



Audit Training of Trainers



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- Chamber of Authorized Auditors of Serbia (CAA)
- Serbian Association of Accountants and Auditors (SAAA)

Introduction

Objective

The objective of the exercise is to enable participants to engage in a role play activity and practice enhancing their interview, communication and interpersonal skills. Engaging in a role play exercises also allows simulation of a real-life business situation and provides an opportunity for participants to tackle and solve some real-life problems. This is critical in order to acquire the complex skills needed by auditors that go beyond the theory and technical competence, allowing participants to exercise their professional judgement and understand particular problems from different perspectives.

Approach and Format

The session is 90 minutes in duration. It starts with a brief presentation [app. 20 min], followed by the role play exercise, which includes simulating a client interview [app. 70 min].

Brief Presentation

Documenting internal controls involves gaining an understanding how transactions are initiated, authorized, processed and recorded for significant classes of transactions within significant processes. It also entails performing a walkthrough to confirm that the documented understanding is correct.

When gaining an understanding of the internal control system, the auditor considers a range of information sources. These include: performing client interviews; reviewing client flowcharts, policy and procedure manuals; and re-performance and inspection activities in the case of walkthroughs. Documentation techniques usually consist of narrative system descriptions, process maps, checklists and questionnaires.

Participants are also reminded that in the case of smaller audit clients, evaluating internal control may be particularly challenging. This is because controls may not be as well defined or as abundant, and management has wider responsibility for areas of the business. Further, segregation of duties can often be an issue and there is the inherent possibility for management to override internal controls. Because of this, finding effective controls to test is quite challenging in smaller audit clients and may lead to costly and time consuming substantive work. On the other hand, however, relying on purely substantive procedures may not be an efficient nor advisable approach to meet the ISA requirements. Smaller auditors need to test smartly and develop skills to overcome these difficulties.

Role Play Exercise

Participants are divided into four groups and engage in the role play exercise involving a client interview, based on the integrated case study “PejaSko”. This case study simulates a small audit client and is used throughout the Audit Training of Trainers Modules. A short summary of the “PejaSko” scenario and the relevant members of management to be interviewed is provided on the following pages to facilitate a stand-alone replication of this group exercise.

Each group is assigned one of the following processes and asked to focus further on this particular audit area when preparing for the client interview:

- Revenue
- Purchases
- Payroll
- Cash receipts
- Cash disbursements

Groups are allowed 10 minutes to prepare for the interview and come up with questions regarding assigned topics to be discussed during the client interview. While preparing for the interview and developing questions, groups are reminded to focus on the following areas within the assigned processes:

- Authorizations
- Segregation of duties
- Cut-off procedures
- Manual and automated procedures
- Control and review procedures

Each group nominates two representatives who are allowed 10 minutes for the actual client interview. Two trainers simulate client management and after the interview, they engage in a short five-minute feedback session summarizing the participant’s interview performance. Other participants are also invited to join the discussion and make observations or provide comments.

Expected Outcomes

- Engaging in practical exercises to help develop participants’ interview, communication and interpersonal skills;
- Develop participants’ soft skills and enable them to exercise their professional judgment while simulating a real-life business situation.

Successful Interview Tips

Interviewing clients is a skill that improves with practice and experience. Below are some tips which, when applied, should enable professionals to maximize their success before, during and after the client interview:

Before the Interview

- Coming prepared is an important factor for success. Having knowledge of the background and issue is required so a preliminary review of the available information (e.g. client flowchart, procedures and manuals) is necessary;
- Plan your interview in advance. A good practice is to provide the client with a meeting agenda and any preliminary information requests so that they are also prepared;
- Appear professional and be punctual.

During the Interview

- Make a brief introduction explaining the purpose and objective of the meeting and indicate how long the meeting is expected to last;
- Ask questions but also steer the interview by listening actively. Focus on specific areas that are relevant. Your client doesn't necessarily know what is relevant but you do. Avoid interrupting or speaking while others are talking;
- Enable two way communications and remind the client to ask questions and seek clarifications, when necessary;
- Manage time well and leave space for follow up questions and additional information gathering at a later stage.

