

STATEMENT OF DISCIPLINARY ACTION

Exchange's Disciplinary Action against Longrun Tea Group Company Limited (stock code: 2898) and Its Current Directors

The Exchange Listing Rules are designed to protect investors and, amongst other things, to dispel any actual or perception of conflict. Investors rely on information in the public domain to make their investment decisions. It is important that issuers publish their accurate and complete financial information in a timely manner, and comply with the notifiable and connected transaction requirements under the Exchange Listing Rules. Failure to do so can destroy transparency and confidence in the market.

It is imperative for issuers and directors to ensure that adequate and effective internal controls are implemented and maintained for procuring compliance with the Exchange Listing Rules and for protecting the interests of issuers and shareholders.

In performing their duties, directors must, inter alia, act honestly, for proper purpose and in good faith in the issuer's interests, and also follow up anything untoward that comes to their attention. The Exchange attaches great importance to the proper discharge of director's duties and takes breaches of these duties seriously. Such breaches may result in disciplinary actions and the imposition of public sanctions and, in cases with egregious conduct (as in this case), statements that the retention of office by directors is prejudicial to the investors' interests.

.../2

The Listing Review Committee of The Stock Exchange of Hong Kong Limited (Listing Review Committee)**CENSURES:****(1) Longrun Tea Group Company Limited (Company) (Stock Code: 2898)**

for breaching Rules 2.13(2), 13.46(2)(a), 13.48(1), 13.49(1), 13.49(3)(i), 13.49(6), 13.89(3), 14.34, 14.38A, 14.40, 14.41, 14A.22, 14A.35, 14A.36 and 14A.46 of the *Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (Exchange Listing Rules or Rules)* for:

- (a) failing to comply with the reporting, announcement, circular and shareholders' approval requirements for a major and connected transaction;
- (b) failing to ensure that the Company's financial information contained in its interim results for the six months ended 30 September 2016 (**2016 Interim Results**) was accurate and complete in all material respects, and not misleading or deceptive;
- (c) its delay in publishing and/or despatching seven sets of financial results and/or reports (**Outstanding Results and Reports**); and
- (d) failing to explain its deviation from a code provision in the Corporate Governance Code (**CG Code**), Appendix 14 to the Exchange Listing Rules;

AND FURTHER CENSURES:

- (2) **Dr Chiu Ka Leung (Dr Chiu)**, current executive director (**ED**) and Chairman of the Company;
- (3) **Mr Jiao Shaoliang (Mr Jiao)**, current ED of the Company;
- (4) **Ms Yeh Shu Ping (Ms Yeh)**, current ED, Vice-chairman and Chief Executive Officer of the Company;
- (5) **Dr He William** (also known as **Lu Pingguo (Dr He)**), current ED of the Company;
- (6) **Mr Guo Guoqing (Mr Guo)**, current independent non-executive director (**INED**) of the Company;
- (7) **Mr Kwok Hok Lun (Mr Kwok)**, current INED of the Company;
- (8) **Mr Lam Siu Hung (Mr Lam)**, current INED of the Company; and
- (9) **Dr Liu Zhonghua (Dr Liu)**, current INED of the Company;

for breaching their obligations under:

- (a) Rules 3.08(a), (b), (d) and (e) (Dr Chiu and Mr Jiao only), and 3.08(f); and
- (b) the *Declaration and Undertaking with regard to Directors* given to the Exchange in the form set out in Appendix 5B to the Exchange Listing Rules (**Undertaking**) for failing to comply with the Exchange Listing Rules to the best of their ability and failing to use their best endeavours to procure the Company's compliance with the Exchange Listing Rules,

(the directors identified at (2) to (9) above are collectively referred to as the **Relevant Directors**).

AND FURTHER DIRECTS publication of a public statement under Rule 2A.09(7) that, in the Exchange's opinion, by reason of their persistent and/or wilful failure to discharge their responsibilities under the Exchange Listing Rules, the retention of office by Dr Chiu and Mr Jiao is prejudicial to the interests of investors.

For the avoidance of doubt, the Exchange confirms that the sanctions and directions in this Statement of Disciplinary Action apply only to the Company and the Relevant Directors, and not to any other past or present members of the board of directors of the Company.

HEARINGS

On 11 November 2020, the Listing Committee conducted a hearing into the conduct of the Company and the Relevant Directors in relation to their obligations under the Exchange Listing Rules and/or the Undertakings. The Listing Committee issued its decision as set out in a letter dated 30 December 2020 (the **Listing Committee Decision**).

