

How audit committees can respond to COVID-19



Key considerations to navigate the pandemic

The mandate of the audit committee includes critical items to be considered during the COVID-19 outbreak. These include:

- Financial reporting**
- Oversight of external audit**
- Internal control over financial reporting**
- Information technology including cyber risk**
- Oversight of internal audit**
- Oversight of taxation matters**

Below is guidance that touches on each of these although it's not meant to be an exhaustive list. Clearly, this is a fluid situation and this list will be updated regularly. The potential global and economic impacts of the pandemic continue to evolve rapidly. Audit Committees and Boards are clearly monitoring the situation. Changes in circumstances will require additional or revised disclosure in filings. Disclosures should include material, relevant information for investors as of the date of the periodic filing. Everyone is encouraged to maintain close communications among the board of directors, external auditors, legal counsel and other service providers as the circumstances progress.

Financial reporting

The financial reporting impacts of the pandemic will depend on facts and circumstances, including the degree to which an entity's operations are exposed to the impacts of the outbreak and the sensitivity of amounts recorded in the financial statements to the more volatile economic conditions.

It is important for audit committees to understand the nature and extent of an entity's potential operating or financial exposure to the impacts of the pandemic and to consider the potential impacts on financial reporting, in particular management's assessment of the entity's ability to continue as a going concern and the potential need for additional disclosures to reflect uncertainties and potential volatility triggered by the outbreak and the developments in the oil market.

There are different considerations depending on whether or not the December 31, 2019, financial statements have been filed.

1. December 31, 2019, financial statements that have not yet been filed

If you have financial statements as of December 31, 2019 that have not yet been filed, there are still considerations that are necessary.

The declaration of a pandemic is a subsequent event that needs to be considered for its impact either as an "adjusting" item or "non-adjusting" item. The difference is whether the balance sheet and income statement need to be changed or whether only disclosure is required.

There is a broad consensus that a pandemic is a non-adjusting event as the significant changes in business activities and economic conditions occurred as a result of events occurring after the reporting date of December 31, 2019, such as actions taken by the government and private sector to respond to the pandemic. Consequently, there is no impact on recognition and measurement of assets and liabilities e.g., long-lived asset impairment, deferred tax asset recognition. Material non-adjusting events are to be disclosed in the notes to the financial statements. This includes a description of the implications of the pandemic and any actions taken by governments and the private sector to respond to the outbreak that has an impact on the company's financial situation. If possible the financial effect should be disclosed or a statement that such an estimate cannot be made. For example, non-adjusting events could include impairments of financial and non-financial assets (considering events and new information arising after the reporting date), covenant breaches, amendments, or waivers in lending agreements, losses due to supply chain issues, volatility in commodities or foreign currency exchange markets, etc. after December 31, 2019.

Here is an example of simple pandemic related disclosure assuming that the impact is not pervasive:

Subsequent to December 31, 2019, the COVID-19 outbreak was declared a pandemic by the World Health Organization. The situation is dynamic with various cities and countries around the world responding in different ways to address the outbreak. There are meaningful direct and indirect effects developing and the Company will continue to monitor the impact of the outbreak on its business and its subsidiaries. Realizable values of assets post December 31, 2019, may materially be affected as a result of this outbreak.

The concept of adjusting vs. non-adjusting events does not apply to the going concern assumption. Management needs to assess before the release of the financial statements whether the current events and conditions cast significant doubt on the entity's ability to continue as a going concern, or in severe cases, whether the going concern assumption is still appropriate as a basis for the preparation of the entity's financial statements.

It will be critical to understand what impacts current events and conditions have on an entity's operations and forecasted cash flows, with the key immediate issue being whether an entity still has sufficient cash and liquidity to continue to meet its obligations as they fall due. Conditions or events caused by the pandemic that may put the going concern assumption in doubt include:

- Cash flow shortages and greater restrictions on access to necessary capital and credit
- Suspension or curtailment of operations and related significant drops in revenue
- Inability to comply with the terms of loan agreements
- Shortages of important supplies
- Closing facilities or large lay-offs of employees

In these cases, there will clearly be constant communication necessary between management, the board and the external auditor. When management identifies events or conditions that may cast significant doubt on the entity's ability to continue as a going concern, management will develop plans to address the situation. The auditor will need to evaluate management's assessment and the feasibility of their plans for future actions in respect of going concern and evaluate the adequacy of the disclosures in the financial statements as well as reading other supplemental disclosures for any material inconsistency with the financial statements. The external auditors would also consider the impact on their report including, but not limited to, the need for disclosure of a Key Audit Matter (or a Critical Audit Matter under US standards) and an "emphasis of matter" paragraph drawing attention to the disclosure of significant doubt in the financial statements.