After the Interview

- Document your findings as soon as possible while memory is fresh.
- Thank the client and use this opportunity for any follow ups.
- Discuss any concerns with your colleagues/supervisor.

Company Overview: PejaSko

Background

PejaSko Cheese Ltd. ("PejaSko" or "PC") is a small sized producer of pasteurized and unpasteurized sheep and goat cheese, which produces its own cheese to sell locally and for export. Customers vary from medium size grocery store chains to smaller independent stores. Exports to neighboring countries account for approximately 20 percent of the company's sales. The company has a share capital with a nominal value of EUR 20,000 equivalent in local currency. The Chairman of the board and the company's founder — Svetozar Brankomat — owns 85 percent of the company's shares while a group of 10 local farmers owns the remaining 15 percent.

The company's board also consists of Vesna Nebesna (Chief Accountant) and Gego Bioncev (Lawyer). Certified Public Accountant Dejan Vuk, partner at Best Audit Ltd., has been approached by Svetozar Brankomat, who has requested an audit of PC's financial statements. This is a voluntary audit and the main users of the statements will be the company's bankers.

The current year's financial performance has not been great for PC: sales have continued to decrease this year, given the slow movement in the economy and the increased competition in the market segment. Mr. Brankomat is confident that this is just a temporary situation as the quality of the cheese and the company's reputation is impressive.

The company was founded in 1995 as a family business and has slowly expanded its business locally to become one of the major suppliers of pasteurized and unpasteurized sheep and goat cheese in the local market. The milk used to produce the cheese has traditionally been from sheep and goat from the company's own farms. Over the years, the company has been able to acquire some pastures and meadows, but the area is very mountainous – surrounded by many gorges and hills – which prevents any further expansion of the land. The animals roam around freely and come to the main barn to feed and for milking. The owner does not know the exact number of the livestock he owns at any given time. This was always an issue for the predecessor auditor since it was not possible to verify the precise value or quantity of the livestock in the company's accounting records.

Although the production and sale of cheese seems to be the main activity of PC, the company also sells wool obtained from sheep shearing. The revenue derived from this activity comprises approximately 10 percent of the company's total revenue. Sheep shearing is especially difficult with the lambs, which tend to roam around, do not come for milking, and their precise numbers are unclear.

Market conditions and customers

The market for cheese is very much divided between different producers – customers tend to change their preferences quite often – so the company's market share is estimated at 6.5 percent. The company is considering expanding its export sales: approximately 20 percent of its current sales comprise exports to neighboring countries. The company is also considering entering its products into the EU market. The company assumes that it will have to meet some additional health and safety requirements in this case, but it is unsure about the details. There is also an expectation that the company will have to invest in new machinery and equipment, which have to be purchased in the EU. Current and future export sales and planned purchases of machinery and equipment would be denominated in Euros, which would result in fluctuating operating margins.

Customers for the company's cheeses include: an international grocery chain which accounts for 100 percent of export sales; two local grocery chain, which account for 70 percent of domestic sales; and approximately 30 different family owned shops and supermarkets around the country, which account for 30 percent of domestic revenue. The customers for unprocessed wool include 10 different local clients – producers of woolen blankets, toys and tourist memorabilia.

The biggest threat for the company in the short term is to lose one or two of the chains which collectively account for about 30 percent of PC's turnover. Work is therefore focused on reducing PC's dependency of these chains by securing more small retail companies and increasing exports.

Purchases

Purchases include food for the livestock (grain and hay for the winter, specialized vitamins and additives), specialized bacteria colonies used in the production of cheese (most of them are imported) and some raw milk – the company has to purchase additional milk on the market in order to fulfill the planned production volumes. Suppliers of the additional milk mainly include minority shareholders – i.e. the 10 local farmers.

