

## Understanding Going Concern in Auditing: Seker Poultry, Inc.

Ayca Zeynep Suer<sup>1</sup>, Ahmet Turel<sup>2</sup>

**Abstract:** Under the going concern assumption, an entity is viewed as continuing in business for the foreseeable future. General purpose financial statements are prepared on a going concern basis, unless management either intends to liquidate the entity or to cease operations, or has no realistic alternative but to do so. In this case study, we examine the recent financial problems of Seker Poultry, Inc. – one of the listed companies in Borsa Istanbul –and their impacts on the financial statement audit process. This case provides an opportunity to examine the auditor’s judgment process and responsibilities regarding the going concern assumption. This case uses information in Seker’s recent publicly available financial statements and annual reports. The case can be used in undergraduate or graduate level audit courses.

**Keywords:** Independent Auditing; Going Concern; Audit Risk

**JEL Classification:** M41; M42

### 1. Introduction

Assume that after graduating from Istanbul University School of Business, you started at ABC Accounting Company as a junior auditor and are assigned to the Seker Poultry, Inc. (Seker) financial statement audit team by your partner for your first task. Seker is one of the leaders in the market and, produces and sells chicken meat, chick, breeding, egg and animal feed. The audit manager in your team wants you to prepare a report regarding the financial sustainability of Seker and issues that might be faced during the audit. You have never prepared such a report before so you collected information about the poultry industry in Turkey and the history, financial position and financial performance of Seker, which are provided in the following section.

---

<sup>1</sup>Assistant Professor, PhD, Accounting, Istanbul University School of Business, Turkey, Address: Avcilar, Istanbul, 34320, Turkey, Tel.: +90 212 4737000, +90 212 5904000, Corresponding author: ayca@istanbul.edu.tr.

<sup>2</sup>Associate Professor, PhD, Accounting, Istanbul University School of Business, Turkey, Address: Avcilar, Istanbul, 34320, Turkey, Tel.: +90 212 4737000, +90 212 5904000, E-mail: aturel@istanbul.edu.tr.

## **2. History of the Company**

Seker Poultry was founded in 1960. Seker invested in egg incubators due to increased demand for breeding. In 1973, Seker increased its weekly egg capacity to 14 thousand units and in 1983 imported Holland-made incubators which have a capacity of 230 thousand units per week and expanded the business quickly. With the joint cooperation of American Hy-line, the company set up breeding houses and started producing chickens for meat and eggs.

In 1990, the company scaled up and established a feed factory and new incubation facilities as well as increased the number of plantations. Shares of Seker Poultry, Inc. started to trade on the Istanbul Stock Exchange in February, 2000.

In 2008 and 2009, Seker increased its production capacity with new investments. In addition, the company allocated more resources for promoting its brand and changed its logo. In parallel with increased white meat consumption, Seker expanded its capacity gradually and in July 2010 went into production in new butchering facilities which have a capacity of 12 thousand chickens per hour. With new facilities the production capacity reached 20 thousand chickens per hour. The new butchering plant has a capacity of 75 tons per day and also includes further processing facilities that produce delicatessen food such as sausage, pepperoni, salami as well as nugget, cordon bleu, and gyros. The company planned to increase its production capacity to 100 thousand tons with new investments in the following years.

Seker primarily exports to Middle East and East Asian countries. In addition to that, the company completed the necessary infrastructure investments to export to European countries. Seker renewed its vision as "On land, in air, and everywhere" in 2009 and had increasing demand from China, Germany, Iran and Iraq. The managers thought that they could increase their export capacity in the future. Pursuing its continuous growth strategy, the company became one of the leaders in white meat production in Turkey. It was selected as one of the most successful food companies in Turkey by the Department of Agriculture in October 2010.

## **3. Poultry Industry**

The poultry industry in Turkey has been developing since 1950. Entrepreneurships started to become corporations in the 1970s. With the foundation of incubation companies in the 1980s, the industry established capacity beyond domestic needs and therefore focused on exports. Since the 1990s, there has been a boom in production capacity. The chicken production, which was 217 thousand tons in 1990 and 752 thousand tons in 2000, reached 1.7 million tons in 2012. With 943 thousand tons of white meat production, Turkey was ranked 14th in the world in 2005.

