

THE EFFECTS OF BIG BATH ACCOUNTING IN THE CONDITIONS OF UNCERTAINTY CAUSED BY THE COVID-19 PANDEMIC

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Abstract:

The current economic crisis is a direct consequence of the health crisis. This crisis has appeared suddenly, is evolving unpredictably, and vulnerability and uncertainty are much more strongly felt economically and socially than in the past economic and financial crises. Fundamental questions can be asked about the contribution of accounting to mitigating the negative effects of the health crisis on financial reporting. The aim of the research is to illustrate the effects of big bath accounting during the pandemic. The main objective is to show how accounting estimates can be affected by the economic crisis. The results of the study lead to the conclusion that the accounting information cannot be based only on the accuracy of the evaluation of past and present events, but must take into account estimates of future events, even if they involve uncertainty and risk. Through techniques that have the effect of smoothing revenues and avoiding losses, accounting plays a significant role in reducing the impact of the crisis on financial position and performance. Big bath accounting techniques can be useful to managers, as long as the costs involved in negative signals in the capital markets do not outweigh the benefits of such an accounting strategy.

Key words: economic crisis, pandemic, COVID-19, big bath accounting, financial reporting, financial statements, uncertainty, net realizable value, stocks

JEL classification: M41, M19, G32, H12

1. INTRODUCTION

Crises, as transient phenomena, appear whenever a certain economic, social, political or natural process does not evolve according to the expected parameters and disrupts, with serious consequences, the systems of established values. Crises produce phenomena of instability that influence the present and future of the affected field, generating effects that contradict the legitimacies and paradigms agreed by the sciences.

The economic crisis is a process that interrupts a phase of expansion of economic activity and precipitates the economy towards the recession phase, characterized by declining economic activity, overproduction, unemployment, chain bankruptcy, inflation, inefficiency, wage cuts, over-indebtedness, value erosion and more. phenomena with negative effects on the economy. Scientific research has been able to ascertain over the years the inevitability of crises, conferred by the uncertainty that manifests itself regarding the results of economic processes.

The main objective is to show how accounting estimates can be affected by the economic crisis. In order to achieve the proposed goal, we set the following objectives:

- highlighting the different economic effects of the covid-19 pandemic from those of previous economic crises;
- presentation of an overview of big bath accounting strategies;
- analysis of big bath techniques in stock accounting.

In order to achieve the proposed and implicit purpose of the set objectives, the research methodology aims at a methodological instrumentation specific to the social sciences. In this sense, techniques specific to the researched field were used, respectively: review of the specialized literature, synthesis, analysis, comparison and problematization.

In the expansion phases of economic activity, companies pay employees' salaries, pay taxes and fees to the state, create jobs, remunerate by dividends the risk assumed by shareholders and

invest the capital attracted for the development of new products, services or modern technology. Under these conditions, the role of the state is minimal because its task is only to redistribute the added value generated by companies and the population. Economists who support the neoliberal theory believe that the state should refrain from any intervention in the market because it seems to have no deviations and not to follow the ideologies, but only the interests of its players. In neoliberal theory, the market is considered unique and sovereign economic self-regulator. The market is presented "as a perfect system, unpretentious and with a dynamic very easy to predict." (Friedman, 1995)

Pragmatism, a theory opposed to neoliberal doctrine, supports the action of the state in the economy and puts among the causes of economic crises the idea of self-regulatory markets. (Gloria-Palermo, 2010)

Any economic activity involves uncertainty and risks, but the scale of risk perception is particular to each individual. "A significant margin of irrational, affective or normative is associated with the conscious and assumed risk in the economic decision-making process." (Beudean, 2013)

In exceptional conditions (pandemic, global economic recession, military conflicts), the role of the state in the economy becomes decisive for the physical and financial protection of the population and the business environment. If the state quickly implements the most appropriate measures, then the private sector retains its resources to accelerate economic recovery.

