## General Announcement::Update on Review

### Issuer & Securities

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| **Issuer/ Manager** | S I2I LIMITED |
| **Securities** | S I2I LIMITED - SG1BD0000008 - BAI |
| **Stapled Security** | No |

### Announcement Details

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| **Announcement Title** | General Announcement |
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| **Submitted By (Co./ Ind. Name)** | Maneesh Tripathi |
| **Designation** | Executive Director & Group CEO |
| **Description (Please provide a detailed description of the event in the box below)** | Reference to the announcement dated 24 March 2014 with regards to, inter alia, the qualified opinion and emphasis of matter by the Company's erstwhile auditor's Ernst &Young LLP on the FY2013 Financial Statements.<br><br>Update on review of certain procedures performed by two independent professional firms.<br><br>Please see the attached. |

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| **Attachments** | Si2i_BDO_Announcement_final.pdf<br>Si2i_BDO_Announcement_final_Annex1.pdf<br>Si2i_BDO_Announcement_final_Annex2.pdf<br>Total size =443K |

**S I2I LIMITED**
**(Formerly known as Spice i2i Ltd.)**
**(Incorporated in the Republic of Singapore)**
**(Company Registration No. 199304568R)**

**UPDATE ON REVIEW**

## 1. Introduction

1.1 The Board of Directors (the "**Board**") of S i2i Limited (the "**Company**") refers to the announcement made on 24 March 2014 (the "**24 March 2014 Announcement**") with regards to, *inter alia*, the qualified opinion and emphasis of matter by the Company's erstwhile auditor's Ernst &Young LLP ("Auditor") on the FY2013 Financial Statements.

1.2 All capitalised terms not defined in this announcement shall bear the meaning ascribed to them in the 24 March 2014 Announcement.

1.3 As stated in the 24 March 2014 Announcement, the Company had engaged two independent professional firms to perform certain procedures regarding:

(a) certain irregularities in the accounting records of the Cavu Group (details of which are set out in paragraph (C)(i)(a) of the 24 March 2014 Announcement); and

(b) certain quantities of mobile phones billed and allegedly not delivered in Indonesia (details of which are set out in paragraph (C)(ii)(b)(1) of the 24 March 2014 Announcement).

1.4 Ernst & Young Advisory Pte. Ltd. ("**EY Advisory**") and BDO LLP ("**BDO**"), the professional firms engaged to perform the review of the allegations stated above respectively, have since completed their review of information and documents provided by the Company and interviews with various staff members of the Company and Cavu Group. Each of EY Advisory and BDO have issued reports respectively dated 7th July 2014 (the "**EY Report**") and 27 August 2014 (the "**BDO Report**") on its findings of the above allegations.

1.5 Copies of the summaries of procedures performed by EY Advisory and agreed upon procedures performed by BDO, as prepared by the management of the Company and reviewed by EY Advisory and BDO respectively, are annexed to this announcement as Annexure 1 and Annexure 2 respectively.

1.6 As stated in the report by the current statutory auditor of the Company, Moore Stephens LLP, in relation to the audited financial statements of the Group for the financial year ended 31 December 2014 ("**FY2014 Financial Statements**"), the consolidated financial statements of the Group and the balance sheet of the Company are properly drawn up with the provisions of the Singapore Companies Act and Singapore Financial Reporting Standards so as to give a true and fair view of the state of the affairs of the Group and of the Company as at 31 December 2014. An electronic copy of the annual report of the Company for the financial year ended 31 December 2014 enclosing the FY2014 Financial Statements is available online at www.sgx.com.

## 2. Cavu Group

2.1 The Company would like to provide updates to various points made in paragraph (C)(i) of the 24 March 2014 Announcement. The Company wishes to inform the Shareholders that after the auditors of Cavu Group Ernst & Young LLP had performed additional audit procedures, Ernst & Young LLP has given an unqualified opinion on the accounts of the Cavu Group for the period ended 31 December 2013.

2.2 The key findings of the EY Report are summarised as follows:

(a) A staff member of the Cavu Group had admitted to creating evidence that companies within the Cavu Group had in its possession an amount of software and stock when in fact such software and stock was not in its possession. In addition, the same staff member had admitted to creating documents on two lease/hire purchase agreements involving companies within the Cavu Group and a third party company.

(b) A staff member of the Cavu Group had failed to disclose his interest in companies which had dealings with the Cavu Group. There is evidence to suggest that one of these dealings may not have taken place on an at arm's length basis.

