Tel: 312-856-9100
Fax: 312-856-1379
www.bdo.com

330 North Wabash, Suite 3200
Chicago, IL 60611

April 15, 2025

Via email to director@fasb.org

Mr. Jackson M. Day, Technical Director
Financial Accounting Standards Board
801 Main Avenue
P.O. Box 5116
Norwalk, CT 06856-5116

Re: Environmental Credits and Environmental Credit Obligations (Topic 818) (File Reference No. 2024-ED910)

Dear Mr. Day:

We appreciate the opportunity to respond to the exposure draft on Environmental Credits and Environmental Credit Obligations (Topic 818). We support the goals of this project given the diversity in practice.

While we believe the proposal generally is clear, we believe intent-based models can be challenging to apply in practice, and we observe that the Board has moved away from intent-based models in other areas of U.S. GAAP. We would prefer a model that recognizes all environmental credits, including those used to meet compliance obligations and to achieve voluntary goals, at cost less impairment (with a trigger-based impairment analysis similar to the one in Topic 360). We believe that a model that is not intent-based may prove more durable than an intent-based model, as perceptions about the ability to derive value from a credit improves, and as the market for credits increases, and that including a trigger-based impairment model would provide some relief from the costs of performing impairment tests. However, providing additional guidance could enhance the operability of the proposed model if the Board proceeds with an intent-based model.

We also believe that entities should be allowed (but not required) to capitalize all the direct and incremental costs of generating environmental credits (similar to the inventory model in Topic 330), and to not limit the cost of such credits to transaction costs. We believe this would provide better information to users of an entity's financial statements, particularly when generating credits is the entity's primary means of generating revenues. Further, we believe that benefits of providing such information would exceed the costs of doing so, for those entities.

We have described our concerns and suggestions with respect to the proposal in our responses to the Questions for Respondents in the attached Appendix.

We would be pleased to discuss our comments with the FASB staff. Please direct questions to Meredith Taylor at (571) 461-6744 or Angela Newell at (214) 689-5669.

Very truly yours,

BDO USA, P.C.

BDO USA, P.C.

Appendix

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

We agree that the criteria in the definition of "Environmental Credit" generally are clear and operable and will help capture the intended assets within the scope of Topic 818.

However, we have some concerns regarding criterion (c) in the definition of "Environmental Credit," which states that the credit is "separately transferable in an exchange transaction," wherein the definition of an "exchange" refers to a "reciprocal transfer." It is not clear whether an entity evaluates this criterion from the transferor's or transferee's perspective (or both), and further clarification is needed. Consider the following:

- It is not clear whether a credit obtained in an exchange transaction, or internally generated, that is by its nature separately transferable, but by contract may only be transferred by the entity to another party in a nonreciprocal transfer would be within the scope of Topic 818 for that entity. For example, consider a scenario in which a sponsor establishes an investment entity and the unrelated equity investors in that investment entity have the rights to receive all credits obtained or generated by that investment entity, but the credits would be separately transferable by the transferees (equity investors) in subsequent exchange transactions. It is unclear whether the credits are within the scope of Topic 818 in the investment entity's financial statements (or in the sponsor's financial statements if it consolidates the investment entity) since the investment entity cannot (by virtue of its governance agreements) transfer the credits other than in a nonreciprocal transfer.
- Given that Topic 818 provides guidance for credits received in nonreciprocal transfers (for example, in paragraphs 818-20-55-6(b) through 55-7), we believe the Board intended that if an entity receives credits in a nonreciprocal transfer, such credits would be within the scope of Topic 818. If that entity is contractually required to transfer the received credits in a second nonreciprocal transfer, it is not clear whether the credits are outside the scope of Topic 818, or whether it would expense such credits since they do not meet the recognition criteria in paragraph 818-20-25-1.

