

# SA's and industry specific considerations

## Manufacturing & retail

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Webinar

WIRC of ICAI

# Content

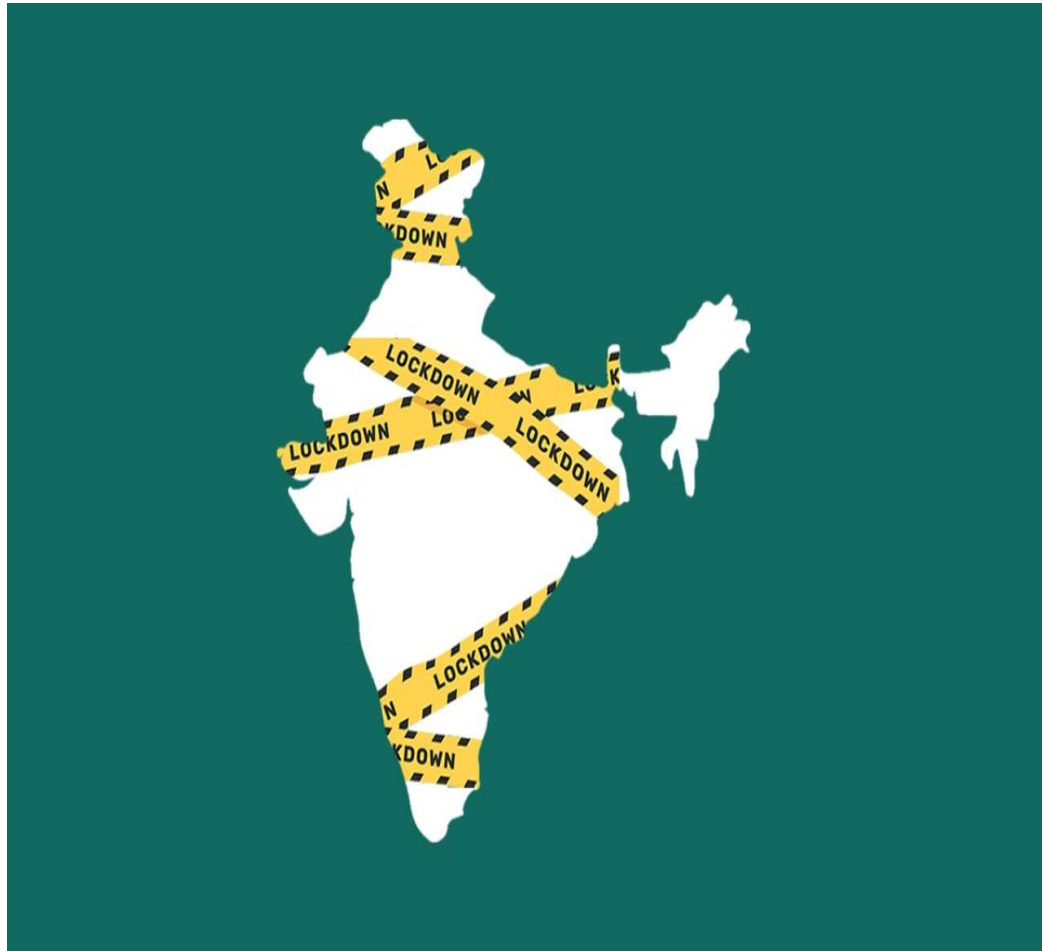
- Background
- Case studies
- Reporting
- Conclusion
- Questions

# The ICAI – Partner in nation serving



In service to the Indian economy in public interest

Stay HOME. Stay SAFE.



Background

# Background



Digital fit : e-tailoring and virtual trial rooms.



Your sweet home is the temple of God ...

