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## **DAISHO MICROLINE HOLDINGS LIMITED**

*(Incorporated in Bermuda with limited liability)*

**(Stock Code: 0567)**

- (1) UPDATE ON THE CONSULTANT REPORT OF THE INDEPENDENT FORENSIC INVESTIGATION;**
- (2) FOLLOW-UP ACTIONS AND MEASURES WITH RESPECT TO THE CONSULTANT REPORT; AND**
- (3) PROGRESS ON THE PREPARATION OF THE 2015 ANNUAL RESULTS, 2015 ANNUAL REPORT, 2016 INTERIM RESULTS AND 2016 INTERIM REPORT**

Reference is made to the announcements of Daisho Microline Holdings Limited (the “**Company**”) dated 30 June 2015, 5 August 2015, 17 August 2015, 1 December 2015 and 31 December 2015 respectively (the “**Announcements**”). Unless the context requires otherwise, the capitalised terms used herein shall have the same meanings as defined in the Announcements.

### **UPDATE ON THE CONSULTANT REPORT OF THE INDEPENDENT FORENSIC INVESTIGATION**

As mentioned in the announcement of the Company dated 31 December 2015, the report from the Consultant dated 30 November 2015 (the “**Consultant Report**”) was received by the Audit Committee on 2 December 2015 and was passed to the Management on 3 December 2015, and the Management raised comments on the Consultant Report to the Audit Committee on 8 December 2015 (the “**Relevant Comments**”), which had been passed to the Consultant. Subsequently on 25 January 2016, the Consultant has provided its reply to the Relevant Comments, and issued an Addendum dated 22 January 2016 to the Consultant Report (the “**Addendum**”). As requested by the Audit Committee, the Management provided the formal management responses to the Consultant Report and the Addendum (the “**Formal Management Responses**”) to the Audit Committee on 8 March 2016. As at the date of this announcement, the Consultant is reviewing the Formal Management Responses. The Company will promptly publish further announcement to update the public regarding the Consultant’s responses on the Formal Management Responses and the view of all the INEDs in due course.

Below are the brief details of the background facts considered by the Consultant on those five subject issues as identified by the Audit Committee requiring independent forensic investigation (the “**Subject Issues**”), and a summary of the key findings of the Consultant in the Review.

## The five Subject Issues

### **Issue 1: prepayment of RMB10 million for sewage treatment services**

On 12 April 2013, a sewage treatment contract (the “**Sewage Treatment Contract**”) was entered into between Huafeng Microline (Huizhou) Circuits Limited (“**Huafeng**”) (a wholly-owned subsidiary of the Company), a sewage treatment company based in Huizhou, the People’s Republic of China (the “**Sewage Treatment Company**”) and the ultimate holding company of the Sewage Treatment Company (the “**Target Company**”, together with its subsidiaries, the “**Target Group**”) as guarantor for a contract period of thirty months from 16 April 2013 to 15 October 2015. The Sewage Treatment Company had been the operator of sewage treatment facilities for Huafeng since 2007. Pursuant to the payment terms contained therein, (i) Huafeng agreed to prepay a sewage treatment fee in the sum of RMB10,000,000 (the “**Prepayment**”) to the Sewage Treatment Company which can be applied to offset against the monthly sewage treatment fee incurred by Huafeng under the Sewage Treatment Contract; (ii) the Sewage Treatment Company agreed to give a monthly discount of RMB50,000 from the monthly sewage treatment fee payable by Huafeng for each of the first three months of the contract period; and (iii) Huafeng may at any time after the first three months request the Sewage Treatment Company to repay the balance of the Prepayment which has not been applied to offset the monthly sewage treatment fee incurred or if the Sewage Treatment Company agreed to give further monthly discount of RMB50,000 after the first three months of the contract period, Huafeng was entitled to allow the Sewage Treatment Company to retain the balance of the Prepayment to offset the subsequent monthly sewage treatment fee.

