

Proposed Accounting Standards Update

Issued: December 17, 2024

Comments Due: April 15, 2025

Environmental Credits and Environmental
Credit Obligations (Topic 818)

The Board issued this Exposure Draft to solicit public comment on Topic 818 of the *FASB Accounting Standards Codification*[®]. Individuals can submit comments in one of three ways: using the electronic feedback form on the FASB website, emailing comments to director@fasb.org, or sending a letter to “Technical Director, File Reference No. 2024-ED910, FASB, 801 Main Avenue, PO Box 5116, Norwalk, CT 06856-5116.”

Notice to Recipients of This Exposure Draft of a Proposed Accounting Standards Update

The Board invites comments on all matters in this Exposure Draft until April 15, 2025. Interested parties may submit comments in one of three ways:

- Using the electronic feedback form available on the FASB website at [Exposure Documents Open for Comment](#)
- Emailing comments to director@fasb.org, File Reference No. 2024-ED910
- Sending a letter to “Technical Director, File Reference No. 2024-ED910, FASB, 801 Main Avenue, PO Box 5116, Norwalk, CT 06856-5116.”

All comments received are part of the FASB’s public file and are available at www.fasb.org.

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. A copy of this Exposure Draft is available at www.fasb.org.

Copyright © 2024 by Financial Accounting Foundation. All rights reserved. Certain portions may include material copyrighted by American Institute of Certified Public Accountants. Content copyrighted by Financial Accounting Foundation, or any third parties who have not provided specific permission, may not be reproduced, stored in a retrieval system, or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording, or otherwise, without the prior written permission of Financial Accounting Foundation or such applicable third party. Financial Accounting Foundation claims no copyright in any portion hereof that constitutes a work of the United States Government.

Proposed Accounting Standards Update

Environmental Credits and Environmental Credit Obligations (Topic 818)

December 17, 2024

Comment Deadline: April 15, 2025

CONTENTS

	Page Numbers
Summary and Questions for Respondents.....	1–12
Amendments to the <i>FASB Accounting Standards Codification</i> ®	13–64
Background Information and Basis for Conclusions.....	65–104
Amendments to the GAAP Taxonomy.....	105

Summary and Questions for Respondents

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

The Board is issuing this proposed Update to improve the financial accounting for and disclosure of environmental credits and environmental credit obligations. This proposed Update provides recognition, measurement, presentation, and disclosure requirements for all entities that purchase or hold 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*, indicates that entities are increasingly subject to additional 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) 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.

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

1. Emissions allowances originating from domestic and global cap-and-trade programs
2. Corporate Average Fuel Economy (CAFE) credits originating from U.S. CAFE Standards

3. Renewable identification numbers originating from the U.S. Renewable Fuel Standard
4. 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 proposed Update.

The amendments in this proposed 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 proposed 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 proposed amendments.

Who Would Be Affected by the Amendments in This Proposed Update?

The amendments in this proposed Update would apply to all entities and would 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 sell or trade
 - c. For voluntary purposes, such as carbon neutral or net zero initiatives.
2. Generate environmental credits.

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

The amendments in this proposed Update would 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 proposed Update are enforceable rights represented to prevent, control, reduce, or remove emissions or other pollution that are separately transferable in an exchange transaction. Environmental credits are acquired, received through a grant from a regulator or its designee(s) as part of a compliance program, internally generated, or received in a nonreciprocal transfer that is not a grant from a regulator or its designee(s).

Recognition and Measurement

An entity would be 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 or (2) transferred to another party in an exchange transaction. An entity would be required to recognize costs to obtain all other environmental credits as an expense when incurred.

Environmental credits recognized as assets would be initially measured at cost unless received in a nonreciprocal transfer that is not a grant from a regulator or its designee(s). Environmental credits received through a grant from a regulator or internally generated by an entity initially would be measured at the amount of transaction costs incurred to obtain those environmental credits, if any.

An entity would be 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 would be subsequently measured at cost and not tested for impairment at each reporting period.
2. Noncompliance environmental credits. All other environmental credits owned by an entity would be subsequently measured at cost, less impairment losses, if any. Noncompliance environmental credits would be tested for impairment at the end of each reporting period. Impairment expense would 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 would be prohibited.

Additionally, an entity would be permitted to elect an accounting policy to measure certain classes of noncompliance environmental credits at fair value, with subsequent changes recognized through earnings.

Presentation

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

Disclosure

An entity would be required to disclose in each interim and annual reporting period information about significant environmental credit holdings, cash paid for environmental credits, revenues and gains and losses from sales of environmental credits, expenses for environmental credits not initially recognized (or subsequently derecognized because an entity intends to use those environmental credits for voluntary purposes), and impairment expense. An entity also would be required to provide the applicable fair value disclosures for noncompliance environmental credits measured at fair value in accordance with its accounting policy.

An entity also would be required to disclose in annual reporting periods qualitative information about how it obtains and uses environmental credits, significant estimates and judgments, and methods used in applying the environmental credit accounting requirements.

Environmental Credit Obligations

Environmental credit obligations as defined by the amendments in this proposed Update are enforceable obligations resulting from regulatory compliance programs represented to prevent, control, reduce, or remove emissions or other pollution that may or are required to 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 would be 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 proposed Update would 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 would be required to initially and subsequently measure an environmental credit obligation liability 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 would 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 would be derecognized when an entity remits the necessary environmental credits to a regulator.

Disclosure

The amendments in this proposed Update would require that an entity disclose in interim and annual reporting periods information about significant environmental credit obligation liabilities, 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), and expenses related to environmental credit obligation liabilities, disaggregated between accruals for emissions occurring and liability remeasurements during the

reporting period. An entity also would be required to provide the applicable fair value disclosures for the unfunded portion of environmental credit obligation liabilities.

For each annual reporting period, an entity would disclose the following information about its environmental credit obligations:

1. A description of regulatory compliance programs that the entity is subject to, including the nature, settlement provisions, types of environmental credits accepted as settlement, and activities that result in environmental credit obligations in those programs
2. How the unfunded portion of an environmental credit obligation liability is measured.

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

An entity would be required to apply the amendments in this proposed Update 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 and would not recast any financial statement information before the period of adoption. At the date of initial application, the entity would:

1. Recognize an environmental credit asset if it is probable that the entity will use the environmental credit to settle an environmental credit obligation or transfer the credit to another party in an exchange transaction.
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. 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 proposed 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.

The Board will determine the effective date after it considers stakeholder feedback on the amendments in this proposed Update. Early adoption would be permitted for both interim and annual reporting periods for which financial statements have not yet been issued (or made available for issuance). An entity adopting the amendments in this proposed Update in an interim reporting period would be required to adopt them as of the beginning of the annual reporting period that includes that interim reporting period.

Questions for Respondents

The Board invites individuals and organizations to comment on all matters in this proposed Update, particularly on the issues and questions below. Comments are requested from those who agree with the proposed guidance as well as from those who do not agree. Comments are most helpful if they identify and clearly explain the issue or question to which they relate. Those who disagree with the proposed guidance are asked to describe their suggested alternatives, supported by specific reasoning.

Environmental Credits

Question 1: Is the proposed definition of *environmental credit* clear and operable? Does the proposed definition of *environmental credit* capture the population of items that require specific accounting guidance? Please explain why or why not. If not, what changes would you suggest? Do you anticipate any auditing challenges? If so, please explain.

Question 2: The proposed amendments would require that an entity recognize an environmental credit as an asset when it is probable that the entity will use the environmental credit to settle an environmental credit obligation or transfer

that credit in an exchange transaction. Costs incurred to obtain all other environmental credits would be recognized as an expense when incurred.

- a. Do you agree with those proposed amendments, including the probability threshold? Should the costs incurred to obtain all other environmental credits be recognized as an expense when incurred? Please explain why or why not.
- b. Are the recognition requirements clear and operable? Please explain why or why not. If not, what changes would you suggest? Do you anticipate any auditing challenges? If so, please explain.

Question 3: The proposed amendments would require that an entity initially measure environmental credits recognized as assets at cost unless received in a nonreciprocal transfer that is not a grant from a regulator or its designee(s). For environmental credits received as a grant from a regulator or internally generated, cost would be limited to the transaction costs to obtain those environmental credits, if any. Are the proposed initial measurement requirements clear and operable? Please explain why or why not. If not, what changes would you suggest? Do you anticipate any auditing challenges? If so, please explain.

Question 4: The proposed amendments would require that an entity subsequently measure an environmental credit based on whether it is determined to be a compliance or noncompliance environmental credit at the reporting date using a costing method (specific identification; first-in, first-out; or average cost). The subsequent measurement requirements in the proposed Update include:

- a. For a compliance environmental credit, an entity would subsequently measure the environmental credit at cost and would not test the environmental credit for impairment at each interim and annual reporting date.
- b. For a noncompliance environmental credit, an entity would be required to evaluate the environmental credit for impairment at each interim and annual reporting date.

An entity would be permitted to use a portfolio approach when applying the proposed subsequent measurement requirements to similar types of environmental credits. Are those proposed subsequent requirements clear and

operable? Please explain why or why not. If not, what changes would you suggest? Do you anticipate any auditing challenges? If so, please explain.

Question 5: The proposed amendments would permit an entity to make an accounting policy election to subsequently measure a class of eligible noncompliance environmental credit assets at fair value at the reporting date, with changes recognized in earnings. Is the proposed fair value measurement accounting policy election clear and operable? Please explain why or why not. If not, what changes would you suggest? Do you anticipate any auditing challenges? If so, please explain.

Question 6: The proposed amendments would require qualitative disclosures for annual reporting periods and quantitative disclosures for interim and annual reporting periods in accordance with paragraphs 818-20-50-1 through 50-7. Are the proposed disclosure requirements for interim and annual reporting periods clear and operable? Please explain why or why not. If not, what changes would you suggest? Do you anticipate any auditing challenges? If so, please explain.

Question 7: For investors, would the proposed recognition, measurement (including the fair value measurement accounting policy election for certain noncompliance environmental credits), and disclosure requirements for environmental credits provide decision-useful information? How would this information be used in your investment and capital allocation decisions? Are the proposed disclosure requirements sufficient? Are there other disclosures that would be decision useful? If so, please explain.

Environmental Credit Obligations

Question 8: Is the proposed definition of *environmental credit obligation* clear and operable? Does the proposed definition of *environmental credit obligation* capture the population of obligations that require specific accounting guidance? Please explain why or why not. If not, what changes would you suggest? Do you anticipate any auditing challenges? If so, please explain.