Following an application for a review of the Listing Committee Decision by the Company and Relevant Directors (the **LRC Review**), the Listing Review Committee conducted a review hearing on 25 May 2021 into the conduct of the Company and the Relevant Directors in relation to their obligations under the Exchange Listing Rules and/or the Undertakings.

SUMMARY OF FACTS

Major and connected transaction

On 1 September 2016, Dr Chiu and Mr Jiao procured the Company's subsidiary (**Subsidiary**) to enter into a loan agreement (**Loan Agreement**) with a borrower (**Borrower**), by which the Subsidiary agreed to provide a short-term bridging loan not exceeding RMB140 million (**Loan**) to the Borrower for investing in Longrun tea products. On the same day, the Borrower entered into a tea storage agreement (**TSA**) with a connected person (**Supplier**) owned by Dr Chiu and Mr Jiao. Under the TSA, the Supplier agreed to provide two-year storage service, free of charge, for storing Longrun tea products to be invested by the Borrower.

According to the Company, the parties agreed that the loan proceeds were to be directly transferred by the Subsidiary to the Supplier to settle the consideration payable by the Borrower under the TSA. The Loan arrangement was approved by Dr Chiu and Mr Jiao without informing the Company's and the Subsidiary's boards of directors.

The Borrower is a deemed connected person of the Company. The Loan transaction constituted a major and connected transaction. The Company failed to comply with the announcement, reporting, circular and independent shareholders' approval requirements under the Exchange Listing Rules in connection with the Loan Agreement.

Inaccurate disclosure

The Loan (in the total sum of RMB137.57 million) was transferred in tranches by the Subsidiary between September and December 2016. At the relevant time, the Loan and interest receivable (as at 30 September 2016) were not recorded in the Subsidiary's accounts and in its 2016 Interim Results published on 18 November 2016.

Audit findings and disclaimers of opinion

During the audit of the FY16/17 results, the Company's then auditors, Ernst & Young (**EY**), identified inconsistencies between the cash and bank balances on the Subsidiary's books and the banks' confirmation (**Inconsistencies**). EY advised the Company to conduct an independent forensic investigation into the Inconsistencies. Despite EY's advice, the Company engaged Baker Tilly Hong Kong Risk Assurance Limited (**Baker Tilly**) only to perform certain agreed-upon procedures (**AUP**).

Subsequently, the Company terminated EY's engagement and appointed Moore Stephens CPA Limited (**Moore Stephens**) as its new auditors. Moore Stephens issued a disclaimer of opinion on both the FY16/17 and FY17/18 annual results.

Internal controls

Prior to the Loan transaction, it was found during the FY14/15 internal control review that the Company did not have an effective system for its senior management to declare their material interests in transactions with the Group so as to ensure Exchange Listing Rule compliance. The Company did not take any steps to address this issue apart from simply informing its directors and senior management of their responsibility to declare their interests in transactions with the Group.

Baker Tilly identified a number of internal control deficiencies, among other things, during the AUP. The Company's audit committee (**Audit Committee**) agreed there were deficiencies in the Company's internal control procedures, and the Company announced on 24 August 2018 that it had adopted remedial measures to strengthen its internal controls.

Outstanding Results and Reports

The Company failed to publish and/or despatch the following results and/or reports as they fell due under the Exchange Listing Rules:

Financial results / report	Period end	Due date	Published	Delay (months)	Rule breached
Unaudited management accounts	31/03/2017	30/06/2017	13/09/2017	2.5	13.49(3)(i)
FY16/17 annual results	31/03/2017	30/06/2017	10/10/2018	15	13.49(1)
FY16/17 annual report	31/03/2017	31/07/2017	29/10/2018	15	13.46(2)(a)
2017 interim results	31/09/2017	30/11/2017	10/10/2018	10	13.49(6)
2017 interim report	31/09/2017	31/12/2017	8/11/2018	10	13.48(1)
FY17/18 annual results	31/03/2018	30/06/2018	10/10/2018	3	13.49(1)
FY17/18 annual report	31/03/2018	30/07/2018	21/11/2018	3	13.46(2)(a)

Deviation from CG Code

The Company circulated quarterly management accounts to its board of directors between June and December 2016. The Company's 2016 interim report and FY16/17 annual report did not disclose its practice to circulate quarterly (instead of monthly) management accounts to the board, nor did the Company provide any reasons for its deviation from code provision C.1.2 of the CG Code.

