Impact of COVID-19 on Preparation and Presentation of Financials Statements – From Companies Viewpoint:

Background

In this difficult environment, each regulatory body is releasing relief measures and guidelines for easing out the impact of COVID 19. On the financial and compliance front, announcements have been flowing from the Government authorities in the form of deferment of statutory due dates or relaxation in payment terms to overcome the financial crisis being faced due to lock-down.

Institute of Chartered Accountant of India (ICAI) has come out with its guidelines for care to be taken by the PREPARER and AUDITOR of the financial statements. This guidance from the ICAI addresses the common issues which would be encountered on account of COVID 19 while preparing the financial statements and its audits and how they should be addressed.

For better understanding of the quarterly and year-to date financial results, separate disclosure may be presented in financial statement for aggregate loss incurred due to COVID 19 being irregular and not ordinary in nature.

We have bifurcated the guidelines for the preparers and auditors into two sections. In this note, we have focused from the viewpoint of the Company. Separate note on Auditor's Viewpoint is also prepared and published in our website.

I. Guidelines for the PREPARER of the financial statements

A. Impact of corona virus on financial reporting - Assets & Liabilities.

- **Inventory**

Inventories would have piled up since due to lock-down, supply chain has come to halt. Also fresh production activity is also stopped. This will require entities to examine the need to write down the inventories where the net realisable value is lower than cost price. Also the overhead costs incurred during the lock-down period cannot be loaded to the cost of inventory and will have to be charged off as expense immediately.

- **Impairment test for assets**

Reassess the need for impairment of non-financial assets like property, plant & equipment, intangibles and goodwill, considering reduced economic activity, change in financial forecast and budgeted cash flows, etc. Management will have to append the explanatory note in financial statements in regard to impairment test carried out along with sensitivity analysis.

- **Change in useful life of fixed assets**

During lock-down the assets are not functional and kept idle. The management should reassess whether there is any change required in the useful life / residual life of such property, plant and equipment.

- **Fair value of financial assets / instruments**

Current market sentiments are not the correct representative for the market prices as at year-end. Accordingly, additional care to be taken in case of the financial assets and financial instruments which are mark-to-market price at the period end.

- **Trade receivables – Expected Credit Loss**

Year-end outstanding trade receivables would certainly rise due to liquidity constraint being faced by the customers in releasing the over-due payments. In such scenarios, management need to estimate and provide for bad debts and expected doubtful debts.

- **Leased assets**

In case of modification in lease arrangements like waiver or concession in rental payouts, financial effect needs to be factored in financial statement. Further, in case of non-cancellable lease arrangement which are onerous in nature, provision for impairment of leased assets also to be considered.

- **Capitalization of borrowing cost**

During this lock-down period, the construction projects have come to halt. In such scenario, borrowing cost incurred during such period does not form part of the cost of qualifying asset and will be charged off as expense immediately.

- **Provision for onerous contract**

There is overall disruption in supply chain baring essential items & logistic services which resulted into hike in procurement prices. Provision should be made of onerous contracts like expected loss which will be incurred to fulfill the commitment give to customer to supply the products at contract prices which are lower than the procurement prices.

- **Going concern assumption need to be reassessed by management**

The management will have to assess the impact of COVID 19 on the going concern assumption and accordingly measure its assets and liabilities. Management should include appropriate explanatory note for its impact on the financial statement as on balance sheet date and next 12 months.

- **Impact of COVID 19 on significant uncertainties**

Financial statement should include disclosure of significant recognition and measurement uncertainties that might have been emerged by the outbreak of the COVID -19 in measuring various assets and liabilities. Management should also disclose how they have dealt with the impact of COVID -19 on the financial position and financial performance of the entity.

B. Impact of coronavirus on financial reporting- Revenue & Expenses

- **Revenue recognition**

Measurement of revenue need to be reassessed considering the impact of COVID 19 on expected increase in sales return, primary and secondary discounts to liquidated the inventories, etc. Additionally, disclosure is required for revenue not recognized due to uncertainty of cash flows.

