Exposure Draft

Accounting Standard (AS) 20

Accounting for Government Grants

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Accounting Standards Board

The Institute of Chartered Accountants of India

Exposure Draft

Accounting Standard (AS) 20

Accounting for Government Grants

(The Indian Accounting Standards (Ind AS), as notified by the Ministry of Corporate Affairs in February, 2015, have been applicable to the specified class of companies. For other class of companies, i.e., primarily the unlisted entities having net worth less than Rs. 250 crores, Accounting Standards, as notified under Companies (Accounting Standards) Rules, 2006, has been applicable. However, the Ministry of Corporate Affairs has requested the Accounting Standards Board of The Institute of Chartered Accountants of India (ICAI) to upgrade Accounting Standards, as notified under Companies (Accounting Standards) Rules, 2006, to bring them nearer to Indian Accounting Standards. Accordingly, the Accounting Standards Board, ICAI, initiated to upgrade these standards which will be applicable to all companies having net-worth less than Rs. 250 crores including non-corporate entities. While formulating these Accounting Standards, the Accounting Standards Board, ICAI, decided to maintain the consistency with the paragraph numbers and with the numbering of Standards of the Indian Accounting Standards).

Following is the Exposure Draft of the revised Accounting Standard (AS) 20, Accounting for Government Grants, issued by the Accounting Standards Board of the Institute of Chartered Accountants of India, for comments. The Board invites comments on any aspect of this Exposure Draft. The Board would particularly welcome answers to the question set out below. Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.

Comments can be submitted using one of the following methods so as to receive not later than October 7, 2015:
Electronically: click on ***http://www.icai.org/comments/asb/*** *to submit comments online*
Email: Comments can be sent at commentsasb@icai.in
Postal: Deputy Director, Accounting Standards Board, The Institute of Chartered Accountants of India, ICAI Bhawan, Post Box No. 7100, Indraprastha Marg, New Delhi – 110 002

Further clarifications on any aspect of this Exposure Draft may be sought by e-mail to sonia.gulati@icai.in.

(This Accounting Standard includes paragraphs set in ***bold*** *type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles.)*

Question 1.

In AS 20, the concept of promoters' contribution to deal with contributions made by government in the capacity of owners has been retained from existing AS 12, notified under Companies (Accounting Standards) Rules 2006. Such grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income. It is considered that since such grants are given by way of contribution towards the entity capital outlay and no repayment is ordinary expected in case of such grants, therefore, it should be credited to shareholders' fund. However, another view is that, if such grants are credited to shareholders' funds, no correlation is done between the accounting treatments of the grant and the expenditure to which grant relates and, therefore, should be taken into income and matched with associated cost which the grant intended to compensate. Also, treating a grant as equity might not be in accordance with the Framework for the Preparation and Presentation of Financial Statements which defines equity as anything that evidences a residual interest, that is, the amount that remains after deducting all liabilities from assets. Accordingly, view emerges that since such grants are provided on satisfaction of obligations, such grants cannot be treated as equity.,

Do you think that the concept of promoters' contribution and treatment of such contribution as capital reserve should be retained? Why or why not?

Introduction

1. This Standard shall be applied in accounting for, and in the disclosure of, government grants.

2. This Standard does not deal with:

   (a) the special problems arising in accounting for government grants in financial statements reflecting the effects of changing prices or in supplementary information of a similar nature;

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

   (c) government participation in the ownership of the entity.

   (d) government grants covered by AS 41[1], *Agriculture.*

Definitions

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

   <u>Government</u> refers to government, government agencies and similar bodies whether local, national or international.

[1] The Standard is under formulation and will be issued as exposure draft shortly.

***<u>Government grants</u>** are assistance by government in the form of transfer of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity. 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 entity.*

<u>Grants related to fixed assets</u> **are government grants whose primary condition is that an entity qualifying for them should purchase, construct or otherwise acquire such assets. Subsidiary 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.**

<u>Grants related to income</u> **are government grants other than those related to assets.**

4. The receipt of government grants by an entity may be 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 entity has benefited from such grant during the reporting period. This facilitates comparison of an entity's financial statements with those of prior periods and with those of other entities.

5. [Refer Appendix 1].

6. Government grants are sometimes called by other names such as subsidies, subventions, or premiums.

Government Grants

7 Government grants shall not be recognised until there is reasonable assurance that:

(a) the entity will comply with the conditions attaching to them; and

(b) the grants will be received.

8. A government grant is not recognised until there is reasonable assurance that the entity will comply with the conditions attaching to it, and that the grant will be received. Receipt of a grant does not of itself provide conclusive evidence that the conditions attaching to the grant have been or will be fulfilled.

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

10-10A [Refer Appendix 1].

11 Once a government grant is recognised, any related contingent liability or contingent asset is treated in accordance with AS 37[2], *Provisions, Contingent Liabilities and Contingent Assets*.

12. **Government grants shall be recognised in profit or loss over the periods in which the entity recognises as expenses the related costs for which the grants are intended to compensate.**

Capital Approach versus Income Approach

13. 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.

14 [Refer Annexure 1]

15 [Refer Annexure 1]

16 [Refer Annexure 1]

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

18. Grants related to non-depreciable asset may require the fulfillment of certain obligations and would then be recognised in profit or loss over the periods that bear the cost of meeting the obligations.

