

ENVIRONMENTAL CREDITS AND ENVIRONMENTAL CREDIT OBLIGATIONS UNDER ASC 818

MAY 2026

SUMMARY

The Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2026-02, *Environmental Credits and Environmental Credit Obligations (Topic 818)* to provide guidance on the recognition, measurement, presentation, and disclosure requirements for environmental credits (ECs) and EC obligations (ECOs) in an entity's financial statements.

BACKGROUND

Environmental credits, such as carbon credits and renewable energy certificates, are becoming an important part of efforts to promote sustainability. An entity may hold environmental credits to:

- ▶ Settle regulatory compliance obligations.
- ▶ Transfer in an exchange transaction (for example, a sale or trade).
- ▶ Distribute in a nonreciprocal transaction (for example, to an investor).
- ▶ Meet voluntary environmental, social, and governance (ESG) goals (such as carbon neutral or net-zero commitments).

An entity may obtain environmental credits in many ways, including by grant or allocation from regulators, by acquisition, or by producing the credit itself.

Historically, the lack of specific accounting guidance in U.S. GAAP has led to diverse practices. If environmental credit meets the definition of an asset,¹ entities commonly applied one of the two accounting models shown in the table.

¹ The definition in *FASB Concepts Statements No. 8, Conceptual Framework for Financial Reporting*, Chapter 4, includes the requirement that the credit represent a present right to an economic benefit.

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CLASSIFICATION	INITIAL RECOGNITION	SUBSEQUENT ACCOUNTING
Inventory (ASC 330)	Recognize at cost	<ul style="list-style-type: none"> ▶ Expense when used (retired) ▶ Diversity in practice exists for subsequent measurement (lower of cost or market)
Intangible Asset (ASC 350)	Recognize at cost	<ul style="list-style-type: none"> ▶ Expense when used (retired) ▶ Diversity in practice exists for amortization ▶ Diversity in practice exists when evaluating impairment

Entities subject to regulatory requirements often recognized liabilities in accordance with ASC 450, *Contingencies*. Diversity in practice also existed for measurement and presentation:

- ▶ Net presentation: Some entities recognized an obligation for the excess of total emissions over their environmental credit assets.
- ▶ Gross presentation: Other entities recognized an obligation for their total emissions (in addition to an asset for environmental credit assets).

In response to the diversity in practice, the FASB issued ASU 2026-02, which is codified in Accounting Standards Codification (ASC) 818, to enhance transparency, comparability, and reliability in financial statements.

ENVIRONMENTAL CREDIT ASSETS

Scope and Definition of Environmental Credit Assets

To meet the definition of an environmental credit, the item must be 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 regulatory agency or its designee(s). It also must meet **all** the following criteria:

- ▶ It lacks physical substance and is not a financial asset.
- ▶ It is represented to prevent, control, reduce, or remove emissions or other forms of pollution.
- ▶ It is or was separately transferable in an exchange transaction or can be used to satisfy an ECO if no longer separately transferable.
- ▶ It is not an income tax credit and cannot be used to reduce income taxes.



