

BEST WORLD INTERNATIONAL LIMITED

Company Registration No. 199006030Z

INDEPENDENT REVIEW – INTERIM UPDATE

The audit committee (the “**AC**”) of Best World International Limited (the “**Company**” and together with its subsidiaries, the “**Group**”) refers to:

- (a) the Company’s announcements dated 23 February 2019, 19 March 2019, 15 July 2019, 12 December 2019 and 14 February 2020 relating to the conduct by PricewaterhouseCoopers Advisory Services Pte. Ltd. (the “**Independent Accountant**”) of an independent review of the Export Model and the Franchise Model adopted by the Group in China (the “**Independent Review**”); and
- (b) the Notice of Compliance issued by Singapore Exchange Regulation Pte Ltd (“**SGX RegCo**”) to the Company on 13 May 2019 (the “**Notice of Compliance**”).

The decision to conduct the Independent Review was made in response to the Business Times article entitled “Sales of DR’s Secret in China: Best World’s best-kept secret?” published on 18 February 2019. The Independent Review has been a comprehensive exercise with the following principal objectives¹:

- (i) to verify the existence of the Franchisees as at 31 December 2018, and to validate the sales and cash received from sales to significant Franchisees by value of sales;
- (ii) to establish the facts and circumstances surrounding the establishment, appointment and business relationship with Changsha Best, the Group’s primary import agent in China under the Export Model;
- (iii) to verify the sales to Changsha Best and the other import agents² used by the Group in the China market, if any, for the period from FY2015 to FY2018 under the Export Model, and ascertain if these transactions were on normal commercial terms and conducted on an arm’s length basis; and
- (iv) to validate the cash received from the sales to the distributors and customers by Changsha Best.

As at the date of this announcement, the Independent Review is at an advanced stage, however there remains certain outstanding information and documents required for the Independent Accountant to complete its work.³ In the meantime, the Independent Accountant has issued an interim update (the “**Interim Update**”) setting out its interim observations concerning the Group’s sales in China under the Export Model and Franchise Model, as well as its key findings on the veracity of the Group’s sales in China. The Interim Update is attached as **Annex A** to this announcement. This announcement should be read in conjunction with the Interim Update.

¹ Please refer to the Company’s announcements dated 19 March 2019 and 15 July 2019 for further details on the objectives of the Independent Review.

² The Group’s import agents were (a) 青岛贝汇贸易有限公司 (“**Qingdao Beihui**”) during the period from January 2012 to September 2015; and (b) 长沙百世特威日用品贸易有限公司 (“**Changsha Best**”) during the period from September 2015 to June 2018.

³ The Company is working with its China subsidiary to facilitate the retrieval of the necessary information and documents for the Independent Accountant.

Key Findings of the Interim Update

A summary of the key findings of the Interim Update is set out below.

1. Veracity of sales under the Export Model during the period from January 2015 to June 2018

1.1. Key findings

In respect of the Group's sales to import agents under the Export Model, the Independent Accountant did not note any significant exceptions based on the work performed on the samples selected. The Independent Accountant was able to independently trace such sales from the Company to Qingdao Beihui and Changsha Best from FY2015 to FY2018 to the Company's underlying supporting documents, such as sales invoices, packing lists and third-party bills of lading, as well as trace these sales to cash receipts based on the Company's bank statements. The Independent Accountant also performed a throughput analysis of the DR's Secret⁴ Stock Keeping Unit ("SKU") from the quantity of raw materials purchased by the Company to the quantity of finished goods sold to China for the same period.

In respect of the sales of Changsha Best to its customers,⁵ the Independent Accountant was provided with cash flow movement spreadsheets for FY2017 and FY2018 and was able to trace these movements on a sampling basis to Changsha Best's bank statements which were obtained independently, but was not able to trace these cash flow movements to third party documents, such as sales orders, third-party delivery documents and payment vouchers, as these documents were not available. As an alternative, the Independent Accountant was able to match the sales orders obtained from the distributors of Changsha Best in 2017 and 2018 to Changsha Best's sales data recorded in the Company's Customer Relationship Management ("CRM") System on a sampling basis.⁶ The Independent Accountant also attempted to reconcile the total cash receipts and commission payments in Changsha Best's bank statements for FY2017 and FY2018 with CRM System.

