

COVID-19 Pandemic: Guidance Notes on the Implications on Auditing

The 2019 novel Coronavirus infection ('coronavirus') or 'COVID-19' outbreak poses a serious public health threat and global economic downturn. The emergence and spread of the coronavirus have also resulted in many businesses, including audit firms, restricting travel of the staff members to client organisations due to government restrictions and other health reasons. At the time of formulating this guidance notes, the requirements of social distancing have brought about significant limitations on the ability of the auditor to perform traditional audit procedures as a result of the lock-down mandated by the authorities. Under normal circumstances, inability to carry out the required audit procedures may have created a scope limitation on the performance of the audit. This guidance notes address complexities and uncertainties auditors are facing as a result of the coronavirus pandemic and provide practical guidance on how to deal with the challenges that are being encountered in performing audits, thereby attempting to mitigate the limitations that may have otherwise created a scope limitation. Accordingly, this guidance notes attempts to provide temporary emergency measures that deviate from normal practices and procedures, which would nevertheless be acceptable under Sri Lanka Auditing Standards.

The following is a non-exhaustive list of factors auditors should consider when carrying out audit engagements in the current circumstances, along with guidance on how they might be addressed. This guidance is intended to help auditors deal with the emerging situation and should not be considered to be enduring or long-term solutions that will apply when normal circumstances resume.

Affected Area	Guidance
Risk Assessment and Planned Audit Approach in Responding to Risk	<p>For audits which are underway relating to periods ending 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.</p> <p>Due to this outbreak, entities and auditors would have to evaluate additional risks arising from the following areas:</p> <ul style="list-style-type: none">• Risks on financial reporting:<ul style="list-style-type: none">– Operational disruption resulting in any changes to the business model arising from significant drop in demand, reduced customer base, disruptions in the supply chain, etc.– Non-compliance resulting in contractual breaches.– Liquidity and working capital issues.– Impact on valuations of assets and liabilities.• Risks on internal controls and audit procedures:<ul style="list-style-type: none">– The design and effectiveness of management's control may have changed because of social distancing, and at times could heighten the risk of fraud.

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	<ul style="list-style-type: none">- The individual responsible for executing a control is unable to perform the work for an extended period, causing a lapse of a critical control.- Auditor not being able to observe a control in operation during the period under review, and inability to carrying our planned interim audit procedures because of social distancing.- The authenticity of evidence obtained from management while practicing social distancing, and evidence gathered in non-traditional methods. <p>Suggested action:</p> <ul style="list-style-type: none">• Consider and document whether the assessment of risks of material misstatement due to fraud or irregularity needs to be heightened.• Evaluate whether any of the controls is not operating effectively due to absence of concerned personnel due to issues such as illness, under quarantine, working from home or inaccessibility in travelling.• Inquire whether the management has designed and implemented controls specifically to address risks arising from social distancing.• Obtain an understanding of the revised design of the control and update the documentation. Changes to the design of management’s control may also require us to alter the combination of testing procedures previously planned as appropriately.• Raise tolerances or the number of instances of exceptions investigated in the audit procedures, if management has not been able to execute a control as planned.• Assess whether the control activities that are not performed represents a control deficiency. If so address control exceptions and evaluate the severity of control deficiencies using existing guidance in SLAuS.• Discuss specific elements of the audit evidence obtained by means of non-traditional methods with the individual responsible for performing the control/preparing the document; make corroborating inquiries of others involved in the process; agree information to source documentation obtained as part of other procedures, if practicable, and confirming the authenticity of the document directly with any third party.<ul style="list-style-type: none">▪ Enhance the use of computer-assisted audit techniques (CAATs) which would enable more extensive testing of electronic transactions and account files▪ Examine adjustments made during the course of preparing and closing the financial statements, with extensive focus. <p>General guidance can be found in SLAuS 315 <i>Identifying and assessing the risks of material misstatement</i>, and SLAuS 330 <i>The Auditor’s Responses to Assessed Risks</i>.</p>

