

Mt hood assignment



The case documentation is presented in two segments: Introduction and background to the company. Assignments, together with any additional documentation necessary for their completion. For each question, students should prepare fully detailed and written answers as though they are for inclusion in an audit working paper file. Detailed instructions will be given for each section of the work required to be completed. Mat Hood Furniture Ltd – Mini Audit The group project is worth 40% of the total mark for this paper.

Students are required to complete the requirements of the following questions: QUESTIONS Question 1: New client acceptance & Risk assessment Question 2: Assessment of internal controls in sales cycle Question 3: Accounts receivable confirmations and allowance for doubtful debts Self-reflection Group Marks 50 25 Due dates Week 10 workshop Week 1 1 workshop HOW TO STUDY THE AUDIT CASE An audit case is in many ways similar to a workshop case study. If you are going to benefit fully from the arguments and discussions about the case, not to mention give a good account of your own opinions, you must be well prepared before the workshop discussion.

In effect, you must place yourself in the role of the senior on the audit engagement. You must plan the audit, design the programs and perform the work as called for by the facts as you interpret them. You must also be able to identify and discuss important practical auditing issues arising from the assignment. There are several common techniques of case writing which are important for you to understand. These techniques are necessary as the case writer has in effect represented you at the meetings and discussions with the client.

Since you were not present to Judge the facts for yourself, the case writer must signal to you the quality of the evidence, or information that was obtained, on which you must base your sections. Any simple factual statement such as “ the company was incorporated in ox”, or that “ the company manufactures furniture” may be accepted as “ true” in the sense that the facts are readily ascertainable and verifiable. Whereas, a statement such as “ costs and calculations are performed by Mr. XX” is more likely to be what you would have been told if you were there. T may or may not be true – audit tests will have to be performed to prove the statement. Similarly a statement such as “ the stocks were properly counted” is only the opinion of the observer based on what was seen. It goes not guarantee that no errors were made. Quotations by or statements attributed to a person can be accepted as having been made by the person, but not necessarily as true. Further evidence may have to be sought elsewhere on the case documentation before the opinions can be accepted as true or false. Generally statements attributed to the audit team have more reliability than those attributed to the client or third parties.

Documentation presented with the case or debtors confirmations can be accepted as genuine unless there is evidence to the contrary. Steps in the Study of the Audit Case Read the information provided, general instructions and preparations through once very quickly to familiarize yourself with the company and the characters involved. Briefly review the requirements for each assignment to give yourself an understanding of what you will be required to do. Read background information in detail a second time noting important facts and opinions and their relevance to particular assignments.

This effort is well worth the time spent as the assignments are based on the case information provided in the background material as well as relevant information contained in the various assignments. As those in practice know full well, you cannot perform an effective audit if you do not know the client's business. The Schedules should be completed as if they were to be included in audit working papers in practice. Once you have completed the work assigned, your lecturer will check your work and annotate any errors or omissions in your answer.

This is important as queries or adjustments arising in one assignment may affect a subsequent assignment. In practice there are numerous situations where adjustments arising in one audit area will impact another area of the audit, for example stock cut-off errors may also affect directors' and debtors' balances. HOW TO MANAGE YOUR GROUP 1. Four students in each group. 2. Students are given 2 weeks to settle into a group – no changes is allowed after the third week of class 3. Appoint a group leader to oversee the group activities (the appointment may be for each assignment question) 4.

Appoint a different person as note taker for each meeting 5. For the meetings: 5. 1 . Include the following issues for your meetings: 5. 2. Frequency and duration of each meeting 5. 3. Who is responsible for initiating meeting – if meetings are not scheduled regularly? 5. 4. What are the protocols to follow when someone is unable to attend a meeting? 5. 5. Outline a suggested structure for the meetings 5. 6. Prepare minutes for each meeting and submit it with the completed assignment to the lecturer 6. Minutes of meetings should include the following 6. 1. Date and Venue off team meeting 6. . Time of commencement and conclusion of meeting 6. 3.

Record relevant discussions and decisions made. A template is given on the next page 7. The minutes of meeting will provide:

7. 1 . A mechanism for accountability and quality assurance for the group Mini Audit project
7. 2. Information in the event of any disputes between students
8. Where a team member is not contributing sufficient effort:
 8. 1 . The team has to resolve the problem with the individual member
 8. 2. Document the issues and its resolution, signed by all by members of the team (including the defaulting member)
- 9.

