



# FASB Staff Educational Paper

## Intersection of Environmental, Social, and Governance Matters with Financial Accounting Standards

### Educational Paper Purpose

1. Environmental, social, and governance (ESG) reporting is an area of growing focus for a wide range of interested parties including investors, credit rating agencies, lenders, preparers, regulators, and policy makers. ESG reporting includes a broad spectrum of quantitative and qualitative information. Interested parties seek to understand the effects of relevant ESG matters on an entity's business strategy, cash flows, financial position, and financial performance. In other cases, parties seek that information from a public policy perspective or to influence corporate behavior.
2. Investors and other interested parties have raised questions about the intersection of ESG matters with financial accounting standards that are issued by the Financial Accounting Standards Board (FASB). While ESG matters cover a broad range of topics well beyond the topics covered by financial accounting standards, the FASB staff observes that many current accounting standards require an entity to consider changes in its business and operating environment when those changes have a material direct or indirect effect on the financial statements and notes thereto. That is often the case in areas of accounting that require management judgment and estimation.
3. The FASB staff developed this educational paper to provide investors and other interested parties with an overview of the intersection of ESG matters with financial accounting standards. This paper also provides examples of how an entity may consider the effects of material ESG matters when applying current accounting standards, similar to how an entity considers other changes in its business and operating environment that have a material direct or indirect effect on the financial statements. To better understand this topic, the FASB staff believes that it is important to understand the FASB's role as the designated independent financial accounting standard setter for public companies, private companies, and not-for-profit entities. Therefore, this educational paper also discusses this topic.
4. This educational paper is organized as follows:
  - (a) Overview of ESG Reporting
  - (b) The FASB's Role in Setting Financial Accounting Standards
  - (c) Intersection of ESG Matters with Financial Accounting Standards.
5. This educational paper does not change or modify current generally accepted accounting principles (GAAP) and is not intended to be a comprehensive assessment of the intersection of ESG matters with financial accounting standards. In addition, the examples included in this paper are illustrative and are not intended to convey additional requirements beyond those in current GAAP. Entities should refer to current GAAP and consider entity-specific facts and circumstances when preparing financial statements.
6. The views expressed in this educational paper are those of the FASB staff. Official positions of the FASB are reached only after extensive due process and deliberations.

## Overview of ESG Reporting

7. ESG matters cover a broad range of topics well beyond the topics covered by financial accounting standards. There are several organizations that have established frameworks that an entity may leverage for voluntary or other reporting purposes. There are also several industry-based organizations that have established industry-specific recommendations for such reporting.
8. The following table includes examples of broad topics that interested parties commonly consider as ESG matters (not intended to be all-inclusive):<sup>1</sup>

Environmental	
<ul style="list-style-type: none"> <li>• Climate change</li> <li>• Ecological impacts, such as pollution, deforestation, and loss of biodiversity</li> <li>• Energy management, such as energy-efficient buildings and production processes</li> <li>• Greenhouse gas emissions</li> <li>• Litigation risk, for example, related to environmental contamination</li> <li>• Policies and regulations</li> <li>• Raw material sourcing</li> <li>• Renewable energy</li> <li>• Sustainable products and packaging</li> <li>• Water and waste management</li> </ul>	
Social	Governance
<ul style="list-style-type: none"> <li>• Community relations</li> <li>• Diversity, equity, and inclusion</li> <li>• Employee health and safety</li> <li>• Human capital development</li> <li>• Labor management</li> <li>• Privacy and data security</li> <li>• Product quality and safety</li> <li>• Supply-chain standards</li> </ul>	<ul style="list-style-type: none"> <li>• Antibribery and anticorruption</li> <li>• Business ethics</li> <li>• Corporate resiliency</li> <li>• Diversity of leadership</li> <li>• Executive compensation</li> <li>• Lobbying and political contributions</li> <li>• Ownership structure</li> <li>• Tax transparency</li> </ul>

