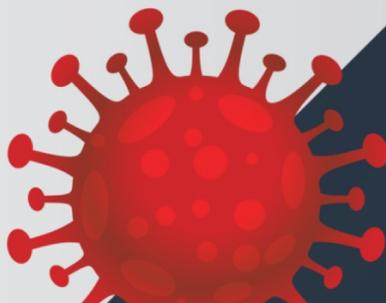
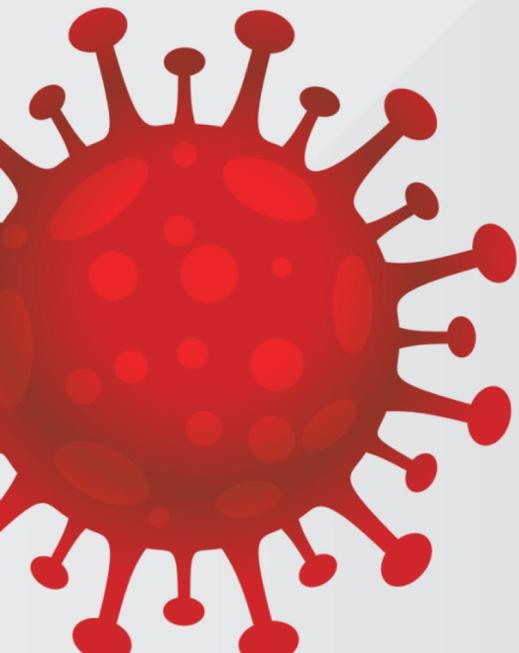


# **CORONAVIRUS** **COVID-19**

## **IMPACT ON** **GOING CONCERN**



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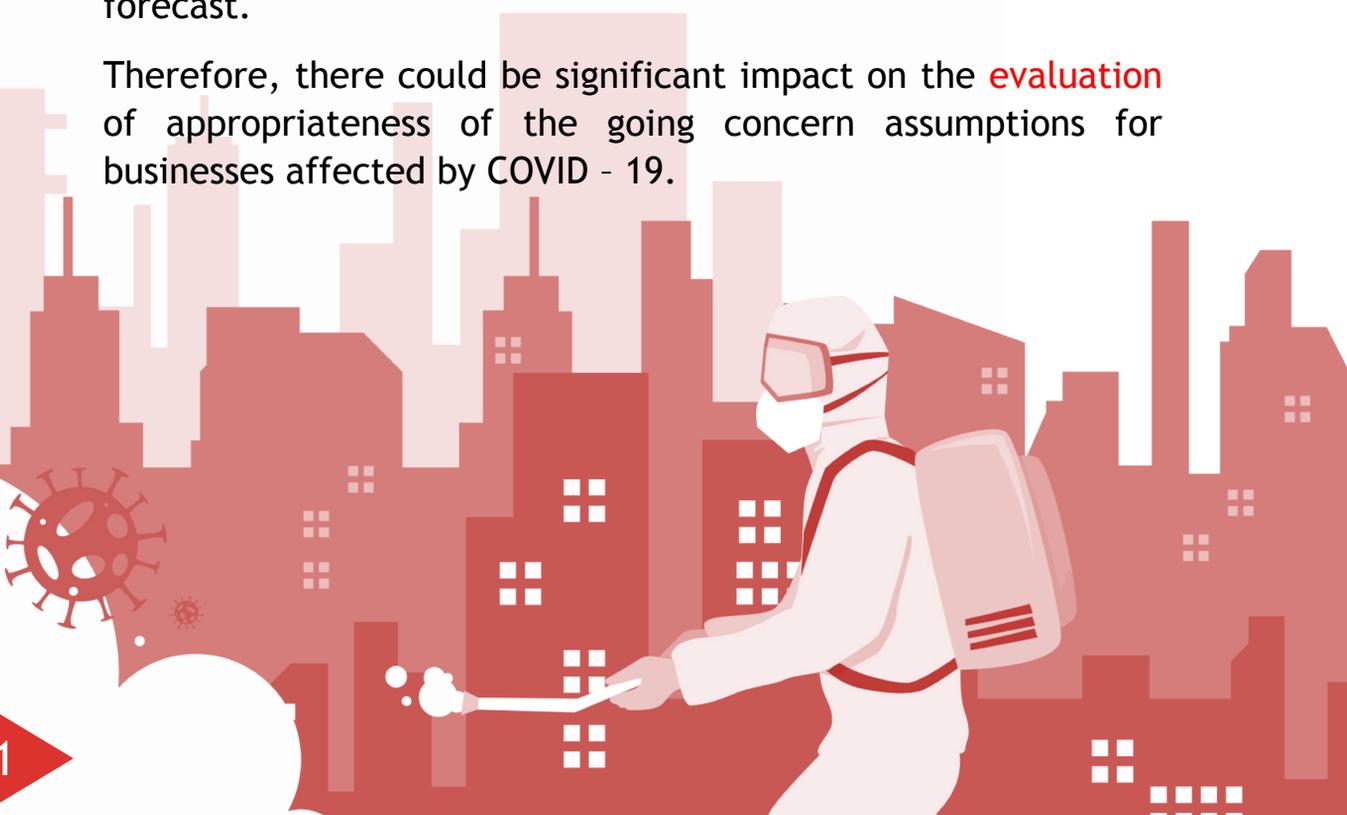
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## Getting Started

