

Query No. 6

Subject: *Provisioning for expected credit loss on the amount due in the course of business from Government organisations.*¹

A. Facts of the Case

1. A company is a listed Government of India Navratna Enterprise under the Ministry of Housing and Urban Affairs, Government of India. The company operates in three business segments viz., (a) Project Management Consultancy (PMC); (b) Real Estate and (c) Engineering, Procurement and Construction ('EPC'). Under the PMC segment, the company executes cost plus contracts obtained on either nomination basis or through competitive bidding. The projects are executed by contractors appointed by the company through transparent tendering process. Under the Real Estate segment, the company works as a developer, procures land, gets the works executed by entering into contractual engagements with contractors and the project is sold in pre-construction and post-construction stages. Marketing is done by the company only. Under the EPC segment, the company takes contracts at fixed prices and the work is executed through sub-contractors.

2. Indian Accounting Standards (Ind ASs) are applicable for the company w.e.f. 01.04.2016. The accounts of the F.Y. 2016-17 were prepared in accordance with Ind ASs with comparatives for 2015-16 and opening Ind AS balance sheet as on 01.04.2015. For implementing Ind ASs, M/S XYZ & Co., LLP were appointed as consultants. As per their advice and suggested methodology, provision for expected credit loss ('ECL') was calculated. The accounts were audited by both statutory auditors and Govt. auditors and, as per the querist, the methodology was acceptable to them also.

3. The historical pattern of the company shows the debtors' age profile as follows:

(Rs. in Crore)

Age as on	0 – 1 year	1 – 2 years	2 – 3 years	< 3 years	Total
01.04.2015	1198.62	238.19	138.27	73.84	1648.92
31.03.2016	1449.34	193.36	126.98	170.13	1939.81
31.03.2017	1796.25	176.68	91.99	248.17	2313.09
31.03.2018 (Expected)	1850.00	390.04	161.75	328.41	2730.20

4. In accordance with the principles set out in Ind AS 109, 'Financial Instruments', the following provision for ECL has been made:

	(Rs. in Crore)
(i) Provision upto 01.04.2015 (Adjusted in retained earnings)	75.66
(ii) Provision charged in the year 2015-16	28.65
(iii) Provision charged in the year 2016-17	21.97
(iv) Provision charged in the year 2017-18 (upto 30.09.2017)	44.34

¹ Opinion finalised by the Committee on 4.4.2018 and 5.4.2018.

5. The company's accounting policy on provision for ECL is as follows:

“IMPAIRMENT OF FINANCIAL ASSETS

In accordance with Ind AS-109, the Company applies Expected Credit Loss (ECL) model for measurement and recognition of impairment loss for Financial Assets.

ECL is the difference between all contractual cash flows that are due to the company in accordance with the contract and all the cash flows that the Company expects to receive. When estimating the cash flows, the Company considers the following –

- All contractual terms of the Financial Assets (including prepayment and extension) over the expected life of the assets.
- Cash flows from the sale of collateral held or other credit enhancements that are integral to the contractual terms.

Trade Receivables

As a practical expedient the Company has adopted ‘simplified approach’ using the provision matrix method for recognition of expected loss on trade receivables. The provision matrix is based on three years rolling average default rates observed over the expected life of the trade receivables and is adjusted for forward-looking estimates. These average default rates are applied on total credit risk exposure on trade receivables and outstanding for more than one year at the reporting date to determine lifetime Expected Credit Losses.”

6. The company, being a Government company, is mainly engaged in business with Central Govt. / State Govt. / Autonomous Bodies/ Public Sector Undertakings. Generally, it takes long time to liquidate the debt such entities. Hence, the company is of the view that the requirement to make provision for ECL should not be applied in general.

B. Query

7. The querist has sought the opinion of the Expert Advisory Committee as to whether any exemption is available from making provision for expected credit loss under Ind ASs / other guidelines issued as on date where the clients are Central Govt. / State Govt. / Autonomous Bodies/ Public Sector Undertakings.

C. Points considered by the Committee

8. The Committee notes that the basic issue raised by the querist relates to availability of any exemption from making provision for expected credit loss under Ind AS 109. The Committee has, therefore, considered only this issue and has not examined any other issue that may be contained in the Facts of the Case, such as, text of the Accounting Policy, propriety of making provision for expected credit loss in respect of credit risk exposure on trade receivables and outstanding for *more than one year* at the reporting date, etc. The Committee notes that the company in the extant case is a Government company.

9. The Committee notes that section 5.5 of Indian Accounting Standard (Ind AS) 109, ‘Financial Instruments’, notified under the Companies (Indian Accounting Standards) Rules, 2015 (hereinafter referred to as the ‘Rules’), deals with impairment recognition of expected credit losses on financial instruments. Related application guidance is given in paragraphs B5.5.1 to B5.5.55 of Appendix B to Ind AS 109. Further, the Committee notes paragraph 2.2 of Ind AS 109, reproduced below:

“2.2 The impairment requirements of this Standard shall be applied to those rights that Ind AS 11 and Ind AS 18 specify are accounted for in accordance with this Standard for the purposes of recognising impairment gains or losses.”

The Committee also notes that Ind AS 11, ‘Construction Contracts’, and Ind AS 18, ‘Revenue’, notified under the Rules, make cross-reference to Ind AS 109 for recognition of impairment losses in respect of rights arising from the application of these Standards. Relevant paragraphs of these Standards are reproduced below:

Ind AS 11

“1A The impairment of any contractual right to receive cash or another financial asset arising from this Standard shall be dealt in accordance with Ind AS 109, *Financial Instruments*.”

Ind AS 18

“1B The impairment of any contractual right to receive cash or another financial asset arising from this Standard shall be dealt in accordance with Ind AS 109, *Financial Instruments*.”

Further, the Committee notes the following paragraphs of Ind AS 109:

“5.5.15 Despite paragraphs 5.5.3 and 5.5.5, an entity shall always measure the loss allowance at an amount equal to lifetime expected credit losses for:

- (a) trade receivables or any contractual right to receive cash or another financial asset that result from transactions that are within the scope of Ind AS 11 and Ind AS 18.**
- (b) ...”**

“5.5.17 An entity shall measure expected credit losses of a financial instrument in a way that reflects:

- (a) an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes;**
- (b) the time value of money; and**
- (c) 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.”**

Further, the Committee notes that paragraph B5.5.35 of Ind AS 109 permits use of practical expedients when measuring expected credit losses if they are consistent with the principles in paragraph 5.5.17 of that Standard, reproduced above. Paragraph B5.5.35 of Ind AS 109 cites calculation of the expected credit losses on trade receivables using a provision matrix as an example of a practical expedient.

10. From the above, the Committee notes that impairment requirements of Ind AS 109 are mandatory. In particular, receivables arising from the application of Ind AS 11 and Ind AS 18, if measured at amortised cost, are subject to the impairment requirements of Ind AS 109. No exemption is given in Ind AS 109 from compliance with impairment requirements of that Standard for *any* entity.

D. Opinion

11. On the basis of the above, the Committee is of the opinion that no exemption is available from making provision for expected credit loss under Ind ASs / other guidelines issued as on date where the clients are Central Govt. / State Govt. / Autonomous Bodies/ Public Sector Undertakings.
