PRICEWATERHOUSECOOPERS

Corporate Watch

May 2004 Issue

Companies (Amendment) Act 2004 – How would it affect you?

The Companies (Amendment) Act 2004 (CA 2004) was passed by the Singapore Parliament on 6 February 2004 and is effective from 1 April 2004, except for specified sections. These amendments follow a public consultation in June 2003 proposing amendments primarily to put forth the recommendations of the Company Legislation and Regulatory Framework Committee (CLRFC).

CA 2004 did not legislate all the proposed amendments in the consultation paper. Proposed amendments such as abolishing the concept of par value, allowing repurchased shares to be held as treasury shares and capital to be reduced without court sanction, were not included in CA 2004. On the other hand, CA 2004 included clarifications in respect of corporate reporting requirements.

This article examines the impact of selected amendments effected via CA 2004, focussing on those directly affecting corporate reporting.

In this Issue:

Accounting Updates

Companies need not prepare consolidated accounts if not required to do so by Singapore Financial Reporting Standards (FRS)

The Companies Act requires that statutory accounts be prepared in accordance with FRS. FRS 27 *Consolidated Financial Statements and Accounting for Investments in Subsidiaries* exempts wholly-owned and virtually owned (90% or more of the voting power) subsidiaries, regardless of their parents' countries of incorporation, from preparing consolidated accounts provided that (i) their parents publish consolidated accounts, and (ii) for virtually-owned subsidiaries, they have obtained the approval of their minority interests.

However, prior to CA 2004, Companies Act specifically exempted only the wholly-owned subsidiaries of Singapore-incorporated companies from preparing consolidated accounts. Wholly-owned subsidiaries of foreign companies and virtually owned subsidiaries were required under the Companies Act to prepare consolidated accounts, even if they are not required to do so under FRS.

CA 2004 has removed these conflicting requirements. It clarifies that companies exempted from preparing consolidated accounts under FRS would not be required to do so under the Act.

Going forward, when the "improved" FRS 27 *Consolidated and Separate Financial Statements* becomes effective on 1 January 2005, the exemption from preparing consolidated accounts would be extended to subsidiaries with less than 90% of voting power, provided certain conditions (e.g. informing other owners about the subsidiary not presenting consolidated financial statements and they do not object to it) are met.

Directors are no longer required to receive the audited accounts of each subsidiary before issuing the consolidated accounts

Section 201A previously required the directors of a holding company to receive the audited accounts of each subsidiary before issuing the consolidated accounts. CA 2004 has removed this requirement.

That said, even though the directors are no longer required to receive the audited accounts of each subsidiary before issuing consolidated accounts, they should proceed to do so only when they are satisfied that each subsidiary's accounts are properly prepared for consolidation purposes and that the consolidated accounts present a true and fair view of the group's state of affairs, results of business, changes in equity and cash flows.

Directors are accorded protection for reasonable reliance on advice and information from professionals and experts

With CA 2004, directors may rely on reports, statements, financial data and other information prepared or supplied, and on professional or expert advice given by any of the following persons :

- an employee of the company whom the director believes on reasonable grounds to be reliable and competent in relation to the matters concerned;

- a professional adviser or an expert in relation to matters which the director believes on reasonable grounds to be within the person's professional or expert competence; and
- any other director or any committee of directors upon which the director did not serve in relation to matters within that other director's or committee's designated authority.

Notwithstanding that, such reliance is warranted only if the director (i) acts in good faith, (ii) makes proper inquiry where the circumstances necessitates the need for inquiry and (iii) has no knowledge that such reliance is unwarranted.

