

TOPIC – 15

ACCOUNTING STANDARD – 12

ACCOUNTING FOR GOVERNMENT GRANTS

TOTAL NO. OF QUESTIONS - 17

(Questions of Study Material, RTPs, MTPs and Past Exams)

Q.AS12.SM.01

Co X runs a charitable hospital. It incurs salary of doctors, staff etc to the extent of Rs. 30 lakhs per annum. As a support, the local govt grants a lumpsum payment of Rs.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:

- Case 1 - Shown separately as Other Income; and
- Case 2 - Deducted against the Salary costs.

Q.AS12.RMP.02: (RTP May'20, Nov'20; MTP Nov'22)

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

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



Q.AS12.SM.03 (RTP May'25)

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.



Q.AS12.SM.04 (Also in 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.

Q.AS12.SM.05 (Refund)

Co X runs a charitable hospital. It incurs salary of doctors, staff etc to the extent of Rs. 30 lakhs per annum. As a support, the local govt grants a lumpsum payment of Rs.90 lakhs to meet the salary expense for a period of the 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.

Q.AS12.SM.06 (Refund)

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

Q.AS12.SM.07 (Refund)

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

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

- (1) the grant is credited to Fixed Assets A/c.
- (2) the grant is credited to Deferred Grant A/c.

**Q.AS12.RMP.08: (RTP May'18, Nov'21)**

D Ltd. acquired a machine on 01-04-2012 for Rs. 20,00,000. The useful life is 5 years. The company had applied on 01-04-2012, for a subsidy to the tune of 80% of the cost. The sanction letter for subsidy was received in November 2015. The Company's Fixed Assets Account for the financial year 2015-16 shows a credit balance as under:



Particulars	Rs
Machine (Original Cost)	20,00,000
Less: Accumulated Depreciation	12,00,000

(from 2012-13- to 2014-15 on Straight Line Method)	
	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 2015-16?

Q.AS12.RMP.09: (EXAM July'21)

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

- (i) Rs. 120 Lacs received as Subsidy from the Central Government for setting up an Industrial undertaking in Medak, a notified backward area.
- (ii) Rs. 15 Lacs Grant received from the Central Government on installation of Effluent Treatment Plant.
- (iii) Rs. 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".

Q.AS12.RMP.10: (Exam May'23)

On 1st April 2021, Eleanor Limited purchased a manufacturing Plant for Rs. 60 lakhs, which has an estimated useful life of 10 years with a salvage value of Rs. 10 lakhs. On purchase of the Plant, a grant of Rs. 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 Rs. 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.)

Q.AS12.SM.11

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

Q.AS12.RMP.12: (RTP May'21)

Hygiene Ltd. had received a grant of Rs. 50 lakhs 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.

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?

Q.AS12.RMP.13: (EXAM May'22)

Suraj Limited provides you the following information:

- (i) It received a Government Grant @ 40% towards the acquisition of Machinery worth Rs. 25 crores.
- (ii) It received a Capital Subsidy of Rs. 150 lakhs from Government for setting up a plant costing Rs. 300 lakhs in a notified backward region.
- (iii) It received Rs. 50 lakhs from Government for setting up a project for supply of arsenic free water in a notified area.
- (iv) It received Rs. 5 lakhs from a Local Authority for providing Corona Vaccine free of charge to its employees and their families.
- (v) It also received a performance award of Rs. 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.

EXTRA PRACTICE QUESTIONS**Q.AS12.SM.14**

Z Ltd. purchased a fixed asset for Rs. 50 lakhs, which has the estimated useful life of 5 years with the salvage value of Rs. 5,00,000. On purchase of the assets government granted it a grant for Rs. 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.

**Q.AS12.RMP.15: (RTP Nov'18) (Refund)**

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

income on that date was Rs. 10.50 lakhs and written down value of plant was Rs. 66.50 lakhs.

- (i) What should be the treatment of the refund of the grant and the effect on cost of plant and the amount of depreciation to be charged during the year 2017 -18 in profit and loss account?
- (ii) What should be the treatment of the refund, if grant was deducted from the cost of the plant during 2014-15 assuming plant account showed the balance of Rs 56 lakhs as on 1.4.2017?

