KPMG

Global Government Study

COVID-19 report impacts

KPMG International

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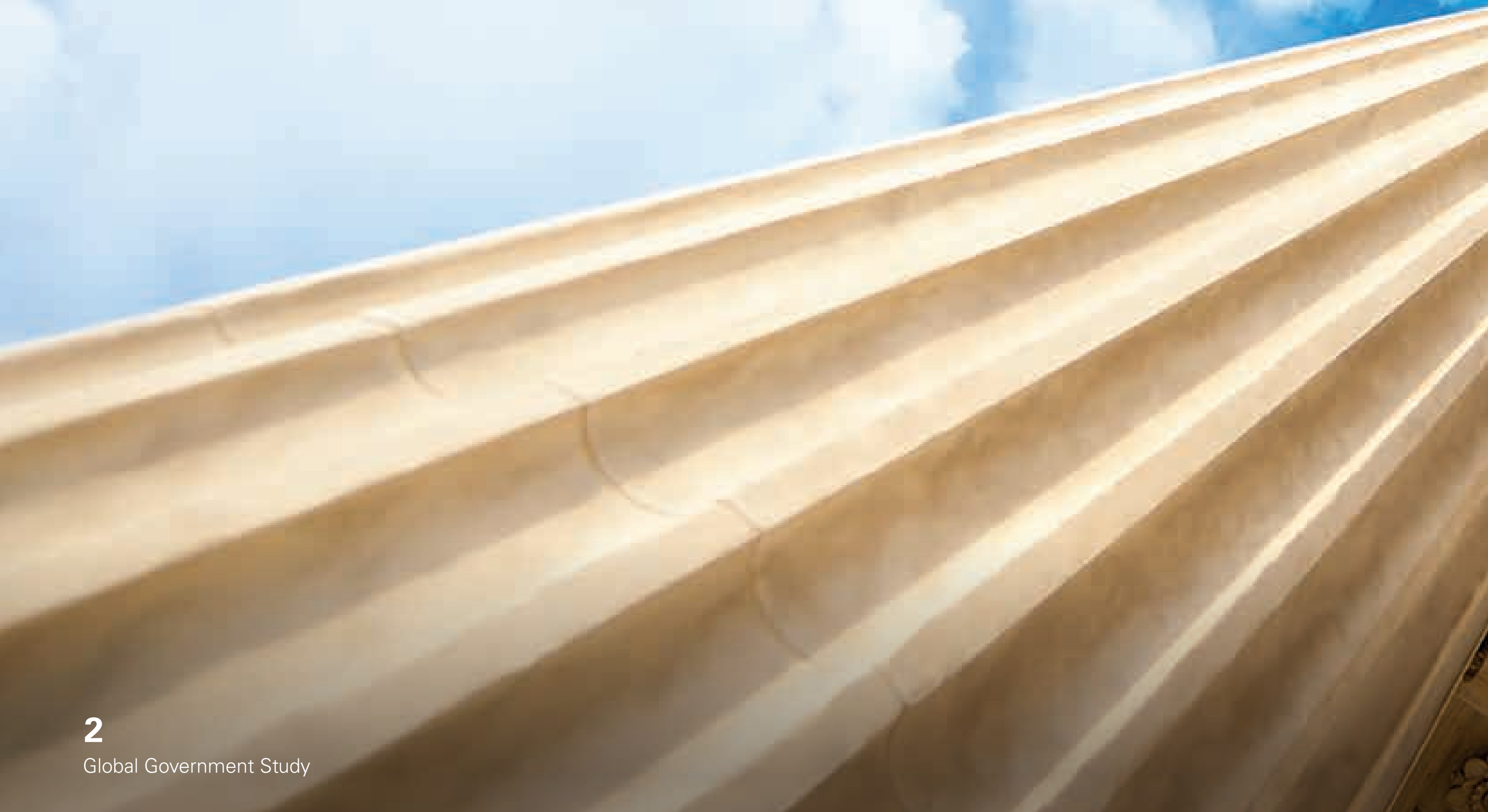
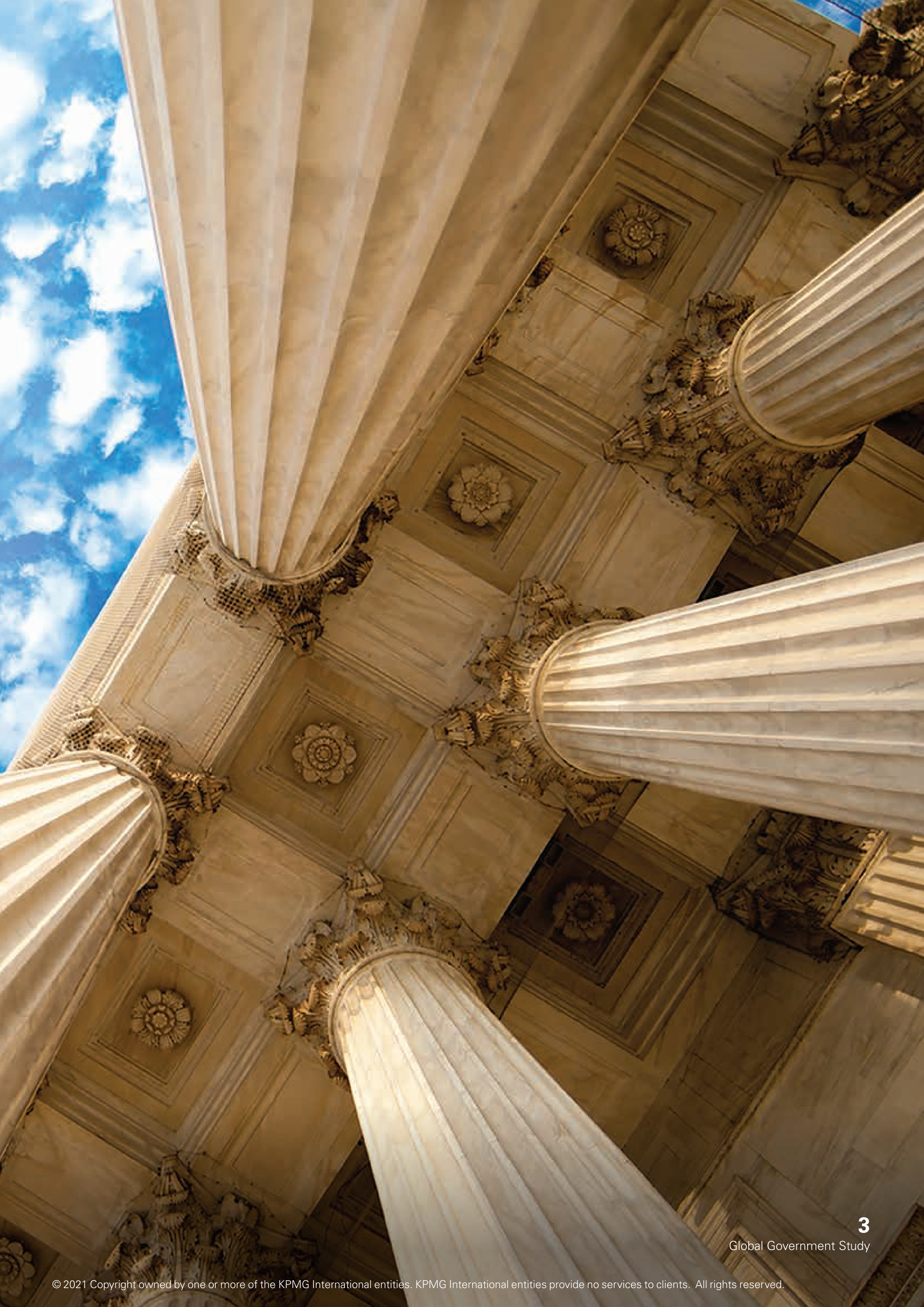




