



TPE 2023 – Mock 2

Darkfurn – Guide to Answer

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TPE GUIDE TO ANSWER – DARKFURN BRIEFING PAPER FOR MICHAELA

This briefing paper sets out comments in relation to the issues raised by Michaela at the initial introductory telephone conversation with Britney. The issues and comments are set out below:

- An analysis of the trading performance of Darkfurn including commentary and analysis of store performance
- An appraisal of the contract between Darkfurn and WHM

1. *Analysis of underlying trading performance of Darkfurn, recommendations for operational improvements and an assessment of which stores are underperforming.*

Darkfurn

The information available is limited to just the four years to September Yr52 and therefore any conclusions drawn from the analysis should be used for indicative purposes only. Yr51, which was the year greatly affected by the Covid-19 pandemic, is largely discounted in the following analysis.

1.1 Turnover

The turnover has decreased 9%¹ from Yr49 to Yr52. This appears to be a relatively steady decrease given that the number of stores has remained unchanged throughout this period and therefore needs to be addressed.

One option is to consider introducing a sales incentive scheme. Presently there is no bonus scheme in operation and so some form of performance related pay could stimulate sales.

Consideration needs to be given to ensure it does not encourage increased sales at the expense of reduced profitability. There are numerous options and this is an area BCB can provide further assistance on if required.

1.2 Gross margin

Gross margin is decreasing year after year from 46% in Yr49 to 40% in Yr52².

This reflects the increased mark-up being applied by WHM to the cost price of the goods to Darkfurn and is having a direct impact on the overall profitability.

It is recommended the price paid for the goods is renegotiated with WHM to secure a cost reduction. The fact that the impact on the overall profit of the WHM group is only 49% of any price reduction should be part of any negotiations.

1.3 Store variable costs

Store variable costs are, on average 10%. It is likely some stores will be performing better than others and thus it is recommended that more information is obtained prior to any decisions being made in relation to these costs.

A general comment is that as a result of each store negotiating an agreement with a local courier firm then it is likely these costs will be higher as compared to the company negotiating with one courier firm on a national basis.

It is recommended the company enter into negotiations with a number of national courier firms to provide delivery services for every UK store. Alternatively, the company should consider bringing the delivery of the

¹ $435.3 - 396 / 435.3$

² $200.2 / 435.3 = 46\%$ $159.3 / 396 = 40.2\%$

goods 'in-house' and a cost-benefit analysis exercise should be undertaken to assess the viability of this suggestion and/or allow customers to collect the goods from the store.

This is an area BCB can provide assistance with if necessary.

The method of accounting for the labour should be reviewed regularly to ensure that it is appropriate and providing relevant information.

1.4 Store fixed costs

As mentioned at section 1.1 a review of incentivising the sales staff could be introduced to improve motivation and productivity.

This would also include members of the Darkfurn management team/directors.

The information is silent on the control over the store managers and thus a system of control should be in place e.g. regular review of store management accounts or an area supervisor.

Store analysis

1.5 Turnover per store analysis (appendix 1)

In broad terms the turnover per store decreases the further north the store is located in England.

The turnover per store in the south is approximately 50% higher as compared to those situated in the north for both small stores and large stores.

The turnover for the larger stores is approximately five times that of the smaller stores.

The information as provided is not in sufficient detail to be able to undertake a comprehensive analysis of the turnover per store since some same size stores in the same region could be outperforming others. It is recommended the geographical locations are subdivided into smaller regions such as counties/cities.

Furthermore, the size classification of the stores should be revised since the variation of the size of store within each category could be substantial e.g. one large store could be three times the size of another large store. Ideally the information should be provided on a store-by-store basis.

1.6 Gross margin/contribution per store analysis (appendix 1)

The gross margins show a similar trend to the turnover in that it decreases the further north the store is located in England. For example, the smaller stores in the north have an average margin of 37% as compared to 45% in the south.

It is recommended further analysis is undertaken to see which goods are being sold in the different locations at what quantities and at what margins.

If the reason behind the sales is understood, this will enable more a targeted marketing approach to be undertaken aimed at maximising the gross margin per location.

The smaller stores have a higher gross margin as compared to the larger stores across all three locations.

The reasons why this is the case should be investigated to see if the margin of the larger stores can be increased. The reason maybe as straight forward as the smaller stores are concentrating on the higher margin goods given the limited floor area.

However, the larger stores may generate a greater gross profit by selling a higher volume of lower margin goods, hence the importance of further analysis.

The contribution per store (after deduction of store variable costs) shows a decreasing trend the further north the store is located, for each store size. As expected, given the high-mark-up applied to the goods, the contribution is positive for all store sizes at all locations.

