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FASB Proposes Guidance on the Accounting for Government Grants

Background

On November 19, 2024, the FASB issued a proposed ASU[1] that would add guidance to ASC 832[2] on the recognition, measurement, and presentation of government grants. In the absence of such guidance, many companies have analogized to other GAAP, including IAS 20[3] or ASC 958-605, when accounting for these grants. In developing the proposed ASU's recognition and measurement framework, the FASB largely leveraged the guidance in IAS 20.

Comments on the proposal are due by March 31, 2025. For ease of reference, the proposed ASU's questions for respondents are reproduced in the appendix below.

Scope

The proposed ASU defines a government grant as "[a] transfer of a monetary asset or a tangible nonmonetary asset, other than an exchange transaction, from a government to a business entity."[4] All business entities other than not-for-profit entities or certain employee benefit plans would be subject to the proposed guidance, but it would not apply to the following transaction types:

- "Exchange transactions, such as transactions within the scope of [ASC] 606 on revenue from contracts with customers and [ASC] 610-20 on gains and losses from the derecognition of nonfinancial assets."
- "Transactions within the scope of [ASC] 740 on income taxes."
- "The benefit of below-market interest rate loans."

[1] FASB Proposed Accounting Standards Update, *Accounting for Government Grants by Business Entities*.
[2] For titles of *FASB Accounting Standards Codification* (ASC) references, see Deloitte's "Titles of Topics and Subtopics in the *FASB Accounting Standards Codification*."
[3] International Accounting Standard (IAS) 20, *Accounting for Government Grants and Disclosure of Government Assistance*.
[4] Boldface is omitted in quoted text throughout this publication for terms defined in the ASC master glossary.

- “Government guarantees.”
- “An intangible asset or service.”
- “A reduction of an entity’s liabilities (for example, a sales, property, or other tax abatement).”
- “Government participation in the ownership of an entity.”
- “Contributions to business entities from nongovernmental sources within the scope of [ASC] 958-605 on not-for-profit entities — revenue recognition.”

Connecting the Dots

In the absence of authoritative guidance, business entities that generate transferable tax credits have established various practices. Business entities may make an accounting policy election to account for such credits under ASC 740 or other GAAP because the credits may be transferred to an unrelated third party in an exchange transaction. Accordingly, the entity generating the credits does not need taxable income to obtain an economic benefit from them. Many entities that elect to account for the transferable tax credits outside the scope of ASC 740 currently apply IAS 20 by analogy because the receiving entity is obtaining an intangible asset (i.e., a transferable tax credit) from the government. This is similar to the manner in which entities account for refundable tax credits (which are effectively a monetary grant from the government). Proposed ASC 832-10-55-4 states that a “refundable tax credit that is not within the scope of [ASC] 740 on income taxes” should be accounted for as a government grant. However, intangible assets, which may include transferable tax credits not accounted for in accordance with ASC 740, are also excluded from the scope of this proposed guidance. The Board is seeking feedback on which government grants to include within the scope of the proposed guidance.

Recognition, Measurement, and Presentation

Under the proposed ASU, recognition, measurement, and presentation of government grants depends upon whether the grant is related to an asset or to income. The Board is seeking feedback on the decision-usefulness of the different accounting and presentation alternatives included in the proposed ASU, which provides the following definitions:

- *Grant related to an asset* — “A government grant in which the primary condition is for an entity to purchase, construct, or otherwise acquire a long-term asset, including the direct grant of a tangible nonmonetary asset. Other conditions also may be attached, such as restricting the type or location of the asset, the periods during which the asset is to be acquired or held, or the disposal of the asset.”
- *Grant related to income* — “A government grant other than a grant related to an asset.”

Regardless of whether a government grant is related to an asset or to income, an entity would not be able to recognize the grant unless it concludes that it is probable that both of the following criteria will be met:

- “An entity will comply with the conditions attached to the government grant.”
- “The government grant will be received.”

The proposed ASU clarifies that receipt of the grant does not, by itself, indicate that the above conditions are met. For example, the proposed guidance would apply to forgivable loans issued by the government. To recognize a forgivable loan as a government grant, an entity would have to conclude that it is probable that the loan will be forgiven (i.e., the entity will meet the conditions required for the loan to be forgiven). The entity would thus need to consider the conditions associated with the forgivable loan in determining the timing of recognition of the government grant in the income statement.

