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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 EXTENDED SCOPE OF THE INDEPENDENT FORENSIC ACCOUNTING REVIEW**

Huazhang Technology Holding Limited (the “**Company**” and together with its subsidiaries, the “**Group**”) wishes to inform its shareholders and investors on the findings of the extended scope of the independent forensic accounting review on the transactions (the “**Baoshan Paper Transactions**”) entered into between the Group and Baoshan Xingshengtai Paper Industry Co., Ltd.\* (保山鑫盛泰紙業有限公司) (“**Baoshan Paper**”) up to 30 June 2022, as referred to the Company’s announcement dated 26 October 2022.

### **BACKGROUND**

During the review and preparation of the annual results (the “**2022 Annual Results**”) of the Group for the year ended 30 June 2022, the management of the Company (the “**Management**”) noted that the total amount of the trade and other receivables (the “**Baoshan Paper Receivables**”) from Baoshan Paper was approximately RMB157,000,000 as at 30 June 2022 and the Baoshan Paper Receivables were proposed to have an impairment loss (the “**Proposed Impairment Provision**”) of approximately RMB123,000,000 during the year ended 30 June 2022. In order to ascertain the details and nature of the Baoshan Paper Transactions, RSM Corporate Advisory (Hong Kong) Limited (the “**Independent Forensic Accountant**”) was appointed to conduct a forensic accounting review on such transactions (the “**Extended Forensic Review**”). The report (the “**Extended Review Report**”) of the Extended Forensic Review was issued on 30 December 2022, and the key findings are summarised below.

### **SCOPE OF THE EXTENDED FORENSIC REVIEW**

The purpose of the Extended Forensic Review was to identify the following matters, (i) commercial rationale of the Baoshan Paper Transactions; (ii) reason(s) for not being able to recover the trade and other receivables from Baoshan Paper; (iii) reason(s) and commercial rationale for the Proposed Impairment Provision; and (iv) impact of Ms. Zhu Lingyun (“**Ms.**

**Zhu**”) being the legal representative of Baoshan Paper and the financial controller of Zhejiang Huazhang during the period when the Baoshan Paper Transactions were entered into by the Group.

The Independent Forensic Accountant conducted the following procedures (the “**Forensic Review Procedures**”) for the Extended Forensic Review:

- (1) identified and preserved all evidence up to 30 June 2022 in relation to:
  - (a) the Baoshan Paper Receivables, including without limitation to trade receivable or other receivables ledgers, sales agreements, invoices, receipts and bank receipts, etc.;
  - (b) Ms. Zhu, being the legal representative of Baoshan Paper; and
  - (c) the provision made by the Group for the balance of the Baoshan Paper Receivables;
- (2) reviewed and analysed the evidence identified as mentioned paragraph (1) above so as to discerning and confirming:
  - (a) the commercial substance of the Baoshan Paper Transactions;
  - (b) whether Baoshan Paper was an independent third party and whether there was any suspicion regarding Ms. Zhu’s appointment of legal representative of Baoshan Paper; and
  - (c) the reasons and commercial rationale of the provisions made by the Group for the balance of the Baoshan Paper Receivables for the relevant periods and whether there was any suspicion regarding such provisions;
- (3) conducted background checks on Baoshan Paper and other related parties, and interviewed the counterparties to the Baoshan Paper Transactions;
- (4) obtained a list of the relevant departments and employees within the Group which/who were involved in the Baoshan Paper Transactions and interviewed them so as to understand their roles and responsibilities in such transactions, the reasons for the entering into of the Baoshan Paper Transactions and the reasons why the trade receivable and other receivables had not been collected up to date;
- (5) obtained information regarding the communications between the Group and Baoshan Paper, measures taken and the relevant documents in relation to the recovery of the Baoshan Paper Receivables; and
- (6) interviewed members of the Board (including independent non-executive Directors) to obtain their views and opinions on the provision made by the Group for the balance of the Baoshan Paper Receivables.

## SUMMARY OF KEY FINDINGS

During the Extended Forensic Review, the Independent Forensic Accountant identified three wholly owned subsidiaries of the Company which were involved the Baoshan Paper Transactions, namely (i) Huazhang Technology (Hangzhou) Limited\* (華章科技(杭州)有限公司) (“**HZ Hangzhou**”); (ii) Zhejiang Huazhang Technology Limited\* (浙江華章科技有限公司) (“**Zhejiang Huazhang**”); and (iii) Baoshan Jintaisheng Logistics Limited\* (保山金泰盛物流有限公司) (“**Jintaisheng**”). The Group commenced to transact with Baoshan Paper in 2015 and ceased all transactions during the financial year ended 30 June 2020.

