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Introduction

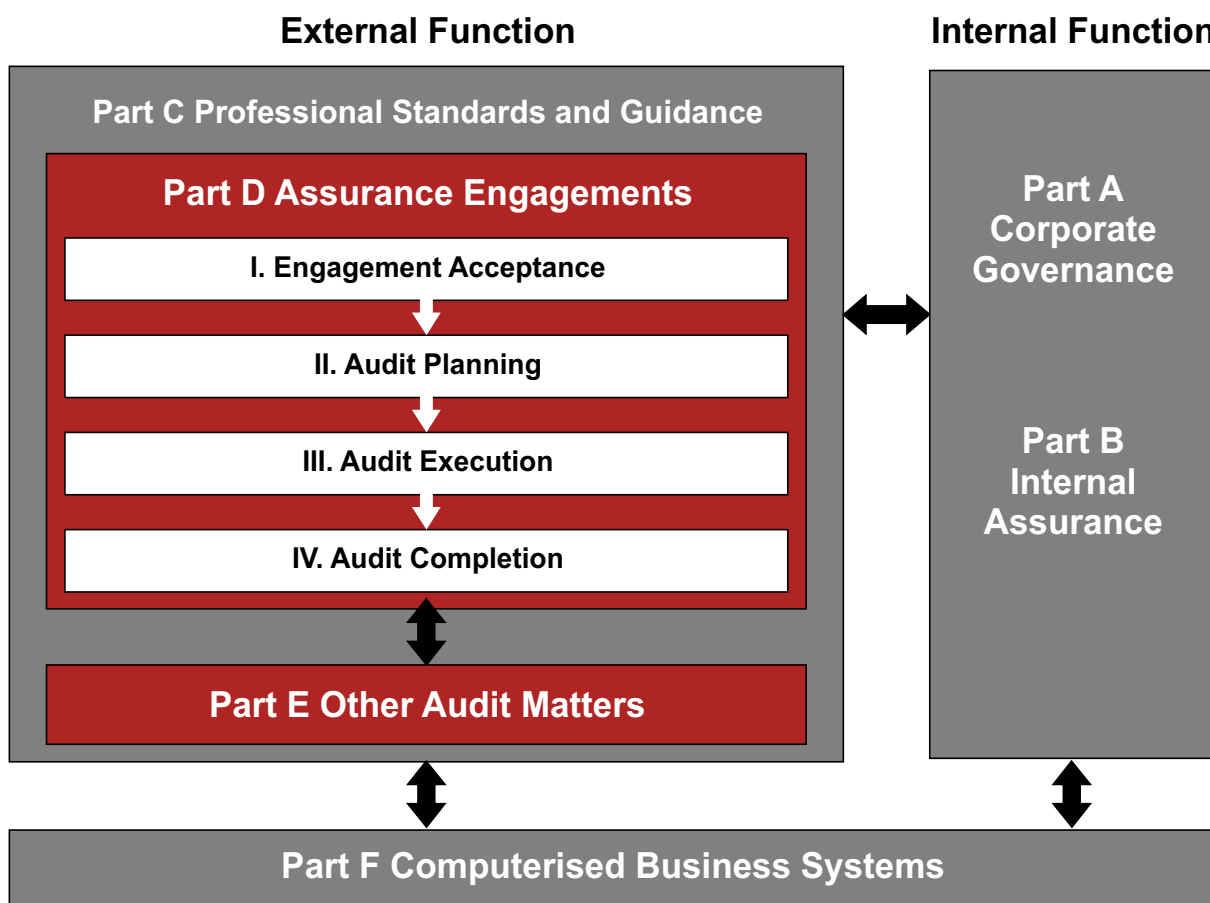
Module Aim and Structure

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 assignment 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 requirement;
- Recognise conflicts or ethical issues and advise on appropriate actions;
- Identify potential risks in accepting or continuing with an audit 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 assertions levels;
- Evaluate the internal controls of an organisation for their effectiveness;
- 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 the 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; and
- 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; 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 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); and
- 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 assertion levels;
- Ability to evaluate 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; and
- 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; 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 materials including the case 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. Corporate governance	<ul style="list-style-type: none"> • Case study • Group discussion 	Ch. 1 & 2
3. Overview of an audit	<ul style="list-style-type: none"> • Card game 	
4. Audit acceptance / continuance	<ul style="list-style-type: none"> • Case study • Group discussion 	Ch. 4 & 7
5. Audit planning	<ul style="list-style-type: none"> • Case study • Group discussion 	Ch. 8, 9, 10, 11 & 12
6. Project management in audit planning stage	<ul style="list-style-type: none"> • Group discussion 	Ch. 8
7. Conclusion	<ul style="list-style-type: none"> • Presentation • Group discussion 	
Workshop 2		
8. Reboot	<ul style="list-style-type: none"> • Presentation • Group discussion 	
9. Audit execution	<ul style="list-style-type: none"> • Individual work • Progress meeting and reporting • Group discussion 	Ch. 9 – 15, 19, 20
10. Project management in audit execution stage	<ul style="list-style-type: none"> • Presentation • Group discussion 	
11. Audit completion	<ul style="list-style-type: none"> • Group sharing • Group discussion 	Ch. 16 & 17
12. Group audit	<ul style="list-style-type: none"> • Group discussion 	Ch. 18
13. Conclusion	<ul style="list-style-type: none"> • Presentation • Group discussion 	

You are expected to have studied the relevant auditing standards, chapters of the Learning Pack and completed the pre-workshop materials (if any) 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.

