Coronavirus (COVID-19) Impact on Financial Reporting

Recently on March 27, 2020, ICAI had issued an Accounting and Auditing Advisory titled "Impact of Coronavirus on Financial Reporting and Auditors Consideration". This addendum provides additional guidance in relation to estimation of impairment loss for financial instruments under Expected Credit Loss approach. The guidance is also given on considerations to be made in respect of loan moratorium.

Financial Instruments

Impairment Losses (This Guidance is in addition to that given in our previous Advisory dated March 27, 2020)[1]

Ind AS 109, Financial Instruments

Financial Instruments within the scope of Ind AS 109 such as Loans, Trade Receivables, Other Receivables, Investment in Debt instruments, Financial Guarantees and Loan Commitments which are not measured at fair value through profit or loss, Contract Assets (Ind AS 115) and Lease Receivables (Ind AS 116) are subject to impairment loss recognition and measurement based on an approach called Expected Credit Loss (ECL). This approach was introduced in IFRS 9, an IFRS Standard corresponding to Ind AS 109, in the aftermath of the global financial crisis of 2008 to strengthen the accounting recognition of loan-loss provisions by incorporating a broader range of credit information and to provide transparent and timely information about changes in the credit risk. 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. It is important to bear in mind that Ind AS 109, like other Indian Accounting Standards (Ind ASs), is principle-based standard and requires application of management judgement and consideration of different approaches depending upon different circumstances. More importantly, it allows estimation of ECL based on reasonable and supportable information that is available without undue cost and effort, about past events, current conditions and forecast of future economic conditions including macroeconomic conditions. Ind AS 109 being a principle-based standard does not require a mechanistic application of the prescriptions and it does not set bright lines rather prescribes a few rebuttable presumptions. In this context, following are additional important factors to be considered by the preparers.

[1] Also, refer IFRS 9 ECL advisory of International Accounting Standards Board at https://www.ifrs.org/news-and-events/2020/03/application-of-ifrs-9-in-the-light-of-the-coronavirus-uncertainty/

- For the purpose of determination of classification of the financial instruments in Stage 2, Ind AS 109 requires evaluation of Significant Increase in Credit Risk (SICR) based on likelihood of risk of default over the entire expected life of the financial instrument and not just over next 12 months.

- In this period of heightened uncertainty and fast moving changes around impact of COVID-19 entities may find it difficult to incorporate all the reasonable and supportable information while measuring the ECL in its credit risk measurement models. In such as situation, entities may consider post-model overlays or adjustments to its impairment models.

- In respect of consideration of any Prudential Regulatory actions taken to sustain the economy such as loan repayment holidays, reduction in interest rates etc., it is important to bear in mind that Ind AS 109, like other the Ind ASs, is a principle-based standard and requires application of management judgement. Therefore, prudential regulatory support measures such as temporary repayment moratoriums to tide over the current uncertain economic environment caused by COVID-19 should not be applied mechanistically to reclassify the financial instrument into Stage 2 requiring lifetime expected credit losses. This assessment should be made considering all available information about past events, current conditions and forecasts of economic conditions including impact of COVID-19 and Prudential Regulatory Actions. As a guiding factor to retain these financial instruments in existing category the entities should consider whether the financial instruments where repayment moratoriums are granted were regular with no signs of credit deterioration at the time of granting moratoriums and whether these financial instruments are expected to remain regular during relief period and thereafter.

- Non-Banking Financial Companies (NBFCs) should also consider the guidance given by the Prudential Regulators and there is a need to differentiate between the Ind AS 109 application guidance, if any, from those relevant only for Prudential Regulations e.g. Capital Adequacy Requirements, Liquidity Risk Management etc.