After the Sewage Treatment Company’s failure to repay the said prepayment on demand and the application of arbitration against the Sewage Treatment Company by Huafeng on 11 November 2013, during the meeting of the Audit Committee held on 22 November 2013, one of the INEDs enquired the reason for advancing the Prepayment. The management of Huafeng at the material time of the relevant transactions (the “**Relevant Management**”), namely Mr. Chan Sik Ming, Harry (“**Mr. Chan**”) and Mr. Au-Yeung Wai Hung (“**Mr. Au-Yeung**”) explained that (a) the Target Group was then confronting temporary shortage of working capital due to the recent change in the policy on the timing for the payment of subsidy from the PRC government for the disposition of obsolete home appliances, and therefore, requested for funding in order to resolve their temporary shortage of working capital; and (b) that the business of the Target Group was fast-growing and related to environmental conservation industry. In addition, a major subsidiary of the Target Company was at that time one of a few approved enterprises which was qualified to dispose of obsolete home appliances in the Guangdong Province. Thus, the Relevant Management, considered that the Prepayment and the then lending of short-term loan to the Target Company with an annual yield rate of about 6% could contribute to the potential business opportunity with the Target Company in the future on one hand and also a higher return on the surplus cash of the Group on the other hand.

For the avoidance of doubt, the INEDs had not been notified for the said rationales behind the Prepayment prior to the Audit Committee's meeting on 22 November 2013 when one of the INEDs enquired the reason for advancing the Prepayment and the 2013 Loan (as defined below).

The Relevant Management took the view (which does not represent the view of the INEDs) that the money paid by Huafeng is a prepayment of sewage water treatment fee for the services provided by the Sewage Treatment Company, while the Consultant took the view that the transaction appeared to be covered as a loan of RMB10 million granted to the Sewage Treatment Company that was disguised as the Prepayment. The Consultant further noted the Relevant Management's explanation that the grant of such loan was principally aimed at investing into the relationship with the Target Company and granting the loan could mitigate the risk exposure. However, the Consultant considered that there was a lack of supporting documents to support what the Relevant Management had done prior to the granting of such loan along with insufficient credit risk assessment, and that the explanation given by the Relevant Management that the granting of such loan was to invest into the relationship with the Target Company was a very preliminary idea to be commercially justifiable for putting such significant amount of money at risk. The Consultant also opined that granting of the loan could not really mitigate the risk exposure, as there was no certainty that the Sewage Treatment Company could provide services continuously if it and/or the Target Group had liquidity problems, and in such case, the Consultant considered that there was a strong inference that such Prepayment arrangement may be intended to conceal the loan.

Further, the Consultant was also concerned that the last price adjustment of the sewage treatment service might be unusually high and based on the available documents, the Relevant Management may have failed to exercise reasonable scepticism and question the reasonableness of such price adjustment. This also raised the concern whether the Relevant Management had the intention to allow the Target Company to set off the outstanding Prepayment quicker.

Besides, the Consultant further noted that the Relevant Management had not informed the INEDs at the material time that the Prepayment was in fact a loan or the alleged rationale of increasing security. Although the Relevant Management indicated in the Relevant Comments that the reasons for the arrangement of the Prepayment had been informed to the INEDs at the board meeting of the Company held on 26 August 2013 and the INEDs were updated regularly on the status of the relevant litigation and recovery action afterwards, the Consultant however noted that:

- (1) as shown in the minutes of the board meeting of the Company held on 26 August 2013, the INEDs were only informed that there was a RMB10 million prepayment of sewage treatment fee; and

- (2) as shown in the minutes of the meeting of the Audit Committee held on 22 November 2013, notwithstanding the Relevant Management was faced with enquiries of the reason for advancing the Prepayment and the 2013 Loan (as defined below) by one of the INEDs, the Relevant Management still failed to disclose to the INEDs explicitly that the Prepayment was in fact a loan. Albeit that the Relevant Management may argue that they did mention the yield rate of 6% p.a. for the Prepayment and the 2013 Loan (as defined below) could have implied to the Prepayment, this cannot be said that the Relevant Management did make full and frank disclosure to the INEDs as to that the Prepayment was in fact a loan (but packaged as prepayment).

### **Relevant Management's Explanation**

The Relevant Management explained that in April 2013, Mr. Chan was informed by the president of the Sewage Treatment Company and the Target Company, and her spouse, being the major shareholder and statutory representative of the Target Company (collectively, the “**Target Couple**”) that the Target Group was then confronting temporary shortage of working capital due to the recent change in the policy on the timing for the payment of subsidy from the PRC government for the disposition of obsolete home appliances, and therefore, requested for funding by Huafeng in order to resolve their temporary shortage of working capital.

