



## Financial Reporting Insights

# FASB ISSUES GUIDANCE ON ACCOUNTING FOR ENVIRONMENTAL CREDITS

May 2026

## Overview

On May 19, 2026, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2026-02, *Environmental Credits and Environmental Credit Obligations* (Topic 818). This new guidance provides a comprehensive accounting model for all entities that generate, purchase or receive environmental credits or have a regulatory compliance obligation that may be settled with environmental credits.

The new guidance defines “environmental credits” and provides an intent-based probability model for determining both when they should be recognized as assets and the subsequent measurement of those assets. The guidance also requires enhanced disclosures about how credits are obtained, used and valued.

Additionally, the new guidance defines “environmental credit obligations”, clarifying when entities must recognize environmental credit obligation liabilities arising from regulatory compliance programs, how those liabilities are measured and what disclosures are required related to those obligations.

The amendments in ASU 2026-02 are effective for public business entities in annual periods beginning after December 15, 2027, including interim periods therein, and one year later for all other entities. Early adoption is permitted for all entities. The amendments are generally required to be applied on a retrospective basis.

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## 1 BACKGROUND

Environmental credit programs are typically designed to prevent or reduce emissions or other pollutants and have become increasingly prevalent in recent years. Many entities obtain environmental credits, such as renewable energy certificates or carbon allowances, to comply with regulatory requirements. Entities may also obtain credits under voluntary initiatives (e.g., to meet voluntary commitments to reduce net emissions through carbon offsets or other environmental credits). Under these regulatory and voluntary programs, entities may generate, purchase or receive environmental credits. In addition to being used to satisfy regulatory obligations or voluntary initiatives, environmental credits can also be transferred or sold in secondary markets.

Prior to the FASB's issuance of ASU 2026-02, entities have generally accounted for environmental credits and related obligations by analogy to other areas of U.S. generally accepted accounting principles (GAAP), such as the accounting for inventory, intangible assets or contingencies. This approach has led to diversity in practice and reduced comparability for investors and other users of financial statements. ASU 2026-02 addresses this diversity in practice by introducing a comprehensive accounting model—including recognition, measurement, presentation and disclosure requirements—under new Accounting Standards Codification (ASC) Topic 818, *Environmental Credits and Environmental Credit Obligations*.

## 2 SCOPE AND DEFINITIONS

The new guidance in ASC 818 applies to all environmental credits (ECs) and environmental credit obligations (ECOs), as those terms are defined in the ASC Master Glossary. ECs and ECOs within the scope of ASC 818 are outside the scope of ASC 815, *Derivatives and Hedging*, although a freestanding contract to obtain or sell an EC in the future may be subject to the requirements in ASC 815, unless it qualifies for any of the scope exceptions within that Topic.

### 2.1 Environmental Credits



#### ASC Master Glossary

##### Environmental Credit

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

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

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

##### 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.

**Noncompliance Environmental Credit**

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

Broadly, ECs are enforceable rights that are separately transferable in an exchange transaction and are represented to prevent, control, reduce or remove emissions or other pollution. Paragraph BC31 of ASU-2026-02 explains that the FASB chose the term “represented to” since it may be impractical to determine the environmental impact of an activity linked to an environmental credit. Therefore, the scope of ASC 818 is limited to items such as emissions allowances, renewable energy certificates, renewable identification numbers, fuel economy credits and carbon offsets. In response to comment letter feedback, the FASB also clarified that if an EC was previously separately transferable, but later becomes no longer separately transferable, it would still meet the definition of an EC as long as the entity can use it to satisfy an ECO. Lastly, an EC is not limited to a specific legal form, but it does need to represent an enforceable right. The FASB expects enforceability to be clear in most cases, but some situations may require judgment.

As discussed in [Section 3](#), the subsequent measurement of an EC varies depending on whether it is a compliance EC or a noncompliance EC as now defined in the ASC Master Glossary.

**2.2 Environmental Credit Obligations**



**ASC Master Glossary**

**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.

In developing the definition of an ECO, the FASB leveraged the ASC Master Glossary definition of “legal obligation” and noted that the obligation must be able to be settled with ECs. As a result, the FASB decided an entity’s voluntary programs (e.g., net zero emission-reduction initiatives or carbon neutral initiatives) are not within the scope of ASC 818, even if an entity intends to satisfy such voluntary initiatives with ECs.

An ECO liability can be funded or unfunded. The funded portion of an ECO liability refers to the portion for which the entity has associated compliance ECs that can be used to satisfy or settle the ECO liability. If an entity does not have sufficient ECs to satisfy an ECO liability, the difference is deemed to be the unfunded portion of the ECO liability.

