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## **CHINA FORESTRY HOLDINGS CO., LTD.**

**中國森林控股有限公司**

*(Incorporated in the Cayman Islands with limited liability)*

**(Stock Code: 930)**

### **ANNOUNCEMENT PROGRESS UPDATE INDEPENDENT INVESTIGATION CONDUCTED BY THE INDEPENDENT BOARD COMMITTEE**

Reference is made to the announcement of the Company dated 29 April 2011 in relation to, among other things, the findings by the Independent Board Committee and rectification measures taken by the Company with respect to certain audit related issues identified by KPMG and other issues identified by the Independent Board Committee and the announcement of the Company dated 14 October 2011 in relation to the Independent Investigation for the period from 2006 to 2010 in relation to the Irregularities and any other matters as requested by the Company or the Independent Board Committee.

The Board would like to inform the shareholders of the Company that the Independent Investigation was completed in April 2012. The objectives and scope and a summary of the findings of the Independent Investigation are set out below.

#### **OBJECTIVES AND SCOPE OF THE INDEPENDENT INVESTIGATION**

The objectives of the Independent Investigation were to follow up on the results of the investigation conducted by the Independent Board Committee regarding the non-compliance issues of the former management of the Company in 2010 and to investigate whether similar or other issues were involved in the primary business activities of the Group during the Review Period.

The Independent Investigation covered all the subsidiaries of the Company established or in existence during the Review Period. The scope of the Independent Investigation includes the following:

- review bank balances and bank records of significant payments and receipts from 2006 to 2010;

- review supporting documents for sales transactions and remittance records of related tax payments from 2006 to September 2011;
- review payment records and related supporting documents in relation to acquisition of forestry rights by the Group from 2006 to March 2012;
- review payment records and related supporting documents in relation to acquisition of logging permits by the Group from 2006 to September 2011;
- review payment records and related supporting documents in relation to insurance taken out in respect of forests owned by the Group from 2006 to September 2011;
- collect information regarding non-compliance issues discovered by KPMG, adviser to the audit committee of the Board and the Independent Board Committee, and investigate whether similar non-compliance issues existed before 2010;
- investigate whether the management of the Group has materially and adversely affected the financial statements of the Group or has engaged in other non-compliance activities;
- evaluate the impact of the Irregularities on the consolidated financial statements of the Group for the year ended 31 December 2010; and
- analyze the use of proceeds from the initial public offering of the Company and investigate any unusual situation in this respect.

The Independent Investigation is subject to limitations, including but not limited to the following: important financial information and records in respect of the Review Period are unavailable for inspection; most of the former management team involved in the Irregularities refused to cooperate with the investigation after their employment was terminated; the electronic storage devices in the computers of key members of the former management team have been formatted; and important counterparties in the Group's forest acquisition transactions as well as major customers refused to be contacted and/or provide information.

## **SUMMARY OF FINDINGS**

### **Published financial information of the Group**

#### ***2006 and 2007***

The financial statements of the Group for the years ended 31 December 2006 and 2007 as disclosed in the Prospectus are not verifiable because the underlying supporting information for the major operating subsidiary of the Group during 2006 and 2007, Beijing Zhaolin, are no longer available.

## 2008 and 2009

The financial statements of the Group for the years ended 31 December 2008 and 2009 as disclosed in the Prospectus and the Company's 2009 annual report are not verifiable because the HQ Books (as defined below) for the years ended 31 December 2008 and 2009 are no longer available.

In the course of the Independent Investigation, it was discovered that the local offices of Kunming Ultra Big kept a different set of accounting records (the "Local Books") from those maintained by the Group's former management at the head office for the purpose of preparing the consolidated financial statements of the Group as disclosed in the Prospectus and the 2009 annual report of the Company (the "HQ Books"). The records in the Local Books were generally supported by underlying documents while no supporting documents could be found in respect of the HQ Books. There are significant differences between the Local Books and the HQ Books. Please refer to the paragraph headed "Books and Records of Kunming Ultra Big" for details.

