Alberco – Auditing a Subsidiary in Russia

Alberco is a Canadian mining public company with operations in Alberta, Congo, and Russia. It is part of a larger group of affiliated mining companies in Western Canada. XYZ LLP has traditionally had this audit but is in danger of losing it because all the other companies in the group are audited by another firm. XYZ has retained the audit because the partner on the job and the CEO are fishing buddies. But XYZ has its eyes on getting all the audits in the group because they are aware of some client dissatisfaction with the other firm.

Over 60% of the profit comes from a mine in Siberia. The firm's Moscow office performed the audit work in Russia. They visited the mine the previous year but did not this year (or, rather, they had arranged for a local firm in Siberia to do the work). The Calgary partner has never visited the mine, or Moscow, nor have any staff. He said it would cost a fortune, cause fee problems and would not be productive. He pointed out that flying from Toronto to Moscow, he would only have been about halfway there!

The Canadian partner was an acknowledged expert in his knowledge of mining operations and had a practice of visiting significant mine sites within Alberta. However, a firm internal quality control inspection the previous year criticized him and suggested because they were not provided access to the working papers, that at least he go to Moscow to closely examine the work done by his Russian staff. But he resisted even that on cost grounds. He said to the quality control team that the cost might mean losing the client. The Moscow firm refused to provide their working papers to the XYZ because, they said, most were in Russian and in any case under their local rules could not be sent out of the country. Instead they provided a detailed report on the work done and the findings.

In year three of the audit, major accounting problems were discovered at the mine that indicated that revenue had been significantly overstated for years. A visit to the mine by Moscow staff revealed no internal controls and a totally chaotic accounting system that culminated in telling head office in Calgary that a very large loss had to be reported. XYZ lost the audit, and the fishing buddies became former fishing buddies.

Questions

1. What red flags should have been identified by an auditor demonstrating professional skepticism?
2. Why was it important that the partner visit Moscow? And the mine site?
3. What procedures should an auditor perform to ensure that work performed by affiliates in a foreign country are performed to an appropriate standard?
4. What would be the key elements of the instructions you would have provided to your Moscow office regarding the operations of the Siberian mine?
5. To what extent can fee pressure cause audit failures?
6. Is it inappropriate for an audit partner to be "best buddies" with the CEO of his client? If not, why not? If so, what safety measures can be put in place?

7. How should an auditor deal with reviewing working papers in a language they do not understand?

Source: Professional Skepticism Case Collection for Professional Accountants, University of Toronto Professional Accounting Centre, 2023, PAC website https://www.utm.utoronto.ca/pac/case-collections/enhancing-professional-skepticism-case-collection.