**3 RECOGNITION AND MEASUREMENT**

The following table summarizes the key recognition and measurement guidance for EC assets and ECO liabilities under ASC 818, including the relationship between the accounting for EC assets and ECO liabilities.

	<b>EC Assets</b>	<b>ECO Liabilities</b>
<b>Recognition</b>	An EC is recognized as an asset if it is probable the EC will be used to settle an ECO, transferred in an exchange transaction or used in a nonreciprocal transfer. This probability assessment is not required to be applied at the	A liability is recognized when events (e.g., emissions) that occur on or before a reporting date result in an ECO. When evaluating whether to recognize an ECO liability, an entity should determine whether ECs or other economic benefits



	EC Assets	ECO Liabilities
	<p>individual EC level; an entity may conclude that a portion of a pool of similar types of ECs may meet the recognition criteria without identifying which individual ECs in the pool would meet the criteria.</p> <p>Costs to obtain all other ECs, including any nonrefundable deposits made to obtain ECs, are expensed as incurred.</p>	<p>would be due to settle the ECO assuming that the reporting date is the end of the regulatory compliance period, regardless of whether the compliance period ends on or after that date.</p> <p>An entity should recognize an ECO liability through earnings or, if appropriate, as part of the carrying amount of another asset accounted for in accordance with other GAAP.</p>
<b>Initial measurement</b>	<p>ECs that are either internally generated or received through a grant from a regulator are initially measured at the transaction costs incurred to obtain those ECs, if any. Examples of transaction costs include costs necessary to validate, register or authenticate an EC. If an entity does not incur transaction costs, the EC is still deemed to be a recognized EC asset measured at zero.</p> <p>ECs obtained in a transaction initially measured in accordance with other GAAP (e.g., an EC received as consideration in a contract within the scope of ASC 606, <i>Revenue from Contracts with Customers</i>) should be measured pursuant to such other GAAP.</p> <p>All other ECs should be initially measured at cost, as defined in ASC 805-50-30-1 through 30-4 (<i>Acquisition of Assets Rather than a Business</i>).</p>	<p>The initial measurement of an ECO liability is based on the extent to which the ECO liability is funded or unfunded.</p> <p>The funded portion of an ECO liability is measured at the carrying value of recognized compliance ECs that are expected to be derecognized for accounting purposes upon settlement of the liability, including recognized compliance ECs measured at zero.</p> <p>The unfunded portion of the ECO liability is measured using the fair value of ECs necessary to settle that portion of the liability at the measurement date, with two exceptions:</p> <ul style="list-style-type: none"> <li>• To the extent the entity intends to settle the unfunded portion in cash, the unfunded portion should be measured using the cash settlement amount specified by the regulatory compliance program.</li> <li>• To the extent the entity intends to settle the unfunded portion with ECs to be received prior to settlement pursuant to specific types of unconditional purchase commitments or rights as described in ASC 818, the unfunded portion should be measured using the estimated cost basis of ECs to be obtained.</li> </ul> <p><b>Note:</b> An entity should not consider expected future activities that may increase, reduce or eliminate its ECO</p>



	EC Assets	ECO Liabilities
		liability when determining the unfunded portion of its liability.
<b>Recognition reassessment and subsequent measurement</b>	<p><u>Recognition reassessment</u></p> <p>At each reporting date, entities should reassess whether it remains probable that the ECs will be used to settle an ECO, transferred in an exchange transaction or used in a nonreciprocal transfer. If no longer probable, the EC asset should be derecognized through earnings.</p> <p>An EC that was previously derecognized or was never recognized as an asset is prohibited from being subsequently recognized as an asset, even if the EC later meets the probability threshold.</p> <p><u>Subsequent measurement</u></p> <p>The subsequent measurement of EC assets considers the entity’s intended use of the ECs, which is determined at each reporting date:</p> <ul style="list-style-type: none"> <li>• Compliance ECs are not subsequently remeasured.</li> <li>• Noncompliance ECs are tested for impairment at each reporting date. An impairment loss should be recognized for any excess of the carrying value over fair value. Impairment losses may not be reversed in future periods.</li> </ul> <p><b>Note:</b> Similar EC assets may be subsequently measured using the average cost; first-in, first-out; or specific identification costing methods. The selected method should be applied separately for the entity’s compliance and noncompliance ECs.</p>	<p>ECO liabilities are remeasured at each reporting date by applying the initial measurement guidance, and assuming the reporting date is the end of the regulatory compliance period.</p> <p>Any changes in the ECO liability balance are recognized through earnings or, if appropriate, as an adjustment to the carrying amount of another asset accounted for in accordance with other GAAP, consistent with the application of the ECO liability recognition requirements described above.</p>
<b>Derecognition</b>	<p>EC assets should be derecognized using the guidance in ASC 610-20, <i>Other Income – Gains and Losses from the Derecognition of Nonfinancial Assets</i>, unless a scope exception from that Subtopic exists (e.g., EC assets should be derecognized using the guidance in</p>	<p>ECO liabilities should be derecognized using the guidance in ASC 405-20, <i>Liabilities – Extinguishments of Liabilities</i>.</p>



