funded and unfunded portions of environmental credit obligation liabilities (if not separately presented on a classified balance sheet)
2. Total expense related to environmental credit obligation liabilities
3. Total costs associated with environmental credit obligation liabilities that are capitalized in the carrying amount of another asset during the reporting period in accordance with another Topic.

When Will the Amendments Be Effective and What Are the Transition Requirements?

For public business entities, the amendments in this Update are effective for annual reporting periods beginning after December 15, 2027, and interim reporting periods within those annual reporting periods. For entities other than public business entities, the amendments are effective for annual reporting periods beginning after December 15, 2028, and interim reporting periods within those annual reporting periods. Early adoption is permitted as of the beginning of an annual reporting period.

An entity should apply the amendments in this Update on a retrospective basis through a cumulative-effect adjustment to the opening balance of retained earnings (or other appropriate components of equity or net assets on the balance sheet) as of the beginning of the annual reporting period of adoption. An entity should not recast any financial statement information before the period of adoption. At the date of initial application, the entity should:

1. Recognize an environmental credit asset if it is probable that the entity will use the environmental credit to settle an environmental credit obligation, transfer the credit in an exchange transaction, or use the credit in a nonreciprocal transfer. For all other environmental credits (voluntary environmental credits), the entity should derecognize the carrying amount of those environmental credits unless that amount was capitalized as part of another asset (for example, inventory) before the date of initial application. An entity also should derecognize the carrying amount of an asset recognized for a nonrefundable deposit made to obtain voluntary environmental credits.
2. Measure environmental credits recognized as assets as follows:
   a. Compliance environmental credits. Using the entity's carrying amount existing at the date of initial application.
   b. Noncompliance environmental credits. At the lower of the entity's carrying amount of the environmental credits existing at the date of initial application and the fair value of the environmental credits at the date of initial application.
   c. Notwithstanding (a) and (b) above, an entity may elect to measure all of its environmental credits that were internally generated or received through a grant from a regulator or its designee(s) at their transaction costs, if any.
   d. Any class of eligible noncompliance environmental credits that an entity elects to measure at fair value. Using the fair value of those environmental credits at the date of initial application.
3. Continue to include the cost of environmental credits capitalized as part of another asset (for example, manufactured inventory) before the date of initial application as part of the carrying amount of that other asset.
4. Recognize and measure environmental credit obligation liabilities by applying the amendments at the date of initial application.
5. Apply the amendments to Topic 805, Business Combinations, prospectively to transactions occurring after the date of initial application.

Amendments to the *FASB Accounting Standards Codification®*

Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2–24. Terms from the Master Glossary are in **bold** type. Added text is underlined, and deleted text is ~~struck out~~.

Amendments to Master Glossary

2. Add the following new Master Glossary terms, with a link to transition paragraph 818-10-65-1, as follows:

Compliance Environmental Credit

An **environmental credit** recognized as an asset in accordance with Topic 818 and **probable** of being used to settle an **environmental credit obligation**.

Environmental Credit

An enforceable right that is acquired, internally generated, granted by a regulatory agency or its designee(s), or received in a **nonreciprocal transfer {first definition}** that is not a grant from a regulator or its designee(s) that meets all of the following criteria:

a. Lacks physical substance and is not a **financial asset**.
b. Is represented to prevent, control, reduce, or remove emissions or other pollution.
c. Is, or previously was, separately transferable in an **exchange** transaction. If an item is no longer separately transferable in an exchange transaction, an entity must be able to use that item to satisfy an **environmental credit obligation** to meet this criterion.
d. Is not an **income tax** credit that may be used to settle an entity's income tax liability, regardless of whether the entity has a tax liability or intends to use the credit for that purpose.

An environmental credit that meets the above criteria may exist in a variety of forms, including (but not limited to) credits, certificates, allowances, and offsets.

Environmental Credit Obligation

A regulatory compliance obligation arising from existing or enacted laws, statutes, or ordinances represented to prevent, control, reduce, or remove emissions or other pollution that may be settled with **environmental credits**. Obligations within the scope of Subtopic 410-30 are not environmental credit obligations.

Noncompliance Environmental Credit

An **environmental credit** recognized as an asset in accordance with Topic 818 that is not a **compliance environmental credit**.

Addition of Topic 818

3. Add Subtopic 818-10, with a link to transition paragraph 818-10-65-1, as follows:

[For ease of readability, the new Subtopic is not underlined.]

Environmental Credits and Environmental Credit Obligations—Overall

Overview and Background

General

818-10-05-1 The Environmental Credits and Environmental Credit Obligations Topic includes the following Subtopics:

a. Overall
b. Environmental Credits
c. Environmental Credit Obligations.

818-10-05-2 The Subtopics listed in paragraph 818-10-05-1 establish the financial accounting and reporting requirements for entities that obtain or generate an **environmental credit** or are subject to regulatory compliance programs (for example, cap-and-trade, renewable portfolio standards, or renewable fuel standards) that result in an **environmental credit obligation**.

818-10-05-3 Entities engage in a variety of transactions that involve environmental credits. Environmental credits are acquired, internally generated, granted by a regulator or its designee(s), or received in a **nonreciprocal transfer** that is not a grant from a regulator or its designee(s). Entities use those environmental credits:

a. To settle environmental credit obligations
b. To transfer in an **exchange** transaction
c. In a nonreciprocal transfer
d. To meet voluntary environmental initiatives (referred to as using environmental credits for voluntary purposes).

Objectives

General

818-10-10-1 This Topic specifies the financial accounting and reporting requirements for transactions and arrangements involving **environmental credits** and **environmental credit obligations** with the objective of providing investors with useful information about the amount, timing, and uncertainty of cash flows arising from those transactions. An entity should consider the rights provided by the environmental credits it obtains and the terms and conditions of the regulatory compliance programs that result in environmental credit obligations when applying this Topic.

Scope and Scope Exceptions

General

818-10-15-1 The guidance in this Topic applies to all **environmental credits** and **environmental credit obligations**.

818-10-15-2 See paragraph 818-10-55-1 for implementation guidance on the application of the scope of this Topic.

> Other Considerations

818-10-15-3 Environmental credits and environmental credit obligations that are within the scope of this Topic are outside the scope of Topic 815 on derivatives and hedging in accordance with paragraph 815-10-15-82B.

Glossary

Active Market

A market in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

Compliance Environmental Credit

An **environmental credit** recognized as an asset in accordance with Topic 818 and **probable** of being used to settle an **environmental credit obligation**.

Environmental Credit

An enforceable right that is acquired, internally generated, granted by a regulatory agency or its designee(s), or received in a **nonreciprocal transfer {first definition}** that is not a grant from a regulator or its designee(s) that meets all of the following criteria:

a. Lacks physical substance and is not a **financial asset**.
b. Is represented to prevent, control, reduce, or remove emissions or other pollution.
c. Is, or previously was, separately transferable in an **exchange** transaction. If an item is no longer separately transferable in an exchange transaction, an entity must be able to use that item to satisfy an **environmental credit obligation** to meet this criterion.
d. Is not an **income tax** credit that may be used to settle an entity's income tax liability, regardless of whether the entity has a tax liability or intends to use the credit for that purpose.

An environmental credit that meets the above criteria may exist in a variety of forms, including (but not limited to) credits, certificates, allowances, and offsets.

Environmental Credit Obligation

A regulatory compliance obligation arising from existing or enacted laws, statutes, or ordinances represented to prevent, control, reduce, or remove emissions or other pollution that may be settled with **environmental credits**. Obligations within the scope of Subtopic 410-30 are not environmental credit obligations.

Exchange

An exchange (or exchange transaction) is a reciprocal transfer between two entities that results in one of the entities acquiring assets or services or satisfying liabilities by surrendering other assets or services or incurring other obligations.

Fair Value (second definition)

The price that would be received to sell an asset or paid to transfer a liability in an **orderly transaction** between **market participants** at the measurement date.

Financial Asset

Cash, evidence of an ownership interest in an entity, or a contract that conveys to one entity a right to do either of the following:

a. Receive cash or another financial instrument from a second entity
b. Exchange other financial instruments on potentially favorable terms with the second entity.

Income Taxes

Domestic and foreign federal (national), state, and local (including franchise) taxes based on income.

Market Participants

Buyers and sellers in the principal (or most advantageous) market for the asset or liability that have all of the following characteristics:

a. They are independent of each other, that is, they are not **related parties**, although the price in a related-party transaction may be used as an input to a fair value measurement if the reporting entity has evidence that the transaction was entered into at market terms
b. They are knowledgeable, having a reasonable understanding about the asset or liability and the transaction using all available information, including information that might be obtained through due diligence efforts that are usual and customary
c. They are able to enter into a transaction for the asset or liability
d. They are willing to enter into a transaction for the asset or liability, that is, they are motivated but not forced or otherwise compelled to do so.

Noncompliance Environmental Credit

An **environmental credit** recognized as an asset in accordance with Topic 818 that is not a **compliance environmental credit**.

Nonreciprocal Transfer (first definition)

Nonreciprocal transfer is a transfer of assets or services in one direction, either from an entity to its owners (whether or not in exchange for their ownership interests) or to another entity, or from owners or another entity to the entity. An entity's reacquisition of its outstanding stock is an example of a nonreciprocal transfer.

Orderly Transaction

A transaction that assumes exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities; it is not a forced transaction (for example, a forced liquidation or distress sale).

Probable

The future event or events are likely to occur.

Related Parties

Related parties include:

a. Affiliates of the entity

b. Entities for which investments in their equity securities would be required, absent the election of the fair value option under the Fair Value Option Subsection of Section 825-10-15, to be accounted for by the equity method by the investing entity
c. Trusts for the benefit of employees, such as pension and profit-sharing trusts that are managed by or under the trusteeship of management
d. Principal owners of the entity and members of their immediate families
e. Management of the entity and members of their immediate families
f. Other parties with which the entity may deal if one party controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests
g. Other parties that can significantly influence the management or operating policies of the transacting parties or that have an ownership interest in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests.

Implementation Guidance and Illustrations

General

> Implementation Guidance

• > Scope

818-10-55-1 The existence of **active markets** is not a requirement when determining whether an item that may be an **environmental credit** is separately transferable in an **exchange** transaction. Additionally, the length of time that an item is transferable should not be considered for that purpose. In certain instances, an item may only be separately transferable momentarily because an entity retires the item immediately after obtaining it or instructs another party, such as a broker, to do so. That item would be subject to the provisions of this Topic if all other criteria in the environmental credit definition are met.

Transition and Open Effective Date Information

General

> Transition Related to Accounting Standards Update No. 2026-02, *Environmental Credits and Environmental Credit Obligations (Topic 818)*

818-10-65-1 The following represents the transition and effective date information related to Accounting Standards Update No. 2026-02, *Environmental Credits and Environmental Credit Obligations (Topic 818)*:

Effective date and early adoption

a. Public business entities shall apply the pending content that links to this paragraph for annual reporting periods beginning after December 15, 2027, and interim reporting periods within those annual reporting periods.
b. Entities other than public business entities shall apply the pending content that links to this paragraph for annual reporting periods beginning after December 15, 2028, and interim reporting periods within those annual reporting periods.
c. Early adoption of the pending content that links to this paragraph is permitted in an interim or annual reporting period in which financial statements have not yet been issued or made available for issuance. If an entity adopts the pending content that links to this paragraph in an interim reporting period, it shall adopt the pending content as of the beginning of the annual reporting period that includes that interim reporting period.

Transition method

d. An entity shall apply the pending content that links to this paragraph on a retrospective basis through a cumulative-effect adjustment to the opening balance of retained earnings (or other appropriate components of equity or net assets on the balance sheet) as of the beginning of the annual reporting period of adoption, subject to the guidance in (e) through (i). The date of initial application shall be the beginning of the annual reporting period in which the entity first applies the pending content that links to this paragraph.

e. An entity shall recognize an **environmental credit** as an asset at the date of initial application of the pending content that links to this paragraph if it is probable at that date that the environmental credit will be used to settle an **environmental credit obligation**, transferred in an **exchange** transaction, or used in a **nonreciprocal transfer**. For all other environmental credits, an entity shall derecognize the carrying amount of those environmental credits at the date of initial application unless those environmental credits are within the scope of (g). In addition, at the date of initial application, an entity shall derecognize the carrying amount of an asset recognized for a nonrefundable deposit made to obtain an environmental credit if it is not probable that the environmental credit will be used to settle an environmental credit obligation, transferred in an exchange transaction, or used in a nonreciprocal transfer.
f. An entity shall measure an environmental credit recognized as an asset at the date of initial application of the pending content that links to this paragraph in accordance with (e) as follows:
    1. An environmental credit that is classified as a **compliance environmental credit** at the date of initial application of the pending content that links to this paragraph shall be measured using the entity's carrying amount of that environmental credit existing at the date of initial application.
    2. An environmental credit that is classified as a **noncompliance environmental credit** at the date of initial application of the pending content that links to this paragraph shall be measured at the lower of the entity's carrying amount of the environmental credit existing at the date of initial application and the **fair value** of the environmental credit at the date of initial application.
    3. Notwithstanding the requirements of (f)(1) and (f)(2), an entity may make an entity-wide election to measure those environmental credits that were internally generated by the entity or received through a grant from a regulator or its designee(s) at the amount of the transaction costs incurred in accordance with paragraph 818-20-30-1.
    4. Notwithstanding the requirements of (f)(2), an entity that elects an accounting policy to subsequently measure a class of eligible noncompliance environmental credits at fair value shall measure those environmental credits at fair value at the date of initial application of the pending content that links to this paragraph.

g. An entity shall continue to include the cost of environmental credits capitalized as part of another asset accounted for in accordance with another Topic (for example, Topic 330 on inventory) before the date of initial application of the pending content that links to this paragraph as part of the carrying amount of that other asset.
h. An entity shall apply the liability recognition and measurement requirements of Subtopic 818-30 on environmental credit obligations at the date of initial application of the pending content that links to this paragraph.
i. An entity shall apply the pending content in paragraphs 805-20-25-15B through 25-15D and 805-20-30-32 prospectively to transactions accounted for as business combinations occurring after the date of initial application of the pending content that links to this paragraph.

Transition disclosures

j. An entity shall provide the transition disclosures required by paragraph 250-10-50-1(a), (b)(3), and (c) and paragraph 250-10-50-2. The transition disclosure required by paragraph 250-10-50-1(b)(3) shall be as of the beginning of the annual reporting period of adoption rather than as of the beginning of the earliest period presented.

4. Add Subtopic 818-20, with a link to transition paragraph 818-10-65-1, as follows:

[For ease of readability, the new Subtopic is not underlined.]

Environmental Credits and Environmental Credit Obligations—Environmental Credits

Overview and Background

General

818-20-05-1 This Subtopic addresses the accounting for an **environmental credit**. Paragraph 818-20-55-1 provides a flowchart of the recognition and measurement requirements of this Subtopic.

Scope and Scope Exceptions

General

818-20-15-1 This Subtopic follows the same Scope and Scope Exceptions as the Overall Subtopic.

Glossary

Acquiree

The **business** or **businesses** that the **acquirer** obtains in control of a **business combination**. This term also includes a nonprofit activity or business that a not-for-profit acquirer obtains control of in an **acquisition by a not-for-profit entity**.

Acquirer

The entity that obtains control of the **acquiree**. See paragraphs 805-10-25-4 through 25-5 for guidance on determining the acquirer.

Acquisition by a Not-for-Profit Entity

A transaction or other event in which a not-for-profit acquirer obtains control of one or more nonprofit activities or businesses and initially recognizes their assets and liabilities in the acquirer's financial statements. When applicable guidance in Topic 805 is applied by a **not-for-profit entity**, the term **business combination** has the same meaning as this term has for a for-profit entity. Likewise, a reference to business combinations in guidance that links to Topic 805 has the same meaning as a reference to acquisitions by not-for-profit entities.

Business

Paragraphs 805-10-55-3A through 55-6 and 805-10-55-8 through 55-9 define what is considered a business.

Business Combination

A transaction or other event in which an **acquirer** obtains control of one or more **businesses**. Transactions sometimes referred to as true mergers or mergers of equals also are business combinations. See also **Acquisition by a Not-for-Profit Entity**.

Compliance Environmental Credit

An **environmental credit** recognized as an asset in accordance with Topic 818 and **probable** of being used to settle an **environmental credit obligation**.

Contract

An agreement between two or more parties that creates enforceable rights and obligations.

Customer

A party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration.

Environmental Credit

An enforceable right that is acquired, internally generated, granted by a regulatory agency or its designee(s), or received in a **nonreciprocal transfer {first definition}** that is not a grant from a regulator or its designee(s) that meets all of the following criteria:

a. Lacks physical substance and is not a **financial asset**.
b. Is represented to prevent, control, reduce, or remove emissions or other pollution.
c. Is, or previously was, separately transferable in an **exchange** transaction. If an item is no longer separately transferable in an exchange transaction, an entity must be able to use that item to satisfy an **environmental credit obligation** to meet this criterion.
d. Is not an **income tax** credit that may be used to settle an entity's income tax liability, regardless of whether the entity has a tax liability or intends to use the credit for that purpose.

An environmental credit that meets the above criteria may exist in a variety of forms, including (but not limited to) credits, certificates, allowances, and offsets.

Environmental Credit Obligation

A regulatory compliance obligation arising from existing or enacted laws, statutes, or ordinances represented to prevent, control, reduce, or remove emissions or other pollution that may be settled with **environmental credits**. Obligations within the scope of Subtopic 410-30 are not environmental credit obligations.

Exchange

An exchange (or exchange transaction) is a reciprocal transfer between two entities that results in one of the entities acquiring assets or services or satisfying liabilities by surrendering other assets or services or incurring other obligations.

Fair Value (second definition)

The price that would be received to sell an asset or paid to transfer a liability in an **orderly transaction** between **market participants** at the measurement date.

Financial Asset

Cash, evidence of an ownership interest in an entity, or a contract that conveys to one entity a right to do either of the following:

a. Receive cash or another financial instrument from a second entity
b. Exchange other financial instruments on potentially favorable terms with the second entity.

Income Taxes

Domestic and foreign federal (national), state, and local (including franchise) taxes based on income.

Market Participants

Buyers and sellers in the principal (or most advantageous) market for the asset or liability that have all of the following characteristics:

a. They are independent of each other, that is, they are not **related parties**, although the price in a related-party transaction may be used as an input to a fair value measurement if the reporting entity has evidence that the transaction was entered into at market terms
b. They are knowledgeable, having a reasonable understanding about the asset or liability and the transaction using all available information, including information that might be obtained through due diligence efforts that are usual and customary
c. They are able to enter into a transaction for the asset or liability
d. They are willing to enter into a transaction for the asset or liability, that is, they are motivated but not forced or otherwise compelled to do so.

Noncompliance Environmental Credit

An **environmental credit** recognized as an asset in accordance with Topic 818 that is not a **compliance environmental credit**.

Nonreciprocal Transfer (first definition)

Nonreciprocal transfer is a transfer of assets or services in one direction, either from an entity to its owners (whether or not in exchange for their ownership interests) or to another entity, or from owners or another entity to the entity. An entity's reacquisition of its outstanding stock is an example of a nonreciprocal transfer.

Not-for-Profit Entity

An entity that possesses the following characteristics, in varying degrees, that distinguish it from a business entity:

a. Contributions of significant amounts of resources from resource providers who do not expect commensurate or proportionate pecuniary return
b. Operating purposes other than to provide goods or services at a profit
c. Absence of ownership interests like those of business entities.

Entities that clearly fall outside this definition include the following:

a. All investor-owned entities

b. Entities that provide dividends, lower costs, or other economic benefits directly and proportionately to their owners, members, or participants, such as mutual insurance entities, credit unions, farm and rural electric cooperatives, and employee benefit plans.

Operating Cycle

The average time intervening between the acquisition of materials or services and the final cash realization constitutes an operating cycle.

Orderly Transaction

A transaction that assumes exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities; it is not a forced transaction (for example, a forced liquidation or distress sale).

Probable

The future event or events are likely to occur.

Related Parties

Related parties include:

a. Affiliates of the entity
b. Entities for which investments in their equity securities would be required, absent the election of the fair value option under the Fair Value Option Subsection of Section 825-10-15, to be accounted for by the equity method by the investing entity
c. Trusts for the benefit of employees, such as pension and profit-sharing trusts that are managed by or under the trusteeship of management
d. Principal owners of the entity and members of their immediate families
e. Management of the entity and members of their immediate families
f. Other parties with which the entity may deal if one party controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests
g. Other parties that can significantly influence the management or operating policies of the transacting parties or that have an ownership interest in one of the transacting parties and can significantly influence

the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests.

Recognition

General

818-20-25-1 An entity shall recognize an **environmental credit** as an asset if it is **probable** that the environmental credit will be used to settle an **environmental credit obligation,** transferred in an **exchange** transaction, or used in a **nonreciprocal transfer**. For all other environmental credits, an entity shall recognize an expense when costs are incurred and is prohibited from including those costs in the carrying amount of another asset accounted for in accordance with another Topic.

818-20-25-2 An entity that recognizes an environmental credit as an asset in accordance with paragraph 818-20-25-1 shall classify an environmental credit that is probable of being used to settle an environmental credit obligation as a **compliance environmental credit**. All other environmental credits recognized as assets shall be classified as **noncompliance environmental credits**.

818-20-25-3 An entity shall recognize an expense for a nonrefundable deposit made to obtain an environmental credit for which it is not probable that the entity will use the environmental credit:

a. To settle an environmental credit obligation
b. To transfer in an exchange transaction
c. In a nonreciprocal transfer.

818-20-25-4 See paragraphs 818-20-55-2 through 55-3 for implementation guidance on the application of asset recognition.

818-20-25-5 The recognition guidance in paragraphs 818-20-25-1 through 25-2 is not required to be applied at the individual environmental credit level. See paragraph 818-20-55-4 for implementation guidance on the application of this paragraph.

Initial Measurement

General

818-20-30-1 An **environmental credit** that is internally generated by an entity or received through a grant from a regulator or its designee(s) shall be initially measured at the transaction costs incurred, if any. See paragraph 818-20-55-5 for implementation guidance on the application of this paragraph.

818-20-30-2 Environmental credits other than those measured in accordance with paragraph 818-20-30-1 that are obtained in a transaction initially measured in accordance with another Topic shall follow the requirements of that other Topic. See paragraph 818-20-55-6 for implementation guidance on the application of this paragraph.

818-20-30-3 Environmental credits other than those measured in accordance with paragraph 818-20-30-1 or 818-20-30-2 shall be initially measured at cost in accordance with paragraphs 805-50-30-1 through 30-4.

Subsequent Measurement

General

818-20-35-1 Before applying the subsequent measurement requirements of this Subtopic, an entity shall apply the asset recognition reassessment requirements in paragraph 818-20-40-2 at each reporting date.

818-20-35-2 An entity shall subsequently measure similar **environmental credits** recognized as assets using one of the following costing methods:

a. Average cost
b. First-in, first-out
c. Specific identification.

An entity shall apply the costing methods in (a) through (c) separately for **compliance environmental credits** measured in accordance with paragraph 818-20-35-3 and **noncompliance environmental credits** measured in accordance with paragraph 818-20-35-4.

