

Notes to the Financial Statements

1. Organisation and Principal Activities

Water Oasis Group Limited (the “Company”) was incorporated in the Cayman Islands as an exempted company with limited liability on 27th September 2001 under the Companies Law, Cap. 22 (Law 3 of 1961, as consolidated and revised) of the Cayman Islands. The address of the registered office and principal place of business of the Company are disclosed in the “Corporate Information” section to the Annual Report. Its shares have been listed on The Stock Exchange of Hong Kong Limited (the “Stock Exchange”) since 11th March 2002.

The Company is an investment holding company. Its subsidiaries are principally engaged in the distribution of skin-care products in Hong Kong, Macau, Taiwan, Singapore and China and the operation of spa and beauty centres in Hong Kong.

The consolidated financial statements are presented in Hong Kong Dollars unless otherwise stated. These consolidated financial statements have been approved for issue by the Board of Directors on 16th January 2007.

2. Principal Accounting Policies

The principal accounting policies adopted in the preparation of the financial statements are set out below:

(a) Basis of preparation and impact of new and revised HKFRSs and HKASs

The financial statements have been prepared in accordance with Hong Kong Financial Reporting Standards (“HKFRSs”), Hong Kong Accounting Standards (“HKASs”) and Interpretations (hereinafter collectively referred to as “HKFRSs”) issued by the Hong Kong Institute of Certified Public Accountants (the “HKICPA”). They have been prepared under the historical cost convention except that financial assets and liabilities at fair value through profit or loss and investment properties are stated at fair value.

The accounting policies and methods of computation used in the preparation of the financial statements are consistent with those used in 2005 except that the Group has changed certain of its accounting policies following its adoption of new and revised HKFRSs and HKASs which are effective for accounting years beginning on or after 1st January 2005.

The preparation of the financial statements in conformity with HKFRSs requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group’s accounting policies.



2. Principal Accounting Policies (Continued)

The relevant changes to the Group's accounting policies and the effect of adopting those new policies are set out below:

Effect of adopting new HKFRSs

For the year ended 30th September 2006, the Group adopted the new/revised HKFRSs below, which are relevant to its operations. The 2005 comparatives have been restated as required, in accordance with the relevant requirements.

HKAS 1	Presentation of Financial Statements
HKAS 2	Inventories
HKAS 7	Cash Flow Statements
HKAS 8	Accounting Policies, Changes in Accounting Estimates and Errors
HKAS 10	Events after the Balance Sheet Date
HKAS 16	Property, Plant and Equipment
HKAS 17	Leases
HKAS 21	The Effects of Changes in Foreign Exchange Rates
HKAS 23	Borrowing Costs
HKAS 24	Related Party Disclosures
HKAS 27	Consolidated and Separate Financial Statements
HKAS 32	Financial Instruments: Disclosures and Presentation
HKAS 33	Earnings per Share
HKAS 36	Impairment of Assets
HKAS 38	Intangible Assets
HKAS 39	Financial Instruments: Recognition and Measurement
HKAS-Int 15	Operating Leases – Incentives
HKAS-Int 21	Income Taxes – Recovery of Revalued Non-Depreciated Assets
HKFRS 2	Share-based Payments
HKFRS 3	Business Combinations

The adoption of new/revised HKASs 1, 2, 7, 8, 10, 16, 17, 21, 23, 24, 27, 33, 36, 38, HKAS-Int 15 and HKFRS 3 did not result in substantial changes to the Group's accounting policies. In summary:

- HKAS 1 has affected the presentation of minority interest and other disclosures;
- HKASs 2, 7, 8, 10, 16, 17, 23, 27, 33, 36, HKAS-Int 15 and HKFRS 3 had no material effect on the Group's accounting policies;

2. Principal Accounting Policies (Continued)

Effect of adopting new HKFRSs (Continued)

- HKAS 21 had no material effect on the Group's accounting policy. The functional currency of each of the consolidated entities has been re-evaluated based on the guidance to the revised standard. All the Group entities have the same functional currency as the presentation currency for respective entity financial statements;
- HKAS 24 has affected the identification of related parties and some other related-party disclosures; and
- The Group has reassessed the useful lives of its intangible assets in accordance with the provisions of HKAS 38. No adjustment was resulted from this reassessment.

