Impact of Novel Coronavirus (COVID-19) on Audit of Financial Statements for the Financial Year ending March 31, 2020

Background
The global pandemic COVID-19 has already had a significant impact on global trade and economy with consequential impact on global and Indian financial markets. This may also have accounting, disclosure, internal control and auditing implications for many entities. There is a great deal of uncertainty as to how the COVID-19 situation will continue to evolve and the scenario is rapidly changing. The uncertainty arises primarily from interruptions in production, supply chain disruptions, unavailability of personnel, closure of facilities/offices due to the rapid outbreak of COVID-19, decline in demand, liquidity, business continuity issues, etc. The resultant outbreak though started outside of India impacts entities in India as well.

Given there are increasing restrictions on travel, meetings and access to client locations, auditors would be facing practical difficulties in carrying out audits. These underlying situations, however, must not undermine the delivery of high quality audits. Audits should continue to be planned and performed in compliance with the auditing standards. To enable the auditors to perform audits additional time may be required and alternate audit procedures may need to be performed in order to obtain sufficient appropriate audit evidence.

This document discusses key Advisory to auditors related to conditions that may arise as a result of COVID-19. Auditors must carefully evaluate unique circumstances prevailing in their audits and assess risk accordingly when applying the concepts in this Advisory in their audits.

Principles of Specific Standards on Auditing used in this Advisory

Areas which require special attention of auditors in current scenario are cited below along with reference of relevant Standards on Auditing (SAs):

1. Identifying and Assessing the Risk of Material Misstatements and Materiality in Planning and Performing an Audit (SA 315, Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and its Environment & SA 320, Materiality in Planning and Performing an Audit)


3. Valuation of Inventory on a date other than date of financial statements i.e. 31st March 2020 (SA 501, Audit Evidence - Specific Considerations for Selected Items)

4. Audit of Consolidated Financial Statements where Components/component auditors are located in

Contributed by Auditing and Assurance Board of ICAI
The outbreak of COVID-19 can have a number of potential issues for entities, particularly entities that operate in geographies that are significantly exposed to the outbreak. In addition there could also be impact on those entities whose vendors/bankers/suppliers/service providers are in geographies that are exposed. There is already a broader economic impact of the outbreak on global and Indian financial markets and the outbreak will also pose increasing risks and potentially have accounting implications for all entities with exposure to broader economic downturn and decline in financial markets.

Due to the above conditions, entities and auditors would have to evaluate additional risks arising from the following areas:

- Operational disruption resulting in any changes to the business model arising from significant drop in demand, reduced customer base, disruption in supply chain, employee’s absence or work from home, geographical implications of group operations, public lock down etc.
- Contractual non-compliance resulting in contractual breaches, additional security requirements or stressed asset valuations.
- Liquidity and working capital issues given the reduced/impaired ability to service debt or replenish working capital requirements due to possible lower cash flows.

d. Asset valuations – downward asset valuations may trigger legal and compliance issues or lead to liquidity challenge.

In applying SA 315 - Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment, the auditor should consider the implications of the above matters when obtaining an understanding of the entity and its environment, in light of its objectives, strategies and other business risks.

The auditor should also discuss with TCWG and management whether the impact of the COVID-19 has been incorporated into their risk assessment processes and how they have identified and assessed the significance of the emerging business risks. The auditor should also consider if disclosures are required in the financial statements about the key assumptions made in reaching this conclusion.

If the auditor has revised the risk assessment as a result, audit materiality may also need to be revised as the audit progresses. Reference may be made to SA 320 - Materiality in Planning and Performing an Audit. Paragraphs 12 and 13 of SA 320 are reproduced below:

“Revision as the Audit Progresses

12. The auditor shall revise materiality for the financial statements as a whole.
(and, if applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures) in the event of becoming aware of information during the audit that would have caused the auditor to have determined a different amount (or amounts) initially. (Ref: Para. A13)

13. If the auditor concludes that a lower materiality for the financial statements as a whole (and, if applicable, materiality level or levels for particular classes of transactions, account balances or disclosures) than that initially determined is appropriate, the auditor shall determine whether it is necessary to revise performance materiality, and whether the nature, timing and extent of the further audit procedures remain appropriate.”


