01 Accounting under Ind AS in the COVID-19 environment

This article aims to:

Highlight the guidance issued by ICAI through its FAQs regarding accounting under Ind AS in the COVID-19 scenario.

Introduction

The coronavirus (COVID-19) pandemic has raised global concerns regarding the health and safety of people, it has disrupted financial markets and created a challenging operating environment. This environment has consequently affected the Indian economy and financial reporting. While the Indian Accounting Standards (Ind AS) entail comprehensive and robust accounting principles, the preparers of financial statements should ensure that the potential impact of COVID-19 is suitably considered in preparing and reporting their financial statements for the year ended 31 March 2020. Accordingly, the Institute of Chartered Accountants of India (ICAI) issued 'COVID-19 Frequently Asked Questions (FAQs) on Ind AS' that highlight specific requirements of certain accounting standards that may need special attention while preparing and reporting financial information for the year ended 31 March 2020.

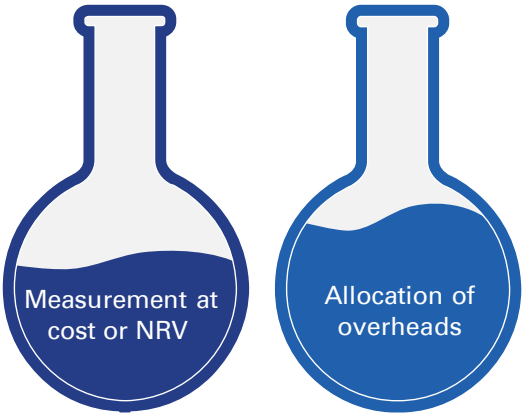
This article summarises some of critical aspects as highlighted by ICAI to be considered while financial reporting.

Inventory valuation

- **Measurement of inventory at cost or NRV:** Conduct of business in the period of lockdown or during the COVID-19 pandemic will be considered as conducting business 'in the ordinary course'. Therefore, the requirement to measure inventories at the lower of cost or Net Realisable Value (NRV) would still apply.

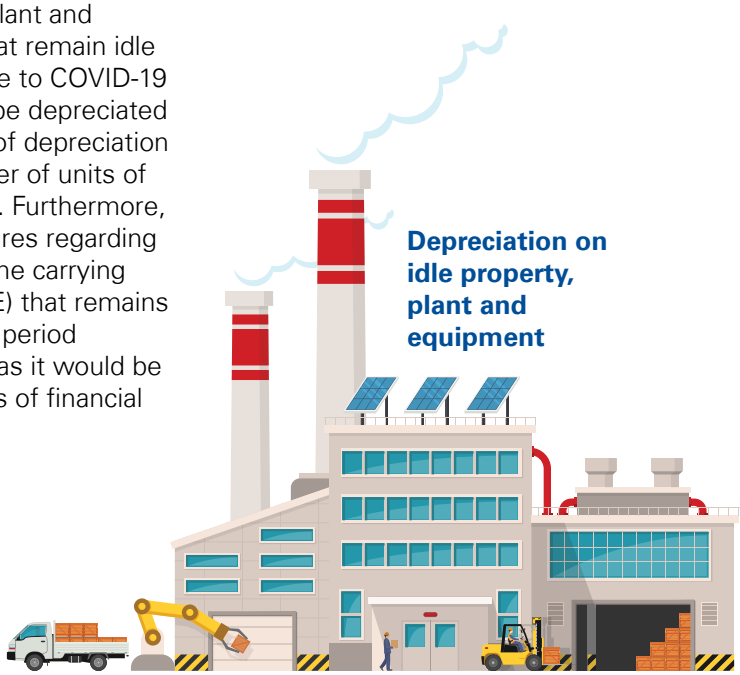
  Reduction in selling prices subsequent to the balance sheet date needs to be considered in arriving at the NRV at the balance sheet date as condition of COVID-19 existed at the balance sheet date which has caused reduction in the selling prices.