Mr. Chan had previously discussed with the Target Couple about the possible cooperation between the Group and the Target Group relating to the business of the disposition of obsolete home appliances in the PRC (the “**Potential Business**”). Based on the publicly available information obtained by the management of Huafeng, a major subsidiary of the Target Company was at that time one of a few approved enterprises which was qualified to dispose of obsolete home appliances in the Guangdong Province. Thus, the Relevant Management considered that if the Target Group's temporary shortage of working capital can be resolved, it would be an opportunity to contribute to the realization of the cooperation between the Group and the Target Group in relation to the Potential Business which would be in the long-term interests of the Group.

According to the Relevant Management, the average monthly sewage treatment fee paid by Huafeng to the Sewage Treatment Company prior to the entering into of the Sewage Treatment Contract was approximately RMB300,000 per month. The Relevant Management considered that since the Sewage Treatment Company had been a long term and stable service provider of sewage treatment service to Huafeng and that the monthly discount of RMB50,000 represented an annual yield rate for the Prepayment of about 6% which was much higher than the then bank deposit rate, it would be beneficial to Huafeng to agree to the above payment terms whilst the Group had surplus cash on hand.

The Relevant Management explained that the Prepayment was at most a quasi-loan which was principally aimed at investing into the relationship with the Target Company and the Prepayment arrangement instead of a loan to a borrower as nominated by the Target Couple could mitigate the risk exposure.

Regarding the Consultant's concern that the last price adjustment of the sewage treatment service was unusually high, the Relevant Management pointed out in the Formal Management Responses that the Consultant's own methods of analysis, assessment and evaluation of the findings from which its inference on the reasonableness of the last price adjustment of the sewage treatment service was derived were never discussed with the Relevant Management beforehand and were found by the Relevant Management to be inappropriate.

The above information had not been set out in the Consultant Report or the Addendum. However, the above view of the Relevant Management had been set out either in the draft special review report prepared by the Relevant Management and provided to the Audit Committee on 23 June 2015, or in the Formal Management Responses, both of which were provided to the Consultant. The draft special review report was also mentioned in the Consultant Report. In addition, the above explanation and view of the Relevant Management does not represent the view of the INEDs.

### **Issue 2: a loan of RMB4.7 million granted to the Target Company**

On 24 May 2013 (i.e. approximately one month after the Prepayment was made), Huafeng entered into a loan contract with the Target Company, pursuant to which a loan of RMB4.7 million (the "**2013 Loan**") was made by Huafeng to the Target Company for a term of two months commencing from 24 May 2013 to 24 July 2013. The interest rate was 0.54% per month and the interest was payable on a monthly basis.

The Consultant noted that the rationale of the Relevant Management in entering into the 2013 Loan was no different from that of the Prepayment.

The Consultant however was of the view that the 2013 Loan was undoubtedly an extension to the Prepayment, and was concerned that at the time of granting the 2013 Loan, the Sewage Treatment Company and the Target Company were already in financial difficulties but the Relevant Management granted the 2013 Loan without any reasonable justification and documentation. The Consultant also noted that there were no terms and conditions in the arrangement of the 2013 Loan to mitigate the credit risk.

### **Issue 3: a loan of RMB6 million granted to a chamber of commerce in Huizhou**

In May 2014, the executive president (the "**Chamber President**") of a chamber of commerce in Huizhou (the "**Chamber**") approached Mr. Au-Yeung, requesting for the lending of a loan in the amount of RMB6 million (the "**2014 Loan**") by Huafeng to the Chamber for liquidity purpose. On 5 May 2014, the contract for the 2014 Loan was entered into between Huafeng, the Chamber and the Chamber President as the guarantor for the 2014 Loan for a term of nine months from 6 May 2014 to 6 February 2015.

The Consultant noted that the Relevant Management took into consideration that:

- (1) the Chamber President had helped Huafeng on two major occasions in the past in dealing with business issues/matters such as the change in the category of the land use rights for Huafeng's factory site from "allotment" to "assignment", and therefore, the Relevant Management regarded the 2014 Loan as a return of favour to him;



- (2) the interest rate for the 2014 Loan was 12% p.a., which was more attractive than bank deposits for the Group's surplus cash;
- (3) the Chamber was a social organization in Huizhou, the PRC registered in January 2012 and with numerous entrepreneurs as its members; and
- (4) the Chamber President, who is known to be a wealthy individual in Huizhou, the PRC, agreed to personally guarantee the repayment of the 2014 Loan,

and therefore agreed to the provision of the 2014 Loan to the Chamber.

