COVID-19 IMPLICATIONS ON FINANCIAL REPORTING

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Abstract

The outbreak of the COVID-19 pandemic was marked by enormous restrictions, problems that the world was not prepared for and did not know how to deal with. The problems were not limited to medicine, they affected all aspects of life, including business and financial reporting. The emergence of new measures, implementation of aid packages, various reliefs due to the pandemic that reduced economic activity led to many changes in financial reporting. From the beginning of its appearance until now, there are constantly new reactions and responses to COVID-19, from the aspect of financial reporting. One of the most intimidating tasks facing companies' financial representatives today is the urgent need to provide extensive disclosures detailing the pandemic's impact and how that risk is being managed. The first and most important topic to address is going concern and liquidity. Reporting entities may have to revise their disclosures about liquidity risks to let investors know how they are managing their liquidity while dealing with the COVID-19 crisis. Basically, this is an evaluation of company's chance of survival. A survey conducted by Deloitte, one of the "Big Four", will give an even clearer picture of how Covid-19 affects the operations and reporting of global companies.

Keywords: Covid-19, financial, reporting, implications, responses

1.Introduction

Accounting and financial reports give great insight into the inner working of a business. That kind of insight and information is crucial for stakeholders to make important economic decisions. This information also needs to be relevant, consistent, easily understandable, transparent and comparable. That bring us to the need of constant changes in the IFRS regulations. The pandemic caused an enormous and unexpected fall of the economic activity with it, entities in the economic sphere encountered conditions often associated with a general economic downturn. The continuation of these circumstances may result in an even wider economic downturn which may have a continuing negative impact on the entities financial performances. Therefore, changes were made and recommendations were given as their implementation was of great importance in order for entities to continue to work as best as they can, in these abnormal conditions.

Accountants and auditors must remain focused on their ethical responsibilities and the public's interest. It is important for them to have an increased attention and professional judgment in combating higher risks of financial misinterpretation and fraud and to ensure the proper use of government and other assistances. The application of this requirement is aided by the IESBA international code of ethics for professional accountants, including compliance with the fundamental principles as a key for preserving and enhancing public trust. Professional accountants are and will be required to produce, analyze and submit information from which critical decisions will be made.

2.Implications on the public sector

Global reactions and responses to the pandemic continue to arise as the implications of this virus are widespread. The spread of this virus affected the public sector in many ways such as reduced consumer demand for goods and services as a result of loss revenue and restrictions on consumers ability to move freely, decreased ability to provide goods and services due to government imposed movement restrictions, difficulties in raising funds from clients, taxpayers and other contracting parties facing financial difficulties, formation of market prices for goods and financial assets including equity and debt instruments, increase of security grants from the government, uncertainty of future income, reduced donations and many more. We will take a look at where and how the pandemic impacted the public sector.[1]

2.1. Business continuity

Is it possible for the management of public sector entities to make a clear assessment of the principle of business continuity in so called "new normal"? Financial statements are prepared on the assumption that the public center entity has business continuity which means that it will continue to operate and be able to fulfill legal obligations in the normal course of operations in the foreseeable future. When assessing a business continuity, entities circumstances must be taken into consideration. Of course, the pandemic is a circumstance that has caused many changes and fast shift of economic conditions, that the entities are forced to make a more robust assessment of business continuity.

2.2. Impairment

We will look at the impairment of financial assets such as investments and receivables. The public sector usually has many types of investments and due to the impact of COVID-19 these investments are sometimes subject to impairment. The timing of the recognition of impairments depends on the type of investment. Investments that should be considered for impairment are investments measured at fair value, temporary investments and portfolio investments. These types of investments differ from how they are to be recognized. For example, when the market value of temporary investments falls below their carrying amount, they are measured at market value, and for investments measured at fair value impairment is recognized immediately.

When it comes to receivables, public sector entities have different types of accounts receivables. Due to the increase in financial difficulty an estimate may be required to increase the fee provision at the end of the year. Many borrowers face financial difficulties because of COVID-19. As a result, the public sector entities will need to reevaluate the non-collection of loan receivables. This may lead to an increase in the provision for an appraisal fee or an increase in right offs. [2]

Another aspect to look at is that the government may have various difficulties in collecting tax claims because of the increasing taxpayers' financial difficulties as a result of the pandemic. The relevant evaluation should be reevaluated and adjusted as necessary due to the impact of the pandemic. The public sector should consider whether the claims from the government may be impaired and whether the net presentation requirements are still met.

