ACRA LEGAL DIGEST

August 2005, Issue No. 9

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A WORD FROM THE EDITORIAL TEAM

Welcome to the 9th issue of our Digest.

The Companies (Amendment) Bill 2005 was read in Parliament in April and May 2005. The proposed date of implementation of the Bill is 30 January 2006. The Companies (Amendment) Act 2005 is one of the most impactful pieces of corporate legislation to be introduced in recent years. It abolishes par value of shares and also reforms the capital maintenance regimes. In this issue ACRA will share with you the questions raised in two public education seminars by the professional bodies and our replies.

Under the purview of CCDG, we provide an update on the FRSs introduced from 1 June 2005 as well as the Code of Corporate Governance 2005 issued by MOF.

Lastly, we also highlight Practice Direction Number 5 of 2005 relating to requirements on the requisite experience and capacity of an approved liquidator under the Companies Act.

We hope you will find our Digest useful.

All information contained herein is correct at the time of publication. Please do not hesitate to send us your comments or suggestions for future topics to: www.acra.gov.sg/feedback.

The Editorial Team
Accounting and Corporate Regulatory Authority
11 August 2005

1. HIGHLIGHTS OF THE COMPANIES (AMENDMENT) ACT 2005

Background

1.1 The Companies Act has been amended from 2002 to 2004 to implement the recommendations of the private sector-led Company Legislation and Regulatory Framework Committee (CLRFC). These recommendations simplify business regulations, reduce the costs of capital maintenance in Singapore and keep pace with practices in other leading jurisdictions. The Companies (Amendment) Act 2005 ("the Amendment Act") was read in April and May 2005. It was published in the public gazette in June 2005. It is expected to be implemented in January 2006.

1.2 ACRA has been actively involved in public education seminars such as those conducted by the Singapore Association of the Institute of Chartered Secretaries and Administrators (SAICSA) and the Law Society of Singapore in July 2005 to explain the policies behind these amendments. A list of commonly asked questions during and beyond these seminars and our replies is presented below.

Scope of Amendment Act

1.3 The amendments in the Amendment Act:

- abolish the concepts of par value and authorised capital;
- reform the capital maintenance regime;
- introduce the concept of treasury shares; and
- liberalise the amalgamation process for companies.

Highlights of Amendment Act

<u>Abolishing the concept of par value and authorised capital</u>

1.4 Presently all shares issued by a company must have a par value and the company is required to report its authorised capital. Par value is the face or nominal value of a share while authorised capital is the maximum amount of capital which a company can raise. The Amendment Act abolishes the concept of par value and authorised capital. This is because:

- par value is an outdated concept that is no longer relied on by investors and creditors as an accurate proxy of a company's value;
- it does not reflect any loss in capital or when there are shares issued at an amount higher than par value;
- other measures such as earnings per share or net tangible asset backing provide a more accurate view of the economic value of a company;

- the authorised capital as a ceiling is artificial as a company is free to amend and increase its authorised share capital; and
- other consequential restrictions, such as shares cannot be issued at a discount to par value, prevent a company from raising new funds when the market value of its shares has fallen below par value.

1.5 The key amendments in the Amendment Act include:

- Clause 8 that amends Section 22 to abolish the concept of authorised capital, removing the upper limit to the number of shares that companies may issue;
- Clause 15 that introduces new Sections 62A and 62B to abolish the par value concept and provide for transitional provisions for the treatment of share capital; and
- Clause 18 that repeals Sections 67 to 69F which are no longer applicable as the concepts of share premium and share discount will cease to apply.

1.6 The notion of issued or paid capital will continue to be relevant even after the abolition of par value, and it would now also reflect the amount in the share premium account. In other words, it will represent the amount the company actually receives from its shareholders as capital contribution.

