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COVID-19 Is Increasing Audit Risks

The coronavirus (COVID-19) pandemic has rightly become the focus of massive public attention in recent weeks, and financial markets around the world have reacted accordingly. As a result, auditors should be mindful of heightened audit risks this year. This article summarizes a few of the audit risks that may be encountered and lists several resources for additional COVID-19 news, updates, and guidance.

Audit Risks

Some of the possible audit risks that may arise due to the COVID-19 pandemic are summarized below:

- **Valuation of Financial Assets.** With financial markets reacting to concerns over the spread of the virus, the measurement of financial assets will be a risk. The duration of the disruption is still unknown, but auditors and management may want to consider the potential for impairment. Financial assets reported at fair value on the statement of financial position may also result in realized and unrealized losses. Management and auditors will also have to exercise judgment around critical estimates and cash flow projections used in the fair value measurement of non-quoted financial instruments.
- **Hedging.** Hedge accounting may be disrupted by higher-than-anticipated levels of volatility, resulting in higher levels of hedge ineffectiveness to recognize in the change in net assets. Clients may also rethink the likelihood of the occurrence of a hedged forecasted transaction, with potential immediate consequences on earnings as well. Finally, management may be re-thinking their hedging strategies.
- **Valuation of Inventory.** Supply chains are disrupted, and production levels may be affected. If your client has reduced or idle production capacity, their overhead costs may not be allocated to inventory as they usually are. In addition, inventory that can't be turned over because of travel restrictions may have to be evaluated for impairment. Finally, changes in prices and reduction in the level of demand will also have to be taken into consideration.

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- **Credit and Liquidity Risks.** Your clients' customers, as well as your clients themselves, may find themselves in financial difficulty, resulting in additional credit risks, higher than usual bad debt, and potentially even impairments and write-offs. Cash flows from operations may also be affected.
- **Measurement and Funded Status of Pension and Other Post-retirement Plans.** Both the expected return on plan assets and the funded status of the plans may have to be revisited in light of the volatility in financial markets.
- **Valuation of Goodwill on Subsidiaries in Affected Areas.** Subsidiaries in areas heavily affected by the COVID-19 pandemic may see their revenues or net income affected by the pandemic. This may trigger a goodwill impairment test. The reassessment of key accounting estimates and projections may result in an immediate goodwill impairment. Goodwill may also have to be tested more than once this year if management considers that evolving circumstances result in more than one triggering event over the next year. This is equally true for other intangible assets.
- **Subsequent Events.** The situation around the spread of COVID-19 is evolving daily, sometimes even hourly. Auditors should ensure that their clients include the appropriate subsequent event disclosures in their annual and interim financial statements.
- **Disclosures.** Events that significantly affect customers' businesses and operations may require disclosures, both in the financial statements and outside of the financial statements.
- **Communication to Those Charged with Governance.** A number of significant accounting estimates and assumptions may be affected by the COVID-19 pandemic, and they may need to be communicated to those charged with governance. Other issues relating to the pandemic may also need to be communicated.

By engaging with your client and their audit committee or similar group about these audit risks and the client's preparedness for such a crisis as it develops, auditors can demonstrate their value as a trusted business advisor.

Thomson Reuters Resources

Checkpoint has provided all its customers with access to a dedicated 2020 COVID-19 Guidance folder containing COVID-19 related news and guidance from across its practice areas:

- RIA Tax Watch
- Federal Tax Update
- Accounting Compliance Alert
- EBIA Pension & Benefit Weekly
- Payroll Update
- Special Studies and Journal Articles across multiple practice areas.

We are also adding a series of articles addressing auditing and SSARS implications of COVID-19 to the 2020 COVID-19 Guidance folder on Checkpoint. Practitioners who are not current Checkpoint customers can get complimentary access to that same content on Checkpoint.

In addition, Thomson Reuters provides resources on its website at **www.thomsonreuters.com**, including links to up-to-the-minute coverage from Reuters News.

AICPA Resources

The AICPA provides several resources for assistance with technical matters relating to the effect of the pandemic on accounting and auditing matters:

- Accounting and Auditing Technical Hotline: **https://apps.aicpa.org/technicalhotline/**
- AICPA COVID-19 Resource Center: **www.aicpa.org/news/aicpa-coronavirus-resource-center.html?&_ga=2.52199081.1614185514.1585172752-21664957.1576552119**
- Peer Review Questions: **mailto:prptechnical@aicpa.org**

Practical Consideration:

Practitioners should closely monitor the breaking news and guidance relating to COVID-19. And, most of all, please stay safe! We are all in this together.