2.3. Loan obligations and guarantees

A public sector can appear as a debtor as a result of a contract, its own legislation, legislation of another government, a constructive obligation or a legal obligation. As a part of the response to the pandemic crisis the government may introduce legislation that results in liabilities for themselves or other public sector organizations. In addition, the public sector entity may experience constructive or legal obligations when it creates a valid expectation from other entities and has no alternative but to resolve this obligation. National difficulties caused by the impact of the pandemic may also impose the need for the public sector entity to increase its loan guarantee reserve.

2.4. Employee benefits

Due to the pandemic, there was a decline in the fair value of plan assets together with the changes in all countries and that may result in an increased retirement obligation for many public sector entities with defined benefit plans in the current and future years. Public sector entities should consider a change in the discount rate used when measuring the accrued liability for a particular benefit plan. Over the years the public sector entities are expected to make several changes which may affect the commitment to defined benefit plans. The entity should determine whether an updated actuarial valuation is required. Some public sectors may even reduce their workforce in the future to reduce the costs [3]. A public sector entity recognizes the benefits of termination when there is proof of:

- termination of employment of an employee or group of employees.
- providing termination benefits as a result of the offer to encourage voluntary termination.

3. Implications on private sector

As many changes were made due to the pandemic, IFRS issued proposals to address the coronavirus implications that focus on addressing the financial effects of preparing financial statements. The new circumstances put the entities in front of bigger challenges when preparing their financial statements that must be in accordance with the IFRS. The proposals were issued or updated to recall existing accountant requirements that need to be considered in addressing the financial effects of the pandemic while preparing financial statements for annual or quarterly reporting periods. There were many financial reporting issues, but some needed more attention than others, so we will now take a look at the ones that needed the most attention.

3.1. Impairment

All financial assets other than those measured at fair value in the income statement are subject to impairment review. Assessments should be made at the end of each reporting period as to whether there is any objective evidence fact that a financial asset or group of assets is impaired. A financial asset or group of assets is impaired if and only if there is objective evidence of impairment as a result of one or more internal or external events that occurred after initial recognition such as a loss event. That loss has an impact on estimated future cash flow of a financial asset or group of assets that can be estimated with certainty. The effect of several events can also cause damage which is important to consider under current circumstances. Expected loss as a result of future events no matter how probable is not recognized.

3.2. Government grants

The distinction between government grants and other forms of state aid is important because the standard accounting requirement applies only to government grants. Government grants are transfers of an entity's resources in exchange for past and future compliance with certain conditions relating to the entities operating activities. Government grants which can be called subsidies, premiums or other forms of state aid are usually given to encourage private sector entities to take a course of action that they would not take if the aid was not provide. Recently there were relevant measures introduced to assist entities in responding to the coronavirus. These measures include direct subsidies, tax exemption, text adduction and loans, extending tax loss, reduction of public duties, reduction of rent or deferral and low interest loans.[4]

3.3. Profit tax

Several economic stimulus packages have been announced and implemented by governments around the world. Government response to the coronavirus outbreak include profit tax exemptions and other releases. Therefore, entity should consider the impact of these legal changes in accounting. Income taxes require current tax liabilities and assets for current and prior periods to be measured at the amount expected to be paid or collected from the tax authority using tax rates and laws that have been enacted or substantially enacted. Deferred tax assets and liabilities must be measured at the tax rates that are expected to be valid for the period in which the asset is realized or settled, using tax rates and laws that were enacted or substantially enacted.[5] Governments may also discuss tax exemption so that it applies to entities that are affected by the coronavirus based on certain eligibility criteria. This may cause uncertainty about the need for entities to make judgment and assess means when assessing their profit tax position for example whether during the tax the entity will fall below the income threshold to obtain a tax concession.

3.4. Measuring objective value

The purpose of measuring objective value is to estimate the price under which a transaction will happen for the sale of an asset or a transfer of liability between market participants on the measurement date, under current market conditions. Estimates are subject to significant measurement uncertainty due to current environment and wider range of possible estimates of fair value measurement. The entity is required to apply judgment to determine the point in the range that is the most relevant to fair measurement in certain circumstances. It would not be appropriate for an entity to disregard market prices at the measurement unless those prices are due to a regular transaction. Evidence of whether the transaction is orderly must be assessed in determining the weight placed on the transaction price when assessing the measurability of the book value or market risk premiums. In order to minimize the use of unprotected inputs, and the fair value higher key requires valuation techniques for increased monitored inputs from orderly transactions. As a result, even when the asset market has become less liquid due to the current environment the relevant prices or inputs observe from the orderly transactions in these markets must still be taken into account. It would not be appropriate for an entity to subscribe so we could do value of a model based on unsustainable imports such as an income approach that uses only the entries on imports. [6] Judgment is also needed to assess the relevance of market observe data and whether they reflect appropriate transactions, especially in situations where there is a significant reduction in market activity for an asset or liability.

