Snapshot

FASB addresses accounting for environmental credits and environmental credit obligations

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The FASB issued ASU 2026-02, *Environmental Credits and Environmental Credit Obligations (Topic 818),* to improve the accounting and financial reporting for environmental credits and environmental credit obligations.

The amendments provide recognition, measurement, presentation, and disclosure requirements for all entities that generate, purchase, or receive environmental credits or that have a regulatory compliance obligation that may be settled with environmental credits. Prior to these amendments, there was a lack of specific authoritative guidance for the recognition and measurement of environmental credits or related regulatory obligations, which resulted in diversity in practice.

The amendments are effective for annual reporting periods and interim reporting periods within those annual reporting periods beginning after December 15, 2027 for public business entities, and after December 15, 2028 for all other entities.

Early adoption is permitted as of the beginning of an annual reporting period.

A. Overview

The amendments in ASU 2026-02 introduce a new Codification topic, ASC 818, *Environmental Credits and Environmental Credit Obligations,* which provides recognition, measurement, presentation, and disclosure requirements for all entities that have either environmental credit transactions or regulatory compliance obligations that may be settled with environmental credits.

The FASB had received feedback from stakeholders indicating that entities are increasingly subject to various government mandates and regulatory compliance programs, which often result in compliance obligations that may be settled with environmental credits. In addition, entities may also use environmental credits on a voluntary basis as a means to partially offset their own emissions in pursuit of climate-related goals, such as "net zero" or "carbon neutral" initiatives.

Because U.S. GAAP lacked specific authoritative guidance to address the accounting for environmental credits or related environmental obligations arising from regulatory compliance programs, diversity in practice ensued. As a result, entities analogized to the guidance in ASC 330, *Inventory*, ASC 350-30, *Intangibles – Goodwill and Other: General Intangibles Other than Goodwill*, or ASC 450, *Contingencies,* depending on the nature of the entity's environmental credit transactions or obligations and how each entity determined the most appropriate guidance.

The amendments in ASU 2026-02 fill that void and are organized into two subsections: ASC 818-20, *Environmental Credits,* and ASC 818-30, *Environmental Credit Obligations*. Entities may be subject to one or both subtopics, depending on the nature of their environmental credit activities and regulatory compliance programs.

B. Scope

The amendments in ASU 2026-02 apply to all entities with *environmental credit transactions* and/or *environmental credit obligations*, terms that are defined in the Codification's Master Glossary, as follows.

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, or previously was, separately transferable in an exchange transaction. If an item is no longer separately transferable in an exchange transaction, an entity must be able to use that item to satisfy an environmental credit obligation to meet this criterion.

d. Is not an income tax credit that may be used to settle an entity's income tax liability, regardless of whether the entity has a tax liability or intends to use the credit for that purpose.

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

Environmental Credit Obligation

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

The examples of environmental credits and the related regulatory compliance program that are within the scope of ASC 818 include the following:

- Emissions allowances originating from domestic and global cap-and-trade programs
- Renewable identification numbers (RINs) originating from the U.S. Renewal Fuel Standard
- Renewable energy certificates (REC) originating from U.S. State Renewable Portfolio Standards
- Carbon offsets that are often generated as a result of projects designed to reduce or remove carbon dioxide from the atmosphere. Typically, carbon offsets are used to achieve voluntary climate initiatives rather than regulatory compliance programs.

The list above is not intended to be all-inclusive, as there may be other types of environmental credits that meet the definition provided in the amendments. Further, the amendments in ASU 2026-02 state that environmental credits and environmental credit obligations within the scope of ASC 818 are outside the scope of ASC 815 on derivatives and hedging.

Grant Thornton insight: Transactions outside the scope of ASC 818

Income tax credits

The Master Glossary definition of “environmental credit” specifically excludes income tax credits that can be used to settle an income tax liability from the scope of ASC 818, irrespective of whether the entity has an income tax liability or intends to use the credit for that purpose. This includes transferrable or refundable income tax credits that relate to the production of renewable energy and other pollution-reduction or climate initiatives, such as those originating from the federal Inflation Reduction Act of 2022.

Environmental remediation obligations

Similarly, the definition of “environmental credit obligation” specifically excludes from the scope of ASC 818 those obligations that are within the scope of ASC 410-30, *Asset Retirement and Environmental Obligations: Environmental Obligations.* In paragraph 45 of the Basis for Conclusions (BC45) of ASU 2026-02, the Board clarifies that this exclusion applies regardless of whether such environmental remediation obligations can be settled using environmental credits. The Board explains that such obligations within the scope of ASC 410-30 typically relate to legal obligations to remediate the effect of past activities that have impacted the environment, rather than to obligations governed by ongoing regulatory compliance programs, and should therefore continue to be accounted for under ASC 410-30, regardless of the permitted forms of settlement.

C. Environmental credits

Recognition

Under the amendments, whether or not an entity recognizes environmental credits as an asset or as an expense depends on the entity's intended use of the environmental credit, as explained in ASC 818-20-25-1.

