

Enquiry Report
Dahe Media Co., Ltd.
2007 Interim Financial Statements

Financial Reporting Review Committee (E01-07)

21 May 2008

This report has been adopted by the Financial Reporting Council on 29 May 2008 in accordance with section 47(3) of the Financial Reporting Council Ordinance.

TABLE OF CONTENTS

	<u>Paragraph</u>	
Executive summary		
1	Introduction	1.1 to 1.5
2	Details of complaints	2.1 to 2.8
3	Appointment of the FRRC	3.1 to 3.3
4	The enquiry approach	4.1 to 4.9
5	Accounting of Dahe Basu before appointment of liquidation committee	
5.1	Conclusion	5.1.1 to 5.1.3
5.2	Principal findings	5.2.1 to 5.2.4
5.3	Non-compliance with HKFRSs	5.3.1 to 5.3.7
5.4	Detailed findings	5.4.1 to 5.4.42
6	Accounting of Dahe Basu after appointment of liquidation committee	
6.1	Conclusion	6.1.1 to 6.1.3
6.2	Principal findings	6.2.1 to 6.2.4
6.3	Non-compliance with HKFRSs	6.3.1 to 6.3.10
6.4	Detailed findings	6.4.1 to 6.4.57

LIST OF ENCLOSURES

Notes concerning this report

This report relates to possible relevant non-compliance(s) by a listed entity as to whether a relevant financial report has not complied with an accounting requirement of a type specified under the Financial Reporting Council Ordinance (Cap.588).

Any references in this report to breaches of any law, regulation, financial reporting standard, practice or principle, or GEM Listing Rules should be understood in the context of that Ordinance only and pursuant to which this report was prepared.

This report, whenever it relates to the private rights of third parties between themselves, makes and implies no comment as to the rights and obligations, and the merits of the conduct, of these third parties as between themselves.

The enclosures are not published because they may contain non-public third party information.

Executive summary

Introduction

This report pertains to the enquiry conducted by the Financial Reporting Review Committee, reference E01-07, (the “FRRC”) pursuant to section 40(1)(b) of the Financial Reporting Council Ordinance (the “FRC Ordinance”) in relation to the condensed consolidated financial statements for the six months ended 30 June 2007 of Dahe Media Co., Ltd. (“Dahe Media”) (formerly known as “Nanjing Dahe Outdoor Media Co., Ltd.”) (the “Relevant Financial Statements”) prepared in accordance with Hong Kong Accounting Standard (“HKAS”) 34 *Interim Financial Reporting*.

Background

Dahe Media is a corporation listed on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited (stock code: 8243). Dahe Media is incorporated in the People’s Republic of China.

According to the Relevant Financial Statements, the profit of Dahe Media and its subsidiaries amounted to RMB 9 million for the six months ended 30 June 2007 and the consolidated net assets amounted to RMB 299 million as at 30 June 2007.

In the annual financial statements of Dahe Media for the year ended 31 December 2006, Chongqing Dahe Basu Media Co., Ltd. (“Dahe Basu”) was accounted for as a non-wholly owned subsidiary of Dahe Media. Dahe Media contributed 60 per cent of the registered capital of Dahe Basu. In the management discussion and analysis section of Dahe Media’s 2006 annual report, it mentioned that the loss incurred by Dahe Basu led to the reduction in consolidated profit of RMB 5.5 million. The profit reported in the 2006 annual consolidated financial statements amounted to RMB 17 million.

A liquidation committee was established under a court order to dissolve Dahe Basu on 15 May 2007. The liquidation was a voluntary non-bankruptcy liquidation.

On 26 March 2008, Dahe Media published its annual report for the year ended 31 December 2007. The auditor expressed an “except for” opinion in respect of the financial statements for the year ended 31 December 2007 arising from limitation of scope and disagreement about accounting treatments in relation to the investment in Dahe Basu.

Details of complaints

The Financial Reporting Council (the “Council”) received two complaints. The first complaint was received from a regulator on 16 August 2007. Another complaint was received from the public on 20 August 2007. The subject matter of the first complaint is similar to one of the elements of the second complaint. The Council therefore consolidated both complaints for reviewing purpose.

The allegations of the complaints are related to the accounting treatment of Dahe Basu in the consolidated financial information of Dahe Media for the three months ended 31 March 2007 and the Relevant Financial Statements.

Quarterly financial information for the three months ended 31 March 2007 is outside the remit of the Council. The enquiry, therefore, only focuses on the Relevant Financial Statements.

Appointment of FRRC

On 31 October 2007, the Council resolved the appointment of an FRRC to conduct an enquiry into the relevant non-compliance and the question whether or not there is such a non-compliance in relation to the Relevant Financial Statements. The FRRC comprised of five members, including the chairman.

Terms of reference of the FRRC

The terms of reference approved by the Council are:

- (a) To enquire into the question whether or not the investment in Dahe Basu has been properly classified and accounted for in accordance with the requirements under Hong Kong Financial Reporting Standards (“HKFRSs”) issued by the Hong Kong Institute of Certified Public Accountants in preparing the Relevant Financial Statements included in the interim report and whether or not this gives rise to a relevant non-compliance with reference to the FRC Ordinance and to record such facts.
- (b) To exercise the powers under Division 2 of Part 4 of the FRC Ordinance and such other powers as may be delegated from time to time by the Council.
- (c) To form an opinion on whether and why there is a relevant non-compliance and how this non-compliance should be rectified.
- (d) To report to the Council the findings of the enquiry and to make recommendations for future actions.

Relevant HKFRSs

The HKFRSs effective during the period covered by the Relevant Financial Statements and relevant to the findings of the potential non-compliances are:

HKAS 27	Consolidated and Separate Financial Statements
HKAS 34	Interim Financial Reporting
HKAS 39	Financial Instruments: Recognition and Measurement

Principal Findings

The FRRC considers Dahe Media, being the majority shareholder holding 60 per cent of the equity interest in Dahe Basu, was able to control Dahe Basu up to 14 May 2007, before the Dahe Basu liquidation committee was established. The FRRC has concluded that Dahe Media did not account for Dahe Basu as a subsidiary in accordance with HKAS 27 in the Relevant Financial Statements up to the date Dahe Media ceased to have control over Dahe Basu.

The FRRC believes that Dahe Media was unable to exercise control, joint control or significant influence over the investment in Dahe Basu after the liquidation committee was appointed by the court on 15 May 2007. The FRRC has concluded that Dahe Media failed to deconsolidate Dahe Basu on the date it ceased to have control in accordance with HKAS 27 and account for the investment in Dahe Basu as a financial asset (more specifically, as

available-for-sale financial assets) in accordance with HKAS 39 in the Relevant Financial Statements.

In the 2007 annual financial statements issued on 26 March 2008, Dahe Media admitted the non-compliance with HKAS 27 and accounted for the investment in Dahe Basu as an available-for-sale financial asset from 15 May 2007 onwards. However, it did not perform an impairment assessment for the financial asset.

Recommendations

The FRRC recommends the Council to give a written notice under section 49 of the FRC Ordinance (the “Section 49 Notice”) to Dahe Media to ask it to exhaust all reasonable means to obtain sufficient information for the accounting of Dahe Basu in the Relevant Financial Statements and at least apply formally to the Dahe Basu liquidation committee and the relevant court in order to obtain accounting records and financial information of Dahe Basu for the period from 1 January 2007 to 30 June 2007.

The FRRC also recommends that, if Dahe Media was able to obtain sufficient information of Dahe Basu, the Council could decide whether or not to issue a notice to secure removal of the non-compliances and revise the Relevant Financial Statements by:

- consolidating the investment in Dahe Basu in the Relevant Financial Statements in accordance with HKAS 27 for the period from 1 January 2007 to 14 May 2007; and
- account for the investment in Dahe Basu as an available-for-sale financial asset in accordance with HKAS 39 from 15 May 2007 to 30 June 2007.

Comments on enquiry report from Dahe Media

The draft enquiry report was sent to Dahe Media for review and comment on 22 April 2008. In the reply letter of 5 May 2008, Dahe Media stated that it had appointed a law firm in 2007 to deal with the liquidation of Dahe Basu and applied to court and liquidation committee to obtain financial information of Dahe Basu but the applications were rejected. Dahe Media also stated that since there is a representative of Dahe Media in the liquidation committee, it is aware of the latest development of the liquidation of Dahe Basu but it did not have the right to obtain financial information from the liquidation committee. Nevertheless, Dahe Media agreed to submit written applications to the liquidation committee of Dahe Basu and the relevant court in order to obtain the financial information of Dahe Basu as recommended in page 3 of this report. The result of the application was not known as at the date of this report.

Section 1 Introduction

1.1 General

- 1.1.1 This report pertains to the enquiry conducted by the Financial Reporting Review Committee (the “FRRC”) pursuant to section 40(1)(b) of the Financial Reporting Council Ordinance (the “FRC Ordinance”) in relation to the condensed consolidated financial statements for the six months ended 30 June 2007 of Dahe Media Co., Ltd. (“Dahe Media”) (formerly known as “Nanjing Dahe Outdoor Media Co., Ltd.”) (the “Relevant Financial Statements”).
- 1.1.2 The Council received two complaints in relation to Dahe Media. The first complaint was received from a regulator on 16 August 2007. Another complaint was received from the public on 20 August 2007.
- 1.1.3 The subject matter of the first complaint is similar to one of the elements of the second complaint. The Council therefore consolidated both complaints for reviewing purpose. The allegations of the complaints are related to the accounting treatment of Chongqing Dahe Basu Media Co., Ltd. (“Dahe Basu”) in the consolidated financial information of Dahe Media for the three months ended 31 March 2007 and the Relevant Financial Statements.

