Accounting Standard (AS) 12
(issued 1991)

Accounting for Government Grants

Contents

INTRODUCTION	**Paragraphs 1-3**
Definitions	3
EXPLANATION	**4-12**
Accounting Treatment of Government Grants	5-11
Capital Approach versus Income Approach	5
Recognition of Government Grants	6
Non-monetary Government Grants	7
Presentation of Grants Related to Specific Fixed Assets	8
Presentation of Grants Related to Revenue	9
Presentation of Grants of the nature of Promoters' contribution	10
Refund of Government Grants	11
Disclosure	12
ACCOUNTING STANDARD	**13-23**
Disclosure	23

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(This Accounting Standard includes paragraphs 13-23 set in ***bold italic*** *type and paragraphs 1-12 set in plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of the Preface to the Statements of Accounting Standards[1].)*

The following is the text of the Accounting Standard (AS) 12 issued by the Council of the Institute of Chartered Accountants of India on 'Accounting for Government Grants'.

The Standard comes into effect in respect of accounting periods commencing on or after 1.4.1992 and will be recommendatory in nature for an initial period of two years. Accordingly, the Guidance Note on 'Accounting for Capital Based Grants' issued by the Institute in 1981 shall stand withdrawn from this date. This Standard will become mandatory in respect of accounts for periods commencing on or after 1.4.1994.[2]

Introduction

1. This Statement deals with accounting for government grants. Government grants are sometimes called by other names such as subsidies, cash incentives, duty drawbacks, etc.

2. This Statement does not deal with:

   (i) the special problems arising in accounting for government grants in financial statements reflecting the effects of changing prices

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[1] Attention is specifically drawn to paragraph 4.3 of the Preface, according to which Accounting Standards are intended to apply only to items which are material.

[2] Reference may be made to the section titled 'Announcements of the Council regarding status of various documents issued by the Institute of Chartered Accountants of India' appearing at the beginning of this Compendium for a detailed discussion on the implications of the mandatory status of an accounting standard.

or in supplementary information of a similar nature;

(ii) government assistance other than in the form of government grants;

(iii) government participation in the ownership of the enterprise.

Definitions

3. The following terms are used in this Statement with the meanings specified:

3.1 *Government* refers to government, government agencies and similar bodies whether local, national or international.

3.2 *Government grants* are assistance by government in cash or kind to an enterprise for past or future compliance with certain conditions. They exclude those forms of government assistance which cannot reasonably have a value placed upon them and transactions with government which cannot be distinguished from the normal trading transactions of the enterprise.

Explanation

4. The receipt of government grants by an enterprise is significant for preparation of the financial statements for two reasons. Firstly, if a government grant has been received, an appropriate method of accounting therefor is necessary. Secondly, it is desirable to give an indication of the extent to which the enterprise has benefited from such grant during the reporting period. This facilitates comparison of an enterprise's financial statements with those
of prior periods and with those of other enterprises.

Accounting Treatment of Government Grants

5. Capital Approach versus Income Approach

5.1 Two broad approaches may be followed for the accounting treatment of government grants: the 'capital approach', under which a grant is treated as part of shareholders' funds, and the 'income approach', under which a grant is taken to income over one or more periods.

5.2 Those in support of the 'capital approach' argue as follows:

(i) Many government grants are in the nature of promoters' contribution, i.e., they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay and no repayment is ordinarily expected in the case of such grants. These should, therefore, be credited directly to shareholders' funds.

(ii) 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.

5.3 Arguments in support of the 'income approach' are as follows:

(i) Government grants are rarely gratuitous. The enterprise earns them through compliance with their conditions and meeting the envisaged obligations. They should therefore be taken to income and matched with the associated costs which the grant is intended to compensate.

(ii) As income tax and other taxes are charges against income, it is logical to deal also with government grants, which are an extension of fiscal policies, in the profit and loss statement.

(iii) In case grants are credited to shareholders' funds, no correlation is done between the accounting treatment of the grant and the accounting treatment of the expenditure to which the grant relates.

5.4 It is generally considered appropriate that accounting for government grant should be based on the nature of the relevant grant. Grants which have the characteristics similar to those of promoters' contribution should be treated as part of shareholders' funds. Income approach may be more appropriate in the case of other grants.

