

AUDITORS' REPORT

TO THE MEMBERS OF FUJIAN GROUP LIMITED (PROVISIONAL LIQUIDATORS APPOINTED)

(Incorporated in Hong Kong with limited liability)

We have audited the financial statements on pages 17 to 57 which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

The Companies Ordinance requires the Directors to prepare financial statements which give a true and fair view. In preparing financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently.

It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion to you.

BASIS OF OPINION

We conducted our audit in accordance with Statements of Auditing Standards issued by the Hong Kong Society of Accountants, except that the scope of our work was limited as explained below.

An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the Directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Company's and the Group's circumstances, consistently applied and adequately disclosed.

We planned our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the financial statements are free from material misstatement. However, the evidence available to us was limited as follows:

1. Opening balance sheet

We were appointed auditors on 3 June 2003 and did not report on the financial statements for the year ended 31 March 2002. Furthermore, the auditors appointed in respect of the year ended 31 March 2002 were unable to form an opinion as to whether the financial statements gave a true and fair view of the state of affairs of the Company and of the Group as at 31 March 2002 and of the loss and cash flows of the Group for the year then ended because of the possible effect of the limitations in evidence available to them and the fundamental uncertainties.

We have been unable to carry out auditing procedures necessary to obtain adequate assurance regarding the opening balances. Therefore the corresponding amounts shown may not be comparable and any adjustments to the opening balances as at 1 April 2002 might have a consequential effect on the loss for the year ended 31 March 2003.

2. Appointment of provisional liquidators

As explained in note 2(d) to the financial statements, Messrs. Cosimo Borrelli and Fan Wai Kuen of RSM Nelson Wheeler Corporate Advisory Services Limited were appointed joint and several provisional liquidators ("the Provisional Liquidators") of the Company on 15 January 2003. The Provisional Liquidators have not been able, notwithstanding taken all necessary procedures, to give an unqualified representation as to the completeness of the recording of the transactions entered into by the Group prior to their appointment and also as to whether the financial statements present a true and fair view of the Group's operations for the year ended 31 March 2003 and financial status as at 31 March 2003. As a consequence, we have been unable to obtain adequate assurance regarding the completeness and accuracy of the assets, liabilities, income and expenses as well as the disclosures appearing in the financial statements.

3. Prior year adjustment

As explained in note 4(f) to the financial statements, the Company has made a prior year adjustment in restating the net balance of the goodwill and negative goodwill as at 31 March 2002 on the basis that the Group's goodwill should have been impaired and that the negative goodwill should have been released to the consolidated income statement for the year ended 31 March 2002. However, in the absence of sufficient documentary evidence and accounting records, we have been unable to ascertain whether the prior year adjustment had been appropriate and properly accounted for in the financial statements.

4. Gain on disposal of investment properties

As explained in note 13(b) to the financial statements, certain charged investment properties with a carrying value of HK\$124,600,000 were disposed of during the year under enforcement by the mortgagees. Purchase and sale agreements and statements from the mortgagee banks regarding the disposals have not been made available to the Group. The net gain on disposal amounting to HK\$2,023,664 as shown in the consolidated income statement was calculated based on the proceeds as shown in the land search documents of such properties. As a consequence, we have been unable to ascertain whether the disposal of the investment properties and the corresponding net gain have been properly accounted for in the financial statements.

5. Revaluation of properties

The properties of the Group and those held by its associates were revalued by independent professional valuers as at 31 March 2003. The values as stated in the draft valuation reports were used for preparing these financial statements. However, the respective signed valuation reports were not yet available for our inspection. Accordingly, we have been unable to ascertain the values of the Group's hotel properties of HK\$107,359,047, investment properties of HK\$11,890,000 and the share of the properties held by the associates of HK\$6,166,666 and the resulting revaluation deficit of the investment properties of HK\$1,610,000 and the provision for impairment loss on hotel properties of HK\$12,500,000 as reflected in the consolidated income statement and the share of deficit of the revaluation of the associates' investment property of HK\$2,866,667 as reflected in the investment property revaluation reserve of the associates.

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6. Bank and other borrowings

We have not been able to obtain direct confirmations and/or other documentary evidence in respect of the bank loans and overdrafts of HK\$206,664,076 and other borrowings of HK\$192,914,286 and interest payable on borrowings of HK\$81,276,465 for the Group and the bank loans and overdrafts of HK\$70,541,118 and other borrowings of HK\$192,914,286 and interest payable on borrowings of HK\$70,056,776 for the Company as at 31 March 2003. Accordingly, we have been unable to satisfy ourselves as to whether these amounts have been properly accounted for in the financial statements.

7. Obligation to a jointly controlled entity

As explained in note 15(b) to the financial statements, the Company and the Group provided for obligation to a jointly controlled entity in the amount of HK\$15,000,000 as at 31 March 2003, being the net exposure of the Company and of the Group on the outstanding bank loan and other loan balances drawn down by the jointly controlled entity. However, in the absence of direct confirmation and/or sufficient documentary evidence, we have been unable to ascertain whether the obligation to a jointly controlled entity has been properly accounted for in the financial statements.

8. Litigation claim by former directors

As explained in note 28(b) to the financial statements, two former directors of the Company have lodged a claim against the Company demanding unpaid salaries, severance pay and entitled long service payments of HK\$5,722,581. The Company has served a counterclaim of HK\$6,581,892 for damages as a result of the unauthorised actions performed by these former directors without the knowledge and authority of the Company. A provision of HK\$1,111,358 has been made in the financial statements in respect of the said unpaid salaries. However, we have been unable to obtain sufficient evidence to ascertain whether the provision made against the liabilities from the claim, taking into account of the Company's counterclaim, is sufficient.

