

INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS IN BULGARIA

GUIDELINES IMPACT OF THE COVID-19 PANDEMIC 2019 FINANCIAL STATEMENTS AUDIT REPORT ON THE 2019 FINANCIAL STATEMENTS

Dear colleagues,

With regard to the emergency situation related to the coronavirus COVID-19 pandemic, a number of significant issues arise regarding financial reporting and the performance of audits of the financial statements as at 31 December 2019. We follow and discuss emerging approaches and guidelines on this matter by various European regulatory bodies, professional organizations and audit practices. The situation with COVID-19 however is exceptionally dynamic and at this stage does not allow for possibilities to make a commitment to specific opinions and detailed guidance.

However, we would like to set out below some important considerations to take into account in your practice.

A. Financial reporting and financial statements as at 31 December 2019

The coronavirus epidemic started in China at the end of 2019 and spread across the entire world. In Bulgaria, the first positive tests were confirmed on 8 March 2020 and subsequently, on 13 March 2020, a state of emergency was established by a decision of the Parliament. Stringent anti-epidemic measures and restrictions were imposed which lead to disruptions in normal economic activities of almost all business entities in the country. Due to the unpredictable dynamics of COVID-19, at this stage, it is very difficult and virtually impossible to evaluate with precision the magnitude and impact on business. A number of important social and economic measures and the accompanying legislative changes are expected to be adopted to mitigate the effects and support the future recovery of the Bulgarian economy.

In view of the above, in entities' financial statements for the year ended 31 December 2019, **the situation related to COVID-19 represents a material non-adjusting event under IAS 10/AS 10** and accordingly, by itself:

- **is subject to disclosure in the annual financial statements as at 31 December 2019:** the nature of the situation and an estimation of the expected financial effects or the fact that such an estimation is practically impossible to be made. It is important for these disclosures to be **specific and relevant** in the context of the entity's particular facts and circumstances as at the date of authorization for issue of the financial statements. The disclosures might comprise: a) a description of the identified possible risks and uncertainties for the business;

b) the existence of unfavorable consequences and their nature; c) possible evaluation of the potential impact or a disclosure that such an evaluation is impractical at this stage; d) the actions and plans (already undertaken, planned/forthcoming and considered) of entity's management to cope with the emergency situation.

- **does not result in restatement of accounting estimates and fair values:** no revision is required for assumptions and parameters in impairment models and fair value measurements, tests for recoverability of receivables, loans, fixed assets, inventories, deferred tax assets and other similar items.
- **does not result in changes in classifications (e.g., current/non-current, held for sale/trading) of assets and liabilities:** any related changes in entity management's intentions and arrangements after 31 December 2019 do not lead to revision of classifications of assets and liabilities as at 31 December 2019.
- **should be taken into account as an important consideration in the assessment of going concern** which requires covering a timeframe of at least one year after the reporting date (i.e., the period from 1.1.2020 till 31.12.2020). Depending on the scope and materiality of the potential impact, it is possible that the going concern assumption would be affected to various degrees in the annual financial statements as at 31 December 2019. For example, it is possible that a) there would be no indications about significant impact on going concern; b) significant uncertainty arises; or c) the going concern assumption would not be applicable. Some of the factors that could be considered in this assessment are prolonged ceasing of operations, inability to service debt and comply with the respective covenants, significant difficulties in operating activities due to cancellation of supplies, positive coronavirus tests in considerable number of employees, etc.

We remind about the importance of disclosures in the financial statements on key judgements made by management related to the existence of indications and doubts about material uncertainty related to going concern.

B. Audits of general purpose annual financial statements as at 31 December 2019

The emergency situation related to the COVID-19 coronavirus also affects the way the audit process is carried out which, in general, requires remote work, extensive exchange of information in electronic form, revision of schedules and deadlines as a result of delays, performance of additional procedures related to the evaluation of the effects of the material non-adjusting event.

