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## **TIANHE CHEMICALS GROUP LIMITED**

天合化工集團有限公司

*(Incorporated in the British Virgin Islands with limited liability)*

(Stock Code: 1619)

### **UPDATE ON SUSPENSION OF TRADING AND INFORMATION RELATING TO THE ANNUAL RESULTS FOR THE YEAR ENDED 31 DECEMBER 2014**

The Company considers it appropriate to inform its shareholders about the latest status in relation to the suspension of trading of its shares, the issues causing delay in publication of the 2014 Annual Results, as well as the work that the Audit Committee has performed to address such issues.

The Auditor advised the Board and the Audit Committee in March 2015 that the short attack of September 2014 has heightened the risk sensitivity of the Auditor. The Audit Committee has done its best to be responsive to requests of the Auditor in light of this background and kept the Auditor fully apprised of the actions it took and its findings throughout this period. The Company's management acted in compliance with the directions of the Audit Committee, and also fully co-operated with the Auditor.

There are three areas where the Auditor considers that its concerns have not been fully addressed, namely: (i) construction-in-progress; (ii) sales to a key customer which is a subsidiary of a central state-owned enterprise; and (iii) bank statements with a large state-owned bank, the Auditor is proposing to disclaim its audit opinion. Please refer to the main text of this announcement for details of the matters and the work performed.

The Audit Committee is considering the Auditor's proposed opinion in light of all the work that has been performed. The Company is also taking necessary steps to address comments raised by the Stock Exchange with the aim of publication of 2014 audited annual results as soon as practicable. The Company will make further announcement as and when appropriate to keep shareholders informed of the progress from time to time.

The matters concerning the 2014 Annual Results do not relate to any financial statements of the Company for the financial years prior to 2014. The construction-in-progress is expected to go into production in late 2015.

Reference is made to the announcements of Tianhe Chemicals Group Limited ("**Company**") dated 26 March and 29 May 2015 in relation to, amongst others, delay in publication of the final results of the Company and its subsidiaries for the year ended 31 December 2014 ("**2014 Annual Results**"). Terms used in this announcement shall have the same meanings as defined in the abovementioned announcements unless the context otherwise requires.

As stated in the previous announcements, additional time was required by the Company to provide further information to its Auditor for the audit of the 2014 Annual Results. In light of the discussions of the Audit Committee and the Auditor, the Company considers it appropriate to inform the shareholders of the Company the issues causing the delay in publication of the 2014 Annual Results and the work that the Audit Committee has performed to resolve such issues.

## **INFORMATION RELATING TO THE ANNUAL RESULTS FOR THE YEAR ENDED 31 DECEMBER 2014**

### *Issues Causing Delay in Publication of the 2014 Annual Results*

#### **1. Construction-in-progress**

##### *Background*

- 1.1 The Group is undertaking a Group II/III base oil project and a fluoride lubricating oil project (collectively the "**Project**").
- 1.2 As part of the Project, Jinzhou DPF-TH Chemicals Co., Ltd. ("**DPF-TH**"), a wholly-owned subsidiary of the Company, after selection processes with participation of multiple independent suppliers, effected certain equipment purchase transactions from a vendor in Nanjing, Jiangsu Province ("**Vendor**").

The aggregate value of these equipment purchases from the Vendor which comprised of four contracts amounted to RMB4,032 million. Such purchases were settled by way of bank transfers in cash and value-added tax ("**VAT**") invoices were issued by the Vendor to DPF-TH ("**Relevant Invoices**").

Other than the four contracts related to the Relevant Invoices, DPF-TH has also entered into three contracts with the Vendor. One relates to supplemental equipment for the Project and the other two relate to the production of lubricant oil additive components.

- 1.3 The Vendor is a manufacturer of industrial machinery and equipment (particularly chemical equipment) in China. It is an independent third party not connected with the Company or its directors. The Vendor became an equipment supplier to the Company in 2007.

