

## **POTENTIAL COVID-19 IMPACT ON FINANCIAL REPORTING, AUDITING AND ETHICS**

### **PART A: FINANCIAL REPORTING IMPACT**

What started in the Chinese city of Wuhan in Hubei province during December 2019 as an outbreak of unknown virus has become a global Pandemic declared by World Health Organization (WHO) on 11 March 2020 with a name tag of COVID 19. This Pandemic has created global disruption at an unprecedented level and at such speed that most of us could not comprehend even couple of weeks earlier. Along with great human toll and impacts on public health, COVID 19 has also created devastating effect on global trade, commerce and industry with consequential implications on financial reporting by the affected entity and audit of those entities.

Although COVID 19 originated during December 2019 but as at 31 December 2019 it was not widely known outside China nor any impact of this was felt anywhere outside China. COVID 19 started to get global attention only towards end of January when WHO declared this as health emergency on 30 January 2020. Finally, on 11 March 2020 WHO declared it a global Pandemic and by this time COVID 19 has created a Global shock and disturbance not seen in many decades.

To tackle outbreak of COVID 19, many countries went for complete lock down running into weeks, closed international borders with restriction on movement of people, implemented social distancing and other strict conditions. All these measures have severe effects on global trade and commerce in many forms ranging from supply chain disruptions to closures of business activities. To support business and economic activities during this critical time and ensure liquidity in the market Governments across the world has announced various types of economic stimulus program.

The Government of Bangladesh has also announced a number of economic stimulus packages for affected businesses. The major packages declared so far are creation of BDT 5,000 crore loan fund at 2% interest rate with relaxed repayment term for export industry to pay labour wages for next three months, special loan funds with lower interest rate of BDT 30,000 for big industries and service sector and BDT 20,000 for small and medium enterprises (SMEs) including the cottage industries, Export Development Fund (EDF) loans, extension of tenure for settlement of foreign currency loans, reduction in CRR requirement, re-fixation of repo rate, direct purchase of additional government securities in excess of SLR requirement from secondary market on market price etc.

Since every business and industry would have different impact from COVID 19 it is very important for each entity to make its own individual assessment. However, to assist with such assessment we have covered most areas of financial reporting, auditing and ethical issues that may be impacted by COVID 19.

## **I. Financial Reporting issues on Entities with reporting period ended on 31 December 2020**

For entities with the reporting date of 31 December 2020, the financial reporting effects of the COVID 19 outbreak are generally **adjusting events, if any** because the significant changes in business activities and economic conditions as a result of COVID 19 events existed at the reporting date.

IAS 10 has defined non-adjusting event as an event after the reporting period that is indicative of a condition that arose after the end of the reporting period, and an adjusting event as an event after the reporting period that provides further evidence of conditions that existed at the end of the reporting period and on the other hand. As stated above, applying this definition of IAS 10, for entities with reporting period ended on or before 31 December 2020 are most likely to be adjusting event. In Bangladesh, all Banks, NBFIs, Insurance companies and their subsidiaries as well some foreign owned entities are classified in this Group. Depending on the timing of the financial statements authorized for issue, adjustment of COVID 19 related subsequent events including potential financial impact, if any, may require to be recognized in the financial statements or annual report of these entities.

### **Going concern**

Management should consider the potential implications of COVID 19 when assessing the entity's ability to continue as a going concern. An entity is no longer a going concern if management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so. In assessing whether the going concern assumption is appropriate, management takes into account all available information about the future, which is at least, but is not limited to, twelve months from the date when the financial statements are authorised for issue. Material uncertainties that might cast significant doubt upon an entity's ability to continue as a going concern should be disclosed in accordance with IAS 1.

The assessment will be specific to the entity's circumstance and also to consider external supports expected by the entity (i.e. declaration of salary support for export industry, deferral of loan repayment, additional borrowing at lower interest rate etc.). While conducting going concern assessment the entity need to specifically consider the extent of operational disruption, potential reduction in demand for products or services, contractual obligations due or anticipated within one year, potential liquidity and working capital shortfalls and access to existing sources of capital. In making its going concern assessment, IAS 10 Events after the Reporting Period requires an entity to consider events up to the date of authorization of the financial statements.

If the entity is a going concern, the financial statements should be prepared on a going concern basis. If not, they should be prepared on a basis other than going concern. An entity shall not prepare its financial statements on a going concern basis if events after the end of the reporting period result in the going concern basis becoming inappropriate. Due to such rapid changes in economic environment from COVID 19, an entity, reporting date at 31 December 2020, may be or may not be a going concern due to COVID 19 impact, and in such case the financial statements shall be prepared depending on the above situation.

Because of COVID 19 impact, preparation of reliable financial information can be challenging and need to be closely monitored as this can have pervasive impact across multiple elements of financial statements.

We are summarizing key potential financial reporting impacts as follows:

▪ **Impairment of non-current assets and goodwill**

Due to the lower demand of products, many entities would reduce its operation and some may have closed the operation altogether resulting lesser utilization of capacity and hence potential impairment of PP&E. Also, due to adverse impact on future cash flows resulting from lower sale/demand of products or services, any goodwill recognized during business combination may need to be impaired (IAS 36). In this regard, the entity may need to assess whether the impact of COVID-19 has led to an asset impairment. Their financial performance, including estimates of future cash flows and earnings, may be significantly affected by the direct or indirect impacts of recent and ongoing events (such as lower demand of products, reduction of commodity price or disrupted supplies of raw material) resulting closure of factories or discontinued operation.

IAS 36: *Impairment of Assets* requires entities to perform an impairment test (i.e., estimate the recoverable amount of the affected cash generating unit and compared with carrying value of assets) at the end of each reporting period when there is any indication that the cash generating unit may be impaired. Indicators of impairment include (but are not limited to) significant changes with an adverse effect on the entity that have taken place during the period, or will take place in the near future. According to IAS 36.12, impairment tests should be performed whenever an indicator of impairment has been identified. Both external and internal indicators should be considered. Indicators include, but are not limited to:

- Significant declines in market capitalization below book value (net asset value);
- Disruption in the supply chain, i.e. lockdown restrictions on travel and transport;
- Decrease in the expected growth of the economy in which the CGU operates; and/or
- Increased credit risk due to declines in the ability of customers to meet obligations.

