



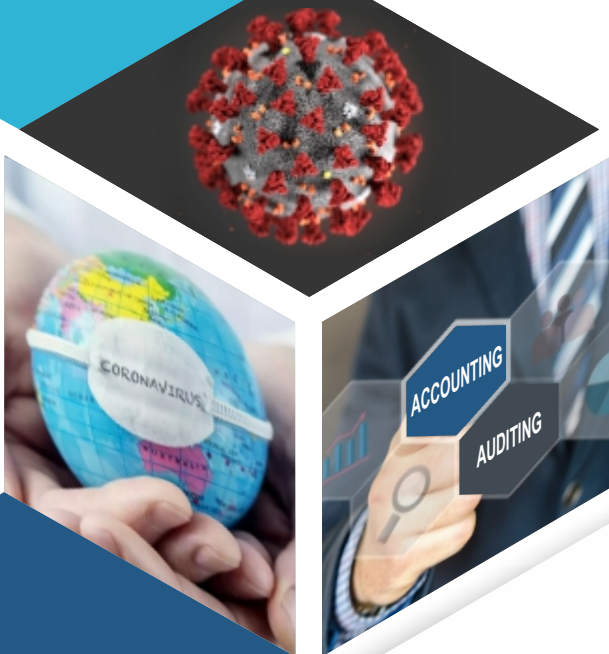
The Institute of Chartered  
Accountants of India

## Joint Initiative of Accounting Standards Board & Auditing and Assurance Standards Board

# ICAI ACCOUNTING & AUDITING ADVISORY

March 2020

## Impact of Corona Virus on Financial Reporting and the Auditors Consideration





# CONTENT

## **TOPIC**

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## **PAGE**

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**1. Impact of Corona Virus on  
Financial Reporting**

**1-20**

**2. Impact of Corona Virus on  
Audit of Financial Statements**

**22-45**





# **Impact of Corona Virus on Financial Reporting**



## **Coronavirus (COVID-19) Impact on Financial Reporting – Accounting Year Ending March 31, 2020**

ICAI is concerned about the impact of Coronavirus disease (known as COVID-2019 or COVID-19) on the health of people worldwide as well as on the state of economy and commerce of the world in general and on India specifically. COVID-19 was first reported to the World Health Organisation (WHO) in December 2019 and it has rapidly spread to many other countries. Very recently, WHO has declared it as global pandemic. COVID-19 has not only affected the health of people across the globe and it has also caused severe disturbances in the global economic environment which has consequential impact on financial statements and reporting.

### **Indian Accounting Standards (Ind AS) and Accounting Standards (AS) Areas to be considered**

#### **Part I**

- 1. Inventory Measurement**
- 2. Impairment of Non-Financial Assets**
- 3. Financial Instruments**
  - **Impairment Losses**
  - **Fair Value Measurement**
  - **Hedge Accounting**
- 4. Leases**
- 5. Revenue**
- 6. Provisions, Contingent Liabilities and Contingent Assets**
- 7. Modifications or termination of Contracts or Arrangements**
- 8. Going Concern Assessment**
- 9. Income Taxes**
- 10. Consolidated Financial Statements**
- 11. Property, Plant and Equipment**
- 12. Presentation of Financial Statements**
- 13. Borrowing Costs**

#### **Part II**

- 14. Post Balance Events**
- 15. Interim Financial Reporting**



## Coronavirus (COVID-19) Impact on Financial Reporting – Accounting Year Ending March 31, 2020

### Background

ICAI is concerned about the impact of Coronavirus disease (known as COVID-2019 or COVID-19) on the health of people worldwide as well as on the state of economy and commerce of the world in general and on India specifically. ICAI is guided by the assessments given by the Government and public health authorities, domestic and international.

Latest media reports indicate the possible severe impact of this pandemic that the World Health Organisation (WHO), has been closely monitoring and considering its global impact. On March 11, 2020, WHO has assessed its risk and characterized it as global pandemic in view of the alarming levels of spread and severity, and of the alarming levels of infection.

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 economic environment which in turn has consequential impact on the results in the financial statements and reporting.

While we are empathetic to the global concerns of health and safety of people, 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 in this Accounting Advisory. It may be noted that we are only drawing the attention of preparers to some of the important requirements of Indian Accounting Standards (Ind AS) and Accounting Standards (AS), and this is not meant to be exhaustive and may differ based on specific facts, circumstances and business of respective preparers.



**Note: The advisory has been prepared for:**

1. Entities to whom Ind AS is applicable and
2. Entities to whom AS is applicable, viz,
  - a. Companies to whom Companies, Accounting Standards Rules, 2006 is applicable and
  - b. Non-corporate entities to whom AS issued by ICAI is applicable.

## Part I

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

**(a) In accordance with Ind AS 2, Inventories, and AS 2, Valuation of Inventories, it might be necessary to write down inventories to net realisable value due to reduced movement in inventory, decline in selling prices, or inventory obsolescence due to lower than expected sales.**

Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale. Net realisable value refers to the net amount that an entity expects to realise from the sale of inventory in the ordinary course of business. The management may consider written down of inventories to net realisable value item by item.

Ind AS 2 and AS 2 also provide that the allocation of fixed production overheads to the costs of conversion is 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, 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. It is unlikely that the normal production capacity is to be reviewed for allocating fixed production overheads for the year 2019-2020, because of adverse impact on the utilisation of the production capacity due to the impact of coronavirus on the overall economy or the segment (s) in which the entity is operating.



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

- (a) 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 test only has to be carried out if there are such indications. If any such indication exists, the entity shall estimate the recoverable amount of the asset.

Ind AS 36 relies on an 'economic' criterion for the recognition of an impairment loss. An 'economic' criterion is the best criterion to give information which is useful to users in assessing future cash flows to be generated as a whole. In estimating the time value of money and the risks specific to an asset in determining whether the asset is impaired, factors, such as the probability or permanence of the impairment loss, are subsumed in the measurement.

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.

- (b) For indefinite useful life intangible asset or an intangible asset not yet available for use and goodwill, Ind AS 36 requires an annual impairment testing. There could be an indicator that impairment testing of goodwill and indefinite useful life intangible assets are tested as of reporting date even if the entity follows other annual testing cycle as per Ind AS 36.

