Research Paper:

Key Financial Reporting Implications of COVID-19 and Possible Approaches

11 April 2020

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1.0 Background

1.1 Coronavirus (COVID-19) has been rightly described as an unprecedented Human, Economic and Financial Crisis facing the world. This pandemic has resulted in widespread economic uncertainty and disruption of businesses.

1.2 COVID-19 has and will have far reaching implications on financial reporting. These circumstances would potentially present entities with several challenges when preparing their financial statements for year/quarter ended 31 March 2020. In this whitepaper, we have covered some of the key financial reporting implications that companies need to consider and, also, possible approaches that they may consider to dealing with the same keeping in view the business objectives, financial covenants and the accounting standards.

1.3 The key aspects impacted by COVID-19 for financial reporting are:

- Relaxations in the time limits for meeting the regulatory compliances (refer section 2.0 below)
- Assets impairment
- Inventory valuations and write downs
- Revenue recognition
- Debt covenants and debt servicing
- Foreign exchange accounting and losses/gains due to extreme volatility
- Litigation resulting from contractual defaults, invocation of force majeure clauses and potential exposure
- Insurance claims for losses during shutdown period or loss of lives
- Going concern
- Extension of Financial Reporting Period
- Presentation issues

The Companies shall ensure that they provide sufficient disclosures in the notes to the financial statements with information about the entity that's useful to existing and potential investors, creditors, lenders, and other stakeholders. This research paper highlights the existing financial reporting requirements under Companies (Indian Accounting Standards) Rules, 2015 and Companies (Accounting Standards) Rules, 2006 that should be considered when addressing the financial effects of COVID 19 when preparing annual financial statements and possible audit approaches that can be considered relevant.

1.4 The role of auditors at this stage would be under increased scrutiny as the auditors have a public interest obligation to complete the audit work in accordance with professional standards and ethics requirements. Under the current circumstances, auditors must recognize that the manner in which they conducted the audits in the past may need significant modification to address the challenges and uncertainties arising out of the impact of COVID-19. Additionally, irrespective of the challenges and uncertainties, there should not be any dilution in the reporting or non-compliance with the auditing standards in carrying out the audits.

2.0 Key Regulatory relaxations in the backdrop of COVID-19

2.1 COMPANIES ACT and SEBI related:

- The SEBI has relaxed compliance regulations for listed entities by extending the timelines under LODR until June 30, 2020.
- SEBI extended the due date for regulatory filings and compliances for REIT and InvIT for the period ending March 31, 2020 by one month due to the developments arising due to the spread of the COVID 19 virus.
- Applicability of Companies (Auditor's Report) Order, 2020 (CARO 2020) shall be made applicable from the financial year 2020-2021 instead of from 2019-2020 notified earlier. This will significantly ease the burden on companies & their auditors for the year 2019-20.
- No additional fees shall be charged for late filing during a moratorium period from 01st April to 30th September 2020, in respect of any document, return, statement etc., required to be filed in the MCA-21 Registry, irrespective of its due date, which will not only reduce the compliance burden, including financial burden of companies/ LLPs at large, but also enable long-standing noncompliant companies/ LLPs to make a 'fresh start';
- The mandatory requirement of holding meetings of the Board of the companies within prescribed interval provided in the Companies Act (120 days), 2013, shall be extended by a period of 60 days till next two quarters i.e., till 30th September;
- MCA has clarified that the spending of CSR fund for COVID-19 will be considered valid under corporate social responsibility (CSR) activities under the Companies Act, 2013. MCA has also clarified that contribution made to 'PM CARES Fund' shall qualify as CSR expenditure. Further, it is clarified that 'Chief Minister's Relief Fund' or 'State Relief Fund for COVID-19' is not included in Schedule VII of the Companies Act, 2013 and therefore any contribution to such funds shall not qualify as admissible CSR expenditure.
- As per Schedule 4 to the Companies Act, 2013, Independent Directors are required to hold at least one meeting without the attendance of Non-independent directors and members of management. For the year 2019-20, if the IDs of a company have not been able to hold even one meeting, the same shall not be viewed as a violation.
- Requirement to create a deposit reserve of 20% of deposits maturing during the financial year 2020-21 before 30th April 2020 shall be allowed to be complied with till 30th June 2020. Requirement to invest 15% of debentures maturing during a particular year in specified instruments before 30th April 2020 may be done so before 30th June 2020.
- Clarification on passing of ordinary and special resolutions under Companies Act and rules made thereunder
- Introduction of the Companies Fresh Start Scheme (CFSS) to complete all the past filings of Annual Accounts and Annual Returns of Companies as well as of LLPs without any additional filing fees and grant of immunity, till 30 September,2020.

2.2 DIRECT TAXES:

- Extension of last date for income tax returns for FY 2018-19 from 31 March 2020 to 30 June, 2020.

- Due dates for issue of notice, intimation, notification, approval order, sanction order, filing of
- appeal, furnishing of return, statements, applications, reports, any other documents and time limit for completion of proceedings by the authority and any compliance by the taxpayer including investment in saving instruments or investments for roll over benefit of capital gains under
- Income Tax Act, Wealth Tax Act, Prohibition of Benami Property Transaction Act, Black Money Act, STT law, CTT Law, Equalization Levy law, Vivad Se Vishwas law where the time limit is expiring between 20 March 2020 to 29 June 2020 shall be extended to 30th June 2020.
- For delayed payments of advanced tax, self-assessment tax, regular tax, TDS, TCS, equalization levy, STT, CTT made between 20th March 2020 and 30 June 2020, reduced interest rate at 9% instead of 12 %/18 % per annum (i.e. 0.75% per month instead of 1/1.5 percent per month) will be charged for this period. No late fee/penalty shall be charged for delay relating to this period.
- The Income Tax Department announced that it will issue all pending income tax refunds up to Rs 5 lakh immediately to individuals and business entities.