Should problems re-occur, you should inform your lecturer

10. Individual contribution assessment forms will be completed. These form the basis for the allocation of marks to group participation
11. Group meeting log needs to be kept over the duration of the mint-audit project. Meeting minutes need to be submitted. These are evidences in supporting self- reflection and overvaluations.

GROUP MEETING LOG

NAME OF AUDIT TEAM	TEAM MEMBERS	Date of meeting	Time Start time	End time	Venue	Discussions and Decisions	Team Members' Signature
MINI AUDIT PROJECT – MAT. HOOD FURNITURE LTD.							

BACKGROUND INFORMATION Reedy & Able, Chartered Accountants is a medium size accounting firm located in Auckland with 3 audit partners, 5 business advisor partners and 2 tax partners. The firm has been approached to audit Mat. Hood Furniture Ltd. The firm has adopted procedures for acceptance and continuance of clients following SIS(NZ) 220 and PEES (Revised) and PEES 3 (Amended). To determine whether Reedy & Able accept a new client, an audit partner needs to interview the prospective

client to determine what services the client needs and the ability of the firm to provide those services.

As the prospective audit manager on the engagement, you accompanied the partner on the interview. The following is a summary of your notes from the interviews with senior management of Mat. Hood Furniture. NOTES FROM CLIENT INTERVIEW Mat. Hood Furniture is an Auckland company incorporated in 1975. The company is a regional manufacturer of office furniture and cabinetry. The product line includes desks, chairs, filing cabinets, bookcases, credenzas and European-style cabinets. The company's manufacturing and executive offices are located in facilities leased from the founder, adjacent to shipping and transportation facilities in Managua.

Two adjacent buildings house the corporation, with the offices located above the warehouse. The company purchases raw materials including coil steel, bar stock, hardware, laminated particleboard, casters, fabric, rubber and plastic products, and shipping cartons. Materials are delivered to the dock by common carriers or by supplier's trucks. Finished products are shipped FOB from the warehouse, or picked up by the customer. Mat. Hood has a delivery truck for smaller, local orders. The company has 80 employees involved in manufacturing operations and 10 in the executive offices. The company's work force is stable and highly skilled.

Many of the employees have been with the company for more than 15 years. The company's work environment and solid reputation has allowed it to attract and keep employees in a tight market place. Mat. Hood offers both pension and profit-sharing plans to their employees. The plans have been in

place for over 25 years. Mat. Hood Furniture is subject to a variety of government, and local laws and regulations relating to the use, storage, handling, generation, transportation, treatment, emission, discharge, disposal and remediation of, and exposure to, hazardous and non-hazardous substances, materials, and wastes.

In particular, the N. Z. Environmental protection agency standards for the wood furniture manufacturing industry require reduction of emissions of certain volatile organic compounds found in the coatings, stains, and adhesives used by Mat. Hood. Company officers believe that Mat. Hood's operations are in substantial compliance with all environmental laws. Mat. Hood Furniture is family owned and not publicly traded; 1, 000, 000 shares of \$1 par common stock are authorized. Major stockholders include the founder, who recently retired as the Chairman of the Board, Robert S. Saws. He holds 30% of the outstanding shares.

Mr.. Saws is 70 years old, and until his retirement, was closely involved in all major decisions affecting the company. He personally signed corporate cheques and supervised the company's operations. He is very proud of the strong reputation his company has for being ethical and for meeting its commitments and promises. His son, Conrad P. Saws, has worked in the business for the last 15 years, is the current President and Chairman of the board, and under his father's guidance during the last 5 years, has assumed the responsibility of overseeing the business's day-to-day operations.

Conrad is also a 30% owner. Other family members own an additional 30% of the business. The Chief operating officer (COO) and chief financial officer

(SCOFF) are the only non-family owners at 5% each. Mat. Hood's senior management is comprised of Conrad Saws, the President and Chairman of the Board; James Meddling, the COO; and Emma Henderson, the SCOFF. Meddling joined the company two years ago after working for 11 years in the industry for a major office furniture manufacturer. Henderson has worked for the company for about 15 months. She was an audit manager with Reedy & Able prior to joining Mat. Hood Furniture.

