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NATURAL BEAUTY

Natural Beauty Bio-Technology Limited

自然美生物科技有限公司

(Incorporated in the Cayman Islands with limited liability)

(Stock code: 00157)

INSIDE INFORMATION KEY FINDINGS OF FORENSIC REVIEW

This announcement is made by Natural Beauty Bio-Technology Limited (the “**Company**”, and together with its subsidiaries, the “**Group**”) pursuant to Rule 13.09 of the Rules Governing the Listing of Securities (the “**Listing Rules**”) on The Stock Exchange of Hong Kong Limited (the “**Stock Exchange**”) and the Inside Information Provisions (as defined under the Listing Rules) under Part XIVA of the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong).

References are made to (i) the announcement of the Company dated 24 March 2020 in relation to, amongst others, an investigation on certain audit findings raised by the Company’s auditors (“**Forensic Review**”); (ii) the announcement of the Company dated 29 April 2020 in relation to an update on the Forensic Review; (iii) the announcement of the Company dated 21 May 2020 (“**Resumption Conditions Announcement**”) in relation to the conditions for the resumption of trading in the shares of the Company (the “**Resumption Conditions**”); and (iv) the announcement of the Company dated 24 June 2020 (the “**Announcement**”) in relation to an update on the progress of the Forensic Review and fulfilment of the Resumption Conditions. Unless otherwise stated, capitalised terms used herein shall have the same meanings as those defined in the Announcement.

KEY FINDINGS OF FORENSIC REVIEW

As disclosed in the Resumption Conditions Announcement, one of the Resumption Conditions is for the Company to conduct an appropriate investigation into certain issues raised by the Auditors, announce the findings and take appropriate remedial actions.

Since the publication of the announcement on the Forensic Review on 24 March 2020, in response to the Auditors' enquires on the sales made by the Group to certain distributors and how certain individual distributors and customers settled their payments to the Group (the "**Issues**"), the Audit Committee has engaged PricewaterhouseCoopers Management Consulting (Shanghai) Limited as Forensic Accountant to conduct Forensic Review on certain Group's wholly-owned subsidiaries in China ("**Subject Group Companies**") of the Issues.

The Company understands that:

- the Forensic Accountant has provided a draft report dated 16 June 2020 on the Forensic Review ("**Draft Forensic Review Report**") to the Audit Committee;
- an updated draft report on the Forensic Review dated 6 July 2020 with no material change against the Draft Forensic Review Report was sent to the Audit Committee;
- the Audit Committee sent the Draft Forensic Review Report to the Auditors and for the purpose of considering whether the findings contained in the Draft Forensic Review Report were sufficient to address the concerns that were raised during the Auditors' audit process for the Group's 2019 Financial Statement, the Auditors have conducted a review on the procedures performed by the Forensic Accountant and the documents examined by the Forensic Accountant, and such review has been completed;
- the Auditors may have comments on the Draft Forensic Review Report.

As at the date of this announcement, the Auditors have not provided written comments on the on the Draft Forensic Review Report. The Company will disclose the Auditors' comments on the Draft Forensic Review Report when the same becomes available.

The Company would like to announce the key findings of the Forensic Review contained in the draft forensic review report dated 6 July 2020 together with the response of the Company as set out below:

1. Sales spike relating to four individual distributors

Background

During the Auditors' audit process for the Group's 2019 Financial Statements, the Auditors noted that certain transactions of the Subject Group Companies involved sales to four individual distributors with total revenue of approximately RMB42.4 million in 2019, representing an increase of 123% compared with the prior year, of which approximately RMB17.5 million in sales were made close to the end of 2019.

Findings

Sales analysis

Based on the findings of the Forensic Review, during the period from 1 January 2019 to 31 December 2019 (the "**Review Period**"), the Subject Group Companies achieved a total revenue (excluding taxes) of approximately RMB284.7 million, of which, approximately RMB261.4 million (91.8%) were sales to distributors and franchisees. The Subject Group Companies have 677 franchisees and four distributors (the "**Four Distributors**"). The Four Distributors are individuals located in Shanghai, who became the Subject Group Companies' distributors as early as 2014. Two of them were former employees of the Subject Group Companies.

The Forensic Accountant noted that each of the top 24 distributors/franchisees (the "**Major Customers**") has purchased products in an amount of over RMB1 million from the Subject Group Companies. Sales made to the Major Customers totalled RMB103 million, representing 36.2% of the Subject Group Companies' annual revenue during the Review Period. In addition, among the Major Customers, the top six customers (the "**Top Six Customers**") have altogether achieved an annual revenue of approximately RMB78.3 million, representing 27.5% of the Subject Group Companies' annual revenue during the Review Period.