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

Q.AS12.RMP.16: (EXAM Jan21)

Darshan Ltd. purchased a Machinery on 1st April 2016 for Rs. 130 Lakhs (useful life is 4 years). Government grant received is Rs. 40 Lakhs for the purchase of above Machinery. Salvage value as at the end of useful life is estimated at Rs. 60 Lakhs. Darshan Ltd decides to treat the grant as deferred income.

You are required to calculate the amount of depreciation and grant to be recognized in profit and loss a/c for the year ending 31st March 2017, 31st March 2018, 31st March 2019 & 31st March 2020.

Darshan Ltd. follows straight line method for charging depreciation.

Q.AS12.RMP.17: (RTP Sep'24)

Energy Ltd. has acquired a generator on 1.4.2023 for ₹ 100 lakh. On 2.4.2023, it applied to Indian Renewal 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?

SOLUTIONS OF ABOVE QUESTIONS

Solution: Q1

Case 1:

Bank A/c	Dr.	90,00,000
To Deferred Income A/c		90,00,000
Salary Expense A/c	Dr.	30,00,000
To Bank A/c		30,00,000
Deferred Income A/c	Dr.	18,00,000
To Income A/c (Other Incomes)		18,00,000

Note: The Grant shall be spread on straight line basis over a period of 5 Years.

Case 2:

Bank A/c	Dr.	90,00,000
To Deferred Income A/c		90,00,000
Salary Expense A/c	Dr.	30,00,000

To Bank A/c		30,00,000
Deferred Income A/c	Dr.	18,00,000
To Salary Expense A/c		18,00,000

SOLUTION Q2

- (i) Rs. 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, Rs. 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 Rs 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 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, 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.

SOLUTION Q3

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.

SOLUTION Q4

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.

Solution: Q5

As per AS 12, the govt. grant is refundable the un-amortised balance in deferred grant account shall be reversed first and remaining amount in excess of deferred grant shall be transferred to profit and loss account as under:

Deferred Grant A/c	Dr.	36 Lacs
Profit and Loss A/c	Dr.	54 Lacs
To Bank A/c		90 Lacs

Workings:

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

SOLUTION Q6**Journal Entries**

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

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

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

2. Depreciation for Year 2

	Rs in lakhs
Cost of the Asset	20
Less: Government grant received	(8)
	12
Less: Depreciation for the first year $\frac{12-4}{4}$	<u>2</u>

	10
Add: Government grant refundable	<u>5</u>
	<u>15</u>
Depreciation for the second year $\frac{15-4}{3}$	3.67

SOLUTION Q7**IN THE BOOKS OF A LTD.****Journal Entries (at the time of refund of grant)****(1) If the grant is credited to Fixed Assets Account:**

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

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

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

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

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

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

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

Working Notes:

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

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

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

Value of fixed assets after two years but before refund of grant = Rs 24 lakhs - $(Rs 4 \text{ lakhs} \times 2 \text{ years}) = Rs 16 \text{ lakhs}$

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

Fixed assets initially recorded in the books = Rs 40 lakhs

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

Book value of fixed assets after two years = Rs 40 lakhs - $(Rs 8 \text{ lakhs} \times 2 \text{ years}) = Rs 24 \text{ lakhs}$

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

SOLUTION Q8

From the above account, it is inferred that the Company follows Reduction Method for accounting of Government Grants. Accordingly, out of the Rs. 16,00,000 that has been received, Rs. 8,00,000 (being the balance in Machinery A/c) should be credited to the machinery A/c. The balance Rs. 8,00,000 may be credited to P&L A/c, since already the cost of the asset to the tune of Rs. 12,00,000 had been debited to P&L A/c in the earlier years by way of depreciation charge, and Rs. 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 2015-16 or 2016-17 as the depreciable amount is now Nil.

SOLUTION Q9

(i) 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 Rs. 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)

(ii) As per AS 12 'Accounting for Government Grants', two methods of presentation in financial statements of grants related to specific fixed assets are regarded as acceptable alternatives –

(a) 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.

(b) 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, Rs. 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.

(iii) Rs. 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 credit in the profit and loss statement, either separately or under a general heading such as "Other Income". Alternatively, Rs. 25 lacs may be deducted in reporting the related expense i.e., employee benefit expense.

