Covid-19: Financial Impact and Disclosure

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Abstract. This paper identifies key areas of financial reporting that need to be considered when determining the impact of the pandemic on the companies’ financial position, the performance and disclosure of material information. The article collected and analyzed experts’ opinions among the representatives of the academic environment, the professional community and the reporting enterprises from the economic sectors which were influenced by the pandemic. In the practical part of our research we have analysed financial reports of companies from different sectors over the first quarter of the year 2020 with a view to identifying practical cases of the disclosure of COVID-19 impact consequences. For analysis we chose companies’ reports from the sectors which were affected strongly by the pandemic: air transportation, online travel and related services, retail, metallurgy. Based on the analysis performed, we made recommendations on the disclosure of material information in the financial statements. These disclosures should be correlated with companies’ social and environmental responsibility reporting.

Keywords: Coronavirus COVID-19 · Coronavirus impact · Financial consequences · Financial Statements · Disclosure

1 Introduction

The spread of Covid-19 in the world has impacted seriously on the global economy, financial markets, and business, regardless of the size of enterprises. The pandemic resulted in a fall in solvent demand, a decrease in production and sales volumes, an increase in additional costs, in particular, in order to maintain safe working environment, also difficulties in managing supply chains and inventories, high volatility of financial markets, growing financial risks, primarily liquidity and credit, rising unemployment and associated social risks and threats. The continuation of these circumstances could have a prolonged impact on an entity’s financial results and cash flows. This situation makes it necessary to consider and monitor the financial and accounting consequences of Covid-19 carefully. While the pandemic has impacted on almost all businesses either directly or indirectly, some of the most hit sectors are air transportation, tourism, hospitality and retail. The aviation industry is facing massive disruption owing to travel restrictions, the tourism and hospitality sector has been affected with low occupancy in business and holiday travel. Also, we can expect significant consequences of the pandemic for production sectors, for example, for the
steel and metal industry due to a sharp drop in demand, the closure of borders and the suspension of the supply chains across the world.

Despite the fact that some companies did not experience serious negative impact and some entities could benefit from the current situation, the activities of very few enterprises remained unchanged. Therefore, organizations should consider the Covid-19 financial impact on the business and the areas of financial reporting that will be affected in order to determine the necessary information.

Companies are required to test their assets for impairment when indicators of impairment are identified. Cases of forced shutdown of equipment or its use to solve urgent problems of the spread of COVID-19, as well as a decrease in sales and the recession in production demand, can be attributed to possible reasons for impairment.

It is known that goodwill should be tested annually for impairment. COVID-19 could affect goodwill due to significant changes in the business climate, outbreaks of infection among staff and key staff losses, and a serious decrease in the market capitalization of the enterprise. In addition, growing financial and social risks may require increasing of the discount rate, which may also lead to impairment of goodwill.

In accordance with IFRS 9 Financial Instruments, expected credit losses should be recognized for some types of financial assets. A negative economic outlook as result of COVID-19 could lead to credit risk increasing. Even if estimates do not require re-evaluation, full disclosure of the circumstances should be provided in the financial statements.

The revenue of an entity may reduce due to the spread of the pandemic. Under pandemic conditions companies run a promotion in order to collect money or offer refunds or credits to customers for goods or services that cannot be used during this crisis period. Consequently, some contracts may become less profitable, or even loss-making.

Some entities may be facing supply chain disruptions. Companies would need to assess whether adjustments to the carrying value of their inventory are required to bring them to their net realizable value in accordance with IAS 2 ‘Inventories’.

Rapidly changing economic environment is subject to the new assessment of credit, liquidity and market risks. Management should determine if additional risk disclosures are required.

To remain a going concern companies must have the ability to meet their obligations as they come due within one year after the financial statements are issued. Management needs to determine whether there are conditions and events that raise ‘substantial doubt’ about a company’s ability to continue as a going concern and to provide appropriate disclosure.

This article identifies key areas of financial reporting that need to be considered when determining the impact of a pandemic on the financial position, results, and disclosure of information in the financial statements. This is not a final list, and there may be other areas not included in this article that should be considered by preparers and interested users.
2 Research Method

The research intended to analyze the following issues. Since the impact of COVID-19 pandemic around the globe is unprecedented (Fig. 1), we have set a goal of collecting, generalizing and analyzing experts’ opinions among the representatives of the academic environment, the professional community and the reporting enterprises from different sectors which are influenced by the pandemic greatly.

![Global Situation](https://covid19.who.int/)

**Fig. 1.** COVID-19 aftermath for the world [https://covid19.who.int/](https://covid19.who.int/)

Three most affected countries are presented in Fig. 2.