The Forensic Accountant noted a spike of revenue in June 2019 (approximately RMB38.5 million, i.e. 14.7% of annual revenue made from franchisees and distributors) and a larger spike of revenue in December 2019 (approximately RMB56.2 million, i.e. 21.5% of annual revenue made from franchisees and distributors). Further, most of the revenue in December 2019 were achieved in the 2nd half of December 2019 (approximately RMB52.9 million), among which 57.6% were mainly contributed by sales to the Top Six Customers (approximately RMB30.5 million).

Year-end sales arrangement

The Forensic Accountant noted several documents which appear to suggest that the sales personnel of the Subject Group Companies had entered into oral goods exchange agreements (totalled approximately RMB7.2 million) in late December 2019 with five of the Top Six Customers including Top Customer A and the Four Distributors, who were offered the ability to exchange goods at a certain value after 2019. There was no evidence to suggest that the Company's CEO or CFO were involved.

The relevant sales personnel advised that save as the goods exchange quota of RMB30,000 that had been agreed to be offered by certain sales personnel to a customer and those mentioned above, there was no other goods exchange quota offered to customers.

As of 31 May 2020, except for a handful of goods exchange transactions (totalled RMB832), the Forensic Accountant **did not note any goods exchange rights mentioned above being exercised.**

Rationale for placing large orders in December 2019

During the interviews, Top Customer A and the Four Distributors advised the Forensic Accountant that:

- They usually place large orders at year-end because of the shut-down of logistics during the Chinese New Year;
- They heard that a new executive director will relocate to Shanghai in 2020 who may change the Subject Group Companies' business strategy and stop supplying the Four Distributors;

- When they placed the sales orders in December 2019, some of the products in their initial requests were out of stock. As there was 70% discount for the orders in December 2019 and the verbal promise they received from relevant sales personnel that they could exchange some of the goods in 2020, they replaced the out of stock goods with some other available products; the post December 2019 goods exchange rights had not been exercised as of the date of the interviews on 14 to 16 April 2020, which appears to be consistent with the Forensic Accountant noted from their review of the Subject Group Companies' records.

The Forensic Accountant noted that the statements given by all relevant sales personnel during interviews that the customers had voluntarily placed large orders in December 2019 to get more benefits (including discounts and complimentary products) and the arrangement of goods exchange post 2019 appear to be consistent with those provided by Top Customer A and the Four Distributors.

However, the Forensic Accountant noted certain indications that the management and the sales personnel were under the pressure of achieving sales target, including the fact that Sales General Manager and all other sales personnel would be entitled to sales incentives and a special bonus plan for the revenue achieved in December 2019.

Company's response

As disclosed in the Forensic Review, the Company is of the view that the main reasons contributed to the sales spike relating to the Four Distributors are (i) they were strongly incentivised to place more orders in December given the deep discount; and (ii) some of the products were out of stock, and they were given the option to exchange some of the goods later in 2020.

The Forensic Review reveals concerns over individual sales personnel offering various rights for customers to exchange goods. The Board has taken remedial actions to address these concerns. Please refer to the section headed "Remedial Actions" below for details. In addition, as the Group's 2019 Financial Statements are still not yet in agreement with the Auditors, the recognition of the revenue generated from the transactions (totalled approximately RMB7.2 million) which are subject to the right to exchange goods will be determined by the Auditors in accordance with the applicable accounting standards.

2. Concerns over how certain individual distributors and customers settled their payments to the Subject Group Companies

Background

During the Auditors' audit process for the Group's 2019 Financial Statements, the Auditors noted that some transactions between the Subject Group Companies and their customers appeared to be settled by their employees and certain individual distributors used multiple bank accounts/credit cards for settlement.

Findings

The Forensic Accountant noted that some employees of the Subject Group Companies settled receivables for customers and some sales personnel have kept credit cards for customers. The relevant sales personnel advised that such practice started five or six years ago when the Subject Group Companies first started using POS machines to collect sales proceeds. The relevant arrangement and the major reasons obtained from interviews with the relevant customers and sales personnel are summarised as follows:

- Generally, customers prefer using credit cards over transfer by bank/WeChat Pay/Alipay, for the benefit of up to one-month credit period, and/or credit card points. For the sake of convenience, some customers left their credit cards to relevant sales personnel, so that they would not need to visit the Subject Group Companies' physical location when proceeding payment transactions using the POS machines.
- Certain sales personnel of the Subject Group Companies would settle the receivables on behalf of the customers using their personal credit cards, and get reimbursed by customers before the credit cards' repayment date.
- Distributors/franchisees sometimes ask their downstream customers to transfer funds to the Subject Group Companies directly instead of paying the distributors/franchisees, which helped to demonstrate to their downstream customers that the products were genuine.

