ACCOUNTING STANDARD – 12

QUESTION 1: ABC Ltd. received an area of Land, free of cost, from the Government. This amount is not recorded at all. The Company argues that - (a) No money has been spent by the Company on its acquisition, and (b) Land is not a depreciable asset. Comment.

SOLUTION:

1. **Principle:** Non-Monetary Grants/Assets received free of cost, are recorded at a Nominal Value for the purposes of identification and control). Whether it is depreciable or non-depreciable is not relevant in this regard.
2. **Conclusion:** As per AS-12, the above Land should be recorded at a Nominal Value, for identification and control purposes. Hence, the Company's stand is not in accordance with AS-12.

QUESTION 2: ABC Ltd. purchased a Machinery for ₹1.00 Crore. The State Government granted the company a subsidy of ₹40 Lakhs to meet partial cost of Machinery. The Company credited the subsidy received from the State Government to its Profit and Loss Account for the year ended 31st March. Comment on the above.

SOLUTION:

1. **Principle:** Where a Government Grant is received towards a specific depreciable Fixed Asset, it should be accounted for either under Cost Reduction Method or Deferred Income Method.
2. **Conclusion:** The accounting treatment of the Company, i.e., crediting P&L A/c. is incorrect.

QUESTION 3: XYZ Ltd. acquired the Fixed Asset of ₹100 Lakhs on which it received a Grant of ₹10 Lakhs. What will be the cost of the Fixed Assets as per AS-12 and how it will be disclosed in the Financial Statements?

SOLUTION: Principle: Where a Government Grant is received towards a specific depreciable Fixed Assets, it should be accounted for either under Cost Reduction Method or Deferred Income Method. The accounting will be as under:

1. **Asset Reduction Method:** Cost ₹ 100 Lakhs Less Grant ₹ 10 Lakhs = ₹ 90 Lakhs will be the Carrying Amount, and written off over its useful life.
2. **Deferred Income Method:** ₹ 10 Lakhs in Deferred Income Account shall be shown in Balance Sheet separately under an appropriate head. A portion of this ₹ 10 Lakhs will be credited to P&L A/c. every year, over the useful life of the asset.

QUESTION 4: PQR Ltd. purchased a special machinery on 1st April of a financial year, for ₹25 Lakhs. It received a Government Grant for 20% of the Price. The machine has an effective life of 10 years Advise the Company of the accounting treatment(s)

SOLUTION 4: Under AS-12, where the Grant relates to a specific depreciable Fixed Asset, the Company can follow any of the following accounting methods, as illustrated below:-

Particulars	Cost Reduction Method	Deferred Income Method
1. Original Cost of Machinery	₹ 25 Lakhs	₹ 25 Lakhs
2. Scarp Value of Asset	Nil	Nil
3. Specific Grant Received	₹ 5 Lakhs (reduced from cost)	₹ 5 Lakhs (treated as Deferred Income)

4. Depreciable Value (1)-(2)-(3)	₹ 20 Lakhs	₹ 25 Lakhs
5. Useful Life of Machinery	10 Years	10 Years
6. Depreciation provided p.a. (4) / (5)	₹ 2 Lakhs	₹ 2.5 Lakhs
7. Other Income credited to P&L A/c. every year	Not applicable	(3) ÷ (5) ₹ 0.5 Lakhs

Note: The balance in the Deferred Income Account shall be shown in the Balance Sheet separately as 'Deferred Government Grants' under an appropriate head

QUESTION 5: CARS Ltd, purchased a Fixed Asset for ₹75 Lakhs, which has an estimated useful life of 5 years, with the Salvage Value of ₹7,50,000. On Purchase of the asset, the Government have the Company a grant of ₹15 Lakhs. Pass the necessary journal entries in the books of the Company for the first two years

