

# **FALSE BANKRUPTCY IDENTIFICATION IN THE PROCESS OF CORPORATE ANTICRISIS MANAGEMENT**

**Rybak Tatsiana N.**

## **ABSTRACT**

**Imperfect legislation impedes greatly the false bankruptcy identification and concomitant expeditious detection and prevention of this crime in Belarus. We suggest that this process start from analyzing the debtor's accounting and reporting accuracy first and foremost, followed by adjusted reporting indexes analysis, and then one can identify whether any sign of false bankruptcy can be incriminated.**

## **Introduction**

Bankruptcy proceedings, initiated by an economic court and followed by false bankruptcy denunciation, result in serious negative legal and economic consequences for creditors and other persons involved. The Department for Reorganization and Bankruptcy of the Belarusian Ministry of Economy has worked out the system for false bankruptcy identification. However, the existing statutory regulations and legal acts are not perfect to determine false bankruptcy. Imperfect legislation is required to be improved by including new methods of false bankruptcy identification.

## **1. Theoretical and methodological basis of false bankruptcy identification**

### **1.1 Essence of false bankruptcy**

During the protective period and bankruptcy proceedings the estate administrator (liquidator) shall determine the features of false bankruptcy, if any.

Reference to the official comments to the Belarusian Law on Economic Insolvency (Bankruptcy) dated 18/07/2000 (Reg. No. 423-3), the definition of "false bankruptcy" differs in its legal nature, subject orientation and consequences, as compared to that of the criminal laws [3, p. 44].

Pursuant to Art. 9 of the Belarusian Law on Economic Insolvency (Bankruptcy), in case the debtor's proxy files a bankruptcy petition with economic court while the petitioner is able to de facto settle creditors' claims absolutely (false bankruptcy), the petitioner shall indemnify before the creditors any damages (harm, including moral damage) incurred in relation thereto, if not stipulated otherwise by law [2, p. 28]. In other words, false bankruptcy is a petition, filed by a debtor's proxy with economic court in de facto situation of no insolvency (bankruptcy), namely, when the debtor's assets are sufficient to cover all creditor's claims in full. Thus, the Belarusian Law on Economic Insolvency (Bankruptcy) stipulates debtor's indemnification against any damages as a legal consequence of false bankruptcy revealed.

The Belarusian Criminal Code of 09/07/1999 (Reg. No. 275-3) defines "false bankruptcy" as willful submission of false documents by a private business or officer / owner / founder of any legal entity for bankruptcy notification purposes [6, p. 12]. The crime of this kind is punishable by fines or, alternatively, office holding / business

conducting restrictions; or under-6-month detention; or under-3-year restrain; or same period imprisonment. Any false bankruptcy resulting in major damages is punishable by under-5-year restrain or same period imprisonment [6, p. 12]. Any legal consequences, as may be applied pursuant to the Belarusian Law on Economic Insolvency (Bankruptcy), does not waive the criminal prosecution of the physical person committing such crime, as stipulated by Art. 238 of the Belarusian Criminal Code [3, p. 45].

In this study the author kept to the definition given by the Belarusian Law on Economic Insolvency (Bankruptcy), because all orders by the Belarusian Ministry of Economy, as related to false bankruptcy, are based on this Law provisions.

## **2.2. Legal basis for false bankruptcy identification in the Republic of Belarus**

The Department for Reorganization and Bankruptcy of the Belarusian Ministry of Economy has worked out the system for false bankruptcy identification. By Order No. 271 of the Belarusian Ministry of Economy dated 16/12/2002 the Regulations has been approved to determine false or fraudulent bankruptcy criteria, bankruptcy concealment or creditor indemnification disruption, and to properly report on such issues. The aforesaid Regulations are binding on all estate administrators (liquidators) involved in bankruptcy proceedings when analyzing debtor's financial position and solvency, and on other professional analysts when identifying bankruptcy features and making the related expert opinions [4, p. 49]. The Regulations are aimed at crime-associated acts substantiation for preliminaries and bankruptcy proceedings opened with the competent economic court [4, p. 49].

