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# Introduction

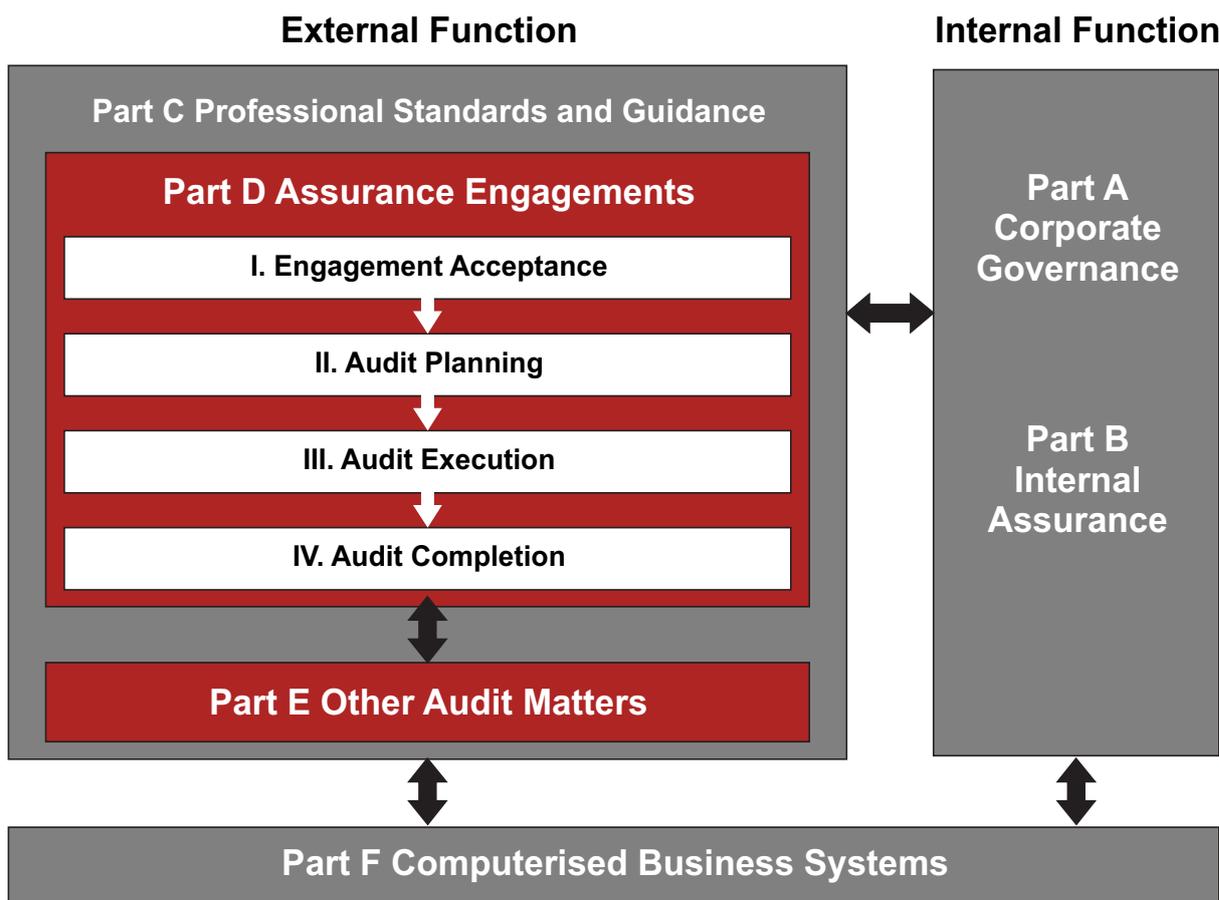
## Module Aim and Structure

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

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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

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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 effectiveness of internal controls of an organisation.
- 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.
- 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

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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

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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

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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
<b>Workshop 1</b>		
1. Introduction	<ul style="list-style-type: none"> <li>• Presentation</li> <li>• Group discussion</li> </ul>	
2. Corporate governance	<ul style="list-style-type: none"> <li>• Case study</li> <li>• Group discussion</li> </ul>	Ch. 1 and 2
3. Overview of an audit	<ul style="list-style-type: none"> <li>• Card game</li> </ul>	
4. Audit acceptance/ continuance	<ul style="list-style-type: none"> <li>• Case study</li> <li>• Group discussion</li> </ul>	Ch. 4 and 7
5. Audit planning	<ul style="list-style-type: none"> <li>• Case study</li> <li>• Group discussion</li> </ul>	Ch. 8 – 13
6. Project management in audit planning stage	<ul style="list-style-type: none"> <li>• Group discussion</li> </ul>	Ch. 8
7. Conclusion	<ul style="list-style-type: none"> <li>• Presentation</li> <li>• Group discussion</li> </ul>	
<b>Workshop 2</b>		
8. Reboot	<ul style="list-style-type: none"> <li>• Presentation</li> <li>• Group discussion</li> </ul>	
9. Audit execution	<ul style="list-style-type: none"> <li>• Individual work</li> <li>• Progress meeting and reporting</li> <li>• Group discussion</li> </ul>	Ch. 3, 5, 9 – 15, 19, 20
10. Project management in audit execution stage	<ul style="list-style-type: none"> <li>• Presentation</li> <li>• Group discussion</li> </ul>	
11. Audit completion	<ul style="list-style-type: none"> <li>• Group sharing</li> <li>• Group discussion</li> </ul>	Ch. 16 and 17
12. Group audit	<ul style="list-style-type: none"> <li>• Group discussion</li> </ul>	Ch. 18
13. Conclusion	<ul style="list-style-type: none"> <li>• Presentation</li> <li>• Group discussion</li> </ul>	

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 for Workshops 1 and 2

#### Top-fit Body Building Limited ('Top Body')

##### Background Information

You are a senior audit manager at Wong Lam & Co. ('Wong Lam'), a medium-sized audit and assurance firm in Hong Kong. Wong Lam has been the external auditor of Top-fit Body Building Limited ('Top Body') for a number of years. Top Body operates a successful chain of seven fitness centres located in prime locations throughout Hong Kong, such as Wanchai, Causeway Bay and Mong Kok. The first centre opened in Wanchai in 2002 and Top Body has added a new centre to its fitness chain at an average rate of one centre for every two years.

The first centre was owned and founded by Kevin Lai, who having worked as an instructor in the fitness industry in his whole life, decided to be his own boss and took the opportunity to invest an inheritance he received in 2001 to set up Top Body's first fitness centre.

Top Body quickly became very successful and was popular with Hong Kong office workers who looked for flexible and innovative ways to exercise and maintain a healthy lifestyle in a modern and up-market environment. Kevin Lai reinvested cash generated from the fitness centre in Wanchai to expand the Top Body brand to other locations throughout Hong Kong. Cash flow was sufficiently available for operation and expansion as Top Body sold many 'lifetime' memberships meaning that customers paid large amount of fees up-front in order to secure their long term memberships. The Top Body brand became something of a 'must-have' fashion statement amongst professional office workers and consequently Top Body was also able to generate substantial revenue through signing up large-sized companies to corporate style memberships for their employees.

