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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 also 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
4. Management reporting	<ul style="list-style-type: none"> • Case study • Formal presentations 	Ch. 3, 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, 10 & 11
7. Corporate finance	<ul style="list-style-type: none"> • Case study • Formal presentations 	Ch. 12, 13, 14 & 17
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

Speed Eater Limited ('SEL') began operations in Hong Kong 35 years ago, as a small family-based company. It was started in 1978 by Matthew Chan and his wife Cindy as a single noodle-specialist restaurant. Matthew and his wife had a dream to do for noodles what other fast food restaurants had done for the burger – make them a cheap and cheerful fast food staple. They followed this dream and soon Speed Eater noodle restaurants began to spring up all over Hong Kong, with up to ten new outlets opening each year. The business continued to develop successfully over time, but it became much more difficult to find suitable premises for new outlets in areas where the company did not already have existing outlets.

Matthew therefore began to expand internationally. He began expansion in North America and then into mainland China.

In 1996, Matthew's cousin, Thomas Chan, was appointed as Chief Executive Officer of the North American operation, but the operations of this division have been restricted geographically to the North Eastern part of the USA. All the Speed Eater outlets in North America are located in the states of New York and New Jersey. Market penetration has been slow and difficult, and the expansion is proving unsuccessful.

From 1998 SEL began to expand into mainland China, where growth was much faster than in the USA. SEL now has a large chain of fast food outlets in Hong Kong, mainland China and the United States, which all operate under the name of Speed Eater Bars (SEB). The company also operates a small chain of Hokkien Food House (HFH) restaurants in Hong Kong.

In total, there are now 135 outlets in Hong Kong, 56 outlets in mainland China and 24 in the USA.

The company does not run on a franchise model; rather all outlets are owned and operated by SEL. Matthew considered that by franchising Speed Eater Bars, there was too much risk of damage to the reputation of the Speed Eater brand name.

The family business was floated on the Hong Kong Stock Exchange in 1998, when Cindy retired from the company. Matthew became Chairman, a position he still holds. For a number of years he also acted as Chief Executive Officer (CEO), but in 2005 his son David Chan (Hong Kong CPA) became the CEO, having spent several years as the Chief Operating Officer. Although there are other Board members, Matthew and David Chan exercise firm control over the business. Sixty per cent (60%) of the shares in SEL are owned by the Chan family.

More recently David Chan's daughter, Vicky, also became involved in the business. She started up a small side business, supplying the Hong Kong corporate market with in-house catering (lunches and evening functions). This is known internally as the SEL Corporate Catering business unit, and it has now been in operation for just over two years. Vicky is a young (26 years old) and ambitious entrepreneur. She has an Economics degree and has recently become a Hong Kong CPA. This is the first business venture she has been involved with, and may consider herself fortunate that her father was prepared to give her the opportunity to demonstrate her entrepreneurial ability. David Chan has put his trust in Vicky to leverage off the reputation and business of SEB and HFH but is allowing her to run the business with a high level of autonomy. She supplies monthly reports to the CEO and Board on the performance of the business unit.

SEL has always prided itself on its excellent reputation for workplace safety and its high levels of staff satisfaction leading to strong staff retention rates. Matthew is viewed as a retail business leader in the Hong Kong corporate community and is a chair and member of various business and

charitable boards. The entire family are perceived as valuable and philanthropic members of the Hong Kong community.

Recent developments

After a period of fairly rapid growth throughout the 2000s, expansion of the business has slowed down in the last two to three years. Although annual sales revenue continues to rise, SEL did not open any new outlets in 2013. It has been unable to find suitable new premises in Hong Kong and this has acted as a severe constraint on business growth.

Senior management have considered faster expansion in mainland China, but so far the Board has taken a cautious approach. After some problems with operations at a number of outlets in 2009 and 2010, the Board has chosen, since 2010, to focus on increasing revenue and profitability in its existing outlets. Matthew in particular has supported the view that SEL should build up its existing business in mainland China before opening more new outlets there. Competition in the USA among fast-food companies is strong: the Board was surprised at the intensity of price competition, which restricts gross profit margins. In addition, the large number of competing fast food companies gives consumers wide choice, and it has been difficult to build up sales revenue in the US outlets. The Board of Directors of SEL do not see any growth opportunities in North America in the foreseeable future.

