Policies and Procedures

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Subject: **Inventory Reserves**	Date Issued:	Supersedes:

POLICY/PURPOSE:

It is J&E Hall Inc's ("the Company's") policy to establish standards and procedures to ensure that inventory reserves are in accordance with Daikin Group Policy and IFRS accounting standard. The purpose of this policy is to provide guidelines for accounting for inventory reserves under Daikin group policy. Any non-compliance to this policy requires written approval by the Finance Director.

SCOPE:

This policy applies to all inventory reserves in the Company's subsidiaries and business units.

POLICY AND PROCEDURES:

It is the policy of the Company to provide adequate reserves related to *obsolete*, *slow-moving*, and *surplus inventory*[1] items. The reserve accounts should be reconciled as needed, but at a minimum quarterly, toinsure that accurate inventory levels and valuations are reflected in Company financial statements.

1.0 PROCEDURES

1.1 Reserve requirements should be determined based on the schedule found in 1.2 and compared to the existing reserve balance. Any difference is charged to the P&L (manufacturing variances) by the end of the current quarter.

1.2 Business units should identify inventories which are held over one year by individual item and write-down such inventories using the specified percentages to reflect the lower realizable value.

[1] Words in *Italic* are defined in Section 4.0 of this policy.

1.3 Business units should identify inventories which are held at quantities significantly exceeding the reasonable level expected to be sold (excess goods) and write-down such inventories using the specified percentages.

1.4 Reserve requirement schedule:

1.4.1 Valuation of Reserve for Slow Moving Goods

Starting from termination of production

Aged more than 1 year after termination of production 50%,

Aged more than 2 years after termination of production 100%

However, for sales companies, in cases where the date that production was terminated is unknown, it is acceptable to calculate the slow-moving valuation based on aging of the inventory from the final point it was acquired by the sales company.

1.4.2 Valuation of Reserve for Excess Goods

Scope of valuation	Valuation rate
Finished goods (Work-in-progress and raw materials) where the quantity in stock exceeds the quantity sold (consumed) in the previous 12 months	50%
Finished goods (Work-in-progress and raw materials) where the quantity in stock exceeds the quantity sold (consumed) in the previous 24 months	100%

1.5 If the current reserve analysis happens to include materials with no usage due to the materials being stocked for a new product, it is appropriate to exclude these materials from the reserve, as long as this is clearly documented in the reserve analysis.

1.6 If the current reserve analysis includes a reserve for raw materials with scrap value, it is appropriate to exclude these materials from the reserve by adding back the scrap value of materials, as long as this is clearly documented in the reserve analysis.

2.0 RECORD RETENTION

2.1 All reserve records during the current fiscal year and one fiscal year back should be retained.

3.0 FINANCIAL STATEMENT CLASSIFICATION:

3.1 All inventory reserves should be classified on the balance sheet in the current asset section as a reduction to the gross inventory value to arrive at the net inventory value.

4.0 DEFINITIONS:

4.1 Obsolete Inventory - Raw materials and work in process shall be considered obsolete if it is not called for in current bills of material for product currently being marketed by the Company. Exceptions would be stock held for service requirements or parts directly substitutable for other current parts. Finished goods shall generally be considered obsolete when they are not of current vintage and/or are not salable at normal margins. This will often be somewhat subjective and require marketing judgment.

4.2 Slow-moving Inventory - Raw materials, work in process, and finished goods that have had no activity in the past twelve months, adjusted for new items that have not yet had any activity are considered slow-moving. Due to unique properties and features of some items, this time period is a guideline for slow-moving inventory and could vary significantly, as in the case of spares and service parts.

4.3 Surplus Inventory - Raw material, work in process, and finished goods in excess of one year's supply is considered surplus. If the next year's requirements can be reasonably forecasted, that should be the basis. If no reliable forecast exists, the past year's usage should be used.

4.4 Inventory Shrink - The difference between the physical count value and the book value due to cycle counts and/or the annual physical inventory count is inventory shrink. This reserve is incurred during the year where there are either known deficiencies in the cost accounting system, or other historical evidence that a shrink is likely to occur. In certain situations this account should also be used to deal with cycle count adjustments. The reason for a balance in this account is to attempt to recognize the P & L impact of shrink during the proper quarter. Upon completion of a full physical inventory this account should have a "zero" balance.

/s/ Gary Burnett
Finance Director, J&E Hall