INDAS – 20 – ACCOUNTING FOR GOVERNMENT GRANTS & DISCLOSURE OF GOVT. ASSISTANCE

(TOTAL NO. OF QUESTIONS – 8)

INDEX

RTPs QUESTIONS

Q1 (May 20 & MTP March 21 – 6 marks)

Rainbow Limited is carrying out various projects for which the company has either received government financial assistance or is in the process of receiving the same. The company has received two grants of Rs 1,00,000 each, relating to the following ongoing research and development projects:

(i) The first grant relates to the "Clean river project" which involves research into the effect of various chemical waste from the industrial area in Madhya Pradesh. However, no major steps have been completed by Rainbow limited to commence this research as at 31st march, 20X2.

(ii) The second grant relates to the commercial development of a new equipment that can be used to manufacture eco-friendly substitutes for existing plastic products. Rainbow Limited is confident about the technical feasibility and financial viability of this new technology which will be available for sale in the market by April 20X3.

(iii) In September 20X1, due to the floods near one of its factories, the entire production was lost and Rainbow Limited had to shut down the factory for a period of 3 months. The State Government announced a compensation package for all the manufacturing entities affected due to the floods. As per the scheme, Rainbow Limited is entitled to a compensation based on the average of previous three months' sales figures prior to the floods, for which the company is required to submit an application form on or before 30th June, 20X2 with necessary figures. The financial statements of Rainbow Limited are to be adopted on 31st May, 20X2, by which date the claim form would not have been filed with the State Government.

Suggest the accounting treatment of, if any, for the two grants received and the flood-related compensation in the books of accounts of Rainbow Limited as on 31st March, 20X2.

Solution

Accounting treatment for:

1. First Grant

The first grant for 'Clear River Project' involving research into effects of various chemical waste from the industrial area in Madhya Pradesh seems to be unconditional as no details regarding its refund has been mentioned. Even though the research has not been started nor any major steps have been completed by Rainbow Limited to commence the research, yet the grant will be recognized immediately in profit or loss for the year ended 31st March, 20X2.

***Alternatively,** in case, the grant is conditional as to expenditure on research, the grant will be recognized in the books of Rainbow Limited over the year the expenditure is being incurred.*

2. Second Grant

The second grant related to commercial development of new equipment is a grant related to depreciable assets. As per the information given in the question, the equipment will be available for sale in the market from April, 20X3. Hence, by that time, grant relates to the construction of an asset and should be initially recognized as deferred income.

The deferred income should be recognized as income on a systematic and rational basis over the asset's useful life.

The entity should recognise a liability on the balance sheet for the years ending 31st March, 20X2 and 31st March, 20X3. Once the equipment starts being used in the manufacturing process, the deferred grant income of Rs 100,000 should be recognised over the asset's useful life to compensate for depreciation costs.

***Alternatively**, as per Ind AS 20, Rainbow Limited would also be permitted to offset the deferred income of Rs 100,000 against the cost of the equipment as on 1st April, 20X3.*

3. For flood related compensation

Rainbow Limited will be able to submit an application form only after 31st May, 20X2 i.e. in the year 20X2-20X3. Although flood happened in September, 20X1 and loss was incurred due to flood related to the year 20X1-20X2, the entity should recognise the income from the government grant in the year when the application form related to it is submitted & approved by the government for compensation.

Since, in the year 20X1-20X2, the application form could not be submitted due to adoption of financials with respect to sales figure before flood occurred, Rainbow Limited should not recognise the grant income as it has not become receivable as on 31st March, 20X2.

Q2 (Nov 20)

Entity A is awarded a government grant of Rs.60,000 receivable over three years (Rs.40,000 in year 1 and Rs.10,000 in each of years 2 and 3), contingent on creating 10 new jobs and maintaining them for three years. The employees are recruited at a total cost of Rs.30,000, and the wage bill for the first year is Rs.1,00,000, rising by Rs.10,000 in each of the subsequent years. Calculate the grant income and deferred income to be accounted for in the books for year 1, 2 and 3.

Solution

The income of Rs. 60,000 should be recognised over the three year period to compensate for the related costs.