For the avoidance of doubt, the INEDs were not informed about the 2014 Loan to the Chamber at the time the loan was granted to the Chamber.

However, the Consultant had doubts as to whether the Chamber had liquidity need, as the Chamber had many contributing wealthy members and that it held a large-scale anniversary banquet shortly before the 2014 Loan repayment was due. The Consultant also noted that Huafeng had made a prepayment of consultancy fee to a company controlled by the Chamber President about three months prior to the 2014 Loan but such prepayment was thereafter wholly refunded prior to the 2014 Loan because it was rejected by the INEDs. The Consultant considered that the nature of the prepayment of consultancy fee was apparently like a loan. The Consultant was concerned that the Relevant Management did not voluntarily disclose the abovementioned prepayment made by Huafeng prior to the 2014 Loan even though the Consultant had asked the Relevant Management to list out all the previous loans in the last 3 years, and that the 2014 Loan was merely a replacement of the abovementioned prepayment made by Huafeng to a company controlled by the Chamber President prior to the 2014 Loan. In view of the above, the Consultant considered that it was suspicious as to what was the actual loan arrangement with the Chamber and who was prima facie the borrower in the 2014 Loan. In addition, the Consultant was concerned that the Relevant Management may have disguised the loan to the Chamber President as the 2014 Loan and ignored or circumvented the objection of the INEDs to make the abovementioned prepayment to the company controlled by the Chamber President or parties related to the Chamber President.

Further, although the Relevant Management had pointed out in the Relevant Comments that the prepayment made by Huafeng to the company controlled by the Chamber President was related to the consultancy fee, the nature of which was entirely different from that of a loan which required repayment, the Consultant clarified that it had been clearly stated in the Consultant Report that the payment to the company controlled by the Chamber President was recorded as prepayment and the Consultant was unclear what clarification and/or amendment was required.

The Relevant Management reiterated in the Formal Management Responses that the nature of the consultancy fee which need not be repaid was entirely different from that of a loan which required repayment and hence the Relevant Management did not agree with the comment by the Consultant that the prepayment of consultancy fee to the company controlled by the Chamber President was equivalent or similar to a loan to the company controlled by the Chamber President.

#### **Issue 4: expenditures of RMB1.03 million reimbursed to a friend of Mr. Chan**

The Group recorded RMB1.03 million worth of expenditure during April to December 2014 in the “Staff Welfare” account. The Relevant Management explained that these expenditures were reimbursements paid to a friend of Mr. Chan, who had been assisting Huafeng in the three-old transformation of Huafeng’s factory site into residential and commercial area for the attempt to increase the plot ratio in the redevelopment. Mr. Chan considered that the approved plot ratio limit would be too low for such a prime site and expected that the revision of the plot ratio limit would bring in additional revenue in the order of hundreds of millions. Accordingly, Mr. Chan sought assistance from his friend. These expenditures incurred by his friend were initially without supporting documents when the Auditor started the audit of the financial statements for the year ended 31 March 2015. Upon the request by the Auditor, general tax invoices issued by different hotels were subsequently provided as supporting documents for these expenditures.

The Consultant had concern as to the genuineness of the general tax invoices (e.g. certain general tax invoices were back-dated, certain invoice numbers were almost sequential and the expenditure amount was inconsistent with the period of accommodation), as there was no explanation on how the substantial sums were spent in the hotels, and how these spending correlated to the facilitation of increasing the plot ratio in the redevelopment. The Consultant considered that the nature and purpose of the reimbursements was in doubt, and how the reimbursements were actually spent was questionable.

The Consultant further noted that other than the fact that Huafeng had changed the land use right of the factory site from “allotment” to “assignment”, it had applied to participate in the three-old redevelopment, and that it had engaged an estate consultant to conduct a market feasibility study in relation to the redevelopment of the factory site in or around October 2014, the Consultant had not been provided with evidence which indicated that the Group was prepared for the redevelopment of the factory site. If the Group had already obtained solid support on the commercial rationales and had been determined to proceed with the redevelopment project, the Consultant would consider that the assistance from an individual with solid network in the government could be beneficial. However, the vision of earning additional hundreds of millions of revenue by increasing the plot ratio would not be sufficient to justify the expenditure of RMB1.03 million at this stage of the project.

