



FINANCIAL REPORTING COUNCIL

COVID 19 GUIDANCE – To Auditors Pursuant to Section 73 of the Financial Reporting Act

On 11 March 2020, the World Health Organisation declared the Coronavirus COVID-19 outbreak to be a pandemic in recognition of its rapid spread across the globe.

The COVID 19 crisis has significant economic effects on companies due to restrictions in production, trade and consumption. These have an impact on both **financial reporting** and **auditing**. The impact on companies will differ. Companies and their auditors, have to consider how it affects their business and review them regularly.

Financial Reporting

Companies must consider the unique circumstances and risk exposures when analyzing how recent events may affect their financial reporting. Specifically, financial reporting and related financial statement disclosures need to convey all material effects of COVID-19.

The ultimate recognition of accounting impacts will vary depending on each entity's specific facts and circumstances. The following accounting areas may be more likely to be affected as a result of the COVID-19 outbreak:

- Material judgements and uncertainties
- Impairment of non-financial assets
- Valuation of inventories
- Allowance for expected credit losses
- Fair value measurements
- Onerous contract provisions
- Restructuring plan
- Breach of covenants
- Going concern
- Liquidity risk management
- Events after the end of the reporting period

We would need to distinguish between reporting year ends prior to 11 March 2020 and those after 11 March 2020. Taking a year end of December 2019 for example, it is likely that the Covid-19 would be a **non-adjusting event** given that this condition did not exist at 31 December 2019. The accounting implication would be that financial statements at 31 December 2019 **would not be adjusted**. **However**, *"if the impact from the outbreak and the subsequent measures is material, the entities should **disclose** such events"*. And this **disclosure** should be clear/understandable/unambiguous and should be company specific.

Auditing

Whilst auditors have to comply fully with required standards, FRC wishes to emphasise certain challenges that auditors are facing due to the unprecedented scale of the COVID 19 outbreak, which could have an adverse effect on audit quality.

FRC highlights the following guidance on areas that auditors should be considering when carrying out audit engagements in the current circumstances.

Acceptance and take-on of new audit engagements

Restrictions over travel and office-based working may make it impossible for an incoming auditor to carry out their review of the previous auditors working papers.

Incoming auditors should consider and seek to agree what work can be undertaken remotely, supported by technology to make an assessment. This might include access to the audit file remotely, subject to appropriate confidentiality considerations. This assessment should flag areas where confirmation of certain matters is contingent on being physically present at a later stage and ensure that these outstanding matters are completed before the conclusion of the audit.

Planned Audit Approach

For audits which are underway relating to periods that end on or 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.

Additionally, the planned audit approach may anticipate obtaining audit evidence about internal controls operating around the year end, which the auditor may not be able to obtain due to a lack of audit staff or a lack of access to information or personnel at the audited entity. In such circumstances the auditor will need to consider whether alternative work is necessary, and what alternative audit procedures they can carry out, to obtain sufficient, appropriate audit evidence in support of their audit opinion.

At a time when entities are under increased pressure, and internal controls may not be operating as planned, the auditor should also consider whether their assessment of risks of material misstatement due to fraud or irregularity needs to be heightened as a result, and additional audit procedures need to be carried out.

Materiality

The impact of Covid-19 on an audited entity may result in non-standard amounts or disclosures being recorded in the financial statements. The auditor may want to consider how to take account of this when setting materiality.

The auditor may also need to consider whether a separate materiality level or levels should be determined and applied to the particular related classes of transactions, account balances or disclosures in accordance with paragraph 10 of ISA 320.

Communication with Those Charged with Governance

Physical meetings of audit committees may now be impossible - auditors will need to agree with audit committees how to communicate with them through other means, and how to ensure that sufficient time is set aside by audit committees for comprehensive, complete and informed communication with the auditor. This will need to take account of the potential for extended communication to explain any modified audit reports, or to report any higher than expected deficiencies or misstatements, that may result from the current circumstances.

Where the auditor intends to modify their opinion, they should engage with TCWG, to explain whether the nature of the modification may be ameliorated by allowing the auditor additional time to undertake their work, and obtain the evidence required. TCWG will need to consider the balance between the timing of reporting and the assurance the auditor is able to provide.

Audit Evidence, including Audit Confirmations

The auditor must seek to obtain sufficient, appropriate audit evidence to support their auditor's report. However, restrictions on travel, movement and visiting client sites may mean this cannot be carried out as planned or cannot be carried out within management's planned timetable for issuance of the audited financial statements.

*Auditors will need to think about whether there are other ways for them to obtain sufficient, appropriate audit evidence. This might include employing greater use of technology to examine evidence, **but only where the auditor has assessed both the sufficiency and appropriateness** of the audit evidence produced. The basis for this assessment should be clearly documented on the file. That assessment should recognise and explain how the auditor addresses any risk that the quality and reliability of such evidence may be lower, for instance through more directed testing of items evaluated in this way. This needs to be carried out on a case by case basis and will be dependent on the applicable facts and circumstances.*

Some items will still require the testing and verification of original source documentation, or the verification of physical assets and inventories. The auditor may consider which items are absolutely vital to test physically, and where evidence can be obtained through other means. Verification through other means is more likely to be appropriate where balances are less material. A small number of items which need to be physically verified may still be manageable on a case by case basis.

