

COVID-19

Accounting and Auditing implications



COVID 19: Key Accounting Considerations

Key accounting considerations | Various areas

Revenue recognition

Financial assets

Leases

Debt restructuring

Insurance claims

Government subsidies /grants

Contingent liabilities

Provisions

Hedge accounting

PPE – Impairment

Taxes

Going concern

Disclosures

Key accounting considerations | Impact on Revenue recognition



Decline in Revenue
Decrease in volume discounts

Increase in sales return
High price discounts

Existence of a contract

Assess whether collection is probable while evaluating new contracts.

Variable Consideration

Adjustments to the transaction price to the extent it is probable that a significant reversal will not occur

Disclosure

Ind AS 115 requires disclosure of nature, amount, timing and uncertainty of revenue and cash flows affected by economic factors.

Admissibility

Does policy includes claims towards losses incurred on account of communicable diseases?

Contingent assets

Insurance claims filed by companies are only contingent assets until the claim is accepted by the insurer

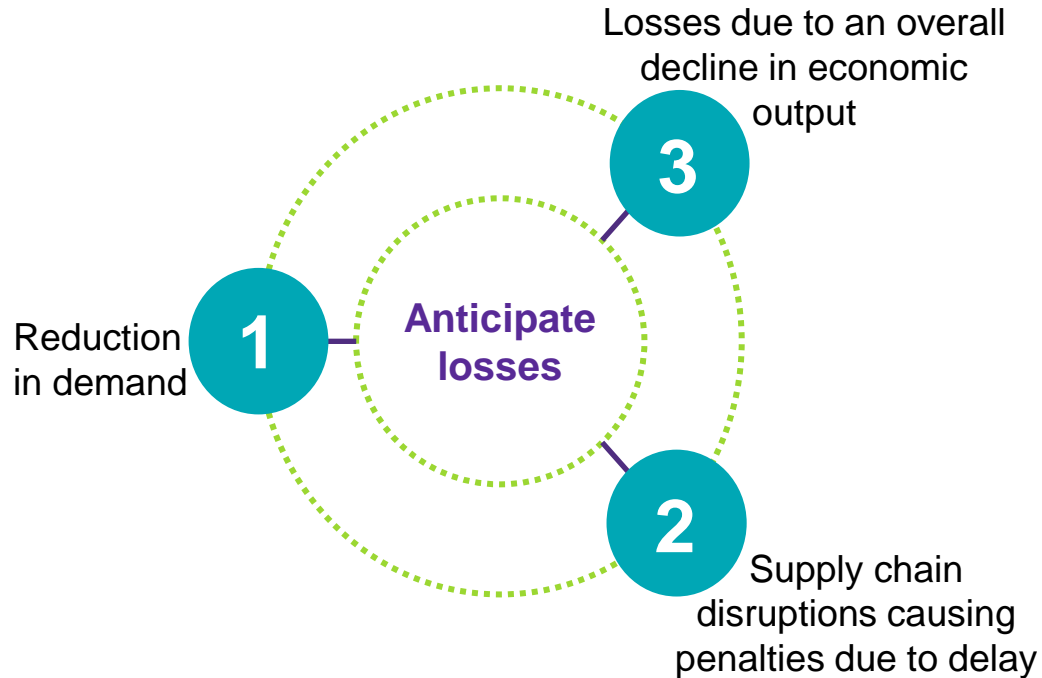
Recognition

Income can be recognized only on virtual certainty i.e. claim accepted by the insurer