1.7 Profit per store (appendix 1)

After taking in to account the fixed costs per store the profit per store shows a different picture. The profit per store for the smaller stores is approximately break-even with each location producing between £nil and £0.1million profit.

This in contrast to the larger stores where there is an overall loss per store.

However, within this overall loss for the larger stores there is a variation in the locations as shown below with the stores in the south producing a loss of £2.0 million per store.

Location-store size	Profit per store
	£million
North - small	0.1
Midlands - small	0.1
South - small	0.0
North – large	0.0
Midlands – large	0.7
South – large	(2.0)

Table 1: Profit per store per geographic location

1.8 Footfall to sales conversion rate analysis (appendix 2)

The ability of staff to convert potential customers to actual customers is an important metric to consider when assessing the performance of an individual member of staff or store. An analysis of the conversion rate per store shows each store has a conversion rate of 10% with the exception of the larger southern stores, which have a conversion rate of 8%.

With the exception of the larger southern stores, all stores are consistent, including the smaller southern stores, indicating 10% is the natural conversion rate based on current selling practices.

The reasons why the larger southern stores have a much lower conversion rate needs to be investigated and action taken to bring it more in line with the others.

1.9 Recommendations

More detailed analysis needs to be undertaken on the profitability per store before a firm conclusion can be reached e.g. smaller geographical locations and/or more accurate store size categories.

However, based on the above analysis the smaller shops are, on average, not making a profit per store and are therefore not making a contribution towards the administrative and finance costs of the company. After market research and further analysis, the goods sold in all stores should be aligned to the local demand so as to maximise the profit per store.

If any stores are to be closed the larger stores in the south should be considered first.

Consideration should be given to further expansion of larger stores in the Midlands due to the positive profit per store arising from a combination of relatively high turnover generating reasonable gross margins coupled with reasonable fixed costs per store.

1.10 Governance

It is clear that historically Darkfurn has been controlled by the board of WHM and they have effectively taken all of the important decisions.

This may be as a result of the lack of confidence in the ex-managing director, who was closely related to the managing director of WHM and who was probably being 'controlled' by his father-in-law.

It is more likely that the board of Darkfurn will know their market better than the board of WHM, who will spend time on other geographical areas in addition to the supply side of the business.

It is recommended the board of directors of Darkfurn take responsibility for the main decisions of the company and advise the board of WHM accordingly, perhaps using them in more of an advisory capacity.

1.11 Staff and delivery

The staff hiring, promotion, firing and training policies are very outdated and should be reviewed to bring them up to date with current 'thinking'. Areas to be considered include the gender balance of managers and sales assistants, the minimum degree qualification for the sales assistants, zero-hour contracts and the lack of training.

The length of time between placing an order and receiving the goods is long (being around a month). With an increasing volume of sales on the internet the modern consumer expectation is for fast delivery. Since most stock ordered from WHM is delivered within a week it seems the delay in delivering the goods lies with the stores. The management of Darkfurn should introduce targets to reduce the delivery times, albeit the customer expectations should be managed.

1.12 Reputation

Closing the larger stores in the south of England may adversely affect the reputation of the brand nationwide, especially if they are considered to be 'flagship' stores.

Consideration should be given to making the existing ten stores more profitable by perhaps reviewing if there are any economies of scale that can be gained by combining the operations of all or some of the stores.

1.13 Closure procedure and costs

An understanding of the closure procedures would need to be gained prior to any decision being taken coupled with an analysis of closure costs e.g. redundancy and cost of breaking lease/rent agreements with the landlords.

The timing of the cash flow of such closure costs needs to be understood.

1.14 Other

The board of WHM may not approve store closures since it will impact the overall group profitability.

2. Appraisal of salient terms of trading contract

2.1 General

The contract was written in Yr33 when both the retail-trading environment and the shareholding of Darkfurn was significantly different. It therefore needs to be updated to reflect both of these factors so that it produces an agreement that is acceptable and fair to both parties.

At present the contract is heavily biased towards WHM, which was fine when it was a wholly-owned subsidiary but it is now hindering the development of Darkfurn, which is clearly not in the best interests of either party.

A copy of the full contract should be obtained and all the clauses reviewed. It is possible that the salient terms on their own do not convey the correct meaning.

It is recommended a legal expert with experience in reviewing commercial contracts is engaged to review the contract prior to any discussions with the board of WHM after consideration of the likely charge for this work.

