Volume **XVII**/2021 ISSN 2344-102X
Issue (XXVII) / **October** 2021 ISSN-L 2344-102X

APPLICATION OF THE CONTINUITY PRINCIPLE IN THE SITUATION OF REORGANIZATION OF ACTIVITY FOR COMPANIES IN INSOLVENCY

PhD. Student Ancuța-Anisia CHELBA
Stefan cel Mare University of Suceava, 720229, Romania
ancutza_anisia@yahoo.com
Professor PhD. Veronica GROSU
Stefan cel Mare University of Suceava, 720229, Romania
veronica.grosu@usm.ro

Abstract
In an extremely dynamic economic environment marked by uncertainties, any company in financial difficulty or in a state of insolvency must have correct and current information at hand about the possibility of reorganizing the activity, as a fundamental landmark in the natural opportunity to continue business in the economic environment. Also, stakelorders constantly need real and concrete information about their business partners in order to make quick and intelligent decisions regarding the collaboration they carry out with them. In this context, we can say that the insolvency situation reflects the health of the business environment in which the actors manage business relationships and more. From this point of view, the main objective of this article is to provide information support to companies tried especially in this pandemic period by highlighting the possibility of applying the principle of business continuity even in situations of financial crisis. For this purpose, the article delimited the concept of continuity of the company's activity in insolvency proceedings, presented and explained the compensation agreement with creditors in insolvency, and finally highlighted the usefulness of financial-accounting rates in risk prevention of insolvency.

Keywords: *the principle of continuity; insolvency; risk; companies; financial-accounting rates*

JEL Classification: *M41*

I. INTRODUCTION

In economic and social terms, when a company fails to pay its payments, it is necessary to protect a general interest in the recognition of unpaid amounts and in resolving the situation created, and the establishment of a collective procedure to cover the liabilities of the debtor in state of insolvency can be the way to recover its activity or resolve the situation, with the consequence of removing the blockage on payments.

The notion of insolvency implies a difficult patrimonial or crisis situation of a trader in which the liability exceeds the asset, determining the impossibility for the trader to fulfill the payment obligations assumed on time and in good conditions (Lică, 2012). The concept of insolvency should not be confused with the notion of insolvability, because the latter is that legal status of a person's assets characterized by the fact that the passive elements outnumber the active elements. The existence of the state of insolvability has no relevance in itself regarding the initiation of the insolvency procedure, because only the insolvency attracts the application of the special procedure, not the insolvability. Therefore, according to the Explanatory Dictionary of the Romanian Language, insolvability is "a situation in which there is a debtor whose assets are of less than the totality of the obligations that would be satisfied with those assets" (see https://dexonline.ro/definitie/insolvabilitate).

A first sign that should raise questions about the company's financial health are arrears, namely the time when debts older than 60 days can no longer be paid. In general, the problems faced by a firm in financial difficulty are: arrears of taxes, inability to repay loans and borrowings, cash flow deficit, petition for liquidation by the court. (see https://www.liquidate-ltd.co.uk).

The insolvency procedure is a collective, general one, directed at the debtor, having as sole purpose the payment of the debts by reorganizing his activity or by liquidating the patrimony (bankruptcy). This procedure also provides the debtor with the possibility to bring the company back to the financial state prior to the decline, through reorganization, if there are premises for recovery of its activity, and creditors and the syndic judge agree with the reorganization plan proposed by the debtor.

Volume **XVII**/2021
Issue (XXVII) / **October** 2021
ISSN 2344-102X
ISSN-L 2344-102X

II. Continuity Of The Company's Activity In Insolvency Proceedings

The continuity of the activity in the insolvency proceedings consists in the possibility of reorganizing the company in order to get out of the state of insolvency.