![Situation by Country, Territory or Area](https://covid19.who.int/)

**Fig. 2.** Countries affected by the pandemic most of all according to World Health Organization [https://covid19.who.int/](https://covid19.who.int/)

In accordance with Fig. 2 we can single out the USA and Russia among the countries that have suffered from COVID-19 badly. That is why we chose academic publications originated from these countries as objects of our study. We have analyzed Russian scientific publications that investigate new trends in accounting and financial reporting in connection with Covid-19 and came to conclusion that there are virtually no articles about the pandemic impact on accounting issues for the present. We have analyzed USA scientific journals as well. We have studied journal issues of American Accounting Association: Accounting Horizons, The Accounting Review, Issues in
Accounting Education\textsuperscript{1} for the year 2020. We have not found any articles on the pandemic topical issue and accounting in these journals either. It is caused by the fact that scientists need time to conduct a comprehensive analysis of the events. Besides the publication process in serious scientific journals takes a long period of time in the current context. For instance, in Russia depending on the level of a scientific journal it can take from half a year to a year and a half from the moment of passing an article to an editorial office till the time of its publication. The period of considering, reviewing and publishing an article in the stated academic periodicals in the USA exceeds the abovementioned period of 6–18 months in Russian ones.

There is no doubt that considerable scientific papers based on in-depth research results and reliable information will be published soon. But at the same time there is also a concern that the events taken place in the spring and in the beginning of the summer of 2020 are not reflected in a timely manner in academic periodicals. It is obvious that new models of scientific studies in the field of accounting and the forms of their promotion should be found, and furthermore, digitization gives wide opportunities to implement it.

As distinct from academic periodicals, practical accounting publications \textsuperscript{1–3}, issues of audit and consulting companies \textsuperscript{4–6} or international professional bodies \textsuperscript{7–9} have a lot of articles on this problem. The authors of practice-oriented journals analyze COVID-19 impact on accounting and give recommendations how to act most properly in the current situation. For example, based on the analysis, Kulaga, E. offers recommendations to management and accountants on how to reflect the impact of the pandemic in the financial statements for 2019, taking into account events after the reporting date \textsuperscript{10}; Lesnova, Y.V. studied the way in which enterprises would have to present economic aftermath of COVID-19 in interim and annual accounts for the year 2020 \textsuperscript{11}.

It should be noted that there is a link between climate change, environmental disasters and arising epidemics. This link, even if it is not expressed clearly at first sight, has become especially evident in 2020. The study of Brenner and Marwan (2018) indicated the existence of a direct link between climate change and the occurrence of epidemics seems extremely relevant \textsuperscript{12}. The presented results focus on the effect that climate change has on spreading patterns of airborne infectious diseases. On the one hand, the pandemic exhibited one of the catastrophic scenario options resulting from climate change. On the other hand, it made it evident that even temporary reduction in the scale of activity had an impact on the environmental situation. Antipova (2020) recognizes the pandemic as “a black swan event” and considers its economic and social impact on all sectors of life \textsuperscript{13}. Rozhnova and Efimova (2020) argue the necessity of considering financial implications of climate change risks as information important for the disclosure \textsuperscript{14}. We believe that such disclosures are also appropriate for the pandemic.

We support the opinion of Kuter et. al (2018) who argue that study of the historical parallels is useful for the understanding of the current situation \textsuperscript{15}. In continuation Peterson K. Ozili \textsuperscript{16} discusses the accounting practices and financial reporting options for firms during a pandemic. The author concludes that accounting practices can help to dampen the effect of a pandemic on companies’ financial reports.

\textsuperscript{1} https://meridian.allenpress.com/aaa.
Online academic debate and practical discussion concerning the issues of the pandemic impact on the accounting are very heated. New online platforms are still appearing. In our opinion these are the most widely used means of discussing the questions concerning accounting and pandemic:

a) Online publications and the placement of research results on the sites of international professional organizations. Such publications draw a wide response in both academic and practice-oriented accounting environment.

b) International scientific conferences where important issues on the current state of accounting and its evolution are discussed.

c) Organizing forums for discussing accounting issues of the pandemic, inviting to a broad discussion and publishing research results.

In the practical part of our research we have analyzed financial reports of companies from different branches over the first quarter of the year 2020 with a view to identifying practical cases of the disclosure of COVID-19 impact consequences. For analysis we chose companies’ reports from the sectors which were affected strongly by the pandemic: air transportation, online travel and related services, retail, metallurgy.

We studied key issues concerning the assessment of the current situation, financial implications of the pandemic, perspectives and ongoing efforts to ensure sustainability made by the companies themselves.

