

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES ACT OF 1933**  
**Release No. 8664 / February 27, 2006**

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 53379 / February 27, 2006**

**ACCOUNTING AND AUDITING ENFORCEMENT**  
**Release No. 2384 / February 27, 2006**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-12219**

In the Matter of	:	ORDER INSTITUTING PROCEEDINGS
	:	PURSUANT TO SECTION 8A OF THE
Helen Haiwen He,	:	SECURITIES ACT OF 1933 AND SECTION
	:	21C OF THE SECURITIES EXCHANGE ACT
	:	OF 1934, MAKING FINDINGS AND
Respondent.	:	IMPOSING A CEASE-AND-DESIST ORDER
	:	

**I.**

The Securities and Exchange Commission (“Commission”) deems it appropriate that public administrative proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 (“Securities Act”) and Section 21C of the Securities Exchange Act of 1934 (“Exchange Act”) against Helen Haiwen He (“Helen He” or “Respondent”).

**II.**

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the “Offer”), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over Respondent and the subject matter of these proceedings, which Respondent admits, Respondent consents to the issuance of this Order Instituting Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934, Making Findings and Imposing a Cease-and-Desist Order (“Order”), as set forth below.

### III.

On the basis of this Order and Respondent's Offer, the Commission finds<sup>1</sup> that:

#### A. Respondent

**Helen Haiwen He**, age 37, is a citizen of China with the right of permanent residency in the United States. Helen He, a Chartered Financial Analyst, was Chief Financial Officer of NetEase.com, Inc. ("NetEase" or the "Company") and head of its Finance Department from August 1999 until December 31, 2000, and a Director from August 1999 to August 2001.

#### B. Other Relevant Parties

**NetEase.com, Inc.** is a Cayman Islands corporation established in July 1999 to conduct an Internet business in China. In June 2000, NetEase raised \$65 million in an initial public offering in the United States. NetEase offers a wide range of Internet services to Chinese customers including news, email, instant messaging, chat rooms and online auctions. During the relevant time, NetEase had approximately 250 employees and operated through offices in Beijing, Shanghai and Guangzhou, China. NetEase's American Depositary Shares ("ADS") are registered with the Commission pursuant to Section 12(g) of the Exchange Act and trade on the Nasdaq Stock Market under the ticker symbol NTES.

#### C. Facts

##### 1. Summary

During 2000 and 2001, NetEase employees circumvented the Company's internal accounting controls and falsified the Company's books and records in connection with hundreds of advertising and e-commerce contracts. NetEase then recorded revenue from the transactions in a manner that did not conform with U.S. Generally Accepted Accounting Principles ("GAAP"). As a result, NetEase materially overstated its revenue and made numerous false and misleading statements about its financial condition in annual and periodic reports filed with the Commission and in other public statements, including earnings releases.<sup>2</sup>

During 2000, Helen He contributed to NetEase's recognition of revenue for two barter arrangements that lacked economic substance. The arrangements called for NetEase to perform advertising or e-commerce services for customers, and for the customers to provide an offsetting amount of products and services to NetEase.

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<sup>1</sup> The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

<sup>2</sup> The Commission filed a related case against NetEase in Federal District Court on February 27, 2006.

However, none of the parties ever performed the services. Nevertheless, without engaging in sufficient due diligence, Helen He allowed the company to record revenue in connection with these arrangements in NetEase's books and records. The revenue helped NetEase "close-the-gap" between its actual results and analysts' expectations.

As a result, NetEase materially overstated its revenue in financial statements furnished to the Commission, three of which Helen He signed. By engaging in this conduct, Helen He violated Sections 17(a)(2) and 17(a)(3) of the Securities Act and Rules 13b2-1 and 13b2-2 under the Exchange Act, and was a cause of NetEase's violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20 and 13a-16 thereunder.

