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The impact of Covid-19 on Audit and Assurance – challenges and considerations

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Introduction

The unprecedented current situation caused by Covid-19, has disrupted most professions across the globe with accounting and auditing being no exception. Mandatory lockdown measures were imposed by governments to control the spread of the virus, with individuals having to work from home where possible. For auditors, this means they can no longer travel to audited entity premises, nor even to their own offices and that their audits will have to be completed remotely.

If there is a positive side to this significant challenge for auditors, it is that the audit profession was already on a journey to becoming more digital, and the investment in digital capability has allowed many firms and practitioners to adapt to the new circumstances relatively more quick than other industries.

Notwithstanding this, a number of practical challenges have emerged. As ACCA's Covid-19 global survey: Inside Business, Impacts and Responses finds[1], a significant 53% of respondents working in public practice said they were experiencing pressures completing client services work, and over a third (36%) said they faced an inability to meet reporting deadlines - a point recognised in many jurisdictions where reporting deadlines have been flexed. A quarter said they're experiencing difficulties in gathering audit evidence, and 27% said they saw an increased audit risk relating to valuation of assets, completeness of liabilities or going concern issues.

This paper highlights some of the practical challenges auditors are now faced with, in light of Covid-19, and highlights some of the key considerations for auditors by referring to the relevant International Auditing Standards. The paper also refers to useful links published by regulators, standard setters and by other relevant stakeholders.

ACCA is very grateful to the members of its Global Forum on Audit and Assurance for sharing their own practical experiences to support the development of this paper.

Identifying and Assessing Risks of Material Misstatement

ISA 315 (Revised), Identifying and Assessing the Risks of Material Misstatement Through Understanding the Business and its Environment, requires auditors to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels, through understanding the entity and its environment, including the entity's internal control, thereby providing a basis for designing and implementing responses to the assessed risks of material misstatement.

Revision of Risk Assessment

Additionally, paragraph 31 of ISA 315 (Revised) states that the auditor's assessment of the risks of material misstatement at the assertion level may change during the course of the audit as additional audit evidence is obtained. In circumstances where the auditor obtains audit evidence from performing further audit procedures, or if new information is obtained, either of which is inconsistent with the audit evidence on which the auditor originally based the assessment, the auditor shall revise the assessment and modify the further planned audit procedures accordingly.

The unprecedented state of emergency caused by Covid-19 has impacted the operating environment of entities. As a result, auditors must consider how this impacts their risk

[1] https://www.accaglobal.com/gb/en/professional-insights/global-economics/Covid-19_A-Global-Survey.html

assessments and whether any revision is needed. This was also noted in the UK's Financial Reporting Council (FRC) Covid-19 Bulletin March 2020[2], which stated that, for audits which are underway relating to periods that end after 31 December 2019, the impact of Covid-19 is likely to require the auditor to revisit their risk assessment and the proposed response to identified risks. The Institute of Certified Public Accountants of Cyprus' Technical Circular 2/2020 [TC 2_2020][3] provides similar guidance, clarifying that risk assessments would need to be continuously reassessed and calibrated as the situation evolves, up until the audit report signing date and emphasising this as an area that needs to be treated with a higher degree of professional scepticism.

For example, as noted in ACCA's article on Covid-19 issues for corporate reporting[4], the pandemic is likely to be a "triggering" event, requiring more frequent impairment testing and greater scepticism. Given the heightened degree of uncertainty about future business performance and economic conditions affecting assumptions, valuations are likely to difficult to determine. As such, we expect more auditors to recognise an increased audit risk in the valuation of assets.

We also note that part of the auditor's risk assessment procedures as per ISA 315 (Revised), the auditor should also take into consideration any preliminary assessment performed by management regarding the entity's ability to continue as a going concern. Covid-19 is highly likely that would affect such preliminary assessments. *ISA 570 (Revised), Going Concern* paragraph 11 states, auditors should remain alert throughout the audit for audit evidence of events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. The challenges and considerations for auditors regarding the going concern assessment are discussed later in this paper.