2.3 INDIRECT TAXES:

- Those having aggregate annual turnover less than Rs. 5 Crore Last date can file GSTR-3B due in March, April and May 2020 by the last week of June, 2020. No interest, late fee, and penalty to be charged.
- Others can file returns due in March, April and May 2020 by last week of June 2020 but the same would attract reduced rate of interest @9 % per annum from 15 days after due date (current interest rate is 18 % per annum). No late fee and penalty to be charged, if complied before till 30 June 2020.
- Date for opting for composition scheme is extended till the last week of June, 2020. Further, the last date for making payments for the quarter ending 31 March, 2020 and filing of return for 2019-20 by the composition dealers will be extended till the last week of June, 2020.
- Date for filing GST annual returns of FY 18-19, which is due on 31 March, 2020 is extended till the last week of June 2020.
- Due date for issue of notice, notification, approval order, sanction order, filing of appeal, furnishing applications, reports, any other documents etc., time limit for any compliance under the Customs Act and other allied Laws where the time limit is expiring between 20 March 2020 to 29th June 2020 shall be extended to 30th June 2020.
- CBIC exempted the requirement to file GSTR-1 and CMP-08 for F.Y. 2019-20 for those persons who were eligible to avail of the option of special composition scheme as per Notification No. 2/2019-Central Tax (Rate) dated 7-3-2019, has filed GSTR-3B instead of statement containing details of payment of self-assessed tax in Form CMP-08.
- The Ministry of Finance extended the due date for filing return in FORM GSTR-3B for February by all registered persons to April 7, 2020. Also the due date for opting for composition scheme is extended from March 31 to April 7.
- Also, the due date of filing the annual return in FORM GSTR-9 and reconciliation statement for financial year 2018-19 is extended from March 31 to June 30, 2020.

2.4 OTHERS:

- The Director General relaxed the provisions of ESI (General) Regulations, 1950 and stated that the ESI contribution for month of February 2020 and March 2020 can be filed and paid up to 15th April, 2020 and 15th May 2020 instead of 15th March, 2020 & 15th April, 2020 respectively

- RBI has extended the priority sector classification for bank loans to NBFCs for on-lending for FY 2020-21. Further, existing loans disbursed under the on-lending model will continue to be classified under Priority Sector till the date of repayment/maturity.
- EPFO on Monday said it has issued directions for timely credit of monthly pension to over 65 aged employees' pension scheme beneficiaries
- Extension of realisation period of export proceeds extended to 15 months from 9 months from the date of export for all exports made till July 31, 2020.
- The threshold of default under section 4 of the IBC 2016 has been raised to Rs 1 Crore (from the existing threshold of Rs 1 lakh).
- Sections 7, 9 and 10 of the IBC 2016 has been suspended for a period of 6 months so as to stop companies at large from being forced into insolvency proceedings for such force majeure causes of default.

3.0 Key Financial Reporting Implications and Approaches

3.1 Impairment testing

Both Ind AS 36 *Impairment of Assets* and AS 28 *Impairment of Assets* require an entity to assess, at the end of each reporting period, whether there is any impairment for an entity's non-financial assets. An entity is required to assess at each reporting date whether there are any indications of impairment (other than for goodwill and indefinite life intangible assets under Ind AS 36). The impairment test only has to be carried out if there are such indications. An asset is impaired when an entity is not able to recover its carrying value, either by using it or selling it. An entity estimates the recoverable amount of the asset for impairment testing. Recoverable amount is the higher of the fair value less costs of disposal and the value in use. Value in use is defined as the present value of the future cash flows expected to be derived from an asset or cash-generating unit. The calculation of an asset's value in use incorporates an estimate of expected future cash flows and expectations about possible variations of such cash flows. The effects of the COVID-19 outbreak should be considered in impairment of financial and non-financial assets when reporting on years ended 31 March, 2020. Consequently, forecasts, projections, and valuations for impairment calculations will need to be carefully reviewed to ensure that significant events related to the COVID-19 outbreak are being incorporated. Value in use calculations maybe required to be adjusted (e.g. revised cash flows and/or adjusted discount rate). Fair value less costs of disposal may decrease and active markets for certain types of assets may disappear or may not exist.

Many companies in a vast array of sectors may experience an economic loss because of this virus. For example, the hospitality, travel and leisure industry has incurred sharp declines in revenue from a sudden decline and cancellation in travel and consumer spending. Other major public focussed sectors such as- ports and airports, automobiles, real estate, oil & gas, banks/ financial institutions and insurance companies are also likely to be adversely impacted to a large extent in one way or the other. The impact is not limited to the leisure industry; manufacturers may close facilities, retailers may face supply chain issues, education and recreation facilities may cancel classes, distributors may not be getting international shipments of inventory, and entities may incur significant penalties for cancelling contracts. In India, the implications of COVID- 19 can be cascading with banking sector, automobile sector and real estate sector were already having serious challenges.

