



COVID-19: impact  
on the expected  
credit loss  
using simplified  
approach

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## 1. Background and scope

The impairment requirements in Ind AS 109, Financial Instruments, are based on the expected credit loss (ECL) model as against the earlier practice (incurred loss model). These requirements affect most of the entities and not just large financial institutions. They also affect those entities that have material trade receivables, contract assets and lease receivable balances, and where care is needed to ensure that an appropriate process is put in place to calculate the expected credit losses.

The measurement of ECL reflects a probability-weighted outcome, the time value of money and the best available forward-looking information. The need to incorporate forward-looking information means that application of the standard will require considerable judgement as to how changes in macroeconomic factors will affect ECL. The comparison of reported results of different entities may be difficult due to the increased level of judgement required in the computation of expected credit loss. However, entities are required to explain their inputs, assumptions and techniques used in estimating the ECL, which should provide greater transparency in respect of entities' provisioning processes.



## 2. Simplified approach

The application of simplified approach is considered to be a comparatively simpler as compared to general approach. However, with the outbreak of COVID-19, computing ECLs based on simplified approach would also involve significant complications and judgements and the mechanical methodologies would become redundant.

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Ind AS 109 provides three approaches for computation of ECL, viz. general approach, simplified approach, and the purchased or originated credit-impaired approach.

Simplified approach measures impairment losses and is applicable to trade receivables, contract assets and lease receivables. An entity is required to always apply the simplified approach for trade receivables or contract assets<sup>1</sup> that result from transactions within the scope of Ind AS 115, Revenue from contracts with customers, and that do not contain a significant financing component<sup>2</sup>. For other trade receivables, other contract assets, operating lease receivables and finance lease receivables, there is an accounting policy choice available - whether to apply general approach or simplified approach. Such policy choice can be separately applied for each type of asset (but applies to all assets of a particular type).

It was observed that offering the policy choice would reduce comparability. However, it would ease some of the practical concerns of tracking changes in credit risk for entities that do not have sophisticated credit risk management systems.

**This document highlights how an entity could apply the simplified approach for computing ECL on trade receivables that do not contain a significant financing component.**

### Computation of ECL under simplified approach

The simplified approach does not require an entity to track the changes in credit risk, but, instead, requires it to recognize a loss allowance based on lifetime ECL at each reporting date, since initial recognition.

Ind AS 109 states that an entity may use practical expedients when measuring ECL under simplified approach, as long as the methodology reflects a probability-weighted outcome, the time value of money and

1 A contract asset is defined as an entity's right to consideration in exchange for goods or services that it has transferred to a customer when that right is conditional on something other than the passage of time (for e.g., the entity's future performance).

2 A significant financing component exists if the timing of payments agreed to by the parties to the contract (either explicitly or implicitly) provides the customer or the entity with a significant benefit of financing the transfer of goods or services to the customer.

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.

One of the approaches suggested in the standard is the use of a provision matrix as a practical expedient for measuring ECL on trade receivables. A provision matrix might, for e.g., specify fixed provision rates depending on the number of days that a trade receivable is past due (for example, 1% if not past due, 2% if less than 30 days past due, 3% if more than 30 days but less than 90 days past due, 20% if 90-180 days past due, etc.).

The use of historical loss experience to determine lifetime expected credit losses is permitted under Ind AS 109. However, entities are required to adjust data based on their credit loss experience on the basis of their current observable data to reflect the effects of the current conditions and forecasts of future conditions. Further, information about historical credit loss rates should be applied to groups of receivables that are consistent with groups for which the historical loss rates were observed. The grouping may be based on geographical region, product type, customer rating, type of customer (wholesale or retail), etc.



### 3. Key challenges faced while computing ECL under simplified approach due to COVID-19 outbreak

As the pandemic continues to evolve, it is difficult, at this juncture, to estimate fully the extent and duration of its business and economic impact. Consequently, under these circumstances, the estimation of ECL poses a greater challenge in preparation of financial statements.