Top Body offers the following facilities at each fitness centre:

- Fitness training facilities, including fitness studios for classes and a gymnasium incorporating cardio and resistance machines as well as free weights. Top Body has a reputation in the market place for always having the latest equipment and training members using the latest fitness techniques.
- Indoor swimming pool, steam room, sauna and Jacuzzi.
- Personal trainers.
- Top Body KitShop selling health and fitness supplements, small fitness equipment, such as hand weights, gloves, yoga mats etc. and accessories such as towels, swimming costumes, shampoo etc.
- Top Body iEat internet café serving lunches, snacks and drinks and where free Wi-Fi is available to members.

Top Body generates revenue from its members in the following ways:

- Individual memberships:
  - Up-front joining fee (one-off payment).
  - Up-front lifetime membership fee (one-off payment).
  - Monthly membership fee (collected in advance by direct debit).

- Corporate memberships:
  - Monthly membership fee from the company for each employee who is a corporate member.
  - Monthly membership fee from the employee (subsidised by their employers and collected in advance by direct debit).
- Fitness classes:
  - The sale of the monthly 'ClassPass' allowing the member to attend 15 or 20 classes in the month (lifetime members can attend as many classes as they wish for free).
- Personal training sessions:
  - One-off training session with a personal trainer.
  - The sale of the monthly 'TrainPass' allowing the member to book up to eight sessions in the month with a personal trainer.
- Sales in Top Body KitShop and iEat internet café are settled by cash, credit or debit card. Lifetime members can add their purchases to their accounts and settle with their membership fee on a monthly basis by direct debit or credit card.

### **Top Body's Financial and Corporate Structure**

In 2011, the popularity and growth of Top Body fitness centres attracted the attention of GlobeFit Inc. ('GlobeFit'), a listed US company operating fitness centres in the US, UK and Australia under local brand names. Wishing to extend its reach into the Asian market, GlobeFit offered Kevin Lai a deal in order to acquire the shares in Top Body. Kevin agreed to sell 80% of his shares to GlobeFit on the condition that he remains on the board of directors of the Hong Kong based operation of Top Body as well as retains a 20% stake in Top Body.

Kevin Lai continues on the Top Body's board of directors today which consists of the following:

- Chairman – Mr. Donald Lim
- Chief Executive Officer (CEO) – Mr. David Pao
- Chief Financial Officer (CFO) – Mr. Kenneth Luk
- Managing Director (MD) – Mr. Kevin Lai
- Non-executive director and GlobeFit representative – Mr. Adrian Lin
- Non-executive director – Mr. Ali Shen

### **The Hong Kong Fitness Industry**

The Hong Kong fitness market is expanding rapidly and is being heavily influenced by the more advanced fitness markets in the US, UK and Australia. Hong Kong residents are becoming increasingly health-conscious and are willing to pay a premium for fitness products, including fitness centre memberships.

There are increasingly diversified ways to keep fit in Hong Kong, including martial arts, Thai boxing, yoga, dance classes – from salsa to ballet – and body-conditioning training regimens including the most popular 'boot camp' style programs. The growing market is responding to Hong Kong's demand for the latest trend and to its thrill-seeking consumers. Over the last two years, Hong Kong has seen an explosion in the number of new entrants to the fitness market, many being imported from overseas.

Personal trainers have been popular, particularly with those in high pressured jobs who need to get the most out of their limited time in the fitness centre. However, recent publicity has exposed a proportion of bad personal trainers who demonstrate little knowledge in the latest fitness techniques and who don't know how to teach their clients to follow a proper diet in order to maintain an overall healthy lifestyle.

Hong Kong residents also look for a one-stop shop to provide all of their health and lifestyle needs with emphasis not only on fitness but also on health and well-being. Time deprived office workers increasingly seek out ways to relax and reinvigorate themselves but don't want to subscribe for

these services with a different provider to their current fitness memberships. Therefore, there is also a developing trend of fitness centres to offer spa treatments, personal grooming and alternative therapy services.

The importance of physical fitness has also been promoted by the Hong Kong government through a study in 2014/15 'The Physical Fitness Test for the Community'. The objectives of the study were to enable individuals to gain a general understanding of their physical fitness condition; build up a physical fitness database of Hong Kong people; identify the relationship between physical exercise patterns and the physical fitness of Hong Kong people; and identify priority areas for improvement to enhance the overall physical fitness of the public. The main reasons for the lack of exercise cited by adults participating in the study were tiredness, laziness and lack of time. The study collected the following data in relation to obesity levels and concluded that the majority of the general public did not undertake sufficient physical activities to maintain good health.

	Underweight		Normal		Overweight		Obese	
	Male (%)	Female (%)	Male (%)	Female (%)	Male (%)	Female (%)	Male (%)	Female (%)
Adolescents	15.5	21.0	66.0	69.5	13.2	7.4	5.3	2.1
Young adults	6.8	14.0	39.1	60.1	19.3	13.3	34.8	12.6
Middle-aged adults	2.1	3.5	31.4	48.1	26.2	21.7	40.3	26.7
Elderly	5.4	3.0	31.7	37.1	28.7	19.1	34.2	40.8

Source: Hong Kong Monthly Digest of Statistics, February 2015  
Census and Statistics Department, Hong Kong Special Administrative Region

The results have led the Hong Kong government to further promote sport and fitness through a number of initiatives, including government's provision of fitness facilities for the elderly and an action plan to promote healthy diet and physical activity participation.

The industry operates under a large number of health and safety regulations, compliance with which is regularly monitored by government departments. Relevant certification and licences for operation are required and where serious breaches of regulations are found, the authorities have the power to either temporarily or permanently revoke licences. Licences must be held by both the company offering fitness centre facilities and by the individuals providing any kind of fitness instruction to members.

There are also a large number of health and safety and environmental regulations which must be complied with in relation to occupational health and safety for employees, management of swimming pools and heavy equipment etc.

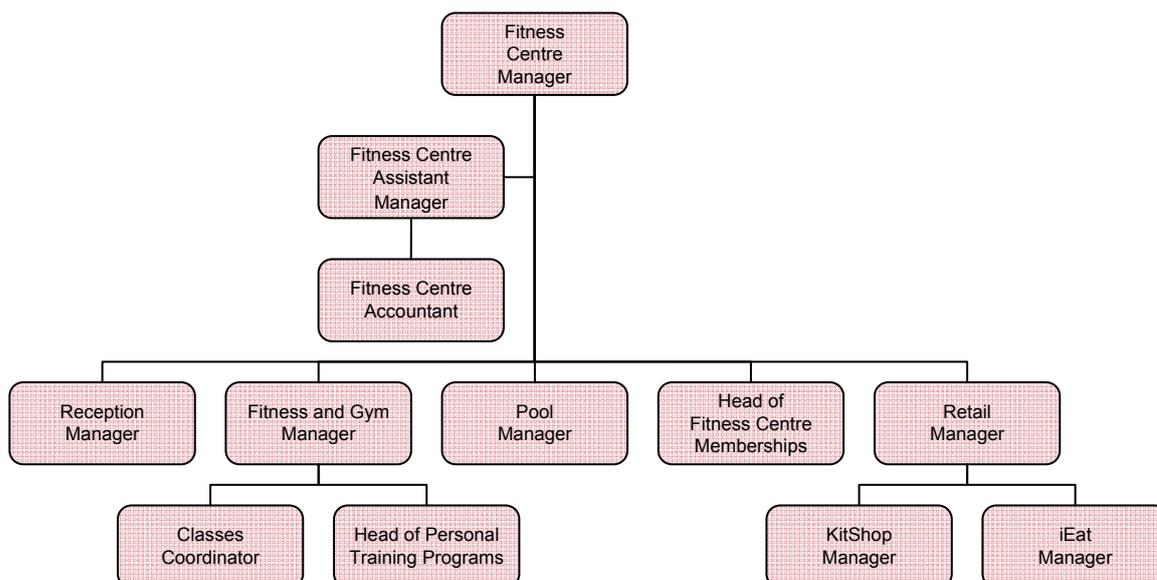
### Top Body Management

The board of Top Body oversees the strategic direction of the business, along with the centralised functions of finance, human resources and memberships, from the head office in Wanchai. The head office finance team reports to Kenneth Luk, CFO, and the human resources and membership teams report to Kevin Lai, MD.

