

Fibrechem Technologies Limited

**REPORT
OF THE INDEPENDENT INVESTIGATION
BY
NTan Corporate Advisory Pte Ltd**



Independent Investigation Report

Content	Page
1. IMPORTANT NOTE	1
2. LIST OF ABBREVIATIONS AND DEFINITIONS	4
3. DRAMATIS PERSONAE	9
4. REPORT OF THE INDEPENDENT INVESTIGATION	11
a. PART A. BACKGROUND	11
i. FCT and its subsidiaries	12
ii. Business of FCT and the Group	15
iii. Published financial statements of the Group	16
iv. Audit difficulties in February 2009	18
b. PART B. KEY FINDINGS	21
i. Introduction	21
ii. Key findings	24
iii. Numerous financial and accounting irregularities	25
■ Overstatement of cash balance in the Initial Group Balance Sheet	28
■ Understatement of assets (excluding cash balance) in the Initial Group Balance Sheet	28
■ Understatement of liabilities in the Initial Group Balance Sheet	29
■ Overstatement of profits in the Initial Group Balance Sheet	29

■ Omission of PRC bank loans in the Group's audited financial statements and published financial statements over an extended period of time	30
iv. Unauthorised change in corporate structure of the Group	35
v. The financial impact / implications of the various transactions we investigated	38
■ Unaccounted cash balance	39
■ Inaccurate published financial statements	41
■ Lack of regard for internal controls	45
■ Persons responsible	47
c. PART C. LIMITATIONS AND CHALLENGES	50
d. PART D. CONCLUSION	56
e. PART E. OUR RECOMMENDATIONS	61
f. Annex 1 – Group structure	65
g. Annex 2 – Initial Group Balance Sheet and the Revised Group Balance Sheet	66
h. Annex 3 – Summary of expenses incurred in connection with the Independent Investigation, the Resumption Proposal and the operating expenses of FCT and its non-PRC subsidiaries	67
i. Annex 4 – Comments from individuals and/or entities against whom findings, comments, inferences and conclusions have been drawn in this Report	68

IMPORTANT NOTE

In February 2009, Fibrechem Technologies Limited (“**FCT**”) and its external auditors, Ernst & Young LLP (“**EY**”) who was appointed on 8 September 2008, encountered certain difficulties in the finalisation of the audit of the trade receivables and cash balances of FCT and its subsidiaries (“**Group**”) as at 31 December 2008.

As a result of these difficulties, the Board of Directors of FCT (the “**Board**”) appointed us, NTan Corporate Advisory Pte Ltd (“**NTan**”), to, inter alia, investigate the transactions giving rise to the aforesaid difficulties (the “**Independent Investigation**”). We were also to advise on the appropriate measures to be adopted by the Group to safeguard its assets, continue its operations smoothly and enhance values to all its stakeholders. Drew & Napier LLC were engaged to, inter alia, assist us in our work.

On 25 February 2009, as a result of the aforesaid developments, trading in the shares of FCT was suspended as the potential impact of the matters under investigation on the Group’s business and financial position was not clear.

We commenced the Independent Investigation immediately upon our appointment. On 22 February 2010, FCT submitted its resumption of trading proposal pursuant to Rule 1304 of the Listing Manual (“**Resumption Proposal**”). As part of the Resumption Proposal, the Board requested that we prepare a report of the findings of the Independent Investigation. Pursuant to the direction of the Board, this report has been prepared (the “**Report**”). It is

intended that the Report be included and/or referred to in a circular to be sent to FCT's shareholders and/or in the Explanatory Statement of a Scheme of Arrangement to be proposed by FCT to its creditors ("**Purposes**").

The Board directed that the Report be prepared on the basis of work carried out up to and based on information available as at 1 December 2011.

The Independent Investigation has faced substantial challenges and limitations, which are explained at paragraphs 92 to 95 of this Report. Given these challenges and limitations, this Report is by no means a comprehensive account of the irregularities and wrongdoings that took place at FCT and/or its subsidiaries. This Report is also not determinative of exactly how, when and why some of the financial and accounting irregularities took place, the persons responsible and whether there were in fact misappropriations of assets of the Group or unrecorded utilisation of assets of the Group. This Report sets out the findings of the Independent Investigation based on work carried out up to and information available as at 1 December 2011.

Where findings, comments, inferences and conclusions have been drawn in this Report against individuals and/or entities, wherever reasonably practicable, these individuals and/or entities have been given the opportunity to comment on the said findings. This exercise is known as "**Maxwellisation**". This Report should be read subject to the comments from these individuals and/or entities set out at **Annex 4** to this Report.

This Report is prepared solely for the use of FCT for the aforesaid Purposes and is not intended or approved for publication to any other individual or entity other than the parties contemplated in connection with the Purposes and the relevant regulatory authorities in connection therewith, save with our consent. No representation whatsoever is made to any individual and/or entity as to the accuracy or completeness of this Report and no such person(s) should place any reliance whatsoever on this Report.

This Report has been prepared by us solely as agents of FCT and neither we nor any party assisting us, including but not limited to the law firm of Drew & Napier LLC, accept any liability whatsoever, whether direct, indirect or consequential, in relation to or arising out of this Report.

Dated the 1st day of December, 2011.

LIST OF ABBREVIATIONS AND DEFINITIONS

Big Four Audit Firm	Any of EY, PwC, Deloitte & Touche LLP, KPMG LLP audit firm
Board	Board of Directors of FCT
CEO	Chief Executive Officer
CFO	Chief Financial Officer
EY	Ernst & Young LLP, the external auditor of FCT appointed on 8 September 2008 for FY 2008.
FCT	Fibrechem Technologies Limited, a company incorporated in Bermuda and listed on the main board of SGX-ST.
FY	Financial year ended 31 December
Group	FCT and its subsidiaries.
Honglin International	Honglin International Company Limited, a company incorporated in Hong Kong and a wholly-owned subsidiary of Privy Management.

LIST OF ABBREVIATIONS AND DEFINITIONS

Independent Investigation	The investigation into the transactions in relation to the difficulties encountered by FCT and its external auditors during the finalisation of the audit of the trade receivables and cash balances of FCT and its subsidiaries as at 31 December 2008.
Initial Group Balance Sheet	The balance sheet of the Group as at 31 December 2008 which was initially being audited by EY.
Listing Manual	The listing manual of the SGX-ST.
Maxwellisation	The exercise whereby, as far as practicable, a copy of our draft Report is provided to the individuals and/or entities against whom findings, comments, inferences and conclusions have been drawn in this Report (based on the limited Relevant Accounting Records made available to us) to give an opportunity to these individuals and/or entities to comment on the said findings.
NTan	NTan Corporate Advisory Pte Ltd, which has been appointed by the Board of FCT, to carry out the Independent Investigation.
PPE	Property, plant and equipment
PRC	People's Republic of China

LIST OF ABBREVIATIONS AND DEFINITIONS

PRC Management	The key executive personnel of the PRC Subsidiaries, which comprise Mr James Zhang (Executive Chairman), Mr Cheung Fei Pang (Executive Vice Chairman), Mr Xu Xuhui (Executive Vice Chairman), Mr Liu Donghui (Executive Vice Chairman), Mr Zhuang Li (Executive Vice Chairman) and Mr Zheng Peirong (Chief Financial Officer), as set out at paragraph 8 of this Report.
PRC Subsidiaries	The Group's subsidiaries in PRC, namely Quanzhou Chemical, Xiamen Specialised, Xiamen Microfibre and Xiamen Leather.
PRC Subsidiaries Balance Sheets	The balance sheets of the PRC Subsidiaries as at 31 December 2008 provided by the PRC Management during the Independent Investigation.
Privy Management	Privy Management Limited, a company incorporated in the British Virgin Islands and wholly-owned subsidiary of FCT.
Prospectus	The prospectus document issued by FCT when it was seeking its listing on the main board of SGX-ST in April 2004.
Purposes	The inclusion and/or reference of the Report in a circular to be sent to FCT's shareholders and/or in the Explanatory Statement of a Scheme of Arrangement to be proposed by FCT to its creditors.

LIST OF ABBREVIATIONS AND DEFINITIONS

PwC	PricewaterhouseCoopers LLP, the reporting accountant engaged by FCT to perform a Special Purpose Audit in connection with its Resumption Proposal.
Quanzhou Chemical	Quanzhou Honglin Chemical Fibre Co. Ltd, a company incorporated in PRC and a wholly-owned subsidiary of Honglin International.
Relevant Accounting Records	Relevant underlying financial and accounting books, records and documents.
Report	The report of NTan's findings to-date of the Independent Investigation.
Resumption Proposal	FCT's resumption of trading proposal submitted on 22 February 2010 pursuant to Rule 1304 of the Listing Manual.
Revised Group Balance Sheet	The restated balance sheet of the Group as at 31 December 2008 prepared by the Group during the Independent Investigation, and subjected to the Special Purpose Audit. The Revised Group Balance Sheet has not been adjusted to include (a) contingent liabilities arising from financial and accounting irregularities or (b) further adjustments, if any, arising from the Special Purpose Audit, which may have the effect of further reducing the net assets of the Group.
SGX-ST	Singapore Exchange Securities Trading Limited

LIST OF ABBREVIATIONS AND DEFINITIONS

SFA	Securities and Futures Act (Chapter 289) of the Republic of Singapore.
Special Purpose Audit	The audit of the consolidated balance sheets of the Group as at 31 December 2008 and 31 December 2009 and the consolidated income statements of the Group for FY 2009 and the first half of FY 2010 in accordance with the Singapore Standards on Auditing applicable to special purpose audit engagements.
Xiamen Leather	Xiamen Hongxin Leather Co. Ltd, a company incorporated in PRC and a wholly-owned subsidiary of Honglin International.
Xiamen Microfibre	Xiamen Hongxin Microfibre Materials Co. Ltd, a company incorporated in PRC and a wholly-owned subsidiary of Honglin International.
Xiamen Specialised	Xiamen Hongxin Specialised Fibre Co. Ltd, a company incorporated in PRC and a wholly-owned subsidiary of Honglin International.

