International Journal of Experiential Learning & Case Studies
5 : 2 (December 2020) pp. 183-192. dx.doi.org/10.22555/ijelcs.v5i2.60

COVID-19 and the related accounting considerations in preparing financial statements and disclosure requirements. (A case study based on Unilever Pakistan Limited)

*Ghias ul Hassan Khan**

Abstract

The idea behind this case study is to examine the impacts of COVID-19 on financial reporting from the different view sides of IFRS disclosure requirements. As it is a case study that is why other companies can take benefit from this study. Most of the countries in the world carrying the effects of COVID-19 and nearly a quarter of the population is quarantined and most of the business is in lockdown condition. As a result of the businesses working online as well as change their pattern of operations due to COVID-19 pandemic. The government also imposes legislation related to it and there must be significant changes in IFRS implication concerning pandemic to improve the situation all the way. A questionnaire with 31 questions based on IFRS implications in pandemic has been prepared and sent to the concerned officials of the company in the subject here to ascertain the facts related to the implications of IFRS adoption in the current period of the pandemic. The questionnaire covers around 31 aspects related to disclosures as per IFRS and the study here analyzes how Unilever Pakistan Limited adopted these changes or in which areas still following the same policy without impacting COVID-19.

Keywords: *COVID-19, financial reporting, Unilever Pakistan*

JEL Classification*: M40, M41*

INTRODUCTION

This is not the first time that the world is dealing with a pandemic like this, the world always has gone through different crises with different faces. Currently, the whole world is dealing with this respiratory disease or illness named Coronavirus 2019 (COVID-19) which is affecting nearly all areas of life. This outbreak crisis initially started from Wuhan a city in China at the end quarter of 2019 and rapidly capture around 200 nations in 2020 and this

Correspondence:
**Instructor, Department of Accounting, College of Business Administration, University of Bahrain, ghiasacca@gmail.com, ghkhan@uob.edu.bh*

is not the end even, it still taking its peaks and affecting the whole world in every industry or sector in terms of economic crises, social issues as well as behavioral aspects of the society at large. It harms industrial business also, but highly instantaneous negative impacts of most non-industrial business-like, tourism, hoteling, retail, transportation as well as in education, etc. Initially, it affects all supply chain in general but afterward, some of its control through the enhancement of using technology and the most business moved towards the online sales and delivery methods, which also initiate the new ways of dealing and new ideas of business as well as handling the services in all sectors. "As the pandemic extended in both magnitude and duration all entities experiencing conditions in a general economic downturn" (IFRS in focus, May 2020). COVID-19 caused unprecedented conditions in all sectors as a result many people lost their jobs in all sizes nearly which can be seen in figure 1 below and it also results in a liquidity crunch. This will lead to the need to adjust the issues related to financial reporting concerns with the implication of IFRS disclosure requirements. It also involved changing the accounting policies and methods as well as making provisions from the most affecting parts of the financial reporting in general.

