

Mercedes-Benz U.S. International
*Using a Strategic-Systems Approach to Auditing to Identify and
Integrate Business Process Knowledge*

CASE PROSPECTUS

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This case prospectus provides a case overview, describes how the case can be used within various courses, and outlines learning objectives and take-aways associated with the case. Please refer to the teaching note for possible discussion questions, suggested solutions and further strategies for using the case.

Case Prospectus

Using KPMG's Business Measurement Process (BMP) audit approach as described by Bell, Marrs, Solomon, and Thomas (1997), students can analyze Mercedes-Benz U.S. International (MBUSI) by performing a strategic analysis and focusing on several important business processes. As businesses adapt to a more dynamic, global and information-based environment, students must better understand how managers think and operate within this economic web. By integrating knowledge obtained from both strategic and process analyses, students should be able to understand how the fragile aspects of the company's economic web can have significant impacts on its operations and financial performance. Perhaps the most enticing aspect of this case study is that the apparently near-perfect operations of MBUSI may lead students to initially believe that this entities' operations are not fraught with risk. For example, because there is excess market demand for the M-Class, the Company can sell as many cars as it can assemble. However, upon careful analysis it becomes clear that there are a number of fragile aspects and virtual characteristics of MBUSI's operations that should concern both managers and auditors.

MBUSI operates within a highly integrated supply chain where the Company relies heavily upon its suppliers' controls. MBUSI and its suppliers communicate constantly, however MBUSI is susceptible to its suppliers' business risks. Given this high-risk environment, MBUSI will be able to meet its business objectives only when it can effectively mitigate relevant risks, both internal and external to the Company.

To better understand MBUSI, its strategy and the business processes described in the case, Appendix A contains a detailed entity-level business model and business process analyses for the assembly and supply chain management processes. We recommend that instructors read these analyses prior to deciding how to best use the case in the classroom (the background preparation section of the teaching notes offers suggestions for implementing the analyses into the case assignment).

The specific take-aways associated with using this case in the classroom will vary according to how the case is used. The following section suggests some ways the case can be effectively used

in different courses. The case is applicable to accounting, auditing and management courses, which is one reason case questions are included in the teaching notes--instructors can choose the most relevant questions according to their desired learning objectives. Given the amount of detail included in the process analyses and the benefits obtained from student discussions of issues, group exercises are recommended for background preparation and/or assignments to be submitted for grading.

How Case Fits into Various Curricula

This case can be used in various accounting, auditing and management courses. To illustrate, we describe how the case fits into auditing and MBA curricula. For auditing, we outline suggested approaches for the undergraduate and graduate courses. For MBA programs, we outline suggested approaches for operations management and executive strategy courses. A summary of suggestions for each of the courses appears in Table 1. The following brief discussions focus on the primary contributions of the case within each course.

Auditing Curricula

This case provides auditing students the opportunity to understand the opportunities, risks, execution, controls and business measurements associated with a client who is heavily integrated with other entities. It also demonstrates how integrating this knowledge can be used as evidence for evaluating an organization's financial statements and advising an assurance client. Traditionally, accounting has focused on historical costs and measurement of past economic events of an entity. Consequently, financial statements are thought to reflect assurance about the past. A factor that led to the development of BMP is the recognition that financial statements often contain *at least* as many management assertions about future expectations (e.g. inventory valuation, recoverability of PP&E) as they do about the past (e.g. cash on hand at the balance sheet date). Thus, the auditor's understanding of the client's viability, business risk and ability to seize opportunities and control business risks are critical to effectively evaluating the fairness of financial statements. Only after students are able to understand the importance of this knowledge in terms of assessing audit risk and evaluating financial statements can they begin to appreciate the importance of viewing entities from a strategic-systems lens, as opposed to an accounting, or transaction-oriented, lens.

For companies that are highly integrated with suppliers and/or customers, effective auditing requires that auditors obtain an understanding of the supplier's and/or customer's controls that the client relies upon to meet its business objectives. To the extent that controls external to the client are critical for managing significant business risks, auditors need to examine evidence to obtain assurance that the controls are in place and operating effectively. This case provides students an opportunity to explore why such evidence may not be obtainable from substantive tests of details, yet is a critical in terms of determining the reasonableness of the financial statements.

This case can be implemented effectively at either the undergraduate or graduate level. The objectives, skills required and enhanced by the case, course placement and most applicable case questions (as suggested in Table 1) should guide instructors on how to best use this case.