Dramatis Personae

Name	Position with the Group
Mr James Zhang (“Mr Zhang”)	<ul style="list-style-type: none"> a) Executive Chairman, Executive Director and CEO of FCT (from 19 September 2003 to 24 February 2009 (suspended)) b) Executive Chairman of the PRC Subsidiaries (since 1 June 1996) c) Legal representative of Quanzhou Chemical (up to 9 March 2010) d) Legal representative of Xiamen Specialised (current) e) Legal representative of Xiamen Microfibre (since 24 December 2009) f) Supervisor of Xiamen Leather (from 28 February 2007 to 22 May 2009)
Mr Cheung Fei Pang (“Mr Cheung”)	<ul style="list-style-type: none"> a) Executive Vice Chairman and Executive Director of FCT (since 19 September 2003) b) Executive Vice Chairman of the PRC Subsidiaries (from 1 January 2004 to 28 October 2010) c) Legal representative of Xiamen Microfibre (up to 24 December 2009)
Mr Ong Tiong Seng	Lead Independent Director and Chairman of the audit committee of FCT
Mr Lim Chin Tong	Independent Director and Chairman of the remuneration committee of FCT
Dr Chong Weng Chiew	Independent Director and Chairman of the nominating committee of FCT
Mr Low Check Kian	Non-Independent and Non-Executive Director
Ms Tan Sin Mui	Alternate Director to Mr Low Check Kian (ceased to be the Alternate Director to Mr Low Check Kian since 15 June 2011)

Name	Position with the Group
Mr Xu Xuhui (“ Mr Xu ”)	<ul style="list-style-type: none"> a) Acting CEO of FCT (since 25 February 2009) b) Executive Vice Chairman of the PRC Subsidiaries (since 1 June 1996) c) Legal representative of Quanzhou Chemical (since 11 November 2010) d) Legal representative of Xiamen Leather (since 19 September 2010) e) Supervisor of Xiamen Microfibre (from 7 April 2009 to 2 September 2010)
Mr Liu Donghui (“ Mr Liu ”)	<ul style="list-style-type: none"> a) Executive Vice Chairman of the PRC Subsidiaries (from 25 January 2006 to 28 October 2010) b) Legal representative of Quanzhou Chemical (from 9 March 2010 to 11 November 2010) c) Legal representative of Xiamen Leather (up to 19 September 2010)
Mr Zhuang Li (“ Mr Zhuang ”)	Executive Vice Chairman of the PRC Subsidiaries (from 1 August 2007 to 2 September 2010)
Mr Zheng Peirong (“ Mr Zheng ”)	<ul style="list-style-type: none"> a) CFO of FCT (since April 2004 when FCT was listed on the main board of SGX-ST) b) Financial Controller of the PRC Subsidiaries (since 1 June 1997) and is responsible for the overall financial planning and management and supervision of the PRC accounting team c) Supervisor of Quanzhou Chemical (since 7 October 2010)
Mr Christopher Tan (“ Mr Tan ”)	Financial Controller of FCT (since 1 October 2005)
Mr Zhu Junyi (“ Mr Zhu ”)	Accounts Manager of the PRC Subsidiaries (since 13 February 2006)

REPORT OF THE INDEPENDENT INVESTIGATION

1. In February 2009, FCT and its external auditors encountered certain difficulties in the finalisation of the audit of the Group's trade receivables and cash balances as at 31 December 2008. As a result of these difficulties, the Board appointed us to, inter alia, carry out the Independent Investigation and to advise on the appropriate measures to be adopted by the Group to safeguard its assets, continue its operations smoothly and enhance values to all its stakeholders.

PART A. BACKGROUND

2. The background information on the Group set out hereafter is primarily based on announcements and statements released by FCT to the public. However, in view of the findings of the Independent Investigation to-date, in particular with regards to certain significant omissions in the announcements of financial statements made by FCT to the public, and the doubts cast on the reliability of information on the Group made publicly available by FCT, we are unable to verify the assertions made by FCT in relation to the information on the Group in these public announcements and statements. Therefore, the information in relation to the Group set out in this Report of the Independent Investigation should be read with this qualification in mind.

FCT and its subsidiaries

3. FCT serves as the ultimate holding company of the Group through its wholly-owned intermediate holding company, Privy Management Limited (**“Privy Management”**), a company incorporated in the British Virgin Islands, which in turn wholly-owns a Hong Kong incorporated holding company, Honglin International Company Limited (**“Honglin International”**). Honglin International is the holding company of the Group’s subsidiaries in the People’s Republic of China (**“PRC”**), namely Quanzhou Honglin Chemical Fibre Co. Ltd (**“Quanzhou Chemical”**), Xiamen Hongxin Specialised Fibre Co. Ltd (**“Xiamen Specialised”**), Xiamen Hongxin Microfibre Materials Co. Ltd (**“Xiamen Microfibre”**) and Xiamen Hongxin Leather Co. Ltd (**“Xiamen Leather”**) (collectively the **“PRC Subsidiaries”**). A chart setting out the structure of the Group is annexed hereto and marked as **“Annex 1”**.

4. As at 24 February 2009, the Board comprised:

Name	Position with FCT
Mr James Zhang (“Mr Zhang”)	Executive Chairman, Executive Director and Chief Executive Officer (“CEO”)
Mr Cheung Fei Pang (“Mr Cheung”)	Executive Vice Chairman and Executive Director
Mr Ong Tiong Seng	Lead Independent Director and Chairman of the audit committee of FCT
Mr Lim Chin Tong	Independent Director and Chairman of the remuneration committee of FCT
Dr Chong Weng Chiew	Independent Director and Chairman of the nominating committee of FCT
Mr Low Check Kian	Non-Independent and Non-Executive Director
Ms Tan Sin Mui	Alternate Director to Mr Low Check Kian

5. Mr Zhang and Mr Cheung are the only executive directors of the Board. Mr Cheung is the brother of Mr Zhang. Both executive directors of the Board, who are mainly based in the PRC, are responsible for the Group's corporate planning, strategic business development and overall management as well as overseeing operations in the PRC.

6. As at 24 February 2009, prior to the commencement of the Independent Investigation, the legal representatives of the PRC Subsidiaries were as follows:

Name	PRC Subsidiaries
Mr Zhang	Quanzhou Chemical
Mr Zhang	Xiamen Specialised
Mr Cheung	Xiamen Microfibre
Mr Liu Donghui (" Mr Liu ")	Xiamen Leather

7. On 9 March 2010, Mr Liu, the Executive Vice Chairman of the PRC Subsidiaries, was appointed the legal representative of Quanzhou Chemical in place of Mr Zhang. Mr Xu Xuhui ("**Mr Xu**"), the Executive Vice Chairman of the PRC Subsidiaries and Acting CEO of FCT, was appointed the legal representative of Quanzhou Chemical and of Xiamen Leather in place of Mr Liu on 11 November 2010 and 19 September 2010 respectively. On 24 December 2009, Mr Zhang was appointed as legal representative of Xiamen Microfibre in place of Mr Cheung. As explained at paragraph 23 below, Mr Zhang remains as legal representative of Xiamen Specialised to-date.
8. The key executives of FCT and of the PRC Subsidiaries ("**PRC Management**") comprised the following:

Name	Position with the Group
Mr Zhang	Executive Chairman, Executive Director and CEO of FCT from 19 September 2003 to 24 February 2009 (suspended) and Executive Chairman of the PRC Subsidiaries from 1 June 1996 and Supervisor of the Xiamen Leather from 28 February 2007 to 22 May 2009
Mr Cheung	Executive Vice Chairman and Executive Director of FCT from 19 September 2003 and Executive Vice Chairman of the PRC Subsidiaries from 1 January 2004 to 28 October 2010
Mr Xu	Acting CEO of FCT from 25 February 2009 and Executive Vice Chairman of the PRC Subsidiaries from 1 June 1996 and Supervisor of Xiamen Microfibre from 7 April 2009 to 2 September 2010
Mr Liu	Executive Vice Chairman of the PRC Subsidiaries from 25 January 2006 to 28 October 2010
Mr Zhuang Li (“ Mr Zhuang ”)	Executive Vice Chairman of the PRC Subsidiaries from 1 August 2007 to 2 September 2010
Mr Zheng Peirong (“ Mr Zheng ”)	Chief Financial Officer (“ CFO ”) of FCT and Financial Controller of the PRC Subsidiaries from 1 June 1997 and Supervisor of Quanzhou Chemical from 7 October 2010. It was stated in the Group’s annual reports from 2004 to 2007 that Mr Zheng was appointed CFO of FCT since its listing on the main board of SGX-ST in April 2004 and was responsible for the overall financial planning and management and supervision of the PRC accounting team.
Mr Christopher Tan (“ Mr Tan ”)	Financial Controller of FCT from 1 October 2005

Business of FCT and the Group

9. Based on the annual reports of FCT, the Group is a leading manufacturer of chemical fibres in the Fujian Province of the PRC. Amongst other things, the Group manufactures bi-component and specialised chemical fibres which FCT claims are sold to more than 600 customers in the textile and garment industry in the PRC that manufacture a variety of fabrics and apparels. According to FCT, the Group is also the only fully integrated manufacturer of environmentally friendly synthetic leather in the PRC with a base of more than 200 customers.
10. As explained to us by the PRC Management, in particular Mr Zhang, Mr Xu and Mr Zheng, the Group is currently engaged in the business of the manufacture and sale of differential bi-component chemical fibres, which are essentially specialised chemical fibres that are a blend of both nylon and polyester products. According to the annual reports of FCT, the Group has also moved up the production value chain since its listing in 2004 and is currently the only fully integrated manufacturer of uniform microfiber leather in the PRC.
11. According to the PRC Management, the Group's customers, currently totalling more than 800, are mainly yarn and textile manufacturers, and leather products and shoe manufacturers located in the Fujian Province, PRC.
12. The prospectus issued by FCT when it was seeking its listing on the main board of the Singapore Exchange Securities Trading Limited ("SGX-ST") disclosed that the Group's business was founded in 1995 by Mr Zhang to tap into the growing textile

business in the PRC. The said prospectus (“**Prospectus**”) explained that as there were already many fabric and textile manufacturers in the PRC and the barriers to entry in these industries were relatively low, the Group decided to focus on the manufacture of chemical fibres, which possess properties that are able to overcome the limitations of natural fibres and are widely used in the apparel, home furnishing, medical, aeronautics and energy sectors.

13. According to the Prospectus, the Group started its first production facility in the industrial area of Quanzhou city, Fujian Province, of which operations commenced in 1997 with the manufacture and sales of polyester fully drawn yarn.
14. According to the PRC Management, in particular Mr Zhang and Mr Xu, the Group embarked on the research and production of differential bi-component chemical fibres to set the Group apart from other chemical fibre manufacturers. Such bi-component long fibres are a blend of approximately 75% polyester and 25% nylon and are different from the commoditised chemical fibres which are either 100% nylon or 100% polyester. Bi-component fibres enhance fabric qualities and are relatively difficult for potential competitors to replicate.

Published financial statements of the Group

15. In its published financial statements, FCT is portrayed as a viable concern with an excellent track record. These published financial statements disclose that the Group has recorded impressive growth figures over the past years. However, as explained

below, the reliability of the Group's growth figures over the past years is put into question in light of matters that will be explained later in this Report.

16. In this Report, the abbreviation "FY" will refer to a financial year ended 31 December. For the period from FY 2003 to the third quarter of FY 2008, the turnover and gross profit of the Group, based on its published financial statements, are set out below:

	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	First three quarters of FY2008
	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m	HK\$'m
Turnover	308.1	475.7	829.9	1,263.3	1,815.6	1,479.6
Gross Profit	119.7	167.4	287.6	476.3	697.9	538.4
Gross Profit Margin	38.84%	35.20%	34.65%	37.70%	38.44%	36.39%
Net Profit for the period	90.1	101.2	196.9	332.0	538.6	405.9

17. Based on FCT's published financial statements, since its inception in 2003 and its listing on the main board of the SGX-ST in April 2004, it has consistently delivered healthy gross profit margins. During the period from FY 2003 to the third quarter of FY 2008, the published financial statements of FCT reflected gross profit margins of between 34.65% to 38.84%. In FY 2005, FCT recorded particularly impressive growth figures of a 74.5% increase in turnover to HK\$829.9 million and a 71.7% increase in gross profit to HK\$287.6 million. Based on the last available audited

accounts of FCT, the Group reported an impressive performance in FY 2007 by turning in a 43.7% increase in its turnover to reach some HK\$1.8 billion and a 46.5% increase in gross profit to reach close to HK\$700 million.

18. The Group's published financial statements for the first three quarters of FY 2008, which have not been audited, showed continued impressive growth in turnover, profit and net asset value. As set out in paragraphs 46 to 49 of this Report, the said financial statements for the third quarter of FY 2008 did not accurately reflect the Group's liabilities position due to the omission of PRC bank loans of some RMB364 million as at 30 September 2008. For this reason and the reasons set out in paragraphs 46 to 54 of this Report, the Group's published financial statements for the third quarter of FY 2008 were not a true and fair reflection of the Group's financial position as at 30 September 2008.

Audit difficulties in February 2009

19. On or around 23 February 2009, a meeting was convened in Singapore between the audit committee of FCT, the external auditors, EY, and Mr Zhang, the CEO of the Group, to finalise the audit of the Group's financial statements for FY 2008. During the meeting, questions were raised about the audit confirmations of trade receivables and cash balances. After the discussions, the meeting was adjourned to the afternoon pending receipt of an official confirmation on the authenticity of a bank seal on the bank statements of a PRC bank. However, before the meeting recommenced, Mr Zhang left Singapore. Attempts to contact Mr Zhang were unsuccessful. The price of FCT's shares subsequently plummeted.