1.2 Background information

- 1.2.1 Dahe Media is a corporation listed on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited (stock code: 08243). Dahe Media and Dahe Basu are incorporated in the People’s Republic of China (the “PRC”).
- 1.2.2 The financial information of Dahe Media for the three months ended 31 March 2007 was prepared in accordance with the relevant requirements set out in the Rules Governing the Listing of Securities on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited (“GEM Rules”). The Relevant Financial Statements were prepared in accordance with Hong Kong Accounting Standard (“HKAS”) 34 *Interim Financial Reporting* and related GEM Rules.
- 1.2.3 According to the Relevant Financial Statements, the profit of Dahe Media and its subsidiaries amounted to RMB 9 million for the six months ended 30 June 2007 and the consolidated net assets amounted to RMB 299 million as at 30 June 2007. The interim financial report of Dahe Media is enclosed. (Annex 3A/3A.1)
- 1.2.4 In the management discussion and analysis section of Dahe Media’s 2006 annual report, it mentioned that the loss incurred by Dahe Basu led to the reduction in consolidated profit of RMB 5.5 million. The profit reported in the 2006 annual consolidated financial statements amounted to RMB 17 million.
- 1.2.5 On 26 March 2008, Dahe Media published its annual consolidated financial statements for the year ended 31 December 2007 (the “2007 Financial Statements”). The profit for the year was RMB 21 million. The investment in Dahe Basu was deconsolidated and transferred to available-for-sale financial asset on 15 May 2007 at the carrying amount of the net assets of Dahe Basu attributable to Dahe Media as at 31 December 2006. As at 31 December 2007, the available-for-sale financial asset was carried at RMB 20 million on the consolidated balance sheet.

1.2.6 The auditor expressed an “except for” opinion arising from limitation of scope and disagreement of accounting treatment in respect of the following items:

- (a) Non-consolidation of Dahe Basu from 1 January 2007 to 14 May 2007 which is not in accordance with HKAS 27.
- (b) The auditor was unable to carry out sufficient audit procedures to obtain reasonable assurance regarding the measurement of the initial cost of the available-for-sale financial asset.
- (c) In the absence of reliable financial information of Dahe Basu, the auditor is unable to satisfy itself as to whether any impairment provision is required for the investment in Dahe Basu which was accounted for as an available-for-sale financial asset (RMB 20 million) and the amount due from Dahe Basu (RMB 1.5 million).

1.3 Appointment of FRRC

1.3.1 For the purpose of assessing the complaints and to decide whether or not an enquiry should be initiated, the Secretariat of the Council (the “Secretariat”), under the direction of the Council, issued two inquiry letters to Dahe Media to collect additional information.

1.3.2 On 31 October 2007, having considered the information supplied by the complainants and Dahe Media, the Council resolved the appointment of an FRRC referred to as the FRRC hereinafter (meaning the FRRC E01-07), to conduct an enquiry into the relevant non-compliance and the question whether or not there is such a non-compliance with regard to the Relevant Financial Statements. The appointment of the FRRC and the terms of reference are set out in section 3.

1.4 The enquiry

1.4.1 Three FRRC meetings were held on 7 November 2007, 15 February 2008 and 31 March 2008 respectively. The FRRC issued a requirement under section 43(1) of the FRC Ordinance to Dahe Media following each of the first two meetings. The accounting issues, findings and analysis are discussed in sections 5 to 6.

1.4.2 Most of the explanation and information provided by Dahe Media are in Chinese. The Secretariat had either translated the materials into English or prepared summaries as appropriate for the purpose of the FRRC and the English version of this report. The original records and documents provided by Dahe Media, together with the translations and summaries are enclosed as Annexes to this report.

1.4.3 The persons named in this report who may be adversely affected by publication of the report have been given a reasonable opportunity of being heard in accordance with section 47(4) of the FRC Ordinance. The draft enquiry report was sent to Dahe Media on 22 April 2008. Its comments were received on 5 May 2008 and incorporated in paragraphs 5.4.41 to 5.4.42 and 6.4.55 to 6.4.57 of this report.

1.5 Abbreviations

Council	Financial Reporting Council
FRRC	Financial Reporting Review Committee (E01-07)
FRC Ordinance	Financial Reporting Council Ordinance
Dahe Media	Dahe Media Co., Ltd.
Dahe Basu	Chongqing Dahe Basu Media Co., Ltd.
Basu Art	Chongqing Basu Art and Media Co.
Relevant Financial Statements	Condensed consolidated financial statements of Dahe Media for the six months ended 30 June 2007
2007 Financial Statements	Consolidated financial statements of Dahe Media for the year ended 31 December 2007
GEM Rules	Rules Governing the Listing of Securities on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited
HKAS	Hong Kong Accounting Standard
HKFRSs	Hong Kong Financial Reporting Standards
PRC	People's Republic of China
Secretariat	Secretariat of the Council

Section 2 Details of complaints

- 2.1 The Council received two complaints in relation to Dahe Media. Because the subject matters of both complaints are similar, the Council has therefore consolidated both complaints for reviewing purpose. The complaints are enclosed for reference. (Annex 1A and 1B/1C)
- 2.2 The allegations set out in the complaints are summarized as follows:
- (a) Non-consolidation of Dahe Basu in the financial information of Dahe Media for the three months ended 31 March 2007 and the Relevant Financial Statements;
 - (b) Misleading clarification announcement issued by Dahe Media on 26 July 2007 (Annex 3B/3B.1) in relation to the liquidation of Dahe Basu;
 - (c) Overstatement of Dahe Basu's results for the period from 2004 to 2005 by capitalising certain expenses which should be otherwise charged to profit or loss;
 - (d) No announcement or disclosure in Dahe Media's 2006 annual consolidated financial statements regarding (i) the petition to wind up Dahe Basu (Annex 1B/1C Appendix 7), (ii) certain assets of Dahe Basu were being frozen or held under custody of court as at 31 December 2006; and (iii) a mediation agreement was reached between Dahe Media and Basu Art in March 2007 to dissolve Dahe Basu (Annex 1B/1C Appendix 8).
- 2.3 For 2.2 (a), the quarterly financial report does not satisfy the definition of relevant financial report defined in Schedule 1 to the FRC Ordinance and is outside the remit of the FRC Ordinance. Accordingly, no action has been taken by the Council in this respect. However, the Council has jurisdiction over the half-yearly financial report for the six months ended 30 June 2007.
- 2.4 Regarding the disclosure deficiencies in the 2006 annual consolidated financial statements and the failure to issue an announcement to inform investors concerning the wind-up petition filed by Basu Art (see 2.2 (d)), the Council considered re-issuing the 2006 annual consolidated financial statements may not be necessary as long as an announcement was issued to inform investors of such facts, which Dahe Media has done. (Annex 3D/3D.1)
- 2.5 Issuance of announcement (see 2.2(b) & (d)) is governed by the GEM Rules. The Council has referred the relevant allegations to The Stock Exchange of Hong Kong Limited.
- 2.6 In order to assess whether or not the other allegations represent relevant non-compliances, the Secretariat has sent two inquiry letters to Dahe Media to collect additional information. Dahe Media replied on 8 October 2007 (Annex 4B) and 22 October 2007 (Annex 4D) respectively.
- 2.7 After reviewing all the available information, the Council considered the non-consolidation of Dahe Basu in the Relevant Financial Statements appears to be a relevant non-compliance (see 2.2(a)). The Council decided to appoint an FRRC to perform the enquiry.

2.8 In relation to other allegations with minor financial impact, the Council decided not to take further action.

Section 3 Appointment of the FRRC

- 3.1 On 31 October 2007, the Council appointed an FRRC in accordance with section 40(1)(b) of the FRC Ordinance for the purpose of enquiring into the relevant non-compliance and the question whether or not there is such a non-compliance with regard to the Relevant Financial Statements.
- 3.2 The FRRC consists of the following members:-
1. Dr. LI Ka-cheung Eric (Chairman)
 2. Ms. CHAU Suet Fung Dilys
 3. Prof. CHEUNG Yan Leung Stephen, JP.
 4. Mr. LEES John Robert, and
 5. Mr. Stephen TAYLOR
- 3.3 The terms of reference approved by the Council are:
- (a) To enquire into the question whether or not the investment in Dahe Basu has been properly classified and accounted for in accordance with the requirements under Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants in preparing the Relevant Financial Statements included in the interim report and whether or not this gives rise to a relevant non-compliance with reference to the FRC Ordinance and to record such facts.
 - (b) To exercise the powers under Division 2 of Part 4 of the FRC Ordinance and such other powers as may be delegated from time to time by the Council.
 - (c) To form an opinion on whether and why there is a relevant non-compliance and how this non-compliance should be rectified.
 - (d) To report to the Council the findings of the enquiry and to make recommendations for future actions.

Section 4 The enquiry

- 4.1 The first FRRC meeting was held on 7 November 2007 to discuss the case of Dahe Media.
- 4.2 The following accounting issues were identified during the first FRRC meeting in relation to the Relevant Financial Statements:
 - (a) Accounting of Dahe Basu in the Relevant Financial Statements for the period before the appointment of the liquidation committee (see section 5);
 - (b) Accounting of Dahe Basu in the Relevant Financial Statements for the period after the appointment of the liquidation committee (see section 6); and
 - (c) Impairment assessment of Dahe Basu for the preparation of the Relevant Financial Statements (see section 6).
- 4.3 A requirement was sent to Dahe Media on 13 November 2007 based on the issues identified during the first FRRC meeting (Annex 5A). Dahe Media replied on 27 November 2007 (Annex 5B/5B.1 to 5D/5D.1) and 11 December 2007 (Annex 5E/5E.1 to 5J/5J.1) respectively. To further clarify the explanation, the Secretariat sent another letter to Dahe Media on 18 December 2007 (Annex 5K/5K.1). A reply was received on 4 January 2008 (Annex 5L/5L.1).
- 4.4 With the agreement of the FRRC, the Secretariat made enquiries with a law firm on the representation of Dahe Media in relation to the roles, power and operation of the liquidation committee under the PRC legal environment.
- 4.5 The second FRRC meeting was held on 15 February 2008 to discuss the information and explanation provided by Dahe Media in response to the FRRC's requirement dated 13 November 2007 and the reply provided by the lawyers.
- 4.6 A requirement was sent to Dahe Media on 28 February 2008 based on the issues identified during the second FRRC meeting (Annex 5M/5M.1). Dahe Media replied on 13 March 2008 (Annex 5N/5N.1).
- 4.7 On 31 March 2008, the third FRRC meeting was held. Members discussed the explanations received from Dahe Media in response to the requirement of 28 February 2008 and the 2007 Financial Statements issued by Dahe Media on 26 March 2008. Members concluded the findings of the enquiry and determined the recommendations to be made to the Council. Members which instructed the Secretariat to prepare a draft of this report.
- 4.8 The draft of the report was sent to Dahe Media for comment on 22 April 2008. Comments received from Dahe Media were incorporated in the report. The final report is approved by FRRC members by circulation of papers on 21 May 2008.
- 4.9 A discussion of the findings and analysis is in sections 5 and 6.