The company's employment, health and safety and environmental policies are written centrally and communicated to each of the fitness centre managers using the company intranet.

Operational management is devolved to each fitness centre manager who is responsible for the day to day running of his or her local fitness centre, recruitment and training of employees (including freelance fitness instructors), local memberships, centre's compliance with health and safety and environmental regulations, and budgeting for and reporting on (to head office) its own centre's financial performance. This devolved style of management was necessary for Kevin Lai to grow the business from the original Wanchai location and for him to be sufficiently involved in the start-up of new fitness centres throughout Hong Kong. This management culture remains in place today.

The specific management structure at each fitness centre is determined by the individual fitness centre manager but typically includes the following areas of responsibility:



Each centre has its own accountant who is responsible for managing and recording the centre's transactions in the central accounting system, preparing an annual budget for presentation to the board as well as preparing a quarterly forecast. Each fitness centre manager prepares a monthly board report for the directors and attends the monthly board meeting on a quarterly basis, with the fitness centre managers rotating so that they do not all attend at the same meeting.

There is no internal audit function, although members of the board and senior management do visit individual fitness centres on a regular basis to ascertain whether operations are being managed appropriately. The directors take the quality of the service provision at each fitness centre very seriously and in 2015, it introduced a 'secret member' program. The program uses an external agency to regularly visit each fitness centre as a member and report on its performance on key criteria. The results are summarised and shared across the entire company on a quarterly basis. Fitness centre managers are responsible for updating the board on their progress on any necessary improvements on areas identified by the secret member, through the monthly board report.

Since Top Body was acquired by GlobeFit, Top Body has been the subject of visits by GlobeFit's own internal auditors, both at the head office and the fitness centres. Wong Lam has found that the work of this internal audit team is reliable.

### Top Body's Employees and Freelancers

Most employees hold employment contracts with Top Body. These employees tend to work in the membership teams (see below), fitness centre facilities management or head office functions. However, a significant number of the fitness and class instructors, and personal trainers working in the fitness centres operate on a freelance basis. Those working on a freelance basis usually commit to provide fitness services to Top Body and its members for a fixed number of hours per week, with the length of those commitments ranging from three to twelve months. On some occasions, when shortages arise or to cover sickness, a freelance instructor may be hired to cover a single class or a few hours of instruction. Freelance instructors bill Top Body on a monthly basis in arrears for the number of instruction hours delivered at their own pre-agreed rates.

## Membership Generation

Top Body has two membership teams, individual and corporate, run by Horace Lai, from the company's head office, based above the fitness centre in Wanchai.

The individual membership team generates new memberships through extensive promotion in the press, including TV, and marketing campaigns on social network sites and by email and post. The marketing campaigns often include extending invitations to non-members for free trial of the fitness facilities for a short period of time.

Each fitness centre also has its own local membership team which is responsible for showing prospective members of the facilities, encouraging them to sign up for membership and completing the necessary paper work, including the membership agreement. The local membership team works closely with the head office team, so it is aware of the marketing campaigns as they happen.

The corporate membership team visits companies located in the vicinity of each fitness centre to discuss potential corporate deals with the companies' human resources departments. The corporate membership team works on persuading the prospective customer of the benefits to their businesses of having fit and healthy employees as well as the allure for employees of having a fitness centre membership included in their remuneration. The corporate membership team is also responsible for finalising the paper work and contracts with each corporate customer.

The individual membership team, including the local membership teams, and the corporate membership team are incentivised to maximise the number of new memberships through a bonus-related pay scheme. All staff of the head office and local membership teams are permitted to discount membership fees and waive certain up-front fees in order to secure the sale of new memberships.

## Technology

Top Body uses an off-the-shelf membership management and accounting package supplied by an external software company, Fitness Suite Ltd. ('Fitness Suite'). The off-the-shelf package includes online bookings, membership software, point of sale, inventory control, access control, swipe card entry and fingerprint recognition systems, direct debit payment collections, ClassPass and TrainPass management, accounting functionality and head office access to remote sites.

The package has been used by Top Body since Kevin Lai introduced it into the business in 2006 when the third fitness centre was opened and a more sophisticated package was required. Since then, Top Body has worked closely with Fitness Suite in order to execute a number of bespoke developments of the software so that the system was able to cope with the expansion of Top Body's business. However, as Top Body's membership packages have increased in complexity over time, some processes are currently undertaken manually. The board of Top Body wishes to replace the current membership management and accounting system and have asked your firm for advice.

## Top Body's Recent Events, Current Performance and Future Plans

Top Body continues to perform well in a rapidly expanding market but during 2015-16, it has found that the extent to which the membership teams are having to discount the membership fees has increased significantly. The vast array of different fitness provisions has put customers in a strong bargaining position. Having said Top Body continues to grow, albeit more slowly, and continues to be profitable.

Top Body has historically been noted for being one of the most advanced fitness centres in Hong Kong in relation to its fitness training techniques and training equipment. However, during 2016, Future Fitness Club ('Future Fitness'), a direct competitor, imported internet enabled training equipment for each of its six fitness centres operating in locations close to many of the Top Body's fitness centres. The equipment of Future Fitness enables members to keep track of their fitness training performance online and to compete, virtually, with other members of the same fitness centre. Future Fitness launched an extensive marketing campaign in October 2015 and Top Body has started to see some of its members move to Future Fitness at the end of their membership terms.

In November 2015, Top Body was hit by a scandal in the headlines of the Hong Kong newspapers. The scandal was related to the way in which its employees at some fitness centres used hard sales tactics in order to persuade prospective members to sign up.

