



Hong Kong Institute of
Certified Public Accountants
香港會計師公會



Qualification Programme

Capstone Final Examination

December 2021 Session (Pre-seen Materials)

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Capstone – Final Examination

Pre-seen materials provide background information and issues arise on a fictitious organisation that will be featured in the Capstone Examination. They will form the basis of the tasks you need to tackle during the examination.

It is essential to be familiar with the pre-seen materials before sitting the Capstone Examination. The pre-seen materials are available five working days in advance for candidates to prepare for the examination through independent reading, research in industry and news, etc.

The pre-seen materials contain:

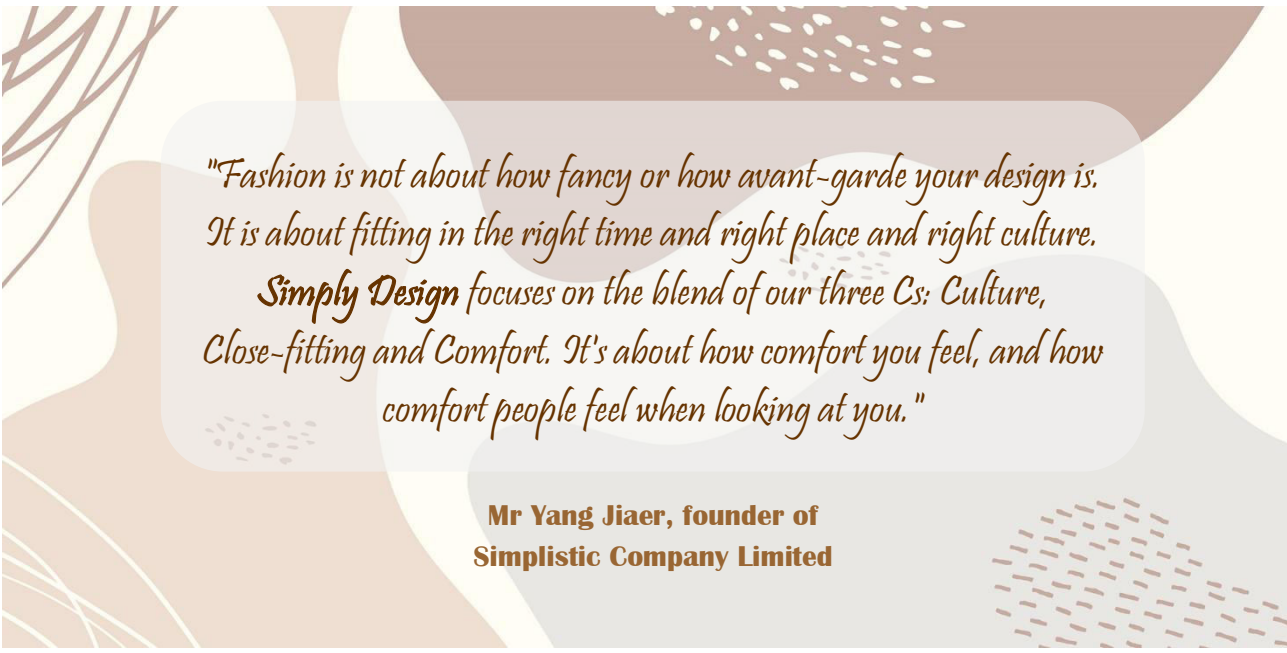
- The Case Background of Simplistic Company Limited
- Exhibit 1 – Email to you, Lin Chan, from the Finance Director, Melaine Wong
- Exhibit 2 – Organisation chart of Simplistic Company Limited
- Exhibit 3 – Financial statements and operation statistics of Simplistic Company Limited
- Exhibit 4 – General overview of major exchanges or markets
- Exhibit 5 – Media coverages
- Exhibit 6 – Risks concerning garment industry

Additional information, which comprises supplementary information that expands upon the background in the pre-seen, along with the examination task requirements, will be provided on the day of the examination.