Introduction

Government finance functions are on the front lines of the economic tsunami brought on by the COVID-19 pandemic. In addition to the record debt levels for governments around the world, the pandemic is re-writing the social contract between governments and citizens and emphasizing public expectations of transparency and accountability for financial management decisions like never before.

Finance functions at all levels of government have been challenged to meet their ongoing financial reporting responsibilities despite severe capacity limitations, while ensuring the integrity of financial information critical to the government's COVID-19 response. Finance functions rose to the challenge in 2020 and are prepared to do the same for 2021. Finance functions have clearly demonstrated the value they bring to the timely spending and financial management decisions made by elected officials.

From a financial reporting perspective, the biggest issues may lie with what is to come for the 2021 fiscal year end, as governments address the first full year of spending in the COVID-19 environment. In addition, governments must account for additional measures of financial support provided to individuals and businesses. The historical nature of the pandemic is challenging the assumptions finance functions have traditionally made and is requiring a rethink of financial reporting.

Government finance functions serve an essential accountability role, regardless of the economic environment. Finance functions are expected to bring a discipline and rigor to financial data that is essential to government decision making. In times of economic crisis, government finance functions are the trusted and steady hands on the wheel, bringing transparency to state of the government's finances and financial management activities.

Ian Carruthers, Chair of the International Public Sector Accounting Standards ("IPSAS") Board, highlighted finance's critical role though the pandemic in a recent article. "With more than $9 trillion spent by governments globally on fiscal interventions in the past three months, the effect of the pandemic on public finances will be both immediate and long-lasting. In view of the unprecedented scale of these interventions, there is an urgent need to understand the full impacts they have already had, and will continue to have, on governments' finances. This requires accrual accounting."[2]

Ian further emphasized that, "Politicians and other decision-makers need access to high-quality financial information to make tough decisions that are now required in order to support citizen well-being sustainably over the long term. The pandemic has exposed the weaknesses in many government programs and infrastructure that will have to be addressed somehow in the post-COVID-19 world. We have an opportunity to learn from the crisis — and improving financial reporting must be part of the package of reforms implemented in order to mitigate the pandemic's effects sustainably."

Context

The unprecedented nature of the COVID-19 pandemic, and the elevated role for government finance functions was highlighted in a recent report released by the Organization for Economic Co-operation and Development ('OECD'). According to the OECD, "In 2020, COVID-19 affected almost all countries and more than 50 million people around the world. It has governments operating in a context of radical uncertainty, and faced with difficult trade-offs given the health, economic and social challenges it raises... Beyond the health and human tragedy of the coronavirus, it is now widely recognized that the pandemic triggered the most serious economic crisis since World War II."[1]

Pulse check

How are governments doing in their efforts to enhance financial reporting? KPMG held discussions in November 2020 with senior personnel from 11 government finance functions from around the world to understand the impacts of COVID-19 on their financial reporting. We consulted financial statements for an additional four governments issued since the pandemic, to consider how the pandemic has impacted accounting policy choices and financial statement presentation.

The consulted governments represent a wide spectrum of maturity of finance functions.

[1] OECD, "The territorial impact of COVID-19: Managing the crisis across levels of government", Updated 10 November 2020

[2] IFAC, "COVID-19: Urgent Government Finance Reforms Essential for a Sustainable Future", Ian Carruthers, September 30, 2020

Summary findings

6 of the 15

40%

governments surveyed were provincial or regional governments, while remainder 9 (60%) were national governments

All governments experienced a substantial increase in their expenses and deficit with declines in the various streams of revenue

13 of the 15

87%

governments surveyed prepare consolidated financial statements based upon accrual accounting principles

14 of the 15

93%

governments surveyed have initiatives under way to adopt IPSAS to some extent

2 of the 15

13%

governments surveyed are presently reporting under a cash basis, and are transitioning to accrual-based accounting policies under IPSAS

11 of the 15

73%

governments surveyed had a reporting year-end of 31 March, while the remaining (27%) had a reporting year-end of 31 December

Survey results

While this survey highlighted several reporting challenges for governments through fiscal year 2020, the greatest issues are still likely to surface in 2021 as governments grapple to report a full year impact of COVID-19 on their financial reporting.

Of the 11 governments surveyed, only minor delays in the financial reporting process were noted for 2020:

governments reported no delays in issuing their public accounts/ financial statements

governments reported minor delays, ranging from 2 weeks to 2 months for the issuance of financial statements

Accounting & auditing issues

The primary accounting issues noted for current reporting periods included:

— **Estimation uncertainty and judgments —** Most governments noted a significant increase in the level of estimation uncertainty and judgment involved in the various aspects of financial reporting. While there was no major change reported in the existing accounting policies, each government reported a much higher degree of estimation uncertainty and judgment in the application of these existing policies considering COVID-19. The duration of the pandemic poses one of the biggest sources of estimation uncertainty due to its evolving nature. Auditors will likely be looking for more robust qualitative and quantitative assessment made by governments to support their estimates, based on a wider range of data points for key inputs and variables.