In light of the recent events, the board of Top Body has carried out a strategic review of the business and has made the following decisions:

- In January 2016, the fitness centre at Shatin was closed and memberships were automatically transferred to the fitness centre at Mong Kok or an alternative fitness centre if the member so chose. Shatin had been the least profitable fitness centre for the last four years and membership numbers at Mong Kok were static. The board therefore decided that strategically it made sense to effectively merge the two centres.
- A new centre will be opened at Sheung Wan where the growth in expatriate workers has made this an attractive location in which to operate. A leasehold premises has already been secured and the fitness centre is currently being fitted out. Equipment from Shatin that is still in good working order has been transferred to Sheung Wan so that the fitness centre can be opened in June 2016. Sheung Wan will not have a swimming pool.
- The leasehold for the property for the fitness centre at Shatin is currently available for sale and is being marketed by a real estate agent but was not sold at 31 March 2016.
- Equipment in four of the Top Body's most prestigious fitness centres will be replaced with equipment which are able to compete with that enjoyed by members at Future Fitness. The equipment is currently being researched and the new equipment is anticipated to be installed by November 2016.
- The board has commissioned an investigation into the newspaper allegations regarding its selling practices which will be carried out by Horace Lai, who heads up the membership team at the head office in Wanchai. Horace is Kevin Lai's son and Kevin has selected him for this task due to his good relationship with the membership teams and level of trustworthiness.
- The board has identified an opportunity in the fitness market in mainland China where there is substantial growth. The board plans to expand the Top Body brand in this region through the set-up of a franchise operation. GlobeFit has approved the strategy but in spite of providing interest-free loans for previous projects, it is unable to supply the required funding for the franchise project due to poor market conditions in the US. Top Body has therefore approached its own bank for funding this project.

### Auditors

Your firm, Wong Lam, has been the external auditor of Top Body since its incorporation and Ms. Martha Atkinson has served as the audit engagement partner since that time.

The board of Top Body has requested Wong Lam to accept, in addition to performing the external audit for the year ended 31 March 2016, the following engagements:

- (i) An engagement to perform agreed-upon procedures in relation to loan finance requested from its bank; and
- (ii) An engagement to provide advice on Top Body's membership management and accounting system.

The following additional information are available to you at the planning stage:

- Top Body's membership packages, terms and conditions (Appendix A).
- Hong Kong Trainer – magazine article (Appendix B).
- Email from Horace Lai, membership team to Kevin Lai re Consumer Council (HK) (Appendix C).

## Business Assurance

- Web page from [www.howbusinessworks.com](http://www.howbusinessworks.com) (Appendix D).
- Letter from Creditsure (Hong Kong) Ltd. (Appendix E).
- GlobeFit's internal audit report (Appendix F).

## Additional information

### Top Body's Prior Years Audited Financial Information Extracts

#### STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 MARCH 2015

	<i>Note</i>	<i>2015</i> HK\$'000	<i>2014</i> HK\$'000
Revenue	1	144,932	146,784
Cost of sales		<u>(126,091)</u>	<u>(124,766)</u>
Gross profit		18,841	22,018
Administrative expenses		<u>(12,101)</u>	<u>(11,744)</u>
Profit before tax		6,740	10,274
Taxation		<u>(1,215)</u>	<u>(1,700)</u>
Profit for the year		<u>5,525</u>	<u>8,574</u>

#### STATEMENT OF FINANCIAL POSITION AT 31 MARCH 2015

	<i>Notes</i>	<i>2015</i>		<i>2014</i>	
		HK\$'000	HK\$'000	HK\$'000	HK\$'000
<b>ASSETS</b>					
<i>Non-current assets</i>					
Property, plant and equipment	2		360,114		357,557
<i>Current assets</i>					
Inventories		1,541		2,997	
Trade receivables	3	22,497		25,814	
Cash and bank balances		<u>20,144</u>		<u>26,059</u>	
			<u>44,182</u>		<u>54,870</u>
<i>Total assets</i>			<u>404,296</u>		<u>412,427</u>
<b>EQUITY AND LIABILITIES</b>					
<i>Equity</i>					
Issued share capital		100,000		100,000	
Accumulated profits		<u>102,743</u>		<u>97,218</u>	
			202,743		197,218
<i>Non-current liabilities</i>	4		150,730		166,234
<i>Current liabilities</i>	5		<u>50,823</u>		<u>48,975</u>
<i>Total equity and liabilities</i>			<u>404,296</u>		<u>412,427</u>

STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 MARCH 2015

	<i>Issued share capital</i>	<i>Accumulated profits</i>	<i>Total</i>
	HK\$'000	HK\$'000	HK\$'000
At 1 April 2014	100,000	97,218	197,218
Profit for the year	<u>–</u>	<u>5,525</u>	<u>5,525</u>
At 31 March 2015	<u>100,000</u>	<u>102,743</u>	<u>202,743</u>

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 MARCH 2015

	2015 HK\$'000
<i>Cash flows from operating activities</i>	
<i>Profit before tax</i>	6,740
Adjustments for:	
Depreciation	42,035
Reversal of impairment loss recognised on receivables	(87)
Decrease in inventories	1,456
Decrease in trade receivables	3,404
Increase in trade and other payables	<u>2,837</u>
<i>Cash generated from operations</i>	<u>7,697</u>
	56,385
Income taxes paid	<u>(2,708)</u>
<i>Net cash from operating activities</i>	53,677
<i>Cash flows from investing activities</i>	
Purchase of property, plant & equipment	(48,967)
Proceeds from disposal of property, plant and equipment	<u>4,375</u>
<i>Net cash used in investing activities</i>	(44,592)
<i>Net cash used in financing activities</i>	<u>(15,000)</u>
<i>Net decrease in cash and cash equivalents</i>	(5,915)
<i>Cash and cash equivalents at beginning of the year</i>	<u>26,059</u>
<i>Cash and cash equivalents at end of the year</i>	<u>20,144</u>

## Extracts of notes to the financial statements for the year ended 31 March 2015

**1 ACCOUNTING POLICIES****1.1 Basis of preparation**

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

**1.2 Revenue**

Revenue comprises the amounts earned from membership fees and the retail sale of related fitness products and services.

Membership fees are recognised in the month to which they relate. Up-front joining fees and lifetime membership payments are recognised over the average expected life of the membership.

**1.3 Property, plant and equipment**

Items of property, plant and equipment are stated at cost less accumulated depreciation. Depreciation is provided at rates calculated to write off the cost of non-current assets, less their estimated residual values, over their expected useful lives on the following bases:

Leasehold properties	– 5% to 15% straight line
Plant and machinery	– 15% reducing balance
Fixtures and fittings	– 25% reducing balance

**1.4 Inventories**

Inventories are valued at the lower of cost and net realisable value.

**1.5 Trade receivables**

Trade receivables are reduced by an allowance for estimated irrecoverable amounts.

**1.6 Trade and other payables**

Trade payables and accruals include amounts owed to suppliers. Deferred income represents amounts received from customers in advance of recognition in the financial statements.

**1.7 Provisions – deferred taxation**

Deferred taxation is provided in full in respect of taxation deferred by timing differences between the treatment of certain items included in plant and machinery for taxation and accounting purposes.

