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HUAZHANG TECHNOLOGY HOLDING LIMITED

華章科技控股有限公司

(Incorporated in the Cayman Islands with limited liability)

(Stock Code: 1673)

KEY FINDINGS OF THE INDEPENDENT FORENSIC ACCOUNTING REVIEW

Reference is made to the announcement of Huazhang Technology Holding Limited (the “**Company**” and, together with its subsidiaries, the “**Group**”) dated 11 August 2022 in relation to the formation of an independent investigation committee and the appointment of an independent forensic accountant (the “**Announcement**”). Capitalised terms used in this announcement shall have the same meanings as defined in the Announcement unless defined otherwise herein.

BACKGROUND

During the first half of 2022, when reviewing the balance of the long outstanding receivables of the Zhejiang Huazhang, the management of Zhejiang Huazhang discovered a number of abnormal payments and receipts between Zhejiang Huazhang, and three companies which are not subsidiaries of the Company (the “**Subject Transactions**”), and reported the same to the Board.

According to the preliminary investigation conducted by the management of Zhejiang Huazhang, as at 30 June 2022, the total amount due to the Group as a result of the Subject Transactions amounted to approximately RMB75,000,000. The three companies are (i) Tongxiang Jiafu Paper Equipment Co., Ltd.* (桐鄉加福造紙設備有限公司) (“**Jiafu Paper**”), (ii) Tongxiang Yuxin Electric Co., Ltd.* (桐鄉市宇新電氣有限公司) (“**Yuxin Electric**”) and (iii) Zhejiang Huazhang Fibertech Co., Ltd.* (浙江華章纖維科技有限公司) (“**Fibertech**”).

Subsequently, the Company established the Independent Investigation Committee on 5 August 2022, comprising all the independent non-executive Directors, whose duties include, among others, to conduct an internal review of the Group’s accounts, documents, records and affairs in relation to the Subject Transactions. The Independent Investigation Committee engaged RSM Corporate Advisory (Hong Kong) Limited on 9 August 2022 as the independent forensic accountant to conduct an independent forensic accounting review on the transactions made between Zhejiang Huazhang and Jiafu Paper, Yuxin Electric and Fibertech during the period from 1 July 2019 to 30 June 2022 (the “**Review Period**”).

Scope of the forensic accounting review

For the purpose of the forensic accounting review, the Independent Forensic Accountant conducted the following procedures:

- (i) obtained the relevant documents, including but not limited to, sub-ledgers, accounting vouchers and agreements of relevant payments and receipts, and the attached internal approval slips and bank receipts, etc.;
- (ii) conducted on-site visits to obtain information and data of relevant companies and personnel and conducted interviews with relevant personnel;
- (iii) reviewed, compared and analysed the information and documents obtained from paragraphs (i) and (ii) above and conducted follow up interviews; and
- (iv) obtained electronic evidence from laptop and desktop computers of the relevant personnel of Zhejiang Huazhang and used forensic softwares to sort electronic evidence, identify key words and documents in relation to the Subject Transactions and conduct data deletion analysis.

SUMMARY OF KEY FINDINGS

The Independent Forensic Accountant issued a forensic accounting review report on 26 October 2022 (the “**Review Report**”) which covered the Subject Transactions involving Jiafu Paper, Yuxin Electric and Fibertech. Below are the key findings of the forensic accounting review.

Jiafu Paper

Background

Jiafu Paper was established in Tongxiang City of Zhejiang Province on 25 March 2020. Based on its business registration records, its scope of business includes the manufacture of equipment for making pulp and paper, and its registered address is the same as that of Zhejiang Huazhang. Zhejiang Huazhang injected RMB5,000,000 into Jiafu Paper on 10 August 2021 and owns 33.33% of its entire equity interest. Thus, Jiafu Paper is an associate company of the Company. Jiafu Paper was a supplier of Zhejiang Huazhang from whom Zhejiang Huazhang purchase parts for the manufacture of its equipment.

Transactions between Zhejiang Huazhang and Jiafu Paper

According to the Review Report, there were two current accounts between Zhejiang Huazhang and Jiafu Paper during the Review Period, namely (i) Accounts Payable, and (ii) Other Accounts Payable.