## 2. Background

In April 2001, a potential purchaser of NetEase identified and questioned a large amount of past due accounts receivable balances. As a result, NetEase's audit committee conducted an internal investigation, which found that the Company's management had directed employees to circumvent internal controls on a widespread basis causing the Company to materially overstate revenue. Specifically, NetEase materially inflated revenue by \$4.3 million, or 109%, and understated net loss by 16% for the fiscal year ended December 31, 2000. NetEase also overstated revenue by approximately 5%, 36%, 138%, 290% and 116% for the fiscal quarters ended March 31, June 30, September 30, and December 31, 2000, and March 31, 2001, respectively and understated net loss by 6%, 20% and 23% for the final three quarters of year 2000. Due to its improper accounting, NetEase restated previously reported fiscal year 2000 financial results and corrected, before public dissemination, its financial results for the quarter ended March 31, 2001.

## 3. Relevant GAAP

GAAP permits revenue recognition when, among other things, the seller has provided the product or service to the customer. Statement of Financial Accounting Concepts No. 5, "*Recognition and Measurement in Financial Statements of Business Enterprises.*" When a company renders services over time, revenue generally is recognized on a straight line basis over the service period. Staff Accounting Bulletin: No. 101, "*Revenue Recognition in Financial Statements.*" For barter transactions, a company is required to record revenue based on the fair values of the assets or services exchanged by the parties. Accounting Principles Board Opinion No. 29, "*Accounting for Nonmonetary Transactions*"; Emerging Issues Task Force Issue No. 99-17, "*Accounting for Advertising Barter Transactions.*" Finally, GAAP requires that companies account for a transaction in accordance with its substance, rather than its form. Statement of Financial Accounting Concepts No. 2, "*Qualitative Characteristics of Accounting Information.*"

As is discussed below, NetEase improperly accounted for hundreds of advertising and e-commerce transactions during 2000 and 2001. For some arrangements, NetEase's

accounting did not conform with GAAP because the Company recognized revenue when it had not rendered any services to the customer. In other instances, NetEase improperly accelerated revenue recognition by recording revenue over an artificially shortened service period. Finally, NetEase improperly recognized revenue in connection with barter arrangements lacking economic substance in that neither party provided any products or services to the other or because the Company had no evidence establishing that anything of value had been provided.

#### 4. Circumvention of Internal Controls

NetEase established a system of internal accounting controls in 2000 that segregated revenue recognition controls among three departments – Sales, Contracts and Finance. The Sales Department was responsible for negotiating contracts. The Contracts Department was responsible for signing contracts, arranging for advertising placements, and completing documents evidencing that the advertisements were shown on NetEase’s website. The Finance Department, the only department that reported to Helen He, was responsible for affixing NetEase’s corporate seal on the contracts and for preparing revenue recognition journal entries. However, this system did not provide reasonable assurances that services actually were performed before recognizing revenue. NetEase also failed to maintain its internal controls by verifying whether NetEase employees were complying with them.

In 2000 and 2001, NetEase’s employees in these departments circumvented the Company’s internal controls in order to materially inflate reported revenue. NetEase’s improper revenue recognition can be classified into the following three categories, even though some transactions may involve more than one category:

- a. Recording approximately \$2 million in revenue in connection with barter arrangements lacking economic substance;
- b. Shifting approximately \$1.1 million in revenue into earlier quarters by artificially bifurcating advertising arrangements with customers into two contracts and improperly recognizing revenue over a shortened time. NetEase employees referred to this technique as “revenue-brought-forward”; and
- c. Recording approximately \$1.2 million in fictitious revenue in situations in which NetEase had not performed the required advertising or e-commerce services.

For all three categories, NetEase’s Contracts Department, which was responsible for arranging provision of the services, prepared reports falsely showing that NetEase had performed the advertising. The Finance Department, which placed the Company’s seal on the contracts, prepared revenue recognition journal entries using the Contract Department’s false performance records. Finally, the Sales Department artificially bifurcated sales arrangements into two contracts in order to accelerate revenue into earlier quarters. For example, a contract having a six-month term was divided into two

agreements, one having a three-month term and another “bonus contract” for which NetEase provided “free” services for three additional months. Contrary to GAAP, NetEase recognized revenue over the shortened three-month period instead of the true term of six months. To identify which contracts to conceal from its independent auditor, employees marked the initial contracts with the prefix “G” and the bonus contracts with the prefix “Z.”

