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File Reference No. 2024-ED700
Financial Accounting Standards Board
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Proposed Accounting Standards Update*, Government Grants (Topic 832): Accounting for Government Grants by Business Entities* (File Reference No. 2024-ED700)

Dear Mr. Day,

We appreciate the opportunity to comment on the Proposed Accounting Standards Update, *Government Grants (Topic 832): Accounting for Government Grants by Business Entities*, issued by the Financial Accounting Standards Board (FASB or Board).

We support the FASB's efforts to establish authoritative guidance on the accounting for government grants by business entities by leveraging the guidance in International Accounting Standard (IAS) 20, *Accounting for Government Grants and Disclosure of Government Grants*. Because many business entities currently account for government grants by analogizing to IAS 20, we believe this approach would result in the least disruption to current practice.

We believe the FASB's proposal responds to concerns raised by stakeholders about the lack of specific authoritative guidance in US GAAP to account for government grants by business entities. Under the proposal, business entities would no longer analogize to other guidance (e.g., Accounting Standards Codification (ASC or Codification) 450, *Contingencies*) and would account for government grants in a way that best reflects the nature and economic effect of grants they receive on their business or operations.

While we largely support the FASB's proposal, we believe it is important for the Board to address several aspects. Most significantly, the proposed amendments to ASC 805, *Business Combinations*, may not be operable, and the proposed recognition threshold would potentially result in a business entity recording a grant related to an asset before obtaining the related asset and/or beginning to recognize a grant related to income before incurring the related expenses. Additionally, we believe the Board should address the applicability of the guidance to business entities that generate nonrefundable, transferable tax credits.

Our responses to questions in the proposal and our recommendations for the Board's consideration are included in Appendix A and Appendix B.

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We would be pleased to discuss our comments with the Board or its staff at their convenience.

Very truly yours,

Ernst & Young LLP

Appendix A — Responses to questions raised in the Proposed Accounting Standards Update, *Government Grants (Topic 832) — Accounting for Government Grants by Business Entities*

> **Question 1 - Scope:** 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.

We believe that the proposed scope is generally understandable and operable, and we agree with the population of government grants that would be included in the scope. However, we recommend that the Board clarify the accounting for an agreement with a government that includes elements partially in the scope of ASC 832, *Government Assistance*, and partially in the scope of other topics, such as those listed in ASC 832-10-15-4A. IAS 20 does not provide guidance on transactions with a government that have multiple elements for which different guidance applies. We have seen an increase in these types of arrangements in recent years (e.g., when the US government provided grants in response to COVID-19).

The Board noted in paragraph BC18 in the proposal's Background Information and Basis for Conclusions that "an agreement with the government may include elements that are partially in scope of Topic 832 and partially within the scope of other Topics …" However, further clarification on how an entity should allocate consideration among components both in and outside the scope of ASC 832, including illustrative examples, would be helpful. The agreement with the government may not clearly assign the consideration to different components. For example, if an entity receives cash from a government ostensibly for the provision of vaccines, but the consideration received is well in excess of current vaccine standalone selling prices, it is unclear whether an entity would be required to allocate the consideration between ASC 606, *Revenue from Contracts with Customers*, and ASC 832. If it is, we believe it is also unclear whether this allocation should be done on a relative standalone selling price basis, through the use of a residual approach, or another allocation method.

An entity could also receive cash from the government, as well as a free or reduced rate lease. Because paragraph BC22 excludes free or reduced rate leases from the scope of ASC 832, we believe it is unclear whether an entity would be required to only apply the guidance to the amount stated as the cash grant in the agreement or to allocate any of the cash amount to the lease component.

Additionally, we believe it is important that the final Accounting Standards Update (ASU) address nonrefundable, transferable tax credits which are not discussed in the proposal.[1] That is, an entity would be able to account for these credits under either ASC 740, *Income Taxes*, or ASC 832. We note that the proposal addresses the applicability of the guidance to refundable tax credits, so also

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[1] US GAAP does not address how an entity that generates a nonrefundable, transferable tax credit should consider the ability to transfer the credit when determining which accounting guidance to apply. In response to a technical inquiry, the FASB staff stated that because ASC 740 does not specifically address this issue, it is acceptable to account for the credits under ASC 740 or other GAAP (which, in practice, has included the application of IAS 20).

discussing nonrefundable, transferable credits that may be in the scope would be relevant. We recommend the following changes (in bold and underscored):

