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山東墨龍石油機械股份有限公司

Shandong Molong Petroleum Machinery Company Limited*

(A sino-foreign joint stock limited company incorporated in the People's Republic of China with limited liability)
(Stock Code: 568)

ANNOUNCEMENT

INTERNAL CONTROL FOLLOW-UP REVIEW

References are made to the announcements of Shandong Molong Petroleum Machinery Company Limited (the “**Company**” or “**Shandong Molong**”, together with its subsidiaries, the “**Group**”) dated 12 May 2021, 27 September 2019, 11 February 2018, 16 January 2018, 25 September 2017, 25 August 2017, 26 July 2017, 26 June 2017, 26 May 2017, 15 May 2017, 27 April 2017, 21 March 2017 and 8 February 2017, and the news release published by The Stock Exchange of Hong Kong Limited (the “**Stock Exchange**”) on 6 September 2019 in relation to the material misstatement and false inflation (“**Financial Position Inflation Plan**”) in the financial information disclosed by the Company for 2015 and 2016.

As disclosed in the announcements of the Company dated 21 November 2019 and 16 January 2020, the Company has, in accordance with the directions of the Stock Exchange, appointed Crowe (HK) Risk Advisory Limited to conduct a review of the effectiveness of the Group’s internal control system, so as to improve the internal control system designed and implemented by the Company’s management according to the Group’s Practical Regulations on Corporate Governance and as required under the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the “**Listing Rules**”), and to assess the adequacy of the systems, structures and monitoring measures formulated by the Group and whether they are sufficient for the directors of the Company (the “**Directors**”) to make an appropriate assessment of the financial position and prospects of the Company (the “**Relevant Listing Rules Compliance Review**”), and has disclosed the results of the Relevant Listing Rules Compliance Review and of its follow-up review.

INTERNAL CONTROL FOLLOW-UP REVIEW

In compliance with the judgment of and Court order made by the High Court of the Hong Kong Special Administrative Region of the People’s Republic of China in respect of the petition (the “**Petition**”) filed by the Securities and Futures Commission (the “**SFC**”) under section 214 of the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong), the Company has appointed Crowe (HK) Risk Advisory Limited, an independent external auditor acceptable to the SFC (“**Crowe**” or the “**Independent External Auditor**”) to review and prepare a report on the internal control and financial reporting procedures of the Company (the “**Internal Control Review Report**” or “**Report**”) so as to ensure that the Company complies with all relevant rules and regulations in Hong Kong and minimise the risk of recurrence of the misconduct complained of in the Petition. The Company has also been ordered to publish and implement the recommended measures as advised by the Independent External Auditor in the Internal Control Review Report. Please refer to the announcement dated 12 May 2021 of the Company for details

related to the Internal Control Review Report.

The board of Directors (the “**Board**”) announces that Crowe has finished its internal control follow-up review and issued a report in respect of the findings and results of the Internal Control Review Report, and details (including main review findings, review recommendation, responses of the management and responsible personnel for the review recommendation followup actions, date of completion of rectification and implementation of rectification) are set out as follows:

Findings #1

Adjustment on the management responsibilities of certain existing management and administrative personnel are needed to enhance the integrity of the management and to comply with the relevant provisions in the Securities and Futures Ordinance

Entity

Shandong Molong

Process involved

Corporate Integrity Governance

Findings in the review

During the course of the review conducted by Crowe, the management of the Company confirmed that, among the seven former senior management and administrative personnel of Shandong Molong who were involved in the misconduct as set out in the Petition of the SFC and the order of the Court of First Instance (the “**Involved Persons**”), some are still in management positions within the Group, including:

- Guo Huan Ran (國煥然), then executive Director and currently acting as assistant to general manager;
- Zhao Hong Feng (趙洪峰), then secretary to the Board and deputy general manager, and currently acting as assistant to general manager;
- Ding Zhi Shui (丁志水), still serving the same position as manager of the finance department; and
- Yang Jun Qiu (楊俊秋), still serving the same position as deputy manager of the finance department.

Crowe understood from the management of the Company that the Involved Persons, who are still in employment, are only employees of the Group.