The adoption of HKASs 32 and 39 has resulted in a change in the accounting policy relating to the classification of financial assets at fair value through profit or loss. It has also resulted in the recognition of derivative financial instruments at fair value and the change in the recognition and measurement of hedging activities.

The adoption of revised HKAS-Int 21 has resulted in a change in the accounting policy relating to the measurement of deferred tax liabilities arising from the revaluation of investment properties. Such deferred tax liabilities are measured on the basis of tax consequences that would follow from recovery of the carrying amount of that asset through use. In prior years, the carrying amount of that asset was expected to be recovered through sale.

The adoption of HKFRS 2 has resulted in a change in the accounting policy for share-based payments. Until 30th September 2005 the provision of share options to employees did not result in an expense in the income statements. Effective 1st October 2005, the Group expenses the cost of share options in the income statement. The Group did not have any share options which were granted after 7th November 2002 and had not yet vested on 1st October 2005. Therefore, no adjustment was made to the Group's financial statements on the costs, if any, of these share options.



2. Principal Accounting Policies (Continued)

Effect of adopting new HKFRSs (Continued)

All changes in the accounting policies have been made in accordance with the transitional provisions in the respective standards. All standards adopted by the Group require retrospective application except:

- HKAS 16 – the initial measurement of an item of property, plant and equipment acquired in an exchange of assets transaction is accounted at fair value prospectively only to future transactions;
- HKAS 39 – the standard does not permit to recognise, derecognise and measure financial assets and liabilities in accordance with this standard on a retrospective basis. The Group applied the previous Statement of Standard Accounting Practice (“SSAP”) 24 “Accounting for investments in securities” to trading investments. The adjustments required for the accounting differences between SSAP 24 and HKAS 39 are determined and considered immaterial;
- HKAS-Int 15 – the standard does not require the recognition of incentives for leases beginning before 1st October 2005; and
- HKFRS 2 – retrospective application only applies to all equity instruments granted after 7th November 2002 and not vested at 1st October 2005.

Certain new standards, amendments and interpretations to existing standards have been published that are mandatory for the Group’s accounting periods beginning on or after 1st October 2006 or later periods. The Group has already commenced an assessment of their impact when they become effective and does not expect this will result in substantial changes to the Group’s principal accounting policies.

2. Principal Accounting Policies (Continued)

(b) Basis of consolidation

The consolidated financial statements include the financial statements of the Company and all of its subsidiaries made up to 30th September.

Subsidiaries are all entities over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity.

Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases.

All significant inter-company transactions, balances and unrealised gains on transactions between group companies are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

In the Company's balance sheet the investments in subsidiaries are stated at cost less provision for impairment losses. The results of subsidiaries are accounted by the Company on the basis of dividend received and receivable.

(c) Segment reporting

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. A geographical segment is engaged in providing products or services within a particular economic environment that are subject to risks and returns that are different from those of segments operating in other economic environments.



2. Principal Accounting Policies (Continued)

(d) Foreign currency translation

(i) Functional and presentation currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). The consolidated financial statements are presented in Hong Kong Dollars, which is the Company's functional and presentation currency.

(ii) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies at period-end applicable exchange rates are recognised in the income statement.

(iii) Group companies

The results and financial position of all the Group entities (none of which has the currency of a hyperinflationary economy) that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- assets and liabilities at each balance sheet are translated at the closing rate at the date of that balance sheet;
- income and expenses for each income statement are translated at average exchange rates prevailing during the relevant period unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions; and
- all resulting exchange differences are recognised as a separate component of equity.

On consolidation, exchange differences arising from the translation of the net investment in foreign entities, and of borrowings and other foreign currency instruments designated as hedges of such investments, are taken to shareholders' equity. When a foreign operation is sold, the exchange differences are recognised in the income statement as part of the gain or loss on sale.

2. Principal Accounting Policies (Continued)

(e) Investment properties

Property that is held for long-term rental yields or for capital appreciation or both, and that is not occupied by the companies within the Group, is classified as investment property.

Investment property comprises land held under operating leases and buildings held under finance leases. Land held under operating leases are classified and accounted for as investment property when the rest of the definition of investment property is met. The operating lease is accounted for as if it were a finance lease.

Investment property is measured initially at its cost, including related transaction costs.