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The COVID-19 outbreak and the measures taken to contain the pandemic may severely affect the economic activity, not just in India but also globally. Measures such as restricting the movement of people, flights and travel, temporary closure of commercial establishments, schools, colleges, cancellation of events, etc. may have impact on the businesses, especially in sectors such as transport, retail, entertainment, tourism, etc. It has impacted the supply chain and production of goods and services.

The pandemic may also impact the cashflow generating ability of many entities which may reduce the ability of debtors/ trade receivables to pay the entity in a timely manner as per the contractual terms. In such a scenario, one will have to not just evaluate the risk of default but also a risk of delay that may be significant.

The International Accounting Standards Board (IASB) has, inter alia, stated the following in its document, 'IFRS 9 and COVID-19: Accounting for expected credit losses applying IFRS 9 Financial Instruments in the light of current uncertainty resulting from the COVID-19 pandemic':

- ▶ 'IFRS 9 requires the application of judgement and both requires and allows entities to adjust their approach to determining ECL in different circumstances. A number of assumptions and linkages underlying the way ECL have been implemented to date may no longer hold true in the current environment. Entities should not continue to apply their existing ECL methodology mechanically.
- ▶ Entities are required to develop estimates based on the best available information about past events, current conditions and forecasts of economic conditions. In assessing forecast conditions, consideration should be given both to the effects of COVID-19 and the significant government support measures being undertaken.
- ▶ It is likely to be difficult at this time to incorporate the specific effects of COVID-19 and government support measures on a reasonable and supportable basis. However, changes in economic conditions should be reflected in macroeconomic scenarios applied by entities and in their weightings. If the effects of COVID-19 cannot be reflected in models, post-model overlays or adjustments will need to be considered. The environment is subject to rapid change and updated facts and circumstances should continue to be monitored as new information becomes available.

These are testing times and the credit quality of trade receivables have been significantly impacted and hence the expected credit loss model should be robust enough to reflect such impact.

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- ▶ Although current circumstances are difficult and create high levels of uncertainty, if ECL estimates are based on reasonable and supportable information and IFRS 9 is not applied mechanistically, useful information can be provided about ECL. Indeed, in the current stressed environment, IFRS 9 and the associated disclosures can provide much needed transparency to users of financial statements.

Due to the outbreak of COVID-19, entities may face numerous challenges in applying the simplified approach. Some of those key challenges are as follows:

- ▶ Segmentation of portfolio: the segmentation applied in previous periods may no longer be relevant. An indicative segmentation based on the stress faced by trade receivables may be considered.
- ▶ Factoring the impact of time value of money: the probability of trade receivables becoming overdue will be high and hence the impact of time value of money will be significant. There may also be certain negotiations with the trade receivables such as change in payment terms, extension of credit period, etc. and such changes should be suitably captured in the model.
- ▶ Impact of macroeconomic conditions: the application of macroeconomic factors has become particularly challenging during the pandemic as the relationships of macroeconomic indicators with credit risk parameters may not be entirely reliable, especially due to the uncertainties pertaining to rapid change in events and government and regulatory interventions which may impact the economic behavior of the markets and borrowers. Entities may consider applying a mix of approaches ranging from management overlays and statistical models.
- ▶ Increase in disclosure requirements: entities will have to disclose and explain the impact of COVID-19 outbreak on its ECL computation and in particular, the assumptions that their managements have considered.

An entity may be required to include illustrative additional disclosures in its financial statements. The following are the some of them:

- ▶ Information about its credit risk management practices and how they relate to the recognition and measurement of ECLs: an entity may have changed its risk management practices in response to COVID-19, for e.g. by extending the credit period for its trade receivables or by following specific guidance issued by governments or regulators.
- ▶ The methods, assumptions and information that an entity has used to measure ECLs, especially with regards to incorporating forward-looking information into measuring ECLs, in particular:
  - a) How it has dealt with the challenge of ECL models that were not designed for the current economic shocks.
  - b) How it has calculated overlays and adjustments to the ECL models.
  - c) Quantitative and qualitative information that allows evaluation of the amounts arising from ECLs. The types of analysis disclosed previously may need to be adjusted or supplemented to clearly convey the impacts arising from COVID-19.
- ▶ Information on the assumptions that the entity has made about the future and from other major sources while estimating the uncertainties at the reporting date that have a significant risk of resulting in material adjustment within the next financial year.





