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The impacts of COVID-19 on audit practices

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THE IMPACTS OF COVID-19 ON AUDIT PRACTICES

By

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INTRODUCTION

The coronavirus disease 2019 (COVID-19), also known as the coronavirus pandemic, is an ongoing pandemic caused by severe acute respiratory syndrome coronavirus 2 (SARS-CoV-2). It was first identified in December 2019 in Wuhan, China. The World Health Organization declared the outbreak a Public Health Emergency of International Concern in January 2020 and a pandemic in March 2020 (COVID-19 Pandemic, 2021).

This virus has had a significant impact on how various industries and businesses have had to conduct their operations. The retail, hospitality, real-estate, and financial services industries are some that have had to improvise, adjust, and strategize on ways to cope with this pandemic. Within the public accounting field, this pandemic has caused challenges never before faced by auditors in performing audits. In response, some auditors have needed to be more agile and creative in performing audits and complying with the auditing standards.

“From banks to Main Street investors, financial statement users place their trust in auditors to assure the accuracy of the financial information they use to make decisions. As the impacts of COVID-19 are being navigated, the auditor's role as protector of the capital markets has never been more important” (Dohrer & Mayes, 2020).

There are seven (7) major phases of an audit. These include client continuance/acceptance, preliminary engagement activities, audit planning, consideration and audit of internal controls, audit of business processes and related accounts, completing the audit and lastly, the evaluation of results and issuing of an audit report. Each of these phases comprise certain steps and requirements to achieve an effective and efficient audit (Messier et al., 2019 p. 19). The aim of this thesis is to thoroughly analyze each phase, and examine potential and current impacts of the COVID-19 pandemic on each of them.

CLIENT ACCEPTANCE & CONTINUANCE

The first phase of an audit process is client acceptance and continuance (Messier et al., 2019 p. 19). The purpose of a client acceptance and retention evaluation process is to assist the audit firm in assessing the risks associated with providing services to each client. The factors to consider are determined solely by the firm as each has a different level of risk tolerance (CPABC, 2016). However, there are some general considerations that are consistent among several firms.

"The AICPA Statements on Quality Control Standards (SQCS) require firms to establish policies and procedures for the acceptance and continuance of client relationships and specific engagements" (Ferrence, 2020). Management Integrity, Management Commitment to GAAP, Management Internal Control Consciousness, and the Financial Strength of the Client and other General Considerations are some of the evaluations that should be included in the formation of policies and procedures related to accepting a new client and retaining an existing client. These factors contribute significantly to the auditor's business risk and should, taken together, direct the client acceptance decision (Decker et al., 2016 p. 100-101).

Decker et al. discuss each of these general risk factors that auditors should consider when making the decision to accept or reject a client, as paraphrased below.

General Considerations: A couple of general considerations that an auditor should consider when accepting a new client include:

a. The nature of the auditee's business.
b. If the client is a good fit for the auditing firm from an integrity, reputation, and industry-focus perspective.
c. The scope of services to be provided within the context of a financial statement audit.

d. The auditor’s expertise and capacity to serve the prospective client well.
e. Whether the auditee is a publicly traded entity.
f. Independence considerations including examination of existing relationships are other general considerations in this process.

Management Integrity: Client integrity is critical. A CPA must be able to rely upon the client's representations and information provided. In conducting a financial statement audit, the auditor is highly dependent upon honest, complete, and accurate answers in response to auditor inquiries as well as being forthcoming in providing other forms of evidence requested by the auditor. A client's tone at the top speaks of its attitude toward risk. If a client lacks integrity, irrespective of how well the service is performed, a problem may still arise (Ferrence, 2020).

Before accepting a new client or retaining an existing client, “The auditor should obtain background checks that include a search for civil and criminal litigation, bankruptcies, tax liens, SEC violations, media reports and any needed additional research on principal management personnel” (Decker et al., 2016 p. 100).

In most cases, background checks for management personnel may be limited to those individuals from whom the auditor would obtain management representations. These usually include the chief executive officer, the chief financial officer, and the chief accounting officer. The auditor should make outside inquiries to attorneys, bankers, and others. Outside legal counsel, primary bank officers, predecessor auditors and any other additional sources deemed significant should be contacted to make inquiries to obtain their impressions of the entity and its management (Decker et al., 2016 p. 101).

Management Commitment to GAAP:

Deckler et al. explains that to determine management's commitment to GAAP, the auditor should review for any questionable accounting policies. The auditor should read the prospective client's financial statements for the past several years looking for any questionable policies, practices, or transactions. Inquiries should be made to management by the auditor, and if the auditor believes the prospective client should adopt different accounting policies or practices, the auditor should propose these changes to the prospective client. It is meaningful for the auditor to note whether the prospective client is willing to adopt other policies or practices, if any.

CLIENT CONTINUANCE/RETENTION

Client continuance should be done by public accounting firms to assess whether they would like to continue their professional relationship with their client. A client's level of risk may change over time. A firm's level of risk tolerance may change as well. Performance of client continuance evaluations is just as important as client acceptance. The fundamental question to ask in any continuance evaluation is this: "If this client walked through my door today as a new client prospect, would they pass my acceptance criteria?" If the answer is "no," it may be time to part ways" (Ferrence, 2020).

IMPACTS OF COVID-19 ON CLIENT ACCEPTANCE/RETENTION

In regards to the recruiting of new clients, there has not been a slow down in business due to the pandemic says Lakeisha Florence - Senior Manager at Deloitte. "Business is growing a lot because of Initial Public Offerings (IPOs) and (Special Purpose Acquisition Company) SPAC transactions, which are in the market currently" Audit partner at Deloitte - Lindsay Bielski explains.

One way that the pandemic has affected this phase of the audit process is by restricting the in-person recruiting strategy that firms would usually incorporate when trying to acquire a new client. Bielski explains that due to the pandemic, recruiting of clients has shifted to a more intentional strategy compared to the old way of being able to casually meet potential clients via relationships and in-person events.

Although this strategy has changed, it has been beneficial in maintaining relationships and building trust between the audit team members and clients. Florence explains that due to the virtual environment, the availability of clients has increased slightly compared to pre-covid. There is more access to people, and more ability to build those relationships.