We recommend that this case be used as a first case assigned for understanding the strategic-systems audit approach. To complete the case, students must view a client from a broad business perspective and perform selected process analyses. Students can conclude on the client's ability to control business risk and they can develop independent, knowledge-laden expectations about the entities financial results by effectively integrating their knowledge of MBUSI's strategy and operations. For example, after understanding the nature of the client's JIT operations and the speed with which finished goods are shipped to customers, students may expect the inventory balance to be relatively small. Students can debate what the auditor can learn from substantive tests of details vs. complex analytical procedures. For example, what does the auditor learn from inspecting supplier contracts in order to verify terms and signatures on the contracts versus obtaining a rich understanding of the co-dependent nature of the client's supplier relationships and both parties' incentives and ability to perform?

This case does not involve a significant analysis of strategy. Strategic objectives are fairly clear and MBUSI (as a wholly-owned subsidiary) has limited control over changes to strategy. However, students are likely not to identify all critical issues because the client looks near perfect. Identifying critical issues requires successful integration of the analyses. For example, if the auditor analyzed either the assembly process or supply chain management process in isolation, she would not be as likely to understand the fragile nature of the client's operations as would the auditor who was able to obtain and integrate knowledge across *both* processes. Thus, this case should contribute to students' appreciation for the potential effectiveness of using a strategic-systems lens approach to auditing.

Some potential take-aways for auditing students include (but are not limited to):

- Ability to analyze a business organization holistically, from the top-down, using a strategic-systems lens,
- Practical knowledge of conducting a financial statement audit by focusing on the client's management of business risks,
- Appreciation for the importance of gaining a sufficient understanding of a client's business and industry as a part of the audit process,
- Experience analyzing the strategy and business processes for an automotive company,
- Ability to integrate information obtained from several analyses to make predictions about future economic events that impact the current-year and/or future financial statements, and
- Appreciation for the tenuous nature of a company strategy that integrates business processes with outside suppliers of materials and information technology.

MBA Curricula

Performing the analyses that are required in the case, integrating the knowledge obtained and developing an understanding of the implication of future economic events on current financial-statement measures are critical challenges for managers, consultants, analysts, and those providing assurance services. Enabling students to use the BMP framework for understanding a business, understanding the importance of managing business risks and measuring business performance can generate awareness of how accounting fits into an entities' economic web and

the extent with which accounting numbers reflect economic reality. In addition, the experiences of the students in the course can serve to enhance the importance of the issues surrounding a highly integrated approach to outsourcing and integrating business processes.

In Table 1, we have shown two ways that this case can be used within an MBA curriculum. One use suggests how the integration of strategy and business processes can help those in operations management courses obtain a better understanding of what type of information is needed for executives to determine a strategic direction for the entity. Another use is for those in executive MBA programs. Here, high-level managers can gain an understanding of the fragile economic web in which companies operate. This understanding is obtained from exposure to a dynamic, economic environment where an entity must manage aspects of the company that exhibit virtual characteristics.

Some potential take-aways for MBA students from using the case include (but are not limited to):

- Ability to analyze a business organization holistically, from the top-down, using a strategic-systems lens,
- Appreciation for insights gained by understanding implications of business risks,
- Experience developing a business model,
- Experience analyzing the strategy and business processes for an automotive company,
- Ability to integrate information obtained from several analyses to make predictions about future economic events that impact the current-year and/or future financial statements,
- Appreciation for the tenuous nature of a company strategy that integrates business processes with outside suppliers of materials and information technology, and
- Exposure to a case that demonstrates how taxation issues (often an overlooked angle of business strategy in corporate business cases) can impact the organizational structure and strategy of a company.

