

AS 12 ACCOUNTING FOR GOVERNMENT GRANTS

Illustration 1

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. Pass the necessary journal entries in the books of the company for first two years if the grant amount is deducted from the value of fixed asset.

Solution:

Journal in the books of Z Ltd.

Year	Particulars	₹ (Dr.)	₹ (Cr.)
1st	Fixed Assets Account Dr.	50,00,000	
	To Bank Account		50,00,000
	(Being Fixed Assets purchased)		
	Bank Account Dr.	10,00,000	
	To Fixed Assets Account	10,00,000	
	(Being grant received from the government)		
	Depreciation Account Dr.	7,00,000	
	To Fixed Assets Account		7,00,000
	(Being Depreciation charged on SLM)		
	Profit & Loss Account Dr.	7,00,000	
	To Depreciation Account		7,00,000
	(Being Depreciation transferred to P&L Account)		
	2nd Depreciation Account Dr.	7,00,000	
	To Fixed Assets Account		7,00,000
	(Being Depreciation charged on SLM)		
	Profit & Loss Account Dr.	7,00,000	
	To Depreciation Account		7,00,000
	(Being Depreciation transferred to P&L Account)		

Method II:

- 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.
- Grants related to non-depreciable assets are credited to capital reserve under this method, as there is usually no charge to income in respect of such assets.
- If a grant related to a non-depreciable asset requires the fulfilment 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.

Illustration 2

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. Pass the necessary journal entries in the books of the company for first two years if the grant is treated as deferred income.

Solution

Journal in the books of Z Ltd.

Year	Particulars	₹ (Dr.)	₹ (Cr.)
1st	Fixed Assets Account Dr.	50,00,000	
	To Bank Account		50,00,000
	(Being fixed assets purchased)		
	Bank Account Dr.	10,00,000	
	To Deferred Government Grant Account		10,00,000
	(Being grant received from the government)		
	Depreciation Account Dr.	9,00,000	
	To Fixed Assets Account		9,00,000
	(Being depreciation charged on SLM)		
	Profit & Loss Account Dr.	9,00,000	
	To Depreciation Account		9,00,000
	(Being depreciation transferred to P/L Account)		
	Deferred Government Grants Account Dr.	2,00,000	
	To Profit & Loss Account		2,00,000
	(Being proportionate government grant taken to P/L Account)		
2nd	Depreciation Account Dr.	9,00,000	
	To Fixed Assets Account		9,00,000
	(Being depreciation charged on SLM)		
	Profit & Loss Account Dr.	9,00,000	
	To Depreciation Account		9,00,000
	(Being depreciation transferred to P/L Account)		
	Deferred Government Grant Account Dr.	2,00,000	
	To Profit & Loss Account		2,00,000
	(Being proportionate government grant taken to P/L Account)		

Illustration 3 (RTP Nov '23)

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.

Solution

As per AS 12 'Accounting for Government Grants', when government grant is received for a specific purpose, it should be utilised for the same. 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.

Illustration 4

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.

You are required to pass the necessary journal entries in the books of the company for first year if the grant is:

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

Solution

(a)

Particulars		₹ (Dr.)	₹ (Cr.)
Bank Account	Dr.	90,00,000	
To Deferred Income Account			90,00,000
(Being receipt of grant from government)			
Salary Expense Account	Dr.	30,00,000	
To Bank Account			30,00,000
(Being Salary expense paid for the year)			
Deferred Income Account	Dr.	18,00,000	
To Other Income Account			18,00,000
(Being Year 1 Grant income recognised in Profit & Loss)			

Note: The grant has been spread on a straight-line basis over a period of 5 years [$\text{₹}90,00,000/5 \text{ years} = \text{₹}18,00,000$].

(b)

Particulars		₹ (Dr.)	₹ (Cr.)
Bank Account	Dr.	90,00,000	
To Deferred Income Account			90,00,000
(Being receipt of grant from government)			
Salary Expense Account	Dr.	12,00,000	
To Bank Account			12,00,000
(Being Salary expense paid (net of grant income) for the year)			
Deferred Income Account	Dr.	18,00,000	
To Salary Expense Account			18,00,000
(Being Year 1 grant adjusted against Salary expense for the year)			

Illustration 5 (RTP Nov'19, Nov'22)

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, 20X2 (accounting period being 20X1-20X2). 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, 20X2.