Another Reporting SAS Issued

In March 2020, the Auditing Standards Board issued SAS 139, *Amendments to AU-C Sections 800, 805, 810 to Incorporate Auditor Reporting Changes From SAS No. 134*. As the title indicates, the changes conform those sections with the reporting standard changes introduced by SAS 134, *Auditor Reporting and Amendments, Including Amendments Addressing Disclosures in the Audit of Financial Statements*.

Practical Consideration:

See the January 2020 edition of *PPC's Nonprofit Update* for information on SAS 134 and its changes to the auditor's report.

AU-C Sections Impacted

The superseded standards will be moved to sections AU-C 800A, AU-C 805A, and AU-C 810A. The new standards become:

- AU-C 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*,
- AU-C 805, *Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement*, and
- AU-C 810, *Engagements to Report on Summary Financial Statements*.

Other Changes

SAS 139 also clarifies a few other areas:

- AU-C 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, applies to audits of special purpose financial statements.
- A statement on the suitability of the auditor's report is required when the financial statements are prepared in accordance with either (1) a regulatory or contractual basis of accounting or (2) an other basis of accounting and AU-C 800 requires the auditor to restrict use of the auditor's report.
- The auditor may need to apply the reporting requirements in other AU-C sections when applicable. For example, AU-C 701, *Communicating Key Audit Matters in the Independent Auditor's Report*, applies when the client engages the auditor to communicate key audit matters.

Effective Date

As with SAS 134, the changes to the AU-C 800 series sections are effective for periods ending on or after December 15, 2020. Early implementation is not allowed.

Practical Consideration:

The 2020 editions of *PPC's Guide to Auditor's Reports* and *PPC's Guide to Cash, Tax, and Other Bases of Accounting* will include auditor's report illustrations in compliance with SAS 139.

We Want Your Financial Statements!

We have begun work on the 2020 edition of *PPC's Nonprofit Financial Illustrations and Trends (Nonprofit Trends)* and are on the lookout for new illustrative financial statements. We are especially interested in financial statements for entities that have implemented new accounting standards. We ask that the financial statements include note disclosures and *not* be for governmental units.

To comply with AICPA or state ethics requirements, you may need to obtain permission from your client before submitting financial statements for consideration. We will carefully edit any financial statements to obscure the name and location of the organization and other identifying information. If your submission is selected for inclusion in the 2020 edition of *Nonprofit Trends*, you will receive a free copy of that edition plus *PPC's Guide to Nonprofit GAAP* when they are available in the fall.

Financial statements may be submitted by attaching the files to an email and sending to **Checkpoint.PPC.NPT@thomsonreuters.com**.

Websites of Interest

The following websites may be of interest to the nonprofit sector.

https://www.johnhaydon.com/

This is the virtual home of speaker/author/coach John Haydon who has developed a reputation as a digital marketing expert. His site offers articles on a number of nonprofit topics including fundraising, donor communications, website design, and a variety of specific marketing areas. Follow John on Twitter @johnhaydon.

https://oag.ca.gov/charities

The California Department of Justice webpage for charities offers links with information and resources specific to California nonprofit organizations, including a guide providing best practices for operating and fundraising in California and various webinars.

COVID-19 Relief

The federal government has been busy enacting Coronavirus/COVID-19 relief legislation and providing resources and administrative relief for taxpayers and employers (including exempt organizations). This edition summarizes selected provisions most applicable to exempt organizations. Guidance is coming out daily.

Families First Act (FFA)

The Families First Coronavirus Response Act (P.L. 116-127) was enacted on March 18, 2020, and requires certain employers to provide employees with paid sick leave or expanded family and medical leave for specified reasons related to COVID-19. Additionally, the FFA provides payroll tax credits to employers providing the leave. Generally, the FFA requires employers with fewer than 500 employees to provide both paid and unpaid public health emergency leave to certain employees from April 1, 2020, through December 31, 2020.

Emergency Family and Medical Leave. The first 10 days of a *covered employee's* leave may be unpaid, but an employee may elect to substitute vacation, personal, medical, or sick leave for the unpaid leave. After the first 10 days, the employer must provide up to an additional 10 weeks of paid expanded family and medical leave. The required paid leave is calculated based on an amount not less than two-thirds of an employee's regular rate of pay and the number of hours the employee would otherwise be normally scheduled to work, but not in excess of $200 per day and $10,000 in the aggregate. Certain exceptions, special rules, and a payroll tax credit may apply.

