FASB

Environmental Credit Programs

FASB | IASB Education Meeting

October 11, 2024

FASB FINANCIAL ACCOUNTING STANDARDS BOARD® GASB GOVERNMENTAL ACCOUNTING STANDARDS BOARD® FAF FINANCIAL ACCOUNTING FOUNDATION®

Tentative Decisions Reached

Project objective: *To improve the recognition, measurement, presentation, and disclosure requirements for participants in compliance and voluntary programs that result in the creation of environmental credits and for the nongovernmental creators of environmental credits*

October 2023
- Asset Scope
- Liability Scope
- Asset: Recognition and Measurement

January 2024
- Liability: Recognition and Measurement
- Presentation

March 2024
- Fair Value Policy Election
- Interaction with Business Combinations

June 2024
- Fair Value Policy Election Refinements
- Disclosures
- Transition
- Permission to Ballot

Asset Scope

- An item that meets the following definition of an environmental credit would be within the scope of the project:

  An enforceable right that is acquired, internally generated, or granted by a regulatory agency or its designees that meets all of the following:

  1. Lacks physical substance and is not a *financial asset* (as defined in the Master Glossary)
  2. Is represented to prevent, control, reduce, or remove emissions or other pollution
  3. Is separately transferable in an exchange transaction
  4. Is not a 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 (for example, a refundable or transferable clean energy tax credit).

  An environmental credit may be represented by a variety of forms, including credits, certificates, allowances, and offsets.

Examples of Items That Would Be Affected by This Project

Within Scope

- Carbon offsets
- Carbon credits
- Renewable energy certificates (RECs)
- Renewable identification numbers (RINs)
- Cap-and-trade allowances
- Baseline program allowances
- Corporate Average Fuel Economy (CAFE) credits
- Environmental credits received from partnerships or other equity structures that generate credits

Not Addressed by This Project

- Renewable clean energy tax credits
  - Transferable tax credits
  - Refundable tax credits
- Additional payments made for "carbon neutral" activities for which no credit is transferred (e.g., paying more for a carbon neutral flight)
- Investments in partnerships or other equity structures that generate credits

Liability Scope

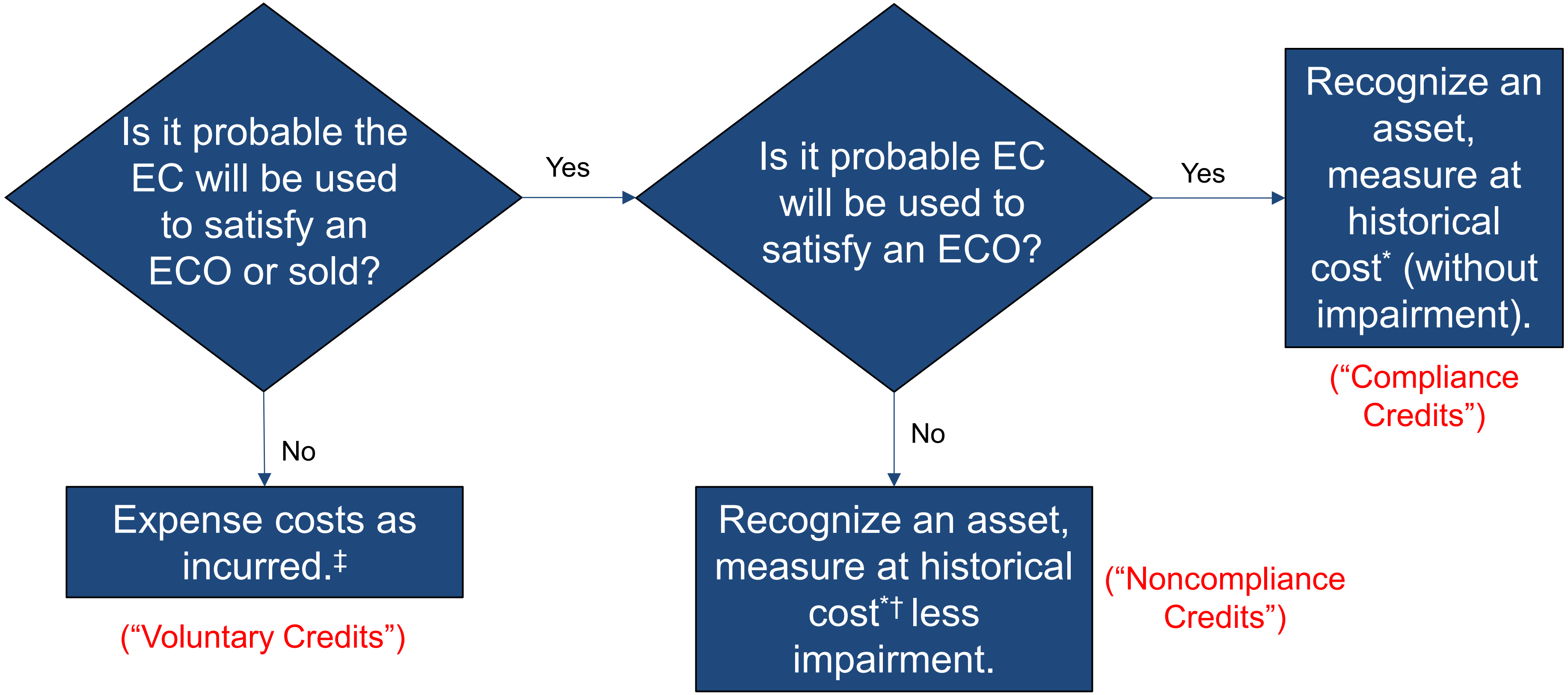
- An obligation that meets the following definition of an environmental credit obligation would be within the scope of this project:

