

Table of Contents

Introduction	3
General Accounting, Auditing, and Reporting Matters	3
Risks and Uncertainties	3
Financial Reporting Considerations Related to COVID-19	3
What should auditors be aware of as it relates to disclosures of risks and uncertainties related to COVID-19?	5
Subsequent Events	5
Financial Reporting Considerations Related to COVID-19	5
What should auditors keep in mind as it relates to subsequent events disclosures related to COVID-19?	7
Going Concern	7
Financial Reporting Considerations Related to COVID-19	7
What about auditing going concern assumptions and disclosures related to COVID-19?	8
What if management is struggling with some of the assumptions and forecasts related to going concern given the volatility of our current environment?	9
Audit and Auditor Reporting Specific Matters	9
Inventory Observations	9
What if my client’s warehouses are closed down during COVID-19 and they are unable to perform their year-end inventory counts?	9
What could auditors do if they are unable to attend (in person) a client’s inventory counts due to travel restrictions caused by COVID-19?	10
Can auditors use cameras and other technologies to observe inventory if they are unable to attend in person?	10
After considering the options above, what if the auditor still is unable to attend the inventory counts virtually or perform alternative procedures?	10
Fraud Inquiries	11
What about fraud risk during these uncertain times?	11
What if the auditor is unable to conduct fraud interviews in person with the client due to the impacts of COVID-19?	11
Access to Books and Records	11
What if the auditor has trouble gaining access to the client’s books and records during the pandemic?	11
Internal Control	12

What should auditors be thinking about with regard to a client’s internal control with many audits taking place remotely due to travel and social distancing restrictions?	12
Use of External Confirmations	12
How should auditors handle situations where responses to account confirmations might be limited due to COVID-19?	12
Is it permissible for auditors to send electronic account confirmations in lieu of traditional paper ones?.....	13
Planning Meetings	13
How should auditors perform audit planning in the current environment?	13
Management Representation Letters	13
Should auditors be adding additional representations related to COVID-19 to the management representation letter?.....	13
What if my client is unable to provide the signed original management representation letter with an original signature on their company letterhead?	13
Emphasis-of-Matter Paragraphs and Types of Auditor’s Reports	14
Should auditors be including emphasis-of-matter paragraphs related to COVID-19 in their audit reports?.....	14
What if the auditor encounters situations where an unmodified auditor’s report is not appropriate? What type of auditor’s report should be issued?	14
Accounting and Financial Reporting Specific Matters	15
Fair Value of Investments	15
Financial Reporting Considerations Related to COVID-19	15
Asset Impairments	16
Financial Reporting Considerations Related to COVID-19	16
Unusual or Infrequent Events	19
Financial Reporting Considerations Related to COVID-19	19
Deferred Tax Assets	20
Financial Reporting Considerations Related to COVID-19	20

FAQs — Audit Matters and Auditor Reporting Issues Related to COVID-19

Introduction

In our desire to serve AICPA members in the United States and throughout the world during this pandemic, and the public in general, the following list of representative frequently asked questions (FAQs) and topics has been compiled to aid (1) practitioners as they perform audit engagements in these uncertain times, and (2) preparers of financial statements. The guidance offered in this document is not applicable to preparation and issuance of audit reports within the jurisdiction of the Public Company Accounting Oversight Board (PCAOB). Additionally, this document does not focus on accounting, disclosure, and reporting nuances for public companies.

This document provides nonauthoritative guidance on accounting and auditing matters as develop by AICPA staff. Official AICPA positions are determined through certain specific committee procedures, due process, and extensive deliberation. The AICPA staff views expressed in this report are intended to provide member services, but not for the purposes of providing accounting services or practicing public accounting. The AICPA makes no warranties or representations concerning the accuracy of information issued.

This document will be updated as additional questions are collected through various AICPA sources and channels.

General Accounting, Auditing, and Reporting Matters

Risks and Uncertainties

Financial Reporting Considerations Related to COVID-19

Financial Accounting Standards Board (FASB) *Accounting Standards Codification*® (ASC) 275, *Risks and Uncertainties*, requires disclosures that focus primarily on risks and uncertainties that could significantly affect the amounts reported in the financial statements in the near term or the near-term functioning of the reporting entity. The risks and uncertainties addressed can stem from the nature of an entity's operations, the use of significant estimates, and current vulnerabilities due to certain concentrations. The effects of COVID-19 may negatively impact significant estimates and exacerbate a vulnerability due to certain concentrations (e.g., business concentration in a market or geographical area severely affected by the effects of COVID-19), as discussed in the following paragraphs.

Significant Estimates. FASB ASC 275-10-50-8 states that:

Disclosure regarding an estimate shall be made when known information available before the financial statements are issued or are available to be issued ... indicates that both of the following criteria are met:

- a. It is at least reasonably possible that the estimate of the effect on the financial statements of a condition, situation, or set of circumstances that existed at the date of the financial statements will change in the near term due to one or more future confirming events.
- b. The effect of the change would be material to the financial statements.