As stated in the Petition of the SFC, given that the Involved Persons who are still under employment were then serving as key management and executive personnel, it is inevitable for the SFC to believe that it was impossible for those personnel to perform the Group’s functions without being aware of the Financial Position Inflation Plan, therefore there was a suspicion of those personnel of misconduct Financial Position Inflation Plan. On 2 March 2021, the SFC issued a press release mentioning that it had obtained a disqualification order in the Court of First

Instance against the Involved Persons in relation to their role in the Financial Position Inflation Plan, i.e. the Court had ordered the the Involved Persons to be prohibited from acting as a director of any listed or unlisted corporation in Hong Kong or directly or indirectly participant in the management of any listed or unlisted corporation in Hong Kong from 26 February 2021, except with leave of the Court. The disqualification period for the above-mentioned Involved Persons who are still in office is as follows: Guo Huan Ran for 8 years; Zhao Hong Feng, Ding Zhi Shui and Yang Jun Qiu for 7 years, respectively.

For the purpose of complying with the requirements of the Court order, users of the Report may consider that, due to the current employment of the Involved Persons, certain existing management and executive personnel (i.e. the Involved Persons) do not have the appropriate integrity to adequately and effectively implement proper internal control and financial reporting procedures to ensure the Company's financial information is properly prepared and disclosed. The management of the Company has indicated that, the current management duties of those personnel will be handed over to suitable personnel to be sourced and identified in the future, and have also undertaken that, if those personnel are still under employment of the Group in the future, they will not be involved in management duties relating to internal control activities and/or financial information reporting, etc..

Impact

With reference to the provision in section 214(2) of the Securities and Future Ordinance, the prohibition on any direct or indirect involvement or participation in the management of the Group's affairs by the relevant personnel in any way may further ensure the credibility of the preparation and disclosure of financial information.

Risk rating

High

Recommendations

The Group is recommended to make reference to the provision in section 214(2) of the Securities and Future Ordinance and comply with the disqualification order of the Court of First Instance, and complete the identification of suitable personnel to replace the management duties of the four Involved Persons mentioned above as soon as possible.

Response from the management

The Company has improved the governance and composition of the Board, and has better control and governance over financial reporting and internal control procedures. The Company has subsequently adjusted the duties and work of the aforementioned Involved Persons, who are no longer involved in the management of the Group's affairs and can only act as advisors or general staff of the Company to ensure accuracy in the preparation and disclosure of the Company's financial information and compliance and effectiveness of internal control and financial reporting procedures.

Responsible persons and their titles

Liu Yun Long (劉雲龍) General Manager

Zhao Xiao Tong (趙曉潼) Secretary to the Board

Expected date of completion of rectification/implementation

31 March 2021

Status of implementation of rectification

In July 2021, Shandong Molong issued an internal re-designation notice for Involved Persons who are still working in the Company, effective from March 2021, and the details were as follows:

- Guo Huan Ran was transferred from assistant to general manager to technical advisor to provide advice on technical and quality control aspects of the Company and has no decision-making, signing and approval authority and is not involved in the financial reporting related work of Shandong Molong;
- Zhao Hong Feng was transferred from assistant to general manager to administrative consultant to advise on human resources and administrative aspects of the Company and has no decision-making, signing and approval authority and is not involved in the financial reporting of Shandong Molong;
- Ding Zhi Shui was transferred from manager of finance department to a staff of the finance general section, responsible for handling payment and taxation matters of the Company and has no decision-making, signing and approval authority; and
- Yang Jun Qiu was transferred from deputy manager of the finance department to a staff of the finance general section and is responsible for the analysis of financial information and has no decision-making, signing and approval authority.

The management stated that, upon consultation with the legal advisor of the Company during the follow-up review period, it is determined that in general, the aforesaid duties and authorities of consultants and general financial staff do not involve management of the Company, and such re-designation can already fulfill the requirement under the Court order to prohibit the Involved Persons from directly or indirectly taking part in the management of the Company's affairs. Based on the opinion above, the Company confirmed the rectification relating to the re-designation of position of the Involved Persons was completed.