— **Recognition of grants and transfer payments —** Most governments announced various grant and transfer payment programs to support individuals and businesses through the pandemic. These payments include direct government expenditures, support for individuals, support for businesses and other public sector entities, and support for financial systems. The key issues resulting from these new transfer payment programs included measurement, recognition and cut-off of the related expenses. Most of these payments had specific eligibility criteria attached to them which require the governments to monitor whether the funds were spent on the intended purpose. The timing of recognition of these expenditures was an issue for many governments, including the distinction between what should be expensed in the current fiscal year, compared to balances remaining as future commitments. Another issue noted by the governments was whether the unspent funds should be returned to government at the end of the fiscal year. Governments noted that in certain cases it has been difficult to define the funding period due to the evolving nature of the pandemic. Auditors will likely be looking for support for the measurement and recognition of such expenses by the governments and to ensure that proper cut-off was exercised. Auditors will likely be looking to the accounting standards for government transfer to help ensure the measurement, recognition and cut-off is reasonable.

— **Recognition and measurement of tax revenues —** Many governments pushed out the timelines for payment of taxes during 2020. Deferred payment arrangements combined with the economic difficulties for individuals and businesses brought on by the pandemic challenged assumptions regarding allowance for doubtful accounts and valuation of the tax revenue receivable. Tax receivable is likely going to be higher compared to prior year without any corresponding increase in the tax rates. Governments will therefore need to revisit the assumptions related to allowance for doubtful accounts for tax revenue receivable. The underlying inputs to estimate taxation revenues are also changing. This shift was not a large issue for governments with year-ends earlier in 2020, given the timing of the onset of the pandemic, however the impact will be more prominent for the first full year under pandemic. Auditors will likely challenge the collectability of tax revenues and the calculation of tax revenues more rigorously due to the impacts of the pandemic.

- **Concessionary loans —** In response to the pandemic, many governments announced stimulus programs for individuals and businesses including loans. These loan arrangements often included concessionary and forgivable terms. For 2020 financial reporting, governments were required to apply judgement to determine what portion of the loan was concessionary in nature or may be forgiven. Judgement was also applied to evaluating the loan arrangement terms, and whether they were market driven. This application of judgement impacted the measurement of loans receivable, and the recognition of expenses for the forgivable or concessionary element. Auditors will be looking closely at the basis for judgments made by governments for such concessionary loans. Auditors will likely challenge the reasonableness of assumptions related to loan measurement, recognition and disclosure, and what element of the loan might be considered a grant.

- **COVID-19 related expenditures —** All the governments surveyed had implemented measures to track and report COVID-19 related expenditures to their legislative bodies and the general public.

  The mechanisms established to track COVID-19 expenditures varied significantly, depending on financial systems and chart of account design. For example, some governments relied on the creation of cost centers in the general ledger where COVID-19 expenditures are recorded, while others established specific project and program codes, or tracked expenditures through variance analysis. Other governments relied on each ministry or government agency to track pandemic-related expenditures on their own and report aggregate expenditures up to the central government finance function.

  Regardless of the method used, the most common challenge encountered was the completeness of expenditures captured in the reporting. For example, certain tracking methods captured ministry or department level COVID-19 expenditures, but not necessarily grants which may be provided to fund pandemic-related costs at public sector entities such as hospitals or universities.