818-20-35-3 An entity shall determine at each reporting date whether it is **probable** that an environmental credit recognized as an asset will be used to settle an **environmental credit obligation**. If it is probable, the environmental credit shall be classified as a compliance environmental credit and shall not be subsequently remeasured.

818-20-35-4 All other environmental credits recognized as assets shall be classified as noncompliance environmental credits and tested for impairment at each reporting date. An entity shall recognize an impairment loss when the carrying value of the noncompliance environmental credit exceeds its **fair value**. The impairment loss shall be measured as the excess of the carrying value over fair value. Subsequent reversal of a previously recognized impairment loss is prohibited.

818-20-35-5 If an environmental credit is reclassified from a compliance environmental credit to a noncompliance environmental credit or vice versa, an entity shall apply the impairment requirements in paragraph 818-20-35-4 before applying the subsequent measurement guidance related to the new classification of the environmental credit.

818-20-35-6 An entity shall not amortize an environmental credit.

> Fair Value Measurement Accounting Policy Election

818-20-35-7 Notwithstanding the requirements of paragraphs 818-20-35-4 through 35-5, an entity may elect an accounting policy by class to subsequently measure a class of eligible (see paragraph 818-20-35-9) noncompliance environmental credits at fair value at each reporting date, with changes in fair value recognized in earnings. An entity should determine what constitutes a class based on its specific facts and circumstances.

818-20-35-8 An environmental credit subsequently measured at fair value in accordance with paragraph 818-20-35-7 shall continue to be measured at fair value at each reporting date until that environmental credit is derecognized. See paragraph 818-20-55-8 for implementation guidance on the application of this paragraph.

• > Eligibility

818-20-35-9 To be eligible for subsequent fair value measurement, a noncompliance environmental credit shall be obtained through one of the following:

a. An **exchange** transaction
b. A **nonreciprocal transfer** that is not a grant from a regulator or its designee(s)
c. A **business combination**.

See paragraph 818-20-55-7 for implementation guidance on the application of this paragraph.

• > Fair Value Measurement Accounting Policy

818-20-35-10 A change in accounting policy to elect fair value measurement shall be subject to the guidance in Topic 250 on accounting changes and error corrections, including the requirements related to a change in accounting policy in an interim period in paragraphs 250-10-45-14 through 45-16. However, notwithstanding the requirements of paragraph 250-10-45-5, an entity that elects to change its accounting policy to subsequently measure a class of eligible noncompliance environmental credits at fair value shall apply that fair value measurement accounting policy prospectively, with a cumulative-effect adjustment to retained earnings as of the beginning of the annual reporting period in which the change is made. The change shall not be retrospectively applied to prior annual reporting periods. The adjustment to retained earnings shall be determined in accordance with Topic 250 and shall include the difference between the fair value and the carrying amount of all affected noncompliance environmental credits at the beginning of the annual reporting period in which the fair value measurement accounting policy change is made. The initial adoption of an accounting policy for a class of eligible noncompliance environmental credits is not a change in accounting policy subject to the guidance in Topic 250.

Derecognition

General

818-20-40-1 An entity shall derecognize an **environmental credit** in accordance with Subtopic 610-20 on gains and losses from the derecognition of nonfinancial assets unless a scope exception from that Subtopic applies. For example, a nonfinancial asset in a **contract** with a **customer** shall be derecognized in accordance with Topic 606 on revenue from contracts with customers.

> Asset Recognition Reassessment

818-20-40-2 At each reporting date, an entity shall reassess whether environmental credits shall continue to be recognized as assets in accordance with paragraph 818-20-25-1. If an entity determines that it is no longer **probable** that an environmental credit will be used to settle an **environmental credit obligation**, transferred in an **exchange** transaction, or used in a **nonreciprocal transfer**, the entity shall derecognize the environmental credit through earnings.

818-20-40-3 An entity is prohibited from recognizing an environmental credit as an asset if the entity previously determined that the environmental credit was not probable of being used to settle an environmental credit obligation, transferred in an exchange transaction, or used in a nonreciprocal transfer. Therefore, an environmental credit previously derecognized or never recognized as an asset shall not subsequently be recognized as an asset.

Other Presentation Matters

General

> Balance Sheet

818-20-45-1 An entity that presents a classified balance sheet shall classify **environmental credits** reasonably expected to be transferred in an **exchange** transaction, used in a **nonreciprocal transfer**, or remitted to a regulator within one year (or the **operating cycle** of the business, if longer) as current assets. All other environmental credits shall be classified as noncurrent assets.

818-20-45-2 An entity shall present **compliance environmental credits** separately from any related **environmental credit obligation** liabilities recognized in accordance with Subtopic 818-30 on its balance sheet.

Disclosure

General

818-20-50-1 For annual reporting periods, an entity shall disclose the types of **environmental credits** owned by the entity and all of the following:

a. How the entity obtained the environmental credits (acquired, granted, internally generated, or received in a **nonreciprocal transfer**)
b. How the entity intends to use the environmental credits (to settle **environmental credit obligations**, to transfer in an **exchange** transaction, to use in a nonreciprocal transfer, or to meet voluntary environmental initiatives)
c. The accounting policies used to account for the environmental credits in accordance with Topic 235 on notes to financial statements (for example, whether the environmental credits are subsequently measured using the average cost; first-in, first-out; or specific identification costing methods)
d. Significant estimates and judgments used in applying the guidance.

818-20-50-2 For annual reporting periods, an entity shall disclose, if not separately presented on the entity's balance sheet, the current and noncurrent assets portion of both of the following:

a. **Compliance environmental credits**
b. **Noncompliance environmental credits**.

An entity also shall disclose the line item or items on the balance sheet that include the current asset and noncurrent assets portion of the amounts in (a) and (b).

818-20-50-3 For annual reporting periods, an entity shall disclose all of the following:

a. Total expense recognized for environmental credits not initially recognized as an asset in accordance with paragraph 818-20-25-1 or subsequently derecognized in accordance with paragraph 818-20-40-2.
b. Total impairment expense recognized during the reporting period, the nature of the environmental credits that were impaired, and a description of the facts and circumstances giving rise to the impairment.

c. The line item or items in the income statement that include the amounts in (a) and (b).

See paragraphs 220-40-50-21 through 50-25 for additional disclosure requirements.

818-20-50-4 For annual reporting periods, if as a result of applying the guidance in paragraphs 818-20-35-3 through 35-4 and paragraph 818-20-40-2 an entity changes its use or intended use of its environmental credits, it shall disclose the nature of that change as of the date that it occurs and the related effect on earnings on that date, if any.

818-20-50-5 An entity shall apply the **fair value** disclosure requirements in Topic 820 for any fair value measurements made in accordance with this Subtopic.

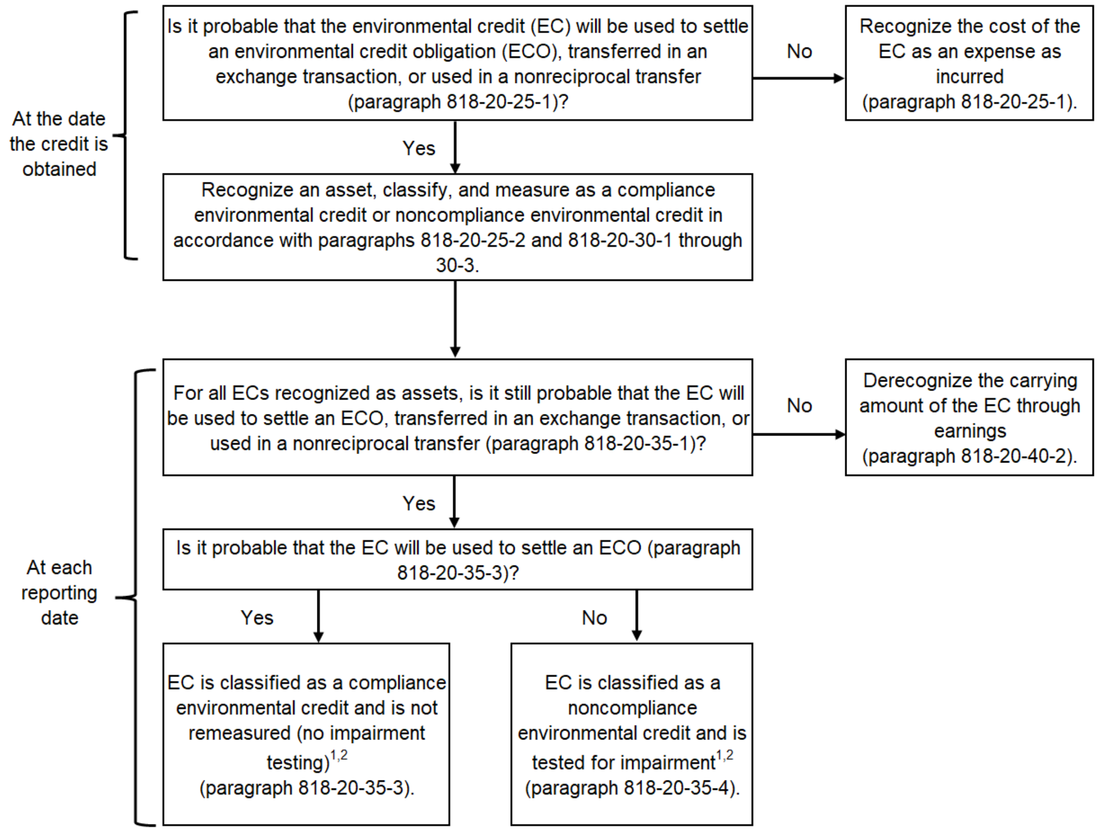
818-20-50-6 See paragraph 818-20-55-14 for an illustration of the quantitative disclosures required by this Subtopic.

Implementation Guidance and Illustrations

General

> Implementation Guidance

818-20-55-1 The following flowchart illustrates the accounting requirements for **environmental credits**. The flowchart is a supplement to the guidance in this Subtopic, and it should not be interpreted to change any requirements of this Topic or be considered a substitute for those requirements.



[1] If the classification of the EC changes from a previously determined classification, the EC is tested for impairment before it is reclassified (paragraph 818-20-35-5).

[2] The flowchart assumes an entity has not made an accounting policy election to remeasure noncompliance environmental credits at fair value at each reporting period (paragraph 818-20-35-7).

• > Recognition

818-20-55-2 Paragraph 818-20-25-1 requires that an entity recognize an environmental credit as an asset if it is **probable** that the environmental credit will be used to settle an **environmental credit obligation**, transferred in an **exchange** transaction, or used in a **nonreciprocal transfer**. That assessment of probability is a collective assessment whereby the evaluation is made on the probability of any of those events occurring. For example, an entity purchases an environmental credit that it will use to either settle an environmental credit obligation or transfer in an exchange transaction. The entity determines that there is a 50 percent likelihood that the environmental credit will be used to settle an environmental credit obligation and a 50 percent likelihood that the environmental credit will be transferred in an exchange transaction. Therefore, an asset would be recognized because collectively the likelihood of those outcomes occurring is probable.

818-20-55-3 An entity does not need to have recognized an environmental credit obligation liability in accordance with Subtopic 818-30 to determine that it is probable that the entity will use an environmental credit to settle an environmental credit obligation because the liability may be recognized in a future period. In most instances, an entity will be able to readily determine whether it is probable that an environmental credit will be used to settle an environmental credit obligation, transferred in an exchange transaction, or used in a nonreciprocal transfer. The following factors may be helpful in determining whether it is probable that an environmental credit will be used to settle an environmental credit obligation, transferred in an exchange transaction, or used in a nonreciprocal transfer:

a. The entity's purpose for acquiring the environmental credit
b. The quantity of environmental credits the entity owns compared with existing and expected environmental credit obligations
c. Expected events and activities that may change the entity's need for **compliance environmental credits** in future periods
d. The entity's past uses of environmental credits
e. Whether the entity would be committed to transfer in an exchange transaction any environmental credits in excess of those needed to satisfy an environmental credit obligation
f. An entity's internal emission reduction initiatives.

818-20-55-4 In accordance with paragraph 818-20-25-5, an entity is not required to apply the recognition requirements in paragraphs 818-20-25-1 through 25-2 at the individual environmental credit level. For example, if an entity acquires 1,000 Class A renewable energy certificates, it evaluates whether it is probable that the renewable energy certificates will be used to settle an environmental credit obligation, transferred in an exchange transaction, or used in a nonreciprocal transfer. The entity determines that it is probable that it will use 900 of those renewable energy certificates to settle an environmental credit obligation and that it is not probable that it will use the remaining 100 renewable energy certificates to settle an environmental credit obligation, transfer the renewable energy certificates in an exchange transaction, or use the renewable energy certificates in a nonreciprocal transfer. Therefore, the entity recognizes 900 Class A renewable energy certificates as environmental credit assets, and the remaining 100 Class A renewable energy certificates are expensed as incurred.

• > Initial Measurement

818-20-55-5 Paragraph 818-20-30-1 requires that an entity initially measure an internally generated environmental credit or an environmental credit received through a grant from a regulator or its designee(s) at the transaction costs incurred, if any. Transaction costs include costs such as those that are necessary to validate, register, or authenticate an environmental credit so that the environmental credit may be used to settle an environmental credit obligation, transferred in an exchange transaction, or used in a nonreciprocal transfer. If an entity does not incur transaction costs, the initial measurement of those environmental credits should be zero. That initial measurement should not affect whether an asset is recognized in accordance with paragraph 818-20-25-1 or whether the environmental credit is classified as a compliance environmental credit or a **noncompliance environmental credit** in accordance with paragraph 818-20-25-2. For example, a renewable energy certificate granted to an entity by a regulator that is determined to be probable of being used to settle an environmental credit obligation when received would be recognized as an asset and classified as a compliance environmental credit at initial recognition. That compliance environmental credit would be measured at zero if the entity does not incur transaction costs. Additionally, when that environmental credit is used to measure the funded portion of an environmental credit obligation liability, the liability also would be measured at zero.

818-20-55-6 Paragraph 818-20-30-2 requires an entity that obtains an environmental credit in a transaction initially measured in accordance with another Topic to follow the initial measurement requirements of that other Topic. For example:

a. A renewable energy certificate received as consideration in a **contract** that is within the scope of Topic 606 on revenue from contracts with **customers** should be initially measured in accordance with paragraphs 606-10-32-21 through 32-22.
b. A carbon offset or renewable energy certificate received in a nonreciprocal transfer from an investee in a transaction that is within the scope of Topic 845 on nonmonetary transactions should be initially measured in accordance with that Topic.
c. An environmental credit received in a nonreciprocal transfer between entities under common control should initially be measured in accordance with paragraphs 805-50-30-5 through 30-6.

• > Fair Value Measurement Accounting Policy Election

818-20-55-7 Paragraphs 818-20-35-7 through 35-10 permit an entity, as an accounting policy election, to subsequently measure a class of eligible noncompliance environmental credits at **fair value** at each reporting date, with changes recognized in earnings. An entity should determine what constitutes a class based on its facts and circumstances. Eligible noncompliance environmental credits are those obtained in an exchange transaction, received in a nonreciprocal transfer that is not a grant from a regulator or its designee(s), or acquired in a **business combination**. Environmental credits generated by the entity or received through a grant from a regulator (or its designee(s)) are ineligible for fair value measurement. For example, an oil refinery acquires 100 renewable identification numbers in an exchange transaction and is granted 20 similar renewable identification numbers from a regulator. The oil refinery determines that it is not probable that it will use the environmental credits to settle an environmental credit obligation because the entity intends to transfer in an exchange transaction all 120 of those noncompliance environmental credits. The 100 acquired renewable identification numbers are eligible for fair value measurement, and the 20 granted renewable identification numbers are not.

818-20-55-8 Notwithstanding the requirements of paragraphs 818-20-35-4 through 35-5, an environmental credit subsequently measured at fair value in accordance with an entity's accounting policy election should continue to be measured at fair value at each reporting date until the environmental credit is derecognized. For example, assume that an entity elects an accounting policy to subsequently measure a class of 600 eligible noncompliance renewable identification numbers at fair value at each reporting date. If the entity subsequently determines that it is probable that a portion (or all) of those 600 noncompliance renewable identification numbers will be used to settle environmental credit obligations, those renewable identification numbers would be reclassified as compliance environmental credits and would continue to be measured at fair value at each reporting date until derecognized. Therefore, measuring those compliance environmental credits at fair value would affect the measurement of the related funded portion of an entity's environmental credit obligation liability measured in accordance with paragraph 818-30-30-2.

> Illustrations

• > Applying the Environmental Credit Recognition and Measurement Requirements

818-20-55-9 Examples 1 through 4 illustrate the application of the recognition and measurement requirements of this Subtopic.

• • > Example 1: Acquired Environmental Credits Recognized as an Asset

818-20-55-10 An industrial manufacturing entity is subject to a cap-and-trade regulatory compliance program that mandates the remittance of emissions allowances to a regulator by March 31, 20X5, based on the amount of the entity's emissions for a compliance year ending on December 31, 20X4. On January 1, 20X4, the entity purchases 10,000 emissions allowances at a regulator-sponsored auction for $1,000,000 ($100 per allowance) and pays $25,000 in auction fees. At initial recognition, the entity determines that it is probable that it will use those emissions allowances to settle its 20X4 cap-and-trade environmental credit obligation because it estimates that its emissions during 20X4 will require the remittance of 15,000 emissions allowances. The entity classifies the 10,000 emissions allowances as compliance environmental credits, initially measured at $1,025,000, in accordance with paragraph 818-

20-30-3. Those emissions allowances are not remeasured if they continue to be classified, at each reporting date, as compliance environmental credits.

• • > Example 2: Acquired Environmental Credits Recognized as an Expense as Incurred

818-20-55-11 A cloud-based software developer publicly announces its voluntary initiative to be carbon neutral for the fiscal year ending December 31, 20X4. The carbon neutral initiative of the cloud-based software developer does not represent an environmental credit obligation because it does not result from a regulatory compliance obligation under existing or enacted laws, statutes, or ordinances. Specifically, this voluntary initiative does not establish an environmental credit obligation. The entity purchases 1,000 carbon offsets for $50,000 on March 1, 20X4, to meet its voluntary initiative. Because it is not probable that the entity will use the acquired carbon offsets to settle an environmental credit obligation, transfer those carbon offsets in an exchange transaction, or use those carbon offsets in a nonreciprocal transfer, the entity recognizes the $50,000 as an expense as incurred on March 1, 20X4, in accordance with paragraph 818-20-25-1.

• • > Example 3: Internally Generated Environmental Credits Recognized as an Asset

818-20-55-12 An entity that owns a tree farm uses a nationally accredited third-party registry to certify the tree farm and issue carbon offsets. During January 20X4, the entity's tree farm activities resulted in 30,000 carbon offsets issued to the entity by the registry. The entity pays $1 per carbon offset as an administrative fee to the registry. The entity determines that it is not probable that it will use the carbon offsets to settle an environmental credit obligation because it intends to sell all of the carbon offsets created as a result of its tree farm activities. The entity recognizes the carbon offsets as assets and classifies them as noncompliance environmental credits. Those noncompliance environmental credits are initially measured at $30,000, the amount of the transaction costs, in accordance with paragraph 818-20-30-1. In accordance with paragraph 818-20-35-9, an entity's internally generated environmental credits are not eligible for the fair value measurement accounting policy election.

• • > Example 4: Environmental Credits Granted by a Regulator and Recognized as an Asset

818-20-55-13 A U.S. oil refinery is subject to a regulatory compliance program represented to control fuel emissions. The program requires fuel produced by the entity to include a minimum volume of fuel generated from renewable sources. The entity refines crude oil and conventional biofuel (renewable). During October 20X4, the entity refines 100,000 gallons of conventional biofuel, which results in 100,000 renewable identification numbers granted to the entity by the regulator in accordance with the program. The entity incurred no transaction costs to obtain the renewable identification numbers. The entity determines that it is probable that the renewable identification numbers will be used to settle an environmental credit obligation, transferred in an exchange transaction, or used in a nonreciprocal transfer and recognizes an asset that is initially measured at zero, in accordance with paragraph 818-20-30-1. Environmental credits received through a grant by a regulator or its designee(s) are not eligible for the fair value measurement accounting policy election in accordance with paragraph 818-20-35-9.

• > Applying the Quantitative Disclosure Requirements

818-20-55-14 The following is an illustration of the quantitative disclosures required by paragraphs 818-20-50-2 through 50-4 for annual reporting periods. The format in the illustration is not a requirement, and the information should be formatted in the most understandable manner for an entity's specific circumstances. This illustration does not illustrate comparative period disclosures.

Environmental Credit	As of December 31, 20X4 Carrying Amount	Classification
Current portion	$ 5,100	Compliance
Current portion	500	Noncompliance
Noncurrent portion	3,800	Compliance
Noncurrent portion	-	Noncompliance
Total	$ 9,400	

Environmental Credit Expense Information	For the Year Ended December 31, 20X4
Expense for voluntary environmental credit costs[a]	$ 118
Impairment expense[b]	$ 15

[a] Expense for voluntary environmental credit costs is included in other expenses in the income statement.
[b] Impairment expense is recorded because of a decline in the fair market value of Project A carbon offsets. Impairment expense is included in cost of goods sold in the income statement.

Change in Use of Environmental Credit Information	For the Year Ended December 31, 20X4
Expense for voluntary environmental credit costs[a]	$ 100

[a] Certain compliance environmental credits were expensed because it was no longer probable that the credits would be used to settle an ECO, transferred in an exchange transaction, or used in a nonreciprocal transfer.

5. Add Subtopic 818-30, with a link to transition paragraph 818-10-65-1, as follows:

[For ease of readability, the new Subtopic is not underlined.]

Environmental Credits and Environmental Credit Obligations—Environmental Credit Obligations

Overview and Background

General

818-30-05-1 This Subtopic addresses the accounting for an **environmental credit obligation**. Paragraph 818-30-55-1 provides a flowchart of the recognition and measurement requirements of this Subtopic.

Scope and Scope Exceptions

General

818-30-15-1 This Subtopic follows the same Scope and Scope Exceptions as the Overall Subtopic.

Glossary

Compliance Environmental Credit

An **environmental credit** recognized as an asset in accordance with Topic 818 and **probable** of being used to settle an **environmental credit obligation**.

Environmental Credit

An enforceable right that is acquired, internally generated, granted by a regulatory agency or its designee(s), or received in a **nonreciprocal transfer {first definition}** that is not a grant from a regulator or its designee(s) that meets all of the following criteria:

a. Lacks physical substance and is not a **financial asset**.
b. Is represented to prevent, control, reduce, or remove emissions or other pollution.
c. Is, or previously was, separately transferable in an **exchange** transaction. If an item is no longer separately transferable in an exchange transaction, an entity must be able to use that item to satisfy an **environmental credit obligation** to meet this criterion.
d. Is not an **income tax** credit that may be used to settle an entity's income tax liability, regardless of whether the entity has a tax liability or intends to use the credit for that purpose.

An environmental credit that meets the above criteria may exist in a variety of forms, including (but not limited to) credits, certificates, allowances, and offsets.

