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# DISCLOSURE OF FINANCIAL INFORMATION DURING THE PANDEMIC: SECTORS ANALYSIS ON B3

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## ABSTRACT

This study assessed the relevant information disclosure to operational continuity in explanatory notes during the crisis caused by the COVID-19 pandemic, in light of the Disclosure Theory. The sample consisted of 39 companies listed on B3, belonging to the sectors of Agriculture and Cattle Raising, Clothing, Textiles and Accessories, and Electric Energy. The 2020 financial statements were analyzed, considering the length of the explanatory notes (number of words), readability (Flesch index) and compliance with the Brazilian Securities and Exchange Commission (CVM) recommendations, through content analysis. The results indicated that companies most negatively impacted by the crisis tend to disclose information in greater quantity, with greater readability and in compliance with legal requirements. These findings are in line with the disclosure theory, which postulates that companies evaluate the cost-benefit of disclosure considering the stakeholders' expectation regarding the information provided. In times of crisis, managers attribute greater usefulness and relevance to the information disclosed when companies are negatively affected.

**Keywords:** Explanatory Notes. Compliance. Readability. Size. COVID-19.

## DIVULGAÇÃO DE INFORMAÇÕES FINANCEIRAS DURANTE A PANDEMIA: ANÁLISE DE SETORES NA B3

## RESUMO

Esta pesquisa avaliou a evidenciação de informações relevantes à continuidade operacional em notas explicativas durante a crise causada pela pandemia da COVID-19, à luz da teoria da divulgação. A amostra consistiu em 39 empresas listadas na B3, pertencentes aos setores de Agropecuária e Agricultura, Vestuário, Tecidos e Acessórios, e Energia Elétrica. Foram analisadas as demonstrações

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financeiras de 2020, considerando o tamanho das notas explicativas (quantidade de palavras), a legibilidade (índice Flesch) e a conformidade às recomendações da Comissão de Valores Mobiliários (CVM), por meio de análise de conteúdo. Os resultados indicaram que as empresas mais negativamente impactadas pela crise tendem a divulgar informações em maior quantidade, com maior legibilidade e em conformidade com as exigências legais. Esses achados estão em consonância com a teoria da divulgação, que postula que as companhias avaliam o custo-benefício da divulgação considerando a expectativa dos stakeholders em relação às informações fornecidas. Em épocas de crise, os gestores atribuem maior utilidade e relevância às informações divulgadas quando as empresas são negativamente afetadas.

**Palavras-chave:** Notas Explicativas. Conformidade. Legibilidade. Tamanho. COVID-19.

## 1 INTRODUCTION

One of the main concerns of the International Accounting Standards Board (IASB), responsible for publishing and updating the International Financial Reporting Standards (IFRS), is the effectiveness of communication provided by financial statements, which serve as an information source for various market agents. According to the IASB, good communication contributes to more assertive decisions and can provide a reduction in the capital cost (IFRS Foundation, 2017). Communication by financial reports becomes ineffective when it does not achieve its primary objective, which is to be useful to users in the decision-making process. The conceptual framework for accounting information cites two fundamental qualitative characteristics to guarantee the usefulness of financial information: relevance and faithful representation. In order to be relevant, accounting information must have predictive and/or confirmatory value; to be reliable, it must be complete, neutral and free of errors (Accounting Pronouncements Committee, 2019).

According to Disclosure Theory, in the business world there are two agents: those who offer and those who demand information. Between these two agents there is a natural asymmetry of information, as the first has greater access to internal data. In this sense, the higher the level of disclosure, the lower the asymmetry between agents (Ferreira et al., 2021).

Ferreira et al. (2021) highlight that when there is an effort on the part of the company to obtain data from different sectors, the information generated becomes reliable, including for internal decisions. Furthermore, the benefits generated from external disclosure may include increasing share liquidity, reducing the cost of capital and maximizing the company's value.

In this context are the Explanatory Notes (EN), which are part of the complete set of financial statements and must present: the preparation bases, the accounting policies used in the disclosure process and any other relevant information so that the user can understand the reality of the entity (IFRS Foundation, 2021). Unlike other financial statements, explanatory notes present a greater level of discretion, that is, judgment on the part of the information preparer

(Ferreira, Miranda & Santos, 2021). Thus, explanatory notes are tools that aim to improve the information communication process.

Considering the crisis generated by the COVID-19 pandemic, studying the usefulness of explanatory notes in the communication process and the motivations for what is disclosed or omitted becomes even more important, as the uncertainties caused by the pandemic may have generated changes in the preparation of financial statements (Sobreira, Silva, Garcia & Teodósio, 2021).

Previous studies indicate that the disclosure of explanatory notes may present weaknesses that affect the quality of accounting information, such as: low readability (Inger, Meckfessel, Zhou, Fan, 2018; Salehi, Bayaz, Mohammadi, Adibian & Fahimifard, 2020; Jang & Rho, 2014; Holtz & Santos, 2020; Telles & Salotti, 2021); lack of relevant information (Liu, 2021; Dalkilic & Limoncuoglu, 2011; Telles & Salotti, 2015, Nakao & Oliveira; Nardi, 2017); excessive information (Castro, Leôncio, Silva, Domingos & Ponte, 2019; Pinheiro, Iudícibus, Salotti & Galegale, 2017; Karim & Sakar, 2019; Abernathy, Guo, Kubick, & Masli, 2019) and excerpts copied from standards (Silva, Castro, Domingos & Ponte, 2020; Ruberto & Alves, 2015).