1.2. Exceptions observed based on work done

In performing the reconciliation exercise, the Independent Accountant found that Changsha Best only recorded approximately 60% of the value of its sales to its distributors and customers, while proceeds from the remaining 40% of its sales were deposited into other bank accounts not in the name of Changsha Best, which were then used for commission payments to distributors and customers, sales incentives and transfers to Vicstar Lifestyle Pte Ltd ("Vicstar"). By way of background, the Company sold products into China through Vicstar from January 2010 to December 2011.⁷ Vicstar was owned by the spouses of two top Singapore distributors. During the Export Model period, Vicstar continued to support the China operations of Qingdao Beihui and Changsha Best by maintaining the China customer database and facilitating the calculation of commissions due to the China distributors. From 2012, the Group provided Vicstar with IT and consultancy services in return for a service fee based on contracts between the Company and Vicstar.

The Independent Accountant is currently tracing the cash outflows from the abovementioned bank accounts not in the name of Changsha Best, and performing further work to determine the circumstances

⁴ Throughput analysis was performed only on DR's Secret SKU as these constitute the majority of sales to China.

⁵ As Qingdao Beihui ceased operations in 2015 and its financial records were not available, the Independent Accountant did not conduct any work on the sales activities of Qingdao Beihui.

⁶ The Company's CRM System is a sales ordering system through which Changsha Best's sales to its distributors and customers were processed and tracked.

⁷ This was prior to the commencement of the Export Model in January 2012.

surrounding the business relationships between the Company and Vicstar, and between Vicstar and the import agents.

2. Veracity of sales under the Franchise Model during the period from June 2018 to December 2018

2.1. Key findings

In respect of the Group's sales to Best World (China) Pharmaceutical Co., Ltd. (Hunan Branch) (全美世界(中国)药业有限公司湖南分公司) ("BW Changsha")⁸ under the Franchise Model, the Independent Accountant did not note any significant exceptions based on the work performed on the samples selected. The Independent Accountant traced the sales and movement of goods from the Company to BW Changsha during the Franchise Model period to third party documents such as bills of lading on a sampling basis, and payments for these goods to the bank statements of the Company and BW Changsha. The Independent Accountant also further performed a throughput analysis of the DR's Secret SKU from the quantity of raw materials purchased by the Company to the quantity of finished goods sold to BW Changsha.

In respect of BW Changsha's sales to significant Franchisees, the Independent Accountant was able to trace such sales recorded in BW Changsha's financials on a sampling basis for the period from 1 June 2018 to 31 December 2018 to underlying invoices, delivery instructions, third party warehouse records and confirmations from third-party logistics providers. As part of its throughput analysis, the Independent Accountant also attempted to reconcile purchases from the Company and sales to Franchisees with BW Changsha's inventory balance as at 31 December 2018. Based on the Independent Accountant's work, the following exceptions were noted:

- (a) potential sales cut-off issue for goods sold which remained undelivered as at 31 December 2018; and
- (b) potential understatement of BW Changsha's sales and certain related expenses.

2.2. Exceptions observed based on work done

(a) *Goods sold but undelivered as at 31 December 2018*

The Independent Accountant observed that there were undelivered goods at the third-party warehouse with an estimated value of approximately CNY111.8 million as at 31 December 2018, which were recorded as sold by the Group in FY2018 as payment for such goods had been received. The Independent Accountant highlighted that this may potentially be a sales cut-off issue for goods sold but undelivered as at 31 December 2018. Based on the records of the third-party warehouse, these goods were subsequently delivered in 2019.

The Company's management has performed a subsequent review of all sales to Franchisees and informed the Independent Accountant that the estimated value of sold but undelivered goods as at 31 December 2018 was approximately CNY54 million. The Independent Accountant is in the process of reconciling the difference. The Independent Accountant has recommended that the Group's auditors review the quantification and consider if any adjustments are required to the sales and inventory numbers for FY2018.