Under the proposed ASU, an entity must account for any changes in expectations related to whether the conditions associated with the grant will be met after the grant is recognized as a contingent liability or contingent asset in accordance with ASC 450. (See discussion of repayment of government grants below.)

Grant Related to an Asset

In accordance with the proposed ASU, ASC 832-10-25-5 would allow an entity to use either of the following approaches to recognize a grant related to an asset:

- *Deferred income approach* — Under this approach, an entity would recognize deferred income as a separate financial statement line item on the balance sheet. For a monetary grant, the deferred income recognized would be the amount of cash received or expected to be received on the date the grant meets the recognition criteria. For a nonmonetary grant of a tangible asset (e.g., equipment or land), deferred income would be measured at the fair value of the asset as of the date the grant meets the recognition criteria. According to the proposal, the deferred income "shall be recognized in earnings on a systematic and rational basis over the periods in which the entity recognizes as expenses the related costs for which the government grant is intended to compensate." The grant should be presented in earnings either (1) "[s]eparately under a general heading such as other income" or (2) "[d]educted in reporting the related expense."
- *Cost accumulation approach* — Under this approach, the grant would be reflected as a reduction of the "carrying amount of the asset on the balance sheet." For a monetary grant, an entity should measure the asset on the basis of the cost incurred "to acquire or construct the asset" less the monetary government grant received or expected to be received when the grant meets the recognition criteria. Note that there may be timing differences between when the asset is acquired or constructed and when the recognition criteria for the grant are met. (See Example 1 below for an illustration of this concept.) For a nonmonetary grant of a tangible asset (e.g., grant of equipment or land), the carrying value of the asset would be the cost to the entity, if any. In accordance with this approach, the grant would be a part of the carrying value of the asset and, since it would not be separately identifiable, no separate subsequent measurement or presentation guidance would apply. Application of the subsequent measurement and presentation guidance would depend on the nature of the asset. In other words, the cost basis (net of the grant) would be subject to depreciation, impairment, or other subsequent measurement and presentation guidance (e.g., ASC 360-10 or ASC 330) on the basis of the asset's nature.

In the proposed ASU's Basis for Conclusions, the Board clarifies that "a business entity must choose an accounting policy to be applied consistently for similar types of grants."

The example below illustrates the application of the proposed guidance to a grant related to an asset.

Example 1

Entity A applied for a monetary grant that was approved by the governmental agency. The grant would be for $20 million, which A must use to build a manufacturing facility that is capable of producing 5 million vaccines and making them available for purchase by third parties. Entity A and the governmental agency have not entered into any agreements related to the governmental agency's purchase of vaccines or any minimum capacity that must be reserved for such agency. In addition, A has concluded that the grant does not represent an exchange transaction because it does not have a contract under ASC 606 or ASC 610-20 with the governmental agency. None of the other scope exceptions apply, and A concludes the grant is within the scope of the proposed guidance in ASC 832. Entity A has elected to apply the cost accumulation approach to account for grants related to an asset.

Example 1 (continued)

On January 1, 20X0, A receives the $20 million from the governmental agency. At this time, A has not engaged a construction company to build the manufacturing facility and has not obtained any of the requisite permits from the local authorities. When the cash is received, A does not believe that it is probable that it will comply with the government grant's conditions. As a result, A recognizes cash with a liability for the repayment of the government grant of $20 million because the proposed recognition criteria in ASC 832 have not been met.

As of June 30, 20X0, A has entered into a contract with a construction company to build the manufacturing facility and has incurred $15 million in costs. While the construction is not complete, all necessary permits have been acquired and the construction company has a history of completing similar projects. On June 30, 20X0, A believes that it is probable that it will comply with the government grant's conditions. At this time, the $20 million monetary grant is recognizable in accordance with the proposed guidance in ASC 832. Under the cost accumulation approach, A should recognize the asset on the basis of its cost incurred to date (i.e., $15 million) less the amount of the monetary grant received (i.e., $20 million). Because this results in a negative net asset position of $5 million, we believe that A should present the net deferred credit balance in the liability section of the balance sheet.