- **Allocation of overheads:** The adverse impact on the utilisation of the production capacity due to the impact of COVID-19 will be akin to idle capacity. Accordingly, the normal production capacity should not be reassessed for allocating fixed production overheads for the financial year 2019-20. The unallocated overheads will be recognised as an expense in the period in which they are incurred.



Property, plant and equipment

- **Depreciation on idle PPE:** The items of Property, Plant and Equipment (PPE) that remain idle during lockdown due to COVID-19 should continue to be depreciated where the method of depreciation is other than 'number of units of production method'. Furthermore, appropriate disclosures regarding the PPE (including the carrying amount of such PPE) that remains idle for a temporary period should be provided as it would be relevant to the users of financial statements[1].



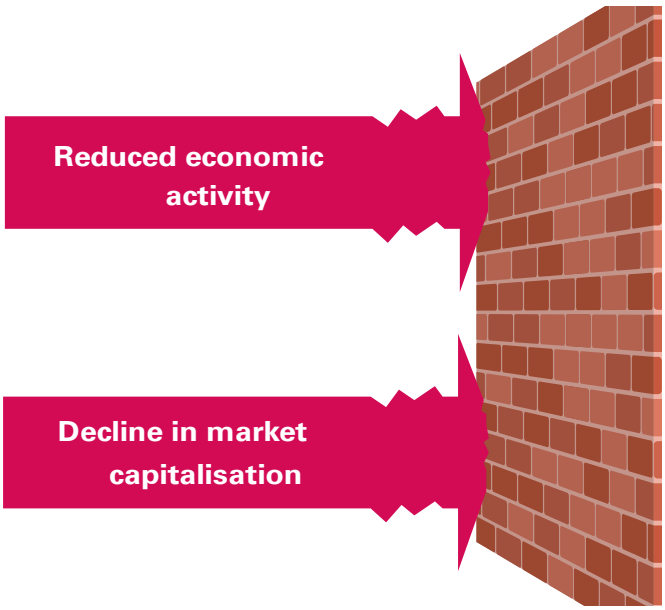
1. As required by para 79(a) of Ind AS 16, *Property, Plant and Equipment* and para 112(c) of Ind AS 1, *Presentation of Financial Statements*

Impairment of assets

- **Impairment assessment required under conditions of reduced economic activity:** The COVID-19 outbreak has resulted in a significant contraction in economic activities of entities. The temporary ceasing of operations has culminated in an immediate decline in demand and profitability, which indicates impairment. Accordingly, many businesses will have to perform an impairment testing, including determining the recoverable amount of non-financial assets.

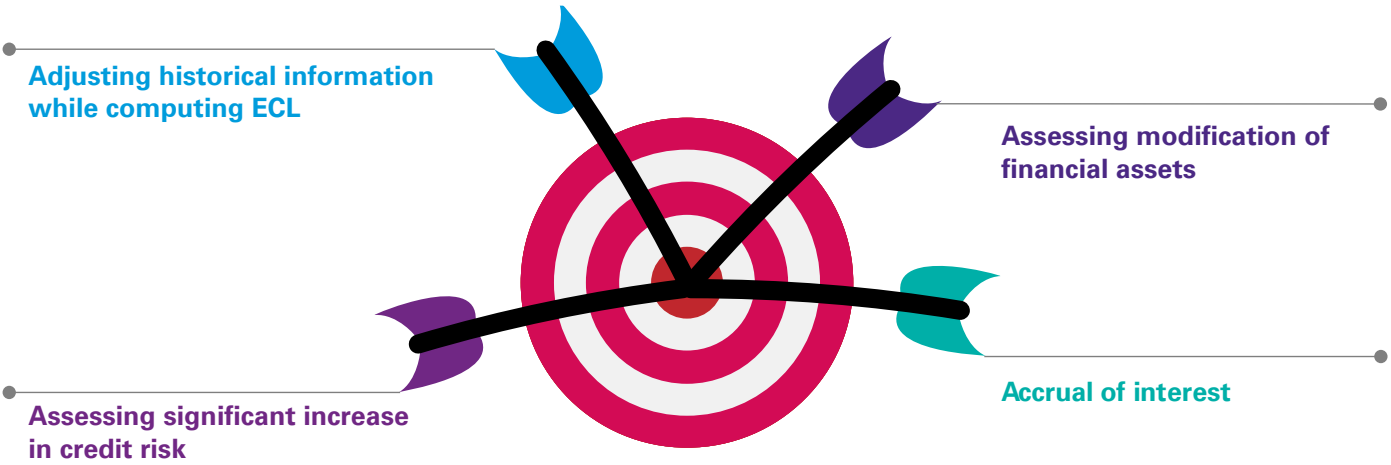
  With regard to assets that are required to be tested for impairment annually[2], an entity may follow an annual cycle of impairment testing other than the reporting date (e.g. testing for impairment on 31 December). In certain cases, if there could be an indicator for impairment testing as at 31 March 2020, then impairment testing would be required again as at 31 March 2020.

