Guidance on subsequent events owing to COVID-19

17 June 2020

First Notes on

Financial reporting

Corporate law updates

Regulatory and other information

Disclosures

Sector

All

Banking and insurance

Information, communication, entertainment

Consumer and industrial markets

Infrastructure and government

Relevant to

All

Audit committee

CFO

Others

Transition

Immediately

Within the next three months

Post three months but within six months

Post six months

Forthcoming requirement

Background

Financial statements of companies may be affected by certain events that occur after the date of the financial statements but before they are approved by the Board of Directors (BoD) of the company for issue, commonly referred as 'subsequent events'. The requirement for accounting and disclosure of subsequent events is an important area of financial reporting especially in an uncertain and rapidly changing environment such as now. Indian Accounting Standard (Ind AS) 10, *Events after the Reporting Period*, prescribes the treatment of transactions and events that occur between the date of the financial statements and the date when the financial statements are approved by the BoD for issue.

There are generally two types of subsequent events:

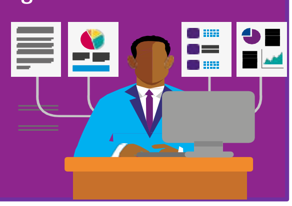
- Events which provide evidence of conditions that existed *at the date* of the financial statements and
- Events which provide evidence of conditions that arose *after the date* of the financial statements.

Preparers of financial statements are responsible for making adjustment or provide relevant disclosures in the financial statements, as appropriate, with regard to subsequent events in accordance with the applicable financial reporting framework.

Due to coronavirus (COVID-19) pandemic and the uncertainty that it has unleashed, it has become more important than before that management and auditors of companies are vigilant to subsequent events and provide appropriate adjustment or disclosure for these events in order to enhance the quality of financial reporting.

New development

Recently, the Institute of Chartered Accountants of India (ICAI) and the International Accounting and Auditing Standards Board (IAASB) have issued guidance on 'subsequent events' arising on account of COVID-19. The guidance specifies management considerations while assessing events occurring after the date of financial statements along with auditor's responsibilities.



In this issue of First Notes, we cast our lens on the matters relevant for management while evaluating subsequent events arising as a result of the pandemic as highlighted in the guidance.

Assessment of events after the date of financial statements - Management consideration

Determination of impact of any subsequent event related to the COVID-19 pandemic on the financial statements would involve management judgement. This would include consideration of the date of the financial statements, the facts and circumstances pertaining to the entity and the conditions that existed at, or arose after, that date.

As the impacts of the COVID-19 outbreak continue to evolve, capturing events that relate specifically to conditions that existed or exist at the date of the financial statements, or after the reporting date, will require careful assessment. Few examples of events and conditions that may be affected by, or exist due to COVID-19 and can facilitate identification of subsequent events are given below:

- **Commitments:** New commitments, borrowings or guarantees
- **Force majeure:** Invocation of force majeure clause after the year-end by any party (e.g. supplier or customer) thereby impacting the supply chain/availability of customers for the entity's products
- **Government stimulus package:** Relief or economic stimulus payments provided by the government in the form of loans or grants
- **Expected Credit Loss (ECL) provisioning:** Collectability of trade receivables would get affected in cases where there are customers in COVID-19 impacted countries and where they have filed for liquidation post the entity's year-end
- **Impairment indicators:** Indications of impairment in the value of investments in companies whose businesses have been severely affected by the pandemic
- **Employee related expenses:** Employee termination benefits resulting from a workforce reduction (e.g. as a result of closure or re-organisation of operations that occurred after the reporting date)
- **Other events:** Events that are relevant to the recoverability of assets, ongoing pertinence of business and valuation assumptions

  Events that will bring into question the appropriateness of accounting policies used in the financial statements. For instance, events call into question the validity of the going concern assumption, ECL model and useful lives of property, plant and equipment

  Events that are relevant to the measurement of estimates or provisions made in the financial statements. For instance, derivative and hedging considerations, insurance claims and rebate arrangements with customers.
- **Contingences:** Any developments regarding contingencies (for example, new contingent liabilities or circumstances affecting the evaluation of existing contingent liabilities, the ability to meet agreed-on performance targets for contingent consideration in business combination arrangements, etc.)
- **Tax considerations:** Tax considerations e.g. impact of reduced flow of goods and services on transfer pricing agreements; recoverability of deferred tax assets.

Due to the pandemic, some industries are likely to be more impacted than others. For instance, entities in the aviation sector (and therefore, entities that are feeder industries to entities in the aviation sector), real estate, construction, retail, tourism, hospitality, transportation, financing, infrastructure sectors. Therefore, it is critical for management to assess the impact of events occurring after the balance sheet date on the financial statements in such industries.

Auditor's responsibility

Auditors are required to focus on events occurring between the date of the financial statements and the date of the auditor's report and the effect, if any, on the entity's financial statements. While doing so, an auditor would need to consider management's adjustments or disclosures, including the timelines used to distinguish between adjusting and non-adjusting events and impact of the changes in the environment on the recognition and measurement of account balances and transactions in the financial statements or other specific disclosures. While focusing on events occurring between the date of financial statements and the date of the auditor's report, an auditor would consider following aspects:

- **Exercise professional skepticism and written representation:** Significant management judgements owing to uncertainties created by COVID-19 would entail an auditor to exercise professional skepticism in undertaking work on subsequent events. This would involve evaluating whether all material subsequent events (those requiring adjustment of, or disclosure in the financial statements) have been identified and are appropriately reflected in the financial statements. A written representation from the management can be taken to this effect.

