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CAA Resources Limited

優庫資源有限公司*

(Incorporated in the Cayman Islands with limited liability)

(Stock Code: 02112)

PROPOSED CHANGE OF AUDITOR

The Board announces that it proposes, subject to the approval of the shareholders of the Company at an EGM, to terminate the engagement of EY as auditor of the Company before the expiration of their term of office and to appoint Graham H. Y. Chan & Co. as the new auditor of the Company in place of EY and to hold office until the conclusion of the forthcoming annual general meeting of the Company.

A circular containing, among others, information on the Proposed Change of Auditor together with a notice convening the EGM will be despatched to the shareholders of the Company as soon as practicable.

PROPOSED CHANGE OF AUDITOR

The board of directors (the “**Board**”) of CAA Resources Limited (the “**Company**”, together with its subsidiaries as “**Group**”) proposes, subject to the approval of the shareholders of the Company (the “**Shareholders**”) at an extraordinary general meeting of the Company (the “**EGM**”), to terminate the engagement of Ernst & Young (“**EY**”) as auditor of the Company before the expiration of their term of office and to appoint Graham H. Y. Chan & Co. as the new auditor of the Company (the “**Proposed Change of Auditor**”) and to hold office until the conclusion of the forthcoming annual general meeting of the Company.

The reason for the Proposed Change of Auditor was mainly due to the disagreement between the Board and EY on certain scope of Forensic Investigation with respect to the EY Review Findings, which led to the uncertainty on the time for commencing audit (“**2017 Annual Audit**”) for the annual results for the year ended 31 December 2017 by EY. The details of the events are stated below for reference.

* *For identification purpose only*

Preliminary Review Findings by EY and the 2017 Interim Results

During the review (“**Review**”) of the Company’s consolidated financial statements for the six months ended 30 June 2017 (“**2017 Interim Results**”) in accordance with International Standards on Review Engagements 2410 “*Review of Interim Financial Information performed by the Independent Auditor of the Entity*”, EY identified inconsistencies between the cash and bank balance of two bank accounts of the Group (“**Subject Bank Accounts**”) and the management accounts (“**Initial Incorrect Management Accounts**”) compiled by the finance department (“**Finance Department**”) of the Company which was initially provided to EY during the Review. The inconsistencies were due to the Initial Incorrect Management Accounts had not recorded the prepayments (“**Prepayments**”) in an aggregate amount of approximately USD106 million to a total of four commodities suppliers (“**Suppliers**”) (collectively, the “**EY Review Findings**”).

By a letter dated 23 August 2017 to each of the Board and the audit committee of the Company (the “**Audit Committee**”) and various subsequent communications, EY informed the Audit Committee (including other members of the Board) of the EY Review Findings, expressed their view that the Company should engage an independent third party to conduct an independent forensic investigation (“**Forensic Investigation**”) on the EY Review Findings with a view to clarifying the situation and the background in relation thereto, and that EY would not commence the 2017 Annual Audit pending, among others, agreeing on the scope of the Forensic Investigation and obtaining a forensic investigation report to its satisfaction.

The Audit Committee, together with all of the other board members of the Company, duly noted the EY Review Findings and forthwith conducted internal investigation. Thereafter, the Audit Committee, together with all of the other board members of the Company approved the publication of the 2017 Interim Results on 29 August 2017 which correctly reflected the Prepayments, after considering the following findings from their preliminary investigation:

- (1) upon being verbally informed by EY of the EY Review Findings on or about 18 August 2017, the executive Directors of the Company immediately instructed the Finance Department to look into the matter urgently. On 21 August 2017, the Finance Department provided the corrected management accounts (“**Corrected Management Accounts**”) of the Group to EY which correctly reflected the Prepayments with a view to replacing the Initial Incorrect Management Accounts which formed the subject of the EY Review Findings. As such, the said Corrected Management Accounts were provided to EY before the first formal notification letter issued by EY to the Audit Committee on 23 August 2017, and that the 2017 Interim Results have correctly reflected the Prepayments based on the Corrected Management Accounts;
- (2) the Audit Committee has engaged a legal adviser to independently obtain written confirmations from the Suppliers which all have confirmed the receipt of the Prepayments for the purpose of commodities trading business; and

- (3) the Prepayments were made to secure competitive purchase price and/or reliable supply for our commodities trading activities with the Suppliers, all of whom were top ten suppliers of the Group in terms of transaction amounts during the year ended 31 December 2016.