- **Decline in market capitalisation:** One external source of impairment indication is decline in market capitalisation. In the current market environment, it is expected that this will be accompanied by other impairment indicators, such as decline in actual or forecast profits. Market capitalisation is an indicator of value for an entity as a whole as opposed to separate cash generating units (CGUs). As a result, where the impairment indicator is triggered, the entity will also need to apply judgement to determine whether the entity needs to undertake a detailed impairment assessment for all CGUs or only a subset that have had other impairment indicators triggered.



Financial instruments

- **Adjusting historical information while computing ECL:** Historical information is an important base to measure Expected Credit Losses (ECL). However, due to outbreak of COVID-19, an entity should adjust the historical information for current observable data and for the forecasts of future conditions that did not affect the historical data or remove those that are not relevant for the future cash flows.



2. Intangible assets with indefinite useful lives, intangible assets not yet available for use and goodwill acquired in a business combination.

Loan repayment moratoriums by financial institutions to borrowers

- **Assessing Significant Increase in Credit Risk (SICR):** For assessing whether there has been a SICR of a financial instrument while computing ECL, entities should look at the change in the risk of default occurring over the expected life of the financial instrument. For this purpose, assessment should be made considering all available information about past events, current conditions and forecasts of economic conditions including impact of COVID-19 and prudential regulatory actions.

  Therefore, prudential regulatory support measures such as temporary repayment moratoriums to tide over the current uncertain economic environment caused by COVID-19 should not be applied mechanistically to mean that all borrowers availing of this moratorium have experienced a SICR.

- **Assessing modification of financial assets:** Financial institutions need to assess whether the economic relief packages announced by the government and regulatory authorities would result in a modification of the loan balances, and whether such modification would lead to derecognition.
- **Accrual of interest:** Financial institutions need to continue accruing interest revenue on loan balances (of accounts that have availed the moratorium) using the effective interest rate method as given below:
  - For assets classified under stage 1 and stage 2, interest revenue would be computed on the gross carrying amount of the financial asset
  - For assets classified under stage 3, interest revenue would be computed on the net carrying amount (net of ECL) of the financial asset.

Leases

- **Lease concessions:** An entity would need to evaluate whether rent concessions indicate a lease modification. Assessing whether the rent concession is a lease modification includes determining whether there has been a change in the consideration for the lease as defined in Ind AS 116. A change in payment terms does not necessarily give rise to a change in consideration. Entities should also assess whether any change in consideration arising from the concession was part of the original terms and conditions of the lease.

  If a rent concession results from a lease modification, a lessee determines a new discount rate, and remeasures the lease liability to reflect the revised lease payments using that revised discount rate and by making a corresponding adjustment to the right-of-use asset. It should be noted that lease modification should be accounted for on the effective date of the modification, i.e. the date when both parties agree to a lease modification.