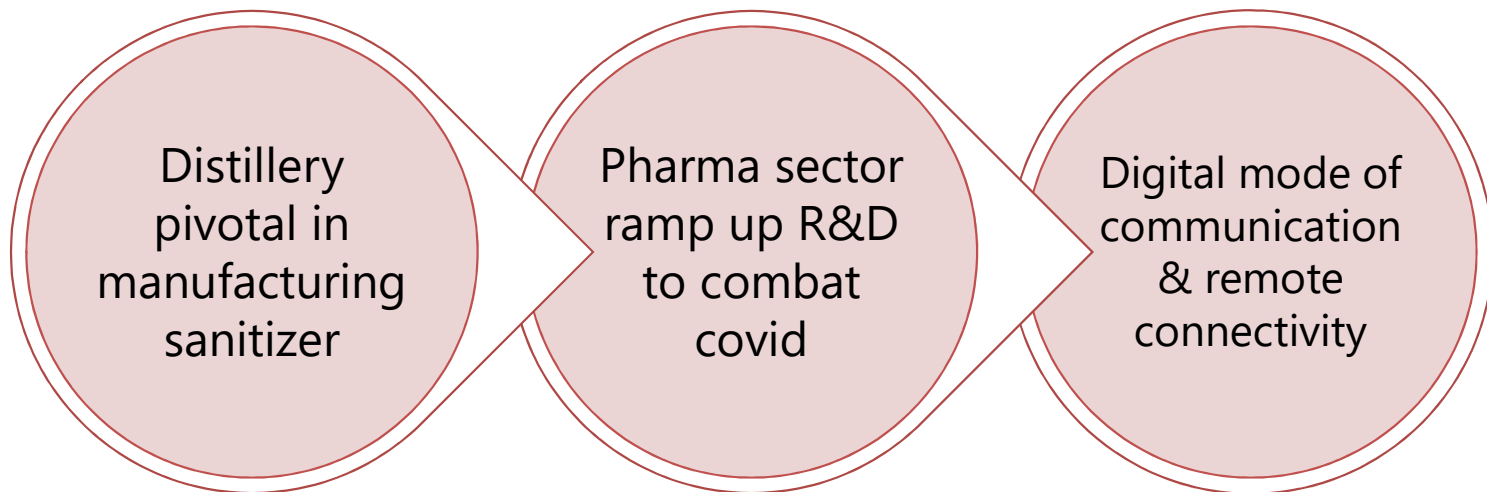


Online payments will be preferred and avoid exchange.



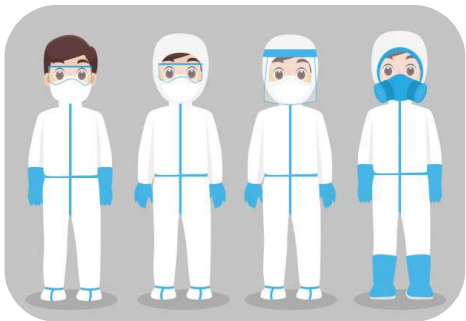
WFH & alternate visits to office may gain momentum.

# Liquidating the potential



# New ventures by businesses

## MANUFACTURING



New businesses by  
Marico, Dabur,  
HUL



Corrugated cardboard  
beds

## RETAIL



Grocery delivery  
by Dominos, D-  
Mart and Zomato

Swiggy delivering  
non food courier



Virtual tour by  
Retail stores –  
experience  
shopping from  
home

# Business challenges





# Business around the world

- **Tim Cook, Apple's CEO** - "Despite COVID-19's unprecedented global impact, we're proud to report that Apple grew for the quarter ended 28<sup>th</sup> March 2020, driven by an all-time record in services and a quarterly record for Wearables".
- **Tiffany Jewellery sales** dropped by 50% in the first quarter ended 31.3.20.
- Wide spread pay-cut and lay off to sustain in industry (severe impact in **automobile, engineering, aviation, retail**)

# Developments in India

- Pharma companies like Glenmark launched **Favipiravir** for the treatment of mild to moderate COVID-19 patients.
- Sectors like **Pharma** and **Essential items** falling under FMCG remain insulated from adverse impact from COVID-19.
- TTK Prestige seeing more demand for kitchen appliances in Q1 20 as more families are cooking 24\*7
- Losses in **Pulp** and **Paper** industry vs. rise in **Digital** consumption.
- Exceptional losses in businesses due to fixed cost and leveraging



# Audit execution challenges



Travel restriction

Expect  
delays

Delays by auditee in  
responding to queries  
& requirements



Limitations of IT  
support



Limited availability &  
access

## Message for Auditors ...to Always remember

*"We are not expecting an auditor to detect a needle in a hay stack, but if an elephant is in a room, they ought to find it."*