> BC24. The Board decided to exclude transactions that are within the scope of Topic 740 from the scope of the amendments in this proposed Update. Respondents to the 2022 GG ITC were generally supportive of the scope exclusion in paragraph 2(b) of IAS 20, which excludes "government assistance that is provided for an entity in the form of benefits that are available in determining taxable profit or tax loss, or are determined or limited on the basis of income tax liability." In addition, the Board noted that GAAP contains comprehensive accounting and disclosure guidance for income taxes, including investment tax credits. **Refundable tax credits (regardless of their transferability provisions) are generally not subject to the provisions of Topic 740 since receipt of such credits is not dependent upon having taxable income. Since it is not clear whether nonrefundable, transferable tax credits are in the scope of Topic 740, entities can apply a policy election to account for nonrefundable, transferable tax credits under either Topic 740 or the guidance in this proposed Update.**

Question 2 – Recognition and Measurement: 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.

While the recognition threshold would be largely consistent with IAS 20, we believe there is a difference that could cause confusion. IAS 20.7 states: "Government grants, including non-monetary grants at fair value, shall not be recognized until there is reasonable assurance that: (a) the entity will comply with the conditions attaching to them; and (b) the grants will be received." ASC 832-10-25-1 states, "A government grant shall be recognized when it is probable that both of the following criteria will apply: (a) An entity will comply with the conditions attached to the grant. (b) The government grant will be received."

The use of "until" in IAS 20.7 means that the grant should be recognized no earlier than when there is reasonable assurance of meeting the two criteria. The use of "when" in the proposal could be seen as depicting the exact timing of when to recognize the grant. We suggest that ASC 832-10-25-1 be revised to state that (edits are in bold and underscored): "A government grant shall **not** be recognized **until** ~~when~~ it is probable …" If amended, this paragraph would serve as a recognition threshold, rather than dictating the timing of recognition. Otherwise, the use of "when" in ASC 832-10-25-1 would imply that an entity should "gross up" its balance sheet for government grants not yet received, begin to recognize a grant related to an asset before obtaining the related asset and/or begin to recognize a grant related to income before incurring the related expenses.

Clarifying the recognition criteria and aligning it with IAS 20.7 would reduce the opportunity for a balance sheet gross-up, because we believe an entity should not record a receivable or other asset (other than recording any cash received) before performing the required activities to receive the grant.

Additionally, we suggest that the Board clarify the recognition threshold either in the illustrative examples or elsewhere in the guidance. Consider the facts in Example 1 of the proposal. If Entity A received its cash grant of $5 million before purchasing the building (but believed it otherwise met the recognition criteria in ASC 832-10-25-1) and elected to use the cost accumulation approach, we do not believe it would be appropriate for the entity to debit cash and credit the cost basis of the building not yet purchased. We believe Entity A should wait to recognize the grant under ASC 832 until the building is purchased and recorded on its books because it would be more appropriate for the credit recorded for the cash receipt to be a refundable advance until the building is purchased.

Conversely, if Entity A did not receive the cash grant before the end of a reporting period (but believed it otherwise met the recognition criteria in ASC 832-10-25-1) and elected to use the deferred income approach, it is unclear whether Entity A should gross up its balance sheet by recording a receivable and a deferred income liability as of period end.

While we acknowledge that IAS 20 does not include guidance on the recognition of a receivable, we believe that any guidance on government grant accounting included in US GAAP should address the accounting for any grant receivables.

Question 3 – Recognition and Measurement: 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.

We believe the distinction between a grant related to an asset and a grant related to income would generally be clear. However, we suggest clarifying certain aspects of the proposal. Similar to IAS 20, the proposal would provide different accounting requirements and alternatives for a grant related to an asset and a grant related to income, and investors would be in a better position to determine whether these alternatives provide decision-useful information. However, maintaining these alternatives would provide greater consistency with IAS 20 and require fewer changes by business entities already applying IAS 20 by analogy.

As discussed in paragraph BC30, the Board concluded that the direct grant of a tangible nonmonetary asset by a government is a grant related to an asset, which is different from IAS 20. That is, the proposal defines a grant related to an asset as 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."

We believe changing the definition of a grant related to an asset from IAS 20 may result in confusion over which period to recognize the direct grant of a depreciable tangible nonmonetary asset in the income statement. This is because the form of the grant (i.e., the direct grant of a tangible monetary asset) is dictating the grant type (i.e., a grant related to an asset) rather than the primary condition of the grant. Refer to our response to Question 5 for more details.