Who are involved and/or aware of such arrangement

The Sales General Manager and the majority of the sales managers and representatives were involved in making payments on behalf of customers or keeping credit cards for customers. There was no evidence to suggest that the Company's CFO or CEO were aware of this practice.

Sales receipts sources

The Forensic Accountant analysed the receipts involving the Major Customers in the Review Period (amounting to approximately RMB91.6 million in sales receipts). Based on the representations by the customers and the sales personnel, the Forensic Accountant has categorised the sales receipts as below:

Table No.1 – Analysis on the Source of Sales Receipts in the Review Period

Sales Receipts Sources	Payment Amt. Involving the Major Customers in 2019 (RMB)		Payment Amt. in Jun 2019 (RMB)		Payment Amt. in Dec 2019 (RMB)	
	% of Total Payment Amt.		% of Total Payment Amt.		% of Total Payment Amt.	
Receipts paid by cards/accounts under the Customers' names and the cards were not kept by employees	20,130,003	22.0%	11,216,638	29.7%	10,685,971	30.7%
Receipts paid by cards/accounts the names of Customers' relatives or friends and the cards were not kept by employees	18,650,481	20.4%	7,687,274	20.4%	7,821,521	22.5%
Receipts paid by employees and/or their relatives	10,951,071	12.0%	3,460,352	9.2%	4,194,856	12.0%
Receipts paid by cards/accounts under the names of Customers, their relatives or friends but the cards were kept by employees	25,165,513	27.5%	4,025,132	10.7%	3,099,242	8.9%
Receipts paid by the downstream customers of distributors/franchisees	4,188,291	4.6%	996,747	2.6%	523,143	1.5%
Unknown sources	12,482,803	13.6%	10,384,959	27.5%	8,493,096	24.4%
Total	91,568,162	100.0%	37,771,101	100.0%	34,817,830	100.0%

For sales receipts being settled by employees, the Forensic Accountant selected a sample of transactions totalling approximately RMB11.1 million and reviewed the statements of personal bank accounts of employee payers in order to identify the source of funds. The Forensic Accountant noted that the majority of the funds appeared to originate from relevant customers, and their bank cards had not been kept by the Subject Group Companies' employees, based on relevant employees' representation. As the payers of the remaining transactions (amounting to RMB 2,209,702, representing 19.9% of the sampled transactions) were not documented on the bank statements/WeChat conversations whereby the employees were repaid, the source of this remaining balance was unknown.

Table No.2 – Source of Funds Traced Regarding Employee Payers

Descriptions	Receipts			Total	% of Total Payment Amount
	Involving Major Customers in 2019	Receipts in Jun 2019 (excl. Major Customers)	Receipts in Dec 2019 (excl. Major Customers)		
Sourced from customers or customers, spouses	6,484,942	1,076,502	545,560	8,107,004	72.9%
Sourced from customers' relatives or friends other than spouses	619,034	21,912	93,932	734,878	6.6%
Unknown sources	1,315,624	280,817	613,261	2,209,702	19.9%
Not paid by customers yet	—	—	75,000	75,000	0.7%
Total	<u>8,419,600</u>	<u>1,379,231</u>	<u>1,327,753</u>	<u>11,126,584</u>	<u>100%</u>

In addition, among RMB11.1 million being settled by employees and selected for the Forensic Account's review, according to the employees' bank statements provided, approximately RMB8.3 million (74.7%) appeared to be paid by the customers to employees upfront; approximately RMB1.4 million (12.9%) appeared to be paid upfront by employees but repaid by customer within one month.

The Forensic Accountant requested through the Subject Group Companies for the bank statements of customers or their relatives or friends whose credit cards were under custody of sales employees, with an attempt to identify the source of funds. However, such requests were declined by the customers, due to privacy concerns.

Alternatively, the Forensic Accountant was provided with certain WeChat conversations between the sales personnel and the Major Customers discussing account receivables settlement totalling RMB22,194,502 (which accounts for 24% of the total settlement involving the Major Customers), to substantiate the assertion that it was the customers who gave the instructions to the sales personnel to settle on their behalf. Also, the Forensic Accountant matched the transactions described in WeChat conversations to POS slips and noted that the arrangements of sales proceeds collection (e.g. amount and date) mentioned in WeChat conversations were consistent with the information shown on the POS slips.

