COVID-19 COMBAT: IMPACT ON FINANCIAL STATEMENT

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OVERVIEW

1. Valuation of Inventory:

- Assess whether on the reporting date; any adjustment is required to the carrying value of inventory to bring them to their net realizable value.
- Due to forced plant shutdown, unallocated fixed overheads are recognized in profit or loss in the period in which they are incurred.

2. Impairment of Non-Financial Assets:

- Many companies have been affected by the restriction imposed by the government, and are facing low demand for their product and services within India and abroad due to lock down and this situation may trigger impairment testing.

3. Leases:

- Lessor would need to ascertain whether some of the underlying assets held for lease are to be considered for impairment due to decrease in demand or decline in rentals.
- Other impact areas could be determination of lessee incremental borrowing rate on account of change in borrowing cost consequent to decline in credit rating**.**

4. Revenue:

- Companies need to assess the revision of estimates of variable consideration and timing of revenue recognition.
- Assess the impact on recoverability of trade receivable including estimate of ECL.

5. Financial Instrument

- Currently many companies are using simplified approach or the 3-stage model set out in IFRS 9 to assess ECL. The company needs to revisit the models being used for ECL calculation as the estimates being used in ECL at the reporting date may undergo change as a result of COVID19. If estimates do not require revision, full disclosure of circumstances taken into consideration is recommended.

6. Provision, Contingent Liability and Contingent Assets.

- Review of onerous contacts - Possibility of certain supply/services contracts becoming onerous due to increase in cost and hence necessary provision would be required for projected losses

7. Modification and Termination of Contract and Arrangements:

- The attributes of actuarial valuation such as Interest rate, Salary escalation percentages etc.needs to be looked into as actuarial assumption may undergo significant change.

8. Going Concern

- It would be critical to understand the impact of current event and condition on company's operation and forecast cash flow to understand the company's liquidity position and its ability to meet obligation as they fall due.

9. Consolidation

- Due to the current scenario the financial statements of various foreign subsidiaries may not be available for consolidation and hence might require additional consideration - IND AS allows date difference up to 3 months between the holding company and subsidiary

10. Property, Plant & Equipment

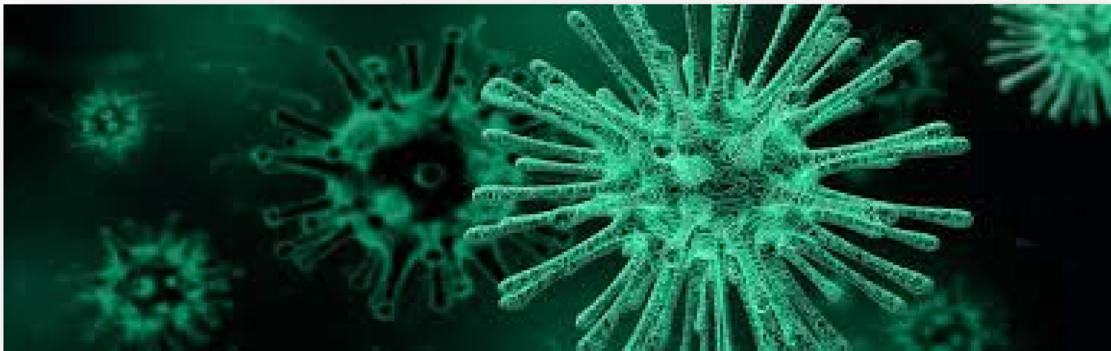
- The useful life of property plant & equipment may require reassessment as there could be adverse or favorable impact in remaining useful life of the PPE due to lock down.

11. Borrowing Cost

- Capitalization of borrowing cost may require suspension due to cessation of active progress in capital project.

12. Fair Value Measurements

- The fair value measurement (FVM) impact would depend on the evaluation of whether the severity of the outbreak at the reporting date would have impacted participants' valuation assumptions at that time.
- Companies will also need to consider making related disclosures that could reasonably be expected to influence decisions that the users of general-purpose financial statements would make on the basis of those financial statements.