20. Given the serious potential impact of the matter, and to obtain a thorough and complete understanding of the transactions in question, the Board of FCT engaged us to, inter alia, carry out the Independent Investigation. Drew & Napier LLC were engaged to, inter alia, assist us in our work. It should be noted that given the limited financial resources of FCT, Mr Zhang had procured funds for the payment of expenses in connection with the Independent Investigation, the Resumption Proposal and the operating expenses of FCT and its non-PRC subsidiaries.
21. On 25 February 2009, the Board requested a suspension of trading of FCT shares pending the completion of the Independent Investigation.
22. The Board also implemented the following measures (to the extent the circumstances permitted) to safeguard the interests of FCT and all its stakeholders pending the completion of the Independent Investigation:
- (a) The appointment of Mr Xu, the Executive Vice Chairman of the PRC Subsidiaries, as the Acting CEO of FCT, in place of Mr Zhang, the CEO of FCT;
 - (b) Taking possession, custody and control of the corporate seals and company stamps of each of the PRC Subsidiaries and entrusting the same to the possession, custody and control of the Acting CEO, Mr Xu;

- (c) The removal of Mr Zhang and Mr Cheung as directors of FCT's non-PRC subsidiaries and the appointment of Mr Tan, Financial Controller of FCT, as a director of FCT's non-PRC subsidiaries; and
 - (d) The removal of Mr Zhang as a bank signatory of the Group and the appointment of Mr Tan, the Financial Controller of FCT, as replacement bank signatory of the Group.
23. With regard to paragraph 22(c) above, despite our recommendation to remove Mr Zhang from management of the PRC Subsidiaries, we understand the situation to be as follows (which was subsequently affirmed by Mr Zhang during Maxwellisation):
- (a) Xiamen Specialised - Mr Zhang remains the legal representative and a director of Xiamen Specialised because, as we understand from Mr Zheng, Mr Zhang is a personal guarantor in 2010 for the PRC bank loans given by the PRC lenders to Xiamen Specialised and the PRC lenders of Xiamen Specialised have imposed a condition that Mr Zhang must remain as the legal representative failing which the PRC lenders would withdraw the said loans. Mr Zhang commented during Maxwellisation that following the suspension of trading of FCT shares on 25 February 2009, the PRC lenders made the renewal of the PRC bank loans obtained by the PRC Subsidiaries conditional upon Mr Zhang providing a personal guarantee for these PRC bank loans. According to Mr Zhang although this condition placed an onerous obligation on him, he agreed to provide a personal guarantee for these PRC bank loans in the interest of maintaining the continued operations of the PRC Subsidiaries.

- (b) Xiamen Microfibre - on 24 December 2009, Mr Zhang was appointed the legal representative and director of Xiamen Microfibre in place of Mr Cheung when Mr Cheung resigned as legal representative. Again, we understand that Mr Zhang is the personal guarantor in 2010 for the PRC bank loans given by the PRC lenders to Xiamen Microfibre, and the PRC lenders have imposed a condition that Mr Zhang must be the legal representative failing which the PRC lenders would withdraw the loans to Xiamen Microfibre.
- (c) Quanzhou Chemical – Mr Zhang has been removed as director and legal representative of Quanzhou Chemical..

24. We set out hereafter our key findings.

PART B. KEY FINDINGS

Introduction

- 25. The Independent Investigation has faced substantial challenges and limitations, which are explained at paragraphs 92 to 95 of this Report, and this Report should be viewed in the light of these challenges and limitations.
- 26. Our primary task was to establish whether the FY 2008 financial statements prepared by the Group for the purpose of the audit by EY were reliable and accurately reflected the financial position of the Group. We sought to corroborate these financial

statements against the relevant underlying financial and accounting books, records and documents (“**Relevant Accounting Records**”), particularly those of the PRC Subsidiaries, in Xiamen.

27. In brief, when members of our team first arrived in Xiamen to commence the Independent Investigation, they found that several key employees of the Group (including Mr Zheng and his PRC accounting team) were missing and uncontactable, while Mr Zhang, Mr Cheung and Mr Zheng of PRC Management at the material time were either unavailable or unwilling to cooperate in the Independent Investigation. The computers used by the PRC accounting team were missing and the Relevant Accounting Records of the Group were also incomplete and/or unreliable. We were provided the balance sheets of the PRC Subsidiaries as at 31 December 2008 (“**PRC Subsidiaries Balance Sheets**”) by the PRC Management. We were informed by Mr Zhu Junyi, the Accounts Manager of the PRC Subsidiaries (“**Mr Zhu**”), that these PRC Subsidiaries Balance Sheets reflected the actual financial position of the PRC Subsidiaries. We were also granted limited access to certain Relevant Accounting Records in respect of these PRC Subsidiaries Balance Sheets. During Maxwellisation, Mr Zhang responded that he was available and willing to co-operate in the Independent Investigation. In his response, Mr Zhang stated that he had, wherever possible, rendered his co-operation and cited examples of the extent of his co-operation in the Independent Investigation. These examples are set out at paragraph 93 below.

28. Unlike other investigative assignments that we had carried out in Singapore, we did not have any statutory coercive powers in the PRC to enable us to require the co-

operation of, inter alia, the present and former employees of the Group, certain customers and suppliers of the Group who were all in the PRC.

29. Given these circumstances, the progress of our Independent Investigation was initially limited. However, we persisted and finally after several months of discussions with the PRC Management, in particular Mr Zhang, we were provided with revised PRC Subsidiaries Balance Sheets. They also granted limited access to further Relevant Accounting Records in respect of these revised PRC Subsidiaries Balance Sheets.
30. However, we were not prepared to accept, at face value, these revised PRC Subsidiaries Balance Sheets and the limited Relevant Accounting Records provided to us given the doubts cast on the reliability of the financial statements of the Group as explained at paragraph 19 above. We reviewed the revised PRC Subsidiaries Balance Sheets and the limited Relevant Accounting Records provided to us and we tested and questioned the reasonableness of the components of these revised PRC Subsidiaries Balance Sheets. This process underwent several rounds of review, tests and questions. Each time, the PRC Management would revise the PRC Subsidiaries Balance Sheets and provide us with further Relevant Accounting Records until the resultant PRC Subsidiaries Balance Sheets appear, as far as it is reasonably possible to ascertain it, to reasonably reflect the Group's financial position.
31. At the same time, FCT is seeking a resumption of trading of its shares on the main board of the SGX-ST. The trading resumption application process requires an independent audit of the Group's financial statements to present the relevant financial position of the Group in a circular to its shareholders. Accordingly, FCT engaged

PricewaterhouseCoopers LLP (“PwC”) to perform a special purpose audit of the consolidated balance sheets of the Group as at 31 December 2008 and 31 December 2009 and the consolidated income statements of the Group for FY 2009 and first half of FY 2010 in accordance with the Singapore Standards on Auditing applicable to special purpose audit engagements (“**Special Purpose Audit**”). The result of the Special Purpose Audit would also allow us to corroborate the reliability of the resultant PRC Subsidiaries Balance Sheets and the Relevant Accounting Records provided to us by the PRC Management. As at the date of this Report, PwC has not issued its audit report on the Special Purpose Audit.

Key findings

32. At the time the audit difficulties were made known to FCT, it appeared to the Board that the transactions in question were limited to the Group’s trade receivables and cash balances as at 31 December 2008.
33. The matters uncovered by the Independent Investigation were, however, more extensive. What was uncovered were financial and accounting misstatements that extended beyond the apparent initial scope of the Group’s trade receivables and cash balances. Our Independent Investigation uncovered:
 - (a) Numerous financial and accounting irregularities; and
 - (b) Unauthorised change in corporate structure of the Group.

Numerous financial and accounting irregularities

34. On 3 November 2008, FCT announced the Group's unaudited financial statements for the third quarter of FY 2008. The published net assets of the Group, as at 30 September 2008, stood at some HK\$2.83 billion.
35. In February 2009, based on the Group's balance sheet as at 31 December 2008 ("**Initial Group Balance Sheet**") which was initially being audited by EY at the material time, the unaudited net assets of the Group as at 31 December 2008 stood at some HK\$2.98 billion.
36. During the Independent Investigation, the Group prepared a restated balance sheet as at 31 December 2008 ("**Revised Group Balance Sheet**") which was subjected to the Special Purpose Audit. The Revised Group Balance Sheet has not been adjusted to include (a) contingent liabilities arising from financial and accounting irregularities or (b) further adjustments, if any, arising from the Special Purpose Audit. Such an adjustment may have the effect of further reducing the net assets of the Group. The Revised Group Balance Sheet is set out at paragraph 39 of this Report and it shows some HK\$2.60 billion of net assets.
37. A copy of the Initial Group Balance Sheet and the Revised Group Balance Sheet is annexed hereto and marked herein as "**Annex 2**".
38. The Revised Group Balance Sheet revealed *a reduction of some HK\$382 million in the net asset value of the Group* from that stated in the Initial Group Balance Sheet.

39. The differences between the Initial Group Balance Sheet and the Revised Group

Balance Sheet are:

Consolidated group balance sheet	(A) Initial Group Balance Sheet (31 Dec 08) HK\$'m	(B) Revised Group Balance Sheet (31 Dec 08) HK\$'m	(B) – (A) Difference between (A) and (B) HK\$'m	Remarks
Current assets				
Cash and bank balances	764	77	(686)	Overstatement of cash balances
Bills receivables	-	3	3	
Accounts receivables	482	482	(0)	
Security deposit for land development	36	87	51	Understatement of security deposits for land
Other receivables, deposits & prepayment	201 ^(a)	490	289	Understatement of prepayments of equipments
Inventory	67	129	62	Understatement of inventory
Total current assets	1,550	1,268	(282)	
Non-current assets				
Property, plant and equipment ("PPE")	1,960 ^(a)	2,059	98	Understatement of property, plant and equipment
Lease premium for land	106	84	(23)	Impairment loss on lease premium for land
Prepayments for land acquisition	85	223	138	Understatement of prepayments for land acquisition
Deposits paid for property, plant and equipment	- ^(a)	101	101	Non-disclosure of deposit paid for office building
Long term investment	-	54	54	Non-disclosure of long term notes receivables
Total non-current assets	2,152	2,520	368	
Total assets	3,702	3,788	87	
Current liabilities				
Short term loan	37	487 ^(b)	450	Non-disclosure of PRC bank loans
Bills payables	-	26	26	
Accounts payables	53	79	26	Understatement of accounts payables
Tax payables	17	3	(14)	
Other payables	32	17	(14)	
Accrued expenses	12	10	(2)	
Total current liabilities	150	623	473	
Non-current liabilities				
Long term loan	572	568 ^(b)	(4)	
Total liabilities	722	1,190	469	

CONFIDENTIAL – 1 DECEMBER 2011
REPORT OF THE INDEPENDENT INVESTIGATION
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Consolidated group balance sheet	(A) Initial Group Balance Sheet (31 Dec 08) HK\$'m	(B) Revised Group Balance Sheet (31 Dec 08) HK\$'m	(B) – (A) Difference between (A) and (B) HK\$'m	Remarks
Shareholders' equity				
Share capital	9	9	-	
Preference shares	598	598	-	
Reserves	757	730	(27)	
Retained earnings				
Retained earnings at beginning of year ^(c)	1,246	1,246	-	
Profit/(loss) for the year ^(c)	521	136	(385)	Overstatement of profits for FY 2008 ^(c)
Less: dividend paid in the year	(106)	(106)	-	
Less: transfer to statutory reserves	(45)	(16)	29	
Retained earnings at end of year	1,616	1,260	(356)	
Total shareholders' equity	2,980	2,598	(382)	
Total liabilities & shareholders' equity	3,702	3,788	87	

Notes:

- (a) Reclassification of "Deposits paid for property, plant and equipment" for HK\$479m
 - i. To "PPE" for HK\$285m within non-current assets for better comparison
 - ii. To "Other receivables, deposits & prepayment" for HK\$194m from non-current assets to current assets for better comparison
- (b) Reclassification of non-PRC bank borrowings for HK\$568m from current liabilities to non-current liabilities for better comparison
- (c) As we were not given full access to the Relevant Accounting Records for the periods prior to FY 2008, we were unable to determine whether the overstatement of net profit of some HK\$385 million was attributable solely to FY 2008 or whether part of it was attributable to prior periods

40. The material differences of categories more than HK\$50 million in value and with more than HK\$20 million in variance between the Initial Group Balance Sheet and the Revised Group Balance Sheet can be categorised into the following:

- (a) the overstatement of cash balance in the Initial Group Balance Sheet;

- (b) the understatement of assets (excluding cash balance) in the Initial Group Balance Sheet;
- (c) the understatement of liabilities in the Initial Group Balance Sheet;
- (d) the overstatement of profits in the Initial Group Balance Sheet; and
- (e) the omission of PRC bank loans in the Group's audited financial statements and published financial statements over an extended period of time.