#### **Issue 5: a prepayment of RMB2 million to a construction company for renovation of Huafeng’s factory after a fire incident in January 2013**

As mentioned in the announcement of the Company dated 30 January 2013, a fire accident occurred at the principal printed circuit board production base of the Group in Huizhou, the People’s Republic of China. The then unmarried partner of Mr. Chan (“Miss L”) assisted Huafeng and sourced a construction company (the “**Construction Company**”) for renovating the damaged part of the factory. Huafeng prepaid a sum of RMB2 million to the Construction Company on 18 September 2013 according to a draft renovation contract between Huafeng and the Construction Company (the “**Construction Contract**”) but no renovation work had been performed by the Construction Company since then.

The Consultant noted that Miss L allegedly had assumed the role of the general manager of Huafeng in practice but she had never been appointed officially and had no official role or employment within the Group. The Consultant also noted that the Construction Contract had not been properly signed because only the first page instead of the signing page of the Construction Contract was signed and chopped by Huafeng and the Construction Company and it appeared that the chop was meant to acknowledge certain amendment on the first page.

### **Conclusion of the Consultant**

During the Review, the Consultant reviewed, analysed, assessed and evaluated the five Subject Issues, in particular whether there was any potential fraud and/or irregularity on the part of any director, management, employee or representative of the Group and/or their respective associates involved therein.

The Consultant did not find any clear evidence to suggest that any of the Subject Issues was related to fraud, nor was there any evidence clear enough to completely reject the explanations and/or clarifications given by the Relevant Management in relation to the Subject Issues. However, the Consultant had serious concern that the Relevant Management's explanations and clarifications were in many aspects extraordinary and unreasonable and, in some cases, suspicious in nature as demonstrated in the result of the independent forensic investigation. The Consultant further noted that even though there was no evidence to suggest that any of the Relevant Management had benefited from the Subject Issues, the lack of supporting evidence and documentation clearly weakened the explanation by the Relevant Management and the Subject Issues were further complicated by their unique nature. This caused the Consultant to conclude that the Relevant Management's explanations were hardly believable and suspicious. While the Consultant could not conclude that the Subject Issues were related to fraud or false accounting, there were clear evidence which supported that the Subject Issues raised serious concern as to the Group's internal controls.

Accordingly, the Consultant made the following recommendations in the Consultant Report:

- (1) internal control or corporate governance expert should be sought to review the Group's internal controls; and
- (2) proper advice should be sought as to whether any member of the Relevant Management had breached their duties in the Subject Issues.

### **Relevant Comments**

The Relevant Management raised out the Relevant Comments on 8 December 2015, in which the Relevant Management considered that they were not given any opportunity to preview nor to respond on the Consultant Report before it was finalized by the Consultant on 30 November 2015.

The Relevant Management also considers that certain events in the Consultant Report were not described or understood by the Consultant precisely. The Relevant Comments were just examples of certain events in the Consultant Report, which were considered by the Relevant Management as not being described or understood by the Consultant precisely.



The views of the Relevant Management set forth above do not represent the views of the INEDs.

### **Response by the Consultant to the Relevant Comments**

After reviewing the Relevant Comments by the Consultant, the Consultant provided its reply on 25 January 2016 for each of those events as raised in the Relevant Comments and issued an Addendum dated 22 January 2016 to the Consultant Report. The Consultant believed that it had adequately dealt with the questions or concerns raised by the Relevant Management. Conversely, the Consultant did not consider that the Relevant Management had provided any substantive explanation or evidence which would cause to alter any of its review, analysis and/or conclusion in the Consultant Report.

### **Formal Management Responses**

The Relevant Management was provided with a soft copy of the Consultant Report on 3 December 2015 when a Board meeting was requested by the Audit Committee to be convened on 9 December 2015 to discuss the result of the Consultant Report and other matters relating to the Review. Due to the limited time in this short intervening period, the Relevant Management could only provide to the Board members of the Company on 8 December 2015 with the Relevant Comments as an immediate management response to the Consultant Report prior to the Board meeting on 9 December 2015. The Relevant Comments were just part of the management responses to the Consultant Report by indicating examples of certain events mentioned in the Consultant Report which were considered by the Relevant Management as not being described accurately or understood correctly by the Consultant. As requested by the Audit Committee, the Relevant Management provided the Formal Management Responses to the Audit Committee on 8 March 2016. Below is a summary of the Formal Management Responses:

The conclusion of the Consultant Report echoed the previous representations made by the Relevant Management to the Audit Committee that there was no fraud involved in the Subject Issues and the Relevant Management did not have any personal interests in nor derive any personal benefits from the Subject Issues.