LISTING RULE REQUIREMENTS

Company

Rule 2.13(2) requires a listed issuer to ensure that the information contained in any announcement or corporate communication is accurate and complete in all material respects and not misleading or deceptive.

Rules 13.46(2)(a), 13.48(1), 13.49(1), 13.49(6) and 13.49(3)(i) stipulate the timing for the publication or despatch of a listed issuer's preliminary announcement of interim and annual results and interim and annual reports and results based on unaudited management accounts.

Rule 13.89(3) stipulates that a listed issuer must give considered reasons for any deviation from the code provisions of the CG Code in its annual reports and interim reports.

Rule 14.34 requires a listed issuer to publish an announcement as soon as possible after the terms of a major transaction have been finalised.

Rules 14.38A, 14.40 and 14.41 provide that a major transaction must be conditional upon shareholders' approval and a circular must be sent to its shareholders and the Exchange.

Rule 14A.22 requires a listed issuer to inform the Exchange of any proposed transaction with a deemed connected person.

Rule 14A.35 requires a listed issuer to announce a connected transaction as soon as practicable after its terms have been agreed.

Rules 14A.36 and 14A.46 provide that a connected transaction must be conditional upon shareholders' approval at a general meeting held by the listed issuer, and a circular must be issued to shareholders.

Code provision C.1.2 of the CG Code requires a listed issuer's management to provide all members of the board with monthly updates in sufficient detail to enable the board as a whole and each director to discharge their duties under Rule 3.08 and Chapter 13.

Directors

Under Rules 3.08, 3.16 and 13.04 of the Exchange Listing Rules, the board is collectively responsible for the company's management and operations, and the directors are collectively and individually responsible for the company's compliance with the Exchange Listing Rules.

Rule 3.08 provides that the Exchange expects the directors, both collectively and individually, to fulfil fiduciary duties and duties of skill, care and diligence to a standard at least commensurate with the standard established by Hong Kong law. These duties include the duty to act honestly and in good faith in the interests of the company as a whole (Rule 3.08(a)), to act for proper purpose (Rule 3.08(b)), to avoid actual and potential conflicts of interest and duty (Rule 3.08(d)), to disclose fully and fairly his/her interests in contracts with the issuer (Rule 3.08(e)) and to apply such degree of skill, care and diligence as may reasonably be expected of a person of his/her knowledge and experience and holding his/her office within the issuer (Rule 3.08(f)).

Rule 3.08 highlights the importance of directors taking an active interest in the issuer's affairs and having a general understanding of its business. This includes an obligation that they must follow up anything untoward that comes to their attention.

A director of a listed issuer is under an obligation, pursuant to his/her Undertaking, to comply to the best of his/her ability with the Exchange Listing Rules and use his/her best endeavours to procure the Company's compliance with the Exchange Listing Rules.

Under the CG Code (Appendix 14 to the Exchange Listing Rules), directors are required, among other things, to oversee the issuer's risk management and internal control systems on an ongoing basis and ensure that a review of the effectiveness of the issuer's and its subsidiaries' risk management and internal control systems has been conducted at least annually, and when conducting their annual review, the directors should consider the effectiveness of the issuer's processes for financial reporting and Exchange Listing Rule compliance (code provisions C.2.1 and C.2.3 of the CG Code).

Further, code provision C.3.3 of the CG Code requires, among other things, the audit committee's terms of reference to include the review of the issuer's risk management and internal control systems, the review of any material queries raised by the auditor to management about accounting records, financial accounts or systems of control and management's response, and to ensure that the board will provide a timely response to the issues raised in the external auditor's management letter.

LISTING COMMITTEE'S FINDINGS OF BREACHES BY THE COMPANY

The Listing Committee under the Listing Committee Decision, having considered the written and/or oral submissions of the Listing Division, the Company and the Relevant Directors, concluded as follows with respect to the Company's breaches:

The Listing Committee noted that the Company had admitted that it breached Rules 2.13(2), 13.46(2)(a), 13.48(1), 13.49(1), 13.49(3)(i), 13.49(6), 14.34, 14.38A, 14.40, 14.41, 14A.22, 14A.35, 14A.36 and 14A.46, and found that the Company did breach these Rules, as well as Rule 13.89(3) for failing to comply with the announcement, reporting, circular and independent shareholders' approval requirements in connection with the Loan Agreement, to record the Loan and interest receivable (as at 30 September 2016) in its 2016 Interim Results, to publish and/or despatch the Outstanding Results and Reports in a timely manner, and to give considered reasons for its deviation from code provision C.1.2 of the CG Code.

