



**TPE 2023 – Mock 2**

**Darkfurn – Case Study Part 2**

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**This mock exam is taking place remotely.**

**ICAS would remind you to continue to be ethical and observe the exam conditions applicable to the TPE exam.**

## CASE STUDY

It is now November Yr52 and Brunel Clifton Blaise & Partners Ltd ('BCB') has been formally appointed as management consultancy advisors to Darkfurn with effect from the start of the month.

"Ah, there you are," says Britney as she beckons you to take a seat at a table with her and Michaela. "Michaela was just about to bring me up to date with developments at Darkfurn and I would like you to hear what she has to say. After all, it was partially down to you that we have been appointed as advisors to Darkfurn. Michaela?"

"Thank you Britney. Good afternoon to you Artemis," says Michaela. "I was so impressed by your pragmatic and practical suggestions when Darkfurn was previously owned by WHM that I am very keen to read more of them now that this is no longer the case."

"During the meeting with the board of WHM scheduled to discuss my suggestions to change the trading agreement between WHM and Darkfurn, I was advised that a decision had been taken to sell WHM's 51% shareholding in Darkfurn to Uventus. The board informed me I had been kept out of discussions to avoid any conflicts of interests on my part. The sale took place at the end of October and the consideration for the shares was a nominal sum of £510,000 plus repayment of a £10 million interest-free loan made to Darkfurn by WHM within three months."

You interject, "That's a turn up for the books. That means that most of our recommendations made previously are now irrelevant."

"Not exactly," replies Michaela. "WHM will still remain the principal supplier of goods to Darkfurn for the immediate future and your comments on the contract are being taken on board as we finalise a new trading agreement. I do also need to consider which stores are to remain open, but now that I am no longer constrained by WHM I'm about to change the direction and strategy of the company."

"And not before time too," you say a little too quickly. Seeing the look on Michaela's face you continue, "That is to say, when I was an auditor, I advised your predecessor that the retail market is in a state of constant change and that sticking with a trading format that was designed for the 'noughties' is no longer relevant. Both he and my audit manager told me it was not my place to make such comments hence I have since kept my thoughts to myself."

"Well not anymore, I hope," interrupts Britney. "I see our role as management consultants to advise the client on a whole range of options, some of which may not be taken up. Nonetheless it is important they are all made so the client can choose which they think are appropriate for their future plans."

"Exactly," says Michaela. "The main reason I am here today is that I would like a report on my current thinking and a few related issues. You will recall that last month I asked you to look at fine-tuning the way the company traded when there were two major shareholders. With there now being no controlling interest by WHM I am planning on implementing a completely new strategy and want your critical appraisal of it. The main threads of the new strategy are to expand the product range and pricing points and to change much of the sourcing of the goods from third parties to manufacturing in-house."

"I have been of the opinion for some time that concentrating solely on pre-assembled dark-wood furniture is not the way forward. While I still want to sell these product lines, I am considering introducing a much wider range of low-cost wooden furniture and to rebrand the company, perhaps rename it something like 'Michaela's', i.e. something completely different to Darkfurn. This new larger range of products will include a much greater variety of wood, such as pine, oak, cherry as well as 'value-for-money' furniture made from chipboard and laminate. Most of the new range will be sold 'flat-packed' (needs to be assembled by the purchaser) and not pre-assembled. The customers would be able to pick up their furniture at the point of sale and not have to wait for it to be delivered. Your appraisal of this new strategy, and any other ideas you may have, would be welcome. I came across the results of a marketing survey that you may find interesting (Appendix 1)."

"In conjunction with the change of selling strategy, I want to change the way in which the furniture is sourced. It makes sense to be in control of one's destiny and so I am considering setting up a manufacturing operation to produce as much of the furniture as is possible. However, I am unsure whether it would be better to have this located in the UK or in an Asian country close to the source of many of the raw materials. Could you please set out the factors I should consider, evaluate them accordingly and come to a conclusion as to which you think is most appropriate for Darkfurn?"

"The final part regarding the change of strategy is that I need to introduce an online shop for at least some of the goods. However, I'm not planning on doing this until early next year, so at this stage don't include any points on this."