The Relevant Management admitted that there were rooms for improvement in the internal control system of the Group. The Relevant Management agreed to engage an external qualified expert to review annually the corporate governance (including internal control system) of the Group from the year of 2016 onwards on an on-going basis with the scope of such review clearly defined. The Relevant Management considered that the possible root-causes of the weaknesses in the internal control system of the Group and the recommended corrective actions had not been asked about from the Relevant Management by the Consultant nor explored by the Consultant in the Consultant Report and so set out the details of the symptoms for the weaknesses in the internal control system of the Group along with the possible root-causes and recommended corrective actions in the Formal Management Responses.

The Relevant Management failed to see the logic how the Consultant came to the conclusion that the Relevant Management's explanations were hardly believable and suspicious. The Consultant questioned that the Relevant Management did not provide any documentary evidence such as internal approval form, memorandum, discussion between the management, research and/or credit assessment etc., and therefore considered the Relevant Management's explanations to be completely unsupported or bare allegations. However, the Consultant actually acknowledged that the Relevant Management had provided them with the relevant agreements and accounting vouchers relating to the Subject Issues. In any event, the Relevant Management considered that there was no direct correlation between the presence of documentary evidence and the credibility of the Relevant Management's explanations, although the Relevant Management agreed that the lack of such documentary evidence was not entirely satisfactory. The Relevant Management also considered that there was no direct correlation between the unusual nature of the Subject Issues and the credibility of the Relevant Management's explanations. The Relevant Management agreed that the Subject Issues were unique and unusual in nature. However, this was more of a result of the special circumstances surrounding Huafeng and the business environment in the PRC when the Subject Issues happened.

The Relevant Management noted from the Consultant Report that regarding Issue 1, the Consultant made use of their own methods of analysis, assessment and evaluation of the findings and made inferences using such methods accordingly. However, the appropriateness of their methods of analysis, assessment and evaluation of the findings were never discussed with the Relevant Management beforehand and hence, some of their inferences with respect to Issue 1 were inappropriate.

The Relevant Management noted from the Consultant Report that the Consultant took into account information not available when the Subject Issues happened, so it would be relatively easy for the Consultant to criticize with hindsight. In order to do justice to the Relevant Management, the Subject Issues should be looked at with reference to the information available to the Relevant Management at the relevant point of time.

Apart from those mentioned in the Relevant Comments, the Relevant Management considered that certain events in the Consultant Report were not described accurately or understood correctly by the Consultant.

Although it was mentioned in the Consultant Report that the Relevant Management provided the Audit Committee with a special review report on 23 June 2015, this special review report was not included as an annexure to the Consultant Report and certain relevant information contained therein was not mentioned in the Consultant Report. The Relevant Management considered that the omission of such relevant information would prejudice the Relevant Management.

Last but not the least, it should be noted that the Relevant Management had not rebutted certain criticisms made by the Consultant in the Consultant Report due to the lack of relevant and persuasive documentary evidence. However, it does not mean that such criticisms made by the Consultant in the Consultant Report had been agreed to by the Relevant Management.

As at the date of this announcement, the Consultant is reviewing the Formal Management Responses. The Company will promptly publish further announcement to update the public regarding the Consultant's responses on the Formal Management Responses and the view of all the INEDs in due course.

## **FOLLOW-UP ACTIONS AND MEASURES WITH RESPECT TO THE CONSULTANT REPORT**

With regard to the Subject Issues, the Group has all along been taking active steps to recover the loss suffered:

1. Concerning Issue 1, Huafeng has been pursuing legal actions against the Sewage Treatment Company and the Target Company for the recovery of the outstanding amount of the Prepayment. Huafeng was awarded a seizure order (the “**Seizure Order**”) by the Huizhou Huicheng District People’s Court in November 2013 to freeze certain assets (being shareholding interests in two subsidiaries of the Target Company (the “**Two Subsidiaries**”)) held by the Target Company (the “**Freezed Assets**”), and was awarded an order by the Huizhou Arbitration Commission in April 2014 for the Sewage Treatment Company and the Target Company to return the outstanding amount of the Prepayment.