ASC 818-20-25-1

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

The new guidance provides the following three uses of environmental assets that qualify for asset recognition under the new amendments:

- It is probable the credit will be used to settle an environmental credit obligation;
- It is probable the credit will be transferred in an exchange transaction; or
- It is probable the credit will be used in a nonreciprocal transfer.

The guidance further states that the probability assessment is a *collective* assessment, meaning that the evaluation is made based on the probability that any of these three events will occur as opposed to whether any one of the events is probable of occurring independently. Under the new guidance, entities should consider the following factors in making the probability assessment:

- The entity's purpose for acquiring the environmental credit
- The quantity of environmental credits the entity owns compared with the combined total of both existing and expected environmental credit obligations
- Expected events and activities that may change the entity's need for compliance environmental credits in future periods
- The entity's past uses of environmental credits
- Whether the entity would be committed to exchanging environmental credits in excess of those needed to satisfy an environmental credit obligation
- An entity's internal emission-reduction initiatives

For environmental credits that do not meet this recognition threshold, the cost of such credits (including any nonrefundable deposit) is expensed as incurred, and entities are prohibited from including those costs in the carrying amount of another asset recognized under other GAAP. This requirement to recognize the cost as an expense when incurred also applies to environmental credits acquired for purposes of achieving voluntary emission-reduction goals or similar initiatives.

Classification

Entities should classify recognized environmental credits as either *compliance* environmental credits or *noncompliance* environmental credits. *Compliance* environmental credits are those that will probably be used to settle an environmental credit obligation, whereas all other recognized environmental credits should be classified as *noncompliance* environmental credits.

Recognition reassessment

Entities are required to reassess the probable use of recognized environmental credits at each reporting date in a manner consistent with the three uses outlined above, in accordance with ASC 818-20-25-1. If it is no longer probable that the entity will use the environmental credit in a qualifying manner, then the carrying amount for that environmental credit should be derecognized through earnings.

In addition, the new guidance prohibits an entity from subsequently recognizing an environmental credit asset if it has previously determined that the probable use of the credit does not qualify for recognition under ASC 818-20-25-1. As a result, environmental credits that either are derecognized due to a reassessment or were never recognized upon initial acquisition should not be subsequently recognized as an asset, regardless of subsequent changes in intended use.

Measurement

Initial measurement

Environmental credits should be initially measured at the costs incurred to obtain them. However, environmental credits that are internally generated by the entity or received through a grant from a regulator (or its designee) should be initially measured based *only* on transaction costs incurred, if any. Transaction costs include costs necessary to validate, register, or authenticate an environmental credit that was internally generated or received through a grant from a regulator. If there are no transaction costs, the entity should recognize the credit with a carrying amount of zero.

Grant Thornton insight: Cost of internally generated or granted environmental credits

For internally generated environmental credits or those received through a grant from a regulator, there may be a set of internal costs associated with the activity or product that gave rise to the environmental credit in addition to the transaction costs described above. These costs may include the use of facilities and equipment that result in generating environmental credits. Such costs may be recognized and depreciated as fixed assets or expensed as incurred, depending on the relevant GAAP.

Environmental credits obtained in a transaction that are initially measured under other applicable GAAP should be measured in accordance with the initial measurement guidance in the applicable Codification Topic, including credits obtained as consideration in a revenue contract under ASC 606, credits received in a nonreciprocal transfer from an investee under ASC 845, or credits received in a nonreciprocal transfer between entities under common control under ASC 805-50.

Environmental credits acquired in a business combination

The amendments in ASU 2026-02 clarify the guidance on accounting for environmental credits acquired in a business combination in ASC 805. In a business combination, the acquirer should recognize an acquired environmental credit as an asset, regardless of the recognition criteria in ASC 818-20-25-1. Therefore, in a business combination transaction, an environmental credit would be recognized as an acquired asset, even if it is not probable that the acquirer will use the environmental credit to settle an environmental credit obligation or in an exchange transaction or a nonreciprocal transfer.

Further, the amendments in ASU 2026-02 do not introduce any measurement exception for environmental credits acquired in a business combination; therefore, entities should initially measure environmental credits acquired in a business combination at their acquisition-date fair value under ASC 805.

Subsequent measurement

The guidance in ASC 818-20 does not require entities to subsequently remeasure compliance environmental credits after their initial measurement. However, entities should assess at each reporting date whether it is probable that these credits will continue to be used to settle an environmental credit obligation. If such use is no longer probable, then the credit should either be (1) reclassified as a noncompliance environmental credit if it is probable that it will be transferred in an exchange transaction or in a nonreciprocal transfer, or (2) derecognized through earnings if it is no longer probable that it will be used in any of these ways.

Noncompliance environmental credits are subject to impairment testing at each reporting date. An impairment loss should be recorded to the extent that the carrying value of a noncompliance environmental credits exceeds its fair value. The subsequent reversal of any previously recognized impairment loss is not permitted.