The financial statements have various items which would have been affected by the outbreak of COVID-19, a detailed list of them has been mentioned in the Accounting Advisory. In addition to the detailed list of items of financial statements mentioned in the aforesaid Advisory, specific accounting issues could arise in the following areas:


b. Valuation of defined benefit plans and obligations – due to significant changes in employee strength or de-valuation of underlying plan assets.

c. Stock compensation performance conditions and obligations.

d. Contractual penalties.

e. Employment termination benefits.

f. Insurance recoveries related to business interruptions.

g. Onerous contract provisions.

h. Allowance for expected credit losses.

The above items are likely to have significant accounting estimates to be made by the management. Significant assumptions including projected cash flows, used in these accounting estimates may be affected by the impact of COVID-19. Hence, the auditor should use procedures as prescribed by SA 540, Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures to check whether (a) the accounting estimates, including fair value accounting estimates, in the financial statements, whether recognised or disclosed, are reasonable; and (b) related disclosures in the financial statements are adequate.

The above procedures include how management has assessed the effect of estimation uncertainty or the risk assessment and audit evidence supporting these accounting estimates and related disclosures that may be affected by the impact of COVID-19 on the business of the entity and the economic environment.

3. Valuation of Inventory on a date other than date of financial statements i.e. 31st March 2020

Due to government-imposed shutdowns or due to unavailability of the client personnel, it may not be practicable for most of the business entities to conduct physical verification of inventory as on the date of the financial statements i.e. 31st March, 2020. The auditor must plan procedures depending on the underlying circumstances wherein the inventory count date could be advanced prior to the year-end or deferred to a date after the year-end.

The auditor would need to comply with the procedures given in Paragraphs 5 and 7 read with Paragraphs A9 to A14 of SA 501 cited below:

“5. If physical inventory counting is conducted at a date other than the date of the financial statements, the auditor shall, in addition to the procedures required by paragraph 4, perform audit procedures to obtain audit evidence about whether changes in inventory between the count date and the date of the financial statements are properly recorded. (Ref: Para. A9-A11)"
the financial statements. This may be done irrespective of whether management determines inventory quantities by an annual physical inventory counting or maintains a perpetual inventory system. In either case, the effectiveness of the design, implementation and maintenance of controls over changes in inventory determines whether the conduct of physical inventory counting at a date, or dates, other than the date of the financial statements is appropriate for audit purposes. SA 330 establishes requirements and provides guidance on substantive procedures performed at an interim date.

A10. Where a perpetual inventory system is maintained, management may perform physical counts or other tests to ascertain the reliability of inventory quantity information included in the entity’s perpetual inventory records. In some cases, management or the auditor may identify differences between the perpetual inventory records and actual physical inventory quantities on hand; this may indicate that the controls over changes in inventory are not operating effectively.

A11. Relevant matters for consideration when designing audit procedures to obtain audit evidence about whether changes in inventory amounts between the count date, or dates, and the final inventory records are properly recorded include:

- Whether the perpetual inventory records are properly adjusted.
- Reliability of the entity’s perpetual inventory records.
- Reasons for significant differences between the information obtained during the physical count and the perpetual inventory records.

7. If attendance at physical inventory counting is impracticable, the auditor shall perform alternative audit procedures to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory. If it is not possible to do so, the auditor shall modify the opinion in the auditor’s report in accordance with SA 705(Revised). (Ref: Para. A12-A14)

**Attendance at Physical Inventory Counting Is Impracticable (Ref: Para. 7)**

A12. In some cases, attendance at physical inventory counting may be impracticable. This may be due to factors such as the nature and location of the inventory, for example, where inventory is held in a location that may pose threats to the safety of the auditor. The matter of general inconvenience to the auditor, however, is not sufficient to support a decision by the auditor that attendance is impracticable. Further, as explained in SA 200, the matter of difficulty, time, or cost involved is not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative or to be satisfied with audit evidence that is less than persuasive.

A13. In some cases where attendance is impracticable, alternative audit procedures, for example inspection of documentation of the subsequent sale of specific inventory items acquired or purchased prior to the physical inventory counting, may provide sufficient appropriate audit evidence about the existence and condition of inventory.