(c) There were also accounting matters identified relating to an inter-company transfer of asset and the cross allocation of a contingency/marketing reserve fund by a staff member of the Cavu Group.

(d) There were allegations relating to improper business practices involving employees/ex-employees of the Cavu Group.

2.3 The Company takes a serious view of these findings and has undertaken an internal review of the same. To that end, the Company has implemented appropriate disciplinary measures against the employees concerned, including the exit of certain employees.

2.4 The Company has clawed back the variable pay component from the errant employees and exited certain employees who had violated the Company's policy. Warning letters were given to other employees who needed to be disciplined. Counselling and training was imparted to all concerned staff members, with extra degree of scrutiny initiated. A report has been made to the ministry of finance by statutory auditors. The Company has not been informed by the ministry of finance regarding any follow up actions which the ministry of finance proposes to take or has taken in relation to the report.

2.5 In particular, to address the issues highlighted in:

- 2.2(a) above, the Company has implemented disciplinary measures against the employees concerned and reminded all staff that perpetrators of such improper activities will be disciplined by the Company;
- 2.2(b) above, the Company has made it now mandatory for all the employees to declare their interest in any transaction that they may be entering into with third parties; and
- 2.2(c) above, a new delegation of authority matrix has been approved which defines responsibility for all sales and purchase transactions. The Company notes that the accounting matters referred to in paragraph 2.2(c) above complied with the relevant accounting standards.

The alleged improper practices highlighted in 2.2(d) above relate to the period of 2009. Since then, there has been no occurrences of such alleged improper practices.

2.6 The Board had already made adjustments for the accounting irregularities in the FY2013standalone financial statements of the respective subsidiaries of Cavu Group as reflected in Note 39 of the FY2013 Financial Statements and as such, no further adjustments are required to be made.

**3. PT Selular Group**

3.1 The Company would like to provide updates to various points made in paragraphs (C)(ii)(b) of the 24 March 2014 Announcement.

3.2 The Company wishes to inform Shareholders that BDO has completed the agreed-upon special audit procedures. The exceptions noted in their review are being addressed by the Company's management as indicated in the table below. Apart from these exceptions, which relate to the strengthening of internal controls, BDO has concluded that they did not come across any potential basis to indicate that quantities of phones billed and booked as sold by PT Selular Group remained kept in the warehouse. In addition, BDO concluded that they did not come across any incorrect provisions and write-offs other than the exceptions arising from the agreed upon audit procedures highlighted in their review. BDO noted that the value of the errors for the unserviceable, free of charge stock discrepancies of concern were considered to be small (amounting to approximately USD 582,000) as compared with the total transactional value.

3.3 The Company has taken into account all the findings of BDO and has undertaken the necessary corrective actions, which are currently ongoing, to address these findings. The progress of these corrective actions has been and will continue to be monitored by BDO.

3.4 The Company wishes to highlight that prior to the appointment of BDO to perform the review of the allegations referred to in paragraph 1.3(b) of this announcement, the Company had since July 2013 began implementing corrective steps to improve internal control.

3.5 A summary of some of the key findings in the BDO Report, as well as the specific measures which the Company has taken in connection with the BDO Report to strengthen the internal control procedures in the PT Selular Group are set out as follows.

| **Findings** | **Follow up action** |
|---|---|
| Lack of supporting documents for sales returns and subsequent re-sale to other customers | <u>Tightening returns policy and minimising sales returns</u><br><br>The Company has sought to minimise incidents of sales returns by expressly providing in its sales contracts and invoices with customers that mobile phones once sold may not be returned.<br><br>In instances where sales returns may be appropriate, the PT Selular Group will allow such sales return only (i) when it is in the process of final settlement with the customer; or (ii) with the approval of the Chief Financial Officer and Chief Executive Officer of the PT Selular Group in special cases.<br><br>All mobile phones returned are counted and certified by the PT Selular Group's warehouse personnel before resale to the next customer. |
| Lack of formal documentation of the Distributor Price Protection process | <u>More rigorous approval process for Distribution Price Protection</u><br><br>The PT Selular Group has monitored more closely its Distribution Price Protection policies and procedures. The credit note for the price support rebate must be approved by an authorised person and must be supported by the relevant documentation such as (i) the price evaluation report; (ii) stock balance; and (iii) Accounts Receivable report. |
| Lack of signed delivery orders for retail sale transactions | <u>Discipline staff members who fail to obtain retail customer signatures on invoices</u><br><br>The PT Selular Group will continue to require each retail customer to sign the invoice, and has taken disciplinary action against staff members who fail to not inform customers of this requirement at the point of sale.<br><br>The PT Selular Group has followed up on a regular basis to ensure compliance. |
| Lack of signed delivery orders for sale transactions to distributors | <u>Re-assignment of the preparation of sales orders from sales personnel to finance personnel</u><br><br>The PT Selular Group has required every delivery order issued to be signed and stamped by the recipient and the air waybill from the courier attached.<br><br>The PT Selular Group has discontinued the practice of allowing its sales personnel to prepare sales orders for release and posting. These tasks have been undertaken by the finance personnel with more clearly delineated segregation of duties between the sales and finance teams. |