Employees and Taxes

The company employs 12 people, of whom 10 are full time employees. The staff involved in the company's administration are: Svetozar Brankomat (Chairman of the Board and founder); Vesna Nebesna (Chief Accountant); and Gego Bioncev (lawyer, part time). Nine people work in the production process and the maintenance of livestock, including one person who works part time.

There have been some recent changes in the Personal Income Tax law but it is unclear at present how the company will be affected. The changes need to be implemented by February following the current year-end. The company's lawyer is currently conducting some

investigations regarding these matters, mainly by approaching other companies in similar situations and inquiring how they propose to address these changes in the law.

IT System and Segregation of Duties

Segregating duties is a key issue for the company, which means that auditors cannot rely entirely on internal controls in the audit. The predecessor statutory auditor revealed that in the past there had been instances when the Chairman overused the company's funds (hospitality, representation, petty gifts), but so far these expenses could always be justified.

The company uses a standard IT-based accounting and reporting system - "Buchalter"- to record, process and report relevant financial data. The system is integrated with the company's key processes for purchasing, sales and payroll, with necessary individual customizations conducted in cooperation with the system's provider. Payments for raw milk and other production supplies are made using electronic banking with the three banks with which the company has accounts. The payments are authorized by both Mr. Brankomat and the Chief Accountant. In some cases, especially during Mr. Brankomat's holidays, the Chief Accountant authorizes the payments using her password and that of Mr. Brankomat. According to the Chief Accountant: "The payments cannot wait and the suppliers are getting anxious since they want to get their money as soon as possible." Mr. Brankomat allegedly controls all such payments made from the company's main account after he is back in the office. In the event of Mr. Brankomat checking other, less important and less material payments, the effectiveness of such a control and verification system is under question and the auditor should investigate this further.

The IT system is maintained by an external IT consultant, although all the data is stored at the company's premises. The physical accounting records are also stored with the company (in one of its barn buildings) for the duration required by the local Accounting Act.

Other items

Other operating expenses include the cost of business trips for Mr Brankomat and his family to various West European locations in order to "investigate potential export opportunities and market investigation".

Fixed assets comprise office furniture, vehicles, and production equipment purchased in 2000. The company also owns some land and buildings, including production buildings and barns for the livestock. Fixed assets are valued at cost and depreciated over their useful lives, as estimated by Mr. Brankomat based on information provided by the Chief Accountant. Valuation of the buildings and land has always been an issue – the predecessor auditor questioned the low valuation (buildings were almost fully depreciated) – but the owner defended the figures by referring to the report of the local real estate agent who performed the valuation.

Current assets are mainly from finished goods inventories and accounts receivable. Accounts receivable are recorded at nominal value and the finished goods inventory at the selling price. The company has not experienced any problems with obsolete inventory in the past, but the hard cheese production process requires some ageing. The collection of accounts receivables has always been a problem for the company. PC has two main types of customers: grocery chains and individual shop owners. Grocery chains have long payment terms – 60 days and they rarely pay on time. Individual shop owners have much shorter payment terms – the standard is 14 days, but they also never pay on time and major payment delays are not unusual.

The company has an open line of credit with one of the local banks – Farmers Bank – which it uses to finance any current deficits and the repayment of current liabilities, including liabilities for raw milk from local farmers. The company has a long term credit facility with one of the local banks – Investment Bank – which was used to finance the purchase of equipment and machinery. The remaining life of the loan is five years. The company also has a third current account with Balkan Bank.

When accounting in foreign currency, the daily rates from the central bank are used as a reference. Monetary items denominated in foreign currencies are reevaluated at the exchange rate at year-end. Fluctuations in exchange rates have led to foreign exchange losses and gains when settling accounts payables and receivables.

On 5 January, part of the inventory of unpasteurized goat cheese was returned to the company by a couple of local stores. The cheese was counted and included in the inventory balance at the year-end and included in the stock-take on 31 December. According to the explanation provided, this inventory was brought back because the shop owners complained that their customers had experienced stomach problems after eating cheese from a particular batch. The company owners maintained that the stomach problems had been caused by “too much celebrating on New Year’s Eve, as usual”, rather than the quality of the product, especially since “this has never happened in the past”. The company is planning to rebrand the cheese from this batch and resell it at a discounted price to a local grocery chain in mid-January.

