Perspective

This is one of a series of articles where experts in assurance, reporting and regulatory matters discuss recent technical and policy developments in these areas

Auditing in a crisis – some issues to consider

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COVID-19 has created an extraordinary disruption to business as usual. However, even though lockdowns and/or other restrictions are in place some work must go on. This can include completing financial statements and the auditing of these. So, what are some of the issues for auditors in all of this?

This article looks at some of the challenges COVID-19 presents to auditors and how they can deal with these.

Firstly, let us just acknowledge that this is an unprecedented crisis. At its heart is a very serious health issue and we must all take appropriate responsibility and do everything we can to help get this under control with the minimal loss of life.

Secondly, for almost every organisation this is a situation we have never seen before. It will also affect different organisations very differently. Some may not survive, and this is very sad. For all, they will be facing considerably increased levels of uncertainty. This makes preparing a set of financial statements and the auditing of these much harder.

So, what are some key issues and impacts for auditors and things for them to consider?

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1. Auditing standards remain the same

There are no exemptions for unusual circumstances such as pandemics. Auditors still need to comply fully with required standards and perform high quality audits. If audit procedures are unable to be performed satisfactorily then auditors must consider the impact of this on their resulting audit report.

A frustrating but highly likely outcome of this pandemic will be an increase in modified audit opinions due to auditors not being able to obtain the evidence they require. Auditors should communicate with those charged with governance as and when this outcome is anticipated.

2. Planning and risk assessment impacts

Many aspects of audit planning will be impacted by possible effects of COVID-19. Risk assessments by auditors will need to consider the effect of COVID-19 on the audited entity's business. Some inherent risks that were considered non-significant in the previous period might become significant for the current period's audit. This could include areas such as impairments, estimates and fair value measurements.

Auditors need to engage with the entities they audit early in the process to ensure they set clear expectations as to the level of disclosure they expect to see from management in financial reports to communicate the impact and risk of COVID-19 on the business.

There are also likely to be new matters to audit as a result of the pandemic. Examples include:

- wage subsidies
- other forms of Government financial relief
- changes to employee terms, reduced or additional hours etc
- insurance proceeds
- rent relief, or other negotiated contractual delays or changes to contract terms
- banking covenant or other funding waivers
- increased and/or decreased cost of entity operations due to supply chain disruption
- increased bad debts and contingent liabilities.

3. Fraud and error

Sadly, auditors need to have a heightened awareness of the possibility of fraud or error, including fraudulent financial reporting.

There may be strong motivations for some clients to present their financial situation in the most favourable light borne out of desperation to ensure entity survival.

In addition, fraud experience tells us that fraudsters often capitalise on changes in regular controls as well as periods of volatility in order to mask their fraudulent activity.

As such all auditors will need a heightened sense of professional scepticism in performing their work.

4. Gathering sufficient appropriate audit evidence upon which to base their audit opinion

This phrase is at the heart of an auditor's work.

Given the COVID-19 induced restrictions on travel, physical contact, meetings and access to business sites, auditors will most likely need to conduct the audit remotely and consider developing alternative audit procedures to gather sufficient, appropriate audit evidence.

Thankfully advances in technology in recent years has made many alternatives viable to traditional physical contact. Useful examples and related issues include:

- Remote enquiry and viewing access to clients' computer systems.
- Planning and other audit meetings, such as fraud discussions, that are normally done face to face will need to be carried out by conference call or video-meeting.
- Both preliminary and substantive analytics are likely to be more difficult because the historical numbers may bear little relation to those for the current year. Variances will therefore need to be investigated carefully and greater judgment required in determining whether changes in management's assumptions compared to the prior period are reasonable. For substantive analytics, explanations will need to be supportable and variances will need to be within the thresholds determined. An analytic which simply explains every movement with "variance is due to the impact of COVID-19" is unlikely to be acceptable as audit evidence.
- When testing controls auditors often need to obtain original documents to evidence the performance of a control. This may be particularly challenging because, even though copies of documentation may be provided to the audit team via scanning and email, the auditor may find it difficult to evidence the operating effectiveness of the control. In this situation, alternative controls which are easier to evidence may need to be tested or the audit team may need to consider performing additional substantive procedures.
- Stocktakes are an obvious area of concern should the client be unable to perform their own inventory count or auditors be unable to attend due to government restrictions put in place. There are sometimes alternative procedures that can be adopted depending upon the nature of the client's inventory system and movement recording procedures in place. However, the reality in many situations is that even with considerable additional audit procedures being performed that it may still not be possible to gain sufficient appropriate audit evidence. In such cases a modification to the audit opinion may need to be considered.
- The use of external confirmations that are still sent by post may be very challenging since one or both recipient and the auditor may not be at their office. Accordingly, auditors should look to the use of email as an efficient alternative.