SOLUTION 5: Journal Entries under Asset Cost Reduction Method

Year	Particulars		Dr.	Cr.
1	Machinery A/C.	Dr.	75	
	To Bank A/C.			75
	(Being Machinery Purchased)			
	Bank A/c.	Dr.	15	
	To Machinery A/c.			15
	(Being Government Grant received and credited to Fixed Asset A/c.)			
	Depreciation A/c. (Cost 75 – Grant 15 – Salvage Value 7.5)/5 Years	Dr.	10.5	
	To Machinery A/c.			10.5
	(Being Depreciation Charged on Straight Line Method on Cost net of Grant & SV)			
	Profit & Loss A/C.	Dr.	10.5	
	To Depreciation A/C.			10.5
	(Being Depreciation transferred to P&L A/c.)			
2	Depreciation A/c.	Dr.	10.5	
	To Machinery A/c.			10.5
	(Being Depreciation charged on Straight line method)			
	Profit & Loss A/C.	Dr.	10.5	
	To Depreciation A/c.			10.5
	(Being Depreciation transferred to P&L A/C.)			

Journal Entries under Deferred Income Method

Year	Particulars		Dr.	Cr.

1	Machinery A/c. To Bank A/C. (Being Machinery Purchased)	Dr.	75	75
	Bank A/c. To Deferred Income (Being Government Grant received as Deferred Income)	Dr.	15	15
	Government Grants Deferred Income A/c. (15 Lakhs ÷ 5 years) To Profit & Loss A/c. (Being Grant Portion for this year, considered as Income in P&L A/c)		3	3
	Depreciation A/c. (Cost 75 - Salvage Value 7.5) ÷ 5 Years To Machinery A/C. (Being Depreciation Charged on Straight Line Method on Cost net of Grant & SV)		13.5	13.5
	Profit & Loss A/C. To Depreciation A/C. (Being Depreciation transferred to P&L A/c.)	Dr.	13.5	13.5
2	Government Grants Deferred Income A/c. (15 Lakhs = 5 Years) To Profit & Loss A/C. (Being Grant portion for this year, considered as Income in P&L A/c)		3	3
	Depreciation A/C. To Machinery A/c. (Being Depreciation charged on Straight line method)	Dr.	13.5	13.5
	Profit & Loss A/C. To Depreciation A/c. (Being Depreciation transferred to P&L A/c.)	Dr.	13.5	13.5

QUESTION 6: Bhava Limited purchased a Machinery for ₹25,00,000 which has an Estimated Useful Life of 10 years and a Salvage Value of ₹5,00,000. On Purchase of the Assets, the Central Government pays a Grant for ₹5,00,000. Pass the Journal Entries with narrations in the books of the Company for the first year, treating Grant as Deferred income.

SOLUTION 6: Journal Entries under Deferred Income Method (₹ in Lakhs)

Year	Particulars		Dr.	Cr.
1	Machinery A/c. To Bank A/C.	Dr.	25	25

	(Being Machinery Purchased)			
2	Bank A/C. To Government Grants Deferred Income A/C. (Being Government Grant received and retained as Deferred Income)	Dr.	5	5
3	Government Grants Deferred Income A/c. (5 Lakhs - 10 years) To Profit & Loss A/C. (Being Grant Portion for this year, considered as Income in P&L A/c.)	Dr	0.5	0.5
4	Depreciation A/c. (Cost 25 (-) Salvage Value 5) / 10 Years To Machinery A/C. (Being Depreciation Charged on Straight Line Method on Cost net of Grant & Salvage value)	Dr.	2	2
5	Profit & Loss A/C. To Depreciation A/C. (Being Depreciation transferred to P&L A/C.)	Dr.	2	2

QUESTION 7: Santosh Ltd. has received a Grant of ₹& Crones 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 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 7: 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.

QUESTION 8: Supriya Ltd. received a grant of ₹2,500 Lakhs from the Government during the last accounting year for welfare activities to be carried on by the Company for its Employees. The Grant prescribed conditions for its utilization. However, during the current year, it was found that the conditions of Grants were not complied with and the Grant had to be refunded to the Government in full. Explain the accounting treatment, under AS-12.

SOLUTION:

1. The above Grant is Revenue Grant, since it is for welfare activities for its Employees. Therefore, when received, it should have been credited to P&L Account.
2. Therefore, in the event of refund, the amount refunded should be debited to P&L account.
3. Such debt should be shown as an Extra-Ordinary item in the P&L Statement.

