Global Impact of COVID 19 on the Concept of "Going Concern",

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Abstract.

Research background: The article presents a problem in the field of financial reporting. "Going concern" is the basic concept and principle in the preparation of the financial statements of enterprises.

Purpose of the article: The purpose of this article is to present the global impact of COVID 19 on the concept of "going concern", which is used as a basis for the development of the financial statements of the companies. The essence of the "going concern" concept is clarified. The key factors provoking a crisis in the capital cycle of the enterprises and possible scenarios of manifestation of a "going concern" in conditions of uncertainty are presented.

Methods: The research methodology is based on a systematic approach with appropriate methodological tools for analysis, generalization, and graphic visualization of the achieved results. Empiric research of the information on revenues, profitability, and net cash availability of non-financial enterprises - issuers on the Bulgarian Stock Exchange was conducted, based on published interim financial statements for the first quarter of 2020.

Findings & Value added: The content of the research is useful for potential investors who are interested in non-financial companies - issuers on the Bulgarian Stock Exchange. It provides important knowledge into understanding the economic nature of the 'going concern' concept applied in the globalizing economy as a basis for preparing financial statements.

Key words: *going concern; interim financial statements; revenue; money balance; Bulgaria.*

JEL Classification: *M40; M41*

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1 Introduction

A memorable event during the year 2020 is the Coronavirus pandemic. It caused a cataclysm in the globalizing world economy. At the same time, however, it spurred human intellect to adequate, meaningful and appropriate actions for maintaining and continuing capital turnover. Accounting mirrors the effects generated by the extraordinary event for an individual entity and creates information for its assessment as a going concern.

„Going concern“ is currently one of the basic notions in the accounting regulatory framework. At its heart is the continuation of company's business activities in the foreseeable future – which covers, but is not limited to, the next twelve months from the date of the financial statements. Under the conditions of extraordinary events such as COVID 19, this appears to be an essential issue for many companies. Investors need transparent information about the financial position and assets, about cash flows, income and expenses of the companies where they have invested their capital. With the global economy having come to a standstill, more than ever a detailed and profound analysis is required for the application of the accounting concept of going concern.

The purpose of this research is to present the global impact of COVID 19 on the going concern concept and principle, which is applied as a basis for preparing the financial statements of entities.

The following tasks are put forward in pursuance of this objective:

- to present the essence of the going concern principle;
- to analyze the influence of COVID 19 on the going concern concept when preparing interim financial statements during the year 2020;
- to make an empirical study with conclusions about the manifestation of the going concern principle compared to non-financial entities, which are corporate issuers at the Bulgarian Stock Exchange, based on their interim financial statements for the first quarter of the year 2020.

The methodology and methods of research are grounded on the general principles of knowledge by applying the systemic approach, the methods of analysis and synthesis, empirical study and generalization of comparative graphical analysis.

Limitations of the research – the studies concern a single country – Bulgaria, listed non-financial entities, published interim financial statements for the first quarter of the year 2020 made on the basis of IAS/IFRS.

The methodology offered and used in this research does not claim to be the only possible and applicable one when examining and substantiating the results of the research.

2 Bibliography review

The European Securities and Markets Authority (ESMA) delivered a public statement in the end of May this year addressing the implications of the COVID 19 pandemic on the half yearly financial statements of listed issuers for the purpose of clarifying the going concern principle.[1] The recommendations are focused on transparency of information in the financial statements of the participants in the capital markets regarding the effect of COVID 19 on their current and potential financial position. The Financial Stability Board (FSB) recommends measures in five categories to cope with financial instability generated by COVID 19 and support the going concern.[2] Accountancy Europe (the successor of the

