ISDA® Safe, Efficient Markets

April 15th, 2025

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

By email: director@fasb.org

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

Dear Mr. Day,

The International Swaps and Derivatives Association's (ISDA)[1] North American Accounting Committee (the "Committee") appreciates the opportunity to comment and provide our feedback on the Financial Accounting Standards Board's ("FASB" or "Board") Proposed Accounting Standards Update, Environmental Credits and Environmental Credit Obligations (Topic 818) (the "Proposed ASU" or "Exposure Draft"). Collectively, the Committee members have substantial professional and practical expertise addressing accounting policy issues related to financial instruments. This letter provides our organization's overall views on the Proposed ASU.

The Committee appreciates the Board's efforts to establish clear and consistent accounting guidance for environmental credits and is overall supportive of the Exposure Draft. However, as detailed in our response, we believe certain aspects of the Proposed ASU, particularly those related to recognition, derecognition, impairment, and hedge accounting impacts, should be clarified to ensure operability and alignment with existing accounting frameworks.

We have reviewed the questions for respondents included in the Proposed ASU and have provided our feedback below. Our comments reflect ISDA's perspective on the implications of the proposed guidance, its impact on financial reporting and risk management, and the broader cost-benefit considerations for preparers and investors.

Questions for Respondents

Environmental Credits

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.

The Committee believes the proposed definition of environmental credit is clear and operable and captures the population of items that require specific accounting guidance.

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1 Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 1,000 member institutions from 76 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org. Follow us on LinkedIn and YouTube.

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.**

Yes, the Committee supports the proposed amendments requiring an entity to recognize an environmental credit as an asset when it is probable that the entity will use the credit to settle an environmental credit obligation or transfer that credit in an exchange transaction. The Committee also supports the recognition of a non-compliance credit as an asset, and the immediate recognition of an environmental credit as an expense if they do not meet the definition of a compliance environmental credit or a non-compliance environmental credit.

The probable threshold is well known in existing U.S. GAAP including with respect to cash flow hedge accounting relationships under Accounting Standards Codification ("ASC") 815, *Derivatives and Hedging* ("ASC 815"), and therefore the Committee believes the recognition requirements are clear and operable. The Committee believes a clarification in the Basis for Conclusions may be necessary to avoid diversity in practice or misinterpretation by preparers or audit firms when applying the probability threshold when the hedged item is the forecasted purchase or sale of an environmental credit in a cash flow hedge. The following text could be included after Basis for Conclusions 119 under the sub-header Derivatives Accounting:

> <u>The probable threshold is well known in existing U.S. GAAP including with respect to cash flow hedge accounting relationships under Accounting Standards Codification ("ASC") 815, Derivatives and Hedging ("ASC 815"). Pursuant to ASC 818-20-25-1, the recognition of an environmental credit as an asset only occurs if it is probable to be used to settle an environmental obligation or transferred in an exchange transaction. If the hedged item is identified to be the forecasted purchase of an environmental credit and the hedged risk is changed in the purchase price of the credit, the recognition of the credit as an asset does not impact the probability of forecasted cash flows under ASC 815 or result in a missed forecast if the forecasted transaction does not result in the recognition of an asset. Even if, upon purchase of the environmental credit, the amount is immediately expensed (i.e., they do not meet the Topic 818 criteria to be recognized as an asset), this payment could still represent the occurrence of the forecasted transaction and therefore would not constitute a missed forecast under ASC 815.</u>

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.

Refer to Question #2 above for the Committee's comments regarding how the initial recognition and measurement guidance can be further clarified.

Additionally, the Committee recommends that the Board explicitly clarify that the proposed measurement guidance in Topic 818 is not intended to override existing industry-specific GAAP, such as ASC 940 (Financial Services—Brokers and Dealers) and ASC 946 (Financial Services—Investment Companies). For avoidance of doubt, we suggest adding a statement that entities subject to ASC 940 or ASC 946 should continue to follow the applicable guidance, which typically requires fair value measurement for inventory or investment assets.

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.

Refer to Question #2 for the Committee's comments regarding how the initial recognition and measurement guidance can be further clarified.

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.

The Committee supports the accounting policy election and ability to measure noncompliance environmental credits at fair value. The Committee believes this accounting policy election is clear and operable.

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.

