

## HKICPA Business Case Competition 2023

### Supreme Accounting Company Limited

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**Extract of the introduction of Supreme Accounting Company Limited (the “Firm”) from its website:**

Supreme Accounting Company Limited is a professional service provider that offers a wide range of advisory services to businesses and individuals. Our services are designed to help clients manage their finances, comply with regulations, and make informed decisions.

One of our key services is internal audit, where we assess a company's internal controls and processes to identify areas for improvement. By conducting internal audit, we help businesses improve efficiency, reduce risks, and protect their assets.

We also offer risk assessment services to help businesses identify and manage potential risks that could affect their financial performance or reputation. Our expertise in this area allows us to develop effective strategies to mitigate these risks.

For clients involved in mergers and acquisitions, we provide comprehensive advisory support throughout the entire process. From due diligence to negotiation and integration, we leverage our financial expertise and industry knowledge to help clients make informed decisions and maximize the value of their transactions.

In response to the growing importance of sustainability, we offer advisory services to help businesses integrate sustainable practices into their operations. These include assessing and reporting on sustainability performance, developing strategies, and ensuring compliance with relevant regulations and standards.

In addition to our advisory services, we also offer bookkeeping and company secretarial services. Our bookkeeping services ensure accurate and up-to-date financial records, while our company secretarial services help businesses meet their compliance obligations.

At Supreme Accounting Company Limited, we are committed to providing high-quality advisory services that help our clients succeed in their financial endeavours.

## Your Action – Mainland and HK Undergraduate Group

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You are Anson Chan, working as a consultant of Supreme Accounting Limited. You are going to prepare a business proposal according to a discussion that was held during a meeting with Alfred Wong, who is the CEO of Brilliant Gaming Limited.

### Meeting Notes of Supreme Accounting Company Limited

Date: 31 August 2023

Attendees: Alfred Wong, CEO of Brilliant Gaming Limited (the “Company”)

Anson Chan, Consultant of Supreme Accounting Company Limited (the “Firm”)

#### **Summary:**

During the meeting, Alfred Wong met with Anson Chan from Supreme Accounting Company Limited to discuss the preparation of a business proposal. The proposal is expected to address several key points highlighted below:

#### **1. Business Strategy:**

- Evaluate the Company’s business strategy model to assess the competitive landscape and industry dynamics.
- Evaluate the Company's core competencies, competitive advantages, and potential growth opportunities.
- Identify any ethical dilemmas that may arise in the Company's recent operations, identify the fundamental principles violated, explore alternative solutions, and recommend a suitable solution.

#### **2. Performance Management Program:**

- Analyze the current performance management programme and identify areas for improvement.
- Recommend additional performance measurement indicators to assist with the expansion initiative.
- Evaluate both financial and non-financial key performance indicators (KPIs) that are appropriate for measuring performance in the context of the expansion initiatives.

#### **3. Acquisition Targets in the Gaming Sector:**

- Evaluate two potential acquisition targets within the gaming sector.
- Highlight the impact the acquisitions would have on the primary goal of expanding market shares in the gaming sector.
- Make recommendations for acquisitions based on the due diligence information gathered.

## **Your Action – Mainland and HK Undergraduate Group (Cont'd)**

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### **Action Items:**

- The Firm will prepare a comprehensive business proposal for the services that the Firm can provide in addressing the points discussed in the meeting.
- The proposal will include an evaluation of the Company using an appropriate model, an assessment of core competencies and growth opportunities, identification and resolution of ethical dilemmas, recommendations for additional performance measurement indicators, and an analysis of potential acquisition targets in the gaming sector.

### **Specifications of the business proposal**

**15-page written proposal with not more than 5-page abstract summary in English that includes:**

- **Executive summary:** This section provides a brief overview of the proposal, highlighting the key points and objectives.
- **Introduction:** This section introduces the Firm and provides background information about their expertise and experience in the industry.
- **Scope of work:** This section outlines the specific services that the Firm will provide.
- **Objectives:** This section clearly defines the goals and objectives of the proposed engagement.
- **Others:** Certain basic house-keeping information, including timeline and team members.