QUESTION 9: Three years ago, CARS Ltd. had received Subsidy of ₹25 Lakhs from Government by way of contribution towards its Total Capital Outlay. However, due to non-fulfilment of some specified conditions. ₹16 Lakhs was recovered by the Government during the current accounting year. Discuss the accounting treatment.

SOLUTION: Principle: Where a Grant, which is in the nature of Promoter's Contribution becomes refundable to the Government, in part or in full, due to non- fulfilment of some specified conditions, the relevant amount recoverable by the Government is reduced from the Capital Reserve.

Conclusion: In the above case, the amount of ₹ 16 Lakhs should be reduced from the Capital Reserve. The balance in the Capital Reserve will be ₹ 9 Lakhs.

QUESTION 10: JS Ltd. purchased a Machinery for ₹40 Lakhs (Useful Life 4 years and Residual value ₹8 Lakhs). Government Grant received is ₹16 Lakhs. Due to non- compliance of certain condition, the Grant become refundable in 3rd year to the extent of ₹12 Lakhs. Show the Journal Entry to be passed at the time of refund of Grant and the value of the Fixed Assets, if (a) the Grant is credited to Fixed Assets (b) the Grant is credited to Deferred Grant A/c

SOLUTION 10:

A. If Grant is credited to Fixed Assets (i.e., Assets Cost Reduction Method)

Particulars		Dr. (₹)	Cr. (₹)
Fixed Assets A/C.	Dr.	12,00,000	
To Bank A/C.			12,00,000
(Being Grant refunded to the Government on non- compliance of related conditions, and Cost of the Asset thereby increased) (See Note below)			

*Depreciation p.a. = Cost 40 Lakhs - Grant 16 Lakhs - Residual Value 8 Lakhs / 4 Years Useful Life = ₹ 4,00,000 p.a.

- WDV of Asset before the above Journal Entry = Cost ₹40,00,000 less Grant Credited at inception ₹ 16,00,000 less Depreciation of ₹ 4,00,000 for 2 years = ₹16,00,000
- Carrying Book Value of Asset after above Journal Entry = ₹16,00,000 + ₹12,00,000 = ₹ 28,00 000

B. If Grant is credited to Deferred Grant A/c. (i.e., Deferred Income Method)

Particulars		Dr. (₹)	Cr. (₹)
Deferred Government Grant A/c.	Dr.	8,00,000	
Profit and Loss A/C.	Dr.	4,00,000	
To Bank A/C.			12,00,000
(Being Grant refunded to Government, and excess provided from P&L A/c)			

- Depreciation p.a. under Deferred Income Method = Cost 40 Lakhs - Residual Value 8 Lakhs / 4 Years Useful Life = ₹ 8,00,000 p.a.
- WDV of Asset at beginning of year 3 = Cost ₹40,00,000 less Depreciation of ₹ 8,00,000 for 2 years = ₹24,00,000

- Balance of Deferred Grant at the end of 2 years ₹16,00,000 - (₹4,00,000 x 2 years) = ₹ 8,00,000
- There will not be any change in the Carrying Amount of the Asset.

QUESTION 11: Srilanka Ltd. received a specific grant of ₹30 Lakhs for acquiring the Plant of ₹150 Lakhs during 2010-11 having useful life of 10 years The Grant received was credited to Deferred Income in the Balance Sheet. During 2013- 14, 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.

SOLUTION 11: If Grant is credited to Deferred Grant A/c. (i.e. Deferred Income Method)

Particulars		Dr. (₹)	Cr. (₹)
Deferred Government Grant A/C. (given)	Dr.	21,00,000	
Profit and Loss A/c. (balancing figure)	Dr.	9,00,000	
To Bank A/c.			30,00,000
(Being Grant refunded to Government, and excess provided from P&L a/c)			

Note: There will not be any change in the carrying Amount of the Asset. Depreciation will be charged on the same basis as charged in the earlier years.

