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AS
12

ACCOUNTING FOR GOVERNMENT GRANTS

CA/36

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Meaning of Government	Refers to <u>government</u> , <u>government agencies</u> and similar <u>bodies</u> whether <u>local</u> , <u>national</u> or <u>international</u> . (like WHO, UNICEF)
Meaning of Government Grants	Assistance by <u>Government</u> in <u>cash/kind</u> to an enterprise for <u>past</u> or <u>future</u> <u>compliance</u> with <u>certain conditions</u>
Other nomenclatures	<u>Subsidies</u> , <u>Cash incentives</u> , <u>duty drawback</u> etc.
Recognition	When there is a <u>reasonable assurance</u> that ➤ The enterprise will <u>comply with the conditions</u> attached to them and ➤ The <u>grants will be received</u>
Scope Exclusion	This Standard does <u>not deal</u> with: ➤ <u>Government assistance</u> other than in the form of <u>government grants</u> . ➤ <u>Government participation</u> in the <u>ownership</u> of the enterprise.

SPECIFIC FIXED ASSETS

Meaning	Government grants whose primary condition is that an enterprise qualifying for them should <u>purchase</u> , <u>construct</u> or otherwise <u>acquire</u> such <u>asset</u> . Other conditions may also be <u>attached</u> <u>restricting</u> the <u>type</u> or <u>location</u> of assets or <u>periods</u> during which they are to be <u>acquired</u> or <u>held</u> .
Method 1	➤ Grant-should be presented in balance sheet by showing it as a <u>deduction from gross value</u> of the concerned asset while arriving at its book value. ➤ If the <u>grant amount equals</u> the <u>whole</u> of the <u>fixed asset cost</u> , then the <u>assets should be shown</u> in the <u>balance sheet</u> at a <u>nominal value</u> .
Method 2	Related to Depreciable asset Should be treated as <u>deferred income</u> which should be recognized in the P & L statement on a <u>systematic</u> and <u>rational basis</u> <u>over the useful life</u> of the <u>asset</u> i.e. <u>income is allocated</u> over the <u>period</u> and in the <u>proportions</u> in which <u>depreciation</u> on <u>related assets</u> is <u>charged</u> .
	Related to Non-Depreciable asset Should be credited to <u>capital reserve</u> . However, if a grant <u>related to</u> a <u>non-depreciable asset</u> requires fulfillment of certain obligations, the grant should be credited to <u>income</u> over the same period over which the <u>cost of meeting</u> such obligations is <u>charged</u> to <u>income</u> .

REVENUE

Treatment	❖ Such <u>grants</u> should be recognized in the <u>Statement of P&L</u> on a <u>systematic basis</u> so as to <u>match</u> them with the <u>related cost</u> . ❖ These grants presented as a <u>credit</u> in the <u>profit and loss statement</u> , either <u>separately</u> or under a <u>general heading</u> such as ' <u>Other Income</u> '. or <u>alternatively</u> , these may be <u>deducted</u> from the <u>related expenses</u> .
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PROMOTER'S CONTRIBUTION	
Meaning	These are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay & no repayment is ordinarily expected in respect thereof.
Example	Central investment subsidy scheme (capital subsidy), investment in backward area etc.
Accounting	Treated as capital reserve and treated as part of shareholders funds. These cannot be distributed as dividend, nor considered as deferred income.
NON-MONETARY GRANT	
Assets given at concessional rate	It should be accounted for on the basis of its acquisition cost
Assets given free of cost	It should be recorded at a nominal value 1, 11, 51, 101 AS 12 To Cap. Res.
GRANT RECEIVABLE AS COMPENSATION FOR EXPENSE/LOSS	
Government grants that are receivable as compensation for expenses or losses incurred in a previous accounting period or for the purpose of giving immediate financial support to the enterprise with no further related costs, should be recognised and disclosed in the profit and loss statement of the period in which they are receivable, as an extraordinary item if appropriate.	
REFUND OF GOVERNMENT GRANTS	
Nature	Government grants sometimes become refundable because certain conditions are not fulfilled & are treated as an extraordinary item (AS 5).
Related to Revenue	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.
Related to Specific Fixed Asset	Recorded by increasing the book value of the asset or by reducing 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.
In the nature of Promoter's Contribution	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.
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.	

Special grant PALAFC

ASSIGNMENT QUESTIONS

Question 1 (ICAI Study Material) _____ Pg no. _____

Residual Z Ltd. purchased a fixed asset for ₹ 50 lakhs, which has the estimated useful life of 5 years with the salvage value of ₹ 5,00,000. On purchase of the asset government granted it a grant for ₹ 10 lakhs. Pass the necessary journal entries in the books of the company for first two years if

Case 1: Grant is deducted from the value of fixed asset.

Case 2: Grant is treated as deferred income.