Question 9: The proposed amendments would require that an entity recognize an environmental credit obligation liability when events occurring on or before the reporting date result in an environmental credit obligation. The entity would be required to assume that the reporting date is the end of the compliance period. Are those recognition requirements clear and operable? Please explain

why or why not. If not, what changes would you suggest? Do you anticipate any auditing challenges? If so, please explain.

Question 10: The proposed amendments would require that an entity initially measure the funded portion of an environmental credit obligation liability using the carrying amount of compliance environmental credits associated with that obligation at the reporting date. If an entity has insufficient compliance environmental credits at a reporting date to satisfy an environmental credit obligation liability, the unfunded portion of its environmental credit obligation liability would be measured under the proposed amendments using the fair value of the environmental credits necessary to settle that portion of the liability at the reporting date, with certain exceptions (see paragraph 818-30-30-3(a) through (b) in this proposed Update). Are the proposed amendments for initially measuring the environmental credit obligation liability clear and operable? Please explain why or why not. If not, what changes would you suggest? Do you anticipate any auditing challenges? If so, please explain.

Question 11: The proposed amendments would require that at each interim and annual reporting date an entity subsequently measure an environmental credit obligation liability using the same method as initial measurement and recognize any measurement changes through earnings. Are the proposed amendments for the subsequent measurement of an environmental credit obligation liability clear and operable? Please explain why or why not. If not, what changes would you suggest? Do you anticipate any auditing challenges? If so, please explain.

Question 12: The proposed amendments would require that an entity account for the derecognition of an environmental credit obligation liability in accordance with Subtopic 405-20, Liabilities—Extinguishments of Liabilities. Is that proposed derecognition guidance clear and operable? Please explain why or why not. If not, what changes would you suggest? Do you anticipate any auditing challenges? If so, please explain.

Question 13: The proposed amendments would require that an entity present its compliance environmental credits separately from its environmental credit obligation liabilities on its consolidated balance sheet. Do you agree with that proposed presentation, or should environmental credit obligation liabilities be offset with their related compliance environmental credits and presented on a

net basis? Please explain why or why not. If not, what changes would you suggest?

Question 14: The proposed amendments would require qualitative disclosures for annual reporting periods and quantitative disclosures for interim and annual reporting periods in accordance with paragraphs 818-30-50-1 through 50-7. Are those proposed disclosure requirements clear and operable? Please explain why or why not. If not, what changes would you suggest? Do you anticipate any auditing challenges? If so, please explain.

Question 15: For investors, would the proposed recognition, measurement, and disclosure requirements for environmental credit obligation liabilities provide decision-useful information? Are the proposed disclosure requirements sufficient, and do they provide investors with sufficient information to understand the nature of those items, including noncash activity associated with the settlement of environmental credit obligation liabilities? How would that information be used in your investment and capital allocation decisions? Are there other disclosures that would be decision useful?

Transition and Effective Date

Question 16: An entity would be required to apply the proposed amendments 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. The entity would apply the proposed amendments as if they always had been applicable, subject to specific modifications to those requirements upon adoption. Are the proposed transition requirements clear and operable? Please explain why or why not. If not, what changes would you suggest? Do you anticipate any auditing challenges? If so, please explain.

Question 17: Would full retrospective application (compared with the approach described in Question 16) of the proposed amendments be operable and should it be permitted? Please explain why or why not.

Question 18: How much time would be needed to implement the proposed amendments? Should the effective date for entities other than public business entities differ from the effective date for public business entities? If so, how much additional time would you recommend for entities other than public

business entities? Should early adoption be permitted? Please explain your reasoning.

Private Companies

Question 19: The proposed amendments, including disclosures, would apply to all entities, including private companies. Do you agree? Are there any private company considerations that the Board should be aware of in developing a final Accounting Standards Update? Please explain your reasoning.

Amendments to the *FASB Accounting Standards Codification*[®]

Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2–10. 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** 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 separately transferable in an **exchange** transaction
- 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 to:

- a. Settle environmental credit obligations
- b. Sell or trade in an **exchange** transaction
- c. Meet voluntary environmental initiatives (referred to as using 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 within the scope of this Topic are outside the scope of Topic 815 on derivatives and hedging (as required by 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** 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 separately transferable in an **exchange** transaction
- 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, a credit may only be separately transferable momentarily because an entity retires the credit immediately after obtaining it or instructs another party, such as a broker, to do so. That credit 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. 202X-XX, *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. 202X-XX, *Environmental Credits and Environmental Credit Obligations (Topic 818)*:

Effective date and early adoption

- a. The pending content that links to this paragraph shall be effective for all entities for annual reporting periods beginning after [date to be inserted

after exposure], including interim reporting periods within those annual reporting periods. Early adoption is permitted for both interim and annual reporting periods for 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 must adopt the pending content as of the beginning of the annual reporting period that includes that interim reporting period.

Transition method

- b. An entity shall apply the pending content that links to this paragraph 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 period of adoption. An entity shall apply the pending content that links to this paragraph as if that pending content had always been applicable, subject to the guidance in (c) through (g). 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.
- c. An entity shall determine whether it should recognize an **environmental credit** as an asset at the date of initial application by applying the asset recognition requirements of paragraph 818-20-25-1 and considering the entity's intended use of its environmental credits at that date.
- d. An entity shall measure an environmental credit recognized as an asset at the date of initial application as follows:
 1. An environmental credit that is classified as a **compliance environmental credit** at the date of initial application 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 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 (d)(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 using the fair value of that environmental credit at the date of initial application.

- e. 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.
- f. An entity shall apply the liability recognition and measurement requirements of Subtopic 818-30 on environmental credit obligations at the date of initial application.
- g. An entity shall apply the pending content in paragraphs 805-20-25-15B through 25-15C and 805-20-30-31 prospectively to transactions accounted for as business combinations occurring after the date of initial application.

Transition disclosures

- h. 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.

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

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** 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 separately transferable in an **exchange** transaction
- 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

818-20-25-1 An entity shall recognize an **environmental credit** as an asset if it is **probable** that the environmental credit will be used by the entity to settle an **environmental credit obligation** or transferred by the entity in an **exchange** transaction. 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 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 to settle an environmental credit obligation or transfer it in an exchange transaction.

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

818-20-25-4 The recognition requirements in paragraph 818-20-25-1 are 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.

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.

818-20-35-7 An entity may use a portfolio approach in applying paragraphs 818-20-35-1 through 35-5. Portfolios shall comprise environmental credits that are sufficiently similar such that it is unlikely at a reporting date that an entity will recognize a significant loss upon the derecognition of an individual environmental credit from a portfolio. See paragraph 818-20-55-9 for implementation guidance on the application of this paragraph.

> Fair Value Measurement Accounting Policy Election

818-20-35-8 Notwithstanding the requirements of paragraphs 818-20-35-4 and 35-5, an entity may elect an accounting policy to subsequently measure a class of eligible (see paragraph 818-20-35-10) noncompliance environmental credits at fair value at the reporting date, with changes recognized in earnings.

818-20-35-9 An environmental credit subsequently measured at fair value in accordance with paragraph 818-20-35-8 shall continue to be measured at fair value until that environmental credit is derecognized. See paragraph 818-20-55-8 for implementation guidance on the application of this paragraph.

• > **Eligibility**

818-20-35-10 To be eligible for subsequent fair value measurement, a noncompliance environmental credit shall be obtained through either of the following:

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

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

• > **Changes in Fair Value Measurement Accounting Policy**

818-20-35-11 If an entity adopts the fair value measurement accounting policy election in an interim or annual reporting period, the entity shall apply Topic 250 on accounting changes and error corrections. However, notwithstanding the requirements of paragraph 250-10-45-5, an entity that elects 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. That adjustment to retained earnings shall be determined as 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. Prior annual reporting periods shall not be recast.

Derecognition

General

818-20-40-1 An entity shall account for the derecognition of 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, the derecognition of a nonfinancial asset in a **contract** with a **customer** shall be accounted for 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** or transferred in an **exchange** transaction, 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 or transferred in an exchange transaction. 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** expected to be transferred in an **exchange** transaction 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 a description of the following:

- a. How the entity obtains the environmental credits (acquired, granted, internally generated, or received in a **nonreciprocal transfer**)

- b. How the entity uses or intends to use the environmental credits (sell or trade, to settle **environmental credit obligations**, or for voluntary purposes)
- c. The entity's method for subsequently measuring environmental credits recognized as assets (first-in, first-out; average cost; or specific identification)
- d. If the entity accounts for environmental credits as a portfolio, how the entity determined the portfolio(s).

818-20-50-2 For annual reporting periods, an entity shall disclose significant estimates and judgments used in applying the guidance in this Subtopic.

818-20-50-3 For interim and annual reporting periods, an entity shall disclose the following for each significant environmental credit asset holding:

- a. Description
- b. Carrying amount
- c. The classification of the environmental credit in accordance with paragraphs 818-20-35-3 through 35-4.

An entity also shall disclose the aggregate carrying amount of environmental credits not considered individually significant.

818-20-50-4 For interim and annual reporting periods, if not separately presented on an entity's balance sheet, an entity shall disclose the current and noncurrent assets portion of each 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 amounts in items (a) and (b).

818-20-50-5 At interim and annual reporting periods, an entity shall disclose the following:

- a. Revenues from sales of environmental credits in **contracts** with **customers** and the carrying amount of those environmental credits at the date of sale.
- b. Gains and losses from sales of environmental credits to noncustomers and the carrying amount of those environmental credits at the date of sale.

- c. Total revenue (or gains) from sales of environmental credits that were never recognized as an asset in accordance with paragraph 818-20-25-1 or were previously derecognized in accordance with paragraph 818-20-40-2.
- d. 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.
- e. Total impairment expense recognized during the reporting period. Additionally, the nature of the environmental credits that were impaired and a description of the facts and circumstances giving rise to the impairment.
- f. The line item or items in the income statement that include the amounts in (a) through (e). See paragraphs 220-40-50-21 through 50-25 for additional disclosure requirements.
- g. Cash paid for environmental credits during the reporting period.

818-20-50-6 An entity shall apply the applicable **fair value** disclosure requirements in Topic 820 for noncompliance environmental credits subsequently measured at fair value in accordance with paragraph 818-20-35-8.

