THE PRINCIPLE OF BUSINESS CONTINUITY IN TERMS OF FINANCIAL AUDIT

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ABSTRACT: Standard IAS 1 Presentation of Financial Statements requires disclosure of all significant accounting policies used in preparing the financial statements. It also indicates the business continuity assumption as one of the basic principles of all aspects of the accounting policy applied. Therefore, if the financial statements are not prepared on a business continuity issue. the reasons behind its failure must be submitted. Entity's management is responsible to evaluate based on the information held the fulfillment of this principle, the time horizon should not be limited to 12 months from the balance sheet date, because this is the minimum acceptable. From the complexity of aspects regarding the risk of bankruptcy, which is essential for decision making, is the static analysis of bankruptcy risk on balance sheet heritage. This article has as objective presentation of the importance of determining and reporting the business continuity concern basis (fundamental principle) of the financial statements especially in the current global financial crisis stage where more and more entities avoid deliberately referring to this principle. Towards achieving this goal through qualitative analysis - empirical study aims to present financial statements in conformity going basis by state-owned companies with the same aspect in the realization of a local sample. Research directions included the following: financial analysis patrimonial state-owned companies and mixed in Alba county during the two financial years (2010-2011) and the importance of audit opinion expressed by the independent auditor regarding obtaining reasonable assurance on the correct application of the business continuity basis in preparing the financial statements. The result of the research is the development of a mandatory reporting methodologies of business continuity principle.

Key words: the principle of business continuity, ongoing capital, asset, circulating active

JEL Codes: M40, M41, M42

Introduction

At the basis of the global financial crisis, lies mainly the reporting entities crisis of audited financial statements, financial statements, and reports of audit, in which the going concern principle has not been and is not at this point adequately presented. An essential element of the need for change regarding this situation is to create a methodological instrument on the going concern basis, mandatory for all entities reporting of financial statements and response mode of auditors on compliance or non-compliance of the entities with this instrument.

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Research Methodology

In this paper developed, we presented the objectives and the methods by which these objectives were achieved, and finally we can draw conclusions of the research undertaken. Through its place in the investigative process this paper is based on data interpretation methods so that it prevails deductive approach from theory to practice, research inductive interference consisting case study designed to validate the regulatory aspects in terms of practical and comparison results.

Methods of analysis based on time criteria of financial- patrimonial analysis issues of state-owned companies and mixed in Alba county during two financial years were mainly longitudinal. In terms of typology of the investigative approach, this paper is based on qualitative methods, namely the analysis of the rules issued by accounting standard-bodies nationally and internationally, presenting the main indicators used in the analysis of going concern and is found in the statement subject to financial reporting. We used the empirical study with documents analysis guide on the appraisal limits of the principle of continuity, and state heritage and evolution of the main indicators on overdue payments to state-owned companies and joint where the documentation was made.

Literature review

In our country, the Accounting Law no. 82/1991, operating since 1994 has established a dual accounting system, normalizing and regulating accounting having public profile, with professional bodies having an advisory role only. The Ministry of Finance's role to solve the problem of insufficient supply of information and general interest to substitute private interests makes this process with the General Directorate of Accounting Regulations assisted by the Financial and Accounting Reporting Council, with important implications also in the field by the professional bodies (CECCAR, CAFR). In the reinsurance and insurance units operating in the capital market, are the ones working under the direction of NBR, the Insurance Supervisory Commission respectively NSC with the Ministry of Finance.

After 1989, with the output of the socioeconomic system, device standardization and regulatory accounting in Romania, was based on the following elements: European accounting regulations (Law no. 571/2003 regarding the Fiscal Code as amended and supplemented, OMF 403/1999 approving the Accounting Regulations harmonized with the Fourth EEC and International Accounting Standards; OMF 94/2001 for approving the Accounting Regulations harmonized with the Fourth EEC and International Accounting Standards; OMFP 2374/12.12.2007 for change and the Minister of Public Finance no. 1752/2005 for Accounting Regulations in accordance with Directive IV of the European Economic Community and accounting regulations compliant with Directive VII of the European Economic Community and International Accounting Standards; OMPF 3055/2009 for the approval accounting regulations compliant with European Directives) conceptual framework developed by the International Accounting Standards Board (IASB) International Financial Reporting Standards - IFRS: official rules issued on January 1, 2011, Part A - Conceptual Framework and requirements, International Standards Financial Reporting - IFRS: official rules issued on January 1, 2011, Part B - Documents accompanying standards. Therefore, europeanization and internationalization are two major processes influencing the Romanian accounting law.

