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Abstract. The COVID-19 pandemic has posed numerous difficulties before business entities and thus before accounting professionals. The paper summarizes the main issues financial reporting faces during the pandemic with respect to the quality of the financial information provided by the financial statements of the entities. The main quality characteristics of useful financial information are brought to light in the context of the impediments posed by the COVID-19 crisis. Different aspects of financial reporting are discussed: the implications on the going concern principle; the effects on accounting judgements and estimates; events after the reporting period. The paper provides real-life examples for the worsened quality of the financial information caused by the COVID-19 pandemic.

Keywords: quality of financial information, financial reporting, financial statements, judgements and estimates, going concern, uncertainty, COVID-19

1 The problem with certainty

The COVID-19 crisis has posed many difficulties before business entities which resulted mostly in financial downturn. Accounting professionals faced numerous difficulties in the process of providing true and fair financial information. Among the professional accounting communities, a realization came into being – **certainty** was a factor that accountants heavily relied on. Most of the accounting standards require certain judgements or estimates in order different accounting objects to be recognized and disclosed in the financial statements of entities.

Great number of accounting aspects were affected. The provision of financial information of high and undisputable quality became more demanding and problematical. The inability to foretell consequences and outcomes lead to ambiguous and misleading financial statements which in turn made the decision-making process of the users of the financial statements even more difficult and ineffective.

The degree of impact is highly dependent on the nature of the business, its resilience, and the ability of the entity to meet its obligations in the midst of ubiquitous economic downturn. Managerial decisions are of a crucial importance and more than often they also rely on financial statements which meet the quality criteria set by the accounting standards.

2 Qualitative characteristics of financial information in the context of the COVID-19 crisis

"As capital markets developed, the function of financial reporting expands beyond just supporting the managerial decision-makers. It has to provide actual information to the external users of the financial statements in the process of investment decision-making." [1]

In many cases financial statements are used as a base for decision-making which affects not only the parties involved, but all stakeholders at hand. For example, financial institutions use the information provided by the statements and make decisions about extending loans. The amount of non-performing loans affects the economy as a whole, so banks and other financial institutions try to minimize them. If financial statements provide misleading information about the financial position and the efficacy of entities, third parties would be exposed (and are exposed) to higher risks, for example, of defaulting.

The COVID-19 pandemic places infringements of all the qualitative characteristics of useful financial information set out in the Conceptual Framework for Financial Reporting (CFFR).

The first criterion – **relevance** requires the information to make difference in the decisions made both by internal and external users. The hectic economic conditions had made it difficult to distinguish which information is relevant to the user and which information plays the role of information "noise". In the case of Bulgaria, complex orders issued by the Ministry of Health had made it impossible for businesses to make clear and relevant decisions.

Complete depiction includes all the information needed to provide the user with the opportunity to have a thorough understanding about the phenomenon at hand. The COVID-19 pandemic deprives managers and accountants from this opportunity. The decisions' timespan has been significantly shortened due to the unknown development of the crisis.

Another criterion for the usefulness of the financial information is **neutrality**. Neutrality is supported by the exercise of caution when making decisions under conditions of uncertainty. As it was already discussed, uncertainty is the main threat which managers and accountants face nowadays.

The financial statements should be **free from error** so that users are not mislead. The reporting of many financial objects was affected (leases, impairment, deferred tax assets and liabilities) which increased the probability of errors made. Guidelines, interpretations, laws and other normative documents are issued on the go and accounting professionals have to keep up and apply the flow of new information.

3 The going concern principle

"For the first time the management of many entities would be forced to analyze in detail how applicable the going concern principle is to them." [2] Financial statements are normally prepared under the assumption that the reporting entity is a going concern and will continue its operations in the foreseeable future. The main assumption is that the entity has neither the intention, nor the need to enter liquidation or to cease business activity. Table 1 represents the main assumptions under the going concern principle and the impediments that the COVID-19 crisis has posed.

Table 1. COVID-19 impediments to going concern assumptions.