In regards to the evaluation process used to assess whether clients should be accepted or current clients should be retained, Florence says that there has not been any change. She further explains that for new client acceptance, checks and balances are done to make sure no management integrity issues are found. These evaluations already happen remotely, so there has been no change in that area. There have been clients with financial difficulties due to the pandemic but nothing that would affect increased risks in the client acceptance process or decisions to continue serving clients.

Another impact of COVID-19 on this phase of the audit is the level of understanding needed. One of the important general considerations when making the decision to accept or retain a new or existing client is to have a solid understanding of the auditee's business environment. With COVID-19, the business environment of several companies have been unpredictable, negatively impacted, and different from previous years.

"The auditor's understanding of the entity and its environment has likely changed from previous periods due to the implications of COVID-19. There may be changes to the entity's objectives, strategy, organizational structure, governance arrangements and business model and it is important that the auditor considers how these changes impact the audit." (Arnold, 2020).

Management commitment to GAAP and other relevant rules and regulations is another important consideration for the client acceptance/retention decision process. "With the COVID-19 pandemic it is important to understand how any relevant changes in laws or regulations impact the entity and how it operates, including extension of reporting periods in some jurisdictions. There may also be changes to the applicable financial reporting standards in different jurisdictions that may need to be considered" (Arnold, 2020).

PRELIMINARY ENGAGEMENT ACTIVITIES

The purpose of preliminary engagement activities is to help ensure that the auditor has considered any events or circumstances that may adversely affect the auditor's ability to plan and perform the audit engagement to reduce audit risk to an acceptably low level.

According to the Public Company Accounting Oversight Board (PCAOB) - AS 2101, the auditor should perform procedures regarding the acceptance or continuance of the client relationship and the specific audit engagement and determine compliance with independence and ethics requirements at the beginning of the audit. The auditor should also establish an understanding of the terms of the audit engagement with the audit committee.

The steps involved in the acceptance/continuance of the client relationship and the specific audit engagement is the first step of the audit and is described in the preceding section. The auditor must act without bias with respect to the client; otherwise, they would lack the impartiality necessary for the dependability of their findings. It is important to the profession that the general public maintain confidence in the independence of independent auditors. Public confidence would be impaired if the independence of the auditor is in question. It might also be impaired by the existence of circumstances that reasonable people might believe likely to influence independence (PCAOB - AU Section 220).

Establishing an understanding of the terms of the audit engagement is the third requirement of preliminary engagement activities. Auditing Standard No. 16 requires the auditor to communicate with the company's audit committee regarding certain matters related to the conduct of an audit and to obtain certain information from the audit committee relevant to the audit. This standard also requires the auditor to establish an understanding of the terms of the audit engagement with the audit committee and to record that understanding in an engagement letter.

The objectives of this step for the auditor are to:

- Communicate to the audit committee the responsibilities of the auditor in relation to the audit and establish an understanding of the terms of the audit engagement with the audit committee. This understanding includes communicating to the audit committee about the objective of the audit, the responsibilities of the auditor, and the responsibilities of management (AS No. 16 -3a).
- Obtain information from the audit committee relevant to the audit. The auditor should inquire of the audit committee about its knowledge of matters pertaining to the audit (AS No. 16 -3b).
- Communicate to the audit committee an overview of the overall audit strategy and timing of the audit, as required by (AS No. 16 - 9). The timing of the audit and any significant risks that were identified during the auditor's risk assessment procedures should also be discussed with the audit committee. If applicable, during this stage the auditor should communicate to the audit committee the nature and extent of any specialized skills or

knowledge needed to perform the likely audit procedures. This includes communicating the extent to which the auditor plans to use the work of the company's internal auditors in conducting the financial statement audit.

During this step, the auditor should also identify the names, locations, and planned responsibilities of other independent public accounting firms or other persons, who are not employed by the auditor, that will perform audit procedures in the current period audit. Related to this, the auditor should provide the basis for the auditor's determination that the auditor can serve as the principal auditor, if significant parts of the audit are to be performed by other auditors.

- Commit to provide the audit committee with timely observations arising from the audit that are significant to the financial reporting process.

IMPACTS OF COVID-19 ON PRELIMINARY ENGAGEMENT ACTIVITIES

An article published in the Journal of Accountancy discusses best practices for an audit, and common/recurring deficiencies identified in PCAOB inspections conducted during the pandemic. These were addressed by George Biotic - the director of the PCAOB's Division of Registrations and Inspections.

"Risk assessment and understanding clients" which are a part of the preliminary audit engagement are two key audit takeaways that Biotic discusses that Audit practitioners should keep in mind as they work toward performing high-quality audits as a result of COVID-19. "Performing robust risk assessment procedures and understanding the client's business is as important as ever. This includes understanding the impact of known and/or potential changes due to COVID-19 and other economic challenges. "Auditors should revisit their initial assessment of risk and modify planned procedures as circumstances evolve," Biotic says (Tysiac, 2020).

Staffing Levels

A factor that is accounted for during the Preliminary Audit Phase is the staffing needed for each audit engagement. Due to the pandemic, the workload for most audit engagements may have increased and in turn affecting the number of team members needed for an audit engagement. Todd Miller - Audit Senior at Deloitte attests to the increased workload by saying "we have worked the most hours out of any busy season, this busy season"

Lindsay Bieslki says that overall the pandemic has not affected the number of interns new hires and staff needed for each audit engagement. However, due to the increase in business and partly due to the pandemic, there has been a need for more higher-level employees. There have been more job openings for higher-level positions. Todd also explains that even though there were no adjustments to staffing levels, that is something that should probably have been considered. He says that things were kept the same due to two reasons; first being the uncertainty of the pandemic, and the second being that staffing structures are normally set about two years in advance.

PLANNING THE AUDIT

Planning the audit includes establishing the overall audit strategy for the engagement and developing an audit plan. This includes planned risk assessment procedures and planned responses to the risks of material misstatement. Planning is not a discrete phase of an audit but, rather, a continual and iterative process that might begin shortly after (or in connection with) the completion of the previous audit and continues until the completion of the current audit (PCAOB Auditing Standard No. 9).

According to the AS 9, the engagement partner is responsible for the engagement and its performance. Accordingly, the engagement partner is responsible for planning the audit and may seek assistance from appropriate engagement team members in fulfilling this responsibility. When planning an audit, the auditor should establish an overall audit strategy (PCAOB Auditing Standard No. 9 - 8).