<u>Changes to Capital Maintenance Regime and Amalgamation of Companies</u>

1.7 The two other major changes relate to the capital maintenance regime and amalgamation of companies. In company law "capital maintenance" refers to the rule that a company cannot return capital gratuitously to its shareholders (except in the form of dividends, the distribution of which is subject to strict rules) as this would mean a depletion of capital that could be used to pay creditors or even to fund business operations.

1.8 For this reason, companies are generally prohibited from giving financial assistance to third parties to buy its shares (and thereby becoming shareholders), to reduce its share capital and to buy back shares of existing shareholders. However, it has long been recognised that these restrictions on the use of the company's capital are not necessarily effective in protecting creditors. What is important to creditors is not the amount of capital a company may or may not have, but rather whether they can be paid.

1.9 As such, the amendments have introduced changes that specifically address the real concerns of creditors. While the restrictions against financial assistance, capital reduction and share buybacks have been liberalised as a result of the amendments, the interests of creditors continue to be safeguarded.

1.10 Financial assistance can now be given in 2 specific instances – where the amount is no more than 10% of the total share capital or where all the shareholders agree to the financial assistance. In either case, the directors must sign a solvency statement, declaring that the company is able to pay its debts and that its assets exceed its liabilities.

1.11 For reduction of capital, an alternative process as recommended by the CLRFC has been introduced. Instead of requiring the reduction of capital to be confirmed by the court, companies may reduce their capital via a special resolution, subject to solvency and publicity requirements. As with the giving of financial assistance, a solvency statement is required.

1.12 One point to be noted about the amendments relating to the reduction of capital is that while the CLRFC and the UK Draft Bill on which we were modelling these provisions drew a distinction between public and private companies for the publicity requirements, the new provisions require both public and private companies to be subject to publicity requirements. This was a result of strong public feedback that indicated that there should not be any discrimination in this respect.

1.13 While the share buy back provisions saw relatively few changes, the amendments were no less significant. Under the current provisions, all shares can only be bought back out of distributable profits, and once bought back are to be cancelled. The amendments will allow shares to be repurchased out of capital if supported by a solvency statement and may also be held in treasury after repurchase.

1.14 Those who have gone through the entire Bill would have noticed that there are actually three different sets of provisions relating to solvency requirements. The first is found in section 7A, the second in section 76F and the last in sections 215I to 215J. The primary difference between section 7A and 76F is that a solvency statement is not required for the latter. However, the directors must still satisfy themselves as to the solvency of the company. Section 215I and 215J deal with the situation where two or more companies will amalgamate. As only one company will remain after the amalgamation, the test in section 7A is not appropriate since that test envisages the company continues to exist after the financial assistance or capital reduction.

1.15 The amalgamation provisions were adapted from the New Zealand Companies Act. The new provisions are meant to supplement, not supplant the existing section 212 which relies on a court order. As with the other amendments in this Act, solvency requirements need to be met, and like that for capital reduction, publicity is also required for the amalgamation.

Commonly Asked Questions and Answers on Companies (Amendment) Act 2005

Q1	***Which countries have adopted such a fundamental shift to abolish par value of shares? UK has not moved in such a direction, so why are we not retaining our position?***
A1	Australia and New Zealand have abolished the concept of par value. UK has brought up this issue time and again, and they were inclined to adopt such a stand. However they will not be abolishing par value as it is constrained to do so by reason of the 2nd European Union Company Directive[1].
Q2	***What happens when companies issues shares with no par value? Must they take active steps to convert their shares with par value into no par ones?***
A2	All shares issued, before, on and after the abolition shall have no par value. The law will deem all shares issued before the abolition to have no par value. There is no conversion process required from the companies. However the law will provide that when computing the amount paid and unpaid on the shares that are issued before the abolition, the share premium shall not be included. With the abolition of par value, the share premium account and capital redemption reserve shall cease to exist. Hence the amount standing to the credit of a company's share premium account and any amount standing to the credit of a company's capital redemption reserve shall become part of the company's share capital. Nevertheless the company may use the outstanding amounts from the share premium account for certain uses. Please refer to question 5 for more details. In addition, companies may be required to file a prescribed form with ACRA. The prescribed form shall report the share capital of the company. If the company does not do so, ACRA shall be empowered to compute the share capital based on the aggregate nominal amount value of shares before the abolishment. Companies that have issued shares at a premium would be advised to file this prescribed form to accurately reflect the value of its share capital.