In the context of the far-reaching economic consequences of COVID-19, a significant number of entities face indicators of impairment. As per our analysis, the cash flows (at least in the near term) of most companies have been affected by COVID-19. As a result of the impact of COVID-19, certain entities may need to perform an impairment assessment of assets in addition to the requirement to perform an impairment test at least annually of goodwill and intangible assets with an indefinite useful life. Although not all of these impairment tests are performed in accordance with IAS 36, the principle that the carrying value cannot exceed the recoverable amount is typically applied. Assessment of whether COVID-19 is a triggering event is company-specific and should be evaluated holistically.

## ▪ **Significant Increase in Credit Risk (SICR) and Expected Credit Losses (ECLs)**

IFRS 9 sets out a framework for determining the amount of expected credit losses (ECL) that should be recognized. It requires that lifetime ECLs be recognized when there is a significant increase in credit risk (SICR) on a financial instrument. Management shall apply judgment and adjust their approach to determine ECLs in different circumstances. A number of assumptions and expectations underlying the way ECLs have been implemented previously may no longer remain valid in the current situation resulted from COVID 19. Therefore, each entity need to re-assess their credit risk, timing and uncertainty of future cash flows, moratorium in repayment declared by Government, potential insolvency of customer and other related factors to calculate provision for impairment of financial assets in accordance with IFRS 9.

As COVID-19 can impact the ability of borrowers, whether corporate or individuals, to meet their obligations under loan relationships, individual and corporate borrowers may have a particular exposure to the economic impacts in their geography and industry sector. More broadly, reductions in forecasts in economic growth increase the probability of default across many borrowers and loss given default rates may increase due to the fall in value of collateral evident more generally by falls in prices of assets.

Applying IFRS 9 Financial Instruments, an entity should measure ECL in a way that reflects:

- An unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes;
- The time value of money; and
- Reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

ECL applies to trade receivables, loans, debt securities, as well as the losses recognized in measuring loan commitments and financial guarantee contracts.

The amount and timing of the expected credit losses as well as the probability assigned thereto must be based on reasonable and supportable information that is available without undue cost and effort at the end of the reporting period without the use of hindsight. In some cases, this may require significant judgement.

IFRS Foundation on 27 March 2020 has issued a publication on "Accounting for expected credit losses applying IFRS 9 *Financial Instruments* in the light of current uncertainty resulting from the COVID 19 pandemic" which can be referred for further guidance on ECL impact. It is however, worthwhile to mention that in Bangladesh, Banks and NBFIs follow Bangladesh Bank Circulars to calculate required loan loss provision which are based on actual duration of overdue/arrear and hence IFRS 9 ECL model is not applicable for those entities. Nevertheless, other entities having trade and other receivables need to consider COVID 19 impact to assess ECL of those balances.

## ▪ **Fair value measurement**

COVID-19 is having an unprecedented impact on financial markets globally, across all industries and sectors. Therefore, the companies need to immediately take a fresh look at the decisions, assumptions and inputs they use to measure the fair values of assets and liabilities to ensure that fair value measurements accurately reflect current market conditions. In particular, the companies will need to pay and attention to fair value measurements based on unobservable inputs (sometimes referred to as level 3 measurements) and ensure that the unobservable input used reflect how market participants would reflect the effect of COVID-19, if any, in their expectations of future cash flows related to the asset or liability at the reporting date.

As a result of significant changes in macro-economic assumptions as well as entity specific conditions from COVID 19, key estimates and variable previously used for fair value measurement of assets and liabilities (i.e. Level 2 and Level 3 inputs) may be no longer valid and therefore, require re-assessment and supported by the latest input as per IFRS 13.

## ▪ **Revenue Recognition**

The COVID-19 outbreak, a global Pandemic declared by World Health Organization (WHO), has developed rapidly in 2020, with a significant number of infections across the world and in Bangladesh. The COVID-19 outbreak has created devastating effect on local and global trades, commerce and industry with consequential implications on financial reporting by affected entity. Various measures taken by the Government of Bangladesh to contain the virus have affected economic activities of the entities and its business in various significant ways including the followings:

- Lockdown has resulted in significant fall in economic activities which has adversely impacted the entities' regular business;
- Due to government measures taken, the Bank has to scale down its activities since 12-04-2020 in the Head Office as well as all the Branches;
- Loan installment holiday/moratorium until 30 June 2020 proclaimed by Bangladesh Bank through BRPD Circular No-04 has affected the Bank's earnings significantly;
- Waiver of credit card fees, charges and accrued interest;
- Loan installment holiday/moratorium until 31 December 2020 proclaimed by Bangladesh Bank has affected the Bank's earnings significantly.

An entity's sales and revenue might decline as a result of the reduced economic activity. There could be an effect on the assumptions made by management in measuring the revenue from goods or services already delivered and in particular on the measurement of variable consideration. For example, reduced demand could lead to an increase in expected returns, additional price concessions, reduced volume discounts, penalties for late delivery or a reduction in the prices that can be obtained by a customer. All of these could affect the measurement of variable consideration. IFRS 15 Revenue from contracts with customers requires that variable consideration is recognized only when it is highly probable that amounts recognized will not be reversed when the uncertainty is resolved.

Management should reconsider both its estimate of variable consideration and whether the recognition threshold is met. IFRS 15 is applied only to those contracts where management expects its customer to meet its obligations as they fall due. Management might choose to continue to supply a customer even when it is aware that the customer might not be able to pay for some or all the goods being supplied. Revenue is recognized in these circumstances only when it is probable that the customer will pay the transaction price when it is due net of any price concession.