Prepayments

The Prepayments were made to a total of four Suppliers, all of whom were top ten suppliers of the Group in terms of transaction amounts during the year ended 31 December 2016:

	Prepayments paid up to 30 June 2017	Utilization of Prepayments as of 31 December 2017 <i>(Note 2)</i>	Historical transaction amounts for the year ended 31 December 2016	Background for Prepayments
Supplier A	USD35 million	All of the prepayments made up to 30 June 2017 have been utilized as purchase price for the commodities by the Group. <i>(Note 3)</i>	USD160 million	Supplier A informed that it can offer more favourable price if the Group can provide prepayments.
Supplier B	USD31 million	All of the prepayments made up to 30 June 2017 have been utilized as purchase price for the commodities by the Group.	USD378 million	Supplier B informed that it required prepayments to ensure reliable supply since its upstream suppliers also required deposits/ prepayments to ensure reliable supply.
Supplier C	USD25 million	All of the prepayments made up to 30 June 2017 have been utilized as purchase price for the commodities by the Group.	USD103 million	Supplier C informed that it required prepayments to ensure reliable supply since its upstream suppliers also required deposits/ prepayments to ensure reliable supply.

	Prepayments paid up to 30 June 2017	Utilization of Prepayments as of 31 December 2017 (Note 2)	Historical transaction amounts for the year ended 31 December 2016	Background for Prepayments
Supplier D	USD15 million	All of the prepayments made up to 30 June 2017 have been utilized as purchase price for the commodities, except for USD7.12 million which has been returned to the Group.	USD30 million	Supplier D informed that, since 2017, it was in the process of selecting downstream buyers and therefore required prepayments from comparatively less sizeable commodities trading companies such as the Group for the year of 2017. The Company provided pre-payments accordingly with a view to establishing long-term business relationships with Supplier D.

Note 1: all figures are rounded figures.

Note 2: all the amounts utilized are used as purchase proceeds for commodities which the Group has on-sold to downstream commodities traders or end-users for cash or letter of credit.

Note 3: The Group paid subsequent prepayments to Supplier A after the initial prepayments of USD35 million has been utilized. As of 31 December 2017, the subsequent prepayments to Supplier A which have not been utilized are approximately USD23.7 million. According to the prepayment agreement, the Supplier A agreed to offer more favourable price in return for the prepayment. There was no prepayments paid to Suppliers B, C & D which have not been utilized as purchase price or returned to the Group as of 31 December 2017.

Note 4: All the amounts of deposits were negotiated based on, among others, the historical transaction amounts, the projected minimum transaction amounts.

Each of the Suppliers was our top ten suppliers in terms of transaction amount during the financial year ended 31 December 2016, in respect of which no transactions with the Suppliers were identified as related party transactions in the audited accounts of the Company for the year ended 31 December 2016. To the best knowledge of the Directors and based on the update confirmation obtained from the Suppliers in December 2017, none of the Suppliers was our connected person under the Listing Rules.

Industry Report

As part of the proactive exercise in addition to the Forensic Investigation, the Audit Committee has also engaged Frost & Sullivan to study normal market practice in relation to prepayments, who has issued a report opining that transaction with deposit as pre-payment or advance payment is not uncommon in commodities trading industry. For buyers, key benefits of pre-payment or deposit include (i) guaranteed source of supply of commodity for buyer, and (ii) provide alternative source of liquidity and working capital required for purchasing, warehousing and processing (if any) for sellers so as to obtain better pricing terms or to secure reliable suppliers from the sellers' upstream suppliers.

Forensic Investigation Report

Scope of Forensic Investigation

Although in fact the Corrected Management Accounts have been provided to EY before publication of the 2017 Interim Results which correctly state the cash and bank balance, the Board having considered (1) the results of the Forensic Investigation may be required to collaborate with and/or clarify the situation; and (2) the finding of the reasons and backgrounds of providing the Initial Incorrect Management Accounts may improve the corporate governance, the Audit Committee agreed with EY with regard to conducting Forensic Investigation. Accordingly, BDO Financial Services Limited (“**BDOFS**”) was instructed by order of the Audit Committee to commence a forensic investigation on 4 December 2017 which has covered all the investigation scope proposed by EY based on rounds of communication, except for the Additional Investigation Scope below.

Apart from the Additional Investigation Scope, the scope of the Forensic Investigation conducted by BDOFS covered, among others, the following:

- Interview with the directors, management, financial personnel and cashier of the Group and the Company to understand the background and process of the subject matter, staff involved as well as review relevant supporting documents and relevant information in order to identify the key reasons of the matter.
- For the Subject Bank Accounts (i.e. the bank accounts concerning the cash balance discrepancy and out of which all the Prepayments were made), independently visit the bank to perform account inquiry and to obtain the bank statements of the Subject Bank Accounts covering the period from 1 January 2017 to 31 July 2017.
- Perform bank confirmation procedures in respect of the monthly bank balances of the Subject Bank Accounts for the period from 1 January 2017 to 31 July 2017.

