

# COVID-19: ASSESSING THE IMPACT AND AUDIT IMPLICATIONS

Auditors need to assess the impact of COVID-19 for their audit clients. In this download, we look at 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. We have also included a checklist which could be used as a supplement to your audit methodology.

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.

We set out below some of the key implications for auditors to consider and have included a complimentary 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.

Mercia Audit Manual references are included within the guidance below to help subscribers link their consideration of COVID-19 to documentation on their audit files.

## ISA 315 AND ISA 330 (UNDERSTANDING, RISK AND RESPONSE)

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.

### COVID-19 RISK FACTOR EXAMPLES

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#### 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

#### Policy and regulation

- Availability of grants and other forms of government support
- Imposed operating restrictions
- Business stimulus strategy

#### Macro-economic

- Inflation rates
- Increased unemployment
- Taxation

#### 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 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.



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# COVID-19 IMPACT ASSESSMENT & RISK ANALYSIS

**Objective:** To assess the impact of COVID-19 on the entity and summarise resultant conditions and events that may indicate risks of material misstatement in the financial statements.

## COVID-19 impact assessment

Identify COVID-19 related risk factors and assess the impact.

Risk Factors	Impact

**Conclusion:** Based on the above, the impact of COVID-19 on the entity has been assessed as [low / medium / high]\*.

A full COVID-19 risk analysis [has / has not]\* been completed (B32- COVID/2-7).

An appropriate response to these areas is set out on B32 / B33 / X2.

**Prepared by:** \_\_\_\_\_

**Date:** \_\_\_\_\_

**Reviewed by:** \_\_\_\_\_

**Date:** \_\_\_\_\_

\*Delete as applicable.

## COVID-19 IMPACT ASSESSMENT & RISK ANALYSIS

### COVID-19 risk analysis

Consider the impact in the following areas. A yes answer will normally indicate a possibility of increased risk. Use the comments column to explain if this is not the case. Ensure relevant matters are discussed with the team and consider the impact when assessing (B32) overall risk and also when specifying the risks at the assertion level and setting out the ensuing approach on the relevant section of B33/X2.

This risk analysis may not be required on all engagements and is designed as an aide memoir of common factors that give rise to action being needed within the audit approach and signposts relevant documentation on the audit file.

	Y/N/ n/a	Comments / Other factors
<p><b>Accepting appointment or reappointment</b></p> <p>For initial audit engagements, have we been unable to obtain sufficient appropriate evidence on opening balances and comparative figures due to an inability to obtain access to the predecessor auditor's working papers?</p> <p>Has rotation of the RI due to their long association been suspended in order to maintain audit quality and support for the client at a challenging time?</p> <ul style="list-style-type: none"> <li>Where yes, ensure additional safeguards are considered and implemented and communicated as appropriate (B13).</li> </ul> <p>Are there excessive overdue fees due to financial challenges faced by the client?</p> <ul style="list-style-type: none"> <li>Where yes and it is not considered appropriate to resign from the engagement, ensure the Ethics Partner is notified and any appropriate safeguards are implemented (B13).</li> </ul> <p>Have any additional non-audit services been provided as a consequence of the COVID-19 pandemic (eg. grant applications, accounting support)?</p> <ul style="list-style-type: none"> <li>Where yes, ensure compliance with Ethical Standard requirements and where no prohibition, safeguards are implemented and communicated as appropriate (B13).</li> </ul>		
<p><b>Entity and environment, systems and controls</b></p> <p>Has our understanding of the financial implications of the pandemic on the client (eg. changes in the market and demand for the client's products and services, macro-economic factors, availability of additional finance etc) indicated a significant deterioration in the entity's financial performance or position (PF1)?</p> <p>Is the client exposed to areas where the consequences of the pandemic have been severe (eg. location of production facility, key suppliers or customers) (PF1)?</p>		



	Y/N/ n/a	Comments / Other factors
<p><b>Entity and environment, systems and controls (...continued)</b></p> <p>Has the client failed to implement an appropriate response to the challenges caused by the pandemic (eg. restructuring plans) (PF1)?</p> <p>Is the client's accounting system unable to provide management with an accurate picture on a timely basis of the entity's financial performance and position, limiting effective decision making (PF1)?</p> <p>Has management failed to reassess its corporate objectives in response to the pandemic (PF1)?</p> <p>Are client staff showing signs of excessive stress due to the pressure of working under the current conditions (PF3)?</p> <p>Has the pandemic made the client more susceptible to fraudulent activity (PF3)?</p> <p>Have enquiries of management indicated changes of systems and internal controls in response to the pandemic that require understanding and assessment (PF2)?</p> <p>Has consideration of accounting systems and internal controls (PF2) identified that resultant changes have given rise to deficiencies in internal control (A52)?</p>		
<p><b>Materiality and misstatements</b></p> <p>Do we need to reassess the basis by which materiality is calculated (eg. selection of benchmark) due to a change in the areas of the financial statements that are of greatest importance to the users of the financial statements (B41)?</p> <p>Do we need to reassess the basis on which performance materiality is calculated due to the impact of the pandemic on our risk assessment (B41)?</p> <p>Have we identified any specific areas in the financial statements that are likely to face additional scrutiny due to issues raised by the pandemic, such that a lower level of materiality may be required for that area (B41)?</p>		
<p><b>Financial reporting issues, including accounting estimates and fair values</b></p> <p>Does the client need to develop accounting policies to recognise grant income or other forms of government support (PF1)?</p> <p>Does the changing economic environment caused by the pandemic indicate that the client's assets may be impaired (PF1-8)?</p>		