The rapid outbreak of the Coronavirus (COVID-19) is an **evolving crisis**, which has been labelled a pandemic by many countries and institutions, including the World Health Organization. The COVID - 19 outbreak has already had a significant effect on the economies and international financial markets. To stop its spread Business has been stopped and population are ordered to stay at home. This has forced the government to provide stimulus packages in a hope to revive their economies.

The result of the above is that companies in highly exposed sectors are experiencing decline demand, falling sales and margin and many entities across a wide variety of industries are facing extended closures, reduced access to customers, **supply chain disruptions**, difficulty collecting from customers and other parties, or other events that negatively affect operating cash flows and liquidity. This uncertain period can make it difficult for organizations to evaluate the impact on their operations and the ability to develop a reasonable forecast.

Therefore, there could be significant impact on the **evaluation** of appropriateness of the going concern assumptions for businesses affected by COVID - 19.



## Assessment

Under Standard of Auditing (SA) - 570 “Going Concern”, management is responsible to assess the entity’s ability to continue as a going concern. Also, Indian Accounting Standard (Ind AS) 10 “Events after the Reporting Period” requires the management to evaluate an entity’s ability to continue as a going concern within one year after the date of financial statements. Hence, management must evaluate whether there are conditions and events (e.g. COVID - 19) that raise substantial doubt about an entity’s ability to continue as a going concern.

The COVID - 19 crisis provides many known and unknown factors for the management to consider when evaluating its future.

Management’s evaluation is based only on conditions and events known and information available at the time. It involves making a **judgement** at a particular point of time, about **uncertain future** outcomes of events or conditions.

The following factors are to be considered by management while evaluating:

- ✓ The degree of **uncertainty** associated with the outcome of an event or condition increases significantly further into the future event or condition or the outcome occurs. Thus, management is required to take into account all available information.
- ✓ The size and **complexity** of the entity, the nature and condition of its business and the degree to which it is affected by external factors.
- ✓ All the possible outcomes that are inconsistent with judgements that were reasonable at the time they were made.

- ✓ The entity's current financial condition, including its liquidity sources (e.g. negotiating debt contracts, available liquid funds) at the date the financial statements are issued.
- ✓ Other **conditions and events** that may adversely affect the entity's ability to meet obligations within one year after the date the financial statements are issued.

Example of events or conditions that may cast **significant doubt** on the entity's ability to continue as a going concern:

- Fixed-term borrowings approaching maturity without realistic prospects of renewal or repayment; or excessive reliance on short-term borrowings to finance long-term assets.
- Loss of a major market, key customer(s), franchise, license, or principal supplier(s).
- Labour difficulties.
- Shortages of important supplies.
- Substantial operating losses or significant deterioration in the value of assets used to generate cash flows.
- Inability to obtain financing for essential new product development or other essential investments.

In assessing whether the going concern assumption is appropriate, management assesses all **available information** about the future, considering the possible outcomes of events and changes in conditions, and the realistically possible responses to such events and conditions that are available.

## Revised Budget and Forecasts

Sudden breakdown in economies due to COVID - 19 has limited the relevance of budgets and forecasts prepared for the year 2020 by the entities. Uncertain present scenario has compelled the organisations to **rethink** over its business processes and survival is still a question mark in the upcoming future. Management has no other way but to modify/regenerate their budgets and forecasts.

Management needs to assess whether it expects to remain in compliance with financial covenants or not. Companies need to consider whether:

1. To restructure operations to reduce operating costs;
2. It has sufficient cash and unused credit lines/borrowing facilities to meet short-term needs;
3. Further actions are needed by management to enable the company to generate sufficient cash flows to meet its obligations when they fall due;
4. To seek financial **support** from shareholders and/or government programmes designed to support businesses.