After initial recognition, investment property is carried at fair value. Fair value is based on active market prices, adjusted, if necessary, for any difference in the nature, location or condition of the specific asset. These valuations are performed in accordance with guidance issued by the International Valuation Standards Committee. These valuations are reviewed annually by external valuers. Investment property that is being redeveloped for continuing use as investment property, or for which the market has become less active, continues to be measured at fair value.

The fair value of investment property reflects, among other things, rental income from current leases and assumptions about rental income from future leases in the light of current market conditions.

The fair value also reflects, on a similar basis, any cash outflows that could be expected in respect of the property. Some of those outflows are recognised as a liability, including finance lease liabilities in respect of land classified as investment property; others, including contingent rent payments, are not recognised in the financial statements.

Subsequent expenditure is charged to the asset's carrying amount only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance costs are expensed in the income statement during the financial period in which they are incurred.

Changes in fair values are recognised in the income statement .



2. Principal Accounting Policies (Continued)

(f) Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and accumulated impairment losses.

Depreciation of leasehold improvements is calculated to write off their costs less accumulated impairment losses on a straight-line basis over the unexpired periods of the leases.

Depreciation of other property, plant and equipment is calculated to write off their costs less accumulated impairment losses on a straight-line basis over their estimated useful lives to the Group. The principal annual rates used for this purpose are as follows:

Motor vehicles	20% to 33 $\frac{1}{3}$ %
Computer equipment	33 $\frac{1}{3}$ %
Machinery and equipment	20%
Office equipment, furniture and fixtures	20% to 33 $\frac{1}{3}$ %

Assets' residual values and useful lives are reviewed and adjusted if appropriate, at each balance sheet date.

Major costs incurred in restoring property, plant and equipment to their normal working conditions are charged to the income statement. Improvements are capitalised and depreciated over their expected useful lives to the Group.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

The gain or loss on disposal is the difference between the net sales proceeds and the carrying amount of the relevant asset, and is recognised in the income statement.

(g) Intangible assets

Expenditure on acquiring licenses for sale of products is capitalised and amortised using the straight-line method over the licenses period.

Where an indication of impairment exists, the carrying amount of any intangible asset is assessed and written down immediately to its recoverable amount.

2. Principal Accounting Policies (Continued)

(h) Impairment of non-financial assets

Assets that have an indefinite useful life are not subject to amortisation, which are at least tested annually for impairment, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purpose of assessing impairment, assets are grouped at the lowest level for which there are separately identifiable cash flows (cash-generating units). Non-financial assets that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

(i) Financial assets

The Group classifies its financial assets in the following categories: financial assets at fair value through profit or loss and loans and receivables. The classification depends on the purpose for which the investments were acquired. The initial classification will be re-evaluated at every reporting date.

(a) Financial assets at fair value through profit or loss

This category has two sub-categories: financial assets held for trading, and those designated at fair value through profit or loss at inception. A financial asset is classified in this category if acquired principally for the purpose of sales in the short term or if so designated by the management. Derivatives are also categorised here if they are held for trading unless they are designated as tools for hedging. Assets in this category are classified as current assets if they are either held for trading or are expected to be realised within 12 months of the balance sheet date.

Realised and unrealised gains and losses arising from changes in the fair value of the financial assets at fair value through profit or loss category are included in the income statement in the period in which they arise.



2. Principal Accounting Policies (Continued)

(i) Financial assets (Continued)

(b) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Group provides money, goods or services directly to a debtor with no intention of trading the receivable. They are included in current assets, except for maturities greater than 12 months after the balance sheet date. Loans and receivables are included in accounts receivable in the balance sheet (Note k).

(j) Inventories

Inventories are stated at the lower of cost and net realisable value. Cost represents invoiced value on purchases and is calculated on a weighted-average basis. Net realisable value is determined on the basis of anticipated sales proceeds less estimated selling expenses.

(k) Trade and other receivables

Trade and other receivables are recognised initially at fair value and subsequently measured at amortised costs using the effective interest method, less provision for impairment. A provision for impairment of trade and other receivables is established when there is an objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the effective interests rate. The amount of the provision is recognised in the income statement.

(l) Cash and cash equivalents

Cash and cash equivalents include cash in hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less.

(m) Trade payables

Trade payables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method.