As of December 31, 20X0, the construction is complete and the manufacturing facility is ready to be placed into service. Entity A has incurred a cumulative $50 million cost related to the construction of the facility. After the grant is accounted for under the cost accumulation approach, the carrying value of the manufacturing facility is $30 million as of December 31, 20X0. Note that for simplicity, the manufacturing facility is treated as a single asset even though such a facility typically consists of several assets, including the land, building, machinery, and equipment. We believe that an entity may use a reasonable approach to allocate the grant among the different assets, or it may conclude that the grant is related to a primary asset and allocate it to that single asset.

The manufacturing facility would be subject to the guidance in ASC 360-10 on subsequent measurement, including depreciation and impairment.

Grant Related to Income

A grant related to income would be "recognized in earnings on a systematic and rational basis over the periods in which the entity recognizes as expenses the related costs for which the government grant is intended to compensate." If a grant related to income is received before an entity complies with the conditions associated with the grant (i.e., the entity has not incurred the related expenses associated with the grant), the entity would recognize a deferred credit liability that would be reduced as grant income is earned. Alternatively, if a grant related to income is received (1) after the expenses or losses have been incurred or (2) to provide financial support to the entity, the grant is recognized in earnings in the period in which the recognition criteria (discussed above) are met.

In a manner similar to a grant related to an asset accounted for under the deferred income approach, the earnings impact would either (1) be recorded "[s]eparately under a general heading such as other income" or (2) "[d]educted in reporting the related expense."

The example below illustrates the application of the proposed guidance to a grant related to income.

Example 2

Entity B manufactures medical devices and is developing a new product that uses cutting-edge technology to aid in patient sample collection (e.g., blood and tissue samples). In 20X1, B applies for a grant from the government. If B obtains the grant, the government would reimburse B for expenses incurred in its R&D efforts related to getting this product to market.

Example 2 (continued)

On February 1, 20X2, B was approved for a $1 million government grant that requires B to submit its qualifying R&D expenses to the government in exchange for subsequent reimbursement on a cost-reimbursement basis. Entity B forecasts that it will incur costs of $1.5 million that would be considered qualifying R&D expenses. On the date of the grant, B determined that it is not probable that the grant will be received until the qualifying expenses are incurred.

Further, on February 1, 20X2, B does not record anything related to the grant. During 20X2, B incurs $1.5 million of qualifying R&D expenses. Entity B receives all of the $1 million grant on December 15, 20X2.

Entity B recognizes the grant systematically throughout the period in which the expenses were incurred, up to the $1 million and elects to record the grant related to income in earnings as a deduction in reporting the related expense. This results in $0.5 million ($1.5 million incurred – $1 million grant = $0.5 million earnings impact) of R&D expenses associated with the recognition of the project in earnings during 20X2.

Statement of Cash Flows Presentation

Rather than providing prescriptive guidance on the presentation of government grants in the statement of cash flows, the proposed ASU refers to ASC 230. The Board clarifies in paragraph BC44 of the proposal that an "entity may classify proceeds from a grant related to income as a cash flow from an operating activity or as a cash flow from a financing activity." For grants related to an asset, an entity may classify proceeds "as a cash flow from an operating activity, an investing activity, or a financing activity." Entities would need to apply significant judgment when determining the underlying nature of the grant and the resulting presentation in the statement of cash flows.

Connecting the Dots

Although many entities have applied IAS 20 by analogy, IFRS guidance does not specifically address the classification of government grants within the statement of cash flows. The classification of grants related to an asset depends on the nature of the asset to which the grant is related. We expect that entities will need to continue to apply judgment in determining the appropriate classification of grants related to an asset. If a monetary grant is related to an asset that an entity considers to be "inventory," we would expect the entity to classify the inflow in cash flows from either operating activities or financing activities. If the entity considers the asset to be a "long-lived asset," we would expect the monetary grant to be classified in cash flows from investing activities or financing activities.

Disclosure

Under the proposed ASU, the current disclosure requirements in ASC 832 for government assistance would apply to government grants. The proposal clarifies that for a grant related to an asset accounted for under the cost accumulation approach, an entity only needs to disclose the line items on the balance sheet and income statement that are affected by the grant and the amounts applicable to each financial statement line item in the period in which the grant was recognized. Further, the proposed ASU adds a requirement to disclose the fair value of nonmonetary tangible assets that are received as a government grant even if accounted for under the cost accumulation approach.