An audit strategy sets the direction, timing, and scope of an audit. The strategy is then used as a guideline when developing an audit plan. By developing an audit strategy, it is easier to create a more targeted audit plan, thus improving the efficiency of the planning phase of an audit. The strategy document usually includes a statement of the key decisions needed to properly plan the audit. The audit strategy is based on the following considerations in Auditing Standard No.9 - 10:

- The scope of the engagement
- The characteristics of the engagement
- Reporting objectives
- Timing of the audit
- Nature of communications
- Significant factors in directing engagement team efforts
- The results of preliminary engagement activities
- The knowledge gained on other engagements
- The nature, timing, and extent of resources available for the engagement

Auditing standard 9.10 states that after the audit strategy has been formulated, the auditor should develop and document an audit plan that includes a description of the planned nature, timing, and extent of the risk assessment procedures, tests of controls, and substantive procedures, as well as other planned audit procedures required to be performed so the engagement complies with PCAOB standards.

An audit program states the detailed steps to be followed in the conduct of an audit. The audit program is much more detailed than the strategy document, since the program states the nature, timing, and extent of the specific audit procedures to be conducted (Bragg, 2021).

Supervision

In the audit planning phase, while determining the audit plan and program, supervision is accounted for. The engagement partner is responsible for proper supervision of the work of engagement team members and for compliance with PCAOB standards. This includes standards regarding using the work of specialists, other auditors, internal auditors, and others who are involved in testing controls (PCAOB-AS 1201).

The engagement partner and other engagement team members performing supervisory activities, should inform engagement team members of their responsibilities, including (1) The objectives of the procedures that they are to perform; (2) The nature, timing, and extent of procedures they are to perform; and (3) Matters that could affect the procedures to be performed or the evaluation of the results of those procedures, including relevant aspects of the company, its environment, and its internal control over financial reporting, and possible accounting and auditing issues (PCAOB - AS 1201).

IMPACTS OF COVID-19 ON PLANNING THE AUDIT

Lakeisha Florence discusses the effects that the pandemic has had on this phase of the audit. She explains that in regards to planning, the audit team had to take a step back and consider the risks that have been newly introduced to the process now that both the auditors and clients are remote. For example, the auditor should consider the changes that have occurred in their controls. When dealing with accounts payable for instance, if prior to COVID-19 clients were cutting checks three days a week and there were certain reviews and approvals that happened, now that fewer staff are in the office on a regular basis, these functions might be reduced to one day a week. That being considered, the auditor must now consider the additional risks this introduces into the process, and how it will affect the scope and planning.

Concerning the timing of the audits, Todd Miller mentions that "whenever there is a change, it is going to take more time" to adjust. As mentioned during the preceding section, Todd mentions that this busy season has required more time that any other. He continued that the revisions of the scope, timing, nature and extent of the audits is very dependent on the type of client and the industry in which they operate. If the client was heavily impacted by covid (e.g., a massive restaurant chain or mask manufacturer whose revenues would be heavily impacted), then the audit and its scoping are going to be altered. Reassessments would have had to be made to the scope, timing and risks associated with the engagement.

Todd Miller also touches on testing conducted during this phase of the audit and how the pandemic has impacted it. He states that, in regard to testing, a lot of times analytics are done. For example if a client had a $100 million in Accounts Receivable in the preceding year, expectations would usually be the same for the following year. Generally year to year a quick analytic can be conducted. However, due to the pandemic, if their balance significantly grew or decreased as a result of lost or heightened sales, a simple quick analytics will not suffice anymore. Samples would have to be taken, getting the detail, and making comparisons, asking more questions etc.

Setting materiality levels is accounted for during the planning process. Todd Miller explains that the way to determine materiality has had to change across the board whether the client was heavily impacted by COVID-19 or not. Miller states that an adjustment would be made if for example, income was being used to determine materiality, and the client's income significantly fluctuated from the past.. If equity was being used and due to the pandemic, the client had to issue new shares then that is a factor that has to be addressed. Miller states that on his engagements, they tended to be more conservative this year with their materiality calculations. He says "you would look at it and say, if we could isolate how much their revenue grew due to COVID-19 we can probably keep their materiality at the same level historically and not adjust it. If materiality was to be brought down, we took it all the way down, and if we could justify bringing their materiality up, we were conservative."

One of the most important parts of developing an audit plan includes a thorough assessment of planned risk procedures and planned responses to the risks of material misstatement. Audit effectiveness is highly dependent upon the auditor's ability to identify risks of material misstatement, and to design and implement appropriate responses that adequately address those risks. In connection with the risk assessment process conducted in every audit, circumstances surrounding the COVID-19 pandemic need to be closely examined in almost all audit areas.

Risk assessments in the current environment are unlike any others, as clients are dealing with significant changes to their businesses, the work environment, and the economy overall as a result of COVID-19. “We have gone back to the basics of audit risk, risk of material misstatements, and detection risk, and encouraged our practitioners to reconsider risks throughout the audit cycle,” said Jen Haskell, CPA, chief auditor at Deloitte (Murphy, 2020).

Lindsay Bielski mentions that concerning the audit risk, it is industry-specific, as risk varies from industry to industry. However, fraud risk and management override was something that was scrutinized a little more due to the effects of COVID-19. Florence states that - if you think of the fraud triangle, there is opportunity because folks are operating in different locations. To some degree there was some rationalization that happened. Clients have had to reduce paychecks temporarily or even ask employees to leave just to keep their business alive. Therefore, in this environment, the risk of fraud has heightened and auditors have had to examine what companies may attempt to do to present a better picture of themselves versus what the reality is.

As a result of COVID-19, when planning the audit, communication is also very important more than ever. “Auditors should also have discussions with management and those charged with governance about how they have assessed the impact of the pandemic on the business and evaluate whether there are new or changed risks that could be material. Understanding how those charged with governance are addressing the new or changed risks is essential for the auditor in understanding where changes may be needed to the audit. Ongoing communication throughout the audit is also essential as the entity’s circumstances may change” (Arnold, 2020).

Supervision is an important factor that is accounted for while planning the audit. Bielski and Florence both mention that as a result of COVID-19, supervising and training staff has had to be more intentional especially for new hires and interns. Senior staff have had to be more deliberate in reaching out to them in order to ensure that they understand their tasks and duties.