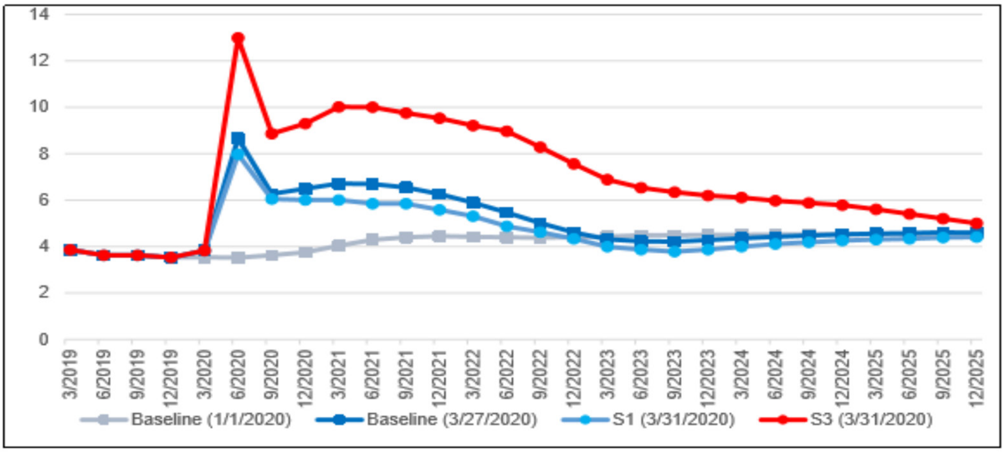


Figure 1: Moody's Analytics

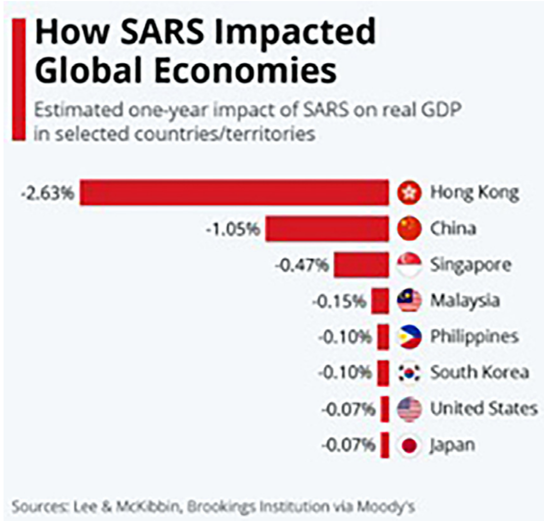
"An entity shall not adjust the amounts recognized in its financial statements as of 31 December 2019 to reflect the events occurring after the reporting period that are caused by the COVID-19 outbreak, unless such events call seriously into question the validity of the going concern assumption" (COVID-19 accounting implications, April 2020).

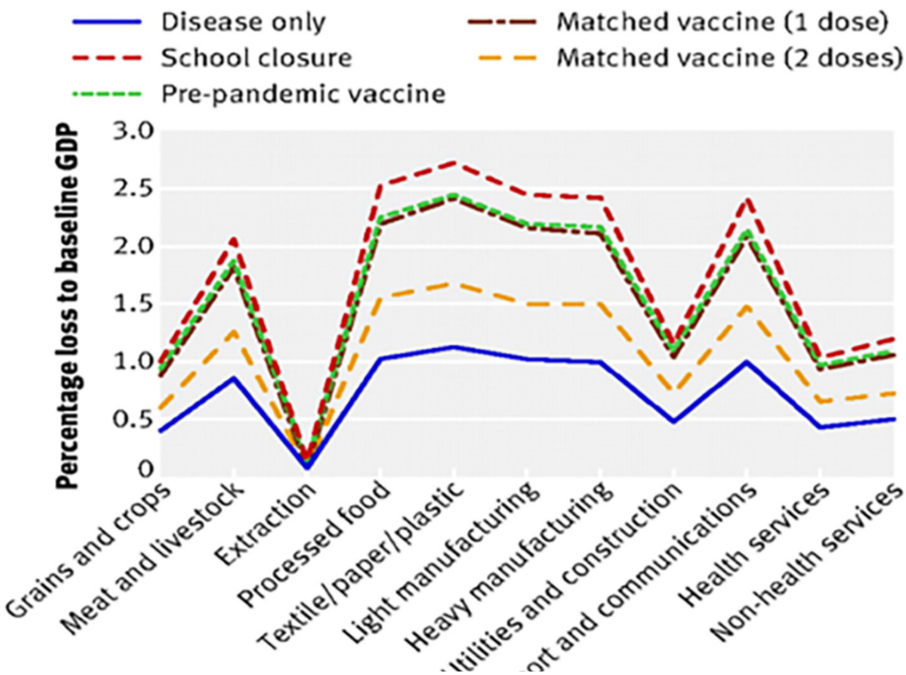
BACKGROUND INFORMATION

This is not the first time that the world facing such type or nature of pandemic which currently in discussion. Disease-causing influenza, respiratory disorder, flu, and like symptoms in past decades also encountering by the world such as follows.

1. 1976 – Ebola virus
2. 2002 – 2004 outbreak – Severe acute respiratory syndrome – (SARS coronavirus)
3. 2009 – 2010 – Swine influenza pandemic – (H1N1)
4. 2013 – Avian influenza– (H7N9) and
5. Currently COVID-19

Fan (2003) during the period of the virus named SARS because of shaken the customers' confidence reduces the demand for products which results in declining economic growth in many countries affecting by it. The main cause of this impact is the fear of strengthening in people's minds due to the pandemic lie currently also we are facing such a scenario. People make their minds and decided to stay safe at home to reduce the likelihood and pace of the spread of that virus. In addition to it also export and the tourism industry have drastic negative impacts due to the prevailing pandemic situation in that current period.