In Brazil, regulatory bodies such as the Comissão de Valores Mobiliários (CVM) also interfere in disclosure processes. CVM letter no. 02/2020, for example, highlighted the importance of companies presenting the main risks and uncertainties related to the COVID-19 pandemic, mainly regarding economic events that could impact the operational continuity of business, such as recoverability of assets, measurement of fair value, contingencies accruals, revenue recognition and accruals for expected losses.

However, it is known that disclosures in explanatory notes are subject to the managers' discretion, who assess which information should be disclosed and which should be withheld, according to the expectations of external users and the impacts of this information on the evaluations that these users make of the company. company (Verrecchia, 2001). In this sense, due to the importance of explanatory notes in the communication process, especially in the period of crisis generated by the COVID-19 pandemic, this study sought to answer the following research question: how can information regarding economic events, which can impact the continuity operating business, were they evidenced in the Explanatory Notes of companies opened during the COVID-19 pandemic period? In this sense, the general objective was to evaluate the disclosure of information relevant to operational continuity in explications notes during the crisis caused by the COVID-19 pandemic, in light of the Disclosure Theory.

In order to achieve this purpose, three sectors of the economy were analyzed, representing companies that had growth, stability and decrease in investment return rates between 2019 and 2020. Aspects relating to compliance, readability, and size of the explanatory notes released were analyzed, and based on the assumptions of the Disclosure Theory.

The motivation for this study arises from the need to evaluate the usefulness of explanatory notes in communication between market agents, considering the challenges related to this type of disclosure in times of crisis. The Covid-19 pandemic generated many uncertainties, so managers' behavior regarding the

level of disclosure may have changed. At these times, companies tend to adopt defensive strategies, such as reducing costs and budgets and postponing investments (Karaibrahimoglu, 2010; Mesquita, Bonfim, Soares & Silva 2022).

Considering possible effects of economic events on the operational continuity of companies, additional information may be required by users. The aim of this study is to contribute to users of accounting information who depend on the information provided in explanatory notes to make decisions, helping them to identify weaknesses in the information preparation process.

## **2 DISCLOSURE THEORY**

The disclosure theory, advocated by Verrecchia (2001), addresses mandatory and voluntary disclosure, defining three distinct approaches for studies that intend to analyze the determinants of disclosure: association, discretion (judgment) and efficiency.

Salotti and Yamamoto (2005), based on the Verrecchia's (2001) work, discuss the dissemination models developed by the author. The association approach is applied in studies that evaluate the effects of disclosure on investor behavior, generally considering variables such as asset prices and traded volume.

Discretionary or judgment is used in studies that aim to analyze the behavior of managers in relation to the disclosure of information. According to this approach, the level of disclosure is determined by the manager, who decides what to disclose or withhold, considering the expectations of stakeholders and the effects on the capital market (Verrecchia, 2001). Although much information presented in the financial statements is mandatory, others, which are additional and important for analyzing the company's future prospects, are subject to managers' judgment. Verrecchia (2001) questions whether in this scenario, the manager would disclose relevant information or not.

The efficiency approach differs from the previous ones mainly due to the timing of the disclosure. While association and judgment are considered *ex post*, evaluating the effects of disclosure that have already occurred; efficiency is considered *ex ante*, discussing more efficient forms of dissemination (Verrecchia, 2001; Salotti & Yamamoto, 2005).

Efficiency is related to the information asymmetry that generates a cost of capital for the company. In order to reduce this cost, the company should focus on a complete disclosure model. However, such a model is not feasible, as some information is strategic and private. Thus, the efficiency approach proposes a level of full disclosure that balances the reduction of information asymmetry and the losses associated with the disclosure of private information (Verrecchia, 2001; Salotti & Yamamoto, 2005).

These approaches are part of the disclosure theory developed by Verrecchia (2001), which attempts to create a comprehensive theoretical model for different types of studies. According to the author, there is no single consolidated model, and each approach represents a part of the "enigma" of disclosure.

In the context of the Explanatory Notes (EN), even in the case of mandatory disclosure, the manager's judgment on the best form of disclosure is present (Ferreira et al., 2021). Therefore, the judgment approach founded by Verrecchia (2001) is suitable to support studies on this topic.

Several studies analyzed explanatory notes based on disclosure theory, such as Silva, Machado and Hein (2013), Telles and Salotti (2015) and Santos, Calixto and Bispo (2019). Silva et al. (2013), evaluated the level of disclosure related to the nature and risk disclosed in the explanatory notes of companies in the industrial production sector listed on the Brazilian stock exchange in 2010. They concluded that qualitative information about financial instruments predominates in explanatory notes, and that some aspects of the standard were not completely met.

Telles and Salotti (2015) analyzed the explanatory notes before and after the adoption of IFRS, identifying whether there was progress in the disclosure of information related to the depreciation of fixed assets. The study, through content analysis, analyzed the financial statements of 74 publicly traded companies listed on the Brazilian stock exchange, considering the period from 2006 to 2012. The study identified relevant changes in the disclosure of information regarding the depreciation of fixed assets, highlighting that some aspects required by the standard have not yet been met, in line with the discretionary approach of the Disclosure Theory.

Santos et al. (2019) analyzed the effects of OCPC 07 on reducing the size of explanatory notes in companies in the non-financial sector, listed on B3 between 2010 and 2015. They identified a discrete reduction in the size of explanatory notes and in the readability levels after the issuance of the OCPC 07. Comparing Brazilian disclosures with British ones, they concluded that Brazilian ones are still 40% larger, and that the higher the level of governance, the greater the size of the disclosure.

