Botswana Accountancy Oversight Authority

The Impact of the Coronavirus Disease (COVID-19) on Audit and Financial Reporting

The global economy has had a significant shift as a result of COVID-19. There has been a significant impact on global financial markets and the level of uncertainty about the outlook for many companies has increased.

The way in which audit firms carry out the audit of companies has been significantly affected by COVID-19, considering limited access to company sites. There would therefore be need to develop alternative audit procedures to gather sufficient, appropriate audit evidence.

Entities being audited are revisiting their financial reporting processes, disclosures in financial statements and their ability to maintain operations in the foreseeable future as a result of COVID-19.

BAOA would like to emphasise that the current situation should not undermine the delivery of high-quality audits and Financial Reporting. Public Interest Entities and Auditors should continue to comply fully with required professional standards. Notwithstanding that additional time may be required to complete audits, it is important that arrangements are made to mitigate this constraint.

Auditing and Accounting Considerations

Auditor's risk assessment

Auditors may need to revisit their risk assessment and assess how their planned audit approach would addressed the new or revised risks that have arisen because of COVID-19. The level of professional scepticism would need to be increased in a number of areas depending on the nature of the business.

Audit Evidence

Auditors need to ensure that sufficient, appropriate audit evidence is gathered to support audit opinions issued. All areas making use of assumptions as audit evidence will need more thorough scrutiny and challenging of the assumptions and input data.

Group Audits

The effects of COVID-19 may differ from country to country, so group auditors will need to consider this in their risk assessment to ensure that the work of the component auditors meet the requirements of standards and that audit evidence obtained is sufficient and appropriate to base the group audit opinion on.

The Auditor's responsibilities relating to Going Concern

Some entities may never recover from the effects of COVID-19 especially the undercapitalised businesses. Auditors should assess the ability of the companies to raise capital through, for example, shareholders and banks to ensure the going concern principle is still applicable. The audit opinion and robust disclosures should reflect any such concerns**.**

Impairment of non-financial assets (including goodwill)

Key issues to consider include:

- Goodwill impairment - allocation of goodwill to various cash generating units depending on the specific effects of COVID-19 business disruptions and prospects for recovery - IAS 36.

- Property, Plant and Equipment (PPE) - some items of PPE may need to be impaired owing to non-utilisation or reduced capacity.

- Intangible assets - the carrying amounts need to be re-evaluated.

- Investment properties - companies in the property sector especially hotels need to be assessed if they have a realistic chance of recovery as the tourism sector has been significantly impacted, particularly if the lockdown continues for a protracted period.

Valuation of inventories

- Extended lockdowns by countries may result in a higher incidence of expired products being carried in inventory.

- The unexpected shutdown may result in some raw material wastages especially work-in progress at the time of shut down.

Financial Instruments-Allowance for expected credit losses

Financial institutions account for the bulk of financial instruments globally. Many companies are already taking drastic steps to cut costs including laying off staff until the situation improves. This inadvertently will affect loans repayments by borrowers. Greater emphasis should be placed on current and forward-looking information than historical data which is the emphasis in IFRS 9 after the 2008 credit crisis.

- ***Credit impaired loans*** - Auditors and Client Finance personnel should be more critical of 12 Months credit losses. In addition, incidences of impaired loans will increase (Stage 3 loan advances). This will affect income as the calculation of interest income will be based on the amortised cost carrying amount as opposed to being based on the gross amount.

- ***Regulatory capital compliance*** - increased impairments may ultimately affect the regulatory compliance of financial institutions as the impairments eat away the capital base.

Fair value-based measurements (IFRS 13)

- Level 3 and Level 2 valuations will need greater scrutiny to ensure that they are supported by robust assumptions and supporting data.

- Level 1 valuations should focus on post balance sheet events (IAS 10) since most stock markets globally have had significant declines which can only be reflected through enhanced post balance sheet disclosures.

Events after the end of the reporting period

The state of the companies after the reporting date will need to be carefully evaluated than ever before as some entities with earlier year ends might have significant issues such as impairment and going concern problems after COVID-19 took over the whole world.

Restructuring costs and Provisions

Some entities will be forced to restructure and /or retrench staff resulting in significant provisions for restructuring. Auditors need to be alert to such possibilities for all their clients.

Insurance/Reinsurance Companies

Auditors of insurance companies need to be alert to the following:

- Claims - consider whether the client has insured natural disasters such as COVID-19 and the significance of the claims to the business.

- Insurance policies - with job losses, the significance of insurance policy lapses needs to be evaluated.

Conclusion

Management and the auditors need to ensure that relevant COVID-19 disclosures are made in the financial statements, so that users of the financial statements are properly informed about the company's prospects and how they might be affected, recognising the high degree of uncertainty.

It might be necessary for entities to arrange with their regulators such as the Botswana Stock Exchange (BSE), Company Intellectual Property Authority (CIPA), Non-Bank Financial Institutions Regulatory Authority (NBFIRA), Bank of Botswana (BoB), and the Authority (BAOA) to reschedule their reporting deadliness to delay penalties kicking in.

This communication is purely highlighting areas of focus in an evolving audit, corporate governance and financial reporting environment occasioned by COVID-19. The areas highlighted above should not be considered to be exhaustive.

Duncan Dankie Majinda
Chief Executive Officer
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