

# **ACRA-SGX-SID Audit Committee Seminar – Raising The Bar for Financial Reporting and Audit**

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**Singapore Exchange**

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# Agenda

- 1 **Recent Developments**
  - ❖ Introduction to SGX Independent Listings Committees
  - ❖ Listing Compliance Bulletin
  
- 2 **Areas of Concern**
  - ❖ Issuance of Convertible Securities
  - ❖ Rights Issue or Bonus Issue?
  - ❖ Ability to Operate as Going Concern
  - ❖ Change in Auditors
  - ❖ Publishing Research Reports on SGXNet
  - ❖ Internal Controls & Safeguards of Assets

# Recent Developments

# SGX's Enforcement Powers against Issuers and Directors

## Exchange's Direct Enforcement Powers

## Powers of Listings Disciplinary Committee and Listings Appeals Committee

Issuers

 Private warning	 <b>Composition sum</b>	 Appoint independent professionals / advisers	 Independent review of internal controls and processes	 Remedial action	 Education / compliance program / mandatory training for directors / executive officers	 Other requirements
			 Suspension	 Delisting		

**All powers of the Exchange and**

 Public reprimand	 Fine	 <b>Prohibiting access to market facilities for a specified period</b>
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Directors and Executive Officers

 Private warning	 Requiring prior approval for appointment (max 3 years)	 Object to appointment (max 3 years)
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**All powers of the Exchange and**

 Public reprimand	 Requiring resignation
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# SGX Listing Compliance Bulletin

Launched 17 December 2015

Launched as part of an effort to increase the transparency of deliberations made by the Exchange on disciplinary actions and to help the relevant stakeholders in regulatory compliance and corporate actions.

## ✓ Regulatory Decisions

- Sheds light on non-public regulatory actions SGX has taken in response to listing rule breaches through the publication of case studies

## ✓ Listing Compliance Toolkit

- Aimed at making regulatory compliance more structured, efficient and simpler to understand; and
- Designed to address areas of the highest regulatory concerns with regards to corporate actions and to facilitate approval of submissions

The Bulletin will be enhanced and expanded over time to cover other areas of regulatory compliance and to improve communication with our stakeholders.



## Listing Compliance Bulletin

A securities market is only sustainable if it constantly improves itself. This Bulletin is part of Singapore Exchange's (SGX) efforts to strengthen and enhance the market. We hope that by sharing case studies of non-compliance of the Listing Rules with Listed Companies, market professionals, investors and other stakeholders, awareness of recommended practices and guidelines will increase, thereby raising overall governance standards.

### Regulatory Decisions

Case studies on past non-compliance with the listing rules and key points of deliberations by SGX in taking Regulatory action. [View More >](#)

### Listing Compliance Toolkit

To make regulatory compliance more structured and simpler to understand, the Listing Compliance Toolkit comprises form templates for corporate actions in the aim of addressing areas of the highest regulatory concerns. [View More >](#)

# Areas of Concern

# Area of Concern ► Issuance of Convertible Securities (1)

## Observations

- Company A proposes the issuance of redeemable exchangeable bonds to an investor.
- Key features of the bonds:
  - Interest bearing;
  - Exercisable into shares in Company A (“Exercised Shares”) prior to maturity date; and
  - If not exercised into shares, will be redeemed upon maturity.
- Exercise price for the Exercised Shares will be at the lower of:
  - S\$0.20 (10% discount); or
  - 10% discount to 20 days’ VWAP prior to date of exercise.
- Company A will be using its general mandate for the purpose of issuing the Exercised Shares.

## Concerns

- Rule 806(5) states that an issuer cannot rely on the general mandate for an issue of convertible securities if the maximum number of shares to be issued upon conversion cannot be determined at the time of issue of the convertible securities.
- As the exercise price for the Exercised Shares is not fixed, the maximum number of shares to be issued cannot be determined. Accordingly, the following concerns were raised:
  - How would Company A know if its general mandate is sufficient assuming all bonds are exercised into shares?
  - Does Company A comply with Rule 806(5)?