Other Matters

Repayment of Government Grants

The proposed ASU provides guidance on repayments that occur after a government grant has initially been recognized. Under such guidance, repayment obligations would be "accounted for as a change in estimate in accordance with [ASC] 250 on accounting changes and error corrections."

For a grant related to income, the repayment would first be applied against any deferred income liability remaining. Any excess repayment beyond the deferred income liability would then be immediately recognized in earnings.

For a grant related to an asset, the repayment would be recognized by increasing the carrying amount of the asset (if the cost accumulation approach was used) or reducing the deferred income balance (if the deferred income approach was used) by the amount repayable. An entity would recognize in earnings the cumulative effect of additional depreciation, impairment, or gain or loss on a prior sale of the asset as of the date of the repayment. Repayment of a government grant establishes a new carrying value for the asset.

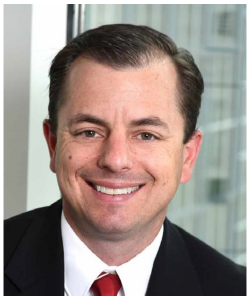
Business Combinations

The Board has proposed amendments to ASC 805-20 specifically related to the recognition and measurement of liabilities associated with government grants. Application of the proposed ASU's measurement guidance differs when (1) the entity has complied with the grant's conditions as of the acquisition date, (2) it is probable that the entity will comply with the grant's conditions, or (3) the entity has not fully complied with the grant's conditions. Rather than requiring measurement of the grant (including any liabilities related to the grant) at fair value, proposed ASC 805-20-30-31 requires "[i]nitial measurement of a liability to repay government grant proceeds . . . at the amount that can be reasonably estimated." The acquirer must assess whether the acquiree has complied with the grant's conditions. If such conditions have not yet been fully satisfied, the acquirer must determine whether it is probable that they will be met in the future. If it is not probable that the conditions will be met, a liability must be established at the reasonably estimable amount.

Transition

Entities would be permitted to apply the guidance prospectively or retrospectively, with a cumulative-effect adjustment to the opening balance of retained earnings at the beginning of the earliest period presented.

Contacts



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Appendix — Questions for Respondents

The proposed ASU's questions for respondents are reproduced below for reference.

Scope

Question 1: Is the proposed scope understandable and operable? Please explain why or why not and, if not, what changes you would suggest. Do you agree with the population of government grants included in the scope of the amendments in this proposed Update? Please explain why or why not.

Recognition and Measurement

Question 2: Under the proposed amendments, a government grant would be recognized when it is probable that (a) the business entity will comply with the conditions attached to the grant and (b) the grant will be received. Are these proposed amendments clear, operable, and auditable? Please explain why or why not.

Question 3: The proposed amendments would provide different accounting requirements and alternatives for a grant related to an asset and a grant related to income. Is the distinction between the types of grants clear? Do the different accounting requirements and alternatives for a grant related to an asset and a grant related to income provide decision-useful information? Please explain why or why not.

Question 4: The proposed amendments would allow a business entity to elect to recognize and present a grant related to an asset either under the deferred income approach or under the cost accumulation approach.

a. Is the deferred income approach operable and understandable? Please explain why or why not.
b. Is the cost accumulation approach operable and understandable? Please explain why or why not.
c. Should there be two approaches to account for a grant related to an asset? Please explain why or why not. If not, what approach do you prefer?
d. Should there be separate recognition or presentation requirements (and implementation guidance) for a grant related to a nondepreciable asset (for example, land)? If yes, should the guidance align with IAS 20 or would you suggest an alternative approach and why?

Question 5: Should a business entity be required to recognize a grant related to income and a grant related to an asset under the deferred income approach in earnings on a systematic and rational basis over the periods in which the business entity recognizes as expenses the related costs for which the grant is intended to compensate? Please explain why or why not. If not, what changes would you suggest?

Question 6: Should a business entity be required to initially measure a government grant of a tangible nonmonetary asset (a) at fair value if the deferred income approach is elected and (b) at cost if a cost accumulation approach is elected? Please explain why or why not.

