

Audit Implications of Covid-19

by Colm Divilly

At the time of writing of this article (April 2020), Covid-19 continues to spread rapidly around the world. While the full implications of the Covid-19 pandemic for the Irish economy and Irish business is still becoming clear, it is certain that the impact will be negative and long lasting. The work of auditors will be impacted in the months and years ahead as companies account for the fallout from the economic impact of the Covid-19 pandemic.

Due to the timing of the pandemic, the initial impact on the work of the auditor will be in respect of audits of financial statements for financial periods ending on or before the 31 December 2019. In this article, I highlight a number of areas that the auditor will need to consider in the coming months when reporting on financial statements for periods ending on or before the 31 December 2019.

Audit planning

It is likely that auditors will have completed much of their audit planning work for audits of financial statements for financial periods ending on or before the 31 December 2019 before the full impact of the Covid-19 pandemic becomes clear. "International Standard on Auditing 300 Planning an Audit of Financial Statements" states that *"the auditor shall update and change the overall audit strategy and the audit plan as necessary during the course of the audit"*.

Because of the unprecedented nature of the Covid-19 pandemic and the economic implications of same for businesses, the auditor will need to revisit their audit plans and consider what modifications are required in the audit plan to ensure that the audit strategy applied during the audit assignment is adequate.

In revisiting the audit plan, the auditor may wish to pay particular attention to the following areas:

- Accounting for events after the balance sheet date and adequacy of the planned audit work in this area.

- The adequacy of the planned audit work in relation to the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements.
- Possible impact of social distancing and business lockdown measures on the ability of the Auditor to execute the planned audit procedures.
- The possible impact of the Covid-19 pandemic on access by the auditor to audit evidence and implications of any restrictions identified for the audit report.
- Feasibility of planned audit timetable having regard to the current disruption to business.
- The possible impact on the audit assignment of having audit staff working remotely on the assignment.

Events after the end of the reporting period

FRS 102 defines events after the reporting period as **"Events after the end of the reporting period are those events, favourable and unfavourable, that occur between the end of the reporting period and the date when the financial statements are authorised for issue. There are two types of events:**

- a. those that provide evidence of conditions that existed at the end of the reporting period (adjusting events after the end of the reporting period); and**
- b. those that are indicative of conditions that arose after the**

end of the reporting period (non-adjusting events after the end of the reporting period).

Events after the end of the reporting period include all events up to the date when the financial statements are authorised for issue, even if those events occur after the public announcement of profit or loss or other selected financial information."

The impact of the Covid-19 pandemic for financial statements for the periods ending on or before 31 December 2019 will generally be a non-adjusting post balance sheet event. While Covid-19 did exist in China in December 2019, the implications of the disease and the nature of the spread of the disease did not become clear until the first quarter of 2020. Financial statements for periods ending on or before 31st December 2019 should reflect conditions that existed at 31 December 2019.

FRS 102 states that **"An entity shall disclose the following for each category of non-adjusting event after the end of the reporting period:**

- a. the nature of the event; and**
- b. an estimate of its financial effect or a statement that such an estimate cannot be made".**

The declaration by the World Health Organisation of the Covid-19 pandemic in March 2020 and the grave implications of the Covid-19 pandemic for the world economy, must warrant disclosure as a non-adjusting post balance sheet event in company financial statements for



the year ended 31 December 2019. The disclosure should be company specific and attempt to set out the possible implications for the company of the Covid-19 pandemic.

Going concern

The Covid-19 pandemic will result in significant uncertainty for many companies. In preparing the financial statements for these entities the directors will need to consider the impact of this uncertainty for the company and the adequacy of the disclosure of this uncertainty within the financial statements.

In preparing financial statements in a situation where there is uncertainty about the ability of the company to continue as a going concern, FRS 102 states:

“When preparing financial statements, the management of an entity using this FRS shall assess the entity’s ability to continue as a going concern. An entity is a going concern unless management either intends to liquidate the entity or to cease trading or has no realistic alternative but to do so.

In assessing whether the going concern assumption is appropriate, management takes into account

all available information about the future, which is at least, but is not limited to, twelve months from the date when the financial statements are authorised for issue”.

“When management is aware, in making its assessment, of material uncertainties related to events or conditions that cast significant doubt upon the entity’s ability to continue as a going concern, the entity shall disclose those uncertainties. When an entity does not prepare financial statements on a going concern basis, it shall disclose that fact, together with the basis on which it prepared the financial statements and the reason why the entity is not regarded as a going concern”.

