

A Synopsis of the Case Study

Manfold Toy Company Ltd. is a listed company in Hong Kong specialising in the production of bath and water toys. It was founded by Joseph Wan in 1983 and since its establishment, the company has experienced phenomenal growth. Despite its fast-growing business, Manfold's management paid little attention to the internal control aspects of its operations. For example, when the company secretary, Vivian Chen, proposed to the Managing Director, Daniel Kot, to adopt some internal control best practices in the company, she was told to see into the basic requirements of the Hong Kong Exchange only. The issue was never revisited.

Hoping to sell Manfold at the best possible price before his retirement, Joseph approached a US corporation Mitchell & Meyer about a takeover bid which required a 20% growth in sales on Manfold's 2006 year-end report.

To achieve the target, Joseph instructed Daniel and President of its Mainland operations, Wu Jiaxiong, to increase market shares and profit margins and minimise the cost respectively. These two trusted lieutenants then set out to work on their given tasks. Daniel decided to loosen their credit policy, extend long-term credit to their customers and secretly signed collateral agreements with the distributors to buy back products unsold after 12 months. He also treated a financial analyst from a huge investment bank to a toy fair in Thailand, resulting in the rating of Manfold's stock in the press as "outperform". As for Wu Jiaxiong, he planned to make short-term savings by cutting down on maintenance costs and delaying the replacement of aging machinery. Wu also accepted the recommendations from his production manager, Peter Lee, to obtain cheaper but lower grade material although there were rumors that Peter might be too close to some suppliers.

Joseph was also acquainted with the external auditor of Manfold, Ken Tse, as they belonged to the same vintage car association. Being the godfather of Ken's son, Joseph sold a vintage car to Ken's son at a huge discount. Desperate for a good picture, Joseph also invited Ken to the Thailand toy fair where Joseph asked Ken to complete the audit report within six weeks and he would not press for the usual 20% discount if the deadline was met. As his books had always been in order, Ken found it difficult to refuse. Ken knew very well that his firm also undertook tax work and a consultancy assignment for Manfold.

Other directors of Manfold were also facing different kinds of dilemmas. Fred Wong, an INED of Manfold as well as the Chairman of its audit committee, knew very well the financial risks Manfold was facing. Being a director of On Yee Hong Kong, Fred knew that On Yee USA, Manfold's major distributor in USA, was about to file for bankruptcy protection. He told Joseph about that who rebuked Fred to beware of his director's duty.

At the same time, Mitchell & Meyer paid a consultant firm a handsome amount hoping to find out more about Manfold. This consultant firm was indeed owned by Manfold's Executive Director, Maggie Mok, who kept quiet about the deal.

Another INED of Manfold, Matthew Ip, who sat on the boards of 15 other listed companies, casually told his wife about the impending takeover of Manfold leading her to buy Manfold's stock afterwards and make good gains.

At the audit committee meeting, members were informed that Manfold's revenue and profit grew significantly. Daniel and Wu Jiaxiong were praised for their strategies while Ken also gave an unqualified opinion on the accounts, too.

Joseph seemed to have succeeded. Or had he? Had some characters of the case study crossed the border on some ethical issues? Are there any possible legal or professional repercussions that could follow as a result of their behaviour? What corporate governance mechanism could be put in place to protect them against the activities that had transpired at Manfold?