AS -12-
ACCOUNTING FOR
GOVERNMENT GRANTS

IPCC PAPER 5 ADVANCED ACCOUNTING
CHAPTER 2

CA. ANAND J. BANKA
PREAMBLE

• Basic function of any good government is promoting economic and industrial development of the country.

• Government discharges its duty either by undertaking promotional activities or by giving incentives for select items.

• Incentives in shape of
  • Tax Breaks (80HHC)
  • Grants
NEED OF AS-12

• Receipt of grant is significant for the preparation of financial statements for two reasons...
  
  • Appropriate method of accounting of grant is essential.

• Users of financial statements must know the extent to which the reporting entity has benefited from such assistance.
SCOPE

• Deals with accounting for government grants, both capital and revenue from government agencies
• Grants in the form of
  • Monetary - Subsidies, cash incentives, duty drawbacks
  • Non-Monetary - Land or other assets/resources
EXCLUSIONS

• This statement does not deal with
  • Accounting for government grants in financial statements reflecting the effects of changing prices
  • Government Assistance other than in the form of Government Grants (e.g. Tax holidays, Tax exemption)
  • Government participation in ownership of the enterprise
DEFINITION

• Government Grant
  • Assistance by government in cash or kind
  • for past or future compliance of certain conditions.
  • Does not include grants which cannot be reasonably measured.
  • Does not include transactions with government which cannot be distinguished from normal trading transactions of an enterprise

Note: Government includes Union, State, Government agencies and similar bodies viz. local, national and international.
ACCOUNTING METHODS PRESCRIBED

- Two approaches

  - Capital Approach
    {Grant treated as part of the shareholders fund}

  - Income or Revenue Approach
    {Grant is taken to income over one or more periods}

  Method of accounting should be based upon the nature of the relevant grant
CAPITAL APPROACH

• Many 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 and no repayment is ordinarily expected in the case of such grants. These should, therefore, be credited directly to shareholders’ funds.

• E.g.
  • Proportion of total investment in business
  • Related to specific Fixed Assets
GRANT IN NATURE OF PROMOTERS CONTRIBUTION

- Where the government grants are of 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.
RELATED TO SPECIFIC FIXED ASSETS

- Grants related to specific fixed assets are government grants whose primary condition is that an enterprise qualifying for them should purchase, construct or otherwise acquire such assets.
- Other 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.
SPECIFIC FIXED ASSETS: METHOD 1

- The grant is shown as a deduction from the gross value of the asset concerned in arriving at its book value.
- The grant is thus recognised in the profit and loss statement over the useful life of a depreciable asset by way of a reduced depreciation charge.
- Where the grant equals the whole, or virtually the whole, of the cost of the asset, the asset is shown in the balance sheet at a nominal value.
EXAMPLE – METHOD 1

• Z Ltd. purchased a fixed asset for Rs. 50 Lakhs, which has the estimated useful life of 5 years with the salvage value of Rs. 5 Lakhs.
• On purchase of the assets government granted it a grant of Rs. 10 Lakhs.
**ANSWER – METHOD 1**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount Dr.</th>
<th>Amount Cr.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fixed Asset Account</td>
<td>50,00,000</td>
<td></td>
</tr>
<tr>
<td>To Bank Account</td>
<td></td>
<td>50,00,000</td>
</tr>
<tr>
<td><em>(Being Asset Purchased)</em></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bank Account</td>
<td>10,00,000</td>
<td></td>
</tr>
<tr>
<td>To Fixed Asset Account</td>
<td></td>
<td>10,00,000</td>
</tr>
<tr>
<td><em>(Being govt. grant received)</em></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depreciation Account</td>
<td>7,00,000</td>
<td></td>
</tr>
<tr>
<td>To Fixed Asset Account</td>
<td></td>
<td>7,00,000</td>
</tr>
<tr>
<td><em>(50-10)-5] Lakhs/5 years</em></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
SPECIFIC FIXED ASSETS: METHOD 2

- Grants related to depreciable assets are treated as deferred income which is recognised in the profit and loss statement on a systematic and rational basis over the useful life of the asset i.e. in proportion in which depreciation is charged.
- Grants related to non-depreciable assets are credited to capital reserve, as there is usually no charge to income in respect of such assets.
- However, if a grant related to a non-depreciable asset requires the fulfillment of certain obligations, the grant is credited to income over the same period over which the cost of meeting such obligations is charged to income.
- The deferred income is suitably disclosed in the balance sheet pending its apportionment to profit and loss account.
EXAMPLE – METHOD 2

• ZLtd. purchased a fixed asset for Rs. 50 Lakhs, which has the estimated useful life of 5 years with the salvage value of Rs. 5 Lakhs.
• On purchase of the assets government granted it a grant of Rs. 10 Lakhs.
ANSWER – METHOD 2