GOING CONCERN ASSUMPTIONS	IMPEDIMENTS POSED BY COVID-19 CRISIS
The business is in healthy and stable condition	The worsening of the financial conditions of all businesses around the world causes instability and uncertainty in business entities.
High probability to continue business operations in the next few financial periods	Supply chain issues, travelling and transportation restriction has made it difficult to assume that business entities would continue to operate in the next few years.
No intention to reduce the size of the business	On the contrary, many businesses have made the decision to close down local or international subsidiaries in order to make the ends meet.
No intention to liquidate the business	For many entities this is the inevitable consequence of the crisis.[1]
The business has enough liquid assets at hand to cover its short-term liabilities	The duration of the COVID-19 crisis plays a very important role here. The pandemic has been present for more than year and a half which significantly drained the liquid assets of companies and left them unable to cover short-term liabilities.

[1] Proceedings of The National Academy of Sciences (PNAS) has conducted a research by drawing a survey of more than 5'800 small businesses based in the USA. Across the full sample, 43% of businesses had temporarily closed, and nearly all of these closures were due to COVID-19. [3]

4 Judgements and estimates

When monetary amounts in financial reports cannot be observed directly and must instead be estimated, measurement uncertainty arises. The use of reasonable estimates is an essential part of the preparation of financial information and does not undermine the usefulness of the information if the estimates are clearly and accurately described and explained.

An example for hindered process of judgements and estimates is impairment. Impairment is necessary so that the assets of the companies are not presented at an overvalued amount in the financial statement. The COVID-19 pandemic has significantly broadened the scope of accounting objects that must be impaired.

IAS 36 “Impairment of Assets” provides information about the indications that an asset might be impaired. COVID-19 can be considered an such an indication of external characteristic.

The decision whether to impair an asset or not is an example of accounting judgement. However, the amount of the impairment (impairment loss) is an example for accounting estimate which is dependent on the recoverable amount of the asset. How to determine the correct recoverable amount in such unstable economic conditions? Many elements must be taken into account – the fluctuating market prices, expert’s opinions, etc.

We are able to conclude that accounting judgements and estimates is an aspect of the accounting profession which is highly influenced by the current pandemic. This poses additional impediments to the usefulness of the financial information.

5 Events after the reporting period

IAS 10 “Events After the Reporting Period” provides us with guidelines on how to treat events that occur between the reporting date and the date when financial statements are authorized for issue.

The standard distinguishes between two types of events – adjusting and non-adjusting. **Adjusting** are those events which provide evidence of conditions that existed at the end of the reporting period. **Non-adjusting** are those events which are indicative of conditions that arose after the end of the reporting period.

The COVID-19 pandemic impacts how companies evaluate and treat such events. Accounting professionals are faced with the challenge to determine which of the events after the reporting period caused by COVID-19 are adjusting and which not. IAS 10 requires us to adjust the already compiled financial statements if an adjusting event is at hand. If the event is non-adjusting, it is disclosed if it is of a material amount.

Usually, the effects caused by the COVID-19 crisis are of a non-adjusting type. It is presumed that significant spread of COVID-19 did not take place until January 2020. The financial statements of entities for the reporting period which ends on 31 December 2019 must reflect only the events which occurred before the year end. Figure 1 [4] represents the timeline of events. This means that there was no impact on the recognition and measurement of assets and liabilities for this period.

Fig. 1. Timeline of events which occurred after 31 December 2019[2]

On 11 March 2020 the World Health Organization (WHO) declared COVID-19 to be a global pandemic. For the reporting periods that ended after January 2020 enough was known so that it could be reflected in the statements for the respective periods. We can make the same conclusion for the financial period that ends on 31 December 2021.

However, managers and accountants must establish their judgements on whether certain disclosers should be made in the financial statements or not. The following factors should be considered in the process of assessing the accuracy of the estimates, judgements, and disclosures:

- Disruption of supply chains.
- Government support.
- Liquidity problems.
- Cessation of essential and non-essential services.

Such events greatly affect the quality of financial information provided by the statements due to their high dependence on expert judgements. If an adjusting event is falsely considered to be non-adjusting, the values at which assets and liabilities are presented in the statements would depict the economic condition of the entity in a misleading light.