### **Next Meeting:**

The next meeting will be scheduled to review and discuss the business proposal prepared by the Firm.

### **Encl.**

Background information of Brilliant Gaming Limited provided by Alfred Wong, including the background information of two potential acquisition targets (Appendix)

## **Appendix 1: Background information of Brilliant Gaming Limited**

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### **Background**

Brilliant Gaming Limited ('Brilliant Gaming') operates within the digital entertainment industry. The company was established by Alfred Wong ('Alfred') five years ago as a startup company. It then developed into a flourishing, closely held incorporated entity, in which Alfred owns 60% of the equity shares. The Company is now looking for advisory services from the Firm to help it move into the next stages of growth. Alfred agrees that the move should include the enhancement of the Company's corporate governance, risk management and internal control procedures. Therefore, Alfred wishes for the Firm to provide advice on relevant aspects.

### **VISION AND MISSION STATEMENTS**

Vision statement: To be the most popular online video game provider in the world.

Mission statement: To provide our customers with fun and distraction from the stresses of life by creating online video games built with the most innovative gaming technologies.

### **INDUSTRY**

Brilliant Gaming operates in the highly competitive gaming industry, which has experienced rapid growth in recent years. The industry has been driven by technological advancements and the emergence of professional gaming, leading to an increased demand for digital entertainment. Recognizing the competitive nature of the industry, Alfred and the senior management team have requested a market summary from the Marketing Department to assess potential acquisition opportunities.

While the larger companies offer a wide range of games at comparable prices, the smaller companies have a more limited product portfolio and lower-priced options are offered. Brilliant Gaming stands out as the only company offering a game which includes multiple sports, while most competitors focus on single-sport games.

Alfred is particularly attentive to new entrants in the market. The analysis reveals that government regulations have become more lenient, leading to an increase in the number of suppliers and a downward pressure on input prices.

### **PRODUCTS**

Brilliant Gaming has achieved great success with two main products: a sporting video game and an open-world video game (i.e. an open world is a virtual world in which the player can approach objectives freely, as opposed to a world with more linear and structured gameplay.). These two games make up 80% of their game sales, while the remaining 20% comes from niche games with a smaller audience. Game sales account for 85% of their overall sales, with the rest coming from gaming peripherals.

The company developed the sporting video game in their first year and the open-world game in their second year. Both games are updated quarterly with new features and

improvements. Brilliant Gaming holds copyrights for the games' code, names, logos, characters, scripts, and accessory designs.

The sporting video game is popular because it includes multiple sports in one game, allowing players to switch between football, tennis, and other sports without leaving the game. However, it is priced higher compared to other sporting games.

The open-world game's popularity stems from being one of the first games of its kind. Players tend to stick with it because they have invested a lot of time and effort into developing their profiles. The game often depicts characters and storylines that can perpetuate stereotypes or lack diversity. Switching games may require purchasing a different gaming console, which can be a challenge in attracting new customers. One of the reasons the game is popular is because they contain certain violent and graphic content.

Both games require players to input their personal data, which will also include access to their online activities and personal information. The online multiplayer games also foster an environment that encourages the organic formation and growth of enthusiastic communities.

Brilliant Gaming also sells gaming peripherals like headsets with microphones and controllers designed specifically for their games. These accessories contribute 15% of the Company's total revenue.

## **PRODUCT DEVELOPMENT**

Alfred focuses on expanding the product line by developing new games, considering it a core competency of the company.

While Brilliant Gaming has invested in IT resources to streamline product development, some processes still require manual work, which can be time-consuming and prone to errors. The Company's Human Resources Department recently received employees' feedback about their long working hours under intense pressure to meet deadlines during the annual performance review. They expressed their hope for the Company to improve the working environment.

The Company uses a peer review system, where a team of developers reviews the code written by another team. They refer to a quality control checklist and provide feedback until the code meets all requirements. Management acknowledges the need to minimize manual steps and is exploring IT solutions, such as project management software designed for coding.

Another challenge is that the code for different games is stored in separate data warehouses, making it difficult for developers to reuse existing code from other games. Additionally, the company has implemented a new product development system, but some games developed on the old system have not been migrated, requiring the existing product teams to maintain both systems for ongoing development.

