accounting implications of the Singapore Companies (Amendment) Act 2005

relevant to CAT Scheme Paper 6 (SGP), Professional Scheme Papers 1.1 (SGP), 2.5 (SGP), 3.6 (SGP), and new ACCA Qualification Papers F3 (SGP), F7 (SGP), and P2 (SGP)

consequences

This article considers the 2006 amendments to the Singapore Companies Act which have consequential effects on financial accounting and financial statements. The amendments that affect ACCA examination papers are identified, and the impact of these amendments is assessed from an examination perspective. Note that the article is relevant for Singapore-adapted exam papers only.

The Singapore Companies Act was amended between 2002 and 2004. The Companies (Amendment) Act 2005 (CAA 2005) took effect on 30 January 2006. Although the amendments have major implications in practice, the impact on examination papers is more limited.

ABOLITION OF THE CONCEPT OF PAR VALUE

Prior to CAA 2005, all shares (ordinary and preference) issued in Singapore were required to have a par value, also referred to as the nominal or face value. The par value is an arbitrary amount decided by the issuing company at incorporation, and it bears no relation to the fair (or market) value of the shares. For example, the par value of Singapore Telecommunications Ltd shares was $0.15 even though its market price had always been much higher since the company went public in 1993. The difference between par value and market value is one of the main reasons for the abolition of the concept of par value. With its abolition several accounting implications arose, as explained below.

Issue of shares – no more share premium reserve (relevant to CAT Scheme Paper 6 (SGP), Professional Scheme Papers 1.1 (SGP), 2.5 (SGP) and 3.6 (SGP), and new ACCA Qualification Papers F3 (SGP), F7 (SGP), and P2 (SGP))

If shares have par value and are issued at a price greater than par value (ie at a premium), the issue proceeds are recorded in two separate accounts: the share capital account, based on the number of issued shares multiplied by the par value; and the share premium account, made up of the remainder of the proceeds. With the abolition of par value, the proceeds of the entire issue are now recorded in the share capital account.

EXAMPLE 1

ABC Ltd issued 10,000 ordinary shares for $15,000. The par value (prior to CAA 2005) was $1.00. The journal entries to record the share issue are:

Before CAA 2005:

DR	Bank	$15,000	
CR	Share capital		$10,000 (10,000 shares x $1 par value)
CR	Share premium		$5,000 (10,000 shares x $0.50 share premium)

To record issue of new shares.

After CAA 2005:

DR	Bank	$15,000	
CR	Share capital		$15,000

To record issue of new shares.

Previously recorded share premium accounts – balance sheet impact (relevant to CAT Scheme Paper 6 (SGP), Professional Scheme Papers 1.1 (SGP), 2.5 (SGP) and 3.6 (SGP), and new ACCA Qualification Papers F3 (SGP), F7 (SGP), and P2 (SGP))

CAA 2005 stipulates that share premium accounts existing at 30 January 2006, when CAA 2005 took effect, will automatically be converted into a part of share capital.

EXAMPLE 2

DEF Ltd has $100,000 of share capital and $80,000 of share premium reserve at 31 December 2005.

Extract of balance sheet or statement of changes in equity:

	Before 30 January 2006	**On and after 30 January 2006**
Share capital	$100,000	$180,000
Share premium	$80,000	Not applicable
Retained earnings	XXXX	XXXX

Preliminary expenses and share issue costs (relevant to Professional Scheme Papers 2.5 (SGP) and 3.6 (SGP), and new ACCA Qualification Papers F7 (SGP) and P2 (SGP))

Before CAA 2005, the Companies Act allowed for the share premium reserve to be used for, *inter alia*, writing off preliminary (company formation) expenses and share issue costs. Once par value was abolished, the share premium account was no longer in existence and so these costs could no longer be written off in this manner. Instead, preliminary costs are now written off to the income statement as required by FRS 38, *Intangible Assets* (paragraph 69).

