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## Regulatory Action

11 November 2016

# SGX reprimands Foreland Fabrictech Holdings Limited, former Executive Chairman Tsoi Kin Chit, former Executive Director Zhang Hong Lai and former Non-Executive Director Chen Chao Ying

### Public reprimand: Breaches of Listing Rules

1. Singapore Exchange ("SGX") reprimands Foreland Fabrictech Holdings Limited ("Foreland Fabrictech" or the "Company") [福联面料科技控股有限公司] for breaches of the following Listing Rules:
  - (a) Listing Rule 703(1) for the failure to promptly announce the significant customer claim of RMB290 million; and
  - (b) Listing Rule 719(1) for the failure to put in place a robust internal control to address financial, operational and compliance risks.
2. SGX reprimands Mr Tsoi Kin Chit [蔡建设] (former Executive Chairman) and Mr Zhang Hong Lai [张宏来] (former Executive Director) as Executive Directors who had through their failure in carrying out their fiduciary duties, caused the Company to breach its obligations under the listing rules.
3. In addition, SGX is of the view that Mr Tsoi Kin Chit, Mr Zhang Hong Lai and Mr Chen Chao Ying [陈超英] (former Non-Executive Director) have failed to act in the interests of shareholders as a whole. SGX reprimands Mr Tsoi Kin Chit, Mr Zhang Hong Lai and Mr Chen Chao Ying for not demonstrating the character and integrity expected of directors and management of SGX-listed companies, as required under Listing Rules 210(5)(b) read with 720(1), in failing to act in the interests of shareholders as a whole.
4. SGX-listed companies are advised to consult SGX before they appoint Mr Tsoi Kin Chit, Mr Zhang Hong Lai and Mr Chen Chao Ying as a director or member of management.

### Details of Listing Rule breaches

#### Background

5. On 14 December 2013, the Company announced ("Announcement") that the Company's wholly-owned subsidiary, Fulian Knitting Co., Ltd ("Fulian") [福建省晋江福联织造有限公司], received a claim from a customer, Jiangxi Longdu Clothing & Accessories Weaving Limited Company ("Jiangxi Longdu") [江西龙都服饰织造有限公司]. The claim relates to the "supply to Jiangxi Longdu 324,990 yards of high colour fastness taslon (the "Textiles") at a consideration of RMB4,062,375.00".