Overstatement of cash balance in the Initial Group Balance Sheet

41. The cash balance in the Initial Group Balance Sheet was overstated by some HK\$686 million.

Understatement of assets (excluding cash balance) in the Initial Group Balance Sheet

42. The following assets (excluding cash balance) were understated by the following material amounts in the Initial Group Balance Sheet:

	HK\$ million
i) Prepayments of equipments	289
ii) Security deposits for land	51
iii) Inventory	62
iv) Property, plant and equipment	98

v)	Prepayments for land	138
vi)	Deposits paid for office building	101
vii)	Long term notes receivables	54
viii)	Impairment loss on lease premium for land	<u>(23)</u>
		770

Understatement of liabilities in the Initial Group Balance Sheet

43. The following liabilities were omitted and/or understated by the following material amounts in the Initial Group Balance Sheet:

	HK\$ million
(a) omission of PRC bank loans	(450)
(b) understatement of accounts payable	<u>(26)</u>
	(476)

44. The PRC bank loans of some HK\$450 million as at 31 December 2008 were not disclosed in the Initial Group Balance Sheet.

Overstatement of profits in the Initial Group Balance Sheet

45. The Independent Investigation also revealed that the net profit for FY 2008 was overstated in the Initial Group Balance Sheet by some HK\$385 million. As we were not given full access to the Relevant Accounting Records for the periods prior to FY 2008, we were unable to determine whether the overstatement of net profit of some

HK\$385 million was attributable solely to FY 2008 or whether part of it was attributable to prior periods.

Omission of PRC bank loans in the Group's audited financial statements and published financial statements over an extended period of time

46. The Independent Investigation also revealed that two of the PRC Subsidiaries, namely Xiamen Specialised and Xiamen Microfibre had, as early as in 2005, obtained PRC bank loans from the Agricultural Bank of China ("ABC"), Xiamen International Bank ("XIB") and Bank of Communications ("BCOM"). According to Mr Zhang during Maxwellisation, the amount of the PRC bank loans, for which he is a personal guarantor, was RMB266.9 million as at 29 September 2011.
47. The amounts of the PRC bank loans obtained by Xiamen Specialised and Xiamen Microfibre for the period between 2005 and 2010 were:

Outstanding balance of PRC bank loans as at	Xiamen Specialised		Xiamen Microfibre				Total
	PRC bank	Amount RMB (million)	PRC bank	Amount RMB (million)	PRC bank	Amount RMB (million)	Amount RMB (million)
1 January 2005	-	-	-	-	-	-	-
31 December 2005	ABC	94.1	XIB	6.0	-	-	100.1
31 December 2006	ABC	190.0	XIB	-	-	-	190.0
31 December 2007	ABC	208.0	BCOM	20.0	-	-	228.0
31 March 2008	ABC	246.0	BCOM	20.0	-	-	266.0
30 June 2008	ABC	268.0	BCOM	-	-	-	268.0
30 September 2008	ABC	324.0	BCOM	40.0	-	-	364.0

31 December 2008	ABC	360.5	BCOM	40.0	-	-	400.5
31 December 2009	ABC	361.0	BCOM	20.0	ABC	28.0	409.0
30 June 2010	ABC	356.0	-	-	ABC	28.0	384.0

48. Based on the Relevant Accounting Records made available to us in the course of our Independent Investigation, including bank loan agreements and guarantee agreements which were affixed with the company stamp of Xiamen Specialised or Xiamen Microfibre and/or the signature or personal seal of the respective legal representative (namely Mr Zhang or Mr Cheung), these PRC bank loans obtained by Xiamen Specialised and Xiamen Microfibre in 2008 were short-term bank loans of one year duration. They were procured by the respective legal representatives of Xiamen Specialised and Xiamen Microfibre, namely Mr Zhang and Mr Cheung, on behalf of Xiamen Specialised and Xiamen Microfibre respectively. Based on the Relevant Accounting Records made available to us in the course of our Independent Investigation, including general ledgers for PRC bank loans of Xiamen Specialised and Xiamen Microfibre for the period between 2005 and June 2010, various PRC bank confirmations on loans drawn down by Xiamen Specialised and Xiamen Microfibre and various payments vouchers in respect of payments by Xiamen Specialised and Xiamen Microfibre to the PRC banks, we noted that PRC bank loans were obtained, repaid and renewed annually from as early as 2005 until June 2010, save that Xiamen Microfibre had obtained the PRC bank loans from XIB from 2005 to 2006 and thereafter from BCOM from 2007 to 2010 as well as from ABC from 2009 to 2010. We also noted that the aggregate amount of PRC bank loans steadily increased at each annual renewal from an initial amount of some RMB1.98 million in March 2005 to some RMB409 million as at 31 December 2009. However, we were unable to sight any document identifying the person who authorised the draw down of

the PRC bank loans. In addition, most of the journal vouchers for the repayment of the PRC bank loans do not indicate the person who approved, checked or prepared these payment vouchers, save for a few journal vouchers made in 2006 and 2007 which indicate that these journal vouchers were prepared by either one “Lin Xiaohua”, “Liu Runfang” or “Zeng Xiaolin”, who were the accounting staff of the PRC Subsidiaries. Some of these journal vouchers indicate that Mr Zhu had checked these journal vouchers.

49. Our Independent Investigation revealed that PRC bank loans of some RMB1.98 million in March 2005 to some RMB364 million as at 30 September 2008 were not disclosed in the audited financial statements and published financial statements of the Group for FY 2005 to FY 2008. However, these PRC bank loans were reflected in the PRC audited financial statements of Xiamen Specialised and Xiamen Microfibre for FY 2005 to FY 2008. No PRC bank loan was disclosed by FCT at the time it was seeking its listing on the main board of the SGX-ST in April 2004. We were not provided any of the Relevant Accounting Records of the Group for the period from 2003 to 2004 and are therefore unable to ascertain whether the PRC bank loans were similarly not disclosed in the audited financial statements of the Group when FCT was seeking its listing on the main board of the SGX-ST in April 2004.
50. As explained at paragraphs 70 to 79 below, the findings of the Independent Investigation cast doubts on the reliability of the published financial statements of the Group. Taking the published financial statements of the Group at face value, the PRC bank loans obtained by Xiamen Specialised and Xiamen Microfibre for the period from 30 June 2005 to 30 September 2008 constituted between some 6% of the

Group's total net asset value to as high as 21% of the Group's total net asset value. An analysis of the PRC bank loans on the Group's total net asset value (based on the Group's published financial statements from 31 March 2005 to 30 September 2008) is set out below:

As at	Outstanding PRC bank loans (RMB million)	Outstanding PRC bank loans (equivalent HK\$ million)	FCT Group's published Net Asset Value (HK\$ million)	Proportion of PRC bank loans to FCT Group's published Net Asset Value
31 March 2005 ^(a)	-	-	645.9	-
30 June 2005	60.0	56.6	690.0	8%
30 September 2005	46.0	44.2	736.2	6%
31 December 2005	100.1	96.3	798.2	12%
31 March 2006	94.1	90.9	868.5	10%
30 June 2006	118.1	114.1	893.9	13%
30 September 2006	129.0	124.6	985.7	13%
31 December 2006	190.0	186.3	1,136.4	16%
31 March 2007	255.0	255.0	1,242.6	21%
30 June 2007	260.0	268.0	1,484.7	18%
30 September 2007	315.0	324.7	1,628.9	20%
31 December 2007	228.0	242.6	2,442.5	10%
31 March 2008	266.0	295.6	2,644.2	11%
30 June 2008	268.0	297.8	2,722.3	11%
30 September 2008	364.0	404.4	2,834.1	14%

Notes:

(a) PRC bank loans of some RMB 1.98 million were borrowed by PRC Subsidiaries in the month of March 2005 and repaid by 31 March 2005.

51. The corporate disclosure policy under Appendix 7.1 of the Listing Manual (paragraph 8(k)) requires immediate disclosure of significant borrowings of funds. Although the

Listing Manual does not provide a definition of “significant borrowing of funds”, we note that under Chapter 10 of the Listing Manual, transactions which constituted 5% or more of the net asset value of a listed company and its subsidiaries require immediate disclosure. Using the threshold of disclosure set out in Chapter 10 of the Listing Manual and given the impact of the PRC bank loans on the Group’s net asset value as illustrated above, the PRC bank loans obtained by Xiamen Specialised and Xiamen Microfibre from June 2005 to 30 September 2008 were significant and required immediate disclosure in accordance with the underlying principles of the Listing Manual.

52. In March 2008, FCT obtained an additional bank loan facility which contained a financial covenant that FCT would ensure its subsidiaries do not incur any indebtedness, guarantees and/or borrowings in excess of US\$10 million. During this period from March 2008, the PRC bank loans were in excess of US\$10 million and FCT would have breached this financial covenant and an event of default would have occurred under FCT’s bank loan facilities.
53. In addition, as these PRC bank loans would have contravened FCT’s bank loan facilities and resulted in an event of default, this would constitute material information which required immediate disclosure under Chapter 7 of the Listing Manual.
54. Given that the bank loan agreements and guarantee agreements for the PRC bank loans obtained by Xiamen Specialised and Xiamen Microfibre for the period between 2005 and 2010 were affixed with the company stamp of Xiamen Specialised or

Xiamen Microfibre and/or the signature or personal seal of the respective legal representative (namely Mr Zhang or Mr Cheung), Mr Zhang or Mr Cheung would have been aware of these PRC bank loans. Further, given that Mr Zhang and Mr Cheung were also directors of FCT, who had approved the published financial statements of the Group for the period from FY 2005 to the third quarter of FY 2008 and would have been aware of these PRC bank loans, they similarly would have been or ought reasonably to have been aware of the omission of these PRC bank loans from the Group's published financial statements for the period from FY 2005 to the third quarter of FY 2008. In this regard, Mr Zhang responded during Maxwellisation that Mr Zheng had all along been in charge of the preparation and finalisation of the financial statements of the Group and he (Mr Zhang) had relied on Mr Zheng to ensure that the PRC bank loans, as well as all other accounting items, would be accurately reflected in the Group's published financial statements. Mr Zhang commented that these matters were always within the knowledge and purview of Mr Zheng and there was no reason for him (Mr Zhang) to doubt Mr Zheng's expertise.

Unauthorised change in corporate structure of the Group

55. As disclosed in FCT's FY 2007 annual report, FCT serves as the ultimate holding company of the Group through its wholly-owned intermediate holding company, Privy Management, which in turn wholly-owns a Hong Kong incorporated holding company, Honglin International, that directly holds the investments in the PRC Subsidiaries.