Keeping in view the relevant Accounting Standard, discuss whether this action is justified or not.

Solution

As per para 10 of 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.

Illustration 6 (RTP May 20, MTP Oct'22)

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

- (i) ₹ 35 Lakhs received from the Local Authority for providing medical facilities to the employees.
- (ii) ₹ 100 Lakhs received as Subsidy from the Central Government for setting up a unit in notified backward area. This subsidy is in nature of nature of promoters' contribution.
- (iii) Rs.10 Lakhs Grant received from the Central Government on installation of anti- pollution equipment.

(5 Marks)

Solution

(i) ₹ 35 lakhs received from the local authority for providing medical facilities 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 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.

(ii) 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.

(iii) Rs.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 recognized 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, Rs.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.

Illustration 7

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

Fixed Assets Account		Dr.	₹ 7,00,000	
To Bank Account	₹			7,00,000

(Being government grant on asset refunded)

Illustration 8

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 two years.

Solution

Journal Entries

Year	Particulars	₹ in lakhs (Dr.)	₹ in lakhs (Cr.)
1	Fixed Asset Account Dr. To Bank Account (Being fixed asset purchased)	20	20
	Bank Account Dr. To Fixed Asset Account (Being grant received from the government reduced the cost of fixed asset)	8	8
	Depreciation Account (W.N.1) Dr. To Fixed Asset Account (Being depreciation charged on Straight Line method (SLM))	2	2
	Profit & Loss Account Dr. To Depreciation Account (Being depreciation transferred to Profit and Loss Account at the end of year 1)	2	2
2	Fixed Asset Account Dr. To Bank Account (Being government grant on asset partly refunded which increased the cost of fixed asset)	5	5
	Depreciation Account (W.N.2) Dr. To Fixed Asset Account (Being depreciation charged on SLM on revised value of fixed asset prospectively)	3.67	3.67
	Profit & Loss Account Dr. To Depreciation Account (Being depreciation transferred to Profit and Loss Account at the end of year 2)	3.67	3.67

Working Notes:

1. Depreciation for Year 1

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

2. Depreciation for Year 2

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

Illustration 9 (MTP Oct'20, Mar'22) (Past Exam May'18, Nov '20)

On 1st April, 2016, 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 2019 due to non-compliance 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 2019-20. Pass necessary Journal Entries for the year 2019-20.

Solution:

	(₹ in lakhs)	
1st April, 2016	Acquisition cost of machinery	300.00
	Less: Government Grant	60.00
		240.00
31st March, 2017	Less: Depreciation @ 10%	(24.00)
1st April, 2017	Book value	216.00
31st March, 2018	Less: Depreciation @ 10%	(21.60)
1st April, 2018	Book value	194.40
31st March, 2019	Less: Depreciation @ 10%	(19.44)
1st April, 2019	Book value	174.96
	Less: Depreciation @10% for 2 months	(2.916)
1st June, 2019	Book value	172.044
June 2019	Add: Refund of grant*	60.00
	Revised book value	232.044

Depreciation @10% on the revised book value amounting to ₹ 232;044 lakhs is to be provided prospectively over the residual useful life of the machinery.

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

Journal Entries

Machinery Account	Dr.	60	
To Bank Account			60
(Being government grant on asset partly refunded which increased the cost of fixed asset)			
Depreciation Account	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 amounting to ₹ (2;916 + 19.337= 22.253)			

Illustration 10

A Ltd. purchased a 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 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:

I.

		₹	₹
Fixed Assets A/c	Dr	. 16 lakhs	
To Bank A/c			16 lakhs
(Being grant refunded)			

II. The balance of fixed assets after two years depreciation will be ₹16 lakhs (W.N.1) and after refund of grant it will become (₹16 lakhs + ₹16 lakhs) = ₹32 lakhs on which depreciation will be charged for remaining two years. Depreciation = $(32-8)/2 = ₹12$ 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 (₹16 lakhs /4 years) = ₹4 lakhs p.a. x 2 years = ₹8 lakhs were credited to Profit and Loss Account and ₹8 lakhs was the balance of Deferred Grant Account after two years.