Research results of the disclosure of the information in financial statements of the studied companies on key development issues in the context of the pandemic are presented in Table 1.

| Analysis of the situation | Financial implications of the pandemic | Ongoing efforts | Perspectives |
|---------------------------|---------------------------------------|----------------|--------------|
| Air transportation PJSC “Aeroflot” | Negative –Figures of revenue decline, passenger traffic costs are given | Considerable – Measures to effectively address threats of the pandemic and its negative impact on the company are disclosed | Negative – Negative expectations for the second quarter of the year 2020 are described |

|Retail Group “M.Video – Eldorado” |
|----------------------------------|
| Positive - Full transition to an online platform and transformation into online business | Positive - data of transaction growth in the first quarter of the year 2020 are shown as compared with the first quarter of the year 2019 | Considerable – Several projects which allow providing customers with necessary domestic equipment and devices in a contactless, safe way promptly in conditions of self-quarantine are launched | Positive - Developing the ecosystem ONE RETAIL. Using RTD (Real Time Dealing); promoting strategies on entering telecom segment |

(continued)
The analysis found that impact consequences for the financial position of the companies and cash flows as well as the completeness itself of the disclosure in the companies’ reporting varied significantly. Such issues as going concern assessing; revenue recognition; goodwill and long-lived asset impairment testing; expected credit losses; measurement of financial instruments; inventory management and valuation; debt covenants; lease accounting; government support; forward-looking information; cash flow impacts and some others facts can be highlighted among the key topics related to COVID-19 impact. These issues are essential for a true and fair presentation of financial position, current and future financial results.

Table 1. (continued)

| Analysis of the situation | Financial implications of the pandemic | Ongoing efforts | Perspectives |
|---------------------------|--------------------------------------|----------------|--------------|
| Metallurgy PJSC «MMK»     | Negative, caused by the decline of product demand | Considerable – The Group is taking active measures to prevent the spread and reduce the risk of coronavirus | The Group and its largest debtors are included in the list of backbone enterprises established by the Russian Government. This allows the Group to take advantage of government support measures, if necessary |
| Cautious - the Group has established a special committee under the leadership of the Parent Company’s CEO and is promptly monitoring the situation | To date, the Group has not experienced any difficulties with the liquidity and supply of basic raw materials, equipment or spare parts | In order to reduce the risks to the Group’s financial stability and optimize capital expenditures, the stress scenario provides for a reduction in CAPEX, with the active phase of construction of the coke oven battery complex being shifted to a later date |
| Online travel and related services Booking Holdings Inc. | Negative - «The COVID-19 has resulted in a material decrease in consumer spending and an unprecedented decline in travel and restaurant activities and consumer demand for related services» | Very considerable («elimination of non-essential business travel, cancelation of internal company events, reducing in marketing spend worldwide, a general company-wide hiring freeze, suspending share repurchases and other actions to provide additional financial flexibility») | Negative- «Even if economic and operating conditions for the Company’s business improve, the Company cannot predict the long-term effects of the pandemic on its business» |

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3 Results

Based on the analysis we have made the following recommendations:

- It is necessary to give coverage to topical accounting issues in academic periodicals during the period when such issues are in great demand. It is possible to publish mini-papers in a special column covering ‘Opinions and Recommendations’ even in serious scientific journals. This should be done to create relevant environment for the scientific debate and for the further in-depth researches on those topical issues.
- We had studied practical cases of reporting companies’ disclosures and had analyzed them with a view to identifying redundant, insufficient, unsubstantiated information to discovering the best practical cases of the disclosure. We suppose that such studies should be transformed into a regular practice in the process of professional accountant education.
- The role of interim accounts is becoming more important in the rapidly changing world. Interim accounts allow companies to react promptly to significant events and to bring relevant information to interested users.
- Disclosures in financial reporting must be coordinated with links to non-financial reporting (for example, the number of cases, the measures to staff protection taken by a company, the cost estimation of these measures). Such studies were not carried out in the analyzed reporting documents; this reduces their value for users.
- Disclosures should be structured more clearly in financial reporting to make data more comparable.
- It is needed to encompass the linkage between the company’s strategy and the results of reporting analysis.
- It is advisable to disclose information about the contribution of an enterprise to the fight against the spread of threats in the context of global crises comparable with the pandemic in reporting. This information should be correlated with social and environmental responsibility in non-financial reporting.
- It is useful to include such a section as “Risks, forecasts” in the company’s disclosure of material accounting aspects.

4 Conclusion

The research has certain limitations. Although the paper presents the results of the analysis of only four companies from different sectors, we analyzed financial reports of more than 30 enterprises in the first research stage. Then we selected several companies which reflected the pandemic impact (positive and negative) to a greater extent. The first stage showed that many enterprises do not disclose issues of pandemic impact on their activity and its results at all. Due to available information limitation the research is also not sufficiently detailed. But now is the time to raise a range of issues and attract as many academics and practitioners in the field of accountancy as it is possible to the debate. We consider that management, accountants, auditors and standard-setters should make certain conclusions as early as 2020.
Further course of the study must be aimed at the digitization of accounting and reporting [17] since it allows collecting more extensive information, processing it quickly, detailing and aggregating it in the right directions, including users’ opinion and making more accurate forecasts [18]. Furthermore, it is evident that accounting should help choose the right strategy and business model of a company, consider all risks allowing reducing a negative influence of different climate, social, environmental disasters on business.

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