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Materiality and testing thresholds	<p>The impact of Covid-19 may result in significant changes to amounts and disclosures in the financial statements. In particular, it may have significantly affected the earnings of an entity, requiring the auditor to reassess the materiality thresholds. The auditor may need to consider how to deal with this situation when setting materiality levels.</p> <p>Suggested action:</p> <ul style="list-style-type: none"> • Consider if there is evidence that any other financial statement measure becomes more important to the users of the financial statements, if so consider changing the measurement basis for materiality. Document the rationale for such a change. • Consider lowering testing thresholds for areas of sensitivity arising from the current market conditions. For example, accounts that may be subject to impairment. • Consider whether a separate materiality level or levels shall be determined and applied to the particular related classes of transactions, account balances or disclosures in accordance with paragraph 10 of SLAuS 320 <i>Materiality in Planning and Performing an Audit</i>. In setting up the materiality levels the auditor needs to consider whether it is appropriate to exclude the effects of items that are specific to the impact of COVID 19.
Communication with Those Charged with Governance (TCWG)	<p>It is important to discuss with Those Charge with Governance (TCWG) and management whether the impact of the coronavirus crisis has been incorporated into their risk assessment processes and how they have identified and assessed the significance of the business risks arising.</p> <p>Suggested action:</p> <ul style="list-style-type: none"> • Evaluate the assessment by TCWG and management whether risks from coronavirus crisis could be material, including whether users reasonably expect coronavirus crisis to have an impact on the entity, regardless of any quantitative impact. • Exercise professional skepticism when considering the assessment by TCWG and consider the reasonableness of disclosure in the financial statements. • Agree with audit committees on how to communicate with them through alternative means (such as virtual meetings), to ensure that sufficient time is devoted by the audit committees for comprehensive communication with the auditor as physical meetings of audit committees may not be possible • Explain to TCWG any modifications to the audit reporting, due to the increased deficiencies or misstatements than expected, that may arise as a result of the current circumstances.

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	<ul style="list-style-type: none"> • Discuss with TCWG the reasonableness of time provided to form an opinion on the financial statements specially when time limitations for reporting has caused the auditor to resort to a modification of the opinion. • Engage with TCWG, to explain whether the nature of the modification(s) may be prevented by allowing the auditor to devote additional time to undertake the work, and obtain the sufficient appropriate evidence. <p>General guidance can be found in SLAuS 260 <i>Communication with Those Charged with Governance</i>.</p>
Audit Evidence	<p>In carrying out an audit, the auditor must to obtain sufficient, appropriate audit evidence to support the auditor’s report. However, social distancing may cause the planned audit procedures impracticable. To address this, auditors will need to think about alternative ways available and non-traditional methods to obtain sufficient, appropriate audit evidence. This might include employing greater use of technology to examine and obtain audit evidence, but only where the auditor has assessed both the sufficiency and appropriateness of the audit evidence produced.</p> <p>The source of information, which influences its reliability, may be impacted by remote working arrangements due to the closure of offices, which would result in certain information being unavailable for the physical examination of them by the auditor, elevating the risk of authenticity of audit evidence. Although, an auditor is not expected to be an expert in document authentication, it is necessary to maintain awareness of conditions indicating that a document may not be authentic or that the content in a document have been modified without disclosure of such modifications to auditors.</p> <p>Suggested action:</p> <ul style="list-style-type: none"> • Document the modes of technology determined by the auditor as alternative means of obtaining audit evidence clearly indicating the rationale why the auditor thinks such modes provide practical methods of obtaining appropriate audit evidence in the current context. • Obtain an understanding of the controls management has placed over the generation of information and determine if those controls are operating effectively; • Determine and document if management has restricted or made limited access to data stored as appropriately and observe such aspects virtually (e.g. through Skype) and obtain information directly from sources. • Obtain read-only access to the client’s ERP system(s) and relevant data to enable comparison of the information provided by management to that obtained independently by auditors to validate the accuracy.