2. THE ECONOMIC EFFECTS OF THE COVID-19 PANDEMIC DIFFERENT FROM THOSE OF THE FINANCIAL CRISIS OF 2007 – 2008

Humanity has faced several economic crises, of which those that have a significant impact on the evolution of the economy have been: the Great Interwar Depression (1923-1933), the oil crisis (1970s), the crisis in the IT sector (2000), the crisis 2007-2008 and the COVID-19 pandemic (ongoing crisis) All these crises have generated periods of recession with negative effects on the business environment.

In the period 2007-2008, the first major imbalance occurred in the banking system, resulting in a financial crisis that subsequently generated cascading effects on other economic branches. This phenomenon has emerged as a result of two features common to all financial crises of the last century: the existence of a fragile banking system and the process of contagion between asset markets. There was a failure of financial companies to manage risks. To a certain extent, the analyzes made by specialists in the period 2005-2007 indicated a possible economic recession. The financial crisis of 2007-2008 demonstrated the duality of the use of derivatives and debt securitization. Securitization is "a financial technique that converts illiquid assets into easily negotiable securities, such as bonds." (Cerna, 2008) Theoretically, the two financial instruments, derivatives and securitization have the role of improving risk management in the face of increasing financial instability. Instead, from a practical point of view, these elements have proven to be instruments of speculation and therefore of financial instability. The negative effects of this financial instability have highlighted the need for measures in the areas of prudential regulation, accounting, risk measurement and monetary policy.

Unlike previous economic and financial crises which were caused by economic and social factors, the current economic crisis is a direct consequence of the health crisis and the isolation measures imposed in order to reduce the effects on human health of the new coronavirus.

Preventive measures to slow the spread of the pandemic, from March to May 2020, have led to the total or partial closure of economic and social activities. Economic entities no longer aim to maximize profits, but to protect assets that can generate economic benefits and human capital. In 2020 and 2021, the economic crisis generated by the pandemic represents a challenge for professional accountants who face difficulties in accurately and truly reflecting their financial position and performance.

In the current crisis, most economic sectors have declined simultaneously because consumption has frozen in the main developed markets. Transport has been severely affected due to

the suspension of flights, logistical procedures for customs clearance or the closure of borders. Reducing the mobility of the population for tourism has negative consequences on the tourism sector. The hotel, restaurant and bar industry had to restructure its business for the entire period when the sale of food and drink indoors was banned. The real estate market makes fewer transactions because part of the home purchases was financed by bank loans which decreased due to consumer financial insecurity or more restrictive conditions applied by banks. The decrease in the purchasing power of the population has led to a decrease in the demand for non-food products. Agriculture is another economic sector affected because some farmers did not have stocks of seeds, pesticides and fertilizers, and applications for subsidies were submitted late due to social distancing measures.

While most economic sectors are affected by the negative effects of the health crisis, there are also sectors that have identified opportunities to increase profitability, at least in the short term. For example, the pharmaceutical industry has record sales for certain categories of drugs, telecommunications companies have increased their customers and increased the volume of services offered to old customers, and companies that manufacture hygiene products and food distributors benefit from an increase in sales during the pandemic. These positive effects cannot compensate at the macroeconomic level for the long-term negative consequences, widespread in the business environment and in most economic branches.

Unlike previous recessions, “economic recovery after COVID-19 is expected to be slower” (Guda, 2020). It will be difficult to return to consumer behaviour like before the pandemic. Observing how vulnerable the companies they work for are, people will put more emphasis on safety, by saving and maintaining consumption to what is really needed. In the area of public finances, the problems will be related to higher debts and undersized revenues. The reduction of interest rates by central banks and the monetary issuance needed for crisis budgets will lead to increased liquidity in the market, stimulating rising inflation and eroding purchasing power. The effects of foreign direct investment „can exert on the economies are both, positive and negative, but most researchers agree that the effects are in generally positive (Macovei and Scutaru, 2016). Encouraging foreign direct investment could be a solution to the economic growth of Central and Eastern European countries. Foreign companies contribute to “the adaptation of new technologies and managerial ideas involving human capital” (Ciobanu and all, 2020).