As for share issue costs FRS 32, *Financial Instruments: Disclosure and Presentation*, states that these costs 'shall be accounted for as a deduction from equity' (paragraph 35). However, FRS 32 does not specify whether this deduction is against share capital, capital reserves, or retained earnings, and so presumably companies can choose from these options, but should do so consistently.

EXAMPLE 3

ABC Ltd, in **Example 1**, was incorporated at the same time as it issued the 10,000 shares for $15,000. ABC paid $1,000 in connection with the share issue and another $2,000 for other incorporation expenses. The journal entries are:

Before CAA 2005:

DR	Other preliminary expenses	$2,000	
DR	Share issue costs	$1,000	
CR	Bank		$3,000

To record incurrence of various costs.

DR	Share premium	$3,000	
CR	Other preliminary expenses		$2,000
CR	Share issue costs		$1,000

To write off preliminary expenses and share issue costs against share premium.

After CAA 2005:

DR	Other preliminary expenses	$2,000	
DR	Share issue costs	$1,000	
CR	Bank		$3,000

To record incurrence of various costs.

DR	Write off of other preliminary expenses	$2,000	
CR	Other preliminary expenses		$2,000

To write off preliminary expenses to income statement.

DR	Share capital	$1,000	
CR	Share issue costs		$1,000

To write off share issue costs against share capital (assumed).

No more capital redemption reserve (relevant to Professional Scheme Papers 2.5 (SGP) and 3.6 (SGP), and new ACCA Qualification Papers F7 (SGP) and P2 (SGP))

Prior to CAA 2005, when preference shares were redeemed, or when shares were repurchased and cancelled, a capital redemption reserve had to be created to record the total par value of the redeemed or cancelled shares. With the abolition of par value, such a requirement has been revoked. Also, with effect from 30 January 2006, previously created capital redemption reserves are absorbed as part of share capital, in the same manner as for previously created share premium reserves, as discussed in **Example 2**.

Payment of dividend (relevant to CAT Scheme Paper 6 (SGP), Professional Scheme Papers 1.1 (SGP), 2.5 (SGP) and 3.6 (SGP), and new ACCA Qualification Papers F3 (SGP), F7 (SGP), and P2 (SGP))

It was customary, in the past, for some companies to declare dividend as a percentage based on par value. For example, if the dividend is declared to be 10%, and the par value of the shares is 1 cent, then the dividend to be paid is 0.1 cent per share. With the abolition of par value, companies are likely to declare dividend in terms of the absolute amount per share, for example, $0.01 per share, and this makes for greater clarity for investors. A recent visit to the Singapore Exchange website confirmed this to be the case for listed companies.

Bonus issues (relevant to CAT Scheme Paper 6 (SGP), Professional Scheme Papers 1.1 (SGP), 2.5 (SGP) and 3.6 (SGP), and new ACCA Qualification Papers F3 (SGP), F7 (SGP), and P2 (SGP))

Prior to CAA 2005, when a company declared bonus shares, the new bonus shares were assumed to be issued at par value, according to the Companies Act.

EXAMPLE 4

XYZ Ltd declared a one-for-five (20%) bonus issue; the number of shares in issue before the bonus issue was 100,000 shares at par value of $1.

Before CAA 2005:

DR	Reserve	$20,000	
CR	Share capital		$20,000 (20,000 new shares x $1 par value)

To record one-for-five bonus issue.

'Reserve' account can be a capital reserve (eg share premium reserve) or a revenue reserve (eg retained earnings).

With the abolition of par value, the question arises as to how to record the issue of the new bonus shares, bearing in mind that shareholders do not provide any consideration for the new shares they receive.

