Contents

Introduction

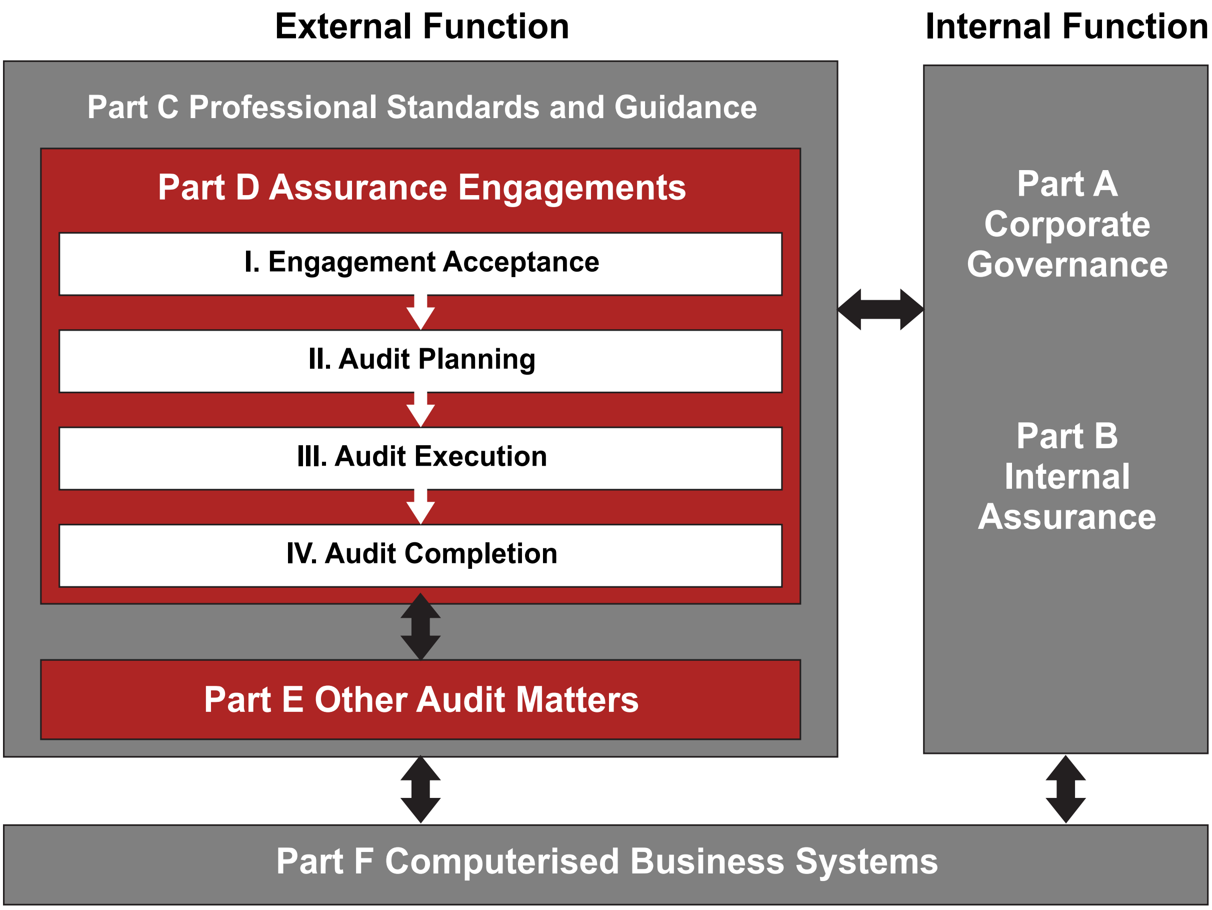
Module Aim and Structure

This module will enable you to perform effective assurance and related assignments. You will also understand the importance of corporate governance and be able to ensure it has been effectively set up in an organisation.

The module is structured in such a way that it can achieve the module aim. The module structure displayed below starts with internal focus on corporate governance and internal assurance. It then extends to the external focus. The external focus follows the audit process, from engagement acceptance, audit planning and execution to audit completion. Activities of both internal and external assurance usually take place on an IT platform.

This module structure 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 C (Business Assurance)



Workshop Structure and Format

During Workshop 1, we first look at the corporate governance issue from the point of view of different stakeholders (internal assurance). We will then go through an audit journey in which we will experience the whole audit process (external assurance).

You will be working on case exercises during the workshops. Through group activities and discussion, you will look at how the auditing standards are applied to given case scenarios and how an assurance engagement is managed as a project in the business world.

Workshop Objectives

The workshop objectives include the following:

- Understand the needs and the relevant issues of various stakeholders in corporate governance and address them in accordance with the statutory requirements.
- Recognise conflicts or ethical issues and advise on appropriate actions.
- Identify potential risks in accepting or continuing with an assurance engagement in the client acceptance procedures.
- Identify inherent risks based on an understanding of the client operation and environment, and evaluate the impact of risks on the financial statements and at assertion levels.
- Evaluate the effectiveness of internal controls of an entity.
- Evaluate the control system of an entity and identify control risks, including IT related risks.
- Exercise judgment to decide on an appropriate audit approach that can address the risks identified.
- Judge when to rely on the work of clients' internal audit function.
- Identify audit issues, evaluate their implications and resolve them.
- Perform final review of the financial statements to evaluate the reasonableness of the financial statements.
- Determine and draft the appropriate audit opinion in various situations.
- Understand the project and audit issues in relation to a group audit for effective planning and management.
- Be aware of the internal and external stakeholders' needs and be able to manage and address their expectations.

