Government Industry Alert
By CalCPA Governmental Accounting & Auditing Committee and
California Committee on Municipal Accounting
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COVID-19 MAY AFFECT FINANCIAL REPORTING

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Introduction

The coronavirus (COVID-19) outbreak — officially a pandemic as of March 11 — has prompted global health concerns. But you also may be worried about how it will affect the governments' financial statements for 2019 and beyond.

Close up on financial reporting

The duration and full effects of the COVID-19 outbreak are yet unknown, but the financial impacts are already widespread. When preparing financial statements, consider whether this outbreak will have a material effect on the government:

- Fair value measurements of investments in a time of high market volatility,
- Financial assets, potential impairments and hedging strategies,
- Measurement and funded status of pension and other postretirement benefit (OPEB) plans,
- Liquidity and cash flow risks,
- Accounting estimates,
- Debt service payments.

For enterprise operations, also monitor the customers' credit standing. A decline may affect a customer's ability to pay its outstanding balance, and, in turn, require you to re-evaluate the adequacy of your allowance for bad debts.

Disclosure requirements and best practices

How should your government report the effects of the COVID-19 outbreak in the financial statements? Under U.S. Generally Accepted Accounting Principles (GAAP), entities must differentiate between two types of subsequent events:

- **Recognized subsequent events.** These events provide additional evidence about conditions, such as bankruptcy or pending litigation, that existed at the balance sheet date. The effects of these events generally need to be recorded directly in the financial statements.

- **Nonrecognized subsequent events.** These provide evidence about conditions, such as a natural disaster, that did not exist at the balance sheet. Rather, they arose after that date but before the financial statements are issued (or available to be issued). Such events should be disclosed in the footnotes to prevent the financial statements from being misleading. Disclosures should include the nature of the event and an estimate of its financial effect (or disclosure that such an estimate cannot be made).

The World Health Organization did not declare the COVID-19 outbreak a public health emergency until January 30, 2020. However, events that caused the outbreak had occurred before the end of 2019. So, the COVID-19 risk was present on December 31, 2019. Accordingly, calendar-year entities may need to recognize the effects in their financial statements for 2019 and, if applicable, the first quarter of 2020.

Sample Note Disclosures

Sample 1:

The COVID-19 outbreak in the United States has caused business disruption through mandated and voluntary closings of businesses. While the disruption is currently expected to be temporary, there is considerable uncertainty around the duration of the closings. However, the related financial impact on [the client] and the duration cannot be estimated at this time.

Sample 2:

On March 11, 2020, the World Health Organization declared the novel strain of coronavirus (COVID-19) a global pandemic and recommended containment and mitigation measures worldwide. The COVID-19 outbreak in the United States has caused business disruption through mandated and voluntary closings of businesses and shelter in place orders for all but those deemed essential services. While the business disruption is currently expected to be temporary, there is considerable uncertainty around the duration of the closings and shelter in place orders. As a result, the outbreak has caused uncertainty in the financial markets. Although many of the [Client]'s services are considered essential, City Hall was closed to the public, certain other services transitioned to online-only and because the [Client]'s major revenue sources, including businesses that collect sales taxes, are directly impacted by these events, it is probable that this matter will negatively impact the [Client]. However, the ultimate financial impact and duration cannot be estimated at this time.

Sample 3:

On March 11, 2020, the World Health Organization declared the novel strain of coronavirus (COVID-19) a global pandemic and recommended containment and mitigation measures worldwide. The COVID-19 outbreak in the United States has caused business disruption through mandated and voluntary closings of businesses and shelter in place orders for all but those deemed essential services. While the business disruption is currently expected to be temporary, there is considerable uncertainty around the duration of the closings and shelter in place orders. As a result, the [Client]'s investment portfolio has declined $_____________ from its June 30, 2019 values. Although many of the [Client]'s services are considered essential, City Hall was closed to the public, certain other services transitioned to online-only and because the [Client]'s major revenue sources, including businesses that collect sales taxes, are directly impacted by these events, it is probable that this matter will result in a negative impact on the [Client]. However, the ultimate financial impact and duration cannot be estimated at this time.