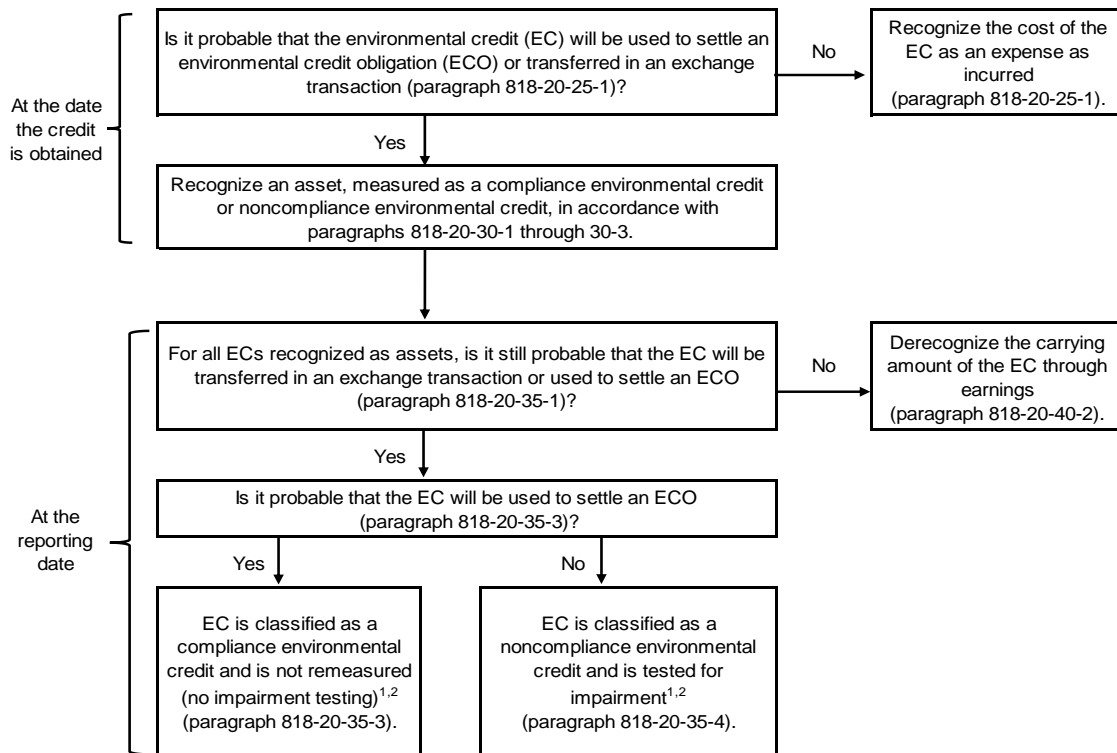
818-20-50-7 See paragraph 818-20-55-17 for an illustration of the quantitative disclosures required by this Subtopic.

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.



¹If the classification of the EC differs from the classification determined at the end of the previous reporting period, the EC is tested for impairment before it is reclassified (paragraph 818-20-35-5).

²The flowchart assumes an entity has not made an accounting policy election to remeasure noncompliance environmental credits at fair value at each reporting period (paragraph 818-20-35-8).

• > 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**, collectively, that the environmental credit will be used to settle an **environmental credit obligation** or transferred in an **exchange** transaction. 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 one of those two 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 incurred 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 or transferred in an exchange transaction. 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 or transferred in an exchange transaction:

- 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 818-20-25-4, an entity is not required to apply the recognition requirements in paragraph 818-20-25-1 at the individual environmental credit level. For example, if an entity acquires 1,000 Class A renewable energy certificates and determines that it is probable that it will use 900 of those renewable energy certificates to settle an environmental credit obligation or transfer in an exchange transaction, but does not know which individual environmental credits will be used for which purposes, the entity would recognize 900 Class A renewable energy certificates as environmental credit assets. The remaining 100 Class A renewable energy certificates would be 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 that are necessary to validate,

register, or authenticate an environmental credit so that the environmental credit may be separately transferred in an exchange transaction or used to settle an environmental credit obligation. 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 or **noncompliance environmental credit** in accordance with paragraphs 818-20-35-3 through 35-4. 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 would be recognized as an asset and classified as a compliance environmental credit. That compliance environmental credit would be measured at zero if an 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 requirements of that other Topic. For example:

- a. A renewable energy certificate received as consideration in a **contract** with a **customer** 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 should be initially measured in accordance with paragraph 845-10-30-1.

• > **Fair Value Measurement Accounting Policy Election**

818-20-55-7 Paragraphs 818-20-35-8 through 35-11 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. Eligible noncompliance environmental credits are those obtained in an exchange transaction or a nonreciprocal transfer that is not a grant from a regulator or its designee(s). 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 and is granted 20

similar renewable identification numbers from a regulator and 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 paragraph 818-20-35-5, 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 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 period until derecognized. Additionally, 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.

• > **Portfolio Approach**

818-20-55-9 An entity may use a portfolio approach to apply the subsequent measurement requirements. Portfolios should comprise environmental credits that are sufficiently similar such that it is unlikely at a reporting date that an entity will recognize a significant loss upon the derecognition of an individual environmental credit from a portfolio. Significant losses may arise from:

- a. The sale of an individual environmental credit within a portfolio in which the selling price of the individual environmental credit sold is less than its carrying amount established at the portfolio level
- b. Impairment of a portfolio of environmental credits upon the derecognition of an individual environmental credit within that portfolio. For example, if an individual environmental credit was sold at an amount greater than its carrying amount determined at the portfolio level upon derecognition, the fair value of the remaining portfolio may be reduced to an amount less than its carrying value, triggering an impairment loss.

Determining whether environmental credits are sufficiently similar to be subsequently measured as a single portfolio may be determined qualitatively or quantitatively (or a combination of both), depending on specific facts and circumstances.

> Illustrations

• > Applying the Environmental Credit Recognition and Measurement Requirements

818-20-55-10 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

818-20-55-11 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. 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 as compliance environmental credits, which is determined at each reporting date.

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

818-20-55-12 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 or transfer those carbon offsets in an exchange transaction, 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**

818-20-55-13 An entity that owns a solar renewable energy project in a state without renewable energy regulatory compliance programs uses a nationally accredited third-party registry to certify the project and issue renewable energy certificates to the entity as renewable electricity is produced. During January 20X4, the project's renewable energy generation results in 30,000 renewable energy certificates issued to the entity by the registry. The entity pays a \$1 per renewable energy certificate administrative fee to the registry. The entity intends to transfer all renewable energy certificates generated by its renewable energy project in exchange transactions. The entity recognizes the renewable energy certificates 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 818-20-35-10, 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**

818-20-55-14 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 transferred in an exchange transaction or used to settle an environmental credit

obligation 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 818-20-35-10.

• > **Applying Portfolio Requirements for Subsequent Measurement**

• • > **Example 5: Environmental Credits Are Not Sufficiently Similar**

818-20-55-15 On January 1, 20X4, an entity acquires 100 Class A renewable energy certificates (Environmental Credit As) for \$5 per credit and 100 Class B renewable energy certificates (Environmental Credit Bs) for \$8 per credit. The entity intends to transfer the environmental credits in exchange transactions and classifies them as noncompliance environmental credits. The entity uses an average cost method to subsequently measure its Environmental Credit As and Environmental Credit Bs. The entity concludes that Environmental Credit As and Environmental Credit Bs are not sufficiently similar and may not be accounted for within the same portfolio because:

- a. If subsequently measured in a single portfolio, the carrying amount of its Environmental Credit As and Environmental Credit Bs would be \$6.50 per renewable credit. The entity estimates that the fair value of Environmental Credit As is unlikely to be equal to or exceed the \$6.50 carrying amount upon a future sale and, therefore, determines that a significant loss upon the derecognition of individual Environmental Credit As may occur.
- b. Future sales of Environmental Credit Bs would likely result in an impairment loss for the remaining portfolio because the fair value of the remaining portfolio would likely be reduced to less than \$6.50 per credit upon the derecognition of Environmental Credit Bs.

The entity concludes that its Environmental Credit As and Environmental Credit Bs are not sufficiently similar in accordance with paragraph 818-20-35-7 because of the differences in their acquisition prices and estimated sales prices (derecognition event). Therefore, the entity may not subsequently measure its Environmental Credit As and Environmental Credit Bs in the same portfolio.

• • > **Example 6: Environmental Credits Are Sufficiently Similar**

818-20-55-16 Assume the same facts as Example 5, except that the entity intends to use its Environmental Credit As and Environmental Credit Bs to settle environmental credit obligations. The entity classifies those environmental credits as compliance environmental credits. The entity concludes that it is unlikely that a significant loss would be recognized upon the derecognition of an individual environmental credit from the portfolio and, thus, its Environmental Credit As and Environmental Credit Bs are sufficiently similar and may be subsequently measured in a single portfolio, in accordance with paragraph 818-20-35-7, for the following reasons:

- a. If subsequently measured within the same portfolio, the carrying amount of each environmental credit would be \$6.50. The entity should measure the associated environmental credit obligation liability when recognized in accordance with Subtopic 818-30 using that carrying amount. Therefore, remitting individual Environmental Credit As or Environmental Credit Bs to a regulator to satisfy that liability should have no earnings effect.
- b. Compliance environmental credits are not remeasured (that is, there are no impairment requirements).

• > **Applying the Quantitative Disclosure Requirements**

818-20-55-17 The following is an illustration of the quantitative disclosures required by paragraphs 818-20-50-3 through 50-5 for interim and 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 required by this Subtopic.

<u>Environmental Credit</u>	<u>As of December 31, 20X4</u>	
	<u>Carrying Amount</u>	<u>Classification</u>
EU emissions allowance	\$ 5,640	Compliance
State A cap-and-trade allowances	2,380	Compliance
State B cap-and-trade allowances	880	Compliance
State A solar renewable energy certificates	325	Noncompliance
State A cap-and-trade allowances	175	Noncompliance
Other (not significant) holdings	-	
Total	<u>\$ 9,400</u>	
Current portion	\$ 5,100	Compliance
Current portion	\$ 500	Noncompliance
Noncurrent portion	\$ 3,800	Compliance
Noncurrent portion	\$ -	Noncompliance

<u>Sales of Environmental Credits</u>	<u>For the Year Ended December 31, 20X4</u>		
	<u>Revenue</u>	<u>Other Income</u>	<u>Carrying Amount of Credits Sold</u>
Sales of noncompliance environmental credits with customers	\$ 5,322	\$ -	\$ 4,760
Sales of noncompliance environmental credits with noncustomers	\$ -	\$ 20	\$ 100
Sales of voluntary environmental credits with customers	\$ 40	\$ -	\$ -
Sales of voluntary environmental credits with noncustomers	\$ -	\$ 10	\$ -

<u>Environmental Credit Expense Information</u>	<u>For the Year Ended December 31, 20X4</u>
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 consolidated income statement.

(b) Impairment expense is recorded because of a decline in the fair market value of State A solar renewable energy certificates. Impairment expense is included in cost of goods sold in the consolidated income statement.