On 30 December one of the barns which was being renovated caught on fire and completely burned down. Luckily, this happened during the day when the animals were outside so no major damage occurred to the livestock. The barn was insured and PC included the expected receivable amount of EUR 200,000 from the insurance company in the financial statements.

Because of the issue with the barn, the company decided not to physically count the sheep and goats this year and instead to value the livestock at the same amount as last year. Counting live animals is always problematic as they prefer to roam around and some never return to the barn. The company is relying on auditors to come up with ideas about how to count the animals more accurately.

Management Representatives

You are asked to conduct an interview will representatives of key management of PejaSko Cheese Ltd., including: Mr. Svetozar Brankomat (majority owner and Chairman of the Board) and Ms. Vesna Nebesna (Chief Accountant).

Mr. Svetozar Brankomat (Majority owner and Chairman of the Board)

Mr. Svetozar Brankomat is the company's Chairman and majority shareholder. He is closely involved in the company's operations and likes to have the final word regarding any operational and financial decision.

Mr. Brankomat is also solely responsible for developing the company's strategy. Mr. Brankomat is well experienced in running the business and knows the production process well. However, he finds issues related to accounting and auditing overwhelming and although he likes to have the final word on everything, he relies on advice from the company's Chief Accountant.

He is middle aged and has a son and a daughter who could potentially follow in his footsteps in the future. At the moment, they are mainly interested in art and travel and are not really engaged in the business.

Mr. Brankomat's state of health is unknown, but there are some indications that he should take a closer look at these aspects in the future. When he broke his leg two years ago it caused a lot of inertia in the company's decision-making process. Luckily, this happened in the low-season so the business was not too adversely affected.

He founded the company back in 1995 and grew it from a small family shop into a successful local cheese producer. Mr. Brankomat is a natural entrepreneur with a positive outlook on the future, realizing that bad times come and go.

In a recent local newspaper article, Mr. Brankomat was featured in an interview speaking about his great deeds for the local community, such as financing a small monument of their patron in front of the local school which was designed by a talented artist who happens to be Mr. Brankomat's son. In the interview he also explained how the company has donated a certain amount of cheese to local families in need. In addition, Mr. Brankomat has financed a few children's playgrounds for the local community featuring logos of the various cheese brands produced by PC. He is also considering initiating a larger project in the future: a PejaSko Cheese amusement park for children promoting the great nutritional qualities of local milk and cheese products.

He likes to talk about the company and engages in long conversations about PC. Sometimes it is difficult to get a quick and straight answer because he steers discussions toward various topics of his choice.

Ms. Vesna Nebesna (Chief Accountant)

Ms. Vesna Nebesna (Chief Accountant) is suitably qualified to carry out the assigned responsibilities of combined Chief Accountant and HR manager, especially since she has been working for the company from the beginning. Ms. Nebesna is highly appreciative of Mr. Brankomat and often praises his knowledge, good qualities and sales skills.

The final operational and financial decisions regarding the company are made by the Chairman of the board and founder, Mr. Svetozar Brankomat. However, he finds issues related to accounting and auditing overwhelming and although he likes to have the final word on everything, he relies on advice from the company's Chief Accountant.

The Chief Accountant is generally regarded as very competent, although she tends to make estimates that are too approximate and mostly undervalued (this seems to be because of the majority shareholder's influence). The predecessor auditor also supports these assessments.

Some technical assistance will be necessary in connection with the preparation of the financial statements, although it is mainly the Chief Accountant who responsible for this process. The Chief Accountant is also interested in receiving advice from the auditors regarding some other issues which have been a concern for the company such as taxation, including the ongoing legal changes, and improving ways to count the livestock.

She is straightforward and comes straight to the point when it comes to discussing issues. She does not like to be bothered too much because she is very busy with her daily responsibilities. She is easily irritated so it's best to approach her when she has sufficient time.

