ICAI ACCOUNTING ADVISORY

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Impact of Coronavirus on Financial Reporting

Indian Accounting Standards (Ind AS): Areas to be considered

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1. Inventory Measurement (Ind AS 2)

(a) In accordance with Ind AS 2 Inventories, , it might be necessary to write down inventories to net realisable value due to reduced movement in inventory, decline in selling prices, or inventory obsolescence due to lower than expected sales.

Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale. Net realisable value refers to the net amount that an entity expects to realise from the sale of inventory in the ordinary course of business. The management may consider written down of inventories to net realisable value item by item.

Ind AS 2 also provide that the allocation of fixed production overheads to the costs of conversion is based on the normal production capacity. The amount of fixed overhead allocated to each unit of production is not increased as a consequence of low production or idle plant. Unallocated overheads are recognised as an expense in the period in which they are incurred.

It is unlikely that the normal production capacity is to be reviewed for allocating fixed production overheads for the year 2019-2020, because of adverse impact on the utilisation of the production capacity due to the impact of coronavirus on the overall economy or the segment (s) in which the entity is operating.

Q 1

In view of the significant contraction in the economic activity caused by COVID-19, an entity expects significant reduction in its sales in the near future. Therefore, it has decided to offer substantial amount of discount on its selling price of products and has made public announcements to this effect after March 31, 2020. How should the entity consider this policy decision while measuring its inventory as of its annual financial reporting date of March 31, 2020? Is any disclosure required?

Answer

Due to COVID-19 pandemic the reduction in the estimated selling price must be considered while estimating NRV. So it will also be considered as conducting business 'in the ordinary course' and, therefore, the requirement to assess NRV would still apply. Accordingly, in the current scenario, entities may have to assess as to whether there is a decline in their future estimated selling price and, if so, write-down of carrying value of inventory is required.

For example, cost of per unit of inventory is Rs. 100, but due to the prevailing restrictions with regard to the movement of inventory in lockdown period coupled with sluggish demand of the product, NRV is Rs. 80. The entity should write down Rs. 20 (Rs. 100-Rs. 80) as an expense.

Ind AS 2 states that estimates of net realisable value are based on the most reliable evidence available at the time the estimates are made. Accordingly, subsequent reduction in selling prices needs to be considered in arriving at the net realisable value at the balance sheet date as condition of COVID-19 existed at the balance sheet date which has caused reduction in the selling prices.

Where an entity has written down its inventories to NRV as per the facts stated above, it is important to give appropriate and adequate disclosures in the financial statements of the entity for the year ended March 31, 2020, to inform users regarding the circumstances leading to, and impact of, write-down of inventories. In this regard, the following disclosures are prescribed under Ind AS:

a. The amount of write down recognised as an expense

b. The nature and amount of write down of inventories to NRV.

Q 2

Consequent to the Government's decision to lockdown all working establishments from March 23, 2020 as a COVID-19 preventive measure, in the financial year ended March 31,2020, the manufacturing units of the entity were not working during the period March 23, 2020 to March 31, 2020, and, hence, annual production capacity has reduced for the financial year 2019-20. In this scenario, what should be the entity's approach to allocate fixed production overhead while determining the cost conversion of its inventory?

Answer

Cost of inventories include a systematic allocation of fixed production overheads that are incurred in converting materials into finished goods. The allocation of fixed production overheads to the costs of conversion is based on the normal production capacity. In the event of low production or idle plant, the amount of fixed overhead allocated to each unit of production is not increased. The normal production capacity should not be reassessed for allocating fixed production overheads for the financial year 2019-2020, because the adverse impact on the utilisation of the production capacity due to the impact of COVID-19 will be akin to idle capacity. Unallocated overheads will be recognised as an expense in the period in which they are incurred.

2. Impairment of Non-Financial Assets (Ind AS 36 and AS 28)

(a) Ind AS 36 Impairment of Assets, Impairment of Assets, require an entity to assess, at the end of each reporting period, whether there is any indication that non-financial assets may be impaired. The impairment test only has to be carried out if there are such indications. If any such indication exists, the entity shall estimate the recoverable amount of the asset.

Due to COVID-19, there might be temporary ceasing of operations or an immediate decline in demand or prices resulting in lowering of revenues and profitability and reduced economic activity. These are the factors that the management may consider as the indicators that may require impairment testing for the purpose of Ind AS 36.

(b) For indefinite useful life intangible asset or an intangible asset not yet available for use and goodwill, Ind AS 36 requires an annual impairment testing. There could be an indicator that impairment testing of goodwill and indefinite useful life intangible assets are tested as of reporting date even if the entity follows other annual testing cycle as per Ind AS 36.

(c) An entity needs to estimate the recoverable amount of the asset for impairment testing. Recoverable amount is the higher of the fair value less costs of disposal and the value in use. In cases where the recoverable amount is estimated based on value in use, the considerations on accounting estimates apply.

(d) Contraction in economic activity due to the outbreak of COVID-19 is considered to be an impairment indicator at the reporting date, which results in an impairment assessment;

- assumptions used for impairment testing and to determine the recoverable amounts before the outbreak of COVID-19 requires any change;
- the assumptions used to determine discount rate to measure the recoverable amount require any adjustments;
- the forecasts or budgets for future cash flows prepared by management should be updated to reflect the impact of COVID-19;
- market assumptions used to determine fair value for recoverable amounts needs reconsideration;
- reasonable assumptions are taken in estimating the value-in-use and fair value less costs of disposal and ensure that the impairment loss, if any, is estimated reliably.

Goodwill impairment

The standard requires that goodwill being tested for impairment at a level that reflects the way an entity manages its operations and with which the goodwill would naturally be associated. Due to COVID-19, there might be significant changes with an adverse effect in operations of a cash generating unit to which goodwill is allocated and therefore requiring additional focus and attention while testing of impairment of goodwill as at March 31, 2020.

Q 1

Consequent to the Government's decision to lockdown all working establishments from March 23, 2020, as a COVID-19 preventive measure, in the financial year ended March 31, 2020, the manufacturing units of the entity were not working and plant and machinery were lying idle during the period March 23, 2020 to March 31, 2020. In this scenario,

- Should the entity discontinue depreciating these PPE from the date those have remained idle?
- Should the entity suspend recognizing depreciation for these items of PPE, which were depreciated by using a method other than "number of units of production method", such as straight-line method, written down value method, etc., for the period those have remained idle?

Answer

Depreciation of an asset begins when it is available for use, that is, after it is in the location and condition necessary for it to be capable of operating in the manner intended by management. Further, depreciation of an asset ceases at the earlier of the date that the asset is classified as held for sale and the date the asset is derecognised. Therefore, the asset continues to be depreciated even if it remains idle, unless the asset is fully depreciated.

Depreciation is a measure of the wearing out, consumption or other loss of value of a depreciable asset arising from use, efflux of time or obsolescence through technology and market changes, therefore, the asset is continued to be depreciated even if it remains idle.

In view of the above, the items of 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", such as straight line method, written down value method, etc.

However, in case the depreciation is based on the "number of units of production method" where appropriate, the depreciation charge can be zero for the period when there is no production.

The entity shall provide suitable disclosures in its financial statements as relevant in the current economic environment of COVID-19.

Q 2

COVID-19 global pandemic has caused substantial contraction in the entity's business since March 2020 and this depressed business scenario is expected to continue over next six to nine months in the next financial year 2020-21 as well. Entities are experiencing significant cancellation of its business orders and bookings by its customers. Does the entity need to carry out an impairment test to estimate recoverable amount of its non-financial assets for the year ending on March 31, 2020?

Answer

If an asset's carrying amount is more than the amount recoverable through its future use (Value in use) or sale (Fair value less costs of disposal), then the asset is considered to be impaired.

Ind AS 36 requires estimate of recoverable amount if there are indications that the impairment loss has occurred. An entity shall also test an intangible asset with an indefinite useful life or an intangible asset not yet available for use and goodwill acquired in a business combination for impairment annually.

In view of the significant contraction in economic activity of the entity due to COVID-19 outbreak the likelihood that a triggering event has occurred in the January- March quarter of 2020 and impairment test is required, has increased significantly, including for assets that are required to be tested for impairment annually. Therefore, for the financial year ending March 31, 2020, the entity should perform an impairment testing including determining the recoverable amount of its non-financial assets.