The studies by Silva et al. (2013), Telles and Salotti (2015) and Santos et al. (2019) sought to evaluate the behavior of managers when preparing explanatory notes, considering new guidelines or adoption of standards. In general, they identified the effects of standards and guidelines on the disclosure process, but with limitations, leaving the company to choose to disclose information whose mission could negatively impact the market. The issuance of new standards can create expectations for stakeholders, who expect that certain information is disclosed, in a way that non-disclosure could be interpreted negatively.

The main weaknesses in the disclosure of explanatory notes present in the literature refer to the following aspects:

- Size: excess of information (Santos et al., 2019; Gomes et al., 2019);
- Readability: high level of complexity of accounting information (Silva et al., 2020; Telles & Salotti, 2021; Holtz & Santos, 2020);
- Compliance: lack of relevant information (Nakao et al., 2017);
- Similarity: excerpts copied from standards (Silva et al., 2020b; Silva et al., 2018).

In view of the above, this study aims to evaluate how economic events that could impact the operational continuity of businesses were disclosed, considering the period of intense uncertainty caused by the COVID-19 pandemic

(Karaibrahimoglu, 2010; Mesquita, Bonfim, Soares & Silva, 2022 ). Based on letter No. 02/2020 issued by the CVM and from the perspective of the Disclosure Theory, specifically in terms of discretion, weaknesses related to size, readability and compliance in the explanatory notes investigated are assessed.

### **3 METHODOLOGICAL ASPECTS**

This study is classified as descriptive research, since the general objective is to evaluate the disclosure of information relevant to operational continuity in explanatory notes during the crisis caused by the COVID-19 pandemic. In other words, the facts are analyzed and interpreted without interference from the researcher (Andrade, 2008).

The object of study are the explanatory notes disclosed in the annual financial statements of Brazilian companies listed on B3, selected for this study. The explanatory notes from 2020 were analyzed, a period in which the CVM issued a letter reinforcing the need for detailed information regarding COVID-19. The information necessary for this study was extracted from the Standardized Financial Statements (DFP), obtained from the B3 website.

#### **3.1 Sample Selection**

The sample is made up of companies from the Agriculture, Electricity and Clothing, Fabrics and Accessories sectors, which were selected by evaluating the following aspects: variation in ROCE and revenue between 2019 and 2020 and the number of companies per sector.

The Agriculture and Cattle raising sector was selected due to the greatest variations in ROCE (relation between broad operating income and total investment) between 2019 and 2020 (81% growth in the sectoral index) and the high growth rates in revenue in the same period (Assaf Institute, 2023). This sector, classified as non-cyclical consumption in B3, tends to be less affected by macroeconomic factors, as it produces essential goods such as food, beverages and cleaning materials (Pandini; Stüpp; Fabre, 2018). During the pandemic, the sector showed improvements in performance, with an increase in production volume and sales prices (Oliveira Filho, 2021).

The Electric Energy sector was chosen due to its stability in ROCE (2% growth in the sectoral index, compared to inflation of 4.52% in 2020) and the largest number of companies suitable for analysis (Instituto Assaf, 2023). This sector is made up of companies and public institutions that provide fundamental services for the country's quality of life and economic growth. During the pandemic, the sector was affected by the energy crisis, leading the government to create support measures, such as Conta-Covid, a special loan line regulated by ANEEL to avoid tariff adjustments and provide greater liquidity (Ministry of Mines and Energy, 2021).

The Clothing, Fabrics and Accessories sector was one of the sectors most affected by the pandemic in 2020, presenting an average drop of 82% in ROCE (Instituto Assaf, 2023), substantial drops in revenue, and a large number of companies able to participate in the search. This sector, classified as cyclical

consumption in B3, is highly sensitive to changes in the population's income (Pandini et al., 2018).

The Table 1 presents the companies that make up the respective sectors, according to the classification proposed by the Assaf Institute (2023).

**Table 1**

List of companies in the selected sectors

Agriculture and Castle Raising	Electric Energy	Clothing, Fabrics and Accessories
1) Agrogalaxy Participações S.A;	1) Alupar investimento S.A;	1) Arezzo Indústria e Comércio S.A;
2) SLC Agrícola S.A;	2) Centrais Elétricas Brasileiras;	2) C&A Modas S.A;
3) Terra Santa Prosperidades Agrícolas S.A;	3) Centrais Elétricas de Santa Catarina;	3) Cia Fiação Tecidos Cedro Cachoeira;
4) Terra Santa Prosperidades Agrícolas S.A;	4) CESP – Cia Energética de São Paulo;	4) Cia Hering;
5) Vittia Fertilizantes e Biológicos S.A	5) Cia Energética de Brasília;	5) Cia Norte de Minas Coteminas;
	6) Cia Energética de Minas Gerais – CEMIG;	6) Cia Tecidos Santanense;
	7) Cia Paranaense de energia – COPEL;	7) Grazziontin S.A;
	8) CPFL Energia S.A;	8) Grupo de Moda Soma S.A;
	9) CTEEP – Cia Transm. Energia Elétrica Paulista;	9) Grupo SBF S.A;
	10) EDP Energias do Brasil S.A;	10) Guararapes Confecções S.A;
	11) EMAE – Empresa Metr. Água Energia S.A;	11) Lojas Renner;
	12) ENEVA S.A;	12) Marisa Lojas S.A;
	13) Engie Brasil Energia S.A;	13) Springs Global Participações S.A
	14) Equatorial Energia S.A;	14) Technos S.A;
	15) Light S.A;	15) Track Fild CO S.A;
	16) Neoenergia S.A;	16) Vivara Participações S.A
	17) Rede Energia Participações S.A;	
	18) Rio Parapanema Energia S.A;	

Source: Prepared by the authors based on data released by the Assaf Institute.