Table 1
Summary of How Case Fits Within Auditing and MBA Curricula

	<u>Undergraduate Auditing</u>	<u>Graduate Auditing</u>	<u>Operations Management</u>	<u>ExMBA Strategy</u>
Audience	Undergraduate accounting majors at the senior level	Graduate accounting students, typically with light work experience (e.g., internships)	Traditional MBA students, typically with several years of work experience	Mid- to upper-level managers of medium-sized to large corporations
Recommended Use of Analyses Included in Teaching Notes Appendix	<ol style="list-style-type: none"> 1) Provide appendix but require students to identify sources of information 2) Require students to answer questions prior to discussing them 	<ol style="list-style-type: none"> 1) Require students to complete analyses contained in appendix 2) Consider spending a session discussing the analyses 3) Discuss the suggested solutions to questions in class 	<ol style="list-style-type: none"> 1) Provide appendix but require students to identify sources of information 2) Answer very basic questions that draw lightly on appendix 	<ol style="list-style-type: none"> 1) Require preparation of the analyses 2) Prepare a list of issues and challenges that are raised by the case
Case Objective	<ol style="list-style-type: none"> 1) Expose students to the importance of understanding an audit client's business and industry 2) Expose students to the process of viewing a client through a strategic-systems lens using the audit approach of KPMG 3) Expose students to the importance of understanding controls of suppliers that are relied upon by clients operating within a highly integrated supply chain 	<ol style="list-style-type: none"> 1) Give students experience completing a business model and business process analyses for an actual client 2) Demonstrate the benefits for audit gained by integrating business process knowledge 3) Allow students to gain an appreciation for the challenge of auditing companies exhibiting virtual characteristics 4) Expose students to the importance of understanding controls of suppliers that are relied upon by clients operating within a highly integrated supply chain 	<ol style="list-style-type: none"> 1) Open students' eyes to the radical changes that are occurring in cutting edge manufacturing companies 2) Expose and highlight the degree to which accounting and operations issues are seamlessly intertwined 3) Expose students to the importance of understanding controls of suppliers that are relied upon by clients operating within a highly integrated supply chain 	<ol style="list-style-type: none"> 1) Explore the complex financial implications of increasingly virtual corporate operations 2) Explore the challenge that virtual operations pose for performance measurement and shareholder relations 3) Expose students to the importance of understanding controls of suppliers that are relied upon by clients operating within a highly integrated supply chain
Possible Case Placement in Course	When covering the need to understand the industry and business or when introducing strategic-systems lens approaches to auditing	During a segment on applying a strategic-systems lens approach (we suggest also using a case that requires students to delve deeper into the audit approach)	Late in the course, coincident with discussion of JIT and supply chain management	During a segment when discussing the effects of JIT and supply chain management on corporate strategy

Table 1 (continued)
Summary of How Case Fits Within Auditing and MBA Curricula

	<u>Undergraduate Auditing</u>	<u>Graduate Auditing</u>	<u>Operations Management</u>	<u>Executive Strategy</u>
Knowledge and Skills Required to Perform Case	<ol style="list-style-type: none"> 1) Exposure to Bell et al. (1997) monograph 2) Knowledge of accounting for inventory, COGS, fixed assets, estimates, and loss reserves 3) General business knowledge 4) Intermediate research skills 5) Intermediate analytical skills (e.g., ability to make inferences based on available information) 	<ol style="list-style-type: none"> 1) Exposure to Bell et al. (1997) monograph 2) Basic skills and knowledge from undergraduate accounting and auditing 3) General business process and strategy knowledge (hopefully w/internship experience) 4) Advanced research skills 5) Advanced analytical skills 	<ol style="list-style-type: none"> 1) Exposure to Bell et al. (1997) monograph 2) General business knowledge 3) Foundation courses in financial accounting 4) Advanced analytical skills 	<ol style="list-style-type: none"> 1) Exposure to Bell et al. (1997) monograph 2) Exposure and experience with shareholder issues 3) Personal experience in operations 4) Advanced analytical skills
Knowledge and Skills Enhanced by Case Preparation	<ol style="list-style-type: none"> 1) Research and analytical skills 2) Understanding of how to model a business and industry 3) Insight regarding how auditors are applying concepts learned in class and discussed in Bell et al. 4) Understanding of implications associated with a manufacturer adopting a high-risk, high-performance strategy for managing its supply chain 	<ol style="list-style-type: none"> 1) Research and analytical skills 2) Ability to model a business and industry 3) Experience applying KPMG's audit approach to reach evidence gathering decisions 4) A mental framework for contrasting traditional and strategic-systems lens approaches 5) Understanding of implications associated with a manufacturer adopting a high-risk, high-performance strategy for managing its supply chain 	<ol style="list-style-type: none"> 1) Heightened awareness of potential for radical operational approaches 2) Awareness of the extent of the "ripple effect" that these changes will create 3) Understanding of implications associated with a manufacturer adopting a high-risk, high-performance strategy for managing its supply chain 	<ol style="list-style-type: none"> 1) Increased sensitivity to the growing challenge of performance measurement 2) Understanding how professional services firms can add value to a company by advising on how to better manage business risks and measure business processes 3) Understanding of implications associated with a manufacturer adopting a high-risk, high-performance strategy for managing its supply chain
Most Relevant Questions from Teaching Notes to Assign/Discuss	1, 2, 3, 5, 6, 8, 10 and 11 The other questions are relevant, but they might be difficult depending on the case placement in the course	All questions are relevant for this audience	All questions are relevant for this audience with the possible exception of questions 11 and 12	All questions are relevant for this audience with the possible exception of questions 11 and 12