	EC Assets	ECO Liabilities
	ASC 606 if the transaction is a contract with a customer).	
<b>Business Combinations</b>	<p>An acquirer should recognize an EC acquired in a business combination as an asset, regardless of whether it is probable that the acquirer will use the EC to settle an ECO, transfer it in an exchange transaction or use it in a nonreciprocal transfer.</p> <p>If an item acquired in a business combination does not meet the definition of an EC solely because it is not separately transferable in an exchange transaction at the acquisition date, it is not an identifiable asset and should not be recognized as an asset.</p> <p>An EC asset acquired in a business combination is subject to the recognition reassessment requirements described above and would therefore be derecognized through earnings at the first reporting date after the business combination if it is not probable of being used to settle an ECO, transferred in an exchange transaction or used in a nonreciprocal transfer at that reporting date.</p>	<p>An ECO liability assumed in a business combination should be measured according to the initial measurement guidance in ASC 818 described above, assuming the acquisition date is the end of the regulatory compliance period for purposes of determining whether an ECO liability should be recognized as part of the business combination.</p>
<b>Fair value option (Accounting policy election)</b>	<p>Entities may make an accounting policy election to subsequently measure a class of eligible noncompliance ECs at fair value with changes in fair value recognized in earnings until the EC is derecognized, even if the EC is reclassified as a compliance EC at a subsequent reporting date. An entity should determine what constitutes a class based on its specific facts and circumstances.</p> <p>Noncompliance ECs eligible for the fair value option include only those obtained through either an exchange transaction, a nonreciprocal transfer that is not a grant from a regulator or its designee, or a business combination.</p>	<p>There is no fair value option for ECO liabilities, even if the liability can be settled in cash. However, if an entity elects to measure noncompliance ECs at fair value and a noncompliance EC is subsequently reclassified as a compliance EC, the compliance EC continues to be measured at fair value, therefore affecting the measurement of the related funded portion of the entity's ECO liability.</p>



## 4 PRESENTATION AND DISCLOSURE

Under ASC 818, ECO liabilities must be presented separately from compliance EC assets on the balance sheet (i.e., on a gross basis; net presentation is not permitted).

An entity that presents a classified balance should classify ECs reasonably expected to be transferred in an exchange transaction, used in a nonreciprocal transfer or remitted to a regulator within one year (or the operating cycle of the business, if longer) as current assets, and classify all other ECs as noncurrent assets. Similarly, ECOs that are reasonably expected to be settled within one year (or the operating cycle of the business used for applying the guidance to ECs, if longer) should be classified as current liabilities, and all other ECOs should be classified as noncurrent liabilities.

Changes in the balance of an ECO liability recognized through earnings, and any gain or loss upon derecognition of an ECO liability, should be presented in the income statement in a manner consistent with the recognition and measurement of that liability.

ASC 818 requires certain qualitative disclosures in annual financial statements. Such requirements include specific disclosures regarding regulatory compliance programs, how an entity obtained and intends to use its ECs, accounting policies for ECs and ECOs, and significant estimates and judgments used in applying the guidance. Certain quantitative disclosures are also required, including the total expense for voluntary environmental credits and total expense related to ECO liabilities. If an entity changes its use, or intended use, of its ECs, it is required to disclose the nature of that change and the related effect on earnings.

In addition to the requirements of ASC 818, the fair value disclosures required under ASC 820, *Fair Value Measurement*, should be provided for any fair value measurements made under ASC 818.

## 5 IMPLEMENTATION CONSIDERATIONS

While the effective date of ASU 2026-02 may seem far off, there are some things that entities should start to think about now to ensure they are ready to apply the requirements of the ASU upon adoption.

Under Staff Accounting Bulletin (SAB) 74, SEC registrants should disclose the potential effects of adoption of the amendments in ASU 2026-02 in registration statements and annual and quarterly filings until the amendments are adopted, unless the impact is not expected to be material. SAB 74 is codified in [SAB Topic 11M, Disclosure of the Impact That Recently Issued Accounting Standards Will Have On The Financial Statements Of the Registrant When Adopted In A Future Period](#).