One of the recent reviews in the literature on the importance of professional judgment in the application of standards is done by Popa I. (2011): practice demonstrates that professional judgment is a process that includes references to standards, sensitivity to company or firm expectations, justification and identification of consequences. Moreover, professional judgment involves consultation, largely with others in the company or firm, usually after reaching a tentative conclusion (Popa I.E. et al., 2011).

The principle of business continuity reflected both in IAS / IFRS and the national rules provide that "the entity continues its normal operation, without going into liquidation or significant reduction in activity."(MFP Order no 3055 from 29 octobre 2009, for approval of accounting regulations with European Directives, published in M.Of. no 766 from 10 November 2009) Although over time this principle was challenged and we remember the memorandum initiated by the consulting firm Arthur Andersen in which disbands its legitimacy in that it has no foundation (Andersen, 1960). However the principle resisted and is recognized at this time, so he was adopted by the Romanian legislature by accounting regulations compliant with EEC directives approved by OMFP no.1752/2005 Repealed by O.M.F.P. no. 3055/2009. So we can speak about a reinforcement of this principle with internationalization of accounting rules.

Standard IAS 1 Presentation of Financial Statements states that when preparing financial statements, management shall make an assessment of the company to continue operations. "Financial statements should be prepared on the business continuity basis unless management intends to liquidate the enterprise or to cease trading, or when it has not a realistic alternative than this. If management is aware, when making the assessment, of material uncertainties related to events or conditions that may cast significant doubt on the ability of the company to continue its work, those uncertainties shall be given."(International Financial Reporting Standards - IFRS: official rules issued on January 1, 2011, Part A - Conceptual Framework and provisions, Publishing House CECCAR, Bucharest, 2011)

Therefore, if the financial statements are not prepared on a business continuity principle this issue and the reasons behind its failure must be submitted. Also it must be presented the principle that stood at the basis of the financial statements. The management of the entity is responsible to evaluate based the information held, but not to be limited to 12 months from the balance sheet date, but this is the minimum acceptable.

Based on the above findings, we can say that, especially in the current period, modernization of audit standards, both public and private, is essential. This is justified on public level, the imminent entry into insolvency of several European countries and at the same time, the opening of the bankruptcy of the national companies that audit mechanisms have not given any warning signal, the most recent example being that of Hidroelectrica Romania where there are contradictory statements, auditors' on the one hand, and the Board of Directors, on the other.

Thus, the statement by the President of the Board of Hidroelectrica, Remus Vulpescu even contradict the data presented in the auditor's report, claiming that at the end of 2011 Hidroelectrica losses were of 121 million, and not profit of about 6.4 million.[5] (http://www.curierulnational.ro/Eveniment/2012-06-20/Hidroelectrica+se+ scalda+intre+doua +ape) It can be seen yet by any user of financial information that the Hidroelectrica 31.12.2011 claims volume increased significantly (from 219 million to 418 million) - without adjustments for depreciation up to the required level, especially from thermal plants. Board report indicated only one sentence related claims: that they have increased compared to 2010 due to VAT and customers in the energy sector.

On the other hand, the audit report on financial statements drawn up to 31.12.2011 does not appear to raise any issue that any doubt about the business continuity principle, although only one month after the date of filing to open insolvency proceedings.

As of Oltchim S.A., it is confirmed that it does not have funds to continue their existence and, in addition, there are elements of state recognition of difficulty (capital losses, high leverage ratios, recording turnover and net assets lower, etc.) since previous years, not only on the basis of financial statements from 31.12.2011.

Moreover, the situations described above are symptomatic for most of the public companies and indicates that the damage of the heritage and solvency indicators is, especially in the last 2-3 years, very sharp.

