



TPE 2023 – Case Study Part 2

Hutden

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CASE STUDY

It is Tuesday afternoon on 19 May Yr20 and once again you find yourself in the boardroom sitting opposite Walter and Zena. Your six-month secondment finishes at the end of next month and during this time you have enjoyed the work and made a good impression with the directors. You have also started a personal relationship with Zena during the last few weeks although you have both decided to keep it quiet and not tell anybody.

Earlier in January, and as a result of your evaluation of the in-house construction of eco-houses, the directors made the decision to start constructing and marketing eco-houses via EcoFries. However, it is taking longer to get the company established in the market than had been originally anticipated.

The board's earlier decision not to go ahead with the acquisition of Weeco proved to be wise since on 1 May Yr20 Weeco went into liquidation. The real reason the owners wanted to dispose of the business in January was because one of their eco-friendly material suppliers was considering taking legal action against the company, which they then started in April. They alleged that during the last 12 months Weeco was using cheaper non eco-friendly material and passing it off as eco-friendly by falsifying the relevant documentation.

Walter starts by saying, "Good afternoon, Bobbie. We have a lot to do in a short period of time so I'll be brief and to the point. There are a number of issues I want you to have a look at and, rather than have a series of differing documents, I think it would be useful to include them all in an internal report to me. I will then review it, make any changes and then issue it to all the board members for discussion at our next board meeting.

"As EcoFries is causing problems, it has got me thinking about risks. Given the fact that EcoFries is not performing as well as we had hoped, I would like you to set out the critical risks facing the group given the current situation and to advise on what actions we should have in place to mitigate those risks. I want to see short, sharp, focused comments on the critical risks and not rambling imprecise commentary."

"Okay," you reply. "I'll refer to the documentation used previously (Sections 1 to 3 of this morning's material), and to the contents of our initial meeting to give me a steer."

"Good idea," interjects Zena. "However, as Walter said, focus on the critical risks and include a comment on their impact on the business for each risk. Clearly you will need to use your judgement as to what is and what is not critical as the documentation will mainly provide you with pointers rather than answers. It is what we do not have in place that is of prime importance to us."

Walter continues, "On a more pressing matter, we need to consider the impact that bringing the construction of the eco-houses in-house is having on the group. After reading your initial documentation on starting the construction and marketing of eco-houses through EcoFries the board were under the impression it would be a quick and easy thing to do. The reality has proved to be quite the opposite."

"I thought I gave a balanced evaluation of the proposed venture, as you asked me to do," you reply, quickly defending your work.

"I don't recall saying anything else," replies Walter. "However, be that as it may, you will recall the plan was to continue using Weeco as a subcontractor until we put in place the infrastructure to construct the eco-

houses ourselves, which at the time we thought would be by the end of March. The intention was to then undertake the construction of a few of the smaller eco-houses to gain experience of the processes involved but at the same time continue to use Weeco for the bulk of the construction. As more experience was gained, the plan was to eventually move over all of the construction of the eco-houses to ourselves.

“It transpired that putting in place the infrastructure was much more problematic than we anticipated. Perhaps we should have both been less optimistic but that’s in the past. In an attempt to recover some of the large initial set-up costs, the board decided to increase the gross margin to 15% on the leads we thought we would bring in-house. This, coupled with our higher than anticipated estimated cost of sales figure, has so far resulted in no firm eco-house orders. Interestingly enough, when applying the 10% gross margin to Weeco’s costs, the level of sales was broadly similar to last year. However, with Weeco now in liquidation, these sales look like being lost. What a mess.

“As you will recall, Zena and I had no thoughts of financially damaging Weeco when we considered bringing the construction of the eco-houses in house. Its liquidation couldn’t have come at a worse time. Not only are we finding out we have to incur a higher cost of sales than we anticipated but that the general market conditions have deteriorated quite markedly during the last few months. Some of our major shareholders have heard about Weeco and are making enquiries regarding the impact Weeco’s liquidation will have on the group’s future profitability. I’ve managed to stall them for the time being, but I do need to inform them soon.

“I therefore want you to produce a revised group profit forecast for the year ending 31 March Yr21 taking into consideration the liquidation of Weeco and the recent market changes. Include commentary on any other matters, financial or otherwise, that you think are relevant to the situation. I’ve had my personal assistant summarise comments on the market changes and other issues from national and local newspapers. Take a look at them (Appendix 1) and use what you think is relevant. At this stage I suggest you assume there will be no more future sales from eco-houses and ignore the initial set-up costs.”

After deciding not to comment on Walter’s recollection of the facts you say, “That seems sensible given the uncertainty of the eco-house operation. I’ll use my best judgement to assess the impact the market changes will have on the figures, which will be rough; there is little merit in using more precise figures when it is impossible to predict what is going to happen next week, let alone in 12 months’ time.”

“I agree but make sure you adequately explain your assumptions; figures on their own are of little value,” says Walter.

Walter continues, “However, we still have the problem about what to do with regards to the eco-house situation, which I still want to develop. I therefore want you to make suggestions as to how this can be turned around and improved. At this stage the board will consider any relevant ideas or proposals no matter how unusual they may appear at first sight. Also, let me have your main practical recommendations from your list of suggestions. If the liquidation of Weeco can be used to our advantage then so much the better.

“We appear to have created a problem and need a way out, quickly. Good suggestions will almost certainly help my situation since a whistle-blower has tipped off the board claiming that I knew Weeco were using non eco-friendly materials and that I did nothing about it.”

“Sure,” you reply. “I’ll give it some thought and include my suggestions, but one question? Did you really not know about the use of non eco-friendly materials?”