Environmental Credit Obligation

A regulatory compliance obligation arising from existing or enacted laws, statutes, or ordinances represented to prevent, control, reduce, or remove emissions or other pollution that may be settled with **environmental credits**. Obligations within the scope of Subtopic 410-30 are not environmental credit obligations.

Exchange

An exchange (or exchange transaction) is a reciprocal transfer between two entities that results in one of the entities acquiring assets or services or satisfying liabilities by surrendering other assets or services or incurring other obligations.

Fair Value (second definition)

The price that would be received to sell an asset or paid to transfer a liability in an **orderly transaction** between **market participants** at the measurement date.

Financial Asset

Cash, evidence of an ownership interest in an entity, or a contract that conveys to one entity a right to do either of the following:

a. Receive cash or another financial instrument from a second entity
b. Exchange other financial instruments on potentially favorable terms with the second entity.

Income Taxes

Domestic and foreign federal (national), state, and local (including franchise) taxes based on income.

Market Participants

Buyers and sellers in the principal (or most advantageous) market for the asset or liability that have all of the following characteristics:

a. They are independent of each other, that is, they are not **related parties**, although the price in a related-party transaction may be used as an input to a fair value measurement if the reporting entity has evidence that the transaction was entered into at market terms
b. They are knowledgeable, having a reasonable understanding about the asset or liability and the transaction using all available information, including information that might be obtained through due diligence efforts that are usual and customary
c. They are able to enter into a transaction for the asset or liability

d. They are willing to enter into a transaction for the asset or liability, that is, they are motivated but not forced or otherwise compelled to do so.

Noncompliance Environmental Credit

An **environmental credit** recognized as an asset in accordance with Topic 818 that is not a **compliance environmental credit**.

Nonreciprocal Transfer (first definition)

Nonreciprocal transfer is a transfer of assets or services in one direction, either from an entity to its owners (whether or not in exchange for their ownership interests) or to another entity, or from owners or another entity to the entity. An entity's reacquisition of its outstanding stock is an example of a nonreciprocal transfer.

Operating Cycle

The average time intervening between the acquisition of materials or services and the final cash realization constitutes an operating cycle.

Orderly Transaction

A transaction that assumes exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities; it is not a forced transaction (for example, a forced liquidation or distress sale).

Probable

The future event or events are likely to occur.

Related Parties

Related parties include:

a. Affiliates of the entity
b. Entities for which investments in their equity securities would be required, absent the election of the fair value option under the Fair Value Option Subsection of Section 825-10-15, to be accounted for by the equity method by the investing entity

c. Trusts for the benefit of employees, such as pension and profit-sharing trusts that are managed by or under the trusteeship of management
d. Principal owners of the entity and members of their immediate families
e. Management of the entity and members of their immediate families
f. Other parties with which the entity may deal if one party controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests
g. Other parties that can significantly influence the management or operating policies of the transacting parties or that have an ownership interest in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests.

Recognition

General

818-30-25-1 An entity shall recognize a liability when events that occur on or before a reporting date result in an **environmental credit obligation**. When evaluating whether a liability should be recognized, an entity shall determine whether **environmental credits** would be due assuming that the reporting date is the end of the regulatory compliance period, regardless of whether the regulatory compliance period ends after the reporting date. An entity shall recognize the costs associated with an environmental credit obligation liability either in earnings or, if appropriate, as part of another asset accounted for in accordance with another Topic.

818-30-25-2 See paragraphs 818-30-55-2 through 55-4 for implementation guidance on the application of recognition requirements.

Initial Measurement

General

818-30-30-1 An entity shall apply the recognition and measurement requirements of Subtopic 818-20 before applying the measurement requirements of this Subtopic on **environmental credit obligations**. An environmental credit obligation liability may have a funded portion and an unfunded portion to be measured in accordance with paragraphs 818-30-30-2 and 818-30-30-3, respectively.

818-30-30-2 The funded portion of an environmental credit obligation liability is the portion for which an entity has associated **compliance environmental credits**. An entity shall measure the funded portion using the carrying amount of the compliance environmental credits expected to be derecognized upon settlement of the liability using costing methods consistent with those applied when subsequently measuring its compliance environmental credits in accordance with Subtopic 818-20. When measuring the funded portion of an environmental credit obligation liability, an entity shall not consider any of the following:

a. **Noncompliance environmental credits**
b. **Environmental credits** that were never recognized as assets in accordance with paragraph 818-20-25-1
c. Environmental credits that were previously derecognized in accordance with paragraph 818-20-40-2.

818-30-30-3 If an entity does not have sufficient compliance environmental credits to satisfy an environmental credit obligation liability at a reporting date, the unfunded portion of its environmental credit obligation liability shall be measured using the **fair value** of the environmental credits necessary to settle that portion of the liability at the reporting date, unless an entity intends to settle (or partially settle) the unfunded portion by remitting any of the following:

a. Cash. An entity that intends to settle the unfunded portion by remitting cash shall measure the unfunded portion using the cash settlement amount specified by the regulatory compliance program.
b. Environmental credits that will be received before the settlement of the liability from either an existing unconditional purchase commitment for a fixed quantity of environmental credits at a fixed price or an unconditional right to receive a fixed quantity of environmental credits as part of a regulatory compliance program or contract for which environmental credits will be received as consideration. For purposes of applying the requirements in this paragraph, an unconditional right exists when an entity has satisfied all performance requirements of the regulatory compliance program or contract necessary to receive environmental credits as of the reporting date. An entity that intends to settle the unfunded portion using environmental credits from those

unconditional commitments or rights shall measure the unfunded portion using the estimated cost basis of the environmental credits to be obtained (which may differ from the fixed price per the contract).

818-30-30-4 An entity shall not consider expected future activities that may increase, reduce, or eliminate its environmental credit obligation liability when applying paragraph 818-30-30-3.

818-30-30-5 See paragraphs 818-30-55-5 through 55-7 for implementation guidance on the application of initially measuring environmental credit obligation liabilities.

Subsequent Measurement

General

818-30-35-1 At each reporting date, an entity shall apply the initial measurement guidance in paragraphs 818-30-30-2 through 30-3 and recognize any changes in an **environmental credit obligation** liability through earnings or as part of another asset accounted for in accordance with another Topic as required by paragraph 818-30-25-1.

Derecognition

General

818-30-40-1 An entity shall derecognize an **environmental credit obligation** liability in accordance with Subtopic 405-20 on extinguishments of liabilities.

Other Presentation Matters

General

> Balance Sheet

818-30-45-1 An entity shall present its **environmental credit obligation** liabilities separate from its **compliance environmental credits** recognized as assets in accordance with Subtopic 818-20 on its balance sheet.

818-30-45-2 An entity that presents a classified balance sheet shall classify environmental credit obligation liabilities reasonably expected to be settled within one year (or the **operating cycle** of the business used for applying paragraph 818-20-45-1, if longer) as a current liability. All other environmental credit obligation liabilities shall be classified as noncurrent liabilities.

> Income Statement

818-30-45-3 An entity shall present any changes in an environmental credit obligation liability in the income statement in a manner consistent with the recognition and measurement of that liability.

818-30-45-4 An entity shall present any gain or loss recognized upon derecognition of an environmental credit obligation liability in the income statement in a manner consistent with the recognition and measurement of that liability.

Disclosure

General

818-30-50-1 For annual reporting periods, an entity shall disclose all of the following about regulatory compliance programs that result in the entity's **environmental credit obligation** liabilities:

a. The activities or events that result in environmental credit obligation liabilities under those programs, including the nature and timing of settlement provisions
b. The accounting policies used to account for the environmental credit obligations in accordance with Topic 235 on notes to financial statements
c. How the unfunded portion of an environmental credit obligation liability is measured in accordance with paragraph 818-30-30-3
d. Significant estimates and judgments used in applying the guidance.

818-30-50-2 For annual reporting periods, if not separately presented on an entity's balance sheet, an entity shall disclose the current and noncurrent portions of both of the following:

a. The funded portion of an environmental credit obligation liability
b. The unfunded portion of an environmental credit obligation liability.

An entity also shall disclose the line item or items on the balance sheet that include the current and noncurrent portions of amounts in (a) and (b).

818-30-50-3 For annual reporting periods, an entity shall disclose the total expense recognized for environmental credit obligation liabilities during the reporting period and the line item in the income statement that includes that amount. See paragraphs 220-40-50-21 through 50-25 for additional disclosure requirements.

818-30-50-4 For annual reporting periods, an entity shall disclose both of the following:

a. The total costs associated with environmental credit obligation liabilities that are capitalized in the carrying amount of another asset during the reporting period in accordance with another Topic
b. A description of the other asset.

818-30-50-5 An entity shall apply the **fair value** disclosure requirements in Topic 820 for any fair value measurements made in accordance with this Subtopic.

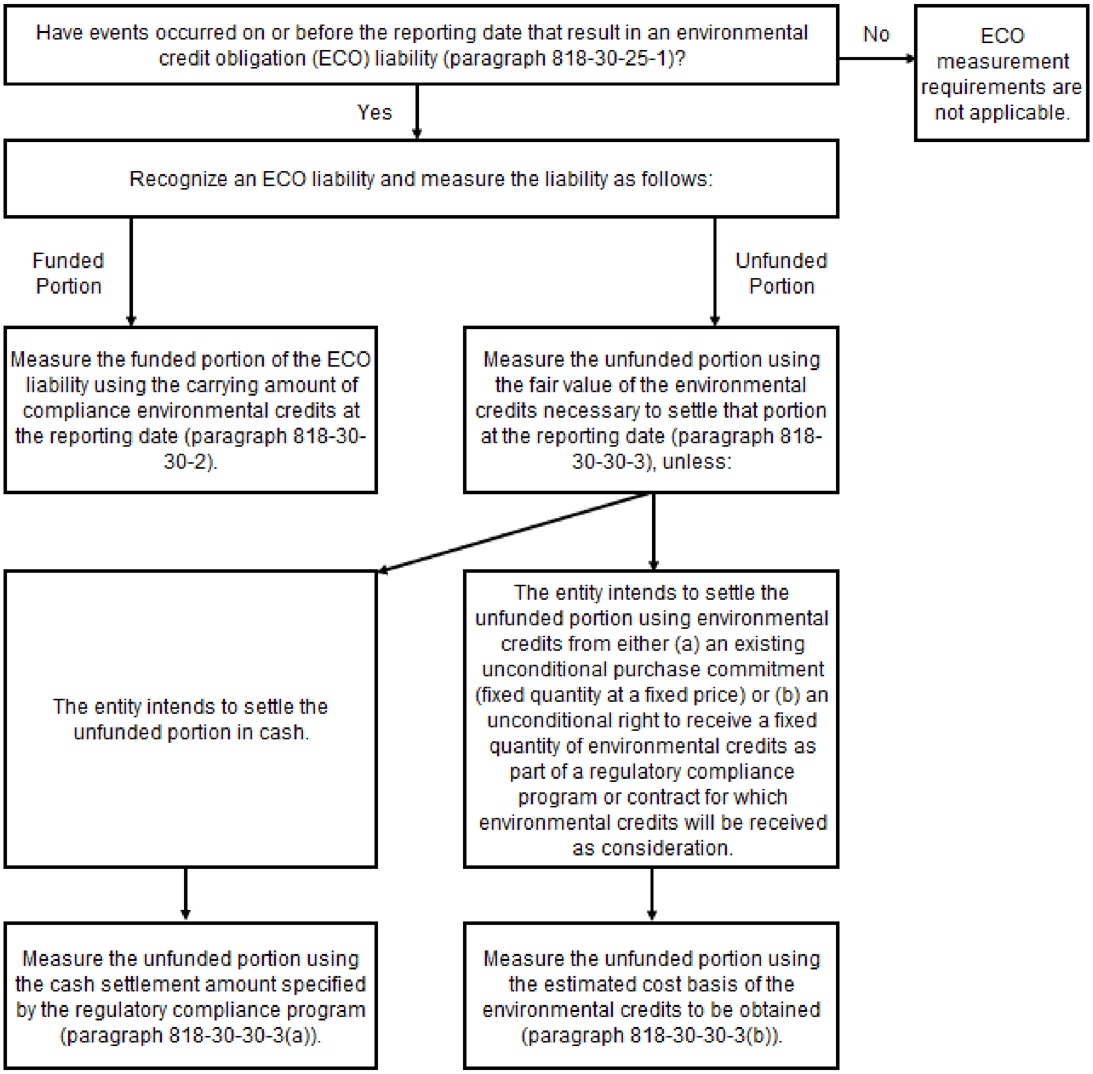
818-30-50-6 See paragraph 818-30-55-21 for an illustration of the quantitative disclosures required by this Subtopic.

Implementation Guidance and Illustrations

General

> Implementation Guidance

818-30-55-1 The following flowchart illustrates the accounting requirements of this Subtopic for **environmental credit obligations**. The flowchart is a supplement to the guidance in this Subtopic. It should not be interpreted to change any requirements of this Topic or be considered a substitute for those requirements.



• > **Recognition**

818-30-55-2 In some regulatory compliance programs, the qualifying events or activities that trigger an obligation to remit an **environmental credit** (which is often emissions as they occur) are established and specified by the program. In those programs, an entity typically cannot reduce the quantity of environmental credits that it is obligated to remit to the regulator at a point in time through future performance. For those programs, an entity should recognize an environmental credit obligation liability upon the occurrence of each qualifying event or activity. For example, if a utility company is required to remit one renewable energy certificate for every one megawatt-hour of electricity delivered to customers, the entity would recognize an environmental credit obligation liability for the obligation to remit one renewable energy certificate upon the delivery of one megawatt-hour to a customer.

818-30-55-3 In other regulatory compliance programs that result in environmental credit obligations, an entity is obligated to remit environmental credits to a regulator after it exceeds an established threshold of emissions. After exceeding the established threshold, each qualifying activity results in an incremental obligation to remit an environmental credit to the regulator at the settlement date specified by the program. For example, a regulatory compliance program obligates an entity to remit one emissions allowance for each metric ton of greenhouse gas emitted over 1,000 metric tons. An entity subject to that program should recognize an environmental credit obligation liability after its emissions exceed 1,000 metric tons. Because the entity is not obligated to remit an environmental credit until the threshold is exceeded, a liability should not be recognized before excess emissions occur. Therefore, when the entity emits above the 1,000 metric ton threshold, it should recognize an environmental credit obligation liability for each emissions allowance due thereafter.

818-30-55-4 Some regulatory compliance programs determine an entity's environmental credit obligation by considering activities over a period of time. Under those programs, an entity's future performance or actions may increase, reduce, or eliminate the need to remit environmental credits to a regulator at the settlement date. For those regulatory compliance programs, an entity should recognize an environmental credit obligation liability at a reporting date when activities or events occurring on or before that date obligate the entity to remit an environmental credit to the regulator assuming that the reporting date was the end of the compliance period. This assumption should be applied regardless of whether the regulatory compliance period ends after the reporting date. For example, consider an automotive manufacturer subject to a regulatory compliance program that requires that an entity remit environmental credits if the fuel efficiency of vehicles sold over a multiyear compliance period does not satisfy a benchmark threshold for that compliance period. Under those programs, an entity may sell vehicles during a reporting period that indicates that an environmental credit obligation liability exists at one reporting date that can be reduced or eliminated upon future sales of more fuel-efficient vehicles and before the compliance period ends. The entity should recognize an environmental credit obligation liability at the reporting date based on the facts and circumstances existing at that date. An entity should not forecast future activities or events that may increase, reduce, or eliminate the need to remit environmental credits to a regulator at the settlement date when determining whether it should recognize an environmental credit obligation liability.

• > Measurement

• • > The Funded Portion

818-30-55-5 When applying paragraph 818-30-30-2 for the measurement of the funded portion of an environmental credit obligation liability, an entity should consider only **compliance environmental credits** recognized as assets at the reporting date, not those credits that will (or may) be obtained in future periods.

• • > The Unfunded Portion

818-30-55-6 In accordance with paragraph 818-30-30-3(b), if an entity intends to settle the unfunded portion of an environmental credit obligation liability using environmental credits to be obtained before the settlement date through an unconditional purchase commitment for a fixed quantity of environmental credits at a fixed price that exists at the reporting date, that liability should be measured using the estimated cost basis of the environmental credits to be obtained. For example, a contract specifying that an entity will purchase 10,000 renewable energy certificates each year for the next 5 years at a fixed price of $20,000 ($2 per renewable energy certificate) per year may be considered when measuring the unfunded portion. If the entity intends to settle the unfunded portion of an environmental credit obligation liability using environmental credits to be obtained under that commitment before the settlement date, that unfunded portion would be measured using a cost basis of $2 per renewable energy certificate. However, if those renewable energy certificates are obtained as part of a bundled arrangement (for example, a power purchase arrangement) that includes the related energy, the estimated cost basis of the environmental credits to be obtained may differ from the fixed price per the contract because the amount allocated to that renewable energy certificate in accordance with Subtopic 805-50 on asset acquisitions may be different from the fixed price per the contract. In that scenario, an entity would measure the environmental credit obligation liability using the estimated cost basis of the renewable energy certificates to be obtained based on the estimated amount to be allocated to the renewable energy certificates in accordance with Subtopic 805-50.

818-30-55-7 Also in accordance with paragraph 818-30-30-3(b), if an entity has an unconditional right to receive a fixed quantity of environmental credits either from a regulator at a future date as part of a regulatory compliance program or as part of a contract for which the environmental credits are received as consideration, it should consider those environmental credits when measuring the unfunded portion of an environmental credit obligation liability if it intends to settle the obligation by remitting those credits. For example, if an entity is subject to a cap-and-trade program that specifies that the entity has an unconditional right on December 31, 20X4, to receive 1,000 emissions allowances on March 15, 20X5, the entity may consider those environmental credits to be received at a later date when measuring the unfunded portion if it intends to settle its environmental credit obligation by remitting those credits. That right would not be considered unconditional if the future grant is contingent on the entity's future performance, including continuing to conduct business in the program's jurisdiction after the reporting date. For example, if an entity subject to a cap-and-trade program specifying that an entity subject to the program as of December 31, 20X4, will receive 1,000 emissions allowances on March 15, 20X5, if the entity continues to operate in the program's jurisdiction on that date, the entity should not consider those environmental credits when measuring the unfunded portion before March 15, 20X5.

> Illustrations

• > Environmental Credit Obligation Liability Recognition and Measurement

818-30-55-8 Examples 1 through 3 illustrate the application of the environmental credit obligation liability recognition and measurement requirements in this Subtopic.

• • > Example 1: Funded Environmental Credit Obligation Liability

• • • > Case A—Compliance Environmental Credits Using the First-In, First-Out Costing Method

818-30-55-9 A manufacturing entity is subject to a cap-and-trade program that obligates the entity to remit emissions allowances to a regulator at a future settlement date with the quantity due determined based on greenhouse gas emissions for a calendar year. On March 31, 20X4, the entity determines that its 20X4 emissions to date would obligate it to remit 10,000 emissions allowances assuming that the March 31, 20X4 reporting date represents the end of the program's compliance period. On that date, the entity has 20,000 emissions allowances accounted for as compliance environmental credits with a carrying amount of $206,000. The entity subsequently measures its emissions allowances using the first-in, first-out costing method in accordance with paragraph 818-20-35-2. Those 20,000 emissions allowances comprise 8,000 acquired in March 20X3 for $96,000 ($12 per allowance Vintage Year 20X2), 7,000 acquired in August 20X3 for $70,000 ($10 per allowance Vintage Year 20X3), and 5,000 acquired in January 20X4 for $40,000 ($8 per allowance Vintage Year 20X4). For purposes of this Example, vintage year refers to the year that the emissions allowances were issued or sold at auctions by the regulator of the cap-and-trade program.

818-30-55-10 The entity first applies the asset reassessment requirements in paragraph 818-20-35-3 and determines that all 20,000 emissions allowances continue to be **probable** of being used to settle environmental credit obligation liabilities. Therefore, those emissions allowances remain classified and accounted for as compliance environmental credits. In accordance with paragraph 818-30-30-2, the entity measures the environmental credit obligation liability for the 10,000 emissions allowances using the carrying amount of compliance environmental credits recognized on March 31, 20X4. When assessing the carrying amount of the related compliance environmental credits, the entity considers the costing method applied in accordance with the requirements in paragraph 818-20-35-2 and uses that method to determine its best estimate of the carrying amount of compliance environmental credits.

818-30-55-11 Therefore, the carrying amount of the 10,000 credits expected to be used to satisfy the regulatory compliance program is $116,000 (the sum of the 8,000 Vintage Year 20X2 allowances at $12 per allowance plus 2,000 of the Vintage Year 20X3 allowances at $10 per allowance). The entity recognizes an environmental credit obligation liability on March 31, 20X4, for 10,000 emissions allowances measured at $116,000.

• • • > Case B—Compliance Environmental Credits Using an Average Cost Method

818-30-55-12 Assume the same facts and circumstances as Case A except that the entity's 20X4 emissions to date would obligate it to remit 14,000 emissions allowances. Additionally, assume that the entity subsequently measures the emissions allowances using an average cost method in accordance with paragraph 818-20-35-2. Vintage Years 20X2 through 20X4 emissions allowances are accepted methods of settlement for 20X4 cap-and-trade obligations, and the entity accounts for them as a single cost pool.

818-30-55-13 Regardless of the specific emissions allowances that the entity intends to transfer to the regulator, the entity will derecognize the environmental credits remitted at their average cost based on the entity's previously elected accounting policy. Average cost is one of the three allowable costing methods that an entity can use for subsequently measuring similar environmental credits in accordance with paragraph 818-20-35-2. On March 31, 20X4, the entity determines that the average cost is $10.30 per emissions allowance (the total cost of the emissions allowances of $206,000 divided by the total number of emissions allowances of 20,000). On that basis, the environmental credit obligation liability recognized for the 14,000 emissions allowances necessary to satisfy the liability at the reporting date is $144,200 in accordance with paragraph 818-30-30-2 (the average cost of $10.30 per emissions allowance multiplied by 14,000 emissions allowances necessary to satisfy the liability).

• • > Example 2: Excess Environmental Credit Obligation Liability

• • • > Case A—Environmental Credit Obligation Liability Measured Using the Fair Value of Environmental Credits

818-30-55-14 An automotive manufacturer selling vehicles is subject to a regulatory compliance program represented to control greenhouse gas emissions by establishing minimum levels of average fuel economy standards for vehicles sold. The compliance period begins on January 1, 20X4, and ends on December 31, 20X7. The entity is obligated to remit 1 environmental credit per vehicle for each mile per gallon that the average fuel economy of all of its vehicles sold within a designated model year is less than 32 miles per gallon. The regulator grants the entity 1 environmental credit per vehicle for every mile per gallon that the average fuel economy of all vehicles sold exceeds 32 miles per gallon. The entity has not executed an unconditional purchase commitment to acquire environmental credits, and the regulatory compliance program does not permit an alternative cash settlement mechanism. The entity determines that it intends to settle the obligation by acquiring the necessary environmental credits from another automotive manufacturer.