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| Failure to match time periods for issuing invoices and subsequent credit notes for stock write-offs | Revision of accounting treatment of promotional stocks provided free of charge ("**FOC**")<br><br>The PT Selular Group has discontinued the practice of writing-off FOC stocks. Instead, the FOC stocks have been debited directly as promotional expenses and credited cost of goods sold. |
| Lack of adequate documentation to record the serial numbers of stock | Implementation of records system for IMEI number of incoming and outgoing phone stocks<br><br>The PT Selular Group has put in place measures to ensure that IMEI numbers for the mobile phones have been recorded in the system for incoming and outgoing mobile phones. |
| Lack of stocktake documents | More frequent warehouse stock-taking<br><br>The PT Selular Group has put in place monthly stock taking of mobile phones stored in the Pluit warehouse, and a periodic random stock take of the mobile phones kept in its retail shops.<br><br>The PT Selular Group has since 2013 required that all stock-taking documents are kept and maintained by the credit-controller, and if there has been any negative difference, the same has been charged to the party responsible. |
| Inventory write-off process not implemented | Regular scrapping of unserviceable phones<br><br>The PT Selular Group has obtained the necessary approvals from the tax authorities, and has implemented the scrapping of unserviceable mobile phones on an annual basis.<br><br>The PT Selular Group has scraped unserviceable mobile phones on an annual basis after obtaining the necessary approval from the tax authorities. |

3.6 The Company has discussed with BDO as to whether a follow up additional audit process would change the conclusion or impact the conclusion of the current BDO Report in any way. Accordingly, BDO has provided confirmation to the Audit Committee that they do not foresee that the outcome of the additional review procedures (if undertaken) will have any implications on the conclusion in the BDO Report (as highlighted in paragraph 3.2 of this announcement).

3.7 The Audit Committee along with the management of the Company has reviewed the findings and the final BDO Report by BDO taking serious note of the short comings. The Audit Committee has accepted the findings, conclusion, final BDO Report and the corrective actions taken.

**4. Other remedial actions taken by the Company**

4.1 In addition, the Company has undertaken further steps (including incorporating the recommendations of EY Advisory and BDO where appropriate) to address the findings by EY Advisory and BDO, including the following:

(a) The creation of a new position of Head-Process Control to ensure that the above measures are appropriately designed and remain fully operational after their respective implementation. The Head Process Control will work closely with management and will report to the Chief Financial Officer of the Company in respect of the operation and effectiveness of the above measures from time to time on a regular basis.

(b) The Company will assume direct control and oversight over the operation and management of the Pluit warehouse in Jakarta (which stores the mobile phones) by discontinuing the practice of out-sourcing the operation and management to a third party vendor. The Company has drawn up a series of hand-over procedures to facilitate a proper and efficient transition.

(c) The commencement of surprise audits to assess the adequacy and effectiveness of internal controls over the retail and airtime businesses of the PT Selular Group in Indonesia.

(d) The commencement of quarterly confirmations to check that transactions of sales to key customers are properly documented with the appropriate supporting documents.

(e) Delegation of authority matrix has been reworked for better internal control.

4.2 The Board would like to assure Shareholders that it takes the findings of the EY Report and BDO Report seriously, and has taken, and continues to take, steps to address such findings, and that it is committed to maintain the appropriate standards of internal control.