“Of course he didn’t,” interrupts Zena a little too quickly, “but you know how reputations can easily get tarnished. Getting back to the profit forecast, you will need to take into consideration the latest development at Wallace P Ltd. We’ve received a letter from the local planning officer setting out a problem concerning the number of affordable flats that were to be constructed and this will impact the profit forecast. Don’t worry about replying to the letter, that has been taken care of.” Zena hands you a letter from the local planning officer (Appendix 2).

“Okay,” you reply. “Is there anything else?”

“No, that is probably enough to keep you going this afternoon,” says Walter. “Do you have any questions, Bobbie?”

“Not really,” you reply as you get up and head for the door. “You would like a report on the critical risks of the group and what actions should be in place to mitigate those risks, a revised profit forecast with comments on the impact on the group the liquidation of Weeco will have and my suggestions and recommendations regarding the eco-houses situation.”

“You’ve got it,” says Walter. “I would like it by the end of the afternoon since I have to leave the office around six o’clock and I would like to read it beforehand.”

“Sure, you’ll have it in your inbox well before then,” you say. A moment later you see the text

message from Ali, your manager, which reads “..... where is the assignment ethics memo re: Hutden? The ethics partner needs it by close of play this afternoon even if it is only to state that you are not aware of any issues.”

Required:

- prepare the report to Walter as requested by Walter; and
- prepare the ethics memo to your firm’s ethics partner.

APPENDIX 1

Comments on the market changes and other issues from national and local newspapers

National Newspapers

16 April Yr20

Where are all the houses? The country needs at least 200,000 new houses built each year but only around 152,000 were completed in the year to June Yr19. This is an improvement on the previous year's 6% growth but still woefully short of what is required. If the population continues to expand it doesn't take a rocket scientist to work out the number of houses needed also requires to increase accordingly. So much for the new government-backed home-ownership schemes; perhaps it is too soon to judge but the early signs are not good. If the increase in new houses fails to keep up with the increasing population there can only be one end result, a boom in house prices.

20 April Yr20

The days of the 'family unit' comprising of mum, dad, three kids and a dog are well and truly over. A recent survey shows the trend amongst the under 50s is to live together for an average of seven years, have a child, separate and then stay 'single'. The old housing stock designed for accommodating the traditional 'family unit' is no longer suitable for the modern 'family unit'. Why is the government not giving incentives to individuals to convert the old, outdated housing into more appropriate new housing? Seems an obvious solution to an age-old problem.

1 May Yr20

Unsubstantiated rumours abound that the Bank of England is to review its monetary policy and may increase the Bank Interest rate. However unlikely this may be, any increase will hit existing mortgage holders and those seeking to take out new mortgages. The major conurbations of London, Greater Manchester and Birmingham are likely to be the hardest hit.

5 May Yr20

The latest national survey shows that the average national house price has fallen by 1% during the last three months and this trend is forecast to continue for the next 12 months. This has been put down to a combination of factors not least of which is the uncertainty over interest rates and the average price being in excess of over 8 times the average salary.

14 May Yr20

What a poor year it has been for importers. The weak pound has meant that manufacturers using overseas materials have had to pass on cost increases to customers thus limiting demand. Industries that have been unable to pass on the costs, such as retail and construction, have had to take a hit on their profits. However, the pound is forecast to strengthen over the next 12 months which is great news for importers although it is likely it will take 12 months for the profit margins to return to their previous levels, if at all.

Local Newspapers

15 April Yr20

The population growth of Greater Manchester is forecast to rise by 0.8% during the year to June Yr21. This growth rate is almost twice the national average.

18 April Yr20

Have a burst pipe or need a local builder to undertake a small project? Forget it! Building contractors of all the traditional trades are in short supply and the demand for their services is at an all-time high. Although the local colleges are running apprenticeship courses it is anticipated that it will take four to five years for the supply to catch up with demand. In the meantime sales at the DIY stores are buoyant.

2 May Yr20

Local residents are fed up with accommodation being let out for short durations at peak times of the year. The temporary residents show little respect to the local population and the number of 'unsociable' incidents reported to the police has increased by over 35% annually for each of the last three years.

The council has decided enough is enough. As from 1 July Yr20 a levy equivalent to 100% of the council tax will be levied on all let property in the Greater Manchester area even if it is just let for one day. A 'whistle blowing' helpline will be introduced offering callers a £100 reward for reporting any landlord letting out a property, which will be paid if that landlord is not already on the register and paying the higher council tax. It is anticipated that many of the 'Buy-to-Let' investors will sell and the accommodation will be bought by owner-occupiers intending to make the local area their home.

APPENDIX 2

Letter from Local Planning Officer

13 May Yr20

Mr W Hutcheson
Hutden plc
7 Construction Way
Hightower
Manchester
M90 1OW

Dear Mr Hutcheson,

Wallace P Limited – Affordable Housing

Further to my recent visit to the construction site I was dismayed to be advised by the site manager that only 10 (ten) flats were earmarked as affordable housing.

When I returned to my office I referred to the original planning permission documentation and it states very clearly that planning permission was only granted on the basis that the development would include 30 (thirty) affordable housing flats and that these were to be sold to the council at 50% of the market value of the flats.

This is probably no more than an oversight on your company's behalf. However, I would like to receive confirmation of exactly which flats have been allocated as the 30 affordable housing flats and that the specification of those properties is going to be identical to the others, as agreed in the planning permission.

I look forward to receiving your reply within the next seven working days. In the meantime I can advise that we will allow work on the site to continue but this will not be the case if we do not receive your reply within this time frame.

Yours sincerely,

A Jones

END OF PAPER