The adverse impact of this global pandemic can vary from nation to nation,industry to industry and above all entity to entity. The effect depends upon the nature and extent of business connectivity of the individual entities with the nations more seriously affected by this pandemic. Apart from the health and safety of mankind, COVID-19 has unfavourably affected the economicenvironment which in turn has consequential impact on the results in thefinancial statements and reporting.

There is also a need to advise the preparers of financial statements to ensure that the potential impact of COVID-19 is suitably considered in preparing and reporting their financial statements for the year ended March 31, 2020. Specific requirements of a few accounting standards that may need special attention are indicated below.

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

Write-down inventory to Net Realizable Value:

In accordance with Ind AS 2, Inventories, and AS 2, Valuation of Inventories, **it might be necessary to write down inventories to net realizable value due to reduced movement in inventory, decline in selling prices, or inventory obsolescence due to lower than expected sales.** The management may consider to written down its inventories to net realizable value item by item.

Fixed Overhead related to Lockdown period charged to Profit & Loss Account:

The amount of fixed overhead allocated to each unit of production may require adjustment due to lower production. **Unallocated overheads are recognized as an expense** in the period in which they are incurred.

Disclosure

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, Presentation of Financial Statements, and paragraph 14(a) of AS 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies.

2. Impairment of Non-Financial Assets (Ind AS 36 and AS 28)

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 indication that non-financial assets may be impaired. The impairment testhastobecarriedoutiftherearesuchindications and theentityshall be required to estimate therecoverableamountoftheasset.

Due to COVID 19, there might be temporary ceasing of operations or an immediate **decline in demand or prices resulting in lowering of revenues and profitability and reduced economic activity**. These are the factors that the management may consider as the indicators that may require impairment testing for the purpose of Ind AS 36 and AS 28.

Critical Factors to Consider:

Management needs to consider whether due to outbreak of Covid 19 -

a) Assumption used for **impairment testing** and to determine **recoverable amount** requires any change.
b) Assumption used to determine **discount rate**to measure the recoverable amount requires any adjustment.
c) Forecasted or **budgeted future cash flow** requires to be updated.
d) Market assumption used to determine FV for recoverable amount needs reconsideration.
e) **Reasonable assumptions** are taken in estimating **Value in Use** and **FV less costof disposal**.
f) **Contraction in economic activity** is considered as indicator for impairment testing.

Goodwill Impairment

Due to COVID-19, there might be significant changes with an adverse effect in **operations of cash generating unit to which goodwill is allocated** and therefore requiring additional focus and attention while testing of impairment of goodwill as at March 31, 2020.

Disclosures:

The disclosure requirements in Ind AS 36 and AS 28 are extensive. Depending on specific facts and circumstances, entities need to consider providing detailed disclosures on the assumptions and sensitivities considered for effects of the COVID-19.

3. Leases (Ind AS 116, AS 19, AS 29)

Entities shall give attention to the following points -

For Entities on which Ind AS 116 is applicable:	For Entities on which AS 19 and AS 29 is applicable:
a) Any 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. may leads to application of accounting relating to modification of leases. b) Variable lease payments may be significantly impacted, especially those linked to revenues from the use of underlying asses due to contracted business activity. c) Discount rate used to determine the present value of new lease liabilities may need to incorporate any risk associated with COVID-19. d) Entities will need to determine whether as a result of COVID -19, any lease arrangement has become onerous. e) Any compensation from government to lessor for proving concession to lessee, whether the same to be considered as Modification as per IND AS 116 or Government Grant under IND AS 20	a) Any revised terms or concession shall be considered for accounting of lease. b) Discount Rate used for MLP (minimum Lease payment) of new lease needs to incorporate any risk associated with COVID-19 c) Entities will need 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. d) Compensation received by government to lessor for providing concession to lessee. Whether same is to be treated under AS-19 (Leases) or AS -12 (Government Grants)