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

Pre-Workshop Materials

Workshops 1 and 2

Case Background

EasyGold Jewellery Company

EasyGold Jewellery Company – Background Information

EasyGold Jewellery Company Ltd (EasyGold) is an established gold jewellery manufacturer, wholesaler and retailer. The company sells high quality fine gold jewellery, such as rings, necklaces, bracelets and chains, as well as stocking a range of high quality watches. It operates 50 luxury retail stores located in Hong Kong and mainland China and it also has an online retail store where customers can browse the full range of gold jewellery items and make purchases using credit cards.

The company was established in 1980 by a brother and sister team, Auric and Cammi Kim, who grew up in a family of skilled jewellery craftsmen. Today, Cammi and Auric are the majority shareholders and control the company as well as holding the positions of Managing Director and CEO respectively. Auric and Cammi are based at the company headquarters in Mongkok, Hong Kong although they regularly travel to each of the stores in Hong Kong and mainland China as they prefer a 'hands on' style of management which they believe results in good management within each store.

EasyGold has been highly successful and has experienced rapid growth in recent years due to an influx of tourists and investors from mainland China. The customers from mainland China have a passion for gold and view it as a financial asset which can be easily converted into cash. EasyGold's brand name has been highly popular with those from mainland China and this has meant that EasyGold has been able to pursue a strategy of rapid expansion into mainland China over the last three years, opening a number of luxury retail stores in many key Chinese cities as well as additional production units where gold jewellery is manufactured.

The company is structured around four core divisions:

- **Purchasing:** The purchasing team is based in Hong Kong and is responsible for purchasing:
 - Raw materials, including gold, for use in production
 - Finished gold jewellery
 - Watches

The team manages the relationships with suppliers and negotiates with them on quality, price and delivery terms. Where there are contracts for supply between EasyGold and a supplier the purchasing team is responsible for agreeing the terms and having the contract approved by EasyGold's legal team.

The purchasing team must also satisfy a set of criteria when making purchase decisions over gold to ensure that it meets Fairtrade & Fairmined gold standards set by the Fairtrade Foundation and the Alliance for Responsible Mining.

- **Design and production:** EasyGold is renowned for its innovative and contemporary designs as well as its high quality craftsmanship. The company produces approximately 50% of its own finished gold jewellery with the remaining 50% being purchased from other Hong Kong wholesalers and manufacturers as well as a proportion being imported from Italy. All watches are purchased from wholesalers as finished items. EasyGold has recently expanded the number of production units in order that each unit can specialise in the production of certain items resulting in increased efficiencies. Almost all production is now based in mainland China where skilled craftsmen can be hired more cheaply than in Hong Kong. However, the company employs a number of Production and Quality Managers in Hong Kong to oversee and manage the quality of items produced. The design team is also based in Hong Kong and both Auric and Cammi are heavily involved in managing the teams and approving the designs in order to ensure that the company's reputation for innovation and quality is maintained.
- **Wholesale sales:** EasyGold has wholesale agreements to sell jewellery to a number of other jewellery retailers in mainland China, Philippines, Thailand, Japan and the United States. In some cases a specific concept or design, called a commission, is created for the customer, using the customer's own brand name, and is then manufactured and sold exclusively to them. Other wholesale customers purchase EasyGold products from its wholesale catalogue and sell them to their own customers under the EasyGold brand.
- **Retail sales:** EasyGold has flagship 'concept' stores in many major towns and cities in Hong Kong and mainland China, as well as smaller 'boutique' style outlets in smaller towns, and 'concessions' in a number of high quality department stores.

The company's online retail presence was launched in 2003, however, in spite of significant investment during 2014 redesigning its 'estore', the volume of online sales has been disappointing, with customers preferring to 'see and feel' the jewellery they are buying. The website is now used predominantly as a social media and marketing tool and there are plans for the 'estore' functionality within the site to be decommissioned during May 2014.

To date the growth strategy of the company has been financed by its own success, an injection of capital by a venture capitalist during 2007 and on-going financial support from the company's bank. Furthermore, it was agreed that no dividends would be paid in 2014 and 2013 in order that cash could be reinvested in the business. Auric and Cammi Kim wish to accelerate the speed of EasyGold's growth and are therefore preparing to list EasyGold on the Hong Kong stock exchange in order to raise further funds.

The company's business strategy sets out the following targets:

- Open 25 new retail stores in mainland China in the next five years
- Open two new stores in Singapore, a market new to EasyGold, in the next year
- To build three new production units in mainland China, required in order to attain further cost effectiveness and production efficiencies

EasyGold does not plan to reappoint its current external auditors for the year ended 31 March 2014, instead the directors have approached Yin Yang & Co to become the external auditors, as they believe that Yin Yang & Co is better placed to support EasyGold in the listing process and with its growth strategy. You are an audit senior at Yin Yang & Co.

EasyGold – Financial and Corporate Structure

EasyGold is currently controlled by the Kim family. Auric and Cammi each owns 30% of the ordinary share capital with other members of the Kim family owning a further 20% in total. The remaining 20% is owned by a venture capitalist who invested in EasyGold in 2007 and is now seeking an exit strategy which will be fulfilled when the company is listed.