- (c) An entity needs to estimate 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. In cases

where the recoverable amount is estimated based on value in use, the considerations on accounting estimates apply.





## Critical Factors to Consider

The management needs to consider whether:

- contraction in economic activity due to the outbreak of COVID 19 is considered to be an impairment indicator at the reporting date, which results in an impairment assessment;
- assumptions used for impairment testing and to determine the recoverable amounts before the outbreak of COVID 19 requires any change;
- the assumptions used to determine discount rate to measure the recoverable amount require any adjustments;
- the forecasts or budgets for future cash flows prepared by management should be updated to reflect the impact of COVID 19;
- market assumptions used to determine fair value for recoverable amounts needs reconsideration;
- reasonable assumptions are taken in estimating the value-in-use and fair value less costs of disposal and ensure that the impairment loss, if any, is estimated reliably.

## Goodwill impairment

The standard requires that goodwill being tested for impairment at a level that reflects the way an entity manages its operations and with which the goodwill would naturally be associated. Due to COVID-19, there might be significant changes with an adverse effect in operations of a 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.

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. Financial Instruments

### Impairment Losses

Entities to whom Ind AS is applicable

Ind AS 109, Financial Instruments

Financial Instruments within the scope of Ind AS 109 such as Loans, Trade Receivables, Other Receivables, Investment in Debt instruments, Financial Guarantees and Loan Commitments not measured at fair value through profit or loss, Contract Assets and Lease Receivables are subject to impairment loss recognition and measurement based on an approach called Expected Credit Loss (ECL). This approach was introduced in the aftermath of the global financial crisis of 2008 to strengthen the accounting recognition of loan-loss provisions by incorporating a broader range of credit information. ECL approach is expected to consider forward looking information and it is measured based on probability weighted amount that is determined by evaluating a range of possible outcomes. The widespread contraction in economic activity across the globe due to the rapid spread of COVID-19 is likely to have an impact on the quantification of ECL and classification of financial assets into 3 buckets for recognition and measurement of impairment losses. In this context, following are important factors to be considered by the preparers.



### Critical Factors to Consider

- Recognition of 12 months ECL versus Lifetime ECL is based on segregation of credit exposures into 3 buckets viz. Stage 1- those with no significant increase in credit risk, Stage -2 those with significant increase in credit risk and Stage 3- Credit impaired. In case of certain financial assets such as Trade Receivables where the simplified approach is applicable, this segregation of credit exposures into 3 buckets is not required.



- Measurement of ECL- Adverse impact on the business of borrowers or debtors may impact the following credit risk parameters:
  - Risk of default (probability of default) i.e. the likelihood of default by the borrower may have increased significantly due to reduced economic activity;
  - Estimated amount of the loss itself in the event of default (loss given default). Contraction in economic activity and its impact on consumers may have affected value of collaterals and business cash flows adversely affecting the expected amount of loss;
  - In this period of substantial business dislocation, borrowers may tend to fully utilise undrawn limits and loan commitments, which in turn would impact another credit risk parameter i.e. exposure at default.
- ECL requirement of Ind AS 109, the measurement of ECL is expected to consider current as well as forecasted macro-economic conditions and more than one scenario. Entities may need to develop one or more scenarios considering the potential impact of COVID-19.
- Ind AS 109 – Appendix A states that a financial asset is credit-impaired when one or more events that have a detrimental impact on the estimated future cash flow of the financial asset have occurred. Evidence that a financial asset is credit-impaired include observable data about various events, for example, the lender(s) of the borrower, for economic or contractual reasons relating to the borrower’s financial difficulty, having granted to the borrower a concession(s) that the lender(s) would not otherwise consider.
- Entities may also need to consider the impact of any Prudential Regulatory actions to sustain the economy such as loan repayment holidays, reduction in interest rates etc.
- 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.
- If the entity is unable to assess the impact of COVID-19 in estimating the impairment loss due to the inadequacy of information, the same should be disclosed appropriately.



Non-Banking Financial Companies (NBFCs) and Asset Reconstruction Companies (ARCs) should also carefully consider the recent guidance provided by Reserve Bank of India (RBI) on implementation of Ind AS (RBI/2019-20/170 DOR (NBFC).CC.PD.No.109/22.10.106/2019-20 - Implementation of Indian Accounting Standards).

Entities to whom AS is applicable

- 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.
- 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.
- In respect of Banks and Insurance Entities, preparers need to consider impact of COVID-19 on classification of Loans and Advances into Standard, Sub-standard, Doubtful and Loss categories in addition to the Prudential Regulatory requirements of RBI and The Insurance Regulatory and Development Authority of India (IRDAI).

## Fair Value Measurement

Entities to whom Ind AS is applicable

Ind AS 113 Fair Value Measurement

Individual Ind ASs such as Ind AS 109, Ind AS 16, etc. prescribe when to measure an asset or liability at fair value and how to recognise the resultant fair value gains and losses i.e. in profit or loss section or other comprehensive income section of Statement of Profit and Loss. Equally, important is Ind AS 113, Fair Value Measurement, which lays down certain fundamental principles in respect of Fair value, its definition and how to determine it? In this context, the following are the critical factors to be considered in determining fair value both for measurement or disclosure requirements by the preparers.



## Critical Factors to Consider

- Ind AS 113 recognises the fact that there are different ways in which fair value is determined i.e. it can be based on observable market price (quoted price in an active market – Level 1) or application of valuation techniques (Level 2 and Level 3) as of the reporting date.
- The current financial and capital market environment across the globe has got affected by the rapid spread of COVID-19 and may have developed the following features.
  - Significant volatility or indications of the significant decline in market prices of financial instruments like equity, bonds and derivatives.
  - Significant decrease in volume or level of activity.
- The above features may need adequate management consideration and professional judgment to determine whether the quoted prices are based on transactions in an orderly market. It may not be always appropriate to conclude that all transactions in such a market are not orderly. Preparers should be guided by the application guidance in Ind AS 113 that indicates circumstances in which the transaction is not considered an orderly transaction.
- Preparers using valuation techniques may have to consider the impact of COVID-19 on various assumptions including discount rates, credit-spread/counter-party credit risk etc.



### *Entities to whom AS is applicable*

#### AS 13 Accounting for Investments

- In respect of financial assets within the scope of AS 13, entities have to carefully consider the impact of COVID-19 on determination of fair value for valuation of investments classified as Current Investments.



