CHINA OUHUA WINERY HOLDINGS LIMITED (“CNOUHUA” OR “THE COMPANY”)

STATEMENT OF COMPLIANCE WITH PARAGRAPH 9.19(37) OF THE MAIN MARKET LISTING REQUIREMENTS ON QUALIFIED OPINION ON THE AUDITED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2017

Pursuant to Paragraph 9.19(37) of the Main Market Listing Requirements of Bursa Malaysia Securities Berhad (“Bursa Securities”), and before our submission of the Audited Financial Statements for the financial year ended 31 December 2017 (“AFS”) of CNOUHUA to Bursa Securities, the Board of Directors of CNOUHUA wishes to inform that Messrs UHY Lee Seng Chan & Co., the External Auditors of CNOUHUA, had qualified their report for the AFS of the Company in respect of other receivables on Deposits, the Company hereby set outs below the full details of the qualified opinion:-

(a) <u>Key Audit Matter Disclosed In The External Auditors’ Report</u>

The key audit matter disclosed is as follows: -

<u>Basis for Qualified Opinion</u>

Included in trade and other receivables are deposits of RMB 118,800,000 representing 90% of the total cash consideration price, which were made to Huangwu Subdistrict Office, Zhifu District, Yantai City, People’s Republic of China. As disclosed in Note 5 to the financial statements, on 17 December 2013, the Group entered into a contract to purchase land, buildings and ancillary facilities including 320KVA power distribution equipment, water supply system, roads surrounding the factory and enclosing wall (collectively known as “Assets”) for a cash consideration of RMB 132,000,000.

The External Auditors have not been able to obtain sufficient appropriate audit evidence to satisfy themselves of the extent of recoverability of the deposits of RMB 118,800,000 in the event that the transaction is not completed. Consequently, the External Auditors were unable to determine whether any adjustments to the carrying amount of deposits as at 31 December 2017 were necessary.

<u>Key Audit Matters</u>

Key audit matters are those matters that, in the External Auditors’ professional judgement, were of most significance in their audit of the financial statements of the current period. These matters were addressed in the context of the External Auditors’ audit of the financial statements as a whole, and in forming their opinion thereon, and they do not provide a separate opinion on these matters. In addition to the matter disclosed in the Basis of Qualified Opinion section, the External Auditors have determined the matters described below to be the key audit matters to be communicated in their report.

i. **Valuation of trade receivables (RMB 20.533 million) (Refer to Note 5 to the financial statements)**

The Group has long outstanding trade receivables amounting to RMB890,000, representing 6% of the total trade receivables.

Management monitors and assesses the Group’s credit risk and where required, adjusts the level of impairment allowance, which requires management to make significant judgements regarding the expected future financial condition and payment ability of the debtors, especially where the debts are aged more than 150 days.

…2/-

Inappropriate judgements and estimates made in the impairment assessment would result in a significant impact on the carrying amount of the trade receivables.

Disclosure on the above significant management's judgement is provided in Note 3 to the financial statements and further information related to the aged trade receivables is in Note 22(b) to the financial statements.

Audit Response

The External Auditors' have evaluated and challenged management's assessment on the recoverability of the Group's aged trade receivables which are past due but not impaired, including the assessment of any allowance to be made by the Group in respect of overdue debts. They have enquired with management on the reasons for the delay in payments of certain aged trade receivables and review of appropriateness of any allowance for impairment to be made by considering factors such as subsequent cash receipts, past payment records, ongoing business relationship with the debtors and the repayment plans agreed with the debtors.

Based on their work performed, they found management's assessment of the recoverability of trade receivables, which premised on the repayment plans to be reasonable.

They also found the disclosures in the financial statements to be adequate.

ii. **Valuation of inventories (RMB 87.147million) (Refer to Note 6 to the financial statements)**

The Group's work-in-progress inventories amounting to RMB86.736 million represents 99% of the total inventories. These inventories relate mainly to the direct costs incurred for the wine production. The period over which the wine inventories are converted to finished goods can be a significant length of time and forecasting demand and market prices can vary significantly over the holding period up to the likely date of sale.

Management has estimated the net realisable value of the work-in-progress inventories based on certain assumptions relating to spoilage and obsolescence. Obsolescence considerations include inventory aging profile, as well as different market factors impacting the sale of these product lines.

Inappropriate judgement and estimate made in estimating the conditions and estimated selling price would result in a significant impact on the net realisable value of the work-in-progress inventories.

Disclosure on the above significant judgement is given made in Note 3 to the financial statements and further information related to the write-down of the inventories to its net realisable values is disclosed under Note 6 to the financial statements.

Audit Response

The External Auditors' audit procedures to validate the valuation of the inventories included performance of test of details on actual margins and valuation of obsolete inventories. They assessed whether there were inventories which were sold with negative margin by evaluating sales invoices issued subsequent to year end to validate management's assessment and decision as to whether inventories need be adjusted to their net realisable values.

…3/-

Based on the work performed, they found management’s estimates to be reasonable.

They also found the disclosures in the financial statements to be adequate.

iii. **Impairment of property, plant and equipment and deposit for purchase of land buildings, and ancillary facilities (RMB 118.800 million) Refer to Note 5 to the financial statements**

As at 31 December 2017, property, plant and equipment and deposit for purchase of land, buildings and ancillary facilities with carrying amounts of RMB42.228 million and RMB118.800 million constituted approximately 17% and 48% of the total assets of the Group respectively.

During the current financial year, the Group carried out a review of the recoverable amount of its property, plant and equipment and deposit for purchase of land, buildings and ancillary facilities based on valuations carried out by an independent external valuer engaged by the Group.

The valuation process involves significant judgement in determining the appropriate valuation methods to be used, and in estimating the key underlying assumptions to be applied.

These critical judgement and significant estimation are disclosed in Note 3 to the financial statements.

Audit Response

The External Auditors’ audit procedures focused on evaluating the appropriateness and adequacy of the impairment loss recognised for property, plant and equipment.

They have assessed the competency, capabilities and objectivity of the external valuer and obtained an understanding of his work. They have also challenged the key assumptions used by the external valuer in the valuation report.

Based on their work performed, they found the external valuer’s key assumptions and valuation methods to be reasonable.

They also found the disclosures in the financial statements to be adequate.

(b) Steps Taken Or Proposed To Be Taken To Address Those Key Audit Matter That Relate To The Qualified Opinion

Most of the processes of the land title ownership transfer procedure have been completed. The management of the Company had been following up closely with the Yantai Land Commission Office (“Land Office”) in Yantai City, People’s Republic of China (“PRC”) on the approval of the Company’s application of the transfer of land title.

China Ouhua will proactively follow up with meticulous supervision with the Land Office to ensure the land title ownership be transferred to Yantai Fazenda Ouhua Winery Co., Ltd. (“Yantai Ouhua”) as soon as possible.

(c) Timeline For The Steps Referred To Sub-Paragraph (b) Above

China Ouhua will continuously follow up with the Land Office until the approval for the transfer of land title to Yantai Ouhua is granted by the Land Office.