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.
- 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 counselling 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 a 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).
- Adhere to an ethical mindset and professional behaviour.

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

- Reasonable understanding and ability to decide on an audit approach.
- Ability to evaluate the impact of risks on the financial statements and at assertion levels.
- Ability to evaluate the effectiveness of the control system of an entity and identify its control risks.
- Reasonable understanding and ability to resolve audit issues.
- An awareness of stakeholders' different interests and expectations, and the ability to manage them.
- Ability to plan and manage a project.

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.
- 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, and, 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 materials including the case background and exercises (if any).
- The module Learning Pack.

During the workshops, you will be given:

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

Workshop Outline and Learning Methodologies

Session	Methodologies	Chapters covered
Workshop 1		
1. Introduction	• Presentation • Group discussion	
2. Corporate governance	• Case study • Group discussion	Ch. 1
3. Overview of an audit	• Card game	
4. Audit acceptance/ continuance	• Case study • Group discussion	Ch. 4 and 7 and Supplement
5. Audit planning	• Case study • Group discussion	Ch. 8 – 13 and Supplement
6. Project management in audit planning stage	• Group discussion	Ch. 8
7. Conclusion	• Presentation • Group discussion	
Workshop 2		
8. Reboot	• Presentation • Group discussion	
9. Audit planning and execution	• Individual work • Progress meeting and reporting • Group discussion	Ch. 9,13,16 and Supplement
10. Project management in audit execution stage	• Presentation • Group discussion	
11. Audit completion	• Group sharing • Group discussion	Ch. 15-17 and Supplement
12. Group audits	• Group discussion	Ch. 18
13. Conclusion	• Presentation • Group discussion	

It is extremely important that you have studied the relevant chapters of the Learning Pack and completed the pre-workshop materials thoroughly prior to attending the workshops so that you can derive the maximum benefit from them. You should become familiar with the workshop materials as they will be raised for discussion throughout the workshops.

You are advised to bring the relevant auditing standards to the workshops for reference use.

Pre-Workshop Materials

Workshops 1 and 2

Case background

S&T Footwear Group (S&T Group)

Background information

S&T Group is a manufacturer, distributor, wholesaler and retailer of sports and leisure footwear. It comprises a parent company, S&T Footwear Group Holdings Ltd and two subsidiaries S&T Footwear Ltd (S&T Footwear) and S&T Footwear Retail Ltd (S&T Retail). The business was originally set up by the Chen family in the 1980s and has grown in to one of the largest footwear manufacturers in China. In 1992, it formed its own distribution division, ceasing the use of third party distributors. It also began to supply wholesale retailers directly (i.e. sale in bulk to third party retailers). In 1998, it purchased 100% of the shares of a shoe retailer named Popular Footwear Ltd. and rebranded all of its retail outlets to S&T Retail. Since 1998, it has continued to add to the number of retail outlets owned by S&T Retail. During 2016, the leasehold on a number of additional stores in prime locations were purchased from a competitor which went in to liquidation. S&T Retail has invested heavily in rebranding these stores as they were viewed by the market to be out-dated and old-fashioned. Costs incurred included the complete refurbishment of the stores together with a marketing and advertising campaign.

The manufacturing, distribution and wholesale parts of the business are based in China. S&T Footwear has a number of leasehold factories which manufacture all of the sports and leisure footwear produced by the group. This includes its own brand 'S&TGear' as well as manufacturing for four other leading sportswear brands under Original Design Manufacturer (ODM) arrangements (see below). The distribution division is responsible for the worldwide distribution of all footwear manufactured by S&T Footwear including those sold through S&T Retail. S&T Retail has a presence in all the major cities in China and Hong Kong where it sells directly to the end consumer through its retail outlets. It has also recently introduced an online service.

The sports and leisure footwear manufacturing industry and retail market in China

China has long been the largest global footwear manufacturer, supplying products to countries all over the world. However, in recent years, fierce international competition and manufacturing being transferred to Southeast Asia has presented challenges in the industry. Over the five years to 2015, the industry revenue grew on average by 6.6% per year. In 2015, revenue was just increased by 4.2%.

Recently, large manufacturers with more automated techniques have increased their investment in equipment and technologies to comply with new regulations on environmental and labour protection. These include measures to reduce the greenhouse gas (GHG) emissions caused by production processes and improvements in safety features, particularly where hazardous chemicals are used.

Most footwear retailers are facing challenges due to slow growth and margin erosion. In 2015, China's gross domestic product (GDP) growth slowed and whilst online retail channels continued their high growth, competition has intensified. Many chains have resorted to promotions and deep discounting. Most footwear retailers' profits were further squeezed due to the pressures on operating costs.

The sports and leisure footwear retail market in Hong Kong

Footwear sales in Hong Kong grew by 5% in 2015, driven largely by sports footwear and casual footwear. Consumers' enthusiasm for fitness, running and outdoor activities continued to support footwear sales. These categories are expected to benefit from the advent of a more relaxed dress code, both at work and at home. Both men and women wear performance footwear and sports-inspired footwear in everyday life, rather than simply reserving these items for use during sporting activities.