Analyses

1. Static analysis of the principle of business continuity

Financial-patrimonial analysis is essentially a static analysis in which value and solvency of the company have priority. This type of analysis has long been in economic theory the only way to evaluate risk assessment. The main operational tools that use static financial analysis to investigate the risk of bankruptcy are: working capital and solvency ratios. We will develop this concept in detail in this paper as it is in detail discussed in the literature on default risk.

2. Dynamic analysis of the principle of business continuity

The main assumptions regarding business continuity situations, in which the principle is not observed, refer to:

- Public sector entities do not have funds to continue their existence (recent examples: Oltchim SA, SN CFR, SN TVR, etc.), registering year-after-year a substantial deterioration of self-financing;
- Registration of state of difficulty for companies in accordance with the Community guidelines on State aid for rescuing and restructuring firms in difficulty, published in the Official Journal of the European Communities no. C 244/01.10.2004. Thus, a company (every entity engaged in an economic activity, irrespective of legal form) is regarded as being in difficulty, in principle and irrespective of its size in the following circumstances:

a) if a limited liability company, it is found loss of more than half of the capital and more than one quarter of that capital has been lost over the past 12 months, or
b) if a society in which associations unlimited liability for the debt of the company, when it lost more than half of its capital as shown in the accounting records of the company and more than one quarter of that capital has been lost over the preceding 12 months, or
c) for companies of any legal form, when such organization meets the conditions to be subject to proceedings under the law on judicial reorganization and bankruptcy. (Official Journal of the European Communities no. C 244/01.10.2004 - Commission Guidelines on State aid for rescuing and restructuring firms in difficulty)

In accordance with national legislation, Law no. 85 of 5 April 2006 on insolvency proceedings, Art. 3, pt.1 insolvency is defined as "the state of insolvency of the debtor's assets is characterized by lack of funds available for the payment of certain, liquid and due:

a) insolvency is presumed to be obvious when the debtor, after 90 days in arrears not paid his debt to the creditor, the presumption is relative;
b) insolvency is imminent when it is proved that the debtor cannot pay at maturity outstanding liabilities incurred with the funds available on the due date."

In addition, in accordance with article 3 section 12 of the same law, "the minimum amount of the claim, may be brought to the creditor's request is for 45,000 lei, and for employees, 6 average gross salary / per employee." Moreover, an enterprise can be considered in difficulty, especially if there are present the usual signs of a firm in difficulty increasing losses, diminishing turnover, growing stock inventories, excess capacity, declining cash flow, debt , rising interest charges and falling or disappearance of net asset value.

Analyzing financial statements of state-owned companies included in the sample, the range Alba County, results in a great extent identification of some elements symptomatic of a firm in difficulty, but these issues will be reported in the financial statements as shown in appendix 1 attached patrimonial situation of the sample (20 state-owned companies on the territory of Alba) clearly reveals general patrimonial damage and substantial in the past 2 financial years for items:

- Total equity - registering a net loss of capital -17,074,927;
- Net profit or loss for the financial year, registering a net loss of -11,716,923;
- Short-term debt, net growth registering 16,156,273 lei;
- Total assets, registering decreases total net -1,204,460 lei, but increases to a total of 11 entities, totaling 28,548,902.

From appendix. 2 results that a total of 5 companies have outstanding payments over 90 days and a total of 8 companies have arrears to the consolidated budget (in fact all budgets), there are on any of these companies (in number 9, accumulating all situations where there is arrears), the risk of triggering insolvency procedure by some of the creditors. The analysis based on the table no. 1 shows that at least a total of 11 entities (55%) had clear symptoms of enterprises in difficulty for which the financial statements must be clear statement on the principle of business continuity.

The intersection of all the situations that are identified elements that characterize the difficulty of the two tables show that a total of 14 companies are within this situation, out of 20 (meaning 70%) - which confirms the premises reporting methodology according to which the situation in the financial statements of the principle of continuity must necessarily be reviewed.