The term "reorganization" comes from the French verb "reorganizer" which means "to restructure, to organize on new bases, to rearrange". In a broad sense, reorganization or restructuring means the operation or set of measures or operations by which an entity remedies its organizational structure, adopting a new configuration. In economics, the term is used to designate an operation of a financial nature that may refer to the restructuring of capital or debt or the reorganization of a sector of activity or a company (Târșia, 2012).

Since the 1980s, the term has been used more and more frequently to designate the reorganization of legal entities, by restructuring the business, which had implications for employment contracts. Mainly, the concept was understood either as a strategy of reducing the size of the company ("downsizing"), or as a complete reorganization of the production process of a company, the approach being predominantly economic in nature. In economic terms, the authors of Bowman & Singh (1993) consider the reorganization "(...) a set of operations whose purpose is to buy or sell assets, change the structure of capital, or transform the internal organization of the enterprise". In another opinion (Cameron, 1994), reorganization is in fact a restructuring involving a "(...) set of activities undertaken by the administration of an organization and designed to improve organizational effectiveness, productivity and competitiveness."

Strictly referring to the insolvency process, the reorganization is the mechanism applied to debtors, legal entities, to cover their debts on the basis of a debt payment schedule, including practically a timed schedule for the payment of amounts due to creditors according to the table containing claims. finale (Cameron, 1994).

During this period, the aim is to recover the debtor's activity according to those provided in the plan voted by the creditors and confirmed by the syndic judge. By carrying out the reorganization period itself, the amounts of money needed to pay the receivables are ensured, according to the payment schedule (terms and amounts) that is part of the plan.

The reorganization period starts from the date of confirmation of the plan by the decision of the syndic judge and can be completed as follows: if the plan succeeds the claims are paid, i.e. the debtor's liabilities are covered and the judicial reorganization is closed by the syndic judge, without going bankrupt. In this case, the debtor leaves the insolvency procedure itself and, at the same time, the overall procedure, being reinstated in the commercial environment and in the normal activity. But, if the plan fails then the debtor remains in the overall procedure, passing, based on the decision of the syndic judge to the next period, the bankruptcy period.

It is important to mention that the liquidation of some assets of the debtor based on the plan for the payment of receivables can be included in the procedural way of reorganization, and only the actual liquidation of the debtor's assets is the object of bankruptcy proceedings (Avram, 2010).

The plan, named the reorganization plan, should provide, together or separately:
- operational and / or financial restructuring of the debtor;
- corporate restructuring by changing the structure of registered share capital;
- limiting the activity by liquidating certain assets from the debtor's assets.

One of the most important obligations during this period is that which provides for the obligation of the debtor to comply, without any delay, with the structural changes provided for in the reorganization plan (Birchall, 2010).

III. Compesation Agreement With Creditors In Insolvency Prevention Proceedings

In the act of preventing insolvency proceedings, there are, in addition to well-known judicial contracts, alternative means for out-of-court settlement of debt settlement difficulties within a firm; all this is formed on the basis of the will of the parties, ie the debtor (enterprise) and its creditors.

The debtor undertakes to reorganize his company in order to pay the debts, and the creditors agree on a series of facilities for the benefit of the debtor, facilities that favor the recovery of debts. Although there is no specific regulation for this purpose, the (unofficial) agreements concluded between the debtor and his creditors for debt restructuring are recognized and even encouraged by the legal framework. In most cases, in practice, they remain the most attractive way for creditors whose borrowers, although with cash flow problems, continue to enjoy the economic and financial confidence of their business partners. These agreements also have the undeniable advantage of flexibility and lead to the rapid implementation of an agreement on business restructuring and the complete avoidance of insolvency proceedings..

To encourage the use of these instruments, the Insolvency Law no. 85/2014 regulates that the documents concluded in good faith in the execution of an agreement with creditors, concluded as a result of extrajudicial negotiations for debt restructuring of the debtor are not considered fraudulent, under the provision that the agreement was intended to lead - reasonably - to the financial recovery of the debtor and did not aim at causing damage and / or discrimination to some creditors (Iconia, & Doina, 2015).