Britney says, "That's logical. Trying to do everything at once is often a recipe for disaster. BCB has many online-retailing specialists that can assist with the implementation of an online shop if you need our assistance at the time."

"I'll bear that in mind, as it certainly has been very chaotic recently and I could do with all the help I can get," replies Michaela. "During the last few months I've seen on CCTV that a few store managers have been pocketing cash from the tills prior to sending it to head office. The amounts are only a few thousand pounds a month and so I have turned a blind eye to it. Moving to online-retailing will reduce this problem but, as I said, it is one for the future."

She continues, "When I was clearing out some files I came across a copy of a draft internal audit report produced by WHM's internal audit department (Appendix 2) issued a few days prior to the transfer of the shareholding. While events have superseded the reason as to why the report was produced it does, nonetheless, include a number of points that are pertinent to the current situation. Please include a section in your report on your evaluation of the contents of the internal audit report and, if appropriate, provide recommendations following on from your evaluation. I am always wary when the subject of taxation is raised and tend to rely on accountants when it comes to numbers."

"While we're on the subject of finance departments, I know WHM has a separate treasury department and I'm wondering if it is worth having one in Darkfurn. I am concerned that Olly, our financial controller, is already under time-pressure and adding another task to his workload could be too much. He is a key employee and I would not want him to leave. An option is to pass down some of the treasury management to the store managers but they too have a busy workload."

"Could you please suggest how you would envisage a treasury department operating within Darkfurn and what tasks it may undertake to alleviate the workload of the rest of the finance department? Don't spend too long on this section of the report and include comments relevant to both the current and the new strategy I am considering."

"That should be sufficient for the time being. Do you have all of that?", asks Michaela?

"Yes, I think so," you reply. "To sum up, we will prepare a report for you which is to include:

- (a) a critical appraisal of the new strategy including a section which sets out the factors you should consider when deciding on the location of a manufacturing operation, and our evaluation of those factors;
- (b) an evaluation of the contents of the internal audit report including recommendations, where appropriate; and
- (c) our suggestion on how a treasury department would operate within Darkfurn and what tasks it could undertake."

"That sums it up nicely, Artemis," responds Michaela. "I'm sorry but I have to leave for another meeting. There's no rush for the report, anytime this evening will be fine." With that Michaela gets up and leaves. "Ah," says Michaela turning back and popping her head through the doorway, "I almost forgot. If either of you are interested in having an intricately-carved coffee table do let me know. There is a small consignment of them arriving next month. Although they are produced by trainee carvers and, therefore, cannot be sold as new by the company, they are rather nice." With that Michaela departs.

Britney says, “That will keep you busy this afternoon. In addition to drafting the report for me to review, I also want you to produce a briefing note on any ethical issues involved in both this assignment and those arising from the work on the briefing paper last month. The briefing note should start with extracts I can uplift to include in a letter to Michaela followed by any other points that you want to draw to my attention. I’ll pencil in a meeting later this afternoon for us to discuss your work.”

With that you get up to start work, once more thinking about intricately-carved coffee tables.

**Required**

- Prepare the draft report to Michaela for Britney to review; and
- Prepare the briefing note to Britney on the ethical issues as discussed.

## APPENDIX 1

**Extracts from the “Marketing survey on consumer attitudes towards purchasing typical household furniture” undertaken during September Yr52. The sample size of 10,068 was representative of UK demographics.**