[2] Derived from article produced by KPMPG available here. Last access: 29.10.2021

6 Example for financial statements affected by the COVID-19 pandemic

The hotel industry is one of the most significantly affected industries all around the world. Some of the considerations that managers and accountants of such business entities must take into account are as follows:

1. Modification of the **revenue recognition** policies. Considerations on how to adjust for cancellations, disrupted loyalty programs, inability to extrapolate historical trends into the future.
2. Amendments to **agreements**. Management salaries are usually based on a percentage of total sales. Entities usually have concluded contracts with suppliers with various terms and conditions which must be adjusted for the new economic conditions.
3. **Impairment of assets**. Hotel property assets with reduced capacity or idle must be impaired in order to reflect the inability of entities to generate cashflows through the usage of these assets.

Figure 2 present an excerpt from the consolidated income statement of one of the biggest hotel chains in the world – Choice Hotels International[3]. As seen from the excerpt, the impairment of long-term assets doubled since the 2019 year end. This is in sync with the ongoing pandemic.

	Years Ended December 31,		
	2020	2019	2018
REVENUES			
Royalty fees	$ **263,308**	$ 388,151	$ 376,676
Initial franchise and relicensing fees	**25,906**	27,489	26,072
Procurement services	**45,242**	61,429	52,088
Marketing and reservation system	**402,568**	577,426	543,677
Owned hotels	**20,168**	20,282	—
Other	**16,880**	40,043	42,791
Total revenues	**774,072**	1,114,820	1,041,304
OPERATING EXPENSES			
Selling, general and administrative	**148,524**	168,833	170,027
Depreciation and amortization	**25,831**	18,828	14,330
Marketing and reservation system	**446,847**	579,139	534,266
Owned hotels	**16,066**	14,448	—
Total operating expenses	**637,268**	781,248	718,623
Impairment of goodwill	**—**	(3,097)	(4,289)
Impairment of long-lived assets	**(14,751)**	(7,259)	—
Loss on sale of business	**—**	(4,674)	—
Gain on sale of assets, net	**—**	100	82
Operating income	**122,053**	318,642	318,474

Fig. 2. Choice Hotels International, INC. Consolidated Statement of Income (excerpt)

It is important to stress once again on the fact that the determination of correct impairment loss affects the reliability of the financial information provided. Incorrect impairment amount would result in ineffective decisions on liquidity considerations, financing, investing, conclusion of contracts, etc.

[3] Available here, last access: 29.10.2021

Figure 3[4] is an excerpt from the consolidated income statements of Darden Restaurants, INC which is the largest full-service restaurant company, base in Orlando, Florida. As seen from the excerpt there is a significant increase in the impairment of both tangible and intangible assets (in the form of goodwill).

	Fiscal Year Ended		
	May 31, 2020	May 26, 2019	May 27, 2018
Sales	$ 7,806.9	$ 8,510.4	$ 8,080.1
Costs and expenses:			
Food and beverage	2,240.8	2,412.5	2,303.1
Restaurant labor	2,682.6	2,771.1	2,614.5
Restaurant expenses	1,475.1	1,477.8	1,417.1
Marketing expenses	238.0	255.3	252.3
General and administrative expenses	376.4	405.5	409.8
Depreciation and amortization	355.9	336.7	313.1
Impairments and disposal of assets, net	221.0	19.0	3.4
Goodwill impairment	169.2	—	—
Total operating costs and expenses	$ 7,759.0	$ 7,677.9	$ 7,313.3

Fig. 3. Darden Restaurants, INC. Consolidated Statement of Income (excerpt)

Figure 2 and Figure 3 also provide information about the revenues of these representatives of the tourism industry. There is a significant decline in revenues which is normal when we consider the impediments posed by the COVID-19 pandemic to such business entities.

7 Conclusion

Financial statements are one of the tools used by managers, investors, and creditors in the decision-making process. An example for the effects that erroneous financial statements could have is the spectacular collapse of Enron which lead to economic turmoil in the USA in 2002. The collapse caused $74 billion in shareholders' losses. Billions more were lost in the form of employees' pension benefits. This is a notorious example of how misleading financial information can affect not only the financial condition of the business entity, but the well-being of a nation as a whole.

COVID-19 has presented many challenges to financial reporting. The way to cope with them is to stay up to date with respect to our knowledge, skills, and competencies. Education have become increasingly more important as the pandemic progresses. The importance of true and reliable financial information has increased. The International Accounting Standards Board (IASB) has to continue updating the current accounting standards and, if necessary, issue new standards and interpretations so that we can overcome the impediments caused by the COVID-19 disease.

[4] Available here, last access: 29.10.2021

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