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Disclosures by companies amid COVID-19

This article aims to:

Highlight the key areas to be considered while disclosing COVID-19 related impact by companies.

Introduction

Apart from the huge health crisis, the pandemic (COVID-19) has posed significant business disruptions for almost all companies across sectors in India. Stringent preventive and restrictive measures to contain the pandemic have led to supply chain disruption, reduction in demand for goods, non-availability of personnel, reduced sales and profits, to name a few. As the situation continues to evolve, it becomes all the more imperative for companies to provide timely and adequate information to investors and various stakeholders about the impact of COVID-19 on their business operations, performance, financial position and future prospects.

These disclosures could form part of the financial statements accompanied with notes (quarterly/half-yearly/annual), board's report, management's discussion and analysis section of the annual report and disclosures to stock exchange(s) as part of material events.

Recently, the Securities and Exchange Board of India (SEBI) has also, as part of its advisory encouraged listed companies to evaluate and communicate all information available about the impact of the pandemic (both qualitative and quantitative) on the company and its operations in a cogent manner. This should at a minimum include:

- Details of impact of COVID-19 on a listed company's:
  - Capital and financial resources
  - Liquidity position
  - Internal financial reporting and control
  - Ability to service debt and other financing arrangements
- Steps taken to ensure smooth functioning of operations and
- Estimation of the future impact of COVID-19 on its operations.

Though the impact would vary from company to company and in the unprecedented times such as now, endeavour should be to update the information so provided as and when there are material developments.

Recently, the International Organisation of Securities Commissions (IOSCO)[1] has also issued a statement on importance of disclosure about COVID-19. With the statement, IOSCO encouraged timely and high-quality information complete with transparent and entity-specific disclosures, including information about the impact of COVID-19 on the issuer's operating performance, financial position, liquidity, and future prospects.

IOSCO also pointed out that companies should not limit disclosures to boilerplate discussion on COVID-19 itself, but to explain; (i) how COVID-19 impacted and/or is expected to impact the financial performance, financial position and cash flows of the company, (ii) how the strategy and targets of the companies have been modified to address the effects of COVID-19 and (iii) measures taken to address and mitigate the impacts of the pandemic on the company.

In this article, we aim to summarise some of the key areas to be considered by companies while disclosing the impact of the pandemic within or outside financial statements.

Assessment of impact of the pandemic

Given the current economic situation, most of the companies are likely to be impacted by the pandemic in one way or the other. However, the extent of impact cannot be predicted with great accuracy as various factors are involved that are beyond a company's control and knowledge and impact would vary sector to sector. Disclosure about the effects of the pandemic along with how management is responding to them would be critical and based on specific facts and circumstances of a company. At a minimum, this would involve assessment and disclosure relating to:

- **Risk factors:** Evaluate specific risks faced on account of COVID-19 and assess the need to revisit the risks identified and disclosed previously. These could relate to business risks, financial risks, technology risk, etc.
- **Liquidity and capital resources:** To address the pandemic, many companies would have taken steps to strengthen their liquidity in the form of increase in borrowings, reduction in dividend, etc. Details relating to these measures along with their impact in short and medium term should be adequately reported. In case of material liquidity deficiency, address the concern along with how management expects to overcome them over an estimated period.

  In case a company intends to raise its capital resources through issue of equity or debt, relevant details relating to the terms and nature of issue should be disclosed.

1. IOSCO is a leading international policy forum for securities regulators and is recognised as the global standard setter for securities regulation.

- **Key performance metrics:** Assess the impact of the pandemic on existing key performance metrics and ascertain the need to establish and report new indicators to depict the current situation.
- **Impact on assets and liabilities:** There is likely to be a significant change in the value of assets and liabilities to be reported in the financial statements on account of COVID-19. For instance, reduction in estimated selling price may affect inventory valuation, change in useful life of assets, increase in allowances for losses, etc.
- **Non-GAAP measures:** Non-GAAP measures could prove to be useful if they provide additional information relating to the financial condition and operating results of a company. Due to the pandemic, companies might be contemplating to adjust the non-GAAP measures or to depict the impact. A proper explanation to the adjustment would be warranted if related to COVID-19. For instance, categorising impairment of an asset due to COVID-19 may not be appropriate in case indicators of impairment existed even before COVID-19.
- **Internal Control over Financial Reporting (ICOFR):** It is also important to assess and reflect the effect of changes/new controls on internal control over financial reporting, if any that have arisen due to the pandemic. For instance, adequacy of controls to enable remote workforces.

Impact on financial statements

Significant judgements and estimates

Determination of impact of COVID-19 on business operations and resultant financial impact to be reported in the financial statements would involve significant management judgement and estimation. Due to the uncertainty posed by the pandemic, presentation of relevant information in the financial statements which might get change after it is made available publicly is quite challenging. Therefore, companies should make use of best available information while making such estimates and judgements considering the effects of COVID-19, significant government measures being undertaken to address it and other relevant factors such as industry outlook.

