PCAOB
PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

SPOTLIGHT

Auditing Considerations Related to the Invasion of Ukraine

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INTRODUCTION

Overview

The recent Russian invasion of Ukraine not only is affecting companies with operations in the region but also has the potential for far-reaching economic impacts on companies operating across different jurisdictions. We are providing this Spotlight to highlight important considerations for auditors of issuers and broker-dealers (collectively "companies") as they plan and conduct audits and reviews of interim financial information in this evolving environment.

Economic Implications

As a result of the military action, companies located (or with significant business ties) in Ukraine are experiencing major disruptions of their operations, including the loss of some or all of their physical assets and workforce. Some companies may have idled or abandoned their production facilities and inventories in anticipation of escalating hostilities in the region.

In response to Russia's actions, many governments and international organizations have imposed various types of economic sanctions against Russia, certain Russian companies and products, and specific individuals. Similar measures have also been imposed on Belarus for its role in the conflict. Additionally, several major Russian banks have been removed from the network for international bank transfers (SWIFT), limiting their ability to make and receive international payments. Further measures are also under consideration or being implemented, including US import and export restrictions of Russian goods and commodities, suspension of Russian securities from trading on US exchanges, bans of institutional investment in Russian securities, and limitations on Russian banks' ability to borrow funds. These developments are likely to have a wide range of effects on many companies with business ties in the region, including supply and distribution chain disruptions, materials and other inventory shortages, significant increases in prices of raw materials and borrowing costs, and loss of liquidity.

Additionally, many global companies have made public statements that they would not do business in or with Russia, including intentions to close operations in Russia and boycott goods produced and sold by Russian companies. These boycotts may continue for the foreseeable future. Some organizations, including accounting firms, have also announced that they are cutting ties with their Russian affiliates.

These events also have broader global economic implications. Rising global inflation, driven partially by sanctions on Russia and supply chain issues, and the region's market strength in oil and other commodities markets, may lead to higher interest rates. This in turn may increase borrowing costs for a variety of companies in various industries, whether or not they have direct business ties to the region. Fluctuations in foreign currencies, rising oil and gas prices, and volatility in some equity and commodity markets may also negatively affect some companies. As the potential economic impacts of the conflict continue to evolve rapidly, continuous monitoring of the situation and reassessing relevant implications remain important.

AUDIT AND INTERIM REVIEW CONSIDERATIONS

The financial statement effects from the events surrounding the Russian invasion ("current environment") are likely to vary significantly depending on a company's geographic location, industry, and other factors. Further, the effects on some companies and industries may be longer-lasting whereas for others the effects may be only temporary. As the situation evolves, auditors should remain aware of developments and the potential for broader economic issues that could in turn affect more companies. Auditors may also be faced with certain challenges in completing audits of affected companies. In some cases, obtaining sufficient appropriate audit evidence to support the auditor's opinion on the financial statements may take longer or require more audit effort. Nonetheless, auditors are required to comply with PCAOB standards and exercise due professional care, which requires that auditors exercise professional skepticism.

Identifying and Assessing Risks

The auditor has a fundamental responsibility to identify and assess risks of material misstatement, due to error or fraud, and design and implement overall responses that address those risks. Risks of material misstatement can arise from a variety of sources, including external factors, such as economic, legal, and political conditions in the company's industry and environment.

In times of unrest and economic uncertainty, a company's environment may change quickly. Knowledge obtained from past audits or interim reviews may no longer be as relevant. It is important for the auditor to understand how changes in events, conditions, and company activities affect risks of material misstatement and whether those changes give rise to new or different risks (as described in the following examples).

- Supply chain disruptions, whether from continuing to rely on Russian counterparts or from severing ties with them, may affect a company's ability to meet contractual obligations.
- A decision to boycott a key supplier, suspend sales to a key customer, or abandon investments in Russian entities may have longer-term negative effects on projected earnings.
- Companies choosing to continue doing business with certain Russian entities or individuals may have reputational risks, while companies with significant operations in Russia may experience boycotts of their products or operations.
- A company may not be able to regularly access funds through short-term borrowings and may have other liquidity issues, casting doubt about the company's ability to continue as a going concern.
- Changing circumstances may force an unplanned reallocation of resources (e.g., closure of shared service centers used by the company) or shutdown of subsidiaries or product lines.
- Heightened volatility and uncertainty may result in market and counterparty risk for some broker-dealers.[1]

Fraud Risks

The current environment may also create opportunities, incentives, and pressures to commit fraud. For example, company management may be motivated to downplay the effects of economic sanctions and make financial results more favorable to meet the expectations of third parties. Fraud risks may also arise from companies potentially doing business with sanctioned entities. (See "Possible Illegal Acts" discussion below.) Communication among engagement team

[1] *TM Staff Statement*, SEC Division of Trading and Markets, (March 14, 2022).

members about significant matters affecting the risks of material misstatement should continue throughout the audit, including when conditions change.