There is no guidance as to how to account for bonus issues in CAA 2005, and so I suggest two possible methods based on practices in the US and in Australia (countries that allow no-par shares):

1 The new shares are issued, but no formal journal entry is made. Instead, a memorandum entry records the issue of the new shares. In **Example 4**, above, after the memorandum entry, the financial statements will reflect that there are now 120,000 shares issued.
2 The new shares are issued at a price to be decided by a directors' resolution. This price is likely to be made with reference to a market price, if available. In **Example 4**, if the market price is assumed to be $1.50, the journal entry will be similar to that illustrated except that the amount will be $30,000 (20,000 shares x $1.50 market price) and the debit is to the retained earnings account. This method should be used if the bonus issue is, in fact, a share dividend, where distributable profits are to be converted into paid-up shares.

Method 1 should be adopted for ACCA examinations unless otherwise stated. To clarify, in a question involving a bonus issue of shares, no monetary journal entry is required, but it must be considered that the issued number of shares increases. Where Method 2 is required (limited to Papers 2.5 (SGP) and 3.6 (SGP), or the corresponding new ACCA Qualification papers, only), full information will be given in the question.

ABOLITION OF THE CONCEPT OF AUTHORISED CAPITAL **(relevant to CAT Scheme Paper 6 (SGP), Professional Scheme Papers 1.1 (SGP), 2.5 (SGP) and 3.6 (SGP), and new ACCA Qualification Papers F3 (SGP), F7 (SGP), and P2 (SGP))**

Prior to CAA 2005, a Singapore incorporated company was required to specify its authorised capital, which was the maximum number of shares it could issue multiplied by the par value. Thus, if a company decided that it would issue up to a maximum of 100m shares of $1 par value, its authorised capital would be $100m. Since the authorised capital represented unissued shares, there was no accounting entry to record it. Instead, the authorised number of shares and authorised capital were required to be disclosed in the notes to the financial statements.

CAA 2005 abolished the concept of authorised capital with effect from 30 January 2006, which means that all references in the memorandum and articles of association to this concept are deemed deleted. Also, the related disclosure in the notes to financial statements is no longer needed. The reason for the abolition is that the authorised capital is an artificial ceiling that can, in practice, be easily raised (or lowered) by an appropriate shareholders' resolution, and by filing with the Accounting and Corporate Regulatory Authority (ACRA). Moreover, there is no sound reason for the law to require a ceiling in the first place. Note, however, that since 30 January 2006, shareholders may still choose to impose a ceiling on the company in respect of share issues and if so, new provisions should be made in the memorandum and articles of association.

SHARE REPURCHASES

Cancellation of repurchased shares (relevant to Professional Scheme Papers 2.5 (SGP) and 3.6 (SGP), and new ACCA Qualification Papers F7 (SGP) and P2 (SGP))

Before CAA 2005, a company was allowed to repurchase its own shares provided, *inter alia*, the repurchase was funded out of retained earnings (or distributable profits), and the repurchased shares were deemed to be cancelled immediately. On cancellation, the total par value of the repurchased shares had to be transferred out of share capital to a capital redemption reserve. This whole procedure is commonly referred to as share buyback.

EXAMPLE 5

GHI Ltd had 100,000 issued shares. It then repurchased 10,000 shares (par value $1) at $1.50 per share and cancelled the shares. Regardless of the original issue price of the 10,000 shares, the relevant accounting entries are as follows:

Before CAA 2005:

DR	Retained earnings	$15,000 (10,000 shares x $1.50)	
CR	Bank		$15,000

To record repurchase of shares (out of profits).

DR	Share capital	$10,000 (10,000 shares x $1 par value)	
CR	Capital redemption reserve		$10,000

To record the cancellation of repurchased shares.

As already discussed, although CAA 2005 abolished par value and capital redemption reserves, companies can continue to repurchase shares that are deemed to be immediately cancelled unless they are held as treasury shares (see below). CAA 2005 allows a company to repurchase shares out of share capital, retained earnings, or both. A repurchase out of capital is on the condition that the company is solvent, and there are defined conditions for solvency. A repurchase out of retained earnings will reduce distributable profits. Using **Example 5**, the journal entries will now be:

Under CAA 2005:

DR	? (see discussion below)	$15,000 (10,000 shares x $1.50)	
CR	Bank		$15,000

To record repurchase and cancellation of shares.

