

## **An Introduction: Accounting Standard for Business Enterprises No. 16 - Government grants**

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**ABSTRACT:** *This paper makes some research on Chinese accounting standards and international accounting standards, analyzes some changes brought by the revision of Chinese accounting standards for Enterprises No. 16, and explains the reasons for these changes. Moreover, this paper enumerates the Lotus Health Group (600186. SH) and Jianghuai Automobile Group (600418. SH) on Government grants related accounting case, interpreting the point identified problems of enterprise Government grants in the accounting, the use problem of accounting subject, and the distinguish problem of government grants to the business income, aiming to help the Chinese accounting industry understand and implement the new accounting standards.*

**KEY WORD:** *Accounting Standards, Government grants, Lotus Health Group, Jianghuai Automobile Group*

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### **I. INTRODUCTION**

With the increasing complexity of economic business, some problems in the implementation of accounting standards have gradually emerged. In order to effectively solve the accounting practice problems related to enterprises, further standardize the recognition, measurement and disclosure of Government grants in China, and improve the quality of accounting information, the Ministry of Finance revised the Accounting standard for Business Enterprises No. 16 -- Government grants in 2017. The revision of accounting standards is conducive to the consideration of China's reality, while maintaining the convergence with the international financial reporting standards. The new accounting standard effectively solved the three problems of the old standard, contributed to the consistency of Chinese accounting standard and international accounting standard, and improved the competitiveness of Chinese enterprises to compete in accordance with international standards.<sup>[2]</sup>

This paper finds that the revised standards have been improved in three aspects: firstly, it has added the expression of the characteristics of Government grants, which is helpful to clarify the scope of application of Government grants standards; Secondly, it further converges with the international financial reporting standards in accounting, which is beneficial for enterprises to participate in competition in accordance with international rules. Finally, it makes more detailed provisions on the accounting of discount interest of policy-based preferential loans, which is convenient for practical operation.

#### **1.1. The Distinction between Government grants and Operating Income**

The economic resources obtained by enterprises from the government are not all Government grants. It may be the government's investment as a shareholder, or the government's purchase of services. For example, the price grants given by the government to new energy vehicles constitutes a part of the price consideration of enterprises' goods or services, which should be treated as income. Therefore, the Government grants that meet the income recognition conditions should be further clarified.

#### **1.2. The Use of Accounting Subjects**

CAS16 (2006) stipulates that Government grants should be included in non-operating income. However, in the actual transaction of the enterprise, part of the government grants received by the enterprise is closely related to the daily business activities of the enterprise, and it is against the essence of economic business to include it in the non-business income, so the provisions of accounting standards are not reasonable.<sup>[1]</sup>

#### **1.3. The Accounting Problem of Financial Discount Interest**

CAS16 (2006) only stipulates that enterprises can calculate the financial discount interest according to the "total amount method", and does not calculate the financial discount interest paid to the lending bank. In fact, there is no detailed provision on the accounting of financial discount interest, which leads to the difference between CAS16 (2006) and the "capital Construction Financial Rules" on whether to adopt the "total amount method" or the "net amount method", and the financial personnel are confused in practical work.<sup>[1]</sup>

## **II. CHANGES IN ACCOUNTING STANDARDS**

### **2.1. The Application of Government grants Guidelines**

CAS16(2017) no longer emphasizes that Government grants are directly obtained from the government. It is considered that if the payer was paying on behalf of the Government, it was also a government grant. It clarifies the "non-compensation" and points out that Government grants have no consideration. It is used to distinguish Government grants, government capital investment (capital reserve) and government purchase of services. The accounting income standard is applied to collect the consideration from the government and no longer emphasizes debt forgiveness. These changes are helpful to distinguish economic business which belongs to government grants, reduce the arbitrariness of business judgment, and make the accounting standard conform to the actual needs.<sup>[2]</sup>

### **2.2. The "Net Method"**

The "Net Method" refers to the use of Government grants to deduct the book value, borrowing costs, costs and losses of related assets. CAS16(2017) proposes that Government grants related to income can be used to offset costs by the net method. On the one hand, if it is used to compensate the relevant costs or losses of the enterprise in the future period, it shall be recognized as deferred income. During the period of cost or loss recognition, enter into current profit and loss or write off relevant costs. On the other hand, if it is used to compensate the relevant costs or losses incurred by the enterprise, it shall be directly recorded into the current profit and loss or written off the relevant costs. These changes are convenient for enterprises to conduct business processing according to the essence of economic business, can truly reflect the actual asset depreciation, cost and financing cost, and is conducive to improving the accuracy of accounting of relevant assets and operating cost items.<sup>[2]</sup>