If a compliance environmental credit is reclassified as a noncompliance environmental credit, or vice versa, then the reclassified credit should be subject to impairment testing immediately prior to reclassification and before the subsequent measurement guidance is applied to the new classification.

Entities should not amortize environmental credits, regardless of whether they're classified as compliance or noncompliance environmental credits.

The requirements in ASC 818-20 provide the following acceptable costing methods for subsequently measuring similar types of environmental credits:

a. Average cost

b. First-in, first-out (FIFO)

c. Specific identification

The costing methods above should be applied separately for compliance environmental credits and noncompliance environmental credits.

Grant Thornton insight: Subsequent accounting for environmental credits acquired in a business combination

Environmental credits acquired in a business combination should be subsequently measured under ASC 818-20. Therefore, it is possible for an acquirer to recognize environmental credits acquired in a business combination at fair value, and then immediately derecognize the asset through earnings in the post-combination period, if it is probable that the acquirer will not use the acquired credits to settle an environmental credit obligation or in an exchange transaction or a nonreciprocal transfer.

Fair value election

For certain eligible noncompliance environmental credits, ASC 818 provides an accounting policy election to subsequently measure the credits at fair value at each reporting date, with changes in fair value recognized in earnings each period. This election should be made by class of noncompliance credit. The class of noncompliance credit should be determined by an entity based on its specific facts and circumstances.

ASC 818-20-35-9

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

a. An exchange transaction

b. A nonreciprocal transfer that is not a grant from a regulator or its designee(s)

c. A business combination

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

This fair value election is only eligible for noncompliance environmental credits that were obtained through one of the following methods:

a. An exchange transaction

b. A nonreciprocal transfer that is not a grant from a regulator or its designee(s)

c. A business combination

Compliance environmental credits are not eligible for the fair value election, regardless of how they were obtained. However, ASC 818-20-55-8 requires that any environmental credit for which the fair value election has been made should continue to be measured at fair value each reporting date until that credit is derecognized. This requirement includes eligible noncompliance credits that were subsequently reclassified as compliance environmental credits, which would continue to be recognized at fair value until derecognized.

An entity that adopts the fair value measurement accounting policy in a period after it initially adopts the amendments in ASU 2026-02 is subject to the requirements of ASC 205, *Accounting Changes and Error Corrections.* However, the fair value election should be applied prospectively rather than retrospectively, with a cumulative-effect adjustment recorded to retained earnings as of the beginning of the annual reporting period in which the change in policy occurs. This retained earnings adjustment should reflect the difference between the fair value and the carrying amount as of the beginning of the annual reporting period in which the change in policy occurs for all noncompliance environmental credits subject to the fair value measurement election. Annual periods prior to this change in accounting policy should not be retrospectively adjusted.