When a video game development team is spread across different regions due to remote work, project management can become a key challenge. The project manager have pointed out certain difficulties he is now facing everyday:

1. Communication and collaboration
2. Time zone differences
3. Task allocation and tracking
4. Team cohesion and morale
5. Adaptability and flexibility
6. Trust and accountability

## **SALES AND MARKETING STRATEGY**

Brilliant Gaming is considering developing a futuristic first-person shooter war game. They recognize the popularity of such game types but are cautious due to recent public feedback and criticisms. While there is an opportunity for expansion in this category, the Company is mindful of public perception and how the story and gameplay could have a potential negative influence on users. The sales and marketing team is considering the following options:

Option A: Creating a game that focuses solely on the action and excitement of war, without addressing the ethical complexities and consequences of armed conflicts.

Option B: Taking a more responsible approach – creating a game that not only provides an immersive and engaging experience but also incorporates ethical dilemmas, consequences, and the human cost of war.

## **PERFORMANCE MEASUREMENT**

Brilliant Gaming has programmes in place to measure performance at both the individual and organizational levels.

### ***INDIVIDUALS***

The company has a formal performance management programme that evaluates employees annually. Managers gather feedback on their employees' performance from five individuals they have interacted with. The feedback should come from people at different levels within the company. To ensure confidentiality, managers use a designated template for collecting feedback.

The template includes five evaluation categories that assess different aspects of performance:

1. Building positive relationships with colleagues;
2. Effective communication across all levels;
3. Meeting deadlines consistently;
4. Delivering high-quality work consistently; and
5. Demonstrating a strong work ethic and willingness to support others.

Feedback providers rate the employees' performance in each category on a scale from one to five. Comments are optional but can be provided if desired. The manager compiles a Summary Performance Report using the feedback received, along with their own observations and experiences. The report includes the same five evaluation categories and an overall performance rating. It is reviewed and approved by the manager's superior before being shared with the employee and the Human Resources Department.

A Performance Review meeting is scheduled by the Human Resources Department to discuss the feedback in the Summary Performance Report. During this meeting, the manager and employee review and discuss the feedback. Additionally, employees set SMART objectives annually, which are reviewed during semi-annual meetings with their managers. If an employee is not making sufficient progress, Alfred and the direct supervisors work together to modify goals or develop steps to help the employees make improvements.

This performance management programme promotes a comprehensive evaluation process, encourages feedback from multiple sources, and emphasizes goal-setting and ongoing development for employees.

## **ORGANIZATION**

At the beginning of each year, Alfred and the Board of Directors set goals for the company based on the management's priorities, industry trends, financial forecasts, and performance metrics. The performance metrics used include:

1. User Acquisition
2. Active Users/Player Retention
3. Average Revenue Per User
4. Churn Rate
5. Conversion Rate
6. Average Session Length
7. Customer Satisfaction
8. Technical Performance
9. Social Engagement
10. Cost per Acquisition (CPA) and Return on Investment (ROI).

To achieve these goals, the management develops strategic plans that may involve growth, acquisitions, or new game development. They also review profitability, expenses, and supplier contracts to optimize performance. Each department sets goals approved by senior management, and progress is monitored through monthly performance reports. These reports compare current performance to previous periods and include financial and non-financial metrics. Departments provide information such as sales, marketing expenses, customer feedback, demographic data, cash and assets, expenses, product development updates, technology initiatives, compliance costs, HR costs, employee performance, and audit results.

By implementing this performance measurement scheme, Alfred aims to monitor performance, identify areas for improvement, and take appropriate actions to achieve goals.



## **ACQUISITION OPTIONS**

### *Due Diligence Findings Summary for option 1:*

#### **Company Overview:**

The company is a new entrant in the video game industry.

- It currently holds a de minimis market share.
- Historically, the company has not paid dividends.

#### **Operations:**

- The company is efficiently managed by a sole proprietor.
- It employs five developers and a small administrative team.
- The administrative team handles accounting/tax, finance, compliance, and human resource functions.
- The company has a fully developed IT architecture and integrated systems, although manual intervention is required for certain tasks.