Cybersecurity Risks

The economic volatility in the current environment can pose an increased risk of cybersecurity attacks. In response to economic sanctions and boycotts, there may be increased incentive and opportunity for hackers to launch ransomware attacks or take advantage of potential weaknesses in companies' information systems. Some companies (e.g., those with multinational operations) and industries (e.g., financial institutions, utility companies) may be more likely targets of these attacks. It is important for auditors' risk assessment procedures to include an understanding of how companies are addressing cybersecurity risks specific to the current environment with a focus on potential financial reporting impacts.

Planning and Performing Audit Procedures

The nature and extent of planning activities that are necessary depend on, among other things, changes in circumstances that occur during the audit. Audit planning is not a discrete phase of an audit but rather a continual and iterative process. As conditions in the company's environment evolve, auditors may need to revisit their initial assessment of risks and modify planned audit procedures. In some cases, auditors may need to perform additional or different audit procedures to obtain sufficient appropriate audit evidence compared to those performed in prior audits. The nature of the circumstances facing the company may pose unique challenges for the auditor. For example, audit evidence may not be available in the form originally expected (e.g., inability to obtain confirmations). As a result, auditors may need to revise the nature, timing, and extent of audit procedures (e.g., performing new or extended procedures).

Materiality

The current environment may also cause the auditor to re-evaluate materiality and tolerable misstatement (e.g., if the auditor initially established materiality and tolerable misstatement based on estimated or preliminary financial statement amounts that differ significantly from actual amounts). Changes in materiality can also affect the auditor's evaluation of audit results and the determination as to whether sufficient appropriate audit evidence has been obtained.

Internal Control Over Financial Reporting

Modifications to the company's operating structure and business processes may affect its flow of transactions, financial reporting processes, and related controls. For example, control owners may no longer have access to information necessary to complete their assigned roles, which may lead to implementation of new or modified processes and controls. In some cases, new controls may have been implemented to address evolving areas, or new control owners may be involved. For example, controls over contracts may have been modified to include additional evaluation for compliance with laws and regulations as a result of government sanctions. The rapidly changing environment further exacerbates the potential for disruptions to the timing and operation of certain controls, including IT-related and review-type controls. The auditor's procedures to understand, select, and test relevant controls may need to be modified to address the increased risk of deficiencies posed by these changes (e.g., potential lack of segregation of duties and risk of management override).

Effects on Specific Audit Areas

Certain financial statement areas may be particularly affected by the changing conditions and present challenges to the auditor's evaluation of the presentation of the financial statements and disclosures. As circumstances change, auditors may need to pay particular attention to, or revisit initial conclusions in, these and other areas.

Going Concern

Auditors may identify conditions and events giving rise to substantial doubt about the ability of the company to continue as a going concern for a reasonable period of time (not to exceed one year beyond the date of the financial statements being audited). In addition, as conditions continue to change, management's initial plans to alleviate substantial doubt may no longer be viable. For example, projected financial information used to support management's plans may be based on assumptions that are likely to change. Exercising professional skepticism includes questioning whether relevant factors are missing from projected financial information and, if necessary, requesting revised information or performing additional procedures.

Asset Impairment and Valuation

The current environment may give rise to triggering events or other impairment indicators of the value of a company's long-lived assets, intangibles (including goodwill and lease-related assets), and equity method investments. In some cases, property, plant, and equipment may be damaged, destroyed or abandoned. In other cases, import/export restrictions or other economic sanctions may affect the cash flows related to a particular asset or asset group. As circumstances evolve, auditors may need to direct additional audit effort to evaluating the reasonableness of cash flow projections and other significant assumptions used by the company in its impairment analyses (e.g., anticipated insurance recoveries) to determine whether impairment is appropriately recognized and impairment charges are not understated or overstated.

Supply chain disruptions and sharply increasing costs may lead to shortages in inventory for some companies. Other companies, however, may experience excess quantities and require write-downs due to, for example, a boycott of products. It is important for auditors to understand the relevant facts and circumstances to determine the appropriate audit response.