During the selection process in October 2011 for the purchase of equipment to commence the Project, the Company considered relevant factors of three potential suppliers including the Vendor. Since the Vendor did not provide the lowest quote initially, the Company did not choose the Vendor at that stage. But due to the original successful bidder having not met the Company's requirements in product quality and timing of delivery, the Company reopened negotiation with the other two potential suppliers including the Vendor in mid-2013, and switched accordingly after the Vendor agreed to match the lowest quote received by the Company.

The Board unanimously considers that the equipment purchases are made on normal commercial terms and an arm's length basis, the terms of the contracts are fair and reasonable and the equipment purchases are in the interest of the Company and its shareholders as a whole.

1.4 As indicated on the Relevant Invoices, the Company's VAT credits related to the purchase of plant and machinery from the Vendor amounted to approximately RMB586 million. In accordance with relevant PRC laws and regulations, the Company is permitted to offset the full amount of these VAT credits against the VAT payables arising from its operations after the Relevant Invoices have been verified and accepted by the principal tax bureau of DPF-TH. A list of VAT invoices, for which VAT credits have been verified and approved by the tax bureau, has been obtained by the Company and provided to the Auditor in preparing the 2014 Annual Results (the "**Company's Statements**").

1.5 Below is the updated status of the Project and the comparison summary between end of 2013 and 2014.

Products	Deigned capacity upon completion (thousand tonnes per year)		Total expected investment (RMB in millions)		Incurred investment (RMB in millions)		Expected completion time	
	31-Dec-13	31-Dec-14	31-Dec-13	31-Dec-14	31-Dec-13	31-Dec-14	31-Dec-13	31-Dec-14
Group II/III base oil	600	600	2,950	4,960	2,102	4,836	Late 2014	Late 2015
Fluoride lubricating oil	200	300	1,100	1,850	735	1,565	Late 2015	Late 2015

1.6 The Project was funded by the Company's operating cash flows and short term bank borrowing. The intended use of proceeds as stipulated in the Company's prospectus has not been changed. The Project will begin production by end of 2015.

*The Auditor's Questions*

1.7 The Auditor raised questions about some inconsistent information regarding Relevant Invoices issued by the Vendor and shown on the Company's Statements. When checking through Nanjing State Tax Bureau's publicly accessible verification website, which is an online system maintained by the principal tax bureau of the Vendor that provides members of the public a means to verify VAT invoices, the Relevant Invoices could not be verified using the online system. Also, some of the Relevant Invoices contained VAT invoice serial numbers which were shown on tax bureau's online system to be VAT invoices that appeared to be allocated to a company other than the Vendor.

- 1.8 The Auditor also obtained a separate VAT invoice list which only contained part of the information of the Company's Statements.
- 1.9 Given the above, the Auditor raised questions as to:
- (a) the validity of the purchase from the Vendor of the equipment for the Project, in particular, whether such equipment had been delivered to DPF-TH;
  - (b) the validity of the Relevant Invoices issued by the Vendor to DPF-TH, with VAT-input invoice amount of RMB3,446 million and VAT credits of RMB586 million, giving a total cost of the equipment of RMB4,032 million; and
  - (c) whether the Company's Statements had been tampered with.

*Work performed during the Audit Committee's investigation*

- 1.10 In response to the questions raised by the Auditor, the Audit Committee took a number of actions between March and June 2015 to investigate the matters and appointed three independent professional parties to assist with the investigation. Throughout this period, the Audit Committee kept the Auditor fully apprised of the actions it took and the findings of the investigation. During the investigation, consideration has also been given to incorporating the Auditor's comments. The Auditor did not have further comments regarding the work scope of these investigations taken by the Audit Committee.