As the Sewage Treatment Company and the Target Company continued to fail to repay Huafeng, Huafeng made an application in June 2014 to the Huizhou Intermediate People’s Court (the “**Huizhou Court**”) for the mandatory enforcement of the order granted by the Huizhou Arbitration Commission. Huafeng was requested by the relevant judge of the Huizhou Court to undertake the payment of the costs for the Huizhou Court to appoint a valuer to conduct a valuation on the Freezed Assets before such mandatory enforcement action. According to the view of the Relevant Management, the prospect of obtaining proceeds from the Freezed Assets was low because the Two Subsidiaries were already out of operation after the detention of the Target Couple by the PRC public security bureau in mid-2013 arising from issues relating to one of the Two Subsidiaries. Therefore the Relevant Management decided not to proceed with the valuation. The Seizure Order subsequently expired in November 2015.

The current outstanding amount of the Prepayment was RMB5,941,563 (equivalent to about HK\$7,093,632, and the initial amount of the Prepayment was RMB10 million) for which full impairment loss had been made by the Company for the financial year ended 31 March 2015 but the Auditor has not yet agreed to this accounting treatment.

2. Concerning Issue 2, Huafeng filed a claim against the Target Company at the Huizhou Huicheng District People’s Court in November 2013 for the outstanding amount of the 2013 Loan, and a court order in favour of Huafeng was obtained in February 2014. According to the view of the Relevant Management, the prospect of obtaining proceeds from the Freezed Assets was low because of the same reason as mentioned in Issue 1 above.

The current outstanding amount of the 2013 Loan was RMB2,000,000 (equivalent to about HK\$2,387,800, and the full amount of the 2013 Loan was RMB4.7 million) for which full impairment loss had been made by the Company for the financial year ended 31 March 2015 but the Auditor has not yet agreed to this accounting treatment.

3. Concerning Issue 3, Huafeng filed a claim against the Chamber at the Huizhou Arbitration Commission in July 2015, demanding the payment of the outstanding amount of the 2014 Loan, and an order granted by the Huizhou Arbitration Commission in favour of Huafeng was obtained in December 2015. Huafeng made an application in January 2016 to the Huizhou Court for the mandatory enforcement of the order granted by the Huizhou Arbitration Commission. The Huizhou Court issued an enforcement verdict on 2 March 2016 to freeze certain bank accounts of the Chamber and the Chamber President to the extent of RMB4.95 million for each bank account for a period of one year. According to the reply up to 4 March 2016 by the relevant banks to the Huizhou Court in relation to the enforcement verdict, the actual frozen amount of bank balances for the Chamber and the Chamber President were about RMB867,252 and RMB18,354 respectively. The Relevant Management was of the opinion that the possibility of recovering the outstanding amount of the 2014 Loan was high based on the advice from the solicitor for Huafeng and the current circumstance.

The current outstanding amount of the 2014 Loan was RMB4,180,000 (equivalent to about HK\$4,990,502, and the full amount of the 2014 Loan was RMB6 million) for which no impairment loss was made by the Company for the financial year ended 31 March 2015 but the Auditor has not yet agreed to this accounting treatment.

4. Concerning Issue 4, according to the Relevant Management, Mr. Chan will discuss with his friend to recover some of the reimbursements as previously paid to his friend because the result for the attempt to increase the plot ratio in the redevelopment was not satisfactory.
5. Concerning Issue 5, Huafeng obtained an order granted by the Huizhou Huicheng District People's Court in July 2015 to freeze the bank account of the Construction Company. Huafeng also filed a claim to the Huizhou Huicheng District People's Court in August 2015 against the Construction Company for the prepaid amount but a court order in favour of the Construction Company was obtained in November 2015 and Huafeng appealed to the Huizhou Court afterwards.

The current outstanding amount paid to the Construction Company was RMB2,000,000 (equivalent to about HK\$2,387,000, being the full amount of the prepayment) for which no impairment loss was made by the Company for the financial year ended 31 March 2015 because Mr. Chan has undertaken to pursue the return of the said amount to the Group due to the involvement of Miss L in Issue 5 but the Auditor has not yet agreed to this accounting treatment.