5. Joyo.com/Kingsoft Barter Arrangement

During the third quarter of 2000, NetEase recognized \$330,000 in revenue from two contracts with Joyo.com. Under these contracts, NetEase purportedly agreed to host an online shopping mall for Joyo. The same quarter, NetEase also purportedly purchased dictation software worth in excess of \$330,000 from Kingsoft, one of China’s largest PC software vendors and a related party to Joyo. In fact, NetEase did not provide any services to Joyo and Kingsoft did not provide any software to NetEase. In its restatement, NetEase reversed the Joyo revenue because it was part of a three-way barter arrangement that lacked economic substance.

In October 2000, a NetEase employee informed Helen He about two Joyo contracts, dated July 10, 2000 and August 15, 2000, that had not been recorded in NetEase’s books. The employee did not provide Helen He with an explanation as to why the revenue from these contracts had not already been recorded in the third quarter. Nonetheless, without doing any due diligence as to whether the contract dates had been backdated or whether the contracts represented legitimate third quarter sales, Helen He approved NetEase’s revenue recognition as of September 30, 2000. The Joyo revenue made up approximately 33% of the revenue shortfall that NetEase had identified only two weeks before the end of the third quarter of 2000. Helen He also represented to the company’s independent auditor that the Joyo contracts were for legitimate third quarter sales. In fact, the contracts had been backdated and were not signed until October 2000, after the third quarter had ended. By her actions, Helen He facilitated NetEase’s improper recognition of the Joyo revenue.

Revenue recognition in the third quarter of 2000 was improper because the contracts were not executed until the fourth quarter of 2000 and because they were part of a barter arrangement lacking economic substance. Helen He failed to follow-up on red flags associated with the Joyo contracts at a time when she knew that NetEase was under pressure to close the gap between actual results and expectations, and she knew or should have known that NetEase’s recognition of revenue in connection with them was improper.

6. Techpacific.com

In the fourth quarter of 2000, Helen He signed an advertising contract with Techpacific.com, a key NetEase shareholder from prior to NetEase’s initial public offering in the United States. The contract, which was negotiated by a member of the Sales Department, called for Techpacific to pay \$50,000 to sponsor NetEase’s electronic

holiday card site. The agreement was modified by a supplementary contract signed by another NetEase employee that included an improper “revenue-brought-forward” element, about which Helen He should have known, requiring NetEase to provide free advertising services after December 31, 2000. The revenue from this contract helped NetEase close the gap on its revenue shortfall for the fourth quarter of 2000. Helen He also negotiated and signed another contract with Techpacific, dated January 2001, calling for NetEase to pay Techpacific \$50,000 for financial advisory services, purportedly in connection with merger discussions between NetEase and various third parties.

In connection with the year-end audit of NetEase for 2000, Helen He was aware that NetEase’s independent auditor would audit the \$50,000 in revenue recognized from the advertising contract with Techpacific. She did not inform the independent auditor that she had also executed a \$50,000 financial advisory agreement, so that the auditor could consider that fact in making a judgment about whether NetEase’s revenue recognition on the advertising contract was appropriate. In fact, NetEase did not provide any advertising services under the first contract and Techpacific did not provide any genuine financial advisory work under the second contract. As a result, in its restatement, NetEase reversed the \$50,000 of revenue recorded in December 2000 because it was part of a barter arrangement that lacked economic substance.

As CFO, Helen He ultimately was responsible for revenue recognition decisions for the fourth quarter of 2000. In that capacity, she permitted NetEase to recognize revenue despite the fact that she had executed contracts for offsetting amounts and for which she did insufficient due diligence to determine whether either party had performed. As a result, Helen He knew or should have known that the contracts lacked economic substance and that NetEase’s accounting was improper.

