

AUDITORS' REPORT



Arthur Andersen • Hua Qiang

Certified Public Accountants

11/F, China World Tower 1
1, Jian Guo Men Wai Avenue
Beijing 100004
the PRC

To the Shareholders of Guangdong Kelon Electrical Holdings Company Limited:

Arthur Andersen • Hua Qiang Certified Public Accountants (hereinafter referred to as "We") have audited the 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, the related consolidated statement of income and profit appropriation, and the consolidated statement of cash flows of the Group for the year then ended, and the balance sheet of the Company as of 31 December 2001, the statement of income and profit appropriation, and the statement of cash flows of the Company for the year then ended. These financial statements are the responsibility of the Group and the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with "China's Independent Auditing Standards". Our audit included such tests of the accounting records and such other auditing procedures, as we considered necessary and appropriate to the circumstances of the Group and the Company.

As disclosed in Note 1 in the financial statements, the Group incurred net loss of approximately RMB1,555,573,000 and RMB830,653,000 during the years 2001 and 2000, respectively. As of 31 December 2001, the Group had negative working capital of approximately RMB182,501,000. The Group may have possible additional losses and reclassification of assets arising from the matters described in the paragraphs below which will increase its losses and current liabilities. There exists a material uncertainty which may cast significant doubt on 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 have resigned from the Company. We are unable to obtain reasonable representation and assurance 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 of RMB230,000,000 to secure borrowings of Guangdong Kelon (Rongsheng) Group Company Limited ("GKG"), the major shareholder, without proper approval. This guarantee has been enforced and the Company has settled RMB211,000,000 of GKG's liabilities as a result. This incident indicates inadequate control over the granting of guarantees. The management of the Group represents that up to now, they are not aware of any other 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 assess their impacts on the financial statements. Steps taken by the management of the Group to address the situation are set out in Note 8 to the financial statements.

AUDITORS' REPORT

Included in the consolidated balance sheet of the Group are land use right of approximately RMB304,000,000, fixed assets of RMB2,058,000,000, construction-in-progress of RMB31,000,000 and long-term equity investment of RMB260,000,000. Included in the balance sheet of the Company are land use right of approximately RMB207,000,000, fixed assets of RMB1,000,000,000, construction-in-progress of RMB17,000,000 and long-term equity investment of RMB1,165,000,000. Given the operating results during year 2000 and 2001, and the rapidly changing market conditions, we are unable to assess the appropriateness of the management's assumptions underlying the Group's discounted cash flow analysis to assess the recoverable amount of the land use right, fixed assets, construction-in-progress and long-term equity investment, and the possible impact of asset impairment.

Included in the accrual of the Group's and the Company's balance sheets as of 31 December 2001 is an accrual for advertising expenditures of RMB160,000,000. This accrual is provided for the advertising services received during year 2001. We are unable to obtain sufficient evidence to support that related advertising services have been performed.

Included in the balance sheets of the Group and the Company as of 31 December 2001 are notes receivable of RMB170,000,000 and other receivable of RMB692,000,000 due from GKG, which resulted from payments to GKG in 2001. The Group has made provision against these receivables for the amount of RMB172,000,000. 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 ultimate settlement.

Included in long-term receivables of the Group's and the Company's balance sheets is receivable from Kelon Employee Union of RMB58,000,000. We are unable to assess whether any provision is required to reflect the collectibility of this receivable.

Because the impact of the matters discussed in the preceding paragraphs on the financial statements cannot be ascertained, we are unable to form an opinion as to whether the financial statements give a true and fair view of the financial positions of the Group and the Company as of 31 December 2001, the results of operations and the cash flows of the Group and the Company for the year then ended, and whether the financial statements have been properly prepared in accordance with the requirements of "Accounting Standards for Business Enterprises"; "Accounting Regulations for Business enterprise"; "Temporary Regulations for Consolidated Financial Statements" and other relevant regulations of the PRC.

Arthur Andersen • Hua Qiang
Certified Public Accountants

Certified Public Accountant
Chen Yun Jin

Certified Public Accountant
He Ying Fan

Beijing, the PRC
24 April 2002