CAA 2005 does not specify an accounting treatment, but FRS 32 (paragraph 33) makes it clear that the transaction cannot pass through the income statement. It is envisaged that companies will explicitly specify whether the repurchase and cancellation is made out of capital or retained earnings, or a mixture of both, and so the debit is to share capital and/or retained earnings as appropriate. Interestingly, if it is funded entirely out of retained earnings, the share capital account will not be reduced even though the number of shares issued will reduce due to the cancellation. What happens here, for shareholders, is that the loss in future dividends (reduction of retained earnings) is offset by the increased capital per remaining share.

Treasury shares (relevant to Professional Scheme Paper 3.6 (SGP) and new ACCA Qualification Paper P2 (SGP))

CAA 2005 introduced a new alternative for repurchased shares: companies may (subject to specified conditions) hold them as treasury shares and subsequently sell them; transfer them (eg to employees in the form of stock compensation plans); or cancel them. Note that treasury shares are considered issued shares which do not carry an entitlement to voting rights or cash dividends (but owners can be entitled to bonus issues, share splits and share consolidations). With the introduction of treasury shares, it is important to distinguish between issued shares and outstanding shares. Assume JKL Ltd is identical to GHI Ltd in **Example 5**, and JKL Ltd holds the 10,000 repurchased shares as treasury shares instead of cancelling them. The number of outstanding shares is 90,000

To illustrate the limited impact of the amendments on examinations, reference can be made to Question 1 of the June 2006 CAT Paper 6 (SGP) exam, and Question 1 in the June 2006 Paper 2.5 (SGP) exam, where the share capital and share premium accounts given in the (INT) examination are merged in the SGP exam.

(100,000 issued shares minus 10,000 treasury shares), and this is the number used in the computation of ratios such as the book value per share, and basic earnings per share.

CAA 2005 does not specify an accounting treatment for treasury shares and so guidance is obtained from FRS 32 (paragraph 33), which requires them to be 'deducted from equity' without specifying the manner of deduction. A suggested approach, based on US practice, is as follows, using the JKL Ltd scenario above.

EXAMPLE 6

DR	Treasury shares	$15,000 (10,000 shares x $1.50)	
CR	Bank		$15,000

To record the purchase of treasury shares.

Table 1 on the last page of this article shows the presentation of the treasury shares in balance sheet or statement of changes in equity.

In Table 1, the 'treasury shares' account is a contra-equity account, and it records the cost of purchase of the treasury shares – this is referred to as the cost method. The share repurchase and cancellation scenario (**Example 5**) is added in the right-hand column of Table 1 for comparisons. Notice that both the treasury share scenario and the cancellation scenario result in the same total equity and the same number of outstanding shares.

While the company holds the treasury shares, there is no need to recognise changes in fair value, because treasury shares are not 'financial assets' within FRS 39, *Financial Instruments: Recognition and Measurement*. When treasury shares are subsequently re-sold (or transferred), the company may make a gain or loss. Under FRS 32 (paragraph 33), the gain or loss cannot pass through the income statement and must be recognised directly through equity. However, FRS 32 is not specific about how to recognise through equity. CAA 2005 stipulates that a gain from the sale of treasury shares is not distributable as dividends and, by implication, a loss will also not reduce distributable profits. Thus, it is logical to use a separate capital reserve account to record any gain or loss from treasury share transactions.

EXAMPLE 7

To illustrate, let us continue with the JKL Ltd example. Assume in Scenario A that all the treasury shares are re-sold for $1.20 per share, and in Scenario B for $1.90 per share. The suggested journal entries and presentation are as follows:

Scenario A

DR	Bank	$12,000 (10,000 shares x $1.20)	
DR	Treasury share transaction reserve	$3,000	
CR	Treasury shares		$15,000

To record the sale of treasury shares.

Scenario B

DR	Bank	$19,000 (10,000 shares x $1.90)	
CR	Treasury share transaction reserve		$4,000
CR	Treasury shares		$15,000

To record the sale of treasury shares.