**BY ORDER OF THE BOARD**

*Hanif M Dahya*

*Chairman, Audit Committee*
**S I2I LIMITED**
21 August 2015

Annexure 1

**MANAGEMENT SUMMARY OF THE CERTAIN PROCEDURES CARRIED OUT BY ERNST & YOUNG ADVISORY PTE. LTD. ("EY ADVISORY") IN RELATION TO CERTAIN IRREGULARITIES IN THE ACCOUNTS OF CAVU CORP PTE LIMITED AND ITS SUBSIDIARIES ("CAVU GROUP")**

Following is the summary of Key observations:

1. **Confirmation from third parties**

a. During the statutory audit of Financial Year ended 31 December 2013 for Cavu Group, Ernst & Young LLP ("**EY**"), the independent auditor of the Company for the relevant period, came across irregularities in relation to inventory amounting to S$993,547. EY was provided with supporting documents including third party confirmation letters to explain the recorded amount of inventory.

b. On 19 February 2014, a certain finance employee (referred to in this management summary as "Employee A") of Cavu Group hand-delivered an audit confirmation dated 19 February 2014 on the letterhead of one of third party company (referred to in this management summary as "Company X") to the Auditors in response to an EY audit confirmation request. The audit confirmation stated that Company X has in its possession S$726,400 worth of software. Based on the search with Accounting Corporate Regulatory Authority ("ACRA") of Singapore, the concerned Employee A was the company secretary of Company X from 13 July 2011 and Company X was struck off the ACRA register on 7 January 2014. The date of striking off was prior to the audit confirmation from Company X.

c. On the same day, EY received an email confirmation from a certain employee ("Employee B") of one of the third party company (referred to in this management summary as "Company Y"). The email confirmation dated 19 February 2014 contained an audit confirmation that was signed by Employee B and carried Company Y's company stamp. The audit confirmation stated that Company Y has in its possession S$267,148 worth of stock. Email evidence appears to suggest that certain officials of the Cavu Group (including Employee A) emailed that audit confirmation to Employee B which Employee B subsequently sent to EY on the same day.

d. On 27 February 2014, EY and EY Advisory jointly conducted an interview with Employee A.

During the interview, Employee A admitted that he was the author of the audit confirmations and confirmed that he had created documents to evidence that Company X and Company Y were in possession of the respective stocks referred to above in 1b and 1c, when in fact such software and stock did not existed. These documents were provided to EY during the course of audit. These entries have been reversed in the financial statements for the financial year ended 31December 2013.

e. Employee A also informed during his interview that he created these documents in the hope that EY would be convinced that the inventory was legitimate and because Employee A wanted to protect the results of Cavu Group.

f. In the interview with a certain employee ("Employee C") of the Cavu Group dated 20 March 2014, Employee C admitted that Employee C was involved in the creation of documents from Company Y. Employee C admitted that Employee C had a connection with Company Y through Employee C's business dealings with them. Employee C said that Employee C was asked by Employee A to obtain Company Y's signature on the audit confirmation and to inform them that the goods would arrive some time later.

**2. Loan agreement with third party**

a. A certain employee ("Employee D") of the Cavu Group provided EY with copies of two loan agreements between one of the third party companies (referred to in this management summary as "Company Z")and Delteq dated 15 July 2013 and 24 September 2013 (the "Loan Agreements") amounting to US$2,000,000 and US$2,200,000, respectively.

b. An email exchange between Employee D and Employee A stated: "Attached loan template and the two original agreements" The attached documents contained in the email are two master and financing agreements (the "Lease Agreements") dated 15 July 2013 and 24 September 2013 amounting to US$2,000,000 and US$2,200,000 respectively.

c. During the interview with Employee A on 20 March 2014, Employee A admitted that Employee A created the Loan Agreements with the help of Employee C and Employee D . Employee A requested Employee D to draft the Loan Agreements by amending the inter-company loan template to evidence the Loan Agreements. The Employee C's role was to get Company Z to sign, as this employee knows one of the signatories of Company Z through their years of working relationship.

d. Employee A also told EY Advisory that Employee A has always considered the Lease Agreements as the Loan Agreements because there was never an intention to lease. Delteq needed financing for a major project and they negotiated terms of the financing with Company Z. They discussed about tying the payment terms back to back (which allows Delteq to pay Company Z only upon receipt of monies from the major project), and when everything was agreed, Employee A thought it was a loan agreement but it turned out to be a lease agreement when he saw the lease agreement. Employee A then instructed Employee D to create the Loan Agreements using the inter- company loan template.

e. During the interview with Employee D on 20 March 2014, Employee D told EY Advisory that Employee D first noticed the Lease Agreements during the statutory audit in December 2013. Employee D checked the inventory and noted that Delteq does not have these inventories and thus it cannot be a lease agreement. Employee D then went to Employee A and told Employee A that Delteq has delivered most of the goods for the major project and that Delteq does not have these inventories in their inventory listing. Employee A told Employee D that technically this is a loan that was advanced by Company Z but because traditionally Company Z does not disburse unsecured loans so it is called a lease instead. Employee A then asked Employee D for details on the Lease Agreements and instructed Employee D to create the Loan Agreements using the inter-company loan template. Employee D agreed and created the document.

