Juhász J. (ed) 2022: Proceedings of the European Union's Contention in the Reshaping Global Economy. University of Szeged, Doctoral School in Economics, Szeged, https://doi.org/10.14232/eucrge.2022.14

COVID-related disclosure practices of Hungarian entities

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The pandemic has brought unexpected challenges to businesses as they need to cope with the impact of the virus on their sales performance and face the information need of their stakeholders at the same time. Our study aims to discover the COVID-related risk disclosure practices of Hungarian, publicly listed sample entities in the annual statements prepared for the year 2020. Based on what we have found, the disclosure practices of Hungarian listed entities is quite heterogeneous, there are great differences in the extent of communication with the stakeholders.

Keywords: COVID-related disclosure, non-financial reporting, Hungary

1. Introduction

Even before the COVID pandemic, there had been a consensus about the need to focus more on human well-being when it comes to economic growth (World Economic Forum 2017). Based on the latter source, the idea of sustainable growth entails finding solutions to create enough resources for the present generations without endangering the opportunities of future ones. The report also emphasizes that competitiveness should be considered an important tool in achieving human-centered economic progress by providing the resources needed for well-being, such as *better education, health, and security, and higher per capita income* (World Economic Forum 2017, 9).

1.1. Sustainability in corporate reporting

Based on (Ikram et al. 2020, 2), the consideration of sustainability in corporate strategy and processes is inevitable while coping with the ever-changing business environment and the emerging expectations related to the idea of sustainability. The authors also shed light on the fact that this is a matter of strategic decisions and goes deep into firms' culture (strategy and vision).

The pandemic has formed our economy in ways we have never imagined before and has influenced the operation of businesses in several aspects. As a consequence of the recent spread of COVID around the world, the ideas of competitiveness and the protection of human resources are to be necessarily reinvented by management these days.

According to the World Economic Forum (2020), *human capital* needs to be transformed during the process of revival. The report emphasizes the role of new talent management policies and adaptation to the needs of today's job markets. The COVID-pandemic has also brought light to the vulnerabilities of the healthcare systems and their capacity to deal with such burdens as the consequences of the spread of the virus (World Economic Forum 2020, 6).

From the point of view of the businesses, their survival in the economic slowdown depends on their ability to adapt to the new circumstances and the speed of their reactions. The safety of customers and staff, the continuity of the supply chain, the methods of keeping in touch with the employees and organizing trainings or recruitment are just a few areas to mention in which the entities had to cope with new challenges.

Competitiveness had already been a complex issue even before 2019-2020 (World Economic Forum 2017). Setting short-term goals and considering the financial consequences of operations has not been enough for a long time now. The notion of sustainability and the concept of the long-term impacts of business operations are ideas that all leaders have to embrace when elaborating strategies for great organizations. Many stakeholders of companies (investors, creditors, employees, customers, and society in general) today care about satisfying the needs of today's generations without harming the opportunities of future generations. Creating enough resources today and still making it possible for future decision makers to continue the task decades later is a great challenge today.

Our research presented in this paper is a pilot project aiming to provide the basis for future analysis. We examine the COVID-related disclosure practices of the Hungarian premium category publicly listed firms. The overall research questions are the following:

What type of COVID-related information is disclosed in the annual statements of the sample entities? How deep is the disclosure? Which topics are addressed?

The paper consists of four sections. Section 1 introduces the topic and provides insight into the difficulties around the inclusion of human resources in financial statements and about the various channels firms use to communicate with stakeholders besides financial statements. Section 2 describes the process of voluntary reposting and presents the results of related international literature. Section 3 presents the empirical study carried out by the authors of this paper, and Section 4 provides conclusion and discusses future research plans.

1.2. Human resources in the annual statements

Human resources constitute a key driver in achieving economic prosperity and productivity, and the development of this kind of capital is based on the following steps (World Economic Forum 2020, 21): sustaining good health for individuals and developing skills and capabilities for them as required by the market.

Neither of these steps are evident these days. Nor is the place of human resources in financial statements as these fall into the category of intangible items and have many attributions that make them difficult to handle from an accounting point of view – at least based on the traditional reporting paradigm (Canibano et al. 2000). The value of human capital is realized by entities and their stakeholders: investors value transparency when it comes to how firms engage in sustainability – green investments are becoming more and more popular and scores based on ESG information (i.e. Environmental, Social and Governance) are reflected in special indexes. However, when it comes to financial reporting, the issue becomes less obvious. Human resources are intangible, they do not correspond to the recognition criteria of the traditional accounting paradigm – they are not controlled by the entities and their elements incorporate high risk in terms of returns, let alone the question of quantifying the value (see Figure 1).