*Source : representative from MCA*

# ICAI Guidelines

Impact of Coronavirus on Financial Reporting and the Auditors  
Consideration



Going Concern - Key considerations for Auditors amid COVID-19



Physical Inventory Verification – Key Audit Considerations amid  
COVID- 19



Auditor's Reporting - Key Audit Considerations amid COVID- 19



Subsequent Events – Key Audit Considerations amid COVID- 19



# Use of audit guidelines



# Global audit guidelines: COVID-19 spotlight

## **IFAC**

Summary of  
COVID-19  
Audit  
considerations

## **IAASB**

Staff audit  
practice, Alert  
on Auditor  
reporting

Audit  
challenges  
**[AICPA]**

Series of  
**webinars**  
for auditors

COVID-19:  
Ethics &  
Independence  
considerations  
**(IESBA)**



# Outcome of travel ban

## Facts / concern areas

- Management College had to cancel planned foreign trip for its students due to travel bans.
- Without consent of students trip fees is adjusted against new courses and refund is denied to students.

## Audit approach

- Discussion with those charge with governance
- Relook the terms & conditions of students admission (i.e. legal rights with college to add new courses and adjust the fees)
- Seek legal advise on such matter



Case studies  
– Industry  
specific

# Retail Store

## Facts / concern areas

- Management needs to review the portfolio of retail stores.
- It involves significant judgement in identifying indicators, assumptions, estimated cost of disposal, onerous commitments, site restoration cost, negotiation of rental costs, sublease part of space to downsize and fair value of the property.
- Luggage industry is severely affected since leisure travel is stopped.

## Audit approach

- Understand the relevant controls around impairment process
- Challenge key assumptions in cash flow forecast, market expectations and the reasonableness of management's forecasts
- Understand the Covid risk adjustment factored in the impairment review
- Sensitivity analysis
- Review of overall cost Vs cost of rental
- Subsequent events like Samsonite has closed 100 stores and flagship store continues

# Automobile

## Facts / concerns areas

- New offers (like free battery testing) & extension in the period of **product warranty, AMC and CMC**.
- Stock lying in central warehouse & showroom are being verified for any damage / wear and tear.
- Impact of SC order about **BS-IV vehicles**:
  - Permission to sell BS-IV vehicles - 10 days after lock-down
  - 10% of the existing inventory
  - Vehicle Registration date extended upto April 30<sup>th</sup>, 2020

## Audit approach

- Inquire about management estimates for such extended terms of warranty / AMC.
- Evaluate the financial impact of the estimates given in closing the financial statements. In hindsight, additional information to be sought for actual utilization of provisions till the accounts are finalized and approved by the Board.
- Estimate the NRV of the unsold stock of BS-IV and compensation to distributors for such call back.

# Automotive Tyres and Tubes

## Facts / concern areas

- On account of nation wide lock-down and abrupt stoppage of the production facility, there were raw material /unfinished goods / WIP stage at year end.
- Considering the nature of product involved, it is difficult to rework / recycle the materials.

## Audit approach

- NRV test to be carried out and if materials are not usable then it has to be written off
- Ceat Tyre has made provision for unsaleable semi-finished inventory and raw materials aggregating to Rs. 1,327 lakhs due to such cause. This loss is disclosed under 'exceptional item' in quarter and year ended 31.3.20.

# Seasonal rainy wear

## Facts / concern areas

- **Rainy wears** (e.g. jackets, boots, shoes, caps, umbrella, etc.) which could not be manufactured or FG could not be dispatched to stores / distribution channel before the season begins i.e. June
- **Contract manufacturing** – Raw material is delivered to contractors but delay in production
- **Franchises & Distributors** have approached the manufacturer for cancelling / holding back of their scheduled purchase orders & delivery of finished goods
- Significant rise in **stock levels** due to drop in sales

## Audit approach

- Evaluate the overall assessment provided by the management due to this disruption and its financial impact on books of account
- Factor additional sales discounts / commission including to e-commerce platform for NRV test
- Take the revised dates for openings of new retail outlets which got delayed due to lock-down

# Fans & Consumer electrical appliances

## Facts / concern areas

- Management has undertaken **cost reduction programs** for neutralizing the adverse impact on volume due to lockdown.
- **Open job orders** whose work was partly done but not finished before the day of lockdown need to be re-worked / scrapped.
- Inventory has piled up and management has informed that care is taken while valuing the closing inventory as on 31.3.20

## Audit approach

- Discussion with management in regard to impact of such cost reduction / rationalization on inventory valuation i.e. fixed cost / variable cost / reduction in overheads due to changes in manufacturing process which consumes less number of man-hours.
- Ensure that overheads during the idle period are not loaded on inventory value
- Ensure that new 'Machine Hour Rates' are not applied to earlier manufactured inventories in stock

# Bicycle

## Facts / concerns areas

- Brands like Atlas cycles have **stopped the production** and **layoff** is given to many factory workers.
- However, management estimates that demand will pick-up in near term for **e-cycles** and an overall **cycle revolution** around the world is expected for short commutes.
- **State Government** and '**All India Cycle Manufacturers Association**' is also taking steps to support this industry and small scale workers.