3.5. Income recognition

Pandemic outbreak may affect revenue estimates and current client contracts under the IFRS. This is because when a contract with a client involves variable consideration, such as discounts, refunds, price debates and such, the entity is generally required to make estimation of the amount at the beginning of the contract. An entity making such estimates is also required to update the assessment throughout the duration of the contract to reflect the conditions that exist at each reporting date. This will include updating the variable account estimation to reflect the entities revised expectations of the amount of compensation it expects to be entitled to. Uncertainties that are related to the occurrence of coronavirus can also prompt entities to change customer contracts or to reconsider them whether it is likely that the entity will collect the compensation which it is entitled to. If both parties to the agreement agree to change the scope or price or both elements of the agreement, the entity shall notify the amendment in accordance with the modification requirements. [7] Judgment is required to determine when the expectation of partial payments indicate that there is an implicit price concession for which the variable consideration should be reported, there is a loss during damage, there is not enough substance in the arrangement to be considered a standard contract.

3.6. Events after the reporting period

These events are favorable and unfavorable events that occur between the end of the reporting period and the date on which the financial statements are authorized for issue. The importance here is to distinguish between adjustable and nonadjustable events after the reporting period. The main question and problem that occurs is how to determine which events happens after the end of the reporting period that should be reflected in the financial statements as adjustment events and for non-adjusting events as well as what additional disclosures should be provided [8]

3.7. Other accounting estimates

In addition to all the above mentioned, some of the other key accounting estimates that management should make in the time of pandemic are:

- Net fair value of inventories
- Compensation for impairment of investments in subsidiaries and joint ventures
- Residual useful life and residual value of property, plant and equipment
- Non-material assets.

3.8. Loans

In April 2020, the IASB board issue a document, prepared for educational purposes, outlining the requirements under IFRS 16 leases and other IFRS standards relevant to entities considering how to account for rental concessions.[9] This educational document does not alter, remove, or add to the requirements of a IFRS standards and was intended to support the consistent application of IFRS 16. It explains how an entity estimates whether a lease concession is a modification of a lease or lease station that was not a part of the original terms of the lease [10].

4. Examples of post pandemic booms

Although the COVID-19 pandemic was unexpected and very new to the modern world, this is not the first time that a pandemic has occurred, therefore we can look at history and what it tells us about a post pandemic booms. We have evidence of the Cholera pandemic of the early 1830s that hit France and wiped out nearly 3% of Parisians in a month. History offers us a guide to what people do once life gets back to normal. As COVID-19 rages across poor countries the rich world is on the verge of a post pandemic boom. The COVID-19 pandemic is very unfamiliar, and economists are turning to history for a sense of what is to come next. The record suggests that after a massive non-financial destruction such as wars and pandemics GDP does bounce back. It is expected that people will be keen to go out and spend, businesses will try to find new ways of doing things and there will be a political upheaval that will follow with an unpredictable economic consequence. Although this is what history suggests, it is not certain that history will repeat itself. The rise of technology led the economists to draw a link between pandemics and changes to the supply side of the economy i.e. use of labor saving technology. Management would want to use a robot that does not fall ill. While this is very plausible, another option that is suggested by researchers is that workers in fact do better in aftermath of pandemics. When people have suffered in large numbers the attitudes towards the workers may shift which might be the case for our current pandemic. Policymakers across the world are less interested in reducing public debt or warding off inflation then they are in getting unemployment down. We have yet to find out whether big companies, bosses and management will employ people or robots, whether the employees will be keener on working better and harder and what the overall result of this pandemic will be. In some cases, history does repeat itself fully and follows certain trends.[11]