The Board of Directors (BODY) includes the retired Chairman (Robert Saws), the President and current Chairman (Conrad Saws), a family member with a business background in the retail residential furniture sector (Howard Saws), another family member trained in architecture and interior design (Catherine Saws), and the senior president of a large regional bank. During the on-site interview, you and Mr. Reedy met with Robert Saws privately for over two hours, then were introduced to and interviewed individually the other members of the senior management team. Each of these interviews extended beyond an hour, and allowed Mr.

Reedy the opportunity to explore the business goals driving the company. Office furniture is a highly competitive, multimillion-dollar annual market. With a strong economy the market has grown about 15% per year over the last two years; however industry experts expect this growth to slow down in the years ahead. Mat. Hood does not have significant market share, and competes with a number of nationally recognized companies. Mat. Hood's primary advantages are competitively pricing and consistently high-quality products. Its low profit margins are part of pricing strategy to build market share by undercutting the competition.

Mat Hood has two production lines: furniture and cabinetry. Approximately 80% of fiscal year xx net sales were in office furniture and 20% in cabinetry. The cabinetry unit underwent major retooling commencing in xx, which approximated 85% of the capital expenditures that year. The retooling was financed with significant long-term debt. The improvements enabled the company to manufacture ready-assemble furniture products, and develop a modular ready-to-install cabinet line, which has resulted in an increase in sales. The customized office cabinetry grants the company a wider profit margin and substantial sales growth potential.

This is a unique product line; it offers a custom-built-in look not readily available from other manufacturers. Demand is steadily growing. The company plans on expanding its marketing in this niche. The company also has developed new, award-winning designs in office furniture, signs that stress the efficient and ergonomic use of technology. Ample opportunity exists to expand sales of the existing product lines. Management estimates the current physical plant can support up to \$50 million in sales without significant additions of manufacturing and distribution capacity.

Additional sales up to \$50 million are expected to result in additional costs associated with the variable cost of production and variable overheads, but should not require increases in fixed costs. Robert and Conrad Saws have been the driving force behind the company's success over its long history. They made it clear they know and understand the industry. In their view, succeeding in the increasingly competitive office furniture market place necessitates that the company focus its resources on taking calculated risks to increase its market share and name recognition.

They also believe the company must specialize its product lines. They see the office cabinetry niche as one the company can develop more fully so that this product line is capable of catering to the growing preference for a customized office work environment at a reasonable cost. They explained that Mat. Hood has two general directions in production. The company distributes its products through a network of approximately 30 office furniture dealers in major New Zealand cities and towns. Recently, the company placed its product with several national chains and warehouse-club chains.

Most of the sales growth over the last two years is attributed to this new distribution channel; it made up 35% of year-XX sales. Their largest single customer accounts for 8% of sales. The company also produces a catalogue and has a Website where orders can be placed online. The office cabinetry product-line offers customized products, for on- tit installation. Customers include major hotels and professional and corporate offices. Currently 20% of sales come from this line, and the Chief Operating Officer would like to see this line grow to a total of \$25 million in sales in the next three to five years.

Individuals, which comprise about 5% of total sales, can order directly from Mat. Hood Furniture using the company's Web site. A large showroom is maintained at the corporate offices; customers may also place orders at the showroom. The fastest growing sales are in products that are marketed through warehouse-club outlets. In this market, price and availability are the overriding purchase determinants. The dynamics of the workplace dictate the other growing sales line: office furniture that caters to a technology-

based work environment where increasing the productivity and flexibility of increasingly expensive office space is the driver.

They are confident the company has assembled a management team capable of improving profitability and sales. 2 When asked about the change in accounting firms, Conrad Saws informed Mr.. Reedy that the prior auditor was very skilled at completing the audit to meet debt events, but the company needed a chartered accounting firm capable of helping Mat. Hood move beyond the present. This included assistance with financial planning (both personal and for the company), developing better performance measures for the company, and improving the incentive compensation plan for key employees.

Beginning this year the company put a bonus plan in place for key executives based on sales growth. They saw no reason for any scope limitations and expect the firm of Reedy & Able to offer suggestions to facilitate the firm's desire to successfully negotiate the expansion. They also said that they would contact their previous auditor and grant them permission to talk candidly with Reedy & Able about the potential change in auditors. Mr.. Saws' banker and attorney separately recommended Reedy & Able as a firm capable of understanding the forces driving business success, and capable of forming a mutually beneficial working relationship.

