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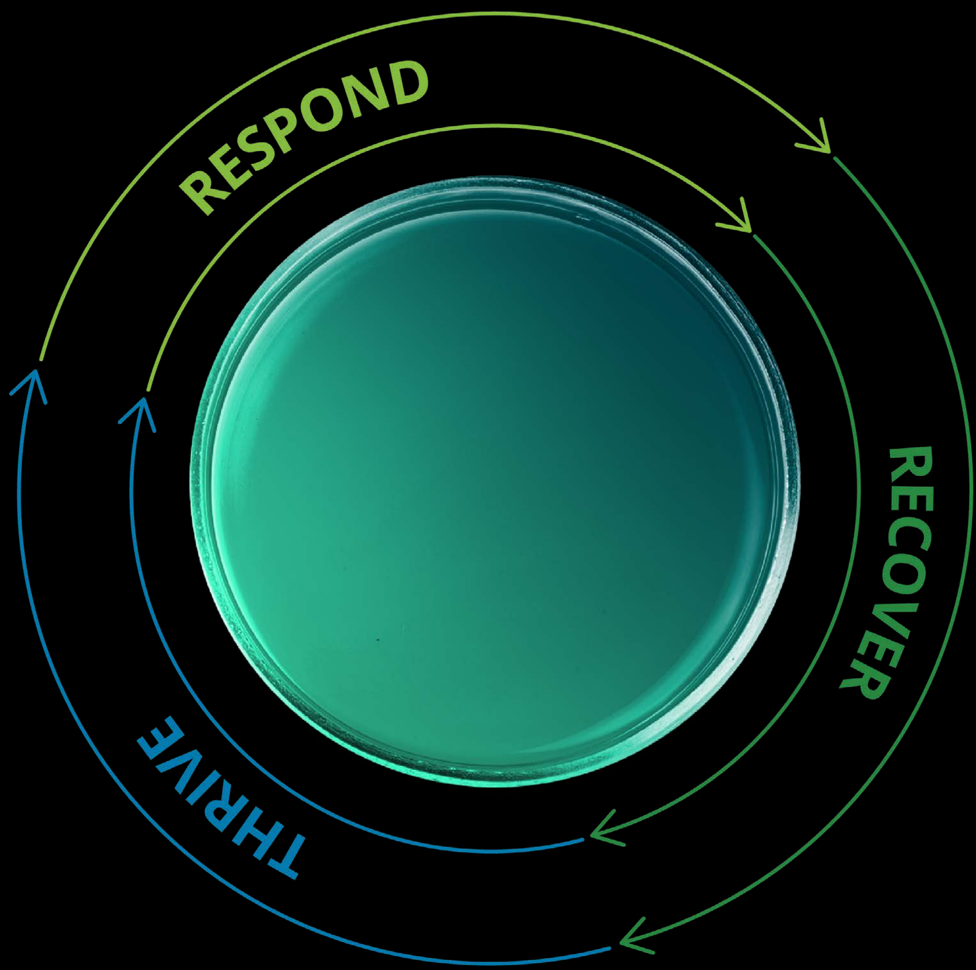

FRC guidance for External Auditors

COVID-19 and its impact on audit of reporting entities in Nigeria

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When Coronavirus (COVID-19) broke out in the city of Wuhan, China in the last quarter of 2019, no one imagined it would spread rapidly to other countries around the world, with the possibility of paralysing business activities and economies.

In the early days of the outbreak in 2019, many thought that COVID-19 was just a health issue with little or no consideration for the potential impact the virus could have. The direct correlation between the health of the people, governance and smooth running of business activities was underestimated.

The subsequent declaration of COVID-19 by the World Health Organisation (WHO) as a pandemic was the first confirmation that it was a global health issue with potentially devastating economic implications. In the past, global pandemics resulted in significant economic consequences to nations and businesses. It was not until this realisation that the world started to take steps to curb the spread of the virus. The potential impact of COVID-19 was aptly put by the Director General of WHO, Dr. Tedros Adhanom Ghebreyesus, who said during a media briefing that “This is not just a public health crisis, it is a crisis that will touch every sector”.

Countries and reporting entities planned their 2020 budget without any reference or assumption to the likely negative effects of COVID-19 in their projected revenues and cash flows. Also, there was no thought of the inevitable extra budgetary spending on health facilities to combat the disease and no one envisaged the current demands for palliative measures to ameliorate the effect of the lockdown/curfew imposed by government on citizens and businesses.