The more the current environment is uncertain, the more important it is for the entity to provide detailed disclosure of the assumptions taken, the evidence they are based on and the impact of a change in the key assumptions (sensitivity analysis). Companies should also pay attention to the disclosures and provide useful information to the financial statements' primary users. Management should consider disclosing the key assumptions and sensitivities, the amounts by which the values may change after incorporating certain consequential effects of change on the other variables used to measure recoverable amounts.

3.2 Accounting for Foreign Exchange differences

Devaluation of Indian Rupee has been a one of the major challenges over past few weeks. Rupee value has fallen swiftly against US dollar, hovering around the 76 level.

Under both AS 11 *The Effects of Changes in Foreign Exchange Rates* and Ind AS 21, a foreign currency transaction should be recorded, on initial recognition in the reporting currency, by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency at the date of the transaction. For practical reasons, a rate that approximates the actual rate at the date of the transaction is often used, for example, an average rate for a week or a month might be used for all transactions in each foreign currency occurring during that period. However, if exchange rates fluctuate significantly, the use of the average rate for a period is unreliable.

Exchange differences arising on change in the exchange rate between transaction date and the date of settlement of any monetary items[1] in foreign currency are recognized as income or expense in the period in which they arise. When the transaction is settled within the same accounting period, in which it occurred, all exchange difference is recognized in that period. When the transaction is settled in a subsequent accounting period, the exchange difference is recognized in each intervening period up to the period of settlement is determined by the change in exchange rates during that period.

Under Ind AS 21, a company needs to determine its functional currency, which may not necessarily be the currency of the country in which it is domiciled. Thus, it is possible that the functional currency of an Indian company may be a foreign currency. Functional currency is determined based on the primary economic environment in which the company operates. Ind AS provides guidance on the criteria to be considered in determining the functional currency.

Foreign currency borrowings and loans are monetary items in nature. Therefore, the foreign exchange differences arising on such borrowings also have to be accounted for as income or expense in the statement of profit and loss as stated above.

However, under Accounting standards, AS 11 paragraph 46/46A provides a limited period irrevocable option for corporate entities to capitalize exchange differences on long term foreign currency monetary items incurred for acquisition of depreciable capital assets or to amortise exchange differences on other long term foreign currency monetary items through 'Foreign Currency Monetary Item Translation Difference Account' in reserves. This option is available only until financial year ended 31 March, 2020, as the paragraph has a sunset clause.

[1] *Monetary items* are units of currency held and assets and liabilities to be received or paid in a fixed or determinable number of units of currency.

This option to capitalise or defer exchange differences is not there under Ind AS. However, upon first time adoption of Ind AS, Ind AS 101 – *First time Adoption of Indian Accounting Standards*, an entity may continue the policy adopted for exchange differences arising from translation of long term foreign currency monetary items recognized in the financial statements for the period ending immediately before the beginning of the first Ind AS financial reporting period as per previous GAAP. However, for subsequent long term foreign currency monetary items, this option to continue with the previous GAAP accounting policy is not available.

Further, both Ind AS 21 and AS 11 provide an exception that allows gains and losses on certain intragroup foreign currency items of a long-term investment nature to be recognised in other comprehensive income instead of being recognised in profit or loss. For an item to qualify as a long-term investment, the entity must be able to assert that "settlement is neither planned nor likely to occur in the foreseeable future". An entity that has characterised an intra-group item as part of its net investment in the entity may need to reassess whether that designation is still appropriate in the current economic environment. For example, an entity that plans to undergo restructuring because of the COVID-19 pandemic may need to reassess whether certain intercompany loans that had previously been determined to be of a "long-term investment nature" should continue to be accounted for as such if the loans could now be settled in the "foreseeable future" in connection with the restructuring plan.

In order to minimise the P&L volatility, one possible approach that companies may consider is adoption of hedge accounting. hedge accounting is an accounting choice available to management under Ind AS 109 as well as under ICAI's *Guidance Note on Accounting for Derivative Contracts* under Accounting Standards to avoid volatility in profit and loss account due to exchange fluctuations where the entity has entered into forward contract to hedge their foreign exchange risk.

Ind AS 109 requires all derivatives to be measured at fair value and any resulting fair value gains or losses to be recognized in the profit and loss account, except if certain criteria for hedge accounting are met. Hedge accounting enables gains and losses on the hedging instrument to be recognised in the profit and loss account in the same period as offsetting losses and gains on the hedged item. Specific criteria, including the existence of formal documentation and the achievement of effectiveness tests, must be met at inception and throughout the term of the hedge relationship in order for hedge accounting to be applied.

Accounting Standards provides limited guidance on hedge accounting. AS 11 provides guidance on forward exchange contracts that are entered into for hedging purposes. It requires exchange differences based on changes in spot rates to be recognised in the profit and loss account (for the underlying foreign currency exposure and the corresponding derivative contract). Further, the premium or discount arising at the inception of the contract is required to be amortised through the profit and loss account over the life of the contract.

The ICAI's *Guidance Note on Accounting for Derivative Contracts* deals with foreign exchange forward contracts that are hedges of highly probable forecast transactions and firm commitments and other foreign currency derivatives such as cross-currency interest rate swaps and foreign currency futures that are not within the scope of AS 11.