Section 5 Accounting of Dahe Basu before appointment of liquidation committee

5.1 Conclusion

- 5.1.1 Based on the results of the enquiry, the FRRC concludes that there is a relevant non-compliance as defined in section 5 of the FRC Ordinance in relation to the Relevant Financial Statements in respect of the accounting of Dahe Basu from 1 January 2007 to the date before a liquidation committee was established to dissolve Dahe Basu, i.e. 14 May 2007.
- 5.1.2 The non-compliance refers to the failure to consolidate Dahe Media's investment in Dahe Basu in the Relevant Financial Statements in accordance with HKAS 27 *Consolidated and Separate Financial Statements* ("HKAS 27") up to the date Dahe Media ceased to have control over Dahe Basu, i.e. the date of appointment of the liquidation committee.
- 5.1.3 The FRRC recommends the Council to give a written notice under section 49 of the FRC Ordinance to Dahe Media to ask Dahe Media to exhaust all reasonable means to obtain sufficient information for the consolidation of Dahe Basu in the Relevant Financial Statements and at least apply formally to the Dahe Basu liquidation committee and the relevant court in order to obtain accounting records and financial information of Dahe Basu for the purpose of the consolidation of Dahe Basu in the Relevant Financial Statements.

If Dahe Media was able to obtain sufficient information of Dahe Basu, the Council could decide whether or not to issue a notice to secure removal of the non-compliance and revise the Relevant Financial Statements by consolidating the investment in Dahe Basu in the Relevant Financial Statements in accordance with HKAS 27 for the period from 1 January 2007 to 14 May 2007.

5.2 Principal findings

- 5.2.1 In the Relevant Financial Statements, Dahe Media deconsolidated Dahe Basu on 1 January 2007 and transferred the carrying amount of the net assets of Dahe Basu attributable to Dahe Media to "long term investments", classified under "other intangible assets". There was no other adjustment made to the carrying amount of the investment in Dahe Basu during the six months ended 30 June 2007.
- 5.2.2 The FRRC considers Dahe Media, being the majority shareholder holding 60 per cent of the equity interest in Dahe Basu, should have been able to control Dahe Basu until 14 May 2007. Dahe Basu should have been accounted for as a subsidiary in accordance with HKAS 27 in the Relevant Financial Statements until Dahe Media ceased control on 15 May 2007.
- 5.2.3 Dahe Media confirmed that Dahe Basu was its subsidiary up to 14 May 2007 and it failed to account for Dahe Basu by consolidation as required under HKAS 27 in the Relevant Financial Statements. However, it did not agree to rectify the non-compliance due to lack of information.
- 5.2.4 In the 2007 Financial Statements, Dahe Media stated that Dahe Basu was its subsidiary up to 14 May 2007. It admitted that the failure to consolidate the financial information of Dahe Basu from 1 January 2007 to 14 May 2007 in the 2007 Financial Statements was not in accordance with HKAS 27.

5.3 Non-compliance with HKFRSs

- 5.3.1 The FRRC is of the opinion that Dahe Media failed to comply with the following HKFRSs in preparing the Relevant Financial Statements.
- 5.3.2 Paragraph 28 of HKAS 34, *Interim Financial Reporting* (“HKAS 34”), states “an entity shall apply the same accounting policies in its interim financial statements as are applied in its annual financial statements, except for accounting policy changes made after the date of the most recent annual financial statements that are to be reflected in the next annual financial statements.”
- 5.3.3 The Relevant Financial Statements were condensed consolidated financial statements prepared in accordance with HKAS 34. Therefore, Dahe Media should apply the same accounting policies as were applied in preparing the annual consolidated financial statements for the year ended 31 December 2006 which complied with other relevant HKFRSs. Hence, the following non-compliances are referenced to the specific HKFRSs that govern the accounting of the specific transactions.
- 5.3.4 Paragraph 4 of HKAS 27 states that “a subsidiary is an entity, including an unincorporated entity such as a partnership, that is controlled by another entity (known as the parent).” “Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.”
- 5.3.5 Paragraph 9 of HKAS 27 states that “a parent, other than a parent described in paragraph 10, shall present consolidated financial statements in which it consolidates its investments in subsidiaries in accordance with this Standard.”
- 5.3.6 Dahe Media confirmed that Dahe Basu was a subsidiary of Dahe Media until 14 May 2007 as defined in paragraph 4 of HKAS 27. However, it did not consolidate its investment in Dahe Basu in accordance with paragraph 9 of HKAS 27 due to lack of information.
- 5.3.7 Dahe Media did not consolidate the investment in Dahe Basu in the 2007 Financial Statements and admitted it was a non-compliance with HKAS 27. The auditor also expressed a disagreement about accounting treatment in this respect.

5.4 Detailed findings

A. Background

- 5.4.1 Dahe Basu was established by Dahe Media and Basu Art in April 2004. Dahe Media and Basu Art contributed 60 per cent and 40 per cent of the registered capital of Dahe Basu respectively. Since the establishment of Dahe Basu, Dahe Media classified Dahe Basu as its subsidiary and consolidated the results of Dahe Basu up to 31 December 2006.
- 5.4.2 A liquidation committee was appointed by Chongqing No. 5 Intermediate People's Court on 15 May 2007 to dissolve Dahe Basu (Appendix 2 to Annex 1B/1C and Annex 4B). A chronology of major events is enclosed (Annex 2).
- 5.4.3 In preparing the Relevant Financial Statements, Dahe Media ceased consolidation of Dahe Basu from 1 January 2007 onwards and admitted the failure to consolidate Dahe Basu in the Relevant Financial Statements up to 14 May 2007 was not in accordance with HKAS 27. It had also issued two clarification announcements (Annex 3C/3C.1 and 3D/3D.1) to state this fact.
- 5.4.4 Except for a statement saying that Dahe Basu was excluded from the financial data in the interim financial report, there was no disclosure in the Relevant Financial Statements (Annex 3A/3A.1) which describes the accounting treatment of Dahe Media's interest in Dahe Basu.
- 5.4.5 In the subsequent clarification announcements (Annex 3C/3C.1 and 3D/3D.1), Dahe Media admitted the non-compliances but did not explain the accounting treatment applied in the Relevant Financial Statements.
- 5.4.6 In the 2007 Financial Statements, Dahe Media disclosed in the notes that Dahe Basu was a subsidiary up to 14 May 2007 but that it was unable to consolidate Dahe Basu's results because Dahe Media had no access to the books and records of Dahe Basu. Instead, Dahe Media de-consolidated the financial position of Dahe Basu from the consolidated financial statements from 1 January 2007 and accounted for the investment in Dahe Basu as an available-for-sale financial asset. The auditor expressed an "except for" opinion arising from disagreement of accounting treatment in relation to the non-consolidation of Dahe Basu from 1 January 2007 to 14 May 2007.

B. Accounting issues

- 5.4.7 There are two accounting issues:
- (a) whether or not Dahe Basu was a subsidiary of Dahe Media up to the date before the Dahe Basu liquidation committee was appointed, i.e. 14 May 2007, in accordance with the definition set out in HKAS 27; and
 - (b) whether or not Dahe Media failed to account for its interest in Dahe Basu in the Relevant Financial Statements up to the date before the Dahe Basu liquidation committee was appointed, i.e. 14 May 2007, in accordance with relevant HKFRSs.

C. Classification of the investment in Dahe Basu

Explanation and documents provided by Dahe Media

- 5.4.8 In order to determine the relationship between Dahe Media and Dahe Basu in the Relevant Financial Statements before appointment of the liquidation committee, on 13 November 2007 the FRRC required (Annex 5A) Dahe Media to provide the following information and explanation:-
- (a) Confirmation of the information and explanation provided in the reply letter dated 8 October 2007 (Annex 4B). This reply letter was received before the initiation of the enquiry in response to the Secretariat's inquiry letter dated 31 August 2007 (Annex 4A). (See 5.4.9 to 5.4.10)
 - (b) Accounting treatment of Dahe Basu, including (see 5.4.15 to 5.4.20):
 - (i) Clarification on whether or not the assets and liabilities of Dahe Basu have been included in Dahe Media's condensed consolidated balance sheet as at 30 June 2007 which is included in the Relevant Financial Statements;
 - (ii) Reconciliation of the amounts of the assets and liabilities of Dahe Basu included in Dahe Media's consolidated balance sheet as at 31 December 2006 to the amounts as at 30 June 2007 identified under (i);and
 - (iii) Explanation on the movements identified in (ii).
 - (c) Original or certified true copy of the following records or documents:
 - (i) Co-operation agreement of Dahe Basu and any subsequent amendments and Articles of Association of Dahe Basu or equivalent (see 5.4.11 to 5.4.14).

Confirmation of previous reply letter

- 5.4.9 In the reply dated 27 November 2007 (Annex 5B/5B.1), Dahe Media confirmed the information and explanation set out in the reply letter dated 8 October 2007.
- 5.4.10 In the reply letter dated 8 October 2007 (Annex 4B), Dahe Media confirmed that it was able to control Dahe Basu up to the date the liquidation committee was appointed and agreed that non-consolidation of Dahe Basu in the Relevant Financial Statements was a non-compliance with HKAS 27. An extract of the reply is set out below:-

“with respect of the period where the Company was able to control the financial and operating activities of Dahe Basu in 2007, i.e. period from 1 January 2007 to 15 May 2007, we agree that non-consolidation of financial statements of Dahe Basu was a non-compliance with HKAS 27”

Co-operation agreement and Articles of Association of Dahe Basu

- 5.4.11 In the written reply (Annex 5B/5B.1) of 27 November 2007, Dahe Media enclosed copies of the co-operation agreement (Annex 5C.1), capital contribution agreement (Annex 5C.2) and Articles of Association (Annex 5C.3) of Dahe Basu.
- 5.4.12 A summary of the co-operation agreement, Articles of Association and capital contribution agreement and translation of the relevant sections are enclosed (Annex 5C).