**3. Undisclosed interests in companies (Cavu Group)**

a. Employee A was involved in several businesses that were also customers/vendors of Cavu Group. In the interview with Employee A dated 27 February 2014, Employee A informed during the interview that Employee A chose not to disclose Employee A's relationships with these companies because Employee A did not think that the relationships were significant.

b. Out of the payments and receipts made/received to/from these companies by Cavu Group in the period July 2012 to December 2013, there was a payment amounting to US$49,714 made by Cavu to one of the above related parties on 24 September 2013 even though goods/services were not received. The payment has since been refunded to Cavu Group.

c. There is also indication that an amount of S$4,000 paid by Cavu in one instance to one of the above related parties may not have taken place on "arm's length" terms. On Internet search by the EY Advisory revealed that similar products was available for S$750 cheaper than the price paid by Cavu. Cavu has received four printers as of 9 June 2014 and one complimentary printer had not been delivered as at 7 July 2014.

d. In addition to the issues raised above, Employee A produced two competitive quotations from Delteq and Cavu for the purpose of complementary bidding. During the interview with Employee A, Employee A admitted that this was a favour to the director of one of Employee A's related companies.

**4. Accounting Matters (Cavu Group)**

a. From the review of electronic data, multiple uses of a marketing fund in 2013 including that of a reserve for future requirements of Delteq was noticed. It was used to offset against projects with negative or low margins. While there was no email evidence that indicates that the marketing fund was created/used prior to the financial year ending 31 December 2013, Employee C said in an interview on 20 March 2014 that the marketing fund is a form of contingency fund that has been in practice in Delteq for a long time. Perusal of the general ledger showed that the balance of the marketing fund reached a peak of S$186,061 for the financial year ended 31 December 2013. This has been reversed in the financial statements for the financial year ended 31 December 2013. Be that as it may, in a letter from S i2i to SGX dated 24 April 2014, S i2i clarified that the "marketing fund" referred to by EY Advisory was a "contingency reserve" created for the purposes of adjusting for any fluctuations in the expenses relating to the project assignments undertaken by the Cavu Group.

b. Email evidence appears to suggest that an inter-company sale of an IBM p570 machine in 2010 was not compliant with Cavu Group's inter-company pricing policy. Inter-company pricing policy is calculated by using market price x 80% + 1% mark-up. Based on the same email, it was noted that the current market price of an IBM p570 machine was US$12,500 and this works out to an inter-company pricing of US$10,100. In the fixed asset listing of Centia Pte Ltd ("Centia") as at 31 December 2013, it was identified that a purchase from Peremex Pte Ltd ("Peremex") dated 31 December 2010 at a cost of S$254,652. The difference between the cost of S$254,652 and the computed inter-company pricing of US$10,100 is approximately S$240,000. If this fixed asset is the same IBM p570 machine described in the email, it would appear that the inter-company sale took place at cost, and not in compliance with the inter- company pricing policy. Employee A stated in the email that Employee A did not want to incur the loss from the sale in the specific quarter of the inter-company sale.

## 5. Business Practices

a. Email evidence appears to suggest that "consultancy fees" that amounted to up to 50% of the value of contracts were paid by certain Malaysian subsidiaries of the Cavu Group as third party broker fees to secure contracts in Malaysia in 2009. Books and records of certain Malaysian subsidiaries of Cavu Group were verified to identify if the amounts were paid, and the parties that were paid.

b. A separate series of emails appears to suggest that Employee A asked one of the third party to provide three invoices totaling MYR5,000 to certain Malaysian subsidiary of Cavu Group with the description "Quarterly standby engineer charges" for a period of one year from 4 January 2014 to 3 January 2015 which seemed improper. The Company clarified that the three invoices were for services carried out by a freelance engineer to introduce to certain Malaysian subsidiary of Cavu Group a business contract in Malaysia. The Company confirms that it does not make any illegal payments and strictly prohibits the same in its subsidiaries

Annexure 2

## MANAGEMENT SUMMARY OF THE ADDITIONAL AUDIT PROCEDURES CARRIED OUT BY BDO LLP

### KEY OBSERVATIONS

The following were the key observations arising from the review carried out by BDO LLP:

1. **Sales returns and subsequent re-sale to other customers**

For the months from July 2012 to December 2012, sales returns and rebilled amounted to around 363,000 Nexian phones with total value of around IDR 95 billion (approximately USD 9.5 million). The returns were agreed with the customer when a second customer[1] agrees to buy these phone models (at same or lower prices). The total sales returns were approximately 10.8% of the total sales value for the same period of about IDR 881 billion (USD 88 million). The original terms of sales could not be verified as orders can be fulfilled via verbal instructions without formally documenting the terms of sales such as credit terms. Internally, once a second customer is found to purchase the items at a same or lower cost, Affinity Group will accept the goods back from the first customer (the "returned goods") and reduce the first customer's outstanding debts based on the value of the returned goods, computed at the original purchase price[2].