## 4. Practical application of ECL model to trade receivables in light of the pandemic

There is a lot of uncertainty that is involved in the expected credit loss computation on account of the COVID-19 crisis, however, companies should commence the revision of their existing models in light with the current circumstances so that estimation of provision is neither understated nor overstated under Ind AS.

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Ind AS 109 provides an example of a practical expedient - a provision matrix for calculation of expected credit losses on trade receivables. Since Ind AS 109 does not provide specific guidance on how to determine the provision matrix, the practical application of the same becomes even more challenging under the COVID-19 crisis.

Hence, a step-wise approach to determine the provision matrix taking into consideration the outbreak of the pandemic should be applied.

**Step 1: -segmentation of trade receivables.**

**Step 2: determine the period over which the data may be considered for determining the loss rates.**

**Step 3: determine the ageing buckets and identify the default buckets.**

**Step 4: consider forward-looking macroeconomic factors and conclude on appropriate loss rates**

**Step 5: calculate expected credit losses**

### Step 1: segmentation of trade receivables

In order to determine the appropriate loss rates based on historical data, it is necessary that trade receivables are grouped based on certain shared credit risk characteristics. The trade receivables may be segmented based on any characteristics such as industry, sector, product type, customer credit rating, geography, etc. The loss patterns generally vary significantly across different customer segments. Hence, it is important that the segmentation is done after sufficient due diligence. If segmentation is inappropriately done, then the loss rate obtained would not be completely representative and the poor performance of a few customers would be offset by performance of certain good customers.

The segmentation carried out earlier by the entities may no longer be appropriate in the current environment. Even if an entity does not have enough visibility of characteristics or risk attributes under the current circumstances of COVID-19 outbreak, there should be bare minimum segregation of customers into at least two pools or segments. This includes the ones that are most impacted by COVID-19 outbreak and the others, which are not so impacted. The resulting loss rates for both these segments would be significantly different.

It is these unprecedented times that will prove to be the real test of the corporate governance and robustness of the risk management of a company.

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The most ideal approach would be to segment the customers after evaluating the stress inherent in the customers post the COVID-19 outbreak.

**Minimal stress:** segmenting customers which are not affected by the crisis, for instance, utilities, traders in essential goods, pharma, etc.

**Short-term stress:** segmenting customers who can bounce back into normal operations within three months.

**Medium-term stress:** segmenting customers who are expected to experience prolonged stress, i.e., beyond three months but are expected to return to normalcy within a year.

**Long-term stress:** segmenting customers who are expected to face a structural shift in their business outlook.

Analyzing and determining the impact of COVID-19 based on the above may be difficult. However, entities must ensure that with every reporting periods, crucial assumptions and methods of computation are revisited so that appropriate impact of current and future circumstances can be factored in the expected credit loss computation.

**Step 2: determine the period over which the data may be considered for determining the loss rates**

This step is crucial in order to determine the historical loss rate. Generally, it is observed that loss rates are determined over a period of past three to five years. There is no clear bright line here, but the historical loss rates should be determined under economic conditions that represent those that are expected to exist during the period of exposure for the respective segment at the reporting date. However, it is important to understand that loss rates should be appropriately adjusted to reflect any expected future changes in the respective segment performance based on the information that is available as at the reporting date. (For further details, please refer to Step 4). The past period of defaults to be considered may be different for different segments of the customers. A lot of judgment is involved to determine the period in which reliable historical data can be obtained and which is relevant to the future period. Due to the uncertainty on account of COVID-19, the decision pertaining to the period over which data should be considered in future will require significant consideration and deliberation. However, the period should be reasonable and not unrealistically too short or too long.

