



2 Executive Summary

2.1 Preliminaries

2.1.1 During the conduct of the statutory audit for financial year 2010, the Company's external auditors were unable to obtain a satisfactory confirmation with regard to Shuangli's bank balance with Xiamen Bank Xiangyu Sub-Branch. In this regard, part of the scope of our engagement was to investigate the cash balances of the Group.

2.1.2 We were unable to confirm the amount or existence of RMB130,339,754.72, which constituted more than 99% of the purportedly available cash held by the Group as at 31 December 2010, because:

2.1.2.1 Despite our requests, Xiamen Bank, with which Shuangli and Xiongjin purportedly maintained the said sum of RMB130,339,754.72 as at 31 December 2010, has to date, not provided us with independent bank confirmations and/or bank statements;

2.1.2.2 Based on the accounting records provided to us, the bank balance of Shuangli's account with Xiamen Bank Xiangyu Sub-Branch as at 31 December 2010 was RMB55,335,052.58. However, we found a deleted "template" on one of the computers assigned to the Group's finance employees which showed that the bank balance of the said account was only RMB280.63.



- 2.1.2.3 When questioned, the Company's Chinese management verbally admitted to us that the bank balance of the said account could have been RMB280.63 due to a scheme perpetrated by a bank officer of Xiamen Bank Xiangyu Sub-Branch to use the monies in the account to temporarily repay loans of other companies which had fallen due. The Company's Chinese management also informed us that they were fully aware of this scheme and had allowed it to take place;
- 2.1.2.4 In January 2011 and February 2011, Shuangli and Xiongjin purportedly entered into a series of contracts which required them to make substantial "advance payments" totalling RMB120 million and representing more than 90% of the sums purportedly held in the accounts maintained with Xiamen Bank Xiangyu Sub-Branch as at 31 December 2010 to suppliers (including a possible interested person) for goods that would only be allegedly supplied over the course of 2011; and
- 2.1.2.5 When queried further, the Company's Chinese management verbally admitted that a portion of the "advance payments" were in fact loans to suppliers, a fact which was not previously disclosed. This puts into doubt the authenticity of the "advance payments" transactions.
- 2.1.3 Further to the above, our findings cast serious doubt over the reliability of the accounting records of the Company's operating subsidiaries, Shuangli and Xiongjin, provided to us and the authenticity of the supporting documents attached to those accounting records. We draw particular attention to the following findings:



- 2.1.3.1 Although the original set of bank statements provided to us for review bore what appeared to be the red-inked official stamps of the relevant banks, they contained material irregularities (e.g. anomalous page numbering and a print date which pre-dated the date of the statement) suggesting that the bank statements were not genuine and had been fabricated;
- 2.1.3.2 From the computers assigned to the Group's finance employees, we retrieved soft copy "templates" (some of which had been deleted prior to the computers being delivered to us) of *inter alia* bank statements, sales tax invoices and vendors' tax invoices, which when printed, created documents which markedly resembled the official documents in format and layout. These "templates" could have been used by the Company to create the irregular bank statements referred to above;
- 2.1.3.3 We discovered three anomalous journal vouchers bearing reference numbers which did not correspond to the accounting records provided to us. The accounting records of Shuangli and Xiongjin provided to us for our review were assigned the reference numbers "005" and "006" by the Company's accounting software. However, these 3 anomalous journal vouchers relating to Shuangli and Xiongjin were marked "001" and "002". The contents of one of these anomalous journal vouchers led us to the discovery of a previously undisclosed bank account maintained by Shuangli with Ping An Bank. Taken together, these findings suggest the possibility of as-yet undisclosed sets of accounting records and/or bank accounts;

- 2.1.3.4 We performed a verification exercise with the relevant tax bureaus' websites and learnt that about 25% of the sales tax invoices purportedly issued by Shuangli and Xiongjin from 1 December 2009 to 31 March 2011, and about 99% of the vendors' tax invoices purportedly issued to Shuangli and Xiongjin during this period showed discrepancies and/or returned an "invalid" result when we tried to verify the invoice codes and/or invoice numbers; and
- 2.1.3.5 We discovered email correspondence between certain individuals within the Group which strongly suggests that the accounting records of Shuangli and Xiongjin, including the supporting tax invoices, were fabricated.

