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Introduction

Module Aim and Structure

This module will enable you to handle ethical dilemmas and financial matters and appreciate the following four key financial roles which are common to commercial organisations.

- The executive management role to provide leadership and direction;
- The management reporting role to provide operational and financial information for decision making;
- The treasury operations role to manage cash flows both present and future and its related financial risks; and
- The corporate finance role to advise on the restructuring and expansion of business.

The module is structured in such a way that it can achieve the module aim. The structure provides the framework for grouping related topics together in a systematic way to facilitate your understanding of the relationship between different topics. This module structure also applies to both the Learning Pack and the module workshops to ensure a linkage between the module study materials and the workshop materials.

Overall Structure of Module B (Corporate Financing)



Workshop Structure and Format

In line with the module aim, the workshop is structured in a five-step approach as listed below.

- Ethics in business;
- Executive management;
- Management reporting;
- Treasury operations; and
- Corporate finance.

You will be working case exercises during the workshops. Through group work and discussion, you will appreciate how to apply commonly used ethical models in deciding on ethics issues, and various models in leading and managing an organisation.

Workshop Objectives

The workshops aim to enable you to understand:

- How to recognise situations where possible ethics issues arise and apply commonly used models in handling ethical dilemmas;
- How to apply various models in data gathering and analysing on an organisation's market environment and position, in order to evaluate and recommend strategic choices;
- How to apply various models in costing and performance measurement in order to evaluate the operational performance and make recommendations to address the issues;
- How to evaluate the liquidity and funding position of an organisation to identify financial risks and make recommendations to address the issues;
- How to apply various models in business valuation and recommend the best option for raising finance;
- The key elements of effective teamwork;
- The key elements in listening attentively and asking probing questions; and
- The consideration of different perspectives of a group before selecting feasible solutions or courses of action.

Development Indicators for Generic and Technical Competencies

The focus of the workshops is on formative development of skills, i.e. to train students to become future CPAs. A set of development indicators has been designed to encourage students to participate in the workshops and demonstrate the development of the intended learning objectives.

The purpose of the development indicators is to encourage you to:

- Prepare for the workshops;
- Actively participate and be engaged in the workshops; and
- Achieve the learning objectives by developing the technical and generic competencies.

It also allows the workshop facilitators to monitor the development of the students so that appropriate actions or counseling can be done.

As the learning objectives of each module are different, there will be different development indicators or criteria for different modules. There are core criteria, i.e. criteria that are common to all four modules, as well as some criteria which are specific to an individual module.

You are expected to demonstrate the following core criteria at each workshop:

- Be well prepared for the workshop by demonstrating reasonable level of knowledge of technical content (i.e. contribute to discussion by offering relevant facts or information);
- Be punctual (i.e. arrive at the workshop on time and do not leave early except with the approval of the Institute or workshop facilitators);
- Work well with team members and workshop facilitators (i.e. interact with them in a constructive manner);
- Proactive participation (i.e. show willingness to take up roles in group discussion and raise questions or express ideas/opinions appropriately); and
- Adhere to an ethical mindset and professional behaviour.

You are expected to demonstrate the development of the following specific criteria for Module B:

- Ability to identify and resolve business ethics issues;
- Reasonable understanding of the roles of executive management and management reporting, and the ability to apply key models;
- Reasonable understanding of the roles of treasury and corporate finance, and the ability to apply key models;
- Possess an enquiring mind;
- Ability to evaluate options and draw conclusion after considering all the pros and cons of each option; and
- Ability to structure your own presentation and to deliver clear presentation.

Passing Criteria for Workshops

A two-scale system of performance comprising 'yes for demonstrated' (i.e. 'green light') and 'no for not demonstrated' (i.e. 'red light') is set up for each development indicator. Students must achieve at least 70% of the available indicators obtaining 'green light' for satisfactory completion of workshops. In quantitative terms, a student will need to retake the two full-day workshops of a module if more than 4 out of the 16 development indicators for two workshops have been marked as 'no for not demonstrated' i.e. 'red light'.