A14. In other cases, however, it may not be possible to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by performing alternative audit procedures. In such cases, SA 705(Revised) requires the auditor to modify the opinion in the auditor’s
4. Audit of Consolidated Financial Statements where Components/Component auditors are located in severely affected places

As per the Advisory, the following must be followed by the management in preparation of financial statements:

“Entities to whom Ind AS is applicable Ind AS 110 Consolidated Financial Statements Ind AS 110 prescribes that the financial Statements Ind AS 110 prescribes that the financial statements of parent and subsidiaries used in preparation of the consolidated financial statements are usually drawn upto the same date. It may be noted that in any case, difference between the reporting dates should not be more than three months.

Entities to whom Ind AS is not applicable

AS 21 Consolidated Financial Statements (revised 2016)

AS 21 prescribes that the financial statements of parent and subsidiaries used in preparation of the consolidated financial statements are usually drawn upto the same date. It may be noted that in any case, difference between the reporting dates should not be more than six months.”

In either of the above instances, if the financial information/financial statements of the components are unavailable, for the year ended March 31, 2020, the maximum difference between the reporting dates cannot exceed the above limits.

**The Roles and Responsibilities of the Auditor with regards to Consolidated Financial Statements are as follows:**

(a) Paragraph 49 of Guidance Note on Audit of Consolidated Financial Statements, issued by ICAI states as under:

“49. In a case where the parent’s auditor is not the auditor of all the components included in the consolidated financial statements, the auditor of the consolidated financial statements should consider the requirements of SA 600.”

(b) As per SA 600, Using the Work of Another Auditor the principal auditor should perform procedures to obtain sufficient appropriate audit evidence, that the work of the other auditor is adequate for the principal auditor’s purposes, in the context of the specific assignment and also should consider the significant findings of the other auditor. While doing so, the principal auditor should consider how the impact of COVID-19 including travel bans, temporary suspension of business operations, government mandated leaves, etc., may affect risk assessments, materiality and the ability to obtain sufficient appropriate audit evidence in respect of components. If principal auditor is unable to obtain adequate information or reporting from the component auditors, the principal auditor should express a qualified opinion or disclaimer of opinion because there is a limitation on the scope of audit. (Refer Paragraph 30 22 of SA 600)

(c) In the current scenario, the alternative means or methods to obtain sufficient appropriate audit evidence by the principal auditor from component auditor are as follows:

- Can data be shared cross-border, to allow for principal auditor for review? Could files be loaded into a cloud-based portal and a login provided to the principal auditor? Local laws may restrict cross-border data sharing. If in doubt, advice should be sought on any local legal restrictions.

- Can video calls and/or screen sharing software be used to discuss the work with the component auditor?

- Can the component auditor be asked to complete a detailed questionnaire or clearance on the work they have performed?

- Consider the outcome of any prior visits, including visits during planning or at an interim stage

- What work of component auditor was previously reviewed?
• Consider the past work of the component auditor – have there been significant errors or issues, or has work been performed to a high standard?

• Can a more detailed memorandum be provided to the component auditor on what work should be done for purpose of group reporting?

• What work can be done centrally by the Principal auditor’s team?

If finance systems are integrated, data may be accessible for review by Principal Auditor. Management may be able to provide information directly to the Principal auditor to allow for testing.

Each individual engagement will need to be assessed on a case by case basis to determine what may be appropriate.

5. Subsequent Events or Events after Reporting date

As per the Accounting Advisory the following needs to be considered by the management in the preparation of financial statements:

“According to Ind AS 10, events occurring aGer the reporting period are categorised into two viz. (i)Adjusting events i.e. those require adjustments to the amounts recognised in its financial statements for the reporting period and (ii) Non-adjusting events i.e. those do not require adjustments to the amounts recognised in its financial statements for the reporting period. In certain cases, Management judgement may be required to categorise the events into one of the above categories.

Similarly, in accordance with AS 4, Contingencies and Events Occurring AGer Balance Sheet Date, adjustments to assets and liabilities are required to be made for events occurring aGer the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the balance sheet date. However, adjustments to assets and liabilities are not appropriate for events occurring aGer the balance sheet date, if such events do not relate to conditions existing at the balance sheet date. Disclosure should be made in the report of the approving authority of those events occurring aGer the balance sheet date that represent material changes and commitments affecting the financial position of the enterprise.