Competition is also strong in Hong Kong and mainland China. This is keeping prices down, whilst rising costs of materials and labour have put pressure on profit margins.

SEL operates most of its outlets from leased premises. Typically, lease agreements are for periods of 10 – 15 years, with rental reviews every two, three or four years. Shortage of retail outlet space in Hong Kong means that rental costs are rising quickly, and this is also putting some pressure on profit margins. This pressure can be expected to continue as leases come up for renewal.

During the previous financial year, the company ended a long-running legal dispute with the lessor of two Hong Kong premises. As a result of the legal settlement, SEL received a one-off payment, after legal expenses of HK\$2,000,000 during the year. The legal dispute has created bad will between the lessor and SEL, and the Board of SEL is aware that the lessor may be unwilling to renew the leases when the current agreements end. The first lease renewal will be in three years' time.

Although the business did not open any new outlets last year, both Matthew and David Chan agree that SEL needs to look for opportunities for growth in the business. They believe that sales revenue growth will not continue without substantial new investment. David Chan is also of the opinion that although the company is very profitable, there are weaknesses in the management of costs and working capital. Action to deal with these problems should have a beneficial effect on profitability.

2014 strategic development

Matthew and David have instructed Kim Ho, Finance Director, to get together a strategy group to assess the internal operating environment of the business and the viability of four proposed strategies:

- (1) To maintain and grow current market share in Hong Kong while focusing on cost-cutting. A specific proposal for reducing costs is to establish a centralised in-house food processing centre for the Hong Kong market and reduce substantially the company's reliance on external suppliers of food. The central processing centre would also act as a distribution centre for all the Hong Kong retail outlets, and possibly also for the SEL Corporate Catering business unit.
- (2) To grow the mainland China market and also push SEB into other areas of Asia, such as Singapore and possibly also Malaysia. This growth could be achieved organically, by opening new fast food outlets. Alternatively the company could seek to expand more quickly by acquiring existing businesses and converting them to SEB outlets. Another option would be to use a franchise model to expand in these other countries.

- (3) To develop existing products into new markets by opening HFH restaurants in mainland China. SEL operates only a small number of HFH restaurants in Hong Kong, but they appear to be popular with customers. Due to difficulties in finding new premises in Hong Kong, opportunities for expanding HFH operations into mainland China is seen as a next-best option.
- (4) To withdraw completely from the US market and refocus funds and other resources on developing the mainland China market.

Earnings, dividends and share price

During the year to 31 December 2013, the company enjoyed very good growth in sales revenue. It is not clear why revenue growth was so strong, since the company did not open any new outlets in the year, and growth in the corporate catering business unit, although satisfactory, did not account for all the growth.

Of much greater concern is the fall in profitability between 2012 and 2013. Earnings and earnings per share fell by nearly 30%. The company's share price has fallen in response to this disappointing performance. However in view of the large fall in earnings, the share price has not fallen by as much as might have been expected, suggesting perhaps that investors continue to have some confidence in the company's management. At 31 December 2012, the share price peaked at \$7.90. It is currently \$6.67 – a fall of about 15% since that time. The company has 300 million shares in issue, so the fall in share price has resulted in a fall in the market value of the company's equity from \$2,370 million to \$2,000 million since December 2012.

The company has a large amount of cash and short-term investments, and the Board has taken the view that, given the limited opportunities for high returns from investments in financial securities, there is no reason to accumulate more cash until new business investment opportunities arise. Cash has been invested mostly in savings accounts to obtain a return, but in 2013, the company also began to invest in sovereign bonds. Since the Board decided in 2011 that there was no need to accumulate more cash, the company paid special dividends in 2012 and 2013, when most profits were distributed to shareholders as dividends.

The Board of Directors

The Board of Directors has firm leadership from its Chairman Matthew Chan and the CEO David Chan.

There are two other executive directors:

- Robert Yang, Director of Operations. Robert has extensive experience in the fast food business, and was recruited to his position in SEL in 2005, when David Chan became the CEO.
- Kim Ho, Finance Director. Kim is a CPA and has a small accountancy team operating at head office.