Presentation

Question 7: If a business entity elects to apply the deferred income approach for a grant related to an asset, the grant would be presented on the balance sheet as deferred income and within earnings either (a) separately under a general heading such as other income or (b) deducted from the related expense. Are these proposed amendments clear, operable, and auditable? Please explain why or why not. Would these presentation options provide decision-useful information? Please explain why or why not.

Question 8: If a business entity elects to apply the cost accumulation approach for a grant related to an asset, the grant would be presented on the balance sheet as part of the cost basis of the asset. Are these proposed amendments clear, operable, and auditable? Please explain why or why not. Would this presentation provide decision-useful information? Please explain why or why not.

Question 9: The proposed amendments would require that a grant related to income be presented as part of earnings either (a) separately under a general heading such as other income or (b) deducted from the related expense. Are these proposed amendments clear, operable, and auditable? Please explain why or why not. Would these presentation options provide decision-useful information? Please explain why or why not.

Disclosure

Question 10: The proposed amendments would require that a business entity comply with the disclosure requirements in Topic 832, Government Assistance. Do the disclosures in Topic 832 provide investors with sufficient information to understand the nature of a government grant and the timing and amount of the grant's impact on a business entity's cash flows? If not, what additional disclosures, if any, should be required and why?

Question 11: If a business entity elects to apply the cost accumulation approach to account for a grant related to an asset, the proposed amendments would require that the business entity disclose the amount of the grant proceeds that was recognized in determining the carrying amount of the asset (in the period the amount was recognized) and if the grant is a grant of a tangible nonmonetary asset, the fair value of the grant (in the period the grant is recognized). The proposed amendments would not require that a business entity disclose in subsequent periods (a) the asset carrying amount that would have been recognized if the business entity had not received the grant, or if the deferred income approach had been used, or (b) depreciation expense, gain or loss on sale, or impairment expense that would have been recorded initially or on an ongoing basis over the life of the asset if the grant had not been received or if the deferred income approach had been used. (See paragraphs BC50–BC52 for additional discussion.)

1. **Investors:** Would the disclosures of the grant proceeds and the fair value of a grant of a tangible nonmonetary asset be decision useful? Would either of the alternative disclosures noted above be useful in your analysis? If so, how would you use this information, particularly in periods after the grant is recognized (for example, in Year 2 for an asset with a 5-year life or in Year 20 for an asset with a 25-year life), and how and when would it affect capital allocation decisions? If this information is not provided, would you seek to obtain it from other sources? Please explain your answer.
2. **Preparers/Practitioners:** What would be the operability and auditing challenges, if any, associated with disclosing either of the alternative disclosures noted above? What would be required to track the accounting for an alternative basis of recognition (including depreciation expense, gain or loss on sale, or impairment expense)? Please explain your answer.

Implementation Guidance and Illustrations

Question 12: Is the proposed implementation guidance, including the illustrative examples, understandable and operable? If not, please explain how it could be improved. Should additional implementation guidance be provided? If yes, please specify what additional guidance should be provided and why.

Accounting for a Government Grant in a Business Combination

Question 13: Are the proposed amendments on how to account for government-grant-related liabilities assumed in a business combination understandable and operable? What operability or auditing challenges, if any, would be associated with those proposed amendments?

Transition and Effective Date

Question 14: Is the proposed transition guidance operable? If not, why? What transition guidance would be more appropriate and why? Should there be different transition guidance for government grants acquired in a business combination? If yes, please explain why.

Question 15: How much time would be needed to implement the proposed amendments? Is additional time needed for entities other than public business entities? Should early adoption be permitted? Please explain your answer.

Benefits and Costs

Question 16: Would the proposed amendments provide investors with decision-useful information? If so, how would that information influence investment and capital allocation decisions? Would the proposed amendments clarify the appropriate accounting, increase consistency among business entities, and reduce diversity in practice? If not, please explain why.

Question 17: To the extent not previously discussed, what costs may be incurred to apply the proposed amendments? If the proposed amendments are expected to impose significant incremental costs, please describe the nature and magnitude of those costs, differentiating between one-time costs and recurring costs. If the proposed amendments are not expected to impose significant incremental costs, or are expected to reduce costs, please explain why.

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