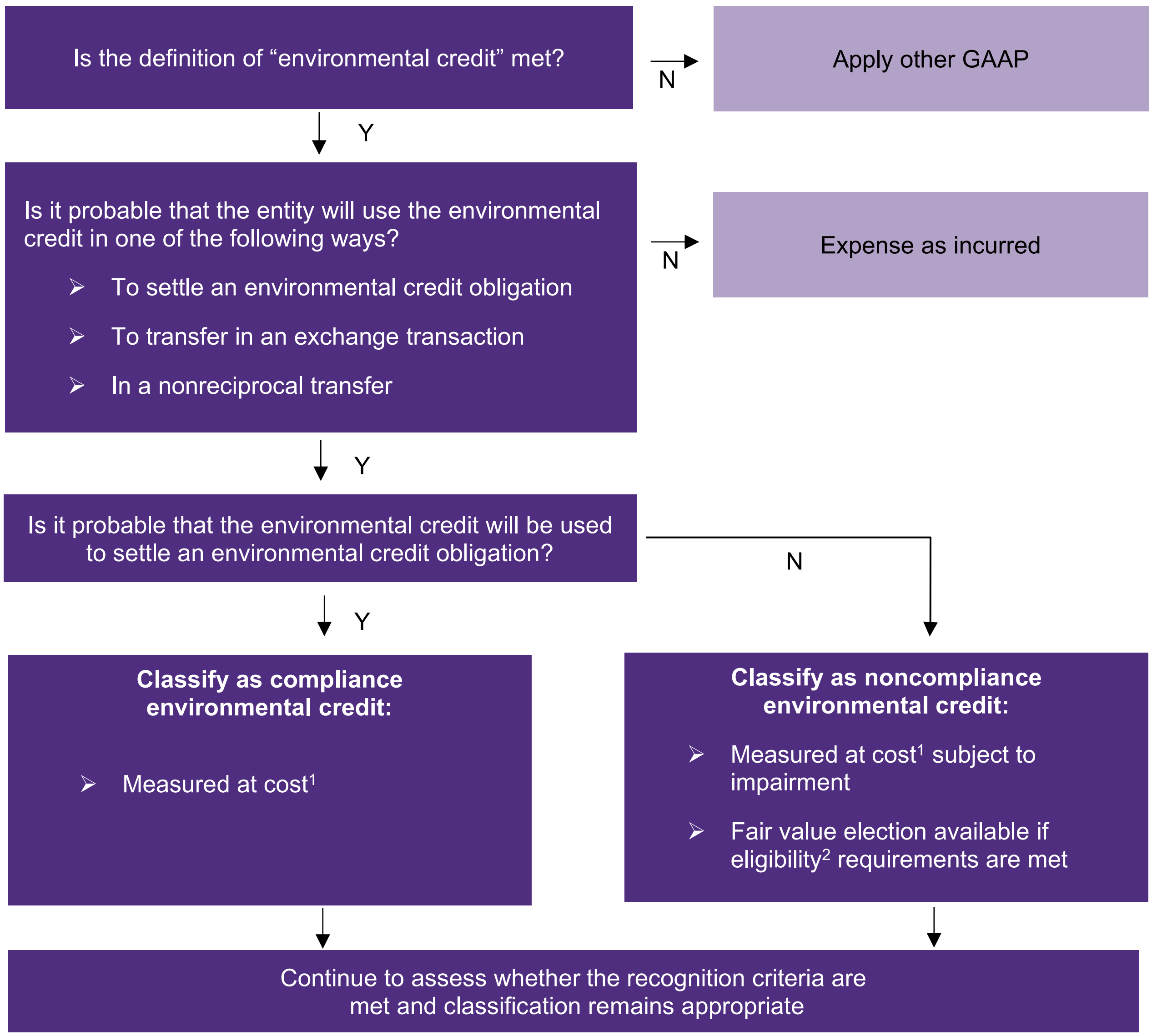
Derecognition

Entities should apply the guidance on gains and losses from the derecognition of nonfinancial assets in ASC 610-20 when derecognizing an environmental credit unless a scope exception applies, such as for environmental credits sold to a customer in a transaction subject to ASC 606, *Revenue from Contracts with Customers*.

Summary of recognition and measurement guidance

The following figure summarizes the guidance for recognizing and measuring environmental credits under ASC 818-20.

Figure 1: Recognizing and measuring environmental credits



1 – For environmental credits that are internally generated or received from a regulator, cost may be only the transaction costs incurred, if any. For environmental credits obtained in a transaction that is subject to other GAAP, entities should apply the guidance in that other Codification Topic for the initial measurement of such environmental credits.

2 – The fair value election is only permitted for noncompliance environmental credits obtained in an exchange transaction, in a nonreciprocal transfer that is not a grant from a regulator, or in a business combination.

Presentation

Recognized environmental credits should be classified as current assets to the extent the credits are reasonably expected to be transferred in an exchange transaction, used in a nonreciprocal transfer, or remitted to a regulator within one year (or the operating cycle, if longer). All other recognized environmental credits should be presented as noncurrent assets.

Environmental credit assets recognized under ASC 818-20 should be presented separately from any liabilities for environmental credit obligations recognized under ASC 818-30. Netting environmental credits and environmental credit obligations is not permitted.

Disclosure

Entities are required to provide the following environmental credit disclosures for annual reporting periods under ASC 818-20-50:

- Qualitative information that includes all of the following:
  - The types of environmental credits owned by the entity
  - How the entity obtained the environmental credits
  - How the entity intends to use the environmental credits
  - The accounting policies used to account for environmental credits
  - Significant estimates and judgments used in applying the guidance in ASC 818-20
- The amount of current and noncurrent compliance and noncompliance environmental credits if not separately presented on the balance sheet:
  - The line item(s) on the balance sheet that includes the current and noncurrent portion of the entity's compliance and noncompliance environmental credits
- Total expense recognized during the period for environmental credits that did not initially meet the asset recognition criteria or that were subsequently derecognized because the entity determined during the period that it was not probable the credits would be used in a manner consistent with the asset recognition criteria:
  - The line item(s) in the income statement that includes this amount
- Total impairment expense recognized and the nature of the environmental credits that were impaired:
  - A description of the facts and circumstances leading to the impairment
  - The line item(s) in the income statement that includes this amount
- The effect on earnings related to environmental credits if there was a change in the entity's use, or intended use, of the credits, as well as the nature of that change
- For any fair value measurements required by ASC 818-20, the applicable fair value disclosures required under ASC 820, *Fair Value Measurement*

D. Environmental credit obligations

Recognition

ASU 2026-02 defines "environmental credit obligations" as obligations resulting from regulatory compliance programs designed to prevent, control, reduce, or remove emissions or other pollution that may be settled with environmental credits. Voluntary initiatives to achieve specified emission-reduction targets or other climate goals, therefore, do not represent environmental credit obligations and should not result in the recognition of a liability. In addition, environmental obligations that are within the scope of

ASC 410-30 are not within the scope of ASC 818-30, since they do not meet the definition of an environmental credit obligation.