S&T Footwear production process

S&T Footwear produces an item of sports or leisure footwear from a number of components. These include the sole unit, comprising an inner sole, a mid-sole and an outer sole primarily made from synthetic rubber, phylon and other synthetic materials. These elements are heated and pressed to form sheets out of which the sole can then be cut. The uppers may be made from a range of materials depending on the style and design but would typically be made from fabric or leather (either natural or synthetic). Historically the production process has been labour intensive with the uppers being hand stitched together with any special design features or laces.

S&T Group revenue

S&T Group generates revenue from a number of different types of customer as follows:

- Retailers supplied wholesale
- ODM customers (see below)
- End consumers in China and Hong Kong through S&T Retail stores
- Online customers in USA, China, Hong Kong, Taiwan and Malaysia (see new developments below)

80% of revenue is generated from the sale of sports footwear, with the remainder being made up of leisure footwear. Retail stores have run a series of promotions during the year offering substantial discounts as a means of generating sales. Sales staff at the retail outlets receive a monthly bonus for meeting sales targets.

Retailers supplied wholesale are offered bulk discounts if the volume of goods which they purchase from S&T Footwear exceeds certain quotas specified in the sales contracts.

S&T Group has adopted HKFRS 15 *Revenue from Contracts with Customers*.

ODM customers

S&T Footwear manufactures products for leading sportswear brands under ODM arrangements. This is a significant part of the business which accounts for approximately 50% of the total revenue to which approximately 25% of total sales was generated from one particular customer, Victory Ltd. S&T Footwear works closely with its ODM customers in product development with its Research and Development (R&D) team working in tandem with those of the customer. R&D costs arising in this process are expensed as incurred. ODM customers are charged a unit price for each item of footwear produced. The unit price includes a notional amount to reflect the costs of development incurred by S&T Footwear.

Increasingly ODM customers have become aware that, to protect their brand, they need to demonstrate that the companies within their supply-chain are operating ethically. To continue ODM supplies, S&T Footwear factories are required to meet high standards set out within agreed 'Codes of Conduct' in respect of the following areas:

- Labour relations (including wages, working hours, collective bargaining and grievance procedures)
- Health and safety (including hazardous materials, hazardous waste and electrical safety)
- Environmental legislation (including emissions and energy use)

In addition, it is S&T Footwear's responsibility to ensure that its own suppliers also meet the required standards within the 'Code of Conduct'. S&T Footwear's compliance with the 'Code of Conduct' is monitored by the ODM customers with the possibility of penalties being imposed. If breaches are identified, S&T Footwear is given a timescale to improve, after which there could be a reduction in orders or the ODM customers may terminate the contracts completely.

The markets in which the ODM customers operate are highly competitive and fast moving with end-consumers looking for the 'next big thing' in leisure footwear. In the last five years the emphasis has been on sports gadgets, including microchips, which fit in the heel of the shoe, capable of monitoring performance and logging the wearer's activity, such as running routes. Wearers are able to upload the data recorded using an app on their smartphone or tablet. The demanding nature of this market has also had consequences for ODM suppliers, including S&T Footwear. S&T Footwear is under increasing pressure to be more flexible and responsive to the needs of its customers. Two of its ODM customers have decided to launch new products every six months (instead of on an annual basis as was previously the case). This has resulted in shorter production runs and led to increased production costs, including production line set-up costs and other administrative expenses.

Suppliers to S&T Footwear

S&T Footwear is responsible for sourcing the textiles and other raw materials for production of its own branded products and those produced under the ODM arrangements. S&T Footwear has developed a network of key suppliers over the years. The majority of textiles and raw materials required are produced in China. However, more recently due to increased demand S&T Footwear has had to source materials from new suppliers in Taiwan and India. These new suppliers invoice in US dollars. Contracts with further new suppliers of eco-friendly raw materials have also been introduced following the launch of S&T Group's own brand new product, EcoS&TGear (see new developments below).

Foreign exchange exposure

Revenues generated from retailers supplied wholesale and ODM customers are denominated in US dollars.

For S&T Retail, revenues generated via the stores are denominated in each store's local currency (i.e. RMB or HK$). Expenses are also denominated in each store's local currency. Online sales to customers in Hong Kong and China are denominated in the local currency. Online sales made to customers in the USA, Taiwan and Malaysia are denominated in US dollars.

A small amount of foreign currency exposure is hedged.

S&T Group Financial and corporate structure

S&T Footwear Group Holdings Ltd, the parent company, is listed on the Hong Kong Stock Exchange having made an initial public offering (IPO) in 2009. It plans to make a further issue of shares (a secondary issue) in the third quarter of 2017 to finance expansion in the USA. Shares are currently owned by private individuals and corporate shareholders, such as pension and investment funds. No individual shareholder has overall control of the company although the Chen family continue to have a significant stake.

S&T Group includes two wholly owned subsidiaries, S&T Footwear and S&T Retail which are managed by a regional head office. Both are significant components and produce financial statements to 31 December. Accounting policies are consistent throughout the group.

S&T Group is run by its board of directors which consists of the following:

- Chairman – Mr. Tristran Suen
- Chief Executive Officer (CEO) – Mr. Brent Bao
- Chief Financial Officer (CFO) – Ms. Talia Foon
- Production Director (Manages S&T Footwear manufacturing and distribution divisions) – Ms. Sue Ling
- Head of Retail Services (Manages S&T Retail) – Ms. Lafa Fan

All members of the board have been in their post for at least three years. S&T Group has three non-executive directors as follows:

- Mr. Madison Tin
- Mr. Kyle Kwai
- Ms. Maureen Yau

All the non-executive directors have expertise in manufacturing and retail business, with strong corporate finance background. S&T Group also has an internal audit function which reports to the audit committee.