IFRS 15 requires that an entity disclose information that allows users to understand the nature, amount, timing and uncertainty of cash flows arising from revenue. This might require for example, information about how an entity has applied its policies taking into account the uncertainty that arises from the virus, the significant judgments applied, for example whether a customer is able to pay, and the significant estimates made, for example in connection with variable consideration.

Due to cancellation of orders and modification of contractual arrangement with customers factors such as probability of return, further discount, timing of transferring risk and reward due to supply chain disruption need to be assessed before recognizing revenue (IFRS 15).

- **Valuation of inventory**

Since inventories shall be measured at lower of cost and net realizable value, subsequent reduction in selling price of goods or cancellation of customer orders may indicate lower net realizable value of related inventories and hence write down may require (IAS 2).

Also, if an entity's production level is abnormally low (for example, as a result of temporary shutdown of the production lines), it may need to review its costing of inventories to ensure that unallocated fixed overheads are recognized in profit or loss in the period in which they are incurred.

- **Employee benefits**

Due to COVID 19 there may be changes to remuneration policies and especially for defined benefit plan changes in key actuarial assumptions (i.e. lower discount rate, lower return from financial assets due to reduced interest rate) which shall be considered (IAS 19).

- **Provisions for Onerous contracts**

The COVID-19 has impacted many companies adversely – e.g. affecting their production processes, disrupting their supply chains, causing labour shortages and leading to closures of stores and facilities. This means that some existing purchase or sale contracts may become loss-making as costs of meeting the obligations under the contract may exceed the benefits expected to be received, resulting in an onerous contract and hence require a provision. When preparing projections of costs and benefits for the onerous contract test, a company needs to reflect expectations at the reporting date and use assumptions that are consistent with those used for other recoverability assessments – e.g. impairment of non-financial assets. As the situation surrounding COVID-19 is rapidly changing,

a company may need to update projections it made before the reporting date to reflect the information available, conditions and outlook at the reporting date.

The provision for an onerous contract is discounted if the effect of the time value of money is material. Central banks in many countries have cut interest rates in response to increasing concerns about the economic impact of COVID-19; this in turn may impact risk-free rates, which are often used to discount provisions. Companies need to update the discount rate if it has changed. Before recognizing a provision for an onerous contract, a company tests all assets dedicated to the contract for impairment.

Delay in fulfilment of contractual obligations may result in penalties or compensation claims unless otherwise protected and need to be provided for (IAS 37).

- **Deferred tax assets**

If any deferred tax asset is recognized on carry forward tax losses the related assumption need to be revisited especially whether the entity can still make adequate taxable profit after COVID 19 impact which will be available to offset such carry forward tax losses (IAS 12).

- **Leases**

The COVID-19 pandemic has led to some lessors providing relief to lessees as lessees are seeking rent concessions from lessors. The rent concessions could be in various forms and may include one-off rent reductions, rent waivers or deferrals of lease payments. For example, a number of retailers are seeking reductions in real estate rents, and similar issues may arise in other leases.

Previously under IFRS 16, rent concessions often met the definition of a lease modification, unless they were envisaged in the original lease agreement. The accounting for lease modifications can be complex. For example, the lessee may be required to recalculate lease assets and liabilities using a revised discount rate.

In response to the COVID-19 coronavirus pandemic, the International Accounting Standards Board (the Board) has issued amendments to IFRS 16 Leases to allow lessees not to account for rent concessions as lease modifications if they are a direct consequence of COVID-19 and meet certain conditions.

The amendments introduce an optional practical expedient that simplifies how a lessee accounts for rent concessions that are a direct consequence of COVID-19. A lessee that applies the practical expedient is not required to assess whether eligible rent concessions are lease modifications, and accounts for them in accordance with other applicable guidance. The resulting accounting will depend on the details of the rent concession. For example, if the concession is in the form of a one-off reduction in rent, it will be accounted for as a variable lease payment and be recognised in profit or loss.

The practical expedient will only apply if:

- the revised consideration is substantially the same or less than the original consideration;
- the reduction in lease payments relates to payments due on or before 30 June 2021; and
- no other substantive changes have been made to the terms of the lease.

Lessees applying the practical expedient are required to disclose:

- that fact, if they have applied the practical expedient to all eligible rent concessions and, if not, the nature of the contracts to which they have applied the practical expedient; and
- the amount recognized in profit or loss for the reporting period arising from application of the practical expedient.

No practical expedient is provided for lessors. Lessors are required to continue to assess if the rent concessions are lease modifications and account for them accordingly.

With adverse impact in business many leases which were earlier expected to be renewed and therefore used in calculation of lease assets/liabilities may not be renewed now and hence need to be revisited along with new calculation of lessee's incremental borrowing rate on account of change in its borrowing costs consequent to lower interest rate, decline in its credit rating, etc. (IFRS 16).

#### ▪ **Insurance claims**

COVID 19 would impact insurer from lower policy renewal, refund of premium for business cancellation, higher claims, and lower returns from investment. On the other hand, an entity taking insurance policy may need to assess whether they are entitled to any claims/ compensation from loss of profits and business disruption including timing of recognition of such claims.

#### ▪ **Government stimulus package**

As stated above the Government of Bangladesh has announced a number of economic stimulus packages for affected businesses. However, so far all these packages are effectively loan arrangement with easier repayment option and at reduced borrowing rate to be disbursed by Banks and NBFIs. Some of those are enumerated as under:

- Loan installment holiday/moratorium from 1 January 2020 to 31 December 2020 proclaimed by Bangladesh Bank;
- Waiver of credit card fees, charges and accrued interest;

Whilst some of these measures are within the scope of IAS 20 Accounting for Government Grants and Disclosure of Government Assistance, others are not.

IAS 20 requires entities to disclose the following information:

- The accounting policy adopted for government grants, including methods of presentation adopted in the financial statements;
- The nature and extent of government grants recognized in the financial statements and an indication of other forms of government assistance from which the entity has directly benefited; and
- Unfulfilled conditions and other contingencies attaching to government assistance that has been recognized.