Conclusions

Current global financial crisis has had as theme, most often erroneous or incomplete recognition of the business continuity principle in the financial statements both the directors and auditors by the reports issued. Against this background, not only because this is the current economic context whether general or particular, have created tools required to check compliance and declared as such in the financial statements and audit reports of the business continuity principle.

One of these tools may represent the introduction, along with the notes to the financial statements of an additional note called business continuity principle to include the following information required, in the form below:

Table no 1

Model explanatory note on business continuity principle

No. Crt.	Indicator	Previous year	Current year	Observations
1	Operating losses			YES is completed in case there has been loss in both exercises
2	Turnover			YES is completed in case there has been diminishing turnover in the current year compared to the previous
3	Growing stock inventories			YES is completed in case there was an increase in total inventories in the current year compared to the previous
4	Total equity			Fill with YES in case it decreases total equity in the current year compared to the previous
5	Short term debt			Fill with YES in case the short-term debt boosted in the current year compared to the previous
6	Short-term debt outstanding over 90 days (suppliers, budget, employees, banks)			YES is completed in case there were liabilities in the current year and minimum amount of debt to creditors is 45,000 lei

Explanatory Note above needs to be completed with accurate information about the situations in which:

a) management intends to liquidate the entity;
b) management intends to stop / reduce operations;
c) management has no realistic alternative to continue.

In case the answer is "yes" to all 6 rows from the table above that the situation is met for any of the situations listed under the table (a-c) directors should expressly declare that there is significant uncertainty. This statement can be made, however, optional, and if they meet only part of elements in the table.

If the auditor concludes that the use of the Business Continuity assumption by the administration is appropriate under the circumstances (under ISA 570 principle of business continuity), but a material uncertainty exists it must express an unmodified opinion and include an explanatory paragraph in its report.

But if the administration does not make an adequate disclosure in the financial statements (the model above), the auditor should express a modified opinion, reference to ISA 705 - Modifications of opinion independent auditor's report. On the other hand, when the financial statements were prepared however with the business continuity basis but, in contrast, the auditor notes that the administration has used of the Business Continuity assumption in the financial statements is not adequate, it will issue an adverse opinion.

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9. *** MFP order no 3055 from 29 October 2009 for approval of accounting regulations with European Directives, published in Official Gazette no 766 from 10 November 2009
10. *** Official Journal of the European Communities no. C 244/01.10.2004 - Commission Guidelines on State aid for rescuing and restructuring firms in difficulty
11. http://www.curierulnational.ro/Eveniment/2012-06-20/Hidroelectrica+se+scalda+intre+doua+ape