For indefinite useful life intangible asset or an intangible asset not yet available for use and goodwill, Ind AS 36 requires an annual impairment testing and whenever there is an indication that these assets may be impaired. There could be an indicator that impairment testing of goodwill and indefinite useful life intangible assets are to be tested as of the reporting date even if the entity follows an annual testing cycle (for a different annual period, say, calendar year end) as per Ind AS 36. Thus, if for these assets, in case the entity concerned followed an annual cycle of impairment testing other than the reporting date (e.g. calendar year ending on 31 December), impairment testing would be required again as at 31 March, 2020, in the current circumstances.

Q 3

Since the declaration of COVID-19 as global pandemic, the entity's market capitalisation in a leading capital market has declined significantly and it is much lower than the net carrying amount of its total assets. Is this an indicator of impairment?

Answer

As per Ind AS 36, one of the external source of information while assessing indication that an asset may be impaired is when the carrying amount of the net assets of the entity is more than its market capitalisation.

Accordingly, if the entity's market capitalisation has declined below the carrying amount of its assets, it is an indicator of impairment as per Ind AS 36.

It may also be noted that 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.

Q 4

Recoverable amount is an important ingredient in the recognition of impairment loss in Ind AS 36, Impairment of Assets. What are the critical factors that need to be considered while estimating the recoverable amount?

Answer

Value in Use is defined as the present value of the future cash flows expected to be derived from an asset or cash-generating unit (CGU).

The entity should consider the following factors:

- In order to estimate the future cash flows in the present situation, given the high degree of uncertainty, entities may find it helpful to consider using an expected cash flow approach. (Expected cash flows x Probabilities)
- The assumptions and cash flow forecasts used to test for impairment should be updated to reflect the potential impact of COVID-19.
- Budgets, forecasts and other assumptions from an earlier impairment testing date that were used to determine the recoverable amount of an asset should be revised to reflect the economic conditions at the balance sheet date, specifically to address increased risk and uncertainty.
- In respect of discount rates to be used, interest rates used to discount cash flows should not reflect risks for which the estimated cash flows have been adjusted, regardless of the approach used. Otherwise, the effect of some factors will be double counted. Discount rate used to discount the cash flows must reflect the way the market would assess the COVID-19 risks associated with the asset's estimated cash flows.
- Estimated cash flows and discount rates should be free from both bias and factors unrelated to the asset in question.

Q 5

What is the length of the future period to be considered for forecasting cash flows mentioned in Q 6 above?

Answer

COVID-19 outbreak should not normally affect the period over which the cash flows are estimated, i.e. cash flows should be projected over the remaining useful life of the asset/ cash generating unit. In view of the significant uncertainty about the direction, timing and magnitude of COVID-19 impact, greater weight should be given to external evidence. Global economic disruption due to COVID-19 pandemic has created scenarios with significant uncertainty which may include a lengthy period of disruption triggering a significant recession, significantly higher than normal estimation uncertainty. An entity is required to estimate the future period for cash-flow projection considering the changes in economic environment in which an entity operates. Thus, entities may need to evaluate whether the forecasts and budgets approved previously i.e. pre-COVID-19, still hold good or do they need revision with specific emphasis on the budgets/forecasts over next 12 months.

Q 6

Since the announcement of COVID-19 pandemic, financial and capital markets have been volatile. In particular, the risk free discount rates have decreased substantially and are expected to be remain low over next few years. Also, asset-specific discount rate may not available. Can the entity use another method i.e. weighted average cost of capital determined using techniques such as the Capital Asset Pricing Model?

Answer

Ind AS 36 provides that when an asset-specific rate is not directly available from the market, an entity uses surrogates to estimate the discount rate. An entity can take into account the weighted average cost of capital determined using techniques such as the Capital Asset Pricing Model or entity's incremental borrowing rate; other market borrowing rates.

Accordingly, as per Ind AS 36, an entity can use weighted average cost of capital determined using techniques such as the Capital Asset Pricing Model. However, the adjustment to such rate to reflect the way that the market would assess the specific risks associated with the asset's estimated cash flows should include the risks arising from COVID-19.

3. Financial Instruments

Impairment Losses

Expected Credit Loss (ECL) approach is expected to consider forward looking information and it is measured based on probability weighted amount that is determined by evaluating a range of possible outcomes.

The widespread contraction in economic activity across the globe due to the rapid spread of COVID-19 is likely to have an impact on the quantification of ECL and classification of financial assets into 3 buckets for recognition and measurement of impairment losses. In this context, following are important factors to be considered by the preparers.

- Recognition of 12 months ECL versus Lifetime ECL is based on segregation of credit exposures into 3 buckets viz. Stage 1- those with no significant increase in credit risk, Stage -2 those with significant increase in credit risk and Stage 3- Credit impaired. In case of certain financial assets such as Trade Receivables where the simplified approach is applicable, this segregation of credit exposures into 3 buckets is not required.
- If the entity is unable to assess the impact of COVID-19 in estimating the impairment loss due to the inadequacy of information, the same should be disclosed appropriately.

A) Fair Value Measurement

Ind AS 113 Fair Value Measurement

- Ind AS 113 recognises the fact that there are different ways in which fair value is determined i.e. it can be based on observable market price (quoted price in an active market – Level 1) or application of valuation techniques (Level 2 and Level 3) as of the reporting date.
- Significant volatility or indications of the significant decline in market prices of financial instruments like equity, bonds and derivatives and significant decrease in volume or level of activity may need adequate management consideration and professional judgment to determine whether the quoted prices are based on transactions in an orderly market. It may not be always appropriate to conclude that all transactions in such a market are not orderly. Preparers should be guided by the application guidance in Ind AS 113 that indicates circumstances in which the transaction is not considered an orderly transaction.
- Preparers using valuation techniques may have to consider the impact of COVID-19 on various assumptions including discount rates, credit-spread/counter-party credit risk etc.

B) Hedge Accounting

Ind AS 109 Financial Instruments

- The standard permits a highly probable forecast transaction to be a qualifying hedged item. If entities have adopted cash-flow hedge accounting for certain forecasted transactions, they should assess whether the transaction still qualifies as a highly probable forecast transaction considering their business environment.
- Entities will need to assess any hedge ineffectiveness and record the impact of that in profit and loss.
- Estimate the fair value of derivatives, including paying special attention to underlying assumptions of derivatives, e.g., forward curve of interest rate, foreign currency, commodity etc.

Q 1

A non-financial institution has a major part of its financial assets in the form of Trade Receivables that result from transactions within the scope of Ind AS 115, Revenue from Contracts with Customers. For the purpose of recognition and measurement of impairment loss for these financial assets, the entity has been following a simplified approach and recognising life time expected credit losses using a provision matrix based on its last five years robust data of loss rates. In the present economic environment of COVID-19 outbreak, can the entity continue with its old provision matrix based on historical loss rates?

Answer

The onset of COVID-19 outbreak around the financial year end of 2019-20 would have an effect on the current and future economic environment of the entity and hence the past data and assumptions may not be fully relevant in the future. Therefore, it is imperative to reassess and re-evaluate the original provision matrix employed by the entity for any changes and considerations required to be made in regard to the changes in the current economic environment and forward-looking information (including macro-economic information) for the entity in light of COVID-19 outbreak.

Q 2

Expected Credit Loss (ECL) approach of Ind AS 109 requires the entities to consider reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions. Can you explain how to comply with this requirement of forecasts of future economic conditions in this present uncertain economic scenario caused by rapidly evolving COVID-19 outbreak? What are the macroeconomic factors the entities are expected to consider?

Answer

Unexpected and sudden onset of the COVID-19 pandemic has brought in many challenges to the entities in estimating the ECL under Ind AS 109 which is not only based on historical data and information but it is required to be based on forward looking information as well. Considering the sudden onset of the COVID-19 outbreak and the fast pace at which the developments are taking place, it is natural that entities will have limited ability to develop detailed forecasts of future conditions.

In relation to the Ind AS 109 ECL requirement to consider the forward-looking information, the following aspects may be useful for the preparers:

- The estimate of expected credit losses does not require a detailed estimate for periods that are far in the future—for such periods, an entity may extrapolate projections from available, detailed information.
- Entities need not undertake an exhaustive search for information but shall consider all reasonable and supportable information that is available without undue cost or effort and that is relevant to the estimate of expected credit losses:
    - The information used should include factors that are specific to the entity's borrowers or credit risk portfolios and more importantly to the economic environment in which the entity is operating;
    - Time horizon of forecast information should be commensurate with the expected life of the credit risk portfolio;
    - Source of information can be internal as well as external e.g. reports and publications from Credit Rating Agencies, International Monetary Authorities and Prudential Regulators, both domestic and global if relevant to the entity's operating environment;

In respect of the type and number of macroeconomic factors to be considered, Ind AS 109 being a principle-based standard, does not set any bright lines nor mandates minima-maxima thresholds in this area. However the following macroeconomic factors are commonly used in the estimation of expected credit losses in general. It is important to ensure correlation between the macroeconomic factors used in Ind AS 109 ECL estimates and the credit risk profile of the entity.