- 5.4.13 As set out in the Articles of Association, the shareholders' meeting is the highest governing body of Dahe Basu. It is noted that the duties and obligations of the shareholders' meeting cover all the major operational and financial policies of Dahe Basu. A resolution of the shareholders' meeting shall be passed if the resolution is agreed by shareholders with more than 50 per cent of the registered capital except for a few items which require the approval of shareholders with more than two thirds of the registered capital. Those items are changes to registered capital, issue of debentures, mergers and acquisitions, liquidation and amendments to the Articles of Associations. All other matters, including operation and investment plans, financial budgets, remuneration matters and reports prepared by directors and supervisors, shall be approved by shareholders with more than 50 per cent of the registered capital.
- 5.4.14 As Dahe Media owned 60 per cent of the registered capital of Dahe Basu, it appears to the FRRC that Dahe Media had the power to control Dahe Basu according to the terms set out in the Articles of Association.

Accounting treatment of Dahe Basu in the Relevant Financial Statements

- 5.4.15 Dahe Media also confirmed in the reply dated 11 December 2007 (Annex 5E/5E.1) that the carrying amounts of the assets and liabilities of Dahe Basu were not consolidated in the Relevant Financial Statements.
- 5.4.16 On 18 December 2007, the Secretariat sent a follow-up letter (Annex 5K/5K.1) to Dahe Media. In the letter, Dahe Media was requested to provide further clarification about the accounting treatment of the interest in Dahe Basu in the Relevant Financial Statements.
- 5.4.17 In response to the Secretariat's follow-up letter of 18 December 2007, Dahe Media replied in writing (Annex 5L/5L.1) on 2 January 2008 and confirmed that the assets and liabilities of Dahe Basu were not consolidated in the Relevant Financial Statements. Instead, the carrying amount of the net assets in Dahe Basu attributable to Dahe Media i.e. 60 per cent of the net assets of Dahe Basu, was recognised as long term investments and included as "other intangible assets" on the condensed consolidated balance sheet as at 30 June 2007. There was no other adjustment. A translation of an extract of the reply is set out below:-

"The figures as at 31 December 2006 include the assets and liabilities of Chongqing Dahe Basu Media Co., Ltd. ("Dahe Basu"), whereas the figures as at 30 June 2007 do not include the assets and liabilities of Dahe Basu. The 60% shareholding of Dahe Basu held by Dahe Media (shareholding as at 31 December 2006) is included in long-term investment, which is categorised as other intangible assets. The assets and liabilities of Dahe Basu are not consolidated when preparing the interim consolidated financial statements, therefore, there is no related accounting adjustment."

- 5.4.18 According to the Relevant Financial Statements, the carrying amounts of other intangible assets held by Dahe Media and its subsidiaries as at 31 December 2006 and 30 June 2007 were RMB 3.4 million and RMB 16.7 million respectively. The FRRC was not aware of any disclosure explaining the accounting treatment of the interest in Dahe Basu in the Relevant Financial Statements.

- 5.4.19 On 28 February 2008, the FRRC required (Annex 5M/5M.1) Dahe Media to provide the reason for not disclosing the accounting policy applied to account for the interest in Dahe Basu and the basis of applying such accounting policy set out in 5.4.17.
- 5.4.20 A translation of an extract of the reply from Dahe Media dated 13 March 2008 (Annex 5N/5N.1) is set out below:

“Dahe Media is not familiar with the accounting standards in Hong Kong and has not experienced similar situation previously. Dahe Media considers treating the long term equity investment under “other intangible assets”, which was a line item reported in the 2006 financial report, is most appropriate.”

Accounting treatment of Dahe Basu in the 2007 Financial Statements

- 5.4.21 On 26 March 2008, Dahe Media issued the annual report for the year ended 31 December 2007. The accounting treatment of Dahe Basu was explained in note 2 to the 2007 Financial statements as follows:

“Notwithstanding that Dahe Basu was a subsidiary of the Company for the period from 1st January, 2007 to 14th May, 2007 (the “Period”), the Minority Owner was responsible for the daily operations and preparation of part of certain books and records of Dahe Basu during the Period, and the Group had no access to the books and records of Dahe Basu for the purpose of obtaining the relevant financial information of Dahe Basu to consolidate its results for the Period into the Group’s consolidated financial statements for the year. Accordingly, the Group de-consolidated the results and financial position of Dahe Basu from the Group’s consolidated financial statements from 1st January, 2007, and accounted for the Group’s investment in Dahe Basu as an available-for-sale financial asset. The Group’s attributable share of the net assets of Dahe Basu as at 31st December, 2006 was deemed as the initial cost of the available-for-sale financial asset as from 15th May, 2007. Moreover, the Group has also recorded an amount due from Dahe Basu pursuant to the above de-consolidation of assets and liabilities of Dahe Basu.”

Analysis

- 5.4.22 Paragraph 4 of HKAS 27 states that “a subsidiary is an entity, including an unincorporated entity such as a partnership, that is controlled by another entity (known as the parent).” “Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.”
- 5.4.23 Paragraph 9 of HKAS 27 states that “a parent, other than a parent described in paragraph 10, shall present consolidated financial statements in which it consolidates its investments in subsidiaries in accordance with this Standard.”
- 5.4.24 Based on the terms set out in the Articles of Association (see 5.4.13), shareholders were responsible for making decisions concerning operating and financial policies of Dahe Basu. In most cases, a resolution could be passed if it was approved by shareholder with more than 50 per cent of the registered capital. Since Dahe Media owned 60 per cent of the registered capital, it appears to the FRRC that Dahe Media had the power and was able to govern the financial and operating policies of Dahe Basu before the liquidation committee was appointed. Dahe Media management also confirmed that it was able to control Dahe Basu before appointment of the liquidation committee and agreed that the non-consolidation of Dahe Basu in the Relevant

Financial Statements was a non-compliance with HKAS 27 (see 5.4.10). The same information was also confirmed and disclosed in note 2 to the 2007 Financial Statements (see 5.4.21).

- 5.4.25 The explanation provided by Dahe Media to support the accounting of the investment in Dahe Basu as a long term investment and reported under “other intangible assets” (see 5.4.20) was inappropriate. As the preparer of the financial statements, the directors of Dahe Media had the primary obligation to prepare a set of financial statements which complied with relevant financial reporting standards.

D. Dahe Media’s ability to obtain financial information of Dahe Basu

Explanation and documents provided by Dahe Media

- 5.4.26 In order to determine whether or not Dahe Media was able to collect information of Dahe Basu for accounting purpose, on 13 November 2007 the FRRC required (Annex 5A) Dahe Media to provide:-

- (a) Confirmation of the information and explanation provided in the reply letter dated 22 October 2007 (Annex 4D). This reply letter was received before the initiation of the enquiry in response to the Secretariat’s inquiry letter dated 11 October 2007 (Annex 4C) (see 5.4.27 to 5.4.28);
- (b) Explanation on whether or not Dahe Media has taken any actions to exercise the “legal” right of control over Dahe Basu as indicated in the reply letter dated 22 October 2007 (Annex 4D) and the details of such actions (see 5.4.29); and
- (c) Original or certified true copy of records or documents that support the contention that Dahe Media was unable to obtain the financial information of Dahe Basu from 1 January 2007 to 15 May 2007, such as (see 5.4.30 to 5.4.35):
 - Meeting notes and correspondence between Dahe Media, Dahe Basu and Basu Art in relation to the operation and financing policies of Dahe Basu;
 - Minutes of board of directors of Dahe Basu;
 - Records or documents to support the actions taken by Dahe Media identified in item (b).

Confirmation of previous reply letter

- 5.4.27 In the reply dated 27 November 2007 (Annex 5B/5B.1), Dahe Media confirmed the information and explanation set out in the reply letter dated 22 October 2007.

- 5.4.28 In the reply letter dated 22 October 2007 (Annex 4D), Dahe Media clarified that there was no legal restriction that prevented Dahe Media from obtaining financial information of Dahe Basu. However, according to Dahe Media, it was then unable to obtain sufficient information because Basu Art seized all the accounting records of Dahe Basu without Dahe Media’s consent and refused to release information to it. An extract of the reply (Annex 4D) is set out below:-

“in or around the year end of 2006, the 40% Owner of Dahe Basu (Basu Art) has taken away the accounting records of Dahe Basu without the consent of the Company.

The Company initially only has a limited portion of accounting records which are not

sufficient for preparation of its consolidated financial statements for the year ended 31 December 2006. After a series of discussion with the 40% Owner of Dahe Basu (Basu Art), the Company successfully procured the 40% Owner of Dahe Basu (Basu Art) to provide financial information of Dahe Basu to the Company for the purpose of annual audit of the Company's consolidated financial statements for the year ended 31 December 2006. After that, the 40% Owner of Dahe Basu (Basu Art) refused to release further information to the Company. Although there is no legal restriction for the Company to obtain the information, the 40% Owner of Dahe Basu (Basu Art) did not cooperate.”

Actions taken by Dahe Media to exercise the control over Dahe Basu

5.4.29 In the further reply dated 11 December 2007 (Annex 5E/5E.1) in response to the FRRC's requirement dated 13 November 2007, Dahe Media explained the actions taken by it in order to re-gain control over Dahe Basu. A translation of an extract of the reply is set out below:-

“After the dispute between the other shareholder of Chongqing Dahe Basu Media Co., Ltd. (“Dahe Basu”) – Chongqing Basu Art and Media Co (“Basu Art”) and Dahe Media, the Company had immediately restructured the board of directors of Dahe Basu and required the resignation of the director appointed by Basu Art. At the same time, Dahe Media held meetings with Basu Art and requested Basu Art to hand over the registration document of Dahe Basu. We enclosed the relevant minutes of board of directors' meeting and other relevant documents for your reference.”

5.4.30 Dahe Media also provided copies of the following documents in the reply dated 11 December 2007 as evidence of the actions taken to re-gain control over Dahe Basu:-

- (a) minutes of Dahe Basu's board of directors meeting dated 23 January 2006 in relation to the resignation and appointment of the Chairman (Annex 5F.3) (see 5.4.31);
- (b) minutes of Dahe Basu's board of directors meeting dated 24 April 2006 in relation to the resignation and appointment of the Chairman (Annex 5F.7) (see 5.4.32); and
- (c) legal advice dated 16 October 2006 in relation to the rejection of the registration of Dahe Basu's statutory representative (Annex 5H.1) (see 5.4.34).