Current Vulnerabilities Due to Certain Concentrations. FASB ASC 275-10-50-16 states that:

Vulnerability from concentrations arises because an entity is exposed to risk of loss greater than it would have had it mitigated its risk through diversification. Such risks of loss manifest themselves differently, depending on the nature of the concentration, and vary in significance. Financial statements shall disclose the concentrations described in paragraph 275-10-50-18 if, based on information known to management before the financial statements are issued or are available to be issued..., all of the following criteria are met:

- a. The concentration exists at the date of the financial statements.
- b. The concentration makes the entity vulnerable to the risk of a near-term severe impact.
- c. It is at least reasonably possible that the events that could cause the severe impact will occur in the near term.

FASB ASC 275-10-50-18 provides the following examples of concentrations that should be disclosed if they meet the preceding criteria:

- a. Concentrations in the volume of business transacted with a particular customer, supplier, lender, grantor, or contributor. The potential for the severe impact can result, for example, from total or partial loss of the business relationship. For purposes of this Subtopic, it is always considered at least reasonably possible that any customer, grantor, or contributor will be lost in the near term.
- b. Concentrations in revenue from particular products, services, or fund-raising events. The potential for the severe impact can result, for example, from volume or price changes or the loss of patent protection for the particular source of revenue.
- c. Concentrations in the available sources of supply of materials, labor, or services, or of licenses or other rights used in the entity's operations. The potential for the severe impact can result, for example, from changes in the availability to the entity of a resource or a right.
- d. Concentrations in the market or geographic area in which an entity conducts its operations. The potential for the severe impact can result, for example, from negative effects of the economic and political forces within the market or geographic area. For purposes of this Subtopic, it is always considered at least reasonably possible that operations located outside an entity's home country will be disrupted in the near term.

Examples of concentrations that are likely to be affected by COVID-19 include specific markets or geographical areas in which the entity conducts its operations, diminishing volume of transactions with a particular customer or a supplier, or limited supply of material or availability of labor or services.

What should auditors be aware of as it relates to disclosures of risks and uncertainties related to COVID-19?

FASB ASC 275 requires disclosures that focus primarily on risks and uncertainties that could significantly affect the amounts reported in the financial statements in the near term or the near-term functioning of the reporting entity. The risks and uncertainties addressed can stem from the nature of an entity's operations, the use of significant estimates, and current vulnerabilities due to certain concentrations. The effects of COVID-19 may meaningfully impact significant estimates and exacerbate a vulnerability due to certain concentrations (e.g., business concentration in a market severely affected by the effects of COVID-19). Finally, COVID-19 may pose risks to the actual functioning of entities in certain industries (e.g., restaurants, hotels, airlines, etc.).

Due to the effects of COVID-19, for entities with year-ends that fall after the declaration of the state of emergency, the necessity for and robustness of the disclosures may require additional scrutiny by the auditor.

Subsequent Events

Financial Reporting Considerations Related to COVID-19

Entities may need to evaluate whether the consequences of COVID-19 represent subsequent events. FASB ASC 855, *Subsequent Events*, defines *subsequent events* as events or transactions that occur after the balance sheet date but before financial statements are issued or are available to be issued.¹ There are two types of subsequent events:

- The first type consists of events or transactions that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements (that is, recognized subsequent events).
- The second type consists of events that provide evidence about conditions that did not exist at the date of the balance sheet but arose subsequent to that date (that is, nonrecognized subsequent events).

For calendar year-end 2019 financial statements, any COVID-19 related subsequent events identified likely are to be nonrecognized subsequent events.

Some nonrecognized subsequent events may be of such a nature that financial statement disclosure is required to keep the statements from being misleading. In these situations, financial statements need to include disclosure of the following:

¹ Financial Accounting Standards Board *Accounting Standards Codification*® 855, *Subsequent Events*, requires that, when a reporting entity meets either of the following criteria, subsequent events need to be evaluated through the date that the financial statements are issued:

- The reporting entity is an SEC filer
- The reporting entity is a conduit bond obligor for conduit debt securities that are traded in a public market

When a reporting entity does not meet either of the above-noted criteria (e.g., typical private company), subsequent events need to be evaluated through the date that the financial statements are available to be issued.

- The nature of the event or events
- An estimate of the financial statement effect of the event or events, or a statement that the estimate cannot be made

Occasionally such an event may be so significant that disclosure can best be made by supplementing the historical financial statements with pro forma financial data giving effect to the event as if it had occurred on the date of the balance sheet. It may be desirable to present pro forma statements, usually a balance sheet only, in columnar form on the face of the historical statements.

Judgment is required and each entity will need to carefully evaluate its relevant facts and circumstances to determine the appropriate treatment for events related to COVID-19, and determine whether COVID-19 is viewed as a current period event based on their financial reporting year end.

Subsequent Events — Market-Value Declines

Given the recent stock market volatility, consider the guidance in paragraph .06 of Q&A section 9070, *Subsequent Events*, of Technical Questions and Answers:

Q&A section 9070.06



Decline in Market Value of Assets Subsequent to the Balance Sheet Date

Inquiry—In light of overall market decline, should the decline in market value of an asset subsequent to the balance sheet date result in the adjustment of the financial statements?

Reply—FASB ASC 855-10-25-1 states that “[a]n entity shall recognize in the financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements.”