Findings #2

Control over the management of inside information is required to be strengthened to comply with the inside information provisions of the Securities and Futures Ordinance

Entity

Shandong Molong

Processes involved

Corporate Integrity Governance

Findings in the review

Shandong Molong has established certain written management systems to regulate the mechanism of inside information confidentiality and the mechanism of its disclosure to the public. Among others, according to the “Management System for Changes in Shareholdings of Directors, Supervisors and Senior Management” (《董事、監事、高級管理人員持有公司股份變動管理制度》), directors, supervisors, senior management and shareholders holding more than 5% of the Company’s shares shall inform the secretary to the Board in writing of relevant trading plans before trading in the Company’s shares and its derivatives, so as to allow the secretary to the Board to make timely disclosure in accordance with the relevant regulations, including the requirements relating to the disclosure of inside information in Chapter 13 of the Listing Rules and Part XIVA of the Securities and Futures Ordinance. However, with reference to the announcement of Shandong Molong dated 7 December 2020 and the discussion with the management of the Company, the following incidents concerning undisclosed inside information were confirmed:

- A shareholder of the Company at the time, Zhang En Rong, intended to sell the Company’s shares in January 2020 and signed an agreement of intent of equity transfer, but did not inform the Board in time so as to make timely disclosure;
- The then chairman of the Board, Liu Yun Long, knowingly failed to perform his duty as a Director by reporting such inside information to Shandong Molong in order to allow Shandong Molong’s disclosure to the public the relevant intended transfer of shares in the Company; and
- The then secretary to the Board, Liu Min (resigned), failed to perform his duties as the secretary to the Board by identifying and disclosing such inside information in a timely manner.

The management explained that, the reason for the failure of proper disclosure of the incident was that the shareholders of the Company and the then chairman of the Board were not fully aware of the duty of confidentiality and disclosure of inside information, therefore, the Board did not have timely information of the potential share sale and failed to make disclosure to the public.

Impact

By signing a written undertaking and conducting targeted training, it can be ensured that the shareholders of the Company and the members of the Board have a proper understanding of the confidentiality and disclosure of inside information, which may mitigate the risk of disciplinary action being taken against the Company and relevant personnel by regulatory authorities for breaches of relevant laws or regulations, including requirements on disclosure of inside information in Chapter 13 of the Listing Rules and Part XIVA of the Securities and Futures Ordinance.

Risk Ratings

High

Recommendations

It is recommended that the Group take the following measures to enhance or maintain awareness

of the relevant personnel on the duty of confidentiality and disclosure of inside information of the Company:

- to require shareholders holding more than 5% of the Company's shares to sign an undertaking to ensure compliance with relevant regulations and to report their potential or actual share transactions to the Board in a timely manner; and
- to arrange training for Directors and secretary to the Board on the handling of inside information to ensure that they are fully aware of their responsibilities to identify and disclose inside information and to disclose any inside information required to be disclosed in a timely manner.

In addition, the secretary to the Board should monitor the price movements of the Company's shares on an on-going basis and report any abnormalities to the Board in a timely manner for further follow-up and confirmation.

Response from the management

The Company has further strengthened the control and management of inside information matters by arranging shareholders holding more than 5% of the Company's shares to sign an undertaking, requiring them to report potential or actual share transactions to the Board in a timely manner; the Company organized a training session for the Directors and the secretary to the Board before the end of April 2021 to ensure that they are fully aware of their responsibilities for identifying and disclosing inside information and disclosing any inside information required to be disclosed in a timely manner.

Responsible persons and their titles

Zhao Xiao Tong Secretary to the Board

Expected date of completion of rectification/implementation

30 April 2021

Status of implementation of rectification

Rectification has been completed. The Company has improved the current management system by requiring shareholders of the Company holding 5% or above shares of the Company to sign the "Controlling Shareholder Undertaking", and undertake to report potential or actual share transactions to the Board in a timely manner. In addition, the Company has provided training to its Directors and senior management on the handling of inside information to enhance their understanding of the handling of inside information. At the same time, the secretary to the Board has continuously monitored the price movements of the Company's shares and will enquire with members of the Board if abnormalities are identified to ensure that relevant inside information is disclosed in a timely manner.