Business Assurance

The board of executive directors comprises:

- CEO – Auric Kim
- Managing Director – Cammi Kim
- Finance Director – John Tse

In addition, EasyGold appointed three independent non-executive directors (INEDs) during February 2014 and formed an audit committee as part of the company's preparations for listing. The INEDs are:

- William Chang – a Certified Public Accountant with 20 years' experience in industry including roles as finance director and managing director, experience in taking a company through listing.
- Kate Ma – has experience in introducing technology into production processes to support growth.
- Dr. Ron Rooney JP – a leading barrister.

The audit committee has the following members:

- William Chang – chair
- Dr. Ron Rooney
- Auric Kim

The company also has a senior executive team in place, each of whom reports directly into the board:

- Head of Purchasing
- Senior Design Executive
- Head of Production and Quality Control
- Human Resources Executive
- Head of Wholesale Sales and Business Development
- Retail Concept Executive
- Marketing Executive
- Head of Accounts Team

Production, Distribution and Sales at EasyGold

The following sets out an overview of the production, distribution and sales channels:

<p>Purchasing</p>	<p>Gold is sourced from mining and refining companies around the world. The price, usually paid in the local currency, is based on quality and the world market for gold. EasyGold has a team responsible for sourcing all gold used in the production process and the team has to meet 'fair trade and fair-Mined' criteria when deciding where to purchase from. Finished gold jewellery and watches are sourced from wholesalers in both Hong Kong and overseas. The purchasing team uses sales data and discussions with store managers and sales managers to inform their purchase decisions.</p>
<p>Design</p>	<p>A team of designers based in Hong Kong prepare contemporary designs. Major 'collections' (a group of items based around a theme) are approved by the board of directors and the senior design executive.</p>
<p>Production</p>	<p>The production process is almost entirely automated, with skilled craftsmen required for finishing certain items. Chains, such as necklaces, are made by rolling purchased gold in specialist machinery to make gold wire, which is then fed into further machinery which makes the links, to the pre-programmed design specification. The links are soldered together in a third machine. Finally the chains are cut to length in a cutting machine and the jump links, used to fasten and unfasten the necklace, are hand soldered by craftsmen.</p>
<p>Distribution</p>	<p>Items of jewellery are distributed direct from the production plant, by a specialist security firm, to either EasyGold's own retail stores or direct to other retailers (i.e. wholesale customers) according to those customers' orders.</p>
<p>Sales to wholesale customers</p>	<p>Sales to wholesale customers are made in Hong Kong, mainland China and overseas. Customers place orders for EasyGold's own products direct from its catalogue and a price and delivery date are agreed and documented by the sales team at the time of ordering. The period of credit extended to each customer varies from customer to customer. Some customers may commission a specific design and the terms and conditions of the sale are set out in a contractual agreement between the customer and EasyGold.</p>
<p>Retail sales - stores</p>	<p>Retail sales are made in EasyGold's own stores with each store manager responsible for the ordering of items from the production units, based on knowledge of the stores own particular customers and the level of inventory showing on their system.</p>
<p>Retail sales - online</p>	<p>Customers may also purchase gold jewellery produced by EasyGold through the estore on its website. Sales through this channel are fairly small and are mostly fulfilled by the production units. Where the production unit does not have the relevant item in stock, the order is fulfilled by a retail store at the production unit's request.</p>

EasyGold Inventory Valuation and Control – Finished Items

Inventory valuation

Inventory valuation for goods purchased from other manufacturers or wholesalers is recorded at the lower of cost and net realisable value.

Inventory which has been manufactured at EasyGold's own production units is valued on an average cost basis and includes a proportion of overheads based on the weight of the item and degree of complexity in its design.

Inventory control

Due to the nature of inventory being of high value and easily misappropriated, EasyGold invested in a highly sophisticated inventory control and management system during 2009. The system is a radio frequency identification technology which is capable of tracking each item of jewellery once it has been appropriately tagged in the store (see Appendix D - Case Study). Since its introduction the system has reduced theft from within stores to virtually nil and means that the company can immediately ascertain the value of inventory on hand in each store and the items held. Since 2014 the company concluded that full year end inventory counts were unnecessary and only sample counts are carried out periodically throughout the year. The system has not yet been applied to the production units and therefore full inventory counts are still carried out at these locations at the company's year end.

EasyGold Systems and Controls – Sales

EasyGold operates an established system of internal controls over sales both for the retail and wholesale businesses. The inventory control and management system which was introduced in 2009 is integrated with the sales system. Each item of jewellery in each retail outlet is tagged with a radio frequency tag. The tag monitors the location of the item of jewellery and when the tag is removed in order to sell an item to a customer the system automatically requires the sales assistant to enter the item as a sale. Inventory is automatically updated when a sale is made.

At the end of each day the retail stores must follow a defined cashing-up procedure which reconciles the sales recorded on the system that day with the days' takings – cash, cheques and credit cards. Any discrepancies are notified to and investigated by head office when they are over a pre-determined threshold set for that store.

The internal control procedures are documented and a copy is held by each store (see Appendix F).

In addition, a set of internal control procedures exists for sales to wholesale customers (see Appendix F). The sales or business development manager responsible for the sale is required to document that the relevant procedures are adhered to by completing a checklist. Checklists are reviewed by senior management.