**2 PROPERTY, PLANT AND EQUIPMENT**

	<i>Leasehold properties</i> HK\$'000	<i>Plant and machinery</i> HK\$'000	<i>Fixtures and fittings</i> HK\$'000	<i>Total</i> HK\$'000
<i>Costs</i>				
At 1 April 2014	369,852	271,741	49,919	691,512
Additions	–	47,880	1,087	48,967
Disposals	–	(51,987)	–	(51,987)
At 31 March 2015	<u>369,852</u>	<u>267,634</u>	<u>51,006</u>	<u>688,492</u>
<i>Depreciation</i>				
At 1 April 2014	131,964	180,764	21,227	333,955
Charge for the year	22,789	13,030	6,216	42,035
Disposals	–	(47,612)	–	(47,612)
At 31 March 2015	<u>154,753</u>	<u>146,182</u>	<u>27,443</u>	<u>328,378</u>
<i>Carrying amounts</i>				
At 31 March 2015	<u>215,099</u>	<u>121,452</u>	<u>23,563</u>	<u>360,114</u>
At 31 March 2014	<u>237,888</u>	<u>90,977</u>	<u>28,692</u>	<u>357,557</u>

**3 TRADE RECEIVABLES**

	2015 HK\$'000	2014 HK\$'000
Gross trade receivables	25,278	28,682
Less allowance for doubtful debts	<u>(2,781)</u>	<u>(2,868)</u>
	<u>22,497</u>	<u>25,814</u>

**4 NON-CURRENT LIABILITIES**

	2015 HK\$'000	2014 HK\$'000
Accruals and deferred income	43,092	42,588
Provisions for liabilities – deferred taxation	5,544	6,552
Amount owed to parent company	<u>102,094</u>	<u>117,094</u>
	<u>150,730</u>	<u>166,234</u>

**5 CURRENT LIABILITIES**

	2015 HK\$'000	2014 HK\$'000
Trade and other payables	12,684	11,844
Tax payable	1,215	1,700
Other taxes and social security costs	17,892	16,380
Accruals and deferred income	4,032	4,051
Amount owed to parent company	<u>15,000</u>	<u>15,000</u>
	<u>50,823</u>	<u>48,975</u>

## Appendix A – Top Body's membership packages, terms and conditions

The following information is taken from Top Body's website:



### Membership terms

#### Membership options

- A. Lifetime membership:** Lifetime membership entitles you to use the facilities at any Top Body fitness centre for life and includes a ClassPass Bolt-on at no extra cost
- Top Body joining fee (one-off payment): HK\$600
- Top Body lifetime fee (one-off payment): HK\$12,000
- Monthly membership fee: HK\$400
- B. Annual membership:** Annual membership entitles you to use the facilities at your 'home' Top Body fitness centre for 12 months from the date of signing your membership agreement
- Top Body joining fee (one-off payment): HK\$600
- Monthly membership fee: HK\$600
- C. Corporate membership:** Please contact our dedicated corporate membership team on +852 2222 5555

#### Membership optional extras

- A. ClassPass:** ClassPass entitles you to attend the specified number of classes at your 'home' Top Body fitness centre
- ClassPass15: HK\$1,100 – purchase from the reception desk, attend 15 classes in the month from the date of purchase
- ClassPass20: HK\$1,450 – purchase from the reception desk, attend 20 classes in the month from the date of purchase
- ClassPass Bolt-on: HK\$960 per month – add the cost of the ClassPass Bolt-on to your monthly membership fee and benefit from reduced classes' costs, up to 20 classes per month
- B. TrainPass:** TrainPass entitles you to the specified number of personal training sessions at your 'home' Top Body fitness centre
- TrainPass – single session: HK\$480 for an hour personal training session
- TrainPass Bolt-on: HK\$3,500 – add the cost of the TrainPass Bolt-on to your monthly membership fee and benefit from reduced personal training costs, up to 8 personal training sessions per month

## Your membership agreement

- You must be over the age of 18 to join a Top Body membership
- You must complete and sign the Top Body membership agreement
- You must complete the 'Fitness Ready Questionnaire' before you start using your membership by completing the questionnaire warrant to us that you have no known condition or are undergoing any treatment that would prevent you from being capable of physical exercise in all material respects
- We reserve the right to make or change minor points or amendments in the membership agreement without notice to you
- We may reassign your 'home' fitness centre at any time during your membership period in case that your 'home' fitness centre ceases to be part of the Top Body group's fitness centres

## Payment of fees

- By completing the membership application form and agreeing to be bound by these terms and conditions, you agree to pay all Top Body membership and other fees on time
- In addition to your monthly fee, lifetime fee, extra bolt-on package or other membership fees, we will also charge you a joining fee. This joining fee will be displayed on the website and is non-refundable
- Membership fees may be paid by either direct debit or credit card
- Paying monthly by direct debit: The joining fee, lifetime fee (where applicable) and your first month's membership fee are collected by direct debit 3-5 working days from your membership application date and are non-refundable under any circumstances. Your second and subsequent payment will be collected on the monthly anniversary of the date of your membership application
- Paying monthly by credit card: The joining fee, lifetime fee (where applicable) and your first month's membership fee are due immediately and will be taken as soon as you complete your membership application and are non-refundable under any circumstances. Your second and subsequent payment will be collected on the monthly anniversary of the date of your membership application
- Paying for optional extras: ClassPass and TrainPass Bolt-ons will be activated on your account, following payment. The fee will be collected on your next monthly membership payment date and is non-refundable under any circumstances. Your second and subsequent payment will include the Bolt-on fee
- Your membership fees are subject to periodic increases. Fees will normally be reviewed on an annual basis but circumstances may dictate an earlier revision. You will normally be given one month's notice of any fee change

## Cancellation by you

### A. Cancellation of membership

- Memberships will be automatically renewed each year on the anniversary date of your membership for both lifetime and annual memberships. Cancellations will only be accepted in the following ways:
  - Lifetime Membership: You may cancel your membership only on the anniversary date of your membership each year providing one month's notice in writing is given to your 'home' fitness centre. Your cancellation will take effect at the end of the month for which the final direct debit payment has been paid

- Annual Membership: You may cancel your membership only on the anniversary date of your membership each year providing one month's notice in writing is given to your 'home' fitness centre. Your cancellation will take effect at the end of the month for which the final direct debit payment has been paid

**B. Cancellation of Bolt-ons**

- Once added to your membership, Bolt-ons will be automatically renewed each year, on the anniversary date of your membership for both lifetime and annual memberships
- ClassPass and TrainPass Bolt-ons can be removed from your monthly membership fee on the anniversary date of your membership each year providing one month's notice in writing is given to your 'home' fitness centre. Your cancellation will take effect at the end of the month for which the final direct debit payment has been paid

## Appendix B – Hong Kong Trainer – magazine article

### Fitness Centre Packages – Fair deal?

The fitness market in Hong Kong is booming as we all realise the importance of getting and keeping fit and one of the best places to get access to a range of facilities and equipment is by signing up for membership to a fitness centre. But with the growth in this market, the choice is becoming overwhelming and Hong Kong Trainer reveals that we do not always know what we are signing up to and warns of the traps to watch out for.

#### Up-front payments

Monthly membership payments are expected when you sign up to one of the many fitness centre chains in Hong Kong and most individuals are careful to consider whether they can continue to pay the monthly fee for the duration of the membership agreement. But watch out for other hidden fees which the membership staff may be less likely to highlight to you.

In an investigation of 15 fitness chains across Hong Kong, we found that 13 of them charge a joining fee either equivalent to or more than the first month's membership fee – doubling the initial payment. And this joining fee is nearly always non-refundable. Some chains also charge other fees for administration or deposits for locker keys and towels – these hidden costs can make the initial month's payment more costly than you realise.

#### Lock-in periods

Many fitness centre contracts will also lock you into membership for significant periods of time. The shortest we found during our research was 12 months but many of the membership deals we examined were for 24 or even 36 months. This is fine whilst your circumstances remain the same and often by agreeing to a longer membership period you can benefit from lower monthly membership fees. However, what if your circumstances change and you can no longer afford the fees or make use of the facilities? (see Real Life Spotlight)

#### Auto-renewal

Read the small print carefully – even a 12 month contract may simply roll over into another year unless you are proactive about terminating it on the anniversary date of your membership. Again many membership sales teams in fitness centres fail to warn customers of this part of the membership agreement and customers find themselves locked into another year due to the auto-renewal clause.