Based on the Independent Forensic Accountant’s review of the details and balance of the abovementioned two current accounts, the nature of the Subject Transactions between Zhejiang Huazhang and Jiafu Paper were mainly procurement transactions, funding arrangements, accounting adjustments and a few transactions related to wages and social

security payments. Apart from the wages and social security transactions being classified as Other Accounts Payable, all other transactions are classified as Accounts Payable. As at 30 June 2022, the balance of Accounts Payable to Jiafu Paper was -RMB39,541,029.05.

Yuxin Electric

Background of Yuxin Electric

Yuxin Electric was established in Tongxiang City of Zhejiang Province on 10 February 2012. Based on its business registration records, its scope of business includes mechanical and electrical equipment manufacturing and automatic control system manufacturing. Its first registered address was also the same as that of Zhejiang Huazhang but was later changed to a different address in December 2021. Yuxin Electric was a supplier of Zhejiang Huazhang. Based on the information obtained by the Independent Forensic Accountant, the two shareholders of Yuxin Electric were and still are the current employees of Zhejiang Huazhang, and the legal representative of Yuxin Electric was the former director and legal representative of another subsidiary of the Company. The Independent Forensic Accountant had interviewed the said two shareholders who both indicated that they did not know when they became the shareholders of Yuxin Electric nor had any knowledge of the businesses of the same. They also claimed that they had never been to the industry and commerce department to file any industry and commerce registration/changes nor signed any documents as shareholders of Yuxin Electric and alleged that their identity documents might had been used by the others without their knowledge. The Independent Forensic Accountant was unable to interview the legal representative of Yuxin Electric as he has been unreachable.

Transactions between Zhejiang Huazhang and Yuxin Electric

Based on the Review Report, there were three current accounts between Zhejiang Huazhang and Yuxin Electric during the Review Period, namely (i) Accounts Receivable, (ii) Accounts Payable, and (iii) Other Accounts Payable.

Based on the Independent Forensic Accountant's review of the details and balance of the abovementioned current accounts, the transactions between Zhejiang Huazhang and Yuxin Electric were mainly sale transactions, procurement transactions, funding arrangements and a few transactions related to wages and social security payments. As at 30 June 2022, the balance of Accounts Payable to Yuxin Electric was -RMB28,656,484.32.

Further, the Independent Forensic Accountant also discovered that there were three transactions amounting to a total of RMB20,447,000.00 which were remitted by a Hangzhou Taige Automatic Co., Ltd.* (杭州泰格動力自動化有限公司) (“**Hangzhou Taige**”) but being booked to the credit side of the Accounts Payable with Yuxin Electric. The Independent Forensic Accountant made adjustments to the balance of Accounts Payable to Yuxin Electric for these three transactions with Hangzhou Taige and hence such balance as at 30 June 2022 was restated as -RMB49,103,484.32. Apart from the said transactions, the actual payment amount matches with the actual receipt amount as shown in the current accounts between Zhejiang Huazhang and Yuxin Electric.

Fibertech

Background of Fibertech

Fibertech was established in Tongxiang City of Zhejiang Province on 15 December 2020. Based on its business registration records, its scope of business includes the manufacture of special equipment for making pulp and paper. Its registered address is also the same as that of Zhejiang Huazhang. Fibertech is a supplier of Zhejiang Huazhang. Zhejiang Huazhang invested RMB5,000,000 into Fibertech, out of which RMB1,500,000 was used to pay up its registered share capital. Zhejiang Huazhang owns 15% equity interest in Fibertech.

Transactions between Zhejiang Huazhang and Fibertech

Based on the Review Report, there were four current accounts between Zhejiang Huazhang and Fibertech during the Review Period, namely (i) Accounts Payable, (ii) Accounts Receivable, (iii) Other Accounts Payable and (iv) Other Accounts Receivables respectively.

Based on the Independent Forensic Accountant's review of the details and balance of the abovementioned four current accounts, the nature of the Subject Transactions between Zhejiang Huazhang and Fibertech were mainly: sale transactions, procurement transactions, funding arrangements and a pre-payments of property fees and utility fees. As at 30 June 2022, the net balance due from Fibertech was RMB7,128,458.23.