Remarks: You are required to print and bring these materials with you to the examination centre on the examination date. No extra copies will be available in the examination centre.

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Note: This case study is a work of fiction. Any resemblance to actual events or persons is entirely coincidental.



*"Fashion is not about how fancy or how avant-garde your design is. It is about fitting in the right time and right place and right culture. **Simply Design** focuses on the blend of our three Cs: Culture, Close-fitting and Comfort. It's about how comfort you feel, and how comfort people feel when looking at you."*

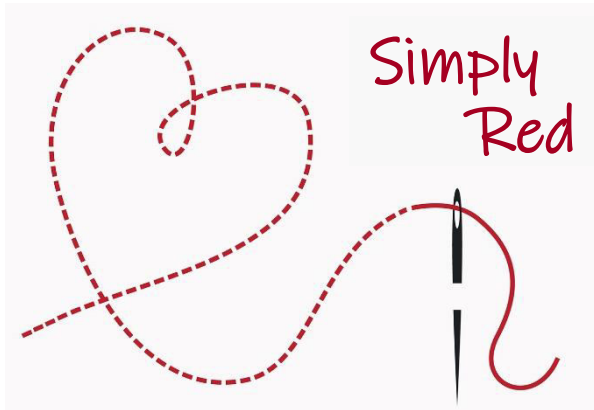
**Mr Yang Jiaer, founder of
Simplistic Company Limited**

Yang Jiaer, the founder of Simplistic Company Limited (the "Company"), was one of the earliest fashion designers to emerge in the People's Republic of China ("PRC"). Since Yang was young, he has always had a particular fondness for fashion design. Yang has never been satisfied with any clothing brought in a store, and will always alter the garment's design. For instance, he always changes the buttons of shirts and resews the buttonholes with coloured threads; sometimes he even cuts a plain T-shirt into pieces and resews it into a totally new and unique design. Yang was always determined to be a fashion designer and to build his own apparel kingdom since.

Following his graduation from the Shanghai Art & Design Academy, Yang furthered his studies in fashion design and also studied brand management in the Istituto Marangoni in Milan, Italy. Afterwards he apprenticed in fashion design in Paris for three years. In 1988, Yang returned to his hometown Shanghai and within a year opened his first store on Sinan Road in the Jingan District.

Deeply influenced by the design and ambience of French architecture, Yang's designs express a unique temperament and spatial language. His designs are simple and minimal, and display a humble connotation of Chinese culture and artistic elegance. Yang named his ladieswear brand *Simply Design*.

At the beginning of his business, each design was handmade by Yang and sold at a premium price: a shirt was priced at around RMB999. Due to the uniqueness and scarcity, Yang's products were widely sought after by young and affluent Shanghai females in their 30s to 50s, who enjoyed life but tended to have an introverted attitude towards brands and trends. The brand became well-known in Shanghai in the mid-90s, and was widely reported in internationally renowned fashion magazines. In short, business flourished. Within five years, the number of stores owned by the Company totalled six in Shanghai, and two in Beijing.



In 2000, Zhang Li, a visiting professor for fashion design at Beijing University of the Arts, and who had been working as chief designer for the China office of an Italian apparel brand, joined the Company as design director. Zhang's designs were renowned for being contemporary, avant-garde and hand-glazed with meticulous care. Her engagement with the Company gave birth to another line of minimalistic ladieswear, *Simply Red*. The launch of the new brand was another success. It received the same market reputation as *Simply Design*, and was widely known as "the best clothing you can buy for work".

Nowadays, *Simply Red* targets at the energetic young workforce, i.e., those who look for quality and design without paying a huge price. *Simply Red* is priced slightly lower to cater for the spending power of this group: a shirt is about RMB699 on average for *Simply Red*, compared to RMB1599 for *Simply Design*.

