AS-12:
ACCOUNTING FOR GOVERNMENT GRANTS

Meaning of Government	Refers to government, government agencies and similar bodies whether local, national or international.
Meaning of Government Grants	Assistance by Government in cash/kind to an enterprise for past or future compliance with certain conditions
Other nomenclatures	Subsidies, Cash incentives, etc.
Recognition of Government grant	When there is a reasonable assurance that ➢ The enterprise will comply with the conditions attached to them and ➢ The grants will be received

Government Grant

- Related to Specific Fixed Asset
  - Method 1
    - Deduction from Gross Value of Asset
    - Entry:
      Bank A/c - Dr
      To Fixed Assets
  - Method 2
    - Depreciable Assets
      - Deferred Income [P&L A/c Systematic Basis]
    - Non Depreciable Assets
      - Capital Reserve
    - Bank A/c - Dr
      To Deferred Govt. Grant
- Related to Revenue
  - Other Income or Deduction from Related Expense [P&L A/c: Systematic Basis to match with related cost]
- Promoter's Contribution
  - Given with reference to total investment in undertaking or Contribution towards capital total outlay
  - Eg: Capital Subsidy, Inv in Backward Area
  - Credited to capital Reserve & treated part of shareholder funds.
  - Cannot be distributed as dividend nor considered as Deferred Income.
- Non Monetary Govt. Grant
  - * Concessional Rate → Acquisition cost
  - * Free of Cost → Nominal Value

Refund of Government Grant

[To be treated as Extraordinary Item]

Related to Specific Fixed Asset

Method 1

* Increase Book value of Asset
* Provide Depreciation on Revised Book value Prospectively.

Entry:

Fixed Assets A/c - Dr

To Bank A/c

Method 2

* Reduce Deferred Income or Capital Reserve as appropriate

Related to Revenue

First utilize unamortised Deferred credit.

Excess to be transferred to P&L A/c

Entry:

Deferred Govt. Grant A/c - Dr

P&L A/c - Dr (B.f.)

To Bank A/c

Promoter's Contribution

Reduce Capital Reserve

DISCLOSURE REQUIREMENTS
(i) the accounting policy adopted for government grants, including the methods of presentation in the financial statements;
(ii) the nature and extent of government grants recognised in the financial statements, including grants of non-monetary assets given at a concessional rate or free of cost.

Question 1

X Ltd. purchased machinery for Rs. 80 lakhs. (useful life 4 years and residual value Rs. 8 lakhs).
Government grant received is Rs. 32 lakhs.
Pass the Journal Entries for the first 2 years if
(i) the grant is credited to Fixed Assets A/c.
(ii) the grant is credited to Deferred Grant A/c

Solution

(i) Grant is credited to Fixed Assets A/c

Year	Particulars	L.F.	Dr. (in Lakhs)	Cr. (in Lakhs)
1	Machinery Account Dr.		80	
	To Bank Account			80
	(Being fixed asset purchased)			
	Bank Account Dr.		32	
	To Machinery Account			32
	(Being grant received from the government reduced the cost of fixed asset)			
	Depreciation Account Dr. [(80-32)-8]/4		10	
	To Machinery Account			10
	(Being depreciation charged on Straight Line method (SLM))			
	Profit & Loss Account Dr.		10	
	To Depreciation Account			10
	(Being depreciation transferred to Profit and Loss Account at the end of year 1)			
2	Depreciation Account Dr.		10	
	To Machinery Account			10
	(Being depreciation charged on Straight Line method (SLM))			
	Profit & Loss Account Dr.		10	
	To Depreciation Account			10
	(Being depreciation transferred to Profit and Loss Account at the end of year 2)			

(ii) Grant is credited to Deferred Grant A/c

Year	Particulars	L.F.	Dr. (in Lakhs)	Cr. (in Lakhs)
1	Machinery Account Dr.		80	
	To Bank Account			80
	(Being fixed asset purchased)			
	Bank A/c Dr.		32	
	To Deferred Government Grant A/c			32
	(Being grant received from the government treated as deferred income)			
	Depreciation A/c Dr. (80-8)/4		18	
	To Machinery A/c			18
	(Being depreciation charged on Straight Line method (SLM))			
	Profit & Loss A/c Dr.		18	
	To Depreciation A/c			18
	(Being depreciation transferred to Profit and Loss Account at the end of year 1)			
	Deferred Government Grant A/c Dr. (32/4)		8	

	To Profit & Loss A/c			8
	(Being proportionate government grant taken to P/L A/c)			
2	Depreciation A/c Dr.		18	
	To Machinery A/c			18
	(Being depreciation charged on Straight Line method (SLM))			
	Profit & Loss A/c Dr.		18	
	To Depreciation A/c			18
	(Being depreciation transferred to Profit and Loss Account at the end of year 2)			
	Deferred Government Grant A/c Dr.		8	
	To Profit & Loss A/c			8
	(Being proportionate government grant taken to P/L A/c)			

Question 2

X Ltd. purchased machinery for Rs. 80 lakhs. (useful life 4 years and residual value Rs. 8 lakhs). Government grant received is Rs. 32 lakhs.