#### The hard sell

Hong Kong Trainer has also had numerous complaints from would-be fitness centre members about hard selling tactics – beware the membership sales representative working for commission or bonus!!!

### Real Life Spotlight



*'Even after the events of 10 November 2015, my two life passions continue to be my motorcycle and keeping fit. The motor cycle accident gave me multiple fractures in my legs which doctors repaired using metal plates. It has taken months of rehabilitation to get me back up on my feet (and on my motorcycle!). I couldn't use the fitness centre the whole time when I was in hospital or during my recovery and my injuries have meant I need more specialized equipment than is provided at the fitness centre where I am a member. After the accident, I tried to cancel my membership thinking these were pretty exceptional circumstances but I was shocked to find that they said they had to up-hold the term of the membership agreement. I'd only signed up a few weeks before the accident and agreed to the 36 month 'deal' as it meant a lower monthly cost. Now I am stuck paying for this whilst having to train at another gym where they do have the fitness equipment I need.'*



## Appendix C – Email from Horace Lai, membership team to Kevin Lai re Consumer Council (HK) – 'unfair terms in standard form consumer contracts'

### Consumer Council (HK) report

**From:** Horace Lai  
**Sent:** 18 December 2015  
**To:** Kevin Lai

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Dear Kevin

As you requested, I have reviewed the findings in the report 'Unfair terms in standard form consumer contracts' issued by the Consumer Council (HK) in April 2015.

I have attached a summary of the key points raised in the report, with some examples extracted from the report and also set out my view on how they might impact on the standard membership agreement terms that we use for Top Body's members.

There do appear to be a number of areas where the Top Body's standard agreement terms are inconsistent with the recommendations set out in the report and we run the risk of our contracts being seen as unfair or Top Body may gain bad publicity as a result.

I particularly concern as the HK government seems to be moving towards more of an 'enforcement stance' rather than simply 'guidance'. This is in line with other countries such as the UK and Australia. There have been recent cases in the UK where major fitness centre chains have been forced to amend their terms and conditions by the UK Office of Fair Trading.

Regards

Horace

1 attachment: *Summary of key points from Consumer Council Report on unfair terms in standard form consumer contracts in relation to the terms in Top Body's own standard contracts*

## Summary of key points from Consumer Council Report on unfair terms in standard form consumer contracts in relation to terms in Top Body's own standard contacts

Issued identified in report	Example of contract clause from report	Possible impact on Top Body
<p><b>Clause limiting the legal liability of the supplier in the event of personal injury to the consumer resulting from an act or omission of the supplier</b></p> <p>The report concludes that the supplier is not allowed under law to exclude the negligence of the supplier, its employees or agents.</p>	<p>"Members agree that XX, its senior staff, directors, staff and independent contractors shall not be liable, so far as the law allows, for any injuries including, but not limited to, the personal or bodily injuries resulting from physical training, the act or negligence of any person acting on behalf of XX."</p>	<p>Our contract includes such a clause, mainly due to the issue of liability arising from negligence by one of the freelance instructors we used. Removing such a clause could lead us to be exposed to liability for negligence by such instructors whereas our own employees are covered by insurance</p>
<p><b>Unnecessary and unreasonable formality requirement</b></p> <p>The report concludes that such formalities are unnecessary and may be impractical and that such terms should be dispensed with.</p>	<p>"If the customer wishes to terminate the fitness card and the credit card authorisation hereof, he/she must give not less than one month's notice to the company by attending in person at any of the centres...."</p>	<p>We do not require attendance in person but do require written termination notice by the customer – we need to consider if this is unreasonable formality.</p>
<p><b>Entire agreement clause</b></p> <p>The report states that this clause attempts to exclude liability for representations made by its sales staff during sales talk.</p> <p>The report concludes that such clauses are against the principle of good faith and in the UK, the Office of Fair Trading has concluded that they are unfair. Such clauses could be disputed by the consumer and should be removed.</p>	<p>"This agreement and its terms and conditions constitute the entire agreement between you and XX and supersede all prior arrangements, whether written or verbal, between you and XX. You confirm hereby that XX or any other person has not made verbal or written representation or undertaking which is not mentioned in this agreement but relied on by you.</p>	<p>We have historically included this in our membership agreements as sometimes we have found that the membership teams in the local fitness centres were a little over zealous and made promises to customers which we could not fulfil – this clause, we thought, would protect us in that situation!</p>
<p><b>Automatic renewal</b></p> <p>The report concludes that such terms are unfair as there is no requirement for the supplier to give a clear reminder at a reasonable time before the contract is expired. Such clauses should be deleted or clear notice should be given that prompts the consumer to consider whether to renew contract. The service should be continued during that period at the contract's current rate.</p>	<p>"For that customer who elects to pay the fee by instalments plan, immediately before the expiry date of such a plan, the fitness card will be automatically extended and the customer shall continue to procure the auto-pay and XX shall also be entitled to continue to debit the relevant credit card account."</p>	<p>All of our agreements auto-renew with no notice to the customer (other than stating this fact in the agreement) – we need to consider new processes to inform customers of the fact that their contracts will be renewed.</p> <p>We also renew for a further whole 12-months rather than on a monthly basis which has been found great for locking customers back into another whole year of membership.</p>

## Appendix D – Web page from www.howbusinessworks.com

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## How Do Merchant Services Work?

'Merchant services' is an industry term that describes the accounts and equipment a business needs in order to accept credit card payments from its customers.

For any business to accept credit cards, it needs a merchant account. When a business makes a sale and the customer pays by credit card, the customer has as much time as they'd like to pay off their credit cards. However, businesses cannot wait for customers to pay the relevant part of their credit card bills so the funds for the transactions come out of a 'merchant account'.

At the end of each day, the sum of the day's sales is sent out for processing and settlement - a process of withdrawing the funds from the merchant account and depositing the funds into the business's bank account. The process usually takes about two business days.

To obtain a merchant account, you'll need to work with a Merchant Service Provider (MSP). The MSP will charge the business a fee for setting up and operating the merchant account. The MSP will also provide the equipment you need to accept credit card payments from your customers. If you meet your customers face-to-face, you would use a credit card terminal or mobile device to take their payments. MSPs sell this equipment, with prices varying widely between MSPs.

0 comments

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Leave a message...

## Appendix E – Letter from Creditsure (Hong Kong) Ltd.



### **Creditsure (Hong Kong) Ltd.**

13 April 2016

Mr. Kevin Lai  
Managing Director  
Top-fit Body Building Limited  
Units 21-32  
Wanchai Mansion  
Hennesey Road  
Wanchai  
Hong Kong

Dear Mr. Lai

#### **Review of merchant account terms and conditions**

As your Merchant Service Provider, you will be aware that Creditsure (Hong Kong) Ltd. continually reviews its terms and conditions in respect of the services provided to businesses with merchant accounts such as Top Body.