Sales and Marketing

Steered by Yang and Zhang, business has grown well. The Company has developed 30 outlets throughout mainland China managed under stringent franchisee selection, except for the six outlets in Shanghai which are all under direct management control. The Company has operated an online store on the Tmall.com platform since 2010, sales from which, however, are only about 6-8% of the Company's total turnover. Yang understands that sales via online platforms are generally not high for the garment industry, and product return rates can be as high as 50%. Yet he believes an online presence is very important and represents the future.

In 2015, Yang witnessed soaring in internet sales via the medium of direct broadcasting. After careful consideration, instead of placing advertisements in traditional media such as magazines, the Company decided to invest in its online presence by engaging internet celebrities, key opinion leaders, and other influencers (collectively "influencers") to promote the Company's products online. Within a year, not only did the Company's online sales increase by 100%, sales in retail outlets also recorded an increase of 40%.

The Company engaged these influencers and paid them a fixed fee plus a commission for sales effected online at a predetermined rate. Over the years, the surge in online marketing costs with these influencers prompted Yang to act. Realising the importance of omni-channel interaction, in 2018, Yang devoted a 200 square metered area right in the middle of the guest floor of the headquarters for setting up 5 individual glass rooms. These glass rooms were populated with a team of newly recruited online salespersons ("online sales team"). The team was employed to promote the Company's two brands and products via direct broadcasting on Douyin --- a popular online interactive social media marketing service platform. The team of online salespersons consisted of energetic and vivacious females. The salespersons represented a size inclusive range of female body shapes and builds. During the broadcasts, the salespersons would try on different outfits as part of the promotion strategy.

The Company has now developed its fully interactive omni-channels consisting of physical retail stores, online platforms and interactive social media marketing platforms. The strategy has proven successful. The online salespersons have quickly built up their own stream of followers. Turnover derived from these salespersons contributes to about 30% of the Company's total revenue.

For brand management and promotional purposes, each year, the Company participates in the China International Fashion Week and one of the international fashion weeks such as the Tokyo Fashion Week.

Procurement and Store Management

The Company has a procurement team of six staff. Fabric and accessory requests from designers are passed to the procurement team for further assessment (scope the market for similar or better alternatives), price negotiation, and procurement after final approval is obtained from Yang. Fabrics are acquired from over 40 suppliers ("qualified suppliers") that includes mainly PRC-based garment manufacturers with a longstanding and trustworthy relationship with the Company. The procurement team arranges the production schedule in a timely manner to cater for the needs of different sales channels. The procurement team is also responsible for the product specification card, packaging and delivery to store outlets. If procurement has to be sought from outside suppliers, instead of the qualified suppliers, the team must obtain quotations from at least three reputable suppliers and submit to Yang and Zhang for approval.

The Company has a small team of three inhouse designers responsible for all interior design and visual merchandising of store outlets, and graphic design of printed materials. The team is responsible for engaging suppliers to produce the required hardware for the seasonal designs and distributing the established store setup guidelines to the store management team.

The store management team of 10 staff is responsible for evaluating the store capacity, arranging store keeping units ("SKU"), negotiating rental agreements, store renovation, visual merchandising, etc. The team is also responsible for the management of the T-mall store, and the delivery of sales items sold via online sales team.

Design and Manufacturing

Yang is the chief designer and head of the design team, and Zhang is the co-head of the design team. Apart from Yang and Zhang, there are six design teams, each with a senior fashion designer, two junior fashion designers, two associates and a trainee. Three of the teams are responsible for *Simply Design* and three for *Simply Red*. Each team, led by the senior designers, produces their own designs following the theme set for each season. Each collection is subject to peer review and voting among the teams. Final approval must be obtained from both Yang and Zhang, although Yang retains the veto right, before going into production. Team performances are assessed semi-annually, the results of which determine the yearly bonus of the team members. More importantly, the winning team of the year and their collection will be able to participate in the upcoming fashion shows joined by the Company.