Volume **XVII**/2021 ISSN 2344-102X
Issue (XXVII) / **October** 2021 ISSN-L 2344-102X

Thus, the company in a state of financial difficulty in order to resolve the situation of non-payment of debts, may resort to negotiation procedures with creditors that may be extrajudicial and judicial. Extrajudicial negotiations may include: simple voluntary negotiation or assisted voluntary negotiation - mediation, and judicial negotiations may include: ad-hoc mandate procedure or concordat procedure. The most convenient method of restructuring is voluntary negotiation.

The result of the voluntary out-of-court restructuring negotiations is the elaboration of a restructuring plan accepted by the debtor and the relevant creditors, which would allow the debtor to continue his activity and cover all or part of his obligations. If this result does not materialize, the possible alternatives are to initiate a pre-insolvency (ad-hoc mandate or preventive composition) or insolvency proceedings. In both cases, according to the Guide to Extrajudicial Restructuring of Company Obligations, the use of information accumulated during the voluntary negotiation period may lead to a more expeditious conduct of legal proceedings (see https://www.bnr.ro/).

Simple voluntary negotiation is the most convenient way to resolve situations of insolvency, representing an alternative to amicable settlement, with the free consent of the parties involved.

At the end of this type of negotiation, the compromise reached may be the best solution for all parties involved: the debtor is discharged from the debt or obtains a debt staggered within a reasonable time, the creditor collects the debt within an agreed time and in an accepted amount, under these conditions the commercial relationship between the parties is maintained and the economic entity still exists without difficulties in the commercial circuit.

Assisted voluntary negotiation (mediation) can be an efficient tool, mediation being a form of assisted voluntary negotiation, through a specialized third party, as a mediator, in conditions of neutrality, impartiality and confidentiality (Miloş, 2013).

In summary, the main features of the mediation procedure are:

- represents an alternative way of solving the con ects;
- it is a voluntary and confidential procedure;
- it involves the intervention of a third person, neutral, impartial and without decision-making power;
- the mediator facilitates communication between the parties in order to identify options for resolving;
- helps the parties find a mutually accepted solution in a private setting (Miloş, 2013).

The ad hoc mandate is a confidential procedure, initiated at the request of the debtor, through which an ad hoc representative appointed by the Court negotiates with the creditors to reach an agreement between one or more of them and the debtor, so as to overcome the state of difficulty of the latter society. (Radu, 2011).

The ad hoc mandate seeks to reach an agreement between the debtor and one or more of his creditors, in order to overcome the financial difficulty, protect him, keep the jobs and cover the debtor's debts.

The purpose of the ad hoc mandate is to cover the debt of the debtor in financial difficulty, to prevent insolvency, to provide an opportunity for an efficient recovery of the debtor's activity, an amicable negotiation of debts, an efficient procedure, with minimal costs, an administrative procedure of insolvency practitioners under the control of the court. It is recommended that the first to be contacted are creditors with whom the debtor has had good business relations for a longer period, with a stronger sense of mutual trust, as smaller creditors may pay them as the legal proceedings are lost or the individual is criminal proceedings are initiated, using for this purpose the financing provided by the relevant creditors (Padure & Tutuianu, 2020).

The ad hoc prosecutor is a third party that is independent of both the debtor and the creditors. It is not a power of attorney of the debtor and no power of attorney of the creditors, but a prosecutor of the president of the court. Here is the greater negotiation and credibility of the ad hoc prosecutor compared to the debtor (Iconia & Doina, 2015).

The preventive agreement, according to Law 85/2014, "is a contract concluded between the debtor in financial difficulty, on the one hand, and the creditors who hold at least 75% of the value of accepted and uncontested claims, on the other hand, approved by the syndic judge, contract by which the debtor proposes a plan for the recovery and realization of the claims of these creditors, and the creditors agree to support the debtor's efforts to overcome the difficulty they are in".