Calculation of Grant Income and Deferred Income:

Year	Labour Cost	Grant Income		Deferred Income	
	Rs.	Rs.		Rs.	
1	1,30,000	21,667	60,000 x (130/360)	18,333	(40,000 – 21,667)
2	1,10,000	18,333	60,000 x (110/360)	10,000	(50,000 – 21,667 –18,333)
3	1,20,000	20,000	60,000 x (120/360)	-	(60,000 – 21,667 – 18,333 – 20,000)
	3,60,000	**60,000**			

So Grant income to be recognised in Profit & Loss for years 1, 2 and 3 are Rs. 21,667, Rs. 18,333 and Rs. 20,000 respectively.

Amount of grant that has not yet been credited to profit & loss i.e; deferred income is to be reflected in the balance sheet. Hence, deferred income balance as at year end 1, 2 and 3 are Rs. 18,333, Rs. 10,000 and Nil respectively.

Q3 (Nov 21)

A Ltd. has been conducting its business activities in backward areas of the country and due to higher operating costs in such regions, it has collectively incurred huge losses in previous years. As per a scheme of government announced in March 20X1, the company will be partially compensated for the losses incurred by it to the extent of Rs. 10,00,00,000, which will be received in October 20X1. The compensation being paid by the government meets the definition of government grant as per Ind AS 20. Assume that no other conditions are to be fulfilled by the company to receive the compensation.

When should the grant be recognised in a statement of profit and loss? Discuss in light of relevant Ind AS.

Solution

Ind AS 20 states that, Government grants, including non-monetary grants at fair value, shall not be recognised until there is reasonable assurance that:

1. *the entity will comply with the conditions attaching to them; and*
2. *the grants will be received.*

Further, Ind AS 20 states as follows:

"A government grant that becomes receivable as compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to the entity with no future related costs shall be recognised in profit or loss of the period in which it becomes receivable".

"A government grant may become receivable by an entity as compensation for expenses or losses incurred in a previous period. Such a grant is recognised in profit or loss of the period in which it becomes receivable, with disclosure to ensure that its effect is clearly understood."

In accordance with the above, in the given case, as at March 20X1, A Ltd. is entitled to receive a government grant in the form of compensation for losses already incurred by it in the previous years. Therefore, even though the compensation will be received in the month of October 20X1, A Ltd. should recognise the compensation receivable by it as a government grant in the profit or loss for the period in which it became receivable, i.e., for the financial year 20X0-20X1 with disclosure to ensure that its effect is clearly understood.

MTPs QUESTIONS

Q4 (MTP Aug. 18 – 4 Marks)

A Limited received from the government a loan of Rs.1,00,00,000 @ 5% payable after 5 years in a bulleted payment. The prevailing market rate of interest is 12%. Interest is payable regularly at the end of each year. Calculate the amount of government grant and Pass necessary journal entry. Also examine how the Government grant is realized. Also state how the grant will be recognized in the statement of profit or loss assuming that the loan is to finance a depreciable asset.

Solution

The fair value of the loan is calculated at Rs. 74,76,656.

Year	Opening Balance	Interest calculated @ 12%	Interest paid @ 5% on Rs. 1,00,00,000 + principal paid	Closing Balance
(a)	(b)	(c) = (b) x 12%	(d)	(e) =(b) + (c) – (d)
1	74,76,656	8,97,200	5,00,000	78,73,856
2	78,73,856	9,44,862	5,00,000	83,18,718
3	83,18,718	9,98,246	5,00,000	88,16,964
4	88,16,964	10,58,036	5,00,000	93,75,000
5	93,75,000	11,25,000	1,05,00,000	Nil

A Limited will recognise Rs. 25,23,344 (Rs. 1,00,00,000 – Rs. 74,76,656) as the government grant and will make the following entry on receipt of loan:

Bank Account	Dr.	Rs. 1,00,00,000	
To Deferred Income			Rs. 25,23,344
To Loan Account			Rs. 74,76,656

Rs. 25,23,344 is to be recognised in profit or loss on a systematic basis over the periods in which A Limited recognises the related costs (which the grant intends to compensate) as expenses.

If the loan is to finance a depreciable asset, Rs. 25,23,344 will be recognised in profit or loss on the same basis as depreciation.

Q5. (MTP Oct. 20 + Exam Nov. 18)

How will you recognize & present the grants received from the Government in the following cases as per Ind AS 20?