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	<ul style="list-style-type: none"> • Agree content of electronic information or audit evidence obtained via non-traditional methods to other source documentation available with the auditor (i.e. the trial balance, sub-ledgers, roll-forward schedules, minutes of meetings, actuarial reports etc.), where possible, and reasonably determine the validity of the information. • Review or inspect electronic file properties to determine when the file was last modified (where possible). • Confirm external information directly with the respective third-party, • Consider holding interactive information review sessions with key client contacts via screen-sharing features available on Skype, WebEx etc, where virtual inspection of original documents may be performed. <p>General guidance can be found in SLAuS 500 <i>Audit Evidence</i>.</p>
<p>Physical Inventory/ Cash Verification</p>	<p>Entities may face challenges in conducting physical inventory verifications and similarly may be prevented from observing such procedures due to the restrictions placed because of social distancing.</p> <p>Suggested action:</p> <ul style="list-style-type: none"> • Conduct such verifications at the earliest possible time subsequent to the year end and perform roll-backward as appropriate. • Assess the post balance sheet period inventory movement in reference to third party evidences. • Backward calculate the physical balance of cash as at the balance sheet date supported with the physical verification of cash at the earliest possible date and relevant documentary evidence of the movement upto the date of subsequent count. • Evaluate whether the work of internal audit can be used if physical verification was attended by internal auditors. • Consider if the auditor was able to observe all planned instances of the client’s cycle counts during the year prior to the pandemic circumstances and the results of the same. <p>General guidance can be found in SLAuS 500 <i>Audit Evidence</i>.</p>
<p>External Confirmations</p>	<p>Closure of other businesses and unavailability of postal service may make it more difficult to obtain external evidence (e.g. confirmations) that is generally more reliable than information obtained from internal sources.</p>

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	<p>Suggested action:</p> <ul style="list-style-type: none">• Obtain required information in electronic forms (e.g. scanned PDFs, Excel files, e-statements etc via emails) rather than through original source documentation.• Control the selection, preparation and distribution of electronic requests for confirmations, arrange for the return of responses directly to the auditor, verify the authenticity of the response received and document the procedures performed to validate the respondents.• Apply further audit procedures by reviewing the post balance sheet events, in order to get the confirmations on the balances that existed as at the balance sheet date or confirm directly with the respective third-party. <p>General guidance can be found in SLAuS 505 <i>External Confirmations</i>.</p>
Going Concern	<p>The going concern assessment made by management is a fundamental part of the audit that may be significantly affected by the current circumstances. Due to this outbreak, country faces an unprecedented level of uncertainty about the economy and consequent future earnings of entities over the foreseeable future. Given that, it is difficult to make a meaningful base case economic forecast, let alone a reasonable downside economic scenario yet. Despite such, an entity cannot assert that reasonable and supportable information about its ability to continue as a going concern is unavailable simply because the effects of COVID 19 appear difficult to estimate, or because it would involve a wider than usual range of possible results. In the assessment of going concern, it is absolutely necessary for the management to evaluate whether the entity has a sufficient liquidity position or can remain solvent at least for a period of 12 months.</p> <p>Suggested action:</p> <ul style="list-style-type: none">• Evaluate management's assessment of the entity's ability to continue as a going concern taking into account the following:<ul style="list-style-type: none">○ Announced business support packages through moratoria, tax reliefs and other assistance for affected entities and decisions by the entities to avail themselves of such reliefs.○ Measures taken and proposed to control costs and conserve available cash.○ Agreed deferral of payments with creditors or the receipt of grants to offset costs.• Exercise professional skepticism 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. <p>General guidance can be found in SLAuS 570 (Revised) <i>Going Concern</i>.</p>