6. The Announcement disclosed that “On 17 November 2013, Jiangxi Longdu complained that the Textiles supplied were defective (the “Complaint”). The Company conducted investigations from 19 November 2013 to 6 December 2013. On 9 December 2013, Jiangxi Longdu demanded from Fulian a total compensation of RMB290 million for all losses and damages it had incurred in connection with the alleged breach of the contract and defective products” (the “Claim”). The Company disclosed that “On 12 December 2013, the Company had engaged the Fujian Minhua Law Firm [福建闽华律师事务所] to provide its legal advice on the merits of the Claim.”
7. On 26 December 2013, the Company announced that Fujian Minhua Law Firm, among other things, recommended the Company to engage an independent auditor firm to assess the Claim and to determine a reasonable compensation amount based on the actual losses suffered by Jiangxi Longdu.
8. On 3 January 2014, the Company announced that the Company and Jiangxi Longdu had jointly appointed Fujian Huatie Certified Public Accounting Firm (“Fujian Huatie”) [福建华铁会计师事务所有限责任公司] to assess the Claim and to determine a reasonable compensation amount of losses suffered by Jiangxi Longdu. Fujian Huatie has on 31 December 2013 issued an appraisal report concluding that the reasonable compensation amount is RMB275,284,800.00 (“Appraisal Report”). It also disclosed that the Company was served on 30 December 2013 a notification of statement of claim from Jiangxi Longdu for the sum of RMB288,666,700.
9. On 10 February 2014, the Company disclosed that “A Board of Directors meeting was convened on 22 January 2014 to discuss the Claim. Pursuant to the discussion, the independent directors are of the view that the Company shall approach Jiangxi Longdu in relation to the appointment of a (i) reputable local audit firm; and (ii) reputable local law firm, to conduct an independent re-assessment on the Claim (the “Appointment”); or the Company shall consider convening an Extraordinary General Meeting (“EGM”) to seek shareholders’ views and support in relation to the settlement of the Claim. The Management has different opinion in relation to the proposal to convening the EGM at the moment because of the time constraint in responding to Jiangxi Longdu.”
10. On 6 May 2014, the Company announced that it has entered into a settlement agreement with Jiangxi Longdu to fully settle the compensation claim of RMB275.3 million and a late interest payment of RMB7.7 million.
11. On 6 May 2014, the Company announced the resignation of the Company’s independent director and audit committee chairman, Mr Lim Siang Kai (“Mr Lim”), citing differences in opinion with the Management in relation to the handling of the dispute with Jiangxi Longdu. The announcement disclosed that “Mr Lim’s decision to resign was primarily due to the desire of the PRC directors wanting to push through the settlement terms with Jiangxi Longdu, notwithstanding his strong objection and disapproval. He insisted that the Company should engage a Singapore-based lawyer and a Singapore or Hong Kong based professional appraiser to review and evaluate the claim. Without doing this, he was unable to agree on a settlement to be entered into with Jiangxi Longdu”.
12. On 7 August 2014, the Company announced that its auditors had issued a disclaimer of opinion on the Company’s audited financial statements for FY2013. The Auditor noted that Fulian entered into a settlement agreement with the customer and an amount of RMB282,992,774 was paid. Management had relied on a legal advisor in the PRC for legal advice with respect to this customer claim and the compensation amount was based on an appraisal report issued by a PRC accounting firm. In a board of directors’ meeting held on 22

January 2014, the independent directors of the Company who held office on that date and who are also the Audit Committee members on that date, had a difference in opinion with Management on the handling of the claim and had required the appointment of another reputable audit firm and reputable law firm to conduct an independent re-assessment of the customer claim. The customer claim was settled subsequent to the end of the reporting period without an independent re-assessment of the customer claim as required by the independent directors and Audit Committee members. The auditors were not able to obtain sufficient appropriate evidence to satisfy themselves as to the reliability of the evidence provided by the legal advisor and the accountant which was relied upon by Management for this customer claim. The auditor has not been able to obtain appropriate audit evidence to satisfy themselves with regards to bank balance and fixed deposits of Fulian totalling RMB292,298,353 as included in the Group's cash and cash equivalents at 31 December 2013.

13. On 22 January 2015, the Company announced the appointment of BDO LLP ("BDO") as an independent reviewer to, *inter-alia*, perform an independent assessment of the Claim. On 25 May 2016, the Company announced the Executive Summary of BDO's findings ("Report").

14. BDO had noted in their Report that before entering into a settlement with Jiangxi Longdu, the Management:

- (a) Did not appoint a third party to carry out an independent quality assurance test to verify Jiangxi Longdu's claim relating to the defective dyed textile;
- (b) Did not provide full information on Jiangxi Longdu's purported claim against Fulian to Fujian Minhua Law Firm and seek their advice on how to defend Fulian and mitigate Fulian's "exposure" to the purported claim;
- (c) Did not accept the Company's former independent directors' requests to seek a second legal opinion and to appoint a reputable audit firm to re-assess Jiangxi Longdu's purported claim against Fulian;
- (d) Did not request Fujian Hua Tie to comment on the accuracy, veracity and/or reasonableness of the items listed in the List of Economic Losses in the Appraisal Report. Fujian Hua Tie also did not take into account whether insurance policy(ies) that Jiangxi Longdu was supposed to purchase covered its purported claim against Fulian;
- (e) Did not obtain documents to support Jiangxi Longdu's claim of RMB1,510 per jacket for the alleged damage to 191,170 units.
- (f) Did not obtain documentary evidence to substantiate the accuracy, veracity and/or reasonableness of the items amounting to RMB1,510 per jacket claimed by Jiangxi Longdu in the purported List of Economic Losses;
- (g) Did not obtain documentary evidence from Jiangxi Longdu to demonstrate that Jiangxi Longdu had taken steps to mitigate its losses as well as documentary evidence to demonstrate that Jiangxi Longdu had compensated Mega Chinese Limited ("Mega Chinese") [香港昌中有限公司] for the cancellation of the contract;
- (h) Did not engage a more renowned law firm/audit firm to re-assess Jiangxi Longdu's purported claim against Fulian in view that the purported claim was substantial.