## The FASB's Role in Setting Financial Accounting Standards

9. The U.S. Securities and Exchange Commission (SEC or Commission) has broad authority over financial accounting principles and financial reporting for public companies<sup>2</sup> and recognizes the FASB as the designated independent financial accounting standard setter for public companies. FASB standards are also recognized as the authoritative source of GAAP for private companies and not-for-profit entities by many organizations such as state Boards of Accountancy and the American Institute of Certified Public Accountants. While the FASB does not establish standards for ESG reporting, the application of many current accounting standards requires an entity to consider changes in its business and operating environment when those changes have a material direct or indirect effect on the financial statements and notes thereto.
10. As noted above, financial reporting requirements for public companies are established by the SEC. Those requirements include the financial statements prepared in accordance with GAAP as established by the FASB. Additionally, the SEC rules include disclosure requirements for information to be included in periodic filings, but outside the financial statements. This includes, for example, Management Discussion and Analysis and Risk Factors. SEC disclosure requirements for information that may need

<sup>1</sup>The categorization of topics as environmental, social, or governance is a matter of judgment and is presented solely to provide context for the discussion in this paper.

<sup>2</sup>The U.S. Securities and Exchange Commission's (SEC or Commission) broad authority over financial accounting principles and financial reporting for public companies is derived from federal securities laws such as the *Securities Act of 1933* and the *Securities Exchange Act of 1934*.

to be included outside the financial statements include Commission guidance on disclosures related to climate change.<sup>3</sup>

11. The FASB's mission is "to establish and improve financial accounting and reporting standards to provide useful information to investors and other users of financial reports and educate stakeholders on how to most effectively understand and implement those standards." The FASB accomplishes its mission through a standard-setting process that is transparent and inclusive. The FASB's Conceptual Framework<sup>4</sup> states that "general purpose financial reports are not designed to show the value of a reporting entity; but they provide information to help existing and potential investors, lenders, and other creditors to estimate the value of the reporting entity." General purpose financial reporting provides information about current conditions and trends that help investors in predicting a reporting entity's future cash flows and results of operation. Financial accounting standards are not intended to drive behavior in any way, including benefitting one industry or business model over another or spurring businesses to take certain actions. Instead, financial accounting standards are intended to provide investors and related users with decision-useful, neutral information that faithfully represents an entity's economic activity as a basis for investment and other capital allocation decisions.
12. General purpose financial reporting does not and cannot meet all the needs of existing and potential investors and related users. Users routinely consider information outside of general purpose financial reporting (for example, nonfinancial measures, qualitative evaluations of trends, earnings calls, press releases, and voluntary ESG reporting) as well as their own perspectives, which may include weighing factors that directly bear on their own personal values to make capital allocation and other decisions.

### Intersection of ESG Matters with Financial Accounting Standards

13. When applying financial accounting standards, an entity may consider the effects of certain material ESG matters, similar to how an entity considers other changes in its business and operating environment that have a material direct or indirect effect on the financial statements and notes thereto. Some industries may be more affected than others (for example, some industries may be more affected by certain environmental matters, such as changes in environmental regulations). The way in which an entity may consider the effects of ESG matters varies based on the accounting standard being applied and the nature and significance of the ESG matter. Some ESG matters may directly affect amounts reported and disclosed in the financial statements, for example, through the recognition and measurement of compensation expense. Other ESG matters may indirectly affect the financial statements; for example, an entity may suffer reputational damage from an environmental contamination that reduces sales. Other ESG matters may not have any material effect on the financial statements. In addition, an entity may consider certain ESG matters as an input to an accounting analysis; for example, a material decline in demand during the reporting period may be a consideration when estimating future cash flows used in a long-lived asset or goodwill impairment analysis. Lastly, risks and opportunities related to ESG matters may have an unfavorable, favorable, or neutral effect on financial statements.
14. The remainder of this educational paper provides examples of how an entity may consider the direct or indirect effects of material environmental matters when applying current GAAP. The examples below are intended to be illustrative and are not intended to convey additional requirements beyond those in current GAAP. While the examples focus on the intersection of environmental matters with financial accounting standards, the FASB staff observes that the effects of such matters on financial statements, if material, are considered in a similar manner as other changes in an entity's business and operating environment (such as shifting consumer preferences and technological or regulatory changes). That is, how or when an entity considers the effects of environmental matters on financial statements is a facts-and-circumstances evaluation that, among other things, considers their significance. Lastly, the discussion below represents a summary of the respective accounting standards and is not intended to

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<sup>3</sup>[Commission Guidance Regarding Disclosure Related to Climate Change](#), Release No. 33-9106 (February 2, 2010) [75 FR 6290 (February 8, 2010)]

<sup>4</sup>FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting*—Chapter 1, *The Objective of General Purpose Financial Reporting*, paragraph OB7

be comprehensive. Entities should refer to current GAAP and consider entity-specific facts and circumstances when preparing financial statements.