### **Step 3: determine the buckets and identify the default buckets**

The standard does not explicitly define the ageing buckets and the default bucket that an entity should consider in the ECL computation. The ageing bucket would generally depend on the credit period offered by the entity to its customers. The interval between ageing buckets could be 30 days, 60 days, 90 days, etc. The ageing bucket of every entity would be different depending on its credit period and type of customers. Along with the ageing buckets, an entity will also have to determine the appropriate default bucket. The default bucket generally depends upon an entity's past experience on how long it takes to collect all its outstanding receivable (i.e., movement or flow of balances through the ageing buckets). Basically, the entity must determine what percentage or proportion of its trade receivables reach a point of no collection or loss.

Thus, the entire provision matrix under the simplified approach is based on the determination of an entity's expectation based on past history of the proportion of trade receivables that default once they reach that specific point of past due.

The determination of the default bucket is one of the most crucial steps of the ECL computation. The default buckets may be different for different segments of trade receivables. Given the current situation of crisis and also considering the relief measures extended by the government and regulatory authorities, entities may want to revisit their default buckets especially for those segment of trade receivables which are most impacted by the COVID-19 outbreak.

There may be entities who have a history of some recovery post its trade receivables reaching the default bucket, thus in this case the default percentage is not really 100% but may be a little lesser than 100% based on the recovery percentage. For e.g., Company X Ltd has outstanding debtors over 360 days at the reporting date. Basis its past experience, X Ltd has determined 360 days as its default bucket. However, on analysis of its data, it has realized that once a debtor is overdue by 360 days, the company manages to recover at least 5% of its outstanding balance. Thus, when X Ltd is practically applying the model, it should factor in this recovery of 5% else it may result in overstatement of the provision amount. Under the COVID-19 crisis, this recovery percentage would also have to be revisited considering the impact the crisis has had on business organizations in general. It may be more prudent to re-evaluate the time to recovery against these defaults. Entities may also continue with a default rate of 100% or consider some additional management overlay (some estimated additional haircut on recovery) on the loss given default percentage.

One may also be mindful of the fact that entities may have to opt for litigation and the arbitration process to recover its dues. In such case, the delay in recovering these dues should also be factored in the model. The probability of an entity opting for this route for settlement should also be given due consideration.

#### **Step 4: consider forward-looking macroeconomic factors and conclude appropriate loss rates**

The historical loss rates, calculated as above, must also reflect the current economic conditions as well as forecast of future economic conditions, provided there is availability of reasonable and supportable information. This step particularly involves significant judgement. Entities need to prima facie identify the relevant macro-economic factors such as GDP, unemployment rate, inflation, etc. that may impact the loss rates of a particular segment of trade receivables and then adjust the historical loss rates to reflect the current and future economic conditions. Entities may also consider using statistical techniques (e.g., Vasicek model) to determine the loss rates. However, the standard does not specifically require the use of complex analysis and relatively simple models may also be sufficient if the results from such models are consistent with the requirements of the standard. Further, an entity may compute the impact of such forward-looking forecasts under various scenarios and compute the adjusted loss rates by applying probability weights to each such scenario.

Practically, entities must be mindful of the fact that different pools of trade receivables would be impacted by different macro-economic factors and it may be likely for more than one factor to have an impact on the loss rates. Thus, using a blanket assumption or overlay without considering the nature and risk characteristic of the debtors would not be entirely appropriate.

Considering the impact of COVID-19 outbreak, if the entity has segmented its trade receivables based on the stress levels that the customers may face, the impact of macro-economic factors for each segment would be significantly different. In fact, entities may also consider adopting different models and calculation methodologies for those set of debtors or trade receivables that are most severely impacted by the crisis. Since the impact of this pandemic is unprecedented, the relationships of macroeconomic indicators with credit risk parameters may not be entirely reliable, especially due to government and regulatory interventions which change the economic behavior of the markets and borrowers. Hence, if the effects of COVID-19 cannot be reflected in models, post-model overlays or adjustments will need to be considered.