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount Dr.</th>
<th>Amount Cr.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fixed Asset Account</td>
<td>50,00,000</td>
<td></td>
</tr>
<tr>
<td>To Bank Account</td>
<td></td>
<td>50,00,000</td>
</tr>
<tr>
<td>(Being Asset Purchased)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bank Account</td>
<td>10,00,000</td>
<td></td>
</tr>
<tr>
<td>To Deferred Govt. Grant Account</td>
<td></td>
<td>10,00,000</td>
</tr>
<tr>
<td>(Being govt. grant received)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depreciation Account</td>
<td>9,00,000</td>
<td></td>
</tr>
<tr>
<td>To Fixed Asset Account</td>
<td></td>
<td>9,00,000</td>
</tr>
<tr>
<td>{(50-10)-5} Lakhs/5 years}</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deferred Govt. Grant Account</td>
<td>2,00,000</td>
<td></td>
</tr>
<tr>
<td>To Profit and Loss Account</td>
<td></td>
<td>2,00,000</td>
</tr>
<tr>
<td>(Being proportionate grant taken to P/L)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
INCOME APPROACH

• Any other grant
• They should be taken to income and matched with the associated costs which the grant is intended to compensate.
• Grants related to revenue are sometimes presented as a credit in the profit and loss statement, either separately or under a general heading such as ‘Other Income’.
• Alternatively, they are deducted in reporting the related expense.
CHART – GOVERNMENT GRANTS

Accounting for Government Grants

Capital Approach

For Fixed Assets

Cash
1. Reduce from Cost; OR
2. Deferred Revenue

Kind
1. Nominal Value

Capital Contribution

Cash

Capital Reserve

Revenue Approach

Recognized in P&L over the period

1. as “other income”
2. as deduction from respective expenses
REFUND OF GOVERNMENT GRANTS

- Government grants sometimes become refundable because certain conditions are not fulfilled.
- They are treated as an extraordinary item (AS 5, Prior Period and Extraordinary Items and Changes in Accounting Policies).
- 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.
REFUND OF GOVERNMENT GRANTS

- The amount refundable in respect of a government grant related to a specific fixed asset is recorded by increasing the book value of the asset or by reducing the capital reserve or the deferred income balance, as appropriate, by the amount refundable.
- In the first alternative, i.e., where the book value of the asset is increased, depreciation on the revised book value is provided prospectively over the residual useful life of the asset.
REFUND OF GOVERNMENT GRANTS

- Where a grant which is in the nature of promoters’ contribution becomes refundable, in part or in full, to the government on non-fulfillment of some specified conditions,
- the relevant amount recoverable by the government is reduced from the capital reserve.
EXAMPLE – REFUND

• Z Ltd. purchased a fixed asset for Rs. 50 Lakhs, which has the estimated useful life of 5 years with the salvage value of Rs. 5 Lakhs.
• On purchase of the assets government granted it a grant of Rs. 10 Lakhs.
• Grant was considered as refundable in the end of 2nd year to the extent of Rs. 7 lakhs.
**ANSWER – REFUND METHOD 1**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount Dr.</th>
<th>Amount Cr.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fixed Asset Account</td>
<td>7,00,000</td>
<td></td>
</tr>
<tr>
<td>To Bank Account</td>
<td></td>
<td>7,00,000</td>
</tr>
<tr>
<td>(Being govt. grant refunded)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
# ANSWER – REFUND METHOD 2

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount Dr.</th>
<th>Amount Cr.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deferred govt. grant account</td>
<td>6,00,000</td>
<td></td>
</tr>
<tr>
<td>Profit and loss account</td>
<td>1,00,000</td>
<td></td>
</tr>
<tr>
<td>To Bank Account</td>
<td></td>
<td>7,00,000</td>
</tr>
<tr>
<td><em>(Being govt. grant refunded)</em></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
CHART – REFUND

Refund of Government Grants

Asset
- Earlier reduced from cost
  1. Add to cost
  2. Depreciation calculated prospectively
- Earlier treated as deferred income
  Adjusted against
  1. Unamortised deferred credit
  2. Balance in Profit & Loss Account

Revenue
- Earlier credited to Capital Reserve
  1. Adjusted with Capital Reserve
    E.g. in nature of promoters contribution
  2. Balance in Profit & Loss Account
  Adjusted against
  1. Unamortised deferred credit
RECOGNITION

- Government grants available to the enterprise are considered for inclusion in accounts:
  - where there is **reasonable assurance** that the enterprise will **comply with the conditions attached** to them; and
  - where such **benefits have been earned** by the enterprise and it is **reasonably certain** that the **ultimate collection** will be made.
- Mere receipt of a grant is not necessarily a conclusive evidence that conditions attaching to the grant have been or will be fulfilled.
DISCLOSURE REQUIREMENTS

- Approach followed (Capital or revenue)
- Method of Accounting followed – reduced from cost or capital reserve
- Nature and extent to which recognized
- Separate disclosure of non-monetary grants at concessional rate or free of cost
- Description of grant refunded during the year