Training has been designed in such a way that new hires and interns are getting the most from it even though they are working remotely.

Virtual Audit rooms have had to be incorporated in order to maintain that knowledge sharing and communication that would typically take place in-person prior to the pandemic. During these sessions each team member would typically join a Zoom call and have themselves muted while working independently. If they have a question, suggestion etc. they would ask it in order to get feedback. Florence emphasizes the importance of working together and the amount of learning that takes place during the process.

INTERNAL CONTROLS

Internal controls are the mechanisms, rules, and procedures implemented by a company to ensure the integrity of financial and accounting information, promote accountability, and prevent fraud (Kenton, 2020).

COSO designed a framework commonly used to assist companies in structuring and evaluating controls. It is composed of five integrated components: control environment, risk assessment, control activities, information and communication, and monitoring activities. Auditing standards require the auditor to obtain an understanding of each of these five components (Messier et al. 2019 p. 189).

“Control Environment is the set of standards, processes, and structures that provide the basis for carrying out internal control across the organization. The board of directors and senior management establish the tone at the top regarding the importance of internal control including expected standards of conduct” (COSO - Control Environment, 2015).

Risk Assessment involves making reviews of the business to assess where the most critical risks lie, and then designing controls to address those risks. Control Activities is the use of accounting systems, information technology, and other resources to ensure that appropriate controls are put in place and operating properly. For example, there may be accounting systems in place to periodically conduct inventory audits and fixed asset audits. In addition, there may be off-site backups to minimize the risk of lost data (Bragg, 2020).

“Information should be communicated to management in a timely manner, so that shortfalls can be addressed promptly. The amount of information communicated should be appropriate to meet the needs of the recipient. Monitoring is the set of processes used by management to examine and assess whether its internal controls are functioning properly. Ideally, management should be able to spot control failures and make adjustments to improve the control environment. Otherwise, an improper or ineffective control may allow misstatements to pass through into the financial statements” (Bragg, 2020).

To assess the effectiveness of a company’s controls, the auditor first gathers the information from their risk assessments. The information gathered is used to evaluate the design of controls and to determine whether the controls have been implemented (Messier et al. 2019 p.185).

The next step is for the auditor to decide whether or not to rely on the entity’s controls for assurance about the management’s financial statement assertions. When the auditor’s risk assessment procedures indicate that the controls are not properly implemented or designed, the auditor will not rely on the controls. In this instance, the auditor will set control risk at the maximum and use substantive procedures to reduce the risk of material misstatements to an acceptable low level (Messier et al. p. 187). This is referred to as the substantive strategy. Substantive procedures include the following general categories of activity (Bragg, 2020):

- Testing classes of transactions, account balances, and disclosures.

- Agreeing the financial statements and accompanying notes to the underlying accounting records.
- Examining material journal entries and other adjustments made during the preparation of the financial statements.

If the auditor's risk assessment procedures suggest that the controls are property designed and implemented, the auditor will likely adopt the reliance strategy and rely on controls. If the auditor decides to rely on controls, tests of controls are required to be performed to obtain audit evidence that the controls are operating effectively (Bragg, 2020).

The following are general classifications of tests of controls (Bragg, 2020):

- Reperformance. Auditors may initiate a new transaction, to see which controls are used by the client and the effectiveness of those controls.
- Observation. Auditors may observe a business process in action, and in particular the control elements of the process.
- Inspection. Auditors may examine business documents for approval signatures, stamps, or review check marks, which indicate that controls have been performed.

IMPACTS OF COVID-19 ON INTERNAL CONTROLS

An understanding of the entity's system of internal controls is important to assist the auditors in identifying possible misstatements. Internal controls may not have operated consistently throughout the audit period because of the changed circumstances resulting from COVID-19. (Arnold, 2020).

As mentioned in the planning phase, there have been new risks that have been introduced due to the pandemic (e.g., fraud risk). These risks may not have been assessed as significant risks in prior audits. "If the auditor has determined that a significant risk exists, they are required to obtain an understanding of the entity's controls, including control activities, relevant to that risk" (Arnold, 2020).

One of the components of internal control that has been affected by the pandemic is the control environment. Many organizations have had to change the way they operate and so would have had to change their oversight processes and how controls operate.

For the most part in terms of the high level controls relating to the control environment, assessments have had to be more deliberate, explains Lindsay Bielski. As it relates to signing of documents, there has been an increase in electronic signatures by using an electronic signing software called docusign. She explains that there have been changes in the types of approvals or the way reviews are conducted due to the new virtual environment, but overall clients have adjusted well to working from home from a control perspective.

Todd Miller also explains that approvals of meetings and reviews of financial results are all done virtually. He explains that on some audit engagements, clients had to make changes to their control structure or their process because people were performing their job functions remotely as opposed to doing so in-person. Historically, for example, where someone was signing off on a reconciliation and scanning that into the system, now that is taking place in a different manner.

In relation to reliance, if the auditor intends to rely on the operating effectiveness of controls, further insight as to the control and how it operates, as well as the auditor's intended reliance, may be required due to COVID-19. Further insights can be found when obtaining audit evidence about the design and implementation of identified controls, including IT controls. However, although this may be difficult because of a lack of access to certain information (e.g., documents or reports) or company personnel (e.g., ability to inquire or observe the application of specific controls), the relevant work still needs to be undertaken in an alternative way or the risk identification or assessment should be changed accordingly. Auditors will need to consider what evidence can be obtained remotely to determine if effectively designed controls have been placed in operation to mitigate the applicable risks (Arnold, 2020).

Overall, in terms of internal controls, being aware and having an understanding of many control changes, as well as new and additional controls now relevant to the audit will be more important than ever before in helping to understand whether controls are still operating as they previously performed, whether any new risks have arisen because of the change, and how impactful these risks are.

AUDIT OF BUSINESS PROCESSES AND RELATED ACCOUNTS

Auditor's generally divide an entity's information system into business processes or transaction cycles. Using this approach, the auditor is able to gather evidence by examining the processing of related transactions from their origin to their ultimate disposition in accounting journals and ledgers. The five basic processes of transaction cycles are the revenue process, the purchasing process, the human resources management process, the inventory management process, and the financing process (Messier et al. 2019 p. 335).