As at January 2020, it was doubtful if any company had considered COVID-19 part of the Top 10 Business Risks for 2020. Companies did not expect that the virus would paralyze businesses for such a long time.
As COVID-19 spreads and the impact is felt, regulators in Nigeria and around the world have issued guidance to entities under their control to provide direction on the impact of COVID-19 on the reporting obligations of those entities. In Nigeria, the Nigerian Stock Exchange (NSE) had on March 23, 2020 issued a circular to issuers of financial statements on the COVID-19 Pandemic. The circular granted listed companies a sixty (60) day grace period for the submission of their Audited Financial Statements for the year ended 31 December 2019, which was due to The Exchange on 30 March, 2020. In a bid to provide appropriate guidance to external Auditors on the impact of COVID-19 on financial statements audit of reporting entities in Nigeria, the Financial Reporting Council of Nigeria (FRC or the Council) on 6 April 2020 issued guidelines for External Auditors on COVID-19 and its impact on audit of financial statements. The guidelines also highlight other matters to be considered on the audit of reporting entities in Nigeria.

While the Financial Reporting Council aligns with all the measures by the Federal and State Governments as well as relevant agencies in containing COVID-19, the Council is concerned about appropriateness or otherwise of the true and fair view of the financial health of corporate entities as usually expressed by External Auditors in audited financial statements. In challenging times like this, the need to drive audit quality becomes more critical especially considering the level of uncertainty with the novel Coronavirus pandemic.

Therefore, additional time may be required to document and review audit engagements due to some measures taken by Federal and State governments in collaboration with Ministries, Departments and Agencies (MDAs) to contain COVID-19. These measures include travel bans, quarantines, social distancing, and closure of non-essential services. Undoubtedly, these measures have triggered significant disruptions to businesses worldwide, resulting in economic downtime and other economic challenges.

The Council has assessed the impact of COVID-19 on the audit of financial statements, and has classified the situation into three major categories:

Audit of 2019 Financial Statements which have been completed, audit opinion issued and report already released to shareholders. No impact of COVID-19. Only accounting issues in first-quarter report.

Audit of 2019 Financial Statements that are still ongoing with respect to reporting periods ended on or before 31 December, 2019. The FRC requires Auditors to consider the adequacy of disclosures included in the financial statements as companies are required to disclose the following for each material category of non-adjusting events after their reporting period:

a. The nature of the event; and
b. An estimate of its financial effect, or a statement that such an estimate cannot be made.

Audit of 2020 Financial Statements (Accounting periods ending on or after 1 January, 2020)

The following are the implications of the COVID-19 outbreak on Audits and Auditors in Nigeria:

New Audit Engagement

The Council requires strict compliance with engagement procedures as provided in International Standard on Auditing (ISA) 210 agreeing the Terms of Audit Engagement. Where it is impracticable to do so, the new Auditor should notify the FRC of such situations and obtain permission before proceeding with the audit.

Audit Planning, Execution and Reporting

The FRC recognised the current realities under which Auditors are working and acknowledged that several audit firms may have difficulties in completing all appropriate audit steps as a result of the lockdown in Nigeria occasioned by the need to contain the spread of COVID-19. This is expected to cause delays in the completion of audit and approval of Financial Statements by the Board of reporting entities.

To address these challenges, the Council encouraged Audit practitioners to demonstrate flexibility in their work pattern, which includes working from home arrangements, use of video/telephone conferencing, and electronic evidence. Virtual working arrangements have been widely embraced by Audit firms as practitioners and client management teams work with phone calls, emails and technology with video capabilities such Skype and Zoom as well as several collaborative platforms such as Microsoft Teams and Audit SharePoint. The Council further acknowledged that despite these measures, there may still be difficulties in obtaining sufficient and appropiate audit evidence as a result of differing levels of infrastructure in the country. Auditors are encouraged to apply alternative procedures in completing the audit process. If the Auditor is still not able to obtain sufficient and appropriate audit evidence, then the Auditor should consider modifying the opinion on the financial statements in line with ISA.

If the reason for the client's inability to provide sufficient audit evidence to Auditors is due to lockdown and other COVID-19 related government restrictions, it is expected that Companies may have some lifeline with the filing extension granted by NSE and other regulators. This extension is expected to provide a flexible timeline that will enable the Auditors to delay issuance of the report until a time when the lockdown and other government restrictions will be over and sufficient audit evidence can be obtained. However, if sufficient audit evidence cannot be obtained by the Auditors, modification of audit opinion would become necessary. The audited financial statements containing the modified opinion must then be brought to the Council's attention in accordance with the provisions of section 8 (1n) of the FRC Act.

In a multi-location audit situation, the group auditor should consider the component auditors ability to complete their work and as well as the group auditor's ability to review the work of component auditors. If he is still not able to obtain sufficient and appropriate audit evidence, then he should consider modifying his opinion in line with the International Standards on Auditing (ISAs).

Assessing the Impact of COVID-19

Obtaining an adequate understanding of the impact of COVID-19 outbreak on the client's reporting framework is imperative for the Auditors. Auditors should assess the implications of COVID-19 outbreak on client's business operations and the financial reporting processes as presented by the client. Auditors should discuss these matters proactively with clients to understand whether there is an impact on the client's audit processes and reporting timetable. Since Audit is risk based, it may be appropriate for Auditors to identify and document specific risks to address the risk around COVID-19 on the client. The level of such risk may vary from Low to significant based on the extent of the impact of COVID-19 on different companies and on different industries.