Revised penalties for directors who fail to comply with Companies Act

CA 2004 distinguishes the penalties for non-compliance with the requirements of preparing FRS-compliant financial statements from those for non-compliance with other provisions in the same Division of the Act. Specifically,

- if a director fails to comply with Section 201(1A), (3), (3A) or (15), he or she shall be liable on conviction to a fine not exceeding $50,000 *(previously, $10,000 or an imprisonment not exceeding 2 years);* and
- if this offence is committed with the intent to defraud creditors of the company or creditors of any other person or for a fraudulent purpose, the offender shall be liable on conviction to a fine not exceeding $100,000 or to an imprisonment for a term not exceeding 3 years or both *(previously, $15,000 or an imprisonment not exceeding 3 years or both).*

The penalties for non-compliance with other provisions remain unchanged.

Public companies shall review the fees, expenses and emoluments of their auditors

Public companies shall undertake a review of the fees, expenses and emoluments of their auditors if the total amount of the fees paid to the auditors for non-audit services in any financial year exceeds 50% of the total amount of fees paid to the auditors in that financial year. The outcome of the review shall be sent to all persons entitled to receive notice of general meetings of the companies.

This requirement does not prohibit the provision of non-audit services by the auditors but serves to ensure that the independence of the auditors are not compromised during the process. See further discussion in page 3 of this newsletter.

Additional information may be required in directors' report

The Minister is now empowered to prescribe any additional information in the directors' report. CA 2004 also explains that such additional information may extend beyond the profit or loss or the state of affairs of the company or the group.

Statutory reports and other documents can be distributed electronically

With CA 2004, statutory reports can now be electronically distributed to members of the company. Similarly, notices of meetings and other documents can be electronically transmitted to members, officers or auditors of the company.

The member, officer, or auditor must however agree to the method of electronic transmission, which could take the form of either:

- sending the notice or document using electronic communications to the current e-mail address of the recipient; or
- publishing the notice or document on a website which is accessible by the recipient.

Private companies can have only one shareholder and one director

Private companies incorporated in Singapore that are owned by individuals are now allowed to have one shareholder and one director ordinarily resident in Singapore. The shareholder and director can be the same person, but where the company has only one director, the director must not be the secretary of that company.

If a company operates without appointing any directors, the Registrar may, either of his own motion or on the application of any person, compel the member (s) to appoint a director. A member is also made personally liable for the debts of a company if the member knows that the company has been carrying on business for more than 6 months without a director who is ordinarily resident in Singapore.

Private companies can raise capital through public means

Private companies were prohibited from inviting the public to (i) subscribe for its shares or (ii) deposit any money with them. CA 2004 has removed these restrictions, enabling certain private companies to raise capital though private and exempted offerings without the need to convert to public companies.

However, these private companies would be subjected to the disclosure requirements of the legislations governing the raising of capital from the public. They would also need to convert to public companies once they have more than 50 shareholders and/or do not impose any restriction(s) on transfer of shares.

Other amendments

Other amendments in CA 2004 which are effective from 1 April 2004 include:

- Companies are statutorily conferred with all the powers of a natural person. The *ultra-vires* doctrine is abolished, except in specified circumstances
- Entrenching provisions, which limit the majority rights, may be included in the memorandum and articles of companies
- Companies are no longer required to display their names outside their offices
- Companies are no longer required to notify the Registrar of their intention to close their register of members
- Any person can now apply to the Minister to be an approved liquidator
- Investors are deemed to have direct relationship with issuers for a wider range of securities
- Trust assets of Central Depository (Pte) Limited (CDP) are statutorily shielded from CDP's creditors in the event of insolvency
- The Minister is empowered to exempt script lending intermediaries from Division 4 of Part IV of the Companies Act

With effect from 1 October 2004, the Companies Act will require companies to include their RCB registration numbers in their business letters, statements of account, invoices, official notes and publications.

These amendments are available for download under the Act Supplements section at the e-gazette website (www.egazette.com.sg)

CCDG to embark on review of Code of Corporate Governance

The Council on Corporate Disclosure and Governance (CCDG) is embarking on a review of the Code of Corporate Governance (the Code).

One of the terms of reference of the CCDG is to review and enhance the framework of corporate governance. The review is intended to introduce improvements to the Code, taking into account feedback received since the inception of the Code and international developments in corporate governance.