If the conclusion is that the consequences of the pandemic have led to a deterioration of the financial situation after the reporting date that is so severe that the going concern basis of preparation is no longer considered appropriate, the financial statements (or interim reporting) would need to be adjusted significantly and extensive disclosure required. This will require close contact with management and your external auditors and likely will lead to a significant delay in the preparation and filing of the financial statements.

2. Financial statements going forward

For reporting dates after December 31, 2019, more information was available that market participants will factor into their assumptions and assessments. Accordingly, we would expect an adjusting event for subsequent reporting dates. Adjusting events are taken into consideration in accounting, which means that any impact will have to be recognized in the financial statements.

The economic consequences and uncertainties resulting from the pandemic itself or from actions taken by governments and the private sector to respond to the outbreak may, for example, have an impact on (non-exhaustive list):

- Assets and liabilities measured at fair value,
- Impairment of intangible and tangible assets,
- Net realizable value of inventory,
- Recoverability of deferred tax assets,
- Expected credit losses on financial assets,
- Classification of financial liabilities as current or non-current,
- Contingent liabilities and provisions,
- Accounting for government grants
- Changes in share-based payments
- Leases including rent concessions, renewals, extensions or terminations
- Revenue recognition under changing contractual arrangements
- Restructuring provisions

Fair value measurement poses a unique challenge given the economic conditions because it should reflect the conditions as of the balance sheet date. This may be particularly challenging when fair value measurement is based on unobservable inputs and circumstances are changing rapidly.

- The current situation may trigger impairment testing, e.g. due to significant adverse changes in the entity's business. In addition, the impairment test itself can be impacted as previous expectations about future cash flows may need to be updated.
- There may be less demand for some goods, which in turn may create pressure on sales prices and/or result in less inventory turnover, thus leading to additional write-downs to net realizable value.
- If the economic outlook deteriorates and the entity's earnings decline, recoverability of any recognized deferred tax assets should be carefully considered.

- Expected credit losses are based on information about past events, current conditions and the prediction of future economic conditions. Economic difficulties of customers and the negative economic outlook, in general, may require an increase in the provision for expected credit losses for financial assets, including both accounts and loan receivables.
- If the financial situation of the entity deteriorates, financial covenants may be triggered. As a consequence, financial liabilities will become immediately repayable. If this cannot be remediated before the reporting date, classification of the respective financial liabilities as current liabilities is required, regardless of the remaining contractual term.
- Liabilities previously meeting the definition of a contingent liability may need to be reconsidered and recognized on the balance sheet.
- The going concern considerations above still apply.

The above items are not meant to be an exhaustive list of all of the impacts of COVID-19. Management and the external auditor should be prepared to discuss these and any other relevant impacts with the audit committee well in advance of a reporting date. Guidance on many of these potential issues is being released regularly.

Additional resources:

[COVID-19 financial reporting resource centre](#)

Filing Requirements

The Canadian Securities Administrators (CSA) has announced that they will provide temporary relief from some regulatory filings required to be made on or before June 1, 2020. The blanket relief will provide a 45-day extension for periodic filings normally required to be made by issuers, investment funds, registrants, certain regulated entities and designated rating organizations on or before June 1, 2020. This includes financial statements, management's discussion and analysis, management reports of fund performance, annual information forms, technical reports, and certain other filings.

Further reading: [Canadian securities regulators to provide blanket relief for market participants due to COVID-19](#)

If you are registered with the SEC, they have also announced that they are providing conditional regulatory relief for certain publicly-traded company filing obligations under the federal securities laws.

Further reading: [SEC Provides Conditional Regulatory Relief and Assistance for Companies Affected by the Coronavirus Disease 2019 \(COVID-19\)](#)

The SEC has also emphasized that entities should assess the effects that the pandemic may have on required reporting. Entities need to consider their disclosure obligations regarding business risks related to the impacts of coronavirus within the context of securities laws. Disclosures should be specific to individual circumstances, avoiding broad or generic language.

Entities should consider similar disclosure in the relevant sections of interim filings, including material changes in

financial condition. An entity's normal disclosure controls and procedures should be applied to the reporting of this information.

Audit committees should continue to monitor information coming from the securities regulators and discuss these matters with legal counsel, management and the external auditors.

Oversight of external audit

The audit committee has oversight of the external auditors and the pandemic has in some cases resulted in challenges in conducting the audit.

Not the least of these challenges is conducting the audit remotely. With the widespread movement to work from home, management's technology systems and the general infrastructure of many jurisdictions is being stretched. Regular communication and detailed planning is required to ensure complex external audits stay on track.