Satisfactory completion of workshops is a prerequisite to sitting the module examination i.e. students who fail to complete the workshop satisfactorily are not allowed to take the relevant module examination. In order to complete the workshop satisfactorily, you are required to attend the two full-day workshops and demonstrate your successful accomplishment of the workshop objectives, via active participation.

Your Role and Responsibilities as a Workshop Student

You are expected to:

- Follow your study plan, study the Learning Pack chapters (and other reference materials where appropriate) in accordance with the workshop coverage and prepare well for the workshops;
- Read the case materials and complete the pre-workshop exercises, if any, prior to attending the workshops;
- Be proactive in discussion and participation in group activities during the workshops;
- Develop your technical and generic skills through active participation in group discussion and activities; and
- Observe relevant rules of the workshops (e.g. be punctual for workshops and follow the instructions of workshop facilitators).

Workshop Materials for Students

Prior to the workshops, you will be given:

- This introduction booklet, providing general information on the workshops in particular the topic coverage and the corresponding chapter list in the Learning Pack, which are listed under Workshop Outline and Learning Methodologies below;
- Pre-workshop cases background and exercises (if any); and
- The module Learning Pack.

During the workshops, you will be given:

- Additional case information; and
- Handouts (i.e. questions) for class work, which will be collected back at the end of each workshop.

Workshop Outline and Learning Methodologies

Session	Methodologies	Chapters covered
Workshop 1		
1. Introduction	<ul style="list-style-type: none"> • Presentation • Group discussion 	
2. Ethics in business	<ul style="list-style-type: none"> • Case study • Group discussion 	Ch. 1
3. Executive management	<ul style="list-style-type: none"> • Case study • Formal presentations 	Ch. 2 & 3
4. Management reporting	<ul style="list-style-type: none"> • Case study • Formal presentations 	Ch. 4 & 5
Workshop 2		
5. Reboot	<ul style="list-style-type: none"> • Presentation • Group discussion 	
6. Treasury operations	<ul style="list-style-type: none"> • Case study • Formal presentations 	Ch. 8, 9 & 11
7. Corporate finance	<ul style="list-style-type: none"> • Case study • Formal presentations 	Ch. 12, 13 & 15
8. Conclusion	<ul style="list-style-type: none"> • Presentation • Group discussion 	

You are expected to have studied the relevant chapters of the Learning Pack and completed the pre-workshop materials thoroughly prior to attending the workshops. It is important for you to become familiar with the workshop materials as they will be raised for discussion throughout the workshops.

Please remember to bring a calculator with you to the Module B Workshops.

Pre-Workshop Materials

Workshops 1 and 2

Case Background

Overview

Tim Yeung and his wife May began their business about 25 years ago in Hong Kong, selling toys on a market stall. Through hard work and selling ability, they were able to develop and expand their business, and after a few years they opened their first toy shop. Their success in business continued. They incorporated the business 15 years ago as Telly Toys Limited (TT Limited).

Over time, they increased the number of retail stores and they now have 20 large stores in Hong Kong and mainland China. Three years ago, following a series of successful years financially, the company acquired public company status and a listing on the Hong Kong Stock Exchange (HKEx). As a result of the initial public offering by the company, Tim and May now together own just 40% of the company's shares.

Tim and May both continue to work in the business. Tim is the Chairman and Chief Executive Officer. May, who was already a qualified accountant when she started in business with Tim, is the Chief Finance Officer, with responsibility for general office administration as well as finance. They have been joined on the board of directors by Tina Chan, who is responsible for retail operations in the company's stores, and Simon Lam, who is the director responsible for procurement of toy products for retail. The company also has four non-executive directors, although Tim and May both question the value of the contribution of these directors to the company.

The market for toys

Until a few years ago, there had been a strong and growing market for toys in Hong Kong. Much of the manufacturing takes place in mainland China, Thailand, Indonesia and Malaysia, but major global companies have a large share of the manufacturing market. These global companies pay licence fees to produce toys based on popular children's TV and film characters, commission their manufacture from businesses in Asia and advertise and promote their products extensively. They sell their products mainly through retail companies and wholesalers.