⁸ BW Changsha, a wholly-owned subsidiary of the Company, operates the Franchise Model in China.

(b) *Potential understatement of sales and expenses*

The Independent Accountant has noted from its testing of BW Changsha's sales to Franchisees that BW Changsha had recognised approximately 80% of the sales value of goods sold to Franchisees based on the tax invoices (*fapiao*) issued, *i.e.*, 80% of the selling price to members. However, members pay 100% of the sales value. In the cash receipts testing performed, the Independent Accountant noted that 20% of the sales value of goods had been deposited into other bank accounts not in the name of BW Changsha.⁹ The Company's management has explained to the Independent Accountant that the 20% of the sales value of goods represented trade rebates due to the Franchisees, and as such, BW Changsha recorded such sales net of the trade rebates. The Independent Accountant has not been able to independently verify this arrangement against any third party supporting documents, and the Company has informed the Independent Accountant that this was an oral arrangement between BW Changsha and its Franchisees. Based on the Independent Accountant's work to date, it is noted that the outflows from these bank accounts include commission payments to members, payments to staff and transfers to Vicstar.

Even though the Independent Accountant has noted that the net financial impact of this arrangement may not be significant, it highlighted that recognising only 80% of the value of the sales transactions in BW Changsha's books without recording related expenses may not be appropriate from an accounting perspective. The Independent Accountant has recommended that the Board of Directors of the Company (the "**Board**") work with the Group's auditors to review and consider if any reclassification or adjustments are necessary to the financial statements for FY2018. The Independent Accountant has also recommended that the Board seeks a formal legal opinion on the legal and regulatory implications of the potential understatement and the arrangement in relation to the proceeds in the other bank accounts not in the name of BW Changsha. The Board is working closely with the Group's auditors to determine whether the above arrangement is appropriate from an accounting perspective, and is seeking legal advice on the implications of the arrangement.

The Independent Accountant is currently performing further work on the cash flow movements in the other bank accounts that are not in the name of BW Changsha.

3. **Legality of the Franchise Model**

- 3.1. The Independent Accountant has noted that with the Group's transition to the Franchise Model, the manner in which sales were conducted through the customer network and the basis of computation of commission remained unchanged from the Export Model. The Independent Accountant has identified seven (7) distributor and customer ranks under the Export Model, and observed that the Group mapped these existing distributor and customer ranks into four (4) tiers under the Franchise Model, Franchisee, Area Representative, Sales Representative and VIP. Under the Franchise Model, the Group selected 28 distributors from the Export Model and entered into franchise agreements with them, as well as Area Representatives and Sales Representatives, on a non-mutually exclusive basis.¹⁰ The Company's management has informed the Independent Accountant that the Franchise Model as currently structured is in compliance with local China regulations and the Franchise License. The details on the structure of the Franchise Model will be included in the full report of the Independent Review.

⁹ The Independent Accountant has noted that some of these bank accounts are the same as the accounts mentioned in paragraph 1.2 of this announcement.

¹⁰ A customer may enter into all three (3) types of contracts with BW Changsha. BW Changsha does not enter into any contracts with VIPs as there are no commissions due to VIPs.

- 3.2. The Independent Accountant recommended that the Board obtain the advice of an independent and suitably qualified Chinese law expert to comment on the legality of the structure of the Franchise Model under local China regulations and whether it falls within the scope of the Franchise License. Accordingly, the Company has engaged Merits and Tree (Beijing) Law Office (“M&T”), an independent law firm in China, to provide a legal opinion on the legality of the Franchise Model, and is working closely with M&T to finalise the opinion.
- 3.3. Shareholders should also note that the Company had announced on 9 May 2019 that it had developed the Franchise Model with advice from its professional advisors, and had obtained an opinion from Beijing Dacheng Law Offices, LLP (part of the global law firm Dentons) following review of the information provided, that the Group’s business under the Franchise Model is in compliance with applicable laws and regulations.

