

STATEMENT OF DISCIPLINARY ACTION

Exchange's Disciplinary Action against Six Directors of Moody Technology Holdings Limited (Stock Code: 1400)

Executive directors should take proactive steps to safeguard company assets in carrying on its business. Particular care should be taken when commencing a new business segment, and all members of the board of directors should be kept informed. Failure to do so may amount to breach of director's duties under the Exchange Listing Rules.

Independent non-executive directors must take an active interest in the issuer's business and its financial performance, raise risk issues with the management, and follow up anything untoward that comes to their attention.

All directors should take proactive steps to address the auditors' concerns to procure the issuer's financial statements to provide a true and fair view of the state of affairs of the issuer and of the results of its operations and its cashflows. Failure to do so may amount to breach of their director's duties.

Should a director fail to cooperate with the Exchange's investigation, the Exchange may view his retention of office as a director of the issuer as being prejudicial to the interests of investors.

The Listing Committee of The Stock Exchange of Hong Kong Limited (the Listing Committee)

CENSURES:

- (1) **Mr Lin Qing Xiong (Mr Lin)**, former executive director (**ED**) and the Chairman (**Chairman**) of Moody Technology Holdings Limited (**Company** (Stock Code: 1400));
- (2) **Mr Qiu Zhi Qiang (Mr Qiu)**, former ED of the Company;
- (3) **Mr Deng Qing Hui (Mr Deng)**, former ED of the Company;

.../2

AND CRITICISES:

- (4) **Mr Chan Sui Wa (Mr Chan)**, former independent non-executive director (**INED**) of the Company and the Chairman of the audit committee (**AC Chairman** and **AC** respectively) of the Company;
- (5) **Mr Ma Chong Qi (Mr Ma)**, INED and AC member of the Company; and
- (6) **Mr Yu Yu Bin (Mr Yu)**, INED and AC member of the Company,

for breaching their directors' duties under Rule 3.08 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (**Exchange Listing Rules**), and the undertaking to comply with the Exchange Listing Rules to the best of their ability (**Best Ability Undertaking**), and/or the undertaking to cooperate with the investigation (**Undertaking to Cooperate**) of the Listing Division (**Division**), breaching their obligations under the Declarations and Undertakings with regard to Directors given to the Exchange in the form of Appendix 5B to the Exchange Listing Rules (**Undertakings**).

(The directors identified at (1) to (6) above are collectively referred to as the **Relevant Directors**.)

AND STATES that:

by reasons of the wilful failure of Mr Qiu to discharge his Undertaking to Cooperate and Mr. Lin to discharge his obligations under the Exchange Listing Rules and the Best Ability Undertaking, had Mr Qiu and Mr Lin remained on the board of directors of the Company, their retention of office would have been prejudicial to the interests of investors.

The Listing Committee further

DIRECTS that:

The Company retain an independent professional adviser satisfactory to the Division to conduct a thorough review of and make recommendations to improve the Company's internal controls; and

As a pre-requisite of any future appointment as a director of any company listed or to be listed on the Exchange, the Relevant Directors (except Mr Lin and Mr Qiu) attend 15 hours of training on Exchange Listing Rule compliance.

For the avoidance of doubt, the Exchange confirms that the sanctions and directions in this statement apply only to the Company and the Relevant Directors, and not to any other past or present members of the Board.

HEARING

On 1 December 2020, the Listing Committee conducted a hearing into the conduct of the Relevant Directors in relation to their obligations under the Exchange Listing Rules and the Undertakings.

The information in respect of the PEI trading business and the Prepayments hereunder is based on information and materials provided by the Company during the Division's investigation.

FACTS

Before the Company's financial year ended 31 December 2016 (**FY2016**), the Company was principally engaged in the design, manufacturing and sales of fabrics and yarns in the People's Republic of China. During FY2016, while continuing with its principal business, the Company also commenced polyetherimide (**PEI**) trading, but suspended it shortly in the following financial year ended 31 December 2017 (**FY2017**).

The Company's financial statements for FY2016 and FY2017 were subject to a qualified opinion and a disclaimer opinion respectively by its then auditors due to, among other issues, the recoverability of the PEI receivables (**PEI Receivables**) and the prepayments to suppliers in FY2016 and FY2017 (**Prepayments**).