Government Grants / Assistance

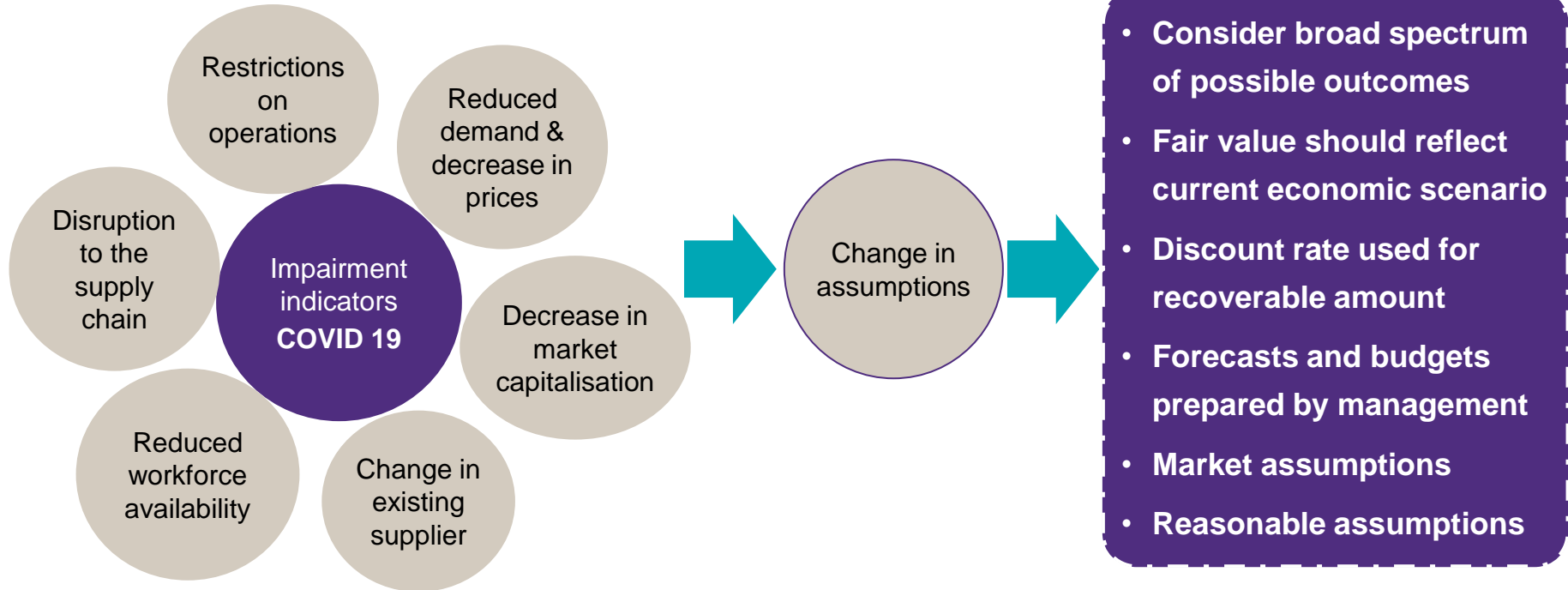
- Distinguish between government assistance and government grants.
- Ensure, grants are recognised only when the recognition criteria as per Ind AS 20, Accounting for Government Grants and Disclosure of Government Assistance (Ind AS 20), are met

Key Accounting considerations | Provisions and Contingent liabilities



- **Future operating losses** on existing contracts do not meet the definition of a liability unless they fall in the category of onerous contracts
- Assets dedicated to a contract which has become onerous to be **tested for impairment** before a liability for onerous contract is recognized
- **Disclosures** to be made where assessment of executory costs becoming onerous cannot be concluded
- **Restructuring cost** should be provided according to the recognition criteria

Impairment – IND AS 36





Economic outlook deteriorates which can impact recoverability of any recognized deferred tax assets

Change in Estimates of future growth, market prices of goods/ services, timing of cash flows etc.

Considering the unprecedented circumstances, the future projections may be subject to multiple uncertainties.

The Companies with global presence, likelihood of change in earnings of foreign entities, basis which management may reconsider its tax strategy.

The Companies may also be granted tax waivers or deferrals by the Government.