According to the Independent Investigation, the major differences between the financial information as disclosed in the Prospectus and the amounts that were verifiable in the course of the Independent Investigation based on available information retrieved by the Company are as follows:

	For the year ended/As at 31 December			
	2008		2009	
	As disclosed in the Prospectus (RMB'000)	Verifiable in the Independent Investigation <sup>1</sup> (RMB'000)	As disclosed in 2009 annual report of the Company (RMB'000)	Verifiable in the Independent Investigation <sup>1</sup> (RMB'000)
Cash and bank balances	104,530	123,550	1,706,636	1,694,848
Revenue	544,948	–	793,693	3,120
Value added tax	46,380	–	89,990	97
Acquisition of forests	714,987	80,594	656	73,908
Logging expenses	145,560	–	185,801	–

Note:

1. Supported by underlying documents.

## 2010

The preparation of the consolidated financial information of the Company for the year ended 31 December 2010 was based on the Local Books of Kunming Ultra Big and took into account of cash ledgers (the “**Cash Ledgers**”) retrieved by the Independent Board Committee. No supporting documents could be found to verify the Cash Ledgers in the course of the Independent Investigation. Below are the major differences between the financial information as disclosed in the 2010 annual report of the Company and the amounts that were verifiable in the course of the Independent Investigation.

	<b>For the year ended/As at 31 December 2010</b>	
	<b>As disclosed in the 2010 annual report of the Company (RMB'000)</b>	<b>Verifiable in the Independent Investigation<sup>1</sup> (RMB'000)</b>
Cash and bank balances	2,784,670	2,784,551
Revenue	1,064,025	5,810
Value added tax	Not reported	40
Acquisition of forests	Not reported	565,651
Logging expenses	361,650	–

*Note:*

1. Supported by underlying documents.

### **Tax**

According to documents retrieved from the relevant tax bureaus in the PRC in the course of the Independent Investigation, the aggregate amount of value added tax paid by the Group for the years ended 31 December 2008 and 2009 was approximately RMB97,000 and there is no record of payment of any enterprise income tax. Such amounts are significantly less than the amount of tax payable reported in the Prospectus and the Company's 2009 annual report, for the years ended 31 December 2008 and 2009, respectively, as well as the amount of value added tax and tax payable for the six months ended 30 June 2009 as reported in the Prospectus.

For the year ended 31 December 2010, the Company has made a provision of approximately RMB218 million for value added tax payable on the sales of wood logs conducted by the Group in cash. As at the date of this announcement, the Group has yet to receive any tax payment notice in respect of any such value added tax that may be outstanding. The Group will settle any such value added tax due when notified by the relevant tax authorities.

### ***Cash balances***

Bank statements of the Group were retrieved directly from the relevant banks and written confirmations were obtained from the banks regarding the Group's bank balances as at each of the balance sheet dates during the Review Period. No significant discrepancy was found between the amounts recorded in the Local Books and those confirmed by the banks.

### **Books and Records of Kunming Ultra Big**

As mentioned above, it was discovered that the local office of Kunming Ultra Big had kept a set of Local Books, while a separate set of accounts was maintained by the Group's former management for consolidation purposes, for each of the years ended 31 December 2008, 2009 and 2010.

The Local Books and HQ Books of Kunming Ultra Big are significantly different. The amounts of sales, payments for acquisition of forestry rights and forest maintenance funds as set out in the HQ Books of Kunming Ultra Big are not reflected in the Local Books. The amounts of sales, payments for acquisition of forestry rights and forest maintenance funds as set out in the HQ Books of Kunming Ultra Big are not reflected in the Local Books. In addition, there is no corresponding record of the sales of wood logs and acquisition of forestry rights recorded in the HQ Books in 2008 and 2009 in the bank statements obtained from the relevant banks. The payments and receipts recorded in the Local Books correspond with the bank statements obtained.

### **Sales of the Group from 2008 to 2010**

For each of the years ended 31 December 2008, 2009 and 2010, there are significant discrepancies between the amount of revenue disclosed in the Prospectus and the relevant annual reports and the amounts of revenue recorded in the Local Books of all subsidiaries. The revenue of the Group as disclosed in the Prospectus and annual reports for the years ended 31 December 2008, 2009 and 2010 were RMB545 million, 794 million and 1,064 million respectively, whereas the amounts recorded in the Local Books for the years ended 31 December 2008, 2009 and 2010 were nil, RMB3 million and RMB5.8 million, respectively.

The amount of sales of the Group for the year ended 31 December 2010 as disclosed in the Company's 2010 annual report was partly based on the Cash Ledgers which recorded certain sales conducted in cash.

Due to the lack of supporting documents for the HQ Books and the Cash Ledgers, there was no reasonable basis to analyze the sales of the Group during the Review Period.

## Customers

In respect of all 17 customers of the Group for the years ended 31 December 2008 and 2009 based on the customer list provided by the Company, the advisers to the Independent Board Committee conducted file retrieval from the relevant administration of industry and commerce in the PRC, the result of which is summarized below:

<b>Result of file retrieval</b>	<b>Number of customers</b>
1. Information retrieved	4
2. Information on the named entities were not found; similarly named entities were found	8
3. No record of registration with the administration of industry and commerce	5
<b>Total</b>	<b>17</b>

Confirmation was also sought from the 17 customers regarding the amount of sales made by the Group to each of them. These customers either replied that information was not available or did not reply at all.