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<p>Group Audits</p>	<p>SLAuS 600 <i>Special Considerations - Audits of Group Financial Statements (Including the Work of Component Auditors)</i> has to be considered in these circumstances along with the other relevant SLAuSs.</p> <p>In a group audit engagement, the potential impact of Covid-19 may affect the audit in two main areas. (a) the auditor may be unable to obtain sufficient, appropriate audit evidence to support the audit opinion as a result of the components that operate in areas where significant restrictions apply due to social distancing resulting in no access to relevant information. Further, challenge may arise where the group auditor/ primary team is unable to carry out the review of component auditor’s working papers as planned (as required by paragraph 42D-1(a) of SLAuS 600).</p> <p>Suggested action:</p> <ul style="list-style-type: none"> • Consider what alternative procedures which the group auditor/primary team can carry out to obtain the sufficient appropriate audit evidence. This may be through carrying out additional procedures at the group level to gain assurance, including: <ul style="list-style-type: none"> ○ greater use of remote working arrangements wherever possible, ○ through deploying staff who can operate in affected areas to provide the group auditor with the required audit evidences. ○ greater use of technology in sharing data or hosting virtual meetings in gathering the sufficient and appropriate audit evidence and to review component work, including through remote access, in a manner that is effective. <p>Under these circumstances, use of meeting minutes, memos and reports produced by the component auditor may be considered adequate to enable the group auditor to gather sufficient appropriate audit evidence to conclude on the audit of the component.</p>
<p>Auditing Accounting Estimates</p>	<p>It is challenging for the auditor to obtain sufficient appropriate audit evidence on whether the accounting estimates in the financial statements that have been recognised or disclosed are reasonable and such related disclosures in the financial statements are adequate.</p> <p>Some of the specific areas of concerns are as follows:</p> <ul style="list-style-type: none"> • asset impairment and changes in judgements and assumptions in testing for impairment. • changes in fair value of assets or net realizable value of inventory. • increased costs and/or reduced demand requiring provisions for onerous contracts, reassessment of variable consideration, including refund liabilities. • changes in expected credit losses for loans and other financial assets.

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	<p>Suggested action:</p> <ul style="list-style-type: none">• Consider medium to long term view in the audit of accounting estimates and in carrying out the audit procedures, due to the uncertainties caused by COVID 19 in the immediate to short term.• Assess whether the disclosures are sufficient and appropriate in accordance with the financial reporting framework.• Obtain management representations wherever necessary, including:<ul style="list-style-type: none">• Changes to regulatory factors such as relaxations that may affect accounting estimates (e.g., initiatives aimed at sustainable solutions for temporarily distressed debtors in the context of the outbreak).• Whether assumptions are appropriate and reasonable in the circumstances and in the context of the applicable financial reporting framework (e.g., cash flow forecasts, discount rates, etc.) and adequately disclosed with comprehensive sensitivity analyses, in concluding that there is a material financial impact or not in the current reporting period.• Whether data being used by the entity is relevant and reliable and rechecking the computations.• The effect of changing inherent risk factors, in particular uncertainty. <p>General guidance can be found in SLAuS 540 <i>Auditing Accounting Estimates and Related Disclosures</i>.</p>
Reporting	<p>The implications for the auditor's report may include:</p> <ul style="list-style-type: none">• For public interest entities, a Key Audit Matter (KAM) related to additional audit work needed because of the coronavirus outbreak.• An 'emphasis of matter' paragraph, for example to highlight a significant subsequent event disclosed in the financial statements, or a significant uncertainty arising from the outbreak.• A material uncertainty in relation to a going concern.• A qualification, or adverse opinion, for example in respect of inadequate disclosures, or going concern uncertainties, in the financial statements• A qualified opinion, or a disclaimer of opinion, because of scope limitation when unable to obtain sufficient appropriate audit evidence.