Delivery orders for six (amounting to IDR 5.5 billion) of 33 (approximately IDR 321,789 billion) instances of sales credit memos to indicate the return of goods from the first customer to Affinity Group were not sighted. There is a recommendation from BDO LLP that all goods received should be counted and certified by the warehouse personnel before resending them to the next customer and that management should formalise the sales process and at minimum, state the agreed terms of sales through their delivery

[1] The management of the Company notes, as far as it is aware, that the first customer and second customers are not related to each other.

[2] The management of the Company wishes to highlight that this practice was undertaken so as to facilitate movement of inventory and improve cash flow and sales by enhancing recoverability of outstanding debt from the customer. These measures would be beneficial to the Company.

orders or invoices so to better establish the correct point in the transaction that revenue should be recognised. The sales returns and reselling process should also be documented including requirements for checks to be conducted on whether the second customer is related to the first customer.

Some mitigating explanations were made by the Management Team that the sales were recognised correctly at the point of transaction and the returns arose from subsequent decisions taken by management and were not expected at the point of the original sale transactions.

The Management Team BDO LLP informed that they did not have any legal obligation to accept the returned sales but had done so in the ordinary course of business as a service to their customers. There was a SGX announcement dated 13 March 2013 made to explain a USD3.8 million provision for stock obsolescence which provided details on sales returns as described above and on the price support issue which is highlighted in the next point. The discussion of these two items in the announcement, although to explain the extent of provision for inventory obsolescence, indicates that management had been open about this practice of return sales by describing the details in the shareholders' announcement. The reasons for the sales returns were indicated in the following extract of the announcement were consistent with the reasons provided to BDO LLP during their review for the sales returns.

*"As announced by Si2i Ltd in its results for the quarter ended December 2012 on 7 February 2013, the markets in which Si2i Ltd and its subsidiaries (Company) operates in are moving from feature phone driven markets to smart phone/Android market. As a result of this shift, local brands in Indonesia are pricing their feature phones aggressively for added competitiveness. This resulted in:*

*1. lower sales of the Company products;*

*2. accumulation of inventory with the Company; and*

*3. accumulation of the Company's product in the inventory of the Company's channel partners/ distributors*

*Due to the above, the Company had to sell its unsold products at lower gross margin or at below cost level. It should be noted that the inventory of handset models which are sold at lower or negative margin has to be adjusted to the lower of cost or net realizable value pursuant to the International Financial Reporting Standards (IFRS).*

*Some distributors seek to return certain products back to the Company. Once returned, the Company sells these returned products (Returned Products) to distributors in other locations."*

Although there were currently some flowcharts established on the workflow for sales and handset returns, there were no policies established to specify how terms of sales should be fixed and when provisions should be made for sales to account for possibility of returns. A list of sales returns was compiled and approved by the Head of Sales and Indonesian CEO but some samples of sales credit memos generated to adjust the system balances were also not signed by the approving parties. There was a recommendation from BDO LLP that the actual sales credit memo be approved by the relevant parties and the approving limits for sales returns be documented.

BDO LLP had also checked if payments have been made from the second customer to whom the returned phones were resold. As customers usually pay on a lump sum basis to settle their outstanding invoices, BDO LLP were only able to check that all the invoices for the resold phones selected as samples have been included in the chronological sequence of invoices settled through the lump sum paid by customers. It might have been more conclusive if customers had made specific payments based on invoiced amounts but it was informed by the Management Team that this has been the customers' practice for the Indonesian entities. No exceptions were noted from this test to check payment by the second customers based on the lump sum payments by the customers. It has been recommended that management send out monthly statements of accounts to customers especially for the bigger customers to confirm that the outstanding balances are accurate. Policies and procedures for such outstanding debt reconciliation process should also be documented and should include the threshold beyond which such statements should be generated. The policies and procedures should also include how feedback on discrepancies should be addressed.