GAAP	Intersection of Environmental Matters with Financial Accounting Standards
Subtopic 205-40, Presentation of Financial Statements—Going Concern	<p>The guidance requires management to evaluate, at each annual and interim reporting period, whether there is substantial doubt about an entity’s ability to continue as a going concern within one year after the date that the financial statements are issued.<sup>5</sup> In performing that evaluation, management is required to consider all information that is known and reasonably knowable at the date that financial statements are issued.</p> <p>In its going concern evaluation, management may consider the effects of environmental matters (for example, increased compliance costs related to enacted emissions regulations), as well as other relevant factors that may be material to an entity’s ability to meet its obligations as they become due within one year after the date that the financial statements are issued. If substantial doubt about the ability to continue as a going concern exists, management is required to consider whether its plans alleviate that doubt. Management is required to make certain disclosures if it concludes that substantial doubt exists or that its plans alleviate substantial doubt that was raised. Such disclosures should include information about those matters that were significant to the going concern evaluation.</p>
Topic 275, Risks and Uncertainties	<p>The guidance requires an entity to provide qualitative disclosures about certain risks and uncertainties that could significantly affect the amounts reported in the financial statements <b>in the near term</b>.<sup>6</sup> Disclosure requirements include information about the nature of an entity’s operations and current vulnerability arising from certain concentrations.<sup>7</sup> An entity may determine that the effects of environmental matters are material to the entity in the near term and provide certain disclosures under that guidance.</p> <p>The guidance also requires disclosure of significant estimates that may be particularly sensitive to change. Disclosures are required if it is reasonably possible that assumptions that an entity makes about the future will result in a material change to the carrying amount of assets and liabilities in the near term. The entity may disclose, among other items, the nature of the uncertainty and an indication that it is at least reasonably possible that the estimate will change in the near term. The guidance encourages (does not require) disclosure of the factors that cause the estimate to be sensitive to change, as well as any risk-reduction techniques (for example, obtaining insurance) used by an entity.</p> <p>The FASB staff notes that disclosure requirements in Topic 275 may be similar to disclosures required under other Topics such as Topic 280, Segments, Topic 410, Asset Retirement and Environmental Obligations, and Topic 450, Contingencies.</p>
Topic 330, Inventory	<p>The guidance requires an entity to initially value its inventory at the cost to bring the inventory to its current condition and location. Such costs are generally determined using an acceptable cost-flow method such as first in, first out</p>

<sup>5</sup>Substantial doubt about an entity’s ability to continue as a going concern exists when conditions and events, considered in the aggregate, indicate that it is probable that the entity will be unable to meet its obligations as they become due within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued when applicable). The term *probable* is used consistently with its use in Topic 450, Contingencies.

<sup>6</sup>*Near term* is defined as a period of time not to exceed one year from the date of the financial statements in accordance with the Master Glossary of the *FASB Accounting Standards Codification*<sup>®</sup>.

<sup>7</sup>An entity should evaluate the criteria in paragraphs 275-10-50-8 and 275-10-50-16 to determine if disclosures related to certain significant estimates and current vulnerability arising from certain concentrations are required.