Since 1998, Yang has started to outsource production to two small factories, one in Jiaying and the other in Ningbo. Prototypes designed by design teams are passed to the production team that segregate the orders to these factories based on their production capability. With the intent of occupying their full production capacity, Yang chose two small factories. Yang's choice ensured that the factories worked exclusively for the brand to retain the highest level of control and confidentiality.

Factory Operations and Quality Control

There is a quality control ("QC") team under the production team. Led by the QC manager, four QC officers closely monitor the operation and production of the factories. To ensure the Company's products are of top-quality and meet all the regulatory standards, the QC team members are responsible for the actual inspection of the products. The following QC procedures are performed:

- (i) Pre-Production Inspection ("PPI") - before production, a QC officer inspects and assesses the quantity and quality of the raw materials to be used, to ensure they conform to the required product specifications.
- (ii) During Production Inspection ("DPI") - when around 10% of one product are produced, QC officer inspects the product and looks for any deviations. If deviations are noted, the product will be re-produced and re-inspected for defects to ensure the identified issue had been corrected.
- (iii) Pre-shipment inspection ("PSI") - Random sampling is conducted by a QC officer, when 80% of the products are produced and packed for delivery, to ensure production complies with the specifications required by the Company on details such as style, color, size, packing details.
- (iv) Loading supervision ("LS") - a QC officer will supervise the loading and unloading of products to guarantee their safe arrival to destination.

The QC manager will assign any of the four QC officers to perform any of the above procedures. The QC manager is also responsible for deciding whether to perform piece-by-piece inspection (normally when a factory fail two or more of the above procedures). Both the QC manager and officers involved in the inspection will sign the QC report detailing each of the above procedures.

Recruitment and Remuneration

Zhang received a profit share of 20% on *Simply Red's* gross profit and a fixed base salary as her remuneration. For the staff of the online sales team, the Company signed and renewed contracts with them on an annual basis, with their remuneration based on a fixed monthly base salary. They also received a commission per sales based on the standard scale set by the Company. The Designers' salaries are fixed but they receive a variable bonus annually based on their team's performance.

To get more international insights and updates on international trends, Yang and Zhang travel frequently to attend fashion shows in Europe, Japan and the US. They bring back valuable insights from each trip and share these with their designers to expand their international dimensions. They have also built good relationships with renowned design schools, their professors and students, not only to exchange views and ideas on fashion design trends and innovations, but also to discuss about future internship opportunities.

During such discussions, Yang and Zhang noted that some famous fashion design houses offered unreasonably high salaries and remuneration packages to attract young talent. At the beginning they could not understand why those inexperienced young designers deserved such packages, but they gradually understood the importance of attracting the best talents for the Company's long-term development. They have casually shared this phenomenon with their senior designers, who is in general strongly against the rationale of offering high salary packages to graduates or young designers with little working experience.

Corporate Social Responsibility

Both Yang and Zhang are philanthropists and believe in the importance of giving back to society. As such, the Company holds a charity program, led by different colleagues on rotation, annually. In 2020, the Company charity program was held in October before the cold weather struck. With the help of local government officials, 1,000 pieces of *Simply Red* products including cotton jackets, hats and scarves donated by the Company and its employees spontaneously arrived in Sichuan Liangshan Yi Autonomous Prefecture and were distributed to the needy families.

Going on to the Next Stage

The strategic setup of the online sales team has catapulted the Company to the next level. The two brands have become more well-known among the young generation. The market effects are reflected from the continuous growth in turnover, both online and offline. The Company has recorded a tremendous 50% growth in revenue in 2020 and solidified its market position as a leading profitable fashion company beating many of the established retail players. However, Yang foresees the growth rate will start to fall. For the coming years, he conservatively expects a 5% annual growth if no new element is injected into the business.