Question 2 (ICAI Study Material) _____ Pg no. _____

A Ltd. purchased machinery for ₹ 40 lakhs. (Useful life 4 years and residual value ₹ 8 lakhs) Government grant received is ₹ 16 lakhs. Show the journal entry to be passed at the time of refund of grant in the third year and the value of fixed assets, if

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

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

Pass entries for all 3 years.

Question 3 (ICAI Study Material) / (RTP May 2022) (Similar) _____ Pg no. _____

A fixed asset is purchased for ₹ 20 lakhs. Government grant received towards it is ₹ 8 lakhs. Residual Value is ₹ 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 ₹ 5 lakhs due to non compliance with certain conditions. Pass journal entries for first 2 years.

Method 1

Question 4 (ICAI Study Material) _____ Pg no. _____

On 1.4.2018 ABC Ltd. received Government grant of ₹ 300 lakhs for acquisition of a machinery costing ₹ 1,500 lakhs. The grant was credited to the cost of the asset. The life of the machinery is 5 years. The machinery is depreciated at 20% on WDV basis. The Company had to refund the grant in May 2021 due to nonfulfillment of certain conditions.

How you would deal with the refund of grant in the books of ABC Ltd. assuming that the company did not charge any depreciation for the year 2021?

Question 5 (RTP May 2019) _____ Pg no. _____

Viva Ltd. received a specific grant of ₹ 30 lakhs for acquiring the plant of ₹ 150 lakhs during 2018-19 having useful life of 10 years. The grant received was credited to deferred income in the balance sheet. During 2021-22, 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 ₹ 21 lakhs and written down value of plant was ₹ 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 2021-22 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 2018-19 assuming plant account showed the balance of ₹ 84 lakhs as on 1.4.2021?

30L - 30L x 3/10

150 - 150 x 3/10

Question 6 (RTP May 2021) / (RTP May 2023) / (ICAI Study Material) _____ Pg no. _____

Hygiene Ltd. had received a grant of ₹ 50 lakh in 2012 from a State Government towards installation of pollution control machinery on fulfilment of certain conditions. The company, however, failed to comply with the said conditions and consequently was required to refund

Method -1

the said amount in 2024. The company debited the said amount to its machinery in 2024 on payment of the same. It also reworked the depreciation for the said machinery from the date of its purchase and passed necessary adjusting entries in the year 2024 to incorporate the retrospective impact of same. State whether treatment done by company is correct or not.

Solution

As per the facts of the case, Hygiene Ltd. had received a grant of ₹ 50 lakh in 2012 from a State Government towards installation of pollution control machinery on fulfilment of certain conditions. However, the amount of grant has to be refunded since it failed to comply with the prescribed conditions.

In such circumstances, AS 12, "Accounting for Government Grants", requires that 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. The Standard further makes it clear that in the first alternative, i.e., 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.

Accordingly, the accounting treatment given by Hygiene Ltd. of increasing the value of the plant and machinery is quite proper. However, the accounting treatment in respect of depreciation given by the company of adjustment of depreciation with retrospective effect is improper and constitutes violation of AS 12.

Question 7 (ICAI Study Material)

Pg no. _____

X Ltd. runs a charitable hospital. It incurs salary of doctors, staff etc. to the extent of ₹ 30 lakhs per annum. As a support, the local govt grants a lumpsum payment of ₹ 90 lakhs to meet the salary expense for a period of next 5 years. You are required to pass the necessary journal entries in the books of the company for first year and present in the statement of Profit & loss when the grant is:

- Shown separately as Other Income; and ;
- Deducted against the Salary costs.

Question 8 (ICAI Study Material)

Pg no. _____

Co X runs a charitable hospital. It incurs salary of doctors, staff etc. to the extent of ₹ 30 lakhs per annum. As a support, the local govt grants a lumpsum payment of ₹ 90 lakhs to meet the salary expense for a period of next 5 years. At the start of Year 4, Co X is unable to meet the conditions attached to the grant and is required to refund the entire grant of 90 lakhs.

You are required to pass the necessary journal entries in the books of the company for refund of the grant if the grant was shown separately as Other Income

Question 9 (ICAI Study Material)

Pg no. _____

Supriya Ltd. received grant of ₹ 2,500 lakhs during accounting year 2020-21 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 2021-22, it was found that 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 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 unamortized 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 first adjusted against the unamortised deferred income in the books and the excess if any will be debited to profit & loss account of the company as an extraordinary item in the year 2021-2022.

