



Auditor's Reporting Key Audit Considerations amid COVID-19



**Auditing and Assurance Standards Board (AASB)
The Institute of Chartered Accountants of India**



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We express our gratitude to the Board members for their valuable suggestions in finalizing this Guidance.

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Other Auditing Guidance on COVID-19 issued by AASB

- ✦ March 27, 2020: ICAI Accounting and Auditing Advisory - Impact of Coronavirus on Financial Reporting and the Auditors Consideration (issued jointly with Accounting Standards Board of ICAI).

Website Link: <https://resource.cdn.icai.org/58829icai47941.pdf>

- ✦ May 10, 2020: Going Concern - Key Considerations for Auditors amid COVID-19.

Website Link: <https://resource.cdn.icai.org/59473aasb48392.pdf>

- ✦ May 13, 2020: Physical Inventory Verification – Key Audit Considerations amid COVID-19.

Website Link: <https://resource.cdn.icai.org/59498aasb48418.pdf>



Background

The auditor's responsibility for forming an opinion on the financial statements is dealt with in SA 700(Revised), "Forming an Opinion and Reporting on Financial Statements". SA 700(Revised) deals with unmodified auditor's opinion. SA 705(Revised), "Modifications to the Opinion in the Independent Auditor's Report" deals with the auditor's responsibility to issue an appropriate report in circumstances when, in forming an opinion in accordance with SA 700(Revised), the auditor concludes that a modification to the auditor's opinion on the financial statements is necessary. SA 705(Revised) requires that if the auditor:

- concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement; or
- is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement, the auditor shall modify the opinion in the auditor's report.

This responsibility is heightened in the present situation, where COVID-19 and its related preventive measures, such as lockdown and travel restrictions by the Government of India have impact on business operations.

Management's Responsibility

While preparing the financial statements, considering the nature of business of the entity, the management needs to make a detailed assessment (to the extent possible based on the information available) of the impact of COVID-19 on the items, components of the financial statements including disclosures in the financial statements (e.g. appropriateness of carrying values of goodwill and other intangible





assets, fair valuation, impairment of assets etc.) and the appropriateness of the going concern basis of accounting.

The management's responsibility includes making appropriate adjustments to the financial statements and ensuring necessary disclosures, such as disclosures of subsequent events, risks and uncertainties, and how events and conditions may impact future operating results, cash flows and financial position of the entity. Other disclosures may include business risk factors and management's discussion and analysis of results, liquidity and capital resources. In this context, the auditor should also consider the requirements of SA 720(Revised), "The Auditor's Responsibilities Relating to Other Information".

It is possible for the management of an entity carrying on the business of essential commodities to conclude that there is no impact on the operations of the entity. However, the management should also consider the related factors, such as the possible disruption of the supply chain, availability of customers for its commodities, and take an informed decision on whether its operations are impacted or not.

Auditor's Responsibility

While carrying out audit in accordance with the Standards on Auditing (SAs) and other applicable authoritative pronouncements issued by the Institute of Chartered Accountants of India, the auditor may conclude on the following:

- Modification to the auditor's opinion due to material misstatements or an inability to obtain sufficient appropriate audit evidence [SA 705(Revised)].
- Inclusion of a 'Material Uncertainty Related to Going Concern' section in the auditor's report [SA 570(Revised), Going Concern].





- Inclusion of an Emphasis of Matter paragraph and/or Other Matter paragraph in the auditor's report [SA 706(Revised), Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report].
- Inclusion of key audit matters in the auditor's report [SA 701, Communicating Key Audit Matters in the Independent Auditor's Report].

While considering the auditor's reporting in respect of the impact of COVID-19 on the financial statements of an entity, the auditor should consider whether **sufficient and appropriate audit evidence** is available for the auditor to be able to assess the factors set out below. These factors are indicative and not exhaustive and the auditor should always maintain professional skepticism and apply professional judgment on a case to case basis and consider other factors as applicable.

- whether the impact on the business operations/ revenues/ cash flows etc. of the entity for the year (including fair valuations, estimates, realisability, discount rates used etc.) has been appropriately assessed by the management.
- whether the events occurring subsequent to the year-end but before issuance of the auditor's report, have been considered.
- whether any adjustments are required to the financial statements; if yes, whether the same have been appropriately accounted for.
- whether the impact on the going concern basis of accounting of the financial statements has been assessed to conclude on (a) appropriateness of the use of going concern basis of accounting, and (b) existence of material uncertainty related to going concern.
- whether appropriate disclosures have been made in the financial statements regarding the impact and the management's assessment of the same including the impact on going concern basis of accounting.



