**COVID-19: Assessing the impact and audit implications**

*Auditors need to assess the impact of COVID-19 for their audit clients. Below are some of the areas where auditors should evidence consideration of the potential implications and areas where the issues raised by the pandemic will impact on the audit approach. A separate checklist which could be used as a supplement to your Mercia audit methodology has also been included. This should be filed at B32 risk assessment.*

None of us will have experienced anything quite like the COVID-19 pandemic, so it will come as no surprise that there are significant implications for the audit process that will need to be considered. Although it may be starting to now feel that life is slowly getting back to normal, considerable uncertainty continues to exist, with the possibility of further waves of the virus taking hold and lockdown measures returning, whether on a local or national scale. Overseas the situation varies, with many countries still seeing the number of cases rising.

Below some of the key implications for auditors to consider and there is a separate COVID-19 Impact Assessment form and checklist that can be used to evidence consideration of relevant COVID-19 related risk factors and their impact on the audit approach.

**ISA 315 (UNDERSTANDING THE ENTITY AND ITS ENVIRONMENT) AND ISA 330 (RESPONSES TO ASSESSED RISKS)**

Auditors need to identify and assess relevant COVID-19 related implications to the extent that they have the potential to materially affect the operations of the entity being audited or its financial statements.

The sector in which a business operates will often have implications for the level of risk, opportunity or uncertainty brought about by the pandemic. Some sectors, such as tourism and hospitality, have been particularly badly hit, as has the charity sector with the dual impact of reduced voluntary income and increased demand for services. Whilst most entities will have been adversely hit by the pandemic, some will have prospered in recent months. This though can bring different challenges to the audit.

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| **COVID-19 RISK FACTOR EXAMPLES** |
| **General trade** |
| * Impact of the closure on operations necessary to comply with lockdown measures on trading performance
* Changes in the demand for the entity’s products and services
* Ability of supply chains to continue to be able to function effectively
* Pressure on working capital and availability of finance
* Exposure to areas significantly affected by the COVID-19 outbreak
* Restructuring plans and the costs of implementation
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| **Policy and regulation** |
| * Availability of grants and other forms of government support
* Imposed operating restrictions
* Business stimulus strategy
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| **Macro-economic** |
| * Inflation rates
* Increased unemployment
* Taxation
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| **Financial reporting** |
| * Increased estimation uncertainty
* Impairment provisions
* Events after the end of the reporting period
* Going concern
* Narrative reporting implications
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These, and other relevant factors specific to the entity being audited, should be considered and recorded on the audit file. Documentation in this area will be critical to demonstrate your understanding of client-specific issues as well as at a macro-level to ensure the audit reflects risks brought into play by the pandemic. This can be done in the format laid out in the attached COVID-19 Impact Assessment & Risk Analysis. Once relevant factors are documented, their impact needs to be considered and the auditor’s approach tailored as necessary.

Within the Mercia Audit Methodology, relevant risks and the impact on the audit work are transferred to B32, the current year risk assessment, and reflected on relevant individual area audit plans (B33) and work programmes.

Some of the issues raised by the pandemic will have a more lasting impact on the entity and the way it carries out its operations to adapt to the ‘new normal’. If so this would be recorded on the understanding the entity and its environment permanent file documentation (eg. PF1-1/2).

**ISA 570 (GOING CONCERN)**

For many entities the pandemic will have increased the uncertainty over their future viability and their ability to survive the inevitable economic downturn caused by the outbreak. This comes at a time when the procedures auditors are required to perform have been strengthened with the recent release of a revised version of ISA(UK) 570, which applies for accounting periods commencing on or after 15 December 2019. Whilst early adoption is not always recommended when a standard is revised, in this case it is recommended that teams at least look at its enhanced requirements to ensure that going concern is given thorough consideration at this time of heightened uncertainty.

It remains management’s responsibility to perform the going concern assessment. Auditors will need to ensure that this assessment has been properly undertaken, considering whether all COVID-19 related risk factors and their impact on the individual entity have been taken into account in order to appraise its going concern status and the presence of any material uncertainties. There is no standard approach that will apply across the board, with those entities that were already struggling before the pandemic took hold, such as those close to borrowing limits or covenant limits, requiring closer attention.

Where going concern is highlighted as a risk this will be reflected in the nature, scope and timing of procedures performed. Some firms are starting with a rebuttal presumption of material uncertainty to ensure a robust appraisal is evidenced.

Appropriate sensitivity analysis of various scenarios may to be required which would normally be evidenced on separate documentation that supplements conclusions drawn on going concern forms (eg. A42) completed as part of the engagement. That documentation should provide clear evidence of professional scepticism being exercised by the auditor, with appropriate challenge of the judgements and assumptions made by management in forming their assessment of going concern.

With the passage of time things may become clearer, but auditors may need to consider multiple outcomes to ensure that all potential scenarios are considered. Changes between the balance sheet date and the date of approval of the accounts (and then to the date of the audit report) will need to be factored in.