ITEMS THAT DO NOT MEET THE DEFINITION OF ENVIRONMENTAL CREDITS

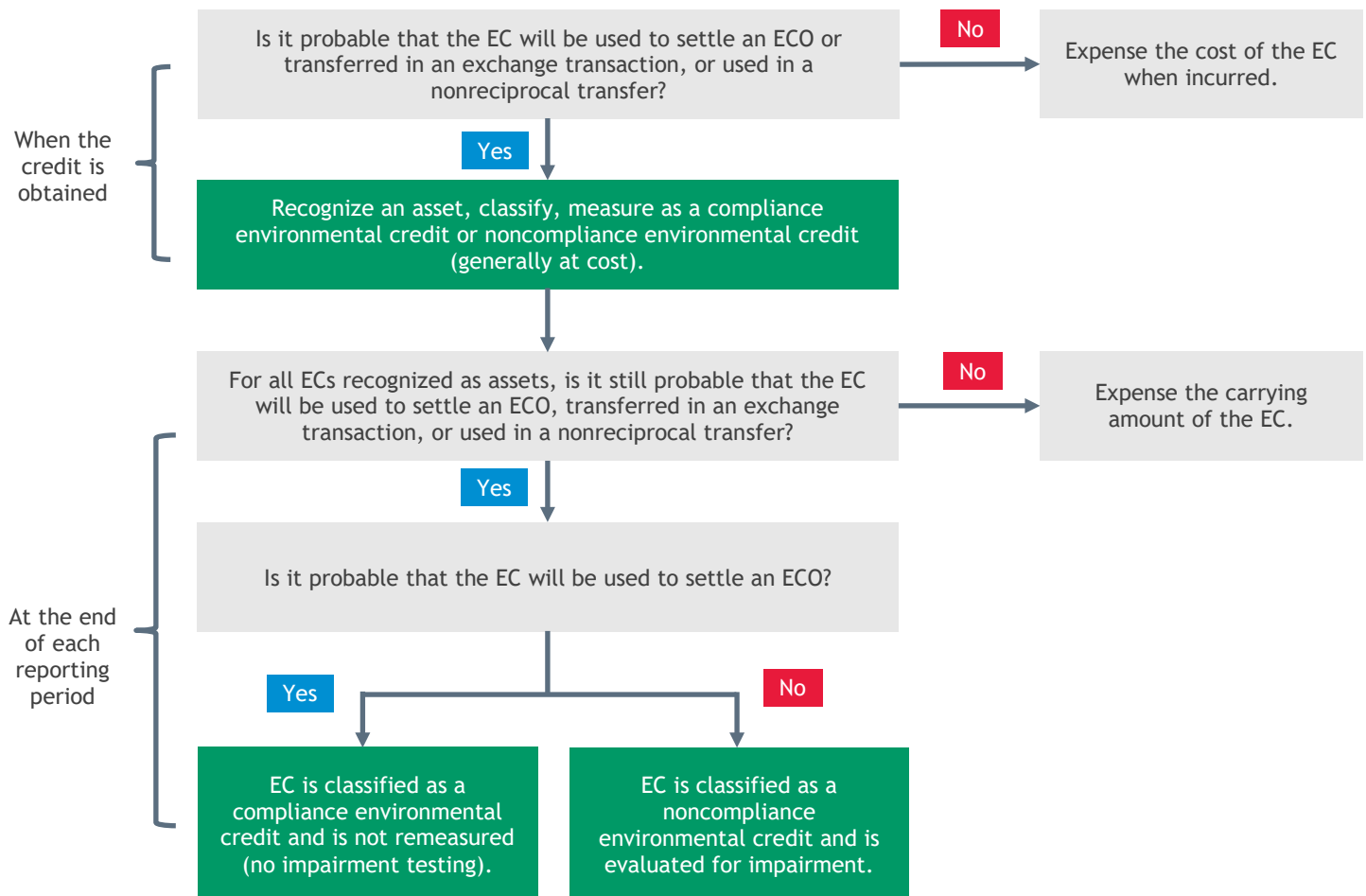
The following items are excluded from the scope of ASU 2026-02:

- ▶ Renewable clean energy tax credits (including transferable and refundable tax credits).
- ▶ Payments made related to voluntary carbon neutral activities.
- ▶ Investments in partnerships or other credit-generating equity structures (although credits received in nonreciprocal distributions from such investments or structures may be in the scope of ASC 818).

An entity would need to apply other U.S. GAAP (for example, ASC 740, *Income Taxes* or ASC 323, *Investments – Equity Method and Joint Ventures*) to account for such items.

Flowchart for Environmental Credit Assets

This flowchart, adapted from ASC 818, summarizes the accounting for an environmental credit asset if an entity has not elected to remeasure eligible noncompliance environmental credits at fair value each reporting period.