S&T Group management structure

The board of S&T Group oversees the strategic direction of the business from its head office in Hong Kong, supported by a number of core business departments which deal with the day to day operations. These include the following departments:

- Finance
- Research and development
- Purchasing and procurement
- Production
- Human resources

- Sales and marketing
- Internal audit
- Information technology

Local factory managers report to the production director. Warehouse managers report to the head of retail services.

The board meets once per month at which monthly management accounts are presented and discussed. Department heads also present a report summarising the key issues/events which have occurred in their areas (based on information provided by the warehouse and factory managers). The non-executive directors attend these meetings.

The finance department produces quarterly budgets and compares actual to budget figures on a regular basis.

S&T Retail is managed as a separate entity with its own accounting and controls system.

The head of internal audit, Eric Zeng, has recently been appointed following the resignation of the previous department head, Jo Fu. Prior to his appointment, Eric worked as a senior finance manager within the finance team.

The internal audit department is responsible for monitoring compliance with ODM customers' Codes of Conduct.

S&T Footwear accounting systems and internal controls

S&T Footwear uses a bespoke accounting system. During the year, the system was revised to integrate the inventory system with the sales and purchases systems. S&T Footwear also intends to rely on a perpetual inventory system for the first time to determine inventory quantities at the year end although full year-end inventory counts are planned for a sample of factories and warehouses. The company operates a standard costing system.

All changes to the system are made by a reputable software company and follow a rigorous process of planning, testing, implementation and review. The report produced by the software company following the integration of the inventory system concluded that the upgrade had been successful and that the system was operating effectively.

The decision has been taken to integrate the systems and controls of S&T Retail with those of S&T Footwear, however this project is currently at the planning stage only.

Sales

Orders from retailers supplied wholesale and ODM customers are received by the sales department at periodic intervals. Retailers supplied wholesale are invoiced at the standard list price (subject to any discounts they may be entitled to). ODM contracts specify a fixed price per unit for the contracted period. The accounting policy adopted by S&T Footwear in relation to ODM sales changed at the start of the accounting period due to the application of HKFRS 15 *Revenue from Contracts with Customers*.

Sales from S&T Footwear to S&T Retail are made at standard cost plus 20%.

S&T Retail

All S&T Retail stores operate an electronic point of sales system (EPOS). When an item is purchased, the barcode on the item is scanned, the price is retrieved from the price database which is maintained centrally and the value of the transaction is recorded. The EPOS system is also integrated with the S&T Retail's inventory system.

Online sales (see new developments below) may be made via S&T Retail's website or through its smartphone/tablet app. Payment is made with a credit or debit card. Customers are able to schedule a specific delivery date up to 30 days from the day of purchase. At the time of purchase, the transaction is automatically recorded in sales and receivables (until settled by the credit card company), and inventory is also updated.

Both the retail stores and online sales allow customers to return their goods if not completely satisfied. For sales from retail stores, returns must be made within 30 days of purchase. For online sales, returns must be made within 30 days of receipt of the goods.

New developments

A number of developments have occurred during the year.

(1) USA expansion

S&T Group via S&T Footwear has been supplying wholesale customers in the USA for a number of years and has seen a steady increase in demand for its products, particularly its own brand 'S&TGear' products. These compare well in terms of quality with the more famous brands but retail at a price which is approximately 20% cheaper than its competitors. S&T Group is keen to exploit this market and plans to set up a new direct retail presence throughout the USA. S&T Group is in the process of raising funds to support this expansion which it aims to do through a share issue (secondary offering).

To export products to the USA, S&T Footwear must comply with detailed regulations including the Consumer Product Safety Act encompassing regulations regarding the lead content of dyes and water repellent finishes.

(2) Factory reorganisation

Manufacturing in S&T Footwear is undergoing a period of re-organisation. A combination of new environmental legislation and increased health and safety regulation has meant that S&T Footwear has had to invest in new equipment as the existing equipment did not meet the new standards. Consequently the automation of the production process has been enhanced. For example, manual assembly of the sole and upper of the item of footwear is no longer required. As a result of this improved efficiency, S&T Group has announced the closure of one of its factories in China. 40% of the employees will be redeployed to other factories but the remainder will be made redundant.

(3) S&T Retail

During the year ending 31 December 2016, S&T Retail set up a new online retail presence serving the USA, China, Hong Kong, Taiwan and Malaysia. Bespoke ecommerce software was developed and is integrated with its accounting system. Online orders are dispatched to customers directly from its warehouses in China and Hong Kong and sales and inventory records are updated in real-time. Customers can choose a delivery date from next day delivery up to a maximum of 30 days from purchase.

(4) EcoS&TGear

In response to customers' demands for products which are made of eco-friendly materials (rather than simply being manufactured in an environmentally friendly manner), S&T Footwear has designed a new range of 'green' casual footwear. Research into environmentally preferred alternative materials commenced in May 2015 with a prototype shoe being completed and approved for production by the board in March 2016. EcoS&TGear was launched to the market in May 2016.

Koo Lau & Co.