Researchers in the field of accounting pointed out in the Accounting Forum (Rinaldi and all, 2020) that „pandemic effects on modern society will be deep and permanent” and they asked „reflexive interdisciplinary contributions in all areas of accounting, business, finance and related subjects that address the responses to the COVID-19 crisis with a global perspective”.

The companies had to not only find solutions, but to rethink their entire business model. “Many companies are reinventing themselves during this period and are adapting to digital technology and online promotion” (Sahlian and all, 2020). The specific tasks and skills of accounting professionals will be subject to major changes in the coming years due to digital technologies based mainly on artificial intelligence. The basic roles will continue to exist in the future, but will not be fulfilled by humans, but by technologies based on artificial intelligence. The new roles that people will play will be more of the nature of interpreting the data and results offered by these new technologies (Leitner-Hanetseder and all., 2021). In parallel with digitization, the mechanisms of search engines in the online space are becoming more and more powerful and help to obtain most of the information. The problems that may arise are related to information sources and the veracity of the data. The solution to these problems is to use critical thinking to filter the multitude of results, to distinguish false information from true information.

3. FINANCIAL REPORTING AND TECHNIQUES BIG BATH ACCOUNTING

Quarantine and emergency measures followed by the establishment of a national alert to prevent the accelerated spread of COVID-19 have major economic consequences for the business environment. In the conditions of declining revenues and economic uncertainty, economic entities

have come to test their limits on the flexibility of business models. In current economic practice, managers have to make decisions without knowing all the possible or possible events, because they refer to future achievements and not past or present. While risk is associated with a possible future situation, uncertainty also characterizes a future situation, but one that is unlikely to be realized. In a state of persistent uncertainty, managers are forced to avoid error and inaccuracy.

The information provided by accounting can help managers develop their knowledge of the organization in several ways (Hall, 2010), making visible those events that are not perceptible through the daily activities of a manager. Business confidence, risk or profitability are inconceivable without the essential contribution of financial communication. In the conditions of uncertainty created by the current crisis generated by the pandemic, the role of financial communication becomes fundamental in shaping a reasonable picture of the position and financial performance of economic entities. An important and current issue is related to the "opportunities of some entities to send false signals on the sustainability of the business model, materialized in the communications and financial reports sent to the actors operating in the capital markets." (Burca et al, 2021)

Given the adverse effects of the pandemic on the economic environment, managers expect to record negative financial results. Consequently, they consider the idea of creativity in accounting, which has the role of beautifying financial statements, to be appropriate. Used within national and international regulations, creativity gives accounting the means to cope with the continued growth and diversification of financial markets. Accounting can help managers overcome the current crisis by highlighting pre-recorded assets or liabilities.

All the current consequences of the pandemic, but also those that will follow in the near future directly affect the financial reporting procedure. Specialists in the field of finance - accounting appreciate that the recognition of the accounting impact of COVID-19 "fluctuates depending on the situation and the specific circumstances of each company requiring a continuous analysis taking into account all the changes that occur from day to day" (Bunget and all, 2020).

The uncertainty of the economic environment does not allow professionals to make reliable accounting estimates. The negative effects of the pandemic are also felt at the level of financial reporting practices. These represent "solid premises for managers to engage in conducting big bath accounting practices, precisely because negative results are expected" (Burca et al, 2021). According to the procedure called big bath, in the year in which "the economic entity records losses, managers increase that loss by including all probable future losses, which will allow the presentation of high gains in the coming years" (Groșanu, 2013)

„Accounting big baths are pervasive in practice. While big baths can improve the information environment and reduce information asymmetry, they can also degrade the information environment and obscure operating performance.” (Hope and all, 2018)

„Some techniques that can be used by firms during a pandemic include fair value accounting, income smoothing, loss avoidance, big-bath earnings management, amongst others. The implications that accounting can play a significant role in mitigating the impact of a pandemic on the performance of firms.” (Ozili, 2021)