Ind AS 109 prescribes when to measure a financial asset at fair value and how to recognise the resultant fair value gains and losses

Financial asset at fair value

Investment in Level 1 securities

- Quoted market price in active market to be used
- Movement in active market price after balance sheet date not to be considered

Investment in level 2 and level 3 securities:

- Appropriate value techniques to be used
- Consider the impact of COVID19 on various assumptions used

Financial assets at amortized cost

- 12 month ECL vs lifetime ECL (except trade receivables)
- Consider current as well as forecasted macro-economic scenarios
- impact of any Prudential Regulatory actions to sustain the economy
- Impact on Investment in subsidiaries
- Disclosure requirements

Key Accounting considerations | Debt Restructuring



Revenues decline | Higher Operating cost | Cash flow challenges

COVID-19
pandemic may

Change the financial
ratio due to
disruption in
business

Impact the cash flow
due to which there
may be delay in
payments of interest
and principal

Have an adverse
impact on
compliance with the
debt covenants

Any Significant
modification or debt
extinguishment need to
be accounted for in
accordance with the
relevant requirements
under Ind AS 109



Hedge Accounting is a policy choice which reduces accounting mismatch

Hedge effectiveness assessment

On reporting date or when there is significant change in circumstances, which occurs first – recognize in profit/loss account

Rebalancing existing hedges

Rebalance or discontinue hedge accounting where hedges no longer found to be effective

Estimate the fair value of derivatives

Special attention to underlying assumptions

There are also possibilities that forecasted transitions may not take place such as purchase/sale of inventories. In such cases hedge accounting will cease prospectively

Key Accounting considerations | Going Concern

Due to disruption to global and local economies, the risk factors related to the high estimation uncertainty may lead to risks with respect to the entity's ability to continue as a going concern

Possible indicators which may be triggered:

- Operational restrictions / plant shutdowns
- Economic slowdown
- Violation of debt-covenants
- Non-payment of statutory dues / employee dues
- Substantial decrease in revenue
- Significant loss of supply chains
- Sharp decline in market capitalization

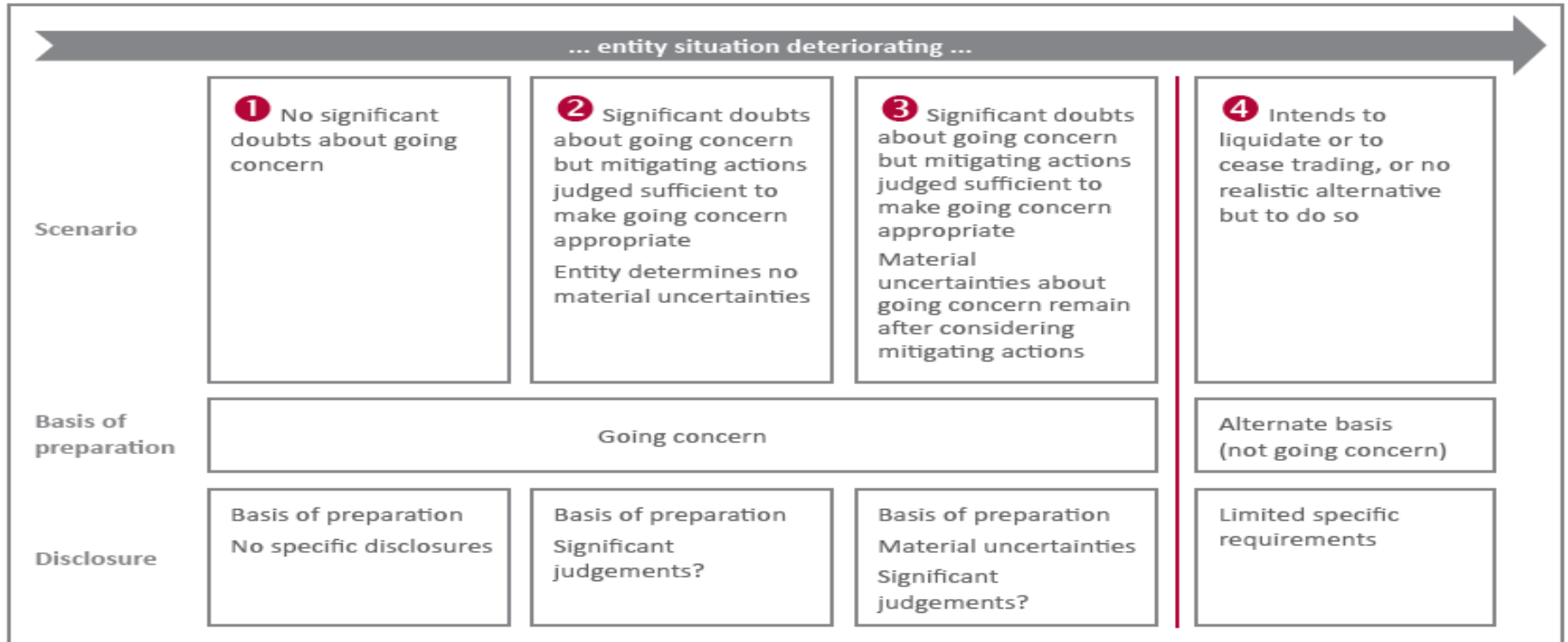
Assessment and potential implication of the indicators:

- Updating the cash flow projections for change in assumptions and estimates
- Impact of COVID 19 after the balance sheet date also to be considered
- Requirement to provide disclosures in the notes to the financial statements, if management concludes that substantial doubt exists or its plans to address that substantial doubt.

Key Accounting considerations | Going Concern

Applying the requirements in IAS 1

The requirements in IAS 1 can be depicted as set out in the diagram below:



COVID 19: Key Auditing Considerations

COVID-19: Key Auditing considerations





Considerations when planning to perform a remote audit

- 1 Initial versus recurring engagements
- 2 Ability to work together remotely
- 3 Ability to supervise the engagement team
- 4 Complexity of the engagement
- 5 Availability of electronic information
- 6 Ability to obtain evidence using video or other screensharing techniques



Exercise enhanced professional skepticism



Professional standards do not require engagement teams to be experts in document authenticity.

Using electronic information

- Understand the processes and controls for producing the information (photocopying / scanning).
 - Assess the risks involved and perform suitable audit procedures under the given circumstances.
 - Obtain photocopied documents which have already been verified in original paper form during the interim audit procedure/prior engagements, and perform a comparison of these photocopied documents obtained now to the documentation of the work performed using original paper form.
 - Evaluate possible scope limitations
-

Video or other screensharing techniques may be useful to perform the following procedures

- 1 Observation of inventory counts
- 2 Observation of the performance of controls
- 3 Performance of walkthroughs
- 4 Obtaining an understanding of internal controls
- 5 Testing operating effectiveness of controls
- 6 Performing inquiries, in particular fraud inquiries



Use variety of forms of communications enabling a more interactive audit engagement



Procedures that can be performed remotely

Procedure	Remote audit
Analytical procedures	<ul style="list-style-type: none">• Use electronic means like spreadsheet or other analytical tools• Investigating results using collaborative tools
External confirmations	<ul style="list-style-type: none">• Using electronic confirmation means• Management can ask their contacts preferred means for confirming
Inspection	<ul style="list-style-type: none">• Scanning of hard-copy items for review electronically• Accessing the entity's IT system externally• Using real-time/live inspection using technology like video, screen sharing.

Procedures that can be performed remotely (Cont'd)

Procedure	Remote audit
Inquiry	<ul style="list-style-type: none">Using video rather than relying upon phone or email
Observation	<ul style="list-style-type: none">Using real-time/live viewing using technology (inventory, processes, and audit evidence)
Recalculation	<ul style="list-style-type: none">Obtaining calculations in electronic form to check the mathematical accuracy
Reperformance	<ul style="list-style-type: none">Obtaining the data electronically and using CAAT to independently execute the procedure or control

Designing external confirmation requests

Factors	Considerations
Method of communication	<ul style="list-style-type: none">• Currently, electronic mode is more effective than paper form.• Electronic confirmation process allowed by standards.• Process should be secure, response should be authenticated
Ability of confirming party to confirm or provide requested information	<ul style="list-style-type: none">• Determine if the confirming party will have the ability to receive the confirmation.• Access to the information needed to respond to the confirmation
Management's authorisation	<ul style="list-style-type: none">• Willingness to respond to a confirmation request containing management's authorization.• Use of authorised e-mail provided by the management.• Use of digital signatures / electronic signatures