## Hedge Accounting

*Entities to whom Ind AS is applicable*

Ind AS 109, Financial Instruments

Ind AS 109 has elaborate requirements on the application of hedge accounting, which is an accounting choice for the entities. The requirements, among others, include the qualifying criteria for hedge accounting, how to assess hedge effectiveness and accounting for its impact in the financial statements.

### Critical Factors to Consider

- The standard permits a highly probable forecast transaction to be a qualifying hedged item. If entities have adopted cash-flow hedge accounting for certain forecasted transactions, they should assess whether the transaction still qualifies as a highly probable forecast transaction considering their business environment.
- Entities will need to assess any hedge ineffectiveness and record the impact of that in profit and loss.
- Estimate the fair value of derivatives, including paying special attention to underlying assumptions of derivatives, e.g., forward curve of interest rate, foreign currency, commodity etc.

*Entities to whom AS is applicable*

ICAI Guidance Note on Accounting for Derivative Contracts (Issued 2015)

- In respect of recognition and measurement of derivatives within the scope ICAI Guidance Note on Derivatives, entities may need to consider the impact on key inputs/assumptions such as foreign currency rate, interest rate, etc. used in their valuation techniques, including the potential impact on hedge accounting.





## 4. Leases

Entities to whom Ind AS is applicable

Ind AS 116, 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 assets due to contracted business activity.
- Discount rate used to determine the present value of new lease liabilities may need to incorporate any risk associated with COVID-19.
- If any compensation is 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 or whether assistance received from Government is to be accounted as government grants under Ind AS 20.
- Entities will need to determine whether as a result of COVID -19, any lease arrangement has become onerous.

Entities to whom AS is applicable

Leases (AS 19, AS 29)

- Due to COVID-19 there can be changes in the terms of lease arrangements or lessor may give some concession to the lessee with regard to lease payments. Such revised terms or concessions shall be considered while accounting for leases. However, 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.
- If any compensation is 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 appropriately as per AS 19. Whether any assistance received from government are government grants under AS 12.
- 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.

## 5. Revenue

Due to COVID-19, there could be likely increase in sales returns, decrease in volume discounts, higher price discounts etc. Under Ind AS 115, these factors need to be considered in estimating the amount of revenue to be recognised, i.e., measurement of variable consideration.

Ind AS 115 also requires disclosure of information that allows users to understand the nature, amount, timing and uncertainty of cash flows arising from revenue. Therefore, entities may have to consider disclosure about the impact of COVID-19 on entities revenue.

Entities to whom AS is applicable, may have postponed recognition of revenue due to significant uncertainty of collection in view of the impact of COVID-19. AS 9, Revenue Recognition requires entities to disclose the circumstances in which revenue recognition has been postponed pending the resolution of significant uncertainties.

## 6. Provisions, Contingent Liabilities and Contingent Assets

Entities to whom Ind AS is applicable

Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets



(I) Onerous contracts are those contracts for which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. Unavoidable costs under a contract are the least net cost of exiting from the contract, which is the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfil it. As a result of COVID -19, some contracts may become onerous for reasons such as increase in cost of material/labour, etc. Management should consider whether any of its contracts have become onerous. The same should be accounted for as per Ind AS 37. Ind AS 37 also requires assets dedicated to a contract to be tested for impairment before a liability for an onerous contract is recognised.

Additionally, there could be losses from imposition of penalty due to delay in supply of goods, which may need to be considered under the guidance of Ind AS 115, Revenue from Contracts with Customers.

If the management is unable to assess whether some of the executory contracts are onerous due to inadequacy of information, the same should be disclosed. Management should disclose that it has assessed whether executory contracts are onerous due to the adverse impact of COVID -19. If, the management is unable to assess whether some of the executory contracts have become onerous due to inadequacy of information, the same should be disclosed.

(ii) Restructuring costs - The Standard provides that a provision for restructuring costs is recognised only when the general recognition criteria for provisions are met and when there is a detailed formal plan for the restructuring and there is evidence that the entity has started to implement a restructuring plan, for example, by dismantling plant or selling assets or by the public announcement of the main features of the plan.

(iii) Insurance claims - Entities may have insurance policies that cover loss of profits due to business disruptions due to events like COVID-19. Entities claims on insurance companies can be recognised 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.





iv) Ind AS 37 requires a provision to be recognised only

- where an entity has a present obligation
- it is probable that an outflow of resources is required to settle the obligation; and
- a reliable estimate can be made.

Due to COVID-19, there is a need for exercising judgement in making provisions for losses and claims. A provision may be accounted for only to the extent that there is a present obligation for which the outflow of economic benefits is probable and can be reliably estimated.

Ind AS 37 does not permit provisions for future operating costs or future business recovery costs. However, Ind AS 37 requires that an entity should disclose the nature of the obligation and the expected timing of the outflow of economic benefits.

*Entities to whom AS is applicable*

*AS 29 Provisions, Contingent Liabilities and Contingent Assets*

Onerous contracts are those contracts for which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. Unavoidable costs under a contract are the least net cost of exiting from the contract, which is the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfil it. 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. The same should be accounted for as per AS 29. Management should disclose that it has assessed whether executory contracts are onerous due to adverse impact of COVID -19. 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.





## 7. Modifications or Termination of Contracts or Arrangements

It may also be noted that the entities may modify or terminate certain contracts which may be within 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 to Whom Ind AS is applicable	Entities to Whom 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)
Ind AS 104, Insurance Contracts For insurance companies this is routine; events like earthquake, huge floods, war situations, etc.	—
Ind AS 115, Revenue from Contracts with Customers	AS 7 Construction Contracts (revised 2002) AS 9 Revenue Recognition) Guidance Note on Accounting for Real Estate Transactions (revised 2012)

## 8. Going Concern Assessment

Entities to whom Ind AS is applicable

Ind AS 1, Presentation of Financial Statements

Ind AS 10, Events after the Reporting Period

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. 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.

Management of the entity should assess the impact of COVID-19 and the measures taken on its ability to continue as a going concern. 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 be prepared 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.

Entities to whom AS is applicable

AS 1 Disclosure of Accounting Policies

AS 4 Contingencies and Events Occurring After the Balance Sheet Date (revised 2016)

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. The impact of COVID-19 after the balance sheet date should also 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 to 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

Entities to whom Ind AS is applicable

Ind AS 12, Income Taxes

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, considering the additional uncertainty arising from the COVID-19 and the steps being taken by the management to control it.