5.4.31 In the minutes of Dahe Basu's board of directors meeting dated 23 January 2006 (Annex 5F.3), it was resolved that Mr. Jia Hua resigned as the Chairman and Mr. Chen Gan appointed as the new Chairman and statutory representative. According to the petition filed by Basu Art dated 30 May 2006 (Annex 1B/1C Appendix 7), the new Chairman was a representative of Dahe Media while the ex-Chairman was a representative of Basu Art. The meeting also requested Mr. Jia Hua to hand over all the accounting information, registration certificate and common seal of Dahe Basu to the new Chairman, Mr. Chen Gan, and other relevant persons. A summary of the minutes is enclosed (Annex 5F).

- 5.4.32 In the minutes of Dahe Basu's board of directors meeting dated 24 April 2006 (Annex 5F.7), it was further resolved that Mr. Jia Hua resigned as the Chairman and Mr. Chen Gan appointed as the new Chairman and statutory representative. It was noted that only Mr. Chen Gan and Mr. Yang Jianliang were present in the meeting. According to the petition filed by Basu Art dated 30 May 2006 (Annex 1B/1C Appendix 7), Mr. Chen Gan and Mr. Yang Jianliang were representatives from Dahe Media. A summary of the minutes is enclosed (Annex 5F).
- 5.4.33 However, Dahe Basu was unable to register the new statutory representative with the relevant authority. In the letter issued by Yuzhong branch of Chongqing Administration for Industry and Commerce dated 20 June 2006 (Annex 5G.4), it was said that the registration was rejected on the basis that a shareholder of Dahe Basu had filed a petition to court regarding the change of the Chairman in the meeting of the board of directors. A summary of the correspondence between Dahe Basu and Chongqing Administration for Industry and Commerce is enclosed (Annex 5G).
- 5.4.34 Dahe Media had obtained legal advice in relation to the rejection of the registration of statutory representative.
- 5.4.35 Based on 5.4.29 to 5.4.34, the actions taken by Dahe Media to re-gain control over Dahe Basu occurred in 2006. It appears to the FRRC that Dahe Media had not taken reasonable steps to exercise "control" over Dahe Basu in order to obtain financial information for the purpose of consolidation in the Relevant Financial Statements.
- 5.4.36 In view of the above, on 28 February 2008, the FRRC required Dahe Media (Annex 5M/5M.1) to confirm:-
- (a) whether or not it had taken any actions to exercise its "legal" control after 1 January 2007; and
 - (b) whether or not it had taken any actions to obtain sufficient information to consolidate Dahe Basu given the latest development of the liquidation.
- 5.4.37 Dahe Media replied in writing on 13 March 2008 (Annex 5N/5N.1), a translation of the response to 5.4.36 is set out below:
- "Since 1 January 2007, Dahe Media has appointed representatives to communicate with the minority shareholder of Dahe Basu hoping that the minority shareholder would provide financial information of Dahe Basu for the purpose of preparing the interim financial report. The court appointed the liquidation committee on 15 May 2007. The liquidation committee took control of all information and the liquidation procedures were officially commenced. Since then, Dahe Media lost control over Dahe Basu.
- Dahe Media has taken a lot of initiatives to communicate with the minority shareholder of Dahe Basu to obtain sufficient information in order to consolidate Dahe Basu's accounts. Nevertheless, the other party was uncooperative. Hence, Dahe Media could not consolidate Dahe Basu's accounts and perform impairment assessments on assets and recognise provisions that might result from the liquidation before the liquidation procedures were officially commenced. Dahe Media will make adjustments to the financial statements after the liquidation is completed."

5.4.38 Similar information was disclosed in the 2007 Financial Statements. Dahe Media stated that it had no access to the books and records of Dahe Basu for the purpose of consolidating the results of Dahe Basu up to 14 May 2007 because Basu Art was responsible for the daily operations and preparation of part of certain books and records of Dahe Basu up to 14 May 2007.

Analysis

5.4.39 In relation to the registration of the new statutory representative, Article 34 of the Articles of Association stated that the Chairman should be elected by the directors. Three directors were appointed, two by Dahe Media and one by Basu Art. To pass a resolution, it required more than 50 per cent votes set out in Article 38 of the Articles of Association. It appears to the FRRC that Dahe Media had the ability to remove and appoint the Chairman (who would become the statutory representative according to Article 31 of the Articles of Association) of Dahe Basu. Although Dahe Basu was unable to register the new statutory representative set out in 5.4.33, it does not seem to affect the parent/subsidiary relationship between Dahe Media and Dahe Basu.

5.4.40 The FRRC acknowledges that Dahe Media might have encountered difficulties when collecting accounting records from Dahe Basu which was under the day-to-day management of the minority shareholder, Basu Art, due to the hostility between the two parties. However, it is unclear to the FRRC whether or not Dahe Media had exercised its best endeavors to explore all reasonable means to collect information for financial reporting purposes, for example, by presenting a formal written application to the relevant court for a court order.

Comments on enquiry report from Dahe Media

5.4.41 The draft enquiry report was sent to Dahe Media for review and comment on 22 April 2008. A reply (Annex 5O) was received on 5 May 2008. In relation to 5.3.40, Dahe Media stated that it had taken all practically viable actions to re-gain control of Dahe Basu and to obtain the financial information of Dahe Basu for consolidation purpose. Dahe Media also produced a letter of a law firm to support its claim. A translation of an extract of the letter from the law firm is set out below:

“Since June 2006, we have been acting as the legal representative of Dahe Media Co., Limited in relation to the liquidation of Chongqing Dahe Basu Media Co., Ltd. We have applied many times to the court and the liquidation committee in order to obtain the financial information from January 2007 to 14 May 2007 for the purpose of preparing the quarterly financial report and the interim financial report of the Company. However, the court and the liquidation committee declined the applications because shareholders are not allowed to have access to the source financial documents before the liquidation is completed.”

5.4.42 In addition, Dahe Media agreed to submit written applications to the court and the liquidation committee to obtain financial information as recommended on page 3 of this report. The results of the applications were not known as at the date of this report.

Section 6 Accounting of Dahe Basu after appointment of liquidation committee

6.1 Conclusion

- 6.1.1 Based on the results of the enquiry, the FRRC concludes that there are relevant non-compliances as defined in section 5 of the FRC Ordinance in relation to the Relevant Financial Statements in respect of the accounting of Dahe Basu after the appointment of the liquidation committee, i.e. from 15 May 2007 to 30 June 2007.
- 6.1.2 The non-compliances refer to the failures to deconsolidate the investment in Dahe Basu on the date Dahe Media ceased to have control in accordance with HKAS 27, *Consolidated and Separate Financial Statements* (“HKAS 27”) and account for the investment in Dahe Basu as a financial asset in accordance with HKAS 39, *Financial Instruments: Recognition and Measurement* (“HKAS 39”).
- 6.1.3 The FRRC recommends the Council to give a written notice to Dahe Media under section 49 of the FRC Ordinance to ask it to exhaust all reasonable means to obtain sufficient information for the accounting of Dahe Basu in the Relevant Financial Statements and at least apply formally to the Dahe Basu liquidation committee and the relevant court in order to obtain accounting records and financial information of Dahe Basu for the purpose of accounting for Dahe Basu in the Relevant Financial Statements.

If Dahe Media was able to obtain sufficient information of Dahe Basu, the Council could decide whether or not to issue a notice to secure removal of the relevant non-compliances and revise the Relevant Financial Statements by accounting for the investment in Dahe Basu as an available-for-sale financial asset in accordance with HKAS 39 from 15 May 2007 to 30 June 2007.

6.2 Principal findings

- 6.2.1 The FRRC believes that Dahe Media was unable to exercise control, joint control or significant influence over Dahe Basu after the liquidation committee was appointed by the court on 15 May 2007. Hence, the investment in Dahe Basu should be accounted for as a financial asset in accordance with HKAS 39.
- 6.2.2 The FRRC considers that it is appropriate to classify the investment in Dahe Basu as an available-for-sale financial asset and the investment should be carried at cost less impairment in accordance with HKAS 39 on the assumption that the fair value of the investment cannot be measured reliably.
- 6.2.3 Dahe Media confirmed that it failed to deconsolidate Dahe Basu at the time it ceased control over Dahe Basu and account for the investment in Dahe Basu as an available-for-sale financial asset in accordance with HKAS 39 in the Relevant Financial Statements but due to lack of information did not agree to rectify the non-compliances.
- 6.2.4 In the 2007 Financial Statements issued on 26 March 2008, Dahe Media accounted for the investment in Dahe Basu as an available-for-sale financial asset. The carrying amount of the net assets of Dahe Basu attributable to Dahe Media as at 31 December 2006 was deemed as the initial cost as at 15 May 2007. No impairment loss was recognised because, in the opinion of the directors, there was no sufficient financial information for the impairment assessment.