FASB ASC 855-10-25-3 states that “[a]n entity shall not recognize subsequent events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after the balance sheet date but before financial statements are issued or are available to be issued.”

FASB ASC 855-10-55-2 provides a list of examples of nonrecognized subsequent events, including changes in the fair value of assets or liabilities (financial or nonfinancial) after the balance sheet date but before financial statements are issued or are available to be issued.

Refer to the [AICPA CPEA Special Report "Consequences of COVID-19: Illustrative Public Company Disclosures"](#) and the [AICPA CPEA Special Report "Consequences of COVID-19"](#) for examples of financial statement subsequent events disclosures as of mid-March 2020.

What should auditors keep in mind as it relates to subsequent events disclosures related to COVID-19? In complying with the requirements of AU-C section 560,² *Subsequent Events and Subsequently Discovered Facts*, the overall objectives of the auditor are to

- obtain sufficient appropriate audit evidence about whether subsequent events are appropriately recognized and disclosed in the financial statements.
- respond appropriately to facts that become known after the audit report date that, had they been known to the auditor as of the report date, may have caused the auditor to revise the report.

For audits of calendar year-end 2019 financial statements, any COVID-19 related subsequent events identified likely will be events that provide evidence of conditions that arose after the date of the financial statements (historically referred to as type II events). Although not requiring recognition in the financial statements, subsequent event disclosures may be required. If appropriate disclosure of subsequent events is not made in the financial statements, a modified auditor's opinion may be appropriate.

Many entities with year-ends after December 2019 will have pandemic-related events that may require an adjustment to the financial statements or additional disclosures (historically referred to as type I events). Auditors will have to work with clients to ensure any subsequent events have been accurately identified and reflected in the financial statements as required by FASB ASC 855. If management is either unable or unwilling to identify those events and properly reflect them in the financial statements, this could result in a modification to the auditors' opinion.

Going Concern

Financial Reporting Considerations Related to COVID-19

FASB ASC 205-40 requires management to evaluate an entity's ability to continue as a going concern within one year after the date the financial statements are issued (or available to be issued, when applicable). Substantial doubt about an entity's ability to continue as a going concern exists when conditions and events, considered in the aggregate, indicate that it is probable that the entity will be unable to meet its obligations as they become due within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued when applicable). Disclosures in the notes to the financial statements are required if management concludes that substantial doubt exists or that its plans alleviate that substantial doubt.

The ability of an entity to continue as a going concern is affected by many factors, including the industry and geographic area in which the entity operates, the financial health of customers and suppliers of the entity, and the accessibility to financing that is available for the entity. The consequences of COVID-19 may impact those factors and may cause a deterioration in an entity's

² All AU-C sections can be found in AICPA *Professional Standards*.

operating results and financial position. As such, entities and practitioners may need to consider recent pertinent information related to their assessments of going concern.

The look-forward period is one year from the date the financial statements are issued (or available to be issued, when applicable). With circumstances changing hourly due to COVID-19, and severe impacts in some industries (restaurants, entertainment, airlines, etc.), management's evaluation of conditions or events that may have an effect on the entity's ability to continue as a going concern under U.S. generally accepted accounting principles (U.S. GAAP) could be extremely difficult.

Refer to the [AICPA CPEA Special Report "Consequences of COVID-19: Illustrative Public Company Disclosures"](#) and the [AICPA CPEA Special Report "Consequences of COVID-19"](#) for an example of financial statement going concern disclosures as of mid-March 2020.

[What about auditing going concern assumptions and disclosures related to COVID-19?](#)

The ability of an entity to continue as a going concern is affected by many factors, including the industry and geographic area in which the entity operates, the financial health of customers and suppliers of the entity, and the accessibility to financing that is available for the entity. The consequences of COVID-19 may impact those factors and may cause a deterioration in an entity's operating results and financial position. As such, entities and auditors may need to consider recent pertinent information related to their assessments of going concern.

Management is required by U.S. GAAP to determine the appropriateness of preparing its financial statements on the basis of a going concern. The look-forward period for auditors pursuant to AU-C section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, is one year from the date the financial statements are issued (or available to be issued) unless otherwise specified by the financial reporting framework. With circumstances changing rapidly due to COVID-19 and severe impacts in some industries (restaurants, entertainment, airlines, etc.), management's evaluation of conditions or events that may have an effect on the entity's ability to continue as a going concern under U.S. GAAP may likely be difficult.

In some cases, management's ability to evaluate going concern issues could cause difficulty in complying with the relevant U.S. GAAP requirements (FASB ASC 205, *Presentation of Financial Statements*, and, more specifically, FASB ASC 205-40). When management performs an evaluation of the entity's ability to continue as a going concern, but auditors are unable to gain access to that information or believe the supporting documentation is inaccurate or incomplete, auditors need to consider a scope limitation or other modification of the auditor's opinion.

If, after considering management's evaluation of going concern, the auditor concludes that substantial doubt about the entity's ability to continue as a going concern has been alleviated by management's plans, then the auditor should evaluate whether the financial statements include adequate disclosure of management's plans and, if adequate, an unmodified auditor's report may be appropriate.