## Area of Concern ► Issuance of Convertible Securities (1)

### Recommended Practices / Resolution

- ✓ Company A clarified that it will determine the number of shares to be issued out of its general mandate based on the maximum exercise price of S\$0.20 and assuming that all bonds are exchanged into shares. Company A will also be seeking listing and quotation for such number of shares.
- ✓ If the exercise price is lower than S\$0.20 at the time of exercise of the bonds, Company A may be required to issue additional Exercised Shares (“Additional Shares”). In such an event, Company A will:
  - Submit another additional listing application for the Additional Shares;
  - Seek shareholders’ approval for the issuance of the Additional Shares (if required); and
  - If the issuance of the Additional Shares constitute a transfer in controlling interest, shareholders’ approval will be sought pursuant to Catalist Rule 803.
- ✓ Company A should monitor ongoing issuance of Exercised Shares, and track the available balance under the general mandate prior to each request by the bondholder to exchange the bonds into shares. Should the available balance under the general mandate be insufficient, Company A must promptly seek shareholders’ approval and obtain a listing and quotation notice from SGX prior to issuing and allotting more Exercised Shares.

## Area of Concern ► Issuance of Convertible Securities (2)

### Observations

- Company B proposes the issuance of redeemable convertible notes to an investor.
- The notes are convertible into shares in Company B, at conversion price based on a floating formula (eg: 30 days' VWAP prior to conversion).
- Company B will be seeking shareholders' approval for the transaction.

### Concerns

- In seeking shareholders' approval for the issuance of convertible securities, Rule 832(1) requires the shareholders' circular to include, amongst others, the maximum number of underlying securities which would be issued or transferred on exercise or conversion of the company warrants or other convertible securities.
- Given the floating conversion price, the maximum number of shares to be issued cannot be determined. Shareholders will not be able to make an informed decision in view of the maximum dilution in the event of full conversion.

### Recommended Practices / Resolution

- ✓ Fixed conversion price.
- ✓ For transactions with floating conversion price, to include:
  - Floor price; or
  - Cap on maximum number of shares that can be converted.

## Area of Concern ► Issuance of Convertible Securities (3)

### Observations

- Company C proposes to issue warrants to certain investors. Terms of the issue are set out in the deed poll.
- The deed poll provides for adjustment to exercise or conversion price and / or number of warrants under specific events.
- However, the deed poll also includes a clause allowing the company and warrant holders the right to adjust the conversion terms under unspecified circumstances as the issuer or warrant holders deem fit.
- In addition, the deed poll also allows the auditors, in reviewing the adjustments, to modify or nullify the adjustments, in such manner as shall be considered appropriate in the auditors' opinion.

### Concerns

- Rule 829(3) states that if there are material alteration to the terms of company warrants or other convertible securities after issue to the advantage of the holders of such securities, such alteration need to be approved by shareholders, except where the alterations are made pursuant to the terms of the issue.
- The inclusion of clauses which gives the issuer, holders or other parties the right to negate other terms of the issue without due basis ("Catch-all Terms", is not in the best interest of shareholders.

### Recommended Practices / Resolution

- ✓ Catch-all Terms should not be included in the deed poll as it enables issuers to circumvent the requirement to seek shareholders' approval for material alteration to terms of an issue.

## Area of Concern ► Bonus Issue

### Observations/ Concerns

- Rule 838 states that An issuer must satisfy the Exchange that its daily weighted average price, adjusted for the capitalization issue or subdivision of shares ("adjusted price"), will not be less than S\$0.50. When deciding, the Exchange may take into account an issuer's adjusted price for the month preceding the application date.
- Company D proposes a bonus issue. Shareholders are entitled to 1 bonus share for every X shares they hold at BCD.
- Company D has taken the monthly weighted average price to satisfy the Exchange instead of using the daily weighted average price.

### Recommended Practices / Resolution

- ✓ Companies must make sure that the **daily** weighted average price, adjusted for the capitalization issue or subdivision of shares will not be less than \$0.50.
- ✓ This means that for each day for the month preceding the application date, the conversion ratio should achieve a theoretical adjusted daily weighted average price that is above S\$0.50.

# Area of Concern ► Rights Issue or Bonus Issue?

## Observations

- Company proposes a rights issue. Shareholders are entitled to 1 rights share for each existing share they hold at BCD.
- The rights shares are issued at a discount of 90% to the prevailing market price.

## Concerns

- Rights issue involves offering shares to existing shareholders, typically at a discount, for the purpose of raising funds.
- Bonus shares are issued to shareholders for free, usually to improve liquidity through affordability of its shares.
- The rules and disclosure requirements for a rights issue and a bonus issue would therefore be very different. For instance:
  - Rights issue – price, terms, purpose; amount and use of proceeds; financial circumstances that call for the issue; subsequent announcement on significant disbursements.
  - Bonus issue – terms, purpose; post issuance adjusted price not less than \$0.20; expected impact on dividends.