Goods for Resale

2.2 Supply

Limiting the purchase of goods for resale to only those supplied by WHM is very restrictive (**clause 1.1**) and whilst it ensures consistency across geographical areas it is unlikely a customer will be too concerned about the same goods being sold in other parts of the country or world.

If Darkfurn is able to source value-for-money goods from third party suppliers that meets the demand from the local market and sell them for a profit then both Darkfurn and WHM will benefit from the increased gross profit.

It is recommended clause 1.1 be amended to allow Darkfurn to purchase goods different to those produced by WHM.

If this meets with resistance from the board of WHM then a maximum percentage could be proposed and/or that this clause is regularly reviewed, say annually.

2.3 Financial

By controlling both the mark-up (**clause 1.2**) and, to a large extent, the selling price of the goods WHM is effectively determining the operating strategy of Darkfurn thereby taking control of the business away from the board of Darkfurn.

The current arrangement is such that effectively all the risks lie with Darkfurn.

By having the ability to change the mark-up, which it has been doing during recent years, and passing on the total costs to Darkfurn coupled with an exclusive purchase arrangement means the board of Darkfurn have limited ability to trade out of the financial difficulties the company is currently experiencing. This is clearly detrimental to both parties.

2.4 Logistics

By not allowing any display goods to be taken away at the time of sale the contract could be restricting the volume of potential sales (**clause 1.4**)

The contract should be amended to allow Darkfurn to dispatch goods at the time of sale. This could be limited to a range of specified goods but at the very least should include smaller easy to handle items.

The once a week delivery from the WHM warehouse within seven days of receiving the order is archaic and demonstrates how far behind the times the logistics have become (**clause 1.5**).

The contract should be amended to include more frequent deliveries, especially of stock items.

Consideration should be given to having a system in place where goods ordered by the customers are dispatched directly to them from the warehouse in Republic of Ireland. This would include future overseas customers. Although a new logistical system will need to be implemented and the costing/recharging structure amended, this will enable cost savings to be produced thus being beneficial for WHM and Darkfurn.

Other

2.5 Sales

Price

By limiting the sales price (**clause 3.1**), it restricts Darkfurn's ability to fine-tune the selling price to local market conditions, which are likely to be different to those in the Republic of Ireland.

The Euro/Sterling exchange rate fluctuations will have a knock on effect on the selling price in the UK (also on purchase costs). It is important to have consistent pricing in the retail environment and therefore Darkfurn need some control over the final selling price.

Clause 3.1 should be amended to include some discretion when it comes to the final selling price. If this is resisted by the board of WHM then it could be offered that they have the final approval if the selling price is different by, say more than +/- 15%.

Credit

Clause 3.2 states that Darkfurn will not provide any credit to customers. This limits the company's ability to sell to local business that are used to receiving credit terms for B2B purchases.

This clause should be amended to allow for some credit to be offered to some customers on the condition that adequate credit checks have been undertaken. If resisted by the board of WHM it should be mentioned that the financial risk lies with Durnfurn and that all costs associated with giving credit will be borne by Darkfurn and that it will only be given in limited circumstances.

It is likely WHM are making a profit on providing Darkfurn's customers with credit. It should be negotiated that Darkfurn is to be entitled to a commission on providing leads to WHM's consumer credit department.

If the board of WHM argue that the provision of credit to customers of Darkfurn is providing a service then evidence of this should be asked for.

If not forthcoming then it should be stated that Darkfurn reserve the right to place this work out to tender and to see if it can generate an additional income stream. On the basis that WHM is not making a profit out of this work then both companies could benefit from this arrangement.

Bank account

WHM will/should be earning interest on the surplus funds held in the bank account controlled by the Treasury Department at WHM (**clause 3.4**). Depending on the amounts involved the negotiations could ask for some form of credit for this. At the least the board of WHM should be advised that this arrangement is benefiting WHM alone and not Darkfurn.

Ideally it should be argued that the bank account should be controlled by Darkfurn.

2.6 Miscellaneous

Management charge (clause 2.2)

The management charge is very heavily biased towards WHM, which will always make a profit on the arrangement. When Darkfurn was a wholly-owned subsidiary the group profit was unaffected and the arrangement seems to be a way of transferring profit from a UK company to a company based in the Republic of Ireland.

It is recommended this clause should be amended so that the management charge reflects the actual costs incurred. If the board of WHM resist this then it could be mentioned that full disclosure of how this charge is calculated will need to be forwarded to HMRC with the next corporation tax return, which assuming there is nothing untoward in the calculation will not cause the board any discomfort.