The auditor will also need to consider the time criticality of certain procedures (for instance stock-takes at the year-end). In these circumstances, it may be that local restrictions in place

mean that work cannot be carried out as planned, and the deferral of necessary procedures may impact on the quality and veracity of the evidence generated. Where physical verification is required, and time critical, and where physical verification procedures cannot be performed, the auditor will need to consider the implications for their opinion.

The provision of independent confirmations as a source of audit evidence may also be impacted. Where this is the case the auditor may consider whether available online access to secure systems can be used to obtain the necessary evidence rather than waiting for the provision of a documentary copy.

The auditor may also need to consider whether additional time is needed to perform identified procedures to seek to obtain sufficient appropriate audit evidence and, if so, whether such time will be available to the auditor. Management may be able to extend their planned timetable, for example when the planned issuance date is sooner than that required by law or regulation or the rules of a market on which the entity's securities are listed. Where this is the case, the auditor will need to request management to do so. If management refuses to do so, the auditor will need to consider whether such refusal constitutes a limitation on the scope of the audit imposed by management. If so, the auditor will need to communicate with the audit committee and take other appropriate actions to comply with the requirements of paragraphs 11 to 14 of ISA 705 (Revised June 2016).

Compliance with Laws and Regulations

Auditors are reminded in the current circumstances that when auditing a Public Interest Entity, they are required to report promptly to the regulator any information concerning that public interest entity of which the auditor has become aware while carrying out the audit and which may bring about any of the following:

- i. A material breach of the laws, regulations or administrative provisions which lay down, where appropriate, the conditions governing authorisation or which specifically govern pursuit of the activities of such public interest entity; or*
- ii. A material threat or doubt concerning the continuous functioning of the public interest entity; or*
- iii. A refusal to issue an audit opinion on the financial statements or the issuing of an adverse or qualified opinion.*

Going Concern

The going concern assessment made by management is a fundamental part of the audit that may be significantly affected by the current circumstances. The revised ISA 570- Going Concern is effective for periods commencing on or after 15 December 2019. It requires a more structured and rigorous auditor risk assessment, greater work effort and expanded reporting. When performing an audit for which the revised standard is not yet effective, auditors may

consider using some or all of the requirements in the revised standard to help them to carry out their risk assessment and to undertake their work in this area to the necessary high standard. The requirements over going concern reporting in paragraphs 19-22 of the standard may be particularly helpful.

We expect, given the current uncertainty and volatility, that more companies and auditors may need to consider reporting on material uncertainties. Where they do so, this should draw on the available facts and circumstances. Auditors should not generically report on material uncertainties.

Governments globally have announced the availability of business support packages for affected entities, which to date have focused on providing liquidity to affected entities, with some measures to also cover business costs (e.g. salary costs) in certain circumstances. Many entities have also imposed measures to control costs and conserve available cash.

In this highly uncertain environment, going concern assessments will be more difficult for entities to make, and more companies will need to report a material uncertainty related to going concern. Companies and auditors should explain to investors the effect on their business of the current public health restrictions in different countries, sensitivities in different short-term scenarios, for example the length and nature of public health restrictions that are in place or may evolve during the period of assessment.

It will be important in making any assessment of going concern to ensure that companies and their auditors evaluate whether the entity both has access to sufficient liquidity and can remain solvent through the period of public health restrictions and beyond. Companies and their auditors will need to take into account the terms of their financing facilities, the terms of any liquidity or other support accessed and whether any such support taken on gives rise to future obligations. Deferral of payments now, or the receipt of grants to offset costs may alleviate liquidity challenges but may affect the entity's solvency if the liquidity support does not continue long enough for the entity to recoup those losses from future profits.

Liquidity and solvency risks faced by the entity may be inter-related and either or both may affect its going concern status and whether it faces material uncertainties related to going concern. Auditors will need to ensure that their assessment of going concern and the evidence that they need to gather in support of that explicitly considers both liquidity and solvency factors which may affect the ability of the directors to assert that the entity is a going concern and to identify and related material uncertainties.

We anticipate in the current circumstances that the auditor's going concern work will be more extensive, require more evidence, and will continue to be performed through to the point of signing the auditor's report. In view of this, more evidence may be required from the entity and the auditor should set a clear expectation with the audited entity of the additional time that will be needed to complete the audit in this area to the high standard that users of the financial statements will expect

In addition, auditors should exercise professional scepticism where management and TCWG have determined that the current circumstances are not reasonably expected to have any

material financial impact on the audited entity and that no material uncertainties related to going concern exist for the entity.

Group Audits

In a group audit engagement, the potential impact of Covid-19 may affect the audit in two main areas.

The first is that the auditor may be unable to obtain sufficient, appropriate audit evidence to support their opinion. This may be because components operate in areas where restrictions apply, for instance, over travel or over access to information. Where this is the case, the group auditor considers what alternative procedures they can carry out to obtain the necessary evidence. This may be by carrying out additional procedures at the group level to gain assurance, including through greater use of remote working where this is possible, or through deploying staff who are able to operate in affected jurisdictions to provide the group auditor with the necessary evidence.