Gross Domestic Product (GDP) Growth	Inflation Rate or Consumer Price Index	Unemployment Rates
Interest Rates	Foreign Exchange Rates Real	Estate Prices
Household Consumption/ Savings	Industrial Production	Crude Oil Prices
Equity Prices	Purchasing Power Index	Investment in Fixed Assets

Q 3

A financial institution has a consumer loan portfolio comprising large number of accounts with average remaining tenor of 3 to 5 years. Ind AS 109 requires the entities to consider forecasts of future conditions for estimating its impairment loss under an approach commonly referred to as expected credit loss. What would be the forecast period for this purpose i.e. can it be over next 12 months or longer period of say credit cycle of 7 years?

Answer

In the context of measurement of ECL, the standard states that the entity consider the maximum contractual period over which an entity is exposed to credit risk. Further, in the context of making assessment of the significant increase in credit risk for segregation of exposures into 3 (three) stage model, the standard requires that the entity should consider likelihood of risk of default occurring over the expected life of the financial instruments. Therefore, an important factor to consider in determining the forecast future period is the period over which the entity is exposed to credit risk. Accordingly, the facts and circumstances relating to the entity's credit risk exposures plays a critical role in deciding the forecast period to be used in estimating ECL.

Therefore the forecast period should be a longer period.

Q 4

(i) In order to sustain the economy in this period of depressed economic conditions resulting from COVID-19 pandemic, the Government and the Prudential Regulatory Authority of Banking sector has advised financial institutions to grant loan repayment moratoriums or payment holidays to its borrowers. A financial institution is required to follow general approach ('three stage' model i.e. Stage 1-financial assets that have not had significant increase in credit risk since initial recognition, Stage 2-financial assets that have significant increase in credit risk since initial recognition and Stage 3-financial assets that have objective evidence of impairment) for recognition and measurement of impairment for its loan portfolio of financial assets as per Ind AS 109. In the event the borrower requests and financial institution grants a loan moratorium to its customers in that loan portfolio, does it result in stage 1 exposures move to stage 2?

Answer

The extension of blanket financial support to all borrowers in a certain class does not automatically mean that all such borrowers have experienced a significant increase in credit risk. So it does not result in stage 1 exposures move to stage 2.

(ii) Consequent to the announcement of economic relief packages by the Government and Regulatory Authorities, a financial institution has given 3 months loans repayment moratoriums to its certain borrowers. How should this change in the loan repayment terms be considered under Ind AS 109 Financial Instruments, assuming such borrowers have not experienced a significant increase in credit risk? Specifically, whether interest income should be accrued during the interest payment deferral period?

Answer

Ind AS 109 requires entities to perform quantitative test (the '10% test) that compares the present value of the cash flows under the revised and original terms to determine whether modified financial liabilities are to be derecognised or not. If the difference is 10% or greater, the existing liability is derecognised and a new financial liability is recognised.

There is no such requirement in the standard to use a similar quantitative test for modified financial assets. However, it would be appropriate to include such a test as one of the indicators, in combination with other qualitative factors to determine whether modified financial assets are to be derecognised or not.

Interest recognition

Yes. Interest income should be recognised during the interest payment deferral period.

Ind AS 109 requires interest revenue to be calculated on the gross carrying amount of the asset. For Stage 3 financial assets (assets that have objective evidence of impairment) interest revenue is calculated on the net carrying amount (that is, net of credit allowance).

Q 5

In measuring ECL, an entity should include the cash flows from the realisation of collateral and other credit enhancement that are an integral part of the contractual terms of the loan. Would Prudential/ Government reliefs provided to industry at large be considered as integral to the contractual terms of the loan?

Answer

According to Ind AS 109, Financial Instruments, while estimating the expected cash shortfalls for measuring the expected credit losses the entity should consider the cash flows expected from collateral and other credit enhancements that are part of the contractual terms and are not recognised separately by the entity. Therefore, an important aspect to note is that the collateral or credit enhancement should be part of the contractual terms of the loan.

Economic reliefs provided by the Government or Prudential Regulatory Authority should may take a variety of forms such as mandating the entities to grant loan repayment moratoriums, giving repayment guarantees on the financial obligations of the industries or providing liquidity facilities and so on. The treatment of these economic reliefs depends upon specific facts and details of those particular schemes and entities need to apply judgment.

Q 6

An entity was following Cash Flow Hedge accounting for its highly probable forecasted foreign currency sale during the next financial year 2020-21. In the previous financial quarter, the entity had discontinued the hedge accounting, however, it had retained the effective portion of the cumulative loss on the hedging instrument in the cash flow hedge reserve as a separate component of equity in accordance with the requirements of Ind AS 109. This is because the forecast transaction was expected to occur as planned earlier, though not considered highly probable. Now, in view the significant economic uncertainty due to COVID-19, the forecasted foreign currency sale transaction is no longer expected to occur. Can the entity continue to retain the cumulative loss on hedging instruments in separate component of equity or immediately reclassified to profit or loss?

Answer

As the entity no longer expects the forecasted foreign currency sale transaction to occur, then the effective portion of the cumulative loss on the hedging instrument accumulated in the cash flow hedge reserve as a separate component of the equity should be immediately reclassified to profit or loss as a reclassification adjustment.

However, if the entity expects the forecasted foreign currency sale transaction to occur, though no longer highly probable, it may continue to recognise the effective portion of the cumulative loss (until the date hedge accounting is discontinued) to be accumulated in the cash flow hedge reserve as a separate component of the equity. In such a case, the entity must apply management judgement on the probability of occurrence of the forecasted foreign currency sale and conclude whether it is expected to occur or not in the future.

Further, if the entity expects that all or a portion of the cumulative loss retained in the cash flow hedge reserve will not be recovered in one or more future periods, the same should be immediately reclassified to profit or loss as a reclassification adjustment.

Q 7

Subsequent to the announcement of COVID-19 as global pandemic in the middle of March 2020, the financial and securities markets have been highly volatile and uncertain. In such uncertain markets, whether quoted prices can be considered to be reliable or meet the requirements of classification under Level 1 as per Ind AS 113?

Answer

The current financial and capital market environment across the globe has got affected by the rapid spread of COVID-19 and may have developed significant volatility or indications of the significant decline in market prices of financial instruments like equity, bonds and derivatives.

The objective of 'fair value' is to determine a price at which an orderly transaction would take place between market participants under conditions that existed at the measurement date. It would not be appropriate to adjust or disregard observable transactions, except in the extraordinarily rare circumstances where those transactions are determined to not be orderly. They are

(a) when a quoted price in an active market does not represent fair value at the measurement date. That might be the case if, for example, significant events take place after the close of a market but before the measurement date. An entity shall establish and consistently apply a policy for identifying those events that might affect fair value measurements. However, if the quoted price is adjusted for new information, the adjustment results in a fair value measurement categorised within a lower level of the fair value hierarchy.

(b) when measuring the fair value of a liability or an entity's own equity instrument using the quoted price for the identical item traded as an asset in an active market and that price needs to be adjusted for factors specific to the item or the asset.

Q 8

Factors and circumstances stated in Q 7, have also resulted in substantial decrease in volume of transactions in the principal markets or the most advantageous market to which the entity has access. Whether the fair value determined in such market conditions be considered an orderly transaction between market participants?

Answer

Depending upon the facts and circumstances of each case and further analysis of transactions or quoted prices, it can be determined whether a decrease in the volume or level of activity indicate that a transaction price or quoted price does not represent fair value or that a transaction in that market is not orderly.

Q 9

An entity has certain equity investments which are quoted in a securities market. The equity investment is classified as fair value through profit or loss (FVTPL). As at previous reporting date the fair value measurement was classified under Level 1 Fair Value Measurement hierarchy of Ind AS 113. COVID-19 outbreak is expected to have significant adverse effect on the future profitability of the issuer of these equity investments and therefore, no transactions in this security occurred during the month of March 2020 in the securities market. Can this equity investment be now measured at cost or reclassified to fair value through other comprehensive income (FVOCI)? Further, if the quoted prices are not available what would be the approach for determining the fair value of these instruments?

