AS 12 Accounting for Government Grants

1. Introduction:-

To help discharge this duty, the government undertakes promotional activities, provides incentives and grants to businesses. The grants received from the government are in various forms such as subsidy, incentives, duty drawbacks among others.

AS 12 deals with grants given by government but does not covers:

i) The accounting for grants which reflect the effect of price changes

ii) Assistance by the government other than grants like tax exemption, etc

iii) Participation of government in organisation’s ownership

2. Meaning of Government Grant:-

The assistance was given by the government in cash or kind with certain specific conditions. These do not include such grants from the government which cannot be measured reasonably. Also, the transactions with the government which cannot be separately identified from normal trading of the organization are not considered as a grant.

For eg:- Receipt of cash on the sale of packaged drinking water to railways by ‘Bisleri’.

3. Methods of Accounting for Government Grants:-

There are two methods outlined by the AS to account for the government grants:

I. Capital approach

II. Income / Revenue approach

The method of accounting for any grant is always based on the nature of grant received. The grants are recognized only where a certainty exists for the fulfilment of conditions and ultimate collection of such grants.

3.I. Capital Approach

To state simply, these grants are treated as a part of capital or shareholder’s funds. These are such grants which are given as a proportion of total investment in a business.

Ordinarily, the government does not expect a repayment of such grants. Due to this reason, such grants are credited to the capital or shareholder’s funds.

These grants are divided primarily into three types:

A) Non-monetary grants

B) The proportion of capital in a business

C) For specific fixed assets

3.I.A. Accounting of grants as a Proportion of total capital in a business

The non-monetary grants are those which are given in form of resources such as land, building. These grants are usually given at a concessional rate or for free. These grants should be accounted for at the acquisition cost or nominal value (if given free of cost).

3.I.B. Accounting of grants as a Proportion of total capital in a business

Where grants are of such nature that they are treated as a proportion to total capital in a business, they are treated as Capital Reserves and shown as Capital Reserve in the Balance Sheet. This way the amount received will not have any effect on Income Statement or Fixed Assets carrying amount. This means that such amounts cannot be distributed as a dividend to shareholders. Also, they are not eligible to be considered as a deferred income.

3.I.C. Accounting of grants for Specific fixed assets

These are such grants which have a primary condition attached to them:

i. The organization receiving such grants must either Construct, Acquire or Purchase such specific fixed assets for which such grant is given.

ii. Other condition may also be imposed as the type of assets, location of assets, period of acquisition, etc.

Two methods are prescribed for recognition of grants in form of grants for specific fixed assets:

Method 1 – The amount of grant is reduced from the gross amount of the asset to calculate book value. This signifies that the grant is being recognized in profit and loss account as a reduced charge of depreciation over the life of such asset.

Method 2 – The grants are treated as a deferred income in the financial statements. This income is recognized gradually in the profit and loss account over the useful life of an asset or say in the proportion of depreciation on such asset.