- Review bank statements of the Subject Bank Accounts as well as accounting vouchers for the period from 1 January 2017 to 31 July 2017 and understand the Group/Company's payment approval procedures regarding payments as well as the department and staff involved in the payment approval process.
- Analyze the relevant purchases and accounts payable journal, ledger and relevant vouchers for the period from 1 January 2017 to 31 December 2017 in connection with the Suppliers and the Prepayments, in order to understand the details of the Prepayments and identify if the Prepayments were set off by purchases of the Company from the Suppliers or refunds to the Company from the Suppliers.
- Interview with the authorized representatives of the Suppliers involved in the Prepayments and arrange confirmation letters for the Suppliers to confirm (1) the prepayments the Suppliers have received from 1 January 2017 to 30 June 2017 from the Group, (2) amount due to/from the Group as at 30 June 2017 and 31 July 2017, and (3) confirming the underlying documents for the prepayments and subsequent utilization of prepayments or return of prepayments which were retrieved from or provided by the Company (such as contracts, invoices and bill of lading) for the period from 1 January 2017 to 31 October 2017.

Additional Forensic Investigation Scope not agreed by Audit Committee

The Additional Investigation Scope which the Audit Committee failed to agree after rounds of communications with EY were:

- (1) EY requested the Forensic Investigation to fully cover the period between 1 January 2017 and 30 November 2017, while the Audit Committee disagreed and considered that (i) the Forensic Investigation shall focus on the period of 1 January 2017 and 31 July 2017 which is sufficient to address the EY Review Findings which relate to the six months ended 30 June 2017 only, (ii) forensic investigation covering the period up to 30 November 2017 will incur cost and take time; and (iii) it will duplicate the audit work for the year ended 31 December 2017 which is expected to commence soon. However, the Audit Committee agreed that the Forensic Investigation shall cover reviewing the supporting documents for the subsequent utilization or refund of the Prepayments;
- (2) EY requested the Forensic Investigation to cover all the material bank accounts of the Group in addition to the Subject Bank Accounts, while the Audit Committee disagreed and considered that (i) the Forensic Investigation shall focus on the Subject Bank Accounts (i.e. the bank accounts showing the cash discrepancy and out of which all the Prepayments were made) which form the subject of the EY Review Findings, and (ii) forensic investigation covering all the bank accounts of the Group will incur additional costs and time which are disproportionate for the purpose of addressing the EY Review Findings; and

- (3) EY requested the Forensic Investigation to obtain supporting documents from the Suppliers with respect to the commercial rationale and genuineness of the transactions, while the Audit Committee disagreed and considered that (i) obtaining supporting documents from Suppliers to support the commercial rationale and genuineness of the transactions would impose unduly burdensome workload on the Suppliers and hence might hinder the business relationships, and therefore it would be more appropriate and practicable to obtain confirmation from Suppliers on transaction amounts and balance etc, as well as the supporting documents which were provided by the Company (such as contracts, invoices and bill of lading); and (ii) all the Suppliers were our Group's major suppliers in the past, hence there is no apparent need to request for additional supporting documents from Suppliers to prove the genuineness and commercial rationale of the transactions.

(collectively, the “**Additional Investigation Scope**”)

Key findings of Forensic Investigation Report

On the date of this announcement, the Audit Committee received the Forensic Investigation Report from BDOFS (the “**BDOFS Report**”). The BDOFS Report included their review on the EY Review Findings after covering the investigation scope proposed by EY except for the Additional Investigation Scope. Based on the BDOFS Report:

- (1) From BDOFS's investigation, the EY Review Findings resulted from the Company's then finance manager not recording the Prepayments in the general ledgers of the Company which resulted in providing the Initial Incorrect Management Accounts to EY. In this respect, the chief financial officer of the Company has also admitted responsibility for the oversight in respect of the Initial Incorrect Management Accounts.
- (2) BDOFS has not identified any evidence indicating that the executive directors of the Company had any involvement in the EY Review Findings. It was noted from an email on 21 August 2017 from the Company's then finance manager to EY provided by the Company that the Company provided amended management accounts to EY.
- (3) Based on the results of background searches performed, information and confirmations provided by the Group and the written confirmations received from the Suppliers, BDOFS has not noted any findings which suggest the Suppliers are parties related to the Group and/or its executive directors.
- (4) BDOFS also noted that the Prepayments were supported by relevant documents and have since been either set off against purchases made by the Company or refunded to the Company.

However, the work performed by BDOFS were subject to the following limitations (BDOFS’s findings are therefore subject to revision if not for the limitations):

- I. BDOFS did not meet or have discussions with EY as EY was of the view that it only provided audit service to the Company and hence would not accept the interview request by BDOFS;
- II. The review on the Prepayments and their corresponding purchases and sales transactions only covered the period between January 2017 and December 2017 and was based solely on the information made available by the Company, interviews with the Suppliers and obtaining confirmations from the bank with respect to the Subject Bank Accounts;
- III. EY’s requested Additional Investigation Scope was not performed for reasons as explained in this announcement.

