

Possible impact of the COVID-19 outbreak over the 2019 financial statements and other considerations related to the auditors' work.

Dear friends

This is the first communiqué of a set that will follow in the coming weeks related to the events and difficulties that the COVID-19 outbreak is directly and indirectly posing over our profession, and that we hope it will help you to manage them adequately. In order to facilitate the search of all those matters that can be of interest about COVID-19, the ICJCE has enabled a site on the ICJCE website at <https://www.icjce.es/auditoria-y-covid-19> where all the communiqués from the ICJCE will be posted on, and where we will publish links to other sites and documents produced by other organizations.

We understand that we must provide Auditing and our members with the maximum support, so we will do our best to help you in all those matters that you may deem necessary.

As a cornerstone of this support, the Technical Department of the ICJCE will fully operate. We encourage you to send us any question about the effects of this situation in your daily work or any initiative that you consider it might help us to improve our services. Although as you might be aware, our headquarters and regional offices are closed to the public, we are working online and trying to keep the ICJCE activity to the maximum extent as possible. All face-to-face education activities have been postponed. Online education and sale of seals, with restricted opening hours, is still available.

The technical department is at your disposal at its normal hours, on the usual telephone numbers, and at their email addresses. At the same time, different Committees, the Technical and Legal departments and the Management of the ICJCE are daily monitoring the situation to assess it and provide answers to any question or doubt arisen. We remain paying attention to any aspect that may affect your professional activity and we will keep you informed about any conclusion reached.

As a first response to the situation, below, you will find some considerations that we think are key to perform the audit work at this time.

Thank you all for your collaboration and comprehension and keep safe.

Background and current situation of the coronavirus

Since the City of Wuhan (China) reported the coronavirus outbreak in December 2019, the number of cases in other cities of China and in a high number of countries around the World (currently more than 100 countries) , including Spain (whose first case was reported in late January 2020) has spread to the point that the World Health Organization (WHO) has recently characterized COVID-19 disease as a pandemic. Among the measures already adopted by governments around the World, including those with no reported cases, there is the isolation of cities and countries, and the restriction of the free movement of people with their cities, between cities in the same country and between countries (countries around the World have imposed entry restrictions on people from Spain).

All that, has had, and is having, a very significant impact on a huge number of business that have seen their activities dramatically reduced, forced to adopt measures such as the suspension of their operations (in some cases imposed by the preventive measures adopted by the Government) and the elaboration of business continuity plans (which means in many cases remote working obligations). In Spain, this situation affects all the country and has forced the Government to publish a Royal Decree (Real Decreto 463/2020 of 14 March -RD) declaring the alert status to manage the sanitary crisis due to COVID-19 and adopting a series of measures to protect citizens' health and safety, control disease progression and reinforce the public health care system. The alert status declaration affects all the Spanish territory and has a duration of 15 calendar days, although this term may be extended with the approval of the Parliament.

The above referred RD includes a number of provisions, including prohibitions and obligations that may affect any activity or service and, of course, statutory audit. Beyond what it is stated in the articles of the RD, we want to draw your attention to the provisions related to the suspension of the procedural deadlines (2nd additional provision); the suspension of administrative deadlines (3rd additional provision) and the suspension of periods of prescription and limitation (4th additional provision). All that, is now being analysed within the ICJCE.

The impact may vary, although it's serious for all industries. The main reason is the slowdown in the worldwide economic growth that can even turn into a recession in some economies, including Spain, and the consequent impact on companies.

That's why the ICJCE has considered that the present communiqué is necessary to highlight the work that the auditor must perform when assessing the impact that coronavirus disease is having and will have in the business activity (for instance it may affect to matters such as going concern, liquidity plans, supply chain, workers mobility or financial reporting) and its appropriate record in the financial statements for periods ending on December 31, 2019. In addition, we believe that considering the different circumstances and challenges that auditors are facing when auditing groups, is necessary because of the changes in the usual communication channels with the client and the impact of this fact in the internal organization of their practices. Although this communiqué refers to financial statements of periods ending on December 31, 2019, its content may also apply to other ending dates, both previous (for reports that have not been issued yet) and subsequent, and specially for 2020 interim reports (although in case of those reports with subsequent issuing date, an assessment of the need of an adjustment to and relevant disclosures in the financial statements due to the impact of the coronavirus shall be performed).

Impact to the financial statements and to the auditors' work

In any case, retaining and documenting in our audit files discussions held with those charged with governance within the entities, related to the impact of coronavirus is key, since it is highly probable that we need to reassess the original audit plan and to design supplementary audit procedures as a result of the reassessment.

As of the date of this communication, considering the circumstances, an analysis of the subsequent events and an assessment of the need of a note to the financial statements (as well as in the management report), depending on the specific circumstances of the entity, will be necessary. The note to the financial statements shall include information concerning the subsequent events, their potential effect on the entity's operations, and even on the existing uncertainties on the operations of the entity and their continuity. The content of such note to the financial statements will depend on the specific circumstances of the entity and will be affected by situations such as the activity, level of indebtedness, liquidity, ability to attract financing, etc. In some cases, the impact of coronavirus might affect the going concern principle compliance, thus this shall be an aspect to

consider by the auditor and the entity. The degree of analysis required, the conclusion reached, and disclosures will depend on the facts and circumstances of each case, because not all entities will be affected in the same way and degree.