Company's response

Based on the findings of the Forensic Review, the Company believes that the sales were genuinely made by the relevant customers, and the employees were merely making the payment on behalf of the customers for convenience.

Nevertheless, the Board has taken remedial actions to forbid employees from keeping customers' credit cards or making payments on behalf of the customers. Please refer to the section headed "Remedial Actions" below for details.

3. Some sales did not appear to be supported by third party evidence of delivery

Background

During the Auditors' audit process for the Group's 2019 Financial Statements, the Auditors noted that some sales transactions did not appear to be supported by third party evidence of delivery.

Findings

Goods delivery arranged by Xinyitai

For the majority of the goods delivered to customers, the Subject Group Companies retained a warehousing and logistics vendor named Xinyitai Logistics Co., Ltd ("**Xinyitai**"), which was responsible for arranging warehousing and delivery of the goods from Xinyitai's warehouses to the customers. According to the Forensic Accountant's interview with a representative from Xinyitai, as Xinyitai doesn't have its own car fleets or delivery employees, it retains various kinds of downstream logistics providers (e.g. branded courier companies and self-employed truck drivers) for goods delivery depending on the quantities of goods, delivery distance and locations of Xinyitai's warehouse. The same Xinyitai representative also informed the Forensic Accountant that goods delivered by special vehicles, mostly owned by self-employed truck drivers ("**Special Vehicle**"), did not have tracking numbers.

The Forensic Accountant performed certain procedures to validate (i) the logistics tracking sheets maintained by Xinyitai, (ii) the Subject Group Companies' sales records provided by the Subject Group Companies and (iii) the logistic tracking sheets submitted by Xinyitai to the Subject Group Companies between December 2019 and January 2020 (which was downloaded from the QQ conversation history of a QQ chat group between the Subject Group Companies' logistics staff and personnel from Xinyitai stored on the Subject Group Companies' Logistics Manager's corporate computer). No inconsistencies were noted.

The Forensic Accountant also matched the weight for each shipment in June and December 2019 to the Subject Group Companies' customers on the logistics tracking sheets to the settlement records, and did not note any irregularities except for a few minor inconsistencies. The Forensic Accountant calculated the logistics fees for 51 sampled transactions and did not note any irregularities. Further, the Forensic Accountant verified the payments of logistics fees in June and December 2019 by the Subject Group Companies' bank statements and logistics fee fapiaos (invoices) issued by Xinyitai.

Goods delivery by Special Vehicles

Based on the logistics tracking sheets maintained by Xinyitai which were provided through the Subject Group Companies, in 2019, goods with corresponding sales totalling approximately RMB68.4 million (i.e., 24.0% of total annual sales) were purportedly delivered by Special Vehicles.

Due to the unavailability of tracking numbers for goods shipped by Special Vehicles, alternatively, the Forensic Accountant requested for the Good Received Notes ("GRNs") for all the orders placed in 2019 which were purportedly delivered by Special Vehicles (142 GRNs in total). The Forensic Accountant noted the following observations relating to goods shipped by Special Vehicles:

- The Forensic Accountant noted that the driver and customer should both sign on the GRNs for all the shipments. However, for 37 GRNs with sales amount totalling approximately RMB17.7 million, the Subject Group Companies could only provide GRNs signed off by truck drivers. For 58 GRNs with sales amount totalling approximately RMB16.4 million, both customers' and drivers' copies of GRNs were not provided. The Subject Group Companies represented that GRNs were not well-maintained by Xinyitai and therefore certain GRNs could not be located.
- For 8 GRNs with sales amount totalling approximately RMB4.5 million, the Subject Group Companies provided the WeChat and QQ conversations regarding customer's complaint on this shipment about delivering goods without carrying the goods to the customer's warehouse. This appears to indicate that the Customer has received the goods.

- 39 GRNs with customers' signatures were provided, with sales amount totalling approximately RMB29.8 million. However, the Forensic Accountant noted various observations for these shipments, including inconsistent statements given by one truck driver in three interviews regarding delivery destination, transportation capacity, etc.; inconsistent dates/weights noted across documentations.