Federation of the European Accountants FEE) defines the Coronavirus pandemic as an adjusting event for each reporting period after 31 January 2020. It provides guidance, apart from the one on the going concern assumption, also on the areas of permanent monitoring for assessment.[3] The International Federation of Accountants (IFAC) recommends variants for assessment of entity's ability to continue as a going concern during 2020.[4] International Accounting Standards Board (IASB) published clarifications on the application of IFRS 9 *Financial Instruments* and other standards under the conditions of uncertainty originating from the Coronavirus pandemic, for the purposes of going concern assessment.[5] ICAEW states that COVID 19 heightens going concern risks, what requires raising professional skepticism of accountants and auditors.[6] In this respect, there are also scientific developments on the "accounting conservatism consistent with the hypothesized causal relation".[7]. Currently the causal relation is not a hypothesis, but a fact. The causal effect of specific events increases voluntary disclosures which is extremely important for the impact of COVID 19. In similar situations, accounting conservatism is also a prevention against fraud through the information in the financial statements, in view of the considerable amount of expenses in unfavorable events on a global scale.[8] According to other empirical researches of authors, it has been established that influenza pandemics result in the annual economic loss caused by epidemics to be as high as \$570 billion, accounting for 0.7% of global total income, after taking into account the potential loss caused by population deaths.[9] Losses of approximately 500 billion US dollars, or 0.6% of global income are forecasted for the global economic impact of COVID 19.[10] In this respect, it is necessary to make the methods applied in creative accounting more precise for delaying the imminent corporation bankruptcy.[11] Faithful establishment of the going concern principle is necessary to forecast the global economic tendencies.

It is widely recognized that in 2020 we need transparency of information in the financial statements for the faithful presentation of the going concern principle, which is one of the basic prerequisites for the continuation of the global economic development.

3 Essence of the going concern principle and its manifestation under the conditions of uncertainty when preparing interim financial statements

3.1 Going concern – essence and manifestation under the conditions of COVID 19

The going concern assumption has a central place and significance when preparing financial statements of entities. Clarification of its substance actually contributes to the improvement of financial literacy, which bears an important role for the financial wellbeing. Informed financial decisions are a key factor for making effective financial choices.[12] This is necessary more than ever under the conditions of the world economic crisis caused by the Coronavirus pandemic.

The nature of the going concern principle is regarded from an economic, legal and applied perspective. The economic aspect is the capital turnover within the globalizing economy. Thanks to economic activities, capital is recovered in an increased amount, changes its ownership and acquires new functional forms. From the perspective of accounting, going concern is the dynamics of the capital invested in an entity and manifested in the everlasting balance equation between assets and sources of capital. From the legal perspective going concern is defined as entity's establishing for an unlimited period of time. The applied aspect

of going concern is identified in the incessant reproduction process performed by individual entities. A summary of the basic aspects of the going concern principle is given in Table 1.

Table 1: "Going concern"- aspects of manifestation

GOING CONCERN		
<i>Economic aspect</i>	<i>Legal aspect</i>	<i>Applied aspect</i>
Capital turnover	Entity’s establishment for an unlimited period of time	Performance of business activities

The going concern notion is designated by various terms in distinct documents of contemporary regulatory accounting framework. In the Conceptual Framework for Financial Reporting (§3.9. and 4.33.) and in IAS 1 Presentation of Financial Statements (§25-26), it is defined as an *assumption and as a basis for preparation of general purpose financial statements*. It is specified as one of the *characteristics of financial statements*. In study materials for accountants and auditors (ACCA), it is identifies as a *concept*. After the publication of the first regulatory documents in the world, which regulate accounting activities, the term “*accounting principles*” became widely accepted.[13] In the Law on Accounting in Bulgaria, „going concern“ is *one of the principles for recognition and measurement of the elements in the financial statements*. One can summarize from the quintessence of the specified definitions that „going concern“ is an initial assumption and a concept. Making it even more precise as a relevant and faithful (assumption), predetermines it as a basis for preparation of financial statements and as an accounting principle. Therefore, the notion of “going concern” is identified as: an assumption and a concept, characteristic and a basis for preparation of financial statements, as an accounting principle. The substance of the abovementioned terms is one and the same, and the difference is in the manifestation of the faithfulness of “going concern” in time.