We believe that how an entity receives or intends to distribute a credit (that is, in a reciprocal or nonreciprocal transaction) should not affect its recognition or measurement. We believe this limitation ("in an exchange transaction") should be removed. Instead, we believe guidance similar to that in paragraph 805-20-55-3 should be added to Topic 818 to assist in evaluating this criterion in the definition. For example, Topic 818 could state:

> "The separability criterion means that an environmental credit is capable of being separated or divided from energy or other assets and sold, transferred, or exchanged, either individually or together with other assets. An environmental credit that a market participant would be able to sell, transfer, or otherwise exchange for something else of value or use to extinguish an environmental credit obligation meets the separability criterion even if the entity does not intend to sell, transfer, or otherwise exchange it."

We are concerned that if credits that by contract must be received or distributed in nonreciprocal transfers are not within the scope of Topic 818, entities may structure arrangements to obtain (or distribute) credits used for voluntary purposes only through nonreciprocal transfers, thereby circumventing this guidance.

We also believe that as currently drafted, criterion (c) excludes deposits (prepayments) for environmental credits, or debt or equity investments in legal entities that provide the holder with rights to receive future environmental credits (i.e., an investment in a project or fund that will distribute environmental credits) from the scope of Topic 818, since the deposit or investment itself would likely not be transferable in an exchange without the counterparty's permission or be subject to other cancellation provisions. We believe those deposits and investments likely would be in the scope of other U.S. GAAP. However, paragraph 818-20-25-2 suggests that such deposits would be in the scope of Topic 818 for the party paying the deposit. This raises further questions as to whether the party receiving the deposit would also account for the deposit in accordance with Topic 818, or whether the deposit would be in the scope of other guidance (for example, Topic 606 as a contract liability). We believe such deposits and investments should be outside the scope of Topic 818 for both parties to the transaction, and paragraph 818-20-25-2 should be removed.

We also observe that the guidance in Topic 360 regarding the impairment or disposal of long-lived assets does not define "long-lived assets" and does not exclude environmental credits within the scope of Topic 818. We recommend clarifying how such environmental credits should be treated in Topic 360-10-15.

Question 2: The proposed amendments would require that an entity recognize an environmental credit as an asset when it is probable that the entity will use the environmental credit to settle an environmental credit obligation or transfer that credit in an exchange transaction. Costs incurred to obtain all other environmental credits would be recognized as an expense when incurred.

a. ***Do you agree with those proposed amendments, including the probability threshold? Should the costs incurred to obtain all other environmental credits be recognized as an expense when incurred? Please explain why or why not.***

b. ***Are the recognition requirements clear and operable? Please explain why or why not. If not, what changes would you suggest? Do you anticipate any auditing challenges? If so, please explain.***

We believe the guidance for recognizing an environmental credit asset is generally clear. However, applying an intent-based model can be challenging. Historically, the Board has moved away from intent-based or usage-based models because of the challenges in operationalizing such assertions (for example, with respect to classifying financial instruments and hedging effectiveness), or where such models led to a lack of comparability over time (for example, software developed for internal or external use).

Furthermore, under the proposal, an entity may expense a voluntary environmental credit that it later sells, which would result in a mismatch of revenue and expense, thereby not reflecting the transaction's economic substance. We would prefer a model that requires all environmental credits (as defined) to be recognized as assets. We believe that model would best align with the definition of an asset in Concept Statement No. 8 *Conceptual Framework for Financial Reporting*. Specifically, we would prefer a model in which all environmental credits would be recognized at cost, less impairment, with impairment tests required upon specific triggering events similar to those for intangible assets with finite lives. While we understand that impairment analysis for environmental credits is costly and time-consuming, we believe that a trigger-based impairment assessment may help reduce the frequency of impairment evaluations. We believe that a model that is not intent-based may prove more durable than an intent-based model, as perceptions about the ability to derive value from a credit improves, and as the market for credits increases.