GAAP	Intersection of Environmental Matters with Financial Accounting Standards
	<p>(FIFO) or last in, first out (LIFO). Inventory measured using any method other than LIFO or the retail inventory method (RIM) is subsequently valued at the lower of cost and net realizable value (that is, the estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation). Inventory measured using LIFO or RIM is subsequently valued at the lower of cost or market.<sup>8</sup></p> <p>When estimating net realizable value, management is required to consider all relevant facts and circumstances. Estimates of net realizable value could be materially affected by, for example, a regulatory change that renders inventories obsolete, a significant weather event that causes physical damage to inventories, a decrease in demand for an entity's goods resulting from changes in consumer behavior or an increase in completion costs because of raw material sourcing constraints.</p>
<p>Subtopic 350-20, Intangibles—Goodwill and Other—Goodwill<sup>9</sup></p> <p>Subtopic 350-30, Intangibles—Goodwill and Other—General Intangibles Other Than Goodwill</p>	<p><i>Impairment of Goodwill and Indefinite-Lived Intangible Assets</i></p> <p>The guidance states that goodwill and indefinite-lived intangible assets (for example, trade names) are not amortized<sup>10</sup> but are instead tested for impairment at least annually or more frequently if impairment indicators exist.<sup>11</sup> For goodwill, an impairment exists when the carrying amount of a reporting unit exceeds its fair value.<sup>12</sup> For indefinite-lived intangible assets, a decrease in an asset's fair value below its carrying amount results in an impairment charge.</p> <p>The direct or indirect effects of an environmental matter could give rise to an impairment indicator; for example, changes in hazardous waste management regulations that adversely affect an entity's operations may be an impairment indicator. Environmental matters also may affect the measurement of an impairment loss when, for example, the matter materially affects the market participant assumptions used to calculate the fair value of the reporting unit (goodwill) or the fair value of the indefinite-lived intangible asset. An entity is required to disclose, among other items, the facts and circumstances that led to the recognition of an impairment loss and the method for determining fair value.</p> <p><i>Finite-Lived Intangible Assets</i></p> <p>The guidance requires an entity to amortize a finite-lived intangible asset (for example, client relationships or developed technologies) over its useful life, which is the period in which the intangible asset is expected to contribute directly or indirectly to cash flows of an entity. An entity is required to evaluate the remaining useful life at each reporting period and reflect any changes to the estimate in the financial statements prospectively.</p> <p>The effect of an environmental matter may be one of many factors that affect the estimated useful life of an intangible asset. For example, an entity may develop a more energy-efficient product to substitute a legacy product,</p>

<sup>8</sup>Topic 330 defines the term *market* as the current replacement cost, subject to a ceiling (market shall not exceed net realizable value) and floor (market shall not be less than net realizable value reduced by an allowance for an approximately normal profit margin).

<sup>9</sup>The FASB currently has a [project](#) on its technical agenda related to the subsequent accounting for goodwill and identifiable intangible assets and a [project](#) to address performing an interim triggering event evaluation for certain private companies and not-for-profit entities.

<sup>10</sup>See paragraphs 350-20-35-62 through 35-63 for guidance on an accounting alternative for the subsequent measurement of goodwill for certain private companies and not-for-profit entities.

<sup>11</sup>See paragraphs 350-20-35-3 and 350-30-35-18A for guidance that allows an entity to first perform a qualitative impairment assessment to determine whether it is necessary to perform an annual quantitative test.

<sup>12</sup>Accounting Standards Update No. 2017-04, *Intangibles—Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment*, eliminates the requirement to calculate the implied fair value of goodwill to measure an impairment charge.