#### **Entities may consider a mix of approaches. These may be as follows:**

- ▶ Build some specific macroeconomic scenarios independent of the existing scenarios to determine the potential impact of COVID-19 and use the revised scenarios in the model.
- ▶ Revise the current baseline and stress scenarios to incorporate the impact of COVID-19.
- ▶ Provide higher weightings on the downside or adverse cases and reduce on the base case scenarios;
- ▶ Entities may consider applying a higher loss rates, i.e., one or two notches higher default rates to its ageing buckets.



An entity may apply these different approaches to different segment of trade receivables. In case a segment is not severely affected by COVID-19, the entity may still continue with its current approach. However, it may have to update its forward-looking macroeconomic factors in light of the crisis. But in case of segments that are severely impacted by the crisis, the entity may adopt any of the above approaches or may also consider applying more than one set of approaches in order to ensure that the appropriate impact of the pandemic is adequately captured and there is no understatement of the provision amount.

### **Step 5: calculate expected credit losses**

The expected credit loss of each segment of trade receivables as determined in Step 1 should be calculated by multiplying the outstanding gross receivable as at the reporting date by the loss rate. For example, the respective loss rate needs to be applied to the outstanding balance of receivables for each ageing bucket in each pool/segment. In such a case, once the expected credit losses of each ageing bucket for the receivables have been calculated, total expected credit loss can be derived by a simple addition of all the expected credit losses of each ageing bucket of that pool/segment. Additionally, specific individual provision may be recognized in respect of trade receivables which witness a significant financial stress or deterioration in the credit worthiness. It may also be recognized in case there is any other objective evidence in respect of higher expected losses irrespective of their current ageing (for e.g., a trade receivable that is 30 days over-due but is declared insolvent on the reporting date). A sum of expected credit loss of all identified segments, including the individual provision, would provide us with the total expected credit loss for the entity as at the reporting date.

Thus, the computation of ECL under the simplified approach has got slightly more complex as companies may, after considering the above factors in the computation, have to rely on certain assumptions and judgements, mainly due to the future uncertainties due to the outbreak of coronavirus.



## Appendix

### Illustrative example

#### Fact pattern

XYZ Limited is a textile company having its branches in various states of the country. It uses the provision matrix as a practical expedient to measure ECL on its portfolio of trade receivables. Based on its past experiences, it segments its receivables into the types of customers, for e.g., wholesale and retail. However, in the light of COVID-19 pandemic, the company has further bifurcated its customers on geographical regions.

The company computes flow rates based on ageing analysis and applies macroeconomic overlay.

Assumption: macroeconomic adjustment

- a) For the year ended 31 March 2019, the company has assumed an overlay of 10%.
- b) For the year ended 31 March 2020, the company has bifurcated the wholesale trade receivables in Maharashtra based on the expected stress and assumed an overlay as follows:

Category	Macroeconomic overlay
Minimal stress	10%
Short-term stress	15%
Medium-term stress	20%
Long-term stress	25%

Given the above facts, XYZ company would compute the ECL for March 2019 and March 2020 as follows.

## a) Computation of ECL as at 31 March 2019

The following table shows the ageing of its wholesale receivables for the past 12 months. Receivables that are more than 120 days old are considered uncollectible.