What seems to benefit creditors in such proceedings are in fact the aspects that actually disadvantage creditors in the insolvency proceedings, namely: in the case of opening insolvency creditors who have unsecured claims (the creditor whose claim is not secured by personal or real guarantees, but only by the right of general pledge over the debtor's patrimony), find that the risk of non-collection of their claim is quite high, given the fact that these claims do not bear interest or penalties and, and that for these receivables from the unsecured class is voted the partial payment, in a certain proportion, at the end of a reorganization period, in conditions of staggered periods of 3 or 4 years, or, in the worst case, could find the lack of assets in the debtor's patrimony and the impossibility of paying the debts - which would automatically lead to closing the insolvency proceedings.

Almost all modern laws provide for measures to prevent insolvency, which, naturally, are left to the debtor, who should be aware of the financial difficulty that his own company may be going through.

Volume **XVII**/2021 ISSN 2344-102X
Issue (XXVII) / **October** 2021 ISSN-L 2344-102X

IV. Usefulness Of Financial-Accounting Rates In Detection Of Insolvency Risk

In the prediction of bankruptcy one cannot ignore the popular method of rates. These rates are formed on the basis of financial-accounting information. Both practitioners and researchers agree that financial rates are also used to compare risk and return on different firms in size and industry, in order to help investors and creditors make smart decisions.

Financial rates play an important role in disclosing the company's financial health, a role that helps in making decisions about maintaining the company's competitive position, achieving stable development and eliminating potential financial risks.

The use of financial rates in the analysis brings many benefits, as can be seen in Figure 1.

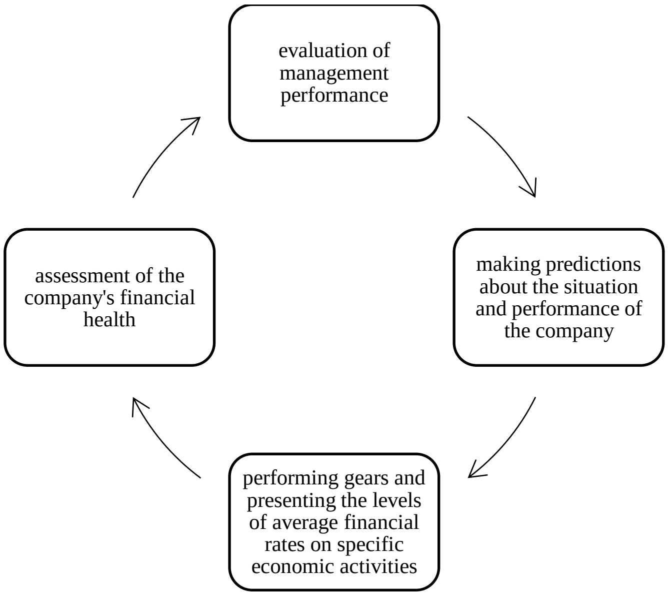

Figure 1 – The benefits of using financial-accounting rates in the analysis
Source: Anghel, 2002

The authors Kliestik, Valaskova, Lazaroiu, Kovacova, & Vrbka (2020) group financial rates on firm health prediction into activity-related rates, liquidity rates, profitability-related rates, and debt, as can be seen in Table 1. An important indicator is the group of liquidity rates that focus on a company's ability to pay its short-term obligations. Most important is the current rate, which is a liquidity and efficiency ratio that measures a company's ability to pay off its short-term debt using its current assets. The current ratio determines liquidity, as short-term debt is due during the following year. A higher current ratio is always more favorable than a lower current ratio because it shows that the company can more easily make payments on current debts.