Sales made through the internet estore are automatically recorded in the general ledger and fulfilled by the production unit where possible.

Yin Yang & Co – Background Information

Yin Yang & Co, an audit firm, has recently been approached by EasyGold to act as external auditors for the year ended 31 March 2014. EasyGold has approached Yin Yang & Co as the directors feel the firm will be able to support them during the listing process and in the company's growth strategy and the firm also has a good reputation as the auditor of Fook Gold Limited, another major jewellery retailer in Hong Kong.

The audit partner responsible for considering the engagement, Jane Wang, has asked you to assist her in the client acceptance stage and to assume the role of audit senior should Yin Yang & Co decide to accept the engagement.

To date your research has provided you with the following information:

- Industry background and commentary by Hong Kong Trade Board (Appendix B)
- Interview with Cammi Kim in 'The Jeweller', trade press magazine (Appendix C)
- Case study by Secsys of EasyGold's inventory control and management system (Appendix D)

In addition, EasyGold has provided the following information:

- Draft summary trial balance as at 31 March 2014 (Appendix A)
- Copy of internal controls questionnaire completed by auditors for year ended 31 March 2013 (Appendix E)
- Copy of extracts from internal control procedures manual for sales to retail and wholesale customers (Appendix F)

Additional Information

Financial Information Extracts

Statement of profit or loss and other comprehensive income for the year ended 31 March 2013

	Note	2013 HK\$'000	2014 HK\$'000
Revenue	2	842,568	561,712
Cost of sales		(608,782)	(403,750)
Gross profit		233,786	157,962
Distribution and selling expenses		(140,115)	(102,307)
Administrative expenses		(50,865)	(30,876)
Operating profit		42,806	24,779
Finance costs	3	(3,275)	(1,808)
Profit before taxation		39,531	22,971
Taxation	4	(7,115)	(4,594)
Profit for the year		<u>32,416</u>	<u>18,377</u>

Statement of financial position as at 31 March 2013

	Note	2013		2014	
		HK\$'000	HK\$'000	HK\$'000	HK\$'000
ASSETS					
Non-current assets					
Property, plant and equipment	5		68,201		40,986
Current assets					
Inventories		435,396		353,973	
Trade receivables	6	94,644		61,557	
Cash and bank balances		<u>19,480</u>		<u>35,765</u>	
			549,520		451,295
Total Assets			<u>617,721</u>		<u>492,281</u>
EQUITY AND LIABILITIES					
Equity					
Share capital	7	25,000		25,000	
Share premium		75,000		75,000	
Reserves		<u>346,517</u>		<u>314,101</u>	
			446,517		414,101
Non-current Liabilities					
Long term borrowings			50,000		26,160
Current liabilities					
Trade payables, deposits received and accruals	8	96,723		39,822	
Taxation payable		3,178		2,198	
Bank loan		<u>21,303</u>		<u>10,000</u>	
			121,204		52,020
Total equity and liabilities			<u>617,721</u>		<u>492,281</u>

Statement of changes in equity for the year ended 31 March 2013

	Share capital HK\$'000	Share premium HK\$'000	Retained earnings HK\$'000	Total HK\$'000
Balance as at 1 April	25,000	75,000	314,101	414,101
Profit for the year	-	-	32,416	32,416
Balance as at 31 March	<u>25,000</u>	<u>75,000</u>	<u>346,517</u>	<u>446,517</u>

Cashflow statement extract as at 31 March 2013

	2013 HK\$'000	HK\$'000
Profit before taxation		39,531
Adjustments for:		
Depreciation	18,195	
Interest expense	3,275	
(Increase) in inventory	(81,423)	
(Increase) in receivables	(33,087)	
Increase in trade payables, deposits received and accruals	<u>56,901</u>	
		<u>(36,139)</u>
Cash generated from operations		3,392
Interest paid		(3,275)
Income taxes paid		<u>(6,135)</u>
Net cash outflow from operating activities		(6,018)
Cash flows from investing activities		
Purchase of property, plant & equipment	(57,609)	
Income from sale of property, plant & equipment	<u>12,199</u>	
Net cash used in investing activities		(45,410)
Cash flows from financing activities		
Proceeds from long term borrowings	<u>35,143</u>	
Net cash received from financing activities		35,143
Net decrease in cash		<u>(16,285)</u>

Notes to financial statements for the year ended 31 March 2013

1 ACCOUNTING POLICIES

1.1 Basis of preparation

The financial statements have been prepared under the historical cost convention and in accordance with applicable accounting standards.

1.2 Revenue

Revenue comprises revenue recognised by the Group in respect of the sale of gold jewellery and watches. Revenue is reported less value added tax and after discounts and returns. An estimate is made for returns from customers after the reporting date which relate to sales made during the reporting period.

1.3 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:

Buildings	- 3% straight line
Leasehold improvements	- 15% or over the remaining term of the lease, whichever is shorter
Plant and machinery	- 12% straight line
Motor vehicles	- 20% straight line
Fixtures, fittings and office equipment	- 20% straight line

Depreciation costs are recognised as part of cost of sales, with the exception of depreciation on motor vehicles which is included as part of distribution costs.

1.4 Inventories

Inventories are valued at the lower of cost and net realisable value. Cost is determined on an average cost basis. Net realisable value is determined by reference to management estimates based on prevailing market conditions.