6.3 Non-compliances with HKFRSs

- 6.3.1 The FRRC is of the opinion that Dahe Media failed to comply with the following HKFRSs in preparing the Relevant Financial Statements.
- 6.3.2 Paragraph 28 of the HKAS 34, *Interim Financial Reporting* (“HKAS 34”), states “an entity shall apply the same accounting policies in its interim financial statements as are applied in its annual financial statements, except for accounting policy changes made after the date of the most recent annual financial statements that are to be reflected in the next annual financial statements.”
- 6.3.3 The Relevant Financial Statements were condensed consolidated financial statements prepared in accordance with HKAS 34. Therefore, Dahe Media should apply the same accounting policies as were applied in preparing the annual consolidated financial statements for the year ended 31 December 2006 which complied with other relevant HKFRSs. Hence, the following non-compliances are referenced to the specific HKFRSs that govern the accounting of the specific transactions.
- 6.3.4 Paragraph 31 of HKAS 27 states that “an investment in an entity shall be accounted for in accordance with HKAS 39 *Financial Instruments: Recognition and Measurement* from the date that it ceases to be a subsidiary, provided that it does not become an associate as defined in HKAS 28, *Investments in Associates*, or a jointly controlled entity as described in HKAS 31, *Interests in Joint Ventures*.”
- 6.3.5 Paragraph 32 of HKAS 27 states that “the carrying amount of the investment at the date that the entity ceases to be a subsidiary shall be regarded as the cost on initial measurement of a financial asset in accordance with HKAS 39.”
- 6.3.6 Dahe Media ceased control over Dahe Basu on 15 May 2007, the date which the liquidation committee was appointed. Dahe Media did not take the carrying amount of the investment in Dahe Basu on that date as the cost on initial measurement of applying HKAS 39. Instead, Dahe Media transferred the carrying amount of Dahe Basu’s assets and liabilities on 31 December 2006 to long term investments and classified as “other intangible assets”.
- 6.3.7 Paragraph 46(c) of HKAS 39 states that “investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured and derivatives that are linked to and must be settled by delivery of such unquoted equity instruments, which shall be measured at cost.”
- 6.3.8 Paragraph 58 of HKAS 39 states that, “an entity shall assess at each balance sheet date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. If any such evidence exists, the entity shall apply paragraph 63 (for financial assets carried at amortised cost), paragraph 66 (for financial assets carried at cost) or paragraph 67 (for available-for-sale financial assets) to determine the amount of any impairment loss.”
- 6.3.9 Paragraphs 46(c) and 58 of HKAS 39 govern the subsequent measurement of available-for-sale financial assets for which the fair value of such equity investment cannot be measured reliably. Given that Dahe Basu was in liquidation (which represented an objective evidence of potential impairment), Dahe Media failed to assess impairment in respect of its investment in Dahe Basu in accordance with these requirements.

6.3.10 Dahe Media accounted for the investment in Dahe Basu as an available-for-sale financial asset in the 2007 Financial Statements. Although the accounting classification of the investment in Dahe Basu was appropriate, the auditor stated in the auditor's report that it was unable to obtain reasonable assurance regarding the measurement of the initial cost of the available-for-sale financial asset and to ascertain whether or not any impairment loss should be recognised in the absence of sufficient evidence.

6.4 Detailed findings

A. Background information

- 6.4.1 On 30 May 2006, Basu Art filed a petition (Appendix 7 to Annex 1B/1C) to a Mainland court to dissolve Dahe Basu because there was a dispute between Dahe Media and Basu Art.
- 6.4.2 On 14 March 2007, the dispute was settled by a mediation agreement (Appendix 8 to Annex 1B/1C) under which Dahe Media, Basu Art and Dahe Basu agreed to dissolve Dahe Basu. A chronology of major events is enclosed (Annex 2).
- 6.4.3 On 15 May 2007, a liquidation committee was appointed by Chongqing No. 5 Intermediate People's Court (Appendix 2 to Annex 1B/1C). Both Dahe Media and Basu Art had a representative in the liquidation committee which was chaired by a local liquidator. A chronology of major events is enclosed (Annex 2).
- 6.4.4 In preparing the Relevant Financial Statements, Dahe Media ceased the consolidation of Dahe Basu from 1 January 2007 onwards. Except for a statement saying that Dahe Basu was excluded from the financial data in the interim financial report, there was no disclosure in the Relevant Financial Statements (Annex 3A/3A.1) which describes the accounting treatment of Dahe Basu in the Relevant Financial Statements.
- 6.4.5 In the 2007 Financial Statements, Dahe Media disclosed in the notes that Dahe Basu was a subsidiary up to 14 May 2007. Since 15 May 2007, the investment in Dahe Basu was accounted for as an available-for-sale financial asset. The share of net assets of Dahe Basu attributable to Dahe Media as at 31 December 2006 was deemed as the initial cost of the available-for-sale financial asset at 15 May 2007. No impairment was recognised because there was no sufficient reliable financial information for impairment assessment. The auditor issued an "except for" opinion and stated in the auditor's report that it was unable to obtain reasonable assurance regarding the measurement of the initial cost of the available-for-sale financial asset and to ascertain whether or not any impairment loss should be recognised in the absence of sufficient evidence.

B. Accounting issues

- 6.4.6 With respect to the accounting of Dahe Basu after the liquidation committee was appointed, there are two major accounting issues:
- (a) The classification of the investment in Dahe Basu in the Relevant Financial Statements after the liquidation committee was appointed on 15 May 2007, i.e. whether the investment in Dahe Basu should continue to be accounted for as a subsidiary in accordance with HKAS 27, a jointly controlled entity in accordance with HKAS 31, *Interests in Joint Ventures*, an associate in accordance with HKAS 28, *Investments in Associates*, or a financial asset in accordance with HKAS 39 (see 6.4.7 to 6.4.24).
 - (b) Impairment assessment in respect of the investment in Dahe Basu in preparing the Relevant Financial Statements (see 6.4.25 to 6.4.36).

C. Classification of the investment in Dahe Basu

Explanation and documents provided by Dahe Media

- 6.4.7 Before the initiation of this enquiry, the Secretariat had collected information from Dahe Media by sending inquiry letters in order to ascertain the relationship between Dahe Media and Dahe Basu after the liquidation committee was appointed. The inquiry and reply letters are enclosed (Annex 4A to 4D).
- 6.4.8 On 13 November 2007, the FRRC required (Annex 5A) Dahe Media to confirm the information and explanation provided in the reply letters dated 8 October 2007 (Annex 4B) and 22 October 2007 (Annex 4D).

Confirmation of previous reply letters

- 6.4.9 In the reply dated 27 November 2007 (Annex 5B/5B.1), Dahe Media confirmed the information and explanation set out in the reply letters dated 8 October 2007 and 22 October 2007 from Dahe Media.
- 6.4.10 In the reply letter dated 8 October 2007 (Annex 4B) to the Secretariat's inquiry, Dahe Media explained the relationship between Dahe Media and Dahe Basu after appointment of the liquidation committee. Dahe Media, it said, was unable to control, exercise significant influence or joint control over Dahe Basu after the liquidation committee was appointed on 15 May 2007 and the interest in Dahe Basu should therefore be accounted for as an available-for-sale financial asset in accordance with HKAS 39 at cost less impairment because the fair value of the equity instrument could not be measured reliably.

An extract of the reply is set out below:-

“As Dahe Basu was put into liquidation and a liquidation committee was appointed on 15 May 2007, we consider that the Company ceased control over financial and operating activities of Dahe Basu since 15 May 2007 in accordance with paragraph 21 of HKAS 27. After 15 May 2007, Dahe Basu is no longer a subsidiary of the Company in accordance with HKAS 27 and Dahe Basu's financial position and results subsequent to 15 May 2007 should not be consolidated into the financial statements of the Company. As the Company was also unable to exercise significant influence or joint control over the financial and operating activities of Dahe Basu since 15 May 2007, the Company's interest in Dahe Basu should be accounted for in accordance with HKAS 39 according to paragraph 31 of HKAS 27. Pursuant to paragraph 32 of HKAS 27, the carrying amount of the Company's interest in Dahe Basu (the net assets of Dahe Basu net of attributable 40% minority interest) at the date that Dahe Basu ceases to be a subsidiary, i.e. on 15 May 2007, shall be regarded as the cost on initial measurement of a financial asset in accordance with HKAS 39. According to paragraph 9 of HKAS 39 (definition of available-for-sale financial assets), the above cost of Company's interest in Dahe Basu should be classified as an available-for-sale investment, which should be stated at cost less any impairment losses under paragraph AG80 of HKAS 27 (HKAS 39) because the probabilities of the various estimates within the range cannot be reasonably assessed and used in estimating fair value given the significant uncertainty on the outcome of the liquidation process of Dahe Basu.”

6.4.11 In the reply letter dated 22 October 2007 (Annex 4D), Dahe Media accepted that there was a non-compliance with HKAS 39 in the Relevant Financial Statements but did not agree to rectify such non-compliance. An extract of the reply is set out below:-

“There is a non-compliance with HKAS 39. As the Company has issued the Clarification Announcements and the cost implications, the Company will not re-issue the Relevant Financial Statements. However, the Company will state the non-compliances concerning the Relevant Financial Statements in its next financial statements.”

Accounting treatment of Dahe Basu in the Relevant Financial Statements

6.4.12 The Secretariat further requested Dahe Media to clarify the accounting treatment of Dahe Basu in the Relevant Financial Statements and received a response on 2 January 2008 (Annex 5L/5L.1). The translation of the response is set out below:

“The unaudited figures as at 30 June 2007 and the audited figures as at 31 December 2006 are presented on the interim consolidated balance sheet. The figures as at 31 December 2006 include the assets and liabilities of Chongqing Dahe Basu Media Co., Ltd. (“Dahe Basu”), whereas the figures as at 30 June 2007 do not include the assets and liabilities of Dahe Basu. The 60% shareholding of Dahe Basu held by Dahe Media (shareholding as at 31 December 2006) is included in long-term investment, which is categorised as other intangible assets. The assets and liabilities of Dahe Basu are not consolidated when preparing the interim consolidated financial statements, therefore, there is no related accounting adjustment.”

6.4.13 The accounting treatment adopted as set out in 6.4.12 was not explained in the Relevant Financial Statements. The FRRC required Dahe Media to explain the reason for not disclosing the accounting policy applied to account for the interest in Dahe Basu and the basis of applying such accounting policy in its requirement of 28 February 2008 (Annex 5M/5M.1).

6.4.14 A translation of the reply from Dahe Media dated 13 March 2008 (Annex 5N/5N.1) is set out below:

“Dahe Media is not familiar with the accounting standards in Hong Kong and has not experienced similar situation previously. Dahe Media considers treating the long term equity investment under “other intangible assets”, which was a line item reported in the 2006 financial report, is most appropriate.”

Accounting treatment of Dahe Basu in the 2007 Financial Statements

6.4.15 Dahe Media accounted for the investment in Dahe Basu as an available-for-sale financial asset at a deemed cost which equals to the carrying amount of net assets attributable to Dahe Media as at 31 December 2006.