*(1) The Existence and Fair Value of the Equipment Purchased from the Vendor*

The following steps had been taken to assess the validity of the purchase of the equipment for the Project, and the delivery, installation and fair market value of such equipment:

- (a) Valuation of the equipment:** The Audit Committee appointed, after a selection process involving three candidates, Shenyang International Engineering Consulting Center (瀋陽國際工程諮詢中心), an independent chemical equipment consulting firm (the "**Appraiser**"), to appraise the value of the equipment for the Project. The Appraiser is a comprehensive consultancy institute that has been certified with Grade A qualification (甲級資質) approved by the National Development and Reform Commission (國家發展和改革委員會). It has extensive qualifications in appraisal projects on the relevant industry and also agreed to engage both international and domestic experts for conducting the appraisal. The appraised value assessed by the Appraiser is in line with the amount the Company paid for the equipment and as recorded in the Company's books and records. The Appraiser has also confirmed the value of the equipment is fair market value. In particular, the appraised value of the equipment purchased from the Vendor is in line with the amounts stated in the Relevant Invoices.

- (b) ***Examination of procurement, delivery and installation records:*** The Audit Committee appointed Commerce & Finance Law Offices ("C&F") to examine the procurement records of the Company (including the documentation setting out the evaluation of the quotations from multiple potential equipment suppliers, records of handover/takeover of deliveries (貨物交接記錄), VAT invoices received from the Vendor (增值稅發票抵扣聯) and bank payment records), the sales and delivery records of the Vendor as well as the installation records of the company responsible for installing the equipment purchased from the Vendor. C&F found that the records of the three parties were consistent.
- (c) ***Physical inspection of the equipment:*** C&F, together with the Appraiser and the Auditor's representatives, carried out an on site inspection of certain tanks selected on a random basis and established that the equipment was indeed installed in each of such tanks. The Auditor's representatives were given complete access and discretion to select the tanks they wished to inspect; the Company was not involved in any way in the selection of the tanks for inspection.

(2) *The Validity of the Relevant Invoices*

The following steps had been taken to assess the validity of the Relevant Invoices:

- (a) ***Confirmation from DPF-TH's principal tax bureau:*** C&F, under the observation of the Chairman of the Audit Committee and the Auditor, visited the principal tax bureau of DPF-TH on 16 April 2015 to obtain on site a copy of the official records held and saved in the state taxation system (金稅系統) by the tax bureau. The records on the state taxation system include, among others, information on the Relevant Invoices' reference number (發票代碼), serial number (發票號碼), invoice date (開票日期), issuer's identification number (銷貨方稅號), invoice amount (金額), VAT rate (增值稅率), VAT amount (增值稅額), and verification results (認證結果). The copy of the records so obtained from the official tax system matched the Company's Statements. The principal tax bureau of DPF-TH also issued a written confirmation to this effect.
- (b) ***Unannounced check:*** During the investigation carried out by C&F, the Auditor conducted an on-screen sampling, on a random basis, of the VAT tax records relating to DPF-TH at its principal tax bureau. There was no inconsistency between the results of such random on-screen sampling and tax records kept by the Company.

- (c) ***E-Discovery:*** Since the Auditor also obtained a separate VAT invoice list which only contained part of the information of the Company's Statements, the Audit Committee appointed a reputable qualified international accounting firm to conduct e-discovery work on the computers of the Company's finance department staff who have access to DPF-TH's tax information. The e-discovery work included scanning the unallocated space for fragments, slack space and other area of the subject hard drives and searching keywords using specialized testing tools on both existing files and deleted files during the period from covering the time related to the Company's Statements up to early 2015. The e-discovery work did not find any evidence that the Company's Statements may have been tampered with.
- (d) ***Interview with the Vendor:*** C&F interviewed the vice general manager for sales and a finance staff of the Vendor who confirmed to C&F that the Relevant Invoices were issued by the Vendor to DPF-TH. C&F also inspected the VAT invoice copies retained by the Vendor (增值稅發票存根聯) on a random basis and found these to be consistent with Relevant Invoices that the Company have (增值稅發票抵扣聯). (The VAT invoices were issued after the relevant orders were paid and delivered under a contract. The information on the equipment's delivery notes matches with each of the equipment purchase contracts and the relevant VAT invoices issued by the Vendor.)