15. In respect of Jiangxi Longdu's purported claim against Fulian, BDO expressed:

- (a) Doubt on the veracity of the complaint made by Jiangxi Longdu, including the date on which it was purportedly made;
- (b) Doubt on the veracity of the claim made by Jiangxi Longdu against Fulian;
- (c) Doubt on the claim for Economic Losses of RMB1,510 per winter jacket for 191,170 units.
- (d) Doubt on the purported sample sent to SGS-CSTC Standards Technical Services Co., Ltd by Jiangxi Longdu for testing and on the veracity of the contract between Jiangxi Longdu and Mega Chinese;
- (e) Doubt on the veracity of the purported defective dyed textile;
- (f) Doubt on the accuracy, veracity and/or reasonableness of the items listed in the List of Economic Losses comprising the following:
 

Material costs	-	RMB196 per winter jacket
Business expenses loss	-	RMB120 per winter jacket
Wages costs	-	RMB198 per winter jacket
Loss of profit	-	RMB453 per winter jacket
Packing and transportation costs	-	RMB35 per winter jacket
Delivery loss	-	RMB278 per winter jacket
Branding loss	-	RMB230 per winter jacket
- (g) Doubt on the existence of Hong Kong Yong Sheng [香港永胜行], the shareholder of Jiangxi Longdu.

16. BDO noted that in a Chinese Circular dated 10 December 2013 written by Mr Tsoi Kin Chit to the Board, Jiangxi Longdu had informed Fulian about the defective dyed textile in early December 2013. If so, Jiangxi Longdu's Complaint would have been "out of time" as they had to make a complaint to Fulian within 30 days from 15 October 2013, 18 October 2013 and 20 October 2013 (dates of delivery).

#### Breach of Listing Rule 703(1)

17. Although the Company purportedly received the Jiangxi Longdu's "Complaint" on 17 November 2013 as disclosed in its Announcement, this was announced by the Company only almost one month later on 13 December 2013. The claim by Jiangxi Longdu amounted to RMB 290 million which is 45% of the Company's NAV as at 30 September 2013 and is significant compared to the Company's Pre-Tax Losses of RMB28.6 million.
18. From the board's minutes of 11 December 2013, BDO noted that Mr Tsoi Kin Chit had reported to the directors that Jiangxi Longdu had informed Fulian about the defective dyed textile in early December 2013. However, the Announcement disclosed that the Complaint was received on 17 November 2013. BDO had noted that disclosure of the date of Complaint in the Announcement was inconsistent with those stated in an internal memo (which stated that the claim was made on 24 November 2013) and the Chinese Circular (which stated that the claim was made in early December 2013).
19. Rule 703(1) obligates an issuer to announce any information known to the issuer concerning it or any of its subsidiaries or associated companies which:

- (a) is necessary to avoid the establishment of a false market in the issuer's securities; or
- (b) would be likely to materially affect the price or value of its securities.