Question 10 (ICAI Study Material)

Pg no. _____

Top & Top Limited has set up its business in a designated backward area which entitles the company to receive from the Government of India a subsidy of 20% of the cost of investment, for which no repayment was ordinarily expected. Moreover, there was no condition that the company should purchase any specified assets for this subsidy. Having fulfilled all the conditions under the scheme, the company on its investment of ₹ 50 crore in capital assets received ₹ 10 crore from the Government in January, 2022 (accounting period being 2021-2022). The company wants to treat this receipt as an item of revenue and thereby reduce the losses on profit and loss account for the year ended 31st March, 2022. Keeping in view the relevant Accounting Standard, discuss whether this action is justified or not.

Solution

As per AS 12 'Accounting for Government Grants', 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.

In the given case, the subsidy received is neither in relation to specific fixed asset nor in relation to revenue. Thus, it is inappropriate to recognise government grants in the profit and loss statement, since they are not earned but represent an incentive provided by government without related costs. The correct treatment is to credit the subsidy to capital reserve. Therefore, the accounting treatment desired by the company is not proper.

Question 11 (ICAI Study Material) / (RTP Nov 2023) (Similar)

Pg no. _____

Santosh Ltd. has received a grant of ₹ 8 crores from the Government for setting up a factory in a backward area. Out of this grant, the company distributed ₹ 2 crores as dividend. Also, Santosh Ltd. received land free of cost from the State Government but it has not recorded it at all in the books as no money has been spent.

In the light of AS 12 examine, whether the treatment of both the grants is correct. → Incorrect

Solution

As per AS 12 'Accounting for Government Grants', 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. So the grant received for setting up a factory is not available for distribution of dividend.

In the second case, even if the company has not spent money for the acquisition of land, land should be recorded in the books of accounts at a nominal value.

The treatment of both the elements of the grant is incorrect as per AS 12.

Question 12 (RTP May 2020) / (RTP Nov 2020) / (ICAI Study Material) (Similar) Pg no. _____

How would you treat the following in accounts in accordance with AS-12 'Government Grants'?

- a) ₹ 35 Lakhs received from Local Authority for providing medical facilities to employees. *Revenue*
- b) ₹ 100 Lakhs received as Subsidy from the Central Government for setting up a unit in a notified backward area. This subsidy is in nature of promoters' contribution. *Capital Reserve*
- c) ₹ 10 Lakhs Grant received from the Central Government on installation of antipollution equipment *→ Fixed Assets*

Solution

- a) ₹ 35 lakhs received from the local authority for providing medical facilities to the employees is a grant received in the nature of **revenue grant**. Such grants are generally presented as a credit in the profit and loss statement, either **separately or under a general heading** such as 'Other Income' **Alternatively** ₹ 35 lakhs may be deducted in reporting the related expense i.e. employee benefit expenses.
- b) 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 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. In the given case, the subsidy received from the Central Government for setting up a unit in notified backward area is neither in relation to specific fixed asset nor in relation to revenue. Thus, amount of ₹ 100 lakhs should be credited to capital reserve.
- c) ₹ 10 lakhs grant received for installation anti-pollution equipment is a grant related to **specific fixed asset**. **Two methods** of presentation in financial statements of grants related to specific fixed assets are regarded as acceptable alternatives. Under **first method**, 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**. Under the **second method**, 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**. Thus, ₹ 10 lakhs may either be deducted from the cost of equipment or treated as deferred income to be recognized on a systematic basis in profit & Loss A/c over the useful life of equipment.

Question 13 (RTP May 2018) / (RTP Nov 2021) (Similar) Pg no. _____

D Ltd. acquired a machine on 01-04-2018 for ₹ 20,00,000. The useful life is 5 years. The company had applied on 01-04-2018, for a subsidy to the tune of **80% of the cost**. The **sanction letter** for subsidy was received in November 2021. The Company's **Fixed Assets Account** for the financial year 2021-22 shows a credit balance as under:

Particulars	₹
Machine (Original Cost)	20,00,000
Less: Accumulated Depreciation (from 2018-19- to 2020-21 on Straight Line Method)	(12,00,000)
	8,00,000
Less: Grant received	(16,00,000)
Balance	(8,00,000)

(200/5 x 3)

(200 x 80%)

How should the company deal with this asset in its accounts for 2021-22? Can it charge depreciation or negative depreciation for 2021-22? Can it credit ₹ 8,00,000 to Capital Reserve?

Solution

Method 1

From the above account, it is inferred that the Company follows Reduction Method for accounting of Government Grants. Accordingly, out of the ₹ 16,00,000 that has been received, ₹ 8,00,000 (being the balance in Machinery A/c) should be credited to the machinery A/c. The balance ₹ 8,00,000 may be credited to P&L A/c, since already the cost of the asset to the tune of ₹ 12,00,000 had been debited to P&L A/c in the earlier years by way of depreciation charge, and ₹ 8,00,000 transferred to P&L A/c now would be partial recovery of that cost.

