The Impact of Coronavirus on Financial Reporting and the Auditor's Considerations

AASB–AUASB JOINT FAQ **MARCH 2020**

Australian Government
Australian Accounting Standards Board

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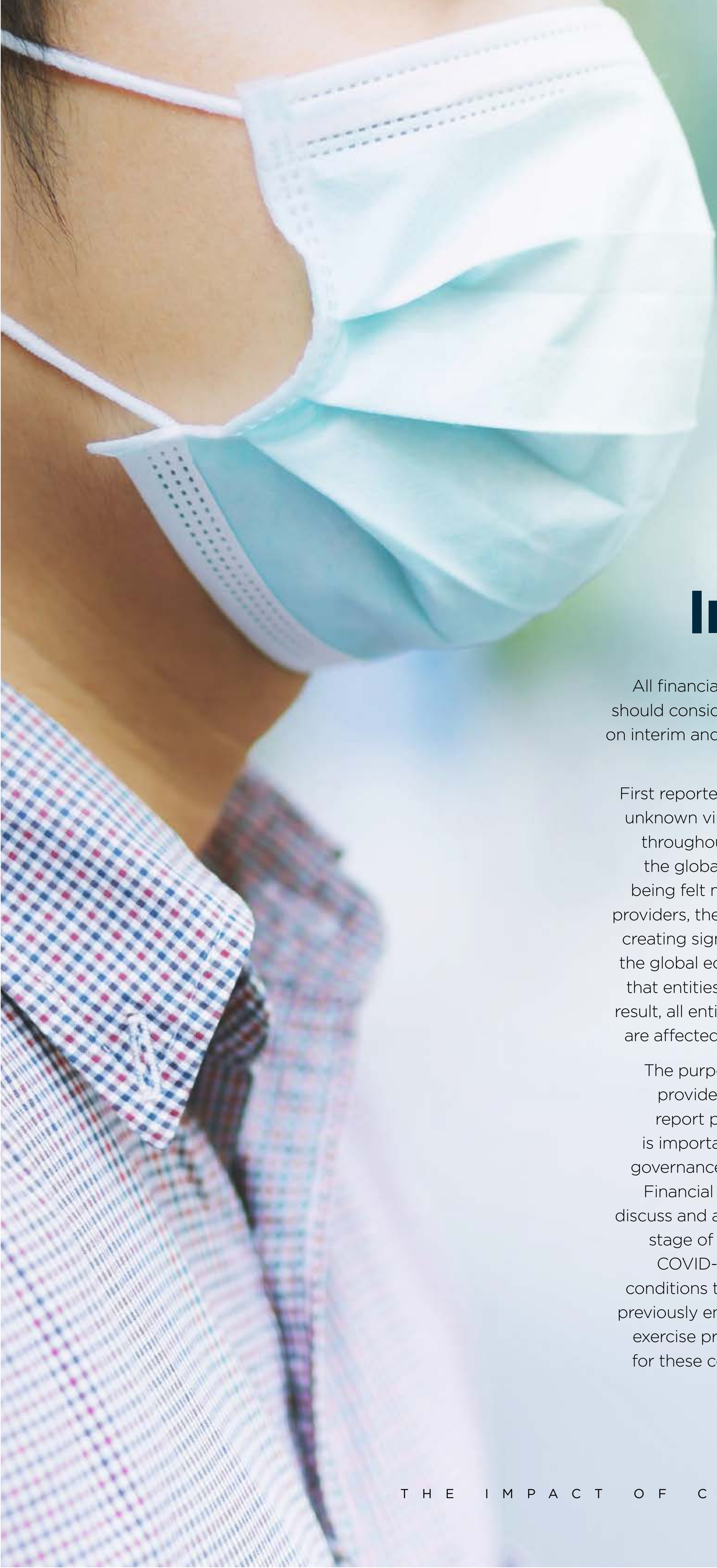
Auditing and Assurance Standards Board

Contents



Introduction

All financial report preparers and audit practitioners should consider the impact of Coronavirus (COVID-19) on interim and annual financial reports arising from this major global risk.

First reported to the World Health Organisation as an unknown virus in late December 2019, developments throughout 2020 are causing great uncertainty for the global economy. Whilst the initial effects were being felt most by the travel industry and education providers, the impact is now considerably wider and is creating significant uncertainty for supply chains and the global economy. This uncertainty is creating risks that entities may not have encountered before. As a result, all entities should assess whether and how they are affected, and the impact on their financial report.