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.



Management should disclose any significant judgements and estimates made in assessing the recoverability of deferred tax assets, in accordance with Ind AS 1.

*Entities to whom AS is applicable*

AS 22, Accounting for Taxes on Income

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

## **10. Consolidated Financial Statements**

*Entities to whom Ind AS is applicable*

Ind AS 110 Consolidated Financial Statements

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.

*Entities to whom AS is applicable*

AS 21 Consolidated Financial Statements (revised 2016)

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, difference between the reporting dates should not be more than six months.

## **11. Property Plant and Equipment (PPE)**

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. Presentation of Financial Statements

### Ind AS 1 Presentation of Financial Statements

- (i) Breach of loan covenants (including classification of liabilities into current and non-current)

Ind AS 1- Due to COVID-19 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.

- (ii) 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. COVID-19 may have created many uncertainties about the likely future scenarios which may affect the estimations of amounts recognised in the balance sheet as of reporting date. Entities shall be guided by the prescriptions in paragraphs 125 to 133 of Ind AS 1.

- (iii) Comparative information

Ind AS 1 requires presentation of minimum comparative information. Framework for the preparation and presentation of financial statements under Ind AS considers comparability as an important qualitative characteristic of financial statements. The Framework requires that users must be able to compare the financial statements of an entity through time in order to identify trends in its financial position and performance and also compare it with financial statements of other entities. COVID-19 may have



Affected the financial performance and financial position of entities. Therefore, preparers may consider making adequate disclosures and explanatory notes regarding the impact of COVID-19 on its financial position, performance and cash flows.

### **13. Borrowing Costs**

#### **Ind AS 23, Borrowing Costs, and AS 16 Borrowing Costs**

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.

## **Part II**

### **14. 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 31 December 2019. 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. In certain cases, Management judgement may be required to categorise the events into one of the above categories.

Similarly, 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.

However, 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 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. They should also disclose how they have dealt with the impact of COVID -19 on the financial position and financial performance of the entity.

## **15. Interim Financial Reporting (Ind AS 34 and AS 25) (Currently, this section may be applicable to a limited set of entities)**

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, Interim Financial Reporting, states that there might be greater use of estimates in interim financial statements, but it requires that the information is reliable and that all relevant information is disclosed. Ind AS 34/AS 25 Interim financial information usually updates the information in the annual financial statements. However, Ind AS 34/AS 25 requires that an entity shall include in its interim financial report an explanation of events and transactions that are significant to an understanding of the changes in financial position and performance of the entity since the end of the last annual reporting period. This implies that 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 Coronavirus (COVID-19) on the overall risks to the businesses in which the entity is engaged.

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# **Impact of Corona Virus on Audit of Financial Statements**

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## Impact of Novel Corona Virus (COVID-19) on Audit of Financial Statements for the Financial Year ending March 31, 2020

### Background

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

Given there are increasing restrictions on travel, meetings and access to client locations, auditors would be facing practical difficulties in carrying out audits. These underlying situations, however, must not undermine the delivery of high quality audits. Audits should continue to be planned and performed in compliance with the auditing standards. To enable the auditors to perform audits additional time may be required and alternate audit procedures may need to be performed in order to obtain sufficient appropriate audit evidence.



This document discusses key Advisory to auditors related to conditions that may arise as a result of COVID-19. Auditors must carefully evaluate unique circumstances prevailing in their audits and assess risk accordingly when applying the concepts in this Advisory in their audits.



## Principles of Specific Standards on Auditing used in this Advisory

Areas which require special attention of auditors in current scenario are cited below along with reference of relevant Standards on Auditing (SAs):

1. Identifying and Assessing the Risk of Material Misstatements and Materiality in Planning and Performing an Audit (SA 315, Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and its Environment & SA 320, Materiality in Planning and Performing an Audit)
2. Assessing Financial Impact and their Reasonable Estimation (SA 540, Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures)
3. Valuation of Inventory on a date other than date of financial statements i.e. 31st March 2020 (SA 501, Audit Evidence - Specific Considerations for Selected Items)
4. Audit of Consolidated Financial Statements where Components/component auditors are located in severely affected places (SA 600, Using the Work of Another Auditor)
5. Subsequent Events or Events after Reporting date (SA 560, Subsequent Events)
6. Going Concern [SA 570(Revised), Going Concern]
7. Evaluation of Work of Management's Expert (SA 500, Audit Evidence)
8. Written Representations (SA 580, Written Representations)
9. Auditor's Opinion, [SA 700(Revised)], Forming an Opinion and Reporting on Financial Statements, SA 705(Revised), Modifications to the Opinion in the Independent Auditor's Report, SA 706(Revised), Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report
10. Reporting on Key Audit Matters (SA 701, Communicating Key Audit Matters in the Independent Auditor's Report)
11. The Auditor's Responsibilities Relating to Other Information [SA 720(Revised)]
12. Internal Control Considerations
13. External Confirmations (SA 505, External Confirmations)
14. Risk of Fraud (SA 240, The Auditor's Responsibilities Relating to Fraud in An Audit of Financial Statements)





## 1. Identifying and Assessing the Risk of Material Misstatements and Materiality in Planning and Performing an Audit

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

Due to the above conditions, entities and auditors would have to evaluate additional risks arising from the following areas:

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

In applying SA 315 - Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment, the auditor should consider the implications of the above matters when obtaining an understanding of the entity and its environment, in light of its objectives, strategies and other business risks.





The auditor should also discuss with TCWG and management whether the impact of the COVID-19 has been incorporated into their risk assessment processes and how they have identified and assessed the significance of the emerging business risks. The auditor should also consider if disclosures are required in the financial statements about the key assumptions made in reaching this conclusion.

If the auditor has revised the risk assessment as a result, audit materiality may also need to be revised as the audit progresses. Reference may be made to SA 320 - Materiality in Planning and Performing an Audit. Paragraphs 12 and 13 of SA 320 are reproduced below:



### **“Revision as the Audit Progresses**

12. The auditor shall revise materiality for the financial statements as a whole (and, if applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures) in the event of becoming aware of information during the audit that would have caused the auditor to have determined a different amount (or amounts) initially. (Ref: Para. A13)
13. If the auditor concludes that a lower materiality for the financial statements as a whole (and, if applicable, materiality level or levels for particular classes of transactions, account balances or disclosures) than that initially determined is appropriate, the auditor shall determine whether it is necessary to revise performance materiality, and whether the nature, timing and extent of the further audit procedures remain appropriate.”





