COVID-19

Key considerations for accounting and financial reporting for the year ended 31 March 2020

The outbreak of COVID-19 and subsequent lockdown has disrupted the operations of almost all organisations across the globe. One function of an organisation for which this time of the year is very critical is the finance function as 31st March is the statutory year-end for most organisations in India.

With all organisations learning new ways of working remotely to close their books of accounts in a timely and efficient manner, this new normal would require a look at certain aspects with a different lens.

Below are some of the practical considerations that need to be kept in mind as organisations finalise their financial statements for the year ended 31 March 2020.

1. Revenue

- **Contract enforceability**
  - Are the active customer contracts still enforceable?
  - Have you assessed the impact of any force majeure claims made by your customers on existing revenue contracts?
- **Transaction price**
  - Are the estimates of variable consideration trued up for items such as penalties, volume rebates, etc.?
  - Have the sales returns estimates been revisited?
- **Timing of revenue recognition**
  - For over-time revenue recognition contracts, is the right to payment still enforceable? If not, has the assessment for changing the revenue recognition to a point-in-time been carried out?
  - Have you revisited the estimates to measure progress for over-time revenue recognition contracts?
- **Other specific matters:**
  - Do you have any insurance policies covering loss of revenue? Are those accounted for appropriately?
  - Do you have any bill and hold arrangements as at the year-end? If yes, is revenue recognition still appropriate for these arrangements?
  - Is the amortisation period for contract costs to be revisited based on modifications/changes to contract terms? Do they need to be charged off or amortisation to be accelerated?

2. Inventories

- For year-end inventory count, have you devised an approach for a physical count of inventory, based on inventory outstanding on a later date with a mechanism to roll back to the inventory position as at the year end?
- How have you recognised the costs incurred during the lockdown period? They may qualify as abnormal costs and hence would not be considered as part of the cost of inventory.
- Have you evaluated the impact on inventory which is highly perishable or for which the demand may have fallen significantly (cost versus NRV testing)? Have you assessed the carrying value of work-in-progress inventory that has been hampered by the supply-chain disruption?

3. Tangible and intangible assets

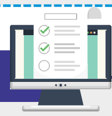
- Have the current idle capacities and uncertain outlook been considered as potential indicators for impairment of plant, machinery and similar tangible assets? Have similar tests been considered for
  - intangible assets with indefinite useful lives such as distribution rights (with no end date), goodwill etc.
  - Right of Use (ROU) asset recognised for leased premises/properties?

  If yes:
  - to determine the value in use, how are the cash flow projections arrived and what discount rates are considered appropriate?
  - to determine the fair value less cost to sell, how is the fair value in the current market derived?
- Have you suspended capitalisation of borrowing costs for qualifying assets on which active development has stopped?
- Have you revisited the residual values and useful lives of the assets in view of the current market conditions?
- As the assets would not be operational for a significant period, have you assessed how the potential overhauling costs would be accounted for?
- For assets classified as held for sale, is there a need to reassess and classify them back to use? If yes, have you considered corresponding accounting implications?

4. Financial instruments

- Is there a business model change for certain financial assets that might require a reclassification i.e. from fair value model to amortised cost model or vice versa?
- In case of simplified expected credit loss (ECL) provisioning model, have you revisited the key inputs such as:
  - definition of default bearing in mind the magnitude of impact on the underlying customer base
  - forward looking probability of default - as the past trends may not be reflective of the future
  - loss given default – reassessment of collaterals obtained
- For the hedges linked to forecasted sales / other hedging relationships, has the impact on effectiveness of hedge accounting been considered?
- How have the changes to key inputs such as interest rate, volatility, credit risk impacted the valuation of financial assets? Have you considered a change in the valuation hierarchy (from level 2 to 3)?
- For financial guarantees given, have you revisited the assessment for possible cash outflows that might require recognition of an additional liability?
- Are you undertaking any renegotiations with respect to bank borrowings, inter-company loans? Have you evaluated the impact of modification accounting?

5. Leases



- As a lessee, have you assessed the impact on ROU asset and lease liability in terms of cash flows, discount rates for:
  - rent concessions and waivers obtained from the lessor,
  - early termination penalties (if any),
  - other modifications to contract terms
- As a lessor, how have you accounted for the rent concessions and waivers given to a lessee (if any) - impact on lease equalisation reserves?

6. Employee benefits

- Do you have any equity settled ESOP plans with non-market performance conditions (say EBITDA, revenue linked)? Have you considered the accounting impact of the revisions to your performance targets?
- Have you evaluated the accounting impact of any ESOP plan modifications made during this period?
- Do your actuarial valuations consider the change in estimates in factors such as future increments, discount rate, attrition?
- Have you revisited the employee benefits related provisions such as bonus, basis the expectations of payouts?

7. Taxes

- With an uncertain outlook, will enough taxable profits be available to reverse the deferred tax assets recognised?