Perform mandatory additional procedures and apply skepticism

Obtaining an understanding of internal controls

Inquire of changes in the entity's system of internal control:

- 1 The impact of COVID-19 on the existing internal controls
- 2 Interim internal controls that may have been put in place
- 3 Changes in internal control to accommodate remote working arrangements
- 4 Changes in IT general controls (Eg: enable remote workforces)
- 5 The impact in the entity's ability to properly segregate duties



Considerations related to pervasive controls

- 1 Changes in oversight responsibilities
- 2 Impact on management's ability to complete the financial statement closing process
- 3 Identification of risks related to COVID-19



Determining implementation of internal controls remotely

Inquiry alone is not sufficient to evaluate the design and implementation of relevant controls

- 1 Observation of the activities by means of live image transmission
- 2 Observation of control activities carried via video recording or web meeting
- 3 Inspecting training materials, manuals, instructions, and so on to provide insight about changes in controls.
- 4 Obtain electronic copies of documents



Testing operating effectiveness of controls

When unable to access audit evidence, the engagement team may consider (non-IFC audits):

- 1 Placing no reliance on controls and performing only substantive procedures
- 2 Placing reliance on controls for a portion of the period (Interim strategy)



Using audit evidence about operating effectiveness obtained in previous audits

Consider the following:

- 1 Effectiveness of other elements of internal control
- 2 Risks arising from the characteristics of the control (Eg: Manual or automated)
- 3 Effectiveness of IT general controls
- 4 The nature and extent of deviations in the application of the control noted in previous audits
- 5 Lack of change in a particular control pose a risk due to changing circumstances
- 6 Risks of material misstatement and the extent of reliance on the control



Not to be used for placing reliance on operating effectiveness of controls over a significant risk and manual controls that are not formally documented

IT general controls

Evaluate whether sufficient appropriate audit evidence can be obtained remotely. Consider:

- 1 Real-time image transmission for inspection
- 2 Obtaining external access to the IT system of the entity, for example using VPN
- 3 Involving an individual with specialized skills or knowledge in IT
- 4 Changes to IT general controls, for example to enable or extend remote work arrangements



COVID-19 may create situations where there have been changes in the risk assessment which has resulted in a significant increase in sample sizes

Significant increase in the sample size may be due to:

- The inability to test controls for operating effectiveness for the entire period under audit.
- Decreased financial statement materiality
- Increased risk of material misstatement at the assertion level for the relevant assertion

Other factors

Considerations to reduce the sample size or improve the effectiveness of the procedure

- 1 Evidence provided by analytical procedures or tests of controls
- 2 Testing key items separately
- 3 Evaluate and understand population characteristics and identify subpopulations
- 4 Consider use of an interim or advanced strategy for test of details / controls



Due to the impact of COVID-19, service auditor reports may be delayed or may include modifications of opinions, caveats or exceptions which may impact the engagement

Service organisations that may impact financial reporting include:

- 1 Organisations that process payroll and payroll taxes
- 2 Trust departments of banks and insurance companies that invest assets
- 3 Transfer agents, custodians, and record keepers for investment companies
- 4 Mortgage servicers or depository institutions that service loans for others
- 5 Application service providers that develop and maintain software
- 6 External bookkeeping services



Risk assessment and planning

The following are considerations when the service auditor's report is not available

Requirement	Considerations when service auditor's report not available
<p>Obtain an understanding of the following:</p> <ul style="list-style-type: none">• The nature of the services• Materiality of the transactions processed• The degree of interaction• Nature of the relationship with the service organisation	<p>Read one or more of the following:</p> <ul style="list-style-type: none">• User manuals• System overviews• Technical manuals• Contract / agreement with the service organisation• Reports on controls at the service organisation

Risk assessment and planning (Cont'd)

The following are considerations when the service auditor's report is not available