Findings on the Subject Transactions

1. After the review of the Independent Forensic Accountant and including the adjustment from the payments made by Hangzhou Taige, the total amount due to the Group as a result of the Subject Transactions amounted to RMB95,772,971.60. The actual balance and classification of the Subject Transactions as at 30 June 2022 were as follows:

Counterparty company	Balance of Accounts Payable RMB	Balance of Accounts Receivable RMB	Balance of Other Accounts Payable RMB
Jiafu Paper	-39,541,029.05	/	/
Yuxin Electric	-49,103,484.32	/	/
Fibertech	87,041.77	266,000.00	-6,949,500.00

2. The abnormality of the Subject Transactions lies in the fact that there existed funding arrangement transactions of significant amount between Zhejiang Huazhang and its suppliers, Jiafu Paper, Yuxin Electric and Fibertech, which were without any procurement business nature and lacking supporting agreements with Zhejiang Huazhang. Further, most of the Subject Transactions were not approved by the Company's BPM system, resulting in the existence of outstanding receivables between Zhejiang Huazhang and Jiafu Paper, Yuxin Electric and Fibertech exceeding a reasonable limit.

3. The funding arrangements between Zhejiang Huazhang and Jiafu Paper, Yuxin Electric and Fibertech were arranged under the direct instruction of Mr. Zhu Genrong, the then chairman of the board of Zhejiang Huazhang (“**Mr. Zhu**”) and Ms. Zhu Lingyun, the then financial controller of Zhejiang Huazhang (“**Ms. Zhu**”). Other finance personnel of Zhejiang Huazhang only executed the payments and receipts of the Subject Transactions and recorded the same in the accounting books according to the instructions of Mr. Zhu and Ms. Zhu.
4. After the termination of Mr. Zhu as the chairman of the board of Zhejiang Huazhang in December 2021, all transactions or funding arrangements unrelated to the procurement business between Zhejiang Huazhang and Jiafu Paper, Yuxin Electric and Fibertech were terminated. Since the change in the management of Zhejiang Huazhang in April 2022, no further payment of any nature has been made to Jiafu Paper and Yuxin Electric by Zhejiang Huazhang.
5. In respect of the balances of receivables between Zhejiang Huazhang and Jiafu Paper and Yuxin Electric, including the balance of prepayment arising from the procurement transactions and the balance arising from the funding arrangements, and the Subject Transactions with Fibertech of RMB7,000,000, the Company has engaged legal advisers in the People’s Republic of China (“**PRC**”) to provide advice on seeking possible remedy through legal proceedings.

Recommendations from Independent Forensic Accountant to Independent Investigation Committee

1. Engage PRC legal advisers to seek legal advice on:
 - (a) the possibility of the Company recovering its losses through legal proceedings; and
 - (b) whether to hold Mr. Zhu and Ms. Zhu liable and whether to take appropriate civil action or criminal reporting measures.
2. Consider whether the Company should make a provision for the balance of the underlying transactions between Zhejiang Huazhang and Jiafu Paper, Yuxin Electric and Fibertech.
3. Engage a professional team of internal control advisor to provide professional advice on whether there is any significant deficiency in the Group’s risk management and internal control systems and the corresponding remedial and enhancement measures, given that there existed funding arrangement transactions of significant amount between Zhejiang Huazhang, Jiafu Paper, Yuxin Electric and Fibertech, which were of no procurement nature and were instructed by Mr. Zhu and Ms. Zhu bypassing the approval of the Company’s BPM system.

Key limitations of the forensic accounting review

The findings of the forensic accounting review were subject to certain limitations. The key limitations being the Independent Forensic Accountant was unable to contact and conduct interviews with Mr. Zhu, Ms. Zhu, the largest shareholder and the respective legal representatives of Jiafu Paper, and the ultimate beneficial owner and legal representative of Yuxin Electric. As a result, the Independent Forensic Accountant was unable to ascertain or clarify the rationale behind the funding arrangements between Zhejiang Huazhang, Jiafu Paper and Yuxin Electric.

VIEWS OF THE INDEPENDENT INVESTIGATION COMMITTEE

Having considered the Review Report, the Independent Investigation Committee noted that the Subject Transactions were mainly instructed by Mr. Zhu and Ms. Zhu and were primarily caused by:

- (i) Mr. Zhu and Ms. Zhu having instructed transactions of procurement business nature with Jiafu Paper and Yuxin Electric without sufficient justification; and
- (ii) Mr. Zhu and Ms. Zhu having bypassed the Company's internal payment approval procedures and instructed the finance personnel of Zhejiang Huazhang to execute transactions with Jiafu Paper, Yuxin Electric and Fibertech without notifying the Board.