56. During our Independent Investigation, we determined that the PRC Management had in December 2008 effected a transfer of 51% of the shareholding in Xiamen Microfibre from Honglin International to Xiamen Specialised. The change in corporate structure of the Group was effected without the knowledge and approval of the Board. This change must have been carried out with the knowledge and approval of the directors of Xiamen Specialised (the transferee of the shareholding in Xiamen Microfibre) and of Honglin International (the transferor and shareholder of Xiamen Microfibre) and the legal representatives of Xiamen Specialised and Xiamen Microfibre, who were Mr Zhang and Mr Cheung at the material time. Given that Mr Zhang and Mr Cheung were also directors of FCT at the material time of the change in corporate structure, they would have been aware of the change in corporate structure of the Group, but failed to inform the Board of the same.
57. Mr Zhu explained that the aforesaid change in corporate structure of the Group was part of a plan formulated by the PRC Management sometime in the second half of 2008 to restructure the shareholdings in the PRC Subsidiaries such that the intermediate holding company of the PRC Subsidiaries was a PRC registered holding company. According to him, the purpose of the restructuring of the shareholdings in the PRC Subsidiaries was to achieve strategic benefits from the integration of finance resources, human resources, tax efficiency in relation to the land use rights, buildings and other properties owned by the PRC Subsidiaries as well as to enlarge the funding scale of the PRC Subsidiaries. During Maxwellisation, Mr Zhang stated that the aforesaid change in corporate structure of the Group was mooted with the intention of allowing the PRC Subsidiaries to reap strategic benefits from resource consolidation arising from such change.

58. Although the restructuring of the PRC Subsidiaries may have had strategic operational benefits to the Group, it also resulted in assets of the Group being placed out of reach of FCT's creditors, in particular the off-shore creditors. The transfer of 51% of the shareholding in Xiamen Microfibre from Honglin International to Xiamen Specialised opened the risk of ABC, which had extended bank loans of some RMB 360 million to Xiamen Specialised as at 31 December 2008, seizing the shareholdings in Xiamen Microfibre and/or its assets, in the event of a default in the PRC bank loans, in priority to the off-shore creditors, an advantage that would not have been available to ABC otherwise. Based on our experience in advising in debt restructuring exercises, such a change in corporate structure would be a serious impediment in persuading creditors, in particular the off-shore creditors, to participate in a consensual debt restructuring exercise. In this regard, Mr Zhang stated during Maxwellisation that he was surprised to learn that the aforesaid change in corporate structure of the Group would result in assets of the Group being placed out of reach of FCT's creditors.
59. In order to prevent FCT's creditors from withdrawing their support for FCT's consensual debt restructuring exercise, we engaged in several discussions with the PRC Management, in particular Mr Zhang, after we uncovered the unauthorised change in the corporate structure of the Group. We eventually managed to convince Mr Zhang to reinstate the corporate structure of the Group to the position as disclosed in the Group's FY 2007 annual report. The Group's corporate structure was reinstated by May 2009.

60. In any event, the formulation of the plan to restructure the PRC Subsidiaries and the implementation of the same by the PRC Management took place without the knowledge and prior approval of the Board.

61. We will next deal with the financial impact of the transactions we investigated.

The financial impact / implications of the various transactions we investigated

62. The financial and accounting irregularities resulted in the understating of assets and liabilities in the Initial Group Balance Sheet as itemised in paragraph 39 above.

63. The uncovering of the financial and accounting irregularities was extremely challenging and time consuming. It was therefore not cost effective for us to identify each and every financial and accounting irregularity that took place, and ascertain the financial impact of all these transactions. This will be elaborated upon later in this Report.

64. An alternative solution was to restate the Group's balance sheet in order to estimate the financial impact of all the financial and accounting irregularities. This involved adjusting the carrying values of the Group's assets and liabilities to reflect their estimated fair values and ensuring that all assets and liabilities were duly recorded.

65. The Revised Group Balance Sheet (subject to the Special Purpose Audit and the possible adjustments (if any) as set out in paragraph 36) reflects the reduction in the net asset value of the Group from some HK\$2.98 billion to some HK\$2.60 billion.

Unaccounted cash balance

66. An analysis of the Initial Group Balance Sheet and the Revised Group Balance Sheet revealed an aggregate unaccounted cash balance of HK\$777 million in the Revised Group Balance Sheet comprising the following material differences of categories more than HK\$50 million in value and with more than HK\$20 million in variance:

	HK\$ million
Overstatement of cash balance - cash balance stated in the Initial Group Balance Sheet but not in the Revised Group Balance Sheet	686
Less: portion of overstated cash balance related to the overstatement of profits in the Initial Group Balance Sheet	(385)
Add: unaccounted cash balance arising from the understatement of liabilities in the Initial Group Balance Sheet	
i) PRC bank loans	450
ii) Accounts payables	<u>26</u>
	<u>476</u>
Total unaccounted cash balance in the Revised Group Balance Sheet	<u>777</u>

67. The above analysis shows that, after accounting for the effects of the overstatement of profits and the understatement of material liabilities, a total of HK\$777 million of cash balance, which should have been accounted for in the Revised Group Balance Sheet was not reflected in the Revised Group Balance Sheet.
68. In addition, a comparison of the Initial Group Balance Sheet and the Revised Group Balance Sheet shows an increase of HK\$770 million in the following material assets (which are now accounted for in the Revised Group Balance Sheet but were not reflected in the Initial Group Balance Sheet):

	HK\$ million
i) Prepayments of equipments	289
ii) Security deposits for land	51
iii) Inventory	62
iv) Property, plant and equipment	98
v) Prepayments for land	138
vi) Deposits paid for office building	101
vii) Long term notes receivables	54
viii) Impairment loss on lease premium for land	<u>(23)</u>
	770

69. The PRC Management, in particular Mr Zhang, represented to us that as at 31 December 2008, the Group did not have the HK\$777 million of cash balance (referred to in paragraph 66). We do not have sufficient evidence to conclusively explain (a) the unaccounted cash balance of HK\$777 million which were not reflected in the Revised Group Balance Sheet; and (b) the additional assets of HK\$770 million which were not reflected in the Initial Group Balance Sheet but have now been accounted for in the Revised Group Balance Sheet. The following are possible explanations:

- i) In the worst case, it is possible that the unaccounted cash balance was misappropriated;
- ii) The additional material assets of HK\$770 million which have now been accounted for in the Revised Group Balance Sheet may well represent restitution made to the Group; or

- iii) Alternatively, the unaccounted cash balance of HK\$777 million was used to purchase the additional assets reflected in the Revised Group Balance Sheet but these assets had not been properly recorded in the Initial Group Balance Sheet.

Inaccurate published financial statements

- 70. If the unaccounted cash balance of HK\$777 million did not in fact exist (by reason of misappropriation or misclassification), the overstatement of cash balance of HK\$686 million and overstatement of profits of HK\$385 million in the Initial Group Balance Sheet may have been an attempt to artificially inflate the Group's cash balance and profitability. This would render the published financial statements of the Group and, in particular, the reported growth and profit wholly unreliable.
- 71. The significant overstatement of the Group's value, and the omission of the PRC bank loans from the Group's published financial statements over an extended period of time despite the full disclosure of the PRC bank loans in the PRC audited financial statements (which had been filed with the PRC tax authority), suggest that the Group's published financial statements that the public was relying upon when trading in the shares of FCT were almost entirely inaccurate. As set out above in paragraph 51, by reason of the impact on the Group's net asset value, the PRC bank loans obtained by Xiamen Specialised and Xiamen Microfibre for the period from June 2005 to 30 September 2008 were significant and would have required immediate disclosure in accordance with the actual requirements and the underlying principles of the Listing Manual as early as June 2005 and until 30 September 2008.

72. Further, as set out above in paragraph 52, FCT obtained an additional bank loan facility in March 2008 which contained a financial covenant that FCT would ensure that its subsidiaries do not incur any indebtedness, guarantees and/or borrowings in excess of US\$10 million. During this period from March 2008, the PRC bank loans were in excess of US\$10 million and FCT would have breached this financial covenant and an event of default would have occurred under of FCT's bank loan facilities. In this regard, the PRC bank loans obtained during the period from March 2008 onwards constituted significant borrowing of funds which would have required immediate disclosure from March 2008 onwards in accordance with the underlying principles of the Listing Manual.
73. In any event, the occurrence of the events of default of FCT's bank loan facilities would have required immediate disclosure under Rule 703 of the Listing Manual from March 2008 to 30 September 2008 as further elaborated under the corporate disclosure policy under Appendix 7.1 of the Listing Manual (paragraph 8(l)). As such, the omission of the PRC bank loans from the published financial statements of the Group from the second quarter of FY 2005 to the third quarter of FY 2008 would have constituted breaches of provisions in the Securities and Futures Act ("SFA") relating to non-disclosure of information required to be disclosed under the Listing Manual (SFA Section 203 read with Rule 703 of the Listing Manual).
74. Similarly, the omission of the PRC bank loans from the published financial statements of the Group from FY 2005 to the third quarter of FY 2008 rendered the published financial statements of the Group inaccurate. As explained at paragraph 54 above,

given that Mr Zhang or Mr Cheung would have been aware of these PRC bank loans and were also directors of FCT who had approved the published financial statements of the Group for the period from FY 2005 to the third quarter of FY 2008, they similarly would have been or ought reasonably to have been aware that the Group's published financial statements from FY 2005 to the third quarter of FY 2008 were false or misleading in a material way by reason of the omission of these PRC bank loans from these published financial statements. This may constitute a breach of the provision in the SFA relating to false or misleading statements (SFA Section 199).

75. Further, when approving the financial statements of the Group for the period from FY 2005 to the third quarter of FY 2008 for publication, Mr Zhang or Mr Cheung would have been or ought reasonably to have been aware that the said financial statements were false or misleading by reason of the omission of the PRC bank loans. They would have also been reasonably aware that the disclosure would have had an effect on the price of the shares of FCT and that the non-disclosure may have had the effect of raising or maintaining the price of the shares of FCT (a state which may not have occurred if the true facts had been disclosed). The failure to make these disclosures may have been done with the intent of inducing other persons to purchase FCT shares. This may constitute a breach of the provision in the SFA relating to the fraudulent inducement of persons to deal in securities (SFA Section 200) and may be in contravention of securities market manipulation prohibition (SFA Section 198) under the SFA. The misstatements of the other categories of financial and accounting transactions, if also present in the published financial statements of the Group from FY 2005 to the third quarter of FY 2008, may also constitute likely breaches of these provisions of the SFA.

76. The financial and accounting irregularities led to the production of the Initial Group Balance Sheet which reflected a higher total Group consolidated shareholders' equity value of an additional HK\$382 million compared to the Revised Group Balance Sheet.
77. These findings rendered the published financial statements of the Group, and in particular its reported growth and profit, wholly unreliable. This raises the question whether the Group was really achieving the reported level of turnover and profit that fuelled the spectacular increase in the traded price of FCT's shares. FCT's share price soared from S\$0.37 to an all-time high of S\$2.70 in May 2007.
78. As mentioned above in paragraph 17, FCT recorded impressive growth figures in turnover and gross profit during the period from FY 2005 to FY 2007.
79. If there was a concerted effort to increase the reported profit of the Group by overstating the net profits in the Initial Group Balance Sheet, this may constitute a breach of the provision in the SFA relating to false or misleading statements (SFA Section 199) and may amount to breaches under the SFA in relation to securities market manipulation (SFA Section 198) and fraudulent inducement of persons to deal in securities (SFA Section 200). If the financial results were in fact overstated in the Prospectus or FCT's quarterly announcements of financial results, it would be reasonable to draw the conclusion that such misleading, false or deceptive disclosure of inflated financial performance of the Group was made to induce or an attempt to induce the investing public to purchase or trade in FCT's shares.

