Impact of Corona Virus on Financial Reporting and Audit Consideration

1. Valuation of Inventory

A. Impact of Corona Virus on Financial Reporting.

In accordance with **AS 2 Valuation of Inventories** it might be necessary to write down inventories to Net Realizable Value (NRV) due to reduced movement in inventory, decline in selling prices, or inventory obsolescence due to lower than expected sales.

a) **NRV = Estimated selling price - Estimated costs of completion and the estimated costs necessary to make the sale.**

b) **AS 2** also provides 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**.

c) <u>**Disclosures**</u>
Entities should assess the significance of any write-downs and whether they require disclosure in accordance with AS 2 as well as paragraph 14(a) of AS 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies.

B. Impact of Corona Virus on Audit of Financial Statement.

Verification of Inventory on 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 deferred to a date after the year-end.
- An auditor needs to comply with procedures given in **SA-501.**
- 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 Above paragraph, 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.

2. Valuation of Current and non current investment.

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A. Non Current investment.

a. 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 - Implement**

b. In respect of financial assets within the scope of **AS 13, Accounting for Investments**, entities may have to carefully consider the requirements of making provisions for decline in the value of investments, which is other than temporary.

c. In respect of Banks and Insurance Entities, preparers need to consider impact of COVID-19 on classification of Loans and Advances into Standard, Substandard, Doubtful and Loss categories in addition to the Prudential Regulatory requirements of RBI and IRDAI.

B. Current investment.

As per AS -13 in case of Current investments must be carried in financial statements at lower of cost and fair value which is determined either by category of investment or on an individual investment basis, however, not on the overall basis.

However, 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 for measurement

1. 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.

2. 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.

3. 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.

3. **Depreciation – Useful life.**

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1. 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.

2. 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.

4. **Impairment.**

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1. 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.

2. 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.

3. **Critical factors to consider.**

   i. 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;
   ii. Assumptions used for impairment testing and to determine the recoverable amounts before the outbreak of COVID 19 requires any change;
   iii. The assumptions used to determine discount rate to measure the recoverable amount require any adjustments;
   iv. The forecasts or budgets for future cash flows prepared by management should be updated to reflect the impact of COVID 19.
   v. Market assumptions used to determine fair value for recoverable amounts needs reconsideration.

vi. 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.

5. Retirement dues provisions

It may also be noted that the entities may modify or terminate certain contracts which may be within the scope of AS 15 Employee benefit. Entities are advised to consider the specific requirements of these standards and guidance note to account for these modifications or termination.

6. Other Considerations due to Uncertainty

1. Postponement of Revenue Recognition due to uncertainty of collection.
2. Recognition of Liability/ Contingent Liability arising out of Contractual Obligations and Onerous Contracts
3. Impact on 'Going Concern' may have to be evaluated for businesses/sectors