With regard to the potential internal control weakness as revealed by the Subject Issues, the Group has taken or will take the following follow-up actions with respect to its corporate governance (including internal control systems):

1. The Group has recruited a new chief operating officer – Mr. Mak Chin To, who is responsible for managing the routine operation of the Group since August 2015 so as to lighten the workload of the Relevant Management. Mr. Mak Chin To, aged 59, graduated from the University of Manitoba in Winnipeg of Canada with a Bachelor of Economic degree. He is a veteran management with proven track record in building business operations on both strategic and operation levels and also in turning around loss-making companies. He has over 28 years of experience in sales and marketing, retail development, operation management, business development and distributor management and he had taken senior positions in various multi-national corporations and publicly listed companies. He has been conducting business in the Mainland China market since the year 1992 and he is well versed in multi culture. His skill set of key performance indicator management and standard operating practice control can greatly enhance the operation of the Group;
2. The Group has recruited a new internal audit manager with over 23 years of relevant experience to lead an in-house review of the corporate governance (including internal controls system) of the Group since November 2015; and
3. The Group will engage an external qualified expert to review annually the corporate governance (including internal controls system) of the Group from the year 2016 onwards.

The Relevant Management has also proposed the following measures in order to enhance its internal control:

1. Any person without official position in the Group would not be allowed to involve in or to manage the daily operation of the Group;
2. All contracts to be entered into by the Group will be first reviewed by qualified legal adviser before signing;
3. All lending transactions of the Group exceeding the limit of HK\$1,000,000 will have to be approved by the Board; and
4. All transactions of the Group exceeding the limit of HK\$200,000 for each individual transaction will not be allowed to be conducted in cash.

The Group will consider and impose any additional measures recommended by its new internal audit manager and/or the external qualified expert engaged to review the corporate governance of the Group, as appropriate.

With regard to the recommendation by the Consultant to seek advice on whether the Relevant Management is in breach of their duties in the Subject Issues, the Board will discuss it in subsequent meeting in due course.



Further, Mr. Chan has resigned as the managing director of Huafeng with effect from 16 October 2015. Mr. Chan remains as a director of Huafeng, and an executive Director and Chairman of the Company.

With effect from 16 October 2015, Mr. Au-Yeung has resigned as a director of Huafeng. It is proposed that Mr. Au-Yeung will step down from the post of executive Director and will be re-designated as a non-executive Director after the publication of all the outstanding financial information of the Company as required under the Listing Rules while he will remain as the Company Secretary of the Company. Further, Mr. Au-Yeung voluntarily puts forward a penalty arrangement to have his emoluments cut from HK\$84,000 per month to HK\$50,000 per month with effect from 1 April 2016 until such time when the Board would be satisfied with his performance and contribution in light of his lack of communication with the INEDs prior to the entering into of the Subject Issues resulting in their mistrust.

### **PROGRESS ON THE PREPARATION OF THE 2015 ANNUAL RESULTS, 2015 ANNUAL REPORT, 2016 INTERIM RESULTS AND 2016 INTERIM REPORT**

A copy of the Consultant Report has been provided to the Auditor on 2 February 2016. The Company is keeping in close contacts with the Auditor on the preparation of the 2015 Annual Results. It is currently targeted to publish the 2015 Annual Results, the 2015 Annual Report, the 2016 Interim Results and the 2016 Interim Report on 22 April 2016, 3 May 2016, 22 April 2016 and 3 May 2016 respectively.

Trading in the shares of the Company on the Stock Exchange has been suspended with effect from 9:00 a.m. on 25 June 2015, and will continue to be suspended until further notice. **Shareholders and the investing public should exercise caution when dealing in the securities of the Company.**

By Order of the Board  
**Chan Sik Ming, Harry**  
*Chairman*

Hong Kong, 31 March 2016

*As at the date of this announcement, the Board comprises the following members:*

***Executive Directors:***

CHAN Sik Ming, Harry (*Chairman & CEO*)  
AU-YEUNG Wai Hung  
CHEUNG Lai Na

***Independent Non-executive Directors:***

LI Chi Kwong  
YEUNG Chi Shing, Bret  
CHONG Chi Wah  
LEUNG King Fai