Due to the lack of supporting documents, there was no reasonable basis to ascertain the amount of sales of the Group for the years ended 31 December 2008 and 2009.

## Ownership of Forestry Rights

The originals or copies of forestry rights certificates and related forest transfer agreements up to 31 March 2012 provided by the Group have been reviewed. The following table summarizes the area of forests covered by these forestry rights certificates and related forest transfer agreements as at 30 June 2011.

<b>Location</b>	<b>Number of Forestry Rights Certificates (include 1,695 original and 48 copies)<sup>1</sup></b>	<b>Area (mu)</b>	<b>Area (Ha)</b>
Sichuan	116	495,304	33,020
Yunnan	1,581	876,587	58,439
Guizhou	59	37,490	2,519
<b>Total</b>	<b>1,756</b>	<b>1,409,381</b>	<b>93,979</b>

*Note:*

1. The 48 copies of forestry rights certificates represent approximately 48,000 mu, or approximately 3,200 Ha, of forests.

The area of forests covered by the forestry rights certificates reviewed in the course of the Independent Investigation represents approximately 41% of the area of forests in which the Group owned forestry rights as at 31 December 2010 as disclosed in the Company's 2010 annual report.

The list of forestry rights certificates (the "**IPO Forest List**") which has been disclosed in the Prospectus was reviewed in the Independent Investigation. The original copy of the 44 forestry rights certificates as disclosed in the Prospectus was not available. As instructed by the Independent Board Committee, the professional advisers to the Independent Board Committee visited the relevant forestry bureaus during August 2011 in an attempt to verify the area of the forests in which the Group owned forestry rights. However, the relevant forestry bureaus were unable to provide the information because of the forestry reform in the PRC currently underway and the changes in forestry rights certificates as a result of the reform. Therefore, the forestry rights owned by the Group at the time when the Prospectus was issued could not be verified. For the purpose of the audit on the consolidated accounts of the Company for the year ended 31 December 2011, the Company has engaged a PRC law firm to request the relevant forestry bureaus to confirm the Group's forestry rights in their respective jurisdictions and issue a PRC legal opinion in this respect.

The Company also provided an updated list of forestry rights certificates as at December 2011 (the "**Updated Forest List**") to the Independent Board Committee and its professional advisers. It was noted that the information on the IPO Forest List is inconsistent with that of the Updated Forest List, such as certificate number, names of the location of the relevant forests and the area of forest covered. According to the Company's understanding, such inconsistency in the information is primarily due to the forestry reform in the PRC currently in progress, pursuant to which areas previously covered by one forestry rights certificate are now covered by multiple forestry rights certificates each covering a smaller area.

### **Logging Activities**

There is no record of expenses related to logging activities, namely, logging costs, and forest maintenance fund contribution in the Local Books of all subsidiaries from 2008 to 2010. As no underlying supporting document was available in respect of the expenses related to logging activities for the years ended 31 December 2008, 2009 and 2010, the Independent Board Committee was unable to verify the amounts of such expenses as reported in the Prospectus and the annual reports of the Company.

The Company could not produce any logging permit for the years ended 31 December 2006 to 2009 granted to the Group or information related to them due to loss of books and records. As instructed by the Independent Board Committee, the professional advisers of the Independent Board Committee visited forestry bureaus in Sichuan and Yunnan in an attempt to ascertain the logging rights and activities of the Group during 2006 to 2009. Most of the forestry bureaus were not able to provide clear information regarding the Group's logging rights and activities and did not have records that could be searched against.

## Insurance

There is no record of expenses related to forest insurance in the Local Books of all subsidiaries from 2008 to 2010. The Company was not able to produce any evidence for payment of insurance premiums in respect of insurance taken out on forests for the years ended 31 December 2006, 2007 and 2008 and the six months ended 30 June 2009 as disclosed in the Prospectus due to loss of books and records.

Inquiries were made with the relevant insurance companies regarding the Group's insurance on its forests before 2009. Except for one policy registered under Beijing Zhaolin in 2006, there was no other record of insurance policies taken out by the Company from 2006 to 2009. The Company paid RMB6 million in March 2011 for a forest insurance policy covering the period from 1 January 2010 to 31 December 2010.

A copy of an insurance policy against forest fires taken out by the Group covering the period from 1 January 2010 to 31 December 2010 was reviewed by the Independent Board Committee and its advisers, who verified the information in the insurance policy with the relevant insurance company.

