THE ABANDON OF GOING CONCERN PRINCIPLE FACED WITH THE IMMINENT INSOLVENCY STATUS

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Abstract:
In the current economic national climate, more and more entities are often constrained to "abandon" the fundamental principle of accounting according to which they carry out their activity normally without the susceptibility to interrupt or reduce significantly for various reasons.
The current economic crisis has abundantly proved that any entity, no matter how vigilant would be, can be in the position not to be able to meet all the debts-to-date. So have appeared those so-called chain reactions, and the insolvency risk has increased significantly.
In the current economic crisis most countries have adapted their legislation seeking to help those in need to recover. Legislative measures aim to avoid "chain reactions", an entity entered into insolvency could engage after it the entrance in collective procedure of many trading partners.

Keywords: *accounting principles, going concern, insolvency, insolvency risk, signs of not going concern.*

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Introduction

The current financial crisis, characterized by instability, mistrust and disruption at micro and macroeconomic level, is considered by some economists as having the greatest impact since the Great Crises of the 1930s. The impact of global financial crisis is felt through a deep economic recession, by affecting financial markets and by increasing business risk.

Many specialists in the field accuse accounting of making available only a few quantity of information that triggered the global financial crisis.

Accounting regulations, often insufficient and ambiguous, have allowed the use of creative accounting, "swelling of" bank assets.[160]

The current economic crisis highlights the importance of one of the fundamental principles of accounting namely the hypothesis of business continuity (going concern).

As a repercussion of the financial crisis, more and more companies are facing with difficulties in forecasting the continuity risk business continuity risk normally. While the potential impact on the result and on property value is considerable, the liquidation value is obviously lower than the normal use of the asset.

Research methodology

The conducted research conducted aims to highlight issues relating to events that suggest a possible state of abandon of the going concern principle in the current economic crisis.

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[160] Ojo, M., *The Role of the IASB and Auditing Standards in the Aftermath of the 2008/2009 Financial Crisis*, European Law Journal, Vol. 16, No. 5, September 2010, p. 605

To achieve that goal, we used a fundamental research methodology. To determine the state of discontinued activity followed by the imminent appearance of the state of insolvency followed by bankruptcy and assets liquidation of an entity, it was used inductive and deductive research mechanisms.

Causes that can cause the abandon of the going concern principle

Going concern principle starts from the assumption that the economic entity continues its normal activity, in a foreseeable future, without being unable to continue its business or to significantly reduce it. In other words it does not have the intention to stop the activity and it isn't forced to enter in bankruptcy, liquidation or significantly reduce its activity.

If the management of the entity knows certain elements, factors or events that could threaten the continuation of company activity, they must be presented in the explanatory notes, together with the expected impact on business conduct.

According to the rules in force, in our country elaboration and presenting financial statements have, most frequently, as evaluation base the historical cost.

If in a situation the going concern principle is no longer respected, it's required that financial statements to be prepared and presented in accordance with other measurement bases, which must to be indicated.[161] The wanted or required "abandon" of the going concern principle, requires that the evaluation base to be replaced with the liquidation value, and synthetic accounting documents must be prepared in liquidation value.

This applies in conjunction with principles: prudence, consistent methods and independence. If the business continuity becomes very unlikely or the management are in possession of some information that could lead to the impossibility of continuing the activity, this information will be mentioned and justified in the explanatory notes and audit reports where it's relevant.

The principle of continuity comes to solve the paradox which is the fact of presenting periodic information on a continuous activity.[162] It makes a temporary reconciliation between trimming time of business life and economic reality: financial statements must be interpreted in terms of going concern and that these are not a final state.

Taking into account the going concern is significantly conditioning information from the annual financial statements: if this is not verified in practice, financial statements based on the principles arising from this convention are not accurate.

Activity continuity of an entity is not a hypothesis which, tacitly, we can accept, but it must be verified. Although national accounting regulations refers to the obligation of presenting information about an entity's ability or inability to continue its activity, however evidence which must be taken in consideration for the evaluation state of continuity are not detailed enough. It is specified only that "the deterioration of operating results and financial position, after the balance sheet date, may indicate a need to analyze whether the going concern assumption is still adequate."[163]

Assessing the level of continuity can lead us to assess the achievement of an economic enterprise diagnostic.