Furthermore, auditors must also take into consideration any changes to the entity's internal control system due to Covid-19, and whether any planned reliance on controls in determining responses to identified risks of material misstatement should also be reassessed as noted in the IAASB's Staff Audit Practice Alert[5].

The Auditor's Responses to Assessed Risks

ISA 330, The Auditor's Responses to Assessed Risks, requires auditors to respond to assessed risks by obtaining sufficient appropriate audit evidence regarding the assessed risk of material misstatement, through designing and implementing appropriate responses to those risks.

Paragraph 25 of ISA 330 states that, based on the audit procedures performed and the audit evidence obtained, the auditor should evaluate prior to the audit conclusion, whether the assessments of the risks of material misstatement at the assertion level remain appropriate.

Covid-19 in many cases will necessitate auditors to consider if the design and implementation of their responses to the identified risks is still relevant or whether they need to be revised.

[2] https://www.frc.org.uk/about-the-frc/covid-19/covid-19-bulletin-march-2020
[3] https://www.icpac.org.cy/selk/common/PreviewDocument.ashx?itemId=2346&refItemId=T470DOCUMENTS&refTableId=470&language=EL
[4] https://www.accaglobal.com/hk/en/cam/coronavirus/corpreporting-covid19.html
[5] https://www.ifac.org/system/files/uploads/IAASB/Staff%20Alert%20-%20Audit%20Considerations%20Arising%20from%20Changes%20Due%20to%20Coronavirus.pdf

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Audit Evidence

ISA 500, Audit Evidence, requires auditors to design and perform audit procedures to enable the auditor to obtain sufficient appropriate audit evidence, from which to draw reasonable conclusions on which to base the auditor's opinion.

However, due to the current restrictions in place due to Covid-19, auditors in most, if not all cases, can no longer visit audited entity premises. This creates obvious practical challenges for auditors needing to obtain physical forms of evidence. The use of technology can help auditors overcome these challenges.

For example, auditors may not be able to attend planned inventory counts physically in order to observe the process. However, auditors may be able to observe inventory counts virtually via videocalls or drawing on drone technology. Auditors must ensure that they can rely on the technology they are planning to use and remain sceptical when observing the process. For example, they may need to consider asking their company staff to show them a clear view of the entire warehouse before the inventory count starts, which will avoid restricting themselves in choosing to test items that are only visible during the videocall. It is also very important that the process followed is well documented. Some practical examples noted by ACCA's Audit and Assurance global forum members included:

- Participation of more than one member of the audit team during observation through video-conferencing equipment to enhance the observation capabilities and mitigate the risk
- Selecting more items to test during observation than usual
- Taking screenshots during the observation to enhance the evidence

Some forum members also noted that, for audits with deadlines close to the dates of implementing the lockdown orders, they had some late switch at a late stage from mailed paper-based confirmations to electronic confirmation. Although this started initially as a temporary change for some practitioners, most of them are now seeking to obtain electronic confirmation universally given the current circumstances.

Paragraph 4 of *ISA 501, Audit Evidence - Specific Considerations for Selected Items states that* if inventory is material to the financial statements, the auditor should obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by:

a) Attendance of physical inventory counting, unless impracticable.
b) Perform audit procedures over the entity's final inventory records to determine whether they accurately reflect actual inventory count results.

In cases where the inventory count is scheduled at a date other than the financial statements period end, auditors will need to perform additional audit procedures to obtain evidence regarding the changes in inventory between date of the inventory count and the financial statements date.

If physical inventory counting is impracticable

The current Covid-19 restrictions affect both auditor and the organisations that they audit, and in some cases, it may not be possible to conduct inventory counts at the period end. In such cases, auditors will need to discuss with their clients whether an inventory count at a later date is planned and determine the feasibility of physical auditor attendance or virtual as noted above. Further, auditors will need to perform audit procedures to assess the validity of the recorded changes between the count date and the date the financial statements. The changes between the two dates will mainly depend on the industry that the entity operates in. In cases where businesses have paused their operations, the changes may not be significant and so, should not cause much problem for auditors to perform their audit procedures, although that could still impact the valuation of inventory. However, where trade has been possible, the changes between period end and count dates may be significant and this may be exacerbated if the duration between dates is long.

