

COVID-19: Reminders for Audits Nearing Completion

SPOTLIGHT

Overview

The COVID-19 crisis and related economic uncertainty present a unique set of challenges for auditors of issuers and broker-dealers. We are providing important reminders to these auditors relating to audits that are nearing completion.

We realize that, as of the date of this communication, auditors who are close to completing in-process audits of issuers and broker-dealers are actively dealing with time-sensitive and complex auditing issues. Appropriate responses to COVID-19 issues will depend on each audit's unique facts and circumstances, and therefore this communication does not intend to provide detailed guidance on how to apply our standards, nor are the matters and examples included herein intended to be all-inclusive.

In all circumstances, auditors have an obligation to comply with PCAOB standards and rules, and other applicable regulatory and professional requirements. Auditors should exercise due professional care in performing audits, which requires that auditors exercise professional skepticism. Auditors' opinions on financial statements, and if applicable, internal control over financial reporting, need to be supported by sufficient appropriate evidence that provides a reasonable basis for those opinion(s). The breadth and scale of COVID-19 issues may present challenges to auditors in fulfilling these responsibilities and completion of audits may require more effort or may take longer.

The current situation is evolving and, as a result, regulators and others have announced certain regulatory relief and other accommodations. For example, the U.S. Securities and Exchange Commission has conditionally extended its relief for registrants affected by COVID-19 to file Securities Exchange Act of 1934 reports due through July 1, 2020, and has made various other communications in [response to COVID-19](#). Congress passed the [Coronavirus Aid, Relief, and Economic Security Act](#), which is designed, in part, to stabilize the U.S. economy and provide targeted relief and assistance to various industries. New challenges may continue to arise, and we will continue to monitor the evolving situation and assess whether additional communication from the PCAOB is needed.

The PCAOB staff has prepared this publication to provide information. This publication does not establish rules of the Board, nor has it been approved by the Board.

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The information in this Spotlight is not staff guidance; rather, it highlights timely and relevant observations for auditors.

Auditors' Responsibilities to Identify, Assess, and Respond to Risks of Material Misstatement

The effectiveness of a risk-based audit approach is highly dependent on the ability of the auditor to identify the risks of material misstatement, due to error or fraud, and to have an appropriate basis for assessing those risks. Auditors are then required to design and implement responses that address the risks of material misstatement, including responses that have an overall effect on how the audit is conducted and responses involving the nature, timing, and extent of the audit procedures to be performed.

The risk assessment process is not a discrete phase of an audit but rather a continual and iterative one. PCAOB standards require the auditor's assessment of the risks of material misstatement, including fraud risks, to continue throughout the audit. When the auditor obtains audit evidence during the course of the audit that contradicts the audit evidence on which the auditor originally based his or her risk assessment, the auditor should revise the risk assessment and modify planned audit procedures or perform additional procedures in response to the revised risk assessments.

As part of the evaluation of whether sufficient appropriate audit evidence has been obtained, auditors are required to evaluate the appropriateness of their initial risk assessments. In light of the economic effects of the COVID-19 crisis, new risks may emerge, or the assessments of previously identified risks may need to be revisited because the expected magnitude and likelihood of misstatement has changed. Changing incentives or increased pressures on management, especially when taken together with changes in internal controls or increased ability for management override of controls, may result in new risks of material misstatement due to fraud or changes to the auditor's previous assessment of risks of material misstatement due to fraud. Similarly, increased pressure on, and changes in, management processes, systems, and controls may give rise to increased risk of error. Initial responses to assessed risks may not be adequate given the revised risk assessments, or planned procedures may not be practical or possible to perform under current circumstances.

Auditors may face time constraints in completing the audit and challenges in obtaining and evaluating the sufficiency and appropriateness of audit evidence, including:

- Limited availability of, or access to, company personnel;
- Delays by management in responding to auditor's inquiries; or
- Challenges in access to, or communicating with, other auditors.

Auditors may need to obtain evidence of a different nature or form than originally planned, which may affect the auditor's consideration of its relevance and reliability. For example, evidence obtained may be a copy or in digital form, giving rise to the need for procedures to support its validity. Auditors may also face challenges in obtaining evidence previously planned to be obtained

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through physical observation procedures (e.g., of inventory and property, plant, and equipment). The specifics of each situation are likely to vary, including the issuer's approach, the materiality of balances, the assessed risks of material misstatement, consideration of the issuer's controls, and the procedures already performed by the auditor, all of which will affect the auditor's approach to obtaining sufficient appropriate audit evidence. For example, procedures that the auditor may consider performing include roll-forward or roll-back procedures from or to the date of a physical observation, or virtual observation procedures.

Auditors may also consider the following matters in modifying audit procedures or designing new procedures:

- Enhancing direction and supervision of less experienced team members; and modifying the nature and extent of review of their work;
- Increasing the involvement of more senior or experienced members of the engagement team in performing procedures related to more complex issues;
- Involving – or increasing the involvement of – specialists or others with specialized skills and knowledge; and
- For engagements where other auditors are involved:
 - Developing alternative approaches for direction and supervision where previous plans involved travel and in-person interactions (including considering use of technology); and
 - Considering whether audit evidence may be gathered by alternative approaches, including new or extended procedures to be performed by the lead auditor.