4. Existence of Franchisees

As part of its scope of work, the Independent Accountant selected eight (8) Franchisees and performed scheduled site visits to verify the existence of each Franchisee’s physical shop front, which were arranged by BW Changsha. The Independent Accountant also performed four (4) additional surprise visits to other Franchisees. Based on these site visits, interviews conducted with Franchisee owners and the Company’s management, the Independent Accountant has made the general observation that the Franchisees’ offices do not operate as retail outlets but are used for the conduct of training events or seminars and product demonstrations for potential customers, as well as collection points for customers to pick up their purchases.¹¹

Future Actions

The Company’s auditors are in the midst of reviewing the findings of the Independent Accountant in the Interim Update. The Company will continue to work with its auditors and legal advisors on the matters raised in the Interim Update and will update its shareholders on the steps taken and to be taken in due course.

A full report of the Independent Review will be issued by the Independent Accountant to the AC and SGX RegCo after it has completed its work. The outstanding matters and further work required to complete the Independent Review primarily relate to (a) the Company’s business relationship with the import agents in China and their sales and transactions with distributors and customers, (b) verification of cash movements in the accounts mentioned in paragraphs 1.2 and 2.2(b) above during the relevant periods under the Export Model and Franchise Model, and (c) the circumstances surrounding the business relationships between the Company and Vicstar, and between Vicstar and the import agents. The Company will publish an executive summary of all key findings of the Independent Accountant on SGXNet following the completion of the Independent Review.

Shareholders are reminded that the trading suspension of the Company’s shares will continue following this announcement and will only be lifted after the Company has submitted a trading resumption proposal pursuant to Rule 1304 of the Listing Manual and upon fulfilment of the conditions required by SGX RegCo, including the finalisation of the Group’s audited financial statements for FY2018 and FY2019, and SGX RegCo indicating that it has no objections to the resumption proposal.¹² The Board will make further announcement(s) as and when there are any material developments on this matter.

¹¹ The Independent Accountant has noted from third-party delivery documents that the goods are either delivered to the Franchisees or directly to customers.

¹² Please also refer to the announcement made by SGX RegCo on 9 May 2019 in relation to the trading suspension of the Company’s shares.

BY ORDER OF THE BOARD

Lee Sen Choon
Chairman of the Audit Committee
22 March 2020

Annex A – Interim Update

***Best World
International
Limited***
Interim Update

22 March 2020



Interim update on the Independent Review of the financial affairs of BW Changsha

Background and appointment of PwC as Independent Accountant

1. Pursuant to a news article published in the Business Times on Best World International Limited (“BWI”) which raised certain concerns over the Group’s sales transactions under the new Franchise Model, PricewaterhouseCoopers Advisory Services Pte. Ltd. (“PwC” or “we”) was appointed on 18 March 2019 to perform an independent review on the financial affairs of 全美世界（中国）药业有限公司湖南分公司 (“BW Changsha”) focusing on the following key areas:
 - (a) To verify the existence of the Franchisees as at 31 December 2018;
 - (b) To validate the sales to the significant Franchisees (by sales value);
 - (c) To validate the cash received from the sales to the significant Franchisees.
2. As a result of the circumstances surrounding the previously undisclosed relationship with the primary import agent in China, and pursuant to the issuance of the Notice of Compliance (the “Notice”) by Singapore Exchange Regulation Pte Ltd (“SGX RegCo”) on 13 May 2019, PwC was instructed to perform the following additional work:
 - (a) To establish the facts and circumstances surrounding the establishment, appointment and business relationship with the primary import agent;
 - (b) To verify the sales to the primary import agent and other import agents used by the Group in the China market, if any, for the period from FY2015 to FY2018 under the Export Model, and ascertain if these transactions were on normal commercial terms and conducted at an arm’s length basis;
 - (c) To validate the cash received from the sales to the distributors/ customers by the primary import agent.