## 2. Assessing Financial Impact and their Reasonable Estimation

The financial statements have various items which would have been affected by the outbreak of COVID-19, a detailed list of them has been mentioned in the Accounting Advisory.

In addition to the detailed list of items of financial statements mentioned in the aforesaid Advisory, specific accounting issues could arise in the following areas:

- a. Impairment of Goodwill, Property Plant and Equipment, Intangible Assets and Valuation & impairment of receivables, loans and advances.
- b. Valuation of defined benefit plans and obligations – due to significant changes in employee strength or de-valuation of underlying plan assets.
- c. Stock compensation performance conditions and obligations.
- d. Contractual penalties.
- e. Employment termination benefits.
- f. Insurance recoveries related to business interruptions.
- g. Onerous contract provisions.
- h. Allowance for expected credit losses.

The above items are likely to have significant accounting estimates to be made by the management. Significant assumptions including projected cash flows, used in these accounting estimates may be affected by the impact of COVID-19. Hence, the auditor should use procedures as prescribed by SA 540, Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures to check whether (a) the accounting estimates, including fair value accounting estimates, in the financial statements, whether recognised or disclosed, are reasonable; and (b) related disclosures in the financial statements are adequate.

The above procedures include how management has assessed the effect of estimation uncertainty or the risk assessment and audit evidence supporting these accounting estimates and related disclosures that may be affected by the impact of COVID-19 on the business of the entity and the economic environment.





### **3. Valuation of Inventory on a date other than date of financial statements i.e. 31st March 2020**

Due to government-imposed shutdowns or due to unavailability of the client personnel, it may not be practicable for most of the business entities to conduct physical verification of inventory as on the date of the financial statements i.e. 31st March, 2020. The auditor must plan procedures depending on the underlying circumstances wherein the inventory count date could be advanced prior to the year-end or deferred to a date after the year-end.

The auditor would need to comply with the procedures given in Paragraphs 5 and 7 read with Paragraphs A9 to A14 of SA 501 cited below:

“5. If physical inventory counting is conducted at a date other than the date of the financial statements, the auditor shall, in addition to the procedures required by paragraph 4, perform audit procedures to obtain audit evidence about whether changes in inventory between the count date and the date of the financial statements are properly recorded. (Ref: Para. A9-A11)

#### **Physical Inventory Counting Conducted Other than At the Date of the Financial Statements (Ref: Para. 5)**

A9. For practical reasons, the physical inventory counting may be conducted at a date, or dates, other than the date of the financial statements. This may be done irrespective of whether management determines inventory quantities by an annual physical inventory counting or maintains a perpetual inventory system. In either case, the

effectiveness of the design, implementation and maintenance of controls over changes in inventory determines whether the conduct of physical inventory counting at a date, or dates, other than the date of the financial statements is appropriate for audit purposes. SA 330 establishes requirements and provides guidance on substantive procedures performed at an interim date.





A10. Where a perpetual inventory system is maintained, management may perform physical counts or other tests to ascertain the reliability of inventory quantity information included in the entity's perpetual inventory records. In some cases, management or the auditor may identify differences between the perpetual inventory records and actual physical inventory quantities on hand; this may indicate that the controls over changes in inventory are not operating effectively.



A11. Relevant matters for consideration when designing audit procedures to obtain audit evidence about whether changes in inventory amounts between the count date, or dates, and the final inventory records are properly recorded include:

- Whether the perpetual inventory records are properly adjusted.
  - Reliability of the entity's perpetual inventory records.
  - Reasons for significant differences between the information obtained during the physical count and the perpetual inventory records.
7. If attendance at physical inventory counting is impracticable, the auditor shall perform alternative audit procedures to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory. If it is not possible to do so, the auditor shall modify the opinion in the auditor's report in accordance with SA 705(Revised). (Ref: Para. A12-A14)

## **Attendance at Physical Inventory Counting Is Impracticable (Ref: Para. 7)**

A12. In some cases, attendance at physical inventory counting may be impracticable. This may be due to factors such as the nature and location of the inventory, for example, where inventory is held in a location that may pose threats to the safety of the auditor. The matter of general inconvenience to the auditor, however, is not sufficient to support a decision by the auditor that attendance is impracticable. Further, as explained in SA 200, the matter of difficulty, time, or cost involved is not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative or to be satisfied with audit evidence that is less than persuasive.



A13. In some cases where attendance is impracticable, alternative audit procedures, for example inspection of documentation of the subsequent sale of specific inventory items acquired or purchased prior to the physical inventory counting, may provide sufficient appropriate audit evidence about the existence and condition of inventory.

A14. In other cases, however, it may not be possible to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by performing



alternative audit procedures. In such cases, SA 705(Revised) requires the auditor to modify the opinion in the auditor's report as a result of the scope limitation.”

#### **4. Audit of Consolidated Financial Statements where Components/ Component auditors are located in severely affected places**

As per the Accounting Advisory the following must be followed by the management in preparation of financial statements:

“Entities to whom Ind AS is applicable

Ind AS 110 Consolidated Financial Statements

Ind AS 110 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, difference between the reporting dates should not be more than three months.





Entities to whom Ind AS is not applicable

AS 21 Consolidated Financial Statements (revised 2016)

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, difference between the reporting dates should not be more than six months.”

In either of the above instances, if the financial information/ financial statements of the components are unavailable, for the year ended March 31, 2020, the maximum difference between the reporting dates cannot exceed the above limits.

### **The Roles and Responsibilities of the Auditor with regards to Consolidated Financial Statements are as follows:**

(a) Paragraph 49 of Guidance Note on Audit of Consolidated Financial Statements, issued by ICAI states as under:

“49. In a case where the parent's auditor is not the auditor of all the components included in the consolidated financial statements, the auditor of the consolidated financial statements should consider the requirements of SA 600.”

