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China Forestry's auditor resigns amid accounting irregularities

By [Anette Jönsson](#)

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China Forestry operates forest plantations in Yunnan and Sichuan provinces

KPMG has resigned as the auditor of China Forestry Holdings as a result of the accounting irregularities that the firm identified more than 12 months ago, the company said in an announcement to the Hong Kong stock exchange. The stock has been suspended from trading since January 26 last year and the resignation of the auditors suggests there is no reprieve in sight for shareholders who want to sell.

Despite the swift removal by the company of its CEO and the appointment of an independent board committee to investigate the issues after the irregularities were first brought to light, there are still a number of outstanding matters with regard to the 2011 financial year that need to be resolved, KPMG said in a letter to the company, part of which was included in the stock exchange announcement.

These matters relate to the verification of ownership and valuation of the group's plantation assets; the valuation of lease prepayments; valuation and ownership of the group's inventories of logs and related sales and purchase transactions; estimation of payables for plantation assets; and taxation matters, it said.

KPMG also noted that it has requested that the company "extend the scope of its investigations to identify all irregularities that may have occurred and all management and officers involved in the irregularities, trace where the group spent the proceeds from the initial public offering and reconcile the details of recorded planted assets".

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The firm said it was still awaiting the results from this extended investigation, but noted that the initial findings by the independent board committee had "cast serious doubt over the authenticity and reliability of records and documents of the group and over the reliability of information and explanations provided to [it] by members of management as well as by [external parties]".

China Forest said in April last year that the independent committee had found that its former management team had faked bank documents and logging permits.

As a result of these issues, KPMG told the company that it would not stand for re-appointment at the next annual general meeting. At that point China Forestry said it had requested KPMG to step down immediately to facilitate the change of auditors and to allow the incoming auditors to start work on the financial year to December 2011. Hence, KPMG resigned on January 5.

China Forestry operates forest plantations in Yunnan and Sichuan provinces. On its website it claims to be one of the three largest, privately held, naturally regenerated and plantation forest operators in China in terms of coverage area. The company didn't harvest

any logs in the first six months of 2011 as it focused on getting its books in order and on putting a new senior management team in place, and as a result it reported a loss of Rmb130 million (\$21 million) for that period. The company's former CEO, Li Han Chun, was detained by police in Guizhou province in February last year for the alleged embezzlement of Rmb30 million.

While the questions surrounding China Forestry's accounting aren't new, KPMG's resignation once again highlights the need for more transparency and better corporate governance at Chinese firms. And while companies may be dismissive of negative reports and accusations about fraud from short-selling specialists like Muddy Waters, they certainly should take questions from their auditors seriously.

It also shows the need for managements to act quickly to get to the bottom of questions about irregularities in their accounts and valuations. Dragging their feet doesn't help. As one blogger argued over the weekend: "How difficult can it be to count some trees?"

Other Chinese companies that are suspended from trading pending the outcome of investigations into various accounting and valuation irregularities include Toronto-listed Sino-Forest and Hong Kong-listed fruit and vegetable grower Chaoda Modern Agriculture. Longtop Financial Technologies, which was listed on the New York Stock Exchange, was suspended from trading in May after its auditor, the Shanghai unit of Deloitte Touche, resigned after drawing attention to accounting irregularities at that firm. Last month, the US Securities and Exchange Commission also revoked Longtop's registration citing a violation of disclosure agreements, which means the stock can also no longer be traded over-the-counter.

For Chaoda, the prolonged trading halt has triggered a possibility for its convertible bondholders to put the bonds back to the company. And sources say many of the bondholders have done so, which means the company will have to redeem up to \$200 million worth of CBs that were issued in August last year. The bonds were issued concurrently with \$150 million of equity and \$6 million worth of three-year warrants.

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