<u>Supplemental Cash Flow Information</u>	<u>For the Year Ended December 31, 20X4</u>
Cash paid for environmental credits	\$ 6,590

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** 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 separately transferable in an **exchange** transaction

- 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.

818-30-25-2 If an entity is obligated to remit a fixed number of environmental credits solely because the entity exists as of a specified assessment date (and not based on the entity's activities or events), the entity shall recognize a liability on the date that it becomes obligated to remit the environmental credits. In those circumstances, the entity also shall recognize a corresponding asset. That asset is separate from the environmental credits that will be used to satisfy the environmental credit obligation liability and shall be amortized over the compliance period as specified by the regulatory compliance program.

818-30-25-3 See paragraphs 818-30-55-2 through 55-5 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 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 and portfolio approaches 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:

- 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 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 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 reduce or eliminate its environmental credit obligation liability when applying paragraph 818-30-30-3.

818-30-30-5 See paragraphs 818-30-55-6 through 55-8 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.

818-30-35-2 Changes resulting from applying the initial measurement guidance in paragraphs 818-30-30-2 through 30-3 for an environmental credit obligation liability accounted for in accordance with paragraph 818-30-25-2 shall be recognized through an adjustment to the asset described in paragraph 818-30-25-2.

Derecognition

General

Environmental Credit Obligations

818-30-40-1 An entity shall account for the derecognition of 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 consolidated 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 initial 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 initial measurement of that liability.

Disclosure

General

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

- a. A description of the activities or events that result in environmental credit obligation liabilities under those programs
- b. The types of **environmental credits** accepted by those programs
- c. The nature and timing of settlement provisions
- d. Significant estimates and judgments made in accounting for the entity's environmental credit obligation liabilities
- e. How the unfunded portion of an environmental credit obligation liability is measured in accordance with paragraph 818-30-30-3.

818-30-50-2 For interim and annual reporting periods, an entity shall disclose the following for each significant environmental credit obligation liability:

- a. Description of the compliance program, including its jurisdiction
- b. Carrying amount, disaggregated between the funded and the unfunded portion.

An entity also shall disclose the aggregate carrying amount of environmental credit obligation liabilities not considered individually significant.

818-30-50-3 For interim and annual reporting periods, if not separately presented on an entity's balance sheet, an entity shall disclose the current and noncurrent portions of each of the following:

- a. The funded portion of an environmental credit obligation liability

b. The unfunded portion an environmental credit obligation liability.

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

818-30-50-4 For interim and annual reporting periods, an entity shall disclose the total expense recognized for environmental credit obligation liabilities, disaggregated between accruals for emissions occurring during the reporting period and remeasurement of environmental credit obligation liabilities previously recognized, and the line item in the income statement that includes that amount.

818-30-50-5 For interim and annual reporting periods, an entity shall disclose the total amortization expense recognized in accordance with paragraph 818-30-25-2.

818-30-50-6 An entity shall apply the applicable disclosure requirements in Topic 820 for the unfunded portion of environmental credit obligation liability measured at **fair value** in accordance with paragraph 818-30-30-3.

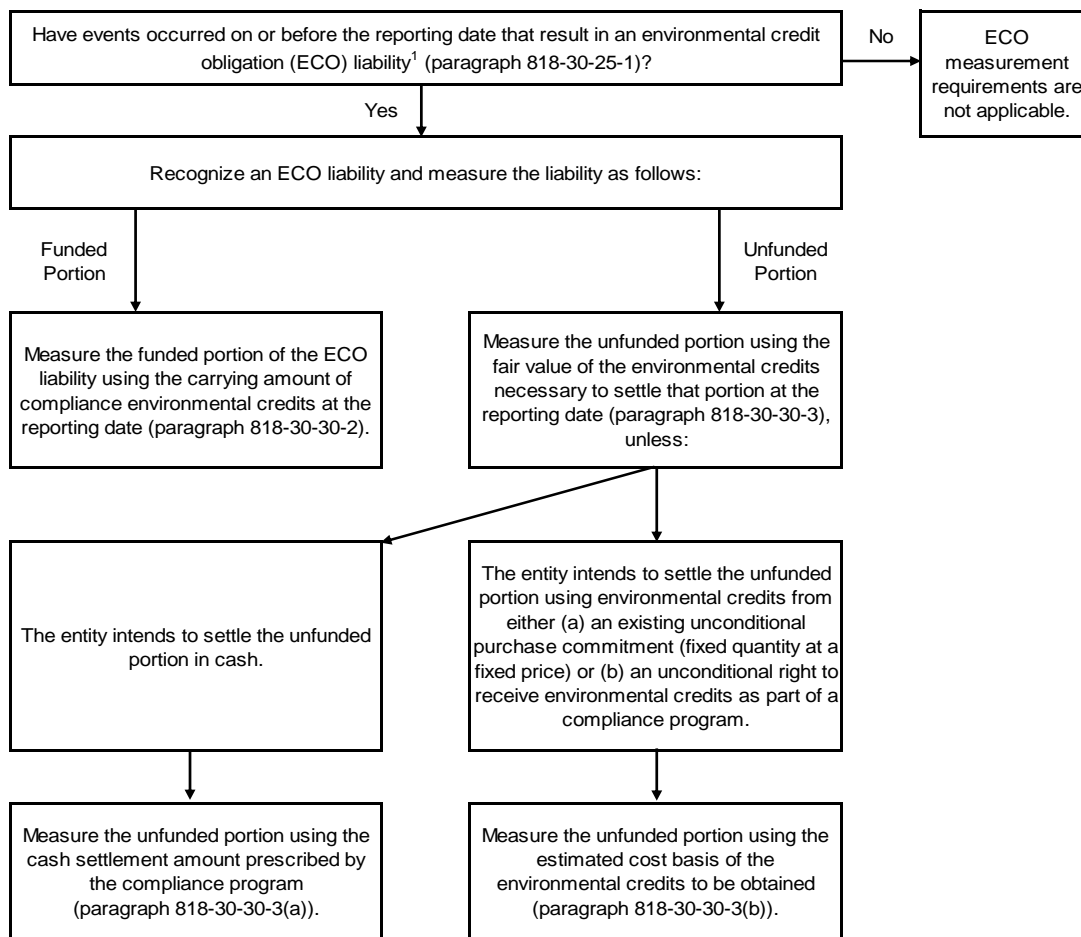
818-30-50-7 See paragraph 818-30-55-28 for an illustration of the quantitative disclosures required by this Subtopic.

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.



¹ Paragraph 818-30-25-2 provides separate requirements for compliance programs that obligate an entity to remit a fixed number of environmental credits because the entity exists as of a specified assessment date (and not based on the entity's activities or events).

• > Recognition

818-30-55-2 In some 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 of one renewable energy certificate upon the delivery of one megawatt-hour to a customer.

818-30-55-3 In other compliance programs, 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 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 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 reduce or eliminate the need to remit environmental credits to a regulator. For those 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 reporting date is the actual settlement date. For example, consider an automotive manufacturer subject to a 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 when determining whether it should recognize an environmental credit obligation liability.

818-30-55-5 Some compliance programs require that an entity remit a fixed number of environmental credits to a regulator solely because the entity exists at an assessment date. Under those compliance programs, events or activities are not considered in determining the magnitude of environmental credits due to a regulator at the settlement date. Effectively, the environmental credits required to be remitted at a future date represent a fee to operate for a period of time (the compliance period). In accordance with paragraph 818-30-25-2, an entity should recognize a liability at the beginning of the compliance period for the total amount of environmental credits due under the compliance program in accordance with paragraphs 818-30-30-2 through 30-3 with an offsetting amount recognized as an asset (similar to a prepaid operating license). That asset is separate from the environmental credits held to satisfy that liability and is amortized over the compliance period. For example, a local ordinance requires an entity licensed in its jurisdiction that exists as of January 1, 20X4, to remit 1,000 environmental credits by March 31, 20X5, for the 12-month period ending December 31, 20X4. The entity does not own related environmental credits on January 1, 20X4, and the market price of those credits is \$12 per credit. The entity would recognize an environmental credit obligation liability of \$12,000 and an offsetting asset for that amount on January 1, 20X4. That liability would be initially and subsequently measured in accordance with this Subtopic, and the asset would be amortized over the 12-month period ending December 31, 20X4. The liability would be derecognized upon remittance of environmental credits to the regulator on or before March 31, 20X5.

- > **Measurement**

- • > **The Funded Portion**

818-30-55-6 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**

818-30-55-7 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.

818-30-55-8 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 compliance program or as part of a contract for which the environmental credits are received as consideration, it should consider those environmental credits for measuring the unfunded portion of an environmental credit obligation liability. For example, if an entity is subject to a cap-and-trade program that specifies that the entity has an unconditional right at 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 in measuring the unfunded portion. 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.

> Illustrations

• > Environmental Credit Obligation Liability Recognition and Measurement

818-30-55-9 Examples 1 through 4 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—Single Portfolio of Compliance Environmental Credits Using the First-In, First-Out Costing Method

818-30-55-10 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. 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.

818-30-55-11 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.

818-30-55-12 The entity subsequently measures its emissions allowances using a portfolio approach and the first-in, first-out costing method. 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—Multiple Portfolios of Compliance Environmental Credits Using an Average Costing Method

818-30-55-13 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 and its accounting policy is to use an average cost method and portfolios based on vintage years to subsequently measure its emissions allowances and related environmental credit obligation liabilities. Vintage Years 20X2 through 20X4 emissions allowances are accepted methods of settlement for 20X4 cap-and-trade obligations.

818-30-55-14 The entity determines that compliance environmental credits from its 20X2 Vintage Year portfolio and its 20X3 Vintage Year portfolio would be used to settle the March 31, 20X4 environmental credit obligation liability because those environmental credits expire before the 20X4 emissions allowances. On that basis, the environmental credit liability recognized for the 14,000 emissions allowances necessary to satisfy the liability at the reporting date is \$156,000 in accordance with paragraph 818-30-30-2 (the sum of 8,000 20X2 Vintage Year emissions allowances with an average cost of \$12 per allowance and 6,000 20X3 Vintage Year emissions allowances with an average cost of \$10 per allowance).

• • > **Example 2: Excess Environmental Credit Obligation Liability**

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

818-30-55-15 An automotive manufacturer selling vehicles in the United States is subject to a 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.

818-30-55-16 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. The entity determines that it would settle the obligation by acquiring the necessary environmental credits from another automobile manufacturer. 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.

818-30-55-17 When measuring its March 31, 20X4 environmental credit obligation liability, the entity is prohibited from incorporating into the estimate intended future activities or events that may reduce or eliminate the number of environmental credits that are currently required, such as selling more fuel-efficient vehicle models before the settlement date.