5.5 It is fundamental to the 'income approach' that government grants be recognised in the profit and loss statement on a systematic and rational basis over the periods necessary to match them with the related costs. Income recognition of government grants on a receipts basis is not in accordance with the accrual accounting assumption (see Accounting Standard (AS) 1, Disclosure of Accounting Policies).

5.6 In most cases, the periods over which an enterprise recognises the costs or expenses related to a government grant are readily ascertainable and thus grants in recognition of specific expenses are taken to income in the same period as the relevant expenses.

6. Recognition of Government Grants

6.1 Government grants available to the enterprise are considered for inclusion in accounts:

(i) where there is reasonable assurance that the enterprise will comply with the conditions attached to them; and

(ii) where such benefits have been earned by the enterprise and it is reasonably certain that the ultimate collection will be made.

Mere receipt of a grant is not necessarily a conclusive evidence that conditions attaching to the grant have been or will be fulfilled.

6.2 An appropriate amount in respect of such earned benefits, estimated on a prudent basis, is credited to income for the year even though the actual amount of such benefits may be finally settled and received after the end of the relevant accounting period.

6.3 A contingency related to a government grant, arising after the grant has been recognised, is treated in accordance with Accounting Standard (AS) 4, Contingencies and Events Occurring After the Balance Sheet Date.[3]

6.4 In certain circumstances, a government grant is awarded for the purpose of giving immediate financial support to an enterprise rather than as an incentive to undertake specific expenditure. Such grants may be confined to an individual enterprise and may not be available to a whole class of enterprises. These circumstances may warrant taking the grant to income in

[3] Pursuant to AS 29, Provisions, Contingent Liabilities and Contingent Assets, becoming mandatory in respect of accounting periods commencing on or after 1-4-2004, all paragraphs of AS 4 that deal with contingencies stand withdrawn except to the extent they deal with impairment of assets not covered by other Indian Accounting Standards. Reference may be made to Announcement XX under the section titled 'Announcements of the Council regarding status of various documents issued by the Institute of Chartered Accountants of India' appearing at the beginning of this Compendium.

the period in which the enterprise qualifies to receive it, as an extraordinary item if appropriate (see Accounting Standard (AS) 5, Prior Period and Extraordinary Items and Changes in Accounting Policies[4]).

6.5 Government grants may become receivable by an enterprise as compensation for expenses or losses incurred in a previous accounting period. Such a grant is recognised in the income statement of the period in which it becomes receivable, as an extraordinary item if appropriate (see Accounting Standard (AS) 5, Prior Period and Extraordinary Items and Changes in Accounting Policies[4]).

7. Non-monetary Government Grants

7.1 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.

8. Presentation of Grants Related to Specific Fixed Assets

8.1 Grants related to specific fixed assets are government grants whose primary condition is that an enterprise qualifying for them should purchase, construct or otherwise acquire such assets. Other conditions may also be attached restricting the type or location of the assets or the periods during which they are to be acquired or held.

8.2 Two methods of presentation in financial statements of grants (or the appropriate portions of grants) related to specific fixed assets are regarded as acceptable alternatives.

8.3 Under one 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. 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.

8.4 Under the other method, grants related to depreciable assets are treated

[4] AS 5 has been revised in February 1997. The title of revised AS 5 is 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies'.

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. 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. However, if a grant related to a non-depreciable asset requires the fulfillment of certain obligations, the grant is credited to income over the same period over which the cost of meeting such obligations is charged to income. The deferred income is suitably disclosed in the balance sheet pending its apportionment to profit and loss account. For example, in the case of a company, it is shown after 'Reserves and Surplus' but before 'Secured Loans' with a suitable description, e.g., 'Deferred government grants'.

8.5 The purchase of assets and the receipt of related grants can cause major movements in the cash flow of an enterprise. For this reason and in order to show the gross investment in assets, such movements are often disclosed as separate items in the statement of changes in financial position regardless of whether or not the grant is deducted from the related asset for the purpose of balance sheet presentation.