The effect of the worldwide economic crisis in 2008 on the poultry industry was limited since chicken meat is one of the main foods consumed. Chicken meat consumption was stable in European countries and there was an increase in consumption in Turkey. Moreover, the export to Middle East countries increased with the Arab Spring. However, due to political barriers the export to Europe is limited.

With Turkish Lira (TL) 6 billion of total revenues, the poultry industry is a big job creator in Turkey. Though, chicken production has shown huge improvements in the last decade, some issues have not been resolved yet. The imbalance between production versus domestic consumption and obstacles related to export top the list. For example, the chicken meat consumption per capita is between 15kg/year to 27kg/year in developed EU countries whereas the consumption in Turkey reached 16kg/year in 2008 and 19kg/year in 2011. In addition egg consumption is lower in Turkey than in European countries as well.

As noted above, chicken plantation facilities in Turkey have a capacity above domestic demand. Therefore, oversupply needs to be exported. When export is restricted, the domestic market cannot consume the supply which can lead to crisis in the poultry sector. Diseases, and input costs are cited among the most important factors that negatively affect production and consumption. In particular, 70 per cent of total production cost arises from feed expenditure in chicken meat and egg production which are to a large extent important.

#### **4. Financial Position and Performance of the Company**

The financial statements of Seker have been prepared in accordance with International Financial Reporting Standards and have been audited according to International Standards on Auditing published by the IFAC. The capital of Seker is TL 44 million as of December 31, 2011. The balance sheet, income statement, and cash flow statements for the years 2011, 2012, and 2013 are attached in Exhibit 1, 2, and 3 respectively.

Seker reported net loss of TL 13 million in the year 2011. In December 31, 2011, after an evaluation by company management, it was determined that the net realizable value of some portion of the inventory and biological assets were below historical cost; therefore, the company recorded an expense of TL 1.3 million for impairment. In addition, TL 2.5 million worth of inventory was lost because of a fire in the further processing department and flooding in feed production facilities. These items were classified as other inventories and Seker recorded an allowance expense. (Seker Poultry and Feed Industry Incorporation, Financial Statements for the year 2012, Footnote 13, Inventories, Footnote 14, Biological Assets.)

In 2012, the revenue of Seker increased 19 per cent compared to 2011 and reached TL 401 million. In spite of the increase in revenues, the company suffered a loss of TL 49.5 million, and the total debt of Seker exceeded its assets by TL 29.8 million.

In December 31, 2012 the company management determined that the net realizable value of some portion of inventories and biological assets were again below historical cost value, and, therefore, recorded an expense of TL 6.6 million for impairment. After the balance sheet date, all of the production operations were stopped, and the value of the inventories and biological assets significantly dropped. (Seker Poultry and Feed Industry Incorporation, Financial Statements for the year 2012, Footnote 13: Inventories, Footnote 14: Biological Assets.)

Seker reported a net loss of TL 83 million in the year 2013. The company could not make payments to suppliers because of liquidity problems, and some suppliers started to seize Seker's assets in January 2013. Demands by and payments to led to a total stoppage of production (except for some breeding ranches). In order to keep control of its assets, maintain day-to-day business operations, and restructure its debt, the management filed in bankruptcy court for protection in January 31, 2013. So far, the prosecution has not been finished but the court made some interim judgments which released the blocked bank accounts of Seker. Despite these emergency actions, the production was not sustainable because of capital deficit and it was totally stopped except for egg production.

## **5. Causes of Financial Problems**

Seker management asserted that the source of its problems was due to significant increases in feed prices which already constitute 70 per cent of total production costs. In addition, while costs are increasing, white meat prices stayed stable in 2012. In the last quarter of 2012, the revenues dropped significantly compared to the first three quarters because of seasonal effects caused by religious holidays. (Seker Poultry and Feed Industry Incorporation, Annual Report, 2012)

The other reason for financial difficulties was Seker's substantial investments in 2008 and 2012. These investments included slaughter houses, further processing, and rotary facilities, feed factory, and breeding farms. Total investments were approximately TL 132 million. These investments were financed by loans and leasing agreements. Since the cash conversion cycle of the Seker is 140 days, a significant increase in credit sales in the year 2012 caused a significant liquidity problem for Seker.