Paragraph A13 of ISA 501, guides that where attendance is impracticable alternative audit procedures may include the inspection of documentation of the subsequent sale of specific inventory items acquired or purchased prior to the physical inventory counting, and this may provide sufficient appropriate audit evidence about the existence and condition of inventory.

Where it is not possible to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by performing alternative audit procedures, auditors will need to consider the implications to their audit opinion, following *ISA 705 (Revised), Modifications to the Opinion in the Independent Auditor's Report*, as noted later in this paper.

Auditing Accounting Estimates

ISA 540 (Revised), Auditing Accounting Estimates and Related Disclosures, requires auditors to obtain sufficient appropriate audit evidence on accounting estimates and the reasonableness of their disclosure, in accordance with the applicable financial reporting framework.

The uncertainty in light of Covid-19 creates challenges for management, and auditors are reminded that they should remain sceptical when assessing management's judgements. As noted in the IAASB'S Staff Audit Practice Alert [6]some examples of the areas with greater focus are, whether assumptions are appropriate in the circumstances and in the context of the applicable financial reporting framework, whether data being used by the entity is relevant and reliable etc.

Some areas of concern noted by ACCA's Global Forum Members included:

- Impairment of assets
- Expected credit losses
- Accounting for lease modifications
- Revenue recognition given collection concerns
- Return provisions for merchandise sales
- Onerous contracts
- Accounting for government assistance
- Actuarial estimates for business insurance and for investment performance,
- Held-for-sale assets 12-month assessments
- Recoverability of deferred tax assets
- Weighted average cost of capital and volatility inputs

[6] https://www.ifac.org/system/files/uploads/IAASB/Staff%20Alert%20-%20Audit%20Considerations%20Arising%20from%20Changes%20Due%20to%20Coronavirus.pdf

In the case of expected credit losses (ECL), preparers follow *IFRS 9, Financial Instruments*, framework (or equivalent national accounting standards) in determining the amount of ECL. The IASB's recent publication on IFRS 9 and Covid-19[7], requires entities to develop estimates based on the best available information about past events, current conditions and forecasts of economic conditions. In assessing forecast conditions, consideration should be given both to the effects of Covid-19 and the significant government support measures being undertaken. However, due to the uncertainty caused by Covid-19, if ECL estimates are based on reasonable and supportable information, IFRS 9 and the associated disclosures can provide much needed transparency to users of financial statements.

Covid-19 has resulted in many entities renegotiating or planning to renegotiate rent payments, which may trigger the application of the lease modification guidance of *IFRS 16, Leases.* The IASB has issued a timely Exposure Draft on Covid-19-Related Rent Concessions[8] in April 2020, it has the aim of clarifying if and how the accounting treatment of lease modifications applies, also providing simplification of the accounting treatment during this unprecedented time. The exposure draft proposes to exempt lessees from having to consider whether Covid-19 related rent concessions are lease modifications and allow them to be account for these changes as if they were not lease modifications.[9]

Auditing accounting estimates is inherently risky due to both the complexity and judgments involved. Auditors must remain alert for any increase in risks of material misstatements due to any further impact on complexity in estimations such as in the case of ECL in light of Covid-19. It also of vital importance that auditors remain current with the various updates issued by both auditing and accounting standard setters, recognising that some of the updates may be temporary.

Subsequent Events

Paragraph 4 of ISA 560 requires auditors:

- To obtain sufficient appropriate audit evidence about whether events occurring between the date of the financial statements and the date of the auditor's report necessitates adjustment of, or disclosure in, the financial statements; and
- To respond appropriately to information available post the date of the auditor's report that relates to issues known to the auditor at the time of the audit report, especially if it may have caused the auditor to amend the auditor's report.