Your firm, Koo Lau & Co. is a large national audit firm with offices in Hong Kong and China (Shanghai, Beijing and Shenzhen). Your firm has been asked to tender for the audit of S&T Group for the year ending 31 December 2016. The tender team is to be headed up by the audit engagement partner Ms. Caty Wai who has arranged a meeting with the Chief Financial Officer of S&T Group, Ms. Talia Foon, to discuss this and the potential for other non-audit work.

The following information is also available:

- Article from International Trader Magazine (Appendix A)
- Hong Kong Morning Post News Article (5 December 2016) (Appendix B)
- S&T Group Accounting and Controls Manual (Extracts) (Appendix C)
- Internal Controls questionnaire (Extracts) (Appendix D)
- Draft Consolidated Financial Statements and Budget (Appendix E)
- Email from Jo Fu (Appendix F)

Additional Information

Audited Financial Information Extract

S&T Group

Consolidated statement of profit or loss for the year ended 31 December 2015

	Note	2015 HK$m
Revenue	2	18,400
Cost of sales		(14,700)
Gross profit		3,700
Other income		313
Selling and distribution expenses		(1,587)
Administrative expenses		(1,269)
Finance cost		(180)
Profit before tax		977
Tax		(88)
Profit for the year		889

Consolidated statement of financial position as at 31 December 2015

	Notes	2015 HK$m	
ASSETS			
Non-current assets			
Intangible non-current assets	3		751
Property, plant and equipment	4		4,645
			5,396
Current assets			
Inventories	5	3,080	
Trade and other receivables	6	3,278	
Cash and bank balances		2,261	
			8,619
Total assets			14,015
EQUITY AND LIABILITIES			
Equity			
Issued share capital	7	125	
Accumulated profit		8,368	
			8,493
Non-current liabilities	8		1,810
Current liabilities	9		3,712
Total equity and liabilities			14,015

Consolidated statement of changes in equity for the year ended 31 December 2015

	2015 HK$m
Balance as at 1 January	8,004
Profit for the year	889
Transactions with owners – dividends	(400)
Balance as at 31 December	8,493

Notes to the consolidated financial statements for the year ended 31 December 2015

1 Accounting Policies

1.1 Basis of preparation

The consolidated financial statements for the year ended 31 December 2015 are prepared on the historical cost basis.

1.2 Revenue

Revenue is recognised to depict the transfer of the promised goods to customers in an amount that reflects the consideration to which we expect to be entitled for these goods.

1.3 Intangible non-current assets and amortisation

Intangible non-current assets include goodwill, software development costs and development expenditure.

Intangible non-current assets with an indefinite useful life are tested for impairment annually.

Intangible non-current assets with a finite useful life are stated at cost less amortisation. Amortisation is calculated on a straight line basis over the asset's expected useful life on the following basis:

Software development costs	20% straight line
Development expenditure	10-15% straight line

1.4 Non-current tangible assets and depreciation

Non-current tangible assets are stated at cost less depreciation. Depreciation is provided at rates calculated to write off the cost of non-current assets, less their estimated residual value, over their expected useful lives on the following bases:

Leasehold properties	2-5% straight line
Plant and machinery	5-15% straight line
Other	20-30% straight line

1.5 Inventories

Inventories are valued at the lower of cost and net realisable value after making allowance for obsolete and slow-moving inventory.

1.6 Foreign currencies

Transactions in foreign currencies are translated into Hong Kong dollars at the rate ruling on the date of the transaction. Exchange gains and losses are recognised in the consolidated statement of profit or loss.

2 REVENUE

Revenue is attributable to the principal activity of the group. An analysis of revenue is given below:

	2015
	HK$m
China (including Hong Kong)	5,704
USA, Taiwan and Malaysia	12,696
	18,400

3 INTANGIBLE NON-CURRENT ASSETS

	Goodwill HK$m	Software development HK$m	Development expenditure HK$m	Total HK$m
Cost				
At 1 January 2015	642	150	32	824
Additions	-	-	10	10
At 31 December 2015	642	150	42	834
Amortisation				
At 1 January 2015	-	(30)	(17)	(47)
Charge for the year	-	(30)	(6)	(36)
At 31 December 2015	-	(60)	(23)	(83)
Net book value				
At 31 December 2015	642	90	19	751
At 1 January 2015	642	120	15	777

4 PROPERTY, PLANT AND EQUIPMENT

	Land HK$m	Leasehold properties HK$m	Plant and machinery HK$m	Other HK$m	Total HK$m
Cost					
At 1 January 2015	9	4,501	2,784	707	8,001
Additions	-	326	322	56	704
Disposals	-	(53)	(154)	(49)	(256)
At 31 December 2015	9	4,774	2,952	714	8,449
Depreciation					
At 1 January 2015	-	1,332	1,644	378	3,354
Charge for the year	-	221	256	156	633
Disposals	-	(30)	(109)	(44)	(183)
At 31 December 2015	-	1,523	1,791	490	3,804
Net book value					
At 31 December 2015	9	3,251	1,161	224	4,645
At 1 January 2015	9	3,169	1,140	329	4,647

5 INVENTORIES

	2015 HK$m
Raw materials	648
Work in progress	371
Finished goods	2,061
	3,080

6 TRADE AND OTHER RECEIVABLES

	2015
	HK$m
Trade receivables	2,350
Prepayments and unamortised mould costs	963
Allowance for doubtful debts	(35)
	3,278

7 SHARE CAPITAL

	2015
	HK$m
Share capital called up, allotted and fully paid	125

8 NON-CURRENT LIABILITIES

	2015
	HK$m
Long-term bank borrowings	1,720
Deferred tax	90
	1,810

9 CURRENT LIABILITIES

	2015
	HK$m
Bank loans and overdrafts	519
Trade payables	1,576
Taxation payable	37
Staff bonus accruals and other accruals	1,580
	3,712

Appendix A – Article from International Trader Magazine

Why enter an ODM arrangement?