Company's response

In the logistics service agreement signed between the Subject Group Companies and Xinyitai, Xinyitai shall be liable for any loss of goods once the goods are delivered from the Subject Group Companies to Xinyitai. As of the date of the announcement, Xinyitai have not reported any loss. The findings of the Forensic Review demonstrate that 57.5% of the Company's annual sales were supported by the tracking numbers either by way of trucks with tracking numbers or express delivery with tracking numbers, while the remaining transactions were supporting by other evidence such as Xinyitai's logistics tracking sheets and QQ conversations with Xinyitai's staff, etc. The customers whom the Forensic Accountant interviewed confirmed that all the goods have been received, and this can make up for the lack of support from GRNs.

It is the Company's practice that once the goods are delivered, the logistics staff of the Company will call the customers to confirm the receipt of the goods. Due to a large number of orders are delivered by Special Vehicles, not all of them are confirmed one by one by the logistics customer service, but they are instead confirmed by the relevant sale personnel. As of the date of this announcement, all customers have confirmed receipt of the goods that were ordered in 2019. In relation to the delivery by Special Vehicles, the Company has in place internal policy requiring both the driver and customer should sign on the GRNs for all the shipments. The Forensic Review shows that such policy is not strictly followed. The Board has since taken remedial actions to ensure that all shipments will be supported by third party delivery evidence. Please refer to the section headed "Remedial Actions" below for details.

4. Fictitious Sales Allegations

Background

On 21 April 2020, the Company's Auditors received an anonymous SMS message, alleging that:

- sales made to a particular customer ("**Customer X**") in Jiangsu were fictitious over the past few years;

- the Subject Group Companies’ Regional Sales Head of Jiangsu and some of the Subject Group Companies’ staff in Jiangsu colluded with Customer X to generate fictitious sales; and
- A store purportedly owned by Customer X in Changshu and other two stores purportedly owned by another customer (“**Customer Y**”) in Xuancheng are actually owned by relatives of certain Subject Group Companies’ staff (together, “**Allegations**”).

Findings

During interviews, the Subject Group Companies’ sales personnel responsible for handling the two alleged customers both admitted that they were relatives of owners of the relevant franchise stores.

The Forensic Accountant noted the revenue generated from Customer X and Customer Y in 2019 totalled RMB484,895 and RMB539,334, respectively. The Forensic Accountant also reviewed sampled sales orders placed by Customer X and Customer Y. Based on the procedures performed, the Forensic Accountant did not identify any evidence indicating that the Allegations were substantiated except that the ultimate beneficial owner of the relevant customers appeared to be related to certain Subject Group Companies’ staff.

Company’s response

There is no evidence to suggest that there had been fictitious sales made to Customer X or Customer Y, and the terms of the agreements of these two customers are consistent with other customers. Nevertheless, the Company acknowledges there may be conflicts if employees of the Company (or their relatives) open stores and become customers of the Company. In this regard, the Company has since implemented internal control measures to ensure that franchise stores are not related or connected to the Company’s employees and their relatives.

5. Accounts Receivables (“ARs”) of the Major Customers as of 31 May 2020

Background and Findings

The Subject Group Companies’ finance policy allows payment by monthly instalments for most sales orders and customers would enter into agreements with the Subject Group Companies agreeing to settle the sales amount by three to eight monthly instalments. According to the instalment agreements, customers need to repay their AR before the due date for each instalment.

The Forensic Accountant noted that as of 31 May 2020, three out of the Top Six Customers had overdue receivables ranging from RMB963,357 to RMB8,268,547, representing 27% – 63% of their corresponding AR, while the remaining three had very little or no overdue receivables. The Forensic Accountant also noted that the total overdue AR for the remaining 18 Major Customers represented 51% of their total ARs.

As of 31 May 2020, Top Customer A had overdue AR of approximately RMB 8.3 million. Nonetheless, the Forensic Accountant noted that in 2020 Top Customer A placed additional orders totalling approximately RMB 1.6 million. The Forensic Accountant was advised that customer codes with overdue AR would be de-activated, in order to prohibit the customers from placing additional orders before repaying the overdue AR. However, the Forensic Accountant was provided with a special approval document dated February 2020, which showed that the Company management had approved the re-activation of two of Top Customer A's customer codes to allow the customer to place orders in 2020.

Company's response

In order to mitigate the credit risks, the Company has revisited its AR management policy and redrafted the "Authorised Dealers Agreement" with certain Major Customers. Please refer to the section headed "Remedial Actions" below for details.