The substance of the going concern assumption is established in the accounting regulations as a functioning of an entity in the foreseeable future without the intention or necessity of liquidation or termination of its activities. [14] This is established by the entire available information about the future economic development. The potential economic activity is identified with at least, without being limited to, twelve months after the end of the reporting period. [15] To that effect, the history of the enterprise is analyzed with regard to realized financial results, its access to financial and manufacturing resources, sales and collectability of receivables, etc. The governance of an undertaking decides on, and is held responsible for, determining the entity as a going concern. Consequently, this is confirmed or rejected based on an independent auditor’s opinion on entity’s financial statements.

It shall be clearly disclosed about the financial statements whether they have been prepared on the going concern basis. If the entity is not a going concern, then the basis on which the financial statements have been prepared is to be disclosed. There is no standard in the currently effective IAS/IFRS which can present the treatment of financial statements prepared on the basis of liquidation. There is a special standard in the National Accounting Standards in Bulgaria for preparation of financial statements in the process of liquidation or insolvency.[16]

The Coronavirus pandemic is a distinctive „stress-test“ about the resilience of an enterprise, which means whether an entity is able to react to, or “recover” from shock

events.[17] This requires an in-depth examination of the factors proving that the entity exists as a going concern. Of important significance are:

- Current and expected profitability;
- Measures undertaken to cope with uncertainty risks;
- Effects on investment policy and dividend payout behavior;
- Possibilities for potential financial sources;
- Updating debt repayment schedules according to uncertainty conditions;
- Methods of accumulating and disposing of available and potential cash sources and others.

The results of the above specified factors form the following scenarios, without being limited to them, regarding “going concern” and preparation of financial statements:

Scenario1: The entity is a functioning enterprise and its financial statements are prepared based on “going concern” basis. Therefore:

- o The Coronavirus pandemic has not turned out to have a substantial impact on the business activities of the entity or
- o The entity has undertaken measures to deal with the negative effects of COVID 19 or
- o The existence of COVID 19 is beneficial for the development of the business activities.

Scenario 2: The entity is not a functioning one, but its financial statements are prepared based on the going concern basis.

This is a variant where the activities are interrupted by a regulatory document. Such enterprises under the conditions of COVID 19 are the enterprises in the tourism sector, sports sector, aviation sector, etc. Their activities are interrupted (suspended) because of the legal measures imposed for the purposes of prevention of the negative consequences for people’s health due to the Coronavirus pandemic.

Scenario 3: The enterprise is not a functioning one and its financial statements are not prepared on the going concern basis.

This is a variant where the activities are suspended and the entity ceases to function. The reason can be an extraordinary event, but that is not a mandatory factor.

COVID 19 has a global impact on humanity. Its effects on the going concern concept primarily depend on the following:

- duration of epidemic spread-out, hence the drop in economic activities;
- fiscal and monetary policy under the conditions of global economic crisis.[18]

The results of the analysis of factors confirming or rejecting the going concern principle are fundamental when preparing interim and annual financial statements during the year 2020.

3.2 Interim financial statements – preparation under uncertainty conditions

The Coronavirus pandemic caused uncertainty in the activities of most of the enterprises. This had a dramatic effect on many economies and global trade to the point close to “deglobalization”, with almost all activities on a global scale have either been temporarily closed or substantially delayed.[19] Provision of information about the business activities of enterprises, about their property and financial position through the financial statements is a process which is also conducted in extraordinary events. The focus is on the fields that appear

to be of interest to potential investors and creditors. It is stated in the publication of FRS that the key needs of information are associated with liquidity, longevity and solvency of companies.[20] It is necessary to understand to what extent an enterprise is resilient under conditions of uncertainty and what the assumptions and evaluations for the preparation of interim financial statements are during 2020 on the going concern basis. A great part of enterprises are not able to evaluate the effects of the Coronavirus pandemic as at the interim financial statements date. This stirred the issue for developing a standard on the financial reporting under extraordinary conditions.[21] That is why the current aim is to achieve clear understanding of the global impact of COVID 19 on the implementation of the going concern assumption, liquidity maintenance, general financial position, current and potential types of risks, through the disclosures to the interim financial statements. Management judges whether the enterprise would continue as a going concern during the next twelve months. The assessment is based on events and facts which are known as at the issuance of the interim financial statements date.