Show the Journal Entry to be passed at the time of refund of grant at the beginning of year 3 and the value of the fixed assets in the third year and the amount of depreciation for remaining two years, if

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

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

Solution

(i) Grant is credited to Fixed Assets A/c

a) Journal Entry (at the time of refund of grant)

Particulars	L.F.	Dr. (in Lakhs)	Cr. (in Lakhs)
Machinery Account Dr.		32	
To Bank Account			32
(Being government grant refunded)			

b) Value of Fixed Assets after two years but before refund of grant

Fixed assets initially recorded in the books = Rs. 80 lakhs – Rs. 32 lakhs = Rs. 48 lakhs

Depreciation for each year = (Rs. 48 lakhs – Rs.8 lakhs)/4 years

= Rs. 10 lakhs per year for first two years.

Value of the assets before refund of grant =Rs. 48 lakhs - Rs. 20 lakhs = Rs. 28 lakhs

c) Value of Fixed Assets after refund of grant

Value of Fixed Assets before refund of grant	Rs. 28 lakhs
Add Refund of grant	Rs. 32 lakhs
	Rs. 60 lakhs

d) Amount of depreciation for remaining two years

Value of the fixed assets after refund of grant –residual value of the assets / No. of years

= Rs. 60 lakhs - Rs. 8 lakhs / 2

= Rs. 26 lakhs per annum will be charged for next two years.

(ii) Grant is credited to Deffered Grant A/c

As per 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. 32 lakhs /4 years) = Rs. 8 lakhs x 2 years = Rs. 16 lakhs will be credited to Profit and Loss Account and Rs. 16 lakhs will be the balance of Deferred Grant Account after two years.

a) Journal Entry (at the time of refund of grant)

Particulars	**L.F.**	**Dr. (in Lakhs)**	**Cr. (in Lakhs)**
Deffered Govt. Grant A/c Dr.		16	
P&L A/c Dr.		16	
To Bank Account			32
(Being government grant refunded)			

b) Value of Fixed Assets after two years but before refund of grant
Fixed assets initially recorded in the books = Rs. 80 lakhs
Depreciation for each year = (Rs. 80 lakhs – Rs.8 lakhs)/4 years = Rs. 18 lakhs per year
Book value of fixed assets after two years = Rs. 80 lakhs – (Rs. 18 lakhs x 2 years) = Rs. 44 lakhs

c) Value of Fixed Assets after refund of grant
On refund of grant the balance of deferred grant account will become nil. The fixed assets will continue to be shown in the books at Rs. 44 lakhs.

d) Amount of depreciation for remaining two years
Depreciation will continue to be charged at Rs. 18 lakhs per annum for the remaining two years

Question 3

On 01.04.2016, XYZ Ltd. received Government grant of Rs. 100 Lakhs for an acquisition of new machinery costing Rs. 500 lakhs. The grant was received and credited to the cost of the assets. The life span of the machinery is 5 years. The machinery is depreciated at 20% on WDV method. The company had to refund the entire grant in 2nd April, 2019 due to non-fulfilment of certain conditions which was imposed by the government at the time of approval of grant. How do you deal with the refund of grant to the Government in the books of XYZ Ltd., as per AS 12?

Solution

According to AS 12 on Accounting for Government Grants, the amount refundable in respect of a grant related to a specific fixed asset (if the grant had been credited to the cost of fixed asset at the time of receipt of grant) should be recorded by increasing the book value of the asset, by the amount refundable. Where the book value is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset.

		(in Lakhs)
1st April 2016	Acquisition cost of machinery (500 – 100)	400.00
31st March 2017	Less: Depreciation @ 20%	(80.00)
1st April 2017	Book value	320.00
31st March 2018	Less: Depreciation @ 20%	(64.00)
1st April 2018	Book value	256.00
31st March 2019	Less: Depreciation @ 20%	(51.20)
1st April 2019	Book value	204.80
2nd April 2019	Add: Refund of grant	100.00
	Revised Book value	**304.80**

Depreciation @ 20% on the revised book value amounting Rs. 304.80 lakhs is to be provided prospectively over the residual useful life of the asset.

Question 4

Viva Ltd. received a specific grant of Rs. 30 lakhs for acquiring the plant of Rs. 150 lakhs during 2016-17 having useful life of 10 years. The grant received was credited to deferred income in the balance sheet.

During 2019-20, 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. 21 lakhs and written down value of plant was Rs. 105 lakhs.

(i) What should be the treatment of the refund of the grant and the effect on cost of the fixed asset and the amount of depreciation to be charged during the year 2019-20 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 2016-17 assuming plant account showed the balance of Rs. 84 lakhs as on 1.4.2019?

Solution

As per 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. 30 lakhs and balance in deferred income is Rs. 21 lakhs, Rs. 9 lakhs shall be charged to the profit and loss account for the year 2019-20. 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 2016-17 then, 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. 30 lakhs. The increased cost of Rs. 30 lakhs of the plant should be amortized over 7 years (residual life). Depreciation charged during the year 2019-20 shall be (84 + 30)/7 years = Rs. 16.286 lakhs presuming the depreciation is charged on SLM.

Question 5

S Ltd. received a grant of Rs. 5,000 lakhs during the last accounting year (2018-19) from government for welfare activities to be carried on by the company for its employees. The grant prescribed conditions for its utilization. However, during the year 2019-20, 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 correct accounting treatment, with reference to the provisions of AS 12.

Solution

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 and loss account of the company as an extraordinary item during the year 2019-20.

Question 6

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 Rs. 80 crores in the eligible investments. The company is eligible for the subsidy and has received Rs. 20 crores from the government in February 2020. 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?

Also state whether the company can distribute this amount by way of dividend

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.