Figure 1 Facts about the Balance Sheet and Intangible Elements

The balance sheet is a part of financial statements that is familiar to all: it has two sides, and it demonstrates the assets of reporting entities and the claims against those assets. The traditional definition of the asset includes: resource presently controlled by the entity that provides economic benefits in the future and has a cost or value that can be measured reliably.

Knowledge assets and other intangible resources have some specific features that make it very difficult to incorporate them in the balance sheet according to present accounting regulations. Problem: entities do not always 'control' them and their 'book value' is hard to measure reliably.

Consequently, financial statements display a very limited set of these kinds of items, although they have a great influence on the success and competitiveness of reporting entities. On the other hand, stakeholders need information on these kinds of resources, so business entities tend to find other ways to supply stakeholders with what they need.

Source: own construction based on (Z. I. Kovács 2015)

Consequently, firms do not have the competence and skills of their workforce listed in Balance Sheets. Traditional financial statements completely lack workforce on the list of capitalized items. This fact influences the quality of information given to the users of financial statements and distorts the picture they get about an entity. That is why the picture given by financial statements needs to be completed by other types of reports. Financial and non-financial reporting provides communications channels to convince the stakeholders.

1.3. Channels of Communication with Stakeholders

Reporting entities are subjects to accounting regulations, and, as a consequence, are required to provide some basic information to their stakeholders. Financial accounting is a methodology that prescribes the amount of information to be provided on a compulsory basis. Besides complying with the standards and giving the required minimum level of information, firms may provide additional details that they consider relevant for the users of the statements.

The financial report is only one of the ways of communication, yet, it has a special status, which lies in the fact that it is created and published in the case of all entities, on a common conceptual basis (the local financial reporting regulations), with regularity. Thus, the role of these reports is outstanding as they can be considered as primary sources of information for the stakeholders. Other reports about ESG topics may include significant information on intangible resources, but these are made on a voluntary basis and do not result in comparable data as they lack a common conceptual basis (there are no globally accepted international standards for non-financial reporting yet).

What is more, according to the most recent developments, integrated reporting is evolving, conflating financial with non-financial. This can bring a lot of challenges but also opportunities: if the same group of individuals work on the elaboration of an information package containing both financial and non-financial information, this can lead to a better focus and more consistency in reporting. Aligning financial ratios and non-financial key performance indicators in one report can create high value for the users of these integrated statements.

According to a recent survey by KPMG International (2020, 12), 77 per cent of the largest European companies publish social responsibility reports, but the continent is not uniform in this respect. Although the ratio is lower in Eastern Europe, there has been significant improvement over the past three years, while growth has slowed down in Western Europe.

The European Union has recently started placing more emphasis on the issue of reporting ESG information. Directive 2013/34/EU already required entities to include issues related to environmental and social aspects in the management report. In 2014, directive 2014/95/EU amended the already existing requirements to enhance the disclosure of non-financial information by certain large public interest entities, leading all member states to incorporate these rules in their accounting regulations (in Hungary this lead to an amendment in the Hungarian Act on Accounting).

Among the list of topics required to be published by this Directive we can find the following:

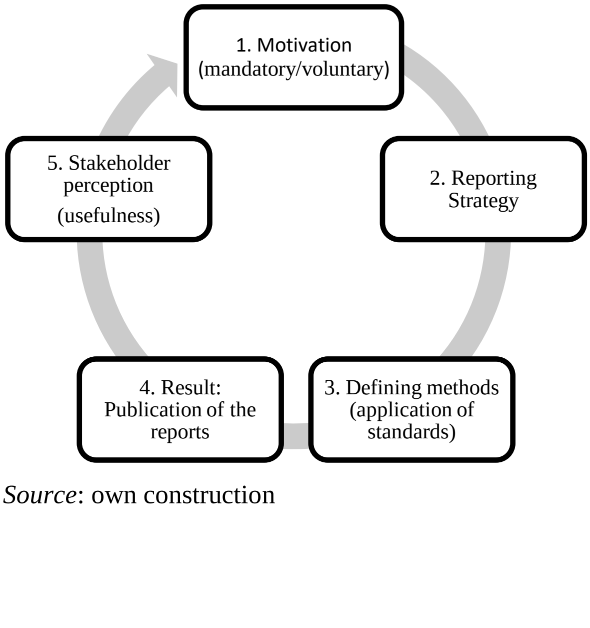
– Health and safety at work
– Actions taken to ensure the protection and the development of the local communities.