#### **Product Offering:**

- The company offers a virtual reality (VR) video game.
- The game is a first-person action game set in Medieval Europe.
- The company holds a trademark for the game's name and a patent for its functionality.
- The VR patent is valuable as it is the first and only one in the video game space.

#### **Sales and Distribution:**

- The company sells its game directly to consumers online.
- Basic customer information is available, but there are no relationships or contracts with retail stores.

#### **Legal and Compliance:**

- No open legal or compliance matters were identified.

#### **Financials:**

- The company accumulated a tax loss of HK\$250,000 in the prior tax years.
- It has two contracts with reputable suppliers, covering all necessary inputs for game manufacturing.
- The terms of these contracts are comparable to those of Brilliant Gaming's contracts with the same suppliers.

### *Due Diligence Findings Summary for option 2:*

#### **Company Overview:**

- The company has maintained steady revenue over the past two years.
- The statement of financial position shows low cash levels compared to debt.
- It is a closely held, incorporated entity.

#### **Financials:**

- The company consistently pays a 2% annual dividend to shareholders.
- It has been in operation for over six years.



- The company holds approximately 6% of the video game market in terms of annual revenue.
- The operational structure is similar to Brilliant Gaming, but on a smaller scale.

**IT Infrastructure:**

- The company relies on disparate legacy systems from historical acquisitions.
- This has resulted in development and operational issues.
- Adequate backup and recovery plans are not in place for all systems.

**Product Offering:**

- The company offers four distinct games, including a football game, an arcade-style game with multiple options, a car racing game, and a first-person military-style game.
- Overlap with Brilliant Gaming's product lines is limited to the football and car racing games.
- The company holds patents for the functionality and trademarks for the names of all four games.

**Sales and Distribution:**

- Several national and regional retail stores carry the company's games.
- Contracts are in place with most retail stores for pre-purchasing new releases.

**Legal and Compliance:**

- No open legal or compliance matters were identified.
- The company has a contract in place with three years remaining, with favorable price terms for key inputs into the video game manufacturing process.
- The price terms are 10% lower than what Brilliant Gaming is currently paying for the same components.

## **Appendix 2: Latest Financial Position of Brilliant Gaming Limited**

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Brilliant Gaming Limited (the “Company”) operates as a privately held, limited company. Alfred owns 60% of the shares and voting rights of the company. The remaining 40% is owned by four other individuals with 10% each.

The Company consistently pays a 2.5% annual dividend to shareholders.

The Finance and Accounting Department of the Company maintains comprehensive books and records that are routinely audited. Current financial statements indicate that the Company is in strong financial health. The CFO presents a financial summary report to the Board of Directors on a quarterly basis. The most recent financial result showed that the Company experiences stable revenue growth and cash flows with high liquidity.

The CFO recommended to the Board at the most recent meeting that the firm should use its liquidity to return capital to shareholders through increased dividends, acquiring a competitor or investing in new product development.

### *Policy for revenue generated from operations of online games extracted from the Company’s latest audit report*

The Company creates and sells its own games, which are free to play. Players can buy virtual currency or virtual items within the games to enhance their experience. The Company sells these virtual items and currency through its own platform and other platforms like app stores.

When the Company works with another party to provide goods or services to customers, it determines if it is responsible for providing those goods or services itself. If it is, it is considered the principal in the transaction.

Since the Company is responsible for delivering the game experience to paying players, it considers those players to be its customers. The price paid by the players is considered the total revenue. The third-party platforms and payment channels collect the payment from the players and deduct a commission before remitting the remaining cash to the Company.

When the Company sells game credits or virtual items, it also has an obligation to provide the services that allow those credits or items to be used in the games. The proceeds from these sales are initially recorded as liabilities until the services are provided to the players. At that point, the portion of the liabilities related to the consumed credits or converted items is recognized as revenue.

The Company also licenses its games and intellectual property to third parties. Any upfront licensing fees are recognized evenly over the duration of the license agreement. Royalty income from these licenses is recognized based on the terms of the agreements, including any sales-based royalties.