- **Recognition of insurance claims filed due to loss on account of COVID 19**

Business interruption insurance claim to be recognized as income in books only if the recovery is virtually certainty else it would be in nature of contingent nature. Disclosure of such contingent assets would be required in financial statement prepared under Indian Accounting Standard.

- **Re-measurement of deferred taxes**

Management should reassess the recognition of deferred taxes like deferred tax asset recognized on carry-forward business losses, impairment losses, deferred tax liability on distributable profits from subsidiaries, etc.

C. Impact Concerning Indian Accounting Standards (Ind AS) and Accounting Standards (AS) Areas to be Considered

- Inventory Measurement
- Leases
- Revenue
- Provisions, Contingent Liabilities and Contingent Assets
- Modifications or Termination of Contracts or Arrangements
- Going Concern Assessment
- Income Taxes
- Consolidated Financial Statements
- Property, Plant and Equipment
- Presentation of Financial Statements
- Borrowing Costs
- Post Balance Sheet Events

1. Inventory Measurement (Ind AS 2 and AS 2)

- As per the AS 2, IND AS 2, Inventory and its valuation, it might be imperative to write down the inventories to the net realizable value due to reduced movement /decline in selling prices/ stock obsolescence in market.
- The management may consider written down of inventories to net realisable value item by item.
- Ind AS 2 and AS 2 also provides allocation of fixed production overheads to the costs of conversion based on the normal production capacity.
- The amount of fixed overhead allocated to each unit of production is not increased as a consequence of low production or idle plant. Unallocated overheads are recognised as an expense in the period in which they are incurred.
- Entities should assess the significance of any write-downs and whether they require disclosure in accordance with Ind AS 2/AS 2 as well as paragraph 98 (a) of Ind AS 1, and paragraph 14(a) of AS 5.

2. Leases (AS 19)

- Changes in the terms of lease arrangements or concession given towards to lease payments shall be considered while accounting for leases. Anticipated revision should not be taken into account.
- Discount rate used to determine present value of minimum lease payments of new leases may need to incorporate any risk associated with COVID-19.
- Compensation any given/declared by Government to the lessor for providing concession to the lessee, it should be considered whether the same needs to be accounted for appropriately as per AS 19.
- Whether any assistance received from government are government grants under AS 12.
- Entities needs to determine whether as a result of COVID -19, any lease arrangement has become onerous. The same should be accounted for as per AS 29.

3. Revenue (AS 9)

- Under Ind AS 115, these factors like sales return, higher price discounts etc. to be considered in estimating the amount of revenue to recognised, i.e., measurement of variable consideration.
- As per Ind AS 115 disclosure requirement entities may have to consider disclosure about the impact of COVID-19 on entities revenue.
- AS 9, Revenue Recognition requires entities to disclose the circumstances in which revenue recognition has been postponed pending the resolution of significant uncertainties

4. Provisions, Contingent Liabilities and Contingent Assets

- Onerous Contract - some contracts may become onerous for reasons such as increase in cost of material/labour. Management should consider whether any contract has become Onerous and the same be accounted as per Ind AS 37/AS 29.
- If management is unable to assess the contracts are onerous the same should be disclosed.
- Restructuring Cost – Provision is recognized only when general recognition criteria for provision are met and there is a detailed plan.
- Insurance Claim - Entities claims on insurance companies can be recognised in accordance with Ind AS 37 only if the recovery is virtually certain.
- Ind AS 37 requires Provision to be recognized only where an entity has present obligation, probable outflow of resources and a reliable estimate.