## Use of Proceeds

Based on information provided by the Company and as verified against bank records, it was found that the proceeds from the IPO in 2009 were primarily utilized to increase the registered share capital of the subsidiaries of the Company in the PRC. The details of such increase in share capital in the Company's subsidiaries are as follows:

<b>Subsidiary</b>	<b>Amount utilized as increase in share capital</b>
Kunming Ultra Big	US\$40 million
Yunnan Zhaoneng	US\$50 million
上海森嘉林業科技有限公司 (Shanghai Senjia Forestry Technology Co., Ltd.*)	US\$6.6 million
Chengdu Yishang	US\$20 million
貴州沃森林業發展有限公司 (Guizhou Wosen Forestry Development Co., Ltd.*)	US\$90 million
Yichun Jingfeng	<u>US\$45 million</u>
<b>Total</b>	US\$251.6 million



Based on the analysis of the cashflows of the subsidiaries since the abovementioned increase in their share capital until 30 September 2011, the Independent Board Committee estimated that the proceeds from the IPO have been utilized as follows:

<b>Usage</b>	<b>Amount</b> <i>(in RMB' 000)</i>
Acquisition of forests	941,894
Purchase of wood logs	209,920
Purchase of land	15,000
Logging expenses	16,000
Forest insurance	<u>6,009</u>
 Total	 1,188,823

### **Sale of Wood Logs in 2011**

Certain wood logs owned by Kunming Ultra Big were physically kept by Yichun Jingfeng and Manzhouli Yishang. Based on the inventory assessment report produced by CFK as at 31 March 2011 and the estimation of PKF, the amount of such wood logs and their value as at 31 December 2010 was approximately RMB413.87 million.

#### ***Sale of wood logs through Manzhouli Yishang***

Based on the sales contracts and accounting records of Manzhouli Yishang, the sales of wood logs by Kunming Ultra Big through Manzhouli Yishang was approximately RMB50.38 million. The Group received sales proceeds of RMB7.5 million.

Out of the RMB7.5 million of cash receipt from the sales of wood logs, there are documents suggesting that RMB6 million was remitted to Kunming Ultra Big through a personal bank account, yet such documents were not sufficient in proving such events. The remaining RMB1.5 million was found to be kept in a personal bank account and not yet remitted to Kunming Ultra Big, which the management of Manzhouli Yishang claimed to be funds reserved for paying processing and other fees. The remaining RMB42.88 million of the sales has not been received.

#### ***Sale of wood logs through Yichun Jingfeng***

Based on the sales contracts and accounting records of Yichun Jingfeng, the sales of wood logs by Kunming Ultra Big through Yichun Jingfeng was RMB213.67 million. The Group received sales proceeds of RMB157.34 million.

The cash receipt for sales of wood logs through Yichun Jingfeng was remitted to the bank accounts of Kunming Ultra Big through certain personal bank accounts. Based on a review of the bank statements of Kunming Ultra Big and the statements of the relevant personal bank accounts, no material discrepancies in the amounts received from the sales of wood logs and the amounts remitted to Kunming Ultra Big was found. The remaining RMB56.33 million of the sales has not been received.

## **Other Issues**

### ***Use of personal bank accounts***

During an internal review of the Company's sales in 2011, it was discovered that personal bank accounts were involved in the receipt of funds from the sales of wood logs conducted by Manzhouli Yishang and Yichun Jingfeng. In particular, transactions recorded in the personal bank statements of employees of Manzhouli Yishang cannot be reconciled with the records in the Cash Ledger or Bank Ledger of Manzhouli Yishang. Due to the manner in which records were maintained, sales conducted through the personal bank accounts of employees of Manzhouli Yishang in 2011 cannot be verified. The Company became aware of the use of personal bank accounts in August 2011 and implemented new controls for their use in September 2011.

### ***Books and Records of Manzhouli Yishang***

It was discovered that for the year ended 31 December 2011, Manzhouli Yishang maintained a separate set of books for recording sales for the purpose of filing its tax returns, while keeping an internal set of books that reflects actual amount of sales. The Company will engage and seek opinion from tax advisors in this respect.

### ***Fraudulent Bank Statements***

Bank statements for the year ended 31 December 2010 in electronic forms that are editable were found in the computers of certain employees and former employees of the Group.