Therefore, further scrutiny of these incentives are required along with other existing regulatory framework, before an assessment can be made whether such incentive would fall under 'IAS 20: Accounting for Government Grants and Disclosure of Government Assistance'.

▪ **Interest Cost**

The Interest Cost needs a special mention as many of the financial institutions have announced relief measures for the businesses due to the situation of COVID19. One of major reliefs is the Moratorium in the payment of instalments for a period of 3 months. Thus there is a relief as to Cash Flow for the businesses. But in accounting treatment, the interest will accrue in the books of accounts and will appear as the Interest & Finance Cost. The amount of Interest / Finance Charge pertaining to the period of COVID19 operational stoppage needs to be ascertained and shall be treated as Abnormal Cost. Additionally, it is likely that the businesses will have to incur additional interest cost for the moratorium availed. This excess Interest/Finance Cost whenever incurred shall be treated as Abnormal Cost resulting out of the COVID19 Pandemic.

▪ **Review of Interim Financial Statements**

Entities preparing their interim financial reports applying IAS 34 Interim Financial Reporting are required to apply the same accounting policies as will be applicable in their next annual financial statements.

▪ **Other financial statement disclosure requirements**

Adequate disclosure regarding the impact of COVID 19 should be included in the notes to the financial statements.

## **PART B: IMPACT ON AUDITING OF FINANCIAL STATEMENTS**

The COVID 19 related challenges on an auditor while conducting audit of financial statements are described below:

### **Going concern**

ISA 570, Going concern confirms that the auditor's responsibilities are to obtain sufficient appropriate audit evidence 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.

The auditor will only be able to form a conclusion relating to going concern once management has made its own assessment. The auditor should inquire of management and those charged with governance as to what information available about the future, and determine whether this has been appropriately considered as part of management's assessment. The auditor should apply similar considerations to those of management, in assessing the appropriateness of the going concern assumption.

If events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern, the auditor shall obtain sufficient appropriate audit evidence to determine whether or not a material uncertainty exists. This should, for example, include a detailed and robust review of up to date forecasts, cash flows, sensitivity analyses and reviews of COVID 19 contingency plans and impact assessments conducted by management. The audit team should robustly challenge the managements' the assumptions underlying the assessment and the consistency of these assumptions across the entity's business model, principal risks and mitigation activities.

### **Legal and contractual implications:**

Substantive legal and contractual changes may result due to disruptions created by the pandemic. These may pose significant challenges to the longer-term prospects and operations of the entity. Audit team should consider whether these have been appropriately considered by management. Sufficient and appropriate audit evidence should be prepared and maintained in the audit working file regarding this with particular focus adequacy of any provision due to legal and contractual changes and going concern viability of the entity.

### **Asset valuations**

Certain assets may require revaluing based on usage. Items of property, plant and equipment may lose value when not in continued use, or may have degraded or become obsolete over the lockdown period. The re-assessment of asset valuation should be reflected in modelling assumptions, including any loan to value covenants.

## **Audit Evidence, including Audit Confirmations**

The auditor must seek to obtain sufficient, appropriate audit evidence to support their auditor's report. However, restrictions on travel, movement and visiting client sites may mean this cannot be carried out as planned or cannot be carried out within management's planned timetable for issuance of the audited financial statements.

Auditors will need to think about whether there are other ways for them to obtain sufficient, appropriate audit evidence. This might include employing greater use of technology to examine evidence, but only where the auditor has assessed both the sufficiency and appropriateness of the audit evidence produced. The basis for this assessment should be clearly documented on the file. That assessment should recognise and explain how the auditor addresses any risk that the quality and reliability of such evidence may be lower, for instance through more directed testing of items evaluated in this way. This needs to be carried out on a case by case basis and will be dependent on the applicable facts and circumstances.

Some items will still require the testing and verification of original source documentation, or the verification of physical assets and inventories. The auditor may consider which items are absolutely vital to test physically, and where evidence can be obtained through other means. Verification through other means is more likely to be appropriate where balances are less material. A small number of items which need to be physically verified may still be manageable on a case by case basis.

The auditor will also need to consider the time criticality of certain procedures (for instance stock-takes at the year-end). In these circumstances, it may be that local restrictions in place mean that work cannot be carried out as planned, and the deferral of necessary procedures may impact on the quality and veracity of the evidence generated. Where physical verification is required, and time critical, and where physical verification procedures cannot be performed, the auditor will need to consider the implications for their opinion.

The provision of independent confirmations as a source of audit evidence may also be impacted. Where this is the case the auditor may consider whether available online access to secure systems can be used to obtain the necessary evidence rather than waiting for the provision of a documentary copy.

The auditor may also need to consider whether additional time is needed to perform identified procedures to seek to obtain sufficient appropriate audit evidence and, if so, whether such time will be available to the auditor. Management may be able to extend their planned timetable, for example when the planned issuance date is sooner than that required by law or regulation or the rules of a market on which the entity's securities are listed. Where this is the case, the auditor will need to request management to do so. If management refuses to do so, the auditor will need to consider whether such refusal constitutes a limitation on the scope of the audit imposed by management. If so, the auditor will need to communicate with the audit committee and take other appropriate actions to comply with the requirements of paragraphs 11 to 14 of ISA 705 (Revised June 2016).

### **Impact on auditor's report**

The implications of COVID 19 on the auditor's report will depend on the sufficiency and appropriateness of audit evidence obtained, the basis of preparation adopted and the disclosures provided in the financial statements.

For example, there is a situation where management has concluded that the entity is a going concern but there is a material uncertainty and if the auditor agrees that the entity is a going concern, and the material uncertainty is adequately disclosed in the financial statements, in the auditor's report, the 'conclusions relating to going concern' section should be removed and instead a 'material uncertainty related to going concern' section shall be included. However, if management is not willing to disclose material uncertainties, then the auditor may need to consider issuing a modified auditor's report.