(i) A Ltd. received one acre of land to set up a plant in a backward area (fair value of land Rs. 12 lakh and acquired value by Government is Rs. 8 lakhs).

(ii) B Ltd. received an amount of loan for setting up a plant at concessional rate of interest from the Government.

(iii) D Ltd. received an amount of Rs. 25 lakh for immediate start-up of a business without any condition.

(iv) S Ltd. received Rs. 10 lakh for purchase of machinery costing Rs. 80 lakh. Useful life of machinery is 10 years. Depreciation on this machinery is to be charged on a straight line basis.

(v) Government gives a grant of Rs. 25 lakh to U Limited for research and development of medicine for *breast cancer, even though similar medicines are available in the market but are expensive. The company is to ensure by developing a manufacturing process over a period of two years so that the cost comes down at least to 50%.*

Solution

1. The land and government grant should be recognized by A Ltd. at a fair value of Rs. 12,00,000 and this government grant should be presented in the books as deferred income. Alternatively, if the company is following the policy of recognising non-monetary grants at nominal value, the company will not recognise any government grant. Land will be shown in the financial statements at Rs. 1
2. As per Ind AS 20 'Accounting for Government Grants and Disclosure of Government Assistance', loan at concessional rates of interest is to be measured at fair value and recognised as per Ind AS 109. Value of concession is the difference between the initial carrying value of the loan determined in accordance with Ind AS 109, and the proceeds received. The benefit is accounted for as a Government grant.
3. Rs. 25 lakh has been received by D Ltd. for immediate start-up of business. Since this grant is given to provide immediate financial support to an entity, it should be recognised in the Statement of Profit and Loss immediately with disclosure to ensure that its effect is clearly understood, as per Ind AS 20.
4. Rs. 10 lakh should be recognized by S Ltd. as deferred income and will be transferred to profit and loss over the useful life of the asset. In this case, Rs. 1,00,000 [Rs. 10 lakh/10 years] should be credited to profit and loss each year over a period of 10 years. Alternatively, if the company is following the policy of recognising non-monetary grants at nominal value, the company will not recognise any government grant. The machinery will be recognised at Rs. 70 lakhs (80 – 10). Reduced depreciation will be charged to the Statement of Profit and Loss.
5. As per Ind AS 20, the entire grant of Rs. 25 lakh should be recognized immediately as deferred income and charged to profit and loss over a period of two years based on the related costs for which the grants are intended to compensate provided that there is reasonable assurance that U Ltd. will comply with the conditions attached to the grant.

QUESTIONS FROM PAST EXAM PAPERS

Q6 (May. 19 – 4 Marks)

Mediquick Ltd. has received the following grants from the Central Government for its newly started pharmaceutical business:

- Rs. 50 lakh received for immediate start-up of business without any condition.
- Rs. 70 lakh received for research and development of drugs required for the treatment of cardiovascular diseases with following conditions:
  (i) That drugs should be available to the public at 20% cheaper from current market price and
  (ii) The drugs should be in accordance with quality prescribed by the Govt. Drug Control department.
- Three acres of land (fair value: Rs. 20 lakh) received for set up of plant.
- Rs.4 lakh received for purchase of machinery of Rs.10 lakh. Useful life of machinery is 4years. Depreciation on this machinery is to be charged on a straight-line basis.

How should Mediquick Ltd. recognize the government grants in its books of accounts as per relevant Ind AS?

Solution

Mediquick Ltd. should recognise the grants in the following manner:

- Rs. 50 lakhs have been received for immediate start-up of business. This should be recognised in the Statement of Profit and Loss immediately as there are no conditions attached to the grant.
- Rs. 70 lakhs should be recognised in profit or loss on a systematic basis over the periods in which the entity recognises as expense the related costs for which the grants are intended to compensate. However, for this compliance, there should be reasonable assurance that Mediquick Ltd. complies with the conditions attached to the grant.
- Land should be recognised at fair value of Rs. 20 lakhs and government grants should be presented in the balance sheet by setting up the grant as deferred income.
  Alternatively, since the land is granted at no cost, it may be presented in the books at nominal value.
- Rs. 4 lakhs should be recognised as deferred income and will be transferred to profit and loss account over the useful life of the asset. In these cases, Rs.1,00,000 [Rs. 4 lakhs/ 4 years] should be credited to the profit and loss account each year over the period of 4 years.
  Alternatively, Rs. 4,00,000 will be deducted from the cost of the asset and depreciation will be charged at reduced amount of Rs. 6,00,000 (Rs. 10,00,000 – Rs. 4,00,000) i.e. Rs. 1,50,000 each year.

