TOPIC 7.

ACCOUNTING STANDARD – 12

ACCOUNTING FOR GOVERNMENT GRANTS

The government gives grants to entities for various purposes including ***for industrial, geographic and social development****, to facilitate the flow of foreign investments, to promote entrepreneurship, as subsidies to* ***reduce the prices*** *of goods and services offered by these entities.*

The grant could be in different forms, e.g., monetary or non-monetary government grants.

Government grants may be significant for an entity and requires appropriate treatment in the books of accounts and disclosures in financial statements to facilitate comparison with other entities and with prior periods.

DEFINITIONS

1. ***Government*** refers to government, government agencies and similar bodies whether local, national or international.

    Example of international body: WHO (World Health Organisation)
    Example of National body: ICAI allows grant to institutes for conducting accounting research.

2. ***Government grants*** are assistance by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity. (Any Consideration allowed in cash or noncash, whose value can be determined.)

They exclude those forms of government assistance which cannot reasonably have a value placed upon them and transactions with government which cannot be distinguished from the normal trading transactions of the entity.

Government grants are sometimes called by other names such as subsidies, subventions, or premiums.
Tax exemptions are not considered as grants.

3. **Grants related to assets** *are government grants whose primary condition is that an entity qualifying for them should purchase, construct or otherwise acquire long-term assets. Subsidiary conditions may also be attached restricting the type or location of the assets or the periods during which they are to be acquired or held.*

4. **Grants related to income** *are government grants other than those related to assets.*

RECOGNITION OF GOVERNMENT GRANTS

Government grants, including non-monetary grants at fair value, should be recognised only when there is **reasonable assurance** *that:*
(a) The entity will comply with the conditions attaching to them; and
(b) The grants will be received.

A government grant is not recognised until there is reasonable assurance that the entity will comply with the conditions attaching to it, and that the grant will be received. **Receipt of a grant does not of itself provide conclusive evidence that the conditions attaching to the grant have been or will be fulfilled.**

TYPES AND TREATMENT OF GOVERNMENT GRANTS

Sr.No.	Type of Grant	Treatment
1.	**Grants related to Income (Income Grant)**	(a) (first method) presented as a credit in the statement of profit and loss, either separately or under a general heading such as 'Other income'; or (b) (Second method) deducted in reporting the related expense. ..

		If a Grant is Received to incur expenditure, then firstly it should be reecognised as Liability until the expenditure is incurred. **When expenditure is incurred then liability shall be reversed.**
2.	**Grant for Expenses or Losses already incurred; or** **Grant for immediate financial Support (Eg. Bailout Package to save a company)**	If no future cost – then recognise directly to Profit and Loss a/c in the period when receivable. (Accrual)
3.	**Non-Monetary Grants** (i) Free of Cost (ii) At concessional price	 At nominal value and credited to capital reserve, depreciation not charged. At acquisition cost
5.	**Grants as promoter contribution (for working in backward areas)**	Credit grant to Capital Reserve.
4.	**Grants related to Non-depreciable Assets**	If it requires fulfillment of certain obligations then recognise in P&L a/c over the period that bears the cost of meeting the obligations.
5.	**Grants related to depreciable assets (See Note Also)**	**Option - I** Should be recognised by creating Deferred Govt Grant A/c in the balance sheet as deferred income. DGG a/c shall be recognised in P&L a/c on a systematic basis over the useful life of the asset. **Option - 2** Should be presented by deducting the grant amount from Carrying Amount.

Note - Grants for Depreciable Fixed Assets: Two Methods for Recognisition.

(A) Method- I: Net Method: Such Grants are credited to concerned Fixed Assets i.e. deducted from the gross book value of the F.A. Depreciation is applied on Net Value thereafter.

Journal Entries:

(i) Bank a/c Dr.
To Grant a/c

(ii) Fixed Asset a/c Dr.
To Bank a/c

(ii) Grant a/c Dr.
To Fixed Asset a/c

(B) Method- II: Gross Method: Such Grants are shown as Differed grants and amortized in ratio of depreciation over useful life of Assets.

Journal Entries:

(i) Bank a/c Dr.

(ii) Differed Grant a/c Dr. (at every year end)

To Differed Grant a/c   To P&L a/c

REPAYMENT (REFUND) OF GOVERNMENT GRANTS

An entity may have to repay the government grant including in cases where conditions related to the grant are not fulfilled by it.

A government grant that becomes repayable should be accounted for as a **Extra-Ordinary Item (as per AS 5)**.

The following steps should be followed in repayment of a grant related to income:

(a) The repayment should be applied **first against any un-amortized deferred credit recognised** in respect of the grant.

(b) To the extent that the repayment exceeds any such deferred credit, or when no deferred credit exists, the repayment should be recognised immediately in profit or loss.

*The repayment of a grant related to an asset should be recognised by reducing the deferred income balance by the amount repayable.