ASC 818-30-25-1

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

ASC 818-30-55-2

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

ASC 818-30-55-3

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

ASC 818-30-55-4

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

The events that cause an environmental credit obligation to arise are determined by each regulatory compliance program. Oftentimes, the event is the occurrence of certain emissions or the use of some quantity of energy (for example, electricity delivered), which results in an obligation to remit economic resources, such as cash or environmental credits, to the regulator to settle the obligation. The new guidance requires entities to recognize a liability by assuming that the reporting date is the end of the regulatory compliance program; therefore, the environmental credit obligation at the end of each reporting period should reflect the obligation as of that date, without consideration of events occurring after the reporting period ends that may increase or decrease the amount of the obligation that exists as of the reporting date.

When recognizing an environmental credit obligation, the cost associated with that liability may result in an expense that is recognized in earnings or, if appropriate under other GAAP, capitalized as part of another asset.

Measurement

Initial measurement

Environmental credit obligation liabilities that exist at the reporting date may include both funded and unfunded portions. Under ASC 818-30, the funded portion is measured as the carrying amount of the compliance environmental credits held and recognized as an asset as of the reporting date, to the extent that such credits are expected to be used to settle the environmental credit obligation. Credits that the entity expects to obtain in future periods cannot be considered in measuring the funded portion of the environmental credit obligation.

Because the measurement of the funded portion of the environmental credit obligation liability is based on the carrying amount of the compliance environmental credit assets, entities are required to first apply the guidance on environmental credits in ASC 818-20 before applying the guidance on environmental credit obligations in ASC 818-30.

ASC 818-30-30-2

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

a. Noncompliance environmental credits

b. Environmental credits that were never recognized as assets in accordance with paragraph ASC 818-20-25-1

c. Environmental credits that were previously derecognized in accordance with paragraph 818-20-40-2.

ASC 818-30-55-5

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

Grant Thornton insight: Measurement of environmental credit obligation liabilities based on carrying amount of compliance environmental credits

Environmental credit assets measured at zero

There may be scenarios where entities recognize environmental credit assets at a cost basis of zero, for example, if an entity internally generates environmental credits or is granted environmental credits at no cost and with no associated transaction costs. Because the measurement of the funded portion of an environmental credit obligation liability is directly tied to the carrying amount of compliance environmental credit assets, it is possible for entities to have a portion of their environmental credit obligation liabilities recorded at zero.

Environmental credit assets measured at fair value

If an entity elects to measure noncompliance environmental credits at fair value and subsequently reclassifies these credits as compliance environmental credits based on a change in their expected use, the guidance in ASC 818-20-55-8 requires the entity to continue to apply the fair value measurement until that credit is derecognized, regardless of the reclassification. Therefore, a compliance environmental credit asset could be carried at a recurring fair value measurement, and the corresponding funded portion of the environmental credit obligation liability would, in turn, be subsequently measured based on changes in the fair value of the compliance environmental credit.

The unfunded portion of an environmental credit obligation liability represents the difference between the quantity of compliance environmental credits in the funded portion and the total amount of environmental credits necessary to settle the environmental credit obligation as of the reporting date. The measurement of the unfunded portion is generally based on the fair value of those environmental credits necessary to settle the unfunded portion of the environmental credit obligation as of the reporting date.

Two exceptions to the fair value measurement requirement for the unfunded portion of environmental credits are when the entity expects to either

a. Cash-settle the unfunded obligation, in which case, the obligation would be measured at the cash-settlement amount; or

b. Remit environmental credits to be received from either (1) an existing unconditional purchase commitment for a fixed quantity of environmental credits at a fixed price, or (2) an unconditional right to receive a fixed quantity of environmental credits as part of a regulatory compliance program or from a contract where the environmental credits would be received as consideration, in which case, the obligation would be measured at the estimated acquisition cost of the credits.

ASC 818-30-30-3

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

a. Cash. An entity that intends to settle the unfunded portion by remitting cash shall measure the unfunded portion using the cash settlement amount specified by the regulatory compliance program.

b. Environmental credits that will be received before the settlement of the liability from either an existing unconditional purchase commitment for a fixed quantity of environmental credits at a fixed price or an unconditional right to receive a fixed quantity of environmental credits as part of a regulatory compliance program or contract for which environmental credits will be received as consideration. For purposes of applying the requirements in this paragraph, an unconditional right exists when an entity has satisfied all performance requirements of the regulatory compliance program or contract necessary to receive environmental credits as of the reporting date. An entity that intends to settle the unfunded portion using environmental credits from those unconditional commitments or rights shall measure the unfunded portion using the estimated cost basis of the environmental credits to be obtained (which may differ from the fixed price per the contract).