Findings #3

Improvement on monitoring of the employment, promotion and termination investigation of management personnel is required to strengthen the integrity and conduct of management personnel

Entity

Shandong Molong

Processes involved

Corporate Integrity Governance

Findings in the review

During the review period, the following areas were identified for improvement in the Group's current investigation procedures for the employment, promotion and termination of management personnel:

(a) Investigation and control of employment and promotion of management personnel

Shandong Molong has established its Anti-Corruption Regulations, which require background investigation (on areas including educational background, working experience and criminal records) for the personnel proposed to be employed and promoted (including members of the Board and senior management), and during the review by Crowe, room for improvement was found in the execution of the following processes:

- In the background investigation of the employment of the Company's members of the Board, Shandong Molong only keeps written records of the minutes and resolutions of the Board and the nomination committee under it to set out the results of the background investigation of the appointees. However, there were no sufficient written records of the manner and procedures of the investigation, the investigators and the information used for the investigation; and
- The Company confirms that the above background investigation procedures also cover management personnel other than members of the Board (e.g. deputy general managers and financial officers), but in addition to the above deficiencies, there is no documentation to support that criminal record investigation on such personnel have been properly conducted.

(b) Control of termination investigation

In accordance with the "Measures for Management of Accountability" (《責任追究管理辦法》), Shandong Molong is required to conduct outgoing audit and keep written records of the resignation of its management personnel and employees in key positions, but the Company confirms that:

- At present, there is no specific definition of personnel in key positions, such as whether they include non-Board members, financial officers, personnel of subsidiaries, etc.; and
- No relevant written records in respect of the outgoing audit process have been kept to support the results of the outgoing audit (including the impact to the Group of departing personnel and remaining responsibilities, etc.).

Impact

Complete written records of the employment, promotion and termination investigations provide sufficient traces of review to support the results of investigation. Clearly defining the target can ensure that investigations are conducted in a comprehensive manner and that risks related to talents, ethics and integrity are properly controlled.

Risk Rating

Moderate

Recommendations

Shandong Molong should improve its investigation procedures for the employment, promotion and termination of management personnel with respect to the above findings in the review, and keep complete documentation, including criminal investigation records. Shandong Molong should also improve the contents of its "Measures for Management of Accountability" (《責任追究管理辦法》) to clearly define the ranks or positions that are required to be subject to an outgoing audit.

Response from the management

The Company has further improved the procedures for investigating the employment, promotion and outgoing audit of senior management and financial management staff, and has maintained relevant documentation and records. The Company has further improved the relevant contents of the "Measures for Management of Accountability" (《責任追究管理辦法》) to clearly define the ranks or positions for which outgoing audits must be conducted, so as to properly control the risks in terms of talents, ethics and integrity.

Responsible persons and their titles

Liu Shu Bao Director of audit department

Liu Zhi Jiang Director of human resources department

Expected date of completion of rectification/implementation

30 April 2021

Status of implementation of rectification

Rectification has been completed. The Company has required to keep complete written records for the employment, promotion or termination of management personnel, including background investigation of personnel employed (including criminal investigation record) and outgoing audit report of the management personnel. At the same time, improvements have also been made to the "Measures for Management of Accountability" (《責任追究管理辦法》), which specify that the ranks or positions for which an outgoing audit must be conducted range from heads of department to executive Directors of the Group.

Findings #4

Arrangement for effective directors' and officers' liability insurance in accordance with Listing

Rules is required

Entity

Shandong Molong

Processes involved

Corporate Integrity Governance

Findings in the review

The Company has arranged directors' and officers' liability insurance (the "**Liability Insurance**") for its directors, supervisors and senior management in accordance with Code Provision A.1.8 of the Corporate Governance Code set out in Appendix 14 to the Listing Rules. However, the latest Liability Insurance expired in October 2020 and had not been renewed at the time of review conducted by Crowe. The Company explained that as the specific terms of the Liability Insurance were being re-examined and have been submitted to the Board for consideration and approval. The Liability Insurance will be arranged for the Directors, supervisors and senior management immediately upon approval at general meeting.

Impact

Effective Liability Insurance arranged for directors and senior management will be able to comply with the Code Provision A.1.8 of the Corporate Governance Code set out in Appendix 14 to the Listing Rules and will mitigate the financial losses of directors and officers arising from legal action.

Risk Rating

Moderate

Recommendations

Shandong Molong is recommended to assess the risks of legal action against the directors and senior management and to complete the arrangement of Liability Insurance in accordance with the relevant Code Provisions as soon as possible.