The Coronavirus pandemic is an adjusting event for reporting periods following January 2020. The effects that have occurred in the activities of the enterprises are reported through the applicable basis of accounting. The main trends that reveal the manifestation of the consequences of COVID 19 in the financial reporting are:

- Impairment of assets and changes to the fair values – permanent tests for similar indications are conducted for that purpose.
- Cash flow movement, which presumes constant analysis of factual and forthcoming cash transactions;
- Sufficiency of financial and material resources – current identification of availabilities is required;
- Optimization of costs and liability maturity tracking, etc. is required.

The preparation of interim financial statements is subject to interpretation in IAS 34 „Interim Financial Statements“. Interim Financial Statements are analogous to the annual financial statements and are prepared for a period of time shorter than twelve months. The information in them is intended for investors and creditors. That is why IASB recommends IAS 34 „Interim Financial Statements“ to be applied by publicly traded enterprises (IAS 34, §1). The mandatory application of the standard is regulated by the national economies. A specific feature of interim financial statements is that there are circumstances which are not disclosed in the latest annual financial statements. These are events that have occurred during the current year and are of material significance for the business activity (IAS 34, §15). The Coronavirus pandemic is within the scope of this definition. It is identified as a material adjusting event for the year 2020 having effect on the financial reporting. The comparative information in the interim financial statements is for the same interim period of the preceding year, except for the financial position statement where the comparative information is presented as at the latest annual financial statements date /in Bulgaria this is 31.12./ It is clearly disclosed for the interim financial statements whether they have been prepared on the going concern principle or not. Under conditions of uncertainty, it is recommended to disclose various scenarios of going concern according to the factual and expected effects of the extraordinary event - the Coronavirus pandemic in this particular case.

4 Empirical study

The global and presently short-term impact of COVID 19 is immediately and effortlessly felt because of the widely spread lockdown and social distancing measures on a global scale. Even though the pandemic will come to an end, it is already expected to have long-lasting and profound economic, social, political and cultural impacts.[22] The obvious initial economic

effects of the impact of COVID 19 are revealed through the information in the interim financial statements of public enterprises. It is through the stock exchange that the global movement of capital is carried out. It is estimated that investors' trust is determined by the degree of capital markets development.[23] Developed capital markets attract participants whose financial statements are prepared on the going concern principle and contain reliable and faithful information about their financial and property position.

This empirical study covers the first three months of the year 2020 and refers to the registered joint stock companies at the Sofia Stock Exchange. This is the period of the first effects of the pandemic that are presented in the interim financial statements of the publicly traded companies for the first quarter of the year 2020. Public entities in Bulgaria apply IAS/IFRS as a basis of accounting by virtue of law.

Registered non-financial enterprises at the Bulgarian Stock Exchange amount to twenty one in total from different sectors of economy as at the date of this research. They publish interim financial statements for each quarter of the year according to the national legislation. In view of the extraordinary situation, the time period for publishing the financial statements in Bulgaria during the year 2020 was statutory extended by three months.

The data used for the empirical study has been examined and processed as at 20.07.2020. All non-financial corporate issuers on the Bulgarian Stock Exchange, who had published their financial statements for the first quarter of the year 2020 at the date of this research, were included in the sample. They are twelve in total and are presented in Appendix 1-***Non-financial enterprises - issuers on the Bulgarian stock exchange***

In order to achieve the goals of the research: for the purpose of clarifying the manifestation of the going concern principle, within the period of global economic uncertainty caused by the Coronavirus pandemic when preparing the interim financial statements during the year 2020, a review was made of the financial statements and the notes thereto prepared for the first quarter of the year 2020 by the publicly traded non-financial entities in Bulgaria in two aspects:

- In the first place – is there any disclosed information about going concern in the existence of a material adjusting event – COVID 19, during the current year and
- In the second place – analysis of going concern by means of:
 - Comparative analysis of the revenues earned, and the profitability determined on this basis;
 - Comparative analysis of available cash liquidity for the interim reporting period compared to the same interim period of the preceding year.