**Table 1: Historical ageing of trade receivables held by XYZ Limited (in INR million)**

Month	Balance	Current (Not due)	0-30 days	31-60 days	61-90 days	91-120 days	More than 120 days
Mar-19	4,800.0	970.0	900.0	800.0	600.0	540.0	990.0
Feb-19	4,400.0	940.0	800.0	780.0	580.0	400.0	900.0
Jan-19	4,200.0	850.0	780.0	750.0	550.0	420.0	850.0
Dec-18	3,880.0	820.0	700.0	620.0	570.0	400.0	770.0
Nov-18	3,680.0	790.0	660.0	590.0	510.0	400.0	730.0
Oct-18	3,500.0	750.0	640.0	550.0	510.0	350.0	700.0
Sep-18	3,360.0	720.0	620.0	520.0	450.0	380.0	670.0
Aug-18	3,220.0	680.0	610.0	480.0	430.0	370.0	650.0
Jul-18	3,040.0	640.0	580.0	440.0	420.0	360.0	600.0
Jun-18	2,900.0	630.0	570.0	430.0	410.0	340.0	520.0
May-18	2,760.0	620.0	560.0	420.0	390.0	320.0	450.0
Apr-18	2,610.0	600.0	530.0	400.0	380.0	310.0	390.0
Mar-18	2,520.0	590.0	520.0	400.0	390.0	300.0	320.0

### Note

- 1) Historical ageing for last 12 months is only considered for the purpose of this illustration. However, in practice, a higher period may be considered by the entities.
- 2) This illustration is based on the assumption that the trade receivables have a short tenure and do not carry a contractual interest rate. Therefore, the effective interest rate (EIR) of these receivables is zero and the impact of discounting has not been considered.

A provision matrix is developed by XYZ Limited to compute the historically observed flow rates. These are derived by computing the historical 'flow rate' of trade receivables, based on their ageing and arriving at an average loss rate. This is demonstrated in the table below:

**Table 2: Computation of 'flow rate' based on historical ageing of trade receivables**

Month	0-30 days	31-60 days	61-90 days	91-120 days	More than 120 days
Mar-19	95.7%	100.0%	76.9%	93.1%	22.5%
Feb-19	94.1%	100.0%	77.3%	72.7%	11.9%
Jan-19	95.1%	107.1%	88.7%	73.7%	20.0%
Dec-18	88.6%	93.9%	96.6%	78.4%	10.0%
Nov-18	88.0%	92.2%	92.7%	78.4%	8.6%
Oct-18	88.9%	88.7%	98.1%	77.8%	7.9%
Sep-18	91.2%	85.2%	93.8%	88.4%	5.4%
Aug-18	95.3%	82.8%	97.7%	88.1%	13.9%
Jul-18	92.1%	77.2%	97.7%	87.8%	23.5%
Jun-18	91.9%	76.8%	97.6%	87.2%	21.9%
May-18	93.3%	79.2%	97.5%	84.2%	19.4%
Apr-18	89.8%	76.9%	95.0%	79.5%	23.3%
<b>Average</b>	<b>92.0%</b>	<b>88.3%</b>	<b>92.5%</b>	<b>82.4%</b>	<b>15.7%</b>

In the above table, the flow rate shows the percentage of trade receivables in an ageing bucket that have not been collected during the month and have therefore moved into the next ageing bucket. For example, INR590 million of trade receivables were not due as at 31 March 2018. Out of these, INR530 million were not collected during the next month and moved into the 0-30 days ageing bucket as at 30 April 2018. Therefore, the flow rate for the 0-30 days ageing bucket at 30 April 2018 is 89.8% (530/590\*100). The flow rate for all ageing buckets has been computed in the same manner. Accordingly, the company has computed the historical average flow rates for all ageing buckets.

These average flow rates are then used to determine the loss rate (determined as a product of the average flow rates for the applicable ageing bucket) to be applied to the trade receivables as at 31 March 2019. This loss rate is adjusted by a forward-looking estimate that includes the probability of a deteriorating domestic economic environment in the future periods. The final provision matrix is illustrated in the table below:

**Table 3: Loss rate computation**

Ageing bucket	0-30 days	31-60 days	61-90 days	91-120 days	More than 120 days	LGD (Not collected)	Loss rate	Adjusted loss rate
	(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)
Current (Not due)	92.0%	88.3%	92.5%	82.4%	15.7%	100.0%	9.7%	10.7%
0-30 days		88.3%	92.5%	82.4%	15.7%	100.0%	10.6%	11.6%
31-60 days			92.5%	82.4%	15.7%	100.0%	12.0%	13.2%
61-90 days				82.4%	15.7%	100.0%	12.9%	14.2%
91-120 days					15.7%	100.0%	15.7%	17.3%
More than 120 days						100.0%	100.0%	100.0%