(b) As per SA 600, Using the Work of Another Auditor the principal auditor should perform procedures to obtain sufficient appropriate audit evidence, that the work of the other auditor is adequate for the principal auditor's purposes, in the context of the specific assignment and also should consider the significant findings of the other auditor. While doing so, the principal auditor should consider how the impact of COVID-19 including travel bans, temporary suspension of business operations, government mandated leaves, etc., may affect risk assessments, materiality and the ability to obtain sufficient appropriate audit evidence in respect of components. If principal auditor is unable to obtain adequate information or reporting from the component auditors, the principal auditor should express a qualified opinion or disclaimer of opinion because there is a limitation on the scope of audit. (Refer Paragraph 22 of SA 600)



(c) In the current scenario, the alternative means or methods to obtain sufficient appropriate audit evidence by the principal auditor from component auditor are as follows:

- Can data be shared cross-border, to allow for principal auditor for review? Could files be loaded into a cloud-based portal and a login provided to the principal auditor? Local laws may restrict cross-border data sharing. If in doubt, advice should be sought on any local legal restrictions.
- Can video calls and/or screen sharing software be used to discuss the work with the component auditor?
- Can the component auditor be asked to complete a detailed questionnaire or clearance on the work they have performed?
- Consider the outcome of any prior visits, including visits during planning or at an interim stage
- What work of component auditor was previously reviewed?
- Consider the past work of the component auditor – have there been significant errors or issues, or has work been performed to a high standard?
- Can a more detailed memorandum be provided to the component auditor on what work should be done for purpose of group reporting?
- What work can be done centrally by the Principal auditor's team?

If finance systems are integrated, data may be accessible for review by Principal Auditor. Management may be able to provide information directly to the Principal auditor to allow for testing.

Each individual engagement will need to be assessed on a case by case basis to determine what may be appropriate.





## 5. Subsequent Events or Events after Reporting date

As per the Accounting Advisory the following needs to be considered by the management in the preparation of financial statements:

“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. In certain cases, Management judgement may be required to categorise the events into one of the above categories.

Similarly, 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. However, 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 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. They should also disclose how they have dealt with the impact of COVID -19 on the financial position and financial performance of the entity.”





## The Responsibilities of the auditor for the subsequent events i.e. events between the date of financial statements and the date of auditor's report as per SA 560 are as follows:

### “Events Occurring Between the Date of the Financial Statements and the Date of the Auditor's Report

6. The auditor shall perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements have been identified. The auditor is not, however, expected to perform additional audit procedures on matters to which previously applied audit procedures have provided satisfactory conclusions. (Ref: Para. A6)

7. The auditor shall perform the procedures required by paragraph 6 so that they cover the period from the date of the financial statements to the date of the auditor's report, or as near as practicable thereto. The auditor shall take into account the auditor's risk assessment in determining the nature and extent of such audit procedures, which shall include the following: (Ref: Para. A7-A8)

- a) Obtaining an understanding of any procedures management has established to ensure that subsequent events are identified.
- b) Inquiring of management and, where appropriate, those charged with governance as to whether any subsequent events have occurred which might affect the financial statements. (Ref: Para. A9)
- c) Reading minutes, if any, of the meetings, of the entity's owners, management and those charged with governance, that have been held after the date of the financial statements and inquiring about matters discussed at any such meetings for which minutes are not yet available. (Ref: Para. A10)
- d) Reading the entity's latest subsequent interim financial statements, if any.





8. When, as a result of the procedures performed as required by paragraphs 6 and 7, the auditor identifies events that require adjustment of, or disclosure in, the financial statements, the auditor shall determine whether each such event is appropriately reflected in those financial statements.”

## 6. Going Concern

COVID-19 is resulting in significant operational disruption and presents an existential threat for many businesses. Entities and audit teams need to consider the implications on the assessment of going concern and viability in the financial report and whether these circumstances will result in prolonged operational disruption which will significantly erode the financial position of the entity or otherwise result in failure.



This is critically important for the going concern assessment. Auditors will need to consider whether the threat to liquidity as a result of supply/demand disruption presents a material uncertainty to the going concern status for the 12 months look forward period. SA 570(Revised) also requires auditors to consider events that may cast significant doubt on the entity's ability to continue as a going concern beyond the period of management's assessment.

Audit teams should robustly assess the going concern and viability risks relating to COVID-19 threat in compliance with SA 570(Revised). This includes evaluating whether there is adequate support for the assumptions underlying management's assessment and the consistency of these assumptions across the entity's business activities.

As per paragraph 5 of SA 570(Revised), Going Concern

The Management's assessment of the entity's ability to continue as a going concern involves making a judgment, at a particular point in time, about inherently uncertain future outcomes of events or conditions. The following factors are relevant to that judgment:



- The degree of uncertainty associated with the outcome of an event or condition increases significantly the further into the future an event or condition or the outcome occurs. For that reason, most financial reporting frameworks that require an



- explicit management assessment specify the period for which management is required to take into account all available information.
- The size and complexity of the entity, the nature and condition of its business and the degree to which it is affected by external factors affect the judgment regarding the outcome of events or conditions.
- Any judgment about the future is based on information available at the time at which the judgment is made. Subsequent events may result in outcomes that are inconsistent with judgments that were reasonable at the time they were made.

The auditor's responsibilities relating to going concern are mentioned in Paragraphs 6 & 7 of SA 570(Revised), Going Concern which are cited below:

### **“Responsibilities of the Auditor**

6. The auditor's responsibilities are to obtain sufficient appropriate audit evidence regarding, and conclude on, the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements, and to conclude, based on the audit evidence obtained, whether a material uncertainty exists about the entity's ability to continue as a going concern. These responsibilities exist even if the financial reporting framework used in the preparation of the financial statements does not include an explicit requirement for management to make a specific assessment of the entity's ability to continue as a going concern.



6. However, as described in SA 200, the potential effects of inherent limitations on the auditor's ability to detect material misstatements are greater for future events or conditions that may cause an entity to cease to continue as a going concern. The auditor cannot predict such future events or conditions. Accordingly, the absence of any reference to a material uncertainty about the entity's ability to continue as a going concern in an auditor's report cannot be viewed as a guarantee as to the entity's ability to continue as a going concern.”

There could be several situations arising from the ongoing COVID-19 outbreak that could have an impact on the assumption relating to going concern. For some entities, the impact could be severe and may leave management with no

realistic alternative but to liquidate or cease operations. There could also be entities which may have to scale down their operations while impact may not be significant for other entities.