As to the first aspect of the empirical research, it was found out that all the entities in the sample have disclosed that they are functioning enterprises and that their interim financial statements at 31.03.2020 had been prepared on the basis of the going concern principle. This is the first scenario of the above indicated ones with regard to the manifestation of going concern under conditions of economic uncertainty. The data used in the research indicate to some specific features, namely: Entities of the sector of restaurants and mobile food service activities suspended their activities for the period of the emergency situation, but they have been working on their dealings for the period after the measures have been imposed. This is a modification between the first and the second scenario. The remaining enterprises have been performing their activities. And the entities within the sector of electrical power and courier services have a positive effect of the Coronavirus pandemic. All the enterprises have disclosed that they had undertaken the necessary measures for coping with COVID 19 implications.

With reference to the second aspect of the research, a comparative analysis was made of the revenue and of the profitability determined on this basis. The results for the dynamics of revenues are presented in Chart 1 and are as follows:

Chart 1. Changes in revenue at 31.03.2020 compared to 31.03.2019.:

As can be seen from the chart, all enterprises in the sample have a change in the value of the operating revenue for the first quarter of 2020 against the same period of the preceding year. There is a drop in the revenue by more than 20% in only one enterprise, and this is an indication of an unfavorable risk for the going concern principle. The changes in revenue of the rest of the enterprises in the sample presume an enlarged or maintained volume of business activities, respectively. This is in consistence with the going concern principle in view of the global economic environment of uncertainty.

Revenues are in direct relation with entities’ profitability.[24] They are in many professional works identified as decisive aspects of strategic and tactical decision making of the company. Based on the interim financial statements at 31.03.2020, a tendency was ascertained in profitability dynamics, calculated on the grounds of the revenues earned. The changes in profitability are presented in Chart 2 and are as follows:

Chart 2. Changes in profitability as at 31.03.2020 compared to 31.03.2019:

The chart reveals that there is a decline in profitability for the first quarter of the year 2020 compared to the same period of the preceding year in four of the enterprises in the sample. According to the figures, the decrease in the four enterprises is by more than 20%.

This is an indicator of an unfavorable risk for the going concern principle. The profitability of the remaining eight enterprises corresponds to the going concern characteristics. What is more, taking into account the spread of COVID 19 globally, to maintain and increase profitability is a real success.

Availability of cash resources is designated as an important factor for determining whether a company is a going concern especially under conditions of uncertainty. Based on the interim financial statements of the enterprises in the sample, the following results about their cash availability were found out, presented in Chart 3.

Chart 3. Changes in net cash availability as at 31.03.2020 compared to 31.03.2019:

The chart illustrates that all the entities in the sample have a change in the net cash availability for the first quarter of the year 2020 compared to the same period of the previous year. The change is identified as a percentage against the value of cash resources at the same period of the preceding year. Four of the entities have a decrease in cash by more than 50%, what actually threatens the going concern principle. Net cash availability of the remaining eight enterprises in the sample corresponds to the going concern concept.

The availability of cash resources appears to be a basis to prolong entity’s longevity. The effects of COVID 19 mainly result in the value of cash availability. In order to overcome the negative consequences in this regard, a variety of measures was undertaken on a national and international scale.

Interim financial statements are regarded as continuation of the latest published annual financial statements. In their financial statements as at 31.12.2019, the analyzed entities made disclosures about the expected risks of the global impact of COVID 19 on their business activities.[25] Six of the enterprises in the sample have disclosed an expected risk of drop in revenues. Other three entities have disclosed that they did not expect any substantial changes to their business activities. The figures of the empirical research of the first interim financial statements for the year 2020 have proven the disclosed forecasts in the annual financial statements for the year 2019.

The conclusion of the empirical study of the revenues earned, the profitability determined on the basis of the operating revenues, and of the net cash availability is that non-financial corporate issuers at the Bulgarian Stock Exchange who published their interim financial statements for the first quarter of the year 2020, are going concern entities. The alterations in the value of the revenues earned, the profitability, and cash resources availability under the conditions of Coronavirus pandemic over the first three months of the year, which mark the beginning of COVID 19, reveal indications to risks for the going concern principle.