However, if the Board continues with the intent-based model, then for it to be consistently applied in practice, we recommend adding examples or indicators that would support an entity's assertion that a credit meets the "probable" threshold in paragraph 818-20-25-1. That is, to support classification as a compliance or noncompliance environmental credit, a reporting entity would be required to support its intent, which may generate the questions such as:

- Would recognizing an environmental credit obligation provide sufficient evidence that an environmental credit would be used for compliance?
- Would a mere history of selling environmental credits be sufficient to assert that any excess or all environmental credits are noncompliance credits?
- Would a start-up entity (that has no history of selling credits) be prohibited from asserting that it intends to sell credits?
- Would an entity that sells its products to customers with and without a surcharge to offset carbon emissions (for example, airline tickets) be selling credits, even though the airline passenger cannot buy the credit without buying a ticket?
- Would specific contemporaneous documentation be needed for each credit (or for each class, portfolio, type, or holdings of credits)?
- Would evidence similar to that required in paragraph 360-10-45-9 for long-lived assets held for sale be required (for example, does the entity need to have a trading desk)?

The Board should provide more interpretive guidance so that practitioners can consistently apply the intent-based model in paragraph 818-20-25-1. If the Board continues with an intent-based model, we believe the bar should be low for making such probability assessments.

In addition, we suggest the following changes or clarifications to the intent-based model:

- Paragraph 818-20-25-1 states that "For all other environmental credits, an entity shall recognize an expense when costs are incurred and is prohibited from including **<u>those costs</u>** in the carrying amount of another asset accounted for in accordance with another Topic." (Emphasis added) It is unclear whether the reference to "those costs" only refers to the transaction costs of registering the credit (as referenced in paragraph 818-30-30-1 and Example 4 in paragraph 819-20-55-14) or whether it is intended to refer to all costs the entity might have incurred in generating the credit. For example, if the refiner in Example 4 had instead intended to use the renewable identification numbers (RINs) for voluntary purposes, and incurred internal costs (e.g., salaries) to obtain the RINs, is it required to expense those salary costs as incurred, or may it capitalize such costs in the cost of its inventory. That is, it is not clear whether the view expressed in BC49 (with respect to not allocating costs) only applies when the credit meets the initial recognition criteria, or also applies when the credit is expensed for voluntary purposes. We recommend clarifying paragraph 818-20-25-1 and adding an example similar to our variation on Example 4 to clarify the requirements.
- While the proposal establishes "probable" as the recognition threshold (in paragraph 818-20-25-1), several examples (see paragraphs 818-20-55-13, 55-15, 55-16, etc.) use the word "intends" which is not defined in U.S. GAAP and which may be interpreted as a

lower threshold like "more likely than not." For example, in several examples, the proposal states that "the entity intends…" vs. "it is probable that the entity will…". We recommend revising Topic 818 to use the word "probable" more consistently.

- As discussed in our response to Question #1, as currently drafted, we believe that Topic 818 excludes from its scope any credits that an entity intends to (or is required to under its governance agreements) distribute in a nonreciprocal transfer to its equity owners (as a noncash dividend). If the scope of Topic 818 were revised to include such credits, then without further changes to paragraph 818-20-25-1, the entity would be required to expense the cost of those voluntary credits when incurred. If the Board continues with the intent-based model, we would prefer that credits that an entity intends (or is required) to distribute in a nonreciprocal transfer to its equity owners (as a noncash dividend) be recognized as noncompliance credits. We believe such presentation would be more useful to the entity's investors, who indirectly funded the credits.
- As discussed in our response to Question #1, as currently drafted, we believe that Topic 818 excludes from its scope any deposits or investments that may eventually give the entity the right to receive a credit because the deposit or investment is likely nontransferable. Paragraph 818-20-25-2 requires an entity to expense a nonrefundable deposit made to obtain an environmental credit if it is not probable that it will use the credit to settle an environmental credit obligation or transfer the credit in an exchange transaction. We do not agree with this proposal, because we believe deposits and investments should be accounted for pursuant to Topic 340 (or other applicable U.S. GAAP) and that Topic 818 should apply once it has control over and the ability to direct the use of the environmental credit.
- We recommend adding to paragraph 818-20-55-3 bullet "g.": "the characteristics of the credit, such as the jurisdictions in which it may be used, obligations that it may be used to settle, age (vintage)." We understand these factors (or characteristics) affect an entity's ability to use an environmental credit for settlement and its value in an exchange transaction (and therefore whether an entity could monetize and would want to monetize the credit through transfer).
- For clarity, we believe the Board should add to Topic 330, Topic 350, Topic 360, etc., that the costs of credits that did not meet the probability threshold in paragraph 818-20-25-2 (voluntary credits) cannot be capitalized in the cost of those assets. For example, in Topic 330-10-30, we would suggest including ""The cost of inventory does not include costs to obtain environmental credits within the scope of Topic 818 (including the cost of credits that do not meet the recognition criteria in Topic 818)."