### 3.2 Data Collection and Analysis

In order to achieve the general objective of the research, information published in the explanatory notes of the 2020 DFP was collected on the effects of

the COVID-19 pandemic. Three analyzes were carried out, focused on: size, readability and compliance of the explanatory notes.

### 3.2.1 Size analysis

The size of the explanatory notes is an indicator of excess information that can harm the quality of the information, according to OCPC 07. Studies indicate that excess information in explanatory notes can overshadow the company's performance (Karim and Sakar, 2019; Abernathy et al., 2019).

In this study, the size of specific explanatory notes about COVID-19 in 2020 was measured by the number of words using Wordcount360. The Mann-Whitney non-parametric test was applied to evaluate statistical differences among sectors, due to the absence of normal distribution in the data.

### 3.2.2 Readability analysis

Readability is fundamental to the usefulness of information. The most used methods to measure readability are the Flesch Index and the Gunning Fog Index (Telles & Salotti, 2021).

The Gunning Fog Index is a method that consists of evaluating the number of complex words in a text and the length of sentences, a method widely used by writers who prefer to choose more readable words and shorter periods (Gunning, 1969). The method was applied by Inger et al. (2018) and Salehi et al. (2020) to analyze EN. According to the authors, the low readability rate of some explanatory notes may be related to the company's performance, lower audit fees and even reduced delays in reporting.

As for the Flesch method, the metric is calculated based on the number of syllables and the number of words, the result obtained is evaluated following a difficulty table (Moreno & Casasola, 2016). This method was adapted to the Portuguese language by Martins, Ghiraldelo, Nunes & Oliveira Junior (1996), which is why it is adopted in this study. The adaptation resulted in equation 1:

$$FLF = 248.835 - (84.6 * ASL) - (1.015 * ASW) \quad \text{Equation 1}$$

Where:

FLF = Measure of reading ease measured by the Flesch index;

ASL = Average number of syllables per word;

ASW = Average number of words per sentence.

The Flesch index adapted to Portuguese was widely used by Brazilian researchers (Telles & Salotti, 2021; Holtz & Santos, 2020; Borges & Rech, 2019; Silva, Ponte, De Luca, Santos e Domingos, 2018; Gomes, Ferreira & Martins, 2019; Batalha, Souza & Calegari, 2013; Jang & Rho, 2014). According to Borges and Rech (2019), some of the determinants of the readability of explanatory notes are variables, such as the size of the company, level of operational complexity, size of



the report, time the company has been listed on the stock exchange, type of corporate governance and whether or not the external audit company is “big four”.

Although useful, the methods for measuring the level of readability have limitations, as the formulas were created to measure the difficulty of common texts. According to Hendriksen and Van Breda (1999), explanatory notes are considered technical texts. Therefore, users of financial information are expected to have a level of knowledge sufficient to understand technical information.

In order to obtain information for calculating the Flesch index, the WordCounter360 tool was used, with which the number of words and sentences existing in the specific explanatory note that dealt with the effects of COVID-19 on the financial statements was measured. Then, the Separarensilabas tool was used to obtain the number of syllables. Thus, it was possible to apply the formula adapted to Portuguese proposed by Martins et al. (1996). Table 2 below presents the classifications of reading difficulty levels, considering the Flesch index score.

**Table 2**

Reading Difficulty Classification Levels according to the Flesch Index adapted for Portuguese

Score FLF	Classification
100-75	Very easy
75-50	Easy
50-25	Difficult
25-0	Very Difficult

Source: Prepared by the authors based on Martins et al. (1996).

The readability level measurement was applied to obtain the level of difficulty in reading the specific explanatory notes on the effects of COVID-19 in the financial statements. The main results are related to the comparison of the level of difficulty between the sectors analyzed. To assess whether there was a significant relation between the level of readability (Flesh index) and return on investment (ROCE), the Spearman correlation test was used. This is a non-parametric test, considering that the data did not present a normal distribution.

### 3.2.3 Conformity analysis

The compliance of the information disclosed was assessed in relation to CVM letter no. 02/2020, using the content analysis proposed by Bardin (2016). This method includes the steps of data organization, coding, categorization, inference and data computerization.

Data organization involves the stages of pre-analysis, exploration of the material and treatment and interpretation of results. During pre-analysis, initial ideas must be systematized precisely. At this stage, the documents analyzed, the objectives and the base indicators for the final conclusion must be determined (Bardin, 2016). For this study, the analysis documents are the DFP of the selected companies.

The process of exploring the material occurs at the moment the information is encoded. At this stage, Bardin (2016) suggests that the selections, rules for

enumeration and categories be determined. For this study, the explanatory notes that specifically dealt with the effects of COVID-19, prepared by companies with the aim of meeting CVM requirements, as highlighted in letter no. 02/2020, were analyzed. As for the enumeration, this was carried out considering the presence or absence of certain information according to pre-determined categories. According to Bardin (2016), a quantitative content analysis approach is based on the frequency in which certain elements are identified throughout a text, but the assessment of presence or absence is considered a non-frequency indicator, which can be considered an index as or even more useful than a quantitative indicator.

Categorization is the process in which elements are classified into different sets, considering pre-established criteria. This process involves two stages, the inventory, when the elements are isolated and then the classification. The categories determined for this study consider the points of attention highlighted by the CVM in letter no. 02/2020, as follows: recoverability of assets, measurement of fair value, contingencies accruals contingencies, revenue recognition and accruals for expected loss.