Hedge accounting would result in the fair value loss on outstanding derivative contract at the balance sheet date being recognised in other comprehensive income rather than in profit and loss until the settlement of the underlying foreign exchange contract. However, it must be noted that applying hedge accounting requires robust risk management policies and procedures, documentation and effectiveness testing on the part of the company.

Given the severity of the devaluation of Indian Rupee against US Dollars and other major international currencies in recent weeks, the ICAI/ MCA/ NFRA[2] may consider to extend the option under AS 21 beyond financial year ended 31 March, 2020. Also, ICAI/ MCA/ NFRA may consider providing such an option to defer foreign exchange differences for Ind AS compliant companies as well.

3.3 Revenue recognition

Under both Ind AS 115 *Revenue from Contracts with Customers* and AS 9 *Revenue Recognition* as also AS 7 *Construction Contracts*, the amount of revenue recognized and the pattern of revenue recognition may be impacted by COVID-19. With the possibility of recession and reduced cash flows, dramatic changes are expected in the pattern of customer or public spending which is expected to be more on necessities instead on other goods and services.

Entities may need to account for returns and refund liabilities towards the customers. For example, a fast moving consumer goods company may have flexible return policies and consumers stocking up non-perishable items. These unused goods may be returned once the virus has stabilized. Airlines and event organizers may have to provide refunds for cancelled flights and events.

For companies that follow percentage of completion method for revenue recognition, such as, engineering and construction companies that recognize revenue over a long period of time, the pattern of revenue recognition may change for delays in rendering services. Further contract costs recovery of which is not probable are recognised as an expense immediately and cannot be considered to be part of contract cost for the purpose of percentage of completion.

Entities in some of the significantly impacted sectors or otherwise, may consider renegotiating existing contractual arrangements with their customers with respect to product pricing, delivery schedule, logistics costs etc. in the revised scenario. Appropriate accounting or disclosures need to be ensured by the management for such mutually agreed amendments, based on the information available till the date of approval of financial statements by the Board of Directors.

There can be dramatic change in the way certain industries might earn revenue. For example certain industries such as Hotel and accommodation business might get converted into COVID, 19 centres for patients and medical staff thereby causing an entire shift in customer base. There can be mass production and sale of medical equipment and accessories such as masks, ventilators, medicines etc. to government agencies instead of private hospitals/ clinics.

These disruptions could result into emergence of some new streams of revenue as the organisations will make their own attempt to survive in the COVID 19 situation. This is likely to pose new industry- specific challenges to determine the timing and amount of revenue recognition including presentation issues.

[2] Institute of Chartered Accountants of India/Ministry of Corporate Affairs/ National Financial Reporting Authority

3.4 **Disclosure as material/exceptional event**

When the items of income and expense are material, their nature and amount are required to be disclosed in the financial statements separately. However, under Ind AS, gains and losses should not be reported as extraordinary items, either on the face of the statement of comprehensive income (or income statement) or in the notes.

Ind AS 1 *Presentation of Financial Statements* requires disclosure of information about the assumptions concerning the future, and other major sources of estimation 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, such as noncurrent assets subject to impairment, within the next financial year (with the exception of assets and liabilities measured at fair value based on recently observed market prices). The disclosures are required to be presented in a manner that helps users of financial statements to understand the judgements that management makes about the future and about other key sources of estimation uncertainty. The nature and extent of the information provided will vary according to the nature of the assumption and other circumstances.

Examples of the types of disclosures that an entity is required to make include:

- The nature of the assumption or other estimation uncertainty
- The sensitivity of carrying amounts to the methods, assumptions and estimates underlying their calculation, including the reasons for the sensitivity
- The expected resolution of an uncertainty and the range of reasonably possible outcomes within the next financial year in respect of the carrying amounts of the assets and liabilities affected
- An explanation of changes made to past assumptions concerning those assets and liabilities, if the uncertainty remains unresolved

When it is impracticable to disclose the extent of the possible effects of an assumption or other source of estimation uncertainty at the end of a reporting period, the entity discloses that it is reasonably possible, based on existing knowledge, that outcomes within the next financial year that are different from assumptions used could require a material adjustment to the carrying amount of the asset or liability affected.

AS 5 - *Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies* requires that extraordinary items should be disclosed in the statement of profit and loss as a part of net profit or loss for the period. The nature and the amount of each extraordinary item should be separately disclosed in the statement of profit and loss in a manner that its impact on current profit or loss can be perceived.

Even if management concludes that the impact of the events around coronavirus are non-adjusting but are material, the entity is required to disclose the nature of the event and an estimate of its financial effect. For example, it may have to describe how the outbreak has affected or may affect its operations, such as whether there are any locations affected or operations suspended due to the governmental measures imposed, etc. In the early stages of the outbreak, the high level of uncertainties due to the unpredictable outcome of this disease may make it difficult to estimate the financial effects of the outbreak. If an estimate cannot be made, then the entity is required to disclose that fact.

There could be the potential impact on classification of assets and liabilities as current or non-current. Assets may no longer be consumed or settled in an entity's 'normal operating cycle'. Liabilities may become due on demand due to breaches of contractual terms and covenants and therefore will be classified as current liabilities.

3.5 Expected credit loss assessment under Ind AS 109

Ind AS 109 *Financial Instruments* requires an entity to incorporate reasonable and supportable information about past events, current conditions and the forecast of future economic conditions into the assessment of expected credit losses (ECL) for financial assets not measured at fair value through profit or loss. ECL is a probability weighted amount that is determined by evaluating a range of possible outcomes.

