

COVID-19: Management and audit considerations



This article aims to:

Summarise key financial reporting and audit considerations for management and auditors amid COVID-19.



Introduction

As the impact of the novel coronavirus (COVID-19) continues to unfold, it has created significant financial reporting and auditing challenges for the management, those charged with governance and auditors of companies. An increase in uncertainty caused by the pandemic has affected various inputs to the financial reporting process such as future projections including cash flow projections, reliable estimates and related provisioning, recoverability and valuation of assets and many more. These may also pose significant auditing challenges, for instance, limited access to information or people, testing of internal controls due to change in mode of operations, etc. which can affect obtaining sufficient and appropriate audit evidence necessary to form an opinion on the assertions and judgements used to prepare financial statements.

Therefore, it becomes imperative for companies and auditors to engage in a continuous dialogue to ensure seamless impact assessment for financial reporting purposes and transparency in the audit process.

In this article, we aim to discuss some of the key considerations for management and auditors during these unprecedented times.

Preparation of financial statements

Management responsibility

Management is responsible for the preparation of financial statements in accordance with the applicable financial reporting framework. With the pandemic, users of financial statements would be keen to get an insight into how management has assessed the impact on a company's operations, performance and cash flows in medium and long-term along with measures taken to address them. This would require significant judgement and estimation corroborated with adequate disclosures. These disclosures should aim to address the impact of the pandemic such as liquidity concerns, government measures adopted, going concern assessment, steps taken to ensure smooth operations and other identified risks.

Auditor's responsibility

COVID-19 has resulted in significant challenges for auditors in obtaining sufficient appropriate audit evidence. For example, travel restrictions may have impacted physical access (e.g. attending inventory counts), the ability to obtain original documents (e.g. inspection of records for evidence of authorisation as a test of controls) and availability of client staff. This would require consideration of alternative procedures and accordingly, assessment of the sources and reliability of evidences obtained through such alternative procedures.

Accounting estimates

Given the continuous change in the economic landscape, accounting estimates is an area that is going to be certainly challenging and would require significantly more judgement. Management can take following points into consideration:

- **Relevant factors:** Management would need to consider relevant factors while making such estimates, such as adherence to the requirements of accounting standards, judgements to be based on company's specific facts and circumstances, use of consistent approach across financial reporting process and proper documentation for future reference.
- **Adequate disclosures:** Adequate disclosures about the nature of key assumptions, and the sources of estimation uncertainty, sensitivity of the carrying amount to changes in those assumptions and range of reasonably possible measurement outcomes, as well as the key assumptions used to determine that range should be provided.
- **Quality of data:** Use of historical information would be less relevant for making estimates, therefore, management may need to have processes and controls in place to continuously monitor the availability and quality of the data they need.



Estimates would also be a key area of focus for the audit. Auditors may need to consider whether management has assessed the continued use of previous methods, assumptions and data and if not, whether the methods, assumptions and data used remain appropriate. Relevant controls over management's process for making estimates would be evaluated for design and implementation test. There is likely to be an increase in estimation uncertainty, complexity and subjectivity on account of COVID-19 requiring significant auditor judgement. Additionally, auditor also need to assess the potential indicators of management bias. This may cause the auditor to perform robust audit procedures.

Going concern

Management is responsible for the assessment of an entity's ability to continue as a going concern and any necessary disclosures required by the applicable financial reporting framework. Given the economic uncertainty created by COVID-19 coupled with significant business disruptions, there is likely to be an increase in events and circumstances which may cast significant doubt on a company's ability to continue as a going concern. Management can take following points into consideration:

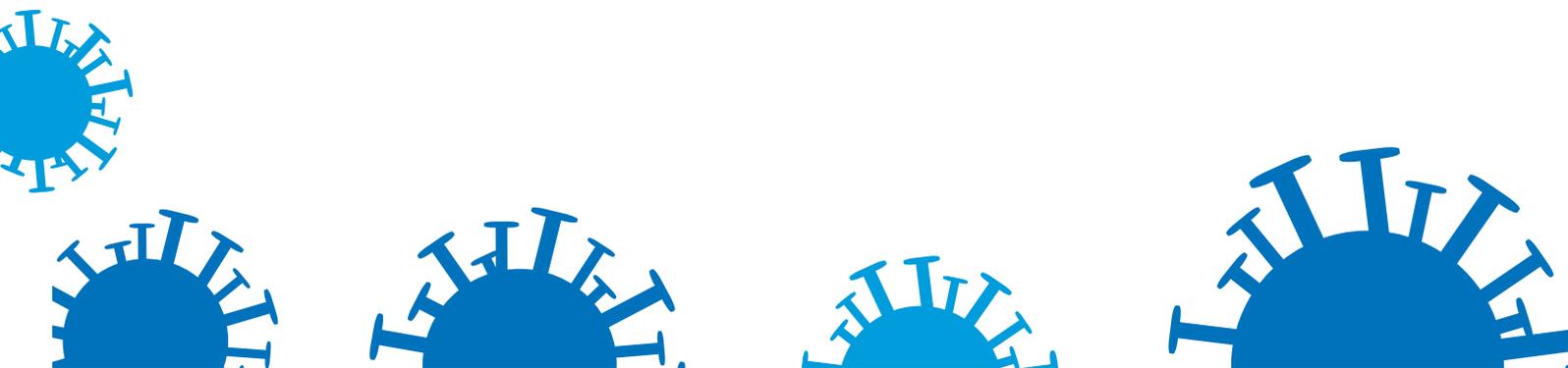
- **Assess current events and conditions:** Management would need to assess what impact the current events and conditions have on an entity's operations and forecasted cash flows, with a focus on whether the entity will have sufficient liquidity to continue to meet its obligations as they fall due. Also, they would need to consider the existing and anticipated effects of the COVID-19 on the assumptions, in particular significant assumptions that are sensitive or susceptible to change or are inconsistent with historical trends.

- **Measure taken in response to COVID-19:**

Matters specific to COVID-19 would require careful assessment such as impact of measures taken by government, general considerations including restructuring of the entity/group (actual or planned) and its business, inability to honour certain terms of contracts leading to penalties by regulators/ counterparties and suitability of invocation of force majeure clauses and operational and funding considerations such as risk relating to receivables.

Auditors are also expected to perform additional audit procedures to evaluate management's assessment around going concern. These would at a minimum involve, evaluation of reliability of cash flow forecast prepared by the management considering change in economic environment, management's plan for future actions and assessing its feasibility in the circumstances. The pace at which events are occurring during current times, maintaining regular and effective communication by auditors with those charged with governance is likely to be more important.

Additionally, auditors might need to critically analyse the 'other information' (forming part of the annual report) which could highlight matters relating to an entity's going concern viability or strategy and compare the same with the information presented in the financial statements. The analysis would enable them to identify whether there is a material inconsistency between the other information and the financial statements or if there is material inconsistency between the other information and auditor's knowledge obtained in the audit, in the context of audit evidence obtained and conclusions reached in the audit, with possible implications on the auditor's report.



Subsequent events

Determination of impact of any subsequent event related to the COVID-19 pandemic on the financial statements would involve significant 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. Some of the examples of events and conditions that may be affected by, or exist due to COVID-19 and can facilitate identification of subsequent events can include:

- New commitments, borrowings or guarantees
- Invocation of force majeure clause by any party, e.g., supplier or customer
- Relief or economic stimulus payments provided by the government in the form of loans or grants
- Any developments regarding contingencies
- Indications of impairment
- Tax considerations such as recoverability of deferred tax assets.

On the other hand, auditors would need to 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 and appropriately reflected in the financial statements. Significant management judgements owing to uncertainties created by COVID-19 would entail an auditor to exercise professional skepticism in undertaking work on subsequent events.

Exercise of professional judgement and professional skepticism

The assumptions and judgements used by the management in preparation of financial statements, particularly relating to going concern, accounting estimates such as impairment, fair value, etc. would require an auditor to exercise professional judgement and professional skepticism. Documentation of the professional judgement and the exercise of professional skepticism as well discussions with management and those charged with governance would facilitate the auditor's conclusions and reinforce the quality of the opinion on financial statements.

In case the auditor is not able to obtain sufficient appropriate audit evidence necessary for the auditor to form an opinion, it may need to consider the impact on the auditor's report, including whether a modified opinion is needed.

Auditor reporting

COVID-19 is likely to result in increase in modifications to the auditor's opinion on account of material misstatement of the financial statements including inadequate disclosures in financial statements for the impact of pandemic or inability to obtain sufficient appropriate audit evidence.

Auditors may also intend to highlight COVID-19 related disclosures through Emphasis of Matter (EOM) paragraphs, for instance, significant developments owing to COVID-19 or separate disclosures to highlight material uncertainty relating to going concern. In case of listed companies, there could be an impact on Key Audit Matters (KAM) relating to COVID-19 including more areas of the audit that will likely require significant auditor attention or the nature of KAMs previously reported may change.

(Source: Summary of COVID-19 audit considerations, webpage - International Federation of Accountants)