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

818-30-55-18 Assume the same facts and circumstances as in Case A except that the 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

818-30-55-19 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

818-30-55-20 An e-commerce retailer is subject to an annual regulatory compliance program that obligates it to remit one environmental credit for each metric ton of emissions in excess of 1,000,000 metric tons. The 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 compliance program, it will be obligated to remit 500,000 environmental credits to the regulator for its excess emissions. At 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**

818-30-55-21 An entity publicly states its voluntary initiative to reduce its net annual emissions by 50 percent by 20X0 by making infrastructure investments and process changes and by also acquiring carbon offsets. Because the entity's statement does not result from a regulatory compliance obligation under enacted laws, statutes, or ordinances, it is not an environmental credit obligation accounted for in accordance with this Subtopic.

•• > **Example 4: Environmental Credit Obligations Not Based on Activities or Events**

818-30-55-22 This Example illustrates the application of the requirements in paragraph 818-30-25-2 for compliance programs that result in environmental credit obligations that do not result from an entity's emitting activities or events.

818-30-55-23 Beginning on January 1, 20X3, a local ordinance represented to reduce emissions obligates entities licensed in a certain jurisdiction to remit 1,000 environmental credits for the calendar year ending December 31, 20X3, by March 31, 20X4. Under the ordinance, an entity is obligated to remit that quantity of environmental credits regardless of its actions or activities during the annual period or its status at the end of that period. As of January 1, 20X3, the **fair value** of 1 environmental credit is \$500.

818-30-55-24 A manufacturing entity subject to the ordinance is licensed to operate in the jurisdiction on January 1, 20X3. The entity owns no environmental credits on that date. The entity recognizes an unfunded environmental credit obligation liability of \$500,000 on January 1, 20X3, and a corresponding asset for that amount. The asset is amortized over the annual period ending December 31, 20X3, because the obligation exists regardless of the entity's emitting activities or events.

818-30-55-25 On March 31, 20X3, the entity still owns no environmental credits, which have a **fair value** of \$550 per credit at that date. The entity remeasures the unfunded environmental credit obligation liability and recognizes the \$50,000 change in fair value as an adjustment to the asset recognized on January 1, 20X3. The entity also recognizes amortization expense of \$125,000 for the 3 months ending March 31, 20X3, related to that asset and prospectively amortizes the \$50,000 remeasurement over the remaining 9 months of the compliance period.

818-30-55-26 On June 30, 20X3, the entity acquires 1,000 environmental credits for \$575,000 and determines that it is probable that those environmental credits will be used to settle the environmental credit obligation associated with the ordinance. The entity classifies and accounts for those environmental credits as compliance environmental credits. The entity remeasures the environmental credit obligation liability, which is now fully funded, to \$575,000, which represents the carrying amount of the related compliance environmental credits and recognizes a \$25,000 adjustment to the asset recognized on January 1, 20X3. The entity recognizes an amortization expense of \$141,667 for that asset and prospectively amortizes the \$25,000 remeasurement over the remaining 6 months of the compliance period. If the entity continues to hold sufficient compliance environmental credits over the remaining six months of the compliance period, the environmental credit obligation liability and the asset recognized on January 1, 20X3, are not remeasured.

818-30-55-27 During the six months ending December 31, 20X3, the entity determines that its environmental credits will continue to be classified and accounted for as compliance environmental credits. Because the entity's environmental credit obligation liability is fully funded during the period July 1, 20X3, through December 31, 20X3, the liability is not remeasured during that period. The entity recognizes amortization expense of \$308,333 for the 6 months ended December 31, 20X3, for the asset established on January 1, 20X3. In March 20X4, the entity remits its 1,000 compliance environmental credits to the regulator to satisfy its environmental credit obligation liability and derecognizes both amounts.

• > **Applying the Quantitative Disclosure Requirements**

818-30-55-28 The following is an illustration of the quantitative disclosures required by paragraphs 818-30-50-2 through 50-4 for interim and 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 required by this Subtopic.

<u>Environmental Credit Obligation Liability</u>	<u>As of December 31, 20X4</u>		
	<u>Funded Obligation</u>	<u>Unfunded Obligation</u>	<u>Total Obligation</u>
EU Emissions Trading Scheme	\$ 5,640	\$ 1,400	\$ 7,040
State A cap-and-trade	2,380	-	2,380
State B cap-and-trade	880	380	1,260
Other (not significant) obligations	-	20	20
Total	<u>\$ 8,900</u>	<u>\$ 1,800</u>	<u>\$ 10,700</u>
Current liability	\$ 5,100	\$ 1,400	\$ 6,500
Noncurrent liability	\$ 3,800	\$ 400	\$ 4,200

<u>Environmental Credit Obligation Expense Information</u>	<u>For the Year Ended December 31, 20X4</u>
Environmental credit obligation expense (includes \$250 remeasurement of amounts recognized at December 31, 20X3)	\$ 9,370

Amendments to Subtopic 220-40

6. Amend paragraph 220-40-50-21 by amending item m and adding items n through s, with a link to transition paragraph 818-10-65-1, as follows:

Income Statement—Reporting Comprehensive Income—Expense Disaggregation Disclosures

Disclosure

• > 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):

- m. Impairment of film costs (see paragraph 925-20-50-4C ~~926-20-50-4C~~).
- n. Gains and losses from sales of **environmental credits** to noncustomers (see paragraph 818-20-50-5(b))
- o. Total revenue (or gains) from sales of environmental credits that were never recognized as an asset in accordance with paragraph 818-20-25-1 or were previously derecognized in accordance with paragraph 818-20-40-2 (see paragraph 818-20-50-5(c))
- p. 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 818-20-50-5(d))

- q. Total impairment expense recognized during the reporting period relating to environmental credits (see paragraph 818-20-50-5(e))
- r. Total expense recognized for **environmental credit obligation** liabilities, disaggregated between accruals for emissions occurring during the reporting period and remeasurement of environmental credit obligation liabilities previously recognized (see paragraph 818-30-50-4)
- s. Total amortization expense recognized in accordance with paragraph 818-30-25-2 (see paragraph 818-30-50-5).

Amendments to Subtopic 270-10

7. Amend paragraph 270-10-50-7 by adding item r, with a link to transition paragraph 818-10-65-1, as follows:

Interim Reporting—Overall

Disclosure

> Guidance Related to Disclosure of Other Topics at Interim Dates

270-10-50-7 The following may not represent all references to interim disclosure:

- r. For **environmental credits** and **environmental credit obligations**, see Subtopics 818-20 and 818-30.

Amendments to Subtopic 805-20

8. Add paragraphs 805-20-25-15B through 25-15C and their related headings and 805-20-30-31 and its related heading and amend paragraph 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

> Environmental Credits Acquired

• > 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** or transfer the environmental credit in an **exchange** transaction. 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.

Initial Measurement

> Exceptions to the Measurement Principle

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**
- j. Contract assets and contract ~~liabilities~~ ~~liabilities~~.
- k. **Environmental credit obligations.**

• > Environmental Credit Obligations

805-20-30-31 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

9. 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, although a contract to obtain an environmental credit may be subject to the requirements of this Subtopic.

Amendments to Subtopic 825-10

10. 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.

The amendments in this proposed Update were approved for publication 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. Cospers
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 proposed 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 proposed Update are to (a) establish specific accounting requirements for environmental credits and environmental credit obligations and (b) reduce diversity in practice. This is expected to improve the comparability and understandability of financial information about environmental credits and environmental credit obligations.

Background Information

BC3. As regulatory compliance programs that were specific to emissions became more prominent in the early 2000s, both 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. Both 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 Standards).

BC4. More recently, stakeholder feedback, including from respondents to the 2021 FASB Invitation to Comment (ITC), *Agenda Consultation*, indicates that many entities whose operations involve emissions are subject to additional 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 offset their emissions.

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 proposed Update (these examples are not all-inclusive):

- a. Emissions allowances originating from domestic and global cap-and-trade programs
- b. Corporate Average Fuel Economy (CAFE) credits originating from U.S. CAFE Standards
- c. Renewable identification numbers originating from the U.S. Renewable Fuel Standard
- d. 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 proposed 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 proposed 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 proposed amendments.

Benefits and Costs

BC10. 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.

BC11. Over the course of this project, extensive outreach has been 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.

BC12. For the amendments in this proposed Update, the Board expects the following main benefits:

- a. 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. Minimal diversity in practice. Because specific authoritative guidance does not currently exist for environmental credits and obligations that result from regulatory compliance programs, the proposed amendments are expected to minimize 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 among entities.

BC13. The Board acknowledges that entities may incur one-time costs to develop systems, processes, and accounting policies to comply with the amendments in this proposed 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 received over the course of the project indicates that many entities have the information needed to apply the proposed amendments. Therefore, the Board expects that the proposed amendments will be clear and operable without undue cost and complexity.

BC14. Overall, the Board concluded that the expected benefits of the amendments in this proposed Update would justify the expected costs. The Board's specific considerations about the benefits and costs of these proposed amendments are further discussed in subsequent sections below.

Basis for Conclusions

Scope

BC15. The Board developed the scope of the amendments in this proposed 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 proposed definitions of *environmental credit* and *environmental credit obligation* describe the rights and obligations that are affected by the proposed amendments.

Environmental Credit

BC16. 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.

BC17. The Board decided that an item that meets the following definition would be an environmental credit within the scope of the amendments in this proposed 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 separately transferable in an exchange transaction
- 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.

Enforceable right

BC18. Paragraph E16 of Concepts Statement 8 defines *asset* as “a present right of an entity to an economic benefit.”

BC19. To eliminate ambiguity about whether an item provides an entity with a present right and to align the definition of an environmental credit with the definition of an asset in Concepts Statement 8, the Board decided that, to meet the definition of an environmental credit, an item should be an enforceable right. Including enforceability in the definition is intended to mitigate the risk of items being considered “owned” for financial reporting purposes by more than

one reporting entity. The Board noted that including enforceability in the definition would be consistent with rights obtained through legal ownership, such as those established by a contract. 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.

BC20. 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 proposed Update.

Method of obtaining an environmental credit

BC21. Stakeholder 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 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). Consequently, the Board decided that an environmental credit 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) would be within the scope of the amendments in this proposed Update.

BC22. The Board also understands that an entity may receive an environmental credit as part of a grant directly from the 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)” within the proposed definition of environmental credit to ensure

that the amendments in this proposed Update would include all environmental credits granted as part of compliance programs.