Response from the management

The Company attaches importance to and strictly complies with the Code Provisions of the Corporate Governance Code set out in Appendix 14 to the Listing Rules in relation to the arrangement of Liability Insurance and has been arranging Liability Insurance for its Directors, supervisors and senior management in recent years. The arrangement of Liability Insurance for the year 2021 has been submitted to the Board for consideration and was approved by the shareholders in the general meeting on 3 March 2021. The management of the Company has communicated with the insurance company on the specific terms of liability and has completed the procurement of Liability Insurance for the Directors, supervisors and senior management.

Responsible persons and their titles

Zhao Xiao Tong Secretary to the Board

Expected date of completion of rectification/implementation

15 April 2021

Status of implementation of rectification

Rectification has been completed. The Company has arranged adequate liability insurance for its Directors, supervisors and senior management until 30 April 2022 to protect them against legal liabilities arising from the performance of their duties.

Findings #5

Improvement on existing written management system is required

Entity

Shandong Molong

Processes involved

Corporate Integrity Governance

Findings in the review

As a company listed in both Hong Kong and Shenzhen, Shandong Molong is required to comply with the laws and regulations applicable to both Mainland China and Hong Kong, in particular the Listing Rules and the Securities and Futures Ordinance under the laws of Hong Kong. Shandong Molong has established a written management system at the company level to regulate the Group's corporate governance. However, the existing management system was mainly prepared with reference to the Rules Governing the Listing of Shares on Shenzhen Stock Exchange to comply with the statutory requirements in both Mainland China and Hong Kong, without explicitly and specifically stating the requirements to comply with the same or relevant Hong Kong laws and regulations.

In view of the circumstances described in findings in the review #1 and #2 above, it could be seen that the current management system can be further improved, including but not limited to covering the following provisions of the Securities and Futures Ordinance:

- Interpretation of misconduct (sections 193 and 245 of the Securities and Futures Ordinance);
- The duty of officers of a corporation to prevent misconduct (section 279 of the Securities and Futures Ordinance);
- Disclosure requirements for inside information (section 307B of the Securities and Futures Ordinance);
- The duty of officers of a corporation to disclose inside information (section 307G of the Securities and Futures Ordinance); and

- Requirements relating to false or misleading information (section 384 of the Securities and Futures Ordinance).

Impact

To clearly and specifically state the laws and regulations and related internal control measures to be complied with in the written management system (especially including the aforementioned Securities and Futures Ordinance) would effectively regulate corporate compliance controls and reduce the risk of the Company and its senior management being penalised under the regulatory regime for non-compliance with the relevant laws and regulations.

Risk Rating

Moderate

Recommendations

Shandong Molong should identify the key laws and regulations in Mainland China and Hong Kong that the Group is required to comply with, clearly set out the relevant legal requirements (including the abovementioned Securities and Futures Ordinance) and internal control mechanisms in its existing written management system in respect of the areas listed above, ensuring that its employees (in particular Directors and senior management) have full understanding on the relevant legal liabilities (including legal liabilities arising from non-compliance with such requirements) and implementing appropriate internal control measures to comply with relevant requirements.

Response from the management

The Company has made reference to the relevant provisions of the Listing Rules of the Stock Exchange and other relevant laws to improve and amend the existing written management system of the Company for confirmation and approval by members of the Board, so as to ensure that employees (especially Directors and senior management) are fully aware of the relevant legal liabilities (including those arising from non-compliance with the relevant regulations) and implement appropriate internal control measures to comply with the relevant regulations.

Responsible persons and their titles

Zhao Xiao Tong Secretary to the Board

Expected date of completion of rectification/implementation

30 April 2021

Status of implementation of rectification

Rectification has been completed. The Company has improved its written management system at the company level, including the “Code of Conduct for Directors, Supervisors and Senior Management” (《董事、監事及高級管理人員行為規範》), “Registration and Filing System for Personnel in Possession of Inside Information” (《內幕資訊知情人登記及報備制度》) and “Management Policy on Information Disclosure” (《信息披露管理制度》), to include the aforesaid contents relating to misconduct, disclosure of inside information and false or

misleading information. The updated and approved management system has been formally issued to relevant units for implementation through the intranet.