ASC 818-30-30-4

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

ASC 818-30-55-6

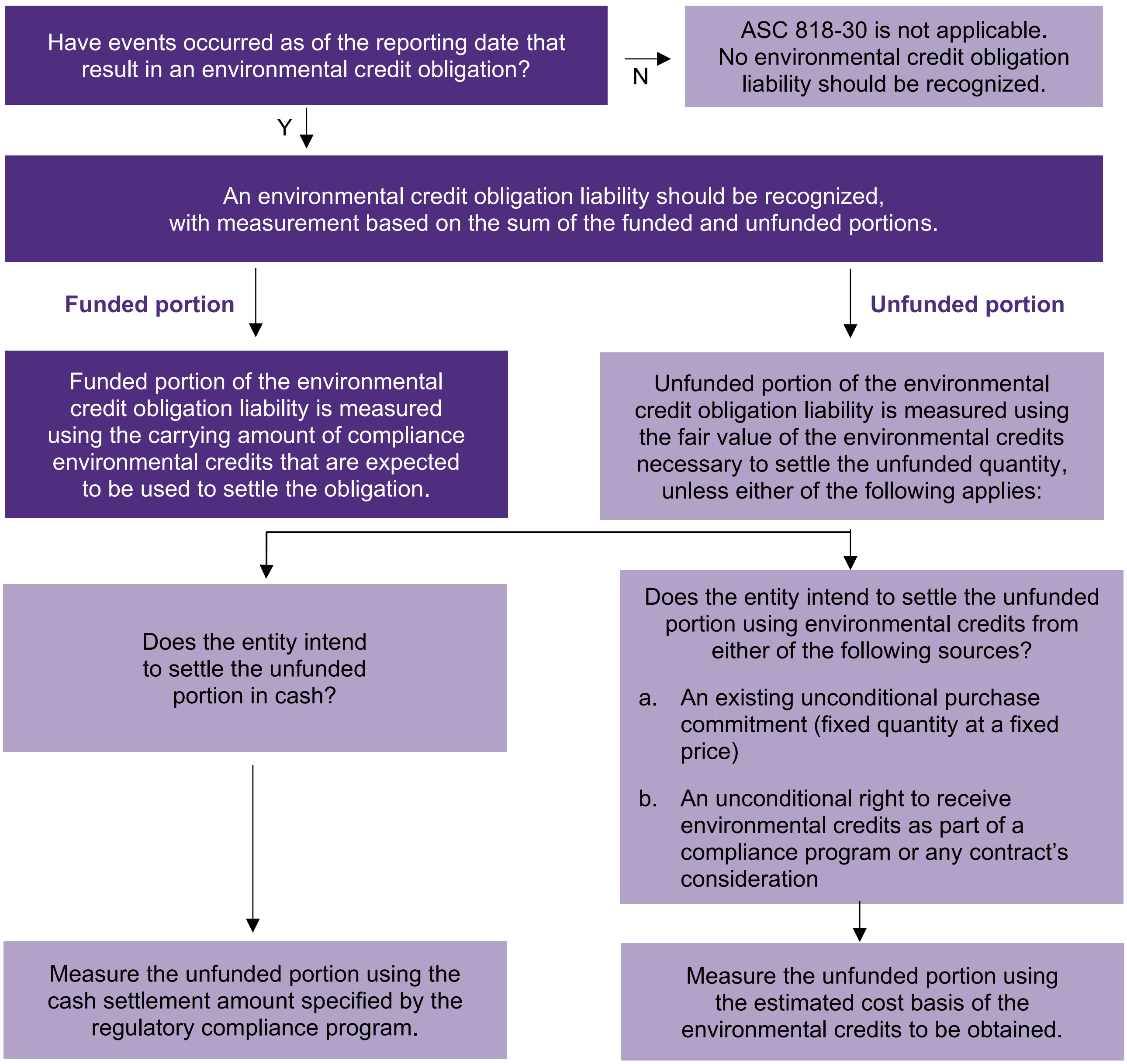
In accordance with paragraph 818-30-30-3(b), if an entity intends to settle the unfunded portion of an environmental credit obligation liability using environmental credits to be obtained before the settlement date through an unconditional purchase commitment for a fixed quantity of environmental credits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

ASC 818-30-55-7

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

The following figure summarizes the recognition and initial measurement guidance for environmental credit obligation liabilities.

Figure 2: Recognizing and measuring environmental credits obligation liabilities[1]



1 – Reproduced from implementation guidance under ASC 818-30-55-1.

Environmental credit obligations assumed in a business combination

Environmental credit obligations assumed in a business combination should be recognized by the acquirer if the environmental credits would be due under a regulatory compliance program, assuming that the acquisition date is the end of the regulatory compliance period.

The amendments to ASC 805 under ASU 2026-02 also provide a measurement exception for environmental credit obligations, which allows entities to measure the liability assumed using the guidance in ASC 818-30 instead of measuring at fair value at the acquisition date.

The amendments to ASC 805 require the acquirer to include only those environmental credits acquired in a business combination that are classified as compliance environmental credits when measuring the funded portion of the acquiree's environmental credit obligation liability. The acquirer should consider only the rights *of the acquiree* that exist at the acquisition date when measuring the unfunded portion of the acquiree's environmental credit obligation liability that is based on either (1) an existing unconditional purchase commitment for a fixed quantity of environmental credits at a fixed price, or (2) an unconditional right to receive a fixed quantity of environmental credits as part of a regulatory compliance program or contract for which environmental credits will be received as consideration.