## Auditors approach

- Need to assess going concern and discuss it with those charged with governance. Forward looking statements may be considered but with appropriate probability factors.
- Modified opinion or Emphasis of matter paragraph to be given in the audit report in such cases.



# Raw / cured coffee beans

## Facts / concern areas

- Finished goods inventory are valued at lower of cost and net realizable value (estimated selling price less estimated cost to sell). Considering that there is always a volatility in the selling price of green coffee beans, tea and pepper, which is dependent upon various market conditions and the possible impact of COVID-19, determination of the net realizable value for green coffee beans, tea and pepper involves **significant management judgement**.

## Audit approach


- Understand the significant judgement applied and reasonable assessment of NRV
- Evaluate the internal controls and test operative effectiveness
- Committed price as per open sales orders
- Verify the information available in public domain
- Benchmark the cost to sell with the latest sale transaction
- The expiry dates of the cured coffee beans should be examined.

# Paints & Home Decorative

- Significant drop in top line due to slowdown in automotive industry, real-estate and industry coating. Covid added additional challenges.
- New avenues like sanitizing the shops, work-place and home is being introduced to supplement the current segment
- In case of Asian Paints, taking into account the recent business performance and the increased uncertainty in business conditions, as a matter of prudence, the Company has taken a provision for impairment in the value of its investment in Sleek to the tune of Rs. 29.7 crores.

# Poultry industry –perishable items

- Significant losses due to drop in demand, rumors circulated in social media, drop in prices and short shelf perishable items
- The crash in prices towards end of March 2020 required recognition of loss in respect of fair valuation of biological assets.



Other  
common  
case studies

# Sales cut-off

## Facts / concern areas

- Transport & courier services were not allowed in certain regions / states. Consequently, goods invoiced from the CFA locations (across India) could not reach the customers destinations on or before the year end.
- Company has reversed the sales based on the expected lead time for delivery and information was obtained from the respective CFA for delayed deliveries / deliveries on hold as on 31.3.20

## Audit approach

- Understand the internal control process to ensure that the information of undelivered stock is correctly and completely collated
- Check sales register for the subsequent sales returns (if any) posted in the system
- Substantive testing (check the LR receipts from the CFA, sought balance confirmation from customers, collection status)

# Penalty & Liquidated damages

## Facts / concern areas

- Schedule delivery timelines are agreed upon with customers as per contractual terms. Non-adherence will result into LD / penalties.
- Buyers failing to honour purchase contract or fails to offtake committed quantity resulting in reversal of discounts obtained during contract period.
- Such penal terms are observed in infrastructure, pharma (mainly USA), real-estate (though RERA has given some relaxation) etc.
- Unless protected through force-majeure clause (specific pandemic related), the management need to ascertain its probable and likelihood of expected outflow on account of such penalty.

## Audit approach

- Evaluate the IFC to identify such contracts
- Enquiry for events subsequent to year end
- Discussion with management for likely cases where customers have not agreed for waiver / extension of contractual delivery period.
- Obtain legal opinion if force majeure condition being applied for liquidated damages
- Assess the provisions made by management and document the basis on which it is quantified.

# Changes in IT environment

## **Facts / concern areas**

- Due to lockdown, changes were made in the authorization matrix for release of purchase orders and approval mechanism for online banking payments.
- Additionally, access right to vendor masters were also modified.

## **Audit approach**

- Obtain management's approval note to validate the changes in matrix during the lockdown period and take audit trail of changes in the systems.
- Inquire for corresponding changes in the internal financial controls and effective testing as at Balance sheet date.
- Carry-out substantive and analytical audit procedure.

# Inventory valuation

## Facts / concern areas

- Manufacturing units working below the normal capacity have led to over absorption of fixed overheads.
- Reduction in demand has led to lower realization of inventories in case of those not backed by orders.