If auditors conclude that use of the going concern basis of accounting is appropriate, but substantial doubt about the entity's ability to continue as a going concern remains, then the auditor's report, modified to add an emphasis-of-matter (EOM) paragraph in accordance with paragraphs .24–.25 of AU-C section 570, should be issued.

If the financial statements have been prepared on the going concern basis and auditors conclude that use of the going concern basis of accounting is inappropriate, then the auditor should express an adverse opinion.

What if management is struggling with some of the assumptions and forecasts related to going concern given the volatility of our current environment?

Auditors should keep in mind that management's assumptions are just that and, in these times of uncertainty, making some of these evaluations or forecasts might be difficult so, in many cases, management's best estimate would be acceptable and may not result in a scope limitation.

Audit and Auditor Reporting Specific Matters

Inventory Observations

What if my client's warehouses are closed down during COVID-19 and they are unable to perform their year-end inventory counts?

If clients are unable to perform physical inventory counts at year-end due to unforeseen circumstances, they might decide to perform those physical counts on an alternative date. Auditors may be able to observe the rescheduled counts and perform additional audit procedures on intervening transactions. If the physical inventory counts are to take place at a later date than originally scheduled, auditors will have to perform additional procedures such as reviewing and testing inventory rollforwards. For businesses that have closed storefronts and warehouses, this may not be a difficult task because there may be very few receipts or shipments coming in if facilities have been closed between year-end and the count date.

Another traditional alternative procedure can be performed if the client is using a cycle count procedure and a perpetual inventory system. A cycle count procedure relates to the client essentially having an internal control in place where, on a periodic basis, many times quarterly, they conduct their own test counts of just a portion of inventory. And, then, the client goes back to its perpetual system and prepares the counts, making any corrections as necessary to the general ledger.

Auditors may need to perform procedures to obtain assurance that client inventory locations have in fact been locked down for a period of time. This might include obtaining live feeds of security camera footage taken of the retail locations and warehouses during that time and reviewing shipping and receiving records during that time to ensure movement was minimal.

What could auditors do if they are unable to attend (in person) a client's inventory counts due to travel restrictions caused by COVID-19?

AU-C section 501,³ *Audit Evidence—Specific Considerations for Selected Items*, notes that, if inventory is material to the financial statements, the auditor should obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by attending physical inventory counting, *unless impracticable*, and perform audit procedures over the entity's final inventory records to determine whether they accurately reflect actual inventory count results. We believe the COVID-19 pandemic may be considered a circumstance rendering in-person attendance during physical inventory counting impracticable.

In some cases, clients may be able to perform the usual physical inventory counts, but auditors are unable to attend due to travel restrictions. In those cases, auditors may take advantage of technologies including camera systems with live video feeds, to observe inventory counts. Of course, auditors should be aware that procedures that can be performed virtually might be a bit more limited and may pose additional audit risks that will need to be addressed. When there are multiple inventory locations, auditors will need to address control of inventory counts to obtain evidence that inventory wasn't moved from one location to another during the inventory counts. If the audit risks cannot be reduced to an acceptable level, this will pose a scope limitation.

Can auditors use cameras and other technologies to observe inventory if they are unable to attend in person?

The auditing standards do not prohibit use of technology when performing inventory observations. If auditors are satisfied with the inventory counting process, they may be able to utilize technologies to observe these counts. Of course, auditors may need to ensure there is some level of comfort that the videos are live feeds of client inventory locations, perhaps, for example, by confirming visually with key staff and using voice technology to have cameras moved to specified locations on command and direct certain boxes to be opened.

After considering the options above, what if the auditor still is unable to attend the inventory counts virtually or perform alternative procedures?

In cases where clients are unable to perform a physical inventory count at year-end or auditors are unable to obtain sufficient appropriate audit evidence that those counts were conducted properly (either unable to attend physical counts in person or remotely, or unable to test rollforward of inventory from balance sheet date to inventory observation date), these issues likely will present scope limitations that will impact auditor reports. In cases where inventory balances are material but are not pervasive, this will result in qualified audit opinions.

Some alternatives auditors might discuss with clients include issuing qualified opinions now and, then, performing agreed-upon procedures engagements on inventory after travel restrictions ease or perhaps if not already having been engaged to perform an audit, having clients discuss with financial statement users whether review engagements would be sufficient for the year-end, supplemented with agreed-upon procedures on inventory after year-end when counts can be taken. Of course,

³ See footnote 2.

auditors should follow the guidance in paragraphs .14–.15, and .A35–.A39 of AU-C section 210, *Terms of Engagement*, when considering changing the terms of the engagement.

Fraud Inquiries

What about fraud risk during these uncertain times?

Auditors should be on higher alert for fraud risks given these uncertain times. For companies that have laid off key personnel and with work forces moving out of the typical office environment, there could be a breakdown in internal control. Auditors may need to adjust audit procedures as necessary to help appropriately address any potential fraud risks that could have a material effect on the financial statements.

What if the auditor is unable to conduct fraud interviews in person with the client due to the impacts of COVID-19?