**If the grant amount was deducted from Cost or Carrying amount of Asset, then at the time of Refund the amount of Refund shall be added to the carrying amount.

Whenever grants are to be refunded debit will be given to that account which had been credited earlier at the time of receipt.

DISCLOSURE

The following should be disclosed:

(a) the **accounting policy adopted** for government grants;

(b) the **methods of presentation adopted** for government grants in the financial statements;

(c) the **nature and extent of government grants** recognised in the financial statements;

Question 1 **(ICAI Module)**

A fixed asset is purchased for Rs 20 lakhs. Government grant received towards it is Rs 8 lakhs. Residual Value is Rs 4 lakhs and useful life is 4 years. Assume depreciation on the basis of Straight Line method. Asset is shown in the balance sheet net of grant. After 1 year, grant becomes refundable to the extent of Rs 5 lakhs due to non-compliance with certain conditions. Pass journal entries for first two years.

Solution

Journal Entries

Year	Particulars		Rs in lakhs (Dr.)	Rs in lakhs (Cr.)
1	Fixed Asset Account	Dr.	20	
	To Bank Account			20
	(Being fixed asset purchased)			
	Bank Account	Dr.	8	
	To Fixed Asset Account			8

	(Being grant received from the government reduced the cost of fixed asset)		
	Depreciation Account (W.N.1) Dr.	2	
	To Fixed Asset Account		2
	(Being depreciation charged on Straight Line method (SLM))		
	Profit & Loss Account Dr.	2	
	To Depreciation Account		2
	(Being depreciation transferred to Profit and Loss Account at the end of year 1)		
2	Fixed Asset Account Dr.	5	
	To Bank Account		5
	(Being government grant on asset partly refunded which increased the cost of fixed asset)		
	Depreciation Account (W.N.2) Dr.	3.67	
	To Fixed Asset Account		3.67
	(Being depreciation charged on SLM on revised value of fixed asset prospectively)		
	Profit & Loss Account Dr.	3.67	
	To Depreciation Account		3.67
	(Being depreciation transferred to Profit and Loss Account at the end of year 2)		

Working Notes:

1. Depreciation for Year 1

	Rs in lakhs
Cost of the Asset	20
Less: Government grant received	(8)
	12
Depreciation $\frac{12-4}{4}$	2

2. Depreciation for Year 2

	Rs in lakhs
Cost of the Asset	20
Less: Government grant received	(8)
	12
Less: Depreciation for the first year $\frac{12-4}{4}$	2
	10
Add: Government grant refundable	5
	15
Depreciation for the second year $\frac{15-4}{3}$	3.67

Question 2 *(ICAI Module)*

A Ltd. purchased a machinery for Rs 40 lakhs. (Useful life 4 years and residual value Rs 8 lakhs) Government grant received is Rs 16 lakhs.

Show the Journal Entry to be passed at the time of refund of grant in the third year and the value of the fixed assets, if:

(1) the grant is credited to Fixed Assets A/c.

(2) the grant is credited to Deferred Grant A/c.

Solution

In the books of A Ltd.

Journal Entries (at the time of refund of grant)

(1) If the grant is credited to Fixed Assets Account:

		Rs	Rs
I.	Fixed Assets A/c Dr.		16 lakhs
	To Bank A/c	16 lakhs	
	(Being grant refunded)The amount of refund should be Rs 16 Lakhs		

II. The balance of fixed assets after two years depreciation will be Rs 16 lakhs (W.N.1) and after refund of grant it will become (Rs 16 lakhs + Rs 16 lakhs) = Rs 32 lakhs on which depreciation will be charged for remaining two years. Depreciation = (32-8)/2 = Rs 12 lakhs p.a. will be charged for next two years.

(2) If the grant is credited to Deferred Grant Account:

As per para 14 of AS 12 'Accounting for Government Grants,' income from Deferred Grant Account is allocated to Profit and Loss account usually over the periods and in the proportions in which depreciation on related assets is charged. Accordingly, in the first two years (Rs 16 lakhs /4 years) = Rs 4 lakhs p.a. x 2 years = Rs 8 lakhs were credited to Profit and Loss Account and Rs 8 lakhs was the balance of Deferred Grant Account after two years.

Therefore, on refund in the 3rd year, following entry will be passed:

		Rs	Rs
I.	Deferred Grant A/c Dr.	8 lakhs	
	Profit & Loss A/c Dr.	8 lakhs	
	To Bank A/c		16 lakhs
	(Being Government grant refunded)		

II. Deferred grant account will become Nil. The fixed assets will continue to be shown in the books at Rs 24 lakhs (W.N.2) and depreciation will continue to be charged at Rs 8 lakhs per annum for the remaining two years.