ECL is a probability weighted amount that is determined by evaluating a range of possible outcomes. The impact from the outbreak may vary depending on an entity's specific situation and its methodology in assessing ECL. Accordingly, management should ensure that there is reasonable and supportable consideration of past events, current conditions and forecast of future economic conditions when making that assessment.

When considering the Ind AS 109 requirements to incorporate the forecast of future economic conditions on a probability weighted basis, from a technical standpoint, an entity should evaluate the likelihood of the occurrence of an event (i.e., in this case its severity and the potential impact leading to an epidemic) if this would significantly affect the estimation of expected losses of financial assets. In assessing the expected credit loss, management should consider reasonable and supportable information at the reporting date.

The implications could vary depending on an entity's specific situation and its methodology in assessing ECL. For example, financial institutions may incorporate estimates of forward-looking macro-economic factors into multiple scenarios about the future economy.

Entities should provide qualitative and quantitative disclosure to enable users of financial statements to understand the effect of credit risk on the amount, timing and uncertainty of future cash flows. This includes the basis of inputs and assumptions and estimation techniques used, and how forward-looking information has been incorporated. If an entity considers it appropriate to incorporate in the ECL model an input or assumption or forward-looking adjustment associated with the outbreak, and if the effect of this is significant, or it is otherwise useful to understand the uncertainty of future cash flows, the entity should disclose such an input or assumption or forward-looking adjustment. If an entity changes its ECL methodology in order to better estimate the impact of the outbreak in accordance with the requirements of Ind AS 109, the entity should disclose the change of the estimation technique and the reasons for its change.
ECL may increase due to an increase in both the probability of default ('PD') and the loss given default ('LGD') for financial assets. As all financial assets subject to ECL require the PD to be estimated over the next 12 months, the effects of uncertainty relating to coronavirus may be very significant. Besides this, the impact of the coronavirus may trigger a significant increase in credit risk, and therefore, the recognition of a lifetime ECL provision may arise on many financial assets.

3.6 Borrowing cost

Under Both Ind AS 23 *Borrowing costs* and AS 16 *Borrowing costs* require an entity to suspend capitalisation of borrowing costs during extended periods in which it suspends active development of a qualifying asset. During the COVID-19 related lockdowns/ curfews, an entity may incur borrowing costs during an extended period in which it suspends the activities necessary to prepare an asset for its intended use or sale. Such costs are costs of holding partially completed assets and do not qualify for capitalisation.

3.7 Penalties related to termination of contracts

Companies may incur significant penalties for terminating contracts. As an example, many conferences and events are being cancelled, which can result in loss of deposits and/or require penalties to be paid. These non-recurring costs will need to be appropriately recognized, measured, presented, and disclosed in financial statements. Even when an entity has not made a decision to cancel an event, consideration will have to be given to the issues related to deposits and potential penalties if the event cancellation is probable in the future. It's important that the contracts are reviewed for termination and force majeure clauses. Such assessment needs to be especially done as per Ind AS 37 for all executory agreements that are likely to become onerous.

3.8 Debt restructurings and breach of loan covenants

Uncertain economic environment may result in a decline in cash inflows and as such companies may seek additional financing, relief from being classified as non-performing asset (NPA), revise repayment terms and interest rates of existing debt agreements, or request waivers if they no longer satisfy debt covenants. The consequential impact any non- compliance with debt covenants need to be appropriately dealt with in the financial statements.

Small businesses that were already reeling under stress due to the economic slowdown have been among the worst affected and banks have begun to see delays in loan repayments from them. Many appeals to the RBI are being made asking relief on NPA classification. Such revisions may have an impact on the classification and measurement of financial liabilities presented on the balance sheet.

Lenders and borrowers both may enter into agreements to modify the terms of financial instruments such as bank loans. These modifications may take the form of reduced interest rates, modification to payment terms and 'grace periods' for covenant violations. Entities should consider the requirements of Ind AS 109 for the modification of assets (for lenders) and liabilities (for borrowers). These modifications may give rise to gains for borrowers and losses for lenders.

3.9 Inventory

Inventory is a key asset in a company's financial statements, as it can be used as collateral for bank loans. Companies typically put in place internal controls, such as a custodian of inventory or a segregation of duties between the custodian of inventory and the individual with access to the perpetual records.

Due to the travel restrictions and lockdowns/curfews, the management may not be able to fully or partially carry out annual inventory count around 31 March this year. Due to this the management and the auditors may be compelled to carry out the inventory count/ stock take process at a later date when the situation normalises.

The management and the auditor may consider carrying out appropriate roll back procedures. For example, let's say the date of actual inventory count/ stock take is 15 June 2020. The company needs to take a firm stance on keeping the separate information pertaining to anything purchased and sold after 31 March 2020. With today's technology, the inventory software should be able to manage this easily. Once the company has properly segregated this, it will need to take a look at any invoices received and sent after 31 March 2020. During this part of the process, you may also want to double-check your segregated inventory to make sure everything that has been set aside was received after that date. Once the stock is counted as at 15 June 2020, the management shall carry out a roll back procedure in order to derive the implied stock level as at 31 March 2020. This can be cross checked and reconciled with the inventory level as per the company's inventory software. Appropriate adjustments shall be made for possible shrinkage or damage of inventory.

It might be necessary to write-down inventories to net realisable value. These write-downs could be due to reduced movement in inventory, lower commodity prices, or inventory obsolescence due to lower than expected sales.