AU-C section 240, *Consideration of Fraud in a Financial Statement Audit*, lays out a number of requirements and procedures that may be more challenging in a remote audit. For example, auditors still will need to carry out an appropriate discussion among the engagement team in order to understand what fraud risk factors may be affecting the entity in this environment. Paragraph .A17 of AU-C section 240 indicates that inquiries of management and others within the entity are *generally* most effective when they involve an in-person discussion. However, due to the current circumstances related to the pandemic, these inquiries could be done via video conferencing technology. The key consideration is whether the manner in which the inquiries are made allow the auditor to “read the body language” of the person to whom the inquiries are directed. So, when fraud interviews cannot be performed in person, use of video conferencing would be preferable to audio-only conferencing because auditors would be able to see body language.

Access to Books and Records

What if the auditor has trouble gaining access to the client’s books and records during the pandemic?

During the pandemic, accessing client books and records may present hurdles for some auditors, especially in cases where clients still maintain mostly paper records. Auditors may be able to obtain client-prepared copies or scans of key records, but auditors need to consider the authenticity of those records and perhaps perform additional audit procedures to be satisfied that those records are complete, accurate, and authentic.

In cases where auditors are unable to access client books and records, auditors may have to inform clients that audits cannot be completed until books and records can be accessed.

In cases where clients are required to have audited financial statements before specific dates, perhaps due to bank covenant requirements, auditors may want to encourage clients to contact users of the financial statements, such as bank credit officers, as soon as possible to see if waivers or extensions can be obtained.

Internal Control

What should auditors be thinking about with regard to a client's internal control with many audits taking place remotely due to travel and social distancing restrictions?

In an ever-changing and somewhat unstable environment, auditors should inquire about any changes in the client system of internal control since the time that preliminary work was performed. In many cases, those controls may have changed dramatically, and procedures may have been changed to accommodate remote work forces and process flows. In such cases, auditors would need to evaluate how much reliance can be placed on those controls that were only in effect for a portion of the year.

If client sites are closed and auditors are unable to perform audits on-site, performing walkthroughs and certain tests of internal control will be challenging. In these cases, auditors may not be able to rely on controls and may have to increase substantive testing.

An understanding of internal control assists auditors in identifying types of potential misstatements and factors that affect the risks of material misstatement and in designing the nature, timing, and extent of further audit procedures. Even when auditors have no plans to rely on the operating effectiveness of controls, auditors still are required to obtain an understanding of internal control relevant to audits and to determine that those controls have been placed in operation. Obtaining an understanding of controls may be achieved remotely; however, inquiry alone is not sufficient to determine whether such controls have been placed in operation. As such, auditors need to consider what evidence can be obtained remotely to determine if effectively designed controls have been placed in operation. If auditors are unable to obtain sufficient appropriate audit evidence to perform and complete the risk assessment process, then auditors may have scope limitations.

Use of External Confirmations

How should auditors handle situations where responses to account confirmations might be limited due to COVID-19?

As noted in AU-C section 505, *External Confirmations*, depending on the circumstances of the audit, audit evidence in the form of external confirmations received directly by auditors from confirming parties may be more reliable than evidence generated internally by the entity. In cases where a client site has been shut down or key staff are no longer on-site, obtaining external confirmations could be an alternative way to obtain audit evidence. However, there could be situations in which those audit confirmations are not completed and sent back to the auditors, perhaps due to the respondent's office closures or mail issues. In such cases, auditors would have to design additional audit procedures to gain sufficient appropriate audit evidence related to the relevant assertions for the particular account balance or class of transaction for which confirmation was requested.

Typically, if auditors are able to design and perform additional tests of those relevant assertions, non-receipt of confirmations in and of itself should not result in a scope limitation. However, if auditors are unable to obtain sufficient audit evidence through review of the client books and records and are relying on receipt of audit confirmations as a key source of audit evidence, the non-receipt of those

confirmations could result in a scope limitation (where balances are material to the financial statements).

Is it permissible for auditors to send electronic account confirmations in lieu of traditional paper ones? Due to increasing business closures and movement to telecommuting models, auditors may consider sending electronic confirmations rather than paper confirmations. Some firms may have process flow software where this could be done quite easily and might result in a better response rate. Asking clients to contact their vendors and suppliers in advance may be prudent to understand the best way to contact these parties in the current environment. Additionally, auditors should be aware that although oral confirmations may be the fastest and most effective way to obtain evidence about account balances, they would be considered akin to an inquiry of a third party. In considering procedures, firms also should consider that, given sensitivity to cash flow in certain parts of the economy, more accounts receivable may remain outstanding when audit procedures are performed than in prior audits.

Planning Meetings

How should auditors perform audit planning in the current environment?

The first standard of fieldwork indicates that, "the auditor must adequately plan the work and must properly supervise any assistants." Auditors should take note that remote working does not excuse having required audit planning meetings. Auditors should ensure they still are holding these discussions as needed and having substantive discussions on engagement risks with the engagement team prior to commencing audit fieldwork.

Management Representation Letters

Should auditors be adding additional representations related to COVID-19 to the management representation letter?

During this pandemic, additional representations could be added to the management representation letter, depending upon the particular circumstances of an engagement. Those additional representations may relate to the going concern assumption, subsequent events, risks and uncertainties, fraud, and significant estimates, among others.

What if my client is unable to provide the signed original management representation letter with an original signature on their company letterhead?