Additionally, entities should begin to compile an inventory of their ECs and ECOs and assess the differences between their current accounting policies and the guidance under ASC 818. Implementing ASC 818 may require coordination across finance, operations and compliance teams. Key initial planning considerations include:

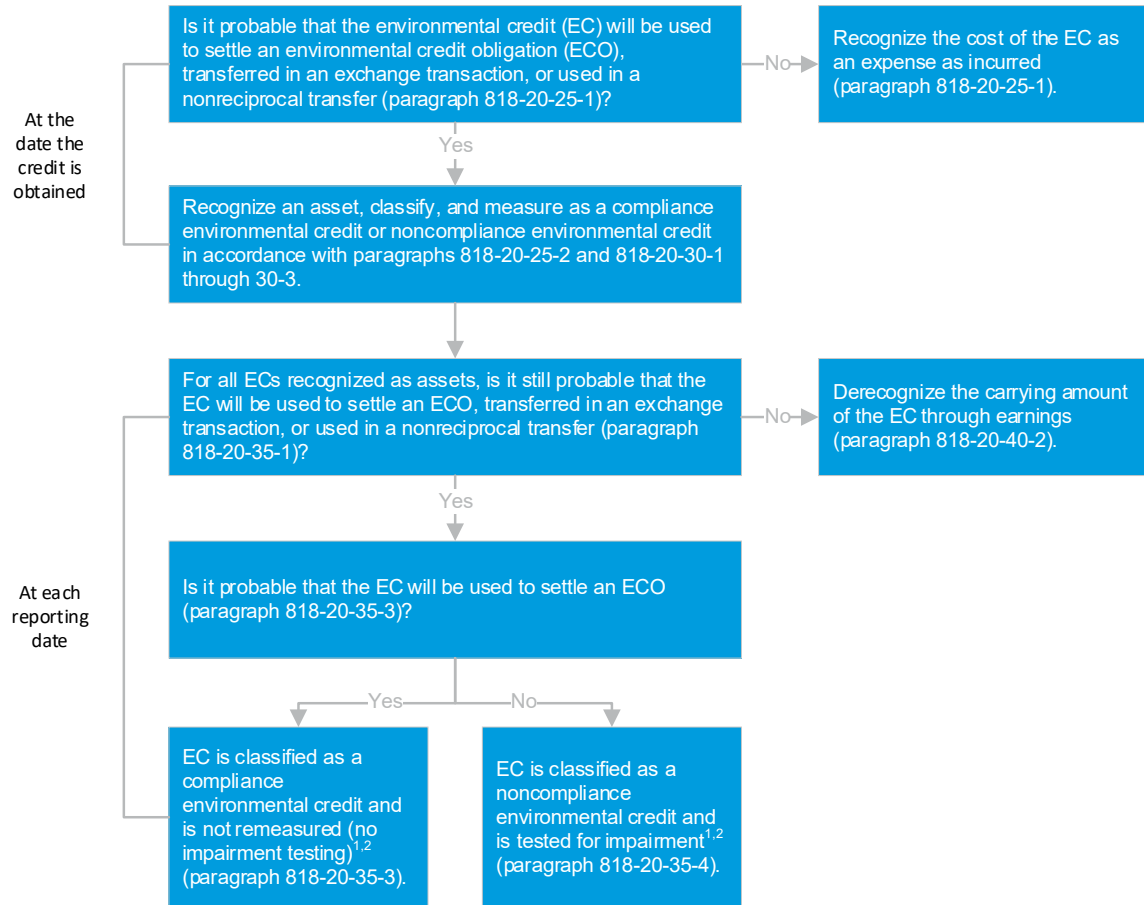
- **Governance and controls.** Expanded disclosures and fair value measurements will require related internal control processes and associated documentation. Entities will need to assess whether changes or updates are necessary to their existing governance frameworks and process narratives.
- **Systems and processes.** Entities must track ECs and ECOs by classification and apply costing methods consistently. Existing ERP systems may need modifications to capture the required data and entities will need to start assessing whether any system changes are necessary.
- **Industry impact.** Energy producers, utilities, and automotive and other manufacturers are most likely to be affected due to the prevalence of compliance programs in these industries. Entities that trade ECs will also be impacted.
- **Alignment with ESG reporting.** Many entities already report environmental metrics, including reporting related to environmental credit programs, as part of sustainability disclosures. Entities

should consider whether the information in reports outside the financial statements is consistent with financial reporting under ASC 818.

