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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
AUDITORS' COMMENTS ON FORENSIC REVIEW FINDINGS
AND
AUDIT COMMITTEE'S RESPONSE TO AUDITORS' COMMENTS

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 (the “**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 in relation to the conditions for the resumption of trading in the shares of the Company; (iv) the announcement of the Company dated 24 June 2020 in relation to an update on the progress of the Forensic Review and fulfilment of the Resumption Conditions; (v) the announcement of the Company dated 16 July 2020 in relation to the profit warning of the Company; and (vi) the announcement of the Company dated 21 July 2020 in relation to key findings of the Forensic Review (the “**Announcement**”). Unless otherwise stated, capitalised terms used herein shall have the same meanings as those defined in the Announcement.

AUDITORS’ COMMENTS ON FORENSIC REVIEW FINDINGS AND AUDIT COMMITTEE’S RESPONSE TO AUDITORS’ COMMENTS

As disclosed in the Announcement, 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 of Group’s wholly-owned subsidiaries in China (the “**Subject Group Companies**”) of the Issues. The key findings of the Forensic Review have been disclosed in the Announcement.

On 22 July 2020, the Audit Committee received a letter from the Auditors, which sets out the Auditors’ comments on the Draft Forensic Review Report and their recommendations (“**AC Letter**”). On 27 July 2020, the Audit Committee wrote to the Auditors in response to the Auditors’ comments and recommendations contained in the AC Letter (“**AC Reply**”).

The Company would like to announce the Auditors’ comments on the Draft Forensic Review Report and their recommendations contained in the AC Letter together with the response of the Audit Committee contained in the AC Reply as set out below:

Auditors’ comment 1:

The Draft Forensic Review Report did not identify wrongdoers.

Recommendation: the Auditors request the Audit Committee to instruct the Forensic Accountant to identify any wrongdoers.

Audit Committee’s response:

The key findings of the Forensic Review have already identified the names or the positions of the relevant personnel involved in the relevant matters. The Company has already conducted all necessary investigation on the relevant personnel, and taken disciplinary actions against some of the personnel, and has adopted measures to strengthen the internal control. As such, the Audit Committee does not agree that the Draft Forensic Review Report did not identify any wrongdoers.

Auditors’ comment 2:

The Draft Forensic Review Report did not assess the financial impacts of the Issues.

Recommendation: the Auditors request the Audit Committee to instruct the Forensic Accountant to assess the financial impact of the Issues on the Group.

Audit Committee's response

The Forensic Review has roughly identified the financial impact of the relevant matters on the 2019 Financial Statements, including the amount of goods exchange promised by sales staff at the end of 2019 totalling approximately RMB7.2 million, and the amount involved in the revenue recognition cut-off date totalling approximately RMB23.4 million.

The exact financial impact of the matters mentioned in the Forensic Review on the 2019 Financial Statements should not be determined by the Forensic Accountant, but should be determined by the Auditors based on the findings of the final report of the Forensic Review.

Auditors' comment 3:

According to the Draft Forensic Review Report, 24% of the sales in 2019 were delivered by Special Vehicles. The rationale of such delivery arrangement was unclear. The only supporting documents to demonstrate goods delivery by Special Vehicles were the Goods Delivery Notes (“GRNs”). The Auditors deem a lack of sufficient audit trail, due to the following observations: (i) the GRNs were not well-maintained and therefore certain GRNs could not be located; (ii) the GRNs did not present detailed information regarding what products were delivered; (iii) inconsistent information, such as dates and weights, were noted across documentations; (iv) there were inconsistent statements given by one truck driver in three interviews regarding delivery destination, transportation capacity, etc.

Recommendations: the Auditors request the Audit Committee to instruct the Forensic Accountant to collect evidence to demonstrate the delivery by Special Vehicles and to understand the rationale of the delivery arrangement involving Special Vehicles.

Audit Committee's response

In relation to the rationale of using Special Vehicles for delivery, as stated in the Draft Forensic Review Report, the logistics provider Xinyitai does not have its own fleets or delivery employees. Depending on the quantity of goods, the delivery distance and the location of the warehouse, Xinyitai retains various kinds of downstream logistics providers (such as branded couriers and self-employed truck drivers) for goods delivery. Therefore, the use of Special Vehicles was determined by the logistics provider Xinyitai. The Audit Committee believes that the Draft Forensic Review Report has clearly pointed out the rationale for using Special Vehicles for delivery.

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 between the staff of the Company's logistics department and Xinyitai's staff. The customers whom the Forensic Accountant interviewed confirmed that all the goods have been received, and these additional verification procedures can make up for the lack of complete GRNs maintained by the logistics provider.

Auditors' comment 4:

Based on the Forensic Accountant's analysis of the sales receipts, there appeared to be an excessive number of cards being used for payments. The source of funds included customers, the Company's employees, customers' relatives, and down-stream customers, etc. For payments made by individuals other than customers and the Company's employees, there was a lack of records to demonstrate the relationship between the payers and the customers. For 27.5% receipts in June 2019 and 24.4% receipts in December 2019, the source of the funds was not known, as some customers could not recall the card holders.