Requirement	Considerations when service auditor's report not available
Evaluate the design and implementation of relevant controls at the user entity.	<p>The need for a service auditor's report depends on the level of interaction:</p> <ul style="list-style-type: none">• <u>High interaction:</u> a service auditor report may not be necessary.• <u>Low interaction:</u><ol style="list-style-type: none">a) understand controlsb) read prior period service auditor's report and perform proceduresc) read communications from the service organisation to the user entity about its COVID-19 responses and the effects on the systemd) obtain bridge letter

Responses to risks

The following are considerations when responding to the assessed risks of material misstatement:

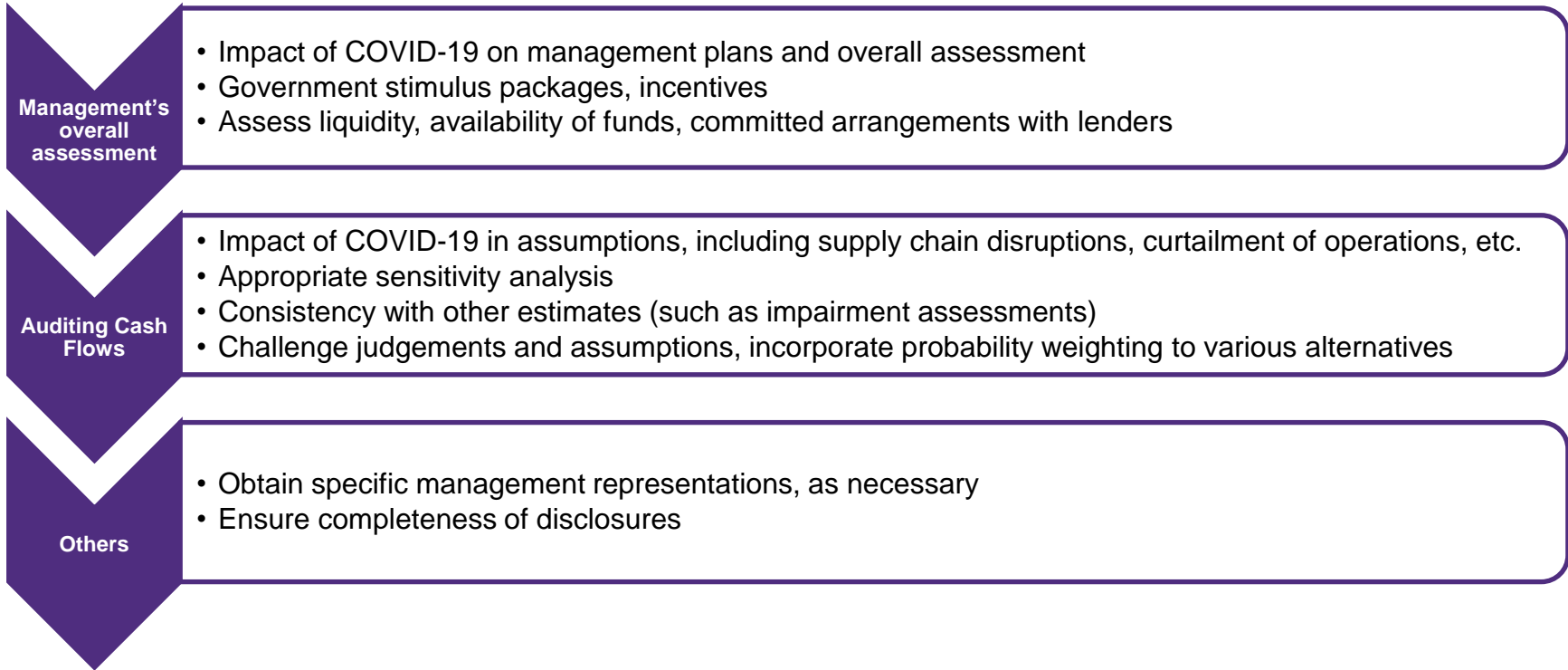
Requirement	Considerations when service auditor's report not available
<p>Obtain audit evidence about the operating effectiveness of controls. Consider:</p> <ul style="list-style-type: none">• Type 2 report• Performing TOC at service organisation• Using another auditor to perform TOC at service organisation	<ul style="list-style-type: none">• Whether it is feasible to delay the issuance of the auditor's report until the receipt of type 2 report• Alternatively, consider visiting the service organisation to perform the relevant tests or consider performing the tests remotely.

