

Alert

Updates on financial reporting, auditing and ethics



Issue 32 (February 2020)

Dear members,

Impact of Coronavirus Outbreak on Audits and Auditors

The coronavirus outbreak has brought challenges to almost all entities in various areas, including human resources, business activities and operations. In addition, disruptions to business operations and economic activity in the Mainland China have had a cascading effect on both upstream and downstream supply chains.

We understand that auditors are now facing great challenges created by the coronavirus outbreak, especially on the audit of financial statements of entities for the 31 December 2019 year ends or the upcoming audits of other year ends. Despite the potential delay or difficulties in accessing client premises or information, auditors will still need to obtain sufficient appropriate audit evidence to enable them to draw reasonable conclusions on which to base the auditor's opinions and to comply with the auditing standards to ensure the quality of the audit is maintained. Continuous and timely communication with management, directors and those charged with governance, including the audit committee, and the respective component auditors in the case of group audits is of utmost importance for ensuring the audit timetable is realistic and achievable.

Auditors are responsible for acting in the public interest and are reminded to exercise professional skepticism, maintain objectivity, integrity and independence, and to act professionally and ethically throughout the audit process.

The Institute's Auditing and Assurance Standards Committee has convened a working group to provide guidance for members in this difficult situation. This article highlights some specific issues which are anticipated to pose an impact on a client's business and audit risks. Auditors are encouraged to consider the highlighted areas when performing risk assessments and formulating the appropriate audit strategy and plan.

Obtaining an understanding on the impact of coronavirus outbreak on the client's reporting timetable

The coronavirus outbreak may disrupt the business operations of entities and the financial reporting process may also be impacted. Auditors should proactively discuss with clients to understand whether there is an impact on the client's reporting timetable and the impact on the audit processes.

Listed issuers could also be impacted which may result in a need to delay the publishing of preliminary results announcements. According to the Joint Statement in relation to Results Announcements in light of Travel Restrictions related to the Severe Respiratory Disease associated with a Novel Infectious Agent issued by the Stock Exchange of Hong Kong Limited (“the Exchange”) and the Securities and Futures Commission on 4 February 2020, the listed issuer should continue publishing its preliminary results without delay even it is not able to obtain agreement from its auditor. It is stated in the Joint Statement that “Where an issuer is unable to obtain agreement from its auditors but is otherwise in all respects able to publish its preliminary results in full compliance with the other reporting requirements set out in the Listing Rules, it should publish such preliminary results (without the agreement with its auditors) on or before the deadline. In such cases, the Exchange will normally allow trading in the securities of the issuer to continue.”

Points for consideration:

- Communicate with management and those charged with governance to fully understand the situation and determine the appropriate course of action; and
- Auditors may refer to guidance in PN 730 (Revised), *Guidance for Auditors Regarding Preliminary Announcements of Annual Results*.

Risk assessment

With the coronavirus outbreak, auditors may need to reassess the risks of material misstatement of the financial statements as the information on which the initial risk assessment was based may have changed. Auditors should evaluate the impact and may need to revise the risk assessments and modify planned audit procedures accordingly. (HKSA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*, paragraphs 31 and A152)

Points for consideration:

- Any new risk that was not assessed during the planning phase;
- Any risk assessed during planning stage that now becomes a significant risk and any additional work to address the significant risk; and
- Modify the responses to these risks.

Obtaining audit evidence

Due to the travel restrictions and various work arrangements, auditors may have difficulties in accessing client premises to perform procedures (e.g. client’s warehouse may be closed or auditors may not be able to travel and observe client’s inventory counts) and/or may not be able to obtain the anticipated audit evidence (e.g. significant delay in the provision of audit confirmations).

Points for consideration:

- Observe some physical inventory counts on an alternative date if the attendance of physical counting cannot be performed at the year-end date or perform alternative audit procedures where attendance of physical inventory counts is impracticable (HKSA 501 *Audit Evidence – Specific Considerations for Selected Items*, paragraphs 7, A12–A14);
- Consider performing alternative audit procedures when significant delay in the provision of audit confirmations (HKSA 505 *External Confirmations*, paragraphs 12, A18-19);
- Consider any scope limitation that may lead to a modified audit opinion; and
- Communicate with management and those charged with governance on a timely basis with respect to significant matters like difficulties encountered during the audit, potential delays in the auditor’s reporting and expected modifications to the auditor’s report.