There is no need to provide depreciation for 2021-22 or 2022-23 as the depreciable amount is now Nil. In respect of Depreciable Assets, AS-12 does not permit the crediting of the grant or any part thereof to Capital Reserve A/c.

Question 14 (Inter May 2022) (5 Marks)

Pg no. _____

Suraj Limited provides you the following information:

- 10cr
- (i) It received a Government Grant @40% towards acquisition of Machinery worth ₹ 25 Crores.
- (ii) It received a Capital Subsidy of ₹ 150 Lakhs from Government for setting up a Plant costing ₹ 300 Lakhs in a notified backward region. → Project
- (iii) It received ₹ 50 Lakhs from Government for setting up a project for supply of arsenic free water in a notified area.
- Revenue (iv) It received ₹ 5 Lakhs from the Local Authority for providing Corona Vaccine free of charge to its employees and their families.
- (v) It also received a performance award of ₹ 500 Lakhs from Government with a condition of major renovation in the Power Plant within 3 years. Suraj Limited incurred 90% of amount towards Capital expenditure and balance for Revenue Expenditure.

State, how you will treat the above in the books of Suraj Limited.

Solution

- (i) As per AS 12 "Accounting for Govt. Grants", two methods of presentation in financial statements of grants related to specific fixed assets are regarded as acceptable alternatives. Under the first alternative, the grant of ₹ 10 crores (40% of 25 crores) is shown as a deduction from the gross value of the asset concerned in arriving at its book value. The grant is thus recognized the profit and loss statement over the useful life of a depreciable asset by way of a reduced depreciation charge. Under second alternative, grant amounting ₹ 10 crores is treated as deferred income which is recognized in the profit & loss statement on a systematic and rational basis over the useful life of the asset.

- Alternative Same like case (iii)
- (ii) In the given case, the grant amounting ₹ 150 lakhs received from the Central Government for setting up a plant in notified backward area may be considered as in the nature of promoters' contribution. Thus, amount of ₹ 150 lakhs should be credited to capital reserve and the plant will be shown at ₹ 300 lakhs.

- (iii) ₹ 50 lakhs received from Govt. for setting up a project for supply of arsenic free water in notified area should be credited to capital reserve. (Promoter contribution)

- Specific Fixed Asset ← Alternatively, if it is assumed that the project consists of capital asset only, then the amount of ₹ 50 lakhs received from Govt. for setting up a project for supply of arsenic free water should either be deducted from cost of asset of the project concerned in the balance sheet or treated as deferred income which is recognized in the profit and loss statement on a systematic and rational basis over the useful life of the asset.

- (iv) ₹ 5 lakhs received from the local authority for providing corona vaccine to the employees is a grant received in nature of revenue grant. Such grants are generally presented as a credit in the profit and loss account, either separately or under a general heading 'Other Income' Alternatively, ₹ 5 lakhs may be deducted in reporting the related expense i.e. employee benefit expenses.

- (v) ₹ 500 Lakhs will be reduced from the renovation cost of power plant or will be treated as deferred income irrespective of the expenditure done by the entity out of it as it was specifically received for the purpose major renovation of power plant. However, it may be, later on, decided by the Govt. whether the grant will have to be refunded or not due to non-compliance of conditions attached to the grant.

Question 15 (RTP Sep 2024)

Pg no. _____

Energy Ltd. has acquired a generator on 1.4.2023 for ₹ 100 lakh. On 2.4.2023, it applied to Indian Renewable Energy Development Authority (IREDA) for a subsidy. The subsidy was granted in June, 2024 after the accounts for 2023-2024 were finalized. The company has not accounted for the subsidy for the year ended 31.3.2024.

State

- (i) Is this a prior period item?
 (ii) How should the subsidy be accounted in the accounting year 2024-2025?

Solution

- (i) Whether a subsidy applied is to be classified as prior period item as per AS 5, depends upon whether the company has committed an error in 2023-2024 by not recognising the subsidy?

The answer is in para 13 of AS 12 "Accounting for Government Grants" which permits recognition of grant only when there is reasonable assurance that -

- (i) the enterprise will comply with the conditions attached to them and
 (ii) the subsidy will be received.

Mere making of an application does not provide the reasonable assurance that the subsidy will be received. Letter of sanction from IREDA is required to provide this assurance. Since, the subsidy was granted in June, 2024 after approval of accounts, non-recognition of grant in 2023-2024 will not be considered as an error. Hence, this is not a prior period item. Therefore, the company was right in not recognizing the grant.

Further, AS 4 requires adjustment of events occurring after the balance sheet date only upto the date of approval of accounts by the Board of Directors. In view of this, the company is correct in not adjusting the same in the accounts in the year 2023-2024.

- (ii) The subsidy should be deducted from the cost of the generator. The revised unamortised amount of generator should be written off over the remaining useful life. Alternatively, the same may be treated as 'deferred income' and allocated over the remaining useful life in the proportion in which depreciation is charged.