GAAP	Intersection of Environmental Matters with Financial Accounting Standards
	resulting in a change in the estimated useful life of the client relationship intangible asset associated with the legacy product. Alternatively, an entity may acquire the rights to certain green technology that did not perform commercially as expected and, thus, would be subject to an impairment charge. A finite-lived intangible asset is evaluated for impairment in accordance with Topic 360.
Topic 360, Property, Plant, and Equipment	<p>The guidance requires an entity to account for long-lived assets such as buildings, machinery, equipment, furniture, and fixtures, at their historical cost. An entity subsequently depreciates the cost of the asset, less any estimated salvage value, over the expected useful life of the asset. The availability of more energy-efficient equipment in the marketplace may result in a decrease in the estimated salvage value of less energy-efficient equipment and/or a decrease in its estimated useful life.</p> <p>The guidance also requires an entity to test a long-lived asset (or asset group) that is held and used for recoverability whenever an impairment indicator exists. Environmental matters could give rise to impairment indicators; for example, a material decline in market demand for products or a change in regulation that adversely affects an entity could indicate that a manufacturing plant may be impaired. When impairment indicators are present, an entity is required to evaluate whether the long-lived asset is recoverable (that is, if the undiscounted cash flow projections directly associated with the asset exceed the carrying amount of that asset).</p>
Subtopic 410-20, Asset Retirement and Environmental Obligations—Asset Retirement Obligations  Subtopic 410-30, Asset Retirement and Environmental Obligations—Environmental Obligations  Subtopic 450-20, Contingencies—Loss Contingencies  Subtopic 450-30, Contingencies—Gain Contingencies	<p><b>Loss Contingencies and Related Topics</b></p> <p><i>Loss Contingencies</i></p> <p>Subtopic 450-20 provides a framework for determining when an accrual is required for a loss contingency<sup>13</sup> (if the loss is probable and reasonably estimable). Examples of loss contingencies include liabilities for injury or damage caused by products sold and obligations related to product warranties. The guidance also states that general or unspecified business risks do not meet the conditions for accrual and that an entity is prohibited from accruing a loss contingency for those risks.</p> <p><i>Environmental Obligations</i></p> <p>The guidance requires an entity to consider relevant regulatory, legal, and contractual requirements when accounting for environmental obligations, for example, regulatory requirements to remediate land contamination or fines imposed by the government for failure to meet emissions targets. Entities are required to disclose the nature of the contingency and, in some cases, an indication that it is reasonably possible that the amount accrued could change in the near term. For unrecognized loss contingencies, entities are required to disclose an estimate of the possible loss or range of losses or a statement that such an estimate cannot be made.</p> <p><i>Asset Retirement Obligations</i></p> <p>The guidance applies to contractual and other legal obligations associated with the retirement of long-lived assets that result from acquisition, construction,</p>

<sup>13</sup>A contingency is defined in the Codification's Master Glossary as "an existing condition, situation or set of circumstances involving uncertainty as to possible gain...or loss...to an entity that will ultimately be resolved when one or more future events occur or fail to occur." Not all uncertainties inherent in accounting give rise to contingencies. The FASB staff observes that management judgment is required to evaluate whether a condition, situation, or set of circumstances meets the definition of a contingency. Topic 450, Contingencies, also includes specific transactional scope exclusions, for example, uncertainty in income taxes and accounting and reporting by insurance entities.

GAAP	Intersection of Environmental Matters with Financial Accounting Standards
	<p>development, and/or normal operation of a long-lived asset. An asset retirement obligation (ARO) is a liability initially measured at fair value. An entity capitalizes the cost as part of the cost basis of the related long-lived asset and depreciates the asset over its useful life. Environmental matters may affect the recognition, measurement, and disclosure of an ARO in the financial statements, for example, those related to (a) a legal obligation to remove a toxic waste storage facility at the end of its useful life or (b) a regulatory requirement to decommission a nuclear power plant or an offshore drilling platform.</p> <p><b>Gain Contingencies</b></p> <p>Environmental matters may give rise to both risks and opportunities for an entity and, therefore, could result in decreases or increases to earnings and cash flows. Subtopic 450-30 states that gain contingencies usually should not be recognized in the financial statements until all contingencies are resolved and the amount is realized or realizable. For example, a gain contingency may result from a potential insurance recovery (that exceeds a recognized loss) related to damage sustained to a manufacturing facility during a significant weather event.</p>
Topic 740, Income Taxes	<p>Entities are required to recognize deferred tax assets for deductible temporary differences, operating loss carryforwards, and tax credit carryforwards to the extent that there is sufficient future taxable income to realize the tax benefit. A valuation allowance is recognized if, based on positive and negative evidence, it is more likely than not that some portion or all the deferred tax asset will not be realized. Environmental regulations could affect estimates of future taxable income. For example, estimates of future taxable income may be affected by projected increases in costs to comply with enacted environmental regulations.</p>
Topic 820, Fair Value Measurement	<p>Fair value measurements are used broadly in GAAP, for example, when accounting for assets acquired and liabilities assumed in a business combination, accounting for many financial instruments, measuring impairment of long-lived assets, goodwill, and other intangible assets, and performing a lease classification test. Fair value is a market-based measurement of the price to sell an asset or transfer a liability in an orderly transaction between market participants. Market participants' assumptions related to, for example, potential legislation, or an asset's highest and best use, may affect fair value measurements.</p>
Various Industry Guidance in the 900 Topics	<p>The effects of environmental matters, if material, may be an input to many accounting measurements under various industry guidance.</p>

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