The loss rates above are computed based on the flow rates are derived in table 2 above. For example, out of the receivables that are currently not due, 92% is expected to move into the 0-30 days bucket. However, 88.3% of the receivables in the 0-30 days bucket are expected to move into the 31-60 days ageing bracket, and so on. The loss rate computed in column (g) above is a product of the flow rates for the applicable ageing brackets, i.e., product of flow rates in columns (a) to (e) and further multiplied by the loss given default (LGD) in column (f), i.e., the amount uncollectible post a receivable is 120-days old. The adjusted loss rate includes the forward-looking estimate to reflect the probability of deteriorating economic conditions. In this illustration, an overlay of 10% has been assumed. However, in practice, such adjustment may be done based on a statistical analysis or based on a judgmental overlay based on management assessment and considering probability weighted scenarios.



Based on the above, computation of ECL may be done as follows:

Ageing bucket	Adjusted loss rate	Balance as at 31 March 2019 (in INR million)	ECL
Current (Not due)	10.7%	970.0	103.8
0-30 days	11.6%	900.0	104.4
31-60 days	13.2%	800.0	105.6
61-90 days	14.2%	600.0	85.2
91-120 days	17.3%	480.0	83.0
More than 120 days	100.0%	990.0	990.0
	<b>TOTAL</b>	<b>4,740.0</b>	<b>1,472.0</b>

**Note:**

Specific individual provision may be recognized in respect of trade receivables which witness a significant financial stress or deterioration in the credit worthiness or if there is any other objective evidence in respect of higher expected losses irrespective of their current ageing.

Accordingly, as at 31 March 2019, XYZ Limited is required to measure its total impairment allowance on wholesale trade receivables at INR1,472.0 million. It should perform a similar analysis to compute the expected credit loss for trade receivables for the retail segment.

**b) Computation of ECL as at 31 March 2020 considering the impact of COVID-19**

**Step 1: segmentation of trade receivables**

As a first step to consider the impact of COVID-19 for computation of ECL on trade receivables as at 31 March 2020, XYZ Limited has revisited its segmentation approach for the trade receivables. It determined that stratifying the trade receivables portfolio only based on the type of customer may not be appropriate. Hence, it further segmented them on the basis of region. The company believes that trade receivables in areas that are adversely impacted by the pandemic may tend to default more as compared to those that are not impacted significantly. It would further bifurcate the segment based on expected stress into the following categories:

- ▶ Minimal stress
- ▶ Short-term stress
- ▶ Medium-term stress
- ▶ Long-term stress

**Step 2: determine the period over which data may be considered**

Given the current economic conditions, XYZ Limited has determined that it would consider the loss experience of past 12 months for computing the loss rates.

### Step 3: determine the buckets and identify the default buckets

The company will compute average flow rate of past 12 months for wholesale customers in Maharashtra as follows:

Month	0-30 days	31-60 days	61-90 days	91-120 days	More than 120 days
Average	97.2%	94.7%	91.8%	89.6%	17.9%

(The flow rates above are derived by the company based on ageing analysis and are computed in the same manner as per the flow rates computed in Table 2 above for the year ended 31 March 2019)

#### Note

In this illustration, it has been assumed that geographical region is one of the criteria for further segmenting the trade receivables portfolio. However, in practice, entities would have to consider the facts and circumstances related to the nature of its own business.