APPENDIX 1

Profit per store Calculation

= calculated from figures as provided

No of stores Yr52

	Small	Large	Total
North	9	4	13
Midlands	13	5	18
South	24	10	34
Total	46	19	65

Turnover (£million)

	Small	Large	Total
North	18.9	39.6	58.5
Midlands	35.1	71.0	106.1
South	74.4	157.0	231.4
Total	128.4	267.6	396.0

Turnover per store (£million)

	Small	Large
North	2.1	9.9
Midlands	2.7	14.2
South	3.1	15.7

Variable cost per store (%) 10.00%

Gross profit per store classification

	Small	Large	Total
North	7.0	13.5	20.5
Midlands	14.0	27.0	41.0
South	33.5	64.4	97.9
Total	54.5	104.8	159.3

Gross margin per store

	Small	Large
North	37.0%	34.0%
Midlands	40.0%	38.0%
South	45.0%	41.0%

Profit per store

	Small			Large		
	North	Midlands	South	North	Midlands	South
	£m	£m	£m	£m	£m	£m
Turnover per store	2.1	2.7	3.1	9.9	14.2	15.7
Gross profit per store	0.8	1.1	1.4	3.4	5.4	6.4
Variable cost per store	0.2	0.3	0.3	1.0	1.4	1.6
Contribution per store	0.6	0.8	1.1	2.4	4.0	4.9
Fixed costs per store	0.5	0.7	1.1	2.4	3.3	6.9
Profit per store	0.1	0.1	0.0	0.0	0.7	-2.0

APPENDIX 2

Footfall to sales conversion factor

	Small Stores			Large Stores		
Geographical area	North	Midlands	South	North	Midlands	South
Turnover/store (£000)*	2,100	2,700	3,100	9,900	14,200	15,700
Turnover/day (£)	5,833	7,500	8,611	27,500	39,444	43,611
Av customer sale (£)	580	750	860	550	790	1,090
No. sales per day (£)	10	10	10	50	50	40
Daily footfall 100	100	100	500	500	500	
Sales/footfall	10%	10%	10%	10%	10%	8%

* = from Appendix 1

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1. Introduction

This report has been prepared for Michaela Xa to provide advice on the following matters:

- Assessment of new strategy including comments on manufacturing options.
- Evaluation of the contents of an internal audit report produced by WHM
- Puts forwards the arguments for and against having a separate Treasury department within Darkfurn.

It should not be shown or used by any third party without our prior written consent. We have prepared this report based on the information provided. Brunel Clifton Blaise & Partners Ltd do not accept any liability if this report is used for an alternative purpose for which it is intended.

2. Executive Summary

- The company should decide on how it is to raise the funds to repay £10million to WHM within the next three months.
- The new strategy is much more in-tune with the current retail environment and the company should move towards implementing it after undertaking appropriate research into its viability given the competitiveness of this market.
- The new strategy should be adequately costed and funded before it is undertaken bearing in mind the repayment of the £10million to WHM.
- A review into whether or not manufacturing the furniture in-house should be undertaken prior to deciding upon where any manufacturing facility is to be located.
- A full cost-benefit analysis of the manufacturing locations should be undertaken prior to a final decision being made. {or comment agreeing with conclusion in report}
- The full potential cost of the tax issues arising from the internal audit report should be ascertained and appropriate steps put in place to ensure these type of issues do not recur.
- It is unlikely a new treasury department is appropriate at present although engaging the services of someone with treasury experience should be considered when the new strategy is implemented.

3. Appraisal of new strategy

3.1 Selling strategy

3.1.1 Overview/wood type

The change from selling solely premium-priced pre-assembled dark-wood furniture and related items to a much wider-range of low-cost wooden furniture is a significant change in direction.

The Darkfurn stores are likely to be well known for their focus on dark-wood furniture and so any significant change e.g. a reduction in the range of dark-wood furniture may alienate many of its existing customers, who in turn may be less likely to recommend the company to their friends.

However, it is unlikely that many of the customers would buy repeat purchases of premium-priced pre-assembled furniture due to the relatively high cost. This would suggest that the change is unlikely to result in a significant loss of existing customers.

However, the cumulative benefit gained from over four years of national marketing would be lost unless the stores retain a large selection of the previously stocked furniture.

The results from a marketing survey undertaken in September Yr52 showed that of those surveyed only 10% preferred dark-coloured wood over the medium and light-coloured woods, which was down from 15% two years ago.

This indicates a trend towards the lighter coloured woods, which is consistent with the change in strategy and therefore a positive indicator.

There are a lot of competitors operating in the new strategy retail market, which suggests it may be difficult to generate high rates of returns on any investment if this strategy is pursued.