Additionally, in relation to the definition of a grant related to an asset, we recommend that the Board clarify whether it intends for a "long-term asset" to include a right-of-use (ROU) asset for a lease accounted for under ASC 842, *Leases*. For example, if an entity receives cash from a government in which the primary condition is to acquire a lease (i.e., an ROU asset) with a third party, we believe it is unclear whether that could constitute a grant related to an asset. We also believe it is unclear whether a recognized ROU asset acquired through a lease with a term that is a year or less would be considered a long-term asset. Therefore, we recommend that the Board clarify its intent with respect to ROU assets.

Further, ASC 832-10-55-7, Example 3 and paragraph BC29 in the proposal discuss government grants that contain multiple conditions. While the language in ASC 832-10-55-7 appears to be leveraged from IAS 20.19, it is unclear why the last sentence of IAS 20.19 was not carried over (i.e., "It may be appropriate to allocate part of a grant on one basis and part on another.") This principle is illustrated in Example 3 (ASC 832-10-55-16) and paragraph BC29. We suggest either adding this sentence to ASC 832-10-55-7 or making the change below (in bold and underscored):

> **832-10-55-7** Government grants may be received as part of a package of financial or fiscal aid that contains a number of conditions. In such cases, judgment is needed to identify the conditions related to the costs that determine the periods over which the government grant will be recognized. <u>**Further, a government grant may need to be accounted for as both a grant related to an asset and a grant related to income if multiple primary conditions are identified.**</u>

Question 4 – Recognition and Measurement: 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?

We believe the two approaches would generally be operable and understandable, with limited exceptions as we discuss elsewhere in this letter. Allowing two approaches to account for a grant related to an asset (i.e., the deferred income approach and the cost accumulation approach) would be largely consistent with IAS 20 and likely reduce implementation costs for business entities that currently analogize to IAS 20.

We recommend the Board clarify whether an entity that recognizes a grant related to an asset under the cost accumulation approach that meets the recognition criteria in ASC 832-10-25-1 after the asset has already been placed in service should be allowed to "catch up" depreciation by either (1) immediately reducing depreciation expense as if the grant was always part of the cost basis of the asset (which could be seen as similar to the outcome discussed in ASC 832-10-35-1 when a government grant becomes repayable) or (2) updating depreciation expense prospectively.

We also recommend the Board establish separate recognition, presentation and implementation guidance for grants related to a nondepreciable asset, including a direct grant of a tangible nondepreciable nonmonetary asset (e.g., land). IAS 20.18 requires judgment in accounting for nondepreciable assets and states, "Grants related to non-depreciable assets may also require the fulfilment of certain obligations and would then be recognised in profit or loss over the periods that bear the cost of meeting the obligations. As an example, a grant of land may be conditional upon the erection of a building on the site and it may be appropriate to recognise the grant in profit or loss over the life of the building."

There could be scenarios under this guidance in which the nondepreciable asset is not conditional, and therefore, the period of time over which an entity would recognize the grant in earnings is unclear and/or nonexistent (i.e., there is no period over which the entity recognizes as expenses the related costs for which the grant is intended to compensate). We believe a grant related to a nondepreciable asset (including a direct grant of a tangible nondepreciable nonmonetary asset) would be accounted for as a grant related to an asset under the proposal.

If an entity were to elect the deferred income approach, and there were no related conditions, the grant would be initially measured at fair value but not recognized in earnings unless it was sold. It is unclear whether this would be the Board's intent and/or a preferable accounting outcome. Therefore, we believe that the grant of a nondepreciable asset with no conditions should be required to be accounted for under the cost accumulation approach (i.e., initially measured at the cost to entity, if any).

Question 5 – Recognition and Measurement: 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?

For a grant related to income under the deferred income approach, we believe a business entity should be required to recognize the grant in earnings on a systematic and rational basis over the periods in which it recognizes as expenses the related costs for which the grant is intended to compensate. This accounting would reflect the economics of the grant, and we believe the consistency with IAS 20 would reduce implementation costs for many business entities that currently analogize to IAS 20.