Consumer demand for toys, in spite of a recent setback in sales globally, is expected to remain strong in the long term, due to demographic changes and an increasing proportion of young people in several large countries. However, consumer tastes change quickly and there is a trend towards much shorter life cycles for products, and much more digital technology in toys. One toy retailer has commented that: 'Children are getting older younger.' To satisfy consumer demand, manufacturers need to spend extensively on research and development, and to innovate continually.

Manufacturers compete with each other largely on the basis of product quality, play value and price. Product safety is a major issue, for both manufacturers and retailers.

Toy retailers buy products from a number of different manufacturers. They seek to buy and re-sell the most popular products, but it is difficult to predict demand accurately, and retailers usually have to sell slow-moving items during sales periods at a deep discount to their original price. In an attempt to improve sales turnover, some toys retailers are experimenting with 'click and collect' online selling, where customers order goods online and collect them the next day from their local toys store or another collection point.

Retailers advertise their stores locally to customers, but rely on manufacturers for the advertising and promotion of products and brands.

Profitability in the toy business

Although the market for toys has grown over the years, there has been a downturn in the past two years due to depressed economic conditions. Hong Kong has also been affected by a reduction in the number of foreign tourists, many of whom shop in Hong Kong's retail centres.

However, toy manufacturers have in general performed much better than toy retailers. This has been partly due to the strength of the US dollar, the currency in which the largest manufacturers trade. A strong US dollar has reduced their product costs and improved their gross margins on sales to non-US retailers.

In comparison, retailers have experienced some difficult times. Manufacturers have been reluctant to reduce their prices to retailers, and consumer demand for toys has been weaker, since toys are not a 'necessity'. In these difficult economic conditions therefore, customers have been less prepared to buy toys, except at very attractive prices.

In the past, manufacturers have provided retailers with a catalogue of their products for the next few months, and retailers decided which products to buy and in what quantities. They indicated to manufacturers about three months in advance what their purchase intentions were, and manufacturers planned their production schedules accordingly. More recently, there has been an increase in the frequency with which retailers have placed an order about three months in advance, but have subsequently reduced it or even cancelled it. Many retailers have also been making much more extensive use of just-in-time (JIT) purchasing, in an attempt to match their purchases to customer demand. As a result, manufacturers have found it much more difficult to predict demand quantities from retailers. This has led to conservative production scheduling by manufacturers and supply shortages for some of the most popular products.

Operations

TT Limited has a warehouse in Hong Kong. Deliveries of goods from suppliers are initially held in the warehouse, but most are distributed promptly between the company's stores. An IT system tracks the location of stores items and sales, so that if one store runs out of a particular product item, replacement items can be transferred quickly from the central warehouse or another store. The IT system for tracking inventories and sales is in the process of being upgraded; there have been discrepancies in the past between inventory records on the system and actual inventories held in the stores and the warehouse. These discrepancies are caused by theft of items from stores, damaged items being discarded, and unrecorded customer returns. The new IT system is expected to improve the reliability of the inventory data.

Each store is divided into departments or sections. There are sections for toys for children of different age groups, and sections for digital and 'outdoor' toys. Each section has a floor manager, who reports to the store manager. Store managers in turn are accountable to Tina Chan, the Operations Director. Each store manager is responsible for staff training and service quality. Service quality is monitored partly by customer feedback and partly by market research organisations, who send in 'secret shoppers' to monitor activities in both TT Limited's stores and in the stores of competitors.

Sales volumes are seasonal. Sales peak in the period before Christmas and in the run-up to the Chinese New Year. The sales periods when retailers seek to dispose of their unsold items are in the late summer and in January.

Responsibility for promoting the company's stores to customers is shared by Tina Chan and the store managers. Tina arranges in-store promotions for the company. Store managers are each responsible for promoting their own store through social media, and for the stores' layout and operational efficiencies.

