Impact of COVID 19 on FS –Explained in simple terms

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CA RAKESH SARMA R

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INVENTORIES (IND AS 2)

Valuation rule= Cost or NRV which ever is lower.

Impact-1: NRV would be lower:
In most of the cases, the cost would be lower than NRV. However, due to COVID 19, the demand might get reduced for the inventories and so, NRV in the market could be lower. So, Management may consider reduction of value to NRV by charging, (COST- NRV) to P&L.

Impact-2: Under absorption of fixed OH:
The computation of cost of inventories includes, "**Portion of Fixed Production overheads**". As per IND AS, computation per unit is as follows:

$$\frac{\text{Total Fixed Production OH}}{\text{Normal Capacity}}$$

Since, the actual production would have been hampered due to COVID 19, the cost to be absorbed would be lower than normal. Hence, the balance unabsorbed OH would be charged to P&L.

INVENTORIES (IND AS 2)

The impact would be on the increase of costs charged to P&L.

Management Disclosure:

Since the increase in costs is due to the extraordinary activity, management should clearly disclose the effect of the same in Financial statements.

IMPAIRMENT (IND AS 36)

Valuation rule= Carrying value or (higher among, Value in use or Net realisable amount), which ever is lower.

Due to COVID 19, many of the operations and businesses would have been hampered. That would be considered as a criteria for performing impairment testing by an entity.

The possibility of impairment could arise because of the following:

Impact 1- Reduction in realisable amount- Due to reduction in demand.

Impact 2- Change in value in use- Due to changes in Discounting rate or reduction in future use of the asset.

Impact 3- Goodwill impairment- The operations of the Cash generating unit to which the good will is mainly associated, would have hampered due to COVID 19.

FINANCIAL INSTRUMENTS (IND AS 109)

The major impact will arise on the recoverability of the receivables, loans etc.,

The debtors or the customers, from whom the entity has receivable outstanding's, might have been impacted due to COVID 19. This will arise a big Question mark on the repayment ability of them.

Hence, the ECL provisions which were created earlier has to be revised based on our assumptions.

Every entity which is changing its ECL estimates on account of COVID 19, should disclose its impact separately and all its underlying assumptions in assessing the repayable capacity- Debtor wise, Debtor wise changes in their financial capacity, change in business models etc.,

Further in case, the borrower has exhausted all his credit limits, that will arise for the risk of default, which has to be disclosed separately.

FAIR VALUE MEASUREMENT

The Fair value of the financial instruments may be measured based on market trends (in case of shares and securities trading in markets) and by using various valuation rules such as discounting of expected cash flows etc.,

Due to COVID 19, most of the securities in the markets are being traded at record lower rates. One should not directly comment, that the market is not an orderly market and the rates should not be considered. Entities should assess the real behaviour in the markets and the expected revivals in the near future, to estimate the fair values.

Consideration of the changes in discount rates, increased credit risk etc., to be considered while valuing the securities.

Every entity, which restated the fair values of its financial instruments, should clearly disclose the fact separately and need to assess the impact due to COVID 19 for separate disclosure.

LEASES (IND AS 116)

Valuation rule= Discount all the expected future cash-in flows and create a lease asset and corresponding liability in the books.

Impact 1- Change in Future expected cash flows:

➔Due to COVID 19, the expected cash flows might change.
➔The lease agreements might be revised or became onerous.
➔Any variable payments related to performance, might be effected.
➔Might receive some concession from government.
➔The cash in flows might get delayed.

Impact 2- Changes in the discount rates

The impact of all the above needs to be considered while revaluing the lease asset and liability and any change on account of COVID 19, needs to be separately identified and disclosed.

REVENUE (IND AS 115)

Due to COVID 19, there will be decrease in demand. This might result in increase of sales returns, decrease in volume discounts, increase in price discounts to clear the stock etc.,

There might be changes in the variable considerations which are linked to performance.

There might be changes in nature, timing and certainty of cash flows.

All the above might have a significant impact over the revenue of the entity.

All entities should separately disclose all the events leading to the downfall of the revenue and should disclose the impact as a result of COVID 19.

GOING CONCERN ASSESSMENT

Usually all the financial statement should be prepared considering the going concern assumption, which is a fundamental accounting assumption.