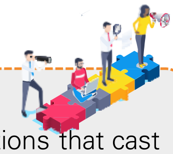
8. Provisions

- Have you identified any contracts that have turned onerous i.e. expected contract costs exceeding the contract price on account of overruns? Have you recognised the losses on such contracts upfront?
- Have you undertaken any measures that would qualify as a restructuring activity?

9. Government grants

- Are you expecting any government assistance/grants? Have you assessed the accounting and disclosure requirements for the same?

10. Going concern



- Are there any indicators/conditions that cast a significant doubt on the company's ability to continue as a going concern?

11. Presentation and disclosures

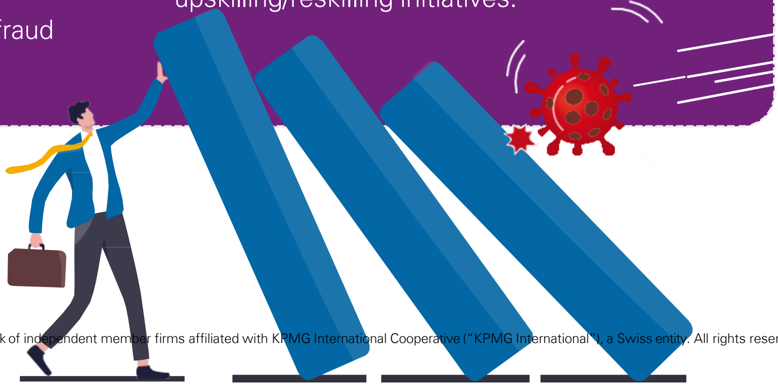
Have you evaluated the impact of COVID-19 on specific matters with respect to the annual financial statements such as:

- Current/non-current classification on account of any loan defaults/covenant breaches;
- Critical estimates and judgements used;
- Policies and processes in place for credit risk management on all receivables;
- Liquidity risk management, asset-liability management arising out of the cash flow disruption;
- Capital management measures taken;
- Any contingent liabilities arising out of contract defaults, penal obligations;
- Any significant events occurring after the reporting date.

Other considerations

In addition to the above financial reporting considerations, below are some of the other critical business considerations that would require attention:

- Reassess the existing internal financial controls over financial reporting to accommodate virtual work environment;
- Consider updating the assessment for fraud risk, cyber risk, operational risk, etc.
- Frequent communication and dissemination of information to key internal and external stakeholders
- Stress-test sales forecasts, cash forecasts and other key metrics and revisit budgets
- Chalk out a plan to keep people engaged - upskilling/reskilling initiatives.



We understand what you are facing

During a crisis, finance functions will see a significant increase in financial reporting requirements from their key stakeholders, including management, banks and lenders, regulators, and investors. To deal with the broader economic impact of this crisis, finance teams will also face a surge in workload as financial and cash forecasting volumes increase significantly and they are expected to provide on-demand analytics and insights.

Further, finance teams will be dealing with all these increased demands, while coping with the challenges of increased remote working and potentially unfamiliar virtual team dynamics, social distancing and family responsibilities. While you may feel in unchartered territory, these challenging times can be navigated successfully.

The help you need, the way you need it

KPMG in India's CFO Advisory team can help you identify the need for supplemental resources to enable a virtual close with the right technical expertise. In addition to providing **consulting services on technical matters**, we can also provide interim capacity to organizations who need expanded financial reporting, management reporting and related capabilities to support their Finance Controllership and allied functions.

We can provide this interim capacity as a managed service or staff augmentation:

- With **managed services,** you determine the extent of support you require and the areas (such as processes, activities or tasks) where you require such support, and we will deliver the services you need, taking responsibility for those areas.
- With **staff augmentation,** you acquire the services of a selected professional(s) with the technical and/or functional expertise you need, typically to support an existing team, who operate under your supervision.

Our team includes a variety of designated accounting professionals that provide business-focused, technology-enabled skillsets, combined with deep technical knowledge on regulatory and financial reporting to help you quickly achieve value for the finance function.

In particular, we can help you/ augment your resources in the following areas relating to your financial reporting process:

COVID-19 financial reporting helpdesk

Assist with on-call advisory or drafting technical position papers on topics such as revenue recognition, financial instruments, leases, impairment assessments, going concern assessments, valuations and other complex areas

Statutory and regulatory reporting

Support with preparation of year-end financial statements, consolidation, Ind AS 116 computations, Ind-AS/IFRS/US GAAP conversion, amongst others

Year-end, quarterly and monthly close

Assist with reconciliations, journal calculations/processing/ posting, intercompany, cost allocation, period end close

Other areas where we can support

Investor relations and stakeholder management

Investor/stakeholder communication, conceptualising related collaterals, preparing spokespersons, benchmarking peer communication

Management reporting

Data collection from various sources and population of reporting dashboards, commentaries created after speaking with business leads

Cash forecasting

Payables, receivables, advances, ageing, banking arrangements

Reconciliations

High volume reconciliations, investigation and resolution of breaks, operational reporting

Accounts receivable/ payable

Collection, cash application, claims, adjustments, reporting/ Travel and expense management, payment preparation, reporting

Business planning

Scenario building, impact analysis, capex projects analysis

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