Government assistance – Medcare Limited

Medcare Limited entered into an agreement on 1 May 2011 to buy three mobile clinics for R5 000 000 in total to be used in a rural area in Limpopo. On 2 January 2012 the clinics were received and ready for use, the risks and rewards of ownership were transferred to Medcare Limited, and the building contractor was paid in cash.

Since it is important for National Government to provide medical services to all citizens, Medcare Limited received a government grant of R625 000 (asset-based) on 2 January 2012 in respect of the clinics.

Medcare Limited provided medical services from 2 January 2012 and had to employ 3 general practitioners and 3 qualified nurses from that date. To encourage Medcare Limited to continue with the provision of medical services, the provincial government indicated that it would subsidise the salaries of the medical staff, provided that it could appoint them. Medcare Limited had to contract the medical staff for a period of three years, where after the provincial government will appoint new medical staff or renew the contracts of the current staff. The total government grant amounted to R2 100 000 for the three years, received in year 1. If any of the conditions are not met, the total or part (pro rata) of the subsidy will have to be repaid.

The annual salaries amounted to R400 000 per general practitioner and R200 000 per nurse for the year ended 31 December 2012. It was expected that their salaries would increase by 8% per annum.

The clinics have a useful life of 10 years. It is the company's policy to depreciate the clinics over their useful lives on the straight-line basis.

Additional information:

1. The government grants are taxable. The South African Revenue Service will grant a tax allowance on a pro rata basis over 5 years, on the straight-line method, on the total cost of the clinics.

2. Medcare Limited's profit before tax but after the grants and related depreciation were taken into account, amounted to R1 355 000 for the year ended 31 December 2013 (2012: R1 450 000).

3. The company provides for deferred tax on all temporary differences by using the statement of financial position approach. The only temporary differences are those in respect of the grants received. The balance of the deferred tax account on 1 January 2012 was R nil.

4. Assume a SA normal tax rate of 28%.

5. It is estimated that the company will realise taxable income in future.

REQUIRED:

a) Prepare the journal entries and calculate the figures to be included in the SPL and SFP for the years ended 2012 and 2013 assuming the income based grant is deducted in reporting the relevant expense and the asset based grant is considered to be deferred income.

b) Prepare the journal entries and calculate the figures to be included in the SPL and SFP for the years ended 2012 and 2013 assuming the income based grant is recognised as other income and the asset based grant is deducted from the carrying amount of the asset.