  An obligation arising from existing or enacted laws, statutes, or ordinances represented to control, reduce, or remove emissions or other pollution that may be settled with *environmental credits.* Obligations associated with environmental remediation liabilities (in Subtopic 410-30) are not environmental credit obligations, regardless of whether those obligations may be settled using environmental credits.

- The scope of this project does not include an entity’s internally established emission reduction or environmental, social, and governance goals (for example, “net zero” commitments).

Asset Recognition and Measurement

- The following diagram summarizes the Board's tentative decisions for asset recognition and measurement:



Required to reassess each question at each reporting period until EC is derecognized

Notes

EC = Environmental Credit

ECO = Environmental Credit Obligation

* Historical cost (purchase price + transaction costs). The historical cost of granted and created credits would be limited to transaction costs incurred or zero if none.

‡ An entity is prohibited from capitalizing the cost of ECs that will not be sold or used to settle an ECO liability, including as part of another asset. Additionally, an entity should recognize nonrefundable deposits for ECs that are not probable of being used to settle an ECO or transferred in an exchange transaction as an expense.

† An entity is permitted to make a fair value accounting policy election to remeasure a class of noncompliance ECs obtained in an exchange transaction or through a nonreciprocal transfer that is not a grant from a regulator or its designee.

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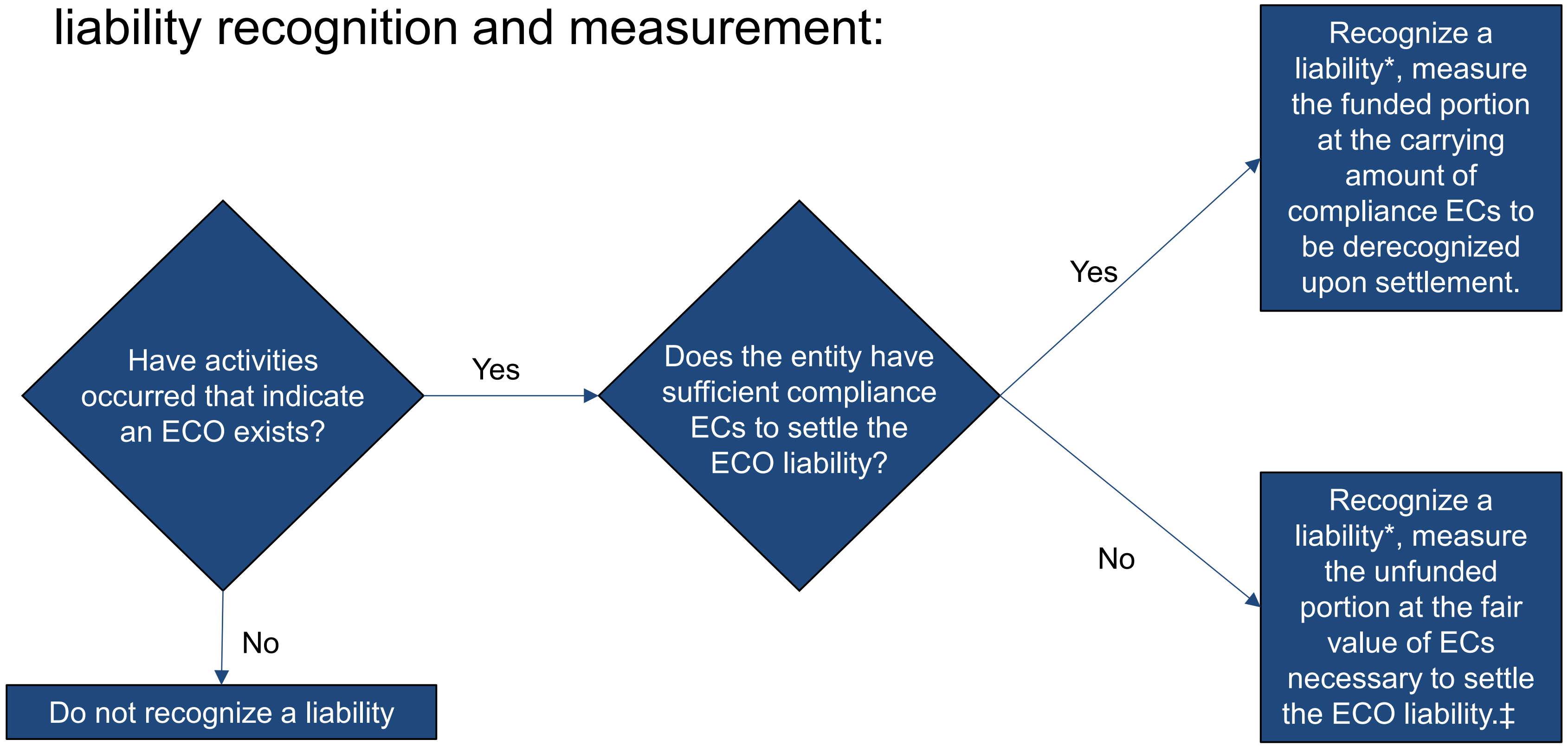
Liability Recognition and Measurement

- The following diagram summarizes the Board's tentative decisions for liability recognition and measurement:



Notes

EC = Environmental Credit

ECO = Environmental Credit Obligation

* For obligations requiring an entity to remit a fixed number of ECs to a regulator at a specified date solely as a result of existing as a business, an entity would recognize a liability on the day it becomes obligated. Additionally, the entity should recognize a corresponding asset, which should be amortized over the compliance period.

‡ Unless the entity intends to settle by remitting cash to the regulator (measure the liability at cash settlement amount) **or** using ECs obtained through an existing commitment to purchase a fixed quantity of ECs at a fixed price (measure the liability at estimated cost basis of credits to be obtained).

- When determining whether to recognize an ECO liability, an entity should consider the balance sheet date to be the end of the compliance period.
- Required to reassess each question at each reporting period until ECO liability is derecognized.

Presentation and Illustrative Example

- Assets (environmental credits) and liabilities (ECOs) required to be presented on a gross basis
- Example:
  - As of June 30, 202X, Entity has emitted 1,000 tons and would be required to remit 1,000 credits if the compliance period ended on that date. Entity owns 800 compliance environmental credits with a carrying amount of $8,000.
  - The fair value of a similar credit on June 30 is $15.
  - The entity would recognize a liability for $11,000 ($8,000 + 200 * $15)
  - The entity would present an asset of $8,000 and a liability of $11,000.

Disclosures

- Qualitative information and accounting policy
- Significant holdings and obligations
- Income statement information
- Cash paid to acquire credits
- Current requirements for fair value measurement

Next Steps

Proposed Accounting Standards Update expected to be issued during Q4 2024

90 day comment period