  If a waiver/reduction of lease payments does not represent a lease modification, that change would generally be accounted for as a variable lease payment.

- **Lease rent deferrals:** A change in lease payments that reduces payments in one period but proportionally increases payments in another, does not change the consideration for the lease, thus there is no remeasurement of lease liability. While accounting for such deferral, the lessee must adjust the timing of future cash flows and either:
  - Revise the discount rate, or
  - Bifurcate the lease liability into the portion (based on the original payment schedule) that remains subject to accretion and the portion that is not.

  A lease deferral that results in reduction in payments that is greater than any subsequent increase in payments (i.e. a reduction in total consideration of the lease), incorporates both, a forgiveness of payments and deferred lease payments. These should be accounted for as below:
  - Forgiveness of payments should be evaluated:
    - If forgiveness is considered as a modification of the lease, the lessee should determine a new discount rate and remeasure the lease liability to reflect the revised lease payments using that revised discount rate and by making a corresponding adjustment to the right-of-use asset.
    - If forgiveness is considered as a variable consideration, lessee should derecognise the relevant part of the lease liability with a corresponding credit to statement of profit and loss.
  - Deferred lease payments: Accounting for lease rent deferrals would be as stated in the preceding column.

Revenue from contracts with customers

- **Revenue on goods not dispatched due to lockdown:** Revenue on goods ready for dispatch, but which could not be sent due to lockdown, can be recognised depending on whether the stringent conditions of Ind AS 115, *Revenue from Contracts with Customers* for bill and hold transactions are met. While performing this evaluation, entities need to determine when they have satisfied their performance obligation to transfer the product to the customer (i.e. when a customer obtains control of the product). For this, all of the following criteria must be met:
  - The reason for the bill and hold arrangement must be substantive
  - Product must be identified separately as belonging to the customer
  - The product currently must be ready for physical transfer to the customer and
  - The entity cannot have the ability to use the product or to direct it to another customer.

Provisions, income taxes and government grants and assistance

- **CSR contributions:** Contributions to the Government's COVID-19 Relief Fund made within three months after year-end are deductible under taxation laws for the year ended 31 March 2020. However, for the purpose of accounting:
  - These amounts would not be recognised as expenses/liabilities for FY2019-20 as it does not meet the criteria of a present obligation as at the balance sheet date
  - A deferred tax liability would be recognised as there would be tax saving in FY2019-20 for a spend incurred in subsequent year. Accordingly, this should be explained in the notes to account.
- **Reassessment of deferred tax assets:** Entities should re-assess its estimation of recoverability of deferred tax asset considering the uncertainty arising out of the impact of the COVID-19 pandemic on its assumptions and likelihood of occurrence of profits. An entity's forecasted profits may be adversely affected as a result of direct and indirect (effect on customers, suppliers, service providers) factors such as decrease in production, decrease in sale prices, increase in costs, impairment of assets and various other factors that are directly connected to conditions impacting the economy as a whole and the entity in particular. Additionally, carry forward of unused tax losses and unused credits that were otherwise expected to be utilised in the near future should also be reviewed to determine if they might expire unutilised.
- **Payment of employer's share of provident fund by government:** Waiver of liabilities by government will classify as government grant because in substance there is a transfer of resources, although it is in form of waiver of expense. Thus, contribution of employer's share to provident fund by the government will fall within the definition of government grants of Ind AS 20, *Accounting for Government Grants and Disclosure of Government Assistance,* therefore, an entity should recognise it in accordance with the provisions of Ind AS 20.

The ICAI FAQs also provide guidance in other areas such as presentation of financial statements, the effects of changes in foreign exchange rates, intangible assets, borrowing costs, share-based payments, employee benefits, etc.

(Source: ICAI COVID-19 FAQS on Ind AS issued in May 2020)