Inference is related to the elements present in the communication process, the message, the channel, the sender and the receiver. In the case of the financial statements of companies listed on B3, the message is related to an entity's economic and financial information, disclosed by B3 (this being one of the communication channels). The sender is the company itself, responsible for preparing the information and the receiver is those interested in the information (investors, banks, customers, suppliers, etc.).

For the content analysis technique, computer resources can be used to process texts in the process of categorizing information and for data analysis, making use of statistical resources (Bardin, 2016). For this study, Excell spreadsheets were used to tabulate the information present in the EN, which deal with the effects of COVID-19, they were segregated and classified into the proposed categories. This process depends on careful reading, so that all elements are captured and classified appropriately.

Thus, for the final interpretation of the data, the indicator considered was the disclosure or absence of information related to the items mentioned by the CVM. It is worth highlighting that materiality, according to CPC 00, is an aspect of relevance used to determine, based on the nature or magnitude, information whose omission or distortion could affect the decision of the main users of financial information.

The Table 3 presents the checklist prepared based on CVM letter no. 02/2020 to assess differences between the three groups of companies in relation to disclosures in accordance with the information requested by the CVM.

**Table 3**

Checklist of Disclosure Items Established in CVM letter no. 02/2020

- |    |  |
|----|--|
| 1) | Has a specific explanatory note been prepared for the purposes of COVID in the financial statements? |
| 2) | Is there disclosure regarding the recoverability of assets?  |

- 3) Is there disclosure about fair value measurement?
- 4) Is there disclosure regarding assets and liabilities accruals and contingencies?
- 5) Is there disclosure about revenue recognition?
- 6) Is there disclosure about accruals for expected losses?

Source: Prepared by the authors.

Binary compliance analysis (meets/does not meet) was used and frequency analysis was carried out to assess companies' compliance.

## 4 RESULTS

The following results refer to the disclosure of economic events that could impact the operational continuity of companies during the COVID-19 pandemic. The analyzes are carried out in light of the Disclosure Theory, considering the aspects of compliance, readability and size of the explanatory notes of the companies investigated.

### 4.1 Size analysis

The first analysis deals with the size of explanatory notes about COVID-19. Table 4 presents the descriptive statistics of the number of words in the aforementioned explanatory notes.

**Table 4**  
Descriptive Statistics Regarding the Number of Words in the COVID-19 Note

Sector	n	Minimum	Maximum	Average	Median
Agriculture and Cattle Raising	4	0	659	241	152,5
Clothing, Fabrics and Accessories	16	0	1.637	713,1	704
Electricity Energy	19	0	3.255	1.098	890

Source: Prepared by the authors.

It is important to highlight at first that the Electricity sector had the highest median (890 words), followed by the Clothing, Fabrics and Accessories sector (704) words. Between these two sectors, no significant differences were found in the size of the explanatory notes ( $p$ -value = 0.257), as shown in Table 5.

The Agriculture and Cattle Raising sector, which showed growth in ROCE in the period under analysis, was the one with the lowest median (152.5) words, with statistically significant differences for the others. The Mann-Whitney test revealed that this sector has a lower median than the Electricity sector ( $p$ -value = 0.044) at the level of 5%, and also the Clothing, Fabrics and Accessories sector ( $p$ -value = 0.039) also at the level of 5 %. In other words, in the Agriculture and Cattle Raising sector, companies published smaller explanatory notes regarding the effects of COVID-19.

**Table 5**

Mann-Whitney Test - Comparison of Sector Medians

Comparison	U-Value	P-Value	Significance
Agriculture and Cattle Raising x Electricity Energy	13.00	0.044	Significant
Agriculture and Cattle Raising x Clothing, Fabrics and Accessories	10.50	0.039	Significant
Clothing, Fabrics and Accessories x Electricity Energy	117.0	0.257	Not Significant

Source: Prepared by the authors.

These results are in line with Disclosure Theory, suggesting that companies with positive performance can opt for more succinct disclosures, considering the cost-benefit of the information. On the other hand, previous studies indicate that higher explanatory notes can be seen negatively, associated with an excess of information (Karim & Sakar, 2019; Abernathy et al., 2019).

## 4.2 Readability analysis

The readability of the explanatory notes was assessed using the Flesch index, as proposed by Martins et al. (1996). Table 6 shows that 62% of the explanatory notes were classified as "very difficult" to read.

**Table 6**

Sectoral Readability Level of Explanatory Notes – Flesch Index

Readability	Agriculture and Cattle Raising		Electricity Energy		Clothing, Fabrics and Accessories		Total	
Easy	0	0%	1	5%	1	6%	2	5%
Difficult	0	0%	3	16%	5	31%	8	20%
Very difficult	2	50%	13	68%	9	56%	24	62%
Without explanatory note	2	50%	2	11%	1	6%	5	13%
Total	4	100%	19	100%	16	100%	39	100%

Source: Prepared by the authors.

It can be seen that the sector that presented the lowest readability was the Agriculture and Cattle Raising sector, since 50% of the companies did not publish specific explanatory notes about COVID-19 and the others (50%) were classified as "very difficult" explanatory notes. Next comes the Electric Energy sector, in which 11% of companies did not publish explanatory notes about COVID-19 and 68% were classified as very difficult. Finally, the Clothing, Fabrics and Accessories sector presented 6% of the sample without any explanatory note and 56% classified as very difficult to read. This result indicates an inverse trend between readability and profitability, with the sectors most negatively impacted by the pandemic making greater efforts to disseminate clear information about their economic situation.

### 4.3 Compliance analysis

The compliance analysis of the DFP of companies in the Agriculture, Clothing, Fabrics and Accessories, and Electricity sectors reveals the following results presented in Table 7.