Work Done

3. As part of our independent review, the following work was performed:
 - (a) We obtained the sales and purchases records for the Group’s DR’s Secret line of products as recorded in BWI and performed tests of details over these transactions for the sales to China from FY2015 to FY2018 (i.e. sales to import agents in China and sales to BW Changsha) on a sampling basis. This included tracing to supporting documents such as sales invoices, third-party bill of lading and bank statements of BWI and BW Changsha;
 - (b) We obtained the sales records of BW Changsha and performed tests of details over their sales to the Franchisees for FY2018 on a sampling basis. This included tracing to supporting documents such as sales invoices, delivery documents and cash receipts;

- (c) We also performed a throughput analysis by DR's Secret Stock Keeping Unit ("SKU") from the quantity of raw materials purchased by BWI to the quantity of finished goods sold to China for FY2015 to FY2018. We extended this throughput analysis to the financial records in BW Changsha for their purchases from BWI and their sales to the Franchisees for 2018 and performed a reconciliation to BW Changsha's inventory balance as at 31 December 2018;
 - (d) We independently obtained written confirmations from the three third party logistics providers used by the third-party warehouse for the deliveries made for sales to the Franchisees during FY2018;
 - (e) We independently obtained the physical bank statements of BW Changsha and agreed the cash balance as at 31 December 2018 to the financial records of BW Changsha;
 - (f) We imaged the laptops of relevant individuals to obtain information on the Group's operations in the China market for the purposes of our review;
 - (g) We performed company searches of the Franchisees based on details announced by the Group and performed site visits to eight Franchisees and an additional four surprise visits to other Franchisees. We also conducted background searches of the identified import agents used by the Group in the China market for FY2015 to FY2018 on public domains as well as 国家企业信用信息公示系统 ("National Enterprise Credit Information Publicity System");
 - (h) We conducted various interviews and discussions to understand the journey that the Group had taken in its entry into China and the transition into the Franchise Model. We also interviewed Franchisees and customers to understand the sales process and operations under the Franchise Model.
4. We have completed our work on BWI's sales to the import agents (during the Export Model period from January 2015 to June 2018) and BW Changsha's sales to the Franchisees (during the Franchise Model period from June 2018 to December 2018), to the extent reasonably practicable based on documents/ information that has been made available to us.
 5. Due to the incomplete information/ documents of Changsha Best, there are certain outstanding matters and further work that is required with regard to BWI's business relationship with the import agents in China and their sales/ transactions with its distributors and customers. Additional work is also required to verify the cash movement during the Export Model and Franchise Model period.
 6. We will report on these outstanding matters once we have concluded our work. In this interim update (the "Update") we set out our current observations and findings in relation to BWI's sales to the import agents during the Export Model period and BWI's sales to BW Changsha (and its subsequent sales to the Franchisees) during the Franchise Model period.

¹ Throughput analysis is performed only on DR's Secret SKU as these constitute the majority of sales to China.

Overview of the Group's China operations

7. We understand from BWI Management that in the early years, China customers frequently purchased products from Singapore outlets. Recognising the potential of the demand for the Group's products, BWI Management completed the set-up of a manufacturing facility in Shanghai in 1996 in order to tap into the domestic China market. However, the Group's China strategy was disrupted by the Asian Financial Crisis in July 1997 and the ban on Direct Selling and Multi-level Marketing activities in China in April 1998. With China's accession to WTO in 2004, China authorities liberated the Direct Selling Industry in 2006 with the issuance of its first direct selling license. While this opened the opportunity for the Group to re-enter the market through joint ventures with local licensed partners, their attempts were unsuccessful.
8. To continue selling into the China market, BWI partnered with two of its top distributors in Singapore (please see (a) below). Over time as the business grew, new entities were incorporated in China as import agents. BWI would sell products directly to these import agents who will then on sell into the market ("Export Model"). In 2018 when the Group was able to obtain its Franchise License it ceased operating through the import agents and transitioned the business into the Franchise Model operating under its subsidiary, BW Changsha. The various entities which were involved in the China operations during the period leading to the Franchise Model were:
 - (a) Vicstar Lifestyle Pte Ltd ("Vicstar") – January 2010 to December 2011. This company is owned by two individual shareholders who are the spouses of two top Singapore distributors. BWI sold directly to Vicstar from early 2010 but this ceased in December 2011. We were informed that Vicstar continued to work with the import agents to develop the China market during the Export Model period. In particular, Vicstar maintained the China customer database, facilitated the calculation of commissions due to distributors, and helped organise trainings and events for China distributors.
 - (b) 青岛贝汇贸易有限公司 ("Qingdao Beihui") – January 2012 to September 2015. This company is owned by one individual shareholder. Qingdao Beihui was set-up as an import agent as the China market grew and demand for BWI products increased. This was the first import agent in China. We were informed that Qingdao Beihui ceased business in 2015 due to the poor health of its key operations personnel.
 - (c) 长沙百世特威日用品贸易有限公司 ("Changsha Best") – September 2015 to June 2018. This company is owned by Mr. Koh Kim Chuan ("Mr. Koh KC") who is the brother-in-law of Ms. Dora Hoan. Mr. Koh KC is also the legal representative of the company. It took over the import agent role from Qingdao Beihui from 2015. We were informed that Mr. Yan Weijun ("Mr. Yan"), a Chinese citizen, was the general manager of Changsha Best and was responsible for the management and business operations of the company. We were further informed that Mr. Koh KC was only a passive investor.