Recent publicity over high-pressure selling techniques in the fitness industry has led us to review the processing and settlement terms for new membership agreements that are paid by a new member using a credit card. Credit card companies have recently seen an increase in complaints from credit card holders in respect of such high-pressure selling techniques frequently resulting in the customer withdrawing from the membership agreement. In these circumstances, we have experienced a low rate of success in recovering monies already passed to fitness centres through their merchant accounts.

For this reason, Creditsure (Hong Kong) Ltd. will amend its terms and conditions such that the amounts paid for new memberships will not be passed from the merchant account to Top Body's bank account until three months after the transaction has occurred. Should the customer cancel the membership agreement within this three month period, no transfer of funds will be made from the merchant account to Top Body.

We take changes to our terms and conditions very seriously and only make changes where they are necessary to protect our business from unnecessary risk and keep our costs low for all of our customers.

Yours sincerely,

*Charlotte Yeung*

Charlotte Yeung  
Risk Manager  
Creditsure (Hong Kong) Ltd.

## Appendix F – GlobeFit's internal audit report



15 March 2016

Mr. Kevin Lai  
 Managing Director  
 Top-fit Body Building Limited  
 Units 21-32  
 Wanchai Mansion  
 Hennesey Road  
 Wanchai  
 Hong Kong

Dear Mr. Lai

### **GlobeFit internal audit visit – January 2016**

I have pleasure in enclosing GlobeFit's initial internal audit report covering the internal controls and processes in operation over revenue and trade receivables at Top Body.

As part of GlobeFit's internal audit process, our report highlights both areas of strength in the internal controls and processes tested and areas which require improvement. I would like to arrange for a follow up webinar with you and the relevant members of your team when you have had an opportunity to consider our observations – particularly in relation to those areas which require improvement. Please contact my personal assistant, Robin Wager, to arrange this.

I would also like to take this opportunity to thank you and your staff for your hospitality during our visit and also to echo the conclusions in the report that the approach of Top Body management to internal controls has, overall, resulted in a strong culture of proper and appropriate business processes throughout the organisation.

Yours sincerely,

*James Charmers*

James Charmers

Head of Internal Audit  
 GlobeFit Inc.



## Internal Audit Report

<p><b>Top-fit Body Building Limited</b> <b>Revenue and Trade Receivables</b></p>
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Date of internal audit visit: January 2016

Date of report: March 2016



## Contents

1. Introduction and scope
2. Objectives of the internal audit
3. Executive summary
4. Findings and Recommendations
  - I. Areas of strength identified in internal control procedures
  - II. Areas for improvement identified in internal control procedures

## 1. Introduction and scope

- 1.1 An internal audit review of the internal controls was undertaken by the GlobeFit internal audit team as part of its regular review of all of the GlobeFit's significant international businesses where it has a controlling interest.
- 1.2 The internal audit covered a review of internal controls, processes and systems in respect of revenue and trade receivables.
- 1.3 Two functions were included in the internal audit visit: the accounts department and the membership team operating at Wanchai Head Office as well as a sample of the membership teams located in the fitness centres. The sample consisted of fitness centres at Wanchai, Mong Kok and Causeway Bay.
- 1.4 The internal audit findings are based on:
  - Discussions with and observation of Top Body's employees
  - The use of test data in the membership management and accounting system
  - Review of controls operating over the trade receivables ledger and credit control function

## 2. Objectives of the internal audit

- 2.1 The main objectives of the internal audit were to identify areas of weakness in controls and provide recommendations for improvement.

## 3. Executive summary

- 3.1 Overall the attitude of management and employees at Top Body to the design and implementation of controls was found to be good with a structured approach to ensure that employees are trained to perform relevant internal control procedures.
- 3.2 Notably the control procedures in relation to corporate memberships and recording of standard new individual memberships were found to be very good.
- 3.3 The monitoring of control procedures in some significant areas were found to be deficient, resulting in an increased risk of non-compliance with the internal control procedures or fail to detect fraudulent conduct. The key areas where monitoring procedures require improvement are:
  - Membership sales techniques
  - Recognition of income from lifetime membership fees
  - Cash sales in iEat cafés and KitShop retail outlets
- 3.4 Concerns were also raised by the internal audit team regarding the membership management and accounting system and whether these continue to be fit for purpose given the growth of the business.

## 1. Findings and Recommendations

### I Areas of strength identified in internal control procedures

Internal controls observed	Findings
<p><b>1 Corporate memberships</b></p> <p>The following control procedures were observed in relation to the processing, recording and management of corporate memberships at the Wanchai Head Office:</p> <ul style="list-style-type: none"> <li>• Obtaining of credit references/checks before final acceptance of a new corporate member</li> <li>• Approval of discounts</li> <li>• Preparation of statements for corporate customers</li> <li>• Documented procedures for chasing overdue accounts</li> <li>• Suspension of member access for overdue accounts</li> <li>• Review of aged receivables analysis by senior employees</li> </ul>	<p>The internal control procedures operating within the corporate membership team were found to be strong with no instances of non-compliance with the internal control procedures being observed. Prospective corporate customers are subjected to rigorous credit checks before acceptance and appropriate procedures are adopted to identify and recover overdue balances.</p> <p>We had initial concerns in respect of the bonus payments received by Top Body employees working in the membership team as this may encourage the risk taking when selling to prospective corporate members or the granting of excessive discounts. However, the terms of such bonus payments include the completion of satisfactory credit references/checks and senior management authorisation of discounts, so it was not found to unduly promote risk taking amongst these employees.</p>
<p><b>2 New individual memberships</b></p> <p>The following control procedures were observed in relation to the recording of new individual memberships, by membership team employees, in the membership system at the three fitness centres visited:</p> <ul style="list-style-type: none"> <li>• Clear documented procedures manual available at each location</li> <li>• Sequentially numbered membership agreements</li> <li>• Independent checking of sequentially numbered membership agreements</li> <li>• Checking of accuracy of recording of new member details</li> <li>• Credit card payments taken in case of new members paying by credit card</li> <li>• Direct debit mandate forms completed and signed by new members paying by direct debit</li> </ul>	<p>The internal control procedures surrounding the accuracy and completeness of the recording of new membership agreements were found to be strong with only a minor number of errors identified. Employees of each location were aware of the procedures manual and were able to locate and refer to it.</p> <p>The sequential numbering of membership agreements was independently checked by the membership team at Wanchai Head Office and any omissions in the sequence of membership agreements sent by the local fitness centre were appropriately investigated and explained.</p> <p>Details entered into the membership system by the local membership team member are checked against the membership agreement when received by the Wanchai Head Office team.</p> <p>In all our observations, appropriate payment was taken from the customer before the new membership was entered into the system or any fitness centre passes were issued to the member.</p>