The Covid-19 outbreak was treated as a non-adjusting post balance sheet event by most entities with December 2019 year-ends. ACCA's article on the impact of Covid-19 on corporate reporting[10] states there is more doubt about whether for January or February reporting dates the consequences of the COVID19 are adjusting or non-adjusting events. The outcome will depend upon the particular circumstances impacting the entity, and when the major impacts occurred in different parts of the world. For reporting dates of March and later then they generally will be adjusting.

[7] https://cdn.ifrs.org/-/media/feature/supporting-implementation/ifrs-9/ifrs-9-ecl-and-coronavirus.pdf?la=en
[8] https://cdn.ifrs.org/-/media/project/ifrs-16-covid-19/ed-covid-19-related-rent-concessions.pdf?la=en
[9] https://www.ifrs.org/news-and-events/2020/04/amendment-to-leases-standard-to-help-companies-with-covid-19-related-rent-concessions/
[10] https://www.accaglobal.com/hk/en/cam/coronavirus/corpreporting-covid19.html

In countries where audits of financial statements with year-ends in 2019 are still happening, auditors will need to obtain sufficient appropriate audit evidence regarding the disclosures made by management in accordance with the applicable financial reporting framework assuming that COVID-19 was treated as a non-adjusting post balance sheet event. In the case of audits of financial statements with year-ends in 2020, auditors will need to obtain sufficient appropriate audit evidence regarding the necessary adjustments made by management in accordance with the applicable financial reporting framework.

Going Concern

ISA 570 (Revised), Going Concern, paragraph 7 requires auditors:

(a) To obtain sufficient appropriate audit evidence regarding, and conclude on, the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements;

(b) To conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern; and

(c) To report in accordance with this ISA.

Going concern is probably the most challenging area for both management and auditors because of the uncertainty caused by Covid-19. It is management's responsibility to assess whether the going concern basis for accounting is appropriate, and for auditors to obtain sufficient appropriate audit evidence and conclude on the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements.

'However, this does not necessarily mean that a material uncertainty automatically exists – the increased risk of significant doubt on an entity's ability to continue as a going concern will rather depend on the nature and circumstances of the entity, including the industry in which it operates.'[11]

Paragraph 18 of ISA 570 (Revised) states that based on the audit evidence obtained, the auditor should conclude whether, in the auditor's judgment, a material uncertainty exists related to events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern. A material uncertainty exists when the magnitude of its potential impact and likelihood of occurrence is such that, in the auditor's judgment, appropriate disclosure of the nature and implications of the uncertainty is necessary for:

(a) In the case of a fair presentation financial reporting framework, the fair presentation of the financial statements, or
(b) In the case of a compliance framework, the financial statements not to be misleading.

COVID-19 creates significant uncertainty for the future of many businesses. . In the UK as noted by the FRC's Covid-19 Bulletin March 2020 publication[12], it is expected that given the current uncertainty and volatility that more companies and auditors may need to consider reporting on

[11] https://www.ifac.org/system/files/publications/files/IAASB-Staff-Alert-Going-Concern-April-2020.pdf
[12] https://www.frc.org.uk/about-the-frc/covid-19/covid-19-bulletin-march-2020

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material uncertainties. The FRC also stresses the importance that auditors report on the available facts and circumstances and not generically report on material uncertainties.