However, as initially discussed in our response to Question 3, we believe the Board's proposal to change the definition of a grant related to an asset from IAS 20 may result in confusion over which period to recognize the direct grant of a depreciable tangible nonmonetary asset under the deferred income approach when the primary condition of the grant is not for an entity to purchase, construct or otherwise acquire a long-term asset. That is, we believe it is unclear whether it would be recognized over the period in which the business entity recognizes as expenses the related costs for which the government grant is intended to compensate (as discussed in ASC 832-10-25-6) or over the asset's useful life (as discussed in ASC 832-10-55-6). This period of time may be the same for some but not all grants. Refer to our response to Question 4.d. related to grants of nondepreciable assets.

Under IAS 20, a grant related to an asset is always recognized in earnings over the useful life of the asset. However, under the proposal, it is possible that the primary condition related to the direct grant of a depreciable tangible nonmonetary asset may not be to "purchase, construct, or otherwise acquire a long-term asset." This is because the Board decided that all direct grants of tangible nonmonetary assets would be grants related to assets, regardless of their primary condition.

Further, as noted above, there is inconsistency between ASC 832-10-25-6 and 55-6, which both discuss the recognition period for a grant related to an asset under the deferred income approach.

ASC 832-10-25-6 states that "a grant related to an asset accounted for using the deferred income approach 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 expenses that are recognized for a grant related to an asset could include depreciation, gain or loss on sale, or impairment." However, ASC 832-10-55-6 states that "… a government grant related to a depreciable asset that is accounted for under the deferred income approach in accordance with paragraph 832-10-25-5(a) should be recognized in earnings on a systematic and rational basis over the periods in which depreciation expense on that asset is recognized (in the absence of impairment or disposal)."

That is, ASC 832-10-25-6 seems to allow that the recognition period for a grant related to an asset using the deferred income approach could be different from the useful life of the asset, but ASC 832-10-55-6 does not. We believe the Board should clarify its intent regarding the period the direct grant of a depreciable tangible nonmonetary asset should be recognized. Further, we recommend that a grant related to an asset (including direct grants of depreciable tangible nonmonetary assets as defined by the proposed definition of a grant related to an asset) accounted for using the deferred income approach be recognized over the asset's useful life (in the absence of impairment or disposal) to maintain consistency with IAS 20.26 and align the recognition period under both the deferred income approach and the cost accumulation approach.

Question 6 – Recognition and Measurement: 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.

We support the Board's proposal to require that a business entity initially measure a government grant of a tangible nonmonetary asset (1) at fair value if the deferred income approach is elected or (2) at cost if the cost accumulation approach is elected.

We acknowledge that IAS 20.23 provides for accounting for such grants at fair value but gives the option to measure nonmonetary assets at a nominal amount. However, similar to the discussion in paragraph BC32, we agree that this approach is not commonly used in practice.

Question 7 - Presentation: 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.

We believe these proposed amendments are generally clear and operable and would not present auditing challenges. We encourage the Board to consider feedback from investors on whether these presentation options would provide decision-useful information.

However, we suggest the Board clarify (potentially in the Basis for Conclusions) that the presentation of a "general heading such as other income" would not include revenue unless receiving grants meets the definition of revenue in the Codification's Master Glossary, which is, "inflows or other enhancements of assets of an entity or settlement of its liabilities (or a combination of both) from delivering or producing goods, rendering services, or other activities that constitute the entity's ongoing major or central operations." We would not generally expect a business entity to classify receiving governments grants as a part of its "ongoing major or central operations."

Question 8 - Presentation: 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.

We believe these proposed amendments are generally clear and operable and would not present auditing challenges. In addition, we encourage the Board to consider feedback from investors on whether these presentation options would provide decision-useful information.

However, as discussed in our response to Question 2, the proposed guidance is unclear about when a business entity elects to apply the cost accumulation approach and the recognition criteria in ASC 832-10-25-1 are met before the asset is purchased and recorded on the entity's books. In this situation, there is not yet an underlying asset recorded that would be offset by the grant proceeds. We suggest the Board clarify the guidance in ASC 832-10-25-1.

Question 9 - Presentation: 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.

We believe these proposed amendments are generally clear and operable and would not present auditing challenges. We encourage the Board to consider feedback from investors on whether these presentation options would provide decision-useful information. However, please refer to our response to Question 7 related to income versus revenue presentation.

Question 10 - Disclosure: 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?

We encourage the Board to consider feedback from investors on whether the proposed disclosures would provide them 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.