1.5 Foreign currencies

Transactions in foreign currencies are translated into Hong Kong Dollars at the rate ruling on the date of the transaction.

2 REVENUE

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

	2013 HK\$'000	2014 HK\$'000
China (including Hong Kong)	783,588	544,860
Rest of the world	<u>58,980</u>	<u>16,852</u>
	<u>842,568</u>	<u>561,712</u>

3 FINANCE COSTS

	2013 HK\$'000	2014 HK\$'000
On bank loans and overdrafts	<u>(3,275)</u>	<u>(1,808)</u>

4 TAXATION

	2013 HK\$'000	2014 HK\$'000
Corporation tax	<u>(7,115)</u>	<u>(4,594)</u>

5 PROPERTY, PLANT AND EQUIPMENT

	Buildings	Leasehold improvements	Plant, machinery, fixtures, fittings and equipment	Total
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Cost				
At 1 April 2014	16,214	29,527	41,909	87,650
Additions	3,407	41,978	12,224	57,609
Write off/Disposals	<u>-</u>	<u>(9,555)</u>	<u>(7,413)</u>	<u>(16,968)</u>
At 31 March 2013	<u>19,621</u>	<u>61,950</u>	<u>46,720</u>	<u>128,291</u>

	Buildings	Leasehold improvements	Plant, machinery, fixtures, fittings and equipment	Total
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Depreciation				
At 1 April 2014	7,397	10,357	28,910	46,664
Charge for the year	579	8,999	8,617	18,195
Write Off/Disposals	-	(1,789)	(2,980)	(4,769)
At 31 March 2013	<u>7,976</u>	<u>17,567</u>	<u>34,547</u>	<u>60,090</u>
Net book value				
At 31 March 2013	<u>11,645</u>	<u>44,383</u>	<u>12,173</u>	<u>68,201</u>
At 1 April 2014	<u>8,817</u>	<u>19,170</u>	<u>12,999</u>	<u>40,986</u>
6 TRADE RECEIVABLES				
		2013	2014	
		HK\$'000	HK\$'000	
Gross trade receivables		105,160	68,396	
Allowance for receivables		(10,516)	(6,839)	
Trade receivables		<u>94,644</u>	<u>61,557</u>	
7 SHARE CAPITAL				
		2013	2014	
		HK\$'000	HK\$'000	
Share capital called up, allotted and fully paid		<u>25,000</u>	<u>25,000</u>	
8 TRADE PAYABLES, DEPOSITS RECEIVED AND ACCRUALS				
		2013	2014	
		HK\$'000	HK\$'000	
Trade payables		82,214	29,866	
Deposits received		12,541	5,973	
Accruals		1,968	3,983	
		<u>96,723</u>	<u>39,822</u>	

Appendix A – Draft summary trial balance

In order to assist your research into EasyGold John Tse has provided you with a draft summary trial balance, extracted from the general ledger, as at 31 March 2014, before year end accounting adjustments have been made.

	Debit HK\$'000	Credit HK\$'000
Revenue		1,121,825
Purchases	814,483	
Distribution costs	96,321	
Selling expenses	74,721	
Administrative expenses	48,869	
Finance costs	5,875	
Buildings – cost as at 31 March 2014	33,678	
Leasehold improvements – cost as at 31 March 2014	74,462	
Plant and equipment – cost as at 31 March 2014	28,767	
Fixtures and fitting – cost as at 31 March 2014	18,449	
Motor vehicles – cost as at 31 March 2014	5,117	
Buildings – accumulated depreciation as at 31 March 2013		7,976
Leasehold improvements – accumulated depreciation as at 31 March 2013		17,567
Plant and equipment – accumulated depreciation as at 31 March 2013		20,321
Fixtures and fitting – accumulated depreciation as at 31 March 2013		10,329
Motor vehicles – accumulated depreciation as at 31 March 2013		3,897
Inventory as at 31 March 2013	435,396	
Trade receivables	160,416	
Allowance for receivables as at 31 March 2013		10,516
Cash in bank	53,513	
Cash on hand	2,765	
Trade payables		111,573
Deposits received		19,178
Bank loan		83,133
Share capital		25,000
Share premium		75,000
Reserves as at 31 March 2013		346,517
	<u>1,852,832</u>	<u>1,852,832</u>

The following year-end adjustments are yet to be made:

- Depreciation charges for the year
- Inclusion of inventory at 31 March 2014
- Allowance against receivables at 31 March 2014
- Accruals at 31 March 2014
- Estimation of year end income tax liability

Appendix B – Industry comment

Research on jewellery sector in Hong Kong

Prepared by Hong Kong Trade Board

January 2014

1. Introduction and overview of the Hong Kong jewellery market

The Hong Kong jewellery industry can be divided into two main categories: precious metal jewellery and imitation jewellery. In terms of production and sales volume, more than 90% of Hong Kong's total exports of jewellery are made of precious metal.

Manufacturers in Hong Kong specialise in creating contemporary design jewellery. Jewellery 'made in Hong Kong' is highly renowned all over the world and attains a higher standard of craftsmanship over its counterparts in other South East Asian countries. In particular, Hong Kong leads the world in the production and consumption of 24kt gold.