**Table 7**

List of Items Disclosed about the Effect of COVID-19 on the Financial Statements

Items	Agriculture and Cattle Raising		Clothing, Fabrics and Accessories		Electricity Energy	
Has a specific explanatory note been prepared for the effects of COVID-19?	2	50%	15	94%	17	89%
Is there disclosure regarding the recoverability of assets?	2	50%	12	75%	8	47%
Is there disclosure about fair value measurement?	1	25%	3	19%	3	16%
Is there disclosure about accruals and contingencies?	0	0%	2	13%	0	0%
Is there disclosure about revenue recognition?	2	50%	2	13%	7	37%
Is there disclosure about accruals for expected losses?	2	50%	9	56%	12	63%
Total companies analyzed	4	100%	16	100%	19	100%

Source: Prepared by the authors.

#### 4.3.1 Agriculture and Cattle Raising Sector

The Agriculture and Cattle Raising sector, representing the group of companies that showed positive performance during the crisis period generated by COVID-19, has a total of 4 companies, according to the sectoral classification of the Assaf Institute. Only 2 (50%) of them prepared an exclusive explanatory note to meet CVM requirements. It is important to highlight that the preparation of an exclusive explanatory note was not a requirement of the CVM.

In cases where companies prepared a specific explanatory note to meet the CVM's request, issues relating to asset recoverability analysis, impairment tests, impacts on fiscal year revenue and margins, increased risk of losses on financial assets were addressed. and measurement of fair value.

As it belongs to the group of non-cyclical consumption companies, characterized by the production of essential products, it was expected that the Agriculture and Cattle Raising sector would not be negatively affected. This behavior was highlighted in the DFPs. Agrogalaxy Participações S.A., for example, mentions in a specific explanatory note about COVID-19 that "Brazilian agriculture was a less affected sector, since it was considered an essential activity and the population needs to feed, even in the face of unemployment and reduced of income."

As the CVM did not determine a standard for disclosure about the effects of COVID-19, all other explanatory notes were analyzed, with the aim of verifying other information throughout the DFP. Among the companies that did not prepare

a specific explanatory note to address the effects of COVID-19 in the financial statements, one of them, Vittia Fertilizandos e Biológicas S.A., briefly mentioned in the operational context that the company was not seriously affected by the crisis, as the other companies did not mention any information related to the pandemic.

The performance of the Agriculture and Cattle Raising sector shows that in addition to companies not being seriously affected by the crisis, there was an improvement in results for the period analyzed, which was observed when comparing the ROCE of 2019 versus 2020, which ranged from 7.68% to 13.88%, corroborating what was mentioned by Schneider et al. (2020).

Despite the improvement in the sector's performance, considering a context of crisis generated by COVID-19, which led the CVM to request additional information, the non-disclosure of the company's actions to guarantee the amounts recorded in the representative lines for the sector can be characterized as non-compliance.

For the four companies analyzed, only two detailed the analyzes carried out, only to conclude that no relevant aspects of COVID-19 were identified in the financial statements and operational continuity of the business. As for the other companies, it is understood that not enough information was presented to provide security to the user of accounting information regarding the procedures applied in times of crisis. These results are in line with the judgment aspect of the Disclosure Theory, since despite CVM letter no. 02/20, the manager decides what to disclose. Considering that during the pandemic period generated by COVID-19 the company showed an improvement in performance, he decides not to disclose it.

#### **4.3.2 Electricity Sector**

The Electric Energy sector showed little variation in ROCE, growth of 2% (Table 2), therefore with regard to its operational performance, it is considered that the sector remained stable during the critical period of crisis generated by the COVID-19 pandemic. As shown in Table 7, of the 19 companies classified in this sector, according to information from the Assaf Institute, 17 chose to highlight information about the effects of COVID-19 in the financial statements, in a specific explanatory note about the subject. Among the topics covered by the sector most frequently are accruals for expected losses (63%) and Asset Recoverability (47%).

Regarding the evidence about the effects of the pandemic on accruals for expected losses, companies such as CESP (Cia Energética de São Paulo) and COPEL (Cia Paranaense de Energia) highlighted that in the midst of the crisis, a relevant risk for companies and their subsidiaries was related to customer default.

Explanatory notes were also used as a means of informing the measures taken by companies to mitigate this risk. COPEL, CEMIG (Cia Energética de Minas Gerais), EDP Energias do Brasil S.A. reported that they took measures to make charges more flexible. CTEEP (Cia Transmissão Energia Elétrica Paulista) showed that the government's actions were effective and, therefore, there was no relevant variation in default rates.

With regard to the constitution of accruals, some companies highlighted in explanatory notes the need for an increase, due to the COVID-19 pandemic, as is

the case of Equatorial Energia S.A. and Neoenergia S.A., which highlighted that there was an increase in overdue notes receivable, while Light S.A. attributed the increase in overdue notes to the suspension of electricity cuts by concessionaires. Companies such as Rio Paranaapanema S.A, Engie Brasil Energia S.A., ENEVA S.A., CTEEP, COPEL and CESP reported that the measures taken by the companies and the government were sufficient and, therefore, there were no relevant variations in default levels, and it was not necessary make an increase in the accruals for expected losses in the period.

The other recurring theme in the explanatory notes of companies in the Electric Energy sector, related to COVID-19, was the recoverability of assets. COPEL highlighted the need to make adjustments due to the reduction in demand for energy in the country, which impacted its cash flow. However, other companies, such as CEMIG, ENEVA S.A., Engie Brasil Energia S.A. and Rede Energia Participações, showed that the analyzes were carried out, but no adjustment was necessary, as the values attributed to the assets already represented reality at that time.