Question 16 (ICAI Study Material)

Pg no. _____

AS 12 deals with recognition and measurement of government grants. Please elaborate the parameters which are required to be met before an entity can recognise government grants in its books?

Solution

A government grant is recognised when there is reasonable assurance that:

- the enterprise will comply with the conditions attaching to it; and
- the grant will be received.

Receipt of a grant is not of itself conclusive evidence that the conditions attaching to the grant have been or will be fulfilled.

PRACTICE QUESTIONS

Question 1 *(Inter Jan 2021) (5 Marks)*

Pg no. _____

Darshan Ltd. purchased a Machinery on 1st April, 2018 for ₹ 130 lakhs (Useful life is 4 Years). Government grant received is ₹ 40 lakhs for the purchase of above Machinery. Salvage value at the end of useful life is estimated at ₹ 60 lakhs. Darshan Ltd. decides to treat the grant as deferred income. Calculate the amount of depreciation and grant to be recognized in profit & loss account for the year ending 31st March, 2019, 31st March, 2020, 31st March, 2021 & 31st March, 2022. Darshan Ltd. follows straight line method for charging depreciation.

Solution

As per 12 "Accounting for government grants", grants related to depreciable assets, if treated as deferred income are recognized in the profit and loss statement on a systematic and rational basis over the useful life of the asset. Amount of depreciation & grant to be recognized in the Profit & Loss account each year

Depreciation per year:

	Amount (in Lakhs)
Cost of the Asset	130
Less: Salvage Value	(60)
	70
Depreciation per year (70 Lakhs/4)	17.50

₹ 17.50 Lakhs depreciation will be recognized for the year ending 31st March, 2019, 31st March, 2020, 31st March, 2021 and 31st March, 2022.

Amount of grant recognized in P&L Account each year: 40 lakhs /4 years = ₹ 10 Lakhs for the year ending 31st March, 2019, 31st March, 2020, 31st March, 2021 and 31st March, 2022.

Question 2 *(Inter Nov 2023) (5 Marks)*

Pg no. _____

A Ltd. purchased a Machinery for ₹ 75 Lakhs. Government Grant received towards this Machinery is ₹ 10 Lakhs. Residual Value of Machinery at the end of useful life of 6 Years is ₹ 5 Lakhs. Asset is shown in Balance Sheet at net of grant. At the beginning of the 3rd year, an amount becomes refundable to the extent of ₹ 8 Lakhs due to non-compliance of certain conditions of grant. You are required to give necessary Journal entries for the 1st year and the 3rd year in the books of A Ltd.

Solution

Journal Entries in the Books of A Ltd.

Year	Particulars		₹ in lakhs (Dr.)	₹ in lakhs (Cr.)
1	Machinery Account	Dr.	75	
	To Bank Account			75
	(Being machinery purchased)			
2	Bank Account	Dr.	10	
	To Machinery Account			10
	(Being grant received from the government reduced from the cost of machinery)			
3	Depreciation Account (W.N.1)	Dr.	10	
	To Machinery Account			10
	(Being depreciation charged on Straight Line method (SLM))			

4	Profit & Loss Account	Dr.	10	
	To Depreciation Account			10
	(Being depreciation transferred to Profit and Loss Account at the end of year 1)			
5	Machinery Account	Dr.	8	
	To Bank Account			8
	(Being government grant on machinery partly refunded which increased the cost of fixed asset)			
6	Depreciation Account (W.N.2)	Dr.	12	
	To Machinery Account			12
	(Being depreciation charged on SLM on revised value of fixed asset prospectively)			
7	Profit & Loss Account	Dr.	12	
	To Depreciation Account			12
	(Being depreciation transferred to Profit and Loss Account at the end of year 3)			

Working Notes:**1. Depreciation for Year 1**

	₹ in lakhs
Cost of the Machinery	75
Less: Government grant received	(10)
	65
Depreciation $[(65 - 5)/6]$	10

2. Depreciation for Year 3

	₹ in lakhs
Cost of the Machinery	75
Less: Government grant received	(10)
	65
Less: Depreciation for the first two years	20
	45
Add: Government grant refundable	8
	53
Depreciation for the third year $[(53 - 5)/4]$	12

Question 3 (ICAI Study Material)

Pg no. _____

Z Ltd. purchased a fixed asset for ₹ 50 lakhs, which has the estimated useful life of 5 years with the salvage value of ₹ 5,00,000. On purchase of the assets government granted it a grant for ₹ 10 lakhs (This amount was reduced from the cost of fixed asset). Grant was considered as refundable in the end of 2nd year to the extent of ₹ 7,00,000. Pass the journal entry for refund of the grant as per the first method.