Sample 4:

In December 2019, a novel strain of coronavirus has spread around the world resulting in business and social disruption. The coronavirus was declared a Public Health Emergency of International Concern by the World Health Organization on January 30, 2020. The operations and business results of the [Client] could potentially be adversely affected by this global pandemic. The extent to which the coronavirus may impact business activity or investment results will depend on future developments, which are highly uncertain and cannot be predicted, including new information which may emerge concerning the severity of the coronavirus and the actions required to contain the coronavirus. The [Client] has not included any contingencies in the financial statements specific to this issue.

Audit Considerations for Fiscal Year 2020

1. Grant Issues (FEMA, CARES)

    a. In many cases, governments may not know until they submit for reimbursement how much money they will receive. In those cases, governments should not record revenue until they are awarded a specific amount.
    b. Additionally, governments should not report expenditures on the SEFA until the grant is awarded
    c. CARES funding may be subject to single audit requirements
    d. Single Audit submissions have been extended for 6 months, including FYE June 30, 2020 filers
    e. REAC filings have been granted a global 30-day extension for all submissions with a due date of 3/31/20

2. Government programs allowing deferral of customer payments (deferral of TOT payments, Water Bills, and other Rent holidays to help the community)

    a. In governmental fund types, this may impact the government's ability to record revenue because of the "measurable" and "available" criteria
    b. In proprietary fund types, this may impact the allowance for doubtful accounts estimates

3. How will the CDTFA's extension of the sales tax return due dates and the small business relief payment plan for sales and use tax affect the third and fourth quarter sales tax remittances to municipalities?

4. Internal controls during COVID – audit impact on possible circumvention of internal controls for emergency purchases or when individuals were not available to sign/approve activities

5. Investment losses and credit risk

6. Pension and OPEB plans – impact of investment losses

7. Will the State Controller's Office provide any extensions for filing State Controller's Reports, Street Reports, Transparency Reports?

8. Is there an increased risk of litigation?

9. Audit response to analytical variances – expectation for decrease in Sales Tax, decrease in TOT revenue, decrease in Recreation and Library revenues, decrease in building permits, layoffs/furloughs, expanded senior and low/income program costs

10. Going concern issues

11. Subsequent events footnote to mention COVID issues

AU-C Section 570, Auditor's Consideration of an Entity's Ability to Continue as a Going Concern

GASB Codification Section 2250.118 provides the following indicators that may raise significant doubt about a government's ability to continue as a going concern:

- **Negative trends.** Recurring periods in which expenses and expenditures significantly exceed revenues, recurring unsubsidized operating losses in business-type activities consistent working capital deficiencies, continuing negative operating cash flows from business-type activities, or adverse key financial ratios.

- **Other indications of possible financial difficulties.** Default on bonds, loans or similar agreements, proximity to debt and tax limitations, denial of usual trade credit from suppliers, restructuring of debt (other than refundings), noncompliance with statutory capital or reserve requirements, or the need to seek new sources or methods of financing or to dispose of substantial assets.

- **Internal matters.** Work stoppages or other labor difficulties, substantial dependence on the success of a particular project or program, uneconomic long-term commitments (burdensome labor contracts for example) or the need to significantly revise operations.

- **External matters.** Legal proceedings, legislation, or similar matters that might jeopardize intergovernmental revenues and the fiscal sustainability of key governmental programs; loss of a critical license or patent for a business-type activity; loss of a principal customer, taxpayer, or supplier; or uninsured or underinsured catastrophe such as a drought, earthquake, or flood" (AICPA, 2015, p. 507).

Going Concern Evaluation:

- Review GASB Codification Section 2250.117 to .120

- Complete Going Concern Checklist

- Identify client resources to continue for 12 months after the financial statements are issued. Use client information such as budget, cash projection, etc.

- Review client's plan for continuance

"Going Concern" requires the auditor to include an Emphasis of Matter paragraph in the auditor's report on financial statements to highlight the existence of a material uncertainty regarding an entity's ability to continue as a going concern.