Entities must disclose significant recognition and measurement uncertainties that might have been created by the outbreak of the COVID -19 in measuring various assets and liabilities. They should also disclose how they have dealt with the impact of COVID -19 on the financial position and financial performance of the entity.”

The Responsibilities of the auditor for the subsequent events i.e. events between the date of financial statements and the date of auditor's report as per SA 560 are as follows:

“Events Occurring Between the Date of the Financial Statements and the Date of the Auditor’s Report

6. The auditor shall perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor’s report that require adjustment of, or disclosure in, the financial statements have been identified. The auditor is not, however, expected to perform additional audit procedures on matters to which previously applied audit procedures have provided satisfactory conclusions. (Ref: Para. A6)

7. The auditor shall perform the procedures required by paragraph 6 so that they cover the period from the date of the financial statements to the date of the auditor’s report, or as near as practicable thereto. The auditor shall take into account the auditor’s risk assessment in determining the nature and extent of such audit procedures, which shall include the following: (Ref: Para. A7-A8)

a) Obtaining an understanding of any procedures management has established to ensure that subsequent events are identified.

b) Inquiring of management and, where appropriate, those charged with governance as to whether any subsequent events have
occurred which might affect the financial statements. (Ref: Para. A9)

c) Reading minutes, if any, of the meetings, of the entity’s owners, management and those charged with governance, that have been held after the date of the financial statements and inquiring about matters discussed at any such meetings for which minutes are not yet available. (Ref: Para. A10)

d) Reading the entity’s latest subsequent interim financial statements, if any. 33

8. When, as a result of the procedures performed as required by paragraphs 6 and 7, the auditor identifies events that require adjustment of, or disclosure in, the financial statements, the auditor shall determine whether each such event is appropriately reflected in those financial statements.”

6. Going Concern

COVID-19 is resulting in significant operational disruption and presents an existential threat for many businesses. Entities and audit teams need to consider the implications on the assessment of going concern and viability in the financial report and whether these circumstances will result in prolonged operational disruption which will significantly erode the financial position of the entity or otherwise result in failure.

This is critically important for the going concern assessment. Auditors will need to consider whether the threat to liquidity as a result of supply/demand disruption presents a material uncertainty to the going concern status for the 12 months look forward period. SA 570(Revised) also requires auditors to consider events that may cast significant doubt on the entity’s ability to continue as a going concern beyond the period of management’s assessment.

Audit teams should robustly assess the going concern and viability risks relating to COVID-19 threat in compliance with SA 570(Revised). This includes evaluating whether there is adequate support for the assumptions underlying management’s assessment and the consistency of these assumptions across the entity’s business activities.

As per paragraph 5 of SA 570(Revised), Going Concern The Management’s assessment of the entity’s ability to continue as a going concern involves making a judgment, at a particular point in time, about inherently uncertain future outcomes of events or conditions. The following 34 factors are relevant to that judgment:

- The degree of uncertainty associated with the outcome of an event or condition increases significantly the further into the future an event or condition or the outcome occurs. For that reason, most financial reporting frameworks that require an explicit management assessment specify the period for which management is required to take into account all available information.

- The size and complexity of the entity, the nature and condition of its business and the degree to which it is affected by external factors affect the judgment regarding the outcome of events or conditions.

- Any judgment about the future is based on information available at the time at which the judgment is made. Subsequent events may result in outcomes that are inconsistent with judgments that were reasonable at the time they were made.

The auditor’s responsibilities relating to going concern are mentioned in Paragraphs 6 & 7 of SA 570(Revised), Going Concern which are cited below:

**“Responsibilities of the Auditor**

6. The auditor’s responsibilities are 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, and to conclude, based on the audit evidence obtained, whether a material uncertainty exists about the entity’s ability to continue as a going concern. These responsibilities exist even if the financial reporting framework used in the preparation of the financial statements does not include an explicit requirement for management to make a specific assessment of the entity’s ability to continue as a going concern.
6. However, as described in SA 200, the potential effects of inherent limitations on the auditor’s ability to detect material misstatements are greater for future events or conditions that may cause an entity to cease to continue as a going concern. The auditor cannot predict such future events or conditions. Accordingly, the absence of any reference to a material uncertainty about the entity’s ability to continue as a going concern in an auditor’s report cannot be viewed as a guarantee as to the entity’s ability to continue as a going concern.”