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

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 ₹24 lakhs (W.N.2) and depreciation will continue to be charged at ₹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 = ₹40 lakhs – ₹16 lakhs = ₹24 lakhs

Depreciation p.a. = $(₹24 \text{ lakhs} - ₹8 \text{ lakhs})/4 \text{ years} = ₹4$ lakhs per year

Value of fixed assets after two years but before refund of grant

= ₹24 lakhs – (₹4 lakhs x 2 years) = ₹16 lakhs

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

Fixed assets initially recorded in the books = ₹40 lakhs

Depreciation p.a. = $(₹40 \text{ lakhs} - ₹8 \text{ lakhs})/4 \text{ years} = ₹8$ lakhs per year

Book value of fixed assets after two years = ₹40 lakhs – (₹8 lakhs x 2 years) = ₹24 lakhs

Note: Value of fixed assets given above is after refund of government grant.

Illustration 11

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.

Solution

		₹	₹
Deferred Grant A/c	Dr.	36 lakhs	
Profit & Loss A/c	Dr.	54 lakhs	
To Bank A/c			90 lakhs
(Being Government grant refunded)			

Workings:

Total grant received:	₹ 90 Lakhs
Grant recognised as income for first 3 years:	₹ 18 lakhs × 3
	= ₹ 54 lakhs
Remaining Deferred Income	= ₹ 90 Lakhs – 54 lakhs
	= ₹ 36 lakhs

Illustration 12

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.

Illustration 13

Supriya Ltd. received a grant of ₹ 2,500 lakhs during the accounting year 20X1- 20X2 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 20X2-20X3, 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

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 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 20X2-20X3.

MTP / RTP / Past Exam**Question 1 (MTP May 20, March '21, Sep'22, April'23) (RTP May '19)**

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 and was not deducted from the cost of plant. 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. 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? **(5 Marks)**

Solution: 1

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.

In this case the grant refunded is ₹ 30 lakhs and balance in deferred income is ₹ 21 lakhs, ₹ 9 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.

Question 2 (MTP April 19, April 21, April 22, Oct '23)

Ram Ltd. purchased machinery for Rs. 80 lakhs (useful life 4 years and residual value Rs. 8 lakhs). Government grant received was Rs. 32 lakhs. The grant had to be refunded at the beginning of third year. 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 the grant had been credited to Deferred Grant A/c. **(5 Marks)**

Solution:

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. Therefore, on refund of grant, following entry will be passed:

		Rs.	Rs.
Deferred Grant A/c	Dr.	16 lakhs	
Profit & Loss A/c	Dr.	16 lakhs	
	To Bank A/c		32 lakhs
(Being Government grant refunded)			

1. 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

2. 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.

3. 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 (MTP March '23) (RTP May'18, Nov 21)

D Ltd. acquired a machine on 01-04-2017 for ₹ 20,00,000. The useful life is 5 years. The company had applied on 01-04-2017, for a subsidy to the tune of 80% of the cost. The sanction letter for subsidy was received in November 2020. The Company's Fixed Assets Account for the financial year 2020-21 shows a credit balance as under:

Particulars	₹
Machine (Original Cost)	20,00,000
Less: Accumulated Depreciation (from 2017-18- to 2019-20 on Straight Line Method)	12,00,000
	8,00,000
Less: Grant received	(16,00,000)
Balance	(8,00,000)

You are required to explain how should the company deal with this asset in its accounts for 2020-21?

(5 Marks)

Solution:

From the above account, it is inferred that the Company has deducted grant from the book value of asset 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 2020-21 or 2021-22 as the depreciable amount is now Nil.

Question 4 (RTP May '21, May'23)

- (i) Hygiene Ltd. had received a grant of Rs. 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 the said amount in 2020.

The company debited the said amount to its machinery account in 2020 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 2020 to incorporate the retrospective impact of the same. State whether the treatment done by the company is correct or not.

- (ii) ABC Ltd. received two acres of land received for set up of plant. It also received Rs.2 lakhs received for purchase of machinery of Rs. 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:

- (i) As per the facts of the case, Hygiene Ltd. had received a grant of Rs. 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.

- (ii) 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 recognized 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 Rs. 2 lakhs is deducted from the cost of the machinery.

Machinery will be recognised in the books at Rs. 10 lakhs – Rs. 2 lakhs = Rs. 8 lakhs and depreciation will be charged on it as follows:

Rs. 8 lakhs/ 5 years = Rs. 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. Rs. 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, Rs. 40,000 [Rs. 2 lakhs / 5 years] should be credited to profit and loss each year over the period of 5 years.

Question 5 (RTP Nov 18)

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 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 ₹ 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 2017 -18 in profit and loss account?
- 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 ₹ 56 lakhs as on 1.4.2017?