BC23. The Board considered whether internally generated environmental credits should be excluded from the amendments in this proposed 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.

Lacks physical substance and is not a financial asset

BC24. The Board decided that to be within the scope of the amendments in this proposed Update, an environmental credit should lack physical substance and not be a financial asset as defined in the Master Glossary. The Board noted that the accounting requirements for financial assets are provided in other Topics. In addition, the Board included this criterion because it would exclude from the scope of the proposed amendments many assets that are considered securities and subject to other Topics.

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

BC25. The Board proposed that an environmental credit should be represented to prevent, control, reduce, or remove emissions or other pollution to appropriately limit the scope to items such as emissions allowances, renewable energy certificates, renewable identification numbers, CAFE credits, and carbon offsets. The Board noted that the proposed definition would mitigate the risk that other items not directly related to emissions or other

pollution, such as various licenses and permits, would be included within the scope of the amendments in this proposed Update.

BC26. The Board decided to use the phrase “represented to” 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 would likely require detailed scientific analysis. The Board expects that market participants would factor the environmental effect of an environmental credit into its cost or value.

Separately transferable in an exchange transaction

BC27. The Board believes that the ability to transfer an item in an exchange transaction provides compelling evidence that the item provides an entity with a present right to an economic benefit. The Board also 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 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.

BC28. 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 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 environmental compliance programs. Rather, those environmental credits often are used for voluntary purposes.

BC29. The Board decided that an environmental credit should be separately transferable in an exchange transaction to be within the scope of the amendments in this proposed Update. The Board intends for this language to include rights that may 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 was necessary to mitigate the risk that items represented as favorably affecting the environment that cannot be used to settle compliance obligations or transferred in exchange transactions might otherwise be within the scope of this proposed Update.

BC30. 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 would be considered as part of the subsequent measurement of certain environmental credits that are recognized as assets.

BC31. The Board considered whether items that otherwise would have met the definition of an environmental credit but are not transferable should be within the scope of this proposed Update. The Board decided against including those items within the scope primarily because research and outreach indicated that environmental credits that may be used to settle compliance obligations are almost always separately transferable. The Board expects that the cost of items with environmental credit features that are not transferable would be recognized as an expense when incurred.

Not an income tax credit that may be used to settle an entity's income tax liability

BC32. 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 decided 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 within the scope of this proposed Update. The Board observed that other current accounting guidance is applicable for those income tax credits.

Environmental Credit Obligation

BC33. In defining the environmental credit obligations that would be affected by the amendments in this proposed 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. CAFE Standards, the U.S. Renewable Fuel Standard, and U.S. State Renewable Portfolio Standards.

BC34. The Board decided that an obligation that meets the following definition is an environmental credit obligation within the scope of the amendments in this proposed 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.

BC35. In developing the proposed definition of an environmental credit obligation, the Board leveraged the Master Glossary's definition of *legal obligation*, which is "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 within the scope of the amendments in this proposed Update.

BC36. The Board also decided to clarify the types of obligations within the scope of this proposed Update by including "is represented to prevent, control, reduce, or remove emissions or other pollution" in the definition, which is consistent with the proposed definition of environmental credit.

BC37. 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 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.

BC38. 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 proposed Update. The Board reached that decision primarily because those voluntary initiatives do not establish accounting liabilities and are distinct from and dissimilar to compliance programs established and administrated by governments and regulators.

Environmental Credits

Recognition

BC39. The Board decided that environmental credits represent assets in accordance with Concepts Statement 8. The Board observed that environmental credits are used by entities in the following ways:

- a. To settle an environmental credit obligation
- b. Transfer in an exchange transaction
- c. For voluntary purposes (for example, net zero initiatives and regulatory emissions reporting).

BC40. Although the Board acknowledges that all environmental credits, as defined, represent assets in accordance with Concepts Statement 8, the Board observed that the uses of the credits in paragraph BC39(a) and (b) represent present economic benefits (that is, economic benefits that exist at the date that those environmental credits are obtained), while the use described in (c) does not. Therefore, in developing the proposed 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. The Board acknowledges that assessments of intent are inevitably subjective but decided that those assessments are necessary for determining whether an entity will realize a present economic benefit from an environmental credit.

BC41. The amendments in this proposed Update would 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) or transfer the environmental credit in an exchange transaction. The Board noted that using an environmental credit for either of those purposes results in a present economic benefit. Therefore, the proposed amendments would 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 or transferred in an exchange transaction.

BC42. The Board decided to propose immediate expense recognition of environmental credits that are not probable of being used to settle an environmental credit obligation or transferred in an exchange transaction for a variety of reasons. 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, Topic 360, Property, Plant, and Equipment, requires that an entity recognize an expense for the carrying value of an asset at the date that the entity intends to abandon the asset. 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, acknowledging that the contribution is effectively 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.

BC43. More broadly, the Board noted that paragraph E20 of Chapter 4 of Concepts Statement 8 states that "rights that give an entity no advantage beyond the common advantages of others because they are available to all do not qualify as assets." The Board observed that if the only potential economic benefit of an item is reduced emissions or pollution that is not specific or limited to the entity holding the item, that item would not qualify as an asset.

BC44. The Board decided to establish 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 would use the asset in ways that would 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.

BC45. 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 842, Leases, Topic 705, Cost of Sales and Services, Topic 718, Compensation—Stock Compensation, and Topic 730, Research and Development. Stakeholders 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.

BC46. 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 communicated that the recognition of environmental credits on the basis of 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 proposed Update at the individual environmental credit level. The Board decided to allow an entity to group environmental credits with similar characteristics for that purpose. Therefore, the entity would not be required to determine at the individual environmental credit level whether it is probable that it will use the environmental credit to settle an environmental credit obligation or transfer in an exchange transaction.

Initial Measurement

BC47. 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 communicated 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 accounted for in accordance with Subtopic 350-30. Subtopic 350-30 generally requires that an entity measure an intangible asset at its acquisition cost, including any associated transaction costs, in accordance with Subtopic 805-50, Business Combinations—Related Issues (specifically, 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 Board emphasized that a main objective of the proposed amendments is to address the accounting for items and transactions for which specific GAAP does not exist, not to alter current requirements.

BC48. The asset acquisition guidance (paragraphs 805-50-30-1 through 30-4) applies only to assets acquired in exchange transactions. 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 proposed Update would require initial measurement to be limited to transaction costs, if any, associated with obtaining the environmental credit. The Board anticipates that many granted and internally generated environmental credits would have an initial measurement at or near zero because it expects that transaction costs will be minimal. The Board observed that the proposed initial measurement 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. 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. Therefore, those Board members believe that limiting the initial measurement of a granted environmental credit to its transaction costs, if any, is preferable to fair value measurement.

BC49. The Board considered whether to require that an entity allocate a portion of the costs associated with the activity or product giving rise to an environmental credit granted to an entity. For example, the Board considered whether a portion of the cost of selling a zero-emission vehicle should be allocated to the initial cost of a CAFE credit, consistent with the guidance in Topic 330 for allocating costs to separate units of production. The Board decided not to permit allocation of costs to those granted environmental credits primarily because stakeholders indicated that determining a relevant and decision-useful amount to allocate would be costly and likely would require significant judgment. Moreover, the Board noted that allocating costs to environmental credits granted to an entity for performance would be inconsistent with GAAP that generally prohibits the capitalization of costs of internally developing intangible assets.

BC50. The Board considered but dismissed an alternative that would have permitted or required that an entity initially measure environmental credits at fair value. 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. The Board and stakeholders also supported the initial measurement in the amendments in this proposed Update because that initial measurement appropriately depicts the resources expended to obtain an environmental credit.

Subsequent Measurement

BC51. Almost all stakeholders advocated for subsequently measuring an environmental credit on the basis of 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 BC64 through BC69).

BC52. 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 decided that an environmental credit that an entity intends to use to settle an environmental credit obligation should not be subsequently remeasured. 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 decided that subsequently measuring those environmental credits consistent with the cost to obtain the environmental credits would more appropriately depict an entity's future compliance expenses.

BC53. The Board decided that environmental credit assets that an entity does not intend to use to settle an environmental credit obligation should be measured at historical cost less impairment, if any. Those environmental credit assets comprise (a) those that an entity intends to transfer in an exchange transaction and (b) those for which an entity has not yet determined an intended use. The Board decided that 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.

BC54. The Board also considered whether to require that an entity perform an impairment test on the occurrence of a triggering event 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 more frequent impairment testing may not be justified by the expected costs.

Amortization

BC55. 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. Therefore, the amendments in this proposed Update clarify that an entity would not be permitted to amortize an environmental credit.

Establishing the intended use of an environmental credit

BC56. Consistent with the asset recognition requirements, the Board observed that 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 uses environmental credits to both settle environmental credit obligations and transfer environmental credits in exchange transactions. The Board expects that requiring different subsequent measurement requirements based on the intended use of an environmental credit would maximize the relevance and decision usefulness of the information being provided.

BC57. The Board considered ways to balance the risk that (a) an entity would have to prove with virtual certainty its intended use of an environmental credit and (b) an environmental credit is inappropriately classified and measured. The Board decided that if it is *probable* that an environmental credit will be used to settle an environmental credit obligation, that environmental credit should be classified as a compliance environmental credit and subsequently measured at cost and not be tested for impairment at each reporting period. All other environmental credit assets would be classified as noncompliance environmental credits and would be tested for impairment at each reporting date. The Board observes that this is the second probable threshold used in the accounting for environmental credits. The Board decided that two probable thresholds were necessary to first determine whether an environmental credit

should be recognized as an asset and to then determine the appropriate subsequent measurement. The Board determined that using a single probable threshold and combining the recognition and measurement determinations would result in unintuitive financial reporting outcomes.

BC58. 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.

Classification reassessment

BC59. 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. The amendments in this proposed Update would require that an entity determine at each reporting date whether an environmental credit should be classified as a compliance environmental credit before applying the applicable subsequent measurement requirements. 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.

Costing methods

BC60. The Board decided to 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 proposed Update also are permitted for measuring inventory in accordance with Topic 330.

BC61. 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 the Board excluded 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 necessitate developing LIFO-specific requirements like those in Topic 330, which the Board determined would be overly complex.