Recognition of Environmental Credit Assets

Once an entity determines that the item meets the U.S. GAAP definition of an environmental credit, its intent dictates whether it recognizes the credit. An entity recognizes an environmental credit as an asset **only** when it is **probable that** it will use the credit to:

- ▶ Settle an ECO.
- ▶ Be sold or traded in an exchange transaction.
- ▶ Distribute the credit in a nonreciprocal transfer.

An entity must expense all other environmental credits (including voluntary environmental credits the entity intends to use to meet ESG goals) when incurred.

BDO INSIGHTS: INTENT-BASED STANDARD

The environmental credit asset model is intent-based, which may result in a different accounting treatment for the same (or similar) environmental credits based on an entity's intended use.

For example, if Entity A acquires an environmental credit for transfer in exchange it would recognize the environmental credit as an asset. However, if Entity A sells that credit to Entity B, which intends to use the credit to meet its voluntary ESG goals, Entity B must expense the cost of acquiring that credit.

Initial Measurement of Environmental Credit Assets

An entity generally will measure an acquired environmental credit asset at cost in accordance with the asset acquisition guidance in ASC 805-50, *Business Combinations – Related Issues*, unless it was acquired as part of a transaction within the scope of other U.S. GAAP. See Appendix C of BDO's Blueprint, [Business Combinations Under ASC 805](#), for guidance on the asset acquisition guidance in ASC 805-50.

However, if the environmental credit is internally generated or obtained through a government grant from a regulator or its designee, an entity measures the credit using the transaction costs incurred to obtain the environmental credit, if any. Transaction costs include only those costs necessary to validate, register, or authenticate an environmental credit so that the environmental credit may be separately transferred in an exchange transaction or used to settle an environmental credit obligation. An entity may not capitalize other costs related to internally generated credits.

Subsequent Measurement of Environmental Credit Assets

At each reporting period, an entity must reassess whether it is **probable** that it will use the environmental credit to:

- ▶ Settle an ECO (compliance credits).
- ▶ Be sold or traded in an exchange transaction.
- ▶ Distribute the credit in a nonreciprocal transfer.

All recognized environmental credits that are not probable of being used to settle an ECO are considered noncompliance credits (regardless of whether they can be used by another entity to settle an ECO).

As shown in the flowchart above, an entity subsequently measures environmental credits based on its intent. Both compliance credits and noncompliance credits are initially measured at cost (unless other U.S. GAAP applies). However, compliance credits are not evaluated for impairment, whereas noncompliance credits are evaluated for impairment at the end of each reporting period. An impairment is recognized when a noncompliance credit's carrying amount exceeds its fair value. An entity may not subsequently reverse an impairment.

If upon reassessment the entity determines that a compliance environmental credit requires reclassification to a noncompliance credit (or vice versa), it must evaluate the credit for impairment before applying the applicable subsequent measurement guidance. An entity cannot amortize an environmental credit.

Other Accounting Guidance for Environmental Credit Assets

ASU 2026-02 also includes guidance on:

- ▶ Derecognition in exchange transactions.
- ▶ Costing methods (first-in, first-out; specific identification; or average cost).
- ▶ Fair value measurement accounting policy election for eligible noncompliance environmental credits.