Moreover, the value added tax rates for wholesale chicken meat went from 8 per cent to 1 per cent in November 2011. This meant that Seker had to fund TL 2 million of VAT which it was not able to collect because of the change in the rates. Fortunately, in February 2013 the government increased the value added tax rate to

8 per cent. Seker received TL 19.3 million of the VAT refund receivables in cash and on account in 2013. The amount of VAT refund which is received back is used for paying back liabilities and as an entity capital in the process of production again. Managers believe that the change in VAT tax rates will be significant in helping Seker overcome its liquidity and capital deficit problems.

## **6. The Impact of Financial Problems and Precautions Taken by Management**

Biological assets (living animals) production - the main operation of Seker - is almost completely stopped because of the difficulties in paying for raw material, particularly feed. Management made efforts to decrease costs such as sending some of the poultry to slaughterhouses before maturity, cutting wholesale prices. Nonetheless, poultry casualties increased due to lack of feed.

There have been 8 lawsuits against the company as of December 31, 2013 totaling TL 272.6 thousand. Creditors of Seker sent written demands for their receivables and, some commenced "execution proceedings" including demands for immediate payment of interest and principal. Filing for bankruptcy led to a stoppage of these payments. Therefore, no provisions were reported in 2013 financial statements for the execution proceedings. However, the amount of claims for default interest, proceedings expenditures, etc. which were not reported in the statements is calculated to be TL 59.8 million. The value of assets and cash flows are affected significantly because of the legal procedures and discontinued production. The value of inventories is affected as the market price declined. The net book value of chickens on hand is TL 1.4 million as of December 31, 2013.

Management is focused on procurement of necessary capital and hopes to resume production at full capacity. In addition, Seker has been considering the likelihood of long term borrowings and the sale of controlling shares as well as negotiating with creditors to restructure loans.

Seker has collected its existing VAT receivables for new fund procurement. Seker used these funds to repay debts and resume production. In general, analysts view the increase in the VAT rates as a positive development for the poultry industry. This fund was used as capital for paying the debts to public and re-operating the production. Seker has initiated the necessary procedures to re-operate the business as disclosed in its Public Disclosure Platform (PDP)<sup>1</sup>. As a result of re-operation, 6,508 tons of poultry meat and products were produced from June 30-December 31, 2013. However, this production could not be sustained due to lack of funding.

Although the restructuring process has been interrupted by fluctuation in financial markets at the end of 2013, Seker is still continuing its efforts to find permanent

solutions to its cash flow and capital problems. Management asserts that company operations are sustainable.

## 7. Requirements

- i. Research the directive within International Auditing Standards regarding the responsibilities of auditors regarding a “going concern” assumption.*
- ii. What are the steps the auditor should follow in the going-concern evaluation?*
- iii. What are the major events or conditions that may indicate going concern problems?*
- iv. After considering the above events and conditions for Seker Poultry, Inc., do you think that there is significant doubt on the entity’s ability to continue as a going concern? Support your opinion with the help of ratios calculated from the financial statements.*
- v. Based on the events, conditions and management’s assessment describe the impact on the audit report of Seker Poultry, Inc.*

## 8. Case Learning Objectives and Instructional Guidance

### 8.1. Learning Objectives

At the conclusion of the case, students should be able to:

- Explain management’s responsibility to assess an entity’s ability to continue as a going concern.
- Exercise judgment in assessing uncertain future outcomes of events or conditions.
- Develop a technical knowledge on auditor’s responsibility to obtain sufficient appropriate audit evidence about the appropriateness of management’s use of the going concern assumption in the preparation of the financial statements.
- Explain and apply “International Standard on Auditing (ISA) 570 Going Concern.”
- Develop critical thinking including analysis of an entity’s financial results.
- Describe auditor’s risk assessment procedures and related activities.
- Increase awareness about importance of entity’s going concern issue.

### 8.2. Instructional Guidance

The case can be used in undergraduate or graduate level audit courses to introduce the “Going Concern” concept. The following instructional approach could be suggested to the case study. The case could be assigned as a class project to groups of three students. One week later, a quiz on the case facts is given to each group to

ensure that they have read the case. In week three, they are asked for a progress report on the case requirements. In week four, each group is required to present the case in class. At the end of discussion, the instructor should provide some other real auditors' going concern judgments.