3.1.2 Furniture - cost

After the effects of the Covid-19 pandemic on the economy and the resulting possible greater unemployment it is likely that, on average, there will be a greater demand for lower-priced furniture as opposed to premium-priced furniture. This too indicates the new strategy of focusing on lower-cost is more suited to the current economic climate as compared to the existing strategy.

Furniture – assembly

The change from pre-assembled furniture towards 'flat-packed' furniture is consistent with the results of a survey where 67% of those surveyed said they were prepared to construct the furniture themselves if there was reasonable saving and it was not high-end furniture.

Furniture - delivery

85% of those surveyed preferred to collect their purchases themselves, an increase from 79% two years ago. This higher percentage is consistent with the new strategy and is therefore another positive indicator.

The increase from 79% to 85% could suggest a greater awareness of cost savings by the general public rather than paying for an additional service. This too suggests moving to a lower-cost pricing model is the correct strategy.

3.1.3 Branding

A well-recognised brand is essential for a large chain of retailers to trade successfully; even this is no guarantee as evidenced by the collapse of well-known retail chains in recent years.

A change of name could signify a 'fresh start' but it would be expensive to rebrand the stores coupled with the associated advertising.

The name of the brand is important and it may be preferable to have a name that is associated with the products rather than the name of a person.

Before any final decision is taken on the rebranding it is recommended brand marketing consultants who have relevant retail expertise are approached.

3.1.4 Stores

The current portfolio of stores is biased towards smaller stores (46 small, 19 large).

The results of the marketing survey shows that 84% of those surveyed preferred to use super-stores rather than small stores. This suggests the new strategy does not fit well with the current store portfolio.

However, none of the store leases will be for a period of longer than five-years. The new strategy will take years to fully implement and therefore the smaller stores could be closed down using a phased approach if necessary.

3.1.5 Conclusion

The new strategy is much more in-tune with the current retail environment as compared to the existing strategy. However, there is high competition in this market segment and the portfolio of stores does not exactly match the customer preferences as per the recent market survey.

On balance the positive indicators outweigh the negative indicators and therefore the company should move towards implementing the new strategy.

A fresh start does enable the company to introduce innovative selling techniques to give it a unique selling proposition ('USP') e.g. introduce tiered pricing for self-assembly furniture so that each item has three choices; i) purchase the flat pack only, ii) purchase the flat pack and have it delivered and iii) purchase the flat pack and have it delivered and assembled. A discounting structure for multiple delivery of items can be given at the point of purchase.

However, to assess the credibility of such options and the new strategy the company should consider engaging retail specialists to advise on the rebranding and marketing of the company.

This is an area BCB can assist with if required.

The new strategy will need to be adequately costed and funded before it is undertaken.

At present the company does not have the funds available to spend on launching a new strategy, and therefore a fund raising exercise will need to be undertaken bearing in mind the commitment to repay £10million to WHM within the next three months.

3.2 Manufacturing location

3.2.1/3.2.2

Factor	Commentary
Financial	
Cost of materials	<p>The cost of dark wood will be cheaper in an Asian country due to the proximity to the source of supply.</p> <p>This may not be the case for other types of wood and so before a conclusion can be made the quantity of wood for each wood type would need to be estimated.</p> <p>However, on balance it is likely the overall cost of materials is likely to be cheaper in an Asian country.</p>
Cost of labour	Labour is cheaper in an Asian country.
Geographical distance	<p>It is clearly much easier to visit and control a UK manufacturing operation as opposed to one based overseas.</p> <p>If a major unexpected event took place e.g. another pandemic this may prevent entry into an Asian country thus potentially causing problems with control.</p> <p>This is less likely to such an issue in UK.</p>
Foreign exchange	Paying the manufacturing costs in a local foreign currency will introduce some volatility into the costs.