In the past two years, several countries have revised or issued some form of corporate governance rules and guidelines, namely the revised UK Combined Code, the Australian Stock Exchange's Principles of Good Corporate Governance and Best Practice Recommendations, and the New York Stock Exchange's Corporate Governance Listing Standards.

The CCDG will form a review committee consisting of members and non-members of the CCDG to study the matter in detail, seek views from the public, and submit a report to the CCDG. The CCDG aims to complete its review and submit its recommendations to the Ministry of Finance by first half of 2005.

New Regulations on Review of Auditors' Independence

The Companies (Amendment) Act 2004 (CA 2004), passed by the Parliament in February 2004, contains a new provision [section 206(1A)] requiring a public company, under prescribed circumstances, to undertake a review of the fees, expenses and emolument of its auditor with the objective of determining whether the independence of the auditor has been compromised. The outcome of the review is required to be "sent to all persons entitled to receive notice of general meetings of the company". This new provision is effective on 1 April 2004.

The "prescribed circumstances" is set out in CA2004. The regulation requires the public company to perform a review of the auditors' independence if "the total amount of the fees paid to the auditor for non-audit services in any financial year of the company exceeds 50% of the total amount of the fees paid to the auditor in that financial year".

The following paragraphs discuss some of the key features and implications of this new legislation.

Does CA 2004 prohibit auditors of a public company from rendering non-audit services? *NO.*

Section 206(1A) requires a public company to perform a review to determine if the auditors' independence is impaired when the non-audit fees paid to its auditor in a financial year exceeds 50% of the total fees to the auditor. It is not a blanket prohibition of the provision of non-audit services by the auditor of the company.

In this regard, companies should note that there are other existing safeguards in Singapore legislations such as the Accountants (Public Accountants) Rules 2004, formerly known as Public Accountants Board (Amendment) Rules 2002 (PAB Rules), which auditors (or "public accountants" as the legislations refer them as) are required to comply with since 1 October 2002. Under these PAB Rules, certain non-audit services are specifically restricted or prohibited to be rendered by the auditors, whilst certain other non-audit services are specifically permitted. Hence, the non-audit services currently rendered or anticipated to be rendered to the company should be those permitted under the PAB Rules.

Is this a new requirement for listed companies? *NO.*

Whilst section 206(1A) is a newly-added provision to the Companies Act, the requirement to review for auditors' independence for companies listed on the Singapore Exchange (SGX) is not new.

SGX Continual Listing Obligations

Under the SGX Listing Manual, a SGX-listed company is required to disclose in its annual report a confirmation that its audit committee has "undertaken a review of all non-audit services provided by the auditors and that they would not, in the audit committee's opinion, affect the independence of the auditors"[1]. This requirement has been in effect since 2 January 2003.

To confirm this fact in the annual report, the audit committee is thus required to review all non-audit services performed by the auditors.

SGX Code of Corporate Governance (the Code)

In addition, the Code[2] specifies that audit committees of listed companies should review the independence and objectivity of external auditors. Where the auditors also supply a substantial volume of non-audit services to the company, the committee should keep the nature and extent of such services under review, seeking to balance the maintenance of objectivity and value for money[3]. The Code also recommends that the audit committee review the independence of the external auditors annually[4].

PAB rules

On top of specifying prohibited, restricted or permitted services as mentioned above, the PAB rules include a similar requirement for the

auditors to conduct a review with its client to ensure that auditors' independence is not compromised where the non-audit fees is 50% or more of the total audit fees[5]. Hence, section 206(1A) can be viewed as mirroring the obligations already imposed on the auditors, to the directors of the company.

How are "non-audit" fees determined?

The term "audit fees" is not defined in the Companies Act, SGX Listing Manual, or in any case law. In common layman terms, "audit fees" would mean such fees charged by auditors for professional auditing services rendered. These services would include those annual statutory assurance work imposed on the company that can only be performed by the company's auditors (e.g. MAS returns, supplementary reports, etc), and those relating to annual head office reporting and quarterly/ interim review of financial statements.