Subsequent measurement

For each subsequent reporting period, an entity should continue to apply the initial measurement guidance outlined above to determine the environmental credit obligation liability as of each reporting date. Changes in the carrying amount of the environmental credit obligation liability should be recognized in earnings or as part of another asset if applicable under other GAAP.

Derecognition

Environmental credit obligation liabilities should be derecognized in accordance with the guidance in ASC 405-20 on the extinguishment of liabilities, as amended by ASU 2026-02.

ASC 405-20-40-1 [as amended by ASU 2026-02]

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

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

Presentation

Environmental credit obligation liabilities should be classified as a current liability to the extent the obligation is reasonably expected to be settled within one year (or the operating cycle, if longer). All other environmental credit obligation liabilities should be presented as noncurrent liabilities. All environmental credit obligation liabilities should be presented separately from any compliance environmental credit assets.

Changes in the amount of environmental credit obligation liabilities, along with any gain or loss recognized upon derecognition, should be presented in the income statement in a manner consistent with the initial recognition and measurement of the liability.

Disclosure

The amendments in ASC 818-30-50 require the following environmental credit obligation disclosures for annual reporting periods:

- Qualitative information related to the regulatory compliance programs that the entity is subject to resulting in the recognition of environmental credit obligation liabilities, including all of the following items:
  - The activities or events that result in environmental credit obligation liabilities under the regulatory compliance programs as well as the nature and timing of settlement provisions
  - The accounting policies used to account for environmental credit obligations
  - How the unfunded portion of an environmental credit obligation liability is measured
  - Significant estimates and judgments made in applying the guidance in ASC 818-30
- The amount of the current and noncurrent portions of funded and unfunded environmental credit obligation liabilities, if not separately presented on the balance sheet:
  - The line item(s) on the balance sheet that includes the current and noncurrent portion of the entity's funded and unfunded environmental credit obligation liability
- Total expense recognized during the period for environmental credit obligation liabilities:
  - The line item in the income statement that includes this amount
- Total costs associated with environmental credit obligation liabilities that are capitalized and included in the carrying amount of another asset in accordance with other GAAP:
  - A description of the other asset(s)

For any fair value measurements required under ASC 818-30, the fair value disclosure requirements under ASC 820, *Fair Value Measurement*, are also required.

E. Effective date and transition

Effective date

The amendments in ASU 2026-02 are effective for public business entities for annual reporting periods beginning after December 15, 2027 and for interim reporting periods within those annual reporting periods. For entities other than public business entities, the amendments are effective for annual reporting periods beginning after December 15, 2028 and for interim reporting periods within those annual reporting periods.

Early adoption is permitted in an interim or annual reporting period if the financial statements have not yet been issued or made available for issuance. If adopting the amendments in an interim reporting period, an entity should adopt them as of the beginning of the annual reporting period that includes the interim period of adoption.

Transition

Entities should adopt the amendments in ASU 2026-02 using a retrospective approach through a cumulative-effect adjustment to opening retained earnings as of the beginning of the annual reporting period of adoption. An entity should not recast any financial statement information for periods prior to the annual reporting period of adoption.

On the date of initial adoption of the amendments in ASU 2026-02, entities should

- Recognize environmental credit assets for credits that meet the recognition criteria in ASC 818-20-25-1 and derecognize the carrying amount of environmental credits that do not meet these criteria (for example, voluntary environmental credits), unless such credits were previously capitalized as part of another asset accounted for in accordance with other GAAP Topics, such as ASC 330, *Inventory,* prior to the adoption date. In such cases, the cost of credits capitalized under other Codification Topics should still be included as part of the carrying amount of that other asset. In addition, entities should also derecognize the carrying amount of any nonrefundable deposit assets related to the purchase of environmental credits that do not meet the recognition criteria in ASC 818-20-25-1.
- At the date of initial application, measure recognized environmental credit assets as follows:
    a. Compliance environmental credits at the entity's adoption-date carrying amount
    b. Noncompliance environmental credits at the lower of the entity's adoption-date carrying amount and the adoption-date fair value. The class of eligible noncompliance environmental credits that the entity elects to subsequently measure at fair value should be recognized at the adoption-date fair value
    c. Compliance and noncompliance environmental credits that were internally generated or received through a grant from a regulator at the amount of their transaction costs under an accounting policy election, in accordance with ASC 818-20-30-1
- Recognize and measure environmental credit obligations as of the adoption date in accordance with the guidance under ASC 818-30.

The amendments to ASC 805-20 related to environmental credits acquired and environmental credit obligations assumed in a business combination should be applied prospectively to business combination transactions that occur after the adoption date of the amendments in ASU 2026-02.