New elements include adding more categories to the existing product lines or adding a new product line to the Company. Currently, *Simply Design* and *Simply Red* each constitutes half of the company's total revenue. Quantity-wise *Simply Red* constituted 70%. Despite a lower margin for *Simply Red*, the line is important as its maturing customers will migrate to become customers of *Simply Design*, indicating to Yang and Zhang that horizontal expansion is worth considering. They are also considering adding a new line, *Simply Black*, for menswear. Although confident, both Yang and Zhang have no solid or established experience in menswear.

On the other hand, sportswear has always been in the mind of Yang. Although Yang and Zhang have no experience at all in sportswear, they believe they can master it. Nowadays, sportswear has become a fashion. In the past, sportswear was mainly designed for functional and technical needs without much emphasis on the style. In order to test market acceptance, the Company created a prototype collection of stylish casual sportswear under a new brand *Simply Sporty* and had them previewed in the recent Tokyo Fashion Week. They received a good market response.

Several private equity firms have approached the Company for investment opportunities. Investment bankers have also pitched the Company for the listing of its shares. In fact, Yang has been considering listing the Company for a long time, as this will help the Company build up an international image which it currently lacks. There are many reputable stock exchanges around the world, such as those in New York, London, Hong Kong, Frankfurt, and Tokyo. Yang and Zhang understand that they need to consider many issues to go for listing, such as listing requirements and regulations of individual stock exchanges, financial reporting and relevant regulations on listed companies in that country, expected likelihood of getting sufficient subscription on new share issues, the Company's valuation, and investors' general understanding and perception of the industry. There will be pros and cons for each market, for instance, it may be easier to get a higher valuation in a particular stock exchange but more stringent financial reporting requirements will be placed on the Company. It is important to make a balanced consideration when making the listing choice.

Under increasing market competition and overwhelmed by the growing business, Yang and Zhang both want to take the opportunity to lift the Company to the next stage. Now, they are seriously considering what the next steps should be. A management meeting will be held next week, and you, Lin Chan, as the Finance Manager will have to be well prepared to supply the management team with information relating to these matters.

Exhibit 1



20/01/2021 (Wednesday) 16:33

melainewong@simplistic.com.cn

Preparation for management meeting

To: linchan@simplistic.com.cn

Dear Lin,

I have left this afternoon to travel to Hong Kong with Yang for some urgent matters and will not be back until next week. During my absence, I will need your help to prepare for the management meeting next Wednesday.

The focus of the meeting will be on the strategic direction of our company. We will be discussing about the coming workplan and the expansion plan from different perspectives. As such, I would like you to research on information and matters related to the meeting's focus to assist management in decision making.

I have left on your table some information I gathered this morning for you to continue to work on:

- Financial statements [Exhibit 3];
- General overview of major exchanges [Exhibit 4];
- Media coverages on fashion week [Exhibit 5]; and
- Risks concerning garment industry [Exhibit 6].

Again, please further research for more information such that our presentation will be able to keep everyone in the meeting well-informed. If you have any question, please feel free to text me but I will likely be replying late due to the tight schedule.