19. Grants are sometimes received as part of a package of financial or fiscal aids to which a number of conditions are attached. In such cases, care is needed in identifying the conditions giving rise to costs and expenses which determine the periods over which the grant will be earned. It may be appropriate to allocate part of a grant on one basis and part on another.

20. 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 they become receivable.**

21 In some circumstances, a government grant may be awarded for the purpose of giving immediate financial support to an entity rather than as an incentive to undertake specific expenditure. Such grants may be confined to a particular entity and may not be available

[2] The Standard is under revision.

to a whole class of entities. These circumstances may warrant recognising a grant in profit or loss of the period in which the entity qualifies to receive it, with disclosure to ensure that its effect is clearly understood.

22 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.

Non-monetary Government Grants

23 A government grant may take the form of non-monetary assets, such as land or other resources, for the use of the entity 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 recognised at a nominal value.

Presentation of Grants Related to Assets

24 Government grants related to specific assets shall be presented in the balance sheet either by setting up the grant as deferred income or by deducting the grant in arriving at the book value of the asset.

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

26 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 or loss 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.

27 Under the other method, grants related to depreciable assets are treated as deferred income which is recognised in the profit or loss on a systematic 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.

28 The purchase of assets and the receipt of related grants can cause major movements in the cash flow of an entity. 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 cash flows regardless of whether or not the grant is deducted from the related asset for the purpose of balance sheet presentation.

Presentation of grants Related to income

29 Grants related to income are presented as part of profit or loss, either separately or under a general heading such as 'Other Income'; alternatively, they are deducted in reporting the related expense.

29A [Refer Appendix 1]

30 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 entity if the grant had not been available and presentation of the expense without offsetting the grant may therefore be misleading.

31 Both methods are regarded as acceptable for the presentation of grants related to income. Disclosure of the grant may be necessary for a proper understanding of the financial statements. Disclosure of the effect of the grants on any item of income or expense which is required to be separately disclosed is usually appropriate.

Presentation of Grants of the nature of Promoters' contribution

31A 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.

Repayment of government grants

32 **A government grant that becomes repayable shall be accounted for as a change in accounting estimate (see AS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*).** Repayment of a grant related to income shall be applied first against any unamortised deferred credit recognised in respect of the grant. To the extent that the repayment exceeds any such deferred credit, or where no deferred credit exists, the repayment shall be recognised immediately in profit or loss.

32A The amount repayable in respect of a government grant related to an asset is recorded by increasing the book value of the asset or the deferred income balance, as appropriate, by the amount repayable. 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.

32B 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.

33 [Refer Appendix 1]

34- 38 [Refer Appendix 1]

Disclosure

39. The following matters shall be disclosed:

(i) the accounting policy adopted for government grants, including the methods of presentation adopted 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.

Appendix 1

Note: This Appendix is not a part of the Indian Accounting Standard. The purpose of this Appendix is only to bring out the major differences, if any, between Indian Accounting Standard (Ind AS) 20, Accounting for Government Grants and Disclosure of Government Assistance, and the Accounting Standard (AS) 20, Accounting for Government Grants.

Comparison with Ind AS 20, *Accounting for Government Grants and Disclosure of Government Assistance*

1. Ind AS 20 requires measurement of non-monetary government grants at their fair value. AS 20 requires measurement of such grants at their nominal value.

2. Ind AS 20 requires presentation of grants related to assets in balance sheet only by setting up the grant as deferred income. AS 20 gives an option to present the grants related to assets in the balance sheet either by setting up the grant as deferred income or by deducting the grant from the gross value of the asset in arriving at its book value. Thus, the option to present such grants by deduction of the grant from gross value in arriving at its book value is not available under Ind AS 20. Accordingly, paragraphs 24-27 have been modified in AS 20.

3. Paragraphs 5 and 34-38 of Ind AS 20 relates to government assistance. Since AS 20 does not deal with the concept, the paragraphs have been deleted in AS 20. However, paragraph numbers have been retained in AS 20 to maintain consistency with paragraph numbers of Ind AS 20.

4. Paragraphs 10 and 10A of Ind AS 20 relate to forgivable loan from government. Since AS 20 does not deal with the concept, the paragraphs have been deleted in AS 20. However, paragraph numbers have been retained in AS 20 to maintain consistency with paragraph numbers of Ind AS 20.

5. Paragraphs 14, 15 and 16 of Ind AS 20 provide for the basis for conclusion of the two approaches described in paragraph 13. In AS 20, the paragraphs have been deleted since it is felt that it is not necessary for smaller companies. However, paragraph numbers have been retained in AS 20 to maintain consistency with paragraph numbers of Ind AS 20.

6. Ind AS 20 does not cover government grants in the nature of promoter's contribution. However, it has been decided to retain the concept in AS 20 to deal with contributions made by government in the capacity of owners. Accordingly, paragraphs 31 and 32 B has been inserted.

7. The following paragraph numbers appear as 'Deleted' in Ind AS 20. In order to maintain consistency with paragraph numbers of Ind AS 20, the paragraph numbers are retained in AS 20:
   (i) Paragraph 29A
   (ii) Paragraph 33