In January 2012, while checking the bank statements of its subsidiaries, the Company discovered that Yichun Jingfeng had altered copies of bank statements. As a result, the initial scope of review of the Independent Investigation was expanded. Consequently, discrepancies between the information contained in the copies of bank statements of Yichun Jingfeng provided to the Company's head office and the corresponding information obtained from the relevant banks directly were identified. It was further discovered that the staff of Yichun Jingfeng made such alterations to the copies of bank statements provided to the Company's head office during 2011 in order to cover up unapproved payments made as well as the use of three personal bank accounts to receive cash proceeds from sales of wood logs on behalf of Kunming Ultra Big.

### ***Foreign Exchange Settlement***

It was discovered that in September 2011, the management of Kunming Ultra Big used forest transfer agreements between itself and its staff in respect of non-existent transactions to facilitate the settlement of foreign exchange in order to settle acquisition of forests in RMB. We have taken proper remedial actions to address the non-compliance and it has been confirmed by the relevant banks that they were satisfied with our remedial actions.

### ***Company Records of Beijing Zhaolin, Chengdu Yishang and Kunming Ultra Big***

It was discovered that certain signatures signed during 2008 and 2009 in the corporate documents of the Group were inconsistent with those of the alleged signatories or have been confirmed not signed by the relevant signatories. Nonetheless the relevant signatories have confirmed that they agreed to the content of the document on which these signatures appeared.

### **DEFINITIONS**

In this announcement, the following expressions shall have the following meanings unless the context requires otherwise:

“Board”	the board of directors of the Company
“CFK”	Chandler Fraser Keating Limited, an independent technical consultant engaged by the Group to provide valuation services for the purpose of the Independent Investigation
“Chengdu Yishang”	成都億尚林業資源開發有限公司 (Chengdu Yishang Forestry Resource Development Co., Ltd.*), a company established in the PRC and an indirect subsidiary of the Company
“Company”	China Forestry Holdings Co., Ltd., a company incorporated in the Cayman Islands with limited liability, the shares of which are listed on the Stock Exchange
“Director(s)”	the director(s) of the Company
“Group”	the Company and its subsidiaries
“Independent Board Committee”	the independent board committee of the Board established to conduct an inquiry into the Irregularities as disclosed in the announcement of the Company dated 31 January 2011

“Independent Investigation”	the forensic review conducted by the Independent Board Committee with the assistance of a major accounting firm and other professionals engaged by the Company for the period from 2006 to 2010 in relation to, among other things, the Irregularities and any other matters as disclosed in this announcement
“Independent Third Party”	a third party that is independent of the Company and connected persons (as defined under the Listing Rules) of the Company
“Irregularities”	certain audit related issues identified by KPMG as disclosed in the announcement of the Company dated 29 April 2011 and other issues identified by the Independent Board Committee
“Kunming Ultra Big”	Kunming Ultra Big Forestry Resource Development Co., Ltd. (昆明錦德林業資源開發有限公司), a limited company established in the PRC and an indirect wholly-owned subsidiary of the Company, and is engaged in the management and development of forest and sales of logs
“IPO”	the global offering of shares of the Company in 2009, the details of which are set out in the Prospectus
“Listing Rules”	the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited
“Manzhouli Yishang”	滿洲里億尚林業資源開發有限公司 (Manzhouli Yishang Forestry Resource Development Co., Ltd.*), a company established in the PRC and an indirect subsidiary of the Company
“PKF”	安鵬投資諮詢(上海)有限公司 (PKF Consulting Inc.), one of the professional advisers engaged by the Independent Board Committee for the purpose of the Independent Investigation
“PRC”	the People’s Republic of China
“Prospectus”	the prospectus of the Company dated 19 November 2009
“Review Period”	the period from 1 January 2006 to 31 December 2010
“RMB”	Renminbi, the lawful currency of the PRC
“Stock Exchange”	The Stock Exchange of Hong Kong Limited

“US\$”	United States Dollars, the lawful currency of the United States of America
“Yichun Jingfeng”	伊春景豐林業開發有限公司 (Yichun Jingfeng Forestry Development Co., Ltd.*), a company established in the PRC on 28 December 2010 and an indirect subsidiary of the Company
“%”	per cent.

By Order of the Board of  
**China Forestry Holdings Co., Ltd.**  
**Li Kwok Cheong**  
*Chairman*

\* *denotes English translation of the name of a Chinese company or entity or vice versa and is provided for identification purposes only.*

Hong Kong, 27 April 2012

*As at the date of this announcement, the executive directors of the Company are Mr. Li Kwok Cheong and Mr. Lin Pu, the non-executive directors of the Company are Mr. Xiao Feng, Mr. Li Zhi Tong and Mr. Meng Fanzhi, and the independent non-executive directors of the Company are Mr. Wong Tak-jun, Mr. Liu Can, Mr. Zhu Demiao and Ms. Hsu Wai Man, Helen.*