2.2 Cash held by the Company and its subsidiaries

- 2.2.1 In April 2011, during our first fieldwork, the Company provided us with what were purportedly originals of Shuangli and Xiongjin's bank statements issued by United Overseas Bank, Bank of China, China Construction Bank, Industrial Commercial Bank of China ("ICBC"), Citic Bank and Xiamen Bank. The identifying security feature that one typically holds out as being officially generated by the bank is the coloured-ink (typically red in colour) stamp of the bank which is affixed on the statements.
- 2.2.2 We discovered material irregularities in these original bank statements – save for the bank statements from United Overseas Bank – which suggest that these bank statements were not genuine, such as:
- 2.2.2.1 In the bank statements for the period January **2011** and February **2011** for Xiongjin's bank account with Citic Bank Xiamen Branch, we noted that there are four transactions bearing transaction dates of "**2010/01/18**", "**2010/02/01**", "**2010/02/21**" and "**2010/02/24**" (emphasis added);

- 2.2.2.2 In the bank statement for January 2011 for Xiongjin's bank account with China Construction Bank, we noted that the print date of the said statement was stated as "12 February 2010" (emphasis added), eleven months before the date of the bank statement; and
- 2.2.2.3 In the bank statements for 2010 for Xiongjin's bank account with ICBC, we noted that the page numbers for the 12 bank statements ran sequentially even though they were purportedly issued independent of each other. The first page of each monthly bank statement should have started with "1". However, for Xiongjin's bank account with ICBC, the bank statement for January 2010 was page numbered "1", the bank statement for February 2010 was page numbered "2", and so on, with the bank statement for December 2010 being page numbered "12".
- 2.2.3 Because of the abovementioned irregularities, we attempted to obtain an independent set of bank statements from the relevant banks during our second fieldwork. When we received the fresh set of bank statements directly from ICBC, the Company's Chinese management verbally admitted that there were transactions in this second set of ICBC bank statements that were not recorded in the purported originals provided to us in our first fieldwork, thereby casting further doubt on the authenticity of the purported original set of bank statements.
- 2.2.4 We have received neither independent bank confirmations nor bank statements from Xiamen Bank. This is noteworthy as the Group purportedly maintained RMB130,339,754.72, or more than 99% of its available funds as at 31 December 2010, with Xiamen Bank Xiangyu Sub-Branch. Further, it was EY's second bank confirmation on Shuangli's account maintained with Xiamen Bank Xiangyu Sub-Branch which first raised the possibility that Shuangli had a bank balance of only RMB280.63 with Xiamen Bank Xiangyu Sub-Branch as at 31 December 2010, instead of RMB55,335,052.58 as stated in the accounting records.



- 2.2.5 The Company's Chinese management explained that the bank balance of Shuangli's account with Xiamen Bank Xiangyu Sub-Branch as at 31 December 2010 could have been RMB280.63 instead of RMB55,335,052.58 as a result of a scheme perpetrated by a bank officer. The Company's Chinese management further informed us that they were aware of the scheme and allowed it to take place. Further, we have not been able to independently verify the Company's Chinese management explanation as we have been unable to obtain independent bank confirmations and bank statements from Xiamen Bank Xiangyu Sub-Branch.
- 2.2.6 Further to the above, from the computers assigned to the Group's finance employees, we retrieved "templates" of bank statements for certain of Shuangli's and Xiongjin's accounts with Bank of China, China Construction Bank, ICBC, Citic Bank Xiamen Branch, Citic Bank Bailu Sub-Branch and Xiamen Bank Xiangyu Sub-Branch. One of the templates retrieved reflected the bank balance of Shuangli's account with Xiamen Bank Xiangyu Sub-Branch as at 31 December 2010 to be RMB280.63, which is the exact same figure reflected in EY's second bank confirmation.
- 2.2.7 Apart from the templates of bank statements, we also retrieved templates of banking slips, which are the supporting documents to the bank statements from the computers assigned to the Group's finance employees.
- 2.2.8 Our findings raised serious doubts over the authenticity of the bank statements and the supporting documents and in this regard:
- 2.2.8.1 Lead us to conclude that despite what is stated in the accounting records of Shuangli provided to us, Shuangli may not have had the sum of RMB55,335,052.58 in its account maintained with Xiamen Bank Xiangyu Sub-Branch as at 31 December 2010; and

2.2.8.2 Cast doubt on the existence of RMB130,339,754.72 purportedly held by the Group in Xiamen Bank Xiangyu Sub-Branch as at 31 December 2010. This constitutes more than 99% of the purportedly available cash held by the Group as at 31 December 2010

2.3 Discovery of an undisclosed bank account and the possibility of undisclosed accounting records

2.3.1 Further to our findings regarding the bank statements and supporting documents, we discovered a previously undisclosed bank account which Shuangli maintained with Ping An Bank since 22 June 2010.