Answer

The entity cannot subsequently designate its equity investment at FVOCI.

An entity should use all information about the performance and operations of the investee that becomes available after the date of initial recognition. With regard to the issue on determination of fair value if the quoted prices are not available, Ind AS 113 states that fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions (i.e. an exit price) regardless of whether that price is directly observable or estimated using another valuation technique.

Ind AS 113 establishes a fair value hierarchy that categorises fair value into three levels, the inputs to valuation techniques used to measure fair value. The fair value hierarchy gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1 inputs) and the lowest priority to unobservable inputs (Level 3 inputs).

4. Leases

Entities to whom Ind AS is applicable

- Due to COVID-19 there can be changes in the terms of lease arrangements or lessor may give some concession to the lessee with regard to lease payments. Such revised terms or concessions shall be considered while accounting for leases. However, anticipated revision should not be taken into account.
- Discount rate used to determine present value of minimum lease payments of new leases may need to incorporate any risk associated with COVID-19.
- If any compensation is given/declared by the Government to the lessor for providing concession to the lessee, it should be considered whether the same needs to be accounted for appropriately as per Ind AS 116 or Ind AS 20.

Q 1

The COVID-19 pandemic has led to some lessors providing relief to lessees by relieving them of amounts that would otherwise be payable. How should these lease rent concessions dealt with under Ind AS 116?

Answer

Due to COVID-19 pandemic, many lessors have provided, or are expected to provide, rent concessions to lessees. Lessees are also seeking rent concessions where not proactively offered by their landlords to lessen their economic burden. This is more likely in the retail industry and may be encouraged or required by Government.

COVID-19-related rent concessions can have the following outcomes:

A. **Lease modification:** A rent concession not envisaged in the original lease agreement will often be a lease modification. This is already discussed in Ind AS 116.;

B. **No modification i.e. Variable Lease Payments:** the application of an existing contractual mechanism to adjust rent may represent a variable lease payment.

Lessee recognises the effect of the rent concession in profit or loss in the period in which the event or condition that triggers those reduced rent payments occurs. If a change in lease payments results in the extinguishment of a part of a lessee’s obligation specified in the contract (for example, a lessee is legally released from its obligation to make specifically identified payments), the lessee would consider whether the requirements for derecognition of a part of the lease liability are met. The circumstances that give rise to rent concession as a result of the COVID-19 pandemic are likely to indicate that ROU asset may be impaired and hence ROU should be tested for impairment.

In accordance with Ind AS 116, for an operating lease, a lessor recognises the effect of the rent concession by recognising lower income from leases.

Q 2

The COVID-19 pandemic has led to some lessors providing relief to lessees by deferring or relieving them of amounts for the time being with condition of increased payment in future. How this lease rent payment waiver with increased lease payment later on shall be dealt with under Ind AS 116?

Answer

Due to COVID-19, it might be possible that lessors may provide relief to lessees by deferring or relieving them of amounts for the time being with condition of increased payment in future.

(a) A change in lease payments that reduces payments in one period but proportionally increases payments in another ('deferred lease payments') does not extinguish the lessee's lease liability. Deferred lease payments do not change the consideration for the lease; they change only the timing of individual payments. Thus, there is no remeasurement of the lease liability. In such a case, the lessee must adjust the timing of the future cash flows and either

(1) revise the discount rate or,

(2) in effect, bifurcate the lease liability into the portion (based on the original payment schedule) that remains subject to accretion and the portion that is not (the 'interest free' deferral).

Q 3

An entity with multiple retail outlets located in various shopping malls has taken premises on leases with lease term of two to three years. According to Ind AS 116, it has recognised asset in the form of Right of Use (ROU) with a corresponding lease liability. Unexpected global outbreak of COVID-19 has resulted in its profitability being severely affected due to lower customer footfalls over next six to nine months as a consequence of customers behaviour regarding health and safety concerns. Does the entity need to perform impairment test and carry out estimate of recoverable amount?

Answer

The significant impact on the profitability due to lower customer footfalls over next six to nine months as a result of unexpected global outbreak of COVID-19 is an impairment indicator. Hence, the entity should estimate the recoverable amount of the asset and recognise impairment when its carrying amount exceeds its recoverable amount.

5. Revenue

Due to COVID-19, there could be likely increase in sales returns, decrease in volume discounts, higher price discounts etc. Under Ind AS 115, these factors need to be considered in estimating the amount of revenue to recognised, i.e., measurement of variable consideration.

Ind AS 115 also requires disclosure of information that allows users to understand the nature, amount, timing and uncertainty of cash flows arising from revenue. Therefore, entities may have to consider disclosure about the impact of COVID-19 on entities revenue.

Entities to whom AS is applicable, may have postponed recognition of revenue due to significant uncertainty of collection in view of the impact of COVID-19. AS 9, Revenue Recognition requires entities to disclose the circumstances in which revenue recognition has been postponed pending the resolution of significant uncertainties.

Q 1

Ind AS 115, Revenue from Contracts with Customers, paragraph 9 requires entities to account for revenue contracts i.e. start recognising in the financial statements, only when five (5) conditions are fulfilled. One of the conditions i.e. clause (e) of paragraph 9 stipulates that it is probable that the entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customers. In compliance with this condition, an entity has started recognising revenue from a sale of goods contract from the beginning of financial year 2019-20. Now, due to COVID-19 outbreak the customer has come into serious financial difficulties and this liquidity scenario is likely to continue for another 12 months. Does the entity need to reassess this criterion due to significant deterioration in the customer's credit worthiness? What is the accounting for the initial advance/ part consideration that the entity had received from the customer whose credit worthiness has subsequently deteriorated significantly?

Answer

If a customer's ability to pay the consideration deteriorates significantly, an entity would reassess whether it is probable that the entity will collect the consideration to which the entity will be entitled in exchange for the remaining goods or services that will be transferred to the customer.

If the entity determines that the contract does not meet the collectability criteria as specified in paragraph 9 (e) of Ind AS 115, the entity will not recognise any further revenue from the time of such assessment till the time the criteria of paragraph 9(e) is fulfilled.

It is to be noted that this assessment of the customer's ability to pay having deteriorated significantly does not affect the initially recorded revenue already recognised under the said contract, on satisfactory fulfilment of the relevant performance obligations towards the customer. However, related trade receivables/contract assets are required to be assessed for impairment under Ind AS 109, Financial Instruments.

Q 2

An entity has a 3 years contract for supply of electricity power to an industrial undertaking. In view of the expected manufacturing activity due to depressed economic conditions of COVID-19, the entity has accepted customer's request to reduce the electricity tariff as well as the minimum quantity that will be taken over the remaining period of the contract. How should the change in terms and conditions be accounted?

Answer

Ind AS 115 provides that a contract modification is a change in the scope or price (or both) of a contract that is approved by the parties to the contract. In the given case, there is change in price and some other conditions of the contract, therefore, it is a case of a contract modification.

Now the entity needs to determine whether the contract modification leads to recognition of a new contract or not. Ind AS 115, provides that contract modification shall be accounted for as a separate contract if both of the following conditions are present:

(a) the scope of the contract increases because of the addition of promised goods or services that are distinct; and

(b) the price of the contract increases by an amount of consideration that reflects the entity's stand-alone selling prices of the additional promised goods or services and any appropriate adjustments to that price to reflect the circumstances of the particular contract.

In the instant case, both of the above conditions are not met, therefore, it is not to be accounted for as a separate contract and the same shall be accounted for in accordance with paragraph 21 of Ind AS 115. This means that the revenue already recognized will not change. Future revenue will be recognized taking into consideration the reduced tariff and the reduced minimum quantity. So it is actually termination of the old contract and the creation of a new contract.

Q 3

An entity, engaged in wholesale distribution of electronic equipment's offers various price concessions based on the volume of purchases by customers. The price concessions are considered as variable consideration under Ind AS 115 and the entity estimates its amount of revenue recognition based on its past experience. Can the entity continue to adjust its revenue recognition based on its past experience or need to review it in the context of current and expected conditions during the post- COVID-19 era?

Answer

No the entity cannot continue to adjust its revenue based on its past experience.

In the instant case, given the current scenario, since there may be significant change in the business economic conditions of the entity and that of the customer due to COVID-19, there can be significant change in the price concessions. The entity would need to re estimate the volume of purchases by the customer and, in turn, the estimated price concessions offered when determining the amount of revenue to be recognised.