	<p>Although UK manufacturing will involve some overseas costs these will be less than those of an Asian country.</p> <p>Management of foreign currency can be controlled but the use of financial instruments, perhaps in a treasury department.</p>
Shipping	<p>Could be a long-time lag between production and delivery to store due to shipping times.</p>
Taxation/contract law/setting up	<p>Knowledge of UK taxation/contract law will be known to Darkfurn whereas this is not the case with an Asian country.</p> <p>This is likely to involve an increase in costs involved with local compliance and taxation issues.</p>
Other	
Labour conditions	<p>In UK there are strict legislation regarding Health and Safety, which will add to the cost of employing staff.</p> <p>Research would need to be undertaken to understand similar legislation in the Asian countries under consideration.</p>
Expertise/quality control	<p>If the current product range is to be sold then the labour in Asian countries will have the experience and knowledge to produce intricately-carved dark-wood furniture.</p> <p>This may not be the case in UK</p>
Human Rights	<p>The perception of the abuse of human rights/exploitation needs to be managed if manufacture is undertaken in an Asian country.</p> <p>This is the case irrespective of the actual working conditions and treatment of employees, which could be the same, if not better than those in UK.</p>
Culture	<p>The UK culture is generally well understood.</p> <p>This may not be the case with an Asian country and therefore inadvertent misunderstandings may occur.</p>
Political	<p>The political situation within UK is relatively stable and understood.</p> <p>This may not necessarily be the case in all Asian countries e.g. a change of controlling political party may impose currency control sanctions and other restrictions.</p>
Paperwork	<p>Shipping from an Asian country will involve more paperwork and potential issues due to dealing with importation rules and regulations e.g. customs duty, VAT.</p>
Reputation	<p>Some people in UK like to support UK businesses and therefore having the manufacturing operation in an Asian country may discourage some people to purchase from Darkfurn.</p> <p>If the furniture is manufactured in UK this could be incorporated into a marketing campaign.</p>
Environmental impact and sustainability	<p>Reducing the carbon footprint and sustainability are political hot topics and are at the front of many people's thoughts. Using an Asian country for manufacturing the furniture could have the perception that the carbon footprint of Darkfurn is high.</p> <p>A UK manufacturing facility is likely to have to opposite effect, especially if used in a marketing campaign, if it is the case.</p>

3.2.3 Conclusion

It may be difficult to quantify many of the non-monetary points mentioned above, for example reputation, but an attempt should nonetheless be made to assess the impact these may have on the company.

Prior to a firm decision being taken on where to locate a manufacturing operation it is recommended an exercise is carried out to determine if manufacturing as much of the furniture in-house is the most effective way forward.

It may be the case that only manufacturing some of the furniture e.g. just the dark wood is more appropriate for the company at this moment in time.

Likewise, although complete independence is great in theory it may be the case that Darkfurn would be financially more profitable if it simply acted as pure retailer.

Unless a review of all options, including a cost-benefit analysis, is undertaken it may be possible the optimum decision not known.

This is an area BCB can assist if required.

4. Internal Audit Report

Although the report was produced as part of the control process of WHM it does nonetheless raise some points that are relevant to Darkfurn as a stand-alone company.

4.1 VAT on exported sale of goods

On the face of it the rate of VAT applied to exports is Zero % and therefore there is no issue other than the lack of documentation.

However, without adequate evidence to support the fact that the goods were exported HMRC could argue that VAT is due on these sales. At present internally generated 'Goods Despatch Notes' may not be considered sufficient evidence.

In the worst case scenario if there is insufficient evidence to prove the goods were exported the underdeclared VAT would be approximately £333,000³.

It is recommended third party documentation to support the exported sales is obtained for historical sales and for all future sales. This could be shipping documentation, emails from customers, VAT declarations made by customers, etc.

4.2 Consultancy services to China

VAT on exported services are outside the scope of VAT and therefore VAT should not have been charged on the invoice.

Although there is no net VAT impact the error should be corrected and HMRC advised appropriately (most probably by correcting the next VAT return).

Customers should only be given credit after passing an approved credit control procedure.

Darkfurn should introduce a debt collection policy, which should be strictly adhered to.

4.3 Potential unregistered VAT trader

VAT should not be claimed on purchases that are not supported with a VAT invoice.

The internal auditor should be contacted to ascertain if the whole year had been reviewed and that this relates to a one-off supplier or if the problem could be more wide spread.

Where VAT has been claimed on invoices without a VAT number the supplier(s) should be contacted and a request made for the issuance of replacement VAT invoices.

³ Oversea sales are approx 0.5% x £396mill = £2mill. If gross VAT is £2mill/6 = £333,000

If these are not forthcoming or it is confirmed the trader is not VAT registered then the error should be corrected (at least £20,000⁴) and HMRC advised appropriately.

Legal advice may have to be obtained to see if the company has a duty to report under the Proceeds of Crime legislation.

4.4 Malaysian supplier

A review of all the paperwork needs to be undertaken to determine the full extent of the fraud.

Assuming the whole £500,000 has had the incorrect customs duty rate applied to it then the correct amount should have been £200,000 (40% x £500,000) i.e. an underpayment of £175,000⁵.

Darkfurn should contact HMRC and voluntarily declare the underpaid duty with a full explanation as to how it arose.

Legal advice should be taken to ascertain the correct reporting procedure for such an event.