Currently, under ASC 832 (as well as in the proposed amendments), the disclosures are required for annual periods. Paragraph BC49 of the proposal states that the disclosures in ASC 832 "would not be required in interim periods." However, we understand that it is the Board's intent, through its separate interim disclosure project, to include a principle in ASC 270, *Interim Reporting*, that would require an entity to make disclosures at interim periods when a significant event or transaction that has a material effect on the entity has occurred since the previous year end.

For these reasons, we recommend that the Board make the following changes (in bold and underscored) to paragraph BC49:

> BC49. The Board decided to affirm that the disclosures in Topic 832, including the amendments to those disclosures in this proposed Update, should be required for annual reporting periods. ~~The Board also decided that the disclosures would not be required in interim periods.~~ The Board concluded that requiring specific disclosures on an interim basis would increase costs for preparers without a commensurate increase in the benefit to investors. **However, if a reporting entity prepares interim financial statements, that entity should look to the existing disclosure requirements in Topic 270, Interim Reporting, for guidance.**

These edits would be consistent with the wording in paragraph BC33 of ASU 2021-10, *Government Assistance (Topic 832): Disclosures by Business Entities about Government Assistance*.

ASC 832-10-45-4 notes that cash flows from a government grant should be presented in accordance with ASC 230, *Statement of Cash Flows*. We acknowledge paragraph BC44 notes that an entity may "classify proceeds from a grant related to an asset as a cash flow from an operating activity, an investing activity, or a financing activity." We believe that it would benefit stakeholders if the Board clarified how the principles in ASC 230 are expected to interact with the proposed guidance on government grant accounting. To help clarify the application of ASC 230's principles and mitigate potential diversity in practice across the primary financial statements, we recommend the Board consider including additional application guidance on statement of cash flow classification for common arrangements, such as:

1. Cash inflows from grants related to an asset under both the deferred income and cost accumulation approaches and grants related to income

2. Cash inflows from grants that are received before the related costs are incurred under each approach listed in 1. above (e.g., when a grant related to an asset is received prior to construction costs being incurred)

3. Cash outflows from the repayment of grants

Question 11 - Disclosure: 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.)

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.

We agree with the Board's decision to not require a business entity to provide either of the alternative disclosures above. We believe that presenting the asset's carrying amount that would have been recognized for the useful life of the asset as if the grant was not received or if the deferred income approach had been elected would become repetitive over the life of the grant and could possibly require hypothetical impairment calculations.

Presenting depreciation expense, gain or loss on sale or impairment expense that would have been recorded initially or on an ongoing basis over the useful life of the asset if the grant had not been received or if the deferred income approach had been used would also require hypothetical calculations and requires entities and auditors to spend additional effort recording and verifying two different accounting approaches.

Additionally, selecting the cost accumulation approach or the deferred income approach would be an accounting policy election, and requiring entities to disclose the effect of both methods is not common in US GAAP.

Question 12 – Implementation Guidance and Illustrations: 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.

Refer to our response to Question 3 for comments related to clarifying the implementation guidance in ASC 832-10-55-7 and our response to Question 5 for comments related to clarifying the implementation guidance in ASC 832-10-55-6.

We also believe there is an inconsistency in the principles underlying Example 1 and Example 2. In Example 1, Entity A determines it has met the recognition criteria under ASC 832-10-25-1 even though it has not yet purchased the building that is the only condition attached to the grant. However, in Example 2, Entity B determines it has not met the recognition threshold because it has not yet incurred the qualifying expenses that are the only conditions of the grant.

While Example 1 illustrates a grant related to an asset and Example 2 illustrates a grant related to income, we do not believe the recognition threshold should be interpreted differently by type of grant, as seems to be the case in these two examples. We believe the Board should clarify its intent regarding the recognition threshold. We note that this comment relates to our comments in response to Question 2, which highlighted additional questions we have regarding Example 1.

Question 13 – Accounting for a Government Grant in a Business Combination: 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?

The proposal to add an exception to the general recognition principle in ASC 805 would require entities to recognize government grant-related liabilities assumed in a business combination if the acquiree has not fully complied with the conditions attached to the acquired grant as of the acquisition date. In that circumstance, the proposed recognition requirements would differ depending on whether the grant relates to an asset or income. We believe the Board should clarify certain aspects of the proposed recognition requirements for each type of grant to make the guidance understandable and operable.

