Consulting Marketplace

BANKRUPTCY

A CONVERSATION WITH ELISABETH DA SILVA, CPA, CFF DGC (DICICCO, GULMAN & COMPANY)

WHERE ARE WE NOW?

COVID-19 is expected to directly impact the volume of bankruptcy cases for years to come. Currently, bankruptcy filings show no significant overall uptick as of August 2020. This could be the result of the liquidity injected into the economy in the form of PPP, in combination with other temporary obligations stays such as forbearance agreements. Chapter 11 filings are up year over year by 28% as of August 2020, however, total commercial filings are down year over year by 14% as of August 2020. There are calls for an increase in the number of bankruptcy judges, with the anticipated onslaught of filings expected to unfold in the coming months as reserves are depleted and businesses are unable to sustain the current economic conditions. It seems many of the early filers were businesses that were having trouble prior to COVID-19 file for relief under bankruptcy protection. Not surprisingly, some industry sectors have been impacted more severely or more frequently than others:

- Retail
- Private education (high school, colleges)
- Restaurant
- Tourism (cruise, hotel, booking sites)
- Commercial real estate (co-working)

Now is the time for businesses to assess their financial situation and plan for their future. Utilizing a financial expert may be warranted, in order to address liquidity issues and reposition the business for success.

Clients are in need of liquidity and we are currently serving our clients by educating and consulting on PPP loan forgiveness. Clients are interested in pivoting their business to adapt to the changing world and the behaviors of customers. Clients are interested now more than ever in preserving value.

Many businesses are in need of additional financial support from the government. For those that utilized the Paycheck Protection Program, those monies have run out. There has not been additional federal assistance and businesses are not “back to normal”. They face a multitude of challenges, including workforce availability, capacity limitations, and customer willingness to reengage.

The Main Street Lending Program has the ability to support up to $600 billion in lending but has been a largely unutilized tool, making $497 million in loans as of August 19, 2020. Congress continues to speculate as to why the program continues to be underutilized. While the intention of the program is to make loans to businesses that the lender would not otherwise make, the lenders are applying traditional underwriting and it’s likely that businesses find the program too rigid to meet their needs. And Congress has yet to pass further legislation, including a possible second PPP program, with the first PPP closing August 8th.

HOW DID WE GET HERE?

While COVID-19 has presented a challenge to businesses that was simply insurmountable to prepare for, businesses have faced financial hardships and turned to bankruptcy or restructuring and will continue to do so when COVID-19 is behind us.

There is a new option for small businesses to file a petition for bankruptcy under subchapter V. This trend should make it easier and less expensive for small businesses to reorganize.

WHERE ARE WE GOING?

Businesses can stay in front of issues by financial modeling and consulting with bankruptcy/restructuring teams including attorneys and financial advisors. Also, businesses should not be relaxing controls or the control environment in these uncertain times. With remote workforces it may seem reasonable to forgo some of the old internal controls for ease, but that can lead to bigger issues down the road. Continue to train and be vigilant.

Trends/predictions/cases we are watching:

PPP Loans and Discharge in Bankruptcy

There is uncertainty around the ability to discharge PPP loans in the event a business declares bankruptcy and what long-term implications this will have for a borrower. In terms of PPP forgiveness, while the SBA has provided a safe harbor in which businesses may cite their inability to operate at the same level of business activity due to compliance with certain government agencies' requirements, the timeline of events may come into play. For example, when and how the PPP loan proceeds were used, when the borrower applies for forgiveness and when a bankruptcy proceeding is initiated. It has been reported that some businesses that received PPP loans have subsequently filed for bankruptcy and are using the funds to assist with allowable costs during turnaround, in lieu of more expensive financing borrowers typically find in these situations. As previously mentioned, now-bankrupt borrowers that work within the PPP program rules are likely to find that their PPP loans can be forgiven, given the safe harbors available. It would behoove a borrower to explore PPP forgiveness before turning to discharge as a means to satisfy PPP debt.

Accountants' Liability Claims by Bankruptcy Trustee

As bankruptcies increase, we expect to see an increase in actions against auditors for failing to follow GAAS, failing to arrive at a going concern conclusion, or failing to find fraud. These suits were not uncommon in pre-COVID times but with the uptick in filings we would expect to see an uptick in accountants' liability matters.

We may see accountants sign tolling agreements and agree to cooperate with discovery in order to delay or avoid litigation. Many of these actions are mediated or settled before trial. In either case, there are opportunities for litigation consulting including analysis of audit workpapers, discovery assistance, and solvency analysis.

Business Interruption Claims

Additionally, there is legislation to address the business interruption losses. At both the state and federal level, legislators are attempting to address the financial recovery available to businesses, including the creation of a Business Interruption Relief Program to reimburse insurers that voluntarily cover certain COVID-19-related business interruption claims.

There are multiple lawsuits filed against insurers by restaurant owner policy holders in the aftermath of the vast number of business interruption claims denied by the insurers.

White Collar Investigations/Bankruptcy-Related Crimes

The United States Trustee Program (USTP or Program) made 2,280 bankruptcy and bankruptcy-related criminal referrals during Fiscal Year (FY) 2019. This represents a 1% increase from the 2,257 criminal referrals made during FY 2018. The five most common allegations contained in the FY 2019 criminal referrals involved tax fraud (60.0%), false oaths or statements (23.7%), a bankruptcy fraud scheme (19.8%), identity theft or use of false/multiple Social Security numbers (19.2%), and concealment (18.6%). The USTP is committed to identifying and referring for investigation and prosecution bankruptcy fraud and bankruptcy-related crimes. We would expect to see an increase in white collar crime and bankruptcy-related crimes due to the financial distress in certain sectors, the expected increase in bankruptcy filings, and the continued focus of USTP and other enforcement groups on combating fraud and protecting the integrity of the bankruptcy system.

Elisabeth da Silva, CPA, CFF
Partner | DGC
Moore NA Consulting Marketplace
Service Provider
edasilva@dgccpa.com

Bankruptcy is just one offering available in the Moore North America Consulting Marketplace.

To learn more about this resource and how you can incorporate it into your service offerings, contact Lauren Williams (lwilliams@moore-na.com).