- **Early adoption.** An entity may choose to early adopt the amendments in ASU 2026-02 for a variety of reasons, particularly if it has material EC or ECO activity, given the introduction of a comprehensive accounting and disclosure model in ASC 818 to address the previous diversity in practice and lack of guidance.

## APPENDIX A: FLOWCHARTS

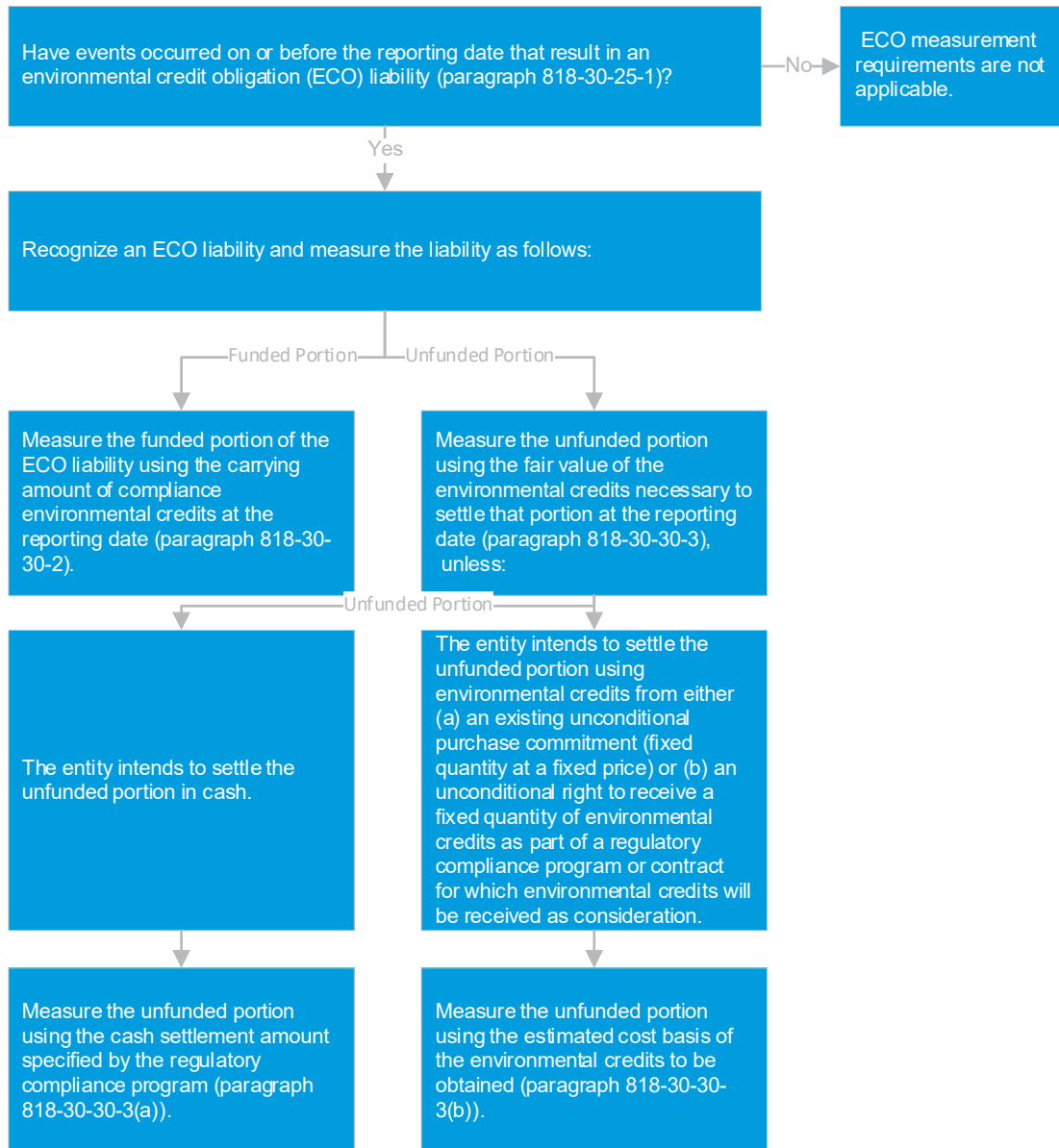
The following flowchart from ASC 818-20-55-1 walks through the requirements for accounting for environmental credits.



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

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

The following flowchart from ASC 818-30-55-1 walks through the requirements for accounting for environmental credit obligations.



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