Using electronic means to obtain signed management representation letters is acceptable if auditors can obtain appropriate evidence of management's receipt and acknowledgment of the representations. In other words, confirmation that the signatory knowingly and willingly signed the representation letter. Whether auditors accept electronic signatures, scanned images of signatures, and so on, is a matter of firm risk management practices as well as applicable state laws or regulations addressing legal acceptability of electronic signatures.

On a recent AICPA webcast, participants asked whether it was acceptable for management representation letters to be on “plain paper” rather than on company letterhead. The standards do not require use of client letterhead. However, as a matter of best practice, it might be prudent for companies to note the company name and address at the top of the letter.

Depending on what is omitted from management’s representation letter, the failure to obtain all representations does not necessarily result in a scope limitation. If management does not provide one or more of the requested written representations, auditors should

- discuss the matter with management;
- re-evaluate the integrity of management and evaluate the effect this may have on the reliability of representations (verbal or written) and audit evidence in general; and
- take appropriate actions, including determining the possible effect on the opinion in the auditor's report in accordance with AU-C section 705A, *Modifications to the Opinion in the Independent Auditor’s Report*.

Emphasis-of-Matter Paragraphs and Types of Auditor’s Reports

Should auditors be including emphasis-of-matter paragraphs related to COVID-19 in their audit reports?

Auditors may conclude that an event has such a material impact on the entity that it would be appropriate to include an emphasis-of-matter (EOM) paragraph in the auditor’s report directing the reader’s attention to the event and its effects. As paragraph .06 of AU-C section 706A, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor’s Report*, notes, EOM paragraphs are included in the auditor’s report if the auditor considers it necessary to draw users’ attention to a matter appropriately presented or disclosed in the financial statements that, in the auditor’s professional judgment, is of such importance that it is fundamental to users’ understanding of the financial statements.

Paragraph .A2 of AU-C section 706A indicates that a major catastrophe that has had, or continues to have, a significant effect on the entity’s financial position is an example of circumstances when auditors may consider it necessary to include an EOM paragraph. Whether the COVID-19 pandemic constitutes a major catastrophe for the client is a matter of the auditor’s professional judgment.

What if the auditor encounters situations where an unmodified auditor’s report is not appropriate? What type of auditor’s report should be issued?

In situations where auditors encountered misstatements of the financial statements or scope limitations, auditors may find the following table from paragraph .A1 of AU-C section 705A helpful.

<i>Nature of Matter Giving Rise to the Modification</i>	<i>Auditor's Professional Judgment About the Pervasiveness of the Effects or Possible Effects on the Financial Statements</i>	
	<i>Material but Not Pervasive</i>	<i>Material and Pervasive</i>
Financial statements are materially misstated	Qualified opinion	Adverse opinion
Inability to obtain sufficient appropriate audit evidence	Qualified opinion	Disclaimer of opinion

Accounting and Financial Reporting Specific Matters

Fair Value of Investments

Financial Reporting Considerations Related to COVID-19

If an entity reports its investments at fair value in accordance with Financial Accounting Standards Board (FASB) *Accounting Standards Codification*® (ASC) 820, *Fair Value Measurement*, it would not be appropriate to disregard observable market prices at the measurement date unless those prices are from transactions that are not orderly.

FASB ASC 820 establishes a framework for measuring fair value when U.S. generally accepted accounting principles (U.S. GAAP) requires or permits a fair value measurement. *Fair value* is defined in FASB ASC 820 as "[t]he price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date." FASB ASC 820-10-35-41 indicates that "[a] quoted price in an active market provides the most reliable evidence of fair value and shall be used without adjustment to measure fair value whenever available, except as specified in paragraph 820-10-35-41C." In other words, if a security trades in an active market at the measurement date, its fair value will equal the quoted price.

FASB ASC 820 defines *active market* as "[a] market in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis" and does not provide bright lines or rules of thumb for what constitutes an active market. To assist entities with determining fair value in periods of market disruption, paragraphs 54C–54H of FASB ASC 820-10-35 provide guidance on measuring fair value when the volume or level of activity for an asset or a liability has significantly decreased. In situations when there has been a significant decrease in the volume or level of activity, it may be appropriate to consider other valuation techniques in estimating the fair value.

As indicated in FASB ASC 820-10-35-54H, "[a] reporting entity's intention to hold the asset or to settle or otherwise fulfill the liability is not relevant when measuring fair value because fair value is a market-based measurement, not an entity-specific measurement."

FASB ASC 820-10-35-54I lists circumstances that may indicate a transaction is not orderly, whereas FASB ASC 820-10-35-54J provides guidance on how to consider such transitions.

Estimating fair value requires significant judgment in normal circumstances. However, in the current environment characterized by market volatility and an uncertain outlook, applying judgement in determining fair value will be even more challenging.

Asset Impairments

Financial Reporting Considerations Related to COVID-19

Among the many consequences of COVID-19, impacts such as business and production disruptions, supply chain interruptions, negative impacts on customers, volatility in the equity and debt markets, reduced revenue and cash flows, and other economic consequences may occur. The entities whose operations are negatively affected by COVID-19 may need to consider testing their assets for impairment.