### **2.3. The Accounting Subject**

CAS 16 (2017) provides for a new "other income" accounting subject, which can be divided into two categories, "related to the daily business activities of an enterprise" and "unrelated to the daily business activities of an enterprise", according to the nature of economic business. Government grants related to the daily business activities of an enterprise shall be included in "other income" or cost shall be deducted on a net basis. Government grants not related to the daily business activities of an enterprise shall be recorded as "non-business income". These changes help enterprises to correctly distinguish other income and non-operating income according to the requirements of the basic guidelines. It can improve the accuracy of other income calculation and the transparency of accounting information.<sup>[1]</sup> In addition, CAS16 (2006) stipulates that Government grants should be included in non-operating income or deferred income, but this may not be consistent with economic substance. In the enterprise's economic business, some companies received Government grants is closely related to the enterprise daily business activities, such as: all kinds of price subsidies in the form of government purchase services, nominally for Government grants, but because is closely connected with enterprise day-to-day operations, often applicable income standards, thus facilitating the correct accounting revenues.<sup>[2]</sup>

### **2.4. The Financial Discount Interest Accounting**

CAS 16 (2006) stipulated that enterprises could calculate the financial discount interest in accordance with the "total amount method", and did not calculate the situation of disbursement to the lending bank. In fact, it did not make detailed provisions on the accounting of the financial discount interest. As for the financial discount interest directly or indirectly obtained by enterprises<sup>[1]</sup>, CAS16 (2017) requires enterprises to conduct accounting according to the way of offsetting the borrowing costs, that is, "net method". CAS16 (2017) refers to the accounting method of financial discount interest allocated to lending Banks in international accounting standards, and requires enterprises to calculate it as a government grants according to the method of measuring it at fair value and adjusting the actual interest rate. Such a change can balance international convergence and domestic reality, and answer the confusion of financial personnel. CAS16 (2017) solves the problem of whether the financial discount interest is capitalized or expensed by adjusting the borrowing costs associated with the discount interest paid to the lending Banks and enterprises.<sup>[2]</sup>

### **2.5. The Amortization Method of Government grants Related to Assets**

CAS 16 (2017) changed the amortization method of deferred income related to assets and included it into the current cost in a systematic way. Moreover, it also increases the specific accounting method of the residual deferred income when the assets are disposed of in advance. The new amortization method is more compatible with the consumption way of the future economic benefits of the asset, and the accounting personnel can refer to the depreciation method that matches the consumption way of the future economic benefits of the asset to amortize the deferred income. The new amortization method is more compatible with the consumption

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method of the future economic benefits of the assets, and the accountants can refer to the amortization deferred income of the depreciation method of fixed assets matching the consumption method of the future economic benefits of the assets.<sup>[2]</sup>

## **III. INTERPRETATION OF ACCOUNTING STANDARDS**

### **3.1. The Confirmation Point of Government grants**

**Case 1:** Lotus Health Group applied for a 194.4 million yuan government grants from the Xiangcheng city government, which agreed to offset its costs with 194.4 million yuan in food price compensation. Later, both Xiangcheng and Zhoukou municipal governments acknowledged the existence of Government grants and explained the objective reasons for the lack of Government grants. However, when the government grants did not arrive in the account, Lotus Health Group entered the government grants into the account, which inflated the profit of 194.4 million yuan in 2007. In the end, Lotus Health Group reported a net profit of 26,513,425.97 yuan in 2007.

In this case, Lotus Health Group recorded the government grants that did not reach the account, which turned the disclosed profit into a profit, forming an illegal act of information disclosure and receiving administrative punishment from the CSRC.

The accounting standards stipulate that the government grants meets the relevant recognition conditions and can be confirmed when it is actually received. Therefore, Lotus Health Group should be recorded in the account when the government grants can be confirmed, otherwise there will be an error when the government grants is confirmed.

### **3.2. The Use of Government grants Items**

**Case 2:** From June 2008 to December 2008, Lotus Health Group received a total of 18.98 million yuan of environmental protection related grants funds, and 22.72 million yuan of government compensation funds for closing down backward production capacity. 41.7 million yuan should be included in the non-operating income, but Lotus Health Group will directly offset the production cost. In April 2009, Lotus Health Group received 900,000 yuan of government enterprise development promotion funds and 176,900 yuan of foreign trade development promotion funds. In May of the same year, it received 800,000 yuan of development promotion funds from the four cities of Huanghuai. The 1.8769 million yuan should be included in the non-operating income, but Lotus Health Group will directly offset the cost of its main business. Lotus Health Group reduced the product cost with Government grants, raised the gross profit rate of the product, inflated the company's net profit excluding non-recurring gains and losses in 2008 and 2009, and finally caused illegal information disclosure facts, and was punished by the CSRC.<sup>[3]</sup>