Many manufacturers have moved their production facilities to mainland China, especially mass production and labour intensive jewellery. Shenzhen is developing at a fast pace in chain-making and jewellery casting from medium to low end price range; in Panyu county around 250 factories are found, the majority belonging to Hong Kong manufacturers that produce high quality gold jewellery. These companies maintain their facilities in Hong Kong for design output, management and control.

While European counterparts concentrate efforts on producing high-ticket value items and promoting brand image, local manufacturers specialize instead in offering contemporary and innovative designs, with good quality and a competitive pricing strategy. Even though Italian designs are famous all over the world, local importers find them too expensive and a high labour cost in Italy. As a result, demand for imports is relatively limited for high end jewellery.

2. Production

Hong Kong has diminished its own production capacity in precious metal jewellery. Manufacturers have established new factories in Shenzhen and Panyu, both within the Guangdong Provinces to capitalize on lower production cost for labour intensive jewellery.

A growing number of Hong Kong owned jewellery factories either produce and distribute their own branded collection or enter into franchising agreements with other local companies. In fact some key players have established their own retail network not only in Hong Kong, but have also expanded into mainland China, Taiwan and other South East Asian countries.

Recent technological development allows mass production of jewellery products with good quality and competitive prices. A number of larger establishments, such as EasyGold Jewellery Company, have made use of sophisticated and automated production equipment. These manufacturers integrate advanced production techniques, such as electroforming, with handicraft skills to enhance their efficiency. They install computer-aided design and manufacturing systems.

3. Sales and and distribution

The larger jewellery establishments operate in the manufacture, wholesale and retail of jewellery. Smaller establishments will focus on either wholesale or retail and will purchase their products from the larger manufacturers. Some wholesalers and retailers may, with sufficient buying power, commission manufacturers to produce designs specifically for them to sell, often under their own brand name.

International fashion houses also command the production of jewellery to accessorize their garment collections – as in the case of Gucci, Prada, Chanel, YSL, Christian Dior, Versace, etc. Jewellery is specially designed to complement the signature look of the fashion house and is either sold in a specialized jewellery store or inside the boutiques.

The jewellery retail market in Hong Kong caters for both the needs of local residents and tourists alike, with sales to the latter accounting for 50% of total turnover. As of December 2013, sales of jewellery, watches and precious gifts increased by 12.9% in value in comparison to the same month of the previous year. Local government has also introduced various measures to attract tourists from other countries in the Asian region, in particular mainland China. The Hong Kong Tourism Board stated that a record figure of nearly 60 million visitors arrived in Hong Kong during 2013.

Online shopping has not diffused in Hong Kong as it has in other countries as Hong Kong enjoys geographical proximity and local consumers have a habit to shop around before they buy. Jewellers face intense competition in price, design and quality. Even though conducting business through the internet, either B2B or B2C, has gained momentum all over Asia especially Japan, Australia, South Korea and Taiwan, its development in the jewellery sector in Hong Kong is still quite limited. Jewellers have opened their websites as a major communication channel to release latest product information and to collect data from prospective clients. Hong Kong has a broadband network which is efficient and advanced.

4. Outlook

Building on Hong Kong's reputation for style, quality and craftsmanship, as well as strong interest from mainland consumers, local jewellery exports and domestic sales are expected to grow.

Slow growth in the US and European markets may impact some manufacturers who have targeted these markets specifically, however the growth in the Chinese and domestic markets should provide sufficient opportunities. Some consolidation of companies is expected as the industry moves from small quality craftsmen to large high precision industrial manufacturing.

Appendix C – Article from 'The Jeweller' magazine

The rise and rise of EasyGold

The Jeweller interviews Cammi Kim, Managing Director of the prestigious EasyGold jewellers to find out what has made this family business into such a successful company



“...we need to act quickly to ensure EasyGold can grow fast enough to meet demand.”

The Jeweller: Cammi, what is it about EasyGold that has made it such a popular brand?

Cammi Kim: Auric and I have always held the belief that quality comes first, we come from a line of skilled jewellery craftsmen and even though more of our processes are becoming highly automated they still have to stand the quality test.

TJ: So with such rapid expansion and moving almost all production to mainland China how do you ensure quality standards don't fall?

CK: Auric and I are both very hands on with the business – we don't spend much time at head office but prefer to visit the retail stores to make sure they are delivering on service, talk to our wholesaler customers and visit our production units to check quality. We also have a very talented management team who are constantly at the production units on the mainland carrying out formal checks on quality and making corrections when necessary.

TJ: And what about staff training?

CK: All staff are put through the EasyGold academy when they join us. The academy is designed to impart the values of the organization right from sourcing fair-trade and fair-mined gold through to wrapping our customers' purchases. We've also invested in a company-wide learning system which provides all our staff with on-the-job real-time training right when they need it.

TJ: So what are your biggest challenges right now?

CK: The market continues to expand and we need to act quickly to ensure EasyGold can grow fast enough to meet demand. We need to invest heavily in new stores and production units. The problem with the Hong Kong property market is the short leases. We spend a fortune on leasehold improvements to achieve the high specification of our retail premises synonymous with the EasyGold brand, but some leases might be only as long as 3 years which is barely time to establish the store before we are renegotiating the lease. We also have to think beyond the Chinese market, which is a substantial proportion of our revenue, so we are looking to expand overseas. We are starting with Singapore but it is harder in markets that we don't know as well as the domestic market.