Melaine Wong

Finance Director

Organisation Chart of Simplistic Group Limited

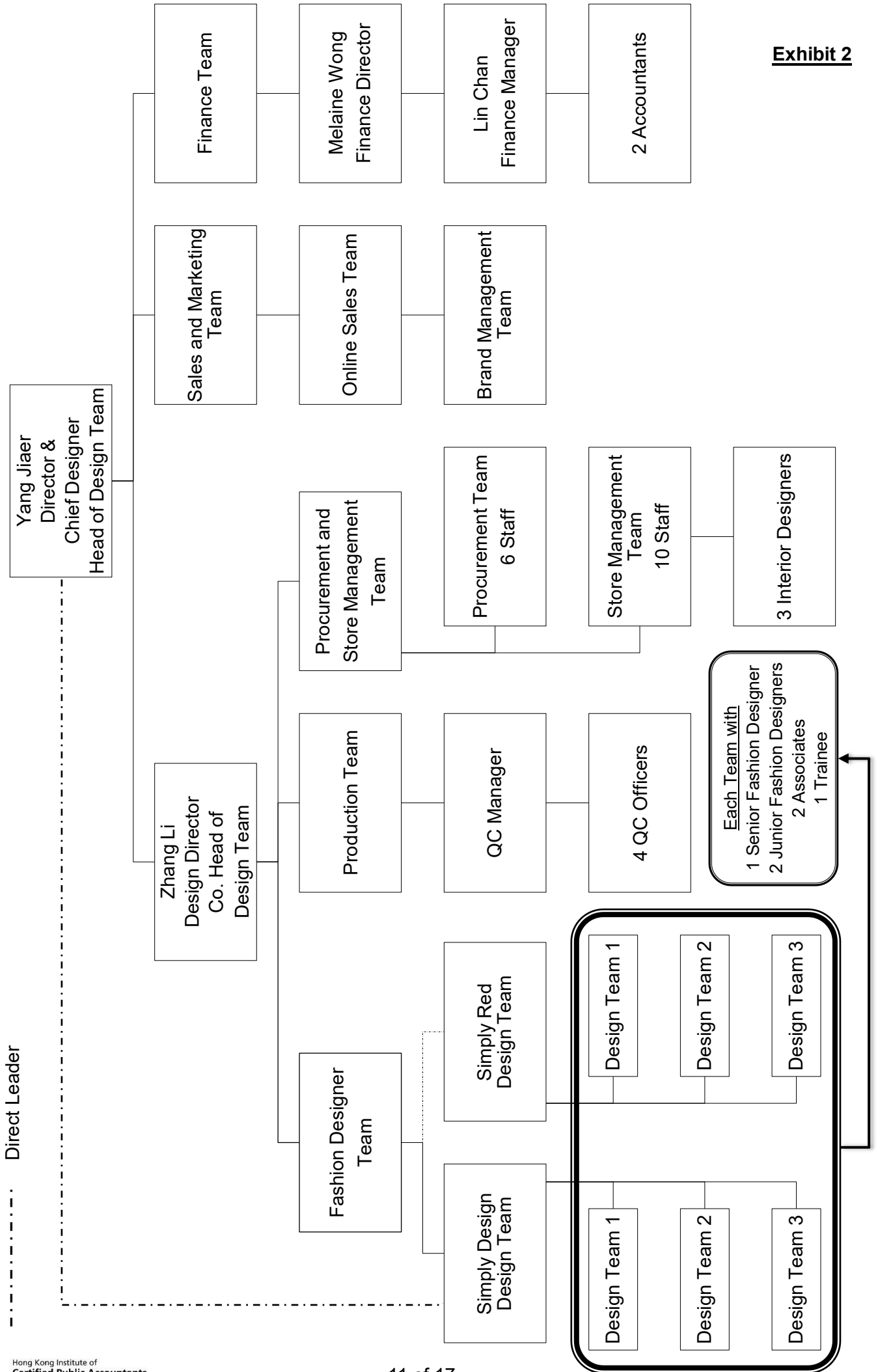


Exhibit 2

Exhibit 3**Simplistic Company Limited
Statement of Financial Position
As at 31 December 2020**