An Original Design Manufacturer (ODM) arrangement is a type of outsourcing arrangement. This enables a company (the ODM customer) to outsource the design and manufacture of its products based on its own specifications. These products are then branded as its own. Typically the ODM customer and the manufacturer (ODM supplier) will work together closely at the design stage enabling the manufacturing company to use its manufacturing expertise to advise the customer on the practical feasibility of its designs and to make practical suggestions as to how any challenges can be overcome.

In recent years, this type of business model has become increasingly popular with companies involved in international trade. Originally the practice was developed in the IT industry with most phones and tablets now being produced under this type of arrangement. More recently the practice has spread to other industries including fashion and footwear.

For the customer, there are many advantages:

- ODM suppliers are normally based where manufacturing costs are cheaper, for example in China and Taiwan.
- Using an ODM supplier removes the need to start up business in that country circumventing logistical and set-up cost issues.
- Many ODM suppliers invest heavily in R&D and the customer can benefit from this expertise.
- ODM suppliers may be selected on the basis of their proximity to specific markets reducing distribution costs.
- In certain jurisdictions, local law prohibits ownership of assets by foreign companies. The ODM model is a means of getting round this problem.

(*Retrieved on 6 April 2016 from www.szceit.com/our-services/guides/a-guide-to-odm-manufacturing/ and rockleighindustries.com/oem-odm-manufacturing.html*)

Appendix B – Hong Kong Morning Post News Article (5 December 2016)

STRIKE HITS PRODUCTION AT S&T FACTORY

S&T Footwear has confirmed that 2,000 workers at one of its Zhuhai factories are on strike for the second day. S&T Footwear produces sports and leisure footwear for a number of household name brands however none of the customers affected were prepared to comment, stating that it was an internal issue.

The striking workers, were unhappy about the way that new efficiency practices have been implemented resulting in the planned closure of one factory and the loss of over 1,000 jobs.

'There are supposed to be procedures in place so that changes like this are made in consultation with the employees. These procedures have not been followed and we feel very let down. This is typical of management who only care about profits and shareholders and who show little or no respect for the people who work for them,' explained a disgruntled employee outside the factory gates.

A spokesman for the company refuted this claim saying that the reorganisation had been the result of the introduction of new machinery which was required to comply with changes in environmental legislation and health and safety. He did confirm that there would be job losses as a result, and whilst this was unfortunate the company was planning to redeploy over 40% of the workforce affected. When pressed on the allegation that consultation procedures had not been followed by management at the factory, the spokesman stated that the company adhered to a strict code of practice and that the company took its responsibilities to its employees seriously. An investigation into the way in which the matter had been handled was ongoing and the company would not be issuing any further statements until it was completed.

Outside the factory today, there was no indication that the workers were intending to end their dispute and further action is planned for the remainder of the week. At present, S&T Footwear is confident that customers will not experience any disruption to supply, although it is possible that the big brand names will consider switching manufacture to alternative suppliers.

Appendix C – S&T Group Accounting and Controls Manual (Extracts)

S&T Group – Accounting and Controls Manual 2016

Purchases

The following procedures must be followed in all cases.

Suppliers

- All new suppliers must have been cleared through our supplier due diligence process before being added to the Approved Suppliers file
- All purchases must be made from suppliers listed in the Approved Suppliers file
- All suppliers must be subject to a competitive tender bid every 3 years
- Rotation of supplier account managers every 4 years
- All employees in the purchasing department must have completed the company training module 'S&T Group Anti-bribery policy'

Goods ordering

- A requisition must be raised by the production department/ user department and authorised by the production director/ user department manager
- A purchase order (PO) must only be raised by the purchasing department on receipt of an authorised requisition
- POs must be raised with reference to prices in the authorised supplier catalogue
- POs must be authorised by a purchasing manager
- POs exceeding HK$250,000 must be authorised by the CFO

Goods received

- All goods received must be counted on delivery at the warehouse and matched to the purchase order
- All goods received must be checked for quality and specification
- The supplier's despatch note must be signed to evidence these checks
- Goods received notes (GRNs) must be manually entered on to the inventory system within 48 hours of receipt

Supplier payment

- PDF invoices received from suppliers must be scanned into the system
- The system then performs purchase invoice matching (i.e. the PO, GRN and invoice are all matched to each other)
- Matching is accepted to a tolerance of the following differences:

  Amount: <HK$50
  Quantity: <2%
- The first-time matching-rate target is 85% of first-time matches
- Matched invoices are approved by the CFO and an automated payment is made
- Details of unmatched POs are recorded on an exceptions report and discrepancies are investigated through discussion with the supplier account manager

Inventory: standard costing system

A standard cost system is operated to allow for effective cost control. A standard cost card is set up for each new product and is approved by the production director and the finance director. For existing production, the standard cost card is reviewed and updated annually to reflect changes in costs and production methods. The standard cost per item of footwear includes the following costs:

- Raw materials
- Labour
- A proportion of variable production overheads
- A proportion of fixed production overheads