"Non-audit fees" would mean such fees for all other types of services other than those described above. This definition is consistent with SGX's clarification that "non-audit fees" means other fees paid to auditors by a listed company for services unrelated to the audit of the financial statements - for example, consulting services or any other miscellaneous fees.

Should the fees paid by the group of companies be included in the computation of non-audit fees and total fees?

Section 206(1A) refers to fees paid by the public company to the auditors. Hence, legally, the computation of the 50% threshold is computed on the fees paid to the public company only. However, looking at the objective of the requirement, it is not unreasonable to approach the review on a group basis, i.e. by taking the non-audit fees and the total fees paid by the group of companies to the auditors of the company. This would prevent circumvention of the spirit of the legislation by having the subsidiaries to record the non-audit fees.

Currently, SGX-listed companies are already required to perform a review of the non-audit services rendered to all companies in the group by auditors of the company under the SGX Continual Listing Obligations and the Code.

In addition, under the SGX Continuing Listing Obligations, the total amount of non-audit fees paid to the auditors of a SGX-listed company is also required to be disclosed in the annual report of the company[6].

How often should the review be conducted and the outcome of the review be circulated?

Section 206(1A) does not specify how often the review should be undertaken and the results sent. We expect ACRA to issue further clarification on the interpretation of this section. Until this is issued, there will be varied interpretations and practice by various companies and we believe that a practical approach should be taken. Companies could use the Code and the SGX Listing Manual as a guide and perform the review and report the results in the annual report at least annually. If there are significant non-audit services rendered by the auditors during the year, the audit committee may consider reviewing these services on a quarterly basis and include the outcome of the review in its quarterly announcements. Where there are significant non-audit fees paid to auditors of the company, the audit committee or directors should consider performing the review more frequently. To facilitate the review process, directors or the audit committee should consider setting policies and procedures that govern the pre-approval of non-audit services and reporting of such services to the audit committee or the Board.

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[1] SGX Listing Manual Rule 1207 (6)(b).

[2] Compliance with the Code is not mandatory. However, Rule 710(2) of SGX Listing Manual requires all listed companies to disclose their corporate governance practices and give explanations for deviations from the Code in their annual reports for annual general meetings held from 1 January 2003 onwards.

[3] Guidance note 11.4.

[4] Guidance note 11.6.

[5] PAB Rules 2004, Fourth Schedule,paragraph 16(1).

[6] SGX Listing Manual Rule 1207 (6)(a).

IFRS News – May 2004 is now available

This issue features an article on three complex issues on accounting for business acquisitions under IFRS 3 *Business Combinations*: fair value exercise, allocation of goodwill to cash-generating units and impairment tests. It also includes a broad comparison of IFRS 2 *Share-based Payments* and the proposed amendments to the US standard, SFAS 123. Lastly, issues facing the investment funds industry in applying IFRS are also examined in this issue.

IFRS News is a monthly newsletter produced by PwC Global Corporate Reporting Group and is available for download at the PwC Global website. (www.pwc.com/corporatereporting).

IASB Improvements Project Series

– *The Effects of Changes in Foreign Exchange Rates and Related Party Disclosures*

The International Accounting Standards Board (IASB) embarked on a project (generally referred to as "Improvements Project") in 2001 to reduce or eliminate alternatives, redundancies and conflicts within the International Accounting Standards (IAS), to deal with some convergence issues and to make other improvements. Exposure drafts to amend the IAS were issued by the IASB in May 2002. All 13 revised standards were issued and one standard was withdrawn by the IASB in December 2003. In Singapore, similar exposure drafts were issued in July 2002 and the revised standards, except for revised IAS 40 *Investment Property*, were issued with some refinements in April 2004. These revised standards are effective from 1 January 2005. IAS 40 would be considered for adoption at a later stage.