PEI

According to the Company:

- (a) The PEI trading business started in January 2016 and involved the Company's purchase of PEI from trading companies in Hong Kong and resale of PEI to four overseas buyers which were all introduced by Mr Qiu. After delivering the resale, the Company recorded the PEI Receivables in its accounts.
- (b) The first batch of the resale trading business which took place in March 2016 had a value of approximately RMB100 million. Before receiving any payment for the first batch, the EDs decided in May 2016 to conduct the second batch which had a value of about RMB200 million and involved the three buyers in the first batch plus a fourth one. The second batch was delivered in July 2016.

- (c) On 15 and 20 July 2016, the EDs considered and decided to extend the payment term from 270 days up to 360 days as requested by the PEI buyers due to their tight cashflow.
- (d) All the four buyers complained about the product quality in late 2016. In November 2016, the EDs discussed the complaints. The Company offered the buyers a 5 per cent discount on the invoiced sum, but this was not accepted.
- (e) On 17 March 2017, Mr Qiu reported the PEI Receivables issue to the board of directors (**Board**). It was decided that Mr Qiu would follow up with the PEI buyers for the payment.
- (f) Before publishing the FY2016 financial results (**Results**) on 2 April 2017, Mr Qiu verbally informed the Board that the Company had decided to offer a discount to the PEI buyers with an extension of the credit period. The EDs decided not to provide any impairment at that time as the PEI Receivables were not yet due then and Mr Qiu advised that there was a high chance of recovery because the buyers indicated their intention to repay on the basis that the Company offered a discount subject to the rate to be agreed. The INEDs agreed with the EDs but reminded them to closely monitor the progress.
- (g) It only recovered less than 10 per cent of the total invoiced amount in this business in 2017 and suspended the business segment. As there was no expectation of recovering the outstanding balance, the Company wrote off the rest in FY2017.

Prepayments

According to the Company:

- (a) It made prepayments to suppliers to secure raw material supply for making fabrics and yarns ordered by customers.
- (b) It had over 100 suppliers during the financial year ended 31 December 2015 (**FY2015**) and FY2016 to which it had made prepayments. The prepayments to the top three major suppliers comprised over 50.8 per cent, 93.3 per cent and 77.5 per cent of the prepayments for FY2015, FY2016 and FY2017 respectively. The balances of the prepayments to those major suppliers as at the respective year end and the impairments made were:

| <u>RMB</u> | <u>FY2015</u> | <u>FY2016</u> | <u>FY2017</u> |
|--------------------|---------------|---------------|---------------|
| Supplier A | | | |
| Prepayment balance | 44,999,961 | 91,627,358 | 57,928,879 |
| Impairment | 0 | 35,847,358 | 14,683,936 |
| Supplier B | | | |
| Prepayment balance | 16,513,620 | 82,853,281 | 82,853,281 |
| Impairment | 0 | 0 | 82,853,281 |
| Supplier C | | | |
| Prepayment balance | 17,551,968 | 19,039,924 | - |
| Impairment | 0 | 19,039,924 | - |

Audit issues

Before the PEI trading segment was established, the Company used to provide a credit period of 90 to 120 days for collecting its receivables.

The FY2016 Results were subject to a qualified opinion by its then auditors due to, among other issues, the management's inability to provide the auditors with:

- (a) satisfactory explanation and adequate information to support their recoverability assessment of the PEI Receivables, and adequate information on the credit history and settlement patterns of the PEI buyers; and
- (b) satisfactory explanation and evidence to support the business rationale and commercial substance of the excessive prepayments, and sufficient supporting evidence to justify the basis of provisions made in FY2016 for those suppliers.

The FY2017 Results were subject to a disclaimer opinion because, among other issues, its then auditors had been unable to obtain sufficient and appropriate audit evidence to satisfy themselves whether the balances of trade receivables and prepayments and the related impairment losses were fairly stated for FY2016 and FY2017. The FY2018 Results were consequently also subject to a disclaimer opinion.

LISTING RULE REQUIREMENTS

Rule 3.08 provides that the Exchange expects directors, both collectively and individually, to fulfil fiduciary duties and duties of skill, care and diligence to a standard at least commensurate with the standard established by Hong Kong law. These duties include a duty to apply such degree of skill, care and diligence as may reasonably be expected of a person of his knowledge and experience and holding his/her office within the issuer (Rule 3.08(f)). Directors do not satisfy these required levels if they pay attention to the issuer's affairs only at formal meetings. At a minimum, they must take an active interest in the issuer's affairs and obtain a general understanding of its business. They must follow up anything untoward that comes to their attention.