They each own a small quantity of shares in the company.

The company also has six non-executive directors; of these four are independent.

Business operations

Due to the nature of the company's main business operations, most of its sales are for cash. The only exception is the SEL Corporate Catering business unit, where sales to all corporate customers are on credit terms.

Currently all supplies of food are purchased from external suppliers. Purchased supplies are held in SEL-operated distribution centres in the relevant country of operation, from where they are distributed to the local SEB and HFH outlets. The establishment of a central in-house food processing centre for the Hong Kong operations is one of the strategies under consideration by the strategy review group.

Responsibility for business operations is divided. David Chan has overall responsibility for business performance. Three senior managers report to David. Robert Yang is responsible for the fast-food business operations in Hong Kong and mainland China and is regarded as the “Deputy CEO” within the company. Vicky Chan has the responsibility for the SEL Corporate Catering business unit, reporting directly to her brother David, and not to Robert. Thomas Chan has the responsibility for the US operations, and also reports directly to David.

Financial affairs are the responsibility of Kim Ho, who produces quarterly performance reports for the company. She is also responsible for treasury operations and the management of the company’s cash and investments. Her current policy is to hold cash in the three currencies in which the company has business operations: Hong Kong dollars, renminbi and US dollars, but she has also made some investment in British government bonds.

Summary financial statements for the year to 31 December 2013, and comparative figures for the previous year, are shown in Appendix 1. Segment performance figures for the year to 31 December 2013 are shown in Appendix 2.

Review of receivables and trade payables

David Chan is dissatisfied with the relatively poor performance during 2013. He is convinced that measures can be taken to improve profitability through better cost control, but he is also concerned that management of working capital throughout the company may be inefficient.

David suspects that because the company has a lot of cash, it has not given enough consideration to cash management or the cash cycle of the business. He has asked for information about trade receivables, prepayments and deposits, and also about trade payables, in order to investigate this area of the business more closely. Kim Ho has provided the information in Appendix 3 and Appendix 4.

Appendix 1: Summary financial statements

SEL Company

Statement of financial position as at 31 December:

	2013 HK\$'000	2012 HK\$'000
Non-current assets		
Property, plant and equipment	1,169,261	1,135,284
Current assets		
Inventories (note 1)	97,131	82,677
Trade and other receivables	43,114	36,433
Prepayments and deposits (note 2)	49,620	54,865
Short-term investments	43,084	–
Cash and cash equivalents	478,878	561,144
Total assets	<u>1,881,088</u>	<u>1,870,403</u>
Equity		
Share capital and non-distributable reserves	491,828	491,828
Retained earnings	1,131,353	1,114,759
Total equity	<u>1,623,181</u>	<u>1,606,587</u>
Current liabilities		
Trade payables	69,262	70,635
Other creditors and accrued liabilities	174,125	171,008
Current income tax liabilities	14,520	22,173
Total liabilities	<u>257,907</u>	<u>263,816</u>
Total equity and liabilities	<u>1,881,088</u>	<u>1,870,403</u>
Number of shares in issue	<u>30 million</u>	<u>30 million</u>

Notes:

- Inventories consist of food and consumable stores.
- Prepayments and deposits consist of deposits and prepayments for rented premises and utilities, and for some purchases of plant and equipment.
- Exchange gains or losses have been kept out of these summary financial statements to prevent complication of the data.

Income statement for the year to 31 December

	2013 HK\$'000	2012 HK\$'000
Revenue	2,984,900	2,665,080
Cost of sales	<u>(2,558,653)</u>	<u>(2,170,966)</u>
Gross profit	426,247	494,114
Administrative expenses	<u>(157,688)</u>	<u>(136,852)</u>
Operating profit	268,559	357,262
Finance income and net income from legal settlement (note 4)	12,926	11,857
Profit before income tax	281,485	369,119
Income tax expense	<u>(46,318)</u>	<u>(60,160)</u>
Profit for the year	<u>235,167</u>	<u>308,959</u>
Dividends	218,573	284,240
Number of shares in issue	300 million	300 million
Earnings per share	78.39 cents	102.99 cents

Note 4: A legal settlement during the year to 31 December 2013 resulted in net income for the company of HK\$2,000,000.

