阿里巴巴·影业集团™
Alibaba·Pictures

Alibaba Pictures Group Limited
阿里巴巴影業集團有限公司

(Incorporated in Bermuda with limited liability)
(Stock Code: 1060)

POSSIBLE NON-COMPLIANT ACCOUNTING TREATMENT FOR PRIOR ACCOUNTING PERIODS AND POSSIBLE INSUFFICIENT PROVISION FOR IMPAIRMENTS

UPDATE ANNOUNCEMENT

We refer to the announcement of Alibaba Pictures Group Limited (the "Company" and, together with its subsidiaries and variable interest entities, the "Group") dated August 14, 2014 concerning, among other things, certain possibly non-compliant treatment of financial information in the Company's financial statements covering periods prior to completion of the share subscription by Ali CV Investment Holding Limited (an indirectly wholly-owned subsidiary of Alibaba Group Holding Limited ("Alibaba Group")) of a majority stake in the Company and the update announcements of the Company dated September 22, 2014 and November 14, 2014.

PricewaterhouseCoopers Business Consulting (Shanghai) Co. Ltd. ("PwC") has been engaged to conduct an independent inspection and analysis of the Company's historical financial statements as at and for the financial years ended December 31, 2012 and December 31, 2013 and the six months ended June 30, 2014 (the "Review") and has reported on its preliminary findings and made recommendations to the Audit Committee of the Company (the "Audit Committee") and then to the board of directors of the Company (the "Board") on November 12, 2014.

A summary of the issues identified by PwC in the Review and acknowledged by the Board and the Audit Committee are as follows:

1. Misstatements affecting the 2012 and 2013 financial statements:

Based on the reassessment carried out under the Review, there were misstatements on certain tax areas, including PRC Enterprise Income Tax ("EIT"), Business Tax ("BT") and Value-added Tax ("VAT"), arising, in particular, from (i) not obtaining and/or issuing official tax invoices, and/or delay in doing so, for the purchase and/or sale of certain artwork and film and TV copyrights as well as for certain TV drama production costs; and (ii) the application of inappropriate VAT tax rates and/or adjustments in certain PRC tax computations.

In respect of (i) above, in prior years, certain of the Group's PRC subsidiaries did not obtain all requisite official tax invoices upon purchase of certain art work and film and TV copyright and the incurrence of TV drama production costs in the PRC. In assessing the EIT liabilities of each of the individual PRC subsidiaries, the prior management of the Group was of the view that the costs were incurred from genuine transactions and that valid official tax invoices would be obtained in subsequent periods from the relevant vendors for the purpose of formalizing the procedures to claim the tax deductions. Tax deductions without official tax invoices are generally disallowed in the period in which the costs were incurred in the PRC, but tax deductions would be allowed once the official tax invoices are obtained. At the same time, some of the Group's PRC subsidiaries did not issue official tax invoices upon sale of certain art work, film and TV copyrights in the PRC and therefore the tax payments had been delayed.

In respect of (ii) above, in prior years, when estimating the related tax positions in the past, the Group had applied incorrect VAT rates in respect of the sale of certain art work and film and TV copyrights by certain of its PRC subsidiaries, because these subsidiaries were in fact already qualified as normal taxpayers in the relevant periods and were therefore required to apply a higher VAT rate. In addition, certain PRC subsidiaries also failed to take into account the fact that the selling price of some art work and film and TV copyrights was inclusive of VAT. These errors were largely resulted from the lack of effective communications between the then sales team and finance team of the Group in the PRC and in Hong Kong when preparing the consolidated financial statements.

There are also likely to be late interest payments incurred for the late payment of taxes by the Group's PRC subsidiaries concerned in respect of the above matters. It is estimated that (i) net assets as at December 31, 2012 and December 31, 2013 will be decreased by approximately HK$27 million and approximately HK$52 million, respectively, and (ii) net profit for the years ended December 31, 2012 and December 31, 2013 will be decreased by approximately HK$29 million and approximately HK$25 million, respectively, due to the misstatements in the above tax matters.