Ind AS 2 and AS 2 require that fixed production overheads are included in the cost of inventory based on normal production capacity. Reduced production might affect the extent to which overheads can be included in the cost of inventory.

There may be significant inventories in transit as on the Balance Sheet date and the entities may have to consider the events after the Balance sheet date to ensure that such inventories, including for perishable items or for the inventories where contractual terms are subsequently renegotiated are appropriately valued as on the Balance Sheet date

Entities should assess the significance of any write-downs and whether they require disclosure in accordance with Ind AS 2/AS 2

If an entity ceases production or significantly reduces production for a period of time, significant portions of fixed production overheads (e.g. rent, depreciation of assets, some fixed labour, etc.) will need to be expensed rather than loading these overhead on, even if some reduced quantity of inventory that were produced.

3.10 Reimbursements

Companies that have business disruption insurance may be entitled to a certain amount of insurance proceeds to cover some or all costs. In addition, there may be government grants/incentives available to help support businesses. In many cases, determining if an entity is actually covered or eligible will require a detailed analysis of the policy or grant criteria. Given that we're in unprecedented times, careful technical interpretation of the policy/grant criteria and the accounting standards is required to determine the appropriate presentation and disclosures.

Any reimbursement recoverable for costs incurred for provisions are presented separately as an asset. Such as an asset is recognised only if it is virtually certain that settlement of the obligation will result in a reimbursement, and the amount. is recoverable. The amount recognised for the reimbursement should not exceed the amount of the provision. The amount of any expected reimbursement is disclosed. In profit and loss account, net presentation of provision and reimbursement amount is permitted.

Many entities may have to look at its existing insurance arrangements (eg. loss of profits, employee corporate policies etc.) to evaluate if it provides cover against pandemics in the nature of COVID-19 and if such claims would be sustainable. The accrual for such claims should be made in the financial statements only if there is a valid acceptance by the insurance company.

3.11 Going concern

In assessing the entity's ability to continue as a going concern, management must take into account events after the date of the financial statements. Management will have to consider all factors known up to the date of authorization of the financial statements. For those companies affected by COVID-19, management will need to look at the following in assessing going concern:

- updated financial forecasts for the foreseeable future, but not less than a 12-month period;
- updated sensitivity analysis;
- forecasted compliance, or lack thereof, with banking and other covenants for the foreseeable future; and
- any other information available up to the date the financial statements are authorized for issuance.

In extreme scenarios, based on the information available, an entity will consider whether or not there is material uncertainty which raises significant doubt about their ability to continue as a going concern. In extreme cases, an entity will need to determine if the financial statements should be prepared on a going concern basis, or if another basis of preparation would be more appropriate.

3.12 Fair valuation challenges

Ind AS 113 *Fair Value Measurement* specifies that fair value measurement is a measurement date specific exit price estimate based on assumptions (including those about risks) that market participants would make under current market conditions. That is, at the reporting date, what assumptions would market participants have made using all available information, including information that may be obtained through due diligence efforts that are usual and customary. Unobservable inputs should be used to measure fair value to the extent that relevant observable inputs are not available. However, the fair value measurement objective remains the same, i.e., an exit price at the measurement date from the perspective of a market participant.

Following the above, the objective of Ind AS 113 is to convey the fair value of the asset or liability that reflects conditions as of the measurement date and not a future date. although events and/or transactions occurring after the measurement date may provide insight into the assumptions used in estimating fair value as of the measurement date (especially those that are unobservable), they are only adjusted for in fair value measurement to the extent where they provide additional evidence of conditions that existed at the measurement date and these conditions were known or knowable by market participants. Ind AS 113 also requires the disclosure of information that helps users of financial statements assess the valuation techniques and inputs used to develop recurring fair values at the reporting date, and therefore by implication the impact these fair value measurements will have on reported financial performance.

Ind AS 109 requires all investments in equity instruments (including unquoted equity shares) to be measured at fair value. If an entity used cost as an estimate of fair value for earlier reporting dates it should revisit whether this is still appropriate. Ind AS 109 states that using cost in that way is only appropriate “in limited circumstances”, and it provides indicators when cost might not be representative of fair value, including for example:

“(a) a significant change in the performance of the investee compared with budgets, plans or milestones.

[…]

(c) a significant change in the market for the investee's equity or its products or potential products.

(d) a significant change in the global economy or the economic environment in which the investee operates.

(e) a significant change in the performance of comparable entities, or in the valuations implied by the overall market.

[…]"

Entities that need to measure fair value for investments in equity instruments should prepare for the situation that at the next measurement date for fair value the outbreak will have affected those indicators in many cases, and hence a valuation technique will have to be used.

Several Ind AS Standards provide entities an option to measure assets at fair value. Some of these standards include the following:

- Ind AS 40, *Investment Properties*, requires entities to disclose fair values of investment properties in notes to accounts
- Ind AS 16, *Property, Plant and Equipment*, provides entities with an option to use the revaluation method where the fair value can be measured reliably.
- Ind AS 41, *Agriculture*, requires entities to record biological assets at fair value less costs to sell, unless the fair value cannot be measured reliably.