It is clear that companies, despite belonging to the same sector, can identify different needs in relation to the recognition or not of accounting adjustments related to the impacts caused by the crisis, which reinforces the need for detailed disclosure about which assessments were carried out and the conclusions of management. In this sense, the importance of explanatory notes in representing reality is noted, as they enable the disclosure of complementary and relevant information.

The Electric Energy sector showed stability in its operational performance during the period of crisis generated by the COVID-19 pandemic, mainly due to government actions. According to information from the Ministry of Mines and Energy (2021), the Conta-Covid credit line was essential for maintaining the companies' operations, guaranteeing the necessary liquidity that allowed collection flexibility measures and, therefore, the reduction of the level of default.

The aspects mentioned above may have influenced the wide disclosure about the effects of COVID-19 in a sector that presented stable ROCE in the period. In line with the Disclosure Theory, the sector chose to present information in detail, considering that stakeholders expected to receive this information, given the crisis scenario and the expected effects on the sector.

Despite the size of the explanatory notes released by the Electric Energy sector, of the nineteen companies, six did not disclose information on the effect of COVID-19 on the financial statements and eleven did not disclose details on the asset recoverability analysis, relevant information considering the representativeness of the fixed assets for the sector. Therefore, these cases can be characterized as non-compliance with CVM letter no. 02/2020, as relevant information was not disclosed.

#### **4.3.2 Clothing, Fabrics and Accessories Sector**

The Clothing, Fabrics and Accessories sector showed a relevant reduction in ROCE from 2019 to 2020, a drop of 82%, which may justify the size of the

explanatory notes disclosed on the effects of COVID-19 in the financial statements, according to the Disclosure Theory. In other words, considering the sector's performance in a crisis scenario and the request for detailed information from a regulatory body, in this case the CVM, there is an increased expectation from stakeholders to obtain more details about aspects that may involve operational continuity of the company. At this time, the manager, at his discretion, evaluates the effect of not disclosing this information and chooses to disclose it.

Of the total of sixteen companies, 15 (94%) were concerned with preparing an exclusive explanatory note to address the subject. Of the information mentioned by the CVM that could represent operational continuity risk for companies, sector analyzes focused mainly on the recoverability of assets (75%) and accruals for expected losses (56%).

In the Clothing, Fabrics and Accessories sector, there are some common objects of analysis, related to the company's own operation in times of crisis, which may represent a relevant risk for the sector. As is the case with inventory assessment, tax recoverability, impairment testing and accounts receivable.

According to CPC 01, the reduction in the recoverable value of assets is due when the amount recorded in accounting is greater than the amount that would be recovered with the sale of the asset. In the case of the Clothing, Fabrics and Accessories sector, restrictive measures that led to a reduction in the level of sales could indicate a possible deterioration of inventories, difficulty in realizing deferred assets in the short term and a reduction in the value of fixed and intangible assets.

Regarding the assessment of inventories, specific information about the tests carried out to analyze the need or not to reduce the value of assets was widely disseminated by companies in the sector. Companies such as Arezzo Indústria e Comércio S.A., C&A Modas, CIA Hering, Grupo SBF S.A., among others, presented in a specific explanatory note about the effects of COVID-19, measures adopted to ensure that the stock was valued correctly. They highlighted that there was no need to change policies or recognize new accruals. The explanatory note released by Arezzo Indústria e Comércio S.A., for example, highlights that measures such as the anticipation of ending the supply of new products and promotional actions to sell goods avoided the need for accruals in this line of the financial statement. C&A Modas highlighted that the products in stock are basic and non-perishable. CIA Hering disclosed that, following the policy of not carrying stocks below cost, it reinforces the argument that an accrual would not be necessary.

Information about tax recoverability analyzes was disclosed in explanatory notes from companies such as C&A Modas S.A., Grupo SBF S.A., Guararapes Confecções S.A. and Marisa Lojas S.A., of which only C&A Modas identified the need to adjust some realization projections, but without making new accruals.

Regarding impairment tests, it was observed that details about the actions taken by the companies were highlighted in explanatory notes. C&A Modas S.A. reported that, when reevaluating the cash flows of the company's cash generating units (CGU), the need to adjust the value of assets was not identified, given that in the second half of 2020 there was an increase in volume sales, so that a positive performance was also expected for the following periods.



Companies such as Track Field Co S.A. and Lojas Renner also showed that the assumptions were revisited, but without the need to recognize new accruals. CIA Hering announced that, after reviewing the impairment test assumptions, it was necessary to recognize an accrual for loss of fixed assets, due to the closure of a production line.

It can be seen that, given the context of the Clothing, Fabrics and Accessories sector, this information has become even more relevant in a time of crisis, as it is in the interest of the external user to obtain detailed information on how the assets were valued, if there was a change in assumptions and whether it was necessary to recognize new accruals. Thus, it is possible to reduce the asymmetry between those who disclose and those who receive information, so that the company can provide more security to its stakeholders regarding the real value of its assets.

Another aspect highlighted in explanatory notes about the effects of COVID-19 on the financial statements, with the potential to affect the continuity of companies, is the possibility of not realizing their receivables. Arezzo Indústria e Comércio S.A. showed that "the administration did analyze the potential risk related to the default of its customers in the face of this challenging and unprecedented scenario...", according to Grupo Technos S.A., because of the pandemic "... the Group on March 31, 2020 analyzed the risk of default and concluded on the need to aggravate the expectation of expected loss."