Generally, a *covered employee* is any full-time (FT) or part-time (PT) employee, employed for at least 30 days, who is unable to work or telework because he or she needs leave to care for a child under age 18 resulting from (1) an elementary school, secondary school, or place of care closing, or (2) a regularly compensated child care provider being unavailable due to a COVID-19 federal, state, or locally declared emergency.

Emergency Sick Leave. Private employers (including exempt organizations) with fewer than 500 employees, and public employers of any size, must provide 80 hours of paid sick leave to FT employees who are unable to work (or telework) for specified COVID-19 related reasons. PT employees are entitled to paid sick leave based on their average hours worked over a two-week period. Certain special rules apply, such as when calculating compensation for an employee whose schedule varies from week to week.

The maximum required sick pay varies based on the reason for the absence. Employees must be compensated at their regular rate, up to a maximum of $511 per day and $5,110 in the aggregate (per employee) if they are, due to COVID-19—

- subject to a federal, state, or local quarantine or isolation order,
- advised by a health care provider to self-quarantine, or
- experiencing symptoms and seeking a medical diagnosis.

Employees caring for an individual described in the first two bullet points, caring for a child whose school or place of care is closed or child care provider is unavailable, or experiencing a *substantially similar condition* specified by the government must receive two-thirds of their regular rate, up to a maximum of $200 per day and $2,000 in the aggregate (per employee).

The paid sick leave is immediately available regardless of the employee's length of employment. Employers cannot require employees to search for or find a replacement employee or use other paid leave before this paid sick time. The sick leave mandate takes effect on April 1, 2020, and expires December 31, 2020.

The Fine Print. The DOL is authorized to issue regulations that exclude (1) certain health care providers and emergency responders from the definition of employee, and (2) small businesses with fewer than 50 employees if the leave requirements would jeopardize the viability of the business as a going concern.

Refundable Payroll Tax Credit. The FFA provides a refundable credit against an employer's 6.2% portion of the FICA tax to cover wages required to be paid to employees under the two previously described leave programs. The credits are equal to 100% of the emergency sick leave and emergency family leave paid during a quarter, subject respectively to the dollar limitations stated previously, increased by the portion of the employers' qualified plan expenses that are properly allocated to qualified sick leave wages or qualified family leave wages and the amount imposed by the 1.45% hospital insurance portion of FICA on these wages. The credits apply only to wages paid for the period beginning on April 1, 2020, and ending on December 31, 2020 [IR News Release 2020-57, Notice 2020-21 (2020-16 IRB)].

CARES Act

The Coronavirus Aid, Relief, and Economic Security (CARES) Act (P.L. 116-136) was signed into law by President Trump on March 27, 2020. The CARES Act includes, among its many provisions, direct payments to individuals; enhanced unemployment aid; business loans and grants; money for states, hospitals, and education; and tax cuts. Many of the tax provisions highlighted here are designed to preserve jobs and help an organization's cash flow.

Employee Retention Credit. A refundable payroll tax credit is available for 50% of *qualified wages* paid by eligible employers to certain employees during the COVID-19 crisis. The credit is available to (1) employers, including nonprofits, whose operations in any calendar quarter during 2020 were fully or partially suspended due to a COVID-19-related shut-down order and (2) employers whose gross receipts declined by more than 50% when compared to the same quarter in the prior year.

Observation: This benefit is apparently available to churches and other Section 501(c)(3) organizations that under government orders have suspended group meetings due to COVID-19 whether or not they have fully or partially suspended operations.

Qualified wages. For employers with an average number of full-time (FT) employees during 2019 greater than 100, *qualified wages* are wages paid to employees when they are not providing services due to the COVID-19-related circumstances described earlier. For eligible employers with an average number of FT employees during 2019 of 100 or less, all employee wages qualify for the credit, whether the employer is open for business or subject to a shut-down order. The credit applies to the first $10,000 of compensation, including health benefits, paid to an eligible employee after March 12, 2020, and before January 1, 2021.

Excluded wages. Qualified wages do not include those taken into account when calculating the (1) payroll credits for required paid sick leave or required paid family leave under the FFA (see previous discussion) or (2) employer credit for paid family and medical leave (IRC Sec. 45S). In addition, no credit is available with respect to an employee for any period for which the employer is allowed a Work Opportunity Credit under IRC Sec. 51 with respect to that employee.

Note: In Notice 2020-22 (2020-17 IRB), the IRS provided relief from the Section 6656 penalty for failure to timely deposit employment taxes to the extent amounts not deposited are equal to or less than the amount of the employee retention credit. The credit is not available to employers receiving Small Business Interruption Loans.