Export Model

Qingdao Beihui and Changsha Best

9. In respect of BWI's sales to the import agents, we did not note any significant exceptions based on the work performed on the samples selected. We were able to independently trace such sales from BWI to Qingdao Beihui and Changsha Best during the period from FY2015 to FY2018 to BWI's underlying supporting documents i.e. invoices, packing lists and third-party bill of lading. We were also able to trace these sales to cash receipts based on BWI's bank statements. Further, we also performed a throughput analysis of the DR's Secret SKU from the quantity of raw materials purchased by BWI to the quantity of finished goods sold to China for the same period.
10. We were informed that Qingdao Beihui ceased operations in 2015 and was subsequently de-registered on 18 February 2019. We were also told that the documents were not kept as the key operations personnel had passed away. As Qingdao Beihui's financial records were not available, we were not able to perform any work on the sales activities of Qingdao Beihui.
11. With regard to Changsha Best, we were informed that records prior to FY2017 were not available as the company had moved to a smaller premise and these records were not kept. For FY2017 and FY2018, we were provided with cash flow movement spreadsheets and were able to trace these movements on a sampling basis to Changsha Best's bank statements which we obtained independently. However, we were not able to trace these cash flow movements to any underlying source documents² as these were not available.
12. As an alternative, we requested for Changsha Best's sales data recorded on BWI's Customer Relationship Management ("CRM") system³. On a sampling basis, we obtained the sales orders from the distributors of Changsha Best spanning across 2017 and 2018. We were able to match these sales orders to the CRM system.
13. We also attempted to reconcile the total cash receipts and commission payments in the bank statements of Changsha Best for FY2017 and FY2018 to BWI's CRM system. Through our reconciliation exercise, we found that Changsha Best only recorded approximately 60% of the value of its sales to distributors/ customers. Proceeds from the remaining 40% of its sales had been deposited into other bank accounts which are not in the name of Changsha Best. These monies were then subsequently used for commission payments to distributors/ customers, sales incentives and transfers to Vicstar.
14. We are in the process of tracing the cash outflows from these bank accounts. We will report on our findings on the cash flow tracing once we have completed our work.

² Underlying source documents such as third-party documents supporting inflow of funds from individual distributors/ customers to sales orders, third-party delivery documents, payment vouchers supported by vendor/ distributor invoices evidencing nature of payments etc.

³ BWI's CRM system is used as a sales ordering system, which tracks all product sales made to distributors/ customers and computes the commission earned and payable to these distributors/ customers based on the sales orders. We understand that Changsha Best's sales to its distributors/ customers are also processed and tracked through this system.

Vicstar

15. Based on the contracts between BWI and Vicstar, the Group provided Vicstar with IT services, financial and business management, and personnel support from 2012 in return for a service fee. As part of the IT services, we were informed by BWI Management that Vicstar was given the right to use BWI's CRM system. Through this system, Vicstar supported the China operations of Qingdao Beihui and Changsha Best by maintaining the China customer database and facilitating the calculation of commissions due to the China distributors. Vicstar also helped develop the China market by organising trainings and events for China distributors.
16. We are in the process of performing further work to determine the circumstances surrounding BWI's business relationship with Vicstar and also between Vicstar and the import agents. We are also in the process of performing further work on Vicstar's cash flow movements. We will provide our findings upon completion of our further work.