On the question as to why the Auditor could not verify the Relevant Invoices using the Nanjing State Tax Bureau's publicly accessible verification website, the Vendor explained to C&F that some VAT invoices, such as those related to state secrecy or high-technology confidential products, though validly issued, cannot be checked on the publicly accessible verification website of its principal tax bureau. C&F randomly selected samples of the Relevant Invoices and logged onto the Nanjing State Tax Bureau's publicly accessible verification website, and a "non-exist" (不存在) result appeared on the screen page. Such result is consistent with the Vendor's explanation.

- (e) ***Counterchecking at the Vendor's principal tax bureau:*** C&F also consulted with an officer responsible for tax-related enquiry services (負責辦稅諮詢事務人員) and an officer responsible for external affairs and military-related secrecy matters (負責外事、軍事涉密事務人員) at the branches of Nanjing State Tax Bureau. C&F confirmed that these officers were responsible and authorized to answer enquiries related to the verification of VAT invoices at the two state tax bureau branches. C&F was informed that where the VAT invoices were verified and deducted by VAT invoice recipient's principal tax bureau, the possibility of such invoices having been fabricated is remote. In addition, C&F presented a set of ten randomly selected originals of the Relevant Invoices to bureau staff at the Nanjing State Tax Bureau and it was confirmed to C&F that none of such Relevant Invoices were or had been the subject of any red-flag or other investigatory notice by the tax bureau.

- 1.11 The Auditor also asked the Company to address the question as to why some of the Relevant Invoices issued by the Vendor have VAT invoice serial numbers which appeared to be allocated to a company other than the Vendor. The Audit Committee attempted to further investigate the matter but was not able to do so because the Vendor declined a request made by the Audit Committee (through C&F) for additional interviews or procedures (as PRC laws require the concerned enterprise's authorization for enquires or investigation). After reviewing the written confirmation from the Vendor and official document issued to the Vendor by the relevant state authority, C&F has confirmed to the Company and the Audit Committee that the Vendor is a sensitive enterprise related to state secrecy, and hence further investigation cannot be carried out.
- 1.12 As a summary, the work performed in addressing the Auditor's questions on construction-in-progress comprises of a wide range of inter-locking confirmations, including estimates of value by the Appraiser, examination of procurement, delivery and installation records, physical inspection of the equipment, review and confirmation of tax records at DPF-TH's principal tax bureau, e-discovery of the Company records, counterchecking of tax invoices at the Vendor's principal tax bureau, and official confirmation obtained from the Vendor.

## **2. Sales to a key customer ("Key Customer")**

### *Background and audit work performed*

- 2.1 The Key Customer, a subsidiary of one of the largest central state-owned enterprises, is one of the Company's major customers in both the specialty fluorochemicals and the lubricant additives segments. The Company's revenue generated from sales to the Key Customer in 2014 amounted to RMB1,808 million, of which the sales under the specialty fluorochemicals and the lubricant additives segments were RMB1,518.7 million and RMB289.3 million respectively.
- 2.2 The Company requested the Key Customer to issue, and the Key Customer has issued an official sales confirmation letter directly to the Auditor, which confirmed details of the sales transactions in 2014 with the following: (i) key terms of the contracts between the Company and the Key Customer, (ii) types of products the Key Customer purchased (including both specialty fluorochemicals and lubricant additives), (iii) quantity (tonnage), unit price and sales amount of each of the products, and (iv) total value of the Company's sales transactions to the Key Customer in 2014.
- 2.3 The Company has also provided contracts with the Key Customer, sales invoices, warehouse vouchers and bank deposit receipts to the Auditor for review and inspection.
- 2.4 No discrepancies or irregularities were identified and no queries were raised by the Auditor in relation to the sales information or records.

### *The Auditor's Request*

- 2.5 The Auditor has requested an interview with the Key Customer to be arranged as part of its audit procedures.
- 2.6 The Key Customer has turned down the interview request citing its current internal policy which prohibits its staff from interviews with external parties.