The purpose of this AASB–AUASB Joint FAQ is to provide guidance on some of the issues financial report preparers and auditors should consider. It is important that directors and those charged with governance (TCWG), Chief Executive Officers, Chief Financial Officers and auditors of financial reports, discuss and assess the impact of COVID-19 at an early stage of the financial reporting and audit process. COVID-19 gives rise to new and rapidly changing conditions that preparers and auditors may not have previously encountered. Auditors should be alert and exercise professional scepticism about the potential for these conditions to give rise to possible financial reporting misstatements.

Key considerations

This FAQ sets out a number of key questions and considerations that should be asked by preparers and auditors of financial statements, such as:

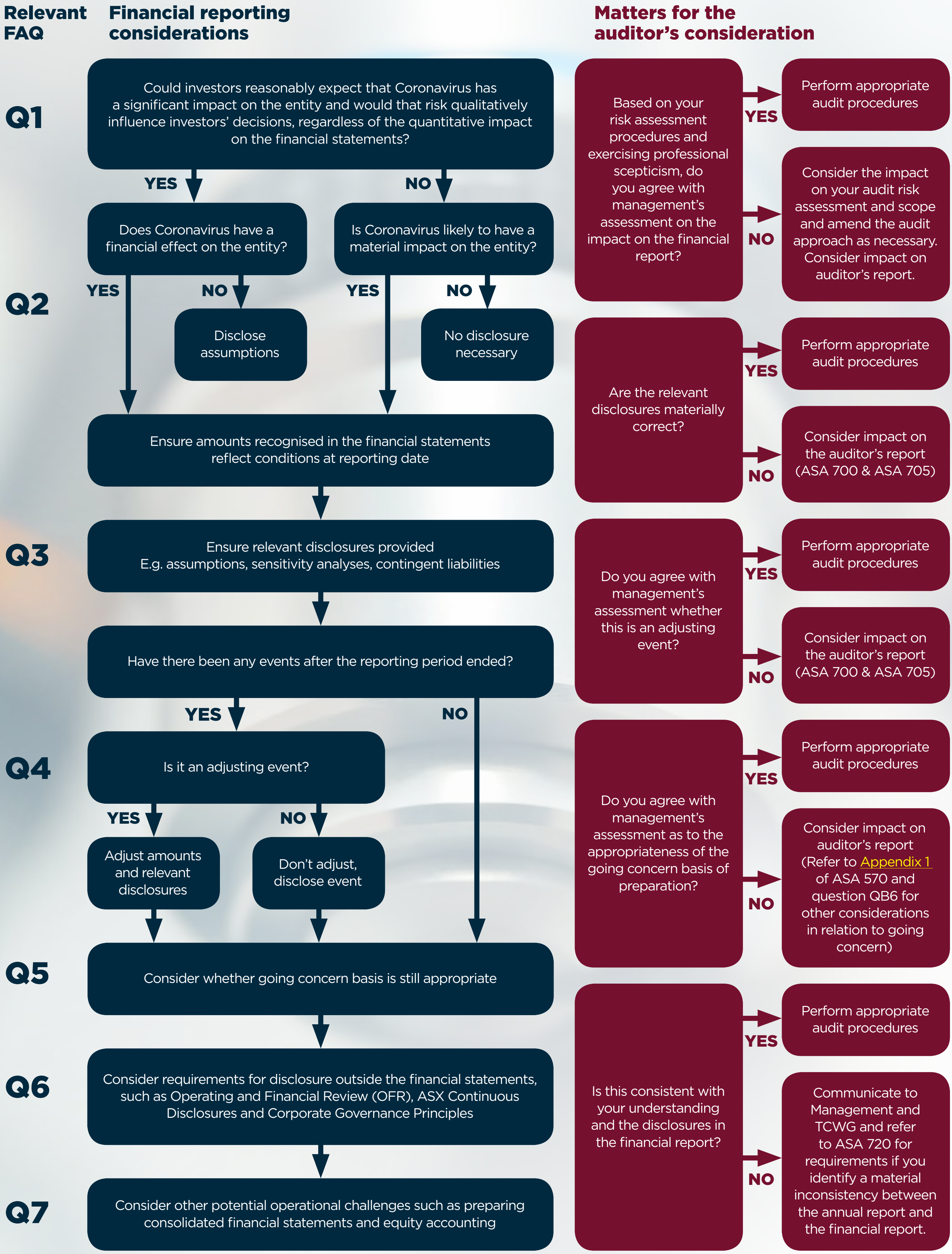
Preparers

- How to assess whether the impacts of COVID-19 are material to the entity?
- When to adjust the financial statements, including where events continue to develop after the reporting period ends?
- What disclosures might be required of the entity (including any continuous disclosure obligations for listed entities)?