## Appendix 3: Statement of financial position as at 30 June 2023

### Statement of financial position as at 30 June 2023:

	<b>2023</b>	<b>2022</b>
	<b>HK\$</b>	<b>HK\$</b>
<b>Assets</b>		
<i>Non-current assets</i>		
Property, plant and equipment	296,057	282,457
Intangible assets	909,503	775,684
Deferred income tax assets	173,665	165,325
Other receivables	89,542	90,543
	<u>1,468,767</u>	<u>1,314,009</u>
<i>Current assets</i>		
Inventories	140,659	109,023
Trade and other receivables	296,457	285,223
Available-for-sale assets	240,684	236,586
Cash and cash equivalents	1,084,324	700,895
	<u>1,762,124</u>	<u>1,331,727</u>
<b>Total assets</b>	<b><u>3,230,891</u></b>	<b><u>2,645,736</u></b>
<b>Equity and liabilities</b>		
Share capital	10,000	10,000
Retained earnings	1,838,050	907,783
<b>Total equity</b>	<b><u>1,848,050</u></b>	<b><u>917,783</u></b>
<b>Liabilities</b>		
<i>Non-current liabilities</i>		
Borrowings	548,643	629,583
	<u>548,643</u>	<u>629,583</u>
<i>Current liabilities</i>		
Trade and other payables	239,332	340,313
Contract liabilities	321,543	465,827
Current income tax liabilities	98,633	85,876
Borrowings	174,690	206,354
	<u>834,198</u>	<u>1,098,370</u>
<b>Total liabilities</b>	<b><u>1,382,841</u></b>	<b><u>1,727,953</u></b>
<b>Total equity and liabilities</b>	<b><u>3,230,891</u></b>	<b><u>2,645,736</u></b>

## **Appendix 4: Statement of Profit or Loss for the year ended 30 June 2023**

### Statement of Profit or Loss for the year ended 30 June 2023:

	<b>2023</b>	<b>2022</b>
	<b>HK\$</b>	<b>HK\$</b>
<b>Continuing operations</b>		
Revenue	5,422,749	4,945,260
Cost of sales	(2,725,090)	(2,888,381)
<b>Gross profit</b>	<u>2,697,659</u>	<u>2,056,879</u>
Distribution expenses	(805,876)	(784,675)
Administrative expenses	(746,875)	(796,576)
Other income	150	80
<b>Operating profit</b>	<u>1,145,058</u>	<u>475,708</u>
Finance income	120,587	119,576
Finance expenses	(216,857)	(215,575)
<b>Profit before income tax</b>	<u>1,048,788</u>	<u>379,709</u>
Income tax expense	(94,668)	(34,576)
<b>Profit for the year</b>	<u>954,120</u>	<u>345,133</u>

## Appendix 5: Other financial information

### 1. Breakdown of revenue

	<b>2023</b>	<b>2022</b>
	<b>HK\$</b>	<b>HK\$</b>
Game sales	4,567,117	4,186,481
Accessories sales	813,086	726,793
License income	42,546	31,986
<b>Total</b>	<b><u>5,422,749</u></b>	<b><u>4,945,260</u></b>

### 2. Breakdown of intangible assets\*

	<b>2023</b>	<b>2022</b>
	<b>HK\$</b>	<b>HK\$</b>
License right and patent	402,664	325,667
Deferred development cost	506,839	450,017
<b>Total</b>	<b><u>909,503</u></b>	<b><u>775,684</u></b>

\*Note: The intangible assets represented licenses, self-developed games and development expenditure incurred in developing games and software patent with finite useful life. During the year ended 30 June 2023: HK\$267,000(2022: HK\$248,000) deferred development cost were transferred to license right.

### 3. Breakdown of contract liabilities\*

	<b>2023</b>	<b>2022</b>
	<b>HK\$</b>	<b>HK\$</b>
Receipt in advance	40,846	71,971
Deferred income	280,697	393,856
<b>Total</b>	<b><u>321,543</u></b>	<b><u>465,827</u></b>

\*Note: Typical payment terms which impact on the amount of contract liabilities are as follows:

- Receipt in advance represents the advance received from licensee
- Deferred income represents the unutilized game credit of income received in respect of in-game virtual items paid by Paying Players