Q 4

An entity engaged in the manufacture and sale of heavy commercial vehicles used to offer six months interest free credit period to its customers. In view of the free credit period being less than 12 months, the entity has assessed that there is no financing component in the arrangement based on the practical expedient in paragraph 63 of Ind AS 115. Now in order to facilitate its customers to tide over liquidity crunch, the entity has decided to extend the interest free credit period for existing completed contracts by another 8 months, that is, a total of 14 months. Does this trigger application of requirements to segregate significant financing component from revenue under Ind AS 115?

Answer

The objective of adjusting the promised amount of consideration for a significant financing component is to recognise revenue at an amount that reflects the price that a customer would have paid for the promised goods or services if the customer had paid cash for those goods or services when (or as) they transfer to the customer (i.e. the cash selling price).

In the instant case, the objective of extending the credit period appears to facilitate its customers to tide over liquidity crunch which has arisen due to COVID-19 circumstances. Moreover, the price being charged is not changed due to the extension of credit period, i.e., the entity is charging the same consideration that it was charging earlier with six months credit period. Further, since the existing contracts are complete and there are no further vehicles to be delivered against such contracts, it appears that a reassessment of the contract to determine the financing component is not required.

However, since there is an expected delay in the realisation of the sale proceeds from the customer, the related trade receivables shall be assessed for impairment under Ind AS 109, Financial Instruments.

In cases where the contracts are only partially complete, the treatment would depend on the facts and circumstances of the case.

Q 5

An entity has entered into a contract to manufacture a generator for a customer before the lockdown period caused by an unprecedented outbreak of COVID-19. The generator is designed and manufactured to the customer's specifications. Generally, the entity transfers the control over the goods sold to the customers and recognises revenue on dispatch from the factory. In view of the social distancing norms imposed by the Government, the entity could not dispatch the good to the customer. In such a situation whether the entity can recognize sales revenue for this item ready for despatch to the customer?

Answer

The generator is designed and manufactured to the customer's specifications, the customer acceptance of the asset is an important feature of the contract for assessment of transfer of control. In the time of the COVID-19 there could be goods ready for dispatch but which could not be sent due to the lockdown.

Assuming that control transfers at a point in time and in the given case it is passed on at dispatch from the factory.

Therefore, in case of highly customised or specialised goods (as in this case), the acceptance of goods by the customer as discussed above would also need to be considered. In situations where control is transferred only when the product is delivered to the customer's site, it would not be appropriate to recognise revenue on bill and hold basis.

Q 6

An entity engaged in event management business had a contract for a mega cultural event in March 2020. The entity recognises the revenue for such contracts at a point in time and it incurs certain costs to fulfil the contract. The costs incurred to fulfil the contract are not covered by other Ind Ass and in compliance with the requirements of Ind AS 115 (paragraph 95) the entity recognises those costs as assets. Following the Government's preventive measure to contain the spread of COVID-19, the planned mega cultural event could not be held and the customer has cancelled the contract. How should such contract assets (costs for fulfilling the contract) be accounted now?

Answer

In the instant case, since the contract has been cancelled and presuming neither any consideration will be received nor the cost is expected to be recovered, impairment loss should be recognized for the asset.

Management should first apply impairment guidance for specific assets (for example, inventory). Management will then apply the impairment guidance for contract costs under Ind AS 115.

Q 7

An entity engaged in the provision of IT and Data Management Services incurred certain costs to obtain a new contract. These costs fulfil the criteria of incremental costs of obtaining a contract with customer and the entity had recognised these costs as per paragraphs 91 to 93 of Ind AS 115. These were amortised in a systematic manner in accordance with paragraph 99 of Ind AS 115. Now, due to onset of COVID-19 is there any change in the method of accounting for these costs?

Answer

The basis of amortization of these assets would be the entity's expected timing of transfer of the related goods and services to the customer. If due to COVID-19 circumstances, the entity expects any change in timing of transfer of services due to various factors, such as, its ability to deliver services under lockdown conditions, customer's behaviour due to changed circumstances, etc., the amortization of these assets will have to be revised accordingly.

Another significant element to be considered in these circumstances would be impairment loss to be recorded for these assets. If the carrying amount of the asset exceeds the amount of consideration receivable reduced for the related costs as per paragraph 101 of Ind AS 115, impairment loss shall be recognised. This could arise due to various factors, such as, deterioration in the customer's credit rating, liquidity condition of the customer, increase in related cost, etc.

6. Provisions, Contingent Liabilities and Contingent Assets

Ind AS 37 Provisions, Contingent Liabilities and Contingent Assets

(I) Onerous contracts are those contracts for which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. Unavoidable costs under a contract are the least net cost of exiting from the contract, which is the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfil it. As a result of COVID -19, some contracts may become onerous for reasons such as increase in cost of material/labour, etc. Management should consider whether any of its contracts have become onerous. The same should be accounted for as per Ind AS 37. Ind AS 37 also requires assets dedicated to a contract to be tested for impairment before a liability for an onerous contract is recognised.

Additionally, there could be losses from imposition of penalty due to delay in supply of goods, which may need to be considered under the guidance of Ind AS 115, Revenue from Contracts with Customers.

If the management is unable to assess whether some of the executory contracts are onerous due to inadequacy of information, the same should be disclosed. Management should disclose that it has assessed whether executory contracts are onerous due to the adverse impact of COVID -19.

(ii) Insurance claims - Entities may have insurance policies that cover loss of profits due to business disruptions due to events like COVID-19. Entities claims on insurance companies can be recognised in accordance with Ind AS 37 only if the recovery is virtually certain i.e. the insurance entities have accepted the claims and the insurance entity will meet its obligations.

Iii) Due to COVID-19, there is a need for exercising judgement in making provisions for losses and claims. A provision may be accounted for only to the extent that there is a present obligation for which the outflow of economic benefits is probable and can be reliably estimated. Future obligations which may arise due to COVID-19 shall not be recognised.

Ind AS 37 does not permit provisions for future operating costs or future business recovery costs. Entity must consider this as there will be lot of future operating losses due to COVID -19.

Q 1

An entity engaged in automobile sector has assessed the impact of COVID-19 outbreak on its future viability of business model. Senior Management has identified the need for restructuring some of its business activities and retrenching its employees in many areas. Senior Management is drawing up a plan for the consideration of the Board of Directors in their meeting scheduled in May 2020, which is subsequent to the reporting date of the current financial year i.e. March 31, 2020. Can the entity recognise provisions for restructuring costs in the financial statements of the current year i.e. 2019-20?

Answer

Since COVID-19 pandemic impact started during March 2020, it is likely that the senior management started drawing up the plan for restructuring of some of its business activities after the end of the reporting period, i.e., 2019-20. If that be so, as per Ind AS 37, the management decisions subsequent to reporting date do not give rise to constructive obligation as of reporting date and no provision is required for restructuring costs as at 31 March 2020.

However a disclosure is required under Ind AS 10, Events after the Reporting Period, if the restructuring is material and non-disclosure could influence the economic decisions that users make on the basis of the financial statements.

Q 2

An entity engaged in tourism and hospitality is heavily dependent upon the tourists from India travelling overseas and foreign nationals visiting India. In the light of COVID-19 outbreak across the globe, the entity has analysed the likely impact of customers behaviour coupled with bleak employment scenario on its revenue over the next one year. This review has indicated possible substantial operating losses during the next financial year i.e. 2020-21. The entity is exploring the possibility of recognising certain amount of operating losses as provision in the financial statements of the current year itself i.e. 2019-20. Is this accounting permitted under Ind AS?

Answer

In the given case, the entity, in the light of COVID-19 outbreak across the globe, after the review expected that there might be possible substantial operating losses during the next financial year i.e. 2020-21. In this scenario, for losses expected in the next financial year, entity cannot create provisions for operating losses in the current financial year itself.

However, an expectation of future operating losses might be an indication that certain assets of the operation may be impaired and an entity tests these assets for impairment under Ind AS 36, Impairment of Assets.

Q 3

A reputed event and conference management company had obtained loss of profits insurance cover to mitigate the risk of potential business losses due to circumstances beyond its control. During the current accounting year, it has estimated a loss of profit of certain amount and initiated its discussion with the insurance company for reimbursement of the loss. The entity is confident that the insurance company will admit and honour its claims for loss of profits. Accordingly, the entity is considering recognising an asset for this insurance claim recovery. Is this accounting acceptable under Ind AS?