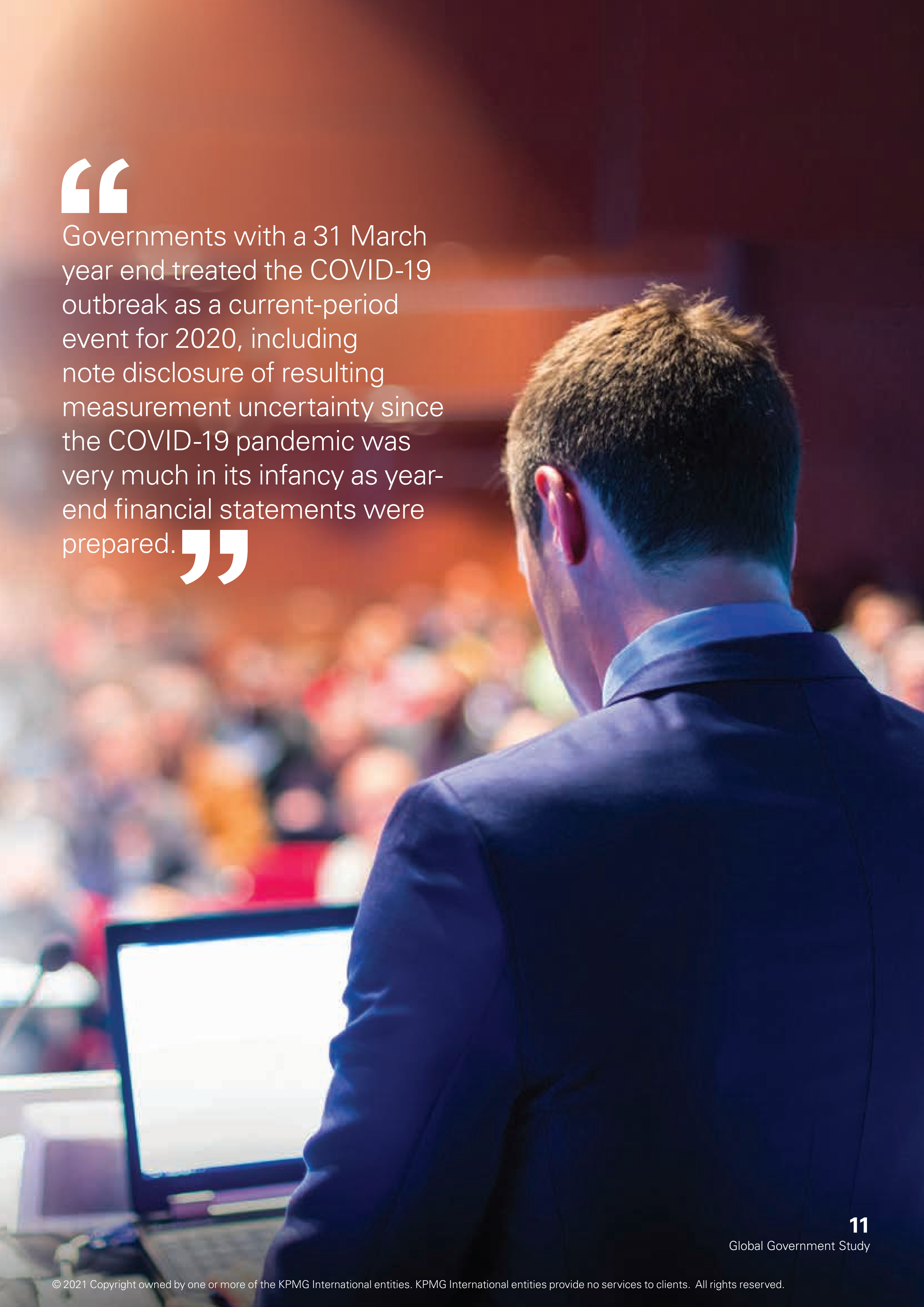
  There is an onus on central government finance functions to ensure costing methods and reporting processes are in place to support the accuracy and completeness of COVID-19 related expenditures.

- **Subsequent event —** The COVID-19 pandemic evolved rapidly in 2020, impacting how governments evaluated and disclosed events after their financial reporting date. Depending on a government's reporting date, the impacts of the COVID-19 outbreak could comprise adjusting or non-adjusting events. Each of the governments surveyed included specific note disclosures related to COVID-19 in their financial statements. The nature of note disclosures varied depending on the timing of each government's fiscal year end and reporting date.

  Governments with a 31 March year end treated the COVID-19 outbreak as a current-period event for 2020, including note disclosure of resulting measurement uncertainty since the COVID-19 pandemic was very much in its infancy as year-end financial statements were prepared. For these governments, the year-end date was only 20 days after the World Health Organization officially declared COVID-19 a global pandemic on 11 March 2020. Note, disclosure focused on enhanced measurement uncertainty for key estimates like taxation revenues and the recoverability of loans, as well as subsequent events disclosures for emergency financial assistance announced for individuals and businesses between year-end and the financial statement issuance date.

  For governments with later fiscal year-end dates, note disclosure has focused more on the measurement uncertainty arising from the pandemic, and an emphasis that historical assumptions used to develop estimates may no longer be appropriate in the COVID-19 environment.

  For December 2020 and 31 March 2021 year-ends, governments will reflect the financial impact of COVID-19 throughout their financial statements. A subsequent event note will not be necessary for these year ends, unless there are new facts and circumstances arising after year end such as significant new financial commitments.