Expenses by nature

Expenses included in cost of sales and administrative expenses are analysed as follows:

In the year to 31 December	2013	2012
	HK\$'000	HK\$'000
Cost of food and consumables used	1,061,624	895,467
Depreciation	120,280	104,345
Operating lease rentals in respect of rented premises	313,415	266,532
Employee cost	713,391	588,983
Electricity, water and gas costs	163,448	143,935
Advertising and promotion expenses	38,654	35,840
Provision for impairment of trade receivables	150	–
Other expenses	305,379	272,716
	<u>2,716,341</u>	<u>2,307,818</u>
Representing		
Cost of sales	2,558,653	2,170,966
Administrative expenses	157,688	136,852
	<u>2,716,341</u>	<u>2,307,818</u>

Appendix 2: Segment performance for the year to 31 December 2013

For the year to 31 December 2013	<i>HK</i>	<i>Mainland China</i>	<i>North America</i>	<i>Total</i>
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Segment revenue	2,396,200	435,800	152,900	2,984,900
Segment gross profit before depreciation and income tax	367,822	48,457	9,968	426,247
Depreciation and amortisation	86,262	25,712	9,306	121,280
Income tax expense/(credit)	40,981	5,387	(50)	46,318

Throughout the financial year, the company operated 135 outlets in Hong Kong plus its corporate catering service, 56 outlets in mainland China and 24 outlets in the USA.

Appendix 3: Trade and other receivables, prepayments and deposits

At 31 December:	<i>2013</i>	<i>2012</i>
	HK\$'000	HK\$'000
Trade receivables	24,025	20,172
Less provision for impairment of receivables	(212)	(262)
Trade receivables – net	<u>23,813</u>	<u>19,910</u>
Trade and other receivables	43,114	36,433
Prepayments and deposits	49,620	54,865
	<u>92,734</u>	<u>91,298</u>

The company's sales to customers are mainly on a cash basis. However the company allows credit of between 30 to 45 days to corporate customers for the provision of the corporate catering services.

The ageing analysis of trade receivables is as follows:

At 31 December:	<i>2013</i>	<i>2012</i>
	HK\$'000	HK\$'000
0 – 30 days	14,315	12,709
31 – 60 days	4,936	4,438
61 – 90 days	1,420	1,008
Over 90 days	3,354	2,017
	<u>24,025</u>	<u>20,172</u>

Sales to corporate customers were HK\$203,900,000 in the year to 31 December 2013. (2012: HK\$188,790,000).

The trade and other receivables and deposits are denominated in the following currencies:

At 31 December:	<i>2013</i>	<i>2012</i>
	HK\$'000	HK\$'000
HK dollar	28,751	26,295
RMB	12,433	8,304
US dollar	1,930	1,834
	<u>43,114</u>	<u>36,433</u>

Appendix 4: Trade payables

The ageing analysis of trade payables is as follows:

At 31 December:	<i>2013</i>	<i>2012</i>
	HK\$'000	HK\$'000
0 – 30 days	61,851	63,077
31 – 60 days	4,171	4,199
61 – 90 days	3,240	3,359
	<u>69,262</u>	<u>70,635</u>

The carrying amounts of trade payables are denominated in the following currencies:

At 31 December:	<i>2013</i>	<i>2012</i>
	HK\$'000	HK\$'000
HK dollar	47,192	52,103
RMB	19,511	16,455
US dollar	2,559	2,077
	<u>69,262</u>	<u>70,635</u>

Appendix 5: SEL management

Matthew Chan	One of the co-founders of SEL with his wife Cindy. Currently the company Chairman. Until 2005 was also the Chief Executive Officer.
Cindy Chan	One of the co-founders of SEL with her husband Matthew. Retired from the business in 1998.
Thomas Chan	Cousin of Matthew Chan. Head of SEL's North American operations in New York and New Jersey. Reports to David Chan.
David Chan	CPA. Chief Executive Officer of SEL since 2005. Formerly the Chief Operating Officer.
Vicky Chan	CPA. Daughter of David Chan. Head of the SEL Corporate Catering business unit, established just over two years ago. Reports to David Chan.
Robert Yang	Director of Operations. Appointed in 2005 when David Chan became CEO. Regarded as the 'Deputy Chief Executive Officer' in SEL.
Kim Ho	CPA. Finance Director of SEL.