This communication does not specifically include observations relating to audits at initial or earlier stages of completion, and reviews of interim financial information, where different or additional challenges may also arise.

Effect on the Financial Statements that May Affect the Audit

The economic effects of COVID-19 on the financial statements of an issuer or broker-dealer are likely to vary significantly depending on industry, geographic location, or other factors.

The auditor may need to challenge or revise previous risk assessments in light of the COVID-19 crisis for certain financial statement areas. Additionally, some financial statement areas may present challenges to the auditor's evaluation of the presentation of the financial statements, including the disclosures. For example:

- Subsequent events;
- Going concern;
- Asset valuation, including impairment triggers and related assessments;
- Accounting estimates, including fair value measurements;
- Revenue recognition, including effects of contract modifications;
- Leases;
- Hedging;

- Income taxes, including tax valuation allowances;
- Provisions, allowances, and loss contingencies;
- Debt modifications or restructuring;
- Debt covenants, other regulatory ratios, and minimum net capital requirements for broker-dealers; and
- Disclosures, including those pertaining to risks and uncertainties, and liquidity-related disclosures.

Effect on Financial Reporting Processes and Controls that May Affect the Audit

The COVID-19 crisis may affect an issuer's or broker-dealer's financial reporting processes and related controls, including in particular those relating to "closing the books" and preparation of financial statements. Processes and controls may be affected by necessary changes to business processes, including rapid design and implementation of new or modified processes and controls in light of circumstances such as travel restrictions, or as a result of remote working arrangements.

The risk of deficiencies in new, modified, or existing controls could increase for reasons such as lack of segregation of duties or lack of effective monitoring controls, which may give rise to increased risk of potential management override. As a result, auditor's procedures to understand and test relevant controls may need to be reconsidered. In addition to performing procedures to understand new or modified processes and controls, auditors may need to design and perform new procedures, or modify previously planned procedures, to test new or modified implemented controls. For example, the auditor may need to design and perform procedures involving inspection and reperformance if observing real-time operation of controls is no longer possible.

Audit Committee Communications

During this time, it is important for auditors to remember required communications to the audit committee. Among other things, the following matters that auditors are required to communicate may be affected by COVID-19 issues:

- Significant changes to the planned audit strategy or the significant risks initially identified, and the reasons for such changes;
- Matters related to accounting policies, practices, and estimates, and the auditor's evaluation of the quality of the company's financial reporting, including any significant changes management made to the processes used to develop critical accounting estimates or significant assumptions, a description of management's reasons for the changes, and the effects of the changes on the financial statements;

- Control-related matters, including significant deficiencies and material weaknesses;
- Matters that are difficult or contentious for which the auditor consulted outside the engagement team and that the auditor reasonably determined are relevant to the audit committee's oversight of the financial reporting process;
- Matters relating to the auditor's evaluation of the company's ability to continue as a going concern; and
- Significant difficulties encountered during the audit.

Auditor's Report

The COVID-19 crisis may affect the auditor's report, such as when the auditor is determining and communicating critical audit matters (CAMs). The guidance in our publications, *Implementation of Critical Audit Matters: A Deeper Dive on Determination of CAMs* and *Implementation of Critical Audit Matters: A Deeper Dive on the Communication of CAMs*, may be relevant when considering the effects of COVID-19 on CAM determinations and communications. While the COVID-19 crisis may not itself be a CAM, it may be a principal consideration in the auditor's determination as to whether one or more CAM(s) exist, and may also affect how CAMs were addressed in the audit.

Additionally, the significance of the impacts of COVID-19 may warrant including additional elements in the auditor's report, such as explanatory language or an explanatory paragraph when there is substantial doubt about the ability of the company to continue as a going concern.

Quality Control Considerations

With respect to firms' system of quality control, firms may modify policies and procedures relating to engagement performance. For example, a firm may add or re-emphasize requirements for consultations with suitably qualified individuals within or outside the firm in areas where judgments and conclusions are most likely to be affected by COVID-19 issues. Additionally, the scope of engagement quality reviews may be affected by an increase in the number and different nature of significant judgments being made by engagement teams because of COVID-19 issues.

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Other Resources

The following PCAOB alerts address uncertain economic environments. While these alerts do not specifically deal with issues relating to the COVID-19 crisis, some of the topics addressed in this Spotlight are also addressed in these alerts. Auditors may therefore refer to them for additional information.

- [PCAOB Staff Audit Practice Alert No. 9, Assessing and Responding to Risk in the Current Economic Environment, December 6, 2011](#)
- [PCAOB Staff Audit Practice Alert No. 3, Audit Considerations in the Current Economic Environment, December 5, 2008](#)

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