Employer Payroll Taxes Payments Delayed. Employers may defer paying the 6.2% employer portion of FICA taxes. The deferral applies beginning March 27, 2020, and extends through December 31, 2020. The deferred employment tax must be paid over the following two years, with half of the amount required to be paid by December 31, 2021, and the other half by December 31, 2022.

Note: Employers that had debt forgiven with respect to an SBA 7(a) loan are not eligible for the deferral.

Net Operating Loss (NOL) Carryback and Carryforwards. For NOLs arising in a tax year beginning in 2018, 2019, or 2020, organizations may carry back the loss to the prior five tax years. Effectively, this delays the 80% of taxable income limitation until 2021 and temporarily extends the carryback period from zero to five years. For NOL carryforwards, in tax years beginning before 2021, taxpayers will be allowed an NOL deduction equal to 100% (as opposed to 80%) of taxable income. In tax years beginning after 2020, taxpayers will be allowed (1) a 100% deduction for NOLs arising in tax years beginning before 2018 and (2) a deduction limited to 80% of modified taxable income for NOLs arising in tax years beginning after 2017.

Paycheck Protection Program. Employers, including nonprofit organizations, can receive loans to fund payroll, mortgage, rent, utility, and other debt obligations during the *covered period*. The *covered period* begins February 15, 2020, and ends June 30, 2020. The loans, administered by the Small Business Administration (SBA), can be requested starting April 3. For additional information, see **https://home.treasury.gov/policy-issues/top-priorities/cares-act/assistance-for-small-businesses**.

Pandemic Unemployment Assistance Benefits. While space does not allow coverage in this edition, the CARES Act Sec. 2102 creates a new federally funded benefit designed to provide coverage to individuals who do not otherwise qualify for state benefits.

Observation: It appears this benefit will expand benefits to furloughed or laid-off employees of churches and other employers that are not required to participate in state unemployment insurance programs.

Charitable Contributions. A new provision has been added, beginning in tax year 2020, allowing individuals who do not itemize deductions to deduct up to $300 of cash contributions made to churches and other public charities [IRC Sec. 62(a)(22)]. Also, the 60% of modified income limitation for deducting cash charitable contributions by individuals who itemize is increased to 100% for 2020 [IRC Sec. 170(b)(1)]. The

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limit on the deductibility of corporate cash contributions made during 2020 is increased from 10% to 25% [IRC Sec. 170(b)(2)]. In addition, the limitation on deductions for contributions of food inventory under IRC Sec. 170(e)(3)(C) is increased from 15% to 25% for both C corporations and other business taxpayers.

Practical Consideration:

Information is being released almost daily related to the COVID-19 pandemic caused by the new coronavirus. Organizations and practitioners advising organizations should continue to monitor guidance.

Tax Briefs

IRS CREATES CORONAVIRUS TAX RELIEF WEBPAGE. The IRS has created a webpage focused on resources to help taxpayers, businesses, and others affected by the new coronavirus. So far, the site features recent guidance issued in various Notices, News Releases, Statements, and Frequently Asked Questions. The site also references other IRS online resources including information on the Economic Impact Payments that were provided for in the CARES Act. The website will be updated as new information is available and can be accessed at **www.irs.gov/coronavirus**.

TAX DEADLINES EXTENDED. Federal tax returns (not including payroll or information returns such as the Form 990) for corporations, trusts, and individuals, originally due to the IRS between April 1, 2020, and July 15, 2020, are automatically extended to July 15, 2020. The relief is also extended to estimated tax payments for tax year 2020 that are due between April 1 and July 15, 2020. This notice provides filing and payment relief for Form 990-T and Form 990-PF. Estimated tax payments due during that timeframe with Form 990-W are also postponed [Notice 2020-23 (2020-18 IRB)].

HIGH DEDUCTIBLE HEALTH PLANS (HDHPs). An HDHP will not fail to qualify under IRC Sec. 223(c)(2)(A) merely because it provides health benefits associated with testing for, and treatment of, COVID-19 without a deductible, or with a deductible below the minimum deductible (self only or family) for an HDHP. Therefore, an individual with an HDHP that covers these costs may continue to contribute to a health savings account (HSA). Also, as in the past, any vaccination costs continue to count as preventive care and can be paid for by the HDHP. According to the IRS, such relief is needed to avoid administrative delays or financial disincentives that might otherwise impede treatment of COVID-19 for participants in HDHPs. The relief, however, does not modify previous guidance on other HDHP requirements [Notice 2020-15 (2020-14 IRB 559) and News Release IR 2020-54].