Workshop 1 Session 2

Pre-workshop exercise 1 (Ethics in Business)

Ethical scenario

The introduction of a statutory minimum wage in Hong Kong of \$28 per hour from 1 May 2011 had a large impact on the bottom line of Hong Kong operations and is a contributor to rising costs. All employee wages were increased to reflect the minimum rate of \$28 per hour from that date.

On 2 April 2013 SEL released a press release stating their continued support of paying a base statutory minimum wage and highlighted their leadership in this area. The press release also stated that the SEL Board believed strongly in minimum wage protection for Hong Kong workers and called on the corporate community to put their support behind minimum wage increases. The press release was written by the marketing department and signed by CEO, David Chan, and the Chairman of the Board and founder of the company – his father, Matthew Chan.

Vicky Chan, head of the SEL Corporate Catering unit, is not involved in this area of the business. It is not known whether she is aware of the press release, but its release was discussed at the last board meeting.

On 1 May 2013 the hourly minimum wage in Hong Kong was raised from \$28 to \$30 an hour.

On 10 May 2013 Lucy Lee, a junior chef for the SEL Corporate Catering unit, asks her boss when her pay increase of \$2 an hour will be paid: “My boyfriend works for HFH (another arm of SEL) and he got his pay increase yesterday – when is mine coming through?” The boss reports this request to the manager of SEL Corporate Catering who emails Vicky, asking when the minimum wage increase will be coming through.

Vicky sends out an email to all line managers saying: “Due to the fact that SEL Corporate Catering is in start-up mode, we are asking all staff to forgo the \$2 hourly increase for the time being until the business grows. Please inform staff that the wage increase will be passed on from 1 January 2014.”

Lucy Lee is told this and she is furious! She thinks: “Why should my boyfriend get the increase and not me – when we work for the same company?” She decides to complain to her boss who tells her to “be patient and grateful you have a job”. After much thought, Lucy emails the CEO directly using his publicly available email address, outlining the situation. She refers to the press release signed by David and his father, Matthew.

David receives the email and meets with his father Matthew to discuss the situation. He decides not to reply to Lucy until they have a solution.

Lucy is even angrier when she has not heard back from David after a few days. She is in the kitchens of a major client – Scooter & Sons, a corporate law firm – preparing for a cocktail party, when she starts talking about it to other staff members and urging them to join her in taking action. Helen Fung, a legal Partner in the Corporate division of Scooter & Sons, who is holding the party, happens to be in the kitchens at the time. She overhears Lucy and is concerned, particularly as the law firm also acts for the Hong Kong government in employment-related matters.

Group discussion

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

- (1) David Chan, CEO and Hong Kong CPA
- (2) Vicky Chan, SEL Corporate Catering business unit head and Hong Kong CPA
- (3) Lucy Lee, junior chef at SEL Corporate Catering
- (4) Helen Fung, Partner in the Corporate division of Scooter & Sons, a major customer of SEL Corporate Catering

Required

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.**
- (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)

Kim Ho, Finance Director, 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 Kim and the other members of the management committee to take up to the Board.

They will certainly raise a lot of questions to you after your presentation to the management committee. You are very pleased to take on this opportunity to impress Kim and the team.

Required

- (a) **Evaluate SEL's business using a 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 relevant items/components for each activity**
- **Briefly comment on what the organisation could do to improve the value added by each item**

Note: It is recognised that there may be many more than three possible items for each element of the value chain.

- (b) **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)

David Chan is concerned about the disappointing results in 2013 and has arranged a meeting with Robert Yang and Kim Ho to discuss the possible reasons why performance in 2013 was not as good as in 2012. Kim suggests that they should look initially at the performance of the company as a whole. They will then need to look at the performance in each of the three geographical areas of the business operations.