Auditors

- Have TCWG performed appropriate risk assessment procedures and assessed the impact of COVID-19 on the entity and the financial report, including re-assessing the appropriateness of the going concern basis of accounting?
- Are the disclosures in the financial report sufficient, and if not, what are the implications for the auditor's report?
- Do any travel bans affecting audit personnel cause a potential scope limitation in performing the audit work?

The COVID-19 outbreak is an example of an emerging risk addressed by AASB–AUASB Bulletin *Climate-related and other emerging risks disclosures: assessing financial statement materiality using AASB/IASB Practice Statement* 2 (April 2019). This publication provides links to that guidance and other consideration points in the context of COVID-19.


Relevant FAQ
Financial reporting considerations
Matters for the auditor's consideration
Q1
Could investors reasonably expect that Coronavirus has a significant impact on the entity and would that risk qualitatively influence investors' decisions, regardless of the quantitative impact on the financial statements?
YES
NO
Does Coronavirus have a financial effect on the entity?
Is Coronavirus likely to have a material impact on the entity?
Q2
YES
NO
YES
NO
Disclose assumptions
No disclosure necessary
Ensure amounts recognised in the financial statements reflect conditions at reporting date
Q3
Ensure relevant disclosures provided
E.g. assumptions, sensitivity analyses, contingent liabilities
Have there been any events after the reporting period ended?
YES
NO
Q4
Is it an adjusting event?
YES
NO
Adjust amounts and relevant disclosures
Don't adjust, disclose event
Q5
Consider whether going concern basis is still appropriate
Q6
Consider requirements for disclosure outside the financial statements, such as Operating and Financial Review (OFR), ASX Continuous Disclosures and Corporate Governance Principles
Q7
Consider other potential operational challenges such as preparing consolidated financial statements and equity accounting
Based on your risk assessment procedures and exercising professional scepticism, do you agree with management's assessment on the impact on the financial report?
YES
Perform appropriate audit procedures
NO
Consider the impact on your audit risk assessment and scope and amend the audit approach as necessary. Consider impact on auditor's report.
Are the relevant disclosures materially correct?
YES
Perform appropriate audit procedures
NO
Consider impact on the auditor's report (ASA 700 & ASA 705)
Do you agree with management's assessment whether this is an adjusting event?
YES
Perform appropriate audit procedures
NO
Consider impact on the auditor's report (ASA 700 & ASA 705)
Do you agree with management's assessment as to the appropriateness of the going concern basis of preparation?
YES
Perform appropriate audit procedures
NO
Consider impact on auditor's report (Refer to Appendix 1 of ASA 570 and question QB6 for other considerations in relation to going concern)
Is this consistent with your understanding and the disclosures in the financial report?
YES
Perform appropriate audit procedures
NO
Communicate to Management and TCWG and refer to ASA 720 for requirements if you identify a material inconsistency between the annual report and the financial report.

Potential impacts

Key issue	Preparers	Auditors
Materiality of the event	**QA1: How do I assess whether COVID-19 is material to my entity?** Consider the guidance in the AASB–AUASB Bulletin on whether emerging risks are material. COVID-19 could be material if: • there is a material financial impact (see next section); or • users reasonably expect COVID-19 to impact your entity, regardless of whether there is a quantitative impact.	**QB1: How does the COVID-19 impact risk assessment and materiality?** In applying ASA 315 *Identifying and Assessing the Risks of Material Misstatement* auditors should consider the implications of COVID-19 when obtaining an understanding of the entity and its environment, in light of its objectives, strategies and other business risks. Auditors 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 business risks arising. For example, if the business has trading relationships or components in affected jurisdictions, there may be an impact on the risk assessment. Evaluate the assessment by TCWG and management as to whether risks from COVID-19 could be material, including whether users reasonably expect COVID-19 to impact the entity, regardless of any quantitative impact. If TCWG and management have determined that there is no material financial impact (or reasonably expected impact) on their entity, auditors should exercise professional scepticism when considering this assessment. Also consider if there should be disclosure in the financial report about the key assumptions made in reaching this conclusion. If you have revised the risk assessment as a result of the COVID-19 event, your audit materiality may also need to be revised as the audit progresses (refer to ASA 320 *Materiality in Planning and Performing an Audit*, paragraphs 12 and 13).