Appendix 1

Evolving situation of the main heritage indicators

Denumire	Capitaluri proprii totale (lei)		Diferente (lei)	Profitul sau pierderea neta a exercițiului financiar (lei)		Diferente (lei)	Datorii pe termen scurt (lei)		Diferente (lei)	Active circulante totale (lei)		Diferente (lei)
	2010	2011	2011/201	2010	2011	2011/201	2010	2011	2011/201	2010	2011	2011/2010
SC URBAN CUGIR SRL	315059	-46916	-361975	-81601	-361975	-280374	480409	765850	285441	754757	691071	-63686
SC DRUMURI SI PODURI	6672025	6578759	-93266	51187	-486405	-537592	7528510	7807800	279290	5297513	4864782	-432731
SC CUPRU MIN SA	2522675	32264978	29742303	18825347	30680272	11854925	11436452	16240022	4803570	41256139	65936480	24680341
SC HIDROSERV SEBES SA	10095978	9691810	-404168	1118902	945898	-173004	4154222	6453959	2299737	6608474	9380858	2772384
R.A.L. OCOLUL SILVIC VALEA	256695	-161820	-418515	122640	10689	-111951	255486	486377	230891	864563	796533	-68030
SC CUGIREANA SA	-1214491	-1363703	-149212	-332014	-149211	182803	4990276	5123357	133081	2525618	2534253	8635
S.C. BLASIUS BLAJ SA	-457727	-521238	-63511	-106716	-63511	43205	0	15576	15576	181866	235168	53302
AQUA VITA SRL	6695584	6677360	-18224	-78144	-18224	59920	0	0	0	824891	802342	-22549
SC FABRICA DE ARME CUGIR	-65237939	-82332414	-17094475	-10584202	-17094475	-6510273	96702574	111642645	14940071	18963259	16827413	-2135846
SC SALUBRITATE APUSENI SRL	113415	186468	73053	59415	67053	7638	102318	112968	10650	199809	232775	32966
SC PREGO SA	120893	-32758	-153651	-61464	-124379	-62915	469156	543540	74384	319443	324656	5213
S.C PREST CIMPENI SRL	-1060293	-1060293	0	-1689	0	1689	1140048	1140045	-3	79755	79752	-3
SC PARCUL INDUSTRIAL CUGIR	3874549	4035901	161352	37663	45249	7586	223607	340991	117384	404440	488718	84278
OCOLUL SILVIC ABRUD R.A.	124736	125395	659	197209	107235	-89974	218031	310899	92868	1245375	1493303	247928
FILIALA ROSIAMIN S.A.	-9469081	-9514870	-45789	5190167	-45788	-5235955	10028847	10848390	819543	278535	865812	587277
SC AGROMEC CUNTA SA	-11306	-59281	-47975	19059	-47976	-67035	4307	10758	6451	22995	7208	-15787
SC.HERBA SA	59784	55550	-4234	-3293	-4233	-940	21690	214817	193127	227345	210285	-17060
SC ICIM COPREST SA	9051	66402	57351	-100030	57351	157381	135710	14082	-121628	110032	62577	-47455
SC AGROMEC BLAJ SA	67543	66444	-1099	-19148	-1098	18050	0	7811	7811	39263	42171	2908
SC ZETED STYLE SRL	0	-1895	-1895	0	-2095	-2095	0	15615	15615	0	73670	73670
Total	-64713064	-81787991	-17074927	-5344457	-17061380	-11716923	109046288	125202561	16156273	22715142	21510682	-1204460

Appendix 2

Evolving situation on outstanding payments

Denumire	Furnizori restanţi > 90 zile (lei)	Obligatii restante fata de bugetul asigurarilor sociale (lei)	Impozite si taxe neplatite la termenul stabilit la bugetul de stat (lei)	Impozite si taxe neplatite la termenul stabilit la bugetele locale (lei)	Credite bancare nerambursate la scadenta > 90 zile (lei)	Dobanzi restante (lei)
	2011	2011	2011	2011	2011	2011
SC URBAN CUGIR SRL	5.694	31.305	23.153	167.481	0	0
SC DRUMURI SI PODURI LOCALE ALBA SA	435.155	0	0	0	0	0
SC CUPRU MIN SA	0	0	0	0	0	0
SC HIDROSERV SEBES SA	0	0		0	0	0
R.A.L. OCOLUL SILVIC VALEA PIANULUI	0	0	0	0	0	0
SC CUGIREANA SA	0	1.604.554	502.443	43.109	0	0
S.C. BLASIUS BLAJ SA	0	186.966	1.263.473	25.569	0	0
AQUA VITA SRL	0	0	0	0	0	0
SC FABRICA DE ARME CUGIR SA	4.437.730	76.437.616	1.891.465	926.874	0	0
SC SALUBRITATE APUSENI SRL	0	0	0	8.361	0	0
SC PREGO SA	20.167	135.227	107.052	34.243	0	0
S.C PREST CIMPENI SRL	0	0	0	0	0	0
SC PARCUL INDUSTRIAL CUGIR SA	0	0	0	0	0	0
OCOLUL SILVIC ABRUD R.A.	0	0	22.854	0	0	0
FILIALA ROSIAMIN S.A.	0	1.725.572	167.841	1.255.095	0	0
SC AGROMEC CUNTA SA	0	0	0	59.110	0	0
SC.HERBA SA	0	17.067	8.858	10.533	0	0
SC ICIM COPREST SA	0	0	0	0	0	0
SC AGROMEC BLAJ SA	3.064	924	756	0	0	0
SC ZETED STYLE SRL	0	0	0	0	0	0