Portfolio approach

BC62. Many stakeholders communicated that applying the proposed subsequent measurement requirements for environmental credits, including (a) classification as compliance environmental credits and noncompliance environmental credits, (b) the permitted costing methods, and (c) the initial and subsequent measurement requirements for environmental credit obligation liabilities may be impracticable unless applied using a portfolio approach. The Board decided to permit the use of a portfolio approach for *sufficiently similar* environmental credits. The Board decided not to define *sufficiently similar* or provide specific criteria for determining what constitutes a portfolio. Rather, the Board decided to describe the intended meaning of *sufficiently similar* with an overarching principle. The principle is that environmental credits measured using a portfolio approach are sufficiently similar such that it is unlikely at a reporting date that an entity will recognize a significant loss upon the derecognition of an individual environmental credit from a portfolio. Because environmental credits have different subsequent measurement requirements based on their classification as compliance environmental credits or noncompliance environmental credits, the Board determined that the *sufficiently similar* principle was necessary for subsequent measurement to avoid the inappropriate deferral of losses. The Board noted that an entity should apply reasonable judgment in determining whether environmental credits are *sufficiently similar* to be subsequently measured using a portfolio approach.

BC63. The Board considered but dismissed alternatives that would have further limited the application of a portfolio approach, for example, limiting portfolios to identical environmental credits, credits with the same year of issuance or jurisdiction, or credits with substantially the same fair value. Stakeholders informed the Board that significant differences in those characteristics exist among different types of environmental credits. Therefore, the Board decided that requiring an entity to apply additional criteria to use a portfolio approach would unnecessarily restrict the use of portfolios. The Board also noted that Topic 330 provides a similar overarching principle for applying subsequent measurement guidance, that is, the portfolio does not inappropriately result in the deferral of losses.

Fair value measurement accounting policy election

BC64. The amendments in this proposed Update would permit an entity to make an accounting policy election to subsequently measure a class of eligible noncompliance environmental credit assets at fair value at the reporting date, with changes recognized in earnings. The Board decided that only noncompliance environmental credits obtained through an exchange transaction or a nonreciprocal transfer that is not a grant from a regulator or its designee(s) 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 would be measured at fair value until that environmental credit is derecognized.

BC65. 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 because certain Board members were concerned about potential structuring opportunities. Specifically, there was concern that an entity could acquire a noncompliance environmental credit from a related party at a discount and immediately recognize a gain by electing the fair value measurement accounting policy election.

BC66. The Board decided that noncompliance environmental credits that are internally generated or granted to an entity by a regulator or its designee(s) would 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. The Board observed that if the fair value measurement accounting policy election was permitted for those environmental credits, an entity would recognize an immediate gain through 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.

BC67. 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. The Board decided not to provide specific criteria for determining what constitutes a class of environmental credits and noted that entities should apply reasonable judgment in determining classes of noncompliance environmental credits.

BC68. 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 CAFE 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.

BC69. The amendments in this proposed Update would require an entity that changes its fair value measurement accounting policy election to apply Topic 250, Accounting Changes and Error Corrections. Notwithstanding, the Board decided that an entity that elects to establish an accounting policy to

subsequently measure a class of noncompliance environmental credits at fair value should apply the fair value measurement accounting policy election prospectively, with a cumulative-effect adjustment to the opening balance of retained earnings for the reporting period in which the change is made. The Board acknowledges that, consistent with its decision for initially applying fair value measurement to crypto assets, the expected benefits for investors may not justify the expected costs of retrospective application. Additionally, the Board observed that requiring retrospective application may disincentivize entities from electing fair value measurement at a future date for an eligible class of noncompliance environmental credits, even if active markets for those environmental credits develop.

Derecognition

BC70. The amendments in this proposed Update would 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 of 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 expects that it will be operable for environmental credits. The Board expects that the proposed derecognition guidance typically would 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.

Recognition reassessment

BC71. The amendments in this proposed Update would require that at each reporting date an entity determine whether an environmental credit should continue to be recognized as an asset. Specifically, an entity would be required to determine whether at that date an environmental credit is probable of being used to settle an environmental credit obligation or transferred in an exchange transaction. If not, an entity would be 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.

BC72. 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. The Board proposed 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

BC73. Concepts Statement 8 defines *liability* as “a present obligation of an entity to transfer an economic benefit.” Stakeholder feedback indicated that the types of 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 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. Considering that feedback and research, as well as the definition of a liability, the Board decided that liability recognition for regulatory compliance programs would occur when an entity is obligated to transfer environmental credits or other economic benefits at the reporting date because of its activities or events that occur on or before that date.

BC74. The Board also noted that many 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 would assume that the reporting date represents the settlement date, regardless of whether the settlement date occurs at a future date. The Board decided that:

- a. An entity would be presently obligated if previous emitting or polluting events or activities occurring on or before a reporting date obligates 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 reduce the number of environmental credits due to a regulator at the compliance program's settlement date would not be permitted because those actions or activities do not negate the existing present obligation at the reporting date.

BC75. Paragraphs 818-30-55-2 through 55-5 describe various compliance programs that result in environmental credit obligation liabilities. The Board noted that most existing 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.

BC76. Other 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 (for example, the U.S. CAFE Standards). 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 would be appropriate for an entity to (a) determine the amount of environmental credits that would be 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.

BC77. Some 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.

BC78. Other programs (believed to be uncommon) 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 programs permit an entity to operate in the jurisdiction for a specified period. For example, if an entity exists in a jurisdiction on January 1, 20X4, it would be required to remit 1,000 environmental credits to the jurisdiction by March 31, 20X5, to operate in the jurisdiction between January 1, 20X4, through December 31, 20X4. Under those programs, that obligation cannot be reduced, even if the business ceases to exist after January 1, 20X4. The Board determined that the nature of those programs is fundamentally different from other regulatory compliance programs and, therefore, proposed specific recognition and measurement guidance in the event that those programs become more prevalent.

BC79. Considering the characteristics of the programs, which are similar to a fixed fee to operate in a jurisdiction for a specified period, the Board decided that an entity should recognize an environmental credit obligation liability at the date that it becomes obligated with an offsetting asset, effectively representing a deferred expense. The Board further determined that the entity should amortize the asset during the period specified by the program through earnings and derecognize the liability upon settlement to align the accounting with similar fixed fee operating arrangements. For any environmental credits held by the entity during the compliance period to be used to satisfy the obligation, the Board specified that an entity should apply the proposed guidance in Subtopic 818-20.

Initial Measurement

BC80. The Board observed that entities commonly satisfy environmental credit obligations with environmental credits but may also do so through cash-settlement mechanisms specified in 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. The Board decided that the most relevant and decision-useful measurement for environmental credit obligation liabilities would be the cost basis of the economic benefits necessary at a reporting date to satisfy those liabilities. Considering that environmental credit obligations are either satisfied with environmental credits or with cash, the Board decided that those items represent the economic benefits to be transferred for that purpose.

Funded portion of an environmental credit obligation liability

BC81. Based on the rationale in paragraph BC80 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 an entity should use the costing methods and portfolio approaches applied for measuring its related compliance environmental credits for measuring that funded portion. Initial feedback from stakeholders indicated broad support for this "linked" measurement approach. Additionally, the Board emphasized that, in accordance with the asset recognition and reassessment requirements in the amendments in this proposed 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 should recognize a gain when that liability is derecognized.

Unfunded portion of an environmental credit obligation liability

BC82. 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.

BC83. 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 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.

BC84. 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 compliance program or as part of a contract for which environmental credits are received as consideration.

BC85. The Board agreed that the arrangements in paragraph BC84 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 those arrangements using the estimated cost basis of the related environmental credits.

BC86. The Board considered alternatives that would have required that an entity 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.

BC87. The Board considered certain stakeholders' view that the measurement of an environmental credit obligation liability should depict an entity's expected cash outflows at the settlement date of a compliance period, rather than those that would be necessary to settle the obligation if the reporting date was the settlement date. Those stakeholders noted that factoring in the expected future events or entity-specific performance to the initial measurement of the unfunded portion may minimize earnings volatility, specifically for compliance programs that consider emission activities for the total compliance period.

BC88. 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) in the measurement of the unfunded portion. The Board observed that doing so would be inconsistent with other GAAP, such as Topic 740, Income Taxes, which does not permit anticipating changes in future tax rates or laws or the consideration of expected future net operating losses when measuring 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.

Subsequent Measurement

BC89. Stakeholder feedback indicated that specific subsequent measurement guidance would be preferable to enhance operability and reduce diversity in practice. The Board agreed with that feedback and decided to require that an entity apply the initial measurement requirements in Subtopic 818-30 at each reporting date, with changes recognized in earnings.

Additionally, the Board specified that any change in an environmental credit obligation liability from a previous reporting date should be presented within the same income statement line item as the initial recognition and measurement of the environmental credit obligation liability.

Derecognition

BC90. Stakeholder feedback and the staff's research indicate that the rules and regulations of most compliance programs clearly specify settlement procedures and the criteria for settlement, which are objective and verifiable. The Board decided that the derecognition requirements in Subtopic 405-20, Liabilities—Extinguishments of Liabilities, would be effective and operable for determining when an environmental credit obligation liability should be derecognized. 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

BC91. The Board considered whether the accounting requirements for environmental credit obligation liabilities in an interim reporting period should be different from those in an annual reporting period. 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. Therefore, the Board decided not to provide accounting requirements for interim reporting periods that differ from the requirements for annual reporting periods for those environmental credit obligation liabilities.

Presentation

BC92. The Board decided that an entity would be required to present its environmental credit assets separately from its environmental credit obligation liabilities on its consolidated 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.

Disclosure

BC93. The Board considered disclosure requirements under current GAAP in other Topics, as well as stakeholder feedback, particularly from investors. Although stakeholders stated that entities' environmental credits and environmental credit obligations have not been material, they stated that those items are rapidly growing and are expected to be material to many entities' financial statements in the future. Therefore, the Board expects that the disclosure requirements in this proposed Update would improve the information about environmental credits and environmental credit obligations provided to investors in the financial statements.

BC94. Chapter 8, *Notes to Financial Statements*, of Concepts Statement 8 provides information that the Board considered when evaluating the proposed disclosure requirements.

BC95. Board members observed that the proposed disclosures are comprehensive and should result in a significant amount of disclosure if an entity is subject to all of the proposed disclosure amendments. Stakeholder feedback and the staff's research indicated that most entities likely would not be subject to all of the proposed disclosure requirements. The Board expects

that entities would 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.

Environmental Credits

Annual reporting periods

BC96. Investor feedback indicated that the qualitative disclosures in paragraphs 818-20-50-1 through 50-2 would facilitate investors' ability to understand the nature and uses of an entity's environmental credits and would enable them to better understand an entity's key estimates and judgments in recognizing and measuring environmental credits.

BC97. The amendments in this proposed Update would require that an entity provide the disclosures for annual periods. The Board expects that entities would be able to readily provide that information because it would be needed to apply the recognition and measurement guidance in this proposed Update.

