

AUDITORS' REPORT

**Arthur Andersen & Co**

Certified Public Accountants

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Hong Kong

**TO THE SHAREHOLDERS OF
GUANGDONG KELON ELECTRICAL HOLDINGS COMPANY LIMITED**

(Incorporated in the People's Republic of China with limited liability)

We have audited the accompanying consolidated balance sheet of Guangdong Kelon Electrical Holdings Company Limited (the "Company") and its subsidiaries (hereinafter collectively referred to as the "Group") as of 31 December 2001, and the related consolidated statement of income, changes in equity, and cash flows for the year then ended, and the balance sheet of the Company as of 31 December 2001. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

Except as discussed in the following paragraphs, we conducted our audit in accordance with International Standards on Auditing. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

We draw attention to Note 1 to the financial statements. The Group incurred net losses of RMB1,571 million and RMB846 million during the years ended 31 December 2001 and 31 December 2000, respectively. As of 31 December 2001, the Group's current liabilities exceeded its current assets by RMB219 million. The Group may have possible additional losses and reclassification of assets arising from the matters described in the paragraphs below which would increase its losses and current liabilities. There exists a material uncertainty which may cast significant doubt about the Group's ability to continue as a going concern. Steps taken by the management to address this situation are set out in Note 1 to the financial statements.

In late 2001 and early 2002, most of the board members and senior management of the Company who are responsible for the operations of 2001 resigned from the Company. As such, we were unable to obtain reasonable representations and assurances from management on which we could rely for the purpose of our audit and there were no satisfactory audit procedures that we could perform to obtain reasonable assurance that all material transactions were properly recorded and completely disclosed.

During 2001, a subsidiary of the Group executed a debt guarantee for RMB230 million to secure borrowings of Guangdong Kelon (Rongsheng) Group Company Limited ("GKG"), the major shareholder, without proper approvals. This guarantee has been enforced and the Company has settled RMB211 million of GKG's liabilities as a result. This incident indicated inadequate controls over the granting of guarantees. Management of the Group has represented that to date they have not become aware of any further liability arising from unauthorised guarantees. However, we are unable to identify all contingent or real liabilities that might have arisen from guarantees issued by the Group and to assess their effect on the financial statements. Steps taken by the management of the Group to address the situation are set out in Note 39 to the financial statements.

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Included in the consolidated balance sheet of the Group are leasehold land of RMB304 million, property, plant and equipment of RMB2,268 million, construction-in-progress of 31 million and investment in associates of RMB284 million. Included in the balance sheet of the Company are leasehold land of RMB207 million, property, plant & equipment of RMB1,147 million, construction-in-progress of RMB17 million, investment in subsidiaries of RMB1,548 million and investment in associates of RMB303 million. According to IFRS 16, the Group is required to revalue its property, plant and equipment at regular intervals, normally three to five years. The last valuation was performed on 30 April 1996. The Group is currently performing a valuation of its assets. As the valuation has not been completed, the valuation results have not been reflected in the financial statements. This does not comply with the requirements of IFRS 16. Furthermore, given the operating results of 2000 and 2001 and the fast changing market condition in which the Group operates, we are unable to assess the appropriateness of the management assumptions underlying the Group's discounted cash flow analysis used to assess the recoverable amount of the leasehold land, property, plant and equipment, construction-in-progress, investment in associates and investment in subsidiaries, and the possible impact of asset impairment.

Included in the accrual and other payable balance on the Group's and the Company's balance sheets as of 31 December 2001 is an accrual for advertising fee amounting to RMB160 million. This accrual is provided for advertising services performed in 2001. We are unable to obtain sufficient evidence to support that the related advertising services have been performed.

Included in the receivables from major shareholder on the Group's and the Company's balance sheets as of 31 December 2001 is a receivable from GKG of RMB862 million which resulted from payments made to GKG in 2001. The Group and the Company recorded a provision against this receivable in the amount of RMB172 million. The management is currently negotiating with GKG on the method and timing of settlement of the outstanding balance. We are unable to assess whether the provision is adequate and whether any reclassification may be required to reflect the timing of the ultimate settlement.

Included in long-term receivables from related parties on the Group's and the Company's balance sheets is a receivable from Kelon Employee Union of RMB58 million. We are unable to assess whether any provision is required to reflect the collectibility of the receivable from Kelon Employee Union.

Because of the significance of the matters discussed in the preceding paragraphs, we are unable to form an opinion as to whether the financial statements give a true and fair view of the state of affairs of the Group and the Company as of 31 December 2001 and of the loss and cash flows of the Group for the year then ended in accordance with International Financial Reporting Standards, as published by International Accounting Standards Board, and whether the financial statements have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

Arthur Andersen & Co
Certified Public Accountants

Hong Kong, the PRC
24 April 2002