The directive also mentions the aim of the development of such frameworks that serve as the common basis for sustainability reporting, setting already existing ones as examples.

2. The process of voluntary reporting

In the following paragraphs, we discuss the process of voluntary reporting (Figure 2). By voluntary reports, we mean the information given to stakeholders outside the four core financial statements: the statement of financial position, the statement of comprehensive income, the statement of cash flow, and the statement of changes of equity.

Figure 2 The process of voluntary reporting



Source: own construction

2.1. Motivation

As a trigger step in the process, some incentives motivate firms to engage in voluntary reporting (step 1). Motivation theories listed by (Shehata 2014) support the notion that motivations exist:

- Agency theory: Voluntary reporting can reduce agency costs (information asymmetry: agent/manager – principal/owner)
- Signalling theory: Voluntary reporting can be used for signalling purposes (entities signal that they are better than their competitors, disclosing more than mandatory)
- Capital need theory: Voluntary reporting helps to attract capital at lower cost – reducing uncertainty
- Legitimacy theory: Voluntary reporting is a method of establishing legitimacy: showing the shared values with society => social contract/earn right to exist

Based on (Ferriani 2020), sustainability data has been increasingly valued by financial investors over the last ten years. The author also highlights that assets that score high on ESG matters attract financing. The reason they mention behind this phenomenon is that the ESG scores reflect firms' ability to internalize the common objective of sustainable development. Investors seem to consider those firms with more ESG disclosure less risky, and the authors also mention a shift in the perspective of ESG indexing from indicators of sustainability to measures of internal vulnerability.

2.2. Reporting strategy

As a consequence of these incentives, entities elaborate their reporting cultures and determine the topics included in the disclosures (step 2). According to Ikram et al. (2020), the COVID-19 pandemic is opening new challenges for corporate sustainability. The authors see the post-COVID-19 era as an opportunity for decision makers to rethink firms' sustainable business practices (including a shift in their manufacturing, supply chain, and sustainability strategies). Based on literature, there is also a great prospect in embracing the advantages that could arise from adapting to the situation:

"Entering into an unknown world, leaders took unofficial steps toward CSR practices that could lead to a strategic competitive advantage. As the world emerges from the COVID-19 pandemic, leaders of organizations should reflect on the positive approaches that emerged. Just as how leaders experienced the benefits of a remote workforce resulting in increased efficiencies due to reduced commuting times with social distancing and shelter-in-place mandates, the increased focus on the organization's true capital – its human capital – may lead to a more sustainable world" (Goldston 2020 5514).

2.3. Standards for non-financial reporting

After considering the motivating factors, there is the issue of whether the firm chooses to follow some kind of reporting standard or guideline (step 3). The difficulty of this decision is caused by the fact that there are multiple standards available, and there is not one favored by the ED either. Petty et al. (2009) believe the most important barrier in the process of intellectual capital reporting is the lack of consistency of the methods of reporting and the difficulty of assigning relevant quantitative values to the various categories. This issue is also a setback in the area of ESG reporting due to the similar nature of the area (elements are difficult to quantify). However, several standards exist (GRI, IR, SASB) and, in the future, we might see the emergence of a global set of standards in this field.

2.4. Publishing reports

Step 4 is the publication of the reports. An example of how firms incorporate COVID-related disclosure into the existing framework to apply an integrated approach is described by Ikram et al. (2020, 7–8), as the authors list the following as decision sub-categories for Corporate Sustainability after the pandemic:

- Corporate Governance
- Product Responsibility
- Transparency and Communication
- Economics
- Environmental
- Social
- Natural Environment and Climate
- Energy Consumption and Saving
- Pandemic
  - Emergency response plan
  - Commitment to employee safety
  - Just in time and lean delivery
  - Social distancing and employee working hours modification

After the reports are published, the interested parties perceive and evaluate the content of the reports either directly or indirectly, which can create further motivations for entities to continue or adjust their communication strategies.

2.5. The usefulness of the reports

Firms disclose non-financial information because they suspect that users of the annual statements will perceive this information as useful in making their financing decisions. What is more, several studies provide empirical evidence on the connection between the quantity of disclosure on behalf of firms and investor confidence. Ho et al. (2012) studied the Hong Kong exchange to analyze the correlation relation between initial public offering (IPO) of enterprises and the disclosure of intellectual capital components between 2008 and 2010. They found a significant positive correlation between disclosure and investor confidence, which supports that enterprises benefit from communication with their stakeholders.

