

## THE ASSESSMENT OF THE COVID-19 IMPACT UPON THE FIRMS FROM THE FINANCIAL AUDITORS' PERSPECTIVE

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**Abstract:** *As a result of the risks to which the firm is presently exposed, their assessment and the analysis of the financial implications on the company imply a high level of professional judgement of the management. The recent events related to COVID 19 have implications for the financial reports of the companies, especially for those with economic connections with the affected areas. From January 2020, auditors must be extremely alert to audit risk, mainly in terms of the direct implications for the compliance with the principle of continuity by the audited companies.*

**Key words:** *financial audit, financial situations, pandemic, continuity.*

**JEL Classification:** *M41, M40, M42.*

### 1. Introduction

Financial auditors must evaluate the impact of COVID-19 upon the financial reporting and compliance with the principle of business continuity both for the entities of public interest and for the other categories of economic entities.

There are recommendations from professional bodies for the financial auditors related to the implications of COVID 19 auditors need to be extremely alert to audit risk, especially in view of the direct implications of the audited companies.

When applying the audit procedures and preparing the audit report, one of the key issues in the statutory audit may be how the auditor reviewed, observed, and applied the audit procedures regarding significant developments before and after the pandemic within the entity.

### 2. The evaluation of continuity principle

The business continuity principle assumes that the financial statements are prepared on the same grounds as the current ones, unless management intends to either liquidate the entity or cease trading or has no other realistic alternative. The assessment of whether the appropriate basis for the continuation of the activity is appropriate shall be taken into account in subsequent events after the end of the reporting period. For example, for December 31, 2019, for companies that are severely affected by the impact of the COVID-19 pandemic, even if the significant impact on operations occurred after the end of the year, the management will need to consider the appropriateness of financial statements on an ongoing basis. When management is aware of significant uncertainties that seriously call into question the entity's ability to continue to operate, the entity should disclose those material uncertainties in the financial statements. Thus, on the basis of ISA 560 “Subsequent Events”, it is necessary to include in the annual financial statements as of December 31, 2019 detailed information notes on the impact of this situation on the company, so that users can assess the implications or at least be aware of the effects on the entity, itself and the economy in general. Stock market participants, investors, authorities need detailed information, specific to each field of activity, in order to make economic decisions (CAFR, 2020).

The assessment of the business continuity must also be based on all information available after 31 December 2019, and this information may be linked to the existence of major uncertainties due to the unpredictable evolution of emergencies: whether a company with a good track record profitability is based on external financial resources and, due to the urgency imposed by “COVID-19”, is forced to suspend operations in March 2020,

directors must consider a wide range of factors such as the worsening economic situation, the impact on profitability, debt repayment capacity, etc. Thus, companies must ascertain whether COVID-19 and its effects influence the business continuity assumption or change the time horizon used for the purpose of the assessment (Mazars, 2020).

In what the further events are regarded, there may be two extreme situations (CAFR, 2020):

1. There is an explanatory note on subsequent events, which details the measures taken by the company and there is a degree of insignificant uncertainty about the risk of business continuity. In this situation, the audit report will be affected by an explanatory paragraph that will draw attention to this issue, without affecting the audit opinion on the situations as of December 31, 2019.

2. There is no explanatory note on subsequent events detailing the measures taken by the company and there is a significant degree of uncertainty about the risk of business continuity. In this situation, the audit report will contain in the opinion basis a remark related to the significant risk of business continuity and, as such, will change the audit opinion accordingly, in the sense of a contrary opinion or even the impossibility of expressing the opinion.

IAS 10 stipulates that the financial statements may include those events that occur after the balance sheet date, but do not require the introduction of accounting data in the balance sheet (which does not affect the financial statements). In addition, IAS 1 “Presentation of Financial Statements” generally requires disclosures of future developments and the main causes of uncertainty. Therefore, directors should consider the impact of the COVID-19 emergency on their economic activity and provide adequate information on assets and liabilities that are particularly exposed to the uncertainty of the estimates, which generally include directors' assumptions about future recovery capacity of an asset or the liquidation value of a liability, as follows (Mazars, 2020):

- variable fees according to IFRS 15 “Revenues from contracts with customers”;
- net achievable value of inventories, according to IAS 2 “Inventories”;
- ability to recover prepaid taxes in accordance with IAS 12 “Income Taxes”;
- the residual value of fixed assets, intangible assets and rights of use, according to IAS 16 “Property, plant and equipment”, IAS 38 “Intangible assets” and, respectively, IFRS 16 “Leases”;
- provisions for risks, in accordance with IAS 37 “Provisions, contingent liabilities and contingent assets”.

### **3. The auditor's procedures for auditing companies in the context of COVID-19 events**

The documentation regarding the key aspects and application of audit procedures involves performing the following activities:

Procedure 1: analysis of the uncertainties and risks to which the company is exposed in the context of events related to COVID-19 and the presentation in the explanatory notes and in the note of subsequent events, as well as in the directors' report.