Most products sold through the company's stores are bought for cash by customers and taken away at the time of sale. TT Limited has established a small online selling operation, whereby customers can order items online for delivery to their homes. In addition, customers buying goods in store can ask for their purchases to be delivered to their homes: TT Limited makes a delivery

charge for sales below a certain value and provides free deliveries for sales above this threshold amount.

Purchasing is an important part of the company's operations. The company needs to match, as far as possible, purchases with customer demand. Unfortunately it has to make the purchases in advance of knowing what sales demand for each product will be. As a result, TT Limited sometimes under-purchases items for which there is unexpected strong demand, and has difficulty in obtaining re-supply from the manufacturer. On the other hand, the company has difficulty in re-selling all its purchases of many items, and as a result it has to try to sell unsold items at a discount during the sales periods.

Some items are not sold even in the sales periods. The company has an ethical policy of donating all its unsold items to hospitals and children's care homes, rather than re-selling them at heavily discounted prices to budget (low-price) retailers.

Simon Lam is the director with responsibility for purchases. He bases his sales orders on data provided by Tina Chan about expected sales demand in the company's stores. He tries to use just-in-time purchasing to reduce inventories, but has difficult negotiations with many suppliers about the period between placing orders and receiving delivery, as well as about prices.

Simon is frustrated by the slow sales turnover that the company is currently experiencing, and the large proportion of items that are sold at a discount. Even though he approves of the company's ethical policy, he is also annoyed by the large quantities of toys the company gives away to hospitals and children's homes.

At the moment the company does not have its own credit cards, and it has not operated any form of rewards scheme for regular customers. However May Yeung has now started to look into the possible benefits from having both a company credit card and a loyalty rewards scheme, as a means of improving sales.

Financial performance

TT Limited, like other retailers, has been through a difficult two-year period. The initial response of the board to the downturn in consumer demand was to carry on with business as usual, and wait for economic conditions, and the toy market, to recover. As a result the company did not open any new stores in 2014 and 2015.

However the board is concerned about the fall in annual profits. In the year to 31 January 2016, profit after taxation was less than half the profit in the previous year. May Yeung has produced an analysis of the cost of sales and gross profit, which she believes helps to explain the deteriorating performance (See Appendix 2).

There has been no sign of economic recovery yet, and the board of directors has scheduled a lengthy meeting to discuss, amongst other things, the company's financial performance and strategic initiatives to restore growth to the company's business.

A summary of the financial results for the year ended 31 January 2016 is shown in Appendix 1.

Cash flows and financing

TT Limited, like other retailers, has to buy goods from manufacturers and hold them until they are sold to customers, and sales are seasonal. The company also pays in advance for the rental of its stores. Cash flows are therefore subject to large variations between months. Although the company believes that it has strong cash flows, there are certain times of the year when it operates with a cash deficit. At these times, the company makes use of a credit facility that May Yeung negotiated with the company's bank. This facility, which allows the company to borrow up to HK\$30 million, is nearing the end of the negotiated term. May Yeung is hoping to arrange an extension to this facility for a further three years.

All borrowings by the company from banks are at a floating rate of interest. When arranging extensions to maturing loans, banks have recently increased the margin above their base rate at which TT Limited is required to pay interest.

Although TT Limited makes most of its purchases of toys in US dollar, it does not hedge any foreign exchange transaction exposures.

Share price and dividends

The company acquired its stock market listing three years ago. The board intended to pursue a policy of continual dividend growth each year, but in the most recent year, dividends were maintained at an unchanged level, at 41.7 cents per share or HK\$50 million in total, due to the disappointing financial performance. The annual dividend per share and the company's share price in recent years have been as follows.

Year ended 31 January	2013	2014	2015	2016
Dividend per share (cents)	37.0	39.5	41.7	41.7
Share price:				
High for the year (HK\$)	-	16.91	14.93	12.60
Low for the year (HK\$)	-	16.38	12.04	10.34

The current share price is HK\$11.87.

Diversification into manufacturing

The directors of the company are annoyed by the difference in profitability between toy manufacturers and toy retailers. They recognise that since manufacturers create the toys for selling and spend much more heavily on advertising and sales promotions than retailers, they are in a stronger position in the industry than retailers. Simon Lam intends to discuss with the other directors the possibility that TT Limited might establish its own manufacturing operations.