TJ: How will EasyGold fund such an expansion?

CK: We plan to list the company at the end of 2014, our venture capitalists are seeking an exit so its an ideal opportunity and other successful listings in this market have shown there is an appetite to invest.

TJ: Is it true that you have been invited to sponsor the Miss Hong Kong contest?

CK: Yes! We are working on the prize right now!!!

Appendix D – Case study by Secsys

CASE STUDY

Secsys Limited

EasyGold implements Secsys radio frequency identification technology



“Since implementing Secsys radio frequency identification technology, there have been virtually no internal thefts. Prior to implementing this technology, missing items would go unnoticed until a month or two later. Periodic inventory checks performed manually usually took 2-3 working days to audit all stores, costing valuable company time and resources. With the new system, it takes about 10 minutes to audit the entire inventory.” Cammi Kim, EasyGold Managing Director

The challenge: Problems with Security and Inventory

In the past, EasyGold experienced substantial financial loss as a result of missing jewellery attributed to internal theft and wasted resources employed in controlling and counting inventory. The situation led to major accounting problems with inventory, and EasyGold approached Secsys to provide a technology solution which could monitor sales and in-store activities and keep track of inventory at its growing number of stores.

The solution

Following a trial EasyGold rolled out the Secsys system to all its major stores.

Each piece of jewellery in the shop is fixed with a tag before being placed on display. The tags carry stored data and use radio waves to automatically identify items.

Radio frequency readers are installed within the shelves, at the entry and exit point of the shop, and in front of the safe door. The system was customized to monitor, track and control all items within the store based on company policies. The system reacts and responds to the behaviour of employees, and alarms alert the manager if company policies in handling goods are not met. Each employee is issued a radio frequency badge which is used to log their activities and enables them to access the jewellery without setting off any alarms. The system is programmed to give EasyGold employees one minute to transfer an item of jewellery from its case to the customer display tray or any other display. Any abnormal behaviour in handling the goods while executing operations such as sales, transfers, consignments or safe replenishment will set off an alarm.

At the end of each day, the system identifies and records the goods being transferred to the safe.

Additional services, such as the transfer of items from one shop to another, consignments, and returns from customers, are all tracked using the radio frequency readers.

Customer profile

EasyGold
Hong Kong
Jewellery retailer

Benefits

- Internal theft reduced to zero
- Real-time alerts for mishandled goods
- Improved inventory management and inventory control
- Instantaneous auditing of in-store inventory
- Real-time view of in-store operational activity
- Reports on customer behaviour and preferences



About Secsys



Secsys is a Hong Kong based company which leads the market in radio frequency identification technology and supplies many leading organizations in Hong Kong and internationally. For more information on our products visit www.secsys.com.hk

Appendix E – Internal control questionnaire prepared by prior year external auditors

Prepared By: ABC
 Date: 11 Feb 2013

EasyGold

INTERNAL CONTROL QUESTIONNAIRE

Purpose: To obtain background information on the control environment and existing controls for the entity as a whole.

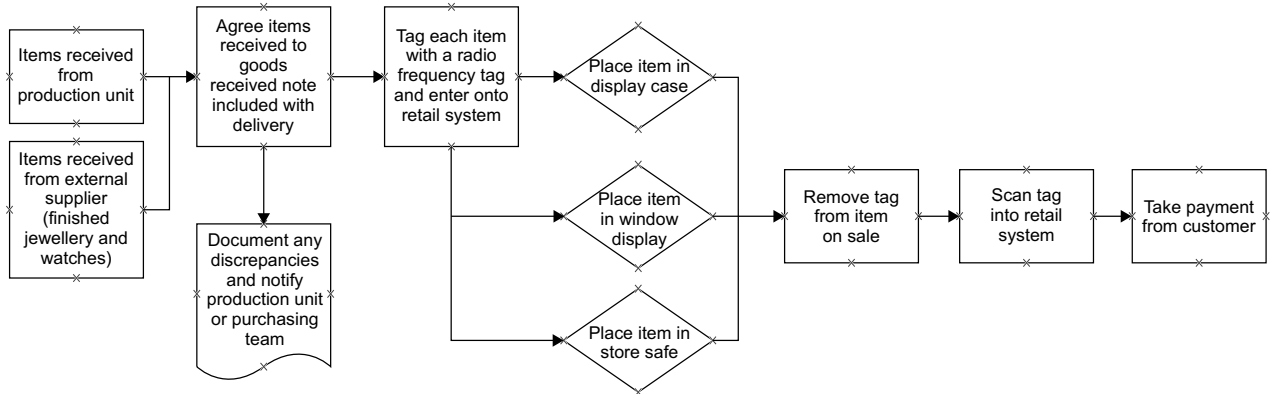
QUESTION	RESPONSE	Initial/Date
ETHICAL ENVIRONMENT		
Do board members and senior executives set a day-in, day-out example of high integrity and ethical behaviour?	Yes	ABC 11/2/13
Is there a written code of conduct for employees? Is it reinforced by training, top-down communications and periodic written statements of compliance from key employees?	A code of conduct is issued to all employees annually who confirm their understanding in writing. The HR executive is tasked with carrying out relevant and timely training.	ABC 11/2/13
Are performance and incentive compensation targets reasonable and realistic, or do they create undue pressure for short-term results?	A system of annual budgetary control is in place. Store managers and production unit managers are incentivized to meet budgetary targets through a bonus compensation scheme.	ABC 11/2/13
Is it clear that fraudulent financial reporting at any level and in any form will not be tolerated?	Yes	ABC 11/2/13
Are ethics woven into criteria used to evaluate individual and business unit performance?	Yes. The company has, and communicates, an ethical standards policy at all levels of the organization.	ABC 11/2/13
Are business risks identified and candidly discussed with the board of directors?	Senior management and store managers regularly meet with a member of the board to discuss risks facing their part of the business.	ABC 11/2/13
RISK ASSESSMENT AND CONTROL ACTIVITIES		
Is relevant, reliable internal and external information timely identified, compiled and communicated to those positioned to act?	The company produces monthly management accounts which are distributed to senior management who then report on the performance for their part of the business. Senior managers prepare a monthly board report which is discussed by the board of directors.	ABC 11/2/13
Are risks identified and analyzed and actions taken to mitigate them?	Risks identified during board meetings are assigned to a director or senior manager for analysis and appropriate action.	ABC 11/2/13