#### 7. False Financial Results

Based on her actions and inactions discussed above, Helen He contributed to NetEase’s public dissemination of materially false and misleading financial results for the quarters ended March 31, June 30 and September 30, 2000, and the quarter and year ended December 31, 2000, as follows:

- a. First Quarter Ended March 31, 2000 – NetEase’s registration statement for its June 30, 2000 IPO, which was filed with the Commission on June 29, 2000, included financial statements for the quarter ended March 31, 2000, which overstated quarterly revenue by approximately 5%. Helen He signed this registration statement.
- b. Second Quarter Ended June 30, 2000 – NetEase’s earnings press release issued on July 31, 2000, and Form 6-K furnished to the Commission on or about August 3, 2000, overstated second quarter revenue by approximately 36% and understated net loss by 6%. The earnings release also falsely claimed 103% revenue growth over the previous quarter. The restated results reflect 56% growth. Helen He signed this Form 6-K, which contained the false press release.

- c. Third Quarter Ended September 30, 2000 – NetEase’s earnings press release issued on October 31, 2000, and Form 6-K furnished the same day, overstated quarterly revenue by approximately 138% and understated net loss by 20%. The press release falsely claimed revenue growth of 47% over the previous quarter and a 539% increase over the same quarter in the prior year. The restated results reflect a 16% decline in revenue from the previous quarter and a 169% increase from the prior year’s quarter. Helen He signed this Form 6-K, which contained the false press release.
- d. Fourth Quarter Ended December 31, 2000 – NetEase’s earnings press release for the quarter and year ended December 31, 2000 (issued on March 1, 2001), and Form 6-K furnished to the Commission the same day, overstated quarterly revenue by approximately 290% and annual revenue by 109% and understated net loss by 23% for the quarter and 16% for the year. The earnings release claimed fourth quarter revenue growth of 25% over the previous quarter and a 159% increase over the same quarter in the prior year. The release also claimed that full year 2000 revenue increased 311% over the prior year. The restated fourth quarter results reflect a 24% drop from the previous quarter, a 34% drop from the prior year’s quarter, and the restated full year results reflect a 97% increase from the prior year. NetEase falsely attributed increases in its advertising revenue to a continued increase in the number of advertisers as well the size of their purchases.
- e. Year Ended December 31, 2000 – NetEase’s glossy annual report for fiscal 2000, which was disseminated to investors with the Company’s proxy materials on or about April 1, 2001, overstated full year revenue by \$4.3 million, or 109% (\$4.0 million versus \$8.3 million), understated its net loss by \$3.2 million, or 16% (-\$20.5 million versus -\$17.3 million) and understated its ADS loss per share by \$.13, or 16% (-\$.82 versus -\$.69). The glossy annual report falsely represented that NetEase’s annual advertising revenue grew by 456% (\$1.3 million to \$7.3 million). The Company’s annual report on Form 20-F for fiscal 2000, which was filed with the Commission on August 31, 2001, included corrected financial results (based upon the August 2001 restatement).

After she no longer was the Company’s CFO, but at a time when she remained a director, Helen He was asked to sign, and did sign, along with NetEase’s then-CFO, NetEase’s management representation letter to its independent auditor dated February 14, 2001. In the letter, Helen He stated, among other things, that NetEase’s financial statements were “fairly presented” in conformance with GAAP, that the Company and its executives, including Respondent, had given the auditor “all financial records and related data,” and that all material transactions had been properly recorded in the Company’s accounting records. These statements were materially false or misleading. Based in part on this letter, NetEase’s auditor issued an audit report containing an unqualified opinion

for fiscal 2000, which was included in the Company's annual report disseminated to investors along with proxy materials.

#### IV.

#### LEGAL DISCUSSION

##### A. Violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act

Section 17(a) of the Securities Act proscribes a variety of fraudulent practices in the offer or sale of securities. Section 17(a)(2) of the Securities Act prohibits obtaining money or property by means of untrue statements of material fact or misleading omissions of material fact in the offer or sale of securities. Section 17(a)(3) of the Securities Act prohibits engaging in transactions, practices or courses of business which operate or would operate as a fraud or deceit upon the purchaser in the offer or sale of securities. To prove a violation of these provisions, it must be shown that the alleged misrepresentations or omitted facts were material. Information is deemed material upon a showing that there is a substantial likelihood that the omitted facts would have assumed significance in the investment deliberations of a reasonable investor. Basic, Inc. v. Levinson, 485 U.S. 224 (1988). Establishing violations of Sections 17(a)(2) and 17(a)(3) does not require a showing of scienter. Aaron v. SEC, 446 U.S. 680, 697 (1980).