*Goodwill*⁴

FASB ASC 350-20 provides guidance on accounting and reporting for goodwill and requires that goodwill be tested for impairment on an annual basis and between annual tests in certain circumstances. FASB ASC 350-20-35-3C provides the following examples of events and circumstances (triggering events) that may warrant an interim test:

- a. Macroeconomic conditions such as a deterioration in general economic conditions, limitations on accessing capital, fluctuations in foreign exchange rates, or other developments in equity and credit markets
- b. Industry and market considerations such as a deterioration in the environment in which an entity operates, an increased competitive environment, a decline in market-dependent multiples or metrics (consider in both absolute terms and relative to peers), a change in the market for an entity's products or services, or a regulatory or political development
- c. Cost factors such as increases in raw materials, labor, or other costs that have a negative effect on earnings and cash flows
- d. Overall financial performance such as negative or declining cash flows or a decline in actual or planned revenue or earnings compared with actual and projected results of relevant prior periods
- e. Other relevant entity-specific events such as changes in management, key personnel, strategy, or customers; contemplation of bankruptcy; or litigation
- f. Events affecting a reporting unit such as a change in the composition or carrying amount of its net assets, a more-likely-than-not expectation of selling or disposing of all, or a portion, of a reporting unit, the testing for recoverability of a significant asset group within a reporting unit,

⁴ When considering and/or performing a goodwill impairment test, it may be helpful to refer to the [AICPA Accounting and Valuation Guide Testing Goodwill for Impairment](#), which provides guidance and illustrations for preparers of financial statements, independent auditors, and valuation specialists regarding the accounting, valuation, and disclosures related to goodwill impairment testing.

or recognition of a goodwill impairment loss in the financial statements of a subsidiary that is a component of a reporting unit

- g. If applicable, a sustained decrease in share price (consider in both absolute terms and relative to peers)

As indicated in FASB ASC 350-20-35-3F, these examples are not all-inclusive, and an entity should consider other relevant events and circumstances that affect the fair value or carrying amount of a reporting unit. Given the current economic environment, many entities are likely to conclude that triggering events are present, causing them to perform an interim goodwill impairment test.

Private companies and not-for-profit entities that have elected the accounting alternative under FASB ASC 350-20 to amortize goodwill are still required to test it for impairment upon a triggering event at either the entity level or the reporting-unit level. FASB ASC 350-20 uses the same triggering events guidance for entities that have elected the accounting alternative as well as for those that have not. As a result, entities that have elected the accounting alternative are also likely to conclude that they have a triggering event, requiring them to test goodwill for impairment. The likelihood of goodwill being actually impaired will depend on many factors, including the recency of the acquisition giving rise to goodwill. In other words, goodwill that results from a recent acquisition and which, therefore, has not yet been amortized over a significant period, is more likely to be impaired than goodwill that results from a more distant acquisition.

Entities should also consider whether to test their other assets for impairment and to make sure they perform those tests in the appropriate order. FASB ASC 350-20-35-31 requires that goodwill be tested for impairment only after the carrying amounts of the other assets of the reporting unit have been tested for impairment under other applicable accounting guidance. For more information, see the “Order of Impairment Testing” discussion later in this section.

Indefinite-Lived Intangible Assets

Entities’ indefinite-lived intangible assets (such as certain trademarks) may also need to be evaluated for impairment. Paragraphs 15-20 of FASB ASC 350-30-35 provide guidance on impairment testing of indefinite-lived intangible assets and require that they be tested for impairment annually and more frequently if events or changes in circumstances indicate that it is more likely than not that the asset is impaired (triggering events). FASB ASC 350-30-35-18B provides examples of such events and circumstances, which are similar to those considered for goodwill.

As a result, entities needing to perform interim testing of goodwill for impairment are also likely to conclude that they should test their indefinite-lived intangible assets.

Long-lived Assets

Long-lived assets to be held and used (including property, plant, and equipment, finite-lived intangible assets, and right-of-use assets recognized under FASB ASC 842, *Leases*) are tested for impairment in accordance with the guidance in paragraphs 17-35 of FASB ASC 360-10-35. FASB ASC 360-10-35-21

requires that they be tested for recoverability (which involves comparing undiscounted cash flows for a long-lived asset or asset group being evaluated with the carrying amount of that asset or asset group) whenever events or changes in circumstances indicate that their carrying amount may not be recoverable and provides the following examples of such events:

- a. A significant decrease in the market price of a long-lived asset (asset group)
- b. A significant adverse change in the extent or manner in which a long-lived asset (asset group) is being used or in its physical condition
- c. A significant adverse change in legal factors or in the business climate that could affect the value of a long-lived asset (asset group), including an adverse action or assessment by a regulator
- d. An accumulation of costs significantly in excess of the amount originally expected for the acquisition or construction of a long-lived asset (asset group)
- e. A current-period operating or cash flow loss combined with a history of operating or cash flow losses or a projection or forecast that demonstrates continuing losses associated with the use of a long-lived asset (asset group)
- f. A current expectation that, more likely than not, a long-lived asset (asset group) will be sold or otherwise disposed of significantly before the end of its previously estimated useful life. The term more likely than not refers to a level of likelihood that is more than 50 percent

FASB ASC 360-10-35-17 states that an impairment loss should be recognized only if the carrying amount is not recoverable and exceeds fair value. An impairment loss should be measured as the amount by which the carrying amount exceeds fair value.