Research in the field of accounting shows that „that companies that tend to do a big bath accounting will recognize a loss of asset value.” (Kustono and Augustini, 2021) „Firms can manage deferred income tax as a form of big bath” (Rathke and all, 2020)

In general, big bath accounting techniques consist of artificial adjustments to financial statements, without supporting real economic transactions. Assets that can be adjusted through these techniques are fixed assets, inventories and uncertain trade receivables. The formation of stocks of materials at the level of the economic entity has the role of ensuring optimal conditions for production. Production is “the activity that supports the sustainable development of society”. (Mateș and all, 2020) Significant impact on the financial statements is due to the overvaluation of provisions, the reclassification of contingent assets and liabilities and the presentation of losses arising from the restructuring of bank loans as a result of non-compliance with the contractual conditions on performance indicators.

4. BIG BATH TECHNIQUES IN STOCK ACCOUNTING

From the multitude of big bath techniques, we chose the ones specific to stocks due to the fact that during the crisis generated by the pandemic, many companies faced problems related to overstocking or the opposite of this phenomenon, the lack of stocks. For good inventory management, professional accountants can be advisors to managers, helping them build a stable supply chain for the near future. Because, at the macroeconomic level, the pandemic generated a shortage of demand at the same time as a shortage of supply, the supply chains of economic entities were severely affected. Accounting professionals "have the role of evaluating strategies that balance the costs and risks associated with supply, starting from a new planning or even a change in the business model used by companies" (Ciobanu and all, 2020). Economic entities should establish a methodology for each node in the supply chain, in order to minimize the risk of non-timely delivery of stocks.

Reduced consumer purchasing power can directly influence the price of products that an economic entity sells. Against the background of declining demand, market prices for certain products may decline in the short term. Under these conditions, a big bath accounting technique can be used, through which an excessive reduction (write-down) of stocks is achieved, up to the level of net realizable value. The increased uncertainty in the market does not allow managers to reasonably estimate the degree of capitalization of stocks. In order to reduce the risks generated by this uncertainty, the professional accountant may resort to the excessive write-down of unsold stocks.

The net realizable value is the estimated selling price that could be obtained during the normal course of business, less the estimated costs of completing the good and the estimated costs required to sell. The estimation of the net realizable value is based on professional reasoning in order to establish the moral and physical wear of the stocks. Moral wear and tear is generated by the decrease in market demand for the stocks held or by the decrease in the quality expected by consumers of the stocks, or by other events that cannot be controlled by the entity: fires, floods, earthquakes.

The cost of inventories is irrecoverable if the estimated costs for completion or the estimated costs required to make the sale have increased. The practice of reducing the value of inventories below cost to net realizable value is consistent with the precautionary principle that assets should not be reflected in the balance sheet at a value greater than the value that can be obtained by using or selling them.

The estimate of net realizable value is based on the most credible evidence proven when estimating the value of inventories expected to be realized. These estimates take into account price and cost fluctuations that are related to events that occurred after the end of the period, insofar as these events confirm the conditions existing at the end of the period.

The following example analyses the decrease in stocks to net realizable value, taking into account the particular evolution of demand for certain products in 2020, as a consequence of the economic crisis generated by the health crisis.

It is considered an entity in the field of garment production that at the beginning of 2020 focused on the production and marketing of school uniforms. Due to the fact that most of the school activities took place during 2020 in the online version, the company faced a significant decrease in the demand for school uniforms. In order to continue the activity and not to give up some of the staff, the entity's managers decided to orient the production towards sanitary masks and protective equipment for the medical staff. At the inventory at the end of the financial year 2020, the situation of stocks of finished products at the garment entity is presented (in monetary units) in table no. 1:

Table no. 1. Situation of remaining stocks at the end of 2020

Stock categories	Pieces left in stock	Unit cost	Net realizable value per unit
School uniforms			
U1 Girls uniform	40	180	170
U2 Boys' uniforms	80	210	180
Sanitary masks			
M1 textile masks	10	4	5
M2 textile masks with removable visors	20	8	12
Protective equipment for medical personnel			
E1 classic model	10	20	18
E2 model adapted to the conditions of the covid-19 pandemic	5	40	50
TOTAL			

Decreasing the value of stocks to the level of net realizable value can be done item by item (table no. 2), by categories of stocks (table no. 3) or by total stocks (table no. 4)

Table no. 2. Analysis of the value of items item by item

Stock categories	Cost	Net realizable value	Min (cost, net realizable value)	Accounting value
School uniforms				
U1 Girls uniform	7 200	6 800	6 800	400
U2 Boys' uniforms	16 800	14 400	14 400	2 400
Sanitary masks				
M1 textile masks	40	50	40	0
M2 textile masks with removable visors	160	240	160	0
Protective equipment for medical personnel				
E1 classic model	200	180	180	20
E2 model adapted to the conditions of the covid-19 pandemic	200	250	200	0
TOTAL				2 820

The accounting will record a decrease in the value of inventories by 2820 m.u., simultaneously with the occurrence of an expense with the adjustment of inventories not tax deductible. For inventories with a net realizable value in excess of cost, the added value is not recognized. Thus in the financial statements, the value of stocks will be decreased by 2820 m.u..

Table no. 3. Analysis of the value of stocks by categories

Stock categories	Cost	Net realizable value	Min (cost, net realizable value)	Accounting value
School uniforms				
U1 Girls uniform	7 200	6 800		
U2 Boys' uniforms	16 800	14 400		
	24 000	21 200	21 200	2 800
Sanitary masks				
M1 textile masks	40	50		
M2 textile masks with removable visors	160	240		
	200	290	200	0
Protective equipment for medical personnel				
E1 classic model	200	180		
E2 model adapted to the conditions of the covid-19 pandemic	200	250		
	400	430	400	0
TOTAL				2 800

In the case of the analysis by categories of stocks, the accounting will record the decrease of the value of the stocks and the constitution of the expenses regarding the depreciation of the stocks in the amount of 2 800 m.u..

Table no. 4. Determining the minimum value between cost and net realizable value on total stocks

Stock categories	Cost	Net realizable value	Min (cost, net realizable value)	Accounting value
School uniforms				
U1 Girls uniform	7 200	6 800		
U2 Boys' uniforms	16 800	14 400		
Sanitary masks				
M1 textile masks	40	50		
M2 textile masks with removable visors	160	240		
Protective equipment for medical personnel				
E1 classic model	200	180		
E2 model adapted to the conditions of the covid-19 pandemic	200	250		
TOTAL	24 600	21 920	21 920	2 680

The analysis of total inventories generates in the accounting a decrease in the value of inventories and an establishment of expenses regarding the depreciation of inventories of 2680 m.u..

It is noted that in each of the three situations presented the value recorded in the accounting to reduce the cost of inventories at the level of net realizable value is different. In practice, the option in which the cost of inventories is reduced to the net realizable value item by item is preferred. Sometimes, however, it may be appropriate to group similar or related items. This may be

the case for stock items belonging to the same product range, which have similar purposes and uses, which are produced and marketed in the same geographical area and which cannot, in practice, be valued separately from other items in that range products.

In the special economic situation of 2020, in which the evolution of the demand for different storable elements was almost impossible to predict from one month to another, it is preferable to resort to the decrease of stocks at the level of net realizable value item by item.

The estimate of net realizable value is influenced by the purpose for which the stocks are held. For inventories of goods and merchandise held by an entity for the purpose of being sold on the basis of firm contracts, the net realizable value is the contractually determined price. If the contracted quantity is less than the quantity held, the net realizable value of the surplus will be determined starting from the general selling prices practiced on the market.