Some considerations for both companies and their auditors include:

- The company's liquidity over the duration of Covid-19 and after
- Any breach of financing terms
- Deferral of financing repayments and
- The use of available government subsidies and other support
- The impact of Covid-19 in the overall operations of the company

Additionally, the IAASB's Staff Audit Practice Alert on Going Concern in the Current Evolving Environment – Audit Considerations for the impact of COVID-19[13], noted the following examples of events and conditions that may exist as result of Covid-19:

- Loss of major market, key customer(s), revenue, labour shortages
- Significant deterioration in value of assets used to generate cash flows
- Significant deterioration in the value of current assets – inventory
- Delay in the launch of new products or services
- Foreign exchange fluctuations
- Measurements affected by increased uncertainty
- Counterparty credit risk
- The entity's solvency

Furthermore, auditors need to take into consideration the impact of support packages, such as grants and loans, offered by governments when evaluating management's assessment of going concern of an entity. Depending on the circumstances, the following are some considerations for auditors:

- For how long the entity is likely to receive the support
- The extent of reliance on support
- The government transition plan for support packages and that impact on business
- Whether the entity has revised business plans

Auditors are also reminded that if based on their judgement, management's use of going concern basis of accounting in the preparation of the financial statements is inappropriate, they should consider the implications on the auditor's report and/or the audit opinion.

Modifications to the Opinion in the Independent Auditor's Report

The uncertainty caused by Covid-19 and particularly the challenges that auditors are currently facing in obtaining sufficient appropriate audit evidence, could result in modifications to the auditor's opinion. As per ISA 705 (Revised), *Modifications to the Opinion on the Independent Auditor's Report*, there are three types of modified opinions:

- A qualified opinion

[13] https://www.ifac.org/system/files/publications/files/IAASB-Staff-Alert-Going-Concern-April-2020.pdf

- An adverse opinion
- A disclaimer of opinion

As per paragraph 2 of ISA 705 (Revised) the decision regarding which type of modified opinion is appropriate depends upon:

a) The nature of the matter giving rise to the modification, that is, whether the financial statements are materially misstated or, in the case of an inability to obtain sufficient appropriate audit evidence, may be materially misstated; and
b) The auditor's judgment about the pervasiveness of the effects or possible effects of the matter on the financial statements.

Qualified Opinion

Paragraph 7 of ISA 705 (Revised) states that the auditor should express a qualified opinion when:

(a) The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or
(b) The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.

Adverse Opinion

As per paragraph 8 of ISA 570 (Revised), the auditor should express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.

Disclaimer of Opinion

As per paragraph 9 of ISA 570 (Revised), the auditor should disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive.

If for example, auditors are not able to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory due to the current restrictions imposed by Covid-19, then depending on the materiality and pervasiveness of this to the financial statements as a whole, auditors will need to decide which modification in the their opinion is more appropriate.

The Malaysian Institute of Accountants has issued a publication entitled Covid-19: Frequently Asked Questions on Auditing[14], which also refers to the impact on the auditor's report pertaining to the inability to obtain sufficient appropriate audit evidence, referring to similar points noted above.

In the UK, the FRC has issued guidance regarding modifications of Independent Auditor's Opinions and Reports[15] in the current environment, useful for all practitioners.

[14] https://www.mia.org.my/v2/downloads/circulars/2020/29/Covid-19_FAQs_on_Auditing.pdf
[15] https://www.frc.org.uk/getattachment/a45470bb-c331-4653-b256-4d0e7c82227d/Modifications-to-Auditors-Reports-As-a-Result-of-COVID-19-April-2020.pdf

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Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report

As per ISA 706 (Revised), Emphasis of Matter Paragraph and Other Matter Paragraphs in the Independent Auditor's Report, the auditor may consider it necessary to include additional communication in the auditor's report to:

(a) Draw users' attention to a matter or matters presented or disclosed in the financial statements that are of such importance that they are fundamental to users' understanding of the financial statements; or
(b) Draw users' attention to any matter or matters other than those presented or disclosed in the financial statements that are relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.

The uncertainty caused by Covid-19 is likely to cause many auditors having to include an emphasis of matter or other matter paragraph in their report highlighting on the uncertainty caused by Covid-19. We note that in respect of communications in the auditor's report regarding going concern auditors should refer to ISA 570 (Revised) which establishes the requirements and guidance.

It is, of course, important that auditors consider carefully whether it is necessary to include an emphasis of or other matter paragraph, based on the individual circumstances of the entity - use of an EoM or other matter paragraph should not be seen as automatic.