Bottom shekel / Shlomi Shuv

‘Going concern’ notice: A brief respite, but no cure for debt ills

It may seem confusing, but a “going concern” warning in financial reports means management still sees the business continuing as usual despite substantial doubts, with reports consequently still prepared according to the regular International Financial Reporting Standards rules for going concerns.

This has serious implications, because if the company cannot continue operating as a going concern it is reasonable to assume important adjustments need to be made to asset and liability values and how they are classified – due to asset realization under pressure and making provisions for employee rights, for example.

Even after Maariv announced its huge quarterly loss, for instance, the newspaper reported it would have needed to make NIS 102 million more in provisions if it hadn’t prepared its statements under a going concern assumption.

But publishing a going concern comment could in itself have immediate negative accounting consequences. Bond issues usually contain a generic provision stating the trustee may insist on their immediate redemption when significant concern arises over default or that bondholder rights might be compromised.

The circumstances leading to a going concern opinion could also be grounds for demanding immediate repayment, in which case the company would need – taking an IFRS approach – to reclassify its bonds to current liabilities since the redemption date would no longer be considered under company control. Suny Electronics reclassified NIS 249 million in bonds to current liabilities in the second quarter although its first quarter results already carried a going concern notation, presumably because that report wasn’t published until May.

Among company statements with a going concern remark, it can be seen that adjustments aren’t uniform. While Maariv and Tao Tsuot reclassified all their bonds to current liabilities, other companies have resisted: IDB Holdings hasn’t, and doesn’t indicate any expectation of doing so in the third quarter either.

It is hard to ignore the great sensitivity inherent in management’s interpretation of the accounting treatment, which can seem like “an admission of guilt” and explicit acknowledgment of the right of bondholders to immediate repayment. This could push the company onto a slippery slope by putting working capital in deficit, thereby leading to violations of financial covenants and accelerating financial deterioration.

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