It is the responsibility of management to make the assessment as to whether the entity is a going concern. In assessing whether the going concern assumption is appropriate, management takes into account all available information about the future, which is at least, but is not limited to, twelve months from the date when the financial statements are authorised for issue. The assessment will be specific to the entity's circumstances.

In the current scenario, while making this assessment, management would generally be expected to prepare detailed forecasts which, will require regular updation till the financial statements are authorised for issue. These forecasts should capture potential scenarios and management's plans.

Management should consider the impact of COVID-19 on customers, suppliers and employees. For example, could the entity continue to operate if employees are not able to physically present, and how reduced cash flows impact its working capital requirements. Management should also consider whether the insurance policies taken by the entity cover the losses arising from the COVID -19.



The auditor will only be able to form a conclusion relating to going concern once management has made its own assessment. The auditor should inquire of management and TCWG as to what information is available about the future, and determine whether this has been appropriately considered as part of management's assessment. The auditor should apply similar considerations to those of management, as discussed above, in assessing the appropriateness of the going concern assumption. This should, for example, include a detailed and robust review of up to date forecasts, cash flows, sensitivity analyses and reviews of COVID-19 contingency plans and impact assessments conducted by the management.



If events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern, the auditor shall obtain sufficient appropriate audit evidence to determine whether or not a material uncertainty exists.

Given the level of uncertainty and speed of increasing impact of COVID-19, audit teams need to critically consider the current position at the point of sign off as part of the subsequent events review right up to the point of signing the auditor's report, and may need further evidence and information by management, including updating financial models.

If the entity is disclosing in their subsequent events disclosures that an estimate of impact cannot be made due to the evolving situation, this may result in a material uncertainty on going concern within the audit report.

## 7. Evaluation of Work of Management's Expert

Since, lot of estimation is involved regarding the impact on the financial statements and assessment of going concern in the current circumstances, management may take the assistance of a management's expert (an expert in field other than accounting and auditing) to make such estimates or assessments.





As per paragraph 8 of SA 500—Audit Evidence,

“When information to be used as audit evidence has been prepared using the work of a management's expert, the auditor shall, to the extent necessary, having regard to the significance of that expert's work for the auditor's purposes, (Ref: Para. A34- A36)

- a) Evaluate the competence, capabilities and objectivity of that expert; (Ref: Para. A37-A43)
- b) Obtain an understanding of the work of that expert; and (Ref: Para. A44- A47)
- c) Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion. (Ref: Para. A48)”



## 8. Written Representations

As per SA 580, the auditor should obtain written representations from the management regarding the various estimates and assessments made by the management. The written representations should be exhaustive, containing the occurrence, method of measurement, completeness of transactions recorded and the disclosure of financial impacts in the financial statements. Auditors need to assess whether any specific representations may be required to be obtained from the Management in relation to Managements' assessment of impact from the ongoing outbreak of COVID-19 on the financial statements for the year ending March 31, 2020 as well as for the reasonable foreseeable future.

## 9. Auditor's Opinion

The overall objectives of an auditor as per SA 200—Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing, are as follows:



- a) To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework; and
- b) To report on the financial statements, and communicate as required by the SAs, in accordance with the auditor's findings.



Auditor should form an opinion on the financial statements considering the principles enunciated in SA 700(Revised), SA 705(Revised), SA 706 (Revised). Since in the current scenario there are high probabilities of going concern being affected, existence of material uncertainties relating to going concern, the principles enunciated in SA 570(Revised) also need to be considered particularly paragraphs 21 to 24 which prescribe manner of reporting in different situations. The auditor needs to carefully assess the situation applying professional judgement and professional skepticism and report accordingly.

### **Some illustrative Situations where the Auditor may need to express a modified opinion due to COVID-19 are cited below:**

- i. The auditor is unable to obtain sufficient appropriate audit evidence relating to material component audited by the other auditor as per SA 600 due to COVID-19 pandemic.
- ii. The financial impact arising out of the COVID-19 outbreak are not accounted or reported or disclosed as per the prescribed Accounting Standards, in the financial statements.
- iii. If the auditor is unable to obtain sufficient appropriate audit evidence relating to the impact of COVID-19 in the financial statements and is of opinion that there are misstatements that are material to the financial statements.



- iv. The auditor has communicated misstatements to the management and those charged with governance relating to COVID-19 as per SA 450, Evaluation of Misstatements Identified During the Audit and the management or TCWG refuses to correct such misstatements, that are individually or in aggregate, material to the financial statements.

## 10. Reporting on Key Audit Matters

SA 701 – Communicating Key Audit Matters in the Independent Auditor's Report deals with the auditor's responsibility to communicate key audit matters in the auditor's report. Key audit matters are those matters that, in the auditor's professional judgement, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from the matters communicated with those charged with governance.

The auditor would need to comply with the procedures given in Paragraphs 9 (read with Paragraphs A18 to A26) of SA 701 cited below:

“9. The auditor shall determine, from the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit. In making this determination, the auditor shall take into account the following: (Ref: Para. A9–A18)

- a) Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with SA 315. (Ref: Para. A19–A22)
- b) Significant auditor judgments relating to areas in the financial statements that involved significant management judgment, including accounting estimates that have been identified as having high estimation uncertainty. (Ref: Para. A23–A24)
- c) The effect on the audit of significant events or transactions that occurred during the period. (Ref: Para. A25–A26)”

The auditor should evaluate whether the impact of the disruption caused because of COVID-19 to the operations of the entity, consequential impact on the financial statements would be a key audit matter and if determined so, the auditor would need to report the same alongwith how the matter was addressed in the audit.



## 11. The Auditor's Responsibilities Relating to Other Information (SA 720 (Revised))

This SA requires the auditor to read and consider the other information because other information that is materially inconsistent with the financial statements or the auditor's knowledge obtained in the audit may indicate that there is a material misstatement of the financial statements or that a material misstatement of the other information exists,

either of which may undermine the credibility of the financial statements and the auditor's report thereon. Such material misstatements may also inappropriately influence the economic decisions of the users for whom the auditor's report is prepared.



Other information may include amounts or other items that are intended to be the same as, to summarize, or to provide greater detail, about amounts or other items in the financial statements, and other amounts or other items about which the auditor has obtained knowledge in the audit. Other information may also include other matters.

