ARMSTRONG
INTERNATIONAL

COVID - 19

IMPACT ON ACTUARIAL ASSUMPTIONS

N SRINIVASAN
CONSULTING ACTUARY

EMPLOYEE BENEFITS ACCOUNTING

DURING COVID - 19

The global economies are under unprecedented stress, for the first time after World War II. The economy has suffered significant slowdown amid shutdowns and wide-ranging policy uncertainties. The economic risks remain strongly tilted to the down side, aggravated by deepening political polarisation and increasing skepticism over the benefits of multilateralism.

At a time when the trade dispute between president USA and China were about to come to a conclusion after long and protracted negotiation, the world witnessed the outbreak of Corona virus and this was followed by a steep fall in the crude oil prices, this plunging the economy into an uncertain future.

COVID-19 has not only affected the health of people and increased morbidity rates across the globe which has huge implication for the insurance world, it has also caused severe disturbances in the global economic environment which has consequential impact on financial statements reporting and how employee benefits are measured.

IMPACT ON SETTING ASSUMPTIONS

The global pandemic COVID-19 has already impacted global trade and economy with consequential impact on global and Indian financial markets. This will also have impact on accounting, disclosure, internal control implications for entities operating on the affected economies. There is a great deal of uncertainty as to how the COVID-19 situation will continue to evolve, and the scenario is rapidly changing. The uncertainty arises primarily from interruptions in production, supply chain disruptions, unavailability of personnel, closure of facilities / offices due to the rapid outbreak of COVID-19, decline in demand, liquidity issues, business continuity issues, etc. The resultant outbreak, though started outside of India, has now disrupted most Indian business activities and economic operations.

The outbreak of COVID-19 can have a number of potential issues for entities that operate in geographies that are significantly exposed to the outbreak. In addition, there could also be impact on those entities whose vendors/ bankers/ suppliers/ service providers are in geographies that are exposed. There is already a broader economic impact of the outbreak on global and Indian financial markets and the outbreak will also pose increasing risks and potentially have accounting implications for all entities with exposure to broader economic downturn and decline in financial markets.

Evaluating Additional Risk Parameters

There is a need for companies to evaluate additional risks arising from disruption due to COVID-19

Operational Disruptions	Operational disruptions resulting in changes to the business model arising from significant drop in demand, reduced customer base, disruption in supply chain, employee's absence or work from home, geographical implications of group operations, public lock down etc.
Contractual Breaches	Contractual non-compliance resulting in contractual breaches, additional security requirements or stressed asset and liability valuations.
Liquidity	Liquidity and working capital issues given the reduced/ impaired ability to service debt or replenish working capital requirements due to possible lower cashflows.
Asset Valuations	Asset valuations – downward asset valuations may trigger legal and compliance issues or lead to liquidity challenge

The forecasts or budgets for future cashflows prepared by management should be updated to reflect the impact of COVID-19.Companies may need to consider the potential impact on estimates including actuarial assumptions used in measuring employee benefits. Market assumptions used to determine fair value for recoverable assets and liabilities require reconsideration. For employee benefits valuations, where assumptions are fairly long term in nature, HR departments will have to revisit the contracts with employees, both formal and informal, considering the implications for industrial harmony and devise strategies with the CFO that are in line with the future budget estimates of the company and advise the necessary change in assumptions for the employee benefits obligations.

Repo Rate Cut by RBI

In response to the outbreak of COVID19,Reserve Bank of India has slashed the repo rate several times, by 115 basis points since March 2020.

Discount Rate

The 10 year yields on G-Secs has fallen to a low of 5.86 as on end of day 22nd May 2020. This represents a decrease of around 103 basis points from the start of the calendar year 2020. The significant decrease in discounting rate will lead to an increase in liabilities to be reported.

Salary Growth Rate

In our practice, we have seen significant reduction in estimated salary growth rates reported by companies. Several companies have slashed their salary growth rates to zero. The rise in liabilities due to fall in discount rate can be offset by the reduced salary growth rate.

Attrition Rate

Lower attrition rate can be considered in the present climate, as many employees will prefer the comfort of their jobs over switching jobs. However, this has to be decided considering impact on the specific industry.

THANK YOU

ARMSTRONG INTERNATIONAL CONSULTANTS

www.consultactuary.com
mail@consultactuary.com

+91 936 320 0885
+91 967 771 8143

33 MGR Nagar
Coimbatore
Tamil Nadu
India - 641007