Simon believes that there are opportunities to acquire a manufacturing company in mainland China or possibly in Thailand, which would produce toys designed by TT Limited design staff and sold under TT Limited's own brand names. TT Limited's stores would then re-sell goods produced by the manufacturing business. However the manufacturing business would also be free to sell its output to other toy retailers and wholesalers. By diversifying in this way, TT Limited would expect to improve its supply arrangements and also to benefit from the higher profit margins in manufacturing.

Simon's views are shared by Tim Yeung, the Chairman and CEO. He has spent some time with May Yeung and with business advisers, looking for suitable manufacturing companies that are available for sale. They think they have found such a company, in mainland China. Crucially, this company already designs many of its own toys and employs design staff, some of whom have earned awards from their industry for their innovative product designs.

If the board of directors decides to buy a manufacturing business, the company would need to raise new finance to fund the acquisition.

The board of directors

In addition to the four executive directors on the board, there are also four non-executive directors:

- Peter Lee, a retired investment banker
- Wendy Choi, someone with extensive knowledge of retailing in Hong Kong and mainland China, who is also the cousin of May Yeung
- Tanya Wong, the CEO of a listed IT company in Hong Kong
- Don Cheung, a former Operations Director of TT Limited, who retired from full-time working three years ago.

The board meets four times a year on scheduled dates, and holds additional meetings when matters arise that require attention.

All four non-executive directors hold shares in TT Limited.

Remuneration of senior executives

In TT Limited, senior executives are considered to be the four executive directors, the warehouse manager and the IT systems manager. At the moment all executives are paid a fixed salary. In addition, they may receive an annual cash bonus, at the discretion of the board, depending on the company's financial performance each year. However these cash bonuses are not linked to any formal performance target.

The remuneration committee consists of Peter Lee, Wendy Choi and Tanya Wong. They have engaged a firm of remuneration consultants to advise them on senior executive remuneration. The consultants have advised them that in their view, and in comparison with other listed companies in Hong Kong, there is a worrying lack of incentives in the remuneration packages for executives. Peter Lee, chairman of the committee, has discussed this matter with Tim and May Yeung. Tim and May say that they have not seen any need for incentives in the past, since the company had been developing successfully and bonuses, although discretionary, had been generous. They agree that in today's economic climate, an incentive scheme may be a way of prompting executives to put more effort into improving the company's performance. They also agree to meet with the remuneration consultants to discuss ways in which a short-term incentive scheme might be established, based perhaps on a balanced scorecard approach to setting annual targets and rewarding executives for achieving those targets.

Product safety

The company has a motto: 'Giving joy and pleasure'. This motto is displayed in each of the company's stores, having originated as an idea of Tim Yeung many years ago. He is extremely proud of his business, and believes that toy retailing is one of the most ethical businesses imaginable. He was angered two years ago when a faulty product purchased in one of TT Limited's stores caught fire and badly injured a young child. The incident attracted considerable publicity at the time, and the company paid a large amount of money in compensation to the injured child. At the time Tim Yeung publicly announced his deep shame about the incident, and he vowed that nothing similar would ever happen again.

Appendix 1

Summary financial results for Telly Toys Limited

Income statement for the year ended 31 January 2016:

	2016	2015
	HK\$000	HK\$000
Revenue	1,034,237	1,065,257
Cost of sales	<u>(426,108)</u>	<u>(407,502)</u>
Gross profit	608,129	657,755
Operating costs:		
Employee costs	(221,768)	(211,861)
Occupancy costs	(108,325)	(106,167)
Property repairs and maintenance	(16,730)	(18,080)
Depreciation	(77,621)	(77,594)
Other costs	<u>(102,130)</u>	<u>(96,295)</u>
Total operating costs	526,574	509,997
Operating profit	81,555	147,758
Finance costs	<u>(17,321)</u>	<u>(16,226)</u>
Profit before taxation	64,234	131,532
Taxation	<u>(10,598)</u>	<u>(21,703)</u>
Profit after taxation	53,636	109,829