Given the impact of COVID-19, many entities may conclude that they should test their long-lived assets to be held and used for recoverability. As provided in FASB ASC 360-10-35-22, when such assets are tested for recoverability, it also may be necessary to review depreciation estimates and method or the amortization period.

Other Assets

In addition to the assets discussed in the preceding paragraphs, other assets may need to be tested for impairment. Impairment models under U.S. GAAP vary depending on the asset subject to the impairment test. Impairment models consideration of future events also vary significantly under current U.S. GAAP. This can even be the case for the same asset; for example, a financial asset using the “incurred loss” model for impairment versus a financial asset using the current expected credit losses model. Asset impairment considerations (and the related professional guidance for reference) may include the following:

- Financing receivables (e.g., trade accounts receivables, loans)
 - FASB ASC 310, *Receivables*
 - FASB ASC 326, *Financial Instruments — Credit Losses* (if adopted)
- Inventories
 - FASB ASC 330, *Inventory*
- Contract assets

- FASB ASC 310
- Equity securities
 - FASB ASC 320, *Investments—Debt and Equity Securities*, or FASB ASC 321, *Investments—Equity Securities*, if Accounting Standards Update (ASU) No. 2016-01, *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*, has been adopted
- Debt securities
 - FASB ASC 320 or FASB ASC 326, if ASU No. 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, has been adopted
- Other investments
 - FASB ASC 325, *Investments — Other*
- Deferred tax assets
 - FASB ASC 740, *Income Taxes*

Order of Impairment Testing

It is important to perform impairment testing in the appropriate order. Consistent with FASB ASC 360-10-35-27, the impairment testing should be performed in the following order:

- Adjust the carrying amounts of any assets (such as accounts receivable and inventory) and liabilities (such as accounts payable, long-term debt, and asset retirement obligations) not covered by FASB ASC 360-10 that are included in an asset group in accordance with other applicable GAAP.
- Test for impairment and adjust carrying amounts of indefinite-lived intangible asset(s) that are included in an asset group under FASB ASC 350-30.
- Test long-lived assets (asset group) and amortizable intangible assets under FASB ASC 360-10.
- Test goodwill of a reporting unit (or, for private companies, an entity) that includes the aforementioned assets under FASB ASC 350-20.

This sequence is necessary because it allows to make any required adjustments to the carrying amount of the reporting unit (or, for private companies, an entity) prior to the performance of the goodwill impairment test.

Unusual or Infrequent Events

Financial Reporting Considerations Related to COVID-19

Determining whether the COVID-19 pandemic is unusual in nature or an infrequent occurrence requires significant judgement. FASB ASC 220-20-45-1 states:

A material event or transaction that an entity considers to be of an unusual nature or of a type that indicates infrequency of occurrence or both shall be reported as a separate component of income from continuing operations. The nature and financial effects of each event or transaction shall be presented as a separate component of income from continuing operations or, alternatively, disclosed in notes to financial statements. Gains or losses of a similar nature that are not individually material shall be aggregated. Such items shall not be reported on the face of the income statement net of income taxes.

The FASB ASC Master Glossary offers the following definitions:

Infrequency of Occurrence

The underlying event or transaction should be of a type that would not reasonably be expected to recur in the foreseeable future, taking into account the environment in which the entity operates (see FASB ASC 220-20-60-1).

Unusual Nature

The underlying event or transaction should possess a high degree of abnormality and be of a type clearly unrelated to, or only incidentally related to, the ordinary and typical activities of the entity, taking into account the environment in which the entity operates (see FASB ASC 220-20-60-1).

Deferred Tax Assets

Financial Reporting Considerations Related to COVID-19

Recognition of unexpected losses and impairments as a result of the COVID-19 pandemic may impact the entity's tax accounting, including the realizability of the deferred tax assets (DTA).

FASB ASC 740-10-30-2(b) requires that a valuation allowance be established for a DTA if it is more likely than not that the related tax benefit will not be realized. Realization of DTAs depends on the existence of sufficient taxable income of the appropriate character within the carryback and carryforward period available under the tax law. FASB ASC 740-10-30-18 lists the following four sources of future taxable income:

- a. Future reversals of existing taxable temporary differences
- b. Future taxable income exclusive of reversing temporary differences and carryforwards
- c. Taxable income in prior carryback year(s) if carryback is permitted under the tax law
- d. Tax-planning strategies

FASB ASC 740-10-30-17 states the following:

All available evidence, both positive and negative, shall be considered to determine whether, based on the weight of that evidence, a valuation allowance for deferred tax assets is needed. Information about an entity's current financial position and its results of operations for the current and preceding years ordinarily is readily available. That historical information is supplemented by all currently available information about future years.

Entities should consider each source of income incrementally to determine the amount of the valuation allowance needed, if any. FASB ASC 740-10-30-18 also states that “if one or more sources are sufficient to support a conclusion that a valuation allowance is not necessary, other sources need not be considered.”

FASB ASC 740-10-30-21 notes that “forming a conclusion that a valuation allowance is not needed is difficult when there is negative evidence such as cumulative losses in recent years.”