	Y/N/ n/a	Comments / Other factors
<p><b>Financial reporting issues, including accounting estimates and fair values (..continued)</b></p> <p>Is management's determination of any key accounting estimates or fair values recognised in the financial statements likely to be significantly affected by the pandemic? Where yes, consider:</p> <ul style="list-style-type: none"> <li>• Management experience or track record in affected areas (PF1-8);</li> <li>• Understanding of FRF requirements and valuation methods / models used (PF1-8);</li> <li>• Availability and reliability of data used in determining the accounting estimate (PF1-8);</li> <li>• Level of estimation uncertainty (PF1-8);</li> <li>• Possible management bias (PF1-8);</li> <li>• Use of management or auditor's experts, including the possibility of any limitation in the scope of their work (PF1-7);</li> <li>• Availability and reliability of supporting evidence, the need for direct confirmations (eg. requests for derivatives and commodity trading information) and impact on approach (B32 / B33/ X2);</li> <li>• The approach to associated financial statements disclosures.</li> </ul> <p>For reporting periods ending before the COVID-19 pandemic took hold, are there material non-adjusting events that will require disclosure in the financial statements (PF1)?</p> <p>Does the client have narrative reporting obligations that will need to reflect the pandemic's impact on the entity's financial performance and position or the key risks it faces?</p>		
<p><b>Availability of evidence</b></p> <p>Will social distancing measures prevent access to the client's property? Where yes, consider:</p> <ul style="list-style-type: none"> <li>• Alternative procedures that can be implemented to confirm the existence of the client's assets (eg. stocktake attendance, physical verification of tangible fixed assets);</li> <li>• Alternative means by which the client will be able to provide access to the entity's accounting records.</li> </ul> <p>Does the client need to be informed of the need for additional audit evidence to provided related to issues caused by the pandemic (eg. impairment assessments, restructuring provisions, going concern assessment)?</p>		

	Y/N/ n/a	Comments / Other factors
<p>Does the client utilise any service organisations?</p> <ul style="list-style-type: none"> <li>Where yes, consider how the services provided may have been impacted by the pandemic.</li> </ul> <p>Is the pandemic likely to have had an impact on the reliability and comparability of data from which expectations are developed, and hence the effectiveness of substantive analytical review?</p> <ul style="list-style-type: none"> <li>Where yes, consider whether additional, alternative procedures are necessary.</li> </ul>		
<p><b>Going concern</b></p> <p>Is the impact of the pandemic so severe that the going concern basis of accounting may not be appropriate (B31)?</p> <p>Has the pandemic already resulted in cash flow difficulties for the client (B31)?</p> <p>Does the pandemic indicate any material uncertainties that impact upon management's assessment of going concern (B31)? Consider:</p> <ul style="list-style-type: none"> <li>Loan covenants;</li> <li>Availability of finance, including government support;</li> <li>Operating restrictions;</li> <li>Future trading performance;</li> <li>Presentation and disclosure implications.</li> </ul> <p>Does forecast information used to support the going concern basis fail to recognise the uncertainty caused by the pandemic (A42)?</p>		
<p><b>Groups</b></p> <p>Is this the audit of group accounts? Where yes, consider:</p> <ul style="list-style-type: none"> <li>Whether components are subject to additional risk factors as a result of the pandemic due to their location, operations etc (B32 / B33/ X2);</li> <li>Whether there are indicators that the carrying value of goodwill, investments or intra-group debt may be impaired;</li> <li>Whether travel restrictions and the location of components make it impossible or impractical to visit;</li> <li>The impact on evaluation of component auditors and their work, including the process for gaining access to their working papers (B32 / B33/ X2).</li> </ul>		



	Y/N/ n/a	Comments / Other factors
<p><b>General</b></p> <p>Do the challenges caused by the pandemic and the procedures to be performed have implications for the audit timetable? Where yes, consider:</p> <ul style="list-style-type: none"> <li>Managing client expectations for the completion of the audit;</li> <li>Budget implications (B61).</li> </ul>		

**Conclusion:** Conditions and events that may indicate risks of material misstatement in the financial statements resulting from the COVID-19 pandemic have been:

- discussed with the team (B23);
- considered when assessing risk of material misstatement at the financial statement level (B32); and
- considered when specifying the risks at the assertion level and setting out the ensuing approach on the relevant section of B33/X2 and tailored work programmes.

**Prepared by:** \_\_\_\_\_

**Date:** \_\_\_\_\_

**Reviewed by:** \_\_\_\_\_

**Date:** \_\_\_\_\_