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

We believe the initial measurement requirements are generally clear and operable. However, we believe such accounting may not provide decision-useful information for investors about the costs incurred by entities that generate and sell environmental credits as their only (or primary) revenue stream (for example, entities designed to capture carbon from the air or water and sell credits to customers). Such entities may use chemicals or other consumable inputs to generate their credits for sale to customers. Under the proposal, such costs would be recognized as incurred, which could result in recognizing the expenses to generate the credit and the related revenue in different periods, if the credit is not sold immediately.

We believe that entities that generate and sell environmental credits as revenue should be allowed (as an accounting policy) to capitalize the costs (at a minimum, the direct costs) of generating such credits by analogy to Topic 330. Alternatively, the Board might decide to amend the proposal so that such costs would be within the scope of Topic 340-40, *Other Assets and Deferred Costs — Contract with Customers*. In either case, we believe the credits should be then measured at cost, less impairment. We believe this alternative accounting would provide more decision-useful information about entities for which generating credits is a primary source of revenue if such entities would prefer to capitalize such costs.

We understand from discussions with the staff that the requirement to use initial measurement guidance from other topics does not override the recognition requirements in Topic 818. For example, if the REC obtained in the examples in 818-20-55-6(a) or (b) was going to be used for voluntary purposes, we understand that it would be immediately expensed. We believe the Board should clarify these examples; otherwise, preparers and practitioners may believe they are supposed to recognize a credit regardless of its use because of the requirement to consider measurement guidance from other topics. We suggest revising paragraph 818-20-55-6(a) to state:

> "Paragraph 818-20-30-2 requires an entity that obtains an environmental credit in a transaction initially measured in accordance with another Topic to follow the <u>initial measurement</u> requirements of that other Topic<u>.</u> For example:
> a) A renewable energy certificate received as consideration in a contract with a customer should be initially measured in accordance with paragraphs 606-10-32-21 through 32-22; <u>if the renewable energy certificate does not meet the recognition criteria in this Topic, such amount would be immediately expensed.</u>
> b) A carbon offset or renewable energy certificate received in a nonreciprocal transfer from an investee should be initially measured in accordance with paragraph 845-10-30-1; <u>if the environmental credit does not meet the recognition criteria in this Topic, such amount would be immediately expensed."</u>

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

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

An entity would be permitted to use a portfolio approach when applying the proposed subsequent measurement requirements to similar types of environmental credits. Are those proposed subsequent requirements clear and operable? Please explain why or why not. If not, what changes would you suggest? Do you anticipate any auditing challenges? If so, please explain.

Subsequent Measurement of Environmental Credits

As discussed in our response to Questions #1-3, we have concerns about the consistent application and usefulness of an intent-based model and prohibiting cost capitalization for internally generated credits when generating and selling environmental credits is an entity's primary (or only) revenue stream.

Portfolio approach

While we agree in concept with a portfolio approach, we believe clarifications would improve its operability. For example:

- When applying a costing method, as discussed in paragraph 818-20-35-2, it is not clear whether an entity must consistently apply the accounting policy, and whether it can use different methods for different "classes," "holdings," "portfolios," or "types" of credits. We suggest adding language similar to paragraph 330-10-30-15 that requires consistency in costing methods and the level at which a method must be applied.
- Paragraph 818-20-55-9 (a) and (b) describe a significant loss in a portfolio because an individual credit was sold at an amount greater than its carrying amount determined at the portfolio level (implying that credit did not belong in that portfolio). As a result, these examples (which refer to portfolios) seem to contradict the guidance in paragraph 818-20-35-7 and the conclusions in Example 5 and 6 (in paragraphs 818-20-55-15 through 55-16), which conclude the credits cannot be grouped in a portfolio. Accordingly, we suggest deleting 9(a) and (b) and instead referring to Example 5 and 6 (in paragraphs 818-20-55-15 through 55-16). Alternatively, clarify 818-20-55-9 (a) and (b) to conclude that because a significant loss results from the sale, that the credit would not belong in that portfolio.
- We believe the Board should clarify what "significant loss" means in paragraph 818-20-55-9 and BC62 and the unit of assessment (i.e., is the entity evaluating significance with respect to the individual credit, to the portfolio in the aggregate, to all environmental credits held, or to the entity's financial results as a whole).
- We believe the terms "class," "holdings," "portfolio," and "type" (which are also used with respect to the fair value election and in the disclosure requirements) need to be further clarified and distinguished from each other, as they could be otherwise viewed as synonyms. We do not believe these concepts are clear, which may lead to diversity in practice in how practitioners interpret the disclosure requirements, and whether disclosures may be aggregated for different portfolios.
- The proposal only allows for entities to apply the portfolio approach to subsequent measurement. It is not clear why portfolios do not also apply to initial measurement. Paragraph 818-20-55-4 (which interprets 818-20-25-4 on recognition), does allow recognition to be met in groups, but does not reference a portfolio, only a subset of a class.

Derecognition guidance

We believe additional specificity is needed in paragraph 818-20-40-1 and BC70 on how Topic 610-20, which refers to Topic 606, applies to the derecognition of compliance credits. For example, it is unclear how an entity would assess collectibility or present right to payment and evaluate whether a contract exists. We recommend specifying instead that an entity would derecognize compliance credits upon remittance to the regulator, or when the related obligation is extinguished.

Other subsequent measurement clarifications

We believe the operability of the subsequent measurement guidance would be improved with the following clarifications:

- Although the term "noncompliance credit" is clear to those that closely followed the project, we have found it confusing to practitioners unfamiliar with this proposal because a credit held for sale (and thus a noncompliance credit) can sometimes be used to meet compliance obligations. The Board should consider revising the term to "environmental credits held for sale" or another similar term that will be more understandable in practice to preparers and users of financial statements.
- Pending the conclusions regarding the scope of Topic 360 as discussed in our response to Question #1, environmental credits could be included in an asset group tested for impairment under Topic 360 and/or in a reporting unit being tested for impairment under Topic 350-20. Those impairment models could result in an impairment test being performed at a date other than at the end of a reporting period, which could cause a conflict with the requirement to assess noncompliance credits for impairment only at the end of a reporting period. We suggest revising paragraph 818-20-35-4 as follows: "… <u>and evaluated for impairment at each reporting date or earlier if required by another standard.</u>"
- Paragraph 818-20-35-6 states that amortization is prohibited, but amortization is required pursuant to paragraphs 818-30-25-2, 818-30-55-5 and 818-30-55-22 through 27 for programs where an entity is obligated to remit a fixed number of environmental credits solely because the entity exists as of a specified assessment date. As noted in our response to Question #9, we do not support this model. However, if retained, we believe paragraph 818-20-35-6 should be revised to state "An entity shall not amortize an environmental credit, <u>except as required by paragraph 818-30-25-2 for obligations that require an entity to remit a fixed number of environmental credits solely because the entity exists as of a specific assessment date.</u>"

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

We believe the fair value measurement election is generally clear and operable. However, given our concerns with the intent-based model, as discussed in our response to Questions #1-3, we believe the fair value measurement election should be available for all credits.

Paragraph 818-20-35-8 also applies to a “class of eligible noncompliance credits.” It is not clear whether the election applies to all future acquired environmental credits with the same characteristics as the “class,” or if the election only applies to those credits in that class on the date the election was made. We suggest clarifying what is meant by “class,” how it relates or is different from a portfolio, holding or type of credit, and if the election would apply to credits obtained in the future, or just on those environmental credits outstanding on the election date.