All inventory movements are recorded at standard cost as follows:

Materials purchased

DEBIT	Raw materials inventory	(@standard cost)	X	
CREDIT	Trade payables	(@ actual cost)		X
DEBIT/CREDIT	Variance		X/	X

Materials used

DEBIT	Work-in-progress (WIP)	(standard usage@ standard cost)	X	
CREDIT	Raw material inventory	(actual used @ standard cost)		X
DEBIT/CREDIT	Variance		X/	X

Labour used

DEBIT	WIP	(standard hours@ standard rate)	X	
CREDIT	Wages payable	(actual hours @ actual rate)		X
DEBIT/CREDIT	Variance		X/	X

Variable manufacturing overheads (o/h) – o/h incurred

DEBIT	Variable manufacturing o/h	(actual hours @ actual rate)	X	
CREDIT	Other payables	(actual hours @ actual rate)		X

Variable manufacturing – o/h applied

DEBIT	WIP	(standard hours @ standard rate)	X	
CREDIT	Variable manufacturing o/h	(standard hours @ standard rate)		X

Difference remaining in the variable manufacturing o/h account represents the variance

DEBIT/CREDIT	Variable manufacturing o/h		X	
DEBIT/CREDIT	Variance			X

Fixed manufacturing overhead

This is allocated to units of production on standard direct labour hours as follows:

- Estimated fixed manufacturing overheads/expected standard direct labour hours

Variances

Variances must be monitored by the production director and significant variances must be investigated.

These are recognised as follows:

- Credit variance balance (favourable): apportioned between cost of sales and inventory
- Debit variance balance (unfavourable) due to errors or inefficiencies: recognised in cost of sales
- Debit variance balance (unfavourable) other: apportioned between cost of sales and inventory

Appendix D – Internal Controls Questionnaire (Extracts)

S&T Group – Internal controls questionnaire

Prepared by: Internal audit department

Question	Y/N	Comment
Purchases		
Are all policies and procedures up to date and in writing?	Y	Set out in the accounting and controls manual.
Are these policies clearly communicated?	Y	Manual issued to all new staff as relevant.
Have all purchasing staff completed the anti-bribery training module?	Y	As confirmed by HR records/monitoring.
Have all suppliers on the Approved Supplier file been cleared through supplier due diligence?	Y	Sample selected from approved supplier file and traced back to due diligence documentation approved by the production director.
Are purchases made from approved suppliers?	N	Tests showed that purchases were being made from Win Supplies Ltd in respect of materials for the new EcoS&TGear product. Win Supplies Ltd is not on the approved list.
Are all suppliers subject to the competitive bid process every three years?	N	Supplies currently provided by KA Leather Ltd have not been subject to tender for seven years.
Is account management rotation applied every four years?	N	Account manager for KA Leather Ltd has been in place for six years.
Are requisitions approved in accordance with authorisation limits?	Y	No exceptions noted in sample.
Are current inventory levels checked before requisition is authorised?	Y	No exceptions noted.
Are purchase orders only raised in relation to authorised requisitions?	N	Exceptions noted amounting to 2% of total number of purchase orders traced.
Is a price list maintained by the purchasing department?	Y	Authorised supplier catalogue.
Are purchase orders raised by reference to authorised price list?	Y	No exceptions noted in sample.
Do controls exist over changes/additions to supplier master files?	Y	Data change request authorised by production director.
	N	Printout of changes is produced but there is no evidence of the review by production director.
	Y	Supplier master files protected by hierarchical passwords.

Question	Y/N	Comment
Are purchase orders authorised in accordance with authorisation limits?	Y	No exceptions noted.
Are there adequate access controls regarding the input of purchase orders into the purchase order database?	Y	No exceptions noted.
Is the purchasing function separated from the accounting and goods received function?	Y	Although purchase orders over HK$250,000 must be approved by the CFO.
Does management review reports on expenditure levels?	Y	Reviewed weekly by purchasing managers with issues highlighted to CFO. Reviewed monthly by CFO.
Are there clearly defined responsibilities between ordering, accepting, approving, processing and recording of inventory?	Y	Formal organisation chart sets out responsibilities.
Are goods received counted, agreed to PO and checked for quality and specification?	N	Although this policy is in place, there were a number of instances where no evidence of the checks having carried out could be found on the supplier's despatch note.
Is a GRN generated for all goods received?	Y	Customer delivery note is scanned and GRN is generated.
Are GRNs recorded into the system and the perpetual inventory records updated on a timely basis?	N	The target is that GRNs are manually entered within 48 hours of receipt. In October 2016 system problems resulted in a backlog meaning that some GRNs were not processed for 72 hours.
Is purchase invoice matching carried out by reference to mismatching tolerance levels set by management?	Y	85% first time matching target was in place.
Is the 85% first time matching target met?	N	In October 2016, the matching rate fell to 82%.
Are discrepancies investigated?	Y	Discrepancies are highlighted in an exceptions report. Discrepancies are investigated which may result in a change to the purchase order, GRN or invoice. Resulting changes are made manually. However in October 2016, there is no evidence that discrepancies were followed up.
Inventory		
Is a physical inventory count taken at least annually?	N	Counts take place on a rotational monthly basis with most major lines being counted at least once. Full year end counts to be carried out at a sample of factories and warehouses.
Are adequate inventory count instructions issued to all locations holding inventory?	Y	Standard instructions were issued although problems were identified at the Zhuhai factory count where inventory movements continued throughout the course of the inventory count.
Are inventory counts carried out by staff who are independent of receipt and despatch of inventory?	N	Warehouse staff are routinely involved in inventory counts.