Paragraph 2 of Appendix 16 to the Exchange Listing Rules requires financial statements presented in an annual report to provide a true and fair view of the state of affairs of the issuer and of the results of its operations and its cashflows.

In addition, the Relevant Directors were obliged to, under their respective Undertakings, comply with the Best Ability Undertakings and the Undertakings to Cooperate.

LISTING COMMITTEE'S FINDINGS OF BREACH

The Listing Committee considered the written and/or oral submissions of the Division, the Company and certain Relevant Directors, and concluded that the Relevant Directors breached their duties of skill, care and diligence under Rule 3.08(f) and their Best Ability Undertakings:

- (a) The EDs failed to safeguard the Company's assets in respect of the PEI Receivables and the Prepayments;
- (b) The INEDs failed to take an active interest in the PEI business and the Prepayments, and proactively follow up anything untoward that came to their attention;
- (c) All Relevant Directors failed to procure the Company's FY2016 financial statements to provide a true and fair view and, consequently, the FY2017 financial statements (confining to Mr Lin (ED) and Mr Chan (INED) who remained on the Board at that time); and
- (d) All Relevant Directors failed to ensure that the Company implemented an effective internal control system to ensure that key business decisions and significant financial issues were escalated to the Board for consideration and/or information in a timely manner and for managing receivables and prepayments.

The Listing Committee's reasoning is as follows:

Relevant Directors' breaches

PEI

EDs

Mr Qiu (ED) introduced the PEI business and the buyers to the Company. Mr Lin and Mr Deng (both EDs) agreed with Mr Qiu at a monthly management meeting on 5 January 2016 to procure the Company to conduct the PEI business. In view of the following circumstances, the Listing Committee concluded that the EDs, in failing to safeguard the Company's assets, failed to discharge their duties of reasonable skill, care and diligence under Rule 3.08(f):

- (a) The Company had only four buyers for this business. They were all introduced by Mr Qiu and situated overseas. However, it appeared that the EDs did not make any attempt to establish the identity of the owners of the PEI buyers or procure the Company to conduct any credit risk assessment in respect of those buyers. They also did not procure the Company to obtain any deposit or security from them before the deliveries.
- (b) The first batch of transactions, which took place in March 2016, was already valued at about RMB100 million, which was the initial agreed size of the business. (The revenue and net profit for the six months ended 30 June 2015 were RMB304.9 million and RMB6.88 million respectively.) Before receiving any payment for the first batch (although they were not yet due), the EDs, without involving the INEDs, agreed and decided among themselves on 5 May 2016 to expand the business segment to RMB200 million for the second batch in view of the unrealized profit made from the first batch. In addition, they decided to extend the original payment term that already spanned 270 days further to 360 days without any further security being given to the Company.
- (c) They neither informed, nor sought advice or input from, the INEDs in respect of their decisions to start and expand the new PEI trading business, and the associated risks.

INEDs

Whilst the INEDs (Mr Chan, Mr Ma and Mr Yu) were not involved in the decision to commence the PEI business, they were aware of such decision, the business operation and financial performance of the PEI business and the Group when they reviewed the draft interim results for the six months ended 30 June 2016 (**1H2016 Results**) which showed that:

- (a) The Company entered into the PEI trading business and recorded RMB110 million as revenue from this segment, while its total revenue was RMB327.2 million; and
- (b) The Company's bank and cash balances dropped approximately 33.4 per cent from RMB398.4 million as at 31 December 2015 to RMB265.4 million as at 30 June 2016, while the cash used in operations increased approximately 66 per cent from RMB69.8 million (six months ended 30 June 2015) to RMB115.9 million (six months ended 30 June 2016).

Had the INEDs followed up with the EDs in respect of the PEI business after reviewing the 1H2016 Report, they should at least have been aware of the issues in connection with the PEI business.