Potential impacts

Key issue	Preparers	Auditors
Assessing financial impact	**QA2: What type of financial effect might COVID-19 have on my entity?** Direct financial impacts may include: • asset impairment/changes in assumptions for impairment testing (AASB 136); • change in fair value of assets (AASB 13) or net realisable value of inventory (AASB 102); • increased costs and/or reduced demand requiring provisions for onerous contracts (AASB 137), reassessment of variable consideration, including refund liabilities (AASB 15); • changes in expected credit losses for loans and other financial assets (AASB 9). • material uncertainties that cast significant doubt on the ability to continue as a going concern such as extent of the impact on future costs and revenues (AASB 101 and AASB 110) and unknown duration of the impact. Entities should also consider impacts arising indirectly. For example, customers, suppliers, financiers or investments in other entities may be affected, leading to impairments, increased costs or reduced revenues.	**QB2: How to audit the financial effect of COVID-19?** The direct financial impacts are likely to involve accounting estimates prepared by management. Significant assumptions including projected cash flows, used in these accounting estimates may be affected by the COVID-19 event. If your audit client has significant amounts of direct financial impacts that contain estimation uncertainty, the risk assessment and audit evidence supporting these accounting estimates and related disclosures may be affected by the COVID-19 event. Refer to ASA 540 *Auditing Accounting Estimates and Related Disclosures* for requirements. Refer to QB5 for going concern considerations.

Potential impacts

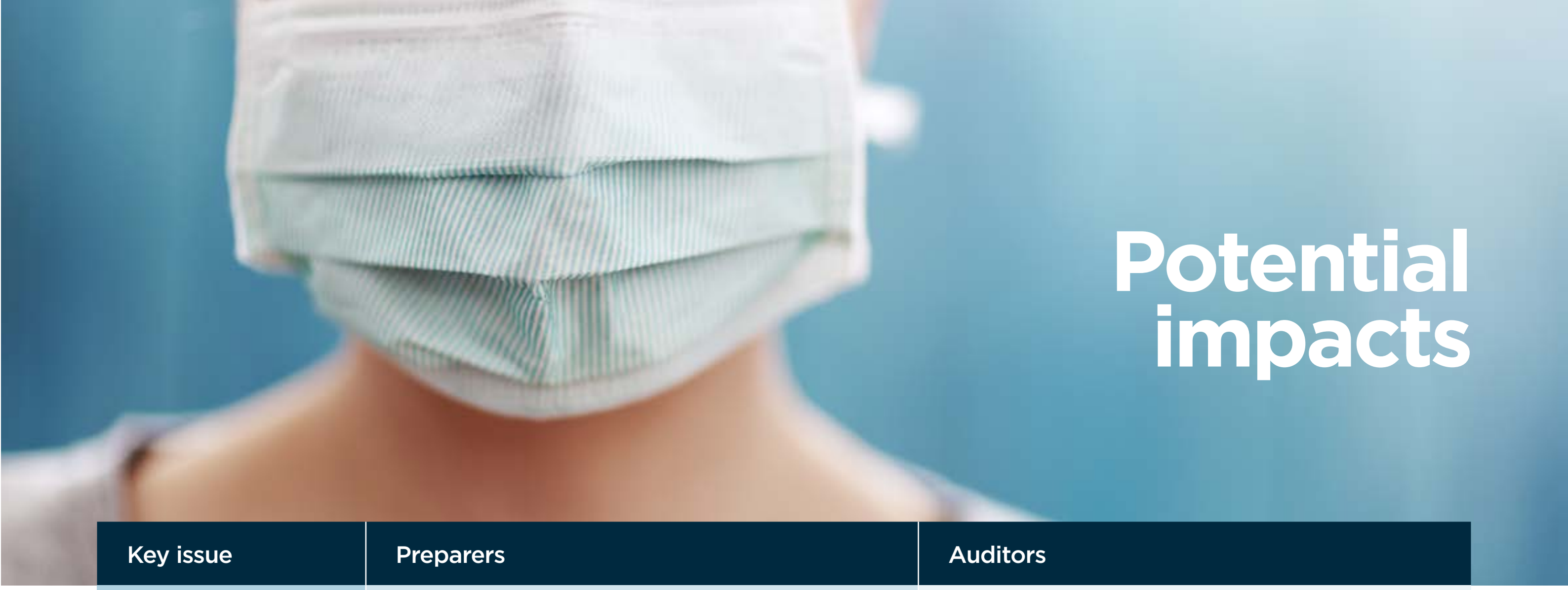
Key issue	Preparers	Auditors
Disclosures within the financial statements	**QA3: What disclosures are necessary if COVID-19 is material?** Consider relevant Standards to determine disclosures. Where there is a financial impact, this may include assumptions made in valuations or sensitivity analyses. Entities should also disclose information about assumptions regarding the future, and other major sources of estimation uncertainty (see AASB 101 paragraph 125). 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 COVID-19 is material (see QA1). Entities should consider the AASB–AUASB Bulletin for further guidance on relevant disclosures.	**QB3: How to apply appropriate audit procedures on the disclosures?** Consider and apply appropriate audit procedures when assessing whether the disclosures are materially correct and in accordance with the financial reporting framework. Refer to ASA 540 when auditing accounting estimates and relevant disclosures. If your client has not provided sufficient disclosures, consider the implications for the audit report and whether it needs to be modified in accordance with ASA 705 *Modifications to the Opinion in the Independent Auditor's Report*. If your client has concluded there is no financial impact in the current reporting period, consider if the disclosures of key assumptions supporting this are adequate. And whilst it is important to be aware of adjustments made by clients to reflect the impact of COVID-19 on their operations, it is equally important for auditors to apply professional scepticism and ensure that adjustments disclosed in the financial report as a result of COVID-19 are not impacted by other issues. If you conclude that your client has provided sufficient disclosures in the financial report, and if your client is a listed entity preparing general purpose financial statements, consider if the event disclosed is a matter of most significance in the audit of the financial report which should be raised as a Key Audit Matter in accordance with ASA 701 *Communicating Key Audit Matters in the Independent Auditor's Report*.