It is necessary to analyze the liquidity situation, it are realized cash flow forecasts, profit and loss account, the balance sheet.

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[161] Consiliul pentru Standarde Internationale de Contabilitate, *Standardele Internationale de Raportare Financiarã (IFRS). Norme oficiale emise la 1ianuarie 2009,* Editura CECCAR, Bucuresti, 2009, pag. 40.

[162] *Ovidiu Bunget, Alin Dumitrescu - Principiului continuităţii activităţii şi opinia auditorului financiar extern asupra situaţiilor financiare, Revista Contabilitatea, Expertiza şi Auditul Afacerilor nr. 10/2005*

[163] *ORDINUL 3055/2009 – Reglementările contabile conforme cu directivele europene, paragraful 38 al. 2*

It also analyzed and documented factors such as sales orders / loss of some important clients; probability that staff remain available to the company, the company's ability to adapt to new circumstances, financial problems, the period for which the company has gained access to banking and financial facilities, reimbursement demands of loans, significant capital investments, planned and canceled, assets used and those to be replaced, use short-term financing for long-term needs, funding by delaying payments to suppliers and state budget, reduction or excessive growth of stocks, liquidity problems.

But even by performing such a work the evidence of going concern can be a failure.

The evidence of going concern should not be a goal in itself: the idea of presumption implies rather that this convention will be accepted in the absence of proof to the contrary, the discontinuity.[164]

On the other hand, the fact that the company knows difficulties at a time is not necessarily a total termination of activity.

The fact that certain specific and temporal obstacles make uncertain in some way going concern, does not necessarily justify the abandonment of this Convention, this being able to reflect in the future may in a partial or total cession of activity and reflect as such in financial statements.

Factors that may affect the company's ability to achieve its current and strategic objectives, is manifested in a diversified range and from different environments, with different intensities from one case to another. The most common are financial difficulties, but we must not neglect the commercial, technical, social, regulatory ones, and even political.

The specialized literature presents a non exhaustive list of the events that may suggest the abandonment of going concern principle. These can be grouped into three categories aimed to:

Financial dimension relates to:

- Net liability or net current liability position.
- Near maturity fixed-term loans without realistic prospects of renewal or reimbursement, or excessive reliance on short-term borrowings to finance long-term assets.
- Signs of withdrawal of financial support by debtors and other creditors.
- Negative operating cash flows indicated by historical or prospective financial statements.
- Key financial indicators not favorable.
- Substantial operating losses or significant deterioration in the value of assets used to generate cash flows.
- Arrears or discontinuance in dividend payments.
- Failure to pay creditors on due dates.
- Difficulty in complying with the terms of loan agreements.
- Change from transactions on credit to cash on delivery with suppliers.
- Inability to obtain financing for essential new product development or other essential investments.

Managerial dimension with reference to:

- loss of key members from management without replacing them.
- loss of a major market, franchise, license, or principal supplier.
- labor difficulties or shortages of important supplies.

[164] *Ovidiu Bunget, Alin Dumitrescu* - Aplicarea principiului continuităţii activităţii în cazul entităţilor aflate în stare de insolvenţă, *Revista Phoenix nr. 3/2005*

Various events which may include:

- Non-compliance with capital or other statutory requirements.
- Pending legal actions against the entity, which, if successful, may result in claims that are unlikely to be meet.
- Changes in legislation or government policy expected to have a negative impact on the entity.

It must be noted that the scope of each criteria or indicator, taken separately, may not be significant and therefore not to affect the continuity of operation. In general, only the accumulation of more unfavorable criteria and their complementarity can express a real risk on continuity.

As we stated in a previous paragraph, by existing laws existing in our country has not been set up a default style of identifying and warnings on the situation of non-going concern principle.[165]

Thus we can encounter in practice three situations:

A. **The going concern principle is tacitly accepted**, if any facts have not been able to prove otherwise. However, is indicated that in the explanatory notes, the policies, principles and accounting methods, to be specified the preparation basis of financial statements.

B. **Continuity is questioned**, but not compromised. In this case, are necessary mandatory explanations in the explanatory notes to the financial statements, indicating the impact on the financial statements.

C. **Continuity is compromised**, in which case the financial statements must be prepared and presented being based on other evaluation methods, entering under the law no. 85/2006 republished, on judicial reorganization and bankruptcy.