9. Consultancy service fee payable to a former potential investor

As explained in note 28(c) to the financial statements, one of the former potential investors is eligible to receive consultancy service fee of HK\$6,000,000 according to a memorandum of understanding dated 29 May 2002 (the "MOU") entered into between the Company and certain potential investors in relation to the possible restructuring of the Group. The confirmation we received from the former potential investor has indicated such claim. However, the Company disputes any such liability as the former potential investor has not fulfilled the conditions set out in the MOU. We have been unable to obtain sufficient evidence to ascertain whether the Company is liable to pay for the said liability.

Any adjustments arising in relation to the matters referred to in (1) to (9) above would have a consequential significant effect on the loss and cash flows for the year ended 31 March 2003 and the net liabilities of the Group and of the Company as at that date.

In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements. We believe that our audit provides a reasonable basis for our opinion.

FUNDAMENTAL UNCERTAINTY RELATING TO THE INCLUSION OF INTERESTS IN SUBSIDIARIES TO THE GROUP

In forming our opinion, we have considered the adequacy of the disclosures made in note 2(b) to the financial statements concerning the Group accounting for 100% equity interest in Yan Hei Limited ("Yan Hei") as a result of a Rescission Order issued on 23 February 2001. The Company has not yet executed the Rescission Order to register the 40% shareholdings in Yan Hei under its name. According to a legal opinion obtained by the Company, there might be practical difficulties in the execution of the Rescission Order. However, it is not possible to identify all the practical difficulties and to quantify the financial effect and the costs which might arise from the execution, or any possible counterclaim in relation to the Rescission Order and accordingly, no provision has been made in the financial statements. We consider that the fundamental uncertainty has been adequately disclosed in the financial statements and our opinion is not qualified in this respect.

FUNDAMENTAL UNCERTAINTIES RELATING TO THE OUTSTANDING ARBITRATIONS

- i. In forming our opinion we have considered the adequacy of the disclosures in note 28(d) to the financial statements concerning a claim lodged by a bank in the PRC against the Company's subsidiaries, Yan Hei Limited ("Yan Hei") and Xiamen South East Asia Hotel Company, Limited ("Xiamen Plaza") in which the bank has obtained a judgment dated 17 June 2002 from Xiamen Arbitration Committee (the "Judgment") in enforcing the repayment of the loan of RMB30 million plus interest thereon within 10 days from the judgment date and the right to share and/or to realize the 40% of Yan Hei's investments in Xiamen Plaza secured thereto for settlement of the outstanding liabilities due to the bank. No action has so far been taken by the bank in enforcing the Judgment. The Company has lodged an appeal to the Court in Xiamen on 3 December 2002 to overturn the Judgment. However, it is uncertain, at this stage, as to the outcome of the appeal. We consider that the fundamental uncertainty has been adequately disclosed in the financial statements and our opinion is not qualified in this respect.
- ii. In forming our opinion we have considered the adequacy of the disclosures made in note 28(e) to the financial statements concerning a claim lodged by a joint venture partner against Yan Hei in which the joint venture partner has obtained a judgment dated 26 August 2002 from an Arbitration Committee in the PRC in enforcing the payment of the guaranteed distributable profits of US\$580,000 for the years 1998 to 2000. The Group is in the course of finalizing the terms of settlement of the guaranteed distributable profits including the continuing use of the land for the operation of the hotel with the joint venture partner. A provision of US\$840,000 has been made in the financial statements for the guaranteed distributable profits. According to the Company, the joint venture partner will continue to grant Xiamen Plaza the right to use the land for the operation of the hotel. We consider that the fundamental uncertainty has been adequately disclosed in the financial statements and our opinion is not qualified in this respect.

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FUNDAMENTAL UNCERTAINTIES RELATING TO THE GOING CONCERN BASIS

In forming our opinion, we have considered the adequacy of the disclosures made in note 2(a) to the financial statements which explains that the adoption of the going concern basis in the preparation of the financial statements is appropriate, provided that (i) the terms of the restructuring agreement for the reorganization of the share capital of the Company can be satisfied; (ii) a compromise could be reached with the bankers and other creditors for restructuring of the Company's borrowings; (iii) the continuing use of the hotel properties of Xiamen Plaza and (iv) the Group could revitalise its business. The financial statements do not include any adjustments that would result from the failure of implementing these measures. If the going concern basis were not to be appropriate, adjustments would have to be made in the financial statements to reclassify non-current assets as current assets, to restate the assets to their recoverable amounts and to provide for any further liabilities which might arise. Such adjustments may have a consequential significant effect on the net liabilities of the Company and the Group as at 31 March 2003 and of the loss and cash flows of the Group for the year then ended. We consider that appropriate disclosures have been made, but the fundamental uncertainty relating to whether the going concern basis is appropriate is so extreme that we have disclaimed our opinion.

QUALIFIED OPINION: DISCLAIMER ON VIEW GIVEN BY THE FINANCIAL STATEMENTS

Because of the significance of the possible effect of the limitations in evidence available to us on matters specified in the "Basis of opinion" section of this report and the fundamental uncertainties relating to the going concern basis referred to above, 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 Company and of the Group as at 31 March 2003 and of the loss and cash flows of the Group for the year then ended and as to whether the financial statements have been properly prepared in accordance with the Companies Ordinance.

In respect alone of the limitations on our work relating to matters specified in the "Basis of opinion" section:

- (a) we have not obtained all the information and explanations that we considered necessary for the purpose of our audit; and
- (b) we were unable to determine whether proper books of account had been kept.

Nexia Charles Mar Fan & Co.

Certified Public Accountants

Hong Kong, 4 September 2003