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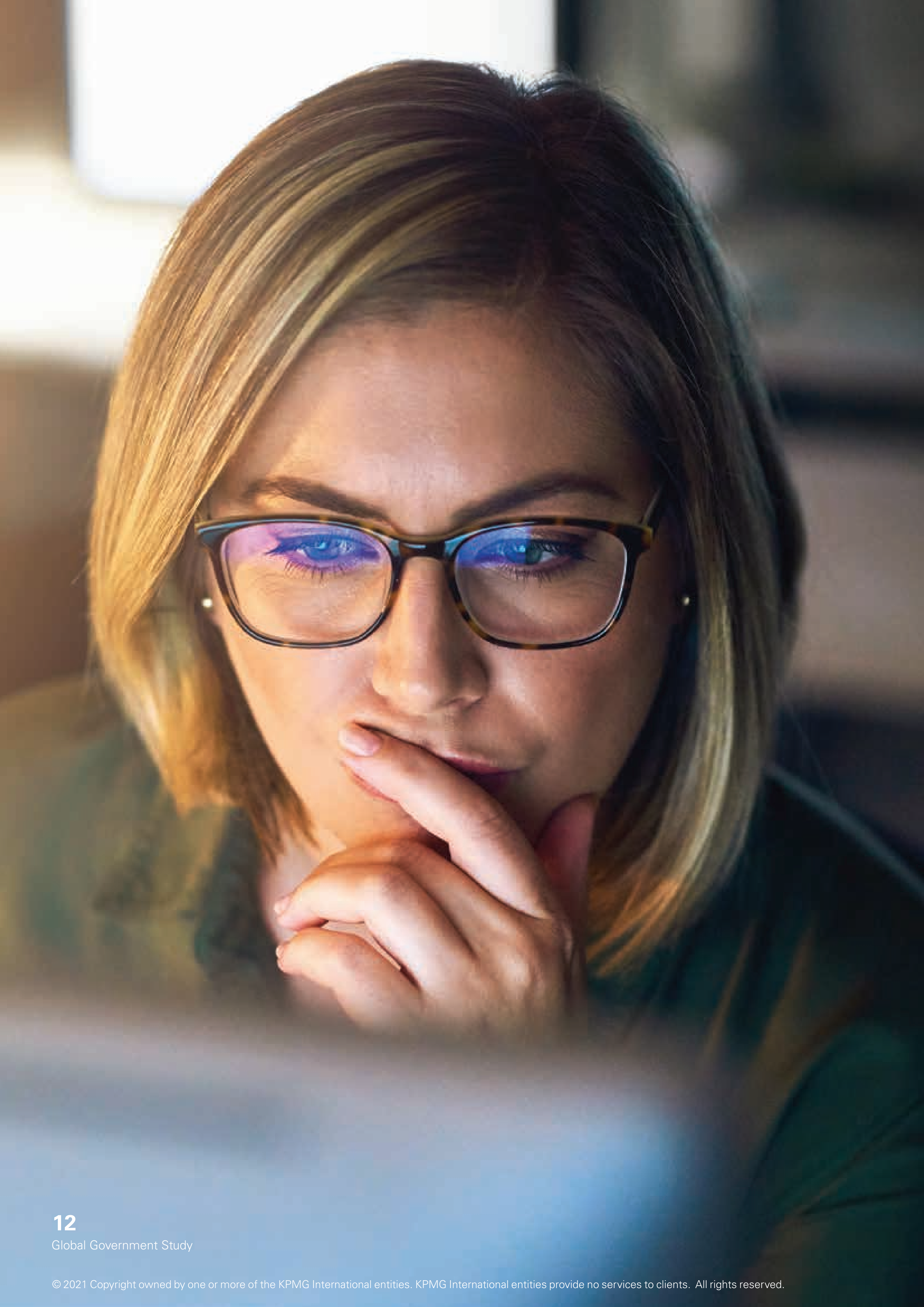


— **Going concern —** Almost all governments that were surveyed noted a spike in their spending and deficit due to pandemic management through increased government funding across the sectors. While growing concern is unlikely to be an issue for most senior governments given their taxation authority, certain public sector entities that they control and consolidate may need to re-evaluate the use of going concern assumption in 2021 or future years. The COVID-19 pandemic has brought prolonged periods of shutdown, as well as fiscal pressures that may impact funding priorities. As governments cope with the unprecedented debt levels arising from socio-economic impacts of the pandemic, they will need to make tough decisions about which ministries and programs continue to be funded. Smaller government enterprises may not be able to sustain the extended or recurring lockdown periods. Impacted public sector entities who do not have alternative sources of revenue may need to re-consider the use of the going concern assumption in their financial reporting. Auditors will be looking for qualitative and quantitative support for the use of going concern assumption in the financial statements of governments and related entities.