### Transactions between HZ Hangzhou and Baoshan Paper/Zhejiang Huijin

The Independent Forensic Accountant conducted a public record search on each of Baoshan Paper and Zhejiang Huijin Financial Leasing Limited\* (浙江匯金融資租賃有限公司) (“**Zehjiang Huijin**”) and obtained the following corporate information, among others:

- (a) Baoshan Paper was established in Baoshan City, Yunnan Province on 22 October 2010, and was principally engaged in the manufacture of paper products, the wholesale and retail of machinery and equipment, and recycling of non-hazardous chemical recycled materials.
- (b) Zhejiang Huijin was established in Hangzhou City, Zhejiang Province on 2 January 2008, and was principally engaged in financial leasing, leasing business, purchase of leased property from overseas, disposal and maintenance of leased property with residual value, leasing transactions, management, investment, merger and acquisition consultation services.

### *Background of transactions between HZ Hangzhou and Baoshan Paper/Zhejiang Huijin*

During the Extended Forensic Review, the Independent Forensic Accountant noted that, in or around 2014, Baoshan Paper intended to develop an automation paper production line (the “**Production Project**”) and purchase the equipment for the Production Project (the “**Equipment**”) from the Group through financial leasing. The Group was mainly responsible for the sale of the Equipment and the provision of the related design and management services.

For the purpose of the Production Project, six contracts (the “**Project Contracts**”) were entered into amongst HZ Hangzhou, Baoshan Paper and Zhejiang Huijin and the arrangement was as follows.

Zhejiang Huijin would purchase the Equipment from HZ Hangzhou at a purchase price which would be paid in full by Zhejiang Huijin after the fulfilment of all conditions stipulated in the Project Contracts. Zhejiang Huijin would then lease the Equipment to Baoshan Paper with a fixed monthly rental payable by Baoshan Paper. The ownership of the Equipment would remain with Zhejiang Huijin and be transferred to Baoshan Paper after all monthly rental and the nominal purchase price of the Equipment have been fully paid by Baoshan Paper. At the request of Zhejiang Huijin, HZ Hangzhou would guarantee Baoshan Paper’s rental payment obligations, and would pay to Zhejiang Huijin a security deposit which would be refunded to HZ Hangzhou by monthly payment after receiving monthly rental payments.

### *Receivables under the Project Contracts*

The Independent Forensic Accountant had examined the accounting ledgers and related accounting documents of HZ Hangzhou in respect of the Production Project for the period from 1 January 2016 to 31 December 2019 as well as other relevant documents and interviewed the financial officer of HZ Hangzhou and chief financial officer of the Company, and noted that, as at 30 June 2022, the total amount of trade and other receivables from Baoshan Paper under the Project Contracts was RMB44,819,655.30.

### *Zhejiang Huijin's legal action against Baoshan Paper*

In October 2019, Zhejiang Huijin initiated legal proceedings in the Hangzhou Intermediate People's Court (杭州市中級人民法院) against Baoshan Paper for the recovery of the outstanding rental with HZ Hangzhou named as a third party in the legal proceedings. The Hangzhou Intermediate People's Court delivered its judgment in September 2020 and made an order, among others, that Baoshan Paper had to pay Zhejiang Huijin all outstanding rental and the ownership of the Equipment remained with Zhejiang Huijin until Baoshan Paper fully paid as ordered. Baoshan Paper appealed to the Higher People's Court of Zhejiang Province (浙江省高級人民法院) against the said judgment in November 2020 and the appeal court in February 2021 dismissed the appeal and ordered to uphold the decision of the trial court.

### *Findings*

The Independent Forensic Accountant had no view on the authenticity and the legality of the Project Contracts as all of them had been examined and accepted by the Hangzhou Intermediate People's Court and the Higher People's Court of Zhejiang Province.