What is insolvency?

Insolvency is the state of the patrimony of a society that is characterized by lack of funds available to pay maturity debts. This condition does not mean that in the assets of the company there aren't any assets or goods that can be valued to settle the debt.

Many times the state of insolvency is confused with bankruptcy state.

A debtor arrived in an insolvency state may, if it meets certain conditions provided by law, to enter into a phase of reorganization of activity, based on a plan approved by creditors and confirmed by the syndic judge. If the so reorganized business is profitable and allows payment of all receivables, according to the terms and conditions established in the plan, then the debtor comes out of the state of insolvency, maintaining its legal status, continuing to operate without interference of judicial administrator or syndic judge.

In these conditions "an adequate insolvency legislation can't and shouldn't aim to restrict economic laws of the market, in particular the freedom of competition between prosperous and insolvent entities, the main purpose of this regulation being to establish the correct criteria to operate and treatment towards the insolvent debtor. "[166]

If the activity does not comply with the plan then reorganized the debtor comes out of the reorganization stage and goes into bankruptcy. At the moment the debtor activity passes under the command of judicial liquidator, that will proceed to assessment of assets and capitalize them, following to pay debts from the amounts collected.

Switching to the state of insolvency of companies, while maintaining its legal personality, has consequence in disruption normal economic activity for companies and

[165] *Ovidiu Bunget, Alin Dumitrescu* - Aplicarea principiului continuităţii activităţii în cazul entităţilor aflate în stare de insolvenţă, *Revista Phoenix nr. 3/2005*

[166] I. Turcu, Legea procedurii Insolvenţei - comentariu pe articole, Ed. C.H. Beck, Bucureşti, 2007, pag. 3.

thus the abandonment of going concern principle. The purpose of its activity is no longer to obtain benefits, but carrying out the plan of reorganization or complete liquidation of it.

In this case, the imperative true and fair view leads to present financial statements on the assumption of liquidation (total or only partial, based on a plan).

Companies in insolvency procedure deviate from the independence principle of exercise (or specialization), distribution of costs over several exercises is unfounded, they must be integrated, in totality, in the exercise in which it was noted the inapplicability state of going concern principle. Also, a special attention must be shown towards intangible fixed assets such as R & D costs, constitution costs, software applications, etc., assets that present interest under the aspect of presentation in financial statements, only seen throw the eyes of a going concern principle, in this situation not being relevant.

Another aspect to take into account aims the valuation rules that are based on the principle of nominalism which becomes inoperative because is raised the problem to present financial statements in liquidation values, this can lead to the emergence of surplus asset values or active elements non recognized through the application of the going concern assumption. It is possible that once abandoned going concern to witness appearance of new debts in the liability side (arising from onerous contracts, litigations and so on).

Conclusions

In circumstances in which funding costs have nearly doubled, specialist consultancy budgets have been reduced or eliminated, and global economy is adjusted significantly, it is increasingly felt the lack of credits, there is a tendency to delay payments, financial blockages propagate in chain – the risk to reach impossibility to pay may increase significantly.

Of course, it is not a new thing that a company can have difficulties, but what is unusual is that this phenomenon has become increasingly common.

The almost certain bankruptcy of many banks and the drastic reduction of credits, the lack of loans renewal, lead to massive closures. Going concern assumption, which basically came naturally, becomes a vital element for those charged with corporate governance and for the financial statement users.

Manager is not the only one responsible for it, he must be helped in this process by the accountant professional. Based on analyzes performed they have the responsibility to analyze whether the entity will have the economic capacity, financial capacity to continue its activity in the foreseeable future.

In the current crisis generalized, professional skepticism and prudence principles will be properly applied.

In such an area as the accounting, publishing of a result at the end of a financial year lower than the previous financial year published is already priming the vicious circle of confidence loss.

Those charged with governance or accounting professionals must solve a dilemma:

• not to raise the issue of going concern, in full awareness, to avoid compromising the chances of survival of the enterprise;

or

• clearly place the risk problem, by itself, to cause a disaster that was for a long time doubtful.

Their situation is very difficult, in the sense that the duty to tell the truth requires to inform the public about business difficulties, but is opposes to the feelings according to which the public does not need to be informed and so not to aggravate the harm that could prejudice to third parties that are not responsible for this situation.

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