Revenue Process

In order to accurately assess the risk of material misstatements concerning the recognition of revenue recognition, an auditor must have robust knowledge of the new revenue recognition standard requirements and how they affect the client's financial statements. The following describes the five-step process for recognizing revenue and areas that require significant judgment (Thorps et al. 2020).

1. Identify contracts with the customer.
2. Identify separate performance obligations.
3. Determine the transaction price.
4. Allocate transaction price to the separate performance obligations.
5. Recognize revenue.

In examining the revenue process the auditor should first consider the inherent factors that may affect both the revenue and cash receipts transactions and the financial statement accounts affected by those transactions. There are four specific inherent risks that may affect the revenue process: industry-related factors, the complexity and contentiousness of revenue recognition issue, the difficulty of auditing transactions and account balances, and misstatements detected in prior audits (Messier et al. 2019 p. 347).

The auditor should also assess the control risk for the revenue process. They should understand and document the revenue process based on a reliance strategy, plan and perform tests of controls on revenue transactions, and set/document the control risks.

Understanding the five components of internal control is discussed in the preceding section. In setting the control risk assessment for the revenue process, the auditor must first have an understanding of the five components of internal control based on the reliance strategy as discussed in the preceding section.

The auditor should also plan and perform tests of controls on revenue transactions, cash receipts, and sales return and allowances transactions. The auditor should systematically analyze the entity's revenue process to identify controls that ensure that material misstatements are prevented or are detected and corrected (Messier et al. 2019 p. 350).

Finally, once the test of controls have been completed, the auditor should set and document the achieved level of control risks. If the results of the tests of controls support the planned level of control risks, the auditor conducts substantive procedures at the planned level. When the tests of controls do not support the planned level of control risks the auditor must set a higher level of control risk. This results in a lower level of detection risk and leads to more substantive procedures than originally planned (Messier et al. 2019 p. 350).

Some important assertions that should be tested include occurrence, completeness, authorization, accuracy, cutoff, and classification. One of the most important assertions for the revenue process is occurrence. Possible misstatements include fictitious revenues being recorded and revenues being recorded prior to goods being shipped or services being performed (Messier et al. 2019 p. 350).

Purchasing Process

"The purchasing process includes the acquisition of goods and services of raw materials, supplies, manufacturing equipment, utilities, and professional services" (Messier et al. 2019 p. 383).

At the beginning of the audit of the purchasing process and its related accounts, the auditor should consider the relevant inherent risk factors that may impact the transactions processed and the financial statement accounts. Some of these risks include: industry-related factors and misstatements detected in prior audits. Industry-related factors relate to whether the supply of raw materials is adequate and how volatile raw material prices are (Messier et al. 2019 p. 392).

In setting the control risk assessment for the purchasing process, the auditor must have an understanding of the five components of internal control based on the reliance strategy as discussed in the preceding section.

Second, the auditor should plan and perform tests of controls on purchase transactions, cash disbursements, and purchase return transactions. Finally, the auditor should set and document the control risks. (Messier et al. 2019 p. 394).

Some important assertions that should be tested include occurrence, completeness, authorization, accuracy, cutoff, classification and presentation. Occurrence is perhaps the most important assertion related to the purchasing process, and a possible misstatement exists when a purchase is recorded without the goods/services ever being ordered or received. Examples of a significant control activity and a test of control for this process include segregation of duties and observation (Messier et al. 2019 p. 393-400).

Prepaid expenses also are commonly processed through the purchasing process. When auditing this process, the inherent risk for prepaid expenses would generally be assessed as low because these accounts do not involve any complex or contentious accounting issues. Common prepaid expenses include prepaid insurance, prepaid rent and prepaid maintenance. Part of the control risk for prepaid expenses is based on the effectiveness of the control activities in the purchasing process. For example, the control activities in the purchasing process should ensure that new insurance policies are properly authorized and recorded (Messier et al. 2019 p. 478).

On many audits, the auditor can gather sufficient, appropriate evidence on prepaid insurance by performing substantive analytical procedures. If substantive tests are performed at all, they are conducted as part of the purchasing process. Detailed tests of balances are typically necessary only when misstatements are expected (Messier et al. 2019 p. 479).

Human Resources Process

"This process starts with the establishment of sound policies for hiring, training, evaluating, counseling, promoting, compensating, and taking remedial actions for employees. Once an individual is hired, the main transaction that affects the financial statement accounts is the payroll transaction" (Messier et al. 2019 p. 420).

Similar to the preceding business processes, inherent risk should be analyzed. Some factors that auditors might consider when assessing inherent risks include: the effects of economic conditions on payroll costs, the supply of skilled workers, and issues related to executive and shared-based compensation.

The next step includes the control risk assessment which involves the same steps discussed in the preceding business processes. Understanding and documenting the human resource management process, planning and performing tests of controls on payroll transactions, setting and documenting the control risk are all related to the risk assessment for this process.

Some primary assertions of concern for payroll transactions include occurrence, completeness and authorization. Possible misstatements include fictitious payments to employees, employee services provided but not recorded, and unauthorized payments made to employees (Messier et al. 2019 p. 425-428).

Inventory Management Process

In examining the inventory management process, the auditor needs to also consider the inherent risk factors that may affect the transactions and financial statements accounts affected by this process. Industry-related risks, operating and engagement characteristics are some risks that auditors should consider (Messier et al. 2019 p. 448).

The inventory management process is affected by the control activities previously described for revenue, purchasing and human resources. Some assertions for this business process include; occurrence, completeness, authorization, accuracy, and cutoff. Possible misstatements relating to these assertions include; fictitious inventory, inventory recorded but not on hand due to theft, unauthorized production activity resulting in excess levels of inventory, inventory obsolescence etc. (Messier et al. 2019 p. 456).

Financing/Investing Process

The audit of the financing/investing process involves auditing select asset accounts such as cash, intangible assets, and property, plant, and equipment. It also involves assessing the entity's long-term liabilities, stockholder's equity as long-term debt and equity are the major sources of financing for most entities. Lastly, income statement accounts are also audited (Messier et al. 2019 p. 477, 503).