For the purposes of false bankruptcy identification, if any, the analysis is made under Official Form No. 1 – Balance Statement to reveal sufficiency of assets and funds to cover the debtor's short-term liabilities. The same is calculated as a ratio of circulating assets to aggregate short-term liabilities. At the same time, in addition to the senior debt payable, the short-term liabilities calculated shall take into account the aggregate of recognized interest, penalty (fines) and other economic (financial) surcharges [4, p. 51].

Based on the assets sufficiency to cover the debtor's short-term liabilities, as calculated, the following conclusions can be efficiently made:

- in case the assets sufficiency index is equal or exceeds one, false bankruptcy is most possible;
- in case the assets sufficiency index never exceeds one, no false bankruptcy is contemplated [4, p. 51].

To confirm the validity and accuracy of the findings and conclusions made by estate administrators, the bankruptcy prevention committees of the national public administrations shall carry out the bankruptcy-involved organizations financial situation and solvency analysis. The committees shall act as stipulated by the Regulations on economic insolvency / bankruptcy-involved organizations financial position and solvency analysis, as approved by Order No. 57 of the Belarusian Ministry of Economy dated 27/02/2004. Following the analysis, the committee shall make the report specifying false bankruptcy features, if any [5, p. 26].

## **2. Methods of false bankruptcy identification**

If strictly followed, the above Regulations to determine false or fraudulent bankruptcy criteria, bankruptcy concealment or creditor indemnification disruption,

and to properly report on such issues might lead the estate administrators or analysts to erroneous conclusions.

Firstly, as stipulated by the Belarusian Law on Economic Insolvency (Bankruptcy), false bankruptcy determination is made only if such bankruptcy has been petitioned by the debtor [2, p. 38]. If claimed by the creditors, no false bankruptcy analysis should be made. Such practice is illogical due to possible collusion between the debtor and creditors, as well as debtor's willful misrepresentation to simulate preparatory submission of a bankruptcy petition.

Pursuant to Art. 9 of the Regulations, false bankruptcy can be determined through the debtor's evident possibility to cover all creditor's claims in full, as of the date of the debtor's bankruptcy petition filed with the economic court [4, p. 50]. Consequently, all assets available should be compared to aggregate long-term and short-term liabilities for proper false bankruptcy determination. At the same time, Art. 12 of the Regulations requires only circulating assets to be compared to short-term liabilities [4, p. 51]. With this reference, the calculation of the debtor's circulating assets sufficiency to cover short-term liabilities may not be considered true-to-life.

False bankruptcy is required to be determined as of the bankruptcy petition date [4, p. 50], while the circulating assets sufficiency shall be controlled under Official Form No. 1 – Balance Statement being basically dated before the petition. If analyzed under the balance statement made by the last closing date, major indexes might change essentially until petition to the economic court.

The circulating assets sufficiency is calculated under the similar formula being applied to the current liquidity coefficient calculation, as given by the Instructions to analyze and control the entities' financial situation and solvency, approved by joint Order No. 69/76/52 by the Belarusian Ministry of Finance, Belarusian Ministry of Economy and Belarusian Ministry for Statistics and Analysis dated 27/04/2007. When analyzing the current liquidity index, as well as own circulating assets availability and liability-related assets sufficiency, persistent insolvency can be detected to further decide on bankruptcy proceedings initiation. Actually, the same indexes are used to determine bankruptcy and false bankruptcy factors.

The Instructions to analyze and control the entities' financial situation and solvency provide different industry-related standards to analyze current liquidity, i.e. for fuel industry – 1.4; for building industry – 1.2; for transport – 1.15 [1, p. 39]. At the same time, the circulating assets sufficiency minimum value shall never drop below 1.0 for all industries. It should be noted that the liability-related assets sufficiency value varies significantly for a leasing company, being mainly financed by borrowed resources, and for a building organization, as an example. An industrial company may have 1.0 index with no false bankruptcy features due to existent low-liquidity circulating assets share (i.e. major share of slow assets and overdue accounts receivable). To avoid erroneous identification of false bankruptcy, sector-related peculiarities and type of business should be taken into account at all times.