## Recommended Practices / Resolution

- ✓ Companies must be clear about whether they are doing a Rights Issue or a Bonus Issue. The substance of the issue will be considered over the form

## Area of Concern ► Ability to Operate as Going Concern

### Observations

- Company F's external auditors issued a disclaimer of audit opinion, raising concerns on its ability to operate as a going concern.
- The Board's basis on Company F's ability to operate as a going concern is contingent upon shareholders' approval for a fund raising exercise. Shareholders' circular has been despatched and EGM date fixed.

### Concerns

- Rule 1303(3) states that trading in an issuer's securities may be suspended if the issuer is unable to continue as a going concern or is unable to demonstrate that it is able to do so.
- Company F's ability to operate as a going concern is uncertain as shareholders may object to the fund raising exercise proposed. Concerns were raised as to whether trading in Company F's securities should be suspended.

### Recommended Practices / Resolution

- ✓ Given the audit opinion, the Board should :
  - Provide its opinion (and bases to support) on the company's ability to operate as a going concern;
  - Confirm that all material disclosures have been provided for trading of the company's securities to continue.
- ✓ If resolution for its fund raising exercise is not passed at the EGM, trading in Company F's securities should be suspended.

# Area of Concern Considerations for Change in Auditors

## Observations

- Company G is in the business of exploration and mining of minerals, with operations in Australia and Malaysia.
- As part of its efforts to reduce costs, Company G proposes to change its external auditor from a “Big 4” firm to a smaller auditing firm.

## Concerns

- Whether the Company G’s Board has assessed suitability of the proposed new auditing firm and engagement partner, in light of the complexity of the industry in which Company G operates in.

## Recommended Practices / Resolution

- ✓ Rule 712(1) states factors for consideration in assessing suitability of auditors:
  - adequacy of the resources and experience of the auditing firm and audit engagement partner;
  - the firm’s other audit engagements;
  - size and complexity of the listed group being audited; and
  - the number and experience of supervisory and professional staff assigned to the audit.
- A mineral, oil and gas company must appoint an auditing firm where the auditing firm and audit partner-in-charge have the relevant industry experience.

# Area of Concern ► Publishing Research Reports on SGXNet

## Rules

- Paragraph 25 of Appendix 7.1 states that announcements on SGXNet should, among other things avoid:
  - omission of important unfavourable facts, or the slighting of such facts (for example by "burying" them at the end of a press release);
  - presentation of favourable possibilities as certain, or as more probable than is actually the case;
  - presentation of projections without sufficient qualification or without sufficient factual basis; and
  - use of promotional jargon calculated to excite rather than to inform;

## Observations

- ✓ Company H misused SGXNet to upload research reports containing an assessment of the Company itself by a 3<sup>rd</sup> party.
- ✓ The research report is a one-sided look at Company H, meant to boost Company H's share price without taking into account potential downsides.
- ✓ This is a violation of the SGXNet terms of use that each issuer is given when they are given access to SGXNet.

# Area of Concern ► Publishing Research Reports on SGXNet

## Concerns

- SGXNet is not meant to be used for publishing research reports. All announcements must be factual and fair, and have no omission of facts.
- Research reports need to be authorized by MAS before they can be distributed in Singapore.
- Because the research report was published by a 3<sup>rd</sup> party, the credibility of the report is not certain, and shareholders can be misinformed.

## Recommended Practices

- ✓ SGXNet announcements must be factual and fair.
- ✓ The announcements must comply with the SGXNet terms of use and Appendix 7.1.
- ✓ If Issuers wish to publish research reports, SGXNet is not the platform to do so. Issuers can do so on their own corporate websites.

## Area of Concern ► Internal Controls & Safeguards of Assets

### Observations/ Concerns

- Disbursement of funds without knowledge of the Board, including the Audit Committee.
- No proper escalation to the Board for approval to use funds.
- Late or Non disclosure of material changes to the terms of the acquisition.
- Failure to act in the interest of shareholders.

### Recommended Practices / Resolution

- ✓ Boards and auditors should be vigilant over company matters.
- ✓ Independent checks and balances for material disbursements.
- ✓ Regular reporting or escalation of material matters to Board for information and approval.
- ✓ High risk areas such as cash balances, accounts receivables and off-balance sheet items must be heavily scrutinized and additional validations regarding these items should be required. With heightened vigilance, any irregularities and wrongdoing will be able to be brought to light.
- ✓ Companies should ensure that sufficient and robust internal controls are put into place to safeguard cash, receivables are managed properly and there are detailed assessment of off-balance sheet items.
- ✓ Engage professional advisors to recommend best practices to address company's needs.

# Thank you

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