Cash: When auditing the financing process, auditors must obtain reasonable assurance that the cash balances of the entity being audited are stated accurately (Audit Procedures for Cash, 2020). Some relevant assertions related to auditing cash include existence, completeness, rights, accuracy and cut-off. Some primary risks associated with cash include cash theft, cash being intentionally overstated to cover up theft, not all cash accounts being reflected accurately in the general ledger, and cash being misstated due to errors in the bank reconciliation. Substantive procedures for cash audits may include confirming cash balances with financial institutions, vouching reconciling items to the subsequent month's bank statement, and making inquiries about bank accounts (Hall, 2020).

Intangible Assets: These are assets that provide economic benefits for longer than a year but lack any physical substance (e.g., trademarks, customer lists, licenses and patents). Significant inherent risk considerations are raised in accounting for intangible assets due to the nature of the judgments involved. The auditor is likely to assess inherent risks of significant intangibles as high, particularly if the assets may be impaired because of the judgment and complexity associated with valuation and impairment testing of intangible assets, (Messier et al. 2019 p. 481-482).

Intangible asset transactions and initial valuation are typically processed through the entity's business acquisition processes. For the auditor to rely on the entity's controls in this process, they need to have a good understanding of the controls, document that understanding, and test the design and operating effectiveness of the key controls. For example, the control activities in the business acquisition process should ensure that all identifiable asset categories are separately valued and that any valuation specialists used are qualified and objective (Messier et al. 2019 p. 482).

Tests of details associated with valuation and impairment of intangible assets are often necessary due to the complexity and degree of judgment involved, increasing the risk of material misstatement. Substantive analytical procedures are not likely to provide sufficient, appropriate evidence for significant transactions involving intangible assets. Test of details would include testing the existence and completeness, valuation, rights and obligations, and classification assertions (Messier et al. 2019 p. 483).

Property, Plant, and Equipment: There are three inherent factors in this area that should be considered by the auditor. These include: complex accounting issues, difficult-to-audit transactions, and misstatements detected in prior audits (Messier et al. 2019 p. 486).

Occurrence, authorization and completeness are some major assertions that relate directly to the property management process. Segregation of duties is an important control activity that relates to this process. For example, the function of initiating a capital asset acquisition should be segregated from the final approval function. This is to prevent the possibility of fictitious or unauthorized purchases from occurring (Messier et al. 2019 p. 487).

Long-Term Liabilities: “Common types of long-term debt financing include notes, bonds, and mortgages” (Messier et al. 2019 p. 504). When auditing this account, the auditor must be assured that the amounts shown on the balance sheet for the various types of long-term debt are not materially misstated. The audit approach used varies depending on the frequency of the entity’s financing activities. If an entity engages in frequent financing activities, then the auditor might opt for a reliance strategy. However, for the vast majority of entities where the auditor is not required to test internal controls over financial reporting, it is more efficient for the auditor to follow a substantive strategy (Messier et al. 2019 p. 505).

Inherent risks for notes and bonds are normally assessed as low to moderate because the volume of transactions is low. However, for the more sophisticated forms of debt that possess characteristics of both equity and debt and can introduce a large amount of leverage, the inherent risk is high (Messier et al. 2019 p. 505).

The assertions that are of primary concern to the auditor are occurrence, authorization, completeness, valuation and disclosure-classification. Some control activities related to this include maintaining detailed records of long-term debt and providing proper disclosures. (Messier et al. 2019 p. 506).

Stockholders’ Equity: Stockholders’ equity includes common stock, preferred stock, paid-in-capital, and retained earnings for most corporate entities. The three major types of transactions that occur in stockholders' equity include issuance of stock, repurchase of stock, and payment of dividends (Messier et al. 2019 p. 508).

A substantive strategy is most commonly used to audit this area because the number of transactions is usually small and often the value is large. The auditor musts still understand the types of controls in place to prevent misstatements, and test the design of the key controls. Some important assertions relating to the stockholders' equity include occurrence, accuracy, authorization, and valuation (Messier et al. 2019 p. 509).

Income Statement Accounts: "In auditing the income statement accounts of an entity, the auditor must be satisfied that the revenues and expense accounts are not materially misstated and that they are accounted for in accordance with GAAP. The audit of the revenue and expense accounts depends on the extent of work conducted by the auditor on the entity's control system and on the entity's balance sheet accounts" (Messier et al. 2019 p. 513).

Auditing the income statement includes consideration of the results of audit work conducted in other parts of the audit. It also involves consideration of the completion of additional substantive procedures on selected income statement accounts such as the results of testing controls for various business processes (Messier et al. 2019 p. 514).

IMPACTS OF COVID-19 ON AUDIT OF BUSINESS PROCESSES AND RELATED ACCOUNTS

The impact of COVID-19 on auditing the inventory management process mainly has to do with the physical inspections and walkthroughs. Auditors have had to be creative in order to effectively assess this process while following CDC guidelines. With COVID-19, social distancing rules and stay at home orders, not only may auditors not be able to travel, but clients' employees also might not be there physically to perform the counts. Lindsay Bielski explains that observing inventory changed to a volunteer basis as a result of the pandemic. Extensive checks were made to ensure clients were following CDC health guidelines to ensure a safe environment for those who volunteered to observe the inventory. Employees were concerned for their safety so the process was different than in the past.

Auditing the revenue process during COVID-19 involves more scrutiny for potential fraud. LaKeisha Florence mentions that fraud and management overrides are risks that have increased as a result of the pandemic. Fictitious revenues, fraudulent management estimates, and improper timing of revenue are examples of some fraud risks involved in the revenue process that may be heightened and auditors would need to pay attention to in the current environment.

The economic impact of covid may have created incentives and opportunities to record fictitious revenue. For example, sales personnel at a given client may have struggled to meet their targets. If their compensation was tied to meeting those targets, they may have had an incentive to inflate their sales figures (Thorps, Harding 2020).

Management estimates, such as goodwill valuation, are at risk of misstatement. For example, many entities enter into loan covenants based on debt or earnings before depreciation. Clients at risk of violating those covenants may seek to manipulate accounting estimates to strengthen their bottom line. In addition, improper timing of revenue recognition happens when an entity inappropriately records revenue in one period that should be recorded in another. This might be done to accelerate revenue recognition to meet earnings projections. Entities could also delay recognition if they have already met their projections for the period (Thorps, Harding 2020).

Auditing these business processes would involve extra attention to the additional risks introduced due to the pandemic, especially the control risks.