This article is part of the series that started in December 2003, where we highlight the key changes between the revised IAS and their exposure drafts. We end the series by addressing IAS 21 *The Effects of Changes in Foreign Exchange Rates and IAS 24 Related Party Disclosures.*

IAS 21 *The Effects of Changes in Foreign Exchange Rate*

The IASB's main objective for revising IAS 21 was to provide additional guidance on the determination of functional and presentation currencies and on the translation of financial statements prepared in their functional currencies to presentation currency.

The following illustrate the new requirements in revised IAS 21, in comparison to those in its exposure draft (ED) :

IASB clarifies that the economic environment in which the entity operates would influence its choice of functional currency

Functional currency is the currency of the primary economic environment in which the entity operates. Based on the ED to IAS 21, an entity shall consider the following factors in determining its functional currency :

(a) the currency

  (i) in which sales prices for its goods and services are denominated and settled (or the currency that mainly influences sales prices, when that is different); and

  (ii) of the country whose competitive forces and regulations mainly determine the sales price of its goods and services.

(b) the currency in which labour, material and other costs of providing goods or services are denominated and settled (or the currency that mainly influences such costs, when that is different).

The revised IAS 21 changes the emphasis on "the currency in which transactions are denominated" to "the currency of the economy that determines the pricing of transactions".

It replaces

- paragraph (a)(i) with "the currency that mainly influences sales prices for goods and services (this will often be the currency in which sales prices for its goods and services are denominated and settled)"; and
- paragraph (b) with "the currency that mainly influences labour, material and other costs of providing goods or services (this will often be the currency in which such costs are denominated and settled)".

Priority for the primary indicators used to determine functional currency

In addition, the revised IAS 21 states that management shall give priority to the above indicators ("primary indicators") before considering the following factors that may provide evidence of an entity's functional currency ("'secondary indicators") :

(a) the currency in which funds from financing activities are generated; and

(b) the currency in which receipts from operating activities are usually retained.

The priority is given to primary indicators because secondary indicators are not linked to the primary economic environment in which the entity operates, normally one in which an entity generates and expends cash. Secondary indicators mainly serve to provide additional supporting evidence in determining an entity's functional currency.

Goodwill shall be expressed in the functional currency of an acquired foreign operation and translated at closing rate

The previous version of IAS 21 allowed a choice of translating goodwill that arise on the acquisition of a foreign entity at either

- the closing rate (i.e. treating the goodwill as an asset of the acquired entity); or
- the historical transaction rate (i.e treating the goodwill as an asset of the parent).

The ED to IAS 21 removed the choice. It required that such goodwill be translated at the closing rate on the premise that goodwill is part of the parent's net investment in the acquired entity, and should therefore, be treated similarly as other assets (particularly, intangible assets) of the acquired entity.

The revised IAS 21 retains the ED requirement. Additionally, it requires that goodwill be allocated to the level of each functional currency of the acquired foreign operation and expressed in that functional currency. Accordingly, the level to which goodwill is allocated may differ from the level at which goodwill is tested for impairment. Entities should follow the requirements in IAS 36 Impairment of Assets to determine the level at which goodwill should be tested for impairment.

Transitional provisions for the translation of goodwill and fair value adjustments

The revised IAS 21 requires an entity to express goodwill and fair value adjustments in the functional currency of the foreign operation and translate them at the closing rate prospectively to all acquisitions occurring after the beginning of the financial reporting period in which IAS 21 is first applied, although retrospective application to earlier acquisitions is permitted.

If an entity treats an acquisition of a foreign operation, which occurred before the date on which IAS 21 is first applied, prospectively, it need not restate for prior years. Goodwill and fair value adjustments arising on that

acquisition could therefore be treated as assets and liabilities of the entity, and be either

- expressed in the entity's functional currency or
- treated as non-monetary foreign currency items, which are reported using the exchange rate at the date of the acquisition.

Reason for the change in functional currency shall be disclosed

The functional currency shall be changed when there is a change to the underlying transactions, events and conditions.

