

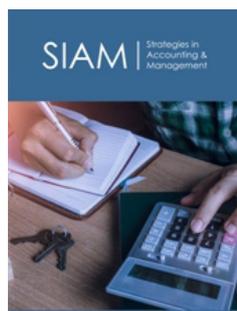
The COVID-19 Pandemic and Bankruptcies of Retail Companies: An Initial Look

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Introduction

As of mid-October 2020, the number of COVID-19 cases worldwide has approached 38 million cases. In the United States (U.S.) alone, as of mid-October 2020, there have been over 7.8 million COVID-19 cases and over 215,000 deaths¹. The negative economic consequences of the COVID-19 pandemic have been considerable. The Bureau of Economic Analysis (BEA) informs that U.S. real gross domestic product (GDP) decreased five percent in the first quarter of 2020 (BEA 2020) [1]. GDP decreased even further at an annual rate of 31.7 percent in the second quarter of 2020, based on the second estimate given by the BEA. Numerous news outlets reported that the 31.7 percent decline represents the worst quarterly contraction in the U.S. economy ever recorded.

Furthermore, BEA (2020) reports that corporate profits from current production (i.e., corporate profits with inventory valuation and capital consumption adjustments) decreased \$226.9 billion in the second quarter, compared with a decrease of \$276.2 billion in the first quarter. The retail industry has particularly been hit hard by the COVID-19 pandemic. Temporary closings of stores and offices have significantly impaired retailers' ability to operate and attain profits. In this short communication article, we profile nine retail companies that have filed for bankruptcy since the beginning of the pandemic. Clearly, there are more than nine retailers that have filed for bankruptcy during the pandemic. However, we focus on those retail companies that were publicly traded on the stock exchange and for which we could analyze their public financial disclosures. Professional auditing standards stipulate that the auditor is responsible for evaluating whether there is substantial doubt about the client's ability to continue as a going concern for a reasonable period, not to exceed one year beyond the date of the financial statements being audited (see PCAOB AS 2415). In essence, auditors need to issue a going concern opinion if they have substantial doubt about the client's ability to continue business operations. Given the adverse consequences of receiving a going concern opinion, management would strongly argue against such an opinion from the auditor. Nevertheless, auditors need to maintain objectivity when assessing whether a going concern opinion is appropriate for a financially distressed client Carson et al. [2]. In our reporting, we examine whether the following bankrupt retailers were issued any going concern opinions from their auditor.

Publicly Traded Retail Companies that Filed Bankruptcy during COVID-19 Pandemic

Pier 1 imports inc: Filed bankruptcy on Feb 17, 2020 at the Virginia Eastern Bankruptcy Court. The company went public in 1970 and operates in the Retail-Home Furniture, Furnishings & Equipment Stores industry. The company reported plans to close up to 450 of its stores. As of the fiscal year ending 3/2/2019, the company reported a net loss of \$199

¹<https://coronavirus.jhu.edu/map.html>

million. The company had reported numerous consecutive quarters of declines in sales. For the last audit opinion given in 2019, the auditor Ernst & Young did not give a going concern modification opinion.

J crew group inc: Filed bankruptcy on May 4, 2020 at the Virginia Eastern Bankruptcy Court. The company went public in 2006 and operates in the Retail-Apparel & Accessory Stores industry. Even before the COVID-19 pandemic, the company was already at risk for bankruptcy. As of the fiscal year ending 2/2/2020, the company reported a net loss of \$79 million. For the last audit opinion given in 2019, the auditor KPMG LLP did not give a going concern modification opinion.

Stage stores inc: Filed bankruptcy on May 10, 2020 at the Texas Southern Bankruptcy Court. The company went public in 1996 and operates in the Family Clothing Stores industry. With the pandemic, the company encountered significant difficulties raising new capital. As of the fiscal year ending 2/2/2019, the company reported a net loss of \$88 million. For the last audit opinion given in 2019, the auditor Deloitte & Touche LLP did not give a going concern modification opinion.

Centric brands inc: Filed bankruptcy on May 18, 2020 at the New York Southern Bankruptcy Court. The company operates in the Apparel & Other Finished Products of Fabrics & Similar Material industry. The company licenses many well known labels, including Calvin Klein, Nautica, Tommy Hilfiger, Kate Spade, Michael Kors, and Under Armor in apparel. As of the fiscal year ending 12/31/2018, the company reported a net loss of \$124 million. For the last audit opinion given in 2019, the auditor Cohn Reznick LLP did not give a going concern modification opinion. However, in the audit opinion dated 2/13/2015, the previous auditor Moss Adams LLP did give a going concern opinion.

Tuesday morning corp: Filed bankruptcy on May 27, 2020 at the Texas Northern Bankruptcy Court. The company went public in 1999 and operates in the Variety Stores industry. As of the fiscal year ending 6/30/2020, the company reported a net loss of \$166 million. After temporarily closing its stores due to the COVID-19 pandemic, the company watched its sales significantly dwindle. For the audit opinion signed on September 14, 2020, the auditor Ernst & Young LLP did give a going concern modification opinion. However, the issuance of the going concern opinion occurred months after the company filed for bankruptcy

RTW retail winds inc: Filed bankruptcy on July 13, 2020 at the New Jersey Bankruptcy Court. The company went public in 2004 and operates in the Women's Clothing Stores industry. The pandemic exerted significant strain on the company's operations

and finances. As of the fiscal year ending 2/1/2020, the company reported a net loss of \$62 million. For the audit opinion signed on June 9, 2020, the auditor BDO USA LLP did give a going concern modification opinion.

Ascena retail group inc: Filed bankruptcy on July 23, 2020 at the Virginia Eastern Bankruptcy Court. The company operates in the Retail-Apparel & Accessory Stores industry. As of the fiscal year ending 8/3/2019, the company reported a net loss of \$661 million. For the last audit opinion given in 2019, the auditor Deloitte & Touche LLP did not give a going concern modification opinion.

Tailored brands inc: Filed bankruptcy on August 2, 2020 at the Texas Southern Bankruptcy Court. The company went public in 1992 and operates in the Retail-Apparel & Accessory Stores industry. As of the fiscal year ending 2/1/2020, the company reported a net loss of \$82 million. For the last audit opinion given in April 2020, the auditor Deloitte & Touche LLP did not give a going concern modification opinion. The company has secured financing from lenders and expects to continue store operations through the bankruptcy process.

Stein mart inc: Filed bankruptcy on August 12, 2020 at the Florida Middle Bankruptcy Court. The company went public in 1992 and operates in the Family Clothing Stores industry. As of the fiscal year ending 2/1/2020, the company reported a net loss of \$10 million. The company was able to secure \$10 million in stimulus aid from the federal government. For the audit opinion signed on June 15, 2020, the auditor KPMG LLP did give a going concern modification opinion.

Out of the nine publicly traded retail companies that filed for bankruptcy, only three retailers received a going concern opinion from the auditor. The auditors that gave going concern opinions are Ernst & Young, KPMG, and BDO. All of the nine retailers reported declining financial performance even before the COVID-19 pandemic. Hence, one could argue that auditors should have noticed signs of impending financial troubles for these companies and warn market participants by issuing a going concern opinion. However, auditors are not fortune-tellers. It is unlikely that auditors could have predicted the enormous negative effect that COVID-19 would have on the retail industry.

References

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2. Carson E, Fargher NL, Geiger MA, Lennox CS, Raghunandan K, et al. (2013) Audit reporting for going-concern uncertainty: A research synthesis. *Auditing: A Journal of Practice & Theory* 32(Supplement 1): 353-384.

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