Solution

Year	Particulars	L.F.	Dr.	Cr.
2	Fixed Asset Account Dr.		7,00,000	
	To Bank Account			7,00,000
	(Being grant on asset partly refunded which increased cost of fixed asset)			

Question 4

Pg no. _____

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

Show the Journal Entry to be passed at the time of refund of grant 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)
Fixed Asset 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 = ₹ 80 lakhs – ₹ 32 lakhs = ₹ 48 lakhs

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

= ₹ 10 lakhs per year for first two years.

Value of the assets before refund of grant = ₹ 48 lakhs – ₹ 20 lakhs = ₹ 28 lakhs

c) Value of Fixed Assets after refund of grant

Value of Fixed Assets before refund of grant ₹ 28 lakhs

Add Refund of grant ₹ 32 lakhs

₹ 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

= (₹ 60 lakhs – ₹ 8 lakhs) / 2 = ₹ 26 lakhs per annum will be charged for next two years.

(ii) Grant is credited to Deferred 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 (₹ 32 lakhs / 4 years) = ₹ 8 lakhs x 2 years = ₹ 16 lakhs will be credited to Profit & Loss A/c and ₹ 16 lakhs will be the balance of Deferred Grant A/c after two years.

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

Particulars	L.F.	Dr. (in Lakhs)	Cr. (in Lakhs)
Deferred 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 = ₹ 80 lakhs

Depreciation for each year = (₹ 80 lakhs – ₹ 8 lakhs)/4 years = ₹ 18 lakhs per year

Book value of fixed assets after 2 years = ₹ 80 lakhs – (₹ 18 lakhs x 2 years) = ₹ 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 ₹ 44 lakhs.

d) Amount of depreciation for remaining two years

Depreciation will continue to be charged at ₹ 18 lakhs per annum for the remaining two years

Question 5 (*Inter May 2018*) (5 Marks)

Pg no. _____

On 01.04.2018, XYZ Ltd. received Government grant of ₹ 100 Lakhs for an acquisition of new machinery costing ₹ 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 on 2nd April, 2021 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)
1 st April 2018	Acquisition cost of machinery (500 - 100)	400.00
31 st March 2019	Less: Depreciation @ 20%	(80.00)
1 st April 2019	Book value	320.00
31 st March 2020	Less: Depreciation @ 20%	(64.00)
1 st April 2020	Book value	256.00
31 st March 2021	Less: Depreciation @ 20%	(51.20)
1 st April 2021	Book value	204.80
2 nd April 2021	Add: Refund of grant	100.00
	Revised Book value	304.80

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

Question 6 (*Inter Nov 2020*) (5 Marks)

Pg no. _____

On 1st April, 2018, Mac Ltd. received a Government Grant of ₹ 60 lakhs for acquisition of machinery costing ₹ 300 lakhs. The grant was credited to the cost of the asset. The estimated useful life of the machinery is 10 years. The machinery is depreciated @ 10% on WDV basis. The company had to refund the grant in June 2021 due to noncompliance of certain conditions. How the refund of the grant is dealt with in the books of Mac Ltd. assuming that the company did not charge any depreciation for the year 2021-22. Pass necessary Journal Entries for the year 2021-22.

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)
1 st April 2018	Acquisition cost of machinery (300 - 60)	240.00
31 st March 2019	Less: Depreciation @ 10%	(24.00)
1 st April 2019	Book value	216.00
31 st March 2020	Less: Depreciation @ 10%	(21.60)
1 st April 2020	Book value	194.40
31 st March 2021	Less: Depreciation @ 10%	(19.44)

1 st April 2021	Book value	174.96
	Less: Depreciation @ 10% for 2 months	(2.916)
1 st June 2021	Book value	172.044
June 2021	Add: Refund of grant	60.00
	Revised Book value	232.044

Depreciation @ 10% on the revised book value amounting ₹ 232.044 lakhs is to be provided prospectively over the residual useful life of the asset.

**considered refund of grant at beginning of June month and depreciation for two months already charged. Alternative answer considering otherwise also possible.*

Year	Particulars	L.F.	Dr. (in Lakhs)	Cr. (in Lakhs)
2021-22	Machinery Account Dr. ✓		60	
	To Bank Account			60
	(Being government grant on asset refunded which increased cost of fixed asset)			
	Depreciation Account (W.N.) Dr. ✓		19.337	
	To Machinery Account			19.337
	(Being depreciation charged on revised value of fixed asset prospectively for 10 months)			
	Profit & Loss Account Dr.		22.253	
	To Depreciation Account			22.253
	[Being depreciation transferred to Profit and Loss Account at end of year (2.916+19.337)]			

Question 7 (RTP Nov 2018)

Pg no. _____

A specific government grant of ₹ 15 lakhs was received by USB Ltd. for acquiring the Hi-Tech Dairy plant of ₹ 95 lakhs during the year 2018-19. Plant has useful life of 10 years. The grant received was credited to deferred income in the balance sheet. During 2021-22, 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 ₹ 10.50 lakhs and written down value of plant was ₹ 66.50 lakhs.