The Listing Committee therefore concluded that the INEDs failed to discharge their duties of skill, care and diligence under Rule 3.08(f) to take an active interest in the PEI business and raise the potential credit risk issue with the EDs after they became aware of the PEI business when approving the 1H2016 Results. They also failed to follow up with the EDs on how the PEI business would be, and was actually, conducted in the second half of 2016, after the 1H2016 Results came to their attention.

All Relevant Directors

The PEI buyers did not accept the 5 per cent discount offered by the Company due to quality claims in November 2016, and instead requested a more substantial discount. Nevertheless, Mr Qiu still took the view that the Company was likely to be able to collect the invoiced amount without giving a reasonable basis to the auditors. On 17 March 2017, he took the view not to make any impairment for the PEI Receivables for FY2016. The other Relevant Directors agreed with Mr Qiu simply based on his representation without making further enquiry or exercising independent judgement. This accounting treatment partly contributed to the qualified audit opinion in FY2016.

In view of the circumstances set out in the preceding paragraph, the Listing Committee concluded that all the Relevant Directors failed to make a reasonable impairment assessment in respect of the PEI Receivables to address the auditors' concerns which contributed to the qualified audit opinion in FY2016 and thus failed to procure the Company's financial statements for FY2016 (and FY2017 for Mr Lin and Mr Chan who remained on the Board at that time) to provide a true and fair view of the state of affairs of the Company and of the results of its operations and its cashflows. They have therefore breached their duty of skill, care and diligence under Rule 3.08(f).

Prepayments

According to the Company's IPO prospectus, the terms of the prepayments were set out in the purchase orders, and its amount in general represented 10 per cent to 40 per cent of the purchase price from the suppliers.

However, it transpired that there was no contractual term governing the Prepayments other than:

- (a) based on the past practice (that the Company could ask the suppliers to provide the required materials or refund when its business or procurement plans change, and the suppliers would accommodate such requests); and
- (b) verbally agreeing with the suppliers on the amount to be prepaid in FY2016 and FY2017 based on the Company's estimated sales and procurement for the following year.

Further, the actual amount of orders that the Company placed with Suppliers A and B in FY2016 was only RMB34,309,934 and RMB12,607,666 respectively, which was only 37.4 per cent and 15.2 per cent of the prepayment balance to the respective suppliers.

In November 2016, the Company was aware that Supplier A was in financial difficulties. In early 2017, the Company asked Suppliers A and B to refund the Prepayments. The two suppliers refunded part of the Prepayments but were unable to refund in full due to insufficient funds.

In March 2017, the Company entered into procurement agreements for FY2017 with Suppliers A and B. Under those agreements, the Company continued to procure raw materials from those suppliers without dealing with the prepayments already made, the suppliers' financial difficulties and/or whether further prepayments were waived as a result.

The Listing Committee concluded that all the Relevant Directors breached Rule 3.08(f) to discharge their duties of skill, care and diligence:

- (a) Notwithstanding the significant accumulation of the prepayments since FY2015, the EDs (Mr Lin, Mr Qiu and Mr Deng) failed to safeguard the Company's assets by:
 - (i) ensuring that the terms of the prepayments were sufficiently detailed to protect the Company's interest, including but not limited to reducing the key terms in writing, and in line with the practice set out in its IPO prospectus to limit the amount of prepayments to 10 per cent to 40 per cent of the purchase price under the purchase orders;

- (ii) controlling the level of the Prepayments, and approving the Prepayments in amounts which should not substantially exceed the value of the actual orders, in view of the balances of the Prepayments in previous years and the reduced market demand for textile products; and
 - (iii) procuring the Company to recover the Prepayments as soon as in 1H2016 by which the prepayment level reached RMB 195.7 million (a 25.8 per cent increase as compared with RMB155.6 million by FY2015). However, they approved further prepayments in FY2016 as a result of which the level reached RMB207.3 million by the year end, and entered into further procurement agreements with Suppliers A and B in March 2017. They only requested Suppliers A and B to refund the Prepayments in early 2017, and started taking follow-up action since 2017.
- (b) Although the INEDs (Mr Chan, Mr Ma and Mr Yu) were said to have been aware of the significant increase in the prepayment level in early 2017, they should have been aware of the increasing trend when they considered the 1H2016 Results, as the amount increased from RMB155.6 million (by FY2015) to RMB195.7 million by 1H2016. They should then have made enquiries with the Company, Mr Lin or the other EDs, and taken steps to procure the Company to address the prepayment issue. However, they only started taking follow-up actions and urged the EDs to recover the Prepayments in March 2017. They failed to take an active interest in the Company's affairs and proactively follow up anything untoward that comes to their attention required under Rule 3.08(f).
- (c) Although all the Relevant Directors claimed to have conducted an impairment assessment, they failed to make a reasonable assessment in respect of the Prepayments to address the auditors' concerns which contributed to the qualified audit opinion in FY2016, including the business rationale and commercial substance of the excessive Prepayments and the basis of the partial impairment provision notwithstanding the financial difficulties of Supplier A and its failure (together with Supplier B) to refund the Prepayments upon the Company's request in early 2017. They therefore failed to procure the Company's FY2016 financial statements to provide a true and fair view of the state of affairs of the Company and of the results of its operations and its cashflows.