Lack of regard for internal controls

80. Our Independent Investigation found that a strong corporate culture that respects internal control measures does not exist at the PRC Subsidiaries. Such an environment may have created a fertile ground for the abuse and overriding of internal controls which allowed the financial and accounting irregularities to be perpetrated at will.
81. Despite the existence of internal control measures, the financial and accounting irregularities were perpetuated over an extensive duration. Some examples of internal control measures present in the Group include:
- (a) the constitution of a Board with a strong independent element, which comprises 2 executive directors, 1 non-executive non-independent director and 3 independent non-executive directors;
 - (b) the constitution of several Board committees, namely a audit committee, a nominating committee and a remuneration committee to assist in the execution of the Board's responsibilities;
 - (c) the constitution of a audit committee which has clearly defined terms of reference, including to assist the Board in discharging its statutory duties on financial and accounting matters, to review the adequacy of the Company's internal controls and risk management policies and systems, review the audit

plans and reports of the external and internal auditors, review the independence of external auditors;

- (d) the appointment of a Big Four Audit Firm as FCT's external auditor;
- (e) the appointment of a Big Four Audit Firm to undertake the functions of an internal auditor with the mandate to direct, perform, review and supervise the internal audit review of the key areas and functions of the operating PRC Subsidiaries; and
- (f) the existence of a transactional based system of approval vouchers and checking and approval by different persons for each transaction.

82. Also, despite the existence of internal control measures and the full disclosure of the PRC bank loans in the PRC audited financial statements which had been filed with the PRC tax authority, the PRC bank loans were not properly recorded in the audited financial statements and published financial statements of the Group over an extensive period of time. In other instances, the assets of the PRC Subsidiaries have been understated in the Initial Group Balance Sheet at will. In addition, as explained at paragraphs 55 to 60 above, the PRC Management had effected a change in the corporate structure of the Group without the knowledge and approval of the Board.

83. Further, it appears that, based on our interactions with Mr Zheng and Mr Zhu in the course of the Independent Investigation, the PRC Management only takes instructions from Mr Zhang. As mentioned previously, when we commenced our Independent

Investigations, Mr Zhang, Mr Cheung and Mr Zheng of the PRC Management were either unavailable or unwilling to cooperate in the Independent Investigation. It was only after several months of discussions between Mr Zhang and us and Drew & Napier LLC that the PRC Management was willing to assist in the Independent Investigation by providing us with the revised PRC Subsidiaries Balance Sheets and further Relevant Accounting Records. Similarly, the unauthorised change in the corporate structure of the Group was only reinstated after we had persuaded Mr Zhang to procure the reinstatement.

84. In such circumstances, the issue of the adequacy of the Group's internal controls is moot. It did not matter what internal controls there were as they have been ignored and/or overridden by people of high standing without the knowledge and approval of the Board. Any internal controls and corporate governance initiatives instituted by the Board will not achieve the desired objectives if their proper implementation can be easily overridden. When a control culture does not exist, internal controls or the lack of them are irrelevant.

Persons responsible

85. Given the various limitations and challenges that we faced in the Independent Investigation, determining exactly how, when and why the financial and accounting irregularities took place was an extremely challenging exercise.
86. In addition, we did not have any statutory coercive powers to obtain access to the Relevant Accounting Records that appear to have been withheld by the management.

Given the lack of contemporaneous Relevant Accounting Records of the underlying transactions to the financial and accounting irregularities revealed by the Revised Group Balance Sheet, we are unable to determine the persons responsible or whether there were in fact misappropriations of assets of the Group or unrecorded utilisation of assets of the Group.

87. However, based on the Revised Group Balance Sheet which was prepared by the Group (and subject to the Special Purpose Audit and the possible adjustments (if any) as set out in paragraph 36), at the worst case, this would possibly indicate that the unaccounted cash balance of HK\$777 million had been misappropriated. Even if the unaccounted cash balance of HK\$777 million had been used to acquire assets but had not been properly recorded in the Initial Group Balance Sheet, the improper accounting of the acquisition of assets reflects extensive financial and accounting irregularities which would have been carried out with the knowledge of the PRC accounting team.
88. Despite the existence of internal control measures, numerous financial and accounting irregularities (in particular the significant overstatement of the Group's value in the Initial Group Balance Sheet and the omission of the PRC bank loans from the Group's audited financial statements and published financial statements for FY 2005 to the third quarter of FY 2008) occurred over an extended period of time. For the reasons set out in paragraphs 89 to 90, it would be reasonable to conclude that the financial and accounting irregularities were probably carried out at the direction or with the knowledge of senior members of the PRC Management, in particular Mr Zhang and Mr Zheng. Other than the individuals identified in this Report, we are unable to

determine direct responsibility of any particular staff member or officer of the Group due to the lack of information for our assessment of this issue.

89. The bank loan agreements and guarantee agreements for the PRC bank loans obtained by Xiamen Specialised and Xiamen Microfibre for the period between 2005 and 2010 were affixed with the company stamp of Xiamen Specialised or Xiamen Microfibre and/or the signature or personal seal of the respective legal representative (namely Mr Zhang or Mr Cheung). In the premises, Mr Zhang or Mr Cheung would have been aware of these PRC bank loans.
90. Further, given the “control” that we perceived Mr Zhang exerts at the PRC Subsidiaries, it would be reasonable to conclude the involvement of Mr Zhang in the financial and accounting irregularities. The initial non-cooperation by senior members of the PRC Management, in particular Mr Zhang, Mr Cheung, and Mr Zheng, and subsequent progress in the Independent Investigation only after several months of discussion with Mr Zhang as well as the reinstatement of the corporate structure of the Group after we had persuaded Mr Zhang to procure the reinstatement would reinforce this conclusion.
91. We note that Mr Zhang responded during Maxwellisation that he has “*never directed or instructed Mr Zheng to prepare the Group’s financial statements in a way that does not accurately depict the actual financial results of the Group*”. According to Mr Zhang, he had always “*relied on and trusted the expertise and integrity of Mr Zheng to prepare and verify the Group’s financial statements*”. Mr Zhang took the position that he was not aware of the omissions and inaccuracies in the Group’s published

financial statements for FY 2008 as he *“was not conversant in the English and did not fully understand the nuanced details of the Group’s financial statements”*. Mr Zhang also stated during Maxwellisation that his *“main focus at all times was to advance the strategic interests of the Group as a whole to ensure that it was profitable and maintained its smooth operations”*.

PART C. LIMITATIONS AND CHALLENGES

92. The Independent Investigation faced a number of limitations and challenges, including the following:

- (a) When we first arrived in Xiamen to begin the Independent Investigation, we found that several key employees of the Group (including Mr Zheng and his PRC accounting team) were missing and uncontactable, while certain members of the PRC Management, in particular Mr Zhang, Mr Cheung and Mr Zheng, at the material time, were either unavailable or unwilling to cooperate in the Independent Investigation. We did not have any statutory coercive powers to enable us to require the cooperation of, inter alia, the present and former employees of the Group, certain customers and suppliers of the Group in our investigation.
- (b) The computers used by the PRC accounting team were missing and the Relevant Accounting Records of the Group were incomplete and to the extent that the Relevant Accounting Records of the Group are available, they were

unreliable. The available Relevant Accounting Records of the Group recovered by us in the course of our Independent Investigation appeared to be prepared for the sole purpose of tax reporting in the PRC, and do not appear to bear any relevance to the finalisation of the audit of the Group's financial statements for FY 2008 or the Group's published financial statements prior to and including the third quarter of FY 2008.

- (c) The Relevant Accounting Records that were made available to us by Mr Zheng of the PRC Management were limited to those that enabled us to be satisfied, as far as reasonably possible to ascertain after several rounds of review, that the resultant PRC Subsidiaries Balance Sheets appear to reasonably reflect the Group's financial position and to facilitate the PwC's Special Purpose Audit. The Relevant Accounting Records in relation to the Initial Group Balance Sheet and in relation to the Group's published financial statements prior to and including the third quarter of FY 2008 were not available.

- (d) The Relevant Accounting Records that were made available to us by Mr Zheng of the PRC Management were limited to those of the Group and we had no access to the Relevant Accounting Records belonging to the counter-parties and third parties involved in the transactions in question. We did not have any statutory coercive powers to enable us to require the production of these documents to us. Therefore, we are unable to confirm the authenticity and veracity of the Relevant Accounting Records of the Group, that were made available to us by Mr Zheng, against the Relevant Accounting Records

belonging to such counter-parties and third parties involved in the transactions in question.

- (e) As at the date of this Report, PwC has performed the Special Purpose Audit (which included, inter alia, the consolidated balance sheet of the Group as at 31 December 2008) during September 2010 to February 2011. PwC has not issued its audit report. For the purpose of the Resumption Proposal, the scope of the Special Purpose Audit will be extended to cover the audit of the consolidated balance sheets and consolidated income statements of the Group up to 6 months prior to the presentation of the Group's financial statements in a circular to FCT's shareholders. PwC is expected to issue its audit report upon the completion of the extended scope of the Special Purpose Audit. The Revised Group Balance Sheet as set out in this Report is subject to the outcome of the Special Purpose Audit.

93. During Maxwellisation, Mr Zhang responded that he was, at all material times, available and willing to co-operate in the Independent Investigation and that he had, wherever possible, rendered his co-operation in the Independent Investigation. Mr Zhang cited the following examples:

- (a) Mr Zhang had several meetings with us over the course of the Independent Investigation, including during the initial stages, to assist us in the Independent Investigation.

- (b) Although Mr Zheng was initially reluctant to co-operate in the Independent Investigation, Mr Zhang had, on his own initiative, persuaded and managed to convince Mr Zheng to meet with us and render his co-operation in the Independent Investigation.
- (c) Following the suspension of trading in FCT's shares, the PRC lenders made the renewal of the PRC bank loans obtained by the PRC Subsidiaries conditional upon the provision of a personal guarantee by Mr Zhang for these PRC bank loans (which amounted to an aggregate of RMB266.9 million as at 29 September 2011). According to Mr Zhang, although this condition placed an onerous obligation on him, he agreed to provide a personal guarantee for these PRC bank loans in the interest of maintaining the continued operations of the PRC Subsidiaries.
- (d) Mr Zhang did his best to facilitate the Board's implementation of measures to safeguard the interests of FCT and all its stakeholders (set out at paragraph 22 above) and also the smooth transition of power in respect of the PRC Subsidiaries by:
 - (i) immediately handling over all company seals of the PRC Subsidiaries to Mr Xu following his appointment by the Board as the Acting CEO of FCT;

- (ii) taking steps to resign as legal representative and director of Xiamen Specialised (although this was not achieved as the PRC lenders did not agreed); and
 - (iii) signing all the relevant documents and taking all necessary steps to effect his resignation as a director of FCT's non-PRC subsidiaries and as legal representative and director of Quanzhou Chemical.
- (e) Mr Zhang extended his co-operation to enable funds from FCT and Honglin International be made available for the payment of expenses incurred by the Company in connection with the Independent Investigation.
- (f) Mr Zhang procured funds from his friends for the payment of expenses incurred by the Company in connection with the Independent Investigation.
94. Despite the aforesaid limitations and challenges, our investigation uncovered a significant number of different types of irregularities, which were more extensive than the transactions involving the Group's trade receivables and cash balances as at 31 December 2008.
95. However, given the above limitations and challenges that we faced, significant further work would have been necessary to complete the Independent Investigation. This would be extremely challenging and time consuming without the assistance of senior members of the PRC Management and access to the Relevant Accounting Records. The cost of further efforts to comprehensively uncover all irregularities and

wrongdoings out-weighed the benefit of uncovering further instances of irregularities and wrongdoings. It should be noted that Mr Zhang had procured funds for the payment of expenses incurred by the Company in connection with the Independent Investigation, its Resumption Proposal and the operating expenses of FCT and its non-PRC subsidiaries. A summary of these expenses are set out at **Annex 3** to this Report.