Statement of financial position as at 31 January:

	2016	2015
	HK\$000	HK\$000
Non-current assets	<u>575,755</u>	<u>549,735</u>
Current assets		
Inventories	186,126	166,434
Trade receivables and prepayments	30,838	31,958
Cash and cash equivalents	<u>105,008</u>	<u>140,552</u>
	321,972	338,944
Current liabilities		
Trade payables	129,833	119,408
Other payables	33,902	32,683
Tax liabilities	6,104	9,420
Bank borrowings	<u>12,905</u>	<u>15,306</u>
	182,744	176,817
Net current assets	139,228	162,127
Total assets less current liabilities	<u>714,983</u>	<u>711,862</u>
Non-current liabilities		
Borrowings	258,558	259,711
Other non-current liabilities	<u>15,587</u>	<u>14,949</u>
	274,145	274,660
Total assets less total liabilities	<u>440,838</u>	<u>437,202</u>
Share capital and reserves	440,838	437,202
Number of shares	120,000,000	120,000,000

Appendix 2

May Yeung, working with Tina Chan, has established that the deterioration in gross profit is due partly to higher purchase costs, but also to an increase in discounting during the sales periods, and an increase in unsold inventory that was given away to hospitals and children's homes.

Their analysis

Year ended 31 January 2016

- 70% of sales were at full retail price
- 27% of sales were at a discount averaging 40% off the full retail price
- 3% of purchases were given away to hospitals and children's homes.

As a consequence, the average selling price of items was 86.2% of the full selling price, calculated as follows.

70% of items sold at 100% of full retail price	0.700
27% of items sold at 60% of full retail price	0.162
3% of items given away	0.000
Average selling price as a % of full retail price	<u>0.862</u>

Year ended 31 January 2015

- 74% of sales were at full retail price
- 24% of sales were at a discount averaging 38% off the full retail price
- 2% of purchases were given away to hospitals and children's homes.

As a consequence, the average selling price of items was 88.88% of the full selling price, calculated as follows.

74% of items sold at 100% of full retail price	0.7400
24% of items sold at 62% of full retail price	0.1488
2% of items given away	0.0000
Average selling price as a % of full retail price	<u>0.8888</u>

May and Tina have therefore established that the fall in the gross profit margin in the year ended 31 January 2016 was due partly to bigger discounting and problems with selling, not just to changes in the ratio of purchase costs to sales revenue.

Appendix 3

Analysis of sales

Year ended 31 January	2016	2015
Sales of toys:	HK\$000	HK\$000
Children, up to age 5	289,588	297,372
Children, ages 6 – 12	238,063	255,483
Children, aged over 12	165,478	203,399
Digital toys	184,206	149,222
Outdoor toys	156,902	159,781
Total sales	<u>1,034,237</u>	<u>1,065,257</u>

Workshop 1 Session 2

Pre-workshop exercise 1 (Ethics in Business)

Ethical scenario

TT Limited sells a range of toy products in its first ever co-branding arrangement with a Mainland China toy manufacturer, Tiger Toys. The range of products is 'Jungle Land' which is a range of small tigers and accompanying natural environment figurines (such as caves, trees, other jungle animals). It is aimed at children aged 4-6 and is designed to stimulate imaginative role-playing jungle and animal play. The range is one of TT Limited's most successful products, as the brand is exclusive to Tiger Toys and has a cult following in boys aged 5 and 6 in Hong Kong and Southern mainland China.

It is also sold through other toy retailers in Australia and New Zealand. This is the first time any TT Limited products have been sold in Australia or New Zealand.

All figurines for Jungle Land are made by the Chinese manufacturer Tiger Toys in their factory in Foshan, Guangdong Province. TT Limited is in a co-branding arrangement with the manufacturer and Tiger Toys is an independently-owned and unaffiliated company.

Tiger Toys derived 75% of its revenue from the co-branded Jungle Land in 2015. Jungle Land accounted for 10% of TT Limited total revenue in 2015.