Findings #6

Improvement on compliance management mechanism is required

Entity

Shandong Molong

Processes involved

Compliance Supervision Mechanism

Findings in the review

Crowe understands from the management of the Company that the company secretary is responsible for the Group's compliance with laws and regulations of Hong Kong, including the Securities and Futures Ordinance and the Listing Rules, and that the Company has appointed Ample Capital Limited as its compliance adviser for a term of two years with effect from 8 October 2019 in accordance with the requirements in the direction from the Listing Committee of the Stock Exchange issued on 6 September 2019 to provide ongoing advice on compliance matters in relation to the Listing Rules.

According to the existing compliance management mechanism, if the Company and its subsidiaries have any doubts in relation to compliance with laws and regulations of Hong Kong, they will seek advice from the company secretary and compliance adviser. As the mechanism is unilateral, i.e. the Group obtains compliance advice from the responsible compliance unit as and when required, the Company is unable to keep valid supporting documentation to monitor and confirm its continued compliance with applicable laws and regulations of Hong Kong in its operations.

Impact

The Group's internal and external compliance units' regular issue of written confirmation documents could ensure that the Group's compliance is continuously and effectively monitored and assist the Group in confirming its continued compliance.

Risk Rating

High

Recommendations

Shandong Molong to require the compliance adviser to issue compliance certification documentations (such as compliance checklists, monitoring reports or compliance statements) on a regular basis in relation to the Group's compliance according to the existing compliance management mechanism so that the Group can continuously ensure that its operations continue to comply with the applicable laws and regulations of Hong Kong.

Response from the management

The Company has been seeking timely advice from the company secretary, the Company's legal adviser and the Company's compliance adviser on all relevant compliance activities to ensure compliance with the requirements of domestic regulations and laws and regulations of Hong Kong. The Company has further improved its compliance control process and retained the relevant valid supporting documents for the feedback of compliance advice from the legal adviser and compliance adviser in a timely manner to ensure that the compliance of the Group's business is effectively monitored on an ongoing basis.

Responsible persons and their titles

Zhao Xiao Tong Secretary to the Board

Expected date of completion of rectification/implementation

31 March 2021

Status of implementation of rectification

The Company has reviewed the above proposed rectification plan with the Company's legal adviser and the Company's compliance adviser, but due to the limitation of the scope of services, it is not possible for them to issue compliance certificates on a regular basis in respect of compliance relating to the Group's ordinary course of business. Instead, the Company has adopted an alternative by including in its "Code of Conduct for Directors, Supervisors and Senior Management" (《董事、監事及高級管理人員行為規範》) an existing compliance consultation mechanism, to ensure that Directors and senior management are aware of the relevant mechanism and will make appropriate compliance enquiries to the Company's legal adviser and/or the Company's compliance adviser through the secretary to the Board in the event of uncertainty regarding compliance issues in the ordinary course of business of the Directors and senior management in order to fulfil their responsibilities. It is to ensure the continual compliance of the Group's operations with applicable laws and regulations of Hong Kong.

During the period from February to October 2021, the Company consulted the Company's legal adviser and the Company's compliance adviser for more than 40 times to assure that no material non-compliance incident would happen. Based on the measures adopted above, Shandong Molong has confirmed the compliance management mechanism has been rectified.

Findings #7

Improvement on estimated sales confirmation mechanism is required

Entity

Shandong Molong

Shouguang Baolong Petroleum Equipment Co., Ltd.* (壽光寶隆石油器材有限公司)

Weihai Baolong Special Petroleum Materials Co., Ltd.* (威海市寶隆石油專材有限公司)
("Weihai Baolong")

Shouguang Maolong New Materials Technology Development Co., Ltd.* (壽光懋隆新材料技術開發有限公司)

Processes involved

Compliance with Financial Reporting Procedures

Findings in the review

The Group settles and recognises sales revenue in accordance with sales contracts. There are two types of contracts, namely customer receipt and customer collection (i.e. storage and sales). The Group recognises sales revenue based on the customer's receipt or collection records.