20. In their response, Mr Tsoi Kin Chit and Mr Zhang Hong Lai stated that the Company received the claim from Jiangxi Longdu on 17 November 2013. In respect of the announcement on the customer claim which was made only one month later, they responded that if the Company releases some complaints without initial investigation and verification and issues another announcement afterward on what it announces, this is even more inappropriate and will cause confusion to the public.
21. If the Company had received the legal claim, it should have disclosed this significant claim promptly and updating the market on what actions the Company is taking. As the announcement of the significant customer claim of RMB 290 million was made only one month later, SGX is of the view that the Company failed to promptly disclose material information on 17 November 2013 in breach of Listing Rule 703(1). As Executive Directors of the Company, Mr Tsoi Kin Chit and Mr Zhang Hong Lai had caused the Company to breach Rule 703(1).

#### Breach of Listing Rule 719(1)

22. BDO noted, inter alia, in its report the following weaknesses in internal controls:-
- (a) Mr Tsoi Kin Chit is the sole director of Fulian and all decisions relating to Fulian were made by Mr Tsoi Kin Chit. Mr Tsoi Kin Chit is also the sole signatory of Fulian's bank account(s). Fulian should have at least two signatories to its bank accounts(s).
  - (b) The Management did not maintain any written records/correspondences with Jiangxi Longdu, Fujian Minhua Law Firm and Fujian Hua Tie.
  - (c) The Management did not obtain documentary evidence to substantiate the accuracy, veracity and/or reasonableness of the items listed in the List of Economic Losses.
  - (d) The Management did not obtain documentary evidence to demonstrate that Jiangxi Longdu had taken steps to mitigate its losses as well as documentary evidence to demonstrate that Jiangxi Longdu had compensated Mega Chinese for the cancellation of the contract.
23. Rule 719(1) states that "An issuer should have a robust and effective system of internal controls, addressing financial, operational and compliance risks. The audit committee (or such other committee responsible) may commission an independent audit on internal controls for its assurance, or where it is not satisfied with the systems of internal control".
24. BDO noted that it appears that limited information and instructions were given to Fujian Minhua Law Firm and their scope of work was also limited. In this regard, it appears that Fujian Minhua Law Firm might not have rendered an extensive legal advice to Fulian to mitigate Fulian's "exposure" in respect of the purported claim by Jiangxi Longdu. Fulian did not seek Fujian Minhua's Law Firm's assistance on, amongst others, their negotiation with Jiangxi Longdu's representative(s)/legal advisor(s), to dispute the items listed in the List of Economic Losses. BDO also noted that Fulian had also not sought legal advice on the extent of responsibility that Jiangxi Longdu would have to share for not carrying out any quality assurance tests on the dyed textile before mass production of the winter jackets. BDO also reported that it is not clear whether Fulian has sought advice from Fujian Minhua Law Firm as to how they could defend the purported claim by Jiangxi Longdu and/or minimise any loss Fulian might suffer arising from such purported claim. BDO had requested but management

had been unable to provide them with Fujian Minhua Law Firm's letter of engagement and working files in relation to the Legal Advice.

25. In response to the charges, Mr Tsoi Kin Chit and Mr Zhang Hong Lai submitted that they have provided all the available documents to BDO. They were also of the view that whether Jiangxi Longdu did compensate its customer or was insured was not relevant to the economic damages as the report by Fujian Huatie already stated clearly the basis of damages.
26. BDO reported serious lapses in internal control including the lack of written records/ correspondence and documentary evidence to substantiate the accuracy and veracity and/or reasonableness of the claims.
27. In light of the above, SGX is of the view that the failure by the Company to put in place a robust internal control to address financial, operational and compliance risks, is a breach of Listing Rule 719(1). As the Executive Directors of the Company, Mr Tsoi Kin Chit and Mr Zhang Hong Lai caused the Company to breach Listing Rule 719(1).