In view of the above, we would like to draw your attention to the following:

- **The emergency situation related to the COVID-19 coronavirus does not reduce the requirements for the quality of audit work** – maintaining audit quality involves spending sufficient time to carry out audits in order to comply with all the applicable requirements of ISAs, as well as the application of a suitable level of professional skepticism in evaluating the sufficiency and appropriateness of audit evidence obtained. Where difficulties are met in carrying out audits due to travel restrictions, access to information or to entity's representatives, we recommend that the schedule of the audit process is

renegotiated and/or, where relevant, alternative procedures applied, and where this proves impossible, consider the consequences for the continuation of engagement performance and the auditor's opinion.

- **The main areas of audit focus with regard to the emergency situation related to the COVID-19 coronavirus concern the adequacy of the disclosures accompanying the financial statements and the assessment of the impact on going concern:** this requires the performance of additional audit procedures, such as: inquiries of management, obtaining and reviewing management's assessments/plans, if such have been prepared, about potential risks and uncertainties, the evaluation of their impact, if practicable; undertaken or planned measures to mitigate the effects, etc.
- **In forming auditor's conclusion, it is necessary to consider the impact of the emergency situation related to the COVID-19 coronavirus,** with some of the most important considerations being related to:
 - the existence of significant limitations in the scope of audit work which require addressing these in auditors' reports in accordance with ISA 705;
 - the existence of material uncertainty related to going concern which should be addressed in accordance with ISA 570;
 - consideration of the significance, materiality and relevance of entity's disclosures about expected risks, uncertainties and potential effects of COVID-19, to be addressed by including an emphasis of matter paragraph in accordance with ISA 706. It is worth noting that the inclusion of an emphasis of matter paragraph is a matter of professional judgement by the auditor on the basis of the degree to which the audit client's business has been or would be affected by the COVID-19 pandemic, including the structure and susceptibility of assets and liabilities, respectively, the scope of operations, audit client's risk profile (a public company, other PIE, non-PIE, a systemic business entity in a specific industry or sphere), users of the financial statements and their information needs (in particular, creditors and other investors), etc. The inclusion of an emphasis of matter paragraph assumes that the financial statements contain quality disclosures with respect to the relevance, adequacy and degree of detail and that, as at the date of the auditor's report, there exist no indications of a significant impact on going concern leading to a material uncertainty which should accordingly be addressed under ISA 570. In this regard, the inclusion of an emphasis of matter paragraph about the expected risks, uncertainties and potential effects of the COVID-19, which is not mandatory in all cases, does not substitute the paragraph on material uncertainty related to going concern where such is needed. The conclusion as to whether reporting in accordance with ISA 706 (an emphasis of matter paragraph), or ISA 570 (paragraph on material uncertainty related to going concern), or ISA 701 (for PIEs – key audit matters in the so called borderline cases where the auditor has concluded that there exists no material uncertainty related to going concern) is applicable requires significant judgement by the auditor, specifically, for audit clients amongst those that operate in industries directly affected by the established state of emergency, such as: the

tourist industry, accommodation and hospitality, restaurants and other catering facilities, sport activities.

- You can find below an example of an emphasis of matter paragraph, where the inclusion of such a paragraph is relevant.

We draw attention to Note No XXXX *Event after the reporting date* to the [separate/consolidated] financial statements which discloses a material non-adjusting event related to the spread of the coronavirus pandemic (COVID-19). The disruption of normal economic activities in the Republic of Bulgaria as a result of COVID-19 may have an adverse impact on the operations of [Company/Group], in particular, on XXXXXX [*please describe a specific activity, segment, key process, arrangement, as applicable*]. Due to the unpredictable dynamics of COVID-19, at this stage it is practically impossible to make a reliable judgement and measurement of the potential effect of the pandemic [*OR, if the financial effect has been evaluated and disclosed*]. Information about the nature of the potential implications and an estimation of the financial and economic effects from them is disclosed in Note No XXXX]. Our opinion is not modified in respect of this matter.

We continue to analyze the situation and stand ready to provide you with additional guidance and recommendations.

We wish you good health and all the best!

Education and Methodological Council

23 March 2020