Business Assurance

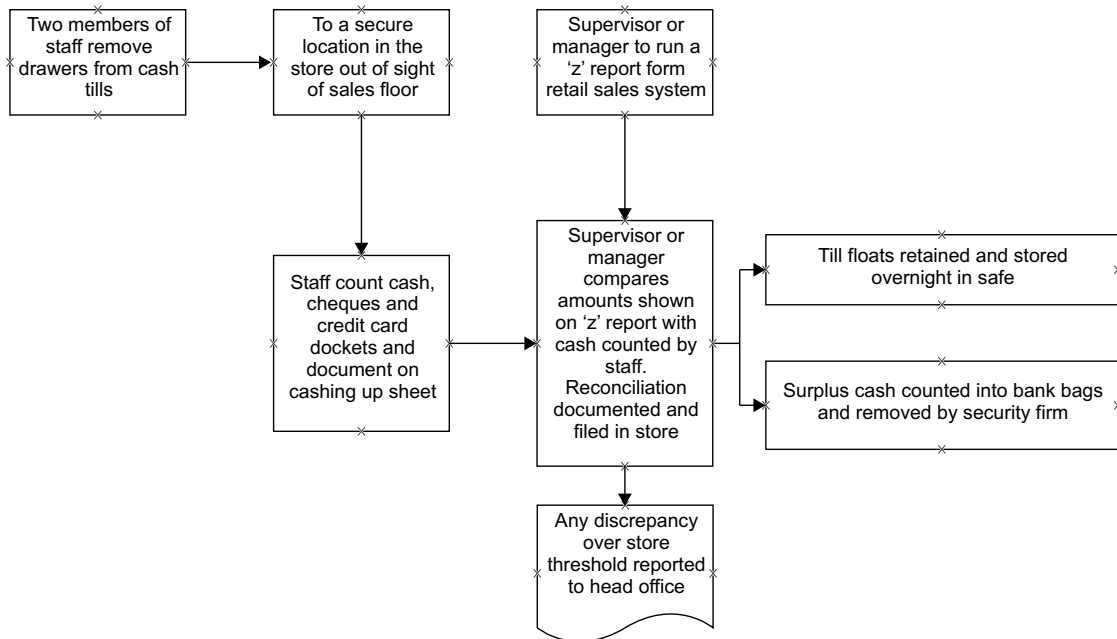
QUESTION	RESPONSE	Initial/Date
Are controls in place to ensure management decisions are properly carried out?	The directors of the business are very "hands-on" and monitor the implementation of board decisions	ABC 11/2/13
Does management routinely monitor controls in the process of running the organization's operations?	A small internal audit department is in position	ABC 11/2/13
Are periodic, systematic evaluations of control systems conducted and documented?	Carried out and documented by internal audit	ABC 11/2/13
AUDIT COMMITTEE EFFECTIVENESS		
Has the board recently reviewed the audit committee's written charter?	There is presently no audit committee in place however the company is considering a listing and therefore will put one in place in order to meet listing requirements	ABC 11/2/13
Are audit committee members functioning independently of management?	n/a	ABC 11/2/13
Do committee members possess an appropriate mix of operating and financial control expertise?	n/a	ABC 11/2/13
Does the committee understand and monitor the broad organizational control environment?	n/a	ABC 11/2/13
Does the committee oversee existence of and compliance with ethical standards?	n/a	ABC 11/2/13
INTERNAL AUDITING FUNCTION EFFECTIVENESS		
Does internal auditing have the support of top management, the audit committee and the board of directors?	Yes. Internal audit was put in place by the board	ABC 11/2/13
Is the organizational relationship between internal auditing and senior executives appropriate?	Internal audit report into the finance director	ABC 11/2/13
Does internal auditing have and use open lines of communication and private access to all senior officers and the audit committee?	Yes	ABC 11/2/13
Is there an internal audit plan (reviewed by the audit committee) describing internal audit responsibility?	Yes, but reviewed by the board	ABC 11/2/13

Appendix F – Extracts from EasyGold internal control procedures manual – sales

(i) Retail sales procedures – handling of items for sale



(ii) Retail sales procedures – daily cashing up process



Z-report: A z-report can be run from all company tills detailing the total takings for that till on any particular day.

(iii) Wholesale sales procedures

