

Case Prospectus



Virtual Control Corporation

Background: Virtual Control Corporation¹ (VCC) is a leading designer and manufacturer of precision joysticks with the feel of jet fighter controls for computer games and other hand-control devices for original equipment manufacturers. In 1995, the company's share of the U.S. market for high-end joysticks was 60 percent but by 1999 its market share had dropped to 28 percent. Additionally, the company's most recent financial results are disappointing. Anxious to regain market share and compete with much larger companies (Microsoft, Logitech, and Thrustmaster), VCC is considering an initial public offering (IPO) of its common stock. Capital raised in the IPO will be used to enter the low-end joystick market—a shift in company strategy.

The audit team has serious concerns about the effectiveness of VCC's inventory management processes and the valuation of its ending inventory, particularly the adequacy of VCC's allowance for obsolete inventory. The primary focus of the case is client/auditor negotiations over a potential adjustment for inventory obsolescence and how an understanding of strategic-systems auditing (SSA) uncovers the necessity for those negotiations.

Case learning objectives: Students completing this case will:

- Develop an understanding of the importance of negotiations in audit practice and be introduced to negotiation concepts and practices.
 - The case scenario and private client/auditor information included in this teaching note provide a realistic negotiation context involving potential inventory obsolescence.
- Reinforce their knowledge of, or provide an introduction to, SSA concepts supported by the business process and key performance indicator (KPI) detail provided in the case.
- Become aware of the value of SSA as an integral part of successful negotiation.
 - Financial statements are replete with estimates, and SSA provides auditors with deep knowledge and a useful frame for examining the reasonableness of the underlying assumptions and methods used by a client to arrive at an estimate.
- Be provided with an opportunity to examine a difficult audit area, estimating inventory obsolescence, from the auditor and client perspectives.

Level of use: You may use this case in undergraduate and graduate courses in auditing. Part of the case—the strategic analysis and the inventory management process analysis sections—may be used in undergraduate or graduate (MBA) strategy courses and in undergraduate management and accounting control system courses.

Time to complete: Class coverage depends on instructor objectives (i.e., audit versus business strategy and process management) and student background in SSA concepts. The case teaching note provides detailed suggestions for class coverage requiring two or three class sessions of 75 minutes each.

Note: As background, students should be encouraged (required) to read, *Auditing Organizations Through a Strategic-Systems Lens* by Bell, et. al.

¹ Although a real company, the company name is fictitious. In addition, all company management and product names are fictitious

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