2. **Distributor Price Protection**

Affinity Group also provided "Distributor Price Protection" ("DPP") to customers with outstanding debts and who were still holding on to large quantities of phones by reducing their outstanding debts with the difference between the last price announced by the company and original prices paid for stocks that were still unsold and held by the distributors (refers to customers who bought phones in bulk for purpose of reselling the phones). The rebates were computed by the Account Manager and the amount was then applied to the outstanding debts of the customers. The total of such support amounted to approximately USD 3.7 million from January 2012 to December 2012 out of a total sales amount for all phones of around USD 197 million (1.88% of total sales) for the same period.

The original terms for price support rebates were not able to be verified as orders can be fulfilled via verbal instructions without formally documenting the terms of sales. This would have better determined if revenue should have been recognised in full at point of the sale. It is recommended that the policies and procedures for monitoring Distribution Price Protection be formally documented including who can approve the rebates, how the stock balances should be checked and how the rebates provided should be reconciled against the amounts receivable on a periodic basis.

Similar to sales returns, the management had provided details of the Distributor Price Protection process in the same 13 March 2013 SGX announcement. There weren't any significant differences between the contents in the announcement and the reasons provided to BDO LLP were noted during their review for the Distribution Price Protection. The following paragraph is extracted from the announcement:

*"Further, the Company also has a practice known as the Distributor Price Protection practice (DPP). The DPP is a common industry practice in the mobile and technology business. The Company applies a DPP by passing credit to a distributor, equivalent to the difference between the last billed price of a product (as charged by the Company), and the latest reduced price announced by the Company. The DPP only kicks in when there is residual stock with a distributor/channel. The DPP is intended to facilitate sales of products accumulating in a distributor's inventory. The amounts of these credit notes are shown in the Profit & Loss Account, and the Accounts Receivables are adjusted by the corresponding amount."*

The details provided in the announcement were consistent with the review of BDO LLP and responses by management with regards to the Distributor Price Protection scheme.

### 3. Signed delivery orders for retail sale transactions

33 samples of sale invoices for retail transactions amounting to IDR 429 million (USD 42,900) were requested by BDO LLP of which 23 out of the 33 requested documents

were emailed to BDO LLP for review. Only seven out of the 23 invoices provided were signed by the customers. It was informed that some customers do not sign on the invoices. This test was designed to verify that the phones had been physically delivered to customers but BDO LLP was only able to sight 21% of the invoices signed by the final retail customers. It was, however, noted that although having signed invoices would have better supported physical delivery of the phones, not having the signed invoices could also be due to customers not wanting to sign on the invoices. It was recommended to management that they should try to obtain customers' verification of sales and to retain all original documents for future reference.

### 4. Signed delivery orders for sale transactions to distributors

For wholesale transactions ("MJKI" and "SMI"), six (15%) out of 40 samples, were not supported with signed acknowledgement from customers on invoices or delivery orders. The quantity of stocks in the six sales transactions was 12,510 (3%) phones out of a total of 413,428 phones for all the sample sales transactions selected (this was around 0.6% out of the approximate total of 2.3 million phones sold during the year).

The total sales amount for the six transactions was about IDR 2.55 billion (USD255,000). In this case, Management Team informed that it is sometimes not easy to get customers to sign on documents, but management will be taking additional efforts to make sure that future delivery notes or at least invoices are signed by customers upon delivery of the goods to them.

Hence, it was not verified that the sales transactions were supported with actual movement of goods for some of these sales transactions selected as samples. The subsequent settlement of debts by the corresponding customers can indicate that they have indeed, received the goods but as customers paid lump sum for various invoices without specifying invoices they were paying for, it was difficult to verify which invoices the customer had intended to settle.

It is recommended to management that especially for wholesale transactions, revenue should only be recognised when the phones have been delivered and accepted by their customers. Hence, they should make all efforts to ensure that evidence on the successful transfer of the phones to customers are properly retained such as signed delivery orders or some other form of documented acknowledgement by the customers. The current workflow document indicating that the delivery of goods only needs to be supported with invoices should also be improved.