6. Revenue recognition appears to be inconsistent with the Company's accounting policy

Background and Findings

The Forensic Accountant understood from the Subject Group Companies' Finance Department that revenue was recognised when Xinyitai checked out the shipment in system because Xinyitai would be responsible for compensation after the goods were picked up by them from the warehouse. However, according to the Company's accounting policy as set out in its unaudited annual report for 2019, for sales of products to the franchisees, revenue is recognised when control of the goods has transferred to the franchisees, being at the point when the goods are delivered to the franchisees. Hence, there may be potential cut-off issue on the Company's sales recognition. In respect of sales orders placed in December 2019, based on the Forensic Accountant's review, goods with corresponding sales amount totalling RMB23.4 million appear to be received by customers post cut-off date in 2020.

Company's response

In relation to the recognition of revenue by the Subject Group Companies' Finance Department, the Company's Auditors acknowledged this revenue recognition cut-off point over the years, and have not expressed any concern or that the revenue should be recognised when the goods are actually received by the customers.

According to the shipping record maintained by the Subject Group Companies' system, the logistics tracking sheets maintained by Xinyitai and Xinyitai's receipts of goods, all the goods ordered in 2019 with the logistics handled by Xinyitai were delivered to Xinyitai in 2019. However, due to the transit time from Xinyitai to the customers, some of the customers only received the goods post 2019 for the goods that they ordered in December 2019.

In light of the observation made by Forensic Accountant, the Finance Department will ensure that revenue is only recognised when the goods are delivered to the franchisees. Sales amount totalling approximately RMB23.4 million will also be recognised in the financial statements of 2020 as opposed to 2019.

Further internal controls include: starting from May 2020, all the month end cut-off day will be pushed forward by 3 days, which will be reserved for logistics delivery time. In the following month, the logistics department will summarise the order receipts of the last five delivery days to the Finance Department for verification. If necessary, the Finance Department may also make accounting adjustment for June and December each year. In the future, the Company will continuously monitor the implementation of the internal control and further enhance the measures if necessary.

7. Other observations

The Forensic Accountant noted that several documents seemed to suggest that after Eastern Media International Corporation (“**EMIC**”, one of the Company's substantial shareholders) acquired the Company's shares in November 2018, the CEO and personnel of EMIC were made aware that during 2016 to 2018, there were certain instances where the Subject Group Companies might have been engaged in channel stuffing (i.e. inflating the sales figures by shipping more products through a distribution channel than the channel is capable of selling) and hence goods might not have been delivered to certain customers after the sales were made.

According to the Forensic Accountant's interview with the CEO, after she joined the Company in November 2018, she was informed by the Company's personnel of the historical practice of channel stuffing. Subsequently, the management looked into the matters and summarised their understanding of the issues. However, due to insufficient details obtained regarding the arrangement, she was unable to further validate the matter or quantify the relevant amount involved. The Forensic Accountant was advised by the CEO that the relevant sales proceeds had been collected.

Company's response

Save for a small percentage of accounts receivable during the period from 2016 to 2018 that were reversed or written-off due to return of goods or bad debts, the Company confirmed that all relevant sales proceeds had been collected based on the Company's accounting record and hence the Company believes that the allegation that the Company might have been engaged in channel stuffing prior to 2019 could not be substantiated.

Having said that, the Board and the Audit Committee take such allegation seriously, and the Audit Committee has instructed the Forensic Accountant to conduct additional procedures to investigate into the allegation. As Messrs Deloitte Touche Tohmatsu acted as the Company's Auditors during the period from 2016 to 2018, such instruction was made independent of Messrs Deloitte Touche Tohmatsu. The Company will announce the forensic review findings and follow-up actions, if any, on this particular issue in due course. In addition, the Company has also implemented various policies and organisational restructuring to further enhance its control over its distributors. Please refer to the section headed "Remedial Actions" below for details.

Key Limitations

The Forensic Review is subject to the following key limitations. The Forensic Accountant has noted that its work could have been significantly different had their work not been subject to these limitations.

Electronic document review

- The Forensic Accountant was unable to gain access to the personal computer used by the former Supply Chain Director of the Subject Group Companies who had used his personal computer for work.
- Subject Group Companies emails deleted by users would be removed from the server/cloud after 30 days since the synchronization. Hence, the Forensic Accountant was unable to ascertain the completeness of the emails from the Subject Group Companies' email server.

Interviews

- The Forensic Accountant was unable to interview the former Supply Chain Director and former Finance Analysis Manager, both left the Subject Group Companies in early March 2020, to understand their involvement and/or knowledge of the matter and seek explanations/clarifications for any issues noted from the review.

- The first two interviews with one of the major Special Vehicle drivers were conducted in the presence of a representative from Xinyitai.
- The Forensic Accountant was not able to conduct interviews with two major Special Vehicle drivers who had delivered the Subject Group Companies' products in 2019.

