***GOING CONCERN PRINCIPLE***

**INTRODUCTION**

In business accounts, there are three accounting assumptions, namely, going concern, consistency and the assumption of accrual. These assumptions are set of rules that ensure that the functioning of an organisation is continued efficiently and as prescribed by the standards of the Financial Accounting Standards Board (FASB). This forms the groundwork for consistency, stability and efficient functioning.

These assumptions are not only crucial for the company but also for the financial statements of the organisation. It amplifies the stability, verifiability and objectivity of the statements. Hence, the accounting principles are important for the well-being of a company.

Going concern principle or continuing concern principle is one of the accounting principles.

In a company, while preparing its financial statements, it is prepared on the basis that the company will effortlessly continue to work and has no intention to close its functioning. This assumption is called going concern assumption.

One of the basic accounting concepts by which a business is assumed to be a going concern—that is, that it will continue in business for the foreseeable future (unless circum-stances change dramatically). On company accounts, assets are shown at cost or cost less depreciation, and not at the break-up value. (International Accounting)[[1]](#footnote-1).

In today’s world, there is intense debates on how effective these assumptions are. The going concern principle has been considered as one of the most essential fundamentals in the making of financial statements.

**RESEARCH OBJECTIVES**

1. To understand the concept of Going Concern Principle
2. To analyse the same and examine its utility by considering case studies

**GOING CONCERN PRINCIPLE**

**DEFINITION-**

It is an accounting term for when a company has the capacity and resources to carry on its functioning indefinitely. It also refers to a company’s ability to generate sufficient funds to function and avoid bankruptcy. If a business is a going concern, it means that it is functioning well and with stability. If a business is not a going concern, it means that it has gone bankrupt and its assets are liquidated.

ASSUMPTIONS-

It is one of the fundamental principles of business accounting. It is based on the following assumptions: -

1. A certain company will complete its present plans, use its current assets and continue fulfilling its financial functioning
2. Demand for the good or service- the concept assumes that there will be a consumer demand for the products and services the company is producing and offering indefinitely
3. Profits- this assumption is related to the assurance that a company will make profits on a long-term basis even if it is incurring losses currently
4. No change in government legislation- another assumption is that no legislation interferes with the company’s administration and continues to be beneficial for its functioning
5. It is also assumed that the entity does not plan to liquidate its assets

When a business goes out of the market, its assets shed off their value they once held because certain assets lose their worth upon resale. Hence, their value falls in the balance sheet. Some reasons for this are: continued losses over years, debt traps, lawsuits, bankruptcy, defaults on loans etc.

When an analyst analyses a company, they assume that the company will not go bankrupt. This basic assumption that a company is in no immediate danger and that the company will not stop its operation hence, will continue to function indefinitely is called the principle of going concern.

Every entity in the business world is assumed to be a going concern unless there are circumstances that nullify that assumption.

**TESTING IF A COMPANY IS A GOING CONCERN OR NOT**

Auditors test if a company is a going concern or not y examining the following factors

1. Losses – If a company has accumulated losses over the past years, then the company is bound to be indebted and hence, will close. It won’t be a going concern

Similarly, if there are no or minimal losses over the prior years, the company will be a going concern.

1. Loan Defaults – A business which had taken corporate loans from various in the past has defaulted to pay them back with the prescribes interest is likely to go into losses since none payment of loan leads to the back ceasing assets etc, such a business is not a going concern.
2. Request for prepayment by suppliers – Some companies while purchasing raw material and machines from various sources are met with suppliers who demand prepayment before the actual delivery thereby causing credit denial.
3. Unprofitable contractual obligations – Many businesses enter into certain contracts which are beneficial at a certain time but they become unprofitable overtime, this also leads to the company becoming less of a going concern because of capital loss related to these obligations. Whereas, if the business has met with and fulfilled all its past contractual obligations, it is more likely to be a going concern.

The going concern principle is used to decide what type of auditing or reporting should be conducted to examine the financial statements of a company.

For example, businesses that are a going concern may prefer reporting on the basis of cost thereby postponing the reporting of long-term assets at current value.

The going concern is also used by accountants to determine how a company should proceed with selling goods, shifting to other products or reducing its expenses.

Going concern is a part of generally accepting auditing standards (GAAS) and not generally accepted accounting principles (GAAP).

Generally accepting auditing standards are what auditors follow when looking through a company’s financial statements and records.

**MITIGATION OF GOING CONCERN-**

A business can change an auditor’s view of its status of going concern by getting a third-party to ensure the debts of the company and agree to donate additional funds when business as needed.

**IMPORTANCEOF GOING CONCERN-**

* Is an indicator of whether a business is going on stably or not
* Enables shareholders to assess if a business is financially stable
* Ensures creditors that doing transactions with a company is safe
* Allows the business to take loans for long-term basis

**ADVANTAGES OF GOING CONCERN PRINCIPLE-**

1. This principle offers a way to calculate certain expenses like: when a business is inaugurated, it incurs immediate expenses for buying fixed assets. The benefit delivered by these assets, however, is spread over a longer time, usually for more than a year. Going principle allows us to record such expenses.
2. It also provides with a way to record income and profits of the business
3. It offers a basis for classifying assets and liabilities for a short period of time, usually 12 months or less, and for a longer term, more than 12 months

**DISADVANTAGES OF GOING CONCERN PRINCIPLE**

1. It may not be accurate and might reflect an unfair market value. Contrary to what the principle might predict, the business might just pull through and not shut down.
2. Any new legislation could affect a business greatly and its plan of going concern might fail. Hence, this principle does not consider such changes in law.
3. Similarly, it does not consider uncertainties that might cause a going concern business to shut down, proving that this principle isn’t consistent in regard to unforeseen circumstances.

**RED FLAGS RELATED TO GOING CONCERN PRINCIPLE-**

The following are some red flags related to going concern

In a business several factors are responsible for the downfall of the business, but some red flags can be identified for the same

1. Low Current Ratio

A business is subjected to be low on cash and liquidated assets for the payment of its short-term liabilities when a current ratio is less than one

1. Inability to get a loan

Lender’s behaviour towards fuelling a business reveals a lot about a business’s assurance to repay the contract.

1. Employees leaving

The business also faces burden when the employees who can’t be easily replaced leave the organisation.

1. Legal problems

Any lawsuits pending against the business or any regulatory issues can lead to monetary burdens on the company.

1. Decline in market share

A company whose goods have a less demand in the market and hence, their market share is on the decline is bound to fall

**CONCLUSION**

In brief, the going concern principle means that a business will carry on indefinitely, giving a realistic picture of the company in a holistic view.

This concept is an internationally accepted accounting principle. It is recognised by generally accepting auditing standards (GAAS) and is used universally by auditors and financial planners to make financial statements. It is also used by investors to see if the business they are investing in will be profitable or not.

Without the going concern principle the financial statements will be unorganised because without it the company will have to recognise all of the prepaid expenses at once. This principle allows the companies to postpone some of the prepaid expenses to the future.

Hence, going concern principle is extremely essential for the systematic functioning of several businesses.

1. Aiyar, P. R. (2017). Going concern concept. Lexis Advance India Research. Retrieved November 10, 2021, from https://advance-lexis-com.eu1.proxy.openathens.net/document [↑](#footnote-ref-1)