818-30-55-15 For the 3 months ending March 31, 20X4, the entity sold 100,000 20X4 model year vehicles with an average fuel economy of 30 miles per gallon. On that basis, the entity would be obligated to remit 200,000 environmental credits if the compliance period ended on March 31, 20X4. In accordance with paragraph 818-30-25-1, the entity should recognize an environmental credit obligation liability on that date. The liability is initially measured in accordance with paragraphs 818-30-30-2 through 30-3. On March 31, 20X4, the fair value of those environmental credits is $4 per credit. Therefore, the entity recognizes an unfunded environmental credit obligation liability of $800,000 on that date.

818-30-55-16 When measuring its March 31, 20X4 environmental credit obligation liability, the entity should not consider any activities or events that may increase, reduce, or eliminate the number of environmental credits that would be required at the reporting date. For example, if the entity intends to manufacture and sell more fuel-efficient vehicle models that result in environmental credits being granted to the entity before the settlement date, it should not consider the receipt of those expected future environmental credits when measuring the existing environmental credit obligation liability.

• • • > Case B—Environmental Credit Obligation Liability Measured Considering Cash Settlement Provisions

818-30-55-17 Assume the same facts and circumstances as in Case A except that the regulatory compliance program permits an alternative cash settlement mechanism that the entity intends to use because of a shortage of environmental credits associated with the program in the market. That alternative cash settlement mechanism allows the entity to settle its environmental credit obligation by paying $4.25 per environmental credit due to the regulator. In accordance with paragraph 818-30-30-3(a) and because the entity intends to use the alternative settlement mechanism, the entity recognizes an environmental credit obligation liability of $850,000 on March 31, 20X4.

• • • > Case C—Environmental Credit Obligation Liability Measured Considering Purchase Commitments

818-30-55-18 Assume the same facts and circumstances as in Case A except that during 20X3 the entity executed an unconditional purchase commitment for 500,000 environmental credits at $3 per credit to be received before the settlement date. On March 31, 20X4, the entity intends to settle its environmental credit obligation liability using environmental credits to be obtained from that purchase commitment. In accordance with paragraph 818-30-30-3(b), the entity recognizes an environmental credit obligation liability of $600,000.

• • > Example 3: Environmental Credit Obligation Liability Not Recognized

• • • > Case A—Emissions below Baseline

818-30-55-19 An e-commerce retailer is subject to an annual regulatory compliance program that obligates it to remit 1 environmental credit for each metric ton of emissions in excess of 1,000,000 metric tons. The regulatory compliance program ends on December 31, 20X4. As of June 30, 20X4, the entity's year-to-date emissions are 750,000 metric tons. At that date, the entity expects to emit 750,000 additional metric tons by December 31, 20X4. On that basis, the entity estimates that by the end of the regulatory compliance program, it will be obligated to remit 500,000 environmental credits to the regulator for its excess emissions. On June 30, 20X4, the entity does not recognize an environmental credit obligation liability because it is not obligated to remit any environmental credits assuming that date was the end of the compliance period. An environmental credit obligation liability is recognized under this program only after emissions exceed 1,000,000 metric tons.

• • • > Case B—Voluntary Environmental Initiatives

818-30-55-20 An entity publicly states its voluntary initiative to reduce its net annual emissions by 50 percent by 20X0 by acquiring carbon offsets in addition to making infrastructure investments and process changes. Because the entity's statement does not arise from a regulatory compliance obligation under existing or enacted laws, statutes, or ordinances, it is not an environmental credit obligation accounted for in accordance with this Subtopic.

• > Applying the Quantitative Disclosure Requirements

818-30-55-21 The following is an illustration of the quantitative disclosures required by paragraphs 818-30-50-2 through 50-4 for annual reporting periods. The format in the illustration is not a requirement, and the information should be formatted in the most understandable manner for an entity's specific circumstances. This illustration does not illustrate comparative period disclosures.

	As of December 31, 20X4					
Environmental Credit Obligation Liability	**Funded Obligation**		**Unfunded Obligation**		**Total Obligation**	
Current liability	$	5,100	$	1,400	$	6,500
Noncurrent liability		3,800		-		3,800
Total	**$**	**8,900**	**$**	**1,400**	**$**	**10,300**

Environmental Credit Obligation Cost and Expense Information	**For the Year Ended December 31, 20X4**	
Expense recognized for environmental credit obligations[(a)]	$	9,370
Costs capitalized as part of inventory that are associated with environmental credit obligations	$	2,000

[(a)] Expense recognized for environmental credit obligations is included in other expenses in the income statement.

Amendments to Subtopic 220-40

6. Amend paragraph 220-40-50-21, with a link to transition paragraph 818-10-65-1, as follows:

Income Statement—Reporting Comprehensive Income—Expense Disaggregation Disclosures

Disclosure

> Overall Guidance

• > Tabular Integration of Other Disclosure Requirements

220-40-50-21 An entity shall disclose, in the same tabular format disclosure in which the disclosures required by paragraph 220-40-50-6 are provided, each of the following expenses, gains, and losses and the amount recognized in each relevant expense caption (see paragraphs 220-40-50-12 through 50-13 for guidance on identifying relevant expense captions):

n. The total amount of a **government grant** recognized during the reporting period and presented as a deduction in reporting the related expense (see paragraphs 832-10-45-1(b), 832-10-45-3(b), and 832-10-50-3A) ~~832-10-50-3A).~~
o. Total expense recognized for **environmental credits** not initially recognized as an asset in accordance with paragraph 818-20-25-1 or subsequently derecognized in accordance with paragraph 818-20-40-2 (see paragraph 818-20-50-3(a))
p. Total impairment expense recognized during the reporting period relating to environmental credits (see paragraph 818-20-50-3(b))
q. Total expense recognized for **environmental credit obligation** liabilities (see paragraph 818-30-50-3).

These disclosures shall be included in the tabular format disclosure required by paragraph 220-40-50-6 using the same frequency (that is, whether the disclosure is required at interim and annual reporting periods or only annual reporting periods) as required by the corresponding Topic.

[Items (a) through (m) are not shown here because they are unchanged.]

Amendments to Subtopic 350-10

7. Amend paragraph 350-10-15-3, with a link to transition paragraph 818-10-65-1, as follows:

Intangibles—Goodwill and Other—Overall

Scope and Scope Exceptions

> Transactions

350-10-15-3 The guidance in the Intangibles–Goodwill and Other Topic does not apply to the following transactions and activities:

a. The accounting at acquisition for **goodwill** acquired in a business combination (for guidance see Subtopic 805-30)
b. Subparagraph not used.

c. The accounting at acquisition for goodwill acquired in an **acquisition by a not-for-profit entity** (for guidance see Subtopic 958-805)
d. The accounting at acquisition for **intangible assets** (other than goodwill) acquired in a business combination or in an acquisition by a not-for-profit entity (for guidance see Subtopics 805-20 and 958-805)
e. The accounting upon formation for intangible assets and goodwill recognized by a **joint venture** (for guidance see Subtopic 805-60) ~~805-60).~~
f. The accounting for **environmental credits** (for guidance see Subtopic 818-20).

Amendments to Subtopic 405-20

8. Amend paragraph 405-20-40-1, with a link to transition paragraph 818-10-65-1, as follows:

Liabilities—Extinguishments of Liabilities

Derecognition

405-20-40-1 Unless addressed by other guidance (for example, paragraphs 405-20-40-3 through 40-4 or paragraphs 606-10-55-46 through 55-49), a debtor shall derecognize a liability if and only if it has been extinguished. A liability has been extinguished if either of the following conditions is met:

a. The debtor pays the creditor and is relieved of its obligation for the liability. Paying the creditor includes the following:
    1. Delivery of cash
    2. Delivery of other financial assets
    3. Delivery of goods or services
    4. Reacquisition by the debtor of its outstanding debt securities whether the securities are cancelled or held as so-called treasury bonds ~~bonds.~~
    5. Delivery of **environmental credits.**
b. The debtor is legally released from being the primary obligor under the liability, either judicially or by the creditor. For purposes of applying this Subtopic, a sale and related assumption effectively accomplish a legal release if nonrecourse debt (such as certain mortgage loans) is

assumed by a third party in conjunction with the sale of an asset that serves as sole collateral for that debt.

Amendments to Subtopic 805-20

9. Add paragraphs 805-20-25-15B through 25-15D and their related headings and paragraph 805-20-30-32 and its related heading and amend paragraphs 805-20-25-9, 805-20-30-2, 805-20-30-10, and 805-20-30-12, with a link to transition paragraph 818-10-65-1, as follows:

Business Combinations—Identifiable Assets and Liabilities, and Any Noncontrolling Interest

Recognition

> Recognizing Particular Assets Acquired and Liabilities Assumed

805-20-25-9 Guidance on recognizing particular assets acquired and liabilities assumed is as ~~identifiable intangible assets, including reacquired rights,~~ follows.

• > Environmental Credits

805-20-25-15B An acquirer shall recognize an **environmental credit** acquired in a business combination as an asset, regardless of whether it is **probable** that the acquirer will use that environmental credit to settle an **environmental credit obligation,** transfer the environmental credit in an **exchange** transaction, or use the environmental credit in a **nonreciprocal transfer**. An environmental credit recognized as an asset in a business combination shall subsequently be accounted for in accordance with Topic 818, including the recognition reassessment requirements in paragraph 818-20-40-2.

805-20-25-15C An item acquired in a business combination that does not meet the definition of an environmental credit solely because it is not separately transferable in an exchange transaction at the acquisition date is not an identifiable asset and shall not be recognized as an asset.

• > Environmental Credit Obligations

805-20-25-15D When evaluating whether an environmental credit obligation liability should be recognized in a business combination, an entity shall determine whether environmental credits would be due assuming that the acquisition date is the end of the regulatory compliance period, regardless of whether the regulatory compliance period ends after the acquisition date.

Initial Measurement

> Measurement Principle

805-20-30-2 Exceptions to the measurement principle are identified and their accounting treatment is addressed in paragraphs 805-20-30-10 through 30-32 ~~30-31~~.

> Exceptions to the Measurement Principle

805-20-30-10 Paragraph 805-20-25-16 notes that the Business Combinations Topic provides limited exceptions to the recognition and measurement principles applicable to business combinations. Paragraphs 805-20-30-12 through 30-32 ~~30-31~~ specify the types of identifiable assets and liabilities that include items for which this Subtopic provides limited exceptions to the paragraph 805-20-30-1 measurement principle. The acquirer shall apply the specified GAAP or the specified requirements rather than that measurement principle to determine how to measure the assets or liabilities identified in paragraphs 805-20-30-12 through 30-32 ~~30-31~~. That will result in some items being measured at an amount other than their acquisition-date fair values.

805-20-30-12 Guidance is presented on all of the following exceptions to the measurement principle:

a. Income taxes
b. Employee benefits
c. Indemnification assets
d. Reacquired rights
e. Share-based payment awards
f. Assets held for sale
g. Certain assets and liabilities arising from contingencies
h. Leases

i. **Purchased financial assets with credit deterioration** and **purchased seasoned loans**
j. Contract assets and contract liabilities
k. Grants related to income ~~income.~~
l. **Environmental credit obligations**.

• > Environmental Credit Obligations

805-20-30-32 An acquirer shall measure an environmental credit obligation liability assumed in a business combination in accordance with the initial measurement requirements of Topic 818. Paragraph 818-30-30-1 specifies that an environmental credit obligation liability may have a funded portion and an unfunded portion. When measuring the funded portion in accordance with paragraph 818-30-30-2, an acquirer shall consider only **environmental credits** acquired in the business combination that will be classified as **compliance environmental credits**. If applicable, the unfunded portion of an environmental credit obligation liability measured in accordance with paragraph 818-30-30-3(b) shall consider only the acquiree's existing purchase commitments and unconditional rights.

Amendments to Subtopic 815-10

10. Add paragraph 815-10-15-82B and its related heading, with a link to transition paragraph 818-10-65-1, as follows:

Derivatives and Hedging—Overall

Scope and Scope Exceptions

> Instruments

• > Instruments Not within Scope

• • > Environmental Credits and Environmental Credit Obligations

815-10-15-82B Environmental credits and **environmental credit obligations** shall be accounted for in accordance with Topic 818 and are not subject to this Subtopic.

Amendments to Subtopic 825-10

11. Amend paragraph 825-10-15-5, with a link to transition paragraph 818-10-65-1, as follows:

Financial Instruments—Overall

Scope and Scope Exceptions

Fair Value Option

> Instruments

825-10-15-5 No entity may elect the fair value option for any of the following financial assets and financial liabilities:

a. An investment in a subsidiary that the entity is required to consolidate.
b. An interest in a variable interest entity (VIE) that the entity is required to consolidate.
c. Employers' and plans' obligations (or assets representing net overfunded positions) for pension benefits, other postretirement benefits (including health care and life insurance benefits), postemployment benefits, employee stock option and stock purchase plans, and other forms of deferred compensation arrangements, as defined in Topics 420; 710; 712; 715; 718; and 960.
d. Financial assets and financial liabilities recognized under leases as defined in Subtopic 842-10. (This exception does not apply to a guarantee of a third-party lease obligation or a contingent obligation arising from a cancelled lease.)
e. Deposit liabilities, withdrawable on demand, of banks, savings and loan associations, credit unions, and other similar depository institutions.
f. Financial instruments that are, in whole or in part, classified by the issuer as a component of shareholders' equity (including temporary equity).
g. **Environmental credit obligation** liabilities that can be settled in cash that are accounted for in accordance with Topic 818.

Amendments to Subtopic 832-10

12. Amend paragraph 832-10-15-4A, with a link to transition paragraph 818-10-65-1, as follows:

Government Grants—Overall

Scope and Scope Exceptions

> Transactions

832-10-15-4A The guidance in this Topic does not apply to the following:

a. Transactions within the scope of Topic 740 on income taxes (for example, nonrefundable, nontransferable income tax credits)
b. The benefit of below-market interest rate loans
c. Government guarantees ~~guarantees.~~
d. **Environmental credits** within the scope of Subtopic 818-20.

Amendments to Subtopic 958-605

13. Amend paragraph 958-605-15-6, with a link to transition paragraph 818-10-65-1, as follows:

Not-for-Profit Entities—Revenue Recognition—Contributions

Scope and Scope Exceptions

Contributions Received

> Transactions

958-605-15-6 The guidance in the Contributions Received Subsections does not apply to the following transactions and activities:

a. Transfers of assets that are in substance purchases of goods or services—exchange transactions in which each party receives and sacrifices commensurate value (in accordance with the guidance in paragraph 958-605-15-5A). However, if an entity voluntarily transfers assets to another or performs services for another in exchange for assets of substantially lower value and no unstated rights or privileges are involved, the contribution received that is inherent in that transaction is within the scope of the Contributions Received Subsections.

b. Transfers of assets in which the reporting entity acts as an **agent**, **trustee**, or **intermediary**, rather than as a donor or donee (see the Transfers of Assets to a Not-for-Profit Entity or Charitable Trust That Raises or Holds Contributions for Others Subsections of this Subtopic).
c. Tax exemptions, tax incentives, or tax abatements.
d. Transfers of assets from government entities to business entities.
e. Transfers of assets (typically from a government entity) that are part of an existing exchange transaction between a recipient and an identified **customer**. Some examples include payments under Medicare and Medicaid programs, provisions of health care or education services by a government for its employees, and Pell Grants or similar state or local government tuition assistance programs. In those instances, an entity shall apply the applicable guidance (for example, Topic 606 on **revenue** from **contracts** with customers) to the underlying transaction with the customer, and the payments from the third parties would be payments on behalf of those customers.
f. Transfers of **environmental credits** received from a regulator or its designee(s). Subtopic 818-20 provides accounting guidance for environmental credits.

Amendments to Status Sections

14. Amend paragraph 220-40-00-1, by adding the following items to the table, as follows:

220-40-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Environmental Credit	Added	2026-02	05/19/2026
Environmental Credit Obligation	Added	2026-02	05/19/2026

Paragraph	Action	Accounting Standards Update	Date
Financial Asset	Added	2026-02	05/19/2026
Income Taxes	Added	2026-02	05/19/2026
Nonreciprocal Transfer (1st def.)	Added	2026-02	05/19/2026
220-40-50-21	Amended	2026-02	05/19/2026

15. Amend paragraph 350-10-00-1, by adding the following items to the table, as follows:

350-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Environmental Credit	Added	2026-02	05/19/2026
Environmental Credit Obligation	Added	2026-02	05/19/2026
Exchange	Added	2026-02	05/19/2026
Financial Asset	Added	2026-02	05/19/2026
Income Taxes	Added	2026-02	05/19/2026
Nonreciprocal Transfer (1st def.)	Added	2026-02	05/19/2026
350-10-15-3	Amended	2026-02	05/19/2026

16. Amend paragraph 405-20-00-1, by adding the following items to the table, as follows:

405-20-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Environmental Credit	Added	2026-02	05/19/2026
Environmental Credit Obligation	Added	2026-02	05/19/2026
Exchange	Added	2026-02	05/19/2026
Financial Asset	Added	2026-02	05/19/2026
Income Taxes	Added	2026-02	05/19/2026
Nonfinancial Asset	Added	2026-02	05/19/2026
Nonreciprocal Transfer (1st def.)	Added	2026-02	05/19/2026
405-20-40-1	Amended	2026-02	05/19/2026

17. Amend paragraph 805-20-00-1, by adding the following items to the table, as follows:

805-20-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Compliance Environmental Credit	Added	2026-02	05/19/2026
Environmental Credit	Added	2026-02	05/19/2026
Environmental Credit Obligation	Added	2026-02	05/19/2026
Income Taxes	Added	2026-02	05/19/2026

Paragraph	Action	Accounting Standards Update	Date
Nonreciprocal Transfer (1st def.)	Added	2026-02	05/19/2026
Probable	Added	2026-02	05/19/2026
805-20-25-9	Amended	2026-02	05/19/2026
805-20-25-15B through 25-15D	Added	2026-02	05/19/2026
805-20-30-2	Amended	2026-02	05/19/2026
805-20-30-10	Amended	2026-02	05/19/2026
805-20-30-12	Amended	2026-02	05/19/2026
805-20-30-32	Added	2026-02	05/19/2026

18. Amend paragraph 815-10-00-1, by adding the following items to the table, as follows:

815-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Environmental Credit	Added	2026-02	05/19/2026
Environmental Credit Obligation	Added	2026-02	05/19/2026
Exchange	Added	2026-02	05/19/2026
Financial Asset	Added	2026-02	05/19/2026
Income Taxes	Added	2026-02	05/19/2026
Nonreciprocal Transfer (1st def.)	Added	2026-02	05/19/2026
815-10-15-82B	Added	2026-02	05/19/2026

19. Add paragraph 818-10-00-1 as follows:

<u>**818-10-00-1** The following table identifies the changes made to this Subtopic.</u>

Paragraph	Action	Accounting Standards Update	Date
Active Market	Added	2026-02	05/19/2026
Compliance Environmental Credit	Added	2026-02	05/19/2026
Environmental Credit	Added	2026-02	05/19/2026
Environmental Credit Obligation	Added	2026-02	05/19/2026
Exchange	Added	2026-02	05/19/2026
Fair Value (2nd def.)	Added	2026-02	05/19/2026
Financial Asset	Added	2026-02	05/19/2026
Income Taxes	Added	2026-02	05/19/2026
Market Participants	Added	2026-02	05/19/2026
Noncompliance Environmental Credit	Added	2026-02	05/19/2026
Nonreciprocal Transfer (1st def.)	Added	2026-02	05/19/2026
Orderly Transaction	Added	2026-02	05/19/2026
Probable	Added	2026-02	05/19/2026
Related Parties	Added	2026-02	05/19/2026
818-10-05-1 through 05-3	Added	2026-02	05/19/2026
818-10-10-1	Added	2026-02	05/19/2026
818-10-15-1 through 15-3	Added	2026-02	05/19/2026
818-10-55-1	Added	2026-02	05/19/2026
818-10-65-1	Added	2026-02	05/19/2026

20. Add paragraph 818-20-00-1 as follows:

<u>**818-20-00-1** The following table identifies the changes made to this Subtopic.</u>

Paragraph	Action	Accounting Standards Update	Date
Acquiree	Added	2026-02	05/19/2026
Acquirer	Added	2026-02	05/19/2026
Acquisition by a Not-for-Profit Entity	Added	2026-02	05/19/2026
Business	Added	2026-02	05/19/2026
Business Combination	Added	2026-02	05/19/2026
Compliance Environmental Credit	Added	2026-02	05/19/2026
Contract	Added	2026-02	05/19/2026
Customer	Added	2026-02	05/19/2026
Environmental Credit	Added	2026-02	05/19/2026
Environmental Credit Obligation	Added	2026-02	05/19/2026
Exchange	Added	2026-02	05/19/2026
Fair Value (2nd def.)	Added	2026-02	05/19/2026
Financial Asset	Added	2026-02	05/19/2026
Income Taxes	Added	2026-02	05/19/2026
Market Participants	Added	2026-02	05/19/2026
Noncompliance Environmental Credit	Added	2026-02	05/19/2026
Nonreciprocal Transfer (1st def.)	Added	2026-02	05/19/2026

Paragraph	Action	Accounting Standards Update	Date
Not-for-Profit Entity	Added	2026-02	05/19/2026
Operating Cycle	Added	2026-02	05/19/2026
Orderly Transaction	Added	2026-02	05/19/2026
Probable	Added	2026-02	05/19/2026
Related Parties	Added	2026-02	05/19/2026
818-20-05-1	Added	2026-02	05/19/2026
818-20-15-1	Added	2026-02	05/19/2026
818-20-25-1 through 25-5	Added	2026-02	05/19/2026
818-20-30-1 through 30-3	Added	2026-02	05/19/2026
818-20-35-1 through 35-10	Added	2026-02	05/19/2026
818-20-40-1 through 40-3	Added	2026-02	05/19/2026
818-20-45-1	Added	2026-02	05/19/2026
818-20-45-2	Added	2026-02	05/19/2026
818-20-50-1 through 50-6	Added	2026-02	05/19/2026
818-20-55-1 through 55-14	Added	2026-02	05/19/2026

21. Add paragraph 818-30-00-1 as follows:

818-30-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Compliance Environmental Credit	Added	2026-02	05/19/2026
Environmental Credit	Added	2026-02	05/19/2026
Environmental Credit Obligation	Added	2026-02	05/19/2026
Exchange	Added	2026-02	05/19/2026
Fair Value (2nd def.)	Added	2026-02	05/19/2026
Financial Asset	Added	2026-02	05/19/2026
Income Taxes	Added	2026-02	05/19/2026
Market Participants	Added	2026-02	05/19/2026
Noncompliance Environmental Credit	Added	2026-02	05/19/2026
Nonreciprocal Transfer (1st def.)	Added	2026-02	05/19/2026
Operating Cycle	Added	2026-02	05/19/2026
Orderly Transaction	Added	2026-02	05/19/2026
Probable	Added	2026-02	05/19/2026
Related Parties	Added	2026-02	05/19/2026
818-30-05-1	Added	2026-02	05/19/2026
818-30-15-1	Added	2026-02	05/19/2026
818-30-25-1	Added	2026-02	05/19/2026
818-30-25-2	Added	2026-02	05/19/2026
818-30-30-1 through 30-5	Added	2026-02	05/19/2026

Paragraph	Action	Accounting Standards Update	Date
818-30-35-1	Added	2026-02	05/19/2026
818-30-40-1	Added	2026-02	05/19/2026
818-30-45-1 through 45-4	Added	2026-02	05/19/2026
818-30-50-1 through 50-6	Added	2026-02	05/19/2026
818-30-55-1 through 55-21	Added	2026-02	05/19/2026

22. Amend paragraph 825-10-00-1, by adding the following items to the table, as follows:

825-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Environmental Credit	Added	2026-02	05/19/2026
Environmental Credit Obligation	Added	2026-02	05/19/2026
Exchange	Added	2026-02	05/19/2026
Income Taxes	Added	2026-02	05/19/2026
Nonreciprocal Transfer (1st def.)	Added	2026-02	05/19/2026
825-10-15-5	Amended	2026-02	05/19/2026

23. Amend paragraph 832-10-00-1, by adding the following items to the table, as follows:

832-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Environmental Credit	Added	2026-02	05/19/2026
Environmental Credit Obligation	Added	2026-02	05/19/2026
Financial Asset	Added	2026-02	05/19/2026
Income Taxes	Added	2026-02	05/19/2026
Nonreciprocal Transfer (1st def.)	Added	2026-02	05/19/2026
832-10-15-4A	Amended	2026-02	05/19/2026

24. Amend paragraph 958-605-00-1, by adding the following items to the table, as follows:

958-605-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Environmental Credit	Added	2026-02	05/19/2026
Environmental Credit Obligation	Added	2026-02	05/19/2026
Income Taxes	Added	2026-02	05/19/2026
Nonreciprocal Transfer (1st def.)	Added	2026-02	05/19/2026
958-605-15-6	Amended	2026-02	05/19/2026

The amendments in this Update were adopted by the unanimous vote of the seven members of the Financial Accounting Standards Board:

Richard R. Jones, *Chair*
Hillary H. Salo, *Vice Chair*
Christine A. Botosan
Frederick L. Cannon
Susan M. Cosper
Marsha L. Hunt
Dr. Joyce T. Joseph

Background Information and Basis for Conclusions

Introduction

BC1. The following summarizes the Board's considerations resulting in the conclusions in this Update. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

BC2. The objectives of the amendments in this Update are to (a) establish specific accounting requirements for environmental credits and environmental credit obligations and (b) reduce diversity in practice. By meeting those objectives, the amendments are expected to improve the comparability and understandability of financial information about environmental credits and environmental credit obligations.