Answer

The entity, before it can recognise a receivable for the claim on insurance company for business interruption or popularly called Loss of Profit Insurance, must examine whether the insurance policy clearly covers pandemic situation. By the time financial statements are prepared, the insurance company may not have decided on the claim as lock down period is still continuing, the entity should recognise loss of profit recovery as an asset only if it is virtually certain, i.e. the insurance entity has accepted the claims and the insurance entity will meet its obligations. Otherwise, it will be considered as a contingent asset.

Q 4

In order to encourage companies and organisations to generously contribute to the Government's COVID-19 relief fund, taxation laws have been amended to reckon these contributions as deductible for the current financial year i.e. year ending March 31, 2020 even if the contributions are made after the year end but within three months after year end. Similarly, such contributions to COVID-19 funds are considered for compliance with annual spends on corporate social responsibility (CSR) for the current accounting year under the Companies Act, 2013. In this scenario, whether the contributions to COVID-19 Relief Funds made subsequent to reporting date of the current accounting period can be provided for as expenses of the current accounting period?

Answer

a. Do not recognize expense/ liability for the contribution to be made subsequent to the year ended 31 March 2020 as it does not meet the criteria of a present obligation as at the balance sheet date. However, the expected spend may be explained in the notes to the accounts as the same will also be considered in measurement of deferred tax liability.

b. If the entity claims a deduction in the Income Tax return for the financial year 2019-20 for that contribution made subsequent to March 31, 2020, recognise Deferred Tax Liability as there would be a tax saving in financial year 2019-2020 for a spend incurred in subsequent year.

7. Modifications or Termination of Contracts or Arrangements

It may also be noted that the entities may modify or terminate certain contracts which may be within the scope of other Ind ASs. Entities are advised to consider the specific requirements of these standards to account for these modifications or terminations. Applicable Ind AS are 19, 102, 109, 32, 115

Q 1

An entity has established a separate Trust to manage the defined benefit plan obligations of its employees. The Trust invests the contributions by the entity in a portfolio comprising government securities and equity investments. In the current volatile and, in some cases, inactive market activities, how should the investments of the Trust be valued and considered for the purpose of accounting under Ind AS 19?

Answer

The entity has to recognise and measure the plan assets at fair value. Fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Q 2

As a consequence to Government's preventive measures to contain the spread of COVID-19, entities have been asked to close down the offices since last week of March 2020 and employees have been advised to work from home and in some cases temporary leaves have been granted. In case of employees sent on temporary leaves but with full pay, whether the salary paid can be deferred and charged to statement of profit and loss when they resume the work?

Answer

In the given case, the employees are in the service of employer and the salaries/wages paid for temporary leaves will be categorised as short-term employee benefits as defined in Ind AS 19. The entity is required to account for these employee benefits as and when incurred.

Q 3

An entity has a number of equity settled share-based payment schemes for its employee across different categories. During last financial year i.e. 2018-19, the entity had granted equity shares to senior management which will vest on April 30, 2021, and one of the conditions for final eligibility of equity shares is based on target market price of the entity's share by the end of the financial year 2020-21 i.e. March 31, 2021. Considering the current scenario affected by global pandemic, the entity expects to experience a severe depressed economic environment in its business sector and substantial decline in its financial performance and cash flows over next two years and, therefore, consequential decline in the market price of its equity shares. As of March 31, 2020, the share price of the entity's equity share is much below the target price required under the employees' share-based payment scheme. How should the entity consider this development in the accounting for its equity settled share-based payments for the current financial year 2019-20?

Answer

Equity settled share-based payments are subject to the accounting requirements of Ind AS 102 Share-based Payments. The eligibility condition of the scheme mentioned above i.e. condition of the equity shares of the entity reaching a target price at the financial year March 31, 2021, is part of a vesting condition which is market condition as defined in Ind AS 102. Market Conditions such as a target share price upon which vesting (or exercisability) is conditioned, shall be taken into account when estimating the fair value of the equity instruments granted.

It may also be noted that the fair value of the shares granted is determined at the grant date and it is not revised subsequently. Therefore, neither increases nor decreases in the fair value of the equity instruments after grant date affect the equity share based payment cost recognised by the entity.

8. Going Concern Assessment

Ind AS 1 Presentation of Financial Statements, Ind AS 10 Events after the Reporting Period

The Financial statements are normally prepared on the assumption that an entity is a going concern and will continue in operation for the foreseeable future. In assessing whether the going concern assumption is appropriate, management considers all available information about the future, which is at least, but is not limited to, twelve months from the end of the reporting period.

Management of the entity should assess the impact of COVID-19 and the measures taken on its ability to continue as a going concern. The impact of COVID-19 after the reporting date should also be considered and if, management after the reporting date either intends to liquidate the entity or to cease trading, or has No realistic alternative but to do so, the financial statements should not be prepared on going concern basis. Necessary disclosures as per Ind AS 1 shall also be made, such as material uncertainties that might cast significant doubt upon an entity's ability to continue as a going concern.

Q 1

In this highly challenging scenario of COVID-19, which is rapidly evolving day by day, there are significant uncertainties about the future economic scenario. How does an entity determine whether it is still a going concern? What disclosures are required to be made in the financial statements in this regard?

Answer

In the current economic and market conditions, historical results may be unlikely to provide a basis for future cash flows and therefore management may need to consider additional sources of information when evaluating the reasonableness of the assumptions used in its assessment. Management is expected to prepare a range of scenarios based on different dates till which the COVID-19 impact will prevail to determine the potential impact on underlying performance and future funding requirements.

As part of a going concern assessment, it is critical for management to assess what impact the current events and conditions have on an entity’s operations and forecasted cash flows, with a focus on whether the entity will have sufficient liquidity to continue to meet its obligations as they fall due. Management will need to consider the existing and anticipated effects of COVID-19 on the assumptions in its assessment giving attention to significant assumptions that are sensitive or susceptible to change or are inconsistent with historical trends. Management should develop a range of scenarios (e.g., different time periods of expected lockdowns, social distancing measures etc.) to determine the potential impact on underlying performance and future funding requirements.

Arising out of the impact of COVID-19, some of the factors (indicative) which an entity may consider

in assessing the ability of the entity to continue as going concern could be:

- Impact on the economy and asset prices, in general.
- Impact of current events and conditions on an entity’s operations and potential impact on forecasts of future cash flows, such as, restrictions imposed by the government, etc.
- Impact of various measures taken by RBI for improving liquidity in the economy, the government assistance including economic packages announced and steps for revival of economy, etc.
- Whether the entity is operating in a sector which in highly impacted
- Whether the entity has sufficient liquidity to continue to meet its obligations as they fall due.
- Whether the entity has sufficient existing and potential borrowing/financing facilities/limits to meet its short-term needs, e.g., invoice discounting and reverse factoring etc.
- If required, has the entity initiated necessary actions to generate sufficient cash flow or access to borrowing facilities/liquidity to meet its obligations when they fall due.

- Whether the entity has plans and ability to restructure their debt obligations if required to ensure short term solvency
- Assessing financial health of key/critical suppliers and customers and their impact on the entity's operations.
- Impact of contractual covenants and commitments.

Material uncertainties that cast significant doubt on the ability to continue as a going concern, such as, extent of the impact on future costs (both fixed and variable) and revenues, unknown duration of the impact, legal claims, liquidity issues, loss of customers etc., should be disclosed.

Q 2

Ind AS 1, Presentation of Financial Statements, states that financial statements are normally prepared on the assumption that an entity is a going concern and will continue in operation for the foreseeable future. The standard also further states that management should consider all available information about the future, which is at least, but is not limited to, twelve months from the end of the reporting period. Considering the above requirements and in the current fragile economic environment caused by COVID-19, whether the entities can assess the going concern basis over the next 12 months only or can consider longer period than 12 months?

Answer

It is important to bear in mind that entities are required to assess whether the entity will continue to be in operation for the foreseeable future. While doing this assessment, the entity is required to consider all the information about the future and time horizon as per paragraphs 25-26 of Ind AS 1, which is at least, but not limited to twelve months, from the end of the reporting period. Therefore, the entities can consider future assessment period which may extend to the period even beyond twelve months if they are fundamentally important to the going concern assumption. In this regard, important aspects to bear in mind are that the longer the future period the higher will be the management judgement required and degree of reliability of information decreases. As a result, entities can consider a longer period than 12 months but it must consider availability of reliable and sufficiently detailed information.