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4. Revenue (Ind AS 115 and AS 9)

Attention needs to be drawn to the following points:

For Entities on which Ind AS 115 is applicable:	For Entities on which AS 9 is applicable:

a) Due to COVID-19, there could be likely increase in sales returns, decrease in volume discounts, higher price discounts etc. These factors need to be considered for estimating the amount of revenue i.e., Measurement of Variable Consideration. b) Entities may have to consider disclosure about impact of COVID-19 on entities Revenue.	a) Entities may have postponed recognition of revenue due to significant uncertainty of collection in view of the impact of COVID-19. b) AS 9, Revenue Recognition requires entities to disclose the circumstances in which revenue recognition has been postponed pending the resolution of significant uncertainties.

5. Financial Instruments

For Entities on which Ind AS 109 is applicable:	For Entities on which AS is applicable:
a) Financial Instruments within the scope of IND AS 109 like Trade Receivable, Other Receivable, Investments in Debt Instruments are subject to impairment loss through ECL (Expected Credit Loss) Method. Due to rapid spread of COVID-19, is likely to have an impact on quantum of ECL and classification of Financial Assets into 3 buckets for recognition and measurement of Impairment loss. Those 3 bucketsare - ✓ Stage -1, No significant increase in credit risk. ✓ Stage -2, significant increase in credit risk. ✓ Satge-3, Credit Impaired. b) Appendix A, of IND AS 109, states that financial assets are credit impaired when one or more events have a detrimental impact on estimated future cash flow. For ex- for economic and contractual	a) In case of financial assets such as Loans, Trade Receivables etc., entities shall be guided by the requirements of AS 4, Contingencies and Events Occurring After the Balance Sheet Date. b) In respect of financial assets within the scope of AS 13, Accounting for Investments, entities may have to carefully consider the requirements of making provisions for decline in the value of investments, which is other than temporary. c) In respect of Banks and Insurance Entities, preparers need to consider impact of COVID-19 on classification of Loans and Advances into Standard, Substandard, Doubtful and Loss categories in addition to the Prudential Regulatory requirements of RBI and The Insurance Regulatory and Development Authority of India (IRDAI).

reasons, lender has given a concession to the borrower that otherwise lender would not otherwise consider. c) Entity may also need to consider the Prudential Regulatory Action to sustain the economy such as Loan Repayment Holidays, Decrease in Interest rate etc. d) In respect of Ind AS 107, Financial Instruments Disclosures, entities may need to disclose the impact of COVID-19 on various credit related aspects such as methods, assumptions and information used in estimating ECL, policies and procedures for valuing collaterals etc.	

6. Provisions, Contingent Liabilities and Contingent Assets

For Entities on which Ind AS 37 is applicable:	For Entities on which AS 29 is applicable:
a) As a result of COVID -19, some contracts may become onerous for reasons such as the imposition of penalty due to delay in supply of goods or increase in cost of material / labour, etc. Management should consider whether any of its contracts have become onerous. b) Imposition of fines due to delay in supply of goods which may needs to be considered as per IND AS 115. c) If the management is unable to assess, whether some of the executory contracts have become onerous due to the inadequacy of information, the same should be disclosed	a) As a result of COVID -19, some contracts may become onerous for reasons such as the imposition of penalty due to delay in supply of goods or increase in cost of material, labour, etc. Management should consider whether any of its contracts have become onerous b) If, the management is unable to assess whether some of the executory contracts have become onerous due to the inadequacy of information, the same should be disclosed.

d) Entities claims on insurance companies can be recognized in accordance with Ind AS 37 only if the recovery is virtually certain i.e. the insurance entities have accepted the claims and the insurance entity will meet its obligations.