Similarly, due to COVID 19 impact operating activities and cash flow of an entity can be significantly reduced during the year 2020 and management has concluded that such reduction is temporary and once the outbreak is contained the entity would be back to its normal activities in very short period of time. Accordingly, management has not made any significant adjustment to the operating plan/cash flow forecast used for impairment assessment and just recalculated discount rate and other market related conditions. If the auditor concludes that management's assessment is reasonable but there is a risk that if the spread of outbreak is not contained by December 2020 there are some key assumptions that would require modification with possible impairment charges, the auditor may consider to issue audit report with an EOM paragraph as per 'ISA 706 (Revised), Emphasis of Matter Paragraphs and Other Matter Paragraphs' in the Independent Auditor's Report without any modification and highlighting the uncertainty.

### **Delaying the issuance of audit report**

Given the unpredictable nature and impact of the COVID 19 outbreak, in some cases it might be appropriate to consider the possibility of delaying the approval of the financial statements and issuance of audit report until more certainty about the impact of such outbreak is known. For example, if Bangladesh Government has made general declaration of economic stimulus package to support a particular industry and if management has assumed certain incentive from that Government package to support its going concern assumption, the auditor may like to wait until the impact of announced package to satisfactorily conclude on appropriateness of going concern assumption.

Consequently, auditors may not be able to meet previously agreed deadlines and required to wait for some time in order to satisfactorily obtain sufficient and appropriate audit evidence for issuing an unmodified audit report. If this is the case the auditor should immediately inform both management and TCWG about the possible delay including the reason for such delay. Due to regulatory timeline for submission of audited financial statements the client may need to approach the concerned regulators at the earliest opportunity to seek extension.

However, if the client is not willing to extend the timeline of completing the audit the Auditor need to assess whether they have obtained sufficient and appropriate audit evidence to issue an audit opinion. If the answer is negative the auditor need to appropriately modify audit report.

### **Exercise Professional Skepticism**

Auditor is always required to carry out their work exercising professional skepticism and the presence of far reaching implications of COVID19 on business, necessitates it even more.

The below are the suggested action related to exercising professional skepticism:

- Consider how appropriate level of skepticism was exercised in the light of current circumstances.
- Documents how judgments and assumptions made by management were challenged and resolved.

### **Quality Control**

Auditors will need to comply with all of the requirements in respect of quality control in ISQC 1 Quality Control for Firms that Perform Audits and Reviews of Financial Statements and Other Assurance and Related Services Engagements and ISA 220 Quality Control for an Audit of Financial Statements. However, in the current circumstances, some meetings, discussions and access to files will be virtual and facilitated through digital modes.

The below are the suggested action related to quality control:

Document clearly how the direction, supervision and review process was structured and operated to overcome obstacles and how communication with team members have been conducted and in particular key audit partners, engagement quality control reviewers, and any firm technical reviewers have been involved for the audit.

### **Physical Inventory/ Cash Verification**

Entities may face challenges in conducting physical inventory verifications and similarly may be prevented from observing such procedures due to the restrictions placed because of social distancing.

The below are the suggested action related to physical inventory verifications:

- Conduct such verifications at the earliest possible time subsequent to the year end and perform roll-backward as appropriate.
- Assess the post balance sheet period inventory movement in reference to third party evidences.
- Backward calculate the physical balance of cash as at the balance sheet date supported with the physical verification of cash at the earliest possible date and relevant documentary evidence of the movement upto the date of subsequent count.

- Evaluate whether the work of internal audit can be used if physical verification was attended by internal auditors.

**Engagement team may consider the following for attendance at both physical and virtual/remote counts:**

- Obtain an understanding of the entity's procedures for the count are in line with the latest government guidelines on Covid-19 secure working, working at home, travel and social distancing. Engagement team may reflect the *Novel Coronavirus (COVID-19) Guidelines* issued by the Directorate General of Health Services.
- Obtain an understanding of the controls over all counts and how these have changed as a result of Covid-19 – does this increase the risk of inventory existence?
- Determine that there will be no movement of stock during the count.
- Check that counts of similar inventory items will not be spread over multiple days (ie so inventory could be moved between locations and double counted).
- Do not inform the entity personnel in advance which items the audit team intends to count (either floor to sheet or sheet to floor) so that there is unpredictability in audit testing.
- If attending a cycle/perpetual count and the audit team has not attended other counts throughout the year, include in the sample selection items not covered by the cycle/perpetual count.

**Safeguards for attendance at a virtual/remote count**

- Consider the nature of the inventory and whether it is feasible to count that inventory remotely
- Consider performing a test count in advance – eg to check that there are no Wifi/signal issues. Check that the selected video call technology is available to both us and the entity and working properly.
- Involve a senior manager or above in planning the remote count attendance and briefing the attendees.
- Request that the entity personnel walk through the location, so the audit team understand how the stock is organised and also have the opportunity to identify any damaged or obsolete inventory. If possible, request a floor plan of the entity site.
- Ask whether there is CCTV footage of the count and if so request that be retained (so we have the option to review if needed).
- Have the Engagement Quality Control Review partner (where one has been appointed) review the remote inventory count work including the rollback/rollforward work.

**Impact on controls testing**

The engagement team should consider whether under lockdown there have been changes to the control. If yes, the engagement team to reconsider the steps of the control and the design factors again as there could easily have been changes. For example:

- What will the entity disclose if they have stopped doing cycle counts whilst under lockdown?

- If the company is doing remote counts with the person that normally does the count instructing and watching, is that sufficient evidence of operation of the control for the company?
- If the company has changed the controls post COVID, does the auditor need to test both if we are seeking to place reliance on controls?
- If the auditors are attempting to rely on remote count evidence to support some or all of the operating effectiveness testing, have the auditors built observation of the count control into plans for the remote count?