Accounting Estimates

Volatility in the current environment may affect a number of accounting estimates, including fair value measurements, loss contingencies, and valuation allowances (e.g., deferred taxes and customer receivables). When testing the company's process for developing accounting estimates, PCAOB standards require auditors to evaluate the reasonableness of significant assumptions used, including whether the company has a reasonable basis for those significant assumptions, and whether the assumptions are consistent with industry, regulatory, and other external factors, including economic conditions. Current economic uncertainties may heighten the subjectivity and measurement uncertainty of certain estimates. For example, estimates in the oil and gas industry might be particularly sensitive to price fluctuations. As another example, the market for certain financial instruments may experience significant loss in volume or level of activity, or transactions may not be considered orderly. These conditions affect how estimates are determined and may necessitate additional audit procedures to determine whether the accounting estimates are properly accounted for and disclosed in the financial statements.

Revenue

Losses of key customers, increased credit risk related to certain customers, changes in the company's ability to fulfill contract provisions, changes to estimates of variable consideration, and other contract modifications may result in significant changes in how revenue is recognized. Further, significant changes in the volume and nature of transactions with customers may result in concentration risk. Additional audit effort may be needed to test revenue from contracts with customers and related disclosures.

Debt

Companies may not be able to comply with debt covenants and may be forced to restructure or modify debt arrangements. In addition, for companies in need of funding, there may be significant increases in borrowing costs or limits on new financing due to economic sanctions. Changes to a company's debt agreements may have a significant effect on the corresponding accounts and disclosures. Auditors are reminded to pay particular attention to these matters when designing and performing audit procedures.

Consolidation

Economic sanctions and other factors stemming from the current environment may affect a company's ability to control or significantly influence investments in entities located in Russia or Ukraine. For example, foreign exchange restrictions and the inability to repatriate funds of the subsidiary may indicate that the parent company no longer has control over its subsidiary. Additional audit effort may be necessary to evaluate the effects of relevant facts and circumstances on a company's ability to consolidate (or apply the equity method of accounting).

Use of Other Auditors

Some global accounting firms have begun to cut ties with Russian (and Belarusian) member firms of their networks. The former member firms may continue to operate as independent entities but are no longer part of the global firm's information technology platform or system of quality control and may no longer have access to the global firm's resources, including its technical experts. Some lead auditors that may use the former member firms to perform audit work on global companies may have difficulties communicating with or accessing these firms and may need to develop an alternative plan for supervising, or using the work and reports of, these other auditors. Further, any shared-service centers based in Russia or Ukraine may no longer be operating. Auditors who planned to use affected shared-service centers for certain audit procedures would need to modify their approach.

Communications With Audit Committees

The rapidly changing environment may necessitate more frequent communications between auditors and audit committees. For example, management may make changes to certain accounting policies, practices, or estimates as a result of the current environment. These changes in turn may affect the planned audit strategy. In addition to the required communications to the audit committee, auditors are also reminded of their responsibilities of obtaining information relevant to the audit from the audit committee. For example, auditors should inquire of the audit committee's knowledge of risks of material misstatement, including fraud risks.

Possible Illegal Acts

As discussed above, some governments have imposed strict economic sanctions prohibiting, among other things, transactions with certain Russian entities or specified individuals, and exports of certain advanced technologies to potential Russian end users. Additional developments in the current environment may give rise to further sanctions and restrictions. The operations of certain companies may be directly or indirectly affected by sanctions and related developments. Auditors should remain alert for instances of potential non-compliance with sanctions and other laws or regulations. If the auditor becomes aware of a possible illegal act by a client, the auditor is required to understand the nature of the act and evaluate the effect on the financial statements, including the adequacy of the company's disclosure of the act on its operations. The auditor should also, among other things, ensure that the audit committee is adequately informed of the illegal act as soon as practicable.

Reviews of Interim Financial Information

Auditors are required to have sufficient knowledge of the company's business and its internal control environment when planning and performing reviews of interim financial information to meet the objectives set out in PCAOB standards. New information or changes in circumstances may arise from one quarter to the next. If auditors become aware of information that leads them to believe that the interim financial information is not in conformity with the applicable financial reporting framework, auditors have a responsibility to make additional inquiries or perform other procedures considered appropriate to provide a basis for communicating whether they are aware of any material modifications that should be made to the interim financial information. For example, inquiries about changes in the company's business activities may necessitate additional inquiries or other procedures, including, when applicable, inquiries about the company's ability to continue as a going concern and events occurring subsequent to the date of the interim information. (See "Subsequent Events" discussion below.) Changes in the auditor's judgments regarding materiality may also affect the planning and performance of reviews of interim financial information.