1 The Second Council Directive 77/91/EEC of 13th December 1976 applies to member states of companies within the meaning of the second paragraph of Article 58 of the Treaty, in respect of formation of public limited liability companies and the maintenance and alteration of their capital, with a view of making such safeguards equivalent. There are restrictions in the said Directive that suggest that shares may not be issued at a price lower than their nominal value, or where there is no nominal value, their accountable par. Hence this means a totally no par system is not allowed.

Q4	***What is the impact on companies of abolition of par value?***
A4	The impact can be broadly summarised as follows: (a) For shares issued after the abolition, the law will recognize the shares of a company to mean the proportion of the equity of the company. The liability of the shareholders will be limited by the total consideration agreed to be paid for the shares. (b) Concepts such as share premium, capital redemption reserve and share discounts shall cease to exist. (c) The concept of paid up capital, issued capital, partly paid shares are still relevant. But they will be related to the total consideration paid or agreed to be paid for the shares issued, and not tied to par value. (d) Share capital can still be altered such as consolidation and further division, conversion into stocks and then re-conversion back into shares, subdivision and cancellation. However these concepts will no longer be tied to the par value of shares.
Q5	***What about the monies in the share premium account and capital redemption reserve before the abolition?***
A5	The monies in the share premium account and capital redemption reserve will become part of capital. However the law will continue to allow monies from the share premium account to be used for the following permitted uses: (a) providing for the premium payable on redemption of debentures or redeemable preference shares issued before the abolition; (b) writing off: (i) the preliminary expenses of the company incurred before that day; and (ii) expenses incurred, commissions and brokerages paid and discounts allowed on or before that day for or on any duty, fee or tax payable on or in connection with any issue of shares of the company; (c) paying up, pursuant to an agreement made before that day, shares which were unissued before that day and which are to be issued on or after that day to members of the company as fully paid bonus shares; (d) paying up in whole or in part the balance unpaid on shares issued before that day to members of the company; (e) paying dividends declared before that day, if such dividends are satisfied by the issue of shares to members of the company; and (f) if the company carries on insurance business in Singapore immediately before that day, appropriating or transferring the

	amounts to any fund established and maintained pursuant to the Insurance Act (Cap. 142).
Q6	***How would the abolition of par value affect listed companies or their shares?***
A6	One of the areas in which listed companies would be affected is the calculation of substantial shareholdings. A person is a substantial shareholder if he holds not less than 5% of the total votes attached to all the voting shares in the company instead of the current one which additionally requires the nominal or aggregate nominal amount of share or shares held to be not less than 5% of the nominal amount of all voting shares in the company.
Q7	***Would the abolition of par value shares and authorized capital increase business costs?***
A7	No, the abolition of par value share and authorized capital does not lead to an increase in reporting or compliance requirements. Hence they do not lead to an increase in business costs. There could be minor housekeeping matters each company is required to do to ensure that their capital structure is reflected accurately after the abolition.
Q8	***With abolition of par value, can companies still issue ordinary shares in different classes? Would the rights attached to different classes of ordinary shares already issued change?***
A8	Companies can still issue ordinary shares from different classes. The class rights attached to already issued shares remain intact and there are no additional reporting requirements imposed.
Q9	***Would the calculation of dividends be different?***
A9	The law does not mandate how dividends should be calculated. This is an internal decision taken by the company. It is common practice for companies to peg the calculation of dividends to the amount paid or credited as paid, on the shares. The amount fully paid is taken to be the par value of the shares. These requirements are usually reflected in the Articles of Association. With the abolition of par value, we would think that companies may peg calculation of dividends to the number of shares held by the shareholders. Companies will have to review their Articles of Association to cater to the changes.