Franchise Model

Site visits and interviews with Franchisees

17. As part of our independent review of the Franchise Model, we selected eight Franchisees and performed site visits to verify the existence of the Franchisee's physical shop front. These site visits were arranged for us by BW Changsha. We interviewed the Franchisee owner⁴ to understand the operational process of sales and purchases of the Franchisee.
18. From our site visits to the eight Franchisees, we observed the following:
 - (a) Franchisees were generally located in buildings with restricted access;
 - (b) There is limited customer traffic during opening hours unless an event and/ or training session has been pre-organised;
 - (c) Franchisees do not have a warehouse to keep stocks and minimal stock is maintained at the premises of the Franchisees;
 - (d) Contrary to the Franchisee agreement where a Franchisee is required to maintain complete and accurate transaction records, the Franchisees we visited do not appear to have standard book-keeping practices and do not maintain complete financial and sales records.
19. We performed four additional "surprise" unscheduled visits to Franchisees and we similarly noted that these Franchisees are located in places which are generally not easily accessible and there were also limited customer traffic while we were there.

⁴ Of the eight Franchisees visited, two Franchise owners were unable to meet with us and we spoke to the overall operations manager of the Franchisee in those two instances.

20. Based on our discussions with BWI Management and the interviews with the Franchisees, we understand that these shops are not intended to be retail outlets but are used by the Franchisees to host training events/ seminars and product demonstrations for potential customers, as well as a collection point for customers to pick up their purchases⁵.

Structure of the Franchise Model

21. To operate within the framework of the Franchise License, the Group sought to align the existing sales structure under Changsha Best to fit the Franchise Model. Under the Franchise Model, the Group mapped the seven existing distributor/ customer ranks into four tiers i.e. Franchisee, Area Representative, Sales Representative and VIP.
22. The Group entered into franchise agreements with 28 distributors under the Export Model and also entered into contracts with the Area Representatives and the Sales Representatives. We understand that the types of contracts entered into are not mutually exclusive, and should an individual customer be eligible, that customer may enter into all three types of contracts with the Group. VIPs do not enter into any contracts with BW Changsha as there are no commissions due to the VIP.
23. While the Group transitioned into this structure, the manner in which sales are conducted through the customer network remained unchanged from the Export Model. Similarly, the basis of commission computation remained the same.
24. BWI Management has informed that the Franchise Model as currently structured is in compliance with local China regulations and the Franchise License. We are unable to comment on the legality of the structure of the Franchise Model under Chinese law and whether it falls within the scope of the Franchise License. In this regard, we have recommended that the Board obtain the advice of an independent and suitably qualified Chinese law expert on these issues, taking into account our findings. We understand that BWI Management has since engaged an independent Chinese law firm to provide a legal opinion on the legality of the Group's present franchise model sales and distribution business under the Franchise Model.

Sales to Franchisees

25. In respect of BWI's sales to BW Changsha, we did not note any significant exceptions based on the work performed on the samples selected. We traced the sales and movement of goods from BWI to BW Changsha during the Franchise Model period to third-party documents such as bill of lading on a sampling basis. We also traced payments for these goods to BWI and BW Changsha's bank statements. As mentioned in paragraph 9, we further performed a throughput analysis of the DR's Secret SKU from the quantity of raw materials purchased by BWI to the quantity of finished goods sold to BW Changsha.

⁵ We note from third-party delivery documents that the goods are either delivered to the Franchisees or directly to customers.

26. In respect of BW Changsha's sales to Franchisees, we traced the sales recorded in BW Changsha's financials to significant Franchisees on a sampling basis for the period from 1 June 2018 to 31 December 2018, to underlying invoices, delivery instructions, third party warehouse records and confirmation from the third-party logistics providers. As part of our throughput analysis, we also attempted to reconcile purchases from BWI and sales to Franchisees with BW Changsha's inventory balance as at 31 December 2018. Based on our work, we did not note any significant exceptions other than the following:

- (a) Potential sales cut-off issue for goods sold which remained undelivered as at 31 December 2018.
- (b) Potential understatement of BW Changsha's sales and certain related expenses.

