Impending Changes To The Companies Act

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Overview

The Singapore Companies Act (the "Act") is poised for the largest number of changes since its enactment as the Ministry of Finance ("MOF") accepts the recommendations resulting from a four-year deliberation.

The case for change is to enable an efficient and transparent corporate regulatory framework within Singapore. Would these impending changes be transformational to that effect?

The 209 recommendations are put forth by a Steering Committee set up by the MOF, debated through public consultations involving a wide range of stakeholders, including businessmen and professionals such as lawyers, accountants and academia. The laws and practices in other leading jurisdictions such as Australia, Hong Kong, New Zealand, United Kingdom and United States have also been considered.

These changes are designed to benefit companies, SMEs, retail investors and company shareholders, particularly by (a) reducing regulatory burden and compliance costs; (b) offering greater flexibility; (c) encouraging greater activity by indirect shareholders; and (d) boost transparency and corporate governance standards. They are expected to be effective by end of 2013.

Reduced Compliance Costs via Audit Exemption of "Small Companies"

One key change is to extend audit exemption to "Small Companies".

A "Small Company" is defined as a private company that fulfils two of the three following criteria:

- total annual revenue of not more than S$10 million;
- total gross assets of not more than S$10 million;
- number of employees not more than 50.

Such companies have limited public interests and therefore there are few compelling reasons to mandate an audit.

With this change, the MOF estimated that 25,000 and more companies will be exempted from audit, an increase of 10 percentage points from the current 79%, out of 250,000 "live companies" estimated as at end of September 2012.

However, this change is likely not

applicable for smaller companies belonging to groups as the "Small Company" criteria above will have to be assessed based on the consolidated accounts of the group to which the subsidiary belongs.

In addition, when the "Small Company" criteria are assessed on a consolidated basis, the group will include all local and foreign-incorporated companies within the group. To achieve parity of treatment of subsidiaries of local parent and those of foreign parent, the requirement to consider at consolidated level will also apply regardless of whether the parent company is incorporated in Singapore or otherwise.

As an illustration, a parent company P has two active subsidiaries, S1 and S2. S1 is incorporated in Singapore whilst S2 is incorporated overseas. To determine whether the Singapore subsidiary S1 qualifies for audit exemption, the "Small Company" criteria are assessed based on the consolidated accounts of P (i.e. consolidating the financial effects of P, S1 and S2). This is applicable even when P is incorporated outside of Singapore.

Where the requirement to assess is applicable to overseas companies, there are some practical barriers to be considered. For example, overseas parent companies may not prepare consolidated accounts or when they do, the consolidated accounts may not be prepared under the recognised accounting frameworks such as International or Singapore FRS or U.S. GAAP. Directors may be expected to apply their best judgement in determining whether the group would satisfy the "Small Company" criteria on a consolidated basis.

Whilst the impact from the audit exemption would be less extensive for groups, this could be viewed as beneficial to directors of parent companies.

Directors of a Singaporean parent company that produces consolidated financial statements have to form a view that the consolidated financial statements (in addition to the company level only balance sheet) are true and fair. In doing so, directors would need to have assurance that the financial statements of the subsidiaries are free from misstatement or errors and fit for consolidation purposes.

Codifying the requirement for Singaporean subsidiaries to be independently audited would provide one form of assurance on the quality of these financial statements, thereby assisting the directors of the parent company to discharge their responsibilities. However, directors would still need to exercise their care and discretion for overseas subsidiaries in jurisdictions with no audit requirements.

Summary of financial reporting and auditing obligations for different companies

	Prepare	File	Audit
Public companies			
Dormant (listed and unlisted)	√	√	x
All, other than 1a.	√	√	√
Private companies – A subsidiary of a listed company			
Dormant	√	√	x
All, other than 2a.	√	√	√
Private companies - Non-subsidiary - A subsidiary of a non-listed company			
Dormant (with assets <=$500,000)	x	x	x
Dormant (with assets >$500,000)	√	√	x
SC that is also a solvent exempt private company	√	x	x
Not SC that is a solvent exempt private company	√	x	√
SC that is - not an exempt private company, or - an insolvent exempt private company	√	√	x
All, other than 3a to e.	√	√	√

"Dormant Companies" need not prepare Accounts Subject to Safeguards

Another key change is to exempt a "dormant company" (other than a listed company and a subsidiary of a listed company), from preparing accounts, subject to:

- the "dormant company" not holding total assets of more than S$500,000;
- its directors make an annual declaration of dormancy;
- the company is dormant for the entire financial year in question; and
- the company is not directed by its shareholders or ACRA to prepare its accounts and/or to lodge them.

As dormant companies are exempted from audit since 2003, exempting them from preparing accounts is long overdue. Generally, it is less likely that anyone will be prejudiced if a dormant company does not prepare accounts and/or be exempted from audit.