COMPLETING THE AUDIT

Once the financial statement accounts and related controls for each of the various business processes have been audited, the auditor summarizes and evaluates the evidence (Messier et al. 2019 p. 559). The following are areas in which the auditor has responsibilities in completing the audit.

Review of contingent liabilities

"A contingent liability is an existing condition or set of circumstances involving uncertainty about a possible loss that will ultimately be resolved when some future event occurs or fails to occur" (Messier et al. 2019 p. 560).

Review of commitments

Examples of these involve long-term commitments to purchase or sell goods at a fixed price (Messier et al. 2019 p. 560).

Review of subsequent events

"Subsequent events are events or transactions that occur after the balance sheet date but before the issuance of the financial statements which materially affects the financial statements" (Messier et al. 2019 p. 560). There are two types of subsequent events. Type I events provide additional evidence about conditions that existed at the date of the balance sheet and affect the amounts involved in the financial statement preparation process. Type I events require adjustments of the numbers in the financial statements (Messier et al. 2019 p. 560).

Type II events provide evidence that did not exist at the date of the balance sheet but arose subsequent to the date, and they require disclosure in the notes to the financial statements (Messier et al. 2019 p. 561).

Final evaluation of audit evidence including going-concern considerations

Final evaluation of audit evidence includes performance of final analytical procedures, obtaining a management representation letter, reviewing of audit documentation, and final evaluation of audit results. Evaluation of financial statement presentation and disclosure, obtaining an independent review of the engagement, and the evaluation of the entity's ability to continue as a going concern are also steps involved in the final evaluation (Messier et al. p. 578).

Communications with the audit committee and management

The objectives of communication with the audit committee are to (1) communicate the auditor's responsibilities and establish an understanding of the terms of the audit engagement with the audit committee; (2) obtain relevant information; (3) communicate an overview of the timing and strategy of the audit; and (4) provide timely and significant observations (Messier et al. 2019 p. 579).

Subsequent discovery of relevant facts existing at the date of the auditor's report

These are events occurring after the issuance of the financial statements and that would have changed the statements or the auditor's opinion had the facts been known prior to the issuance.

IMPACTS OF COVID-19 ON COMPLETING THE AUDIT

Final evaluations of a company's going concern is an important part of wrapping up the audit. The current circumstances make it more difficult for auditors to rely on management's assessment of going concern in light of the many and significant uncertainties. In the event that conditions are identified that may cast significant doubt on the company's ability to continue as a going concern it is likely that auditors may need to perform additional procedures, and consider the impact of their findings on the auditor's report (Arnold, 2020).

Lindsay Bielsky explains that going-concern has been a real issue for clients who were negatively impacted by COVID-19. There has been an increased amount of scrutiny for clients in industries that suffered financially from the pandemic. She says that as a result of the huge uncertainty revolving around covid, not only was more time needed on going-concern analysis, but consultation was also required.

Arnold (2020) provides some examples of the challenges for auditors in evaluating management's assessment of the company's ability to continue as a going concern and the related disclosures that may exist in the current environment:

- Evaluating whether an entity has access to sufficient liquidity and can remain solvent through the period of public health restrictions and beyond.
- It may be difficult to obtain a meaningful baseline economic forecast to develop estimated future cash flow scenarios, including further plausible downside economic scenarios specific to the entity. A focus may be needed on any assumptions used and how any sensitivity analysis has been performed.

- Evaluating the degree of business disruption is complex (i.e., will correlations from past consumer behavior and business practices still apply after the crisis, or does this require a reassessment and recalibration of models used).

Subsequent events is another consideration that has been impacted by COVID-19. For entities with a calendar year ending December 31, 2019, most subsequent events related to the impacts from the pandemic will likely be Type II events, such as the following examples (Obillo et al., 2020):

- Accounts Receivable: A customer's cash flow issue and difficulty paying accounts receivable directly resulting from the COVID-19 pandemic is a Type II event.
- Investments: Subsequent market or fair value declines resulting from the pandemic.
- Debt Modifications: Concessions given to borrowers due to the difficulties in meeting debt obligations because of COVID-19 impacts on business and cash flows are Type II events.
- Income Taxes: Various tax provisions issued under the CARES act are also Type II events.

In terms of communications with the audit committee, LaKeisha Florence stated that audit committees were very interested about COVID-19 and what auditors were seeing across the industry and clients and what would change going forward. Numerous conversations occurred with the audit committees concerning covid occurred during this stage of the engagement.

EVALUATE RESULTS AND ISSUE AUDIT REPORT

Evaluating the results and issuing an audit report is the final stage of the audit engagement. The main objective of the auditor is to evaluate the results derived from conducting the prior steps of the audit to determine whether the evidence obtained is sufficient and appropriate to support the opinion to be expressed in the auditor's report (PCAOB AS - 2810).

An auditor's report is a written letter from the auditor containing their opinion on whether a company's financial statements comply with generally accepted accounting principles (GAAP) and are free from material misstatement (Kenton, 2021).

There are four types of reports that can be given by an auditor, one of which being the standard unqualified audit report. “An unqualified opinion is an independent auditor's judgment that a company's financial statements are fairly and appropriately presented, without any identified exceptions, and in compliance with generally accepted accounting principles (GAAP)” (Tuovila, 2020).

There are eight elements in this report, including the title, the addressee, the “opinion”, the basis of opinion, critical audit matters (CAMs), the name/signatures of the audit firm, the amount of time the auditor has served the company, and the audit location and date (Messier et al. 2019 p. 596).

If an auditor does not issue an unqualified opinion, then they can either issue a qualified audit report, a disclaimer, or an adverse opinion. The auditor qualifies his or her opinion when either a scope limitation or a specific departure from GAAP exists, but overall the financial statements present fairly in conformity with GAAP (Messier et al. 2019 p. 606).

A disclaimer occurs when there is either insufficient appropriate evidence to form an overall opinion or because there is a lack of independence. Lastly, the auditor issues an adverse opinion when the financial statements do not present fairly due to a GAAP departure that materially and pervasively affects the financial statements overall (Messier et al. p. 606).