It is also necessary to consider the requirements of Ind AS 10, Events after the Reporting Period. Ind AS 10 state that entities shall not prepare financial statements on going concern basis if the management decides after the reporting period (emphasis added) either that it intends to liquidate the entity or to cease trading, or that it has no realistic alternative but to do so. Deterioration in operating results and financial position after the reporting period may indicate a need to consider whether the going concern assumption is still appropriate. Accordingly, the entities are also required to monitor the events after the reporting date but before the authorisation of the financial statements for issue.

Q 3

Due to COVID-19 liquidity of an entity is impacted. As a result it is not in a position to pay its liabilities that fall due during the next twelve months. Despite all efforts, neither it has been successful nor it is likely that it will be able to arrange funds particularly in respect of existing restructured accounts to pay off its liabilities. Whether the entity can still be assumed to be going concern?

Answer

In the instant case, the entity is not in a position to pay its liabilities that fall due during next twelve months and after all efforts, it has not been able to arrange funds particularly in respect of existing restructured accounts to pay off its liabilities. This is a material uncertainty that casts significant doubt on the ability of the entity to continue as a going concern. Therefore, greater degree of consideration will be required to assess whether the financial statements can be prepared on going concern basis.

Apart from the aforementioned factors, the entity needs to consider all other related available information about the future while concluding on the matter, such as, expected revenue that may flow to the entity, its ability to raise funds from new sources including equity, its ability to negotiate to defer the payment of liabilities beyond twelve months, potential of availability of facilities such as invoice discounting and reverse factoring, etc. Another important factor to be kept in mind is that consideration of future events is not limited to twelve months, it may extend to a period even beyond twelve months. If the entity is able to defer its liabilities beyond twelve months and it expects that by that time its liquidity position would be such that it would be able to meet its obligations, it may continue to be going concern. But arising out of the above situation, if the management is not able to find any mitigating factors to pay its liabilities then the financial statements cannot be prepared using going concern assumption. When an entity does not prepare financial statements on a going concern basis, it shall disclose that fact, together with the basis on which it prepared the financial statements. The reason why the entity is not regarded as a going concern should also be disclosed.

9. Income Taxes

Ind AS 12 Income Taxes

COVID-19 could affect future profits and/or may also reduce the amount of deferred tax liabilities and/or create additional deductible temporary differences due to various factors (e.g., asset impairment). Entities with deferred tax assets should reassess forecasted profits and the recoverability of deferred tax assets in accordance with Ind AS 12, Income Taxes, considering the additional uncertainty arising from the COVID-19 and the steps being taken by the management to control it.

Management should disclose any significant judgements and estimates made in assessing the recoverability of deferred tax assets, in accordance with Ind AS 1

Q 1

What are the few critical requirements of Ind AS 12, Income taxes, that require particular attention in the context of COVID-19 impact on an entity's current and future financial performance?

Answer

Reduction in probable future taxable profits or incurrence of losses due to COVID-19 impact may result in a reassessment of whether it is probable that some or all of an entity's deferred tax assets can be recovered. Carry forwards 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.

Q 2

An entity has a subsidiary which has substantial amount of undistributed profits and the parent has retained these profits for the purpose of planned expansion of its subsidiary's business. As a result, there were material amounts of taxable temporary difference and consequential amounts of unrecognised deferred tax liability. In view of the unexpected and sudden onset of the global pandemic COVID-19, the parent has re-examined its overall business strategy and decided to postpone the business expansion plans of this subsidiary. Instead, it is contemplating repatriation of undistributed profits of this subsidiary subsequent to the reporting date which would help tide over the liquidity problems at the parent entity. In this scenario, what are the deferred tax accounting implications for the current financial year i.e. 2019-20.

Answer

Ind AS 12 provides that an entity is not required to recognise deferred tax liability for taxable temporary differences associated with investment in subsidiaries, branches, associates and interest in joint arrangements if it is able to control the timing of reversal of temporary difference and is probable that those differences will not reverse in future. In the given case, previously the parent entity had not recognised deferred tax liability in respect of taxable temporary differences associated with the investment in its subsidiary which arose due to undistributed profits of the subsidiary.

However, now in the context of the changed economic environment due to the onset of the global pandemic COVID-19, repatriation of undistributed profits of the subsidiary is contemplated. Consequently, the parent entity should recognise deferred tax liability to the extent that it is probable that the aforesaid taxable temporary difference will reverse in future. This should be accounted for as a change in accounting estimate.

10. Consolidated Financial Statements

Ind AS 110 Consolidated Financial Statements

Ind AS 110 prescribes that the financial statements of parent and subsidiaries used in the preparation of the consolidated financial statements are usually drawn upto the same date. It may be noted that in any case, the difference between the reporting dates should not be more than three months.

11. Property Plant and Equipment (PPE)

Ind AS 16 require that useful life and residual life of PPE needs revision in annual basis. Due to COVID-19, PPE can remain under-utilised or not utilised for a period of time. It may be noted that the standards require depreciation charge even if the PPE remains idle. Further, COVID-19 impact may have affected the expected useful life and residual life of PPE.

The management may review the residual value and the useful life of an asset due to COVID-19 and, if expectations differ from previous estimates, it is appropriate to account for the change(s) as an accounting estimate in accordance with Ind AS 8, Accounting Policies, Changes in Accounting Estimates and Errors.

12. Presentation of Financial Statements

Ind AS 1 Presentation of Financial Statements

(i) Breach of loan covenants (including classification of liabilities into current and non-current)

Due to COVID-19 there may be instances of breach of loan covenants which may trigger the liability becoming due for payment and liability becoming current. However, as per Ind AS 1, such a liability shall not be classified as current, if the lender agreed, after the reporting period and before the approval of the financial statements for issue, not to demand payment as a consequence of the breach.

(ii) Sources of estimation uncertainty under Ind AS 1

COVID-19 may have created many uncertainties about the likely future scenarios which may affect the estimations of amounts recognised in the balance sheet as of reporting date. Entities shall be required to disclose those.

(iii) Comparative information

COVID-19 may have affected the financial performance and financial position of entities. Therefore, preparers may consider making adequate disclosures and explanatory notes regarding the impact of COVID-19 on its financial position, performance and cash flows.

Q 1

Due to COVID-19 significant impairment is recognized in intangible assets held by the entity. Similarly, the huge loss has been recognised due to the recognition of inventory at Net Realisable Value, which is significantly lower than its cost. Can these losses be treated as extraordinary and disclosed separately in the Statement of Profit and Loss? Alternatively, can these items be considered as Exceptional Items of Income and Expense and disclosed separately?

Answer

As per Ind AS 1, no item of income or expense shall be presented as extraordinary item in the statement of profit and loss. Ind AS 1, requires that an entity shall disclose the nature and amount separately for items of income or expense that are material. Ind AS 1 provides examples of circumstances that would give rise to the separate disclosure of items of income and expense. One of such examples is write-downs of inventories to net realisable value or of property, plant and equipment to recoverable amount, as well as reversals of such write-downs.

Accordingly, the entity needs to determine whether the impairment loss and loss due to write-down of inventory are material. In order to determine whether these items are material, the size or nature of an item, or a combination of both, needs to be considered. If these items are material, the entity shall disclose their nature and amount separately. This information may be given on the face of the statement of profit and loss or in the notes.

Further, whether these losses can be classified as exceptional items, it may be noted that exceptional items have not been defined under Ind AS. However, existing Accounting Standard (AS) 5, Net profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies when items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately.

Hence these losses may be considered exceptional. in financial statements if they meet the test of 'materiality' and 'incidence.

Q 2

A company had adopted the revaluation model for valuing its property, plant and equipment. Due to COVID-19, the company expects that fair value as at the reporting date i.e., 31st March, 2020, to be different from its carrying value. It arrives at the fair value using cash flows approach. For this purpose, it has made various estimations, such as, forecasting future revenue, business survival/ growth, etc. Is the company required to make any other disclosure in this regard apart from those required in Ind AS 113, Fair Value Measurement, and Ind AS 16, Property, Plant and Equipment?

Answer

In addition to the disclosures required under various Ind ASs regarding estimates and assumptions, Ind AS 1 requires disclosure of information about the assumptions concerning the future, and other major sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities . Ind AS 1 requires that in respect of those assets and liabilities, the notes shall include details of:

(a) their nature, and

(b) their carrying amount as at the end of the reporting period.

These disclosures help users of financial statements to understand the judgements that management has made about the future and about other key sources of estimation uncertainty.

In the instant case, for determine the fair value of PPE, the company has made various assumptions, estimates and judgements involving estimations, such as, forecasting future revenue, expected business survival/growth, etc. Therefore, the company shall make suitable disclosures. The nature and extent of the disclosures will vary according to the nature of the assumption and other circumstances.