5. Modifications or Termination of Contracts or Arrangements

- Entities may modify or terminate contracts which are within the scope of other Ind AS and the AS or guidelines mentioned below

S.No	Entities to Whom Ind AS is applicable	Entities to Whom AS is applicable
1	Ind AS 19, Employee Benefits	AS 15 Employee Benefits (revised 2005)
2	Ind AS 102, Share-based Payments	Guidance Note on Accounting for Employee Share Based Payments
3	Ind AS 109, Financial Instruments and Ind AS 32, Financial Instruments - Presentation	Guidance Note on Accounting for Derivative Contracts (Issued 2015)
4	Ind AS 104, Insurance Contracts For insurance companies this is routine; events like earthquake, huge floods, war situations, etc.	NA
5	Ind AS 115, Revenue from Contracts with Customers	AS 7 Construction Contracts (revised 2002), AS 9 (Revenue Recognition) and Guidance Note on Accounting for Real Estate Transactions (revised 2012)

6. Going Concern Assessment

- The Financial statements are normally prepared on the assumption that an entity is a going concern and will continue in operation for the foreseeable future.
- Management of the entity should assess the impact of COVID-19 and the measures taken on its ability to continue as a going concern.
- Events occurring after the balance sheet date may indicate that the enterprise ceases be a going concern.
- It may be necessary for the management to evaluate whether it is proper to use the fundamental accounting assumption of going concern in the preparation of the financial statements.

7. Incomes Taxes (Ind AS 12 & AS 22)

- COVID-19 could aect future profits and/or may also reduce the amount of deferred tax liabilities and/or create additional timing dierences due to various factors.
- Entities with deferred tax assets should reassess forecasted profits and the recoverability of deferred tax assets in accordance with Ind AS 12/AS 22.

8. Consolidated Financials Statement (Ind AS 110 & AS 21)

- Ind AS 110 and AS 21 states that the financial statements of the parent and the subsidiary companies used in the preparation of the consolidated financial statements are to be drawn on the same accounting date.
- Difference however between the reporting dates should not be more than six months.

9. Presentation of Financial Statements

- Breach of loan covenants (including classification of liabilities into current and non-current) there may be instances of breach of loan covenants which may trigger the liability becoming due for payment and liability becoming current.
- However, as per paragraph 74 of Ind AS 1, such a liability shall not be classified as current, if the lender agreed, after the reporting period and before the approval of the financial statements for issue, not to demand payment as a consequence of the breach.
- Sources of estimation uncertainty under Ind AS 1 Paragraph 125 of Ind AS 1, Presentation of Financial Statements, requires an entity to disclose information about the assumptions it makes about the future, and other major sources of estimation of uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year. Entities shall be guided by the prescriptions in paragraphs 125 to 133 of Ind AS 1.
- Comparative information- Ind AS 1 requires presentation of minimum comparative information.
- Preparers may consider making adequate disclosures and explanatory notes regarding the impact of COVID-19 on its financial position, performance and cash flows.

10. Borrowing Cost

- Ind AS 23 and AS 16 require that the capitalisation of interest is to be suspended when development of an asset is suspended.
- The management may consider this aspect while evaluating the impact of COVID-19.

11. Post Balance Events

- According to Ind AS 10, events occurring after the reporting period are categorised into two viz.
- (i) Adjusting events i.e. those require adjustments to the amounts recognised in its financial statements for the reporting period and
- (ii) Non-adjusting events i.e. those do not require adjustments to the amounts recognised in its financial statements for the reporting period.
- Management judgement may be required to categories the events into one of the above categories.
- In accordance with AS 4, Contingencies and Events Occurring After Balance Sheet Date, adjustments to assets and liabilities are required to be made for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the balance sheet date.
- Disclosure should be made in the report of the approving authority of those events occurring after the balance sheet date that represent material changes and commitments affecting the financial position of the enterprise.
- Entities must disclose significant recognition and measurement uncertainties that might have been created by the outbreak of the COVID -19 in measuring various assets and liabilities.
- Entity should also disclose how they have dealt with the impact of COVID -19 on the financial position and financial performance of the entity.

Team SandS

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