Q10	***What is the difference between the new capital reduction regime and the existing one?***
A10	With the amendments, companies will have the choice of either court-approved capital reductions or capital reduction by way of special resolution. We have introduced safeguards for capital reduction by way of special resolution: (a) The directors of the company must make a solvency statement. (b) There must be sufficient publicity so that creditors and other interested parties know about the proposed capital reduction. (c) Creditors have the right to object to the reduction by applying to court. The draft Companies Amendment Bill that was available for public consultation in Singapore was drafted following the UK draft Bill. It (like the UK draft Bill) made a distinction between private and public companies for the purposes of publicity and right of creditors to object. Also, the CLRFC recommended that public companies publish a newspaper notice to satisfy the publicity requirement, but did not recommend the same for private companies. However, the respondents to public consultation by MOF on the draft Bill made it very clear that the distinction was not justified. The respondents felt that the private companies should also be subject to some form of publicity requirements and creditors of such companies should also be allowed to object to the capital reduction. <u>Note</u>: the publicity requirements are to be in the Regulations. The requirements for public companies will be as recommended in the CLRFC report, that is, to publish a notice in a national newspaper. Private companies are likely to be similar but may have further options. ACRA is working on an effective but cost-effective means of publicity for all companies undertaking capital reduction and the Regulations will be amended as and when necessary.
Q11	***What do the new provisions on liberalising the giving of financial assistance achieve?***
A11	Because of the prohibition against depletion of capital, companies are generally not allowed to provide financial assistance to a third party if this results in the third party using such funds to acquire the shares in the company. There are limited exceptions to this prohibition but companies and their directors usually have to make a judgment call as to whether such financial assistance is permissible. These new provisions set out clear, objective situations in which financial

	assistance is permitted, thus giving certainty to such transactions.
Q12	***What are the key differences between section 76(9A) and (9B)?***
A12	There are, as seen in the provisions themselves, different requirements, given the different scenarios. Under (9A), as long as the amount of financial assistance is below a certain threshold, the company is free to give the assistance. Any amount given that threshold is to be approved by all shareholders: s76(9B).
Q13	***What good are treasury shares if they have no rights attached to them?***
A13	Shares held in treasury are inactive but this does not mean that they are useless. Currently, no company may hold any of its own shares. Once they are bought back, they must be cancelled. This is a pity as the shares could be later sold or transferred. The introduction of treasury shares means that companies can deal with their repurchased shares more efficiently and in a variety of ways. A useful analogy is that the shares are kept in cold storage until such time when they can be put to good use.
Q14	***What safeguards are in place to prevent abuse?***
A14	A company cannot hold more than 10% of its total number of shares in treasury at any one time. This prevents a company from hoarding a substantial number of shares. Also, as all dividend and voting rights are suspended while the shares are held in treasury, there is little incentive to hold a large number of shares without any rights and privileges.
Q15	***What is the reason for restricting the proceeds of treasury shares to be used only for payment of dividends?***
A15	The Act only allows dividends to be paid out of profits. The restriction is to prevent a company otherwise making losses to use any fortuitous profits from the sale of treasury shares to enrich its shareholders with dividends.
Q16	***Will foreign companies be able to take advantage of the amalgamation provisions?***
A16	The amalgamation provisions apply only to local companies.

Q17	***Will the amalgamated company be a new company?***
A17	The amalgamating companies have a choice and this choice will be reflected in the amalgamation proposal. If the companies choose to amalgamate as a new company, a notice of incorporation will be issued accordingly and the company will have a new registration number. On the other hand, the companies can continue as one of the existing companies, while the other(s) will be struck off the register.