The value of materials and consumables used in production is not reduced in cost if it is estimated that the finished products to be incorporated will be sold for a price equal to or greater than their cost. Such a situation could be encountered in 2020, in the fields of activity, few in number, which have seen an increase in demand. One such field is the one in which companies producing computers, laptops and tablets operate. For example, an Alfa computer company owned, at the end of 2020, 50 hard drives purchased at 2000 m.u. (monetary units) / piece. The average selling price of a computer is 5 000 m.u., and the production cost is 3 500 m.u.. In December, a competing company launched on the market a new hard drive model that caused a decrease of those owned by Alfa by 20%. In this case, because the price of the finished product is higher than the cost of production, the value of the stock of raw materials (hard) will not be reduced to the net realizable value.

In order to reduce the risk of misstatement of information in the financial statements, the European Securities and Markets Authority recommends carefully analysing the indications that indicate the possibility of an asset being impaired on the basis of a set of internal and external information. Determining the net realizable value in the current uncertain environment requires a projection of cash flows over a relevant horizon. The use of an approximation should be carefully assessed, taking into account the level of risk that an impairment loss may have for stocks.

5. CONCLUSIONS

Profitability, value creation and economic growth are elements of progress for society, but solving an economic crisis cannot be achieved without an ethical approach to transactions. Investors plan their business evolution based on a strategy and periodically follow the available information about customers, suppliers, substitute products or services, existing or new competitors. Successful investors understand that their business is dependent on the ecosystem in which they operate and adapt their strategy according to the latest information that appears. Flexibility and the ability to adapt to crisis situations can be based on certain action plans designed in advance for each scenario. The review of the scientific literature in the field leads to the conclusion that the information timely and sufficient financial-accounting information together with the flexible management strategy are the basic conditions for entrepreneurs who want to cope with periods of economic crisis.

The current economic crisis has appeared suddenly, is evolving unpredictably, and vulnerability and uncertainty are much more strongly felt economically and socially than in past economic and financial crises. Accounting plays a very important role in managing the economic effects of the pandemic, and professional accountants will pay close attention to prudent analyzes and forecasts based on several scenarios to eliminate certain errors in the process of estimating an appropriate level of adjustments.

Following the presentation of an overview of big bath accounting strategies, we believe that professional accountants can initiate such techniques depending on the impact they have on their financial position and performance. The purpose of these techniques is to reduce the risk in conditions of economic uncertainty. We believe that caution should be exercised in presenting the pandemic impact separately in the financial statements. Lack of caution would increase the risk that

the separate presentation would not accurately reflect the financial information, to the detriment of users' understanding of the financial statements.

We appreciate that the cancellation of the significant share of uncertain trade receivables, as a technique of big bath accounting, would have the effect of eliminating from the balance sheet the receivables with low probability of collection in the future.

In relation to the main objective of the research, we conclude that the accounting estimates give dynamism to the financial reporting. The analysis of big bath accounting techniques in stock management highlights two such techniques:

- excessive reduction of inventories, in principle at net realizable value and
- excessive recognition of non-marketable stocks in the conditions of an increased uncertainty at the market level, which does not allow the managers to reasonably estimate the degree of capitalization.

The estimate of net realizable value is influenced by the purpose for which the stocks are held. The economic crisis generated by the pandemic has generated a shock both at the level of aggregate demand and at the level of aggregate supply. We appreciate that the effects on demand are more significant than those on sources of supply. In order to overcome difficulties in supply chains, economic entities need to conduct an analysis of suppliers in general and logistics service providers in particular. The professional accountant must consider the time of supply and the possibility of rapid subsequent sale of products because, during this period, cash flow is very important.

Big bath accounting techniques are designed to recognize expenses in advance and defer revenue. The effects of these techniques are observed in the reduction of the accounting result of the current year and the creation of the premises of a higher accounting result in the next period. The negative effects of the pandemic are manifested in the economy and in financial reporting. These are justifiable reasons for managers to resort to big bath accounting techniques. Consequently, a decrease in current financial performance is preferable given that the impact of negative post-crisis outcomes may have greater economic effects.

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