Internal controls observed	Findings		
<p><b>3 Control of non-payment – individual memberships</b></p> <p>A review of Top Body's membership system identified that:</p> <ul style="list-style-type: none"> <li>• Non-payment of a membership fee (either by credit card or debit card) was immediately flagged in the membership system</li> <li>• An exception report was reviewed by either the fitness centre manager or deputy manager on a weekly basis</li> <li>• The member's electronic pass was automatically suspended on non-payment situation, meaning the member would be unable to gain access to the fitness centre</li> <li>• A standard letter was automatically generated by the system, to the member explaining the suspension of their access until overdue amounts were paid</li> </ul>	<p>On review of the processes in place, we observed that the controls described were very effective in ensuring that when member's payment has lapsed, the member was quickly notified and the situation was rectified. Only in a very small number of cases did the member continue to fail to pay and this was addressed through the continued suspension of his/her electronic pass.</p> <p>This means the risk of exposure to unpaid amounts by individual members is limited to one month's membership fee per member.</p>		
<p><b>4 Findings and Recommendations</b></p> <p><b>II Areas for improvement identified in internal control procedures</b></p>			
<p>Risk may be viewed as the chance, or probability, of one or more of the organisation's objectives not being met. It refers both to unwanted outcomes which might arise, and to the potential failure to realise desired results.</p> <p>The <b>recommendations</b> column is categorised on the following basis:  <b>Fundamental</b> – action that is considered imperative to ensure that the organisation is not exposed to high risks;  <b>Significant</b> – action that is considered necessary to avoid exposure to significant risks;  <b>Merits attention</b> – action that is considered desirable and should result in enhanced control or better value for money.</p>			
Findings	Risks	Category	Recommendations
<p><b>1 New individual memberships</b></p> <p>A sample of 'sales meetings' with prospective members were observed by the internal audit team. In 9 of the 26 sales meetings observed, the membership team member used inappropriate and often 'hard' sales techniques in order to ensure the membership agreement was signed. 7 of such sales meetings were observed at the Mong KoK fitness centre.</p>	<p>The use of hard selling techniques exposes the business to complaints and adverse publicity and, in extreme cases, potential legal consequences which could be damaging to the Top Body brand and future membership levels.</p>	<p><b>Fundamental</b></p>	<p>Best practices sales techniques need to be reviewed and a program of retraining membership employees should be undertaken.                      The secret member programme should be extended to include recruitment of new members.</p>

Findings	Risks	Category	Recommendations
<p>In 21 of the 26 sales meetings, the membership team member failed to read or explain, or allow the prospective member to read the terms and conditions of membership before signing the membership agreement. Only two observed sales meetings resulted in the prospective member choosing not to immediately sign the sales agreement.</p> <p>Some sales techniques included the discounting of joining fees, lifetime membership fees and monthly membership fees. Whilst these are permitted by management to support achieving new membership sales, there is insufficient guidance as to the appropriate levels of discount that may be offered to customers nor is there any pre-determined approval levels operating within the individual fitness centres or at head office. Some discounts were agreed with the member with no authorisation from senior management and there was no evidence of monitoring of discounts given at either senior management level or head office.</p>	<p>Failure to make prospective members aware of the terms and conditions may result in the rescinding of membership agreements at a later date or disputes with members who were unaware of agreement terms. This could result in financial loss where members cease to honour their direct debit or credit card payments.</p> <p>The lack of controls over the extent and level of discounting could cause Top Body unnecessary financial loss where discounts applied are excessive. This could also result in member dissatisfaction where discount rates are inconsistent between fitness centres or individual members. Failure to approve discounts opens the possibility of fraudulent conduct by membership employees where they are recruiting friends and family to a fitness centre.</p>	<p><b>Fundamental</b></p>	<p>As part of the proposed retraining identified above, the importance of explaining terms and conditions of membership should be emphasised and the secret member programme should carry out spot checks on this specific area.</p> <p>Guidelines as to the level of discounting should be included in the procedures manual available in each fitness centre and communicated to membership employees. All discounts should be authorised by a senior member of staff and large discounts, over a predetermined level, should be authorised by the membership team at head office.</p>
		<p><b>Significant</b></p>	<p>Discounts given should be regularly monitored by senior managers from the head office membership team to ensure compliance with the guidance and authorisation levels put into place.</p>

Findings	Risks	Category	Recommendations
<p><b>2 Revenue recognition</b></p> <p>A sample of memberships were traced through the membership and accounting systems in order to ascertain the accuracy and cut-off of revenue. In the case of joining fees and monthly membership receipts, this was found to be satisfactory. However, the current membership and accounting systems do not have appropriate functionality to accurately account for the treatment of the lifetime membership fee. Company's accounting policies state that the lifetime membership fee should be recognised over the average life of a membership since it results in reduced future monthly receipts from the customer over a number of years. The current estimated average membership term is six years.</p> <p>As the membership and accounting systems are unable to record such transactions, a manual process for recording deferred income in relation to these fees is required. In a sample of 72 lifetime memberships tested, it was found that 29 had not been accurately accounted for using the manual process:</p> <ul style="list-style-type: none"> <li>In 13 lifetime memberships calculation, errors had occurred</li> <li>In 16 lifetime memberships, 100% of the lifetime membership fee had been recognised as revenue on receipt.</li> </ul> <p>No procedures were in place to monitor the accounting of lifetime membership fees.</p>	<p>The rate of error in accounting for lifetime membership fees is unacceptable with no procedures in place to detect such errors.</p> <p>The errors result in misleading management information and could result in errors in the financial statements.</p> <p>During our review, it was noted that the existing membership and accounting systems have been in place for a number of years and, as the business has grown, have become less able to meet the needs of the increasingly complex transactions — this could lead to increased levels of manual processing in the future and further exposure to the risk of error in respect of such transactions.</p>	<p><b>Fundamental</b></p> <p><b>Merits attention</b></p>	<p>In the short term management should introduce procedures to ensure the checking of manual transactions and calculations in the membership and accounting systems.</p> <p>Given the age of the systems and the growth in the business, we recommend that management plan to undertaking a review of the appropriateness of the current membership and accounting systems with a view to replace them in the next 12 to 18 months with a more comprehensive system which are capable of processing the range of transactions required.</p>

Findings	Risks	Recommendations
<p><b>3 Cash sales</b></p> <p>During our three visits to the fitness centres, we observed controls in operation over cash sales at the iEat cafés and KitShop retail outlets. The following internal control deficiencies were observed:</p> <ul style="list-style-type: none"> <li>• Cash tills left unattended during opening hours, often due to there being only one member of staff present in the relevant outlet</li> <li>• Either no cash collection during the course of the day or collections were carried out by an individual with inadequate security arrangements (i.e. money was transported through the premises in full view of members)</li> <li>• No segregation of duties between those making retail sales during the day and those undertaking cashing up procedures at the end of the day</li> <li>• Discrepancies between the cash receipts recorded by the electronic till and the actual physical cash held in the till at the end of each day were not adequately investigated.</li> </ul>	<p>The internal control deficiencies identified expose Top Body to loss of revenue and cash and the potential for fraudulent conduct by employees working in iEat cafés and KitShop retail outlets.</p> <p>The lack of security around attendance at tills and cash collections, or lack of, during the course of the day exposes the business to potential theft.</p> <p>The failure to adequately investigate discrepancies between end of day z-reads and cash receipts in the till increases the risk that any fraudulent conduct will remain undetected.</p>	<p><b>Fundamental</b></p> <p>Internal controls at iEat Cafés and KitShop retail outlets require review with subsequent communication to staff. Improvements should be made in respect of:</p> <ul style="list-style-type: none"> <li>• Security of cash</li> <li>• Segregation of duties – particularly in relation to end of day cashing up procedures which should be performed by employees not operating the till</li> <li>• Review of cashing up procedures and investigation of discrepancies by senior management in each fitness centre</li> </ul>