### **Effective Communications**

COVID 19 brought in significant changes at very fast pace with limited time to react by an auditor. At the same time, during this period of global turmoil and uncertainty, the users of financial statements in general and investor community in particular would expect to see high quality audit more than ever. Accordingly, this is quite complex time for an auditor with added public expectation and hence the auditor should maintain continuous communication with management and TCWG and constantly made them aware of any audit related issues, be it restrictions of movement or difficulties in obtaining sufficient and appropriate audit evidence. Some of the matters need to be communicated with the TCWG, in particular with audit committee are as follows:

- Significant changes in the planned scope and timing of the audit, including new significant risks and modifications to the audit plan and key audit matters (KAM);
- Major difficulties/restrictions encountered during the audit in areas such as absence from physical attendance during stock take, unavailability of management for corroborative inquiry, lack of response in external confirmations etc. resulting lack of sufficient appropriate audit evidence and/or completing alternate audit procedures;
- Critical matters that were discussed or subject to correspondence with management, including disagreements on key estimates and judgments taken by management on COVID 19 related impact;
- Expected modifications to the auditor's report, e.g. modifications as a result of a scope limitation or disagreement, emphasis of matter paragraphs in respect of significant uncertainty, other matter paragraph to highlight alternate audit procedures etc.;
- Expected delay in finalization of audit due to changes circumstances and lack of clarity to validate reasonableness of management assumptions on key COVID 19 related matters. As mentioned above in the example that if management is planning to rely on Government support for going concern assumption and the detail of the support package is not yet available, the auditor may need to wait for satisfactorily conclude on the appropriateness of going concern assumption.

## **Validation of critical management estimates and judgments**

As explained earlier under financial reporting section, due to COVID 19 related issue a number of areas in financial reporting shall be impacted and management need to make critical estimates and judgments about those matters. Such areas of critical estimates and judgments include among others, business plan and forecast to support going concern assumption, impairment assessment of non-current assets, expected credit losses, fair value of assets and liabilities without active market, etc. However, due to rapidly changing environment, in many such cases information and data used by management could be very difficult for an auditor to validate and assess for reasonableness.

Nevertheless, 'ISA 540 Auditing Accounting Estimate, including Fair Value Accounting Estimates, and Related Disclosures' require an auditor to evaluate, based on the audit evidence, whether the accounting estimates in the financial statements are either reasonable, or are misstated. In addition, auditor shall evaluate the adequacy of the disclosure of estimation uncertainty in the financial statements and review whether there is indication of possible management bias in making those estimates.

Accordingly, auditor shall observe all related steps outlined in ISA 540 and in other auditing standards to conclude that all critical management estimates and judgments are reasonable and should also obtain management representation as per ISA 580. However, if an auditor is unable to conclude on reasonableness of critical estimates and judgment applied by management they should discuss the matter with TCWG and try to resolve differences through developing a 'Point Estimate or Range' as prescribed in ISA 540. However, despite all these efforts if the disagreement persists and there are no alternative, the auditor may consider modification of the audit report in accordance with ISA 705.

For ease of reference we are providing below a list of potential COVID 19 impacts on audit with reference to the related auditing standards:

- Identifying new risks from COVID 19 related impact and re-assessments of the initial Risk of Material Misstatements (RMM) and Materiality in line with 'ISA 315(Revised) Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and its Environment' and 'ISA 320 Materiality in Planning and Performing an Audit'.
- Evaluate applicability of going concern assumption used by management for the preparation of the financial statements in line with 'ISA 570 (Revised) Going Concern'.
- Consider all subsequent events from the date of year-end to the date signing audit report and assess whether these are adjusting or non-adjusting event requiring recognition and disclosure in the financial statements respectively and auditors obligation in accordance with 'ISA 560 Subsequent Events'.
- Obtain specific representations from management especially on any estimates and judgments applied related to COVID 19 related impact in line with 'ISA 580 Written Representations'.

- Formulation of Auditor's Opinion in accordance with 'ISA 700 (Revised) Forming an Opinion and Reporting on Financial Statements', 'ISA 705 (Revised) Modifications to the Opinion in the Independent Auditor's Report', 'ISA 706 (Revised), Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report'.
- Due to COVID 19 related impact if any changes is required in Key Audit Matters (KAM) previously communicated to TCWG updated KAM should be discussed with Management and TCWG in accordance with 'ISA 701 Communicating Key Audit Matters in the Independent Auditor's Report'.
- Risk of material misstatements in financial statements due to fraud including fraud risk factors identified previously may require re-assessment due to pervasive changes in economic environment from COVID 19 related impact and hence the auditor should consider this matter in audit in in accordance with 'ISA 240 The Auditor's Responsibilities Relating to Fraud in An Audit of Financial Statements'.

All listed entity in Bangladesh is required to publish annual report and there would be comment about COVID 19 and its impact on that entity in the annual report. The auditor now has an added responsibility to read and comment on other information published along with the financial statements such as contents in annual report. Accordingly, the auditor should read such disclosure in the annual report and follow the steps prescribed in 'ISA 720 (Revised) The Auditor's Responsibilities Relating to Other Information'.

## **PART C: ETHICS AND INDEPENDENCE CONSIDERATIONS RELATING TO COVID-19:**

### **ALL PROFESSIONAL ACCOUNTANTS**

**1. Compliance with the fundamental principles in the COVID-19 pandemic situation:** As the COVID-19 pandemic continues to negatively impact economies, many businesses face significant financial difficulties. Professional Accountant (PA) working with these organizations as an employee or advisor or auditor could face ethical conflicts in these situations. It is important that Professional Accountants continue to comply with the various Rules in the IESBA Code of ethics and ICAB Bye Laws. Professional Accountants are required to comply with five fundamental principles of ethics set out in the Code, i, e, integrity, objectivity, professional competence and due care, confidentiality and professional behaviour, irrespective of their roles, professional duties, and the circumstances in which they perform their professional activities.

Section 111, Complying with the principle of integrity means being straightforward and honest in all professional and business relationships. It also implies fair dealing and truthfulness.

*a Professional Accountant or firm shall perform professional services with integrity not allow his or her professional or business judgment to be compromised by bias, conflict of interest or the undue influence of others. Professional Accountants should remember that the practical challenges of the pandemic do not reduce professional responsibilities to act with integrity or to exercise sound professional judgment. The Code prohibits PAs from being knowingly associated with information that is materially false or misleading.*

Section 112, Complying with the principle of objectivity means not compromising professional or business judgment because of bias, conflict of interest or undue influence of others.