5. Presentation of a survey of Deloitte for the implication of Covid-19 pandemic

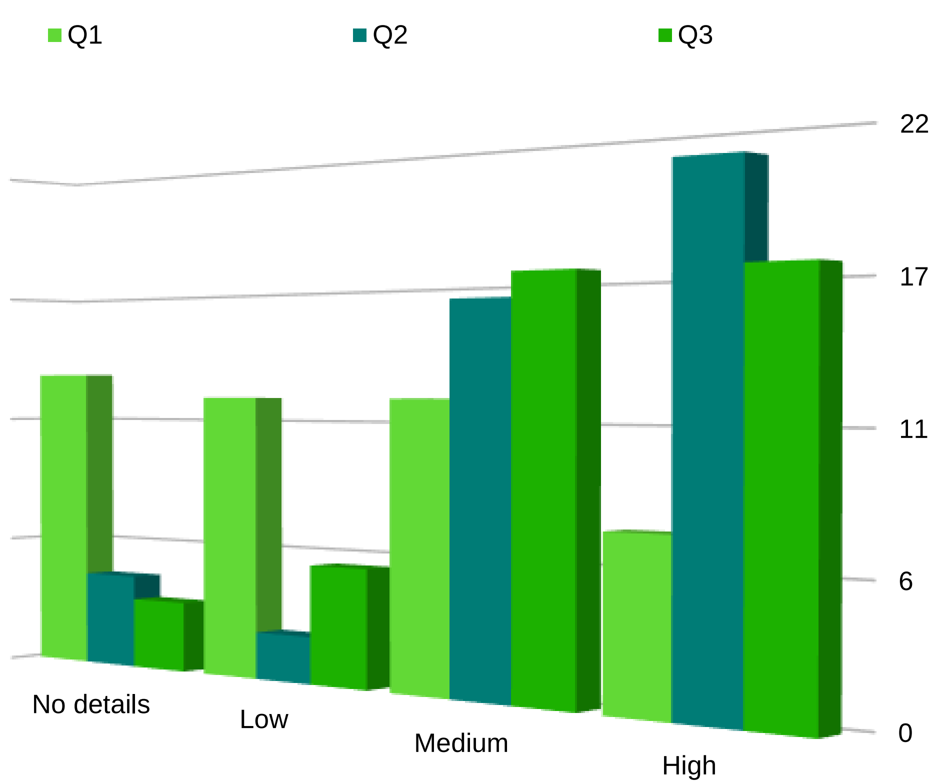
To see how COVID-19 affected business sector as well as financial reporting we present here a survey conducted by Deloitte, one of the companies of “The Big Four”. The survey was conducted to 44 companies out of which 12 were from Great Britain, 17 from Switzerland and 15 from Germany throughout different industries. Even though this survey is not statistically representative, it still gives us an overall picture of how COVID-19 affected different industries.

Out of the 44 countries four did not give out financial results in the third quarter, one of the companies ended their financial year on 30 September 2020. Out of the 39 left countries, 22 which is 50% of the whole sample, have issued full interim financial statements in compliance with IFRS or US GAAP respectively. The remaining 17 (39%) companies have issued limited financial results (sales reports, production reports etc.)

The pandemic led to an unprecedented lockdown of the global economy in spring last year. This resulted in whole industries not being able to sell and deliver their products and services to customers, disruptions in the production process and supply chain, significant uncertainty with plummeting demands. Even after the lockdown, serious restrictions, particularly travel restrictions and social distancing requirements, remained which are adding complexity to delivery models and result in less willingness to consume and, hence decreasing demand. And after a slight recovery during the summer period, we were facing the second wave of lockdowns and tightened restrictions which prevent a speedy recovery.

With regards to the details disclosed, there was a clear trend of providing more transparency and insights, particularly regarding the quantitative information over the quarters in the year 2020.[12]

Chart 1- Amount of details provided from companies in different quarters of the year 2020



6. Conclusion

Stakeholder base important decision making on information given from financial reports. This information must be accurate and in accordance with the IFRS, and that's why it's also important for accountants to be always informed and up-to-date with the newest changes in IFRS. The changes we looked at in this paper were caused by the current COVID-19 pandemic. We saw that the world in general, was not prepared for this kind of shift and change, that affected not only the business sphere but also every other aspect of life. We looked at the most important changes in the public and private sector. To give a better understanding of what is currently happening in financial reporting we also looked at a survey that was conducted by Deloitte, which led us to see how different companies dealt with giving out information and reporting on their financial activities. The most important conclusion here is that accountants must always stay alert and adjust to the current situations to accomplish their main goal of accurately presenting information in financial reports.

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