Another consideration is the potential impact on the external auditor's materiality calculations. This is important because it largely determines the extent of the work necessary for the external audit. Given that this is generally based on profit before tax, any significant forecasts that decrease income will need to be evaluated by the external auditor and materiality reconsidered.

It is also possible that working remotely could cause changes in the entity's internal control over financial reporting. While this is not necessarily the case, management and the external auditor should remain alert for such changes and adjust their evaluations of ICFR accordingly. In addition, material changes in ICFR require disclosure in periodic filings with securities regulators. Consultation with appropriate legal counsel may be required to determine whether or not there is a material change in ICFR.

In response to the pandemic, many governments and businesses are taking certain preventive measures, such as (i) restricting the movement of people (within and outside of a particular jurisdiction) or (ii) restricting the interaction of people or large amounts of people. Some governments and businesses have also instructed employees to remain at home and curtailed or temporarily suspended operations. Furthermore, to further help reduce the risk of spread of, and

exposure to, COVID-19 audit firm personnel movements may be restricted. As a result of these measures, there may be some specific scenarios that would require a change in audit approach from that originally planned. Significant changes in the planned audit approach by the external auditor should be reported to the audit committee. Certain of these may be so severe that they have audit and reporting implications and in certain situations could result in a qualification or a disclaimer of opinion. Examples of these are outlined below.

Limitations faced by management:

- Management's inability to perform inventory counts
- Management's inability to obtain information from management's expert
- Management's inability to provide support for their assertions in the financial statements given they are not on premise
- Management's inability to obtain subsidiary financial and other information

Challenges obtaining access to management and others, including legal counsel, management's experts, and internal audit:

- Not being able to get responses to inquiries or legal inquiry letters
- Not being able to perform appropriate inquiries for walkthroughs

Challenges accessing management premises to perform procedures (i.e. no team members on premise but management is on premise):

- Not being able to attend and observe management's inventory counts
- Not being able to perform inventory counts
- Not being able to physically observe fixed assets
- Not being able to physically visit locations considered necessary
- Not being able to obtain access to technology systems when evidence is stored only in the system
- Not being able to obtain access to audit evidence available at the client's premise or other physical location

Difficulties in obtaining anticipated audit evidence:

- A significant decline in response rates for accounts receivable confirmations (when it is likely that the confirming party is impacted by COVID-19 prevention measures)
- Bank confirmations not being returned (when it is likely that the confirming party is impacted by COVID-19 prevention measures)

If these situations are very severe and there are no alternative procedures, to avoid a scope limitation, management will likely instruct the auditor to suspend audit work until such limitations are no longer present. As a result, entities may need to consider an extension (or equivalent) to file and/or provide their financial statements. Once the limitations are no longer present, external auditors may continue to respond as originally planned or subsequently change their initial planned approach and perform alternative procedures. Where the current circumstances have had a significant impact on the conduct of the audit, the external auditor needs to consider how to explain this in their report, for example, by potentially reporting this as a key audit matter. In very rare circumstances, management of non-listed entities may consider whether their auditor can issue an auditors' report with a scope limitation.

This cannot be done by listed entities except where regulatory relief is sought and granted in the circumstances.

External auditors should stay in contact with audit committees or at least the audit committee chair on a regular basis. There are certain specific items that external auditors are required to communicate on a timely basis with the audit committee when relevant. It is likely that many of the circumstances listed above could trigger these communication requirements, specifically if there are:

- Significant changes in the planned scope and timing of the audit, including new significant risks and modifications to the audit strategy and plan;
- Significant difficulties encountered during the audit, including with respect to:
 - Obtaining sufficient appropriate audit evidence and/or completing their audit procedures;
 - Potential delays in obtaining sufficient appropriate audit evidence;
- Significant matters that were discussed or subject to correspondence with management, including disagreements; and
- Expected modifications to the auditor's report e.g. modifications as a result of a scope limitation or disagreement, an emphasis of matter paragraph in respect of significant doubt about an entity's ability to continue as a going concern, etc.

Communications should be timely and, due to rapidly developing events, will likely need to be more frequent. In many cases, these will be made jointly with management as they respond to the COVID-19 impacts on financial reporting, including working in a more virtual environment. Where communications are initially made orally to avoid delays, these should be followed up in writing where appropriate.