IMPACTS OF COVID-19 ON EVALUATING RESULTS AND ISSUING AN AUDIT REPORT

COVID-19 may result in a rise in modifications to the auditor's opinion due to, for example, issues related to material misstatement of the financial statements or more circumstances where there is an inability to obtain sufficient appropriate audit evidence. Similarly, there could be more 'modified' audit opinions and more 'material uncertainties' highlighted in audit reports in relation to going concern, and more 'emphasis of matter paragraphs' for other COVID-19 related disclosures. In addition, it is a reasonable expectation that for listed entities there will be an impact on CAMs included by auditors in relation to the impact of COVID-19, including more areas of the audit that will likely require significant auditor attention or the nature of CAMs previously reported may change (Arnold, 2020).

"An explanatory paragraph is added to an unqualified opinion for a number of reasons including situations when the auditor believes that there is substantial doubt about an entity's ability to continue as a going concern" (Messier et al. 2019 p. 600). This is one example of a potential impact on audit reports stemming from COVID-19 and the resulting economic uncertainty as companies may face challenges that could impact their ability to continue operating as a going concern. As stated previously, Lindsay Bielski noted that there has been increased scrutiny and time spent on going-concern considerations on certain businesses due to the pandemic. She also states that there has been an increase in going-concern paragraphs explaining some issues such as the inability of clients to pay debts, and other cash flow problems.

“During the audit, if the auditor concludes that an entity’s disclosures included in its financial statements around its ability to continue as a going concern are adequate and if after consideration of management’s plans to alleviate such conditions, the auditor still has substantial doubt about the entity’s ability to continue as a going concern, then the auditor would be required to include an explanatory paragraph in the audit report” (Hyde, 2020).

Another example of a potential impact to auditor reporting as a result of COVID-19 is a scope limitation resulting from the auditor’s inability to observe material inventory balances recorded in a company’s financial statements” (Hyde, 2020).

The remote work environment has disrupted auditors’ traditional approach to observing inventory. The pandemic has not changed the PCAOB auditing standards; therefore, auditors have started to look to alternative methods, such as video technology, to audit the existence of inventory (Hyde, 2020).

While auditors may be able to perform alternative procedures to obtain sufficient appropriate audit evidence over the existence of inventory, there may be situations in which alternative methods to test inventory’s existence are not available, or practical. In such instances, if inventory is material to the company’s financial statements, the auditor’s inability to obtain sufficient appropriate evidential matter may require the auditor to qualify his or her opinion (Hyde, 2020).

“A critical audit matter is any matter arising from the audit of the financial statements that has been communicated or is required to be communicated to the audit committee. It also relates to accounts or disclosures that are material to the financial statements, and that involves especially challenging, subjective, or complex auditor judgments" (Murphy, 2019).

"While COVID-19 in and of itself, or going concern uncertainty, would not necessarily meet the definition of a CAM, the pandemic could increase the subjectivity and complexity of a specific audit area such that it meets the definition of a CAM, when it otherwise may not have prior to the pandemic" (Hyde, 2020). In addition, for audits of large-accelerated filers, COVID-19 also could result in CAMs that were previously identified and communicated in the auditor's report being expanded to include new assumptions that were especially challenging or complex due to the pandemic and/or result in changes to the auditor's response to a previously identified CAM (Hyde, 2020).

IMPACTS OF COVID-19 ON PERSONAL INTERACTIONS WITH COLLEAGUES AND CLIENTS

A significant part of public auditing involves the in person interactions with clients and team members. Working on different engagements helps forge so many relationships and in the process strengthening morale, team spirit and "auditor-client" familiarity. Some of the ways these relationships were formed were through lunch meetings, coffee breaks, in-person team building activities etc.

Due to the COVID-19 pandemic and with the transition to working from home, this key part of the audit is missing. After speaking with audit professionals about how this has affected their work relationships, a general response I got was "being intentional." Lindsay Bielski says that with the new working environment and the video calls, meetings tend to be a lot more structured and formal. As a result, you have to be more intentional in reaching out to conduct check ups, scheduling casual meetings, eating lunch together virtually, and be deliberate to capture milestones to boost morale. Events relating to diversity, equity & inclusion, well being, and volunteering are also hosted virtually now.

Todd Miller also states that in regard to clients, “You still are building relationships but you have to be more intentional. Now that you are in a virtual environment the only times that you would really be reaching out (are) if you need support or information for your audit. Try to have some rapport during the meetings before just jumping right into the main reason. Do more than just ask for requests all day.”

Finally, LaKeisha Florence mentions that as a team there is such a huge value in being together in the same room and working together on audit engagements. “Being intentional and making sure that we are still building and creating that community is more important than ever.”

CONCLUSION

COVID-19 has had a global impact economically, socially and physically, and the audit environment has been no exception. Operational changes, remote procedures, and new risks associated with the coronavirus pandemic have made the audit environment much different than it was in the days before COVID-19. However, auditors must continue to comply with the required auditing standards. Amid all the worldwide changes, auditors have had to make adjustments to their audit strategies to navigate how to maintain an efficient and effective audit.

Based on research, and speaking with audit professionals, each phase of the audit has been impacted one way or another but has varied in significance. Recruiting of clients has had to change to fit the needs of both the auditor and the clients. In addition, the auditor's understanding of the client's business and its environment has also changed from previous periods due to the implications of the pandemic. Increased risk assessments have occurred for both the preliminary engagement activities and the planning phase.

Due to the control environment being affected, it has been more important than ever for auditors to have an understanding of the control changes. The auditing of several business processes has involved more attention to the revenue process, and new ways of observing inventory. Lastly, the audit phases of completing the audit and issuing the report have received increased scrutiny related to the client's going-concern evaluation among other impacts.

It is still unclear what the future holds in terms of the pandemic and its effect on our everyday lives. However, despite all the impacts and uncertainty, auditors are continuing to navigate these effects, and are adjusting well to this new "life as we know it."

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INTERVIEWS CONDUCTED

1. Lindsay Bielski: Audit Partner at Deloitte Detroit, MI
    - Date of Interview: February 15, 2021
    - Type of Interview: Zoom meeting
2. LaKeisha Florence: Audit Senior Manager at Deloitte Detroit, MI
    - Date of Interview: February 24, 2021
    - Type of Interview: Zoom meeting
3. Todd Miller: Audit Senior at Deloitte Detroit, MI
    - Date of Interview: March 2, 2021
    - Type of Interview: Zoom meeting