### **3. The bank statements with a principal bank ("Bank")**

#### *Background and audit work performed*

- 3.1 The Bank, a large state-owned bank in China, is one of the principal bankers of the Company.
- 3.2 In early December 2014, the Auditor indicated that it would like to obtain the monthly statements of the Company's bank account for March, June and September 2014 at the Bank. The Company made official request to the Bank accordingly. The Bank subsequently informed the Company that such statements were ready for collection, and the Auditor visited the Bank with the Company's representatives and obtained such statements directly from the Bank.
- 3.3 In early 2015, the Auditor also obtained the 2014 year-end balance confirmation of the Company's bank account at the Bank, through an official audit procedure by way of bank confirmation letter posted by the Bank directly to the Auditor. The year-end balance was RMB36.3 million at the end of 2014.
- 3.4 No discrepancies or irregularities were identified and no queries were raised by the Auditor in relation to abovementioned bank records.

#### *The Auditor's Request*

- 3.5 It was through the relevant bank account that payments for construction-in-progress were made. Accordingly, the Auditor has requested the Bank to print and provide, *in the presence of and under witness of the Auditor on site*, the Company's bank statements of such bank account for the entire year of 2014.
- 3.6 The Bank has turned down such request on the ground that it is not compliant with the Bank's internal policy. The Bank has indicated that it would only respond to a formal request of the Auditor by way of official confirmation letter as in previous years, through which the Bank will print out the statements and send directly to the Auditor by post.

#### ***Governance Response of the Audit Committee***

The Auditor advised the Board and the Audit Committee in March 2015 that the short attack of September 2014 has heightened the risk sensitivity of the Auditor. The Audit Committee has done its best to be responsive to requests of the Auditor in light of this background and kept the Auditor fully apprised of the actions it took and its findings throughout this period. The Company's management acted in compliance with the directions of the Audit Committee, and also fully co-operated with the Auditor.

The Audit Committee has undertaken its best efforts to conduct a thorough, independent investigation of the issues raised by the Auditor respecting the construction-in-progress. This work comprises of a wide range of inter-locking confirmations, including estimates of value by the Appraiser, examination of procurement, delivery and installation records, physical inspection, confirmations at tax bureaus, official confirmation obtained from the Vendor, and e-discovery of the Company records. The Audit Committee believes it has exhausted all the means available for the investigation.

The Audit Committee is considering the Auditor's proposed opinion in light of all the work that has been performed. The Company is also taking necessary steps to address comments raised by the Stock Exchange with the aim of publication of 2014 audited annual results as soon as practicable. The Company will make further announcement as and when appropriate to keep shareholders informed of the progress from time to time.

### ***Implications***

From the perspective of preparing our 2014 Annual Results, the value of the equipment purchased from the Vendor is accounted for as construction-in-progress in the Company's balance sheet, while the VAT credits of RMB586 million reduced the VAT levied on the Company for 2014. Sales to the Key Customer are accounted for as revenue in the income statements. Our bank balances at the Bank form part of our cash and bank balances in the balance sheet.

The matters concerning the 2014 Annual Results do not relate to any financial statements of the Company for the financial years prior to 2014.

### **UPDATE ON SUSPENSION OF TRADING**

At the request of the Company, trading in the Company's shares on the Stock Exchange has been suspended with effect from 1:01 p.m. on 26 March 2015 pending release of the 2014 Annual Results which is inside information of the Company. Trading in the Company's shares will continue to be suspended until further notice.

The Company continues to execute its business plans and the operations of the Company's subsidiaries and the Group's financial position has not been affected.

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

By order of the Board of Directors  
**Tianhe Chemicals Group Limited**  
**Wei Qi**  
*Chairman*

Hong Kong, 14 August 2015

*As at the date of this announcement, the Board of Directors of the Company comprises Wei Qi, Wei Xuan, Joseph Lee and Jiang Po, as executive Directors; Homer Sun, as non-executive Director; Loke Yu (alias Loke Hoi Lam), Chan Kin Sang and Xu Xiaodong, as independent non-executive Directors.*