I. Impact on Auditor's Report

The possible impact of COVID-19 on the auditor's report is discussed below.

a. **Modification of the Auditor's Opinion [SA 705(Revised)]**

The auditor should modify his opinion on the financial statements in the following circumstances:

- **Improper accounting/ inadequate disclosures:** Auditors should remain alert to the possibility that, in the current circumstances, misstatements may occur. Such misstatements may arise, for example, due to a failure to recognise adequate impairment of assets or adequate provisions for obligations or to provide related disclosures. When the auditor has concluded that the necessary accounting adjustments have not been appropriately made and/or the disclosures in the financial statements that the management has made regarding the impact of COVID-19 on the entity are not adequate or appropriate in the circumstances, the auditor's opinion may be modified. The said modification could be a qualified or adverse opinion, as appropriate in the circumstances depending on the materiality and pervasiveness of the impact [SA 705(Revised), paragraphs 7, 8]. For example, the consequences of COVID-19 may have a potential adverse impact on cash flows and trigger an impairment test; however the management has not carried out such an assessment or has not made appropriate disclosures in respect of the underlying assumptions.
- **Inability to obtain sufficient appropriate audit evidence:** A modification to the auditor's opinion (qualification or disclaimer of opinion, as appropriate in the circumstances) is necessary if the auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement [SA 705(Revised), paragraphs 7, 9].



If the auditor determines that he is unable to obtain sufficient appropriate audit evidence from alternative audit procedures possibly due to lock down, social distancing or work from home restrictions, it may affect auditor's opinion on the financial statements, auditor's opinion on internal financial controls and auditor's reporting on CARO 2016.

b. Going Concern Considerations [SA 570(Revised)]

For many entities, the measures taken by Government in order to curb the spread of COVID-19, such as lockdown restrictions may impact the business operations and result in events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. When such events or conditions are identified, the auditor should seek sufficient appropriate audit evidence to determine whether or not a material uncertainty exists and also assess whether the use of going concern basis of accounting is appropriate and report accordingly. For detailed guidance on this aspect, please refer the guidance: "Going Concern - Key Considerations for Auditors amid COVID-19" issued by the Auditing and Assurance Standards Board of ICAI.

c. Including an Emphasis of Matter Paragraph in the Auditor's Report

- As per SA 706(Revised), the term "Emphasis of Matter Paragraph" is defined as follows:

"Emphasis of Matter paragraph – A paragraph included in the auditor's report that 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."

- Where there are substantive COVID-19 related disclosures in the financial statements made by the management of the entity and the auditor is satisfied that these disclosures are appropriate and adequate, then based on the professional judgment of the auditor, an Emphasis of Matter (EOM) paragraph may be included in the auditor's report. An EOM paragraph is a way to draw



attention / highlight such disclosures to users of the financial statements when the auditor considers it is fundamental to their understanding of the financial statements. An EOM paragraph cannot be used as a substitute for reporting the matter as a key audit matter.

Example of EOM wordings for auditor's report

"Emphasis of matter – Effects of COVID-19

We draw attention to Note X in the financial statements, which describes the economic and social [consequences/disruption] the entity is facing as a result of COVID-19 which is impacting [supply chains / consumer demand/ financial markets/commodity prices/ personnel available for work and or being able to access offices]. Our opinion is not modified in respect of this matter."

- On the basis of its assessment of the impact of the outbreak of COVID-19 on business operations of the entity, the entity's management may conclude that no adjustments are required in the financial statements as it does not impact the current financial year. However, the situation with COVID-19 is still evolving. Also, the various preventive measures taken (such as lockdown restrictions by the Government of India, travel restrictions etc.) are still in force, leading to a highly uncertain economic environment. Due to these circumstances, the management's assessment of the impact on the subsequent period is dependent upon the circumstances as they evolve; and consequently, the auditor shall decide on the adequacy of disclosures made by the management and if disclosures are adequate, the auditor may include an EOM paragraph to highlight the uncertainties relating to the future and to draw the attention of the users of the financial statements. [paragraph A5 of SA 706(Revised)]
- As stated in paragraph A5 of SA 706(Revised), the auditor may include an EOM paragraph in the following situations while assessing the impact of COVID-19 on the entity and the impact on the financial statements:



- *An uncertainty relating to the future outcome of exceptional litigation or regulatory action.*
- *A significant subsequent event that occurs between the date of the financial statements and the date of the auditor's report.*
- *A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position.*

For example, the auditor should assess the impact of COVID-19 on aviation, hospitality industries, etc.