Working Notes:

1. **Balance of Fixed Assets after two years but before refund (under first alternative)**

   Fixed assets initially recorded in the books = Rs 40 lakhs – Rs 16 lakhs = Rs 24 lakhs

   Depreciation p.a. = (Rs 24 lakhs – Rs 8 lakhs)/4 years = Rs 4 lakhs per year

   Value of fixed assets after two years but before refund of grant = Rs 24 lakhs – (Rs 4 lakhs x 2 years) = Rs 16 lakhs

2. **Balance of Fixed Assets after two years but before refund (under second alternative)**

   Fixed assets initially recorded in the books = Rs 40 lakhs

   Depreciation p.a. = (Rs 40 lakhs – Rs 8 lakhs)/4 years = Rs 8 lakhs per year

   Book value of fixed assets after two years = Rs 40 lakhs – (Rs 8 lakhs x 2 years)

   = Rs 24 lakhs

Note: It is assumed that the question requires the value of fixed assets is to be given after refund of government grant.

Question 3 **(ICAI Module)**

Supriya Ltd. received a grant of Rs 2,500 lakhs during the accounting year 2015-16 from government for welfare activities to be carried on by the company for its employees. The grant prescribed conditions for its utilisation. However, during the year 2016-17, it was found that the conditions of grants were not complied with and the grant had to be refunded to the government in full. Elucidate the current accounting treatment, with reference to the provisions of AS-12

Answer:

As per AS 12 'Accounting for Government Grants', Government grants sometimes become refundable because certain conditions are not fulfilled. A government grant that becomes refundable is treated as an extraordinary item as per AS 5.

The amount refundable in respect of a government grant related to revenue is applied first against any unamortised deferred credit remaining in respect of the grant. To the extent that the amount refundable exceeds any such deferred credit, or where no deferred credit exists, the amount is charged immediately to profit and loss statement.

In the present case, the amount of refund of government grant should be shown in the profit & loss account of the company as an extraordinary item during the year.

Question 4 **(RTP – Nov.18)**

A specific government grant of Rs 15 lakhs was received by USB Ltd. for acquiring the Hi-Tech Diary plant of Rs 95 lakhs during the year 2014-15. Plant has useful life of 10 years. The grant received was credited to deferred income in the balance sheet. During 2017-18, due to non-compliance of conditions laid down for the grant, the company had to refund the whole grant to the Government.

Balance in the deferred income on that date was Rs 10.50 lakhs and written down value of plant was RS 66.50 lakhs.

(i) What should be the treatment of the refund of the grant and the effect on cost of plant and the amount of depreciation to be charged during the year 2017-18 in profit and loss account?

(ii) What should be the treatment of the refund, if grant was deducted from the cost of the plant during 2014-15 assuming plant account showed the balance of Rs 56 lakhs as on 1.4.2017?

You are required to explain in the line with provisions of AS 12.

Solution: (Suggested by ICAI)

As per para 21 of AS 12, 'Accounting for Government Grants', "the amount refundable in respect of a grant related to specific fixed asset should be recorded by reducing the deferred income balance. To the extent the amount refundable exceeds any such deferred credit, the amount should be charged to profit and loss statement.

(i) In this case the grant refunded is Rs 15 lakhs and balance in deferred income is Rs 10.50 lakhs, Rs 4.50 lakhs shall be charged to the profit and loss account for the year 2017-18. There will be no effect on the cost of the fixed asset and depreciation charged will be on the same basis as charged in the earlier years.

(ii) If the grant was deducted from the cost of the plant in the year 2014-15 then, para 21 of AS 12 states that the amount refundable in respect of grant which relates to specific fixed assets should be recorded by increasing the book value of the assets, by the amount refundable. Where the book value of the asset is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset. Therefore, in this case, the book value of the plant shall be increased by Rs 15 lakhs. The increased cost of Rs 15 lakhs of the plant should be amortized over 7 years (residual life). Depreciation charged during the year 2017-18 shall be (56+15)/7 years = Rs 10.14 lakhs presuming the depreciation is charged on SLM.

Question 5 **(RTP Nov 19)**

Samrat Limited has set up its business in a designated backward area which entitles the company for subsidy of 25% of the total investment from Government of India. The company has invested ₹ 80 crores in the eligible investments. The company is eligible for the subsidy and has received ₹ 20 crores from the government in February 2019. The company wants to recognize the said subsidy as its income to improve the bottom line of the company.

Do you approve the action of the company in accordance with the Accounting Standard?

Solution

As per AS 12 "Accounting for Government Grants", where the government grants are in the nature of promoters' contribution, *i.e.,* they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay (for example, Central Investment Subsidy Scheme) and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income.

The subsidy received by Samrat Ltd. for setting up its business in a designated backward area will be treated as grant by the government in the nature of promoter's contribution as the grant is given with reference to the total investment in an undertaking i.e. subsidy is 25% of the eligible investment and also no repayment is apparently expected in respect thereof.

Since the subsidy received is neither in relation to specific fixed assets nor in relation to revenue. Thus, the company cannot recognize the said subsidy as income in its financial statements in the given case. It should be recognized as capital reserve which can be neither distributed as dividend nor considered as deferred income.

Student Notes:-