However, in using any alternative forms of audit evidence gathering auditors will need to consider data privacy and security issues even more carefully. This is to ensure that data is transmitted and stored securely, and can be relied upon as valid.

5. Auditing estimates and assumptions

Many estimates will be more challenging to audit, as the level of estimation uncertainty may have increased significantly. Furthermore, past history may no longer be a useful guide in determining the estimate. For example, entities which have previously had low levels of bad debts may now have to consider increasing their level of expected credit losses. Similarly, previous trading results may no longer be a reliable guide when conducting impairment assessments.

The increased level of uncertainty means that the adequate disclosure of assumptions used will assume increased importance within financial statements. As such disclosures are likely to be an area requiring additional auditor focus.

Where the areas requiring significant auditor attention differ to the previous year, this will likely change the 'Key Audit Matters' that are communicated in the auditor's report for certain entities.

6. Timeframes and delays

Auditors live in a world of being up against tight timeframes where they are often the last in the financial reporting supply chain.

Given the fast-changing situation and the significance of the COVID-19 impacts on the business and the wider economy there will also be a need for the auditor to reassess key aspects of their audit. This may require management to provide further evidence.

The impact of the additional risks and challenges presented by COVID-19 on entities will sadly involve more audit effort and take more time. This could be considerable.

Entities also need to understand that it is vital auditors have sufficient time and support to carry out their work to a high standard, including reassessing work done to reflect changed circumstances. In some cases, entities may need to reconsider their reporting deadlines where this is possible.

On this matter, it is heartening to see various regulators already providing some filing timeframe relief.

7. Subsequent events

More judgment will be required here.

To some extent this will depend on whether the full effects of COVID-19 were apparent at the entity's period end and therefore whether it is considered an adjusting event or not. If it is an adjusting event the effects will be reflected in adjustments to the valuation of assets, the estimation of liabilities and the assessment of going concern. Other additional information such as key management assumptions are likely to need to be disclosed and then considered by auditors.

If reporting deadlines are extended this also lengthens the period of time the auditor has to look at for subsequent events, which means more audit procedures.

8. Going concern assumption

Arguably the most important and fundamental assumption in any set of financial statements. If the going concern assumption is no longer valid, or is doubtful, then it potentially calls into question the stated valuations of many of the entity's assets and usually results in additional liabilities needing to be recognised. This can radically change the entity's financial position.

Going concern assessments should be made by management at the date of signature of the financial statements. Therefore, audited entities will have to re-perform their assessment at this time using the best and latest available data that they have. For auditors this means:

- Auditors should re-perform their risk assessment procedures and going concern may need to be re-assessed as a significant risk where it was not previously identified as such. The level of uncertainty around any forecasts will have increased greatly. This will require detailed audit consideration and there are likely to be many more circumstances where it will be necessary to include a 'Material Uncertainty Related to Going Concern' paragraph within the audit report. However, the prerequisite for this is that adequate disclosure about the material uncertainty is made in the financial statements. Frustratingly these disclosures are prescribed by the auditing standards (ASA/ISA (NZ) 570, Par. 19) as opposed to the accounting standards.
- Auditors should pay particular attention to the effect of reduced cashflows on debt covenants and whether clients may need to approach lenders for adjustments or waivers.
- For entities in significantly affected industries, auditors may have to consider whether both they and management have any ability to reliably forecast at all. There may be circumstances where the use of the going concern basis of accounting is inappropriate. In such cases, where a liquidation basis is not used, a disclaimer of opinion in respect of the going concern assumption becomes appropriate.

- Auditors should also encourage directors to carefully consider any responsibilities in respect of insolvent trading in accordance with local laws and regulations, bearing in mind the relief offered by governments in regard to these responsibilities.

9. Some key COVID-19 resources

There are many COVID-19 resources and guides being developed as the situation evolves. Here are a few key resources available now.

- CA ANZ COVID-19 Resource Hub
- CA ANZ Q&A on responding to COVID-19 reporting and audit challenges (this will be updated regularly)
- AASB-AUASB Joint FAQ The Impact of Coronavirus on Financial Reporting and the Auditor's Considerations
- NZ XRB Information in response to COVID-19
- AUASB additional COVID-19 FAQs for auditors

Good luck auditors. Challenging times but you do a very important role!