In view of the above, the Independent Investigation Committee is of view that Mr. Zhu and Ms. Zhu failed to discharge their fiduciary duties as the chairman of the board and chief financial executive of Zhejiang Huazhang. In particular, they failed to act honestly and in good faith in the overall interests of the Company and to exercise reasonable care, skill and diligence.

Accordingly, the Independent Investigation Committee is of the view that Mr. Zhu and Ms. Zhu should be primarily held responsible for any consequential loss suffered by the Group. The Independent Investigation Committee recommends the Company to seek further legal advice from PRC legal advisers on possible legal recourse against Mr. Zhu and Ms. Zhu to be taken in the PRC.

The Independent Investigation Committee has reviewed the Review Report (including the limitations of the forensic accounting review). After due and detailed discussion, the Independent Investigation Committee is of the view that the contents and findings in the Review Report are reasonable and acceptable. Accordingly, the Independent Investigation Committee has recommended the Board to accept the findings of the forensic accounting review.

OVERALL RESPONSES OF THE BOARD

The Board has reviewed the Review Report, in particular, the findings on the Subject Transactions, and considered the recommendations made by the Independent Investigation Committee. The Board concurs with the view of the Independent Investigation Committee that Mr. Zhu and Ms. Zhu should primarily be held responsible for any consequential loss suffered by the Group arising from their failure to discharge their fiduciary duties. The Board also concurs with the Independent Investigation Committee's recommendations that the effectiveness and implementation of the Group's risk management and internal control systems may have to be re-assessed.

The Board has resolved to adopt the recommendations of the Independent Investigation Committee and is of the view that the issues identified in the Review Report do not affect the business operation of the Group. The Group's operation continues as usual despite the suspension of trading of Shares since 3 October 2022.

The Company has engaged PRC legal advisers to advise on the possible legal remedies available to it as a result of the Subject Transactions and may report the Subject Transactions to the Public Security Bureau if so advised. In addition, to prevent the occurrence of similar incidents in the future, the Group has engaged an internal control advisor, Zhonghui Anda Risk Services Limited ("**IC Advisor**"), to review the risk management and internal control systems of the Group. The IC Advisor will formulate a work plan with suggestions to improve the existing systems and follow up on the implementation status.

EXTENDED SCOPE OF FORENSIC ACCOUNTING REVIEW

During the review of the receivables of Zhejiang Huazhang and preparation of the annual results of the Group for the financial year ended 30 June 2022, the management of the Company noted the amount due from a material debtor, namely Baoshan Xintaisheng Paper Industry Co., Ltd.* (保山鑫泰盛紙業有限公司) ("**Baoshan Paper**"), was approximately RMB157,000,000 as at 30 June 2022 and the proposed impairment loss was approximately RMB123,000,000. In order to ascertain the details and nature of the transactions between the Group and Baoshan Paper, the Independent Forensic Accountant has been appointed to conduct a forensic accounting review on the transactions entered into between the Group and Baoshan Paper up to 30 June 2022. Further announcement(s) will be made by the Company on the findings of the Independent Forensic Accountant as and when appropriate.

CONTINUED TRADING SUSPENSION OF THE SHARES OF THE COMPANY

At the request of the Company, trading in its shares on the Stock Exchange has been suspended with effect from 9:00 a.m. on 3 October 2022 and will remain suspended until the publication by the Company of the announcement on the annual results of the Group for the financial year ended 30 June 2022.

Shareholders and potential investors of the Company are advised to exercise caution when dealing in the shares and other securities of the Company.

By Order of the Board
Huazhang Technology Holding Limited
Fang Hui
Executive Director

Hong Kong, 26 October 2022

As at the date of this announcement, the executive Directors are Mr. Fang Hui, Mr. Wang Ai Yan and Mr. Chen Hongwei, the non-executive Director is Mr. Shi Chenghu and the independent non-executive Directors are Mr. Heng, Keith Kai Neng, Mr. Yao Yang Yang and Ms. Zhang Dong Fang.

** For the purpose of identification only*