	Question posed	Summary of replies (Yr50 results in brackets)
1.	Would you be prepared to pay a higher price for premium-priced furniture to be built prior to delivery or would you prefer to pay less for the furniture but construct it yourself, providing the instructions were very clear, the tools provided and it was easy to do?	<p>68% (67%) said they would expect premium-priced furniture to be pre-assembled and delivered.</p> <p>67% (71%) said they would be prepared to construct furniture themselves if there was a reasonable price saving and it was not premium-priced furniture.</p> <p>A sizeable number said they were unemployed and could not afford premium-priced furniture.</p>
2.	Would you be prepared to pay for flat-pack furniture to be assembled by a tradesperson at your home?	<p>52% (50%) said they would providing the price was fair and it was an experienced tradesperson.</p> <p>Many commented that they would only consider this if the tradesperson was an employee of the company selling the furniture. They appeared not to like the idea of an unconnected subcontractor assembling the furniture.</p>
3.	Where do you prefer to purchase furniture? In large super-stores, small stores or online?	<p>Many commented that it depends on the price-point of the furniture. 55% (39%) said they preferred the internet for most furniture.</p> <p>For larger pieces of furniture 84% (87%) said they preferred to use super-stores rather than small stores. The main reasons were that there is a large number of companies to choose from, the stores have a wide range of products and the customers can browse without the feeling of being watched/under pressure to buy, which seems to be the perception in small stores.</p>
4.	What colour/wood type do you prefer furniture to be constructed from: dark (mahogany), medium (oak) or light (pine)?	<p>55% (53%) preferred medium (oak)  35% (32%) preferred light (pine)  10% (15%) preferred dark (mahogany)</p> <p>Many commented that dark wood was a bit depressing and had the perception of being expensive. It was also associated with the use of overseas suppliers and thus not supporting the UK economy.</p>
5.	Would you prefer to collect your purchase(s) at the time of sale or have them delivered?	85% (79%) said they preferred to collect their purchases at the time of sale rather than pay for delivery.

## APPENDIX 2

Date: 28 October Yr52

To: M. Xa

From: WHM Internal Audit Department

Subject: Draft Internal Audit Report of high-level tax issues identified in Darkfurn

ISSUE	RECOMMENDATION
<p><b>Sales of goods for export</b></p> <p>A sample of 12 sales transactions (all to private individuals) relating to the sales exported to overseas customers was reviewed during May. In every case VAT was not charged on the sale. When asked to see the documentary evidence to support the claim the goods had been sold overseas, the only available documents were internally generated copy 'Goods Despatch Notes'.</p>	<p>External documentary evidence should be retained to support the claim the goods were shipped abroad.</p>
<p><b>Sale of consultancy services to Chinese company</b></p> <p>One-off income of £70,000 plus VAT was invoiced and sent to a Chinese company. This was to cover a team of specialists visiting a number of shops in Beijing and reporting on how best to manage the flow of customers through the stores. This invoice has remained unpaid for seven months.</p>	<p>Details of this invoice should be given to WHM's credit controller who will chase up this debt. It is recommended a policy of chasing up all debts of more than one month is implemented as soon as possible, notwithstanding the contract between WHM and Darkfurn prohibits the granting of credit.</p>
<p><b>Purchase of goods from UK suppliers</b></p> <p>A review of the cash book identified £120,000 of goods, including VAT, have been purchased from a UK supplier and VAT claimed on the date the supplier was paid. All the invoices issued by the supplier did not show a VAT number.</p>	<p>The agreement between WHM and Darkfurn states very clearly that ALL goods should be supplied by WHM. It is recommended no more goods should be purchased from other suppliers.</p>
<p><b>Purchase of goods from Malaysian supplier</b></p> <p>Darkfurn purchased £500,000 of goods from a Malaysian supplier. A review of 50% of the import paperwork shows the goods have been described as being made from common conifer wood. Furthermore it states that little work has been undertaken producing the furniture.</p> <p>As a result of this description, the customs duty payable has been levied at 5%. The goods are in fact made from rare hardwood and have very intricate carvings on them. The correct customs duty payable for these goods is 40%.</p>	<p>As above, ALL goods should be purchased from WHM. As a minimum, any purchases from other overseas suppliers must first be approved by WHM.</p> <p>If similar future purchases are made from Malaysia the supplier should be advised to state the correct description on the import documentation.</p>
<p><b>Big Data</b></p> <p>As part of the review of the management accounting information system to identify any tax issues it was noticed the financial information relating to each of the store sizes and the geographical location was poorly structured. This means it is very time consuming to produce the limited store analysis, which is usually late in being forwarded to the WHM board.</p>	<p>Use of 'Big Data' should be considered to streamline the production of the management accounting information.</p>

END OF PAPER