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 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.
- 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 ₹ 15 lakhs. The increased cost of ₹ 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 = ₹ 10;14 lakhs presuming the depreciation is charged on SLM.

Question 6 (Past Exam Nov'23)

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:

(5 Marks)

Journal Entries in the Books of A Ltd.

Year	Particulars		₹ in lakhs (Dr.)	₹ in lakhs (Cr.)
1	Machinery Account To Bank Account (Being machinery purchased)	Dr.	75	75
	Bank Account To Machinery Account (Being grant received from the government reduced from the cost of machinery)	Dr.	10	10
2	Depreciation Account (W.N.1) To Machinery Account (Being depreciation charged on Straight Line method (SLM))	Dr.	10	10
	Profit & Loss Account To Depreciation Account (Being depreciation transferred to Profit and Loss Account at the end of year 1)	Dr.	10	10
3	Machinery Account To Bank Account (Being government grant on machinery partly refunded which increased the cost of fixed asset)	Dr.	8	8
	Depreciation Account (W.N.2) To Machinery Account (Being depreciation charged on SLM on revised value of fixed asset prospectively)	Dr.	12	12
	Profit & Loss Account To Depreciation Account (Being depreciation transferred to Profit and Loss Account at the end of year 3)	Dr.	12	12

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

	₹ in lakhs
Cost of the Machinery	75

Less: Government grant received	(10)
	<u>65</u>
Depreciation $\left[\frac{65-5}{10} \right]$	6

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	<u>20</u>
	45
Add: Government grant refundable	8
	<u>53</u>
Depreciation for the third year $\left[\frac{53-5}{4} \right]$	12

Question 7 (Past Exam May '19)

State whether the following statements are '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., **(1 Mark)**

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 8 (Past Exam May'22)

Suraj Limited provides you the following information:

- (i) It received a Government Grant @40% towards the 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.
- (iii) It received ₹ 50 Lakhs from Government for setting up a project for supply of arsenic free water in a notified area.
- (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.

(5 Marks)

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 method, grant amounting ₹ 10 crores is 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.

- (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.

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 9 (Past Exam May '23)

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:

- (i) If the grant amount is deducted from the value of Plant.
- (ii) If the grant is treated as deferred income.
- (iii) If the grant amount is deducted from the value of Plant, but at the end of the year 2022-2023 grant is refunded to the extent of ₹ 4 lakhs, due to non-compliance of certain conditions.
- (iv) If the grant is treated as the promoter's contribution.

(Assume depreciation on the basis of Straight-Line Method.)

(5 Marks)

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. $(₹ 60,00,000 - ₹ 10,00,000 - ₹ 20,00,000) / 10$ year.
- (ii) If the grant is treated as deferred income, then amount of depreciation will be ₹ 5,00,000 p.a. $(₹ 60,00,000 - ₹ 10,00,000) / 10$ year.
- (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 202122 and for the year 2022-23
- (iv) Depreciation will be ₹ 3,00,000 calculated as follows, $(₹60,00,000 - ₹ 10,00,000 - ₹ 20,00,000 - ₹ 3,00,000) / 10$ 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 ₹ 3,44,444 calculated as follows, (₹ 60,00,000 - ₹10,00,000 - ₹ 20,00,000 + 4,00,000 – ₹ 3,00,000 / 9 years

(v) 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 year.

NOTE: The answer can be presented in the following alternative manner:

(i) (ii) (iii) (iv)

Date	Particulars	Grant Value deducted from Plant	Grant treated as Deferred Income	Grant Refunded	Grant is treated as Promoter's Contribution
01.04.2021	Cost of Plant	60,00,000	60,00,000	60,00,000	60,00,000
	Less: Salvage	10,00,000	10,00,000	10,00,000	10,00,000
		50,00,000	50,00,000	50,00,000	50,00,000
01.04.2021	Less: Grant	20,00,000	-	20,00,000	-
		30,00,000	50,00,000	30,00,000	50,00,000
	Useful Life (years)	10	10	10	10
31.03.2022	Depreciation FY 2021-22	3,00,000	5,00,000	3,00,000	5,00,000
1.4.2022	Cost of Plant			60,00,000	
	Less: Salvage			10,00,000	
				50,00,000	
	Less: Grant			20,00,000	
	Less:			30,00,000	
	Depreciation FY 2022-23			3,00,000	
				27,00,000	
	Book value at the time of refund of grant i.e. at the end of period			4,00,000	
	Add: Grant Refundable at end of 22-23 Book value available for remaining 8 years.			31,00,000	

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:

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

Question 10 (RTP Sep'24)

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.