Some of the key areas which might involve significant judgements and estimates and thus necessitate detailed disclosures could relate to the following:

- Going concern assessment including management's basis of conclusion in case of no material uncertainty
- Fair value measurement
- Impairment assessment in particular relating to goodwill and other non-financial assets
- Recognition of provisions including assessment of onerous contracts
- Measurement of Expected Credit Losses (ECL) incorporating reasonable and supportable forward-looking information
- Subsequent events including categorisation as adjusting or non-adjusting events.

Material items

Indian Accounting Standard (Ind AS) 1, *Presentation of Financial Statements,* requires financial statements to disclose all 'material' items, i.e. the items if they could, individually or collectively, influence the economic decisions that users make on the basis of financial statements. Accordingly, companies would need to determine whether the financial reporting impacts of COVID-19 such as those relating to impairment loss, loss due to write-down of inventory, restructuring of business activities, etc. are material in size and nature or combination of both. If these items are identified to be material, then companies should disclose their nature and amount separately.

Disclosure in interim reporting

Interim financial reports typically focus on changes since the last annual financial statements. However, preparing interim financial statements for the year 2020-21 is likely to involve more than the usual update since the last annual financial statements. Specific disclosures 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 should be provided. These would, *inter alia,* include disclosure of:

- Changes in significant judgements and assumptions as well as areas of estimation uncertainty
- Disclosures of the impact of the COVID-19 outbreak on the interim financial position, performance and cash flows
- Any loan default or breach of a loan agreement that has not been remedied on or before the end of the reporting period
- Transfers between levels of the fair value hierarchy used in measuring the fair value of financial instruments

- Changes in the classification of financial assets as a result of a change in the purpose or use of those assets
- Reversals of any provisions
- Changes in the business or economic circumstances that affect the fair value of the company's financial assets and financial liabilities
- Government measures in the form of loans or grants, if availed and accounting for the same.

Relaxations in filings

The deadlines of statutory filings and compliances have been extended by almost all regulators in India to address the challenges faced by corporates amid COVID-19. For instance, SEBI has extended the timelines for filing of financial results by listed companies up to 31 July 2020 for the quarter/half-year/year ended 31 March 2020. These are expected to provide sufficient time to the companies to assess the impact of the pandemic and provide appropriate disclosures. In case of extended delays, if any, companies should make sure to provide the rationale for the delay and expected time by when it will file the report for better information.

Others

International guidance

Internationally, the European Securities and Markets Authority (ESMA) has issued a statement on 'Implications of the COVID-19 outbreak on the half-yearly financial reports'. The statement seeks to promote transparency and consistent application of European requirements for the information provided in the half-yearly reports under the current circumstances related to the COVID-19 outbreak. With the statement, ESMA has encouraged issuers to disclose information relating to the significant impacts of the COVID-19 outbreak as part of the explanations of the amounts presented and recognised in the statement of profit and loss in a single note as part of the notes to the financial statements.

Similarly, U.S. Securities and Exchange Commission (SEC) has issued a guidance on COVID-19 related disclosures to be considered by companies. As per SEC, depending on a company's particular circumstances, it should consider whether it may need to revisit, refresh, or update previous disclosure to the extent that the information becomes materially inaccurate.

Companies should not provide selective disclosures but rather be sure they disclose the relevant information broadly to investors.

Companies should also refrain from trading prior to dissemination of material non-public information. For instance, if a company becomes aware of a material risk related to COVID-19, then its directors and officers, and other corporate insiders who are aware of these matters should refrain from trading in the company's securities until such information is disclosed to the public.

As far as listed companies in India are concerned, SEBI also prohibits an insider from trading in securities when in possession of Unpublished Price Sensitive information (UPSI).

Role of audit committee

Audit committees also have an important role to play in monitoring management's response to the new events and risks on account of COVID-19. They should consider and review the management's assertions used to assess the impact of the pandemic and ensure that the identified risks, uncertainties and judgments have been adequately disclosed.

Impact on audit and auditor's report

The risks and uncertainties associated with COVID-19 and resultant management responses corroborated with disclosures in financial statements would also be an area of assessment by the auditor of the company. In these unprecedented times, the additional information in the auditor's report would be relied heavily upon by the investors while making investment decisions. These may be reported in the form of Key Audit Matter (KAM) or through an emphasis of matter paragraph highlighting significant doubt in the financial statements.

(Source: IOSCO statement dated 29 May 2020, SEC guidance on COVID-19 dated 25 March 2020 and 23 June 2020 and ESMA statement dated 20 May 2020)