Internal control deficiencies

The Listing Committee concluded that there were material deficiencies in the Company's internal control system:

- (a) There was no system requiring key business decisions (such as the decision to commence the PEI business) and significant financial issues (such as significant rise in the receivables and prepayments level) to be brought to the entire Board's attention for discussion on a regular basis:
- (i) None of the INEDs (ie Mr Chan, Mr Ma or Mr Yu) was involved in or aware of the EDs' decisions at the monthly management meetings and the commitment level in the PEI business before reviewing the 1H2016 Results.
 - (ii) There was no regular update on the Group's financial information (such as management accounts) to the Board (except the EDs) other than the interim and annual financial reporting. The monthly analysis on receivables and prepayments prepared by the finance department (**Monthly Analysis**) was not provided to the INEDs at all. As a result, the other directors were not informed of the PEI Receivables and the Prepayments level during FY2016 before they posed a high credit risk on the Company; and
 - (iii) Discussions and decisions made at the monthly management meetings attended by the EDs, and the relevant meeting minutes, were not made available to the other directors. As a result, the INEDs were unable to positively contribute to the Group's development of its strategy and policies, such as identifying and reducing the risk to the Company in solely relying on Mr Qiu to develop the PEI business segment, in committing RMB300 million within seven months in a new business segment, and in delivering the goods to all four new customers without conducting any credit risk assessment on them and without receiving any deposit or other security.
- (b) No director was designated to handle the recovery of receivables and prepayments before 2017.

The Listing Committee concluded that the Relevant Directors breached their duties of skill, care and diligence under Rule 3.08(f) to procure the Company to implement an effective internal control system for ensuring that key business decisions and significant financial issues were escalated to the Board for consideration and/or information in a timely manner and for managing receivables and prepayments, which contributed to the qualified or disclaimer opinions in the FY2016 to FY2018 Results.

The INEDs were also AC members. The AC's main duties included, among others, reviewing the adequacy and effectiveness of the Company's internal control system and risk management system and associated procedures. However, there was no evidence of any regular internal control review. The Listing Committee concluded that the INEDs also failed to discharge their AC duties.

Non-cooperation by Mr Qiu

Mr Qiu (ED) failed to respond to the Division's enquiry letter. The Division also sent a reminder letter to him. Mr Qiu did not provide a submission to the Division's enquiries. The Listing Committee concluded that Mr Qiu breached his Undertaking to Cooperate.

REGULATORY CONCERN

The Listing Committee regards the breaches in this matter as serious:

- (a) The failure by the EDs (Mr Lin, Mr Qiu and Mr Deng) to discharge their responsibilities under Rule 3.08 was serious in the light of the following circumstances:
 - (i) They procured the Company to commence the PEI business;
 - (ii) Mr Lin and Mr Qiu approved the Prepayments, whereas Mr Deng was or should have been aware of the Prepayments through the monthly management meetings and the Monthly Analysis provided by the finance department;
 - (iii) The amount of the PEI Receivables and the Prepayments was significant to the Company;
 - (iv) They failed to procure the Company to obtain any deposit or security and/or conduct any credit risk assessment in respect of the PEI buyers; and
 - (v) They failed to control the prepayment level and approved further prepayments during FY2016.
- (b) Mr Qiu knowingly and wilfully breached his Undertaking to Cooperate with the Division's investigation.