The dictionary meaning of the word “catastrophe” is “an event causing great and usually sudden damage or suffering; a disaster”. The impact of COVID-19 should be assessed by the auditor and the auditor may include an EOM paragraph in the situations indicated above in the auditor's report. Further, the auditor may include an EOM paragraph to highlight a significant subsequent event. It is highlighted that such EOM paragraph shall be included by the auditor only when all related disclosures are appropriately made by the management. Otherwise, it could even lead to modification of auditor's opinion as per SA 705(Revised).

d. COVID-19 and Key Audit Matters

- A common question that is being asked is whether the impact of COVID-19 is a key audit matter (KAM) in an audit *per se*. The impact of COVID-19 on specific areas of the financial statements needs to be evaluated for the purpose of reporting KAM. For example, physical verification of inventory using alternative audit procedures may involve more effort vis-à-vis a non-COVID-19 scenario. Similarly, the auditor would be more skeptical about impairment assessment in current scenario. Further, it should be noted that the auditor is not performing procedures to assess the impact of COVID-19 itself rather the procedures are being performed in respect of specific items of financial statements or assumptions (for example going concern, impairment, expected



credit loss, valuation etc.) and thus that particular item/assumption would qualify to be a KAM, where the criteria set out in SA 701 are met.

- When drafting the KAM in the auditor's report, the auditor should not use generic / vague language and should use entity specific & clearly articulated language to explain the impact of COVID-19. Language of KAM should bring out clearly the complexities arising from COVID-19 on the verification aspects of the financial statements. Lastly, a matter should be considered for inclusion as KAM only when the auditor has concluded that it does not warrant modification of the auditor's opinion and also does not indicate a material uncertainty related to going concern.
- In some cases, a matter that has been determined to be a KAM in accordance with SA 701 may also be, in the auditor's judgment, fundamental to users' understanding of the financial statements (i.e., could also be reported as an EOM paragraph). When the auditor determines that the matter is a KAM, the auditor should include it in the KAM section of the auditor's report. However, if the auditor wishes to highlight or draw further attention to the KAM (because the KAM is also considered fundamental to users' understanding of the financial statements), the auditor may do so by presenting the matter more prominently than other matters in the key audit matters section of the auditor's report (e.g., as the first matter) or by including additional information in the description of the key audit matter to indicate the importance of the matter to users' understanding of the financial statements.

e. KAM Related to Going Concern

It is possible to identify KAM related to going concern matters, which would be reported in the KAM section of the auditor's report, when the auditor:

- Identifies events and conditions that may cast significant doubt on an entity's ability to continue as a going concern; and
- Concludes that no material uncertainty exists; and
- Concludes that the disclosures related to those events or conditions are adequate.



In such cases, the auditor should describe the identified events or conditions disclosed in the financial statements that were the focus of the auditor's attention, such as substantial operating losses, available borrowing facilities and possible debt refinancing, or non-compliance with loan agreements, and related mitigating factors in accordance with SA 701.

f. Auditor's Responsibilities in respect of Discussion about the COVID-19 Pandemic included in the Other Information in the Entity's Annual Report

Other information that accompanies the financial statements may be expected to include discussion on the risks associated with the COVID-19 pandemic that provides entity's additional perspectives or details beyond the information disclosed in the financial statements. As required by SA 720(Revised), the auditor should read the other information included in the entity's annual report and consider whether there is a material inconsistency between the other information and (a) the audited financial statements; and (b) the auditor's knowledge obtained in the audit, in the context of audit evidence obtained and conclusions reached.

When reading the other information, the auditor should pay particular attention to the information provided with regard to the impact COVID-19 may have on the entity and consider whether there is new or updated information that should be disclosed in the financial statements or that may affect the audit or the auditor's report. In doing so, the auditor should also consider whether the other information contradicts any aspects of the auditor's understanding of the impact the pandemic has on the entity's business or operations.

When the other information is made available after the date of the auditor's report, the auditor is also required to read and consider the other information when it becomes available.

If the auditor identifies a material misstatement in the other information, the auditor should assess the effect on the auditor's report and to deal with the same in accordance with SA 720(Revised).



II. Impact on Reporting under CARO 2016

With the Companies (Auditor's Report) Order, 2020, being made applicable from the financial year 2020-2021, while reporting for the financial year 2019-2020, auditors should continue to comment on the matters set out in the Companies (Auditor's Report) Order, 2016 (CARO 2016).

An illustrative list of the clauses of CARO 2016 which are expected to be impacted by COVID-19, as the auditor is required to comment as at the year-end, is given below.



a. **Clause 3(ii): Physical verification of inventory**

Remarks: This clause requires the auditor to comment whether the inventory of the company have been physically verified by the management at reasonable intervals and further requires the auditor to comment whether any material discrepancies were noticed on such verification and if so, whether those discrepancies have been properly dealt with in the books of account.