## **Transactions between Zhejiang Huazhang and Baoshan Paper**

### *Background of the transactions between Zhejiang Huazhang and Baoshan Paper*

After conducting the Forensic Review Procedures, the Independent Forensic Accountant noted that, between 2016 and 2017, Zhejiang Huazhang entered into four contracts (the "**Purchase Equipment Contracts**") with Baoshan Paper for two sales transactions involving the sale of certain equipment and facilities to Baoshan Paper at the purchase prices and payment schedules set out in the Purchase Equipment Contracts.

### *Receivables under the Purchase Equipment Contracts*

The Independent Forensic Accountant had examined the accounting ledgers and related accounting documents of Zhejiang Huazhang for the period from 1 January 2016 to 31 December 2019, and noted that, as at 30 June 2022, the total amount of trade and other receivables from Baoshan Paper under the Purchase Equipment Contracts was RMB58,577,941.68.

### *Zhejiang Huazhang's legal action against Baoshan Paper*

In October 2019, Zhejiang Huazhang initiated legal proceedings in the Jiaxing Intermediate People's Court (嘉興市中級人民法院) against Baoshan Paper for the recovery of the entire outstanding amount under the Purchase Equipment Contracts. In April 2020, the Jiaxing Intermediate People's Court delivered its judgment and ordered, among others, Baoshan Paper to pay Zhejiang Huazhang (i) a sum of RMB58,443,971.65, being the entire outstanding amount under the Purchase Equipment Contracts; and (ii) the penalty for breach of the Purchase Equipment Contracts together with interest.

### *Findings*

The Independent Forensic Accountant (i) had no view on the authenticity and the legality of the Purchase Equipment Contracts as all of them had been examined and accepted by the Jiaxing Intermediate People's Court; and (ii) noted that there was a slight difference between the sum awarded by the Jiaxing Intermediate People's Court (i.e. RMB58,443,971.65) and the amount of receivables from Baoshan Paper under the Purchase Equipment Contracts in the reviewed accounting records (i.e. RMB58,577,941.68), such difference was mainly attributable to the audit adjustment.

### **Transactions between Jintaisheng and Baoshan Paper**

#### *Background of the transactions between Jintaisheng and Baoshan Paper*

After conducting the Forensic Review Procedures, the Independent Forensic Accountant noted that, on 10 February 2018, Jintaisheng entered into a supply chain services contract (the "**Supply Services Contract**") with Baoshan Paper and three shareholders of Baoshan Paper for a term from 10 February 2018 to 31 December 2021, pursuant to which the parties thereto agreed the following arrangements and obligations:

- (i) Jintaisheng would purchase the goods specified by Baoshan Paper and settle the purchase price; and when Jintaisheng resell the goods to Baoshan Paper, Jintaisheng would charge Baoshan Paper a procurement fee and an interest payment.
- (ii) Jintaisheng would purchase the recycle-paper specified by Baoshan Paper which Baoshan Paper would use as raw material for the manufacture of corrugated cardboards. The corrugated cardboards would then be sold by Jintaisheng to the customers specified by Baoshan Paper. Jintaisheng would charge a supply management fee while Baoshan Paper would charge a processing fee.

By 31 December 2019, Jintaisheng ceased to provide the services stipulated in the Supply Services Contract.

### *Receivables under the Supply Services Contract*

The Independent Forensic Accountant had examined the accounting ledgers and related accounting documents of Jintaisheng for the period from 1 March 2018 to 31 December 2019 and interviewed the sales manager of the Group who was then appointed as the general manager of Jintaisheng. The Independent Forensic Accountant noted that, as at 30 June 2022, the total amount of trade and other receivables from Baoshan Paper under the Supply Services Contract was RMB98,386,981.94.

### *Jintaisheng's legal action against Baoshan Paper*

In March 2020, Jintaisheng initiated legal proceedings in the Hangzhou Intermediate People's Court (杭州市中級人民法院) against Baoshan Paper for the recovery of all overdue amount under the Supply Services Contract. In February 2021, the Hangzhou Intermediate People's Court delivered its judgment and ordered, among others, Baoshan Paper to pay Jintaisheng a sum of RMB101,356,456.34 being all overdue amount under the Supply Services Contract.

Baoshan Paper appealed to the Higher People's Court of Zhejiang Province (浙江省高級人民法院) against the judgment in July 2021 and the appeal court in November 2021 dismissed the appeal and upheld the decision of the trial court.