According to the current accounting system (the "**ERP system**"), the ERP system automatically generates sales record and recognises revenue and related costs based on sales invoices and the cost information of the products sold in the system. For transactions that are not invoiced but which receipt or collection has been recognised, the amount of the uninvoiced sales and related costs for the month can only be aggregated in reliance on the "Provisional Estimated Revenue and Costs Schedule" compiled by the Finance Department. Manual accounting is used to record and recognise the sales revenue and related costs (the "**Provisional Revenue and Costs**") after the amounts are confirmed with the sales department that the sales transaction meets the conditions for revenue recognition and the sales unit price is confirmed.

According to the Company's management, it is unable to ensure the conversion of manual accounting to automatic accounting because the ERP system was purchased from a supplier and not self-developed. However, considering that the potential risk of financial inaccuracy due to human error in the manual accounting of Provisional Revenue and Costs (including incorrect contract prices or transactions that do not meet the agreed terms of receipt or collection), it is recommended that the Group explore with the ERP system software supplier the possibility of replacing manual accounting with automatic accounting and discontinuing manual accounting.

Impact

The conversion from manual accounting to automatic accounting of Provisional Revenue and Costs reduces the risk of inaccurate financial information caused by manual operations (e.g. incorrect entry of contract unit prices or total transaction amounts).

Risk Rating

High

Recommendations

It is recommended that the Group discuss with the ERP system software supplier the possibility of replacing manual accounting with automatic accounting and discontinue manual accounting.

Response from the management

According to the accounting policy, there are different conditions on whether to recognise revenue for products in the current period and such decision requires judgement. Due to the specialty of the business model, the Company has difficulties in automatically generating

certificates in the ERP system and the finance department may not be able to grasp in time of whether the conditions for revenue recognition have been met. Under such circumstances, the Company has rectified the current process of provisional revenue:

After communication and discussion with the relevant business departments, it is considered that the sales department should prepare a breakdown of the Provisional Revenue and Costs of goods issued that have met the revenue recognition criteria at the end of each month and report to the sales department and the finance department for verification, and the accounting officer in charge should prepare the vouchers for recording. The audit department will regularly review the monthly Provisional Revenue and Costs and maintain relevant records to ensure the accuracy of the monthly Provisional Revenue and Costs.

Responsible persons and their titles

Zhao Yu Mei Director of Sales Office

Zhang Xue Mei Chief of comprehensive section of financial management department

Expected date of completion of rectification/implementation

30 April 2021

Status of implementation of rectification

Rectification has been completed. Based on the above management response, the management confirmed that the ERP system cannot be configured to perform recording of Provisional Revenue and Costs in the form of automatic bookkeeping. As an alternative, the Group has arranged for the internal audit department to conduct monthly independent reviews of the contract or order unit prices and product shipment records after the accounting of Provisional Revenue and Costs by the finance department to ensure the accuracy and completeness of the Provisional Revenue and Costs, and has retained the relevant independent review records of the audit department.

Weihai Baolong confirmed that no Provisional Revenue and Costs were incurred during the rectification period and undertook to continue to implement the above rectification alternatives in the event that Provisional Revenue and Costs shall be recorded in future.

Advice of the Audit Committee and the Board

Having considered the further review of internal controls and the rectification measures taken by the Group, the Audit Committee of the Company and the Board are of the opinion that the measures recommended by the independent external auditors in the Internal Control Review Report have been implemented and are adequate to address the findings in the Internal Control Review Report. The Group will put in place adequate internal control systems to comply with all relevant regulations and rules in Hong Kong and to minimize the risk of recurrence of the misconduct complained in the Petition.

Shareholders and potential investors of the Company are advised to exercise caution when dealing in the shares of the Company.

By order of the Board

Shandong Molong Petroleum Machinery Company Limited*
Yang Yun Long
Chairman

Shandong, PRC
3 December 2021

As at the date of this announcement, the Board comprises the executive Directors, namely Mr. Yang Yun Long, Mr. Yuan Rui, Mr. Li Zhi Xin and Mr. Yao You Ling; the non-executive Directors, namely Mr. Wang Quan Hong and Mr. Liu Ji Lu; and the independent non-executive Directors, namely Mr. Tang Qing Bin, Mr. Song Zhi Wang and Mr. Cai Zhong Jie.

** For identification purposes only*