In this regard, where the auditor is unable to obtain sufficient appropriate audit evidence, the commenting on this clause, and where appropriate, the auditor's opinion should also be suitably modified.

b. **Clause 3(vii)(a): Reporting on deposit of undisputed statutory dues**

Remarks: This clause requires reporting on the payment of statutory dues including the extent of arrears as on the last day of the financial year.

Considering that the last day of the financial year 2019-20 fell during the lockdown period, and extension of time is being granted for payment of certain dues by the Government authorities / regulators, the commenting in respect of this clause



should reflect the factual position regarding the extension of date granted by the relevant authorities for payment of such dues. Further, where the company has made the payment within such extended due dates, it does not constitute a non-compliance and accordingly will not be required to be reported under this clause. However, if there is no extension of due date and an option has been given to make payments at a later date upon payment of interest and penalty, it should be reported as default.

c. Clause 3(viii): Default in repayment of loans or borrowing to a financial institution, bank, Government or dues to debenture holders

Remarks: RBI has issued a circular dated 27th March 2020 on COVID-19-Regulatory Package. The circular provides that companies may decide to opt for a moratorium period for repayment of term loans / working capital financing facilities etc., however interest would continue to be charged for this period.

Where the company has exercised this option, the auditor should make a factual statement in his report. Further, where the company has made the payment within such extended due dates, it does not constitute a non-compliance and accordingly is not required to be reported under this clause.



III. Impact on Reporting on Internal Financial Controls with Reference to Financial Statements

Section 143(3)(i) of the Companies Act, 2013 requires that the auditor's report should state whether the company has adequate internal financial controls with reference to financial statements in place and the operating effectiveness of such controls. Also, internal control testing is an integral part of audit procedures, as this determines the level of substantive procedures to be carried out by the auditor.

Key factors to be considered while approaching the audit:

- a. Non-remediation of material weakness noticed during the period for which internal control testing had already been carried out.
- b. Make inquiries on the change in the company's mode of carrying out operations in response to the COVID-19 impact, for example, people working remotely, and consequently, the change in company's policies and procedures, including execution of controls, for example, segregation of duties.
- c. Specific matters for consideration: The impact of changes to the auditor's understanding of the company's system of internal control, including:
 - i. The control environment.
 - ii. Changes to the planned reliance on controls in determining responses to identified risks of material misstatement.
- d. Rewriting the audit plan to address the changes in the internal control framework, including those relating to the design and operation of internal controls and review controls.
- e. Testing the design and operating effectiveness of the updated controls framework including the segregation of duties in line with the requirements set out in the "Guidance Note on Audit of Internal Financial Controls over Financial Reporting" with the help of the related experts.



- f. Evaluating the availability of electronic and digital evidence made available by management, and the review controls around the same, specifically for reliability, security and storage of such evidence.
- g. Remain alert to the possibility of lapse of controls and fraud.
- h. Communication with those charged with governance at every stage of the audit including the implications on the audit of the financial statements and the reporting thereon.

Reporting on Internal Financial Controls with reference to Financial Statements

The following scenarios are envisaged:

- a. Main audit opinion is not modified; Emphasis of Matter paragraph has been included to highlight impact of COVID-19 assessment; the auditor has considered the key factors mentioned above in testing the design and operating effectiveness of the internal controls with reference to financial statements, and:

- i. Material weakness is identified in the design or operation of internal controls [and/or] the material weakness identified earlier remains unremediated [and/or] there is a restriction on the scope of the engagement.

In such cases, the auditor should modify his opinion on the internal financial controls; evaluate the impact of such modification on the main audit report and as appropriate, modify the auditor's opinion on the financial statements as well.

- ii. No concerns have been noted by the auditor with regard to the design and operating effectiveness of internal controls:

Under these circumstances, the auditor should include a cross reference in the opinion on internal financial controls to the Emphasis of Matter paragraph included in the main audit report with regard to COVID-19 assessment.

- b. Where the main audit opinion is modified in respect of any matter (including that relating to COVID-19); the auditor should evaluate the key factors mentioned



above, and determine whether the modification also leads to a modification of the report on internal financial controls and where applicable, modify the report on internal financial controls accordingly.

- c. Where the auditor is unable to obtain sufficient appropriate audit evidence to form an opinion on the design and operating effectiveness of internal financial controls with reference to financial statements, the auditor should issue a disclaimer of opinion.