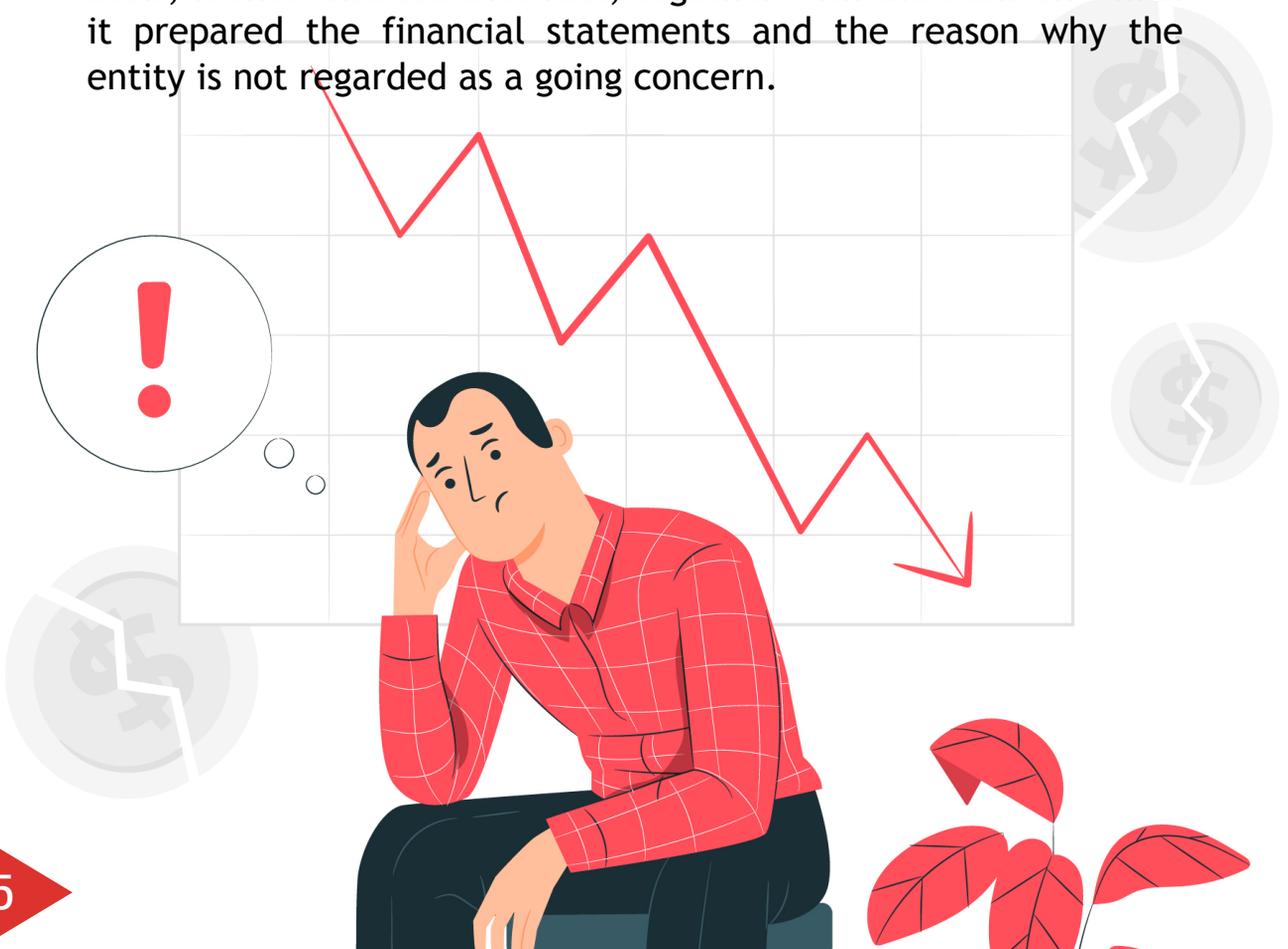
If management concludes that the consequences of the outbreak will result in deterioration in operating results and financial position after the reporting period that is so severe that the going concern assumption is no longer appropriate, then as per Indian Accounting Standard (Ind AS) 10 "Event after the Reporting Period" the financial statements would need to be adjusted- i.e. a change in the going concern assumption is considered an adjusting event.

## Disclosures

As per Indian Accounting Standard (Ind AS) 1 “**Presentation of Financial Statement**” When management is aware, in making its assessment, of material **uncertainties** related to events or conditions that may cast significant doubt upon the entity’s ability to continue as a going concern, the entity shall **disclose** those uncertainties.