SOLUTION Q10**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 Rs. 3,00,000 p.a. $(Rs. 60,00,000 - Rs. 10,00,000 - Rs. 20,00,000) / 10$ year.
- (ii) If the grant is treated as deferred income, then amount of depreciation will be Rs. 5,00,000 p.a. $(Rs. 60,00,000 - Rs. 10,00,000) / 10$ 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 Rs. 4 lakh then the amount of depreciation will be Rs. 3,00,000 p.a. $(Rs. 60,00,000 - Rs. 10,00,000 - Rs. 20,00,000) / 10$ year for year 2021-22 and for the year 2022-23 Depreciation will be Rs. 3,00,000 calculated as follows, $(Rs. 60,00,000 - Rs. 10,00,000 - Rs. 20,00,000 - Rs. 3,00,000) / 10$ 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 Rs. 3,44,444 calculated as follows, $(Rs. 60,00,000 - Rs. 10,00,000 - Rs. 20,00,000 + 4,00,000 - Rs. 3,00,000) / 9$ years

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

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 Value	10,00,000
Less: Grant	20,00,000
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

Answer: Q11

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.

SOLUTION Q12

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.

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 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.

SOLUTION Q13

- 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 Rs. 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 Rs. 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.
- In the given case, the grant amounting Rs. 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 Rs. 150 lakhs should be credited to capital reserve and the plant will be shown at Rs. 300 lakhs.
- Rs. 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 Rs. 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.
- Rs. 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, Rs. 5 lakhs may be deducted in reporting the related expense i.e., employee benefit expenses.
- Rs. 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.

Solution Q14

Journal in the books of Z Ltd.

Year	Particulars	Rs. (Dr.)	Rs. (Cr.)
1st	Fixed Assets Account To Bank Account (Being fixed assets purchased)	Dr.	50,00,000
	Bank Account	Dr.	10,00,000

2nd	To Deferred Government Grant Account (Being grant received from the government)		10,00,000
	Depreciation Account To Fixed Assets Account (Being depreciation charged on SLM)	Dr. 9,00,000	9,00,000
	Profit & Loss Account To Depreciation Account (Being depreciation transferred to P/L Account)	Dr. 9,00,000	9,00,000
	Deferred Government Grants Account To Profit & Loss Account (Being proportionate government grant taken to P/L Account)	Dr. 2,00,000	2,00,000
	Depreciation Account To Fixed Assets Account (Being depreciation charged on SLM)	Dr. 9,00,000	9,00,000
	Profit & Loss Account To Depreciation Account (Being depreciation transferred to P/L Account)	Dr. 9,00,000	9,00,000
	Deferred Government Grant Account To Profit & Loss Account (Being proportionate government grant taken to P/L Account)	Dr. 2,00,000	2,00,000

SOLUTION Q15

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

- (i) In this case the grant refunded is Rs 15 lakhs and balance in deferred income is Rs10.50 lakhs, Rs4.50 lakhs shall be charged to the profit and loss account for the year 2017-18. There will be no effect on the cost of the fixed asset and depreciation charged will be on the same basis as charged in the earlier years.
- (ii) If the grant was deducted from the cost of the plant in the year 2014-15 then, para21 of AS 12 states that the amount refundable in respect of grant which relates to specific fixed assets should be recorded by increasing the book value of the assets, by the amount refundable. Where the book value of the asset is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset. Therefore, in this case, the book value of the plant shall be increased by Rs 15 lakhs. The increased cost of Rs 15 lakhs of the plant should be amortized over 7 years (residual life). Depreciation charged during the year 2017-18 shall be $(56+15)/7 \text{ years} = \text{Rs } 10.14 \text{ lakhs}$ presuming the depreciation is charged on SLM.

SOLUTION Q16

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 and grant to be recognized in the profit and loss account each year

Depreciation per year:

	Rs. in lakhs
Cost of the Asset	130
Less: Salvage value	(60)
	<u>70</u>
Depreciation per year (70lakhs/4)	17.50

Rs. 17.50 Lakhs depreciation will be recognized for the year ending 31st March, 2017, 31st March, 2018, 31st March, 2019 and 31st March, 2020.

Amount of grant recognized in Profit and Loss account each year: $40 \text{ lakhs} / 4 \text{ years} = \text{Rs. } 10 \text{ Lakhs}$ for the year ending 31st March, 2017, 31st March, 2018, 31st March, 2019 and 31st March, 2020.

SOLUTION Q17

(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.

(iii) 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.



Student Notes:-