In addition, there was a misstatement on the financial impact of convertible bonds ("CB") in the 2012 and 2013 financial statements. Due to (i) the incorrect assessment of fair value of the CB based on the valuation report, and (ii) the inaccurate exchange realignment process through which the Group under the prior management continued to translate the CB based on period end exchange rate even though the CB was fixed at Renminbi, which is the functional currency of the Group, there were inaccurate amounts applied in the accounting for the CB issued by the Company in 2010 and 2011 which affected the initial recognition, exchange realignment of the CB on each period end, and settlement of the CB in subsequent periods. It is estimated that (i) net assets value as at December 31, 2012 and December 31, 2013 will be decreased by HK$18 million and increased by HK$25 million, respectively, and (ii) net profit for the years ended December 31, 2012 and December 31, 2013 will be decreased by HK$14 million and increased by HK$51 million, respectively, due to the misstatement on the financial impact of CB.

Taking into account the findings of the Review, the Board considers the above misstatements are largely due to the business and accounting practices, as well as internal control deficiencies of the Group under the prior management, rather than any indications of fraud. The Board will take further actions to improve the internal control environment in these areas, details of which are set out in paragraph 4 below.

These misstatements will not have a material continuing effect of the financial statements of the Company as they will be all reflected and adjusted in the Group's interim financial statements for the six months ended June 30, 2014.

2. **Change of application of accounting policy**

In prior years, according to the local government policies, certain of the Group's PRC subsidiaries were entitled to subsidies as determined according to the amounts of taxes (i.e. corporate income tax and value-added tax) paid. The Group under the prior management recognized such government grant income when the taxes were accrued in the consolidated financial statements, instead of paid, as the prior management of the Group believed that there was reasonable assurance that the Group would comply with the conditions attaching to the local government policies and that the grants would be received.

After the acquisition of a majority stake by Alibaba Group in the Company in June 2014, the current management of the Group has reassessed the application of the Group's accounting policy in respect of these government grants. In view of the potential uncertainties adherent to such government grants until the grants are received, the Board considers it appropriate to align the relevant accounting policy to that adopted by Alibaba Group effective from January 1, 2014, such that the Group would only recognise government grants when all the conditions are met and when such grants are received. This change will be applied to the Group's financial statements on a retrospective basis. It is estimated that (i) net assets as at December 31, 2012 and 2013 will be decreased by approximately HK$25 million and approximately HK$31 million, respectively, and (ii) net profit for the years ended December 31, 2012 and December 31, 2013 will be decreased by HK$18 million and approximately HK$5 million, respectively, due to this change of accounting policy.

3. **Potential asset impairment provisions and fair value change of warrants in 2014**

In assessing the impairment provisions for assets, the Group reviews the carrying amounts of its assets to determine whether there is any indication that those assets have suffered an impairment loss at the end of each reporting period. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). The current management of the Company, after carrying out the impairment assessment review as at June 30, 2014 which took into account events occurred up to the date of this announcement, has estimated that approximately HK$257 million to HK$323 million of provisions in relation to the impairment of certain accounts receivable, film and TV copyrights, prepayments and the investment in an associated company should be provided for during the six months ended June 30, 2014. In making the impairment assessment, the current management took into account all key factors and circumstances affecting the fair value of these assets, for example, the analysis of future distribution income for individual film and TV copyrights, the financial stabilities of individual debtors and the preliminary offer from a potential buyer for investment in an associate, and did not consider it necessary to commission a valuation report.

In addition, the Company has issued certain warrants that will be settled by the exchange of a variable amount of cash for a variable number of the Company's own equity instruments. These warrants are classified as derivative financial instrument with fair value changes to profit or loss. Accordingly, a loss amounting to approximately HK$67 million is expected to result from a significant fair value change in respect of the warrants that were exercised during the six months ended June 30, 2014. The fair value of the warrants is supported by a valuation report issued by an independent valuer.

4. **Areas for improvement in the internal control environment**

During the periods which were the subject of the Review, the Group under the prior management did not have an internal audit function. The structure and delineation of duties and responsibilities within the finance function of the Group under the prior management could have been improved. Further, the accounting and financial processes and procedures, document archiving system and tax risk management system of the Group under the prior management needed to be strengthened.