9. Presentation of Grants Related to Revenue

9.1 Grants related to revenue are sometimes presented as a credit in the profit and loss statement, either separately or under a general heading such as 'Other Income'. Alternatively, they are deducted in reporting the related expense.

9.2 Supporters of the first method claim that it is inappropriate to net income and expense items and that separation of the grant from the expense facilitates comparison with other expenses not affected by a grant. For the second method, it is argued that the expense might well not have been incurred by the enterprise if the grant had not been available and presentation of the expense without offsetting the grant may therefore be misleading.

10. Presentation of Grants of the nature of Promoters' contribution

10.1 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.

11. Refund of Government Grants

11.1 Government grants sometimes become refundable because certain conditions are not fulfilled. A government grant that becomes refundable is treated as an extraordinary item (see Accounting Standard (AS) 5, Prior Period and Extraordinary Items and Changes in Accounting Policies[5]).

11.2 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.

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

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

12. Disclosure

12.1 The following disclosures are appropriate:

(i) the accounting policy adopted for government grants, including the methods of presentation in the financial statements;

(ii) the nature and extent of government grants recognised in the financial statements, including grants of non-monetary assets given at a concessional rate or free of cost.

[5] See footnote 4.

Accounting Standard

13. Government grants should not be recognised until there is reasonable assurance that (i) the enterprise will comply with the conditions attached to them, and (ii) the grants will be received.

14. Government grants related to specific fixed assets should be presented in the balance sheet by showing the grant as a deduction from the gross value of the assets concerned in arriving at their book value. Where the grant related to a specific fixed asset equals the whole, or virtually the whole, of the cost of the asset, the asset should be shown in the balance sheet at a nominal value. Alternatively, government grants related to depreciable fixed assets may be treated as deferred income which should be recognised in the profit and loss statement on a systematic and rational basis over the useful life of the asset, i.e., such grants should be allocated to income over the periods and in the proportions in which depreciation on those assets is charged. Grants related to non-depreciable assets should be credited to capital reserve under this method. However, if a grant related to a non-depreciable asset requires the fulfillment of certain obligations, the grant should be credited to income over the same period over which the cost of meeting such obligations is charged to income. The deferred income balance should be separately disclosed in the financial statements.

15. Government grants related to revenue should be recognised on a systematic basis in the profit and loss statement over the periods necessary to match them with the related costs which they are intended to compensate. Such grants should either be shown separately under 'other income' or deducted in reporting the related expense.

16. Government grants of the nature of promoters' contribution should be credited to capital reserve and treated as a part of shareholders' funds.

17. Government grants in the form of non-monetary assets, given at a concessional rate, should be accounted for on the basis of their acquisition cost. In case a non-monetary asset is given free of cost, it should be recorded at a nominal value.

18. Government grants that are receivable as compensation for expenses or losses incurred in a previous accounting period or for the

purpose of giving immediate financial support to the enterprise with no further related costs, should be recognised and disclosed in the profit and loss statement of the period in which they are receivable, as an extraordinary item if appropriate (see Accounting Standard (AS) 5, Prior Period and Extraordinary Items and Changes in Accounting Policies[6]).

19. A contingency related to a government grant, arising after the grant has been recognised, should be treated in accordance with Accounting Standard (AS) 4, Contingencies and Events Occurring After the Balance Sheet Date.[7]

20. Government grants that become refundable should be accounted for as an extraordinary item (see Accounting Standard (AS) 5, Prior Period and Extraordinary Items and Changes in Accounting Policies[8]).

21. The amount refundable in respect of a grant related to revenue should be 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 should be charged to profit and loss statement. The amount refundable in respect of a grant related to a specific fixed asset should be recorded by increasing the book value of the asset or by reducing the capital reserve or the deferred income balance, as appropriate, by the amount refundable. In the first alternative, i.e., where the book value of the asset is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset.

22. Government grants in the nature of promoters' contribution that become refundable should be reduced from the capital reserve.

Disclosure

23. The following should be disclosed:

(i) the accounting policy adopted for government grants,

[6] See footnote 4.
[7] See footnote 3.
[8] See footnote 4.

including the methods of presentation in the financial statements;

(ii) the nature and extent of government grants recognised in the financial statements, including grants of non-monetary assets given at a concessional rate or free of cost.