In this case, Lotus Health Group's accounting for environment-related grants funds and compensation funds for the elimination of backward production capacity is wrong, which are directly accounted into non-operating income according to the provisions of CAS16 (2006). Lotus health received relevant environmental subsidies and eliminate backward production capacity of compensation funds are Lotus Health Group production equipment of subsidies, namely the Government grants pertinent to assets, therefore is not applicable to the CAS 16 (2017) "net method". Lotus Health Group has received environmental protection grants funds, enterprise development promotion funds and foreign trade development promotion funds. Since they are not directly related to the company's daily business activities, they cannot normally reflect the company's business performance and profitability, and they are sporadic and should be included in the non-business income.

CAS16 (2006) does not allow enterprises to deduct Government grants as the book value of related assets, related costs or losses, and related borrowing costs. However, CAS 16 (2017) provides that Government grants related to income shall be deducted from related costs according to the "net method", Government grants related to daily activities of enterprises shall be included in "other income" or deducted from related costs according to the essence of economic business, and Government grants unrelated to daily activities of enterprises shall be included in non-business income and expenditure. However, CAS 16 (2017) does not define the daily business activities of enterprises. In general, if the cost of government grants compensation is the item in the operating profit, or the grants is closely related to the business activities such as the daily sales activities of the enterprise, it is considered that the government grants is related to the daily business activities. In practice, the inclusion of Government grants into other income, related costs or non-operating income will affect the presentation and disclosure of current profits and losses.

### **3.3. The Distinction between Government grants and Revenue**

**Case 3:** The sales revenue of new energy vehicles listed in the 2017 annual report of Jianghuai Automobile Group (600418.SH) is 5201544958.08 yuan, which includes the government grants amount of 2133461445.00 yuan received by new energy vehicles, accounting for up to 41.02%. Obviously, Jianghuai Automobile Group recognized the government grants as the operating income of the year.

**Table 1:Relation between Income of New Energy Vehicles and Proportion of grantsAmount**

The types of car	Income (RMB)	The amount of grants (RMB)	Subsidies proportion
New energy vehicle	5,201,544,958.08	2,133,461,445.00	41.02%

Source: 2017 Annual Report of Anhui Jianghuai Automobile Group Co., LTD<sup>[2]</sup>.

According to the Notice on The Financial Support Policy for The Promotion and Application of New Energy Vehicles from 2016 to 2020<sup>[5]</sup>, the relevant contents are as follows:

On the one hand,the grants target is consumers.The production enterprises of new energy vehicles shall settle accounts with consumers in accordance with the price after deduction of subsidies, and the central finance shall allocate the grants funds to the production enterprises in accordance with procedures.

On the other hand,the products subsidized by the central government are pure electric vehicles, plug-in hybrid electric vehicles and fuel cell vehicles that are included in the "Recommended Model List of New Energy Vehicle Promotion and Application Project".

The amount of Government grants in China is large, and most A-share listed companies can receive Government grants, which account for A high proportion of the total profits of listed companies.According to CAS 16 (2017), Government grants refer to the monetary or non-monetary assets that enterprises obtain free of charge from the government.Usually, not all the money or things received free from the government are Government grants.In this case, JAC Has obtained the government financial grants, which conforms to the definition of government grants. However, if it is confirmed as government grants, the gross margin of new-energy automobile products will be reduced, and the gross margin may even be negative.It is not conducive to reflect the profitability of normal production and operation of Jianghuai Automobile Group, and investors can not understand the true operating conditions of the enterprise.

From the essence of the transaction, Jianghuai Automobile Group's grants is not free, but a part of the consideration price of selling new energy vehicles.The sale of new energy vehicles is the daily business activity of Jianghuai Automobile Group, and the Government grants meet the income recognition conditions, so the new energy subsidies received from the government should be treated as income.

#### IV. CONCLUSION

In summary, CAS 16 (2017) has the following main changes :(1) the use of accounting items is more in line with economic substance;(2) Clearer division between government grants and income;(3) Allow enterprises to use the "net method" to write off the related costs;(4) More detailed accounting of financial discount interest;(5) Asset-related government grants amortization method is more reasonable.This revision shows that Chinese accounting standards are gradually consistent with international accounting standards, which is conducive to Chinese enterprises to participate in international competition in accordance with international standards. Moreover, the revised content of the standards takes into account the needs of practical accounting, solves the accounting problem of Government grants for Chinese enterprises, and helps to improve the quality of accounting information.

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