2.3.2 On 30 July 2010, the Ping An Bank account had a bank balance of RMB5.25 million. As at 4 August 2011, the bank balance of the Ping An Bank account was RMB183.41. The last deposit made to this account was an amount of RMB200 on 30 June 2011.

2.3.3 We chanced upon three anomalous journal vouchers and the contents of one of these journal vouchers had led us to the discovery of this Ping An Bank. We confirmed the existence of the said Ping An Bank account in or around August 2011 when we performed an independent bank confirmation with the bank. The reference numbers in these three anomalous journal vouchers are noteworthy as the accounting records of Shuangli and Xiongjin provided to us for our review were assigned the reference numbers "005" and "006" by the Company's accounting software. However, these three anomalous journal vouchers relating to Shuangli and Xiongjin were marked "001" and "002". The existence of the anomalous journal vouchers coupled with the existence of a previously undisclosed bank account suggests the possibility of as-yet undisclosed accounting records which may have been recorded in parallel with those that were shown to us and officially maintained by the Group.



2.4 More than 90% of the Group's available funds as at 31 December 2010 paid out as "advance payments"

2.4.1 We noted from our review of the accounting records provided to us that RMB120 million was purportedly paid out of Shuangli's and Xiongjin's bank accounts maintained with Xiamen Bank Xiangyu Sub-Branch to parties held out as being suppliers to the Group, briefly broken down as follows:

2.4.1.1 Shuangli made payments totalling RMB50 million as "advance payments" to suppliers in February 2011; and

2.4.1.2 Xiongjin made payments totalling RMB70 million as "advance payments" to suppliers in January 2011.

2.4.2 Notably, these sums represented 92% of the Group's purported total funds as at 31 December 2010 and are substantially the amount that was purportedly held by the Group in the accounts maintained with Xiamen Bank Xiangyu Sub-Branch. As mentioned above, we are unable to obtain independent bank confirmations and/or bank statements in respect of the accounts maintained with Xiamen Bank Xiangyu Sub-Branch despite our requests. The Company's Chinese management explained that the payments were supposedly to "lock in" the price for the delivery of raw materials over the course of 2011.

2.4.3 When questioned further, the Company's Chinese management admitted that a portion of the advance payments made to certain of its suppliers were in fact "loans". However, they were not treated as such in the accounting records of Shuangli and Xiongjin provided to us. The Company's Chinese management further informed us that they would be able to recover all the "loans" given to the suppliers by the end of 2011 and would provide personal guarantees for the "loans".



2.4.4 We have evidence which indicates that the legal representative and majority shareholder of one of the suppliers is the father of one of the Company's executive directors, and therefore an interested person within the meaning of Rule 902 of the Listing Manual. For the whole of 2010, the Group purchased raw materials amounting to RMB31,864,092.50 from this supplier, and paid a total of RMB34,119,627.50 to this supplier. These raw materials purchases constituted in excess of 8% of the net tangible assets of the Group as at 31 December 2009 and therefore, the transactions have to be announced and shareholder approval should have been obtained prior to the transactions. The Annual Report for 2010 indicated that there were no interested person transactions for that year and to the best of our knowledge, no shareholder approval was obtained for the abovementioned transactions.

2.5 Questionable sales and vendors' tax invoices

2.5.1 We conducted a verification exercise on the sales tax invoices purportedly issued by Shuangli and Xiongjin to customers for sales made from December 2009 to March 2011 by verifying them through the website of the relevant tax bureau. We discovered that approximately RMB218,695,529 or about 25% of the total sales of Shuangli and Xiongjin for the period between 1 December 2009 and 31 March 2011 involved tax invoices which were questionable in that they appear to have been issued by other companies and not by Shuangli and Xiongjin.

2.5.2 We also conducted verification on the vendors' tax invoices purportedly issued to Shuangli and Xiongjin by vendors for purchases made from December 2009 to March 2011 by verifying them through the website of the relevant tax bureau. We discovered that approximately RMB716,782,522 or 99% of all the vendors' tax invoices recorded in the accounting records of Shuangli and Xiongjin for the period from December 2009 to March 2011 either contained discrepancies in the invoice code and/or invoice number or appear to be issued by companies other than the purported suppliers from whom Shuangli and Xiongjin made their purchases.