VAT is levied on the cost of the goods (including insurance and freight) plus import duty.

Notwithstanding the fact that there is no impact on the net VAT position the error should be corrected and HMRC advised appropriately.

4.5 Big Data/other (restrict to 1 mark)

The current use of the financial information available to the company is poor and inefficient.

It is recommended a consultant specialising in the use of analytical data (analytics) is engaged. The specialist will be able to advise on more efficient uses of the data thus producing more reliable management information more quickly. Even the use of basic 'pivot' tables by exporting financial information in comma separated variable (CSV) format to excel will be an improvement.

BCB can provide an analytics specialist if required.

Darkfurn should be mindful of the fact that undertaking activities outwith the strict terms of the legal agreement is a breach of contract. WHM could raise legal action to recover lost profit on such activities, which is now more of a possibility given the transfer of the shareholding.

5. Treasury department and finance

5.1 Responsibilities

The responsibilities of a Treasury department generally cover four key areas:

- Liquidity management (short-term movement of cash)
- Risk management (interest risk, forex risk, commodity price risk)
- Corporate finance (investment appraisal, acquisition valuations)
- Funding (capital structure) and regular liaisons with funders and financial advisers.

To a large extent any assistance a treasury department could provide the finance department would depend on which strands of the new strategy were implemented. At present Darkfurn has operated without such a department and thus a more suitable approach may be to engage the services of someone who has the relevant treasury experience.

They could report directly to the board if the finance director is too busy to oversee such a person although this should only be on an ad-hoc basis. If this is the case consideration should be given to employing someone to assist the finance director so they do have sufficient time to oversee the management of the treasury function.

⁴ £120,000/6 i.e. the VAT element of the £120,000 of goods purchased where the VAT number is not visible, equivalent to £100,000 at 20%

⁵ Original amount paid is 5% x £500,000 = £25,000 so underpayment is £200,000 - £25,000=£175,000

5.2 Tasks

5.2.1 Current strategy

Darkfurn's current operational structure with the retail stores is such that the main function of a treasury department would be that of liquidity management involving the day-to-day management of cash from sales and furniture deposits.

It would be responsible for implementing and monitoring the controls over cash such as:

- Each store should be responsible for controlling their unique part of the company's 'customers ledger' and ensure that goods are only delivered once payment has been received in full. All cash received from stores should be credited to one main bank account controlled by head office/treasury department.
- All main suppliers should be paid by head office on agreed terms after receiving approval from store/factory managers that the expenses have been incurred/are correct.
- Each store/factory should operate a petty cash impress system for small petty cash purchases. Top up requests should not be expected to be more than once a month.
- Each store/factory manager should be allocated a company credit card for small non-creditor ledger items and given a pre-agreed credit limit e.g. £5,000.
- All other monetary items are to be controlled by head office/treasury department.

Control over cash is important and although it is a key control it is unlikely that it would involve too much manager supervision. Assuming this is already part of the finance director's remit, by having this controlled independently it may encourage tighter control over the cash. It should free up time within the finance department.

The treasury department would also be responsible for ensuring the cash is used to gain maximum benefit e.g. by maximising interest received on cash surpluses or minimising interest charged on any loans (offsetting arrangements).

5.2.2 New strategy

The new strategy will introduce an increased element of foreign exchange risk. This will either come from either the overseas manufacturing operation or, if manufacturing is undertaken in UK, from the importing of materials used to produce the furniture. This could be controlled by the treasury department.

Similarly, any manufacturing operation will involve an element of commodity risk, which could also be controlled by the treasury department.

The extent to which the forex and commodity risks should be controlled should be determined by the board of directors. If the decision is taken to pay 'market rate' for the currency and commodities then the involvement of the treasury department will be minimal, although it is recommended these risks are monitored on a regular basis.

The manufacturing operation will also require control over payment to suppliers (e.g. bulk purchasing discounts, prompt payment discounts) and control over customer credit, if given.

5.3 Loan

One of the first tasks a new treasury department should undertake is how to raise finance to repay the £10million interest-free loan to WHM within the next three months.

If a plan is not put in place to repay this then this could cause going-concern issues for Darkfurn and therefore should be given top priority.

BCB can provide suggestions on how the finance could be raised and introduce the company to potential lenders if required.

Ethics

To: Britany

From: Artemis

Ethical issues identified during the recent work on Darkfurn

1. The initial sections are for possible inclusion in a letter to Michaela. I have included in brackets the relevant headings of the ICAS ethics guide. These are for your benefit and should not be included in any letter to Michaela and some of the headings could be combined.