QUESTION 12: Cowboy Ltd. applied for a Government Grant for purchase of a special machinery. The machinery costs ₹80 Lakhs and the Grant was ₹30 Lakhs. The Machinery has a useful life of 10 years and the Company follows SLM for Depreciation. The Grant was promptly received but certain conditions regarding production were attached to it. Four years later, an amount of ₹4 Lakhs become refundable to the Government since the Company did not adhere to the conditions imposed earlier. Explain the accounting treatment.

SOLUTION 12: 1. Where Asset Cost Reduction Method is followed:

(a) Original cost of the Machinery	₹ 80 Lakhs
(b) Government Grant reduced from cost	₹ 30 Lakhs
(c) Depreciable Amount of Machinery (a-b)	₹ 50 Lakhs
(d) Useful Life	10 Years
(e) Depreciation per annum (c ÷ d)	₹ 5 Lakhs
(f) Accumulated Depreciation for four years	₹ 20 Lakhs (₹ 5 Lakhs × 4 years)
(g) Book Value of the asset in fourth year	₹30 Lakhs (₹ 50 Lakhs - ₹20 Lakhs)
(h) Add back: Amount of Refundable Grant	₹ 4 Lakhs
(i) Revised Book Value of Machinery (g + h)	₹ 34 Lakhs
(j) Balance Useful Life	10 – 4 = 6 years
(k) Depreciation to be provided for next 6 years	34 ÷ 6 = ₹ 5.67 Lakhs per annum

2. Where Deferred Income Method is followed:

(a) Original cost of the Machinery	₹ 80 Lakhs

(b) Useful Life	10 Years
(c) Depreciation per annum	₹8 Lakhs
(d) Government Grant treated as Deferred income	₹ 30 Lakhs
(e) Amount allocated/credited to P&L A/c. every year	₹ 3 Lakhs (₹ 30 Lakhs 10 ÷ years)
(f) Total Amount credited to P&L for our years	₹ 12 Lakhs
(g) Balance in Deferred Income Account for 4th year	₹18 Lakhs (₹ 30 Lakhs - ₹12 Lakhs)
(h) Less: Grant Refundable - now adjusted	₹ 4 Lakhs
(i) Revised Balance in Deferred Income Account	₹ 14 Lakhs
(j) Amount to be credited to P&L for next 6 years	₹ 2.33 Lakhs (₹ 14 Lakhs 6 ÷ years)

QUESTION 13: 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 Assumed SLM Depreciation Asset is shown net of Grant. After 1 years, Grant becomes refundable to the extent of ₹5 Lakhs due to non- compliance with conditions. Pass Journal Entries.

SOLUTION 13:

Year	Particulars		Dr.	Cr.
1	Fixed Assets A/C.	Dr.	20,00,000	
	To Bank A/C.			20,00,000
	(Being Purchased of Fixed Asset for ₹20,00,000			
2	Bank A/c.	Dr.	8,00,000	
	To Fixed Asset A/C.			8,00,000
	(Being Grant recorded as reduction from Cost of asset)			
3	Depreciation A/c.	Dr.	2,00,000	
	To Fixed Asset A/C.			2,00,000
	(Being Depreciation for year of acquisition, under SLM before Grant Refund) (Note 1)			
4	Fixed Assets A/C.	Dr.	5,00,000	
	To Bank A/C.			5,00,000
	(Being grant refunded to Government on non- compliance of related conditions and cost of the asset thereby increased).			
5	Depreciation A/c.	Dr	3,66,667	
	To Fixed Assets A/C.			3,66,667
	(Being depreciation charged on Fixed Asset under SLM after Grant Refund (Note 2)			

Note:

1. Depreciation (before Grant Refund) = Cost 20,00,000 (-) Grant 8,00,000 - Residual Value 4,00,000/ 4 Years Useful Life = ₹ 2,00,000
2. Depreciation (after Grant Refund) = WDV 10,00,000 (+) Grant 5,00,000 - Residual Value 4,00,000/ Balance Useful Life 3 Years = ₹ 3,66,667

QUESTION 14: Titu Ltd. acquired a Fixed Asset for ₹50,00,000. The estimated useful life of the asset is 5 years The salvage value after useful life was estimated at ₹5,00,000. The State Government gave a grant of ₹10,00,000 to encourage the asset acquisition. At the end of the second year, the subsidy of the State Government became refundable. What is the Fixed Asset value after refund of Grant/Subsidy to the State Government but before mortising the asset value at the end of the second year?