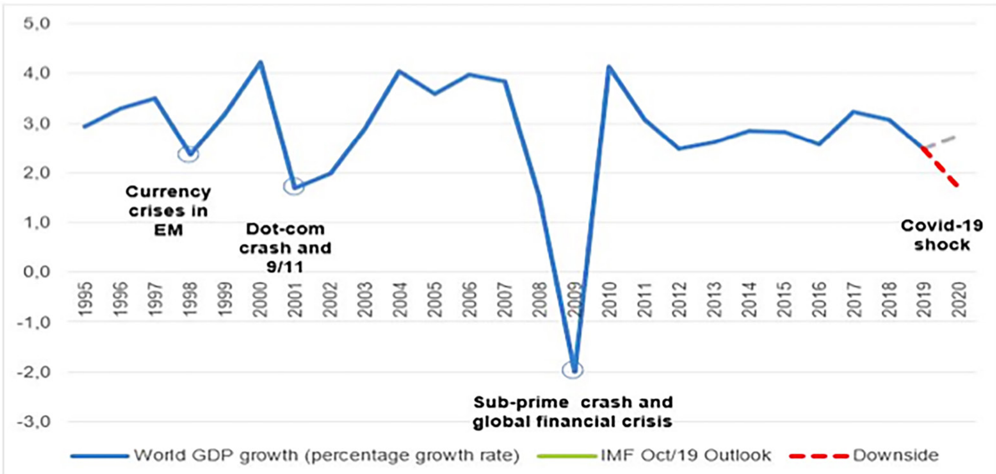




Verikios (2011) in 2009 when the H1N1 pandemic which is swine influenza hit the areas of the economy and as it also notably impacts negatively in the education sector as well as drastically impact on specific sectors' economic conditions about the tourism, transport retail, etc. Businesses due to a reduction in consumption for staying home by consumer experiencing declining curve in growth as shown in the figure concerning the percentage loss to baseline GDP sector-wise.

Qiu (2018) comparatively concerning the SARS pandemic, Avaian Influenza (H7N9) has a much lesser adverse impact on the economy in terms of reduced demand as it is only confined to the poultry and meat consumption as a precautionary measure, that is why it was less severing in adverse impact which mainly affects the poultry industry with no other major industries as far as the economic scale in concern.

Accountancy Europe PwC (2020) currently the COVID-19 pandemic spreading and hitting the countries in the world one by one which also negatively impact organizations in terms of the reduced level of production due to fall in economic demand and consumption. The impact of COVID-19 is not only confined to the reduced consumption, demand or economic downfall as previously mentioned pandemics showed. It also has notable consequences of accounting, auditing, and management aspects. This makes it necessary to do required accounting changes and applications as per the IFRS emergent clauses. The board of a company needs to be taken this seriously and consider the impacts of this outbreak to impart the IFRS issues in financial statements at both the interim and annual stages. This will lead to an indirect but several impacts from reduced economic activities and the organization should have to take account of its areas which affect considerably.



Source: UNCTAD calculations based on IMF, WEO, October, 2019

Parker Russel Intl. (2020) companies need to consider the major impacts of COVID-19 on potential risk areas and uncertainties. The continuous increase in cases and negative economic conditions may create a need for impairment test and most probably need further impairment in carrying values of assets and obligations especially in terms of leases which turning burdensome and required to include this in disclosures.

IFRS in Focus (April 2020) Organizations should take into careful consideration their distinctive conditions and their exposition to risks when they analyze how the current proceedings can impact their financial reporting. More particularly, financial reporting and its related disclosure in the financial statement need to communicate all material current or potential impacts of COVID-19. Likewise, it is of utmost importance that the management understands the risks that its organization is dealing with in addition to how these risks can impact the management.

IFRS in Focus (May 2020) As a result of increasing this pandemic in both magnitude and duration, corporations and other businesses are facing conditions of overall economic downstream. It is not only confined to the financial market attrition, credit clash, liquidity issues but more to increase government intervention in a result of which increase in unemployment due to lockdowns and it considerably reduces the consumer discretion on consumption which could have a prolonged negative impact on an entity's financial results. This case study discusses certain key IFRS accounting considerations related to conditions that may result from the COVID-19 pandemic. Although individual issues discussed here will of course vary by industry and by the entity, but as believe that the topics mentioned in the discussion section will be the most pervasive concerning the current situation.

METHODOLOGY

In this case study, the methodology followed was based on questions related to the selected 31 IFRS implication areas and sent to the company official for getting answers to the questions mentioned in the questionnaire. The questionnaire is also attached in the appendix. Information obtained for the study through a detailed questionnaire of nearly 31 IFRS concerned areas of working and implications. The questionnaire was discussed with the help of the assistant manager in connection with the Chief Executive Officer (CEO) and other managers of Unilever Pakistan Limited. The company officials showed their esteemed cooperation and clarify all doubts raised during the discussion. The information was obtained for this case with different means like some of by telephonic discussion in person and sent questionnaire directly to the concerned person. To ascertain the related concerned areas of IFRS implications here, the study used the publications done by Deloitte, PWC, Moody's as well as other internet sources in large. Author direct knowledge also incorporated and obtaining associated explanation for the related concern used to enhance the credibility of the information.