### 8.3. Student Feedback

The case was taught in both undergraduate and graduate classes. In each class, students are asked to answer a feedback survey asking for their opinions about the case. They were asked to respond nine questions on a five-point Likert scale, ranging from 1 (strongly disagree), to 5 (strongly agree).

The summary of data is presented in Table 1. Mean undergraduate student responses were between 3 and 4. Mean graduate student responses were above 4, nevertheless the sixth question which asks whether the case was difficult to understand was 2.32. The data show that students responded positively to the case, and using real-world business case in class increases their interest to auditing subjects. Also, graduate students were more appreciative of learning auditing issues with real-world business cases than undergraduate students.

**Table 1. Student Feedback on Case Study**

	Undergraduate n= 14		Graduate n= 19	
	<u>Mean</u>	<u>SD</u>	<u>Mean</u>	<u>SD</u>
The case was interesting and related to course subject.	3.86	0.86	4.68	0.48
The case helped me understand "Going Concern" auditing standard.	4.00	0.88	4.58	0.69
I learned how to use ratios to identify going concern issues.	3.57	1.02	4.16	0.83
I learned to assess the precautions that are taken by management against going concern risks during auditing process.	3.57	0.94	4.32	0.75
My technical knowledge is developed related to audit procedures for obtaining audit evidence regarding going concern risk.	3.21	0.89	4.00	0.67
This case was difficult to understand.	2.29	1.07	2.32	1.20
The case requirements helped us to discuss the case effectively.	3.79	0.70	4.37	0.83
The use of real-world business case in the class is increased my interest to auditing subjects.	3.50	1.02	4.42	0.69
Overall, this case is useful.	4.07	0.62	4.53	0.51

#### 8.4. Teaching Notes

- i. Research whether there is a directive within International Auditing Standards regarding the responsibilities of auditor the in “going concern” assumption.*

*International Standard on Auditing (ISA) 570, Going Concern* deals with the responsibilities of the auditor regarding going-concern. Since the going-concern assumption is a fundamental principle in the preparation of financial statements, the standard indicates that the auditor must obtain sufficient and appropriate evidence about the going concern assumption, has the responsibility to evaluate the going-concern, and must conclude whether a material uncertainty exists that may cast significant doubt on the entity’s ability to continue as a going concern. The auditor should consider the going concern assumption during the planning of the engagement as well as near the end of the engagement.

- ii. What are the steps the auditor should follow in the going-concern evaluation?*

First, the auditor should assess whether procedures performed during the planning, performance and completion of the audit indicate a going-concern problem for the relevant period of time. The assessment shall cover at least 12 months from the end of the reporting period. If there is significant doubt, the auditor should obtain information about management’s plans to mitigate the going-concern problem and evaluate the likelihood that such plans can be successfully implemented. Management’s plan may include disposal of assets, restructure of debt, reducing or delaying expenditure and increase ownership equity. Finally, if significant doubt continues, the auditor should consider the adequacy of the disclosures about the entity’s ability to continue and include an “emphasis of matter” paragraph in the audit report. If adequate disclosure is not made in the financial statements, the auditor shall express a qualified opinion or adverse opinion, as appropriate, in accordance with *(ISA) 705, Modifications to the Opinion in the Independent Auditor’s Report*.

- iii. What are the major events or conditions that may indicate going concern problems?*

Some major events or conditions that may indicate going-concern problems are listed below:

- Work stoppages.
- Default on loans.
- Restructuring of debt.
- Negative cash flow.
- Current-year deficit.
- Accumulated deficits.
- Inability to meet interest payments.



- Loss of a major customer or supplier.
  - Loss of a key franchise, license, or patent.
  - Recurring operating losses.
  - Negative net worth.
  - Negative working capital.
  - Negative income from operations.
  - No additional sources of financing.
  - Dependence on the success of one particular project.
  - Legal proceedings.
- iv. *After considering the above events and conditions for Seker Poultry, Inc., do you think that there is significant doubt on the entity's ability to continue as a going concern? Support your opinion with the help of ratios calculated from the financial statements.*

Seker management asserted that the cause of its financial difficulties was the increases in feed prices. We conclude from the information provided from Seker's financials and surrounding events that the company has a significant going concern risk. Seker has been reporting **negative cash flows** for the last three years and **operating losses** and **negative owner's equity** for the last two years. In addition, there have been a deterioration in current ratio, quick ratio, inventory turnover, days of receivables, and days of accounts payable for the last two years.