In case, due to COVID 19, if entity assesses that the going concern would be affected or any major activity or division needs to be closed, then the financial statements SHOULD NOT be prepared with the going concern assumption.

The facts considered for such assessment needs to be disclosed separately.

This has to be done, even it happened after the reporting period, since anything affecting the going concern assumption would always be an adjusting event.

If the entity is not clear, but has significant doubt on the continuation, then the same shall be disclosed appropriately.

INCOME TAXES (IND AS 12)

Due to COVID 19, future profits may be affected. So, deferred tax liabilities could reduce.

Asset impairments could happen, which would result in increase of Deferred tax assets (DTA).

Further, as per IND AS 12, virtual certainty is required for creating and continuing DTA. This could have an impact due to COVID 19. Hence, that should be re-assessed.

All those changes should be disclosed separately by the entity.

PPE (IND AS 16)

Impact 1- Change in accounting estimates:
Due to COVID 19, the estimated residual value of PPE could change. The useful life of PPE could change. Entity needs to re-assess and should disclose as change in accounting estimate.

Impact 2- PPE measured at Fair value:
Due to COVID 19, the fair value of a PPE could have changed by a large extent. Such impact needs to be separately disclosed along with the assumptions made while estimating the fair value figures.

BORROWING COSTS (IND AS 23)

As per IND AS 23, the capitalisation of interest needs to be suspended when the development of qualifying asset is suspended.

Due to COVID 19, the development could have been stopped. In such cases, the impact needs to be separately disclosed.

POST BALANCE SHEET ITEMS (IND AS 10)

The standard speaks about adjusting and non- adjusting events. If any event occurred after balance sheet date, for which conditions exist on the balance sheet date, the events are considered as adjusted and others are non- adjusted.

<u>For Entities having 31-Dec-19 as Financial Closure:</u>
In countries like INDIA, the events of uncertainty do not exist on that date, hence any significant change in future, would be considered as non- adjusting event (unless affecting Going concern assumption).

<u>For Entities having 31-Mar-20 as Financial Closure:</u>
In most of the cases, the events would be visible as on the date of closure, hence the events which affect our position like credit risks, risk of default by debtor etc., can be treated as adjusting events. They require adjustment in the books along with disclosure.

If, no event is visible as on balance sheet date, then only disclosure of a material event is sufficient.

PROVISIONS, CONTINGENT ASSETS AND LIABILITIES (IND AS 37)

Due to COVID 19, some contracts would have become onerous. Entity should check whether any contract has become onerous and should recognise loss immediately as per IND AS 37.

In case any penalties levied on account of delay, that should be accounted as per IND AS 115, i.e., reduction in contract value (in case of construction industries etc.,).

If entity could not evaluate onerous nature but has some doubt, then it should disclose accordingly.

If, entity has announced any restructuring or reconstruction plan, the same has to be disclosed and necessary provision has to be created.

In case of contingent assets, there could be a chance of becoming uncertain. Hence entity has to re-assess them and disclose separately if anything has become uncertain, besides de-recognising the contingent asset.

PROVISIONS, CONTINGENT ASSETS AND LIABILITIES (IND AS 37)

For all the present obligations, necessary provision has to be created. If entity is not sure of the quantification, then, suitable disclosure of the same is to be made.

In all the cases, separate disclosure of the impact due to COVID 19 has to be disclosed separately.

PRESENTATION OF FS (IND AS 1)

Classification of of Current and Non- Current:
Sometimes, non- current liabilities could become current due to COVID 19 outbreak. If that is an adjusting event, then that has to be adjusted in the FS.

Suitable disclosure of the same is also require.

Estimations:
Sources of estimation of the uncertainties, recent future expected changes in the business, changes expected in deployment of PPE etc., needs to be disclosed.

Comparability of FS:
Since, due to COVID 19, many factors might have changed and it might have impact on many reporting heads as discussed earlier, for easy and fair comparison purpose, all necessary disclosures regarding the COVID 19 impact needs to be clearly made.

Thank You

Sources:
Guidance Note issued by ICAI

Presentation by:

CA Rakesh Sarma R
sarmarrakesh@gmail.com