Boujelbene and Affes (2013) studied listed French enterprises and found an association between disclosure on intellectual capital and capital cost as a dependent variable. The authors also found a significant negative correlation between capital cost and reporting on the two components of intellectual capital (human and structural capital).

Based on our approach, steps 3 and 4 can be investigated by using quantitative methods, for example, content analysis. The advantage of these methods is that they do not require personal contact with the firms, since reports are public in most cases (although in Hungary, the Business Report is considered as an attachment to the annual financial statements, not generally available online, except for public entities). The disadvantage of the method is also obvious: the lack of personal contact means that there is no way to ask questions about the reasons behind reporting. Interviews as qualitative methods can be seen as the most appropriate means of examining steps 1, 2 and 5. These methods can provide deeper insight for the researcher into the motivations and are applicable for collecting information that is not published in the reports. However, the difficulty of reaching out to respondents and finding firms who participate is something we experienced in the Hungarian business environment.

3. Empirical research

In the following paragraphs, we introduce the chosen methodology: content analysis. We also shed light on some of the most important decision points in this type of research and present the preliminary results of our pilot research project carried out on a sample of premium publicly listed Hungarian firms.

3.1. Research aims and methodology

One of our research aims is to discover the reporting practices of sample firms and to know more about how they provide information to stakeholders about the impact of the pandemic on their operations. Another research aim is to gather enough information to elaborate a methodology for content analysis that could be used as the basis of future research. In order to do that, we need to acquire a list of the items of information most commonly disclosed by sample firms. This list can be later applied as a benchmark when we evaluate the reporting culture of firms in a wider sample. By examining the frequency of the disclosed items, we can assign scores to the reports in the sample that can serve as a descriptor of the intensity and quality of disclosure.

An alternative approach could be to apply methodology given in prior empirical research published in international literature (Table 1). In the case of COVID-related disclosure, an example of a method borrowed from international literature could be based on García-Sánchez et al. (2020, 6). The advantage of applying a methodology that had already been published provides some degree of opportunity to compare our results with those of other researchers. However, based on our experience (Kovács–Lippai-Makra, 2018, and Lippai-Makra et al. 2019), the process of human coding of annual statements is a very delicate one as there needs to be a common understanding of the items in the list to be searched for. A way to combine the advantages of both elaborating the researcher's own index and still relating to international literature is to select a methodology from a paper authored by other researchers, and ,after running the content analysis based on this method, invent a modified version that considers local circumstances, similarly to Deutsch and Pintér (2018).

Content analysis combined with a list (index) of items to look for provides a more formal output than case studies and offers an opportunity to run statistical tests on the results and to discover any explanatory variables that influence the disclosure practices related to the given topic (in this case the pandemic). The ultimate goal is to gain a better understanding of the motivating or explanatory factors behind Hungarian reporting culture.

An example of similar research is Irimuș (2020), where 2019 annual reports were used to analyze how firms choose to incorporate the coronavirus outbreak in their reporting process (on a sample of 30 entities from the FTSE100 index). The author chose the dependent variable as the references to the coronavirus pandemic in 2019 annual reports. The variable COVID was constructed by performing text analysis of the hand-collected 2019 annual reports. The author then applied a linear regression model and found that financial year influenced the Covid-19 disclosure, with companies publishing their annual reports after the date of 31 December 2019 having significantly more content added to the statements.

After considering the above options, we chose to count any references to COVID (‘COVID’, ‘coronavirus’ or ‘pandemic’) in the 2020 annual statements of the sample entities. We also determined the number of instances the pandemic was mentioned in the various parts of the statements to get a picture of the distribution of this kind of disclosure in different statements. The focus of this paper is to develop a research tool and to gain an understanding of the most commonly reported COVID-related issues within the sample. We do not aim to generalize the results at this point of the research, but rather consider this work as an important step of the process to evaluate larger samples in the future.

3.2. Sample and results

The reason for choosing premium category listed entities[1] for the sample of this pilot project is that based on earlier research, we know that these tend to communicate more – both in quantity and quality – with their stakeholders in their annual statements than non-listed firms, i.e. they are more engaged in voluntary reporting (Kovács Z. I. 2015). At this level of empirical research, our pilot test was carried out on a sample of 20 entities from the Budapest Stock Exchange for the accounting year 2020 to ensure that the most recently available sources of annual reports were processed. The sample includes firms from several sectors, including manufacturing and service-based companies as well as financial institutions.