The Committee believes the disclosure requirements, as proposed in paragraphs 818-20-50-1 through 50-7, are overly burdensome and costly to implement. In particular, for environment credits the proposed guidance requires an extensive amount of detail on both the balance sheet and income statement. This includes disclosing balances of environmental credits broken down by type of credit, classification as compliance or non-compliance, current or non-current portions, as well as income statement disclosures disaggregated by type of credit, income statement line, and how the income was generated. The Committee would like the Board to reconsider whether this granular level of disclosure will provide meaningful and decision useful information to investors. In practice, many environmental credits (regardless of type) are economically similar and tend to trade similarly in the market. As a result, the required granularity would not enhance investors' understanding of the entity's environmental credit activities or provide incremental decision-useful information.

The Committee suggests the following changes to the disclosure requirements for environmental credits and obligations respectively:

818-20-50-5 At interim and annual reporting periods, an entity shall disclose the following:

a. Total revenues (or gains) and expense (or losses) from sales of environmental credits or from environmental credits not initially recognized as an asset in accordance with paragraph 818-20-25-1 or subsequently derecognized in accordance with paragraph 818-20-40-2. ~~Revenues from sales of environmental credits in contracts with customers and the carrying amount of those environmental credits at the date of sale.~~

~~b. Gains and losses from sales of environmental credits to noncustomers and the carrying amount of those environmental credits at the date of sale.~~

~~c. Total revenue (or gains) from sales of environmental credits that were never recognized as an asset in accordance with paragraph 818-20-25-1 or were previously derecognized in accordance with paragraph 818-20-40-2.~~

~~d. Total expense recognized for environmental credits not initially recognized as an asset in accordance with paragraph 818-20-25-1 or subsequently derecognized in accordance with paragraph 818-20-40-2.~~

b~~e~~. Total impairment expense recognized during the reporting period. Additionally, the nature of the environmental credits that were impaired and a description of the facts and circumstances giving rise to the impairment.

c~~f~~. The line item or items in the income statement that include the amounts in (a) through (b~~e~~). See paragraphs 220-40-50-21 through 50-25 for additional disclosure requirements.

d~~g~~. Cash paid for environmental credits during the reporting period.

The Committee believes providing a higher-level disclosure would provide users of the financial statements with the necessary information to understand a company's environmental credit activity without unnecessary burden or costs being borne by the preparers The Committee supports higher-level disclosures that focus on the most relevant and decision-useful information for investors. The proposed disclosures above provide clear insight into environmental credit activity—particularly cash inflows and outflows, realized gains/losses, and impairment—without introducing unnecessary granularity that may provide little insight to the users of investors. For example, disaggregating transactions by customer type is not clear it will provide incremental benefit to users and would only increase complexity for preparers. We believe the proposed edits above to the proposed disclosure requirements strike the right balance between providing decision-useful information to users without unnecessary detail.

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.

As discussed in Question #6 above, the Committee believes higher-level disclosures would provide the same decision-useful information to investors while avoiding unnecessary burden to preparers.

Environmental Credit Obligations

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.

The Committee believes the proposed definition of environmental credit obligation is clear and operable and captures the population of items that require specific accounting guidance.

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.

The Committee believes that the proposed amendments for recognition of environmental credit obligation liability is clear and operable.

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.

The Committee believes the proposed amendments for initially measuring the environmental credit obligation liability is clear and operable.

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.

The Committee believes the proposed amendments for the subsequent measurement of environmental credit obligation liability 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.

The Committee believes the proposed guidance on derecognition is clear and operable.

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?

The Committee agrees with the proposed presentation requirement for entities to present compliance environmental credits separately from environmental credit obligation liabilities on its consolidated balance sheet.

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.

As discussed in Question #6 above, the Committee believes higher-level disclosures would be clearer and more operable.

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?

As discussed in Question #6 above, the Committee believes higher-level disclosures would provide more decision-useful information to investors.

Transition and Effective Date

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.

The Committee agrees with the proposed transition approach of retrospective application through a cumulative-effect adjustment to the opening balance of retained earnings (or other appropriate components of equity) as of the beginning of the annual reporting period of adoption. The transition requirements outlined in the Proposed ASU are clear for entities to apply the amendments.

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.

The Committee agrees that the retrospective application of the proposed amendments would be operable.

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.

The Committee believes that the Board should allow entities enough time to assess the impact of the amendments, implement necessary accounting processes, and ensure compliance with the new recognition, measurement, and disclosure requirements. Given the significant diversity in current practice and the broad implications of the amendments, additional time would help companies to mitigate some of the transition challenges. As such, the Committee would recommend that the Board make the amendments effective for annual and interim periods beginning one year after the issuance of the final ASU.

Private Companies

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.

The Committee agrees that the proposed amendments should also apply to private companies.

Closing

We hope you find ISDA's comments and responses to the Proposed ASU informative and useful. Should you have any questions or desire further clarification on any of the matters discussed in this letter, please do not hesitate to contact the undersigned.

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