There could be several situations arising from the ongoing COVID-19 outbreak that could have an impact on the assumption relating to going concern. For some entities, the impact could be severe and may leave management with no realistic alternative but to liquidate or cease operations. There could also be entities which may have to scale down their operations while impact may not be significant for other entities.

It is the responsibility of management to make the assessment as to whether the entity is a going concern. 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. The assessment will be specific to the entity’s circumstances.

In the current scenario, while making this assessment, management would generally be expected to prepare detailed forecasts which, will require regular updation till the financial statements are authorised for issue. These forecasts should capture potential scenarios and management’s plans.

Management should also consider the impact of COVID-19 on customers, suppliers and employees. For example, could the entity continue to operate if employees are not able to physically present, and how reduced cash flows impact its working capital requirements. Management should also consider whether the insurance 36 policies taken by the entity cover the losses arising from the COVID-19.

The auditor will only be able to form a conclusion relating to going concern once management has made its own assessment. The auditor should inquire of management and TCWG as to what information is available about the future, and determine whether this has been appropriately considered as part of management’s assessment. The auditor should apply similar considerations to those of management, as discussed above, in assessing the appropriateness of the going concern assumption. This should, for example, include a detailed and robust review of up to date forecasts, cash flows, sensitivity analyses and reviews of COVID-19 contingency plans and impact assessments conducted by the management.

If events or conditions have been identified that may cast significant doubt on the entity’s ability to continue as a going concern, the auditor shall obtain sufficient appropriate audit evidence to determine whether or not a material uncertainty exists.

Given the level of uncertainty and speed of increasing impact of COVID-19, audit teams need to critically consider the current position at the point of sign off as part of the subsequent events review right up to the point of signing the auditor’s report, and may need further evidence and information by management, including updating financial models.

If the entity is disclosing in their subsequent events disclosures that an estimate of impact cannot be made due to the evolving situation, this may result in a material uncertainty on going concern within the audit report.

7. Evaluation of Work of Management’s Expert

Since, lot of estimation is involved regarding the impact on the financial statements and assessment of going concern in the current circumstances, management may take the assistance of a management’s expert (an expert in field other than accounting and auditing) to make such estimates or assessments.

As per paragraph 8 of SA 500-Audit Evidence, “When information to be used as audit evidence has been prepared using the work of a management’s expert, the auditor shall, to the extent
necessary, having regard to the significance of that expert’s work for the auditor’s purposes. (Ref: Para. A34- A36)

a) Evaluate the competence, capabilities and objectivity of that expert; (Ref: Para. A37-A43)

b) Obtain an understanding of the work of that expert; and (Ref: Para. A44- A47)

c) Evaluate the appropriateness of that expert’s work as audit evidence for the relevant assertion. (Ref: Para. A48)"

8. Written Representations
As per SA 580, the auditor should obtain written representations from the management regarding the various estimates and assessments made by the management. The written representations should be exhaustive, containing the occurrence, method of measurement, completeness of transactions recorded and the disclosure of financial impacts in the financial statements. Auditors need to assess whether any specific representations may be required to be obtained from the Management in relation to Managements’ assessment of impact from the ongoing outbreak of COVID-19 on the financial statements for the year ending March 31, 2020 as well as for the reasonable foreseeable future.

9. Auditor’s Opinion
The overall objectives of an auditor as per SA 200-Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing, are as follows:

a) To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework; and

b) To report on the financial statements, and communicate as required by the SAs, in accordance with the auditor’s findings.

Audit should form an opinion on the financial statements considering the principles enunciated in SA 700(Revised), SA 705(Revised), SA 706 (Revised). Since in the current scenario there are high probabilities of going concern being affected, existence of material uncertainties relating to going concern, the principles enunciated in SA 570(Revised) also need to be considered particularly paragraphs 21 to 24 which prescribe manner of reporting in different situations. The auditor needs to carefully assess the situation applying professional judgement and professional skepticism and report accordingly.