— **Asset valuation and impairment —** In order to reduce the spread of COVID-19, many governments announced lockdown periods resulting in the shutdown of businesses and government offices for extended periods of time. These lockdowns continued to recur throughout 2020 and into 2021. With the prolonged periods of shutdown brought on by the pandemic, many governments have tangible capital assets which no longer contribute to their ability to provide goods and services. Tangible capital assets that have been closed or shut down due to the pandemic may need to be assessed for impairment. For 2020 financial reporting periods, it was typically considered premature for governments to conclude that the reduction in service potential or economic value was 'other than temporary'. However as the impacts of the pandemic continue into 2021, such conclusions may be challenged by auditors on a going forward basis.

— **Employment benefits —** In response to the COVID-19 pandemic, certain governments made changes to benefit plans and remuneration policies. Many governments reported furlough arrangements for their employees. The appropriate accounting for new employee benefit arrangements, and any plan settlements or termination benefits could be an issue in 2021. Governments should also consider whether the implications of the pandemic on employee benefit plans and remuneration policies are so significant that they require an update to actuarial assumptions and other estimates used to measure employee benefit obligations. For most governments, the pandemic had not been ongoing long enough to update actuarial assumptions in the 2020 fiscal year end. In 2021, governments will have a lot more data points to inform this update. Auditors will be looking at the changes to the employee benefit plans and remuneration policies and whether the employee benefit obligations are complete.

> "Auditors will be looking for qualitative and quantitative support for the use of going concern assumption in the financial statements of governments and related entities."

Other financial reporting issues

Other issues related to financial reporting noted by the governments include:

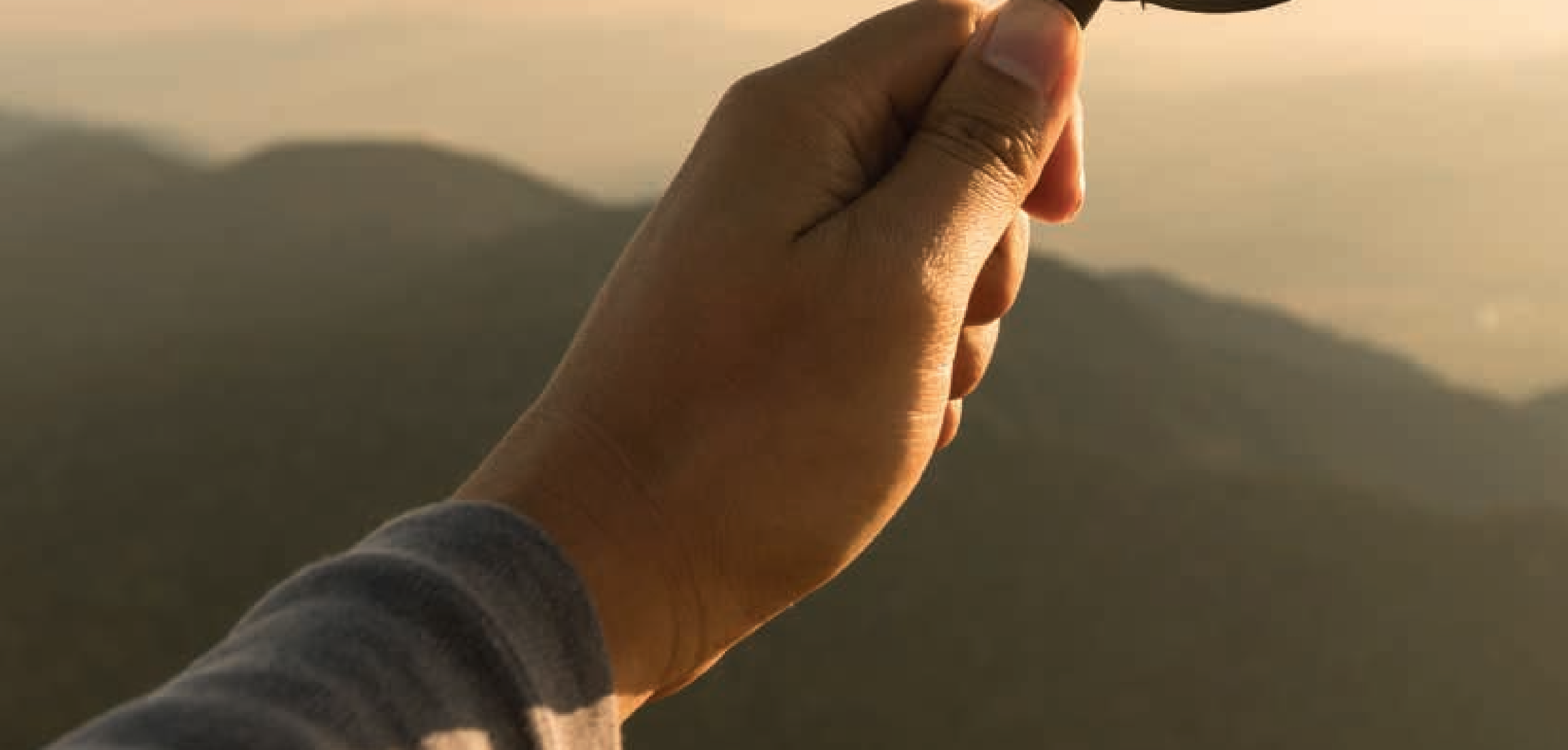
- **Cybersecurity concerns —** Due to the pandemic, most governments allowed their employees to work from home during 2020 and into 2021. This change in the operating model required governments to provide necessary tools for remote work environment for finance department staff. The pandemic disrupted markets and supply chains and forced major change in operating models which forced governments to adopt the increased use of technology to continue to function seamlessly in the pandemic. During this unprecedented change, governments face relentless and increasingly sophisticated cyber-security threats demanding a reassessment and reconfiguration of the security measures in place.
- **Control environment —** The pandemic undoubtedly resulted in a change in the operational models for the governments. A move to electronic authorizations was noted by most governments surveyed, for payments to vendors and grant recipients, as well as key working papers and supporting schedules for the financial statements. Monitoring of basic controls such as segregation of duties became critical due to the ability of individuals to override such controls through system manipulation. Some controls may not be exercised in the virtual environment due to lack of appropriate level of oversight and monitoring. From a financial reporting process perspective, the biggest impact reported by governments was adapting process activities to be fit for purpose in a remote work environment. As the pandemic stretches past the one-year mark in duration, many governments are looking at increased investments in information technology controls, automation, and data analytics to support a sustained change in their operating models and reporting processes.
- **Increasing demands of finance function —** Discussions with the governments surveyed indicated a significant increase in the demands placed on finance functions due to the need for more timely access to financial information. In almost all cases, the finance functions noted that they had more demands placed on them in 2020 than prior years due to the need for the governments and elected officials to have ready access to financial information to inform decision making. Governments need to reassess the capacity in their finance functions to ensure they have the right level of staffing, and the right mix of skills to support the increasing demands during the pandemic and post-pandemic period.
- **Need for accelerated financial reporting —** Due to the fluid and ever-evolving nature of the pandemic, citizens around the world have been demanding more frequent information on the financial results of their governments, and the costs of the pandemic response. There is a demand for more frequent and timely financial reporting by governments to support transparency and accountability. Some local governments have noted their goal to move towards quarterly reporting. This focus on more frequent and timely financial reporting during the pandemic may serve as a catalyst for enhanced reporting processes on a go forward basis. Currently governments issue audited financial statements only on an annual basis. Given the focus by the public on government financial results compared to budget, we may see more governments at all levels moving towards quarterly reporting, accompanied by some level of assurance. Finance departments should use this push towards more frequent reporting as an incentive to enhance accrual-based reporting on a quarterly basis.