Sales receipts

- For certain transactions, the Forensic Accountant requested to obtain the bank statements of customers' or their relatives' or friends' whose credit cards were under custody of sales employees, or bank statements of their relatives' accounts, with an attempt to identify the source of funds. However, such requests were declined by the customers, due to privacy concerns.
- For certain transactions, due to the following reasons, the Forensic Accountant was unable to determine the identity of the payers involved in these transactions: (1) Based on the account numbers shown in the POS slips, the Subject Group Companies' customers could not recall who were the account holders. (2) For certain accounts, the customers could not provide photos of bank cards to validate the card holders. (3) Payers' information was not recorded on the Subject Group Companies' bank statements for certain transactions being paid by scanning the QR codes of payers' QR accounts.
- For certain transactions, the full numbers for payers' accounts/full names of payers were not shown on the Subject Group Companies' bank statements. Alternatively, the Forensic Accountant extracted the first and last four digits of the payers' accounts/the last one/two Chinese characters of payers' names, as unique identifiers for the Forensic Accountant's analysis. The Forensic Accountant cannot ensure the completeness of the accounts being identified.
- The Forensic Accountant relied upon representations made by customers and sales personnel regarding who were the payers, the relationship between the payers and the customers, and the identity of the individuals in the WeChat conversations discussing AR settlement with the sales personnel.

Remedial Actions

The findings of the Forensic Review revealed concerns in the Company's internal control system in areas such as collection of sales proceeds, distributor management (e.g. controls on goods exchange quota to distributors) and delivery of goods.

The Board has taken the following remedial actions to address such internal control concerns:

A. *Concerns over how certain individual distributors and customers settled their payments to the Company*

1. Payments settled by the customers' relatives or friends

If the payer is a relative or a friend of the customer, the customer will need to sign an agreement with the payer entrusting the payer to pay on behalf of the customer.

2. Employees keeping customers' cards

- On 21 May 2020, the Company issued a notice prohibiting employees from taking custody of customers' bank cards for any reason.
- On 29 May 2020, the Company issued an updated employee handbook, which standardizes the disciplinary consequences for employees who violate the Company's policies. All employees are required to sign a letter of commitment to ensure that they will not keep and use the customer's bank card to pay for the Company and advance the payment for the customers.

3. Employees paying on behalf of the customers

- From 17 March 2020 to 25 May 2020, the Company has issued 3 notices and internal policies to all employees prohibiting employees from paying on behalf of the customers, and the disciplinary consequences for failing to do so.
- On 1 June 2020, the Company has issued internal censures against 3 employees who did not comply with the new rules.
- On 13 May 2020, the Company has issued a notice requiring all POS payments to reveal the payer's identity. For certain POS terminals which cannot identify WeChat payers, the Company has stopped accepting payment from WeChat Pay and has only allowed Alipay and card payments; whereas for certain POS terminals which cannot identify WeChat and Alipay payers, the Company will only accept card payments.
- On 1 July 2020, the Company has introduced POS terminal from UnionPay, which allows backend identity verification of the payers.
- Further enhanced measures are also introduced:

- a. The Finance Department has commenced to check the payment slips every day and compare those with the Company's employee roster. An investigation will be carried out immediately upon notice of any payer having the same name as any employees.
- b. If the POS terminal from UnionPay identifies payment is not from the customer, the relevant personnel will be notified to provide the entrustment payment agreement between the customer and the payer.
- c. The finance department shall provide the detailed payment details to the internal audit department every month, and the internal audit department shall conduct sampling inspection on a quarterly basis.

B. Management of Authorised Dealers

In response to the Allegations and individual authorised dealers who are authorised to sell the Company's products or sales personnel of the Company offering various rights to exchange goods to customers, the Company has taken the following internal control remedial actions:

1. Regional Organisational Restructuring

The Company will restructure the current sales team structure, splitting the single sales team in China (excluding Hong Kong, Macau and Taiwan) into 4-6 sales regions for regional management.

2. Management of Authorised Dealers

- 1) For authorised dealers, the Company plans to divest it from the original Sales Department and will be directly led by the CEO. The new authorised dealer team will consist of dedicated sales personnel, legal personnel, finance personnel, and internal audit personnel.
- 2) The Company has also redrafted the "Authorised Dealer Agreement" with the authorised dealer's annual purchase target, financing amount, monthly reconciliation, rebate calculation method, and the percentage of goods exchange clearly set out.
- 3) Assign a special customer code to authorised dealers to distinguish them from other franchise customers.
- 4) During the period between 2 June 2020 and 5 June 2020, the CEO conducted interviews with Major Customers to discuss the above new authorised dealer proposal.