  COVID-19 may be a contributing factor to a delay in the approval of financial statements. Therefore, it is important that the audit evidence obtained regarding subsequent events covers the entire period to the date of the auditor's report. Also, it should be ensured that written representations cover the additional period to the date of the auditor's report, or as close as practicable, including any further changes that may need to be incorporated.

- **Communication with those charged with governance:** Regular communication with those charged with governance, particularly during the period past the date of financial statements should be maintained.

- **Audit procedures:** Auditors are also required to ensure that necessary audit procedures have been performed to obtain sufficient audit evidence to the fact that all events occurring between the date of financial statements and the date of auditor's report that require adjustment of, or disclosure in, the financial statements have been identified and appropriately reflected in the financial statements.

  An auditor is not obliged to perform additional audit procedures regarding the financial statements after the date of auditor's report. However, if it becomes aware of a fact after the date of its report, which, if known at the date of auditor's report may have caused the auditor to amend its report, then it should:

  – Discuss the matter with management and where appropriate, those charged with governance

  – Determine whether the financial statements need amendment and, if so

  – Inquire how management intends to address the matter in the financial statements.

Impact on auditor's report

Based on the results of the audit procedures performed, if an auditor determines that the financial statements are materially misstated or is unable to obtain sufficient appropriate audit evidence to determine whether the financial statements are materially misstated, a modification to the opinion in the auditor's report would be required.

If the auditor is able to obtain sufficient appropriate audit evidence about subsequent events, an auditor may identify the subsequent event as a Key Audit Matter (KAM) or may determine it to be necessary to draw users' attention to the subsequent event through inclusion of an Emphasis of Matter (EOM) paragraph or Other Matter paragraph, as the case may be.

Our comments

Management should carefully assess the requirements of relevant applicable financial reporting frameworks and identify all significant events until the date the financial statements are issued and determine whether these events are adjusting - i.e. they provide evidence of conditions that existed as at the reporting date. Companies would need to adjust the amounts recognised in their financial statements to reflect adjusting events after the reporting period.

For companies with 31 March 2020 as year-end, determining subsequent events that should be reflected (adjusted) versus those that are to be disclosed (non-adjusting) in the financial statements may require significant judgement. This is particularly important for companies in India since the effect of the COVID-19 pandemic and the subsequent lockdown occurred close to the year-end of 31 March 2020. Therefore, in certain cases, the effects of the COVID-19 outbreak is likely to be a current-period event which will require ongoing evaluation to determine the extent to which developments after the reporting date should be recognised in the reporting period. For example, an entity needs to assess the valuation of its inventories at the balance sheet date. In the current scenario, entities may have to assess as to whether there is a decline in their future estimated selling price and, if so, write-down of carrying value of inventory is required. Examples of non-adjusting events that would generally be disclosed in the financial statements would include breaches of loan covenants, management plans to discontinue an operation or implement a major restructuring, significant declines in the fair value of investments held and abnormally large changes in asset prices, after the reporting period.

The lockdown led to uncertainties in various aspects of the businesses of companies such as impact on supply chain thereby, creating uncertainty on liquidation of inventories and collection of receivables. For several companies having long-term contracts, there were force majeure notices either served on them by their customers or vendors or companies themselves having served such notices on their business partners. All these matters require close evaluation on whether they provide additional information on a condition that existed on the balance sheet date or need disclosures in the financial statements. Management should work alongside their auditors and those charged with governance in order to reflect these matters in a manner which complies with the financial reporting framework as well as provide meaningful information to the external stakeholders and users of financial statements.

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KPMG in India's IFRS institute

Visit KPMG in India's IFRS institute - a web-based platform, which seeks to act as a wide-ranging site for information and updates on IFRS implementation in India.

The website provides information and resources to help board and audit committee members, executives, management, stakeholders and government representatives gain insight and access to thought leadership publications that are based on the evolving global financial reporting framework.

Missed an issue of Accounting and Auditing Update or First Notes

Issue no. 46 – May 2020

The topics covered in this issue are:

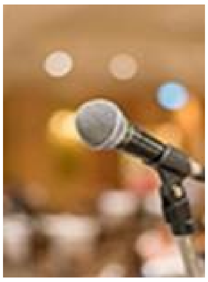
- Accounting under Ind AS in the COVID-19 environment
- Accounting impacts on modification of interest rate benchmarks
- Updates relating to US GAAP
- Regulatory updates

SEBI's advisory on disclosure of material impact of COVID-19 by listed companies

5 June 2020

In the wake of coronavirus (COVID-19), SEBI has observed that many of the listed companies are providing disclosures primarily relating to shutdown of operations owing to the pandemic and resultant lockdowns while some have provided information relating to actions taken towards sanitation, safety, etc. However, a very small number of companies have disclosed the financial impact of the pandemic.

Accordingly, on 20 May 2020, SEBI issued an advisory and encouraged listed companies to evaluate the impact of the COVID-19 pandemic on their business, performance and financial results, both qualitatively and quantitatively, to the extent possible and disseminate the same. This issue of First Notes aims to provide an overview of the SEBI advisory.



Voices on Reporting

KPMG in India is pleased to present Voices on Reporting (VOR) – a series of knowledge sharing calls to discuss current and emerging issues relating to financial reporting.

On 24 April 2020, KPMG in India released its VOR – annual update publication for the year ended 31 March 2020. The publication provides a summary of key updates from the Securities and Exchange Board of India, the Ministry of Corporate Affairs, the Institute of Chartered Accountants of India, the Reserve Bank of India and the Ministry of Law and Justice.

To access the publication, please click here.

Feedback/queries can be sent to aaupdate@kpmg.com

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