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	<p>Where the impact of Covid-19 is in the auditor’s professional judgment is one of the most significant matters that has 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 may consider reporting it as a key audit matter.</p> <p>A key audit matter paragraph can also be used to satisfy the requirements in SLAuS 706, where the auditor might consider to include an emphasis of matter paragraph as well.</p>
<p>Subsequent Events</p>	<p>Suggested action:</p> <ul style="list-style-type: none"> • Consider the difficulties that management may have in preparing future projections, recognising the highly uncertain and fluid situation. • Use professional judgement and skepticism to assess that any projections appropriately reflect the current situation as, and when, an audit report is to be signed. • Consider if there is a shifting in the reporting deadlines that would increase the period (and therefore the related risks) for events occurring between the date of the financial statements and the date of the auditor’s report. Further, it is important to make sure that material subsequent events related to COVID-19, if any have been identified and those have been appropriately addressed or disclosed in the financial statements in accordance with the financial reporting framework. Accordingly, for non-adjusting events, auditor has to consider whether the entity- specific information on the nature of the event after the reporting period and an estimate of its material financial effect, if any have been disclosed. <p>The effects of the coronavirus could be concluded generally as a ‘non-adjusting event’, and therefore forecasts, projections and associated assumptions used in preparing financial statements as at 31 December 2019 would reflect either little or no change as a result of the coronavirus outbreak. However, for reporting periods ending thereafter (e.g.: for financial periods ending 31st March 2020), the effects of the coronavirus would have to be incorporated into the financial statements as an adjusting event.</p> <p>General guidance can be found in SLAuS 560 <i>Subsequent events</i>.</p>
<p>Adequacy of Management’s Disclosures</p>	<p>It is necessary to understand what disclosures are necessary if coronavirus crisis is material. In order to evaluate that, it is vital to determine disclosure requirements of relevant accounting standards. Mostly, when there is a financial impact, this may include assumptions made in valuations or sensitivity analyses under the particular circumstance.</p>

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	<p>Further, entities should also disclose information about assumptions regarding the future, and other major sources of estimation uncertainty. Where there is no financial impact in the current reporting period, entities should make disclosure of their key assumptions as to why it has not had an impact, if coronavirus crisis is material.</p> <p>Suggested action:</p> <ul style="list-style-type: none"> • Assess whether management has disclosed the appropriate details which describe the impact to the users of the financial statements. • Exercise due professional skepticism to ensure that adjustments disclosed in the financial report as a result of coronavirus crisis are not impacted by other issues. If the conditions of this situation existed after balance date, then the auditor need to ensure that appropriate disclosures in the financial report have been identified with regard to the impairment provisioning and need to ensure the appropriateness of these disclosures. <p>General guidance can be found in SLAuS 720 <i>The auditor's responsibilities related to other information</i>.</p>
Risk of Fraud	<p>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 errors in the financial statements.</p> <p>Suggested action:</p> <ul style="list-style-type: none"> • Be mindful of the heightened risk of fraud in carrying out the audit for the financial periods ending on or after 31 March 2020. <p>General guidance can be found in SLAuS 240 <i>The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements</i>.</p>
Exercise Professional Skepticism	<p>Auditor is always required to carry out their work exercising professional skepticism, and the presence of far reaching implications of COVID-19 on business, necessitates it even more.</p> <p>Suggested action:</p> <ul style="list-style-type: none"> • Consider how appropriate level of skepticism was exercised in the light of current circumstances. • documents how judgments and assumptions made by management were challenged and resolved.

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Quality Control	<p>Auditors will need to comply with all of the requirements in respect of quality control in SLSQC 1 <i>Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements</i> and SLAuS 220 <i>Quality Control for an Audit of Financial Statements</i>. However, in the current circumstances, some meetings, discussions and access to files will be virtual and facilitated through digital modes.</p> <p>Suggested action:</p> <ul style="list-style-type: none">• Document clearly how the direction, supervision and review process was structured and operated to overcome obstacles, and how communication with team members have been conducted and in particular key audit partners, engagement quality control reviewers, and any firm technical reviewers have been involved for the audit.