Background Information

BC3. As emissions-specific regulatory compliance programs became more prominent in the early 2000s, the FASB and the International Accounting Standards Board (IASB), individually and jointly, established projects to develop accounting requirements for environmental credits and environmental credit obligations resulting from those programs. The FASB and the IASB ultimately removed the projects from their respective technical agendas, primarily to focus on higher priority projects addressing major areas of GAAP and International Financial Reporting Standards (IFRS Accounting Standards).

BC4. More recently, stakeholder feedback, including from respondents to the 2021 FASB Invitation to Comment (ITC), *Agenda Consultation*, indicated that many entities whose operations involve emissions are subject to government mandates and regulatory compliance programs, which often result in obligations that may be settled with environmental credits. Additionally, some entities that voluntarily commit to reducing their emissions by a future date (for example, voluntary "net zero" and "carbon neutral" initiatives) use environmental credits to partially satisfy their emission reduction goals.

BC5. Stakeholders emphasized that GAAP does not provide specific authoritative guidance on how to recognize and measure environmental credits or the related obligations that result from regulatory compliance programs. As a result, entities typically account for environmental credits and environmental credit obligations by analogy to Topic 330, Inventory, Subtopic 350-30, Intangibles—Goodwill and Other—General Intangibles Other Than Goodwill, and Topic 450, Contingencies, resulting in diversity in practice.

BC6. The following are examples of environmental credits and the associated regulatory compliance program that are subject to the amendments in this Update (these examples are not all-inclusive):

a. Emissions allowances originating from domestic and global cap-and-trade programs
b. Renewable identification numbers originating from the U.S. Renewable Fuel Standard
c. Renewable energy certificates originating from U.S. State Renewable Portfolio Standards.

BC7. Additionally, carbon offsets, which often are generated by projects represented to reduce or remove carbon dioxide from the atmosphere, are typically used by entities to meet voluntary initiatives to reduce net emissions and also are subject to the amendments in this Update.

BC8. On the basis of stakeholder feedback, the Board added a project to its technical agenda in May 2022 to develop a comprehensive accounting model, including recognition, measurement, presentation, and disclosure requirements for entities who participate in compliance and voluntary programs involving environmental credits.

BC9. The FASB's mission is to establish and improve financial accounting and reporting standards; therefore, the amendments in this Update are intended to address only amounts reported in financial statements. As a result, measuring or tracking an entity's voluntary net zero emissions initiatives or the entity's actual greenhouse gas emissions are beyond the scope of the FASB's mission and are not addressed by the FASB or by these amendments.

BC10. On December 17, 2024, the Board issued proposed Accounting Standards Update, *Environmental Credits and Environmental Credit Obligations (Topic 818)*, for public comment with the comment period ending on April 15, 2025. The Board received 41 comment letters in response to the proposed Update. Overall, most comment letter respondents supported the

Board's efforts to add specific authoritative guidance to improve financial accounting for and disclosure of environmental credits and environmental credit obligations and suggested certain clarifications. Other respondents disagreed with or provided alternatives for certain aspects of the proposed amendments. The Board considered stakeholder feedback in reaching its conclusions in this Update, as discussed in each area below.

Benefits and Costs

BC11. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Present and potential investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement new guidance are borne primarily by present investors. The Board's assessment of the costs and benefits of issuing new guidance is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement new guidance or to quantify the value of improved information in financial statements.

BC12. Over the course of the project, extensive outreach was conducted with investors and other allocators of capital (hereinafter, investors), preparers, practitioners, and others to obtain information about entities that own environmental credits or have a regulatory compliance obligation that may be settled with environmental credits. That outreach provided information on the current accounting for those credits and obligations and what information would be decision useful for investors.

BC13. For the amendments in this Update, the Board expects the following benefits:

a. Improved decision-useful information for investors. Improvements in the recognition and measurement of environmental credits and environmental credit obligations that result from regulatory compliance programs, and enhanced disclosures are expected to provide investors with transparent, consistent, comparable, and decision-useful information.

b. Reduced diversity in practice. Because specific authoritative guidance does not currently exist for environmental credits and obligations that result from regulatory compliance programs, the amendments are expected to reduce diversity in practice and eliminate analogies to other guidance. The Board expects that consistent reporting of financial information will enable investors to more effectively analyze the effects of environmental credits and environmental credit obligations on entities and across comparable entities.

BC14. The Board acknowledges that entities may incur one-time costs to develop systems, processes, and accounting policies to comply with the amendments in this Update. The Board also acknowledges that practitioners may incur one-time costs to understand the new requirements and to develop the necessary procedures to effectively audit those requirements. The Board expects that the nature and extent of one-time and ongoing costs will vary depending on the nature and magnitude of an entity's involvement with environmental credits and obligations that result from regulatory compliance programs and the entity's current accounting for those items. However, stakeholder feedback over the course of the project indicated that many entities have the information needed to apply the amendments. Therefore, the Board expects that the amendments will be clear and operable without undue cost and complexity.

BC15. Overall, the Board concluded that the expected benefits of the amendments in this Update justify the expected costs. The Board's specific considerations about the benefits and costs of these amendments are further discussed in subsequent sections below.

Basis for Conclusions

Scope

BC16. The Board developed the scope of the amendments in this Update by considering the definitions and characteristics of assets and liabilities in FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting*, Chapter 4, *Elements of Financial Statements*. The definitions of *environmental credit* and *environmental credit obligation* describe the rights and obligations that are addressed by the amendments.

BC17. Many comment letter respondents stated that the scope of the amendments are clear and operable. Some respondents indicated that additional environmental credits or environmental credit obligations should be within the scope of the amendments or suggested revisions to improve the clarity and operability of the guidance. That feedback is further discussed below.

Environmental Credit

BC18. The amendments in this Update require that an item that meets the following definition is an environmental credit within the scope of this Update:

> An enforceable right that is acquired, internally generated, granted by a regulatory agency or its designee(s), or received in a nonreciprocal transfer that is not a grant from a regulator or its designee(s) that meets all of the following criteria:
>
> a. Lacks physical substance and is not a financial asset.
> b. Is represented to prevent, control, reduce, or remove emissions or other pollution.
> c. Is, or previously was, separately transferable in an exchange transaction. If an item is no longer separately transferable in an exchange transaction, an entity must be able to use that item to satisfy an environmental credit obligation to meet this criterion.
> d. Is not an income tax credit that may be used to settle an entity's income tax liability, regardless of whether the entity has a tax liability or intends to use the credit for that purpose.
>
> An environmental credit that meets the above criteria may exist in a variety of forms, including (but not limited to) credits, certificates, allowances, and offsets.

BC19. Paragraph E16 of Concepts Statement 8 defines *asset* as "a present right of an entity to an economic benefit." Along with the definition of an asset in Concepts Statement 8, the Board considered the definitions for other assets, including crypto assets, intangible assets, and inventory, to determine whether, and to what extent, those definitions could be leveraged in developing a definition of an environmental credit. The Board also considered the essential characteristics as described by stakeholders that differentiate environmental credits from other assets, particularly that the credits are represented to be associated with the prevention, control, reduction, or removal of emissions.

BC20. Many comment letter respondents stated that the definition of an environmental credit is clear and operable. Additionally, some respondents suggested clarifications to improve the operability of the guidance, which are discussed in paragraphs BC35, BC38, and BC40.

Enforceable right

BC21. The amendments in this Update specify that only items that constitute enforceable rights meet the definition of an environmental credit. The Board included this requirement in the definition of an environmental credit to eliminate ambiguity about whether an item provides an entity with a present right. The Board noted that including enforceability in the definition is consistent with rights obtained through legal ownership, such as those established by a contract, and is intended to mitigate the risk of items being considered “owned” for financial reporting purposes by more than one reporting entity. The Board expects that determining enforceability for many types of existing items, such as emissions allowances, renewable energy certificates, and renewable identification numbers, will be straightforward because those items are common and well understood. For other items, the Board acknowledges that determining whether enforceable rights exist may be more challenging. The Board decided not to provide additional guidance for determining whether a right is enforceable because similar judgments are required to be made in other areas of current GAAP.

BC22. The Board also decided to specify that an environmental credit may be represented by a variety of legal forms, including, but not limited to, credits, certificates, allowances, and offsets. Specifically, the Board emphasized that an item does not have to be titled a “credit” to be subject to the amendments in this Update.

BC23. Comment letter respondents broadly agreed that to meet the definition of an environmental credit, an item should be an enforceable right and that the enforceable right gives the owner access to the economic benefits that it embodies.

Method of obtaining an environmental credit

BC24. The amendments in this Update require that to meet the definition of an environmental credit, the item must be acquired, internally generated, granted by a regulatory agency or its designee(s), or received in a nonreciprocal transfer that is not a grant from a regulator or its designee(s). Stakeholder feedback, including comment letter feedback, and the staff's research indicated that environmental credits originate primarily through regulatory compliance programs or projects that are represented to prevent, control, reduce, or remove emissions or other pollution and that environmental credits are acquired, received through grants from regulators as part of regulatory compliance programs, internally generated by projects not associated with regulatory compliance programs, or received in a nonreciprocal transfer that is not a grant from a regulator or its designee(s).

BC25. The Board also understands that an entity may receive an environmental credit as part of a grant directly from a regulatory agency or from its designee(s), which are approved registries that issue and track the related environmental credits. Therefore, the Board included "or its designee(s)" in the definition of environmental credit to ensure that the amendments in this Update include all environmental credits granted as part of regulatory compliance programs.

BC26. The Board considered whether internally generated environmental credits should be excluded from the amendments in this Update, in part because the Board excluded internally generated crypto assets from the scope of Accounting Standards Update No. 2023-08, *Intangibles—Goodwill and Other—Crypto Assets (Subtopic 350-60): Accounting for and Disclosure of Crypto Assets*. The Board decided that, unlike internally generated crypto assets, the nature and characteristics of internally generated environmental credits are similar to those granted by regulators to an entity for its performance. For example, the Board considers a renewable energy certificate granted by a regulator to an entity for its production of one megawatt hour of renewable energy to be similar to a renewable energy certificate issued to the entity by a nongovernmental registry for the same activities. On that basis, the Board decided that consistent accounting requirements for environmental credits received as a grant from a regulator and those internally generated are warranted.

BC27. In response to stakeholder feedback, the Board clarified that environmental credits received in a nonreciprocal transfer that is not a grant from a regulator or its designee(s) are within the scope of the amendments in this Update. The Board observed that some entities receive environmental credits through a nonreciprocal transfer; therefore, for completeness, it revised the definition to clarify that items obtained in those transactions could be environmental credits within the scope of this Update. The Board observed that substantially all nonreciprocal transfers of environmental credits (excluding government grants) are received from related parties, most notably as a distribution (for example, in the form of a dividend) from an equity method investee.

BC28. Comment letter respondents generally agreed that the definition of an environmental credit is clear and operable and that it appropriately reflects the methods of obtaining an environmental credit.

Lacks physical substance and is not a financial asset

BC29. The amendments in this Update specify that to meet the definition of an environmental credit, the item must meet the criterion that it lacks physical substance and is not a financial asset. The Board noted that the accounting requirements for financial assets are provided in other Topics. In addition, the Board included this criterion because it excludes from the scope of the amendments many assets that are considered securities and subject to other Topics. Comment letter respondents broadly agreed with this aspect of the definition of an environmental credit.

Represented to prevent, control, reduce, or remove emissions or other pollution

BC30. The amendments in this Update specify that to meet the definition of an environmental credit, the item must meet the criterion that it is represented to prevent, control, reduce, or remove emissions or other pollution. The Board included this requirement to limit the scope to items such as emissions allowances, renewable energy certificates, renewable identification numbers, and carbon offsets. The Board noted that the definition mitigates the risk that other items not directly related to emissions or other pollution, such as various licenses and permits, would be included in the scope of the amendments in this Update.

BC31. The Board decided to use the phrase “represented to” in the definition of an environmental credit because determining the environmental effect of an activity associated with an environmental credit may be impracticable. Specifically, the Board noted that assessing the validity of the representation likely requires detailed scientific analysis. The Board expects that market participants will factor the environmental effect of an environmental credit into its cost or value. Comment letter respondents broadly agreed with this aspect of the definition of an environmental credit.

Separately transferable in an exchange transaction

BC32. The amendments in this Update specify that to meet the definition of an environmental credit, the item must be or have been separately transferable in an exchange transaction. The amendments also specify that if an item is no longer separately transferable in an exchange transaction, the entity must be able to use that item to settle an environmental credit obligation to meet this criterion.

BC33. The Board intends that items meeting the separately transferable criterion include rights that can be transferred separately from other assets, groups of assets, or goods and services. For example, a renewable energy certificate typically may be transferred separately from the related purchased energy. The Board concluded that the transferability criterion is necessary to mitigate the risk that items that cannot be used to settle compliance obligations, transferred in exchange transactions, or used in nonreciprocal transfers might otherwise be within the scope of the amendments in this Update.

BC34. The Board observed that almost all environmental credits that stakeholders requested to be addressed, including those that may be used to settle enforceable compliance obligations, are enforceable rights that are (or previously were) separately transferable in an exchange transaction. The Board acknowledges that the ability to use an environmental credit to settle an environmental credit obligation may be sufficient to conclude that the credit meets the definition of an asset in Concepts Statement 8. However, the Board noted that many environmental credits, including most carbon offsets, are not accepted forms of settlement of regulatory compliance programs. Rather, those environmental credits often are used for voluntary purposes.

BC35. In response to comment letter feedback, the Board revised the definition of an environmental credit to indicate that an item that *previously was* separately transferable in an exchange transaction can meet the definition of an environmental credit as long as the entity can use that item to satisfy an environmental credit obligation. Specifically, comment letter respondents observed that there are environmental credits that are initially transferred in an exchange transaction and, upon transfer, lose their ability to be transferred again but retain their ability to be used to settle an environmental credit obligation. Therefore, the Board decided to clarify that the scope of this Update includes environmental credits that (a) are separately transferable in an exchange transaction and (b) previously were separately transferable in an exchange transaction and can be used to settle an environmental credit obligation.

BC36. The Board decided not to include in the scope of this Update items that otherwise met the definition of an environmental credit but are not transferable. The Board decided not to include those items in the scope of this Update primarily because research and outreach indicate that environmental credits that may be used to settle compliance obligations generally are, or previously were, separately transferable. The Board observed that the cost of items with environmental credit features that were never transferable and cannot be used to settle an environmental credit obligation will be recognized as an expense when incurred.

BC37. The Board also clarified that the existence of active markets should not be considered in determining whether an environmental credit is separately transferable. Rather, the Board expects that market activity will be considered as part of the subsequent measurement of certain environmental credits that are recognized as assets.

BC38. In response to comment letter feedback, the Board considered whether an environmental credit is within the scope of the amendments in this Update when an entity is contractually required to distribute its environmental credits to another entity. The Board indicated that an entity should evaluate the attributes of the environmental credit in assessing whether an environmental credit is capable of being separately transferable in an exchange transaction. Therefore, a contractual restriction preventing an entity from transferring an environmental credit should not, in isolation, result in an environmental credit failing to meet the transferability requirement.

Income tax credits

BC39. The amendments in this Update specify that an income tax credit that may be used to settle an entity's income tax liability, regardless of whether the entity has a tax liability or intends to use the credit for that purpose, is not an environmental credit.

BC40. Comment letter respondents broadly agreed that transactions that are within the scope of Topic 740, Income Taxes, should be excluded from the scope of the amendments in this Update. However, some respondents observed that there is no guidance directly applicable to transferable tax credits. The Board acknowledges that certain transferable or refundable income tax credits, such as those originating from the Inflation Reduction Act of 2022, are issued to promote the production of renewable energy or activity that purports to reduce the effects of pollution on the environment. The Board considered this feedback but affirmed its conclusion that the scope of this Update should exclude transferable tax credits because the accounting for those transferable tax credits does not relate to the primary objective of this Update.

Environmental Credit Obligation

BC41. The amendments in this Update require that an obligation that meets the following definition is an environmental credit obligation within the scope of this Update:

> A regulatory compliance obligation arising from existing or enacted laws, statutes, or ordinances represented to prevent, control, reduce, or remove emissions or other pollution that may be settled with environmental credits. Obligations within the scope of Subtopic 410-30 are not environmental credit obligations.

BC42. In defining the environmental credit obligations that are affected by the amendments in this Update, the Board considered the nature and terms of various regulatory compliance programs that obligate an entity to provide economic resources, such as cash or environmental credits. Those regulatory compliance programs include domestic and global cap-and-trade programs, the U.S. Renewable Fuel Standard, and U.S. State Renewable Portfolio Standards.

BC43. The Board leveraged the Master Glossary's definition of *legal obligation* when developing the definition of *environmental credit obligation*. A *legal obligation* is defined in the Master Glossary as "an obligation that a party is required to settle as a result of an existing or enacted law, statute, ordinance, or written or oral contract or by legal construction of a contract under the doctrine of promissory estoppel." By doing so and referencing that the obligation may be settled with environmental credits, as defined, the Board expects that practice will be able to readily identify environmental credit obligations that are within the scope of the amendments in this Update.

BC44. The Board also decided to clarify the types of obligations within the scope of this Update by including "is represented to prevent, control, reduce, or remove emissions or other pollution" in the definition to be consistent with the definition of environmental credit.

BC45. The Board clarified that environmental remediation obligations within the scope of Subtopic 410-30, Asset Retirement and Environmental Obligations—Environmental Obligations, are not environmental credit obligations, regardless of whether those obligations can be settled using environmental credits. The Board observed that obligations accounted for in accordance with Subtopic 410-30 have historically been associated with remediating the effects of past activities, such as the improper treatment or release of hazardous waste, and are generally not governed by ongoing regulatory compliance programs permitting settlement with environmental credits. Therefore, the Board decided that those obligations, regardless of the permitted methods of settlement, should continue to be accounted for in accordance with Subtopic 410-30.

BC46. The Board decided that an entity's voluntary emission-reduction initiatives (for example, net zero and carbon neutral initiatives), including those that it intends to satisfy, in full or in part, with environmental credits, are not within the scope of this Update. The Board reached that decision primarily because those voluntary initiatives do not establish accounting liabilities and are distinct from and dissimilar to regulatory compliance programs established and administrated by governments and regulators.

BC47. Most comment letter respondents agreed with the definition of an environmental credit obligation and indicated that the definition is clear and operable. Other comment letter respondents that disagreed with the definition of an environmental credit obligation generally requested that additional types of obligations be included in the definition. For example, some respondents suggested that the definition should be expanded to include (a) obligations beyond those arising from various regulatory compliance programs and (b) an entity's voluntary emission-reduction initiatives. The Board observed that those suggestions were considered during initial deliberations and, for the reasons described above, affirmed its decision not to expand the definition of an environmental credit obligation.

Environmental Credits

Recognition

BC48. The amendments in this Update require that an entity recognize an environmental credit as an asset if it is probable that the entity will use the environmental credit to settle an environmental credit obligation (as defined), transfer the environmental credit in an exchange transaction, or use the environmental credit in a nonreciprocal transfer. The amendments require that an entity recognize the cost of all other environmental credits as an expense as incurred, including nonrefundable deposits for environmental credits that are not probable of being used to settle an environmental credit obligation, transferred in an exchange transaction, or used in a nonreciprocal transfer. Comment letter feedback on the recognition of an environmental credit was mixed. Some respondents indicated that the amendments in the proposed Update were clear and operable. Other respondents disagreed because they supported the recognition of all (or most) environmental credits, including voluntary environmental credits, as assets. Respondents' feedback on recognition is further discussed throughout paragraphs BC49 through BC60.

BC49. The Board decided that environmental credits represent assets in accordance with Concepts Statement 8, and comment letter respondents broadly agreed. The Board observed that environmental credits are used by entities in the following ways:

a. To settle an environmental credit obligation
b. To transfer in an exchange transaction
c. In a nonreciprocal transfer
d. To meet voluntary environmental initiatives (for example, net zero initiatives and regulatory emissions reporting).

BC50. The Board considered whether all environmental credits should be recognized as assets. Although the Board acknowledges that all environmental credits, as defined, represent assets in accordance with Concepts Statement

8, the Board concluded that the uses of the credits described in paragraph BC49 (a) through (c) represent present economic benefits (that is, economic benefits that exist at the date that those environmental credits are obtained), while the use described in (d) does not. The Board considers the ability to use an item to settle an existing or future enforceable obligation as evidence that a present right to an economic benefit exists. In addition, the Board believes that the ability to transfer an item in an exchange transaction or a nonreciprocal transfer provides compelling evidence that a present right to an economic benefit exists. In contrast, the Board believes that, in isolation, the ability to use an item to meet internally established initiatives, such as emission-reduction targets or for societal benefits that are not exclusive to an entity, does not represent a present right to an economic benefit. Therefore, in developing the recognition guidance for environmental credits, the Board decided that recognition should be based on an entity's intended use of the credit and the economic benefits expected to be realized, if any, from that use.