Roles and powers of the Dahe Basu liquidation committee

6.4.16 The FRRC made enquiries with a law firm in respect of the roles and powers of the liquidation committee in order to clarify the relationship between Dahe Media and Dahe Basu’s liquidation committee. An extract of the reply from the law firm is set out below:

“The PRC Company Law and the articles of association of Dahe Basu, set out the roles and powers of the liquidation committee during the liquidation:

- (A) to thoroughly examine the assets of Dahe Basu and prepare a balance sheet and a schedule of assets;
- (B) to notify creditors by notice or announcement in newspaper;
- (C) to dispose of and liquidate relevant unfinished business of Dahe Basu;
- (D) to pay all outstanding taxes in full as well as taxes arising in the course of liquidation;
- (E) to clear claims and debts;
- (F) to dispose of the liquidated assets; and
- (G) to participate in civil litigation activities on behalf of Dahe Basu.”

“In addition, the court order has supplemented these powers by the following:

- the liquidation committee should take over Dahe Basu immediately, including taking over from the legal representative and other personnel the balance sheet, tangible assets schedule, all assets, accounting books, files, chops, certificates and other relevant material;
- retrieve assets belonging to Dahe Basu and exercise rights with respect to such assets against the debtors and the assets holders;
- subject to approval of the court, organize the evaluation, auction and allocation of the assets.

We understand that the PRC Company Law does not explicitly state what the impact of the appointment of a liquidation committee is on the company and its shareholders, in particular, the extent to which shareholders can continue to exercise voting rights or it rights under the articles. However, it seems to us that the exercise of such rights will in many cases be inconsistent with the court’s decision to dissolve the company, and we understand that only very limited rights are capable of being exercised by the shareholders or such powers are rendered irrelevant due to the duties conferred on the liquidation committee under Article 187 of the PRC Company Law and the court order.”

Analysis

6.4.17 Paragraph 21 of HKAS 27 states that “a parent loses control when it loses the power to govern the financial and operating policies of an investee so as to obtain benefit from its activities. The loss of control can occur with or without a change in absolute or relative ownership levels. It could occur, for example, when a subsidiary becomes subject to the control of a government, court, administrator or regulator. It could also occur as a result of a contractual agreement.”

6.4.18 Paragraph 31 of HKAS 27 states that “an investment in an entity shall be accounted for in accordance with HKAS 39 *Financial Instruments: Recognition and Measurement* from the date that it ceases to be a subsidiary, provided that it does not

become an associate as defined in HKAS 28 or a jointly controlled entity as described in HKAS 31.”

- 6.4.19 Whether or not Dahe Media was able to exercise control, joint control or significant influence over Dahe Basu’s liquidation committee was a matter of fact. Dahe Media considered it was unable to exercise any level of control or influence over the liquidation committee. It was supported by the fact that certain shareholders’ right would be surrendered to the liquidation committee under PRC Company Law and the court order. The FRRC agrees that it is reasonable to account for the investment in Dahe Basu as a financial asset in accordance with HKAS 39 in the absence of evidence which suggests otherwise.
- 6.4.20 Paragraph 32 of HKAS 27 states that “the carrying amount of the investment at the date that the entity ceases to be a subsidiary shall be regarded as the cost on initial measurement of a financial asset in accordance with HKAS 39.”
- 6.4.21 As defined in HKAS 39, available-for-sale financial assets are those non-derivative financial assets that are designated as available-for-sale or are not classified as (a) loans and receivables, (b) held-to-maturity investments or (c) financial assets at fair value through profit or loss.
- 6.4.22 The FRRC agrees with Dahe Media’s view that the investment in Dahe Basu satisfied the definition of available-for-sale financial assets. Hence, the classification of the investment in Dahe Basu as “other intangible assets” on the condensed consolidated balance sheet as at 30 June 2007 included in the Relevant Financial Statements was inappropriate.
- 6.4.23 Paragraph 46(c) of HKAS 39 states that “investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured and derivatives that are linked to and must be settled by delivery of such unquoted equity instruments, which shall be measured at cost.”
- 6.4.24 Since a quoted market price in an active market was not available in respect of the equity interest in Dahe Basu, the FRRC accepts Dahe Media’s view set out in 6.4.10 that the interest in Dahe Basu should be measured at cost after initial recognition in accordance with paragraph 46(c) of HKAS 39 on the assumption that the fair value of the investment cannot be measured reliably.

D. Impairment assessment

Explanation and documents provided by Dahe Media

- 6.4.25 In order to determine whether or not Dahe Media had performed a proper impairment assessment in respect of its investment in Dahe Basu, the FRRC required Dahe Media to provide the following on 13 November 2007 (Annex 5A):
- (a) Clarification on whether or not the assets and liabilities of Dahe Basu have been included in Dahe Media’s condensed consolidated balance sheet as at 30 June 2007 which is included in the Relevant Financial Statements;
 - (b) Reconciliation of the amounts of the assets and liabilities of Dahe Basu included in Dahe Media’s consolidated balance sheet as at 31 December 2006 to the amounts as at 30 June 2007 identified under (a);

- (c) Explanation on the movements identified in (b); and
- (d) Explanation on whether or not any impairment test had been performed in respect of the assets identified in (a) and (b) in accordance with HKAS 36 *Impairment of Assets*, HKAS 39 *Financial Instruments: Recognition and Measurement* or other relevant standards.

6.4.26 Dahe Media confirmed that the assets and liabilities of Dahe Basu had not been included in its condensed consolidated balance sheet as at 30 June 2007 in its reply dated 27 November 2007 (Annex 5B/5B.1).

6.4.27 In its reply on 11 December 2007 (Annex 5E/5E.1), Dahe Media further stated that it considered reconciliation and explanation of the movement of the carrying amounts of the assets and liabilities of Dahe Basu from 31 December 2006 to 30 June 2007 are not necessary because the assets and liabilities of Dahe Basu were excluded from the condensed consolidated balance sheet of Dahe Media as at 30 June 2007. A translation of an extract of Dahe Media's reply is set out below:

“Since the consolidated balance sheet of Dahe Media did not include the assets and liabilities of Dahe Basu as at 30 June 2007, reconciliations of assets and liabilities of Dahe Basu are not considered necessary.

The consolidated financial statements of Dahe Media for the year ended 31 December 2006 included assets and liabilities of Dahe Basu of RMB 44,291,000 and RMB 4,938,000 respectively. Because the assets and liabilities of Dahe Basu were not included in the consolidated balance sheet of Dahe Media as at 30 June 2007, no explanation for the movement is considered necessary.”

6.4.28 As set out in 6.4.12, Dahe Media had deconsolidated the assets and liabilities of Dahe Basu and transferred the carrying amount of 60 per cent of the net assets of Dahe Basu as at 31 December 2006 to “other intangible assets”. During 1 January 2007 to 30 June 2007, there was no adjustment to write down any assets.

6.4.29 In response to 6.4.25(d), Dahe Media stated in its reply dated 11 December 2007 that it was not possible to estimate reliably any diminution in the value of its investment in Dahe Basu due to the uncertainties in relation to the result of the liquidation (Annex 5E/5E.1). A translation of the response is set out below.

“Since there were a lot of uncertainties relating to the liquidation of Dahe Basu, Dahe Media was unable to estimate and provide for the diminution in the recoverable amount of its interest in Dahe Basu and any losses that might result from the liquidation. As a result, it did not recognise any impairment loss in respect of its interests in Dahe Basu in the unaudited consolidated financial statements.”

6.4.30 It appears that Dahe Media had taken the view without conducting an impairment test that no impairment of assets was required although Dahe Basu was under liquidation.

6.4.31 On 28 February 2008, the FRRC required (Annex 5M/5M.1) Dahe Media to provide the reason for not disclosing the circumstances that Dahe Media was unable to estimate any diminution in value in respect of its interest in Dahe Basu and related provisions.

6.4.32 In the response of 13 March 2008 (Annex 5N/5N.1), Dahe Media stated it was unable to estimate the diminution in value but did not explain the reason for non-disclosure. A translation of the reply is set out below:

“Since the diminution in value of the equity interest in Dahe Basu and related liquidation loss cannot be estimated, Dahe Media cannot determine the amount and accurately provide for the loss.”

6.4.33 Similar information was also disclosed in note 2 to the 2007 Financial Statements:

“No impairment allowance was made by the directors in respect of (i) the Group’s and the Company’s equity interest in Dahe Basu which was recognised as an available-for-sale financial asset with the carrying amount of approximately RMB 19,922,000 and RMB 20,394,000 respectively as at 31st December, 2007; and (ii) the Group’s and the Company’s amounts due from Dahe Basu of approximately RMB 1,506,000 and RMB 177,000 respectively as at 31st December, 2007. In the opinion of the directors, there was no sufficient reliable financial information available for accessing the impairment on the above assets of the Group and the Company as at 31st December, 2007, and no allowance was made accordingly.”

Analysis

6.4.34 According to paragraphs 58 of HKAS 39, “an entity shall assess at each balance sheet date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. If any such evidence exists, the entity shall apply paragraph 63 (for financial assets carried at amortised cost), paragraph 66 (for financial assets carried at cost) or paragraph 67 (for available-for-sale financial assets) to determine the amount of any impairment loss.”

6.4.35 The FRRC is of the view that the liquidation of Dahe Basu in May 2007 is an objective evidence which indicates the investment in Dahe Basu may have been impaired. Therefore, Dahe Media should determine and recognise the amount of any impairment loss in accordance with HKAS 39.

6.4.36 It appears that the auditor of the 2007 Financial Statements shared the same view with the FRRC. The auditor of the 2007 Financial Statements had issued a qualification in relation to the impairment of the investment in Dahe Basu in the absence of sufficient evidence.

E. Dahe Media’s ability to obtain financial information from liquidation committee

Explanation and documents provided by Dahe Media

6.4.37 In order to determine Dahe Media’s ability to obtain financial information from the liquidation committee for accounting purpose, on 13 November 2007 the FRRC required Dahe Media to provide the following (Annex 5A):

(a) Records or documents that support Dahe Media was unable to obtain financial information of Dahe Basu from the liquidation committee appointed by Chongqing No. 5 Intermediate People’s Court on 15 May 2007, such as:-

- Documents relating to the appointment and operation of the liquidation committee;
- Documents that define the role and power of the liquidation committee, for example, relevant regulations or legislation;
- Meeting notes of the liquidation committee;
- Correspondence between Dahe Media, Dahe Basu, Basu Art and the liquidation committee;
- Progress report on the liquidation process presented to court, creditors and/or shareholders.

(b) Information on the progress of the liquidation of Dahe Basu.