It is worth highlighting that the explanatory notes were also used with the aim of justifying the non-recognition of new accruals, as it is the case of Grupo Soma Moda S.A., which highlighted the following: "On December 31, 2020, no accruals were recorded for losses on accounts receivable arising from COVID-19 due to the recovery in sales throughout the 3rd and 4th quarters." Thus, we can see the importance of qualitative information presented in explanatory notes, as a complement to the financial statements, which helps in understanding the numbers presented.

Regarding the level of conformity of the explanatory notes, it is important to highlight that the failure to present certain information does not mean a lack of conformity; it is necessary, in line with what is requested by OCPC 07, to also assess the relevance of the information.

It is clear that the Clothing, Fabrics and Accessories sector disclosed detailed information about the effects of COVID-19 in the 2020 financial statements, mainly considering aspects related to the recoverability of assets and accruals for doubtful debts, covering representative balances according to vertical analysis of the balance sheet consolidated in the sector. The results are in line with the Disclosure Theory, so that the omission of this information could be interpreted negatively by stakeholders.

The results of the conformity analysis confirm the trends found in the analyzes regarding the size and readability of the explanatory notes. In other words, the companies most negatively affected by the pandemic crisis disclosed a greater amount of information in explanatory notes, with a higher level of readability and seeking to meet CVM requirements, even partially.

## 5 CONCLUSION

The objective of this study was to evaluate the disclosure of information relevant to operational continuity in explanatory notes during the crisis caused by the COVID-19 pandemic. To this end, the Standardized Financial Statements (DFP) closed in 2020 were analyzed, a critical moment in which companies felt the impacts of the pandemic. The study compared sectors that were impacted in different ways, considering the variation in return on capital employed (ROCE) between 2019 and 2020, the variation in revenue and the number of companies per sector. The sectors analyzed were Agriculture and Cattle Raising, which showed an increase in its operational performance; Clothing, Fabrics and Accessories, which showed a reduction in operational performance; and Electricity, which remained stable during the period.

The Electricity and Clothing, Fabrics and Accessories sectors were significantly affected by the crisis generated by COVID-19. However, the Electricity sector, given the essentiality of its economic activity, received government support to remain in operation, which may justify the stability of the ROCE during the period. The Clothing and Fabrics sector, which produces and/or sells non-essential goods, showed a relevant reduction in its operational performance.

In order to evaluate the size of the explanatory notes, the length of the specific notes on the effects of COVID-19 on the financial statements was used. The Electricity and Clothing, Fabrics and Accessories sectors presented explanatory notes with statistically similar sizes, both superior to the Agriculture and Cattle Raising sector. These findings suggest that companies that had stability or increased return on investment during the pandemic released lower explanatory notes.

Regarding readability, the results show that companies negatively affected by the pandemic, belonging to the Clothing, Fabrics and Accessories sector, presented the information in a clearer and more legible way than the others. In other words, the sectors most negatively affected by the pandemic provided more information about their economic and financial situation to the market.

Regarding the level of compliance, the Clothing, Fabrics and Accessories and Electricity sectors were those that were most concerned about disclosing specific notes on the effects of COVID-19 in the financial statements. The information most disclosed by these sectors is related to the recoverability of assets and accruals for expected losses. Companies in the Agriculture and Cattle Raising sector also released information on the measurement of fair value. Although all sectors have partially met the CVM's requirements regarding the effects of COVID-19 on the financial statements, the Electric Energy and Clothing, Fabrics and Accessories sectors presented more details on the effects of the pandemic, highlighting the actions taken to ensure that the assets were measured correctly.

The results of the three analyzes carried out are in line with the discretionary aspect of the Disclosure Theory, as the most negatively impacted companies were concerned with explaining in more detail the effects of the pandemic on operations, both in terms of size, legibility and compliance with the letter. No.

02/2020 of the CVM. These findings indicate that, in times of crisis, managers tend to attribute greater usefulness and relevance to the information disclosed when companies are negatively affected. Managers of companies that were little affected or benefited during the crisis attribute less usefulness and relevance to information about such impacts. Therefore, users of financial information, especially creditors and investors, must pay attention to the level of disclosure presented in the explanatory notes, as this may indicate the company's concern regarding the results for the period.

This research reinforces the importance of qualitative information presented in explanatory notes, which complement accounting information and are essential for stakeholders' decision-making processes. By highlighting the relevance of detailed and transparent disclosures, the research demonstrates that this information increases the understanding and confidence of users of financial statements, especially in times of crisis.

Furthermore, the research offers a significant contribution to regulatory bodies by identifying persistent weaknesses in the process of preparing explanatory notes. By highlighting these gaps, the research is part of the debate about possibilities that can guide the formulation of more effective guidelines and the implementation of improved regulatory practices, aiming to ensure more complete and accurate disclosure of financial information.

This research has limitations, as it only evaluates the effect of operational performance on the disclosure of explanatory notes. For future studies, it is proposed: a) expand the analysis to other economic sectors and compare the disclosure of information in different types of crises, such as financial crises, natural disasters or other pandemics; b) evaluate the relation among the size of the company, its corporate governance model and the quality of the explanatory notes; c) conduct a longitudinal analysis to assess how disclosure practices in explanatory notes evolve over time, especially after crises. Identify improvements or setbacks in disclosure practices and their causes; d) compare the disclosure of information in explanatory notes during crises among different countries. Analyze how different regulatory, cultural and economic environments influence disclosure practices; e) evaluate the effectiveness of regulations issued by regulatory bodies, such as the CVM, in improving the quality of explanatory notes during crises. Investigate whether regulatory guidelines achieve the desired objectives and how they can be improved.

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