Recommendations: the Auditors request the Audit Committee to instruct the Forensic Accountant (1) to collect evidence to demonstrate the relationship between the payers and the customers and (2) to perform check on disbursement claims by top ten employee payers settling receivables for the customers identified.

Audit Committee's response

The main reasons for the shortcomings identified by the Auditors are (1) the payers settled the payment by Alipay or Wechat, which does not disclose the full name of the payers in the transaction details given the Mainland China's personal data protection laws and regulations; (2) due to a large number of transactions involved, some customers cannot recall the name of the card holders. As such, the Audit Committee is of the view that the Forensic Accountant has already verified all payment information to the extent feasible.

Auditors' comment 5:

Top Customer A has not repaid all of its accounts receivables as of 31 May 2020. Top Customer A represented to the Company to use two of its properties as collateral in exchange for the extended credit period from the Company, but according to the Draft Forensic Review Report, it had not registered its properties as collateral with the relevant government authority yet.

Audit Committee's response

Due to the COVID-19 pandemic, the Company's major customers are experiencing financial difficulties. The Company entered into a new repayment agreement with Top Customer A in June 2020. As of the date of the AC Reply, Top Customer A has complied with all the new repayment terms and repaid the debt on time. The Company is actively procuring Top Customer A to register its properties as collateral with the relevant government authority.

Auditors' comment 6:

The Forensic Accountant noted certain sales personnel offered five customers who placed large orders at the end of December 2019 to exchange goods at a certain value post 2019 and such sales arrangement was possibly a result of the pressure from the management in achieving sales target.

Audit Committee's response

The Forensic Accountant noticed certain indications that management and sales staff were under pressure to achieve sales targets, including the general manager of sales and all other sales staff would be entitled to sales incentives and a special bonus plan for the revenue achieved in December 2019.

As disclosed in the Announcement, the Company believes and the Audit Committee agrees that the main reasons for the sales spike are: (i) the distributors were strongly incentivised to place more orders in December 2019 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.

Auditors' comment 7:

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 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 (“**Internal Report**”). However, due to insufficient details obtained regarding the arrangement, she was unable to further validate the matter or quantify the relevant amount involved. Nevertheless, such Internal Report was not provided and disclosed to the Auditors during the Auditors’ audit of the Group’s consolidated financial statements for the year ended 31 December 2019.

Recommendations: the Auditors request the Audit Committee to instruct the Forensic Accountant (1) to investigate into the issues identified in the Internal Report to understand if there was any non-compliant sales arrangement before 2019 and (2) to extend the forensic review scope of the sales in 2019 to ascertain if there was channel stuffing with other customers.

Audit Committee's response

1. Expanding the scope of Forensic Review to look into matters prior to 2019 will have no material impact on the completion of the 2019 audit work.
2. From 2016 to 2018, the Auditors audited the financial statements of the Company and issued unqualified opinions therein.

3. The Audit Committee has separately instructed PricewaterhouseCoopers Management Consulting (Shanghai) Limited on 7 July 2020 to conduct a separate forensic review to look into the matters prior to 2019. However, in order to avoid conflicts of interest, this separate forensic review will be completely led by the Audit Committee and conducted independently of the Auditors.

Further remarks from the Audit Committee

In response to the Auditors' recommendations in the AC Letter, the Audit Committee is of the view that:

- In early May 2020, the Forensic Accountant discussed and reached an agreement with the Auditors on the expansion of the scope of Forensic Review, on which the Audit Committee also agreed. During the expanded Forensic Review, the Company cooperated fully with the Forensic Accountant.
- During the expanded Forensic Review, the Forensic Accountant sampled the sales and payment receipts of June and December 2019 (the two highest sales months of 2019), and also investigated the sales and payment receipts of the top 27 customers with annual sales reaching RMB1 million or more in 2019. Owing to objective factors, Forensic Review is inevitably subject to certain inevitable restrictions and limitations. For example, the resignation or loss of contact of some relevant personnel made it impossible to verify all facts. Further expansion of the Forensic review to look into sales and payment receipts in 2019 cannot completely overcome such restrictions and limitations.
- Up to the date of the AC Reply, the Company has already spent a huge amount for the Forensic Review. As disclosed in the announcement by the Company dated 16 July 2020 in relation to profit warning of the Company, one of the reasons for the significant decline in the Company's profit was the substantial increase of expenses in relation to the audit of the annual results for the year ended 31 December 2019 and the Forensic Review. The Audit Committee expects that expanding the scope of Forensic Review will incur even more expenses, which is not justifiable given the Audit Committee's views contained in the AC Reply.

In the AC Reply, the Audit Committee also stated that:

- 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.

- As disclosed in the Announcement, 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.
- Based on the above responses, the Audit Committee is of the view that it is not necessary and not justifiable to expand the scope of the Forensic Review.

The Company will continue to update the shareholders and potential investors of the Company the latest development on the Forensic Review and the progress of the Company’s efforts to fulfil the resumption conditions as and when appropriate.

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, 27 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.