



## RUSSIA-UKRAINE CONFLICT: TECHNICAL GUIDANCE N° 1

### 1. INTRODUCTION

Current geopolitical situation between Russia and Ukraine and recent invasion (the “*Conflict*”), including potential sanctions may have a severe impact on the operations of a number of entities. In keeping with its commitment to provide support to its members, IRE posted on its website this Council note to provide further detailed support and guidance related to the potential impact of the Conflict within the context of the audit of the (consolidated) financial statements.

This note provides useful information on:

- AML / CTF and the implementation of restrictive measures in financial matters / continued association with the client
- “Cut-off” date to consider the Conflict as an adjusting rather than a non-adjusting event
- Audit risk assessment
- Financial reporting disclosure

In this IRE Council Note, the term “*Auditor*” covers equally the statutory auditor (“*réviseur d’entreprises*”), approved statutory auditor (“*réviseur d’entreprises agréé*”), audit firm (“*cabinet de révision*”) and approved audit firm (“*cabinet de révision agréé*”).

### 2. AML /CTF AND IMPLEMENTATION OF FINANCIAL RESTRICTIVE MEASURES / CONTINUED ASSOCIATION WITH THE CLIENT

Additional sanctions have been put in place against financial institutions, entities and individuals extending the current regulation related to AML/CFT and financial restrictive measures, as described by CSSF in his communication dated March 1, 2022. These regulations require the Auditor to ensure that appropriate due diligence measures (including appropriate and regular names screenings) are implemented for clients who may be in the scope of the sanctions. It is not only about sanctions applicable in Luxembourg but there is a need to consider if sanctions decided by other countries may be applicable to client due to its international business. Depending on the outcome of the due diligence measures performed, the Auditor may have to take appropriate actions if needed, he may need to re-consider the risks associated with its continued association with the entity / group, decide to increase the client and / or engagement risk or ultimately withdraw from the engagement.

For entities with financial reporting periods ending on or after 24 February 2022 (see section 3 below) who have to implement the additional sanctions (specially banks, insurance companies, financial institutions and investment funds), the Auditor will have to consider how clients have integrated additional measures and the potential impact on its audit procedures. This may also have an impact on regulatory work (e.g. special report, long form report, AML procedures, etc.) performed for the entity.

In addition to AML/CFT considerations, the Auditor may also need to re-consider the risks associated with its continued association with the entity / group, decide to increase the client and/or engagement risk or, in the worst case scenario, to terminate the working relationship.



### 3. "CUT-OFF" DATE TO CONSIDER THE CONFLICT AS AN ADJUSTING RATHER THAN A NON-ADJUSTING EVENT

A recurring question is: *"What is the cut-off date to consider the Conflict as an adjusting rather than a non-adjusting event?"*

Considering the long-standing tensions between Russia and Ukraine and finally the invasion dated 24 February 2022, the Conflict:

- Is not an adjusting post balance sheet event, for entities with financial reporting periods ending prior to 24 February 2022, except in case where the going concern assumption is no more relevant (but adequate disclosures may need to be added in the notes to the financial statements),
- Is an adjusting event, for entities with financial reporting periods ending on or after 24 February 2022 that are impacted or expected to be impacted, an adjusting event, whose impacts, if any, have to be recorded in the balance sheet and profit and loss (together with adequate disclosures in the notes to the financial statements).

While the Conflict is considered as non-adjusting for entities with financial reporting periods ending prior to 24 February 2022, events occurring after the reporting date might still provide evidence of uncertainties that existed at the reporting date. As an example, situation of a customer bankruptcy after the reporting date might reflect poor situation that already existed at the reporting date.

### 4. AUDIT RISK ASSESSMENT

There is an expectation that the activities of entities located in Russia and Ukraine are more likely to be impacted. However, the disruption of international business could impact directly or indirectly the business of entities located outside of the Conflict area. For any entity impacted by the Conflict, the disruptions and uncertainty as a result of the sanctions and geopolitical situation do not alleviate the engagement team's responsibility to obtain sufficient appropriate evidence to support their audit opinion.

Due to restrictions on travel (or destruction of sites), meetings and access to client sites in Ukraine, Russia and other closed countries, engagement teams will need to consider developing alternative audit procedures to gather sufficient appropriate audit evidence.

While for the audit of financial year ending 31 December 2021 or even later, the planning and risk assessments procedures have already been performed, ISA 300 §§ 10 and A15 provide that, as a result of unexpected events, changes in condition or the audit evidence obtained from the results of audit procedures, the Auditor shall update and change the overall audit strategy and the audit plan as necessary during the course of the audit.