Internal control over financial reporting

Measures taken to address COVID-19 may have a significant impact on the way in which many organizations are conducting business, and audit committees need to be mindful of the potential implications on regulatory compliance, reporting and disclosure, and internal control over financial reporting (ICFR). The attached overview considers areas that audit committees should ask management about including:

- Are there any barriers to obtaining information necessary for financial reporting, particularly in more international organizations?
- Will roles and responsibilities for ICFR be impacted in a significant way and how will they be addressed?
- Can inventory counts and other physical asset inspections be conducted and, if not, what compensating procedures are possible?
- Have fraud risks increased and what is management doing to respond?
- Are there new or emerging accounting or disclosure matters that require amended or tightened ICFR?
- How will proper supervision, oversight and review be conducted remotely?
- Should we take advantage of extended filing deadlines offered by regulators?
- Is our cybersecurity strategy adequate in light of increased remote access and risk?
- Are our management review controls adequate given the volatile and changing environment and are we relying on preventative controls?
- Can ICFR be tested adequately to support control certifications including the retention and observation of evidence of effectiveness?
- Are there material changes in ICFR that require disclosure in filings?

These considerations will need to be part of an iterative process so audit committees should ensure that there is regular communication between themselves, management, internal audit and external audit. They all have a role to play in ICFR.

Further reading: [COVID-19: Challenges and considerations for effective internal controls over financial reporting](#)

Information technology including cyber risk

Audit committees often have oversight of the information technology function as part of the broader internal control environment. Because organizations are faced with an urgent requirement to maintain critical functions, including cybersecurity functions, during these pandemic conditions, audit committees should be receiving updates from their Chief Information Officers/Chief Information Security Officers about the following:

- As cyber criminals are capitalizing on the public's increasing desire for information, audit committees should receive reports from management about how the organization remains vigilant to ensure they do not fall victim to social engineering, phishing or ransomware events that may be introduced via emails or websites capitalizing on the COVID-19 pandemic.
- As organizations move to remote working conditions, audit committees should understand risks related to confidentiality, integrity and availability of information systems and how those are being addressed.
- As more employees work from home, audit committees should understand how management is addressing an expanded "attack surface" as end-user systems and critical functions move outside the organization's network perimeter.

Refer to the attached for a detailed list of key questions and considerations to help navigate these challenges including:

- Working productively while remote including potential disruptions to data centres
- Working from home securely including responding to cyber incidences
- Scaling digital channels to deal with demand including in the cloud
- Dependencies on key IT personnel and suppliers

Further reading:

[COVID-19: What the CIO and CISO can do to help](#)

Many entities are relying on third parties to provide critical services so audit committees should understand actions that management is taking to determine the possible risks these parties may present to the business in order to mitigate potential impacts. Key considerations and potential strategies of interest to audit committees are provided in the attached.

It addresses business continuity and resiliency when working with third parties, cyber risk at third parties, key person risk at third parties, third party reliance on its suppliers and vendors and service provider monitoring.

Further reading:

[Managing Third Party Risks during COVID-19](#)

Oversight of internal audit

Audit committees have direct oversight of the internal audit function so they should be asking their chief internal audit executive about the execution of their audit plan, how work will be done and considerations around managing their teams.

Immediate considerations include:

- The health and safety of internal audit team members
- Offering assistance to management in areas like business continuity planning and risk assessment
- Rethinking the most immediate elements of the current audit plan
- Considering how to work remotely

Longer-term considerations include:

- Guiding principles of conduct as the COVID-19 pandemic unfolds including potential curtailment or cessation of activities
- How digitally-enabled strategies could bring more insight and assurance to the entity
- How to establish sustainable communication channels to team members working remotely
- Rethinking the entire audit plan in light of a sustained disruption
- Audit committees can review an expanded discussion on these topics in the attached and regularly check back for additional posts.

Further reading:

[Coronavirus and the role of internal audit leaders](#)

Oversight of taxation matters

As businesses work to respond to the impacts and uncertainties of COVID-19, it's important that management updates the audit committees of the impact of measures that governments are taking in regards to tax deadlines and reliefs, as well as the tax impacts of other business decisions. Some of these considerations include:

- Cash-flow management and planning including applying for tax filing and payment extensions
- Taking advantage of tax reliefs and preferential measures to support businesses
- Fiscal stimulus measures that may include tax measures to promote consumption, employment and capital investment
- Employee and related tax requirements including personnel working remotely in different jurisdictions, potential immigration and tax compliance requirements triggered

by relocations and the legal and tax implications of unpaid or part paid vacation entitlements, compelling staff to take annual vacation, or layoffs and terminations in more extreme cases

- Management's ability to respond to tax authorities who are encouraging taxpayers to deal with tax matters remotely, such as over the phone, online or by mobile application

These are just a few of the evolving government interventions. We have established a dedicated [COVID-19 Resource Centre](#) that highlights areas of business operations that will likely be impacted by COVID-19, as well as key contacts should you or your team have specific questions.

Please reach out to your KPMG service team for any support you need as you navigate these challenging times.

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