The above two paragraphs address the situation where there is uncertainty about the ability of the company to continue as a going concern. Management must assess the entity’s ability to continue as a going concern in accordance with the above guidance. If this assessment makes management aware of material uncertainty related to events or conditions that cast significant doubt upon the company’s ability to continue as a going concern

(which is likely in many situations because of the Covid-19 pandemic), the financial statements must disclose details of this uncertainty.

In drafting disclosure notes in relation to uncertainty facing the company, the company should disclose:

1. The principal events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern and management’s plans to deal with these events or conditions; and
2. Disclose clearly that there is a material uncertainty related to events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern and, therefore, that it may be unable to realise its assets and discharge its liabilities in the normal course of business.

In relation to company law, you should note that the Companies Act 2014 sets down as a principle that **“The company shall be presumed to be carrying on business as a going concern”**. The Act further states that if it appears to the directors of a company that there are special reasons for departing from any of the accounting principles set down in

the Act (and this includes the going concern principle) in preparing the company's financial statements in any particular year, they may depart from the principle, but particulars of the departure, the reasons for it and its effect on the balance sheet and profit and loss account of the company must be stated in a note to the financial statements.

If adequate disclosure is made in the financial statements in relation to uncertainty pertaining to the application of the going concern basis in the preparation of the financial statements, the auditor will be able to express an unmodified audit opinion but should address this matter in the section of the audit report headed "Conclusions relating to going concern". It is important to note that the standard wording included under the heading "Conclusions relating to going concern" should be replaced with a suitable wording drawing attention to the disclosure note in the financial statements relating to uncertainty pertaining to going concern. International Standard on Auditing 570 (Ireland) provides an example of such a wording.

In a limited number of circumstances, the economic realities arising from the Covid-19 pandemic may result in management changing their assessment of the company's ability to continue as a going concern, to one where they may conclude that the company must cease trading or be liquidated. In such circumstances, the financial statements should be prepared on a non-going concern basis.

It is important that the auditor performs adequate audit procedures to obtain sufficient appropriate audit evidence regarding, and conclude on, the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements.

The requirements of International Standards on Audit 570 (Ireland) Going Concern should be adhered to by the auditor.

As many companies have staff working remotely from home while other staff have been furloughed, it may well be a challenge to obtain the future financial projections and forecasts that would be available to the auditor as part of his going concern audit work. By working cooperatively with the client, it should be possible to overcome this challenge.

Financial statements disclosures

Financial statements disclosures for financial periods commencing on or before 31 December 2019 but approved after the declaration of the Covid-19 pandemic need to address the impact of the Covid-19 pandemic. The following financial statements disclosures are likely to be impacted:

1. As outlined above, FRS 102 requires disclosure of any uncertainties regarding the ability of the company to continue as a going concern. It is likely that for many companies, the Covid-19 pandemic will be a significant uncertainty.
2. FRS 102 requires disclosure of judgements and key sources of estimation uncertainty in the financial statements. The Covid-19 pandemic is likely to impact what is disclosed under this heading in many company financial statements.
3. The pandemic is likely to be a non-adjusting post balance sheet event requiring disclosure in the notes to the financial statements.
4. Companies Act 2014 requires that the directors' report address the following matters:
 - a. The directors report must include a business review and address future business developments. The impact of Covid-19 pandemic for the company will need to be addressed as part of this review.
 - b. The directors' report must address the principal risks the company faces. The impact of Covid-19 pandemic for the company and the economy is likely to feature as a significant risk.

- c. The directors report is required to disclose any events since the balance sheet date. The declaration by the World Health Organisation of the Covid 19 pandemic in March 2020 is a significant post balance sheet event that should be addressed.

Conclusions

This article has focused on the audit of financial statements for financial periods ending on or before 31 December 2019. The impact of the Covid-19 pandemic on financial statements for periods ending after 31 December 2019 are likely to be very significant and far reaching. The impacts are likely to include impairment of many assets classes and call into question the viability of many businesses. In the months ahead the impact on the financial statements of companies of the economic carnage caused by the Covid-19 pandemic will become clearer.

While this article is focused on the audit of financial statements for financial periods ending before the declaration of the pandemic it would be remiss of the author not to highlight the future challenges that auditors will face in auditing these future financial statements. CPA Ireland website has dedicated Covid-19 Information & Resource pages and members should refer to these pages for future guidance on these important matters.



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