Transition disclosures

Entities are required to provide the following transition disclosures for the period in which the amendments are adopted, as required by ASC 250-10-50-1(a), (b)(3), and (c), as well as by ASC 50-2:

- The nature of and reason for the change in accounting principle

- The cumulative effect of the change on opening retained earnings as of the beginning of the annual reporting period of adoption
- If indirect effects of adoption are recognized, both of the following:
  - A description of those indirect effects, including the amounts that have been recognized in the current period and the related per-share amounts, if applicable
  - Unless impracticable, the amount of the total recognized indirect effects and the related per-share amounts, if applicable, that are attributable to each prior period presented. Compliance with this disclosure requirement is practicable unless an entity cannot comply with it after making every reasonable effort to do so

An entity that issues interim financial statements is required to provide these transition disclosures in the financial statements for both the interim period of the change and for the annual period of the change.

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Appendix

Illustrative examples – Environmental credits

The amendments in ASU 2026-02 provide examples under ASC 818-20-55 showing how to apply the recognition and measurement requirements for environmental credits.

Example 1 illustrates the accounting for purchased environmental credits that are recognized as assets.

Example 1 – Acquired Environmental Credits Recognized as an Asset

ASC 818-20-55-10

An industrial manufacturing entity is subject to a cap-and-trade regulatory compliance program that mandates the remittance of emissions allowances to a regulator by March 31, 20X5, based on the amount of the entity's emissions for a compliance year ending on December 31, 20X4. On January 1, 20X4, the entity purchases 10,000 emissions allowances at a regulator-sponsored auction for $1,000,000 ($100 per allowance) and pays $25,000 in auction fees. At initial recognition, the entity determines that it is probable that it will use those emissions allowances to settle its 20X4 cap-and-trade environmental credit obligation because it estimates that its emissions during 20X4 will require the remittance of 15,000 emissions allowances. The entity classifies the 10,000 emissions allowances as compliance environmental credits, initially measured at $1,025,000, in accordance with paragraph 818-20-30-3. Those emissions allowances are not remeasured if they continue to be classified, at each reporting date, as compliance environmental credits.

Example 2 illustrates the accounting for purchased environmental credits that are expensed as incurred.

Example 2 – Acquired Environmental Credits Recognized as an Expense as Incurred

ASC 818-20-55-11

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

Example 3 illustrates the accounting for internally generated environmental credits that are recognized as assets.

Example 3 – Internally Generated Environmental Credits Recognized as an Asset

ASC 818-20-55-12

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

Example 4 illustrates the accounting for environmental credits granted by a regulator that are recognized as assets.

Example 4 – Environmental Credits Granted by a Regulator and Recognized as an Asset

ASC 818-20-55-13

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

Illustrative examples – Environmental credit obligations

The amendments include examples under ASC 818-30-55 that show how to apply the recognition and measurement requirements for environmental credit obligation liabilities.

Example 1 illustrates the accounting for the funded portion of the environmental credit obligation liability when a first-in, first-out costing method is used (Case A) and when an average cost method is used (Case B).

Example 1 – Funded Environmental Credit Obligation Liability

Case A – Compliance Environmental Credits Using the First-in, First-out Costing Method

ASC 818-30-55-9

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

ASC 818-30-55-10

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

ASC 818-30-55-11

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

Case B – Compliance Environmental Credits Using an Average Cost Method

ASC 818-30-55-12

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

ASC 818-30-55-13

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

Example 2 illustrates the accounting for the unfunded portion of the environmental credit obligation liability when using the fair value of the required environmental credits (Case A), when using cash settlement (Case B), and when using purchase commitments (Case C).

Example 2 – Excess Environmental Credit Obligation Liability

Case A – Compliance Environmental Credits Using the First-in, First-out Costing Method

ASC 818-30-55-14

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

ASC 818-30-55-15

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

March 31, 20X4, the fair value of those environmental credits is $4 per credit. Therefore, the entity recognizes an unfunded environmental credit obligation liability of $800,000 on that date.

ASC 818-30-55-16

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

Case B – Environmental Credit Obligation Liability Measured Considering Cash Settlement Provisions

ASC 818-30-55-17

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

Case C – Environmental Credit Obligation Liability Measured Considering Purchase Commitments

ASC 818-30-55-18

Assume the same facts and circumstances as in Case A except that during 20X3 the entity executed an unconditional purchase commitment for 500,000 environmental credits at $3 per credit to be received before the settlement date. On March 31, 20X4, the entity intends to settle its environmental credit obligation liability using environmental credits to be obtained from that purchase commitment. In accordance with paragraph 81830-30-3(b), the entity recognizes an environmental credit obligation liability of $600,000.

Example 3 demonstrates two scenarios in which an environmental credit obligation would not be recognized.

Example 3 – Environmental Credit Obligation Liability Not Recognized

Case A – Emissions below Baseline

ASC 818-30-55-19

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

Case B – Voluntary Environmental Initiatives

ASC 818-30-55-20

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

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