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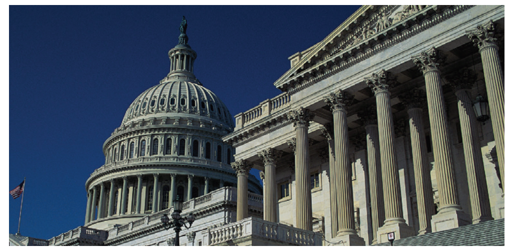

Audit Planning Concerns Due to COVID-19

The COVID-19 pandemic created significant and unique challenges for governmental entities, their governing boards, and auditors. Economic pressures, impacts on governmental employees and internal controls, and risks to personal health have created new and heightened risks unlike any in recent history.

For auditors of periods occurring during this pandemic, planning is critical and involves new considerations, even for existing long-term clients. There will likely be new and changed risks and changes to internal controls as a result of COVID-19 that may require changes to the nature, timing, and extent of audit procedures.

Auditors are required by the first standard of fieldwork to properly plan the audit and supervise staff. The paragraphs that follow discuss specific planning areas to consider in the current environment.

Understanding the Entity

Audit planning requires obtaining an understanding of the entity and its environment, including internal controls and risk factors. Many governmental entities have made significant changes to their operations in response to COVID-19, which may require adjustments to the audit plan. The pandemic has affected various entities and industries differently, so it's important to consider industry-wide issues along with what has changed at the entity since the prior audit.

Auditors should re-evaluate and document client acceptance and continuance procedures based on these changes. This includes assessing the impacts of COVID-19 on the client and on the engagement team's ability to serve the client.

Auditors should discuss with management up front the following: significant new or unusual transactions; supply chain changes; lost customers or major taxpayers; decreases in revenues due to lower sales taxes, property taxes, or permit fees; new types of expenditures; changes in strategic plans; new borrowings or liquidity issues; debt covenant or grant compliance issues; new contingencies;

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litigation changes; new contracts; employee or management turnover; or system changes.

Practical Consideration:

PPC's Guide to Audits of Local Governments, at **ALG-CX-6.3**, "COVID-19 Audit Considerations," provides a checklist and discussion of COVID-19-related audit issues.

Risk Assessment

Auditors need to evaluate the potential for increased risks of material misstatements to the financial statements and how management has assessed the impacts of COVID-19. In addition to the risks discussed above related to changes in the entity, the following are other areas to consider as part of the overall risk assessment:

Fraud Risk. Fraud risk is heightened because of the pandemic. Many entities are struggling financially, so there are more operational and liquidity pressures on management and employees. In addition, closures and shutdowns and employee furloughs and terminations put new pressures on the workforce and can create new opportunities and incentives to commit fraud. Auditors should refer to the requirements of AU-C 240 and consider the need to change audit procedures to address changes in internal controls relating to fraud risks.

Remote Working. Remote working by both client personnel and auditors creates new risks. Access to client personnel and records may have changed since the last audit and may require additional planning and communication. Internal controls over financial reporting have probably changed and need to be evaluated. There are likely new controls and changes to existing controls (like segregation of duties, because of employees working remotely, furloughs, or terminations) to be evaluated, documented, and tested.

Cybersecurity Risks. Governmental entities have increasingly become the targets of cyber incidents, including ransom demands. Many clients have transitioned more data to the cloud to facilitate working remotely, among other reasons. As part of planning, auditors should identify and assess the potential risks of material misstatement to the financial statements from cybersecurity risks and adjust the audit plan to test internal controls that mitigate those risks.

Accounting Issues. Areas of increased accounting risk that may require different audit planning as a result of the pandemic include the following: capital asset impairment, management estimates, timing/cutoff of revenues and expenditures, debt covenant compliance, and investment valuation. As a result of the pandemic, new disclosures may be required for those issues, along with risks and uncertainties and subsequent events. In addition, entities may have implemented new accounting standards that auditors must address, such as fiduciary activities. Going concern may be a new issue for many entities, so auditors should review the requirements of AU-C 570 relating to audit procedures, disclosures, and the audit report. Further, GASBS No. 56 requires financial statement preparers to consider information that may raise substantial doubt for the 12 months after the financial statement date or shortly thereafter (for example, within an additional three months if currently known).

Compliance with Laws and Regulations. In assessing risks of material misstatement to the financial statements, auditors should consider the risk of noncompliance with laws and regulations, including new COVID-19 federal awards, such as the CARES Act. The audit plan should include procedures to review the specific compliance requirements and related controls over them to provide reasonable assurance of detecting noncompliance. These procedures include understanding and evaluating how the client is complying with the relevant provisions of laws, regulations, contracts, and grant agreements, along with the accounting for new awards and expenditures.

Audit Timing

More time may be needed to complete the audit and the audit fee may need to be adjusted in response. In addition to addressing many new audit risks, working and auditing remotely may take more time. Clients working remotely may be less available, less engaged, and have less of a sense of urgency about the audit. The engagement team may have more difficulty accessing client records and obtaining needed information, may be less productive, and the work may take longer. It's important to set expectations about audit timing with the client before and revisit them during the audit. If extensions or waivers are needed from financial statement users, they should be planned for in advance.

Auditors should review the overall audit timeline and phases of fieldwork up to the completion date with management and get their agreement up front. It may be necessary to schedule regular discussions with the client up front, so everyone is aware of open issues and knows what needs to be done to complete the audit.