Goods sold but remain undelivered in the third-party warehouse

27. As part of our samples testing on inventory and sales to significant Franchisees, we noted undelivered goods with an estimated value of approximately CNY111.8 million⁶ as at 31 December 2018. As members have already paid, their goods were recorded as sold in FY2018 even though it was still at the third-party warehouse. Based on the records of the third-party warehouse, these goods were subsequently delivered in 2019.

28. BWI Management has performed a subsequent review of all sales to Franchisees and represented that the estimated value of undelivered goods as at 31 December 2018 is approximately CNY54 million. We are currently in the process of reconciling the difference.

29. We have recommended that BWI's auditors review the quantification and consider if any adjustments ought to be made to the sales and inventory numbers for the financial year ended 31 December 2018.

Potential understatement of sales and expenses

30. We note from our testing of BW Changsha's sales to its Franchisees that BW Changsha had recognised approximately 80% of the sales value based on the *fapiao* issued⁷. However, members pay 100% of the sales value. In our cash receipts testing, we note that proceeds of approximately 20% of the sales value had been deposited into other bank accounts which are not in the name of BW Changsha. Some of these accounts are the same as those mentioned at paragraph 13. According to BWI Management, the 20% represent mainly trade rebates due to the Franchisees and they have therefore recorded sales net of trade rebates. We are unable to independently verify this arrangement against any third-party supporting documents as we have been informed that this was an oral arrangement between BW Changsha and its Franchisees. Based on our work to date, we note that the outflows from these other bank accounts include commission payments to members, payments to staff and transfers to Vicstar.

31. Even though the net financial impact of the above may not be significant, recognising only 80% of the value of the sales transactions in BW Changsha's books without recording related expenses may not be appropriate from an accounting perspective.

⁶ Based on the quantity undelivered as confirmed by the third-party logistics provider at the average price sold by BW Changsha during FY2018.

⁷ The *fapiao* is at 80% of the selling price to members.

32. While this is not part of the scope of the independent review, we have recommended that the Board work with the Group's auditors to review and consider if any reclassification or adjustments are necessary to the financial statements for the year ended 31 December 2018. We understand that BWI's auditors are reviewing these findings. We have also recommended that the Board seeks a formal legal opinion on the legal and regulatory implications of the potential understatement and the arrangement in relation to the proceeds in the other bank accounts not in the name of BW Changsha.
33. We are currently performing further work on the cash flow movements in these other bank accounts that are not in the name of BW Changsha. We will report on our findings once we have completed our outstanding work.

Outstanding matters

34. We have informed BWI Management on the outstanding information and documents necessary for us to complete our work. We understand that BWI Management is currently working with their subsidiary in China to facilitate the retrieval of the necessary information and documents.
35. We will update our interim findings to take into account BWI's auditors review of the accounting issues highlighted above and the legal opinion on the Franchise Model from the Chinese law expert.

Disclaimer

36. PwC has not been asked to (and it has not) comment on, review or assess the validity or enforceability of the documents provided to PwC. The procedures that PwC performed under this engagement do not constitute an audit or review in accordance with generally accepted auditing or attestation standards. PwC has not audited or otherwise verified the information supplied to it in connection with its work from whatever source except as specified herein.
37. PwC's findings are based on documents and information relevant to its scope of work that were made available to PwC up to 11 March 2020. Documents or information provided to PwC after 11 March 2020 may have an impact on this Update. PwC reserves its right to amend any part of its findings as and when relevant new information is made available to us.
38. PwC makes no representation and gives no warranty to any person (except to the extent provided in our engagement letter dated 18 March 2019) as to the accuracy or completeness of the Update. Similarly, PwC does not accept or assume responsibility for its work and the Update to any other party (except as specified in our engagement letter dated 18 March 2019). PwC's work was not planned or conducted in contemplation of or to be relied upon by any other party. Therefore, items of possible interest to any other party will not be specifically addressed and matters may exist that would be assessed differently by any other party.