BC51. Comment letter respondents broadly agreed with the intent-based model for determining whether an environmental credit should be recognized as an asset. The Board acknowledges that assessments of intent are inevitably subjective and decided that those assessments are necessary for determining whether an entity will realize a present economic benefit from an environmental credit. However, other comment letter respondents disagreed with this approach for the following reasons:

a. It would require significant judgment and may be challenging to apply.
b. An entity's intended use of an environmental credit may change over time.
c. Regardless of an entity's intended use of an environmental credit, environmental credits meet the definition of an asset in Concepts Statement 8.
d. Environmental credits that are expected to be used voluntarily continue to provide economic benefits because they can be used at a future date voluntarily, transferred in an exchange transaction, used in a nonreciprocal transfer, or, if applicable, used to settle an environmental credit obligation.

BC52. The amendments in the proposed Update indicated that an environmental credit should be recognized as an asset only if it is probable that the environmental credit will be used by an entity to settle an environmental credit obligation or transferred in an exchange transaction (that is, the proposed Update did not include the use of an environmental credit in a nonreciprocal transfer). However, some comment letter respondents identified additional uses for environmental credits that should be included in the final guidance, most notably nonreciprocal transfers to another party. Comment letter respondents highlighted nonreciprocal transfers in which an investee distributes environmental credits to an investor, as well as environmental credits that are donated to a not-for-profit entity. The Board agreed that receiving an environmental credit in a nonreciprocal transfer provides the recipient with a present economic benefit. Therefore, the Board decided that in determining whether to recognize an environmental credit as an asset, an entity should consider the likelihood of using the environmental credit in a nonreciprocal transfer, along with settling an environmental credit obligation liability or transferring it in an exchange transaction. The Board noted that, generally, the accounting for nonmonetary transactions (for example, nonreciprocal transfers) are typically based on the fair value of the assets or services involved. If the Board did not permit an entity to recognize environmental credits that the entity intends to use in a nonreciprocal transfer, the entity likely would recognize a gain when it uses those environmental credits in a nonreciprocal transfer. While the Board agreed that an environmental credit that an entity expects to use in a nonreciprocal transfer should be recognized as an asset, it noted that transfers executed in the form of spinoffs or split-offs of businesses, as well as retiring or otherwise transferring an environmental credit to a registry, do not constitute nonreciprocal transfers for purposes of applying paragraph 818-20-25-1.

Voluntary environmental credits

BC53. The amendments in this Update require that an entity immediately expense environmental credits that are not probable of being used to settle an environmental credit obligation, transferred in an exchange transaction, or used in a nonreciprocal transfer.

BC54. One reason that the Board supports immediate expense recognition of those credits is that an entity's decision to use environmental credits for voluntary purposes effectively is a decision to forgo the realization of a present economic benefit. The Board also considered other expense recognition in GAAP that is based on an entity's intent. For example, Subtopic 360-10, Property, Plant, and Equipment—Overall, indicates that a long-lived asset to be abandoned is disposed of when it ceases to be used. Additionally, some Board members consider an entity's voluntary use of an environmental credit as similar to marketing costs intended to increase an entity's brand value, which are generally expensed as incurred. Some Board members consider the voluntary use of environmental credits as analogous to a contribution and noted that the contribution is like the retirement of the environmental credit to satisfy voluntary initiatives. Those Board members highlighted that Subtopic 720-25, Other Expenses—Contributions Made, requires that an entity recognize contributions and unconditional promises to give as expenses in the period made.

Nonrefundable deposits made for voluntary environmental credits

BC55. The amendments in this Update limit the expense recognition for commitments to acquire environmental credits to nonrefundable deposits made for voluntary environmental credits. Therefore, if an entity makes a nonrefundable deposit for environmental credits for which it is not probable that the environmental credits will be used to satisfy an environmental credit obligation, transferred in an exchange transaction, or used in a nonreciprocal transfer, the entity would be required to expense the amount of that deposit when it is paid. Although many comment letter respondents supported expensing nonrefundable deposits for voluntary credits, some comment letter respondents did not. Those comment letter respondents who disagreed with the amendments in the proposed Update suggested that an entity recognize an asset upon making the deposit and reclassify the deposit as an intangible asset when the environmental credits are received. Those comment letter respondents also generally supported capitalizing voluntary credits and observed that practice typically recognizes assets for deposits to obtain goods or services at a future date.

BC56. Some Board members also did not support immediate expense recognition of nonrefundable deposits for voluntary environmental credits and indicated that those nonrefundable deposits are a deferred expense akin to a prepayment for marketing expenses. However, the majority of the Board reasoned that the entity conditionally transferred an economic resource through the nonrefundable deposit and should not be permitted to recognize a prepaid asset for a cost that will be recognized as an expense when the item is received. The majority of the Board also reasoned that immediately expensing nonrefundable deposits for voluntary environmental credits aligned the accounting with Subtopic 720-25, which requires that an entity recognize unconditional promises to give as expenses in the period made.

Probable threshold

BC57. The amendments in this Update include a probable threshold for determining whether an environmental credit should be recognized as an asset. The Board observed that determining how an environmental credit will be used is a forward-looking assessment that is expected to require judgment in situations in which an entity uses environmental credits for multiple purposes. The Board decided that “probable” was sufficient to facilitate the recognition of assets in situations in which an entity could determine with a high degree of confidence that it will use the asset in ways that result in the realization of a present economic benefit without being overly restrictive or permissive. Specifically, the Board considered but dismissed other recognition thresholds such as “virtually certain” or “remote” for that reason.

BC58. The Board also observed that *probable* is defined in the Master Glossary as “the future event or events are likely to occur” and is used in many areas of GAAP, including Topic 450, Topic 606, Revenue from Contracts with Customers, Topic 705, Cost of Sales and Services, Topic 718, Compensation—Stock Compensation, Topic 730, Research and Development, and Topic 842, Leases. Stakeholders, including comment letter respondents, indicated that the probable threshold is widely understood in practice and is expected to be operable for determining whether an environmental credit should be recognized as an asset.

Initial classification

BC59. The amendments in this Update specify that an entity that recognizes an environmental credit as an asset should classify that environmental credit as a compliance environmental credit or noncompliance environmental credit at initial recognition. The Board decided to make this clarification in response to comment letter feedback that suggested that the Board specify that an entity should determine the classification of environmental credits recognized as assets as either compliance or noncompliance when the asset is initially recognized (as opposed to at the reporting date immediately after the environmental credit is obtained). The Board noted that classifying a recognized environmental credit at initial recognition will ensure that any environmental credit used is derecognized at an amount determined by the costing method of the pool to which it relates.

BC60. The amendments in this Update also do not require that an entity determine at the individual environmental credit level whether it is probable that it will use the environmental credit to settle an environmental credit obligation, transfer the environmental credit in an exchange transaction, or use the environmental credit in a nonreciprocal transfer. The Board noted that determining the intended use of an environmental credit using a specific identification approach (that is, on an individual environmental credit basis) for recognition purposes may be impracticable in certain circumstances. For example, an entity may acquire a large quantity of identical environmental credits that it intends to use for multiple purposes, including voluntary purposes. Many stakeholders indicated that the recognition of environmental credits based on an entity's intended use would be more operable if the Board did not mandate that entities apply the recognition requirements in the amendments in this Update at the individual environmental credit level. On the basis of that stakeholder feedback, the Board decided to allow an entity to group environmental credits with similar characteristics for that purpose. Comment letter respondents broadly agreed with that approach.

Initial Measurement

BC61. The amendments in this Update require that internally generated environmental credits and granted environmental credits be initially measured at the transaction costs incurred, if any. Environmental credits that are obtained in a transaction initially measured in accordance with another Topic should follow the requirements of that other Topic. All other environmental credits should be initially measured at cost in accordance with the guidance on asset acquisitions in Subtopic 805-50, Business Combinations—Related Issues.

BC62. The Board considered whether explicit initial measurement requirements for environmental credits were necessary, given the current guidance for initial measurement of assets throughout GAAP. Stakeholders indicated that environmental credits should be measured at historical cost because GAAP requires that an entity initially measure many other nonfinancial assets, particularly most intangible assets, at historical cost. The Board decided that an environmental credit should be initially measured in the same manner as intangible assets (specifically, Subtopic 350-30 generally requires that an entity measure an intangible asset at its acquisition cost, including any associated transaction costs, in accordance with the guidance in paragraphs 805-50-30-1 through 30-4). Notwithstanding, the Board further decided that if an environmental credit is obtained through a transaction for which GAAP provides initial measurement requirements, an entity should apply that other GAAP. The implementation guidance in paragraph 818-20-55-6 provides examples of those initial measurement requirements. In addition, the Board added an example in response to comment letter feedback to clarify the initial measurement requirements for nonreciprocal transfers of environmental credits between entities under common control. The Board emphasized that an objective of the amendments is to address the accounting for items and transactions for which specific GAAP does not exist, not to alter current requirements.

BC63. The asset acquisition guidance (paragraphs 805-50-30-1 through 30-4) applies to a transaction or event in which assets acquired and liabilities assumed do not constitute a business. Therefore, the Board determined that it was necessary to develop initial measurement requirements for environmental credits granted by a regulator or its designee(s) to an entity and for internally generated environmental credits. The Board decided that those environmental credits should be measured in the same manner as acquired environmental credits. Therefore, the amendments in this Update require that initial measurement be limited to transaction costs, if any, associated with obtaining the environmental credit. The Board anticipates that many granted and internally generated environmental credits will have an initial measurement at or near zero because it expects that transaction costs will be minimal. The Board observed that the initial measurement of granted and internally generated environmental credits is consistent with that for most internally generated intangible assets. For example, the costs of internally developed intangible assets accounted for in accordance with Subtopic 350-30 are required to be recognized as an expense when incurred.

BC64. In developing the amendments in the proposed Update, the Board considered and decided not to permit an entity to allocate a portion of the costs associated with the activity or product giving rise to an environmental credit granted to an entity in a similar manner to the accounting under Topic 330. While current GAAP requires that an entity recognize and depreciate the physical assets (such as facilities and equipment) that are used to generate the environmental credits, the amendments in this Update require that an entity recognize the costs for activities to create environmental credits as an expense as incurred. Comment letter respondents provided feedback on internally generated environmental credits that are the sole output of an entity's production process, as well as environmental credits that are received from a regulator from products or processes that generate environmental credits. In response to that feedback, the Board reconsidered alternatives that would have permitted or required an entity to capitalize all, or some of, the costs associated with internally generated or granted environmental credits.

BC65. Some Board members acknowledged the potential merits of capitalizing the costs associated with internally generated or granted environmental credits. However, the Board decided not to permit the capitalization of costs associated with those environmental credits for several reasons.

BC66. First, requiring capitalization would have increased the expected ongoing costs to measure environmental credits. During the Board's initial deliberations, stakeholders indicated that determining a relevant and decision-useful amount to allocate a portion of production costs to environmental credits would be costly and likely would require significant judgment. Many comment letter respondents reiterated that feedback, noting that it often would be difficult or impracticable to accurately allocate a portion of production costs to environmental credits.

BC67. Second, the Board noted that attributing costs to internally generated or granted environmental credits would have been inconsistent with GAAP that generally prohibits capitalizing the costs of internally developing intangible assets, including costs to generate crypto assets and various costs to internally develop software to be sold, leased, or otherwise marketed. The Board also observed that the term *inventory,* as defined in the Master Glossary, includes only *tangible personal property*. Therefore, if the capitalization of costs associated with environmental credits had been permitted, the definition of *inventory* and the scope of Topic 330 would have needed to be expanded to include environmental credits.

BC68. Third, while an entity-wide election that permits capitalization of costs associated with environmental credits would have addressed the requests from certain stakeholders, other stakeholders may have preferred an election to capitalize costs associated with the activities to generate some environmental credits but not all environmental credits. Furthermore, optionality in the initial measurement of environmental credits would have led to inconsistency that could have diminished the usefulness of financial statement information.

BC69. The Board also considered but dismissed an alternative that would have permitted or required that an entity initially measure environmental credits at fair value. Some Board members observed that an environmental credit received through a grant from a regulator or its designee(s) differs from other governmental grants primarily because grants of environmental credits relate to preventing, reducing, or eliminating emissions or other pollution associated with an entity's operations. Broadly, stakeholders did not support requiring fair value measurement for environmental credits, emphasizing that currently there are no active markets for most types of environmental credits and that most types of credits are exchanged through bilateral contracts. Additionally, stakeholders noted that other than crypto assets, intangible assets obtained in any manner other than a business combination are not measured at fair value. Stakeholders also supported the initial measurement in the amendments in this Update because that initial measurement more appropriately depicts the resources that an entity expends to obtain an environmental credit than the initial measurement of environmental credits at fair value. Therefore, the Board concluded that limiting the initial measurement of an environmental credit (including granted environmental credits) to its transaction costs, if any, is preferable to fair value measurement.

Subsequent Measurement

BC70. The amendments in this Update require different subsequent measurement of environmental credits that an entity intends to use to settle an environmental credit obligation (compliance environmental credits) and all other environmental credits recognized as assets (noncompliance environmental credits). Specifically, the amendments require that compliance environmental credits not be subsequently remeasured. Noncompliance environmental credits should be subsequently measured at historical cost less impairment, if any. An impairment loss should be recognized if the carrying value of the environmental credit exceeds its fair value, measured as the excess of the carrying value over fair value.

BC71. Almost all stakeholders advocated for subsequently measuring an environmental credit based on how an entity intends to use the environmental credit. Specifically, stakeholders supported no subsequent remeasurement of an environmental credit that an entity intends to use to settle an environmental credit obligation (that is, no impairment requirements and no fair value measurement) because they view the costs to obtain those environmental credits as prepaid compliance costs. For the subsequent measurement of an environmental credit intended to be sold, stakeholders generally supported historical cost, less impairment, although some stakeholders that trade environmental credits (particularly those in active markets) requested that the Board consider a fair value option (see paragraphs BC88 through BC94).

BC72. The Board agreed that subsequent measurement of an environmental credit should be based on its historical cost and should consider an entity's intended use. The Board observed that recognizing an impairment loss on an environmental credit to be used to settle a compliance obligation would effectively accelerate the recognition of a compliance expense, which would likely not be relevant to investors. The Board concluded that subsequently measuring those environmental credits consistent with the cost to obtain the environmental credits will more appropriately depict the timing of an entity's compliance expenses.

BC73. The Board decided that noncompliance environmental credits should be tested for impairment at each reporting date. Noncompliance environmental credits are those environmental credits for which an entity has determined that it is not probable that it will use the credits to settle an environmental credit obligation but the intended use may not yet be determined. The Board considered whether to require that an entity perform an impairment test when a triggering event occurs or at each reporting date. The Board observed that the impairment triggering event for an environmental credit is a decline in the fair value of the environmental credit to an amount less than its carrying amount. The Board decided that continuous monitoring of environmental credit market prices to determine whether an impairment exists during a reporting period may be impracticable because most types of environmental credits trade infrequently. The Board noted that any expected benefit of requiring impairment testing more frequently than at each reporting date may not be justified by the expected costs.

BC74. Some comment letter respondents indicated that the proposed subsequent measurement requirements were clear and operable. Other comment letter respondents recommended changes to improve the operability of the subsequent measurement guidance, which are noted in paragraphs BC82, BC86, BC87, and BC89.

BC75. In particular, some comment letter respondents cited concerns about or requested additional guidance on how to test noncompliance environmental credits for impairment when observable prices in active markets do not exist. The Board acknowledges that determining the fair value of environmental credits that do not have observable prices in active markets may be complex in certain situations. However, the Board observed that the impairment test is required to be performed at each reporting date, rather than more frequently, which may mitigate some of that complexity.

Amortization

BC76. The amendments in this Update do not permit an entity to amortize the cost of an environmental credit. The Board acknowledges that environmental credits recognized as assets may have finite lives. Notwithstanding, the Board observed that the value of environmental credits generally does not deplete in a manner consistent with a finite-lived asset. Rather, the value of an environmental credit recognized as an asset is realized at a point in time through consideration received upon sale or the settlement of a liability. Comment letter respondents broadly agreed that an entity should not be permitted to amortize an environmental credit.

Establishing the intended use of an environmental credit

BC77. The amendments in this Update include two probable thresholds. The first probable threshold (described in paragraph BC57) is used to determine whether an environmental credit should be recognized as an asset. The second probable threshold is used to determine the appropriate subsequent measurement. Under the second probable threshold, an entity is required to determine whether it is *probable* that an environmental credit will be used to settle an environmental credit obligation. If so, that environmental credit should be classified as a compliance environmental credit, subsequently measured at cost, and not tested for impairment at each reporting date. All other environmental credit assets should be classified as noncompliance environmental credits and tested for impairment at each reporting date.

BC78. The Board decided to establish a second probable threshold to balance the risk that (a) an entity has to prove with a high degree of confidence how it intends to use an environmental credit and (b) an environmental credit is inappropriately classified and measured. The Board concluded that using a single probable threshold and combining the recognition and measurement determinations would have resulted in unintuitive financial reporting outcomes.

BC79. The Board observed that, consistent with the asset recognition requirements, determining how an entity intends to use an environmental credit is a forward-looking assessment. The Board expects that assessment will require judgment in situations in which an entity (a) uses environmental credits to settle environmental credit obligations, (b) transfers environmental credits in exchange transactions, or (c) uses environmental credits in nonreciprocal transfers. The Board expects that requiring different subsequent measurement requirements based on the intended use of an environmental credit will maximize the relevance and decision usefulness of the information being provided.

BC80. The Board also noted that the term *probable* is widely understood in practice and expects that the application of that term will be operable for determining the appropriate subsequent measurement classification. In instances in which the intended use of an environmental credit is not readily apparent, the Board decided to provide additional factors in the implementation guidance to increase operability. Comment letter respondents generally agreed with the amendments in the proposed Update, including the use of the term *probable* and the use of two probable thresholds—first to determine whether an environmental credit should be recognized as an asset and second to determine the appropriate subsequent measurement.

Classification reassessment

BC81. The amendments in this Update require that an entity reassess at each reporting date whether an environmental credit should be classified as a compliance environmental credit before applying the applicable subsequent measurement requirements. The Board observed that an entity may change its intended use of an environmental credit, particularly in situations in which the entity determines that it has insufficient or excess compliance environmental credits. If an entity determines that the classification of an environmental credit has changed, the entity should apply the impairment requirements at the reporting date. The Board provided the specific reassessment requirements in paragraph 818-20-40-2 primarily in response to stakeholders' requests for guidance on the application of the classification and subsequent measurement guidance at each reporting date.

BC82. A comment letter respondent requested that the Board establish tainting requirements to restrict an entity's ability to account for environmental credits as compliance environmental credits in the future because an entity could change the classification of its noncompliance environmental credits to compliance environmental credits in a subsequent reporting period. The Board decided not to establish explicit tainting requirements because unforeseen circumstances, including changes in laws and regulations, may change how an entity uses, or intends to use, an environmental credit and prohibiting entities to account for those changes could be overly restrictive. However, the Board considered that feedback and the need for transparent information about the income statement effect of the changes in the classification of an environmental credit when developing disclosure requirements, which is further discussed in paragraph BC138.

Costing methods

BC83. The amendments in this Update require that an entity use average cost; first-in, first-out (FIFO); or specific identification costing methods for subsequently measuring environmental credits (see paragraph 818-20-35-2). The Board decided to prescribe specific costing methods because some entities currently apply costing methods by analogy to other GAAP and stakeholders indicated that a specific identification method may often be impracticable. The Board observed that the permitted costing methods in the amendments in this Update also are permitted for measuring inventory in accordance with Topic 330.

BC84. For purposes of applying an average cost costing method, the Board noted that an entity may combine different vintage years of environmental credits into a single cost pool. However, the Board noted that other approaches to calculating average cost also may be acceptable.

BC85. The Board decided not to permit the other costing methods specified in Topic 330, including the last-in, first-out (LIFO) method. The primary reason for excluding those methods is because stakeholders indicated that average cost, FIFO, and specific identification methods are the most commonly used costing methods in practice for measuring environmental credits. The Board also sought to limit the number of permitted costing methods to promote a level of consistency in application among entities. In addition, the Board was concerned that including the LIFO costing method may have necessitated developing LIFO-specific requirements like those in Topic 330, which the Board determined would be overly complex. Comment letter respondents broadly agreed that the permitted costing methods are well established and operable.

BC86. Comment letter respondents also requested that the Board clarify that an entity cannot combine compliance environmental credits and noncompliance environmental credits within the same average cost or FIFO cost pool. Because compliance and noncompliance environmental credits are subject to different subsequent measurement requirements, the amendments in this Update clarify that an entity should apply the costing methods separately to compliance environmental credits and noncompliance environmental credits.

BC87. The amendments in the proposed Update would have permitted the use of a portfolio approach for *sufficiently similar* environmental credits. However, comment letter respondents that provided feedback on the application of the average cost and FIFO costing methods stated that a portfolio approach for subsequently measuring environmental credits would be unnecessary. The respondents observed that environmental credits would be measured using approaches consistent with those currently used to account for inventory, which are well established and incorporate grouping and pooling concepts. Specifically, an average cost method and FIFO costing method necessitate grouping assets with similar traits and characteristics. Therefore, the Board decided not to include specific portfolio requirements in this Update, which may have been interpreted as different from those currently used for applying the permitted costing methods.

Fair value measurement accounting policy election

BC88. The amendments in this Update permit an entity to make an accounting policy election by class to subsequently measure a class of eligible noncompliance environmental credit assets at fair value, with changes in fair value recognized in earnings. The Board decided that only noncompliance environmental credits obtained through an exchange transaction, a nonreciprocal transfer that is not a grant from a regulator or its designee(s), or a business combination should be eligible to be measured at fair value. The Board specified that an environmental credit measured at fair value as part of an entity's accounting policy should be measured at fair value until that environmental credit is derecognized. Most comment letter respondents agreed with the fair value measurement accounting policy election and indicated that the election as proposed was clear and operable.

BC89. In response to comment letter feedback, the Board decided to clarify that noncompliance environmental credits acquired in a business combination are eligible for the fair value measurement accounting policy election. A comment letter respondent observed that an entity also may acquire a noncompliance environmental credit in connection with a business combination and suggested that those types of credits should be eligible for the fair value measurement accounting policy election. The Board agreed with that feedback and clarified the election accordingly. In accordance with paragraph 810-10-30-2, the initial consolidation of a variable interest entity (VIE) that is a business is a business combination, and in accordance with paragraph 810-10-30-3, the primary beneficiary of a VIE that is not a business measures and recognizes the assets (except for goodwill) and liabilities of the VIE in accordance with Sections 805-20-25 and 805-20-30. Therefore, the Board noted that it also is appropriate for noncompliance environmental credits acquired in that manner to be eligible for the fair value measurement accounting policy election.

BC90. The Board considered whether to limit the fair value measurement accounting policy election to credits obtained from unrelated parties or to exclude a subset of related party transactions or arrangements. The Board decided not to limit the fair value measurement accounting policy election to credits obtained from unrelated parties because excluding all related party transactions may be overly restrictive. In addition, the Board noted that any material related party transactions would be subject to Topic 850, Related Party Disclosures, which should capture transactions that may warrant additional attention by investors.