2. UPDATE ON THE WORK OF THE COUNCIL ON CORPORATE DISCLOSURE AND GOVERNANCE

Issuance of Financial Reporting Standards (FRSs)

2.1 The CCDG issued the following new and revised accounting standards on 1 June 2005. These are available at http://www.ccdg.gov.sg/frs/index.htm:

(a) Amendments to FRS 19 *Employee Benefits* relating to actuarial gains and losses, group plans and disclosures. The objective of FRS 19 is to prescribe accounting and disclosure for employee benefits, which include all forms of consideration given by an entity in exchange for service rendered by employees (e.g. salaries, employee share options, medical subsidies etc). The amendment provides an additional option for an entity to recognise actuarial gains and losses (i.e. unexpected changes in value of a benefit plan) in a statement of recognised income and expense, in addition to recognising such gains or losses in the profit or loss. The amendments to FRS 19 are based on the amendments to IAS 19 *Employee Benefits* issued by the International Accounting Standards Board (IASB) in December 2004. The amendments to FRS 19 are effective for annual periods beginning on or after 1 January 2006.

(b) INT FRS 104 *Determining whether an Arrangement contains a Lease*. INT FRS 104 is based on Interpretation 4 *Determining whether an Arrangement contains a Lease* issued by the International Financial Reporting Interpretations Committee (IFRIC) of the IASB in December 2004. INT FRS 104 gives guidance on determining whether arrangements that do not take the legal form of a lease (e.g. some take-or-pay contracts) should, nonetheless, be accounted for in accordance with FRS 17 *Leases*. INT FRS 104 is effective for annual periods beginning on or after 1 January 2006.

(c) INT FRS 105 *Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds*. INT FRS 105 is based on Interpretation 5 *Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds* issued by IFRIC of

IASB in December 2004. INT FRS 105 explains how to treat expected reimbursements from funds set up to meet the costs of decommissioning plant (e.g. nuclear plant) or equipment (e.g. cars) or in undertaking environmental restoration or rehabilitation (such as rectifying pollution of water or restoring mined land).

Issuance of Code of Corporate Governance 2005

2.2 The Ministry of Finance (MOF) announced its decision on the CCDG's proposed revisions on the Code of Corporate Governance on 14 July 2005. MOF accepted most of the recommendations from the CCDG and issued the Code of Corporate Governance 2005. The Code of Corporate Governance 2005 takes effect from AGMs held on or after 1 January 2007. Listed companies should disclose their corporate governance practices and explain deviations from the Code of Corporate Governance 2005 in their annual reports for AGMs held from 1 January 2007 onwards.

2.3 A copy of the Code of Corporate Governance 2005 can be downloaded from http://www.ccdg.gov.sg/corpgov.htm. For details on the CCDG's review, please refer to http://www.ccdg.gov.sg/news/media_release_13.htm. Please refer to http://app.mof.gov.sg/news_press/pressdetails.asp?pressID=191 for details on MOF's announcement.

3. APPOINTMENT OF ACRA BOARD MEMBER AND CHAIRMAN OF THE PUBLIC ACCOUNTANTS OVERSIGHT COMMITTEE

3.1 The Second Minister for Finance has appointed Mr Thean Lip Ping to the Board of the Accounting and Corporate Regulatory Authority (ACRA) from 1 August 2005 to 31 March 2008. ACRA Board has also appointed Mr Thean as the Chairman of the Public Accountants Oversight Committee (PAOC) for the same period in place of Mr John Palmer.

4. PRACTICE DIRECTION NO. 5 OF 2005 – APPLICATION TO BE AN APPROVED LIQUIDATOR UNDER COMPANIES ACT – REQUIREMENTS AS TO "EXPERIENCE" AND "CAPACITY"

4.1 ACRA issued Practice Direction No. 5 of 2005 on 30 May 2005. The Practice Direction sets out the criteria used in approving liquidators under Section 9(2) of the Companies Act and in particular discusses what constitutes the requisite experience and capacity for purposes of being an "approved liquidator". A copy of the Practice Direction is available at:
http://www.acra.gov.sg/legislation/practice0505.html.

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