Internal Control Deficiencies

While the objective of the procedures performed by BDOFS was not a review on the Company’s internal controls, BDOFS identified a number of major weaknesses in the Company’s internal controls and procedures. The said weaknesses that might have contributed to the occurrence of the EY Review Findings are set out below. The Company’s respective correction measures to improve the controls and corporate governance so as to minimize any future recurrence are also detailed below:

Internal control deficiencies identified	Rectification measures
<p>There was no segregation of duties between the approval of payments from the Subject Bank Accounts and the approval of the corresponding accounting entries. Previously, both tasks were the responsibility of the manager of the Finance Department. There was no additional or independent counter checking to make sure the transaction was supported by relevant documents and accurately recorded in the Company’s accounts in a timely manner.</p>	<p>Group has established a specific role of chief accountant for compiling the ledger and management accounts and thereby separating the previous dual role of the manager of Finance Department who is overseeing both bank transfers and compiling monthly ledger and management accounts.</p>

<p>There was no third party confirmation performed with the Company's suppliers on a regular basis with respect to the amounts due to or from the respective parties. The accuracy and completeness of the reported balances in its general ledgers and management accounts with respect to the Company's purchases, prepayments and accounts payable were not therefore confirmed by the counter parties.</p>	<p>The trading department of the Company will obtain confirmation with suppliers on a monthly basis to confirm the monthly transaction amounts, balance etc.</p>
<p>Manager of the Finance Department compiled the monthly management accounts without a third party to counter check the management accounts with the supporting documents.</p> <p>There were no checks and balances procedures performed after the monthly accounts were prepared by the finance manager. For example, there was no cross checking of the bank balance figures per the monthly management accounts and the original bank statements by another staff.</p>	<p>Group has established a specific role of chief accountant for compiling the ledger and management accounts for counter-checking by the manager of the Finance Department.</p> <p>The finance manager will check the bank balances in the management accounts against the original bank statements.</p>

The Audit Committee has assessed the BDOFS Report and agreed with its findings. The Company has commenced steps to adopt the rectification measures.

Reasons for Proposed Change of Auditor

To the best knowledge of the Audit Committee, the Audit Committee is of the view, with whom the other board members concur, that

- (1) the EY Review Findings have been sufficiently addressed by the Forensic Investigation while all the internal control deficiencies identified in the Forensic Investigation have all been sufficiently addressed by rectification measures;
- (2) for the reasons set out above, the costs, processing time and the uncertainty on the time required for the Additional Investigation Scope might lead to possible delay in dispatch of the annual results for the year ended 31 December 2017; and

- (3) it is in the interest of the Shareholders as a whole to terminate EY's engagement as auditor and to appoint Graham H. Y. Chan & Co. as new auditor so as to attain greater certainty in commencing the audit works for the 2017 Annual Results which is in the interest of the shareholders as a whole. Graham H. Y. Chan & Co. has reviewed the Forensic Investigation Report and the Audit Committee's reasons for disagreeing with EY on the Additional Investigation Scope, and has expressed its view that it is prepared to accept the appointment subject to shareholders' approval in EGM as well as completion of clearance procedures required by applicable laws and regulations.

As such, the Board proposes, subject to the approval of the Shareholders at the EGM to terminate the engagement of EY as auditor of the Company before the expiration of their term of office and to appoint Graham H. Y. Chan & Co. as the new auditor of the Company in place of EY and to hold office until the conclusion of the forthcoming annual general meeting of the Company.

The EGM will be convened and held for the Shareholders to consider and, if thought fit, approve the special resolution for termination of the appointment of EY as the existing auditor of the Company. Further, an ordinary resolution will be submitted for approval by the Shareholders at the EGM to appoint Graham H. Y. Chan & Co. as the new auditor of the Company and to hold office until the conclusion of the next annual general meeting of the Company.

A circular containing, among others, information on the Proposed Change of Auditor together with a notice convening the EGM and the related proxy form will be despatched to the Shareholders as soon as practicable.

EY have confirmed that other than disclosed above, there is no other matter in connection with the change of auditor that needs to be brought to the attention of the Shareholders.

To the best of the Directors' knowledge, information and belief, having made all reasonable enquiries, save for matters disclosed in this announcement, there is no matter in relation to the Proposed Change of Auditor which needs to be brought to the attention of the Shareholders. The Board wishes to take this opportunity to express its gratitude to EY for their professional services rendered to the Group in the past years.

By order of the Board
CAA Resources Limited
Chu Lok Fung Barry
Company Secretary

Hong Kong, 24 January 2018

As at the date of this announcement, the executive Directors are Mr. Li Yang, Ms. Li Xiaolan, Mr. Wang Er and Ms. Xu Mijia, and the independent non-executive Directors are Mr. Leung Yiu Cho, Dr. Li Zhongquan and Dr. Wang Ling.