After determining the average flow rates, XYZ Limited shall compute the loss rates as follows:

Ageing bucket	0-30 days	31-60 days	61-90 days	91-120 days	More than 120 days	LGD (not collected)	Loss rate
	(a)	(b)	(c)	(d)	(e)	(f)	(g)
Current (Not due)	97.2%	94.7%	91.8%	89.6%	17.9%	100%	13.6%
0-30 days		94.7%	91.8%	89.6%	17.9%	100%	13.9%
31-60 days			91.8%	89.6%	17.9%	100%	14.7%
61-90 days				89.6%	17.9%	100%	16.0%
91-120 days					17.9%	100%	17.9%
More than 120 days						100%	100%

### Step 4: consider forward-looking macroeconomic factors

The historical loss rates, calculated as above, must also reflect the current economic conditions as well as the forecast of future economic conditions. Hence, XYZ Limited computes the adjusted loss rates to consider the forward-looking macroeconomic factors including an adjustment for the impact of COVID-19. Since the segment under consideration is expected to be adversely impacted by the pandemic. XYZ Limited has determined the adjusted loss rates by applying statistical technique and an overlay based on management judgement

Ageing bucket	Loss rate	Minimal stress	Short-term stress	Medium-term stress	Long-term stress
Current (Not due)	13.6%	15.0%	15.6%	16.3%	17.0%
0-30 days	13.9%	15.3%	16.0%	16.7%	17.4%
31-60 days	14.7%	16.2%	16.9%	17.6%	18.4%
61-90 days	16.0%	17.6%	18.4%	19.2%	20.0%
91-120 days	17.9%	19.7%	20.6%	21.5%	22.4%
More than 120 days	100%	100%	100%	100%	100%

## Step 5: calculate expected credit loss

Based on the above, computation of ECL may be done as follows:

Ageing bucket	Adjusted loss rate	Balance as at 31 March 2020 (in INR million)	ECL
<b>Minimal stress</b>			
Current (not due)	15.0%	300.0	45.0
0-30 days	15.3%	800.0	122.4
31-60 days	16.2%	500.0	81.0
61-90 days	17.6%	300.0	52.8
91-120 days	19.7%	260.0	51.2
More than 120 days	100%	300.0	300.0
<b>Sub-total (A)</b>		<b>2,460.0</b>	<b>652.4</b>
<b>Short-term stress</b>			
Current (not due)	15.6%	250.0	39.0
0-30 days	16.0%	650.0	104.0
31-60 days	16.9%	380.0	64.2
61-90 days	18.4%	200.0	36.8
91-120 days	20.6%	110.0	22.7
More than 120 days	100%	280.0	280.0
<b>Sub-total (B)</b>		<b>1,870.0</b>	<b>546.7</b>
<b>Medium-term stress</b>			
Current (not due)	16.3%	300.0	48.9
0-30 days	16.7%	720.0	120.2
31-60 days	17.6%	680.0	119.7
61-90 days	19.2%	570.0	109.4
91-120 days	21.5%	320.0	68.8
More than 120 days	100%	390.0	390.0
<b>Sub-total (C)</b>		<b>2,980.0</b>	<b>857.0</b>
<b>Long-term stress</b>			
Current (not due)	17.0%	430.0	73.1
0-30 days	17.4%	680.0	118.3
31-60 days	18.4%	530.0	97.5
61-90 days	20.0%	710.0	142.0
91-120 days	22.4%	550.0	123.2
More than 120 days	100%	410.0	410.0
<b>Sub-total (D)</b>		<b>3,310.0</b>	<b>964.1</b>
<b>Total (A+B+C+D)</b>		<b>10,620.0</b>	<b>3,020.2</b>

### Note

- The total trade receivables above must match with the total receivables for wholesale trade receivables in Maharashtra as per the financial statements as at 31 March 2020.
- Specific individual provision may be recognized in respect of trade receivables which witness a significant financial stress or deterioration in the credit worthiness or if there is any other objective evidence in respect of higher expected losses irrespective of their current ageing.

Accordingly, as at 31 March 2020, XYZ Limited is required to measure its total impairment allowance on wholesale trade receivables in Maharashtra region at INR3,020.2 million. It should perform a similar analysis to compute the expected credit loss for trade receivables for the other segments (i.e., for other states in the wholesale customers category and for the retail customers).

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