The main objective of this study is the analyze the financial reporting implications as per IFRS adoption due to the COVID-19 pandemic in Unilever Pakistan Limited. It also aimed to enhance the knowledge of the reader not only in the implications of IFRS but also the effects of this illness overall in the world economic changes as well as make them familiar with the same type of previous days pandemics.

DISCUSSION

The global response to the outbreak of this COVID-19 disease rapidly evolves and has a significant impact globally in all market sectors and have an impact on the accounting implications in different industries. Summarizing at the same time Unilever Pakistan Limited also has accounting impacts and implications in different areas of record-keeping, but at the same time even with the pandemic some of the areas of accounting without affecting and continuing with the same policies and procedures as before. The discussion below mentioned which area affects how, and which one prevails the same in the COVID-19 pandemic.

Areas have an impact with COVID-19

Cash forecast plans – during the pandemic as a business affects globally with different intensity and everyone is running to keep surviving in the situation. Similarly, in this company, the management focused more on cash forecast instead of profitability. The management of the company in discussion wants to assure the competent survival of the company in the pandemic that is the reason they have more focus on bringing the cash position in a more favorable condition. The other main reason for doing this is to secure the position in meeting financial obligations and to avoid the effect of the pandemic in meeting these obligations.

Goodwill impairment process – in the given situation of COVID-19 pandemic companies needs to review their assets to access the impact of it on assets impairment to look forward to the goodwill condition. Significant changes may occur during the pandemic situation and according to IAS 36, the companies need to perform an impairment process to estimate the recoverable amount of the affected cash-generating unit at the end of each year. Discussion with the staff of the company is subject here also reveal the fact that they perform this process for some assets due to the reduction in demand and the low production levels of certain goods during the pandemic.

Inventories – usually inventory valuing at lower of cost or NRV according to the IAS 2, but in the current pandemic and uncertain situation as to the duration of its sustainability it very difficult and may warrant an additional challenge to calculate the NRV at the reporting date. The company also made some write-offs in inventory and planning to establish provisions for slow-moving inventory especially in categories like ice cream products due to the low level of production and reduced demand to overcome the probability of pilferage and obsolescence in it.

Fixed overhead accounting – in the normal course of operations fixed overheads were absorbed in the cost and some of them allocated and apportioned suitably. In the current situation of the pandemic as a reduction in demand in general it is very hard to cover them up through the cost of production. As per the information revealed from the discussion with the staff, it comes apparent that during the current situation they are releasing them in profit and loss instead of inventorying it.

Specific restructuring activities – in a current pandemic situation entity are facing difficulty in obtaining and arranging finance to cope with the capital as well as revenue stream projects. Because of this, it may be probably that the company may consider and implement some restricting plans like closure and downsizing. Concerning Unilever Pakistan Limited this is also the same case, but because of strong financial background they did not go to permanent disclosure for any part of the business, but to control the current liquidity issue the management decided to close some of the factories and production facilities which have significantly low production level due to the current situation. They also not decided to initiate downsizing and not to send staff on leave without pay, but temporarily freeze any new hiring. All other contracts are going as per plan except for the delays in CAPEX (Capital Expenditure) contracts and the result of which savings which supposed to receive in future-facing reduction, these expectedly may restore in 2021.

Impacts on sales and profitability – usually disruption and reduction in productivity and sales demand will lead to the negative implications of working capital. Companies need to consider the desire policies for managing the working capital, which is the case here, that is why Unilever Pakistan is not facing much liquidity crunch in terms of working capital utilization. But due to the lockdowns and emergent implications of the outbreak, it faces a challenge of reduced sales in general, but the division of ice cream and beauty product sales impacted much comparatively with other products. This may be because of direct contact with the retail and walk-in customer which is a type of quarantine in the current period. Also, the massive, fixed cost de-leverage and additional cost to comply with COVID-19 measures are impacting the profitability of the company in major areas.

Areas have no impact with COVID-19

Accounting for estimates & classification of the lease – estimated here considering the accounting estimates relate to the plant assets and classification reflects the leases. The response reveals that even with the pandemic it has no impact over these estimates, and the company keeping the same depreciation methods, rates, useful life, salvage value as well as consistent with the bad debt policies together with no change in the classification of nay lease and its term. All assets of the company also carried with the same values and pattern as before the pandemic apart from specific assets that have some impairment all other assets have no change in their fair values.