*Under the Code, a PA would be prohibited from undertaking a professional activity if a COVID-19 related circumstance would unduly influence the PA's professional or business judgment regarding that activity.*

Section 113, Complying with the principle of professional competence and due care means being diligent; attaining and maintaining professional knowledge and skills to serve employing organizations and clients; and exercising sound judgment in applying such knowledge and skills.

*a Professional Accountant shall sustain professional competence by keeping informed of, and complying with, developments in professional standards in all functions in which the member provides professional services or is relied upon. As members are asked to take on additional or urgent assignments, it is critical for members to assess whether they have the required professional competence before accepting the assignment. PAs are reminded that practical challenges created by the pandemic do not lessen their responsibility to maintain their professional knowledge and skills to serve their employing organizations and clients competently.*

Section 114, Complying with the principle of confidentiality means respecting the confidentiality of information acquired as a result of professional and business relationships.

*a Professional Accountant or firm shall not disclose any confidential information concerning the affairs of a current or former client or employer without consent, except under certain conditions. As organizations have transitioned to virtual modes of work during the pandemic, it is important for members to be aware of increased security risks to the confidentiality of employers' or client's data, and to implement appropriate controls.*

Section 115, Complying with the principle of professional behavior means complying with relevant laws and regulations and avoiding any conduct that the PA knows or should know might discredit the profession.

*Depending on the roles and professional activities of PAs in business and in public practice, this dramatic change in landscape might create new threats or impact the level of previously identified threats to compliance with the fundamental principles. Under the conceptual framework, PAs are required to exercise professional judgement and remain alert for new information and changes in facts and circumstances. When there is new information or facts and circumstances change, the Code requires PAs to identify and evaluate any new threats, or re-evaluate previously identified threats, and address them.*

Many jurisdictions have introduced a variety of laws and regulations in response to the pandemic. These range from laws enacted to protect payrolls or provide fiscal relief to businesses to regulations aimed at protecting public health. In complying with the principle of professional behavior, PAs are required to understand and comply with such laws and regulations as might apply to their particular circumstances. Importantly, in this time of crisis when employing organizations, clients, government agencies and other stakeholders depend so much on the work of PAs, it is vital that PAs conduct themselves in a manner that upholds the profession's responsibility to act in the public interest and the profession's good reputation.

If Professional Accountants encounter an ethical conflict and, after exhausting all relevant options, it remains unresolved, members should refuse to remain associated with the matter creating the conflict. Members may determine that, in the circumstances, the only option may be to withdraw from the engagement or employing organization in a manner consistent with the IESBA Code.

## **2. Preparing and presenting information during the COVID-19 pandemic:**

Professional Accountants are ideally placed to support employing organizations, clients, government agencies and public authorities navigate the pandemic through their knowledge, skills and experience in preparing or presenting information. The Code requires that in preparing or presenting information,

PAs do so in a manner that is intended neither to mislead nor to influence contractual or regulatory outcomes inappropriately. The Code also requires PAs to exercise professional judgment to represent the facts accurately and completely in all material respects; describe clearly the true nature of business transactions or activities; and classify and record information in a timely and proper manner. It also recognizes that preparing or presenting information might require the exercise of discretion when making professional judgments.

Many entities are facing liquidity or solvency crises as a result of the pandemic. In crisis situations, PAs need to be mindful that opportunities and risks arise for entities to misreport negative developments, withhold disclosure of essential information, or portray a false or misleading picture of financial conditions. Further, the Code prohibits PAs from exercising discretion where there is intent to mislead others or to influence contractual or regulatory outcomes inappropriately. PAs must also always comply with the fundamental principles and uphold the profession's reputation. PAs shall perform professional services in accordance with standards of practice of the profession. Even when faced with time constraints resulting from the pandemic, members must ensure that professional standards are met.

### **3. Non Compliance with Laws and Regulations (NOCLAR) in the COVID-19 pandemic environment:**

NOCLAR is any act of omission or commission, intentional or unintentional, committed by an employing organization or client, or by TCWG, by management or by other individuals working for or under the direction of the employing organization or client which is contrary to the prevailing laws or regulations.

PAs need to be alert that the pandemic has created significant opportunities for fraud, including procurement fraud (especially for personal protective equipment), online fraud (such as the sale of fake medical goods), fraudulent applications for government support, and charity impersonation fraud. Some businesses might also, intentionally or unintentionally, breach social distancing and other COVID-19-related public health and safety laws and regulations as well as those pertaining to labor and employment-related benefits.

The pandemic has left many entities grappling with several urgent business and operational challenges, including in relation to human capital, liquidity and solvency. The resulting financial challenges and other pressures might affect the implementation and oversight of organizational policies and procedures that are intended to help ensure compliance with laws and regulations. Consequently, some entities might fail to comply with certain legal or regulatory requirements.

The Code establishes a comprehensive framework for PAs in business (Section 260) and PAs in public practice (Section 360) to respond to NOCLAR or suspected NOCLAR, including discussion with management, escalating the issue within the employing organization or client, assessing the appropriateness of the response of management and TCWG, and determining whether further action is needed in the public interest.

Professional Accountants are reminded that COVID-19 restrictions and challenges do not lessen their obligation to perform their professional duties in a diligent and competent manner, including

appropriately supervising others within their spheres of responsibility even in a virtual work environment.

#### **4. Respecting Privacy and Consideration of Mental Health**

COVID 19 Pandemic accelerated use of virtual meeting, working from home, online discussion, etc. to an unprecedented level. At times meetings are also organized outside office hours. While people are adopting to these 'new normal', many are also facing various types of physical, emotional and financial distress as well. Accordingly, while dealing with clients and colleagues Professional Accountants should display highest level of Professionalism, along with empathy and respect to the People's wellbeing and privacy of those people attending work/meeting from home.