SOLUTION 14:

Particulars	₹
Original Cost of Fixed Assets	50,00,000
Less: State Government Grant received	(10,00,000)
	40,00,000
Less: Amount to be written off in the first year (40,00,000 - 5,00,000) / 5 years	(7,00,000)
Add: Refund of State Government Grant.	10,00,000
Value of Fixed Assets, at the end of the 2nd year, after refund but before depreciation	43,00,000

QUESTION 15: On 1st April 2010, Sundaram Ltd. received a 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 2013 due to non-fulfilment of certain conditions. How you would deal with the refund of Grant?

SOLUTION 15:

Particulars	₹
Original Cost of the Machinery	1,500
Less: Government Grant (Reduced from Cost)	(300)
Depreciable Cost as on 1.4.2009	1,200
Less: Depreciation for 2010-11 (₹1,200 x 20%)	(240)
WDV on 1.4.2011	960
Less: Depreciation for 2011-12 (₹ 960 x 20%)	(192)
WDV on 1.4.2012	768
Less: Depreciation for 2012-13 (₹ 768 × 20%)	(154)
WDV on 1.4.2013	614
Add: Refundable Government Grant	300

Revised Book Value of Machinery	914

QUESTION 16: A Steel Manufacturing Company has a turnover of ₹, 45 Crores and Net Tax Profit of ₹6 Crores. The company's financial year ends on 31st March. The Company's policy is to treat Grants received in respect of Fixed Assets as Deferred income and to deduct all Grants identified as relating to specific revenue expenditure against that expenditure. All other Grants recognized are credited to P&L Account. Answer the following questions:

A. During the year the Company received a Grant from the Defence Department of Government of India for ₹3,00,000 towards the cost of new equipment. The equipment has an estimated useful economic life of 10 years and cost ₹7,00,000. The Company policy is to depreciate all depreciable Fixed Assets by the Straight-Line Method.

B. During the year, the Company spent ₹70,000 on training in respect of which it is due to receive Government Grant of 50%.

C. In October, a Grant of ₹40,000 was received from the Government in recognition of the high quality that the Company's production had maintained over the five years, which had ended on 31st March, the previous accounting year.

SOLUTION 16: Situation A: The Government Grant has been received relating to specific Fixed Assets. There are two methods for dealing with the Grant in the books:

Particulars	Asset Cost Reduction Method	Deferred Income Method
1. Original Cost of Equipment	₹7,00,000	₹7,00,000
2. Specific Grant Received	₹ 3,00,000 (reduced from Cost)	₹3,00,000
3. Depreciable Value (1)-(2)	₹ 4,00,000	₹7,00,000
4. Useful Life of Machinery	10 Years	10 Years
5. Depreciation Provided p.a. (3)- (4)	₹ 40,000	₹ 70,000
6. Other Income credited to P&L A/c. every year	Not Applicable	(2) / (4) ₹30,000

Note: The balance in the Deferred Income Account shall be shown in the Balance Sheet separately with a description, as 'Deferred Government Grants' under the appropriate head.

Situation B: The Government Grant to be received can be shown either as income or as deduction from Training Expenses. As the Grant has not been received till the year end, it has to be shown as Receivable.

Situation C: This is not a Grant related to specific Fixed Asset or for conditions to be complied in future. This Grant should be credited to P&L Account in the year of receipt only.

QUESTION 17: 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 Crones from the Government in

February 2014. The Company wants to recognize the said Subsidy as of the Company in accordance with the Accounting Standards?

