

Potential Impact of Covid-19 on Auditor Reporting

by Colm Divilly

The Covid-19 virus has changed our lives in a way that we could not have foreseen six months ago. The auditing profession has not escaped this impact as the spread of the virus creates new challenges for the auditor in carrying out his professional work.

Deciding on the correct audit report when reporting on client financial statements is likely to become more challenging in the months ahead as the impact of the virus on business and the economy becomes more pronounced. In this article, we provide a summary of the various reporting options available to the auditor when reporting on the financial statements of an Irish private limited company reporting under the FRS 102 financial reporting framework.

Modified Audit Reports: The Options

Qualified audit opinion

A qualified audit opinion can arise from two possible scenarios:

1. The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate in the financial statements, are material, but not pervasive, to the financial statements;

or

2. The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.

Adverse audit opinion

An adverse audit opinion would arise where having obtained sufficient appropriate audit evidence, the auditor concludes that misstatements

identified in the financial statements, individually or in the aggregate, are both material and pervasive to the financial statements

Disclaimer of audit opinion

A disclaimer of audit opinion would arise in two possible scenarios:

1. Where the auditor is unable to obtain sufficient appropriate audit evidence on which to base the audit opinion and the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive

or

2. The auditor disclaims an opinion when, in extremely rare circumstances involving multiple uncertainties, the auditor concludes that, notwithstanding having obtained sufficient appropriate audit evidence regarding each of the individual uncertainties, it is not possible to form an opinion on the financial statements due to the potential interaction of the uncertainties and their possible cumulative effect on the financial statements.

Emphasis of matter paragraph

An emphasis of matter paragraph is included in the auditor's report where it refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements.

Material uncertainty relating to ability of company to continue as a going concern

If appropriate disclosure about the material uncertainty relating to going concern is made in the financial statements, the auditor will express an unmodified opinion and the auditor's report will include a separate section under the heading "Material Uncertainty Related to Going Concern". This paragraph will identify for the user of the financial statements the material uncertainty in relation to the ability of the company to continue as a going concern as disclosed in the financial statements.

Other matter paragraph

This is a paragraph included in the auditor's report that refers to a matter other than those presented or disclosed in the financial statements that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.

Practical Application of the Guidance

Having examined the various reporting options available to the auditor, it is helpful to examine some possible scenarios that may arise as a result of the impact of Covid-19 on the economy and business.

Availability of audit evidence

The pandemic may restrict the ability of the auditor in obtaining audit evidence. Possible issues that could arise:

- Inability of auditor to attend stock count or decision of client not to

hold count due to health related concerns for staff.

- Auditor unable to get access to client premises due to lockdown.
- Auditor unable to get replies to debtors' circularisation requests due to lockdown.
- Auditor unable to get replies to standard audit letters of request.

In the above scenarios, the auditor should first examine if alternative audit procedures can be designed to obtain sufficient and appropriate audit evidence. If alternative audit procedures cannot provide sufficient and appropriate audit evidence, the auditor must consider the possible impact on the audit report of the failure to obtain the evidence. If the evidence lacking is not material, the matter should not impact the audit report. In the event that the evidence lacking is material, the auditor will need to reach a conclusion on whether the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive or just material. If both material and pervasive, a disclaimer of opinion would be appropriate. If material but not pervasive, a qualified opinion would be appropriate.

Material uncertainty in relation to going concern

The impact of Covid-19 may well create material uncertainty in relation to the ability of a client company to continue as a going concern. If so, the financial statements should contain adequate disclosure setting out full details of the uncertainty. If the auditor concludes that management's use of the going concern basis of accounting is appropriate in the circumstances but a material uncertainty related to going concern exists, the auditor must determine whether the financial statements:

- Appropriately disclose the principal events or conditions that may cast significant doubt on the company's ability to continue as a going concern and management's plans to deal with these events or

conditions; and

- 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.

If appropriate disclosure about the material uncertainty related to going concern is made in the financial statements, the auditor should express an unmodified opinion and the auditor's report should include a separate section under the heading "Material Uncertainty Related to Going Concern" to:

- Draw attention to the note in the financial statements that discloses the matters in relation to the material uncertainty; and
- State that these events or conditions indicate that a material uncertainty exists that may cast significant doubt on the company's ability to continue as a going concern.

Uncertainty in relation to the ability of the company to continue as a going concern; is the uncertainty material?

In the application of the audit reporting standard, a difficult professional judgment can arise in deciding if uncertainty in relation to the ability of the company to continue as a going concern is material or not. This decision is the key to determining the correct approach to addressing uncertainty in relation to going concern in the audit report. Consideration of the following points may assist the auditor in reaching the judgment on whether the uncertainty is material or not:

- What is the magnitude of potential impact on the client's business of the fallout from Covid-19?
- How likely is it that the impact of Covid-19 will effectively put the client company out of business?
- What is the worst-business case scenario for the company over the

coming twelve months?

- What are the range of likely outcomes and how do these outcomes impact the ability of the company to continue as a going concern?
- What is the likelihood of occurrence of the range of outcomes?
- Do management have a realistic Covid-19 contingency plan to deal with the impact on day-to-day operations?
- Has the company access to sufficient funding now and into the future to deal with a range of possible outcomes?

Covid-19 causing unique and unprecedented issues for the client company, but no material uncertainty identified in relation to the ability of the company to continue to trade.

Where the economic impact of Covid-19 is resulting in unique and unprecedented issues for the client company but there is no material uncertainty in relation to the ability



of the company to continue to trade, it would be appropriate for the company to provide adequate disclosures in relation to these matters in the financial statements. Such a scenario requires the auditor to consider if the inclusion of an emphasis of matter paragraph in the audit report is warranted. If you as Auditor form the opinion that the matters disclosed are of such importance that it is fundamental to users' understanding of the financial statements it would be appropriate to include an emphasis of matter paragraph in the audit report to draw attention to the disclosures.

The client company has decided that due to the impact of Covid-19 on their business, the company will cease to trade as of 30th June 2020. All creditors will be paid in full and an orderly wind down of the company will take place. You are auditing the financial statements for the year ended 31 December 2019. What impact, if any, will this decision have on the

financial statements for the year to 31 December 2019?

FRS 102 states that *"an entity shall not prepare its financial statements on a going concern basis if management determines after the reporting period either that it intends to liquidate the entity or to cease trading, or that it has no realistic alternative but to do so"*.

Therefore, the financial statements for the year to 31 December 2019 should be prepared on a non-going concern basis and the basis of preparation disclosure note within the financial statements should explain the basis of preparation used. The assets and liabilities will be measured using the revised basis of preparation rules and the disclosure notes should clearly explain the financial implication of the change in the basis of preparation. If you as Auditor form the opinion that these matters are of such importance that it is fundamental to users' understanding of the financial statements, it would be appropriate to include an emphasis of matter paragraph in the audit report to draw attention to the disclosures in relation to the change in the basis of preparation.

Importance of full consideration of the implications for a modified audit report

When planning to issue a modified audit opinion, the auditor should identify and consider all implications arising from the issue of such a report. Among the matters to consider are that the issue of such a report may create a third-party reporting obligation for the auditor and may result in a breach of bank covenants by the company. While the consideration of such matters is outside the scope of this article, it is important that due consideration is given to these matters by the auditor and the client.

Conclusion

Your Institute, the Irish Auditing and Accounting Supervisory Authority and the Financial Reporting Council have all provided valuable resources on their websites to assist auditors deal with the impact of Covid-19 on their professional work. Practitioners should become familiar with these resources now to be able to deal with the audit reporting challenges that are likely to arise in the months ahead.



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