The engagement team obtains an understanding of the entity and its environment to identify and assess the risks of material misstatement. The information obtained includes relevant industry factors which includes industry conditions such as the competitive environment, supplier and customer relationships, and other external factors. While obtaining this understanding the engagement team needs to obtain an understanding of the impact of the Conflict over the operations of the audit client.



Risk assessment includes identifying and assessing the risks of material misstatement by obtaining an understanding of the entity and its environment, including the entity's internal control. While doing so, risk factors, whether internal or external, that may alert the engagement team to an increased risk of material misstatement may be identified.

The Conflict situation may result in additional risk factors for entities. Risk factors may relate to supply chain interruptions, employee shortages, data corruption or loss, delays in getting access to accounting records and supporting documentation, decrease in global demand, fair value determination issues, liquidity or solvency issues, travel and trade restrictions, destruction of sites, financial transactions restrictions and other sanctions related impacts, among others.

There might be specific considerations in relation to Swift / nostri reconciliation for banks or to gating / NAV suspension/large redemptions in investment funds.

Understanding the risk factors and categorizing them appropriately will result in an appropriate risk assessment

#### Going Concern

Management of the impacted entities should consider whether developments after the reporting date have any impact on the ability of the entity to continue as a going concern. Engagement teams should assess if the use of going concern assumption is still appropriate for impacted entities.

The concept of adjusting vs non-adjusting event does not apply to the going concern assumption. If the consequences of the current Conflict have led to a deterioration of the financial situation, inability to continue operating the business, inability for the governance to discharge their responsibilities or destruction of sites after the reporting date that is so severe that the going concern basis of preparation is no longer considered appropriate, the financial statements would need to be adjusted.

There might also be situations where business plans for the future cannot be established and thus it may not be possible to collect sufficient appropriate evidence to measure the impact of the change in basis of preparation in the (consolidated) financial statements.

#### Professional scepticism

Engagement teams perform audit engagements exercising professional scepticism, which is an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence. Given the changes in how engagement teams will perform their work for the impacted entities, how business is impacted and how management will perform their processes, the engagement team needs to exercise a heightened level of professional scepticism.

When performing audit procedures, including fraud inquiries, engagement teams need to be mindful towards obtaining audit evidence that may be corroborative or towards excluding audit evidence that may be contradictory.



If contradictory information is identified, the engagement team needs to determine the necessary modifications or additions to their audit procedures or inquiries, for example, seeking information and obtaining evidence from other sources such as making additional inquiries to personnel in other departments in addition to the financial reporting function.

### Fraud risk

New potential fraud risk may arise as a result of the Conflict such as the occurrence of cyber-attacks resulting from data corruption or security breaches. In addition, as announced in media and also in CSSF publication, supervised entities are required to be very vigilant about cyber risk and making sure appropriate back up and business recovery plan are in place. Any impact on going concern needs to be appropriately addressed. Enhanced diligences in the context of AML/CFT regulations need also to be considered.

As a result, the Auditor may need to adjust the fraud inquiries and its audit strategy respectively to identify and address those new risks.

### Group audits

For auditor of Group with activity in regions impacted by the Conflict, it is critical for the group engagement team to assess whether the local operations are still up and running, whether local management and finance team can be reached, whether component auditors are still in a position to carry out their audit, and then keep in constant communication with management and component auditor(s).

The group auditor needs to:

- (re)assess the accessibility to the work performed by the component auditor, the means available to do so and the consequences on the audit opinion if no access can be ensured,
- (re)determine the level of involvement in the work of the component auditors.

## 5. FINANCIAL REPORTING DISCLOSURE

When the Conflict would be considered as a non adjusting event, no adjustment would be required in the financial statements. However, as a general rule, and depending on the level of impact for the entities, it would be expected to include specific and comprehensive disclosure in a subsequent event note to the financial statements.



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The content of this note should be specific to the situation and the effects for the entity and should describe:

- whether and how the local operations are still up and running,
- whether and how local management has still control over operations,
- how the entity's employees and activities/revenues have been impacted,
- what are the actions taken by management in response to the decrease of the activities/restrictions imposed by the sanctions,
- any expected impact on the carrying amount of assets and liabilities,
- any restrictions on assets due to sanctions imposed,
- any impact on borrowing covenants,
- any liquidity / solvency issues,
- any cyber-attacks that created problems for the entity,
- any suspension/gating or large redemption for investment funds,
- how the Conflict impacted the valuation and liquidity of the assets for investment funds,
- ...

*This note has been prepared on 3<sup>rd</sup> March 2022 and may be subsequently completed depending on future circumstances.*