Table 1. Rates most frequently used in predicting a company's financial health

Activity rates	**Liquidity rates**	**Rate de profitabilitate**	**Debt rates**
Total sales / Total assets	Current rate	ROE (return on equity)	Total debts / Total assets
Total income / Total assets	Working capital / Total assets	ROA (return on assets)	Equity / Total assets
Availability / Total assets	Fast rate (Acid test)	EBIT (earnings before interest and tax) / Total assets	Cash Flow / Total Debt
Cash flow / Operating income	Working capital / Fixed assets	Operating profit / Total assets	Equity / Total debt
Total sales / Working capital	Short-term assets / Total assets	ROS (sales return)	Total debts / Equity
Total sales / Current assets	Equity / Long-term assets	Retained earnings / Total assets	Total assets / Total debts
Sales revenue / Total Assets	(Equity-Share capital) / Total assets	EBT (pre - tax income) / Total assets	(Current assets + Accumulated assets) / (Current debts + Accumulated rights + Special funds + Accumulated income)
Inventory / Total sales		EBT / Total sales	Total receivables / Total assets

Volume **XVII**/2021 ISSN 2344-102X
Issue (XXVII) / **October** 2021 ISSN-L 2344-102X

Activity rates	Liquidity rates	Rate de profitabilitate	Debt rates
Inventory / Income * 365 days		EBT from sales / Operating costs	Total receivables / Equity
Total sales / Total debt		EBIT / Interest expense	Interest income / (Profit from economic activity + Interest income)
		Earnings after taxes / Inventory	Cash Flow / Total Debt

Source: Kliestik, et al., 2020

The liability-total-assets ratio is the second most significant that measures the ratio between corporate assets covered by liabilities. A high liability-asset-total ratio can be negative, which indicates that shareholders' equity is low and potential solvency problems. Businesses with financial difficulties will often have a high ratio of liabilities to total assets. The third is the ratio between total sales and total assets, which quantifies corporate efficiency, focusing on the relationship of assets to revenue generated, therefore, the higher the value of the ratio, the better for the company. Finally, the capital-asset ratio, which determines the financial health of an enterprise and is used to assess the financial leverage of a company. If a company wants to demonstrate sustainability and a low level of risk, a higher level of capital-asset ratio is needed to convince creditors (Kliestik, et al, 2020).

Another approach to rates was taken by Pinches, Eubank, Mingo & Caruthers (1975), who grouped financial rates in terms of return on investment, indebtedness, capital efficiency, liquidity, cash flow, rotation of inventories and receivables, as can be seen in the table below

.

Table 2. Representative financial-accounting rates in the financial diagnosis

Return on investment	**Leverage**	**Capital efficiency**	**Liquidity**	**Cash flow**	**Stock Rotation**	**Debt rotation**
Net profit / Net assets	Debts / Equity	Turnover / Assets	Current assets / Current liabilities	Cash flow / Assets	Stocks / Turnover	Receivables / Stocks
Net profit / Equity	Debts / Assets	Turnover / Fixed assets	Fast assets / Current liabilities	Cash flow / Expenses	Cost of sales / Stocks	Receivables / Turnover

Source: Pinches, et al (1975)

The rates presented above can provide a profile of the company, its economic characteristics and competitive advantages, as well as its specific operating, financial and investment characteristics. These are an effective way to analyze the financial situation of the company in our research. In the Winakor and Smith study (1935), as in other subsequent studies, the idea that there are major differences between the financial rates of bankrupt firms compared to viable firms was supported.

V. CONCLUSION

Insolvency prevention involves, first of all, an efficient management of the activity and maintaining a balance between the company's expenses and income, but also the permanent monitoring of the cash flow. On the other hand, in a context in which companies are increasingly indebted and have greater pressure on liquidity, systematic and periodic monitoring of business partners contributes to financial well-being and the timely identification of possible vulnerabilities that may affect a business. Through a specialized evaluation of the current or potential partners can be found their financial situation, as well as the imminence of initiating insolvency proceedings against them, in order to make the best decisions regarding not starting the collaboration with them, or even ending the collaboration.

