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Ausnutria

AUSNUTRIA DAIRY CORPORATION LTD
澳優乳業股份有限公司

(Incorporated in the Cayman Islands with limited liability)

(Stock code: 1717)

COMPLETION OF THE INTERNAL CONTROL REVIEW

Reference is made to the supplemental announcement of Ausnutria Dairy Corporation Ltd (the "**Company**", together with its subsidiaries, the "**Group**") dated 7 July 2023 (the "**Announcement**") in relation to the annual results announcement and annual report of the Company for the year ended 31 December 2022. Capitalised terms used in this announcement shall have the same meanings as those defined in the Announcement unless otherwise specified.

BACKGROUND

As disclosed in the Announcement, the Company has engaged the IC Consultant, namely Deloitte Enterprise Consulting (Shanghai) Co., Ltd. Beijing Branch, for the Internal Control Review for the purpose of improving its internal control and financial reporting system. On 30 October 2023, the IC Consultant completed its review on the Company's internal controls and the status of the Company's implementation of its recommendations on the internal controls, and submitted the internal control review report (the "**IC Review Report**") to the Company.

SCOPE OF THE INTERNAL CONTROL REVIEW

The Internal Control Review covers the period from 1 January 2020 to 31 March 2023 and its scope includes:

(i) an assessment of the internal controls at entity level covering control environment, risk assessment, control activities, information and communication, ongoing monitoring system, board governance, legal and compliance and confidentiality and privacy;

(ii) an assessment of the internal controls at process level including sales management, expense management, procurement management, production and inventory, treasury management, financial reporting and disclosure, related parties management and investment management; and

(iii) an assessment of the information system controls of the Group.

KEY FINDINGS OF THE INTERNAL CONTROL REVIEW

Deficiencies in relation to prior year adjustments

The IC Consultant identified one material deficiency and three other internal control deficiencies relating to the accounting errors that led to the prior year adjustments (the "**PYA**") as disclosed in the Announcement, the 2022 Annual Results Announcement and the 2022 Annual Report.

1. Accounting treatment for contract liabilities

The IC Consultant identified one material deficiency in accounting treatment for contract liabilities.

In particular, during the review period, there was a lack of review of rebate calculation working paper, resulting in certain calculation errors not being promptly identified. Furthermore, there was a lack of reconciliation of the accounting results of rebate balances with underlying system data, resulting in the discrepancies in the calculations not being promptly identified.

The IC Consultant further identified that certain sales rebates in the form of reimbursement were only accounted for when the expenses were actually incurred, with no proper pre-approval process, resulting in under-provision of accrued expenses for the relevant period. There was also no strict deadline for application of reimbursement of expenses, some of the expenses for sales activities were accounted for in the subsequent periods.

According to the 2022 Annual Report, the impact of the PYA attributable to the deficiency of accounting treatment for contract liabilities on the profit for the year ended 31 December 2021 amounted to a reduction of approximately RMB219 million.

2. Other Control Deficiencies

The IC Consultant identified three other control deficiencies in relation to the PYA, namely (i) deficiency in investment management policy and post-investment management; (ii) deficiency in month-end closing process and financial accounting and financial statement preparation; and (iii) deficiency in the inventory accounting process.

(i) Deficiency in investment management policy and post-investment management

There was a lack of formal investment management policy and post-investment management which may lead to non-compliance in project implementation or management, investment decision-making and operational procedures.

According to the 2022 Annual Report, the impact of the PYA attributable to the above deficiency (related to post-investment management) on the consolidated financial statements of the Company for the year ended 31 December 2021 amounted to a reduction in profit of approximately RMB4.93 million.

(ii) Deficiency in month-end closing process and financial accounting and financial statement preparation

During the review period, processes such as statement preparation and accounting were independently managed by the regional finance teams. The IC Consultant identified that Ausnutria Dairy China Co., Ltd ("**Ausnutria China**") and Ausnutria B.V. have not set up and used any closing checklists in the month-end closing process, and the financial personnel did not have any unified standards and procedures in the closing process. The IC Consultant further identified that Ausnutria China did not communicate with the legal team in writing on the probability of pending litigation or arbitration at the time of preparation and disclosure of the statements and did not keep any communication records.

According to the 2022 Annual Report, these deficiencies contributed to the PYA in the following respects: (i) under-statement of tax expenses; (ii) under-statement of bad debt provision for accounts receivable; (iii) over-statement of long-term prepayments; (iv) errors in offsetting partial unrealised profit; and (v) under-provision for employees' long-term sick leave.

(iii) Deficiency in the inventory accounting process

The IC Consultant identified that during the review period, the financial personnel of Ausnutria China made provision for the impairment only of products with issues in respect of expiration dates in accordance with policy requirements, but did not measure and make sufficient provision for the impairment of the products through its net realisable value assessment.

According to the 2022 Annual Report, the PYA has been made and the impact of the above deficiency on the financial statements for the year ended 31 December 2021 amounted to a reduction in profit of approximately RMB8.3 million.