BC98. Although investor feedback indicated that the qualitative annual disclosure requirements also would be useful for interim periods, the Board decided that the decision usefulness of the qualitative disclosures about an entity's environmental credits would be limited to situations in which a significant change occurred after the entity's most recent annual reporting date.

Interim and annual reporting periods

BC99. For interim and annual reporting periods, the amendments in this proposed Update would require that an entity disclose the following information for each significant environmental credit asset holding:

- a. Description
- b. Carrying amount
- c. Classification of the environmental credit (compliance versus noncompliance).

BC100. The Board decided that the significant environmental credit holding disclosures are necessary to enable investors to analyze and assess the nature and magnitude of an entity's environmental credits by classification at a

reporting date to forecast future cash flows related to settling environmental credit obligations and sales. The Board expects that the proposed significant holdings disclosures would be operable because the information to satisfy the disclosures would be needed to apply the recognition and measurement requirements in this proposed Update.

BC101. The Board further decided that if not separately presented on an entity's balance sheet, the current and noncurrent portion of each of the following should be disclosed:

- a. Compliance environmental credits
- b. Noncompliance environmental credits.

An entity also would be required to disclose the line item or items on the balance sheet that include the amounts in (a) and (b) above.

BC102. Investors supported the disaggregation of compliance environmental credits and noncompliance environmental credits, noting that understanding the current and noncurrent portions of environmental credits intended to be used for different purposes would better enable them to assess an entity's future cash flows resulting from the entity's environmental credit activities.

BC103. The Board also decided that quantitative and qualitative income statement information would enable investors to understand and analyze the following effects of an entity's environmental credits on its financial performance during a reporting period:

- a. Revenues from sales of environmental credits in contracts with customers and the carrying amount of those environmental credits at the date of sale.
- b. Gains and losses from sales of environmental credits to noncustomers and the carrying amount of those environmental credits at the date of sale.
- c. Total revenue (or gains) from sales of environmental credits that were never recognized as assets or previously derecognized because the entity intended to use them voluntarily.
- d. Total expense recognized for environmental credits not initially recognized as an asset or subsequently derecognized because the entity intended to use them voluntarily.

- e. Total impairment expense recognized during the reporting period. Additionally, the nature of the environmental credits that were impaired and a description of the facts and circumstances giving rise to the impairment.
- f. The line item or items in the income statement that include the amounts in items (a) through (e).

BC104. During outreach, investors broadly supported the income statement disclosures in this proposed Update, emphasizing that the information would be useful in their analyses of the effects of an entity's environmental credit uses and decisions made during a reporting period. The Board expects that those proposed disclosure requirements would 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 proposed Update.

BC105. To facilitate investors' analysis of an entity's cash outflows during a reporting period, and regardless of whether those environmental credits are recognized as assets, the Board decided to require that an entity disclose the cash that it paid for environmental credits during the reporting period.

Environmental Credit Obligations

Annual reporting periods

BC106. The Board decided to require that an entity disclose the following information for annual periods:

- a. A description of regulatory compliance programs that the entity is subject to, including the nature, settlement provisions, types of environmental credits accepted as settlement, and activities that result in environmental credit obligations in those programs
- b. How the unfunded portion of an environmental credit obligation liability is measured.

BC107. Investors broadly supported annual qualitative disclosure requirements, indicating 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.

BC108. The Board expects that the information required to provide the annual qualitative disclosures would be readily available to an entity because that information would be necessary for the entity to apply the amendments in this proposed Update for environmental credits and environmental credit obligations.

Interim and annual reporting periods

BC109. For interim and annual reporting periods, the amendments in this proposed Update would require that an entity disclose the following information about the entity's significant environmental credit obligations:

- a. A description of the compliance program (including its jurisdiction)
- b. The carrying amount at the reporting date (disaggregated between the funded and unfunded portions) and the aggregate carrying amount of environmental credit obligation liabilities not considered individually significant.

BC110. Investors broadly supported the significant environmental credit obligations disclosure, noting that the information expected to be provided by those disclosures would provide needed visibility into specific compliance programs that an entity is subject to and the entity's intended method to fund those obligations. Additionally, investors emphasized that providing distinct information about the funded and unfunded portions of environmental credit obligation liabilities would provide insight into an entity's exposure to future cash outflows at a reporting date.

BC111. Consistent with its decision for environmental credits and as a result of similar investor support, the Board decided that if not separately presented on an entity's balance sheet, the current and noncurrent portion of each 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 would be required to disclose the line item or items on the balance sheet that include the amounts in (a) and (b) above.

BC112. Also consistent with its decisions for environmental credits, the Board decided to require that an entity disclose the income statement effects of its environmental credit obligation liability. Specifically, to provide investors with insight into the components of that expense during a reporting period, an entity should disaggregate its total expense for environmental credit obligation liabilities as follows:

- a. Accruals for emissions occurring during the reporting period
- b. Remeasurement of environmental credit obligation liabilities previously recognized.

BC113. Investors supported the proposed disaggregation, indicating that it would enable them to readily analyze the income statement effect of an entity's emissions during a reporting period separately from remeasurement of liabilities existing at the beginning of the reporting period, which may occur because of a change in funded status.

Consequential Amendments to Other Topics

Business Combinations

BC114. The amendments in this proposed Update would 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

BC115. 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 proposed Update would clarify that an acquirer should measure environmental credits acquired

in a business combination at their acquisition-date fair value. Those environmental credits would subsequently be accounted for in accordance with the proposed amendments for environmental credits.

BC116. 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 proposed 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 proposed Update would 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 or transferred in an exchange transaction). 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 expects that an acquirer would derecognize those environmental credits immediately following the acquisition date.

BC117. The Board also specified that acquired items that otherwise would have met the proposed definition of an environmental credit, but are not separately transferable, should not be recognized as assets in a business combination. The Board noted that this amendment in the proposed Update to the accounting for business combinations is consistent with its decision to exclude those items from the scope of this proposed Update.

Environmental credit liabilities assumed

BC118. The Board decided that an acquirer should measure environmental credit obligation liabilities assumed in a business combination using the measurement requirements for environmental credit obligation liabilities included within the amendments in this proposed 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 proposed Update, the amounts may differ in some situations. Specifically, the acquisition-date fair value would require that an acquirer determine the price that it would pay to transfer the liability in

an orderly transaction between market participants, which would include 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 proposed amendments would approximate the economic resources ultimately transferred to settle that liability in most instances.

Derivative Accounting

BC119. Some stakeholders indicated that in certain circumstances an obligation to transfer environmental credits to a regulator at a future date to satisfy an environmental credit obligation liability may be considered an arrangement with an embedded derivative in accordance with Topic 815, Derivatives and Hedging. The Board specified that environmental credits and environmental credit obligations should not be evaluated under Topic 815 because it decided on specific recognition and measurement amendments that are appropriate for those items and it wants to avoid diversity in practice while reducing unnecessary cost and complexity.

Fair Value Option

BC120. During outreach, some stakeholders questioned whether entities would be permitted to elect the fair value option in Topic 825, Financial Instruments, 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, regardless of how punitive the cash settlement amount is, those liabilities may be considered financial liabilities. To eliminate multiple measurement methods for environmental credit obligation liabilities and potential inconsistency between or within entities, the Board decided to prohibit an entity from electing the fair value option in Topic 825 for environmental credit obligation liabilities.

Effective Date and Transition

BC121. The Board decided that given the expected benefits for investors of providing trend information, the amendments in this proposed 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 as if they always had been applicable, subject to specific transition requirements summarized in paragraph BC122. The Board clarified that the date of initial application would be the beginning of the reporting period in which an entity first applies the proposed amendments.

BC122. Realizing the expected costs of adopting the amendments in this proposed 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 proposed amendments while providing investors with relevant and decision-useful information upon transition, an entity should apply the following additional transition requirements at the date of initial application:

- a. Determine whether it should recognize an environmental credit as an asset at the date of initial application by applying the asset recognition requirements to environmental credits and considering the entity's intended use of those environmental credits at that date
- b. Measure compliance environmental credits recognized as assets using the entity's carrying amount existing at the date of initial application
- c. Measure noncompliance environmental credits using the lower of the entity's carrying amount of the environmental credits existing at the date of initial application or the fair value of the environmental credits at the date of initial application
- d. Measure any class of noncompliance environmental credits for which an entity elected the fair value measurement accounting policy using their fair value at the date of initial application
- e. Continue to include the cost of environmental credits capitalized as part of another asset (for example, inventory) before the date of initial application of the proposed amendments within the carrying amount of that other asset until that asset is derecognized
- f. Apply the liability recognition and measurement requirements of Subtopic 818-30 on environmental credit obligations at the date of initial application
- g. Apply Topic 805 prospectively to transactions occurring after the date of initial application of the proposed amendments.

BC123. 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 proposed Update retrospectively without the additional transition requirements described in paragraph BC122 may often be inoperable.

BC124. 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 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 proposed amendments for the current period, which would be overly burdensome. The Board also observed that the transition disclosure requirement in paragraph 250-10-50-1-(b)(1) would not apply because an entity is not permitted to adopt the proposed amendments on a full retrospective basis.

BC125. The Board will determine the effective date after it considers stakeholder feedback on this proposed Update. Early adoption would be permitted for both interim and annual financial statements that have not yet been issued (or made available for issuance). An entity adopting the amendments in an interim period would be required to adopt them as of the beginning of the fiscal year that includes that interim period.

Application to Private Companies and Not-for-Profit Entities

BC126. 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. In those 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

proposed Update. Similarly, in discussions with the Not-for-Profit Advisory Committee, members expressed sentiments similar to those of the PCC on the pervasiveness of the issues and applicability of the amendments in this proposed Update. Therefore, the Board decided that the proposed amendments should be consistently applied by all entities.

Comparison with IFRS Accounting Standards

BC127. Many respondents, including some users, to the IASB's *Request for Information on the Third Agenda Consultation*, which was issued in November 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 proposed 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.

BC128. Currently, the IASB is considering recent feedback from stakeholders who suggested that the IASB should prioritize a project on pollutant pricing mechanisms, arguing that they are increasing in prevalence and entities would benefit from clear accounting requirements on this topic.

Amendments to the GAAP Taxonomy

The provisions of this Exposure Draft, if finalized as proposed, would require improvements to the GAAP Financial Reporting Taxonomy and SEC Reporting Taxonomy (collectively referred to as the “GAAP Taxonomy”). We welcome comments on these proposed improvements to the GAAP Taxonomy at xbrled@fasb.org. After the FASB has completed its deliberations and issued a final Accounting Standards Update, the proposed improvements to the GAAP Taxonomy will be finalized as part of the annual release process.