An acquired government grant related to an asset

ASC 805-20-25-28E states that an acquired grant related to an asset should be accounted for "in accordance with this Topic, except for any liability to repay grant proceeds that is recognized in accordance with paragraph 805-20-25-28G" (ASC 805-20-25-28G requires recognition based on the provisions of ASC 450). We interpret the general reference to ASC 805 in ASC 805-20-25-28E to mean that an acquirer would need to determine whether a liability would be recognized at fair value on the acquisition date as a distinct unit of account that is separate from the repayment liability recognized pursuant to ASC 450 referenced therein.

We observe that, if an acquiree has not received the related grant proceeds as of the acquisition date, a liability would not be identified and recognized under ASC 805 because an acquirer would conclude that a liability does not exist at that date. On the other hand, if the acquiree has received the grant proceeds, ASC 805-20-25-28E suggests that more than one unit of account requires recognition in the business combination.

We question the nature of the liability that would be recognized at acquisition-date fair value, and how it would be different from the liability to repay the grant proceeds. We recommend that the Board provide additional guidance clarifying the distinct units of account and how each unit of account should be separately determined, either in the Codification or in the Basis for Conclusions. Without this clarification, we believe the proposed amendments may not be operable.

An acquired government grant related to income

ASC 805-20-25-28F states that if it is probable at the acquisition date that the conditions attached to the government grant will be met, an acquirer would account for any deferred income in accordance with ASC 832 (deferred income is not defined under the proposed amendments). We interpret this proposed guidance to mean that an acquirer would apply the relevant provisions of ASC 832 when recognizing and measuring deferred income in a business combination. Accordingly, since the proposed amendments implicitly introduce a measurement exception, we recommend that the Board also make conforming amendments to the initial measurement exceptions section in ASC 805.

ASC 805-20-25-28F also states that "any acquired grant-related assets shall be accounted for in accordance with Topic 805." We observe that "grant-related assets" would not be defined under the proposed amendments or discussed in the Basis for Conclusions. Accordingly, it is unclear what this guidance is intended to address. We recommend that the Board provide specific context in the Codification or the Basis for Conclusions to help stakeholders understand what this guidance applies to.

Furthermore, we would observe that certain intangible assets recognized in a business combination (e.g., in-process research and development (IPR&D) assets) may have been partially funded with a government grant. We observe that an income approach is often used in practice when measuring an IPR&D asset at acquisition-date fair value. This valuation technique, which estimates fair value by discounting the prospective net cash flows the acquirer expects to generate in the future from owning the asset, would generally consider the cash outflows attributable to R&D expenses the entity expects to incur after the acquisition date.

If the acquirer benefits from an acquired government grant related to the continued development of the IPR&D project, recognizing a separate deferred income liability in the business combination would potentially result in an acquirer double counting the impact of the grant received in its balance sheet. For example, an acquirer would recognize the expected future cash outflows in its valuation of the acquired IPR&D project while also recognizing deferred income associated with those same future cash outflows subject to the government grant.

Accordingly, we recommend that the Board provide additional guidance clarifying how these cash flows should be considered when measuring deferred income under ASC 832 and the IPR&D asset under ASC 820, *Fair Value Measurement*, either in the Codification or in the Basis for Conclusions. Without this clarification, we believe the proposed amendments may not be operable.

An assumed liability to repay government grant proceeds

If an acquirer has a liability (e.g., contractual or legal) to repay government grant proceeds at the acquisition date, we do not believe the liability should be recognized in accordance with ASC 450-20-25-1 through 25-5 because there would be no contingency in that scenario. That is, we believe the liability would be recognized under other US GAAP, such as ASC 405, *Liabilities*, or ASC 470, *Debt*. Therefore, we recommend that the Board clarify its intent with respect to ASC 805-20-25-28G.

If the intent is for ASC 805-20-25-28G to also cover scenarios in which the entity has not fully complied with the conditions attached to the grant at the acquisition date, and it is not probable, in accordance with ASC 832-10-25-1, that the conditions attached to the grant will be met, it is not clear whether the application of ASC 450-20 would result in a liability because there may not be an obligating event (e.g., the obligating event may occur when the conditions attached to the grant have not been met).

Question 14 – Transition and Effective Date: 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.