3. Status of implementation of the remedial measures

During the preparation of the 2022 Annual Report, the Company has discovered on its own certain issues relating to the above deficiencies and has made certain enhancements accordingly. Following the completion of the Internal Control Review, the Company has further adopted the recommendations of the IC Consultant and made relevant enhancement to the extent practicable. The IC Consultant has obtained and reviewed the relevant updated policies and/or samples. As of the date of the IC Review Report, no exception has been found. As certain steps relating to the aforesaid other control deficiencies on the PYA (i.e., deficiency (ii) of Ausnutria B.V.), by their nature, require additional time to implement, it is expected that the corresponding remedial measures will be fully implemented by the end of first quarter of 2024.

Having considered the IC Review Report, the recommendations of the IC Consultant and the remedial actions taken by the Group, the Board is of the view that the aforementioned control deficiencies related to the PYA have been rectified and the related risks have been managed to a reasonably acceptable level, which are adequate and sufficient to address the key findings of the IC Review Report to avoid reoccurrence in the future.

Other material deficiencies identified by the IC Consultant

Apart from those internal control deficiencies in relation to the PYA disclosed above, the IC Consultant further identified three other material deficiencies, details of which are set out below:

- ***Deficiencies in reviewing and disclosing the remuneration of directors and senior management***

  According to the IC Review Report, during 2021 to 2023, certain fundings which were granted directly to the then director and senior managements of the Company based on the application request by the Company, were not properly assessed and approved by the then remuneration committee of the Company, and have not been fully disclosed pursuant to the Corporate Governance Code under Appendix 14 to the Listing Rules due to the lack of review by the then remuneration committee of the Company. Further, the Company had not strictly implemented its seal management policy and used its seal for the application documents for such funds to be paid directly to the then director and senior managements of the Company. For certain application documents for advances in relation to individual income tax of the then director and senior managements of the Company, the relevant accounting treatment did not comply with the relevant internal regulations;

- ***Deficiencies in equity transaction management***

  The IC Consultant identified deficiency in the ownership of an underlying intangible asset, being part of technological contribution in respect of the acquisition of equity interest in the Company's subsidiary, due to non-cash contribution in the form of in-kind contribution by technology from the then minority shareholders. Such contribution by technology was not accounted for in a timely manner at the relevant time; and

- ***Deficiency in managing receivables of a joint venture***

  Ausnutria B.V. adopted an accounts receivable management mechanism during the review period. The IC Consultant identified certain deficiencies in the collection and stop-loss management of receivables as such mechanism was not properly implemented for the transactions with a joint venture (the "**JV Group**"). Furthermore, the IC Consultant identified that no effective repayment plan for accounts receivable relating to the JV Group has been established in a timely manner during the review period. For one instance, the agreed repayment plan with the JV Group was reported more than twelve months after the sharp increase in accounts receivable relating to the JV Group.

In respect of all the internal control deficiencies identified by the IC Consultant above, the Company has adopted the recommendations from the IC Consultant and made relevant enhancement to the extent practicable. As of the date of the IC Review Report, the IC Consultant has conducted interviews and reviewed rectification records on a sample basis and no exception has been found. Having considered the recommendations of the IC Consultant and the remedial actions taken by the Group, the Board is of the view that (i) the above key internal control deficiencies have been rectified and the related risks have been managed to a reasonably acceptable level; and (ii) the remedial actions and improvement measures implemented by the Group are adequate and sufficient to address the key findings of the IC Review Report to avoid reoccurrence in the future.

Other control deficiencies

The IC Review Report also mentioned other low-risk control deficiencies of the Group, including the need for improvement in (i) management mechanism for segregation of duties; (ii) software copyright and license management mechanism; (iii) data privacy and confidentiality mechanism; (iv) distributor management policy and contract and pricing management so as to effectively implement procedures for acceptance, credit approval and subsequent evaluation of distributors for meeting its business objectives, to avoid contracts not being executed and deposits not being paid in a timely manner; (v) procurement management policy and deficiencies in supplier management and expense reimbursement; and (vi) inventory safety management.

The Company has adopted the recommendations of the IC Consultant and made relevant enhancement to the extent practicable. On a sample basis, the IC Consultant has obtained and reviewed the relevant updated policies and/or samples. As of the date of the IC Review Report, no exception has been found for all deficiencies.

As the remedial measures in connection with (a) other control deficiency (iii) (in relation to improvement in data privacy and confidentiality management mechanism for avoiding loss, damage or inappropriate use of key business data in Ausnutria B.V.); and (b) other control deficiency (iv) (in relation to improvement in the inadequacy in distributors management in Ausnutria B.V.) under this section, by their nature, require additional time to implement, it is expected that those remedial measures will be fully implemented by the end of first quarter of 2024. Having considered the IC Review Report, the recommendations of the IC Consultant and the remedial actions taken by the Group, the Board is of the view that the aforementioned control deficiencies have been rectified and the related risks have been managed to a reasonably acceptable level, which are adequate and sufficient to address the key findings of the IC Review Report to avoid reoccurrence in the future.

By order of the Board
Ausnutria Dairy Corporation Ltd
ZHANG Zhanqiang
Chairman

The PRC, 29 December 2023

As at the date of this announcement, the Board comprises Mr. Ren Zhijian (CEO), Mr. Bartle van der Meer and Mr. Zhang Zhi as the executive Directors; Mr. Zhang Zhanqiang (Chairman), Mr. Sun Donghong (Vice-Chairman) and Ms. Yan Junrong as the non-executive Directors; and Mr. Ma Ji, Mr. Song Kungang and Mr. Aidan Maurice Coleman as the independent non-executive Directors.