Others if general – in general also there is no change in factoring arrangement as the company still applying and maintaining a good recovery procedure. Also, there is a provision that needs to maintain regarding the onerous contracts except for in some contracts where the try to be made negotiation regarding the fixed cost impact.

Assessment of Going Concern – during the pandemic, many entities faced going concerned as issue loss of customers and sales created liquidity crunch in their affairs as well as due to the uncertain lockdown created a crunch to the entities ability to meet the loan obligations and losing the fair value of assets, these two dimensions creating the environment for those company to tackle with the going concern. In Unilever Pakistan because of taking wise strategy from the day to focus of cash forecast instead of profitability as mentioned in the area have an impact in COVID-19 provide them edge to control the going concern issue and that is why there are no going concern issues and the company still able to meet the loan covenants as disclosed by the company officials.

Working capital standing – regarding the working capital, as the company adopted a focused policy on cash management instead of looking for profitability. As a result of which there are no issues related to the working capital, except for the amount stuck in ice cream-related inventory which is at a high level due to fewer sales and low production levels.

CONCLUSION

Finally, it concluded that the procedures taken to improve the probability of containing the COVID-19 outbreak have affected the economic activity around the globe, which in turn had a lot of negative implications on financial reporting since accounting is the main method of communication of economic events of an organization, that reflects both the economic and social changes of a nation or its level of development (IFRS bulletin from PWC, 2020). On the same face in ¬¬¬Unilever Pakistan Limited also adopt some of the crucial changes in financial reporting as mentioned in the discussion section above with separating areas that have impacts and which not. The company also tested impairment specifically in the areas of low production and reduced market demand which also leads idle some of the facilities. All in all, a part of the business serving the restaurant is majorly affected due to the COVID-19 outbreak because major lockdowns occur. The company adopted cash focused approach to maintained liquidity for smooth operations and avoid working capital issues. As the focus in this respect, Unilever Pakistan limited sets its priorities, and cash is given priority and is taken as a high weighted measure to gauge the performance of the company. Last but not least the main challenges still encountering the company are (a) Loss on Sales (b) Decline in profitability (c) Additional cost for COVID measures and (d) Immense restrictions due to lockdown in various parts of the country.

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APPENDIX

(Questionnaire)

I order to perform a case study about the impact of the COVDI-19 pandemic for academic purposes, can you please cooperate to provide the following information.

1. Any change occurs in the following.
    a. Depreciation methods for any assets
    b. The depreciation rate for any assets
    c. Useful life
    d. Salvage value
    e. Bad debt estimation
    f. Lease classification
2. Any change or adjustments made in the carrying amount of assets give brief details, please.
3. Any changes in pension plans give brief details, please
4. Any major impairment, give brief details, please
5. Any change in the cost of capital, give brief details, please
6. Any new contingent commitment arrived, give brief details, please
7. Any major fair value changes in assets give brief details, please
8. How cash forecast plans affected?
9. Do you perform impairment tests for goodwill or other assets because of COIVD, give brief details, please?
10. Any assets of the facility become IDLE due to COVID.
11. Inventory reduces to NRV or not
12. What impact on production levels?
13. Any changes occur in the method to allocate the fixed overheads due to production

declining in COVID.

14. How the ability to meet financial and non-financial obligations affected?
15. Any additional allowances or changes in allowance made because of COVID for expected credit losses in trade receivables, loans, and debt securities.
16. Any factoring and discounting done for receivables.
17. Any provision made for onerous contracts.
18. Any major modifications were done in any contracts.
19. Any following restructuring activities were done. give brief details, please
    a. Closures
    b. Delays in contracts
    c. Downsizing like leave without pay to some employees
    d. Downsizing like dismissals.
    e. Any termination benefits paid or not. give brief details, please
20. Any breach of loan covenant happened. give brief details, please
21. What is the assessment of going concerned, do you find any indication which may negatively affect the going concern?
22. Any liquidity crunch and what strategies followed to overcome
23. Any working capital lacking issues and what measure is taken to tackle them?
24. Any financial or non-financial assets sold because of COVID
25. What problems faced in recognition of fair values of assets.
26. Any specific hedging contract was done.
27. Do you get any relief in the following?
    a. Lease payments
    b. Tax payments
    c. From government
    d. Obligation (liability) payments
    e. Etc.
28. How sales impact COVID?
29. What impacts on profitability?
30. Any new or alternative performance measures taken, give brief details, please
31. What are the major challenges companies are facing in the COVID-19 pandemic? Please mention as many as you can.