ENVIRONMENTAL CREDIT OBLIGATIONS

Scope and Definition of Environmental Credit Obligations

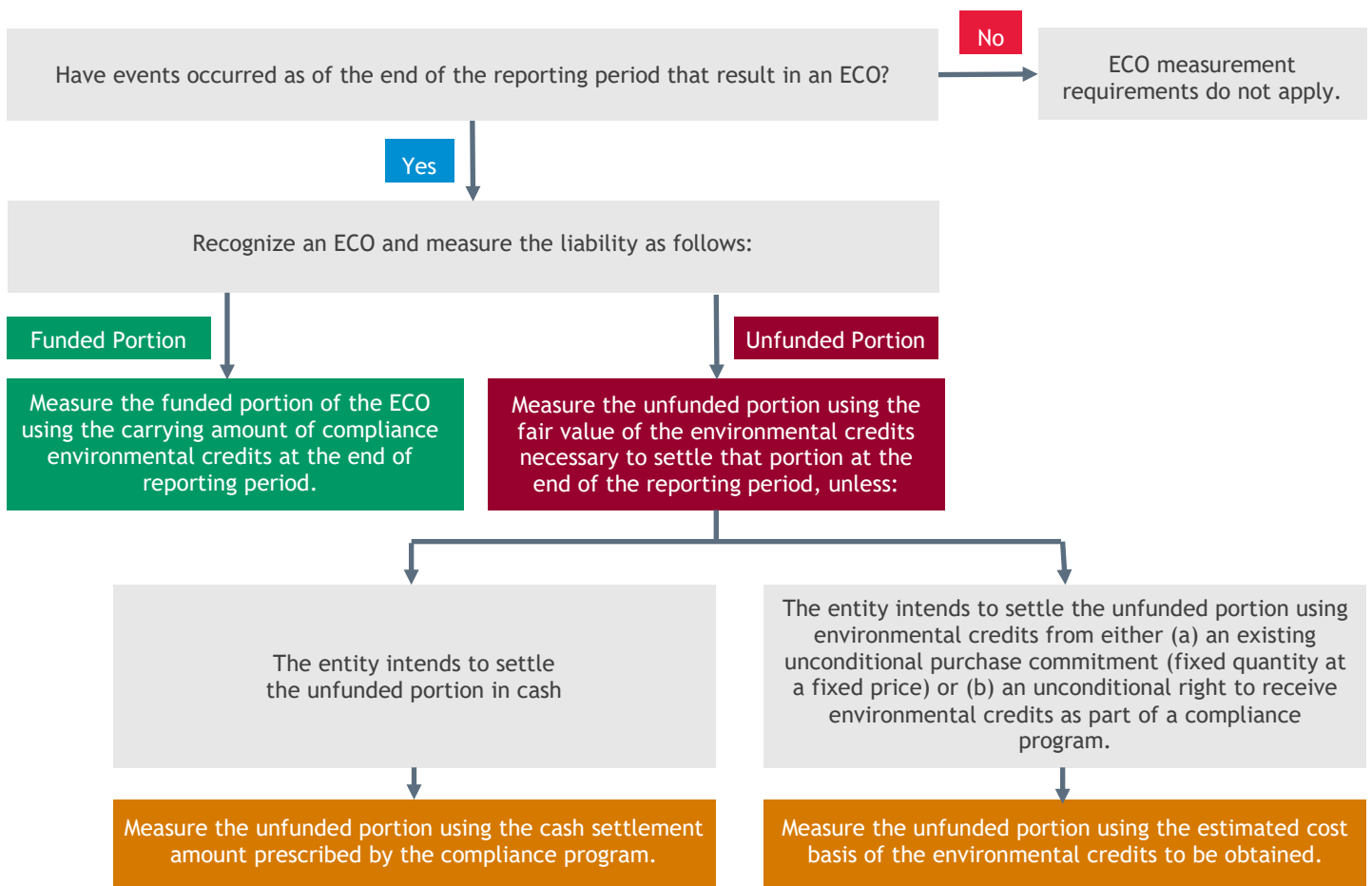
An ECO is a liability that **both**:

- ▶ Arises from laws, statutes, or ordinances represented to prevent, control, reduce, or remove emissions or other forms of pollution.
- ▶ May be settled with environmental credits.

Obligations within the scope of ASC 410-30, *Asset Retirement and Environmental Obligations – Environmental Obligations*, are not environmental credit obligations.

Flowchart for Environmental Credit Obligations

This flowchart, adapted from ASC 818, summarizes the accounting for an environmental credit obligation.



ASU 2026-02 prohibits an entity from measuring liabilities at fair value under ASC 825, *Financial Instruments*.