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

We believe the proposed qualitative disclosure requirements generally are clear. However, we suggest removing the disclosures requirements in paragraph 818-20-50-5(a) through 50-5(c), because we believe the existing disclosure requirements in Topic 606 and Topic 610-20 are adequate, and that revenues and gains from the sale of these credits do not require more disclosure than other types of revenues or gains. We also suggest removing the reference to revenues in paragraph 220-40-50-21(o), which requires a table that includes expenses, gains, and losses, since these are revenues.

Topic 818-20-50 uses the terms “holdings” and “type.” As discussed in our response to Question #4, we believe these terms are not clear (including how they relate to each other and to the terms “class” and “portfolio”), which may lead to diversity in practice. For example, paragraph 818-20-50-1 requires entities to disclose the “types” of credits owned, but then paragraph 818-20-50-3 requires disclosures for each “holding.” These terms are further distinguished from the portfolios used for subsequent measurement and “classes” used for the fair value election. We suggest clearly describing those terms and distinguishing them from each other to promote consistency in financial reporting. For example, with respect to inventory, Regulation S-X Rule 5-02, codified in paragraph 210-10-S99-1, refers only to “classes” of inventory like raw materials, work in progress, and finished goods. Topic 350 also defines an “intangible asset class,” and only requires disclosures for “major” classes, which implies that a class is at a lower level. In contrast, Topic 818 uses “class” to refer to a specific type of (registered) environmental credit (e.g., in paragraph 818-20-55-4). Topic 350-60 requires disclosures only for each “holding” of crypto assets.

We also recommend that specifying in paragraph 818-20-50-6 which disclosures in Topic 820 may be applicable, as this may not be clear to practitioners.

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

We defer to investors on whether the proposed guidance for recognition, measurement and disclosure of environmental credits will provide decision-useful information.

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

We generally agree the definition of "Environmental Credit Obligation" is clear and operable.

However, we believe the definition should be expanded to include an obligation that arises from a contract or an agreement with a government or governmental agency. For example, if a city government requires an entity to purchase credits as part of an agreement to permit construction of a building, we believe that contractual requirement should result in recognizing an environmental credit obligation. We do not believe such agreements would be covered by the proposed definition because the agreement may not result from a law, statute, or ordinance.

We believe the Board also should further consider and discuss with investors and preparers whether to expand the definition of an environmental credit obligation to include other enforceable contractual obligations that are not clearly addressed by other U.S. GAAP in which the entity is required to obtain and remit or retire environmental credits. Such an obligation would be outside the current scope of Topic 818, and the related credits would be expensed when acquired (because they would not be compliance or noncompliance credits).

Question 9: The proposed amendments would require that an entity recognize an environmental credit obligation liability when events occurring on or before the reporting date result in an environmental credit obligation. The entity would be required to assume that the reporting date is the end of the compliance period. Are those recognition requirements clear and operable? Please explain why or why not. If not, what changes would you suggest? Do you anticipate any auditing challenges? If so, please explain.

We generally believe the model is clear and operable.

That said, paragraph 818-30-25-1 states that an "entity shall determine whether environmental credits would be due…." However, the definition of an environmental credit obligation states that it "may be settled with environmental credits" and Topic 818-30 includes guidance on determining the unfunded portion of an obligation when it may be settled with cash. Therefore, we suggest changing paragraph 818-30-25-1 as follows: "entity shall determine whether environmental credits <u>and other assets</u> would be due" to encompass these fact patterns.

Obligations to remit a fixed number of credits solely because an entity exists
We do not support the proposed accounting for obligations to remit a fixed number of credits solely because an entity exists (in paragraphs 818-30-25-2 and 55-5), because we do not believe it would provide useful information to investors. That proposal would result in recognizing an asset that does not exist (using the definition of an asset in Concept Statement No. 8), because there is no present right to a future economic benefit. Under the proposal, an entity would potentially recognize two assets (i.e., the "prepaid asset" and the actual credits used to extinguish that obligation). We do not agree with recognizing an asset that does not exist, since there is no prepayment. Although we understand the desire to recognize expense over the compliance period, we believe it would be preferable and more faithfully depict the economics to accrue the

liability ratably from the assessment date to the payment date. Given the observation that such programs are uncommon in BC78, we recommend removing this concept from Topic 818.