2. Principal Accounting Policies (Continued)

(n) Borrowings

Borrowings are recognised initially at fair value, net of transaction costs incurred. Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability, including fees and commissions paid to agents, advisers, brokers and dealers, levies by regulatory agencies and securities exchanges, and transfer taxes and duties. Borrowings are subsequently stated at amortised costs; any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method.

Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

(o) Deferred taxation

Deferred taxation is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Taxation rates enacted or substantively enacted by the balance sheet date are used to determine deferred taxation.

Deferred tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred taxation is provided on temporary differences arising on investments in subsidiaries, except where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.



2. Principal Accounting Policies (Continued)

(p) Employee benefits

(i) Employee leave entitlements

Employee entitlements to annual leave and long service leave are recognised when they accrue to employees. A provision is made for the estimated liability for annual leave and long service leave as a result of services rendered by employees up to the balance sheet date.

Employee entitlements to sick leave and maternity leave are not recognised until the time of leave.

(ii) Pension obligations

The Group's subsidiaries in Hong Kong and China participate in relevant defined contribution schemes, the assets of which are held separately from those of the Group in independently administered funds. Contributions are made to these schemes based on a certain percentage of the applicable payroll costs. The contributions are expensed as incurred.

The Group's subsidiary in Taiwan participates in a defined benefit pension plan for employees joined before 1st July 2005 in accordance with the local statutory regulations. Pension costs are assessed using the projected unit credit method. The pension obligation is measured as the present value of the estimated future cash outflows using discount rate based on the rate of return on high-quality fixed-income investments in Taiwan which have terms to maturity approximating the terms of the related liability. Actuarial gains and losses are recognised over the average remaining service lives of employees. Past service costs are recognised as expenses on a straight-line basis over the average period until the benefits become vested. The contributions are charged to the income statement in the period to which the contributions relate.

2. Principal Accounting Policies (Continued)

(p) Employee benefits (Continued)

(iii) Profit sharing and bonus plans

Share-based compensation

The Group operates an equity-settled, share-based compensation plan. The fair value of the options granted is recognised as an expense. The total amount to be expensed over the vesting period is determined by reference to the fair value of the options granted, excluding the impact of any non-market vesting conditions (for example, profitability and sales growth targets). Non-market vesting conditions are however included in the assumptions on the number of options that are expected to become exercisable. At each balance sheet date, the Group revises its estimates of the number of options that are expected to become exercisable. It recognises the impact of the revision of original estimates, if any, in the income statement, and a corresponding adjustment to equity over the remaining vesting period.

The proceeds received net of any directly attributable transaction costs are credited to share capital (nominal value) and share premium when the options are exercised.

(q) Provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount can be made.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognised as interest expense.



2. Principal Accounting Policies (Continued)

(r) Contingent liabilities

A contingent liability is a possible obligation that arises from past events and whose existence will only be confirmed by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Group. It can also be a present obligation arising from past events that is not recognised because it is not probable that outflow of economic resources will be required or the amount of obligation cannot be measured reliably.

A contingent liability is not recognised but is disclosed in the notes to the financial statements. When a change in the probability of an outflow occurs so that outflow is probable, they will then be recognised as a provision.

(s) Revenue recognition

Revenue from the sale of goods is recognised on the transfer of risks and rewards of ownership, which generally coincides with the time when the goods are delivered to customers and the title has passed.

Receipts from the sale of gift coupons are recorded as liabilities. Such receipts are recognised as sales when the coupons are redeemed for products or as income upon the coupon expiry date.

Revenue from rendering of services is recognised when the services are rendered. Fees received in advance for prepaid packages are recorded as liabilities and are recognised on a systematic basis in accordance with service usage. Upon expiry of prepaid packages, the corresponding receipts in advance are fully recognised.

Operating lease rental income is recognised on a straight-line basis.

(t) Interest income

Interest income is recognised on a time-proportion basis using the effective interest method. When a receivable is impaired, the Group reduces the carrying amount to its recoverable amount, being the estimated future cash flow discounted at original effective interest rate of the instrument, and continues unwinding the discount as interest income. Interest income on impaired loans is recognised either as cash is collected or on a cost-recovery basis as conditions warrant.

(u) Operating leases

Leases where substantially all the risks and rewards of ownership of assets remain with the leasing company are accounted for as operating leases. Payments made under operating leases, net of any incentives received from the leasing company are charged to the income statement on a straight-line basis over the lease periods.