- 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 2021-22 in P&L Account?
- What should be the treatment of the refund, if grant was deducted from cost of the plant during 2018-19 assuming plant account showed the balance of ₹ 56 lakhs as on 1.4.2021? You are required to explain in the line with provisions of AS 12.

Solution

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.

- In this case the grant refunded is ₹ 15 lakhs and balance in deferred income is ₹ 10.50 lakhs, ₹ 4.50 lakhs shall be charged to the profit and loss account for the year 2021-22. 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 2018-19 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 ₹ 15 lakhs. The increased cost of ₹ 15 lakhs of the plant should be amortized over 7 years (residual life). Depreciation charged during the year 2021-22 shall be $(56+15)/7$ years = ₹ 10.14 lakhs presuming the depreciation is charged on SLM.

Question 8 (RTP Nov 2019) / (RTP Nov 2022) Pg no. _____

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 2022. 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.

Question 9 (Inter May 2019) (1 Marks) Pg no. _____

State whether the following statement is 'True' or 'False'. Also give reason for your answer. As per the provisions of AS-12, government grants in the nature of promoters' contribution which become refundable should be reduced from the capital reserve.

Solution

True: When grants 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 refundable to the government is reduced from the capital reserve.

Question 10 Pg no. _____

Explain in brief treatment of Refund of Government Grants in line with AS 12 in the following situations

- When Government Grant is related to revenue,
- When Government Grant is related to specific fixed assets,
- When Government Grant is in the nature of Promoter's contribution.

Solution

As per AS 12, refund of Government Grant is treated in the following manner:

(a) When Government Grant is related to Revenue:

- (i) The amount of refund is first adjusted against any unamortized deferred credit balance still remaining in respect of the Grant.
- (ii) Any excess refund over such deferred credit balance or where no deferred credit exists, is immediately charged to Profit & Loss Account.

(b) When Government Grant is related to specific Fixed Asset:

- (i) The amount of refund will increase the Book Value of the Asset, if at the time of receipt of Grant, the cost of asset was reduced by the amount of Grant.
- (ii) If at the time of receipt, the Grant amount was credited to Deferred Grant Account, then the amount of refund will first reduce the unamortized balance of Deferred Grant Account.

(c) When the Government Grant is in the nature of Promoter's Contribution:

Capital Reserve will be reduced by the amount of refund.

Question 11 (Inter July 2021) (5 Marks)

Pg no. _____

Alps Limited has received the following Grants from the Government during the year ended 31st March, 2021:

- a) ₹ 120 Lacs received as Subsidy from the Central Government for setting up an Industrial undertaking in Medak, a notified backward area.
- b) ₹ 15 Lacs Grant received from the Central Government on installation of Effluent Treatment Plant.
- c) ₹ 25 Lacs received from State Government for providing Medical facilities to its workmen during the pandemic.

Advise Alps Limited on the treatment of the above Grants in its books of Account in accordance with AS-12 "Government Grants".

Solution

- a) 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 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. In the given case, the subsidy received from the Central Government for setting up an industrial undertaking in Medak is neither in relation to specific fixed asset nor in relation in revenue. Thus, the amount of ₹ 120 Lacs should be credited to capital reserve.
(Note: Subsidy for setting up an industrial undertaking is considered to be in the nature of promoter's contribution)
- b) As per AS 12 'Accounting for Government Grants', 2 methods of presentation in financial statements of grants related to specific fixed assets are regarded as alternatives -
 - (i) 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.
 - (ii) Grants related to depreciable asset 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.

In the given case, ₹ 15 Lacs was received as grant from the Central Government for installation of Effluent Treatment Plant. Since the grant was received for a fixed asset, either of the above methods can be adopted.

- c) ₹ 25 lacs received from State Government for providing medical facilities to its workmen during the pandemic is a grant received in nature of revenue grant. Such grants are generally presented as a credit in the profit and loss statement, either separately or under a general heading such as "Other Income". Alternatively, ₹ 25 lacs may be deducted in reporting the related expense i.e., employee benefit expense.

Question 12 (RTP May 2021)

Pg no. _____

ABC Ltd. received two acres of land received for set up of plant. It also received ₹ 2 lakhs received for purchase of machinery of ₹ 10 lakhs. Useful life of machinery is 5 years. Depreciation on this machinery is to be charged on straight-line basis. How should ABC Ltd. recognize these government grants in its books of accounts?