However, companies that find themselves in a state of financial difficulty are not lost and subjected in any form to bankruptcy proceedings, but they can resort to "rescue" procedures, namely negotiation with creditors, approaches that can be extrajudicial or judicial. Extrajudicial negotiations may include, as we presented in the article: simple voluntary negotiation or assisted voluntary negotiation - mediation, and judicial negotiations may include: ad-hoc mandate procedure or concordat procedure. Following the study of the literature, it was noted that the most convenient method of restructuring is voluntary negotiation.

In addition to the information supported and presented so far, we also support the idea that financial-accounting rates play a key role in disclosing and preventing the financial health of the company, a role that helps make decisions on maintaining the competitive position of the company, to achieve a stable developments and the elimination of potential financial risks, implicitly the risk of insolvency.

Volume **XVII**/2021 ISSN 2344-102X
Issue (XXVII) / **October** 2021 ISSN-L 2344-102X

REFERENCES

1. Anghel, I. (2002). *Falimentul. Radiografie şi predicție*, Economică, Bucharest, Romania.
2. Avram A. (2010). *Procedura insolvenței. Efectele deschiderii procedurii. Primele măsuri*, Hamangiu, Bucharest, Romania.
3. Birchall, A. (2010). *Insolvency Proceedings. Receivership and Bankruptcy Proceedings*, Universul Juridic, Bucharest, Romania.
4. Bowman, E. H., & Singh, H. (1993). Corporate restucturing: Reconfiguring the firm, *Strategic Management Journal*, 14(5-14). Retrieved September 18, 2021 from https://www.jstor.org/stable/2486417/
5. Cameron, K. S. (1994). Strategies for successful organizational downsizing, *Human Resource Management*, 33(2), 189-211.
6. Iconia, T. A., & Doina, L. E. (2015). Prevention of insolvency through contractual and judicial methods, *ANALE Seria Stiinte Economice. Timisoara*, 21, 418-421.
7. Kliestik, T., Valaskova, K., Lazaroiu, G., Kovacova, M., & Vrbka, J. (2020). Remaining Financially Healthy and Competitive: The Role of Financial Predictors, *Journal of Competitiveness*, 12(1), 74–92. https://doi.org/10.7441/joc.2020.01.05.
8. Lică, F. I. (2012). Noţiunea de insolvenţă şi bancrută in legislaţia română, *University Legal Studies*, (1-2), 185-188.
9. Tarsia, A. C. (2012). *Reorganizarea persoanei juridice de drept privat*, Hamangiu, Bucharest, Romania.
10. Miloş, S. M. (2013). Prevenţia insolvenţei prin mijloace contractuale. *Judiciar courier*, (06), 337-341.
11. Padure, L. A., & Tutuianu, A. (2020). Ad-hoc Mandate, *European Journal of Social Law/Revue Européenne du Droit Social*, 47(2), 59-67.
12. Pinches, G., Eubank, A., Mingo, K., & Caruthers K. (1975). The Hierarchical Classification of Financial Rations, *Journal of Business Research*, 3(4), 295-310.
13. Radu, B. (2011, December). Law of Insolvency vs. Law on Preventive Composition with Creditors and the Ad Hoc Mandate, Paper presented at the 2nd Global Conference on RO-RUS-Nipponica, Moscow, 10-17.
14. Târșia, A. C. (2012). *Reorganizarea persoanei juridice de drept privat*, Hamangiu, Bucharest, Romania.
15. Winakor, A., & Smith, R. (1935). Changes in the financial structure of unsuccessful industrial corporations, *The Accounting Review*, 11(1), 87-88.
16. Insolvency company. Retrieved April 12, 2021 from https://www.liquidate-ltd.co.uk
17. Insolvency definition. Retrieved April 10, 2021 from http://dexonline.ro/definitie/insolvabilitate
18. Guide to out-of-court restructuring of company obligations. Retrieved March 30, 2021 from https://www.bnr.ro/DocumentInformation.aspx?idDocument=9343&directLink=1

*** Law 85/2014 on insolvency prevention and insolvency proceedings, updated.