Responses to risks (Cont'd)

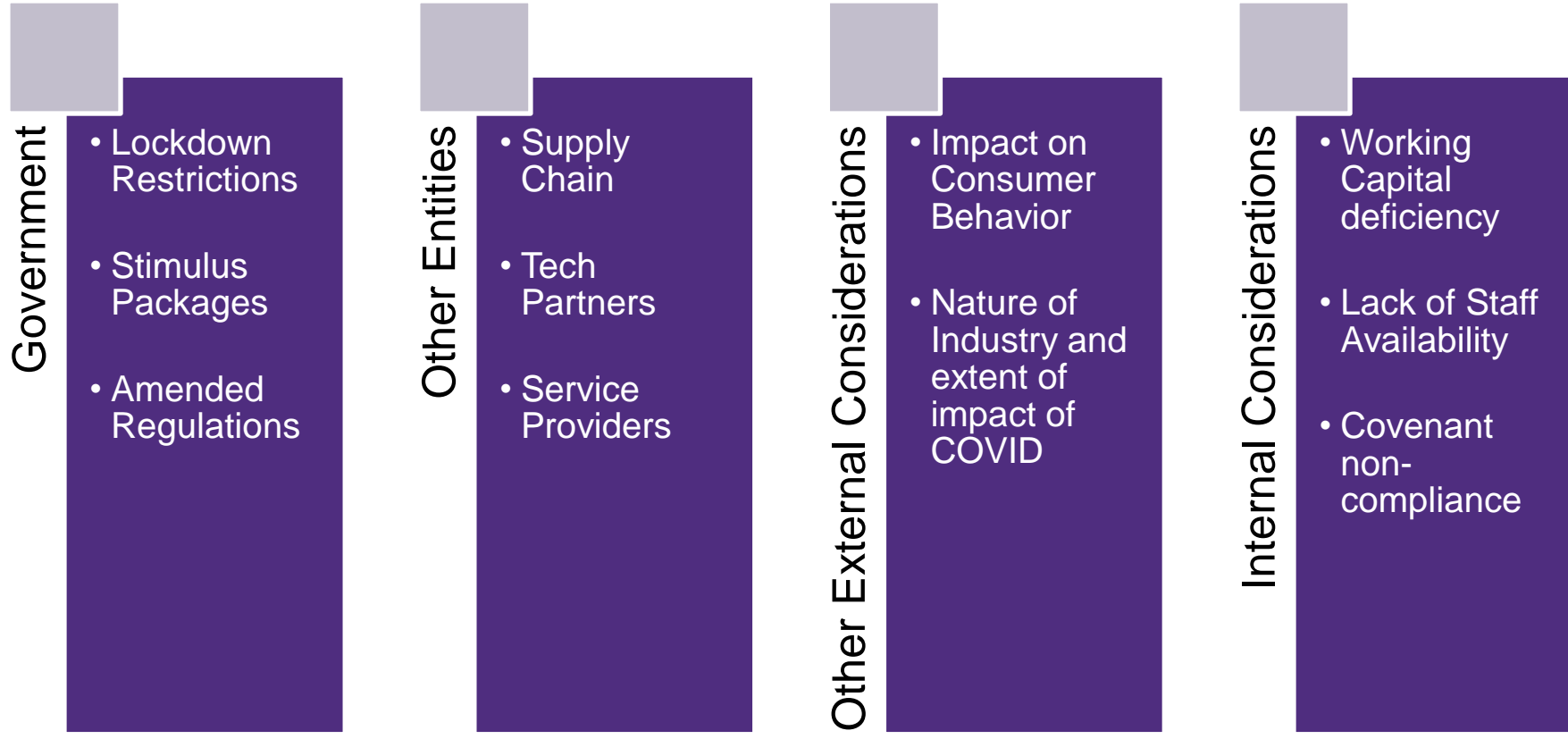
The following are considerations when responding to the assessed risks of material misstatement:

Requirement	Considerations when service auditor's report include modifications to the opinion, exceptions, or caveats within the report
<p>Determine the effectiveness of the controls:</p> <ul style="list-style-type: none">• Whether date / period is appropriate?• Whether complimentary user entity controls implemented?• Adequacy of the time period covered.• Whether TOC provides sufficient appropriate audit evidence?	<ul style="list-style-type: none">• Due to COVID-19, there could be an increase number of type 2 reports with modified opinions, exceptions, or caveats.• Determine the impact on controls relevant to the audit.• Discuss such matters with the service auditor.• If considerations not possible, consider impact on risk assessment

A) Procedures and how they are impacted by COVID 19



B) External and Internal considerations



Key Accounting considerations | Going Concern

Procedure	COVID-19 considerations
Request management to perform an assessment of the entity's ability to continue as a going concern, if not already performed.	<p>Management needs to include potential impact of COVID-19 in their assessment.</p> <p>In situations where management has an informal, ad hoc process, consider discussing the following with management:</p> <ul style="list-style-type: none">• How management plans to manage their cash flow• Government stimulus packages, tax incentives, loans or equivalent programs that may be available for the entity
Where the entity has performed a cash flow analysis, evaluate the reliability of the underlying data generated to prepare the forecast and determine whether there is adequate support for the assumptions underlying the forecast.	<p>Assess the reasonableness of assumptions taking into account the uncertainty of the impact of COVID-19 and whether management has done a reasonable attempt to consider the potential downside.</p> <p>Consider whether there are any modifications to contractual arrangements that may impact cash flow forecasts.</p> <p>Consider the consistency of the assumptions and inputs in this analysis with other areas of the audit engagement, such as impairment analysis.</p> <p>Consider whether assumptions address disruption to the supply chain, lack of availability or delays of supplies.</p> <p>Challenge management's judgments and assessments in the forecast. Consider contradictory evidence that may have been obtained throughout the engagement.</p>

Key Accounting considerations | Going Concern

Procedure	COVID-19 considerations
	<p>Consider areas that may impact bank covenants.</p> <p>If forecast includes assumptions based on expected timing of future conditions evaluate sensitivity of assumptions, where applicable, assuming there were no changes or there was further deterioration. Incorporate probability weighting into the analysis to take into account the degree of estimation uncertainty that may be present in the current economic environment</p> <p>Involve an individual with specialized skills and knowledge in valuations to assist with evaluating the underlying assumptions.</p>
<p>Evaluate management's plans for future actions, whether the outcome of these plans is likely and whether management's plans are feasible.</p>	<p>Assess the impact of the COVID-19 pandemic on management's plans. The feasibility of these plans is likely highly dependent on the industry in which the entity operates, nature of governmental stimulus packages and so forth.</p> <p>Consider whether the credit ratings have weakened or whether any covenants have been breached and how does management plan to resolve the situation with the lender.</p> <p>Consider if the entity has access to sufficient liquidity and can remain solvent through the period of restrictions and beyond.</p> <p>Consider whether the company has committed arrangements with lenders for short/long term financing.</p> <p>Consider if the deferral of payments is available or if other support can be accessed and whether such support gives rise to future obligations.</p>
<p>Request written representations from and management and, where appropriate, those charged with governance, regarding the entity's plans for future actions and the feasibility of these plans.</p>	<p>Tailor management representation letter to include additional representations, as necessary. The engagement team should ensure that the management representations are specific to the entity and covers all conditions or events relevant to the going concern basis of accounting.</p>

Key takeaways



Auditors' obligations remain the same



Think through various ways of obtaining audit evidence



Highlight potential issues early on



Refer to guidance / alerts issued by ICAI



Disclosures in financial statements

Questions

Thank You