- 2.5.3 Further to the above, we also retrieved from the computers assigned to the Group's finance employees templates for sales tax invoices and vendors' tax invoices, which when printed, created documents which markedly resembled the official tax invoices in format and layout. There is no reason for the Company to possess such templates as the blank tax invoices would have to be purchased directly from the relevant tax bureau.
- 2.5.4 The Company's Chinese management provided two explanations for the questionable sales tax invoices:
- 2.5.4.1 The Company's Chinese management admitted that the Company obtained false tax invoices as supporting documents for cash sales of Shuangli and Xiongjin for auditing and bookkeeping purposes; and
- 2.5.4.2 The Company's Chinese management described the following convoluted four party transaction:
- a. Shuangli and Xiongjin sell goods and issue sales invoices to Party A, typically trading companies who are not authorized to issue tax invoices;
 - b. Party A on-sells the goods to Party B, typically small businesses who do not require tax invoices for bookkeeping purposes;
 - c. Party A requires Shuangli or Xiongjin to issue tax invoices to Party B, but Shuangli or Xiongjin would have already issued its tax invoices to Party A and hence, would not be able to issue invoices to Party B;
 - d. Party A pays Party C a commission of about 2% to 3% of the sales value for the latter to issue tax invoices in the name of Shuangli and Xiongjin to Party B; and



- e. Shuangli and Xiongjin will obtain a copy of Party C's tax invoices issued to Party B for bookkeeping purposes, which explains why, when the Questionable Sales Tax Invoices are verified against websites of the relevant tax bureau, they appear to be issued by other companies and not Shuangli or Xiongjin.

2.5.5 The Company's Chinese management's explanation for the convoluted sale arrangement involving four parties is implausible and internally inconsistent for the following reasons:

- a. If Party B is, as the Company's Chinese management asserts, typically a small business which does not require tax invoices for bookkeeping purposes, Party B should not even require any tax invoices from Party A to start with;
- b. Party C could not have been able to issue its invoices in the name of Shuangli or Xiongjin legitimately; and
- c. The Company's Chinese management was unable to provide us the relevant contracts and tax invoices to substantiate this convoluted sales arrangement.

2.5.6 We also extracted highly suspicious email messages exchanged between the Company's employees and senior management, which coupled with the templates of sales and vendors' tax invoices, strongly suggest that the accounting records of Shuangli and Xiongjin provided to us, including the supporting tax invoices, were made-up. For example (with particulars redacted):

2.5.6.1 In the following email dated 16 November 2010 and subject headed “雄进(进项)格式”, the sender refers to “redoing” Shuangli's and Xiongjin's sales and vendors' tax invoices:

■■■■, 你好！

1. 雄进销售发票12张重做, 进项4张重做, 在附表已标上黄色标志。

2. 双利销售发票14张重做, 进项4张重做, 在附表已标上黄色标志。

以上。

■■■■

2.5.6.2 In the following email dated 5 January 2011 and subject headed “雄进发票”, the sender refers to the “creation” of the invoice numbers of Xiongjin’s sales tax invoices:

■■■■:

您好! 附件是雄进销项及进项发票, 因销项发票号码不够用, 自编两本发票的号码。

■■■■

2.5.7 Further to the above, the attachments to the emails appear to demonstrate an ability on the part of the Company to “predict” detailed information relating to sales and purchase transactions which were to take place more than a month later.

2.6 Conclusion

2.6.1 Taken in totality, the evidence seriously undermines the integrity of the accounting records provided to us for our review and supports an arguable case that the said set of accounting records, including the supporting documents such as bank statements, banking slips, sales and vendors’ tax invoices had been doctored and/or fabricated in accordance with the agenda of certain individuals within the Group.

2.6.2 We have grave doubts regarding the cash balances of the Group as at 31 December 2010. The existence of RMB130,339,754.72 purportedly held by the Group in Xiamen Bank Xiangyu Sub-Branch as at 31 December 2010 is highly questionable. The



Hongwei Technologies Limited
Report on Independent Review
21 October 2011

purported “advance payments” totalling RMB120 million to counterparties (including a possible interested person) in January 2011 and February 2011, casts further doubt on the cash balances of the Group as at 31 December 2010.