When making the critical assessments and judgements for measuring fair value, the entity should consider what conditions and the corresponding assumptions were known or knowable to market participants. The impact on fair value measurement would depend on the evaluation of whether the severity of the outbreak at the reporting date would have impacted market participants' valuation assumptions at that date. Accordingly, entities need to evaluate whether its severity, potential impact and the related valuation inputs were known or knowable by market participants by means of usual and customary due diligence performed up to that date.

Under Accounting Standards, under AS 13 *Accounting for Investments*, requires investments to be classified as current investments carried in the financial statements at the lower of cost and fair value determined either on an individual investment basis or by category of investment, but not on an overall (or global) basis.

Investments classified as long term investments are carried in the financial statements at cost. Provision for diminution made to recognise a decline, other than temporary, in the value of the investments, and such reduction are determined and made for each investment individually.

Current stock market volatility and decline in the market values of investments has increased the likelihood that companies having to write down the values of current investments.

Investments classified as long term investments are carried in the financial statements at cost. Provision for diminution are made to recognise a decline, other than temporary, in the value of the investments. Under the current circumstances, the following are some of the factors entities should consider in other than temporary value of the investments:

- Lockdowns, social distancing, travel restrictions and quarantine measures might result in an increase in the number of people working remotely and impact commercial building vacancy rates.
- Lockdowns and border restrictions might have an impact on entities access to principal or most advantageous market. For example, it may not be possible to transport unused plant or equipment into a neighbouring country in which a higher sales price usually could be obtained.

3.13 3.13 Purchase price adjustments for business combinations.

Ind AS 103 *Business Combinations* requires purchase price allocation to be carried out in case of acquisition of a business. The impact of the COVID-19 crisis may necessitate a deviation from the customary approach to purchase price adjustments. As discussed above in terms of interim operating covenants, what constitutes “normalized” working capital may need to be adjusted given the impact of the virus. Sellers may need to take drastic measures to maintain acceptable liquidity at the target company level and may want to seek floors or collars in their purchase price adjustment mechanisms to avoid being unduly penalized during the crisis. Conversely, buyers will be understandably focused on ensuring they will be acquiring a business with levels of working capital and liquidity that are within defined parameters.

3.14 Employee benefits

Under both Ind AS 19 *Employee Benefits* and AS 15 *Employee Benefits* defined benefit obligations are recognized in balance sheet equal to net of:

- The present value of defined benefit obligation i.e. the present value of expected future payments required to settle the obligation resulting from current and past employee service; the estimates (actuarial assumptions) regarding demographic variables (such as, average age profile of the employees, employee turnover and average mortality) and financial variables (such as, future increases in salaries) are made and included in actuarial valuation model, called projected unit credit method. The resultant obligation is then discounted to a present value with reference to market yields at the end of reporting period on government bonds
- Fair value of the plan assets (including long term employee benefit fund and qualifying insurance policies) at the end of the reporting period.

Termination benefits are recognised at the earlier of (i) when the entity can no longer withdraw the offer; and (ii) the entity recognises costs for a restructuring that is within the scope of Ind AS 37 and involves payment of such benefits. An entity is typically unable to withdraw an offer once it has been communicated to the affected employees in sufficient detail.

Due to the current circumstances post COVID 19, there can be following implications:

- The fair value of plan assets may decrease significantly;
- Termination benefits for employees will need to be determined. The timing of when to recognise a liability for such benefits may require careful analysis;
- Termination benefits are recognised at the earlier of (i) when the entity can no longer withdraw the offer; and (ii) the entity recognises costs for a restructuring that is within the scope of Ind AS 37/ AS 29 and involves payment of such benefits. An entity is typically unable to withdraw an offer once it has been communicated to the affected employees in sufficient detail.

For determining employee’s leave obligation at the year end, leave credits allowed/ leaved adjusted during lock down period, etc. also need to be considered by the entities.

With changes required in valuations assumptions due to change in business forecasts/ projections, valuation of existing employee stock option plans (ESOPs) and new ESOPs will need careful evaluation by entities and auditors.

3.15 Leases

Due to COVID-19, there may be changes in the terms of lease arrangements or lessor may give some concession to the lessee with respect to lease payments, rent free holidays etc. Such revised terms or concessions shall be considered while accounting for leases, which may lead to the application of accounting relating to the modification of leases. However, anticipated revisions should not be taken into account.

Variable lease payments may be significantly impacted, especially those linked to revenues from the use of underlying asses due to contracted business activity. If any compensation given/declared by the Government to the lessor for providing concession to the lessee, it should be considered whether the same needs to be accounted for as lease modification as per Ind AS 116 *Leases* or whether assistance received from Government is to be accounted as government grants under Ind AS 20 *Accounting for Government Grants and Disclosure of Government Assistance*.

3.16 Deferred tax assets

COVID-19 could affect future profits and/or may also reduce the amount of deferred tax liabilities and/or create additional deductible temporary differences due to various factors (e.g., asset impairment). Entities with deferred tax assets should reassess forecasted profits and the recoverability of deferred tax assets in accordance with Ind AS 12, Income Taxes, and AS 22 Accounting for Income on Taxes considering the additional uncertainty arising from the COVID-19 and the steps being taken by the management to control it.

Under Ind AS 12, management might also consider whether the impact of the COVID-19 affects its plans to distribute profits from subsidiaries and whether it needs to reconsider the recognition of any deferred tax liability in connection with undistributed profits.