However, if the Board retains this model, it should:

- Clarify the "prepaid asset" measurement in paragraph 818-30-25-2. We inferred from paragraph 818-30-55-5 that an entity measures the "prepaid asset" based on its obligation, which is measured by reference to the credits that will be used to satisfy the obligation. We suggest clarifying paragraph 818-30-25-2 to include prescriptive measurement guidance for the "prepaid asset" and liability, since they usually depend on one another.
- Replace the term "prepaid" in paragraph 818-30-55-5 with another term, such as "compliance program asset" since the asset would not otherwise seem to meet the common definition of a prepaid asset.
- Specify that such assets are not evaluated for impairment pursuant to Topic 360.

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

We generally believe the proposed guidance for initially measuring the liability for the environmental credit obligation is clear and operable. However, we have suggested the following clarifications to the proposed standard.

When measuring the funded portion of an obligation, paragraph 818-30-30-2(b) and (c) state that environmental credits that were previously expensed or derecognized are not considered. However, that paragraph also states the funded portion is based on the carrying amount of compliance environmental credits expected to be <u>derecognized</u>…" (Emphasis added). Paragraph 818-30-30-3 then discusses the unfunded obligation, but begins with "if an entity <u>does not have</u> sufficient compliance environmental credits…" Accordingly, we could read these paragraphs to mean either:

- In measuring an obligation, an entity pretends that it does not own any credits that were previously expensed. Under this reading, an expense would be recognized twice, first when the environmental credit that will be used was initially expensed, and second when measuring the unfunded portion of the environmental credit obligation. This interpretation would be inconsistent with the stated objectives in BC72 to avoid multiple recognition and derecognition of the same environmental credit and the associated earnings.
- In measuring the funded portion of an obligation, since no credits would be derecognized to satisfy that portion of the obligation, the carrying amount is effectively zero. In measuring the unfunded portion of an obligation, since the entity (legally) already has

the credits (although not recognized as compliance credits), the carrying amount for that part of the unfunded obligation is also zero.

We recommend clarifying this guidance and consider adding an example in which credits that were previously expensed are used to satisfy an obligation to avoid diversity in practice. We prefer the latter accounting and believe it is more consistent with the Board's intent. We do not believe an entity should have to recognize an obligation (or a second expense) if it can settle an obligation using environmental credits that it legally owns, but that were previously expensed.

Additionally:

- Paragraph 818-30-30-3(b) addresses when an entity intends to settle the unfunded portion of an environmental credit obligation with credits from an unconditional purchase commitment for a fixed quality of environmental credits at a fixed price or an unconditional right to receive a fixed quantity of environmental credits as part of a compliance program or contract for which environmental credits will be received as consideration. The last sentence of the paragraph states that the estimated cost basis of environmental credits may differ from the fixed price in those scenarios. We suggest clarifying why or when there would be a difference.
- Paragraph 805-20-30-31 states "If applicable, the unfunded portion of an environmental credit obligation liability measured in accordance with paragraph 818-30-30-3(b) ~~shall consider only the acquiree's existing purchase commitments and unconditional rights~~." To be consistent with paragraph 818-30-30-3(b) we recommend deleting the above text (as shown), or the full text of 3(b) should be included in this paragraph to be consistent.

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

We believe the proposed subsequent measurement guidance is clear and operable.

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

We believe the derecognition guidance generally is clear and operable. However, we would amend paragraph 405-20-40-1(a) to add that an obligation can be extinguished upon the delivery of nonfinancial assets, which would include an environmental credit. Currently, paragraph 405-20-40-1(a)(2) is limited to financial assets, which would exclude environmental credits.

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

environmental credits and presented on a net basis? Please explain why or why not. If not, what changes would you suggest?