The worksheets prepared by the auditor may include the following objectives:

- analysis and evaluation of the risks presented by the client in the explanatory notes to the financial statements and the report of the administrators;
- collection of audit evidence to analyze the assessment of the entity's ability to continue its activity and documentation;
- identification of subsequent events and collection of sufficient and adequate audit evidence to document the 3 types of subsequent event situations:

- those that provide additional evidence regarding the conditions that existed at the end of the period - until the issuance of the audit report;
- those that provide additional evidence regarding the conditions that existed at the end of the period-until the submission of the financial statements;
- those that constitute an indication regarding the conditions that arise after the end of the period - after the submission of the financial statements;

Procedure 2: the inspection of the minutes of the shareholders' meetings and of the board of directors for the previous year and in the period until the submission of the financial statements;

The worksheets prepared by the auditor may include the following objectives: conclusions regarding the investigation of the issues discussed in the General Meetings of the Shareholders, the Board of Directors, the audit committees held after the end of the period for any references to financial difficulties, significant risks, subsequent events and continuity of activity.

Procedure 3: interviewing the relevant persons from the management of the entity with regard to the subsequent events and observing the principle of continuity of activity;

The worksheets prepared by the auditor may include the following objectives:

- Preparation and completion of the questionnaire regarding the subsequent events and observance of the principle of continuity of activity by the client and by the auditor
- Establishing the risks based on the questions from the questionnaire regarding the subsequent events and respecting the principle of continuity of activity

The interview of the relevant persons from the management of the entity can be done by oral or written communication, based on some questions asked by the auditor and developed according to the answers received. The questionnaire may include various questions such as:

1. Is the company involved in any activities that may give rise to litigation, which may result in compensation which the company cannot afford?
2. Were you notified of the bankruptcy of an important client this year?
3. Were the amount of bonuses and other entitlements due to employees for the financial year ended after the reporting period, the entity being required to pay these amounts?
4. Have major loan repayments matured or is refinancing required?
5. Has the company been affected by a refusal (or reduction) of the usual commercial credit terms?
6. Does the company face major staff difficulties?
7. Has the company faced a loss of major suppliers or customers or technological developments that lead to the obsolescence of a key product?
8. Is the company subject to a forced external reduction of operations, due to the legislative, regulatory framework or other factors?
9. Is the company involved in any activity, which can have various consequences, which would affect the principle of business continuity?
10. Do recent events related to the COVID-19 virus have a financial impact on society? Please provide details.
11. Does the company have external suppliers and customers in the areas strongly affected by the COVID-19 virus?
12. Does the company have enough stocks to continue the activity in the next period?
13. Have forecasts, estimates of future cash flows been made? If so, please attach.

14. Did the company register the loss of some customers, interruptions in supply and production?

15. Has the company registered the loss of some customers, interruptions in supply and production?

16. Is there a major risk of losing significant contracts?

Procedure 4: obtaining and evaluating the litigation situation prepared by the company's management and discussing with the company's management the status of the litigation and adjustments, as well as the potential exposures.

The worksheets prepared by the auditor may include the following objectives: analysis of the situation of litigation and the need to establish provisions.

Procedure 5: analysis of the main economic-financial indicators.

The worksheets prepared by the auditor may include the following objectives:

- Assessing the entity's ability to continue its activity based on the analysis of checking balances, bank journals / account statements, sales and purchase journals for the previous year and in the period until the submission of financial statements;
- analysis of turnover and operating result;
- analysis of the income and expenditure budget;
- analysis of management forecasts;
- analysis of the situation of external clients and suppliers.

#### **4. Conclusions**

The auditor's conclusion following the applied audit procedures, the adequate and sufficient audit evidence obtained, the corroboration of the information obtained from the client and the results of the auditor's verifications, must justify whether it presents a reasonable basis to assess the subsequent events and the capacity to continue its activity for the next period.

It is the responsibility of the auditors to obtain such information before issuing the final audit report. Movement restrictions and low staffing may affect the obtaining of such information as is necessary in the preparation of the audit report. In the case of audit teams, both the team leader and the other experts will need to adapt their approach to the current context. Auditors will need to explore alternative means of gathering information that make the most of technology. Used relevantly, technology can reduce time and maintain audit quality. Posting in cloud / secure platforms by the beneficiary the requested information, as well as verifying the traceability of the information provided can support the "remote" performance of audit tests (Fanita, 2020).

Even if the audit missions are carried out with difficulty, they must necessarily reach the assumed objectives (Diaconescu, 2020):

- the reflection of the faithful image of the patrimony situation and of the financial results in the balance sheet and in the profit and loss account;
- the expression of an opinion regarding the extent to which the financial statements present a true picture of the economic entity's business at the balance sheet date and the results of the year ended, in compliance with applicable laws and practices in the country where the audited economic entity has its registered office;
- maintaining the quality and coherence of the accounting system, so as to ensure the certainty of the reflection in the balance sheet and in the profit and loss account, correctly, honestly and completely of the patrimony, financial situation and results of the exercise;
- improving the use of the accounting information;

- appreciation of the performances and efficiency of the information and organization systems.

In carrying out a quality financial audit mission, it is necessary to re-evaluate the audit risk by the auditors as a result of the main risks and uncertainties faced by the audited entity. The control risk is very important to be recalculated and analyzed as a result of errors that may occur during the state of alert, emergency, as a result of the use of information technology extremely much, the decrease of staff capacity to cope with adaptation to new conditions inadequate use of office documents, homework, telework, unavailability of use of all staff as a result of those affected by health problems by infection and isolation of covid.

Also, the communication with the company management remains extremely important, especially in the context in which customer trips have been greatly reduced due to traffic restrictions imposed by the pandemic, telework.

Both corporate governance and financial auditors should give importance to the analysis of the exposure to business risk and the implications for the annual financial statements.

The quality of the works both for the auditor and for the audited companies must remain within the allowed limits, as well as the errors as well as the readjustment on the market to the new conditions of competition, client, suppliers.

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