## 5. Issuing invoices and subsequent credit notes for stock write-offs

Free of charge ("FOC") stocks such as phones issued for promotions were written off by generating a sales invoice for the value of the phone and then subsequently writing the same phone off through a credit note. Hence, if theses invoices are not written off in the same period, such as for the four out of ten exceptions noted, revenue might be incorrectly recognised. However, the total FOC phones indicated in the sales listing was around 1,718 phones with a total value of around IDR 1.6 billion (USD 160,000) which would not be very significant in the context of the approximate total sales of USD 197 million per year for Affinity Group. It was informed by the Management Team that they will be not be writing off FOC stocks through this process in the future and necessary corrective steps have been already implemented. As the sale of the phones were also subject to sales tax of 10%, this practice might also have certain tax implications since Affinity Group has written off the sales tax, which was already reported based on the first invoice, through the subsequent credit notes. It is recommended that this process of writing off FOC stocks be stopped and to restructure the process with due consideration to tax implications. Once determined, the policies and procedures for such FOC stocks should be documented.

## 6. Documentation on serial numbers of stock

All selected samples of the handsets were not able to be traced through their serial numbers or IMEI numbers as they were not always recorded in the database especially when the sales are in large numbers as it takes a long time to record all IMEI numbers. As this test is to provide additional support that the recorded sale transactions of Affinity Group were supported with physical movements of stocks (by tracing serial numbers movements) not having such records does not however, indicate otherwise. It was also noted that whilst the serial numbers of the phones were not tracked, the model and quantity of phones received or sold were still being recorded in the inventory records. Based on the sample stock count of 30 items by checking against the phone model number and quantity on hand, no exceptions were noted and also no significant variances were noted in the stock counts performed by the external auditors for FY 2011/ 12 and FY 2012/ 2013.

## 7. Stock take documents

Records for stock takes performed by management were not available for review as it was informed that they were not retained after the stock take has been done as there was no requirement for them to do so previously. The stock takes were done more as a management exercise to monitor stock balances against the stock records. The scanned stock take reports done by the external auditors in 2012 and 2013 were provided, where there were no significant exceptions noted. A stock take of 30 sample stock items was performed by BDO LLP at the Pluit warehouse where no exceptions were noted. The stock count of the physical phones at the warehouse was matched to system records of the quantity of the stock item on hand. This could indicate that the system stock records were consistent with the physical stockholdings at the time of the stocktake. It is recommended that existing stocktake policies and procedures be enhanced to include retention of the documents relating to the stocktake done by management and to document the appropriate follow up and dispensation process for any discrepancies noted.

### 8. Inventory write-off process

The Management Team informed BDO LLP that that phones waiting to be scrapped were kept in the warehouse and not disposed because of tax implications. The unserviceable phones which have been not been disposed amounted to 13,939 units of Nexian phones with approximate total value of IDR 4,224,339,069 (USD 422,434). The ages of the stock ranged from January 2008 to September 2009.

## CONCLUSION

The scope of AUP was based on the objectives as indicated below:

**AUP 1:**

To review all management reports and documents covering Opening Inventory, Purchase, Sales, Returns, Collection and Closing Inventory month by month during the period Jan-12 to Dec-12, to find out whether there is any base for the claim that 600,000 phones over 9 months would have been billed and booked as sold but de facto kept in the warehouse.

**Conclusion:**

BDO LLP did not come across any potential basis to indicate that 600,000 phones billed and booked as sold by Affinity Group remained kept in the warehouse within their scope of review other than the exceptions; which relate to weaknesses in internal controls listed below, arising from the agreed upon audit procedures highlighted in the report. The company is in the process of strengthening and correcting these process weaknesses pointed out.

**AUP 2:**

To review provisions and write-offs relating to item 1 and to confirm they have been correctly done.

**Conclusion:**

BDO LLP did not come across any incorrect provisions and write-offs covered in their scope of review other than the exceptions arising from the agreed upon audit procedures highlighted in the report. They noted however that the value of the errors for the unserviceable, free of charge and stock discrepancies listed below were considered to be small as compared with the total transactional value.

**AUP 3:**

To validate the backup documentation and process flow behind the reports created in item 1.

**Conclusion:**

Process flow for sale transactions has been documented. It is recommended that Policies and procedures be improved via documented systems for:

- Sales returns and subsequent resale tracking system
- Distributor Price Protection
- Approval for “free of charge phones” or commercial samples
- Monitoring and treatment of slow moving or obsolete stock
- Reconciliation of accounts receivable, dealer wise details
- Approval for bad debt process

The Company has already started taking steps to enhance the policies and procedures documentation and to address the internal control weaknesses highlighted in the report.

*Note: The above is an extract of the report from the Agreed-Upon Audit procedures performed by BDO. This engagement was conducted based on specific terms of business which BDO had agreed with S I2I Ltd (“SI2I”). Full report is available for review to any shareholder, within 60 days of announcement, at Si2i Ltd registered office after following due process as per the Terms of Reference stipulated by auditors.*