Conclusion

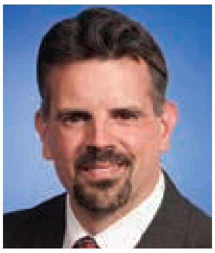
Finance functions continue to demonstrate strong resilience through the pandemic as their 2020 fiscal year-ends are closed. Other than short delays in issuing financial statements, the impact of the COVID-19 pandemic on the finance functions on most governments has been isolated so far. Processes were amended to function in a remote work environment, to enable the year-end close process to continue despite lockdowns and other physical distancing measures.

Greater challenges will likely remain in 2021 as finance functions continue to deal with limited capacity and a larger number of accounting matters related to the pandemic (now nearing the one-year mark). Public expectations for transparency and accountability are high. Senior government and elected officials rely on finance to ensure the integrity and timeliness of financial information for decision making on critical COVID-19 response measures.

Government finance functions have a unique opportunity to demonstrate their value through high quality financial reporting and by taking on the role of strategic advisors. Finance functions should lead initiatives to challenge and rethink business processes in order to build sustainable efficiencies through automation and digital transformation. Finance has a unique opportunity to lead governments through the COVID-19 pandemic, and into the next phase of economic recovery. 2021 is the year — are you ready?



Contacts



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Publication name: Global Government Study
Publication number: 137319-G
Publication date: March 2021