Internal controls

The Listing Committee in the Listing Committee Decision had also concluded that the Company did not have adequate and effective internal controls during the relevant time to protect the interests of the Company and shareholders and to ensure the Company's compliance with the Exchange Listing Rules. The Company's internal control deficiencies contributed, at least partly, to the Company's Rule breaches.

In the LRC Review, the Company had not sought a review of the Listing Committee's findings of breaches with respect to the Company but only sought a review of the sanction imposed on the Company under the Listing Committee Decision.

LISTING REVIEW COMMITTEE'S FINDINGS OF BREACH

The Listing Review Committee in the LRC Review, having considered the written and/or oral submissions of the Listing Division, the Company and the Relevant Directors, concluded as follows:

Relevant Directors' breaches

The Listing Review Committee upheld the Listing Committee Decision with respect to the Relevant Directors' breaches and concluded that:

- (a) the Relevant Directors breached (i) Rule 3.08(f) for failing to apply such degree of skill, care and diligence as may reasonably be expected of persons of their knowledge and experience holding their offices within the Company; and (ii) their respective Undertaking for failing to comply with the Listing Rules to the best of their ability and failing to use their best endeavours to procure the Company's compliance with the Listing Rules:
 - (i) The evidence showed that the Company's then internal controls were deficient. The Relevant Directors failed to ensure the Company had an adequate and effective internal control system to procure the Company's Exchange Listing Rule compliance in relation to the Loan and to protect the interests of the Company and its shareholders.

- (ii) The FY14/15 internal control review report indicated that the Company did not have an effective system for the senior management to declare their material interests in transactions with the Group so as to ensure Exchange Listing Rule compliance. The Relevant Directors did not take sufficient steps to address this deficiency or enhance the Company's internal control procedures to ensure the Company's Exchange Listing Rule compliance.
 - (iii) The evidence also showed that EY informed (a) both the Audit Committee and the board of the Company that the AUP would not be sufficient for audit purposes and that an independent forensic investigation should be conducted; and (b) the Audit Committee of the need to involve EY in setting the scope of the investigation. Despite EY's advice, the board resolved to perform only an AUP. It did not involve Moore Stephens (which was engaged to replace EY as auditors) in discussing the AUP's scope, nor consult Moore Stephens as to whether the AUP would be sufficient to address the issues relating to the Inconsistencies and for the purpose of the FY16/17 audit.
- (b) Dr Chiu and Mr Jiao breached (i) Rule 3.08(a), (b), (d), (e) and (f) for failing to (1) act honestly and in good faith in the interests of the Company as a whole; (2) act for proper purpose; (3) avoid their actual and potential conflicts of interest and duty; (4) disclose fully and fairly their interests in the Loan Agreement; and (5) apply such degree of skill, care and diligence as may reasonably be expected of persons of their knowledge and experience holding their offices within the Company; and (ii) their respective Undertaking for failing to comply with the Listing Rules to the best of their ability and failing to use their best endeavours to procure the Company's compliance with the Listing Rules:
- (i) Dr Chiu and Mr Jiao owned the Supplier. Despite the nature of the Loan and the obvious conflict of interest, they approved the Loan Agreement without informing the respective board of directors of the Company and the Subsidiary. They admitted they failed to consider the actual or potential conflict of interests, the need to disclose their interests in the Loan / the Loan Agreement and the need to abstain from voting on the decision in respect of the Loan Agreement. Dr Chiu and Mr Jiao did not take any steps to procure the Company's compliance with the Exchange Listing Rules at the time of the Loan transactions.

- (ii) Dr Chiu and Mr Jiao asserted that they did not know the Loan was not recorded in the Subsidiary's accounts. A prudent director, in their position exercising due care and diligence, would have identified the significant discrepancies in the cash position in the management accounts for the period ended 31 December 2016, given the significant amount and their knowledge of the Loan.
 - (iii) The Loan Agreement was entered into without complying with the requirements under Chapters 14 and 14A of the Exchange Listing Rules and the Group's internal control procedures. Dr Chiu and Mr Jiao did not disclose the Loan Agreement to the board. The approval of the Loan Agreement by Dr Chiu and Mr Jiao demonstrated their failure to (i) apply such skill, care and diligence as may reasonably be expected of persons of their knowledge and experience holding their offices, (ii) act honestly and in good faith in the interests of the Company as a whole, (iii) act for proper purpose, (iv) avoid their actual and potential conflicts of interest, and (v) disclose their interests in the Loan Agreement fully and fairly. Taking this and the factual matrix relating to the Loan into account, it was apparent that Dr Chiu and Mr Jiao had not exercised their powers as directors in a proper way.
- (c) Dr Chiu's and Mr Jiao's conduct in this case showed a persistent and/or wilful failure to discharge their responsibilities under the Exchange Listing Rules.