We believe certain language describing retrospective adoption should be clarified to make the transition guidance more operable. We would expect an entity to apply the guidance only to government grants that were not "complete" (as defined in this proposal) as of the beginning of the earliest period presented, rather than applying the guidance to "all previously existing government grant arrangements" (as stated in paragraph BC62). If a government grant has been completed before the beginning of the earlier period presented, we would not expect that it would need to be adjusted through retained earnings. Accordingly, we recommend the Board make the following changes (in bold and underscored) to clarify ASC 832-10-65-2(d)(2) and paragraph BC62:

> **832-10-65-2** The following represents the transition and effective date information related to Accounting Standards Update No. 202X-XX, *Government Grants (Topic 832): Accounting for Government Grants by Business Entities*:
>
> d. An entity shall apply the pending content that links to this paragraph either:
> 1. Prospectively to government grants that are not complete as of the effective date and government grants that are entered into after the effective date.
> 2. Retrospectively through a cumulative-effect adjustment to the opening balance of retained earnings ~~at~~ <u>**for any government grants that are not complete as of**</u> the beginning of the earliest period presented.
>
> BC62. The Board considered that some entities may prefer to apply the amendments in this proposed Update retrospectively so that similar government grants are accounted for consistently. The Board therefore decided to permit, but not require, retrospective application of the proposed amendments. Under retrospective application, an entity would recognize a cumulative-effect adjustment to the opening balance of retained earnings ~~at~~ <u>**for any**</u>

<u>government grants that are not complete as of</u> the beginning of the earliest period presented. The opening adjustment to retained earnings would capture the effect on retained earnings for ~~all previously existing~~ **<u>any</u>** government grant arrangements **<u>that are not complete as of</u>** **<u>the beginning of the earliest period presented</u>**. Furthermore, the entity would restate the financial results for all years presented to reflect the effect of the proposed amendments.

If the Board allows entities to apply the proposed guidance to grants acquired in a business combination on a fully retrospective basis, we believe it should explain how the guidance would apply to amounts recognized in business combinations that have occurred in the comparative periods.

Appendix B — Additional comments regarding the Proposed Accounting Standards Update, *Government Grants (Topic 832) — Accounting for Government Grants by Business Entities*

Repayment of a government grant

ASC 832-10-35-1 discusses the accounting for when a government grant "becomes repayable." However, the proposed language does not address when an entity determines it no longer meets the recognition threshold in ASC 832-10-25-1, but it is not yet required to repay the grant. We suggest updating this paragraph to address this situation. We also believe the Board should clarify that an entity is required to reassess its probability assessment related to compliance and receipt of a government grant over its life.

Separately, the reference to guidance in ASC 250, *Accounting Changes and Error Corrections*, on the accounting for a change in estimate in the first sentence of ASC 832-10-35-1 appears unnecessary, because the paragraph already specifies the proposed accounting if a grant becomes repayable. Also, the reference to ASC 250 may inadvertently create confusion over whether other changes in accounting estimates (e.g., changes in depreciable lives) would result in recognizing a cumulative effect in the period of change.

In addition, it is not clear that the proposed accounting in ASC 832-10-35-1 would be entirely consistent with the change in estimate guidance in ASC 250 because repayment of a grant related to an asset results in a cumulative adjustment to depreciation expense, while the repayment of a grant related to income may not result in a cumulative adjustment to earnings. Therefore, because the inclusion of a reference to ASC 250 is both unnecessary and could create unintended confusion, we recommend removing it in paragraph BC42 and ASC 832-10-35-1.

Accordingly, we recommend the Board make the following changes (in bold and underscored) to ASC 832-10-35-1 (other changes may be necessary in the remainder of the paragraph to replace the word "repayment"):

> 832-10-35-1 A government grant that ~~becomes repayable~~ **<u>has been recognized in accordance with paragraph 832-10-25-1 but no longer meets such criteria</u>** shall be accounted for as ~~a change in estimate in accordance with Topic 250 on accounting changes and error corrections~~ **<u>follows</u>**.

Further, ASC 832-10-35-1 states, "To the extent that the repayment exceeds any unamortized deferred credit or when no deferred credit exists, the repayment shall be recognized immediately in earnings." It is not clear whether the Board intends to permit entities to recognize such repayment amount (and/or reversal as discussed above) in any line item in the income statement or intends to require entities to recognize the amount in earnings under the same income statement line item where the grant was initially recognized. We recommend the Board clarify its intent in ASC 832-10-35-1, if needed, or in the Basis for Conclusions.