Robert Saws volunteered that his niece Heather Geiger is a senior accountant with Reedy & Able. She owns a few shares of Mat. Hood Furniture, and is also the executor of Mr.. Saws' will. Robert Saws also heard from Heather that the office premises of Reedy & Able will be refurnished in

xx. Robert offers 30% discount on customized office cabinetry to Mr. Reedy. The interview with the other senior management team members added details to the company's business position. The COO explained that the current information systems have been stressed by the company's growth over the past three years.

Significant computer system improvements are in process (which represents major capital expenditures in xx). The timeline for completing the implementation of a new database system indicates that it should go on-line in the second quarter of year xx. The upgrade is a major capital expenditure, and is seen as a vehicle for improving information throughput and providing timely information on the company's financial performance. The company expects to spend between \$75, 000 and \$85, 000 in xx to complete the project.

Maintaining the physical plant at its current production capacity is estimated to run \$250, 000 to \$400, 000 per year. The SCOFF is concerned about improving cash flow from operations and speeding up the operating cycle, changes which could involve reassessing Mat. Hood's credit and payment terms. The COO is worried that tightening credit terms could hinder sales growth. The president is adamant about maintaining sufficient inventory to make sure orders can be shipped with minimal backorder.

The SCOFF commented that the major reason for the audit is to satisfy a debt covenant of the lender and explained the company's debt maturities are accelerating, hampering cash flows available for investing to expand sales. In expanding capacity to grow sales beyond \$50 million, the SCOFF

suggests that the company consider venture capital to grow the company until it is ready for an Initial Public Offering (IPO). In the past, the major lender has been the primary financial statement user, along with several creditors, but the SCOFF plans on showing the financial statements and in-house projections to potential venture capitalists as well.

Current planned expansion costs are estimated to require about \$3 million in land, manufacturing, and distribution facilities, which could raise revenues to \$100 million. OTHER INFORMATION After the interview, Mr. Reedy contacted the prior auditor, Mr. Will B. Dunn, CA, regarding the potential change in auditor. Mr. Dunn was not surprised that Mat. Hood Furniture was considering a change in auditor. He had been Robert Saws' accountant for nearly 30 years. In recent years, Conrad had taken more responsibility and had been more aggressive about growing the company. Mat.

Hood hired outside management for the first time in company history, and with the hiring of a SCOFF for the first time, he had expected this phone call. Mr. Dunn expressed no concern about the integrity of management. Several years ago, Mr. Dunn said that Conrad Saws had raised several questions with Mr. Dunn about revenue recognition on some possible "bill and hold" sales in advance of negotiating a sales agreement with a national office supply and furniture chain. No problems were noted in the subsequent audit. Mr. Dunn expressed concern about the current accounting system that is expected to be replaced in xx.

Audit adjustments in the last few years resulted from cut-off problems, from an adjustment due to an error in counting inventory, and from discussions

over bad debt reserves. Dunn noted that Ms. Henderson was challenged by an accounting staff that needed more training and an accounting system that was having difficulty keeping up with the company's recent trend associated with the increased volume of transactions. Finally, he noted that if Mr. Redeye's firm was selected as auditor, he would cooperate by allowing Mr. Reedy to review his working papers to the extent needed to prepare for the upcoming audit. FINANCIAL INFORMATION The audited financial results for XX and XX, along with the UN-audited financial information for XX, in addition to industry statistics and related information are included in the related exhibits filed in Excel file posted on Automation under assessment tab. 4 QUESTION 1: NEW CLIENT ACCEPTANCE & RISK ASSESSMENT

Referring to the background information on the company, relevant auditing tankards and professional ethical standards, discuss the key factors impacting acceptance of Mat Hood as an audit client.

Use the following format for your discussions. (20 marks) Present your answers in the table format below: Factors affecting client acceptance Explain your concerns regarding the factors identified For issues of concern, possible solutions or possible resolutions (if any) b. At the bottom of the working paper, draw an overall conclusion regarding accepting or rejecting the client. (5 marks) Perform risk assessment on audit of Mat Hood Furniture.

In your answer (1) identify the risk factors for the company, (2) explain the impact of the risk factors on the company's financial statement, and (3) outline how you may address the risk factors in the audit. You also need to include your concerns raised from performing analytical procedures. (This is where the auditor begins to define the risk of whether an account balance is

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misstated and the likely nature and direction of the misstatement, and to determine audit strategy). Use this format to report your risk assessments.

(25 marks) (1) Audit risk factors (2) The impact on financial statements