David is surprised that the poor results occurred in spite of an increase in sales revenue. He feels that the outlets are all performing well in terms of sales volume, but that outlet managers do not have sufficient control over costs. Robert Yang, on the other hand, believes that as a business expands, it will incur increasing amounts of overhead costs, and that this is an inevitable short-term consequence of growth. He feels that results will improve substantially in 2014, especially if sales growth continues at the same rate as in 2013.

It is agreed that the matter needs urgent attention, and David calls a meeting for the end of the day. He realises that this gives Kim very little time to produce figures for analysis, and that in the time available, Kim should focus on the results for the company as a whole and the reasons for the decline in performance during 2013.

They also agree that they need to consider the future and the implications for future profitability of any trends they can detect in the 2012 and 2013 results. David is worried that without radical action, results in 2014 will continue to deteriorate. He is not nearly as optimistic as Robert Yang.

Required

Using the information in the case study for the company as a whole, you are required to:

- (a) As far as the information permits, analyse the financial performance of SEL in 2013. Identify and comment on any significant difference in performance between the two years. (There is no need to analyse segmental results at this stage.)**
- (b) Assess whether, in your view, the optimistic views of Robert Yang or the more pessimistic views of David Chan are more likely to be correct about prospects for 2014 and beyond.**

Workshop 2 Session 6

Pre-workshop exercise 4 (Treasury Operations)

David Chan is reviewing the cash flows of the company. The company is cash-rich, but David is concerned that in 2013, in spite of making a profit, the company's cash holdings fell by over \$80 million. Normally, David would ask Kim Ho to provide a cash flow statement showing how the cash position changed between the end of 2012 and the end of 2013. However, Kim is on a business trip to some of the company's outlets in mainland China, and she has not yet prepared the final statement of cash flows for inclusion in the published financial statements for 2013.

David also wants to know more about the company's cash cycle for its business operations. His daughter Vicky is a CPA, and she thinks she can provide some information about cash flows in 2013 and about the company's cash cycle. Vicky warns David, however, that this information will be based on the limited information already provided by Kim Ho.

Required

Using the information in the Appendices to the Case Background, you are required to:

- (a) **Prepare a statement of cash flows, to the extent that the available information allows, showing how the company's cash holding fell between the end of 2012 and the end of 2013. Comment on the key information that your statement reveals.**
- (b) **Comment on the cash flow cycle of SEL's fast food business.**

Workshop 2 Session 7

Pre-workshop exercise 5 (Corporate Finance)

The board of SEL has been asked to consider purchasing the franchise for a fast food outlet in Malaysia. The franchise has been in operation for a few years and has only four years left to run before it will be subject to renewal negotiations with the franchisor. The current franchisee is a citizen of Hong Kong, and plans to return to Hong Kong after selling his business, so is interested in selling the franchise on to SEL. The asking price for the franchise is HKD5 million.

David Chan is interested in the possibility of making a small investment in Malaysia, as a way of making SEL's business more international. He has discussed the revenues and cash flows of the Malaysian franchise with the franchisee, and he is fairly confident that by investing in the business, SEL would obtain a return of 600,000 Malaysian ringgit (MYR600,000) at today's prices for each of the next four years.

He has asked Kim Ho to carry out further appraisal into the proposed investment, and Kim intends to carry out a net present value assessment. She is aware of the following information:

- The investment would be paid for in Hong Kong dollars, but annual returns would be in ringgit.
- The current exchange rate for MYR against HKD is 2.60. (HKD against MYR is 0.3846.)
- Kim has estimated that a suitable cost of capital for evaluating this investment would be 9%.
- Economic forecasters are predicting that the annual rate of inflation for each of the next four years will be 3% in Malaysia and 4% in Hong Kong.

As a result of the different inflation rates between the two countries, economists are also predicting that the ringgit will strengthen in value against the Hong Kong dollar by 1% each year.

Required

Explain how a discounted cash flow (DCF) analysis would be carried out on this proposed international investment, taking into consideration the different currencies of investment and returns, inflation in Malaysia and Hong Kong, and also the exchange rate between HKD and MYR. Assess the level of risk in this investment.