Additionally, ASC 832-10-35-1 includes guidance for a repayable grant related to income if the repayment amount exceeds any unamortized deferred credit or if no deferred credit exists. There is also guidance for a grant related to an asset when the cost accumulation approach is used regarding repayment. However, there appears to be a gap in the guidance for a scenario in which the deferred income approach is used for a grant related to an asset and the repayment amounts exceeds any unamortized deferred credit.

We believe it is unclear whether the Board's intent is for an entity to follow the guidance for a grant related to income. We suggest the Board clarify this in ASC 832-10-35-1 or in the Basis for Conclusions.

Contingent liabilities and assets

ASC 832-10-25-4 states, "Once a government grant is recognized, any related contingent liability or contingent asset shall be accounted for in accordance with Topic 450 on contingencies." We acknowledge that ASC 832-10-25-4 is consistent with IAS 20.11. However, under both IAS 20 today and the proposed paragraph, it is unclear under what circumstances a contingent liability or contingent asset related to government grants may need to be recognized. We suggest that the Board remove the guidance in ASC 832-10-25-4 or provide examples of situations when a contingent liability or contingent asset may need to be accounted for after a government grant is recognized.

Disaggregation of income statement expenses (ASC 220-40)

ASC 220-40, *Income Statement — Reporting Comprehensive Income — Expense Disaggregation Disclosures*, requires an entity to disclose disaggregated information about certain income statement expense line items. It also provides certain disclosure requirements for an entity that participates in cost-sharing or cost-reimbursement arrangements (refer to ASC 220-40-50-26 to 50-29). Because cost-reimbursement arrangements are not defined in ASC 220-40, we believe that diversity in practice may emerge with respect to whether certain government grants should be considered cost-reimbursement arrangements under ASC 220-40. We suggest that the Board clarify its intention.

For government grants that are not considered cost-reimbursement arrangements, we recommend the Board clarify that an entity is permitted under ASC 220-40 to net the grant income against a related disaggregated expense disclosure if the entity elects either of the income statement presentation alternatives for government grants in ASC 832-10-45-1(b) or 45-3(b) (i.e., the alternatives to deduct the grant from the related expense for a grant related to an asset or a grant related to income, respectively). We believe this clarification would promote consistency in presentation and disclosure between the two standards.

Based on the definitions of the required expense categories in ASC 220-40-50-6, an entity may conclude that it is unable to disclose certain expenses net of grant income, which may not be the Board's intent. For example, if a grant related to income is deducted in reporting employee compensation expense in accordance with ASC 832-10-45-3(b), the entity may conclude that it is not permitted to net the grant income against employee compensation expense under ASC 220-40 because the grant income does not meet the definition of employee compensation under ASC 220-40.

Interaction with other literature

The proposal defines a grant related to an asset as 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." ASC 832-10-25-8 mentions land as an example of a government grant that may take the form of a transfer of a tangible nonmonetary asset.

However, ASC 845-10-15-3 says that "the contribution of land by a governmental unit for construction of productive facilities by an entity" is an example of a nonreciprocal transfer between an entity and entities other than its owners, which would be in the scope of ASC 845, *Nonmonetary Transactions*. As a result, we believe it is unclear whether ASC 845 or ASC 832 would apply in these circumstances. We recommend the following changes (in bold and underscored) if it is the Board's intent that ASC 832, rather than ASC 845, should apply:

Add a conforming amendment to ASC 845-10-15-4 to clarify that "the guidance in the Nonmonetary Transactions Topic does not apply to the following transactions:"

> **l. Government Grants (glossary link) accounted for in accordance with Topic 832**

Update ASC 845-10-05-5 as follows:

> "Other nonmonetary transactions are nonreciprocal transfers between an entity and entities other than its owners. ~~Examples are~~ **For example,** the contribution of nonmonetary assets by an entity to a charitable organization ~~and the contribution of land by a governmental unit for construction of productive facilities by an entity~~."

Use of 'government grant' as a defined term

We noted that there are various instances throughout the proposal where the use of the defined term "government grant" is not properly identified (i.e., bolded). Refer to ASC 832-10-05-2, ASC 832-10-15-5, ASC 832-10-50-3, ASC 832-10-50-4, ASC 832-10-55-3, ASC 832-10-55-4 and ASC 832-10-55-6 as examples. Other times, "government grant" is incorrectly bolded because it is not used in the context of the defined term. Refer to ASC 832-10-30-1 as an example.