Events after the reporting date

IAS 10 Events After the Reporting Date prescribes when an entity should adjust its financial statements for events after the reporting period and the disclosures that an entity should give about the date when the financial statements were authorised for issue and about events after the reporting period. The standard requires that entities differentiate between those events occurring after the reporting date that provides more information about the conditions that existed at the end of the reporting period ("adjusting events") and those that are indicative of conditions that arose after the reporting period date ("non-adjusting events"). The financial statements should be adjusted in response to adjusting events whilst only disclosures are required in response to material non-adjusting events.

The Council aligns with the consensus that the outbreak of COVID-19 in 2020 was a non-adjusting event for most companies in Nigeria preparing financial statements for the period ended 31 December, 2019. Companies in Nigeria will therefore need to determine the extent of the impact of COVID-19 that should be considered to arise from non-adjusting events for subsequent reporting dates. This however will be dependent on the reporting date, the specific circumstances of the company's operations and the facts under consideration.

Companies will need to focus on the importance of the conditions at the reporting date in reaching this judgment - whether the event confirms incidence at reporting date or indicates or may indicate an adverse situation more than what existed at the reporting date. If the judgment had a significant effect on the amounts in the financial statements, then this judgment should be disclosed and explained.

If an event is considered to be non-adjusting, the nature of the event should however be disclosed. Where an estimate of the financial effect on the company can be made, then this should be disclosed. Otherwise, the fact that the financial effect cannot be estimated should be disclosed. The estimate does not need to be exact – a range of estimated effects is better than no quantitative information at all. In the absence of any quantitative estimate, a qualitative description should be provided.

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Going concern

The COVID-19 pandemic has the potential to wreak havoc on entities' business operations and economic conditions. For instance, the disruption to the business operation could be as a result of an entity's link to the countries mostly affected by the pandemic through interrupted supply chain, capital importation, uncertainty in asset valuation, etc. These will in turn have significant impact on the cash flows and/or projected financial information of the entity, which may likely affect the assessment of the company's ability to continue as a going concern.

As it is the responsibility of management to prepare financial statements, management is therefore required to assess an entity's ability to continue as a going concern. Auditors on the other hand are responsible for obtaining sufficient appropriate audit evidence regarding going concern, and have to conclude on, the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements, as well as to conclude based on the audit evidence obtained, whether a material uncertainty exists about the entity's ability to continue as a going concern. In making these assessments, auditors and companies should draw on the available facts and circumstances including availability of palliatives.

Audit of 2020 Financial Statements

Audit and Accounting issues

At a time like this, valuation, estimation, determination of materiality and disclosure issues become very crucial. The ability to obtain and assess sufficient evidence to support expected credit loss on financial instruments, critical accounting estimates, impairment, and going concern assessments will become very difficult and sometimes complicated.

More so, disclosures regarding subsequent events, material uncertainties and risks will mostly be required in conjunction with quantitative disclosures of estimation or assumption uncertainty. The Financial Reporting Council of Nigeria envisages that many audits and interim audit reviews will become much more complex given the current global COVID-19 pandemic. For instance, IAS 10 paragraphs 14 to 16 describes situations where subsequent deteriorations in the operating results or financial position of an entity after the reporting period may lead to a situation where the financial statements are prepared using alternative basis rather than going concern basis depending on the pervasiveness.

Where the impact of COVID-19 is, in the auditor's professional judgment one of the most significant matters having an impact on the audit of the financial statements, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team, then the auditor should consider reporting this as a key audit matter for entities mandated to report key audit matters.

Given the severity of the COVID-19 pandemic and its impacts on employees, mobility, the financial systems, and the economy, it is very likely that auditors may encounter scope limitations or complex auditing and accounting issues which may require audit teams to consider modifications to audit opinions.

This possibility of FRC granting filing extension was not mentioned in the FRC's guideline bearing in mind that the date that companies are expected to file with FRC as required by Section 58 (3) of the FRC Act is generally triggered with the approval and filing of the FS with respective board of directors. A delay in such approvals and filing automatically translates to delay in filing timeline with FRC. Where listed companies take advantage of the NSE and other regulators' filing extension for instance, it is implied that the filing of those reports with FRC, which is expected to be 30 days after the report approval by the board of directors will also be delayed in equal measure. Board meetings approving the Financial Statement has now gone virtual and circumstance may arise, where Financial Statement are approved in such circumstance and the date for filing with FRC falls due within the lockdown period. Submission of hard copies FS may not be feasible in such circumstances but it is expected that FRC would provide alternative arrangements such as online filing or direct upload on its website should such needs arise.

Consistent with its practice, the FRC is encouraging Audit firms' Quality Assurance leaders/engagement partners to reach out to the Council if there are matters, that would require the support or clarification from the Council. The council believes there is the need to keep the communication lines open ato enable monitoring of issues and events unfolding as a result of the challenges emanating from COVID-19.

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