SOLUTION 17:

1. The Government Grants may be in the nature of Promoters' Contribution, i.e. (a) they are given with reference to the Total Investment in an undertaking, or (b) by way of contribution towards its total Capital Outlay, (e.g. Central Investment Subsidy Scheme).
2. They cannot be shown as income in the Profit and Loss Account. Such Grants are not ordinarily expected to be repaid. Hence, they are treated as Capital Reserve, and as part of Shareholders' Funds which cannot be distributed as dividend or considered as Deferred Income.
3. Only Grants which are not revenue in nature can be capitalised. The correct treatment is to credit the Subsidy to Capital Reserve.

QUESTION 18: A Ltd. has set up its business in a designated backward area with an investment of ₹200 Lakhs. The Company is eligible for 25% subsidy and has received ₹50 Lakhs from the Government. Explain the treatment of the Capital Subsidy received from the Government in the books of the Company.

SOLUTION 18:

1. The Government Grants may be in the nature of Promoters' Contribution i.e., (a) they are given with reference to the Total Investment in an undertaking, or (b) by way of contribution towards its Total Capital Outlay, (e.g. Central Investment Subsidy Scheme).
2. Such Grants are not ordinarily expected to be repaid. Hence, they are treated as Capital Reserve, and as part of Shareholders' Funds which cannot be distributed as dividend or considered as Deferred Income.
3. Subsidy received in this case, is not in relation to specific Fixed Assets or in relation to revenue, Hence, it should not be treated as Deferred Income or as an Item of Revenue. The correct treatment is to credit the Subsidy to capital Reserve.

QUESTION 19: **(CA INTER NOV 2020)** On 1st April, 2016, Mac Ltd. received a Government Grant of 260 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 19:

		(₹in lakhs)
1st April, 2016	Acquisition cost of machinery	300
	Less: Government Grant	60
		240

31st March, 2017	Less: Depreciation @ 10%	(24)
1st April, 2017	Book value	216
31st March, 2018	Less: Depreciation @ 10%	(21.6)
1st April, 2018	Book value	194.4
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
1st June, 19	Add: Refund of grant*	60
	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 a/c amounting to ₹(2.916 + 19.337= 22.253)			

QUESTION 20: (CA INTER JAN 21)

Darshan Ltd. purchased a Machinery on 1st April, 2016 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. You are required to calculate the amount of depreciation and grant to be recognised in profit & loss account 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.

SOLUTION 20: 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:

	₹in lakhs
Cost of the Asset	130
Less: Salvage value	(60)
	70
Depreciation per year (70lakhs/4)	17.5

₹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 lakhs /4 years = ₹10 Lakhs for the year ending 31st March, 2017, 31st March, 2018, 31st March, 2019 and 31st March, 2020.

QUESTION 21: **(CA INTER JULY 21)** Alps Limited has received the following Grants from the Government during the year ended 31st March, 2021:

1) ₹120 Lacs received as Subsidy from the Central Government for setting up an Industrial undertaking in Medak, a notified backward area.
2) ₹15 Lacs Grant received from the Central Government on installation of Effluent Treatment Plant.
3) ₹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 21:

1. 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 in the nature of promoter's contribution)
2. 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, ₹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.

3. ₹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, ₹25 lacs may be deducted in reporting the related expense i.e., employee benefit expense.

QUESTION 22: 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:

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

SOLUTION: (1)

Year	Particulars		Dr.	Cr.
	Bank a/c	Dr.	90,00,000	
	To Deferred Income a/c			90,00,000
	Salary expenses a/c	Dr.	30,00,000	
	To Bank a/c			30,00,000
	Deferred Income a/c	Dr.	18,00,000	
	To other income a/c			18,00,000

(2)

Year	Particulars		Dr.	Cr.
	Bank a/c	Dr.	90,00,000	
	To Deferred Income a/c			90,00,000
	Salary expense a/c	Dr.	12,00,000	
	To Bank a/c			12,00,000
	Deferred Income a/c	Dr.	18,00,000	
	To Salary Expense a/c			18,00,000

QUESTION 23: 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.

QUESTION 24: 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

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.

QUESTION 25: 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)