Tiger Toys is privately owned and operated by the Tong family, with Daniel Tong as CEO and Operations Officer. He is also a Hong Kong CPA. Daniel has discovered that the latest batch of Jungle Land figurines are all painted with a different surface paint, and that this surface paint contains dangerous levels of lead. After conducting an internal investigation (which takes two weeks), he discovers that the last six months of production have all been affected by this issue. All figurines made in this time have been painted with the lead paints.

This is an extremely serious issue. Excessive lead in Chinese-made toys has been a major issue globally in the past, with approximately twenty million toys from the US toy conglomerate Mattel withdrawn in 2007 because of the very real dangers of lead poisoning. Since then, Chinese manufacturers have updated their suppliers and processes. However, a change of suppliers six months ago has led to a collapse in quality control procedures in this area at Tiger Toys.

Daniel has received the report from his internal, extremely private, investigation into the issue. There are two months' worth of stock currently in the factory. However, the first four months of affected product have been supplied to TT Limited, and sold into all markets. One range of figurines was the highly promoted new 'lion family and cubs', all of which have been painted with the lead-based paints.

Now that his fears have been confirmed, Daniel panics. He does not know what to do next. Only two other people know of the issue: his second in command, Aimee Chan (who is also a Hong Kong CPA), who carried out the investigation, and Daniel's brother who is another major shareholder. Daniel decides to think about the next steps over the next 48 hours. He tells Aimee not to do anything for now.

Aimee Chan is stunned by this decision to further delay. She feels that the longer Daniel takes to act on this issue, the greater the risk that children will be adversely affected. Aimee is furious and immediately gets on the phone to her friend and contact at TT Limited, the Operations Director and Hong Kong CPA, Tina Chan.

Aimee tells Tina all about the investigation over the phone. Tina is shocked and extremely concerned. She asks Aimee to email her a copy of the report immediately.

Meanwhile, Jane McDonough is a very concerned consumer of Jungle Land, based in Sydney, Australia. Her son Matthew is obsessed with the Jungle Land figurines. Two months ago, Matthew was given a large range of new figurines for his fifth birthday from his grandfather, who made sure they were the newest figurines on the market. Since that time, Matthew has become increasingly aggressive, irritable and tired. He is displaying sleep issues, says he has headaches and has recently become constipated. Jane's younger son, Seamus, is 14 months old and loves putting everything in his mouth, especially his big brother's Jungle Land toys. In this last week Seamus has rapidly lost his appetite, is increasingly irritable, constipated and appears to be in abdominal pain.

Jane also works part-time as a commercial finance analyst in Sydney and is an Australian CPA.

Jane takes her children to the doctor, who cannot find a cause for their change in behaviour. The doctor is worried, especially with Seamus's rapid decline. Jane goes online and discovers these are all symptoms of lead poisoning. She also finds a Facebook group that has just been started titled 'Lead Poisoning from Jungle Land Toys..!'. There are 25 other Australian members, and it is growing every day. Jane thinks that Jungle Land toys may be the cause and joins the Facebook group to find out more. She removes all Jungle Land toys from her house, and tells all her friends and family. Jane decides that a larger consumer action must be taken immediately.

Jane emails TT Limited as a matter of urgency. Her email is sent through the relevant internal communication channels, and eventually reaches the desk of Operations Director and HKICPA, Tina Chan. This happens on the same day that Tina gets her phone call from Aimee.

Tina immediately calls Jane in Sydney and offers her free toy products and shares in the company if Jane decides to postpone her consumer action until the issue can be resolved by the company.

Required

In your group, you will be asked to consider this scenario from the viewpoint of one of the following persons:

- **Daniel Tong, CEO of Tiger Toys and Hong Kong CPA**
- **Aimee Chan, Operations Officer at Tiger Toys and Hong Kong CPA**
- **Tina Chan, Operations Director at TT Limited and Hong Kong CPA**
- **Jane McDonough, consumer advocate, concerned mother and Australian CPA**

In each individual group discussion, consider the following:

- (a) **Note down the key ethical considerations faced by your allocated person in the scenario.**
- (b) **With reference to the HKICPA Code of Ethics, what does the group consider to be the ethical issues faced in this scenario. This should be assessed from the perspective of the group's allocated person and as a CPA.**

Note. In the case of Jane McDonough, candidates should apply the HKICPA Code of Ethics to Jane even though she is an Australian CPA. The fundamental principles and core structure of both the Hong Kong and the Australian Codes are identical.