We defer to the investors whether gross presentation provides decision-useful information.

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

We defer to preparers.

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

We defer to investors.

Question 16: An entity would be required to apply the proposed amendments retrospectively through a cumulative-effect adjustment to the opening balance of retained earnings (or other appropriate components of equity or net assets in the balance sheet) as of the beginning of the annual reporting period of adoption. The entity would apply the proposed amendments as if they always had been applicable, subject to specific modifications to those requirements upon adoption. Are the proposed transition requirements clear and operable? Please explain why or why not. If not, what changes would you suggest? Do you anticipate any auditing challenges? If so, please explain.

We agree the transition requirements are clear and operable.

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

We believe the Board should permit (but not require) full retrospective application of Topic 818 since it would enhance comparability in the financial statements, especially for entities that generate or sell environmental credits as a primary business and that previously capitalized the costs of such credits as inventory or as intangible assets. Under the proposed transition, such entities would recognize higher expenses in the first year after adoption when they derecognize the inventory or intangible asset upon selling existing credits to a customer while at the same time recognizing costs incurred in the current period to generate new credits because of the prohibition against capitalizing the costs of internally generated credits. We believe that entities should individually determine whether the benefits of comparability outweigh their costs of retrospective adoption.

In addition, we would also support modified retrospective adoption as of the earliest period presented instead of as of the effective date, which would allow for more comparability with less cost.

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

We defer to preparers but at a minimum, we recommend an extra year for private entities after the public company adoption date, consistent with the Private Company Council Framework. We have observed that when new Topics have been introduced (for example, Topics 606 and 842), unforeseen challenges have arisen during public company adoption and additional standard-setting was necessary. It may be prudent to allow for more than a year between the public company and private company adoption dates to resolve any such issues.

We believe early adoption should be permitted.

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

We agree that Topic 818 should also apply to private companies to promote comparability. However, the Board should consider reduced disclosure requirements for private companies to alleviate the costs of applying this guidance.

Other Comments
In addition to our responses to the questions, below are some additional comments on the proposal for the Board's consideration:

- Criterion (b) in the definition of "Environmental Credit" states that the credit "is represented to prevent, control, reduce, or remove emissions or other pollution." We recommend adding the underline text "<u>is issued under a program that</u> is represented to prevent, control, reduce, or remove emissions or other pollution" since the credit itself does not perform those activities.
- We suggest the following revisions to the flowchart in paragraph 818-20-55-1 for clarity:
    - Revise the top left reference in the flowchart to: "At the date the credit is obtained, <u>or the nonrefundable deposit is paid,</u>" since either could result in recognizing an environmental credit.
    - Revise the first row of boxes to also refer to paragraph 818-20-25-2 as follows: "…paragraph 818-20-25-1 <u>through 25-2</u>)" since it also applies.
- We suggest clarifying BC53 as follows to be consistent with paragraph 818-20-25-1, as practitioners might otherwise interpret BC53 to mean that costs could be capitalized even if the probability threshold is not met:

  > "The Board decided that environmental credit assets that <u>meet the recognition criteria in 818-20-25-1 but that</u> an entity does not intend to use to settle an

> environmental credit obligation should be measured at historical cost less impairment, if any. Those environmental credit assets comprise (a) those that an entity intends to transfer in an exchange transaction and (b) those for which <u>it is collectively probable that the environmental credit will be used by the entity to settle an environmental credit obligation or transferred by the entity in an exchange transaction but for which</u> an entity has not yet determined an intended use <u>between those two purposes</u>. The Board decided that an impairment loss should be recognized if the carrying value of the environmental credit exceeds its fair value, measured as the excess of the carrying value over fair value." [new text underlined]

Without these additions, an entity might believe that it could recognize an environmental credit for which the intended use has not yet been determined, even if it is not collectively probable the environmental credit would be used for either compliance or noncompliance purposes. That is, otherwise, an entity might believe it could recognize an asset when the credit may be used for voluntary purposes, so long as the entity has not yet definitively determined the credit's intended use.