96. Where findings, comments, inferences and conclusions have been drawn in this Report (based on the limited Relevant Accounting Records made available to us) against individuals and/or entities, as far as practicable these individuals and/or entities have been given the opportunity to comment on the said findings. This exercise is known as “Maxwellisation”. We provided a draft copy of this Report, together with a Chinese translation, to Mr Zhang, Mr Cheung, Mr Zheng, Mr Xu, and Mr Liu. We were unable to provide a draft copy of this Report to Mr Zhuang as we were unable to locate or contact him. As at the date of this Report, we received comments from Mr Zhang during Maxwellisation. According to Mr Zhang, he did not respond at length to all the assumptions and allegations made in this Report as there are “*numerous assumptions and allegations which do not appear to be supported by evidence*”. Mr Zhang’s comments during Maxwellisation are set out at **Annex 4** to this Report. Therefore, this Report should be read subject to these comments. Where it is reasonably practicable, we have set out the comments from Mr Zhang at the relevant paragraphs of this Report for ease of reference.

97. *The purpose of this Report is purely to meet the stated objectives set out at paragraph 1 above.* This Report is by no means a comprehensive account of the irregularities and wrongdoings that took place at the Group due to the limitations set out in paragraphs 92 to 95 of this Report.

PART D. CONCLUSION

98. The published financial statements of FCT disclosed that the Group recorded impressive growth figures over an extended period of time and had consistently delivered healthy gross profit margins of 34.65% to 38.84% to its stakeholders since its inception in 2003 until the third quarter of FY 2008. Based on the last available audited accounts of FCT, the Group reported an impressive performance for FY 2007 by turning in a 43.7% increase in its turnover to reach some HK\$1.8 billion and a 46.5% increase in gross profit to reach close to HK\$700 million.
99. The Independent Investigation uncovered financial and accounting misstatements in the audited financial statements and the published financial statements of the Group that extended beyond the apparent initial scope of the Group's trade receivables and cash balances. These financial and accounting misstatements also occurred over an extended period of time. The Independent Investigation uncovered the following:
- (a) The net asset value of the Group was overstated by some HK\$382 million in the Initial Group Balance Sheet.

- (b) The cash balance of the Group was overstated by some HK\$686 million in the Initial Group Balance Sheet with unaccounted cash balance of some HK\$777 million (as set out in paragraph 66 of this Report).
- (c) The material assets of the Group (excluding cash balance) were understated by an aggregate of some HK\$770 million in the Initial Group Balance Sheet.
- (d) PRC bank loans of an aggregate of some HK\$450 million were not disclosed in the Initial Group Balance Sheet.
- (e) Over an extended period of time from 2005 to 2008, the PRC Subsidiaries obtained significant PRC bank loans (from some RMB1.98 million in March 2005 to RMB364 million as at 30 September 2008). These PRC bank loans were not disclosed in the audited financial statements and published financial statements of the Group from FY 2005 to FY 2008. These PRC bank loans constituted some 6% to as high as 21% of the Group's published total net asset value for FY 2005 to the third quarter of FY 2008. As at 30 June 2010, the outstanding PRC bank loans were some RMB384 million.
- (f) The net profit of the Group was overstated by some HK\$385 million in the Initial Group Balance Sheet.
- (g) The unauthorised change of the corporate structure of the Group in December 2008 which had the result of placing the Group's assets out of reach of FCT's creditors, in particular its off-shore creditors.

- (h) A blatant lack of regard existed with respect to the internal controls of the PRC Subsidiaries. A strong corporate culture that respects internal control measures does not exist at the PRC Subsidiaries and this allowed internal controls to be overridden at will, facilitating the commission of the financial and accounting irregularities and the unauthorised change in corporate structure of the Group. For the reasons set out at paragraphs 56 and 89 to 90 above, the unauthorised change in corporate structure of the Group and the financial and accounting irregularities were carried out at the direction or with the knowledge of the senior members of the PRC Management, in particular Mr Zhang, Mr Cheung and Mr Zheng.
100. The Independent Investigation shows that the financial and accounting irregularities were taking place extensively in the Group's operations resulting in a total of HK\$777 million of unaccounted cash balance as well as the systemic omission of PRC bank loans of which had steadily increased from an initial amount of some RMB1.98 million in March 2005 to some RMB364 million as at 30 September 2008 in the audited financial statements and published financial statements of the Group. In addition, the Independent Investigation indicates that other assets and liabilities of the Group may have not been properly recorded.
101. For the reasons set out in paragraphs 92 to 95 of this Report, we do not have sufficient information to conclude or infer that the unaccounted cash balance of HK\$777 million have been misappropriated. However, at the very least, there have been significant misstatements in the Group's financial disclosures which would constitute breaches of

provisions in the SFA as well as breaches of the Listing Manual relating to non-disclosure of information required to be disclosed under the Listing Manual.

102. In addition, if the unaccounted cash balance of HK\$777 million did not in fact exist, the overstatement of cash balance of HK\$686 million, profits of HK\$385 million in the Initial Group Balance Sheet and the omission of the PRC bank loans from the published financial statements of the Group over an extended period of time are possibly attempts to artificially inflate the Group's cash balance and profitability. These significant misstatements in the Group's financial disclosures may constitute breaches of the provisions in the SFA relating to false or misleading statements or fraudulent inducement of persons to deal in securities.
103. In any event, given the findings of the Independent Investigation and the doubts cast on the reliability of the published financial statements of the Group, this suggests a concerted effort to increase the reported profit of the Group during the period subsequent to the listing of its shares on the SGX-ST and the perpetuation of systemic accounting irregularities over an extended period of time by key members of the PRC Management, in particular Mr Zhang, Mr Zheng, and ought reasonably have been with the knowledge of Mr Cheung (as explained in paragraphs 74 and 75 above). Other than the individuals identified in this Report, we are unable to determine direct responsibility of any particular staff member or officer of the Group due to the lack of information for our assessment of this issue.
104. In response to our findings of the Independent Investigation, Mr Zhang commented during Maxwellisation that:

- (a) The change in corporate structure of the Group was mooted with the intention of allowing the PRC Subsidiaries to reap strategic benefits from resource consolidation arising from such change. He (Mr Zhang) was surprised to learn that the change in corporate structure of the Group would result in assets of the Group being placed out of reach of FCT's creditors, and had immediately took steps to reinstate the Group's corporate structure.
- (b) The PRC bank loans obtained by the PRC Subsidiaries have always been within the knowledge and purview of Mr Zheng. Given that Mr Zheng had all along been in charge of the preparation and finalisation of the financial statements of the Group, there was no reason for him (Mr Zhang) to doubt Mr Zheng's expertise and had relied on Mr Zheng to ensure that the PRC bank loans (as well as all other accounting items) would be accurately reflected in the Group's published financial statements.
- (c) He (Mr Zhang) has *"never directed or instructed Mr Zheng to prepare the Group's financial statements in a way that does not accurately depict the actual financial results of the Group"*. He (Mr Zhang) had always relied on and trusted in the expertise and integrity of Mr Zheng to prepare and verify the Group's financial statements. According to Mr Zhang, he (Mr Zhang) was not aware of the omissions and inaccuracies in the Group's published financial statements for FY 2008 as he (Mr Zhang) was *"not conversant in the English language and did not fully understand the*

nuanced details of the Group's financial statements". His (Mr Zhang) main focus at all times was to advance the strategic interests of the Group as a whole to ensure that it was profitable and maintained its smooth operations.

PART E. OUR RECOMMENDATIONS

105. Given the possible involvement by the senior members of the PRC Management, in particular Mr Zhang, Mr Cheung and Mr Zheng, in the financial and accounting irregularities, a change of the PRC Management would be necessary and in the best interest of the Group and all stakeholders. A separate exercise to review the internal controls of the Group would also be necessary so that the proper checks and balances can be implemented.
106. The Group should also consider setting up a formal corporate governance committee. This committee should be tasked to, amongst other things, achieve the following objectives:
- (a) inculcate a strong control culture throughout the Group;
 - (b) oversee the proper implementation of robust and comprehensive internal controls to prevent a repeat of the financial and accounting irregularities and to safeguard the Group's assets; and

- (c) adopt a zero tolerance approach to fraudulent or other improper activities.

107. Robust and comprehensive internal controls require:

- (a) the assessment of all material risks, including the risk of fraud;
- (b) the implementation of appropriate internal controls to mitigate material risks;
- (c) the speedy and proper address of failures to adhere to internal controls;
- (d) the review and, where appropriate, improvement of internal controls on a continuous basis; and
- (e) effective channels of communication to ensure that all staff members fully understand and adhere to the internal controls, and provide periodic refresher training to all staff members on the procedures and the rationale for implementing internal controls.

108. For effective corporate governance, it is recommended that:

- (a) the position of Chairman and CEO of the Group be held by separate officers of the Group;
- (b) a separate representative other than the CEO or Chairman be appointed as the legal representatives of the PRC Subsidiaries;

- (c) an independent committee, not comprising the CEO, be set up to approve funds transfers from or within the Group of more than HK\$20 million;
 - (d) the person who is responsible for the overall financial planning and management and supervision of the PRC accounting team reports directly to the CFO of the Group, and not to the CEO or legal representatives of the PRC Subsidiaries;
 - (e) the CFO of the Group reports directly to the audit committee of FCT, and not to the CEO; and
 - (f) the CEO and CFO submits quarterly declaration that the financial statements are free of misstatements and fraudulent acts.
109. Proper whistle blowing policies and procedures should be implemented. These should include, inter alia:
- (a) the adoption of a zero tolerance approach to fraudulent and other improper activities;
 - (b) the independent and expeditious investigation of suspected irregularities;
 - (c) the setting up of proper whistle-blowing policies and procedures which provide employees with clear access within the Group, including a direct

reporting channel to the internal auditors, for reporting suspected fraud, corruption or dishonest practices;

- (d) the setting up of a framework where employees are able to report suspected fraud, corruption or dishonest practices to members of the audit committee of FCT;
- (e) the protection from reprisal of employees making such reports; and
- (f) the education of employees and officers on whistle-blowing policy during staff training.

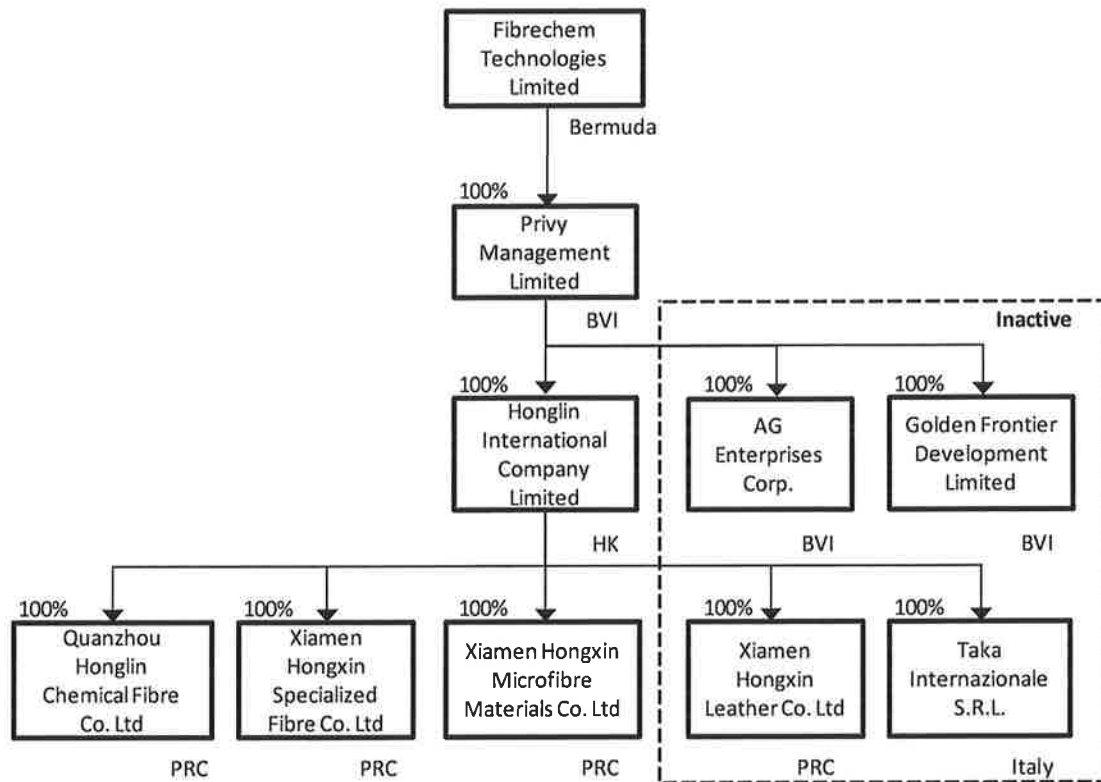
110. However, unless a strong corporate culture that respects and upholds internal control measures is embraced by the Group, any enhancements to internal controls and proposed corporate governance initiatives will not achieve the desired objectives because their proper implementation could easily be overridden.