BC91. The Board decided that noncompliance environmental credits that are internally generated or granted to an entity by a regulator or its designee(s) should be ineligible for the fair value measurement accounting policy election primarily because the initial measurement of those environmental credits is typically expected to be zero. However, some comment letter respondents stated that the fair value measurement accounting policy election should be available for all environmental credits regardless of how they were obtained. The Board observed that if the fair value measurement accounting policy election was permitted for granted or internally generated environmental credits, an entity would recognize an immediate gain in earnings solely by electing to subsequently measure the environmental credits at fair value. Additionally, the Board noted that GAAP does not permit an entity to elect fair value measurement for most nonfinancial assets, particularly those created by the entity, such as manufactured inventory.

BC92. The Board decided that the fair value measurement accounting policy election should be made for a class of noncompliance environmental credits and not on a credit-by-credit basis, primarily to provide investors with consistent measurement outcomes for similar noncompliance environmental credits. Comment letter respondents requested further clarification about what constitutes a class of eligible noncompliance environmental credits. In response, the Board clarified that determining what makes up a class of noncompliance credits that are eligible for the fair value measurement accounting policy election is an entity-specific determination. The Board further noted that entities should apply reasonable judgment in determining classes of noncompliance environmental credits.

BC93. The Board decided to provide a fair value measurement accounting policy election as opposed to requiring fair value for subsequently measuring certain noncompliance environmental credits. The Board observed that only environmental credits originating from a few well-established regulatory compliance programs are actively traded in observable markets. For example, emissions allowances originating from the EU Emissions Trading System and renewable identification numbers originating from the U.S. Renewable Fuel Standard are actively traded. Other environmental credits, such as renewable energy certificates, carbon offsets, and fuel economy credits, trade less frequently. The Board sought to provide entities that intend to trade environmental credits with the ability to reflect those activities through fair value measurement while not imposing additional costs on entities that may intermittently transfer environmental credits through bilateral arrangements. Finally, the Board observed that preparer and practitioner feedback received throughout the Board's deliberations strongly opposed requiring fair value measurement for environmental credits.

BC94. The amendments in this Update specify that a change in accounting policy to elect fair value measurement is subject to Topic 250, Accounting Changes and Error Corrections, including the requirements related to a change in accounting policy in an interim period in paragraphs 250-10-45-14 through 45-16. A change to the fair value measurement accounting policy would be considered a change in accounting principle under Topic 250 unless it is one of the circumstances not considered to be a change in accounting principle in paragraph 250-10-45-1 (for example, the entity is initially adopting a policy for a class of eligible noncompliance environmental credits). The only exception to the requirements of Topic 250 is included in paragraph 818-20-35-10, which prohibits entities from applying the change retrospectively to prior annual reporting periods.

Derecognition

BC95. The amendments in this Update require that an entity account for the derecognition of an environmental credit in accordance with Subtopic 610-20, Other Income—Gains and Losses from the Derecognition of Nonfinancial Assets, unless a scope exception from Subtopic 610-20 applies. For example, the scope of Subtopic 610-20 excludes the derecognition of a nonfinancial asset in a contract with a customer because that derecognition guidance is provided in Topic 606 on revenue from contracts with customers. The Board observed that the current derecognition guidance for nonfinancial assets is readily applied in practice and should be operable for environmental credits. The Board noted that the derecognition guidance typically will result in the derecognition of (a) compliance environmental credits upon remittance to a regulator or its designee(s) in satisfaction of an environmental credit obligation and (b) noncompliance environmental credits upon transfer to another party in an exchange transaction or in a nonreciprocal transfer.

BC96. Most comment letter respondents did not explicitly address the amendments in the proposed Update on the derecognition of environmental credits, and stakeholders consulted during staff outreach also indicated that the guidance is clear and operable. However, some comment letter respondents raised concerns about the application of the derecognition guidance in Subtopic 610-20 to environmental credits and indicated that the Board should clarify how that guidance applies to the derecognition of compliance environmental credits or suggested utilizing different derecognition criteria. The Board decided not to further amend the derecognition guidance related to environmental credits because the guidance in Subtopic 610-20 is currently applied in practice to other intangible assets and, based on the feedback received, is understandable and operable.

Recognition reassessment

BC97. The amendments in this Update require that at each reporting date an entity determine whether an environmental credit should continue to be recognized as an asset. Specifically, an entity is required to determine whether at that date an environmental credit is probable of being used to settle an environmental credit obligation, transferred in an exchange transaction, or used in a nonreciprocal transfer. If not, an entity is required to derecognize the carrying amount of the environmental credit through earnings. The Board decided to require this reassessment to ensure that environmental credits for which an entity does not intend to recognize the present economic benefits do not continue to be recognized as assets. Acknowledging that some comment letter respondents preferred a single subsequent measurement model for all recognized environmental credits, the Board noted that comment letter respondents broadly agreed that at each reporting date an entity should determine whether an environmental credit should continue to be recognized as an asset.

BC98. The Board also decided that an environmental credit previously derecognized or not initially recognized by an entity should not be recognized as an asset at any future date. The Board observed that scenarios can exist in which an entity determines that it is not probable that it will realize a present economic benefit of an environmental credit but does not formally retire the environmental credit on the registry that issued the environmental credit. In a subsequent reporting period, the entity may determine that it is probable that it will use that environmental credit for another purpose, such as to transfer it in an exchange transaction. Nevertheless, the Board included this requirement to enhance the operability of the guidance for environmental credits and to ensure that an entity is precluded from repeatedly derecognizing and recognizing an environmental credit (and the associated earnings).

Environmental Credit Obligations

Recognition

BC99. The amendments in this Update require that an entity:

a. Recognize a liability when events that occur on or before a reporting date result in an environmental credit obligation
b. Recognize a liability for regulatory compliance programs when an entity is obligated to transfer environmental credits or other economic benefits at the reporting date because of an entity's activities or events that occur on or before that date
c. Assume that the reporting date is the end of the regulatory compliance period, regardless of whether the regulatory compliance period ends after the reporting date, when determining whether a liability should be recognized at a reporting date
d. Recognize the costs associated with an environmental credit obligation liability in earnings or, if applicable, as part of another asset accounted for in accordance with another Topic.

BC100. Concepts Statement 8 defines *liability* as "a present obligation of an entity to transfer an economic benefit." Stakeholder feedback indicated that the types of regulatory compliance programs for which diversity in practice exists and guidance is needed are those that obligate an entity to transfer an economic benefit to a regulator or its designee(s) at a future settlement date because of emissions or other pollution from its activities. The Board considers an environmental credit to be an economic benefit that may be transferred to settle obligations arising from regulatory compliance programs. Furthermore, the Board observed that the regulatory compliance programs highlighted by stakeholders and the staff's research are legally enforceable through existing or enacted laws, statutes, or ordinances represented to prevent, control, reduce, or remove emissions or other pollution.

Events that result in an environmental credit obligation

BC101. In developing the recognition requirements for an environmental credit obligation, the Board noted that many regulatory compliance programs have settlement dates that differ from reporting dates. Therefore, the Board specified that when determining whether a liability should be recognized at a reporting date, an entity should assume that the reporting date is the end of the regulatory compliance period, regardless of whether the regulatory compliance period ends after the reporting date. The Board decided that:

a. An entity is presently obligated if previous emitting or polluting events or activities occurring on or before a reporting date obligate the entity to remit a quantity of environmental credits, assuming that the reporting date is the end of the compliance period, regardless of whether the compliance period ends on that date.
b. Considering an entity's future intended actions or activities that may increase, reduce, or eliminate the number of environmental credits due to a regulator at the end of the regulatory compliance period is not permitted because those actions or activities do not negate the existing present obligation at the reporting date.

BC102. Paragraphs 818-30-55-2 through 55-4 describe various regulatory compliance programs that result in environmental credit obligation liabilities. The Board noted that some regulatory compliance programs have specified emission-related obligating events that occur incrementally over a compliance period. Many of those obligating events cannot be reversed by an entity's future actions or activities. For example, global and domestic cap-and-trade programs typically obligate an entity to remit emissions allowances to a regulator for each metric ton of carbon emissions; U.S. State Renewable Portfolio Standards obligate an energy producer to remit renewable energy certificates to a regulator for producing a specified number of megawatt hours of energy. For those programs, the Board expects that the event or activity obligating an entity and necessitating liability recognition should be readily determinable.

BC103. Other regulatory compliance programs determine the quantity of environmental credits owed to a regulator at a settlement date considering an entity's events or activities over a compliance period. Under those programs, an obligation existing at a reporting date may be reduced by an entity's future actions or activities. The Board observed that for those programs, it is appropriate for an entity to (a) determine the amount of environmental credits that are owed to a regulator at the reporting date as if that date was the end of the compliance period without considering its intended future actions or activities for the remainder of the compliance period and (b) recognize a liability accordingly.

BC104. Some regulatory compliance programs obligate an entity to remit environmental credits to a regulator upon triggering a defined threshold of emissions. For those programs, the Board noted that a liability should not be recognized until the date that the threshold is surpassed.

BC105. Comment letter respondents provided mixed views on the amendments in the proposed Update on the recognition of an environmental credit obligation. Respondents did so for different reasons and on the basis of variations in the types of regulatory compliance programs. The key requests raised by comment letter respondents were to require or permit an entity to (a) recognize an environmental credit obligation liability before emissions exceed the established regulatory threshold and (b) consider future events and activities when recognizing and measuring an environmental credit obligation.

BC106. On the basis of comment letter feedback, the Board reconsidered whether to require or permit entities to recognize an environmental credit obligation liability before a defined threshold is triggered. Some comment letter respondents requested that the Board allow entities to recognize a liability for the regulatory compliance programs described in paragraph BC104 when an entity determines that it is probable at a reporting date that the established emissions threshold will be exceeded at a future date. Those comment letter respondents acknowledged that the types of regulatory compliance programs described in paragraph BC104 are not currently pervasive and the effect of those regulatory compliance programs is not expected to be material but that similar regulatory compliance programs potentially could emerge in the future. However, the Board decided not to permit forecasting that would allow an entity to recognize an environmental credit obligation liability before that entity exceeds the established emissions threshold.

BC107. During initial deliberations and on the basis of comment letter feedback, the Board also considered alternatives that would have required or permitted entities to forecast their future events or activities when recognizing environmental credit obligation liabilities. Under those alternatives, an entity would have been able to consider environmental credits that are expected to be received through:

a. Future grants from regulators that are conditional rights at the reporting date because they require an entity's future performance
b. Existing commitments to purchase variable quantities of environmental credits or fixed quantities at variable prices.

BC108. Some comment letter respondents observed that the regulatory compliance programs described in paragraph BC103 have compliance periods that span multiple reporting periods with settlement dates that typically do not align with reporting dates. Those respondents suggested that the Board permit or require that an entity consider future events and activities (typically those expected to generate additional environmental credits) that it expects will reduce or eliminate the liability on or before the settlement date. Many of those respondents noted that the inability to consider an entity's future activities or events will result in overstated liabilities and unnecessary income statement volatility in interim periods.

BC109. The Board decided not to permit or require that an entity consider future events or activities (including variable rates and quantities associated with purchase commitments) when recognizing an environmental credit obligation. The Board observed that doing so would be inconsistent with the definition of a liability in Chapter 4 of Concepts Statement 8 and other GAAP, such as Topic 740, which does not permit anticipating changes in future tax rates or laws or considering expected future net operating losses when recognizing an entity's income tax liability. The Board further noted that reducing or eliminating a present obligation by forecasting future events or activities may result in the recognition of benefits in earnings through lower liability and expense recognition before the benefits of those events and activities occur. Finally, the Board observed that making those forecasts with the necessary precision to accurately reflect the actual cash outflows at a settlement date may often be impracticable. Therefore, the Board observed that the model, as finalized, provides investors with better information and transparency.

Costs associated with the recognition of an environmental credit obligation liability

BC110. The amendments in the proposed Update did not specify where an entity should recognize the offsetting debit upon the recognition of an environmental credit obligation liability. Comment letter feedback indicated that the proposed amendments were unclear about whether an entity would be required to recognize the offsetting debit upon the recognition of an environmental credit obligation liability in earnings or would be permitted to capitalize the cost as part of another asset (for example, in accordance with Topic 330). Additionally, respondents commented that because the proposed amendments would require that an entity recognize subsequent measurement changes in an environmental credit obligation liability in earnings, an entity may have inferred that initial recognition also should be recognized in earnings. Board members observed that other accounting models permit an entity to capitalize certain costs as part of another asset, such as the costs capitalized as part of manufacturing inventory or placing an item of property, plant, and equipment into service. Therefore, the Board decided that an entity may recognize the offsetting debit upon the recognition of its environmental credit obligation liability as part of the carrying amount of another asset accounted for in accordance with another Topic.

Environmental credit obligations not based on activities or events

BC111. The amendments in the proposed Update provided specific recognition guidance for regulatory compliance programs that obligate an entity to remit a fixed number of environmental credits to a regulator at a future date because the entity exists at a specified date. Those regulatory compliance programs permit an entity to operate in a jurisdiction for a specified period and are fundamentally different from other regulatory compliance programs because they are essentially a fixed fee required to operate in a jurisdiction. In response to comment letter feedback, the Board did not affirm the amendments in the proposed Update and decided not to provide guidance on accounting for environmental credit programs that are not based on activities or events. The Board observed that those regulatory compliance programs are uncommon based on stakeholder feedback and research. Furthermore, some Board members were concerned that providing guidance specific to those regulatory compliance programs may cause confusion about whether that guidance should apply to other regulatory compliance programs or may be analogized to when considering transactions or arrangements with similar characteristics.

Initial Measurement

BC112. The Board decided that the most relevant and decision-useful measurement for environmental credit obligation liabilities is the cost basis of the economic benefits necessary at a reporting date to satisfy those liabilities. The Board observed that entities commonly satisfy environmental credit obligations with environmental credits but may also do so through cash-settlement mechanisms specified in regulatory compliance programs. Typically, the specified amount in those cash-settlement mechanisms significantly exceeds the cost to acquire environmental credits to satisfy an environmental credit obligation, in part to incentivize trading of environmental credits issued by a program. Considering that environmental credit obligations are satisfied either with environmental credits or with cash, the Board decided that those items represent the economic benefits to be transferred for that purpose.

BC113. Comment letter feedback on the proposed Update was mixed on the initial measurement of an environmental credit obligation liability. Some comment letter respondents indicated that the amendments in the proposed Update were clear and operable and did not provide any further comments or request clarifications. Other comment letter respondents disagreed with the proposed amendments or with certain aspects of the proposed amendments as further discussed in paragraphs BC114 through BC121.

Funded portion of an environmental credit obligation liability

BC114. On the basis of the rationale in paragraph BC112, the Board decided that at the reporting date, to the extent that an entity owned compliance environmental credits, the funded portion of an environmental credit obligation liability should be measured using the carrying amount of the entity's environmental credits that it expects to use to satisfy that liability. The Board specified that when measuring that funded portion, an entity should use the costing methods consistent with those applied when subsequently measuring its related compliance environmental credits. Stakeholders, during initial deliberations and in comment letter feedback, broadly supported this "linked" measurement approach. Additionally, the Board emphasized that, in accordance with the asset recognition and reassessment requirements in the amendments in this Update, environmental credits that were never recognized as assets or previously derecognized because an entity intended to use those environmental credits for voluntary purposes should not be considered when measuring the funded portion. The Board acknowledges that when an entity uses those environmental credits to satisfy an environmental credit obligation liability, the entity may recognize a gain when that liability is derecognized.

BC115. Some comment letter respondents supported the Board allowing entities to consider voluntary environmental credits that an entity still holds (that is, environmental credits that have not been retired on a registry) when measuring an environmental credit obligation liability. Those comment letter respondents indicated that if an entity intends to use the environmental credits to satisfy an environmental credit obligation liability, those environmental credits should be included in the measurement of the environmental credit obligation liability. The Board noted that including voluntary credits in the measurement of an environmental credit obligation liability would be conceptually inconsistent with the Board's decision that voluntary credits should not be recognized as assets. The Board's rationale for not allowing entities to recognize voluntary credits as assets is detailed in paragraphs BC53 through BC54.

Unfunded portion of an environmental credit obligation liability

BC116. For situations in which an entity at a reporting date does not have sufficient compliance environmental credits to satisfy a recognized environmental credit obligation liability (this is the unfunded portion of the environmental credit obligation liability), the Board decided that the unfunded portion should reflect the economic benefit that an entity would have to transfer at the reporting date to satisfy that portion. Because entities commonly satisfy environmental credit obligation liabilities by remitting environmental credits, the Board decided that an entity should initially measure the unfunded portion using the fair value of the environmental credits necessary to satisfy that portion at the reporting date. The Board observed that an entity should use the applicable requirements in Topic 820, Fair Value Measurement, to measure the fair value of the environmental credits that are necessary to satisfy the unfunded portion.

BC117. Notwithstanding, the Board acknowledges that entities are often permitted to settle an environmental credit obligation liability using cash. The Board decided that if an entity intends to settle the unfunded portion by remitting cash, it should initially measure that portion using the cash settlement amount specified by the regulatory compliance program. Stakeholders broadly supported the ability to measure the unfunded portion using the cash settlement amount if an entity intends to settle that portion using cash.

BC118. Some stakeholders also requested that the Board require that an entity consider arrangements at a reporting date to receive environmental credits before settlement of the liability for measuring the unfunded portion. Specifically, those arrangements include:

a. A purchase commitment existing for a fixed quantity of environmental credits at a fixed price to be received before settlement of the liability
b. An unconditional right to receive a fixed quantity of environmental credits either from a regulator as part of a regulatory compliance program or as part of a contract for which environmental credits are received as consideration.

BC119. The Board agreed that the arrangements in paragraph BC118 should be considered for measuring the unfunded portion if an entity (a) has an unconditional right at the reporting date to receive environmental credits through those arrangements before the settlement date of the environmental credit obligation liability and (b) intends to use the environmental credits that will be obtained for that purpose. The Board specified that an entity should measure the unfunded portion expected to be settled through the arrangements in paragraph BC118 (a) and (b) using the estimated cost basis of the related environmental credits.

BC120. Some comment letter respondents expressed concerns about measuring the unfunded portion of an environmental credit obligation liability when environmental credits are not actively traded in observable markets. Furthermore, stakeholder feedback indicated that when observable markets are not present, determining the fair value of environmental credits at a reporting date will likely involve Level 2 inputs, such as quoted prices for similar environmental credits in markets that are not active. The Board observed that although Level 2 inputs may be used to measure the fair value of the environmental credits needed to satisfy the unfunded portion of an environmental credit obligation liability when an active market does not exist, it may be more likely that the environmental credits needed to satisfy the unfunded portion of an environmental credit obligation liability will be measured using Level 3 inputs (that is, unobservable inputs). However, the Board noted that an entity is typically aware of the amount of consideration that the entity may have to transfer in the future to satisfy an obligation at a reporting date, which the Board believes generally will be achieved through acquiring environmental credits. Therefore, the Board decided to affirm that an entity should initially measure the unfunded portion of an environmental credit obligation liability using the fair value of the environmental credits necessary to satisfy that portion of the liability at the reporting date.

Bundled arrangements

BC121. The Board clarified in the implementation guidance that the estimated cost basis of environmental credits received in a bundled arrangement (for example, a power purchase arrangement) may differ from the fixed price per the contract because the amount allocated to the environmental credit in accordance with the guidance on asset acquisitions in Subtopic 805-50 may be different from the contractually stated price (see paragraph 818-30-55-6). Comment letter respondents noted that significant judgment is required to allocate the consideration transferred in bundled arrangements and noted that diversity in practice may exist when making that allocation. The Board observed that entities may need to use reasonable judgment to allocate consideration between the different components of bundled arrangements. However, the Board did not provide additional guidance on how an entity should allocate consideration when environmental credits are acquired in a bundled arrangement because Subtopic 805-50 already provides guidance.

Subsequent Measurement

BC122. The Board decided to require that an entity apply the initial measurement requirements in Subtopic 818-30 at each subsequent reporting date. Stakeholder feedback indicated that specific subsequent measurement guidance would enhance operability and reduce diversity in practice.

BC123. On the basis of comment letter feedback, the Board specified that any change in an environmental credit obligation liability from a previous reporting date should be accounted for consistent with its initial recognition in accordance with paragraph 818-30-25-1 (see paragraph BC110).

Derecognition

BC124. The Board decided that the derecognition requirements in Subtopic 405-20, Liabilities—Extinguishments of Liabilities, are appropriate for determining when an environmental credit obligation liability should be derecognized. Stakeholders that participated in outreach during initial deliberations and comment letter respondents broadly agreed with those derecognition requirements. Some indicated that most compliance programs clearly specify settlement procedures and the criteria for settlement, which are objective and verifiable. However, some comment letter respondents indicated that the Board should further clarify the application of the guidance in Subtopic 405-20 to environmental credit obligations. Therefore, the Board decided to clarify that the derecognition guidance in Subtopic 405-20 applies to environmental credits. As a result, that derecognition guidance applies when an environmental credit obligation is satisfied with environmental credits. The Board expects that an entity will derecognize those liabilities when the associated environmental credits or the necessary cash settlement amount has been remitted to a regulator. The Board generally does not expect that an entity will need to obtain a legal opinion to substantiate the derecognition of environmental credit obligation liabilities.

Specific Accounting Requirements for Interim Reporting Periods

BC125. The Board decided not to provide accounting requirements for interim reporting periods that differ from the requirements for annual reporting periods for environmental credit obligation liabilities. The Board observed that certain environmental credit obligation liabilities have some similar attributes to income tax obligations and that Topic 740 provides specific accounting requirements for interim reporting periods. The Board noted that Subtopic 740-270, Income Taxes—Interim Reporting, requires that an entity compute the year-to-date income tax provision and income tax liability. The Board determined that providing different interim reporting requirements for environmental credit obligation liabilities would necessitate estimating and forecasting future events and activities for an annual period, which is likely to differ from the compliance period. Along with concerns about forecasting future events and activities, the Board observed that different interim reporting requirements may result in information that is not relevant or decision useful. The Board reasoned that unless the compliance period was a calendar year and had a settlement date that aligned with an entity's annual reporting date, forecasting activities or events for an annual reporting period would likely be misaligned with actual outcomes upon the settlement of environmental credit obligation liabilities.

BC126. No comment letter respondents requested interim recognition and measurement requirements that differed from those for annual reporting purposes. Therefore, the Board affirmed its decision not to provide different accounting requirements for interim reporting periods for environmental credit obligation liabilities.

Presentation

BC127. The amendments in this Update require that an entity present its environmental credit assets separately from its environmental credit obligation liabilities on its balance sheet. Most Board members believe that separate presentation of those items will provide investors with transparent and decision-useful information about an entity's rights and obligations. Some Board members preferred net presentation of environmental credit obligation liabilities and their related compliance environmental credits, primarily because that presentation depicts the future net cash flows associated with an entity's regulatory compliance programs. Other Board members do not view this as a net presentation issue but rather as a different approach to presentation, that is, by regulatory compliance program. Under that approach, an entity would present the position of each regulatory compliance program individually (that is, each environmental credit obligation liability offset by its related environmental credits). However, other Board members and comment letter respondents observed that the right of setoff conditions in Subtopic 210-20, Balance Sheet—Offsetting, are not met for environmental credits and environmental credit obligation liabilities. Therefore, it would not be appropriate to present environmental credits and environmental credit obligation liabilities on a net basis.