- (c) **Using the 3-step strategy to solve ethical dilemmas, what does the group consider to be the best solution or action to address the situation? This should be assessed from the perspective of the group's allocated person and as a CPA.**

Workshop 1 Session 3

Pre-workshop exercise 2 (Executive Management)

May Yeung, Chief Finance Officer, has asked you to attend a monthly management committee meeting. In this committee meeting you will be asked to evaluate **four possible strategic options** and decide on the **appropriate strategy** to be taken by May Yeung and the other members of the management committee to take up to the board.

The management committee will have a lot of questions for you to address after the presentation. You are very pleased to take on this opportunity to impress May Yeung and the team.

Required

Carry out a comprehensive internal audit of the business using value chain analysis.

The purpose of a value chain analysis is to understand how the company creates value through its activities. There are five primary activities and four support activities. For each activity:

- **Identify three items that add value to the activity**
- **Briefly comment on what the organisation could do to improve each item – if anything.**

Note. It is recognised that there may be many more than three possible items for each element of the value chain, and that acceptable answers may vary in content.

Bring your completed value chain analysis to the Workshop as a tool to assist you in evaluating the strategic options presented.

Workshop 1 Session 4

Pre-workshop exercise 3 (Management Reporting)

May Yeung has been asked to prepare an analysis of the profitability of the company in the year to 31 January 2016 compared with the previous year. Her colleagues on the board are interested to know:

- The differences in performance between the two years; and
- An analysis of the reasons for the fall in gross profit in the year to 31 January 2016.

They also want to know whether the company is at risk of failing to breakeven, and making an operating loss or a loss before taxation if sales continue to fall in the next financial year.

They would also like to hear May Yeung's views about what might be done to improve profitability.

Required

Analyse the financial performance of the company over the past two years. Your analysis should include breakeven analysis and suggestions for improving performance.

Workshop 2 Session 6

Pre-workshop exercise 4 (Treasury Operations)

The board of directors of TT Limited are discussing a proposal to acquire a manufacturing company in mainland China and are negotiating a price of about HK\$550 million with the target company's current owners.

Some of the board members are concerned about whether the company is able to raise this amount of funding, and if not how an acquisition of this size might be financed. They are aware that current conditions in the economy and financial markets are not necessarily favourable for financing a business expansion programme.

Required

Identify the potential sources of finance for the acquisition of the manufacturing company and explain, with reasons:

- (a) Whether the company would be able to raise the funding required; and**
- (b) Which source or sources of finance would be the most practicable.**

Workshop 2 Session 7

Pre-workshop exercise 5 (Corporate Finance)

The board of directors of TT Limited will be meeting to discuss the acquisition of a toy manufacturing company at a cost of HK\$550 million.

Estimates have been made of the expected cash flows that will be generated by the acquisition. These have been stated in HK dollars, as follows.

- 1 Annual revenue from sales: HK\$400 million
- 2 Annual cash payments, including taxation: HK\$320 million
- 3 These cash flows are stated at current-day prices. It is expected that revenue will increase by 2% per year for the next five years and that cash payments will increase by 3% per year, also for the next five years. These increases are due to expected price/cost inflation.
- 4 It has been assumed that from Year 6 onwards, annual cash flows will be the same as in Year 5.
- 5 The company uses its cost of capital, which is 12%, to evaluate proposed capital investments.

Required

- (a) **Assess whether the proposed acquisition is financially justifiable on the basis of the information provided.**
- (b) **Assess the risk in the proposed transaction, from a financial point of view, using sensitivity analysis.**

Note. Your analysis of risk in this investment should ignore any doubts you may have about the cost of capital that is used as the discount rate.