

Disclosure Guidance and Other Considerations on the Recent Economic Conditions and its Impact on the Financial Statements

Introduction

As the National Body of Accountants, the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka) intends to provide this guidance to assist the entities in preparation of financial statements to report the effects arising from the prevailing economic conditions on businesses, financial condition, and results of operations under the Framework for Preparation of Financial Statements, LKAS 1 *Presentation of Financial Statements* and where applicable LKAS 10- *Events after the Reporting Period*

It may be challenging to assess or predict the broad effects of economic conditions on industries or individual entities with precision. Further, the actual impact will depend on many factors beyond an entity's knowledge and control. Nevertheless, the management could reasonably assess the effect that the economic conditions would have impacted on an entity based on currently available information, as well as how the management is planning to respond to evolving events, and how they assess the materiality of the economic decisions on the economic conditions related uncertainties. The entities shall ensure that sufficient disclosures are made in the financial statements to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity.

The Impact of the ongoing economic crisis on a particular entity will depend on various facts and circumstances as described above. The companies which issue their interim or annual Financial Statements, after the issuance of this guidance, shall consider the impact of these conditions in the Sri Lankan economy and make appropriate disclosures based on this guideline. In doing so companies shall consider the prevailing events and circumstances up to the date of issuance of the financial statements (interim or annual) to ensure that the information disclosed are more meaningful and useful. In certain instances, the events after the reporting date may constitute adjusting events where they shall be treated in accordance with the LKAS 10 *Events after the Reporting Period* and provide necessary disclosures in accordance with this LKAS 10 and as recommended in this guidance.

It remains important that an entity's financial statements provide information which helps investors to assess the impact of the prevailing economic conditions to the entity. Accordingly, an entity shall disclose the nature of the event, and an estimate of its financial effect. Further, if it is not possible to make an estimate of the event's financial effect, an entity shall disclose that fact as well.

The areas of focus in the disclosure include (*but not limited to*) the following:

1. Increase in the interest rates

- Disclosure about the impact on the rising interest rates to the business operations.
- In addition, actions that the management of the entity or the group undertakes to mitigate the potential impact on the continuity of the business need to be explained (including the actions such as evaluation of the macroeconomic variables while making assumptions and judgments when preparing financial statements and continuous monitoring of the facts and surrounding circumstances).

2. Fluctuations in foreign currency and significant rupee depreciation

- As per paragraph 22 of LKAS 10, exchange rate changes after the reporting date are considered as one of the non-adjusting events.
- Accordingly, the impact of fluctuations in foreign currency shall be disclosed if the effect of the fluctuations is considered to be material to the financial statements.
- Resulting gains or losses on the financial assets and financial liabilities after the balance sheet date determined in foreign currencies after the year end need to be disclosed, if material

3. Other considerations

It is to be noted that the respective Sri Lanka Accounting Standards need to be complied based on each circumstance when disclosures are done. Further, the following areas also need to be taken into consideration.

➤ Considerations on the going concern assumption:

Following paragraph 26 of LKAS 1 *Presentation of Financial Statements*, when an entity prepares its financial statements, it is required to disclose any material uncertainties. Accordingly, if there are such uncertainties arising to the continuity of the business operations due to the economic conditions even after the reporting period; disclosures are required to make clear the readers that the going concern assumption used by management is subject to such material uncertainties. Regardless of whether management concludes that the material uncertainties do not exist, if management has exercised significant judgements in its going concern assessment, such judgements shall be disclosed.

Considerations that an entity might disclose to address its going concern basis include:

- Whether the entity has sufficient cash and/or headroom in its credit facilities to survive the crisis
- Actions the entity has taken to mitigate the risk that the going concern assumption is not appropriate such as activities to preserve liquidity.
- Consideration of the entity's business model and related risks arising from the current economic conditions including shortage of foreign currency, supply of raw materials, etc
- Any challenges of the underlying data and assumptions used to make the going concern assessment.

➤ Revenue

If there are significant judgements and estimates such as on customers' ability to pay, variable consideration and additional concessions that might be provided to customers that have an impact on the revenue of the company, those need to be disclosed. The impact on pricing strategies adopted by the entity due to the changes in the economic variables and the resulting impact on its demand and gross margins also needs to be taken into consideration.

➤ Provisions

Further, consideration needs to be drawn on the disclosure on assumptions and basis under which any contracts became onerous as a result of the present economic conditions. In addition, assessments need to be performed on whether there are any contractual penalties that need provisioning to be done and potential impact due to business closures and downsizing if applicable. *[Eg: Provision on debtors, Tax provisions etc.]*

➤ Impairment

Impairment provisioning need to be dealt with the relevant Sri Lanka Accounting Standards on non-financial assets such as property, plant and equipment, intangible assets, inventories (reductions in the net realizable value) and goodwill. Given the current uncertain environment, it is important for entities to provide detailed disclosures of the supporting evidence and the impact of a change in the key assumptions *[Eg: sensitivity analysis]*.

The above areas of disclosure are not exhaustive. Individual entities need to carefully assess and determine the potential impact of prevailing economic conditions on the business operations and provide material disclosures that would be useful for the users of the financial statements. Entities are also encouraged to provide disclosures that allow investors to evaluate the current and expected impact of the conditions and update disclosures whenever facts and circumstances change. It is also important to keep the users informed that the disclosures that have been included, and the considerations noted include forward looking information that is based on the assumptions and expectations regarding future events based on the current information available.

Please also refer, “Guidance Notes on Accounting Considerations of the COVID 19 Outbreak (updated on 11th May 2020)” and “Corporate Disclosure Guidance Note on Disclosure to be made on the Impact of COVID – 19 (jointly issued with the Colombo Stock Exchange on 09th May 2020)” for further information.

Example for Illustrative disclosure

As at *[Month of the Reporting period end]* inflation rate was xx%. However, it has been escalated up to xx% at *[latest Inflation rate before the financial statements is authorized for issue by the directors]*. Exchange rates also observed a notable fluctuation after the balance sheet date and has not adjusted in the current year financial statements since the conditions that gave rise to the gain/(loss) did not exist as of xxx *[Reporting Date]*.

The Monetary Board of the Central Bank of Sri Lanka (CBSL) has decided to increase the Standing Deposit Facility Rate (SDFR) and the Standing Lending Facility Rate (SLFR). The depletion of foreign reserves has put restrictions on imports and affected supplies.

The Company has taken the following measures to ensure it continues its operations as a going concern. *[Update on company specific impact and the actions initiated to manage the impact of above fluctuations and give the reference of risk management note or any other note if necessary]*. The management of the entity/group continues to monitor the potential impact to the continuity of the business. Accordingly, macroeconomic variables are evaluated while making assumptions and judgments when preparing financial statements.