Potential impacts

Key issue	Preparers	Auditors
Events after the reporting period	**QA4.1: My reporting period has already ended. How do I assess whether subsequent events are adjusting events?** Conditions may evolve rapidly and AASB 110 requires entities to consider whether an event after the reporting period confirms conditions existing before the reporting date, e.g. bankruptcy of a customer may confirm a customer was credit-impaired. If management determines after the reporting period either that it intends to liquidate the entity or to cease trading, or that it has no realistic alternative but to do so, this requires the basis of preparation to be changed from a going concern basis. Government assistance or other financial support obtained after reporting date should be taken into account when assessing the ability to continue as a going concern, as AASB 101 requires management to consider all available information about the future for at least, but not limited to, twelve months from reporting date (see also QA5). Entities should also think carefully about what conditions would cause adjustments (see QA2 above). For example, entities are unlikely to have an adjusting event when the conditions that would lead to adjustments, such as the declaration of new or amended public health emergency did not exist prior to the reporting date. No adjustments should be made to the amounts presented in the financial statements in case of a non-adjusting event. Refer to AASB 110 paragraphs 8-11 to assess whether the outbreak of COVID-19 is an adjusting event.	**QB4.1: What may be the audit implications of any subsequent events?** The auditor should consider if the impact of the COVID-19 event requires adjustment to or disclosure in the financial report based on AASB 110, and whether the event impacts the appropriateness of the going concern basis of accounting. If there is a material financial impact on your audit client's business post balance date due to the COVID-19 event where the conditions existed before the balance date, then consider if appropriate adjustments or disclosures in the financial report have been made and audit these adjustments or disclosures. If the conditions of COVID-19 event existed after balance date, consider if appropriate disclosures in the financial report have been identified and audit these disclosures. Refer to requirements in paragraphs 6 to 9 of ASA 560 *Subsequent Events* for more details. Whilst there is no obligation to perform any audit procedures regarding the financial report after the date of the auditor's report, if matters associated with the COVID-19 event became known after the date of the auditor's report but before the financial report is issued, there are specific requirements auditors must perform to ensure the auditor's report remains appropriate. Refer to paragraphs 10 to 13 of ASA 560 for more details. If the impact of the COVID-19 event became known after the financial report has been issued and, had it been known at the date of the auditor's report may have caused an amendment to the auditor's report, additional consideration by the auditor is required. Refer to paragraphs 14 to 17 of ASA 560 for more details.