- (c) Although the INEDs (Mr Chan, Mr Ma and Mr Yu) were not directly involved in running the PEI business and approving the Prepayments, they failed to take an active interest in the Company's affairs and follow up with the EDs on their conduct of the PEI business and the prepayment level after the 1H2016 Results came to their attention. They should have exercised their independent judgement and used their knowledge and experience to advise and guide the Board on managing the PEI business risk and the related receivables and the Prepayments.
- (d) The financial exposure and risk undertaken by the Group under the PEI business and the Prepayments was significantly high – the Company incurred over RMB332.5 million and RMB207.2 million in the PEI business and the Prepayments respectively in FY2016. The impairment of the PEI Receivables totalled RMB309.6 million, and the impairment of the Prepayments totalled RMB223.4 million, for FY2016 and FY2017. They altogether were equal to approximately 40.6 per cent of the Company's total assets as at 31 December 2016 (RMB1,312 million). The interests of the Company and its shareholders as a whole have been seriously jeopardized as a result of those impairments.
- (e) There were material deficiencies in the Company's internal controls for ensuring that key business decisions and significant financial issues were escalated to the Board for consideration and/or information in a timely manner and for managing receivables and prepayments. Although the Board was expected under the Corporate Governance Code to review the soundness and effectiveness of the internal controls at least annually, and claimed in the FY2015 Corporate Governance Report to have done so, it failed to identify the material internal control deficiencies. The Company has been unable to provide evidence of any regular internal control review conducted by it since 1 January 2016 notwithstanding the Division's request.
- (f) The Company's compliance history - In 2017, the Company received a warning letter for late publication of the FY2016 Results and a guidance letter for late publication of the Environment, Social and Governance report.

SANCTIONS

Having made the findings of breaches stated above, the Listing Committee decided to:

- (1) Censure Mr Lin (ED and Chairman) for breaching Rule 3.08(f) and the Best Ability Undertaking;
- (2) Censure Mr Qiu (ED) for breaching Rule 3.08(f), the Best Ability Undertaking and the

Undertaking to Cooperate;

- (3) State that, in its opinion, by reasons of the wilful failure of Mr Qiu to discharge his Undertaking to Cooperate and Mr. Lin for his breaches in (1) above, had Mr Qiu and Mr Lin remained on the board of directors of the Company, their retention of office would have been prejudicial to the interests of investors;
- (4) Censure Mr Deng (ED) for breaching Rule 3.08(f) and the Best Ability Undertaking;
- (5) Criticise Mr Chan, Mr Ma and Mr Yu (all INEDs) for breaching Rule 3.08(f) and their Best Ability Undertakings.

The Listing Committee further directed:

Internal control review

- (6) The Company to (a) retain an independent professional adviser satisfactory to the Division (**Adviser**) to conduct a thorough review of and make recommendations to improve the Company's internal controls on ensuring that significant financial issues and key business decisions were escalated to the Board for consideration and/or information in a timely manner and for managing receivables and prepayments, within two weeks from the date of publication of the news release. The Company shall provide the Division with the written report of the Adviser containing such recommendations within two months from the publication of the news release. The Company is to submit the proposed scope of retainer to the Division for comment before appointment of the Adviser; and (b) furnish the Division with the Adviser's written report on the Company's full implementation of the Adviser's recommendations within a further period of two months.
- (7) The Company to publish an announcement to confirm that each direction in paragraph (6)(a) and (b) above has been fully complied with within two weeks after the fulfillment of that direction.
- (8) The Company to submit the draft announcements referred to in (7) above for the Division's comment and may only publish the announcements after the Division has confirmed it has no further comment on them.

Director training

- (9) As a pre-requisite of any future appointment as a director of any company listed or to be listed on the Exchange, the Relevant Directors (except Mr Lin and Mr Qiu) to attend 15 hours of training on Listing Rule compliance, including three hours on each of (i) directors' duties and (ii) corporate governance (**Training**), to be provided by training providers approved by the Division. The Training is to be completed, and the Training provider's written certification of full compliance is to be provided to the Division, before the effective date of any such appointment.
- (10) Following the publication of this statement, any changes necessary and any administrative matters which may emerge in the management and operation of any of the directions set out in paragraph (6) to (9) above to be directed to the Division for consideration and approval. The Division should refer any matters of concern to the Listing Committee for determination.

Hong Kong, 17 February 2021