7. Modifications or Termination of Contracts or Arrangements

It should be noted that the entities may modify or terminate certain contracts which arewithin the scope of other Ind ASs or ASs or Guidance notes highlighted below. Entities are advised to consider the specific requirements of these standards and guidance note to account for these modifications or terminations.

Entities on which Ind AS is applicable	Entities on which AS is applicable
Ind AS 19, Employee Benefits	AS 15 Employee Benefits (revised 2005)
Ind AS 102, Share-based Payments	Guidance Note on Accounting for Employee Share Based Payments
Ind AS 109, Financial Instruments and Ind AS 32, Financial Instruments - Presentation	Guidance Note on Accounting for Derivative Contracts (Issued 2015)
IndAS 104, Insurance Contracts for insurancecompanies this is routine; events like earthquake,hugefloods,warsituations,etc.	__
Ind AS 115, Revenue from Contracts with Customers	AS7ConstructionContracts(revised2002)AS9 Revenue Recognition) Guidance Note on Accounting for Real Estate Transactions (revised2012)

8. Going Concern Assessment (Ind AS 1, Ind AS 10 and AS 1, AS 4)

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.

Entities on which Ind AS 1 'Presentation of Financial Statements' and Ind AS 10 'Events after Reporting Period' are applicable:	Entities on which AS 1 'Disclosure of Accounting Policies' and AS 4 'Contingencies and Events occurring after the Balance Sheet date' are applicable:
In assessing whether the going concern assumption is appropriate, management considers all available information about the future, which is at least, but is not limited to, twelve months from the end of the reporting period. The impact of COVID- 19 after the reporting date should also be considered and if, management after the reporting date either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so, the financial statements should not beprepared on going concern basis. Necessary disclosures as per Ind AS 1 shall also be made, such as material uncertainties that might cast significant doubt upon an entity's ability to continue as a going concern.	The impact of COVID- 19 after the balance sheet date should be considered in assessing whether going concern assumption is appropriate or not. 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.

9. Income Taxes (Ind AS 12 and AS 22)

Entities on which Ind AS 12 'Income Taxes' is applicable:	Entities on which AS 22 'Accounting for Taxes on Income' is applicable:
a) Entities with deferred tax assets should reassess forecasted profits and	a) COVID-19 could affect future profits and/or may also reduce the amount of

the recoverability of deferred tax assets in accordance with Ind AS 12 considering the additional uncertainty arising from the COVID-19 and the steps being taken by the management to control it. b) 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. c) Disclose any significant judgments and estimates made in assessing the recoverability of deferred tax assets, in accordance with Ind AS 1.	deferred tax liabilities and/or create additional timing differences due to various factors. b) Entities with deferred tax assets should reassess forecast profits and the recoverability of deferred tax assets in accordance with AS 22, considering the additional uncertainty arising from the COVID- 19 and the steps being taken by the management to control it.

10. Consolidated Financial Statements (Ind AS 110 and AS 21)

Entities on which Ind AS 110 'Consolidated Financial Statements' is applicable:	Entities on which AS 21 'Consolidated Financial Statements' (revised 2016) is applicable:
Ind AS 110 prescribes that the financial statements of parent and subsidiaries used in the preparation of the consolidated financial statements are usually drawn upto the same date. It may be noted that in any case, the difference between the reporting dates should not be more than three months.	AS 21 prescribes that the financial statements of parent and subsidiaries used in preparation of the consolidated financial statements are usually drawn upto the same date. It may be noted that in any case, the difference between the reporting dates should not be more than six months.

11. Property Plant and Equipment (PPE) (Ind AS 16 and AS-10)

Ind AS 16 and AS 10 require that useful life and residual life of PPE needs revision in annual basis. Due to COVID-19, PPE can remain under-utilised or not utilised for a period of time. It may be noted that the standards require depreciation charge even if the PPE remains idle.

Further, COVID-19 impact may have affected the expected useful life and residual life of PPE. The management may review the residual value and the useful life of an asset due to COVID 19 and, if expectations differ from previous estimates, it is appropriate to account for the change(s) as an accounting estimate in accordance with Ind AS 8, Accounting Policies, Changes in Accounting Estimates and Errors and AS 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies.