Potential impacts

Key issue	Preparers	Auditors
Events after the reporting period	**QA4.2: My entity's reporting period has ended and COVID-19 was assessed to be a non-adjusting event. Does my entity need to make any disclosure?** Even if an event is not an adjusting event, the entity shall disclose in the notes entity-specific information on the nature of the event after the reporting period and an estimate of its financial effect, where material. Refer to AASB 110 paragraph 21.	**QB4.2: What impact may any subsequent events have on the appropriateness of the audit client's going concern assessment?** The auditor needs to consider all available information up to the date of the auditor's report when concluding on the appropriateness of the audit client's going concern assessment. Refer to ASA 570 *Going Concern* and the response to QB5 below for more detail.



Potential impacts

Key issue	Preparers	Auditors
Going concern	**QA5: How does my entity determine whether it is still a going concern?** Consider AASB 101 paragraphs 25-26 to assess whether an entity is a going concern. Even if the reporting period has ended, an entity should make this assessment in accordance with AASB 110 paragraphs 14-16 and consider all relevant future information for at least, but not limited to, the twelve months after reporting date – e.g. new travel bans, new community restrictions, government assistance, financial health of key suppliers and customers, existing financial resources and likely period of expiry if conditions continue or deteriorate. If management determines that it intends to liquidate or cease trading, or has no realistic alternative but to do so, either before or after the reporting period ends, the financial statements should no longer be prepared on a going concern basis. Material uncertainties that cast significant doubt on the ability to continue as a going concern such as extent of the impact on future costs and revenues and unknown duration of the impact must be disclosed.	**QB5: What is the impact on going concern procedures?** The auditor's responsibility in relation to going concern is to evaluate and conclude on the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial report, and to conclude whether a Material Uncertainty Related to Going Concern (MURGC) exists about the entity's ability to continue as a going concern. The auditor should apply professional scepticism when fulfilling this responsibility, including if management have appropriately considered this when making their assessment on the entity's ability to continue as a going concern, and the adequacy of the disclosures in the financial report. For example, have management considered: - the potential impact on the forecasts of future cash flows; - banking covenants. If management determines that the basis of preparation is to be changed from a going concern basis the auditor considers if they agree with this. If the auditor does not agree with the basis of preparation of the financial report, or that there are sufficient disclosures in relation to events or conditions which may cast significant doubt on the entity's ability to continue as a going concern, the auditor issues a modified audit report. Refer to ASA 570 for more detail, including when to include a MURGC in the auditor's report.

Potential impacts

Key issue	Preparers	Auditors
Disclosure outside the financial statements	**QA6: Are there any disclosures outside the financial statements?** Entities should consider whether any additional disclosures are required. Such disclosures might provide more information on the future outlook of the entity. For example: • Corporations Act 2001 Operating and Financial Review (OFR) requirements or other management commentary requirements • ASX Continuous Disclosure Requirements • ASX Corporate Governance Principles and Recommendations.	**QB6: What is the auditor's responsibility for disclosures outside the financial statements?** Discuss with TCWG and management if other disclosures relating to this issue have been made outside of the financial statements and assess whether these are materially consistent with disclosures in the financial report. Refer to ASA 720 *The Auditor's Responsibilities Relating to Other Information* for more details about the auditor's responsibilities to review other information and consider whether there is material inconsistency between the other information included in the Annual Report and the financial report.

Potential impacts

Key issue	Preparers	Auditors
Group reporting	**QA7: What are the implications if my entity can't obtain information from subsidiaries, associates or joint ventures?** Financial statements must present fairly the financial position, financial performance and cash flows of the entity – in this case, the group. Where subsidiaries, associates or joint ventures are material, all the available sources of the information necessary to prepare financial statements for the group should be considered. Refer to AASB 10 paragraphs B92 and BC93 for guidance on when it is impracticable to obtain information for subsidiaries with different reporting periods and AASB 128 paragraphs 33 and 34 for associates and joint ventures being accounted for using the equity method. Consideration would also need to be given to whether an extension on reporting deadlines should be sought, and any obligations under the ASX Continuous Disclosure requirements.	**QB7: What are the implications on my group audit if I can't obtain information from component auditors, associates or joint ventures?** If the entity cannot obtain sufficient information in relation to subsidiaries, associates or joint ventures consider if this is material to the financial report as a whole and the impact on the audit opinion. As a group auditor consider how the COVID-19 including travel bans may affect risk assessments, materiality and the ability to obtain sufficient and appropriate audit evidence for components, associates or joint ventures. If you cannot obtain adequate information or reporting from your component auditors, associates or joint ventures, to fulfil your responsibilities under ASA 600 *Special Considerations – Audits of a Group Financial Report*, consider the impact on the audit opinion. Refer to ASA 600 for more detail.