During 2000, Helen He contributed to NetEase's improper recording of revenue in connection with offsetting barter arrangements that lacked economic substance. These barter arrangements contributed to the Company's material overstatement of its revenue in its registration statement, which NetEase distributed to investors and furnished to the Commission. As a result, Helen He violated Sections 17(a)(2) and (3).

##### B. Causing NetEase's Violations of the Reporting and Recordkeeping Provisions of the Exchange Act

Section 13(a) of the Exchange Act and Rule 13a-16 thereunder generally require foreign private issuers with securities registered under Section 12 of the Exchange Act to file certain reports on Form 6-K with the Commission, and the obligation to file such reports includes the requirement that they be true and correct. Exchange Act Rule 12b-20 provides that in addition to the information expressly required to be included in a statement or report, there shall be added such further material information, if any, as may be necessary to make the required statements, in the light of the circumstances under which they were made, not misleading. Financial statements in Commission filings that do not comply with GAAP are presumed to be misleading. Regulation S-X, 17 C.F.R. 210.4-01(a)(1).

Section 13(b)(2)(A) of the Exchange Act requires Section 12 registrants to make and keep books, records, and accounts that accurately and fairly reflect their transactions and dispositions of their assets. Section 13(b)(2)(B) of the Exchange Act requires issuers to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that, among other things, transactions are recorded as necessary to

permit preparation of financial statements in conformity with GAAP and to maintain the accountability of assets.

No showing of scienter is required to prove violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B). See, e.g., SEC v. Savoy Indus., Inc., 587 F.2d 1149, 1165 (D.C. Cir. 1978), cert. denied, 440 U.S. 913 (1979); SEC v. World-Wide Coin Investments, Ltd., 567 F. Supp. 747, 749-50 (N.D. Ga. 1983).

As discussed above, Helen He's conduct contributed to NetEase's improper recording of revenue from two barter arrangements that lacked economic substance. The Company's books and records did not accurately and fairly reflect the terms of the two arrangements, causing the Company to materially overstate its revenue. As a result, Helen He was a cause of NetEase's violations of the reporting, recordkeeping and internal controls provisions of the Exchange Act.

C. Violations of Exchange Act Rules 13b2-1 and 13b2-2

Rule 13b2-1 of the Exchange Act prohibits any person from, directly or indirectly, falsifying or causing to be falsified any book, record or account subject to Section 13(b)(2)(A). Rule 13b2-2 of the Exchange Act prohibits directors and officers from, directly or indirectly, making or causing materially false or misleading statements to an accountant in connection with an audit or the preparation of Commission filings. As detailed above, Helen He was a cause of NetEase's improper recognition of revenue from the Joyo and Techpacific barter arrangements, which lacked economic substance. Helen He did not adequately inquire into and fully disclose the nature of the arrangements to NetEase's independent auditor and also, at the independent auditor's request, signed an inaccurate management representation letter to the auditor, which it relied on in issuing an audit report containing an unqualified opinion for NetEase's fiscal 2000 financial statements. As a result, NetEase's books, records and financial statements were false and misleading and Helen He violated Rules 13b2-1 and 13b2-2 of the Exchange Act.

V.

Based on the foregoing, the Commission finds that Helen He violated Sections 17(a)(2) and 17(a)(3) of the Securities Act and Rules 13b2-1 and 13b2-2 under the Exchange Act, and was a cause of NetEase.com, Inc.'s violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20 and 13a-16 thereunder.

**VI.**

Accordingly, **IT IS HEREBY ORDERED**, pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, that Helen He cease and desist from committing or causing any violations and any future violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act and Rules 13b2-1 and 13b2-2 under the Exchange Act, and from causing any violations and any future violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20 and 13a-16 thereunder.

By the Commission.

Nancy M. Morris  
Secretary