### *Findings*

The Independent Forensic Accountant (i) had no view on the authenticity and the legality of the Supply Services Contract as all of them had been examined and accepted by the Hangzhou Intermediate People's Court and the Higher People's Court of Zhejiang Province; and (ii) noted that (a) during the trial and appeal proceedings, the trial and appeal courts had examined and considered the evidences, such as the statements of accounts, accounting vouchers, details for the receipt and delivery of the procured goods/products, etc., satisfying that the authenticity of the overdue amount; and (b) there was a slight difference between the sum of RMB101,356,456.34 awarded to Jintaisheng by the Hangzhou Intermediate People's Court and the total amount of trade and other receivables from Baoshan Paper in the reviewed accounting records (i.e. RMB98,386,981.94).

### **Reasons and basis for the Proposed Impairment Provision**

As abovementioned, the authenticity and legality of the Baoshan Paper Transactions and the total amount of the Baoshan Paper Receivables, all of which had been examined and accepted by the PRC courts at the relevant legal proceedings.

### *Baoshan Paper Receivables as at 30 June 2020*

The total amount of trade and other receivables from Baoshan Paper as at 30 June 2020 (after audit adjustment) was approximately RMB201,784,578.

According to the valuation report issued by an independent valuer, the total value of the assets held by Baoshan Paper as at 17 June 2019 was approximately RMB330 million. Based on such valuation, the Management believed that as the value of the Baoshan Paper's assets exceeded the total amount of the Baoshan Paper Receivables, it was not necessary to make full provision for impairment of the Baoshan Paper Receivables as at 30 June 2020.

In view of the above and after discussion with the then auditors, the Group made a provision for impairment of the Baoshan Paper Receivables for the year ended 30 June 2020 in compliance with the requirements of Hong Kong Financial Reporting Standard No.9 of approximately RMB72,018,411 in total.

### *Baoshan Paper Receivables as at 30 June 2021*

During the year ended 30 June 2021, the Company, as agreed by the then auditors, did not make any provision for impairment of the Baoshan Paper Receivables because the legal actions against Baoshan Paper were in progress and their outcome were uncertain.

### *Baoshan Paper Receivables as at 30 June 2022*

The Management proposed to make full provision for impairment of the Baoshan Paper's trade and other receivables for the year ended 30 June 2022 after taking into account the following factors:

- (i) Baoshan Paper had leased its plant and equipment to a third party before the court judgment was made, thereby making it more difficult for the Group to enforce the relevant judgment;
- (ii) the PRC lawyer engaged by the Company advised that the value of the equipment held by Zhejiang Huijin was very low thereby the amount of the Baoshan Paper Receivables that could be recovered by the Company was relatively limited; and
- (iii) according to the valuation report issued in August 2022 by an independent valuer engaged by the Hangzhou Intermediate Court, the value of the equity interest in Baoshan Paper was in a loss position at RMB255,768,184.46.

### *Findings*

Based on the above, the Independent Forensic Accountant found that it was not suspicious and unreasonable for the Management and the Board to make the Proposed Impairment Provision.

## **Review of Ms. Zhu Lingyun as the legal representative of Baoshan Paper**

### *Background*

During the period from April 2018 to November 2019, while Ms. Zhu was the legal representative of Baoshan Paper and also the financial controller of Zhejiang Huazhang, the Group entered into the Baoshan Paper Transactions.

During the Extended Forensic Review, the Independent Forensic Accountant noted the following:

- (1) On 10 February 2018, Zhejiang Huijin, Ms. Zhu, three equity holders of Baoshan Paper and Baoshan Paper entered into an equity interest escrow agreement (the “**Escrow Agreement**”), pursuant to which, among others, Ms. Zhu was appointed as the legal representative of Baoshan Paper.
- (2) The reason for appointing Ms. Zhu as the legal representative of Baoshan Paper was to mainly represent the Group to oversee the repayment by Baoshan Paper under the Project Contracts; and as such Ms. Zhu did not participate the business operation of Baoshan Paper. In November 2019, Ms. Zhu resigned as a legal representative of Baoshan Paper.
- (3) Both the Hangzhou Court Judgment and the Zhejiang Appeal Court Judgment ruled that there was no evidence with suggested that Ms. Zhu had influenced on the transactions with Baoshan Paper.