3.17 Internal financial controls over financial reporting

Due to the impact of COVID-19, there could be additional considerations that need to be taken care of:

a. Need to implement new internal controls or modify existing internal controls over financial reporting.

b. Evaluate whether any of the controls is not operating effectively on account of absence of concerned person due to illness/quarantine/ working from home/isolation/travel inaccessibility.

c. Identify alternate controls.

d. Ability to close financial reporting process in time.

In India and in most of the large countries, all companies (with some exceptions) are required to document and follow a system of internal controls over financial reporting. Further, statutory auditors are required to comment on the design and operating effectiveness of these controls in their audit report.

Due to COVID 19 with limited supervision, oversight, few board meetings, limited cyber security and internal reporting; there are possibilities of unintentional override of designed controls or even of planned frauds. Therefore, it is imperative that both auditors and entity should remain alert to any such indicators of override of internal controls.

The auditors should gather sufficient and appropriate audit evidence before issuing their audit opinion.

3.18 Data confidentiality and Cyber Security

With limited connectivity, data transfer taking place using personal hotspots internet connections and use of personal e- mail ids by employees and other stakeholders, there is an increased risk of compromising on data confidentiality and cyber security.

Organisations should issue written detailed standard procedures to all to ensure that flow of information and work is happening with minimised information technology risks.

3.19 Consolidated financial statements

Under AS 21 *Consolidated Financial Statements,* the financial statement of parent and subsidiary are usually drawn upto same date however difference between the reporting dates should not be more than six months. Under Ind AS 110 *Consolidated Financial Statements,* this difference between the reporting dates should not be more than three months.

The entities preparing consolidated financial statements might face certain challenges such as timely flow of information from components, impairment of investment in any subsidiary, etc. Further, special consideration needs to be given in respect of subsidiaries located in a country/local region significantly impacted by COVID 19. Practical challenges can also emerge such as- changes in staff, country GAAP accounts might not be readily available due to extension for filing of accounts given in that country, etc.

Both management and auditors need to be pro-active in planning these contingencies for an effective audit.

3.20 Government assistance or grants

IND AS 20 and AS 12 deal with accounting of government grants and assistance. In the light of COVID 19, such benefits could come from Government to entities in monetary or non- monetary form. Further, such benefits can be one time relief or can be for a specified period. Some of the examples can be- concession loans offered by SIDBI to MSMEs, reimbursement of defined contribution plan expenses, etc.

Entities need to be careful in determining and following appropriate accounting treatment for such benefits. For example, whether benefits received are of capital nature or of revenue nature needs to be determined by underlying scheme documents. The auditors should also be careful to ensure that appropriate accounting treatment and presentation approach is followed by the entities.

3.21 Extensive Disclosures & Reporting of COVID 19 Losses

Transparent disclosures should be made on the effects and risks of this outbreak on the company. This disclosure would generally provide information on the nature of the event and a qualitative or quantitative estimate of its effect on the financial statements. Entities, especially listed companies, will have to consider this from both a financial statement standpoint and for their other public disclosure documents, including the Management Discussion &Analysis and Directors' Report.

It is open to the management to disclose in a separate note the impact of COVID 19 in terms of losses during the shutdown period, the forex and inventory write downs, etc. which may instil greater confidence in the stakeholders as such losses are exceptional under Ind AS 1, or extra ordinary under AS 5 (as explained in section 3.4 above) and one time and may not have direct impact on post COVID 19 periods.

3.22 Extension of Financial Reporting Period

The management may consider extending the financial reporting period. The Companies Act, 1956 permitted extension of financial year up to 15 months with the approval of the Board and even up to 18 months with the approval of the company law authorities. However, the Companies Act, 2013 permits only the holding / subsidiaries of foreign companies to have a different financial year with the prior approval of the Regional Director. Extension from 12 to 15 months will be granted only in such cases and not generally. For example, a company is following April –March as of now but wants to make it July-June to align its FY with is holding company or subsidiary company's financial year. In this case, the company can apply to the Regional Director to extend the current FY from April to June and then subsequently its FY would be July-June. Further, a representation may be made to permit Regional Director to give approval for extension of financial year due to COVID-19 under the power to remove hardships. In case of listed companies, SEBI norms need to be adhered to for the extension of the financial year.

4.0 Concluding Remarks

The financial reporting for the year ended 31 March 2020 needs to be carefully done keeping in view the above aspects and ensuring that adequate disclosures are made to enable the stakeholders to distinguish the exceptional losses resulting from COVID – 19 and the regular operations.

For further information please contact:

RSM Astute Consulting Pvt. Ltd.

301- 307, 3rd Floor, Technopolis

Knowledge Park, Mahakali Caves

Road, Andheri (E), Mumbai 400 093.

T: (91-22) 6108 5555 / 6121 4444

E: emails@rsmindia.in

W: www.rsmindia.in

Offices: Mumbai, New Delhi - NCR, Chennai, Kolkata, Bengaluru, Surat, Hyderabad, Ahmedabad, Pune, Gandhidham and Jaipur.

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The purpose of this Research Paper ('Paper') is to provide a brief overview of the financial reporting implications due to COVID-19. The Paper is prepared for general use and our views as stated above would be required to be revalidated vis-à-vis the facts of each case. It may be noted that nothing contained in the Paper should be regarded as our opinion and facts of each case will need to be analysed to ascertain applicability or otherwise of the said notification and appropriate professional advice should be sought for applicability of legal provisions based on specific facts. We are not responsible for any liability arising from any statements or errors contained in this Paper.

11 April 2020