Auditors are also responsible for making inquiries about whether significant changes in internal control (as it relates to preparation of interim financial information) have occurred subsequent to the preceding year-end audit or review of interim financial information. This includes changes to the company's policies, procedures, and personnel, as well as the nature and extent of such changes.

Acceptance and Continuance of Clients and Engagements

Certain implications arising from the current environment may be particularly relevant to auditors' periodic procedures for acceptance and continuance of clients and engagements. Specifically, in connection with renewing or accepting clients or engagements, auditors need to carefully consider their ability to perform an audit in accordance with PCAOB standards taking into account factors such as:

- Whether the company has any ownership interests or business relationships with companies or individuals that are subject to sanctions or other restrictions;
- The extent and nature of any operations the company has in the region affected by the conflict; and

- Known limitations to the auditor's ability to obtain sufficient appropriate audit evidence and apply all procedures necessary under PCAOB standards to express an opinion on the financial statements or internal control over financial reporting.

AUDITS NEARING COMPLETION

Audits of affected companies that are in process and nearing completion may pose specific challenges for auditors. Appropriate audit responses to evolving risks will depend on the facts and circumstances. As discussed above, conditions at some companies may be fluid and give rise to new or different risks of material misstatement. When auditors obtain audit evidence that contradicts previously obtained evidence on which their risk assessment was based, auditors are reminded of their responsibility to revise the assessed risk and modify planned audit procedures (or perform additional procedures) to respond to the revised risk. Auditors are also reminded that obtaining written management representations is not a substitute for the application of the audit procedures necessary to provide a basis for the auditor's opinion on the financial statements.

Subsequent Events

As the current environment and the related economic impacts continue to evolve, events and conditions are likely to change. Those changes may affect the presentation of a company's financial statements. Auditors are reminded of their responsibilities to assess events or transactions occurring after the balance sheet date but before the financial statements are issued to determine whether they have a material effect on the financial statements and therefore require adjustment or disclosure in the financial statements. The current environment may also cause delays in the issuance of financial statements, increasing the length of time occurring from the balance sheet date. Auditors may need to perform additional procedures to determine whether appropriate disclosures of significant events have been made and consider obtaining additional representations from management.

Other Information

Many public companies may determine that it is necessary or appropriate to enhance their disclosures of material risk factors arising from the current environment, as well as related effects on liquidity, capital resources, and results of operations. Auditors have a responsibility with respect to such disclosures in the other information contained in annual and quarterly reports with audited financial statements or interim financial information that has been reviewed. Auditors should read the other information to consider whether such information, or the manner of its presentation, is materially inconsistent with the financial statements or interim financial information. In doing so, auditors may, for example, consider the consistency of the public company's disclosures about the effects of this conflict in sections such as Risk Factors and Management's Discussion and Analysis with the information presented in the financial statements or interim financial information. In reading and considering the other information, auditors are reminded to discuss the matter with the company if they become aware of information that they believe is a material misstatement of fact.

Auditor Reporting

There may also be implications for the auditor's report due to the effects of the current environment. Depending on the facts and circumstances of the specific audit, the auditor's report may include:

- *Critical audit matters (CAMs):* The effects of this conflict may be relevant to an auditor's determination of whether a matter is a CAM and if so, may also be relevant to the auditor's communication of that CAM. 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*, contain guidance that may be relevant when considering the effects of the conflict on CAM determination and communication.
- *Required explanatory language/ paragraph(s):* There are circumstances in which the auditor is required to add explanatory language to the auditor's report, such as when there is substantial doubt about the company's ability to continue as a going concern or the auditor refers to the report of other auditors.
- *Voluntary emphasis paragraph(s):* The auditor may emphasize a matter regarding the financial statements in the auditor's report, including, for example, an unusually important subsequent event that may have a significant effect on the company's financial position.

Scope Limitations

Auditors of companies with significant operations in the affected areas may face restrictions on the scope of the audit (e.g., limited access to information or inability to obtain sufficient appropriate audit evidence). In the event the auditor concludes that a qualification or a disclaimer of opinion is appropriate in the circumstances for an audit of the financial statements or internal control over financial reporting, the auditor is strongly encouraged to look to the relevant PCAOB requirements and consider the implications under Securities and Exchange Commission requirements resulting from departures from unqualified opinions.

Reissuance or Consenting to the Use of the Auditor's Report

In situations involving report reissuance or consenting to the use of a previously issued report, the auditor is required to perform subsequent event procedures. In the course of performing these procedures, special considerations may arise, especially for audits of financial statements where the auditor's report is dated soon before the date of the invasion and implications from the ensuing conflict were not recognized or disclosed in the audited financial statements.