Some illustrative Situations where the Auditor may need to express a modified opinion due to COVID-19 are cited below:

i. The auditor is unable to obtain sufficient appropriate audit evidence relating to material component audited by the other auditor as per SA 600 due to COVID-19 pandemic.

ii. The financial impact arising out of the COVID-19 outbreak are not accounted or reported or disclosed as per the prescribed Accounting Standards, in the financial statements.

iii. If the auditor is unable to obtain sufficient appropriate audit evidence relating to the impact of COVID-19 in the financial statements and is of opinion that there are misstatements that are material to the financial statements.

iv. The auditor has communicated misstatements to the management and those charged with governance relating to COVID-19 as per SA 450, Evaluation of Misstatements Identified During the Audit and the management or TCWG refuses to correct such misstatements, that are individually or in aggregate, material to the financial statements.

10. Reporting on Key Audit Matters
SA 701 – Communicating Key Audit Matters in the Independent Auditor’s Report deals with the auditor’s responsibility to communicate key audit matters in the auditor’s report. Key audit matters are those matters that, in the auditor’s professional judgement, were of most
significance in the audit of the financial statements of the current period. Key audit matters are selected from the matters communicated with those charged with governance.

The auditor would need to comply with the procedures given in Paragraphs 9 (read with Paragraphs A18 to A26) of SA 701 cited below:

“9. The auditor shall determine, from the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit. In making this determination, the auditor shall take into account the following:
(Ref: Para. A9–A18)

a) Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with SA 315. (Ref: Para. A19–A22)

b) Significant auditor judgments relating to areas in the financial statements that involved significant management judgment, including accounting estimates that have been identified as having high estimation uncertainty. (Ref: Para. A23–A24)

c) The effect on the audit of significant events or transactions that occurred during the period. (Ref: Para. A25–A26)"

The auditor should evaluate whether the impact of the disruption caused because of COVID-19 to the operations of the entity, consequential impact on the financial statements would be a key audit matter and if determined so, the auditor would need to report the same along with how the matter was addressed in the audit.

11. The Auditor’s Responsibilities Relating to Other Information (SA 720 (Revised))

This SA requires the auditor to read and consider the other information because other information that is materially inconsistent with the financial statements or the auditor’s knowledge obtained in the audit may indicate that there is a material misstatement of the financial statements or that a material misstatement of the other information exists, either of which may undermine the credibility of the financial statements and the auditor’s report thereon. Such material misstatements may also inappropriately influence the economic decisions of the users for whom the auditor’s report is prepared.

Other information may include amounts or other items that are intended to be the same as, to summarize, or to provide greater detail, about amounts or other items in the financial statements, and other amounts or other items about which the auditor has obtained knowledge in the audit. Other information may also include other matters.

Entities would need to provide additional disclosure as part of the financial statements/annual report w.r.t. the following areas:

a. Risk assessment – Entities may elaborate on existing reported risks w.r.t. calamities or add new ones relating to COVID-19.

b. Management discussion and analysis – Entities may include management’s discussion and analysis of any material current and potential future impact on their operations, financial condition and liquidity arising out of the entity’s exposure to COVID-19 risks.
c. Notes to the financial statements – Specific disclosures under the subsequent events accounting standards and any other specific account specific disclosures.

The auditor is required to read any other information disclosed in the annual report and consider whether the same is consistent with the financial statements and the auditor’s knowledge obtained in the audit.

12. Internal Control Considerations

In case of companies, where the auditors have to issue a Report on the Internal Financial Controls over Financial reporting under Clause (i) of Sub- section 3 of Section 143 of the Companies Act, 2013, because of the impact of COVID-19, there could be additional considerations that need to be considered as below:

a. Companies may need to implement new internal controls or modify existing internal controls over financial reporting.

b. Evaluate whether any of the controls is not operating effectively on account of absence of concerned person due to illness/ quarantine/ working from home/isolation/travel inaccessibility.

c. Identify alternate controls.

d. Company’s ability to close financial reporting process in time.

e. Company’s ability to design and implement controls related to selection and application of Generally Accepted Accounting Principles (GAAP) for accounting and disclosure issues arising from COVID-19.