	2020	2019	2018
	RMB'000	RMB'000	RMB'000
Non-current assets			
Property, plant and equipment	13,694	12,679	12,581
Prepaid lease payments	1,541	1,440	1,453
Intangible assets	1,558	1,468	1,449
Restricted bank deposits	<u>10,915</u>	<u>10,201</u>	<u>9,997</u>
	<u>27,708</u>	<u>25,788</u>	<u>25,480</u>
Current assets			
Inventories	87,656	73,047	55,516
Trade and other receivables	14,800	12,869	11,325
Prepaid lease payments	444	423	434
Cash and bank deposits	<u>116,730</u>	<u>108,184</u>	<u>110,245</u>
	<u>219,630</u>	<u>194,523</u>	<u>177,520</u>
Current liabilities			
Trade and other payables	82,152	69,620	59,000
Bank borrowings	8,426	7,499	7,124
Tax liabilities	5,381	3,657	3,082
Lease obligations	<u>6,480</u>	<u>6,000</u>	<u>6,108</u>
	<u>102,439</u>	<u>86,776</u>	<u>75,314</u>
Net current assets	<u>117,191</u>	<u>107,747</u>	<u>102,206</u>
Total assets less current liabilities	<u>144,899</u>	<u>133,535</u>	<u>127,686</u>
Non-current liabilities			
Lease obligations	5,703	5,280	5,342
Deferred tax liabilities	<u>1,770</u>	<u>1,203</u>	<u>1,014</u>
	<u>7,473</u>	<u>6,483</u>	<u>6,356</u>
Net assets	<u>137,426</u>	<u>127,052</u>	<u>121,330</u>
Capital and reserves			
Share capital	10,100	10,100	10,100
Reserves	<u>127,326</u>	<u>116,952</u>	<u>111,230</u>
Total equity	<u>137,426</u>	<u>127,052</u>	<u>121,330</u>

**Simplistic Company Limited
Statement of Comprehensive Income
For the year ended 31 December 2020**

	2020	2019	2018
	RMB'000	RMB'000	RMB'000
Revenue	375,967	252,513	202,011
Cost of Sales	<u>(180,464)</u>	<u>(113,631)</u>	<u>(84,844)</u>
Gross Profit	<u>195,503</u>	<u>138,882</u>	<u>117,167</u>
Selling and distribution expenses	(14,202)	(10,292)	(6,861)
Administrative expenses	(34,717)	(28,931)	(26,301)
Finance costs	<u>(123)</u>	<u>(124)</u>	<u>(105)</u>
	<u>(49,042)</u>	<u>(39,347)</u>	<u>(33,267)</u>
Profit before tax	146,461	99,535	83,900
Income tax expense	<u>(36,615)</u>	<u>(24,884)</u>	<u>(20,975)</u>
Profit for the year	<u>109,846</u>	<u>74,651</u>	<u>62,925</u>

Segment in (2018-2020)	Product line	
	Simply Red	Simply Design
Revenue	50%	50%
Quantity	70%	30%
Profit Margin	Simply Red < Simply Design	

Exhibit 4

GENERAL OVERVIEW OF MAJOR EXCHANGES OR MARKETS

Market/Exchange	Characteristics
Australia: Australian Securities Exchange (ASX)	<ul style="list-style-type: none">• Two-thirds of its constituents are small and medium-sized enterprises (SMEs) with market capitalisation under AUD100 million.• Cooperated with the Singapore Stock Exchange in 2000 for the cross-trading of stocks.• In 2005, introduced anonymous broker trading to boost liquidity.• More than three-fourths of ASX's total value made up of stocks in the Standard & Poor's/Australian Securities Exchange index.
China: Shanghai Stock Exchange (SSE) and Shenzhen Stock Exchange (SZSE)	<ul style="list-style-type: none">• The largest financial market in APAC.• SSE and SZSE attract foreign investment through the Qualified Foreign Institutional Investor (QFII and RQFII) programmes, and the Stock Connects through the Hong Kong Exchange or the London Stock Exchange, to get access to A-shares of all SSE and SZSE-listed companies.
Germany: Deutsche Börse (DB)	<ul style="list-style-type: none">• Low capital costs for issuers, and high liquidity and low transaction costs for investors.• Launched in 2005 the Entry Standard, which is opened to all issuers but provides a particularly simple, quick and cost-effective way for SMEs to access the capital markets: no sector focus, no minimal requirements as to the size of a company and only a minimum one-year age requirement.
Hong Kong: Hong Kong Stock Exchange (HKEX)	<ul style="list-style-type: none">• A sophisticated and experienced stock market compared to its mainland counterparts.• Geographically close to mainland China.• High listing standards, but not as strict as those in the US, and relatively less stringent corporate governance requirements.• Hosted many of the world's largest IPOs, e.g. the China Construction Bank, and the Industrial and Commercial Bank of China.• Friendly to foreign investors by easy access.
London: London Stock Exchange (LSE)	<ul style="list-style-type: none">• Special emphasis on attracting more mainland listings.• Opened a representative office in Hong Kong in 2004.• Has high corporate governance standards but do not have to comply with the costly US Sarbanes-Oxley Act.• Has the Alternative Investment Market ("AIM") with low listing costs, low threshold for entry, flexible corporate governance regime, vigorous marketing campaign and a host of nominated advisors (Nomads) to the exchange.• Mining companies make up nearly one fifth of AIM's market capitalisation.