Entities would need to provide additional disclosure as part of the financial statements/ annual report w.r.t. the following areas:-

- a. Risk assessment – Entities may elaborate on existing reported risks w.r.t. calamities or add new ones relating to COVID-19.
- b. Management discussion and analysis – Entities may include management's discussion and analysis of any material current and potential future impact on their operations, financial condition and liquidity arising out of the entity's exposure to COVID-19 risks.
- c. Notes to the financial statements – Specific disclosures under the subsequent events accounting standards and any other specific account specific disclosures.

The auditor is required to read any other information disclosed in the annual report and consider whether the same is consistent with the financial statements and the auditor's knowledge obtained in the audit.



## 12. Internal Control Considerations

In case of companies, where the auditors have to issue a Report on the Internal Financial Controls over Financial reporting under Clause (i) of Sub-section 3 of Section 143 of the Companies Act, 2013, because of the impact of COVID-19, there could be additional considerations that need to be considered as below:



- a. Companies may 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. Company's ability to close financial reporting process in time.
- e. Company's ability to design and implement controls related to selection and application of Generally Accepted Accounting Principles (GAAP) for accounting and disclosure issues arising from COVID-19.

## 13. External Confirmations

SA 330, The Auditor's Responses to Assessed Risks requires that the auditor obtain more persuasive audit evidence the higher the auditor's assessment of risk. To do this, the auditor may increase the quantity of the evidence or obtain evidence that is more relevant or reliable, or both. For example, the auditor may place more emphasis on obtaining evidence directly from third parties or obtaining corroborating evidence from a number of independent sources. SA 330 also indicates that external confirmation procedures may assist the auditor in obtaining audit evidence with the high level of reliability that the auditor requires to respond to significant risks of material misstatement, whether due to fraud or error.

SA 240 indicates that the auditor may design confirmation requests to obtain additional corroborative information as a response to address the assessed risks of material misstatement, whether due to fraud at the assertion level.



SA 500 indicates that corroborating information obtained from a source independent of the entity, such as external confirmations, may increase the assurance the auditor obtains from evidence existing within the accounting records or from the representations made by the management

SA 505, External Confirmations provides guidance regarding the process of seeking external confirmations and evaluating the results of the process. Due to the impact of COVID-19 it is more likely that this key audit procedure which provides significant independent audit evidence may be ineffective due to the inadequate responses or non-responses to the confirmation request sent out.

## Results of the External Confirmation Procedures

### Reliability of Responses to Confirmation Requests

If the auditor identifies factors that give rise to doubts about the reliability of the response to a confirmation request, the auditor shall obtain further audit evidence to resolve those doubts. (Ref: Paragraphs 11-12 of SA 505 reproduced below)

11. If the auditor determines that a response to a confirmation request is not reliable, the auditor shall evaluate the implications on the assessment of the relevant risks of material misstatement, including the risk of fraud, and on the related nature, timing and extent of other audit procedures. (Ref: Para A17)

### Non-Responses

12. In the case of each non-response, the auditor shall perform alternative audit procedures to obtain relevant and reliable audit evidence. (Ref: Para A18-A19 below)

A18. Examples of alternative audit procedures the auditor may perform include:

- For accounts receivable balances – examining specific subsequent cash receipts, shipping documentation, and sales near the period-end.
- For accounts payable balances – examining subsequent cash disbursements or correspondence from third parties, and other records, such as goods received notes.





A19. The nature and extent of alternative audit procedures are affected by the account and assertion in question. A non-response to a confirmation request may indicate a previously unidentified risk of material misstatement. In such situations, the auditor may need to revise the assessed risk of material misstatement at the assertion level, and modify planned audit procedures, in accordance with SA 315. For example, fewer responses to confirmation requests than anticipated, or a greater number of responses than anticipated, may indicate a previously unidentified fraud risk factor that requires evaluation in accordance with SA 240.

## 14. Risk of Fraud

Paragraph 5 of SA 240 states that “An auditor conducting an audit in accordance with SAs is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error. Owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with the SAs.”



As stated in Paragraph 12 of SA 240 “the auditor shall maintain professional skepticism throughout the audit, recognizing the possibility that a material misstatement due to fraud could exist, notwithstanding the auditor's past experience of the honesty and integrity of the entity's management and those charged with governance.

The impact of COVID-19 on businesses could be very significant and could put pressures on management to meet performance targets or market expectations. This raises the risk of the likelihood of fraud in the financial statements to a higher level which requires the auditor to exercise a much higher degree of skepticism and carry out extended audit procedures to eliminate the possibility of fraud or material error in the financial statements.



In carrying out the audit for the financial year ending March 31, 2020 auditors must be particularly mindful of the heightened risk of fraud and comply with the guidance provided by SA 240, “The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements”.

## Conclusion

The impact of COVID-19 on the economy, financial markets and entities in particular continues to evolve.

The role of auditors at times like this is 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 recognise 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. Auditors should exercise a very high degree of skepticism and be prepared to call out where the Company’s narrative that the Board presents is not specific enough and does not “tell the whole story” of the various scenarios and level of uncertainty specific to the Company’s operations. Irrespective of the challenges and uncertainties, there should not be any dilution or non-compliance with the auditing standards in carrying out the audits.

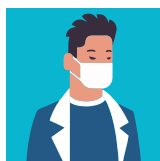
## WIN OVER CORONAVIRUS



WASH YOUR HANDS FREQUENTLY AND THOROUGHLY WITH SOAP AND WATER FOR AT LEAST 20 SECONDS



AVOID TOUCHING EYES, NOSE AND MOUTH



WEAR A FACE MASK OR COVER YOUR MOUTH WHILE SNEEZING AND COUGHING



AVOID TOUCHING “HIGH - TOUCH” SURFACES



CLEAN ALL “HIGH TOUCH” SURFACES DAILY



AVOID PUBLIC GATHERING



AVOID UNNECESSARY TRAVEL



MAINTAIN 1 METRE (3 FEET) DISTANCE BETWEEN YOURSELF AND OTHERS



AVOID SHARING PERSONAL ITEMS FOOD, UTENSILS ETC



AVOID EATING OUTSIDE



MONITOR YOUR SYMPTOMS



SEEK MEDICAL ADVICE IF YOU EXPERIENCE SYMPTOMS