MCQ

1. To encourage industrial promotion, IDCI offers subsidy worth ₹ 50 lakhs to all new industries set up in the specified industrial areas. This grant is in the nature of promoter's contribution. How such subsidy should be accounted in the books?

- (a) Credit it to capital reserve
- (b) Credit it as 'other income' in the profit and loss account in the year of commencement of commercial operations
- (c) Both (a) and (b) are permitted
- (d) Credit it to general reserve

2. 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

- (a) recognised and disclosed in the Statement of Profit and Loss of the period in which they are receivable as an ordinary item.
- (b) recognised and disclosed in the Statement of Profit and Loss of the period in which the losses or expenses were incurred.
- (c) recognised and disclosed in the Statement of Profit and Loss of the period in which they are receivable, as an extraordinary item if appropriate as per AS 5.
- (d) disclosed in the Statement of Profit and Loss of the period in which they are receivable, as an extraordinary item

3. Which of the following is an acceptable method of accounting presentation for a government grant relating to an asset?

- (a) Credit the grant immediately to Income statement
- (b) Show the grant as part of Capital Reserve
- (c) Reduce the grant from the cost of the asset or show it separately as a deferred income on the Liability side of the Balance Sheet.
- (d) Show the grant as part of general Reserve

4. X Ltd. has received a grant of ₹ 20 crore for purchase of a qualified machine costing ₹ 80 crore. X Ltd has a policy to recognise the grant as a deduction from the cost of the asset. The expected remaining useful life of the machine is 10 years. Assume that there is no salvage value and the depreciation method is straight-line. The amount of annual depreciation to be charged as an expense in Profit and Loss Statement will be:

- (a) ₹ 10 crore
- (b) ₹ 6 crore
- (c) ₹ 2 crore
- (d) ₹ 8 crore

5. X Ltd has received a grant of ₹ 20 crore for purchase of a qualified machine costing ₹ 80 crore. X Ltd. has a policy to recognise the grant as deferred income. The expected remaining useful life of the machine is 10 years. Assume that there is no salvage value and the depreciation method is straight-line. The amount of other income to be to be recognised in Profit and Loss Statement will be:

- (a) ₹ 10 crore
- (b) ₹ 6 crore
- (c) ₹ 2 crore
- (d) ₹ 8 crore

Answers

1. (a) 2. (c) 3. (c) 4. (b) 5. (c)

SOLVED EXAMPLE**Example 1**

X Ltd applies for a grant from the local authority towards a social cause. X Ltd. Is required to meet certain conditions to be eligible for the receipt of grant. There is a reasonable assurance that X Ltd will receive the grant in time. However, after having applied for the grant, there is a likelihood that X Ltd may not be able to meet all the conditions attached to the grant.

In such case, X Ltd should not recognise the grant in its books until there is a reasonable assurance that it would be able to meet all conditions attached to the grant

Example 2

X Convent wishes to open a school in locality A. It applies to the State authority for grant of land. The State authority grants the land for construction of the the purposes of the school construction. The market value of the land is ₹ 20 crore whereas However, the authority provides the land at a nominal cost of ₹ 50 lakhs including cost of registration. The State authority requires that free education must be provided to the poor children by way of reserving 20% of the seats in the school for such children. There is a reasonable assurance that X Convent has a reason to believe it can will meet that the above stated condition attached to the grant.

Thus, X Convent needs to would recognise the cost of the land at its acquisition cost of ₹ 50 lakhs. held.

Example 3

The Central Government is planning to generate large employment in rural and backward regions. Thus, it is planning to give grants for the same to entities who will meet the required conditions. F Ltd applied for a grant to the Central Government. The Government will give the grant on the condition that, F Ltd will be required to construct a factory where it would need to employ at least 500 workers for 5 years. Total cost of the construction is expected to be ₹ 50 crore. The amount of the grant is ₹ 30 crore.

F Ltd will be able to recognise the grant only if there is reasonable assurance that it will meet o the condition of employing 500 workers for next 5 years.

Two methods of presentation in financial statements of grants related to specific fixed assets are regarded as acceptable alternatives.