REGULATORY CONCERN

The Listing Committee and Listing Review Committee regarded the breaches in this matter as serious:

- (a) This case revealed serious concerns over the Company's corporate governance, Dr Chiu's and Mr Jiao's persistent and/or wilful disregard towards Rule compliance, and the Relevant Directors' ability to ensure that notifiable and connected transactions were identified and reported to the board for approval and to procure the Company's Exchange Listing Rule compliance by way of the Company's internal control system.
- (b) The Company's failure to comply with Chapters 13, 14 and 14A of the Exchange Listing Rules deprived the Company's investors of their right to the timely receipt of information in relation to, and the Company's independent shareholders of their right to vote on, the Loan. Given the significant amount and unsecured nature of the Loan, the Company had to bear the credit risk and the potential adverse impact arising from the Loan.

- (c) Dr Chiu's and Mr Jiao's conduct represented their persistent and/or wilful disregard towards compliance with the Exchange Listing Rules. They procured the Loan advances in five tranches over three months and persistently failed to inform the other directors, declare their interests and procure the Company's compliance with the Exchange Listing Rules in relation to the Loan.
- (d) It is important for the Relevant Directors to ensure the Company review its internal control system and to follow up on any deficiencies identified or anything untoward that comes to their attention. The evidence in this case revealed deficiencies in the Company's internal controls, which contributed to the Company's Rule breaches. The Directors did not take sufficient steps to ensure the Company's internal control system was adequate and effective.

SANCTIONS

The Listing Review Committee decided to:

- (1) censure the Company for its breaches of Rules 2.13(2), 13.46(2)(a), 13.48(1), 13.49(1), 13.49(3)(i), 13.49(6), 13.89(3), 14.34, 14.38A, 14.40, 14.41, 14A.22, 14A.35, 14A.36 and 14A.46;
- (2) censure each of Dr Chiu and Mr Jiao for his breach of Rules 3.08(a), (b), (d), (e) and (f), and his Undertaking;
- (3) censure each of Ms Yeh, Dr He, Mr Guo, Mr Kwok, Mr Lam and Dr Liu for his/her breach of Rule 3.08(f) and his/her Undertaking; and
- (4) state that in the Exchange's opinion, by reason of the persistent and/or wilful failure of Dr Chiu and Mr Jiao to discharge their responsibilities under the Exchange Listing Rules, the retention of office by Dr Chiu and Mr Jiao is prejudicial to the interests of investors.

The Listing Review Committee further directed:

- (5) the Company to (a) appoint an independent compliance adviser (being any corporation or authorised financial institution licensed or registered under the Securities and Futures Ordinance for Type 6 regulated activity and permitted under its licence or certificate of registration to undertake work as a sponsor) satisfactory to the Listing Division on an ongoing basis for consultation on Exchange Listing Rule compliance for two years within four weeks from the publication of this Statement of Disciplinary Action; and (b) submit the proposed scope of retainer to the Listing Division for comment before appointment of the compliance adviser. The compliance adviser shall be accountable to the Audit Committee;
- (6) Ms Yeh, Dr He, Mr Guo, Mr Kwok, Mr Lam and Dr Liu to (a) attend 26 hours of training on regulatory and legal topics including Listing Rule compliance (**Training**). The Training must include at least three hours on each of (i) directors' duties; (ii) the CG Code; and (iii) the Exchange Listing Rule requirements for notifiable and connected transactions and financial reporting, to be provided by training providers approved by the Listing Division and completed within 90 days from the date of the decision letter of the Listing Committee; and (b) provide the Listing Division with the Training provider's written certification of full compliance within two weeks after Training completion;
- (7) the Company to publish an announcement to confirm that the directions in paragraphs (5) and (6) above have been fully complied with within two weeks after the respective fulfilment of each of those directions;
- (8) the Company to submit a draft announcement referred to in paragraph (7) above for the Listing Division's comment and may only publish the announcement after the Listing Division has confirmed it has no further comment on it; and
- (9) following the publication of this Statement of Disciplinary Action, any changes necessary and any administrative matters which may emerge in the management and operation of any of the directions set out in paragraphs (5) to (8) above are to be directed to the Listing Division for consideration and approval. The Listing Division should refer any matters of concern to the Listing Committee for determination.