Q7 (Nov. 19 – 4 Marks) (Mix of IndAS 20 & IndAS 41)

Arun Ltd. is an entity engaged in plantation and farming on a large scale and diversified across India. On 1st April, 2018, the company has received a government grant for Rs 20 lakh subject· to a condition that it will continue to engage in plantation of eucalyptus trees for a coming period of five years.

The management has a reasonable assurance that the entity will comply with condition of engaging in the plantation of eucalyptus trees for specified period of five years and accordingly it recognizes proportionate grant for Rs 4 lakh in Statement of Profit and Loss as income following the principles laid down under Ind AS 20

Accounting for Government Grants and Disclosure of Government Assistance.

Required:

Evaluate whether the above accounting treatment made by the management is in compliance with the applicable Ind AS. If not, advise the correct treatment.

Solution

Arun Ltd. is engaged in plantation and farming on a large scale. This implies that it has agriculture business. Hence, Ind AS 41 will be applicable.

Further, the government grant has been given subject to a condition that it will continue to engage in plantation of eucalyptus tree for a coming period of five years. This implies that it is a conditional grant.

In the absence of the measurement base of biological asset, it is assumed that "Arun Ltd measures its Biological Asset at fair value less cost to sell":

(i) *As per Ind AS 41, the government grant should be recognised in profit or loss when, and only when, the conditions attaching to the government grant are met i.e., continuous plantation of eucalyptus tree for coming period of 5 years. In this case, the grant shall not be recognised in profit or loss until the five years have passed. The entity has recognised the grant in profit and loss on proportionate basis, which is incorrect.*

(ii) *However, if the terms of the grant allow part of it to be retained according to the time elapsed, the entity recognises that part in profit or loss as time passes. Accordingly, the entity can recognise the proportionate grant for Rs 4 lakh in the statement of Profit and Loss based on the terms of the grant.*

Alternatively, it may be assumed that Arun Ltd. measures its Biological Asset at its cost less any accumulated depreciation and any accumulated impairment losses (as per para 30 of Ind AS 41):

In such a situation, principles of Ind AS 20 (with respect to conditional grant will apply). According to Ind AS 20, the conditional grant should be recognised in the Statement of Profit and Loss over the periods and in the proportions in which depreciation expense on those assets is recognised. Hence the proportionate recognition of grant Rs 4 lakh (20lakh / 5) as income is correct since the entity has reasonable assurance that the entity will comply with the conditions attached to the grant.

Note: *In case eucalyptus tree is considered as bearer plant by Arun Ltd., then Ind AS 20 will be applicable and not Ind AS 41.*

Q8. (Same as Q2)

Entity A is awarded a government grant of Rs.60,000 receivable over three years (Rs.40,000 in year 1 and Rs.10,000 in each of years 2 and 3), contingent on creating 10 new jobs and maintaining them for three years. The employees are recruited at a total cost of Rs.30,000, and the wage bill for the first year is Rs.1,00,000, rising by Rs.10,000 in each of the subsequent years. Calculate the grant income and deferred income to be accounted for in the books for year 1, 2 and 3.

Solution

The income of Rs.60,000 should be recognised over the three year period to compensate for the related costs.

Calculation of Grant Income and Deferred Income:

Year	Labour Cost	Grant Income		Deferred Income	
	Rs.	Rs.		Rs.	
1	1,30,000	21,667	60,000 x (130/360)	18,333	(40,000 – 21,667)
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3	1,20,000	20,000	60,000 x (120/360)	-	(60,000 – 21,667 – 18,333 – 20,000)
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So Grant income to be recognised in Profit & Loss for years 1, 2 and 3 are Rs. 21,667, Rs. 18,333 and Rs. 20,000 respectively.

Amount of grant that has not yet been credited to profit & loss i.e; deferred income is to be reflected in the balance sheet. Hence, deferred income balance as at year end 1, 2 and 3 are Rs. 18,333, Rs. 10,000 and Nil respectively.