New York: New York Stock Exchange (NYSE Euronext)	<ul style="list-style-type: none">• NYSE merged with the Euronext stock exchange in 2007 and became NYSE Euronext with greater geographic and product diversification: combined value of listed companies of reached USD26 trillion.• Covers more time zones and offers trade in both dollars and euros.• Strategic alliance with the Tokyo Stock Exchange in 2007 providing priorities to mutual listing of REITs, exchange-traded funds, and companies.• Acquired a 5% stake in the National Stock Exchange of India in 2007.• Maintains offices in Beijing, Hong Kong, London and Tokyo.• Diversifying into the SME market through NYSE Arca of fewer listing requirements and lower fees.
Singapore: Singapore Stock Exchange	<ul style="list-style-type: none">• Attractive not only to Asian companies from countries without international recognition, but also to some private Chinese enterprises.• Aggressive in attracting listings from Chinese companies, collaborates with some Chinese provinces and municipals such as Liaoning, Zhejiang, Shandong and Wuxi.• SESDAQ, the SGX junior board, offers a sponsor-supervised board regime to target both local and foreign growth companies.
Japan: Tokyo Stock Exchange (TSE)	<ul style="list-style-type: none">• Constituent base of nearly 99% Japanese, the TSE seeks to diversify and attract IPO activity from China and other fast-growing countries in Asia to boost its revenues.• Xinhua Finance Ltd was the first Chinese IPO.• Formed strategic alliance with NYSE for mutual listings, data sharing and a connected trading system.

TODAY NEWSPAPER

SPECIAL EDITION



SIMPLY a big hit at Tokyo Fashion Week

It has been a while that one of the biggest creeping trends on catwalks has been the rise in sportswear. The Simplistic Company Limited, renowned for their legendary SIMPLY DESIGN and SIMPLY RED, surprised and stimulated everyone's eyeballs with their new line SIMPLY SPORTY on the Tokyo Fashion Week. The new collection combined high-concept design of the SIMPLY-style and comforting but playful motifs. It was hard to take our eyes off the wonderful collection!

– Marco Jacks



SPORTS THE FUTURE

As Tokyo Fashion Week came to a close on yesterday, one trend for Spring/Summer 2021 could not be clearer – SIMPLY SPORTY.



Risks concerning garment industry

<p>Industry risk</p> <ul style="list-style-type: none"> • competitive landscape • trade policies • import and export controls • macroeconomic developments • etc. 	<p>Financial risk</p> <ul style="list-style-type: none"> • payment terms • advanced payments • obtaining bank guarantees • securing trade credit insurance coverage • invoice factoring • etc.
<p>Operational risk</p> <ul style="list-style-type: none"> • product quality employees' health and safety • regulatory compliance • seasonality impact • etc. 	<p>Compliance risk</p> <ul style="list-style-type: none"> • laws and regulations • identify gaps in control • corrective action • etc.
<p>Supply chain risk</p> <ul style="list-style-type: none"> • Supply risk: interruptions to product flow • Environmental risks: economic, social, governmental, climate, threat of terrorism • etc. 	<p>Reputational risk</p> <ul style="list-style-type: none"> • garment quality control • pre-sales & posts -sales service quality • delivery • pricing • new styles and varieties (market trend) • etc.