## Audit approach

- Understand the standard capacity for allocation of fixed overheads and excess amounts to be accounted as cost for the year.
- Checking subsequent realizations for ascertaining the net realizable values (net of selling and marketing expenses)
- Reliance to be placed on valuation provided by the experts.



# Actuarial valuation of gratuity

## Facst / concern areas

- Management has reduced the salaries in the range of 10% to 25% based on the annual CTC.
- For the purpose of actuarial valuation of gratuity, it was assumed that there is no increment in next year and revised CTC figures were given to actuary.
- This resulted in significant drop in liability recognized in books and hence excess provision was reversed in year ended 31.3.20

## Audit approach

- Future salary growth rate is for the long term period and not for a year. Hence for the purpose of actuarial valuation, long term horizon needs to be considered with different growth rates projected for the year subsequent to year 1.
- Clarify with management whether it is deferral of part of annual salary or reduction in annual CTC.

# Subsequent events

- Inquire for the loss caused due to cyclone Nisarg and expected insurance claim. Need for disclosure if loss is significant.
- Lay-off / VRS announced (Rolls Royce)
- Legal dispute filed by the auditee for non-recovery of dues from customers
- Significant fixed assets disposed (non-core assets) – Indication of 'assets held for disposal'

# Laws & Regulations

In consolidated financial statement with Foreign subsidiary:

- The US Government enacted Coronavirus Aids, Relief and Economic Security Act (CARES Act) on 27 Mar 2020 in response to COVID-19 pandemic.
- Torrent Pharma Inc., wholly owned subsidiary, elected to carry back Net Operating Losses (NOLs) of current and preceding financial years to set off against taxable profits of earlier years. Accordingly, one time tax benefit of Rs. 53 crores for the year ended 31 March 2020 has been recognized.

## Other common concern areas in audit due to covid

Physical count (where digital modes are not accessible)

Forecast related to Going concern

Accessing client records

Balance confirmations (emails)

Audit planning meeting and joint audits

Changes in LOR, digital signatures, UDIN

Using work of another auditors



Reporting

# Extracts from audit report

## **Mahindra CIE Automative LTD. – Emphasis of matter**

- In view of the highly uncertain economic environment due to COVID-19, a definitive assessment of the impact on the subsequent periods is highly dependent upon circumstances as they evolve. Our conclusion is not modified in respect of this matter.

## **Infosys Limited – KAM on ‘allowance for credit losses’**

- In calculating expected credit loss, the Company has also considered credit reports and other related credit information for its customers to estimate the probability of default in future and has taken into account estimates of possible effect from the pandemic relating to COVID-19.

# Other matter para [SA 706]

## **Tata Coffee Limited – extract of audit report**

- Due to COVID 19 lockdown we were not able to participate in physical verification of inventory that was carried out by the management subsequent to year end. Consequently we have performed alternate procedures to audit the existence of inventory as per guidelines provided in SA 501 "Audit evidence-specific considerations for selected items" and have obtained sufficient appropriate audit evidence to issue our unmodified opinion on these standalone financial results.

## **Piramal enterprises LTD.– extract of audit report**

- Due to the COVID-19 lockdown, we were unable to observe the Management's year-end physical verification of inventory at certain locations of the Parent in India. We have performed alternate procedures to audit the existence of inventory as per the guidance provided in SA 501 "Audit Evidence - Specific Considerations for Selected Items", which includes inspection of supporting documents relating to purchases, production, sales, result of cyclical count performed by the Management through the year and such other third party evidences where applicable, and have obtained sufficient appropriate audit evidence to issue our unmodified opinion on these Consolidated Financial Results.

# Detailed self explanatory report

## Modification

- Qualify / adverse / disclaim if situation demands

## Emphasis

- Draw attention on certain matters (impact of COVID-19, going concern assumption, etc.)

## Going concern

- Assessment of management's assumption

## Other matters

- Highlight audit steps followed due to lock down

## Other information

- Disclosure in FS and Board / Annual report

## Internal Financial Control

- Operating effectiveness to be evaluated





Conclusion

# Conclusion

## Auditors dilemma / judgments

- Inherent limitations
- Alternate procedures may not suffice
- Excess reliance on management representation

## Irrespective of challenges and uncertainties

- No compromise in audit quality
- No dilution or non-compliance with the auditing standards in carrying out the audits
- Modify the audit report if necessary

*Covid-19 still evolving,  
Just now the financial impact can not be ascertained*

# Questions



Thank You

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