### **PROFESSIONAL ACCOUNTANTS IN PUBLIC PRACTICE**

#### **1. Considerations regarding fees in the COVID-19 pandemic environment:**

Many businesses are experiencing financial difficulties during these challenging times. As a result, members may be faced with pressures to reduce or postpone payment of professional fees or with uncertainties regarding the collectability of fees.

##### *Pressure to Reduce Fees*

The Council ICAB has approved fees schedule to keep audit fees at a reasonable level to ensure quality audit with utmost professional care pursuant to ICAB Bye Laws, IFRS, ISA and other regulatory requirements and applicable laws of the country. However, the Code does not specify the level of fees that firms should quote for services to be provided to their clients. Indeed, the Code states that a PA in public practice might quote whatever fee is considered appropriate. (See para. 330.3 A2.)

However, many entities are experiencing significant financial strain and even distress due to the COVID-19 pandemic. As a result, firms may face significant pressure from clients to reduce fees for services in progress or to be provided.

The Code notes that the level of fees quoted creates a self-interest threat to compliance with the fundamental principle of professional competence and due care if the fee quoted is so low that it might be difficult to perform the engagement in accordance with applicable technical and professional standards. (See para. 330.3 A2.) The Code provides guidance on factors relevant to evaluating the level of such a threat and actions that might be safeguards to address the threat. (See para. 330.3 A3-A4.) On the other hand, if any auditor accepts any appointment at a fee below the Fees Schedule approved by the Council- ICAB, the relevant audit working paper files may be subject to review by ICAB to assess the quality of audit done, giving particular emphasis on listed entities. If ICAB is not satisfied with quality of audit, the firm/partner of the firm may be subject to disciplinary actions of ICAB.

In the context of an audit engagement, pressure from an audit client to reduce the level of the audit fee might be amplified if the firm needs to perform additional work to address audit issues created by the pandemic. The Code makes clear that the level of fees might create a self-interest or intimidation threat to independence. (See para. 410.2.) Firms should apply the conceptual framework to identify, evaluate and address such threats to independence.

### *Overdue Fees*

For audit engagements, the Code states that a self-interest threat to independence might be created if a significant part of fees is not paid before the audit report for the following year is issued. The Code adds that it is generally expected that the firm will require payment of such fees before such audit report is issued. (See para. 410.7 A1.)

Given the unprecedented measures taken by governments around the world to temporarily close businesses and restrict movement to control the spread of COVID-19, many entities are now experiencing major liquidity issues or other financial difficulties. As a result, firms may find that some audit clients are unable or unwilling to pay part or all of their outstanding fees. Firms are reminded that when a significant part of fees due from an audit client remains unpaid for a long time, the Code requires them to determine whether the overdue fees might be equivalent to a loan to the client, and whether it is appropriate to continue the audit engagement or be re-appointed. (See para. R410.8.) If such situations arise, firms are encouraged to explore ways to mitigate the potential threats to their independence with management or TCWG of their audit clients, such as instituting instalment payment plans.

In fact, circumstances around COVID-19 might dictate that the amount of work to be performed should be more, and not less, than originally anticipated. Therefore, members must be cautious that the quality of work is not compromised in any way.

## **2. Non-assurance Services Provided to Assurance Clients in the COVID-19 circumstances:**

In the unprecedented circumstances surrounding the pandemic, assurance clients might reach out to members and firms for other services, such as assistance with funding applications to lenders or government relief programs. When such requests are received, members must assess whether such service requests are subject to specific prohibitions for Non-Assurance Services (NAS) provided to an assurance client in the Independence Rules.

Members are cautioned that the NAS must not create a threat to independence that cannot be reduced to an acceptable level with appropriate safeguards and must not involve assuming management responsibility.

Firms may provide such assistance to their audit clients through the provision of specific non-assurance services (NAS), for example, the preparation of prospective financial information and valuation engagements. However, to maintain their independence at all times, firms should be especially mindful of the following key provisions in the Code.

- The service must not be prohibited under the Code.
- The NAS must not involve assuming a management responsibility for the audit client.
- To avoid assuming a management responsibility, the firm must be satisfied that client management makes all judgments and decisions that are the proper responsibility of management.
- The NAS must not create a threat to independence that cannot be eliminated or reduced to an acceptable level.
- The firm must not evaluate or compensate its partners based on success in selling NAS to audit clients.

Where there are specific laws and regulations that apply to the provision of the COVID-19 related NAS to audit clients, firms are also reminded to obtain a full understanding of the legal and regulatory requirements and comply with them.

### **3. Long association, including Partner rotation in COVID-19 situation:**

Firms might face the challenge of an unforeseen reduction in resources due to the COVID-19 illness of certain partners, and therefore be unable to execute a planned partner rotation for the audit engagement. If an incoming engagement partner is unable to serve on an audit engagement due to COVID-19 illness, paragraph R540.7 of the Code provides an exception to the partner rotation requirement, allowing the outgoing engagement partner to serve an additional year provided that certain conditions are met, including obtaining the concurrence of TCWG.

### **4. Communication with those charged with governance in a COVID-19 environment:**

The Code contains provisions addressing communication by firms to TCWG. Effective two-way communication helps both the auditor/member and TCWG understand matters related to the assurance engagement, including, among other things: scope and timing of the engagement, significant risks, significant findings, and independence matters.

The COVID-19 pandemic has caused significant disruptions to entities' operations as well as how firms engage with their audit clients, including TCWG. Social distancing measures imposed by public authorities as well as safety measures taken by entities and firms might impact the approach to, and timing of, such communications. Further, Physical distancing measures as well as working virtually might impact how and when members communicate matters relating to assurance engagements.

It is therefore important for firms to proactively engage with TCWG to agree how ethics and independence matters can be effectively raised and discussed in a timely manner. Equally, it might be necessary to agree contingency plans or alternative arrangements if circumstances change. Firms are also reminded to consider whether it is appropriate to communicate about ethics and independence issues arising from the COVID-19 pandemic to all TCWG versus a sub-group, such as an audit committee. Communications with audit committees and TCWG may be considered a safeguard to certain threats to independence.