Employment/Staff

Diversity and Inclusion issues (integrity)

Darkfurn appears to be inadvertently applying discrimination policies in the workforce, for example only employing female sales assistants and seemingly only having male store-managers in a portfolio of 65 stores. This company's policies on this should be reviewed and amended so as to ensure discrimination is not taking place.

Equal opportunities (professional behaviour)

The company does not employ potentially good salespersons not educated to first-degree level. Neither does it employ candidates living outwith its catchment area. While these are not discriminatory practices the company could consider relaxing these policies to avoid the perception that it is being discriminatory and therefore potentially damaging its reputation in the local market. It could also widen the pool of potentially excellent salespersons.

Although common practice, by recruiting only from a pool of university leavers the company is inadvertently guilty of age discrimination in that appropriately educated candidates who have not just left university are not able to be recruited. The company could consider retaining the education policy but extend the recruitment to other suitably qualified groups e.g. graduates who took a gap-year before seeking employment or young parents who were unable to enter the workplace immediately after graduating. Equal opportunities also extends to promotion. At present it appears no females have been promoted and thus the company could be acting discriminatory.

Staff training (professional behaviour)

Staff are not provided with continuous training and are expected to keep up to date with the latest retail-selling practices themselves. Is it reasonable to expect staff to have to fund their training themselves and in their own time? This could be construed as unethical by some and the company's reputation may begin to suffer as a result. The provision of training should be included in an overall review of the company's employment practices.

Employment contracts (integrity)

Zero-hour contracts could potentially be illegal depending on the wording of the contract. At the very least they could damage the reputation of the company and it is recommended they are reviewed in light of current legislation and working practices.

Financial

VAT and Customs Duty (professional competence)

Darkfurn is in breach of both VAT regulations e.g. claiming VAT on invoices from an unregistered trader and Customs Duty regulations. A full audit/review of the VAT and Customs Duty position should be undertaken to determine the extent of any breach and the results acted upon, including reporting any breach to HMRC. This review could be undertaken by BCB, SIA & Co or by independent VAT consultants.

Theft (professional competence)

The acts of theft should be followed up due to the potential issues involving personal taxation, company taxation and breach of trust. How long has it been going on? What are the amounts involved? What is the extent of the dishonesty? After a thorough audit/review the staff involved should be asked to repay the misappropriated funds and the company should take legal advice to ensure it takes the most appropriate action and protect its position.

Social

Child labour/reputation (professional behaviour)

In today's 'ESG' environment it is important for a company to be able to demonstrate that it is not engaging in unethical practices and this extends to those of its suppliers. Darkfurn should put in place a system of 'supplier audits', which will include WHM. The reference to '*..very cheap employees...*' is of concern and could suggest WHM is using a supplier that is engaging in exploitation of labour, possibly even child labour.

2. Other ethical issues that are relevant to our appointment but are inappropriate to include in a letter to Michaela are:

Bribery

Coffee Tables (integrity/objectivity)

The offer of the coffee tables should be declined although reference to the BCB policy on this matter should be made. Accepting something with a value in the region of £1,200 is arguably too much to accept as a gift. The fact that Michaela is gifting an intricately-carved coffee table to each of the senior members of the audit team does not impact our work unless we consider it to be a bribe.

As a firm BCB will need to determine whether or not the offer is an intentional bribe or merely a generous offer with unintended consequences. Assuming the latter then it may be courteous to suggest to Michaela that she raises the issue with the audit partner at SIA & Co so as to avoid any possible misunderstandings.

Professional Protocol

Pro Bono work (professional behaviour)

Although it is too late for this appointment, we should consider the insurance implications of providing future 'pro bono' work or at least ensure no liability is accepted in an appropriately worded letter of engagement. In this instance it may not be relevant but there could have been implications if Michaela acted on recommendations that turn out to be 'incorrect'.

Financial Irregularities

Theft, VAT and Customs Duties (professional behaviour)

A number of the potential issues raised above to be included in a letter to Michaela involve underpaying tax e.g. theft, VAT and Customs Duties, which require reporting to the authorities if not satisfactorily deal with. If following our letter Michaela does not act appropriately then BCB should consider writing to the NCA with details of any financial irregularities. It should also resign with immediate effect.

Social

Child labour/reputation (professional behaviour)

If it transpires Darkfurn are using suppliers that engage in 'child or slave labour' and will not change their operating practices to prevent or minimise this abuse then BCB should consider resigning with immediate effect. The appropriate authorities should be advised of this activity.

Although WHM is not a client of BCB if it is known that this company uses suppliers that abuse children then this too should be reported to the appropriate authorities.