Key financials and ratios that support going concern uncertainty include:

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Owner's equity	-112,795,555	-29,786,263	19,762,940
Change in cash and cash equivalents	-811,384	-548,400	-13,644,261
Profit / Loss for the period	-83,009,292	-49,549,203	-12,910,357
Current ratio	50.20 %	52.06%	71.78%
Quick ratio	2.65 %	18.25 %	30.44 %
Inventory turnover	6,65	17,01	12,69
Days of receivables	104	32	34
Days of accounts payable	421	87	42

- v. *Based on the events, conditions and management's assessment describe the impact on the audit report of Seker Poultry, Inc of a going concern risk.*

If the directors of Seker have agreed to make going concern disclosures and the disclosures are adequate, then a clean audit opinion can be issued but an emphasis of matter paragraph is required.

The paragraph should state that there is a material uncertainty about going concern and provide cross reference to the disclosure note made by management. The paragraph is included immediately after the opinion paragraph.

If the disclosures made by the directors are not adequate, depending on the materiality of the issue, the opinion will need to be either qualified or adverse. The basis to the modification paragraph describing the matter will be included just before the opinion paragraph. This paragraph will state the lack of disclosure over the going concern uncertainty. The opinion paragraph will be amended to state “except for” or the “financial statements are not fairly presented.”

## **9. Acknowledgements**

This paper is presented in American Accounting Association Annual Meeting August 2015, Chicago. We thank Kevin Stevens (Loyola University) for his academic support and interest in this project.

## **10. References**

- BeMiller, S. M., R. Wirtz, D.L. Lindberg. (2009). Sky Scientific, Inc: An Auditing Minefield. *Issues in Accounting Education* 24 (2): 219-236.
- Cullinan, C.P., Rohland, C.W. (2014). Sentinel Management Group: A Case Study on Attestation Standards. *Issues in Accounting Education* 29 (1): 217-227.
- Bierstaker, J.L., Monahan, T.F. & Peters, M.F. (2013). Going Concern Designations and GAAP versus Non-GAAP Earnings Metrics. *Issues in Accounting Education*. 28 (1): 77-92.
- Clikeman, P.M. (2005). The Rise and fall of Heilig-Meyers. *Journal of Accounting Education*, 23: 215-231.
- Jennings, J.P. & Henry, E.G. (2008). Safety Products, Inc.: A case in financial analysis of a failing company. *Journal of Accounting Education* 26:34-53.
- Jones, Joanne C. (2012). Zoom Snowboards Incorporated: Understanding the Impact of Management Decisions on the Audit Plan. *Issues in Accounting Education* 27 (4): 1193-1213.
- Seker Poultry and Feed Industry Incorporation, Financial Statements and Audit Report for 2011, <http://www.kap.gov.tr>, 22 May 2014.
- Seker Poultry and Feed Industry Incorporation, Annual Report for 2011, <http://www.kap.gov.tr>, 22 May 2014.
- Seker Poultry and Feed Industry Incorporation, Financial Statements and Audit Report for 2012, <http://www.kap.gov.tr>, 22 May 2014.
- Seker Poultry and Feed Industry Incorporation, Annual Report for 2012, <http://www.kap.gov.tr>, 22 May 2014.

Seker Poultry and Feed Industry Incorporation, Financial Statements and Audit Report for 2013, <http://www.kap.gov.tr>, 22 May 2014.

Seker Poultry and Feed Industry Incorporation, Annual Report for 2013, <http://www.kap.gov.tr>, 22 May 2014.

Seker Poultry and Feed Industry Incorporation, Financial Statements and Audit Report for the period of January 1- March 31, 2014, <http://www.kap.gov.tr>, 2 July 2014.

Seker Poultry and Feed Industry Incorporation, Annual Report for the period of January 1- March 31, 2014 2014, <http://www.kap.gov.tr>, 2 July 2014.

<http://www.seker.biz/>, 30 June 2014.

Public Oversight Accounting and Auditing Standards Authority, Statement about Going Concern (AS 570), Turkey Auditing Standards Statement, No: 25, 23 January 2014, Official Gazette No: 28891.

International Standard on Auditing 570, Going Concern, International Auditing and Assurance Standards Board.