12. Borrowing Costs (Ind AS 23 and AS 16)

Above standards require that the capitalisation of interest is suspended when development of an asset is suspended. The management may consider this aspect while evaluating the impact of COVID-19.

13. Post Balance Events (Ind AS 10 and AS 4)

COVID-19 outbreak incidence surfaced in December 2019 and the condition has continued to evolve throughout after 31st December 2019.

Entities on which Ind AS 10 'Events after the Reporting Period' is applicable:	**Entities on which AS 4 'Contingencies and Events Occurring After Balance Sheet Date' is applicable:**
According to Ind AS 10, Events occurring after the Reporting Period are categorized into two viz. (i) Adjusting events (ii) Non-adjusting events In certain cases, Management judgement may be required to categorize the events into one of the above categories.	In accordance with AS 4, adjustments to assets and liabilities are not appropriate for events occurring after the balance sheet date, if such events do not relate 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 ofthe 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. They should also disclose how they have dealt with the impact of COVID -19 on the financial position and financial performance of the entity.

14.Interim Financial Reporting (Ind AS 34 and AS 25)

The recognition and measurement guidance applicable to annual financial statements equally applies to interim financial statements. There are typically no recognition or measurement exceptions for interim reporting, although management might have to consider whether the impact of the COVID-19 is a discrete event for the purposes of calculating the expected effective tax rate.

Ind AS 34/AS 25 Interim financial information usually updates the information in the annual financial statements. An additional disclosure should be given to reflect the financial impact of the COVID-19 and the measures taken to contain it. This disclosure should be entity specific and should reflect each entity's circumstances. Where significant the disclosures required by paragraph 15B in Ind AS 34 should be included.

Further, the preparers may consider making suitable disclosures in the Management Discussion and Analysis section of the Annual Report about the effect of Corona virus (COVID-19) on the overall risks to the businesses in which the entity is engaged.

15.Fair Value Measurement

Companies are required to measure some of their assets and liabilities at fair value. This is a date-specific exit price estimate based on assumptions that market participants would make under current conditions. When making assessments and judgments for measuring fair value, the company should consider the conditions and corresponding assumptions that were known or knowable to market participants. The fair value measurement (FVM) impact would depend on the evaluation of whether the severity of the outbreak at the reporting date would have impacted participants' valuation assumptions at that time. Companies will also need to consider making related disclosures that could reasonably be expected to influence decisions that the users of general-purpose financial statements would make on the basis of those financial statements. Disclosure may be needed to enable users to understand whether or not the outbreak has been considered for the purpose of FVM. Users should understand the basis for selecting the assumptions and inputs that were used and the related sensitivities.

16.Disclosure in Financial Statement

As seen from the above, COVID-19 has a considerable impact on financial statements of entities, irrespective of whether they are impacted directly or indirectly. Apart from specific disclosure requirements under respective standards, Ind AS 1 requires disclosure of sources of estimation uncertainty. COVID-19 will perhaps go down as one of the most unprecedented high-impact events that resulted in multiple uncertainties. Affected entities will need to disclose assumptions that they have made regarding the future. Further, determining whether events are adjusting, or non-adjusting is a potential area that involves significant judgment; hence, a disclosure should be made under Ind AS 1 in this regard. Disclosures will also need to be made with respect to impairment tests carried out for non-financial assets including underlying assumptions. Extensive disclosures may be required under Ind AS 107, Financial Instruments: Disclosures (Ind AS 107), about changes in assumptions and estimates on account of COVID-19, including impact on the financial risks.

17.Disclosure in Management Report

Companies should also consider whether to refer to the possible impact of Corona virus when they report principal risks and uncertainties in the management report. In principle, they should report this when possible further developments can lead to negative deviations from the company's forecasts.

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