13. External Confirmations

SA 330, The Auditor’s Responses to Assessed Risks requires that the auditor obtain more persuasive audit evidence the higher the auditor’s assessment of risk. To do this, the auditor may increase the quantity of the evidence or obtain evidence that is more relevant or reliable, or both. For example, the auditor may place more emphasis on obtaining evidence directly from third parties or obtaining corroborating evidence from a number of independent sources. SA 330 also indicates that external confirmation procedures may assist the auditor in obtaining audit evidence with the high level of reliability that the auditor requires to respond to significant risks of material misstatement, whether due to fraud or error.

SA 240 indicates that the auditor may design confirmation requests to obtain additional corroborative information as a response to address the assessed risks of material misstatement, whether due to fraud at the assertion level. 42

SA 500 indicates that corroborating information obtained from a source independent of the entity, such as external confirmations, may increase the assurance the auditor obtains from evidence existing within the accounting records or from the representations made by the management.

SA 505, External Confirmations provides guidance regarding the process of seeking external confirmations and evaluating the results of the process. Due to the impact of COVID-19 it is more likely that this key audit procedure which provides significant independent audit evidence may be ineffective due to the inadequate responses or non-responses to the confirmation request sent out.

Results of the External Confirmation Procedures

Reliability of Responses to Confirmation Requests

If the auditor identifies factors that give rise to doubts about the reliability of the response to a confirmation request, the auditor shall obtain further audit evidence to resolve those doubts. (Ref: Paragraphs 11-12 of SA 505 reproduced below)

11. If the auditor determines that a response to a confirmation request is not reliable, the auditor shall evaluate the implications on the assessment of the relevant risks of material misstatement, including the risk of fraud, and on the related nature, timing and extent of other audit procedures. (Ref: Para A17) Non-Responses
12. In the case of each non-response, the auditor shall perform alternative audit procedures to obtain relevant and reliable audit evidence. (Ref: Para A18- A19 below)

A18. Examples of alternative audit procedures the auditor may perform include:

- For accounts receivable balances – examining specific subsequent cash receipts, shipping documentation, and sales near the period-end.
- For accounts payable balances – examining subsequent cash disbursements or correspondence from third parties, and other records, such as goods received notes.

A19. The nature and extent of alternative audit procedures are affected by the account and assertion in question. A non-response to a confirmation request may indicate a previously unidentified risk of material misstatement. In such situations, the auditor may need to revise the assessed risk of material misstatement at the assertion level, and modify planned audit procedures, in accordance with SA 315. For example, fewer responses to confirmation requests than anticipated, or a greater number of responses than anticipated, may indicate a previously unidentified fraud risk factor that requires evaluation in accordance with SA 240.

14. Risk of Fraud

Paragraph 5 of SA 240 states that “An auditor conducting an audit in accordance with SAs is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error. Owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with the SAs.”

As stated in Paragraph 12 of SA 240 “the auditor shall maintain professional skepticism throughout the audit, recognizing the possibility that a material misstatement due to fraud could exist, notwithstanding the auditor’s past experience of the honesty and integrity of the entity’s management and those charged with governance.

The impact of COVID-19 on businesses could be very significant and could put pressures on management to meet performance targets or market expectations. This raises the risk of the likelihood of fraud in the financial statements to a higher level which requires the auditor to exercise a much higher degree of skepticism and carry out extended audit procedures to eliminate the possibility of fraud or material error in the financial statements.

44In carrying out the audit for the financial year ending March 31, 2020 auditors must be particularly mindful of the heightened risk of fraud and comply with the guidance provided by SA 240, “The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements”.

Conclusion

The impact of COVID-19 on the economy, financial markets and entities in particular continues to evolve.

The role of auditors at times like this is under increased scrutiny as the auditors have a public interest obligation to complete the audit work in accordance with professional standards and ethics requirements. Under the current circumstances, auditors must recognise that the manner in which they conducted the audits in the past may need significant modification to address the challenges and uncertainties arising out of the impact of COVID-19. Auditors should exercise a very high degree of skepticism and be prepared to call out where the Company’s narrative that the Board presents is not specific enough and does not “tell the whole story” of the various scenarios and level of uncertainty specific to the Company’s operations. Irrespective of the challenges and uncertainties, there should not be any dilution or non-compliance with the auditing standards in carrying out the audits.