Solution

ABC Ltd. should recognize the grants in the following manner:

- As per AS 12, government grants may take the form of non-monetary assets, such as land or other resources, given at concessional rates. In these circumstances, it is usual to account for such assets at their acquisition cost. Non-monetary assets given free of cost are recorded at a nominal value. Accordingly, land should be recognised at nominal value in the balance sheet.
- The standard provides option to treat the grant either as a deduction from the gross value of the asset or to treat it as deferred income as per provisions of the standard. Under first method, 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. Accordingly, the grant of ₹ 2 lakhs is deducted from the cost of the machinery. Machinery will be recognised in the books at ₹ 10 lakhs – ₹ 2 lakhs = ₹ 8 lakhs and depreciation will be charged on it as: ₹ 8 lakhs/ 5 years = ₹ 1.60 lakhs per year. Under the second method, 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. Such allocation to income is usually made over the periods and in the proportions in which depreciation on related assets is charged. ₹ 2 lakhs should be recognised as deferred income and will be transferred to profit and loss over the useful life of the asset. In this case, ₹ 40,000 [₹ 2 lakhs / 5 years] should be credited to profit and loss each year over the period of 5 years.

Question 13 (Inter May 2023) (5 Marks)

Pg no. _____

On 1st April 2021, Eleanor Limited purchased a manufacturing Plant for ₹ 60 lakhs, which has an estimated useful life of 10 years with a salvage value of ₹ 10 lakhs. On purchase of the Plant, a grant of ₹ 20 lakhs was received from the government.

You are required to calculate the amount of depreciation as per AS-12 for the financial year 2022-23 in the following cases:

- If the grant amount is deducted from the value of plant.
 - If the grant is treated as deferred income.
 - If the grant amount is deducted from the value of Plant, but at the end of year 2022-2023 grant is refunded to the extent of ₹ 4 lakhs, due to non-compliance of certain conditions.
 - If the grant is treated as the promoter's contribution.
- (Assume depreciation on the basis of Straight-Line Method.)

Solution**Calculation of depreciation as per AS 12 for the financial year 2022-23:**

- (i) If the grant amount is deducted from the value of Plant, then the amount of depreciation will be ₹ 3,00,000 p.a. $(₹ 60,00,000 - ₹ 10,00,000 - ₹ 20,00,000) / 10$ years.
- (ii) If the grant is treated as deferred income, then amount of depreciation will be ₹ 5,00,000 p.a. $(₹ 60,00,000 - ₹ 10,00,000) / 10$ years.
- (iii) If the grant amount is deducted from the value of plant, but at the end of the year 2022-23 grant is refunded to the extent of ₹ 4 lakh then the amount of depreciation will be ₹ 3,00,000 p.a. $(₹ 60,00,000 - ₹ 10,00,000 - ₹ 20,00,000) / 10$ year for year 2021-22 and for the year 2022-23 Depreciation will be ₹ 3,00,000 calculated as follows, $(₹ 60,00,000 - ₹ 10,00,000 - ₹ 20,00,000 - ₹ 3,00,000) / 9$ years.

Note: It is assumed that the depreciation for the year has been charged on the book value on the plant before making adjustment for grant. Alternatively, if it is considered otherwise then the depreciation will be charged after making adjustment for grant. In that case depreciation for the year 2022-23 will be as:

Particulars	₹
Cost of Plant	60,00,000
Less: Salvage	10,00,000
	50,00,000
Less: Grant	20,00,000
	30,00,000
Add: Grant Refundable	4,00,000
	34,00,000
Less: Depreciation for 2021-22	3,00,000
	31,00,000
Useful Life (years)	9
Depreciation for 2022-23	3,44,444

- (iv) If the grant is treated as promoter's contribution, then the amount of depreciation will be ₹ 5,00,000 p.a. $(₹ 60,00,000 - 10,00,000) / 10$ years.

Question 14

Pg no. _____

An Indian company is engaged by a research company based in USA to carry out research in India, in consideration of billing to be done by Indian company based on cost plus 20% mark up. The Company based in USA paid a sum of ₹ 10 crores to an Indian company to acquire equipment to be used for research. The equipment is owned by the Indian company and a condition is attached in the agreement with the US company that such equipment is to be used for at least 5 years for research work of that company.

How should the amount of ₹ 10 crores be accounted—as capital reserve or as credit to profit and loss account or by credit to the account of the equipment?

Solution

In the given case, the Company has received an amount from a research company in USA to acquire equipment's to be used in research in India which is to be owned by the Indian Company only. The same can be considered as private grant and AS 12 do not apply to private grants. Since the amount received is towards capital items, therefore it is not possible that credit arising out of a grant can be taken to statement of profit and loss. If such grant received is credited to profit and loss, profit or loss position could be easily manipulated through such private grants.

However, in the present case, grant should either be shown as ~~Capital Reserve~~ ^{Deferred Income} (not revenue reserves) with proper disclosures or credited to Equipment Account.