Recognition of Environmental Credit Obligations

An entity recognizes an ECO when an obligation exists, determined as if the end of the reporting period was the end of the compliance period, even if the actual compliance period ends after that date. The entity recognizes the related costs in earnings or, when appropriate, as part of another asset under other U.S. GAAP.

Initial and Subsequent Measurement of ECO Liabilities

An ECO's initial and subsequent measurement depends on how much is funded (covered by associated ECs) and unfunded (not covered by associated ECs), as shown in the table.

ENVIRONMENTAL CREDIT OBLIGATIONS	INITIAL AND SUBSEQUENT MEASUREMENT
Funded ECO liabilities	▶ Measure at the carrying amount of compliance environmental credits that will be used to settle the ECO.
Unfunded ECO liabilities that will be settled by remitting cash to a regulator	▶ Measure at the specified cash settlement amount.
Unfunded ECO liabilities that will be settled through remitting ECs received pursuant to an unconditional purchase commitment for a fixed quantity of ECs at a fixed price or an unconditional right to receive a fixed quantity of environmental credits as part of a compliance program or contract for which environmental credits will be received as consideration.	▶ Measure using the estimated cost of the credits the entity will obtain through the commitment, right, or contract.
All other unfunded ECOs	▶ Measure at fair value in accordance with ASC 820, <i>Fair Value Measurement</i> .

An entity must remeasure the ECO at the end of each reporting period (after remeasuring any environmental credit assets, if applicable) and recognize any changes in earnings or, when appropriate, as part of another asset. Entities will derecognize the ECO in accordance with ASC 405-20, *Liabilities – Extinguishments of Liabilities*, with gains or losses recognized in the same line item as the ECO's initial measurement.

PRESENTATION

ASU 2026-02 includes guidance on presentation in the balance sheet, income statement, and cash flow statement. Notably, it requires gross presentation and does not allow entities to offset ECOs and environmental credit assets. Environmental credit assets and obligations are classified (if an entity presents a classified balance sheet) based on the entity's expectation of when it will transfer or remit the asset or settle the obligation.

DISCLOSURES

Entities are required to make quantitative and qualitative disclosures about how it obtained and intends to use its environmental credits, and the assets, expenses for voluntary credits and impairments recognized. Additional disclosures are required about the activities that resulted in ECOs, the nature and timing of settlement provisions, and how the unfunded environmental credit obligations are measured. Entities must also provide information about their accounting policies and significant judgements and estimates used when applying ASC 818.

EFFECTIVE DATE AND TRANSITION

The following table summarizes transition for ASU 2026-02:

	PUBLIC BUSINESS ENTITIES	ALL OTHER ENTITIES
Effective Date	Annual reporting periods beginning after December 15, 2027, and interim reporting periods within those annual reporting periods.	Annual reporting periods beginning after December 15, 2028, and interim reporting periods within those annual reporting periods.
Early adoption	<ul style="list-style-type: none"> ▶ Permitted in an interim or annual reporting period in which financial statements have not yet been issued or made available for issuance. ▶ If adopted in an interim reporting period, apply from the beginning of the annual reporting period that includes that interim reporting period. 	
Transition	<ul style="list-style-type: none"> ▶ Modified retrospective basis, with a cumulative-effect adjustment to opening retained earnings (or other appropriate equity components or net assets) at the beginning of the annual reporting period of adoption. 	



DEVELOP PROCESSES AND CONTROLS OVER ENVIRONMENTAL CREDIT ASSETS AND OBLIGATIONS

To comply with ASU 2026-02 an entity needs to implement controls that document:

- ▶ The entity's intent for using environmental credits.
- ▶ When the entity expects to sell, trade, distribute, or remit environmental credit assets.
- ▶ When the entity expects to settle an ECO.

That process may require coordinating with personnel outside the accounting function. Management may want to consider revising their processes now to ease transition.

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Link to [ASU 2026-02](#)

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