Therefore, the going concern concept and principle are applicable under the conditions of uncertainty brought about by COVID 19. However, the risk of downsizing the volume of business activities and consequently probable liquidation of the companies has emerged right from the beginning of the pandemic.

This was a reason to impose constant monitoring and effective management of the going concern principle for separate enterprises, what resulted in the activation of the world's globalizing economy.

5 Conclusion

The global impact of COVID 19 on the going concern concept caused uncertainty in the world's economy. This is reflected in the financial reporting as well. International Financial Reporting Standards, as a recognized and applicable basis of accounting, are the foundations for faithful presentation of the effects of the extraordinary event in the financial statements for the first interim period of the year 2020.

The conclusions and results of the presented study contribute to the practical and applied, theoretical and cognitive aspects:

- In theoretical aspect, it was made clear that going concern is first assumption and a concept. The establishment of its faithfulness determines it as a principle of accounting and as a basis for the preparation of financial statements of entities. The essence of the going concern was presented from an economic, legal and applied aspect.
- In view of the cognitive aspect, the terminological designations of going concern in the accounting standardization were clarified. The standardized model of interim financial statements, prepared on the basis of IFRS, was presented. It was substantiated that, by means of the interim financial statements, the effects of the extraordinary events, in this case – the Coronavirus pandemic, on the functioning of the going concern principle, are identified on a current basis.
- From the practical and applied aspect, the inferences and outcomes of the study are useful for potential investors and contractors who have interest in non- financial corporate issuers at the Bulgarian Stock Exchange. Adequate empirical conclusions were made about the influence of COVID 19 on the revenues, profitability and net cash availability of the entities in the sample. It was made clear that the disclosures in the annual financial statements for the prior year regarding the potential implications of the Coronavirus are in consistence with the information provided in the interim financial statements for the first quarter of the current period. This is also useful information for future creditors, in view of the forecasts on liquidity difficulties.

The global impact of COVID 19 on the economy and society will leave enduring traces in human civilization. This provoked adequate, well-reasoned and purposeful actions for protection and continuation of economic activities of entities, what is actually the core substance of the going concern concept and principle in the financial reporting of entities.

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Application 1. Non-financial enterprises - issuers on the Bulgarian stock exchange

<i>Nº</i>	<i>Company name</i>	<i>Sector under NACE Rev. 2</i>	<i>Stock index</i>
1	SOPHARMA AD-SOFIA	Manufacturing	SOFIX; BGBX40 BGTR30
2	MONBAT AD-SOFIA	Manufacturing	SOFIX; BGBX40 BGTR30
3	TCHAIKAPHARMA HIGH QUALITY MEDICINES AD	Manufacturing	BGBX40
4	NEOCHIM AD- DIMITROVGRAD	Manufacturing	BGBX40
5	ODESSOS SHIPREPAIR YARD AD-VARNA	Manufacturing	BGBX40
6	KORADO BULGARIA AD- STRAZHITSA	Manufacturing	BGBX40
7	AGRIA GROUP HOLDING AD- VARNA	Professional, scientific and technical activities	BGBX40
8	SIRMA GROUP HOLDING JSC-SOFIA	Professional, scientific and technical activities	BGBX40 BGTR30
9	SOPHARMA TRADING AD- SOFIA	Wholesale and retail trade; repair of motor vehicles and motorcycles	BGBX40 BGTR30
10	ALBENA AD- ALBENA	Restaurants and mobile food service activities	SOFIX; BGBX40 BGTR30
11	CEZ DISTRIBUTION BULGARIA AD-SOFIA	Electricity, gas, steam and air conditioning supply	BGBX40 BGTR30
12	SPEEDY AD-SOFIA	Transportation and storage	BGBX40

Source: Authors' summaries based on <https://www.bse-sofia.bg/> (10.06.2020)

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