BC128. Most comment letter respondents opposed permitting another exception to the offsetting requirements in Subtopic 210-20 and preferred that environmental credits be presented separately from environmental credit obligations on the balance sheet, noting that this presentation will provide investors with decision-useful information and best represent an entity's distinct rights and obligations. Ultimately, the Board decided to require that an entity present its environmental credits separately from its environmental credit obligation liabilities on its balance sheet.

Disclosure

BC129. In developing the qualitative and quantitative disclosures for environmental credits and environmental credit obligations, the Board considered disclosure requirements under current GAAP in other Topics; the information that should be included in disclosures on the basis of evaluating Chapter 8, *Notes to Financial Statements*, of Concepts Statement 8; and stakeholder feedback, particularly from investors. The amendments in the proposed Update provided a comprehensive set of disclosures, which allowed the Board to gather additional feedback on the clarity, operability, and any anticipated auditing challenges associated with those proposed disclosures.

BC130. Comment letter responses from preparers, practitioners, and others were mixed. Some broadly indicated that the proposed disclosure requirements were clear and operable. Other respondents commented that the proposed disclosures were overly detailed, that certain of the proposed disclosures may be less critical for investors or potentially could be prejudicial, and that certain of the proposed disclosures would be duplicative with other disclosures in GAAP. As described in the paragraphs below, in response to stakeholder feedback, the Board considered ways to refine the required disclosures, while still providing investors with decision-useful information. The Board directed the staff to conduct outreach with investors on an abridged version of the disclosures in the proposed Update. Those investors confirmed that the disclosures in this Update would be helpful and adequate for purposes of forecasting future cash flows resulting from an entity's environmental credit activities.

BC131. Stakeholder feedback and the staff's research indicated that most entities will likely not be subject to all of the disclosure requirements. The Board expects that entities will provide the applicable disclosures only for those environmental credits and environmental credit obligations that are considered material to an entity's financial position or its financial performance during a reporting period. However, an entity is not precluded from providing additional qualitative or quantitative information that it believes will allow users of its financial statements to better understand the entity's assets or obligations.

Environmental Credits

Qualitative disclosures

BC132. The amendments in this Update require that an entity disclose the types of environmental credits it owns and all of the following:

a. How the entity obtained environmental credits (acquired, granted, internally generated, or received in a nonreciprocal transfer)
b. How the entity intends to use the environmental credits (to settle environmental credit obligations, to transfer in an exchange transaction, to use in a nonreciprocal transfer, or to meet voluntary environmental initiatives)
c. The accounting policies used to account for the environmental credits in accordance with Topic 235, Notes to Financial Statements (for example, whether the environmental credits are subsequently measured using the average cost; first-in, first-out; or specific identification costing methods)
d. Significant estimates and judgments used in applying the guidance.

BC133. Comment letter respondents and investors broadly agreed with the qualitative disclosures for environmental credits. Specifically, investor feedback indicated that the qualitative disclosures will facilitate investors' ability to understand the nature and uses of an entity's environmental credits and will enable them to better understand an entity's key estimates and judgments in recognizing and measuring environmental credits.

Quantitative disclosures

BC134. For annual reporting periods, the amendments in this Update require that if not separately presented on an entity's balance sheet, the current and noncurrent assets portion of both of the following should be disclosed:

a. Compliance environmental credits
b. Noncompliance environmental credits.

An entity also is required to disclose the line item or items on the balance sheet that include the current and noncurrent assets portion of the amounts in (a) and (b) above.

BC135. Comment letter respondents and investors generally supported the disaggregation of compliance environmental credits and noncompliance environmental credits. Specifically, investors noted that understanding the current and noncurrent portions of environmental credits intended to be used for different purposes will better enable them to assess an entity's future cash flows resulting from the entity's environmental credit activities.

BC136. The Board also decided that quantitative and qualitative income statement information will enable investors to understand and analyze the following effects of an entity's environmental credits on its financial performance during an annual reporting period:

a. Total expense recognized for environmental credits not initially recognized as an asset or subsequently derecognized because the entity intended to use them voluntarily
b. Total impairment expense recognized during the reporting period, the nature of the environmental credits that were impaired, and a description of the facts and circumstances giving rise to the impairment
c. The line item or items in the income statement that include the amounts in items (a) through (b).

BC137. The staff conducted supplementary outreach with investors to ensure that the quantitative disclosures in the amendments in this Update provide sufficient information. Those outreach participants supported the income statement disclosures in this Update, emphasizing that the information will be useful in their analyses of the effects of an entity's environmental credit uses and decisions made during a reporting period. On the basis of the comment letter feedback, the Board expects that those disclosure requirements will be operable and that preparers should have the information available without undue cost because that information is needed to apply the accounting requirements in this Update.

BC138. In response to comment letter feedback, the amendments in this Update also require that an entity disclose additional information when it changes its use or intended use of its environmental credits as a result of applying the guidance in paragraphs 818-20-35-3 through 35-4 and 818-20-40-2. For annual reporting periods, an entity is required to disclose (a) the nature of the change in use or intended use as of the date that it occurs and (b) the related effect on earnings on that date, if any. The Board decided to require this disclosure to mitigate the concerns raised by comment letter respondents about the judgment inherent in requiring management's intent when determining the recognition and measurement of environmental credits. Specifically, the Board decided to add this disclosure requirement to provide investors with transparent information about the income statement effects of changes in how an entity intends to use its environmental credits.

BC139. On the basis of feedback received from comment letter respondents, the Board decided not to affirm the proposed disclosures that would have required that an entity disclose information for each significant environmental credit asset holding, the sales of environmental credits, and the cash that an entity paid for environmental credits during the reporting period. Those comment letter respondents indicated that the disclosures were overly detailed when compared with other significant nonfinancial asset disclosures (for example, inventory accounted for in accordance with Topic 330) and costly and potentially could provide information that would be less useful in investors' capital allocation decisions. Specifically, some preparer respondents indicated that the proposed significant holdings disclosure would be potentially prejudicial and could unfavorably affect an entity in its negotiations to purchase environmental credits needed to satisfy its current or future regulatory compliance program requirements. Several respondents also noted that for sales of environmental credits the proposed disclosures would be duplicative with other GAAP. Specifically, sales of environmental credits should be accounted for in accordance with Topic 606 when the transactions are with customers and Subtopic 610-20 when the transactions are with noncustomers, including the respective disclosure requirements. Furthermore, some of those respondents indicated, and the majority of the Board members agree, that the balance sheet disclosures combined with the qualitative disclosure requirements are operable and should provide investors with sufficient information.

Environmental Credit Obligations

Qualitative disclosures

BC140. For annual reporting periods, the amendments in this Update require that an entity disclose all of the following about regulatory compliance programs that result in the entity's environmental credit obligation liabilities:

a. The activities or events that result in environmental credit obligation liabilities under those programs, including the nature and timing of settlement provisions

b. The accounting policies used to account for the environmental credit obligations in accordance with Topic 235
c. How the unfunded portion of an environmental credit obligation liability is measured in accordance with paragraph 818-30-30-3
d. Significant estimates and judgments used in applying the guidance.

BC141. Investors and comment letter respondents broadly supported annual qualitative disclosure requirements. Specifically, investors indicated that the information will enable them to better understand an entity's regulatory compliance programs, the magnitude of current and future obligations, and the entity's intended methods of settling those obligations.

BC142. Stakeholders agreed that the information required to provide the qualitative disclosures will be readily available to an entity because that information will be necessary for the entity to apply the amendments in this Update to account for its environmental credit obligations.

Quantitative disclosures

BC143. For annual reporting periods, the amendments in this Update require that if not separately presented on an entity's balance sheet, the current and noncurrent portions of both of the following should be disclosed:

a. The funded portion of environmental credit obligation liabilities
b. The unfunded portion of those liabilities.

An entity also is required to disclose the line item or items on the balance sheet that include the current and noncurrent portions of amounts in (a) and (b) above.

BC144. Consistent with the Board's decisions for environmental credits, the amendments in this Update require that for annual reporting periods an entity disclose the total expense recognized for environmental credit obligation liabilities during the reporting period and the line item in the income statement that includes that amount.

BC145. Comment letter respondents broadly supported these disclosure requirements. Because the disclosures are at an aggregated level, the Board believes that it is unlikely that the information resulting from these disclosures will be prejudicial.

BC146. The Board clarified that an entity may recognize the offsetting debit upon the recognition of its environmental credit obligation liability as part of the carrying amount of another asset (for example, inventory). In addition, the Board decided that at each reporting date an entity should apply the initial measurement guidance in paragraphs 818-30-30-2 through 30-3 and may recognize any changes in an environmental credit obligation as part of another asset accounted for in accordance with another Topic. As a result, the amendments in this Update require that for annual reporting periods an entity disclose the total costs associated with environmental credit obligation liabilities that are capitalized in the carrying amount of another asset during the reporting period in accordance with another Topic, as well as a description of that other asset.

BC147. On the basis of feedback from comment letter respondents, the Board decided not to affirm the proposed amendments that would have required that an entity disclose (a) information about each significant environmental credit obligation liability and (b) disaggregated amounts of the total expense recognized for environmental credit obligation liabilities for accruals of emissions occurring during the reporting period and remeasurement of environmental credit obligation liabilities previously recognized. Comment letter respondents indicated that the disclosures would be overly detailed when compared with existing disclosures for other significant obligations, would be costly, and potentially could provide information that would be less useful in investors' capital allocation decisions. Comment letter respondents indicated that, similar to the proposed amendment that would have required that an entity disclose each significant environmental credit asset holding, the proposed significant obligations disclosure would be potentially prejudicial and could unfavorably affect an entity when negotiating the acquisition of environmental credits needed to satisfy its environmental credit obligation. Some of those respondents indicated, and a majority of the Board members agreed, that the balance sheet disclosures combined with the qualitative disclosure requirements are operable and should provide investors with sufficient information.

Interim Disclosures

BC148. The Board decided that the quantitative disclosures about environmental credits and environmental credit obligations should be required for annual reporting periods. Although the Board decided that the disclosures are required for annual reporting periods, the Board observed that an entity is required to consider whether additional disclosures are required in interim reporting periods under the interim disclosure principle in Topic 270, Interim Reporting, for events that have occurred since the end of the last annual reporting period that have a material impact on the entity. The Board concluded that requiring specific disclosures on an interim basis for events that do not have a material impact on the entity would have increased costs for preparers without a commensurate increase in the benefit provided to investors and that the interim disclosure principle will provide investors with relevant information about events that have occurred since the end of the last annual reporting period that have a material impact on the entity during interim reporting periods.

Fair Value Disclosures

BC149. The amendments in this Update require that an entity apply the fair value disclosure requirements in Topic 820 for any fair value measurements made in accordance with the guidance in Subtopic 818-20 and Subtopic 818-30. This Update does not change the applicability of fair value disclosures.

Consequential Amendments to Other Topics

Business Combinations

BC150. The amendments in this Update prescribe recognition and measurement requirements that are generally based on an entity's intended use of environmental credits. To provide clarity and reduce diversity in practice that may occur when applying Subtopic 805-20, Business Combinations—Identifiable Assets and Liabilities, and Any Noncontrolling Interest, to environmental credits acquired and environmental credit obligation liabilities assumed in a business combination, the Board decided to amend that Subtopic.

Environmental credits acquired

BC151. The Board decided that environmental credits acquired in a business combination are identifiable assets that should be recognized at the acquisition date, regardless of an acquirer's intended use of those environmental credits. Consistent with Subtopic 805-20, the amendments in this Update clarify that an acquirer should measure environmental credits acquired in a business combination at their acquisition-date fair value. Those environmental credits will subsequently be accounted for in accordance with the amendments for environmental credits.

BC152. The Board reasoned that although an acquirer may intend to use certain environmental credits acquired for voluntary purposes, those environmental credits can be separately transferred and meet the definition of an asset in Concepts Statement 8. The Board provided this guidance to clarify whether environmental credits that an acquirer intends to use voluntarily represent an asset at the acquisition date. The Board also observed that the amendments in this Update require that an entity recognize the cost of environmental credits acquired in another manner as an expense as incurred (when it is not probable that the environmental credit will be used to settle an environmental credit obligation, transferred in an exchange transaction, or used in a nonreciprocal transfer). However, the financial reporting outcome of doing so is the same as recognizing and immediately derecognizing environmental credits on the basis of an entity's decision to use environmental credits for voluntary purposes. The Board observed that an acquirer will derecognize those environmental credits immediately following the acquisition date.

BC153. The Board also specified in paragraph 805-20-25-15C that acquired items that otherwise would have met the definition of an environmental credit, but are not separately transferable, should not be recognized as assets in a business combination. The Board noted that the amendment in this Update to the accounting for business combinations is consistent with the definition of an environmental credit and the Board's decision to exclude those items from the scope of this Update. The Board indicated that the clarification in paragraph 805-20-25-15C prevents an acquirer from recognizing environmental credits as identifiable assets in a business combination when the acquiree retired those environmental credits as part of a voluntary initiative before the acquisition date.

BC154. During redeliberations, the Board considered including the same clarification in paragraph 805-20-25-15C that was included in the definition of an environmental credit (that is, if an item is no longer separately transferable in an exchange transaction, then the item must be able to be used to satisfy an environmental credit obligation to meet the definition of an environmental credit). However, the Board did not make that clarification within paragraph 805-20-25-15C because that paragraph refers to items that do not meet the definition of an environmental credit and the change to the definition addresses this issue.

Environmental credit obligation liabilities assumed

BC155. The amendments in this Update require that an acquirer measure environmental credit obligation liabilities assumed in a business combination using the measurement requirements for environmental credit obligation liabilities included within this Update instead of at their acquisition-date fair value. The Board observed that although it expects that the acquisition-date fair value of those liabilities will often be similar to the measurement in this Update, the amounts may differ in some situations. Specifically, the acquisition-date fair value would have required that an acquirer determine the price that it would pay to transfer the liability in an orderly transaction between market participants, which would have included considering factors beyond the compliance environmental credits acquired (funded portion) or expected cash outflows (unfunded portion). For example, an acquirer may be required to consider the effects of a regulator waiving assumed environmental credit obligation liabilities. Along with being more understandable and operable, requiring that an acquirer measure assumed environmental credit obligation liabilities in accordance with the amendments will approximate the economic resources ultimately transferred to settle that liability in most instances.

BC156. The amendments in the Update also require that an acquirer consider only those environmental credits acquired in the business combination that will be classified as compliance environmental credits when measuring the funded portion of its environmental credit obligation liability upon acquisition. As a consequence, the acquirer cannot consider its existing environmental credits when measuring the funded portion of its assumed environmental credit obligation liability. In addition, if applicable, the amendments require that an acquirer measure the unfunded portion of the assumed environmental credit obligation liability considering environmental credits that (a) will be received from the acquiree's existing purchase commitments and unconditional rights and (b) the acquirer intends to remit to settle the environmental credit obligation liability that it assumes from the acquiree in the business combination.

BC157. In response to comment letter feedback, the Board decided to clarify in the amendments in this Update that when evaluating whether an environmental credit obligation should be recognized in a business combination, an entity should determine whether environmental credits would be due assuming that the acquisition date is the end of the regulatory compliance period, regardless of whether the regulatory compliance period ends after the acquisition date. The Board observed that the clarification will prevent diversity in practice and aligns the recognition guidance for environmental credit obligation liabilities assumed in a business combination with the initial recognition guidance for environmental credit obligation liabilities in paragraph 818-30-25-1.

BC158. Some comment letter respondents also indicated that the Board should include explicit recognition guidance in Topic 805 for environmental credit obligation liabilities in the amendments in this Update. The Board decided not to provide explicit recognition requirements in Topic 805 for the following reasons:

a. When a present obligation exists at the acquisition date, an acquiree will have an environmental credit obligation liability recognized on its balance sheet accounted for in accordance with the liability recognition requirements in this Update. Therefore, an acquirer should be able to readily determine the environmental credit obligation liabilities assumed.
b. The acquiree and the acquirer are expected to reach the same recognition conclusions. This is because the Board's decisions on what should be recognized as an environmental credit obligation liability are consistent with the requirements for liability recognition in Subtopic 805-20. The liability recognition requirements in this Update and in the business combinations guidance are based on the recognition criteria in Concepts Statement 8.

Derivative Accounting

BC159. The amendments in this Update indicate that environmental credits and environmental credit obligations accounted for in accordance with Topic 818 are not subject to Subtopic 815-10. The Board is aware that practice has diverse views about the application of Topic 815. To address that diversity, the Board decided to provide a scope exception within Subtopic 815-10 and noted that an entity is not required to assess whether an environmental credit obligation (as defined) contains an embedded derivative with an underlying related to the price of an environmental credit.

BC160. The Board noted that a freestanding contract to obtain or sell an environmental credit in the future may be subject to derivative accounting under the requirements of Topic 815. However, that contract may not be accounted for as a derivative if it qualifies for any of the scope exceptions within Subtopic 815-10.

Fair Value Option

BC161. The Board decided to prohibit an entity from electing the fair value option in Topic 825, Financial Instruments, for environmental credit obligation liabilities. During the Board's initial deliberations, some stakeholders questioned whether entities would be permitted to elect the fair value option in Topic 825 to account for environmental credit obligation liabilities if those liabilities are financial liabilities. Specifically, when an entity is permitted to satisfy environmental credit obligation liabilities by remitting cash, those liabilities may be considered financial liabilities. The Board decided to prohibit the fair value option for environmental credit obligation liabilities to eliminate (a) multiple measurement methods for environmental credit obligation liabilities and (b) potential inconsistency between or within entities. Comment letter respondents did not explicitly address this issue.

Effective Date, Transition, and Transition Disclosures

BC162. The amendments in this Update are effective for public business entities for annual reporting periods beginning after December 15, 2027, and interim reporting periods within those annual reporting periods. Comment letter respondents provided varying perspectives about the time necessary to implement the amendments, noting that entities will need sufficient time to appropriately understand the amendments in this Update and establish effective processes, systems, and controls to apply the amendments. The Board concluded that an effective date for annual reporting periods beginning after December 15, 2027, and interim reporting periods within those annual reporting periods, should provide sufficient time for public business entities to implement the amendments in this Update.

BC163. For an entity other than a public business entity, the amendments in this Update are effective for annual reporting periods beginning after December 15, 2028, and interim reporting periods within those annual reporting periods.

BC164. Early adoption is permitted in an interim or annual reporting period in which financial statements have not yet been issued or made available for issuance. An entity adopting the amendments in an interim reporting period is required to adopt them as of the beginning of the annual reporting period that includes that interim reporting period.

BC165. The Board decided that as a result of the expected benefits for investors of providing trend information, the amendments in this Update should be adopted retrospectively through a cumulative-effect adjustment to the opening balance of retained earnings (or other appropriate components of equity or net assets in the balance sheet) as of the beginning of the annual reporting period of adoption, subject to specific transition requirements in paragraph 818-10-65-1. The Board clarified that the date of initial application is the beginning of the reporting period in which an entity first applies the amendments.

BC166. Realizing the expected costs of adopting the amendments in this Update, the Board considered ways to mitigate the cost and complexity of the retrospective transition requirements. The Board decided that to enhance the operability of initially applying the amendments while providing investors with relevant and decision-useful information upon transition, an entity should apply various transition requirements, as described in paragraph 818-10-65-1.

BC167. Observing significant diversity in practice currently in the recognition, measurement, presentation, and disclosure of environmental credits and environmental credit obligations resulting from the lack of specific authoritative guidance, the Board decided that applying the amendments in this Update retrospectively without the additional transition requirements described in paragraph 818-10-65-1 may often be inoperable.

BC168. The Board considered the transition disclosure requirements in Topic 250 and decided to require that entities provide the transition disclosures in paragraph 250-10-50-1(a), (b)(3), and (c) and paragraph 250-10-50-2. The transition disclosure required by paragraph 250-10-50-1(b)(3) should be as of the beginning of the annual reporting period of adoption rather than as of the beginning of the earliest period presented. The Board decided not to require the transition disclosures in paragraphs 250-10-50-1(b)(2) and 250-10-50-3 because those disclosures would require that an entity account for environmental credits and environmental credit obligations under current guidance and the amendments in this Update for the current period, which would have been overly burdensome. The Board also observed that the transition disclosure requirement in paragraph 250-10-50-1(b)(1) does not apply because an entity is not permitted to adopt the amendments on a full retrospective basis.

Application to Private Companies and Not-for-Profit Entities

BC169. The Board decided that the amendments in this Update should be consistently applied by all entities. The Board considered the *Private Company Decision-Making Framework: A Guide for Evaluating Financial Accounting and Reporting for Private Companies*, and consulted with the Private Company Council (PCC) in assessing whether differences are warranted for private companies. Through its discussions, the PCC observed that the accounting for environmental credits and environmental credit obligations is not currently a pervasive issue for private companies. PCC members acknowledged limited exposure to environmental credits and environmental credit obligations in practice and did not express concerns about the decisions reached by the Board in this Update. Additionally, in discussions with the Not-for-Profit Advisory Committee, its members expressed sentiments similar to those of the PCC on the pervasiveness of the issues and applicability of this Update.

BC170. The amendments in this Update require that all entities disclose information about their environmental credits and environmental credit obligations. While a majority of comment letter respondents supported requiring the same disclosures for all entities, a few respondents preferred requiring fewer disclosures for nonpublic entities. However, in response to comment letter feedback, the Board decided not to affirm all of disclosures in the proposed Update and believes that decision should mitigate certain concerns raised by stakeholders.

BC171. In establishing the effective date for nonpublic entities, the Board considered comment letter feedback and the Private Company Decision-Making Framework and decided to provide an additional year for nonpublic business entities to adopt the amendments in this Update as described in paragraph BC163.

Comparison with IFRS Accounting Standards

BC172. Many respondents, including some users, to the IASB's Request for Information *Third Agenda Consultation*, which was issued in March 2021, rated a project on pollutant pricing mechanisms as a high priority. Those mechanisms are similar to the regulatory compliance programs and the voluntary initiatives addressed by the amendments in this Update. At its April 2022 meeting, the IASB concluded its deliberations on the feedback from its

Third Agenda Consultation and decided on its activities and work plan for 2022 to 2026. Although the IASB concluded that a project on pollutant pricing mechanisms was a high priority, it decided not to add the project to its work plan and, instead, decided that other projects were higher priorities at the time. At its November 2025 meeting, the IASB voted on potential topics, including pollutant pricing mechanisms, for potential addition to its work plan if capacity becomes available before the IASB's next agenda consultation.

Amendments to the GAAP Taxonomy

The amendments to the *FASB Accounting Standards Codification*® in this Accounting Standards Update require improvements to the GAAP Financial Reporting Taxonomy and SEC Reporting Taxonomy (collectively referred to as the "GAAP Taxonomy"). Those improvements, which will be incorporated into the proposed 2027 GAAP Taxonomy, are available through GAAP Taxonomy Improvements provided at www.fasb.org, and finalized as part of the annual release process.