Question	Y/N	Comment
Are cut-off procedures followed?	Y	Inventory is updated in real-time in respect of sales although items sold online may be held in the warehouse for the customer for up to 30 days. GRNs are entered within 48 hours of receipt of goods.
Is access to the perpetual inventory records limited to authorised individuals?	Y	No exceptions noted.
Are reconciliations of actual inventory counted and inventory records performed?	Y	No exceptions noted.
Are discrepancies investigated in a timely manner?	Y	No exceptions noted.
Is there segregation of duties in relation to the recording of transactions in the general ledger and the physical receipt and despatch of inventory?	Y	No exceptions noted.
Are adjustments to inventory authorised?	Y	Approved by factory manager and reviewed by CFO.
Are physical security controls in place at factories/warehouses?	Y	Security system and personnel at warehouses.
Is access to physical inventory restricted?	Y	Only authorised staff allowed access. Random searches of staff at intervals.
Is there adequate insurance cover?	Y	Cover reviewed by CFO in conjunction with the insurance company on an annual basis.
Do up to date standard cost cards exist for all product lines?	Y	New standard cost cards developed by production manager and agreed by production director. Existing standard costs reviewed and updated annually.
Are variances monitored and investigated?	Y	Variance reports are produced on a monthly basis and reviewed by the production director. Significant materials variances have been identified during the year.
Are production levels monitored?	Y	A production schedule is produced by the production manager and reviewed by the board at the monthly board meetings.
Are movements from raw materials to WIP controlled?	Y	Approved production plan is input and system determines materials required for production run. A bill of raw materials is produced showing materials which need to be picked and a journal entry records the transfer from raw materials to WIP. No exceptions noted.
Are the correct raw materials transferred to the production floor?	Y	Bill of raw materials signed by warehouse picker and agreed by production manager on receipt on production floor. Acceptance of materials is evidenced by a signature. No exceptions noted.

Question	Y/N	Comment
Are there adequate controls on transfer from WIP to finished goods?	N	On completion of the production run, the production director authorises the closure of the production run code on the system. This generates an entry recording the transfer from WIP to finished goods. A bill of finished goods is produced and the completed products are transferred to a distribution centre. The bill of finished goods is signed as evidence of receipt. Tests indicated a number of instances where the bill of finished goods predated the closure of the production run on the system.

Appendix E – Draft Consolidated Financial Statements and Budget

S&T Group

Draft consolidated financial statements for the year ended 31 December 2016

	Actual (Draft)	**Budget**
	HK$m	HK$m
REVENUE		
Retailers supplied wholesale	5,096	5,483
ODM customers	9,408	10,135
Retail (from S&T Retail stores)	3,920	3,798
Online	1,176	895
	19,600	20,311
COST OF SALES		
Materials cost	6,173	6,506
Manufacturing overheads (incl. labour)	8,994	9,402
	15,167	15,908
GROSS PROFIT	4,433	4,403
OTHER INCOME	306	305
SELLING AND DISTRIBUTION EXPENSES		
Distribution	979	989
Advertising	429	404
Marketing	405	439
	1,813	1,832
ADMINISTRATIVE EXPENSES		
Salaries		
Directors and seniors	271	247
Head office	158	152
Retail stores	446	399
	875	798
Premises		
Warehouse rental	373	321
Utilities	48	48
Other	119	118
	540	487
Depreciation		
Buildings	62	67
Other	49	51
	111	118

	Actual (Draft)	Budget
	HK$m	HK$m
Other admin expenses	65	74
Total administrative expenses	1,591	1,477
PROFIT BEFORE INTEREST AND TAX	1,335	1,399
FINANCE COST	44	42
PROFIT BEFORE TAX	1,291	1,357
NON-CURRENT ASSETS		
Intangible non-current assets	1,040	930
Land and leasehold properties	3,460	3,460
Plant and machinery	1,232	1,201
Other	238	271
	5,970	5,862
CURRENT ASSETS		
Inventory	2,926	2,998
Gross trade receivables	2,814	2,843
Prepayments and unamortised mould costs	529	498
Allowance for doubtful debts	(46)	(40)
Cash and bank balances	2,841	2,804
	9,064	9,103
CURRENT LIABILITIES		
Bank loans and overdrafts	1,001	995
Trade payables	1,423	1,420
Other payables	1,876	1,750
	4,300	4,165
NET CURRENT ASSETS	4,764	4,938
LONG TERM LIABILITIES		
Long term bank borrowings	860	860
Deferred tax	90	90
	950	950
TOTAL EQUITY	9,784	9,850

Appendix F – Email from Jo Fu

Received: 1 April 2016

FROM: Jo Fu JoFu@S&TGroup.net
RE: Resignation

Dear Brent,

I would be grateful if you would accept this email as notice of my resignation.

Whilst I have enjoyed the two years that I have worked as head of the internal audit department at S&T Group, I have become increasingly concerned about the lack of progress which has been made. Whilst the board appears to accept our recommendations at the time, resources do not seem to be made available to carry out our action plans on a timescale which I believe to be acceptable.

On this basis I have concluded that I am no longer able to lead this department.

Please let me know if you would like to discuss this further.

Kind regards,
Jo