PwC has recommended the Group to seek advices from professionals and take immediate actions to remediate the above deficiencies, and the Group has been in the process of engaging a professional consultant to review its internal control system and provide professional advices for a substantive remediation plan. In the meantime, the Group has been improving the existing processes and procedures as well as recruiting competent personnel designated for the internal control function.

The estimated potential financial effect of the above misstatements, change of application of the accounting policy on government grants, asset impairment and fair value change of warrants to the financial statements as at and for the financial years ended December 31, 2012 and December 31, 2013 and to the financial statements as at and for the six months ended June 30, 2013 and June 30, 2014 is as set out below:

Financial impact to the Group's net profit -

	For the year ended		For the six months ended	
	December 31, 2012	December 31, 2013	June 30, 2013	June 30, 2014*
	HK$ million	HK$ million	HK$ million	HK$ million
Decrease/(increase) in net profit by -				
(1) Misstatements	43	(26)	(2)	-
(2) Change of accounting policy on government grants	18	5	2	-
(3) Potential asset impairment provisions and fair value changes of warrants	-	-	-	324 - 390

Financial impact to the Group's net asset value -

	Year		Six months	
	As at December 31, 2012	As at December 31, 2013	As at June 30, 2013	As at June 30, 2014*
	HK$ million	HK$ million	HK$ million	HK$ million
Decrease in net assets by -				
(1) Misstatements	45	27	49	-
(2) Change of accounting policy on government grants	25	31	28	-
(3) Potential asset impairment provisions and fair value changes of warrants	-	-	-	257 - 323

** This is the estimated financial effect on the financial statements as at and for the six months ended June 30, 2014 as compared to the anticipated results of the same period based on the management accounts of the Group prepared before the Review.*

The Company will make appropriate adjustments to the financial statements for the financial years ended December 31, 2012 and December 31, 2013 based on the findings of the Review and will take into account such findings and adjustments in finalizing the financial statements for the six months ended June 30, 2014.

After careful and due consideration of the findings and recommendations of PwC, the Board proposes to take the following actions to address the issues identified in the Review in the financial reporting and internal control systems of the Group:

- to obtain advice from PwC's tax team in settling the outstanding tax liabilities identified in the Review by the end of June 2015;

- to build a tax planning team that will work with the Group's legal team to design an effective tax risk management system tailored for the future business arrangements and the structure of the Group in early 2015;

- to engage an independent consultant to provide recommendations on how to reform the internal control and financial reporting procedures of the Group by the end of 2014; and

- to build an internal control/internal audit department to strengthen the internal control procedures of the Group in early 2015 according to the recommendations from the independent consultant.

The Board and Audit Committee both consider that the Review has comprehensively addressed the concerns that led to the Company's suspension of trading in its shares on August 15, 2014. The Board believes the actions taken and to be taken are consistent with its commitment to transparency, good corporate governance and investor protection. The Company will make additional announcement in due course in respect of the development and status of the above actions so as to keep shareholders and the investing public duly informed.

The Company expects to apply to The Stock Exchange of Hong Kong Limited (the "Stock Exchange") for resumption of trading in its shares on the Stock Exchange once the Company issues an announcement regarding the interim results of the Company for the six months ended June 30, 2014. The Company has engaged its auditors, Deloitte Touche Tohmatsu, to perform a review on the condensed interim financial statements for the six months ended June 30, 2014 under Hong Kong Standard on Review Engagements 2410, and a clean opinion is expected to be issued. The interim results announcement will be made as soon as the interim results have been made available to, and considered by, the Audit Committee and the Board, which is expected to be on or around December 19, 2014. The Company will continue to monitor the situation and will update the market as and when appropriate to do so.

Other than the Group's interim results for the six months ended June 30, 2014 and matters relating to the Review as disclosed in this announcement, the Board does not consider there being any inside information that needs to be disclosed under Part XIVA of the Securities and Futures Ordinance.

On Behalf of the Board
Alibaba Pictures Group Limited
Shao Xiaofeng
Chairman

Hong Kong, December 9, 2014

As at the date of this announcement, the Board comprises Mr. Shao Xiaofeng, Mr. Liu Chunning and Mr. Zhang Qiang, being the executive directors; and Mr. Li Lianjie, Mr. Tong Xiaomeng and Ms. Zhang Yu, being the independent non-executive directors.