Examples of the types of disclosures that the company will be required to make include:

- The nature of the assumption or other estimation uncertainty
- The sensitivity of carrying amounts to the methods, assumptions and estimates underlying their calculation, including the reasons for the sensitivity
- The expected resolution of an uncertainty and the range of reasonably possible outcomes within the next financial year in respect of the carrying amounts of the assets and liabilities affected
- An explanation of changes made to past assumptions concerning those assets and liabilities, if the uncertainty remains unresolved.

13. Borrowing Costs

Ind AS 23 Borrowing Costs

Above standards require that the capitalisation of interest is suspended when development of an asset is suspended. The management may consider this aspect while evaluating the impact of COVID-19.

Q 1

An entity is in the process of development of power generation facility which is expected to take three years for the facility to get ready for its intended use. In order to fund this huge expenditure, the entity has borrowed substantial amount of money and has been capitalising the borrowing costs as per Ind AS 23, Borrowing Costs. In view of the reduced demands for its products over next one year and also the lockdown of its manufacturing units due to onset of global pandemic recently, the entity has suspended the active work on the development of this power generation facility since one month before the end of the current financial year. The entity has decided to keep this project in abeyance for another six months, however, it continues to incur the borrowing costs. In view of the fact that the suspension of active development of the power generation facility is caused by Act of God and Nature, can the entity continue to capitalise the borrowing costs that it continues to incur?

Answer

An entity shall suspend capitalisation of borrowing costs during extended periods in which it suspends the active development of the qualifying asset. Considering the entity's decision to suspend the active development of the qualifying asset for 7 months, it cannot continue to capitalise the borrowing costs during this extended period regardless of the fact that the situation is caused by factors beyond its control.

This Ind AS elaborates on certain situation of temporary suspension where the entities are not required to suspend the capitalisation of borrowing costs. For example, when a temporary delay is a necessary part of the process of preparing an asset for its intended use. The suspension of construction activity due to COVID-19 pandemic does not fall under this situation.

14. Post Balance Sheet Events (Ind AS 10)

COVID-19 outbreak incidence surfaced in December 2019 and the condition has continued to evolve throughout after 31 December 2019.

According to Ind AS 10, events occurring after the reporting period are categorised into two viz.

(i) Adjusting events i.e. those require adjustments to the amounts recognised in its financial statements for the reporting period and

(ii) Non-adjusting events i.e. those do not require adjustments to the amounts recognised in its financial statements for the reporting period.

In certain cases, Management judgement may be required to categorise the events into one of the above categories.

15. Interim Financial Reporting (Ind AS 34)

(Currently, this section may be applicable to a limited set of entities)

The recognition and measurement guidance applicable to annual financial statements equally applies to interim financial statements. There are typically no recognition or measurement exceptions for interim reporting, although management might have to consider whether the impact of the COVID-19 is a discrete event for the purposes of calculating the expected effective tax rate.

Additional disclosure should be given to reflect the financial impact of the COVID-19 and the measures taken to contain it. This disclosure should be entity specific and should reflect each entity's circumstances.

Further, the preparers may consider making suitable disclosures in the Management Discussion and Analysis section of the Annual Report about the effect of Coronavirus (COVID-19) on the overall risks to the businesses in which the entity is engaged.

MISCELLANEOUS

Q 1

In the present economic environment, many entities have been suffering from acute cash flow problems and facing serious concerns of business viability. In order to prevent huge unemployment scenario and to rescue the business entities, Government has decided to pay the employer's share of employee provident fund contribution (EPF) for March 2020. How should it be accounted for in the financial statements for the year 2019-20?

Answer

Thus, contribution of employer's share to provident fund by the Government in the present case falls within the definition of government grants of Ind AS 20, therefore, the entity should recognise it in accordance with the provisions of Ind AS 20.

As this is a revenue grant the expense as well as income will be recognised in the financial statements.

Q 2

Government of India is giving many economic packages including Income Tax reliefs, Goods and Service Tax reliefs and other many other assistances such as financial guarantees. Are these economic reliefs to be accounted as Government grants under Ind AS 20 or to be accounted under Ind AS 12, Income Taxes or any other Ind AS.

Answer

In this challenging economic environment, Government and Monetary Authorities may offer a number of different types of economic reliefs, concessions and assistances to business entities. These government relief measures could be fall within the scope of following Ind ASs:

- Ind AS 20, Accounting for Government Grants and Disclosure of Government Assistance
- Ind AS 12, Income Taxes
- Ind AS 114, Regulatory Deferral Accounts

Therefore, entities are advised to assess the facts and circumstances and the substance of the underlying specific government assistance schemes, reliefs and economic packages to determine the appropriate Ind AS to be applied.

Q 3

In these rapidly evolving times of COVID-19 and changing economic environment, the public policies are also offering new business opportunities, new products development and new markets to entities e.g. some of the health and safety concerns have enabled the entities to establish new lines of business or products. An entity engaged in medical research and drug manufacturing segment has incurred substantial expenditure for the development of a new vaccine for COVID-19. Can the entity recognise this as Intangible Assets under Ind AS and what consideration should be applied for impairment testing etc.?

Answer

In the facts and circumstances stated above, the entity should consider the recognition and measurement requirements of Ind AS 38, Intangible Assets, relating to internally generated intangible assets. In order to assess the fulfilment of recognition criteria of the standard, expenditure incurred by the entity will be categorised into two phases viz. Research Phase and Development Phase.

Ind AS 38 does not permit recognition of Intangible Asset for Research Phase and requires the expenditure incurred during this phase to be recognised as expense when incurred.

In respect of expenditure incurred during development phase, an entity can recognise it as intangible asset if, and only if the entity can demonstrate compliance with certain conditions laid down in Ind AS 38.

If the total cost accumulated under development and implementation phase is higher than recoverable amount considering the price of vaccine, volume and competition, appropriate provisions for impairment should be made even in respect of the in-process intangible asset under development as per the requirements of Ind AS 36, Impairment of Assets.

Q 4

An entity in order to meet its huge requirement of funds for deployment in business such as investment in plant and machinery or other business requirements raises funds from international markets in foreign currency mainly US$. The outbreak of COVID-19 has led to significant volatility in the financial markets all around the World, depreciation in Indian Rupee (INR) has been witnessed against US$. The entity is preparing its financial statements under Indian Accounting Standards and its functional currency is INR. The entity has not entered into derivative contracts such as Foreign Exchange Forward Contracts to hedge the foreign currency risk. Since the announcement of COVID-19 as a global pandemic, the depreciation of INR against US$ has accelerated and it has a material impact on the profitability of the entity. Therefore, can the foreign exchange translation differences relating to foreign currency borrowings be deferred and recognized over the balance period of the foreign currency borrowings?

Answer

With regard to treatment of foreign exchange differences arising on a monetary item, paragraph 28 of Ind AS 21 prescribes that the exchange differences arising on its settlement or on translation of the foreign currency borrowing at reporting date need to be recognised in the profit or loss section of the statement of profit and loss. Accordingly, the same cannot be deferred and amortised over the balance period of the foreign currency borrowings considering the material impact of high depreciation of INR.

To the above accounting treatment there is one exemption, which was given as a part of transition under Ind AS 101, First-time Adoption of Indian Accounting Standards. A first-time adopter of Ind AS may continue the policy adopted for accounting for exchange differences arising from the translation of long-term foreign currency monetary items recognised in the financial statements for the period ending immediately before the beginning of the first Ind AS financial reporting period as per the previous GAAP. Accordingly for the foreign currency borrowings prior to the transition to Ind AS, if the entity had opted for amortization of foreign exchange differences over the remaining borrowing period or capitalised the same as part of the cost of plant and machinery, the entity can continue the same accounting policy.

Q 5

Continuing with facts in the previous question with assumption that the borrowing referred in the question has been raised after implementation of Ind AS. Additional facts are that the entity has hedged the foreign currency risk of its US$ foreign currency loans and it has been following the fair value hedge accounting framework of Ind AS 109, Financial Instruments. In this fact pattern, can the foreign exchange translation differences relating to foreign currency borrowings be deferred and recognized over the balance period of the foreign currency borrowings?

Answer

(a) The gain or loss on the hedging instrument shall be recognised in profit or loss

(b) The hedging gain or loss on the hedged item shall adjust the carrying amount of the hedged item (if applicable) and be recognised in profit or loss.

PRESENTATION OF FINANCIAL STATEMENTS