Disclosure should include identification of key assumptions about the impact of such uncertainties (e.g. COVID - 19) on material estimates and sources of estimation uncertainty that could result in material adjustments including sensitivity analysis. Along with disclosures about companies policies and procedure to manage its credit and liquidity **risk exposures**.

Whereas, as per Ind AS 1 and Accounting standard 1 when an entity does not prepare financial statements on a going concern basis, it shall disclose that fact, together with the basis on which it prepared the financial statements and the reason why the entity is not regarded as a going concern.



## Audit

Increasing restrictions on Travels, meetings and access to client locations, auditors would be facing practical difficulties in carrying out audits. This must not undermine the delivery of high quality audits and audit should be performed in compliance with **auditing standards**.

The auditor shall perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements have been identified.

Auditor shall take into account the auditor's risk assessment in determining the **nature and extent** of such audit procedures, which shall include the following:

- Obtaining an understanding of any procedures management has established to **ensure** that subsequent events are identified.
- Inquiring management and/or those charged with governance as to whether any subsequent events have occurred which might affect the financial statements.
- Reading minutes, if any, of the meetings and inquiring about matters discussed at any such meetings.
- Identify events that **require adjustment** of, or disclosure in, financial statements, the auditor shall determine whether each such event is appropriately reflected in those financial statements.

There could be several situations arising from the ongoing COVID-19 outbreak that could have an impact on the assumption relating to going concern. For some entities, the impact could be severe and may leave management with no realistic **alternative** but to liquidate or cease operations. There could also be entities which may have to scale down their operations while impact may not be significant for other entities.

The auditor will only be able to form a conclusion relating to going concern once management has made its own assessment. The auditor should **inquire** of management as to what information is available about the future, and determine whether this has been appropriately considered as part of management's assessment. For example: include a detailed and robust review of up to date forecasts, cash flows, sensitivity analysis and reviews of COVID-19 contingency plans and impact assessments conducted by the management.

If events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern, the auditor shall obtain sufficient appropriate audit evidence to determine whether or not a **material uncertainty** exists.

Given the level of uncertainty and speed of increasing impact of COVID-19, audit teams need to critically consider the current position at the point of sign off as part of the subsequent events review right up to the point of signing the auditor's report, and may need further evidence and information by management, including updating financial models.

If the entity is disclosing in their subsequent events disclosures that an estimate of impact cannot be made due to the evolving situation, this may result in a material uncertainty on going concern within the audit report.

Since, lot of estimation is involved regarding the impact on the financial statements and assessment of going concern in the current circumstances, management may take the assistance of a management's expert (an expert in field other than accounting and auditing) to make such estimates or assessments.

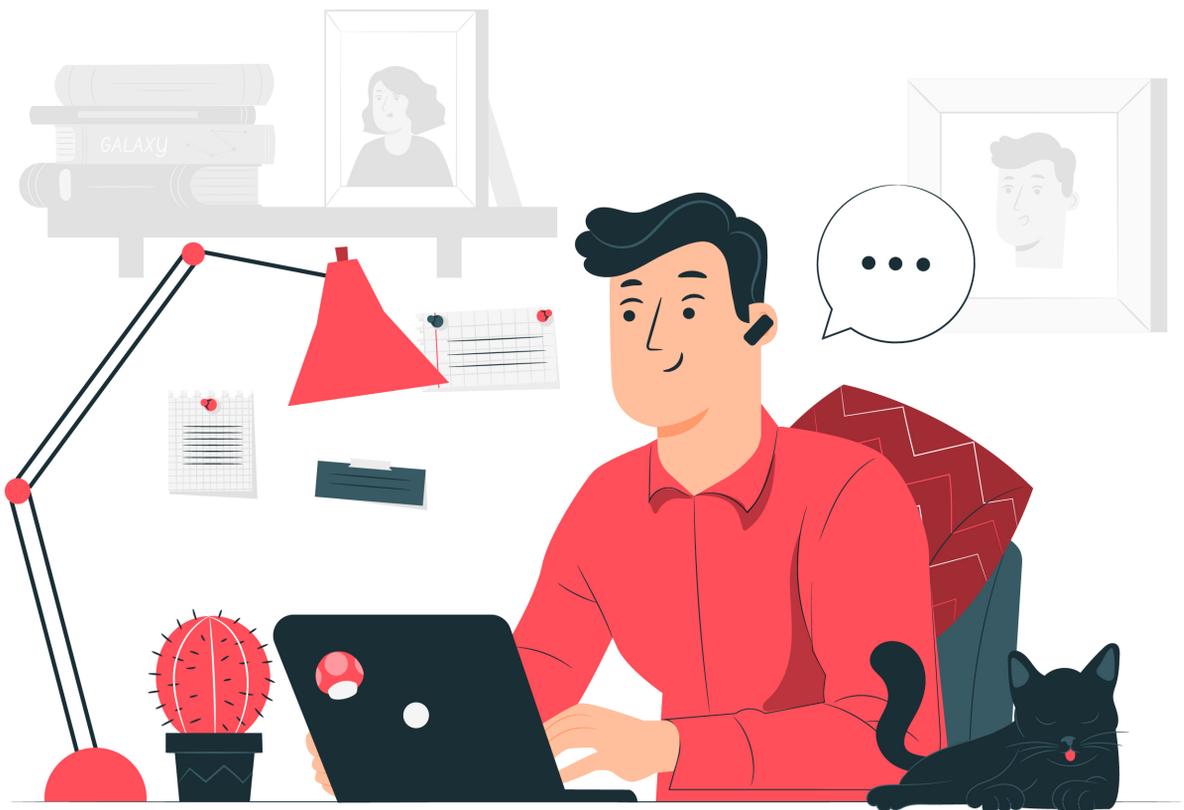
Auditor may need to express a **modified opinion** due to COVID - 19 if:

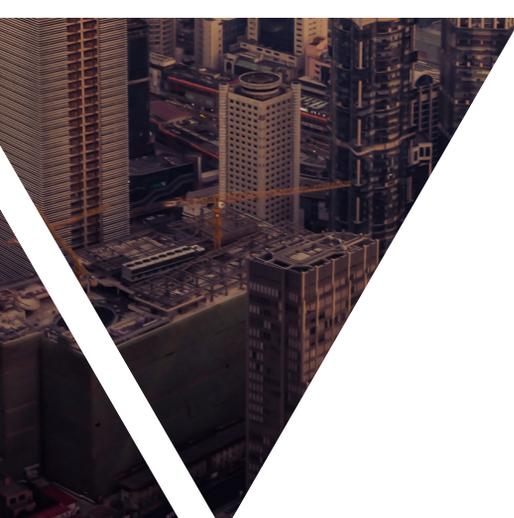
- The auditor is unable to obtain sufficient appropriate audit evidence relating to material component audited by the other auditor as per **SA 600 “Using the Work of another Auditor”** due to COVID-19 pandemic.
- The financial impact arising out of the COVID-19 outbreak are not accounted or reported or disclosed as per the prescribed Accounting Standards, in the financial statements.
- If the auditor is unable to obtain sufficient appropriate audit evidence relating to the impact of COVID-19 in the financial statements and is of opinion that there are misstatements that are material to the financial statements.
- The auditor has communicated misstatements to the management and those charged with governance relating to COVID-19 as per **SA 450, Evaluation of Misstatements Identified during the Audit** and the management or TCWG refuses to correct such misstatements that are individually or in aggregate, material to the financial statements.

## Conclusion

The ultimate impact of COVID-19 is currently unknown, but it is already having a **pervasive impact** on global economy. Most market commentators believe that we have entered a global recession. Sudden uncertainty has created a lot of pressure over each and every entity. This will put more pressure on each entity's going concern assessment and having a robust process in place to identify and adjust to the evolving COVID-19 scenario will be critical. There is still **hope** for those who are ready to take the challenge and evolve with the scenario.

STAY **POSITIVE** AND **SURVIVE**



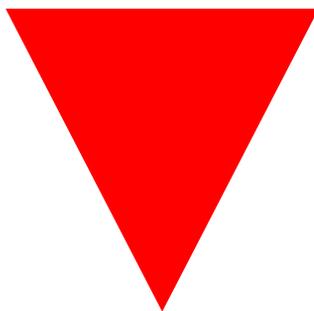


## About Us

**Nucleus** AAR Advisors LLP is a business consulting firm providing specialized services in the field of Investment Banking, Deal Transaction Advisory, Corporate Advisory, International Taxation, Audit & Assurance. We partner entrepreneurs in their critical decision making by providing them various analysis customized as per their requirement. We also help in the effective implementation of decisions and its subsequent monitoring as well.

Team Nucleus is comprised of people from Big4s and reputed consulting firms with combined experience of 30+ years.

Team is distinguished by their functional and technical expertise combined with their hands-on experience, thereby ensuring that our clients receive the most professional service.



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