In addition, circulating assets sufficiency is based on balance statement data of the entity's assets and liabilities, which can be misrepresented and/or fabricated by providing false accompanying documents of accounts payable, concealing the actual accounts receivable as due, balance property-related information, etc.

Finally, when determining false bankruptcy, the aggregate of short-term liabilities, as given in the Balance Statement, is generally taken into account. Such

value can differ from actual liabilities due. For example, the Balance Statement might fail to reflect any personal indemnities (due to personal injury or death), severance pays, unused vacations compensation and other liabilities.

Reference to the aforesaid, the source information might be inaccurate and/or unreliable to a major extent, and, consequently, false bankruptcy can not be determined absolutely. Besides, the existing statutory regulations and legal acts are not perfect to determine false bankruptcy.

False bankruptcy is recommended to be assessed in two stages.

The first stage shall involve the accuracy and reliability analysis of the debtor's accounting and reporting. To determine possible falsification, the synthetic and analytical data shall be compared to those of accounting and reporting, actual assets and liabilities check, debtor / creditor settlements verification, property composition and liquidity analysis, price-formation validity, purpose-oriented allocation of hard-currency and other funds, public investments and borrowings efficiency. The analysis shall be possibly made for the reporting period of three years prior to the debtor's bankruptcy petition filed.

Following such complex analysis, the adjusted balance statement shall be made, as of the date of the debtor's bankruptcy petition.

The second-stage work shall be based on the adjusted balance statement data to calculate the assets sufficiency as a ratio of aggregate assets (nominated in the balance currency) to aggregate short-term and long-term liabilities. Additionally, the total liabilities shall include the creditor's post-petition claims, which were missing in the Balance Statement. If the debtor's assets sufficiency coefficient exceeds 1.0, the assets can be treated sufficient to cover the creditors' claims in full, as of the bankruptcy petition date, and, naturally, false bankruptcy can be incriminated. In case the circulating assets sufficiency value drops below 1.0, no false bankruptcy features can be formally incriminated.

Any false bankruptcy features identification shall be preferably followed by thorough analysis (in dynamics) of debtor's aggregate assets sufficiency to cover overall liabilities and that of circulating assets sufficiency to cover short-term liabilities, as of each reporting date of investigation. Having compared the above indexes to the standard values, the proper expert opinion of the debtor's bankruptcy petition validity and legitimacy can be made.

The bankruptcy assessment based on the debtor's reliable information can be efficiently applied in law-enforcement and judicial practice.

### **3. Conclusion**

The study has resulted in elaborated theoretical background and practical recommendations for false bankruptcy identification in the process of corporate anticrisis management. We have introduced methods of false bankruptcy identification. They can be used for reasonable and grounded anticrisis decision-making, which, consequently, provides for coordination of creditors', investors' and debtor's interests, for capital transfer from unprofitable businesses to efficient economic sectors.

## **LITERATURE**

- [1] Instructions to analyze and control the entities' financial situation and solvency, as approved by joint Order No. 69/76/52 by the Belarusian Ministry of Finance, Belarusian Ministry of Economy and Belarusian Ministry for Statistics & Analysis dated 27/04/2007. Belarusian National Register for legal acts, Reg. No. 8/16431, 2007
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- [6] Belarusian Criminal Code of 09/07/1999 (Reg. No. 275-3). Belarusian National Register for legal acts, Reg. No. 76, 1999.

## **CONTACT**

**Tatsiana N. Rybak, PhD in Economic Sciences**  
**Associate professor**  
**Belarusian State Economic University**  
**26, Partizanski Av.**  
**220070, Minsk, Republic of Belarus**  
**Phone: ++ 375296564618**  
**e-mail: carina96@tut.by**