### *Findings*

Based on the above, the Independent Forensic Accountant found that (i) Ms. Zhu’s appointment as the legal representative of Baoshan Paper was an arrangement agreed by all contractual parties; (ii) the reason and background of such appointment was fully known by the then Management; and (iii) the courts of the PRC confirmed that Ms. Zhu had no influence on the Baoshan Paper Transactions.

## **CONCLUSION OF KEY FINDINGS**

Based on the above, the Independent Forensic Accountant concluded the following:

- (i) The courts of the PRC had examined the Project Contracts, the Purchase Equipment Contracts, the Supply Services Contract and the respective transactions contemplated thereunder and accepted their authenticity and the rationale behind. The Independent Forensic Accountant found that the information and matters reviewed by them did not contradict the judgments of or decisions made by the relevant courts of the PRC.
- (ii) The amount of the trade and other receivables from Baoshan Paper had been also recognised in the decisions made by the relevant court of PRC.

- (iii) The Management had considered the above-mentioned factors, informed the Board of the same and put forward the Proposed Impairment Provisions. The Independent Forensic Accountant did not find any information and matters reviewed by them that indicate the Management's decision was suspicious and lack of commercial rationale.
- (iv) Ms. Zhu's appointment as legal representative of Baoshan Paper was agreed by all parties to the Escrow Agreement, and the Management had knowledge of the background of and reasons for the appointment. The trial court and the appeal court of the PRC in their respective proceedings had ruled that there was no evidence to show that Ms. Zhu had influenced on the Group's transactions with Baoshan Paper.

### **Recommendations from Independent Forensic Accountant to Independent Investigation Committee**

The Independent Forensic Accountant noted that, due to Baoshan Paper's failure to pay the Group, the then board of the Company had engaged internal control advisers in 2019 and 2020 (i) to review the internal control systems of the Group, in particular, in respect of the selection of the customers and assessment on the customers' financial capability; and (ii) to advise on the improvement measures related thereto.

The Independent Forensic Accountants recommended the Independent Investigation Committee to follow up with the Board on the effectiveness of improvement measures on the internal control systems as proposed by the previously engaged internal control advisers.

### **VIEW OF THE INDEPENDENT INVESTIGATION COMMITTEE**

Having considered the Extended Review Report and the explanation of the Management, the Independent Investigation Committee concurred with the view of the Independent Forensic Accountant that (i) the authenticity of the Baoshan Paper Transactions and the amount of the trade and other receivables under the Baoshan Paper Transactions had been examined and accepted by the courts of the PRC thereby the Independent Forensic Accountant had no view on the same; (ii) the decision of the Management on the Proposed Impairment Provision were reasonable; and (iii) Ms. Zhu had no influence on the Baoshan Transactions during the said period.

The Independent Investigation Committee also agreed with the recommendation from the Independent Forensic Accounts as abovementioned. The Independent Investigation Committee understands that the Group has engaged the IC Advisor to conduct an internal control review on the Subject Transactions and the Baoshan Paper Transactions. The Independent Investigation Committee believes that the scope of the current engagement of the IC Advisor has covered the internal control issues previously identified, and the Independent Investigation Committee will follow up with the Board on the effectiveness of improvement measures proposed by the internal control advisers engaged by the then board of the Company.

## **OVERALL RESPONSES OF THE BOARD**

The Board had reviewed the Extended Review Report, in particular, the findings of the Baoshan Paper Transactions and the trade and other receivables arose therefrom and Ms. Zhu's appointment as legal representative of Baoshan Paper during the said period. The Board has also considered the recommendations made by the Independent Investigation Committee and the view of the Management on the Proposed Provision Impairment.

The Board concurs with the view and recommendation of the Independent Investigation Committee as set out in the section headed "View of Independent Investigation Committee" above.

### *Impact of the Proposed Impairment Provision on the Company's financial position and operation position*

The Board is of the view that the Proposed Impairment Provision has an impact on the financial position of the Group as it has increased in the consolidated loss of the Group for the year ended 30 June 2022 under the international financial reporting standards by RMB129.8 million, but the Proposed Impairment Provision has no significant impact on the Group's business operation.

## **CONTINUED SUSPENSION OF TRADING**

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 Company fulfils the resumption guidance disclosed in its announcement dated 28 November 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, 24 February 2023

*As at the date of this announcement, the executive Directors are Mr. Fang Hui 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.*