#### Failure of directors to act in the interest of the company and shareholders as a whole

28. Generally, directors are expected to act in the interest of the Company. BDO had noted in their Report that before entering into a settlement with Jiangxi Longdu, Mr Tsoi Kin Chit and Mr Zhang Hong Lai:
  - (a) Did not appoint a third party to carry out an independent quality assurance test to verify Jiangxi Longdu's claim relating to the defective dyed textile;
  - (b) Did not provide full information on Jiangxi Longdu's purported claim against Fulian to Fujian Minhua Law Firm and seek their advice on how to defend Fulian and mitigate Fulian's "exposure" to the purported claim;
  - (c) Did not engage a more renowned law firm/audit firm to re-assess Jiangxi Longdu's purported claim against Fulian in view that the purported claim was substantial even though this was required by the independent director;
  - (d) Did not request Fujian Hua Tie to comment on the accuracy, veracity and/or reasonableness of the items listed in the List of Economic Losses in the Appraisal Report;
  - (e) Did not obtain documents to support Jiangxi Longdu's claim of RMB1,510 per jacket for the alleged damage to 191,170 units.
  - (f) Did not obtain documentary evidence to substantiate the accuracy, veracity and/or reasonableness of the items amounting to RMB1,510 per jacket claimed by Jiangxi Longdu in the purported List of Economic Losses;
  - (g) Did not obtain documentary evidence from Jiangxi Longdu to demonstrate that Jiangxi Longdu had taken steps to mitigate its losses as well as documentary evidence to demonstrate that Jiangxi Longdu had compensated Mega Chinese for the cancellation of the contract;
29. BDO noted that based on the Chinese Circular, Jiangxi Longdu had informed Fulian about the defective dyed textile in early December 2013. If so, Jiangxi Longdu's Complaint would have been "out of time" as they had to make a complaint to Fulian within 30 days from 15 October 2013, 18 October 2013 and 20 October 2013 (dates of delivery) and the claims would not have been within the contractual timeframe. BDO also noted that the Management had not



required Fujian Hua Tie to check if the insurance policy that Jiangxi Longdu was supposed to purchase covered its purported claim against Fulian.

30. Mr Tsoi Kin Chit and Mr Zhang Hong Lai responded that the Company does not have any ability to pay the legal cost of over RMB 10 million for legal proceedings if Jiangxi Longdu insists on legal proceedings and the primary objective is to protect shareholders interests by avoiding winding up of the Company.
31. Directors of an issuer shall act in the interests of shareholders as a whole. Mr Tsoi Kin Chit, Mr Zhang Hong Lai and Mr Chen Chao Ying have a duty to protect and act in the interests of the Company and/or Fulian and shareholders of the Company as a whole. Mr Tsoi Kin Chit and Mr Zhang Hong Lai failed to exercise sufficient care and diligence to verify the veracity of the significant claims of RMB 290 million before paying off the amount. The payment of the claims depleted the Company's cash balance which amounted to RMB 292 million as at 30 September 2013. Based on BDO's findings which raise doubts about the veracity of the Jiangxi Longdu's claim, the Management had entered into the settlement agreement without supporting documents to substantiate the accuracy, veracity and/or reasonableness of the claim. In addition, limited information and instructions were given by the Management to Fujian Minhua Law Firm and their scope of work was also limited. BDO noted that Fujian Minhua Law Firm might not have rendered an extensive legal advice to Fulian to mitigate Fulian's "exposure" in respect of the purported claim by Jiangxi Longdu. Without taking reasonable steps to defend the Company and/or Fulian and mitigate the Company's and/or Fulian's "exposure in respect of the purported claim by Jiangxi Longdu, the consent to entering into the settlement agreement with Jiangxi Longdu, is against the interest of the shareholders, the Company and/or Fulian.
32. SGX notes that Mr Chen Chao Ying, although he is a Non-Executive Director and not involved in the day-to-day operation of the Company, had voted with Mr Tsoi Kin Chit and Mr Zhang Hong Lai for the settlement of the Claim without conducting proper due diligence and making the payments on the significant customer claims without supporting documents.
33. In light of the above, SGX is of the view that Mr Tsoi Kin Chit, Mr Zhang Hong Lai and Mr Chen Chao Ying have failed to act in the interests of shareholders as a whole.
34. SGX has referred the breaches to the appropriate authorities.

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