C. Enhance Logistics Management

In view of enhancing logistics management, the Company has taken the following internal control remedial measures:

1. Replacing the current logistics company

As the services provided by Xinyitai can no longer meet the Subject Group Companies' daily management need, the Company will replace the current logistics company and has begun to look for new logistics companies.

The current contract signed with Xinyitai will expire at the end of June. The tender process for replacing the logistics company has been completed on 6 July 2020, and it is expected that the new logistics company will commence service in September 2020.

In addition, the Subject Group Companies have in place an arrangement with the new logistics company where all signed GRNs will be photographed and uploaded to the cloud for future reference. The Company expects to spend approximately RMB200,000 per year as service cost for the said arrangement.

2. Improving the internal control management of logistics operations

- 1) On 1 April 2020, the Logistics Department of the Subject Group Companies asked Xinyitai to provide signed receipts from customers and required it to prioritise the use of freight companies which can provide tracking information and signed receipt confirmation information on public platforms. In choosing the new logistics supplier, the Company will also require the new supplier to use a freight company that provides tracking information and sign receipt confirmation information on public platforms.
- 2) The logistics personnel of the Company in the warehouse are required to make telephone follow-ups on all orders and compile customer service call logs for record keeping. The Logistics Department will also record the customers' receipt time of all orders for each month for the Finance Department to check and confirm the income amounts.
- 3) The Company has strengthened the daily internal control management of the logistics department and has sent notices to all key personnel in the logistics department.
- 4) The internal audit department of the Company will review the remedial internal control measures of the Company's logistics management every quarter.

D. Enhance control over franchising stores owned or operated by employees or their relatives

In response to the Allegations, the Company has taken the following internal control remedial measures:

- 1) On 1 June 2020, the Company has issued the “2020 Store Opening Policy for Employees” which strengthens the internal control measures for employees and their relatives to open stores.
- 2) Special customer codes are given to the franchise stores operated by employees and their relatives to distinguish them from other franchise stores.
- 3) If a current employee has already opened or operated a franchise store with another person in the form of anonymous partnership, holding through nominee, shareholding or guarantee, etc. before the issuance of the 2020 Store Opening Policy for Employees, a report to the Human Resource Department shall be made and the relevant employee shall disassociate himself from the operation of such franchise store by tendering his resignation, disposing of any shares, releasing of any guarantee, whichever applicable, within one month.
- 4) Employees whose relatives have been involved in the operation of franchise stores must declare this to the Human Resource Department for record. Such employees must not hold the positions of technical director, technical manager, or district manager in the same district.
- 5) The internal audit department will audit the business and operation of the franchise stores operated by employees or their relatives every six months.

OPINION OF THE AUDIT COMMITTEE AND THE BOARD

The Audit Committee and the Board have reviewed the findings of the Forensic Review and are of the view that despite the limitations as set out in the section headed “Key Limitations”, the Forensic Review has been thoroughly conducted by the Forensic Accountant, and have comprehensively investigated into the Issues raised by the Auditors to the extent that is practicable.

Since the Auditors raised the Issues, the Audit Committee and the Board have proactively taken a number of initiatives and measures to review and remediate not just the Issues, but also other deficiency identified during the Forensic Review. During the Forensic Review process, the Company cooperated fully with the Forensic Accountant in all aspects and offered complete, authentic and unreserved information and support.

The Audit Committee and the Board are also of the view that the issues identified in the Forensic Review do not impose any material adverse impact on the Group's business operation, financial position and contingent liabilities. The Group continues with its normal business operations notwithstanding trading has been suspended since 25 March 2020.

CONTINUED SUSPENSION OF TRADING

Trading in the Shares on the Stock Exchange has been suspended at the request of the Company since 9:00 a.m. on 25 March 2020 and will remain suspended until further notice. Shareholders and potential investors of the Company are advised to exercise caution when dealing in the securities of the Company.

By order of the Board
Natural Beauty Bio-Technology Limited
LEI Chien
Chairperson

Hong Kong, 21 July 2020

As at the date of this announcement, the Board comprises Dr. Lei Chien and Mr. Pan Yi-Fan as executive directors; Ms. Lu Yu-Min, Ms. Lin Shu-Hua and Mr. Chen Shou-Huang as non-executive directors; and Mr. Chen Ruey-Long, Mr. Lu Chi-Chant and Mr. Yang Shih-Chien as independent non-executive directors.