NTan Corporate Advisory Pte Ltd

1 December 2011

Annex 1 – Group structure



Annex 2 – Initial Group Balance Sheet and the Revised Group Balance Sheet

Consolidated group balance sheet	Initial Group Balance Sheet (31 Dec 08) HK\$'m	Revised Group Balance Sheet (31 Dec 08) HK\$'m
Current assets		
Cash and bank balances	764	77
Bills receivables	-	3
Accounts receivables	482	482
Security deposit for land development	36	87
Other receivables, deposits & prepayment	201 ^(a)	490
Inventory	67	129
Total current assets	1,550	1,268
Non-current assets		
Property, plant and equipment ("PPE")	1,960 ^(a)	2,059
Lease premium for land	106	84
Prepayments for land acquisition	85	223
Deposits paid for property, plant and equipment	- ^(a)	101
Long term investment	-	54
Total non-current assets	2,152	2,520
Total assets	3,702	3,788
Current liabilities		
Short term loan	37	487 ^(b)
Bills payables	-	26
Accounts payables	53	79
Tax payables	17	3
Other payables	32	17
Accrued expenses	12	10
Total current liabilities	150	623
Non-current liabilities		
Long term loan	572	568 ^(b)
Total liabilities	722	1,190
Shareholders' equity		
Share capital	9	9
Preference shares	598	598
Reserves	757	730
Retained earnings	1,616	1,260
Total shareholders' equity	2,980	2,598
Total liabilities & shareholders' equity	3,702	3,788

Notes:

- (a) Reclassification of "Deposits paid for property, plant and equipment" for HK\$479m
- i. To "PPE" for HK\$285m within non-current assets for better comparison
 - ii. To "Other receivables, deposits & prepayment" for HK\$194m from non-current assets to current assets for better comparison
- (b) Reclassification of non-PRC bank borrowings for HK\$568m from current liabilities to non-current liabilities for better comparison

Annex 3 – Summary of expenses incurred in connection with the Independent Investigation, the Resumption Proposal and the operating expenses of FCT and its non-PRC subsidiaries

	S\$ '000
1. Expenses incurred and paid	
a) Independent Investigation and Resumption Proposal	
i) nTan Corporate Advisory Pte Ltd as independent investigator and financial advisor to the Company (professional fees and disbursements from February 2009 to November 2010)	3,990
ii) Drew & Napier LLC as legal advisor to the Company (professional fees and disbursements from February 2009 to November 2010)	1,138
iii) PricewaterhouseCoopers LLP as reporting accountant to the Company (professional fees and disbursements from June 2010 to December 2010)	353
iv) Allen & Gledhill LLP as legal advisor to the Company's bank creditors (professional fees and disbursements from March 2009 to September 2009)	140
v) International Risk (Singapore) Pte Limited to carry out due diligence on the investor (professional fees and disbursements in July 2010)	22
vi) Other disbursements (from July 2009 to December 2010)	14
b) Operating expenses of FCT and its non-PRC subsidiaries	
i) Employees' salaries and disbursements (from March 2009 to October 2010)	446
ii) Singapore Exchange Securities Trading Limited and The Central Depository (Pte) Limited (listing-related fees and disbursements from January 2009 to September 2010)	90
iii) Boardroom Corporate & Advisory Services Pte Ltd (Singapore corporate secretarial fees and disbursements from February 2009 to December 2010)	49
iv) Conyers Dill & Pearman Pte Limited (Bermuda corporate secretarial fees from February 2009 to June 2010 and Bermuda Annual Government Fees for 2010 and 2011)	44
v) TDW Business Services Limited (Hong Kong and BVI corporate secretarial fees and disbursements from April 2009 to November 2009 and BVI Annual Fees up to November 2011)	15
vi) Other operating expenses and disbursements (from October 2009 to September 2011)	23
Total expenses incurred and paid	6,324
2. Expenses incurred but not yet paid	
a) nTan Corporate Advisory Pte Ltd as independent investigator and financial advisor to the Company (professional fees and disbursements from December 2010 to August 2011)	651
b) Drew & Napier LLC as legal advisor to the Company (professional fees and disbursements from December 2010 to August 2011)	257
c) PricewaterhouseCoopers LLP as reporting accountant to the Company (professional fees and disbursements from January 2011 to February 2011)	163
d) Allen & Gledhill LLP as legal advisor to the Company's bank creditors (professional fees and disbursements from September 2009 to March 2011)	77
Total expenses incurred but not yet paid	1,148

Annex 4 – Comments from individuals and/or entities against whom findings, comments, inferences and conclusions have been drawn in this Report

James Zhang
Xiamen, PRC

29 September 2011

NTan Corporate Advisory Pte Ltd
55 Market Street
#06-01
Singapore 048941

Attn: Mr. Nicky Tan/ Mr. Yek Boon Seng

Dear Sirs

RESPONSE TO DRAFT REPORT OF THE INDEPENDENT INVESTIGATION BY NTAN CORPORATE ADVISORY PTE LTD ON CERTAIN TRANSACTIONS OF FIBRECHEM TECHNOLOGIES LIMITED

1. I refer to:
 - a. your letter dated 16 September 2011, enclosing a copy of the draft report dated 9 September 2011; and
 - b. your email dated 28 September 2011, enclosing a copy of the revised draft report dated 28 September 2011 (the "Draft Report").
2. As requested, I set out below my comments to the Draft Report.
3. For ease of reference, the abbreviations used in this response will have the same meanings as those set out in the Draft Report.

Introduction

4. Having perused the Draft Report, I note that it makes numerous assumptions and allegations which do not appear to be supported by evidence. As such, I will not be responding at length to all the assumptions and allegations made by NTan in the Draft Report. Insofar as I have not addressed these assumptions and allegations, it is not to be construed as an admission of the same by me.

Comments to the Draft Report

Co-operation in the Independent Investigation

5. In February 2009, the Board appointed NTan to carry out the Independent Investigation on certain transactions of FCT. Over the course of the Independent Investigation, it was inevitable for there to have been some instances of miscommunication between the parties arising from the language barrier or cultural differences. However, I wish to emphasise that I have, wherever possible, rendered my co-operation to NTan in carrying out the Independent Investigation.



6. By way of example, I have set out below a few instances which show the extent of my co-operation in the Independent Investigation:-
- a. At all material times, I was available and willing to co-operate in the Independent Investigation and in fact had several meetings with NTan over the course of the Independent Investigation (including the initial stages) to assist them.
 - b. As alluded to in the Draft Report, Mr. Zheng Peirong (the CFO of FCT) was initially reluctant to co-operate with NTan in the Independent Investigation. On my own initiative, I persuaded and managed to convince Mr. Zheng to meet up with NTan and render his co-operation in the Independent Investigation.
 - c. Following the suspension of trade in FCT's shares, the PRC lenders made the renewal of the PRC bank loans conditional upon my providing a personal guarantee for the same. Although this placed an onerous obligation on me, I agreed to their terms in the interest of maintaining the continued operations of the PRC Subsidiaries. These bank loans, for which I am the personal guarantor, total RMB 266,900,000 to-date.
 - d. When the Board accepted NTan's recommendations as set out at paragraph 22 of the Draft Report, I did my best to facilitate the changes and effect the smooth transition of power, as follows:-
 - i. I immediately handed over all company seals of FCT's PRC Subsidiaries to Mr. Xu Xuhui following his appointment by the Board to be acting CEO of FCT in my place.
 - ii. I signed all the relevant documents and took all necessary steps to effect my resignation as a director of FCT's non-PRC subsidiaries and as legal representative and director of Quanzhou Chemical.
 - iii. Although I also took steps to resign as legal representative and director of Xiamen Specialised, this was not achieved as the PRC lenders did not allow me to do so as I am the personal guarantor for the PRC bank loans extended to this company. The PRC lenders also requested that I replace Mr. Cheung Fei Pang as legal representative and director of Xiamen Microfibre, following which they did not allow me to resign from the positions.
 - e. I extended my co-operation to enable FCT and Honglin International to pay approximately S\$680,000 to NTan so that they could commence the Independent Investigation.
 - f. When it later transpired that FCT lacked the financial resources to continue funding the Independent Investigation, I sought the help of my friends who have to-date paid S\$6,160,000 (out of approximately S\$ 7 million paid to NTan thus far) for the costs of the Independent Investigation. This enabled NTan to proceed with the Independent Investigation without delay.



Proposed change in corporate structure of the Group

7. The proposed change in corporate structure of the Group was mooted with the intention of allowing the PRC Subsidiaries to reap strategic benefits from resource consolidation arising from such change. Indeed, even NTan has conceded at paragraph 58 of the Draft Report that such restructuring *"may have had strategic benefits to the Group"*.
8. It therefore came as a surprise when NTan informed me that the proposed corporate restructuring would result in assets of the Group being placed out of reach of FCT's creditors and I immediately took steps to reinstate the Group's corporate structure, which is acknowledged at paragraph 59 of the Draft Report.

Preparation of the Group's financial statements

9. At this juncture, I wish to state unequivocally that I have never directed or instructed Mr. Zheng to prepare the Group's financial statements in a way that does not accurately depict the actual financial results of the Group.
10. I have always relied on and trusted in the expertise and integrity of Mr. Zheng to prepare and verify the Group's financial statements of the Group. My main focus at all times was to advance the strategic interests of the Group as a whole to ensure that it was profitable and maintained its smooth operations.
11. I am also not conversant in English and did not fully understand the nuanced details of the Group's financial statements. As such, I was not aware of the omissions and inaccuracies in the Group's published financial statements for FY 2008.

Omission of the PRC bank loans in the Group's published financial statements

12. As for the omission of the PRC bank loans in the Group's published financial statements for FY 2005 to FY 2008 (which is pointed out at paragraphs 49 and 51 of the Draft Report), these matters were always within the knowledge and purview of Mr. Zheng. Given that Mr. Zheng has all along been in charge of preparing and finalising the financial statements for the Group, there was no reason for me to doubt his expertise and I had relied on him to ensure that the PRC bank loans (as well as all other accounting items) would be accurately reflected in the Group's published financial statements.

Conclusion

13. I hope that my above comments can clarify certain issues and/or areas of concern raised in the Draft Report. However, these comments are not meant to be an exhaustive response to the Draft Report and I reserve my right to make further comments on the Draft Report, where necessary.

Yours faithfully,



James Zhang