Information Technology Issues

The audit plan should incorporate any needed changes to the audit team's technology and processes, so they are able to access client data and systems and avoid delays. Additional precautions may be needed to ensure security and confidentiality of data transmissions and communications with the client and others.

Changes to Audit Approach

Following are a few specific areas where the auditor may need to alter processes and procedures:

Communications. Communications with the client may need to be more frequent and timely because of working remotely. Auditors may need to plan to communicate differently because access to management and the governing body is different and they are under additional demands that could affect their availability due to the pandemic.

New risks and accounting issues affecting the audit plan and timing should be discussed in advance; more may come to the auditor's attention as the audit continues. Frequent communications with management and the board to see how they are addressing new issues that might affect the audit are critical.

Practical Consideration:

The PCAOB issued a paper summarizing how audit committees are thinking about the effect of COVID-19 on financial reporting and the audit as they perform their oversight duties. It can be useful for auditors of all types of organizations to consider and is available at **https://pcaobus.org/Documents/Conversations-with-Audit-Committee-Chairs-Covid.pdf**.

Specific Procedures. Walkthroughs and internal control tests may be difficult to perform if clients and auditors aren't at the client's locations, requiring more substantive testing. Preliminary analytics of year-over-year actuals and budget-to-actual may produce different results than in prior audits if the current year results have been significantly impacted (negatively or positively) by the economy and the pandemic. Auditors may need to change their audit plan and procedures in response.

If preliminary audit work was already performed, auditors should inquire about changes in internal controls since that time. Where internal controls are relied on, auditors need to evaluate whether they can continue to rely on controls that weren't in place for the full year.

Because of the many new risks and new accounting issues, auditors may—for the first time—need to engage specialists to assist them. These include economists, valuation experts, cybersecurity experts, and fraud specialists. As part of planning, auditors should review existing and proposed auditing standards relating to use of specialists and consider independence issues.

Practical Consideration:

Guidance on using specialists is available at **www.ethicsboard.org/publications/using-specialists-covid-19-environment**.

Audit Wrap-up Activities

Subsequent event procedures are very important in the current environment. Both recognized and unrecognized events need to be evaluated to make sure they are properly recognized or disclosed in the financial statements. Management representation letters, confirmations, and attorney letters can be delayed because of the current environment, which can delay the audit report. Management representation letters may need to include new representations (going concern, risks and uncertainties, significant estimates, subsequent events) because of the pandemic and this should be discussed with management in advance.

Modified Audit Opinions

There is a greater potential for issuing a modified audit opinion in the current environment. The auditor may not be able to obtain sufficient appropriate audit evidence, even if it is not within the entity's control due to lockdowns, access to entity records, or employee health issues. There may be material misstatements in the financial statements because accounting policies were not followed, or new standards were not appropriately implemented. There could be incomplete or misleading disclosures relating to risks, estimates, judgments, subsequent events, and material uncertainties as a result of the pandemic, including going concern. Auditors should review the requirements of AU-C 706 and discuss any required modification to the audit report with management as soon as possible.

Single Audit Implications

For entities subject to single audit requirements, auditors should be aware of the August 2020 OMB Compliance Supplement and the December 2020 Compliance Supplement Addendum.

Practical Consideration:

COVID-19 A&A resources are available at **www.aicpa.org/interestareas/frc/covid19.html** and in ***PPC's Guide to Audits of Local Governments***.

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Accounting Estimates

The AICPA issued SAS No. 143, *Auditing Accounting Estimates and Related Disclosures,* in July 2020. SAS No. 143, which is now codified at AU-C 540, supersedes *Auditing Accounting Estimates, Including Fair Value Accounting Estimates and Related Disclosures,* which is now codified at AU-C 540A (or AU-C 540B prior to the amendments in SASs 134–141), and amends various other AU-Cs. SAS No. 143 is effective for audit periods ending on or after December 15, 2023, with early implementation permitted.

Overview

SAS No. 143 improves audit quality by enabling auditors to address the increasingly complex estimates, including fair value accounting estimates, in new accounting standards. It requires the auditor to evaluate, based on audit procedures performed and audit evidence obtained, whether accounting estimates and related financial statement disclosures are reasonable.

The Standard retains the requirement that the auditor's further procedures should include one or more of three approaches: obtain evidence from events occurring up to the audit report date, test how management made the estimate, or develop the auditor's own point estimate or range.

The "Application and Explanatory Material" provides guidance and examples of additional procedures and considerations for certain estimates or situations, including estimates of fair value and management's use of models.

Key Changes

Key changes, additions, and notable features covered by SAS No. 143 are as follows:

- Separate assessments of inherent risk and control risk are required.
- Assessment of inherent risk requires the auditor to take into account the degree of complexity, subjectivity, or other inherent risk factors, in addition to the degree to which the accounting estimate is subject to estimation uncertainty.
- Scalability is incorporated by providing examples of how the requirements can be applied to simpler and smaller businesses with accounting estimates that generally have less inherent risk.
- Communications with those charged with governance about accounting estimates are enhanced.
- Requirements and guidance are provided on how other AU-Cs, particularly AU-Cs 315 and 330, are to be applied with respect to accounting estimates.
- New documentation requirements for accounting estimates are added.
- A new more robust requirement has been added, requiring the auditor to evaluate whether management has included disclosures beyond those specifically required by the financial reporting framework.

Practical Consideration:

SAS No. 143 is available at **checkpoint.riag.com** for users that subscribe to the content, and on the AICPA's website at **www.aicpa.org/content/dam/aicpa/research/standards/auditattest/downloadabledocuments/sas-143.pdf**.