Group audits with significant components in Mainland China

For group audits, component auditors in Mainland China may also encounter the same difficulties in obtaining sufficient appropriate audit evidence as mentioned above, which may cause significant delays in the completion of component audits; and that the group engagement team may not be able to travel to Mainland China for reviewing the workpapers of significant components. The group engagement team is however responsible for obtaining sufficient appropriate audit evidence to form the group audit opinion. The group engagement partner is responsible for the direction, supervision and performance of the group audit engagement. (HKSA 600 *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)*)

Points for consideration:

- Communicate with component auditors as soon as practicable to discuss potential impacts arising from the coronavirus outbreak;
- Consider any increased risk that financial information for those components may be inaccurate or incomplete due to the coronavirus outbreak;
- Revise the risk assessment and modify the audit strategy and plan accordingly;
- Evaluate the adequacy of component auditors’ work done and consider additional work or any scope limitation that may lead to a modified audit opinion; and
- Communicate with management and those charged with governance on a timely basis with respect to significant matters like difficulties encountered during the audit, potential delays in the auditor’s reporting and expected modifications to the auditor’s report.

Going concern

The coronavirus outbreak has caused a significant impact on the economic conditions for some entities, for example, disruption to business operations in, or with links to, Mainland China, interrupted supply chains, uncertainty on asset valuation, etc. This will in turn impact on cash flows and / or projected financial information of the entity, which may affect the assessment of the entity’s ability to continue as a going concern. When preparing financial statements, management is required to make an assessment of an entity’s ability to continue as a going concern. The related requirements are set out in HKAS 1 (Revised), *Presentation of Financial Statements*. Auditors are responsible for obtaining sufficient appropriate audit evidence regarding, and conclude on, the appropriateness of management’s use of the going concern

basis of accounting in the preparation of the financial statements, and to conclude, based on the audit evidence obtained, whether a material uncertainty exists about the entity's ability to continue as a going concern. (HKSA 570 (Revised), *Going Concern*, paragraph 6).

Points for consideration:

- Evaluate management's assessment of the entity's ability to continue as a going concern and consider whether management's assessment includes all relevant information which auditors are aware of as a result of the audit; management's assessment should be performed up to the date of the issuance of the financial statements;
- Consider inquiring management as to its knowledge of the events or conditions beyond the period of management's assessment, which is at least but not limited to twelve months from the end of the reporting period;
- Maintain professional skepticism and objectively challenge management's plans and significant assumptions on events or conditions affecting the entity and its environment, including uncertainties associated with the coronavirus outbreak;
- Paragraph 16 of HKSA 570 (Revised) sets out additional audit procedures when events or conditions are identified; and
- Evaluate the adequacy of the disclosures related to events or conditions that may cast significant doubt on an entity's ability to continue as a going concern.

Subsequent events

For entities with 31 December 2019 year ends, auditors may also consider the impact of events after the reporting period (HKSA 560 *Subsequent Events*) on asset valuation/impairment assessment and management's disclosures of relevant risks. In particular, auditors may consider the financial reporting and disclosure requirements for material impairment of assets or businesses as a result of the coronavirus outbreak.

Points for consideration:

- Discuss with management and those charged with governance on potential impacts of the coronavirus outbreak on the financial statements;
- Consider carefully the situation in the context of the requirements of HKAS 10 *Events after the Reporting Period*:
 - if conditions are existing at the end of the reporting period and an impairment indicator has been identified, consider whether an impairment test has been performed based on reasonable and supportable assumptions reflecting the conditions existing at the end of the reporting period.
 - if conditions are only existing after the reporting period and the financial effects are material, consider whether appropriate disclosures for each material category of non-adjusting event after the reporting period have been made.

The events resulting from the coronavirus outbreak are generally considered as non-adjusting events. However, auditors may also consider whether there are other events beyond the scope of the coronavirus outbreak that provide evidence of conditions that existed at the end of the reporting period, and hence are adjusting events.

Implications for the auditor's report

In addition to the above areas, auditors may also consider the implications for the auditor's report.

Points for consideration:

- Revisit the Key Audit Matters to be disclosed in the auditor's report and see if any need to be updated to reflect new responses, refer to HKSA 701 *Communicating Key Audit Matters in the Independent Auditor's Report* for guidance;
- Depending on the circumstances, consider whether to include a separate section "Material Uncertainty Related to Going Concern" in the auditor's report (HKSA 570 *Going Concern*);
- Depending on the resolution of accounting and auditing matters due to the impact of coronavirus outbreak, consider whether to express a modified opinion in accordance with HKSA 705 (Revised), *Modifications to the Opinion in the Independent Auditor's Report*; and
- Other information that accompanies the financial statements may include additional discussion of risks associated with the coronavirus outbreak, consider whether there is a material inconsistency between this other information and the financial statements and report in accordance with HKSA 720 (Revised), *The Auditor's Responsibilities Relating to Other Information*.

Sincere regards,

Chris Joy
Executive Director
Hong Kong Institute of Certified Public Accountants

CPA: *The Success Ingredient*

www.hkicpa.org.hk

Connect with us  