मेहनत अगर आदत बन जाए तो, कामयाबी मुकद्दर बन जाती है!

SUMMARY
AND
AFFECTED PRACTICAL QUESTIONS OF ACCOUNTING STANDARDS

DUE TO COVID 19

FOR CA – INTER

BY

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VALUATION OF INVENTORIES – AS 2

A. Important points: If due to COVID-19,

(a) Expected reduction in its sales price then it shall be considered for the purpose of calculating NRV and necessary disclosures are required.

(b) If actual production is reduced below normal production then fixed production overhead shall be allocated on the basis of normal production. Balance of Fixed production overhead shall be charged into P & L Account.

B. Practical questions:

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?

   Solution: AS 2, requires that inventories shall be measured at the lower of cost and NRV.

   Net realisable value (NRV) 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.

   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.

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 includes a systematic (i.e. allocation is based on the normal production capacity) of fixed production overheads that are incurred in converting materials into finished goods. 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 similar to idle capacity.

   Unallocated overheads will be recognised as an expense in the period in which they are incurred.

PROPERTY, PLANT AND EQUIPMENT (PPE) – AS 10

A. **Important point: If the items of PPE 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.”**

B. Practical questions:

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** in the following two cases
   (1) Depreciation ceases to be charged when asset’s residual value exceeds its carrying amount.
   (2) Depreciation of an asset ceases at the earlier of:
      (a) The date that the asset is retired from active use and is held for disposal, and
      (b) The date that the asset is derecognised

   Therefore, depreciation does not cease when the asset becomes idle or is retired from active use (but not held for disposal) unless the asset is fully depreciated.

   However, under usage methods of depreciation, the depreciation charge can be zero while there is no production.

   Therefore, the asset continues to be depreciated even if it remains idle, unless the asset is fully depreciated.
   Therefore, even when the asset is idle, the same should be depreciated due to technical or commercial obsolescence and wear and tear during that period.
   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 EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES –AS 11

Important point: FED arising on a monetary item cannot be deferred even in case of covid 19 circumstances.

ACCOUNTING FOR GOVERNMENT GRANTS – AS 12

Important point: If due to covid 19 circumstance an entity receive any assistance from Govt. whose value can be ascertained shall be recorded as a grant provided there is certainty of consideration and collection.

BORROWING COSTS-AS 16

A. Important point: If due to covid 19 circumstance an entity suspends the active development of the qualifying asset, capitalisation of borrowing shall be suspended during suspended periods.

B. Practical questions:

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 AS 16, 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: Borrowing costs that are attributable to the acquisition, construction or production of a qualifying asset are capitalised as part of the cost of that asset. All other borrowing costs should be expensed in the period incurred.

   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.

INTANGIBLE ASSETS – AS 26

A. **Important point:** If any entity engaged in medical research and drug manufacturing segment has incurred substantial expenditure for the development of a new vaccine for COVID-19 then the entity should consider the recognition and measurement requirements of AS 26, relating to internally generated intangible assets.

B. **Practical questions:**

1. 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 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 AS 26, 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.

   The entity needs to assess whether its activity during the financial year 2019-20 falls within the research phase or development phase.

   The expenditure incurred during research phase to be recognised as expense when incurred.

   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 AS 26.

   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.

PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS-AS 29

A. Important points: If due to covid 19 circumstances

(i) entity has only a plan of restructuring then no provisions shall be recorded due to lack of detailed formal plan for restructuring and start to implement the restructuring plan.

(ii) there is expected future operating losses then no provisions shall be recognized, however an expectation of future operating losses might be an indication for impairment.

(iii) 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 will meet its obligations. Otherwise, it will be considered as a contingent asset.

B. Practical questions:

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. 31st March, 2020. Can the entity recognise provisions for restructuring costs in the financial statements of the current year i.e. 2019 - 2020?

   Solution: In accordance with AS 29, Provisions, Contingent Liabilities and Contingent Assets, a constructive obligation to restructure arises only when an entity has detailed formal plan for restructuring identifying the business or part of business concerned; the principal locations affected; the location, function, and approximate number of employees who will be compensated for terminating their services; the expenditures that will be undertaken; and when the plan will be implemented; and has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it.

   Further, AS 29 provides that a management or board decision to restructure taken before the end of the reporting period does not give rise to a constructive obligation at the end of the reporting period unless the entity has, before the end of the reporting period

   (a) started to implement the restructuring plan; or
   (b) announced the main features of the restructuring plan to those affected by it in a sufficiently specific manner to raise a valid expectation in them that the entity will carry out the restructuring.

   In the given case, 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 -2020. If that be so, as per AS 29, 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.
   In this regard, AS 29 provides that if an entity starts to implement a restructuring plan, or announces its main features to those affected, only after the reporting period, disclosure is required AS 4, if the restructuring is material and non-disclosure could influence the economic decisions that users make on the basis of the financial statements.

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 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. 2020-2021. 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. 2019-2020. Is this accounting permitted under AS?

Solution: AS 29 defines a liability as a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

Further, in accordance AS 29 a provision is required to be recognised only when the following conditions are met:

(a) an entity has a present obligation (legal or constructive) as a result of a past event;
(b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
(c) a reliable estimate can be made of the amount of the obligation.

However, it has been specifically provided in AS 29 that provisions for future operating losses shall not be recognised since the same do not meet the definition of liability and also conditions set out for recognising provisions.

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. 2020-2021. In this scenario, for losses expected in the next financial year, entity cannot create provisions for operating losses in the current financial year itself in accordance with AS 29.

However, AS 29 provides that 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 AS 28, 'Impairment of Assets'.

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 AS?

Solution: 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, where an inflow of economic benefits is probable.