
Response to SGX queries in respect of Disclaimer of Independent Auditors' Opinion for Financial Statements for the Year ended 31 December 2008

SGX queries:

We note that the total assets of the Sub-group (after impairment allowance of \$11.8 million) was \$35.4 million as at 31 December 2008.

Further, the Company believes that there will be no further exposure to the Group or the Company arising from the financial obligations of the Sub-group, which has total liabilities of \$35.4 million. Accordingly, the carrying amount of the assets of the Sub-Group will be used to settle the related liabilities of the Sub-Group.

(a) Please explain why the Company is of the view that no further adjustments are required to the carrying amounts assets of the Sub-group.

Company's Reply:

- i. The loans from a PRC bank were made to a subsidiary company within the sub-group. The loans are secured by certain assets of certain subsidiaries within the sub-group and corporate guarantees of 4 subsidiaries within the sub-group. Since neither the holding company nor any other company within the Group has pledged any asset, given any undertaking or guarantee to the PRC bank, there is no legal recourse to the holding company or other companies within the Group. Similarly, other trade and non-trade liabilities of the sub-group have no implication to the holding company or other companies within the Group. Pursuant to a PRC Arbitration order and in accordance with PRC laws, certain assets of the sub-group were transferred to the holding company as repayment of loans from the holding company. The Company's PRC lawyer has given the opinion that the transfer had been done in accordance with PRC laws and was not subject to restriction. The Company is therefore of the view that the bank has no recourse to the assets transferred to the holding company. In the event of any further actions by the bank or other creditors, the maximum exposure to the group is limited to the assets of the sub-group. On the basis of this, we have made full accounting provision such that the net carrying amount of the assets of the sub-group is equal to the total 3rd party liabilities of the sub-group. In essence, after the provision, the net asset of the sub-group is zero in the consolidated net asset. We believe this valuation truly reflect the economic reality of the present situation.
- ii. The auditors' views (extracts from the auditors' report below) differ from the company's views as the accounting standards requires the company to perform an assessment of the recoverability of the assets at the reporting date, which was not performed for the reasons set out in our reply in (i) above: that the Group is not exposed to any further liabilities of the sub-group. The auditors' view of the carrying value of the assets of the sub-group therefore differs from the company's valuation (differences in accounting estimate).

"As of 31 December 2008, certain subsidiaries in the Sub-group have ceased operations and the related assets of the Sub-group are the subject of the court order seizure. These subsidiaries are therefore not considered to be operating as going concerns and as such, these assets should be adjusted to their net realisable values and provisions be made for any liabilities associated with the costs of cessation of the Sub-group. The consolidated financial statements of the Group and financial statements of the Company do not disclose this fact except for the allowance for impairment of \$11.833 million as disclosed in the preceding paragraphs.

We are unable to satisfy ourselves of, or perform alternative audit procedures to ascertain, the recoverability of the carrying value of the assets of the Sub-group amounting to approximately \$35.4 million as at 31 December 2008 as these assets of the Sub-group are subject to seizure by the bank. The financial statements of the Sub-group which have been consolidated into the financial statements of the Group have been prepared on a going concern basis notwithstanding the court order seizure and the cessation of operations of certain subsidiaries in the Sub-group which in our judgement, is inappropriate under such circumstances."

- iii. The company is of the view that no further adjustment (other than the S\$11.833 million provision) is required to the carrying amount of assets because:
- iii.1 The group's maximum exposure has been accurately reflected with the provision made and in zeroing the net asset of the sub-group.
 - iii.2 It is impractical to determine the realizable value of the assets of the sub-group because the assets have been seized or frozen by the bank or certain creditors through various court actions. The Group is in no position to dispose of these assets in an orderly manner.
 - iii.3 Any further write down of the carrying amount of the assets of the sub-group to below the carrying amount of the liabilities would imply further financial exposure to the group. This would not be a true reflection of the reality. Since neither the holding company nor any other company within the Group has pledged any asset, given any undertaking or guarantee to the PRC bank or other creditors, and the transfer of certain assets from the sub-group to the holding company was done in accordance with PRC laws, there is no legal recourse to the holding company or other companies within the Group.

(b) In the event of write-down of the assets of the Sub-group, what is the financial impact of the Group? Will this affect the Group's ability to operate as a going concern?

Company's Reply:

- i. As explained in iii.3 above, any further write down of the carrying value of the assets of the sub-group would imply that the group has further financial exposure to the liabilities of the sub-group. This would not be a true reflection of the actual situation. We believe it is not appropriate to further inflate the negative equity of the group, with liabilities that the group (the holding company or any other subsidiaries) is not legally responsible for.
- ii. In any case, any further write down will purely be an accounting entry and will not affect the group's ability to operate as a going concern as there is no cash implication. Please also note that following a strategy review (for which announcement has been made by the company) during the financial year ended 31 December 2008, the assets of the sub-group are also no longer required for the on-going business activities of the rest of the group.

On behalf of the Company
SunMoon Food Company Limited