Below, a not exhaustive list of the matters to disclose because of that described above is included:

- Information about the nature and risk level arising from financial instruments, credit risk, liquidity risk and market risk (comprising the exchange risk; interest rate risk; and other price risks).
- Financial and non- financial assets impairment estimations
- The impact of breaks, or possible breaks, of covenants and other contract terms in loans and other financial agreements that may make the debt due.
- Impact of the disruptions in the supply chain.
- Impact of the suspension or termination of contracts and assessment of their classification as an onerous contract.
- Recoverability of deferred tax assets.
- When concerning the going concern principle appropriateness, description of the factor or factors that casts doubts about the ability of the entity to continue as a going concern; the potential impact on the situation of the entity and mitigating factors related to the subsequent event (that may include, among others, the different measures adopted by the local governments).

Considering all the above, the auditor shall obtain sufficient and adequate evidence regarding the adequate record of the impact of the coronavirus in the financial statements of the entity. To that end, the requirements in laws and regulations in force, specially NIA- ES (ISA adapted to Spain) 560, *Subsequent events*; NIA-ES 570 (Revised), *Going Concern* and NIA-ES 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*; and in the accounting regulations, related both to the information in the financial statements and to the preparation and reformulation of the financial statements, if any, shall be considered.

In this regard ESMA (European Securities and Markets Authority) together with the national Competent Authorities (NCAs) are closely monitoring the situation in view of the continued impact of COVID-19 outbreak on the EU financial markets. ESMA in its statement of March 11, 2020 makes a series of **recommendations** to markets' participants regarding, among others, business continuity planning, disclosure to the market and financial reporting. Specially, with regard to this point, we would like to draw your attention to ESMA recommendation to the securities issuers to report transparently on current and potential impacts of COVID-19 in their 2019 annual report if it has not been yet prepared, or otherwise, in their interim 2020 reports, which should be based, to the extent possible, on a qualitative and quantitative analysis of their businesses operations and financial and economic performance .

Auditor's information

Based on the above, and on the circumstances, the auditor shall evaluate the implications and potential impacts of this situation on the auditor's report in accordance with the auditing standards in force.

Group audits

In the Audit of consolidated financial statements of a group in Spain that includes components in countries affected by coronavirus on which making some audit work is planned, the impact of internal and external mobility restrictions in the work to be performed shall be considered (either by the group auditor or by the component auditor). Regarding this matter Art. 7.5 of the Audit Law states that *“If the auditor of the consolidated accounts is unable to review the audit work of other auditors or audit firms, including those from the European Union and third countries, in relation with the accounts of entities included in the consolidated accounts, he/she shall adopt the appropriate measures and inform the Accounting and Auditing Institute of this circumstance and its causes in the time and manner provided for in the regulations. The measures adopted should include carrying out the audit procedures necessary for auditing the consolidated accounts, directly or in co-operation with other auditors, as appropriate, on the accounts of said entities.”*

Based on the aforementioned, the group auditor in Spain may need to evaluate the following matters:

- Identification of audits of components in countries affected by coronavirus.
- Categorisation of the components between significant and non-significant.
- Understanding of the impact on the component :impact on the organisation and their interlocutors (those charged with governance, senior management and key personnel for the audit) and measures adopted by them or by those charged with governance and senior management of the group in order to ensure financial reporting continuity and component audit.
- Review of the component's work plan status and options to perform the outstanding work.
- Assessment and use of review and supervision remote techniques (conference call, video calls) remote access to working papers of the component, etc.
- Assessment of the possible delay in reporting deadlines of the component and of the auditor.

Communication with the entity

In a local context, the current situation in specific regions of Spain, is affecting normal communication with our clients due to, among others, sick leave of personnel key for the audit, impossibility to access to client's premises or the inability to obtain audit documentation or evidence, including, for example, external confirmations, only available in digital or electronic format. In some extreme cases, this sudden situation may lead to certain documentation necessary for the completion of the audit and issuance of the auditor's report (for instance, representation letters, governance bodies' meeting minutes or even the financial statements)can only be obtained via electronic means or in digital format.

Under these circumstances, if the format of the documentation is valid should be analysed together with a way to act. Procedures to apply on documents with a digital signature legally recognized, which may be valid as audit evidence, differ to those to apply on digitalized copies of original handwritten documents received by electronic means, whose reliability may be less. In this regard, the type of documentation will also affect the auditor's conclusion together with the risk or assertion involved. For instance, an individual invoice does not have the same significance in performing a matching test than a confirmation letter from the entity's external legal counsel.

Another issue to pay special attention concerns the adequate and timely preparation of the financial statements with regard to obtaining evidence of such act (signatures of members of the governance board in digital, electronic or handwriting format; absence of signatures and causes of such absence; certifications by the Secretary to the governance board, etc.)

In the coming days we will publish new communiqués including more details about these matters and about others that may arise.

Internal organisation of the auditor and ICJCE services

And last, we want to mention the need for Audit practices and especially individual auditors, to carry out an impact analysis of the coronavirus disease may have and will have in their own practices, that probably requires a continuity plan regarding the current and future audit engagements. In this regard, we wish to inform you that we are temporarily closing most of our regional facilities. This closure will affect to all ICJCE staff and to the face-to-face services to members except certain key services whose provision does not pose risk to our staff, such as the sale of seals (opening hours have been enabled with this purpose) or the organization of webinars. All other services will be provided using remote access. If you need anything from the central services office or from the regional branches, the telephones and email are working as usual and the staff of the ICJCE will respond during the usual hours, trying to keep, to the extent possible the maximum normality.

We understand that this is a time when we have to offer you the maximum support, so we will strive to make the technical advisory service be fully operational. In this sense, we encourage you to send us any question that may arise about the effects that this situation may have on your work or any initiative that you understand that may help improve our services. Meanwhile, we remain attentive to the aspects that may affect you in your professional activity and we will keep you informed about the conclusions reached.

Thank you all for your collaboration and understanding.