A further challenge may arise where the group auditor is unable to carry out their review of component auditor working papers as planned. We are aware that many firms believe the most effective review is one that they can carry out in person. However, with current travel restrictions in many jurisdictions, and restrictions over accessing information remotely in others, firms will have to determine whether they can find other ways to review component work, including through remote access, in a manner that is effective. There is no reason why a thoroughly executed and clearly documented electronic and video review of component auditors' work cannot satisfy the requirement in the standard.

If the work cannot be reviewed, then it cannot provide sufficient appropriate audit evidence, and the group auditor will have to determine whether they can obtain the necessary evidence by carrying out additional procedures at the group level. Where this is not possible, the auditor will need to consider the impact on their report. As noted above, the auditor may also need to consider whether the performance of procedures they consider necessary to seek to obtain sufficient appropriate audit evidence would require deferral of the planned issuance date of the audited financial statements and, if so, the implications for the audit.

Access to Information

Auditors of Public Interest Entities are reminded of the need to notify the FRC where they are unable to access information from a component auditor.

Quality Control

Auditors will need to comply with all of the requirements in respect of quality control in ISQC 1 and ISA 220. However, in the current circumstances, some meetings, discussions and access

to files will be virtual and facilitated through technology. Given this, the auditor will need to document clearly on the file how the direction, supervision and review process was structured and operated to overcome obstacles, and how communication with team members and in particular: key audit partners; engagement quality control reviewers; and any firm technical reviewers was maintained.

Reporting – Key Audit Matters (when ISA 701 applies)

Where the impact of Covid-19 is, in the auditor’s professional judgment one of the most significant matters having an impact on the audit of the financial statements, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team, then the auditor considers reporting this as a key audit matter.

In reporting a key audit matter, the auditor does not use boilerplate language, but reports in a way that informs users of the auditor’s report and the financial statements in a way that will support effective decision making by those users. That will require careful case-by-case consideration of the applicable facts and circumstances. Reporting might also provide context for users about the circumstances in which the audit has been carried out, and the impact of those circumstances on the way the auditor has concluded on significant judgments.

A key audit matter paragraph can also be used to satisfy the requirements in ISA 706, where the auditor might consider an emphasis of matter paragraph.

Reporting – Scoping

Auditors might consider it helpful to also include more information in the scoping paragraph of their auditor’s report reference to the particular circumstances in which the audit was carried out and the impact that this had on the overall audit approach. This might provide further context useful to users. Again, this should not use boilerplate text and should reflect the facts and circumstances on a case-by-case basis.

Reporting – Modified Opinions

It may be likely that the current circumstances lead to more modified opinions in auditor’s reports, than would typically be the case.

Scope Limitation

Where an auditor cannot obtain sufficient appropriate audit evidence, then the auditor is required to modify their opinion in that respect. Where the possible impact on the financial statements could be both material and pervasive, then the auditor is required to disclaim their opinion or if it is material but not pervasive, to express a qualified opinion.

Misstatements

When an auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements are material, the auditor is also required to modify their opinion in that respect. When the effect of such misstatements is both material and pervasive, the auditor is required to express an adverse opinion.

Auditors should remain alert to the possibility that, in the current circumstances, misstatements may occur. Such misstatements may arise, for example, due to: the application of the going concern basis of accounting when it is not appropriate; the omission of disclosures about a material uncertainty relating to going concern; or a failure to recognise adequate impairment of assets or adequate provisions for obligations or to provide related disclosures.

Communication with TCWG

The auditor engages with TCWG to explain the implications of their proposed report and consider whether there are other procedures that could be undertaken, at a future point yet to be determined which could mitigate any modification either fully or in part. This guidance recognises that auditors may be innovative in determining how they plan and perform their audit, and how they ensure that they have sufficient, appropriate audit evidence. However, equally we recognise that there may be occasions where the auditor cannot overcome the limitations in the evidence available to support their audit and recognises that further delay would not change this.

Subsequent Events

The timing of the Covid-19 outbreak was not, for most entities with December 2019 year ends, an adjusting post balance sheet event. However, this may not be the case for entities with year ends from January 2020 onwards.

Given the potential magnitude of these events, auditors will need to carefully consider what evidence they will require in support of the disclosure of such events and any adjustments made as a result.

Written Representations

Written representations will be obtained by auditors to help confirm positions reported by management. Whilst this is a helpful supplement to the available information, written representations will never, alone, constitute sufficient appropriate audit evidence.

Professional Scepticism

Auditors are always required to carry out their work exercising appropriate professional scepticism. In the current circumstances, auditors will need to consider how they demonstrate

and record an appropriate level of scepticism to reflect that engagements may be delivered in a different way. Auditors need to ensure that they appropriately challenge judgments and assumptions made by management.

This guidance is intended to help auditors deal with the current COVID 19 situation and will be withdrawn when circumstances return to normal.

01 April 2020