

# “Emphasis of Matter” Paragraph in the Post Covid-19 Audit Reports.

*by Abdallah Mambo Dallu*

An emphasis of matter paragraph is included in the auditor's report and refers to a matter presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements. It refers to a matter 'appropriately' presented or disclosed in the financial statements.

The auditor will therefore need to document clearly in each case the justification for the inclusion of the matter they wish to highlight to users of the financial statements as fundamental. A policy of including an emphasis of matter paragraph in audit reports for most entities affected by COVID-19, or for all entities in a particular sector or industry, may be challenged by audit regulators, and so firms will need to be prepared to justify that decision with reference to the particular circumstances of each entity.

An emphasis of matter paragraph does not modify the audit opinion. Such a paragraph is also not a substitute for expressing a qualified or adverse opinion, or for disclaiming an opinion, where they are appropriate. The thought process that leads to an emphasis of matter is outlined in the following flow-chart.

How might an emphasis of matter arise due to COVID-19?  
One of the possible reasons ISA (UK) 706 gives for inclusion of an emphasis of matter paragraph is 'a major catastrophe that has had a significant effect on the entity's financial position'. Whether the COVID-19 pandemic amounts to a major catastrophe that has had a significant effect on the entity's financial position is a matter of judgment for the auditor. Accordingly, it is not expected that an emphasis of matter will be used in every case, only where, in the auditor's judgment, the matter is fundamental to the user's understanding of the financial statements.

The following scenarios are examples of where COVID-19 might lead to the auditor including an emphasis of matter paragraph in the auditor's report.

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*The auditor will need to assess whether the disclosures made by the entity regarding subsequent events, and whether they are adjusting or non-adjusting events, are appropriate. The auditor may conclude that it is necessary to include a related emphasis of matter paragraph in the auditor's report to highlight management's subsequent events disclosure, given its significance.*

#### **i. External valuations**

An external specialist or expert, such as a property surveyor, has included a 'material valuation uncertainty' clause in a valuation report explaining that less certainty – and a higher degree of caution – should be attached to the valuation of property or other assets on the entity's balance sheet. Management has appropriately disclosed the matter in the notes to the financial statements.

It is worth noting that this may not always be the case. Just because there is such an uncertainty, and while it may be material, that does not necessarily make it "fundamental" to users. For example, an emphasis of matter may not be appropriate for an entity with one property that, while material, is only a small proportion of total assets. However, it may be appropriate for an entity in the real estate sector holding a number of investment properties that make up a significant proportion of the company's total assets, or similarly for a property fund.

If such a 'material valuation uncertainty' clause has been included in the valuation report, but the auditor has not been able to obtain suffi-

cient appropriate evidence of the valuation of the asset, the auditor may need to consider qualification instead.

#### **ii. Basis other than going concern**

Where the use of the going concern basis is inappropriate and the entity is required to prepare its financial statements on a basis other than that of going concern, the auditor may consider it appropriate or necessary to include an emphasis of matter paragraph in the audit report to draw the user's attention to the basis on which the financial statements have been prepared and the reasons for its use.

#### **iii. Subsequent events**

The notes to the financial statements include disclosures around subsequent events / post balance sheet events because, for many entities, the impact of COVID-19 started to emerge after the end of their financial periods. The auditor will need to assess whether the disclosures made by the entity regarding subsequent events, and whether they are adjusting or non-adjusting events, are appropriate. The auditor may conclude that it is necessary to include a related emphasis of matter paragraph in the auditor's report to highlight man-



agement's subsequent events disclosure, given its significance.

#### iv. Litigation outcome uncertainty

The entity is subject to litigation as a result of breaching the terms of a contract during the COVID-19 crisis. There is uncertainty relating to the outcome of the litigation, and a high level of judgment involved in deciding whether there is a liability, contingent liability or no liability to be recognized.

#### v. Other considerations for the auditor

The auditor may also consider whether:

a) Inclusion of an emphasis of matter paragraph leads to the entity breaching a loan covenant, and whether the lender would waive that covenant breach or not. In this context, it is important to understand that an audit report with an emphasis of matter is not a modification of the auditor's opinion.

b) The explanation is specific to the entity's circumstances.

#### How is an emphasis of matter disclosed?

An emphasis of matter paragraph is included within a separate section of the auditor's report with an appro-

priate heading that includes the term "Emphasis of Matter". The heading may be expanded to include further context of the matter being referred to, e.g., 'Emphasis of Matter – subsequent event COVID-19 pandemic'.

The paragraph should:

- i. include a clear reference to the matter being emphasized and to where relevant disclosures that fully describe the matter are found in the financial statements; and
- ii. indicate that the auditor's opinion is not modified in respect of the matter.

For example;

#### Emphasis of Matter [ - .....]

We draw attention to Note [X] to the financial statements which describes [.....]. Our opinion is not modified in respect of this matter.

#### In Conclusion

The paragraph should only refer to information presented or disclosed in the financial statements and should not provide additional information, explanation or interpretation. The placement of an emphasis of matter paragraph in the

auditor's report depends on the nature of the information to be communicated, and the auditor's judgment as to the relative significance of such information to intended users compared to other elements required to be reported in accordance with ISA (UK) 700 (Revised June 2016).

Coronavirus may lead to situations where an auditor considers including an emphasis of matter paragraph in the auditor's report. However, even in the unprecedented circumstances brought about by COVID-19, inclusion in auditors' reports is not expected to be widespread, and will occur only when the matter is considered to be 'fundamental'. Widespread use of emphasis of matter paragraphs may diminish the effectiveness of the auditor's communication about important matters. It is important to note that emphasis of matter paragraphs is no longer used to draw attention to material uncertainties relating to going concern; these are disclosed in a separate section of the audit report.

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