Particular attention should be paid to the disclosure included in the financial statements on going concern. ‘Boilerplate’ text should be avoided, instead disclosure should be specific to the entity concerned and the areas of uncertainty it faces. Even when it is concluded that no material uncertainties exist in respect of going concern, consideration should be given as to whether disclosure should still be included to explain to the users of the financial statements how management has arrived at that conclusion.

Often though the implicit levels of uncertainty may also hold implications for the auditor’s report, with material uncertainty leading to significant doubt over the ability of the entity to continue as a going concern normally leading to one of three situations from a reporting perspective:

* **Unmodified opinion but with a material uncertainty going concern paragraph:** a material uncertainty exists and is adequately disclosed in the financial statements
* **Qualified opinion:** a material uncertainty exists but there is inadequate disclosure in the financial statements concerning that material uncertainty, but this is not considered to be pervasive in relation to the financial statements as a whole
* **Adverse opinion:** there is disagreement that the going concern basis of accounting is appropriate for the preparation of the financial statements, or a material uncertainty exists but is not disclosed in the financial statements, such that the auditor is of the opinion that the accounts do not present a true and fair view.

**ISA 500 AND ISA 501 (AUDIT EVIDENCE)**

Auditors will need to be adaptive to the restrictions in place to combat the pandemic and be creative in the way that they obtain the audit evidence they require. The pandemic should not be used as an excuse for lowering audit quality, quite the opposite. Auditors need to be more certain than ever that they have sufficient appropriate audit evidence that enables them to form their conclusions on the assertion risks being tested.

In many cases the use of technology may provide the answer when auditors are unable to visit client premises to perform the procedures they would normally perform on site, such as inspection of stock or fixed assets.

Although it may not provide quite the level of assurance as attendance in person might, auditors are getting used to attending stock takes virtually to gain the evidence they need on the existence of stock.

In many cases it should be possible for clients to provide access to accounting records remotely, as has probably already been the case for their own finance team working from home. Auditors need to be aware though that such an approach may require more careful planning with their client to agree on the approach to be taken and documentation to be provided, and procedures may take longer to perform.

Inevitably there will be circumstances when auditors are simply unable to obtain all of the evidence they require, and may be faced with a limitation of scope with possible implications for the audit report.

**ISA 540 (ACCOUNTING ESTIMATES)**

The implications of COVID-19 may mean recognising or remeasuring certain items in the balance sheet. Affected items are likely to include estimates and/or fair values with auditors needing to consider questions such as:

* **Will fixed assets need to be appraised for impairment?** For many entities the economic conditions caused by the pandemic will be an indicator of potential impairment that could affect the valuation of property, plant and equipment, intangible assets such as goodwill and investments.
* **Are fair values affected?** This includes defined benefit pension actuarial assumptions, derivative financial instruments, share option values and the value of investment property portfolios.
* **Are loss provisions required as part of contract accounting?**
* **Are assets recognised on the balance sheet recoverable?** This will include appraisal of amounts owed by other group entities and deferred tax asset recoverability.
* **Is there adequate recognition of any provisions required?** This will include recognition of onerous lease contracts and the restructuring of the business.

For accounting estimates that give rise to significant risks, the auditor is required to evaluate how management has considered alternative assumptions or outcomes (of which there may be many), and why it has rejected them, or how management has otherwise addressed measurement uncertainty in making the accounting estimate.

Where assets are re-measured by the client then the use of sensitivity analysis will be key in relation to the audit work performed. As with going concern auditors will need to ensure that the documentation of the procedures performed demonstrate that professional scepticism has been exercised.

The financial reporting framework is likely to require disclosure of key areas of estimation uncertainty, and the audit procedures performed will need to consider whether adequate disclosure has been included of the specific areas of uncertainty faced by the client in determining the accounting estimates recognised in the financial statements.

**ISA 560 (SUBSEQUENT EVENTS)**

Many auditors will still be working on accounts with reporting periods ending before the pandemic took hold, especially given the extended filing deadlines that have been announced giving companies and LLPs a temporary 3 month extension to the period they have to lodge their accounts at Companies House.

It is widely accepted that for December 2019 year ends that the impact of the pandemic will be treated as a non-adjusting post balance sheet event, and depending on the specific circumstances of the entity it is possible that this extends to January and February 2020 year ends too. The exception to this rule is going concern, as a conclusion that the entity is no longer considered to be a going concern will always be treated as an adjusting event due to its pervasiveness.

Auditors should remind clients to ensure that they incorporate a comprehensive post balance sheet events review up to the date of signing the accounts. This will include how the pandemic has impacted on the entity’s operations and its financial performance and position, and possibly also how it has benefited from any government support. The disclosure should include an indication of monetary effect, but this will not always be possible depending upon the sophistication of the entity’s accounting system. The auditor will need to ensure that the necessary disclosures required by the financial reporting framework are included in the accounts. This would normally be evidenced on separate documentation that supplements conclusions drawn on subsequent events forms (eg. A41) completed as part of the engagement.