However, the existing requirement to prepare accounts and file them, despite being exempted from audit, will be retained from both listed companies and dormant subsidiaries of listed companies.

We would expect a listed company, albeit being dormant, be subjected to a higher level of compliance as it would still have public shareholders.

The basis for retaining the requirement to prepare accounts and file them by dormant subsidiaries of listed companies is somewhat less apparent. There could be a case for exemption with the same safeguards as mentioned above.

It should also be noted that whilst the asset size criterion (asset size must be less than S$500,000) has been newly included, it is unlikely to cause significantly more companies to prepare accounts. This is because a company with such assets is likely to have income generating activities (for example, interest income, income tax expense, property tax, etc) and is therefore not dormant.

Encourage Greater Activity by Indirect Shareholders

To encourage greater shareholder activism among retail investors, members who provide nominee or

custodial services will now be allowed to appoint multiple proxies, beyond the currently allowed maximum of two.

For equality, this multiple-proxy regime will also be extended to Central Provident Fund ("CPF") members who purchase company shares using their CPF fund. These CPF shareholders will be given their due shareholders' rights as though they were cash investors.

In lieu of these changes, the cut-off time for filing of proxy forms will be increased from 48 to 72 hours prior to the shareholders' meeting to give companies more time to handle increased number of proxy forms.

These changes will definitely help to provide a platform for more active (and equitable) participation at general meetings of indirect investors and help to strengthen the culture of corporate governance.

Boosting Transparency and Corporate Governance Standards

Other key changes towards this objective include extending statutory duty to disclose conflict of interests for directors to Chief Executive Office ("CEO") who is not a director. A contravention of any of these disclosure requirements would attract a criminal penalty.

This change is deemed necessary as CEO frequently plays an influential role in the decision-making of a company, sometimes more so than the directors of the company who may not work on a full-time basis for the company. This will also put the CEOs of non-listed and/or private companies at the same level of disclosure requirements as CEOs of listed companies.

Having said that, the MOF backed down from extending the directors' duty to act honestly and use reasonable diligence to CEOs. This is despite the fact that all respondents but one, to the public consultation agreed with this recommendation by the Steering Committee.

The MOF is of the view that it is not timely to adopt the recommendation since most jurisdictions have not done so. The MOF also cited the SC's observation that in practice, the CEO is usually a director of the company. Even if not formally appointed, the CEO may be considered as a de-facto director.

Considering these, would there an expectation for more CEOs to be appointed as directors of the companies that they are serving? This is not uncommon in practice amongst the listed companies so as to enable the CEOs to have as much "skin in the game" as the other directors.

Abolishing Directors' Report

One of the changes that is welcomed by almost all is the abolishment of Directors' Report.

Currently, a Directors' Report must be prepared together with the statutory accounts presented to shareholders. In practice, a Directors' Report typically contains only the prescribed disclosure requirements stipulated in the Act, hence resulting in boilerplate report.

Having considered these, and that the mandatory disclosures (for example, the list of directors in office, directors' interests in shares and debentures of the company and related corporations) could be made elsewhere, the Act will be amended to abolish the requirement for Directors' Report for all companies, whether listed or not.

Dividend Distribution

One of the more controversial issues that was debated but left unchanged is the "profits" test on dividend distribution. Currently, a company can only distribute dividends out of "profits". However, there is no definition in the Act as to whether "profits" are current year's profit or accumulated profits, measured on a realised or unrealised basis, etc. In addition, a private company that is unsure in interpreting "profits" or is unable to pay dividends due to insufficient profits could still take the route of capital reduction which is not too onerous.

There was a suggestion to the MOF to adopt a solvency test for dividend or capital distribution to shareholders. This test has already been adopted by New Zealand. Conceptually, this aligns well to the aim of protection of creditors, i.e. not distributing in excess of what a company owes to its creditors. However, this model may be too different from the current one that is purported to be "well-understood" by stakeholders. Perhaps, this is what we can look forward to in the next round of amendments.

Conclusion

On an overall basis, the changes are aligned to the objectives set.

Those changes geared towards reducing the regulatory burden and compliance costs will be welcomed by businesses, particular in the current economy climate and thrust together increased productivity. Those relating to enfranchising indirect investors and CPF investors will also send a desirable signal to investors on the overall corporate governance of Singapore businesses.

Some may also argue certain changes could have been further liberalised so as to reap more benefits. Some changes such as allowing listed public companies to issue shares with multiple and non-voting rights, and to repurchase odd-lots through discriminatory repurchase offer (i.e. selective off-market buybacks) are pending concurrence by the Singapore Exchange and will take time to be implemented. It is therefore early days to conclude whether the changes will be transformational in a substantive sense.

Notwithstanding that, the efforts and decisions made should be applauded. Approving 209 recommendations by the Steering Committee, albeit 17 were modified, would not have been easy. More importantly, by implementing these changes, we will effectively move the Act from a UK-centric law to one customised to local needs and practices.