When either a reporting entity or a significant foreign operation changes its functional currency, the ED to IAS 21 required that fact to be disclosed. The revised IAS 21 requires both the fact and the reason for change be disclosed.

IAS 24 *Related Party Disclosures*

The IASB's main objective for revising IAS 24 was to provide additional guidance and clarity in the scope, the definitions and the disclosures for related parties.

The major changes between the ED to IAS 24 and the revised IAS 24 are as follows :

Separate financial statements of a parent or a wholly-owned subsidiary are no longer exempted from disclosing related party disclosures

The previous version of IAS 24 stated that no disclosure of related party transactions is required:

(a) in a parent's financial statements when they are made available or published with the consolidated financial statements; and

(b) in a wholly-owned subsidiary's financial statements if its parent incorporated in the same country provides consolidated financial statements.

The ED to IAS 24 retained the concept, but removed the requirement for the parent of a wholly-owned subsidiary to be incorporated in the same country.

The revised IAS 24 did a full reversal and removed all of the above exemptions. Taking the view that related party disclosures are essential to assess the level of support provided by related parties, it requires that related party disclosures be made in the separate financial statements of a parent, venturer or investor. This disclosure is required, even if the separate financial statements is made available or published with consolidated financial statements.

Key management compensation is now specifically required to be disclosed

The ED to IAS 24 proposed removing the requirement to disclose key management personnel compensation. Persuaded by the comments to the ED, the revised IAS 24 reversed the decision. Key management personnel compensation shall now be disclosed in total and for each of the following categories :

(a) short-term employee benefits;

(b) post-employment benefits;

(c) other long-term benefits;

(d) termination benefits; and

(e) equity compensation benefits.

To clarify, the revised IAS 24 also defines:

- "non-executive directors" as part of key management personnel;
- "compensation" to include all employee benefits as defined in IAS 19 Employee Benefits; and
- "employee benefits" to include all forms of consideration paid, payable or provided by the entity, or on behalf of the entity, in exchange for services rendered to the entity.

The name of the entity's parent and, if different, that of the ultimate controlling party shall be disclosed

The revised IAS 24 requires the disclosure of the name of the entity's parent and, if different, the name of ultimate controlling party. It further clarifies that where neither the entity's parent or the ultimate controlling party produces financial statements available for public use, the name of the next most senior parent that does so shall be disclosed. The next most senior parent is defined as the first parent in the group above the immediate parent that produces consolidated financial statements available for public use.

The ED to IAS 24 did not require the above disclosure.

These revised standards are available for download by subscribers at the IASB website (www.iasb.org.uk/)

Need help with the other standards?

The following standards were covered in the previous issues of Corporate Watch:

December 2003

IAS 2 Inventories

IAS 10 Events After the Balance Sheet Date

IAS 33 Earnings Per Share

January 2004

IAS 16 Property, Plant and Equipment

IAS 17 Leases

IAS 40 Investment Property

February 2004

IAS 1 Presentation of Financial Statements

IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors

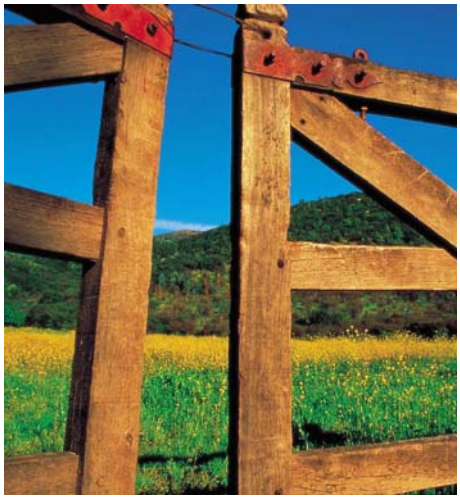
March/April 2004

IAS 27 Consolidated and Separate Financial Statements

IAS 28 Investments in Associates

IAS 31 Interests in Joint Ventures

Previous issues of Corporate Watch are available for download at our website. (www.pwc.com/sg/corporatewatch)



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