6.4.38 Dahe Media stated that it was unable to obtain information to perform impairment test in its letter of 2 January 2008. (Annex 5L/5L.1) A translation of an extract of the reply is set out below:

“Dahe Media has sufficient understanding of the assets and liabilities of Dahe Basu as at 31 December 2006. However, it can no longer get hold of the financial information of Dahe Basu as at 30 June 2007 and Dahe Basu has already entered into the liquidation process. Dahe Media does not know the assets and liabilities condition of Dahe Basu as at 30 June 2007, and cannot foresee the result of the liquidation process. Accordingly, it was unable to perform impairment assessment on the assets of Dahe Basu.”

6.4.39 In order to support that Dahe Media was unable to get hold of the financial information of Dahe Basu after it entered into the liquidation stage, Dahe Media provided a copy of the legal advice dated 26 November 2007 (Annex 5J/5J.1) it obtained. Except for the legal advice, Dahe Media did not provide any other documents or correspondence to support that it was unable to obtain information from the Dahe Basu liquidation committee.

6.4.40 A translation of an extract of the legal advice provided by Dahe Media’s legal counsel (Annex 5J/5J.1) is set out below:

“After the liquidation committee was appointed, according to the current PRC laws and regulations and the current practice and to ensure the liquidation process was fair and free from intervention, the liquidation committee was required to take over the

liquidated company. In addition, all related personal, including staff, the liquidated company and shareholders, should deliver all documents, materials and assets of the liquidated company to the liquidation committee.”

“Any person other than the liquidation committee members (including the staff the shareholders) shall not approach or use any documents and materials which were handed over to the liquidation committee unless it was approved by the court under special request.”

“Chongqing No. 5 Intermediate People’s Court specifically ordered that the shareholders should not approach or use any documents and material that were handed over to the liquidation committee unless approval was obtained.”

- 6.4.41 On 18 December 2007, the Secretariat sent a follow-up letter (Annex 5K/5K.1) to Dahe Media. In the letter, Dahe Media was requested to clarify whether or not it had applied to court or requested the liquidation committee to provide financial information of Dahe Basu and the reason for not doing so.
- 6.4.42 In response to the Secretariat’s follow-up letter, Dahe Media replied in writing (Annex 5L/5L.1) on 2 January 2008 and confirmed it had not done so because (i) “special request” was not defined in the law; (ii) this was not a common practice; (iii) the process may be time consuming; and (iv) an approval may not be obtained.
- 6.4.43 It appears to the FRRC that Dahe Media might be able to obtain financial information for accounting purpose should it make a request to the liquidation committee or apply to court. However, Dahe Media had not taken any actions.
- 6.4.44 The FRRC therefore made enquiries with a law firm in order to understand the legal position of the liquidation committee of Dahe Basu and whether or not Dahe Media was able to obtain information from the liquidation committee for accounting purposes.
- 6.4.45 An extract of the reply from the lawyers is set out below:

“From a liquidation procedure point of view, we are also not aware of any laws or regulations expressly preventing or restricting shareholders from approaching or using documents or materials after the same are handed over to the liquidation committee during a non-bankruptcy liquidation process.

The articles of association of Dahe Basu and the cooperation agreement do not contain specific provisions on this point.

In absence of the relevant guidance or contractual provisions, we would expect that Dahe Media remains entitled to obtain information from the company for the purpose of preparing its consolidated financial statements, subject to the company (through the liquidation committee) exercising a right to object. If the situation between the parties is hostile, it seems likely the liquidation committee will be cautious about disclosure and may require a court order before disclosure. In such case, it seems to us that the court will need to weigh up what should, as we would understand, be the legitimate interests of a shareholder to receive information necessary to enable it to satisfy its legal obligation with respect to the preparation and audit of its account; versus any harm to the company and / or any unfairness in the liquidation process.

In practice, we assume Dahe Media has access to much of the information by virtue of its representative member of the committee; but we assume (and agree) that the preferable/proper means of provision is by the committee, rather than a single member of it.”

- 6.4.46 Based on the above reply, there is no law or regulation that specifically restrict Dahe Media to approach or use information delivered to Dahe Basu’s liquidation committee since it was a non-bankruptcy liquidation. It appears that Dahe Media was entitled to obtain information of Dahe Basu from the liquidation committee but it had not

exercised its right. If Dahe Media and Basu Art were hostile and the liquidation committee was not willing to allow access to any information, Dahe Media might apply for a court order.

6.4.47 Given the inconsistencies between the legal advice provided by Dahe Media's legal counsel and the reply obtained by the FRRC, the FRRC required Dahe Media to provide the reference of the following statements to relevant PRC Law or regulations made in the legal advice provided by Dahe Media's legal counsel in the requirement of 28 February 2008 (Annex 5M/5M.1):

- (a) "Unless as required for special reasons and subject to the approval of the court, neither shareholder shall approach or use any document or material which has been handed over to the liquidation committee."
- (b) "Chongqing No. 5 Intermediate People's Court stated explicitly that neither shareholder shall approach or use any document or material which has been handed over to the liquidation committee."

6.4.48 According to the reply from Dahe Media on 13 March 2008 (Annex 5N/5N.1), the statements in 6.4.47 reflected the market practice in the PRC. There was no specific legal document which contained those statements.

6.4.49 With respect to the progress of the liquidation, Dahe Media stated that certain media-assets were allocated between Dahe Media and Basu Art in the reply of 27 November 2007 (Annex 5B/5B.1). The ruling and the allocation schedule were also provided (Annex 5D/5D.1).

6.4.50 In view of the latest development of the liquidation and the allocation of the media-related assets of Dahe Basu, the FRRC on 28 February 2008 required Dahe Media to provide the following information and explanation (Annex 5M/5M.1):

- (a) Explain whether or not Dahe Media had taken any actions to obtain sufficient information to consolidate Dahe Basu and estimate reliably any impairment of assets and provisions that might result from the liquidation of Dahe Basu.
- (b) Confirm whether or not Dahe Media agrees to account for the financial impact of the liquidation of Dahe Basu when preparing financial statements in future.
- (c) Indicate clearly the reason for not taking any appropriate actions to obtain accounting information for financial reporting purpose or the difficulties encountered in the process of gathering accounting information.

6.4.51 A translation of an extract of the reply from Dahe Media on 13 March 2008 (Annex 5N/5N.1) is set out below:

"Since 1 January 2007, Dahe Media has appointed representatives to communicate with the minority shareholder of Dahe Basu hoping that the minority shareholder would provide financial information of Dahe Basu for the purpose of preparing the interim financial report. The court appointed the liquidation committee on 15 May 2007. The liquidation committee took control of all information and the liquidation procedures were officially commenced. Since then, Dahe Media lost control over Dahe Basu.

Dahe Media has taken a lot of initiatives to communicate with the minority shareholder of Dahe Basu to obtain sufficient information in order to consolidate Dahe Basu's accounts. Nevertheless, Dahe Basu was uncooperative. Hence, Dahe Media could not consolidate Dahe Basu's accounts and perform impairment assessments on assets and recognise provision that might result from the liquidation before the liquidation procedures were officially commenced. Dahe Media will make adjustments to the financial statements after the liquidation is completed.

Dahe Media has applied to the court in order to obtain the relevant information for the purpose of consolidating Dahe Basu's accounts. However, the court verbally rejected the request. The court only agreed to allow Dahe Media to apply for reviewing original vouchers, if there is a disagreement between the shareholders of Dahe Basu after the liquidation committee issues an initial audit opinion."

6.4.52 Dahe Media had not provided any evidence to support the explanations set out in 6.4.51.

6.4.53 In relation to the function of the liquidation committee, Dahe Media had disclosed the following in the 2007 Financial Statements,

"The liquidation team is responsible for reporting the results of liquidation of Dahe Basu to the PRC court and was authorised by the PRC court to, among others, retain all books and records of Dahe Basu, prepare its financial statements, and manage and realise the assets of Dahe Basu for liquidation purpose. As of the date of this report, the liquidation has not been completed and the liquidation team led by the PRC liquidator has not released any sufficiently reliable financial information of Dahe Basu of the current year to the directors of the Company."

Analysis

6.4.54 The FRRC is of the opinion that the reasons provided by Dahe Media to support the contention that it could not obtain financial information from the liquidation committee were not sufficient for the following reasons:

- (a) Dahe Media and Basu Art each had appointed one representative (out of three) on the liquidation committee. It is reasonable to expect that Dahe Media would be informed by its representative the development of the liquidation although it might not be able to influence the liquidation process.
- (b) The liquidation committee was chaired by a local liquidator appointed by the court. The local liquidator should be able to ensure the liquidation was performed fairly, transparently and protect the rights and interests of its shareholders, including the right to obtain financial information to fulfill other legal obligations.
- (c) Dahe Media failed to provide concrete proof that it had difficulty when exercising its right as a shareholder of Dahe Basu to obtain financial information from the liquidation committee except for a verbal rejection from the court.

Comments on enquiry report from Dahe Media

6.4.55 The draft enquiry report was sent to Dahe Media for review and comment on 22 April 2008. A reply (Annex 5O) was received on 5 May 2008. In relation to 6.4.52, Dahe Media produced a letter from a law firm which certified that Dahe Media had applied to court and the liquidation committee to obtain financial information. A translation of an extract of the letter from the law firm is set out below:

“Since June 2006, we have been acting as the legal representative of Dahe Media Co., Limited in relation to the liquidation of Chongqing Dahe Basu Media Co., Ltd. We have applied many times to the court and the liquidation committee in order to obtain the financial information from January 2007 to 14 May 2007 for the purpose of preparing the quarterly financial report and the interim financial report of the company. However, the court and the liquidation committee declined the applications because shareholders are not allowed to have access to the source financial documents before the liquidation is completed.”

6.4.56 Dahe Media stated that it is aware of the progress of the liquidation but it could not obtain financial information for consolidation purposes. A translation of an extract of the letter from the law firm is set out below:

“Although the company has a representative on the liquidation committee, it only acts as a representative of a shareholder. All decisions are made by the court. Shareholders do not have any right to obtain any information submitted to the liquidation committee”

6.4.57 In addition, Dahe Media agreed to submit written applications to the court and the liquidation committee to obtain financial information of Dahe Basu. The result of the application was not known as at the date of this report.