Table 2 on the last page of this article shows the presentation of the treasury share transaction reserve in balance sheet or statement of changes in equity.

Costs of share repurchase transactions (relevant to Professional Scheme Papers 2.5 (SGP) and 3.6 (SGP), and new ACCA Qualification Papers F7 (SGP) and P2 (SGP))

When shares are repurchased, whether for cancellations or treasury shares, a company will incur costs such as brokerage charges. Similarly, when treasury shares are re-sold, costs will also be incurred. What is the appropriate treatment of these costs? Under FRS 32 (paragraph 35), these costs must be deducted against equity. One way is to bind the transaction cost with the re-purchase price (eg the $15,000 in **Examples 5**, **6** and **7** is assumed to include transaction costs). Another way is to treat the transaction cost as a separate component in itself and deduct it against an appropriate equity account.

CONCLUSION

This article explains the significant accounting changes resulting from CAA 2005, without going into legal details (such as solvency conditions). As can be seen from the above analysis, there are several unsettled areas that will undoubtedly be resolved in time by practitioners. Note that the CAA 2005 contains other amendments that do not directly affect accounting or financial statements, but nonetheless are important for accountants.

To illustrate the limited impact of the amendments on examinations, reference can be made to Question 1 of the June 2006 CAT Paper 6 (SGP) examination. One of the requirements in the question is to compute earnings per share (EPS) for Hadrian, a limited liability company. The balance sheet of Hadrian is given. Before CAA 2005, the 2006 balance sheet would show 'ordinary share capital (shares of $1) $2,000' and 'share premium $100'. Candidates will be able to determine the number of issued and outstanding shares as 2,000,000 ($2,000,000 divided by $1 par value) and use this in the computation of EPS. With the abolition of par value, the examiner has modified the balance sheet to show 'ordinary share capital $2,100' and to provide 'further information (ii) 2,000,000 shares are issued and outstanding as at 31 May 2006', in order to give sufficient information for the computation of EPS. Another example is

Question 1 in the June 2006 Paper 2.5 (SGP) examination, where the share capital and share premium accounts given in the (INT) examination are merged in the SGP examination, with the number of shares being specified in Note (iv) to the question.

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TABLE 1: PRESENTATION OF TREASURY SHARES AND SHARE CANCELLATION IN BALANCE SHEET OR STATEMENT OF CHANGES IN EQUITY

	Before transaction	**JKL Ltd (after transaction)**	**GHI Ltd (after transaction) ***
Share capital	$100,000 *(100,000 issued shares)*	$100,000 *(100,000 issued shares)*	$85,000 *(90,000 issued shares)*
Retained earnings	50,000	50,000	50,000
Less: treasury shares	N/A	(15,000) *(less: 10,000 shares)*	N/A
Total equity	$150,000 *(100,000 outstanding shares)*	$135,000 *(90,000 outstanding shares)*	$135,000 *(90,000 outstanding shares)*

* Assume entire repurchase out of capital, and then cancelled.
Note: the shares indicated within brackets are for explanation only

TABLE 2: PRESENTATION OF TREASURY SHARES TRANSACTION RESERVE IN BALANCE SHEET OR STATEMENT OF CHANGES IN EQUITY FOR JKL LTD

	Before re-sale transaction	**Scenario A (loss)**	**Scenario B (gain)**
Share capital	$100,000 *(100,000 issued shares)*	$100,000 *(100,000 issued shares)*	$100,000 *(100,000 issued shares)*
Treasury share transaction reserve	N/A	(3,000)	4,000
Retained earnings	50,000	50,000	50,000
Less: treasury shares	(15,000) *(less: 10,000 shares)*	N/A	N/A
Total equity	$135,000 *(90,000 outstanding shares)*	$147,000 *(100,000 outstanding shares)*	$154,000 *(100,000 outstanding shares)*

Note: the shares indicated within brackets are for explanation only