The average occurrences of the terms we searched for can be seen in Table 1. The term “Covid” was mentioned on average 17 times per statement. However, there is great variance in the frequencies as the minimum is 3 and the maximum is 57. The term “Coronavirus” was mentioned on average 6 times per statement, the minimum being 0 and the maximum 26. The term “Pandemic” was mentioned on average 7 times per statement, the minimum being 0 and the maximum 51. In total, the three terms were mentioned on average 31 times per statement.

[1]Entities of the prime market are more liquid and have broader ownership structure according. Source: https://bse.hu/Products-and-Services/Equities-Section/Equities.

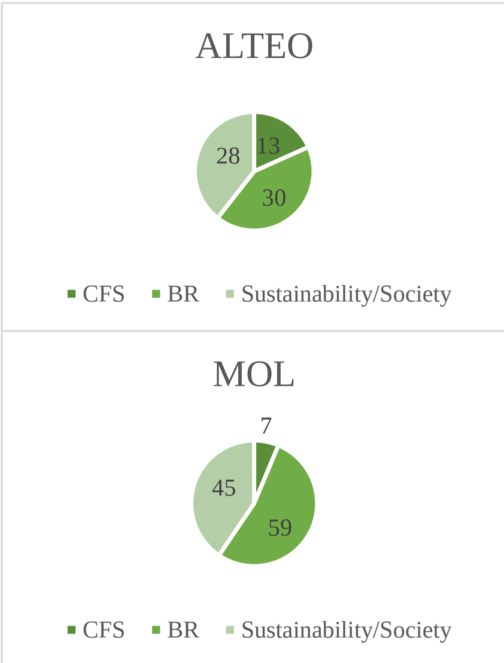
Table 1 Statistical data related to the disclosure of different COVID-related phrases

	Average	Min.	Max.	Median
Covid mentioned	17.25	3	57	11.5
Coronavirus mentioned	6.4	0	26	4.5
Pandemic mentioned	7.25	0	51	1.5
Total	30.9	5	111	22

Source: own construction

We also counted the instances that the above three COVID-related phrases appeared in the various sections of financial statements. In the sample, we have found two integrated statements, which contained the financial statements and different chapters for sustainability of society-related issues. These two statements ranked high in terms of the number of pandemic related disclosure items (111 and 71 in total, ranking 1st and 3rd place in the sample). The distribution of the disclosures within the parts of these integrated statements can be seen in Figures 3 and 4.

Figures 3–4 The distribution of the disclosures in IRs



Source: own construction

For the rest of the sample (18 entities who did not disclose integrated financial statements), we examined the distribution of the disclosure concerning the coronavirus. The average number of disclosures was 14 for the financial statements part and 10 for the business report sections (Table 2).

Table 2 Statistical data related to the disclosure in different sections

Sections of Reports	Average	Min	Max	Median
Financial Statements	14.11	5	55	11.50
Business Report	10.11	0	25	6.50
Total	24.22	5	80	21

Source: own construction

We can also see that there is a great variance in the disclosure scores since there is a large gap between minimums and maximums. In order to investigate the reason for these great differences, we would probably need to expand the statistics looking for variables that affect disclosure or employ qualitative research methods such as interviews.

Besides the above mentioned statistical data, it is worth mentioning which topics were typically addressed in the statements related to COVID. The following list provides the most common examples of the footprint of the pandemic in annual statements:

- global/industry environment, recession
- reactions to pandemic
- EBIT/EBITDA/CAPEX/revenue
- going concern
- rental contracts
- growing demand, inventory management
- supply chain, global movement of goods
- impairment and fair value estimations
- employee & customer safety
- testing of staff
- home office, traveling, road safety
- meetings, trainings, recruitment, events, marketing, trials online
- delay of plans, projects, maintenance
- donations.

What is more, some of the firms shed light on the positive side of adapting to this unique and difficult situation. An entity highlighted the decision to enter a new segment related to the pandemic and listed a series of impacts accordingly.

4. Conclusions and limitations

As we can see, the disclosure practices of Hungarian listed entities is quite heterogeneous, there are great differences in the extent of communication with the stakeholders. Some entities also grasp the advantages that derive from coping with the difficulties, which is in line with what is suggested in the literature.

Sample size is an underlying limitation of the research. In the future, additional results could be obtained by enlarging the sample which would make it possible to find variables (e.g. profitability, firm size, ownership structure) that might explain the differences in disclosure scores. Another way of continuing the research could be the application of other methods: qualitative research could definitely be useful for discovering the motivations and barriers behind the reporting culture.

Acknowledgments

This research was supported by the EU-funded Hungarian grant EFOP-3.6.1-16-2016-00008.

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